Architas' tactical update: our take on today's markets

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This month, we've moved from a moderate underweight to a neutral position in equities. In fixed income, we have increased our US duration from a neutral position to a moderate overweight position and reduced high yield from moderate overweight to neutral.

Regarding equities, we've moved from moderate underweight in European equities back up to neutral, which takes us to a neutral equity position overall. It no longer feels appropriate to be underweight equities: the picture isn't quite as negative as it was previously. During the summer, quite a lot of economic data pointed towards recession. But some of the soft data, by which we mean survey-based data, is starting to improve, which points towards a slightly better outcome than maybe we feared. Even so, some of the hard economic data remains a bit challenged, but payrolls seem fairly steady while the consumer remains resilient.

Supportive central bank policies

At the same time, financial conditions are easing. So we've seen rate cuts and a dovish bias from the US Federal Reserve (Fed). The Fed and the European Central Bank (ECB) increased the sizes of their balance sheets, thereby providing monetary stimulus, while the Bank of Japan has been doing this for years.

Brexit developments

We've also seen some progress on Brexit. Indeed there may now be slightly fewer geopolitical risks than previously. Finally, we saw attractive valuations for European equities.

The combination of all these factors led us to review the underweight position in equities and move up to neutral. We did that by positioning European equities back up to neutral.

Portfolio protection strategy

Despite this, we've done some things to protect portfolios against the potential risk of a fall in equities. First, we reduced our high yield bond position to neutral by taking profits, as they've performed pretty well. This balances the slight increase in risk we've made in our equity allocation.

Building more diversification

We've also added to US duration by buying US long bonds (which means we are buying US government bonds). We were neutral there; now we're moderately overweight. One reason for this move was to build more diversification, more hedges, into the portfolio. In particular, factors that would lead to a decline in equities might be supportive for US duration (meaning US government bonds). But we also wanted to take advantage of the fact that yields in the US were higher more recently, as bonds sold off. We saw US 10-year treasury bonds yielding close to 2%, which was pretty attractive for us.

Watching the gold price

The second thing we're doing is looking to introduce other hedges into the portfolio. We are looking at gold and recommend a phased allocation to this asset class. Gold is at levels of around $1,450 to $1,500 per ounce. But if it moves to a level of, say, below $1,400, we think that would be a good time to phase in an allocation to the precious metal. As with US bonds, it is a diversifier to equity risk.

We're neutral on equities and are not predicting equity markets are going to go up, but we believe some of the downside risk has softened slightly. By adding some duration, we are diversifying the portfolio and adding some hedges in case equity markets go down. There are always risks, so having some diversification in the portfolio, some hedges, is always a sensible thing to do.

This is an edited version of an Architas podcast. If you want to listen to the original podcast, then please use the link below:

https://soundcloud.com/architas/architas-tactical-asset-allocation-monthly-update-dec-2019-investment-professionals-only

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