

Navigating global market volatility

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A few weeks ago, global markets experienced a period of heightened volatility, with notable fluctuations in equities, bonds and currencies. While not a full-blown crisis, these sudden movements disrupted the relatively stable market conditions seen earlier this year, underscoring the need for a nimble and responsive investment strategy.

We took decisive steps to navigate the immediate changes, while positioning for potential opportunities ahead. Below, we address some of the pressing questions that investors have posed to us, providing insights into our recent decisions and the thinking behind them.

QUESTION: Why take a contrarian stance on the Japanese yen? What's the big picture?

Our approach to the Japanese yen stems from a broader strategic perspective on currency exposure. Traditionally, the yen's low yield has made it an attractive candidate for short positions in our strategy, leveraging the concept of 'carry'—where holding higher-yielding currencies typically offers better returns. However, currency markets are rarely straightforward, and the yen's recent behaviour has demonstrated characteristics that could suggest a reversal of its weakness.

We observed that the yen began to move contrary to what rate differentials would typically imply, hinting at episodic factors at play. Maintaining a modest short position allows us to hedge against these unexpected shifts while still benefiting from the broader dynamics in currency markets.

QUESTION: With government debt soaring, why are you still betting on long US Treasuries?

It is a question that comes up often, especially in the current environment of increasing government debt and large-scale issuance. At first glance, one might expect these factors to drive yields higher, making long-duration Treasuries less attractive. However, the reality is more nuanced.

The primary driver of bond yields is the expected path of interest rates, not just the level of debt. In the current environment, US Treasuries still offer real returns that are attractive, even when factoring in higher inflation expectations. More importantly, there is an asymmetry at play: should growth disappoint or economic conditions worsen, there is significant potential for yields to fall, providing a valuable hedge.

This potential for rate cuts, driven by economic slowdown or other shocks, makes long-duration Treasuries a crucial component of our strategy. We are not just betting on current conditions; we aim to perform well in a range of possible future scenarios.

QUESTION: Why stick with long-term bonds when the yield curve is inverted? Isn't that risky?

An inverted yield curve is often seen as a warning signal, leading many to shy away from long-term bonds. However, our perspective is more balanced. The yield curve inversion does signal some risk, particularly in the near term, but it is not the only factor to consider.

Long-term bonds offer distinct advantages, especially in terms of diversification. They tend to respond to shifts in risk perception and can act as a counterbalance when other positions are under pressure. In a scenario where policy rates cannot be cut rapidly—or are even seen as a threat to economic stability—these long-term bonds can provide essential protection.

Moreover, our approach is not to focus solely on the yield curve's current shape but to assess the broader economic landscape. By holding a mix of shorter and longer maturity bonds, we can be resilient across different market conditions, ensuring we are prepared for both expected and unexpected outcomes.

QUESTION: Could rising US debt and deficits spell trouble for the dollar?

It is easy to jump to conclusions when looking at rising debt and deficits, but the reality is that currency markets are influenced by a complex web of factors. The US dollar, in particular, is affected by a multitude of variables, including interest rate differentials, economic growth expectations, and geopolitical developments.

While increased issuance and debt levels are part of the picture, they are far from the whole story. The performance of the US dollar must be considered within a global context, where the relative strength of other currencies and the broader economic environment play critical roles. At present, we maintain a neutral stance on the dollar, recognising that it could move in either direction depending on how these various factors evolve.

By avoiding an overly simplistic analysis, we ensure that our currency strategy remains robust and adaptable, capable of responding to the many forces at play in the global economy.

QUESTION: Is there still value in Chinese/Hong Kong and Mexican markets after the recent turmoil?

Despite the recent market turmoil, we believe there is still significant value to be found in Chinese/Hong Kong equities and Mexican assets. These markets have demonstrated resilience, particularly in the face of broader global uncertainty.

For Chinese and Hong Kong markets, while valuations have come down from their peak earlier this year, in our view, they can remain attractive, especially given the continued negative sentiment that has not fully reflected in prices. This suggests that there could still be opportunities for upside, particularly as market conditions stabilise.

Similarly, the Mexican market, though impacted by broader Latin American weakness, offers compelling value.

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