ALLOCATION PERSPECTIVE

Bull market or Bubble ?

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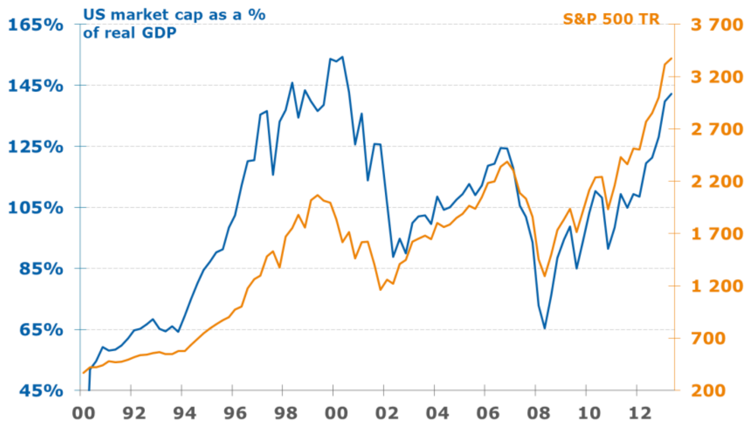
US equities have posted annual gains of more than 24% on a total-return basis over 5 years, i.e. cumulative gains of 210% since the low point in March 2009. Although not yet the case, but it could be in less than one year (in April 2015 to be precise), this rally would become the third-longest bull market in history.

However, the specter of the internet bubble which marked the end of the 1990s is looming once again. Tech giants are wielding their overabundant liquidity and driving the price of unlisted start-ups through the roof, while valuations among certain NASDAQ stocks have also reached excessive levels. Despite the current sector rotation towards defensives, tech stocks are still trading on high valuation multiples.

Total market capitalization is thus dangerously close to the March 2001 peak, expressed as a percentage of GDP (142% at the moment). It would therefore appear normal to question the sustainability of the rally. Of course, since that period, US companies have generated a greater proportion of their profits abroad and US Gross Domestic Product should therefore not be used as their sole yardstick. However…

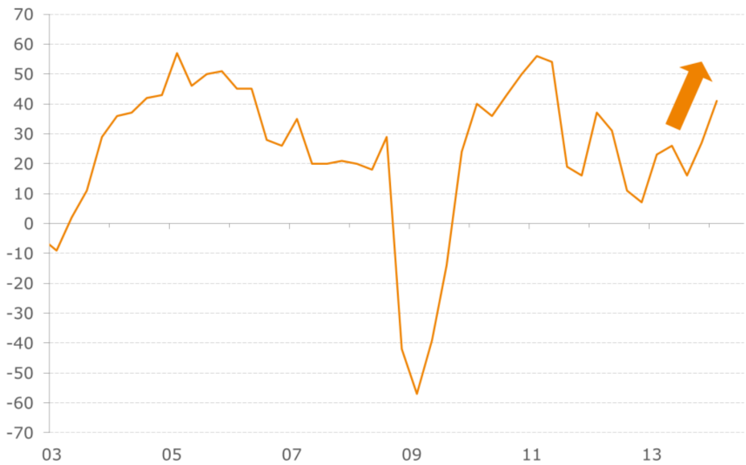


Source : ICS, Bloomberg

To prevent the current rally from bursting like a bubble, and for stock market gains to assume a more tangible character in the real economy, it is vital for corporate investment to supersede the Fed’s quantitative easing programs. Company margins certainly remain wide, but capex remains relatively stagnant, particularly in the US.

Company managers are revising investment outlook upwards, but we have been regularly disappointed on this front, with many companies opting to pay high dividends or buy back their own shares. One factor to watch, which could trigger a wave of investments, is sales growth, which often foreshadows companies adopting a more aggressive approach.

US : company managers’ investment outlook



Source : Business Roundtable Survey, Datastream

Is sales growth likely to kick-in soon? It certainly is, given the optimism in the broader economy, as gearing has been reduced and wealth has been restored following the rally among financial markets and the turnaround in property prices.

In short, it is certainly time for demand to be expressed in terms other than the search for yield or for investment vehicles to cater for the widespread over-liquidity created by the Fed.

Tactical positioning

In the positive global macro trend, we are maintaining our preference for equities vs bonds, which are subject to the risk of a forthcoming hike in US rates. We still prefer developed market assets to emerging market assets.

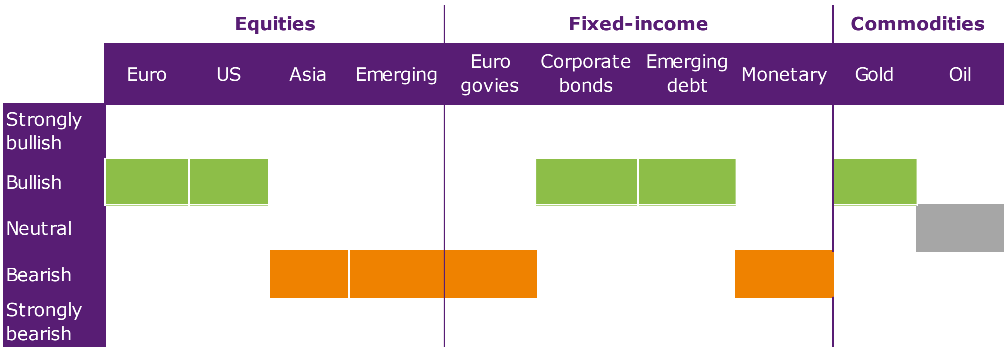
Fixed-income: Fixed-income markets continue to ignore positive indicators (ISM, employment, PMI), and at the current valuation levels, we remain underexposed to US government bond duration. In Europe, we are short Bund to finance peripheral debt positions and credit.

Equities: Given the improvement in the economic climate in Europe and the possibility of a more accommodating monetary policy, we are maintaining our preference for euro zone equity markets. We are nonetheless remaining highly attentive regarding the situation in Ukraine.

Currency: Like last month, the EUR/USD exchange rate was 1.3900$. We are maintaining our bearish view on the euro, in anticipation of the ECB implementing non-conventional measures.

Commodities: In April, gold consolidated to around 1,300$ and oil to almost 108$, whereas gas, cereals and palladium prices were buoyed by tension in Ukraine, gaining 10%, 3% and 5% respectively. On the other hand, the continued economic slowdown in China could weigh further on fundamentals, particularly among industrial metals. We remain bullish on precious metals however.

Tactical view by asset class



Strongly bullish view on the selected asset class
Bullish view on the selected asset class
Neutral view on the selected asset class
Bearish view on the selected asset class
Strongly bearish view on the selected asset class

Written on 16 May 2014

Annex : Theoretical model portfolio

Benchmark	Min	Strategic Allocation	Max	Asset Classes		Tactical Allocation	Change from previous Month	Previous Month
50%	**30%**	**50%**	**70%**	**Bonds**		**45.0%**		**45.0%**
40%	20%		60%	Bonds €		35.0%		35.0%
				Inflation €		0.0%		0.0%
10%	0%		20%	World Bonds*		0.0%		0.0%
				Emerging Debt***		5.0%		5.0%
				Investment Grade €		0.0%		0.0%
				High Yield €		5.0%		5.0%
35%	**20%**	**35%**	**50%**	**Equities**		**39.0%**		**39.0%**
12.5%	5%		20%	Euro		9.5%		9.5%
				Europe ex Euro*		7.0%		7.0%
12.5%	5%		20%	USA*		14.5%		14.5%
5.0%	0%		10%	Japan*		3.0%		3.0%
				Developed Asia*		0.0%		0.0%
5.0%	0%		10%	Emerging Asia**		3.0%		3.0%
				Emerging Europe - Africa - Middle East**	↓	1.0%	-1.0%	2.0%
				Latin America**	↑	1.0%	1.0%	0.0%
5%	**0%**	**5%**	**10%**	**Commodities**		**2.0%**		**2.0%**
				Energy		0.0%		0.0%
				Industrial Metals		0.0%		0.0%
				Agriculture		0.0%		0.0%
				Precious Metals		2.0%		2.0%
10%	**0%**	**10%**	**20%**	**Currencies**		**14.0%**		**14.0%**
5.0%	0%		20%	Cash €		0.0%		0.0%
1.0%			5%	Dollar / €		10.0%		10.0%
1.0%			5%	Pound / €		4.0%		4.0%
1.0%			5%	Swiss Franc / €		0.0%		0.0%
1.0%			5%	Yen / €		0.0%		0.0%
1.0%			5%	Emerging currencies / €		0.0%		0.0%
100%		**100%**				**100.0%**		**100.0%**
				Volatility		6.8%		6.8%
				Tracking error		1.0%		1.3%

* Hedged against currency risk
** Unhedged against currency risk
*** Debt issued in dollar hedged in €uro

The views used as input for the model portfolio are consistent with specialist's ones but may lead to different relative weighting versus benchmark compared to single asset class model portfolios.

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