

31 July 2021

Market Review

Growth concerns dominated investor sentiment during the month as economic data moderated somewhat. Meanwhile, Covid-19 fears increased due to the spread of variants in many countries. However, despite these concerns, riskier assets within developed markets, such as equities and corporate bonds, rose over the month. As corporate earnings season got underway, strong results relative to expectations for most sectors boosted sentiment. On a regional basis, US and European equities posted strong returns. In comparison, Japan and emerging market (EM) stocks fell over July. In particular, rising Covid-19 infections and the slowdown in economic growth and regulatory crackdown in China negatively affected EM equities.

Portfolio review

The Global Absolute Return Strategies Fund returned -1.31% during the month (net of fees). The benchmark Bloomberg AusBond Bank Bill Index returned 0.0% during this period.

The Fund is positioned for strong economic growth and a gradual fall in inflation, with central banks likely to remain supportive. In this environment, we believe that real interest rates will rise modestly, the US dollar will remain steady, EM bonds will generate a modest positive return and equities will continue to perform well. As a result, the Fund retains a preference for equities, corporate bonds and EM bonds (versus the US dollar), with short positions in US real interest rates and UK inflation.

However, the Covid-19 delta variant and growth concerns in some asset classes drove markets in July. The US dollar appreciated, while inflation expectations rose and real interest rates declined. However, lower real interest rates and volatile inflation expectations supported riskier assets. The Federal Reserve's (Fed) shift towards less-supportive policy may also be contributing to a stronger US dollar, but this has not led to a fall in US government bonds.

Our equity strategies were relatively

flat over July. The stable quality basket performed well, but the sustainable staples, growth recovery and industrial automation exposures were down over the month. Within corporate bonds, the high-yield and contingent capital bonds (also known as contingent convertible bonds or 'CoCos') positions delivered modest positive returns. However, our interest rate risk strategies delivered a negative return. The worsening economic growth outlook, triggered by Covid-19 delta variant concerns, negatively affected our short position in US real interest rates and the interest rate curve strategies.

Our inflation strategies also performed poorly, particularly the short UK inflation position. However, the European inflation strategy delivered a positive return. Within EMs, the Fund's South African government bonds position performed well, due to rising bond prices. However, US dollar strength negatively affected the EM income strategy.

Due to increasing economic uncertainty, we reduced the portfolio's equity and interest rate risk. Within equities, we closed the growth recovery and sustainable staples equity baskets, and reduced our industrial automation position. Meanwhile, we modestly increased the global equity stable quality and Chinese equity positions.

Elsewhere, we closed our US versus German interest rate position after it met our target. In addition, we closed the US yield-curve steeper and short US real interest rates strategies, as we felt their return potential has diminished. Similarly, we closed the US interest rate 'butterfly' position, due to recent market developments, and added a US real versus nominal yield-curve flattener strategy. Furthermore, to reduce overall portfolio risk, we cut our European inflation and short UK inflation exposures. Elsewhere, we increased our favoured foreign exchange carry and commodity carry positions. Finally, we added a US equity volatility strategy to mitigate the effects of any further deterioration in the economic growth outlook.

Outlook

Investment strategy

The Fund will invest in the Underlying Fund and may hold up to 5% of its assets in cash.

The Underlying Fund aims to deliver a return of 6 Month EURIBOR plus 5% per annum, before charges, over rolling three-year periods.

The investment team who actively manage the Underlying Fund have a wide investment remit to help them try to achieve this aim. The team look to exploit market inefficiencies through active allocation to a diverse range of market positions.

The Underlying Fund utilises a combination of traditional assets (such as equities, bonds, cash and money market instruments) and investment strategies based on advanced derivative techniques resulting in a highly diversified portfolio.

The Underlying Fund can take long and short positions in markets, securities and groups of securities through derivative contracts.

Investment objective

The primary investment objective of the Fund is to deliver a positive absolute return over the medium to long term in all market conditions.

The Underlying Fund is actively managed, with a wide investment remit to target a level of return over rolling three-year periods equivalent to cash* plus 5% per year, before charges. We would expect it to exhibit annualised volatility** of between 4% and 8% in ordinary market conditions or, more broadly, between one-third and a half of the risk of global equities***.

*Cash returns are currently referenced to 6 month EURIBOR (which has been chosen as a proxy for the return on cash deposits), however the reference index may change over time. Performance of the Australian dollar hedged share class will instead be compared with the Bloomberg AusBond Bank Bill Index.

** Measured over 3 years of monthly returns.

*** The investment objective is expressed before the deduction of management fees, expense recoveries and taxation

Our central case is one of strong economic growth, while any rise in inflation above central banks' targets are likely to be short-lived. In this environment, we expect positive returns from riskier assets like corporate bonds and equities, with nominal and real interest rates remaining fairly stable. However, we are mindful of different market scenarios. In particular, if the Fed tolerates higher-than-expected inflation, this will push real interest rates lower. As a result, riskier assets that benefit from a strong economy should do well. Alternatively, central banks, particularly the Fed, could start removing support earlier than expected, which might have a negative impact on riskier assets.

Fund performance is available on the relevant factsheet.

The opinions expressed are those of Aberdeen Standard Investments as of the date of publication and are subject to change at any time due to changes in market or economic conditions.

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