Monthly Asset Allocation
Private Banking Europe Investment Committee

June 14, 2017

In a nutshell

- **Following the elections in Europe, markets focus on the corporate earnings season and the Fed's monetary policy bias**
- **In the run-up to the next earnings season we expect a consolidation regarding broad stock markets**
- **Reduction of high-yield bonds in favor of emerging markets local currency bonds**

Focus on earnings data and the Fed

After the directional elections in the Eurozone, the resurgence of geopolitical conflicts and countless turns of the U.S. administration, the focus in the coming weeks will be primarily on long-term market relevant news. On the one hand, the earnings reporting season for the second quarter is just around the corner, and on the other hand, the U.S. Federal Reserve remains in the spotlight, as the Fed might hold the balance regarding the market sentiment. Thereby, it is less a case of the widely anticipated interest rate hike, but more the rhetoric of Fed officials. Besides the outlook for further interest rate increases, investors are expecting more information regarding the U.S. labor market and potential wage inflation, as well as the Fed's assessment of the central bank's inflation expectations. It would be also supportive if there were initial indications on how and when the Fed might start to reduce its exaggerate balance sheet. In the summer months we expect a reemerging of various political insecurities, as we have seen already in the first two quarters of this year. The new U.S. administration was still not able to implement many of its plans so far and it is absolutely conceivable that capital markets will get temporarily unsettled on current levels. We see this potential volatility – also on the backdrop of a stable global recovery – as short term.

Graph 1: Generic Tactical Asset Allocation LGT Private Banking Europe (June 14, 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%		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%		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%**		**3.5%**	**3.5%**	**3.5%**
			-8% -6% -4% -2% +2% +4% +6% +8%			
Currencies	USD	86.5%		83.5.5%	10.0%	10.0%
	EUR	0.0%		0.0%	73.1%	0.0%
	CHF	0.0%		0.0%	0.0%	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%		14.5%	14.9%	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.

Graph 2: Current asset allocation preferences

Next meeting: July 10, 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 ▪ Emerging Market Local Currency bonds	▪ Sovereign bonds ▪ High yield bonds
Alternative Investments	▪ Insurance linked bonds ▪ Gold ▪ REITS (Real Estate Investment Trusts)	
Currencies	▪ SEK	

Sources: LGT Investment Services Europe

Equities: Consolidation in the run-up to the corporate earnings season

Global equity markets continued their friendly tone in the last few weeks. Indeed, U.S. technology companies remained in the spotlight once more, as tech shares met continued investors' interest. In the run-up to the corporate earnings season, we expect a broad market consolidation. In July, companies will publish their earnings and revenues for the second quarter. So far we have seen no bad news of a significant profit warning of a leading company. In light of continuously accelerating and positive earnings revision by analysts, we can expect continued profit growth. As stock market valuation – in particular of the U.S. technology market— is not favorable anymore, data of the upcoming earnings season will be followed very closely. Additionally, market participants anticipate to get an indication from the companies for the reminder of the current business year. These data will be directive for capital markets in the second half of this year. On the backdrop of a continued positive global economic environment we can expect a continuation of the positive trend. Geopolitical, as well as monetary policy challenges could however cause some volatility of 5 to 10% on equity markets.

Fixed Income: Reduction of high-yield bonds in favor of emerging markets local currency bonds

Global bond markets – particularly the U.S. government bond market – have outpriced all hopes for growth and inflation based on the new U.S. administration. At the moment, the so called "Trump factor" is not playing any role on fixed income markets. On the one hand, this fact is also mirrored in expectations for U.S. economic data. On the other hand, this brought U.S government bond yields to the lower end of the trading range defined by market participants. The search for yield is however in full swing, given the continued expansive central banks, particularly the European Central Bank (ECB) and the Bank of Japan. This also led the segment of high-yield bonds to record highs, which narrowed the risk premiums to government bonds to historical lows. On this backdrop, the investment committee of Private Banking Europe decided to realize profits in this asset category and to underweight this segment to the strategic asset allocation. The freed financial resources will be used to further increase emerging market local currency bonds (EMLC) on the one hand, and to raise our cash quota for possible buying opportunities in equity markets on the other hand. We consider the EMLC asset category in the medium to long-term as an interesting portfolio component with an attractive risk-yield-profile.

Currencies: The U.S. dollar remains in a continued sideways trend

The U.S. dollar remains in a continued sideways trend within a relatively wide trading range since the beginning of this year. In the short term, the interest rate differential to the Eurozone is still in favor of a solid greenback. Whereas we consider the medium to long-term potential of the U.S. currency on the basis of the purchasing power parity, we notice an overvaluation of between 15-20% to other major currencies. We therefore continue to expect a the U.S. dollar to build a top formation. At the same time, we see the Swedish krona as an interesting portfolio supplement in a global context.

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

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