

Santander GO Absolute Return

11 / 2024

Fund commentary

Market Review:

November market performance was driven mainly by geo-political issues, with the election of Donald Trump as President of the United States sparking a strong rally in US equities, but political uncertainty in Germany and France caused European equities to underperform. The diametric of these equity moves was that Trump's election and ongoing US economic data caused US fixed income to lag European bond markets, as the ECB continued to deliver rate cuts. Meanwhile, markets are growing increasingly sceptical that the Fed will be able to match market rate cut expectations for the next 12 months, as Fed Chair Powell noted that the economy "is not sending any signals that the Fed need to be in a hurry to lower rates". This view was compounded by signs that inflation is proving to be quite sticky at levels above the Fed's target. And lurking in the background are potential tariffs from the new Trump administration, which may have an inflationary impact if they are ever enacted.

Looking in more detail at the equity side, the MSCI World Equity Index returned +4.6% in US terms, with the S&P 500 outperforming and rising +5.9%. European markets significantly underperformed with the Euro Stoxx 50 depreciating by -0.4%. Peripheral European stock markets had mixed performance – the Italian FTSE MIB was actually down -2.5% but the Greek stock market rose nearly 1%. Despite an upcoming election, the German DAX gained +2.9% whilst the French CAC40 fell -1.6%. The UK's FTSE100 was a relative out-performer, rising +2.2% whilst the Swiss SMI recorded a -0.2% loss.

As mentioned above, the slight upward surprise in inflation data coupled with decent US growth in the US has caused some frayed nerves in the US fixed income markets. After rising over 50bps in October, investors saw some value in US yields which experienced modest falls – the US 10-year yield dropped from 4.29% at end-October to 4.17% by end-November. Similar moves were seen in the US 30-year yield, although US 2-year yields only managed to drop 2bps to 4.15%. Falls in German yields were larger, reflecting large falls in headline inflation and sluggish economic activity in the region. German 10-year Bund yields dropped 30bps from 2.39% to 2.09%. The real story in Europe, however, was the significant underperformance of French bonds, as the yield gap between 10-year German French bonds widened to in excess of 80bps, reflecting ongoing issues in passing a French budget. Indeed, French and Greek 10-year bond yields are now at the same level, something that was inconceivable a decade ago.

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Overall, the US Treasury Bond index rose +0.8%, whilst the Euro Government Bond index gained +2.3%. The UK Gilt index was in the middle, appreciating +1.8%. 10-year Japanese yields continued their ongoing rise, moving from 0.95% to 1.05%, whilst the JPM EM Bond index did reasonably well, gaining +1.9%.

On the credit side, investment grade credit spreads were slightly tighter, with the Itraxx Main credit index finishing the month 3bps tighter at +56bps. There was also a slight tightening of High Yield spreads and the Itraxx Crossover index has Euro High Yield spreads at +298bps from +314bps previously. Overall, the Bloomberg Euro Agg Corporate Index gained +1.6%, whilst the Bloomberg US Agg Corporate index underperformed slightly, rising by +1.3%. In the High Yield space, the Bank of America US High Yield Index outperformed, recording a gain of +1.1%, and its Euro counterpart (Bank of America Euro High Yield Index) carved out a gain of +0.5% for the month.

Turning to currencies, the US Dollar continued to appreciate on the prospect of rates remaining higher for longer. The US Dollar Index rose +1.7% after October's +3.2% gain, and the Euro lost ground against the Dollar, dropping -2.8% during the month. However, the Euro also depreciated -1.6% against the British Pound and dropped -4.3% against the Japanese Yen. EM currencies struggled against the backdrop of a stronger US Dollar and the JPM Emerging Markets Currency index depreciated -1.9% in November.

Finally, on the Commodity side, it was again a very mixed story as the West Texas oil price lost -0.8% but Brent gained +1.3%. Gold gave up some of its recent gains, dropping -3.7% in November but it's still up over 28% year-to-date, while Copper lost over 5% during the month. Generally the Precious Metals index lost -3.3%, the Industrials Metals index dropped -2.2% but the Agricultural Index gained +2.4%. Overall, the Bloomberg Commodity index appreciated +0.4% during November.

Portfolio Review:

November was a positive month for the portfolio with markets focusing on the outcome of the US elections. Given the Trump win, markets reacted positively, where we experienced a rally in risk assets, with equity markets accelerating further, benefitting the equity exposure in the portfolio. Duration assets performed well as yields moved lower and similarly credit too added further to overall returns in the portfolio. Commodity was the main detractor from an asset class perspective due to gold prices moving lower.

Performance from duration was the main positive driver for the portfolio returns, as yields moved lower over the month with the Trump win setting more positive expectations for markets and relatively hawkish stance on economic policy. US yields moved lower slightly over the month, meanwhile in Europe we saw a further tightening in bond spreads,

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benefitting our exposure in European peripheral debt. Lower yields also benefitted the Emerging Market bond segment, which saw a positive return from the EM debt exposure in the portfolio. In terms of the duration positioning, we continue to maintain our constructive long duration stance with an overall duration exposure, around 5 years. We also continue to maintain a steeper duration positioning, which we expect to benefit under a rate cutting environment with relatively supportive dynamics around global growth and lower inflationary conditions. In terms of regional exposure, we continue with most of the exposure to US and European peripheral government debt, and some exposure maintained to Emerging Market debt, focused in LATAM, Central and Eastern Europe.

With yields moving lower during the month, credit overall performed positively. Positive performance contribution was mainly due to the exposure to European IG. Exposure to HY and subordinated bonds remained broadly flat. Position wise we still continue to maintain an overall cautious positioning for our credit allocation, maintaining a conservative spread-duration profile, with a slightly higher spread duration of 1.5 years.

Performance from the exposure to equities was positive for November, with equity markets appreciating further post Trump win. Positive performance in equities was mainly led by US, and to a lesser extent from exposure to Europe and Japan. We also took the opportunity to increase the overall equity exposure for the portfolio, mainly increasing the US equity exposure, as we expect Trump's protectionist, pro-business stance and economic policies to be supportive drivers for the US equity market, in particular the domestic market. In Europe, we think the current very negative economic momentum can start to improve with the ECB cutting cycle acceleration. A weaker Euro also provides a positive catalyst in the economic recovery, and potential decline in geopolitical tensions i.e. Ukraine reconstruction, allow overall in our view for an improvement in the European economic picture. We maintain the European equity exposure, with fundamental changes in the equity selection component, rotating exposure to a more cyclical exposure that can benefit under an economic recovery. Overall, for the equity allocation, we continue to keep a bias to US equities, with a more limited exposure to Europe, Japan and Emerging Markets, with an overall equity exposure of 23%

US equity selection was negative during November, driven largely due to the selection in discretionary, IT and consumer staple names. Selection in pharmaceuticals and energy was positive. The results of the US election brought a strong change in market expectations. We made some significant changes in the US equity selection of the portfolio, reducing pharma and staples exposure due to RFK Jr nominee. We cut exposure to interest sensitive sectors like utilities and RE, and we increased domestic names, mostly financials (banks and investments banks), industrials, oil services and discretionary that should be the main beneficiary of lower regulations and taxations.

European equity selection was negative mainly due to staples, pharmaceuticals and industrials, while selection in IT and industrials was positive. Staples and pharma suffered due to the results of US elections, while in financials we have

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zero exposure to French names and so we benefitted from their underperformance. During the month, we added a lot to industrials and insurance, increasing semis in IT, while cutting the exposure to defensive sectors like utilities, pharma, communications and staples. Europe has a very negative economic momentum that should improve with ECB cutting cycle accelerating, where we have started adding to more cyclical stocks. The weaker euro is also providing a positive catalyst, helping the recovery, and a change in German government with more fiscal support can provide supportive dynamics into 2025.

Performance from commodities was overall negative. Our main commodity exposure is to gold which performed negatively as gold prices declined during November. We reduced quite a lot the gold exposure during the month, now keeping a very small position, along with a marginal exposure in oil.

Market Outlook:

We expect a benign economic outlook ahead, with some softening for the global growth in 2025. In the US, growth projections marginally improved due to strong consumption. Some deceleration is expected for 2025 based on fiscal policy tightening and cooling labour market. For the medium-term, protectionist policies could push inflation higher and growth lower, but much will depend on the timing and sizing of measures introduced by the new Trump's administration. The European recovery is more fragile and vulnerable to new tariffs. The growth premium between DM & EM still favours EM, and Asia in particular is enjoying strong growth. Recent policy measures in China may provide upside risk to near-term growth but there is still lots of uncertainty and low visibility. Late cycle still remains the central case for the coming quarters, with S&P 500 EPS expected to close 2024 around 10% and stay around high single digits in 2025. Recent policy measures may provide upside risk to near-term growth. The economic environment is moderately pro risk. Valuations remain expensive, but they are not likely to be relevant driver approaching to year end. We see value in rates but an increase in long term inflation expectations is a risk.

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