Galeo YOU MANAGE. WE CONSOLIDATE.

Newsletter – Q4 2017

29/12/2017

Bespoke service provided by Galeo

Key indicators

According to a portfolio's investment strategy it is appropriate to monitor specific key indicators that will provide you with a rapid overview of the portfolio's status. In our bespoke services we will define these with you, for each of your portfolio groups, as starting points for more detailed drill down analysis.

For example, with a passive bond portfolio you will want to at least monitor the average yield to maturity, the average duration, the average credit and the turnover factor.

Passive Bond Portfolio Key Indicators

Average Yield to Maturity	2.73%
Average Duration	3.4
Average Credit Quality	BBB+
Turnover Factor (monthly)	5.28%

Market Manager

Attractively priced and powerful market data tool

Fund selection. Market Manager allows you to search for funds based on a broad range of criteria including investment focus, currency, domicile, authorisations, size, age, fees, ratings, performance and volatility. In the current example we have selected distributing USD denominated Emerging Markets equity funds domiciled in Luxemburg with assets over 50m and more than 7 years of existence.

Detailed fund search

Fundstype: Equity funds (8'811)
Fund currency: US Dollar (USD) (8'811)
Fund domicile: Luxembourg (6'511)
Authorised: CH
Fund volume (in m) from 50.00
Investment focus: Equities Emerging Markets (54
Fund age in years from 7
Distribution policy: distributing (37)

Name	Performance 3 years	Max loss in 3 years
Polunin Developing Countri C	32.81 %	-35.26 %
Polunin Developing Countri B	32.38 %	-35.22 %
JPMF EM Equity A	31.63 %	-31.82 %
JPMF EM Equity X	30.60 %	-30.92 %
SISF Em Mkts A	30.48 %	-31.28 %
Polunin Developing Countri A	30.44 %	-35.53 %
FTIF Tem EM Fund A	28.33 %	-33.45 %
F&C Pf BMO Res Gl EM Eq A$	27.81 %	-25.54 %
CIEMF Qd $	27.23 %	-36.04 %
FF Emerging Markets A	26.70 %	-25.28 %
SISF Gl Em Mkt Opp A Dis	25.86 %	-27.94 %
UBS ETF MSCI Em Mkts A	25.43 %	-34.51 %
CIEMF Xd $	25.40 %	-36.24 %
Pictet Em Mkts Idx P dy $	24.58 %	-34.55 %
HSBC GIF Gl EM Eq PD	24.57 %	-36.53 %

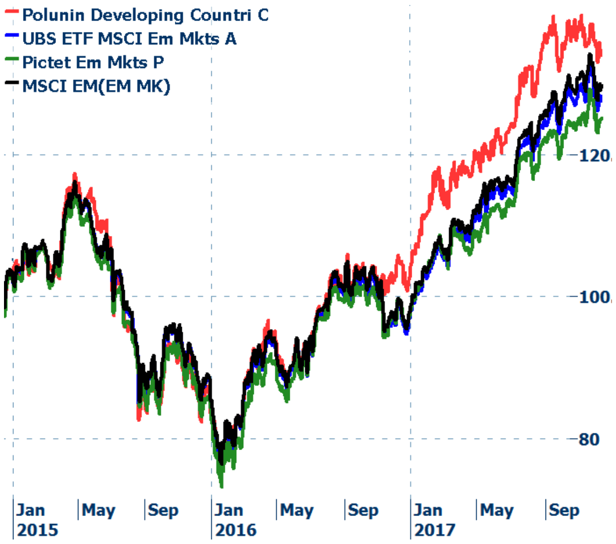
From the search, we selected three funds and dragged these into a table of KPIs containing their benchmark.

Quote list with fund key indicators

Name	Perf 3Y	Vola 3Y	Sharpe 3Y	Tracking 3Y
Polunin Developing Countri C	31.50	17.30	0.45	6.38
MSCI EM(EM MK) NR	27.06	14.76	0.31	
UBS ETF MSCI Em Mkts A	25.54	14.49	0.29	0.30
Pictet Em Mkts P dy $	23.74	14.45	0.27	2.79

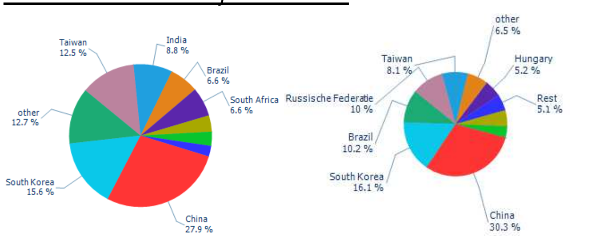
Over the last three years, the Polunin Developing Countries fund provided the higher net and risk adjusted returns. It is also the most volatile and least similar to the benchmark. The Pictet Emerging Markets fund and the UBS Emerging Markets ETF have similar volatilities but the latter tracked the benchmark more closely and offered better performance as shown in the graph below.

Historical chart 3 year comparison



You can drill down further to identify the differences between the Pictet and UBS funds using the information provided in the fund portraits. Compared to the UBS ETF, the Pictet fund has higher weightings in Brazil and Russia but lower weighting in Taiwan and India.

Fund Portrait country allocations



UBS Pictet

These three funds offer investors a choice between an index replicating ETF, an active fund that has performed well over last three years and a fund that diverges less from the benchmark but that has done less well.

Galeo SA, Bd Georges-Favon 19, 1204 Genève, Suisse - T. +41 22 752 32 12 - F. +41 22 752 32 29
galeo@galeo.ch - www.galeo.ch

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Legislation monitor

Financial Institutions and Financial Services acts

The two versions of acts, that of Council of States and that of National Council need to be harmonised. They are currently being reviewed by the Economic Affairs and Taxation Committee of the Council of States. The final unified versions are currently expected to come into effect on the 1st of January 2020 with a transitional period of up to three years providing external asset managers with up to 5 years to adapt to the new legislative framework.

MiFID II

The European MiFID II rules enter into force in January 2018. Swiss external asset managers with a European client basis may wish to comply with this new legislation to be better protected from potential client complaints. This is relevant as a European client can argue, following the Lugano Convention, that the relevant legal venue for a dispute is his country of residence and that, according to the Rome Regulation, the relevant legislation is also that of his residence. **Galeo offers asset managers solutions for MiFID II compliance**.

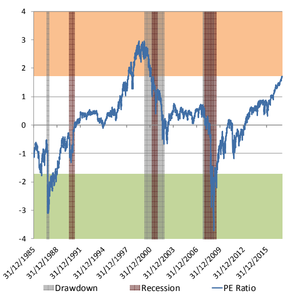
Exuberance and gloom

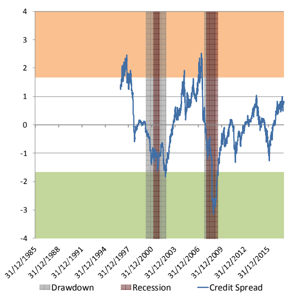
Equity and credit markets diverge

The S&P500 6.1% rise since the start of the quarter has pushed its cyclically adjusted price earnings ratio just below 32. This improvement in sentiment was not mirrored in the corporate credit markets as high yield credit spreads, which had narrowed earlier in the year (from 4.2% to 3.6% for the BofA Merrill Lynch US High Yield Master II index), were unchanged in the fourth quarter.

Equity markets are focusing on the impact on corporate profits of a strong US economy and of fiscal and legislative changes while credit markets are more concerned by rate hikes. Notwithstanding which view is correct, the current equity valuations will be difficult to sustain long term.

S&P500 caPE vs BofA US High Yield credit spread





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Calculation corner

Modified Dietz return estimate

The Modified Dietz method provides an estimate of a portfolio's internal rate of return that takes inflows and outflows into account. It is calculated as follows:

$(V_{END} - V_{START} - \Sigma\, CF_i) / (V_{START} + \Sigma\, W_i * CF_i)$, with

V_{START} and V_{END} the portfolio's start and end values, CF_i the cashflows and W_i = remaining days / period length.

Example

A portfolio, worth 100 at end 2015, grows by 20% to mid-year. After an inflow of 30 its value falls by a third.

Date	*Perf*	*Cum*	*V*	*CF*	*W*	*W*CF*
31/12/15			*100*		*1*	
01/07/16	*20%*	*20%*	*150*	*30*	*0.5*	*15*
31/12/16	*-33%*	***-20%***	*100*		*0*	

Modified Dietz return: (100-100-30) / (100+15) = -26.1%.

This differs from the portfolio's -20% performance due to the long period, large inflow and volatile performance.

Example

The portfolio loses 10% in the first 4 / 5th of 2017. After an outflow of 10, the portfolio gains 25% to year end.

Date	*Perf*	*Cum*	*V*	*CF*	*W*	*W*CF*
31/12/16			*100*		*1*	
19/10/17	*-10%*	*-10%*	*80*	*-10*	*0.2*	*-2*
31/12/17	*25%*	***12.5%***	*100*		*0*	

Mod. Dietz: (100-100+10) / (100-2) = 10.2% vs 12.5%

For the two years in aggregate the result is the following.

Date	*Perf*	*Cum*	*V*	*CF*	*W*	*W*CF*
31/12/15			*100*		*1*	
01/07/16	*20%*	*20%*	*150*	*30*	*0.75*	*22.5*
19/10/17	*-40%*	*-28%*	*80*	*-10*	*0.1*	*-1*
31/12/17	*25%*	***-10%***	*100*		*0*	

Mod. Dietz: (100-100-20) / (100+21.5) = -16.5% vs -10%

This differs from both the portfolio's -10% performance and the compounded 2016 and 2017 Mod. Dietz returns:

(1-26.1%)*(1+10.2%)-1= -18.5%

The Modified Dietz method requires portfolio valuations only at period start and end and it often better reflect a client's perceived return (Q3 2015 Newsletter). It is however sensitive to the calculation period, significant flows and volatile performances. For these reasons it is usually calculated on a monthly or quarterly basis and then compounded to obtain the return for longer periods.

Please contact us for further discussion.

Galeo SA, Bd Georges-Favon 19, 1204 Genève, Suisse - T. +41 22 752 32 12 - F. +41 22 752 32 29
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