FOR PROFESSIONAL CLIENTS ONLY.
NOT TO BE DISTRIBUTED TO RETAIL CLIENTS.

Insight INVESTMENT

MONTHLY UPDATE // AUGUST 2016

ABSOLUTE INSIGHT

OPPORTUNITIES FOR GROWTH

In a world of near-zero yields, where can investors find attractive returns without taking on too much risk?

It is now a familiar story. At the beginning of the year, many expected the Federal Reserve (Fed) to keep raising US interest rates, thereby lifting yields globally. This expectation has since faded, and now government bond yields are broadly expected to stay lower for longer, investors are again seeking out sources of growth.

The search for yield has driven a resurgence in some asset classes. For example, emerging market debt has been a prominent beneficiary, recording substantial inflows in recent weeks. But the asset class is also benefiting from improving fundamentals – data suggests that emerging market economies are growing, suggesting renewed divergence relative to the developed world, while external imbalances are diminishing and fundamental reforms are being pushed through in key markets.

Tactical opportunities are also available for investors seeking out the potential for higher yields. For example, the UK referendum result had a sharp impact across markets. Most assets have since recovered, but the European asset-backed securities (ABS) market is an exception – it has lagged other credit markets despite strong fundamentals.

Taking note of opportunities like these, and seeking to exploit them, is where absolute return strategies can come into their own – taking advantage of less traditional or short-term opportunities, these strategies can make use of their greater freedom and flexibility to exploit sources of return that are beyond the reach of long-only portfolios.

The long and the short view: Absolute Insight positions across asset classes

For illustrative purposes only, as at 31 July 2016. Positions shown are both long and short. Some positions are outright longs or shorts. Positions held in actual portfolios may be materially different. These positions are subject to change without notice and may not represent current or future portfolio composition and should not be construed as investment recommendations.

ANDY CAWKER
Head of Specialist Equities

The surprise UK referendum result led to a bit of a panic and some anomalous relative price action in late June, which we felt threw up investment opportunities. Markets have settled since then, and some have started to recover. The reporting season also helped to refocus investors on stock-specific fundamentals as winners and losers within industries were highlighted. Equity markets rising against a background of falling bond yields reminds us how central banks are driving markets in the absence of accelerating economic growth. Indeed, frustration with stubbornly low growth seems to be moving the debate towards fiscal stimulus. We expect markets to remain very sensitive to macro developments, with any shift in inflation expectations being a key factor determining asset correlations and the shape of performance within equity markets.

ALEX VEROUDE
Head of Credit

The underperformance of ABS, and especially mezzanine European ABS, in 2015 and 2016 has been very notable, and we believe the market now exhibits tremendous value. Fundamentals of all major ABS asset classes have improved significantly as low interest rates, falling unemployment and stable housing market conditions provide excellent conditions for strong borrower performance. Technical factors are also strong: supply is shrinking as many sub-asset classes – such as mezzanine commercial mortgage-backed securities – have virtually disappeared. Meanwhile, the market has become less liquid, and Solvency II has reduced the ability of insurers to purchase ABS in Europe. Given these factors, we believe the strategic opportunity to own ABS over the long-term is exceptional, as investors are rewarded for extracting regulatory premium and not credit risk.

PAUL LAMBERT
Head of Currency

The halt in the British pound's slide has been seen by some as a turning point for the currency and a reason to expect it to hold firmer than first anticipated after the UK's surprise decision to leave the European Union. We remain sceptical. While some have argued that the impact of the UK referendum on consumer and business confidence has so far been limited, we think the UK's structural weakness will likely put sterling under considerable pressure in the medium-to-long term. Given the UK's large current account deficit, we anticipate that sterling will need to fall further, and remain weak for a long time, in order to meaningfully improve the UK's structural position. The Bank of England has also made its intentions clear by unveiling a bolder package of measures in August than expected. We are short sterling versus the US dollar and euro.

COLM MCDONAGH
Head of Emerging Market Fixed Income

Two important drivers of sentiment for fixed income investors in emerging markets is the rates outlook and global growth picture. We would argue both continue to be supportive for the asset class. Emerging market fundamentals have also continued to firm of late. The growth differential between emerging and developed economies has been contracting for a number of years but has started to widen again as economic fundamentals in emerging markets strengthen. Market commentators have criticised the Fed for sending mixed signals on its rate outlook. However, we would argue the rate outlook remains favourable for emerging market investors. While the Fed has room to manoeuvre and move rates off their extremely low base, the medium-term path is still biased towards the lower end of its target band for interest rates. In this environment, and given attractive valuations, we think emerging market fixed income is likely to remain well supported.

NEIL WALKER
Portfolio Manager, Multi-Asset Strategy Group

Loose monetary conditions support riskier assets, but we believe that fundamentals will need to improve for markets to advance much further over the longer term. We therefore expect markets to remain sensitive to growth data. For now, it seems that global growth is failing to accelerate sufficiently to the point where it becomes self-sustaining. Even in the US, where activity has been comparatively robust, expectations for a rate hike continue to be pushed back. And given where yields are now, the message from bond markets is clearly not bullish for global growth – though the scarcity of safe haven assets, including government bonds, complicates that simple interpretation. Still, if our view of the world is correct, we would expect bond yields to remain reasonably well behaved in the near term, and for that to be supportive of risk assets.

FIND OUT MORE

European Business Development
europe@insightinvestment.com
+44 20 7321 1928

@InsightInvestIM

company/insight-investment

www.xing.com/companies/insightinvestment

http://www.insightinvestment.com/de

Telephone calls may be recorded.
Call charges may vary by provider.