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Asset Management

Multi-Asset Strategy Quarterly

January 2021

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Foreword

Jimmy Elliot
Head of Multi-Asset

Welcome to our latest Multi-Asset Strategy Quarterly. In this edition, Philip Saunders explains why investors need to be prepared for a very different year in 2021 in his outlook for the next 12 months. We also explore the five core themes that we expect to be the key long-term structural thematic drivers over the next decade, and why understanding them can provide a valuable analytical advantage. Strategist Russell Silberston reviews the policy announcements by the major central banks over the past quarter, before we close out the Quarterly with a succinct summary of our higher conviction asset class views, beginning with equities, moving on to fixed income, currency and concluding with commodities.

Content

Market review — Q4 2020

Global risk assets moved materially higher in the final quarter of 2020 following positive developments regarding key issues such as COVID-19 vaccines, fiscal stimulus in the US and a Brexit deal. Vaccines with better-than-expected efficacy rates were developed, authorised and deployed in the UK, Europe and US. In light of continued economic challenges, central bankers confirmed they would keep financing conditions favourable, whilst in the US an agreement was made with respect to additional fiscal stimulus. Elsewhere, a Brexit separation deal was finally agreed towards the end of the year. In the US, Joe Biden was elected as the next US President and the market rallied, particularly in those areas most directly linked to his fiscal stimulus and renewable infrastructure. Economic data through the quarter broadly indicated that the recovery still had momentum, although US jobs data showed some cause for concern. More concerning for investors was the increase in COVID-19 case numbers and subsequent reintroduction and/or tightening of restrictions across a number of countries.

Following the vaccine news, global equities posted double-digit-plus returns during the quarter with cyclically exposed assets leading the charge. Emerging market equities in aggregate outperformed developed market equities, led by Asia-ex Japan. The S&P 500 index ended the year at another record level, posting double-digit returns, while Europe and the UK reached post pandemic highs. There were similar outsized risk-on moves in the high yield corporate bond market, as Europe outperformed the US. In emerging markets, both sovereign bonds and currencies posted positive, and in some cases high, returns.

As a 'risk-on' rotation prevailed, performance of developed market government bonds was mixed. In reaction to a slew of positive news, US Treasuries sold off and the yield curve steepened, whilst other developed market sovereign bonds, such as those in the UK and Germany, generated a small positive return. Investment grade corporate bonds in both the US and Europe generated positive returns, attributed to a supportive technical backdrop as the asset class continued to see inflows from both central banks and investors. The US dollar weakened to fresh lows since April 2018 amidst the cautiously optimistic tone seen in the markets and the commitment to highly accommodative policy from the US Federal Reserve, with this benefiting other currencies such as the euro and the Japanese yen, whilst sterling also made gains following the post-Brexit trade deal agreement.

Gold had a challenging start to the quarter but recovered in December to generate a small positive return of c. 1%, ending the quarter just below US$1,900/oz.

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The value of investments, and any income generated from them, can fall as well as rise.

Market observations

Philip Saunders
Co-Head of
Multi-Asset Growth

2021 outlook: from recovery to reflation

After an extremely abnormal year, 2021 promises greater normality. The speed of the vaccine response and efficacy of the leading treatments have confounded the sceptics. In the coming months, the deployment of vaccines and mass testing will pave the way for a return to a more familiar way of life.

In fact, there is a risk of having too much of a good thing by the second half of the year, as savings — which have rocketed in key economies — get run down, monetary and fiscal policies remain extremely stimulative, and a synchronised global expansion gains traction after some loss of momentum in the early part of the year. Inflation rates are set to rise quite briskly from their depressed COVID-19 lows, primarily due to base effects but also increasingly due to a weaker US dollar, supply bottlenecks and a sharp tightening of service prices. The market, however, still seems to be pricing in 'Japanification' (deflation and weak growth). But conditions in the wake of the pandemic are fundamentally different to those that prevailed after the Global Financial Crisis (GFC), and the inflation outcome following the present crisis may turn out to be quite different.

Western central banks are likely to keep official interest rates and the short end of bond yield curves pinned down. They are also likely to persist with quantitative easing, not wishing to risk snuffing out nascent recoveries. This continuation of 'financial repression' will allow governments to put off any fiscal reckoning well beyond 2021.

Government bond markets are set to remain heavily distorted, offering poor long-term real rates of return. Low interest rates mean that even modest yield rises threaten to wipe out carry. With short rates pinned down there is scope for yield curves to steepen further as the recovery becomes more firmly embedded. However, the move higher is likely to be punctuated by sharp rallies, given investors' ongoing propensity to reach for yield, while supply pressure will continue to be offset by quantitative easing.

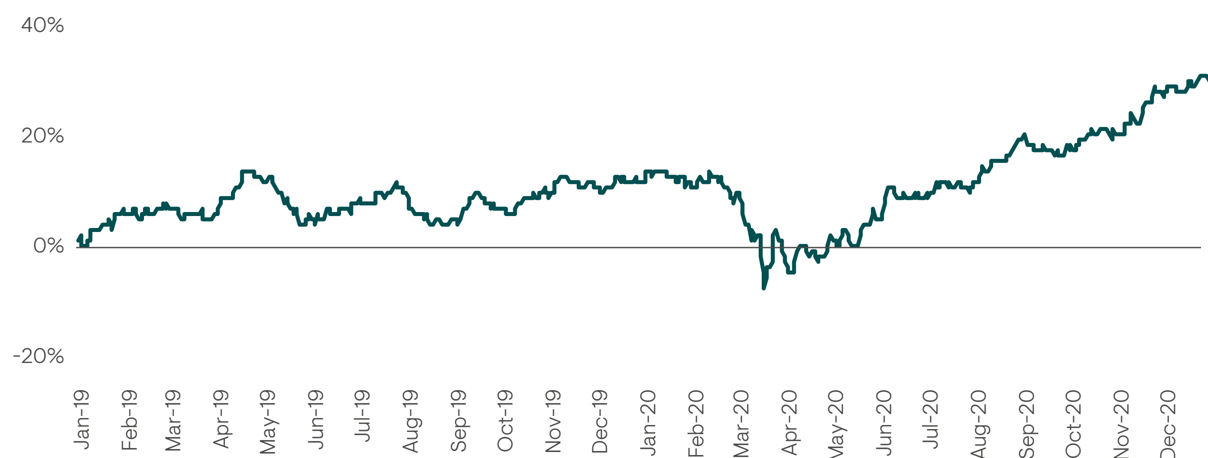
Credit spreads blew out spectacularly in the eye of the COVID-19 storm in March and corporate bonds temporarily became chronically illiquid. The US Federal Reserve acted decisively to backstop credit markets and prevent a liquidity crisis turning into an outright credit crisis. Over the summer, a tentative recovery became more full-blooded, resulting in credit spreads compressing to historically tight levels. However, both investment-grade and high-yield credit are likely to remain supported by central-bank policy in 2021. Technical factors are also likely to help these asset classes as the 2020 supply surge moderates, while fundamentals are improving too. There should be fewer downgrades and defaults and improving credit metrics generally.

In our view, the recent steepening of yield curves confirms an important inflection point in equity markets, which have been characterised by an extraordinary divergence between large-cap 'growth' stocks and cyclical 'value' stocks. Although equity markets overall recovered from the trough in late March, the rally was very narrow, with investors treating the FAANGs (Facebook, Apple, Amazon, Netflix and Google) as, 'safe havens', amid continued COVID-related uncertainties, and with their enthusiasm for these companies further stoked as the pandemic accelerated existing digital trends.

Although we may see modest growth reversals during the first half due to further coronavirus 'waves', there remains every prospect of a more broad-based recovery as 2021 progresses. This is already being signalled by steepening yield curves, marking the beginning of a rotation away from the stocks that had led the market recovery, and into some of the cyclical laggards. Market breadth — lacking hitherto — is now set to increase as confidence in the recovery builds, both from a sector level, but also a regional perspective.

To review our 2021 outlook in full, please click here.

Cyclicals have outperformed Defensives over the past two years



Source: Ninety One, Bloomberg as of 31 December 2020. Chart shows relative performance of aggregated sub component indices representing cyclical and defensive sectors from the MSCI World series.

Thematic viewpoint

Sahil Mahtani
Strategist

Road to 2030: highlighting undiscounted change

The start of a fresh year offers good reason to review the structural themes that we believe are going to dominate macroeconomic and market developments over the next decade. Ninety One Investment Institute's Road to 2030 project is designed to highlight undiscounted change. We believe that understanding the key long-term structural thematic drivers is the basis of good strategic investment thinking and can generate a clear understanding of the key drivers that can provide a valuable analytical advantage. Each decade, getting that one big decision right was the most important driver from investment returns, be it Japan in the 1980s, globalisation in the 1990, or, more recently, the rise of scalable global businesses, led by the technology sector.

Looking to 2030, we have identified five overarching themes that give us a structure for our thinking:

1. The rise of China: China is undergoing three distinct transformations. First is the shift from fixed asset investment to consumption, second is the shift up the value chain as China seeks technological independence in key areas, and third is China's outward economic expansion. The US response to these transformations is a crucial overlay, focusing on security competition; data regulation is going to be a major arena of competition over the next decade.

2. Climate change: The key distinction here is between physical risks — changes to the planet — and transition risks as businesses and households alter their behaviours. Climate change modelling is complex, but it is generally agreed that the main physical risks over the next decade are extreme weather events rather than permanent changes in the physical environment. Transition risks are the key business risk—and opportunity— until 2030. The world remains, for instance, US$2 trillion short of investment in decarbonisation—something our industry has a major role to play in.

3. Technological disruption: Our key insight is that technology is not a sector, but an enabler to new and existing businesses, and we have therefore divided this bucket into five functional areas. First is better healthcare, by which we mean more preventive therapies and new, potentially cheaper, treatments. Second is the growing abundance of goods and services, third is the shift to a more flexible workplace, fourth are innovations in personal mobility and finally, we believe states are going to take a much more activist stance on the economy.

4. Debt: The last four decades have seen an explosion in public and private debt growth around the world, facilitated by declining real and nominal interest rates and latterly by quantitative easing. Unexpected events like COVID-19 have merely accelerated the trend towards the debt build up. We think a combination of measures are likely to be pursued to stabilise these high debt levels: financial repression; competitive devaluations to boost exports; more austerity and taxation; reform and growth; macroprudential policy; helicopter money; private debt forgiveness.

5. Demographics: We have split this vast and hugely important topic into the effect on government budgets, the impact on GDP and some idiosyncratic effects. As people age, pension liabilities will increase, as will healthcare costs, squeezing non-welfare spending. Older people are likely to dominate the political agenda, newer products are likely to emerge to cater for old age care, and there is the potential for a "depopulation dividend," as quality of life improves in a more environmentally friendly world.

Following extensive analysis of these five themes, we have then considered a number of scenarios on each one to convey the plausible futures that may result. They ask investors to think through the investment judgment they would make if certain conditions are fulfilled and therefore before the decision actually has to be taken.

COVID-19's impact on these themes

COVID-19 has accelerated key drivers behind each of these themes. China's ascent up the value chain has clearly been accelerated by the pandemic, with the Chinese government now more committed to spending heavily to secure its own semiconductor supply base. Similarly, the US response to China has been sharpened as a result of COVID-19, with the US now more committed to abandoning its previous permissive strategic stance on China.

Key technological disruption trends have also been accelerated, including: a transformation of the workplace (through the rise of home-working and a shift towards the globalisation of services), a shift towards better healthcare (the unprecedented discovery of multiple effective vaccine candidates in the span of months), an increasing abundance of goods and services (the pandemic-driven rise of e-commerce and video games), and an increasing focus on innovations in personal mobility (the rapid increase in market capitalisations of electric-vehicle companies)

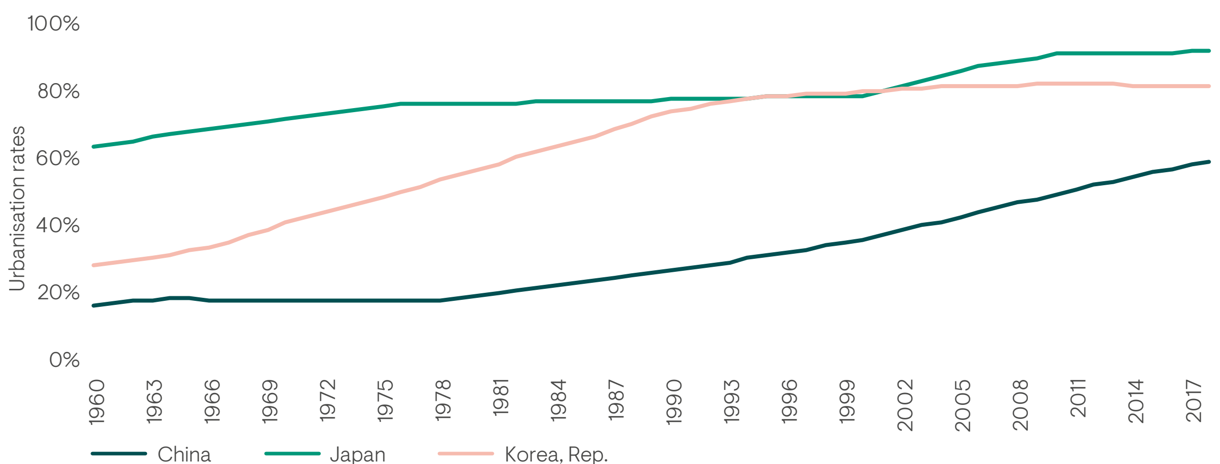
The pandemic has also driven home the need for longer-term thinking and our interconnectedness, facilitating a new movement towards climate change resilience. Governments are increasingly promising to raise carbon taxes, fund innovation, and generally commit to replacing less-efficient energy devices with more efficient ones. In September and October, China, South Korea and Japan all committed to net-zero emissions by 2060. In Europe, one in every 10 cars sold in 2020 was an electric or plug-in hybrid, triple the level last year. The US will commit to the Paris Agreement under a Biden administration. This theme will experience ongoing cyclical and secular tailwinds driven by government policy and regulatory developments.

Meanwhile, for the debt theme, fiscal deficits in 2020 are likely to be 11.1% of GDP in emerging markets and 15.6% in developed markets. Debts are now spiking and will only stabilise as the recovery takes hold. Governments will use a number of tools to keep public and private leverage sustainability in check, including financial repression, currency wars, austerity/taxation, macroprudential policy and selective debt forgiveness. Given the rise in income and wealth inequality during the pandemic, as well as the imperative to restore the pre-pandemic economic order, it will be very difficult for states to pursue austerity and taxation as some did in the 2010s. Therefore, we are more likely to see a consensus building towards the use of unorthodox solutions. The 2010s may well come to be seen as the last gasp of fiscal responsibility, as traditionally understood.

On demographics, the long-term effects of COVID-19 may turn out to be more protected health budgets and healthcare spending. Combined with efforts to reduce obesity and increase vitamin-D intake, this could lead to longer lifespans in the years ahead. Meanwhile, the working-from-home trend, enabled by technological disruption, may also increase labour-market participation as flexible working widens opportunities to more people.

The range of outcomes remains wider than usual, but the contours of the next regime are already coming into view. COVID-19 has increased the possibility of a regime shift with the possibility of faster productivity growth, a material shift in economic activity towards Asia Pacific, a policy shift driven by governments actively targeting growth and not just inflation, and of generally a greater need to ensure shared prosperity amidst widespread inequality and digitalisation. As such thematic analysis continues to be highly relevant for investors.

China arguably still has a significant growth runway. Its urbanisation rate is similar to that of Japan in the 1970s, not the early 1990s. Meanwhile, China's capital stock per worker is still substantially lower than Japan's or Korea's



Source: The World Bank; Penn World Tables.

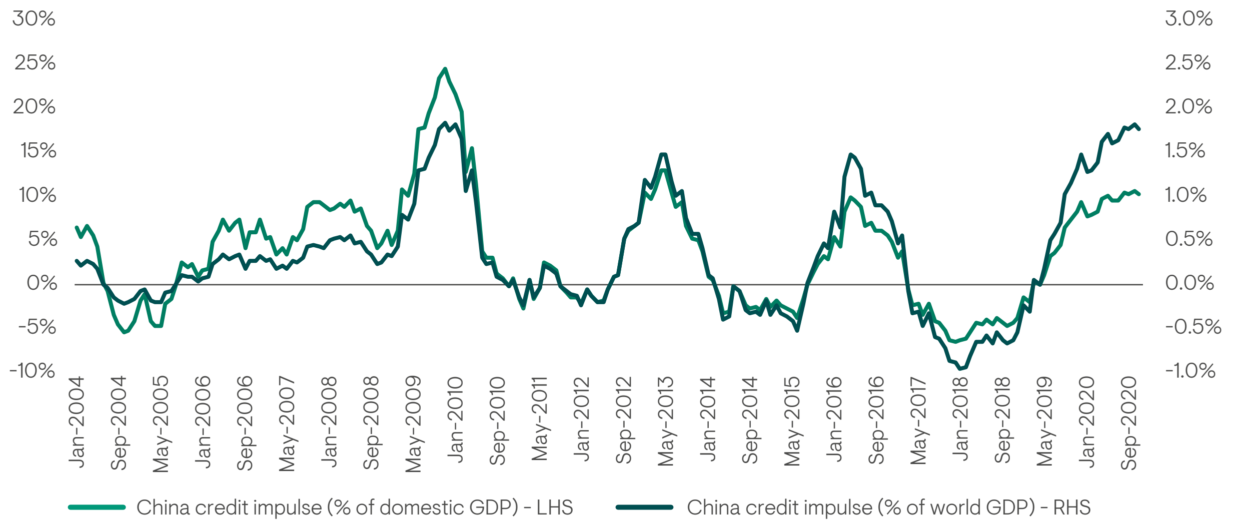
Policy review

Russell Silberston
Strategist

The US Federal Reserve unveiled its new policy framework in Q3 2020 and spent much of Q4 explaining what it means in practice. For interest rates, expect a long period of near zero Fed Funds and for quantitative easing (QE), the Fed guided that it would continue to buy assets at US$120 billion per month until 'substantial further progress' is made toward its employment and price stability goals. The objective of this extraordinary action is to re-anchor inflation back to its 2% target whilst allowing the labour market to run as hot as possible. The Fed doesn't expect to have achieved this by the end of 2021, so it is safe to assume that it will pump an additional US$1.4 trillion into markets next year. We believe US fiscal policy will turn from a major economic tailwind to a major headwind in 2021 as emergency spending begins to unwind. The worst effects are likely to be somewhat mitigated by a bipartisan support package, but its scale and ambition are sub-optimal. With the incoming Biden administration having effective control of the Senate, we can assume fiscal policy will be looser than it otherwise would be. Nonetheless, given an estimated 15.8% of GDP boost this year, the best we can hope for is action to marginally offset the negative impulse coming in 2021.

China was the standout economy of 2020, having controlled the virus effectively whilst benefitting from huge demand for her exports. The monetary and fiscal response has therefore been low relative to other major economies. Over the past quarter, however, the People's Bank of China (PBoC) has been adding liquidity back to the banking system through its Medium Term Lending Facility. Indeed, credit growth in China has been strong, and whilst it is now topping out, it will likely continue to support growth in the months ahead. The modest fiscal response seen in 2020 means that, looking forward, China will have a less negative impulse in 2021, and so a smaller growth headwind. We expect monetary policy will be neutral from here, with rate cuts and further reductions in reserve ratio requirements unlikely.

Chinese credit growth will likely support economic growth in the months ahead



Source: Ninety One, Bloomberg as of 31 December 2020.

Amid the second wave of the virus, the European Central Bank extended its pandemic QE programme until March 2022 and added a third tranche, increasing the envelope size by another €500 billion to €1850 billion. In recent months, this money has been invested at a much slower rate, meaning the ECB has managed to taper purchases without any market stress, while also reserving firepower should financial conditions begin to tighten again. Concurrently, it also extended its preferential bank lending programme by twelve months. Policymakers are very clear that they intend to keep financial conditions ultra-loose to avoid any crowding out that the exceptional fiscal burden undertaken may create. In aggregate, the sheer size of 2020's 26.5% of GDP fiscal response will see a negative fiscal impulse into 2021, modestly offset by the EU recovery fund.

The Bank of Japan (BoJ), having been more dovish than all other major central banks earlier in 2020, actually dialled back the stimulus in the final quarter, which will stimulate upward pressure on the yen. We expect the taps will remain fully open with COVID-specific policy, such as their preferential bank loans, already rolled over beyond their previous expiry in March 2022. A third supplementary budget will also see the BoJ respond by soaking up the extra bond issuance — some JPY 22 trillion this fiscal year — which will see a further acceleration in BoJ balance sheet growth into early 2021.

The Bank of England expanded its Asset Purchase Facility by another £150 billion, bringing the total to £895 billion. This decision was taken in the context of 'risk management considerations' to mitigate downside risks, so the Bank is likely done with QE for now given early vaccine roll out and the possible release of pent up demand from Brexit uncertainty. The prospect of negative rates — still being debated — is unlikely given the negative impact on bank margins, the large number of retail deposit dependent small banks and building societies and continued doubts over the efficacy of negative policy rates more widely. Fiscal policy looks troubling, with the Office for Budget Responsibility forecasting a drop in government borrowing from 19% of GDP this fiscal year to 7.4% in 2021-22 and 4.4% in 2022-23. This colossal tightening would be a major economic headwind, if enacted.

Summary of high conviction asset class views

Regional Equity

Asian region has robust macro and micro fundamentals combined with attractive valuations. There are increasing signs of a broad based recovery across EM supported by commodity prices. US benefits from a positive cyclical outlook, further evidence of resilient capital allocation and the greatest breadth of opportunities.

Positive — Japan, Asia ex Japan, US
Negative — Europe ex UK, UK

Sector Equity

Prefer asset light compounders with structural growth underpinning although increasingly wary of high valuations in some areas. Substantial opportunities which benefit from accelerating structural change in cyclical industrial, technology and consumer sectors. Pharmaceutical and Consumer Staples sectors offer an attractive combination of high quality and reasonable valuations.

Positive — Healthcare Tech, Materials, Industrials, Financials, Consumer Staples, Pharma
Negative — Energy, Telcos & Utilities, Real Estate, Media & Online Retail, Consumer Goods

Defensive Bonds

Outlook negative as the macro environment continues to recover and the case for higher inflation premium becomes more pronounced. Central bank actions to engineer higher inflation expectations should see short-dated real rates remain deeply negative, with higher long-dated real interest rates as the macro environment improves. Implied inflation should continue to move higher.

Positive — US inflation linked, China
Negative — US long end nominal

Growth Bonds

Neutral outlook. Macro environment becoming less supportive as growth and inflation continue to recover. Valuations are mixed as record low nominal yields are offset by more supportive real interest rates and steep curves. Continue to favour those areas that have a nominal and real rate advantages over DM. These should continue to benefit from deeply negative real interest rates in DM and aggressive central bank policy.

Positive — Indonesia, Mexico, South Africa

Credit

Credit valuations are rich across the board. Earnings for Q3 remain negative although show an improvement on the large contractions in Q2, IG is noticeably outperforming HY in terms of earning beats. Direct central bank intervention and strong flows remain a key tailwind in to year end. New issuances have decelerated in to year end.

Positive — High quality BBBs, BB spreads (corporate)

FX

Divergence among the majors remains most evident in CNH with China being further into a recovery and with a neutral PBoC. Divergence has begun to emerge between JPY and EUR & USD following a shift in BoJ asset purchases, although further evidence is needed to become outright positive on the yen. High real yielding and cheap EM FX should be supported by a recovery in global growth and excess DM liquidity.

Positive — CNY, CNY bloc, EM bloc
Negative —EUR, USD, NZD (funding currencies)

Commodities

Biden's US election victory, along with the recent senate victories in Georgia, and vaccine roll-outs have boosted growth prospects in the US and Europe while Chinese growth remains very strong. There are increasing reports of shortages of materials such as steel, plastic coatings, coal as well as containers in many markets. A weakening US dollar, the current bias in the US policy settings to tolerate an overshoot of its 2% inflation target and repeated calls from governments to focus on growth rather than austerity lead us to believe that commodity prices, in particular metals, will remain higher than most forecasts over the next year.

Positive — Metals, Gold and Agriculture
Negative — Oil

Equity views

At the regional level, we maintained our preferences within equities into 2021. Asia ex Japan remains our highest conviction regional view, supported by positive structural trends, a robust cyclical recovery on the back of competent management of the pandemic, improving corporate fundamentals and undemanding relative valuations.

We continue to hold a positive view on Japan as a beneficiary of an improving cyclical outlook across Asia and substantial ongoing monetary easing. Relative balance sheet strength and a longer-term improvement in capital allocation and shareholder return policies are additional underlying positive drivers. Encouragingly, company earnings are now recovering. There are also increasing signs of a broad-based recovery across EM with strong commodity prices particularly helpful for markets such as Brazil.

We retain our confidence in the US equity market. From a macro perspective, leading economic data remains strong and the Federal Reserve remains committed to maintaining a highly accommodative policy stance even as an economic recovery becomes more firmly established. From the bottom-up, the US is the region with the greatest breadth of opportunities to invest in high quality businesses with improving momentum at reasonable relative valuations.

We remain negative on both the UK and Europe ex UK, the latter primarily due to expensive valuations. The UK negative view comes amid challenging cyclical dynamics and structural headwinds. The measures implemented to fight COVID-19 have neither contained the virus nor protected the economy and the country's high dependence on services has intensified the economic shock. Valuations remain at a discount to other markets but are consistent with a market which is heavily skewed towards structurally challenged industries and lacking leavers to pull to change the course of fundamental momentum.

At the sector level we have upgraded our view on materials to maximum positive, as both top-down and bottom-up factors have aligned to prompt the upgrade from positive. Tighter conditions in commodity markets have been driven by both supply constraints caused by the pandemic, physical disruption issues and a more conservative corporate approach to managing supply. Going forward, the credit cycle in China should continue to support commodity demand in to 2021 and prices for the materials companies, in our view. From the bottom-up perspective our positive view is based particularly on the diversified miners who have seen a notable improvement in management behaviour towards capital discipline and the sector has moved away from the boom-bust mentality it has shown in the past. This gives us confidence that the strong earnings revisions we are currently seeing has persistency.

We are closely monitoring the software sector. Valuations are very extended and potentially vulnerable to rotation effects within equity markets. We estimate current valuations are pricing in double digit revenue growth for the next 10 years, which is ambitious but in line with what the sector has achieved on average since the tech bubble. Given how condensed the sector is and the positive views we have from a bottom up perspective on many of the major companies, it is hard to become negative overall without those views changing. To downgrade the sector in the future we would need to see signs that this growth rate is unachievable or beginning to roll over. With the Fed maintaining its easy policy stance and secular growth opportunities in short supply, we may see a substantial valuation premium persist for the foreseeable future.

Finally, we have upgraded our view on US banks to a positive conviction view. There was more incremental data through December that further evidenced the reflationary outlook for the US economy and we have carefully considered how this should weigh against any structural challenges. Earnings for the heavily provisioned large US banks will benefit from write-backs as we move through 2021. In the US, we believe that the cyclical can dominate the structural whereas in the EU and Japan we expect the structural pressures will continue to weigh on the more positive cyclical outlook.

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No representation is being made that any investment will or is likely to achieve profits or losses similar to those achieved in the past, or that significant losses will be avoided. This is not a buy, sell or hold recommendation for any particular security. For further information on specific portfolio names, please see the important information section.

Fixed

Fixed Income views

Government Bonds: We have maintained our core views on government bonds with US nominal rates continuing to score negatively. The Fed has effectively pledged to engineer an inflation overshoot, and we continue to monitor for further details of the path for QE purchases and at what point they will look to taper. The current QE programme is set to a minimum of US$120 billion per month with an average maturity of 8 years (vs. 15 years historically). The market expects it to push the maturity of its purchases out longer but given the signalling effect of the long end of the curve we believe it will avoid doing this and hence there is scope for market disappointment. We expect to see guidance on what conditions will be needed to pullback on purchases and explicitly link a taper to realised outcomes. By linking the rate of purchases to realised outcomes, like it has with interest rates, this should have it continuing the current pace until 2022, when inflation goals are met. This could have large medium-term implications for asset classes given the divergence with other central banks such as the ECB.

Emerging Markets Local Currency: We analyse and consider Emerging Market Local Debt on a currency hedged basis. Our views on underlying emerging market currencies are expressed in the currency section. Sentiment has improved following the US election and vaccine news which is also supportive for growth. Current accounts similarly remain strong, demonstrating a limited need for external financing but as growth returns these should moderate with the recovery in domestic demand. Select opportunities continue to exist in areas where there remains a yield advantage over developed markets, notably Indonesia, Mexico and South Africa and we continue to take a positive view on these markets.

Emerging Markets Hard Currency: Value opportunities have decreased after a large spread compression following November's rally. Opportunities exist further down the credit curve (B-rated assets) but our relative preference has shifted to local currency. Turkey was removed as a recommended position after a large spread compression and diminishing risk premia (although we have moved to a more positive stance on the Turkish Lira in response to an improved institutional framework — see below).

Developed Markets Credit: The closing two months of the year were very strong for all areas of the asset class. Valuations are now rich across the board but have yet to reach post GFC tights; arguably given the central bank impulse currently in place this level is achievable, and we can continue to see spreads grinding tighter. There is even an argument that given the current environment and business conditions, spreads could break through these levels given short-term yields are anchored, companies are less likely to borrow next year and instead use a recovery to deleverage and central bank purchasing continues. Opportunities exist, generally in areas of the market largely impacted by COVID-19, but it has increasingly become about being selective.

Income

Currency

Currency views

The Chinese yuan remains our favoured currency within the majors, along with the broader Asian region given the divergence in growth and policy with the rest of the world. The Chinese economy continues to demonstrate strength and is much further into a recovery versus much of the rest of the world. As a result, the People's Bank of China (PBoC) is currently adopting a neutral policy stance and is not wanting to engage in extraordinary policy measures. This has resulted in notable divergence between the PBoC and other major central banks, which are continuing to ease aggressively to support their respective economic recoveries. We believe the Fed will continue to out-dove the European Central Bank and this may prompt a downgrade of the US dollar versus the euro in the coming months.

The backdrop for selective emerging markets remains positive given the continued aggressive policy from the developed market central banks — especially the Fed — encouraging an abundant global liquidity environment.

We believe value continues to exist in select areas where real yields remain high and underlying fundamentals are improving. We favour the Mexican peso, Turkish lira, Indonesian rupiah and the Russian ruble versus the euro and US dollar.

We believe the ruble has room to appreciate despite its underperformance. Growth continues to recover despite virus cases also picking up and authorities have maintained good control of fiscal spending, essentially offsetting the savings gained by the application of the fiscal rule over the last few years. Recent underperformance seems to have been driven by concerns of rising inflation, but this appears to now be priced in. The currency should also benefit from a stronger oil price.

The Turkish lira has been added as a conviction EMFX position after the authorities shifted to a more orthodox policy stance. This shift included hiking interest rates and creating an environment of positive real yields. An increase of transparency in policy and a slowing in credit growth are supported by a highly depressed currency valuation.

Currency

Commodity views

With President-elect Joe Biden, now with senate control, promising aggressive stimulus spending and a renewable infrastructure build and President Xi calling for strong economic growth in the Chinese Communist Party's 100th anniversary year, growth prospects remain well under-pinned. We have already seen many commodity prices move higher in recent months and we believe the risk is prices remaining at higher than forecast levels in coming months. With commodity prices increasing, inflation is expected to continue to rise, particularly in the first half of the year, but with the US Fed signalling a softer stance, the risk is that inflation continues to accelerate in the second half of the year.

For base metals and bulks, prices have been strong in recent months, with iron ore and steel prices back to levels not seen for nearly 10 years and fundamental tightness being reported in many regions. Copper prices are above $8000/t for the first time since 2013 and other metals are above long-term averages. With capex cut back by mining companies over recent years, supply growth remains muted for most metals and, unless demand weakens, prices look set to stay at elevated levels.

Policy settings also look likely to provide support for precious metal prices as a weaker US dollar and rising inflation encourage investors to keep or add to gold holdings and support silver and PGM prices, which will benefit from industrial growth as well.

The outlook for oil prices has improved with the approval of vaccines in North America and Europe supporting expectations of stronger demand in 2021, though recent harder lockdowns have dampened prospects in the near-term. Saudi Arabia's unilateral decision to cut supply has surprised the market and provided further support short-term but the longer-term outlook remains very uncertain. It is reasonable to assume that Saudi's surprise cut was largely driven by rapidly weakening demand trends in their key export markets. OPEC now has unprecedented levels of spare capacity to bring on as demand improves and accelerating EV adoption rates threaten demand forecasts in the medium term. It is likely to be another highly volatile year for oil prices.

Agriculture and soft commodities have seen very strong price improvements generally in recent months, spurred on by a weaker US dollar and tighter fundamentals. Corn prices are above $5/bushel for the first time since 2014 and wheat prices are also at seven-year highs. With mounting supply concerns from a La Nina weather pattern in South America, prices might continue the upward trend. This should lead to better demand for fertiliser and other agri-inputs in due course, as farmer profitability improves. Protein prices have peaked following the Chinese pork shortages and lower restaurant demand has softened salmon prices though markets remain reasonably tight going into 2021.

General risks. The value of investments, and any income generated from them, can fall as well as rise. Past performance is not a reliable indicator of future results.

Specific risks. Currency exchange: Changes in the relative values of different currencies may adversely affect the value of investments and any related income. **Emerging market (inc. China):** These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems.

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