9 April 2018

AFFARI & FINANZA

Inflation and tariff war: how to manage stock prices

RENEWED FINANCIAL MARKET VOLATILITY IS CHANGING THE SCENARIO FOR FUND MANAGERS. SOME EXPERTS ADVISE CAUTION BUT OTHERS THINK THE PHASE WILL SOON PASS

Milano

There are two sides to volatility: one is the difficulty of choosing management strategies, the other is the chance to stand out from the competition. Renewed financial market volatility is changing the scenario for fund managers, though not necessarily for worse.

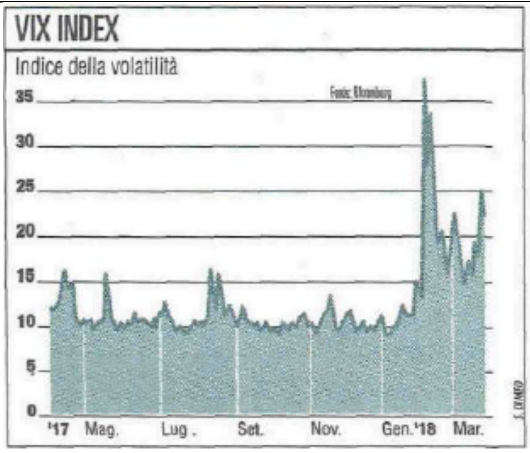
According to Oreste Auleta, head of Wrapping & Product Management at Eurizon Capital Sgr, 2018 is turning out to be very different from the previous two years. "Initial uncertainty about the rate of inflation is now compounded by fears of a trade war and the attendant risk of a global slowdown", he explains. After a long climb, the stock markets have come to a halt, as have interest rates on long-term government bonds, while the dollar is no longer sliding and oil prices are no longer rising. "This phase of the market is like a pause at the end of a period of consistently positive news that was being taken for granted". Auleta adds, "investors are waiting to find out, going forward, whether there are greater risks of inflation accelerating or of growth moderating".

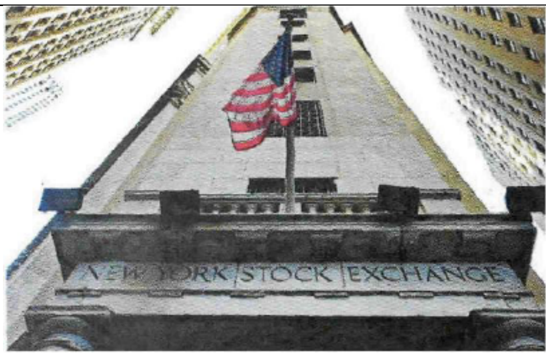
Eurizon Capital Sgr's central assumption is that global growth will continue but without accelerating any further, which should stop consumer prices from heating up too quickly. This would be confirmation that the situation is without danger for either the economic cycle or the markets. As for government bond yields, the Intesa SanPaolo group's asset management company expects them to stop rising in the short term, although the upward trend will persist in the medium term.

Cédric Baron, head of Generali Investments' multi-asset fund, believes that the medium-term prospects for equity are still good, but recommends caution in the short term in view of the increasing volatility and the uncertainty caused by political risks such as the possibility of a global trade war. "For the time being, we prefer to increase our exposure to bonds and correspondingly decrease the share component", he explains. The company has increased the proportion of government bonds of "core" countries, partly to diversify its portfolios and partly as a safeguard should trade tariff tensions escalate.

"In this type of scenario, even precious metals could become a useful hedge", adds Baron. "We are especially keen on gold, because it offers protection and can safeguard against higher than expected inflation". He advises keeping a close eye on the situation regarding the Trump Administration's trade tariff plans. "We think the dollar will appreciate against the currencies of both the industrialised and emerging countries because the US economy is generally less exposed to global trade volatility".

According to Andrea Orsi, deputy head for Italy at M&G Investment, volatility is unlikely to diminish over the coming weeks as several hotbeds of geopolitical tension exist. His advice is to focus on fundamentals. "When investors behave irrationally and shift asset classes away from their fair value, without any deterioration in fundamentals, some interesting buying opportunities can arise, which an active and flexible strategy can exploit to make tactical portfolio decisions". (I.d.o.)





View of the Wall Street Stock Exchange, severely affected by the tariff wars

[ANIMA]

Savings plans and other options. The key to surviving is total flexibility.

Filippo Di Naro, senior investment manager at Anima

The priority is to try to overcome the volatility that will be a feature of the coming months as liquidity progressively diminishes on the markets, while the macro scenario will remain positive. The advice is to focus on "a more flexible approach, adjusting asset allocation according to market performance", explains Filippo Di Naro, senior investment manager at Anima. "You could choose funds with a strategy designed to mitigate volatility or invest 'in instalments' through savings plans". Basically, units are bought periodically, which reduces the risk of staking all your savings when prices are highest. This type of strategy is suitable for investors hoping to see their capital increase in value over the long term, but who are also wary of major shocks.

As far as prices go, Anima still prefers shares to bonds, but has recently increased the liquid assets in its portfolios in response to greater volatility. As for bonds, given the prospective rates increase, Anima continues to view them negatively. “Imagining a cautious portfolio, you might invest 80% in bonds and 20% in shares”. (I.d.o.)

[UBI PRAMERICA]

The scenario remains positive. Stay with equity.

Fabrizio Fiorini, Senior investment manager and deputy general manager of Ubi Pramerica Sgr

Prefer equity. “Fears that Trump’s tariffs will unleash a trade war are casting a shadow over the stock market indices in terms of size of increase, but seem unable to stop a positive performance”, remarks Fabrizio Fiorini, senior investment manager and deputy general manager of Ubi Pramerica Sgr. “Strong and sustainable growth, together with the action of the central banks, provide good safeguards against the volatility stemming from unexpected negative events on the political front”. Current share prices do not take into account the expected growth in corporate profits, leaving scope for an increase. On the other hand, government bond yields “offer too large a premium for their role as insurance in the event of turbulence and so they do not provide enough return in times of nominal growth, as at present, and might produce negative absolute returns during the year”. If you put yourself in the shoes of a small investor, the advice is to go for broad diversification: 25% shares (10% USA; 10% Europe; 5% Italy); 25% European high yield; 30% BTP Italia 2023; 15% emerging bonds (local currency and strong currency); and lastly 5% 30-year BTP. (i.d.o.)

[NORDEA]

Credit quality and restructuring. It’s time to bet on EU banks.

Fabrizio Nikolaj Kamedula, financial analyst with Nordea’s Fundamental equities team

“We’re very optimistic about European banks: we think it’s the best sector to be exposed to at a time of strengthening economic recovery”, explains Nikolaj Kamedula, financial analyst with Nordea’s Fundamental equities team. His position is unusual among professionals in the sector, many of whom are concerned about the tighter new regulations. “Banks on this side of the Atlantic can now see the end of the restructuring process that has been under way for more than a decade, and has involved huge recapitalisations, closures of unprofitable businesses, improvements in corporate governance, massive intervention on credit quality involving changes in underwriting standards and business models, as well as a complete review of the regulatory system governing European and global banks". There is also optimism about the banking union, a project he believes will come into being despite some hitches and will "lead to a consolidation of the banking sector at European level".

Italian banks, too, which "have made an enormous effort to dispose of non-performing loans".(i.d.o.)

[ALLIANCEBERN]

Three rate hikes by the end of the year. For bonds it's better to change.

Steve Hussey, head of financial institutions credit research at Alliance Bernstein

The hardest challenge is to generate value with bonds at a time when rates are raised in the US and on this side of the Atlantic the European Central Bank (ECB) is gradually easing off.

After the new head of the Fed, Jerome Powell, debuted by raising interest rates by 25 basis points (the fork is now between 1.50% and 1.75%), it is reasonable to expect three hikes in total this year and the same again in 2019.

At this point, those who want to keep some exposure to bonds have no option but to look for alternatives to government stock and low-yield securities. "This is the time to consider again bond issues of European banks, which are becoming sound again after a long period of recovery", declares Steve Hussey, head of financial institutions credit research at Alliance Bernstein. "With spreads narrowing and debt levels being compressed by the capital structure, we prefer to focus even more on opportunities offering relative value rather than assume generalised growth".

"We therefore think that the best options are Spanish banks and the top Italian banks, Unicredit and Intesa Sanpaolo".(i.d.o.)

[BNY MELLON IM]

Commodities might rise, but oil and gas will not increase fast.

Marco Palacino, managing director for Italy of BNY Mellon IM

Inflation and commodity prices are regarded as reliable indicators of the health of the economy, as well as being fundamental parameters for any investor.

As far as commodities are concerned, according to Marco Palacino, managing director for Italy of BNY Mellon IM, prices are likely to rise. "The drop in prices of aluminium, zinc, copper and nickel in February could be interpreted as an early sign of a new economic slowdown. Instead, I think that this is due to fears of a tariff war".

In reality, BNY Mellon IM's base scenario remains positive, "particularly in the emerging countries, so commodity prices might continue to rise slowly or at least hold stable", adds Palacino. Who therefore stays with the main commodities. "As for oil and gas, there's little room for a price rise owing to the new shale oil extraction in the US. Gold, on the other hand, is still a hedge in portfolios, particularly as a real guarantee against distortions due to changes in monetary policy". (I.d.o.)

[BANOR SIM]

On the commodity front, leave room for agricultural. Take care choosing, though.

Luca Riboldi, investment manager at Banor SIM

Economic growth is continuing but financial asset prices are stretched. It's between these two widespread schools of thought that asset managers have to navigate as they seek opportunities among solutions that are not yet properly priced by the market. "I don't think the sector is going to see a boom, but rather than it will hold steady", remarks Luca Riboldi, investment manager at Banor SIM. "Since 2009 commodity prices have been generally stable and the relevant companies have made little investment in new production capacity".

Those intending to move into this asset class should remember that it is normally somewhat volatile. "We are more interested in shares linked to commodities, for instance in energy, oil or some producers of fertilisers". Finally, there is some general interest in agricultural commodities, which are particularly low at the moment, at one of the lowest levels of the past 30 years. We shouldn't forget, however, that this asset class is exposed to numerous variables and should therefore be approached with extreme caution. (I.d.o.)