Strategy commentary

Ninety One Global Multi-Asset Income

Month ending 31 October 2020

The following commentary gives the views of the investment manager at the time of publication.

Key points

- October saw a continued deterioration in risk sentiment as markets buckled under the weight of rising coronavirus cases in Europe and the US, in addition to uncertainty surrounding the US election
- Most Growth assets generated a negative return, with equities in particular selling off, notably across US, UK and Japanese markets; Defensive assets were mixed
- The Strategy produced a positive absolute return, with equity hedges, used to reduce risk, providing a significant offset for losses suffered in the equity book; credit positions also contributed
- Our central scenario for financial markets continues to be that volatility will likely remain elevated in the coming quarters with additional lockdowns as we head towards winter

Ninety One

Previously Investec Asset Management

Growth assets

- React positively to economic strength
- Positive correlation with equities over time

Defensive assets

- React positively to economic weakness
- Safe havens in market crises

Uncorrelated assets

- Variable relationship with economic growth
- Independent returns to equities

Market background

October saw a continued deterioration in risk sentiment as markets buckled under the weight of rising coronavirus case numbers in both Europe and the US, and further restrictions were enforced across the continent. At the beginning of the month US president Donald Trump joined the growing list of world leaders reported to have contracted COVID-19. Sentiment was not helped by the falling probability of a fiscal agreement prior to the US election, which itself also remained a source of uncertainty. There was however a slew of economic data throughout the month that indicated that the recovery still had momentum. The US economy expanded at a record annualised rate of 33.1% in the third quarter as businesses reopened and consumer spending was encouraged. Eurozone flash October PMIs surpassed expectations, and strong industrial data from China indicated that domestic demand is driving the recovery. In the UK, Moody's downgraded Britain's credit status to Aa3, citing weaker economic growth and an erosion of fiscal strength. Meanwhile, the UK and Europe remain in talks regarding a future trade deal, with no definitive outcome.

The renewed spike in virus cases was coupled with a fresh round of lockdowns across both Europe and the UK, and the US also starting to see the beginnings of an 'autumnal wave.' Growth assets were therefore negative during the month, led down by developed market equities. October proved challenging for US, UK and Japanese equities; however, it was European equities that suffered the most, with the benchmark Stoxx 600 falling by -5%. Conversely, emerging market assets – both equities and bonds – outperformed in October and were in positive territory, lifted by strong data from China as factory activity expanded at its fastest pace in a decade. Oil was the worst performing Growth asset as prices fell to their lowest level since May as the widespread lockdowns threatened demand at the same time as Libya ramped up production. Compared to equities, high yield corporate bonds proved to be relatively resilient through the month; US high yield generated a positive return and outperformed European high yield, which returned a small negative.

Defensive assets were mixed. Sovereign bonds rallied in Europe with the risk-off sentiment tone and indications that the European Central Bank would continue and possibly expand on its bonds buying programme. US Treasuries, on the other hand, fell -1%, as did UK Gilts. Global investment grade corporate bonds were marginally negative on the month, however this was driven by the US as the prices of European bonds gained in value. Against this cautious backdrop, the US dollar and Japanese yen generated positive returns. The Chinese yuan rallied, as although third-quarter GDP missed estimates, strong retail sales and industrial production for September encouraged investors that the recovery remained intact. Elsewhere within FX, sterling edged higher on the UK restarting Brexit talks – a week after suspending them – encouraging investors that both parties could move closer towards a trade deal. As the US dollar strengthened in value, gold marginally detracted, ending the month just below $1,900/oz.

Performance review

The Strategy produced a positive absolute return in US dollars, gross of fees[1].

Overall, the continuing risk-off sentiment in October was negative for Growth assets. Against this backdrop, the Strategy's equity positions gave back some ground during the month as stock markets weakened and our holdings underperformed the broader market. Equity hedges, however, which are used to reduce risk, provided a significant offset for losses suffered in the equity book.

Credit contributed, with European bonds notable beneficiaries of the ECB's less-than-subtle hints that further stimulus measures could be on the horizon. Emerging market debt was also a marginal positive contributor over the month, while positions in both property & infrastructure and developed market sovereigns were flat.

Elsewhere, modest exposure to the yen and the Chinese renminbi benefited the Strategy, with the former in demand due to its haven status and the latter due to the encouraging retail and industrial data indicating that the economic recovery remains intact.

Outlook and strategy

The global economy has continued to recover from the material lockdown induced contraction experienced through the first half of the year. As we look forward, there is a relatively high degree of uncertainty about the path of the economic recovery and further coronavirus outbreaks and localised lockdowns will continue in the coming quarters. However, economic activity in major economies is recovering and human ingenuity continues to make advances in combating Covid-19, evidenced through quicker testing, the tracking and tracing of outbreaks, treatments and the expected distribution of a vaccine in the near future. At the same time, we continue to take encouragement from the policy response to the global pandemic, with the speed and magnitude of the measures that have been announced and implemented over the past nine months being unprecedented. We believe the ongoing and aggressive monetary response is constructive for asset markets and the broader fiscal support reduces the tail risk of more pronounced economic weakness, and it should aid a faster bounce back in activity as economies continue to recover.

Our central scenario for financial markets continues to be that volatility will likely remain elevated in the coming quarters with additional lockdowns as we head towards winter. We believe investors will continue to have to weigh up the potential longer-term economic damage caused by efforts to contain the coronavirus outbreak, the path of new lockdowns and the likely approval and distribution of a vaccine in the coming months, while monetary and fiscal stimulus continues to provide underlying support. Risk premia have compressed considerably from the relatively extreme levels reached in late March and April but remain elevated relative to history in many areas. We continue to see opportunities for medium-term investors as a result, although these have become more specific rather than broad based. We will continue to take advantage of opportunities as they are presented by market volatility.

[1] Based on gross-of-fee composite returns of various managed accounts and pooled funds. Net returns will be lower and relative returns may differ according to share class held and applicable fee level.

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