MARKET INSIGHT

JUNE 2018

Market Analysis

June 2018

Europe once again in the eye of the storm

> “Managing risk must remain the priority in any asset allocation.”
>
> **FRANÇOIS SAVARY,** CHIEF INVESTMENT OFFICER, PRIME PARTNERS

To put it mildly, the political sphere is far from quiet at present. Donald Trump’s refusal to extend the Iran nuclear deal and the twists and turns concerning the summit between Kim Jong-un and the US President are clear examples of the current tense geopolitical climate.

Against this backdrop, Europe recently contributed to the already shaky situation. Uncertainties about the formation of a lasting government in Italy do not provide much reassurance. Investors were not caught out and all assets on the Italian peninsula have suffered sharp price falls over the last few weeks. There is nothing to indicate that Rome will find a solution to the situation created by the populist triumph in the recent legislative elections.

It never rains but it pours, and Spain has also faced a rise in political tensions. Mariano Rajoy’s minority government is under pressure following court decisions relating to the People’s Party corruption scandal. The likelihood of a snap election, which could favour the Podemos populist party, has increased. The return of political risk in Spain has resulted in rising bond yields.

In general, events in southern Europe have prompted some observers to describe this as a new eurozone crisis like that seen in 2011. We feel this is jumping the gun. However we will keep a close eye on the situation over the coming months.

One thing is certain: the relaunch of the integration project defended by President Macron has been hampered by growing euro-scepticism and Germany’s lack of desire to step up the shift towards greater fiscal and budgetary federalism.

These developments come at the wrong moment for European equities, which had regained some momentum in the wake of the rise in the US currency since March. The dollar has benefited from political developments in Europe to climb further in value. Similarly, the Swiss currency has recovered following a disappointing start to the year.

The same causes have produced the same effects, with the ongoing strength of the US currency once again affecting market behaviour. As in April, emerging market assets came under pressure and gold declined further in May, slipping below the threshold of USD 1,300. While tension in US bond yields can explain the latter phenomenon during the first half of May, this was not the case at the end of the month. Yields on long-maturity debts denominated in US dollars dropped due to increased doubts about the future of European integration.

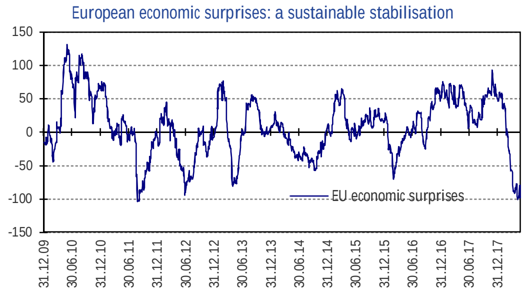
The impact of political developments over the last few weeks is even more noteworthy given the limited developments on the economic front. It seems increasingly likely that there will not be any acceleration in the global economy over the next few months. A phase of relatively robust growth is the most probable scenario for 2018.

We should note that economic surprises in Europe have stabilised following a period of sharp decline during the first four months of the year. It will therefore be interesting to see whether the aforementioned political uncertainties jeopardise this welcome stability.

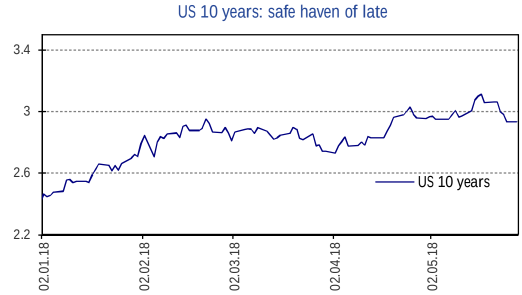
In general, we still firmly believe that we have entered the final phase of the economic and financial cycle.

This belief is reinforced by the behaviour of commodities prices and energy in particular.

The risk of higher inflation as a result could trigger premature “ageing” of the economic cycle. Central banks in certain emerging markets may have to change their monetary policy. It should be borne in mind that the combination of a strong dollar and tension in commodities prices is not optimal for the future of interest rates in these economies.

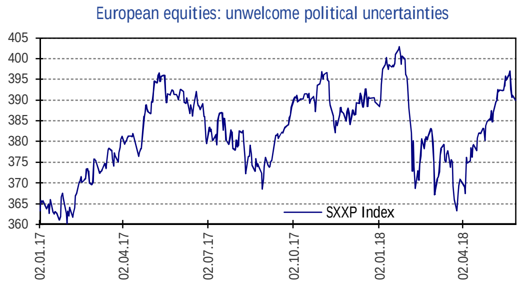


European economic surprises: a sustainable stabilisation



US 10 years: safe haven of late

In the light of the global context, we are leaving our asset allocation unchanged. As uncertainties have risen, we did not think it advisable to increase the level of risk in our portfolios.



European equities: unwelcome political uncertainties

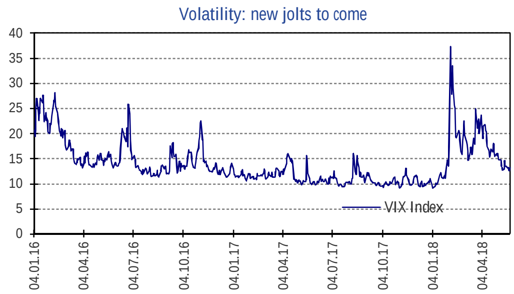
Risk management remains central to our market positioning. Our view – adopted at the start of the year – that 2018 will not resemble 2017 on the financial market is confirmed every day. Despite a decline in share over the last few weeks, there are likely to be further ups and downs in volatility over the coming months.

We maintain our recommendation not to overweight equities in a diversified portfolio. In this regard, we could reduce our exposure to European stocks in the light of recent developments.

We will continue to diversify our equity exposure by adding to the thematic pocket. We will soon be able to introduce a new theme to our allocations, in this case that of education.

We shall maintain our defensive stance towards bonds, which are underweighted in our strategy. We are continuing to reduce credit risk in developed markets in favour of strategies focusing on loans and floating rates, particularly in Europe.

We still recommend a solid exposure in alternative investment strategies. Similarly, we are still convinced by the idea of increasing the level of cash in the portfolio in the medium term.



Volatility: new jolts to come

The rally of the dollar and the Swiss franc did not surprise us as they fit into our set scenario. Although these currencies could benefit from political uncertainties in Europe and remain robust, we have not called into question our medium-term view, particularly as regards the dollar. We maintain a target of 1.25 for the euro/dollar exchange rate at the end of 2018.

To conclude, 2018 is a complicated year. The combination of political and economic uncertainties is likely to maintain a more erratic environment for the financial markets. Managing risk must remain the priority in any asset allocation.

. Geneva, 30 May 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

IMPORTANT INFORMATION