

# Schroders

## Multi-Asset Group: Asset Allocation Views

### Summary

Risk assets regained their strength over the past month following better-than-expected macro data and earnings results. This positive trend is likely to continue for longer than we previously envisaged, leading us to close our small short global equities position, taking us to neutral equities overall. However, we have also closed our long position in high-beta Pacific ex Japan equities as valuations are looking stretched, though we have retained our long emerging markets trade.

We continue to believe that the best way to play the recovery is mainly through credit – both high yield and investment grade. Although spreads have continued to narrow considerably, we believe that there are still some gains to be made as investors continue to search for yield.

In anticipation of the next phase of the recovery, we have opened a long industrials versus consumer discretionary position. We have also added a long UK cash against Gilts trade as government bond yields will likely come under pressure as a result of the revival in activity. On the currency front, we have initiated two short positions in the Japanese yen versus the US dollar and sterling, as relative fundamentals should lend support to the latter.

### Top trades – ranked by contribution to risk

<b>Risk increasing</b>
Credit – long
Commodities - long
Emerging market equities (unhedged) - long
<b>Risk reducing</b>
US Treasury bonds (5 – 10 Year) - long
UK large caps – long
USD - long

The above ranking represents where we are seeking to take risk in our Multi asset portfolios. The weight attached to each asset will depend on the conviction of the fund manager and the contribution to risk within the overall portfolio allowing for volatility and covariance with other assets.

### Economic view

Conviction in the recovery continued to gather momentum in the past month, with a sharp improvement in the inventory cycle. The US housing market is also showing signs of troughing while business confidence continues to improve. This positive trend is likely to continue for the coming months leading to upgrades in growth forecasts; however, we remain wary about the strength of the recovery given our continued doubts about final demand and the structural headwinds facing developed economies.

In addition, while the ongoing thawing of the credit markets is positive, the follow through to bank lending is likely to remain weak at best. This, along with the end of the inventory correction, will likely mean that the recovery will falter when the benefits from falling oil prices and fiscal stimulus fade as we head into next year.

### Interest rate view

Against a backdrop of weak growth and low inflation, monetary policy is likely to remain ultra loose for the remainder of this year. However, as the recovery gains traction, we believe that policy rates



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will start to edge up in the latter part of next year with the risk on the upside, but still likely to remain at low levels. We continue to believe the European Central Bank will lag the US Federal Reserve and the Bank of England in normalising policy rates.

### **Market implications**

The continued pick-up in economic indicators has led a sharp improvement in investor sentiment and produced a strong recovery in markets. Although momentum has slowed, we believe that the markets are likely to remain well supported in the near term, as we see better macro data and earnings results coming through.

Against that, we have turned neutral from negative equities overall after closing our small short global equity position. We have also cut back our exposure to Pacific ex. Japan equities as the strength of the rally has lifted valuations to stretched levels, but have retained our high-beta position in emerging markets. At the sector level, we have closed our short position in consumer discretionary versus consumer staples and re-opened the trade with a long position in industrials in anticipation of the next phase of the cycle. We have maintained the short in consumer discretionary as we see a rebalance towards the industrial sector, further supported by global stimulus measures, which are heavily tilted towards investment.

We continue to believe that the best way to play the recovery is through credit – both high yield and investment grade. While spreads have narrowed considerably, there is still upside given the ongoing desire of investors to search for yield by moving funds away from money markets to bonds. However, we have become less positive on bonds overall and opened a long UK cash position against Gilts, as yields in the latter will likely come under pressure as the UK recovery gets underway and funding pressures remain high.

Amongst alternatives, we have turned less negative on property, which is showing early signs of having bottomed after significant price falls, and remain positive on commodities.

### **Currencies**

Our key currency exposure remains in emerging markets, where their economies are relatively less exposed to the credit crunch versus their developed peers. From a structural perspective, emerging economies are also more attractive with balanced external positions and plentiful savings.

We have also become more positive on sterling by opening a long position versus the Japanese yen. This trade is positively correlated with risk assets while an early recovery in the UK relative to Japan should mean that interest rate differentials will lend support to this trade. From a valuation perspective, sterling also remains close to fair value with scope for gains. Similarly, we have also added a long US dollar against the yen position, as relative fundamentals and the return of risk appetite should justify a stronger dollar.

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