overberg
asset management

# Global Defensive Portfolio

# Q1 2023

## Investment Objective

The OAM Global Defensive Portfolio aims to achieve stable capital growth with favourable income returns over the medium to long-term, while maintaining a relatively low level of risk. Investments are extensively researched to assess their intrinsic value over the longer-term.

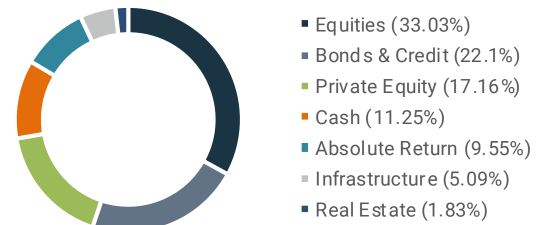
## Risk Rating

## Portfolio Description

This actively-managed share portfolio aims to provide a defensive investment solution intended to enhance resilience against short- term market volatility. The underlying investments include a well-diversified mix of equities, bonds, real estate, private equity, absolute return funds, infrastructure, commodities, and cash. The relatively conservative equity exposure is unlikely to exceed 50% and primarily comprises offshore investment companies listed on the London Stock Exchange.

The portfolio is flexible and fully global in nature, providing exposure to a broad range of geographies, industries, economic sectors, and currencies. The base currency is British Pound Sterling.

## Asset Allocation (see through basis)

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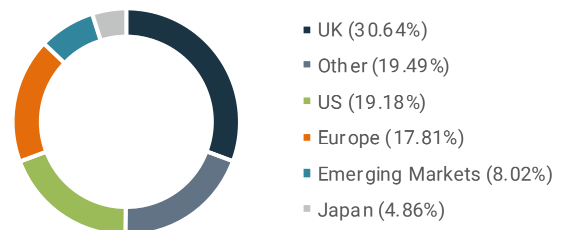



## Investor Criteria

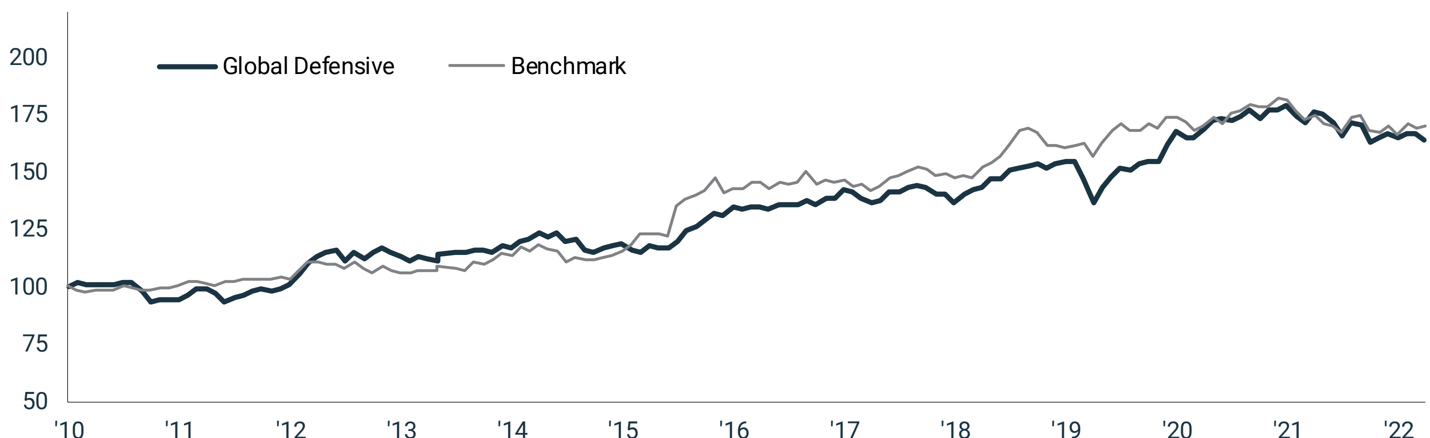
- Seek income and steady capital growth.
- Recognise the benefits of direct offshore exposure in foreign currency.
- Have a moderately conservative risk profile.
- Typically aim to invest for a period of 4 years or longer.

## Performance

| Growth | OAM* | Benchmark** | FX Rate | OAM |
|---|---|---|---|---|
| Annualised (%) | GBP | GBP | GBP/ZAR | ZAR |
| Inception 2010 | 4.12 | 4.44 | 6.32 | 10.69 |
| 10 years | 3.76 | 4.41 | 4.57 | 8.50 |
| 5 years | 3.74 | 3.72 | 5.73 | 9.69 |
| 3 years | 6.27 | 2.69 | -0.35 | 5.90 |
| YTD | -0.77 | 2.51 | | |
| Yield*** | 1.80 | | | |

* Performance figures are based on a typical portfolio.
* **Performance figures are net of all fees.** (Including asset management, platform, trading, and advisor fees).
** The Benchmark is comprised of 30% MSCI ACWI, 70% WorldBIG index
***Income yield since inception

## Top 5 Holdings

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## Global Market Review and Strategy Outlook for the quarter ended March 2023

The year got off to a good start for global financial markets, building on the rally which began in October when investors detected the world had moved past the point of peak inflation, peak bond yields and peak central bank hawkishness. China's sudden reopening from Covid restrictions added to optimism. China is forecast to achieve 5.5% growth in 2023 compared with 3% growth in 2022, as pent-up demand boosts consumer spending. It is the world's second largest economy, so its dramatically improved growth prospects have a positive ripple effect for global growth. The easing of China's supply chain disruptions also helps reduce global goods shortages and goods price inflation. Europe emerged from its energy crisis relatively unscathed, helped by government subsidies and a sharp decline in gas prices, which fell below levels that preceded Russia's invasion of Ukraine. The US economy also surprised to the upside, with a buoyant jobs market and substantial savings reserves accumulated from pandemic handouts helping households withstand sharply higher interest rates.

The global rally paused in mid-February after stronger than expected US inflation data. US CPI had been on a steady downtrend since peaking at 9.1% in June, allowing the Fed to temper its interest rate outlook. However, January's CPI data was disappointing. Year-on-year (y/y) headline CPI slowed only slightly from 6.5% to 6.4%. Month-on-month (m/m) it increased by 0.5% compared with 0.1% in December. Core inflation, which excludes food and energy, did not fare much better, reducing only slightly y/y from 5.7% to 5.6% and m/m remaining at 0.4% unchanged from December's figure. In the UK, inflation also suffered a setback. February CPI increased to 9.2% y/y from 8.8% in January.

Investor sentiment soured further after the rapid collapse of Silicon Valley Bank on 10th March, which set off a rapid withdrawal of deposits from other regional banks in the US. By the following weekend, contagion spread to Europe leading to the rescue and forced takeover of Credit Suisse. However, authorities moved rapidly to prevent a full-blown financial crisis, with ample deposit guarantees and liquidity injection in the US, while the Swiss National Bank provided a credit line to Credit Suisse before arranging its takeover by its banking peer, UBS.

Yet, most equity markets ended the quarter in positive territory. Europe provided the best returns, helped by historically low valuations, lifting the German Dax by 12.3%. Cheap valuations also helped Japan's Nikkei 225 index with a gain of 7.5%. The US benchmark, the S&P 500 index increased by 7.0% but the UK's FTSE 100 lagged with a gain of 2.4%, undermined to some extent by the pound's appreciation. In China, the Shanghai & Shenzhen CSI 300 index built on its powerful Covid reopening rally with a further 4.6% quarterly return. Overall, the MSCI Emerging Market index returned 3.5% while the MSCI World index increased by 7.3%. The all-important 10-year US Treasury bond yield offered valuation support to equity markets by edging lower over the quarter from 3.88% to 3.49%. A slightly weaker US dollar also lent support to market sentiment. The dollar index lost 1% from 103.25 to 102.51 in anticipation that the Fed will end its policy tightening sooner than the other major central banks.

Bank failures so far have been idiosyncratic, caused by poor management rather than systemic imbalances. SVB's failure was due to losses incurred on its portfolio of US Treasury bonds rather than credit defaults. Defaults are generally at low levels. The debt servicing capacity of households and businesses is healthy, helped by steady deleveraging of private sector balance sheets across the US and Europe since the 2008/09 Global Financial Crisis. As a result, non-performing loans are at historically low levels. Moreover, bank balance sheets have steadily improved over the past 15 years, guided by rigorous stress tests. Banks are much better capitalised, loan to deposit ratios are very low, and in the US the banking industry's reserve coverage ratio is at its highest in 40 years. A system-wide crisis is unlikely.

The greater concern is the impact that an ensuing tightening in lending standards might have on economic activity. Tighter lending standards would choke off credit extension, but solid bank capital adequacy and reserve ratios should limit the impact. Economic activity was on a rising trajectory prior to the bank failures so could accommodate a slowdown without resulting in recession. The OECD predicts 0.5% quarter-on-quarter global GDP growth in the first quarter (Q1) a sizeable improvement on the 0.2% contraction in Q4 last year. The global composite purchasing managers' index (PMI), which measures forward looking economic survey data, has steadily increased since the start of the year, rising in February to 52.1, above the neutral 50-threshold for the first time since July last year. Gains were recorded across most major economies. New orders readings indicate further improvement ahead. The March US composite PMI surveyed two weeks after the banking sector turmoil began, unexpectedly jumped to 53.3 from 50.1 in February. In its latest policy meeting on 22nd March, the Fed trimmed its 2023 GDP growth forecast but not by much, from 0.5% to 0.4%.

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Bank failures are par for the course when interest rates increase. The good news is that they tend to mark the end of rate cycles. The end of the rate hiking cycle is now in plain view in the US, with other central banks unlikely to be far behind. At the Fed's March policy meeting, Chair Jay Powell said tighter bank lending standards may well do the Fed's job for it, "in a way that substitutes for rate hikes." The futures market points to a falling fed funds rate, which had been projected at the start of March to rise to 5.7% by mid-year from its current level of 4.75-5.0% but is now projected to drop to 3.8% by year-end. There has also been a constructive decline in the 10-year Treasury bond yield, the benchmark for valuing financial assets worldwide. This is all good news for financial markets, with a recent surge in central bank liquidity providing added impetus. The Fed's balance sheet gained by a massive $300 billion in the week following the SVB collapse, a rate of liquidity expansion not seen since March 2020 at the outset of the Covid pandemic. More liquidity expansion is predicted, which should feed through to higher financial asset prices.

According to independent research company MRB Partners: "The global economy didn't need any help, but just received lower borrowing rates, a reversal (for now) of some of the paper losses on government bonds, lower energy prices and a near certainty that the Fed et al will not deliver a monetary knock-out blow for the foreseeable future."

Inflation will edge lower over coming months, helped by falling energy and goods prices, and helpful base effects. In the US, the moderation in shelter inflation, which has an outsized weighting in core CPI measures, will also be helpful. At the same time, the monetary outlook is improving, which combined with continued economic growth points to a reasonable backdrop for equity markets, especially in faster growing regions including China, the Far East and Europe. Equity valuations are also more attractive in these regions, relative to their own long-term averages and especially, relative to the US. The UK economy has weak prospects compared with other developed economies, stemming from a lack of progress with new post-Brexit trade agreements and an over-leveraged property market but its equity market more than compensates, valued about 25% cheaper than its long-term average. Moreover, a substantial portion of UK equity earnings are generated offshore, so benefit from a weak currency.

The recent bank turmoil masks the progress made over the past year towards normalising inflation, and the adjustment from abnormally low interest rates and excessive equity market valuations. Although inflation is still well above central bank targets, it is gradually declining and interest rates, bond yields and equity valuations have normalised over the period. Although risks remain, as they always do, there is now value in the market and therefore a considerably greater margin of safety for investors with better prospects for investment gains.

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