ALLOCATION PERSPECTIVE

ECB : a fresh deal of the cards

Raphaël Gallardo
Strategist – Investment and client solutions

For once the ECB surprised markets on the upside at its 22 January meeting. Despite numerous press leaks, the measures announced widely exceeded the expectations of market participants … and of governments. This new monetary reality should provide support for European equity markets in the coming months.

Despite the exceptional measures introduced in 2014 (negative deposit rate, subsidised loans for banks in the shape of TLTRO, purchases of covered bonds and asset-backed securities), the ECB failed to raise medium-term inflation expectations (see Chart 1). In the 12 months to December inflation fell to -0.2%, thanks to the impact of oil-related deflation. Strong action was therefore imperative to avoid a knock-on effect for wages and prices.

Chart 1

Eurozone : expected inflation rate over 5 years, starting in 5 years

Source : Bloomberg

GROUPE BPCE

On 22 January, the ECB unveiled an asset purchase programme significantly above expectations. Monthly purchases have been extended to include sovereign securities reaching a level of €60 billion per month. But it is the length of the ECB's programme which is extremely ambitious: it is planned to last for at least 18 months (up until September 2016), representing a minimum of close to 11% of GDP, and until such time as the ECB considers that inflation is credibly on track to meet its 2% target. By outlining a dual constraint for the length of the programme, based on both a set time period and other more vague criteria, Mario Draghi has given himself a great deal of leeway on this issue. In addition, the ECB will purchase sovereign bonds with maturities of up to 30 years, including those with negative yields. At the same time, the interest rate on TLTRO loans for banks has been reduced by 10 basis points.

The impact on sovereign debt markets should be colossal, provoking a new fall in rates for all maturities, including peripheral debt (with the exception of Greece, which is today excluded from the programme). We should see a new flattening of sovereign yield curves across the board. However, falling rates are not a sure sign of immediate victory for the ECB: one element in the fall in rates is a fall in long-term inflation expectations, as shown by the reaction of the inflation swap markets. The fall in expected inflation is consistent with a halt to euro depreciation: the currency plummeted in value in anticipation of the 22 January announcements (see Chart 2). So it is still too early to claim victory, but Mario Draghi has nevertheless succeeded in gaining substantial leeway in the fight against deflation, despite the reticence of some eurozone governments.

Chart 2

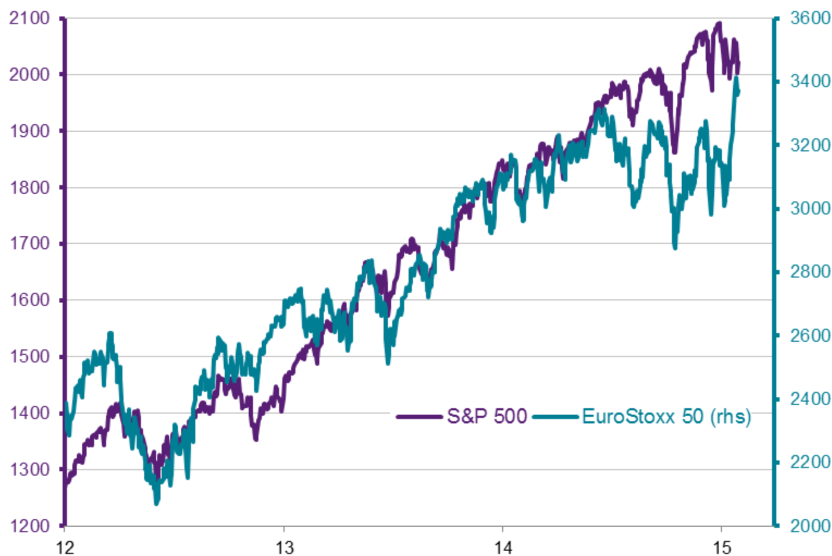
Eurozone : euro versus dollar exchange rate

Source : Bloomberg

These ECB decisions provide comfort for our multi-asset portfolio positions: we prefer bonds versus liquidity, and European equities versus the rest of the world. Taking account of the potential for a pause in euro depreciation, we prefer to play an overexposure to European equities via small caps rather than large caps, as they will benefit from the fall in real rates and easier access to credit thanks to the TLTRO.

Chart 3

Equity indices: US versus eurozone



Source : Bloomberg

Written on 30 January 2015

Tactical positioning

The rise in macro (shaky Chinese growth, looming Fed hikes) and geopolitical (Greece, Russia) risks leads us to neutralize our exposure to equity markets. We nevertheless stick to our overweight on Euro area equities. We still prefer government bonds to cash.

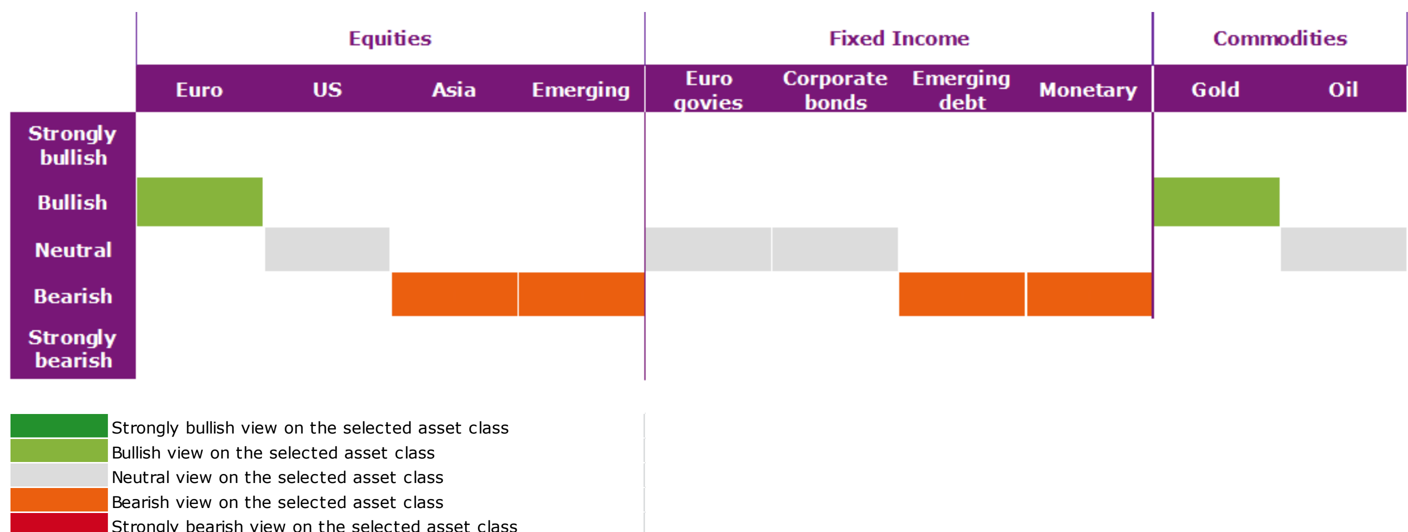
Fixed-income: The European Central Bank's answer to deflation risk in the euro zone surprised markets by its extent. ECB announced a massive purchase programme of sovereign bonds starting in March. The prospect of a drying of liquidity on the bond market causes a yield hunt by investors on the yield curve between 2 and 30 years. The only exception: worries concerning Greece's new government which is determined to abandon the reform plan imposed by the Troika in exchange for support.

Equities: As upside potential on US market seems limited now and as dollar could weaken, we reduce our positions on US equities. At the same time and despite a negative geopolitical context, we maintain our positive view on the euro zone after the ECB announcements, especially regarding small and mid caps.

Currencies: Swiss Central Bank and ECB decisions have taken EURUSD down to 1.1098$, its lowest since September 2003. The degree of Quantitative Easing set up by the ECB has surprised markets, Euro fell further down. However, the pace of decline that started in May 2014 (-21%) portends to moderation concerning the continuation of this trend. The parity may consolidate or even bounce in the coming weeks, especially as the outlook of rising rates in the US appears to be postponed.

Commodities: Another hectic month on the commodities market. Both US dollar strength and mixed macro economic indicators, especially in China, Japan and Europe, have weighed on cyclical commodities such as copper (-13%) and oil (-10%), whose respective markets are expected to remain in over-supply. However, gold benefits from the general decline in developed markets yields which rose above 1300$ in January and ended the month up 7.5%.

Tactical view by asset class



Annex : Theoretical model portfolio

Benchmark	Min	Strategic Allocation	Max	Asset Classes		Tactical Allocation	Change from previous Month	Previous Month
50%	**30%**	**50%**	**70%**	**Bonds**	↑	**55.0%**	**10.0%**	**45.0%**
40%	20%		60%	Bonds €	↑	45.0%	5.0%	40.0%
				Inflation €		0.0%		0.0%
10%	0%		20%	World Bonds*	↑	5.0%	2.5%	2.5%
				Emerging Debt***		0.0%		0.0%
				Investment Grade €		0.0%		0.0%
				High Yield €	↑	5.0%	2.5%	2.5%
35%	**20%**	**35%**	**50%**	**Equities**	↓	**35.0%**	**-6.0%**	**41.0%**
12.5%	5%		20%	Euro	↓	8.5%	-2.5%	11.0%
				Europe ex Euro*		7.0%		7.0%
12.5%	5%		20%	USA*	↓	12.5%	-4.5%	17.0%
5.0%	0%		10%	Japan*	↓	2.0%	-1.0%	3.0%
				Developed Asia*	↑	2.0%	2.0%	0.0%
5.0%	0%		10%	Emerging Asia**		3.0%		3.0%
				Emerging Europe - Africa - Middle East**		0.0%		0.0%
				Latin America**		0.0%		0.0%
5%	**0%**	**5%**	**10%**	**Commodities**		**2.5%**		**2.5%**
				Energy		0.0%		0.0%
				Industrial Metals		0.0%		0.0%
				Agriculture		0.0%		0.0%
				Precious Metals		2.5%		2.5%
10%	**0%**	**10%**	**20%**	**Currencies**	↑	**7.5%**	**-4.0%**	**11.5%**
5.0%	0%		20%	Cash €	↑	7.5%	6.0%	1.5%
1.0%			5%	Dollar / €	↓	0.0%	-5.0%	5.0%
1.0%			5%	Pound / €	↓	0.0%	-5.0%	5.0%
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		7.0%		7.2%
				Tracking error		1.1%		1.1%

* Hedged against currency risk.
** Unhedged against currency risk.
*** Debt issued in dollar hedge in Euro.

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.

Natixis Asset Management

Limited liability company - Share capital €50,434,604.76
Regulated by AMF under no. GP 90-009 RCS Paris n°329 450 738
Registered Office: 21 quai d'Austerlitz – 75634 Paris Cedex 13 - Tel. +33 1 78 40 80 00

This document is intended for professional clients only.
It may not be used for any purpose other than that for which it was intended and may not be reproduced, disseminated or disclosed to third parties, whether in part or in whole, without prior written consent from Natixis Asset Management. No information contained in this document may be interpreted as being contractual in any way. This document has been produced purely for informational purposes. It consists of a presentation created and prepared by Natixis Asset Management based on sources it considers to be reliable.
Natixis Asset Management reserves the right to modify the information presented in this document at any time without notice, and in particular anything relating to the description of the investment process, which under no circumstances constitutes a commitment from Natixis Asset Management. Natixis Asset Management will not be held liable for any decision taken or not taken on the basis of the information in this document, nor for any use that a third party might make of the information.
Figures mentioned refer to previous years. Past performance does not guarantee future results.
The analyses and opinions referenced herein represent the subjective views of the author(s) as referenced, are as of the date shown and are subject to change. There can be no assurance that developments will transpire as may be forecasted in this material.

This material is provided only to investment service providers or other Professional Clients or Qualified Investors and, when required by local regulation, only at their written request. • **In the EU** (ex UK) Distributed by NGAM S.A., a Luxembourg management company authorized by the CSSF, or one of its branch offices. NGAM S.A., 2, rue Jean Monnet, L-2180 Luxembourg, Grand Duchy of Luxembourg. • **In the UK** Provided and approved for use by NGAM UK Limited, which is authorized and regulated by the Financial Conduct Authority. • **In Switzerland** Provided by NGAM, Switzerland Sàrl. • **In and from the DIFC** Distributed in and from the DIFC financial district to Professional Clients only by NGAM Middle East, a branch of NGAM UK Limited, which is regulated by the DFSA. Office 603 – Level 6, Currency House Tower 2, P.O. Box 118257, DIFC, Dubai, United Arab Emirates. • **In Singapore** Provided by NGAM Singapore (name registration no. 5310272FD), a division of Natixis Asset Management Asia Limited, formerly known as Absolute Asia Asset Management Limited, to Institutional Investors and Accredited Investors for information only. Natixis Asset Management Asia Limited is authorized by the Monetary Authority of Singapore (Company registration No.199801044D) and holds a Capital Markets Services License to provide investment management services in Singapore. Address of NGAM Singapore: 10 Collyer Quay, #14-07/08 Ocean Financial Centre. Singapore 049315. • **In Hong Kong** Issued by NGAM Hong Kong Limited. • **In Taiwan**: This material is provided by NGAM Securities Investment Consulting Co., Ltd., a Securities Investment Consulting Enterprise regulated by the Financial Supervisory Commission of the R.O.C and a business development unit of Natixis Global Asset Management. Registered address: 16F-1, No. 76, Section 2, Tun Hwa South Road, Taipei, Taiwan, Da-An District, 106 (Ruentex Financial Building I), R.O.C., license number 2012 FSC SICE No. 039, Tel. +886 2 2784 5777. • **In Japan** Provided by Natixis Asset Management Japan Co., Registration No.: Director-General of the Kanto Local Financial Bureau (kinsho) No. 425. Content of Business: The Company conducts discretionary asset management business and investment advisory and agency business as a Financial Instruments Business Operator. Registered address: 2-2-3 Uchisaiwaicho, Chiyoda-ku, Tokyo. • **In Australia** This document has been issued by NGAM Australia Limited ("NGAM AUST"). Information herein is based on sources NGAM AUST believe to be accurate and reliable as at the date it was made. NGAM AUST reserve the right to revise any information herein at any time without notice. The document is intended for the general information of financial advisers and wholesale clients only and does not constitute any offer or solicitation to buy or sell securities and no investment advice or recommendation. Investment involves risks. • **In Latin America** (outside Mexico) This material is provided by NGAM S.A. • **In Mexico** This material is provided by NGAM Mexico, S. de R.L. de C.V., which is not a regulated financial entity or an investment advisor and is not regulated by the Comisión Nacional Bancaria y de Valores or any other Mexican authority. This material should not be considered investment advice of any type and does not represent the performance of any regulated financial activities. Any products, services or investments referred to herein are rendered or offered in a jurisdiction other than Mexico. In order to request the products or services mentioned in these materials it will be necessary to contact Natixis Global Asset Management outside Mexican territory.

The above referenced entities are business development units of Natixis Global Asset Management, the holding company of a diverse line-up of specialised investment management and distribution entities worldwide. Although Natixis Global Asset Management believes the information provided in this material to be reliable, it does not guarantee the accuracy, adequacy or completeness of such information.

This document is published by Natixis Asset Management's Communications Department.