Monthly Asset Allocation

Private Banking Europe Investment Committee

October 11, 2017

In a nutshell

- **Strong and globally synchronous economic growth despite continuing geopolitical uncertainties**
- **Equity stocks remain in focus on corporate earnings – Eurozone attractively valued**
- **Emerging markets bonds and subordinated bonds remain attractive; USD consolidation and a generally weaker CHF**

Economic growth remains solid and globally synchronized despite continuing geopolitical uncertainties

The global economic engine continues to run at full speed synchronously. In the United States and the Eurozone, particularly in Germany, positive indicators have even improved. On both sides of the Atlantic, consumer confidence is at its highest level since the financial crisis. Various geopolitical tensions, such as the unresolved North Korean conflict, have not had a lasting effect on sentiment. Unemployment continues to fall, particularly in the US, and is already below the "natural rate". We therefore expect first signs of a slow increase in wage inflation next year. However, due to the extremely flexible US labor market, this increase is likely to be small and will only have a temporary impact on capital markets. In Europe, the next European Central Bank meeting is eagerly awaited. ECB President Draghi will then probably present his plan for a gradual reduction ("tapering") of quantitative easing. However, we assume that the ECB will choose a very cautious wording and that the central bank's bond purchase plan will gradually be reduced. Volatility remains low, not only historically but also seasonally, and financial markets seem to be able to put away all uncertainties with ease. Such periods are the exception, but not unusual. This phenomenon has been observed several times in the last 50 years. However, we expect a temporary increase in volatility over the next few months due to various continued uncertainties (North Korea, Yellen succession, Catalonia, or Italian elections). These short term windows should be used to build up equities as the economic environment remains very positive.

Table 1: Generic Tactical Asset Allocation LGT Private Banking Europe (October 11, 2017)

	Asset Class	SAA USD	Strategic (SAA) vs Tactical Asset Allocation (TAA) in USD (underweight -8% … +8% overweight)	TAA USD	TAA EUR	TAA CHF
Equities	US equities	20.0%		20.0%	15.0%	15.0%
	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%**		**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%		0.0%	0.0%	0.0%
	Precious metals	2.0%		2.0%	2.0%	2.0%
	Total Alternatives	**19.0%**		**15.0%**	**15.0%**	**15.0%**
	Cash	**2.0%**		**7.0%**	**7.0%**	**7.0%**
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%
	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.

Table 2: Current asset allocation preferences

Next meeting: Nov 13, 2017	What we like	What we dislike
Equities	▪ European equity ▪ Japanese equity ▪ Oil and gas sector stocks ▪ Low volatility products	
Bonds	▪ Low duration ▪ Emerging Market Local Currency bonds ▪ Subordinated debt	▪ Sovereign bonds ▪ High yield bonds
Alternative Investments	▪ Insurance linked bonds	▪ Listed private equity
Currencies		

Sources: LGT Investment Services Europe

Equities: focus remains on corporate profits – Eurozone with attractive valuation

The forthcoming corporate earnings season for the third quarter of 2017 will be the next litmus test for the equity bull market. In the run-up to this, there have been no profit warnings from significant companies, which makes us confident for the coming weeks. Since valuations continue to be in the upper quartile and a possible price increase can hardly be justified by an expansion of the price-earnings ratio, corporate profits remain in investors' focus. In addition, global monetary policy tends to be less expansive and could therefore increase headwinds for stock markets. We are sticking to our moderate overweight in equities in a balanced portfolio. The euro area remains our preferred region on a global basis, despite the strengthening of the single currency. Not only the relative valuation compared to bonds speaks for this investment category, but also a dividend yield of more than 3.5% and a valuation that is still attractive by historical standards. The foreseeable "tapering" of the ECB should tend to increase volatility in Europe. We consider these possible setbacks to be a buying opportunity from today's view, as economic growth and inflationary trends continue to provide a positive environment for equities.

Fixed Income: emerging market bonds and subordinated bonds remain attractive

On a global basis, long-term government bonds issued by developed countries remain unattractive and have been moving sideways since the beginning of the year. In particular, we recommend private investors to avoid euro area bonds as nominal yields are very low. In various eurozone countries, the real return is even negative. But US government bonds with a yield of around 2.4 percent in the ten-year segment also offer a meager yield in historical terms. Due to the flat yield curve, we recommend to keep a short duration in the portfolio. The ECB's emerging departure from its ultra-expansive monetary policy and the gradual reduction of the US Federal Reserve's balance sheet are likely to shift the interest rate curve upwards. In a fixed-income portfolio, we favor emerging market bonds in hard currency, but also those in local currency. Subordinated bonds are another attractive investment opportunity in our view, as the risk/return ratio remains interesting despite the low interest rate environment in this investment category. In the case of high-yield bonds, we remain negative and would no longer hold positions in this area in a balanced portfolio. Risk premiums in this segment have fallen to an all-time low in the Eurozone, not least due to the ECB's aggressive monetary policy.

Currencies: further consolidation of the US dollar – Swiss franc tends to weaken

The consolidation of the greenback is likely to continue in the next few weeks, as the US currency is still in a dual tension field. On the one hand, there is little evidence of a strong dollar in the long term due to purchasing power parity, with an average overvaluation of 10-15% against most developed countries. On the other hand, a more restrictive monetary policy on the part of the Fed and an interest rate advantage of almost 200 basis points along the entire interest rate curve compared with German government bonds is likely to slow down a further collapse of the US dollar. In addition, we expect the Swiss franc to weaken, especially against the Euro, due to the growth and inflation differential.

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

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