Global Outlook: Asset Allocation

Navigating markets in 2015: 8 core macro themes and a few consensus risks

November 2014
Theme 1: Underweight bonds, overweight equities should work this time around

*Stick with balanced portfolio with modest equity OW*
2014: deflation risks in Europe, more disinflation in China

Aggregate inflation surprises again lower in 2014

Source: Bloomberg, Barclays Research
Theme 2: The Fed will lift off in 2015

USD flatteners, lower portfolio returns and US equity UW
The market needs to price a faster pace of Fed tightening

Markets are still pricing rates well below the Fed’s “dots”
Theme 3: Persistent US dollar strength

Long US dollar vs. majors, US rates divergence trades and OW non-US DM equities
Policy divergence will remain a key theme in 2015

Central bank balance sheets as a % of GDP

Source: Bloomberg, Barclays Research
Theme 4: Lower oil prices: the negative implications are priced, the positive one less so

*Overweight consumer discretionary and Asia ex Japan; underweight EM USD-based fixed income*
The oil price drop is substantial, and it should linger
Theme 5: The Bank of Japan’s bazooka

Long equities (with large caps looking quite cheap), short the yen and long JPY 10y breakevens
Japanese equities: cheapest to JGB’s for at least 20 years

Real yield gap and dividend spread with JGBs

Source: Bloomberg, Barclays Research
Big negative asymmetry in 10y JGBs, but too early to sell

JGB 10y yields lower than its cyclical drivers predict

*10y JGB yields model based on JGB 2y yields, IP growth and core inflation (%y/y).

Source: Bloomberg. Barclays Research
Theme 6: Europe is priced for the Japan scenario, but the ECB can change that

*Short euro, overweight bunds vs. Treasuries, overweight European equities*
Inflation expectations are “de-anchoring”
European equity markets look more like Japan than the US

Source: Barclays Research, Bloomberg
Theme 7: Broad negativity on global growth could be a good opportunity in 2015
Weak cyclically-link asset trend consistent with a weak cycle

Growth-linked assets price in quite a lot of bad news already

Source: Bloomberg, Barclays Research
Theme 8: Four headwinds for EM, but some opportunities as well
EM local debt: Real yields higher than DM but FX depreciation vs. USD to reduce returns

5y EM real rates are high versus DM real rates (%)
EM equity: earnings yields still attractive but not all is good

EM earnings yields (%) still attractive vs. DM despite recent fall

Global earnings yield

- EM-DM diff.
- Developed
- EM

Favour beneficiaries of low oil prices and strong US growth: Kospi. Cautious on commodity producers

Source: Datastream, MSCI, Barclays Research
Theme 9: What are the big consensus risks for 2015?
Little fear about Fed tightening

What is the most important risk to financial markets over the next 12 months?

Source: Barclays Research
Increasing worries about China

What do you think China's growth rate will be in the next year?

What is the probability you place on a significant negative shock to China’s economy over the next two years?

Source: Bloomberg, Barclays Research
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