



EDMOND
DE ROTHSCHILD

ASSET ALLOCATION STRATEGY

MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES

JUNE 2020

ALL IN DUE COURSE



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► We all laughed when US Economist Paul Samuelson joked that 'the market has predicted nine of the past five recessions'. Yet it is true that markets love to make forecasts and can sometimes extrapolate to the extreme. However, quite the opposite has been happening in recent months during the economic crisis.

As soon as investors realised that the spread of the virus was much more global than initially thought (and not having paid enough notice when the first cases were discovered in Asia), the markets came crashing down and fell to pieces, recovering only when the Federal Reserve announced a major 'infinite' quantitative easing policy. In the first few weeks when risky assets began to recover, our attention was immediately drawn to the fact that the two sectors most easily outperforming the equity market were technology and health, probably because the pandemic had prompted greater spending on healthcare and digitisation. The brutal and unprecedented nature of the health emergency, and the utter inability to make accurate forecasts, have drastically shortened investment horizons, forcing the markets to become much more reactive than proactive. Unparalleled support from central banks has nevertheless allowed investors to forget their profound dislike of uncertainty, and the world's stock markets have bounced back better than the shock to business and resulting uncertainty would have suggested. But lacking any real visibility, the markets are only really reflecting current trends, without any forward-looking element.

Nonetheless, this pragmatic approach to the situation could easily change. The time will of course come when the markets regain their ability to forecast (or indeed extrapolate!). The problem is knowing just when that time will be. It is important, therefore, **not to confuse short-term tactical allocation with strategic portfolio management.**

In the short term, things can only get better. Massive financial and fiscal support has been put in place. Countries continue to ease their lockdown restrictions without any major incidents that could once again threaten the economy, there is renewed hope that a vaccine will be discovered (albeit not for a while) and on the European front, the Franco-German initiative backed (in theory) by the European Commission will minimise the risk of a second wave in Europe. We must still keep a close eye on the strained China-US relations, mindful of the risk of these two rival nations cancelling Phase 1 of their trade deal. Globally, things are definitely looking up.



KEY POINTS

**Lower than normal
exposure to risky assets**

**Reduction in US equities in
favour of European stock**

But we are not yet able to extrapolate this improvement in any way or predict when normal business will resume, because there are several possible scenarios. The rivalry between the United States and China will continue to weigh heavily on global trade and corporate strategy. Analysts have stopped wondering the US-China agreement will progress to a second phase. On the other hand, companies will come out of this crisis with much more debt and with dilapidated profit margins, whereas traditionally they would expect to come out of a recession healthier than before. Barring any major policy decisions once 2020 gets back on its feet, fiscal policy for 2021 will be contractionary. Furthermore, the stalemate in negotiations between the UK and the European Union is seriously increasing the risk of a hard Brexit at the end of the year. Finally, no-one is yet in a position to say, beyond any short-term effects, how this crisis will ultimately affect financial behaviours. Bad surprises are far more likely than good ones.

So, motivated by sustainably healthy liquidities and improvement in the short term, our risky asset exposure will remain similar to, albeit just less than normal. Investors have naturally favoured the defensive markets during the pandemic, so we have reduced the proportion of US equities in favour of European stocks, in the hope that our portfolios will benefit from the short term economic upturn and the lull in European risk. This is a tactical move.

We do not want to be exposed to risky assets any more than is necessary, and the current high spirits on the stock markets have put us on our guard. Although the next period looks positive, the risks have not disappeared and we still lack any real forward vision.

	OUR CONVICTIONS FOR JUNE*	CHANGES COMPARED TO THE PREVIOUS MONTH
ASSET CLASSES		
Equities	=/-	→
Fixed Income	=/-	→
Cash	=/+	→
EQUITIES		
US	=/-	↓
Europe (ex-UK)	=	↑
UK	=	→
Japan	=	→
Emerging Markets	=/+	→
Global / others	=/+	→
SOVEREIGN BONDS		
US	=	→
Euro Zone	=	→
Emerging Markets	=/+	↑
CORPORATE BONDS		
US Investment Grade	+	→
Euro Investment Grade	=/+	→
US High Yield	-	→
Euro High Yield	=/-	→

*Range of investment committee ratings on the asset class/geographical zone (from -/- to +/+). Source: Edmond de Rothschild Asset Management (France). Ratings at 28/05/2020.

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EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

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