FINANCIAL PARTNERS

momentum

Asset Allocation Dashboard

Positive | Neutral | Negative

Asset class	View	Comments		
Equities		Positive	Negative	Our view
Developed equities	Neutral	The advent of QEIII, recent positive news from the Eurozone (and not unreasonable DM macro data) have been very well received by the markets, and continue to push markets up overall, although the impetus appears to have slowed somewhat. Additionally corporates are generating very healthy levels of profits, and by standards of the last few decades, equities are relatively cheap.	Many risks remain. The European situation continues to be opaque. The recent economic slowdown looks to have spread into Asia and – to an extent – the US. Despite some positive data surprises in the US of late, little reason for either of these to change in the short term. Prolonged intransigence over the US fiscal cliff could weigh on equity markets.	The bounce back for equities since the last euro summit was welcome but the idea that the issues facing the global economy are now resolved is too simplistic. At these valuation levels we are cautious of moving overweight.
UK equities Relative to developed	Positive	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.	UK economic outlook looks weak (but not yet truly recessionary and indeed some green shoots 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	Neutral	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 (especially in light of some recent data pointing to a German cooling). Sovereign risks continue to dominate, and the banking sector in many countries remains fragile. There is no reason to expect this to change any time soon. The situation will remain tense.	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 means being cautious in this region.
US equities Relative to developed	Negative	The US economic outlook, whilst weakening, still remains the best among major economies. The country is likely to be the beneficiary of reasonable news flow across 2012 (such as QEIII). The Presidential election did not provide cause for concern. Some bombed out sectors like housing, are showing signs of recovery.	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 (such as QEIII) – and there is certainly little room for one in current market pricing. Prolonged intransigence over the fiscal cliff could weigh on US equity.	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	Neutral	A number of valuation measures do suggest Japanese equities are cheap. Meanwhile the corporate sector is starting to adopt Western ideas on shareholder rights.	When adjusted for differing accounting standards Japan in fact looks no cheaper than Europe and comes with considerable uncertainty. Additionally the strong yen, the dull economic backdrop and demographic headwinds are a long term concern.	Inconsistent data readings and a habit of not 'mean reverting' make this a difficult market to call. Neutral.
Emerging market equities	Neutral	While historically we have been cautious on emerging markets, towards the end of 2011 things started to look a bit better as underperformance and investor sentiment combined with monetary easing, made them a reasonable opportunity. For instance dividend yields are now higher in emerging markets than developed markets (as they normally are), 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, and have flat lined now for 18 months. China remains as murky as ever. Across emerging markets, political risk is growing due to higher inflation and commodity "windfalls" and impending government changes.	Given the recent cheapening in emerging markets we feel that to some degree the bad news from China is starting to be priced in. In contrast to our underweight in developed markets we are neutral on emerging markets at present levels but on the balance of probabilities our next move will be back underweight.

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Positive Neutral Negative

Asset class	View	Comments	
Fixed income		**Positive**	**Negative**	**Our view**
Government		Little obvious catalyst for a sell off in the short term. Central banks continue to buy government bonds. Despite some reasonable economic data, treasury yields could stay low for years.	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 'Japanifaction' of the West. QEIII is surely another example of why government debt is fundamentally unattractive in the long run.	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.	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.	Probably not a bad insurance play 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 reasonably attractive. Investment grade corporate balance sheets are in good health and in many instances arguably better than governments. Leverage in the system is low suggesting that a round of aggressive deleveraging as in 2008 is unlikely.	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.	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 LTROs. While still a good 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.
High yield		Remains our favoured 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. 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.	An attractive play for the post credit crunch world. Investors are still well rewarded for lending to companies rather than, for instance, taking equity stakes. Given the strong rally we are more cautious, but remain overweight. As with investment grade, nominal yields are reasonable but not exceptional
Loans		Long term value looks good. Shares much of the spread story as high yield, though yet to become quite as cheap. Tactically wait a little before adding exposure.	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. Political risk growing due to higher inflation and commodity "windfalls" and impending government changes.	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, such as high yield.

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🟩 Positive 🟨 Neutral 🟥 Negative

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Fixed income		**Positive**	**Negative**	**Our view**
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.	Significant systemic risks remain, notably concerning the European situation. The call optionality embedded in converts is only worth something if markets increase.	Convertible bonds have moved back to cheap value relative to their constituent parts, having previously been a little rich.

Asset class	View	Comments		
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.	Economic data remains weak. Harsh austerity plans combined with sluggish growth suggest the European region looks set for at least a mild recession over the next 12 months. Strength of final demand is still questionable; China remains as murky as ever. Furthermore, China holds significant inventories already.	Commodities have been largely flat year to date, but remain sensitive to negative news on growth They could rally from here but volatility and ongoing economic uncertainties suggest caution.
Fund of hedge funds	🟨	The uncorrelated nature of these funds offers diversification and potential return enhancement. A few hedge fund areas are showing reasonable value 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 decent bond replacement 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.
Property (UK)	🟨	Yields remain 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. Outside London strength of final demand remains weak. The illiquidity of direct strategies must also be borne in mind.	Income attractive versus gilts but limited room for capital growth. Neutral.

Asset class	View	Comments	Our view
Currencies			
Dollar	🟨	The dollar is undervalued but with Fed's rhetoric suggests tightening will be pushed further 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	🟥	Sovereign issues remain a threat to the value of the euro.	Underweight
Yen	🟥	Yen is expensive and 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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