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# BILBoard November 2020 – A hint of value



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Much has changed since our last BILBoard note. The Democratic candidate, Joe Biden, won the US presidential election, but the “blue wave” that markets had anticipated did not materialise. Despite being caught wrong-footed, they quickly adopted the opinion that a divided Congress was in fact the most palatable scenario to prevent policy veering too far to the left. November also brought hope on the vaccine front with two candidates delivering efficacy rates of around 95% in trials. There’s a long way to go until the eventual distribution of any vaccine, but heady sentiment sent the S&P 500 and the Dow Jones to new all-time highs, and acted as a catalyst for a brief but violent rotation from

growth into value. However, optimism about the future and a solution to the health crisis must be balanced against the reality of the here and now, with soaring infection levels on both sides of the Atlantic inciting new restrictive measures.

## MACRO

The epidemiological situation is showing up in the macro data, but not to the extent that we need to adjust our base case. Thanks to monetary and fiscal support, we still believe that an economic recovery through 2021 is on the menu, with the wealth lost during the crisis recuperated in 2022.

In the US, the recovery has been stronger than expected. On the corporate side, rising industrial output, capacity utilisation and durable goods orders all point to a pick-up, while the ISM survey indicates that both manufacturing and services are in expansionary territory. This bodes well for the labour market and already in October, the unemployment rate fell by a full percentage point to 6.9%. Despite this, consumer sentiment has been dampened by rising case numbers. An extra helping of fiscal stimulus is due, but it is just hoped that President Trump's last months in the Oval Office go past without any show stoppers.

In Europe, third quarter GDP growth jumped more than expected (+12.7%), thanks to the removal of movement restrictions. But said restrictions are now being rolled out again, leaving the continent teetering on the edge of a double-dip scenario. It does not help that the much-awaited fiscal stimulus package is on the backburner after being blocked by Hungary and Poland, leaving the ECB in the driving seat when it comes to supporting the economy for now. The central bank is expected to expand measures at its December meeting but ultimately, there is little they can do to embolden consumers apart from alleviating the pressure of existing debt. In this area, there is a clear need for fiscal support.

The Chinese economy is enjoying a clear V-shaped bounce-back, expanding 4.9% in Q3 due to a faster than expected recovery in exports and retail sales. Both the

manufacturing and service sectors showed strong growth in October, and PMI data points to continued expansion, helped by targeted fiscal support.

## FIXED INCOME

The vaccine

breakthrough pushed rates higher, but increases are tempered by central bank largesse, as well as concerns over mounting COVID-19 cases. The hunt for yield is on again, and with \$16 trillion of debt offering negative yields, investors are venturing down the quality curve in search of income. It is crucial for investors to remain selective in order to successfully navigate the risk/return trade-off.

In the sovereign space, risk-free rates in the US are slowly rising with the economy showing dynamism, while European yields have retreated as the continent battles with its old demons of low growth and no inflation. Low and negative yields make govies the proverbial Brussels sprouts of a balanced portfolio, standard fare but not very appetizing. We are particularly cautious on duration in the US where there is the potential for a slow uptick in yields.

We continue

to prefer investment grade (IG) corporate bonds which are supported by improving fundamentals. After months of sideways trading, vaccine news allowed spreads to break through previous resistance levels, even falling below the 100 bps level in Europe. The IG market is supported by central banks for the time being, and in Europe this is likely to persist into 2021. In the US, the IG bond market is already standing on its own two feet, with the Fed only using a fraction of its firepower. When it became apparent that the Fed will not continue with corporate bond purchases in 2021, markets reacted calmly: corporates will of course still receive indirect support from the Fed's purchases in the Treasury space.

High-yield

bonds have also broken through resistance levels and the yield on the US HY segment hit an all-time low of 4.56% this month. With flows strong, default levels remaining

contained and the potential for some spread compression (predominantly between BBB and BB), we are taking a selective approach to this asset class. The HY buffet has a wide variety of companies—some are decent, whereas others are a no-go area. Careful selection is key, especially with Moody's forecasting that defaults will not peak until March.

We continue to favour emerging market corporate bonds over emerging market sovereigns due to their volatility profile and shorter duration characteristics.

## EQUITIES

Overall, we are positive on equities. On the heels of the Q3 earnings season, which was much better than analysts had feared in both the US and Europe, analyst revisions for earnings growth over the next 12 months have been turning positive in all regions except Japan. We still prefer the US (home of quality growth names and stay-at-home beneficiaries) and China (due to strong domestic growth).

The scenario of interest rates remaining lower for longer still favours the quality/growth style, and this remains our preference. However, as we witnessed in November, relief rallies often come hand-in-hand with short-lived but violent style rotations. While we do not believe that the current environment is conducive to the prolonged outperformance of value stocks, portfolios require protection against any temporary shifts in sentiment that may arise. In order to achieve this, we have introduced some cyclical rotation via our sector bets, primarily by reducing exposure to Consumer Staples in favour of Industrials.

**Industrials** is a mid-to-late cycle sector that offers a play on rising PMIs. It will be a key beneficiary of large-scale fiscal stimulus programmes in both the US and Europe. We have also become more positive on **Materials**. China's recovery and a pick-up in industrial

activity are among the factors driving the sector's strong earnings revisions, as well as rises in commodity prices. While the sector looks expensive at first glance, this is largely due to high valuations in the Chemicals subsector, and value can still be found elsewhere.

While the above sectors bring a flavour of value, we balance this with strong growth sectors which we believe still have room to run, especially while the pandemic remains rampant. These safer plays are: **IT**, a sector with resilient earnings growth, strong cash flow generation and healthy balance sheets that benefits from both the stay-at-home theme and the structural shift towards digitalisation; **Healthcare**, a defensive sector that has gained impetus from the pandemic; and **Utilities**, another defensive sector that is benefitting—and will continue to benefit—from the global focus on renewables and clean energy.

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It is not yet time to position portfolios for a value renaissance. However, as the economic recovery progresses, stocks that do not have the pizzazz of tech highflyers could start to make a comeback—especially when new fiscal stimulus packages begin to percolate through into the real economy next year. For the time being, we keep a main course of quality/ growth stocks, accompanied by a small helping of value stocks as some kind of amuse-bouche that will help investors stomach any temporary style rotations.

19/11/2020		DEFENSIVE		LOW		MEDIUM		HIGH	
		Stance	Change	Stance	Change	Stance	Change	Stance	Change
<b>Global Allocation</b>	Equities	●	➔	●	➔	●	➔	●	➔
	Bonds	●	➔	●	➔	●	➔	●	➔
	Cash & cash equivalents	●	➔	●	➔	●	➔	●	➔
<b>Equities</b>	Europe	●	➔	●	➔	●	➔	●	➔
	USA	●	➔	●	➔	●	➔	●	➔
	Japan	●	➔	●	➔	●	➔	●	➔
	Emerging Markets	●	➔	●	➔	●	➔	●	➔
<b>Bonds</b>	Government Bonds - Developed	●	➔	●	➔	●	➔	●	➔
	Corporate - Investment Grade	●	➔	●	➔	●	➔	●	➔
	Corporate - High Yield	●	➔	●	➔	●	➔	●	➔
	Emerging Market Debt	●	➔	●	➔	●	➔	●	➔
	Total Return	●	➔	●	➔	●	➔	●	➔
<b>Commodities</b>	Oil	●	➔	●	➔	●	➔	●	➔
	Gold	●	➔	●	➔	●	➔	●	➔

Stance: Indicates whether we are positive, neutral or reluctant on the asset class

Change: Indicates the change in our exposure since the previous month's asset allocation committee

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