ASSET ALLOCATION STRATEGY

MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES

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"Keeping some dry powder"

The global synchronised recovery continues, especially in Europe, even if China is showing signs of slowing due to tighter monetary policy.

A FAVOURABLE INVESTMENT ENVIRONMENT

In the US, the chances of a stimulus plan have improved markedly following the Senate vote on tax reform. The Senate and House of Representatives still have to go through the reconciliation process to validate what is a new more expansionary fiscal policy, especially as concerns companies. But this political success cannot mask the FBI's ongoing enquiry into contacts between Donald Trump's team and Russia, especially during the presidential campaign. This has raised the spectre of impeachment but, in our view, that would be more likely to create short term volatility than change things fundamentally over the medium term. All in all, the latest news confirms that the environment is fundamentally favourable for investment and likely to keep risk assets on an upward trajectory.

Last month, we slightly reduced exposure to equity risk for tactical reasons. It seemed to us that the improving economic environment had not ruled out the risk of short term volatility. We continued to invest in risk assets but more cautiously. After all, they had been rising for 18 months amid low volatility so there is an increased risk that any bad news might cause more turbulence. And many investors have attached too much importance to recent volatility when calibrating portfolio risk budgets. The danger is that those who have taken on too much risk will fuel the selling when the next market accident occurs. That is why we prefer to keep some dry powder so as to benefit from any fresh volatility.

KEY POINTS

- Overweight eurozone and Japanese equities
- Focus on subordinated financial debt

BOND MARKET OPPORTUNITIES ARE THINNING OUT

We continue to focus on eurozone and Japanese equities so as to tap into each zone's accelerating growth and their relatively more attractive valuations. Both also benefit from highly expansionist central bank policy which should continue for several months. Emerging country equities have risen 30% in US dollars year to date and now look slightly less attractive with the Chinese economy slowing and the Fed pursuing its monetary tightening policy.

Bond market opportunities are now rather thin on the ground as markets are generally looking expensive and central banks are moving towards monetary tightening. We are still taking a defensive approach to duration risk and, in the credit universe, prefer subordinated financial debt.

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