



# Market Perspectives

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 **BARCLAYS** | Private Bank



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# Foreword

Welcome to our latest edition of Market Perspectives, which aims to provide much-needed context and clarity, in a period when wild financial market swings and uncertainty weigh on investors' minds.

Since our last report, equity markets have had another bout of nervousness as rates raced higher and investors stared the risk of a recession in the face. The S&P 500 plunged to its lowest level since November 2020 last month. When the near-term picture gets murky, it's crucial to keep long-term goals in mind. Our analysis shows that investors have reasons to be hopeful, and stock market returns look like being similar to their norms over the next decade. This month we also look at new, less market-driven sources of performance. On that front, Asia-Pacific stands out.

Fixed income markets haven't played their role as portfolio ballasts so far this year. Volatility will likely remain in the months to come but opportunities are emerging. Inflation-linked bonds have been a key topic of discussion in recent months. Their appeal is country specific, with some regions set to have stickier elevated inflation for longer than others. But, including inflation-linked bonds with nominal ones can help to diversify portfolios, and so smooth the ride.

Beyond our usual asset class and financial market analysis, you'll also find our latest sustainability insights.

Inconsistent sustainability labelling by fund managers and "greenwashing" underline how difficult investing green can be. Beefed-up rules are aiming to help, forcing companies to disclose more and be clearer on how they invest sustainability funds. While better, investors still need to drill down into the information to make sure their green investments are the right ones for them.

As always, we hope you enjoy the report and we thank you for entrusting us with your investments.

**Jean-Damien Marie  
and Andre Portelli,  
Co-Heads of Investment, Private Bank**

# Hunting for alpha in Asian equities

Equity markets might be tough hunting grounds for investors this year. Views are also split on whether the worst is yet to come or is behind us. When equities appear directionless, because of elevated uncertainty or a lack of conviction, opportunities can still be found, and Asia offers plenty of them.



Financial market sell-offs are frequently driven by macro news and sentiment. Stock prices often plummet in a crisis, with volatility and correlations spiking and being especially elevated for some time. Charging inflation and interest rates have exacerbated this problem recently by ushering in a regime of positive correlation between equities and government bonds.

## IT'S ALL ABOUT ALPHA

For months now, we've advocated the importance of being (and staying) diversified. In particular, we've been vocal about the need, when appropriate, to consider investing in alternative assets to target better risk-adjusted returns. With that simple goal in mind, one strategy might be worth considering: market (or beta) neutral equities.

Behind the fancy name, these strategies eliminate the need to get the market's overall direction right (the beta) and instead focus on generating value by going "long" an asset and shorting another one with similar characteristics. This idiosyncratic performance is commonly referred to as alpha.

**"We've been vocal about the need, when appropriate, to consider investing in alternative assets to target better risk-adjusted returns"**

## DISPERSION, DISPERSION, DISPERSION

In order to generate attractive alpha, fund managers need two things, a rigorous process and talent. But these aren't of much help if alpha opportunities are few and far between. This is why dispersion of returns between markets or securities and low intra-correlations are two prerequisites.

Unfortunately, the influence of central banks on markets in recent years has suppressed a lot of the alpha opportunities that once existed. Indeed, an increasing number of investors simply follow the market's momentum in setting strategy, paying little attention to fundamentals.

This tide, that lifts all boats, makes alpha generation harder, especially in the western world. In fact, the S&P Indices versus Active (SPIVA) scorecard, which tracks the performance of actively managed funds against their respective category benchmarks, recently showed 79% of domestic equity funds underperformed the S&P in 2021<sup>1</sup>.

### ASIA IS AN IDEAL HUNTING GROUND

However, alpha generation has been easier to come by in Asia. There are a few fundamental reasons for this.

First, Asian equity markets, unlike their US peers, include companies from very different countries that each face their own macro trends (some being emerging markets). Second, Asian companies not only operate in many currencies, but their shares are listed in different currencies too. This makes exchange rates a key driver of alpha. Finally, stock markets in the continent offer exposure to a very specific blend of sectors and industries that allows for additional dispersion.

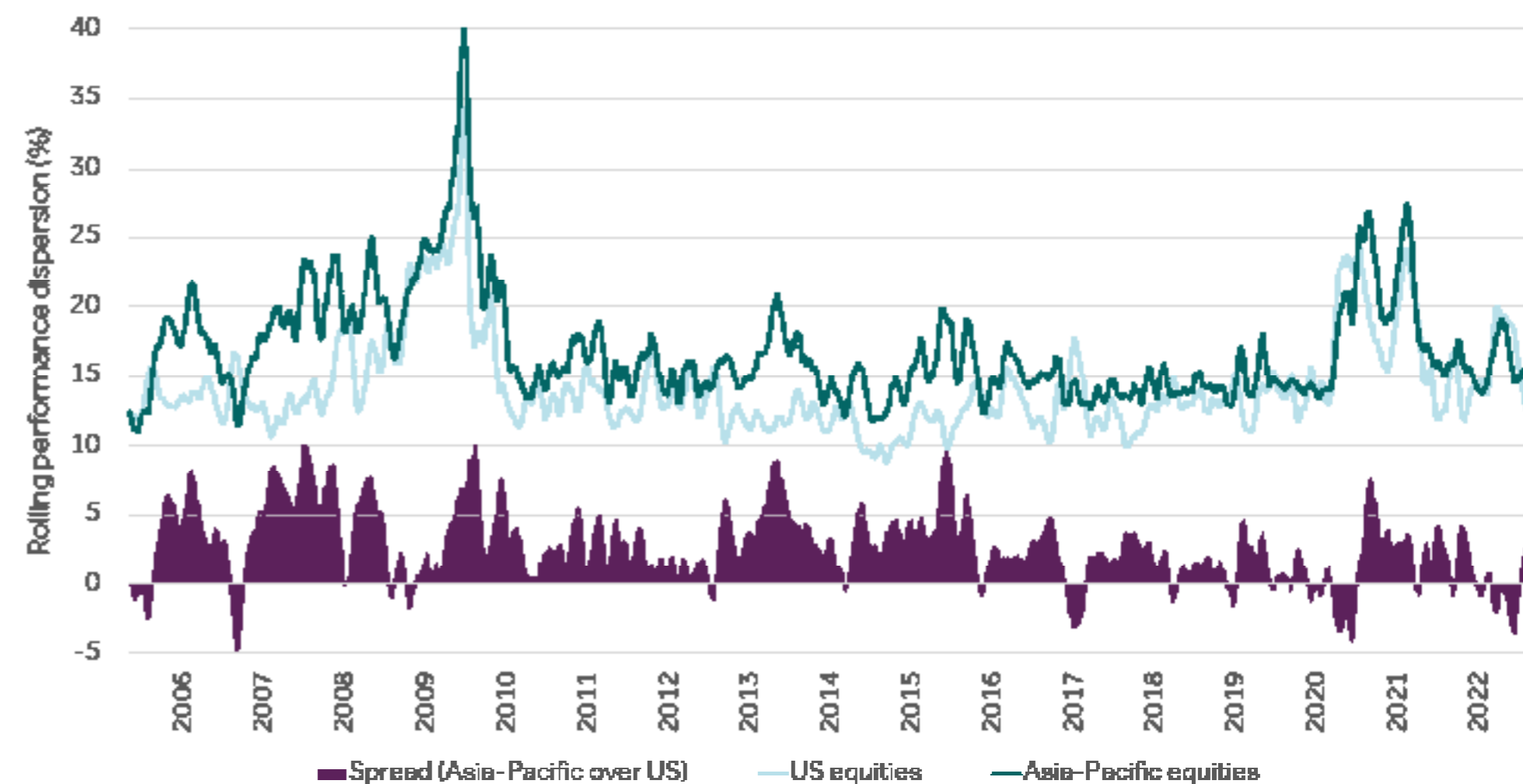
### RUNNING THE NUMBERS

To help illustrate the potential alpha available in Asia, we have looked at the cross-sectional performance dispersion of US and Asian-Pacific (including Japan) large-cap stock markets since January 2005, both areas being measured in US dollars. Our performance dispersion measure is based on the interquartile range, defined as the cross-sectional difference in stock returns between the 75th and 25th percentile.

Our analysis shows that the average performance dispersion exhibits mean-reverting behaviour over longer periods of time. However, it can also be seen over investment horizons of three to six months. Asia-Pacific offers more stock picking opportunities, with a performance dispersion that has been 2.6% higher on average. Since 2005 this spread even reached 10% on occasions, typically during downturns in US equity markets (see chart).

### PERFORMANCE DISPERSION FOR THE US AND ASIA-PACIFIC STOCK MARKETS

The smoothed three-month rolling average performance dispersion of daily stock returns for the US and Asia-Pacific stock markets and the spread between them since 2005



Sources: Bloomberg, Barclays Private Bank, September 2022

<sup>1</sup> SPIVA US Scorecard, S&P Dow Jones Indices, 28 March 2022 <https://www.spglobal.com/spdji/en/documents/spiva/spiva-us-year-end-2021.pdf>

Alpha hunters might be even more attracted to Asia-Pacific dispersion trades if we measure the performance dispersion as the difference between the best and the worst performing stocks (as opposed the interquartile range which is a more statistically robust). In that case, the spread versus the US stock market was 20% on average, and has topped a mindboggling 200% two times over the last 17 years (2011 and 2021).

The above numbers clearly back long-short equity strategies in Asia-Pacific. Historically, skilled stock pickers focusing on this part of the world have been better off than alpha seekers in the US market about 85% percent of the time since 2005. Needless-to-say, past performance does not guarantee future performance.

### ELEVEN SECTORAL SHADES OF THE SAME COLOUR

Significantly lower correlations between Asia-Pacific stocks can explain their superior dispersion properties against the US stocks over the last five years, according to our quantitative analysis (see chart). The same outcome is obtained when stocks are grouped by sectors.

Both regional markets follow a similar pattern in terms of relative correlations. However, overall Asia-Pacific is a clear winner as average correlations in each sector are lower than their US counterparts. As such, they are not driven by specific segments of the two equity markets. The discrepancy is significant in all sectors, being most pronounced in energy and utilities, followed by industrials, real estate, and financials.

### A IS FOR ASIA AND FOR ALPHA

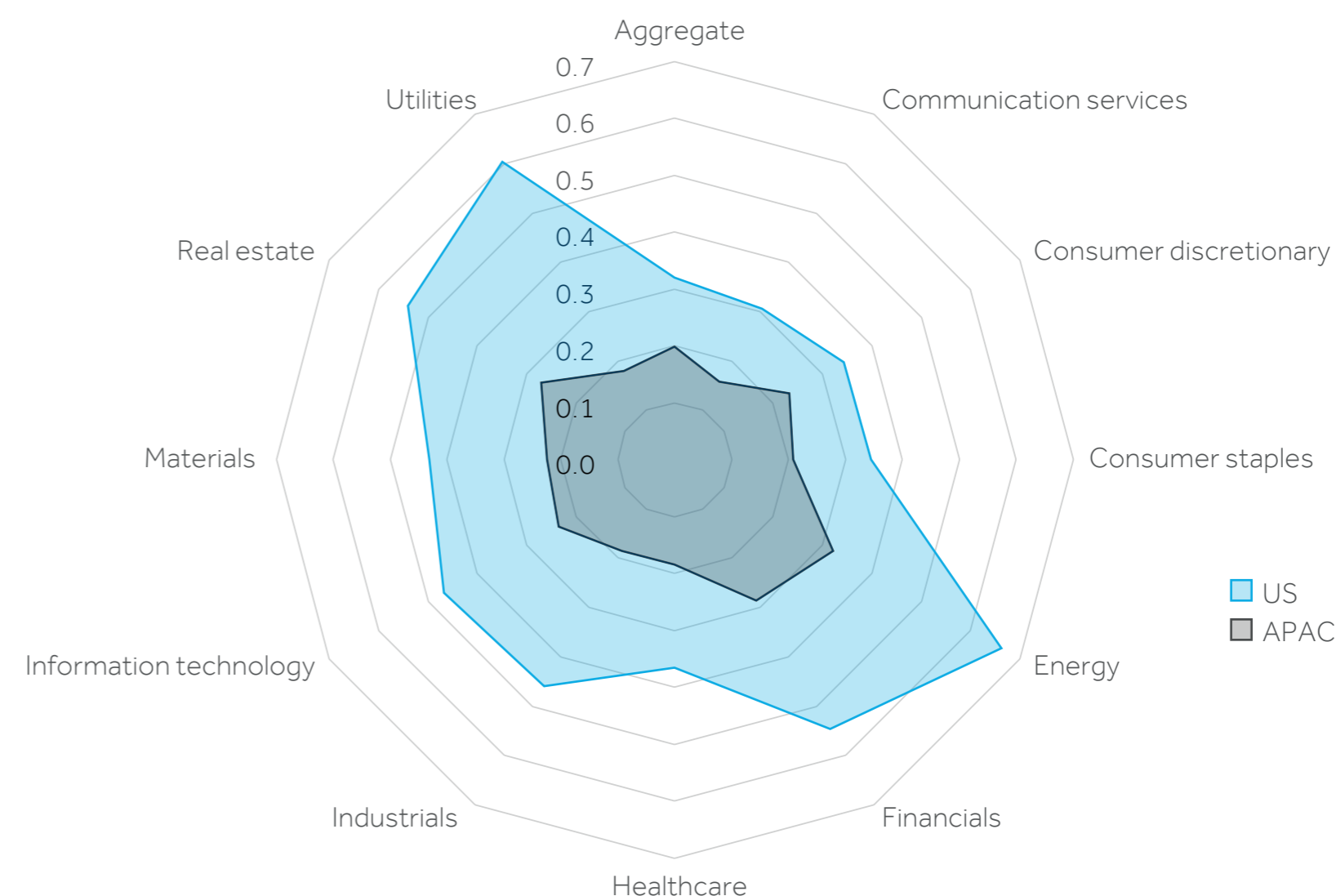
At a time of high uncertainty in equity markets, removing market risk is an attractive proposition. But without beta, investors have to rely on alpha to generate returns. Fund managers and stock pickers have found that excess returns are proving to be increasingly scarce, at least in developed markets.

However, Asia continues to offer plenty of opportunities for those with the know-how and risk budget to capitalise on them.

**Authors: Julien Lafargue, CFA, London UK, Chief Market Strategist; Nikola Vasiljevic, Zurich, Switzerland, Head of Quantitative Strategy**

### AVERAGE CORRELATIONS FOR THE US AND ASIA-PACIFIC STOCKS AND FOR ELEVEN SECTORS

The average three-month rolling correlation of daily stock returns for the US and Asia-Pacific markets and their eleven equity sectors since 2017



Sources: Bloomberg, Barclays Private Bank, September 2022

# All investor eyes turn to the US midterm elections

With US inflation at its highest in four decades, surging interest rates, and a technical recession in the first half of the year, a red wave might be on the cards at November's midterm elections. However, as the Democrats' campaign picks up steam, the battle for control of Congress could be a much closer call than first envisaged.



The midterm congressional elections are scheduled for 8 November 2022 and will determine the American policy agenda for the next two years. The United States Congress consists of the House of Representatives and the Senate. The constitution grants Congress the sole authority to enact legislation and declare war. Senators serve six-year terms, of which one-third are up for election in November. Meanwhile, all 435 members of the US House of Representatives will be elected.

## CHANGE IN THE POLITICAL WINDS

Sitting halfway through the presidential four-year term, the midterm elections are traditionally seen as a referendum on the incumbent president. According to a recent Reuters/Ipsos opinion poll, President Biden's approval ratings continue to hover at around their lowest seen in his term in office, with only 39% of respondents approving of his handling of the job<sup>1</sup>. His approval rating has languished below the 50% mark since August 2021.

History has shown that the governing party invariably loses seats at the midterm elections. President Obama's Democrats lost 63 seats in the House of Representatives at 2010's midterms, while the Republicans lost 40 seats in the House in the last midterms. In the forty midterm elections since 1862, the president's party has lost seats in the House of Representatives 90% of the time.

Despite the worrying historical signs for the Democrats, there are a range of factors that appear to be energising the party's base. For one, the conservative leaning Supreme Court's decision to overturn the federal right to an abortion, in the Roe versus Wade ruling, in June appears to have enraged many Democrats. Further, the party has delivered a plethora of legislative victories in recent months, including in key policy areas such as the economic recovery packages, infrastructure investment, healthcare reform, and climate-change initiatives.

**“In the forty midterm elections since 1862, the president's party has lost seats in the House of Representatives 90% of the time”**

Money can also be a determining factor in US elections. According to data from the Federal Election Committee, Democrats are noticeably ahead of their main rivals in the fundraising arena. Democratic Senate candidates have raised \$526 million, while Republicans trail with \$510 million raised<sup>2</sup>. The re-energised Democratic base has helped to boost turnout as well as candidates to outperform at a range of special elections in recent months.

## BALANCE OF POWER AND KEY BATTLEGROUND

In the Senate, Democrats hold 48 seats and the Republicans 50 seats. Two Independents caucus with the Democrats. The governing party holds the majority in the Senate due to the tie-breaking vote of Vice-President Kamala Harris.

Out of the 100 Senate seats, 35 are up for election this year. Of those 35 seats, 21 are held by Republicans and 14 by Democrats. The electoral cycle may come to the aid of the Democrats too, as they are not defending any seats in states that were won by Trump in the 2020.

<sup>1</sup> 57% of Americans disapprove of the president, Reuters, 20 September 2022 <https://graphics.reuters.com/USA-BIDEN/POLL/nmopagnqapa/>

<sup>2</sup> Raising by numbers, Federal Election Commission, 26 September 2022 <https://www.fec.gov/data/raising-bythenumbers/>

The key battleground seats appear to be in Nevada and Georgia, which are held by the Democrats, and Wisconsin and Pennsylvania, which are held by the Republicans. In order to break the current 50-50 tie, it's considered that Republicans would need to win three of these "too close to call" contests to flip control back into their favour.

### HOUSE OF REPRESENTATIVES

If Democrats were to maintain control of the Senate, Republicans would still be favourites to carry the House of Representatives. Democrats have a majority in 221 seats, with the Republicans holding 212 others, and two vacancies. Looking at the races that are typically won by five percentage points or less, political analysts have highlighted around 80 competitive seats. These are likely to determine the outright result. In order to gain a majority, Republicans would need a net gain of six seats, at a minimum.

The recent fall in petrol prices, robust labour markets, and the stronger fund-raising season has improved the prospects for the Democrats in the House, compared to a few months ago. However, along with the difficult precedent, the fortunes of the party may also be impeded by nearly forty of its incumbents deciding not to seek re-election in November.

Meanwhile, Republicans are thought to have benefited from the redistricting process, which redraws boundaries to account for changes in population, as highlighted by the census. This procedure is conducted at the start of a new decade and appears to favour the "Grand Old Party" in a number of districts this time around.

Given the tradition of protest voting, their lower lead in the polls, and structurally higher turnout for Republications, political forecasters believe that the Democrats will lose control of the House after the midterm election.

### IMPACT OF A SPLIT CONGRESS ON POLICY

A split, or Republican, Congress would impact President Biden's ability to deliver his key spending and tax policies in the second half of his term. The diffusion of power across the political spectrum would likely constrain Congress when deciding on the appropriate levels of government funding and when assessing expiring provisions. Conversely, a Democratic-controlled Congress could reignite proposals for increases in corporate, capital gains, and income taxes.

### MARKETS AND THE MIDTERMS

Over the past century, equities have tended to underperform going into the midterm vote. However, as clarity over the political outlook improves, so does the performance of stocks. Therefore, all things being equal, investors should prepare themselves for yet more volatility in the near term, followed by the potential for a rally.

**“Investors should prepare themselves for yet more volatility in the near term, followed by the potential for a rally”**

Looking at the performance of equities over the course of the presidential cycle, this shows that the midterm year, on average, delivers lower annualised US stock market returns. History shows that year three (pre-election) has delivered the best returns, followed by year one and then year four.

Somewhat counterintuitively, investors appear to actually prefer a split Congress. The average S&P 500 return when Democrats have held the presidency and Congress was split, has been higher than when government or the Congress is unified. So, perhaps investors would agree with the founding fathers that a balance of power is not only good for politics but also for market returns.

**Author: Henk Potts, London UK, Market Strategist EMEA**

# Cyclically-adjusted PEs as a guide to equities' long-term return potential

It's been a violent year for global equities, which returned to bear market territory in September. Views on the way forward are incredibly polarised. We step back from the current market volatility to reflect on equities' long-term return potential, using history as a guide.



It would be an understatement to say that equity investors have had a wild ride this year. At the time of writing, the MSCI All Country World Index is down by 25% from its January peak (through its June lows), but not in a straight line. Its path has been rather erratic: a slide of 14%, followed by moves of +10%, -15%, +7%, -11%, +13%, and -14%.

Along the way, a lot of investors have been wrong footed, and views on where markets will go next have become incredibly polarised.

While the near-term environment remains murky, we reflect on global equities' long-term return potential.

## EQUITY MARKETS REMAIN CHALLENGED IN THE NEAR TERM

Uncertainty is likely to prevail in the short term, with risks skewed to the downside. Inflation looks like moderating in the coming months, but could stay elevated for a while. The US Federal Reserve (Fed) has become increasingly hawkish in its fight against rising prices, and is now prepared to sacrifice growth and risk a recession.

After the September Fed meeting, chair Powell conceded that: "The chances of a soft landing are likely to diminish to the extent that policy needs to be more restrictive, or restrictive for longer. Nonetheless, we're committed to getting inflation back down to 2%. We think a failure to restore price stability would mean far greater pain."

Other central banks are communicating along the same lines. The message couldn't be more explicit: financial conditions will be tighter for longer and recession probabilities have substantially increased. The big question now is around the timing, magnitude, and duration of the next recession.



## YIELD CURVE SUGGESTS A RECESSION IS LIKELY

The 2s10s US yield curve, which initially inverted in March as 2-year bonds yielded more than the 10-year ones, broke below -50 basis points (bp) in late September, a level that has been reached, or even approached, only twice in the past 40 years: in April 2000 and March 1989. On those occasions, a recession followed in the next ten months in the case of the former, and 15 months for the latter.

Yield curve inversions have been reliable indicators of recessions, and a consensus of economists now puts the probability of a recession in the next 12 months at 50% in the US and 73% in the eurozone. Barclays' economists now expect advanced economies' gross domestic product to contract in 2023.

## “A consensus of economists now puts the probability of a recession in the next 12 months at 50% in the US and 73% in the eurozone”

### BUT WHAT ARE THE LONGER-TERM PROSPECTS FOR EQUITIES?

For investors who can ignore the current period of extreme uncertainty, and tolerate market volatility, what are the longer-term prospects?

While risk assets typically struggle in this type of environment, equity markets have already moved a long way and are pricing in some of those risks. The MSCI All Country World Index trades on a forward price-to-earnings (PE) multiple of 14.6 times (x), down from 18.4x in January, and is back in line with its 20-year average. The de-rating is due to the collapse in equity prices, as forward 12-month earnings estimates have barely moved over that period.

However, while valuations certainly appear more attractive now, we would refrain from making hasty investment decisions purely based on forward PEs at present.

As we have argued before, forward earnings PEs are distorted by unrealistic earnings assumptions. We expect earnings forecasts to be downgraded materially in the coming months, as it becomes apparent that companies cannot sustain margins in the face of slowing growth and stubbornly high inflation.

Bottom-up analysts still expect global earnings to grow by 11% this year, and by 6% next year. This is substantially higher than the 7% year-on-year earnings decline suggested by our top down earnings model by the first quarter of 2023.

### TURNING TO CYCLICALLY ADJUSTED PRICE-TO-EARNINGS MULTIPLES

This is why we turn to nominal cyclically adjusted price-to-earnings multiples (CAPEs) to assess equities' long-term return potential. We define CAPEs as the share price divided by nominal ten-year average earnings, as opposed to the price divided by expected earnings in the next 12 months.

It is generally accepted and well documented that buying equities on a low CAPE leads to stronger investment returns in the subsequent years. While not new, the strength and consistency of this relationship can easily be forgotten. Indeed, in times of heightened uncertainty, it is helpful to take a step back from market volatility, and use history as a guide for future returns. Albeit, past performance does not guarantee future performance.

### CAPEs ARE PARTICULARLY USEFUL WHEN LOOKING TEN YEARS' OUT

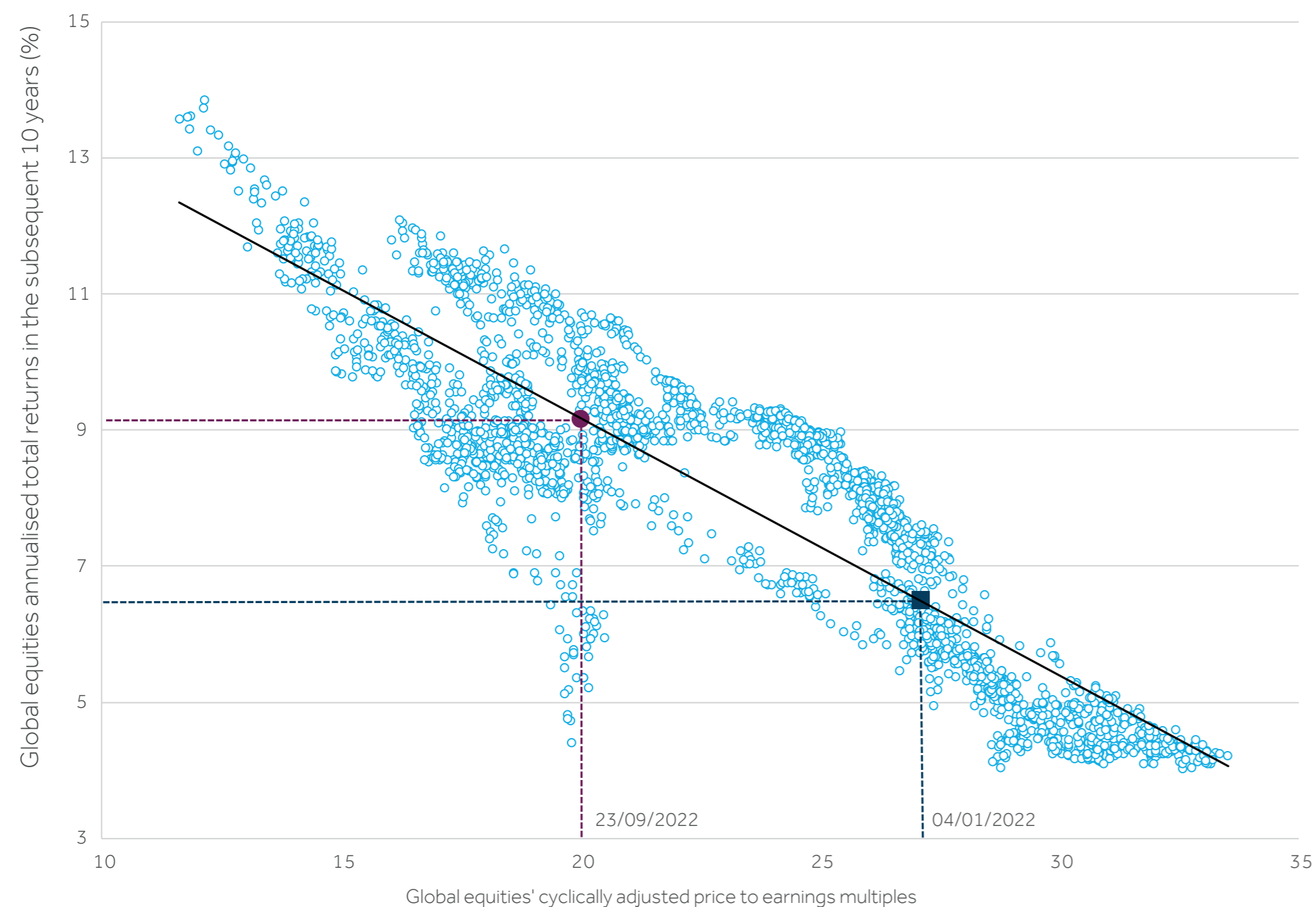
For the purpose of this article, we explored the relationship between CAPEs and historical returns from stocks, in absolute terms and relative to bonds, in the years following an investment at a specific CAPE.

In doing so, we considered various sample periods (ranging between 20 and 40 years of history), and tested forward returns over the subsequent three, five, and ten years. This showed that CAPEs are most useful for predicting forward returns over the following ten years, using 20 years of history. The other combinations also yielded strong correlation coefficients (notably when using forward five-year returns over a 20-year history), but the standard errors were larger. In terms of examining longer histories, we felt that the world was too different prior to 2002 to make useful comparisons.

More specifically, we found a -89% correlation coefficient between CAPEs and forward ten-year returns, over the 2002-2022 period (see chart, p10). This correlation coefficient weakened to -80% when looking at forward five-year returns.

**STRONG NEGATIVE CORRELATION BETWEEN CAPEs AND GLOBAL EQUITY RETURNS IN NEXT 10 YEARS**

Global equities' annualised returns in the 10-year period following an investment at a specific CAPE (based 20 years of daily data)



Sources: Refinitiv, Barclays Private Bank, September 2022

Note: CAPE stands for cyclically adjusted price to earnings ratio

**CYCLICALLY ADJUSTED PES FALL BELOW THEIR LONG-RUN AVERAGES GLOBALLY, POINTING TO ANNUALISED EQUITY RETURNS OF AROUND 9% IN NEXT TEN YEARS**

Following this year's pull-back in global equities, they now trade on a CAPE of 20.0x, significantly below the previous peak of 27.6x in November 2021, and 9% below their 20-year average.

If history were to repeat itself, global equities should return around 9% annualised over the next 10 years, including dividends, from current levels. This is in line with the performance seen over the past two decades. (see table, p11).

This is a substantial improvement from the +6% annualised returns implied at the start of the year, when global CAPEs were at 27.1x.

**“If history were to repeat itself, global equities should return around 9% annualised over the next 10 years, including dividends, from current levels. This is in line with the performance seen over the past two decades”**

## CAPES SUGGEST THAT GLOBAL EQUITIES' RETURN POTENTIAL IS IN LINE WITH THAT SEEN IN THE PAST TWO DECADES

Equity returns implied by cyclically-adjusted PEs over the next 10 years, including dividends and regression statistics

Equity index (local currency)	CAPE (**) - Current	CAPE (**) - 20-year average	CAPE Current/ 20-year average (%)	Correlation coefficient - past 20 years (%)	Total equity returns - past 20-year CAGR (*) (%)	Total equity returns - Implied forward 10-year CAGR (*) (%)	Total equity returns - Implied forward 10-year CAGR (*) on 04/01/22 (%)
Global	20.0	21.9	91	-87	8.8	9.2	6.4
DM	21.1	22.8	92	-90	8.6	9.2	5.9
US	30.3	26.7	114	-89	9.9	6.6	-1.2
Developed Europe	18.2	17.7	103	-90	7.3	6.8	3.7
Eurozone	17.5	17.3	101	-92	7.1	6.3	2.7
France	22.9	18.7	123	-93	8.7	4.3	-0.8
Germany	14.1	17.2	82	-84	7.3	9.2	5.4
Italy	15.5	16.6	93	-91	4.7	4.5	1.2
Spain	15.0	17.0	88	-71	6.6	6.4	5.7
UK	16.7	16.8	99	-57	7.3	7.3	6.7
Switzerland	22.3	21.2	105	-93	7.4	6.2	1.6
Japan	19.1	29.4	65	-93	5.6	10.2	9.2

Sources: Refinitiv, Barclays Private Bank, September 2022

\* CAGR: Compounded annual growth rate

\*\* CAPE: Cyclically adjusted price to earnings ratio

## CAPES SUGGEST THAT GLOBAL EQUITIES SHOULD OUTPERFORM BONDS BY AROUND 5% IN THE NEXT TEN YEARS

Current valuations would also be consistent with global equities outperforming US 10-year Treasuries by around 5% over the next 10 years, broadly in line with the outperformance seen in the past two decades. This compares with the outperformance of 1% implied at the start of the year.

In addition to the outlook for CAPEs, find out more about the long-term prospects for 60/40 portfolios, invested 60% in equities and 40% in bonds, and American cross-asset risk premia with our [After the storm comes great expectations](#).

## JAPAN, GERMANY, AND THE UK SEEM TO OFFER MORE APPEALING RETURN POTENTIAL AMONG DEVELOPED MARKETS OVER THE NEXT DECADE

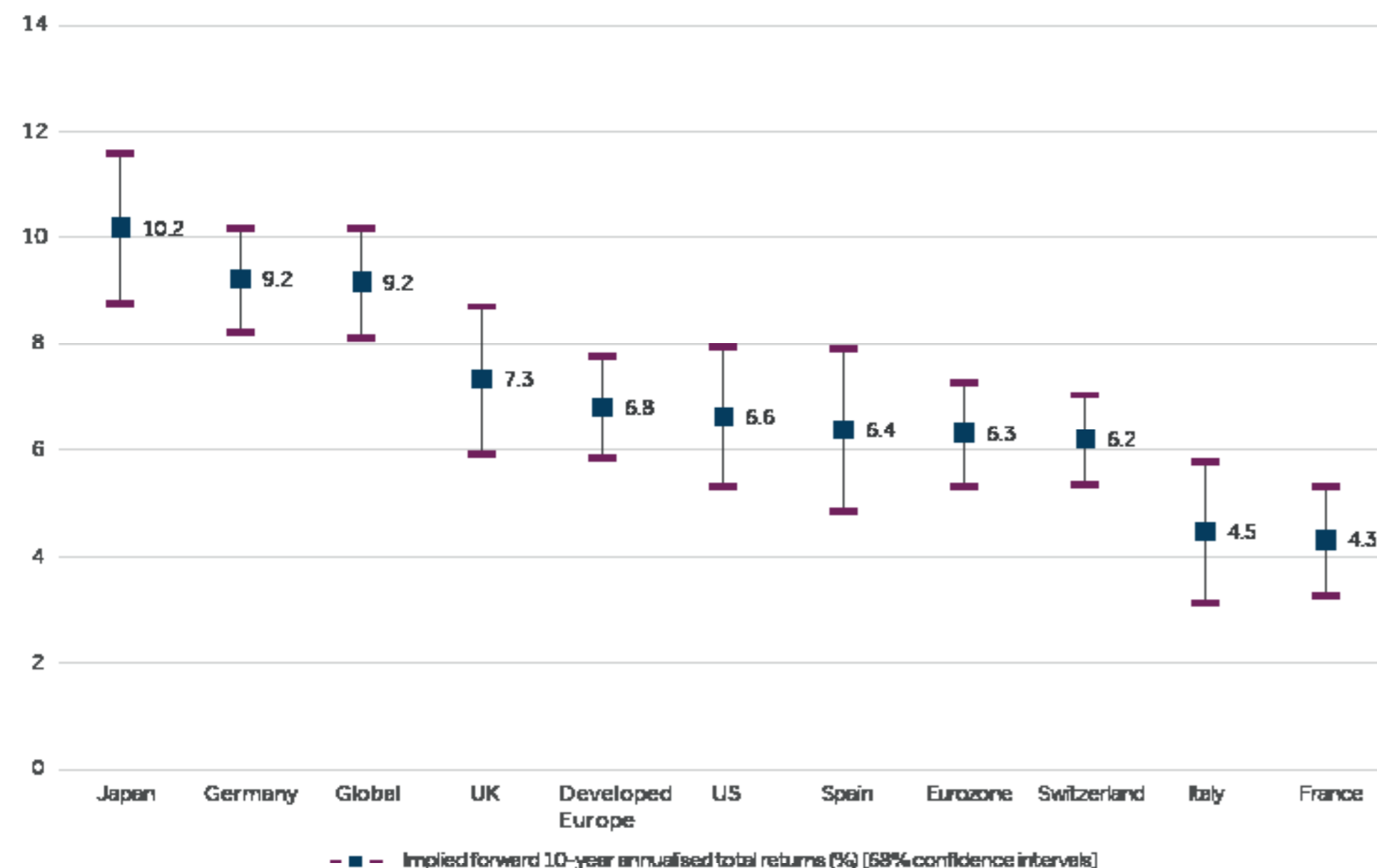
Regionally, our analysis focused mostly on developed markets, the US, Europe, the eurozone, the UK, Switzerland, and Japan (see chart, p12). We excluded emerging markets, due to partial history, as well as the world, excluding the US, as a bloc, due to an unsatisfactory standard error.

But given implied returns globally and in developed markets (where the analysis shows robust regression statistics), we inferred that emerging market equities would also be expected to generate total returns of around +9% annualised over the next decade.

**“But given implied returns globally and in developed markets... we inferred that emerging market equities would also be expected to generate total returns of around +9% annualised over the next decade”**

## INVESTMENT OPPORTUNITIES VARY BY REGION

Implied forward 10-year annualised returns by region, including dividends, within a 68% confidence interval



Sources: Refinitiv, Barclays Private Bank, September 2022

Note: CAPE stands for cyclically adjusted price to earnings ratio

Valuations are also consistent with a convergence of total returns in the US and Europe to 7% or so in the next ten years. This compares with historical returns of 9.9% and 7.3% annualised, respectively, seen in the past 20 years.

In our analysis, Japan ranks as the market with the best return prospects, offering annualised returns of around 10% over the next decade, compared with 5.6% in the past 20 years.

Within Europe, valuations hint at more upside potential in Germany and the UK (at around 9% and 7% implied respectively) than in France or Italy (each around 4%). As a note of warning, our analysis is purely quantitative and fails to capture, for instance, the investment risks related to the energy crisis in Europe, to which the German economy is particularly exposed.

### LONG-TERM EQUITY RETURNS IMPLIED BY CAPES OFFER REASSURANCE

While the macro environment has become increasingly complex and uncertain, we are reassured by the long-term returns implied by current CAPEs.

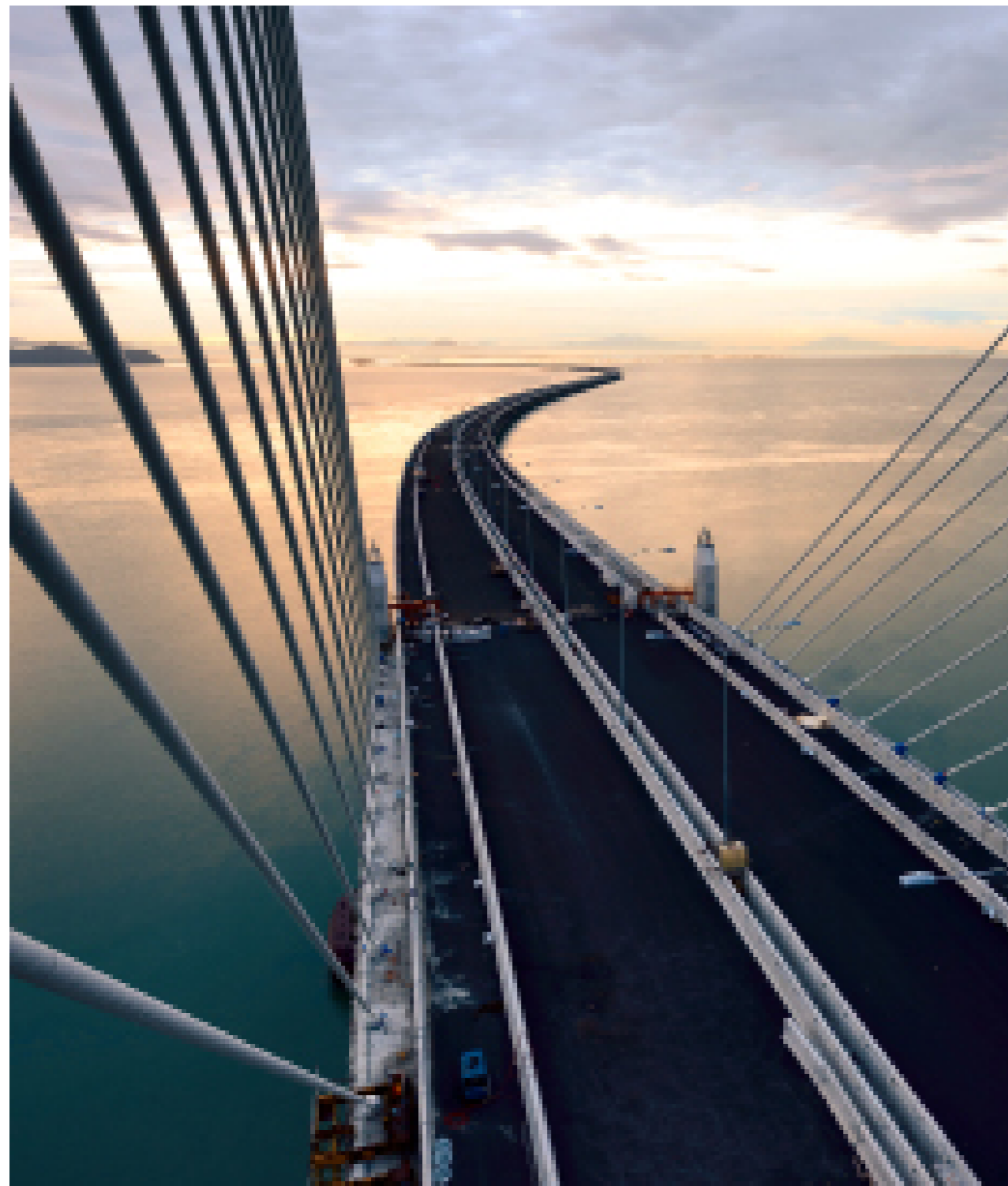
We recognise that our analysis is purely quantitative and may not be appropriate in a world of high inflation, increasingly restrictive monetary policies and heightened geopolitical tensions. However, it certainly provides a useful input into long-term investors' decision-making process, especially when evaluating opportunities across regions.

For shorter-term investors, who are unable or unwilling to weather severe market volatility over the coming months, we encourage a cautious positioning through tactical hedges and structured products, diversified portfolios including alternative assets, and uncorrelated investment strategies.

**Authors: Dorothee Deck, Cross Asset Strategist**

# Inflation-linked bonds: wrong timing or back in focus?

Aggressive central banks hiking and a worsening outlook for the global economy suggests that a period of lower inflation is on the horizon. But the path to moderation is likely to remain choppy. How do inflation-linked bonds stand out at times like these?



Many central banks have picked up the pace of interest rate hikes significantly during the last two months: 50 basis points (bp) represents the absolute minimum these days it seems.

The Bank of England (BoE) hiked by 50bp, while the European Central Bank (ECB) and the US Federal Reserve (Fed) lifted rates by 75bp at their September meetings. Taken together, the three of them have hiked by a whopping 350bp since June.

The three central banks are determined to fight record inflation. While the backdrop for all three economic areas differs, to some extent time is money. And the cost of not acting forcefully and swiftly is believed to be too high.

## NO PAIN, NO GAIN

The Fed leads the hiking cycle charge among the major central banks and does not seem to be shying away from greater growth repercussions. "No one knows whether this process will lead to a recession or if so, how significant that recession would be," Fed chair Jerome Powell told reporters during his FOMC press conference in September. He added: "We have got to get inflation behind us. I wish there were a painless way to do that. There isn't."

The FOMC members project a rate of 4.6% (median) by the first quarter of next year. "The path that we actually execute will be enough", he said when referring to the task of bringing inflation back towards the 2% target (a long way from here).

## FED'S RATE PROJECTION SEEMS REALISTIC

The rate market won't dare challenge the central bank's policy rate path and prices in a peak rate close to the Fed's "dot-plot" projection, at around

4.6% (mid-point) early next year. With such a move, the Fed's forecast for a moderation in inflation towards 3.1% by the end of next year seems realistic, while the risk of stickier inflation remains.

Base effects, diminishing pressure from pandemic-related components like cars and airfares, but also lower trending healthcare insurance costs, as well as a cooling housing market, point to weaker price growth. Until then, the core underlying (longer-lasting) trend, as reported by recent inflation prints, seems firmly up. Meanwhile, food and energy costs remain a risk for the trend of moderation.

While the short end of the curve tries to calibrate towards the possible peak in rates, the long end is already looking beyond the period of peak inflation. This should also explain why bond investors would settle for the lower yields that longer-dated bonds offer over shorter-dated bonds. Over a five-year period, for example, it appears very likely that policy rates in any of the bond markets may fall, especially in a recessionary environment.

## CASH RATES HIGH, FOR NOW

Cash rates, as implied by 2-year bond yields, may be on the up for now. However, over a longer period yields are likely to adjust downwards again. As such, cash is unlikely to perform better than what current long-end yields suggest, in our view (see chart, p14).

Weighing up between the risk of significantly higher rates (duration or price volatility risk) and the possibility of much lower rates in three years' time (re-investment risk) seems to be a crucial exercise. Weighing up between the two, we see value in maturities of between two years and five years at this point. As highlighted in the last [Market Perspectives](#), we prefer investment-grade bonds, especially at current yields of well over 5%.

## INVERTED YIELD CURVE POINTS TO LOWER INTEREST RATES

The yields offered by 2-year and 10-year US bonds show that 2-year yields are at their highest level over those offered by the longer-term bonds in the last decade.



Sources: Bloomberg, Barclays Private Bank, September 2022

## TIME TO CONSIDER INFLATION-LINKED BONDS?

When it comes to diversifying bond portfolios further, inflation-linked bonds (ILBs), also known as “linkers” (in the UK), come to mind. But investors may rightly ask whether this is the right time to invest in this type of bond. Alternatively, they might question if it is too late, given how high inflation is, that peak inflation nears, and that insurance against inflation is usually at its most expensive when the inflation house is burning. That said, there are justifiable reasons for investing in ILBs, especially to diversify bond-heavy portfolios.

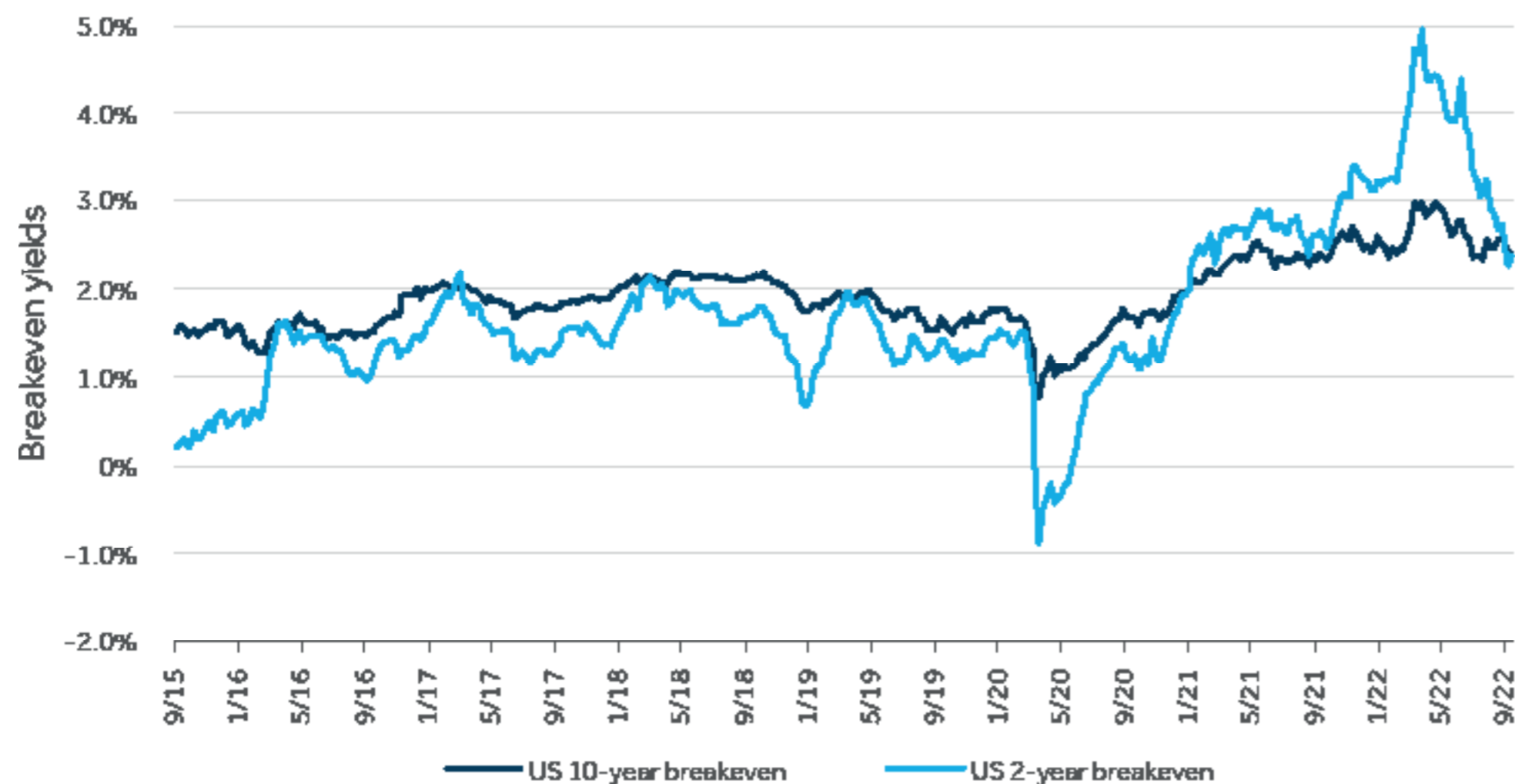
**“Investors may rightly ask whether this is the right time to invest in this type of bond [inflation-linked] or if it is too late”**

In particular, the US inflation bond market has re-priced sharply downwards which reflects the market’s conviction that inflation will plunge (see chart, p15).

For instance, 2-year breakeven rates, which reflect the difference between yields from nominal bonds and linkers, imply that inflation will average 2.3% over the next two years (although the number is partly distorted by the time lag evident within the inflation linked bond market). The substantial retreat from levels over 5% suggests that there is much confidence that inflation is declining on the back of a recession, higher policy rates, or both, which is not set in stone. Similarly, the 10-year breakeven rate implies an average inflation rate over the next ten years of 2.4%.

## US BREAKEVEN RATES ON THE SLIDE

The breakeven yields for 2-year US bonds and 10-year ones over the last seven years show 2-year breakeven yields crashing towards those offered from the latter this year



Sources: Bloomberg, Barclays Private Bank, September 2022

## HOW ARE NOMINAL AND REAL YIELDS CONNECTED?

Holders of nominal bonds would usually expect a coupon or yield that compensates for the inflation anticipated if held to maturity. Investors, on the other hand, might focus on the possibility or risk that the embedded inflation premium in nominal bonds (for example 2.4% breakeven for 10-year bonds) does not reflect the anticipated path of inflation, and turn to ILBs instead. So, keeping an eye on the real yield, the breakeven rate, and the nominal yield matters when deciding whether to invest in ILBs or not.

## PREPARE FOR THE ALMOST UNTHINKABLE

The question remains as to whether inflation compensation of 2.3%, as offered by the US 2-year nominal bonds in the earlier example, seems sufficient. In the last two years, the path of inflation has been particularly difficult for investors and central bankers to predict. It is the optimistic pricing of inflation seen in recent times, that offers value in the US inflation-linked bond market, in our opinion.

While not our base case, a higher inflation trajectory, despite lower growth, is still possible. In such a stagflationary scenario, inflation linked bonds are one of the few asset classes that look likely to provide reasonable and stable returns.

**“In such a stagflationary scenario, inflation-linked bonds are one of the few asset classes that look likely to provide reasonable and stable returns”**

### UK ENVIRONMENT LOOKS DIFFERENT

By contrast to the US market, UK breakeven rates still appear high (with a 10-year breakeven rate of 4.15%), especially given the UK government’s capping of energy bills, which is likely to lead to softer inflation. Admittedly the announced measures including debt financed tax cuts may add to inflationary pressures over the medium term again.

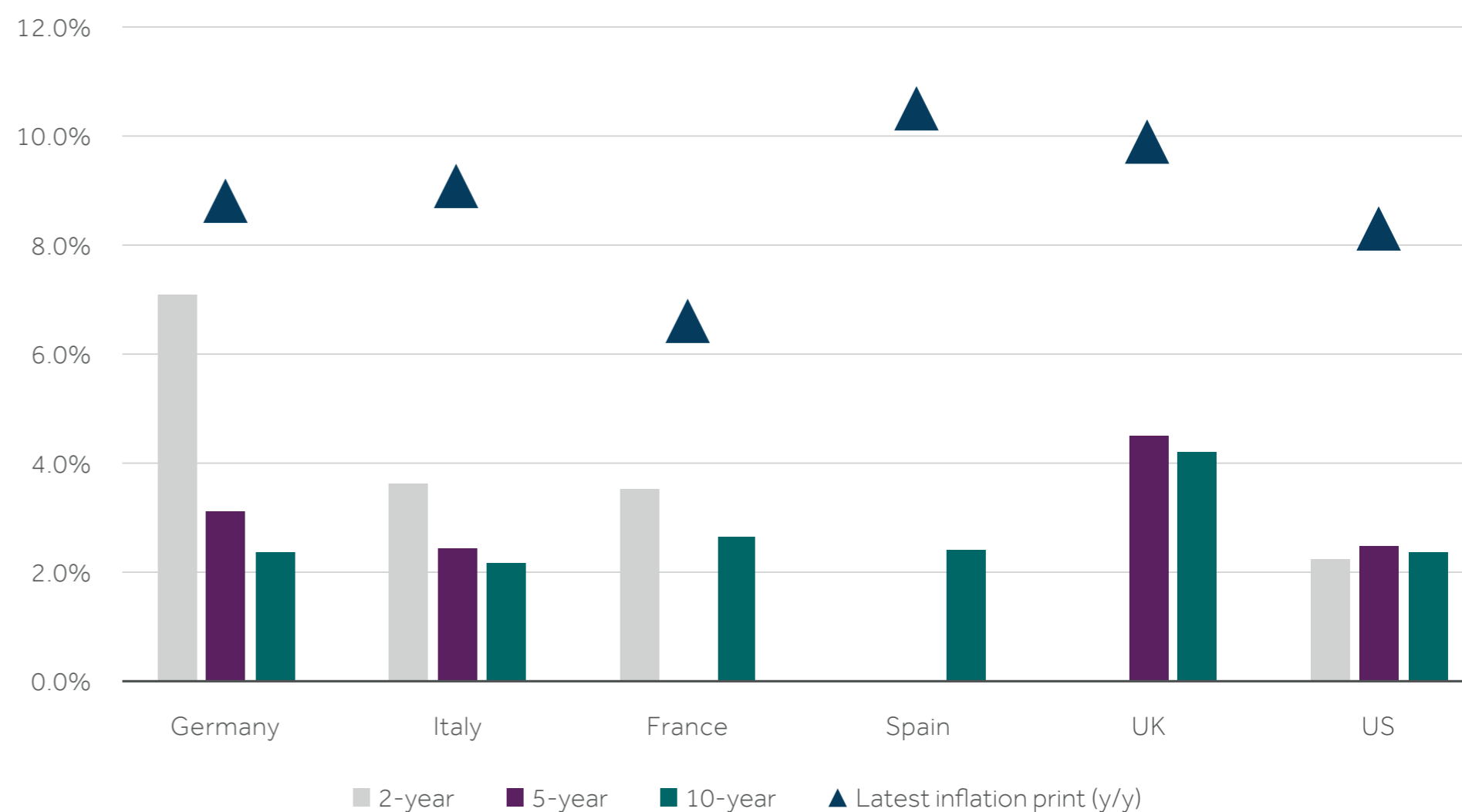
Overall, the outlook for the economy seems very vulnerable with the BoE projecting a recession going into 2024. The next chart illustrates the difference in the pricing among various countries by comparing the current breakeven rate against the most recently reported inflation figure.

While Italian breakeven rates might seem comparatively cheap, the inflation-linked bonds are not insulated from the risk of yet more government debt in the country and the uncertain political backdrop.

**“By contrast to the US market, UK breakeven rates still appear high...especially given the UK government’s capping of energy bills, which is likely to lead to softer inflation”**

### COMPARING BREAKEVEN ANTICIPATED INFLATION WITH ACTUAL PRICE INCREASES

The breakeven rates on 2-year, 5-year and 10-year bonds in Germany, Italy, France, Spain, UK, and the US along with the last reported actual inflation figure



Sources: Bloomberg, Barclays Private Bank, September 2022



## PERFORMANCE OF INFLATION-LINKED BONDS

US real yields have recently hit levels not seen since 2010, potentially suggesting entry levels again. Since 2010 Bloomberg's US 5-10-year inflation linked-bond index has returned 3.13% annually over that period, outperforming nominal bonds by 1.23% a year on average (see table). This is even more remarkable given the period experienced was characterised by lower-trending inflation.

Past performance patterns may not serve as a blue print for what follows. It is also important to note that inflation-linked bonds are not a hedge against inflation as such due to the bond component (real basis). But the inflationary environment has arguably been more uncertain than ever this year. As such, adding inflation-linked bonds at higher and positive real yields seems a reasonable option, as opposed to purely holding nominal bonds in a portfolio.

**Author: Michel Vernier, CFA, London UK, Head of Fixed Income Strategy**

## PERFORMANCE OF US BONDS AND EQUITIES SINCE SEPTEMBER 2010 (BASED ON BLOOMBERG INDICES)

Market	Return per p.a.	Total return since 2010	Volatility over 30 days (current)	Volatility over 90 days (median over the last 10 years)	Duration
US TIPS (0-5y)	1.95%	26.1%	3.3%	1.5%	2.5
US TIPS (5-10y)	3.13%	44.8%	7.3%	4.4%	7.2
US TIPS (10y +)	3.80%	56.4%	18.6%	9.8%	20.9
US Treasury (1-5y)	0.94%	11.9%	2.5%	1.4%	2.7
US Treasury (5-10y)	1.90%	25.3%	6.5%	4.3%	6.5
US Treasury (10-20y)	1.91%	25.5%	13.9%	7.3%	14.2
US corporate aggregate	3.14%	45.0%	7.9%	4.3%	7.5
US corporate bonds (0-3y)	1.66%	21.9%	1.5%	0.6%	1.6
S&P 500	13.65%	364.9%	22.4%	12.9%	

Sources: Bloomberg, Barclays Private Bank, September 2022

# After the storm comes great expectations

A typical 60/40 portfolio, or 60% allocated to equities and 40% to bonds, has been severely punished this year. Equity and bond markets have fallen in lockstep, and are vulnerable to macro uncertainty and political risks. However, the long-term outlook looks better, and expected returns have significantly increased over the past twelve months.



The pandemic-induced global health and supply-chain crises, and supply-demand energy imbalance, hurt the economy. Recent geopolitical events have only rubbed salt into the wound by unleashing global energy and food price shocks, and likely ushering in a more fragmented, precarious world.

## WHEN DIVERSIFICATION BENEFITS ERODE

Government bonds are widely regarded as a safe-haven investment. Historically, they have been lowly correlated with equities and, perhaps more importantly, provided protection during bouts of equity market turmoil.

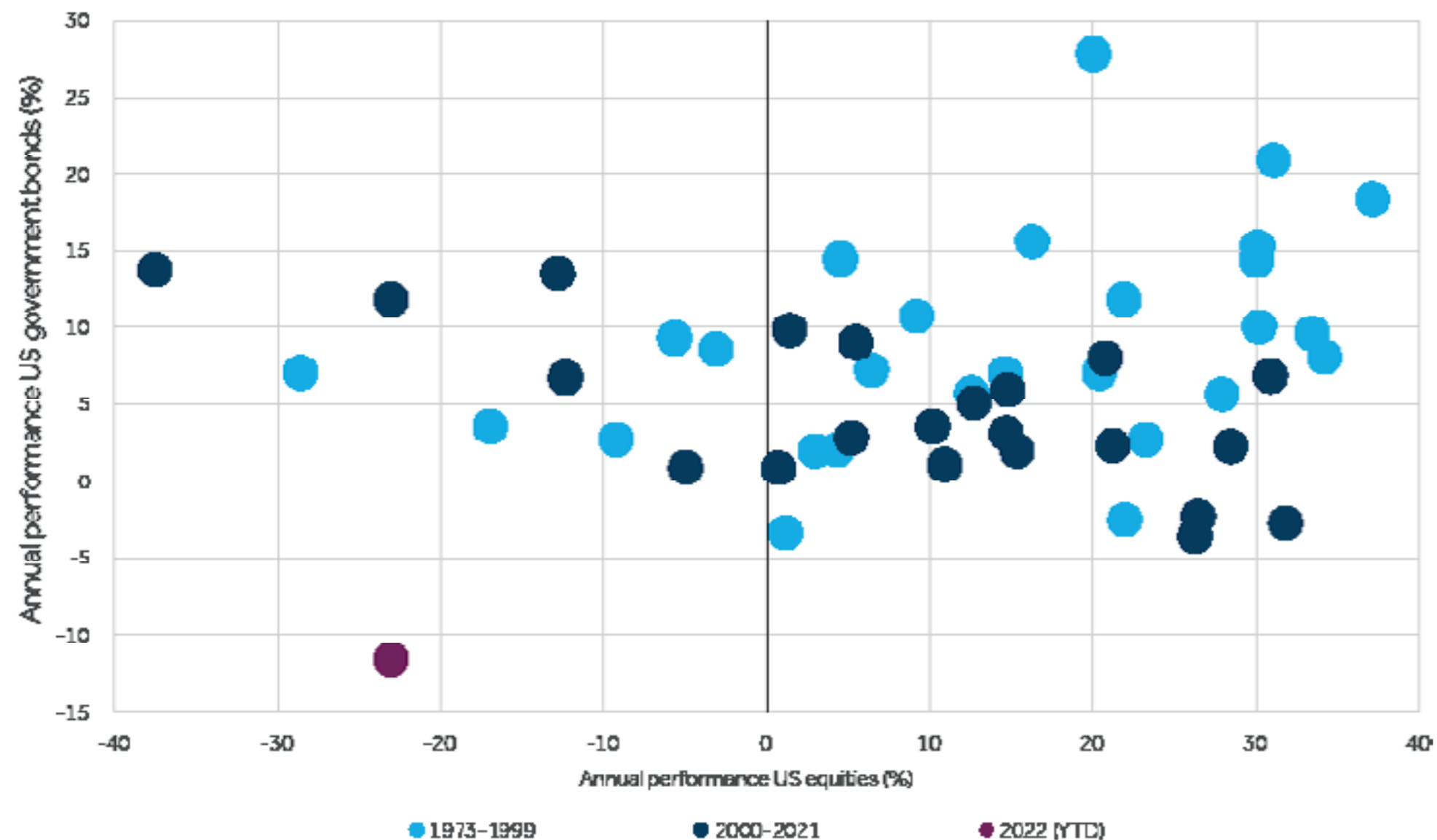
The correlation between equities and bonds has varied substantially in the past. Macro regimes and uncertainty are among the main drivers of these dynamics. Nevertheless, the simultaneous fall in US equity and government bond returns this year is unheard of over the past 50 years, until now.

This year marks the first time US equities and bonds returns have fallen together since 1973 (see chart, p19). Admittedly, the year is not over yet. Unless there is a strong rally in equities and bonds – which seems unlikely – it seems that 2022 will go down in history as the first outlier of this kind.

**“The simultaneous fall in US equity and government bond returns this year is unheard of over the past 50 years, until now”**

### PERFORMANCE OF US EQUITIES AND GOVERNMENT BONDS

MSCI USA Net Total Return index and Bloomberg US Treasury Total Return index annual performance since 1973. The cumulative performance for 2022 is measured on year-to-date basis



Sources: Bloomberg, Barclays Private Bank, September 2022

### STOCKS AND BONDS MOVING IN A LOCKSTEP

By zooming in on 2022, you can see how much equities and bonds have moved in sync, and downwards. US equities and government bonds are off by -23% and -11% respectively so far this year<sup>1</sup>.

An American 60/40 portfolio has seen a drawdown of about 19%. Focusing on the last two decades, such losses by the end of September have only been seen during the bursting of the dot-com bubble in 2002 and at the peak of the global financial crisis in 2008. In fact, a typical US 60/40 portfolio has had the worst start to the year this century.

Although comparable in terms of drawdowns, the crucial difference to this year is that government bonds fulfilled their portfolio diversifier and equity tail-risk hedging roles back in 2002 and 2008 (see chart, p20). As mentioned above, this has not been the case in the post-pandemic world, as the US equity-bond correlation (measured on a three-month rolling basis) is highly positive.

### INFLATION: PANDORA'S BOX

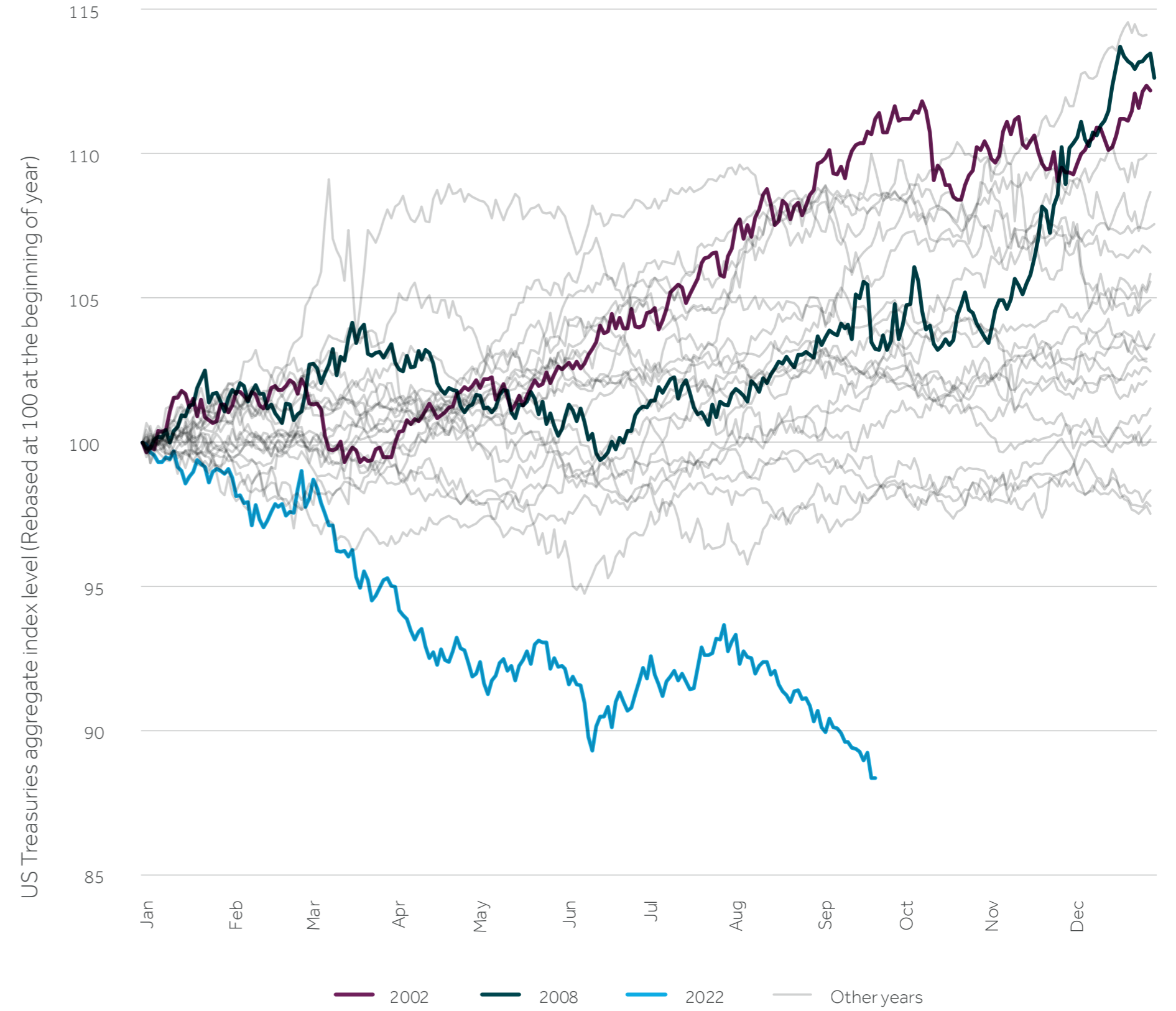
Inflation has sped to multi-decade highs this year. Pent-up demand, accumulated during the pandemic, coupled with supply-chain bottlenecks, rising wages, and soaring oil, gas, and electricity prices have paved the way for a new, more volatile macro regime.

Accommodative monetary policy helped government bonds to offset some equity drawdowns in 2002 and 2008. In contrast, soaring inflation and aggressive, synchronised interest rate hikes (see chart, p21), when economic activity was already slowing, have scared almost all financial assets this year, particularly long-duration assets. Relative to their respective historical averages, equity and bond volatility has doubled this year.

<sup>1</sup> Our benchmark indices for the US equities and government bonds are the MSCI USA Net Total Return and Bloomberg US Treasury Total Return, respectively. Both indices are unhedged in USD.

### INTRA-YEAR CUMULATIVE PERFORMANCE FOR THE US EQUITIES AND GOVERNMENT BONDS

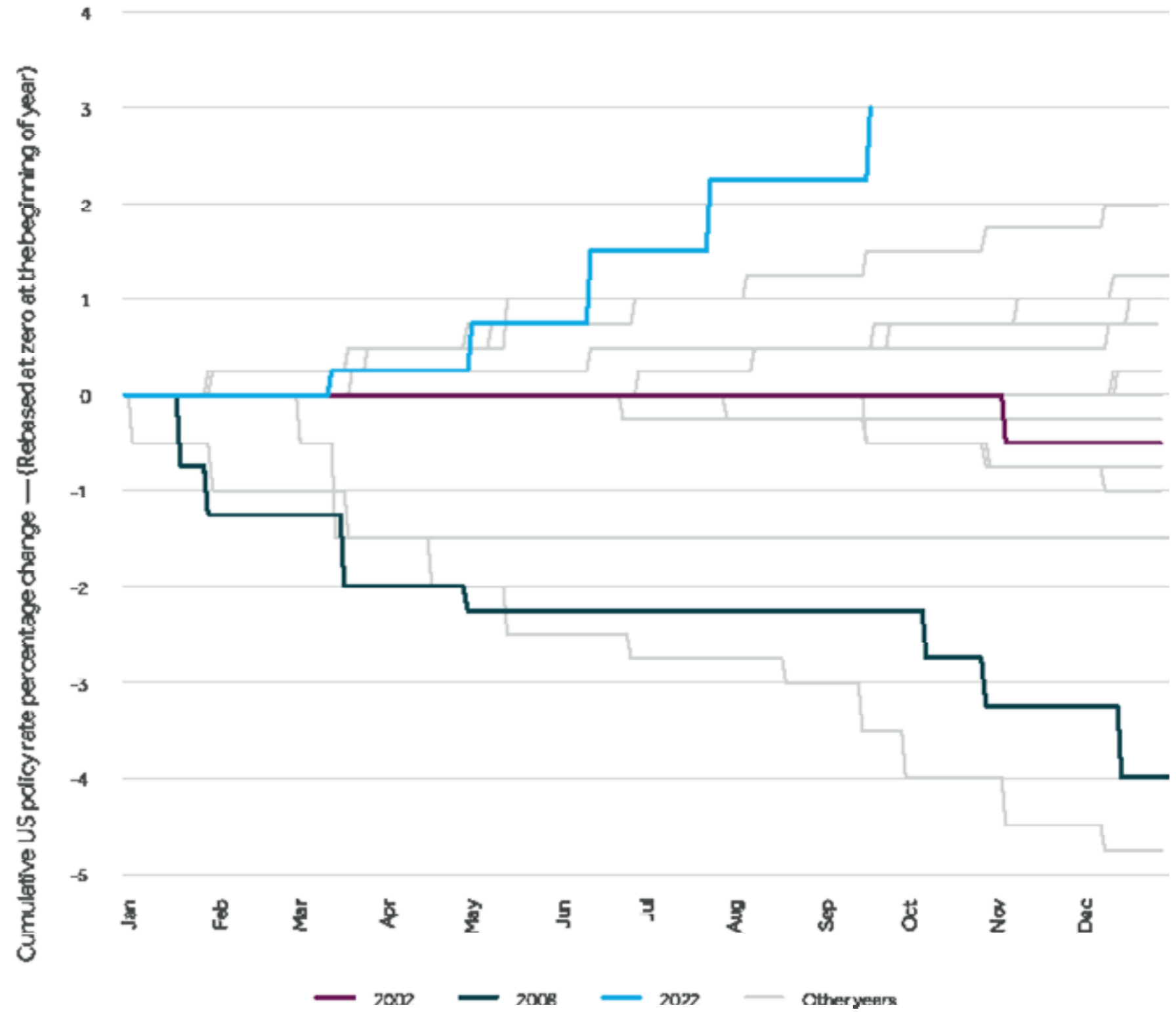
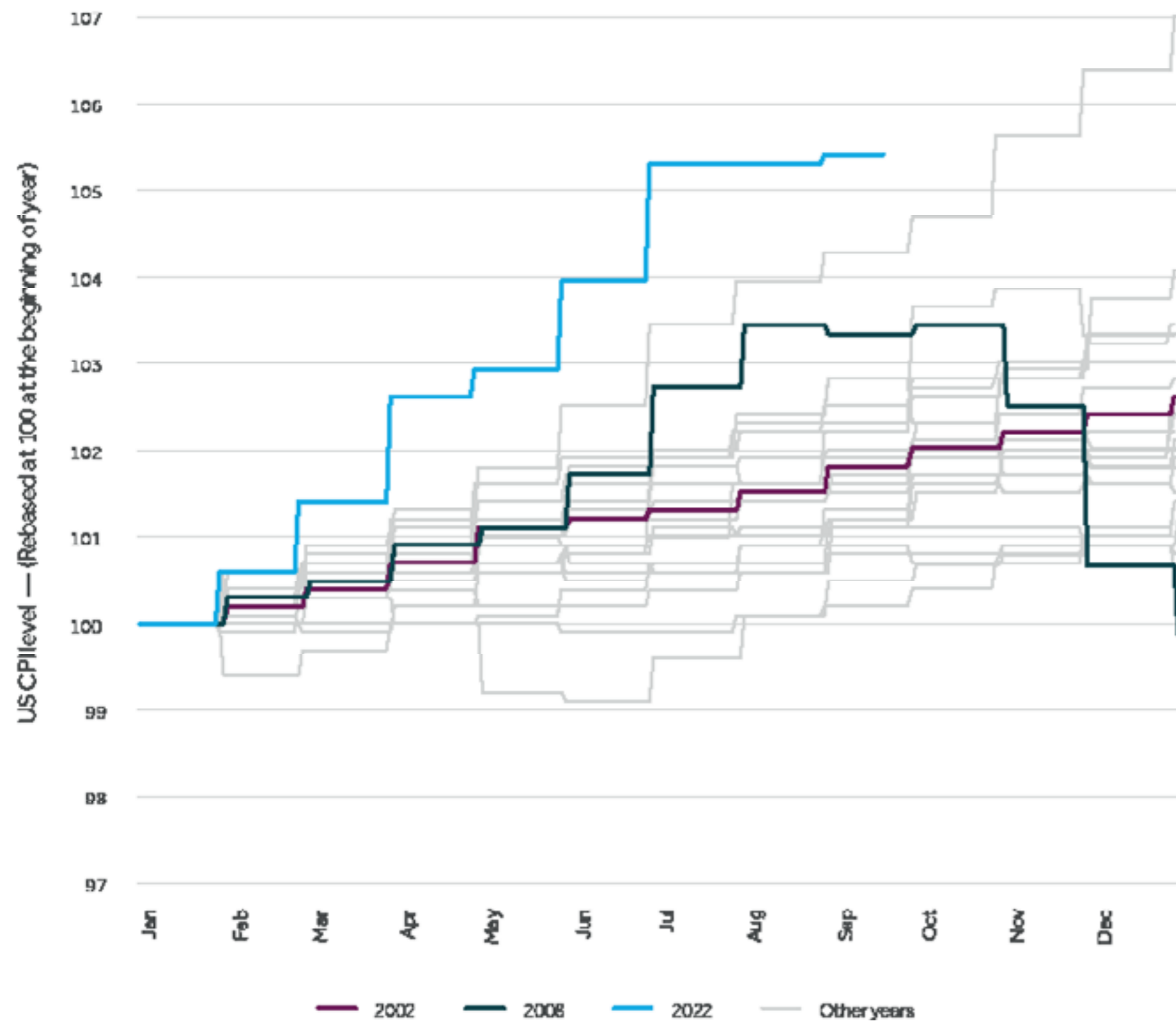
MSCI USA Net Total Return index and Bloomberg US Treasury Total Return index intra-year cumulative performance for each year since 2000, given on daily frequency. The intra-year cumulative performance for 2022 is measured on year-to-date basis. The indices are rebased at 100 at the beginning of each calendar year.



Sources: Bloomberg, Barclays Private Bank, September 2022

### US INTEREST RATE CLIMBS, ALONG WITH INFLATION

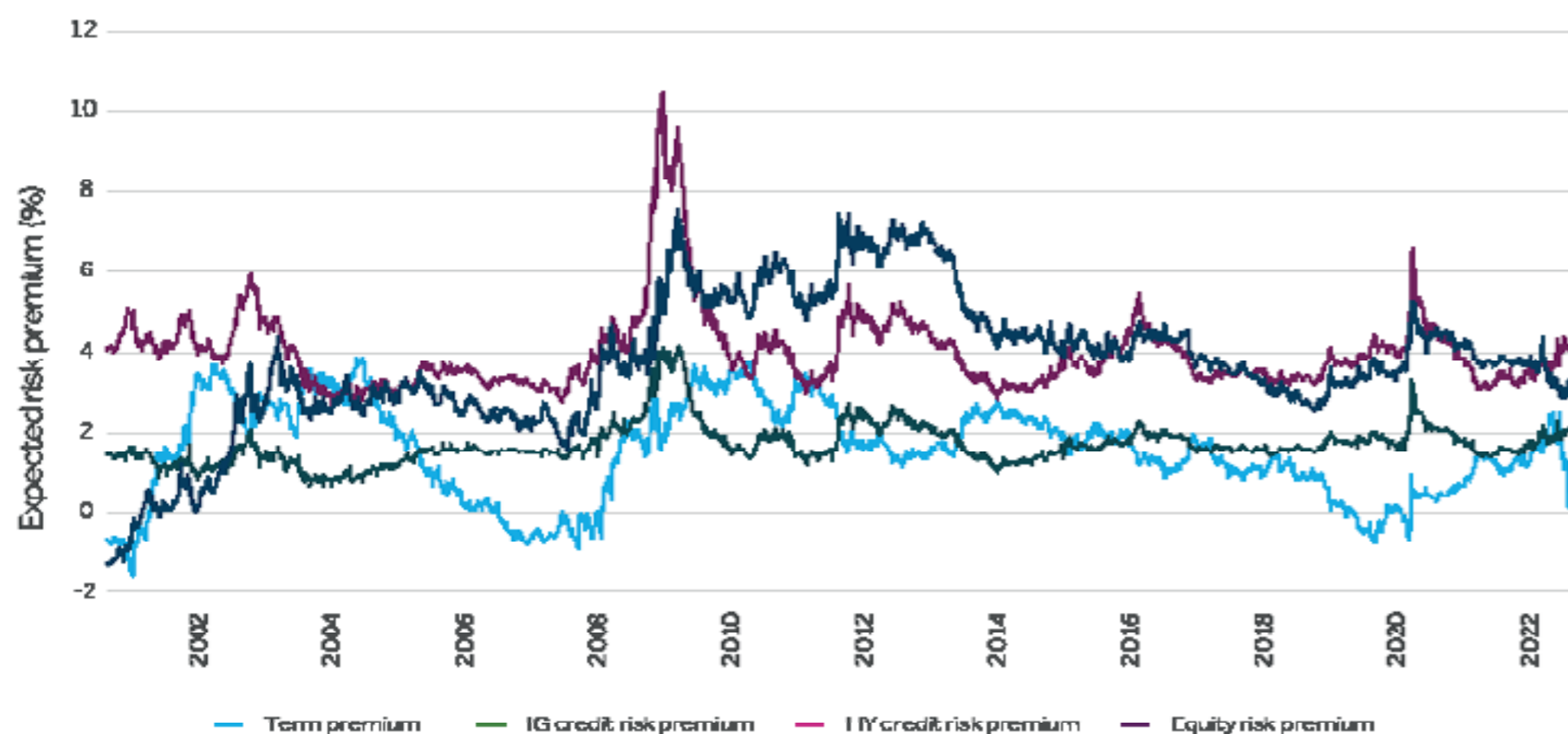
US consumer price index (CPI) and cumulative policy rate change paths for each year since 2000, given on monthly frequency. The intra-year levels for 2022 are measured on year-to-date basis. The US CPI and the cumulative policy rate change are rebased at 100 and zero, respectively, at the beginning of each calendar year



Sources: Bloomberg, Barclays Private Bank, September 2022

## EXPECTED LONG-TERM US CROSS-ASSET RISK PREMIA

Forward-looking market-implied ten-year risk premia for different asset classes since 2000, given on daily frequency. Credit risk premium is represented by two sub-asset classes, investment grade (IG) and high yield (HY) bonds



Sources: Bloomberg, Barclays Private Bank, September 2022

## IT'S DARKEST BEFORE THE DAWN

The macro landscape suggests that bonds have lost their appeal as portfolio diversifiers. Should inflation and economic uncertainty persist over the next three months, a 60/40 portfolio might sustain further losses this year. The portfolio's diversification benefits have slowly eroded over the last decade, culminating in the breakdown of uncorrelated equity and bond returns in 2022.

However, if we look beyond short-term market gyrations and volatility, there are reasons for optimism as the long-term outlook has improved recently.

Currently, market-implied expected returns over the next ten years are on average 2-3% higher than twelve months ago. This holds for both equities and fixed income assets and follows interest rate normalisation and repricing in equity markets<sup>2</sup>.

<sup>1</sup>See [Cyclically-adjusted PEs as a guide to equities' long-term return potential](#)

<sup>2</sup>See [Hunting for alpha in Asian equities](#)

## SHIFTING TIDES OF CROSS-ASSET RISK PREMIA

Since expected long-term nominal returns have been lifted across the board this year, it is worth examining the attractiveness of different asset classes on a relative basis. The expected term and equity premia have actually decreased, according to our analysis, whereas the expected credit premia for investment grade (IG) and high yield (HY) bonds have increased lately.

The expected term premium – defined as the difference between the US Treasury 10-year yield and the current cash rate – has slid about 70 basis points (bp) since September 2021. If we consider the expected cash rate over the next ten years as the proxy for the risk-free rate, then the expected change in the term premium would be around zero.

The expected equity and credit premia are calculated as the difference between the expected returns for the respective asset class (US equities, investment grade and high yield bonds) and the US Treasury 10-year yield. Our findings indicate that the expected equity risk premium has decreased by 120bp, whereas the expected IG and HY credit premia have increased by 50bp and 100bp respectively (see chart).

## ASSET ALLOCATION IMPLICATIONS: REASONS TO BE HOPEFUL

Higher interest rates signal a positive impact on fixed-income assets in a portfolio. They are expected to provide a better source of income, while also leaving room for capital gains if rates reverse at some point in the future. Arguably, locking in rates at current levels seems plausible from a long-term investment perspective.

Under the cross-asset microscope, credit seems more attractive than last year. However, uncertainty will likely remain elevated in the next few months, which could push spreads up. Therefore, it is very important to remain cautious and selective, especially with high yield and emerging market bonds.

Long-term expected returns for equities have also increased this year, although they appear less attractive on the relative basis. However, since further multiple compression is on the cards amid macro and geopolitical uncertainty, it is possible that the equity risk premium will recover soon. For investors seeking exposure to "bond-like" equities, quality and dividend investment styles could be an interesting sub-asset class.

Last, but not least, many investors are hungry for sources of uncorrelated returns. Given today's macro conditions, market-neutral hedge funds appeal as a way to improve portfolio diversification<sup>3</sup>.

The shift in expected risk premia is less problematic for a diversified portfolio which harvests different return sources and factor exposures. This allows investors to focus on the long run. Staying invested, being well diversified, and sticking to your plan are some of the key pillars of successful investment strategies.

**Authors: Nikola Vasiljevic, Head of Quantitative Strategy, Zurich, Switzerland; Lukas Gehrig, Quantitative Strategist, Zurich, Switzerland.**

# Generating value from sustainable regulatory labels

Incoming financial regulation aims to increase capital invested sustainably and prevent potential greenwashing. However, fund labelling is at early-stage of development and can be confusing. We look at how investors might use labels, even in current stage, to help make better investment calls and boost portfolio performance.



Sustainable investing may be becoming mainstream; however, investors can't rely solely on regulatory labels when deciding how to allocate their funds. Indeed, concerns of greenwashing by fund managers marketing their sustainability credentials still abound.

Current regulatory regimes are in their infancy and their approaches to labelling sustainable investments are still developing. Interpretations by different jurisdictions and fund managers mean that there is little consistency when funds are classified.

Additionally, where regimes exist, like in the EU's Sustainable Finance Disclosure Regulation (SFDR), funds have been changing their initial classifications. For example, Morningstar identified 1,800 European funds that were reclassified from March 2021 to Feb 2022; and 713 funds that were reclassified during the second quarter of this year<sup>1</sup>.

As a result, investors should use regulatory labels to inform, but not determine, their investment selection.

Previously, we've explained how investors can [Unpick the jargon of sustainable investing](#). In this article, we outline three ways that investors might profit from regulatory labels without being overly reliant on them.

## LABELS CAN PROVIDE INVESTORS A ROUGH AND READY GUIDE

Investors should read regulatory labels as a rough guide to how sustainability is incorporated into the fund.

Think of them like the frequented spots when taking a holiday fishing trip. Motoring to locations known for a variety of fish that depend on the locality and season, the skipper will make it clear that you're fishing for example for grouper or snapper, but not tuna. Of course, you never know what you might reel in, and there's no guarantee that you'll catch any fish.

In the EU context, fund managers of Article 8 funds are expected to incorporate, and promote, environmental or social characteristics. Managers have various methods to achieve this. However, it's clear that they go further than Article 6 funds which do not necessarily integrate any kind of sustainability into their investment process<sup>2</sup>.

It also differentiates them from Article 9 funds, which have an explicit objective to invest exclusively in sustainable investments. These are investments into organisations whose goods and services (their "economic activity") contribute to environmental objectives, social objectives, or both<sup>3</sup>.

While Article 8 and 9 labeled funds account for about 35% of funds (see chart, P24), they hold just over 50% of all EU funds by asset value (as of 30 June).

In the end, regulatory labels can indicate what type of fish an investor might expect to catch in a given location when told by their adviser or the fund manager its classification, so to speak.

## USING REQUIRED DISCLOSURES TO MAKE BETTER FUND COMPARISONS

Historically, fund managers did not have to publish or explain how they invested sustainably, making it difficult to compare funds.

Now, managers must disclose various aspects of their sustainability policies, processes, and outcomes to merit a regulatory label. Investors can use these disclosures to more effectively compare funds' approaches and portfolios.

For example, under Article 8, fund managers apply a wide range of approaches to promote environmental or social characteristics. One manager could screen for holdings based on ESG ratings. Another might target the portfolio to have a higher/ lower score on sustainability-related metrics, like carbon intensity. Or a manager could exclude companies that violate UN Global Compact criteria. Another may combine several of these approaches.

<sup>1</sup> SFDR Article 8 and Article 9 Funds: Q2 2022 in Review, September 2022 <https://www.morningstar.com/en-uk/lp/sfdr-article8-article9>

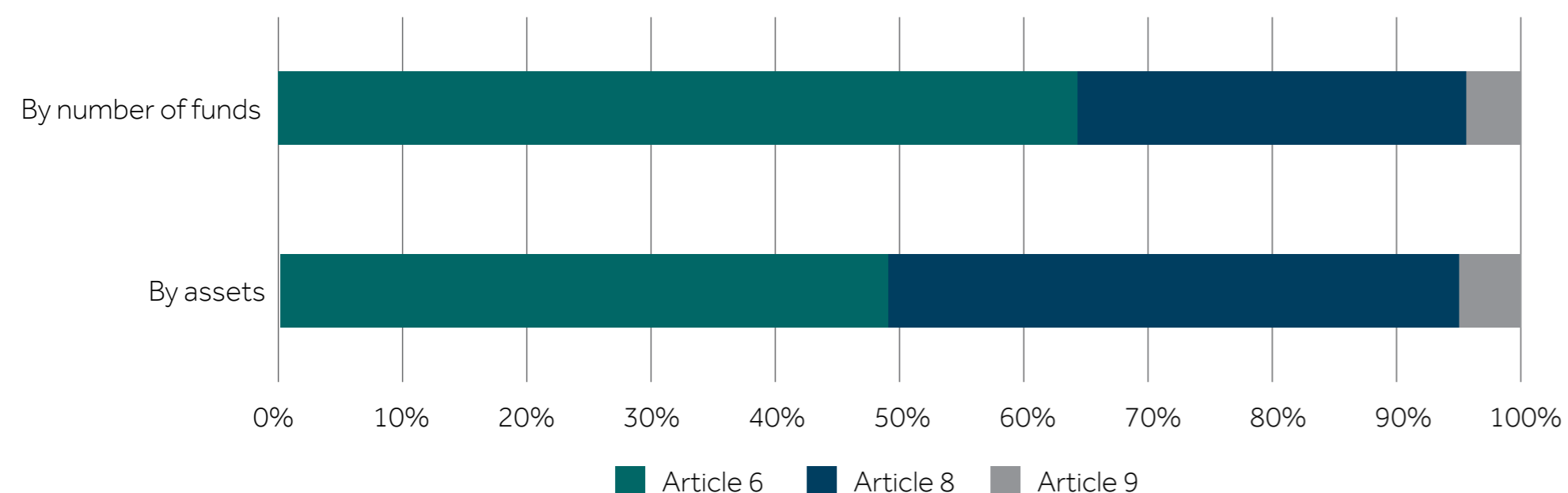
<sup>2</sup> Article 6 funds do have to report how sustainability risks are integrated into their investment decisions, as well as financial implications; and if not, provide an explanation as to why they are not relevant

<sup>3</sup> Example environmental objectives include clean energy, clean water and land, reduction of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy. Social objectives include tackling inequality, promoting good health, wellbeing, education, labour relations, or fostering social cohesion and social integration.

## REGULATORY LABELS AIDING SUSTAINABILITY INVESTORS

The number of European sustainability funds disclosing regulatory sustainability labels, by type of regulation

### Breakdown of European funds by sustainable finance disclosure regulation (SFDR) label



Sources: SFDR Article 8 and Article 9 Funds: Q2 2022 in Review, Morningstar Direct. Data as of 30 June 2022

Based on SFDR data collected from prospectuses on 97% of funds available for sale in the EU, excluding money market funds, funds of funds, and feeder funds.

EU regulation now requires detail on selected fund characteristics, how these are attained, and indicators and measurements to demonstrate the process. Although data availability does remain an issue, investors can use this enforced transparency to evaluate funds more easily.

### CLARIFYING AND CHALLENGING FUND MANAGERS' INVESTMENT PROCESS

Thus far, fund managers have self-determined their fund's regulatory classification.

This means making a conscious decision, as well as internal approvals within their organisation. Some managers and firms have been cautious, others ambitious. Ultimately, though, the final decision needs to be defensible against future regulatory scrutiny.

Investors can use these self-selected categories to ask about the investment holdings and the investment process. Again, to the EU context, considering an Article 8 fund, an investor could ask:

- Can you explain the decision to classify as an Article 8 fund?
- Which approach(es) are you taking to incorporate environmental or social characteristics?
- Why these? And why not any others?
- How are you assuring your fund maintains alignment with your selected sustainability criteria?
- How does your classification compare with other funds within your organisation, or competitors with similar/different classifications in the same asset class or thematic sector?
- What would cause you to change the classification (to become an Article 6 or 9 fund)?
- What evidence are you providing to substantiate the classification?

### MOVING FROM LABELS ON THE OUTSIDE, TO INTENTIONS FROM THE INSIDE

Around the world, financial regulators are establishing frameworks to classify funds. Beyond the EU, the UK, US, Singapore, and others are soon to launch their own systems. Their aim is to encourage greater investment to address social and environmental challenges while also reducing greenwashing.

This is laudable in principle. In practice, the frameworks and their application are embryonic. So investors can't be sure of labels. However, they can still be useful if you know how to read, and look beneath, them.

**“This inside-out approach focuses attention on where it should be – on your intentions, both financial and sustainable, to maximise the value of your investments to you and the wider world”**

More importantly, this reinforces our view that investors should not permit regulatory labels to determine their sustainability ambitions. Instead, begin deciding what you want from your portfolio, then use the frameworks to help with selection and portfolio construction. This inside-out approach focuses attention on where it should be – on your intentions, both financial and sustainable, to maximise the value of your investments to you and the wider world.

**Author: Damian Payiatakis, London UK, Head of Sustainable & Impact Investing**



# The importance of having the right allocation

Investors sometimes need to change their portfolio holdings, however tough this might be, to maximise long-term portfolio returns. However, as well as being in the market, you also need to be in the right parts of the market.



In the [Focus article](#) we discuss the importance of being invested in the market, highlighting how the long-term outlook has improved since the start of the year due to higher interest rates and repriced equities. The macro outlook, however, remains murky in the short- to medium-term.

Holding a well-diversified portfolio is one of the best ways to protect against the ever-present macro uncertainties. By well diversified, we mean holding a range of asset classes, sectors, and geographies.

When building a portfolio from scratch, constructing a well-diversified portfolio may be relatively straightforward. For those that already hold portfolios, possibly many of them with different investment providers, this may be more complicated. Investors can hold investments for legacy reasons that may no longer make sense, given their goals and the allocation that provides the best chance of reaching them.

## THE CHALLENGES OF REBALANCING

Rebalancing a portfolio or making more significant changes to better position it for the long term, may necessitate selling investments that have performed strongly. Conversely, underperforming holdings which may continue to underperform may have to be sold, possibly at a loss.

Rebalancing a portfolio when all parts of the market are selling off and sentiment is dire can be especially tough to do. Investors may ask, why sell anything presently, perhaps at a loss, when a recovery may be around the corner? For those facing selling at a loss, this can be psychologically very challenging.

Despite the difficulties such decisions present, investors must focus on having the right portfolio allocation for the long term. Those attempting to make shorter-term calls, and time markets, can be caught wrong-footed. For example, very few foresaw the 'hawkish pivot' from the Fed this year.

There is a lesson in this. Global uncertainty and violent market reactions to changes in monetary policy hinder those expressing strong conviction. Additionally, however gloomy sentiment is, and oversold a market might look, it doesn't imply that markets are due a rally.

**“Extremely gloomy sentiment and oversold prices do not of themselves mean that markets are due a rally”**

## FOCUS ON THE LONG TERM

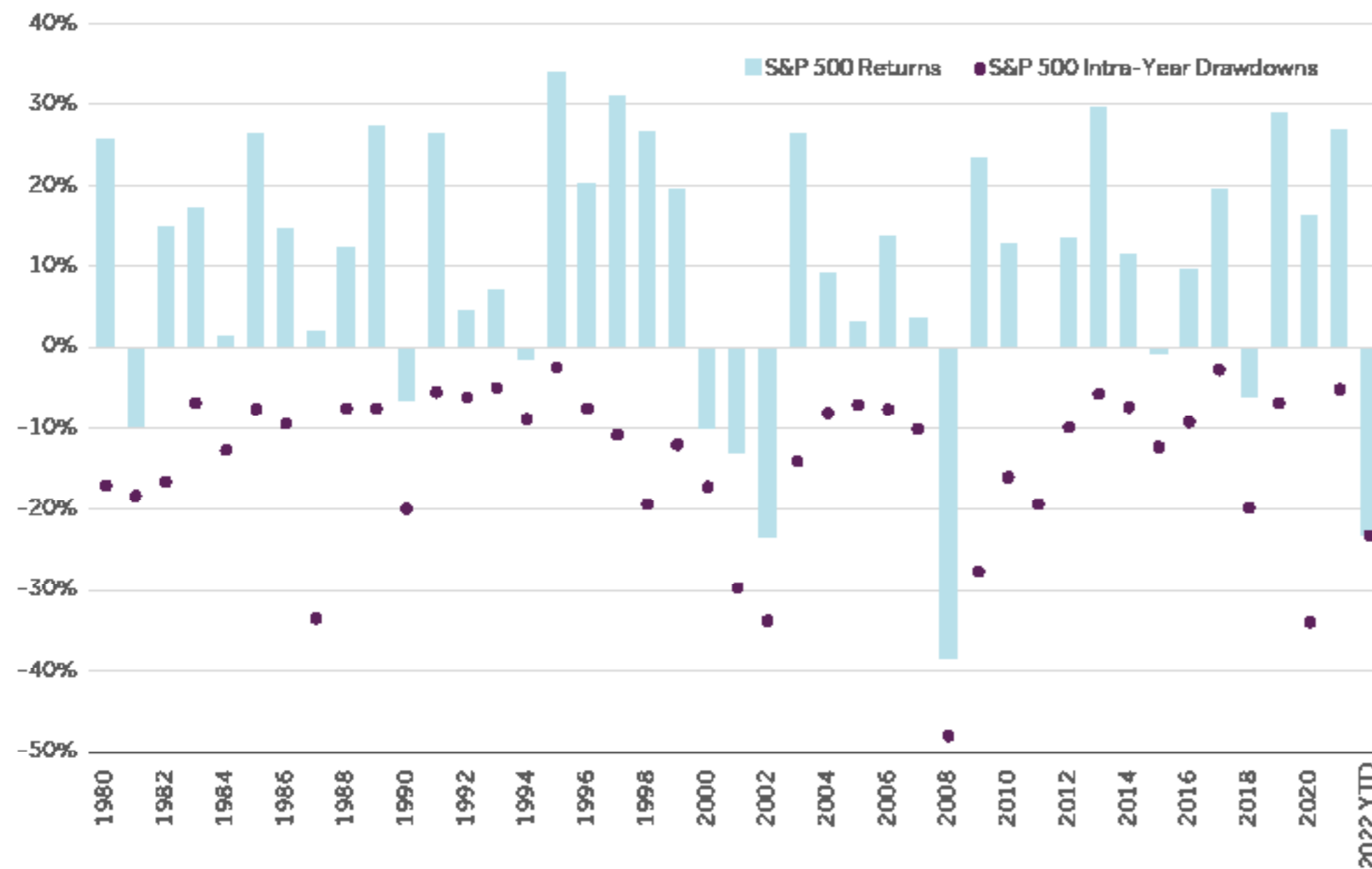
While the short-term outlook is complex and uncertain, there are still reasons for the long-term investor to be optimistic. While investors should temper their return expectations, we do not believe the engines of long-term growth, which drive markets, have turned off for good. That said, to capture any market recovery, and continue to grow assets, investors will need to ensure that they have the right asset allocation.

Investors allocating to the wrong asset classes or sectors at the wrong time may suffer the worst of downturns or fail to fully capture the gains from a recovery. Having poor asset allocation and selection, high fees, and a lack of investment process, can all drag on performance and be very costly over the long term.

The role that cash plays needs to be borne in mind too. A high allocation to cash has strongly outperformed equities and other asset classes so far this year. However, history shows that being overweight this asset class has acted as a drag on returns over the long term.

## HOLDING ON PAYS OFF IN THE LONG TERM

How the S&P 500 annual returns compare with the highest intra-year drawdowns since 1980.



Sources: Bloomberg, Barclays Private Bank, 2022

## SPOTTING OPPORTUNITIES

During downturns the natural reaction may be to focus on minimising losses and finding ways to be comfortable with continuing to hold the investment portfolio. All investors should consider what is more important, minimising short-term discomfort, or maximising long-term returns? Remember that markets regularly experience pullbacks, and investors that focus overly on the short-term can do so at the expense of hitting their long-term goals (see chart).

Making portfolio changes, let alone deploying more capital to the markets, may be daunting, especially when faced with a highly uncertain and bearish picture. However, markets can still provide opportunities for the brave at such times.

For investors that can retain their long-term perspective and maintain a holistic view of their wealth, bear markets can provide good entry points for parts of market which may have been overvalued.

Changing macro conditions can also create fresh investment opportunities in asset classes that were unappealing before. One example is in fixed income; given the hiking cycles underway, starting to "lock in" rates at current levels may mean that fixed income markets are worth considering again for some investors.

## AVOID PITFALLS AT ALL COSTS

The key message, however, is to remain focused on your long-term goals and remember that the primary risk to all investors should be of not reaching those goals. Using that as a lens through which to observe and respond to changing and challenging conditions can help you to avoid common behavioural pitfalls often seen in bear markets.

Remember that whatever the market does, it can be your own actions that matter most.

**Author: Alexander Joshi, London UK, Head of Behavioural Finance**

# Multi-asset portfolio allocation

Barclays Private Bank discusses asset allocation views within the context of a multi-asset class portfolio. Our views elsewhere in the publication are absolute and within the context of each asset class.



	-	=	+
<b>Cash and short duration bonds</b>			
<b>Fixed income</b>			
Developed market government bonds			
Investment grade bonds			
High yield bonds			
Emerging market bonds			
<b>Equities</b>			
Developed market equities			
Emerging market equities			
<b>Other assets</b>			
Alternative trading strategies			
Commodities			

"-" Denotes a cautious view

"=" Denotes a neutral view

"+" Denotes a positive view

## CASH AND SHORT DURATION BONDS

- Given the ongoing uncertainty, and to manage portfolio risks, we still prefer higher-quality and liquid opportunities.

## FIXED INCOME

- We see only limited opportunities in fixed income
- We maintain a preference for developed market government bonds as a hedge against any macroeconomic volatility
- In credit, we prefer the higher quality segment, although, as spreads have recovered remarkably from their highs, our risk budget is directed towards equities

- In high yield, selection is key, and our exposure is low, given the tightness of spreads. We prefer high yield and emerging market (EM) hard currency debt over EM local currency debt, considering the risk that faces their economies and currencies.

## EQUITIES

- We believe that equities remain relatively more appealing than bonds for now
- Yet, we are highly selective in our allocation
- In line with our long-term investment philosophy, portfolios remain geared towards high-quality, cash-generative, and conservatively-capitalised businesses
- As a function of our bottom-up selection, we currently see more opportunities in developed market equities compared to their emerging peers.

## ALTERNATIVE TRADING STRATEGIES (ATS)

- There are a limited number of opportunities in the ATS space, as the cost/benefit trade-off can be challenging
- Our focus is on strategies offering diversification benefits due to their low-correlation to equity markets.

## COMMODITIES

- As a risk-mitigating asset, gold remains the only direct commodity exposure held in portfolios
- From a portfolio management perspective, we believe that our risk budget is better spent outside of the asset class.

**Author: Julien Lafargue, London UK, Chief Market Strategist**

[privatebank.barclays.com](http://privatebank.barclays.com)

**Investments can fall as well as rise in value. Your capital or the income generated from your investment may be at risk.**

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