MyFolio

Strategic Asset Allocation Changes

November 2023

For professional investors only – Not for use by retail investors.

At abrdn, we formally review the Strategic Asset Allocation (SAA) for all our MyFolio funds on at least an annual basis, and consider whether any changes are required. In Q4 2023 we implemented an SAA change which added global infrastructure to all MyFolio ranges, following the introduction of the asset class to MyFolio Sustainable in Q2 2023. The Q4 2023 SAA review also reaffirmed our cautious positioning between credit and government bonds across all MyFolio ranges.

Introducing infrastructure

The primary motivation for our recent SAA changes is the introduction of global infrastructure across the MyFolio range of funds. The MyFolio approach to infrastructure is characterised by our desire for a non-cyclical exposure with stable cashflows and an element of inflation or regulatory protection.

These qualities are useful in a portfolio context because they provide diversification and a potential downside cushion when equity markets fall. The longer-dated, regulated cashflows have the potential to provide stability. Their predictability also means they can be discounted over protracted periods and that returns are often positively related to falls in interest rates. During challenging periods for risk assets, this stability is often beneficial because any interest rate cut is likely to mechanically enhance the value of infrastructure cashflows.

Two reasons for infrastructure optimism

Within MyFolio we are constantly seeking ways to enhance diversification and improve portfolio construction. We think an investment in infrastructure as a component in a broader multi-asset portfolio helps to achieve these aims. Furthermore, we don't feel we are sacrificing returns by adding infrastructure. On the contrary, we have two reasons to believe the outlook for infrastructure is positive.

1. The investment gap

Our first reason for optimism is the investment required to maintain existing assets and keep pace with demographic change. In 2021 the American Society of Civil Engineers forecast that the United States requires an investment of $5.9 trillion over 10 years to bring roads, bridges and airports to a sustainable level. This requires an additional $2.6 billion of private and government funding to that which is already committed; equivalent to an annual investment change from 2.5% to 3.5% of GDP.

A similar study by Oxford Economics in 2020 estimated that the global economy requires $94 trillion in spending over 40 years. Demographic trends in non-Western and developing countries remain a challenge for existing infrastructure. Moreover, the above reports don't fully account for surging interest in Artificial Intelligence (AI), which could potentially boost demand for electricity. The International Energy Agency (IEA) predicts global electricity demand will double from 2022 levels by 2026.

2. Transition demand

Decarbonisation and the transition to a sustainable model of economic growth are further reasons for infrastructure optimism. Aside from considerations around climate change, renewable energy and resource efficiency are increasingly becoming intertwined with national security and industrial policy issues.

The world's two largest economies are clear examples of this. The US is transforming its domestic clean energy production through several recent Federal Statutes. China is already the world's pre-eminent manufacturer of solar photovoltaic panels and electric vehicles and has set various ambitious goals to reduce carbon dioxide emissions under its 14th 5-year plan.[1] Meanwhile, the UK government's legally binding commitment (enshrined in UK Law in 2019) to reach net zero by 2050 is estimated to require a £400 million investment over the next 10 years.[2]

Global investor interest

Unsurprisingly the above dynamics have led to much investor interest in the infrastructure sector. Brookfield Investment Partners recently raised $28 billion in its largest-ever private equity deal targeted at infrastructure investment, while BlackRock recently purchased Global Infrastructure Partners for $12.5 billion.

Balanced risk positioning

The introduction of an asset class that we believe has defensive characteristics without necessarily sacrificing returns is consistent with our broader MyFolio SAA positioning, which otherwise remains unchanged.

In October 2022, we increased our exposure to interest rate duration through a broad move from short-dated to all maturity indices and augmented this move by decreasing our exposure to investment grade credit more generally in June 2023.

These moves were partly predicated on the more attractive yields available on longer-dated indices, our view that the performance of the US economy was likely to be weaker than forecast, and the increasingly extended valuations witnessed in credit markets.

While our expectations for the US economy appear to have been overly pessimistic and our move out of credit too early, we at least benefited from the material increases we made in US equities in October 2022.

A cautious stance

We continue to maintain a cautious stance. Within fixed income, we believe the additional premium available from investment grade corporates over government bonds is towards the lower end of the historical range. In equities, we maintain meaningful exposures to US, emerging market and Asia Pacific equities, whilst welcoming the additional diversification benefit global infrastructure provides.

The case for diversification

The diversified nature of MyFolio is designed to be forward and dynamic in its approach to setting the SAA. The case for a diversified portfolio is alive and well. Indeed, we believe it has strengthened over the long term due to fundamental shifts in the attractiveness of fixed income assets and also the rise in expected returns across Asia and emerging markets.

MyFolio: sophistication delivered simply

For more information about the **MyFolio fund family** visit our **website** or speak to your local business development manager.

[1] The Inflation Reduction Act, Bipartisan Infrastructure & Jobs Act as well as the CHIPS & Science Act '…are making clean energy technologies, prompting…the development of new clean energy manufacturing capacities in the United States (and)…significantly improved the outlook for a host of clean energy technologies.' Source: IEA, World Energy Outlook 2023.

[2] £400bn additional infrastructure spend needed to meet Net Zero target – Source: pwc, November 2020.

For more information visit abrdn.com