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Snapshot

Multi-Asset Investments

Monthly views

August 2019

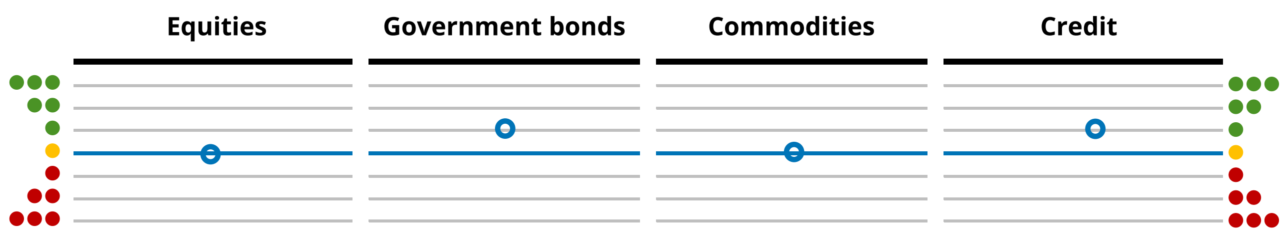
Outlook

All year we have been focused on two inter-linked and somewhat offsetting trends: ample central bank liquidity and a weakening economic cycle. These two trends continue to intensify, with more central banks joining the “cutting club”, and the risk that political events (trade tensions, Brexit, etc.) might push an environment of anaemic growth into outright recession.

The challenge we face is that over a third of global government bonds now trade at negative yields, which leads to a somewhat speculative search for yield. Effectively, we are confronted with the choice of owning ever-more expensive assets, sitting in low/negative yielding cash or rotating into cheap, cyclical assets. Given the absence of positive cyclical catalysts, we are sticking with our ‘expensive’ positions for now; namely, carry strategies such as high yield debt and FX carry, duration (with a shift to the longer end of the yield curve), defensive/growth equities and gold. All of these positions tread a careful line between benefiting from the liquidity environment without taking too much cyclical risk. Long US dollar positions should act as a hedge against disappointment on the liquidity front.

An improvement in the trade war rhetoric between the US and China would prompt a relief rally, but it is difficult to predict tweets, and there is evidence that the underlying tone of global trade is weak irrespective of the political environment. Another positive surprise could come if the Federal Reserve (Fed) were to become even more aggressive, which would likely weaken the US dollar and hence loosen global liquidity conditions. Finally, with monetary policy unable to have a real impact on economic activity, we could see a more forceful fiscal response. We prefer to be patient for now.

Monthly views



Key

●●● Maximum positive ● Neutral ●●● Maximum negative △ Up from last month ▽ Down from last month

Schroders

	Category	View	Comments
MAIN ASSET CLASSES	Equities	🟡	Remain neutral on equities, in part due to seemingly stretched valuations and an anaemic backdrop for growth.
	Government bonds	🟢	Although valuations look stretched, positive momentum and soft cyclical indicators point towards maintaining a positive view on bonds as defensive positions in portfolios.
	Commodities	🟡	We remain neutral overall on commodities, with negative carry and momentum offset by our positive view on gold as a hedge against increased liquidity and geopolitical risks.
	Credit	🟢	Although credit spreads tightened in June, supportive technicals and a more benign backdrop for credit offset longer-term concerns over fundamental credit quality.

	Category	View	Comments
EQUITIES	US	🟢	Valuations have deteriorated slightly, but momentum remains amongst the strongest in the major markets.
	UK	🔴	Uncertainties around political leadership may keep investors away from UK equity markets and the risk of a sterling bounce in the longer term is a concern.
	Europe	🟡	We remain neutral. A dovish Fed may lead the US dollar to weaken against the euro and cast doubt on the recently improved European earnings outlook.
	Japan	🟡	Export weakness and a strong yen continue to be a drag for equities despite an improving domestic economy.
	Pacific ex-Japan	🟡	Singapore export weakness is negative for the region and momentum is lagging. We continue to hold a neutral view.
	Emerging markets (EM)	🟡 ▽	Renewed pressures from trade conflicts raise risks for those markets with an export focus.
GOVERNMENT BONDS	US	🟢	No change to the conditions that prompted last month's upgrade. The cyclical outlook still looks weak and US-China trade war rhetoric shows few signs of abating.
	UK	🟢	Gilts could profit from further political uncertainty in the UK and in particular, the increasing threat of a "No-Deal" Brexit.
	Germany	🟢 ▽	Downgraded to single positive. Increased liquidity, investors seeking yields higher than cash rates and the European Central Bank (ECB) opening the door to stimulus should benefit longer duration bonds.
	Japan	🟢	Given export weakness on the back of the continuing trade war situation, we remain positive.
	US inflation linked	🟡 ▽	Downgraded to neutral as declines in oil prices will limit year-on-year inflation numbers in H2 2019.
	Emerging markets local	🟢	We remain positive. More dovish tones from major central banks should provide support as investors search for yield.
IG CREDIT	US	🟢 △	Upgraded to positive as it offers slightly more attractive valuations against an unusually benign backdrop.
	Europe	🟡 ▽	Downgraded to neutral, as increasing leverage is making any deterioration in earnings or increase in interest costs a potential negative catalyst.
	Emerging markets USD	🟡	We remain neutral. Spreads tightened again in June, leaving valuations still looking unattractive.

HY CREDIT	US	△	Upgraded, as although concerns over fundamental credit quality remain, they are offset by supportive technicals and a more benign backdrop for credit.
	Europe	▽	Downgraded as valuations have become less appealing after the recent spread tightening, and fundamentals are weakening.
COMMODITIES	Energy		As OPEC struggles to agree the next output cuts, the impact of mounting geopolitical tensions is offsetting the effects of weakening economic sentiment.
	Gold		Gold is being supported by dovish Fed comments and picked up further momentum on the back of escalating geopolitical tensions in the Middle East.
	Industrial metals		With the upside capped by cyclical headwinds and downside limited by central bank dovishness and increased Chinese fiscal stimulus, we remain neutral.
	Agriculture		Remain negative given the decreased possibility of a trade war resolution, coupled with bad weather and a negative carry.
CURRENCIES	US $		We remain neutral as we expect both further softness in global growth and the global central bank "race to the bottom" to keep currency volatility low and non-directional.
	UK £		Our view on the pound remains negative as the increased probability of a "no-deal" Brexit compounds the effects of weak economic data.
	EU €		The ECB's recent movement towards increasing stimulus is a headwind for the euro so we maintain our neutral view.
	JPY ¥		The yen's safe-haven status could prove beneficial in an environment where economic weakness persists.
	Swiss ₣		Contagion from weak European industry is impacting Switzerland, leading us to keep our neutral position on the Swiss franc.

Source: Schroders, August 2019. 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 the US dollar which is relative to a trade-weighted basket.

Important information