



ASSET ALLOCATION STRATEGY

MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES

NOVEMBER 2019

MARKETS
MAY HAVE
CHANGED A
LITTLE BUT THE
FUNDAMENTAL
TREND HAS NOT

► Edgar Faure was fond of saying, “Weather vanes don’t turn, the wind does”. Given the renewed, and very cyclical, optimism seen on equity markets and long bond rates in October, we are left wondering if the cycle is back or if all this is just an epiphenomenon.



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These cyclical shifts are based on:

- Encouraging declarations over a first phase agreement in the US-China trade talks;
- A much reduced risk of a hard Brexit in the short term; and
- A few PMI indications that global manufacturing is finally stabilising after a year of severe falls.

The recent drop in political risk is a significant shift in a climate of almost constant one-upmanship. It is highly likely that hopes over a US-China deal and the diminishing risk of a hard Brexit mainly reflect the willingness of all concerned to avoid a worst case scenario. That alone would warrant a rise in anxious markets but there is nothing to justify any substantial reduction in uncertainty. Given the scope of the US-China trade dispute, the first phase in any agreement is the easy bit. Phase 2, and especially Phase 3, would require such a big change in today’s political climate that they currently look unattainable. And there is strong political consensus in the US to impose sanctions on China until Beijing adopts normal trade practices. As for the UK, even if a hard Brexit is avoided, negotiations are likely to last longer than the scheduled period which has 2020 as a deadline. Trade agreements always take several years to conclude and we still have no idea how the next UK government will react. In both cases, political uncertainty will be high enough to do lasting damage to company investment.

And signs of stabilisation in the manufacturing sector over a month do not constitute a trend, especially as services, hitherto a rather resilient segment, now seem a little more prone to the prevailing industrial slump. We are sticking to our global slowdown scenario. Over and above any political uncertainties, wage tensions are putting company margins under pressure both in the US and in Europe. This provides some visibility on consumer spending but hinders investment and job creation, so much so that it places the cycle firmly on a downward trend. In our view, market moves in October were dictated more by investors repositioning portfolios away from heavy exposure to defensives and duration than by a scenario change. Against this backdrop, we remain somewhat cautious in our asset allocation.



KEY POINTS

Recent drop in
political risk

Company margins
are under pressure in
the US and Europe.

We are sticking
to our global
slowdown scenario

Now that UK political risk has followed Italy's example and fallen, we have raised European equity weightings. Political risk had led international investors to be heavily underweight European equities so there could now be a catch up.



NEXT HEADLINE EVENTS

UK Parliamentary Elections: December 12

Next ECB meeting: December 12

Next Fed meeting: December 10 & 11

Written on 04/11/2019. This document is for information only.

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Société anonyme governed by an executive board
and a supervisory board with capital of €11,033,769
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