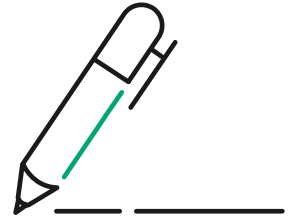


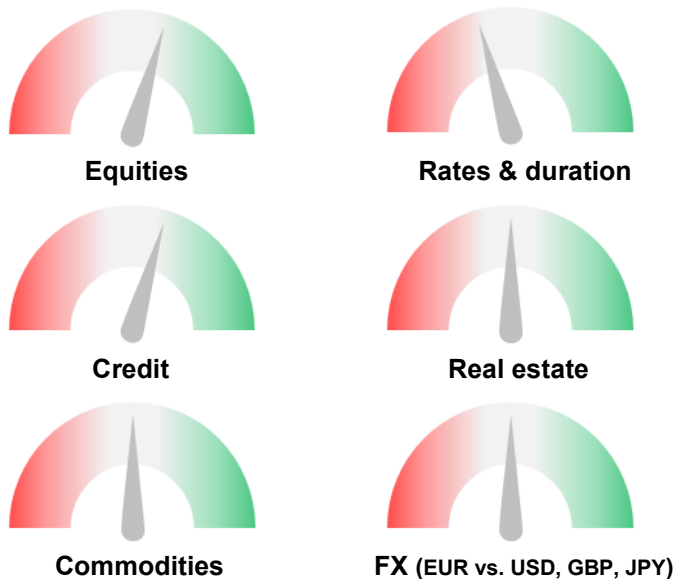
# ASSET ALLOCATION FLASH

BNPP AM – Multi Asset, Quantitative and Solutions (MAQS)



## BUY THE DIP: LONG DM EQUITIES

### Asset allocation overview



**Maximilian MOLDASCHL**  
Senior Multi-Asset Strategist, MAQS  
[maximilian.moldaschl@bnpparibas.com](mailto:maximilian.moldaschl@bnpparibas.com)  
+44 20 7063 7247

**Guillermo FELICES**  
Head of Research and Strategy, MAQS  
[guillermo.felices@bnpparibas.com](mailto:guillermo.felices@bnpparibas.com)  
+44 20 7063 7196

## SUMMARY & ASSET ALLOCATION

- **Buying the dip:** the multi-asset Investment Committee (IC) at MAQS decided to go long developed market (DM) equities on the 10<sup>th</sup> May 2019 after several months of being strategically neutral equities.
- **The main rationale for the trade:**
  - A cautiously constructive view on US-China trade tensions: our base case is that the renewed trade tensions will be tense and prolonged (potentially lasting months), but that eventually further discussions will lead to a trade deal.
  - The economic and policy backdrop (moderate growth, low inflation and Fed policy put) still endorse a 'goldilocks' environment, notably in the US, that is supportive of risky assets.
  - Our proprietary Technical Dynamic Analysis (TDA) still points to a medium term bounce in equities.
  - A preference for DM versus EM equities: the IC preferred to avoid EM equities due to lingering uncertainty about China's economic recovery despite months of monetary and fiscal stimulus.
- **Risks:** the main risk is a further escalation of US-China tensions that leads to a 'no deal' and material damage to global markets/economic sentiment. This could potentially take us to a more bearish global slowdown environment.
- **Implementation:** we decided to implement the trade as a 50% EMU and 50% US equities basket with a fairly low conviction level, leaving room to increase the position in pull backs.



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## BACKGROUND

After being strategically neutral on equities for some time, on Friday 10 May, we decided to go long DM equities following a correction in major equity indices that was triggered by an escalation of US-China trade tensions.

The main rationale on the fundamental side was that the macroeconomic environment of moderate growth and low inflation together with the Fed pivot that followed the Q1 correction provided a supportive environment for risky assets at a 6-12m horizon. Given the mature nature of the US cycle, we call this a 'fragile goldilocks' environment where the two main risks are: (i) an overheating US economy and (ii) a pronounced global slowdown.

Separately, our market dynamic analysis was also supportive medium term (6-12m). Our market temperature indicators still flagged hot and pointed towards a consolidation to more normal conditions and our Technical Dynamic Analysis (TDA) pointed towards a small consolidation in the near term and a structurally bullish configuration medium term.

Taking all these elements together we were generally constructive on risky assets. However, we were unwilling to chase the market after a 15% rally in DM equities year-to-date. In this context, the IC sees our base case ('fragile goldilocks') as one that is conducive of buying dips in the equity market.

## TRADE RATIONALE

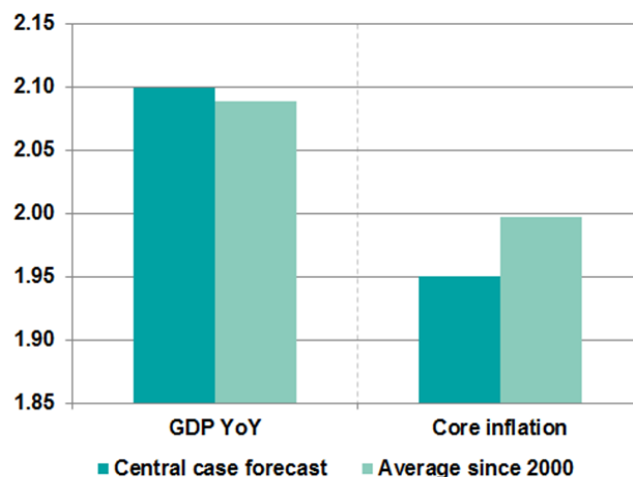
At the time of the IC discussion on Friday 10 May, EMU equities and the S&P 500 had fallen c.4% and c.2.5%, respectively from their late April peaks.

The IC discussed buying the dip with the view that the correction could be larger by the time of trade implementation. The main arguments in favour of buying the dip were:

- Cautiously constructive view on US-China trade tensions: our base case is that the renewed trade tensions will eventually lead to a trade deal. The process will be tense and may last for weeks/months, and it may open other opportunities to add to risk. The key signs to follow for de-escalation are: (i) a reversal of trade tariffs and (ii) progress in trade discussions ahead of the G20 Meetings in Japan on 28-29 June, where President Trump is willing to meet President Xi.
- Economic and policy backdrop (moderate growth, low inflation and Fed policy put) still endorse a goldilocks environment.
- Technical dynamic analysis still points to a medium term bounce in equities.
- Preference for DM versus EM equities: the IC preferred to avoid EM equities due to lingering

uncertainty about China's economic recovery despite months of monetary and fiscal stimulus. US equities have corrected less than EM, but its fundamentals are a lot stronger as seen in the latest earnings season. In addition, our technical analysis suggested that the bullish trend in DM vs. EM equities is not finished.

**Figure 1: Moderate GDP growth and low inflation supports a patient Fed and hence a 'goldilocks' environment**

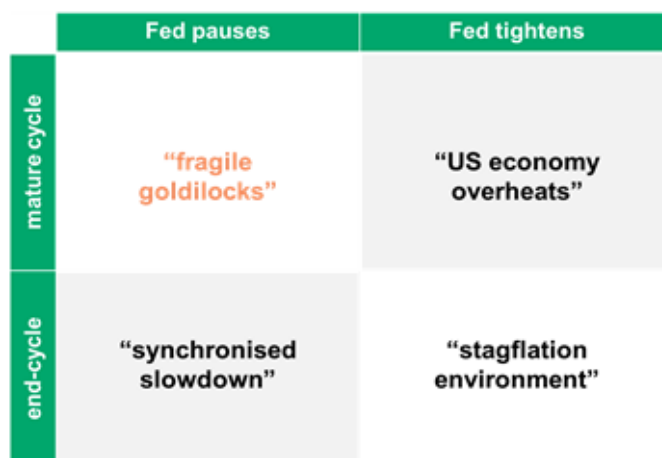


Source: Bloomberg and BNPP AM, as of 17/05/2019

## RISKS

We are very aware of the risks involved. The main risk is a further escalation of US-China tensions that leads to 'no deal' and material damage to global markets/economic sentiment. This could potentially take us to our bearish scenario of 'synchronised slowdown' so we need to monitor the news flow closely.

**Figure 2: A material escalation in US-China tensions risks a transition to a global economic slowdown**



Source: BNPP AM, as of 17/05/2019



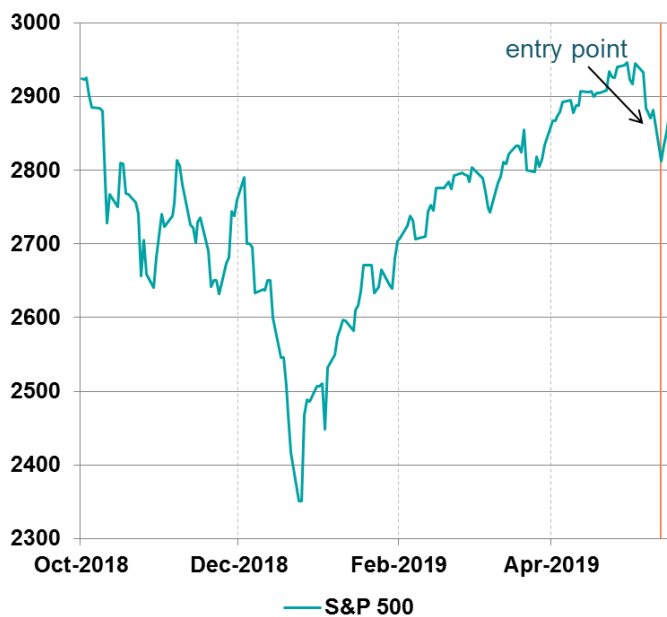
## IMPLEMENTATION

The IC decision was to buy a small amount of US and EMU equities with the view of adding if a further pull back materialises.

We decided to implement the trade as 50% EMU and 50% US equities with a conviction level of 20% (10% each; our bullish/bearish scale goes from -100% to +100%).

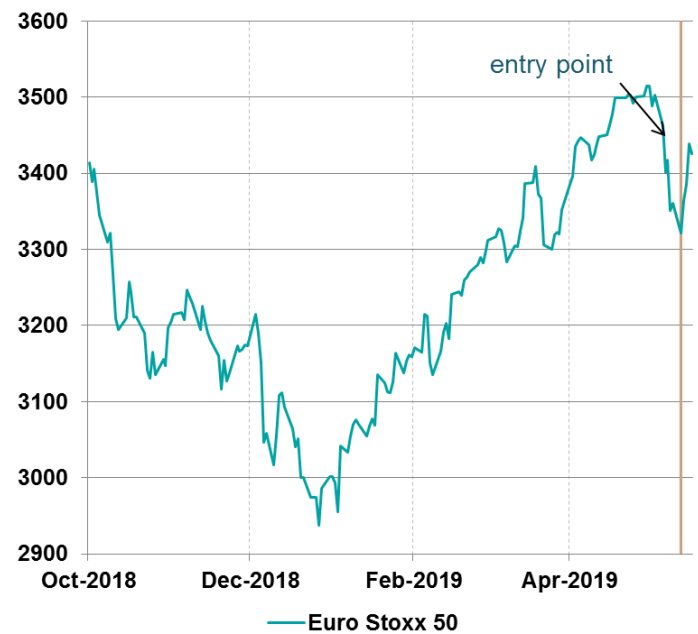
The decision was made on Friday 10<sup>th</sup> May, but most portfolios implemented the strategy on Monday 13<sup>th</sup> May.

**Figure 3: Buying the dip – Long US equities**



Source: Bloomberg and BNPP AM, as of 17/05/2019

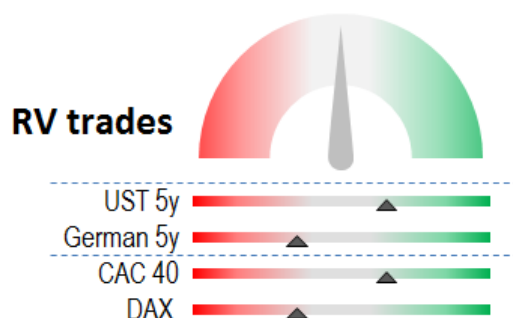
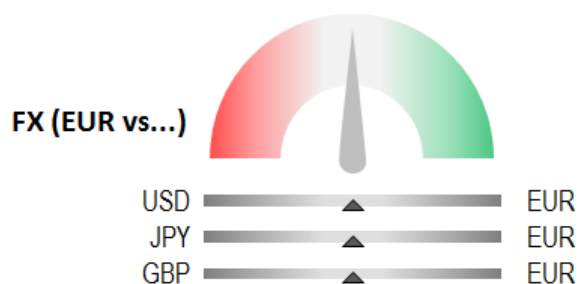
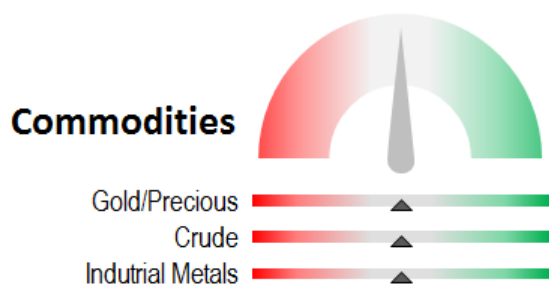
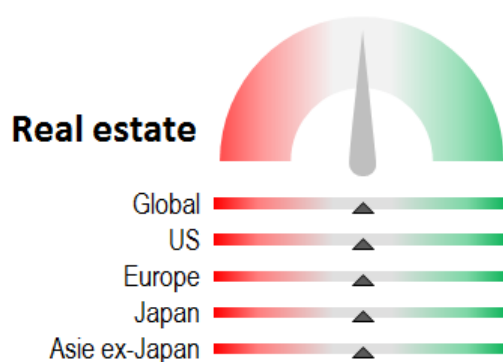
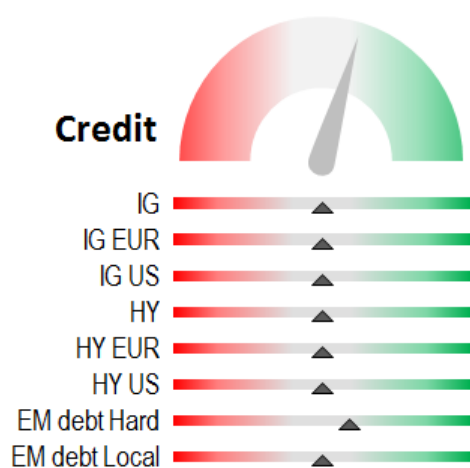
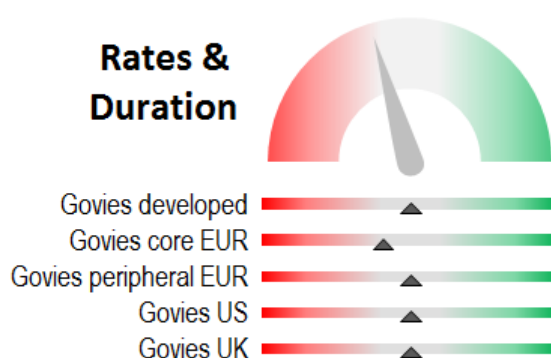
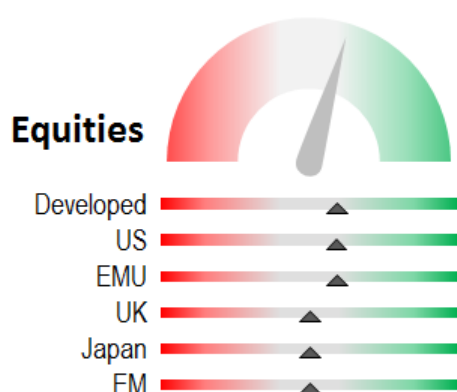
**Figure 4: Buying the dip – Long EMU equities**



Source: Bloomberg and BNPP AM, as of 17/05/2019



## ASSET ALLOCATION DASHBOARD<sup>1</sup>



<sup>1</sup> The dashboard shows the asset allocation in our portfolios and reflects the decisions of the Investment Committee of the Multi-Asset team at MAQS.



Views expressed are those of the Investment Committee of MAQS, as of May 2019. Individual portfolio management teams outside of MAQS may hold different views and may make different investment decisions for different clients.

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As at May 2019.

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