



# ASSET ALLOCATION STRATEGY

MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES

SEPTEMBER 2020

MARKETS AS A  
WHOLE ARE  
GETTING MORE  
EXPENSIVE

► The epidemic is spreading and still posing a threat as we head into the autumn, but risk assets continue to gain ground, though with varied asset and sector returns.



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Central banks have resumed their tight grip on government bonds - even the long part of the curve now only moves a little on news that would normally cause bigger shifts - but their influence goes well beyond sovereign debt yields. While it is true that rating agencies have been reducing their default rate expectations, the extent to which corporate and emerging country bond spreads have tightened is due to massive liquidity injections from central banks.

## EVERYTHING HAS A PRICE

Equity markets have joined in the party. The NASDAQ 100 has gained more than 30% year to date and its rally since the March lows has been parabolic. Since the beginning of 2019 it has doubled. True, unlike the bubble at the end of the 1990s, tech stocks have most often delivered on earnings expectations but there is perhaps a price for everything. There is no doubt that in relative terms, technology has emerged as the big winner from the Covid-19 crisis. It is less clear that this is the case in absolute terms. When companies start to prepare their 2021 budgets, after a particularly difficult year, it will be interesting to see what they actually intend to invest in IT, especially compared to the high hopes driving today's valuations.

Of course, other markets like those in Europe or the emerging zone, have not seen anything like the same exuberance. Nevertheless, given US tech sector weightings and US market weightings in global indices, equity markets as a whole are now expensive compared to historical measures and/or today's still very uncertain economic environment. This provides us with some pointers to the medium to long term prospects - market returns will be lower while any shock will trigger a bigger sell-off - but it says nothing about market performance over the coming quarters.

Note, however, that US tech stocks have seen choppy trading over the past few days. These market moves strike us as essentially technical, primarily because recent price swings have been amplified by investment banks managing their balance sheets after selling large amounts of tech stock options to meet a significant rise in demand. According to the FT, volatility was also increased by



### KEY POINTS

Tech stock volatility is  
essentially technical

We have raised  
exposure to European  
equities at the expense  
of US equities

Softbank's massive buying of these options (reportedly about \$30bn in notional exposure), the sort of concentration that can create instability. There is perhaps more tech stock volatility to come but we think it highly unlikely that this marks a change of market regime.

## THE VACCINE IS A CATALYST

We are reasonably well-exposed to markets. The Fed's change to its inflation target is another message to investors that accommodating monetary policy is here for some time; there is no reason to expect powerful monetary support to markets to fade over the foreseeable future. At the same time, the post-lockdown recovery is proceeding and the issue in coming weeks, apart from the US election, is whether a vaccine is approved. There is some reason to expect one will appear before the end of the year. If so, more cyclical markets like Europe, Japan and emerging countries should rebound. That is why we have raised exposure to European equities at the expense of US equities.

## THE RUN-UP TO THE US ELECTIONS

Despite the big differences between the Democrat and Republican programmes, we believe that what markets really want is for Congress and the White House to be on the same wavelength. Of course, Democrats want to row back on Donald Trump's tax cuts and increase regulation for sectors like energy, healthcare and technology, but they are also the most determined to roll out a stimulus package. The only certitude if Donald Trump were to be re-elected is no change in the fiscal framework. GAFA, or even healthcare, regulation cannot be ruled out. And budgetary stimulus would be less daring and also less likely. The unfavourable scenario is a stand-off between the White House and Congress. And the worst case scenario, given the extent of political polarisation in the US today, would be for the election results to be challenged. We recognise that this would drive volatility but for us it is not a reason to change investment policy.

	OUR CONVICTIONS FOR SEPTEMBER*	CHANGES COMPARED TO THE PREVIOUS MONTH
<b>ASSET CLASSES</b>		
Equities	=/-	→
Fixed Income	=	→
Cash	=	→
<b>EQUITIES</b>		
US	=/-	→
Europe (ex-UK)	=/+	↑
UK	=	→
Japan	=	→
Emerging Markets	=/+	→
Global / others	=/+	→
Convertibles	=	→
<b>SOVEREIGN BONDS</b>		
US	=/+	→
Euro Zone	=	→
Emerging Markets	=/+	→
<b>CORPORATE BONDS</b>		
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 04/09/2020.

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