


# Asset Allocation Dashboard




■ Positive
 ■ Neutral
 ■ Negative

Asset class	View	Comments		
Equities		Positive	Negative	Our view
Developed equities	■	The continued and concerted efforts of governments and central banks, reasonable news from the Eurozone and moderately positive developed markets macro data have been very well received, and continue to push markets up. Additionally corporates are generating healthy levels of profits, and by standards of the last few decades, equities are relatively cheap.	Many risks remain. The global macroeconomic situation continues to be uncertain. Despite some positive data surprises globally of late, there is little reason for macro economics to become a significant driver of markets in the short term. Policy risks are a potential source of volatility.	While economic news has been better in recent months, the idea that the issues facing the global economy are now resolved is too simplistic. At these valuation levels we view a broadly neutral allocation as appropriate. The main tactical risk is how far markets have come from the middle of 2012. Today there is a risk of complacency, although markets seem a little more skittish than at the end of 2012. Policy is key for markets today.
UK equities Relative to developed	■	A marginal green on our colour code. This is our favourite developed market. Valuations are better than elsewhere and there is less systemic risk than Europe.	The UK's economic outlook remains relatively poor (but not yet truly recessionary and indeed some green shoots have emerged recently).	UK is reasonably attractive, but remains vulnerable to resource price normalisation given its over-sized allocation to resource companies and knock on effects from the EU.
European equities Relative to developed	■	The cheapest market with the lowest investor expectations and the highest dividends. Sentiment remains very low, despite the market containing many global companies.	Economic data remains weak. Sovereign risks continue to dominate, and the banking sector in many countries remains fragile (e.g. Cyprus). There is no reason to expect this to change any time soon. The situation will remain tense, even when it falls from the headlines. Furthermore, the potential for the re-emergence of political risk in the periphery is worth noting. The Italian political intransigence highlights how unpopular austerity is outside of political classes	Europe remains cheap, but does not qualify for the "fat pitch" that we look for. It is also the most over indebted developed region. Small, selective positions at most are recommended. Ultimately the macro story and the lack of a valuation extreme suggests caution in this region. Longer term, Europe needs some sort of political and banking consolidation, but the ECB is calming the waters for now.
US equities Relative to developed	■	The US economic outlook remains the best among major economies. Thus far they have been the beneficiary of reasonable news flow in 2013. Some economically significant sectors like housing, are recovering and corporates remain in good fettle. Overall the corporate sector is in good shape.	The most expensive equity region, with low dividend yields and high investor expectations already priced in. The US is the one country not yet to have announced a proper austerity plan and spending continues apace – and there is certainly little room for one in current market pricing. Prolonged intransigence over the fiscal cliff or debt ceiling could weigh on US equity and there is a short term risk that too much good news is priced in. The sequester issues gave the market cause to pause, but did not have a catastrophic impact.	Consistently the most expensive market. Despite the better US news flow, it warrants a small underweight. But again this is not a "fat pitch". Be cautious on sizing. Investors can buy very similar companies elsewhere for less.
Japan equities Relative to developed	■	The market has responded well to the recent governmental and central bank changes. Despite coming a long way, a number of valuation measures do suggest Japanese equities are cheap. The recent weakening of the yen will help exporters.	When adjusted for differing accounting standards Japan in fact looks no cheaper than Europe and comes with considerable uncertainty. Additionally the (still quite) strong yen, the dull economic backdrop and demographic headwinds are a long term concern. The market has moved a long way in recent months and could be due a pause.	The government's pro liquidity policies are welcome – and a weaker yen helps – but inconsistent data readings and a habit of not 'mean reverting' make this a difficult market to call. Neutral.

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Equities		Positive	Negative	Our view
Emerging market equities		A marginal green on our colour code. While historically we have been cautious of emerging markets, today emerging market stocks appear a reasonably interesting opportunity. The valuation differentials between developed markets and emerging market stocks are now relatively modest, highlighting the unwinding of some of the valuation excesses of the prior years.	Recent data continues to highlight the fact that emerging markets are unlikely to decouple from developed equities. Exports in particular remain highly linked to global growth. China remains as murky as ever. The Chinese government appears satisfied to move from a higher quantum of growth to a higher quality of growth	Overall a more circumspect view of the region is being taken compared to the over optimism of a year or so ago. Globalisation works both ways.

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Fixed income		Positive	Negative	Our view
Government		No obvious catalyst for a sell off in the short term. Central banks (and liability driven investors) continue to buy huge volumes of government bonds. Despite some reasonable economic data, treasury yields could stay low for years. High quality government paper remains the ultimate haven in times of elevated risk aversion.	Long term, government bonds can only be described as expensive. Real yields across the world are negative and are clearly pricing in some kind of 'Japanification' of the West. Yields could move out quickly, in which case holders would suffer capital losses.	There is no point in trying to gauge the exact top of the bond rally. So be cautious - move slowly on duration. But investors should incrementally increase their government bond underweights.
Index-linked Relative to government		Given the stickiness of inflation at levels above breakeven inflation rates, linkers look like a more reasonable way of investing in government bonds than the fixed rate government bond market. Recent history suggests projected inflation decreases are over optimistic. A marginal red today.	Linkers will be vulnerable to weak economic news flow. Real yields are still very low, so while these should protect capital value, linkers will not do any more.	At today's price levels, these may not be a bad insurance play (against inflation) but like all government paper, linkers are ultimately expensive. Nonetheless, compared to a conventional government bond they could provide some protection against the risk no one is thinking about - inflation.
Investment grade Relative to government		Investment grade spreads - a measure of relative value compared to government bonds - remain moderately attractive. Investment grade corporate balance sheets are in good health and in many instances arguably better than governments. Good quality corporates are able to access debt markets extremely cheaply - bodes well for the future.	Versus the wides of 2008 spreads are very low. In absolute terms, rather than relative, the duration component of investment grade bonds will be a headwind, if bond yields move higher. While spreads are reasonably attractive, nominal yield levels are not particularly compelling compared to their history due to low reference (government) rates.	Investment grade makes a decent play against government bonds. Our positive views on credit mean investment grade is a reasonable replacement for government debt. Should also benefit from strong technicals of any further liquidity measures. While still a reasonable yield opportunity today relative to governments, looking forward this trade seems to be running out of road - especially if attention is only paid to nominal yield levels. Still green, but proceed more cautiously than a few years ago.

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High yield	■	Remains a popular fixed income asset class. Currently pricing in a typical recession, unlike equities whose valuations are indicative of a recovery of sorts. Hence offer a more defensive position. This asset class has moved to a marginal amber on the basis that valuations today are approximately 'fair' Default rates remain very low.	Significant systemic risks remain, notably concerning the European situation. Headline yields, rather than spreads, remain low by historical standards. Main risk is that default rate surprises from these low levels or that recovery rates fall. While spreads are reasonably attractive, nominal yield levels are not particularly compelling compared to their history and nominal price levels are high.	Remains something of an attractive play for the post credit crunch world. Investors are still reasonably rewarded for lending to companies. Given the level of spreads, today we are increasingly cautious, but remain overweight. As with investment grade, nominal yields are reasonable but not exceptional. Positions should be moderate today. Consider shorter duration paper. Hold today rather than add.
Loans	■	Long term value looks good. Loans share much of the spread story as high yield, though arguably slightly more attractive, thanks to the floating yield. Continue to hold small overweight if appropriate to mandate.	Significant systemic risks remain, notably concerning the European situation. Illiquidity in the market with wide bid/offer spreads. Significant risk of capital rising and asset sales from the financial sector.	Very similar to high yield, with the exception that investors need to consider the less liquid nature of this market. The main advantage is the floating rate nature of the loan universe, which will help if and when interest rates rise. Should also benefit from strong technicals of any further LTROs.
Emerging market debt	■	Despite relatively attractive yields, recent inflation data remains something of a worry, although it does appear to be waning. Currency appreciation by emerging markets could also help the performance of this asset class.	Unlikely to decouple from developed markets. China remains as murky as ever, and debt levels are growing. The data from that region remains mixed and often disappointing. Hard currency spreads are low, better opportunities in local currency debt.	There are a wide range of possibilities with emerging market debt. However in the final analysis there are probably cheaper parts of the credit world that are less over owned.
Convertible bonds	■	Now trading at essentially fair value after approaching expensive levels earlier this year. Probably remain a little better placed than equities given the murky economic outlook and likelihood of consolidation in the short term following a strong equity run.	Significant systemic risks remain, notably concerning the European situation. The call optionality embedded in converts is only worth something if markets continue to increase.	Convertible bonds have moved to fair value relative to their constituent parts, with the exception of Asian converts, which look reasonable value.

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Alternatives		Positive	Negative	Our view
Commodities	■	In a world of fiat currencies the storing of wealth in commodities has attractions. Outlook remains supportive for gold.	Significant systemic risks remain, notably concerning the European situation. Lack of momentum in markets continues to hamper performance of many managers. The liquidity of these strategies must also be borne in mind.	Commodities have had a mixed year to date, but remain sensitive to negative news on growth. They could rally from here but volatility and ongoing economic uncertainties suggest caution. Gold has found some support at today's levels following the recent declines.
Hedge funds	■	The genuinely uncorrelated strategies offer diversification and potential return enhancement. A few hedge fund areas are showing reasonable opportunity at today's levels.	Significant systemic risks remain, notably concerning the European situation. Lack of momentum in markets continues to hamper performance of many managers. The liquidity of these strategies must also be borne in mind.	A potential bond proxy given the uninspiring government bond outlook. However investors need to be cautious on sizing given the higher risk of hedge funds, their current higher correlation to equities and illiquidity of many strategies. In extremis there is no substitute for high quality government debt.

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Property (UK)	■	Yields remain reasonably attractive. Reasonable vacancy rates still remain in certain areas. Active management remains key in this sector.	Economic data remains weak. In London significant systemic risks remain, notably concerning the European situation and the prospect of further retrenchments in the financial sector. Furthermore, reasonable supply is being generated in London. Outside London strength of final demand remains weak, continued malaise of the high street potentially impacts a large section of the UK property bank. The illiquidity of direct strategies must also be borne in mind.	Income attractive versus gilts but limited room for capital growth. Neutral.

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Currencies				
Dollar	■	The dollar is undervalued but Fed's rhetoric suggests tightening will be pushed out for a long time and there is little reason for this to change in the short term. The political and rating situation is likely to remain a weight on the currency.		Neutral to slight overweight
Euro	■	Despite recent resilience, sovereign issues remain a threat to the value of the euro.		Underweight
Yen	■	Despite recent weakness, the yen remains vulnerable to central bank intervention.		Underweight
Emerging market currencies	■	While emerging markets do not have the same structural problems as developed economies and have stronger fiscal, debt and trade positions than developed markets, these advantages are wearing off. But emerging market debt is far more problematic to value and is more volatile making conviction harder to come by.		Long term overweight

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