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INTEREST-RATE OUTLOOK GIVES MULTI-ASSET PORTFOLIOS A SUSTAINABLE COMEBACK

The risk/return ratio for multi-asset portfolios is more attractive than it has been for years, says Maximilian Hefe, Head of Asset Management at Bergos. Bonds are once again capable of cushioning fluctuations in the equity component more effectively, and their return potential has increased. This is unlikely to change in the near future, as no significant interest rate cuts are expected for the time being. Alongside equities and bonds, gold should be in the portfolio, too. Alternative credit also offers good opportunities.

2022 was a disastrous year for traditional mixed portfolios that mainly consist of equities and bonds. "The situation has stabilized this year, but we have not experienced a real turnaround yet. With the massively improved return opportunities on fixed-income investments, however, the situation for multi-asset portfolios has improved significantly," says Maximilian Hefe. The yield on US corporate bonds with good credit ratings and moderate terms of between one and five years just recently climbed to 6.2% on average (as of October 10, 2023). The comparable market segment in euros currently offers over 4.6%. Just two years ago, yields in this market were below 0.5%.

No major interest-rate movement for the time being – neither up nor down

Both the USA and the eurozone are likely to have reached the end of the interest-rate cycle for now. Inflation is on the decline. There are initial signs that the overheated US labor market is cooling slightly. In Europe, the economic outlook remains bleak for the time being. In view of both of these factors, the respective central banks have opted to observe the impact of their bold monetary policies and will therefore refrain from making any key interest-rate decisions in the near future. "Our conclusion is that the headwind from rising interest rates will abate. This environment makes it more likely that investors will be able to fully realize the new yield potential of bonds in the future," Hefe says.

However, speculating on falling interest rates would be premature, the Bergos expert believes: "Forward contracts on future interest rates are not a reliable indicator," he points out. "It is important not to be led astray here." Inflation is still too high in the USA and the eurozone. In September, Federal Reserve Chairman Jerome Powell signaled to the market players that US interest rates would remain at a high level until at least mid-2024, with "higher for longer" being the new mantra.

Many factors suggest that a renaissance of a "Goldilocks scenario" is unlikely in the medium to longer term. The era of low inflation, robust economic growth and highly expansive monetary policy is over for now. Structural deflationary forces are gradually declining. The purely price-related advantage of low-cost Chinese production is falling victim to the power struggle between China and the United States. In the industrial nations, the supply of workers is shrinking relative to the total population. In the medium term, this will lead to somewhat higher average inflation rates and make a return to low- or even zero-interest-rate policies difficult in most Western countries.

Bonds: Good credit ratings, somewhat longer terms

At present, investors do not have to accept increased issuer risks to generate adequate yields on bonds. Government and corporate bonds with good credit ratings are currently the conservative foundations of a multi-asset solution. "The terms can be a little longer again. The one- to five-year segment is very attractive," says Hefele. He views emerging market bonds as a good addition. Caution is advised with regard to high-yield bonds. Their additional risk is not particularly well-remunerated at present and default rates are likely to rise.

Equities: USA remains convincing, Japan is surprisingly positive

Equities still offer higher returns over the long term than bonds and remain the more effective form of inflation protection. US equities continue to have a tactically high weighting in the Bergos portfolios. "The US equity market offers an excellent selection of growth companies with high balance-sheet quality. In addition, the USA is looking more robust than Europe and China in economic terms," says Hefele. Sentiment is also positive among the Japan experts at Bergos. Hefele: "In comparison with all other regions, the companies on the Nikkei 225 are reporting by far the highest year-over-year profit growth and monetary policy remains very expansive."

Alternative investments: The relative attractiveness must also be closely examined

The increase in bond yields is making life difficult for many alternative investments that have to generate a sufficient premium in return for additional risk. The relative attractiveness of commodities, for example, has decreased tangibly. They can still be useful for diversification purposes, however. This applies in particular to gold. "As a crisis currency for negative market scenarios, gold remains a sensible addition to multi-asset portfolios," says Hefele. Alternative credit, such as in the direct lending segment, also offers good opportunities. "Banks are adopting more restrictive policies when it comes to issuing loans to businesses and their loans are becoming more expensive. In direct lending, private investors grant loans directly to companies and are currently being rewarded with high interest-rate premiums," Hefele explains.

Time to review strategic allocations

The current environment is a good opportunity to review individual strategic portfolio allocations. If the required risk tolerance is present, it might make sense to increase the strategic equity ratio. Thanks to bonds' new power as an instrument for diversification, the overall risk does not necessarily have to increase. Conversely, for other investors it may make sense to reduce the strategic equity ratio as the increased yield opportunities offered by the fixed-income segment may lead to a sufficient return on the overall portfolio. "Either way," says Hefele, "the multi-asset solution currently offers more opportunities and options than it has for years."



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