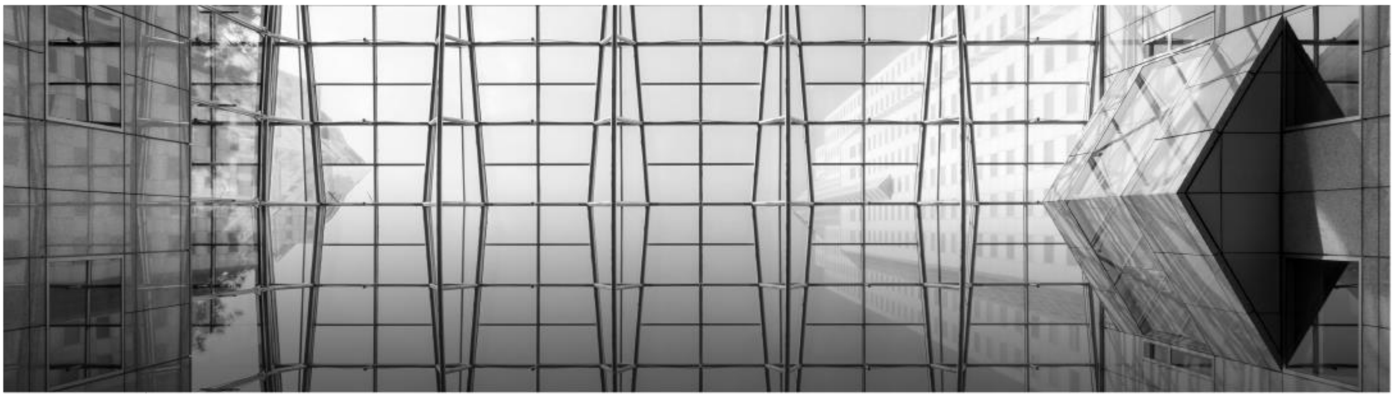
UOB Asset Management

Insights



Late cycle investing: Positioning

This is the third of a multi-part special series on investing at what can be a challenging time for investors.

At a glance:

- Base case remains that the global economic cycle should be sustained, though at slower levels
- Outlook for returns is muted; staying cautious, but not bearish
- Underweight on risk assets
- Monitoring signposts to turn more bullish or bearish

Aside from a slowdown particularly in global manufacturing, business investment and trade, investors are grappling with a growing list of risks that could potentially trigger a global recession. The US and China trade dispute is expected to drag on. We view the probability of a comprehensive deal, and/or significant escalation as low. Meanwhile, the odds of a “no deal” Brexit seem to have dropped. Other geopolitical risks include business pessimism from Hong Kong protests and oil price spikes from conflicts in the Middle East.

Our assessment indicates some chance that a materialisation to any one of the aforementioned tail risks could materially increase the risk of a recession. Though conventional wisdom cautions against tail risks, history tells a different story where none of the tail risks on investors’ radar proved to be the culprit which tipped the world into recession.

Positioning

The US Federal Reserve (Fed) is likely to undertake one more interest rate cut in 2019 to counterbalance the effects of slowing global growth. Though the probability of a recession in the next 12 months is non-trivial, this does not necessarily mean that a recession is imminent. While the near term outlook points to softness, there are some nascent signs that momentum in the US is improving (notably the housing market, as well as economic surprise data). The picture in Europe and Japan, however, remains less encouraging.

Since the global expansion should be able to continue at a muted pace, portfolios need to be protected from the elevated recession risks, but not completely focused on the fear of another 2008-like recession. With the uncertainties, we advocate portfolios remain defensively positioned. We are not in another risk-off environment akin to 2008. We have raised cash levels and are underweighting risk assets generally.

Equities: Underweight

We are underweight on equities. Within equities we are focused on high quality, dividend focused stocks. With one more Fed rate cut, equities can see positive returns if growth stabilises as lower financing costs can encourage borrowing and investing. However, the prospects for equities are muted with valuations that are already high.

Fixed income: Overweight

Given the uncertainties from tail risks, we are overweight on fixed income, focusing on good quality investment grade and short duration that is now more attractive from a risk to reward perspective. With the US Treasury yield curve finally in inverting there is limited room on the downside for yields on the longer tenors.

Government bond yields in developed markets have rallied to levels that are uncompelling, especially against an expectation of stabilising growth in the second half. Hence our preference for credit over government securities.

REITS: Stable ground

We have a tactical position in real estate investment trusts (REITs) as it offers stable income and decent returns. As interest rates trend lower, the yield spread (difference between REITs and government bond yields) rises and is paid out to investors as dividends. We favour more stable regions and sector in its equity allocation in light of the uncertainties and tail risks still prevalent.

Gold: Glitters with growing jitters

Gold tends to rally upon signs of economic uncertainty and shares an inverse relationship with interest rates as the bullion does not pay interest. With bond yields trending downward into negative territory for developed markets, the surge in gold prices represents the increased demand for safe-haven assets.

Signposts to turn more bullish or bearish

To turn more bullish, we look to signs that manufacturing and global growth are stabilising. Global purchasing managers' index bouncing back above 50 is an important signpost to monitor and could prompt us to neutralise our equity exposure in the period ahead.

To turn more bearish, we are closely watching for signs of employment weakness. At this stage where corporate profits are close to zero, businesses could start to retrench. If global employment trends weaken, we would turn more cautious and position in a "recession portfolio".

Important Notice & Disclaimers

UOB Asset Management Ltd Co. Reg. No. 198600120Z

To find out more,
please visit www.uobam.com.sg

RIGHT BY YOU