June 2020

GARS – the road back to performance

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We are often asked what went wrong with GARS in 2016, when performance started to deviate from the long-term objective it had previously tracked so closely. Was it the size of assets under management? Or had management become complacent? More importantly, what have we done to return to the correct path? And how can we be confident that the improved results since 2018 are sustainable?

In answering these questions, we review key aspects of how we seek to generate returns in GARS and how this has evolved in recent years.

Risk-taking in GARS

Allocating to ideas not asset classes

Every risk we take in GARS is a conscious choice that we believe will generate a return. Our ideas are based on broad macro market views rather than individual stocks, offering tremendous scalability. We are also not constrained by an asset class benchmark. This offers versatility but introduces a key challenge.

Seeking genuinely diverse sources of return

For GARS to hit its performance target, a greater number of our ideas need to turn out right than wrong. For there to be a high probability of this happening, our research must be accurate and there must be a healthy supply of new ideas. We therefore encourage a culture of broad research and independent thinking, focused on longer-term drivers of markets. Research shows there are deep inefficiencies to be exploited over three-year plus investment timeframes. Our aim is to promote diversity of thought-input to identify genuinely different drivers of returns.

Construction biased towards our central view

We assemble the GARS portfolio to maximise the range of economic and market scenarios in which it can deliver the return objective. We take care to ensure that the portfolio is robustly diversified to incorporate scenarios that vary around our central view and provide resilience in periods of stress. However, it is inevitable that GARS is more closely aligned to our central view than to other scenarios. As a result, if markets and events do develop very differently, the portfolio is less likely to achieve substantial returns while that difference persists. Over GARS' history, such occasions have been rare but have happened, as in 2016/7.

The origins of underperformance

In late 2014, following what was already an extended period of economic expansion post the global financial crisis, we began to anticipate tighter monetary policy within our three-year time horizon. Specifically, we expected rising interest rates to lead to a cooling of risk-asset returns.

However, rate rises were delayed because of an unusual absence of inflation in goods and wages, despite high employment levels. During this hiatus, the UK's Brexit vote and Donald Trump's election as US president also sharply altered the investment outlook. In particular, President Trump's unorthodox and unexpected tax cuts and regulatory easing were a powerful economic stimulant to the already fast-growing US economy. We envisaged this would create a short term boost to growth without expanding capacity and as a result would actually hasten the onset of the next recession. Therefore, we diversified GARS around this core view.

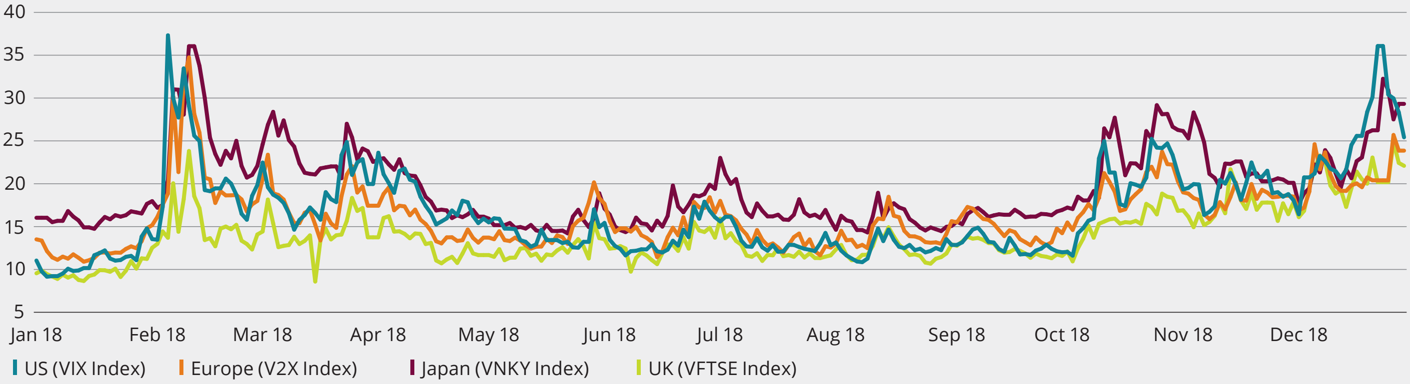
2017 proved to be an exceptional year for risk assets such as equities and corporate bonds. They enjoyed a 'goldilocks' scenario of stronger economic activity, benign inflation and only gradual tightening of monetary policy. By contrast, other asset classes like government bonds and currencies lacked clear direction. For diversified portfolios like GARS that allocate across a broad range of assets, a market that strongly favours just two asset types while leaving others somewhat rudderless is both unusual and challenging to navigate.

2018 was then one of the worst years on record for financial markets, with almost all asset classes losing value. Lofty valuations, worsening economic data, fears about rate rises, political instability and trade conflict all served to unnerve investors and fuel market volatility (see Chart 1).

In this challenging environment, GARS produced a modest negative return. However, the diversification of the portfolio smoothed out much of the volatility experienced in markets, particularly towards year-end, when equity market stress was most pronounced.

Aberdeen Standard Investments

Chart 1: Equity volatility increased sharply in 2018



Source: Bloomberg, January 2019.

For illustrative purposes only. No assumptions regarding future performance should be made.

Issues and action points identified

Importantly, our efforts to learn from the investments that did not work out as we had expected also revealed opportunities to improve how we operate.

- **Research**: the expanded research platform created by the merger between Standard Life Investments and Aberdeen Asset Management meant we need to expand and strengthen the channels of communication between multi-asset managers and asset class teams.
- **Versatility**: our risk-taking had focused on stability as we attempted to navigate the uncertainties of the turning point in the global economy. Returns were scant because that turning point took far longer to occur than expected. When opportunities did arise, our moves to capture them, while often correct, were of insufficient scale. We needed to be more versatile in risk-taking to capture meaningful upside.
- **Accountability and ownership**: GARS originated as a highly collective endeavour but, as it grew, key decisions became more narrowly focused on senior decision-makers. We recognised the need to draw more on the breadth of talent across the team and keep the sense of collective ownership high.

Steps to recovery

- **Research and decision making**
  We strengthened decision-making by structuring the portfolio management and research teams to improve accountability.
  - In 2018, we added to the GARS portfolio management team individuals with expertise in tactical allocation, bond markets, and process enhancement. This blend of experience and expertise has markedly increased the versatility in risk-taking.
  - We created Asset Class Steering Groups to bolster the generation of rewarding investment ideas. These groups work to ensure the best ideas across all our asset class categories are available to GARS' managers.
  - We introduced score-cards for each strategy to provide a more disciplined way to track the underlying drivers of return against the original rationale.
- **Greater focus on ESG**
  We also integrated our extensive ESG (environmental, social, governance) framework more deeply into the research underpinning every GARS investment. For each strategy, we examine and document the role that ESG factors play, to help inform the team's investment decisions. ESG has been an implicit part of our process for many years, and increased focus helps identify important societal changes and risks.

Results

Following these initiatives, GARS has shown a return to form. Since Q4 2018, the 'hit-rate' of successful ideas – a crude but simple indicator of fund return – has improved steadily and last year returned to its longer-term average. During this period, not only were sharp market falls smoothed out, but subsequently GARS captured much of the upside. For example, in the fourth quarter of 2018, GARS suffered only 18% of the MCSI World Index fall, but captured 38% of the upside in the first quarter of 2019.

Similarly, the unprecedented environment in early 2020 presented an enormous challenge to investors globally. However, GARS fared relatively well. The Fund lost only 1.8% over the first quarter before fees. By comparison, global equities fell 15.5%. Within the quarter, the maximum drawdown of global equities was over 35%, more than four times the 8% peak-to-trough fall in GARS.

GARS's resilient performance reflected strong diversification and, importantly, deft reorientation of the portfolio by the managers as they saw the outlook worsening. This included shorting US small-cap equities, hedging emerging market income and high-yield credit positions, and adding defensive currency and rates positions in late-February. As markets collapsed in March, we further reduced equity exposure. However credit market pricing indicated value for longer-term investors. We therefore added substantially to investment-grade credit, mostly in Europe where the asset class was underpinned by fresh central bank support measures.

GARS in the current climate

GARS recovery has been underpinned by years of hard work in understanding the changing dynamics of markets and working out what we needed to do to improve our idea generation and management of the portfolio. The results of the last 18 months are linked directly to the dynamic decision making by the portfolio managers, supported by the accountable structure of the rest of Multi-Asset Solutions. As a result, we have confidence this represents a sustainable new chapter in GARS development and growth for our clients.

Year on year performance to 31 May 2020 (%)

	Year to 31/05/2020	Year to 31/05/2019	Year to 31/05/2018	Year to 31/05/2017	Year to 31/05/2016
Net (Retail Acc)	3.12	0.37	-3.13	-0.52	-3.77
Gross	4.19	1.42	-2.11	0.51	-2.55
6 Month GBP LIBOR	0.78	0.93	0.58	0.54	0.75

Source: Aberdeen Standard Investments; GBP; as at 31 May 2020 Investment involves risk. The value of investments, and the income from them, can go down as well as up and an investor may get back less than the amount invested. **Past performance is not a guide to future results.**

For full details of the fund's objective, policy, investment and borrowing powers and details of the risks investors need to be aware of, please refer to the prospectus. For a full description of those eligible to invest in each share class please refer to the relevant prospectus.

Important Information

The value of an investment is not guaranteed and can go down as well as up. An investor may get back less than they invested.

Please consider the below risk factors:

- The fund invests in securities which are subject to the risk that the issuer may default on interest or capital payments.
- The fund price can go up or down daily for a variety of reasons including changes in interest rates, inflation expectations or the perceived credit quality of individual countries or securities.
- The fund invests in equities and equity related securities. These are sensitive to variations in the stock markets which can be volatile and change substantially in short periods of time.
- The fund may invest in emerging market equities and / or bonds. Investing in emerging markets involves a greater risk of loss than investing in more developed markets due to, among other factors, greater political, tax, economic, foreign exchange, liquidity and regulatory risks.
- The use of derivatives carries the risk of reduced liquidity, substantial loss and increased volatility in adverse market conditions, such as a failure amongst market participants. The use of derivatives will result in the fund being leveraged (where market exposure and thus the potential for loss by the fund exceeds the amount it has invested) and in these market conditions the effect of leverage will be to magnify losses. The fund makes extensive use of derivatives.
- The fund invests in high yielding bonds which carry a greater risk of default than those with lower yields.

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