Schroders

Schroder Multi-Asset Investments
Monthly views

February 2019

Global economic data continues to be soft but central banks have generally reacted by stepping back from tighter monetary policy, helped by muted inflationary pressures.

Against this backdrop, we believe there is an opportunity for risk assets to move modestly higher, but we do not want to take too much cyclical risk. As a consequence, we are emphasizing carry in our strategies – US high yield, European investment grade, and currency carry.

The US 10-year Treasury yield has rallied and is close to our target of 2.5%, so we have reduced our portfolio positions in US bonds. We still like having interest rate sensitivity in our portfolios given the ongoing risks to growth, but are now favoring positions which offer better carry, such as Korean rates versus Japanese rates.

In Q4, we judged that the US dollar was too expensive, and established positions that are negatively correlated with the US dollar, namely gold and emerging equities versus European equities.
Within the US, we believed that small caps looked oversold, and added exposure to US small caps versus US large caps.

After the fall in US Treasury yields in December and January, we now see limited opportunity for further rate convergence between the US and the rest of the world. This leaves us more neutral on the US dollar. We are reducing portfolio sensitivity to a weaker US dollar by increasing our exposure to Japanese and European equities at the expense of the US and the UK.

The key risks to our view are:

A) World ex-US continues to decelerate

and / or

B) US rate tightening in Q2 as the US remains at full employment.

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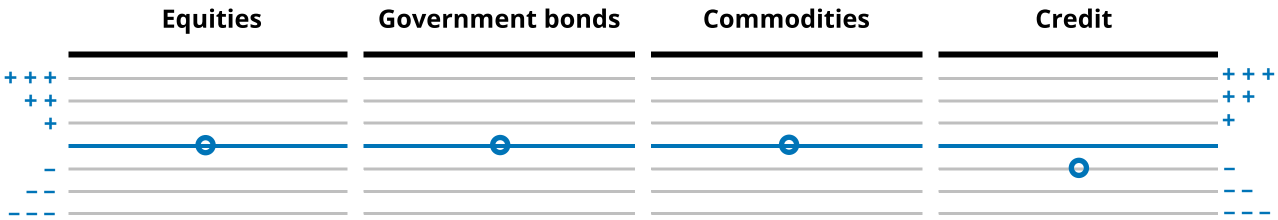

	Category	View	Comments
MAIN ASSET CLASSES	**Equities**	0	The improvement in investor sentiment following the recent change in the Federal Reserve's (Fed) policy stance is supportive, but we still expect equities to trade within a range, albeit with heightened volatility.
	Government bonds	0	Weaker economic growth supports bonds overall, despite some expensive valuations. Our score remains neutral.
	Commodities	0	Gold should benefit from lower interest rates, while energy remains volatile.
	Credit	-	January saw an unusually strong and uniform rally across credit sectors. Continued policy tightening has seen most credit categories recover significantly from their lows at the start of the year.

	Category	View	Comments
EQUITIES	US	0	With the recent change in the Fed's policy stance, worries over "recession in 2020" have softened and are likely to support investor sentiment in coming weeks, but risks to the earnings outlook remain unanswered.
	UK	- ▽	Downgraded, as UK equities are likely to see the support from a weaker sterling decline .
	Europe	-	European equities appear cheap but this is warranted, in our view, given the political and cyclical challenges facing the region.
	Japan	0	Japanese equities have underperformed global equities in local currencies in recent months, despite improved valuations and stable economic growth. Lack of confidence - particularly among international investors - remains a challenge and is likely to take time to resolve.
	Pacific ex-Japan	0	Asia would benefit if trade war tensions fade. However, many countries are seeing weakness in their housing markets with a knock-on economic impact.
	Emerging markets (EM)	+	EM forward valuations are now back to 2015 levels after the large sell-off in 2018. The Fed pause and Chinese stimulus are likely to provide support for EM equities while investors continue to wait for resolutions of US-China trade conflicts.

GOVERNMENT BONDS	US	0	US bond yields look fairly priced after the recent dovish move by the Fed.
	UK	- ▽	The bond market is not pricing in enough hikes for the UK. There will possibly be a hike, as indicated by the Bank of England, if there is a Brexit resolution.
	Germany	0	European data continues to disappoint, and our view is that German growth is being suppressed by fears of a European recession.
	Japan	0	Japanese activity data continues to show weakness in external demand and the manufacturing sector. The headwinds are also being reflected in Japanese earnings.
	US inflation linked	+	We maintain a positive view that US breakevens offer value.
	Emerging markets local	0	We remain neutral. Whilst cyclical (dollar) and technical (outflows) factors have improved, valuations have already moved back to long-term averages.

IG CREDIT	US	-		Spreads do not yet appear excessive when compared to recent historical highs (2011 and 2016). We remain concerned about the deterioration of credit quality in the universe.
	Europe	0	△	We are of the view that European investment grade spreads offer better short-term value, particularly should our core "muddle-through" scenario for the eurozone prove right.
	Emerging markets USD	0		Following a challenging December, there were positive excess returns which may well continue in the near term given the accommodative backdrop.

HY CREDIT	US	-	Remains stable for now although expensive on a historical basis. Strong levels of interest coverage support US high yield (HY) for the moment.
	Europe	-	Despite recent inflows, it is too early to say whether this represents a secular shift, as this would require stabilization in economic data and an improved political backdrop.

COMMODITIES	Energy	0	The oil market in 2019 looks largely in balance but we expect heightened volatility.
	Gold	+	Despite the equity market rally, gold has not given back the gains it made through the equity market tumble in December thanks to a dovish Fed and weaker US dollar (USD).
	Industrial metals	0	Industrial metals have limited upside unless China introduces large-scale fiscal initiatives.
	Agriculture	+	Agriculture remains our preferred way to gain exposure to the political premium of US-China negotiations, supported by favorable valuations and weather risks.

CURRENCIES	US $	0	We remain neutral on USD as both global and US growth are slowing down, causing the Fed to pause their hiking cycle and loosen liquidity conditions marginally.
	UK £	0	The outlook is uncertain whilst awaiting the Brexit negotiations to be concluded; economic growth is slowing and that should increasingly weigh on the currency.
	EU €	0	We see the euro staying range-bound, hemmed in by both the dovish Fed and the European Central Bank, which is turning less hawkish as economic growth weakens in the eurozone.
	JPY ¥	+	The Japanese Yen remains an excellent hedge against slowing global growth. We expect the currency to strengthen as US yields decline in response to coincidental slowing US growth.
	Swiss ₣	0	The Swiss franc (CHF) has weakened as risk conditions have improved and is at the bottom of its trading range. We expect ultimately weak growth fundamentals to trump liquidity, meaning that chasing CHF weakness is not justified.

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, February 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 US dollar which is relative to a trade-weighted basket.

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