Strategy commentary

Ninety One Global Strategic Managed

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
- Most Growth assets generated a positive return, with global equities led by Asia ex-Japan, while Defensive assets also rose, notably investment grade corporate bonds in both Europe and the US
- The Strategy produced a very positive absolute return, outperforming its benchmark. Both the overweight to equities and IG credit contributed, as did our positioning in gold
- Looking forward, we continue to see opportunities for medium-term investors, although these have become more specific rather than broad based. We will continue to take advantage of such opportunities, while maintaining the flexibility to hedge exposure if this outlook begins to change.

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 very positive absolute return in US dollars, gross of fees[1], outperforming its benchmark.

Risk assets continued to rise through the third quarter, supported by a strong rebound in economic activity as governments removed lockdown restrictions, and fiscal and monetary accommodation remained very supportive. US and Asian markets were the strongest performers over the period, while European markets made little headway and finished the period where they started. The former derived a tailwind from a weaker US dollar, while the latter faced a headwind as European currencies rose strongly.

The Strategy's equity allocation added to returns over the period, with an overweight equity position, emerging market domestic growth exposure and Japanese automation companies adding to returns, while diversified miners and several higher quality equity positions underperformed.

The Strategy's fixed income allocation added to returns, driven by the overweight to investment grade credit, while a position in gold also made a positive contribution. Active currency was a positive contributor as positions in Asian currencies gained strongly against the US dollar following the People's Bank of China (PBoC) indicating a shift from an easy to a neutral policy stance.

Activity and positioning

In July, we continued to scale up the portfolio's Chinese yuan exposure due to the PBoC's policy shift. We also added exposure to Indonesian local currency bonds, given high real interest rates and attractive fundamentals. In September, we took advantage of weakness in semiconductor equipment companies and added a basket of four companies, which are all strongly tied into the rise of the digital economy and offer strong return prospects going forward, in our view. In currency we exited and took profits on long positions in the Australian dollar versus the New Zealand dollar and the Canadian dollar, as the Reserve Bank of Australia signalled that additional easing may be on the way due to the protracted lockdown in Victoria.

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 the risk of further coronavirus outbreaks and localised lockdowns remains. 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 vaccine development. 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 six 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 a more pronounced, prolonged downturn, 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 the risk of additional virus outbreaks as we head towards winter and with the US elections approaching. 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 coronavirus cases and the increasing likelihood of a vaccine approval in the US, 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 such opportunities, while maintaining the flexibility to hedge exposure if we see the outlook beginning to change.

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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.

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