Strategy commentary

Ninety One
Global Strategic Managed

Quarter ending 30 June 2024

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

Key points

- The second quarter of 2024 was bumpy, delivering a mixed performance across financial markets
- The Strategy delivered a positive return. Equity selection delivered the bulk of returns, in particular China-listed stocks, as well as tech stocks and utilities
- Equity exposure was increased
- We remain somewhat more constructive on the prospect for risk assets, particularly in Asia and the US

Market background

The second quarter of 2024 got off to a relatively weak start with financial markets delivering a mixed performance. Investors focused on several key risks, including growing concerns regarding inflation. The core CPI print in the US heightened fears of persistent inflation, leading the market to price in fewer rate cuts for the rest of the year. This was even as the European Central Bank (ECB) delivered its first rate cut since the pandemic. Four of the central banks with G10 currencies have now cut rates this year. Finally, politics and geopolitics returned to the fore, notably in the Middle East and later in France, where a notable selloff followed the snap election.

In Q2 global equities advanced delivering low mid-single digit returns with emerging markets (EM) outperforming developed markets (DM). US equities hit fresh record highs, driven by the 'Magnificent 7' with Nvidia advancing for the seventh consecutive quarter. However, once again gains were narrowly led, with the equal-weighted S&P 500 Index losing ground during the quarter. President Macron's snap election announcement led to a selloff in French equities, affecting broader European equities. Conversely, UK equities performed well due to an improving economy, a revival of M&A activity and falling inflation. Chinese equities were mixed, with supportive economic data offset by the prospect of more US trade tariffs, particularly targeting EVs. Global high-yield corporate debt delivered positive returns, while EM debt was mixed, with local currency negatively impacted by US dollar strength. EM debt hard currency bonds saw a small positive return.

Within defensive assets, DM sovereign bonds faced challenges in Q2 as investors priced in slower rate cuts, despite the ECB's first cut since the pandemic. The notable selloff among French assets widened the Franco-German 10 year spread by +29bps in the week after the election announcement – the biggest weekly widening since the 2011 sovereign debt crisis. UK gilts also declined. Global investment-grade corporate debt, affected by rate movements, delivered a negative return. The Japanese yen was the worst performing G10 currency in Q2 for the second consecutive quarter.

The oil price rose due to renewed concerns over Middle East conflict and OPEC+ clarifying potential changes to production cuts. While metals were generally strong, the prices of several agricultural commodities continued to decline in Q2.

The price of gold moved higher by +4%, delivering its third consecutive quarterly gain.

Performance review

Over the quarter the Strategy produced a positive absolute return in US dollars, gross of fees[1], and outperformed its benchmark (60% MSCI ACWI / 40% WGBI).

The largest contributor to the Strategy's positive relative performance was security selection in equities. In April, the portfolio's overweight position towards China drove positive performance, as the Chinese equity market continued to rally from January lows due to positive policy initiatives and improved growth data. Following this, May and June's outperformance was driven by the portfolio's utilities and technology stocks, which were buoyed by growing optimism surrounding AI adoption and the anticipated increase in electricity demand.

Fixed income positions detracted from relative performance, largely due to asset allocation decisions. An overweight positioning in duration, particularly at the longer end of the curve, underperformed relative to the benchmark.

Currency detracted from performance, as the Strategy's long Japanese yen versus euro position continued to weaken as the Bank of Japan's hiking cycle has continued to be slower-than-expected and the European growth outlook improved. The long US dollar positioning detracted after weaker US inflation and growth data in the early months of the quarter failed to be offset by a hawkish shift in the US Federal Reserve's (Fed) interest rate projections in June and the US dollar faced depreciation pressure overall. A long position in the Turkish lira versus Czech koruna provided positive return contribution as underlying fundamentals remained supportive of the high carry cross.

Activity and positioning

There were several changes to the Strategy over the quarter, primarily driven by stronger economic data in Europe and an assessment of increased upside risks to growth as central banks approach the commencement of cutting cycles. At a headline level, relative equity exposure was increased from a c.1.8% overweight to a 5.5% overweight position including option delta exposure. Additionally, duration exposure was adjusted from 1.2 years overweight to being neutral relative to the benchmark exposure.

In equities, the portfolio's underweight position to Europe was reduced, moving from 7.2% underweight to 2.2% underweight. This was via the closure of the remaining short European equity hedging positions due to stronger growth data which increased the probability of a cyclical recovery. North American equity exposure was also increased, primarily through the addition of an out-of-the-money call option on the Nasdaq to hedge against the risk of equities rallying excessively into bubble territory once central banks begin easing. Conversely, the portfolio's overweight allocation to Asia ex-Japan was reduced. This was primarily driven by decreasing Chinese equity exposure via profit-taking on strong performers and exiting the lower conviction cyclical companies which continue to be inhibited by weak growth momentum. We maintain a positive bias towards risk assets in China given the ongoing support from policy easing and underlying supportive structural growth trends.

In currency, several adjustments were made, with the most significant being the reduction in the Japanese yen versus euro position. This decision was driven by Japan's slower-than-expected rate hike cycle, which continues to disconnect policy from underlying fundamentals and exert depreciative pressure on the yen. Meanwhile, improved European growth data reduces the likelihood of an aggressive rate-cutting cycle in Europe. The Strategy remains long US dollars versus currencies where we see potential for policy divergence such as the Chinese renminbi, pound sterling, and New Zealand dollar.

Outlook and strategy

In the US, we believe monetary policy is tight and will continue to progressively feed into the economy as corporations and households refinance their debts at higher interest rates. Evidence of this continues to emerge with a broad-based moderation of economic activity in recent months. While the Fed has backed away from rate cuts in recent quarters, the evolution of data releases is likely to allow the Bank to move towards cuts later this year, in our view. At the same time, fiscal policy in the US has remained loose and continues to support economic growth, which provides some risk to the US inflation outlook.

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[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.

This combination of prospective monetary policy loosening, ongoing fiscal support, and improvement in some of the more rate sensitive areas of the economy leads us to expect a soft landing for the US. In saying this, the risk of a recession remains elevated as present as past policy tightening continues to feed through.

In Europe, we believe policy is tight and the lags are shorter than in the US due to less pandemic stimulus, higher levels of floating rate debt and notably less fiscal support. Growth indicators remain weak despite some modest signs of improvement from a low base. We expect eurozone inflation to continue to moderate as energy price pressures continue to abate. We see an elevated risk of a deflationary period in the eurozone and believe that the ECB's easing cycle will be more pronounced than that of the Fed.

In China, policy appears loose albeit without material easing taking place. Easing measures are however becoming progressively more forceful, with additional fiscal stimulus being implemented and strong efforts being made to clear excess housing inventory through the People's Bank of China funding conversion into social housing. We expect policy makers to do what it takes to ensure that a sustained recovery takes hold. Growth metrics are mixed and the recovery will remain bumpy. Inflation is weak but base effects should begin to provide more support on a forward-looking basis. We continue to believe that the Chinese economy will experience a more benign outcome than the bearish consensus suggests.

Our central investment roadmap, as discussed above, leaves us somewhat more positive on the prospect for risk assets, particularly in Asia and the US. In fixed income, portfolio duration declined through the first half of this year post a strong rally in government bonds at the end of last year and due to an increase in the probability of a US soft landing. We maintain an overweight to defensive duration, however, particularly in Europe. In currency we maintain a preference for the US dollar versus European and Asian currencies, as a diversifying portfolio position, given positive carry dynamics and our expectation that easing in these regions will be more pronounced than in the US.

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