SYZ

ASSET ALLOCATION

INSIGHTS

DECEMBER 2020

PREPARE FOR A NEW YEAR'S ROTATION

Following the initial uplift from the announcement of a Covid-19 vaccine, markets have slowed, caught between optimism for the 2021 outlook and short-term concerns around the second wave impact.

ASSET ALLOCATION VIEWS

EQUITIES

−− − $\boxed{+}$ ++

GOVERNMENT BONDS

−− $\boxed{−}$ + ++

CORPORATE BONDS

−− − $\boxed{+}$ ++

EMERGING DEBT

−− − + $\boxed{++}$

NEW

GOLD

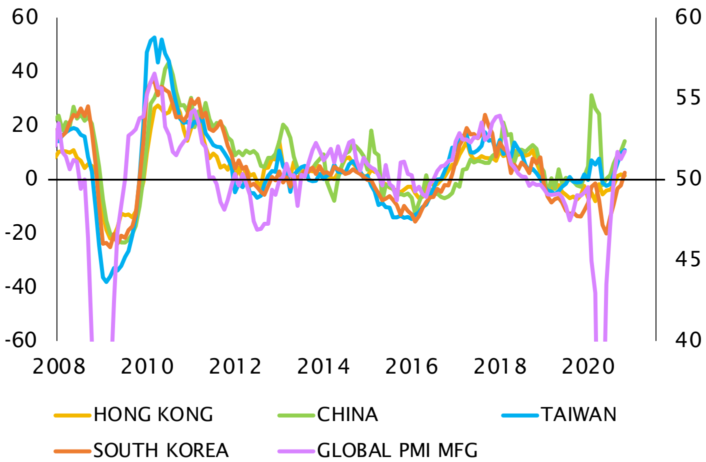
−− − $\boxed{+}$ ++

However, we expect a positive kick off for risk assets in the new year, with conditions ripe for a coordinated acceleration of global growth. Over the next three to six months, as vaccine roll-outs allow economic activity to resume, the return of growth and inflation will offer a temporary relief from the global economy's long-term state of 'Japanification'.

This macro reflation scenario has been confirmed week after week by economic data and is supported by the promise of ongoing accommodative support from central banks. Nevertheless, we do not expect the reflation to evolve in a straight line, with Brexit a potential bump along the road, and investors need to be mindful of ongoing volatility. Moreover, if we head into 2021 with a strong rally, this will be difficult to sustain – and investors will have to be quick to capitalise.

THE ONGOING GLOBAL RECOVERY FUELS A PICKUP IN GLOBAL TRADE AND ESPECIALLY ASIAN EXPORTS, SIMILARLY TO THE PREVIOUS "REFLATION" EPISODE IN 2016/17

EAST-ASIA EXPORTS (YEARLY CHANGE) AND GLOBAL MANUFACTURING ACTIVITY INDEX



SOURCE: BANQUE SYZ, FACTSET

TACTICAL MOVE ON CYCLICALS

While three successive vaccine announcements triggered a sharp rise in unloved 'value' stocks, this quickly gave way to a sideways movement, not quite reversing the decade of value under-performance. However, we think the upcoming reflationary cycle increases the potential for cyclical value names to outperform growth stocks, and we have rebalanced our portfolios to reflect this.

We have been overweight quality stocks in the tech, consumer discretionary and communication services sectors for the past three years. While we want to maintain exposure to these stocks, which will continue to fare well under any economic circumstances – and provide exposure to the long-term digitisation trend – it is now time to increase exposure to cyclical value stocks to capture the upside potential in this section of the market.

As a first step, we have bought a global value ETF, avoiding any geographical bets and neutralising our sector allocation. Picking the right product to increase the cyclicality of portfolios is not easy and this ETF will allow us to benefit from the upside potential in lagging cyclical sectors, such as telecommunications, industrials, financials and some energy, while avoiding too much exposure to fossil fuels and to certain more problematic materials stocks.

Similarly, it is important to exercise caution around financials. While a steepening yield curve should broadly benefit banking stocks, the underlying dynamic for European banks differs vastly from that of US banks and we are mindful of structural headwinds and idiosyncratic issues in the sector.

If we see further confirmation of our expected scenario, we may fine tune our allocation in favour of sectors or stocks benefiting from the rotation. It is important to keep an open mind with regards to how the reflation will develop, and if we see certain value positions overshoot, we will envisage reducing our quality positions.

ASSESS GEOGRAPHIC EQUITY ALLOCATION

The US and China remain our preferred equity markets. The former continues to offer attractive relative valuations in the context of low yields, while the latter owes its appeal to strong macroeconomic momentum and domestic earnings growth prospects, even after the strong performance posted in the summer. The world's largest domestic market, supported by strong fiscal and monetary policies, still offers a clear growth runway and we may look to expand our combination of Hong-Kong listed and domestic A-shares through a specialist active manager.
The composition of the European index is by nature more cyclical – with notable industrial and financial constituents – and our recent value tilt has reinforced our Europe exposure. If the UK and EU are unable to reach an agreement on trade terms, cyclical stocks and sectors with integrated regional supply chains may suffer – although international players would not be overly affected. Nevertheless, the impact may be offset by positive news on the Covid-19 vaccine and the removal of uncertainty. If a deal is reached, this will further boost cyclical stocks on the continent. If the value rotation gathers momentum, we will look to capitalise on the cyclicality of the Japanese market, which also has strong links to China. Meanwhile, emerging markets will benefit from the global macro momentum and we will consider a global or Asia-focused approach if the rebound gathers speed.
For the time being, we are not rolling over our equity protection certificates. However, depending on how the market evolves, we are prepared to strike new ones at any time – for example, if markets go through the roof in the first five to six weeks of 2021.

TAKE ADVANTAGE OF RISING RATES

On the fixed income side, investors should also seek to profit from the reflationary mini-cycle, particularly as we expect a low-rate environment to prevail in the long run.

In a reflationary scenario, it is crucial to selectively allocate to risk assets while containing the impact of a potential rise in rates. We favour short-duration instruments, notably in emerging market debt, which is benefiting from the pick-up in global growth and the weakening of the US dollar.

In addition, we are implementing hedging strategies to minimise interest rate sensitivity – buying bonds that provide exposure to attractive spreads, carry or issuers while shorting US dollar rates of corresponding maturity.

Inflation protected securities still offer some value compared to cash, although they are not designed to make money in a reflationary scenario. Meanwhile, we are cautious on government bonds, especially US treasuries, as the US curve appears most prone to a bear steepening.

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