



investment strategy

18 July 2016

Adjusting to the new reality

A new reality has emerged after the British vote to leave the European Union. Economic growth and corporate earnings expansion are now less certain. The current market rally may be a good time for portfolio adjustments.



In our investment policy we would suggest to take advantage of the ongoing stock market recovery to adjust your portfolio to the new, post-Brexit world. In light of reduced economic growth forecasts, rising political risks and downward pressure on corporate earnings, stocks and commodities have become less attractive. The appeal of income-producing listed real estate and the government bonds of emerging nations (for qualified investors), however, has increased. The overall goal should be to trim cyclical risks, while increasing portfolio defensiveness and diversification.

A new post-Brexit reality

A new reality was introduced with Britain's vote to leave the European Union. The announcement of the result on 24 June has been followed by continued uncertainty in financial

markets and lowered forecasts for economic growth. A more prolonged period of central bank support is now expected, with interest rates forecast to remain low and no hike in US rates expected in 2016. This more negative macroeconomic view coincides with rising political risks in Europe and the US and a tougher environment for company growth.

Despite the recent recovery in stock markets, inflows into safe-haven assets, such as gold, US equities and Treasuries, have not abated. This signals that financial conditions and financial markets have not yet stabilised after the Brexit shock, despite the current rally in equity markets.

Preference for stocks somewhat reduced

While stocks continue to be preferred over bonds, the degree of the preference is lessened. The safe-haven status of bonds has also become more valued. At the same time, the importance of cash in a post-Brexit world has increased, as it can improve your portfolio resiliency in an uncertain market. The recommended portion of a diversified portfolio dedicated to stocks is now slightly lower, as the equity market is sensitive to economic growth, which has now been revised downward.

A mature stock market rally

For some time, there have been signs that the equity market rally was maturing. And after the Brexit vote, an expected uplift in earnings growth that had been expected in the second half of the year, has been quashed. This is owing to downward revised forecasts for economic growth and increasing uncertainty.

Earnings momentum dampened

Earnings momentum is also not expected to find much support in the months ahead. Downward revisions are expected to continue as the second-quarter earnings season unfolds. The ongoing stock market recovery is therefore seen as an opportunity for investors currently at the recommended allocation to sell a portion of their equity position and to use the proceeds to strengthen their cash buffers.

We also suggest that, depending on risk appetite and limits,

emerging-markets government bonds could be attractive for some investors. Bonds are expected to continue to act as a safe-haven asset class, and emerging-markets government bonds offer attractive yields. This is especially true when compared to core government bonds, such as German Bunds. Adding emerging markets debt to a portfolio is seen as a reasonable way to increase the allocation to bonds, while also improving returns. A position in emerging-markets government bonds will also improve a portfolio's diversification. The Brexit vote, for example, had little effect on the emerging-markets debt market.

Commodities slightly tarnished

Commodities continue to be favoured, and the oil price is still expected to recover further this year, as supplies are reduced. But the outlook for commodities is not as promising as when economic growth was expected to be more robust and before the British chose to leave the European Union. Therefore, to make an investment portfolio more defensive, a smaller allocation to commodities should now be considered.

Attractiveness of real estate is rising

If you choose to sell a portion of their commodities holdings, you may want to consider investing in listed real estate. In an environment where interest rates are expected to remain

lower for longer, listed real estate is now more attractive. The asset class has strong momentum, solid fundamentals and attractive dividend yields. Real estate's defensive characteristics (predictable cash flows and attractive dividend yield) can also help it to outperform stocks when markets are volatile. (It should be noted that listed real estate is not the segment of the property market that has been garnering negative headlines recently. The negative news has been mostly confined to the direct property market in London.)

Conclusion

The fact that safe-haven assets continue to see inflows is a clear sign of an uncertain market. The current stock market rally is an opportunity to make adjustments to an investment portfolio. Consider using the rally to reduce the allocation to stocks, to trim commodities and to buy into listed real estate. A slightly larger allocation to bonds through a position in emerging markets government bonds can also be considered. The result can be a more robust and defensive portfolio.

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