# dVAM MULTI-ASSET RANGE

## Quarterly commentary Q4 2019

## REVIEW

- The final quarter of the year saw US equity markets surging to record highs amid increased optimism for global reflation. Had any market participant in January 2019 been told that this was how the year would end, they would likely have been incredulous – the laundry list of challenges facing the global economy and in turn markets at the start of the year made for depressing reading.
- The US Federal Reserve (Fed) had tightened monetary policy prematurely, the trade war between the US and China was intensifying, the UK was embroiled in self-inflicted Brexit agony, Europe was slowing down, Germany barely avoided technical recession and politically the far right was resurgent around the world. Markets had no right to make any progress at all during the year, and yet they did so spectacularly.
- By the end of December, the VIX measure of equity volatility was completely becalmed and the MSCI AC World equity index in local currency terms had climbed nearly 28%. The final quarter of the year saw particular optimism expressed within capital markets. Thus cyclical equity sectors such as industrials and financials fared better than safer bets such as utilities or consumer staples. Long-dated government bond yields perked up and in currencies both the euro and sterling gained against the US dollar. In commodities, copper outperformed gold and crude oil started to rally. Euphoria was becoming deep rooted.
- The reasons for this can broadly be broken down into the proximate and the long term. Most immediately, the US consumer remained rock solid throughout the year thanks to low unemployment, rising wages, cheaper mortgage financing and subdued inflation. This meant that 80% of the world's largest economy was in good shape and that a global recession was therefore unlikely. Second, global liquidity was abundant as central banks did what they could to offset the effects of trade becoming a weapon in international statecraft. The most obvious dispute was between the US and China, but Japan and South Korea also became embroiled in a bitter tussle over historical grievances. The Fed, sensing a loss of economic momentum early in the year, belatedly reversed its tightening of 2017 and 2018 by cutting interest rates, adding that it would now be prepared to allow inflation to overshoot its target "symmetrically" before considering a fresh tightening cycle. It also expanded its balance sheet to address technical issues around repo funding which was widely interpreted, rightly or wrongly, as a further commitment to providing liquidity that would ultimately benefit the economy and equity markets. The European Central Bank (ECB) also renewed its quantitative easing (QE) programme, albeit amid much resistance in Germany and Holland.
- These positive effects were compounded after the summer by the pricing out of some of the uncertainty that had haunted markets. That the UK really, really was going to leave the European Union (EU) began to look certain under new prime minister Boris Johnson and this was all but confirmed by his election victory in December. At the same time, the US and China appeared to reach 'phase one' of a comprehensive trade deal after months of 'will they, won't they' wrangling. But more profoundly, 2019 saw the continuation of a key trend which further supported the equity markets. Specifically, demand for safe assets by pension funds, oil-producing nations, exporters and cash-rich corporates outstripped available supply and kept bond prices high and yields suppressed. In combination with loose monetary policy, the resulting negative or low yields on government bonds made equity dividend or earnings yields look compelling by comparison and contributed to the 'TINA' phenomenon – There Is No Alternative – to equities. Not only did their higher yields make equities a more attractive long-term return prospect than bonds but they also suggested better value.

GAM Investments

**The dVAM Multi-Asset Range are actively managed for dVAM by GAM International Management. The highly experienced fund management team have successfully managed an identical range of funds since 2012.**

### About GAM

GAM is one of the world's leading independent, pure-play asset managers. With over 35 years of active investing, GAM provides active investment solutions and products for institutions, financial intermediaries and private investors.

### Fund Managers

**Charles Hepworth**

Charles is the investment director for the dVAM Multi-Asset Active Range of Funds and joined GAM in May 2012. Charles has 22 years industry experience. Before joining GAM he managed portfolios at Quilter and Albert E. Sharp, where he specialised in looking after the money of private clients.

Source: dVAM

## POSITIONING

- Equities remain the asset class of choice for investors seeking growth thanks to the superior yields and valuations described. But the low-growth backdrop will mean many investors will underestimate their appropriate allocation to the asset class. While volatility and specific circumstances may be more legitimate reasons to be cautious, owning businesses that can increase market share and attract capital from engaged investors will remain compelling. Additional value could be tapped by gaining exposure to 'megatrends' that do not rely on elusive economic growth. Examples include Fortress America (main beneficiary of Fed responsiveness, best corporate managements in the world), technology (growth in a low growth world) and emerging markets (booming middle class, under-represented in equity indices).
- Away from equities in capital preservation, simplicity and consistency will be the primary features to look for. This part of a portfolio's asset allocation should aim to deliver a smooth if unexciting return profile in order to dampen the volatility associated with equities. It is probably best achieved through alternative bonds such as mortgage-backed securities as well as low duration credit and cash.

## OUTLOOK

- Despite the apparent lifting of uncertainty, the global economy remains challenged. Globalisation could continue to reverse as local industries and communities struggle with the disruption and inequality it causes and politicians seek to channel the resulting discontent rather than address it. As such, the US-China trade war and Brexit will remain symptoms of this deep-seated issue.
- World economic growth is likely to be further compromised by slowing demand as working populations in much of the western world and China start to age and ultimately shrink. This backdrop is made all the worse by the remote prospect of any concerted policy response to address it.
- Fiscal policy makes plenty of sense given low borrowing costs around the world and the potential returns from investing in capital projects, with the 1950s Eisenhower interstate highway system's 600% estimated return a shining example of the self-funding nature of infrastructure spending. But co-ordination appears unlikely amid controversy (Germany) and limited fiscal headroom (US, Japan, Italy).
- Immigration is another potential solution to boosting the working age population but has become unpopular across many key economies. As such, it is likely that central banks around the world will continue to perform the heavy lifting by keeping interest rates low via monetary policy and possible QE also.
- Counterintuitively, such an environment of economic stagnation and resulting low bond yields should serve to support rather than suppress equity valuations as investors are forced to seek yield and returns where they can find them. The last few years have been described as exceptional for exhibiting these contrasting features but, given that the underlying conditions have not changed, there is no reason to believe they cannot continue for some time yet.