

# ASSET ALLOCATION STRATEGY

## MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES

March 2017



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### “Tactical trimming into strength”

**Equity markets made further gains amid an ongoing improvement in the economic environment. Surveys across major zones all suggest the cycle is gaining traction while fourth quarter earnings pointed to an incipient recovery.**

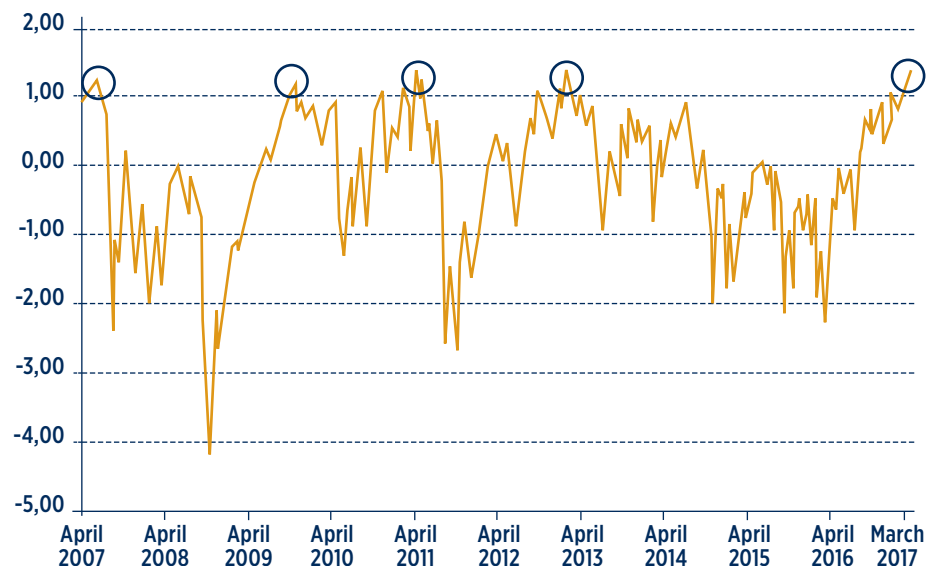
#### ► LOWER RISK AVERSION

Given the almost euphoric mood on markets, we think it is time to temporarily reduce equity exposure, not to adopt a defensive stance but to move towards a more balanced profile.

- Over recent weeks, equities have been rising due to lower risk aversion rather than the reflation theme. Long bond yields stopped rising at the beginning of the year and value stocks have been underperforming growth plays in both the US and Europe. But our risk aversion indicators have reached a floor so it makes sense to be a little more cautious.

- Bond markets have been disjointed in recent weeks due to a rise in European political risk. French and Italian sovereign spreads as well as European swap spreads have tightened but with no significant impact on corporate bonds and European equities. But we should not take this situation for granted as any fresh political worries in both these G7 countries could have more material consequences for all markets. At the same time, US political uncertainty is still high as it is still very unclear how and when the Trump administration will roll out its economic programme.

#### APPETITE FOR RISK



Source: Edmond de Rothschild Asset Management (France), Bloomberg – 6 March 2017.

#### KEY POINTS

- Neutral on equities
- Overweight financial bonds
- High yield score reduced

- Growth may well continue to accelerate but some surveys have already reached all-time highs. And the end to tumbling commodity prices, a big growth driver in 2016, can only hit consumer spending. The global reflation trade started a year ago when China successfully reflatd its economy. But we should note that Beijing, which follows a stop and go approach to the economy, has recently tightened monetary policy, a move that could dampen reflationary momentum.

- US market valuations are now higher than their long term mean. They could stay that way, or even move higher, over a number of months as they are not necessarily a harbinger of a looming correction. However, it is more reassuring to have stretched valuations in the first stage of the cycle rather than in the middle or at the end which is where we are today.

## ▶ AN UPBEAT ENVIRONMENT FOR FINANCIAL BONDS

We are overweight financial bonds compared to high yield. First, subordinated bonds already offer more interesting yields and financial bonds are also enjoying a more favourable environment. Regulation has considerably reduced the sector's risk profile and the steepening yield curve is reinforcing its profitability. Financial bonds are also advantaged by the fact that, unlike high yield, they are generally under held in investor portfolios.

As a result, we have taken some tactical profits in our portfolios but remain reasonably well invested. We are fundamentally convinced that equity markets will do well in 2017 but there are enough technical, political and economic factors at play today to reinject a little volatility, thereby providing us with further opportunities further down the line.

## NEXT HEADLINE EVENTS

▶ *Next ECB meeting on March 9*

▶ *Next Fed meeting on March 14-15*

▶ *Next BoJ meeting on March 15-16*

▶ *Parliamentary elections in the Netherlands on March 15*

**Written on March 6, 2017. This document is for information only.**

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