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Stay overweight equities, bond rally to run out of steam - Pictet Asset Management

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"Stay overweight equities, bond rally to run out of steam" says Luca Paolini, Chief Strategist at Pictet Asset Management.

"The New Year has begun with investors experiencing a reversal of the trends they saw in 2013.

"Growth momentum remains solid and inflation is largely under control. What is more, stocks' current valuations and the Fed's decision to reduce monetary stimulus do not loom as a hindrance to equity investors.

"Investors can therefore maintain a modest overweight in equities and some other riskier asset classes. While we expect developed market stocks to deliver moderate returns of some 5 to 10 per cent in 2014, we would consider any further weakness as a tactical opportunity to increase exposure"

"In our regional allocation portfolio we remain overweight emerging markets and cautious on the US".

"We think the pattern of emerging market equity underperformance vs developed markets, which has widened the discount on emerging-to-developed market stocks to more than 30 per cent on a on a price-earnings basis – is now at odds with fundamentals. Our indicators suggest many markets are oversold while investor sentiment has worsened to an extent that limits the scope for a further market correction. We expect an acceleration in global growth and a dovish policy stance in the US to create the conditions for emerging equities to outperform their developed counterparts in the months ahead".

"That is not to say we would invest indiscriminately. Countries with a stable political climate, whose funding needs are manageable and

whose stock markets are comparatively cheap offer the best prospects in our view".

The investment case for Japanese stocks also remains strong. The policy-induced shift from deflation to information is a major positive. European equities, meanwhile, do not look cheap while the earning season has delivered results that are well below market expectations".

"When it comes to fixed income we remain neutral. We think the government bond rally should soon run its course and that yields will resume their upward trajectory once it becomes clear that global economic growth is accelerating.

"Our favoured currency, meanwhile, remains the USD. Strong US economic growth and the steady withdrawal of US monetary stimulus are pre-conditions for a long term trend of appreciation for the world's reserve currency".

"The sharp sell-off in developing world currencies has provided us with an opportunity to close the underweight stance we have held on local currency emerging bonds since the final quarter of 2013, and shift to a neutral position".

"The sharp depreciation in some EM currencies should bring about a welcome improvement in the current account positions of a number of major developing economies – this is already evident in countries such as Turkey, Indonesia and India.

"Elsewhere, we retain our underweight stance on investment-grade bonds. The prospects for high-yield bonds look more appealing, particularly as high-yield bond issuers have worked hard to extend the maturity of their liabilities.

"We have trimmed the long duration stance in our bond portfolio but we still believe that the market's view of the US interest rate trajectory remains overly hawkish."

-Ends-

Notes to the Editor

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