NATIXIS
INVESTMENT MANAGERS

Perspectives

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IN SHORT

- Markets continue to focus on reopening plans and future growth
- We choose to remain cautious for now, though we believe that downside risks have become more limited
- We remain constructive on the medium term and look to build positions gradually in the coming months

Transition phase

May saw a period of consolidation following April's optimism, with only few asset classes continuing their rally. Indeed, enthusiasm about the prospects of reopening faded as the economic, earnings and pace of recovery reality hit. Nonetheless, assets edged higher, supported by central bank actions and hope that the worst of the pandemic is behind us.

We appear to have entered a transition phase, both in terms of the post-confinement world, and in terms of markets. Indeed, markets front-run economic data and they are already – and have been – pricing in a return to growth in the second half of the year. However, as we gradually reopen, we are seeing that the return to growth will be slow and staggered. As such, it might take better news to lift markets significantly higher – or significant advances on a vaccine. In the meantime, risks remain with regards to bankruptcies, defaults and long-term unemployment, and new ones (or old ones) have crept back in, such as the rise in US-China tensions, and the impact this could have on global trade.

For now, equity markets are likely to continue to trade between improving news on the virus reopening plans and a focus on the "post-corona" phase of the crisis, and concerns that this outlook will take longer to materialise, given ongoing social distancing measures, global trade tensions and businesses closing. As such, we choose to remain prudent, although we have brought our equity allocation back to benchmark. We believe that disappointment risk remains and that markets could correct again, even if we do not believe we will re-test the March lows. Indeed, consensus is bearish and cash levels still elevated, which suggest that the downside has become more limited. In addition, fiscal and monetary stimulus have been much larger and come much sooner than in previous crises, which should help shorten the pain. Nonetheless, the rally has been concentrated in only a few sectors, suggesting a more defensive tilt in investor sentiment rather than broad-based risk on. The rally appears to be broadening, and any confirmation of that trend would be welcome.

Given the amount of central bank support, bond markets have continued to do well, and credit in particular has benefited from a strategy we have been following: buy what the central banks buy. We maintain a neutral position to sovereign debt since we believe that central banks will keep yields capped and an overweight to investment grade credit. While spreads have recovered some of the March widening, there is still potential for compression. We believe that risks in high yield persist, and believe it is still a bit early to reallocate there. We see select opportunities in emerging market debt, particularly in the less volatile corporate space, but remain cautious as many emerging markets are in dire situations.

We believe that gold should remain supported by central bank QE programs and also by the prospect that interest rates will remain low for a long time, suggesting gold's lack of yield will not be a deterrent.

Asset class details

Equities

After April's strong rebound, equity markets entered a period of stabilisation in May, with only a few regions and sectors continuing in their strong upward trajectory. Nonetheless, most segments have advanced further, with the S&P500 retracing more than 60% of its losses, although European and emerging markets remain well below previous peaks.

For now, we remain prudent with a neutral allocation, as we believe that disappointment risk remains with Q2 data a few weeks away and renewed US-China tensions in the headlines. That said, the consensus is bearish and cash levels are still elevated, suggesting we probably will not re-test March lows. In addition, the rally is starting to broaden, which, if confirmed in the coming weeks, would be an encouraging development.

We remain relatively defensively positioned with allocations to the Nordics and South Korea, and have added a position to European banks where valuations are extreme and additional support should come via further European Central Bank support and the expected Recovery Fund.

While we believe the next few months could be complicated, we maintain our more constructive medium-term view and look to gradually build longer-term positions.

Fixed Income

Central bank actions are bearing fruit with stable sovereign yields in US and Europe and tighter credit spreads. Liquidity and funding market stress has eased as well, and central banks are expected to add to stimulus measures even further.

We expect yields to remain low for some time and we maintain a neutral allocation to the sovereign segment, with a preference for the US. We continue to 'buy what the central banks buy', so have an overweight to investment grade (IG) credit. We believe that risks remain in high yield (HY), as defaults are set to rise and the migration of IG names to HY as inflated the BB segment. Moreover, central banks are more focused on protecting the IG segment even if they will act as a backstop for HY if spreads widened in an unorderly fashion.

We see select opportunities in emerging market debt, particularly in hard currency corporates that is typically less volatile and has less trouble with a strong USD. However, given difficult situations in many countries, selectivity is key.

Spreads have only recovered part of the March widening, suggesting attractive entry points for the medium term even if they can remain wide for some time.

Currencies

Major currencies remain within their broad range, though the US dollar has seen some recent softness versus euro and versus commodity-related currencies. We believe that a more risk on sentiment could see further USD weakness, though we expect the greenback to maintain some underlying support. Sterling is facing a tough few weeks, as the crisis has not been handle well and a hard Brexit looms. Emerging market currencies are likely to remain at risk given interest rate cut and tough environments in many countries, though they can offer select opportunities for the medium term.

Commodities

Oil prices have recovered from their lows, but are likely to remain capped given ongoing oversupply and a slow pick-up in demand. Over the medium term, prices should rebound further as supply and production balance out, but we still expect supply to remain ample. Gold should continue to see underlying demand as a safe haven, given inflation expectations and central bank QE programs.

Alternatives

We continue to see a place for alternatives in portfolios, as we look for de-correlating and diversifying strategies to complement traditional asset classes, particularly with liquid alternatives. We believe that real assets can also help provide income in a lower for longer world.

Current views

Asset Classes	Negative	Neutral	Positive
Equities	○	●	
Fixed Income		●	
Equities			
US		●	
Europe		●	
Japan	●	○	
Asia ex Japan		●	
Emerging Markets	●		
Asia			●
Latam	●		
Europe	●		
Fixed Income			
Sovereign US			●
Sovereign EUR		●	
IG US		○	●
IG EUR		○	●
HY US	●		
HY EUR	●		
EM Hard Ccy	●		
EM Local Ccy	●		
Commodities			
Oil	○	●	
Gold			●
Base Metals	○	●	

● Current month ○ Previous month (no dot means no change)

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