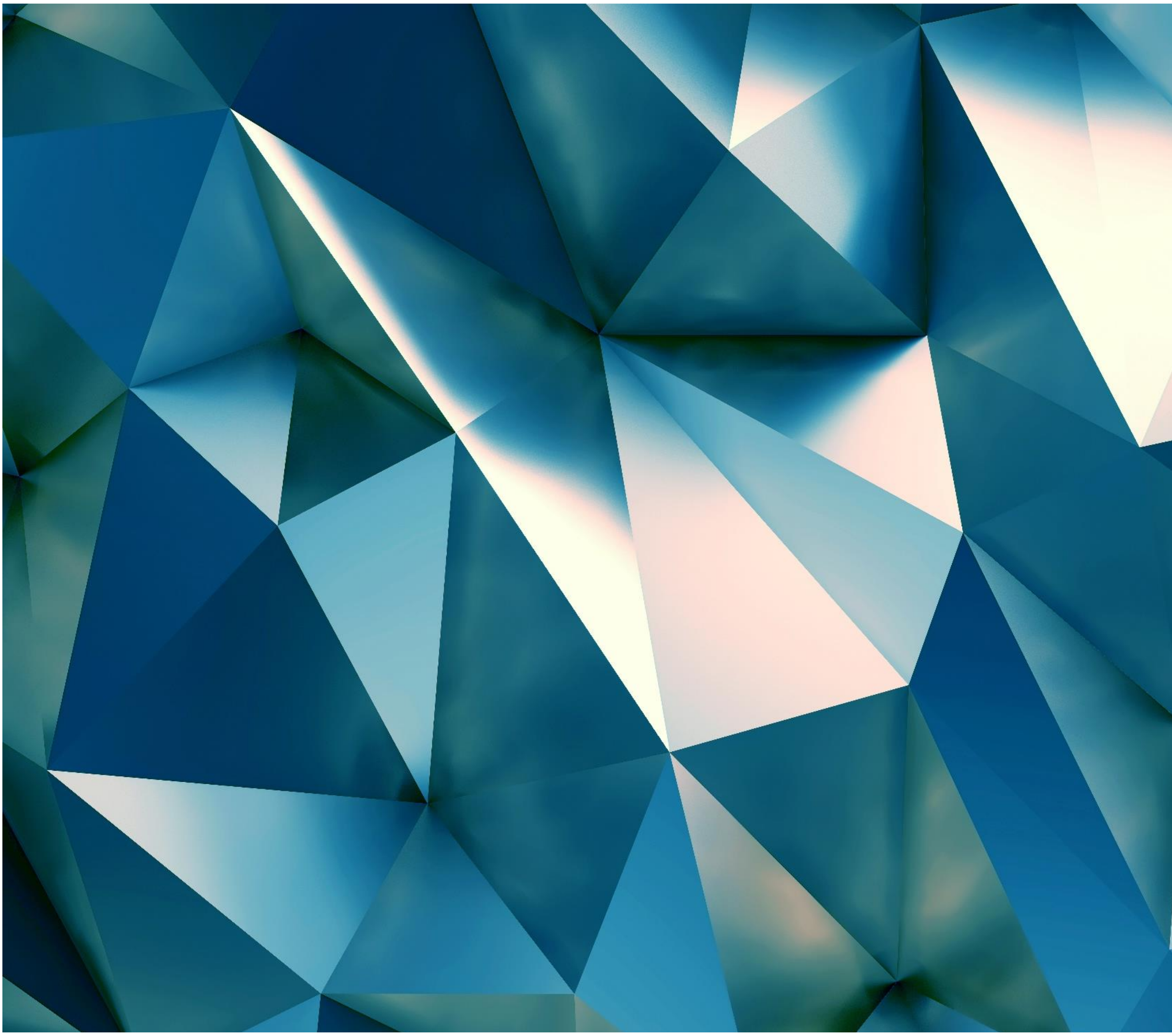
Rothschild & Co
Wealth Management



ASSET ALLOCATION | NOVEMBER / DECEMBER 2022

Mosaique Views

Markets in perspective

Markets are still grappling with interest rate and geopolitical risk

Dr. Carlos Mejia
Chief Investment Officer

Kevin Gardiner
Global Investment Strategist

Our thoughts remain with those hurt by the dreadful conflict still raging, which puts our economic concerns firmly into perspective.

Recently, those concerns have nonetheless become a little more pressing again. Inflation and interest rates still have yet to peak, and growth is still slowing.

The severity of the downturn remains unclear. Europe is most at risk from energy costs and potential supply shortfalls this winter. As yet, however, despite widespread expectations of an imminent and sharp recession, forward-looking data continue to point to a gradual slowdown, and governments are acting further to protect poorer households from the worst of the energy squeeze – which may be peaking: gas prices have softened at last.

Elsewhere, the important US economy is less exposed, and has some momentum (despite its poor GDP showing in the first half). China's economy faces ongoing structural headwinds, and a strict zero-covid policy, but it has the rare luxury of a low inflation rate, allowing its authorities to follow a more lenient monetary policy.

So, talk of global "stagflation" still looks premature to us. That said, the geopolitical climate remains troubling, and not just on account of the ongoing trauma in Ukraine. The West has been reminded that China's claim on Taiwan is not negotiable (though that does not mean that it is imminently actionable either).

We had already reduced our equity weightings in the New Year as it became clear that interest rates might rise faster than expected. We reduced them further on news of the invasion. In each case we chose to keep the funds in liquid form – this might look unusual at a time of inflation, but in the short term cash is more stable even in real terms than are securities, and it would allow us to capitalize on opportunities as they arose.

Our equity holdings returned to neutral only. Valuations have now fallen significantly and we still see corporate profitability staying healthy, but interest rate and earnings risk remain elevated, and we remain neutral.

We have however used some of the extra liquidity to add to our bond holdings, reducing our underweight positions in US and European portfolios. Bond valuations arguably improved by more than equities' as the increase in yields accelerated, and we have been tactically underweight bonds since Mosaique's launch. We have now moved a step further towards neutrality in US portfolios by closing our preference for shorter-duration bonds.

And within equities, we have now decided to close our long-standing overweight in emerging Asia, using the funds to close our underweight in Switzerland. Reducing positions in China after its market has already fallen sharply – and with its economy still outperforming, as noted – is frustrating, but there is no obvious catalyst visible currently.

Key	–	Neutral	+
Material overweight			
Benchmark weight			
Material underweight			

Asset allocation overview

We cut our double (maximum) overweight in equities to neutral, in two stages: first in early January, and then on February 24th. The funds were allocated to cash. As bond yields have rebounded, we have recently used some of that cash to reduce our long-standing underweight positions in bonds – a few months back in US portfolios, and more recently in European and Swiss portfolios too. We have now moved a little further towards neutrality on bonds in US portfolios by closing our preference for shorter-duration bonds.

US	–	Neutral	+
Money market			
Gold			
Fixed income			
Equities			

Europe	–	Neutral	+
Money market			
Gold			
Fixed income			
Equities			

Switzerland	–	Neutral	+
Money market			
Gold			
Fixed income			
Equities			

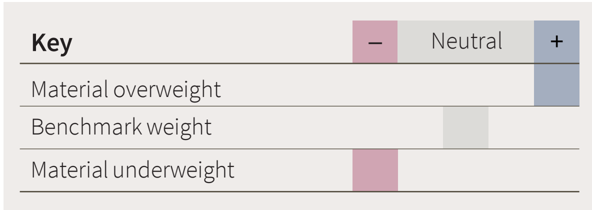
Fixed income

Longer-dated US yields have now risen far enough, we think, for us to close our long-standing underweight position on duration. In European portfolios, however, we stay underweight duration for now: inflation and interest rate risk remains significant, and rates and yields have rebounded by less than in the US: European central banks remain most visibly “behind the curve”. We recently reduced in European portfolios our preference for lower quality investment grade bonds as safe haven yields have risen, but still favour speculative (or “high yield”) credit to investment grade generally. We mostly continue to prefer corporate and emerging markets ahead of core government bonds.

US	–	Neutral	+
Duration			
High-grade			
IG low-grade			
High-yield			

Europe	–	Neutral	+
Duration			
High-grade			
IG low-grade			
High-yield			

Switzerland	–	Neutral	+
Duration			
High-grade			
IG low-grade			
High-yield			

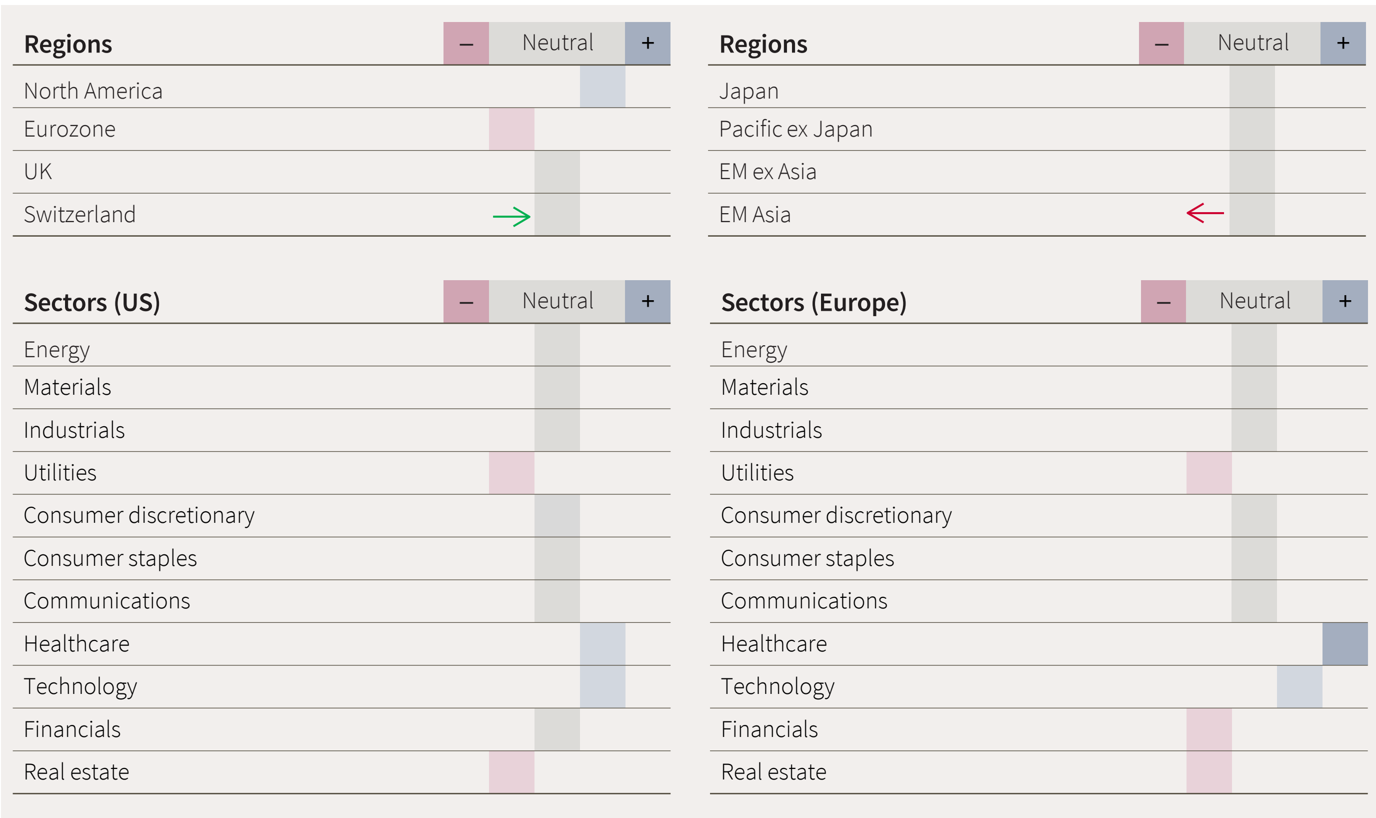


Equities

We cut our overweight firstly to reflect rising interest rate risk, and then on account of the disruption and economic slowdown associated with the conflict in Ukraine (the risk of slower growth has not resulted in a meaningful reduction in interest rate risk). Corporate profitability may not be hit hard, however, and we still see equities as the asset class most likely to preserve real wealth on a long-term view.

Regions: The ongoing threat to growth from the Ukraine conflict, and general global risk aversion, leaves us underweight in (Continental) Europe. We have however now closed an underweight position in the relatively defensive Swiss market, using funds raised by cancelling our long-standing overweight in emerging Asia (notably, China). The latter call has been a difficult one, as the market has already fallen a long way, but sentiment towards the region is still deteriorating and we see no obvious catalyst for low valuations. Elsewhere, we expect US leadership to resume. Russia, part of the Eastern European emerging market bloc, remains effectively uninvestable for international investors.

Sectors: We do not yet see a wholesale reversal of last year's market leadership, and have been favouring a mix of cyclical and structural growth, funded by underweight positions in more defensive and bond-like sectors. As a result of the attack on Ukraine, however, we have reduced some cyclical positions and become less underweight on defensives. Most recently we cut materials and boosted energy within both US and European stocks.



Key	–	Neutral	+
Material overweight			
Benchmark weight			
Material underweight			

Currencies

The major exchange rates had remained remarkably stable for many months, but recently the dollar has been trending markedly higher against most major currencies. It is now rather expensive – with some currencies such as the yen looking very inexpensive – and may lose some of that momentum as US interest rates approach peak levels first. However, we do not have enough conviction to extrapolate any trends, or to call major reversals, just yet (and we do not often take significant currency positions in the Mosaique context, as trading exchange rates is not a credible strategy for adding value). Longer-term, the dollar will likely remain the biggest reserve currency for the foreseeable future: talk of altered invoicing behaviour will not affect underlying demand and supply. The renminbi cannot challenge the dollar more fully until China's capital controls and structural current account surplus disappear.

Currency	–	Neutral	+
USD			
EUR			
GBP			
JPY			
AUD			
CNY			
CHF			

Wealth Insights

At the heart of Investment Insights lies a wide set of timely and insightful publications, podcasts and infographics.

For more information on our Investment Insights, please visit our Wealth Insights page at

www.rothschildandco.com/insights

Important information