MARKET VIEW – Things could get bumpy, folks…

Completed on 7 June 2018

Risks and tensions have been piling up for several months now – geopolitically, in particular with the trade disputes between the United States and China and, to a lesser extent, macro-economically.

Tensions rose by another notch in May on two fronts, in Italy and on emerging markets with rising US government bond yields and gains in the dollar.

A new, openly populist and anti-European government in Italy is obviously not good news, especially at a time when growth there is falling short of forecasts. In the short term, we can hope for a slight easing in political risk if the government opts for a compromise. The possibility of tensions in the market cannot be ruled out until Italy is given a reality check by investors. This was the case last week, with the spike in spreads, even though they have since receded somewhat. Is this just a lull? That's a good question, but keep in mind that Italy's fundamentals have improved markedly, particularly with a decline in unemployment.

Emerging market currencies fell sharply in countries whose external accounts were deep in the red and/or whose economies were on shaky ground, particularly in Argentina, Turkey and Indonesia. The Brazil real was driven down by very local, and probably temporary, causes. The central banks of the various countries concerned have acted with determination, including pre-emptively in Indonesia and Malaysia, and currencies ultimately received some support. However, short-term value on emerging markets has never been created when there is a simultaneous increase in oil prices and the US dollar.

But the real question that investors should be asking themselves is the future direction of global growth and the resurgence in inflation. Rising oil prices redistribute about 1% of global growth to producers, with an impact on inflation and growth. In all likelihood, European growth will be hit the hardest but on a very high base.

Although business climate is solidly anchored in the expansion zone, the possibilities of an adjustment have increased markedly.

In late April we had taken on a more cautious stance by dialling back our exposures in all risk asset classes. We have weathered the recent weeks' turbulences with no major stress. As a result, our diversified wealth management funds ODDO BHF Value Balanced[1] and Oddo Patrimoine[2] ended the months with positive performances on the year to date.

After the recent decline in equity markets and while remaining underweight in Europe, we are currently increasing equity exposures mainly in the US. The US remains our favourite as confidence indicators resume their upward climb.

As we are confident in the business cycle for the medium term, we prefer to reposition ourselves in equities rather than corporate or government bonds.

Central banks are beginning to normalise, albeit gradually, and are withdrawing their current "fake" support of the bond market. It will be hard to argue for an aggressive stance on bonds with rates so low in Europe, especially as the fixed-income/equity correlation is likely to change radically.

We will have to learn to live in a universe in which "risk-free" assets are harder to identify and where nimbleness in asset weightings and hedging capacity will become decisive, as the economic cycle matures.

Current equity exposures: Oddo Patrimoine[2]: from 25% at end-May to 40%; ODDO BHF Value Balanced[1]: 56%; ODDO BHF ProActif Europe[3]: 30%

**The funds mentioned herein incur the risk of a loss of initial investment. Past performances are not a reliable indicator of future performances and are not constant over time.*

[1] This fund is registered for distribution in France.
[2] This fund is registered for distribution in: France, Germany and Belgium
[3] This fund is registered for distribution in: France, Germany, Austria, Belgium, Spain, Italy, Luxembourg, Portugal, Sweden and Switzerland

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ODDO BHF ASSET MANAGEMENT

MARKET VIEW – Our market analysis

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