

LOIM market update

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TOP-DOWN MACRO VIEW

As the COVID-19 pandemic propagates globally, draconian containment measures have been enacted to mitigate the healthcare shock. A number of countries have also unleashed a huge quantum of policy response (both fiscal and monetary) in an effort to alleviate the extremely severe economic and financial implications of such containment measures.

Our framework to assess the COVID-19 crisis looks at the discrete but interconnected issues at play in today's highly stressed global economy. These issues are: the healthcare crisis (origin of the shock) needing economic shutdown; the ensuing economic damage and policy response; fractured liquidity (in fixed income, USD and funding markets); and supply side shocks (including oil).

Very rightly, fiscal policy is taking the lead dealing with the economic damage: the role of direct transfers (e.g. money to households) is critical on this front. We are comforted to see the USD2tn package passed by the US Congress. We also believe that the policy moves from the Federal Reserve and the European Central Bank have helped save the global financial system from complete collapse.

Ultimately, the healthcare crisis needs a vaccine to put the COVID genie back in the bottle. That said, both fiscal and monetary policy measures (especially in developed markets) are

exceptionally aggressive and large in order to address the current and expected loss of economic activity and reduce the intensity of systemic risks.

Short term view: Severe challenges and risks remain – chiefly, the risk of reinfection in China - and there is clouded visibility on earnings across countries and sectors. Nonetheless, we expect the most extreme volatility seen recently to diminish somewhat.

As such, we keep a cautious, somewhat defensive stance and are now focusing on the opportunities that are forming, whilst keeping a close eye on the ongoing spread of the virus.

Long term view: The strong policy response currently will be critical to improving the quality of the recovery after lockdowns end, in our opinion. The ongoing recovery in China gives us strong reason for optimism.

In the current context, investors could find value in global and Asia corporate credit (especially in non-COVID impacted sectors) and convertible bond strategies. Also, positively convex strategies could be used as an addition to risk-on exposure when further clarity reemerges. We believe these strategies have the potential to generate excess returns as lockdowns in various developed and emerging markets run through.

Salman Ahmed, Chief Investment Strategist

OUR CIO VIEWS BY ASSET CLASS

FIXED INCOME

Yannik Zufferey, CIO Fixed Income

Our fixed income strategies incorporate multiple layers of defense in order to boost portfolio resilience in volatile markets. We place credit risk monitoring and diversification at the core of our corporate strategies as a crucial way to add value.

A key component of our approach is to prudently add credit exposure, thereby reducing duration risk. Our credit analysis strictly adheres to predefined processes and justifies any exposure with fundamental research, ensuring that in times of sell-offs, performance recovers. Indeed, assuming no default, prices pull to par at maturity.

We also diversify across issuers and instruments to reduce idiosyncratic risks and add flexibility when thin liquidity challenges

trading in large sizes. Moreover, we employ a tail-risk hedging strategy through credit derivatives. And our multi-manager approach provides diversification and uncorrelated streams of returns.

For investors turning to cash, our short term money market strategy aims to preserve capital and ample liquidity. We do this by increasing the daily liquidity buffers in our funds to above 10% before investing in money market instruments.

We believe the current illiquidity and panic in the market are distorting credit spreads for all borrowers, regardless of fundamentals. Whilst remaining defensive, we believe our differentiated approach could also present opportunities for investors with yield targets.

ASIA FIXED INCOME

Dhiraj Bajaj, Head of Asian credit

In times of market dislocations, we remain guided by our value-focused, active management style. Amid this turbulence, we see the opportunity to make our portfolios more streamlined and position for a high degree of upside potential once markets rebound. We are committed to building resilient portfolios, which can weather times of market stress and deliver strong total returns throughout market cycles.

Our strategy through past crises and every drawdown period has been to stay consistent to our active total return strategy. We look to:

1. Stay fully invested.
2. Avoid forced selling and allow for portfolio declines, staying true to our macro view and underlying fundamentals analysis to support our longer-term convictions.

3. Reassess our top-down and bottom-up views, by country, sector and single-names given the on-going shocks of global growth, commodities, and fiscal pressures in emerging markets.
4. Wait for the market to settle, and based on our revised assessment, do relative value switches to optimise our portfolios for an eventual rebound, while positioning for a new credit upcycle.

We believe that staying invested throughout market cycles is the best approach to generating total returns over time, in order to benefit from carry, roll-down, active management and eventual spread compression once markets stabilise. To mitigate default risk, we continue to ensure a high level of diversification across our funds such that cumulative long-term income and total return potential outweigh any default risk.

EQUITIES

Didier Rabattu, Head of Equities

The current climate highlights the value of our disciplined and focused investment process. We concentrate on companies with strong financials and exposure to long-term structural trends and challenges because we believe this provides sound defensive properties for investors.

For us, companies with robust financials are those that generate excess economic returns. We look at criteria such as capital efficiency, cash flow generation, and limited dependence on financial markets. Focusing on long-term structural trends while understanding key challenges is crucial to separating structural growth from volatile hype.

Our equity portfolios have limited exposure to industries most exposed to the consequences of this crisis. We have also reviewed the corporate liquidity risk of all our holdings.

Our strategies have benefitted from exposure to mainland China, as well as companies geared towards stay-at-home entertainment. Healthcare companies too have proven to be supportive.

We retain our belief that this represents a transitory period of uncertainty - our investment teams are reviewing activities that could benefit from the resumption of economic and social activities.

CONVERTIBLES

Arnaud Gernath and Natalia Bucci, co-Portfolio Managers

In the midst of one of the worst market corrections, we are relieved to see that good quality convertible bonds have reacted well. Indeed, strategies such as ours (focused on the best asymmetrical profiles with strong credit fundamentals) have limited the downside to a fraction of that of global equities (approximately 1/3rd at the time of writing).

As the result of the sharp and deep correction in risky assets, the convertible bond asset class is now offering a large and rising number of technically “dislocated” convertible bonds, which our

portfolios are beginning to take advantage of. These technical profiles, combining strong bond protection¹ features, unusually attractive yields and a free option haven’t been seen since the fourth quarter of 2008.

More attractive still, the fixed-income yield of the portfolio has risen sharply as a result of the market dislocation. Thus, investors are well remunerated for an investment-grade bond credit risk, while obtaining a long option (average maturity of four years) on a market recovery. It should also be noted that our allocation does not currently include the most affected sectors such as energy, transport or travel.

MULTI-ASSET

Aurele Storno, Lead Portfolio Manager

Defensive strategies are core to our multi-asset portfolios. Historically, the founding block of portfolio construction is the concept of diversification, or the recognition that the whole (risk) is less than the sum of the (risk of the) parts.

Although this has worked well for investors, the benefits of diversification have started to wane.

This year, while bonds and equities have moved in opposite ways about two days out of three (which is slightly more than during the 2008 crisis), the performance contribution of bonds is lower than in the past; a reflection of the low absolute of rates.

Hence, investors need to diversify their defensive assets. In our portfolios, we use up to five different forms of protection:¹ diversification is one, especially when it is sized-based on risk rather than capital allocation. Alternative risk premia (such as trend following or carry strategies) can help, too.

Finally, drawdown management (explicit, dynamic risk management to reduce the risk of loss) and tail hedging (long positions in volatility across asset classes) are fundamental tools to buffer our portfolios.

We use such defensive properties as part of our overall strategy to both mitigate the downside and capture possibilities on the upside. This enables investors to participate in the opportunities we see eventually arising.

ALTERNATIVES

Christophe Khaw, CIO 1798 Platform

Our alternative range seeks to be defensive by construction. We are not defensive because we invest in defensive assets, run low risk or have hedges designed to protect¹ from sell offs.

We are defensive because, by design, we focus on strategies: that tend to face little competition (and as a result are not subject to panic or forced selling); and heavily focus on robust trade construction.

We look to avoid exposure to traditional risk premiums, and rather invest on relative value consideration, using the large spectrum of instruments and solutions available to exhibit truly convex profiles.

We recognise we can be wrong, but look to minimise losses when we are wrong. This is enabled by the fact markets are increasingly silo’d, and as a result credit, equity and volatility markets may have a different interpretation of market events and are dominated by passive investments.

Our flagship invests amongst many different uncorrelated strategies - these tend to be nimble and focused on less competitive opportunities, and typically have a key structuring aspect to them.

In the past two years, this strategy has delivered for investors in both supportive market conditions and when there are strong market dislocations such as in March 2020.

¹ Capital protection is a portfolio construction goal that cannot be guaranteed.

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