# Monthly Asset Allocation
## Private Banking Europe Investment Committee

January 10, 2018

## In a nutshell

- **In view of the continued globally synchronous economic upturn, we confirm our stock overweight**
- **Equities offer further yield potential – Continental Europe and emerging markets remain our favorites**
- **The US dollar is likely to have passed its zenith, and we expect a sideways movement in the first half of this year**

### Positive global macroeconomic environment – can it get any better?

The economic environment has continued to improve on a global basis in recent weeks. Leading indicators show no signs of a weakening neither in developed nor emerging countries. In view of the levels that the purchasing managers' indicators in the USA or in Germany reached, the question arises: can things get any better? We expect the positive trend to continue on a global basis, but we are aware, particularly with regard to the United States, that we are already at a late stage of the economic cycle. However, the US tax reform and further fiscal stimulus could well accelerate economic growth on the other side of the Atlantic. Inflation figures on a global basis remain moderate, but we believe the risk scenario is an upward trend in US core inflation. Particular attention is being paid to the US labor market, given the virtually reached full employment and the potential risk of additional scarcity, which would accelerate wage inflation. It remains to be seen how capital markets will react to such a scenario. Our main scenario for the coming months is a continuation of the synchronous economic upswing. Against this backdrop, we are confirming our overweight in equities at the asset allocation level at the expense of the bond ratio. Meanwhile, alternative investments remain underweight on a tactical basis. At the same time, the cash ratio remains overweighted in order to enable a flexible reaction to an increase in market volatility.

**Table 1: Generic Tactical Asset Allocation LGT Private Banking Europe (January 10, 2018)**

| | Asset Class | SAA | underweight – Strategic (SAA) vs Tactical Asset Allocation (TAA) in USD – overweight | TAA | | |
|---|---|---|---|---|---|---|
| | | USD | -8% -6% -4% -2% +2% +4% +6% +8% | USD | EUR | CHF |
| Equities | US equities | 20.0% | | 20.0% | 15.0% | 15.0% |
| | Europe equities | 6.0% | | 8.0% | 11.0% | 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% | | 4.0% | 4.0% | 5.0% |
| | APAC ex JP equities | 3.0% | | 2.0% | 2.0% | 2.0% |
| | Emerging markets equities | 6.0% | | 8.0% | 8.0% | 6.0% |
| | **Total Equities** | **43.0%** | | **46.0%** | **46.0%** | **46.0%** |
| 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% | | 0.0% | 0.0% | 0.0% |
| | Subordinated Debt | 0.0% | | 3.0% | 3.0% | 3.0% |
| | Emerging markets bonds | 6.0% | | 8.0% | 8.0% | 8.0% |
| | **Total Fixed Income** | **36.0%** | | **32.0%** | **32.0%** | **32.0%** |
| Alternatives | Hedge funds | 7.0% | | 6.0% | 6.0% | 6.0% |
| | Listed private equity | 2.0% | | 0.0% | 0.0% | 0.0% |
| | Real estate trusts | 3.0% | | 3.0% | 3.0% | 3.0% |
| | Insurance-linked bonds | 3.0% | | 4.0% | 4.0% | 4.0% |
| | Commodities | 2.0% | | 2.0% | 2.0% | 2.0% |
| | Precious metals | 2.0% | | 2.0% | 2.0% | 2.0% |
| | **Total Alternatives** | **19.0%** | | **17.0%** | **17.0%** | **17.0%** |
| | **Cash** | **2.0%** | | **5.0%** | **5.0%** | **5.0%** |
| | | | -8% -6% -4% -2% +2% +4% +6% +8% | | | |
| Currencies | USD | 86.5% | | 83.5% | 10.0% | 10.0% |
| | EUR | 0.0% | | 0.0% | 73.1% | 0.0% |
| | CHF | 0.0% | | 0.0% | 0.0% | 75.7% |
| | GBP | 0.0% | | 0.0% | 0.0% | 0.0% |
| | Others (incl. EM) | 13.5% | | 16.5% | 16.5% | 14.3% |

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.

**Table 2: Current asset allocation preferences**

| Next meeting: Feb 12, 2018 | What we like | What we dislike |
|---|---|---|
| **Equities** | European equity<br>Emerging markets equity<br>Oil and gas sector equity<br>Low volatility products | |
| **Bonds** | Low duration<br>Emerging Market Local Currency bonds<br>Subordinated debt | Sovereign bonds<br>High yield bonds |
| **Alternative Investments** | Insurance linked bonds | Listed private equity |
| **Currencies** | | |

Sources: LGT Investment Services Europe

### Equities: further yield potential given – continental Europe and emerging markets remain our favorites

Although the equity bull market has certainly come of age and valuations in the US are in the upper quartile, we expect a continuation of the positive trend on equity markets on the back of a very favorable macroeconomic environment and solid corporate earnings growth. The approved US tax reform should give an additional boost of more than 5% to the profit growth of the S&P 500 companies in the current year. This means that we can certainly expect growth rates of more than 15% at the corporate earnings level in 2018. With that there is further upward potential for equities, although we expect an upturn or normalization of the record low volatility in the coming months. In our view, these fluctuations should be used very selectively to build up positions. Within our equity exposure, continental Europe and emerging markets are our preferred regions. For Europe, a return on profits of more than 5% and an attractive dividend yield of 3.5% compared to a zero return on government bonds speak for themselves. We opt for emerging market equities due to the still young profit cycle of companies as well as valuations at absolute and relative levels in a historical comparison.

### Fixed Income: low value justifies underweight at an asset allocation level

Last year was marked by a sideways movement of long interest rates in the USA and the euro zone, with record low volatility on bond markets. There has been little improvement in the attractiveness of developed countries' government bonds. In the euro area as well as in Switzerland, risk assets for private investors remain free of any interest. Even in the case of high-yielding investments, the risk premiums to be earned are so low that we advise against investing in this investment category. After almost ten years of monetary easing by the leading central banks and an increase in the balance sheets of the G3 central banks by more than USD 12,000 billion, there is little added value to be found in the fixed income area. Against this backdrop, we favor emerging market bonds within the bond ratio, with a preference for bonds in local currencies, as we expect a weaker US dollar in the coming quarters. We also see some added value in the area of subordinated bonds, where private investors are still adequately compensated for their risk. We recommend holding a short residual term across the entire portfolio, as a rise in long interest rates is quite possible in the coming months, especially in the USA.

### Currencies: the US dollar has passed its zenith

The US dollar is likely to have passed its zenith in 2017. We expect a sideways movement in the first half of this year, as the continued attractive interest rate differential – especially against the euro of more than 2% along the entire interest rate curve – is in favor of the greenback in the short term. However, in the medium to long term we see downward potential, as the US dollar is still overvalued at a purchasing power parity level and the enormous US current account deficit should also put pressure on the greenback. From today's perspective, we see the Canadian dollar (CAD) as an interesting portfolio addition. In the coming months, we expect some potential for the Canadian currency to appreciate against the US currency in particular, due to the solid growth and inflation trend in Canada, the attractive valuation, and the dynamics of the oil market.

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

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