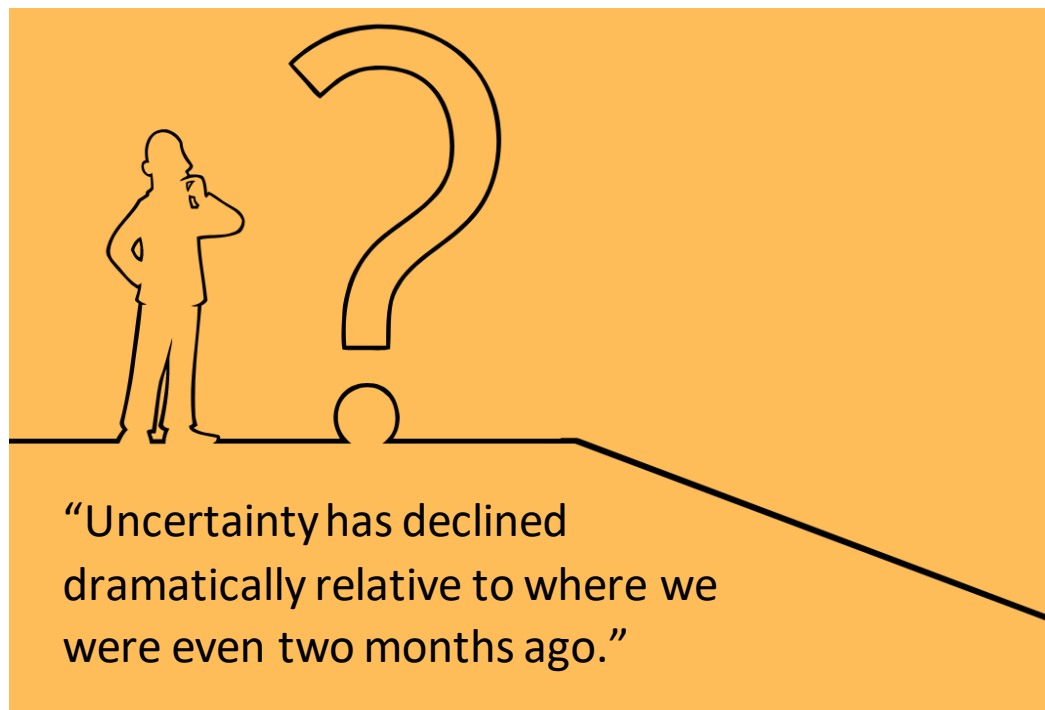


Fund Manager Update - Johanna Kyrklund, Schroders

Schroders' Johanna Kyrklund, manager of the St. James's Place Managed Growth fund, and Chris Ralph, Chief Global Strategist at St. James's Place, discuss how to allocate assets in an uncertain world.



There are lots of uncertainties in the market right now. How are you thinking about that?



“Uncertainty has declined dramatically relative to where we were even two months ago.”

The first point I'd make is that uncertainty has declined dramatically relative to where we were even two months ago. And that is very significant. Because, as fund managers, although we'd like to pretend that we have a crystal ball, in reality we have to create portfolios that position for a range of scenarios. The market overall is, in some sense, a representative probability-weighted assessment of a range of scenarios. If you're able to remove probabilities of very extreme scenarios from that distribution, that is very significant.

For example, in March this year, Trump was saying that COVID-19 would all be over by Easter 2020. Now, we didn't necessarily subscribe to that view, but that view was out there. And then on the other hand, we didn't understand how the virus was being transmitted, we didn't understand the infection rate and there was no sign of a vaccine – so there was a potential scenario where we could have been stuck with the COVID-19 situation for a long time. And there was also uncertainty about the government reaction to all of this. Would they step in to help? As it turns out, we now have much more information. We know what the government reaction is, which is to provide seemingly endless stimulus to plug the gap created by the pandemic. We now have the vaccines, which confirms that this is not going to be a long-term problem and we can start to look through it. So, the range of potential outcomes with COVID-19 has reduced dramatically. That is very important from a market perspective.

That leads us nicely to the reaction from the US election. There is now certainty about who is going to be in the White House on 21 January, but there is still uncertainty about how the Biden administration will be able to implement a stimulus. What's your assessment of that today?:



Again, going into the election, we were dealing with potential outcomes that were unthinkable even a year ago. As recently as a few weeks ago, a number of cities were boarding up their shops, because

there was such a concern about rioting. And obviously we were talking about a contested election as a potential risk. The fact that has gone away, and the US political system is still operating, is actually quite a major gain. The tail risk has been removed, so that we're very grateful for. You're absolutely right, though – it does seem like the Republicans are going to take a very partisan stance.

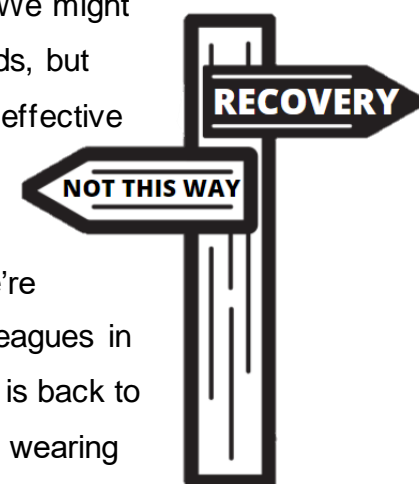
Having said that, the data we're looking at in the US right now points to COVID-19 deaths surging beyond the peak we saw in March in America. And the virus is one area where actually nobody can be blamed. It straddles the political divide. We expect about a trillion dollars of fiscal stimulus out of the States around COVID-19 specifically, because I think it would be difficult for the Republicans not to provide that support. The only major change I would say is on the climate front, where with Biden in the White House I think there's potential for a refreshed impetus towards global coordination.

Let's move on to the 2021 outlook. Should we feel optimistic that the global economy will pick up?

“What we need to remember is that it's easy to get quite gloomy sat here in the UK.”



I am feeling quite optimistic. The market's moving very quickly, so let's see where we end up. But as I said, the reduction of tail risk is very significant. It is comparable to what we saw with the European sovereign debt crisis. We had a nice rally all the way into 2012 off the back of that crisis, even with not very much material change. This time round, people's behaviour will gradually normalise. We have to get through the winter months, but there's light at the end of the tunnel now. The other thing we need to remember is that it's easy to get quite gloomy sat here in the UK, as we lurch from tier to tier and lockdown to lockdown, and can't remember how many people we can actually meet indoors, or outdoors, or when the pubs shut. It's all very confusing here. But the picture in Asia is very different. China's actually come out of this very well. We might question their methods, but they have been very effective in containing and sorting out COVID-19. The message we're getting from our colleagues in Asia is that business is back to normal, albeit they're wearing masks. So, there are parts of the world that are already firmly on the path to recovery, and I think that's the ultimate direction for us as well.



We've seen savings ratios climb this year, suggesting that some of the government stimulus has been saved rather than spent. What change is needed for people to start spending again?

I think some clarity. If you work in the hospitality industry, I think you'd be quite right to be saving any cash you've been given by the government. It's a completely rational thing to do. I'm actually pleased to hear people might

be doing that, because right now they're still facing deep uncertainty. I imagine that if we get to an environment where people can assume that restaurants will stay open, that saving will stop. I do think there is a bit of pent-up demand there, but not a significant amount, because if you look at credit card spending – well, we're all spending plenty of money on the internet. I don't know about you, Chris, but I have been. I'm doing my bit. In some senses it's a funny recession this one, because some forms of



“We’re all spending plenty of money on the internet.”

spending are continuing.

One theory is that fiscal and monetary stimulus will create inflation.

What’s your view on that, and how are you thinking about asset allocation in a world where inflation could be picking up again?

I’ve been firmly in the low inflation camp; I haven’t been worried about inflation for many years. Although we have had fiscal stimulus, it really has been replacing demand that was lost when we were put into hibernation. I don’t think fiscal stimulus will create an inflationary surge. What we are watching, though, is the wages data. Crucial to this low inflation view has been the view that wages were going to remain under pressure. What we need to watch out for, though, is as we come out of this crisis politically, there might be more of a push to increase wages. Ultimately, zero-hour contracts are not a good thing for society. We’re all concerned about inequality. So, I think there’s potential for wage pressure to increase over time, for the pendulum to swing back to labour, if you will, to some extent, and that eventually could lead to inflation. I’m not worried about it for 2021, but on a three-year view it could be a risk. Although, if I see inflation, I’d actually be happy about it, because it would mean we’d averted a Japanese scenario. A bit of inflation is a great thing for equities.

Let’s summarise what all this means for the Managed Growth fund.

On the one hand, you’re optimistic about the technological benefits that have come from the pandemic as well as advantages in medical science. But on the other hand, we’re now seeing some market

rotation into stocks that have struggled more during the pandemic. How do you marry those two ideas?

We introduced an allocation to Alex Tedder a couple of years ago precisely to cope with the fact that we were in an environment that was very technologically driven¹. So, we do have a team that’s focused on picking those kinds of stocks as well. I think that those technological trends, those disruptive trends, will continue. The first point to make is that the UK now looks incredibly cheap relative to the rest of the world, and for a sterling-based investor I think good allocation to the UK market at this point makes a lot of sense. The UK market unfortunately doesn’t have high allocations to tech. It would be wrong to try and chase tech through the UK market.

The UK market does lend itself to the approach that Nick Kirrage and Kevin Murphy take². Their opportunity set has expanded quite significantly; they have increased the number of stocks they own in their portfolio by 33% in the last few months. Why? Because the pandemic accelerated the trend against value, meaning that they’re now able to create a very diversified portfolio across sectors that’s still consistent with their style. That might not have been true a year ago. I think of them right now as a great way of unlocking some of the value that we see in the UK. And I think that both strategies can actually work quite well in this environment.



¹ The Global Equities strategy in the Managed Growth fund, managed by Alex Tedder, accounts for 10% of the overall value.

² Nick Kirrage and Kevin Murphy are on Schroders’ value investment team. Value investors typically focus on purchasing company shares at a price lower than their underlying worth, believing that the market will re-evaluate them in the future and their price will rise to reflect their true worth or “value”.

We're trying to create a balanced strategy that can evolve and stand the test of time.

We need to think through the role of government bonds in the future. How is that going to evolve? I'm not allergic to government bonds just yet, but I'm getting there. They are not as efficacious a holding as they used to be, and we need to think about whether we move up the risk curve into some of the higher-quality emerging market names, for example. Because this crisis also reshuffled the cards, with some emerging economies like China doing better than some of the developed economies like us.

Finally, how do you think about alternative investments? What are your views on public versus private markets, or the inclusion of gold in a portfolio?

One of the challenges we have is that quite a lot of juice has been squeezed out of credit markets – there's not much yield around. Moving into private markets can give you access to better yields if that is a challenge that you face. There are definitely opportunities in the private market. I wouldn't give up on public markets altogether, though, because as I said, under the surface of public markets, there are huge opportunities, huge distortions, that we can exploit as active managers. I mean, Tesla is now the 10th largest company in the world. Does that make sense?

In terms of alternative safe havens, gold is interesting. For many years I didn't like gold because it's inherently a negative-yielding asset. But obviously, right now, government bonds are often in that bucket as well, so

the competing defensive assets are not looking as attractive as they used to. But as we potentially move into more unconventional policies as governments seek to cope with the debt loads that they've accumulated through this crisis, gold could be an interesting addition to think about in our portfolio.

And what about property?

With property, I think the key is in the execution. COVID-19 has accelerated some trends that were already in place, like the struggle of the high street, and even the need for office space. We were working flexibly already, and in some sense this crisis has shown us what is possible. So, there are some headwinds for some areas of the property market, but then there are other areas that are benefiting a lot, from online retail and things like that. I still think it's an attractive asset class.

Schroders is a fund manager for St. James's Place.

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