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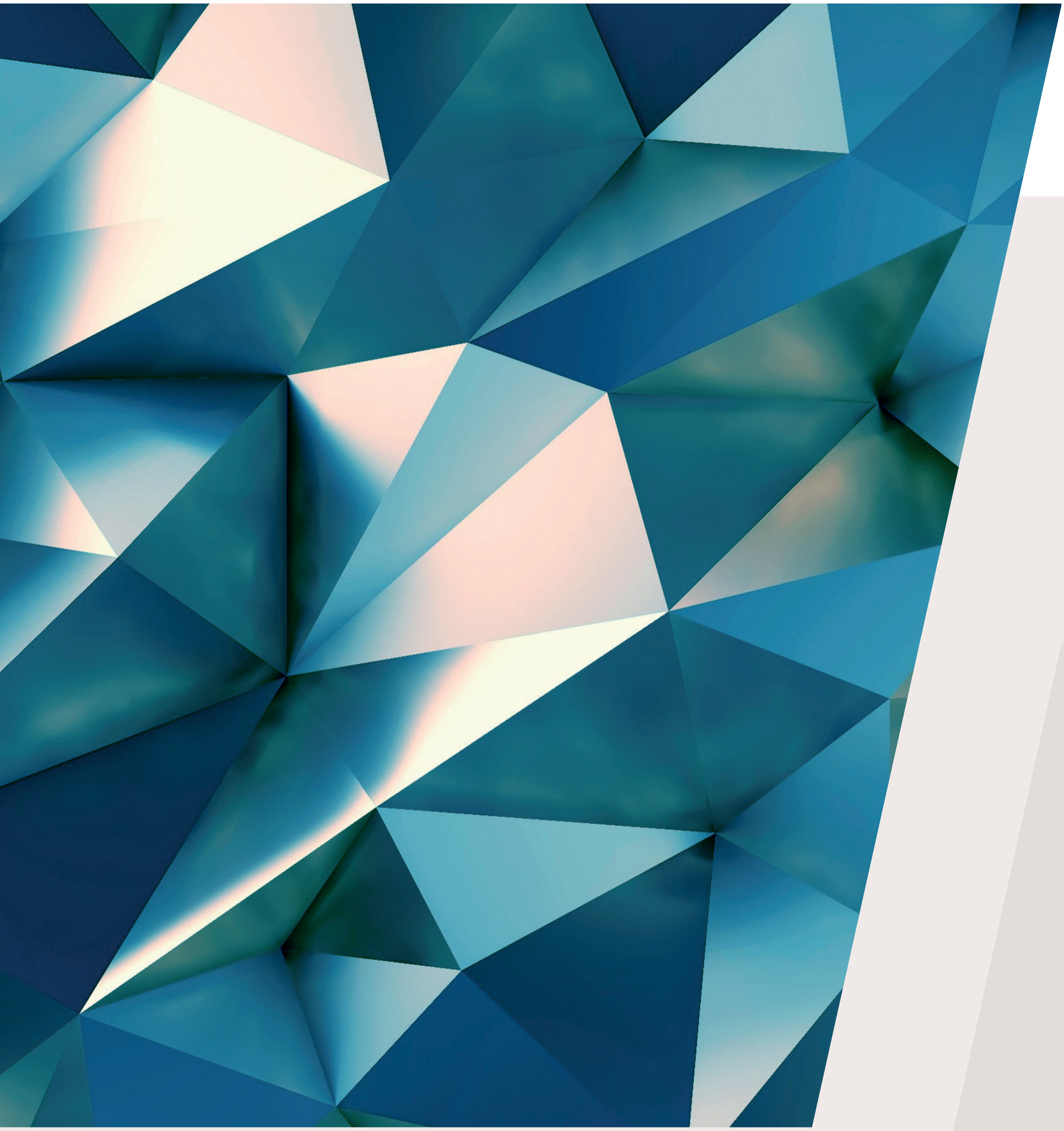

AUGUST 2024

Mosaique Asset Allocation

Our current view

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KEY POINTS

- French and UK election results had little market impact
- Meanwhile, the economic backdrop remains favourable
- We stay overweight stocks, neutral bonds, underweight liquidity

THE MACRO PICTURE

When our asset allocation committee met this month, it noted that the results of the French and UK parliamentary elections had left markets little changed. This had been the outcome we had thought most likely. However, the US presidential campaign has become even noisier in recent weeks, with President Biden's poor debate performance performance (and, since the meeting, his subsequent retirement from the race) and ex-President Trump's near-assassination. Several committee members noted that this noise could begin to affect portfolios in coming months.

We have noted in earlier updates that important political events often do not have a financial impact. Markets are impersonal, and things which matter to us as people and citizens – including even the grim events still unfolding in Ukraine and the Middle East – often seem not to affect them. This could yet turn out to be the case for the US presidential election too. It is possible however that Trump's proposals for extra tariffs, and for more tax cuts, could start to have a significant effect on expected profitability and inflation, and begin to affect portfolios.

Overall the committee felt that this was unlikely to happen imminently, and most of the discussion focused instead on the latest trends in growth, inflation and interest rates. Those trends remain constructive.

In the quarter just ended, current estimates suggest that the influential US economy may have grown a little more quickly than usual. Data for the UK are similarly positive. China is reported to have grown more slowly than usual, but still at a faster pace than the developed world. Continental Europe remains the laggard, but even there the indications are that growth may have bottomed.

Meanwhile, inflation continues to drift lower. It is doing so only slowly, because it has already fallen a long way, and is now close to targeted levels again (2%). We still doubt that it will return sustainably to target, but even if it trends around 3% or so, we think that will permit the major central banks to lower interest rates gradually and modestly. Indeed, the ECB started to do so in June, and the Federal Reserve and the Bank of England seem likely to start cutting rates in the autumn. (The Swiss National Bank started to cut rates back in March, but Switzerland did not have as big an inflation problem to begin with). We are not surprised that interest rates have been higher for longer than markets initially expected, but the corner is now slowly being turned.

This mix of ongoing growth with declining interest rates is positive for client portfolios, but more so for stocks than bonds, we think. Stocks can benefit from both growth, which will support corporate profitability, and lower interest rates, while bonds benefit only from lower interest rates. Stock markets have now risen strongly in 2024, and are starting to look more expensive, but valuations are not yet prohibitive. The committee retained its single overweight position in stocks, financed by a single underweight position in liquidity, and stayed neutral on bonds.

We still do not take the “soft landing” for granted. It would be remarkable for there to have been no economic damage after the dramatic rebound in interest rates since 2021. Such damage may not become visible yet. That said, we have always felt that a more severe economic downturn has been neither necessary nor likely.

INVESTMENT CONCLUSION

We have again left our positioning unchanged this month, both across and within the major asset classes. There was some discussion of political risk, as noted, and of the higher valuations on stocks. There was also a discussion of the prospects for US consumer stocks if spending were to slow unexpectedly. But overall, committee members supported a “no change” stance.

Asset allocation overview

Equities. We continue to favour the asset class. Within the market, the so-called "M7" group of US names, which has led the way up for the last two years or so, has underperformed in recent weeks. More cyclical stocks, including small cap indices, have done better. It is however too soon to conclude that this marks a decisive change in leadership: there have been earlier reversals which did not last long.

We remain overweight technology and communication, but do not have all our eggs in this basket (and we do not favour all M7 names at the stock level). Instead, we continue to favour a mix of structural and cyclical (industrials) growth sectors. Regionally, we retain a preference for the US. Since February we have also favoured eurozone and Nordic markets (the latter as of last month, when we expanded our benchmark as reported).

These overweight positions continue to be funded by underweights in mostly defensive and interest-rate sensitive sectors, and in "low beta" markets such as the UK and Switzerland. The link between the performance of the utility sector and Artificial Intelligence demand, which earlier had seemed to be making it more cyclical, has continued to fade, 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 two months now after US inflation in May and June undershot expectations and the ECB followed through on its rate cut guidance.

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.

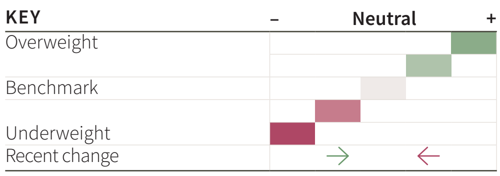
Indeed, there was some discussion about adding to the overweight call in duration in European portfolios. Growth is most subdued there, and there is room for a bigger divergence in inflation and interest rate prospects than has been seen to date. On balance, however, the committee felt this might be premature.

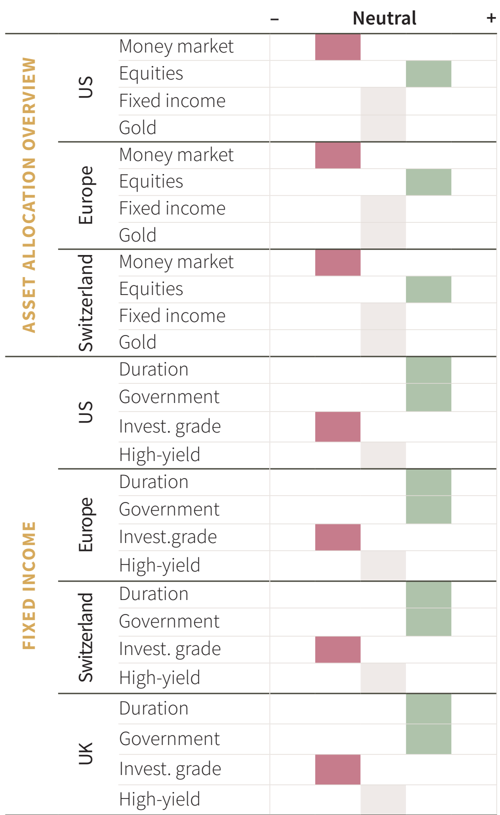
We continue to favour government bonds over credit, a preference introduced in June. We are not especially worried about corporate default rates, but credit spreads are narrow, and government bonds generally have longer duration and are better placed to benefit as inflation risk stabilises.

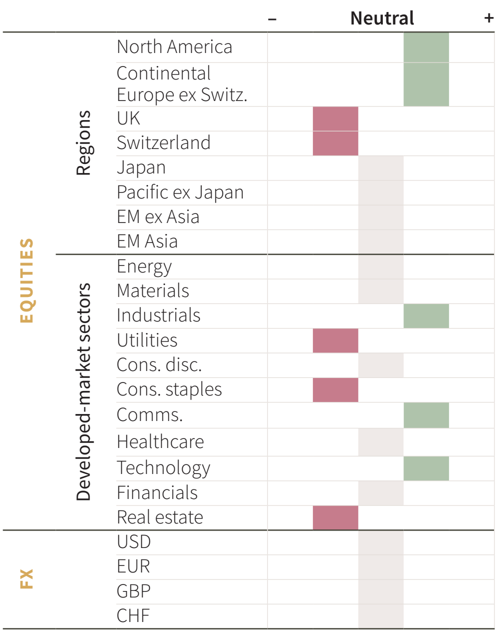
Currencies. The dollar has unexpectedly weakened by 2-3% against the euro, franc and sterling since June's meeting. It does however remain firmly inside recent trading ranges (the yen remains the only major currency to have recently moved far – downwards – from its trend).

It is too soon to say whether this reflects US political noise beginning to make itself felt. It does however signal how difficult it can be even to get cause-and-effect the right way around in analysing currencies. All the talk previously has been of how bigger ECB rate cuts might weaken the euro. Now we face the possibility that a stronger euro – if it persists – might make bigger ECB rates cuts more likely. Currency conviction has been a scarce commodity of late for us, and this illustrates why.

Asset allocation







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