dVAM MULTI-ASSET RANGE

Quarterly commentary Q3 2019

REVIEW

- The third quarter of the year saw equity markets, as defined by the MSCI AC World Index, gain just over 1% in local currency terms. While this may appear unremarkable, the headline number hid a significant drop towards the end of July, as the US-China trade war intensified and the outlook for global growth and inflation darkened accordingly. Markets swiftly regained their poise as central banks stepped in to reduce interest rates and, in some cases, resume extraordinary stimulus measures.
- Simultaneously, the major government bond markets took off as yields plummeted. By early September, the 10-year US Treasury yield was below 1.5%. Even as a degree of confidence returned to markets by the end of the review period, the yield was still hovering around the low 1.7% mark. For many investors, the situation made little sense. How could equity markets coolly brush off an export-slaying trade war while bond markets priced in a future of virtually no growth or inflation? The answer may partly lie in the diverse impact the trade war is having around the world and, in turn, its capital markets. The US economy, for one, is uniquely placed to withstand a sustained assault on globalisation for the simple reason that it is structured towards consumption rather than export manufacturing. The latter now accounts for a mere 11% of America's total GDP, while the energy-intensity of its economic output is a quarter of what it was just 20 years ago.
- This may be why the trade war is being pursued so confidently by the current administration – the US is likely to be 'last man standing' in a protracted trade battle with the rest of the world. In the meantime, China and Asia have been the most obvious victims, but Europe and Japan have also shown just how vulnerable their export-driven economic models are to external political developments. Furthermore, it is important to note that the Federal Reserve's recent monetary easing has had a pronounced effect on US equities, as interest rates there started the year in firmly positive territory. Falling discount rates boost the net present value of equity earnings streams which, for the US, should grow by 1-2% according to analyst forecasts. By contrast, serious questions are being raised about the limits of monetary easing in Europe, the UK and Japan, where interest rates are already low or negative. For many firms in the global supply chain, the lower cost of capital makes little difference if uncertainty is high and demand accordingly low.
- We believe that accepting volatility makes the most sense when owning quality businesses around the world, as well as holding a claim to their future revenue streams. By contrast, capital preservation assets should demonstrate simplicity and consistency, since their vital role is to smooth out turbulence in the near term.

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.

POSITIONING

- Our equity allocations remained broadly constant during the review period, with a reasonable weighting to the more stable US market maintained due to our belief that the Federal Reserve would need to respond to any trade-related slowdown. In fact, our expectations in this regard were exceeded – even if those of the US President were not – as the US central bank under Jay Powell acted pre-emptively, even while the economy remained in fair shape.
- Equity exposure with a bias to the Asia Pacific and emerging markets (EM) presented a headwind, being the ground zero of the trade dispute with the United States. We remain confident that the higher growth offered by EM continues to present a good opportunity to equity investors in the long term; therefore, we remain committed to the allocation – particularly at these valuations, which suggest healthy future returns.

Source: dVAM

- Away from equities in the capital preservation portion of our portfolios, we see little premium in complexity. In practical terms, this translates into high levels of cash. Higher, but still relatively steady, returns are available from relatively steady, returns are available from mortgage-backed securities (MBS), junior debt of European financial issuers and emerging market debt. Taken together, this combination should offer fair returns with controlled volatility and, importantly, low correlation to equity markets. In alternative investments, an allocation is maintained to a fund that tracks the gold price, and a fund that invests in the European property sector.

OUTLOOK

- Central banks, including (crucially) the Federal Reserve, are now protecting their respective economies with increased determination. Fiscal stimulus is at last being discussed in the halls of European power. Happily for investors, underwriting the economy is tantamount to underwriting the equity market. Put more simply, what is good for the economy is often good for the equity market. Markets are consequently able to make rapid recoveries from bad news. As such, knee-jerk responses to a deteriorating economic outlook, a worsening of trade rhetoric or even geopolitical events in the Middle East now make less sense.
- This is not to say that equity markets are bulletproof. The result of this insurance is that valuations – a key determinant of future returns – are no longer cheap, and the high compound rates seen over the last decade are more likely to settle down to a lower long-term return. This remains attractive compared with the alternatives currently on offer, especially when adjusted for liquidity and risk. Returns elsewhere are at best low and consistent, at worst negative and volatile. For investors it is therefore more important than ever to identify the appropriate equity allocation and to stick to it.