Tactical Asset Allocation Update

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The theme of gradual appreciation in overall asset prices, with temporary tantrum-style setbacks, remains in place.

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Overall, we remain neutral, with some scope for above-neutral equity beta. The theme of overall gradual asset price inflation, with temporary tantrum-style setbacks, remains in place. We are approaching a reasonable likelihood of a December rate hike. However, we don't expect a material tantrum in the immediate future since the overarching framework for monetary policy appears to be undergoing a dovish overhaul. Momentum for risk assets is positive and volatility is low, and none of our indicators flagged any near-term warning signs of an interruption to this post-U.K. referendum trend.

Equity: Overall equity remains neutral. We see no compelling evidence that an overweight to equity is warranted, but full equity sensitivity is appropriate.

Within equity allocation: Strong and consistent geographic preferences do not seem to emerge. From a valuation perspective, the general preference for emerging markets over developed markets remains intact. We remain moderately overweight emerging market equities, remain neutral U.S. stocks and move developed equities to neutral. From a size perspective, small cap returns to moderate overweight following prolonged underperformance, model upgrades and the possibility of an economic and earnings trough.

Fixed income: Overall fixed income remains neutral. Duration tools remain neutral with the helpful portfolio construction dynamic of being typically negatively correlated to risk assets.

Within fixed-income allocation: A benign fixed-income environment leaves us mostly neutral. While spreads remain tight, we do not detect an impulse for widening. Investment-grade bonds remain modest overweight while securitized bonds remain modest underweight. Treasuries, TIPS and non-U.S. government bonds are all still neutral. Evidence has strengthened that gilts are overpriced and may be a source of funding for overweighting other countries.

Alternatives: We remain overweight alternative investments. Overall, the concept of expanding our diversifying components remains irresistible.

Within alternatives allocation: Commodities remain mild overweight. Momentum and carry dynamics remain favorable, and commodities offer a dimension of diversification in our risk asset holdings. Absolute return strategies have moved to overweight.

Currency: The euro, yen and British pound remain modest underweight. Partial hedging makes sense from a portfolio construction standpoint, as a weak dollar should flatter risk assets, particularly those we currently favor like EM equities and commodities. Currency hedges are diversifying in that sense.