Santander Asset Management

Santander GO Absolute Return

6 / 2022

Fund commentary

Market Review:

June has been another difficult month for markets with the large majority of non-currency asset classes that we track in negative territory. That was driven by inflation levels continuing to surprise to the upside and this in turn drove investors to expect the Fed to be forced to hike rates even more aggressively to rein in inflation which they followed through on at their meeting when they hiked by 75 bps for the first time since 1994. With Central Banks hiking rates more than expected few week ago, investors' attention turned to growth trending lower increasing stagflationary risks.

Looking in more detail at the equity markets, after May's brief relief rally, global equity markets resumed their plunge with the MSCI world losing -8.7% and the MSCI Emerging markets relatively outperforming with a fall of -6.6%. The S&P 500 depreciated -8.3% whilst Europe underperformed with the EuroStoxx 50 falling -8.8%.

In a month with few positive news, China modified its COVID-19 lockdown policies and reported a modest increase in industrial production, lifting the Shanghai Composite +7.5%, the only major market to finish in positive territory for the month.

Inflationary pressures and tightening financial conditions hit sovereign bonds with markets pricing in further increases in interest rates on top of what has already been announced. Sovereign bonds lost ground on both sides of the Atlantic with Treasuries increasing their YTD losses to -9.4% (June -0.9%).

As growth concerns come in focus, corporate bonds increasingly tended to price in a deteriorated environment with valuations of some segments not far from implying a recessionary scenario. Hawkish messages from central banks also contributed to the negative return for Credit with the European Itraxx Investment Grade index widening +31bps to +119bps and the Itraxx High Yield Index widening by +142bps to +580bps.

Growth risks weighed on commodities too and after a strong start to the year Brent crude (-6.5%) and WTI (-7.8%) posted their first monthly decline in 2022. Potential recessionary fears also weighed on metal prices with Copper depreciating –13.5% and Gold falling -1.6%.

On the FX side, the US Dollar had a positive month, with the Dollar Index rallying +2.9%, and the Dollar appreciating +2.4% against the Euro. The Japanese Yen was the big loser, falling -5.2% against the Dollar and -2.9% against the Euro.

Portfolio Review:

Overall, the Portfolio delivered a negative return in June 2022, driven by our Macro directional positions. Our relative value Satellite positions had small declines in performance terms, whilst our Hedges protected the portfolio by adding some positive performance, as equity markets had negative returns and bond yields were higher.

Our Macro Strategy pillar underperformed and was the most significant driver of overall portfolio losses during June as many positions were affected by challenging market conditions.

The large majority of our risky assets position delivered negative returns: our long European equity position was the largest detractor but the other equity positions lost some ground too as equity markets fell sharply. Worries about the global growth outlook also caused our Global High Yield and Global Investment Grade positions to underperform as spread widened. Another significant detractor was our long Eur Duration positions as rates rose in Core Europe but also our Non-Eur duration were negative due to adverse rate moves. Our long commodities position delivered positive YTD performance but in June it struggled as commodities fell after their strong start to the year with Oil declining and metals in negative as concerns about a recession have mounted. In light of the economic slowdown and of the accelerating tightening policy, market repriced inflation expectations lower and our long Global Inflation-Linked position was another underperformer.

On the positive side, our FX Major positions benefitted from our long position to the US Dollar and our long position in the Emerging market equities also contributed nicely due to the exposure to China and Honk Kong that were the only equity markets in positive in June.

On the Thematic side, we incurred some small losses, mainly from our Blockchain and our Robotics positions which lost some ground.

Our hedges performed well in June. As might be expected when equity markets and credit markets sell-off strongly during the period under review, our equity, fixed income and credit hedges outperformed and helped to protect the portfolio from further drawdowns. As a reminder, to protect the portfolio against an equity market correction (which would hurt overall fund performance given our long equity exposure), we have put options on various equity markets. Given that global equity

markets again performed poorly in June, these put options moved closer to the money and became more valuable, generating some nice profits. The main outperformer was our hedges on US equity indices. Our Fixed Income hedges also helped protect the portfolio against the rises in bond yields seen on both sides of the Atlantic, whilst our credit hedges (particularly on the European High Yield side) also generated some nice gains as the European Crossover index widened by 142bps to 580bps.

Our Relative Value Strategies had small negative contribution in aggregate due to the underperformance of our Spread sub-pillar whilst our Quant Models and our Equity sub-pillar delivered positive return.

On the Spread sub-pillar our High Yield and Non-Financial Hybrid spread strategies were affected by the widening of the basis spread between cash bonds and CDS (Cash bonds underperformed).

In our Quant Models sub-pillar, our Cross Asset Model (short UK Gilts, short Canadian bond and short Yen) and Equity model (long FTSE100, short S&P500) were the main positive.

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Our Equity sub-pillar enjoyed a positive months with several strategies having nice return: top performers were our EU Sectors strategy that benefitted from a long position in Telecom and short position in Basic resources and our EM Strategy that benefitted from a long position in China and a short in Brazil.

The Interest Rates sub-pillar had very small losses whilst our Commodity, Inflation & Volatility sub-pillar had a flat contribution with a positive contribution in our FX Long dated options and European Inflation offset by the negative return of our Trading Commodities strategy and our Italian Inflation Positions. The FX sub-pillar had small gain mainly in our Carry to Volatility Strategy and in our commodity currencies positions.

In terms of portfolio activity, our equity exposure decreased from approx. 8% at end-May to +4% by end-June. We increased our exposure to the Emerging Markets (mainly China) from +1.6% to +5.8% whilst we reduced our position in Europe EMU from +4.9% to +0.3%. We slightly increased our short position to the US from approx. -5.4% to -5.5% and we moved to a short position in Australia where our exposure moved from +1.2% to approx. -0.2%.

Our overall duration stance was reduced from 0.0yrs to -0.5yrs whilst our spread duration dropped from 0.7 years to 0.6 years. Our overall commodity exposure dropped from +5.7% to +3.4%, due to a reduction in our Oil and general commodity exposure. Our US Dollar exposure increased from +18.4% at end-May to +25.2% at end-June. After the Euro and the US Dollar, the Swiss Franc is our largest currency position at +5.4%.

Outlook:

Dramatic price action has taken place over the past weeks in equities and bonds, following hot inflation prints, central bank actions and rising concerns over economic growth. Against this uncertain backdrop, we expect that markets will remain quite volatile in the coming weeks and we think the market repricing, although advanced, is not over yet.

Therefore, it's appropriate that we maintain our cautious stance, as evidenced by our relatively low exposure to risky assets at present. By keeping our exposure low, we hope to limit any potential drawdowns – something that is key to the way we manage the portfolio. We are keeping hedging strategies in place to protect the portfolio, such as equity options, yield curve hedges and credit hedges. We continue to manage liquidity dynamically, keeping the appropriate buffers in place, as we expect that liquidity issues are increasing likely to become a concern to investors.