# Asset class dashboard

October 2018

PACIFIC ASSET MANAGEMENT | MULTI ASSET ACCUMULATOR RANGE

## Equities

**Neutral**

The global economy is growing but slowing and becoming increasingly desynchronised. The ongoing trade dispute between the US and China is a growing threat to growth and corporate earnings. Central banks continue to withdraw liquidity, removing a tailwind to global equities. From a valuation perspective, equities appear attractive versus government bonds but are expensive relative to their own history. However, there are opportunities in undervalued regions, factors and sectors globally.

## Fixed Income

**Negative**

Global government bond yields remain exceptionally low by historical standards and as unemployment continues to fall, inflationary pressures are building, putting upward pressure on yields. Global Quantitative Tightening is likely to accelerate this process. Whilst growth remains supportive, elevated leverage in the corporate sector presents a threat in the future. Emerging market bonds offer attractive yields but returns are being held back by cyclical headwinds.

## Alternatives

**Neutral**

Directional alternatives can provide diversification benefits to multi-asset investors. Given rising inflationary pressures, we expect a buying opportunity in gold in 2018. We are becoming increasingly cautious on REITS given their sensitivity to rising bond yields.

## Diversifying Assets

**Positive**

A creative approach to diversification is required with government bond yields at these levels. Diversifying risk factors provide an alternative source of return with very low correlation to both equities and bonds.

## Cash

**Neutral**

Exceptionally low interest rates ensure that cash is a poor long term investment but it is an effective tactical tool in a rising bond yield environment

Source: Pacific Asset Management as at 28 September 2018.

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| **Equities** | Neutral | UK | Profits of UK companies have bounced back sharply over the past year but the domestic economy is likely to lag the rest of the world in 2018 |
| | | Global | Global energy stocks have lagged global equities for a decade and after cutting capital expenditure are now strongly cash flow positive and look set to benefit from a resurgent oil price. Global value stocks enjoy a significant margin of safety compared to growth stocks and are likely to outperform as bond yields rise. |
| | | US | Tax cuts have provided a one-off boost to earnings and the US economy, but given the high valuation of the US stock market, we expect the region to underperform. |
| | | Europe ex UK | Economic growth has continued to slow over the last year months whilst political risks are rising |
| | | Japan | Profit margins from Japanese companies are rising whilst corporate governance improvements are a positive for shareholders. More that half of Japanese companies have net cash on their balance sheet proving the opportunity to buy back shares or increase dividends. Monetary policy in Japan is likely to remain a highly supportive backdrop to its equity market. |
| | | Asia-Pacific ex Japan | Australia's slowing growth from a changing China is a headwind to growth in this region. |
| | | Emerging | Emerging market equities trade at a significant valuation discount to the rest of the world and offer the potential for faster earnings growth. A stronger dollar and the threat of trade wars have been a headwind, but over the longer term we expect emerging markets to outperform the rest of the world. |
| **Fixed Income** | Negative | UK Govt Bonds | UK gilt yields offer poor prospective returns for investors with yields at these levels and only limited diversification benefits. |
| | | EM Bonds – Local Currency | Emerging market local currency bonds offer attractive yields with only modest sensitivity to interest rates. The strong dollar provides a headwind to certain emerging markets but ultimately high real yields are likely to attract buyers in a world seeking yield. |
| | | EM Bonds – Hard Currency | Hard currency emerging market government bonds offer higher yields than government bonds in the developed world but we our more cautious on their sensitivity to bond yields rising in developed markets |
| | | Investment Grade Corporate Bonds | The environment for investment grade credit remains supportive but credit is showing signs of late cycle behaviour. Our preference is for shorter dated investment grade bonds with lower sensitivity to rising bond yields and potential spread widening. |
| | | High Yield Bonds | Short duration high yield bonds provide an attractive yield and low sensitivity to rising interest rates in an environment that remains supportive for the asset class. |
| **Alternatives** | Neutral | Commodities | The outlook for oil remains bullish given supply constraints and falling inventories whilst gold will thrive if central banks balk at raising interest rates in the face of rising inflation. |
| | | REITS | Rising bond yields are a clear headwind to listed real estate |
| **Diversifying Assets** | Positive | Absolute Return | The environment for macro managers is improving as central banks continue to withdraw stimulus, providing opportunities in both fixed income and currencies |
| | | Diversifying Risk Factors | Finding true diversification is increasingly challenging for investors; diversifying risk factors help to solve this puzzle, offering returns that are uncorrelated with both equities and bonds. |

**Key:** Positive Neutral Negative