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Milano Finanza

Time to book a check-up for your portfolio

With advice from Larry Fink, the world's No 1 asset manager

Stock markets are at record highs (Piazza Affari excepted) and optimism is growing. But there's a rise in US rates on the way… What to ask your financial advisor to see if you've got the right mix.

INVESTMENTS. With stock markets at record highs and the imminent rise in US rates, which will impact bonds, it's time to carry out a stress test with your advisor to see if you've got the right asset allocation in your portfolio. And make the necessary adjustments.

It's time for a check-up.

by Roberta Castellarin

At a slow but regular pace, stock markets are continuing to reach new records. In Wall Street the S&P 500 index has reached 2,550 points and the Nasdaq 6,591. And in Tokyo the Nikkei ended the week's trading at 21,155, another 21-year high. European stock markets are benefiting from increasingly positive economic data that leave room for future surprises on the profits side. And these bourses too, led by the DAX and excluding Milan's "Piazza Affari", notwithstanding the super rally of 2017, are at maximum highs. So too, with yields at record low levels, are European government and corporate bonds.

And yet, in this apparent calm, a sort of little Shangri-La, something is moving. We're beginning to see the first movements in terms of yield premiums on the American curve. Moreover, the minutes of the last Federal Open Market Committee (FOMC) meeting show that the Fed intends to raise interest rates, even though several commentators have called for patience. And portfolios need to be adjusted to take that into account. Indeed, while European banks have passed the rates stress test and seem ready for what economists call a "new period of normalisation", and in spite of the follies of European Central Bank (ECB) Banking Supervision, investors would do well to ask if that's the case for their portfolios too. That’s why the time has come to perform a check-up with your financial advisor, a sort of road-worthiness test for your portfolio, to check whether your investments are exposed to the right assets.

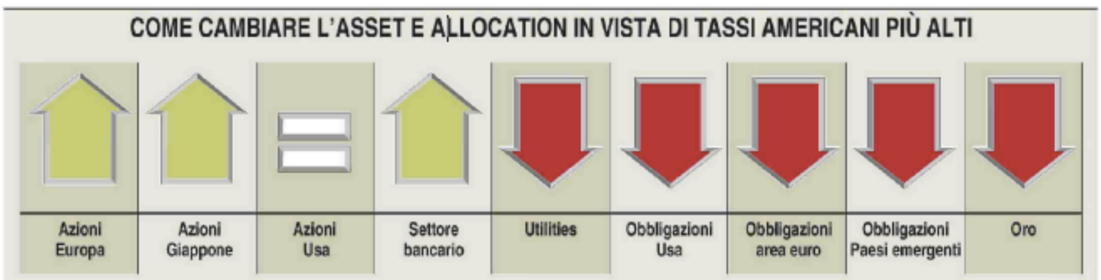
As Pierre Olivier Beffy, chief economist at Exane Bnp Paribas, warns: “The investors I met last week were struck by the speed of the bond market repricing after expectations of a more hawkish Fed”. The markets now expect two rises by the end of 2018. “Even though the size of the movements is still smaller than our estimates, the rise in 10-year yields and the US rates curve is on-going and the sovereign bonds market should continue to be a hot topic in the coming weeks”, adds Beffy. He underscores that the rise in inflation, the change in the euro/dollar exchange rate and the emergence of a more aggressive Fed are all happening in quick succession. “We’re sticking to our euro/dollar target of 1.13 for the end of the year, while yields on 10-year US bonds will very probably rise to 2.6% in the short term”, says Beffy.

A study by Goldman Sachs AM on the possible impacts of a gradual exit from this extraordinary period of accommodative central bank policies highlights that bond purchases by monetary authorities have exerted a downwards pressure on long-term securities. And warns that this trend could be reversed when the Fed begins to reduce its balance sheet. Translated, this means reducing its exposure to bonds, American but also European and those of the emerging economies. Benjamin Melman, head of asset allocation and sovereign debt at Edmond de Rothschild asset management, has also looked at asset allocation. He points out that: “The central banks are moving very cautiously because inflation is still low and they want to avoid any shock on the markets. But investors are behaving as though they don’t believe that the rates rise is just around the corner”, says Melman, who fears that the realisation will dawn on them any minute now. Hence the decision to “reduce exposure to US government bonds and increase exposure to Japanese equity. Japanese shares tend to out-perform, unlike those of the emerging countries, when interest rates are on the up”, adds the expert.

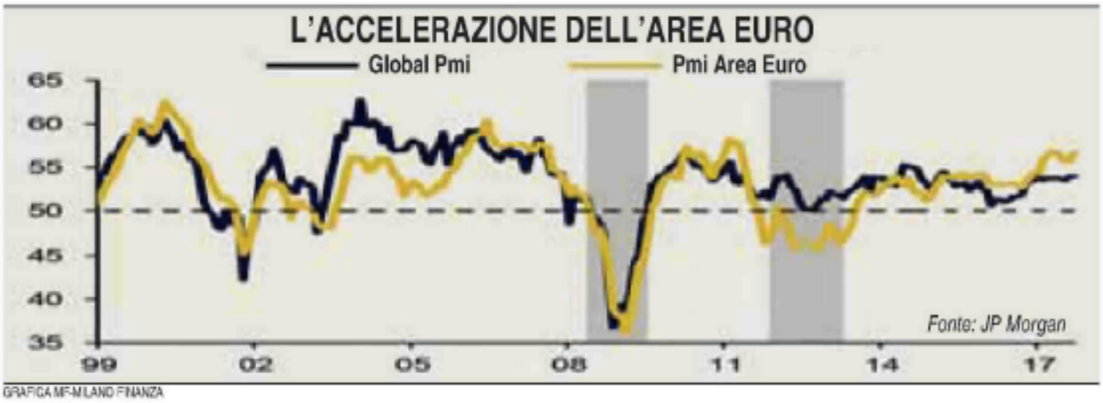
Gold is another asset that should fear a rise in US rates. “In the short term, we expect gold’s performance to be affected mainly by the increase in US bond yields and the stronger dollar”, says Névine Pollini, senior commodities analyst at UPB. Hence the advice: “In the short term we’re staying cautious with gold, which could consolidate around the 1,250 dollar threshold”. However, anyone investing today needs to maintain a balance between all the different movements taking place. The experts at Goldman Sachs underscore that quantitative easing (QE) has lessened market and bond yield volatility, while leading to a preference among investors for risky assets. “A gradual and well communicated departure from QE, re-balanced by the excess liquidity in global savings, could help prevent an abrupt and dramatic change in the situation”, says the Goldman Sachs analyst. “Bond yields will rise gradually, the premiums on long-term products will normalise and the rates curve will be steeper, but ending QE will not in itself necessarily lead to greater volatility”.

And the stock markets? Is there really a danger of a bubble, as so many fear, or are there still opportunities to be grasped? According to the experts, Wall Street has already given the best it has to offer and should have a neutral weighting on portfolios. That's because, in spite of the expected increase in yields, bonds don't yet seem competitive and the US stock market is still good for balancing asset allocations. Much better, and - in addition to Japan, as mentioned - deserving of a higher weighting, are European stocks, not least in the light of the rising trend in company profits. "Europe, especially southern Europe, being the region most penalised by the previous economic crisis and having a significant potential for recovery in terms of GDP, unemployment and company profit margins, could amplify the rising trend with respect to other stock markets", says Angelo Meda of Banor SIM. As far as equity sectors are concerned, Goldman's asset allocation includes an over-weighting on banks in terms of both equity and bonds. Similar pointers can be found in the monthly outlook produced by Allianz Global Investors, which points out that in the medium term the rise in bond yields and inflation rates should favour cyclical sectors, especially in the financial sphere. But the Allianz report also adds that: "At the structural level we still prefer securities that distribute dividends, which continue to be an important component of overall stock performance". And Meda underlines: "In a period when rates should rise as a result of better-than-expected macroeconomic data, the sectors to opt for are the most cyclical ones, like finance and energy. The stocks most penalised in relative terms would be the ones most closely linked to rates, such as utilities and consumer staples". Meda also points out that where technology stocks are concerned there are two sides to the coin: although the growth in profits continues at a good pace, in most cases better than expected, "the valuation levels achieved limit the upside".

HOW TO CHANGE ASSETS AND ALLOCATION IN THE LIGHT OF HIGHER AMERICAN RATES



THE ACCELERATION OF THE EURO AREA



10-YEAR US BOND YIELDS AND FED POLICY