Watch what they say, not what they do

We said in our last investment note, 'We need to talk about volatility', that despite relentless positivity in equity markets since the lows of March 2020, a growing number of institutional investors are feeling the need to take a more defensive orientation and have 'insurance policies', against the risk of markets retreating. In the short-term, we have seen raised activity in options markets to levels seen just before the 2008 Financial Crisis.

This is not to alarm anyone, and as we have stated previously, we think a pullback in equities would be normal, healthy even. With this thought in mind, you might nonetheless expect asset managers looking after client assets to take prudent steps to insure themselves against the chance of a broad selloff.

This is not what we were seeing in equity levels in portfolios in August, and we have seen some volatility around in September which may be altering that thesis. Like all good managers, we take note of market conditions and remain aware of the sentiment drivers with the hope of using it to our clients' advantage.

The recent Bank of America Fund Managers' Survey raised an interesting anomaly and is a widely read monthly publication. It outlines, amongst other things, what managers are thinking and how they are acting in the marketplace. It is an invaluable source of insight into the heart of the industry and lays bare what people in charge of running money are thinking and doing.

We find in September's publication, that expectations of global economic strength were plummeting to the point that a mere 13% of those surveyed believe the global economy will improve in the short-to-medium-term. Wow, that's a shocker! Yet bizarrely, global equities in portfolios remain elevated at or near all-time highs - hence the title to this piece.

There is therefore, a very rare disconnect between what investors are thinking and what they are doing, and it remains our view that something simply must give. Historically we have alluded to the term 'FOMO', aka 'fear of missing out', and it could be argued that this is what is causing such inertia in acting out on their view.

Equity valuations cut through the pandemic like a hot knife through butter and should one delete the months of March and April 2020 from the charts, you would hardly know there had been anything untoward happening at all. The belief that central banks will support economies and markets throughout this pandemic and well into the recovery, is leading perhaps to an element of hubris, which is a behavioural fallacy that rears its head from time to time in the investment world.

We are not so sure, and fear that on this occasion something might give in equity markets. With nothing on the horizon that leads us to believe the global macro environment is set to improve markedly in the short-to-medium term, we have been taking action to bring clients' exposure to equity down responsibly. This has resulted in us taking profit on some of our most successful investments of the last 12-18 months, whilst also reallocating to funds that offer what we believe is meaningful downside protection for Q4.

If a modest setback occurs because of prevailing news there will be many thinking, 'coulda, woulda, shoulda', and be hoping this is not the trigger to a meaningful pullback in global equity markets.

We have reduced equity positions to help protect clients against a short snap back occurring, but we remain optimistic for the longer term. Market participants, however, are saying one thing, and doing another…

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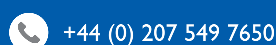

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