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Investment trusts for a new economic era

The ‘goldilocks’ environment of exception returns in equities and bonds is under threat, an analyst has said. Alan Brierley, analyst at Investec, said since the global financial crisis the “unprecedented actions” by financial authorities by way of rate cuts and quantitative easing were catalysts for exceptional returns.

“This has underpinned a 'buy-the-dip and don’t fight the Fed' psychology, with investors confident that the authorities will ride to the market’s rescue whenever required.”

As a consequence, he said, the duration of these “risk-off” events have been increasingly short and “animal spirits” have quickly re-engaged, for instance the Covid sell-off was over in less than five weeks.

However, fears of higher inflation, interest rate rises and the threat of stagflation (a high inflationary, low growth environment) is growing.

“Meanwhile, historically elevated valuations offer little margin of safety, while geopolitical risks stand at multi-decade highs,” he said.

And unlike previous risk-off markets, the looming issue is the lack of toolkit the central banks have to support markets given this rampant inflation.

Brierley said given these clear challenges, he struggles to reconcile global equity levels which are now just 6 per cent off all-time highs

“A transition from the ‘great moderation’ to a new regime of higher inflation and volatility and lower growth represents a fundamental shift, and is likely to be a key investment theme for some time.”

He warns of the challenges to investors if bonds and equities fall in tandem, especially for 60/40 investors.

Brierley recommended a number of investment companies that have both strategic and tactical value and can improve portfolio diversification while providing income protection.

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Aberdeen Diversified Income & Growth - Brierley said while he remains supportive of the board’s move to a multi-asset approach seven years ago, the executive has been disappointing. However, since the last strategic view, he said, there has been some stabilisation and a solid NAV progression ahead of target.

BH Macro - This is a direct feeder into the $8.3bn Brevan Howard Master Fund with most exposure to global fixed income and FX markets, and since 2003 has delivered an annual return of 8.6 per cent. Brierley said the fortunes of this fund tend to be inversely correlated to market distress, and he believes a macro hedge fund strategy has an important role to play in improving portfolio diversification.

Capital Gearing Trust - Brierley highlighted how this trust's manager, Peter Spiller, has managed it since 1982, a "genuinely remarkable record". The portfolio is defensively positioned with a focus on inflation protection and there is material exposure to inflation-linked equities and bonds.

JP Morgan Global Core Real Assets - This fund invests across core real assets in real estate, infrastructure and transportation. Brierley said this fund has an important role to play given it has highly forecastable and stable long-term cash flows with a low margin of error, and low correlation with other asset classes.

Personal Assets Trust - Troy Asset Management was appointed investment adviser in 2009 and then investment manager of this fund in 2020. It is a flexible, long-term, long-only multi-asset fund, and there are no derivatives. Brierley notes how, in the last quarterly for the fund, the manager noted how we have witnessed a 40-year bull market in bonds, a high equity market and record low interest rates, and that "nothing lasts forever".

RIT Capital Partners - This trust is a long-standing member of Investec's flexible model portfolio, and Brierley said he has been particularly impressed with the performance in recent years. He said given the blend of conviction and diversification, the portfolio is well placed to shield capital in much more challenging conditions.

Ruffer Investment Company - Brierley said even before the Ukraine invasion, the manager believed the economy was transitioning to a new regime of higher inflation and volatility. The trust is invested across index-linked investments with a bias towards the UK, providing protection against low yields, and has an "unconventional toolkit" of payer swaptions, gold, equity put options, and credit protections.