Sustainable, Income, Dynamic Multi Asset Team

View From the Desk – May 2023

Observations this month:

Macro Developments	• Headline inflation continues to fall among major economies, but declines in core inflation continue to be much less dramatic. • While tight labour markets and wage growth continue to add pressure for further rate hikes, the market is now pricing in meaningful rate cuts globally over the next two years. • News flow around economic fundamentals remains uncertain – composite PMIs have started to plateau after rising YTD, with service sector PMIs remaining buoyant, but manufacturing PMIs staying depressed. • There was some notable deacceleration in Chinese macroeconomic data.
Asset Price Behaviour	• A relatively subdued period for most equity and credit markets, as US policymakers inched towards a tentative US debt ceiling deal. • The valuation landscape across asset classes seems to us reasonably well calibrated at the moment. • From a multi-asset portfolio perspective, gains in some equity markets have been tempered by malaise in fixed income markets. DM sovereign yields increased notably in May, as concerns over the speed of inflation is falling mount. UK gilts saw price falls across a range of maturities, given lingering inflation. • Some market optimism emerged (particularly in the tech sector) surrounding the growing adoption of artificial intelligence and the potential boost for global growth over the medium to long term. • Chinese equities ended the month flirting with bear market territory due to growing concerns over the country's economic outlook.
Investor Psychology	• Market behaviour appears indicative of a sense of complacency around the macroeconomic picture, with expectations of benign outcomes. We still sense a vulnerability and fragility to this mindset, as evidenced in short bouts of volatility. • Given this backdrop, it is hard to see any big dislocations in risk markets that we can exploit at the moment. However, we remain patient to developments in both the valuation landscape and tactical opportunities. • We are watching for any signs of excess euphoria in the tech sector, given its strong performance YTD.

Our positioning:

Equities	• We remain broadly neutrally positioned across portfolios, but we continue to question whether the profit expectations that feed into valuations are fully discounting potential growth risks ahead. • Risk markets still seem primed for a fairly benign economic outcome moving forward, and whilst we don't strongly disagree with that outlook, we do think there are potential vulnerabilities. We therefore remain selective in our exposure and prefer markets that we consider to have cheaper valuations and/or more conservative earnings expectations, such as Europe, Japan and Asia.
Government Bonds	• We maintain a preference for the long end of the curve and like selected emerging market sovereigns and currencies. To us, potential risk-off diversification opportunities remain attractive under certain circumstances, especially from higher levels of yield. • **We have increased the diversification properties of our DM sovereign exposure (purchasing bunds, gilts and Treasuries) in recent weeks on the Income portfolios. We also rebalanced some of our current EM positions so that they were better optimised from a yield and diversification perspective.** • **The Income portfolios also sold out of a small position in local currency South African government bonds as increased negative news flow fuelled further price weakness.** • **In the Dynamic portfolio, we brought duration back to a neutral level by purchasing UK gilt futures during the recent sell-off.**
Credit	• All-in yields look reasonably attractive, in our view. We maintain a preference for investment grade credit given what we consider to be impressive yields and low default risk on offer in most developed world markets. Spreads still suggest a benign default environment.

Our approach

Global asset allocation demands a comprehensive understanding of risk. Our approach integrates behavioural analysis with an assessment of macro-fundamental drivers to gain insight into valuation, market dynamics and volatility. This allows us to identify the most suitable strategic investment prospects as well as to exploit phases of heightened volatility to capture tactical opportunities.

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