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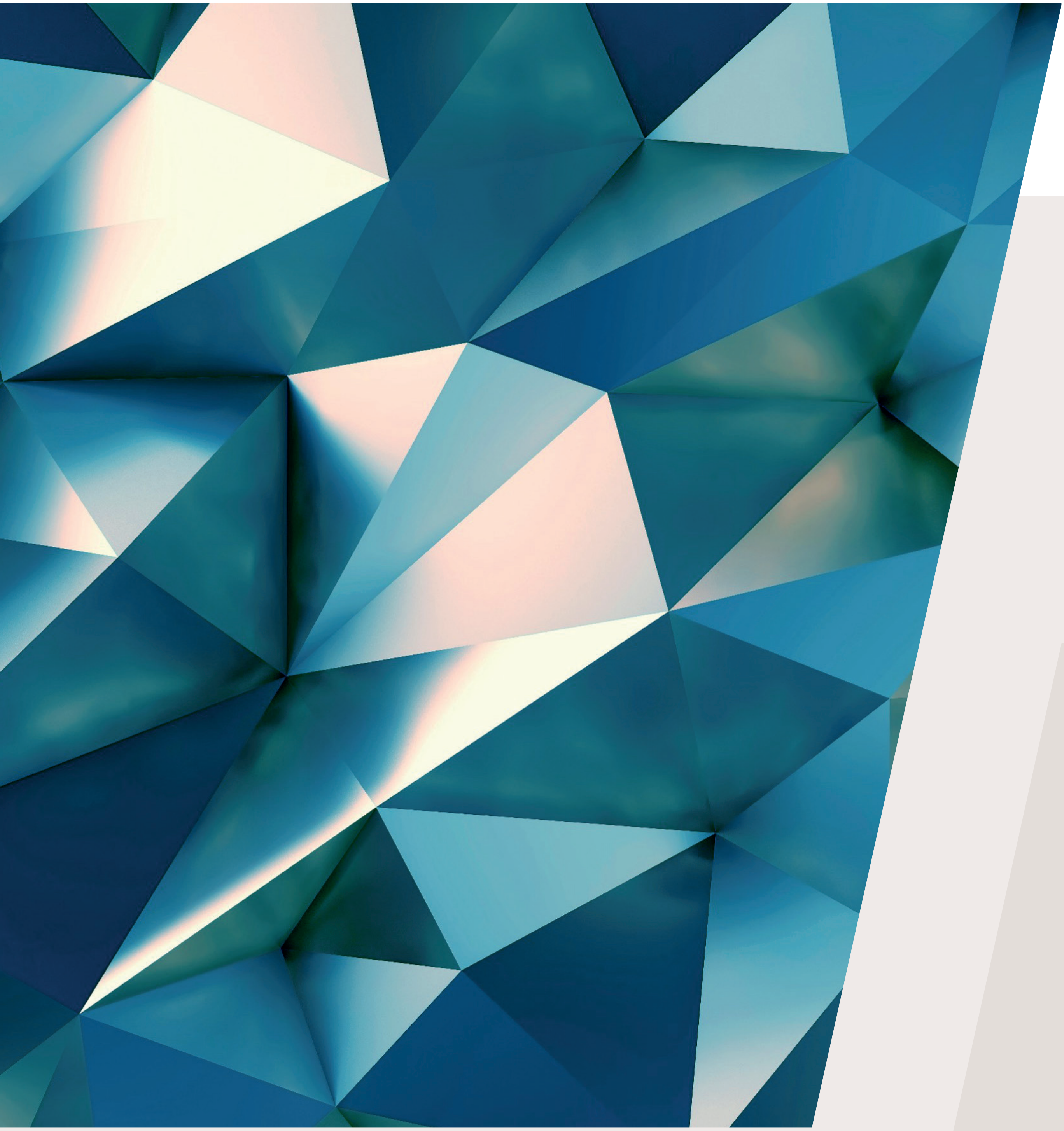

JULY 2024

Mosaique Asset Allocation

Our current view

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KEY POINTS

- An unexpected French election has revived political nerves…
- … but the business cycle remains market-friendly
- We stay overweight stocks, neutral bonds, underweight liquidity
- We are simplifying how we take and report our equity positions

THE MACRO PICTURE

As our asset allocation committee met this month, a busy geopolitical agenda had been made even more so by the announcement of unexpected parliamentary elections in France, and an earlier-than-expected general election in the UK. But neither development, we believe, is likely to materially affect the variables which matter most to client portfolios – the levels of global interest rates and corporate profitability (and we continue to think the same could be true even of the more geopolitically important US election as it approaches).

This can often be the case, as we have noted in earlier updates. Markets are impersonal, and things which matter to us as people and citizens – including even such traumatic events as those still unfolding in Ukraine and the Middle East – often seem not to affect them.

This could be the case in France, for example, if the next administration, whatever its political complexion, reaffirms – as we think it very likely will – France's commitment to the euro. And in the UK, the election is only a little earlier than expected, and the opposition party – which has been far ahead in the polls for many months – has pledged to leave major tax and spending rates, and central bank independence, intact.

This is not to deny that local risks exist. The committee noted the threat posed to French financial stocks, for example, if a socialist coalition were to decide upon (re) nationalisation, and wider OAT spreads are clearly signalling the possibility of greater government borrowing. But these risks are of a different, more parochial nature to those that would be faced by portfolios if "Frexit" were on the table.

As a result, the committee unanimously decided that no changes to asset allocation are as yet warranted by these latest political developments – particularly since they are taking place against an economic backdrop which continues to favour our current stance.

That backdrop is a mix of ongoing economic growth with disinflation, which has been delivering healthy profitability alongside the prospect – now the reality – of declining interest rates. The US economy remains the most robust major economy, but business surveys suggest that European growth rates may have bottomed and are poised to revive.

Interest rates are not falling as fast or as far as money markets were initially expecting, but "higher for longer" seems to have been priced in for a couple of months now. The SNB and now the ECB have felt able to start cutting rates, and we think the Bank of England and then the Fed will follow suit in the third quarter.

We still doubt rates will fall far, but with unemployment still close to historic lows in the US and Europe, and most of the disinflation now behind us, they don't need to and arguably shouldn't.

We are still wary of taking the fabled "soft landing" for granted. After such a dramatic normalisation of policy rates, it would be remarkable for there to be no significant economic damage. That said, we have always felt that a more severe economic downturn has been neither necessary nor likely.

Stocks are able to benefit from both lower rates and economic resilience, which is why we continue to favour them in our asset allocation to date: we maintain a small overweight in stocks, a corresponding underweight in liquidity, and a neutral position in bonds. We keep some cash in reserve: we retain the room to move further underweight there in favour of either stocks or bonds, but as yet the volatility in eurozone markets following the announcement of the French election – like the earlier wider volatility in markets in April – has, we think, not been big enough to unearth one.

INVESTMENT CONCLUSION

We have left our positioning unchanged this month, both across and within the major asset classes. We are however making some changes to the way in which we think about, implement, and report our equity positions in particular.

Most visibly, we are unifying our sectoral analysis: we will no longer take or report different positions on sectors across the eurozone and the US, but will instead adopt a single position for developed market sectors as a whole. At the same time, we are broadening our main developed European benchmark to include the non-euro Scandinavian markets for completeness' sake.

In practice, we have not had many different views on European and US sectors since the launch of Mosaique portfolios, and this simplification is unlikely to affect performance materially. One of the few divergences recently has been an overweight in financials in Europe but not in the US, and an overweight in the communications sector in the US but not in Europe. Both were introduced last month, and funded by a reduction in healthcare in each market to neutral. Of the two, the overweight in US communications has been the higher conviction view – especially at the moment, given those local risks around French financials – and has carried forward into the unified approach.

Asset allocation overview

Equities. As noted, no change here. We continue to favour the asset class. The so-called "M7" group of US names is once again stretching its lead. We remain overweight technology and communication, but do not have all our eggs in this basket (and do not favour all M7 names at the stock level). Instead we continue to favour a mix of structural and cyclical (industrials) growth sectors in our now-unified developed market sector stance.

Regionally, we retain a preference for the US. Since February we have also favoured the eurozone (and now the broader index including the Scandinavian markets), and continue to do so, that political noise notwithstanding.

These overweight positions have been funded by underweights in mostly defensive and interest-rate sensitive sectors, and in "low beta" markets such as the UK and Switzerland. We note that the link between the performance of the utility sector and AI demand, which seemed to be lifting its beta, seems to have faded of late, and we stay underweight there.

Fixed income. Within bond markets, we continue to favour longer-duration exposure across all currency bases, which has supported performance in the last month after US inflation in May undershot expectations and the ECB followed through on its rate cut guidance.

In this context we still see the risk-return balance as skewed positively: with yields now back at "old normal" levels, and inflation closer to targets, there are fewer inflation "vigilantes". If yields were to spike higher again, we doubt they would stay elevated for long, and can imagine a more pronounced rally unfolding in due course as renewed recession fears took hold.

Last month we closed a long-standing overweight in European high yield credit, and in US investment grade credit, to move overweight in government bonds and coincidentally to leave both eurozone and US (and now UK, as noted above) fixed income portfolios fully aligned.

Currencies. The euro has weakened only slightly after the French election news, and the ECB's earlier rate cut had also had little impact (perhaps because it had been so widely signalled). We will continue to watch closely as Fed-ECB monetary policies diverge further, but currency volatility remains subdued, and directional conviction remains in short supply. As we have noted often, the major source of portfolio volatility is usually stock prices, not exchange rates.

Asset allocation

KEY	–		Neutral		+
Overweight					■
				■	
Benchmark			■		
		■			
Underweight	■				
Recent change		→		←	

			–		Neutral		+
ASSET ALLOCATION OVERVIEW	US	Money market		■			
		Equities				■	
		Fixed income			■		
		Gold			■		
	Europe	Money market		■			
		Equities				■	
		Fixed income			■		
		Gold			■		
	Switzerland	Money market		■			
		Equities				■	
		Fixed income			■		
		Gold			■		
FIXED INCOME	US	Duration				■	
		Government				■	
		Invest. grade		■			
		High-yield			■		
	Europe	Duration				■	
		Government				■	
		Invest.grade		■			
		High-yield			■		
	Switzerland	Duration				■	
		Government				■	
		Invest. grade		■			
		High-yield			■		
	UK	Duration				■	
		Government				■	
		Invest. grade		■			
		High-yield			■		

			–		Neutral		+
EQUITIES	Regions	North America				■	
		Continental Europe ex Switz.				■	
		UK		■			
		Switzerland		■			
		Japan			■		
		Pacific ex Japan			■		
		EM ex Asia			■		
		EM Asia			■		
	Developed-market sectors	Energy			■		
		Materials			■		
		Industrials				■	
		Utilities		■			
		Cons. disc.			■		
		Cons. staples		■			
		Comms.				■	
		Healthcare			■		
		Technology				■	
		Financials			■		
		Real estate		■			
FX		USD			■		
		EUR			■		
		GBP			■		
		CHF			■		

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