Capital Market Assumptions and Strategic Asset Allocation 2021

SYNOPSIS

Influence tomorrow

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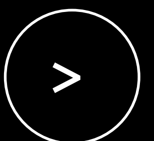


At Barclays Private Bank, we ensure a periodic review of Capital Market Assumptions (CMA) and Strategic Asset Allocation (SAA) to ensure that our long-term investment process reflects our investment thinking and to help optimise a client's overall portfolio performance.

This document provides an overview of our outlook for key macroeconomic drivers and the performance of asset classes beyond the typical one-year outlook. Our long-term views cover an investment horizon from 2021 to 2026. Additionally, we summarise the key SAA changes in discretionary mandates.

For Accredited Investors in Singapore.

Focusing on the long run

We help our clients with their long-term investment goals through a structured and disciplined investment process. This journey starts by understanding their investment needs and objectives – such as liquidity, lifestyle and aspirational goals – as well as their risk tolerance and capacity for loss.

SAA is the bedrock of our investment process, and it represents the preferred long-term positioning in a range of asset classes. The SAA design is guided by our investment philosophy, which revolves around the principles of long-term investing, wealth preservation, international multi-asset class diversification, and an optimal risk-return trade-off.

A good asset allocation requires reliable estimates of future return and risk. To this end, our CMA represent forward-looking estimates of expected returns, volatilities, and correlations over the next five years for a number of asset classes, such as bonds, equities, commodities, real estate, hedge funds, foreign exchange, and private markets.

Economic recovery at different speeds

Starting with the macroeconomic backdrop, we expect the next five years to be characterised by economic recoveries over different time periods. We believe that economies, such as the US, that have experienced aggressive economic and monetary policy stimulus, will reach their pre-pandemic growth trajectories in 2022. At that stage, the baton will pass from government to private demand sooner than for countries administering stimulus more cautiously. In the Eurozone, pre-pandemic trend output is expected to be reached in 2023.

For many countries where policy responses (to the pandemic impact) have been less pronounced, and the path to a full reopening of the economy is more shrouded in uncertainty, the journey to the pre-pandemic growth trajectory may outlast our CMA horizon.

Inflation on average higher than before

The sheer amount of stimulus employed by the US government and central bank has sped up the recovery to the extent that inflationary wage pressure is already a hot topic only one year after the trough of the crisis. We believe that increased upward wage pressure, in combination with other inflation-positive drivers, will lift inflation levels over the next five years across all economies relative to that seen in the previous five years.

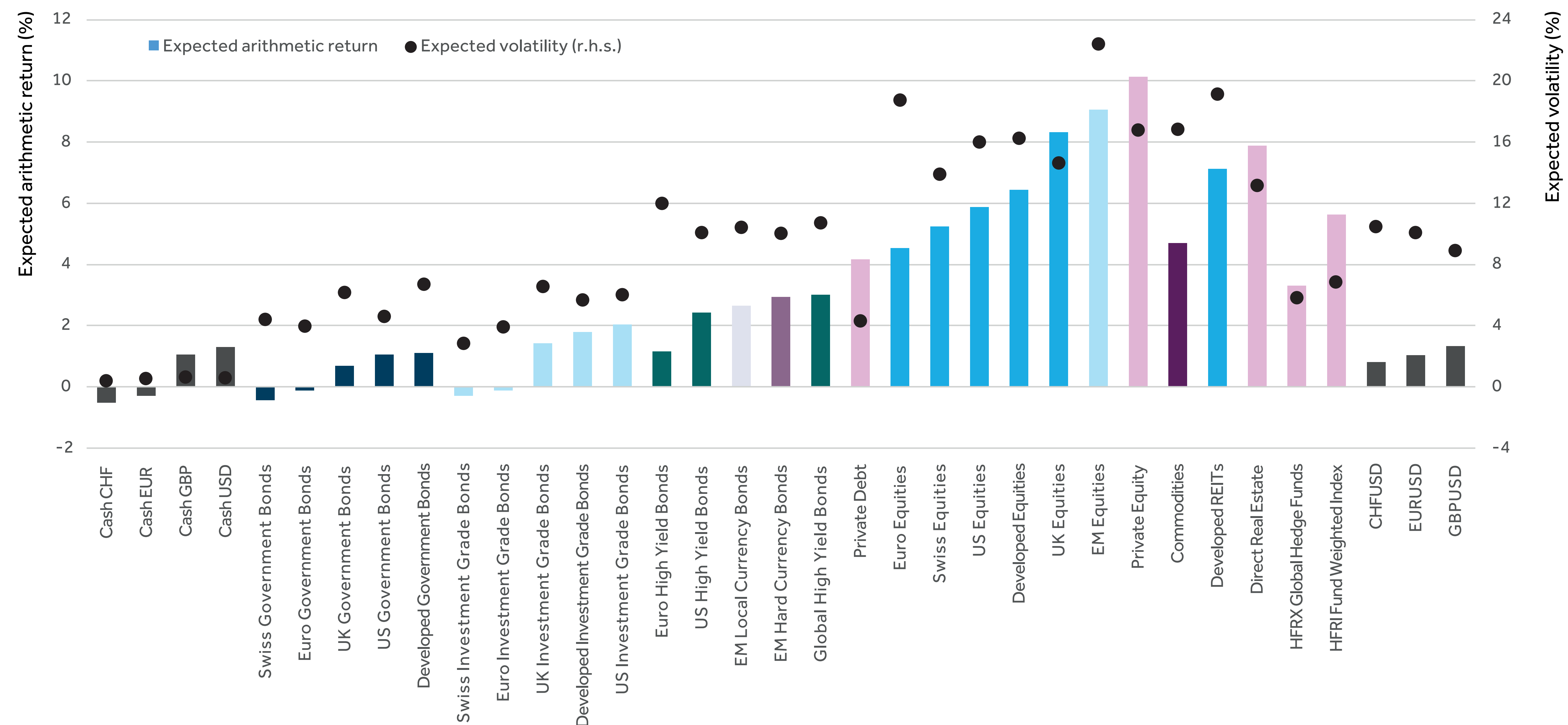
These additional drivers include a rush to secure access to natural resources that are key to the transition towards greener economies, elevated levels of sovereign debt, as well as an increased tolerance towards inflation, in light of leading central banks adjusting targets to longer-term averages.

Cash rates do not compensate for inflation

The different pace of the labour market recovery and levels of inflationary pressure will likely lead to diverging hiking cycles for interest rates. We expect the US Federal Reserve and the Bank of England to commence the rate-hike cycle in 2022, and conclude the cycle by 2026. However, the European Central Bank as well as the Swiss National Bank are expected to hike at a later stage, remaining far from the end of the cycle by the conclusion of our CMA horizon.

Long-term real cash returns are expected to be negative for all CMA currencies. This continues the struggle of employing cash as a means of merely preserving value in portfolios. Consequently, we slightly reduced the allocation to cash in our SAA.

BARCLAYS PRIVATE BANK CMA RETURN AND RISK PROJECTIONS 2021-2026



Source: Barclays Private Bank, November 2021. Forecasts are not a reliable indicator of future performance. The value of investments can fall as well as rise and you may get back less than you invested.

Fixed income: nominal assets in a rising inflation environment

Low interest rates, and our expectation of relatively elevated inflation rates and a fresh hiking cycle, make investing in fixed income more challenging, thus demanding increased selectivity.

For high-quality bonds, yields are typically the main driver of returns over a long investment horizon. As such, differences in the expected speed of interest rate hikes drive our return expectations for the various markets. We expect developed market bonds to return on average between 1.0 and 2.0% from 2021 to 2026.

However, government bonds represent an important portfolio diversifier and they usually outperform investment grade bonds in risk-off environments. In a multi-asset class context, when equity allocation is increased (see chart on p.7), a small increase in government bonds at the expense of investment grade bonds improves risk-adjusted portfolio returns. This is reflected in our new SAA.

High yield and emerging market bonds can support returns in debt, but their relative attractiveness has slipped compared to previous years. Spread levels are low by historical standards, driven by ample liquidity in the market. When, as we expect, this liquidity gradually drains away, we believe that the growth impulse will be enough to keep a lid on these spreads. For this reason, we have slightly decreased the allocation to high yield and emerging market bonds in our discretionary mandates.

Equities: supported by growth and up when inflation is elevated

Given our expectations for above-trend growth paired with a regime of moderately higher inflation, earnings growth is the main driver of our equity return projections.

While dividends and net buyback yields have come under pressure lately, we expect them to slowly revert to their longer-term averages, as the recovery evolves and companies face less uncertainty with regards to their cash flows. Valuations should turn into a moderate headwind, as we expect a gradual multiple contraction over the course of the CMA horizon.

In our view, with potential returns ranging from 4.5% to 9% depending on the market, this makes equities an attractive asset class during a cyclical upswing. Therefore, we have moderately increased our allocation to developed market equities to reflect our five-year outlook.

Real assets thrive with inflation

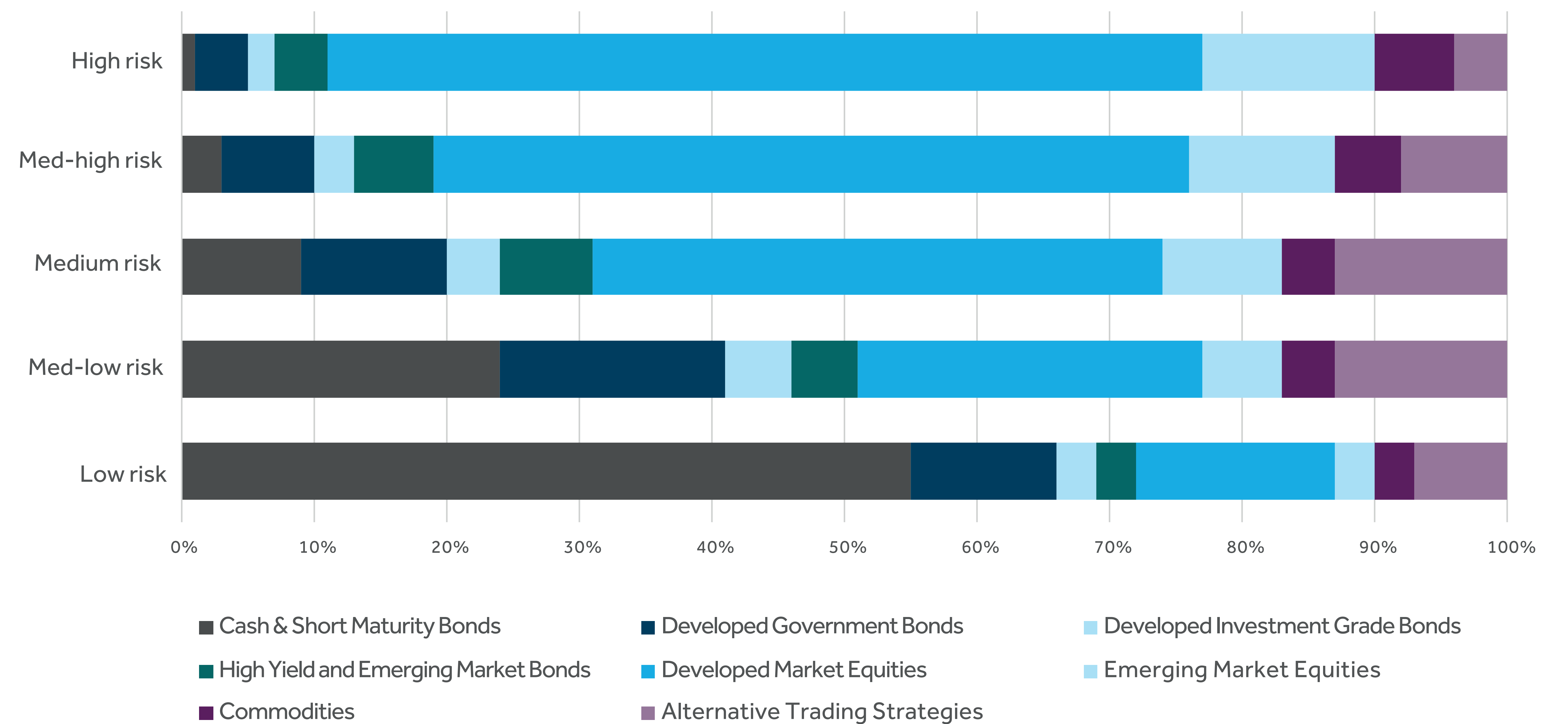
Our expectations for commodity returns are mainly driven by expected changes in valuation. Even though prices have increased considerably lately, we believe that commodity prices can go higher.

One short-to-medium term driver may be the promised transition to greener economies, that has the potential to support demand for several commodities. Moreover, industrial metals and energy tend to perform well in cyclical upswings. Additionally, precious metals are one of the few asset classes that thrive when inflation is sustained at a high level for a long period of time. While this is not our base case, the likelihood has certainly increased compared to the pre-pandemic economy. Overall, we have slightly increased the allocation to commodities in our SAA.

In a liquid portfolio, the only real estate exposure is via liquid securities and listed Real Estate Investment Trusts (REITs). Equity REITs provide exposure to the income and growth return components that are comparable with those available in public equity, without suffering as much from the same expected compression in valuations, according to our forecast. Due to their equity-like characteristics, we have allocated the existing equity REITs exposure into developed market equities and removed real estate as an asset class in discretionary mandates.

BARCLAYS PRIVATE BANK GLOBAL STRATEGIC ASSET ALLOCATION

Global SAA for five risk profiles and reference currencies USD, GDP, EUR and CHF. Colours are aligned with more granular asset classes in the CMA return and risk projections chart.



Source: Barclays Private Bank, November 2021

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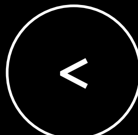

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