FP FINANCIAL PARTNERS

June 2017

Asset Allocation Dashboard

Positive | Neutral | Negative

Asset class	View	Change	Comments		
Equities			**Positive**	**Negative**	**Our view**
Developed equities	Neutral	↔	Corporate revenues and earnings growth remains solid against a backdrop of a sustained global growth recovery Valuations are slightly rich by historical standards but low yields warrant the higher multiple, and valuations are not stretched relative to DM sovereign bonds or credit Central Bank activity continues to support risk markets.	The global macroeconomic environment is more uncertain than risk and volatility markets might suggest. Markets have continued to perform strongly and there is a risk of momentum stalling and profits being taken in the absence of improving sales or profit margins to push stocks higher. Geopolitical and electoral risks may not be sufficiently discounted and remain a source of volatility.	At these valuation levels we continue to believe a neutral allocation is appropriate. Valuations are not cheap but central bank policy remains supportive for risk assets and on a relative value basis vs both sovereign bonds and credit, equity returns remain attractive over the medium term. More elevated volatility should be expected with policy and politics central to risk pricing.
UK equities Relative to developed	Neutral	↔	Valuations remain reasonable today and weak sterling will support UK businesses, more so the exporters and those that earn their revenues overseas. The market is discounting a meaningful move higher in earnings at these levels. Historically low base rates are expected to continue for some time and should keep risk appetite and equity prices buoyed in the near term.	Uncertainty remains in the UK economy at this time as the Brexit negotiations commence under the shadow of the conservative party losing their majority at the general election – a shock result which could weaken the government's hand in protracted negotiations, as it has Theresa May's grip on the Tory leadership. In the smaller cap indexes where businesses are more domestically exposed, one could argue that this risk may be under-priced today and if the earnings fail to materialise then the market looks expensive. The consumer and consumer facing sectors both look increasingly pressured from a squeeze in real wages and challenges to the traditional high street from online retailers. The UK market remains disproportionately exposed to moves in commodity prices.	Following the rally in UK equities return expectations are now at more modest levels. With sterling still looking somewhat cheap, further sustained currency weakness seems less likely. Brexit risks are now firmly focused on the negotiations and any ensuing trade deals that come from them. These risks will remain for some time and will affect business confidence and investment. The market remains disproportionately sensitive to commodity prices and we are cognisant of continued oil price volatility.
European equities Relative to developed	Neutral	↔	The Central Bank continues to purchase corporate debt as part of its QE program. Valuations remain attractive against the backdrop of generationally low yields Political risk has subsided following the election of Emmanuel Macron in France and this backdrop should continue to be supportive of European equities. European manufacturing indicators support strong future growth within the region which should be accretive to European earnings in the medium term.	The ECB has now reduced the size of their monthly bond purchases and the market is expecting further reductions at the end of the year. This may cause some repricing of risk, albeit for the right reasons. Low rates in Europe and beyond puts pressure on the banking sector which remains under pressure, although recently we have seen efforts from governments and the Single Resolution Board to actively manage the systemic risk posed by underperformers Political risks remain in Europe, albeit much reduced.	European equity valuations have compressed in recent months but remain reasonable at current levels, especially when viewed against corporate and sovereign European bond markets. With lingering European political risks and a growing recognition that negative rates do more harm than good, we remain cautious but optimistic today and would look to add on weakness.
US equities Relative to developed	Negative	↔	The broad US economic outlook remains solid and arguably the region warrants a premium at a time of increasing uncertainty elsewhere. Consumer confidence remains high, jobs growth continues – albeit at a slower pace - and economic indicators suggest reasonable growth over the medium term. The new administrations expected program of fiscal spending and tax cuts will benefit certain corporates and sectors as well as the consumer, although its implementation looks increasingly challenged. Equities are better placed over the longer term to capture any reflationary policy fallout.	The US remains one of the most expensive equity regions, with high investor expectations already priced in. With profit margins having peaked, US equity requires meaningful earnings growth to justify today's valuation. The Fed's interest rate policy will remain a source of uncertainty and an inflation surprise could see yields move higher than markets have discounted. If the dollar strengthens further that could be a headwind to earnings. Undefined policy objectives of the Trump administration maintain uncertainty and could increase risk premia for equities. There are increasing risks to the policies underpinning the 'Trump trade'.	Still the most expensive regional equity market in our valuation framework, but not outlandish on a relative basis and at these yields, and driven at the headline index level by surging technology names. Monetary policy remains a key swing factor for the US and on the political front we prefer for now to observe how the Trump administration's policies unfold. There are still many unknowns.

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Equities			**Positive**	**Negative**	**Our view**
Japanese equities Relative to developed	Positive	↔	Low rates should continue to be constructive for equities despite creating bouts of volatility in the near term. Valuations remain attractive in Japan and our return expectations remain one of the highest of the developed market regions. BoJ purchases of equity through ETF structures, as well as the continuing purchase of JGBs, should support prices. Yen weakness would be a boost to Japanese equities.	A strengthening yen is a problem for exporters and leaves equities exposed to the currency. In real terms the currency is not expensive so there is room for this to happen, but it is likely to come in a risk off situation when the yen traditionally offers some protection as offshore capital is repatriated. Longer term, Japan remains in a difficult position with an ageing population, low/no inflation and little or no economic growth. This could hold domestic equities down.	We continue to rate this market as a green today with attractive valuations and the government's continuing program to increase equity allocations within pension portfolios. The government's pro liquidity policies are welcome but the yen's safe haven currency status could impede returns.
Emerging market equities	Positive	↔	Valuations remain very attractive in emerging markets following several years of weak commodity prices and currency adjustments. Leading indicators continue to support reasonable growth expectations in isolation as well as versus DM economies. Global and localised policy action remains supportive towards riskier assets. EM currencies remain cheap in real terms which should be supportive for EM assets	The asset class may face near term headwinds from any renewed bouts of US dollar strength. The continued moderation in Chinese growth and the economic transition taking place there is a risk to EM more broadly, particularly in the face of tightening financial conditions and efforts to contain excessive credit growth. The continuing fallout from US trade policy may continue to provide a headwind to certain companies and countries should trade agreements be revoked or tariffs introduced. Considerable political risks remain and warrant some discount, add to that increasing geopolitical tensions which may affect markets more broadly.	Valuations are attractive in absolute and relative terms. With slowly improving fundamentals and a noticeable repositioning in risk appetite among investors, we like the prospective long term returns offered by the asset class today. This remains a volatile section of the equity market: care is required on position sizing. Caution is warranted until the path of US trade policy becomes clearer, but at current levels we see good return prospects from this asset class.

Asset class	View	Change	Comments		
Fixed income			**Positive**	**Negative**	**Our view**
Government	Neutral	↔	DM policy remains broadly accommodative in aggregate across DM economies but with inflation and rates having repriced sharply from the 2016 lows, bond yields today are under less upward pressure. High quality government paper remains the ultimate haven in times of elevated risk aversion Real treasury yields do not look unreasonable if growth remains muted and inflation is contained. Moderating inflation expectations have been supporting bond valuations of late.	Extraordinary monetary policy has brought about artificially low bond yields and long term government bonds remain expensive in our view. The reflationary theme has more recently come under pressure but upside risks nonetheless remain and can have mark to market implications for rate sensitive securities including treasury debt if reflationary forces reassert themselves.	Despite on-going supportive policy actions, on a medium term outlook the majority of government bond yields remain unattractive and the asymmetric risk of potential returns from this asset class remains elevated. There are some relative value opportunities for the more sophisticated investors but it is mostly the diversifying attributes of the higher quality sovereign bonds that warrant any holding today.
Index-linked Relative to government	Neutral	↔	Realised levels of inflation in the developed world are today low or rising, while forward looking basis inflation expectations have more recently rolled over making inflation breakevens in aggregate look a little cheap. Given the historical stickiness of inflation at levels above breakeven inflation rates, inflation linked bonds in select markets look better value today than fixed rate government bonds.	Linkers remain vulnerable to weak economic news flow and renewed weakness in commodity prices. Real yields in the UK are extremely negative and should be expected to rise as monetary policy normalises, causing MTM losses. It is difficult to use inflation linked bonds without accepting the higher duration risk that comes with most inflation linked bond funds. Inflation linked bonds can be more technically driven and do not always imply a true measure of future realised inflation.	Like their nominal counterparts, linkers are ultimately expensive. Nonetheless, compared to a conventional government bond, at these levels they do provide some protection against higher realised future inflation. In aggregate we think inflation linked bonds are reasonably valued today, with some markets offering better value than others.

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Fixed income			Positive	Negative	Our view
Investment grade Relative to government	Neutral	↔	Investment grade spreads are mildly attractive today. At current levels we think investors are adequately paid for the fundamental risk of owning higher quality corporate bonds. IG corporate bonds provide some diversification to riskier assets with their embedded rate risk and higher beta to sovereign bonds. UK and European investment grade bonds should stay supported with their central banks as marginal buyers.	In absolute terms the duration component of investment grade bonds may prove to be a headwind should government bond yields move higher than what is currently priced in. There are market concerns over liquidity but investors are somewhat compensated for this in the current spread. Financials make up a large part of the investment grade bond universe and we recognise the impact of lower sovereign rates on banks margins and profitability if base rates fall further. The US market – the largest regional allocation within the global asset class – is more progressed through the credit cycle today and leverage, whilst not at punitive levels, has been rising.	Investment grade debt remains a decent play against government bonds and an efficient way to earn a higher quality spread whilst retaining some underlying rate protection. We are cognisant of debt issuance to support share buybacks, high aggregate debt levels, and increased balance sheet leverage. Asset class duration remains near the highs meaning investors are more sensitive to rate moves today than in the past. We retain a neutral rating today and like the balance it provides in a multi asset portfolio.
High yield	Neutral	↔	High yield spreads in both the US and Europe offer an at-best fair pick up versus treasuries but valuations have deteriorated as spreads have tightened. Default rates remain low in non-energy sectors. Recovery rates are below long term averages but this is a function of the market having become bifurcated between energy and non-energy sectors. Interest remains well covered. The ever present 'search for yield' will continue to provide support to this asset class.	Spreads have continued to rally hard and are now starting to look expensive. The large proportion of energy related issuers could again impact US index returns if the oil price fails to hold current levels and defaults pick up in the sector. Furthermore, the credit cycle is now somewhat extended in the US.	We prefer short duration to core high yield today as scenario analysis suggests a better risk return. On the basis of expected returns we prefer US over Europe today.
Loans	Neutral	↔	Long term some value remains and the spread available on loans is attractive with the additional benefit of a floating rate coupon. Seniority over unsecured high yield bonds also provides additional capital security if defaults pick up unexpectedly. Loans have limited exposure to the energy sector where the risk of capital impairment has been highest. A higher exposure to the healthcare sector could benefit from healthcare policy changes in the US.	Loans sit in a less liquid part of the corporate debt market with wider bid/offer spreads. Fundamental risks are much the same as for high yield in the sense that a significant pickup in defaults may negatively impact the asset class. Loans are less liquid than high yield and this risk should be borne in mind when considering investments. Covenant protection remains low. We are mindful of sector concentration in healthcare and technology and the use of new issue loan proceeds for acquisitive purposes.	We retain a modestly favourable view on the asset class and today prefer to high yield bonds in portfolios which can own the asset class. Hold exposure if appropriate to mandate. Similar to high yield, with the exception that investors need to consider the less liquid nature of this market and lack of an embedded rate component. The floating rate nature of the asset class will be accretive when interest rates rise more meaningfully.

Positive   Neutral   Negative

Asset class	View	Change	Comments		
Fixed income			Positive	Negative	Our view
Emerging market debt	Neutral	↔	Spreads today on hard currency denominated emerging markets remain reasonably attractive when considering duration, reinvestment risks and opportunities in other asset classes. All in yields are also reasonable following the recent re-pricing in US rates. In aggregate the sovereign issuers that comprise the EMD universe today have higher currency reserves and more free floating currencies that should prevent a meltdown like that seen during previous EM debt crises, and aggregate rating quality is better. With the real effective level of EM currencies remaining near lows, this should provide some support to hard currency spreads and local bonds will benefit from any dollar weakness.	In the short term, EMD remains sensitive to disappointing growth, bad economic data, a stronger dollar and 'risk aversion' trades as witnessed post-election. Oil price falls will benefit net oil importers to the detriment of EM economies that export and a strong US dollar makes these obligations more difficult to service, although not unmanageably so yet. The large weight of the resources sector in a number of EM economies leaves them exposed to slower Chinese growth and their transitioning economy. The quality of the universe remains investment grade overall but has been deteriorating.	EMD is sensitive to global macro news, especially markets with current account deficits or a reliance on oil exports. Moderate allocations are recommended at current valuations. Local EMD has optically more attractive yields but dollar strength and currency risks warrant some caution and as with high yield we favour combining a core duration strategy with a short duration exposure at this time. Both flavours of sovereign debt should provide reasonable real returns and a decent pick up to DM sovereigns over the longer term.
Convertible bonds	Neutral	↔	Convertible valuations in aggregate remain reasonably attractive today. Following several years of suppressed volatility we expect some pick up going forward which is usually good for convertible bonds.	The call optionality embedded in converts ultimately only has real value if markets increase and the particular stocks in question participate in these moves. Some equity markets look quite fully priced and convertibles there may be impacted more than usually expected if equities come under pressure.	Convertible bonds are priced about fair value to their constituent parts. The asset class should always have a place in a multi asset portfolio given the upside participation and downside bond floor and the asymmetric properties they possess.

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Alternatives			**Positive**	**Negative**	**Our view**
Commodities	Neutral	↔	Although global growth rates remain subdued commodity prices will continue to be influenced by broader risk appetite which remains buoyant at present. As inflation starts to surprise to the upside in some countries commodities can provide an inflation hedge in client portfolios. Gold can also provide a hedge against event risk in what has become a macro environment sensitive to policy error and newsflow. With the US Dollar at cyclical highs in real effective terms, commodities have room to price higher should the Greenback retreat from current levels.	Strength of final demand is still questionable especially with respect to China where commodity imports have slowed, growth continues to moderate and policy has been tightened in recent months. It is difficult to take a direct exposure to commodities and commodity curves will influence returns vehicles that invest via commodity futures, often negatively. The asset class more broadly remains prone to bouts of dollar strength that may accompany changing Fed rate expectations.	Commodities remain sensitive to negative news on global growth. They could move higher from here but volatility and on-going economic uncertainties suggest caution today with the market still pricing inflation risk at the lower end of historical levels. The dollar will be the single biggest influence on future returns.
Property (UK)	Neutral	↔	Yields and returns remain reasonably attractive in selective regional locations Last year's weakness in sterling has revived some foreign flow into the UK property asset class and any further weakness that may fall out of the Brexit negotiations should see additional support for property from the overseas buyer.	The UK's economic outlook remains uncertain as the Brexit negotiations evolve following the triggering of Article 50. The traditional British high street remains under pressure from the continuing growth of online retailing and high street chain closures are testament to this. We have warned in the past of the dangers of liquidity mismatch and this continues to be a risk that the sector is exposed to As a longer duration asset class property remains susceptible to any repricing in long terms bond yields which have moved sharply lower in recent months.	Income is attractive versus gilts but there is limited room for capital growth. On the positive side, rental growth outside of London is likely to provide a positive impetus due to a lack of new supply. We also recognise the 'search for yield' lends support to the asset class.

Asset class	View	View	Comments
Currencies			
USDGBP	Neutral	↔	Fed pricing remains below the Fed committee's 'dot plot' but the two have converged as forward US rate expectations have moved higher. This has generally been constructive for the dollar but recent near term softening in US inflation expectations has failed to push the Greenback higher. In the UK we continue to feel that from Sterling's low valuation today, we should continue to see a more balanced outlook for this currency pairing but until there is a clearer picture of how Brexit is implemented it is difficult to be bullish on Sterling.
EURGBP	Neutral	↔	ECB policy remains accommodative (albeit at a slowing purchase pace) but it will continue to keep rates low for some time. Rate differentials across geographies provide little to no carry advantage for the Euro so the currency will not find any meaningful support there in the near term. Further tapering could see the common currency push higher but lingering financial and political risks in Europe will likely only serve to cap any strength and any persistence to the high and rising inflation in the UK may weaken any motivation to buy this cross.
JPYGBP	Neutral	↔	The BoJ has now moved away from a target bond purchase to a yield target which may ultimately be akin to a tapering of bond purchases. Risk conditions remain favourable so any Yen strength will likely be pared. This pair remains sensitive to risk news but with both currencies looking somewhat cheap on a long term real basis, and no imminent rate events likely to upset the cross, it is difficult to take a strong directional view on this pair today.

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