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Schroders

Schroders Multi-Asset Investments
Monthly views
June 2018

Back to basics

Political issues continue to dominate the headlines - tariffs, North Korea, Brexit and European populism - and in most cases the **political environment suggests some caution** is warranted. While tweets and elections get the most attention, we actually view political risk as a chronic headwind.

The lack of progress for "the many" has resulted in a more extreme political environment as people look for **new solutions to the lack of economic growth** and this is likely to be true for months (and possibly years) to come.

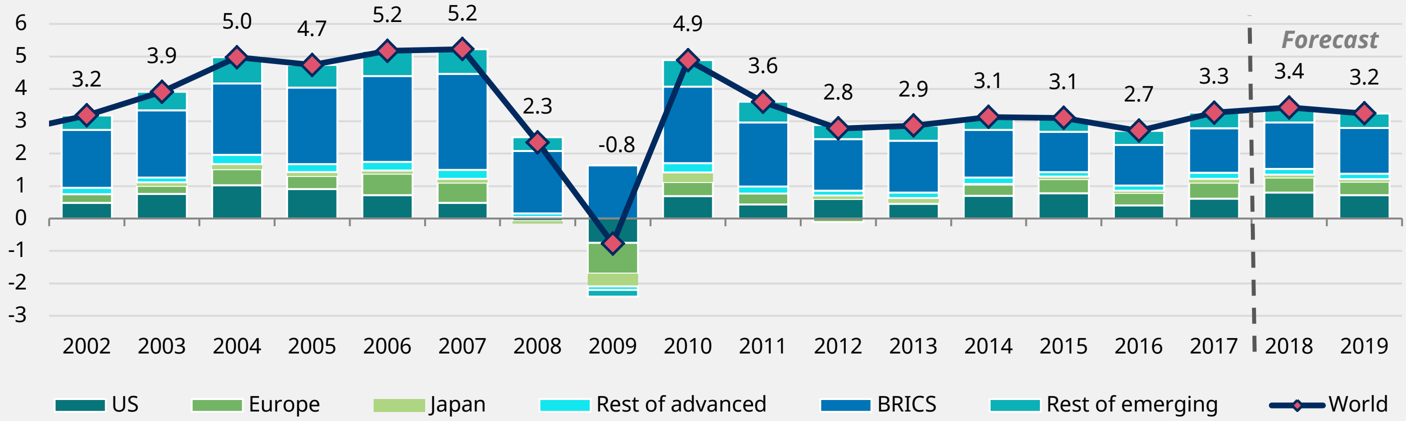
However, for the summer we would urge investors to focus on more traditional concerns, namely: **the liquidity environment.**

At the beginning of the year we stated that **"3 was the magic number"** in that we expected global GDP growth to remain stuck around 3%, and we viewed a 3% yield on the US 10-year Treasury as a challenge to US equity valuations.

Since then global GDP growth has remained around 3%, which is a benign development, but US yields keep pressing on 3% and more importantly, the **European Central Bank may soon join the Federal Reserve** in unwinding its emergency monetary measures through quantitative tightening.

As stated before, this poses a speed limit to returns and we are progressively shifting the portfolio to a less equity-centric, more cautious stance.

Contributions to World GDP growth (y/y)



Source: Thomson Datastream, Schroders Economics Group, 25 May 2018. The forecasts should be regarded as illustrative of trends. Actual figures will differ from forecasts. Please see Important Information regarding forecasts.

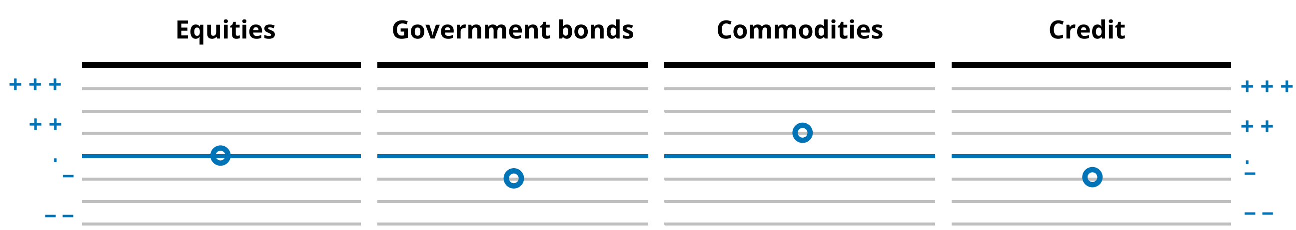
So far our emphasis has been on allocating out of equities into assets that are less vulnerable to stagflationary risks such as Treasury inflation-protected securities (TIPS) and commodities.

To the extent that we own **government bonds**, we have favored Australian government bonds, but US bonds are also starting to offer some value relative to their European counterparts.

After their recent wobble, **emerging market currencies** look cheap and we own them. The tightening of dollar liquidity remains a challenge as we head into the summer however, and so we are offsetting some of our emerging market risks. We're doing this through long positions in the **Japanese yen against the euro**, as this cross tends to benefit from risk aversion, particularly given the **potential for European political stress.**

As markets reprice to reflect the tightening of liquidity, we may see some good opportunities to re-enter risk positions in the autumn. **For now, we remain patient and vigilant.**

Current outlook



	Category	View	Comments
MAIN ASSET CLASSES	**Equities**	0 ▽	We have downgraded equities to neutral, reflecting our more cautious stance. Positive earnings revisions have become less widespread recently and a number of upcoming political events could lead to heightened risk aversion.
	Government bonds	-	We remain negative on duration overall. Valuations have improved, but are not yet attractive enough. Cyclical and technical factors are still negative.
	Commodities	+	The cyclical environment remains supportive, leading to strong fundamentals for most commodities. Momentum and carry continue to add support.
	Credit	-	The late phase of the cycle and monetary tightening continue to create meaningful headwinds.

	Category	View	Comments
EQUITIES	US	+	The US continues to be the most resilient economy and the source of many upward earnings revisions.
	UK	0	We remain neutral on UK equities due to the continued risk of sterling appreciation and uncertainties around on-going Brexit negotiations.
	Europe	0 ▽	We have downgraded Europe to neutral. Cyclical indicators reflect that Europe is in a slowdown and earnings momentum has weakened. Political risk is also in focus again.
	Japan	0 ▽	We have downgraded Japan to neutral. Recent weakness in macroeconomic data and cyclical indicators point to a slowdown. Further yen strengthening would be a risk.
	Pacific ex-Japan	0 ▽	Downgraded to neutral. Within the region, we favor Singapore – where the outlook has steadily improved – over Australia – whose economy faces structural challenges.
	Emerging markets	+ ▽	We have downgraded to single positive. Valuations are relatively attractive, but trade tensions, elections and a stronger dollar may be near-term headwinds.
GOVERNMENT BONDS	US	-	Still expensive against a backdrop of a negative term premium, a large increase in supply and higher currency-hedged yields available in Europe.
	UK	- ▽	We have downgraded gilts to negative, leaving our score in line with other major markets and because of recent outperformance.
	Germany	-	Weather and cautiousness may slow the ECB, but normalization is underway. QE is due to taper in Q4, ending by year end, removing support from Bunds.
	Japan	0	No change. The Bank of Japan's firm stance in April suggests that it is still too early to downgrade this market.
	US inflation linked	+	We remain positive on breakevens but are becoming more cautious as initial targets have been hit and seasonality is expected to turn negative.
	Emerging markets local	0	We remain neutral after last month's downgrade. Carry is still positive, but downside risks have grown.

IG CREDIT	US	-		The increase in funding costs is likely to put forward pressure on coverage ratios.
	Europe	-		Despite the year-to-date widening, spread valuations do not yet look completely attractive.
	Emerging markets USD	0	△	After the recent selloff, we used the opportunity to upgrade to neutral. Valuations are still not compelling but carry is more attractive.
HY CREDIT	US	0		This is the best performing market year-to-date, but the margin for error continues to be limited so we remain neutral.
	Europe	0		Risk sentiment has weighed heavily on spreads, especially for those names with high exposure to Italy.
COMMODITIES	Energy	+		Global oil demand for remains stable, particularly from China and India, while falling Venezuelan output and upcoming sanctions against Iran remain supportive.
	Gold	-		We remain negative on gold, which we expect to struggle in an environment of rising real yields and the stronger US dollar.
	Industrial metals	+		Continue to look attractive against a backdrop of globally synchronized growth and a strong and stable Chinese economy. Momentum has also recently strengthened.
	Agriculture	+		Favorable supply/demand dynamics lead us to retain a positive view.
CURRENCIES	US $	0		We believe that temporary factors such as trade protectionism and political risk will keep the USD stronger than its fundamentals imply.
	UK £	-		GBP is still driven by Brexit newsflow. Our negative view is unchanged as we still see GBP as being vulnerable to further growth and inflation downgrades.
	EU €	0		We believe that European economic activity will recover from recent weakness, with the European Central Bank announcing the end of quantitative easing this year.
	JPY ¥	0		We think any strengthening of JPY would stem from its hedging properties rather than its fundamentals, particularly as the JPY continues to be cheap within the G10 space.
	Swiss ₣	0		We continue to hold a neutral view on CHF and we don't expect the Swiss National Bank to change its current policy.

Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested.

Source: Schroders, June 2018. The views for equities, government bonds and commodities are based on return relative to cash in local currency. The views for corporate bonds and high yield are based on credit spreads (i.e. duration-hedged). The views for currencies are relative to US dollar, apart from US dollar which is relative to a trade-weighted basket.

Important Information