PARTY TIME FOR EQUITIES?

Growth forecasts for 2017 look promising, with key equity markets set to rise as corporate earnings continue to improve. However, ongoing political uncertainty could cut this short. We asked fund selectors which equity markets and funds they are backing to keep the party going and avoid any negative political contagion

FERNANDO MANRIQUE ZUNIGA
Prima AFP
Peru

After the two big events showing how the markets and politicians underestimated people's angst regarding income inequality, job destruction and the same masked 'hope' messages in political campaigns, we find ourselves in a 'party mode' market.

It seems all the fear that the media proliferated (despite giving those outcomes a very small probability) just moments before Brexit and the US elections vanished in a matter of days or even hours after the results came in. In both cases markets chose to see the 'glass half full' and started bidding prices quite aggressively.

So, where do we go from here? On one hand it seems clear that higher inflation numbers, higher growth expectations, fiscal expansion, Trump Twitter messages and European elections might fill the media headlines in the months to come – so volatility is somehow warranted. Everybody talks about stretched valuations, dollar strength, higher rates and higher earnings. We agree on some of those headlines (and disagree on a lot as well). However, we prefer to choose our battles and have picked the following recommendations on the equity side.

We currently like US cyclicals, Japan and non-commodity-linked emerging markets. What we don't like are commodity-linked emerging markets, the UK and growth indices. When it comes to Europe, we have adopted a wait-and-see approach.

We also think the market is mispricing geopolitical and policy risk. That is reason enough to buy a little gold, which also helps hedge portfolios in the case of an inflation overreaction. Overall, it looks like a bumpy road. However, if economic activity finally takes off, helped by the fiscal impulse along with higher sentiment in the private sector and minimized political interference, an overweight to equities makes total sense.

JAIME TORRES
Valores Bancolombia
Colombia

As a result of uncertainty around Brexit and US presidential election surprises, our strategic allocation for 2017 is in general neutral for international equities. However, we turned moderately overweight on US equities in our November 2016 tactical review, due to the positive market response to Donald Trump's election and possible positive policy effects on the US economy and on companies' earnings potential, especially within the financials and healthcare sectors.

To implement this tactical view, in December 2016 we incorporated into our moderate and aggressive model portfolios a 6-12% allocation to both **US Financial** and **US Health Care SPDR** ETFs. We are also including in our buy lists more cyclical, higher-beta US dedicated vehicles such as **Franklin Mutual Beacon**, **Schroder ISF US Small & Mid Cap Equity** and **MFS Meridian US Value** funds. These positions complement longer-term allocations that we've maintained in our recommendations to highly diversified global equity mutual funds with relevant exposure to US equity, such as **MFS Global Concentrated** and **Investec Global Franchise**.

On the emerging market (EM) front we remained neutral in our last tactical review, again due to US global trade policy uncertainty. However, for 2017

we still expect above-average returns in these markets, thanks to steadier commodity prices, stronger US demand, weaker currencies, lower inflation and better financing conditions within most EM economies. Because of this view, we recommend within our diversified solutions a 5-25% allocation to EM markets through active vehicles such as the **Schroder ISF EM** fund, **Investec GSF EM Equity** fund and **Investec GSF Asian** fund.

HOMERO ELIZONDO

SOLIQ

Mexico

Growth forecasts are better for the US. China is expected to grow about 6.5%, which hasn't changed, but services are the main drivers of this growth, with manufacturing still slowing down. Latin America is quite a mix, but the large countries, such as Mexico and Brazil, have low expectations. Mexico will probably be hurt by Trump, and the International Monetary Fund has recently decreased its growth expectations to 1.7%. Brazil will return to positive after three years of negative GDP.

We are focusing on other countries such as India, South Korea, Colombia and Peru as greater overweights in emerging markets. We are considering Russia, Brazil and China as lower overweights.

Nevertheless, we remain bullish on developed markets, where there are still opportunities with small caps, energy, the financial sector (although national banks could have limited returns), industrial and technology sectors.

We invest directly in stocks in the US and a mix between stocks and country exchange-traded funds (ETFs) when investing in emerging markets or ETFs in the case of small caps. In the case of ETFs we are investing in the MSCI country index, although we are starting to look at active fund managers for specific regions or sectors.

EZEQUIEL ZAMBAGLIONE

Puente

Argentina

After Trump won the election we saw an impressive rally in the US equity market, a jump in the 10-year US Treasury yield of around 70 basis points and negative returns in most emerging market assets.

The drivers behind these movements were Trump's campaign promises, which mainly were to increase the fiscal deficit with a corporate tax cut and higher infrastructure spending, and to introduce border taxes to protect US industry and employment.

Under this scenario, we believe US small-cap value stocks will outperform among equities. They will benefit most from a cut in corporate taxes, as they sell most of their production in the domestic market and will be relatively protected in a trade war scenario.

We believe the **ETF IWN** best reflects our view, with high participation in regional banks (30%), which under higher rates and financial deregulation would increase net interest margin and profits, and industrials (13%), which would benefit from fiscal expansion, increasing protectionism and a construction boom.

The main risk to our view is a less aggressive than expected fiscal expansion, or potentially a weak multiplier, which would reduce earnings growth and in part inflation expectations.

In this scenario, US Treasuries and rate-sensitive equities, like Reits, would outperform, making them the best hedge for this position.

A blend of small-cap value stocks, complemented by a smaller position in Reits or US Treasuries, would be the best way to face the uncertainty of 2017.

ALBERTO ARRAMBIDE

Banco Sabadell

US

When it comes to the Trump rally I think the market is getting of ahead itself.

There is a sense the market is priced to perfection on the back of what he said he'd do – it's more about expectation than reality.

While the market may be getting ahead of itself, it does have potential if there's really a turnaround based on themes like economic growth, inflation and interest rates.

We split our exposure here between value and growth and avoid all-cap funds. Among funds we have in portfolio are the **Morgan Stanley US Advantage**, **MFS Meridian US Value**, **Robeco US Select Opportunities**, **Aberdeen North American Smaller Companies** and **Schroder ISF US Small & Mid Cap Opportunities** funds.

Today the most overlooked market in my view is Europe. Nobody is willing to invest here because of headwinds and the upcoming elections, but it offers the best value in the medium to long term. We actually added a bit to our European allocation last year. We currently hold the **Investec GSF European Equity** fund and the **MFS Meridian Europe Value** fund and are currently analyzing the **AB Eurozone Equity** fund.

I still like emerging markets. Even though some companies are more leveraged than before, most economies are actually in a better place than they were previously, except Mexico.

It is in the crosshairs right now for what's happening with Trump, but it could be one of the best opportunities in the coming years – just not right now.

VIEW FROM OVERSEAS:

MARKUS BAMERT

Lenox Capital

Switzerland

Managing assets for mid-sized high-net-worth individuals has had its challenges in the past few years. Global economic growth has been lackluster and many companies loaded up on debt for non-operating purposes to improve per share metrics. Equities climbed, not least thanks to unproven central bank activities, lifting equity valuations to elevated levels. Against such a backdrop, we feel it is paramount to make sure that assets are protected from large losses, rather than striving to outperform markets.

Many funds we picked do not invest in financials. Funds like **Heptagon Yacktman US Equities** hold some cash, which they would deploy only at better valuation levels. **Lindsell Train Japanese Equities** is a strict bottom-up manager, not chasing those stocks that may benefit from Abe's politics. **Exane Ceres** fund, investing with a market neutral approach in consumer related stocks, is one of our picks in politically unstable Europe.

STANISLAS GUÉRIN & ISABELLE SIMON

Agami Family Office

France

In equity markets, we are favoring Europe for valuations as the political risk, in our view, is being exaggerated. We also expect a return of positive flows to the region. The sector rotations we have witnessed since the summer of 2016 and that could continue have led us to not make any bets that are too pronounced in terms of sectors or market cap.

The value style should continue its recovery against growth but in a less linear and slower manner than in the second half of 2016. In light of this we are focusing on pragmatic managers that have flexible sector allocation strategies like the **Crux Special Situations**, **Ulysses LT Fund European General** and **Moneta Multi Caps** funds.

We remain constructive on the US for its resilience and on emerging markets for their economic growth so as not to have an unbalanced geographical exposure in our portfolios. We prefer to use a tactical investment approach in these markets.