

## Alpesh Patel's May Newsletter

Exclusively for ShareScope Alpesh Patel Special Edition Subscribers



10 May 2018

Cutting through noise is my job, so you can focus on what is important. That is the most vital thing you will learn when analysing the markets. So treat these newsletters as tutorials not just market insights.

You have 5 key questions you want answered. Here they are from a webinar I gave recently, with a summary of answers sourced from UBS and what they are telling their richest clients. I've added my view underneath in red.

1. Will the threat of a trade war derail markets?

**Investment view:** We remain overweight global equities. We assign a roughly 20–30% probability to a significant escalation in trade conflicts. Barring this, equities should continue to push higher, backed by strong economic and earnings growth.

**I say 10% probability in reality and the markets know it.**

2. Is the worst over for Bitcoin?

**Investment view:** Blockchain technology has potential, but speculation in the cryptocurrency bubble is a gamble, not an investment.

**Short Cryptos in the short term pay for your 10 year holding in Ethereum and Ripple – my two favourites – when the chance arises. So your long term holding will be free.**

### 3. Is the end of easing a cause for concern?

**Investment view:** Broad-based economic strength should prove resilient against the pragmatic normalization of global **monetary** policy, in our view. Against this backdrop, we believe stocks can edge higher, and we remain overweight global equities. We also believe the rise in government bond yields is mostly over, and have implemented a tactical overweight to 10-year US Treasuries versus cash

**Rising rates, and less QE, is essentially the Government bodies removing cash from the market. But there is less demand for cash from these sources – look at the Starbucks-Nestle deal – Nestle provided the cash to Starbucks. So less demand means the rising cost of capital will not be a worrying drag this year or next.**

### 4. What do Brexit negotiations mean for markets?

**Investment view:** We expect sterling to appreciate, especially versus the Swiss franc. This would likely be a further drag on stocks, especially versus the Eurozone. Added to this, about half of the UK equity index is composed of defensive sectors, which benefit less from strong global growth.

**Sterling will inch up, due to investor demand from the falls making investment cheap and also trade balances correcting themselves as exports have been cheaper.**

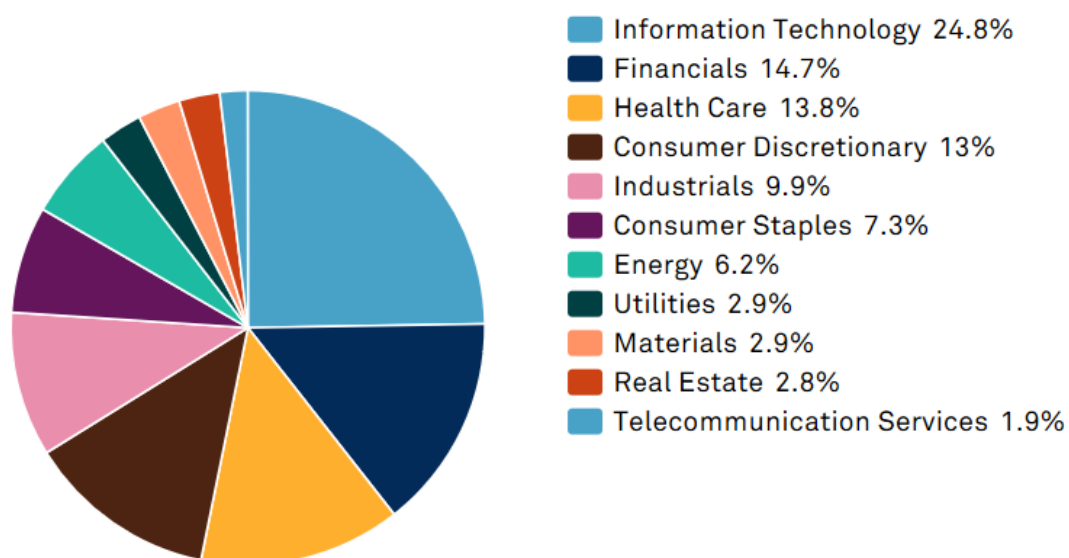
## 5. Will the US dollar slide continue?

**Investment view:** We prefer the euro and the Canadian dollar over the US dollar. We forecast EURUSD at 1.28 and USDCAD at 1.20 over six months. Within Europe, we recommend an overweight to Eurozone stocks over UK equities.

**Buy US stocks over UK and EU and, if Dollar slides, they will be even cheaper.**

## My view on the markets

The world's most important market is the S&P500. It so often leads the FTSE. And is broader than the Dow30. But the S&P500 is IT and Financials really. See image:



Source: Standard and Poors

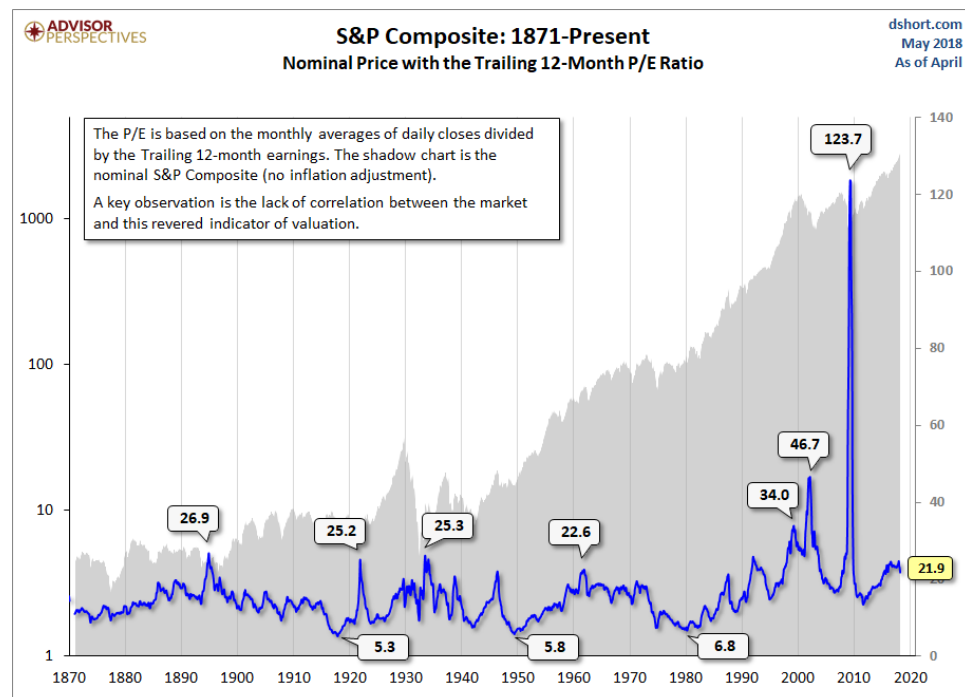
## As for USD

A simple head and shoulders...



## Top insights from the City

Whilst the US is cheap on a PE basis, and the USD falls, it remains a good time to buy into US markets.

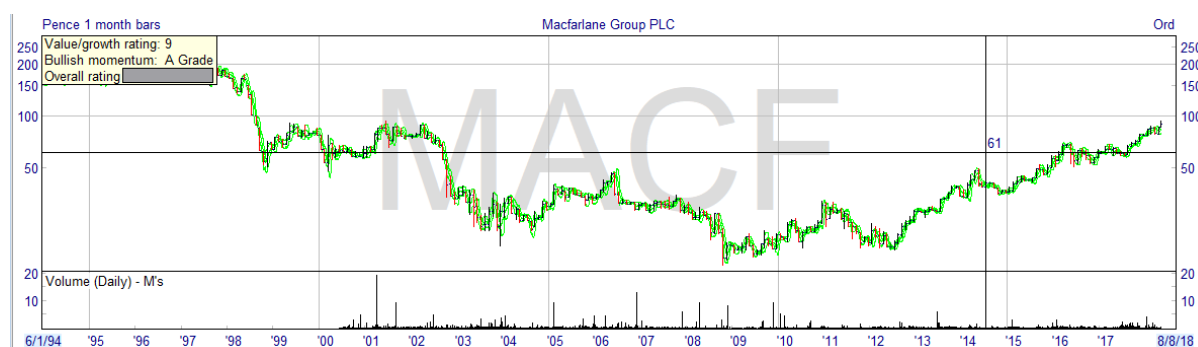


## My favourite Value/Growth picks this month

Using the APSE Value Growth data mining filter for the LSE shares list. Look at the 9s – they are my most highly rated for a 12 month hold, for those who like buy and hold.

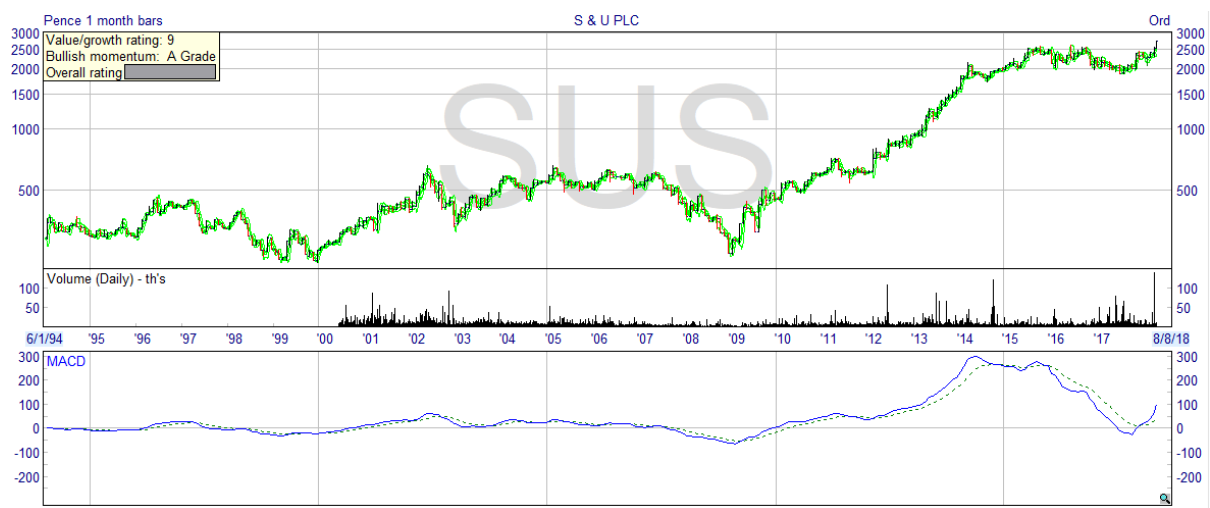
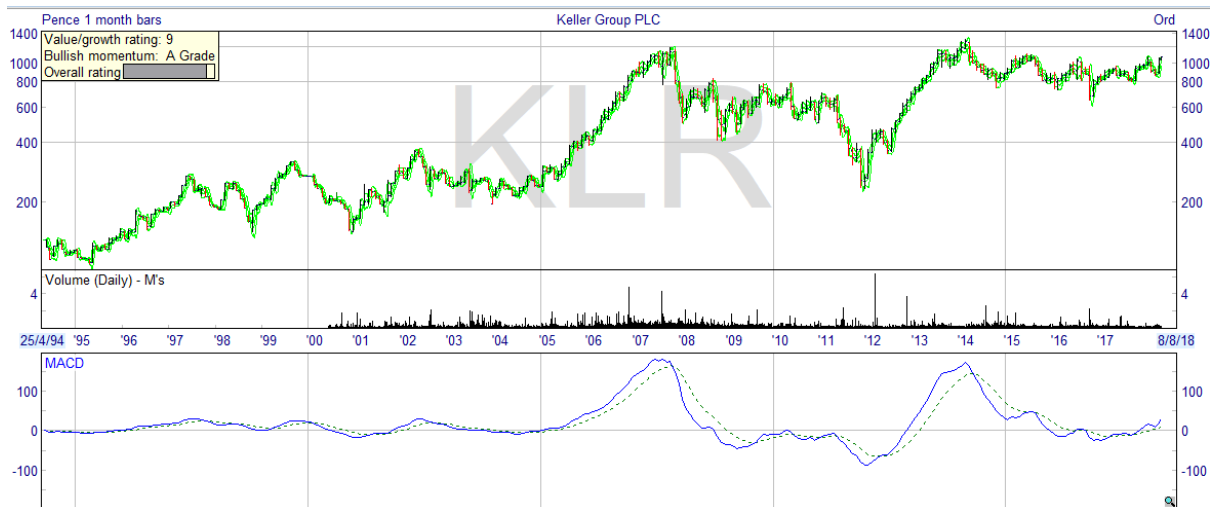
No.	Name	EPIC	Alpesh value/ growth rating	Alpesh bullish momentum rating	Alpesh overall rating
1	IMPAX Asset Management	IPX	9	A Grade	<div><div></div></div>
2	Keller Group PLC	KLR	9	A Grade	<div><div></div></div>
3	M&C Saatchi PLC	SAA	9	B Grade	<div><div></div></div>
4	Macfarlane Group PLC	MACF	9	A Grade	<div><div></div></div>
5	Miton Group PLC	MGR	9	A Grade	<div><div></div></div>
6	Plus500 Ltd	PLUS	9	A Grade	<div><div></div></div>
7	Premier Asset Manager	PAM	9	A Grade	<div><div></div></div>
8	S & U PLC	SUS	9	A Grade	<div><div></div></div>
9	Springfield Properties PLC	SPR	9	A Grade	<div><div></div></div>
10	Telford Homes PLC	TEF	9	A Grade	<div><div></div></div>
11	Vitec Group (The) PLC	VTC	9	A Grade	<div><div></div></div>
12	Vp PLC	VP.	9	A Grade	<div><div></div></div>
13	Hogg Robinson Group PLC	HRG	8	B Grade	<div><div></div></div>
14	Huntsworth PLC	HNT	8	A Grade	<div><div></div></div>
15	Ibstock PLC	IBST	8	A Grade	<div><div></div></div>
16	Norcros PLC	NXR	8	B Grade	<div><div></div></div>
17	easyJet PLC	EZJ	7	B Grade	<div><div></div></div>
18	Haynes Publishing Group F	HYNS	7	B Grade	<div><div></div></div>
19	Impellam Group PLC	IPEL	7	B Grade	<div><div></div></div>
20	IWG PLC	IWG	6	B Grade	<div><div></div></div>

Catching my eye in particular for valuation, growth and income:



## My favourite Momentum/Value picks this month

The point with this radar is to find undervalued stocks showing momentum.



## Top trades for this month

Last month I picked Dechra and Tesco – Growth, momentum, income all in place.  
This month:

Speculative and higher risk: Nostra Terra Oil; and less risk RHI Magnesita and IAG.



## Managing Money

When I wrote my first book, there was a very good reason I called it 'The Mind of a Trader'. Every one of the 10 leading traders I interviewed for the book told me that psychology was key to success. The criteria I as author and the Financial Times as publisher and my editor at the Financial Times used was based on the peer reputation of the traders, their records, and the capital they managed as a mark of success – e.g. Bill Lipschutz as Global Head of Forex Trading at Salomon Brothers at the time was probably one of the world's largest FX traders.

Sourced from *The Mind of a Trader* (Financial Times) in this series we get straight from the horse's mouth, credibly sourced first hand and vetted by the publisher (Financial Times) this series of articles will lift the lid on what these traders which the Financial Times called 'The World's Leading Traders'.

Bill Lipschutz was Global Head of Currency Trading at Salomon Brothers at the end of the 1980s. If ever there was a right time and a right place for a trader, that was it - then and there.

Jack Schwager in *The New Market Wizards* described Bill Lipschutz as 'Salomon Brothers' largest and most successful currency trader.' That's not surprising when you consider that a *single* Lipschutz trade might be measured in billions of dollars, and the resulting profits in tens of millions of dollars. Schwager estimated Bill's trading alone accounted for more than half a billion dollars profit for Salomon in the 8 years he was there. That's the equivalent of \$25,000 profit each and every trading day for 8 years.

I interviewed Bill Lipschutz twice, on both occasions in London. The first interview was conducted by the side of the open air swimming pool on the roof of the Berkeley Hotel, overlooking Green Park and Knightsbridge. The second interview took place in Surrey at the home of Mark Slater, one time Head Currency Trader at Salomon Brothers' in London.

### Working at Salomon

After qualifying as an architect and completing an MBA, Bill joined Salomon in 1982 at the age of 28. He trained in equities and was then recruited into currency options. The forex market is the deepest, most liquid in the world, with daily transactions valued at over \$1000 million.

"I have to say, Salomon Brothers was certainly unique in the market place in the 80s. It certainly was unique in foreign exchange. The way John Gutfreund [pronounced 'Goodfriend.' He gained particular notoriety from Michael Lewis's *Liars Poker*] and Tom Strauss ran that company, really gave all the traders at the firm the ability to run with the ball. I am sure that if I had messed up at some point in time, I would have been unceremoniously out on my butt. But that opportunity, that forum did not really exist at very many institutions. Other firms didn't allow people to take positions, risk, reward of the same size. One learnt a personal responsibility. No one ever said, 'here's a position limit, you have to cut it.'"



“If someone lost a certain amount, all of a sudden their desk was empty. But it was an environment where you were always allowed to push the envelope. As long as you reached that next level successfully, you could try to push it again. That was something quite extraordinary and not something I fully appreciated at the time. In retrospect it was a really unique organisation, but also with a really unique bunch of guys at the top.”

“In the years I was at Salomon, performance in the company was not really measured in the same way as in asset management. The latter tends to be based on percentage return, which in itself is misleading because of additions and growth in capital. When you work for a company there is no real capital. In foreign exchange there are credit facilities, it's all on the margin and marginal return. When I was a trader at Salomon we traded out of a subsidiary which was capitalized at a million dollars. Whatever we made in a year, went upstream to the parent. So, who knows what the returns were. But we had \$150 billion in credit lines.”

### On his own

Bill left Salomon in 1990 to form his own company, Rowayton, named after a town in southern Connecticut.

Rowayton Capital Management started in 1991 as a vehicle to manage our own capital, which was not huge at the time. I started it with two others who had been at Salomon Brothers with me. We did start it with a view to ultimately managing outside capital, but we were not really sure if many of the elements of success would hold up after making the move from a big company environment to a small ‘on our own’ environment.”

“So we traded for a while, and then at the very end of 1993 we started to raise a little outside money. My wife, who had been at Goldman Sachs for nine years as an institutional salesperson, not in FX but in fixed income securities, was largely responsible for the money raising. We raised about \$150m in about 18 months. That was a substantial amount coming from flat. While FX is the only thing that we traded, we developed three programs which all trade FX, but with different combinations of risk/reward objectives and different instruments. For instance, we have one product that trades no options, it is really just spot foreign exchange, mostly day trading and we don't take any overnight positions. We also have a middle kind of a product where we're using certain combinations of options. We don't do too much writing, ratio spreading or anything like that. We do a lot of Europe currency transactions. Then we have a very aggressive program where we are doing a lot of ‘naked’ writing, we are doing a lot of ratio spreads, a lot of very low delta stuff things like that. We were able to use those programs in combination to develop other products.”

“Rowayton, as a company closed down in late 1995, for a variety of reasons, and we currently have a company also with an odd name, Hathersage Capital Management, which is a town in Yorkshire. Hathersage is a new company and does a number of similar things to what Rowayton did.”

## Trading with other people's money

It is often not realized that the source of trading funds can affect one's trading style and performance. As Bill Lipschutz explains, this fact is something even the most experienced traders do not appreciate until they experience it.

"I was unaware that there were these differences. Seven years ago, I had a naive view that you get the money from here, or from Salomon Brothers' proprietary capital, whether it is ten high net worth individuals or a fund of funds I felt it was all the same; let me see how much I can extract from the market. The big issue in leaving a major firm is that I did not foresee that that is something that is learnt, that it is a series of experiences. It's all very well for me to sit here and attempt to articulate it, but it is something you have to experience."

"At Rowayton, we had three different products, if you will. As a side, my experience is that managing people's money and trading for a company, while on the surface one might think they are the same, and I certainly did at one time, they are so vastly different, particularly the motivations. It is not simply a questions of saying, 'Oh, I have some capital. It doesn't matter what the source is. I will go out and I do my best and at the end of the day try to make some money.' It is not like that. There are many, many different strengths that come from being a corporate entity. Whereas dealing for high net worth individuals, you do live and die by your monthly numbers. It is much, much different from being a money manager."

"The whole money-management game is a difficult game. It has not only to do with how well you perform, but what kinds of results people are looking for in their portfolios. Absolute performance is a real misleading thing. I can say to you, 'We were up 600 percent' over five years in our most aggressive program, and you might say, 'Wow 600 percent'. But that does not necessarily mean that much in and of itself, without knowing how well other currency-only managers performed. For example, say a guy is managing \$200 million, and \$120 million of it is a fund that he runs with a very specific mandate. If he made 600 percent over four years in that particular fund, he may have people pulling money out from that particular fund, because they are nervous, because that really was not the kind of variance they were looking for. So, it is very complicated."

"Look at the very different approach of George Soros, when he used to trade, and Peter Lynch. Soros is out there on the margin, trying to make a lot of money. Peter Lynch, in managing the Magellan Fund, was about the preservation of capital. He was in a big bull market, he was a big stock-picker, he made a lot of money, but believe me, if the Magellan Fund is ever starting to be down at all you would have massive redemptions and you would ultimately have no fund. So the people with George Soros understand they may be down 20-30 percent in that part of their portfolio. I mean I don't think you have any people whose whole investment portfolio is in the Quantum Fund, they are going to be diversified. The motivation of the investors is very different. Of course, part of that is that George Soros's style is different to that of Peter Lynch, but that is due to the algebra of the source of money."

As Bill Lipschutz explains, one way the source of funding can affect your trading style is through the motivation of the lender and the terms on which the funds were granted. We all, as traders, seek more capital with which to trade. Sooner or later after a degree of success we decide to seek out new sources of funds; whether as a loan, which then does not require us to be regulated, or as an investment by the lender. Whatever the source of money, you must be aware that since it can affect your trading style it may also affect your trading performance. The worst time to have a deterioration in your trading performance is when the money is not your own. So before you seek new funds think hard about how it is likely to affect your trading.

### **Your own money**

The source of trading capital can vary widely. The most obvious source is ones own capital. So, how does Bill Lipschutz trade with his own money?

“For money I have committed to speculation, as distinct from investment, one would say I have a very high risk tolerance. In essence if I were to lose all that money I have for speculation, that would be OK. I am sure I would not be too happy about it, but that is the point of that money. Now, I would make other investments, owning your own home, that is one investment, owning a stock portfolio, that’s a certain kind of investment, all this sort of stuff. Money I am looking to speculate with, I am expecting a much higher return, but I am also expecting a lot more volatility, a lot more variance, there is a significant risk of ruin, of losing it all.”

With his own funds, Bill Lipschutz is answerable to himself only and can trade as he sees fit. As he goes on to explain, with other people’s money, the degree of freedom is much reduced.

“It’s the old thing, if you go out there and buy IBM stock, and IBM goes down 25 percent, nobody is going to fire you for that, because everybody owns IBM stock, it is the prudent thing to do. But if you go out and you buy a fly by night internet company and its stock goes up 80 percent and then falls and the company goes bankrupt, then you are going to get fired. They’ll pull the money from you and you will have trouble raising more money.”

“So, it’s the same kind of a thing that happens with pension fund managers. I am sure all the money that is invested by British investment funds is very widely diversified. You don’t see people going out on a limb - why? Because it’s a job loser.”

“So we’re back to the same thing, it’s not just what kind of returns you can make, there are many other elements that motivate why people make the investment decisions that they make. It goes right down to the trader level, why did you not put that trade on at a bigger level, because you knew it had an extremely good probability of going up. Well, because sometimes being wrong, even if there is a 5 percent chance of that happening, is a whole lot worse than being right, even if there is a 95 percent chance of that. It’s the old, ‘gee if I make 25% for these guys, they’ll be really happy, and they’ll think I am a great trader and I’ll earn big fees.’ ‘But you know what, if I lose 5 percent for these guys they’re going to pull that money out and I am going to be close to being out of business.’ But that is not the probability of the trade succeeding or failing. So you have to lay this on top of the probability of the

trade succeeding or failing. It is very complicated. It's a whole set of simultaneous constraints that you have to solve at once."

Therefore, trading with other people's money becomes far more complicated than with one's own. You have to consider both the likely outcome of the trade and the likely reaction of the investor to a positive and a negative trading outcome. The decisions you can make are restricted by the likely responses of your client. That in turn could impinge upon your trading performance. There can be slightly greater freedom and less pressure when trading for a firm, as Bill goes on to explain.

### **Playing with the Company's Capital**

"When you manage money for individuals you have to focus on preservation of capital. When you are trading for a company they are looking to make money. They also understand losses better. With a company it has a lot more to do with whether as a corporation they want to be in the business of foreign exchange, or not. It has a lot less to do with the individual traders' performances being a determinant. So if for example a company takes a \$20 million dollar hit, they may decide to terminate the traders, but it is unlikely they will get out of foreign exchange. So, the market sector will almost never be to blame."

Given all the constraints in trading with other people's money, the question arises, 'Why not borrow from a bank as a secured loan which is repaid irrespective of performance?' Unfortunately practical difficulties can often rule out this source of funds.

"First of all, if an investment bank, or some sort of corporate entity, was going to entrust the trading and speculation of their products with an individual, they would probably want that individual in-house. It is not so much that they are averse to that individual managing other people's money. The downside is so great politically to whoever oversees or OKs that, that it's a job loser. If you give money to say, Alpesh's company, and you drop a few million, then the first thing everyone is going to say is, 'who the hell gave that guy that money'. And the next thing you know, you are fired. Whereas, if they give the money to a department in their company, then the company has made a decision, year after year, as to the business they want to be in. And if they lose money year after year, they are not going to lose their job for that decision."

Ultimately one has to consider the various sources of funds available and the disbenefits of each, and weigh this up with having more capital with which to trade. Is it worth it if you have to pay for your borrowed funds with the hen that lays the golden eggs? In other words, what is the point of having extra funds if you cannot trade profitably with them?

So, before taking on new funds, ask yourself the following questions:

1. What does the lender say he expects?
2. What does he *really* expect?
3. Have I traded successfully in the past in the manner required by the lender's expectations?
4. Can I deliver what the lender *really* expects?
5. What are the consequences for me if I fail to deliver?
6. How much control does the lender want?
7. How frequently is the lender going to inquire about the performance?
8. What type of personality has the lender? Is he likely to pester and aggravate?
9. Can some ground rules be set?

## Personal Activities

Voting with baby...mommy having a break...and I will also be hosting these Awards in Parliament...

