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 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.

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.

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.

Please note that this document should be read in context of the full communication as it contains important information regarding the manager, performance and associated risks. Read the full document here.