Quarterly Outlook – Global Equities

MANAGING THE BIFURCATED RETURNS BETWEEN GROWTH AND VALUE STOCKS

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KEY INSIGHTS

- Growth stocks showed market leadership before and throughout the coronavirus crisis, supported by greatly superior sales, earnings, and cashflow characteristics.
- We have reduced positions in many of the outright winners from the coronavirus pandemic, specifically where we felt valuations had expanded to create risk.
- In many cases, we reinvested proceeds into high-quality, product- and innovation-driven cyclicals, where we identified stock-specific drivers of accelerating economic returns.

Global equities faced downward pressure in the third quarter of 2020, but we do not believe that implies the bursting of an equity or, specifically, a growth equity bubble. Earlier in the year, the market began to recognize what we had already been positioning the portfolio for early in the crisis—that certain companies would see their economic futures pulled forward by the coronavirus pandemic. These were mainly in the growth area of the opportunity set and led to the unusual outcome that growth showed market leadership before and throughout the coronavirus crisis, supported by greatly superior sales, earnings, and cashflow characteristics.

Several factors have driven the significantly bifurcated returns we have seen between growth and value stocks. Central is that capacity continues to be unlocked, fueled by monetary stimulus, and enabled by a new era of technology.

CHALLENGES POSED BY NARROW MARKET LEADERSHIP

Massive stimulus and the "stop getting worse" phase of the health crisis have encouraged flows into risk assets, especially certain growth stocks. The direction of the flows has been enhanced by the growth of passive investing and has dovetailed with the most extreme index concentration seen in U.S. equities since 1999, as well as factor-driven investing focused on "momentum" and "growth" characteristics. This is unhelpful in terms of market breadth and for fundamental investors in many senses, but it's a backdrop we've seen and managed through before.

REDUCING POSITIONS IN MANY OF THE OUTRIGHT WINNERS

In our view, broad-based valuations are not extreme, but certain areas in the mid-cap and smaller large-cap spectrum do look expensive. While there are good reasons underlying multiple expansion since equity markets troughed in late March, we have been very conscious of the need to manage the valuation element of the risk equation, and have reduced positions in many of the outright winners from the coronavirus pandemic, specifically where we felt valuations had expanded to create risk. In many cases, we reinvested proceeds into high-quality, product- and innovation-driven cyclicals, where we identified stock-specific drivers of accelerating economic returns.

RISKS

The following risks are materially relevant to the portfolio.

Country risk (China) – all investments in China are subject to risks similar to those for other emerging markets investments. In addition, investments that are purchased or held in connection with a QFII licence or the Stock Connect program may be subject to additional risks.

Country risk (Russia and Ukraine) – in these countries, risks associated with custody, counterparties and market volatility are higher than in developed countries.

Currency risk –changes in currency exchange rates could reduce investment gains or increase investment losses.

Emerging markets risk – emerging markets are less established than developed markets and therefore involve higher risks.

Small and mid-cap risk – stocks of small and mid-size companies can be more volatile than stocks of larger companies.

Style risk – different investment styles typically go in and out of favour depending on market conditions and investor sentiment**.**

General Portfolio Risks

Capital risk –the value of your investment will vary and is not guaranteed. It will be affected by changes in the exchange rate between the base currency of the portfolio and the currency in which you subscribed, if different.

Equity risk –in general, equities involve higher risks than bonds or money market instruments.

Geographic concentration risk –to the extent that a portfolio invests a large portion of its assets in a particular geographic area, its performance will be more strongly affected by events within that area.

Hedging risk –a portfolio's attempts to reduce or eliminate certain risks through hedging may not work as intended.

Investment portfolio risk –investing in portfolios involves certain risks an investor would not face if investing in markets directly.

Management risk –the investment manager or its designees may at times find their obligations to a portfolio to be in conflict with their obligations to other investment portfolios they manage (although in such cases, all portfolios will be dealt with equitably).

Operational risk – operational failures could lead to disruptions of portfolio operations or financial losses.

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