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Portfolio Manager Perspective with Eugene Barbaneagra: Global Equities Review & Positioning

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We recently caught up with **Eugene Barbaneagra**, portfolio manager for SEI's global equity portfolios, to ask about geopolitical issues we've seen over the last year, his outlook for the New Year and how all of this impacts his portfolio positioning.

Q There is currently a lot of uncertainty in global financial markets, with the US-China trade war perhaps the leading cause of concern. What are your views on the trade war?

A First, there are always uncertainties. Remember that 2018 began with tax cuts in the US and abundant global growth, yet finished with one of the sharpest selloffs of the decade. Specific to the US-China trade war, indications are that leadership on both sides have strong political incentives to work out the dispute. While a resolution would provide US President Trump with some political goodwill after his recent impeachment, an agreement would also strengthen Chinese President Xi Jinping's political positioning at home. A lot of today's uncertainties will likely create opportunities for the coming year—which we see as working out favourably for equity markets over the long run.

Q What are your thoughts about Brexit?

A While we have more clarity about the fate of Brexit now that Prime Minister Boris Johnson and his Conservative Party won a sweeping victory, global equity markets have seen increased volatility since the 12 December election—initially rallying strongly, but almost immediately thereafter selling off when Johnson said he is committed to a 31 December 2020 trade-deal deadline with the EU. The lack of an agreement by then could increase the threat of tariffs and other barriers to UK-EU trade.

But the long-term trading relationship is more likely to be worked out faster than the political/emotional divorce deal. Any outcome that would remove the uncertainty of a disorderly Brexit would be a net positive for Europe. The Continent is currently expected to partake in almost none, if any, of the global growth we see elsewhere, so any positive movement is likely to create a favourable repricing of equities.

Q What are your views on the interest-rate environment?

A Forecasting interest rates is as hard as forecasting equity markets. In the short term, there are questions about whether and with what speed rates will go up or down. Recently, the US Federal Reserve (Fed) took a more dovish stance, which should be favourable for equities in the coming year. More importantly, over the past year, we have seen substantial reflationary traits—stronger fiscal stimulus around the world, and a monetising of budget deficits from global central banks (particularly the US Fed)—which should also benefit equities in the long term, especially lower-priced securities.

Q How have geopolitical and interest-rate trends of the past year impacted your portfolio positioning?

A SEI's views about macroeconomic and geopolitical uncertainties like the US-China trade war or Brexit have no bearing on any level of our active-management approach. When discussing portfolio positioning for the global equity portfolios, there are several important things to consider:

First, we use a bottom-up approach.

Second, equity markets forecast the economy, not the other way around. The macro developments of the past year are just a recognition of the environment. So, looking at the economy to determine equity positioning is like putting the cart before the horse: It doesn't work. We therefore aim to build portfolios strategically, evaluating alpha sources (value, momentum and stability) to determine what we expect will work in the long run—allocating actively and dynamically, depending on the market (not the economic) environment. For example, today we prefer value over momentum because spreads in value are more attractive than those of momentum.[1]

Finally, we are an active manager of managers. We build our allocation to alpha sources by employing active managers around the world. For example, the value alpha source is implemented by managers such as Maj Invest, or Poplar Forest Capital and Towle & Co. in the US; momentum is implemented by managers such as Lazard Asset Management and INTECH Investment Management; stability is implemented by LSV Asset Management.[2]

Q How is the Global Equities Building Block currently positioned given that it is constructed using strategic views of alpha sources rather than tactical plays?

A Over last 12 months, we reduced the allocation to momentum, which we found expensive, and increased the active share of our value managers. Specifically, we replaced LSV (a lower active-share value manager) with Poplar (a much higher active-share manager). Therefore, we are expecting a much higher payoff once value rebounds.

The most important input in estimating the outlook for value (more than market liquidity, central bank policy, and the overall sentiment of markets) is valuation dispersions. Why? Because the greater the difference in valuation between the most expensive stocks and least expensive stocks, the larger the valuation band stretches, and the closer it is to snapping.

Our value managers have historically delivered several times their alpha targets in environments that follow high valuation dispersions and conversely lower returns after valuation dispersions have been very tight—and, based on data going back to the 1950s, dispersion today is higher than it has ever been.[3]

[1] Source: SEI, using data from FactSet as at 31/12/2019.
[2] As at 31/12/2019
[3] Source: SEI, using data from FactSet for short-term valuation dispersion and from Ken French's website (http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/index.html) for long-term dispersions. Long-term dispersion is represented by P/E ratio and is updated to 31 December 2019.

Q What has been your strategic positioning generally, and what do you expect in terms of positioning over the next one to three years?

A We are always implementing positioning through active managers. Over the last decade, particularly the last two or three years, active management has struggled substantially relative to capitalisation-weighted benchmarks.[4] But this is cyclical and expected to recover once diversity in the market increases and fundamental drivers come to the forefront of investor mind-sets. We believe that a fundamentally-driven approach is more likely to outperform an emotionally-driven approach over the long term.

[4] Source: LCG Associates, comparing the difference in five-year rolling returns between the S&P 500 Index and active US large-cap managers.