Psigma
Investment Management

For Professional Advisers only

Psigma Asset Class Outlook

Q3 2021

Asset Class Outlook

Psigma's Key Views on Financial Markets & the Global Economy

The early days of the "COVID Crisis" now seem a very long time ago, despite the fact that we are only just over a year on from the anniversary of the start of the economic crash and the most extraordinary period of market behaviour in memory. This most recent economic recovery and market cycle has truly been a wonder to behold.

As we look back on that almost unbelievable period of early 2020, we remember that at the end of Q1 2020 we stated that we thought that "the prospects for long-term returns from a range of investments are now as attractive as they have been for years and, in some cases, even as good as they were in the depths of the crisis of 2008". This positive stance has been rewarded with major gains in asset prices across our portfolios, which continued through the last few months of 2020 and the first half of 2021.

Financial markets have arguably started to forecast a lower rate of economic growth in the months ahead, as fears over the "Delta variant" have grown, but we continue to expect a vigorous economic backdrop to persist through 2021 and in to 2022, and our own forecasts are still for higher rates of short-term economic growth than the consensus expects, as further stimulus from the new US administration kicks-in and other governments around the world continue to run their economies hot.

In our opinion, there are three factors that could still destabilise the ongoing merriment in asset markets: risks around the vaccine/ mutations, structural economic damage, and a return of inflation.

The governments of the west made clear late last year that the whole COVID management strategy boiled down to locking us up for as long as it takes to vaccinate those most necessary across society. Any issues with the vaccine roll-out, take-up and efficacy were undoubtedly the greatest short-term threats to asset markets. But the narrative has changed once again. We should note that recent developments show that vaccines will not be the "freedom pass" we expected, due to concerns over mutations and a continued hesitancy from many to be vaccinated. Any belief that we are finally out of this mess must be delayed.

Notably the "Delta variant" of COVID-19 is causing short term medical concern and economic damage in certain regions of the world that had previously been less exposed to issues from the virus, most notably in Asia (ex China). This shows the passage out of this ongoing crisis will be less easy than financial markets are implying.

Psigma's Key Views on Financial Markets & the Global Economy (Continued)

The US, Europe and the UK are enjoying a period of very strong economic growth, inspired by government stimulus and pent-up demand. But it is not a wholly positive story. The structural economic damage assessment will have to wait until later this year, but surely there will be scarring in various sectors and for those who have sadly seen their financial situation deteriorate over the last year. We must also constantly remind ourselves of the structurally low potential growth rates of an ageing society and debt-laden economies in the future.

The greatest threat to extraordinarily elevated asset prices could well come from a cessation of the never-ending support of financial markets by the central banks. If we see a return of high economic growth and inflation, as we have written about extensively in the past, will this mean that the implicit and explicit stimulus of central bankers might have to end?

Given the potency that monetary policy stimuli have had in elevating asset prices and valuations in the last decade, could this in turn be a major negative if central bankers feel pressured to stop their largesse, fearing that inflation could start to be a problem? For now, the major central banks all seem very committed to continue to boost economic activity through large scale asset purchases and very low interest rates. It is possible that they are now "over-egging the pudding" and creating long term issues through such hyperactivity. Given the worst of the economic crisis has surely passed, now should be the time that the central banks start to unwind their actions?

We expect that inflation could rise in the future, following a sustained period of moderate inflation rates, as government spending and loose monetary policies combine with disrupted global supply chains, in an era where "reshoring" production of strategically important products is fashionable. A rise in inflation could also contribute towards further political uncertainty. Inflation protection remains a key element within our investment strategy.

It is impossible to imagine a future without persistently aggressive monetary easing to both calm markets and aid governments to foot future bills and obligations. What we have learned in the first six months of this year is that the predisposition of central banks is too do "far too much, not too little" in supporting governments and economies.

There remains a major disconnect between asset prices and actual economic activity, which reflects financial markets that have become "overwhelmed by liquidity", which has been created by central banks and governments. We understand why that is the case and we are pleased that our portfolios have enjoyed the recovery in markets, but we currently see a growing problem of insufficient reward for existing risks.

There are also signs that bubbles are building in parts of financial markets, a situation created by rampant money creation by central banks and inefficient stimuli served up by governments.

Our current strategy is to focus in on specific assets that still offer reasonable growth potential at justifiable valuations, with industries like healthcare, elements of the technology sector and specific plays on infrastructure and "green" technology all favoured within our portfolios.

We also have certain investments in the less popular parts of global equity markets, including the UK and Japan, where valuations are attractive and the opportunity for recovery returns is on offer. UK equities could continue their recent pattern of improved performance.

We own a range of fixed interest investments in our strategies, including those that we own for "defensive" returns and others that are priced appropriately for the challenging economic situation we are dealing with. We continue to be able to source attractive fixed interest investments where we are being suitably compensated for the risk that we are taking.

Our best solution to such a situation remains that which we have employed since we first founded our business nearly twenty years ago; remain balanced, remain diversified and remain solely focussed on those investments in which we have high conviction.

Key themes within Our Portfolios

Quality Equity **25.5% of Portfolio**	Within this bucket we can gain exposure to varying long term structural thematic growth themes. Climate change and a "decarbonising world" is one such trend we have exposure to. We are able to combine making good long-term financial returns, with providing capital to fight one of the most pressing issues facing today's world. Fund example: **91 Global Environment**
Inflation Insurance **6.75% of Portfolio**	Finding inflation protection is hard, but we favour shorter duration global inflation-linked bonds over what we view as expensive and much longer duration UK inflation linked bonds. Fund example: **Fidelity Global Inflation Linked Bond**
EM Growth **6% of Portfolio**	Arguably one of the more exciting themes in our portfolios. We particularly like the long term dynamics of Asian domestic consumption. We have high optimism for the economic growth and development of Asia Pacific countries. Fund Example: **Matthews Asia-ex Japan Dividend**
Hunt for Yield **25.5% of Portfolio**	The "hunt for yield" persists in global markets. We hold positions across specialist credit, such as asset backed securities, whilst also having exposure to specialist high yield mandates to supplement our existing income selections. Fund example: **Tikehau Strategic Focus US High Yield**
Equity Recovery **14.75% of Portfolio**	Probably our "riskiest" theme, but we favour the value markets like emerging markets, Japan and to a lesser extent Europe, which should be heavily geared to any continuation of the good performance of equity markets. Fund example: **River & Mercantile World Recovery**

Psigma Asset Class Forecasts – Q3 2021

Red illustrates where a forecast/scenario has decreased from last quarter and Green illustrates where it has increased. Please refer to the Appendix section of this report for a full description of each of Psigma's Scenarios.

Scenario	Structural Downturn	Slowdown	Growth	Strong Growth	Psigma Five Year Forecast Return	
% Chance	15	25	35	25	Q3 2021	Q2 2021
Cash	0	0	0	0	0	0
Sovereign Debt	3	2	0	0	1.0	1.1
Investment Grade	2	2	3	2	2.4	2.6
High Yield	0	1	4	4	2.7	3.2
Index Linked	2	1	3	3	2.4	2.3
Developed World Equity	0	3	5	7	4.3	4.4
Emerging Market Equity	0	2	8	10	5.8	5.8
Property	0	1	3	4	2.3	2.8
Resources	1	3	6	12	6.0	7.2
Gold	9	8	7	5	7.1	7.3
Alternatives	2	3	4	5	3.7	3.7

Psigma Inflation and Interest Rate Forecasts

%	2021	2022	2023	2024	2025	Five Year Rolling Average
Five Year Inflation Forecast	2.25	2.0	3.0	2.5	2.5	2.5
Five Year Interest Rate Forecast	0.1	0.1	0.1	0.1	0.1	0.1

Latest Asset Class Preferences (Based on a Psigma Balanced Strategy)

Asset Class	Bandwidth %	Neutral Allocation	Q3 2021 (1st July) %	Q2 2021 (1st April) %
Cash	0-10	2.5	3.75	3.75
Sovereign Debt	0-10	5.0	10.0	10.0
Investment Grade	5-15	7.5	13.0	13.0
High Yield	0-10	5.0	9.5	9.5
Index Linked	5-20	10.0	5.0	5.0
Developed World Equity	30-50	42.5	37.0	37.0
Emerging Market Equity	5-10	7.5	6.0	6.0
Property	0-5	2.5	0.0	0.0
Resources	0-5	2.5	1.75	1.75
Gold	0-5	2.5	2.5	2.5
Alternatives	10-15	12.5	11.5	11.5

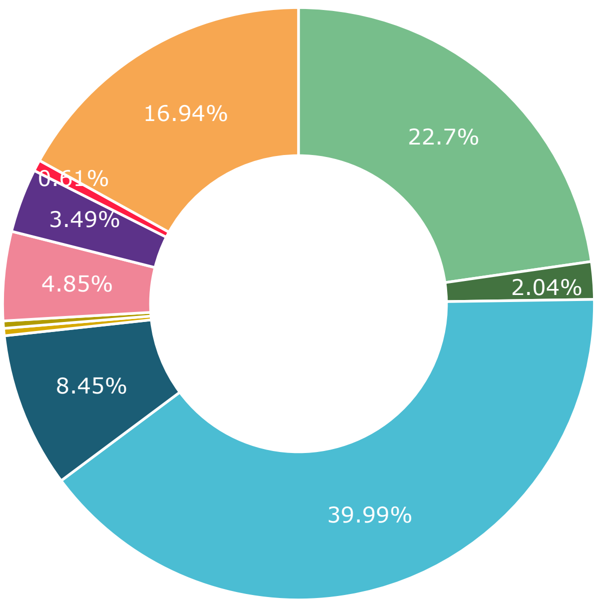
Asset Class Preferences (Based on a Psigma Balanced Strategy)

Asset Class	Short Term View (3 Mths)	Long Term View (1Yr+)	Comments
Cash	Neutral	Neutral	We have gradually reduced our cash allocation to a neutral level and have allocated to defensive fixed income and also Asian credit within our Alternatives allocation. We are using cash allocations for defense, whilst retaining a portion in case the opportunity arises to invest in better priced investments in the coming months.
Sovereign Debt	Neutral	Underweight	Following the Bank of England cutting interest rates down to 0.1%, we are very skeptical of the long-term return prospects offered by UK Government bonds; a view that was borne out in the first quarter of this year. Furthermore, the increased government spending (financed by borrowing) is likely to put upward pressure on bond yields making developed market sovereign bonds a challenged store of value over the longer- term. We see Emerging Market sovereigns as being attractive and also believe short dated debt to be a solid store of value (hence our neutral view).
Investment Grade	Overweight	Neutral	These assets have witnessed a material re-pricing since the depths of the fears about the pandemic in March last year. Spreads within this asset class are now back to fairly tight levels and as such, we limit our investments to boutique managers who remain extremely nimble and focused, which we believe is vital for the months and quarters ahead.
High Yield	Overweight	Overweight	High Yield credit still remains our favored asset class. Specifically, we favour shorter-dated areas of the high yield markets and also areas within the Asset Backed Securities ("ABS") and Collateralized Loan Obligation ("CLO") market where we see the return opportunity as being strong; especially when compared to the risk being under-taken relative to other asset classes.
Index Linked	Underweight	Neutral	We continue to maintain our positions in index-linked bonds and note a material pick-up in inflation expectations over the course of this year. Inflation numbers have picked up dramatically in recent months, with US inflation now running at its highest level in nearly 30 years. Whilst we believe much of this price pick up will be transitory, we also believe that the unprecedented stimulus measures (from central banks and governments) has created inflationary pressures further down the pike. As such, we believe these investments are of increasing importance within a diversified portfolio. That said, we are mindful of the "bond" component of these investments and, as such, retain our underweight positioning. Where we do have exposure, we have opted to focus on strategies that isolate the "breakeven" or "pure inflation" element of an index-linked bond and in particular we favour the US market over the domestic one.
Developed World Equity	Underweight	Neutral	Developed market equities have enjoyed a rapid recovery – fueled on central bank stimulus, with the big technology stocks (in particular) pulling the market higher. We don't question the growing role that technology will play in future economic growth but do have questions around some of the valuations on offer and have looked to spread our allocation to these sectors. As such, we have a broad and balanced split between "quality" and "value" areas of the equity market. "Quality" has performed exceptionally well in recent years; helping to support the market and lead it higher. We maintain a balanced mix across both styles as there are strong arguments for both doing well within different geographies and different sectors. On the "growth" side we favour themes such as green technology and healthcare and on the value side we like recovery stocks which are focused around the global economy re-opening and spurting back to life. On a regional basis, we have a preference for the cheaper markets such as the UK and Japan.

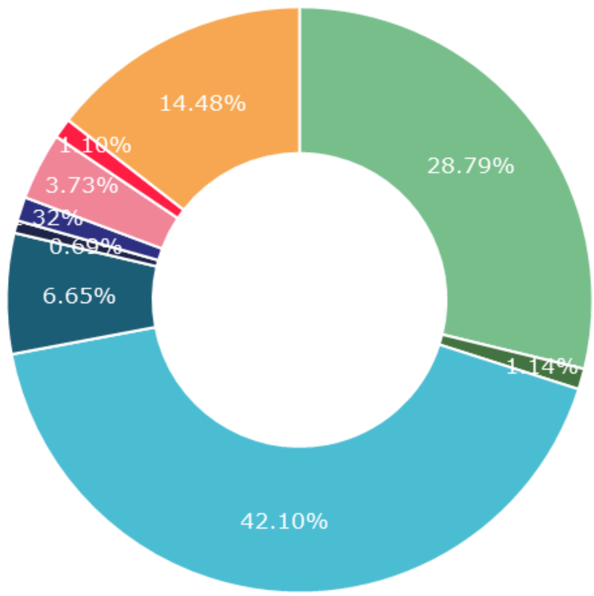
Emerging Market Equity	Neutral	Overweight	Emerging market equities offer decent value and Asia, in particular, is an area that we favour. On balance, we remain positive on the long term growth prospects of the emerging markets and are strongly encouraged by attractive valuations, particularly relative to developed peers. We are attracted to companies that can pay good dividends and have a demonstrated ability of growing these income streams.
Property	Underweight	Underweight	We have zero exposure to the Property markets within our Clients' portfolios. This is based in some-part on valuation grounds, but to a larger degree to the illiquid nature of many of these structures coupled with an expected slow-down in demand for big shopping centers, hotels and other retail outlets. We expect commercial property to struggle in this uncertain environment; not least with an expected rise in employees working from home coupled with consumers not wanting to visit busy areas. The listed side of the market (Real Estate Investment Trusts: "REITs") is more attractive and is a potential investment we continue to monitor; it tends to be more flexible in nature and may actually be able to benefit from the shift to increased warehousing of both goods and data.
Resources	Neutral	Neutral	Although we expect growth to take some time to return to previous levels, the mechanisms are now in place for commodities to gain ground. Namely, we have the Central Banks firing up their printing presses and Governments that are keen to spend in order to ignite growth; or at the very least to prevent a depression. We have already seen that to some degree with a recovery in the oil price. We modestly increased our allocations to these assets at the end of the first quarter of this year, we believe the case has strengthened for growth to reignite and spur demand for these assets.
Gold	Neutral	Overweight	Gold lagged in the first quarter of this year as real rates pushed higher. Gold was (in our view) somewhat left behind as investors flocked to various other inflation protecting assets. With cash rates close to zero (and likely to stay there for some time) and governments hell-bent on trying to promote some inflation, gold has the platform to perform well and serve its role as a store of value in times of uncertainty. We choose to express our view through mining stocks (as opposed to bullion), which provide us with an amplified exposure to an asset we are positive on.
Alternatives	Neutral	Neutral	We have maintained our focus on a small mix of managers; each providing something different and helping to improve the overall mix and set-up of our clients' portfolios. Our expectation is that volatility is likely to be choppy and that the path to recovery is unlikely to be a smooth one. We continue to use our alternatives weighting to try and add further diversification in an investment environment of high correlations (amongst mainstream asset classes).

Current Regional Equity Allocations (Based on a Psigma Balanced Strategy)

Psigma Balanced Total Regional Exposure



Psigma Composite Total Global Equity Index



*Our Psigma benchmark is 42.1% DW ex UK, 42.1% UK and 15.8% EM & updated on a quarterly basis.

North America	Latin America	UK	Europe DM	Europe EM	Africa & Middle East	Japan Hedged	Japan Unhedged	Australasia	Asia

Region	Short Term View (3 Mths)	Long Term View (1Yr+)	Comments
North America	Underweight	Neutral	We are moderately underweight the US market; mindful of its expensiveness relative to other markets. Having had a bias towards growth names for much of the last few years, we shifted towards a more "core" approach at the end of the first quarter. We remain of the view that stock market participation will be more broadly spread across the indices as the recovery takes hold and the economy reopens.
UK	Neutral	Neutral	We are fairly neutral on the UK and within that we have a bias towards the larger companies. We note the attractiveness of this market on a valuation basis which compares favorably to markets such as the US. We choose to express our exposure through a range of passive and high quality active managers. The passive exposure gives us some exposure to the most hated and unloved parts of the market; namely energy and materials, whilst the high quality active managers give us exposure to the stable franchises which we expect to benefit from the demise of smaller and less well capitalised companies.
Europe	Neutral	Underweight	Although we are very bearish on the Euro bloc economically, it has some excellent companies which happen to be franchised here. Hence our having a neutral exposure (on a look-through-basis) without having any dedicated managers within this region. Specifically, some of our global managers have identified strong growth opportunities in areas such as healthcare and technology whilst our infrastructure manager has identified utility companies which are heavily regulated and provide a stable income.

Japan	Overweight	Overweight	Japan is one of our more favored regions and ticks many boxes for us. In addition to valuation support, they have a muscular agenda for corporate reform which is resulting in good developments and is generally friendly for the shareholder. They also have a central bank that is extremely supportive and has stepped up its agenda in response to the coronavirus induced slowdown by increasing its purchase of equity markets and effectively buying unlimited amounts of sovereign debt; both of which should provide wind in the sails to the equity market. We position our exposure across two managers: a very concentrated local specialist which we combine with a more benchmark aware position. The specialist has high exposure to technology and capital light businesses whilst the other position is less punchy yet still favours the growth areas of the market; notably healthcare. We temper our overweight exposure by hedging the currency position (that which is overweight) back to sterling.
Emerging Markets	Overweight	Overweight	We have a neutral position to the emerging market region, but with that are significantly overweight the Asian emerging markets. Emerging markets trade at more compelling valuations than their developed counterparts but the key reason for our liking the Asian markets is the role of the Chinese consumer who continues to grow in dominance, influence and, importantly, spending power. Whilst this is halted somewhat by the impact of the global shutdown, we'd note that the Chinese economy has very much followed a "FIFO" (First-In-First-Out") model; resulting in China being the only major economy to deliver positive growth last year. We'd also note the increasing prevalence that technology plays within these markets and can find attractive companies which trade on better multiples than we're able to find in the more established markets.
Asia	Overweight	Overweight	We retain our Asian overweight, with a preference for the large and fast growing economies. This includes countries such as China, Korea and India where we are trying to tap into the increasing spending power of the middle classes. This encompasses a broad mix of companies, from luxury goods and drinks manufacturers down to more staple goods such as domestic toiletries – all of which we see as beneficiaries of a population growing in wealth and consumption.

Positive and Negative Contributors from Q2 2021

+	-
Higher Risk Fixed Interest – A powerful recovery continued from the March 2020 lows across all corporate and consumer credit fixed interest investments, benefiting our strategies. The laggards from earlier in the recovery continued to perform best.	**Duration** – Contrary to nearly everyone's expectations, market interest rates (bond yields) fell aggressively during the second quarter, meaning that our short duration focus produced lower returns than we could have made. This drag was offset through asset allocation changes made at the end of Q1 to add a bit more duration to our portfolios.
Growth Equities – A major reversal from Q1 with growth equities markedly outperforming value equities, in no small part due to the fall in bond yields which is considered to be a helpful dynamic for growth equities.	**Cash** – There was no need to hold any of our portfolios in cash, at a time when bonds, equities and all asset classes made positive returns. Fortunately, our cash weightings have been low through the last 9 months.
Commodities – The hopes for stronger growth and the realisation of lower supply in commodity markets helped our commodities investment and our view that these dynamics can continue encouraged us to increase our allocations.	**Defensive Alternatives** – In a period where nearly everything went up in value, the protective elements of our portfolios lagged.

Appendix - **Psigma's Current Four Scenarios**

1. **Structural Downturn**
   A potential repeat of the 2008/2009 financial crisis or the 1930's Great Depression.
   Flight to safety, investors holding cash, with demand for gold and other traditional safe haven assets such as US Treasuries, Swiss Franc and the US dollar.

2. **Slowdown**
   The global economy does not grow or has negligible economic growth in the next five years.
   Central banks reignite the huge stimulus efforts to avert the full Depression scenario, with investors holding "safe-haven" assets over" risky" assets.

3. **Growth**
   Continued low growth globally with higher levels of volatility across financial markets and all asset classes.
   Investors seek yield, through high quality equities and corporate bonds.

4. **Strong Growth**
   Eurozone issues are resolved, Chinese and US growth accelerates, global unemployment falls.
   Investor confidence returns, with return of risk appetite into cyclical equities, commodities, EM currencies and global financial shares/credits.

Important information:
This document is prepared for professional advisers and is intended to provide information only. The information contained within this document has been obtained from industry sources that we believe to be reliable and accurate at the time of writing. It is not intended to be construed as a solicitation for the sale of any particular investment nor as investment advice and does not have regard to the specific investment objectives, financial situation, capacity for loss, and particular needs of any person to whom it is presented. The investments contained in this document may not be suitable for all investors.

Investment Risks:

- The value of investments and the income from them can fall as well as rise. An investor may not get back the amount of money that he/she invests. Past performance is not a guide to future performance.
- Foreign currency denominated investments are subject to fluctuations in exchange rates that could have a positive or adverse effect on the value of, and income from, the investment.
- Investors should consult their professional advisers on the possible tax and other consequences of their holding any of the investments contained in this publication.

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