Jaime Arguello CIO Review & Outlook podcast

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Since tumbling in March as the world locked down, financial markets have staged a spectacular rally. US equity markets are back to all-time highs and Apple has become the world's first $2 trillion company. Not only equities, but bond markets and commodities such as gold have also bounced sharply.

Jaime Arguello, Architas Chief Investment Officer, discusses what's on the investment radar for the final period of this eventful year. And outlines our tactical asset allocation set against this outlook. Hosted by Lorna Denny, Investment Specialist.

IN BRIEF

- The rebound in economic activity has been quite strong, but might moderate from here. A number of sectors will not see a return to normal levels of activity until a cure is available, while levels of unemployment will take some time to return to the pre-COVID situation.
- The winner of the US presidential election will maintain support for the economy and particularly the consumer. On the foreign policy front, a Biden victory could potentially reduce tensions with China. Management of the Covid situation could also be improved.
- The main risk to markets remains a large scale resurgence of the virus and a new deceleration in growth. On the positive side, the main surprise could come from a proven cure or vaccine. In that case, the expectation of a cyclical recovery would be very strong.

OUR VIEW

We have seen historic falls in GDP as a result of Covid-19 lockdowns. What are the prospects for continuing recovery from here?
The rebound in economic activity has been quite strong, but obviously from very depressed levels. It is likely that, after such a rebound, the recovery might moderate, particularly as there is still a high level of uncertainty on governments' long-term measures. It is important to highlight that a number of sectors will not see a return to normal levels of activity until a cure is available. Also levels of unemployment will take some time to return to the pre-COVID situation.

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OUR
VIEW (CONTINUED)

The US presidential election is fast approaching. Could you give us a brief idea of the market's response to either a win for the challenger Joe Biden or a Trump second term?
Given the Covid crisis, I believe that any government will maintain a strong support for the economy and particularly the consumer. So I would not expect a major negative reaction for the markets. It is likely that the usual series of promises will flourish into November, but clearly the margin for additional stimulus is more limited now.

On the foreign policy front, a Biden victory could probably be seen as a positive, given the potential reduction in tensions with China.

From the Covid perspective, a Biden victory would be seen as a positive, as the management of the situation can only improve.

What would you say are the 'left field' events that we should look out for?
From a market perspective, the left tail risks have been significantly reduced by the combined action of central banks and fiscal stimulus. The main risk remains a large scale resurgence of the virus and a new deceleration in growth.

On the positive side, the main surprise could come from a proven cure or vaccine. And in that case, the expectation of a cyclical recovery would be very strong. A Brexit deal would also be a positive, but mainly to UK equities.

Finally, to our tactical asset allocation, how are we positioned to reflect the uncertainties, which lie ahead?
In terms of tactical asset allocation, we closed our underweight in equities in June, as we expected range-bound markets after the strong second quarter recovery. Since then, we have run an overweight in most credit sectors, like high yield, investment grade credit, and also emerging market debt. This was a less risky stance than being overweight in equities. And it has been quite positive for our portfolios.

Any thoughts on valuations at these levels?
Clearly at current levels, most risk assets have extended valuations, particularly in the face of the highly uncertain current situation. It is however justified to some extent by the level of interest rates and the expectation of accommodative policy for at least two or three years, but also by the lack of alternatives and the lack of appeal of more defensive asset classes. In the current situation, deciding which type of equities to own is almost as important as asset allocation, because the pandemic has had a material impact on how economies operate, which has created a significant dispersion between sectors and companies. For our part, we have a preference for quality growth companies. We also believe that active managers should perform better than passives, as stock selection can indeed separate the winners from the losers in this new environment.

Your summary then on tactical asset allocation.
At this stage, we believe that the most reasonable approach is to maintain a neutral exposure to our strategic equity allocations. As the main risk is the upside risk of a vaccine, which we are not really in a position to forecast. If this event should materialise, our portfolios will fully participate in the upside and benefit still from our overweight