Monthly Asset Allocation

Private Banking Europe Investment Committee

July 12, 2017

In a nutshell

- **Major central banks change their rhetoric as hawks have gained momentum, indicating a more restrictive monetary bias**
- **For the upcoming earnings season corporate outlook for the second half 2017 will be in the spotlight**
- **While subordinated debt represent an interesting portfolio addition, we have reduced Listed Private Equity**

Global central banks change their rhetoric - hawks gain momentum

The committees of central banks are traditionally split in two groups: on one hand there are the "hawks", supporting a more restrictive monetary policy, and on the other hand the "doves" which are in favor of a more expansive monetary policy. The hawks have gained momentum partially due to the remarks of ECB President Mario Draghi during the past weeks. The capital market was surprised by Draghi's statements, potentially indicating a more restrictive monetary policy in 2018. The Federal Reserve (Fed), too, showed first signs of reducing its inflated balance sheet while leaving important questions unanswered. Already today it seems evident that it will take years before a normalization can materialize. Despite this change we are not immediately facing a dramatic policy adaptation of the G4 central banks, but rather they intend to gradually prepare capital markets in the short to mid-term for a change of course. Macro economic factors are favorable for the central banks' plans as they indicate continued robust growth which should be backed on a broad global scale. In spite of the fact that the inflation targets were not achieved – particularly in the Eurozone and in Japan – in our view there are currently no risks of a return to deflationary tendencies. So far, the Fed still expects to achieve its inflation target of 2% in the mid-term. .

Graph 1: Generic Tactical Asset Allocation LGT Private Banking Europe (July 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%		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%		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%**		**18.0%**	**18.0%**	**18.0%**
	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%	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: Aug 14, 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 ▪ Subordinated debt **NEW**	▪ Sovereign bonds ▪ High yield bonds
Alternative Investments	▪ Insurance linked bonds ▪ Gold ▪ REITS (Real Estate Investment Trusts)	▪ Listed private equity **NEW**
Currencies	▪ SEK	

Sources: LGT Investment Services Europe

Equities: corporate outlook for the second half-year 2017 in the spotlight of the upcoming earnings season

After no significant profit warnings have been reported in the run-up to the corporate earnings season on both sides of the Atlantic, we can expect positive earnings results for the second quarter. Traditionally, at this time companies will also deliver their outlooks for the second half of the year. This year it will be of crucial importance as market participants are not entirely convinced that there will be continued profit growth in the next quarters. It may be expected that the majority of the companies will deliver a positive outlook for the rest of this year. However, it remains to be seen whether market expectations can be met or the consolidation in stock markets will continue. We are convinced that the sector rotation will go on and volatility will increase on a single stock level. Concerning current valuations there is little scope for disappointments. In addition the afore mentioned profit growth, the focus will be on revenue growth and margin expansion.

Fixed Income: yields are starting to rise – subordinated debt represent an interesting portfolio addition

Global bond markets were struggling with selling pressure in the last few weeks after major central banks adjusted their rhetoric regarding their ultra-expansive monetary policy. The U.S. Treasury market for ten-year bonds continues to trade within a range of 2.15% to 2.60%. In the Eurozone, yields also kept on rising with the German Bund (ten-year government bond) reaching a new 12-month high. In our view, we will see a tendency to higher yields at the longer end of the curve in developed economies until the end of the year. This is also reflected in our clear underweight in government bonds in our tactical asset allocation. Within the fixed income quota we advise clients to continue to significantly underweight the high-yield quota. We firmly believe that the upward potential in this sector is very limited, but risks are high due to the current leverage. The risk-yield-ratio remains unattractive. On the contrary, subordinated bonds still have potential, which is why we favor this segment in the fixed income quota. Emerging market bonds in local currencies remain a second investment category with long-term upward potential.

Alternative Assets: reduction of Listed Private Equity

We recommend that our clients sell their position in "Listed Private Equity" after a strong increase during the past quarters. The valuations in this segment are above the ones in the public equity markets. In addition, the discounts have been significantly reduced (actual price for NAV valuation) close to 0%. In a long-term historical comparison, this value ranged on average between 15 -20%. We see more potential in the traditional equity markets.

Currencies: possible US dollar tactical rally, but the Greenback remains overvalued in the long term

After the recent weakness of the US dollar, we see a short-term possibility for a tactical rally of the greenback, particularly against the Swiss franc. The US dollar has also some tactical potential versus the euro. However, the US dollar's upward potential remains limited in the long term due to the contradicting purchasing power parity. Despite the appreciation of the Swedish krona in the past few weeks, we see further drivers against the backdrop of its fundamental undervaluation. We also think that the Canadian dollar (CAD) is becoming more attractive as an addition to a global, diversified portfolio. The CAD should benefit from an outlook onto a less expansive policy of the central banks as well as from improved economic growth.

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

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