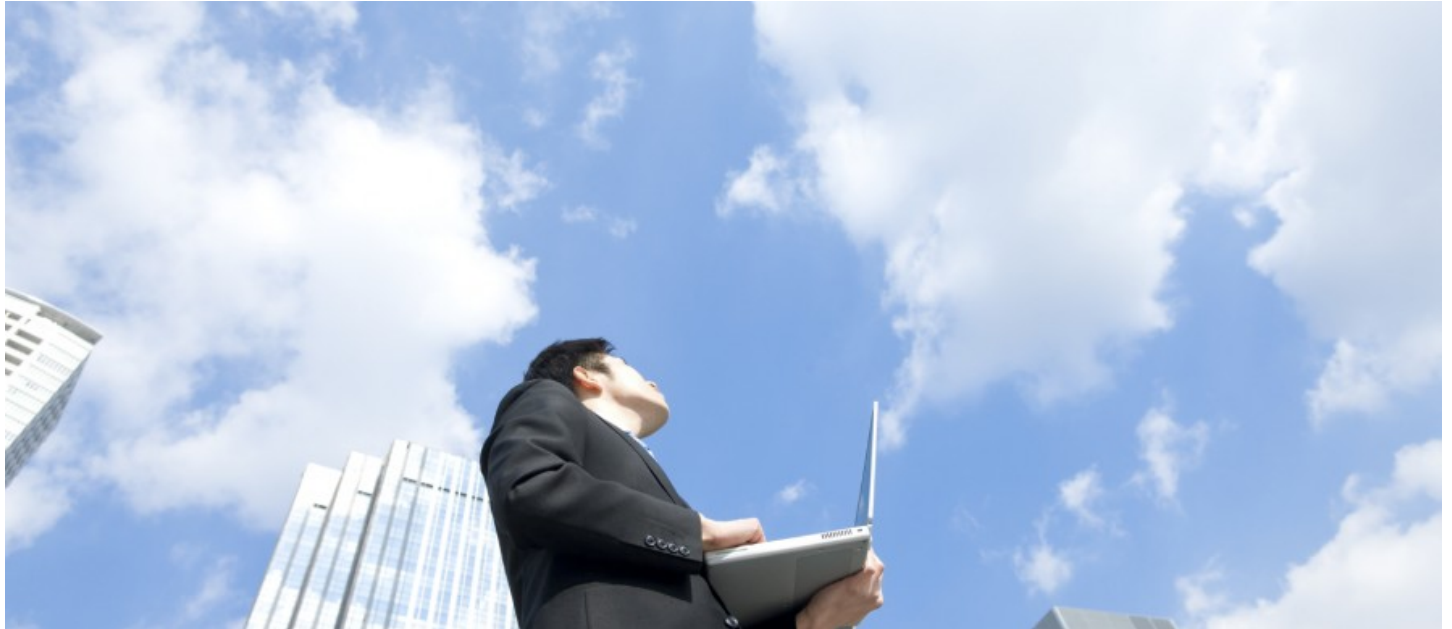


<https://blog.en.erste-am.com/2015/02/13/light-shadow/>

## Light and shadow

Gerhard Winzer



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The environment has become a bit brighter in the past weeks.

In addition to the improvement of the economic environment in the Eurozone and Japan, more and more central banks loosened their monetary policies. For example, on 12 February the central bank of Sweden (Riksbank) surprisingly cut its key-lending rate to -0.1% and announced to buy small volumes of government bonds. The reason behind this measure is the same as for similar steps taken by other central banks: the risk of falling short of the inflation target has increased. The markets reacted in a textbook-fashion with falling yields and a depreciating currency (krona). Both are supportive to the economy. On the financial markets the continuously falling and partially even negative yields of government bonds have pushed investors into securities with a higher expected yield (bonds with longer maturities, bonds with a higher default risk, bonds in foreign currencies, shares).

In addition, the oil price has stabilised after the strong decline in the past months. This helps those asset classes that have recently come under pressure such as for example corporate bonds with low ratings in the USA.

On the downside, it is mainly four developments that have started drawing investors' attention:

1. The conflict of the West and Ukraine with Russia: at the very least, an armistice has been reached. Also, Ukraine will receive further financial aid from the West if it makes structural reforms a top priority.
2. The conflict of Greece with the troika (EU Commission, European Central Bank, and International Monetary Fund). It seems like we are heading for a last-minute showdown. Greece rejects both the current bailout-programme, which includes austerity measures, and the troika, and does not want to pay back the part of debt that is held by the public sector in full. The troika, on the other hand, does not see much need for adjustments and insists on austerity and structural reforms.
3. The increased probability of an increase in the Fed funds rate in the USA due to the solid growth of the economy and the significant rise in employment. A surprising rate hike could have negative short-term effects on the global economy and the financial market.
4. A further deterioration of the outlook for global economic growth in Latin America. The consensus expects an economic growth rate of only 0.8% y/y for the region in 2015. The focus is on Brazil: the high budget deficit forces the government to impose austerity measures, the high inflation forces the central bank to increase key-lending rates, the falling commodity

prices have curtailed income, and the currency is overvalued.

Overall the supporting factors have increased for risky asset classes. However, the risks remain elevated.

Equity weighting remains unchanged

The equity weighting remains unchanged from last month in spite of the fact that the assessment of the equity markets has deteriorated slightly.

In fixed income, the fund management team reduced the money market allocation and instead stepped up the weighting of US corporate bonds with good and very good ratings. US high-yield bonds and global government bonds were newly taken into the portfolio.

Overall the environment for financial markets has become a bit brighter, but the risk remains elevated (please refer also to Gerhard Winzer's article).

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He holds a degree from a polytechnical college and studied economics and business at Vienna University with a special focus on financial markets. He holds a CFA charter and participated from 2001 to 2003 in the doctoral programme for finance at the Center for Central European Financial Markets in Vienna.

From July 1997 to June 2007, he worked in research at CAIB, Bank Austria Creditanstalt, and UniCredit Markets & Investment Banking. His last position was as Executive Director for Fixed Income / FX Research and Strategy. He was responsible for research on asset allocation at Raiffeisen Zentralbank (RZB) in Vienna from July 2007 to February 2008.