ASSET MANAGEMENT

ASSET ALLOCATION STRATEGY

MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES

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« After the rally, our allocation remains procyclical »

Since Donald Trump's election, financial markets have seen some spectacular moves. Equity markets have risen sharply with very strong rotation into cyclicals, financials and value plays. US bond yields have rebounded, dragging yields on other major bond markets higher. And the US dollar has risen, often sharply, against other currencies.

MARKETS HAVE BEEN PUSHED HIGHER BY INVESTORS MOVING BACK INTO DISCOUNTED SECTORS

It is still difficult to predict which campaign promises will actually be implemented by the new Trump administration. It is probable that not everything will be enacted unless the new team is willing to let deficits rise, hardly the best policy at a time of full employment; the US economy may need an infrastructure programme but not fiscal stimulus. Following this impressive rebound, we have trimmed our equity overweight across Europe but our decision was also motivated by the need to factor in higher political risk in Europe.

This is a tactical shift as the economic cycle is still on track. Major economic indicators were favourable almost everywhere prior to the US elections and the first post-election surveys point to a significant recovery in both household and industrial confidence levels. At the same time, markets have been pushed higher by investors moving back into discounted sectors. Equity markets may not be attractive in valuation terms but they are not expensive either. Analysts, meanwhile, seem to have reached the end of the downward phase in earnings expectations.

We are no longer negative on US Treasuries and see some interest in investment grade corporate debt. US long bond yields could rise further but we feel the market could stabilise thanks to the rising US dollar (a deflationary factor in the US) and record spreads between the US, Europe and Japan at the long end of the yield curve. Both factors could end up making the US market look very attractive again.

4,78%

net performance of MSCI Value USA in November

KEY POINTS

- Tactical trimming of equity overweight
- Neutral on US Treasuries and the dollar

At the same time, we cannot rule out the possibility that further US bond tensions could impact other risk assets and eventually entail some easing in US Treasury yields. Markets are applauding today's higher interest rates after long criticising the perverse effects of excessively low rates but the global economy is still higher indebted, especially in US dollars, so it could suffer from a sudden and sharp rise in bond yields.

THE ECB AND THE FED ARE IN THE SPOTLIGHTS

On bond markets, we prefer European high yield bonds and subordinated financials which are benefiting from the ECB's laxist policy. Inflation and inflationary expectations are still low and Europe's recovery is still only proceeding at a modest pace. But we hedged this risk by buying European inflation-linked bonds on the grounds that laxist ECB policy (which is benefiting our investments) will only end when inflationary expectations return to normal.

We have returned to neutral on the US dollar. It has already gained a lot of ground this year. Bear in mind that the eurozone has a current account surplus of around 3% of GDP so the euro is structurally strong.

After the ECB, the FED will take centre stage on December 13 and 14. It is expected to announce a rate hike on the back of the healthy economy and, in particular, the pace of inflation.

NEXT HEADLINE EVENTS

- ***Next Fed meeting on December 13-14***
- ***Next BoJ meeting on December 19-20***

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