EDMOND DE ROTHSCHILD

ASSET ALLOCATION STRATEGY

MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES

FEBRUARY 2019

CENTRAL BANKS HAVE CALMED MARKETS DOWN

► Central banks are continuing to dictate market momentum and never more spectacularly so than in January. The fourth quarter market crash occurred after the Fed had confirmed that its balance sheet shrinkage and rate-hike schedule were on autopilot even amid increasing signs of an economic slowdown in China and Europe.

BENJAMIN MELMAN
CIO Asset Allocation and Sovereign Debt

KEY POINTS

Profit taking on European and US equities

Overweight emerging country equities

THE FED AND ECB PERFORMED AN ABRUPT ABOUT-TURN

The sell-off turned into a rebound as soon as Jerome Powell, speaking on January 4, struck a much more accommodating note. The rally continued after the January 30 FOMC when the Fed made its new position more official by saying it would be "patient" over rate hikes and that its balance sheet contraction would be less drastic than planned.

The ECB followed suit by declaring that it was in tune with the market view which holds that the bank will be unable to raise rates this year even though it had previously always said it would.

In only a month, both the Fed and the ECB have significantly changed their tune. Now the only news we can expect from them, and for an indefinite period, should be on the side of easing rather than tightening, i.e. less stringent balance sheet contraction from the Fed and possibly a new TLTRO from the ECB. Central banks have in fact calmed markets down by lifting the concerns investors had in the fourth quarter.

EMERGING COUNTRY EQUITIES COULD GAIN FROM AN UPTURN IN CHINA'S ECONOMY

We have taken tactical profits on European and US equities while remaining overweight emerging country equities. We reckon that once markets have factored in more pronounced central bank neutrality they will focus more on the economic situation and political risk. And there are still signs of an economic slowdown, especially in Europe where the outlook for Germany's manufacturing industries is more and more downbeat while political risk remains.

Emerging country assets have significantly outperformed in recent weeks, underpinned by the Fed's new patient stance and optimistic reports on how the US-China trade talks are going. Nevertheless, this good news is beginning to be more or less factored into stock prices. We are sticking with our emerging equity overweight because we expect, and it is not a very consensual view, that China's economy will turn upwards.

	OUR CONVICTIONS FOR FEBRUARY*	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 05/02/2019.

NEXT HEADLINE EVENTS

Next ECB meeting: March 7

Next Fed meeting: March 14 & 15

Next BoJ meeting: March 19 & 20

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