Market View

# Time to be tactical again

## Oddo Meriten Asset Management – October 2015

In early September, after the rollercoaster ride of August and with volatility peaking at more than 40 in both Europe and the US, we confidently reiterated our baseline scenario, i.e.:

- That global growth would indeed be soft but would pick up in the second half, driven mainly by robust demand;
- That corporate earnings would be quite acceptable, given current valuations;
- That most central banks would remain accommodating;
- Most of all, that the seriousness of the situation in China had been overdone. Based on proprietary indicators, which reflect trends in services, and when placing various recent financial moves (including the August devaluation) in the current context of the opening of domestic financial markets, we were less concerned than the consensus that things would get out of hand in China.

Now that the equity markets have stabilized, we feel it is important to recall some alternative scenarios to which we have assigned significant probabilities since last June. What are these scenarios?

### 1) A new disappointment on global growth (20% probability).

At a pace of +2.5% (at constant forex), global growth is hovering around its all-time lows, with the exception of 2009. An additional slide, to 2% for example, would require a shock or major disappointment in one of the world's main regions – a US recession, a hard landing of the Chinese economy, or a derailing of Abenomics.

The investment positioning under this scenario, the probability of which we estimate at 20%, is not in doubt (*).

### 2) An acceleration in inflation above expectations (20% probability).

As surprising as this scenario may seem, we also assign a 20% probability to it. There are two possible ways it could come about:

- A stabilization in oil prices combined with a weakening in the dollar and a slight acceleration in wages from current levels would probably be enough.
- Another way would be a further weakening in already low productivity gains, which would mean a further decline in potential growth and could also lead the Fed and other central banks to tighten their monetary policies more than expected, which would be bad news for both equities and fixed income (*).

After the poor macroeconomic figures released last week, we have slightly raised the probability of occurrence of the two alternative scenarios. We have left our direct exposures unchanged but have set up a few hedges. The reason is that the market rally has triggered a sharp decline in volatility and, as a corollary, a significant fall in the prices of hedges.

**We are making no change to our strategy but are introducing more tactics into it, as well as more hedges to provide protection in the event of an adverse scenario.**

(*) Click here for details on alternative scenarios presented in our September 2015 Investment Strategy

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