Surf’s Up

Macro
In the past few weeks, new COVID-19 cases have accelerated across much of Europe and the US, followed by rising hospitalisations and fatalities. Business confidence remains high in the States but has begun to slide recently in Continental Europe, particularly in the services sector. Many governments now look likely to implement lockdowns – perhaps on a short-term basis, to ease pressure on hospitals – and economies now face the risk of a double-dip recession. Asia looks set to remain the exception to the rule – Q3 GDP growth in China has accelerated to 4.9% year-on-year with no discernible sign of a second coronavirus wave.

Central Banks
The expected slowdown in growth is likely keep a cap on inflationary pressures across the globe. In the euro zone for example, core inflation – i.e., ex food and energy – has only risen 0.2% in the last twelve months. Central banks stand ready to ease policy further to mitigate the fallout from the pandemic, but we do not expect the Federal Reserve (Fed) and European Central Bank (ECB) to move until their December meetings. In all likelihood, the easing will come in the form of enhanced and extended asset purchase programmes – of government and high-quality corporate bonds – to ensure that borrowing costs remain under control.

Markets
Subdued inflation and central bank buying are likely to keep most sovereign yields low, that is to say in negative territory after inflation, although emerging market government debt does offer attractive additional yield (or “carry”). Investment grade corporate bonds (IG) pay a sufficient yield premium (or “spread”) to offer positive real yields but caution should be exercised with more speculative high yield bonds (HY) where sluggish growth is likely to impair credit quality. That leaves equities as our preferred asset class for the long term. However, near-term headwinds remain a source of risk and volatility.

Bottom line
No change to our fixed income allocations where we continue to highlight the relative value in higher-quality corporate bonds compared with sovereigns in advanced economies. Within equity markets, we have further reduced exposure to Europe given the impending dip in activity and persistent uncertainties surrounding the future trade relations between the EU and the UK. On the other hand, Asia is emerging relatively unscathed from the pandemic and we expect China’s growth engine to pull other regional economies in its wake – we have moved to a strong Overweight in emerging Asian equities. Regarding commodities, we have downgraded oil to Underweight and continue to prefer gold.

In accordance with the applicable regulation, we inform the reader that this material is qualified as a marketing document.
CA159/H2/20
The table below presents the latest conclusions of our Global Investment Committee.

<table>
<thead>
<tr>
<th>Positioning</th>
<th>Duration</th>
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<tbody>
<tr>
<td>O/W: Overweight</td>
<td>Long - 7-10 years</td>
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<tr>
<td>N: Neutral</td>
<td>Intermediate - 5-7 years</td>
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<tr>
<td>U/W: Underweight</td>
<td>Short - 3-5 years</td>
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### Summary house views

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<th>EQUITY</th>
<th>Strong UW</th>
<th>UW</th>
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<th>Strong OW</th>
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<td>Eurozone</td>
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<td>Emerging</td>
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<th>EMU HY</th>
<th>UK IG</th>
<th>UK HY</th>
<th>Duration USD*</th>
<th>Duration EUR*</th>
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<th>Duration USD*</th>
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<th>EUR/CHF</th>
<th>EM FX (vs. USD)</th>
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<th>L/S Equity</th>
<th>Event-Driven</th>
<th>FI Arbitrage</th>
<th>Global Macro / CTAs</th>
<th>Cash</th>
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<th>CMDTY</th>
<th>Brent</th>
<th>Gold</th>
<th>ALT. STRATEGIES</th>
<th>L/S Equity</th>
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**EQUITIES**

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<thead>
<tr>
<th>Country</th>
<th>Analysis</th>
</tr>
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<tbody>
<tr>
<td>United States</td>
<td>The recovery may slow in the fourth quarter as pandemic restriction measures have tightened recently. We remain Neutral.</td>
</tr>
<tr>
<td>Eurozone</td>
<td>The pandemic has taken a clear turn for the worse across the region leading to new restrictions which are likely to crimp growth for months ahead. We move from Neutral to Underweight.</td>
</tr>
<tr>
<td>UK</td>
<td>Despite the attractive valuation of UK companies, no major progress on the future trade agreement with the EU may continue to weigh on investors’ confidence. We move Underweight.</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Swiss equities have outperformed their regional peers year-to-date, in large part thanks to the defensive sector breakdown.</td>
</tr>
<tr>
<td>Japan</td>
<td>Japan is well-placed to benefit from growth in China and earnings should bounce strongly next year. For now, we are Neutral.</td>
</tr>
<tr>
<td>Emerging (EM)</td>
<td>With the pandemic well under control and GDP growth picking up, we have moved to a strong Overweight in emerging Asia.</td>
</tr>
</tbody>
</table>

**FIXED INCOME**

<table>
<thead>
<tr>
<th>Category</th>
<th>Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sovereigns</td>
<td>Central banks should increase their asset purchase programmes over coming quarters, meaning that yields should remain historically low.</td>
</tr>
<tr>
<td>Duration*</td>
<td>We prefer shorter-dated bonds across markets.</td>
</tr>
<tr>
<td>Inflation-linked</td>
<td>Inflation should recover in the longer term. We maintain our Neutral view.</td>
</tr>
<tr>
<td>Investment Grade</td>
<td>High-quality corporate bonds do offer positive yields both in nominal and real terms. We remain Overweight.</td>
</tr>
<tr>
<td>High Yield</td>
<td>Given new restrictions on activity, default rates for riskier issuers may rise. We are Neutral.</td>
</tr>
<tr>
<td>Emerging debt</td>
<td>Credit spreads still offer an attractive pick-up in yield and we remain Neutral.</td>
</tr>
</tbody>
</table>

**CURRENCIES**

<table>
<thead>
<tr>
<th>Currency Pair</th>
<th>Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR/USD</td>
<td>We expect the euro to trade sideways against the dollar in the near term before resuming its rally next this year.</td>
</tr>
<tr>
<td>GBP/USD</td>
<td>We expect a limited-scope deal between the UK and the EU. However, any sterling strength on its announcement is likely to prove short-lived.</td>
</tr>
<tr>
<td>EUR/GBP</td>
<td>Both parties will take time to adapt to a less favourable trading regime. We are Neutral.</td>
</tr>
<tr>
<td>USD/JPY</td>
<td>Japan has weathered the COVID-19 storm much better than other advanced economies and stands to benefit from China’s rapid recovery from recession.</td>
</tr>
<tr>
<td>EUR/CHF</td>
<td>October has seen a modest rise in the Swiss franc, up 0.8% as traders began to realise that approval for the NGEU fund would take time. However, we expect some modest further CHF weakness against the EUR.</td>
</tr>
<tr>
<td>Emerging</td>
<td>We think it is too early to turn positive as the pandemic continues to spread in several regions like Latin America and India.</td>
</tr>
</tbody>
</table>

**ALTERNATIVES**

<table>
<thead>
<tr>
<th>Category</th>
<th>Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hedge funds</td>
<td>Our preferred hedge fund strategies remain Merger Arbitrage, Long/Short Credit and Global Macro, especially discretionary and emerging market traders.</td>
</tr>
<tr>
<td>Gold</td>
<td>We expect Asian demand for gold jewellery to recover and we maintain our Overweight.</td>
</tr>
<tr>
<td>Oil</td>
<td>Given the impact of new COVID-19 restrictions on demand, we move Underweight oil.</td>
</tr>
</tbody>
</table>

Source: SGPB, 30/10/2020

* Duration: short = 3-5 years, medium = 5-7 years, long = 7-10 years

HY = High Yield bonds (higher return but greater risks), IG = Investment Grade bonds (higher quality but lower return)
ECONOMIC OUTLOOK

To lock down, or not to lock down

The US is the world’s largest single economy, and home to well over half of global equity market capitalisation. Therefore, economic activity there acts as an anchor for growth elsewhere and sets the pace for asset price returns globally.

This pandemic-ravaged year may well be the most fascinating in its economic history – it certainly is record breaking. US GDP grew 7.4% in the third quarter, by far the strongest ever (the previous record was 3.9% in Q1 1950). Nonetheless, after falling 1.3% in Q1 and 9% in Q2, the economy remains 3.5% smaller than at the end of 2019. For comparison, GDP shrank 4% over the entire six-quarter Great Recession. This reveals the US economy – and by extension the world – at a nuanced and delicately poised juncture. Effectively, the US is no longer in recession – indeed, according to headline GDP, it’s experiencing a breath-taking surge. However, it is also still far below its pre-Coronavirus peak, with high underemployment and major dislocations. For example, US consumer spending on services in Q3 was an annualised $660 billion lower than in late 2019, while spending on goods was up $325 billion. Overall, spending remains about 3% percent below pre-pandemic levels.

Of course, the real driving factor behind these enormous swings in the data remains the course of the ongoing COVID-19 pandemic. Unsurprisingly, there is a high degree of nuance here too. In the week ending October 28, there were on average 75,561 cases per day, the highest at any point in this crisis and a 41% surge from two weeks earlier. Yet, at the same time, the number of hospitalisations is 11 for every 100,000 Americans, well below the peak of 18 recorded in the Spring. Deaths, thankfully, remain lower still – the seven-day average to October 28 is 786 compared with highs of 2,232 in April.

The big question – and one which will determine the outcome for the economy – is if rising hospitalisations will lead to increased deaths. If the answer is “yes”, we may well be headed for another full lockdown of the US economy, and a likely fall back into recession. If the answer is “no”, the economy will continue to recover, albeit slowly and unevenly with widely divergent outcomes for various sectors. There are some critical reasons for optimism. Reports suggest that death rates among hospitalised patients in New York have dropped from 25-30% in the Spring to 3-8% in recent months, and a similar trend has been observed across Europe. A combination of factors has contributed to the improved outcomes for hospital patients, chiefly the lessons learned by doctors during the first wave and the development of better treatment protocols using steroid drugs and non-drug interventions.

Bottom line. Our base case remains that we will see slow, uneven growth but no double-dip US recession as full lockdowns will not be repeated. Of course, if the hospital system looks like being overwhelmed and deaths start ticking up, full lockdowns for the US would be back on the cards and our view would prove too optimistic. Already many European countries – notably Germany and France – have instituted new lockdowns and we now expect a decline in GDP there in the fourth quarter.

On the other hand, we could also prove to be too conservative – every day, we get closer to an eventual vaccine which could be widely available as early as by Q2 2021. Even without one, China and much of East Asia appear to be in a “post-pandemic, new normal”, demonstrating that there is a path towards strong economic growth even without a panacea.

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**FIXED INCOME**

**IG Credit Remains the Sweet Spot**

Government bonds remain unattractive, offering negligible or negative yields to investors. “Credit” markets – i.e., corporate or emerging market debt – offer more value but great selectivity is required. We maintain a preference for Investment Grade (IG) issuers over High Yield (HY).

The combination of muted inflation and active central bank buying are likely to keep sovereign bond yields at historically low levels. This will continue to encourage investors to seek higher returns in credit markets. Our preference remains for higher-quality corporate bonds over High Yields. IG bonds offer positive yields after taking inflation into account and bear much less credit risk than lower-quality HY where many issuers run the risk of default.

**Sovereigns**

**US.** In recent weeks, investors have speculated that a Biden presidency might mean a more inflationary policy mix, pushing 10-year Treasury yields up to around 0.85%. However, unemployment remains high and current levels of activity are well below potential, meaning that inflationary pressures should remain muted in coming quarters. The Fed should remain an active buyer of Treasuries – indeed, we expect its programmes will be increased by early next year – meaning that yields are unlikely to break much above recent highs for now.

**Eurozone.** Recent weakness in the region’s equity markets linked to the worsening pandemic has seen government bond yields dip again, in particular among core issuers led by Germany. Periphery “spreads” (i.e., the difference in yields between 10-year German bunds and Italian, Spanish or Portuguese bonds) remain very tight, still boosted by the forthcoming Next Generation EU stimulus fund. However, with yields already at lows and spreads extremely tight, there is limited upside potential for euro zone sovereign bonds.

**UK.** In recent days, speculation has grown that the Bank of England (BoE) will increase the size of its asset purchase programme in November by GBP 100bn to GBP 845bn, almost double the pre-pandemic level. Negative interest rates appear unlikely for now, but the buying should help keep sovereign (“gilt”) yields close to zero.

**Credit**

**US.** Yields on IG corporate bonds have fallen below 2.0%, close to August’s all-time low of 1.8%. Demand has been strong, given the attractive yield spread over Treasuries, and investors have been comforted by the Fed’s Corporate Credit Facility asset purchases. Bond issuance has risen sharply to all-time highs – as borrowers rush to take advantage of low borrowing costs – but has been easily absorbed by the market. However, the downturn in the economy is likely to mean rising default risk for the riskier categories of HY debt – we still prefer IG credit.

**Eurozone.** Although solid, IG issuance in euros is well below last year’s levels, in large part because financial borrowers have scaled back their borrowing requirements. On the other hand, the ECB has emerged as a substantial buyer of corporate credit in its various asset purchase programmes, helping keep IG credit spreads extremely tight. Like in the US, high-quality corporate bonds do offer positive yields – both in nominal terms and after inflation – and we remain overweight. Regarding HY, we continue to focus on better quality issuers where default risk is lower.

**UK.** With more BoE purchases mooted, IG credit in sterling should continue to attract buyers with spreads of around 130 basis points over gilts. However, the combined effect of pandemic restrictions and lingering uncertainty on the future UK/EU trade regime means we continue to prefer IG over HY.

**Emerging Market (EM) debt**

This year’s crisis has not been kind to some EM borrowers – Argentina, Ecuador and Lebanon have defaulted while Turkey’s credit default swaps (a measure of credit risk) have doubled so far this year. However, these appear to be idiosyncratic cases – in fact, EM credit spreads have shrunk dramatically from 8.75% in April to 3.5% at present. This still represents an attractive pick-up in yield – a rare commodity these days – and we continue to recommend a Neutral allocation.

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EQUITIES

Reinforcing Asia

With COVID-19 infections spiking and governments imposing new restrictions on activity, global equities came under selling pressure in late October. We expect a vigorous policy response from central banks and governments which should help limit downside for equity markets.

US. With over 50% of S&P 500 members having reported, Q3 earnings have surprised on the upside – almost 85% of reports so far have come in ahead of expectations. This being said, the fourth quarter is likely to see the recovery slow as pandemic control measures are reinforced. Moreover, a close-run contest for the White House could see legal challenges and recounts, exacerbating market volatility. Nevertheless, we do not expect a double-dip recession.

US equities are hardly cheap, trading at 22.7 times forecast earnings. Much of this year’s positive performance has been generated by a small number of expensive mega-cap technology and internet stocks – the IT sector index is currently trading at an 80% premium compared to the last 10 years. Nonetheless, these companies are clearly well-positioned to thrive in today’s challenging circumstances. We continue to offset exposure to tech with positions in more defensive, cheaper sectors like Healthcare and Utilities.

Eurozone. After keeping pace with US equities in the initial rebound from March’s lows, euro zone stocks have resumed their underperformance. There have been fewer positive Q3 earnings surprises than in the States and reports have only outstripped expectations by 3.5%. Moreover, the pandemic has taken a clear turn for the worse across the region leading to new restrictions which are likely to crimp growth for months ahead. While we expect the ECB to ease again in December, limiting downside risks for regional equities, we see better opportunities elsewhere and have decided to make a temporary move Underweight.

Energy and Real Estate, and upgrades are few and far between. In this context, we prefer to balance defensive plays like Consumer Staples, Healthcare and Utilities with the growth prospects in Technology.

UK. Yet another month has elapsed with no firm progress on the UK’s future trade regime with the EU. We still expect a limited-scope deal before year end but there is little time left for companies to adjust. UK equities boast attractive valuations compared with other markets, but COVID-19 and Brexit headwinds lead us to move Underweight for now.

Switzerland. Swiss equities have outperformed their regional peers year-to-date, in large part thanks to the defensive sector breakdown which helped cushion the downside during March’s sell-off. Corporate fundamentals remain robust – there has been no significant weakening in either return on equity or net profit margins – which should stand Swiss equities in good stead during bouts of volatility.

Japan. Tokyo has kept pace with global equities so far this year, demonstrating resilience during the selloffs in September and October. The country has coped well with the pandemic and the recession should be shallower than in other advanced economies. Japan is well-placed to benefit from growth in China, earnings should bounce strongly next year and the ratio of prices to cyclically-adjusted earnings remains close to multi-decade lows.

Emerging Markets. EM equities have failed to rise above their 2007 highs in recent years while earnings have continued their upward trend (see chart). Moreover, analysts expect a strong 33% bounce in earnings in 2021 following a relatively shallow 9% decline this year. Most of this resilience comes from Asia, in particular from China, South Korea and Taiwan, the only three EM where earnings are expected to rise this year. With the pandemic well under control and GDP growth picking up, we have moved to a strong Overweight in emerging Asia.

The gap between prices and earnings favours Emerging Markets

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CURRENCIES

Seeking safe havens for now

In the near term, renewed restrictions on activity across Europe are likely to heighten macro risks and market volatility, sparking safe-haven buying of US dollars. Longer term however, we expect dollar headwinds to prevail. A lasting rally in emerging market (EM) currencies should remain under pressure for now.

**Dollar Index.** After losing some 10% from March’s highs to September’s lows, the dollar index has traded sideways in a range as we expected. There have been periodic bouts of strength, mainly linked to risk aversion, but these have proved short-lived – the fundamental backdrop of zero rates, a flattened yield curve and enormous twin deficits does not represent a bullish environment for the US dollar. The worsening pandemic may attract safe-haven flows to the dollar for now, but we expect lower levels in 2021.

**EUR/USD.** The euro had a strong run higher against the dollar in July but has moved little since then. Part of the summer vigour can be linked to July’s agreement by the European Union to launch the €750bn Next Generation EU (NGEU) recovery programme, a necessary building block towards fiscal solidarity which has soothed market concerns about euro zone breakup. In addition to the dollar headwinds mentioned above, the euro looks cheap, well below the OECD’s 1.42 estimate of EUR/USD purchasing power parity.

**GBP/USD.** Trade negotiations with the EU have proved fraught and fruitless thus far, which has helped keep the pound low against the dollar. We believe that a limited-scope deal is the most likely outcome, one which would likely prompt a bounce in sterling. However, we would not expect such a relief rally to herald a lasting uptrend – UK businesses will take time to adapt to a less favourable trading regime with their largest export market.

**USD/JPY.** Over recent months, the yen has traded steadily higher against the dollar, getting ever-closer to its early-March highs of close to 102. The surprise illness and subsequent replacement of PM Abe by his chief cabinet secretary Yoshihide Suga failed to interrupt the strengthening trend. Japan has weathered the COVID-19 storm much better than other advanced economies and stands to benefit from China’s rapid recovery from recession. More yen strength could lie ahead.

**EUR/CHF.** October has seen a modest rise in the Swiss franc, up 0.8% as traders began to realise that approval for the NGEU fund would take time. This has prompted a flurry of EUR purchases by the Swiss National Bank (SNB), even though EUR/CHF remains comfortable above the 1.05 level where recent interventions have been triggered. Looking ahead, we still expect modest franc weakness.

**EM currencies.** The JP Morgan index of emerging currencies remains slightly above April’s all-time lows. The perceived probability of a Biden presidency has put pressure on currencies of countries which might face a harder line – like the Russian rouble – and Turkey’s unorthodox monetary policies and depleted foreign exchange reserves have seen the lira plummet lower. There are bright spots – notably in Asia – but EM currencies are unlikely to stage a lasting rally for now.

**USD/CNY.** The renminbi has gained ground steadily against the US dollar since late May. The pandemic remains well under control and the economy has suffered less than its peers – China is the only major economy expected to see an increase in GDP this year. Moreover, expectations of a Biden presidency suggest a less unpredictable approach to relations with China, removing some of the downward pressure on the currency. Looking ahead however, the pace of renminbi appreciation may slow, now that the exchange rate is back in line with its 4-year average.

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Moving Underweight Oil

Given the impact of new COVID-19 restrictions on demand, we move Underweight oil. We expect Asian demand for gold jewellery to recover and we maintain our Overweight. Our preferred hedge fund strategies remain Merger Arbitrage, Long/Short Credit and Global Macro, especially discretionary and emerging market traders.

Commodities

Oil

Crude oil prices have continued to weaken, with Brent dipping below $40 per barrel in recent weeks. The latest wave of COVID-19 infections has led to new restrictions on activity, and mobility and travel are likely to remain depressed in months ahead. The International Energy Agency expects total global demand to fall faster this year than supply, down 8.4 m barrels per day (mb/d) versus -7.1 mb/d.

The current output cap set by OPEC and Russia is due to increase by 1.9 mb/d from January 1 and Libya – which is not bound by the agreement – is currently ramping up production, adding perhaps another 0.7-1.0 mb/d to 2021 supply. It would be difficult for the market to absorb these additional volumes and we expect the next OPEC/Russia meeting to agree to maintain output cuts.

All in all, oil inventories should continue to build again, keeping downward pressure on crude prices in the months to come and we move Underweight.

Gold

Gold prices have continued their consolidation after reaching overbought all-time highs in early August at $2,060 per ounce. Q3 mine output bounced after Q2’s 10% fall but remains down 3% year-on-year (YoY). In partial response, gold recycling activity recovered to reach the highest quarterly total since 2012. However, demand for gold dropped 19% year-on-year in Q3 as COVID-19 severely disrupted the jewellery sector. With many retailers closed and celebrations like weddings postponed, demand for jewellery was down 29% YoY, taking aggregate demand below 1,000 tonnes (t) in the first three quarters for the first time this century. Central banks also turned modest net sellers of gold in Q3 – on closer inspection however, it transpires that most of the sales were conducted by only two countries, Turkey and Uzbekistan. On the other hand, investment demand remained robust, up 21% YoY – buying of bars and coins jumped 49% to 222t while inflows to ETFs generated 273t of purchases, up 5% on Q3 2019.

We believe jewellery demand will recover as Asia emerges from COVID-19 restrictions and remain Overweight.

Hedge funds

Long/Short (L/S) Equity

As expected, volatility has risen in the run-up to the US presidential election, driven also by the sharp rise in new COVID-19 infections. Moreover, dispersion in returns – which helps measure how differently stocks in a given market behave – has fallen sharply from recent highs, making life more difficult for Market Neutral managers. We remain Underweight.

Event Driven

We have further downgraded Special Situations funds to Underweight. These managers play idiosyncratic situations such as turnarounds and spinoffs and tend to run portfolios with relatively high sensitivity to moves in stock prices. We prefer Merger Arbitrage – a number of jumbo deals have been announced and deal spreads continue to widen, offering attractive arbitrage opportunities.

Fixed Income Arbitrage

L/S Credit Arbitrage continues to look attractive. The strategy offers attractive levels of potential returns – an advantage when yields are generally so low – and managers have proven adept in risk management, thanks in large part to their strong credit analysis, which helps reduce volatility in portfolio returns.

Global Macro / CTAs

The market remains challenging for trend-following managers (known as CTAs) – trends in both equities and bonds have proved prone to sharp reversals so far this year. There are better opportunities in Global Macro funds, where we like both the highly tactical approach of Discretionary managers and also funds focusing on the additional yield (or “carry”) in EM currencies and debt.

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