EDMOND DE ROTHSCHILD

ASSET MANAGEMENT

ASSET ALLOCATION STRATEGY

MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES

December 2015

Benjamin Melman
HEAD OF ASSET ALLOCATION
AND SOVEREIGN DEBT
EDMOND DE ROTHSCHILD
ASSET MANAGEMENT (FRANCE)

"Reinforcement of the US-eurozone monetary divergence theme"

KEY POINTS

- European equity overweight maintained
- Positive on the M&A theme
- Reduced exposure to eurozone core country debt

MARKET ANALYSIS

After October's massive rebound, risk assets continued to perform well in November. Japanese and eurozone equity markets were among the big winners with gains of 3.5% and 2.85% respectively in local currency. However, US equities were flat (+0.3%) in local currency. Returns in EUR differed significantly. In a sign of looming monetary policy divergence between the Fed and the ECB, the euro lost more than 4% against the US dollar and 2% against the Yen. Altogether for a European investor, US equities in EUR advanced by 4.5% and Japanese equities ended the period 5.6% higher.

November witnessed the marked reinforcement of the US-eurozone monetary divergence theme. Comments from Fed committee members fuelled expectations of a first rate hike in December. Janet Yellen's hawkish stance when addressing the Financial Services Committee was bolstered when US jobless data came in better than expected. However, the Fed was keen to remind investors that future monetary normalisation would be very gradual. At the same time, the ECB reminded investors it was still present and decided to accentuate its monetary easing programme by cutting the deposit rate, extending its asset purchase calendar, increasing the size of monthly purchases and broadening the range of eligible collateral. As a result, US Treasury yields rose by 6bp while Bund yields fell by 4bp. For 2 year maturities, the move was even more pronounced with US and eurozone rates diverging by more than 30bp. Commodities were hit by the rising US dollar and fell sharply. Oil lost close to 10%. Similarly, emerging markets resumed their downtrend, hit in equal measure by falling commodity prices and domestic weaknesses. Of note, however, was the Shanghai market which moved higher.

Generally speaking, we still believe that equities should be preferred to bonds. We have renewed confidence in eurozone equities. As well as the reasons we advanced last month –resilient European growth (underpinned by the latest PMI data), ECB responsiveness and valuations which have now moved back to their long term average- we think that diverging monetary policy will help eurozone rates stay low amid today's persistently deflationary environment. With such low rates and continued economic growth, eurozone equities still offer the most attractive risk/return profile.

OUR CONVICTIONS

ON EQUITY MARKETS:

We have left our European equity overweight unchanged. We had already taken some profits in November after October's sharp rebound. We are still convinced that European, and especially eurozone, equities have upside potential. The cycle is still gaining traction and companies have continued to reduce debt. In this respect, we still prefer domestic cyclicals for the moment as bank stocks should benefit subsequently.

We also like the M&A theme.

ON BOND MARKETS:

Government bonds: we reduced our core eurozone country weighting to (=/-) as the market had already discounted a big move from the ECB at its December 3 meeting. However, we maintained our weightings in eurozone semi core countries (neutral) and European peripheral countries (positive :=/+). In the US, the yield curve has already discounted three interest rate rises. Even so, we have maintained our negative bias (=/-) because the market could still be exposed to bigger shifts at the long end of the curve after the initial Fed rate hike. To hedge against this eventuality, we have started long positions in US inflation-linked bonds. We are also keen on hard currency emerging country debt.

In **corporate debt**, we are still upbeat on spread securities like high yield given encouraging prospects for European companies.

EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)
47, rue du Faubourg Saint-Honoré – 75401 Paris Cedex 08
Société anonyme governed by an executive board and a supervisory board with capital of €11,033,769
AMF registration No. GP 04000015 – 332.652.536 R.C.S Paris
www.edram.fr