EDMOND DE ROTHSCHILD

ASSET MANAGEMENT

ASSET ALLOCATION STRATEGY

MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES

June 2016

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"Investor caution suggests equity markets could be in for a sharp rally"

MARKET ANALYSIS

Despite improved market performance, investors are clearly still cautious and remain relatively underweight risk assets. And for once, analysts have rather subdued expectations for earnings growth in 2016. Why is the market so unsure of itself? True, certain aspects of today's environment are hardly attractive:

- First quarter earnings in the US and Europe were better than expected but still significantly lower than last year.
- China's credit-driven rebound looks too fragile to last given the country's problematic private debt trends.
- The political landscape could become a source of crisis in Europe what with risks over this month's UK referendum on whether to stay in the EU and Italy's referendum over the constitution in October. In the US, increasing support for Donald Trump in opinion polls is also a matter of concern.
- The Fed's determination to pursue monetary tightening, whenever the situation is favourable, is pushing the US dollar higher and risks undermining emerging market economies and even US growth.

In spite of these considerations, we remain overweight equities in general and the eurozone in particular. We think that earnings will be prevented from falling because commodity prices are now stabilising and there is now more awareness of the damage being done to financials by negative interest rates. Expectations are very low but improved global economic trends should also help earnings rise. At the same time, investor caution suggests equity markets could be in for a sharp rally once certain events like the UK referendum are behind us.

KEY POINTS

- Slightly overweight equities in general and the eurozone in particular
- US Treasury underweight trimmed
- Preference for European high yield bonds

OUR CONVICTIONS

ON EQUITY MARKETS:

Last month, we reduced our European equity overweight and upped exposure to the US dollar to adapt our position to a possible "Leave" vote in the upcoming UK referendum. We took out some short term hedging strategies as this eventuality could still prove very damaging for markets. In other words, we too were being more cautious ahead of the referendum but insofar as a “Leave” vote is not our core scenario, we think it important to remain overweight European equities.

ON BOND MARKETS:

We have reduced our US Treasury underweight because US Treasury prices fell a little following recent Fed statements which argued for a near-term hike.

We continue to prefer European high yield bonds and, to a lesser extent, peripheral country bonds ahead of European political deadlines.

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