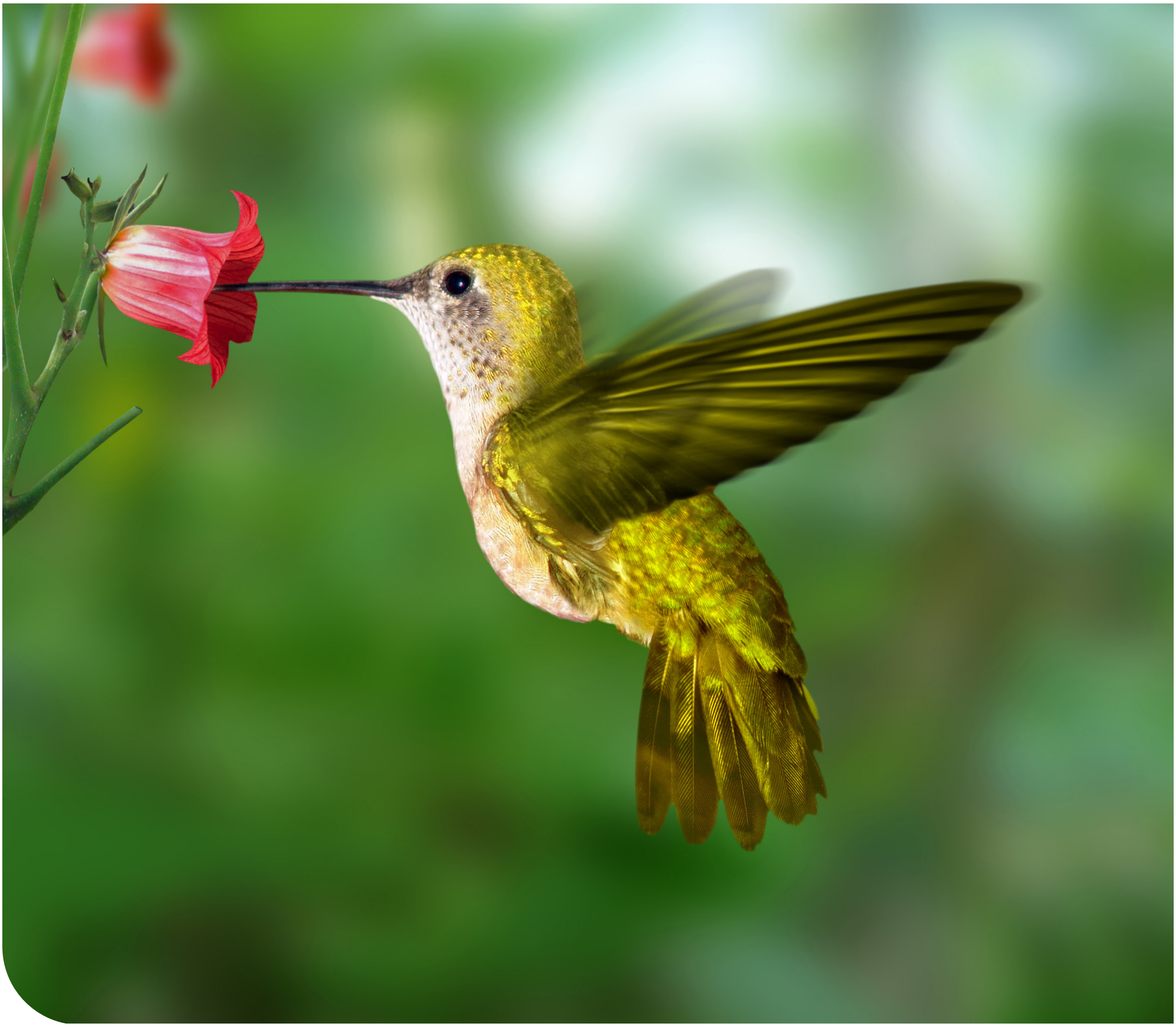
INVIEW

MONTHLY GLOBAL HOUSE VIEW & INVESTMENT PERSPECTIVES

AUGUST 2023



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The icons alongside represent our investment process. Through a disciplined provision of investment policy and security selection at the global level, regional portfolio management teams have the flexibility to construct portfolios to meet the specific requirements of our clients.

HIGHLIGHTED IN THIS PUBLICATION:

GLOBAL STRATEGIC ASSET ALLOCATION

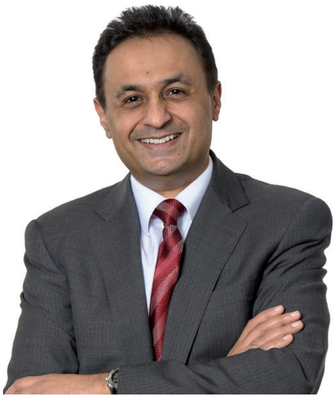
GLOBAL SECURITY SELECTION

REGIONAL ASSET ALLOCATION

REGIONAL PORTFOLIO CONSTRUCTION

Editorial

Welcome to the August edition of *Inview: Monthly Global House View*. In this publication we consider significant developments in the world's markets, and discuss our key convictions and themes for the coming months.



Moz Afzal
Chief Investment Officer

After a strong June, markets enjoyed another positive month in July with the MSCI World index rising around 2% over the month. Global equities have now returned more than 16% year-to-date and are close to recouping the losses experienced in 2022. Fixed income markets also mostly registered positive returns in July. The Bloomberg Barclays Global Aggregate index was up about 1% for the month, though the year-to-date returns are significantly more muted than equities at just over 2%.

The strong performance in July reflects a macroeconomic environment in which activity has remained stronger than expected and recession fears have abated. The IMF's *World Economic Outlook* update pointed to near-term resilience as it upgraded its GDP growth forecasts for 2023. Furthermore, headline inflation has rolled over, reflecting the mechanical impact of base effects due to high inflation in 2022, as well as declines in energy prices. However, core inflation has remained more persistent.

Markets have also taken note of favourable developments on the policy side. Despite core inflation's persistence, central banks appear to be close to the end of monetary policy tightening cycles. In addition, China's Politburo meeting concluded with recognition of the need to support domestic demand, though no specific measures were announced to do so.

The implications for the asset allocation of a diversified portfolio are that, in our view, maintaining moderate overweights in both equities and fixed income assets remains justified. Within equities, a preference remains for emerging markets and, in particular, Asia and Latin America. Japanese equities are also favoured and an underweight allocation to the US is retained to offset the overweights.

Within fixed income assets, longer-dated government bond yields continue to be attractive given monetary policy cycles are drawing to a conclusion and the diversification benefits. With the potential for the lagged impact of interest rate increases to cause a deterioration in the macroeconomic environment, a preference for high quality fixed income assets continues to be appropriate. This means that overweight allocations to investment grade and sovereign bonds remain funded by an underweight allocation to high yield bonds.

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ASSET ALLOCATION

Global Allocation

Based on a balanced mandate, the matrix below shows our 6-12 month view on investment strategy

The general macroeconomic environment continues to show disparities between leading and lagging indicators. Backward looking data continues to appear strong while forward looking data is weaker, with this juxtaposition helping explain market behaviour. One of the main risks of the coming months would be if core inflation remains too high, something which could lead to more volatile markets.

No changes were made to our allocations to the broad asset classes apart from adjustments taking into account the new neutral benchmark and market drift. We maintain a slight overweight allocation to equities and also a small overweight in fixed income. Underweights to alternatives and cash also remain. Hedging using put spreads is currently cheap relative to history although we would wait for the VIX volatility index to move a point or two lower before considering implementing outright hedges on portfolios. The potential rewards from implementing a hedge need to be weighed carefully against the premium cost.

	Allocation versus the benchmark	Weighting change from last month*
FIXED INCOME	+	↔
EQUITIES	+	↔
ALTERNATIVES	–	↔
CASH & MONEY MARKET	–	↔
FX	●	↔

– Underweight + Overweight ● Neutral

↔ No change ↑ Increase ↓ Decrease

*Note that arrows reflect any adjustment to allocation weighting and is not necessarily a full upgrade or downgrade.

Fixed Income

Within the fixed income market, returns have been less pronounced than that of equities. Absent a sharp recession and dramatic unexpected improvement in the inflation outlook, it appears difficult for yields to rebound meaningfully. Nevertheless, year-to-date performance has been positive apart from for the UK.

Investment grade spreads appear relatively more attractive than high yield spreads in the US. The spread to worst of the ICE BofA US High Yield Index is close to its lower quartile while that of the Corporate Index appears in line with its median. The picture appears slightly better in terms of spreads for European and UK bonds.

Having duration exposure within fixed income provides a hedge against a deterioration in the macroeconomic environment. We maintain a bias to 5-7 years duration for the higher quality part of the market. Within high yield our preference would be at the shorter end of the curve which is less exposed to macro risks but could produce an attractive yield pick-up.

		Allocation versus the benchmark	Weighting change from last month
	Rates	+	↔
USD	Investment Grade	+	↔
USD	Sovereign	+	↔
EUR	Investment Grade	+	↔
EUR	Sovereign	+	↔
GBP	Investment Grade	–	↔
GBP	Sovereign	+	↔
CHF	Investment Grade	+	↔
CHF	Sovereign	+	↔
	Credit	–	↔
USD	High Yield	–	↔
EUR	High Yield	–	↔
	Hybrids	–	↔
	Asset-backed Securities	–	↔
	Convertibles	+	↔
	EM Local Currency	●	↔
	EM Hard Currency	–	↔

– Underweight + Overweight ● Neutral

↔ No change ↑ Increase ↓ Decrease

Equities

Absent any major market catalysts, we made no changes to our equity exposure. After their strong performance in the first half of the year, Japanese equities have seen a slower start to July. However, we continue to favour the market and expect a resumption of momentum. Our valuation models indicate that China has become relatively cheaper compared to June. We continue to have an overweight China allocation versus the benchmark, noting that any rebound in the market is likely to be front-loaded.

UK and Europe positioning continues to be in line with the neutral benchmark, supported by positive valuations and technicals offset by a more vulnerable macro situation. US positioning is underweight relative to the benchmark, although the absolute weighting dominates the equity exposure and we note growing odds of a soft landing scenario in the US.

	Allocation versus the benchmark	Weighting change from last month
North America	–	↔
Europe	•	↔
UK	•	↔
Switzerland	•	↔
Asia ex-Japan	+	↔
China	+	↔
India	•	↔
Indonesia	+	↔
Korea	–	↔
Malaysia	–	↔
Philippines	–	↔
Taiwan	–	↔
Thailand	–	↔
Other	–	↔
Japan	+	↔
Latin America	+	↔
EMEA	•	↔
Thematic/Global	•	↔

– Underweight + Overweight • Neutral

↔ No change ↑ Increase ↓ Decrease

Equity Sector Views

UK

Industrials is the largest sector overweight within UK exposure, taking advantage of the de-rating seen across the sector to pick up quality companies. We favour more internationally exposed companies in the sector over those more reliant on domestic UK business.

We have continued to add to utilities to boost defensive holdings in anticipation of a further weakening in the macroeconomic outlook for the UK. Regulatory uncertainty has reduced in recent months with clarity provided on windfall taxes, earnings resilience remains attractive in an inflationary environment, renewable transition programs are being accelerated and peaking bond yields should prove supportive for the sector.

The consumer staples sector has demonstrated resilient earnings through this period of high inflation as it has been able to price ahead of rising costs in raw materials and labour while also keeping volumes stable. However, recent earnings have shown a shift in price elasticities, with several companies reporting weaker volumes and offering more cautious guidance for the future. With this in mind, we remain underweight in UK consumer staples.

Equity Sector Views *(cont.)*

US

We remain cautious given the macroeconomic uncertainties and so choose not to take any large sector bets at this time. Instead, the focus is on individual company earnings resilience from a bottom-up perspective. We are underweight cyclical sectors where there is an unfavourable risk-reward profile, such as banks, heavy industrials and real estate. There have been selective additions to exposure in areas that were first impacted by the downturn and subsequently likely to be the first to recover, including semiconductors, digital advertising and housing.

Europe

Within sectors, we have reduced our financials exposure, where we are now underweight with a focus on banks and insurance. We see limited scope for further earnings upgrades on net interest income/investment yields as terminal rate expectations in Europe have declined. Provisions and liquidity risks, primarily related to real estate, cannot be overlooked. We increased exposure to communication services, consumer staples, healthcare and technology sectors, having an overweight position in all of these sectors, focusing capital on the highest quality, most defensive parts of the European market.

Asia ex-Japan

We maintain our overweight position in Asia ex-Japan. Within the region we maintain an overweight to China, although note that there are weak consumer and property trends with clear downtrading. Within India, industrials and construction related stocks continue to report the strongest trends, with new property starts at a 10-year high. The IT recovery has been weaker than most expected, whereby valuations are no longer supportive.

Alternatives

No changes were made to our alternatives exposure this month. Commodity positioning is neutral with a focus on gold. Indicators are currently pointing to a potential bottom for commodity prices although we will wait for confirmation of this trend in the second half of the year before adding exposure to industrial metals. We remain cautious on the real estate sector owing to liquidity concerns.

Within hedge funds, heightened volatility stemming from uncertainty in inflation and rates should be supportive for equity market neutral managers. Similarly, commodity trading advisor strategies are preferred in the context of more market volatility.

	Allocation versus the benchmark	Weighting change from last month
Hedge Fund	●	↔
Private Markets	●	↔
Real Assets	●	↔
Commodity	●	↔
Insurance	●	↔

− Underweight + Overweight ● Neutral

↔ No change ↑ Increase ↓ Decrease

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