INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

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Horizon Multi-Asset Funds Market Update

8th July 2020

The five Horizon multi-asset funds are managed around strategic asset allocations that are provided by EValue and are based on long-term forecasts and stochastic modelling. EValue set strategic asset allocations in line with a range of risk levels. Columbia Threadneedle Investments is the investment manager of the funds. We seek to ensure each fund conforms with its targeted risk level and aim to add value by tactical asset allocation around the strategic asset allocation and from stock selection, investing in a spread of actively managed Columbia Threadneedle funds.

Over the last two weeks there has been no changes within the Asset Allocation Strategy Group Matrix. As with the previous week we continue to retain a preference for equities and investment grade corporate bonds, at the expense of government bonds.

As equity markets have continued to rise we have taken this strength to top slice our equity allocations given:

- Equity and credit markets have recouped much of what was lost in March, denting their valuation case.
- At the fringes, uncertainty is mounting – from second waves of the virus, to trade tensions, US elections and questions around how labour markets emerge once support schemes fade.

We are not in defensive mode, and have left our preference for equities and credit unchanged:

- Policy easing continues to run at an extraordinary clip: China, Japan and Europe are among regions that are upping their games.
- Lower discount rates are a powerful support as economies recover and we are keen to remain long those assets most impacted.
- Moreover, as economies reset in early stages of recovery, higher equity multiples might be expected.

But, as mentioned previously, we have taken some risk off the table in the Horizon fund range.

In equities, we still favour the quality of the US market with cyclicality in emerging Asia. The US market offers access to high quality companies with strong balance sheets and which look well-placed to deliver growth, even in this highly uncertain environment. Meanwhile, some cyclicality in Asian equities should be rewarded as Asia pulls out of this crisis and parts of its economy - such as Chinese manufacturing – show signs of reverting to pre-virus levels.

We retain a strong preference for investment grade credit. While spreads have tightened from their late-March wides, they remain cheap to long run averages. Meanwhile, the technical environment has improved with vastly better liquidity conditions, and the fundamental picture appears relatively sound, as high-grade credit is a targeted beneficiary of the policy response to the crisis.

Finally, we remain underweight on government bonds at these levels, particularly given sharply deteriorating fiscal accounts as policy makers seek to manage the crisis.

The Columbia Threadneedle Asset Allocation Strategy Group's matrix of relative attractiveness of asset classes as at the 8h July 2020 is shown below:

Figure 1: Asset Allocation Matrix

	Strongly Dislike	Dislike	Neutral	Favour	Strongly Favour
Asset Allocation		Government Bonds inc Index-linked	Cash Commodities Property	Equities Credit	
Equity Region			EM Europe ex-UK Japan UK	US Pacific ex-Japan	
Credit			Corporate HY EMD		Corporate IG

Source: Columbia Threadneedle Investments at 8th July 2020

UK Equity

To say that 2020 has been eventful is an understatement. As we enter the second half of the year we have had one of the worst quarterly returns on record quickly followed a reasonable rebound in market levels considering the economic backdrop.

With central bank support leading to strong risk market returns during the quarter, there has arguably been a dislocation between fundamentals and valuations.

Our focus remains high-quality companies with strong balance sheets, typically those that benefit from factors such as demand for unique products, pricing power and high profit margin. Our holdings are typically leaders in their field and, in many cases, exposed to themes that have likely been accelerated as a result of the pandemic, thus giving us further confidence in the multi-year opportunity.

We are still very engaging with companies and have been in constant dialogue with management teams to ensure balance sheet strategies are scrutinised and accountability is maintained. We are long-term shareholders and want to see companies emerge in as strong a shape as possible.

US Equity

The US market had a strong week last week, with the S&P 500 up by 4%. Momentum/growth names outperformed value again, building on the outperformance of this factor over value, but value returns were still positive.

The market managed to advance despite the concerning growth of coronavirus cases in some parts of the country. California, Texas, Florida and Arizona have all hit a new peak in cases which has led several states to pause or rewind their reopening plans. If this surge continues and becomes embedded it could throw the emergent recovery off course by dampening business activity and confidence.

There was more good news on the vaccine front as Pfizer and BioNTech came back with positive results in trials.

The House of Representatives passed a $1.5 trillion infrastructure proposal, but it is uncertain whether it will be passed into law by the Senate. However, this does bode well for future stimulus action should the Democrats secure a clean sweep in November's election.

Non-farm payrolls in June surprised to the upside for the second month running, as 4.8 million jobs were added to the economy, while the readings for the previous two months were revised upward. However, this data was collected just before the recent uptick in cases so does not reflect the potential impact this will have on the labour market.

Joe Biden continues to pull ahead from Trump in the polls, especially in key battleground states like Florida. Although we have previously commented that a Biden presidency (and Democrat sweep of both houses) might lead to higher tax rates and regulation, Biden is considerably more pro-business than his previous challengers for the Democrat nomination such as Bernie Sanders and Elizabeth Warren. It is also looking increasingly likely that a Biden presidency and control of both houses could lead to economic stimulation in the form of a substantial infrastructure package.

European Equity

The Covid-19 first wave appears to be largely over in Europe, so the medical risks lie around second saves or isolated flare-ups, and high infection rates and mortalities in other territories, for example the US.

The recovery in value stocks has run hard and may now be petering out. Economic activity is set to recover, but expenditure will remain below "normal" (i.e. pre-virus) levels.

This means our focus on robust and sustainable business models is crucial. Sadly, high unemployment and the lack of a 100% recovery in economic activity places many others at risk.

The market recovery has been strong and valuations are more stretched than before. This is only sustainable in the light of stimulatory fiscal and monetary policy, which will again tend to favour our style.

Fixed Income

Fixed Income markets kicked off the new quarter reasonably well:

Valuations remain reasonably attractive. However, the rally since March has moderated the opportunity. Central bank support remains a key technical factor for now in support of all markets. This support will become even more relevant if there are relapses of COVID 19 infections.

Fundamentals remain challenging for many issuers, despite some signs that they may be better than recent expectations.

We continue to be particularly focussed on fundamental analysis and management engagement to help sort through issuers with a combination of fragile balance sheets and lasting industry headwinds.

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