

# MULTI-ASSET VIEW: FOCUS ON EUROPE

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FOR HONG KONG PROFESSIONAL INVESTORS

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# Key talking points for investors

## 1) The (central) banks are back in town

- Fed cut a given, but question over magnitude and extent of easing.
- ECB to follow but how? Diminishing marginal effect of further rate cuts and damages banking
- Structural shift in monetary policy frameworks underway with greater focus on risk management

## 2) Trade tensions on hold for the time being

- It remains very difficult to see a long term solution to US China trade
- Like living on a fault line: tensions have calmed since the G20 and talks restarting, but a tweet could reignite everything
- Have markets become used to this as a persistent political risk premium and moved on?

## 3) Valuation a problem for equity bulls

- 17x S&P forward earnings has been tested but not breached sustainably since 2017
- Earnings unlikely to come to the rescue this year, but low expectations offer low bar for companies to beat

## 4) Euro area: still preference for credit and BTPs over equity

- Fundamentals remain weak: July flash PMIs deteriorated and bank earnings are being slashed again. Highlights that expectations of further monetary policy easing are less equity friendly than in other regions
- Continued preference for credit and peripheral sovereign to play further ECB policy action

The views expressed are those of the presenter at the time of preparation and may change in the future.

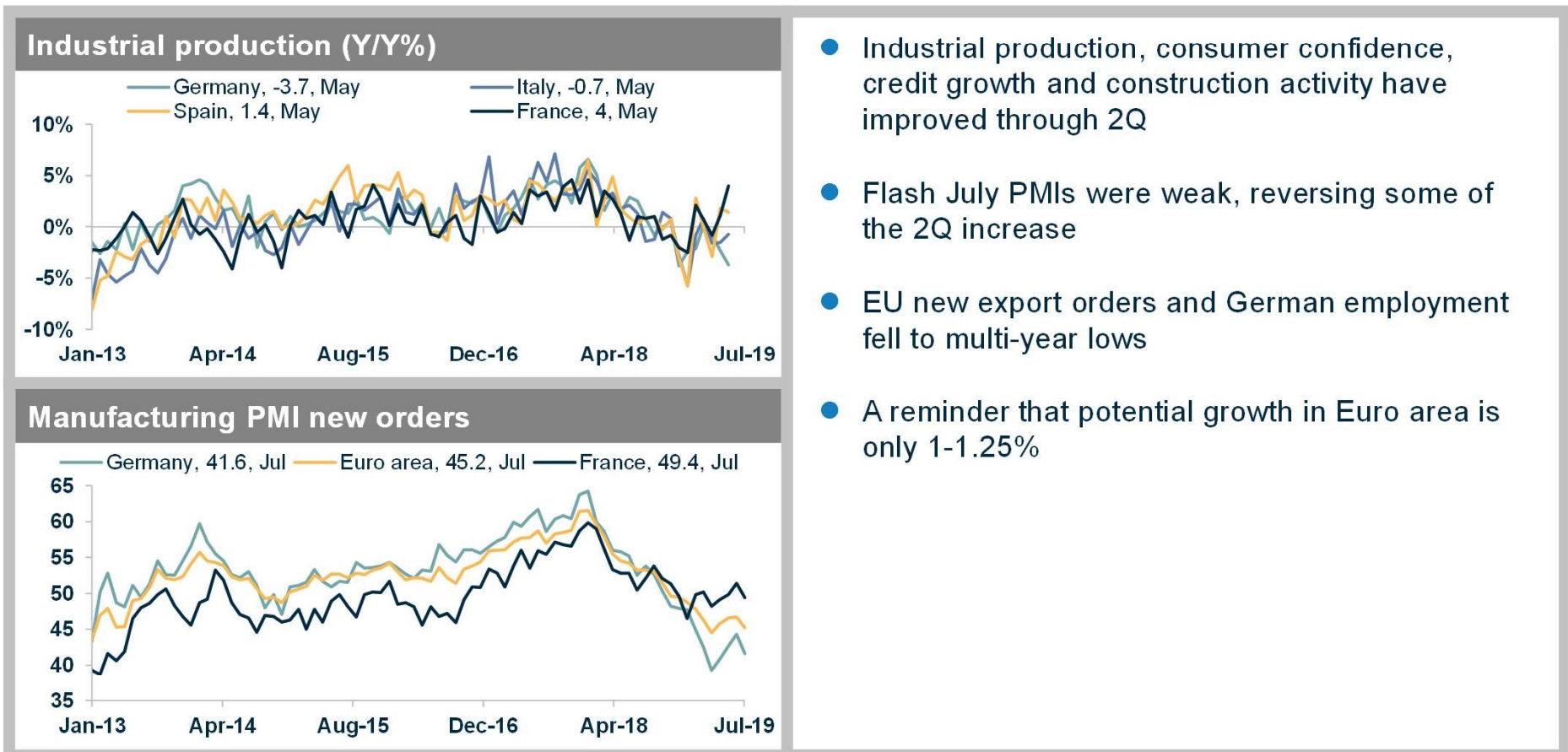


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# Fundamentals still weak

Some pockets of improvement in economic data, but July PMIs deteriorated again



- Industrial production, consumer confidence, credit growth and construction activity have improved through 2Q
- Flash July PMIs were weak, reversing some of the 2Q increase
- EU new export orders and German employment fell to multi-year lows
- A reminder that potential growth in Euro area is only 1-1.25%

Source: Bloomberg, as at 24.07.19



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# Shift lower in inflation expectations is a concern

## Persistently weak inflation appears structural

### Inflation is still firmly below target



- Core inflation stable at close 1%
- Market-based inflation expectations have fallen sharply, depressing bank equity prices
- Consumer surveys of inflation expectations do not show the same deterioration, but are below long-run averages

### Inflation expectations and bank equity



Source: Bloomberg, as at 24.07.19



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# Policy options

Just once in every 40 years the big 3 change at the same time

## All change, please!



**Christine Lagarde**

ECB President

**Charles Michel**

Council President

**Ursula von der Leyen**

Commission President

## Italian spreads



- Persistently low inflation, weakening growth and Fed rate cut will drive the ECB to loosen policy later this year
- All three aspects of policy likely to be used... state-dependent forward guidance, further NIRP with tiering, public and private sector QE
- Low rates will be a feature of European fixed income for years if not decades, supporting tactical allocations to long-dated bunds
- Likelihood of further QE in coming months and less acute political risk keep us positive on Italian BTPs
- Leadership changes in key roles are incrementally positive, but euro area still saddled with inferior ability to combine monetary and fiscal policy relative to other major economies

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Source: Bloomberg, as at 24.07.19



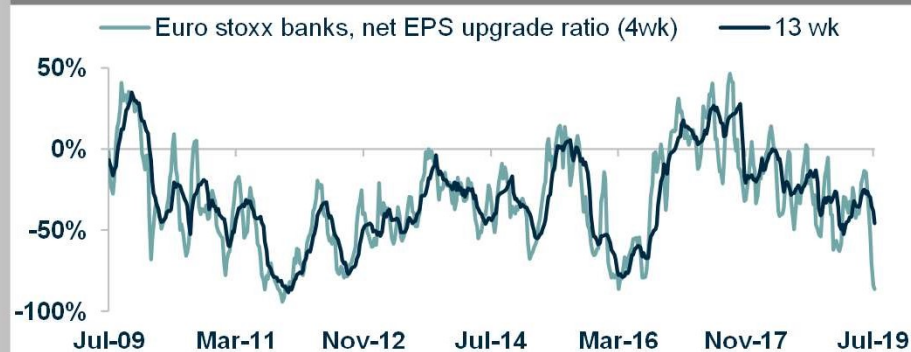
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# Banks profitability a drag

Bank profitability will struggle as long as rates are low, but credit growth is ok.

## Bank earnings revisions



## Household credit (Y/Y%)



- Bank profitability continues to be a worry as low rates reduce profitability
- Rising expectations of ECB rate cuts deeper into negative territory have seen a lurch lower in bank EPS revisions
- Consolidation – especially cross border – necessary but politically difficult
- Indicators of household and corporate lending are in decent health and do not appear to be impeded by negative rates

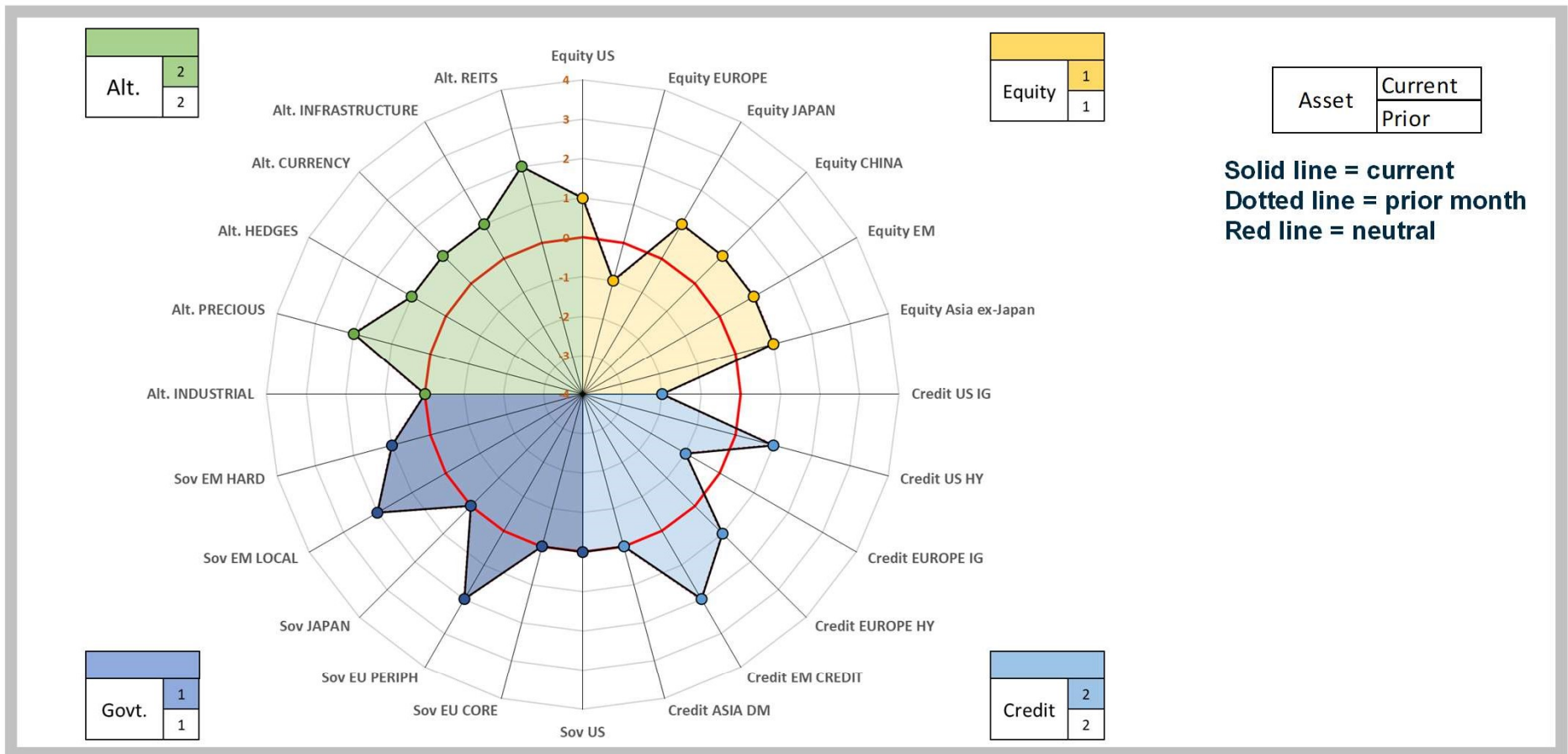
Source: Bloomberg, Refinitiv, as at 24.07.19



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# Medium-term asset allocation overview

Radar chart shows an indicative view on each asset class representing a range from -4 to +4. A reading of zero reflects a neutral allocation.



Source: Jupiter Multi-asset team, as at 24.07.19.



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# Asset allocation overview

## EQUITIES

Moderate allocation to equity risk.

Disciplined use of options for tactical upside.

Structural underweight to Euro area.

Tactical exposure to EM and China equities

Focused security selection via specialist income managers.

## CREDIT

Limited exposure to investment grade bonds on valuation grounds.

Global high yield still attractive, but important to be selective.

Capital structure approach in specialist financials sleeve.

## SOVEREIGN

Increasing conviction in core government bonds providing diversification.

Focused position in Korea.

Tactical position in Italian government bonds

## ALTERNATIVES

Flexibility to invest in liquid alternatives.

Current exposure to REITS and Infrastructure.

Source: Jupiter Multi-Asset team, as 18.07.19.



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