Monthly Asset Allocation
Private Banking Europe Investment Committee

September 12, 2018

In a nutshell

- **We continue to favor equities at the expense of the fixed income ratio and alternative investments**
- **An increased cash ratio provides the flexibility to buy countercyclical positions in the event of setbacks**
- **Developed bond markets, in particular US government bonds, show record low volatility**

US Midterm Elections, Italy's budget and seasonality point to a turbulent autumn

The rhetoric on the US "Midterm Elections" scheduled for November has intensified further in recent weeks. We expect this development to continue in the coming weeks. Although the outcome of the elections cannot yet be predicted, election researchers expect at least one chamber to fall to the Democrats. If both houses were to become democratic, this would limit the White House's ability to act, but would hardly slow down the US President's level of activity. It also remains to be seen whether capital markets will give greater weight to the probability of a possible impeachment of the president. Italy's new government is already on a confrontational course with Brussels regarding the country's budget. We expect that the two parties will finally reach an agreement. However, there could be some short-term unrest among European financial stocks. In historical terms, September and October are usually volatile months based on seasonality, which are then the harbingers of a year-end rally. So it may well be that we are on the verge of a turbulent autumn. At asset allocation level, we confirm our preference for equities as an investment category at the expense of the fixed income ratio and alternative investments. We also maintain an increased cash ratio in order to have the necessary flexibility in the event of setbacks and to buy additional positions counter-cyclically. From today's perspective, this risk build-up should take place in equities and not in fixed-interest securities.

Table 1: Generic Tactical Asset Allocation LGT Private Banking Europe (September 12, 2018)

	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%		20.0%	15.0%	15.0%
	Europe equities	6.0%		8.0%	11.0%	7.0%
	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%	4.0%
	APAC ex JP equities	3.0%		3.0%	3.0%	3.0%
	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%		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%		3.0%	3.0%	3.0%
	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%		4.0%	4.0%	4.0%
	Total Alternatives	**19.0%**		**16.0%**	**16.0%**	**16.0%**
	Cash	**2.0%**		**7.0%**	**7.0%**	**7.0%**
			-8% -6% -4% -2% +2% +4% +6% +8%			
Currencies	USD	86.5%		82.5%	8.0%	8.0%
	EUR	0.0%		0.0%	74.1%	0.0%
	CHF	0.0%		0.0%	0.0%	74.7%
	GBP	0.0%		0.0%	0.0%	0.0%
	JPY	0.0%		2.0%	2.0%	2.0%
	Others (incl. EM)	13.5%		15.5%	15.9%	15.3%

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: Oct 15, 2018	What we like	What we dislike
Equities	▪ European equities	
Bonds	▪ Low duration ▪ Subordinated debt	▪ Sovereign bonds ▪ High yield bonds
Alternative Investments	▪ Gold ▪ Insurance linked bonds	▪ Hedge Funds ▪ Listed private equity
Currencies	▪ Japanese yen	

Sources: LGT Investment Services Europe

Equities: US equity market – top, emerging market equities – flop

The broad US stock market (S&P 500) reached new highs in August 2018. Market participants are currently focusing primarily on strong earnings growth and rather ignoring imponderables such as the imminent trade conflict or geopolitical tensions. Even the strengthening of the US dollar, which in the coming months could put a strain on the margins of US multinationals, has hardly had any lasting impact on the US stock market rally. US equities continue to carry the greatest weight in our asset allocation. The situation is quite different for emerging market securities: There have been some cuts here due to higher US interest rates and a stronger Greenback. Despite attractive valuations, emerging market equities came under constant pressure as the trade conflict between the US and China continues to intensify. We think that the situation is unlikely to improve sustainably until the US Midterm Elections on November 6 and therefore recommend a cautious positioning. Meanwhile, European markets were temporarily under the spell of the upcoming budget discussions in Italy, and some financial stocks came under pressure. We are sticking to our overweight based on cross-asset considerations, also due to the attractive profit and dividend yields compared with the low yields on the European bond market.

Fixed Income: Record low volatility in developed bond markets

The government bonds of developed countries moved in a narrow trading range last month. Volatility in US government bonds in particular has fallen sharply. At present, two important market drivers are keeping almost in balance. Due to the normalization of monetary policy and a possible rise in wage inflation, there is constant pressure for higher yields along the entire yield curve in the USA. On the other hand, government bonds continue to be seen as a safe haven in view of the latently smouldering trade conflicts. The relative yield advantage of US government bonds (+2.95%) compared with German government bonds (+0.4%) and Swiss bonds (-0.10%) also plays a role. We confirm our underweight and continue to see little potential for government bonds. One exception are US Treasuries with a short residual term to maturity, where yields of 2.75% can again be achieved in the two-year range. Within the fixed income allocation, we continue to prefer subordinated bonds at the expense of the high-yield ratio.

Currencies: US dollar – interest rate differential vs. long-term fundamentals

The strong economic data of the world's largest economy, particularly full employment in the US labor market, have once again given rise to new interest rate fantasies on capital markets and strengthened the US dollar in recent weeks, especially against emerging market currencies. Long-term fundamental data, such as the twin deficit and the overvaluation at the purchasing power parity level, are currently being ignored or weighted more weakly by market participants. The capital markets tend to exaggerate or overshoot in one direction or the other. Nevertheless, we would tend to prefer the Japanese yen or the euro at the currency allocation level if the Greenback were to rebound further.

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

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