LGPS CENTRAL LIMITED TACTICAL ASSET ALLOCATION

ISSUE 11 ● **September 2020**

FOR PROFESSIONAL CLIENTS ONLY

CIO SUMMARY

Introduction

Welcome to the eleventh edition of our LGPS Central Limited ("LGPSC") Tactical Asset Allocation ("TAA") Report. We hope that you, your family and friends are safe and in good spirits.

Summary of Strategy Thoughts

Since the publication of the previous edition of this report, we are now closer to both the US elections and Brexit. Furthermore, we are witnessing the second wave of the coronavirus and all the risks that this imposes. After economies opened up once again during the summer, they are now facing local lockdowns where cases have spiked back up. This behaviour will pretty much determine the shape of the recovery.

We have ruled out the V-shape recovery. Rather than a V-shape, we continue to see the recovery as a radical(the shape of a square root symbol), with a much flatter slope of recovery moving forward that will most likely depend on various factors: (a) continued fiscal and monetary support, (b) the level of unemployment, (c) consumer behaviour which will determine to a large extent the survival of many SMEs, and (d) how long it will take for a medical solution to be found.

We are upgrading income assets to **overweight** from **underweight**. The main drivers behind the upgrade are Infrastructure and Emerging Market Debt. We remain **underweight** on stabilising and growth assets.

In terms of factors, the model continues to be **overweight** on **quality** and **low volatility** and **underweight** on **size**. With regard to currencies we continue to remain positive on Sterling despite the current poor economic environment and the approach of Brexit. With the current low level of domestic rates, the increasing size of the domestic deficit, the current sentiment score and oversold nature of Sterling, we believe much of the bad news is already discounted. We continue to support the US Dollar's prolonged period of weakness. JPY and EUR continue to trade in response to the market's perception of relative risk.

Gordon Ross (CIO)

LGPS CENTRAL LIMITED'S VIEW ON WEIGHTINGS

The following table gives a summary of our view on the 6-18 months tactical positioning horizon.

Table1: Weightings   ▲Upgraded ▼Downgraded compared to previous quarter

	Significant Underweight	Underweight	Neutral	Overweight	Significant Overweight
Estimated Probability	80-70%	70-65%	55-45%	70-65%	70-80%
BROAD ASSET CLASS		Growth Stabilising		Income ▲	
GROWTH ASSET CLASS	US Equities	GEM Equities EU Equities Private Equity	UK Equities ▲ Asia Pac Equities ▼	Commodities Japan Equities ▲	
INCOME ASSETS	Property		Credit ▼		EM Debt Infrastructure ▲
STABILISING ASSETS	JP Bonds	Index-Linked EU Bonds ▼ UK Bonds US Bonds ▼		Gold IG Bonds ▲	
INVESTMENT STYLES	Size	Growth ▼	Momentum	Value ▲	Quality/ESG Low Volatility
CURRENCIES		US Dollar		GBP, Yen, Euro	

LGPSC's view on "Weightings":
- We increase the allocation to Income Assets to overweight mainly due to Infrastructure and EM Debt.
- Growth Assets we keep at underweight mainly due to their high valuation and market risk scores.
- Stabilising Assets we keep at underweight mainly due to their high valuations.

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BROAD ASSET CLASSES

Table 2: Growth/Income/Stabilising Assets

	Model Score[1]	View	Investment Notes
GROWTH	-1	Underweight	Kept at underweight, based mainly on high valuation and market risk scores.
INCOME	1	Overweight	We upgraded Infrastructure and together with the already overweight view on Emerging Market Debt, we tend to prefer this asset class backed by positive sentiment.
STABILISING	-1	Underweight	Reflects the high valuations of the stabilising assets.

Table 3: Historical Annualised Returns in local currency (* except for the 3 months, where total return is used)

	3 months*	One year	Three years	Five years	Ten years	Twenty years	Bloomberg Ticker
GLOBAL EQUITIES	8%	11%	8%	11%	9%	5%	FTAW01 Index
PRIVATE EQUITY	-1%	-10%	4%	13%	11%	N/A	IPRV LN Index
PROPERTY	1%	-12%	4%	6%	9%	10%	REIT INDEX
INFRASTRUCTURE	2%	-14%	-1%	4%	5%	N/A	SPGTIND Index
HIGH YIELD	3%	1%	3%	6%	7%	10%	HL00 Index
UK GILTS	-1%	4%	6%	5%	5%	6%	G0L0 Index
UK INDEX-LINKED	-2%	0%	7%	7%	8%	7%	G0LI Index
GOLD	2%	21%	15%	14%	6%	11%	XAUGBP Curncy

Source: Bloomberg (NB: assumes dividends were reinvested), Note: Listed proxies have been used for Infrastructure, Property and Private Equity.

Table 4: Correlation Matrix (5 year historical correlation)

	FTSE All World AW TR GBP	iShares Listed Private	DJ REIT	S&P Global Infra	Sterling High-Yield	UK Gilt	UK Inf-Link Gilt	XAUGBP Index
GLOBAL EQUITIES	1	0.795	0.764	0.869	0.709	-0.103	0.108	-0.144
PRIVATE EQUITY		1	0.716	0.777	0.632	-0.022	0.180	0.073
PROPERTY			1	0.838	0.630	0.190	0.331	0.006
INFRASTRUCTURE				1	0.731	0.107	0.271	0.008
HIGH YIELD					1	0.037	0.201	-0.131
UK GILTS						1	0.786	0.493
UK INDEX-LINKED							1	0.414
GOLD								1

Source: Bloomberg. Note: listed proxies have been used for Infrastructure, Property and Private Equity

LGPSC's view on Broad Asset Classes:
- We can see from Table 3 above that during the three months of the second Quarter most of the asset classes had returns significantly below their ten and twenty year averages. This coincides with the conclusion we made last quarter that most of the asset classes look expensive.
- From Table 4 we can see that the best asset class to protect both equity and high yield exposure is not UK sovereign bonds (gilts) but rather Gold, which has a higher negative correlation.
- While our recommendation is to be underweight Growth and Stabilising asset classes, this recommendation still allows room for a selective approach. Although our recommendation is the Income Asset Class, within Growth and Stabilising asset groups, one can still find niche opportunities.

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[1] Refers to LGPSC model as described on page 7

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GROWTH ASSET VIEW

Table 5: Growth Assets

	Model Score[1]		View	Investment Notes
UK Equities	0	▲	Neutral	Upgrade to Neutral given the extremely negative sentiment which is overdone in our view and also the oversold GBP currency.
NORTH AMERICA Equities	-6		Underweight	Kept underweight due to high valuations, economic outlook, poor currency outlook, as well as increased market risk linked to the political uncertainty.
EUROPE Equities	-1		Underweight	No change from last quarter.
JAPAN Equities	2	▲	Overweight	Increase to overweight due to positive sentiment, economic and currency outlook.
ASIA PAC Equities	0	▼	Neutral	Downgraded due to valuations and sentiment.
GEMs Equities	-2	▲	Underweight	Kept at underweight mainly due to valuations and sentiment.
PRIVATE EQUITY	-2	▼	Underweight	Kept at underweight mainly due to valuations and sentiment.
COMMODITIES	1		Overweight	Kept at overweight. Provides no yield but can be added as a diversifier and potential inflation hedge.

LGPSC's view on Growth Assets:
- Growth Assets continue to have expensive valuations.
- We are underweight most of the regional Growth Assets, except for Commodities and Japanese Equities. Japanese Equities have better economic, currency and sentiment scores in comparison with other regional equity markets. Our overweight in commodities reflects positive currency scores.
- After Q1 20 markets have recovered a significant part of their falls. However, further falls reflecting the economic reality could push markets lower.

INCOME ASSET VIEW

Table 6: Income Assets

	Model Score[1]		View	Investment Notes
CREDIT	0	▼	Neutral	Downgrade to Neutral due to valuation.
EMERGING MARKET DEBT	2		Overweight	No change from last time.
PROPERTY	-3	▲	Underweight	Valuations, sentiment, economics and market risk – all continue to have a negative impact on Property. Some of these have been already reflected last quarter and hence a slight upgrade in the Underweight view.
INFRASTRUCTURE	3	▲	Overweight	Upgrade to Overweight due to positive sentiment, currency and market risk scores.

LGPSC's view on Income Assets:
- We prefer Infrastructure and Emerging Market Debt due to their better currency and sentiment scores.

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STABILISING ASSET VIEW

Table 7: Stabilising Assets

	Model Score[1]	View	Investment Notes
UK BONDS	-2 ▼	Underweight	Further reduced the underweight position due to sentiment and valuations.
INDEX-LINKED	-1	Underweight	No change from last time.
US BONDS	-2 ▼	Underweight	Reduced to underweight due to valuation, currency and sentiment scores.
JP BONDS	-5	Underweight	No change from last time.
EU BONDS	-3 ▼	Underweight	Reduced to underweight due to valuation, sentiment and market risk scores.
IG CORPORATE BONDS	2 ▲	Overweight	Upgraded overweight due to positive sentiment and market risk scores.
GOLD	1	Overweight	No change from last time.

LGPSC's view on Stabilising Assets:
- Regionally, on government bonds, we are underweight across all regions.
- We remain overweight IG corporate bonds and Gold due to positive sentiment and market risk scores
- Gold offers good diversification and a hedge against currency debasement which we are witnessing currently, and should its price be lower, we would have given it a much higher score than just 1.

INVESTMENT FACTORS (EQUITIES)

Factor Based investing provides a way of potentially adding outperformance relative to a market-cap-based approach at a much lower cost than active investing. It recognises that the market-cap-based index does not provide the best risk-adjusted return for a portfolio given its natural overweight to momentum, large cap and expensive stocks. In the following factor model, we have taken the seven factors of value, growth, income growth, size (small cap), ESG, low volatility and momentum and then applied the same criteria we use to consider other asset classes in our model assessing each factor for valuation, sentiment, economic suitability, risk suitability, investment cost and currency. Investment cost in factor-based investing is low relative to the other asset classes, though the momentum factor (given their higher turnover) and ESG factors (given their higher index costs) are both scored neutral. Given all strategies are global, the currency scores are all neutral. Note that ESG and quality share similar characteristics. Climate change as a factor is little correlated to specific economic cycles given its long-term investment impact horizon of 10-20 years. The graph below summarises the preferred overweight factor(s) depending on the various stages of the economic cycle.

Economic Cycle and Investment Factors:

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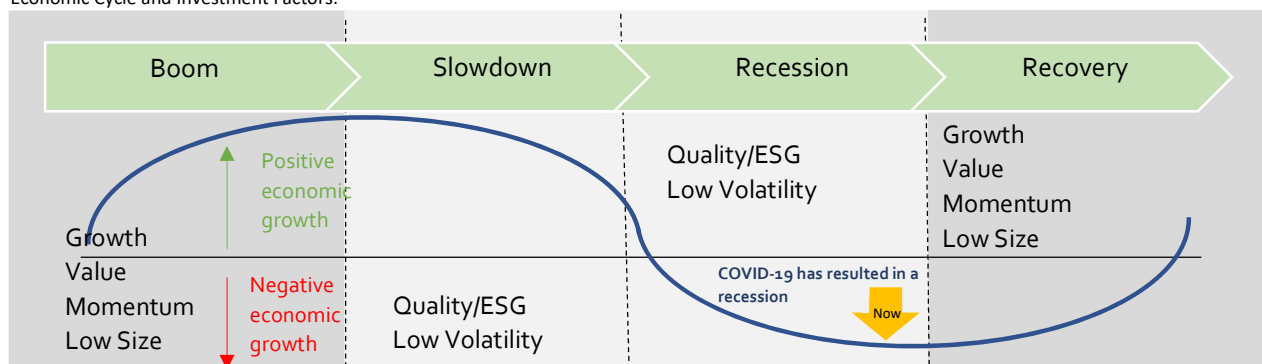
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FACTOR ASSET VIEW

Table 8: Investment Factors

	Model Score[1]	View	Investment Notes
Value	1 ▲	Overweight	Upgraded to overweight due to higher sentiment
Growth	-1 ▼	Underweight	Downgraded to underweight due to perceived higher market risk and lower sentiment
Size	-3 ▲	Underweight	Our view on small caps remains negative due to high valuations, negative economic score, however we are slightly less negative compared to last time
Momentum	0	Neutral	No change from last time
Low Volatility	4 ▲	Overweight	Increased the overweight by a notch due to high scores on valuation, sentiment, economics and market risk
Quality/ESG	3	Overweight	No change from last time

LGPSC's view on Investment Factors:
- Our favourite factors remain Quality/ESG and Low Volatility.
- Least favoured factor remains Small Size.
- Given that the economic recovery is lagging behind current valuations, and uncertainty lies in front of us both about the coronavirus development and the state of the economy, it comes as no surprise that small companies may be vulnerable and Quality & Low Risk factors are favoured.

ABOUT LGPS CENTRAL LIMITED'S SCORING MODEL

LGPSC's model scores each asset class against its valuation, sentiment, economic outlook, market risk, currency and investment cost (scored between -2 and +2). Positive scores suggest strong overweight positions and negative scores, strong underweight positions. Where a zero is assigned, our view is neutral. The scores for the different assessment areas, e.g. valuation, sentiment etc. are then added to derive the final score for that asset class. Please note that sentiment is measured as to whether an asset class is over owned or over loved. We prefer to own asset classes that are under owned and under loved. We are constantly developing this scoring to include other variables such as ESG measures and technical factors.

This quarter we have changed the model to not account for the investment cost as a factor. We believe with the abundant liquidity at present, and the fact that the investment cost is reflected in the price, asset class scores do not need to reflect on the investment cost.

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Q3 LGPS CENTRAL LIMITED MARKET UPDATE[2]

The third quarter of 2020 saw the economic recovery continue after the devastating effects of the coronavirus in late Q1. In the UK, fiscal stimulus is fading, and Chancellor Rishi Sunak's new job support scheme is less generous than the furlough scheme. With the furlough scheme ending at the end of October, a rise in UK unemployment is more than likely. In Europe, on the other hand, support measures for workers affected by covid-19 have been extended. The US Presidential election is taking place on 3rd November and is grabbing headlines as it edges closer. Polls are still suggesting a Joe Biden win, but Donald Trump has gained ground in some key swing states.

The US S&P 500 Index made significant gains returning 8.47% in the quarter. However, September has not been kind as the S&P 500 was up 12.9% as at the end of August. This was due to the lack of progress on talks of a new fiscal stimulus package. The UK had a contrasting quarter falling 4.9% due to fading fiscal stimulus and rising coronavirus cases. The Euro Stoxx 50 had a very volatile quarter and finished down 1.25%. MSCI Asia Pacific (ex. Japan) had a good quarter, finishing up 8.58%. Asia's strong performance was helped by China's success in containing the virus. Nikkei and MOEX Russia also produced positive returns for the quarter.

The Flash Composite PMI's (company surveys) in the UK showed consistent growth, being more than 50 as more of the economy reopened after taking a local lockdown approach rather than a national one. The Eurozone showed growth in July but lagged the UK in September as its Services PMI contracted.

The Michigan Consumer Sentiment Index had a drop in July but has since picked up as US Initial Jobless claims continued to fall. The VIX index has dropped significantly to the end of August, but spiked up at the start of September, meaning the index has only slightly dropped over the quarter. The sudden uptick in the index was due to the elevating risk arising from the US Election.

Concern over the Brexit trade deal continued, causing Sterling to weaken. However, the US Dollar vs the GBP weakened further by about 4.2%. The US Dollar fell sharply following a period of appreciation because of the growing number of covid-19 cases across many of the States. Many investors have shifted from viewing the Dollar as the global haven to an unfashionable bet. The falling Dollar aided the returns in Gold and emerging market currencies. Emerging markets were also helped by the attention turning away from the US-China tensions and towards the US Presidential election.

The oil price rose steadily from slightly below $40 to slightly above $43 for the first two months of the quarter and then fell to finish the quarter at slightly above $40. The fall in price was due to growing concerns around the demand following a sluggish summer.

The prospect of a no-deal Brexit is influencing expectations of the Bank of England's policy. The Bank of England (BoE) is currently reluctant to shift to negative interest rates, but the Governor of the BoE, Andrew Bailey, has not ruled it out. Markets suggest negative rates will be introduced sometime in 2021 as the UK 10Y Gilt ended the quarter above 20bps, very slightly up from the start of the quarter.

Q4 2020 will be an interesting and eventful quarter as we will find out the outcome of the US election and whether the UK gets a no-deal Brexit or not. There is also a good chance that we get further news on a vaccine for covid-19 as the Oxford trials have recommenced after a brief pause.

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[2] Performance for the quarter measured over period of 30/06/2020 to 30/09/2020

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Central Banks and governments have provided huge amounts of stimulus measures, helping the private sector. Central Banks have also made it clear that they are willing to use their full firepower to keep government and borrowing costs low. The Federal Reserve and the BoE have maintained their rates at 0-0.25% and 0.1% respectively. The Governor of the BoE announced that the Bank has considered negative interest rates to expand its policy toolkit and although there is no immediate plan to cut rates below zero, he has not completely ruled out this option.

Q3 LGPS CENTRAL LIMITED RESPONSIBLE INVESTING UDPATE

China has surprised countries around the world by announcing a target of carbon neutrality by 2060. The pledge has reignited hopes of limiting global warming as the country is the world's largest producer of carbon dioxide (accounting for 28% of global emissions). Carbon Action Tracker has estimated that if the pledge materialises, it could lower global warming projections by 0.2°C. The announcement reflects a growing awareness in China of the detrimental effects of climate change, alongside increasing confidence that technological progress can make net-zero emissions attainable without sacrificing economic growth. However, China's current dependence on coal power creates a significant obstacle in its journey to carbon neutrality. The country currently houses over half of the world's coal power capacity, and in 2020 alone has approved the construction of 40 gigawatts worth of new coal plant projects, which is equivalent to Germany's entire capacity. Transforming such a carbon-intensive economy in the next 40 years is a daunting task and China will have to define clearer short-term targets if it is to genuinely follow through.

In the US unprecedented wildfires have been raging across the western States. Devasting numerous towns, destroying thousands of homes and killing 20 people, the fires have propelled climate change to the centre of the US presidential contest between Donald Trump and Joe Biden. The former cites the flammability as the result of "poor forest management" whilst Biden sees the fires as a validation of the progressive green agenda of the Democratic party. This disparity mirrors the views the two politicians hold on wider climate policies. Trump sees manmade climate change as an "hoax" and would initiate further weakening of US climate policies through the rollback of more than 70 environmental regulations. The election of Biden would be a catalyst for policy ratcheting, including possible re-entry into the Paris Agreement and a $2tn plan for net-zero emissions by 2050.

In light of the COVID-19 pandemic, several governments have incorporated instruments supporting a climate transition in their economic recovery plan. In particular, EU policymakers have responded enthusiastically to calls to "build back better". The EU has announced a €750 billion stimulus package that aims to construct a greener, more sustainable and resilient society. The plan encompasses new ways for the EU to generate revenue, including a tax on non-recycled plastics, and makes clear that any expenditure not in line with the Paris Agreement would be rejected. Despite receiving criticism from certain members of the EU Parliament who argue the money would be better spent confronting the health crisis, the stimulus package strongly underlines the EU's belief that climate action and the COVID-19 economic recovery are not mutually exclusive.

Over the past year, BP, Repsol and Shell have all revised down their price assumptions on oil and gas in response to the weakened long-term outlook for fossil fuels. Most recently, BP announced it would take up $17.5bn in charges as it lowers its oil-price assumptions. BP said the price reset was driven by the company's expectation that the coronavirus crisis would accelerate the transition towards cleaner technologies. Shell has announced a write-down of $2bn, with further companies Repsol and Equinor also announcing undisclosed write-downs. Technological advances including declines in the levelized cost of renewable energy and price of electric vehicles pose a threat to the demand for fossil fuels, with obvious risks to investors spanning asset classes, sectors and value chains.

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RISK ANALYSIS

Table 9: Risk in order of probability

RISK	LGPSCL Possibility	LGPSCL Impact	Change on quarter	Comment	LGPSC favoured assets to protect against the risk
CORONAVIRUS	High	High	↑	The second wave of the coronavirus is among us thus increasing the risk of a lengthy recession. While a vaccine may be discovered in any particular moment, until then, the risk the pandemic imposes on the economy is high.	Clients without equity protection should consider re-establishing protection. Selectively investing in Quality Assets and a diversified portfolio.
EQUITY DOWNTURN	High	High	↑	The probability of equity downturn has increased as we are witnessing a second wave of a coronavirus, local lockdowns, deteriorating macro data and fundamentals, adding to the uncertainty.	Safe haven assets such as gold. Renewing equity protection should be considered.
NO DEAL BREXIT	High	Medium	↑	The chances of No Deal Brexit scenario have increased. There are less than three months left for an agreement to be reached.	Hold a well-diversified portfolio.
NATURE OF RECOVERY	High	High		Not likely to be a straightforward V-shaped recovery, most likely either a W-shaped or looking like a radical sign(V with a "tail"). Indicators point towards a prolonged global recession due to a second wave of Covid-19 forcing new lockdowns (although local).	Hold a well-diversified portfolio with emphasis on Quality. Once the recession is gone, factors such as Size and Value are expected to perform best.
POLITICAL RISKS	High	Medium	⇒	The market appears to differentiate less between the two presidential candidates – Trump and Biden. Contested election risk exists in case of Trump losing the elections and the period of uncertainty following the election contest.	Overweight protective assets such as Gold.
ISOLATION & PROTECTION/CHINA	Medium	Medium	↓	Currently a lower risk given that the US presidential candidates have turned their focus on their election campaigns rather than on the foreign policy. Once past the elections, this risk will re-emerge.	Current tactical asset allocation will be dominated by the Coronavirus.
CREDIT RISK/DEBT ISSUES	High	High	⇒	Emerging sovereign debt crisis has become the biggest risk. Argentina, for example, after the restructuring again has problems. Credit markets to a big extent are underwritten by the central banks, thus keeping the default rates at artificially low levels. Mounting government debt, through new issuance, is met with an increase in the QE programmes.	Selective Credit and IG Corporate Bonds.

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RISK	LGPSCL Possibility	LGPSCL Impact	Change on quarter	Comment	LGPSC favoured assets to protect against the risk
CURRENCY RISK/ STERLING STRENGTH/US$ WEAKNESS	Low	Moderate	→	Expectation for a long downtrend in the USD. The currency preference will be (in declining order) GBP, YEN, EUR, USD; in particular, GBP strength and USD weakness is expected. Gold we view as positive.	Buy GEM equities, commodities which historically benefit from a weaker dollar.
CLIMATE-RELATED TRANSITION RISK	Medium	Moderate	→	The EU Carbon Price continues to remain in the mid-€20/tonne. At the UN General Assembly, China announced it aimed to become carbon neutral before 2060. European leaders have agreed a deal on the new 7-year EU budget and the Next Generation EU recovery instrument, with 30% of fund allocated to climate projects. Climate change remains a contentious topic between the two administrations running for presidency in the U.S. Green bond issuance for H1 2020 $91.6bn, down 26% year on year. Beginning to recover in Q2 2020.	Underweight Energy & GEMs, overweight Renewables and Sustainable Investment themes such as Infrastructure.
CLIMATE-RELATED PHYSICAL RISK	Medium	Moderate	→	Carbon emissions are beginning to rebound following national lockdowns There have been record breaking wildfires in parts of the U.S. (particularly California and Oregon). Data from the European Commission's Copernicus Atmosphere Monitoring Service (CAMS) suggest that these wildfires are more intense and the worst in 18 years. Amazon deforestation in Q1 2020 has increased by 55% year on year	Hold a well-diversified portfolio.
LIQUIDITY RISK	Low	Low	→	Liquidity risk is not considered to be a main problem given the ample liquidity support from the central banks.	
UNEXPECTED INFLATION RISK	Low	Low		Unexpected Inflation is not seen on the horizon, though the conditions that could lead to it, are present, even though it may take some time till these materialize. Currently the view is that it will be supply driven rather than demand driven when it happens.	

LGPSC's view on "Scenario Risks":
- We can only repeat our view from last time when we compared the current situation to juggling two balls in one hand. One of the balls we called the "health risk ball", the other ball we called the "economic risk ball". As soon as one of these balls starts approaching the ground, it is immediately caught while simultaneously launching the other ball in the air, which eventually will start approaching the ground as well. No ball should be accidentally allowed to fall on the ground. This act of fine balancing is what is required and is the biggest risk we are facing.
- We also have reviewed the likelihood and impact of risks, and we now see that the biggest risks as a prolonged recession, the economic impact from the second wave of Covid-19 in the autumn/winter, and the lack of clarity on Brexit.
- We highlight that holding a diversified portfolio still offers the best protection against those risks. Equity protection may be necessary. Specific risks such as a weakening US$ can be mitigated by hedging the currency risk. Reducing home-bias made investments can prove to be beneficial post-Brexit.

How will the result of the US election impact the markets?

John Goodall – Portfolio Manager, Active Equities

One of the most significant events this year is the US Presidential Election. We all witnessed the impact when Trump won and all the consequences it brought to the financial markets, the geopolitical scene, the fiscal and monetary policy. In this article, we will explore the consequences of a Biden or Trump victory, and how this will reflect on the asset allocation. Obviously, our conclusions are based on the candidates' agendas, which may or may not materialise as advertised on their electoral campaigns.

BIDEN

A new president generally enjoys a honeymoon period, facilitating the passing of their top one or two priorities, especially if they also control Congress. Investors would have been wrong to bet against George W. Bush's Economic Growth and Tax Relief Act, Barack Obama's Affordable Care Act or Trump's Tax Cut and Jobs Act. If the Democrats were to take the Senate, it is likely they will attempt to remove the filibuster (the use of debate to block legislation). The Senate minority leader has already signalled a willingness to change the rules if he becomes majority leader. Removing the filibuster would enable the Senate to pass laws with a simple majority of 51 votes should no additional clauses be implemented. This would allow the Democrats to pass a lot more ambitious legislation. This matters as Biden's agenda is more left-wing given his history as a traditional Democrat. On the other hand, if Biden was to defeat Trump but proved unable to win the Senate vote, a split house would ensue and he would not be able to push through such an ambitious agenda.

As can be expected, a Democrat government promises a greater level of spending. Part of this additional spending is to be covered by higher tax. This is likely to be administered across the board with changes proposed to payroll tax, capital gains tax, estate tax and most importantly for the stock market, corporate tax which is expected to rise to 28% from 21%. This move in itself is expected to lower S&P 500 profits by around 8% according to research from UBS.[1]

With this in mind, we have examined the key structural changes that matter to investors. Biden proposes to double the federal minimum wage from $7.25 to $15 per hour. This would clearly have negative implications for low margin and small businesses. Companies may respond by cutting hours and accelerating the usage of automation in a bid to offset the higher costs. As further evidence of his support for middle class workers, Biden would prohibit "right to work" laws in a bid to strengthen workers' rights and allow them to earn a fairer wage whilst penalizing companies that take advantage of employees. He is also expected to create a public health insurance option to allow lower-income families more affordable healthcare. This will compete with private health insurance, reducing providers' pricing power. Biden also plans to allow Medicare to directly negotiate drug prices, similar in a way to Trump's price cap. This would be harmful to major pharmaceuticals as Medicare's drug spending represents a significant proportion of their total sales.

Biden's infrastructure plans are ambitious. In addition to traditional infrastructure (such as roads, bridges, broadband), he has a green focus with plans to develop EV charging stations, zero emissions public transport and clean energy technology (e.g. battery storage). Biden's plans would potentially be on a par with recent initiatives seen in Europe, aiming for a 100% clean energy economy and net-zero emissions by 2050. This would see winners and losers across the energy sector. He also plans to subsidize college tuition (whilst reducing student debt payments) and low-income housing. US housing subsidies currently make up 25% of domestic private investment in housing and Biden's government would roll out a significant expansion of these programs. Biden's foreign policy is worthy of consideration. Although not as vocal as Trump on matters of trade and technology theft, he has proved critical of China, notably in respect of the environment and China's position as the world's largest polluter. Even so, it is likely that Biden would prove more cooperative on trade and would look to relax tariffs. This would benefit companies which are involved in exporting goods to China and have been hit hardest by the trade dispute.

If Biden were to prevail, it is likely that his focus on higher tax and the impact on corporate profitability would be perceived as a negative factor for the market in the short-term. Beyond this, we would expect markets to stabilise. Historically, the US market has outperformed in the inauguration year of a Democratic President. Investors typically overreact on the downside when a Democrat is elected on fears that business will suffer. However, when these concerns do not materialise, prospects are re-evaluated as investors focus on the positive aspects of their policies. If this pattern holds, we can expect to see a weak close to 2020 with 2021 proving to be a strong year for equities.

[1] https://www.schroders.com/en/insights/economics/would-a-biden-presidency-hurt-stock-prices/

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TRUMP

Trump's victory in the 2016 election came as a shock to many observers and one could argue that he has continued to surprise in his first term as President. Before we consider the likely implications of a second Trump term, it is best to reflect first of all on the last four years. One of Trump's primary achievements has been to create a business friendly climate by pushing through significant corporate tax cuts. He has also promoted an "America First" culture with the introduction of protectionist measures such as the imposition of tariffs on a range of imported goods, targeting China in particular. While he has clearly fulfilled some of the key promises of his manifesto, there were certain elements which he did not follow through on. For example, he failed to deliver the $1.5tn in infrastructure spending which he promised and also the repeal and replacement of the Affordable Care Act (a.k.a. Obamacare).

Since the day of the 2016 election, US share prices have surged with the S&P 500 rising by over 50%. It has not all been in Trump's favour though. The US dollar has declined by around 4% on a trade-weighted average since election day, with much of the fall taking place this year. Ten year Government bond yields have fallen too from 1.86% to 0.77% despite rising to over 3.2% at one stage, potentially reflecting weaker confidence in future growth prospects.

So what can we expect from a second term and how should we prepare as investors? Trump's 2020 manifesto can be summarised as patriotic, bordering on jingoistic. A whole section is devoted to ending the US' reliance on China. He aims to bring back one million manufacturing jobs from China, offering tax breaks for companies that do this. Trump wields not only the carrot but also the stick, warning that no federal contracts will be awarded for companies that outsource to China. In another threat, which is surely of a purely rhetorical nature, he proposes to hold China accountable for allowing the coronavirus to spread around the world.

Having slashed corporate taxes, Trump is now promising payroll tax cuts, something which he believes could be pushed through by executive order. In the first term, Trump has promoted a deregulatory agenda in the energy and financial sectors, rolling back reforms from the Obama administration, which he claimed were stifling growth. More of the same can be expected in a potential second term as Trump pursues energy independence. This may involve further relaxing of emissions standards or allowing drilling for oil in protected areas. On a different note, Trump boldly promises to build the world's greatest infrastructure system. This is likely to entail spending on traditional areas of infrastructure such as roads and bridges in addition to building the 5G network and a national high-speed wireless internet network. Although, in his first term, Trump has not fully repealed Obamacare, he has certainly weakened it by eliminating the individual mandate, the requirement for all US residents to have health insurance or pay a penalty. Trump is now planning to cut prescription drug prices and lower healthcare insurance premiums by simplifying drug procurement.

In summary, we can expect Trump to carry on work done in the first term and complete some of the promises which were not fulfilled. The key risk is that a split house impedes progress and these goals may not be achieved as legislative initiatives are blocked by the House of Representatives or the Senate. Actions may be limited to those which can be passed by executive order. Having lost control of the House of Representatives in the mid-term elections in 2018, progress has certainly been slowed as it has been difficult for the Republicans to agree with the Democrats on implementing policy.

If Trump were to clinch a second term, we would expect a short-term rally in equity markets as investors focus on the potential for further tax cuts. However, in the long-term, concerns over foreign policy and strained relations with China are likely to weigh. The market is likely to scrutinise Trump's actions more closely. Potentially his strategy could help to increase prosperity in the US. Alternatively, one could argue that dismantling the progress achieved by globalisation is a backward move which will result in higher costs and less efficiency within the global supply chain. US Equities therefore may be preferred due to potential sanctions impacting the Asia Pacific region.

The lower tax take resulting from tax cuts means that the government will most likely not pursue a balanced budget and will rely on increased debt issuance funded by Federal Reserve buying. In normal circumstances, this would prove detrimental to the US dollar. However, with other countries adopting similar policies, the outcome is less clear. The trajectory of bond yields is likely to depend on the longer term outlook for growth; yields are likely to drop further if growth prospects weaken. In terms of specific sectors, we would look to companies which are likely to benefit from the expected rise in US infrastructure spending.

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INVESTMENT TAKEAWAYS

As interest rates have trended towards zero in recent years, the limits of monetary policy have been exposed. Policy makers have thus turned to fiscal measures. Whatever the result of the election, both parties are committed to further stimulus spending. In the case of the Democrats, fiscal largesse will be modestly offset by a higher tax rate. Fiscal rectitude has been abandoned as policymakers have edged towards implementation of "Modern Monetary Theory", the use of fiscal policy to achieve full employment and economic growth by creating new money to fund government purchases. In essence this represents the merger of monetary and fiscal policy. The coronavirus has accelerated this process and it is clear that neither candidate is willing to rein in spending. The Congressional Budget Office forecasts that US federal debt will climb to 195% of GDP by 2050.[2] At the current rate of progress, it is likely that this level will be achieved long before 2050. Gold is a likely winner in the short and long term as a result of these policies regardless of which candidate wins.

While certain sectors will fare better than others and policy will create opportunities, it is uncertain whether any proposals by either candidate will have a meaningful impact on inflation or long-term growth even though both candidates are promoting reflationary agendas. In the short-term, bond yields could rise in reflection of further bond issuance that will be needed, particularly in the case of a Biden win. Further out, yields are likely to fall if growth prospects do not improve materially. The current signals from the market suggest that growth stocks benefit more from a Democratic clean sweep than value stocks. However, the general collapse in value stocks versus growth suggests that there is not much more downside even if the Democrats win.

Antitrust is a hot topic of late. Market concentration is harmful for the consumer because of lack of choice and the ease with which companies can increase prices. Additionally, it stifles competition, holding back productivity. While antitrust action has been in decline since the Jimmy Carter Presidency, there are signs that it may be revived. A recent document from the House Panel could form the basis of a complaint for an antitrust action against the leading technology companies. Under the Republicans, the Justice Department is currently preparing a case against Alphabet. It is possible that the Democrats will go further. Market concentration is not just confined to technology, being prevalent in a range of other industries such as food, brewing, healthcare and airlines. While antitrust may make inroads into various monopolies and oligopolies, given the widespread scale of the problem, it is hard to imagine that these industries will be completely overturned within the next Presidential term.

As long-term investors, we remain cognisant of the potential changes that may occur following the election. Whatever the result, we believe that well managed businesses will be able to adapt and thrive in the future. Elections have not typically affected the long-term intrinsic value of a business. Our managers will closely monitor events and look to exploit any volatility which may provide suitable entry points.

The following table summarises our views. The first part of the table focuses on the likely moves of the major asset classes in both the short (3 month) and medium to long term (2-5 years and beyond). The second part focuses on specific winners and losers across regions, sectors and investment themes.

| Asset Allocation		Biden wins		Trump wins	
		Short Term	Medium to Long Term	Short Term	Medium to Long Term
Equities		Decrease	Increase	Increase	Decrease
Fixed Income		Decrease	Increase	Little change	Increase
Gold		Increase	Increase	Increase	Increase
Asset Allocation		Biden wins		Trump wins	
		Increase	Decrease	Increase	Decrease
Regional Preference		Asia Pacific, Europe	US	US	Asia Pacific, Europe
Equity Sector/Industry		Semiconductors	Energy (fossil fuels), Retail, Restaurants, Hotels	Energy (fossil fuels), Pharmaceuticals	
Investment Themes		High ESG score, Green Infrastructure, Large international caps	Small domestic caps with high wage costs and little pricing power	Traditional Infrastructure; Re-opening Plays (airlines, hotels, department stores)	ESG related

[2] https://www.cbo.gov/system/files/2020-09/56516-LTBO.pdf
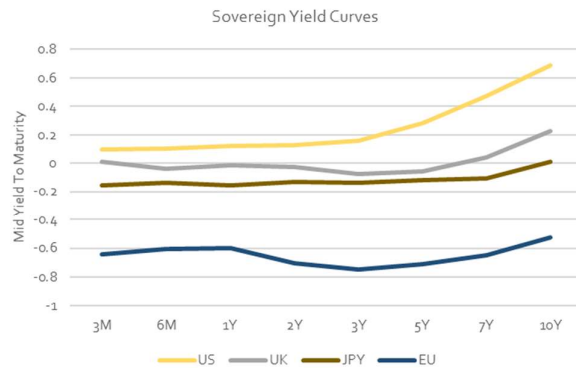
APPENDIX 1: ECONOMIC OUTLOOK
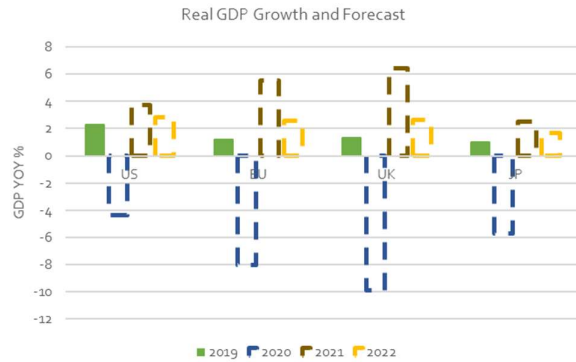
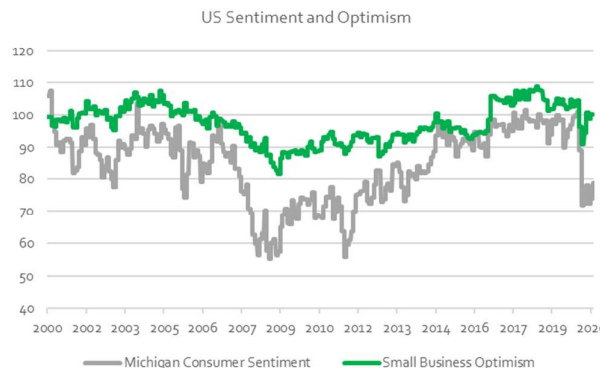**The current crisis has impacted 2020 GDP growth**
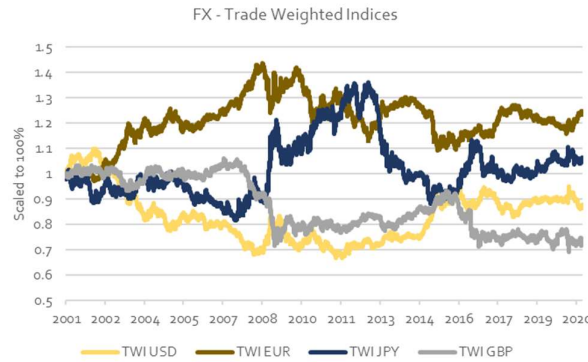
Trade weighted indices, except EU, have stayed at low levels
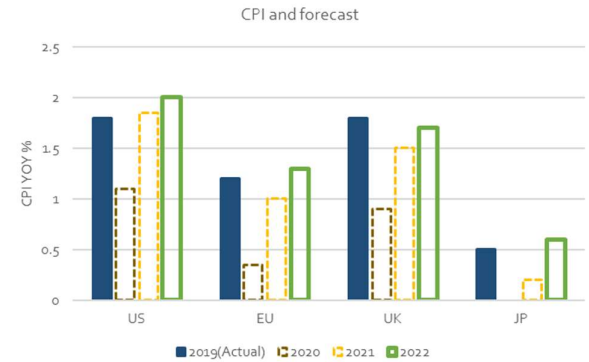
For 2020 deflationary pressures have persisted

Positively sloping yield curves reflecting the money printed impact on the long term.

Consumer confidence is struggling to recover while small business optimism has improved slightly

Initial jobless claims retracted in Q3 after the spike in Q1, while unemployment outlook remains uncertain

Source: Bloomberg, OECD, data as of 30/09/2020

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APPENDIX 2: MARKET OUTLOOK

Equity market performance
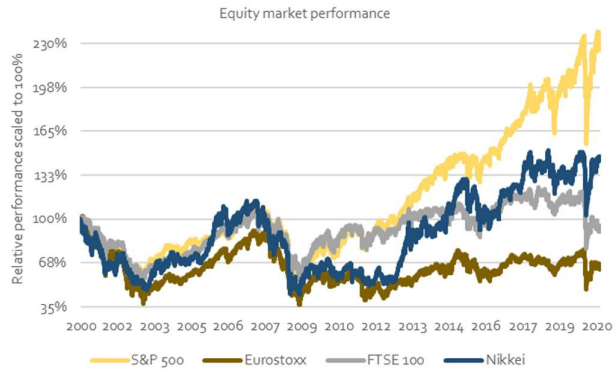
Markets have reached previous heights, given the support of governments and central banks

S&P 500 P/E against S&P Performance

P/E ratios recovered after the strong fiscal and monetary response

VIX Volatility
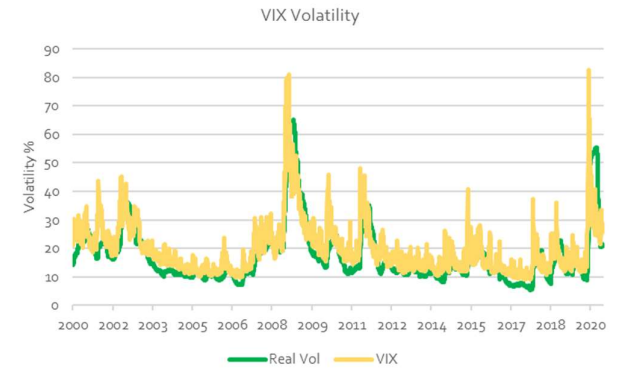
…VIX (fear) got to more normal levels…

Historical Dividend Yield
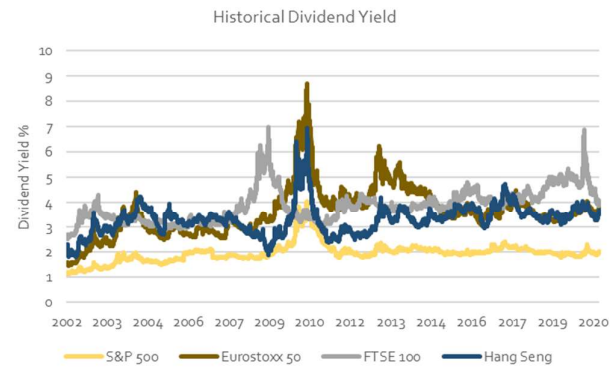
Dividend yields dropped as share prices rose, however we expect many companies to announce dividend cuts

US Corporate Bond Market

Corporate bond spreads declined, following the FED's purchase programme.

Perfromance of asset classes
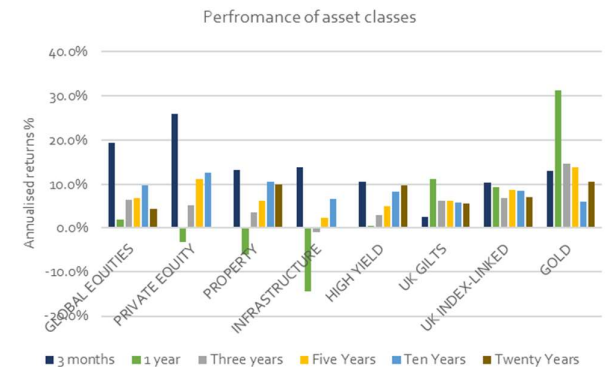
Equities (Public and Private) performed best in Q3

Source: Bloomberg, OECD, data as of 30/09/2020

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APPENDIX 3: INVESTMENT IDEAS – MEET THE TEAM

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Please contact Callum Campbell, Head of Client Services and Stakeholder Relations, if you would like to discuss the views outlined in this report with LGPS Central's Investment Directors

1 Selective Overweight Private Equity (J. Sidhu)

- Valuations are likely to remain volatile in line with public markets and the closing and opening of economies
- Distributions are likely to dry up as exit activity curtails and/or moves to sales of distressed assets
- Buyers want clarity on business levels and/or lower entry prices
- Secondary and Tertiary deals (sales from PE owners to new PE owners) likely to expand ("flight to quality")
- Some LP's sitting on side-lines before making new commitments
- New fund raising being deferred and/or taking longer

2 Underweight property (M. Hardwick)

- Material Uncertainty Clauses now being lifted across various property sub-sectors
- In turn, many Funds now relaxing gating restrictions and opening to investors
- Valuations down but on the whole, resilient
- However, transactional volumes remain severely depressed
- Demise in traditional Retail continues, exacerbated by Covid 19, with Logistics prime benefactor
- General economic fallout from Covid yet to play out in occupational demand
- General feeling of 'not out of the woods yet'

3 Overweight Infrastructure (M. Hardwick)

- Institutional investor interest high, underpinning valuations and providing limited scope for bargain hunting
- Transactional volumes down
- Some evidence of more resilient sectors increasing in valuation
- GDP facing assets recovering well but in general, revenues down on prior years
- Political desire for more infrastructure still high

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4	Underweight Fixed Income (G. Ross)

- Historically low Gilt yields remain unattractive with the prospect of increased issuance to fund fiscal stimulation may push yields higher
- Intermediate peripheral EU bonds (Italy, Spain, Portugal) offer attractive hedged yield pickup in GBP terms
- Global interest rates likely to remain low over the next several years with little immediate sign of inflationary pressures.
- Credit markets offer excellent value given the recent increase in yields and spreads and with the underlying support of the Central Bank purchases
- Sterling has shown recent volatility, although the approach of Brexit may lead to some uncertainty, however the currency continues to remain attractive relative to other majors

5	Neutral Equities (M. Davies)

- The global economy is now heavily reliant on government policy. We expect continued fiscal and monetary stimulus in an attempt to generate growth as we emerge from the coronavirus recession as authorities have little choice in the face of rising unemployment and falling output.
- Although the policies may not stoke inflation, especially if banks do not increase lending, the likelihood of increased liquidity will most probably act to support risk assets.
- Due to valuation issues, we prefer Value over Growth. Stock selection remains key. We prefer companies with strong balance sheets which have the opportunity to gain market share from smaller, more leveraged competitors. They will be well placed once a more normal business environment returns.
- Prefer EM over DM, China's recovery offsetting concerns over 2nd wave and limited ability to provide stimulus; US meanwhile hit by dollar weakness and short-term uncertainty ahead of election
- We prefer Quality and Low Risk over Small Caps given the challenging environment and uncertain support from Governments and potential margin pressures.

GLOSSARY:

GEMs	**Global Emerging Markets**
ESG	**Environmental, social and governance**
LTM	**Last twelve months**
IG	**Investment Grade**
VIX	**S&P Implied Volatility Index**
IPO	**Initial Public Offering**
OPEC	**Organisation of Petroleum Exporting Countries**
FAANG	**Facebook, Apple, Amazon, Netflix & Google**
UNPRI	**Principles for Responsible Investment**
YTD	**Year to date**
PE	**Private Equity**

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