Monthly Asset Allocation

Private Banking Europe Investment Committee

May 17, 2017

In a nutshell

- **Macro-economic environment and abating political risks support positive sentiment on capital markets**
- **A strong corporate earnings season and positive company outlooks continue to spur equity markets**
- **The U.S. dollar's appreciation potential seems exhausted given priced-in Fed interest rate hikes**

Macro-economic data supports a continued friendly tone on capital markets

Following the French presidential elections, which delivered a clear vote in favor of Europe, the markets' focus returns on economic data. Indicators are painting a positive picture on a global basis, although we can observe late-cycle tendencies in the United States. The U.S. labor market is nearing full employment and tightening wage inflation could materialize further in the coming quarters. This will implicate that the Federal Reserve will hike interest rates again already in June. We expect this trend to continue for the remainder of this year. Leading indicators, as well as consumer sentiment also draw a strong image of the Eurozone. Furthermore, it should get more quiet on the political front in Europe in the next few months, until another critical vote on the European Union in the form of the Italian parliamentary elections is taking place early next year. In this environment it remains to be seen when the European Central Bank (ECB) will start tapering its ultra-expansive monetary policy. However, at the moment, the big unknown are the new U.S. administration's politics. Rarely that pre-election promises, respectively campaign announcements, have diverged so much from reality. The announced fiscal stimulus, the corporate tax reform, as well as planned infrastructure projects are still at an early stage, at best. Concerning this hopes, financial markets remain in a standby position, if and when these plans will be realized.

Graph 1: Generic Tactical Asset Allocation LGT Private Banking Europe (May 17, 2017)

	Asset Class	SAA	Tactical allocation versus SAA (underweight -8% -6% -4% -2% / +2% +4% +6% +8% overweight)	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%**
Currencies	USD	86.5%		85.5%	10.0%	10.0%
	EUR	0.0%		0.0%	75.1%	0.0%
	CHF	0.0%		0.0%	0.0%	75.7%
	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

Graph 2: Current asset allocation preferences

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

Sources: LGT Investment Services Europe

Equities: Strong corporate earnings season and positive company outlooks

European equity markets have been spurred after the French election and stocks gained on a global basis. A main reason for accelerating stock prices were the Q1 2017 corporate earnings. Not only that earnings showed two-digit growth rates on both sides of the Atlantic, but also revenue growth was stronger than anticipated by analysts. Particularly European companies' quarterly earnings were able to convince markets, after making negative headlines in the last few years. Another important factor is that companies also delivered positive outlooks for the next quarters. In a global context, we continue to see Europe as the most attractive region. Besides a favorable valuation, now also the acceleration of profit growth is an argument for the Eurozone. From an asset allocation view, a dividend yield of more than 3%, as well as an earnings yield of nearly 4% favor European stocks compared to government bonds in the Eurozone, which offer almost no yield potential anymore for investors. Only the very low equity market volatility, and some sentiment indicators burden the constructive outlook for stocks. As long as overall economic perspectives remain positive, investors should take advantage from a consolidation, or correction to build up positions.

Fixed Income: Wait-and-see mode

While capital markets anticipate another step by the Federal Reserve in the next months, the long end of the U.S. yield curve seems not really impressed by the rhetoric of central bank members. Likewise the publicly discussed possible reduction of the central bank's balance sheet has hardly influenced long-term interest rates. Currently the capital market's focus is also on the events in Washington, which have a certain delaying impact on the anticipated economic stimulus measures. Meanwhile, the desired fiscal impulse, as well as the massive infrastructure projects are taking time to materialize. This seems to question investors' hopes for a successful reflation. We think that most of the U.S. administrations' plans are only postponed, and not annulled. These plans could then possibly unfold in a mitigated form in the coming quarters. We stay with our medium-term assessment of raising interest rates and favor a short duration. Within the fixed income quota the area of local currency emerging market bonds remains our preferred category. Regarding government bonds, particularly in the Eurozone, we continue to see no yield potential.

Currencies: The U.S. dollar's appreciation potential might be exhausted

The potential for a further strong appreciation of the U.S. dollar, analogous to 2015 and 2016, seems unlikely. On the one hand, the Federal Reserve's announced monetary policy tightening are in favor of the Greenback, but the interest rate hikes seem to have priced-in by foreign exchange markets. Additionally, a tapering announcement by the ECB could put the U.S. dollar under pressure. On the other hand, the Greenback is overvalued by about 20% compared to the euro and the Japanese yen, based on purchasing power parity. This has convinced the Private Banking Europe Investment Committee to reduce the tactical position of the U.S. dollar to neutral. Furthermore, we still favor the Swedish krona as an attractive portfolio addition.

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

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