# Monthly Asset Allocation

## Private Banking Europe Investment Committee

April 12, 2017

## In a nutshell

- **The U.S. Federal Reserve keeps its course, emphasizing our reflation scenario**
- **Equity markets are in a consolidation phase, while Europe remains in focus**
- **We increase the weighting in emerging market bonds and stocks to neutral. In developed countries we prefer SEK**

### The U.S. Fed remains on track and emphasizes our reflation scenario

The Federal Open Market Committee (FOMC) of the U.S. Federal Reserve raised interest rates one more time in March. According to the Fed's statement, positive economic data allowed such a step already in the first quarter of 2017. The central bank also clearly communicated that two more rate hikes can be expected in the course of this year. Due to increasing wage inflation in the U.S. it is quite possible that we could see more than the announced monetary tightening this year. Not only the friendly economic data out of the United States, which drive the global economy, but also emerging markets are increasingly contributing to economic growth. In fact this region will probably benefit from a reflation, as the area's dependency on commodities is still very high. In the last few weeks, geopolitical tensions have accelerated and the first round in the Presidential elections in France are just around the corner (April 23). However, capital markets seem rather unimpressed, as neither major price swings in stocks, nor increasing volatility can be observed. Investors' main focus remains clearly on reflation and the associated hope that deflationary trends of the last years are definitely a thing of the past.

**Graph 1: Generic Tactical Asset Allocation LGT Private Banking Europe (April 12, 2017)**

| | Asset Class | SAA | underweight · Tactical allocation versus SAA · overweight (-8% -6% -4% -2% +2% +4% +6% +8%) | USD | EUR | CHF |
|---|---|---|---|---|---|---|
| Equities | US equities | 20.0% | | 19.0% | 14.0% | 14.0% |
| | Europe equities | 6.0% | | 9.0% | 12.0% | 8.0% |
| | UK equities | 3.0% | | 3.0% | 4.0% | 2.0% |
| | Switzerland equities | 1.0% | | 1.0% | 2.0% | 8.0% |
| | Japan equities | 4.0% | | 5.0% | 5.0% | 5.0% |
| | APAC ex JP equities | 3.0% | | 2.0% | 2.0% | 2.0% |
| | Emerging markets equities | 6.0% | | 6.0% | 6.0% | 6.0% |
| | **Total Equities** | **43.0%** | | **45.0%** | **45.0%** | **45.0%** |
| Fixed Income | Government bonds | 6.0% | | 3.0% | 3.0% | 0.0% |
| | Inflation-linked bonds | 6.0% | | 6.0% | 6.0% | 5.0% |
| | Investment grade bonds | 12.0% | | 12.0% | 12.0% | 16.0% |
| | High yield bonds | 6.0% | | 6.0% | 6.0% | 6.0% |
| | Emerging markets bonds | 6.0% | | 6.0% | 6.0% | 6.0% |
| | **Total Fixed Income** | **36.0%** | | **33.0%** | **33.0%** | **33.0%** |
| Alternatives | Hedge funds | 7.0% | | 6.0% | 6.0% | 6.0% |
| | Listed private equity | 2.0% | | 1.5% | 1.5% | 1.5% |
| | Real estate trusts | 3.0% | | 4.0% | 4.0% | 4.0% |
| | Insurance-linked bonds | 3.0% | | 4.0% | 4.0% | 4.0% |
| | Commodities | 2.0% | | 0.0% | 0.0% | 0.0% |
| | Precious metals | 2.0% | | 4.0% | 4.0% | 4.0% |
| | **Total Alternatives** | **19.0%** | | **19.5%** | **19.5%** | **19.5%** |
| | **Cash** | **2.0%** | | **2.5%** | **2.5%** | **2.5%** |
| | | | -8% -6% -4% -2% +2% +4% +6% +8% | | | |
| Currencies | USD | 86.5% | | 85.5% | 12.0% | 12.0% |
| | EUR | 0.0% | | 0.0% | 71.1% | 0.0% |
| | CHF | 0.0% | | 0.0% | 2.0% | 73.7% |
| | GBP | 0.0% | | 0.0% | 0.0% | 0.0% |
| | SEK | 0.0% | | 2.0% | 2.0% | 2.0% |
| | Others (incl. EM) | 13.5% | | 12.5% | 12.9% | 12.3% |

Source: LGT Investment Services Europe

*all calculations based on a "Balanced" portfolio in USD including AI. For EUR and CHF portfolios weights differ for subclasses; over– and underweights apply analogously

**Graph 2: Current asset allocation preferences**

| Next meeting: May 17, 2017 | What we like | What we dislike |
|---|---|---|
| **Equities** | ▪ Temporary hedge U.S. equity exposure<br>▪ European equity<br>▪ Japanese equity<br>▪ Oil and gas sector stocks<br>▪ Low volatility products | |
| **Bonds** | ▪ Low duration | ▪ Sovereign bonds |
| **Alternative Investments** | ▪ Insurance linked bonds<br>▪ Gold<br>▪ REITS (Real Estate Investment Trusts) | |
| **Currencies** | ▪ SEK **NEW** | |

Sources: LGT Investment Services Europe

### Equities: Europe remains in focus

After a positive first quarter, equity markets are currently in a consolidation phase with a very modest, only in the short term increasing, volatility. Market participants expect a continued acceleration of revenue and profit growth in the second half of this year given sustained solid economic data, ignoring the earlier mentioned political risks completely. We keep our positive bias for stocks, but see some potential for a consolidation in the short term. Regarding regions, Europe offers the most promising mix on a global basis. The valuation remains attractive compared to the U.S. and solid dividend yields of more than 3% represent a real alternative to government bonds on an asset class comparison. The increasingly positive profit revisions in the Eurozone are completing this picture. Only the upcoming elections in Europe have to be continuously kept in view and could cause some short-term insecurities. Possible setbacks, initiated through political uncertainty, should be seen as buying opportunity. Friendly leading indicators in emerging markets have convinced us to raise the underweight in this region to neutral. The low historical valuation, as well as the U.S. dollar's limited upward potential are underpinning this step. We will execute this shift in our tactical asset allocation on the expense of liquidity.

### Fixed Income: Bond markets with no clear direction

Global fixed income markets, above all U.S. Treasuries, traded without a clear direction in relatively tight spreads in recent weeks. Bond investors seem still not really convinced of the success of reflation and remain rather cautious at the long end of the yield curve. The Fed currently leaves no doubt that it will tighten monetary policy further in the coming quarters to counter inflationary tendencies. We still expect that the whole interest rate curve in developed countries will move upwards in the next few quarters. In consequence we keep our underweight in bonds. Within the fixed income quota, the Private Banking Europe Investment Committee has decided to increase the weighting in emerging markets local currencies to neutral. On the other hand, we have further reduced corporate bonds from overweight to neutral, as credit spreads are on multi-year lows and not anymore justify an overweight position. Besides emerging market bonds, we see potential in CoCos and hybrids. In government bonds of developed countries we see only limited yield potential in the coming years.

### Currencies: Swedish krona as portfolio addition

The U.S. dollar moved in a tight range versus the euro in the last few weeks. On the one hand, the Fed's announcement of further interest rate hikes are in favor for the Greenback. On the other hand, the euro enjoyed some tailwind as market participants are slowly but surely expect the European Central Bank (ECB) to reduce its Quantitative Easing (QE). In developed countries we have a preference for the Swedish krona (SEK), while we see the euro and the Swiss franc as less attractive. However, our assessment of the U.S. dollar remains constructive. Positive leading indicators in emerging markets increase the potential for EM currencies versus currencies in the developed world.

If you require further information or advise, please contact your LGT relationship manager.

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