Prime Partners

DEPUIS 1998

MARKET INSIGHT

APRIL 2018

Markets racked with doubt

March was not an easy month for investors as, in some weeks, risky assets experienced the kind of volatility seen at the end of January.

Uncertainty about US monetary policy, which the Federal Reserve's recent decision to raise key interest rates by a quarter of a point did little to quell, remained central to traders' concerns. Although the Fed's board did not revise its scenario of raising interest rates gradually, it did raise its rate-hiking forecasts on a 2020 horizon. There was nothing unusual about this considering that the domestic economy remains firm. While the change in the monetary authority's tone failed to reassure investors, it would be wrong to say that they were surprised. The reason for the markets' latest correction lay elsewhere.

The same cannot be said about Donald Trump's increasingly protectionist comments, which troubled investors. A potential trade war would damage the global economic cycle.

This is particularly true as European economic developments are not completely reassuring. The flurry of economic surprises in Europe may have lent weight to the belief that European activity will pick up over the quarters ahead. However, we were always doubtful of this happening, and as such we were not caught off guard unlike many market participants. This partly explains the difficulty that European equities have been having in delivering a satisfactory performance relative to their US peers in the last few months. The persistently strong euro also has something to do with eurozone stock markets' chequered fortunes.

Amid mounting uncertainty, traders have had to play it by ear and factor this potential change of circumstances into their expectation of how financial assets will perform over the coming months.

"Staying calm on turbulent markets can sometimes be a challenge."

We do not think that the basis for the economic scenario over these next few quarters should be questioned. The economic recovery does not appear to be at risk. However, the euphoria that looked to have overcome traders in January now appears to have vanished. The economic and financial cycle has entered a new phase, and we believe that the markets' heightened volatility is merely a natural reflection of this.

Of the various aforementioned factors that could put the dampener on global activity, the issue of protectionism is the one that catches our eye the most. However, recent developments show a degree of restraint in the application of measures. This leads us to believe that it is still too early to be talking of a trade war. We will nonetheless remain vigilant on this front over the coming weeks, especially as stronger attacks on free trade would probably increase the risk of stagflationary drift in the global economy.

In turbulent market conditions, not all news has been bad, though. The yen's robustness on foreign exchange markets has not waned, justifying our decision to gain exposure to this currency in recent months. More generally, pressure on bond yields has eased off as investors have become more circumspect about shares. Although the trend remains limited and does not affect our scenario of US 10-year yields creeping above the 3% mark by the end of 2018, the risk premium on equities has clearly risen.

We are still inclined to believe that stock markets should be able to free themselves from the turmoil that has been prevalent since the end of January. This does not mean that we think our expectation of more erratic equity performances should be questioned, as we uphold the view that we have entered the final stage of the financial cycle that began in 2009.

We are forging ahead with our asset allocation, which had led us to revert to a neutral equity weighting in February. The sale of our last equity hedges in recent weeks only reaffirmed our decision to bet on a stock market rally before the year is out. We have also stuck to our regional choices, preferring emerging market and Japanese equities over US and UK equities. Despite the disappointing performance of Japanese stock indices in recent months, we still believe that Japan's economic fundamentals justify us remaining overweight on the country's equities.

We have made a few adjustments at sector level. Although we remain heavily invested in the industrial and financial sectors, we decided to reduce our exposure to technology stocks in recent weeks. Relatively high prices and certain specific problems, such as those encountered by Facebook, were behind this decision. On the other hand, we have raised our recommendation on some of the more defensive sectors that had been badly affected by pressure on bond yields since late summer 2017.

Staying calm on turbulent markets can sometimes be a challenge. We tried to do this in March, limiting inappropriate adjustments to our asset allocation. Admittedly, the beginning of the year had called for some significant changes to some of our positions.

We have therefore opted for a reasonable approach to what looks like confirmation of a new volatility pattern for the financial markets. High volatility is not incompatible with the markets generating medium-term performance. This realisation has led us to retain the main themes of our investment strategy: equities must be preferred over bonds, and neutral equity exposure is justified. These options reflect our determination to manage portfolios' total risk, which forms an important part of our strategy in 2018.

Alternative investments still have their place in the current climate, even if some of our investments have not really met our expectations of decorrelation since the start of the markets' correction.

Cash emerges stronger from the adjustments to our investment policy in recent months, so we can be more relaxed about the period of heightened volatility that we are predicting for the financial markets.

Geneva, 30 March 2018

Prime Partners SA
Rue des Alpes 15
P.O. Box 1987
1211 Geneva 1

www.prime-partners.com

CONTACTS

François Savary
Chief Investment Officer

Jérome Schupp
Equity Analyst

Julien Serbit
Portfolio Manager

T: 41 22 595 09 97
fsavary@prime-partners.com
jserbit@prime-partners.com