William Blair

Second Quarter 2020

William Blair SICAV Dynamic Diversified Allocation Fund Summary and Outlook

Performance Summary

The SICAV Dynamic Diversified Allocation Fund completed the quarter with positive performance, with both aggregate market exposures and security selection contributing and currency exposures detracting. Within markets, long exposures to U.S., UK, and Vietnam equity markets detracted. Partially offsetting this were short exposures to South Africa, Mexico, and Hong Kong equity. Within currencies, long exposures to the Norwegian krone, Swedish krona, and South African rand hurt performance, while short exposures to the New Zealand dollar, Australian dollar, and Indonesian rupiah detracted. Security selection added value, mostly driven by outperformance of the International Leaders and Emerging Markets Growth strategies.

Fund Positioning

Market strategy remains long of equities, with net exposure of +20%. The strategy remains long of U.S and UK equities. Market strategy is modestly long of fixed income with a net exposure of +32%.

Within currencies, exposure to emerging currencies was increased during the quarter while exposure to safe-haven currencies was reduced. The largest long exposures are the Norwegian krone, Swedish krona, and British pound, while the largest short exposures are to the New Zealand dollar, Chinese yuan, and Israeli shekel.

Review & Outlook

Following very steep declines in the first quarter and a sell-off in panic conditions as the COVID-19 pandemic quickly spread across the world, most equity markets bounced back strongly from the depths to which they plummeted in late March. At one point in June, the S&P 500 index recovered to the level at which it started 2020. Most markets remained significantly below their peaks of February, however, and the rise in index levels was much slower than their earlier descent. Bond yields remained stuck at very low or negative values. Emerging currencies, which had depreciated sharply relative to safe havens in March, also recovered in the quarter. But several currencies continued to fall in April—and in a few cases into May—even though equity markets were rebounding. The oil shock (production increases announced in March by Saudi Arabia and Russia) that had exacerbated the declines of energy-sensitive currencies was later reversed, but energy price weakness persisted after equity markets had bottomed. The price of oil recovered in May and June but remained well below where it ended 2019.

Fund Exposures as of 6/30/20

Equity	**19.9**
U.S.	7.7
Canada	0.6
Europe (ex-U.K.)	-1.0
United Kingdom	6.3
Asia Developed	3.7
Emerging	2.5
Fixed Income	**32.1**
U.S.[1]	18.3
Developed (ex-U.S.[1])	4.6
Emerging	9.1
Unencumbered Cash[2]	**21.1**
Credit Detail	
U.S. Investment Grade Spread	5.3
U.S. High Yield Spread	1.4
U.S. MBS Spread	0.0
European Investment Grade Spread	3.4
Active Currency	
U.S. dollar (USD)	-3.6
Canada dollar (CAD)	-0.8
Other Americas	12.3
Euro (EUR)	-2.7
Switzerland franc (CHF)	-5.1
Great Britain pound (GBP)	5.1
Other Europe	9.7
Australian dollar (AUD) and New Zealand dollar (NZD)	-11.4
Japan yen (JPY)	3.4
China yuan (CNY)	-5.9
Asia (Excluding JPY and CNY)	-4.7
Other	3.8

Select Exposures[3]	
Norwegian Krone (NOK)	5.9
Mexican Peso (MXN)	4.1
Turkish Lira (TRY)	4.2

[1] Reflected as 10-year exposures.
[2] Unencumbered cash is residual cash and equivalents.
[3] Select currency exposures by largest expected contribution to portfolio risk.

We had significantly de-risked our equity and currency exposures through the first quarter as outlined in last quarter's commentary. Our long equity exposure entering 2020 was already somewhat scaled back and we scaled back further through the quarter as well as fully neutralizing many of our long emerging currency exposures. Our interpretation and analysis of developments since then is such that we have only modestly re-established long equity market exposure that we had de-risked in the first quarter. We remain slightly long of government bonds, despite their long-standing and significant fundamental over-valuation based on our analysis, which taken alone would warrant short exposure. We have made a more significant re-engagement with respect to currency risk exposures (compared to our activity in equities). In short, we believe there are significant long-term valuation opportunities in all three domains (equities attractive, bonds very unattractive, most emerging currencies attractive relative to safe havens), but we are most inclined to seek to exploit the currency opportunity at this point, remaining cautious with respect to the equity opportunity, and, as mentioned previously, we are going slightly against the expensive sovereign bond signal.

The primary impact of the pandemic on financial markets comes through curtailment of economic activity, which was a policy enacted worldwide as countries went into varying degrees of "lockdown." With no vaccine nor effective treatment for the virus, which is fatal in some cases, the effort to limit its spread focused on keeping people distant from each other and shuttering most forms of non-essential economic activity. This focus exerted a powerfully depressive influence on spending and earnings. While one or two quarters of lost revenue to a business might not reduce the fundamental value to a very large extent, many firms are likely to be operating well below former capacity for a considerable time, and some will not survive in their present form. Almost all central banks have ramped up their provision of ultra-easy monetary conditions (low, zero, or negative policy interest rates; accelerated asset purchases; and significant increases to provisions of guaranteed liquidity and credit). Governments, too, have aggressively responded through relaxed fiscal policies with increased investment and spending, including outright cash transfers to businesses and individuals, unemployment insurance payments, and, in some countries, direct wage support to employees and self-employed people who have been prevented from working by government-imposed lockdowns. A side effect of these policy responses has been to preserve a large number of firms under the premise that they can eventually restart their prior trading patterns. But since this will not be universally the case, these "zombies" (businesses that will scarcely be viable in a post-pandemic world) will unwittingly have been financed to a greater extent than before, which represents an enormous misallocation of resources. This will have an enduring contractionary side effect on fundamental values in relevant areas. In addition, ballooning government debt as a result of this may ultimately require tax increases that impair future corporate earnings flowing to investors.

Equity price rises have been surprisingly robust since late March given that the spread of the virus has only been slowed down by the deliberate squashing of growth, but market rallies are undoubtedly significantly influenced by the aggressive central bank action, which is not a long-term substitute for valuation support. For these reasons, we are disinclined to materially chase equities upward from generally prevailing levels.

With respect to bonds, in some contrast, the effect of ever-more-powerful quantitative easing on sovereign fixed income yields, along with communicated interest rate expectations of "even-lower-for-even-longer," can have a much more enduring impact on the suppression of yields well below what equilibrium conditions would indicate was fair value. In short, if ultra-easy policy is maintained through to the maturity date of government bonds, such debt can effectively be held above fundamental value for the remainder of its life. Monetary authorities thus have more ability to persistently counter the prospect of negative returns that bond markets would otherwise generate in many cases. Fundamental valuation accordingly exerts its weakest pull on fixed income in the present environment (compared to other assets) and we are not following valuation signals.

Conversely, exchange rates have not generally been a direct policy objective of central banks. Therefore, the widening of currency opportunities that was caused by the pandemic impact has not been "artificially" suppressed/countered in the same way it has with equities and (even more so) government bonds. Indeed, deeper currency under-valuations across oil-producing economies were rather reinforced and exacerbated by ill-timed oil production increase announcements from Saudi Arabia and Russia in early March. This "price war" was later defused, but not before it had disproportionately affected oil-sensitive currencies that continued to weaken in April even after stock markets had regained some stability. As currencies moved far below value through April and beyond in some cases, we saw fit to significantly reverse the large amount of de-risking that we had undertaken in the first quarter.

Markets and currencies remain somewhat abnormally correlated and lacking in diversification in the short term but, for the reasons previously referenced, we anticipate that the fundamental investment opportunities will converge differentially, with the currency opportunities being somewhat more robust looking ahead, followed by equities, and with little likelihood of bond yields experiencing any noticeable near-term "pull" from value.

We do not think there is a high chance of a repeat of the panic conditions that manifested due to the pandemic in the first quarter. This may be the case even as secondary waves of COVID-19 transmission are likely in some places, and even as infection rates continue to climb in several emerging countries where lockdowns were not as effective as in the developed world and merely slowed accelerating infection rates rather than decelerating the spread.

Importantly, market participants now know that even liberal democracies can lock down activity if they need to, and it is also known that this is effective in slowing down the disease transmission (though less effective in emerging economies than developed ones, as noted). Extra capacity in health services that was hurriedly built in many places successfully averted extreme stress on care capacity in health systems in the developed world. Unless secondary waves of infection stress this capacity, which largely did not happen the first time, stringent economic lockdowns are not likely to be repeated. Future adverse shocks to market sentiment will therefore not carry the same fear-inducing, nonlinear aspect that was dominant in the first quarter.

Although, as previously noted, several emerging countries have not been able to achieve declining virus spread rates at this point, they too have loosened their social and economic restrictions (that likely did prevent a worse outcome). While the human cost of the pandemic remains large, and in parts of the world is getting larger, populations will and have already been able to adapt and accommodate risks and adversity over time. From a dispassionate investing perspective, resuming economic activity amid an ongoing health catastrophe that is being controlled, but not yet defeated, argues for fundamental valuations in equities and currencies to ultimately re-exert their prevailing pull on prices. Our goal as investors is to position portfolios to best capture the risks and returns as they relate to price, value, and navigation influences. Previously we observed that our portfolios were well placed to step into what we believe will eventually prove to be large opportunities to take active risk, and for an eventual environment in which fundamental value is not prevented from being an effective force exerted onto prices. The pull of valuation will endure and ultimately prevail over today’s large, tragic, but temporary influences.

Our long-term investment objective is to deliver positive investment returns above inflation through a market cycle. We remain grounded in fundamental valuation as our first step—we strive to only take compensated risk and are unwilling to extend exposures unduly in a reach-for-yield that would be dictated not by opportunities and risks, but by very low real interest rates. There will be environments in which we conclude that macro-oriented exposures do not provide returns and risks compatible with portfolio objectives alongside other periods where compensation is abnormally high. During the last decade, the challenge of navigating these evolving environments has remained a significant component in the investment landscape, but we find our investment process, dialogue, and decision-making well-equipped to meet this challenge in an appropriate way. We remain vigilant as we assess new and relevant information to capture future investment opportunities in a timely manner and will continue balancing the relationship between risk taken and compensation expected.

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Fund Information

The SICAV has appointed FUNDROCK MANAGEMENT COMPANY S.A., a "société anonyme" incorporated under the laws of the Grand Duchy of Luxembourg and having its registered office at 33, rue de Gasperich, L-5826 Hesperange as its management company (the "Management Company").The Management Company is authorised and regulated by the Luxembourg Supervisory Authority of the Financial Sector (the "CSSF") as the management company of UCITS (defined below) under the EU directive 2009/65/EC, as amended.

The Management Company has been appointed as the management company of WILLIAM BLAIR SICAV, a "société d'investissement á capital variable", incorporated under the laws of the Grand Duchy of Luxembourg having its registered office at 31, Z.A.I. Bourmicht, Bertrange, registered in the R.C.S. Luxembourg under n° 98806 and approved by the CSSF as an undertaking for collective investment in transferable securities (UCITS) in accordance with the EU directive 2009/65/EC, as amended (the "Fund").

The Management Company has appointed WILLIAM BLAIR INVESTMENT MANAGEMENT, LLC, having its registered office at 150 North Riverside Plaza Chicago, IL 60606-1598, USA ("William Blair Group") as the investment manager for the Fund (the "Investment Manager").

The Articles of Incorporation, the Prospectus, the Key Investor Information Documents (KIID), the Annual and Half-yearly Reports of the Fund and the Subscription Form are available free of charge in English and German from our website SICAV.williamblair.com or at the registered office of the Management Company (33, rue de Gasperich, L-5826 Hesperange, Grand Duchy of Luxembourg), at the registered office of the Fund (William Blair SICAV, 31, Z.A. Bourmicht, L-8070 Bertrange, Grand Duchy of Luxembourg) or from the Swiss representative, First Independent Fund Services Limited, Klausstrasse 33, CH-8008 Zurich, and in German language at Marcard, Stein & Co., Ballindamm 36, 20095 Hamburg, Germany, and at Bank of Austria Creditanstalt AG, Am Hof 2, 1010 Vienna, Austria.

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