Political risk biggest concern for European fund selectors: it is time to be flexible

European and Emerging markets equities should provide the best opportunities, while Long/short, Relative value, and Event driven funds are favourite in the alternative space

by Alessandro Moise

Main asset classes' returns in 2018	
Commodities	3.36%
Equity USA	1.94%
Euro Gov. Bond	0.57%
Equity World	0.17%
World Gov. Bond	-0.08%
Euro Cash	-0.19%
Equity Europe	-0.30%
Corporate bonds Euro	-0.70%
High yield bonds Euro	-1.79%
Equity Emerging markets	-3.89%

Data updated end of June, 2018.
Data based on the following indices: Reuters/Jefferies Crb Commodities, MSCI Usa (Usd), Bloomberg Barclays EuroAgg Treasury Total Return Index, MSCI World in Local Currency, JP Morgan GBI Global in Lc, Euro Cash Indices Libor Total return 3 Month, EuroStoxx Total Market Net Return (Euro), iBoxx Euro CorporatesiBoxx EUR High Yield core cum crossover LC Total return, MSCI Emerging markets (Local currency)

The next few months will be particularly challenging. The ending of a decade of easy money provided by Central Banks and increasing political risks will result in a more volatile and uncertain financial market environment. European fund selectors currently consider cash and USD long bonds as safe haven assets, while in the long term favour European and Emerging markets equity. In this context, a flexible investment approach should be adopted. However, there are still opportunities for alternative strategies, especially for Long/short equity, Long/short credit, Relative value, Market neutral and Even driven funds. MondoInvestor talks about it with **Thierry Guerillot**, Responsable de la sélection des fonds at Myria Asset Management, **Felix López**, Socio Director at atl Capital Gestión de Patrimonios and **Bart van de Ven**, Wealth Advisor at Accuro Independent Wealth Advisors.

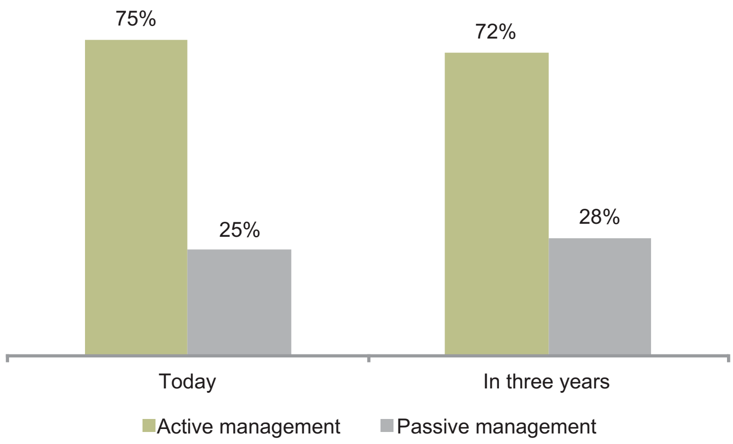
The macro environment is proving to be really tough and volatility has dominated markets for much of 2018. From a long term perspective, would you invest more in Europe, in USA or in emerging economies? Where do you see the best investment opportunities?

Guerillot: In a long term perspective, I think that the emerging markets are still promising, just regarding the demographic issues and their economic consequences (development of the middle class, urbanization, depollution).

López: In a world dominated by the intervention of different Central Banks policies, it seems reasonable to assume that if we come across a gradual withdrawal of the extraordinary measures brought in the past years, market conditions in terms of liquidity and volatility will be for sure less favorable for investors interest. Generally speaking, we see fewer opportunities in the fixed income spectrum rather than the equity space. Interest rates, which have been artificially reduced by Central Banks measures, should return to higher levels taking into consideration the economic cycle we find ourselves in. We have seen this movement already in the USA and it is certainly not an easy path for investors. In Europe, Japan and other developed markets we are at the early stage, as such expectations are truly negative. The recent performance we have observed in emerging markets is a warning of what could happen if normalization comes in disordered manner. After several years with good performance in the fixed income space, I believe we have come over the best and when looking ahead, we can only foresee moderate or even negative returns. However, we still find opportunities in equities market. As previously mentioned, although we find ourselves in the late economic cycle, we do not support the idea that markets are overvalued. Except for specific sectors or concrete geographical areas, on a medium term we see positive returns on the equities spectrum, on the condition that business earnings support is maintained, something we are confident on, with independence of other risks we may tackle. On a long term view we feel more confident on European and Emerging markets equity. These have attractive valuations but short term political problems and uncertainty makes the asset class to be forgotten by the investment community. Here resides the long term attraction.

van de Ven: Accuro Wealth Advisors helps clients to reach their financials goals for the long term. We are macro aware global investors but we do not radically adapt our portfolios based on the macro

CURRENT AND EXPECTED ALLOCATIONS OF PROFESSIONAL FUND SELECTORS



Source: Natixis Investment Managers Global Survey of Professional Fund Buyers. The survey included 200 respondents in 23 countries. chart 1

environment. Our funds and securities gives our clients exposure to global markets. We expect our managers to take a maximum of flexibility in allocation the money where they see the opportunities. We are long term investors and build strong partnerships with asset managers based on excellence. Accuro operates with a tailor-made platform. As a 'fee only advisor' we offer our clients the best advice and access to excellent funds and securities. We help the client building the optimal diversified portfolio based on the client's personal needs and preferences. Every portfolio is different because every client is different but the building blocks are more or less the same. We regularly add new strategies to our platform. We are looking into two strategies: a new global equity manager and a dedicated local Chinese equity strategy. In a political unstable world China is an oasis of stability. The country is fast becoming a world power and its capital market will open. Local expertise is very important; particularly in China.

Where do you see the main risks for the next months and how do you expect to react?

Guerillot: Main risks are events that you cannot have a view on. I don't think that the monetary policies are a problem now. The communication of the Fed and the BCE is clear and quite foreseeable. I am afraid of the political risks: in the USA with Trump and the next mid term elections. How the USA President could cope with Democrats if they win the Parliament? In Europe, the migration issue have heavy consequences on the European governance and on the German coalition, not to speak about Italy. A lot of noise ahead in the European markets for these reasons, I fear. As we have adopted a flexible approach of our asset allocation, that will be the moment to hedge part of our equity portfolio.

López: Main risks are seen in the consequences of Central Bank policy, in addition to politicians of primary world economies. Within the private corporate sector we see management quality and we therefore rely on them. In order to face the main risks, we keep a defensive attitude with fixed income assets and prudent within equities. Although in the short term these risks may affect every asset class equally, on the long run the main winner will always be the equities market.

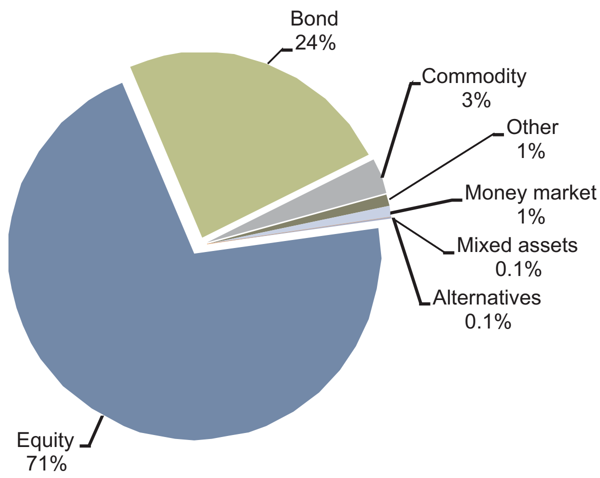
van de Ven: We do not try to predict the market but try to detect the main risks. The synchronised global growth is fading while political risks start having impact. There is a low probability for an immediate recession; global economy is still in relative underinvestment phase. However the political risks are rising. In Europe, mainly in Italy the upcoming confrontation between Germany and the new Italian Government. Also the escalation of the trade war is worrying. For companies, the environment is very uncertain and will have an impact on companies' behaviour and on financial markets. We prepare our clients for more short term volatility.

What do you think regarding gold and other safe assets?

Guerillot: We could invest in USD long bonds as a safe haven asset. We'll certainly not invest in gold as we don't consider that asset as safe haven in the context (the crisis should be far more critical to be envisaged).

López: In the current environment the safe haven assets is by far liquidity beyond every other. I feel more confident with the monetary returns rather than to assume uncertainty on the gold price on a six

ASSETS UNDER MANAGEMENT IN THE EUROPEAN ETF SEGMENT BY ASSET TYPE



Source: Thomson Reuters Lipper as at June 30, 2018. chart 2

months view. This does not mean not to hold gold positions. I am truly convinced of diversification positive effects, and in the end, this is the reason of investing in sovereign bonds, gold and other defensive holdings or asset classes which are uncorrelated to financial markets, but at the moment liquidity is undeniably important.

van de Ven: Basically, for us the only safe asset is cash. It helps to limit drawdowns and can be used for bargains in times of big market stress. As a long term investor, accepting volatility as the price for better performace, we don't need gold. On the long term gold will detract performance since there is no economic value and cash flows. For client believing in gold as volatility reducer, 10% of the portfolio is an appropriate weighting.

According to you, which alternative strategy do you predict to be the best performer in 2018? What is your investment capability across the alternative investment spectrum and what strategies are you looking for at this stage?

Guerillot: In the end, I think that there will be sectorial turnovers in the equity markets again. I believe that the Long/short funds will generate good level of alphas at last the day when very expensive securities and sectors will be down at the benefit of more defensive equities... Furthermore, as the economic cycle is mature, I think that it is still interesting to be invested in an event fund that can profit from the M&A trend.

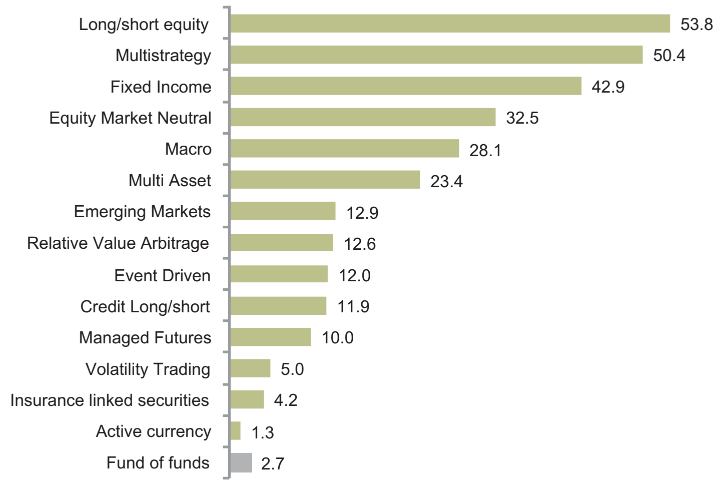
López: 2018 is being a tough environment for the majority of alternative strategies. As Central Banks appear to be less important market players, I strongly believe that companies fundamentals in equity markets will be the driver of their performance. In this scenario, Relative value and Market neutral strategies will be the winners on a risk return point of view. We also believe that Relative value strategies in credit markets will be on the top line.

van de Ven: We invest mainly in traditional strategies, like long only equity funds, fixed income funds and multi-asset funds. We avoid complex strategies. To broaden our offering we are looking into Long/short market neutral funds. These funds are also easy to understand. Price is important for us so we do not want to pay higher fees compared to long only fund.

How do you use ETFs in your portfolios? What kind of ETFs you use (market cap, factorial, Smart beta...) and what is your target allocation?

Guerillot: We hardly use ETFs (less than 2% of our assets under management). We use sectorial ETFs in a secular trend focused fund and an active smart beta ETFs in the USA equity market in another of our funds. We don’t intend to increase

ASSETS OF LIQUID ALTERNATIVE FUNDS IN EUROPE BY STRATEGY



Data in USD billions updated end of June, 2018. Source: MondoAlternative. chart 3

the share of ETFs in our portfolios at the moment.

López: In the past years we have increased the use of ETFs in the majority of our funds. We don't have a determined objective and their use will depend on the investment strategy of each particular fund. We use it for both strategic and tactical proposals. The primarily objective we establish for ETF use is to have a directional exposure to a determined market. We allocate a certain percentage into the asset class and then we distribute according to the internal criteria between active and passive funds (ETFs). For instance, in financial markets such as the American one, we opt for ETFs as it is harder to find portfolio managers which recurrently exceed their benchmark. On the opposite side we have European small and mid-caps, where we invest the vast majority in active funds.

van de Ven: We use ETFs in different ways: passive is for us a style with obvious diversification advantages; we use ETFs to manage equity exposure for more active clients; lastly, we offer on client demand sectorial ETFs for some specific themes like Chinese technologies or water. Theme ETFs perform much better than active managers in specific themes. We do not believe in Smart beta. It is often not so smart as it seems. However we invest in quantitative fund managers able to detract alpha from factors by active management.

How are you taking climate change risk into consideration? Which ESG strategies do you adopt in your investments?

Guerillot: Actually, we have been managing a fund of funds specialized in secular trends. One sixth of that portfolio is invested in environmental equity funds. As for our ESG strategy, we are thinking over implementing it more officially in the coming months for that specific fund.

López: Climate change risk is not a determinant aspect in our current investment process, nor in any other investment process of other portfolio managers. It is true that in the past months we have perceived an increasing interest from the client's side in terms of management responsibility and we have constituted an internal Committee as a first step, to evaluate the implementation of ESG strategies in our portfolio.

van de Ven: We offer dedicated ESG funds only on specific client demand. In the fund industry we see a trend to include ESG criteria in the investment process of active managers. We think this is the right approach.

We want to invest in good companies: good is not limited to financial metrics. Good companies are those which are looking both at the short term and also care about environment, people's wellbeing, etc. I really believe better companies in the broader sense are the long term winners.