Prudential Market Insights – June 2020 – Transcript.

For a monthly update on the global economy, I'm joined by Sahil Shaikh, portfolio manager at the M&G Prudential Treasury and Investment Office. Well Sahil, obviously the coronavirus is still dominating headlines. But as economies slowly open up again. Where do you see the challenges and indeed, the opportunities?

Actually, I think firstly, if we start off with March, the sell off was pretty indiscriminate. Equities, investment grade, global high yield and most asset classes were down. Now, as economies open up, it is clear the pandemic has its losers and its winners, especially between between sectors. Now you think of your Amazon, where so many people are ordering online, versus your traditional lead retailers. Now since March aggregate equity indices have bounced back especially like the US more so than their respective credit markets. So you look at the S&P 500, It's about 10% off its all-time high. Although IG and high yield spreads blew out considerably in March, retraced somewhat, but are still at elevated level investors in recent history. So one challenge we asked about, is have equities bounced back too quickly, especially vs. credit? Now, a lot of investors look at the different sectoral compositions off the equity market, and it's very important to see that although, aggregate equities have rebounded, it's been concentrated in a few sectors and a lot of the large cap the idea of the strong getting stronger. You have certain sectors, financials and energy are still pretty beaten up. So there's undoubted maybe in a rush into growth in equities on those with strong balance sheets. Um, so in terms of opportunities for the short term, we could see a rotation to these unloved cyclical stocks. That's very, very technical. So a lot of them, from evaluation point of view, have been completely hammered. Um, and part of the whole indiscriminate selling and haven't rebounded as much. Now for credit in our view, the risk off the risk of spreads blowing out to that in March is unlikely. That's because you've had central banks to come out and explicitly say we will buy these bonds so there can be an argument that there's a strong technical component off credit versus equities. Asymmetry might be a bit better in the short term. However if we look at the longer term equities still look attractive. A lot of equity markets, like, look at the UK equities for example. A lot of the major sectors have been pummelled , so there is quite a lot of value there. I've given the continued the Brexit premium that the UK has experienced over the last few years, there can be an argument made from an evaluation point of view that is quite attractive. On the flip side, you can see like I said, the strong getting stronger. You could see US tech a lot of the structural things that we were anticipating over the next few years have been accelerated so they could do well, not just the fangs, but all sorts of new tech companies. Now that we should be cognisant, there are still near term challenges. So that's the U. S. China trade tension that's kicking off again. There could be a second wave off covid 19 especially as western economies enter into their winter seasons or as economies open up. So you had Germany and South Korea have opened up, and you've seen an increase in infection rate. So markets have reacted positively to that. Well, not positively, but not negatively they've shrugged it off and then back to home with the UK there still Brexit. It still has to be done by the end of the year so we could see it increase volatility into the end of the year.

Well commercial property has also been making headlines and you have quite a lot of this asset class in your portfolios. Are you still comfortable with this asset class?

Yeah, I'd say we're still comfortable. As with any good investor we are constantly reviewing the asset class. Now it's not a secret that some of the sectors I mentioned earlier in this will also affect property. With that in mind I break down property into two components. The capital component in and the Yield. From a yield point of view, the rental income still provides a attractive yield, especially versus UK 10 year gilts, for example, especially in the current environment. Now you may see this spread compress over time. Um, as investors search for yield, property still provides that attracted you. Now I should caveat that with it depends on the sector you're invested. So rent collection in the retail sector is actually being around about 50 to 60% depending on different peoples portfolios. The retail sector is not just your retail there is things like supermarkets as well, which have it again a structural argument for in favor of them as well. So it depends on the sectors you look at office space in in London. Now you could see some offices emptying out regional offices outside of the major cities might have never, um, increase in demand. If we look at our prime a real estate, what I mean by that is very centrally located highest score, high energy efficiency can be re utilized in innovative ways or have a lot of fun. So in some of our larger funds where we have direct exposure to these, you can see the demand actually increasing for this. Now the last sector ill talk about is the the industrial sector. You, you obviously hear about your major logistical companies. The Amazons, the DHL's the UPS's ,might increase demand for those. A headwind for that is that you actually have a lot of the small manufacturing sector who may go bankrupt. There may be an increase in defaults as a as a result of Covid. So it's a balance argument. I think it's still too early to gauge the impact that covid 19 will have on the property market. Um, but again, it's not all doom and gloom there are certain sectors that may benefit.

Finally have recent events lead you to rethink your investment philosophy or are you very much focused on the long term?

So I don't think we have rethought our investment philosophy. But our view for expected returns for most asset classes has changed as any good investor constantly re-evaluates. Um, given, most of our exposures are active, and what I mean for that is when we invest in say UK equities, we invest in the active manager with a strong belief that active management can really shine in this sort of scenario. Like I said, that I get equities are up. But there's a lot of diversions between sectors. A bottom up manager can make a lot of this. So our approach of being long term, top down investors also, um, leveraging our underlying active managers, I think, can really shine in this situation like this. Now is the opportunity as strong as it was in March ,probably not. There's, Ah, a lot of expertise have retraced, but Managers are still seeing a lot of pockets of value on an aggregate level.

We look at things like the EM currencies. They're down about 20% the old GM regions out there, and it s an issue. But the sell-off again was very indiscriminate. And you haven't seen risk appetite in those asset classes rebound. So it could be some potential and value in those spaces as well, now, longer term, definitely diversification is harder to achieve through traditional asset classes. If you think about government bonds being at such low yield potential, upside they have is quite limited to for any risk off event. So this is where we still look to invest in longer term assets such as real estate private assets, which is private debt. Now one may argue, is that effective? Covid 19 is going to have a lagged effect on these, and it will. But I still think they provide strong diversification benefits for longer term investors. These are not things that you can tactically trade in and out of. So in that sense are our long term philosophy still holds. But in the more public asset classes there, there is still value off tactical asset allocation, which is which is a component of all our porftolios. And there's going to be increased importance on that as the expected returns for asset classes can really lower.

Sahil thank you. Well do you keep an eye out for more updates on multi asset investments here on asset TV and thanks for watching and bye for now.