PRESENTER: For the latest update from the Prudential Portfolio Management Group, I'm joined by Barry Widdows, Head of Multi-Asset Portfolio Management. So Barry it's great to have you back with us today. So since you last appeared here on asset.tv I mean how do you think markets have been performing? BARRY WIDDOWS: Well it's been a pretty tough time for markets; in fact in October we had the worst month for equities for three years. In the UK, we had the FTSE market falling about 5% during the month, leaving it in negative territory for the year. And most actually major markets are now down 5 to 10% for 2018. In the US the S&P was down 7%, retaining positive territory just about, and still probably the best performer globally, but again very weak on the month. I think fixed income markets were pretty interesting. In October we saw, if you look at the benchmark, UK bond, the 10-year gilt, we saw yields widen quite a bit at the start of October. So it was a period where really bonds were selling off at the same time as equities. But then during October that pattern kind of changed. And I think what happened is you saw extra nervousness in the equity market as the selloff in equities continued, and then really bonds started showing some of their safe haven characteristics. You started seeing some buyers come into bonds, the bond market started to rally, and actually ended the month on a pretty positive tone as you saw gilt yields back at about 1.4% at the end of October. In currencies again we saw a bit of increased volatility. So sterling had rallied from its mid-August lows through to early October. Again really on Brexit headlines and hopes that a deal might get done. But then again that kind of reversed a little bit and sterling was weaker later in October and ended the month on a negative tone. So we've really seen a pattern of increased volatility across a number of asset classes, I'd say. PRESENTER: Well staying with volatility then, and do you think this recent volatility we've been experiencing represents a fundamental change or just a reality check? BARRY WIDDOWS: I think a few factors at play here. So firstly the market's still trying to digest this increase in short-term interest rates that we've seen. So early in 2018 we had quite a dramatic and rapid move in short-term rates, and that's really the risk-free rate that most other assets price off. So that's the backdrop of a lot of this move. I think there's also an increased perception as well by investors that we're nearing the end of the economic cycle. And as that belief takes hold, rightly or wrongly, investors start becoming warier about holding risky assets towards the end of the cycle. So again that feeds into a potential nervousness and volatility. I think we would agree that we're probably mid to late cycle, depending which market you look at, but the thing to remember is this cycle is already extended post the GFC and the unusual central bank activity that's been helping to keep it lengthened. And it's very hard to predict the end of the cycle, so there's no reason this couldn't continue for some time still. The other factor I think impacting volatility is really valuations. And we've had a period in early 2018 where equities had done particularly well, and if you look in an area like US tech stocks the valuations had increased somewhat there, leaving people a little bit nervous. And on relative basis if you look at US equities compared to US fixed income, say, we're now at a point where for an investor in a backdrop of where really inflation isn't rearing its head, an investor can have a guaranteed 3%, over 3% risk free rate now on US treasuries, so less than 2% dividend yield on US equities is much less compelling than it used to be. PRESENTER: And this market volatility, what impact has it had on your portfolio? BARRY WIDDOWS: Actually less impact than you might expect. The portfolio that's behind the Pru fund product is actually incredibly diversified. So while of course we hold a lot of conventional equities and corporate bonds, we also hold a substantial amount of less traditional asset classes. So whether it be direct real estate, private equity, infrastructure, hedge funds, private fixed income, all these sorts of assets have been performing somewhat differently, they add diversification. And certainly the unlisted assets have been less prone to some of the sentiment moves and have been more stable during this period, provided more stable returns. The other thing to bear in mind is that Pru fund itself is a smoothed product. So actually investors in Pru fund, provided that the fund returns stay within certain parameters, actually just receive a predefined fixed growth rate on their investment, and actually experience none of this daily volatility.

Most traditional multi-asset funds have had a pretty tough year. Many of them are negative and have shown a lot of volatility this year. And so these smooth products are quite unusual, and I think this could be a year where Pru fund actually stands out from some of the multi-asset competition. PRESENTER: And despite this volatility the UK equity market has been trading a little above the 7,000 level for some time. I mean how would you explain that? BARRY WIDDOWS: Yes, there are a couple of factors I guess influencing the UK still. Brexit is the obvious one. And I think really the investors there are pricing in a Brexit risk premium with this overhang. Investors are somewhat wary about holding UK assets, and they're demanding some sort of compensation for the risk of holding those assets. So you've seen valuations come lower there. And when we look at valuations compared to other equity markets, UK looks relatively attractive. That could support, provide some support on further downside. The other thing to bear in mind is of course the exchange rate, because it's very important for the UK market. It's also very sensitive to the Brexit news, and as we get positive news sterling tends to rally. But that tends to act as a natural hedge on equities. So as sterling rallies, because the UK market has a lot of overseas earners, equities can tend to perform less well. So I think we've got to bear all these factors in mind on the UK market. But we're unlikely to see a real trend emerge there until we see some firmer Brexit news I think on the deal that's arranged. PRESENTER: So staying with Brexit then, what's your outlook, and how has this influenced your investment decisions? BARRY WIDDOWS: I mean one thing we've been spending some time on is the potential different Brexit scenarios. There's still a number of different scenarios on the table, varying from pretty soft Brexit if a deal is done soon and good terms, to a position where we could be crashing out of the EU in March next year in a much more disorderly manner. While our base is that some sort of deal will get done, and we'd expect some mildly positive impact on markets, I think we're cognisant that there are these number of different outcomes still, so we need to think about how all those could potentially impact the portfolio. When we've looked at it, and Pru fund as I mentioned earlier is an extremely diversified product, we hold a lot of overseas assets, and when we look at it in the context of Brexit, we find that those sort of assets are obviously sensitive to sterling. When sterling tends to rally, as it would on a positive Brexit outcome, that would be, those sort of scenarios is when the fund would do less well. And the fund would actually do relatively well on some of the more negative Brexit outcomes. So there is some sensitivity there. And we felt with this increased volatility that we've already seen in sterling, and that that's expected to actually continue in our view for the next six to nine months through this period, it was prudent to actually increase the level of hedging a little bit in our portfolio, to make the portfolio less sensitive to some of this Brexit news. PRESENTER: So aside from the hedging changes you mentioned, how is your portfolio positioned currently? BARRY WIDDOWS: I'd say we remain pretty constructive on risk assets in general. We're trying to see through some of this short-term noise, and actually focus on the fundamentals, which we think are still relatively good. So we remain pretty long in equities, or have a positive stance towards equities; in particular in areas such as Korea, Europe and Japan. In the fixed income markets we think they still remain unattractive, particularly in the UK and Europe where the real yields on offer are just very poor. I'd say the other thing is we're just trying to use these bouts of volatility, and looking for opportunities that this volatility can create, and in particular where other investors may be changing their beliefs rapidly and could create opportunities for us if assets are mispriced. PRESENTER: So finally then, what other activity has been going on in the portfolios? BARRY WIDDOWS: Sure, so we're trying to make some progress adding exposure to new asset classes into the portfolios, and certainly some of the asset classes that we've introduced as part of our strategic asset allocations. Chinese equities is one example. This is an area we want to increase exposure in the portfolio. It's an area we think there's prospect for higher growth and returns going forward. Particularly after the recent selloffs we felt it was an opportune time to actually get exposure into the book. So on a short-term basis we've actually used futures there to get some exposure, and that's a quick and efficient way of doing that. On a longerterm basis we recognise that China is a market we'd like to use active management skill in. I think it's an area where it's important that you use the local expertise, and active management is important. But it will take some time to perform the due diligence, and select the manager to do that, as well as go through the operational and regulatory hurdles. So in the meantime we've got exposure, made sure the clients have got exposure to that asset, which we think is potentially valuable on a shorter timeframe. Another area is, again other asset classes we're adding in are things like European small cap, which we're continuing to make progress towards, and African equities, where we're already a large investor but we're increasing allocations to. And then finally a new asset class is African fixed income, and we're still doing work on that, but expected to add that into the portfolio in due course. PRESENTER: Barry, thank you. BARRY WIDDOWS: Thank you. *This is just for UK advisers – it's not for use with clients. A fund manager's view isn't advice or a recommendation. This video is prepared for information and does not contain or constitute investment advice. Information provided has been obtained from sources that PPMG believes to be reliable and accurate at the time of issue but no representation or warranty is made as to its fairness, accuracy, or completeness. The views expressed herein are subject to change without notice. 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