2020 mid-year check-in

How we are managing our clients' portfolios

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Much of 2020 has been dominated by the COVID-19 pandemic, which has put nations under lockdown, sent financial markets reeling, and driven economies into recession. On July 30th, the Commerce Department announced that U.S. GDP fell at an annualized rate of 33% during the second quarter—a staggering drop that is by far the country's worst on record (in comparison, the second worst recorded decline, in 1958, was merely 10% on an annualized basis). Similarly abysmal GDP numbers trickled out of other developed markets for the same period, with France reporting a 45% annualized drop, and Germany announcing a 35% annualized decline. Consumer and business spending plummeted, and many industries were essentially shuttered overnight due to the widespread lockdowns.

However, countries have begun reopening, markets have rallied, and recent economic data showed a bounce-back towards positive growth starting in the late second quarter. With the potential for more fiscal stimulus on the way, our investment strategists remain positive on the U.S. economic outlook, while keeping a close eye on Phase 3 vaccine trials and COVID-19 infection rates in parts of the country. Meanwhile, our portfolio managers continue to make informed tactical decisions to position our clients' portfolios to capture the upside while protecting against downside risk.

Our cycle, valuation, and sentiment (CVS) investment decision-making framework has served us well during times of volatility, and with no exception now. Here is how we are managing shifting market forces in our clients' multi-asset portfolios.

Equities

Preference for non-U.S. equities

We maintain our preference for non-U.S. equities over U.S. equities, specifically for Europe ex-U.K. equities. This preference is partly driven by cheap relative valuations, but it also reflects the likelihood that the second stage of the post-coronavirus recovery will see corporate profits improve. This should favor cyclically-oriented value stocks (which we continue to prefer thanks to historically cheap valuations and strong upside potential) over defensive and growth stocks.

Relative to the United States, international developed market equities are overweight these sectors. We also like the value in emerging-market equities, as China's early exit from the lockdown, coupled with additional stimulus measures, should benefit emerging markets more broadly. Additional risks we are taking into consideration include the uncertain duration and spread of COVID-19, as well as the approaching U.S. presidential elections in November.

Fixed income

Expensive government bonds

We continue to see government bonds as universally expensive. However, low inflation and dovish central banks set on keeping interest rates low should limit the rise in bond yields during the recovery from lockdowns. We moved from credit risk underweights to overweight positioning via high-yield credit, which helped drive excess returns this past quarter. Beyond fixed income, we continue to maintain underweights to interest-sensitive assets such as infrastructure and utilities.

Currencies

Weakening U.S. dollar during recovery

We hold fast to our underweight positioning to the U.S. dollar, which has stretched valuations relative to historic levels. The U.S. dollar typically gains during global downturns and declines in the recovery phase. We believe that the main beneficiaries during the recovery should be economically sensitive commodity currencies—including the Norwegian krone and the New Zealand dollar, the latter of which is particularly attractive as New Zealand has been managing the infection rate well and may be able to recover sooner than other developed economies. We continue to maintain an overweight to the Japanese yen, a safe-haven asset that is both inexpensive and benefits from healthy current account surpluses. We are also overweight the British sterling (which is undervalued at mid-year 2020) and emerging-market currencies.

Overall, our team's dynamic management of risk has been rewarded, particularly via overweights to risk-on assets like global equities and credit, as well as a shift in focus from defensive managers to value managers. We are well positioned to diversify into areas of the market where we see better upside skew, mainly in small-cap value stocks and high-yield credit. We are maintaining a neutral-to-moderately positive risk stance relative to long-term strategic levels, driven by our value managers and moderated by our more conservative asset allocation.

Our seasoned team of investment strategists and portfolio managers are well prepared to help our clients navigate the months ahead, continuing to monitor the markets and dynamically managing risk within desired parameters. At the end of the day, our focus is on empowering our clients, and making sure we're putting your money in the right place.

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