On the Mark – Multi Asset Strategy

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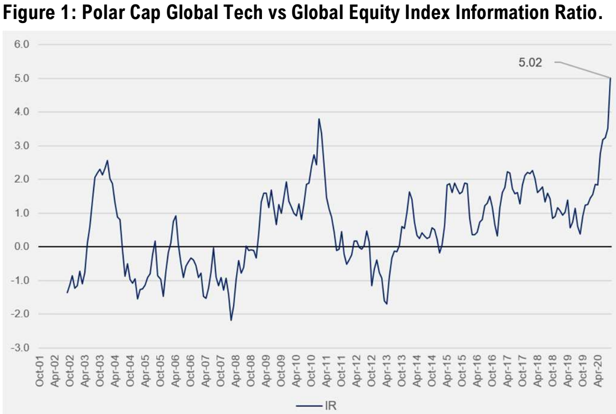
October 2020 – Feels Comfortable but Stay Alert!

Having reviewed several funds at our monthly meeting, we came to the following observation:

The reward from holding growth style funds has been nothing short of ***spectacular*** this year.

Without wishing to unfairly single out a particular manager, we needed to show an example of this characteristic. The Polar Capital Global Technology Fund has a long track record spanning many market cycles and is therefore useful for context and statistical significance. We still believe this manager is 'best in class', but the fund has exhibited one of the most extreme out-performance readings we have seen (Figure 1).

Figure 1: Polar Cap Global Tech vs Global Equity Index Information Ratio.



Source: Garraway, Bloomberg L.P.

The above chart shows rolling one-year information ratio (IR) – a measure of excess risk and reward for the fund vs. a recognised major global equity index. It is constructed using monthly net total returns for both instruments in US$.

From this we see:

- From inception to the Great Financial Crisis (GFC) in Mar-09, the IR was positive only 28% of the time.
- Post the GFC until Sep-20, the IR has spent 84% of its time in positive territory.

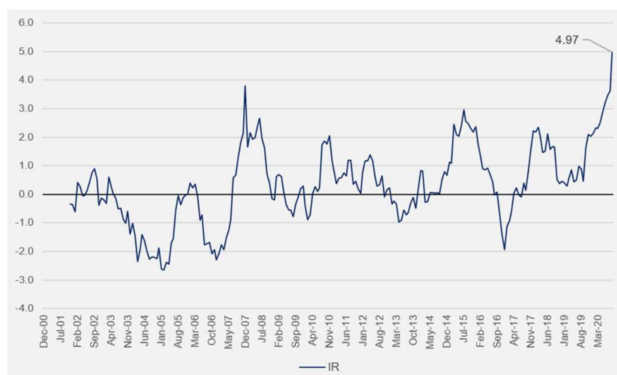
It is not difficult to draw the conclusion that there was a regime shift after the (GFC) that significantly benefitted technology stocks.

By end Sep-20 the IR expanded to an amazing +5.0, clearly breaking out to the upside from the previous near 19 year historical -2.0 to +4.0 range.

Whilst we are aware of the structural shifts that were benefiting technology stocks pre-Covid, it is fairly evident that Covid-19 has accelerated these existing trends and given the sector, and this fund, a 'super charged' period of performance.

For further proof of this, we show the equivalent IR ratio for a recognised growth global equity index, vs. the corresponding value global equity index (Figure 2). Whilst a rather blunt translation, it is clear that similar trends are afoot.

Figure 2: 'Growth' vs 'Value' Global Equity Index Information Ratio.



Source: Garraway, Bloomberg L.P.

Here is the good news – it has been extremely rewarding for the level of risk adopted to have been in growth type funds since the market lows in 2009 and this has accelerated this year. Ned Davis Research (NDR) echo this sentiment (emphasis Garraway):

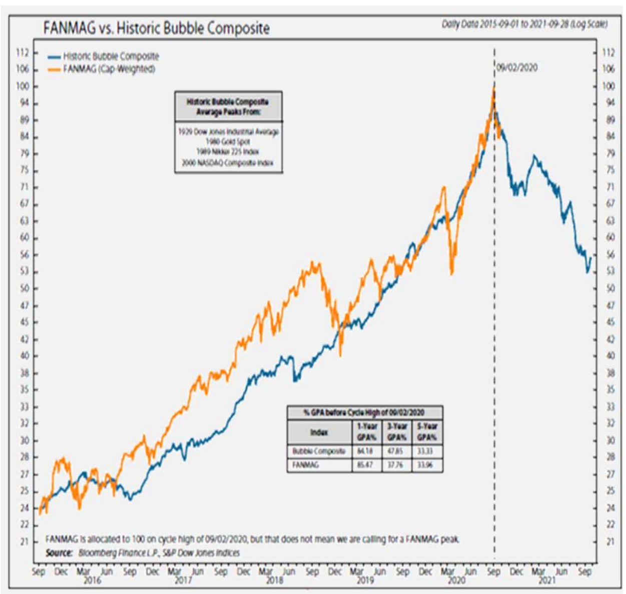
'Growth stocks have been on a historic run. With two days left in September, the Russell 1000 Growth Index has outperformed the Russell 1000 Value Index by 35.1% year-to-date, ***by far the best first nine months on record.*** Second place was 13.2% in 2018. Expanding the history to include Kenneth French's data reveals Growth's second-best start was 20.2% in 1934.'

However, reading on connected matters we notice Ned Davis Research's recent observation that 'the ACWI's top 10 stocks have recently accounted for as much as 18% of ACWI market cap, a record surpassing the previous high of 17% of market cap reached in 2000.'

The increased concentration has come about as Technology has become an increasingly dominant outperformer. That was also the case during the secular bull market that ended in 2000, when the sector's relative strength line reached an extreme that remained unsurpassed until the recent surge of Tech outperformance.

We have pointed out the NDR FANMAG vs. Historic Bubble Composite (Figure 3) chart before and still warrants monitoring, given the extreme dominance of Tech/Growth, how close the fit is, and the propensity for a correction after such levels of outperformance. For these reasons we are still on high alert.

Figure 3: NDR FANMAG vs. Historic Bubble Composite.

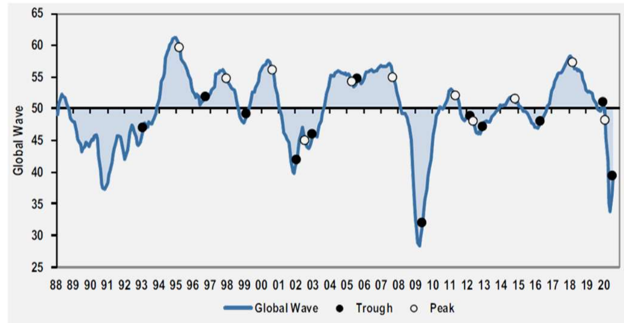


Source: Garraway, NDR.

Now you might think that we are going to get very negative - but having considered all the salient facts we would tend to reach the same conclusion as NDR – 'Our conclusion is that while a cyclical rotation into Value is likely in the coming months as the economy fully reopens, until the economy can sustain faster growth, it is a Growth secular bull until proven otherwise.'

As always, we have to look at the catalyst(s) for such a change and rather neatly, a piece of research from Nigel Tupper of Bank of America securities entitled 'A Catalyst Emerges' recently landed in our inbox. He shows his global wave (Figure 4) and says 'The Global Wave has signaled a trough in the global cycle, suggesting investors now position for a sustained upturn. The global earnings cycle typically moves in tandem with the Global Wave so a globally synchronized two-year earnings upturn is possible. Bond yields also tend to rise when the Global Wave is rising which helps drive rotation away from long-duration equities. History shows that after previous Global Wave troughs, global equities averaged 15% in the next 12 months, and cyclical regions and sectors outperformed.'

Figure 4: Global Wave



Source: Garraway, Source: BofA Global Quantitative Strategy, MSCI, IBES.
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However, he goes on to say that it is not as simple as "value vs growth" rather quality value and growth stocks with some cyclicality are likely to be amongst the best performers.

We still believe that risk assets will reward albeit on a bumpier path. A rotation is highly likely but until proven otherwise existing structural winners will reward longer term. We have positioned accordingly for the longer-term.

The Multi Asset Team

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