COMMENTARY | FOR THE MONTH OF NOVEMBER 2020 | DECEMBER 2020

Jupiter Flexible Income

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The twin uncertainties of US election and Covid-19 were resolved over November, thanks to the vaccine news and Joe Biden's election victory. Assets that had underperformed for the first ten months of the year saw a large bounce. Europe and Japan outperformed the US, and value outperformed growth. High yield spreads narrowed. Leading equity market sectors were energy and financials. High yield spreads narrowed by around 100 basis points, while investment grade was barely in double figures. Leading equity market sectors were energy and financials, those that had been trashed for much of the year. The income-focused assets that had underperformed so much this year rallied significantly. The dollar reached two-year lows. At the same time, the US Treasury market was the calm head at the party, pretty much unmoved through the month. Gold and silver sold off in the rotation. Copper and agriculture outperformed.

To add a bit of perspective, however, this was a significant bounce in a short period of time but is little more than a dent in the year to date context. At the end of November, the Nasdaq was up 40% this year, but US small cap is still in single digits, and most European markets are still deep in the red.

The fund added to returns over November, delivering top decile performance. This quarter has been particularly strong for the strategy: in October, markets were down, and the wider peer group fell, but the fund was flat thanks to relative value and diversifying positions. In November markets had a strong rally and the fund was able to outperform thanks to adding tactical upside to core long positions.

The story of 2020 for our income strategy has been deep market underperformance of income assets which we have mitigated using the flexible overlay. At last in November, the income portfolio performed strongly, and the overlay was able to add additional value. This led to a very strong month in absolute and relative terms. All of the income portfolio assets did well, and the fund's preference for high yield, alternative and emerging markets over investment grade in particular. Cash equities performed strongly. Throughout the tougher periods at the start of the year where income exposures lagged in both the sell off and recovery we consistently said that the higher quality of the exposures we held would recover and it is good to see that happening strongly, particularly in fixed income.

The macro overlay helped give additional exposure to the market moves, on top of the core income exposures, exactly as it is designed to do in a market rally. The primary positive was that the overlay was long equity markets overall, taking equity delta above 70%. Our core long positions made money: in the US through S&P futures, and in Asia, particularly in Korea but also in China, Taiwan and Hong Kong. Against that we held a short Europe position, which detracted. We didn't expect the vaccine and election news to drive a rally this quickly, but we recognised it was a distinct possibility and that would lead to a market rotation we needed to be positioned for: therefore as well as reducing the Europe short early in the month, in October we had added a long Japan position via Nikkei options, preferring Japan exposure as a way of getting access to a rally like this. The Nikkei had its best month of the 21st century, and this position did very well. FX continues to add performance and diversification to the fund. Relative to a neutral positioning, we are long euro, and we have long exposure to a basket of emerging market FX and Japan, all against the dollar. FX added value as a whole, with Mexican peso and South African rand positive and Japanese yen negative.

Aside from the European shorts, the only other detractor was the VIX futures position we held to diversify the fund's equity exposure. We are reluctant to use US Treasuries to diversify the fund at these levels, and volatility futures remain a useful alternative.

We remain positively positioned. The income portfolio is unchanged: we still hold high yield, emerging market credit, financials credit and alternatives in preference to investment grade credit, plus income equities. In the overlay we continue to hold core long positions in the US and Asia (China, Korea, Taiwan, Hong Kong) where fundamentals, policy and improving global trade are supportive. We continue to reduce European exposure via futures: despite the recent rally we continue to have concerns about Europe's long-term growth and policy outlook. Vaccine optimism can continue to extend the rotation we have seen in recent weeks but given the size of the recent move and sentiment levels we prefer to hold cyclical exposure tactically using European and Japan equity options. We also have risk-on positions in FX: we are long the

Mexican peso, South African rand, Indian rupee, all of which contribute a high level of carry as well as potential appreciation. Overall, we are slightly longer euro than neutral, and short US dollar. For diversification we continue to be long Japanese yen and VIX futures. We hold no additional US duration beyond the small duration contribution we get from credit assets. We have a short German bund position, which we see as a trade with an asymmetric return outcome given where bund yields are, and which acts as a hedge against our short European equity holdings.

Outlook

The four pillars that drive our macro outlook are fundamentals, policy, sentiment and valuation. We entered October long risk thanks to supportive fundamentals and policy in particular. The fundamental economic outlook has improved in recent weeks and policy remains loose. Sentiment is our key area of concern at the moment, approaching overbought territory.

Continued positive news from several vaccine developers gives us a clearer view of the next 12 months, increasing confidence that economies can fully reopen next year. In the short term, virus news in Europe has been getting better. We were concerned about the economic impact of rising virus cases in the northern US and while mobility data has deteriorated it has been encouraging to see economic indicators hold steady, particularly in the housing market and the industrial sector. Adding to the optimism generated by the Biden victory and the expected positive impact on global trade, Asian trade data has remained strong for several months now. Solid fundamentals are backed up by loose policy: there remains uncertainty about a US fiscal package particularly in terms of timing but we are confident a package will come at some point and that will support the US economy well into 2021. The announcement of Janet Yellen is also good news. We expect the Fed to reiterate its commitment to easing despite vaccine progress at the December meeting, and the ECB has already committed to act this month.

Sentiment indicators are improving to the point that we are becoming concerned that markets are overbought: the range of surveys we look at are extended, short interest in the US has fallen to pre-crisis levels, and retail buying has intensified. We aren't yet at a point where we will reduce risk and are mindful that December is traditionally a seasonally strong time of year, but are watching levels closely.

Source of all market figures: Bloomberg.

For the latest views from our fund managers, please visit www.jupiteram.com.

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