FP FINANCIAL PARTNERS

momentum

June 2018

Asset Allocation Dashboard

-ve → +ve

Asset class	View
Equities	
Developed equities	» We retain a neutral allocation to global equities today. Valuations vary across regions and sectors and whilst in aggregate they are not cheap, they do offer the prospect of reasonable returns, both in absolute terms and relative to other classes. Low bond yields can support this for now, although we recognise the direction is upward from here » CB policy and politics will remain central to risk pricing, and volatility is likely to remain more elevated than last year's levels, which we'd say is appropriate + The global macro backdrop remains favourable for global equities + Equities are better placed than most asset classes to perform in a moderately pro inflationary environment − Valuations remain selectively expensive at current levels − Continued talk around and implementation of trade tariffs is not constructive for global equities
UK equities (relative to developed)	» UK equities look somewhat cheap today but caution is warranted given UK's evolving Brexit negotiations and prevents us rating more highly. The market has rallied hard in recent weeks but this is mostly a function of weaker Sterling. Any continued weakness - which is quite possible as the Dollar finds near term support - will boost UK stocks further, and that contributes to maintaining the neutral view » While the larger cap market constituents are more globally focused than they are UK, and have earnings shielded in large part from FX swings, the more domestically oriented names may face bigger challenges, not least with traditional high street retailers remaining under pressure » The UK market remains sensitive to commodity prices + The UK market remains exposed to global markets and factors and as such is somewhat insulated from the headline Brexit concerns, benefiting from any associated Sterling weakness − Today the chief worries lie with the ongoing Brexit negotiations, and perhaps an overconfidence in a more 'soft Brexit' outcome is creeping in
European equities (relative to developed)	» European equity valuations remain favourable when viewed against corporate and sovereign European bond markets. From a more cyclical point of view Europe continues to recover from its post crisis lows, though we recognise that data has disappointed significantly in recent weeks and there are signs that the European recovery may be slowing » CB policy and politics will remain central to risk pricing + European earnings have scope to recover meaningfully from their lows, and the recent currency weakness provides a tailwind to European exporters − European assets, including equities, may come under pressure should the ECB's bond programme reduction accelerate, or the Euro strengthen again after recent weakness
US equities (relative to developed)	» The US remains the most expensive of the major developed markets, even when adjusted for the strong tech sector performance. The US economy remains in good health but equity returns face a valuation headwind today, and prices already discount strong earnings growth ahead following a stellar Q1 earnings season. The region continues to lead the rest of the world and a premium seems increasingly warranted » Monetary policy remains crucial to keeping markets in check and volatility under control. To date the Fed has managed this well but there remains an outside risk of higher inflation leaving the Fed little alternative to raising rates more quickly than rates markets are pricing + The economy is strong and leading indicators positive. Tax repatriation could spur investment and share buyback programmes + Returns on equity are comfortably the best of the DM regional markets − Valuations remain somewhat extended despite the recent market volatility, and rising yields may prove an obstacle to staying or extending from current levels
Japan equities (relative to developed)	» Japanese equities remain reasonably attractive and we acknowledge the government's policies to improve working practices and governance. Latest earnings are strong with most companies having reported and 14% growth recorded. However, after rallying back from its recent March lows as the Yen has weakened the valuation is more in line with other ex US markets today, and we pare back the rating » Japanese assets should remain well buoyed by BoJ policy which remains aggressive when compared to the other main DM central banks + Yen weakness will likely boost equities further if the Fed moves in line with their stated intentions and the BoJ maintains their yield curve policy. − In a protracted risk off scenario Yen strength would hit Japanese equities, as seen earlier this year
Emerging market equities	» Valuations have become more attractive as EM assets have come under recent pressure from a buoyant Dollar. However, we continue to favour EM assets more generally over DM as the longer term relative growth dynamics continue to look favourable, which coupled with low inflation and accommodative policy should support EM equities » As we have seen, EM assets are prone to bouts of volatility but this presents opportunity as well as threat + EM currencies have continued to weaken and this provides additional support over the longer term to what already look somewhat cheap currencies in aggregate − Emerging markets remain prone to bouts of volatility and flow reversal at times of heightened perceived risk − Recent Dollar strength bears witness to this. A sustained reversal will see EM assets remain under pressure

Note: Each asset class is reported on in isolation and should not be used as a relative comparison, unless otherwise stated.
These views should not be interpreted as investment advice. Views as at May 2018

-ve ⟷ +ve

Fixed Income

Government	» Despite on-going supportive policy actions, on a medium term outlook the majority of DM government bonds look unattractive today » Treasuries offer improved value today as yields oscillate around the 3% level but aggregate global government bond yields remain low + Quality government bonds remain one of the best diversifiers in a multi asset portfolio, and at current yields treasuries are starting to look somewhat attractive again − 2018 is likely to mark the year that net central bank bond purchases turns negative. That provides a headwind for all rate sensitive debt
Index-linked (relative to government)	» Index linked bonds offer some selective value today but, like their nominal counterparts, they are expensive today with US breakevens starting to look somewhat full » UK linkers remain one of the more expensive DM markets + Index linked bonds are one of the few methods to meaningfully protect against inflation risk − Inflationary forces are at best nascent today and on any renewed concerns over global growth they would almost certainly underperform nominal bonds
Investment grade (relative to government)	» Investment grade bonds provide some diversification benefit in a multi asset portfolio but valuations remain somewhat tight today. Marginally preferred to sovereigns today » Fundamentals remain reasonable but we would advocate owning more shorter dated credit at today's levels as rate sensitivity remains near highs + A reasonable alternative to owning sovereign bonds with diversifying qualities and some spread − It is difficult to see spreads tightening much further, and with central bank buying slowing the risks are asymmetric − Credit quality has drifted lower in recent years, and leverage has moved higher
High yield	» Spreads remain quite tight in leveraged credit markets, and whilst fundamentals remain robust, all in valuations are somewhat expensive » We favour owning shorter duration credit where the risk return looks more favourable today, and loans where permissible + In the absence of a systemic market shock high yield returns will likely trump most of other fixed income − Issuance terms are increasingly favouring the issuer, and valuations look somewhat expensive
Emerging market debt	» Emerging market bonds have come under pressure recently following a period of renewed Dollar strength, notably so local bonds. However this doesn't change the fact that EM bonds still rank as one of the better real return opportunities in fixed income over the longer term. With the sector remaining under pressure we prefer hard currency bonds today » We think a short duration strategy has a better risk return today and would look to re enter core duration strategies at higher spreads + EM bonds continue to offer some of the best return opportunities in core bond markets today − A resurgent dollar is likely to cause some temporary repricing in EM assets, and local bonds would likely bear the brunt of that, as we are currently witnessing
Convertible bonds	» Convertible bonds are somewhat rich to their constituent parts today. Whilst this is driven by loftier US valuations we favour an allocation to this asset class in a multi asset portfolio for the convexity it brings, which remains valuable at a time of elevated valuations, as we are today » Some caution is warranted given the concentration to the US market and technology names + The natural convexity provided by convertibles should continue to provide reasonable protection against any protracted equity correction − The call optionality embedded into convertibles only really has any value if markets move higher, and the US, the largest constituent is well valued today − If volatility reverts again to the recent multi year lows then the optionality holds limited value

-ve ⟷ +ve

Alternatives

Commodities	» Commodity prices are primarily supply and demand driven, and idiosyncratic factors can be as important as the global economic cycle. Prices are also likely to be affected by the increasing number of trade tariffs being imposed by the US and their trade partners (Europe and China in particular) in retaliation » Falling production in Venezuela and the recent pulling out of the Iran deal by the US are both contributory factors to the recent rise in oil prices + With the US Dollar still near cyclical highs, and growth reasonably strong globally, commodities have scope to generate positive returns + Gold remains a good hedge against risk off outcomes − Should the Dollar's decline come to a halt or reverse, commodities would likely come under pressure. However, recent dollar strength has been accompanied by a rising commodity index. The negative relationship is likely to reassert at some point
Property (UK)	» Property remains an attractive asset class for investors requiring yield Total returns will come mostly from income with limited scope for capital growth with global REIT stocks at somewhat elevated valuations after recovering from recent selling pressure » When viewed against high quality, longer duration Sterling assets and inflation linked bonds, UK property holds some appeal + Appealing yields should continue to attract capital and provide some floor to prices, as will any sustained Sterling weakness − As a long duration asset class property remains susceptible to any repricing in long term bond yields − UK property remains sensitive to eventual Brexit terms, and this is proving to be a slow process
Infrastructure	» Infrastructure stocks trade at reasonable valuations today - broadly in line with global equities today Their income generating potential should continue to support the sector and attract buyers of quality infrastructure assets + In a multi asset portfolio the relatively defensive nature of the asset class and a degree of inflation protection make the asset class appealing − As a long duration asset class, infrastructure remains susceptible to any repricing in long term bond yields − Regulation can work both for and against the underlying investments
Liquid Alternatives	» We define this section as less/non-directional, absolute return type strategies that seek to capture long term risk premia or market mispricings, and includes hedge fund alternatives in predominantly UCITS vehicles » We favour an allocation to a basket of liquid strategies today to provide additional diversification as high quality bonds remain expensive + These strategies provide additional diversification with reasonable return potential − The sector is relatively young and growing. It remains somewhat untested through a protracted risk off period so thorough due diligence is vital, and blend is recommended

Currencies

GBP	» Sterling remains buoyant today, both a function of continued Dollar weakness and some softening around the Brexit margins (though real progress remains limited). » In real terms the currency remains at the lower end of valuations and has room to appreciate over the medium to long term, but politics and rate policy is likely to dominate its nearer term path, and remains a source of volatility. » Valuation supports a long position but with the USD looking somewhat oversold, Sterling positioning having rebounded markedly, and Brexit front and centre, we rate slightly under neutral today.
Euro	» As with Sterling the Euro has benefitted most from the weaker Dollar but its own fundamentals have supported its gains. Whilst any change in explicit rate policy still remains some way off, the reducing quantum of bonds the ECB is now buying exerts some marginal upside to rates, certainly in sentiment, and the economic backdrop is as good as its been for a number of years. » In real terms the common currency looks about fair value today and is not a compelling long term buy. » Positioning is ultra extended today and versus the Dollar the currency looks somewhat overbought. As such we look for a better entry level..
Yen	» Rate differentials continue to offer little reason to buy the Yen as the Bank of Japan's yield curve policy means short rates will offer no real value for some time. However, in real terms the Yen remains cheap today. » Yen exposure is a useful portfolio diversifier but after a recent pick up in volatility this quality has mostly played out. Speculative positioning remains near the lows which may provide support. » We retain a cautious view today as the currency looks extended after rallying sharply in recent weeks.

Note: Each asset class is reported on in isolation and should not be used as a relative comparison, unless otherwise stated.
These views should not be interpreted as investment advice. Views as at May 2018

For more information, please contact your adviser or alternatively contact:

Financial Partners Ltd.
泛柏資產管理有限公司
24/F, Kinwick Centre
32 Hollywood Road
Central, Hong Kong

Tel +852 2827 1199
Fax +852 2827 0270
client.services@f-p.hk
www.f-p.hk

Important notes

This communication is issued by Financial Partners Limited 泛柏資產管理有限公司 and/or a Financial Partners' related company (collectively, and individually "FP") solely to its clients, qualified prospective clients or institutional and professional investors. Unless stated otherwise, any opinions or views expressed in this communication do not represent those of FP. Opinions or views of any FP company expressed in this communication may differ from those of other departments or companies within FP, including any opinions or views expressed in any research issued by FP. FP may deal as Distributor or Agent, or have interests, in any financial product referred to in this email. FP has policies designed to negate conflicts of interest. Unless otherwise stated, this e-mail is solely for information purposes.

This message may contain confidential information. Any use, dissemination, distribution or reproduction of this information outside the original recipients of this message is strictly prohibited. If you receive this message by mistake, please notify the sender by reply email immediately.

Unless specifically stated, neither the information nor any opinion contained herein constitutes as an advertisement, an invitation, a solicitation, a recommendation or advice to buy or sell any products, services, securities, futures, options, other financial instruments or provide any investment advice or service by FP.
No representation or warranty is given as to the accuracy, likelihood of achievement or reasonableness of any figures, forecasts, prospects or returns (if any) contained in the message. Such figures, forecasts, prospects or returns are by their nature subject to significant uncertainties and contingencies. The assumptions and parameters used by FP are not the only ones that might reasonably have been selected and therefore FP does not guarantee the sequence, accuracy, completeness or timeliness of the information provided herein. None of FP, its group members or any of their employees or directors shall be held liable, in any way, for any claims, mistakes, errors or otherwise arising out of or in connection with the content of this e-mail.

This e-mail and any accompanying attachments are not encrypted and cannot be guaranteed to be secure, complete or error-free as electronic communications may be intercepted, corrupted, lost, destroyed, delayed or incomplete, and/or may contain viruses. FP therefore does not accept any liability for any interception, corruption, loss, destruction, incompleteness, viruses, errors, omissions or delays in relation to this electronic communication. If verification is required please request a hard-copy version. Electronic communications carried within the FP system may be monitored.