



# ASSET ALLOCATION STRATEGY

## MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES

September 2016



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«Eurozone equities have lagged since the beginning of 2016»

**Risk assets extended gains in August amid particularly low volatility and modest trading volumes. The rebound was largely due to better news on the global economy, especially in the US and in emerging countries, after a particularly anaemic performance in the first half. And although it is still too early to assess Brexit's economic impact, the fact that economic surveys remained upbeat after such a political shock is rather reassuring news.**

**The global economy is finally back on track and we expect the trend to gain traction in coming months. With such extremely low rates, this is a promising backdrop for equity markets. True, they have become rather expensive but valuations are still acceptable. Although it would be reasonable to take some profits after such a surprising, and remarkably long, post-Brexit rebound, we prefer to maintain our slight equity overweight even if this means taking advantage of today's low implicit volatility to buy inexpensive portfolio hedges. We believe that investors who had sharply cut exposure ahead of the UK referendum have not been able to significantly rebuild positions so current market momentum could be self-sustaining for some time.**

### » EMERGING MARKETS HAVE PERFORMED SPECTACULARLY WELL

Investors had been extremely way of emerging markets but have returned in force in recent weeks. Worries over China had seriously perturbed investors at the beginning of 2016 but have since abated and Brazil's economic and political situation has improved. Commodity prices have stabilised after a long period of chaotic trading. And markets began to think that the Fed was no longer in a position to tighten policy, a strong signal that suggested that the biggest emerging market risks had really evaporated. Both the MSCI emerging equities index and the EMBI (hard currency emerging market debt) have gained almost 15% year to date, a spectacular showing compared to other asset classes.

However, two factors make us think that this rally will be irregular:

- given today's conditions, we believe the Fed will resume monetary tightening before the end of 2016, a possibility that has not been properly factored in by markets.
- we do not think that the economic acceleration in developed countries, which has helped Asian economies, can be extrapolated.

#### KEY POINTS

- » Tactical underweight on emerging equities
- » Eurozone equity weightings reinforced
- » US Treasury underweight

## » EUROZONE EQUITIES COULD GAIN ON ANY US DOLLAR REBOUND

We are tactically underweight emerging equities and prefer to reinforce eurozone equities as they have lagged since the beginning of 2016. They could benefit if the US dollar rebounds after a Fed rate hike.

**41%**

The probability of a Fed rate hike in September

(at August 31 2016)

On bond markets, we continue to prefer high yield bonds and financial bonds in Europe as the upbeat economic environment there and the ECB's strategy still make carry strategies attractive. We are underweight US Treasuries because of monetary risk in the US and we continue to favour yield flattening strategies in Europe. Our portfolios are still underweight the US dollar.

## COMING UP

» *Next ECB meeting: Sept 8*

» *Next Fed meeting: Sept 20/21*

» *Next BoJ meeting: Sept 20/21*

**Written on September 1st, 2016. This document is for information only.**

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