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A Clearer Path for Fundamental Navigation

June 17, 2021

Entering 2021, our equity exposure was the highest it had been for several years and we had increased risk in our currency strategy to reflect less caution—both of these reflecting our view that the gravitation of prices toward fundamental value had a somewhat clearer path ahead. As fundamental investors, we believe this is an attractive environment for our approach.

2020: A Year of Sizable Shifts

2020 was an unprecedented year for macro investing, and navigating its challenges involved dynamic shifts in our portfolio exposures—shifts more sizable than in any year since our team has been at William Blair.

In the fourth quarter of 2020, we concluded that the prevailing valuation opportunities across the macro space would be rewarded over the medium term. We believed there were reasons for optimism and that these opportunities would be better exploited with patience rather than navigation.

Accordingly, we have not made significant navigational alterations to our strategy since then, in either the market or currency domains. Our recent strategy changes have mostly been in response to price movements rather than macro-thematic or geopolitical developments.

In fact, we formally neutralized the influence of two macro themes—those centered on global protectionism and Chinese growth.

These themes, which contributed to a higher-risk environment and valuation headwinds, had been integrated into our investment process. But we believe the risks have now abated. Specifically, the risks related to these macro themes had arisen primarily from the Trump administration's trade barriers with China. Although the Biden administration, in the near term, is unlikely to unwind those barriers, an increased level of protectionism is also unlikely.

In addition, the macro influence of European populism (which we still retain as a theme) was reduced as a significant headwind to valuation opportunities in the near term. The change in this theme's intensity occurred as the prospect of a disorderly "no-deal Brexit" was averted just before the 2020 year-end deadline.

As 2020 closed, the reduction of these headwinds was complemented by greater optimism that the economically disruptive impact of the pandemic, while ongoing, could be overcome with the rollout of vaccines.

Notable Changes Toward Fundamental Opportunities

With fewer headwinds, there may be a less obstructed path for price to gravitate toward value, which justifies retaining positions through good performance—or even increasing them should the opportunities widen. Our portfolio strategy has accounted for the dispersion of these headwinds by increasing exposure to those equity markets we believe are fundamentally attractive and stepping into the currency opportunities that presented themselves.

One such opportunity is the Colombian peso, a classic energy-sensitive emerging currency. It has been close to the worst performer in our currency universe through the first few months of 2021, so it is now one of the more compelling long opportunities.

While there are reasons for that underperformance, energy sensitivity is not one of them—the peso has actually moved in the opposite direction of energy prices this year. Instead, the underperformance is related to the country's public finances. Inflation is quiescent, interest rates are low, the economy is in a bit of slump, and therefore there is weakness in the peso.

We've decided to step into that weakness by increasing our long exposure to the peso. That doesn't mean we're more optimistic than market expectations for Colombia; it means we think the currency is priced adequately and there is a larger valuation opportunity as a result.

The other side of that trade was a sale of the Canadian dollar, which has been strong year-to-date and has some energy sensitivity. We remain positive on energy stocks, but crude oil prices are currently at the upper limits of where we think they should be, and we don't want to significantly increase our indirect exposure to energy at this point.

Another response to the headwinds of 2020 has been selling the South African rand (which has been the strongest currency over the last 12 months and year-to-date) and buying the Indian rupee (which has been a bit of a laggard).

India has dominated COVID-19 news during the past couple of months, with about half of all new cases worldwide creating a significant threat to its health system, which is tragically underequipped to respond.

Before India's quite devastating second wave, it had been expected to grow at a double-digit rate this year—faster than China. We're still optimistic. Cases may be peaking, but while consensus expectations have been pared back a bit, India's economy might still be one of the strongest in 2021.

So, the COVID-19 caseload increase weakened the rupee, but not by much. The rupee is still, however, a more attractive opportunity than the rand.

These currency changes have something in common: increasing our exposure where there has been increased pessimism about the economic situation. We view these as relatively short-term situations, and not a threat to the valuation opportunities into which we are stepping.

Looking Ahead

So, coming into 2021, our overall equity exposure was at the highest level it had been for years (although by no means aggressively bullish, as some markets are not sufficiently attractive to justify this). Similarly, our currency strategy was far less cautious than it had been.

Our view remains that the gravitation of prices to fundamental value has a somewhat clearer path ahead than has been the case in the last year or so, and we're positioning our portfolios accordingly.

Thomas Clarke, partner, is a portfolio manager on William Blair's Dynamic Allocation Strategies team.

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