Asset allocation dashboard

September 2017

momentum

● Positive ● Neutral ● Negative

Asset class	View	Change	Comments		
Equities	**View**	**Change**	**Positive**	**Negative**	**Our view**
Developed equities	●	↔	Low yields can sustain the current valuations which are not stretched relative to DM sovereign bonds or credit In aggregate central banks maintain an accommodative stance which continues to support risk markets globally.	The global macroeconomic environment is more uncertain than risk and volatility markets might suggest through market pricing. Markets have continued to perform strongly and there is a risk of momentum stalling if earnings disappoint. Valuations are somewhat expensive at current levels.	At these valuation levels we continue to believe a neutral allocation is appropriate. Valuations are not cheap but central bank policy remains supportive for risk assets and on a relative value basis vs both sovereign bonds and credit, equity returns remain attractive over the medium term. More elevated volatility should be expected in the future with policy and politics remaining central to risk pricing.
UK equities Relative to developed	●	↔	Valuations look reasonable today and the historically weak level of sterling today should continue to be supportive of UK businesses, more so the exporters and those that earn their revenues overseas. Low base rates should keep risk appetite and equity prices buoyed in the near term and relative to Gilts and UK corporate bonds UK equities remain an attractive proposition, particularly when viewed on a real forward return basis.	The UK continues to face uncertain times with regard to Brexit where progress remains slow. In the smaller cap indexes where businesses are more domestically exposed, one could argue that this risk may be under-priced today and if the earnings fail to materialise then the market looks expensive. The consumer and consumer facing sectors look increasingly pressured from a deepening squeeze in real wages and challenges to the traditional high street from online retailers and disruptive forces more broadly.	Return expectations today are now at more modest levels. Brexit risks are now firmly focused on the negotiations and any ensuing trade deals that come from them. These risks will remain for some time and will affect business confidence and investment. The market remains disproportionately sensitive to commodity prices.
European equities Relative to developed	●	↔	The European growth recovery continues apace while the ECB continues to purchase corporate debt as part of its expansive QE program, albeit at a lower monthly rate than in Q1. Valuations remain attractive against the backdrop of generationally low yields and the potential for meaningful earnings growth is very real with European manufacturing indicators supporting strong future growth. Political risk has subsided for now and this backdrop should continue to be supportive of European equities.	The ECB has now reduced the size of their monthly bond purchases and the market is expecting further reductions at the end of the year. This may cause some repricing of risk, albeit for the right reasons. A continued strengthening of the Euro may dampen future earnings if not kept in check and the recent levelling off in equities is testament to this. Political risks remain in Europe, albeit much reduced.	European equity valuations have compressed in recent months but remain reasonable at current levels, especially when viewed against corporate and sovereign European bond markets. We remain optimistic on the economics of the region but are less bullish on valuations today, preferring to add on weakness.

Note: Each asset class is reported on in isolation and should not be used as a relative comparison, unless otherwise stated. These views should not be interpreted as investment advice. Views as at September 2017

Equities	View	Change	Positive	Negative	Our view
US equities Relative to developed	●	↔	The broad US economic outlook remains solid and economic indicators suggest reasonable growth over the medium term. Q2 earnings growth was robust at just shy of 10%, a level which can support the loftier valuation today. The sustained weakness in the US dollar is akin to a loosening of financial conditions and should help drive the overseas earnings of US listed multinational corporations.	The US remains one of the most expensive equity regions in aggregate, with high expectations already priced in. With profit margins having peaked, US equity requires meaningful and sustained double digit earnings growth to justify today's valuation. The Fed's interest rate policy will remain a potential source of uncertainty and any renewed dollar strength could be a headwind to future earnings.	Still the most expensive regional equity market in our valuation framework, but not outlandish on a relative basis and at these yields, and driven at the headline index level this year by technology names. Monetary policy remains key and on the political front we continue to observe how the Trump administration's policies face increasing challenges; There are still many unknowns.
Japanese equities Relative to developed	●	↔	Valuations remain attractive in Japan and our return expectations reasonable compared to other developed market regions. BoJ purchases of equity through ETF structures, as well as the continuing purchase of JGBs, should support prices as long as policy action remains accommodative. Yen weakness would be a boost to export oriented Japanese equities and the currency is at the richer end of its recent range.	A strengthening yen is a problem for exporters and leaves equities exposed to the currency .In real terms the currency is not expensive so there is room for this to happen, but it is likely to come in a risk off situation when the yen traditionally offers some protection as offshore capital is repatriated. Longer term, Japan remains in a difficult position with an ageing population, low/no inflation and little or no economic growth. This could hold domestic equities down.	We continue to favour an allocation to this market with attractive valuations and the government's continuing program to increase equity allocations within pension portfolios and their policy initiatives to improve working practices and corporate governance. The government's pro liquidity policies are welcome but the yen's safe haven currency status could impede returns.
Emerging market equities	●	↔	Valuations remain attractive in emerging markets despite the strong YTD performance. Leading indicators continue to support reasonable growth expectations in isolation as well as versus DM economies. Global policy action remains supportive towards riskier assets. EM currencies in aggregate remain cheap in real terms, which should be supportive for EM assets more broadly.	The asset class may face near term headwinds from any renewed bouts of US dollar strength. The continued moderation in Chinese growth and the economic transition taking place there is a risk to EM more broadly, particularly in the face of tightening financial conditions and efforts to contain excessive credit growth on the Chinese mainland. US trade policy may prove to be a headwind to certain companies and countries should trade agreements be revoked or tariffs introduced. As witnessed recently with North Korea, geopolitical risk is somewhat elevated today so some caution is required.	Valuations are attractive in absolute and relative terms. With slowly improving fundamentals and improving appetite for EM assets among investors, we continue to like the prospective long term returns offered by the asset class today. This remains a volatile section of the equity market -care is required on position sizing – and evolving global trade and tariff policy remains a risk.

Fixed income	View	Change	Positive	Negative	Our view
Government			DM policy remains broadly accommodative in aggregate across DM economies. Bond yields today are under less upward pressure as inflation appears to be rolling over in most regions, notwithstanding the UK where inflation has surprised to the upside High quality government paper remains the ultimate haven in times of elevated risk aversion Real treasury yields do not look unreasonable if growth remains muted and inflation is contained. Moderating inflation expectations have been supporting bond valuations of late.	Extraordinary monetary policy continues to support artificially low bond yields and long term government bonds remain expensive in our view. The reflationary theme has more recently come under pressure but upside risks nonetheless remain and can have mark to market implications for rate sensitive securities. Bonds have performed well in aggregate year to date as forward rate expectations have been pared back to what now appear somewhat overdone levels.	Despite on-going supportive policy actions, on a medium term outlook the majority of government bond yields remain unattractive and the asymmetric risk of potential returns from this asset class remains elevated. There are some relative value opportunities for the more sophisticated investors but it is mostly the diversifying attributes of the higher quality sovereign bonds that warrant any holding today.
Index-linked Relative to government			Realised levels of inflation in the developed world today are mostly low or rising, while inflation breakevens in aggregate look a little cheap. Given the historical stickiness of inflation at levels above breakeven inflation rates, inflation linked bonds in select markets look better value today than fixed rate government bonds.	Inflation linked bonds remain vulnerable to weak economic news flow and renewed weakness in commodity prices. Real yields in the UK are extremely negative and should be expected to rise as monetary policy normalises, causing MTM losses. It is difficult to use inflation linked bonds without accepting the higher duration risk that comes with most inflation linked bond funds.	Like their nominal counterparts, linkers are ultimately expensive. Nonetheless, compared to a conventional government bond, at these levels they do provide some protection against higher realised future inflation, and a cushion to the pure rate risk. In aggregate we think inflation linked bonds are reasonably valued today, with some markets offering better value than others.
Investment grade corporate Relative to government			Investment grade spreads are fairly priced today. At current levels we think investors are adequately paid for the fundamental risk of owning higher quality corporate bonds. IG corporate bonds provide some diversification to riskier assets with their embedded rate risk and higher beta to sovereign bonds.	In absolute terms the duration component of investment grade bonds may prove to be a headwind should government bond yields move higher than what is currently priced in. Financials make up a large part of the investment grade bond universe and we recognise the impact of lower sovereign rates on banks margins and profitability if base rates fall further. The US market is more progressed through the credit cycle today and leverage, whilst not at punitive levels, has been rising.	Investment grade debt remains a decent play against government bonds and an efficient way to earn a higher quality spread whilst retaining some underlying rate protection and traditional diversification. We are cognisant of any debt issuance to support share buybacks, high aggregate debt levels, and increased balance sheet leverage. Asset class duration remains near the highs meaning investors are more sensitive to rate moves today than in the past. We retain a neutral rating today and like the balance it provides in a multi asset portfolio.

Fixed income	View	Change	Positive	Negative	Our view
High yield corporate	●	↔	High yield spreads in both the US and Europe offer a reasonable pick up versus treasuries today. Default rates remain low in non-energy sectors and recovery rates are below long term averages. The ever present ‘search for yield’ will continue to provide support to this asset class. Issuance remains mostly for refinancing and interest is well covered today.	Spreads are somewhat tight today and absolute valuations look pricey. All in yields in European HY paper makes the asset class an un-compelling real return proposition today. The large proportion of energy related issuers could again impact US index returns if the oil price fails to hold in the 40s or higher. Furthermore, the credit cycle is now somewhat extended in the US.	We prefer short duration to core high yield today as scenario analysis suggests a better risk return. On the basis of expected returns we prefer US over Europe today.
Loans	●	↔	Long term some value remains and the spread available on loans is attractive with the additional benefit of a floating rate coupon. Seniority over unsecured high yield bonds also provides additional capital security if defaults pick up unexpectedly. Loans have limited exposure to the energy sector where the risk of capital impairment has been highest in recent years.	Loans sit in a less liquid part of the corporate debt market with wider bid/offer spreads whilst fundamental risks are much the same as for high yield. Covenant protection remains low. We are mindful of sector concentration in healthcare and technology and the use of new issue loan proceeds for acquisitive purposes.	We retain a modestly favourable view on the asset class and today prefer it to high yield bonds in portfolios which can own the asset class. Hold exposure if appropriate to mandate. The floating rate nature of the asset class will be accretive when interest rates rise more meaningfully.
Emerging market debt	●	↔	Spreads and yields today on hard currency denominated emerging markets remain attractive when considering duration, reinvestment risks and opportunities in other asset classes. With the real effective level of EM currencies remaining near lows, this should provide some support to hard currency spreads and local bonds will benefit from any continued dollar weakness.	In the short term, EMD remains sensitive to disappointing global growth, bad economic data, a stronger dollar and ‘risk aversion’ trades as witnessed post-election. Oil price falls will benefit net oil importers to the detriment of EM economies that export. The large weight of the resources sector in a number of EM economies leaves them exposed to slower Chinese growth. The quality of the universe remains investment grade overall but has been deteriorating.	Moderate allocations are recommended at current valuations. Currency risks warrant some caution and as with high yield we favour combining a core duration strategy with a short duration exposure at this time given relative tightness of spreads. Both flavours of sovereign debt should provide reasonable real returns and a decent pick up to DM sovereigns over the longer term,
Convertible bonds	●	↔	Convertible valuations in aggregate remain reasonably attractive today. Following several years of suppressed volatility we expect some pick up going forward which is usually good for option value embedded into convertible bonds. Following a sustained run higher in global equity valuations, the convexity offered by convertibles holds more appeal today.	The call optionality embedded in converts ultimately only has real value if markets increase and the particular stocks in question participate in these moves; if volatility remains at multi year lows that may fail to materialise The US convertibles market has recently exhibited a high ‘delta’ meaning it is more exposed to a repricing in US equities today than it would have been in the past.	Convertible bonds are priced about fair value to their constituent parts. The asset class should always have a place in a multi asset portfolio given the upside participation and downside bond floor and the asymmetric properties they possess, arguably more so today given the extended run we’ve had in equity markets.

Alternatives	View	Change	Positive	Negative	Our view
Commodities	●	↔	The sustained global recovery should be supportive of commodity prices in the near term. Commodities can provide an inflation hedge in client portfolios. Gold can also provide a hedge against event risk in what has become a macro environment sensitive to policy error and news flow. With the US Dollar coming off cyclical highs in real effective terms, commodities have room to price higher should the Greenback continue to weaken.	Strength of final demand is still questionable especially with respect to China where commodity imports have slowed, growth continues to moderate and policy has been tightened in recent months. The asset class more broadly remains prone to bouts of dollar strength that may accompany changing Fed rate expectations. When rates move more meaningfully higher the opportunity cost of taking commodity exposure is higher and commodities may see outflows.	Commodity prices are primarily supply and demand driven, and idiosyncratic factors will drive commodity prices as much or more so than the global economic cycle. Commodities remain sensitive to negative news on global growth. With inflation risk at the lower end of historical levels there is little upward pressure on underlying prices at present. The dollar will likely be the single biggest influence on future returns for the asset class as a whole.
Property (UK)	●	↔	Yields and returns remain reasonably attractive, more so outside the capital, and comfortably above what can be achieved in higher quality UK bonds today. Any renewed pressure on sterling would likely see additional support for property from the overseas buyer.	The UK's economic outlook remains uncertain as the Brexit negotiations slowly move forward We have warned in the past of the dangers of liquidity mismatch and this continues to be a risk in this sector. As a longer duration asset class property remains susceptible to any repricing in long terms bond yields.	Income is attractive versus gilts but there is limited room for capital growth. We also recognise the 'search for yield' lends support to the asset class.

Currencies	View	Change	
USDGBP	●	↓	The Dollar has continued its weak run of form year to date as the 'Trump trade' deflates and inflation fails to gain a hold. The Dollar remains expensive in real terms so the trend lower may continue. Last month we upgraded this pair expecting data in the UK to soften and potentially lead to some forward rate driven divergence, however, in light of the recent higher inflation print and a marked shift in rhetoric from the MPC concerning nearer term rate expectations, we are taking this back to neutral as data dependant downside risk remains in this currency cross.
EURGBP	●	↔	Rate differentials continue to provide little to no carry advantage for the Euro but any additional and unexpected QE tapering will see the common currency push higher. In real terms the currency still has some upside potential but the shifting MPC rhetoric has in the short term driven this pairing lower and near term volatility will likely remain.
JPYGBP	●	↔	With the BoJ maintaining a yield target on its QE bond program and no change in policy rates it is hard to see a fundamental reason for the Yen to under or outperform meaningfully, other than on macro risk concerns as it did recently in August. In real terms however the currency looks somewhat undervalued. This currency cross remains sensitive to risk news but with both currencies looking somewhat cheap on a long term real basis it is difficult to take a strong directional view on this pair today. As with the two other crosses short term Sterling rate volatility will continue to drive in the near term but directionality is harder to call after the recent Sterling rally.

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