Strategy commentary

# Ninety One Global Multi-Asset Income

Quarter ending 30 September 2020

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

## Key points

- Markets continued to rebound in the third quarter as economies continued to recover from their lows, but September saw a sharp pull back in response to rising coronavirus cases
- The Strategy produced a positive absolute return, benefiting from the rally in Growth assets, in particular credit, as further compression in credit spreads overall which saw prices rise across investment grade and high yield corporate bonds
- Within the equity book there was some turnover as a result of our bottom-up security selection process, with seven names being added and one name being sold; The Strategy's duration and credit rating were in line with the previous quarter, at 1.9yrs and BBB+
- Our central case scenario remains that following a short-term shock to growth, the policies of strict isolation coupled with the rapid and meaningful response by policymakers will curtail the impact of a deep recession.

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

Overall, markets continued to rebound through the third quarter of 2020 as economies recovered from their post lock-down lows, the commitment for widespread fiscal and monetary policy support remained, while economic data and corporate earnings generally surprised to the upside. However, September saw a pull-back in markets against a backdrop of concerns over a second wave of COVID-19 infections, the related economic impact and heightened political risk.

Most Growth assets generated a positive return during the third quarter. Global equities were led by Asia ex-Japan, with China in particular delivering strong returns, and emerging markets outperforming developed markets. Following the S&P 500's biggest five-month gain since 1938, the market then corrected aggressively in September driven by a mega cap sell-off – the very stocks that had powered the market to fresh highs over the quarter. The exception was the UK market which lagged to the extent of producing a negative return during the review period as the country suffered a much larger GDP contraction than its European peers, whilst concerns around Brexit also intensified. As risk assets traded higher, there was a compression in credit spreads overall which saw prices rise across high yield corporate bonds with Europe outperforming the US. Emerging market debt was positive at the margin, as a weaker US dollar and low developed market yields continued to provide a tailwind. Oil was flat on the quarter, as prices were driven by supply and demand forces that ebbed and flowed throughout, with steady gains over the summer months reversed in September.

Despite the risk-on mood that prevailed through most of the penultimate quarter of 2020, Defensive assets also rose on average. Developed market sovereign bonds were broadly flat on the quarter, whilst investment grade corporate bonds gained in value in both Europe and the US. The US dollar weakened through the quarter, suffering its worst performance since mid-2017. The Japanese yen appreciated versus the US dollar, whilst sterling weakened. Gold enjoyed a positive quarter, in part helped by the tailwinds of a weaker US dollar and an increase in inflation expectations; the safe-haven asset at one point reached a record high of $2,063/oz, before falling back by the end of September.

## Performance review

The Strategy produced a positive absolute return in US dollars, gross of fees[1]. The Strategy benefited from the continued rebound in Growth assets through the third quarter, led by a further rally in equities, but in particular credit. Having added meaningfully to credit in the second quarter, we benefitted from having

[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.

greater exposure as there was further compression in credit spreads overall which saw prices rise across investment grade and high yield corporate bonds. Our equity selections outperformed the broader equity market, and our equity hedges – which are used to reduce risk – also contributed positively as they were predominantly focused on weaker European equities, with equity call options providing further returns.

Other Growth assets, such as property and infrastructure, also contributed positively, whilst emerging market debt positions marginally detracted. Within FX, there was a negative impact of hedging much of the Strategy's currency exposure back to base (USD) however this was partially offset by an active position in the Japanese yen – a currency held for its safe haven attributes – which appreciated versus the US dollar. Finally, despite the risk-on mood through the quarter, developed market sovereign bonds contributed, attributed to our exposure to New Zealand government bonds on further policy easing.

## Activity and positioning

Net equity exposure marginally increased from 12% to 13% through the quarter however just over half of physical equity exposure is hedged. Despite some improving economic data, following the rally seen in equity markets since the lows on the 23 March, valuations are now less compelling given the uncertainties that remain and the tail risks surrounding the US election and whether there is a successful agreement regarding additional fiscal stimulus. Within the equity book there was some turnover as a result of our bottom-up security selection process, with seven names being added and one name being sold. Overall, there was a slight increase to emerging market equities.

Elsewhere, one REIT holding was sold following a period of strong performance. Fixed income exposure was broadly in line with the previous quarter, across corporate bonds, emerging market debt and developed market sovereign bonds. Corporate bonds remain the largest risk exposure, whilst the majority of developed market sovereign bonds continues to be focused on higher yielding markets such as Canada, Australia and New Zealand. The Strategy's duration and credit rating were in line with the previous quarter, at 1.9yrs and BBB+ respectively. 97% of the Strategy continued to be hedged back to base currency (USD), although throughout the quarter we added to Japanese yen for its risk-reductive properties before taking profits.

## Outlook and strategy

Our central case scenario remains that following a short-term shock to growth, the policies of strict isolation coupled with the rapid and meaningful response by policy makers will curtail the impact of a deep recession. So far this appears to be playing out, with governments globally beginning to ease lockdown restrictions, favourable base effects for growth, and fiscal and monetary stimuli, creating conditions for a gradual revival of economic activity in a phased manner as we go through the final quarter of the year.

The risks that could derail our central case, however, also remain. There is a risk that lockdown measures fail to contain the virus and that this extended disruption is too much for businesses to withstand, even with the significant policy maker support. We are already seeing an increase in restrictions in some regions as concerns focus on a second wave of COVID-19 cases. The extent of the scarring will become increasingly apparent as each nation moves through their respective exit strategies. The high probability of a risk-case evolving in which we see prolonged dampening of activity, is also against a backdrop where there are tail risks surrounding the US election and the agreement of additional fiscal stimulus, as well risks assets having already rallied significantly off the lows seen in March, and there is a lack of historical precedent for riskier assets such as equities recouping losses in a straight from such a sharp loss as the one in the first quarter of 2020. As such, just over half of our equity exposure is hedged but with scope to redeploy dry powder and increase our net equity as the risk environment improves. We continue to hold cheap, out-the-money, equity call options which will help participation in market upside should markets move higher.

As income investors, we continue to find compelling opportunities with a number of asset classes still paying attractive risk premia. We remain optimistic over the medium-term on credit, as we see room for spreads to compress further although it is important to be selective. The emerging market bond exposure remains short duration, with the majority of currency risk hedged back to base. More generally, we have little active currency risk; we have a small exposure to select emerging market currencies where we see value, as well as a long Japanese yen exposure offering the portfolio strong defensive characteristics in difficult times. Finally, we have 1.9 years of duration, retaining moderate exposure to the higher yielding markets such as Canada, New Zealand, Australia. Overall, we continue to focus on securities with sustainable income and upside potential. We expect security selection to drive the portfolio's future return generation, with diversification and risk management used to navigate through volatile markets.

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