EDMOND DE ROTHSCHILD

ASSET MANAGEMENT

ASSET ALLOCATION STRATEGY

MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES

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« We are maintaining our asset allocation focus on risk assets »

Over the last ten days, markets have been focusing on who might win the US elections with the latest opinion polls fuelling uncertainty. Investors would prefer Hillary Clinton to win but a Democrat victory in Congress, which would give her total control, would be viewed in a negative light, especially for sectors like healthcare and financials.

On the other hand, a Trump victory would clearly be bad news for risk assets because it would mean little visibility on future domestic and geopolitical trends. However, fears over the Republican candidate's programme would be assuaged if his party failed to hold on to its majority in Congress. This state of play has led us to use derivatives to tactically hedge our portfolios against election risk.

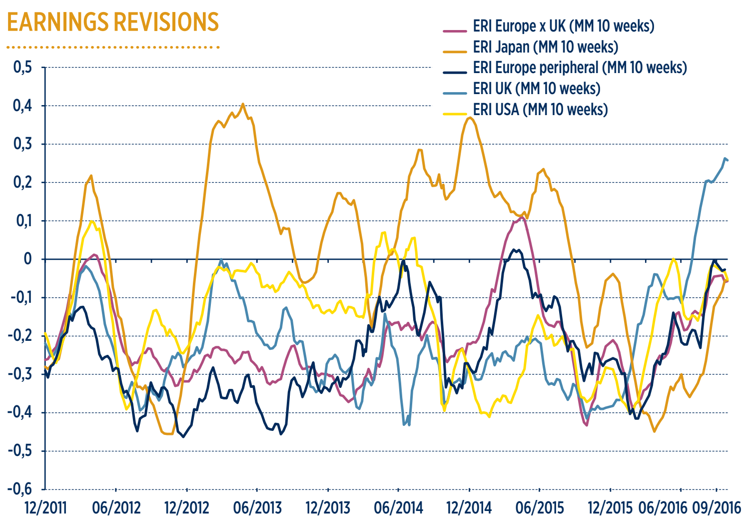
EARNINGS ESTIMATES HAVE STARTED TO STABILISE

There are 3 main reasons why we remain upbeat on risk assets, and why we are primarily overweight European equities, but also emerging country and Japanese equities:

- The macroeconomic environment has improved. Surveys suggest global growth has generally picked up and, most importantly, it is now more synchronised. China's reflationary policies are bearing fruit well beyond its borders and are without doubt playing a big part in this global resynchronisation. Nevertheless, China's economic recovery is far from stable as it is financed with credit and property markets in large cities have once again become highly speculative. This means we should be cautious about the current rebound even if, over the short term, we also have to factor it into our analysis.

- Elsewhere, as the graph demonstrates, analysts' earnings estimates have started to stabilise after a period of downgrades.

- As for equity markets, the S&P has clocked up more than 10 down sessions in a row so increased risk from the run-up to the US elections has already partly been discounted.



Sources: Citigroup/Bloomberg

KEY POINTS

- Overweight European equities
- Also overweight emerging country and Japanese equities but to a lesser extent
- Underweight US Treasuries

INCREASING CONCERNS OVER QE

Government bonds came under pressure in October, especially in Europe where the yield on the German 10-year Bund rose by 25bp. This was due to global deflationary pressures waning amid a recovery in China's economy but also stemmed from more favourable base effects for inflation.

Doubts on the sustainability of the ECB's quantitative easing programme also weighed on sentiment. A number of market rumours triggered this new thinking. We, however, remain unconvinced that the ECB will soon start tapering. Inflation is weak and the eurozone recovery is far from being evenly distributed. This recent tension on sovereign bonds is not, in our view, enough to make us revise our (rather prudent) management of sensitivity and we are still concentrating our underweights on US Treasuries.

	Our convictions for November*	Changes compared to the previous month
EQUITIES	+	→
US	=	→
Europe	+	→
Euro	+	→
United Kingdom	=	→
Japan	=/+	→
Emerging countries	=/+	→
FIXED INCOME	=/-	→
US	=/-	→
Euro	=/+	→
Investment Grade	=/+	→
High Yield	=/+	→
Money market	-	→
DIVERSIFICATION		
Convertible bonds	=	→
Dollar	+	→

*Range of investment committee ratings on the asset class/geographical zone (from -/- to +/+).
Source: Edmond de Rothschild Asset Management (France). Ratings at 07/11/2016.

NEXT HEADLINE EVENTS

- ***Next ECB meeting on December 8***
- ***Next Fed meeting on December 13-14***
- ***Next BoJ meeting on December 19-20***
- ***Italy's referendum on December 4***

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