eQ investors

Positive Impact: February/March Rebalance

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Strategic Asset Allocation Committee

The rosier medium to long-term outlook we described at the last rebalance has continued to play out. This has led to pro-cyclical sectors (such as Financials, Industrials) outperforming defensive sectors (Consumer Staples and Health Care) which performed well at the height of the pandemic last year. Typically, small companies also do well during economic recoveries and this time is no different. Small caps have significantly outperformed large companies over the last several months.

There are still a few areas of the market to which we have little or no exposure, and where expectations remain depressed. However, companies within the Airlines and the Hospitality & Leisure industries, two industries that depend on looser social restrictions, have seen a lot of the recovery now reflected in their share prices. While it's probably fair to say the worst of the Covid-19 crisis is behind us, we think there are a few noteworthy risks that need balancing against otherwise bullish backdrop.

Markets have come a long way since November which was an important month for two reasons. First, the Democratic US election win, and second, positive clinical trial results of not one but three Covid-19 vaccines.

With a new US president now in office, expectations of a reversal in several Trump-era policies have lifted market sentiment and accelerated the progress of some long-term trends. One area of the market we think is set to benefit from a new Biden administration is environmental equities. As one of his first acts as president, Mr Biden signed an executive order to re-join the Paris Climate Agreement, making good on a campaign pledge which commits the US to net zero emissions by the middle of the century. With the COP26 UN climate conference due to be held in Glasgow later this year, it is possible the conference will have a newfound significance as the new president seeks to redress isolationist policy decisions from the previous administration.

Since the election result in November, it's been remarkable to see environmental equities outperform the Technology sector, a rare feat versus a part of the market that had a tremendous run over the past decade. As an example within environmental equities, we think the near-term investment case for the Clean Water theme has been strengthened owing to its pro-cyclical exposure (many water-related companies sit within the industrials sector), making it likely to benefit from an any upswing in economic activity. This is in addition to robust long-term tailwinds driving water-related equities, which stem from an ongoing need for infrastructure investment and urbanisation and other demographic shifts.

There is no doubt that within the Technology sector, consumer internet has been a phenomenal driver of innovation. Indeed, the likes of Facebook and Alphabet (Google), which we don't invest, in have dramatically disrupted the established model of advertising while in the process creating novel business models through advancements in artificial intelligence and data processing. And yet, Biden's election win has the potential to draw the ire of politicians and regulators to the influential role of social media and online content. As the attention of these great businesses turns to the consequences and challenges of growth and innovation, our attention turns to another sector brought to light by the pandemic.

Though historically sentiment has waned towards Health Care with the ebbs and flows of changing political banners, the sector presents some of the most exciting investment opportunities at the apex of digital technology and scientific advancements. From machine learning in gene sequencing to AI in developing messenger RNA therapeutics, Health Care companies have swiftly moved from a public enemy operating in the corporate sphere to the world's saviour from the pandemic. As vaccines roll-out and governments begin to introspect, we think it will be incredibly unlikely that public healthcare spending will see a decline in the coming years. Rather, we think it's likely that we will see the opposite.

In recognition of these risks and opportunities, we have made a small increase in our overall growth asset exposure, and made a reduction in defensive sectors in favour of more cyclical-like exposure where we hope to benefit from an uptick in economic activity. We've also made a conscious effort to increase exposure to medium and small sized companies which we believe will continue to benefit from the strengthening economic environment.

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The numbers below refer to the Balanced risk profile:

Asset Class	Mar-21	Model Change (%)
Growth Assets	63.00%	+1.0%
Equities	61.00%	+1.0%
High Yield	2.00%	+0.0%
Defensive Assets	37.90%	-1.0%
Short Duration	14.60%	*-1.0%*
Long Duration	21.30%	+0.0%
Cash	2.00%	+0.0%

Growth Sectors	Mar-21	Model Change (%)
North America	23.90%	-0.2%
UK	11.00%	+0.7%
Europe	9.10%	+0.1%
Japan	3.80%	+0.2%
Asia Pacific	11.40%	+0.0%
Other EM	1.40%	+0.2%

Overall

- For all risk profiles, we have been increasing the equity allocation by 1% which means a slight overweight to our long-term strategic asset allocation. On balance, at this stage, we feel that the opportunities for the markets to further rebound outweigh the risks outlined above.
- The overall increase in exposure in equities has been achieved through an increase in the UK equity exposure, focusing primarily on small caps where we see attractive valuations when compared to other markets globally.

Detailed changes:

- UK Equities: With most of the Brexit uncertainty behind us, we increased our exposure to UK equities focusing primarily on smaller capitalisations. This was primarily achieved through an increase in our exposure to Ninety One UK Sustainable Equity.
- Emerging Markets Equities: At this rebalance, we have taken the decision to exit our position in BMO Global Responsible Emerging Markets. When we first introduced the fund in 2017, this strategy was a leader in embedding sustainability within its investment process. We successfully engaged with the fund managers to further improve their process but have now reached a plateau. Combined with a more recent period of underperformance, the allocation to this fund have been used to invest in Aberdeen Standard Emerging Markets Sustainable Development Equity. We are really excited to add this strategy to the portfolio as we will be able to leverage on Aberdeen's long-term experience in emerging markets as well as their expertise in impact investing.
- Healthcare theme: We have also taken the decision to exit our long-term exposure in Polar Capital Biotechnology. To help achieve the UN Goal 3 Good Health and Well Being, we have always preferred biotechnology companies particularly over the large pharmaceutical companies to help support the development of new drugs and treatments. But over the last few years, we have seen a number of other segments of healthcare fast developing including medical technology and equipment, healthcare apps and insurance. That's why, we have decided to introduce the Baillie Gifford health Innovation fund to better capture the innovation and growth opportunities that the sector now offers to investor.
- Significant reduction in cost: The removal of Polar and BMO funds combined with the additions of Baillie Gifford and Aberdeen funds have helped materially reduce the portfolios costs both from an OCF and MiFID II basis. The reduction in costs is as large as 16bps for the All Equity risk profile. It is worth mentioning that the costs highlighted below may vary slightly from one platform to another.

	EQ Positive Impact Portfolios	Cautious	Balanced	Adventurous	All Equity
November 2020	OCF	0.55%	0.63%	0.68%	0.73%
	MIFID 2	**0.68%**	**0.82%**	**0.93%**	**1.03%**
March 2021	OCF	0.54%	0.59%	0.62%	0.65%
	MIFID 2	**0.66%**	**0.75%**	**0.81%**	**0.87%**
Difference	OCF	-0.01%	-0.04%	-0.06%	-0.08%
	MIFID 2	**-0.02%**	**-0.07%**	**-0.12%**	**-0.16%**