
Sentiment shifting in favour of emerging markets

- Pictet Asset Management

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“We are building our positions in emerging equity and local currency debt” says Luca Paolini, chief strategist at Pictet Asset Management.

“The risk-return profile of emerging market currencies and local currency bonds continues to improve in the wake of their protracted sell-off. We have consequently raised our exposure to local currency emerging market debt to overweight from neutral while reducing our stance on their USD-denominated counterparts to underweight. A number of developments justify this move.”

“Valuations of emerging market currencies have fallen to a point where they are now starkly at odds with such economies’ fundamentals. Emerging currencies are, on average, trading at almost two standard deviations below their equilibrium level (which takes into account a country’s net foreign asset holdings, inflation rate and its relative productivity).”

“Local currency bond yields have climbed in recent months – quite steeply in some cases – hence, the asset class has acquired some extremely positive characteristics. Such yields are now among the highest of all global fixed income classes, yet their duration is among the lowest (only global high-yield bonds offer a lower duration). In a period likely to see higher US bond yields, that makes for an attractive combination, in our view.

“From a technical standpoint, the trends are also positive. Investment outflows from local emerging debt markets have eased in recent months while anecdotal evidence shows institutional investors are beginning to add to their positions in the asset class.

Our preferred markets are Brazil, where valuations are attractive, and China, which we believe will benefit from what we see as an imminent easing in monetary policy.”

“Separately, we continue to hold an overweight position in European high yield bonds. The yield pick-up offered by speculative-grade bonds continues to offer what we consider to be more than sufficient compensation against the risk of default.”

“We expect default rates to remain low by historical standards: not only are borrowing costs unlikely to rise but corporations should continue to be disciplined in the management of their balance sheets. The monetary backdrop is also positive for European high-yield. Elsewhere, we retain a long duration stance as we believe the Fed’s steady withdrawal of monetary easing should precipitate a drop in the market’s inflation expectations.”

“When it comes to global equities, however, we remain neutral. Geopolitical risks have risen in recent weeks. The escalation of tensions between western powers and Russia following President Vladimir Putin’s annexation of Crimea could yet threaten the EU’s economy recovery. The region’s vulnerability stems from the fact that it imports a quarter of its gas from Russia”.

“Although we expect economic conditions to improve as the year progresses – both in the US and China – world growth is not yet strong enough to lift corporate earnings prospects, and therefore we are keeping our neutral stance on riskier asset classes.”

-Ends-

Notes to the Editor

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Founded in 1805 in Geneva, the Pictet Group is one of the premier independent asset and wealth management specialists in Europe, with GBP265 billion in assets under management and custody at 31st December 2013. The Pictet Group is owned and managed by eight partners with principles of ownership and succession that have remained unchanged since foundation

Based in Geneva, the Pictet Group employs more than 3,400 staff. The Group has offices in the following financial centres: Amsterdam,



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ABOUT THE PSU

The Pictet Asset Management Strategy Unit (PSU) is the investment group responsible for providing asset allocation guidance across stocks, bonds, cash and commodities.

Each month, the PSU sets a broad policy stance based on its analysis of:

- business cycle: proprietary leading indicators, inflation
- liquidity: monetary policy, credit/money variables
- valuation: equity risk premium, yield gap, multiples vs. history
- sentiment: Pictet sentiment index (investors’ surveys, tactical indicators)