EDMOND DE ROTHSCHILD

ASSET ALLOCATION STRATEGY

MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES

MARCH 2019

THE MARKET REBOUND COULD RUN OUT OF STEAM

The risk asset rebound continued in February with not much investor conviction, judging from the modest equity market inflows since the beginning of the year. This is hardly surprising because, apart from central banks reverting to a neutral stance on interest rate rises, fundamentals have not radically change since the big sell-off in the fourth quarter of 2018.

BENJAMIN MELMAN
CIO Asset Allocation and Sovereign Debt

KEY POINTS

Reduced exposure to emerging equities

Emerging bond weightings raised

Slight increase in US dollar exposure

REDUCED CONCERNS OVER LIQUIDITY

As has already been pointed out here, we are convinced that central banks played a big role in December's plunge. A restrictive approach to balance sheet management from the Fed and ECB triggered a rapid contraction in liquidity expansion across the globe. Huge concerns over liquidity have since been lifted thanks to the Fed's decision to end quantitative tightening in the near future and the possibility that the ECB might introduce another wave of long term loans via its TLTRO programme. Investors are also now convinced that the Fed's rate hike cycle has ended and that the ECB is a long way from its first episode of monetary tightening. In other words, the market rebound is warranted and risk seems for the moment to have waned.

RISKS HAVE NOT GONE AWAY

The US economy is currently robust and there are advanced indications that loans to the economy and infrastructure investment could help China's economy gradually recover, our preferred economic scenario. Even so, the fundamental situation lacks strong direction for the moment and is unlikely to significantly strengthen the rebound if it continues.

Valuations have returned to normal but some risks persist. Investors had been very pessimistic over trade talks but have now turned remarkably optimistic after encouraging comments from Donald Trump and Xi Jinping; after all, it is in the interest of both to find a solution. But we should not overlook the complexity of the issues at stake nor the possibility that only a minimal agreement might be reached, leaving other disputes hanging in the air.

THERE IS NO LONGER ANY REASON TO BE OVERWEIGHT EQUITIES

Markets in the coming weeks could well be a little more hesitant and we see no reason to remain overweight equities. We are reducing exposure to emerging country equities. They have already seen a significant upturn in investor flows, so much so that

we cannot help wondering if they have not become too consensual. We are also raising emerging country bond weightings as they should continue to rise thanks to the Fed's benevolent neutrality.

We remain underweight the US dollar but are raising exposure a little. The greenback has been stable against other major currencies even if logically it should have slipped back after the Fed's monetary policy shift. As this easing has now been discounted by investors, downside pressure on the dollar has fallen.

NEXT HEADLINE EVENTS

Next ECB meeting: March 7

Next Fed meeting: March 14 & 15

Next BoJ meeting: March 19 & 20

	OUR CONVICTIONS FOR MARCH*	CHANGES COMPARED TO THE PREVIOUS MONTH
EQUITIES	=	→
US	=	→
Europe	=	→
Euro	=	→
United Kingdom	=	→
Japan	=	→
Emerging countries	=	↓
FIXED INCOME	-	→
US	=	→
Euro	-	→
Investment Grade	-	→
High Yield	=	→
Emerging markets	=/+	↑
DIVERSIFICATION		
Convertible bonds	=	→
Dollar	=/-	↑
MONEY MARKET	+	=

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

Ratings at 01/03/2019.

EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)
47, rue du Faubourg Saint-Honoré, 75401 Paris Cedex 08
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and a supervisory board with capital of €11,033,769
AMF registration No. GP 04000015 – 332.652.536 R.C.S Paris

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