

Aberdeen Standard Multi-Asset Real Return Fund



28 February 2022

Market review

Markets fell again in February, with the Russian invasion of Ukraine, as well as rising inflation, adding to the volatile environment. Investors pulled back from equities as tensions escalated in Eastern Europe. The sharpest falls came on 24 February when troops invaded and launched attacks on airports and military sites. Concerns that the hostilities would affect global oil supplies drove the Brent crude oil price to over US\$100 per barrel for the first time since 2014. Meanwhile, investors sold government and corporate bonds and central banks further tightened monetary policy.

Major indices in the US, Europe and Asia fell, with small rises for UK large-cap companies. Europe was one of the hardest-hit regions, as investors feared the impact the Russia-Ukraine conflict would have on the region. While recent US corporate results have been strong, US stocks slid. In particular, the Nasdaq index continued to underperform the wider market, with losses in technology and consumer companies. Bucking the trend, Australian stocks rose, driven by a string of positive quarterly corporate earnings. In both the UK and Australia, mining and energy companies benefited from rising commodity prices. Elsewhere, Japanese stocks fell but by less than other developed peers, with upbeat corporate results helping to stem losses. In emerging markets (EMs), Russia was one of the worst-performing markets, as many Western countries imposed sanctions and removed Russian banks from the SWIFT global payments system. Chinese stocks continued to move lower due to renewed fears of regulatory tightening and more worrying headlines on the country's ailing property developers. However, China A shares bucked the negative trend, while the Hong Kong market declined as the authorities imposed restrictions designed to stem a surge in Covid-19 infections. Meanwhile, Latin American indices rose, driven by strong commodity prices.

In fixed income, European and US government bond prices fell over the month. Corporate and EM bonds also

performed poorly. Meanwhile, corporate bond issuance dropped sharply as investors grew wary of Russia-Ukraine tensions. The Bank of England raised interest rates to 0.5% at its February monetary policy meeting. Almost one-half of the central bank's policymakers voted for a larger rise. The UK's annual inflation rose to 5.5% in January - the highest level in almost 30 years. Elsewhere, the European Central Bank held rates in February but, after January's annual inflation print showed consumer prices rising by 5.1%, President Christine Lagarde said inflation was likely to be higher for longer and did not rule out interest-rate hikes in 2022. In the US, January's annual inflation print of 7.5% was the highest in 40 years. The People's Bank of China held interest rates steady and reiterated a supportive monetary policy stance. Rising inflation led to the selling of Japanese government bonds, pushing yields higher. The 10-year bond hit 0.23% mid-month, causing the Bank of Japan to announce a purchase programme to keep yields within its target range. Yields had fallen back under 0.2% by the end of the month. In Australia, the Reserve Bank of Australia announced an end to its bond-buying programme as expected, although it kept a more dovish tone.

Portfolio review

In February, the portfolio fell by 1.24% in gross terms and by 1.30% net of fees. The portfolio's exposure to equities and fixed income and its absolute return strategies detracted from performance, although this was slightly offset by positive performance from S&P 500 put options and the infrastructure bucket. Over the year to date, the portfolio is down by 4.41% (gross of fees).

In portfolio activity, we trimmed 1% from US high yield (HY) on 9 February. In addition, with the reduction in EM debt, HY and loans in late January, we trimmed sub-investment-grade credit by about 6% in total over the two weeks from the end of January to early February. As market conditions evolved, we dynamically adjusted a few positions in equities throughout the month, including

Investment strategy

The Fund will apply dynamic asset allocation to a diversified portfolio of traditional and alternative assets, without reference to a benchmark. The Fund may shift its investments quickly and significantly, based on valuations and expected returns, and may completely divest from a particular asset class.

Fund volatility will be controlled through the use of dynamic asset allocation and effective diversification of assets.

Investment objective

To achieve a real return equivalent to 5% per annum above inflation (before fees) over a full market cycle (generally 3 to 5 years).

cutting 2% from US equities, adding 1% to European and Japanese equities and buying 1% in delta-adjusted HSCEI call options, which provides us with upside potential and limited downside. We also rotated from global equities (-3.0% of the MSCI World Index) to a commodity equity basket, which included gold miners (+1.2%), energy companies (+0.75%) and copper miners (+0.75%), as geopolitical tensions exacerbated the already very tight commodity supply/demand imbalance.

In fixed income, we unwound about 6% in short positions in US Treasury and Bund futures, adding duration by about 0.4 years to the portfolio. Given the tightening in financial conditions and lingering geopolitical concerns, the duration factor has incrementally evolved to be a diversifier.

In options, we unwound entire SPX short puts exposures, while leaving VIX calls in place as portfolio hedges. The unwinding of short SPX puts reduced equity beta by about 4%.

Outlook

The major risks faced by financial markets are, firstly, the withdrawal of central-bank policy at a time of heightened macroeconomic uncertainty and secondly, high-asset valuation and rising stagflation risk that is exacerbated by the Russia-Ukraine war.

For the former, the market has already priced in six-to-seven hikes by the US Federal Reserve (Fed) in 2022. Central-bank policy responses to domestic macroeconomic conditions and external threats will be important to monitor. So far, the market has reduced the pricing of March's Fed rate hike from 50bps to 25bps and we do not expect the Fed's stance to shift materially unless the US economy takes a hit. On the other hand, we believe Chinese policymakers will continue with their easing measures to stabilise growth, but the measures will be domestically focused and are unlikely to create strong tailwinds for the global economy.

For the latter, we understand from history that equities, on average, correct 5-7% and take about three weeks to bottom during geopolitical events. However, this time, high inflation and hawkish central banks make the situation trickier. We think the market has priced in the present level of conflict, but not the downside scenario of sustained disruption to commodity supply and further escalation of Western sanctions/Russian retaliation. In the near term, we are likely to stay on our course of reducing equities and

credit, rotating to commodity exposures, and adding to long-end government bonds. If Russia and Ukraine/the West can find a diplomatic solution, or if central banks become more supportive of the markets, the current market sell-off may become a buying opportunity. But if the situation continues to deteriorate further while central banks stick to their hawkish tone, we may turn more defensive by further cutting risk.

Fund performance is available on the relevant factsheet.

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