Santander Asset Management

Santander GO Absolute Return

2 / 2023

Fund commentary

Market Review:

February was generally a difficult month for markets, with broad-based losses across equities (Europe was the exception), credit, sovereign bonds and commodities. This disappointing performance was mainly driven by investors re-assessing their view on the likely peak in official rates, and the possibility that central banks may move rate higher than expected. This view was based on stronger-than-expected headline & core inflation rates, as well as stronger economic data, notably employment data. This stronger growth has led to 2023 GDP forecasts being revised higher.

Starting with the equity side, the MSCI World Equity Index returned -2.4% in US terms, with the S&P 500 also falling -2.4% whilst the EuroStoxx 50 outperformed, appreciating +1.9%. Japan's Topix index rose +0.9%, whilst the UK's FTSE 100 was another strong performer, gaining +1.8%. After spending most of 2022 in the doldrums, the MSCI Emerging Market index gave back most of the gains it made last month, falling -6.5% in February, as fears of higher US interest rates and strong US Dollar affected the region. Hong Kong's Hang Seng index depreciated -9.4% and is now flat year-to-date.

Looking at the bond markets, higher inflation coupled with better-than-expected growth suggests that central banks may push their "terminal rates" higher than previously expected", helping to push bond yields higher, and prices lower. It was the worst February for bond markets on record, and the US Treasury index was down -2.4%, whilst the Euro Government Bond fell -2.3% and UK Gilts dropped -3.4%.

On the credit side, the Bloomberg Euro Agg Corporate Index fell -1.4%, whilst the Bloomberg US Agg Corporate index significantly underperformed, dropping -3.2%. In the High Yield space, the Bank of America US High Yield Index depreciated -1.3% in February, and its Euro counterpart (Bank of America Euro High Yield Index) slightly outperformed, only dropping -0.2%.

Turning to currencies, the US Dollar reversed its recent depreciation trend in February, appreciating +2.6% against the Euro and overall, the US Dollar Index rose +2.7% whilst Sterling also continued its recent appreciation, rallying +0.2% against the Euro. The Japanese Yen was a loser, falling -1.9% against the Euro and -4.5% against the US Dollar.

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Finally, on the Commodity side, the WTI oil price fell -2.3% during February. Gold gave up all the gains it made during January, dropping -5.3% whilst Copper only fell -2.7%, whilst the general Refinitiv Core Commodity Index was down -3% in February, and is down -2.9% year-to-date.

Portfolio Review:

Overall, the Portfolio delivered a negative return in February 2023, with both our directional Macro positions and our relative value Satellite positions detracting from overall performance, whilst our hedges only made small gains as most markets generally depreciated during the period under review.

Our Macro Strategy pillar underperformed and was the most significant negative detractor from overall performance in February 2023 as most equity and all bond markets fell. Increased worries that strong-than-expected inflation along with better economic growth will mean higher terminal rates spooked investors. Our long Non-EUR Duration position was the worst performing position in February – the main underperformers here were our US and Australian bond positions. Our long US Equity and long EM Equity positions also delivered negative returns. With Gold depreciating -5.3% during the month, our long Gold position was another detractor, as was our long Commodities position. It wasn't just US and Australian bond yields that rose – our long EUR Duration position also underperformed. On the positive side, fears that inflation would remain elevated saw inflation breakeven increase significantly during February and our long Global Inflation position was the best-performing position during the month. Another outperformer was our long US Dollar position (which we rebuilt in late January and early February) as the US Dollar appreciated +2.6% against the Euro. Our long EUR Equity position also added some good performance, as European equity markets bucked the global trend and rose during the month.

On the Thematic side, our performance made a small positive contribution, mostly driven by our Robotic idea.

As might be expected when most equity and fixed income markets investment grade credit markets depreciate during the period under review, our hedges outperformed and slightly added to overall performance. Our FX hedges were the best performers, as we were hedged against a weaker Euro and these hedges did well as the Euro depreciated against the US Dollar during the month. Our equity hedges also added some small positive performance. This month, our US Equity hedges did well, but our European and UK equity hedges detracted. Our High Yield Grade credit hedges (we were hedged against widening credit spreads) also made some small losses.

It was a disappointing month in performance terms for the relative value strategies with strong returns from our Spread sub-pillar being more than offset by losses on all other sub-pillars. In the Spread sub-pillar, the drivers of good returns were a general tightening in swap spreads, with High Yield spreads in particular enjoying a good month, but also good returns from our Italian 2yr/10yr flattener. Our Commodity, Inflation & Volatility sub-pillar suffered from a steepening

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of the UK inflation curve and general weakness in commodity prices, whilst in our FX Sub-pillar, we lost some performance due to our decision to go long EM FX, as these currencies generally underperformed against a stronger US Dollar. On the Equity side, negative returns were mainly driven by the under-performance of a couple of positions – we were long some sectors in the US that underperformed (notably Commercial Services, Consumer Discretionary and Technology) and our European Cheap Growth position underperformed vs the overall Euro Stoxx 50 index. Our Quant sub-pillar also disappointed with many of the models suffering small losses, but our Cross Asset model was the worst performer as it was generally positioned for a depreciation of the US Dollar. Finally, in our Interest Rate sub-pillar, we were positioned for a steepening of the US curve (but the curve flattened) and an out-outperformance of Australian bonds which didn't happen,

In terms of portfolio activity, our equity exposure decreased slightly from +16.5% at end-January 2023 to +15% by end-February 2023. We increased our exposure to European equities by 1.6% to +6.4%, whilst decreasing our Europe ex-EMU exposure by -0.5% to +1.3%. We also increased our US exposure by 1.5% to +6.4%, whilst we significantly decreased our position in EM equities from +3.8% to -0.1%.

Our overall duration stance was very slightly decreased from +2.5yrs to +2.3yrs whilst our spread duration was increased from +1.6 years to +2.3yrs. Our overall commodity exposure decreased from +7% to +5.3%, mainly due to a decrease in our gold exposure. Our US Dollar exposure is once again our biggest currency exposure after the Euro and increased to just under 12% by end-February. After the US Dollar, the Japanese Yen is the next biggest currency position at +2.8%.

Outlook:

We continue to keep a fundamentally cautious risk stance in the long-term, against the backdrop of structurally higher inflation. Our concern is that inflation may prove stickier than expected, and when it does fall, it may bottom out at levels that are uncomfortable for central banks. Thus, terminal rates may need to revised higher and rate cuts postponed until 2024. Coupled with this, in both the US and Europe, we think downward revisions to earnings are on the cards. As we have seen in February, markets will continue to remain volatile, and we have adopted a more tactically positive stance. But overall, we maintain our prudent approach, whilst ready to adjust tactically our stance depending on the evolution of the monetary policy rhetoric and economic growth. We are keeping hedging strategies in place to protect the portfolio given the sudden swings in market conditions and investor sentiment.

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