



**ASSET ALLOCATION
INSIGHTS**

NOVEMBER 2020

Although the global economy remains mired in a 'Japanification' scenario – the prevailing state of lower rates and slower growth – positive news of a Covid-19 vaccine was a boost for risk assets. In the short-term, this could trigger an acceleration in both growth and inflation (reflation). If this materialises, investors should capitalise on the temporary shift, before we return to the deeper, more profound deflationary cycle.

VACCINE DELIVERS A SHOT-IN-THE-ARM FOR RISK ASSETS

Within the Japan-style scenario, market cycles still occur, but the episodes are typically milder and shorter. For example, risk assets rose off the back of very accommodative central banks and synchronised global growth in 2017, before being dragged back down by the Federal Reserve reversal on monetary policy. Similarly, we believe that the global economy will experience a positive mini-reflationary cycle in the coming months – and investors need a tactical response to capitalise on it before it fades away.

TOWARD A MINI-REFLATION CYCLE “À LA 2016-17” IN 2021, WITH RISING EQUITIES AND RATES?

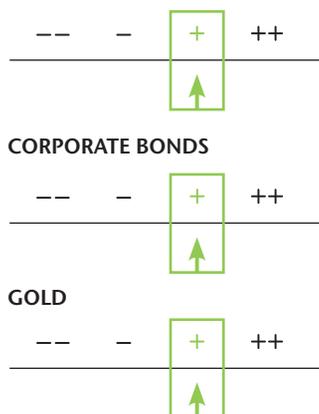
GLOBAL EQUITIES AND US TREASURY 10-YEAR RATE



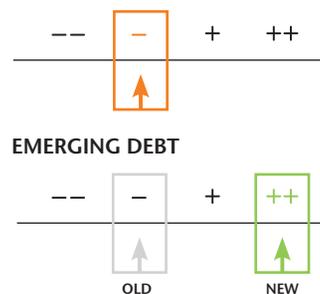
SOURCE: BANQUE SYZ, FACTSET

Reflation requires coordinated global growth and a supportive policy environment. As optimism around a post-Covid return to normal sweeps through markets and economic data adjusts accordingly, we expect these conditions to transpire over the next six months. However, evaluating the impact of the second wave of Covid-19 will be crucial before we can be sure of a reflation.

**ASSET ALLOCATION VIEWS
EQUITIES**



GOVERNMENT BONDS



FLEXIBLE IN FIXED INCOME

Acknowledging the rising possibility of a reflation, we have tactically increased risk exposure through our fixed income allocation. We have reinforced our bias to hard currency emerging market debt, which has lagged the credit recovery so far. Spreads are attractive compared to the broader market and emerging market assets should benefit from a reflation scenario. A combination of global growth, higher risk appetite and a softer dollar is the sweet spot for emerging market debt.

In addition, to counter the rising probability of interest rate increases and steepening yield curves in a global growth environment, we have further reduced duration in the portfolios. We did this by selling long-dated positions, notably US treasuries, as the US curve appears most prone to a bear steepening. We also took some profits on long-dated corporate bonds, as valuations become less appealing.

However, credit remains attractive compared to cash and government bonds in the risk-on environment, and we have implemented hedges that allow us to maintain some exposure to credit spreads while containing the impact of a potential rise in rates. We still have a mild preference for high yield, with attractive valuations, but the deterioration in credit fundamentals warrants remaining selective.

By reacting to shifts in economic dynamics through tactical moves like these – taking advantage of expected mini-cycles in asset prices – we are able to generate positive performance despite the low rate environment – even on negative yielding assets. Dynamic asset allocation and tactical positioning are key for navigating the current environment of very low rates, as this allows us to capitalise on even the shortest and mildest of reflationary cycles.

DYNAMIC APPROACH TO EQUITIES

On the equities side, we are also preparing to make strategic adjustments. Given our conviction we will ultimately return to a Japan-like scenario, we do not believe value can sustainably outperform growth. However, if the impact of the second wave of Covid-19 is relatively mild and coordinated global growth is reignited, there will be an opportunity to tactically increase our cyclical exposure in the short term to drive alpha within the portfolios.

While our portfolios have a growth bias, we also have some cyclical equity allocation – so we will not be wrong-footed if a rotation materialises early. Our overweight to quality companies includes some industrial names and other more cyclical stocks. If we see confirmation of positive global growth, we will look to increase cyclical equity in the portfolios in the short term. Core eurozone equity markets, such as France and Germany, are particularly attractive given the super-low rate context in Europe.

Meanwhile, structurally, we are increasing our exposure to emerging markets – specifically China, as we see long-term potential for the country to catch up to developed market peers. Chinese equities, which have lagged for the last five years, are currently benefiting from the low-rate environment and global growth pickup, in addition to the authoritarian government's handling of the Covid-19 pandemic. The country has not witnessed a second wave of infections, and liquidity injections and fiscal support have boosted domestic credit growth. We are playing this through a combination of ETFs, to provide us with exposure to Hong Kong listed giants, such as Alibaba and JD.com, as well as domestic A-shares, which are less dependent on the foreign environment.

Within the Japanification framework, reflationary episodes will occur. While these events will create short-term volatility, they also provide valuable windows for multi-asset portfolio managers to dynamically deliver additional alpha. At SYZ, we embrace these opportunities to demonstrate the value of active management.

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