

# Market Insights – “Grudging Rationalisation”

October 2017

*“These markets are really quite different from bubbles that we’ve seen in the past.”*  
**Ben Inker, GMO**

**Julian Howard - Head of Multi-Asset Solutions**

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# Isolated Storms

## Key themes for investors

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### **Global economic growth is not the problem**

- High frequency growth indicators point to overall health
- Protectionism's winners and losers are specific
- US equity market gains extraordinary
- "Complacency ratio" at a quarter-century high
- But no leverage or exuberance this time
- And the Retail investor is not really involved

### **Grudging rationalisation of higher prices**

- Profits are permanently higher!
- No risk premium needed in the 21<sup>st</sup> century!
- Central bankers are the real risk
- Mess with TINA at your peril
- The iron law of valuation cannot be ignored

### **Steering past a rich US equity market**

- EM doesn't care about energy or the US dollar anymore
- EM valuations hint at solid future returns
- Better to clip coupons or avoid equity risk?
- Tactical focus – shorting oil
- Tactical focus – risk-off hedge

### **Positioning and performance update**

- Scenario analysis
- Positioning
- Strategy performance

### **Q&A**

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**GLOBAL ECONOMIC  
GROWTH IS NOT THE  
PROBLEM**

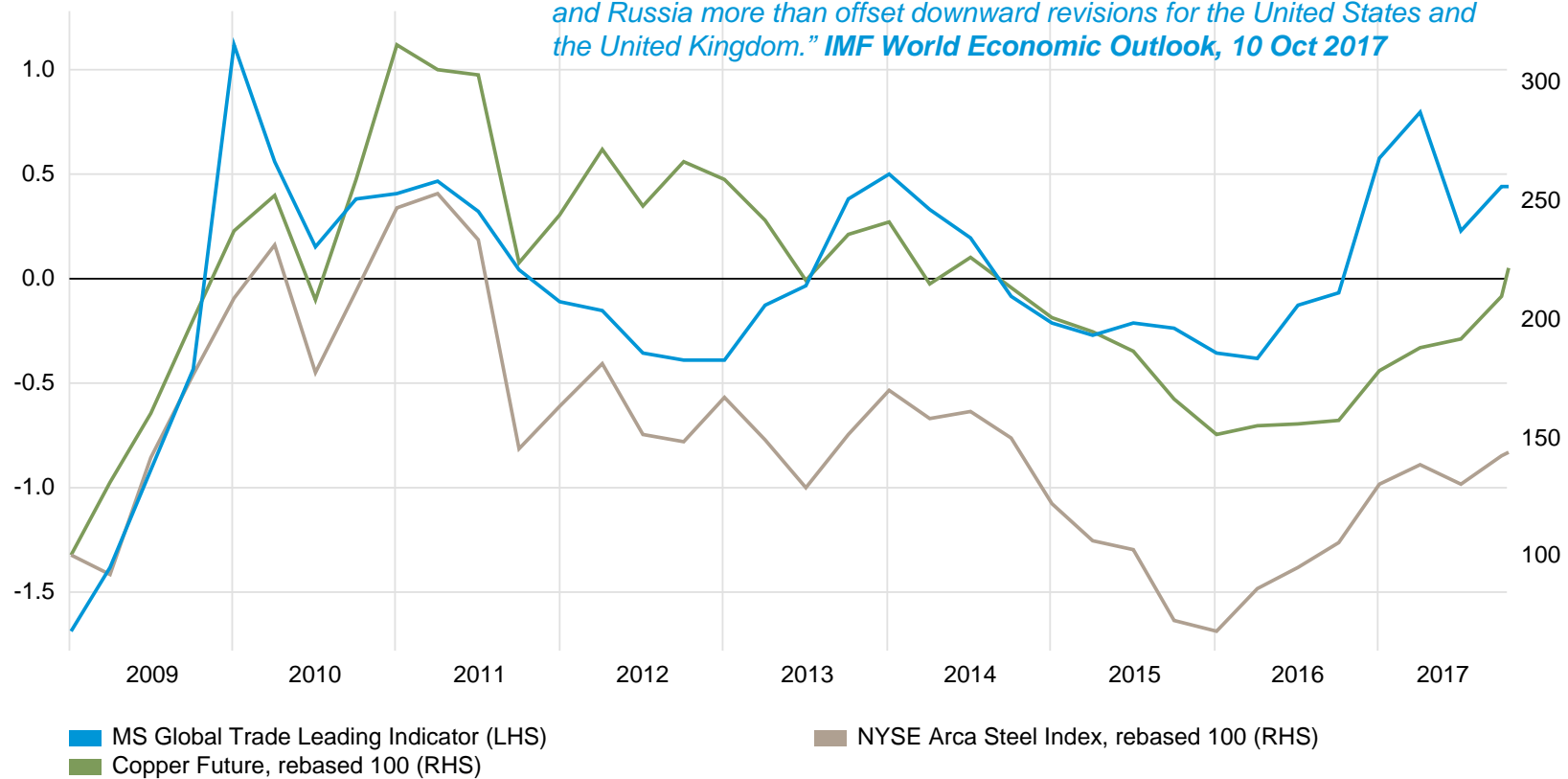
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# High frequency growth indicators point to overall health



From 31 Dec 2008 to 12 Oct 2017

*“The global upswing in economic activity is strengthening...Broad-based upward revisions in the euro area, Japan, emerging Asia, emerging Europe and Russia more than offset downward revisions for the United States and the United Kingdom.” IMF World Economic Outlook, 10 Oct 2017*



Past performance is not indicative of future performance.

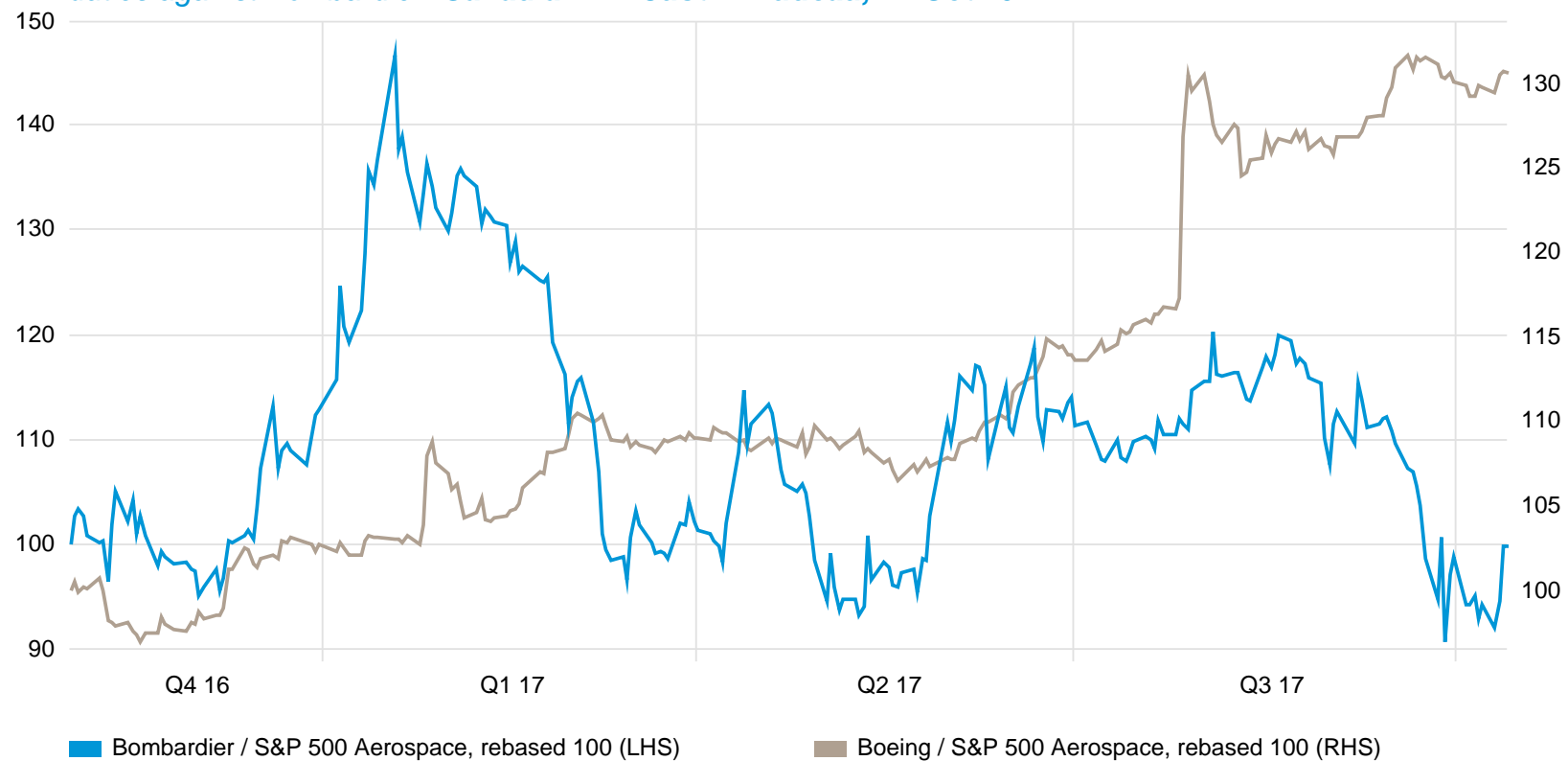
Source: Bloomberg

# Protectionism's winners and losers are specific



From 31 Oct 2016 to 12 Oct 2017

*"I highlighted to the president how we disagree vehemently with Commerce's decision to bring in anti-dumping duties against Bombardier"* **Canadian PM Justin Trudeau, 12 Oct 2017**



Past performance is not indicative of future performance.

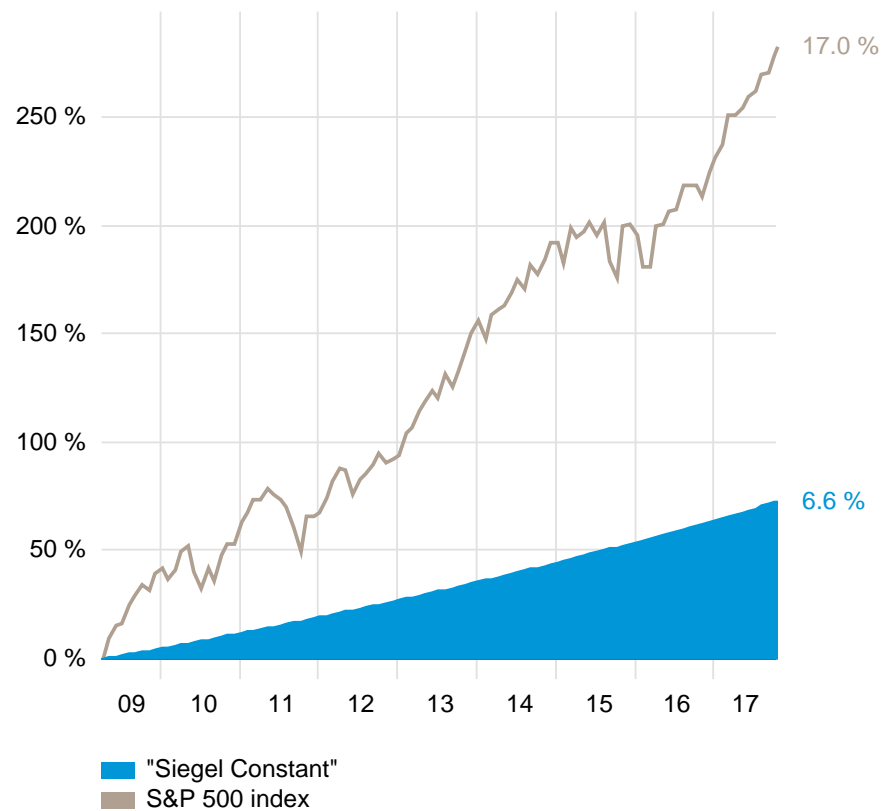
Source: Bloomberg

# US equity market gains have been extraordinary

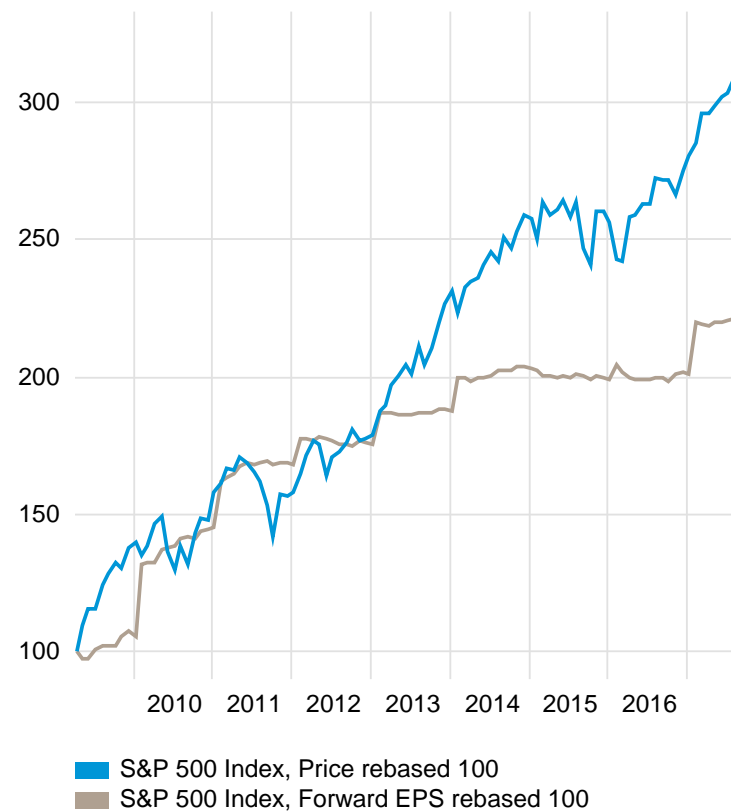


Performance from 31 Mar 2009 to 9 Oct 2017

Market has grown much faster than its 'natural' rate



Price has raced ahead of earnings expectations



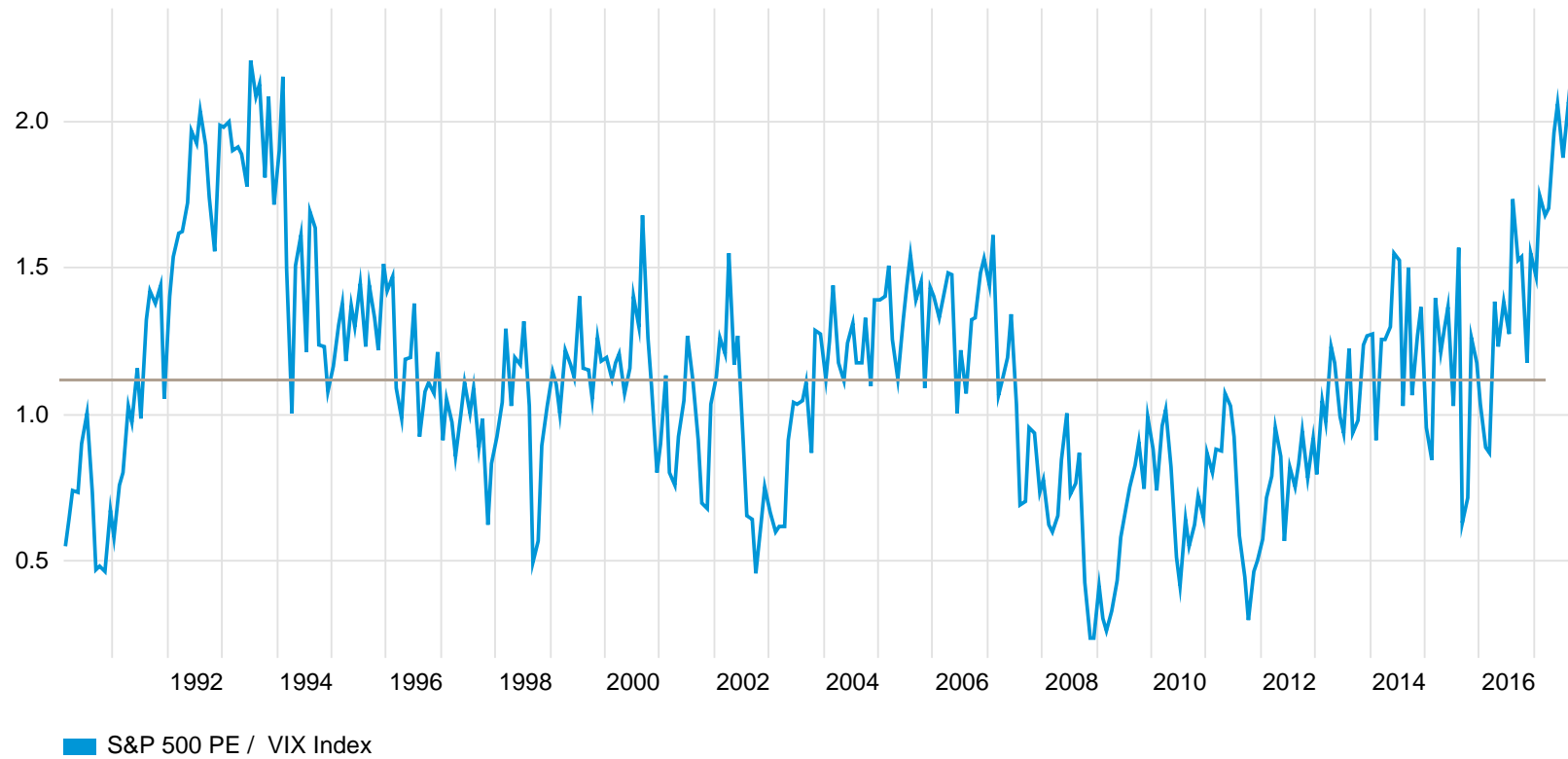
Past performance is not indicative of future performance.

Source: Standard & Poor's, Bloomberg

# "Complacency ratio" at a quarter-century high



From 31 Jan 1990 to 11 Oct 2017



Past performance is not indicative of future performance.

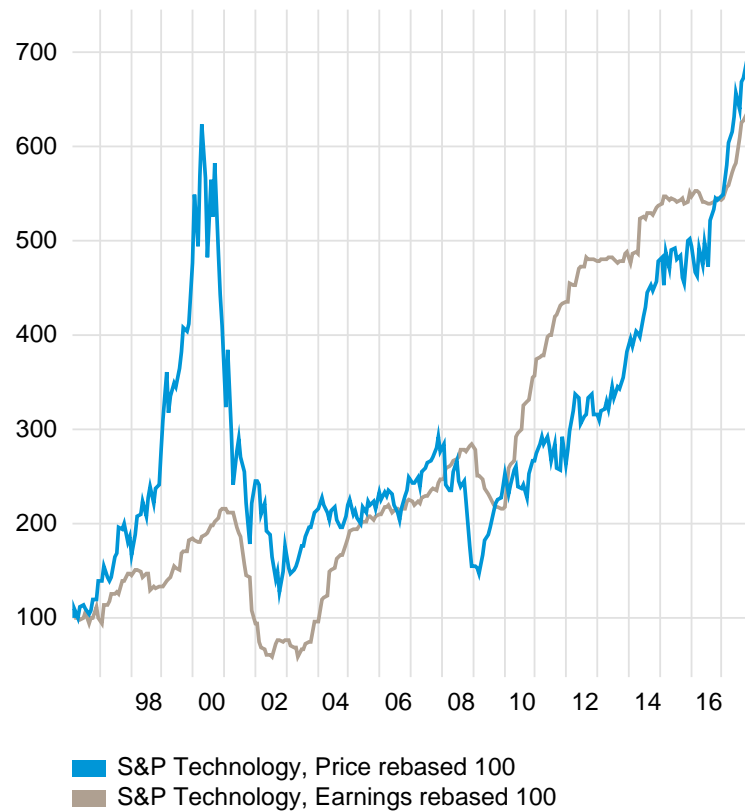
Source: Bloomberg

# But no leverage or exuberance this time



From 2 Feb 1996 to 11 Oct 2017

Earnings in line with Tech gains...



...Discrimination within the sector



Past performance is not indicative of future performance.

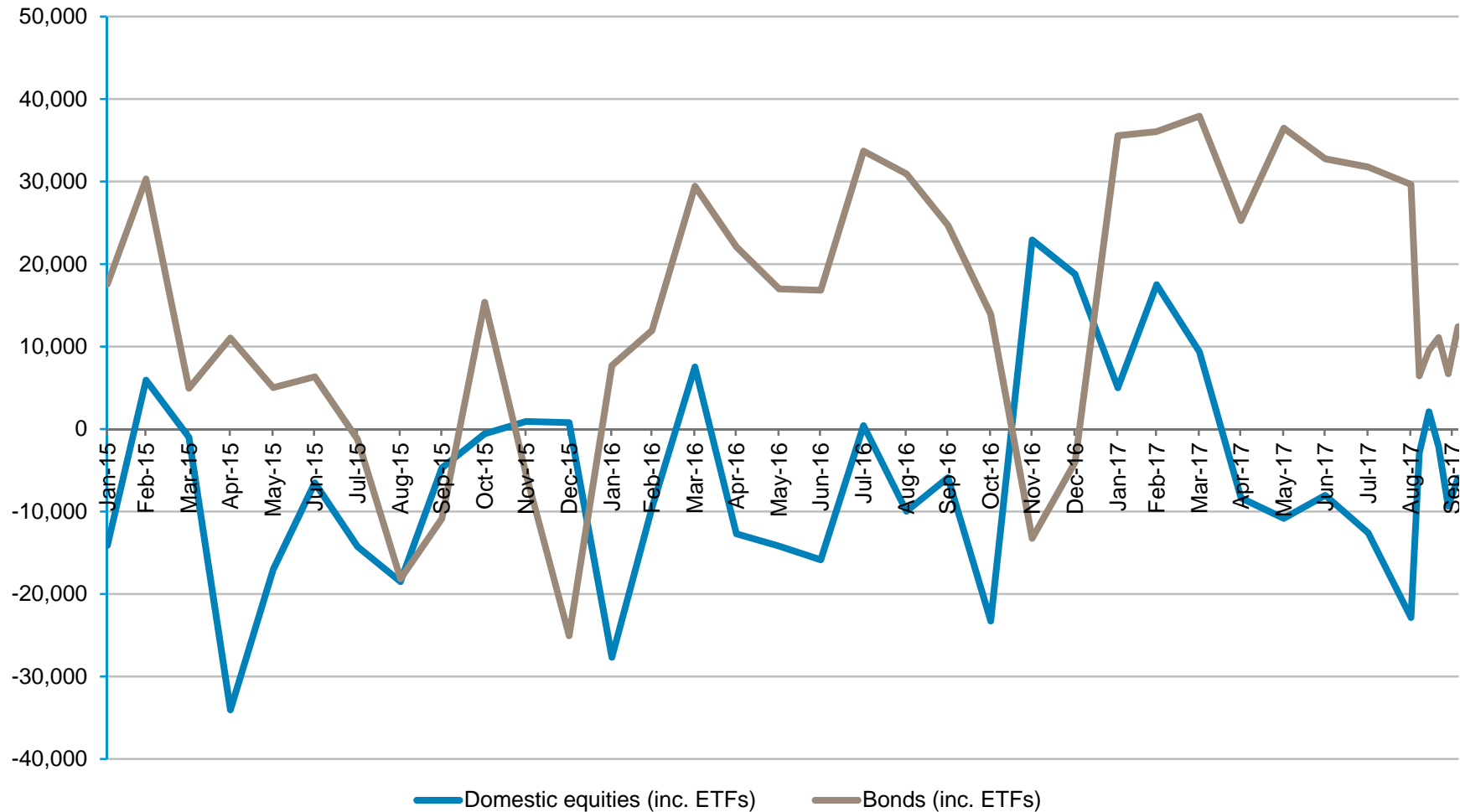
Source: Bloomberg



# Retail investor not really involved

Net new flows, \$m from 31 Jan 2015 to 04 Oct 2017\*

Less than 14% of households directly held stocks but 30% owned a cat



Source: Investment Company Institute, Federal Reserve Survey of Consumer Finances, American Veterinary Medical Association  
 \*ICI estimates after 31 Aug 2017

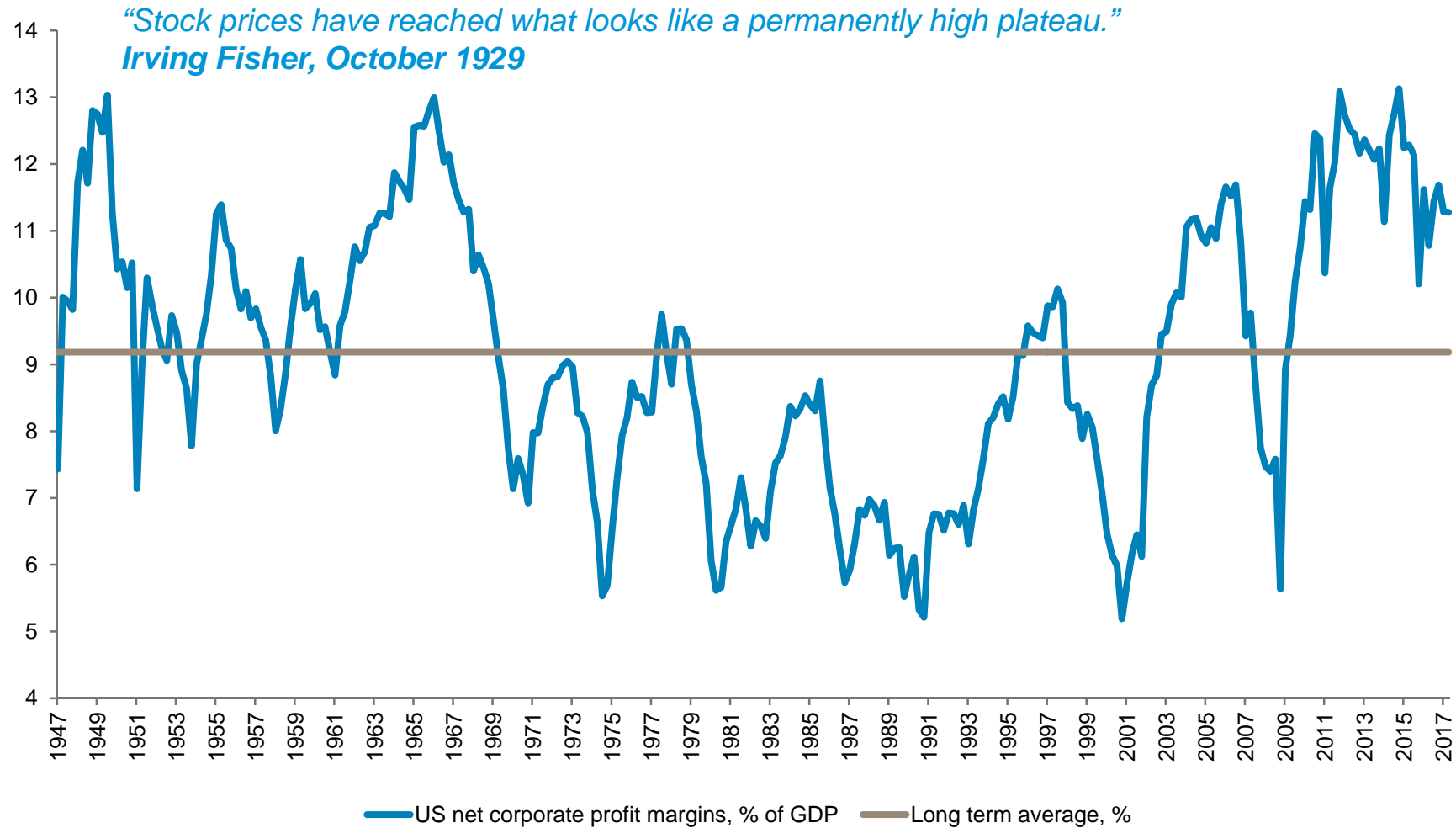
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**GRUDGING**  
**RATIONALISATION**  
**OF HIGHER PRICES**

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# “Profits are permanently higher!”

From 31 Dec 2004 to 1 Sep 2017

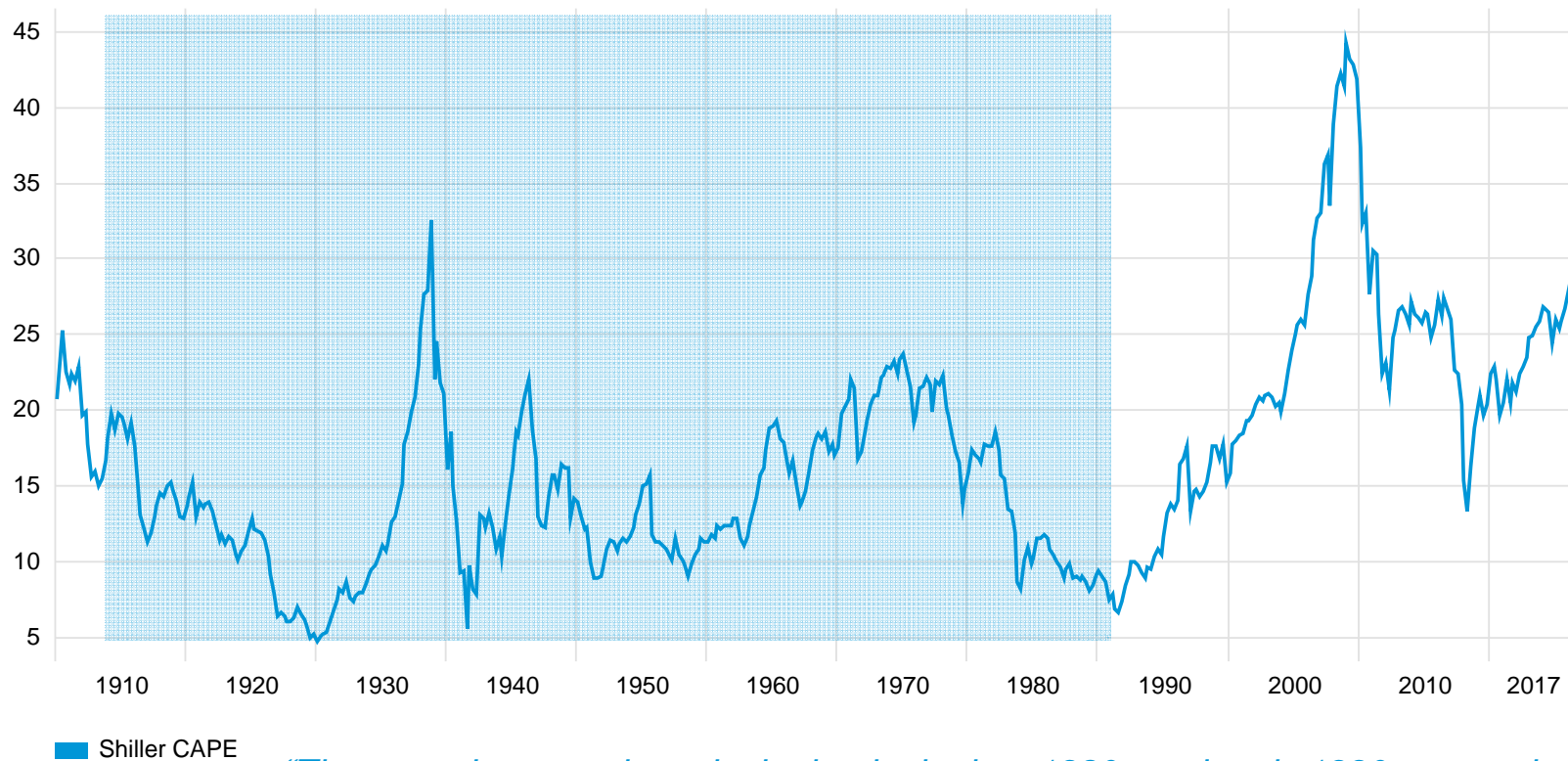


Past performance is not indicative of future performance.

Source: Bloomberg

# “No risk premium needed in the 21st century!”

From 31 Dec 1900 to 4 Oct 2017



*“There can be no serious doubt that in the late 1980s and early 1990s an era in world history ended and a new one began.” Eric Hobsbawm, Age of Extremes*

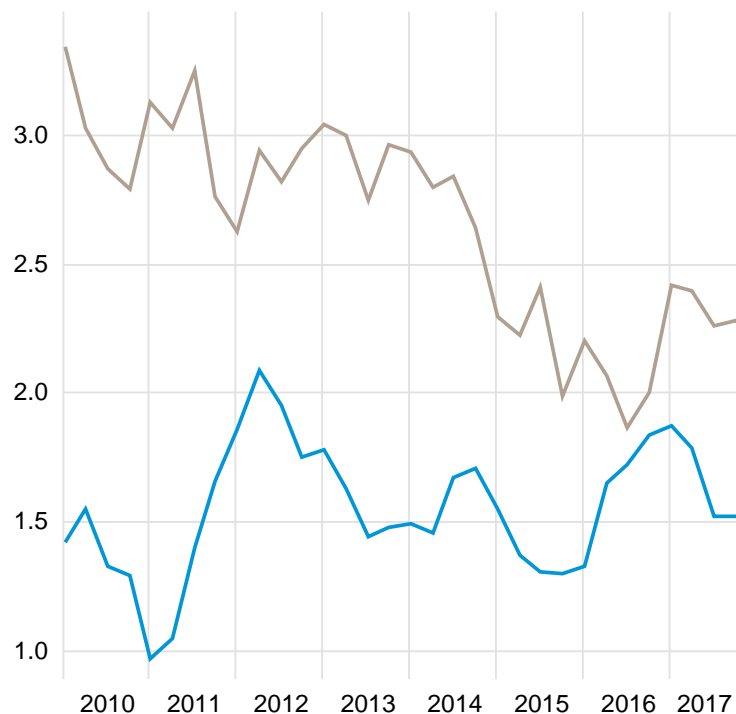
Past performance is not indicative of future performance.

# Central bankers are the real risk

From 31 Dec 2009 to 12 Oct 2017

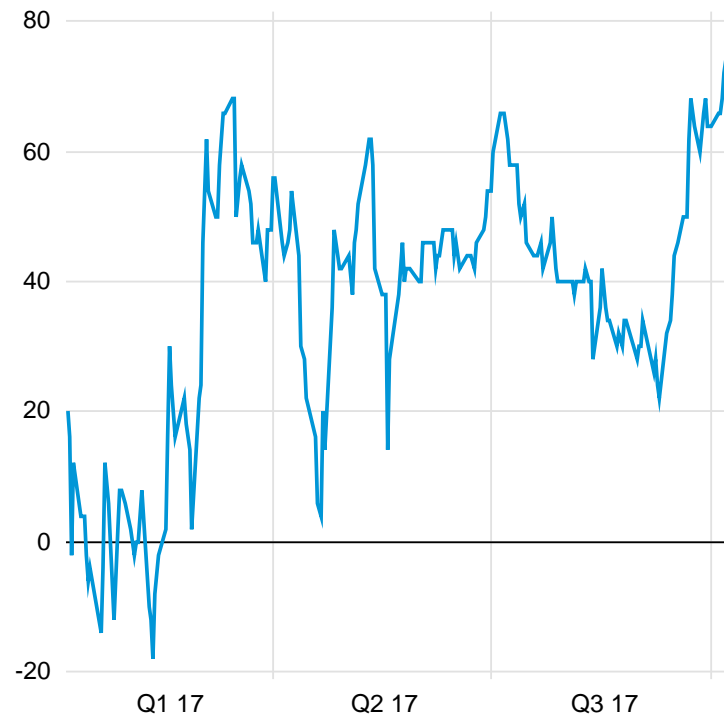


**Inflation 'mystery'**



■ US PCE core inflation, %  
■ US 5yr Inflation Swap Rate, %

**But Fed doesn't care either way**



■ Probability of third rate hike in 2017, %

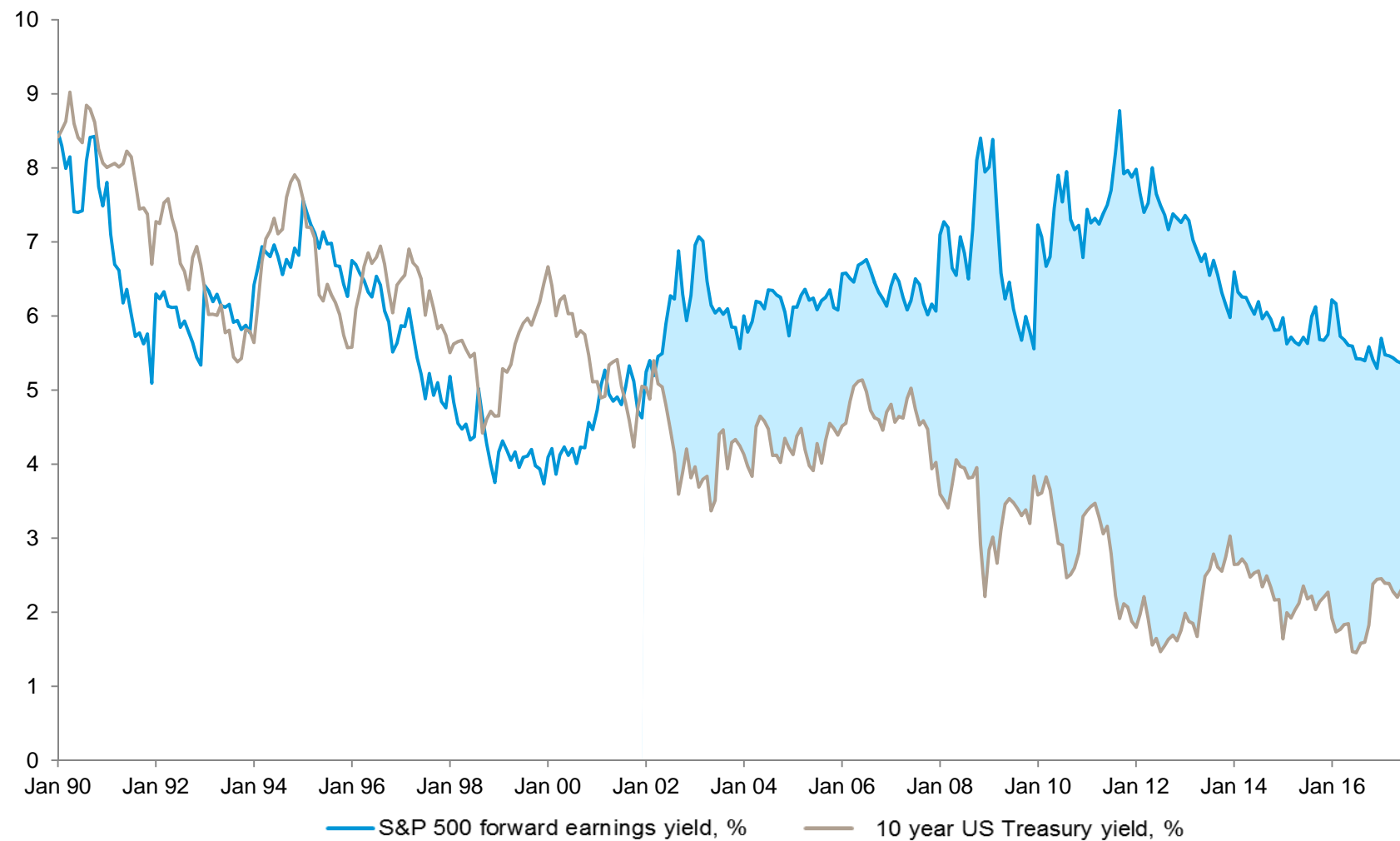
*"We should be cautious about tightening policy further until we are confident inflation is on track." Fed Governor Brainard, 5 Sep 2017*

*"Experience suggests tightness in the labour market gradually tends to push up wage and price inflation." Fed Chair Yellen, 21 Sep 2017*

Past performance is not indicative of future performance.

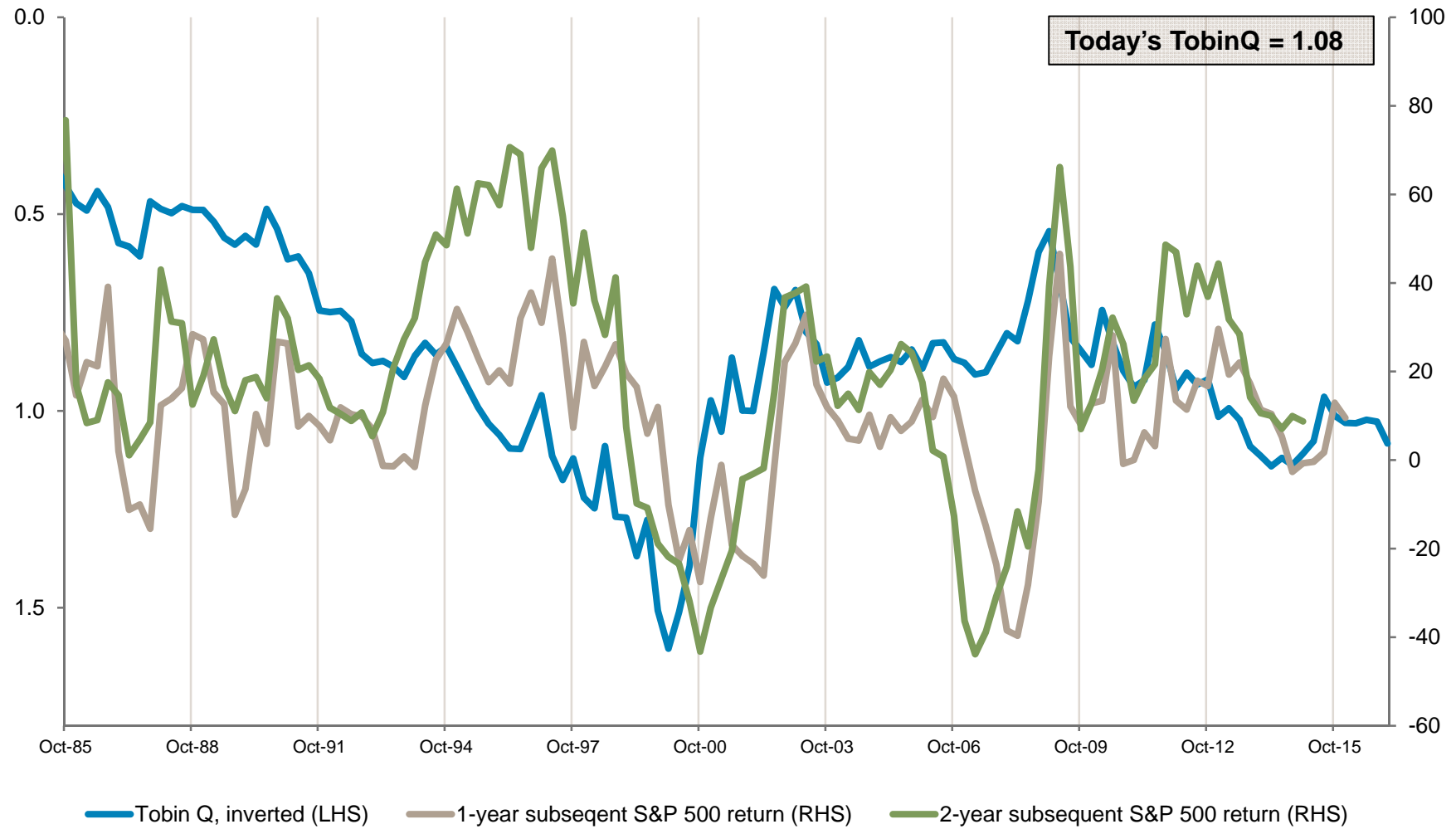
# Mess with TINA at your peril

From 31 Jan 1990 to 12 Oct 2017



# The Iron Law of Valuation cannot be ignored

Data from 30 Sep 1985 to 30 Sep 2017



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**STEERING PAST A  
RICH US EQUITY  
MARKET**

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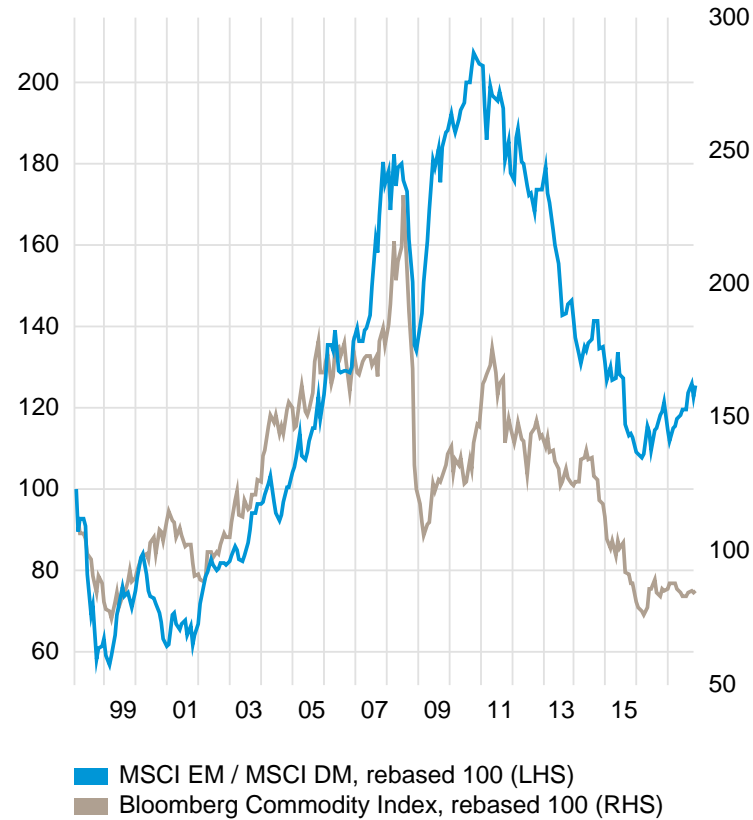


# EM doesn't care about energy or the US dollar anymore

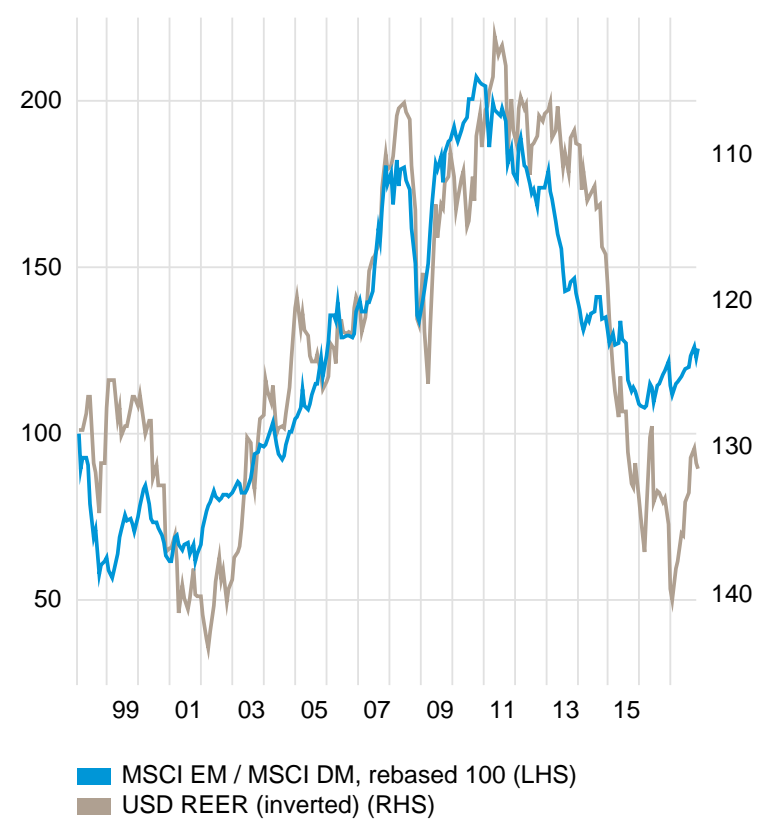


From 31 Dec 1997 to 12 Oct 2017

### Countercyclical policies are paying off



### Low rates, low inflation mean USD less important



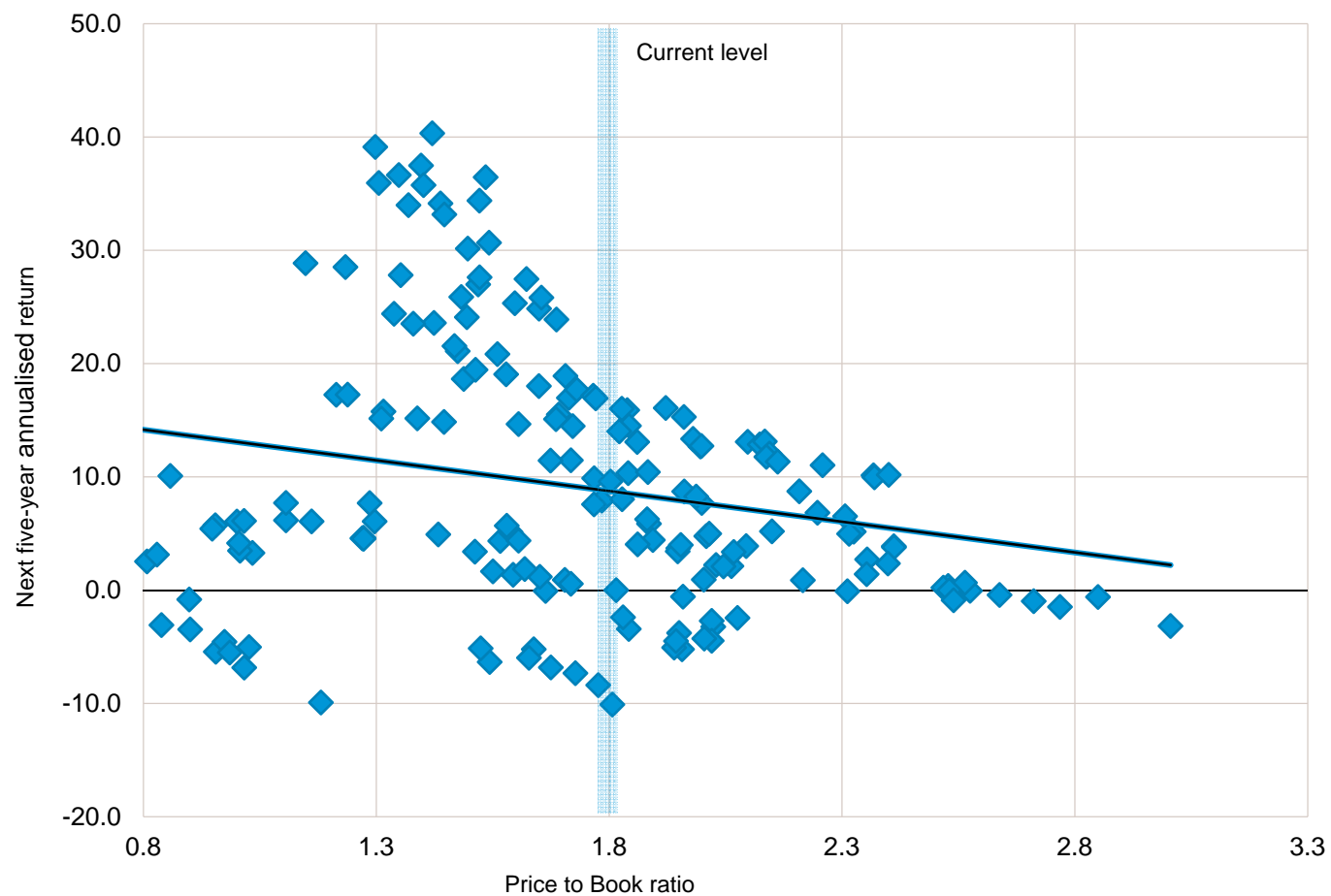
Past performance is not indicative of future performance.

Source: Bloomberg

# EM valuations hint at solid future returns



MSCI Emerging Markets from 31 Jan 1997 to 30 Sep 2017



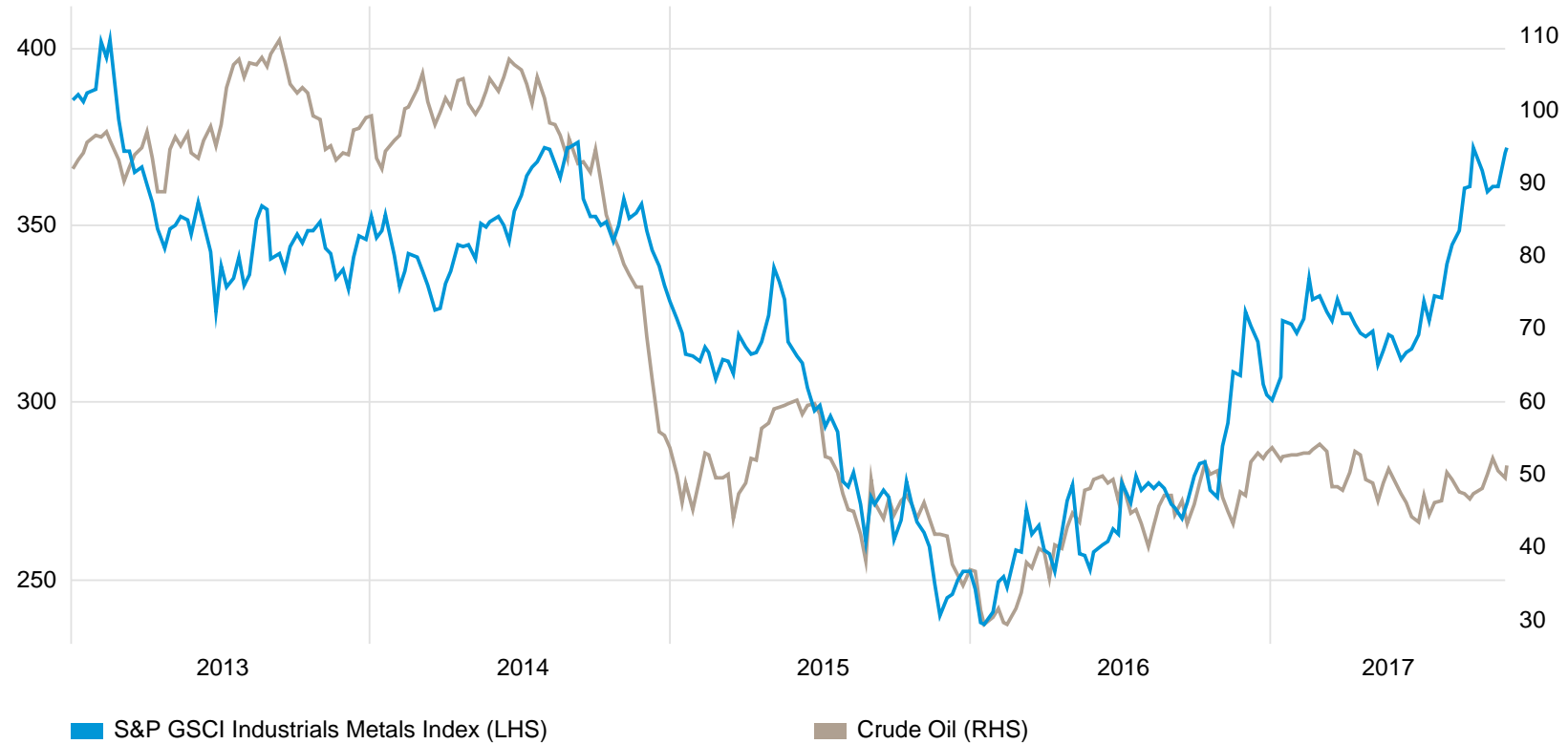
Past performance is not indicative of future performance.

Source: Bloomberg

# Tactical example #1 - shorting oil



From 31 Dec 2012 to 11 Oct 2017



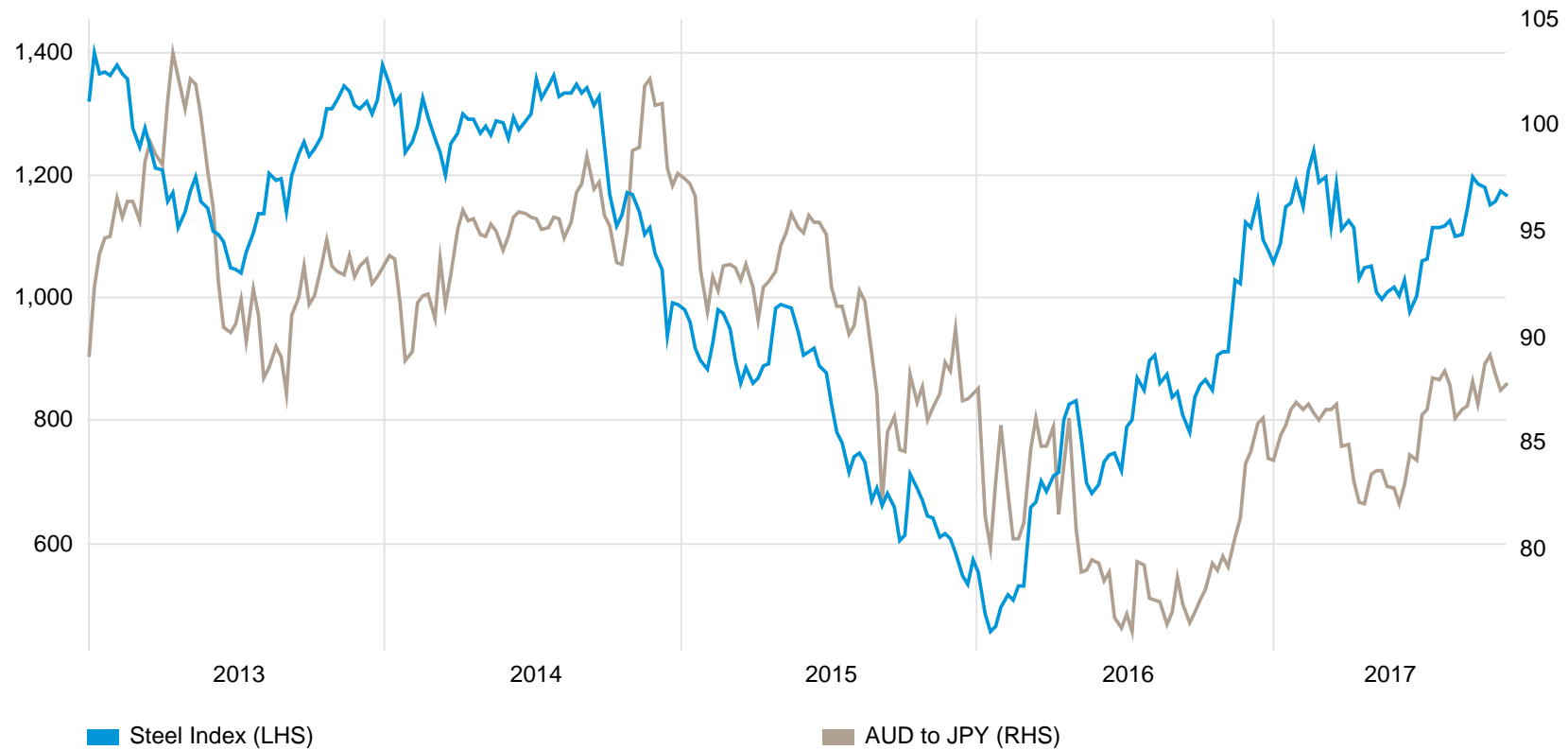
Past performance is not indicative of future performance.

Source: Bloomberg

# Tactical example #2 - hedge world growth slowdown



From 28 Dec 2012 to 13 Oct 2017



Past performance is not indicative of future performance.

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# **POSITIONING AND PERFORMANCE UPDATE**

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# Latest 12-month scenario analysis

Data as at 30 Jun 2017

Probability: %	Crisis: 10%	Slowdown: 25%	Sideways: 50%	Acceleration: 15%
	<ul style="list-style-type: none"> <li>Global GDP &lt;0%</li> <li>DM slows, EM follows</li> <li>Geopol./systemic crisis</li> <li>Profits relapse</li> <li>Markets tumble</li> </ul>	<ul style="list-style-type: none"> <li>Global GDP 1%-2%</li> <li>Reflation stalls, EM lags</li> <li>Geopolitical tensions</li> <li>Profits growth deteriorates</li> <li>Markets correct</li> </ul>	<ul style="list-style-type: none"> <li>Global GDP 2%-3%</li> <li>Moderate DM, EM growth</li> <li>Geopolitics contained</li> <li>Profit recovery stalls</li> <li>Modest market progress</li> </ul>	<ul style="list-style-type: none"> <li>Global GDP &gt;3%</li> <li>DM thrives, EM takeoff</li> <li>Geopolitics benign</li> <li>Profits beat forecasts</li> <li>Late-cycle bull market</li> </ul>
<b>Equities</b>	<b>-20 to -10%</b>	<b>-10 to 0%</b>	<b>2 to 5%</b>	<b>5 to 10%</b>
Allocation	10%	15%	30%	50%
Implied contribution	-1.5%	-0.8%	1.1%	3.8%
<b>Fixed Income &amp; Credit</b>	<b>-3 to 0%</b>	<b>-1 to 2%</b>	<b>2 to 4%</b>	<b>3 to 5%</b>
Allocation	55%	50%	40%	25%
Implied contribution	-0.8%	0.3%	1.2%	1.0%
<b>Alternatives</b>	<b>-2 to 5%</b>	<b>-1 to 5%</b>	<b>-1 to 5%</b>	<b>-2 to 5%</b>
Allocation	20%	25%	25%	20%
Implied contribution	0.3%	0.5%	0.5%	0.3%
<b>Liquidity</b>	<b>0% to 0.5%</b>	<b>0% to 1%</b>	<b>0.5% to 1.5%</b>	<b>2% to 3%</b>
Allocation	15%	10%	5%	5%
Implied contribution	0.0%	0.1%	0.1%	0.1%
<b>Expected return</b>	<b>-2.0%</b>	<b>0.1%</b>	<b>2.8%</b>	<b>5.2%</b>
<b>Including alpha</b>	<b>-1.1%</b>	<b>1.0%</b>	<b>3.8%</b>	<b>6.1%</b>

Source: GAM. For reference, OECD full year 2017 forecast for world GDP growth is 3.3%.

Allocations, asset class ranges and holdings are subject to change. The views expressed are those of the manager at the time and are subject to change. There is no guarantee that forecasts of strategies or objectives will be achieved.

# Strategic and tactical views – summary

As at 15 Sep 2017



	Low Conviction	Cautious	Neutral	Positive	High Conviction
Equities		<b>UK</b> [recession risk, unclear Brexit path] <b>US</b> [exhaustion, marginal underweight]	<b>Japan</b> [underperformed, improving prospects]	<b>Europe</b> [Political risks easing, economy improving]	<b>Emerging Mkts</b> [sound fundamentals, ex-US growth rotation]
Fixed Income			<b>AR approaches</b> [global opportunities] <b>Active aggregate bonds</b> [diversification with a total return mindset]	<b>Financial credit</b> [regulatory trend, steady underlying cashflows] <b>Liquid high yield</b> [safer return extraction]	<b>MBS</b> [steady return profile] <b>Insurance-linked</b> [low correlation to major indices]
Alternatives			<b>Macro trading</b> [potentially rich opportunity set for managers to exploit]	<b>Market neutral Equity L/S</b> [innovative non-directional approaches]	<b>Merger Arbitrage</b> [spread extraction with diversification can provide steady return profile]
Flexibility	<b>Government bonds</b> [shorts in USTs, bunds]	<b>Oil</b> [short amid secular changes] <b>US retail stocks</b> [bricks and mortar internet 'deniers']		<b>Gold, AUDJPY</b> [risk-off hedge] <b>Thematic equities</b> [Buybacks, Technology] <b>Gilts</b> [BoE rate delusion]	<b>Diverse carry</b> [EM, HY, MBS]

Source: GAM.

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# GAM Multi Asset Solutions – Key Strategies



Full range from target return to global equities

For professional investors only

Absolute Return		Relative Return		
<b>GAM Target Return Range</b>	<b>GAM Flexible Global / Absolute Return</b>	<b>GAM Balanced Strategy</b>	<b>GAM Diversified Growth Strategy</b>	<b>GAM Composite Global Equity Strategy</b>
<b>Expected return:</b> Libor+ 3 and 5% p.a.	<b>Expected return:</b> Libor+ 3-4% p.a.	<b>Estimated volatility:</b> 40-60% of global equities	<b>Estimated volatility:</b> 60-80% of global equities	<b>Estimated volatility:</b> 90-100% of global equities
<b>Structure:</b> <ul style="list-style-type: none"> <li>• UCITS Star fund</li> <li>• Segregated strategy</li> </ul>	<b>Structure:</b> <ul style="list-style-type: none"> <li>• UCITS Star fund</li> <li>• Segregated strategy</li> </ul>	<b>Structure:</b> <ul style="list-style-type: none"> <li>• Segregated strategy</li> </ul>	<b>Structure:</b> <ul style="list-style-type: none"> <li>• Segregated strategy</li> </ul>	<b>Structure:</b> <ul style="list-style-type: none"> <li>• UCITS Star fund</li> <li>• Segregated strategy</li> </ul>
<p>Direct securities approach, aiming to deliver independent returns regardless of the market environment.</p> <p>Unconstrained <b>100%</b></p>	<p>Fund of fund, asset allocation approach, aiming to deliver independent returns regardless of the market environment.</p> <p>Equity <b>30.0%</b> Fixed Income <b>33.5%</b> Alternatives <b>21.5%</b> Flexibility* <b>15.0%</b></p>	<p>Balance of capital protection and participation in equity market growth.</p> <p>Equity <b>50.0%</b> Fixed Income <b>22.5%</b> Alternatives <b>18.0%</b> Flexibility* <b>9.5%</b></p>	<p>Significant participation in equity market growth with a moderate focus on capital protection.</p> <p>Equity <b>70.0%</b> Fixed Income <b>13.3%</b> Alternatives <b>11.2%</b> Flexibility* <b>5.5%</b></p>	<p>Strong participation in equity market growth.</p> <p>Equity <b>98.0%</b> Flexibility* <b>2.0%</b></p>

\*Comprises liquidity and tactical asset allocation.

Source: GAM  
All information as at 16 Dec 2016 unless otherwise stated.

Awarded Funds refer to the awards for specific fund categories

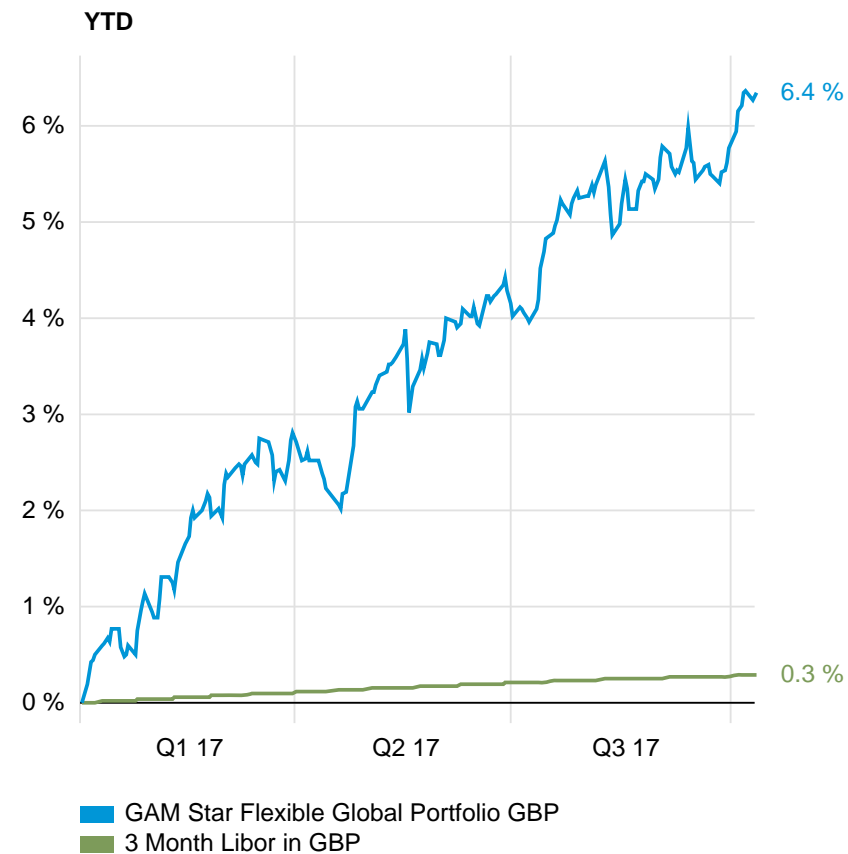
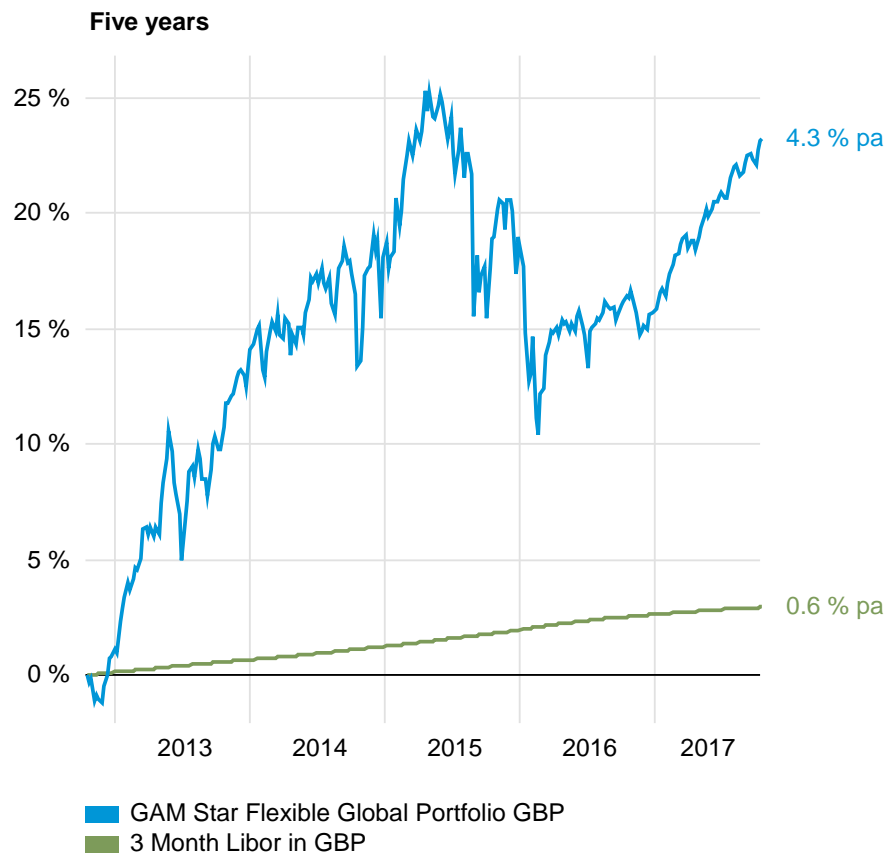




# GAM Star Flexible Global Portfolio GBP



Performance from 8 Oct 2012 to 10 Oct 2017

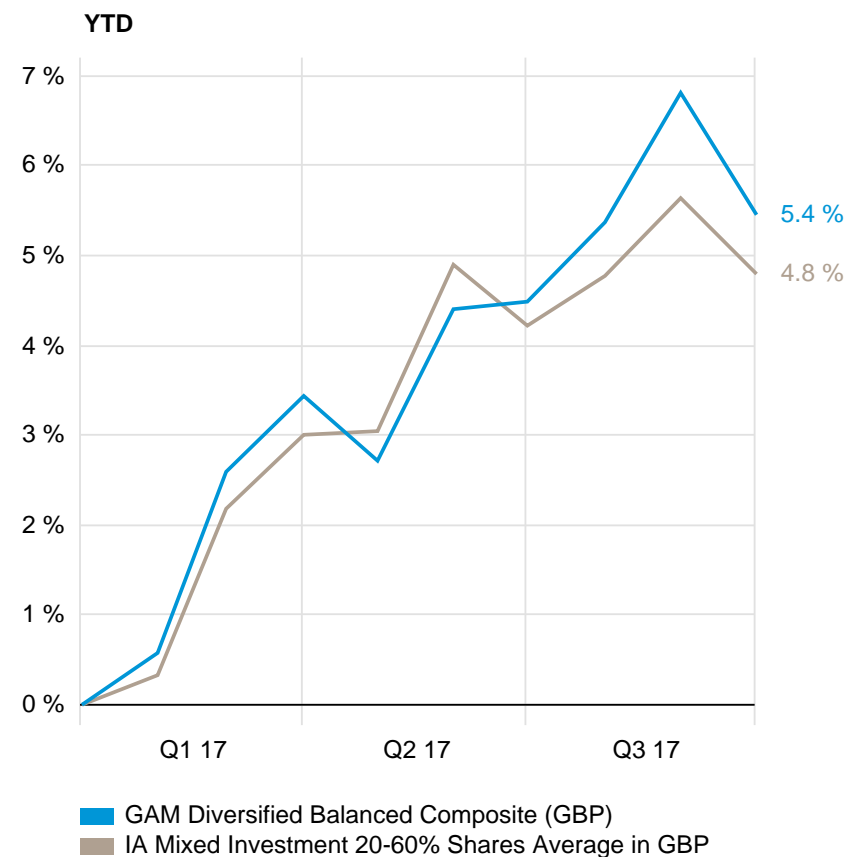
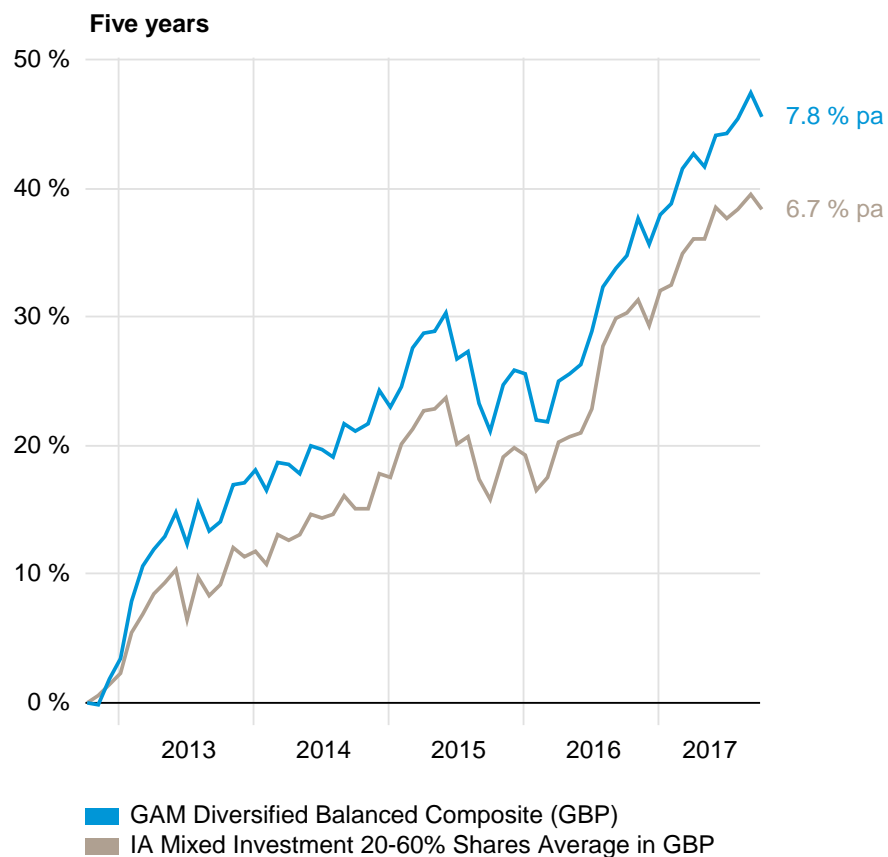


Past performance is not indicative of future performance. Performance is provided net of fees. Funds do not have the security of capital that is characteristic of a bank deposit.

# GAM Diversified Balanced Composite GBP



Performance from 30 Sep 2012 to 30 Sep 2017

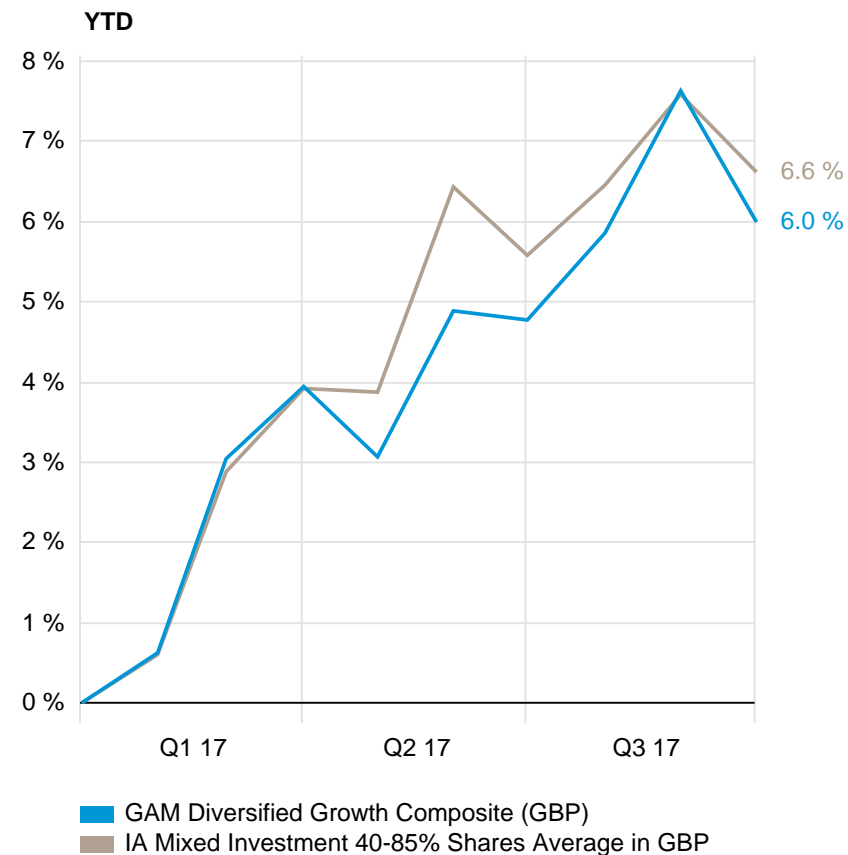
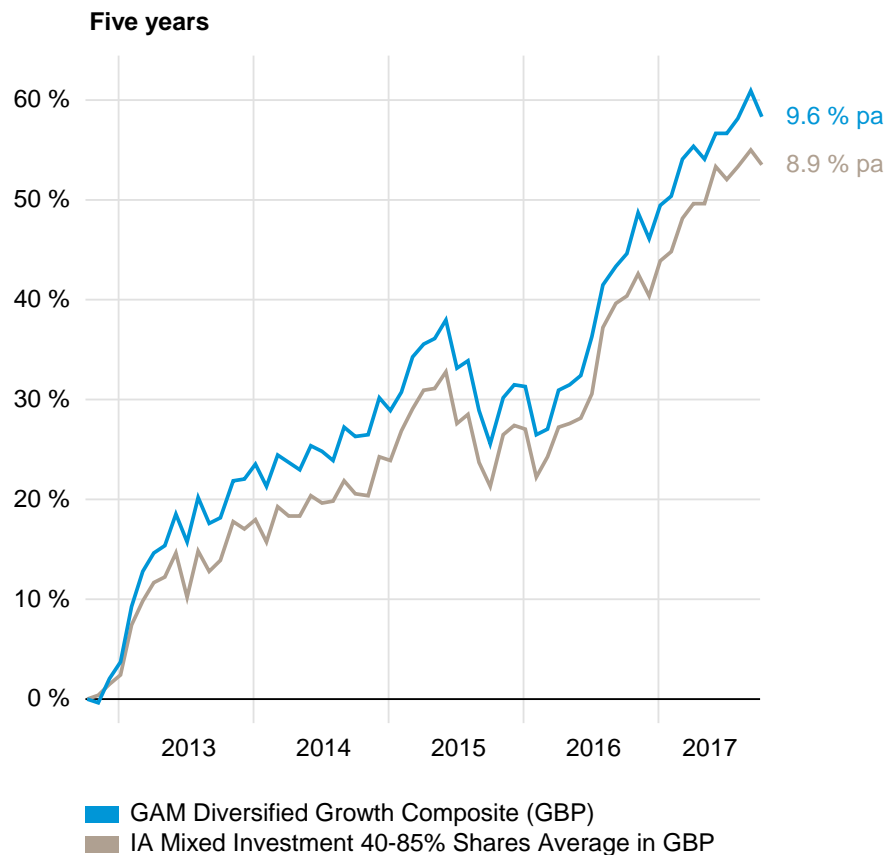


Past performance is not indicative of future performance. Performance is provided gross of fees.

# GAM Diversified Growth Composite GBP



Performance from 30 Sep 2012 to 30 Sep 2017

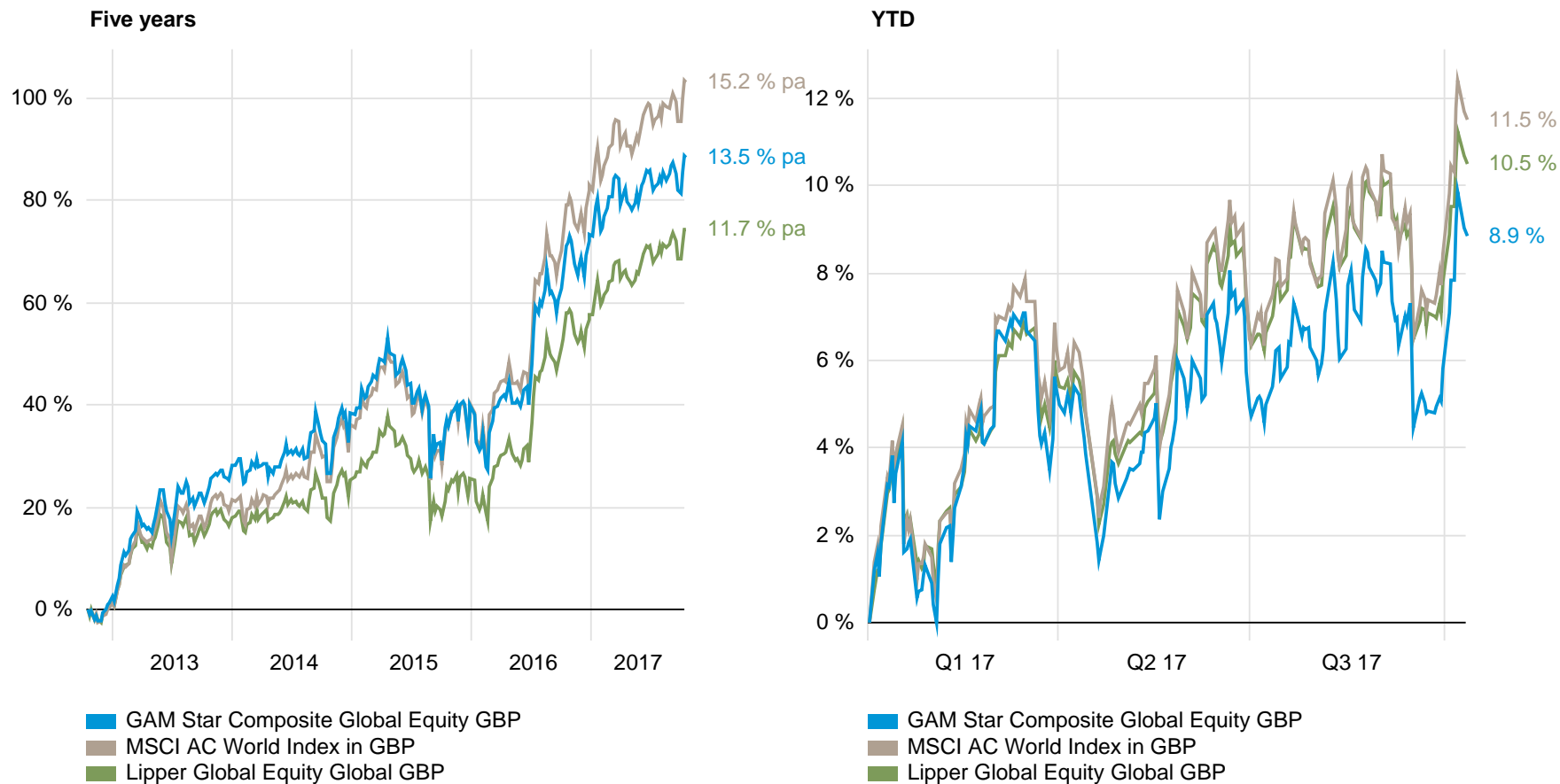


Past performance is not indicative of future performance. Performance is provided gross of fees.

# GAM Star Composite Global Equity GBP



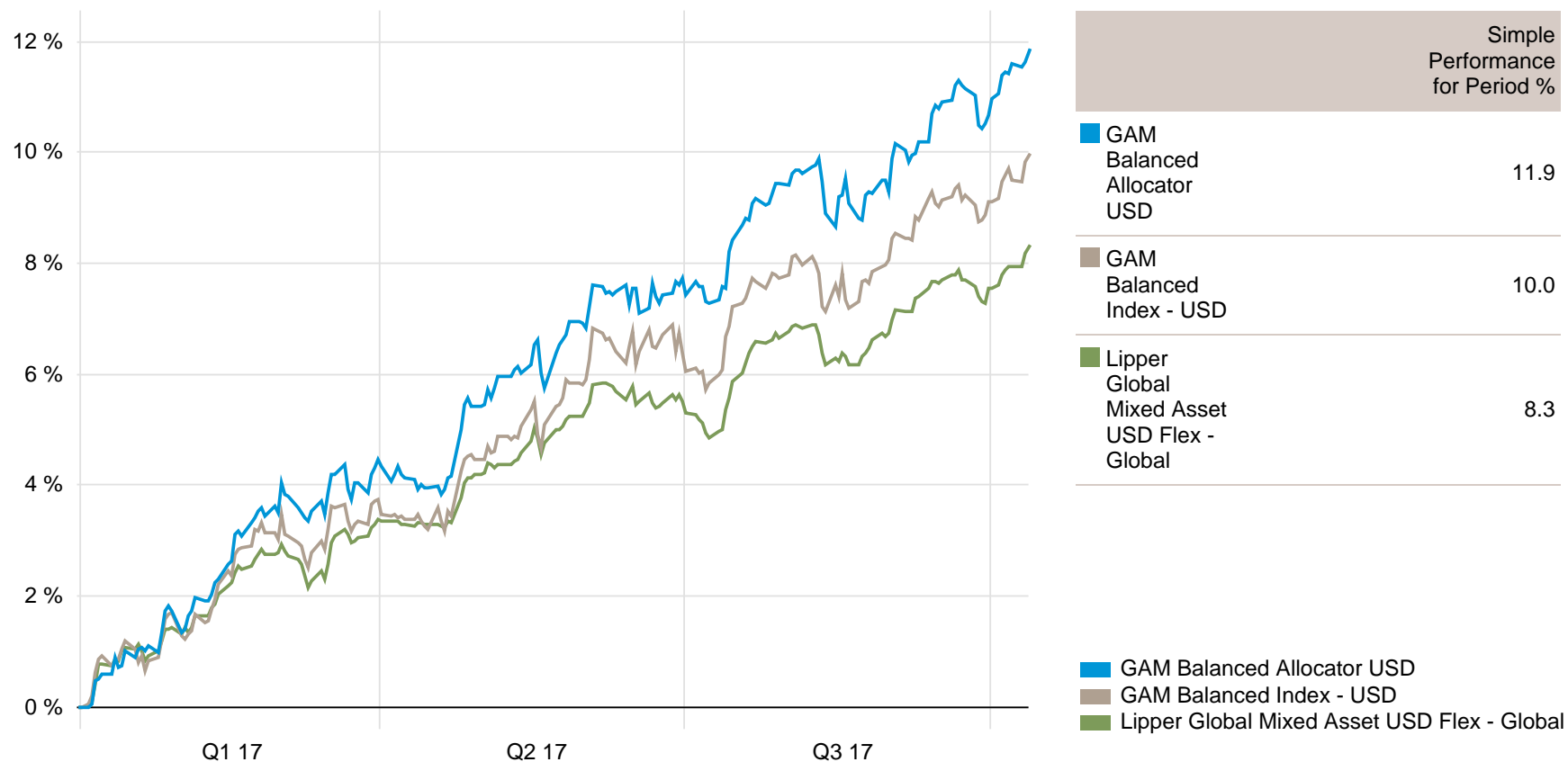
Performance from 8 Oct 2012 to 10 Oct 2017



Past performance is not indicative of future performance. Performance is provided net of fees.

# Balanced Allocator GBP

Performance from 30 Dec 2016 (inception) to 11 Oct 2017



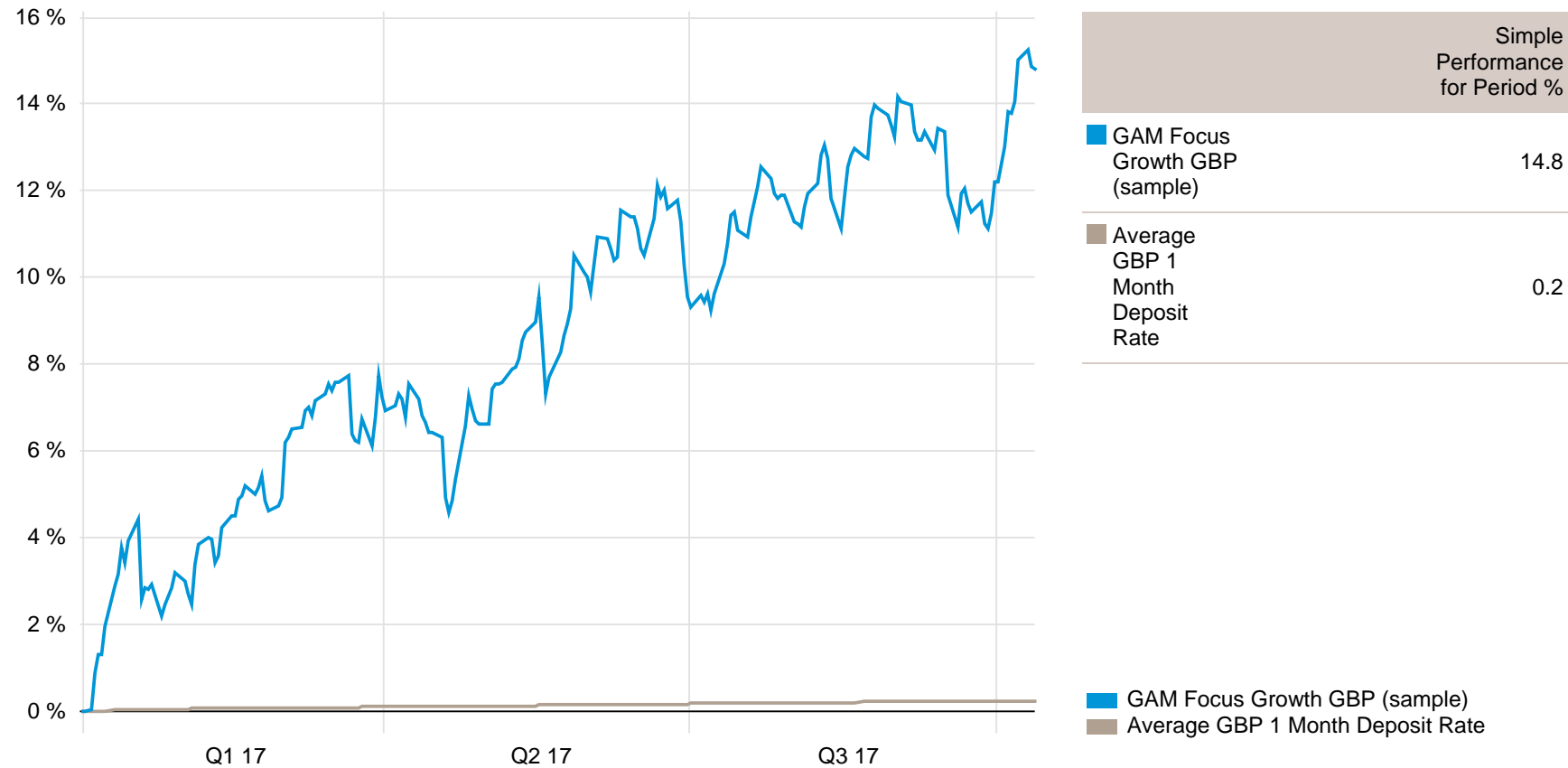
Past performance is not indicative of future performance. Performance is provided net of fees.

Source: GAM, Lipper

Composition of GAM Balanced Index: 10% Average USD 1 Month Deposit Rate, 30% Citigroup (WGBI) UK Bond Index in USD, 50% MSCI AC World Index in USD, 10% HFRI/HFRX Macro Index (GAM Hedged) in USD

# GAM Focus Growth GBP (sample)

Performance from 30 Dec 2016 (inception) to 11 Oct 2017



Past performance is not indicative of future performance. Performance is provided net of fees. Funds do not have the security of capital that is characteristic of a bank deposit.

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# Q & A

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# Disclaimer



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Source: GAM, unless otherwise stated. (Where applicable and, unless otherwise noted, performance is shown net of fees, on a NAV to NAV basis). GAM has not independently verified the information from other sources and no assurance can be given as to whether such information is accurate, true or complete and GAM makes no warranty, expressed or implied, regarding such information. Every effort has been made to ensure the accuracy of the information provided, but GAM cannot be held responsible for any errors or omissions. While every effort has been made to ensure the accuracy of the financial information herein, you should note that some of the information may be based on unaudited or otherwise unverified information.

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