



GLOBAL ASSET ALLOCATION: THE VIEW FROM THE UK

November 2020

MARKET INSIGHTS

As of 31 October 2020

Blue Ripple?

A Biden presidency, with Republicans maintaining control of the Senate, is a possible outcome of the US elections. Most polls heading into the election were predicting the possibility of a 'Blue Wave', leading to a Democratic president, Senate and House that could have resulted in higher levels of fiscal spending countered by the potential for policies of higher taxes. Markets appeared to be celebrating the potential for a divided government, tempering the chances for more aggressive policies by either party and hopefully leading to an environment of more compromise. One area that may come into focus is regulation, with a spotlight on the technology sector, as there appears to be bi-partisan support for such measures. If the increasingly likely outcome of a divided government holds, a more balanced political environment could potentially lead to reduced market volatility and a more supportive backdrop for risk assets.

Insurance Cancelled

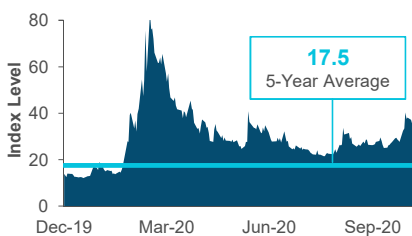
Heading into the election, US Treasury yields remained range-bound to slightly higher despite bouts of increased volatility and stocks selling off. While stock and bond correlations move around over time, their prices historically have been negatively correlated during periods of market stress where risk assets sell off with investors fleeing to the safety of US Treasuries. As volatility picked up, investors took notice as this reliable insurance policy did not respond. It appeared stocks were reacting to short-term risks of an unsettled, chaotic election, while bonds looked through to the potential for fiscal spending that could move yields higher. With yields hovering at record-low levels, investors may not be getting compensated for the increased duration risk if rates were to revert higher. While investors may be rethinking how to hedge against their equity exposures, US Treasuries still provide ballast even if their positive appreciation may be tempered at current levels, and importantly provide liquidity when it is at a premium.

There's No Place Like Housing

Amid the upheaval brought on by the coronavirus pandemic, real estate markets across the board have been impacted on an unprecedented scale. On one hand, the residential housing market continues to boom, spurred on by low rates and a resilient consumer. Many homebuyers are fleeing big cities for more space, as several major companies have extended work from home provisions. However, in stark contrast, commercial real estate, particularly retail, office space and hotels, have continued to face headwinds. Trends that began to take hold pre-coronavirus, such as moves towards online versus brick-and-mortar retail, have been further perpetuated by the pandemic. Similarly, demand for office space could be impaired going forward as working from home trends may become more permanent. If these trends persist, areas of the market exposed to commercial real estate, such as office and retail real estate investment trusts (REITs) will remain challenged.

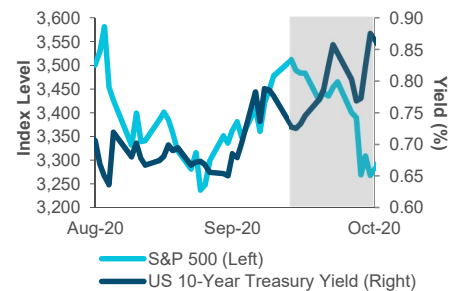
VIX Index¹

As of 5 November 2020



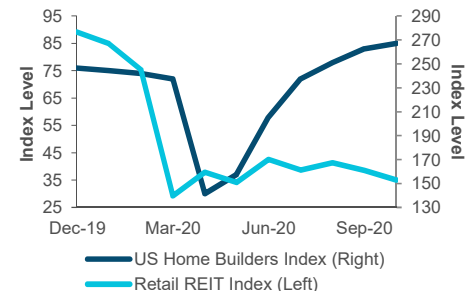
S&P 500 vs. US 10-Year Treasury Yield

As of 31 October 2020



Residential vs. Commercial Real Estate

As of 31 October 2020



Past performance is not a reliable indicator of future performance.

¹ VIX represents CBOE Volatility Index (VIX).

US Home Builders Index is represented by the National Association of Home Builders Market Index. Retail REIT Index is represented by FTSE NAREIT Retail Property Sector Index. Grey shaded area represents the recent sell-off in S&P 500.

Sources: Bloomberg Finance L.P., Bloomberg Services Limited, Standard & Poor's, NAREIT/FTSE (see Additional Disclosures).



 **Positives**

 **Negatives**

United Kingdom

- Vaccine news means that the heavily service-based UK economy is seeing a light at the end of the tunnel
- An exuberant housing market, driven by stamp duty cuts and pent-up demand, will support consumption for now

- The second lockdown could be extended or long-term restrictions may be imposed upon exit
- The transition to post-Brexit trade arrangements will be very disruptive economically
- More fiscal accommodation this year will require greater consolidation thereafter
- All these risks make negative rates in the UK more likely, weighing on the sterling, but positive for UK gilts

Developed Europe

- EU recovery fund provides significant fiscal stimulus and is the first step towards a fiscal union
- Monetary policy remains very accommodative
- Equity valuations are inexpensive
- Stronger long-term euro outlook

- Second wave of virus leading to new lockdowns
- Elongated process to enact further stimulus
- Brexit likely to negatively impact trade
- Lower share of secularly advantaged companies
- Banking sector weakened by negative rates
- Limited scope for European Central Bank to stimulate further

United States

- Unprecedented levels of monetary and fiscal support
- Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of the world
- Healthy consumer balance sheets prior to the crisis

- Heightened political tensions
- Elevated corporate leverage going into the crisis
- Elevated government debt levels
- US dollar strength has faded

 **Positives** **Negatives**

- Japan**
- Smooth political transition signals reforms may continue, especially in governance and digitisation
 - Japanese stocks are under-owned; they remain relatively cheap under conservative expectations and offer optionality to global economic recovery
 - Economic data have improved following effective containment of the coronavirus spread and amid boost to domestic sentiment through government's 'Go To Travel' domestic tourism campaign

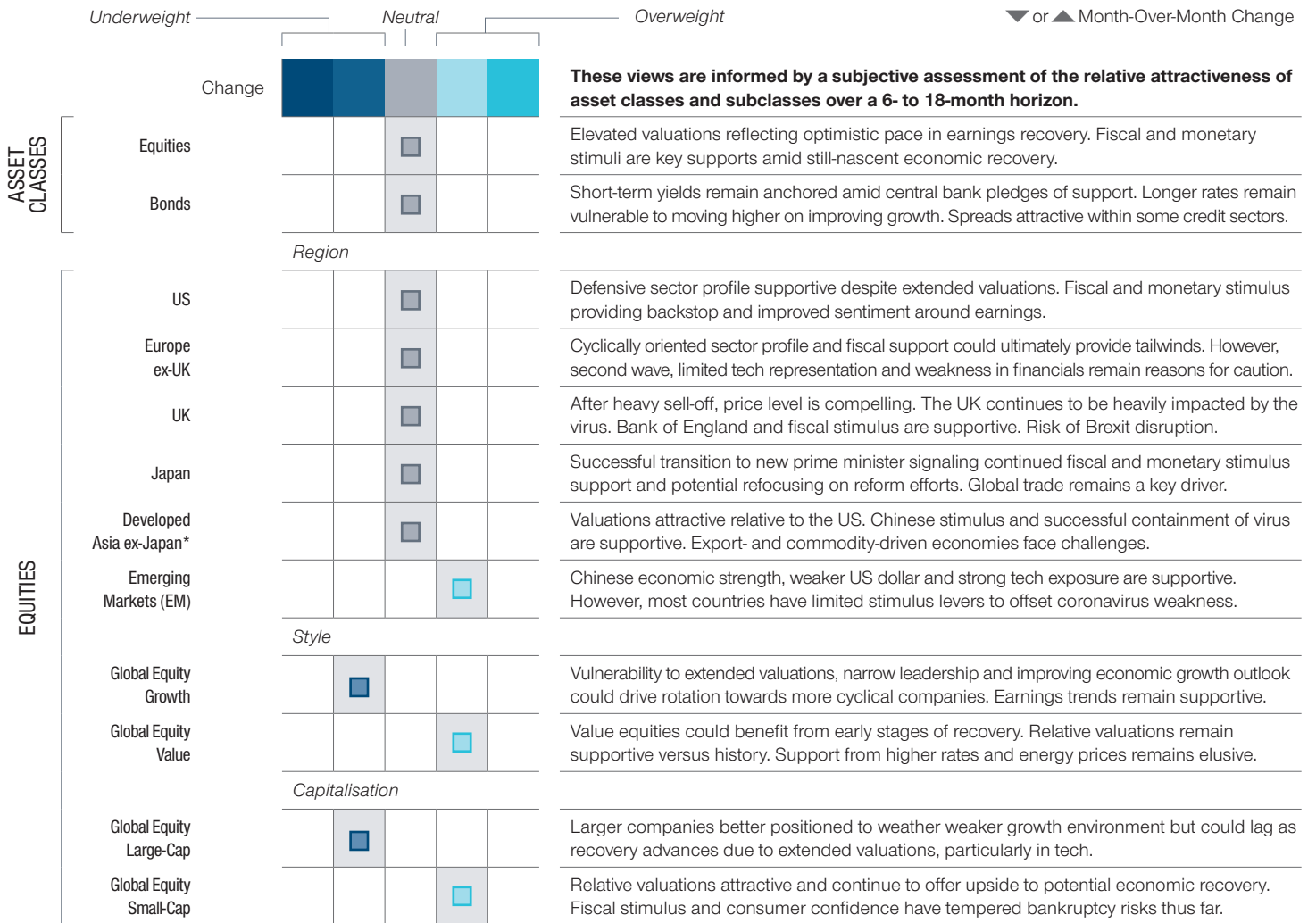
- The economic recovery has been slower than in other developed economies
- Japanese small-cap stocks have reached new highs on the back of retail trading
- Market indicators continue to signal a stronger yen, which would reduce companies' competitiveness and profitability

- Asia Pacific ex-Japan**
- The Chinese economy has largely returned to normal; domestic and services sectors could drive future growth after recent rebound in retail sales
 - We expect the renminbi to remain strong and Chinese bonds to stay attractive given the global low-yield environment
 - Australian consumer spending could surprise on the upside given solid data from retail sales, housing, job reports and cash balances
 - Fiscal and monetary policy support in Australia has been comprehensive and significant

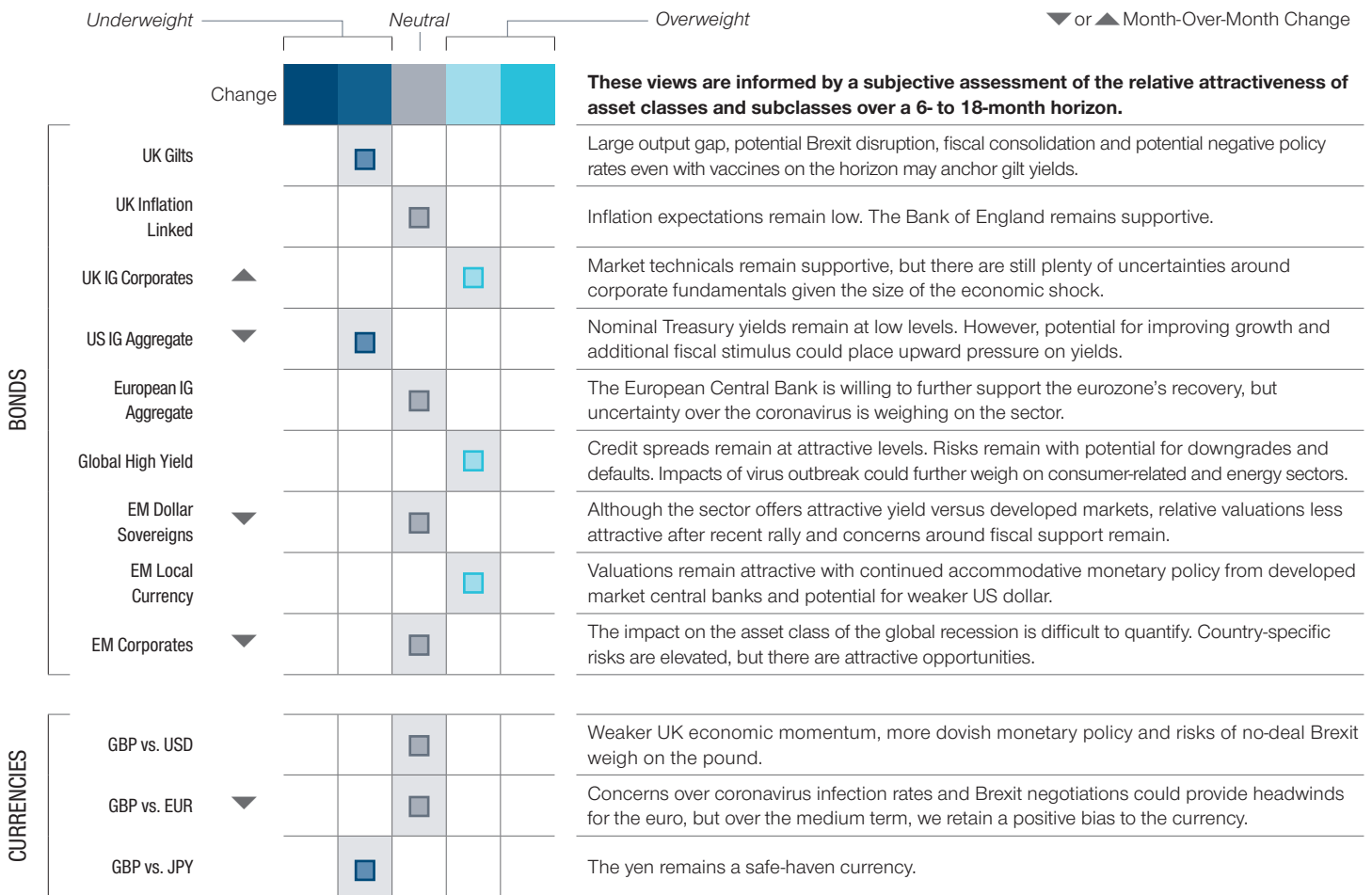
- Stimulus has started to fade after the economy showed signs of recovery
- Chinese stocks face concentration and style divergence risk, with the MSCI China Index having recently hit an all-time high
- Australian support measures could be wound down too quickly, creating a hangover effect if fiscal tap is turned off
- Having effectively contained COVID-19 outbreaks to this point, the Australian market might be less sensitive to positive vaccine developments than other markets yet to slow virus spread

- Emerging Markets**
- Chinese economy has largely rebounded
 - US dollar strength has eased
 - Relatively high share of secularly advantaged companies (e.g., cloud computing, internet retail)
 - Equity valuations attractive relative to developed markets

- Limited ability to enact fiscal stimulus (excluding China)
- Highly sensitive to global industrial production and trade trends, which have improved but remain muted



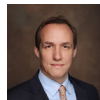
* Includes Australia



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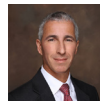
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