Monthly Strategy Review | February 2021

An important proviso for income-oriented investors: A Total Return Perspective

Simply put; attractive income yields for Euro currency-based investors are a mirage. The reason for this reality is firmly rooted to the 2008 financial crisis in which Europe suffered tremendously given its over-reliance on the banking industry. Empirical evidence following the crisis showed that banks were mostly at fault for the crisis as capital buffers were not able to withstand underlying risks to the economy requiring bailouts by taxpayers. This meant that the European Central Bank (ECB) had to ease economic conditions to unprecedented levels in order to support its target of achieving sustainable price growth. The main tool at the ECB's disposal is short term interest rates that have a direct impact on overall interest rates in the Eurozone across all credit spectrums. This led to the ECB to gravitate interest rates ever lower in the hope of resurging the Eurozone's economy. Unfortunately, this policy did not achieve its intended target over time as the Covid-19 shock put further pressure on Euro Area interest rates.

Despite the dreary interest rate environment in the Euro Area; it is not all negative for investors that look at investments from a *total return perspective.* Investors tend to focus on income as a return on an investment and fail to appreciate the value of capital when undertaking an investment. Total return considers both income and capital value (amount invested), as it represents the *true return* on an investment. Despite income yields being so low since the 2008 crisis with an average interest rate of 2.08%* for European Investment Grade debt and 5.94%* for European High Yield debt since the '08 crisis; the total return was 4.93%* and 11.57%* respectively on an annualised basis. Indeed, European investment grade debt returned in total 78%* and European High Yield debt returned 273%* over the same period. All this shows that capital value (i.e. the value of the amount invested) is a major consideration for investors and a main contributor to overall wealth generation.

Equity returns drive monthly returns as fixed income exposures remain flat to negative

Following the negative returns registered in January 2021; equities rebounded strongly for the month of February with Europe overperforming US equities on a constant currency basis. European Investment grade returns lagged other asset classes as positive correlations stood high with the repricing in the US yield curve. Our expectation is that positive correlations will significantly fall as the economic divergence between the US and Europe continues to tilt in favour of the US economy.

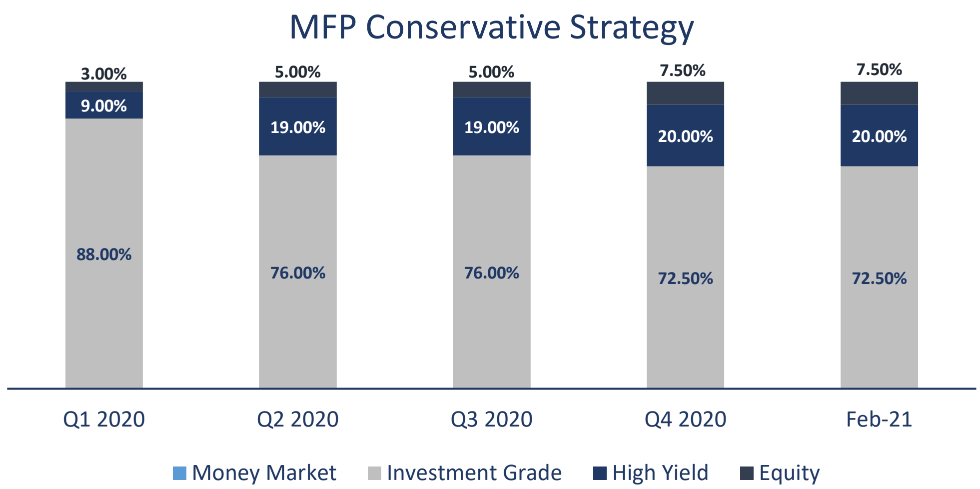
Yield curve movement throughout February reflected the transitory phase for global economies. The standouts for the vaccine rollout are the UK and the US in the Western region as Europe continues to materially lag behind. This led investors to materially rerate their expectations for when key economies will re-open. Intuitevely, this will lead to economic relief which will positively impact key economic data, mostly related to productivity and labour. The upbeat expectations for the US economy led the USD to continue to strengthen for the second consecutive month given the potential from greater attractive yields that will attract global capital flows to US shores. High quality European investment grade debt sold off during the month as European high yield debt continued to perform positively during the month. A deeper look into European high yield debt shows that the lowest rating bucket performed the strongest for the month as spread momentum continued to outperform overall market dynamics.

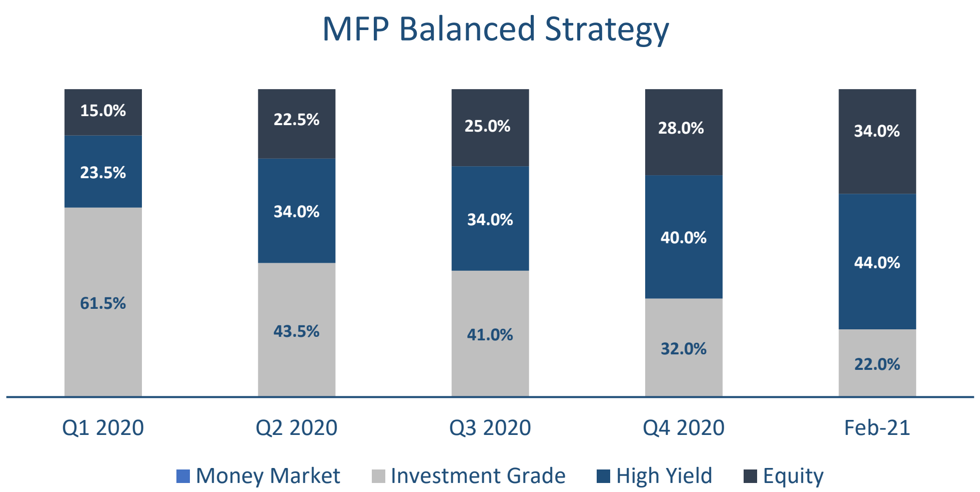
** Period under review is 31/12/2008 to 31/12/2020*

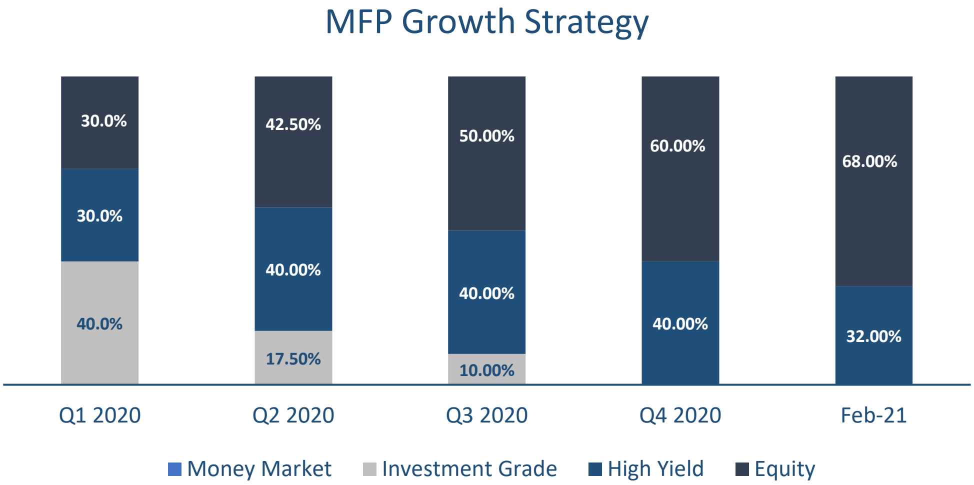
Industry performance within the European High Yield shows that the 're-opening' trade is firmly in place with Oil Refining, Construction Machinery, Industrials and Financials providing the greatest return on a year-to-date basis. Overall Emerging high yield debt has underperformed during the month as the lag in rolling out vaccines continues to drag economic prospects with ramifications on spread compression.

A closer look into European equity industries shows that European banks and insurance significantly outperformed peers' with 'defensively' tilted industries underperforming for the month. This move in markets compliments the economic outlook, in that, cyclicality will be rewarded as the economy continues in its gradual recovery. However, investors need to ensure that they discern between cyclical industries, as the return profile may differ materially over the coming months. In terms of the MFP strategies, the aim is to balance out industry-specific risks in order to ensure greater equity resilience within each separate strategy.

Asset allocation changes over recent quarters for each MFP strategy

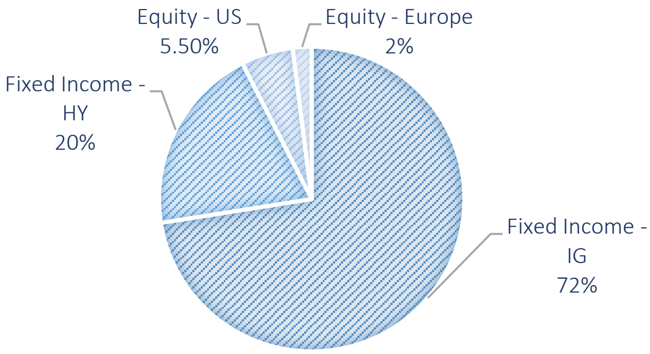






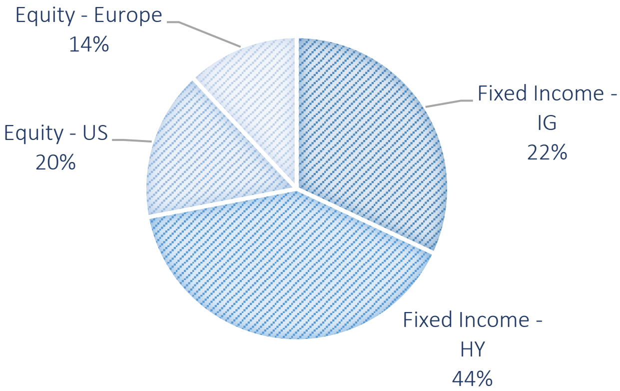
Strategy Snapshot

Asset Allocation | Conservative Strategy



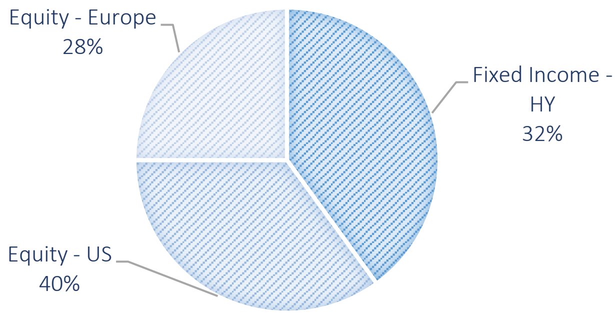
Current Distribution Yield: 1.49%*
Fixed Income Duration: 5.37*

Asset Allocation | Balanced Strategy



Current Distribution Yield: 2.28%*
Fixed Income Duration: 4.02*

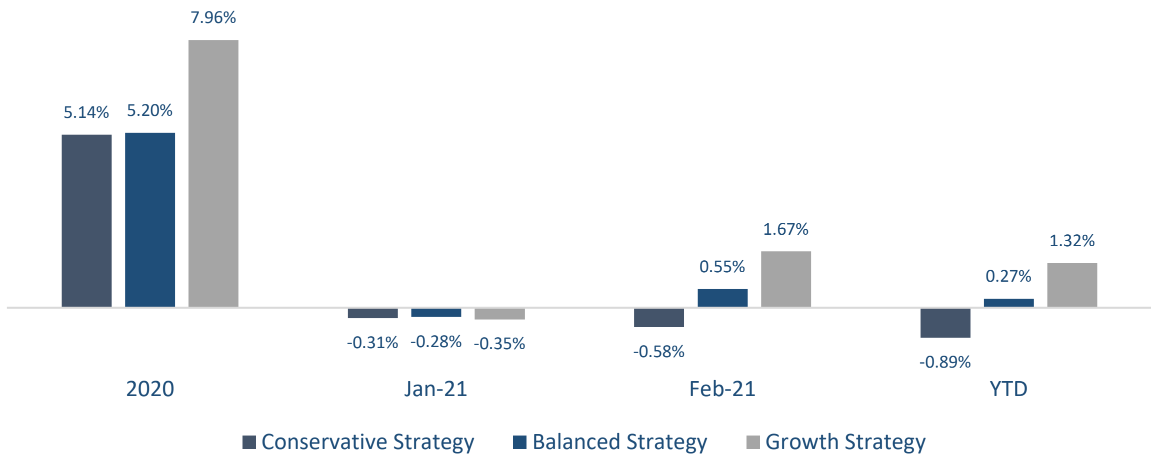
Asset Allocation | Growth Strategy



Fixed Income Duration: 2.77*

** All figures quoted are as at 28th February, 2021*

Performance Snapshot



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