ISSUE 47 AUTUMN 2020

Hub News

INFLATION VS DEFLATION
The road ahead

RESPONSIBLE INVESTING
Alphabet soup

After the pandemic... what next?


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CONTENTS

WELCOME

If investors had hoped for a short, sharp impact from Covid-19, followed by a return to business as usual, they will have been sadly disappointed. The virus has proved stubbornly resistant to all the efforts employed to contain it, with economies bearing the brunt of ongoing lockdown measures and the future still uncertain.

We can now add a number of other uncertainties into the mix: the US election looks set to be hotly contested with the candidates tightly drawn in key swing states. For UK investors we must add in Brexit. While there appears to have been some thawing of tensions in recent weeks, there is still a mountain to climb before the October deadline.

Markets, however, seem optimistic that these problems can be weathered. Since the March lows they have raced ahead apparently untroubled by any looming crises. Many believe this has left them vulnerable, particularly in highly valued areas such as the FAAMGs. These have started to wobble of late.

Advisers have got their clients through these types of problem before and, invariably, will do so again. Keeping people invested and able to participate in the recovery has been vital in preserving long-term wealth and shows the value of advice. In this month's issue, our partners and sponsors give you insights and ideas to help you navigate the path ahead.

As always, we hope you find the magazine an illuminating and insightful read. Please send any thoughts or feedback to **enquiries@adviser-hub.co.uk.**

Cherry Reynard
Editor
www.adviser-hub.co.uk

MARKET UPDATE

HAVE YOU GOT TIME FOR A COFFEE?

This year's extraordinary market volatility has left us all feeling exhausted. LGIM's Multi-Index unfiltered virtual coffee breaks have been designed to give a much-needed boost to navigate the uncertainty.

Sit back and watch Justin Onuekwusi, Head of Retail Multi-Asset Funds and Lars Kreckel, Global Equity Strategist, pore over the US technology concentration conundrum.

The recent rally saw US technology stocks dominate market returns. While there still is an investment case for technology, we believe there is a significant concentration risk that you need to know about, especially if you are a global index investor.

No venti triple, skinny milk, sugar-free vanilla syrup flourishes here. And no presentations with 1,000 slides. Just our freshly brewed insights on the issues that matter the most to you and your clients.

Catch up with us at **lgim.com/multi-index**
For investment professionals only. Capital at risk.

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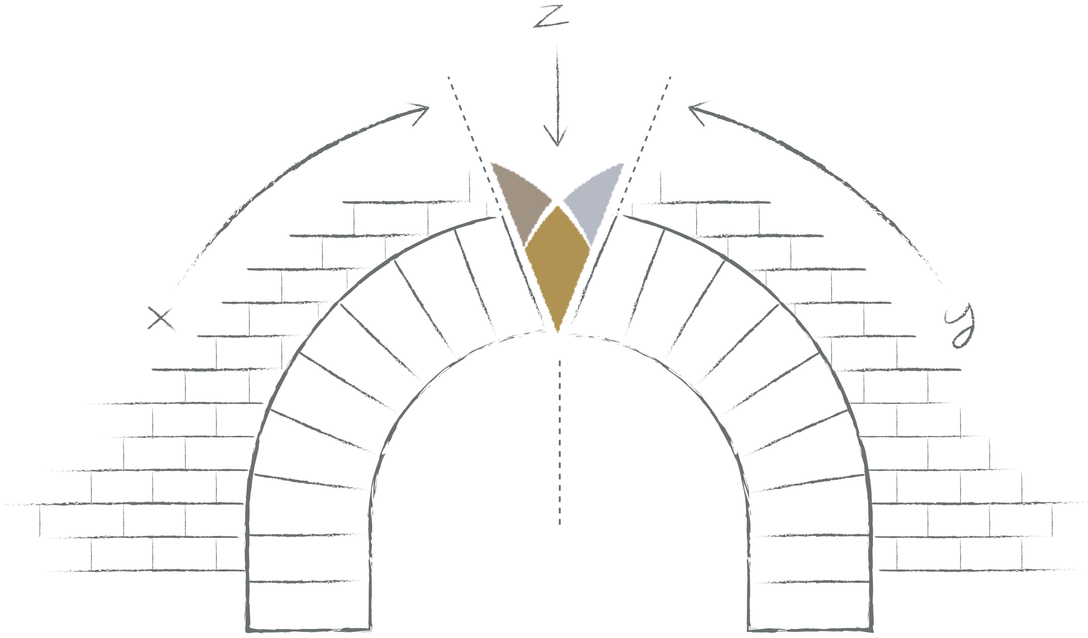


In uncertain markets, a solid foundation is paramount. The BNY Mellon Long-Term Global Equity Fund can act as a keystone, aiming to provide long term stability for any portfolio, to better withstand the market forces that may come its way.

BNY Mellon Long-Term Global Equity Fund

Managed by:

WALTER SCOTT

The value of investments can fall. Investors may not get back the amount invested.

MULTI ASSET

KEEPING AN EYE ON DISINFLATIONARY FORCES

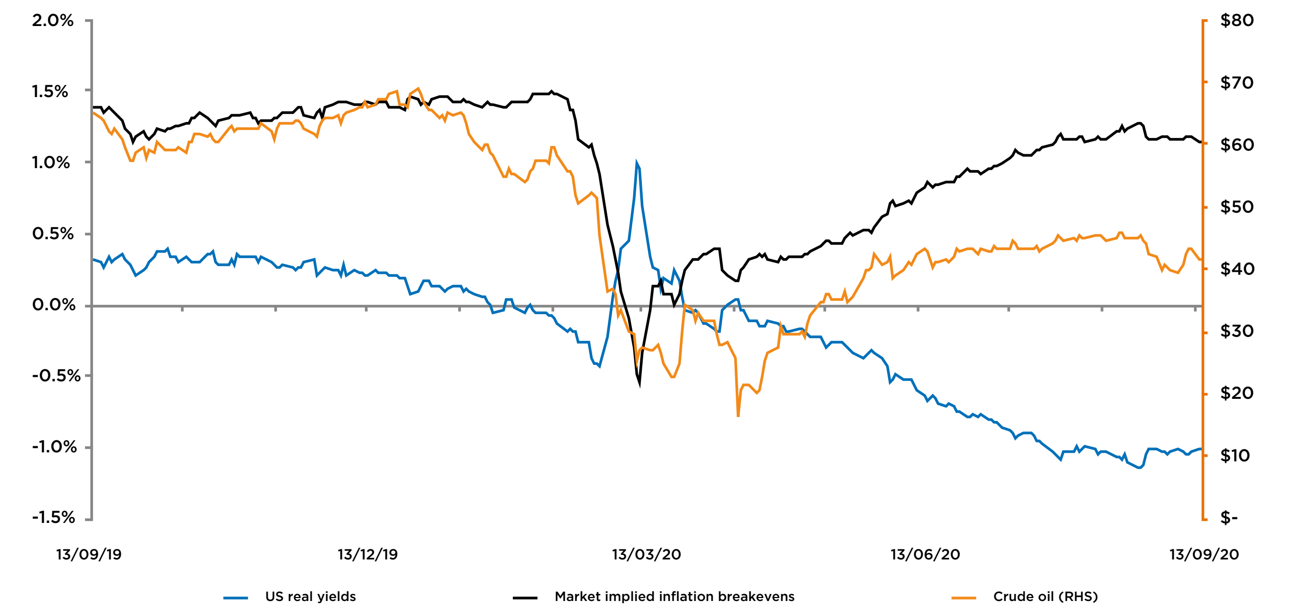
The Fidelity multi asset team explains why it is important to watch how the global inflationary backdrop is evolving.

In the wake of the pandemic, we have seen extraordinary large-scale global monetary stimulus efforts and a change in the stance of major central banks away from inflation targeting and towards inflation averaging to boost growth. The question of whether these policies will stimulate inflation or not remains a hot topic for investors across the board. Our team is watching closely to understand how the global inflationary backdrop will evolve, positioning Fidelity's multi asset income strategies in line with broad disinflationary views overall, while remaining alert to the risk of rising yields in the near term. Indeed, we see a number of signs of disinflationary forces at play in the global economic picture, and these will be important to watch over the coming months.

One of the key signs of disinflation is the sizeable output gaps emerging around the world. The 7.5% gap between supply and demand in China, as well as other historically high output gaps, points towards too much excess supply for businesses to be able to pass on sustainable price increases to consumers. The demand side also looks weak, and likely to remain so given ongoing low expectations for future income. Indeed, the wage inflation required for persistent inflation is hindered by weak employment data globally, even in Asia - the leader of the recovery so far. It is also difficult to see rising inflation coinciding with the credit contraction that we are seeing in some areas. For example, money supply in the US might be running high, but the velocity of money has collapsed with households using stimulus payments to pay down credit card debt and increase savings to an elevated personal savings rate of 2.5 times pre-Covid levels. US consumer credit card debt has contracted in five out of the past six months and credit card balances have reduced at an all-time high of 20% annualised rate.

All these factors are reflected in concerning data. The recent eurozone CPI of -0.2% was not only below expectations but was also deflationary (as opposed to just disinflationary) in direction, while inflation measures for China and emerging markets are at all-time lows.

FIGURE 1: US REAL YIELDS, 2-YEAR MARKET IMPLIED INFLATION BREAKEVEN AND CRUDE OIL PRICES



Source: Fidelity International, Refinitiv Datastream. 17 September 2020.

"Money supply in the US might be running high, but the velocity of money has collapsed with households using stimulus payments to pay down credit card debt and increase savings."

But shouldn't liquidity, fiscal spending and the Fed's average inflation targeting policy lead to more inflation? While it's reasonable to assume in theory that credit growth should lead to inflation, our team sees that this link has been broken down since the 1980s. Inflation has mostly gone to financial asset prices and increasing inequality with it. For the real economy on the other hand, each round of QE brings with it an inflation expectation that only proves to be short-lived, leaving the rest of the economy still very much fighting disinflationary forces. The more asset prices become disconnected with the real economy, the more destabilising a spike in nominal or real yields may be.

It's clear that inflation (or disinflation) will remain front of mind over the coming months, but what does this really mean for income-seeking investors? Of course, inflation is a challenge to any income-seeking investment strategy. Given the extent of policy action we have seen, our team is cognisant of the risk of rising yields and some inflation in the medium term, and Fidelity's multi asset income-focused portfolios are positioned accordingly to insulate against this. Currently we maintain relatively low duration, both in terms of fixed income and equity sector real duration. For example, we are reducing our US investment grade corporate bond exposure as increased duration has made fundamentals less appealing. While we are mindful of the risk of an inflation-driven back-up in government bond yields, we are comfortable with taking duration risk on Chinese government bonds, which have shown their defensive qualities during the March lows this year, while offering an attractive yield pick-up over developed market government bonds.

We have also been reducing exposure to leveraged loans and instead adding to high yield corporate bonds. Leveraged loans typically see inflows and outperform high yield bonds when Libor is rising or expected to rise. Current Fed policy may therefore render loans structural underperformers compared to high yield over the coming years, as Libor will likely be anchored to very low levels. Meanwhile, high yield credit has benefitted from the Fed backstop, resulting in a resilience over the past month against the equity volatility we have seen.

We're now at an important inflection point where in practice, our team's approach to thinking about disinflation is centred on having the conviction to act if and when yields rise, seeing this as a potential buying opportunity to add duration rather than a trigger to play a momentum sell-off in developed market rates.

Overall, we believe that inflation will remain one of the most important stories for investors as we move through the rest of 2020. We are watching the global macroeconomic backdrop closely, continuing to draw on the analysis of Fidelity's dedicated macro research team to understand its likely trajectory over the coming months. We believe it's important to position income-focused strategies for a number of disinflationary forces while remaining flexible to adjust exposure in response to any changes in this unfolding picture.

Fidelity Multi Asset Income team
Eugene Philalithis | George Efstathopoulous | Chris Forgan

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Structural change, durable opportunities

Seeking companies that deliver on tomorrow's needs, not yesterday's.

The world around us is always changing, in ways large and small. Our Global Equities team believes the key to success is to find the significant changes, and then identify the stocks that benefit most from them.

Here are a few examples of structural change where the team see opportunity:

The move to cloud computing
Cloud companies are gaining market share from legacy providers at an accelerating rate.

Medical devices and technology
A post-coronavirus world is one that pays much closer attention to the importance of fast and accurate medical diagnostics.

E-commerce
This trend isn't sneaking up on anyone, dating back to 1997 when the first book was purchased on Amazon.

To find out more about our Invesco Global Focus Equity Strategy and the investment process behind it, visit **invesco.co.uk/globalfocus**

Investment risks: Capital at risk. The strategy invests in a limited number of holdings and is less diversified which may result in large fluctuations in value. The strategy may use derivatives and this may result in greater fluctuations in value. The strategy can invest in emerging and developing markets, where there is potential for a decrease in market liquidity, difficulties in dealing and settlement, and custody problems could arise. The strategy may access shares traded in mainland China, this may result in additional liquidity risk, operational risks including settlement risk, default risk, regulatory risk and system failure risk.

THE INVESTMENT CLIMATE AND WHAT IT MEANS FOR MARKETS

As economies begin to reopen, Invesco's Richard Batty and David Aujla of the multi asset team discuss the market impact and what investors might expect looking forward.

The unlocking of economies is causing a rebound in activity with the prerequisite pick-up in profits expectations, albeit from a very low base. After the initial surge in activity as business and consumer pent-up demand comes through, the longer-term recovery will be slow and difficult as economic disruption and disinflation will remain, absent a universally available Covid vaccine. Structurally high unemployment is likely set to persist for many years as economies adjust to the new 'normal'.

Investors will potentially have to get used to renewed lockdowns as and when the disruptive head of Covid reappears - although governments now appear more willing to close towns and cities rather than whole economies in order to limit the economic damage. The policy response to the economic disruption has been strong, both in actual and promised monetary support mechanisms ranging from liquidity and credit provisioning and interest rates capped close to zero. Central bank quantitative easing (QE) is funding aggressive fiscal expansion, including quasi 'modern monetary theory' (MMT), and direct 'helicopter money' via grants. This has supplied a real lifeline to many businesses.

What does this market backdrop mean for markets? Equities have already enjoyed a strong rally since the worst of the Covid induced sell-off in the early part of 2020, but despite this most markets don't look highly overvalued. At present investors are looking at low discount rates and monetary support as an investment justification. Capital is being allocated to parts of the equity market that look set to survive in the longer term just as new-economy disrupter stocks take market share from traditional bricks-and-mortar businesses. The lack of return potential from alternative asset classes such as government bonds and cash is directing investors towards equities.

One note of caution going forward is that despite the strong recent rebound, equities maybe vulnerable to further volatility as longer-term profits expectations look too elevated at present and rely on a continued improvement in earnings expectations that are starting to appear.

Credit spreads are discounting different default outlooks and as a result, there appears more value in investment grade than high yield, which could be vulnerable to corporate profit uncertainly. Helpfully though, some government bail-out schemes have targeted credit across the risk spectrum. The appetite for high yield names may be limited due to ratings downgrades, but there is also high investor demand as some yields look attractive. Indeed, high investor demand for credit has allowed many corporates to issue bonds to support their balance sheets relatively cheaply.

Emerging market debt yields, despite the credit risk, remain attractive as local central banks appear willing to ease policy, including deploying QE, to counter recession even if that means currency weakness and the chance of higher imported inflation.

The major central banks are targeting government yield levels close to zero, with sustained curve steepening likely to be met with bond buying, suggesting the return outlook for this asset class is limited unless there is a further sustained economic slowdown. The compression trade is still playing out in the US relative to Europe, but all other major bond markets are seeing yields close to zero and so return potential from here is limited. Central bank targeting of both the curve and yield levels, as part of monetary policy, will also keep bond volatility unusually subdued in this recovery when compared to past recoveries.

For more insights and resources from our Multi Asset team, who managed the Invesco Summit Growth Range and other long-only multi asset funds, please visit **invesco.co.uk/summitinsights**

"At present investors are looking at low discount rates and monetary support as an investment justification. Capital is being allocated to parts of the equity market that look set to survive in the longer-term."

Investment risks
The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. The Invesco Summit Growth Range has the ability to use derivatives for investment purposes, which may result in the funds being leveraged and can result in large fluctuation in the value of the funds. The funds may be exposed to counterparty risk should an entity with which the fund does business become insolvent resulting in financial loss. The securities that the funds invest in may not always make interest and other payments nor is the solvency of the issuers guaranteed. Market conditions, such as a decrease in market liquidity for the securities in which the fund invests, may mean that the fund may not be able to sell those securities at their true value. These risks increase where the fund invests in high yield or lower credit quality bonds and where we use derivatives. The funds invest in emerging and developing markets, where there is potential for a decrease in market liquidity, which may mean that it is not easy to buy or sell securities. There may also be difficulties in dealing and settlement, and custody problems could arise.
Richard Batty, Multi Asset Fund Manager and David Aujla, Multi Asset Deputy Fund Manager, Invesco

Important information

KEEPING A QUALITY FOCUS IN A POST-COVID WORLD

After a more dramatic start to the new decade than anyone predicted, the Quality investment team at Ninety One explains why the current UK equity environment is suited to a focus on resilient companies that can offer downside protection during falling markets, and meaningful participation in rising markets.

Having navigated the summer months of a remarkable year, it is worth reminding ourselves that the outlook from here is still very uncertain. From an economic perspective, the UK is now in a significant recession, and while governments globally – and particularly in the UK – have tried to mitigate some of the downside, the reality is when companies are not investing, consumers aren't spending and banks aren't lending, it is very difficult to see economic growth recovering quickly, or a 'V-shaped' recovery.

It is going to take time for confidence to trickle back into the economy and the confidence that the economy needs comes from the science and not from politicians. Therefore, the crucial catalysts to watch for are whether a vaccine is created, or whether we get a second wave of the virus. With that in mind, markets could remain volatile.

Trying to explain the sharp equity rally against such a bleak economic backdrop is not without its challenges. A phrase that comes to mind is 'TINA' (there is no alternative) and, to a degree, equities still remain the go-to place where many feel they can capture positive returns. Having said that, valuations remain full, and this low-growth environment will make it very difficult to generate top-line growth or an improvement to margins. Therefore, investors should consider focusing on owning those companies that can navigate a world of geopolitical and economic stress, and structural change.

WHAT ARE THE CHARACTERISTICS OF A QUALITY COMPANY?

Within the Quality investment team at Ninety One we define high-quality companies as those with hard to replicate, enduring competitive advantages, dominant market positions with sustainable business models that enables them to grow their profits over time. These companies have strong, healthy balance sheets, and typically low capital intensity, which means they convert their profits into cash.

This is crucial; measuring the amount of cash a company generates as a percentage of its market cap is our key metric that we use across our UK, global and regional quality funds; whether they focus on growth or income for investors.

Whatever the economic backdrop, revenues tend to be repeatable for quality companies because they tend to offer products and services that people need. This can relate to a huge breadth of businesses, from medical device makers to elevator manufacturers through to staple food producers: all make goods that are needed through any form of economic environment, ensuring a stable cash flow stream.

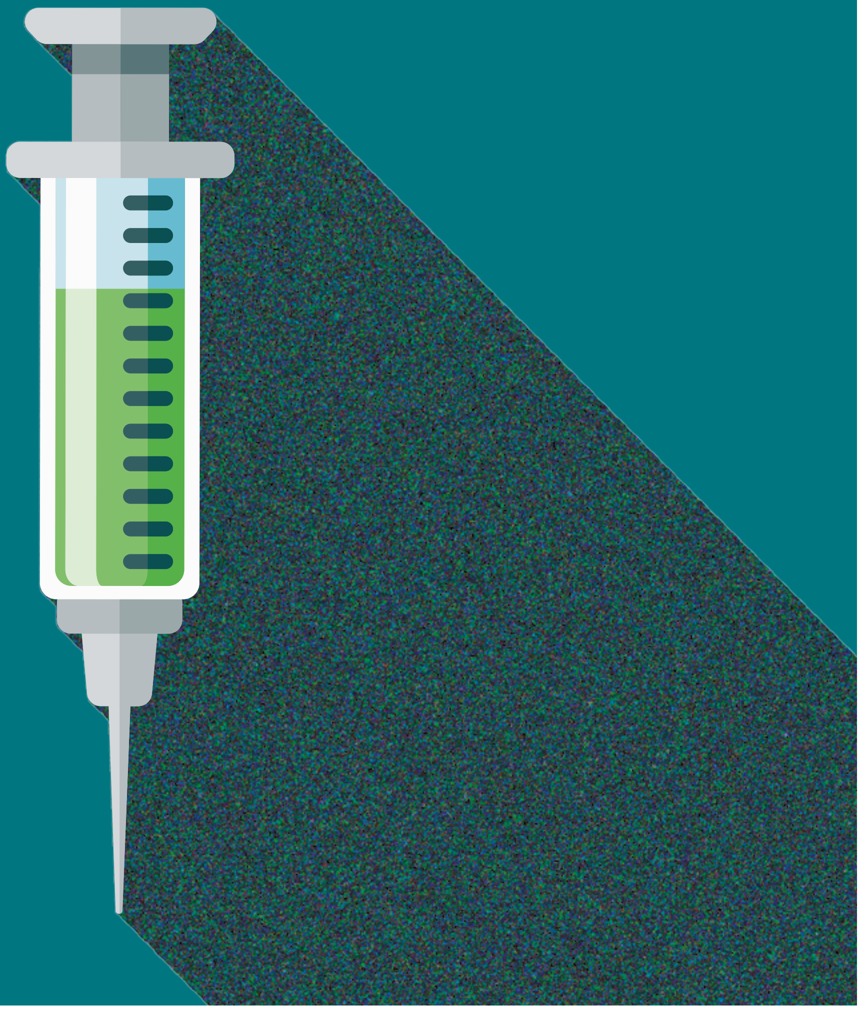
However, this is still not enough to make an investment. Most important of all – and this is an area often overlooked – is capital allocation. This can literally make or break a company. How does a business reinvest its cash flow? Does it return it to shareholders through share buybacks or dividends? Does it pay down debt or does it reinvest this capital at high rates of return back into the business? Companies with prudent, positive capital allocation policies are likely to provide sustainable returns through any form of equity market.

HOW DO SUCH COMPANIES TEND TO PERFORM OVER A CYCLE?

Another compelling feature of these companies is this operational resilience typically translates into share price resilience during downturns, while also being able to participate meaningfully during rising markets. These companies can maintain their high levels of return through long periods of time and, often, markets underestimate the ability for such companies to continue to grow, reallocate capital appropriately and, ultimately, grow the value and the cash flow they can return to shareholders.

Within the RSMR-Rated, Ninety One UK Alpha Fund, at least two-thirds of the portfolio is invested in these resilient Quality companies. We are also able to take advantage of best-of-breed cyclical businesses and restructuring/recovery opportunities that are trading on attractive valuations. We believe these are the cyclical businesses best positioned to thrive in a post-Covid world. It's this blend of Quality and quality cyclical businesses that, we believe, should see the Fund best positioned to

"It is going to take time for confidence to trickle back into the economy and the confidence that the economy needs comes from the science and not from politicians."



navigate the volatile markets ahead.

It's important to stress that we remain in a deeply uncertain environment with very real risks facing investors. No matter what happens with the battle against Covid-19, the Brexit scenario is rearing its head again as the UK and EU seek to agree a trade deal. There is a high possibility that we have a 'no deal' at the end of this year and that will have a significant impact on many companies. Therefore, in our view, this lends itself to a focus on allocating capital to these defensive, resilient companies that can provide more certainty in these uncertain markets.

The value of investments, and any income generated from them, can fall as well as rise. Where charges are taken from capital, this may constrain future growth. Past performance is not a reliable indicator of future results. Investment objectives and performance targets may not necessarily be achieved, losses may be made.

For more information on our Quality approach to investing, visit: **https://www.ninetyone.com/ourquality**

IT WAS NEVER ABOUT THE PRODUCT

Lawrence Cook, Head of UK Intermediary Distribution at Sanlam, takes a closer look at what your clients really value.

Whether you are a financial planner, adviser, investment manager or provider of any intangible service such as law, the training and qualifications you garnered over many years didn't properly prepare you to understand the fundamental truth that the transaction you provide is of little or no interest to clients and is not what they want to pay you for anyway.

You might be able to calculate a Sharpe ratio; well done. You might think you have a very good insight into investment markets and can make good judgements about timing of asset allocations in your client portfolios; good luck to you.

Technical matters and all the administration that goes with it are all secondary to what the client is actually interested in of course. Client interest lies in their own lives and what they want to achieve or perhaps avoid. The fact that they might recognise they need your service isn't something they want to celebrate, it is just a matter of needs must.

In other words the buying of intangible professional services is not a pleasure purchase. During lockdown I decided to upgrade my wireless speakers in the home so I can listen to my music and podcasts in any room I choose. Now that was a pure pleasure purchase. The need at some point to have my pension drawdown affairs sorted out will not be a pleasure purchase.

None of this means the services we provide are inconsequential; quite the reverse. We should remind ourselves that the product or transaction that we deliver, often within a regulatory ambit, is not what clients are actually interested in. It is their lifestyle and all that goes with it they are concerned about.

Recently, I have spent time working with financial advice businesses and discretionary investment managers helping them to focus on what really matters to clients and turning that into commercial success. The essential truth running through it all has been a constant for as long as I can remember – focus on the client need.

Some years ago in discussions with law firms, they shared some frustrations with me around the profitability of the private client operations within their businesses. Both firms were in the

“Technical matters and all the administration that goes with it are all secondary to what the client is actually interested in of course: client interest lies in their own lives”

medium/high price bracket based in posh market towns, operating from several offices and well regarded in the professional community.

It was quite clear after some digging that the vast majority of private clients transacted one service and that was it, typically, a will. If these firms were at the low price end of the market then perhaps focusing on a fast, slick operation to deliver high volume of wills and nothing else would be ok. However, these firms were pricing themselves to suggest that the client was getting a lot more than a piece of paper as their last will and testament. But were clients getting anything else? If you count up-market tea from bone china in a wood-panelled office then yes, but not much more.

When I asked whether their will service was worth the price, they were adamant that it was good value. After all, they employed top-class lawyers and staff. Clients got the very best service. But having top quality lawyers didn’t seem to lead to any aspect of service value that one could put a finger on. What was ‘the very best service’? Nothing really that separated them from another firm of lawyers that offer the same will at half the price, albeit with lower-grade tea and biscuits.

And to compound the problem, some 90% of clients were just transacting one item and this was not profitable despite charging a chunky fee.

Meanwhile in reception, I was able to pick up a brochure that told me all about the wide range of private client services - quite impressive. If the firm had these services why weren’t clients buying them?

I was puzzled as to why - if they had a great range of services, top lawyers and the very best service - they were not getting clients to buy more from them.

We then got into how they engaged with clients. Luckily for law firms lots of people every day recognise they need to get a will sorted out. They pick up the phone to a law firm and make an appointment. Surely then once the client was sat in front of a lawyer there would be ample opportunity to introduce other services of potential interest. It turned out that the law firms in question here had focused on making the client meetings short and to the point, because that was more efficient – one partner proudly told me they could do two wills done and dusted in an hour.

The logic they were pursuing seemed to be hell-bent on reducing the time spent even more to improve profitability. However there didn’t seem to be much fat left in the process of producing a will. The problem seemed to be the reverse of what they thought was the issue i.e. time spent on client engagement.

The lawyers were concerned about efficiency and had lost sight of the big picture with clients. So much so that when I suggested a wider engagement with clients this was met with indignation. The affront I had apparently caused was that this was tantamount to selling to clients and selling was not what they were about. Of course, just presenting products or services to someone is not very professional and a terrible sales strategy in any case.

The underlying fear our lawyers had was about themselves. They were afraid to ask questions of clients, afraid to venture outside their own comfort zone of law and documents. Overcoming personal fears about client engagement is I have found probably the biggest obstacle to a more profitable professional services business whether its finance, law or anything else.

Beyond the personal fears, lawyers also were genuinely concerned about the morals of talking about a service the client had not come to see them about. Therefore even if the lawyer felt discussing a trust in addition to a will was salient, there was reluctance to do so for fear of breaching some ethical code. Looked at another way this was a great client disservice, failing to look at the wider duty of care for clients. Thankfully this latter point became persuasive and we began in a deep dive on client engagement and how it could be enhanced for the benefit of clients and consequentially for the commercial benefit of the law firm.

One of the challenges was persuading some clever people that they could do a lot better by changing how they engaged with clients, not by knowing more law but by being prepared to talk about client issues in client terms with the potential for this to mean emotional connection.

The end result was a change to their whole business plan;

1. Spend more time, not less with clients.
2. Discover what the bigger picture is with clients but to only spend time on clients within a prescribed wealth segment that was likely to be an indicator of wider needs.
3. Provide fee earners with a client engagement track to follow – but not a script.
4. Measure the number of matters opened per client to see what impact the new approach was having.
5. Stop the planned increase spend on marketing – they already had more than enough flow of clients, they just needed to improve conversion.

Happily over time the firm improved their success with private clients which gave them more confidence to keep charging high-end fees and improve profitability.

The points covered here were with two law firms but the underlying issues are often the same in financial advice businesses - we just have different jargon. Whatever the challenges we face in business, if we keep our eyes fixed on solving client problems and achieving their goals we are likely to be well worth our fees.

TRUMP OR BIDEN - SHOULD INVESTORS REALLY CARE?

Politics can create short-term noise. But if you can withstand the volatility, it's best to sit on your hands and wait for it to pass, says Johanna Kyrklund, Chief Investment Officer and Global Head of Multi-Asset at Schroders.

There are two things I'm being asked about constantly at the moment: Covid-19 and the US election. As a former politics student who's always maintained my passion for the subject, I certainly feel more comfortable opining on the latter.

But as an investor, how much should I really care if the next US president is called Donald or Joe?

Although politics matters a lot more to markets than it used to, the answer is still probably "not a lot".

When I first came to work in the City in the late 1990s, political developments were of little interest to most investors. The political consensus had converged on a socially liberal and economically conservative agenda. Electoral outcomes had little direct impact on markets.

Times have changed. Today, political news has become a much greater source of volatility in markets; at times, just a tweet from President Trump has been enough to send markets into a spin.

Unlike the cosy political consensus of the 90s, politics has become more polarised. Particularly the arguments about how the economic pie is divided in a world where growth is more scarce and the gap between the haves and the have-nots is widening. At the same time, there has been a backlash against liberal attitudes on the social front. Trump's arrival on the US political scene was symptomatic of these big picture trends.

Trump's tenure as president has had a direct impact on markets, more so than most. The corporate tax cuts he introduced boosted corporate America, while trade tensions with China clouded the economic outlook, creating nagging uncertainty for investors over the past two to three years.

Most recently, Covid-19 has accentuated pre-existing trends. It's highlighted new forms of inequality, such as in access to healthcare, damaged an already fragile economic environment and challenged the frameworks of fiscal and monetary policy.

Additionally, we have seen the eruption of the Black Lives Matter movement, bringing race relations to the top of the political agenda, as my colleague Piya Sachdeva discussed recently.

These are all factors that will be at play in what is likely to be another close-run contest. At the time of writing, the polls point to a win for Biden and a divided Congress.

Such a result would likely have a muted impact on markets as the new president's ability to significantly change policy direction would be limited.

A Democratic sweep of Congress (i.e. a majority in both the Senate and the House of Representatives) could have more profound consequences, since President Biden would have much freer rein.

The Big Tech stocks, which have been dominating markets (as my colleague Sean Markowicz discussed last week), may be vulnerable as their high valuations reflect a perfect outlook. A strong Democratic victory might raise concerns that Big Tech firms will face tighter regulation, potentially clouding their prospects.

Another risk is that the election result is contested. President Trump has already cast doubt over the reliability of postal votes. If the polls narrow further and Biden wins by a small margin, the result could be contested, which would be highly disruptive to markets and the US economy.

The recent death of Ruth Bader Ginsberg may have added to the risk of a contested election result. Her death has sparked a debate over the make-up of the Supreme Court which looks like adding to an already hostile and divisive election.

So, what are my thoughts having been a fund manager through numerous political events?

Politics can create short-term noise. But if you can withstand the volatility, it's best to sit on your hands and wait for it to pass.

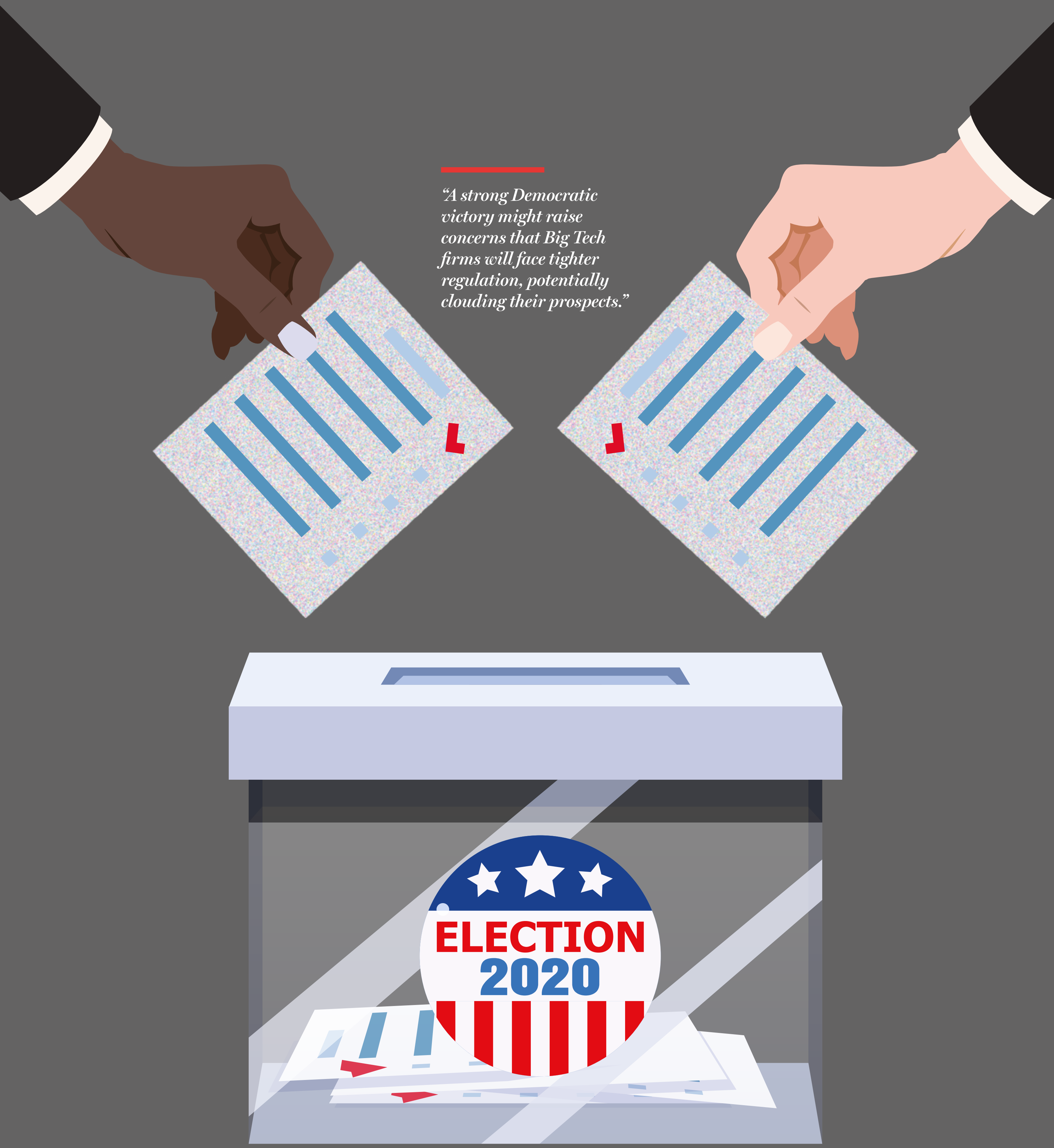
If you really have to trade, then it may be wise to bank any profits (such as from some of the Big Tech giants) before the election. But investors should always avoid knee-jerk reactions when results come out.

Although the market likes to focus on events like elections, political trends tend to play out over months and years. For example, should the Democrats complete a clean sweep, who is to say that regulation of Big Tech will be top of their agenda? There are likely to be other pressing matters to deal with and it could be some time until there is any negative impact.

In the meantime, as much as I would rather talk politics, the more important topic for markets and the economy is Covid-19. Here in the UK and across Europe, cases are rising and there is talk of going back into full lockdown.

The identity of the next US president is a sideshow in comparison.

"A strong Democratic victory might raise concerns that Big Tech firms will face tighter regulation, potentially clouding their prospects."

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SUSTAINABLE INVESTING

THE CLIMATE CHANGE IMPERATIVE

From California wildfires to Greenland's fragmenting ice shelf, the consequences of climate change are in the headlines daily. Randeep Somel, global equity fund manager at M&G, discusses how the group is investing in companies making an impact on carbon emissions.

To our mind, environmental, social and governance should always be a natural focus for long-term shareholders and M&G has long built it into its investment criteria. We will look at how companies are performing on areas such as governance, environment and social policy.

From here, our investment process takes it one step higher to look at impact investment. This is a natural progression. In November 2018, we launched the Positive Impact fund and this sought to find companies that have a good business model, but are also doing something good for the benefit of society in areas such as climate, health, environmental solutions, the circular economy or social inclusion. With impact companies, we want to make a positive social as well as an economic return. More and more investors want companies that have a positive economic benefit as well as a strong social impact.

This fund has a broad remit in terms of sector and geography to find impactful companies. We are finding that in the wake of the Paris Climate Change Agreement and the EU Green Deal, the focus on climate change has increased. To our mind, this should be a huge thematic tailwind for this part of the ESG market.

We have an experienced impact team. It comprises the heads of impact and sustainability, plus a number of specialists in areas such as emerging markets and multi-asset, as well as small companies. This is designed to bring in a range of perspectives. Every investment has to get through this process.

The team can't pass any company unless it is in a position to measure its impact. Sometimes the focus can be on getting companies to make those measurements. For example, we have worked with Darling Ingredients, which is a Texas-based meat rendering company. It picks up leftover meat (rendering) from abattoirs that would otherwise have decomposed and turns it into renewable diesel fuel. This fuel emits 85% less emissions than regular diesel. In 2019, through use of Darling's renewable diesel, close to 1.9mt of CO_2e (tons of carbon dioxide equivalent) were saved, nearly 1mt on a net basis.

We have another company that makes composite (wood effect) decking out of used plastic (such as carrier bags). The composite structure can last up to 50 years. We have worked with them and suggested they put out all environmental factors in their sustainability report such as water use, as well as CO_2 saving, making clear what we needed to assess their impact and progress.

Yes, for our impact fund we need companies to fulfil three criteria – investment, intent and impact. On the investment side, it needs to be a strong investment, with a good business model and a strong competitive position. Intent - is the 'good' it does intentional? We look at companies from a variety of angles to assess their overall impact: lots of companies say they are doing good, but do they have a net positive impact? We also need to be able to measure it, so it is important that we can access reliable statistics that can (where possible) be independently verified.

We have around 120 global companies on our watch list and there are new companies coming into our universe all the time as companies work on measuring their carbon impact. Darling Ingredients, for example, has been more vocal about its sustainability and impact credentials, which has led to it publishing its first sustainability report, also a first for a company in this sector. Companies can see that the market is rewarding these positive trends. The Paris Agreement is a huge positive and the Green Deal and EU taxonomy are likely to provide added impetus into 2021.

We are looking for disruptive companies that substitute and eventually replace products and services that are highly carbon

"We are looking for disruptive companies that substitute and eventually replace products and services that are highly carbon intensive. This is suited for companies that focus on long term goals, that have invested and continue to invest strongly in R&D."

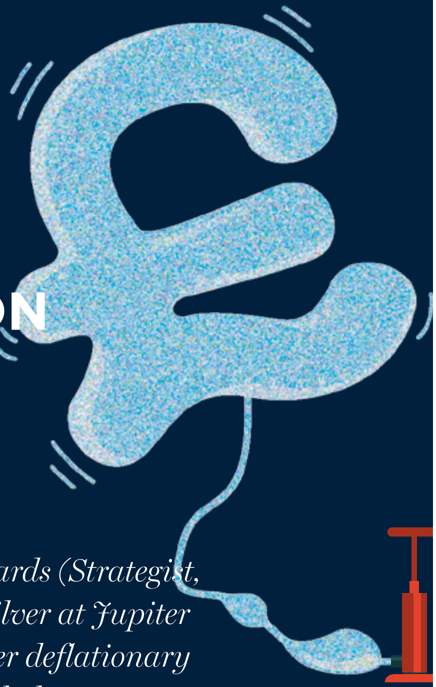
intensive. This is suited for companies that focus on long-term goals, that have invested and continue to invest strongly in R&D. Given the size of the opportunity and the positive tailwind, these companies are characterised as growth companies.

The lockdown due to the coronavirus caused a sharp reduction in economic activity and in transportation. This had a very positive effect on the air quality, especially in large urban cities.

This allowed the inhabitants of those cities to realise what was possible if we moved forward with clean technology alternatives at a greater pace. We have at our disposal the tools to have a much more meaningful impact with regards to the amounts of CO_2 we emit. In order for these changes to be enacted it will require a change in our own behaviours, shifts in the way we consume and also tightening of regulations.

The UN 17 SDGs have truly helped propel impact investing onto the mainstream because they provide a consistent framework, that is both intuitive and easy to use. Despite the fact that they were originally set up for governments, they've quickly been adopted by both investors and companies to frame their impact agenda. The ability to directly link an impactful company's revenues to the SDGs is a powerful and uncontroversial way to demonstrate its positive impact. To avoid the risk of overclaiming alignment with the SDGs, we carefully identify the dominant SDG for each investment.

MACROECONOMICS



INFLATION, DEFLATION ...OR BOTH?

Ariel Bezalel (Head of Strategy, Fixed Income), Mark Richards (Strategist, Multi-Asset) and Ned Naylor-Leyland, Head of Gold & Silver at Jupiter Asset Management outline their views on inflation, whether deflationary forces still hold sway in the global economy, what role deglobalisation may have to play, and address whether people are even thinking about inflation in the right way.

In this century, and since the global financial crisis (GFC) in particular, the world has been beset by deflationary pressures. Yet today there is much talk that higher inflation could be around the corner, a debate which has intensified since the Fed announced it would pursue Average Inflation Targeting (AIT).

Ariel Bezalel (Head of Strategy, Fixed Income) has been in the deflationary camp for many years, pointing to the powerful structural forces of too much debt, ageing demographics, and disruption from globalisation, technology and low-cost labour. Ariel's view is that Covid-19 has accelerated some of those trends, particularly with the massive accumulation of unproductive debt this year, which is simply backstopping the corporate sector rather than doing anything truly stimulative like investing in infrastructure. For these reasons, and perhaps controversially, given all the talk of inflation recently, he sees deflationary pressures as actually having intensified this year.

The views of Mark Richards (Strategist, Multi-Asset) are more in the inflationary camp. Mark agrees that structural deflationary forces are in progress, but what's changed for him is that for the first time in decades he can see a coherent narrative for why higher inflation may materialise. Deglobalisation is part of that, in Mark's view, as the impact of China entering the global labour market and global supply chain in the late 90s/early 2000s – which depressed labour's bargaining power – is now coming to an end.

Ned Naylor-Leyland, Head of Gold & Silver, believes that people are not looking at deflation in the right way. He doesn't see it as an either/or debate, saying that the global economy can have both inflation and deflation simultaneously, and in his view it does. Ned recognises that deflation exists in the monetary sphere, as the end result of about 40 years of policy decisions that have supported states and corporates at the expense of repressing the consumer. But he argues that if you asked people on the street about their experiences with inflation, you'd struggle to find anyone who thought their cost of living was going down.

There are no simple or easy answers to the question of inflation. The views held by Ariel, Mark and Ned reflect to some extent the conversations happening in the wider market. What all three agree upon, however, is that regardless of how things play out there will be opportunities to make money somewhere.

If you require any further information or have any questions, please do not hesitate to contact the Jupiter intermediary support team:

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Please note: Market and exchange rate movements can cause the value of an investment to fall as well as rise, and you may get back less than originally invested. The views expressed are those of the individuals mentioned at the time of writing are not necessarily those of Jupiter as a whole and may be subject to change. This is particularly true during periods of rapidly changing market circumstances.

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Find out more by watching our film at income.bailliegifford.com
BAILLIE GIFFORD
Actual Investors

ACTUAL INCOME

James Budden, director of marketing and distribution at Baillie Gifford, discusses the group's 'Actual Income' campaign – and how it can help income investors build resilience into their portfolios after a tough period.

AS WITH ANY INVESTMENT, YOUR CLIENTS' CAPITAL IS AT RISK.

The pandemic has exposed some vulnerabilities in the way that many investors seek income from their investments. It is not new to say that UK investors tend to be overly reliant on a concentrated group of large, staid companies for their income, but the last few months have brought the problems under an uncomfortable spotlight.

UK dividends have fallen by around half. While the UK has been among the worst hit, a number of other countries have also seen their payouts slide. Importantly, the crisis has hit some of the largest dividend-paying sectors – such as oil and gas – particularly hard. It many cases, the pandemic has forced a tough reappraisal in what constitutes 'resilient income'.

Many investors will now be feeling the full force of those cuts in the income they rely on to support themselves in retirement, pay school fees or supplement their income. Yet the need for a high and growing income is even more pressing as interest rates have been cut further and quantitative easing resumed. Baillie Gifford's 'actual income' initiative has been designed to encourage investors to look more closely at the resilience of their income stream and to 'build back better'.

THE IMPORTANCE OF GROWTH

The starting point for our income approach is that any company needs growth to be able to continue providing income to investors. This may sound counterintuitive, but it is only through growth that companies have the earnings to grow their dividend or repay the coupon on a bond. Too often, investors gravitate to low-growth companies that over-distribute. When crises arrive, as they inevitably do from time to time, those companies are found out and investors find their income is far less secure than they thought.

Our approach is to look for companies in higher growth markets, where earnings are rising sustainably and which are run in an effective and ambitious way by a capable management team. Companies should have strong balance sheets and resilient cash flow. This may mean accepting a lower starting yield, but over time income payments should catch up and then outpace those companies with higher headline yields.

A high headline yield can draw too much attention, in our view. While there will be exceptions, it seldom denotes resilience by itself and may often imply the opposite. Too often, high yields are to be found in low-growth sectors, where businesses only exist to pay dividends to demanding pension funds, rather than because they are attractive growth businesses in themselves.

WHAT IS 'SAFE'?

Too often a high starting yield is seen as a mark of safety. We believe this needs to be reappraised. In our credit portfolio, we like companies such as Netflix, Co-op, Tesco and Virgin Media, all solid names that have proved far more successful than many of the traditional 'safe havens' in the recent crisis. We believe it is a mistake to assume that because a company is large, or well-established, that its income is secure. Income investors must always keep an eye to the future. Across all asset classes, we want to be sure in the ability of the underlying assets – bonds, equity, infrastructure and so on – to pay an attractive level of income.

It is notable that in this crisis, it is those companies with momentum that have proved resilient. Those that were leading the market have got bigger and stronger. To us, this isn't surprising when you consider what these companies do.

A global approach is vitally important. It is not that the UK doesn't have fast-growing companies that can pay an income to investors, but investing globally significantly broadens our opportunity set. This is likely to be particularly important in the wake of the Coronavirus crisis, where some economies and sectors have suffered vastly more than others.

At Baillie Gifford, we have set out our stall as 'actual' investors. We believe the investment industry has a fundamental role in financing great, ambitious ventures and the companies of the future. From healthcare to transport to alternative energy, progress rests on technological breakthroughs, smarter distribution models, building better and more efficient infrastructure, imagination and creativity. This is not incompatible with income investing. We believe delivering a long-term resilient income stream to investors is best done through investing in growth companies. Only then, can investors cement real resilience into their income portfolios.

BAILLIE GIFFORD'S 'ACTUAL INCOME' FUNDS
GLOBAL INCOME GROWTH
STRATEGIC BOND
HIGH YIELD BOND
MULTI-ASSET INCOME

"It is only through growth that companies have the earnings to grow their dividend or repay the coupon on a bond. Too often, investors gravitate to low-growth companies that over-distribute."

ASIAN INVESTING

Dhananjay Phadnis
Fidelity FundsNetwork

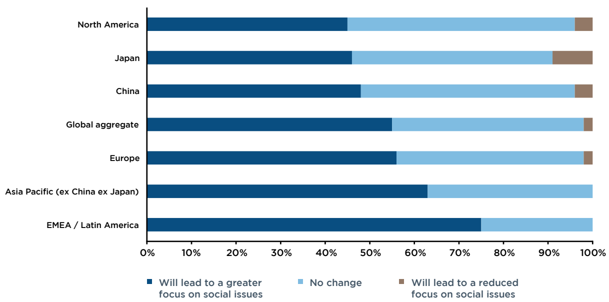
SUSTAINING RETURNS IN ASIA'S NEW WORLD

Fidelity portfolio manager Dhananjay Phadnis looks at the five key questions that investors in Asia need to consider.

The Covid-19 crisis has provided Asian companies with a unique opportunity to look beyond the narrow focus of how to meet this year's financial targets. As a long-term investor, I have been encouraged that an increasing number of companies are clearly using this crisis as an opportunity to protect and enhance the long-term value of their businesses. This is in sharp contrast to the market's traditional focus on short-term earnings. In reality, it appears that companies may be able to enhance stakeholder value by cushioning the impact of this crisis for at least some stakeholders.

We have been able to map this transformation of corporate purpose through a post-crisis survey of more than 140 of our analysts worldwide. Over half of the responses indicated an increase in company plans to step up focus on workers, consumers and the wider community as a result of the pandemic. Notably, this figure was over 60% for our analysts based in Asia, where we have seen several examples of this long-term approach at a company level and across sectors.

FIGURE 1: FIDELITY ANALYST SURVEY - HOW WILL THE COVID-19 CRISIS AFFECT YOUR COMPANIES' APPROACH TO SOCIAL ISSUES?



Source: Fidelity International, May 2020. Note: The survey was conducted between 6-11 May and featured 205 responses from 145 analysts around the globe (analysts who cover more than one sector or region take the survey more than once).

There are five key questions that investors in Asia need to consider:

1. Will current behavioural patterns persist a year from now? The answer probably lies between pre-Covid and mid-Covid levels of activity observed for different behaviours such as working from home and playing online games.
2. Will the short-term earnings hit actually lead to an increase in long term business value? Companies absorbing the near-term impact for their stakeholders may improve customer and employee loyalty, making their business models more sustainable in the long term.
3. What does the business structure look like in the medium to longer term? Staff-related cost rationalisation may take place alongside operating model reviews, with a faster move towards automation and the jettisoning of parts of the portfolio to protect core activities.
4. What is the real earnings power of a business? Reducing investments to help valuations and increasing leverage for share buybacks, to boost EPS growth, are not sustainable. Going forward, the market is likely to place a discount on these earnings-enhancing activities.
5. What is the level of government interference in the business going forward? The response from policymakers has increased the risk of government intervention. For example, banks may have to forgive loans, drug makers to lower their prices, and taxes may rise as well.

By keeping our focus on sustainability and extending our investment horizon, we believe we can identify companies that can create long-term value for both their shareholders and stakeholders.

To read this article in full visit: **professionals.fidelity.co.uk/articles/expert-opinions/**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FIXED INCOME OPPORTUNITIES: POSITIONING FOR THE NEXT WAVE OF BOND MARKET VOLATILITY

Nick Hayes, Head of Total Return & Fixed Income Asset Allocation at AXA Investment Managers, discusses where the opportunities may lie in fixed income markets today.

Bond markets have enjoyed a strong run recently, with yields moving close to, and in some cases reaching, all-time lows in July, but we believe there are potentially further gains to come - despite the current backdrop of uncertainty.

Given that further market volatility is strongly anticipated, agility will of course be key. But we believe attractive risk-adjusted returns can be found across the sovereign and credit spectrum.

Bonds were not exempt from the pressure felt earlier this year when the coronavirus pandemic sent shock waves through global markets. However, since the market nadir in March - amid the ongoing uncertainty around coronavirus – many areas of the fixed income universe have subsequently delivered robust returns.

The JP Morgan Global Government Bond Index has returned 7.6% year-to-date while the Merrill Lynch Global High Yield Index has risen 2.1% in US dollar terms.[1]

SUPPORTIVE MONETARY POLICY AND FUNDAMENTALS

But we think there are many tailwinds that should help ensure bond markets remain attractive, especially as central banks continue to deliver unprecedented levels of stimulus.

Asset purchases are helping provide liquidity and shore up prices in bond markets. Not only do we not see quantitative easing being switched off any time soon, it is also possible that central banks will step in to support markets further if we see renewed volatility.

In addition, we have recently witnessed spreads getting tighter, meaning the difference in yield on offer between government bonds and more risky corporate bonds is smaller.

The rally has naturally made bonds more expensive, but we believe there are still opportunities for investors to access the market, or add to fixed income portfolios, at attractive valuations. Presently, we see potential opportunities in long-duration government bonds, certain developed and emerging market credit, as well as in credit default swaps, which can be a useful tool for increasing or decreasing levels of risk in high yield during volatile periods.

HEADWINDS CHALLENGE THE RECOVERY

While we are some way away from the equity market low seen in March – with the US Nasdaq and S&P 500 Index reaching record highs in September - there is a great deal of uncertainty still on the horizon.

Coronavirus cases continue to increase in some parts of the world, including the US, and there are concerns that a second wave could be on its way. This will have huge implications for the strength and shape of the global economic recovery – and how it varies country by country.

We also expect the recovery to be quite different to that seen after the 2008/2009 financial crisis – unlike 2008, this is an exogenous crisis, and not about a fundamental mispricing of assets.

This time, given the liquidity and central bank support, it is reasonable to think the rebound will be quicker – but as the crisis is different in nature to anything we have seen before, it is difficult to predict the exact path of the recovery.

What's more, there are numerous other headwinds, aside from the pandemic, which could challenge the recovery - including the US Presidential Election in November as well as ongoing tensions between the world's largest economy and China.

NAVIGATING MARKET OPPORTUNITIES

We believe that the best strategy for fixed income investors is to combine a structural and tactical approach, blending together both a long-term and a short-term view.

While bonds may seem expensive in the short term, it's worth remembering that the asset class as a whole has a low correlation to other risk assets, such as shares, and often can perform better in periods of equity market volatility. Investment-grade credit currently has attractive spreads but has a higher correlation to equities and so could potentially form part of a diversified fixed income portfolio.

Diversification across different fixed income assets is particularly important in these kind of market conditions – essentially, not putting all your eggs in one basket to bank on a recovery at a particular time. What's more, diversification is necessary for investors who look to fixed income strategies not only to try to preserve capital, but also to seek returns.

We continue to favour a barbell strategy, holding roughly equal amounts of defensive and more aggressive bonds. Defensive assets tend to consist of developed market government bonds and inflation-linked bonds, while high-yield and emerging market bonds are at the riskier, more aggressive, end of the spectrum – but we see parts of this market as attractively priced.

As we continue to witness, the yield on offer on any given bond does not equate to potential realised returns. Nowhere is this more relevant than traditional safe-haven government bonds where, despite bearish sentiment and ultra-low yields, we continue to witness new historic multi-century lows in yields. Once demand for fixed income remains greater than supply, then we believe that bonds should continue to generate decent returns over the medium term.

STRUCTURAL SUPPORT

Some investors also believe that yield curve control – where the central bank commits to buying the amount of bonds that the market wants to supply at its target price – is on its way, a view that is also contributing to the current rally. Up to now most central banks, with a couple of exceptions, have shied away from this tactic - but equally their huge asset purchase programmes have a similar effect of helping keep borrowing costs low.

While the overall global economic picture does appear to be improving, we expect liquidity to remain relatively strong, but anticipate further volatility – therefore taking a long-term approach is vital. Our conviction-driven active investment strategy is designed to weather short-term noise, rather than aggressively time markets. While we expect a weak macroeconomic backdrop for some time, strong technical factors – particularly central bank policies – should continue to support asset prices and provide further opportunities for active fixed income investors.

"The rally has naturally made bonds more expensive, but we believe there are still opportunities for investors to access the market, or add to fixed income portfolios, at attractive valuations."

[1]Source: Factset, data as of 03/09/20

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MAKING SENSE OF RESPONSIBLE INVESTING

The pandemic has accelerated a longer term shift to responsible investing. Square Mile looks at how the investment industry is adapting.

The ongoing Covid-19 crisis has prompted a widespread reassessment of how we live our lives – from healthcare and economic wellbeing to our everyday activities and the impact they have on society or the environment. This re-evaluation has extended to investments, as investors seek to understand how their money can be used for the greater good and consequently, flows into responsible funds have surpassed expectations throughout this extremely volatile period. However, these trends are not new to the industry, with the pandemic merely accelerating a shift in mindset that has been gaining momentum for a while.

Driven by a combination of greater investor awareness and regulatory pressures, all corners of the asset management industry are working hard to keep up with this rapid evolution. ESG analysis is now being incorporated across fund groups and new strategies are being launched to meet the demand. However, as with any new investment approach, there is still widespread confusion and misinterpretation.

One of the biggest challenges the industry faces when it comes to ESG integration and responsible investing is the use of consistent terminology, particularly when articulating these approaches to clients. This area has proven to be quite subjective, with different interpretations being applied across the market. Although ESG and responsible investment are interlinked, they are distinct – with the analysis of ESG forming part of the fundamental input into the investment process, whilst responsible investing is the concept of actively trying to use investment as a way of creating better outcomes beyond a monetary objective.

Responsible investing is the umbrella term used by the Investment Association to cover all forms of investment that involve social and environmental considerations. Investment can be viewed as a spectrum of approaches by which capital is put to play; at one end there is traditional investment which primarily focuses on financial returns, and at the other end is philanthropy, where financial considerations are very much secondary.

"One of the biggest challenges the industry faces when it comes to ESG and responsible investing is the use of consistent terminology, particularly when articulating these approaches to clients."

In the middle of these two extremes is responsible investing, whereby portfolio managers seek to generate a competitive financial return whilst considering social and environmental concerns. However, responsible investing is by no means homogenous. There are approaches that incorporate a sustainability element which seeks to make a direct contribution to a better world alongside monetary objectives. Further yet, impact investing is explicit in its intent to make a positive social or environmental impact, not only demonstrated by a clear implementation of this kind of strategy but by the ability to measure the extent of its impact for good.

Although these approaches are not exclusive of one another, with some strategies adopting a number of these characteristics in their approach, language is important. Clear and consistent terminology is imperative to avoid misunderstanding when articulating these approaches to clients. However, this is only one piece of the puzzle: there are a number of other misconceptions surrounding responsible investing which may only add to the confusion.

One of the most common of these is that of performance, with the traditional view being that investors are faced with a binary decision between returns and incorporating social purpose into investment. A look back over 2020 can quickly debunk this enduring myth, as the ongoing Covid crisis has demonstrated the resilience of funds with a sustainable or responsible mandate throughout a period of extreme volatility. Although this is a relatively short-term view, when comparing like for like over the longer term, funds which encompass responsible investing consistently deliver comparable or better returns than their conventional equivalents.

This is no coincidence, and there is good reason for these returns. Traditionally, responsible investment funds tended to just avoid ethically unacceptable companies which resulted in a smaller universe of stocks to choose from. However, this is no longer the case. Instead, they now embrace positive solutions which open doors to investment opportunities. There is no doubt the world is facing major challenges, from climate change and food pressures to diminishing natural resources. There are multi-decade opportunities which not only avoid the headwinds of environmental legislation, regulation to limit climate change and reputational risk, but also create tailwinds for those companies providing solutions to these issues, resulting in higher-than-average growth prospects. Investors are no longer faced with the choice between performance and responsible investing: it's one and the same.

With responsible investing proving to be positive not only for the planet but also for financial wellbeing, the rapid shift to do good across the industry presents a further challenge in the form of greenwashing. Alongside this seismic shift has come a proliferation of funds labelled 'responsible' or 'sustainable', all claiming to invest positively or with impact but not all delivering on this promise. Whilst the intention to do good and avoid harm is an easily identifiable objective, it is much harder to evidence in practice and unfortunately some funds overplay their credentials in order to tap into this new stream of investors and their money.

There are many good funds across the market that truly invest in solutions to the social and environmental challenges the world faces. Investments in healthcare, renewable energy infrastructure, resource efficiency and social housing can make a real difference. Although there are funds that report on their impact, providing transparency for investors who want to quantify the real life impact that their money is enabling, this needs to become the standard.

At Square Mile, we have recently completed the acquisition of 3D Investing, a specialist in the assessment of impact investing. The process driving 3D Investing centres on a fund's ability to make a positive and measurable environmental and/or social impact as evidenced by its underlying investment. This acquisition further enhances Square Mile's capability in responsible investing research, which has a broader focus on identifying funds that fall into three categories: exclusion, sustainability and impact. As investors are faced with a plethora of information when it comes to responsible investing, the Square Mile and 3D Investing research processes aim to provide honest and detailed information, outlining exactly what they can expect to achieve from a fund.

There is no doubt the industry is moving rapidly to keep pace with these continually evolving and accelerating trends. The move towards responsible investing has the incredible potential for good, but this can only be truly harnessed if the industry is truly aligned, from consistent terminology and language to the tools and research available to accurately measure and evidence a fund's footprint.

Jake Moeller, Senior Investment Consultant, Square Mile

For more information, visit the Square Mile website, **www.squaremileresearch.com** or contact us at **info@squaremileresearch.com** or **020 3700 7393.**

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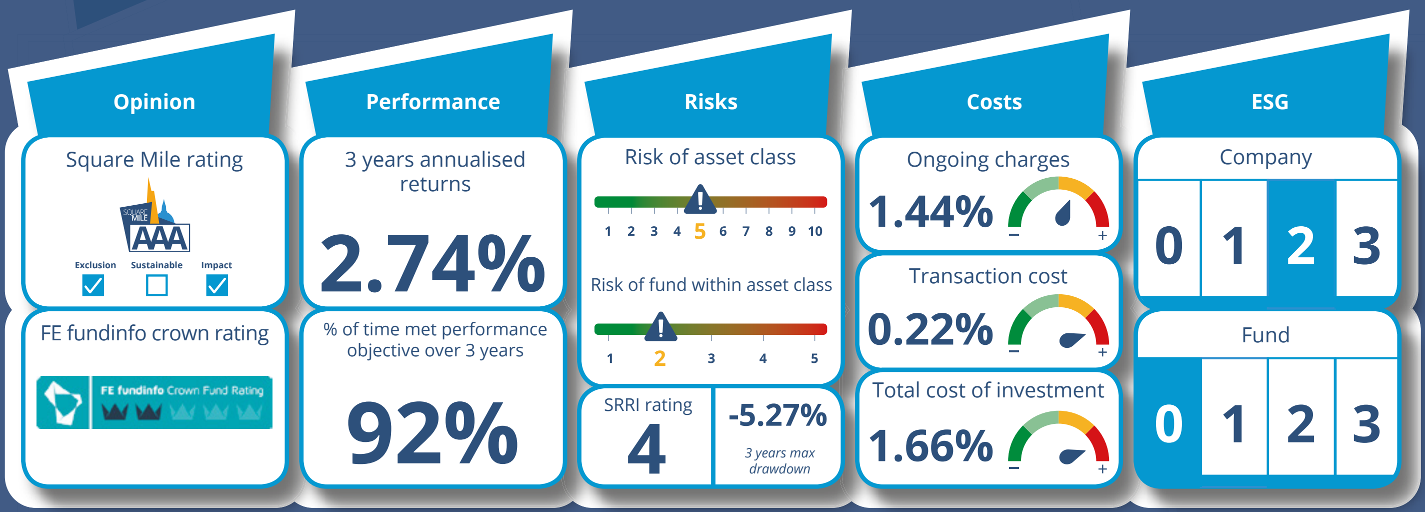

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We would love to hear your feedback on this issue of Hub News. If you would like to contact us on this or any other matter, our details are below.

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