MULTI-ASSET MONTHLY

Insight broad opportunities strategy (USD)

End of March 2019

SUMMARY

In a month when global growth data continued to weaken, fixed income markets were the main beneficiaries, while equities also delivered some positive returns. Central bank thinking continued to reflect the challenges from growth slowing to stall speed, with the European Central Bank in particular re-assessing its approach. The strategy performed solidly in March. Our broad fixed income exposures, total return strategies and equities all contributed positively, while real assets were a small detractor.

ECONOMIC AND MARKET REVIEW

A further rally in government bonds proved to be the most notable market feature of the month, particularly when set against a backdrop of modest gains in the broader risk asset complex. The latest move lower in global bond yields reflects a combination of weak economic data – most obviously in the global manufacturing sector – and a re-assessment of central bank thinking.

For riskier assets, after a strong rebound at the start of the year, the scope for further gains had become a more nuanced assessment of the extent to which easier policy (in the form of a softening in financial conditions and improved chances of some form of US-China trade tension de-escalation) could counter an underwhelming series of economic data releases. Indeed, the break lower in yields reflected a raft of indicators pointing to weak manufacturing activity. Data showing a contraction in German manufacturing to levels last seen in 2009 were a catalyst for the move, but were among a number of inauspicious readings – for example, Chinese industrial profits fell 14% year-on-year in January and February – again, the worst outturn since May 2009.

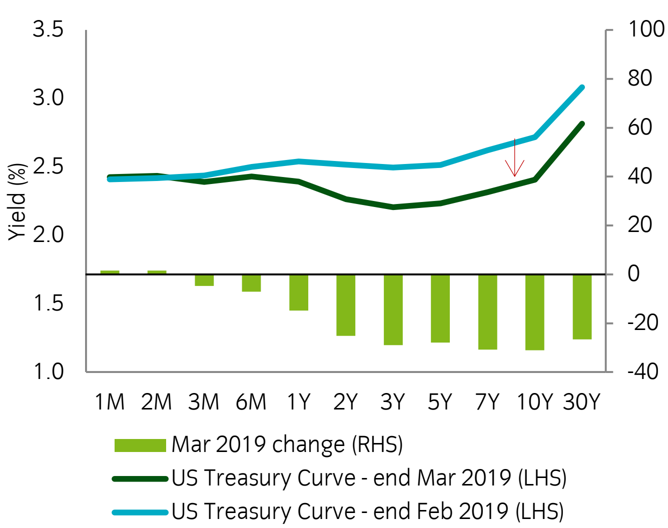
The moves came against a background in which both the Federal Reserve (Fed) and European Central Bank (ECB) had already guided a message of 'lower for longer' in terms of policy settings. The flattening in the US yield curve may not automatically mean a recession is imminent as there has been a secular decline in long-term interest rates. In such an environment it's more natural for yield curves to be flatter than historically was the case and that suggests periods of inversion may occur more frequently. But the inversion of the curve will not be ignored either.

UK assets were once again buffeted by Brexit uncertainty, with sterling a bit firmer as probabilities edged towards a softer Brexit. But again, it was the rally in gilts (part of a global move) that was the stand-out move in the UK asset class space.

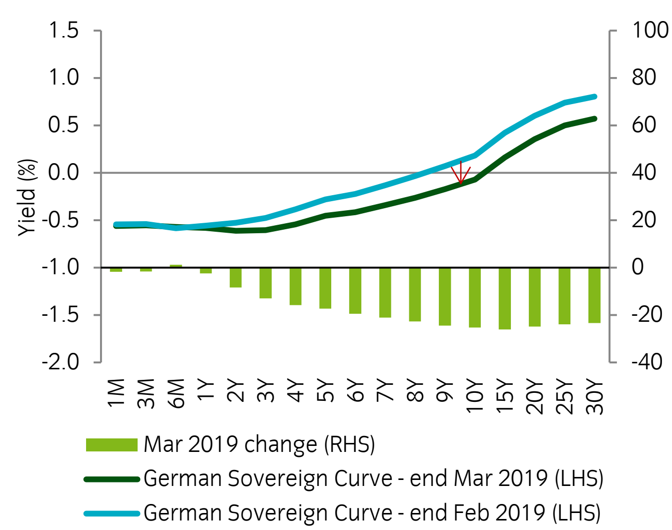
The fall in rates helped most of the credit spectrum (including emerging market debt and high yield) post positive returns in March. Global equities also ground higher, albeit with a little more dispersion than of late. Small-cap indices generally struggled in the face of growth fears while financials continued their torrid form in both absolute and relative performance.

Chart 1: Falling bond yields

US yield curve



German yield curve



Source: Bloomberg and Insight investment as of March 29, 2019.

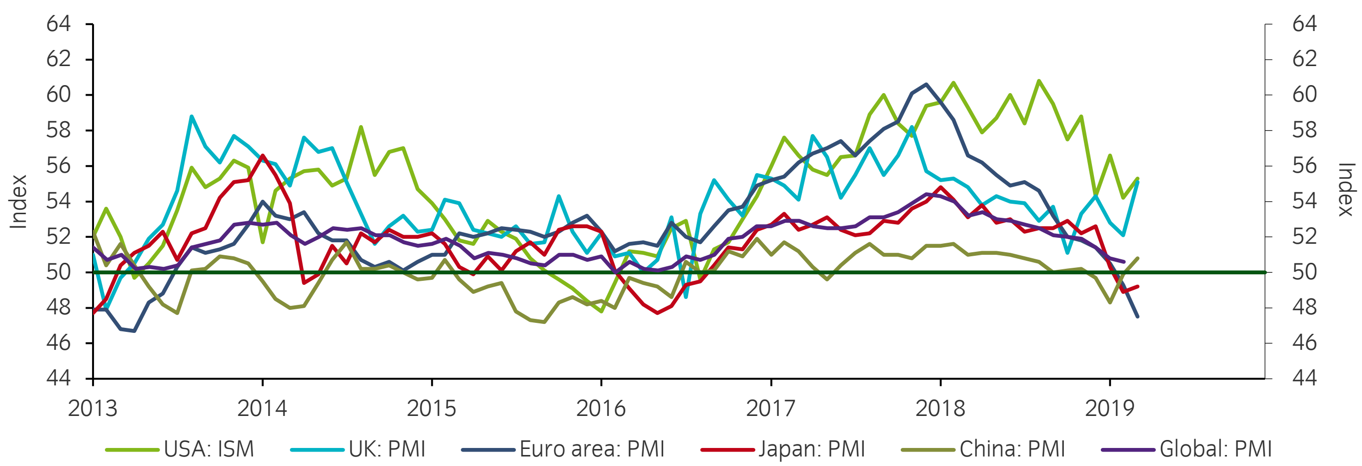
Europe seemed particularly vulnerable to signs of economic weakness. Fiscal easing is a challenge in the eurozone and there are limits as to what the ECB can do to loosen policy further. Back in 2016 it was recognized that driving interest rates into negative territory may well be counterproductive and as the 10-year bund yield went negative last month, President Draghi said the ECB needed to "reflect on possible measures that can preserve the favorable implications of negative rates for the economy while mitigating the side effects".

Amid the economic gloom there were a few green shoots. As we have noted before, there are a few signs that activity in the emerging world, most notably China, is starting to show signs of stabilization in response to the policy easing that began last year. The latest Chinese official and Markit PMIs both bounced above 50 in March, with the sub-components offering hope that activity is stabilizing in those areas where policy was eased first.

For the entire move in rates, developed currency markets were fairly stable, with the US dollar range-trading and FX volatility holding close to its recent lows. Similarly, commodity markets were uneventful with the energy complex continuing its recovery while the broader indices were quiet.

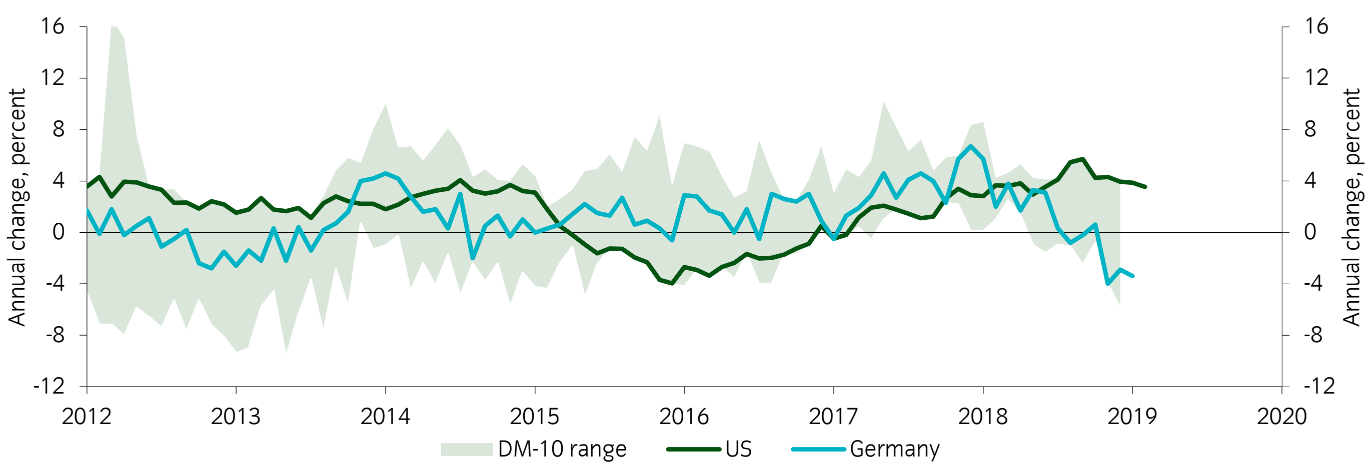
Positive returns in investment grade credit were further boosted by the move in rates, while high yield credit also posted solid returns. Emerging market FX, however, saw some country specific stresses, with Turkey and Brazil helping to push local currency debt to a negative return. By contrast, emerging market equity and US dollar debt posted healthy gains.

Chart 2: Manufacturing PMIs – some improvement, apart from Europe



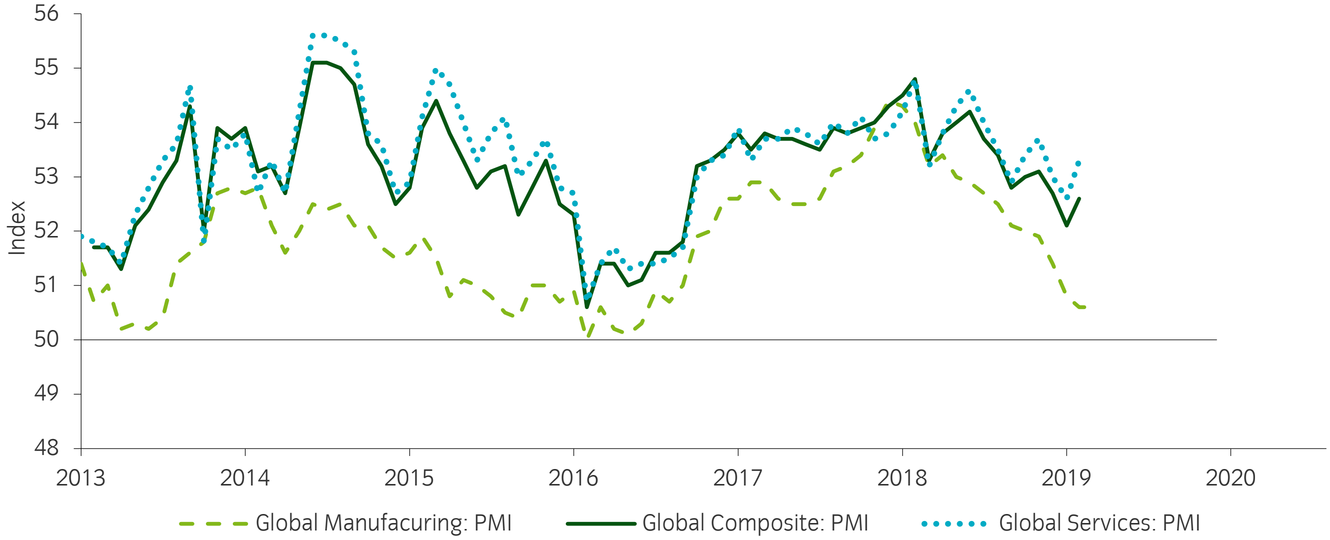
Source: Bloomberg and Insight Investment as of March 29, 2019.

Chart 3: European activity slowing – Industrial production



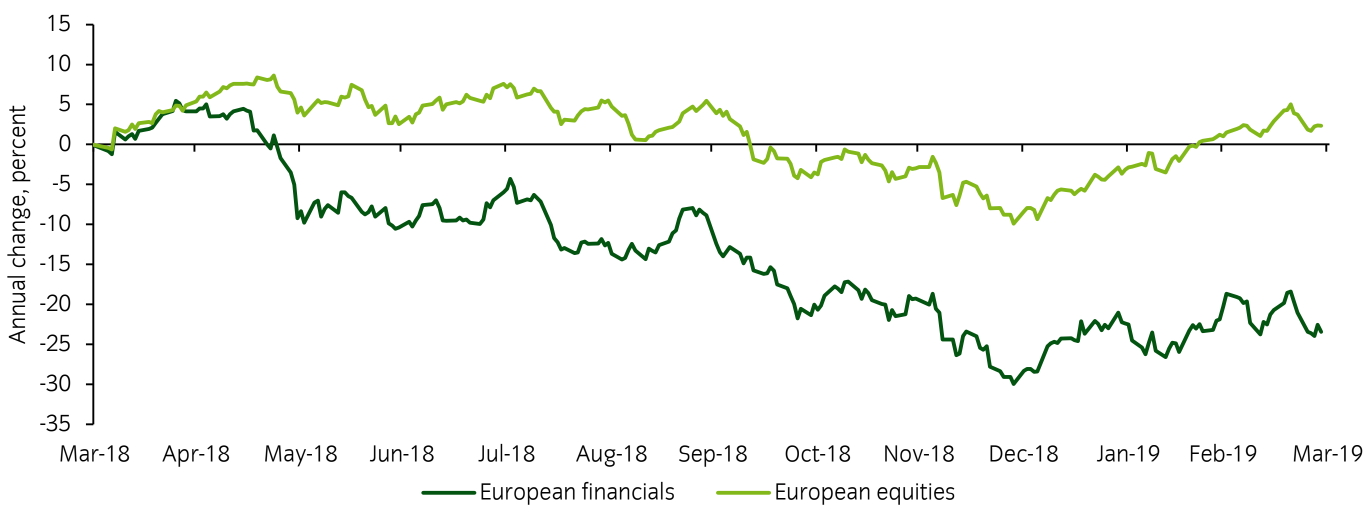
Source: Bloomberg and Insight Investment as of March 29, 2019.

Chart 4: Global manufacturing outlook continues to moderate but services holding up



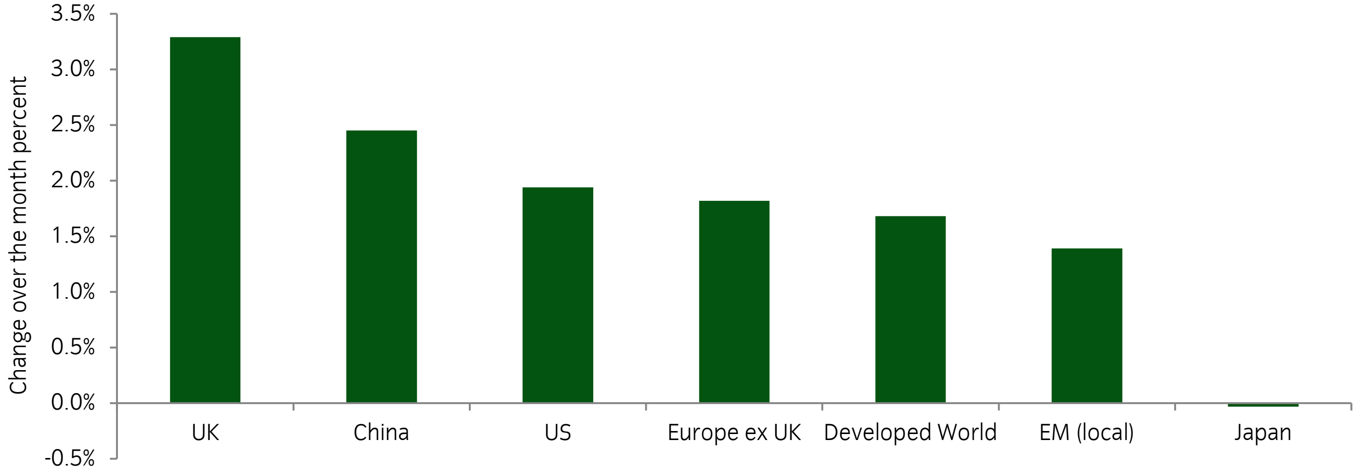
Source: Thomson Reuters and Insight Investment as of March 29, 2019.

Chart 5: Financials suffering from a continued move lower in yields



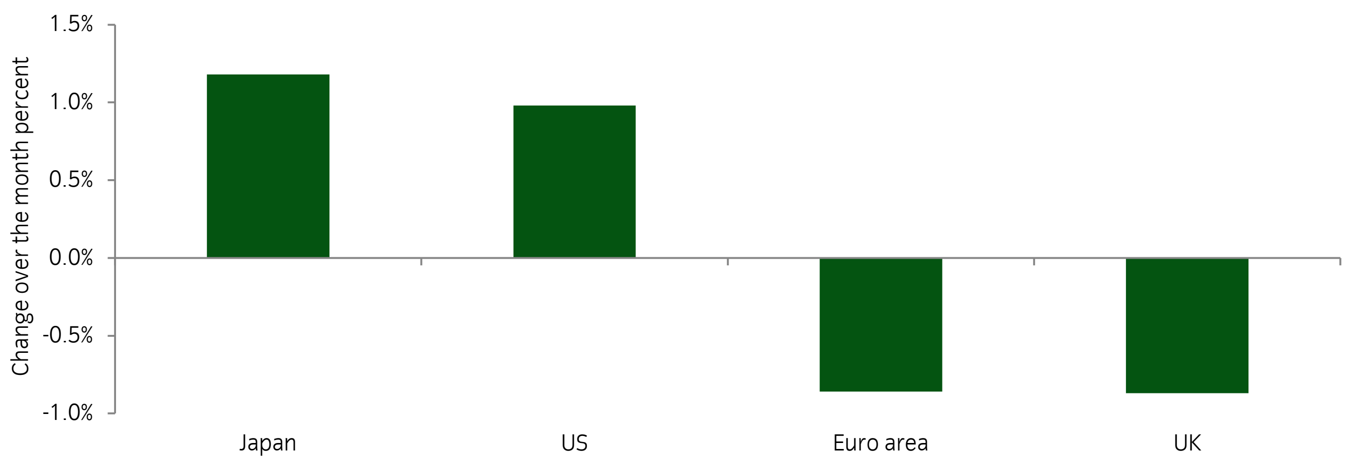
Source: Bloomberg and Insight Investment as of March 29, 2019.

Chart 6: Global change in equity markets during March



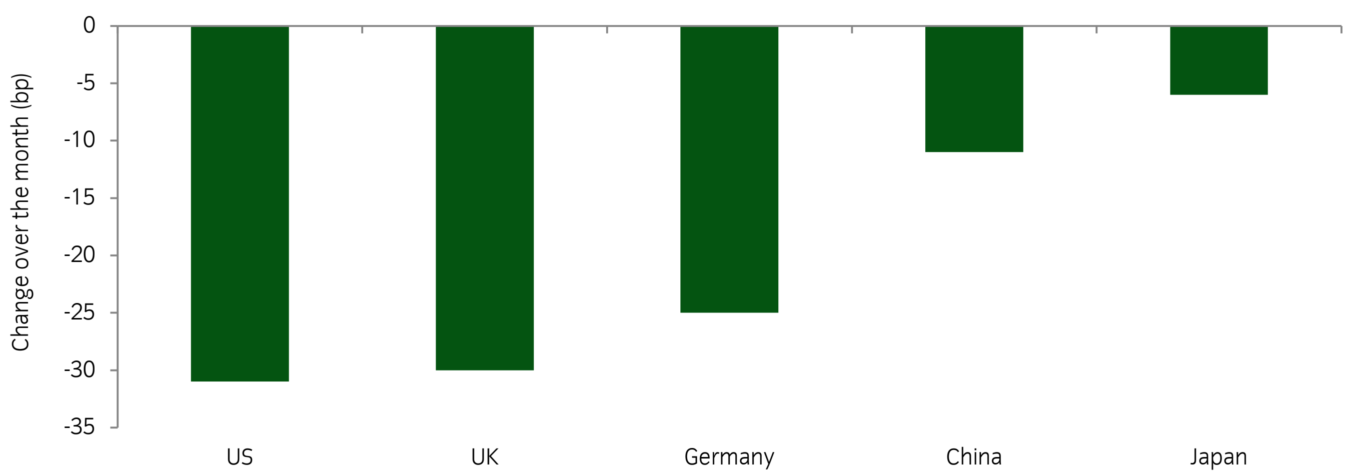
Source: Bloomberg and Insight Investment as of March 29, 2019.

Chart 7: Global change in trade-weighted exchange rates during March



Source: Bloomberg and Insight Investment as of March 29, 2019.

Chart 8: Global 10-year bond yield change in March



Source: Bloomberg and Insight Investment as of March 29, 2019.

STRATEGY PERFORMANCE AND ACTIVITY

DRIVERS OF STRATEGY PERFORMANCE

The rally in risk assets continued this month, but safe-haven assets including US Treasuries also made strong gains. A moderation in economic fundamentals ensured downward pressure on government bond yields, while positive news flow from the ongoing US-China trade talks buoyed risk assets.

Fixed income exposure was the largest contributor to returns, followed by positive contributions from allocations in equity and total return strategies.

Within fixed income, the rally in yields resulted in our exposure to government bonds being the top contributor, followed by investment grade credit exposures. Our equity exposures contributed positively, particularly as developed markets dominated this month with emerging equities remaining broadly flat.

Within total return strategies, relative value positions on the US and German yield curves were the main beneficiaries. Some of the range-bound positions in developed equities gave back performance as the risk rally extended beyond the right tails.

Real assets were a small detractor, with some infrastructure holdings giving back some recent strong performance.

STRATEGY ACTIVITY

In an environment where some of the tail risks have eased, albeit not dissipated, we increased the strategy's cyclical exposure early in the period to benefit from the ongoing move higher in risk assets. The continued moderation in growth data, combined with limited inflationary pressures, makes a compelling case to maintain our duration and broader fixed income exposures, which have been performing well even as risk assets have rallied this year. We added a relative-value flattener position on the German yield curve to benefit from moderating economic fundamentals in Europe.

While risks have become more balanced since the start of the year, including a more patient Fed and improving efficacy of Chinese policies, we expect certain risk assets to remain range-bound in the near term.

To this effect, we added a number of positions to benefit from such an environment, including range-bound positions in US and French equities as well as diversifying currency positions in the Australian dollar and Japanese yen.

Performance as at end March 2019[1]

	1 month return (%)	3 month return (%)	1 year return (%)	3 year return (%p.a.)	5 year return (%p.a.)
Insight broad opportunities strategy (gross)	1.37	5.13	4.19	6.01	4.27
Insight broad opportunities strategy (net)	1.31	4.93	3.41	5.37	3.69
3 month USD Libid	0.22	0.65	2.46	1.54	1.01

Performance as per calendar year

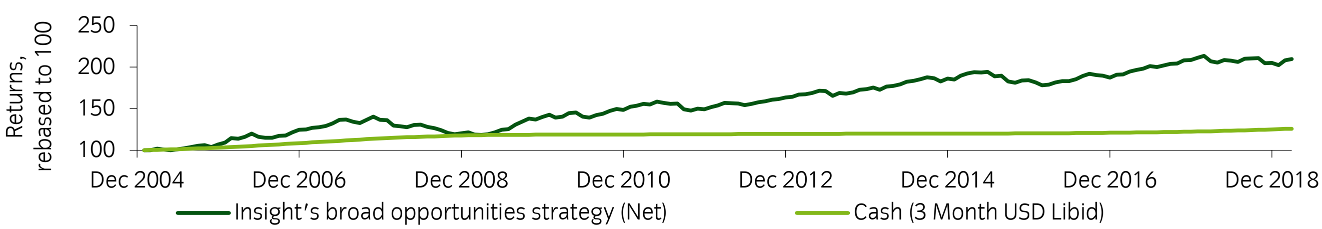
	YTD (%)	2018 (%)	2017 (%)	2016 (%)	2015 (%)	2014 (%)
Insight broad opportunities strategy (gross)	5.13	-3.41	11.31	5.63	-1.51	6.08
Insight broad opportunities strategy (net)	4.93	-4.12	10.73	5.10	-2.00	5.55
3 month USD Libid	0.65	2.27	1.19	0.66	0.22	0.14

Trades put on in the month
Increased commodity and equity exposures
Relative -value German flattener, euro vs yen, Australian vs US dollar
Range-bound positions on US, European and emerging equities

Trades expired/closed in the month
Upside position on Japanese equities
Range-bound positions on European and US credit spreads
Range-bound positions on Canadian, European and emerging equities

Source: Insight Investment as of March 29, 2019

Performance of the Insight broad opportunities strategy (USD) since launch[1]



Source: Insight Investment. As of March 31, 2019. Performance is rebased as of December 31 2004, as a result of a change in investment team leadership. Performance shown is the track record of Insight's overall multi-asset strategy and is intended to illustrate the team's capabilities.

[1]**Past performance is not a guide to future performance. Investment in any strategy involves a risk of loss.** All figures are in USD terms. Net figures are net of 0.5% annual management charge to December 31, 2017 and net of 0.75% annual management charge thereafter. The Insight broad opportunities strategy (USC0840) is shown net of investment management fees and reflects the reinvestment of dividends and/or income and other earnings. Please refer to the important disclosures and index description at the back of this document. Performance presented is that of the Insight broad opportunities strategy which may be managed by an affiliate of Insight North America LLC (INA) and should not be viewed as the performance of INA. Please refer to the disclosures and index definition at the back of this document. The quoted benchmark does not reflect deductions for fees, expenses or taxes. The benchmark is unmanaged and does not reflect actual trading. There could be material factors relevant to any such comparison such as differences in the volatility, and regulatory and legal restrictions between the index shown and the strategy.

ECONOMIC AND MARKET OUTLOOK

ECONOMIC OUTLOOK

Hope versus reality? The reality is most of the recent data points, particularly those reflecting manufacturing activity, are painting a depressing picture of the state of the global economy. The lurch lower in government bond yields is reflective of at least one major asset class recognizing the fragility of a global economy slowing to stall speed.

Why then are other asset prices, specifically risk assets, taking a more relaxed view of the risks associated with an impending slowdown?

The first point is the extent that recent market moves (in rates) reduce economic tail risks. There has been a significant shift in policy thinking this year which has resulted in an implicit loosening in policy. The Federal Reserve has acknowledged that it has failed to create symmetry around its inflation target while the ECB has reaffirmed a belief that negative interest rates can help the economy (so long as negative side effects on the monetary transmission mechanism – banks – can be avoided). Our guess is that a quick reversal in this central bank messaging seems unlikely. We monitor these developments via our financial conditions indicators. Arguably the market and economic weakness evident in Q4 2018 was in part brought about by the tightening in financial conditions that preceded it and, over the last quarter, our measure of financial conditions has eased markedly. The lag between changes in financial conditions and the underlying economy can be substantial, but there are some green shoots – particularly in those areas where easing began first. As noted above, while signs of stabilization in China and the emerging market complex are tentative (at a time when the data – most obviously in Europe – is unambiguously bad), it would be foolish to ignore them.

The second question in our minds is the extent to which markets have already moved to reflect economic growth risks. Regular readers will be familiar with our preference for looking at asset-price performance through the lens of PMI regimes. At the end of last year, equities in particular had moved to levels that would have been extreme even in a falling (sub-50) PMI world.

The Q1 2019 recovery leaves their performance over the last year and a quarter (our assessment of how long we have been in a moderating growth regime) consistent with what you might expect from such an environment. Arguably, the recent sharp rally in government bonds is bringing their returns into line with other asset returns.

Looking forward, however, the onus is on the growth data to show sequential signs of stabilization and improvement. Part of this story will require some form of trade deal between the US and China and in that regard the shift in the US yield curve to inversion will no doubt be helpful in focusing minds.

Brexit of course remains a wild card, and even with a no-deal Brexit deadline rapidly approaching the range of outcomes is uncomfortably large. Indeed, with European parliamentary elections in May, the tussle between a more populist approach to policy versus the current orthodoxy will come into even sharper focus – even more so given the fragile European growth backdrop. A shift in the balance of power would affect key EU policy agendas such as budgetary matters and the appointment of senior personnel and trade. The results may also have repercussions for national politics impacting the prospects for eurozone reform.

MARKET OUTLOOK

Since the beginning of the year we have adopted a more tactical approach to managing our broad directional exposures against a background where asset price moves were likely to be driven more from position extremes and policy responses, rather than tracking the trends in economic data.

Ultimately, the broader trends in the macroeconomic data are likely to dictate market movements but, at turning points, asset-allocation decisions can become more nuanced. Implicit in that assessment is that we might be at such a point where the deceleration in economic activity evident for much of 2018 may transform, at least, into some form of stabilization. For now, the jury is out but we see sufficient signs to stick with our hypothesis. With a policy mistake (of over-tightening) unlikely in the near-term, we see some combination of rising costs and falling revenues (a margin squeeze) as one of the most obvious ways in which more defensive corporate behavior (in the form of hiring and investment) could lead us to a downward tipping point. However, to generate such a squeeze this year or even early next requires some extreme assumptions both on costs and demand. It is of course possible, but for now a more clearly identifiable catalyst seems to be needed for us to make that our central case. From a risk-asset perspective, our broad equity exposure has come up towards our average holdings in recent years while we have also been adding to areas where we see specific value (US dollar emerging market debt, European dividends). Where we go from here is highly data dependent. During the first quarter rally, the oversold conditions evident at end 2018 evaporated. Macro and microeconomic support (in the form of the Q1 2019 earnings season) will be required to justify further progress. US earnings-per-share expectations are subdued (-3% for the S&P 500 Index) but companies are normally expected to beat (lowered) guidance.

Against these risk-asset holdings we retain a reasonable amount of duration. The lack of inflationary pressure combined with the clear guidance of lower-for-longer in central bank policy settings continues to re-affirm the attraction of government bonds within a multi-asset strategy. Admittedly, we did not anticipate the extent of the March rate rally, but if growth anxieties deepen, we believe duration will prove helpful. On the other hand, the extent of any retracement in yields, should the green economic data shoots of growth proliferate, seems likely to be tempered by medium-term central bank direction.

Real assets, despite a negative contribution over the month from infrastructure exposures, retain attractive attributes. The long-term predictable revenue stream, combined with lower levels of economic sensitivity and an element of inflation linkage, offer benefits for strategy diversification.

In the current uncertain market environment the wide range of strategies that we can employ within the total return strategies component offers particular attraction and we continue to run above-average exposures to total return strategies. We generally aim for a range of strategies across equity, currency and bond markets that either offers a high degree of asymmetry in their pay-off profiles, or wide buffers to protect us should risk asset price weakness return. The extent of the risk asset rally last quarter makes us less concerned about significant further up-side moves from here so we have strategies in play that should benefit from more modest movements within broader ranges. Our exposure to modest reversals in risk appetite is fairly limited.

THE INVESTMENT TEAM

Insight's broad opportunities strategy is managed by a team of 10 dedicated portfolio managers. They sit within Insight's investment division which comprises over 200 front-line investment professionals[1]. The team is able to harness investment ideas from all the specialist investment units within the firm ensuring that the strategy benefits from a rich source of investment ideas. The team is specialized in asset allocation, macroeconomic analysis and portfolio construction and has developed a clear and transparent investment process that allows ideas to be channeled into a robust portfolio specifically designed to meet its objectives.

FIND OUT MORE

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