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INVESTMENT WEEK
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Taking the fixed income tack in multi-asset portfolios

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The last two years have seen their fair share of volatile events, including, amongst others, an ongoing and tragic geopolitical travesty in Russia's invasion of Ukraine, the fastest central bank policy rate increase in recent memory, China's protracted zero-COVID-19 policy, a banking crisis which led to the subsequent tightening of lending standards, and to top it all off a tense debt-ceiling drama. For many investors, who were left scarred by last year's worst annual total return in the bond market's history, it still feels too early to add back to fixed income assets.

Yet as these bouts of volatility ebbed away, the discussion has turned once again to the debate of a hard landing versus a soft landing, with the latter seemingly getting the upper hand as demonstrated by the latest inflation numbers.

Indeed, focusing on the US, Goldman Sachs now predicts only a 20% chance of a recession over the coming year. Consumer sentiment has reached a near two-year high, unemployment has barely ticked up, and economic activity has remained resilient despite the 500 basis points of Federal Reserve Funds target rate rises over the past 18 months.

Whilst inflation has been slow to come down from this cycle's historic highs, we may very well be seeing a turning point in recent data releases. However, this is still from a very high base and inflation is expected to fall back to levels higher than the pre-COVID-19 pandemic era. This has consequences as central banks look to tackle high inflation with higher policy rates and are keen to do so having been proven wrong during COVID-19 when they stubbornly pushed the "transitory" rhetoric. In theory this should lead to diminished economic activity and slower growth, in turn crimping the credit cycle. So, why hasn't this been the case yet and should we be adding to risk assets rather than positioning portfolios more defensively?

Firstly, throughout the COVID-19 pandemic, a lot of weaker issuers had been weeded out and those that remained in the weaker cohort, were able (for the most part) to term out their debt, meaning the dreaded 'maturity wall' has not been a concern. In addition, corporate fundamentals have improved drastically since the global financial crisis with leverage ratios close to historical lows and interest coverage ratios close to historical highs. Whilst it's true that we are seeing defaults pick up, they remain some way below the more conservative levels forecast by economic analysts and even the harbingers of doom have been revising their default forecasts down.

Secondly, as the lagged effects of such a rapid and significant policy tightening begin to take hold, inflation will naturally start to fall, and central bankers will need to react by pausing rate hikes. Whilst it's true there are still a few more rate hikes ahead of us, we are certainly closer to peak rates now than we were eighteen months ago. In addition, it is not yet clear how fast and to what degree central banks' rate rises will pass through to the real economy, but as activity declines, so too will inflation and ultimately interest rates. Furthermore, as earnings releases start disappointing, we can expect investors to flock to safe-haven government bonds. In essence, bond investors can look forward to a significant capital gains boost from the lower interest rates that could follow the anticipated fall in inflation. Whilst we wait for this scenario to play out, it's hard to argue against locking-in the attractive yield levels we are seeing currently, certainly via short-dated government bonds and to a certain degree corporate credit, but increasingly to longer-dated bonds to benefit from the capital gains element.

This brings me to my final point. Whilst we do expect the credit cycle to turn negative, corporate credit year-to-date has delivered positive total returns, mainly thanks to the high level of income generated. Higher quality investment grade credit has suffered due to its inherent higher interest rate sensitivity compared to lower quality credit, but whilst yields are elevated, spreads don't seem to be compensating for the risks of an economic slowdown. It is worth noting, however, that corporate credit yields are now above their equity counterparts' dividend yields. Hence, the case can be made for a risk-managed high yield credit allocation from equities, given the former's historically lower drawdowns and higher recovery speeds coming out of a recession.

In conclusion, whilst we patiently decipher the latest data releases, there is a strong case for allocating to fixed income in multi-asset portfolios, locking in high levels of income whilst positioning for the potentially significant capital gains element. It would certainly be a shame to miss that boat!

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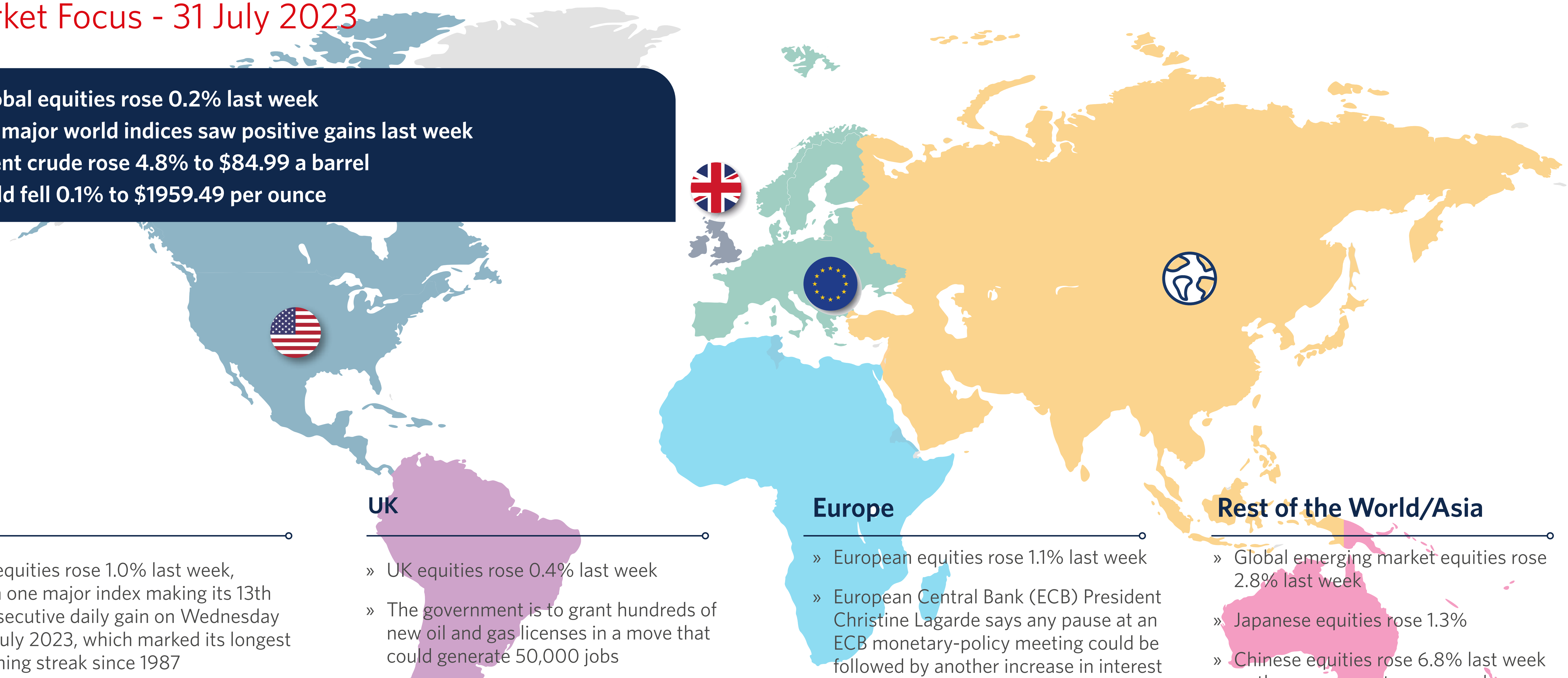
Market Focus - 31 July 2023



- **Global equities rose 0.2% last week**
- **All major world indices saw positive gains last week**
- **Brent crude rose 4.8% to $84.99 a barrel**
- **Gold fell 0.1% to $1959.49 per ounce**

US

- US equities rose 1.0% last week, with one major index making its 13th consecutive daily gain on Wednesday 26 July 2023, which marked its longest winning streak since 1987
- The Federal Reserve announced a 0.25% increase in the federal funds target rate following the conclusion of its two-day policy meeting on Wednesday, as expected
- Federal Reserve Minneapolis President Neel Kashkari says the inflation outlook in the US is “quite positive,” though the central bank’s aggressive monetary tightening campaign to temper price surges will likely result in some job losses and slower growth

UK

- UK equities rose 0.4% last week
- The government is to grant hundreds of new oil and gas licenses in a move that could generate 50,000 jobs
- The composite UK Purchasing Managers’ Index (PMI) for July came in at 50.7 versus 52.4 estimated, with manufacturing at 45 (versus 46.1) and services at 51.5 (versus 53)

Europe

- European equities rose 1.1% last week
- European Central Bank (ECB) President Christine Lagarde says any pause at an ECB monetary-policy meeting could be followed by another increase in interest rates
- European banks emerged stronger from a stress test showing how they would weather a sharp economic downturn, giving them a sound footing to continue paying dividends and buying back shares
- Gross Domestic Product growth in the euro area is seen rising to 0.2% in the second quarter after stagnating in the previous period
- Ukraine will begin talks with the US this week on a bilateral security guarantee

Rest of the World/Asia

- Global emerging market equities rose 2.8% last week
- Japanese equities rose 1.3%
- Chinese equities rose 6.8% last week as the government announced new steps to boost consumption and major cities pledged measures to support the property market
- China’s official manufacturing PMI climbed to 49.3 in July, remaining in contractionary territory but ahead of expectations of 48.9. The services index weakened to 51.5 from 53.2
- Yields on 10-year Japanese Government Bonds retreated from a nine-year high after the Bank of Japan held a surprise bond buying operation

Past performance is not indicative of future returns. Source: Bloomberg Finance L.P., returns in local currency unless otherwise stated.

Market Summary

		Cumulative returns			
Asset Class / Region	**Currency**	**Week ending 28 July**	**Month to date**	**YTD 2023**	**12 months**
Developed Markets Equities					
United States	USD	1.0%	3.0%	20.1%	13.9%
United Kingdom	GBP	0.4%	2.2%	4.8%	7.9%
Continental Europe	EUR	1.1%	1.8%	14.7%	13.9%
Japan	JPY	1.3%	0.1%	22.8%	20.8%
Asia Pacific (ex Japan)	USD	2.6%	5.2%	8.3%	5.6%
Australia	AUD	1.2%	2.8%	7.4%	12.5%
Global	USD	0.2%	2.3%	17.8%	13.9%
Emerging Markets Equities					
Emerging Europe	USD	2.3%	9.4%	23.6%	58.2%
Emerging Asia	USD	3.0%	5.7%	9.9%	5.5%
Emerging Latin America	USD	2.0%	4.9%	24.3%	31.8%
BRICs	USD	4.1%	6.8%	6.4%	3.7%
China	USD	6.8%	9.5%	3.5%	-2.2%
MENA countries	USD	1.3%	4.1%	7.2%	-4.8%
South Africa	USD	5.2%	13.0%	6.8%	9.3%
India	USD	-0.7%	2.3%	9.9%	13.6%
Global emerging markets	USD	2.8%	5.8%	11.0%	7.6%
Bonds					
US Treasuries	USD	-0.6%	-0.4%	1.4%	-3.9%
US Treasuries (inflation protected)	USD	-0.4%	0.0%	2.0%	-5.0%
US Corporate (investment grade)	USD	-0.2%	0.2%	3.5%	-0.7%
US High Yield	USD	0.1%	1.2%	6.7%	4.8%
UK Gilts	GBP	-0.5%	0.5%	-3.1%	-16.6%
UK Corporate (investment grade)	GBP	0.0%	2.1%	1.1%	-7.9%
Euro Government Bonds	EUR	-0.2%	-0.2%	2.4%	-8.5%
Euro Corporate (investment grade)	EUR	0.2%	0.9%	3.0%	-3.5%
Euro High Yield	EUR	0.4%	1.0%	5.4%	5.1%
Japanese Government	JPY	-0.2%	-0.9%	1.8%	-1.4%
Australian Government	AUD	-0.1%	0.4%	1.7%	-1.5%
Global Government Bonds	USD	-0.4%	0.5%	1.4%	-3.8%
Global Bonds	USD	-0.4%	0.6%	2.8%	-2.3%
Global Convertible Bonds	USD	0.8%	3.5%	8.5%	7.7%
Emerging Market Bonds	USD	0.0%	1.6%	5.0%	4.5%

		Cumulative returns			
Asset Class / Region	**Currency**	**Week ending 28 July**	**Month to date**	**YTD 2023**	**12 months**
Property					
US Property Securities	USD	-1.9%	2.2%	7.1%	-7.0%
Australian Property Securities	AUD	1.3%	3.7%	5.4%	-1.7%
Asia Property Securities	USD	3.7%	4.8%	-2.5%	-6.1%
Global Property Securities	USD	-0.3%	3.9%	5.1%	-5.8%
Currencies					
Euro	USD	-0.9%	1.0%	2.9%	8.5%
UK Pound Sterling	USD	0.1%	1.2%	6.4%	6.1%
Japanese Yen	USD	0.6%	2.5%	-7.0%	-4.5%
Australian Dollar	USD	-1.1%	-0.1%	-2.3%	-4.3%
South African Rand	USD	2.1%	6.9%	-3.1%	-6.0%
Swiss Franc	USD	-0.3%	3.1%	6.2%	10.2%
Chinese Yuan	USD	0.6%	1.5%	-3.5%	-5.6%
Commodities & Alternatives					
Commodities	USD	1.6%	7.7%	0.1%	-2.1%
Agricultural Commodities	USD	-0.7%	5.7%	6.2%	8.7%
Oil	USD	4.8%	13.5%	-1.1%	-20.7%
Gold	USD	-0.1%	2.1%	7.4%	11.7%
Hedge funds	USD	0.0%	0.3%	1.0%	1.2%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

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