Long or short, Larry Adam?

Six market views from our Chief Investment Officer for Wealth Management in the Americas and Chief Investment Strategist for Deutsche AWM Americas

Can you usefully quantify and qualify risks to portfolios?
LONG Risks to portfolios can come from a number of different sources – from central-bank-policy surprises to geopolitical developments. Any assessment of such risks cannot be precise, in part because many risks are wholly unpredictable. But we still think that it is useful to look at the risks that we can foresee and then consider not just how likely an event is to occur but also the probable portfolio impact. Some risks may not seem particularly likely to materialize, but would be very disruptive if they did. These are the ones to watch and, if possible, prepare for.

Are central-bank-policy surprises on this risk list?
LONG There is still an enormous amount of uncertainty around central-bank monetary policy. At the top level, this is focused on the "when" and "what" questions – e.g. the timing and extent of the forthcoming Fed rate-hiking cycle. But there are other dimensions to this uncertainty – for example, around the management of market expectations of policy action. Skepticism may also increase about the effectiveness of QE. All this will maintain an environment where policy surprises – good and bad – are possible and could have a major impact on portfolios.

Can the likely impact of geopolitical events be overemphasized?
LONG Geopolitical events – often unforeseen – will continue to hog the headlines. But it is always worth asking to what extent they will have an immediate impact on portfolios. In previous decades, their main impact has been via increased oil prices due to the threat of supply disruption. This transmission process may be less important now given new sources of oil supply. Of course, many geopolitical events – for example, the European refugee crisis – may have a long-term impact on economies and investment. But their immediate effects may be more limited than first appears.

Are we now in an "end-cycle" market phase?
SHORT The first interest-rate increase by the Fed is an important development in the market cycle. However, it does not constitute the end of the cycle – instead, the first rate hike has typically marked the middle of the cycle in previous decades. In the sixth year of the global recovery, this may sound strange. Keep in mind, though, that the recovery has remained lackluster and slow. That is why we have described it in the past as the "turtle cycle", slow but long-lived. So we expect the cycle to continue on its steady upward path, supporting some further market gains.

Will positive returns be possible on fixed income too?
LONG Returns on core government bonds are likely to be modest but generally positive. Higher returns are possible on investment grade (U.S. and euro). High-yield bonds remain interesting in both regions, but less so in the United States, where default rates are likely to start rising from current relatively low levels. Emerging-market debt should offer some interesting opportunities but you will need to be selective.

Are currencies likely to be an important driver of returns?
LONG In recent months we have seen periods of euro strength but the fundamentals underpinning a strong U.S. dollar are likely to win out. These include stronger U.S. economic growth and – perhaps more importantly – expectations of further monetary easing by the ECB and the BOJ. So we expect the U.S. dollar to make further gains against the euro and, to a lesser extent, the Japanese yen and pound sterling. Currency risk must also remain an important consideration for emerging-market investments.

LONG represents a positive answer
SHORT represents a negative answer

Past performance is not indicative of future returns.
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