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Investing for a world of change

Managing downside: participating in the upside

The case study of Global Multi-Asset Income Fund

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The fast view

- Global Multi-Asset Income (GMAI) seeks to deliver a defensive return over time, driven by an attractive resilient yield, with low volatility and low drawdowns. It therefore can be a core part of a portfolio, possibly as an alternative to fixed income.
- 2022 was a bruising year with most markets posting significant falls, but the GMAI managed to reduce much of that downside.
- Market uncertainty is likely to continue for a while, but there are pockets of opportunity. We are defensively positioned but alert to those opportunities.
- GMAI has a history of providing defensive returns with positive skew – i.e., providing more exposure to rising markets than to falling markets. This paper profiles how we have successfully managed the Fund to achieve this.
- Going forward we are optimistic about achieving our objectives. This is based on the 5.9% current yield on the portfolio which is at a recent high; current valuations of higher yielding equities; opportunities in both developed and emerging market bonds; and faith in our bespoke multi-variate cyclical analysis which allows us to manage our risk and exposure to opportunities as we see them arise.
- This ability to provide income-driven returns from multiple sources, makes us believe that GMAI could be an attractive alternative to fixed income as a defensive core in portfolios.

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Past performance does not predict future returns; losses may be made.
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The case study of Global Multi-Asset Income Fund

2022 was a bruising year for most asset classes, with most posting significant falls. Many fixed income markets ended their multi-decade bull run and so the usual benefits of diversification, particularly to fixed income, failed to protect investors. As we start the new year, markets remain dogged by uncertainty, with high levels of inflation, low levels of growth, higher rates, and continued geo-political uncertainty. The valuation re-set of 2022 has led to many asset classes trading at historically attractive levels – however this is no time for heroics. Current valuations may have further to adjust before the potential material deterioration in earnings that would come in a deep recession is fully discounted. Our main concern is that given the speed and magnitude of the hiking cycles in the developed world, a recession over the next 6-12 months is likely.

Should we see markets move to price in our base case more fully, or risks start to diminish, then we would expect to add more risk to our Global Multi-Asset Income Fund (GMAI). However, while the signals remain mixed, we favour a cautious but opportunistic approach.

As the table below shows, GMAI successfully managed to mitigate much of the downside in markets in 2022 - our objective in more challenging times. However, we are also actively looking at how we can use its diverse tool kit to exploit upside opportunities as they arise.

2022: a year of successful management of downside

Equity	-18.36%
Bonds	-16.25%
High yield	-13.23%
Global Multi-Asset Income Fund	-4.84%

Past performance does not predict future returns; losses may be made.
Source: Ninety One, Morningstar as at 31 December 2022. GMAI performance is I Acc net of fees (NAV based, including ongoing charges, excluding initial charges), gross income reinvested, in USD.
Equity = MSCI ACWI; Bonds = BBgGlobal Aggregate TR USD;
High yield = BofAML Global High Yield

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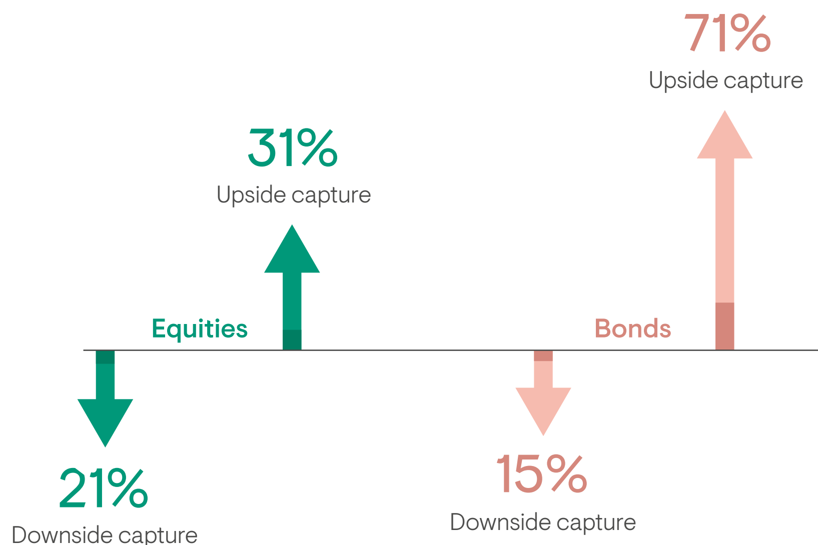
Asymmetric skew – participating more in upside than downside

GMAI seeks to be a defensive total return fund and its investment approach focuses on limiting drawdowns while also aiming to maximise upside capture, and taking on additional risk when we believe it will be rewarded. This is achieved through an emphasis on resilient income drivers and tactical hedging of market risks, whilst also seeking to position ourselves for any subsequent recoveries.

As shown below, this has led to the Fund over its life producing a positive asymmetric return skew since its launch – with greater participation in rising equity and bond markets than in falling markets. This has helped compound risk-adjusted returns over time.

GMAI: asymmetric return skew



Past performance does not predict future returns; losses may be made.
Source: Ninety One as at 31 December 2022. Performance is gross of fees (returns will be reduced by management fees and other expenses incurred), income is reinvested, in USD. Equities = MSCI World Index USD. Bonds = BBgBarc Global Agg TR USD; these are not the official benchmarks and the chart above is provided solely for information purposes only. For further information on indices, please see the Important information section.

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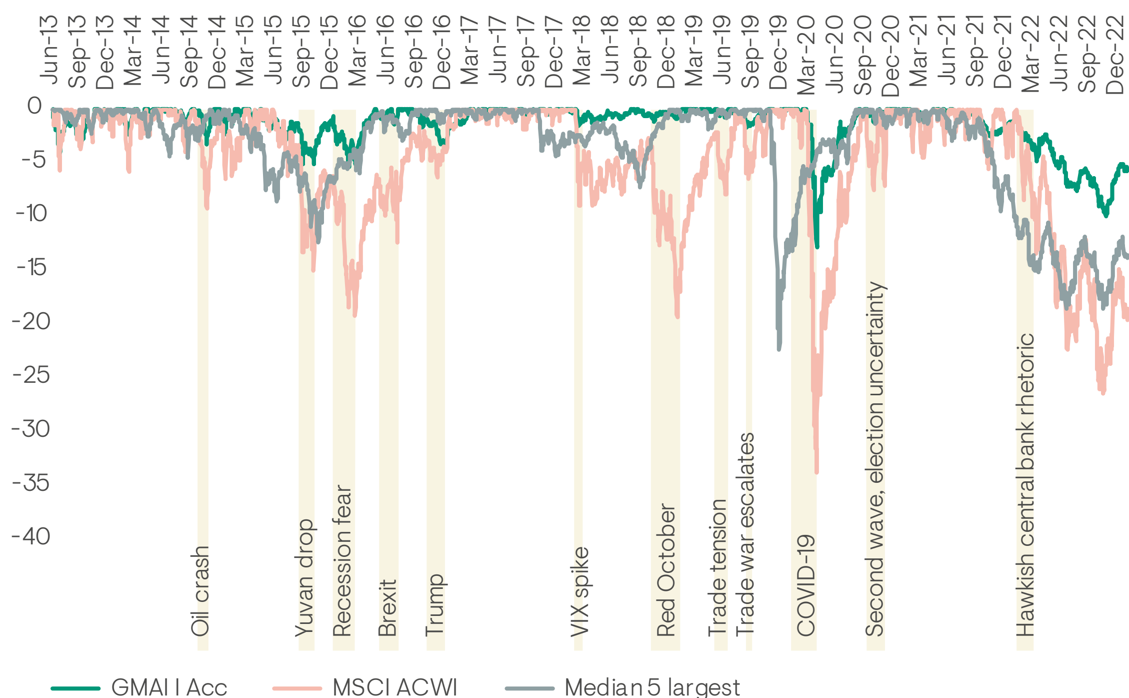
Managing the downside; participating in the upside

The chart below shows how since inception the Fund has performed relative to the MSCI ACWI and five of its largest competitors during market downturns and subsequent rallies back to their pre-drawdown level. It shows that over the life of the Fund, markets have become more volatile with periods of downturn becoming more frequent and severe. In each of these cases the Fund has managed to outperform the Index during the downturn and recovered well in the subsequent rally.

Peak to trough performance during drawdown episodes



Past performance is not a reliable indicator of future results, losses may be made.

Calendar year returns for the Fund (and competitor group); **2022**: -4.8% (-5.6%); **2021**: 1.2% (5.8%); **2020**: 5.7% (3.2%); **2019**: 6.9% (13.5%); **2018**: 1.2% (-4.9%); **2017**: 6.6% (8.7%); **2016**: 5.0% (6.7%) ; **2015**: 1.6% (-2.4%); **2014**: 4.5% (4.2%).

Source: Morningstar, 31 December 2022. Period shown is since 31 May 2013, from inception of the I Acc share class. Performance is net of fees (NAV based, including ongoing charges, excluding initial charges), gross income reinvested, USD. The competitors shown for comparison purposes are the five largest Luxembourg/Dublin domiciled Multi-Asset income funds by AUM based on our Multi-Asset team's analysis of the competitor landscape. The Fund is actively managed. Any index is shown for illustrative purposes only.

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Below we show examples of how we have put this approach into practice over three distinct downturns.

Rebuilding risk after 2015/2016 drawdown, to capture upside through 2016/2017

May 2015 – Feb 2016: 21% downside capture[1]
Feb 2016 – Dec 2017: 29% upside capture[1]

In May 2015 there was a slowdown in the rate of growth in China which sent reverberations around the world. The Chinese authorities responded by devaluing the Chinese Yen (CNY).

We de-risked the portfolio initially, reducing net equity exposure from c.30% in May 2015 to 19% in February 2016 in order to protect in falling markets. Bonds at this time were behaving defensively, so we also increased duration from 1.3 years to 3.1 years.

However, after Q1 2016 we re-risked as we saw the market environment stabilise with the valuation of Growth assets appearing reasonable and probability of recession low. We built net equity back up to 30% which helped us recoup losses and participate in the rising markets seen through 2017.

Rebuilding risk after 2018

Q4 2018: 0% downside capture[1]
2019: 25% upside capture[1]

Following the withdrawal of liquidity resulting from the quantitative tightening which began in October 2017, risk assets looked strategically challenged in Q4 2018. Valuations of growth assets appeared high, and the probability of recession was increasing. As a result, In Q4 2018 we took our hedged equity exposure to close to 0%, and duration to less than 1 year as both traditional assets were being negatively impacted by quantitative tightening and the withdrawal of liquidity by central banks.

Following the sharp sell off in traditional assets in Q4 2018, net equity was increased from 0% to 23% by April 2019. We also increased other Growth assets such as high yield corporate bonds. This was funded by a reduction in defensive fixed income such as developed market sovereign bonds and helped us participate in rising markets through 2019.

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1. Source: Bloomberg and Ninety One. Downside and upside capture are versus MSCI World Index USD and is net of GMAI's I share fees, income is reinvested, in USD. This is not the Fund's official benchmark and is provided solely for information purposes only. For further information on indices, please see the Important information section.

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Rebuilding risk after the sharp COVID-induced sell off in 2020

2020, to 23 March: 36% downside capture[2]
2020, after 23 March: 27% upside capture[2]

The global spread of COVID saw us take net equity to close to zero by early March, which helped us to reduce losses. The Fund did however suffer as high quality fixed income fell proportionately more than the fall in equities would normally have suggested.

However the speed and magnitude of the sell off – including the dislocation in the corporate bond markets – provided an attractive future return opportunity and we quickly built back risk after the lows seen on 23 March.

Net equity was increased from almost zero to 20% by the end of May, whilst our credit exposure (including both high yield and investment grade) was taken from c.25% to c.35%. This swift action enabled us to participate in the V-shape recovery.

This approach of seeking to manage downside, whilst being alert to opportunities to take on risk when we feel appropriate, has helped the Fund to compound returns over time.

Long term performance

(%)	1 year	3 years p.a.	5 years p.a.	Since inception p.a.
Fund	-4.8	0.6	2.0	3.0

(%)	2014	2015	2016	2017	2018	2019	2020	2021	2022
Fund	4.5	1.6	5.0	6.6	1.2	6.9	5.7	1.2	-4.8

Past performance does not predict future returns; losses may be made.
Source: Morningstar, 31 December 2022. Performance is net of fees (NAV based, including ongoing charges, excluding initial charges), gross income reinvested, in USD. Performance start: 31 May 2013. Performance prior to 28/11/2013 is based on a longer existing share class, adjusted to match the fees of this share class. Fund: Global Multi-Asset Income (I Acc USD). This fund is actively managed and is a sub-fund of the Ninety One Global Strategy Fund (GSF). The Fund does not have a benchmark.

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2. Source: Bloomberg and Ninety One. Downside and upside capture are versus MSCI World Index and is net of GMAI's I share fees. This is not the Fund's official benchmark and is provided solely for information purposes only. For further information on indices, please see the Important information section.

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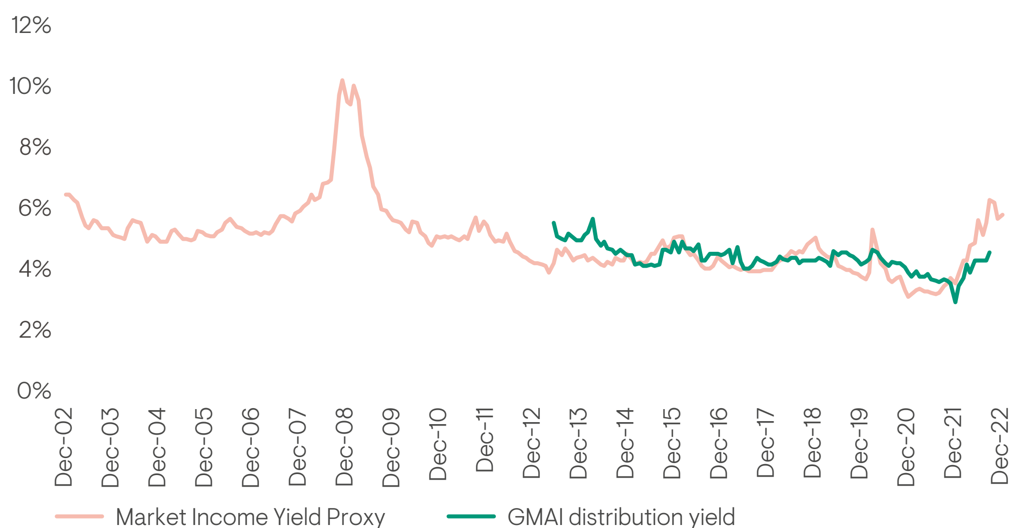
Current opportunities: reasons to be cheerful

While markets remain uncertain, we feel there are a number of reasons for optimism regarding future returns for GMAI.

1 Yields have risen and provide a good building block for forward-looking returns

Historically income has been a more dependable source of return than capital gains and lies at the heart of the Fund's investment strategy. With market falls in 2022, yields are now at attractive levels: the current portfolio yield, at 5.9%[3], is at a recent high. This provides an attractive building-block for forward looking total returns in accumulation units or a compelling source of cashflow for those seeking regular income.

Market and fund distribution yields at recent historic highs



Charges are taken from capital and may constrain future growth. The amount of income may rise or fall.

Source: Ninety One, as at 31 December 2022. I Inc-2 Yield = 4.4% (2.8%). 'The Market Yield Proxy is 30% MSCI World High Dividend Yield, 30% BoAML Global Corporate Index Yield, 20% BoAML Global High Yield Constrained Index Yield, 10% JP Morgan EMBI GD Sovereign Yield, 10% JP Morgan GBI-EM GD Composite Yield, all from the inception of the latter.' The bracketed number shows the level of yield had charges been deducted from income. For further information on yields and the figure in brackets, please see the Important information section.

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3. As at 31 December 2022.

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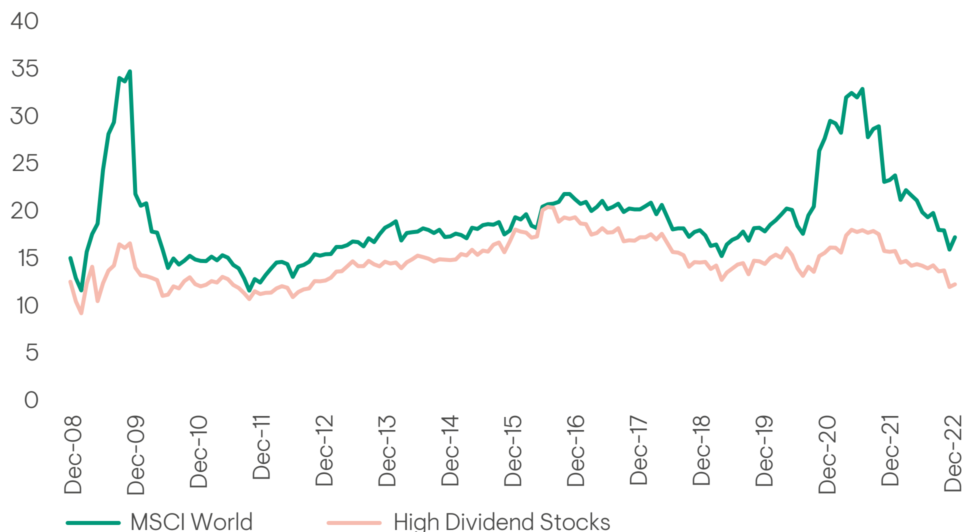
2 Current valuations provide the potential for capital appreciation without the reliance on beta

High yielding equities

Within GMAI we seek higher yielding equities chosen on the basis of the resilience of their income. We believe these equities with quality income streams are well placed to navigate a higher inflationary environment. They are also currently trading at cheaper valuations than the rest of the market which provides them with significant upside potential.

Valuations of high dividend stocks are currently attractive



Past performance is not a reliable indicator of future results, losses may be made.
Source: Bloomberg, Ninety One calculations, July 2008 and August 2022.
High dividend stocks = MSCI World High Dividend Yield Index

Developed market sovereign bonds

After their sharp sell off in 2022, US Treasuries are showing more value than for some time and, with the likelihood that inflation may have peaked and interest rates may be approaching their peak, we have begun to add duration exposure. In addition, we have increased exposure to other high-grade markets where household leverage and housing market imbalances are present, such as Australia, New Zealand and South Korea. This is because these markets are less likely to be able to withstand higher interest rates for as long as the US, and we think their government bonds can rally materially even if US Treasury yields have yet to peak. Additionally, as we see more evidence that the US economy is beginning to suffer from their higher rates, we are likely to add further to the Fund's duration.

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Emerging market sovereign debt

Despite the rise in DM government bond yields in 2022, the yield differential between DM and EM local currency yields remains fairly wide in a historical context. Furthermore, as many EM economies started to raise rates earlier than DM, we believe many of their interest rates are closer to peaking and have the potential to be cut in 2023. This could create opportunities for further outperformance over the next year (on a currency hedged basis), especially where curves price in even higher interest rates.

As an example, we favour South African bonds on a hedged basis. Currently South Africa's 8 year government bonds yield 10.2%. Meanwhile cash rates are 7.0%[4] and inflation is 7.2%[5], with both likely approaching peak levels. This means the Fund, for a duration of 5 years, can earn a c.4% yield premium over US dollar interest rates on a hedged basis, and so with no exposure to the South African Rand, while benefitting from the yield rolling down the curve as the bond moves towards maturity.

3 GMAI: Active management across a broad multi-asset tool kit

Over the years, we have demonstrated a willingness to actively manage GMAI's portfolio to align it more defensively when our cyclical analysis suggests risks are increasing, and positioning to benefit from growth opportunities when we see them arise.

The Fund can invest across a broad multi-asset opportunity set which spans the full equity and fixed income spectrum, but also property and infrastructure as well as currency. Decisions to invest are based not on asset class labels, but on their performance characteristics – ie whether they are growth or defensive assets or uncorrelated to either. Individual security selection is based on a precise bottom up basis, so we have absolute transparency on what we own.

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4. Source: Trading Economics.
5. Source: Trading Economics.

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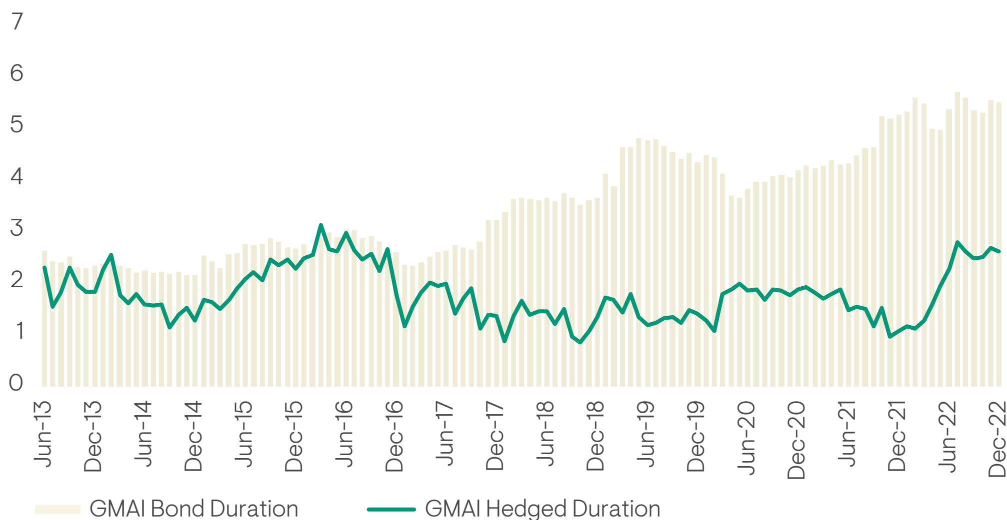
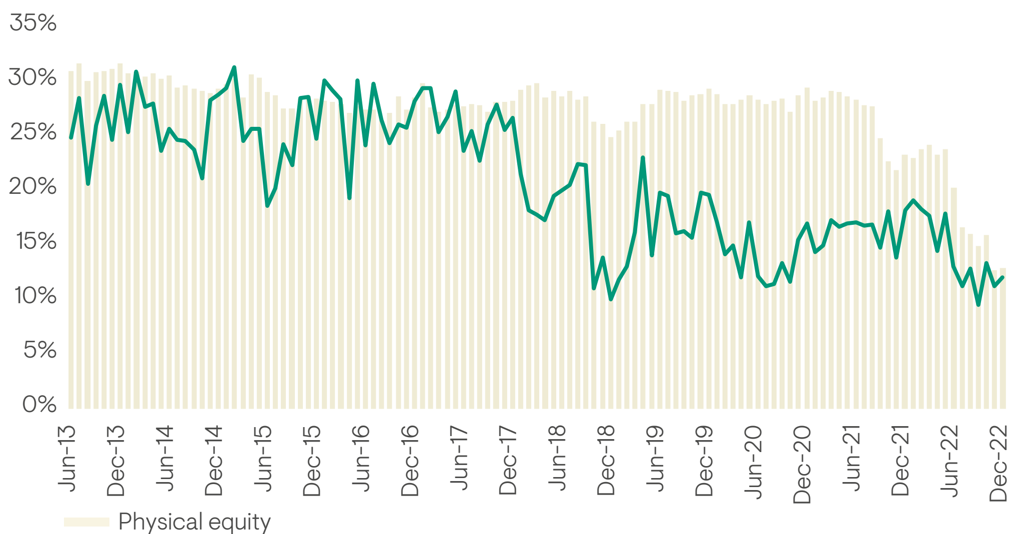
We also use a wide array of tools to manage our exposure: We are able to reduce the portfolio's equity sensitivity by using equity index futures and options, and the portfolios overall duration and sensitivity to interest rate changes by using bond futures and interest rate swaps, whilst retaining access to their dividend streams .

Active management of duration risk



Source: Ninety One, 31 December 2022. The portfolio may change significantly over a short period of time.

Active management of equity risk



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> With markets remaining uncertain, but also appearing to offer pockets of significant value, we remain alert to both continuing to manage the downside risk, but also exploiting opportunities to increase risk and benefit from market rallies.

We believe this flexibility gives the Fund more options for providing defensive returns even in markets that are challenging for both equities and bonds. It also allows us to quickly re-align the portfolio when we foresee opportunity and provides us with confidence of achieving our objectives in what undoubtedly will be a challenging year. We therefore believe it could be an attractive alternative to fixed income as a defensive core to portfolios.

General risks. The value of investments, and any income generated from them, can fall as well as rise. Where charges are taken from capital, this may constrain future growth. Ongoing costs and charges will impact returns. Past performance does not predict future returns, losses may be made. If any currency differs from the investor's home currency, returns may increase or decrease as a result of currency fluctuations. Investment objectives and performance targets are subject to change and may not necessarily be achieved, losses may be made. Environmental, social or governance related risk events or factors, if they occur, could cause a negative impact on the value of investments.

Specific risks. **Currency exchange:** Changes in the relative values of different currencies may adversely affect the value of investments and any related income. **Default:** There is a risk that the issuers of fixed income investments (e.g. bonds) may not be able to meet interest payments nor repay the money they have borrowed. The worse the credit quality of the issuer, the greater the risk of default and therefore investment loss. **Derivatives:** The use of derivatives may increase overall risk by magnifying the effect of both gains and losses leading to large changes in value and potentially large financial loss. A counterparty to a derivative transaction may fail to meet its obligations which may also lead to a financial loss. **Interest rate:** The value of fixed income investments (e.g. bonds) tends to decrease when interest rates rise. **Equity investment:** The value of equities (e.g. shares) and equity-related investments may vary according to company profits and future prospects as well as more general market factors. In the event of a company default (e.g. insolvency), the owners of their equity rank last in terms of any financial payment from that company. **Commodity-related investment:** Commodity prices can be extremely volatile and losses may be made. **Government securities exposure:** The Fund may invest more than 35% of its assets in securities issued or guaranteed by a permitted sovereign entity, as defined in the definitions section of the Fund’s prospectus. **Emerging and Frontier 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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Yields

The yield reflects the amount that may be distributed over the next 12 months as a percentage of the Fund's net asset value per share, as at the date shown, based on a snapshot of the portfolio on that day. Where there is a yield number in brackets, it is calculated in the same way, however, as the charges of the share class are deducted from capital rather than income, it shows the level of yield had these charges been deducted from income. This has the effect of increasing the income payable whilst reducing capital to an equivalent extent. Yields do not include any preliminary charge and investors may be subject to tax on their distributions.

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