



# market turmoil: assessment and advice investment strategy

Investment

Strategy

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Since the beginning of the year, financial markets have been in turmoil. The trigger has been a succession of fears, ranging from the threat of currency devaluation in China, the consequence of low oil prices on the energy sector and the fear that policymakers will not be able to avert a global recession.

The downturn has been more severe than we expected. Markets are clearly in a period of heightened uncertainty and, even, confusion. We believe markets are exaggerating the threat of recession and that the situation remains manageable by policymakers. Moreover, once it becomes clear that a recession is not in the offing, we expect an improvement in markets to occur.

## **Domestic consumption overrides recession risk**

Fears of a recession are arising mainly from the US, where worries focus on the oil sector, manufacturing and financial conditions. We do not expect a recession in the US or for the problems now seen in the energy, materials and financials sectors to spill over to other areas of the economy.

The strength of domestic consumption, which constitutes 70% of US GDP, is the bulwark that provides protection from recession. Employment and income growth are in good shape and real disposable income is supportive. Moreover, the US consumer remains optimistic and the housing market is continuing to improve.

Nonetheless, it is clear that the situation in the US has deteriorated since the beginning of the year. Financial conditions, such as bank lending, are tightening; and data, such as economic growth, has not met our expectations. We are in the midst of revising our growth forecasts downward for the US and also adjusting our forecast for rate hikes by the Federal Reserve. Yesterday's testimony by Federal Reserve Chair Janet Yellen left open the possibility of adjusting the

Fed's path back to more normal interest rates, given uncertain market conditions and the risks posed to the US economy.

## **Central banks still have a powerful arsenal**

Central banks hold the key to an improvement in market sentiment, and they have already started to react. The European Central Bank is expected to continue to ease monetary policy in March and the Bank of Japan recently moved to negative interest rates. In the US, the market is already pricing in no further rate hikes in 2016. An extended period of accommodative central bank policies can dispel market worries and nurture growth.

There are also still plenty of policy actions possible by central banks. Their arsenal of measures remains formidable. In a worst-case scenario of a serious risk of recession, a new policy mix could be put in place. This could include a return to quantitative easing with a broader range of asset purchases or enhanced public spending. The financial crisis clearly proved that central banks can be innovative and effective in fighting destructive market forces.

## **What should clients do?**

### **Not the time to sell risky assets**

The decline seen in equity markets and rising spreads in bond markets are largely owing to the pricing-in of a recession scenario. We believe this goes too far, although, admittedly, we are not as positive regarding the economic outlook as we were at the beginning of the year.

We do not believe it is a time to sell risky assets. Instead, we believe that for many clients it is a time for caution and perseverance. Investing in traditional safe-haven assets is also not the answer. US Treasuries and the yen are expensive and could be subject to sharp reversals. The price for hedging equity risk is also high.

## Clients underweight in risk should consider selectively adding to equity positions

Clients who are significantly underweight in terms of risk relative to the tactical asset allocation should consider taking steps toward increasing equity positions. Careful selection is needed, and it is not suggested to “buy the market.” Instead, selective investments in sectors with defensive characteristics in the current environment, such as health care, and in the growth area of the information technology sector, are recommended.

## European high-yield preferred to global high yield

In fixed income markets, we believe that risks in the global high-yield market have risen, largely based on the sizable proportion of energy and mining companies in the US high-yield market, where default risk is increasing. We therefore advise clients to switch to European high-yield bonds, where the risk profile is more attractive.

Market uncertainty has increased in line with new worries. We are monitoring markets carefully and will continue to interpret events in terms of the risk and opportunities for our clients.

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Global Investment Committee

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