VIDEO TRANSCRIPT

2016 GLOBAL ASSET ALLOCATION OUTLOOK

CHALLENGING CYCLICAL PROFIT OUTLOOK AND THE IMPLICATIONS FOR INVESTORS

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Q1. With emerging equities underperforming global equities by 9%[1], will you increase allocation in this sector?

In our view, the underperformance of emerging market equities is a secular trend that has been underway for about five years. The markets have de-rated and are now trading at a 26%[2] discount to the rest of the world.

However, we feel unfortunate that there may be further underperformance that may come. The reason being that this is a genuine deterioration in profits in these markets and that may have further to run. Our fear really is that there is an increase in the cost of capital for these companies such as, increase wages over the last few years.

As such, the region probably needs to trade down to a larger discount, such as 50% as it has done so in previous episodes. So, while the markets are now getting inexpensive, the de-rating probably has further to run. Within emerging markets, we have a preference for North Asian markets and Emerging Europe where we feel valuations are more extreme. We continue to remain underweight Latin America.

Q2. What are your preferred and least preferred markets within equities?

As I noted earlier, we have a preference for markets in north Asia (China, Taiwan, Korea and Japan) we see valuations as being more extreme in these markets and fundamentals such as growth and profits are modestly better than their peer group.

Elsewhere in the world, we are overweight European equities with a preference for Italy and Austria. Europe has already experienced their crisis and appears to be making a bottom with trends in growth and profits are starting to improve albeit from a low base. The credit transmission mechanism in Europe is now seems to be working and monetary policy remains extremely accommodative. Within the US, we have a modest underweight; that country has outperformed largely due to superior profits. However, it is now modestly expensive relative to other markets, hence for underweight.

Finally, in Latin America, despite the poor fundamentals the region still trades at a valuation premium to the rest of the world, hence for maximum underweight.

[1] Emerging market equities underperformed global equities by 9% in 2015, Bloomberg, as at 28 October 2015. [2] Emerging market equities trading at 26% discount, Bloomberg, as at 28 October 2015.

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Q3. With the relatively poor performance in bonds – do sovereign bonds still provide value in multi asset portfolios?

Global inflation pressure and expectations remain fairly low. Therefore, we do not anticipate an aggressive monetary normalisation cycle in the US. Indeed, policy is more likely to be eased elsewhere in the world, causing bond yields to remain well behaved and low levels. Within fixed income, we have a modest preference for the US high yield markets where we still see some value.

Despite the episode in the energy sector which makes up 17%[3] of that market, high yield bonds are only slightly down year to date and have recovered quite well from the August panic. Overall, risk compensation of high yield market is still around 500 basis points or 5 percent[4] in yield term, so slightly above average and therefore we do see some value in that segment to the market.

Over the medium term, the earnings yield on equities relative to the yield available on bond does suggests that equities should deliver superior returns of the order of 6% in real terms compared to bonds. So we would still have a preference for equities over bonds in multi asset portfolios.

[3] US energy sector, 17% of the high yield market, Bloomberg, as at 28 October 2015. [4] Credit spreads trading around 500 basis points, Bloomberg, as at 28 October 2015.

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