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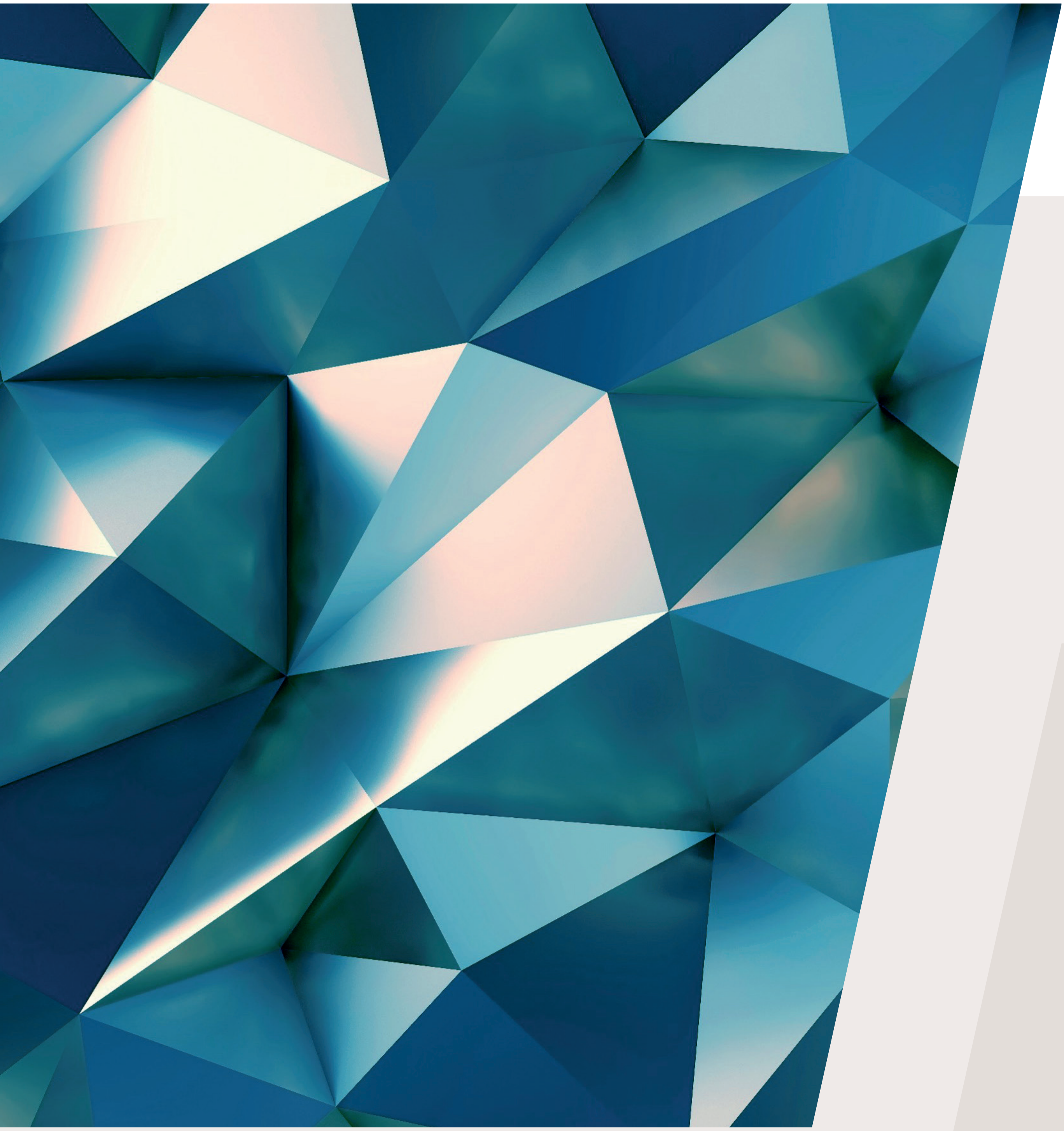

APRIL 2024

Mosaique Asset Allocation

Our current view

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KEY POINTS

- Central banks remain in no hurry to cut interest rates
- A favourable mix of lower inflation and ongoing growth continues
- We stay overweight stocks, neutral on bonds and underweight cash

THE MACRO PICTURE

Interest rates are turning a corner, but in the US, the eurozone and the UK, they continue to do so more slowly than money markets have been expecting – even as inflation continues to subside. Major policy rates had already been significantly "higher for longer" than the consensus expected when they started to rise in late 2021/early 2022. They are turning out to be higher for even longer.

There are two main reasons: unemployment is still low, and monetary credibility is being rebuilt.

If unemployment were rising meaningfully, the big central banks would be more likely to cut rates. Even then, however, their decision-making would likely be shadowed by their mistakenly generous stance to 2021, which dented their credibility and as a result has likely had the effect of raising the bar for monetary easing in most circumstances now.

The door is still open for rate cuts in the months ahead – as the big central banks have been careful to tell us – possibly led by the ECB around mid-year. But the slow approach of lower rates continues to keep both our bond positions, and our overall allocation to portfolio risk, in check.

Bucking this trend, the smaller Swiss National Bank has been able to start cutting rates already: it has enjoyed relatively low inflation, and correspondingly high credibility, throughout. But the impact of its cut on local bonds has been overshadowed by the ECB's wariness, and our asset allocation for Swiss franc-based portfolios is little different to that for other currency bases.

The troubling geopolitical backdrop – including a looming, closely-run US presidential election which might see the re-election of the most outspoken POTUS of recent times – continues to have little effect on capital markets. History tells us that markets are impersonal, and that unless regional conflicts and geopolitical stresses affect economic activity and/or interest rates significantly – and they are not doing so at present – then markets are quite capable of seemingly setting them to one side. And the resilience of economic activity (with business surveys stabilising even in Europe) is the source of the low unemployment which is slowing the descent of interest rates, but also elevating corporate profitability and stock market sentiment.

INVESTMENT CONCLUSION

In this context we still feel it would be premature to be overweight bonds as an asset class, and to be fully invested in securities generally. As a result, we stay no more than neutral on bonds in all portfolios, having finally closed a residual, long-standing underweight in bonds in European portfolios in the summer, and we retain a single overweight position in stocks, financed by a correspondingly moderate underweight in liquidity.

The low level of market volatility recently has also featured in discussion at our asset allocation committee. Generally, we see it as another reason for refraining from tactically adding more portfolio risk now: some revival in short-term volatility seems overdue, and might offer a better entry point.

Asset allocation overview

Equities. We continue to favour equities, though we are looking for signs that the stock market's advance is broadening. Within stocks we have been favouring a mix of structural and cyclical growth sectors: the emphasis has been mostly on the former, where we continue to favour technology, but as business surveys stabilise and recession fears abate, we are expecting more conventional, cyclical growth to share more of the market leadership.

Regionally, since mid-2023 we have again had a preference for the US, where many of the more influential technology stocks are capitalised, and where developed-world economic growth tends to be more resilient. Since February we have also favoured the eurozone, which we think is able to capture the cyclical impetus from an improving global economy (in today's circumstances, more so than emerging Asia, which we cut back to neutral).

These overweight positions have been funded by underweights in mostly defensive and interest-rate sensitive sectors, and in defensive markets such as the UK and Switzerland. Some of those sectors – namely, utilities and real estate – will need to be watched for improving momentum as lower interest rates approach, but so far at least the overall mix has been a constructive one for portfolios.

Fixed income. Within bond markets, we favour longer-duration exposure across all currency bases, even though yield curves remain firmly inverted, as we think it offers the best play on the slow reduction in policy rates we expect.

We have no strong preference for credit quality, favouring credit and government bonds equally. Both investment and sub-investment grade credit spreads have only been significantly lower in the 'noughties, ahead of the Global Financial Crisis, but while economies remain resilient, we see little immediate prospect of the sharp rise in default and loss risk that could drive a major sell off.

There is a small divergence still in place between European and US portfolios: we retain an overweight in sub-investment grade bonds ("high yield", speculative bonds) in Europe, financed by an underweight in investment grade credit. They remain an important source of income in European portfolios, and it continues to be one of the better-performing segments of the entire fixed income market. In US portfolios we are completely neutral along the entire credit quality curve.

Currencies. Both the Swiss franc and the yen have weakened in recent weeks – the former from high levels, the latter close to historic lows. But the major exchange rates continue mostly to display little momentum, and while the dollar is expensive it has been for some time, and is not outlandishly so. We will be watching currencies closely if, as seems possible, more divergent monetary policies emerge in the second half of the year, when rates likely start falling, perhaps at varying speeds. Meanwhile, a lack of conviction on the major currencies has not hurt us in the last year or two. The major source of portfolio volatility is usually stock prices, not currency.

Asset allocation

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