Monthly Asset Allocation

Private Banking Europe Investment Committee

July 11, 2018

In a nutshell

- **Focus on US earnings reporting, which will send a signal to global equity markets**
- **The yield curves on both sides of the Atlantic are so flat that we prefer a short residual maturity for bonds**
- **For currencies, we recommend reducing the US dollar into its strength and overweighting the Japanese yen**

US policy likely to further reinforce inflationary tendencies

Last month's economic data for the second half of 2018 point to an acceleration of growth in the USA and a stabilization in the euro zone at a solid level. So far so good. But the spoilsport could be political decisions by the US government. According to the textbook, all directions are conducive to inflation, starting with the tariffs announced by the US and the "counter" tariffs of China and the EU. A fiscal stimulus with full employment also has a price-driving effect. The Trump government's immigration policy should also reduce labor supply, at a time when the labor market is already showing first signs of overheating. In addition, with the termination of the nuclear treaty with Iran, the price of oil should tend to rise. As long as growth remains solid, the slow rise in inflation will not have a major impact, and a stagflationary environment is not our main scenario. However, the development of the above mentioned points must be closely monitored, as volatility could increase abruptly in all asset classes. In the summer months we expect greater fluctuation ranges being the first harbingers of the US mid-term elections. The US government's fiscal stimulus will likely cause the late-cycle, global economic growth to go into overtime. As a result, global equities continue to offer intact yield potential, focusing less on absolute valuation and more on earnings growth. We remain cautious regarding bonds and alternative investments. The fixed income sector is likely to come under pressure as inflationary tendencies emerge.

Table 1: Generic Tactical Asset Allocation LGT Private Banking Europe (July 11, 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%		3.0%	4.0%	10.0%
	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%**		**47.0%**	**47.0%**	**47.0%**
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%		10.0%	10.0%	10.0%
	Total Fixed Income	**36.0%**		**34.0%**	**34.0%**	**34.0%**
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%		4.0%	4.0%	4.0%
	Precious metals	2.0%		2.0%	2.0%	2.0%
	Total Alternatives	**19.0%**		**16.0%**	**16.0%**	**16.0%**
	Cash	**2.0%**		**3.0%**	**3.0%**	**3.0%**
Currencies	USD	86.5%		80.5%	8.0%	8.0%
	EUR	0.0%		0.0%	72.1%	0.0%
	CHF	0.0%		0.0%	0.0%	72.7%
	GBP	0.0%		0.0%	0.0%	0.0%
	JPY	0.0%		2.0%	2.0%	2.0%
	Others (incl. EM)	13.5%		17.5%	17.9%	17.3%

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: Aug 13, 2018	What we like	What we dislike
Equities	▪ European equities ▪ Swiss equities	
Bonds	▪ Emerging Market Local Currency bonds ▪ Low duration ▪ Subordinated debt	▪ Sovereign bonds ▪ High yield bonds
Alternative Investments	▪ Commodities ▪ Insurance linked bonds	▪ Hedge Funds ▪ Listed private equity
Currencies	▪ Japanese yen	▪ US dollar

Sources: LGT Investment Services Europe

Equities: US profit reporting with signal effect

The corporate tax reform announced by the US government at the end of 2017 has led to a massive increase in companies' profit and sales expectations. Most American companies clearly exceeded the high expectations of the market in the first quarter. The focus is now on the results for the second quarter of 2018, with a projected increase of over 20% in profits similar to the first quarter. As there were hardly any profit warnings from companies in June, we are confident that Corporate America will deliver again. We are also focusing on the outlook for the second half of the year which will have a signal character: will the companies' growth remain solid? And how sustainable will companies assess the profit statements brought about by the tax reform? The biggest risk for these trends is the trade conflict between the USA and China. In this context, the sentiment of investors, who are still relatively relaxed about political events, is important. Europe (margin potential and attractive valuations) and Switzerland (above-average yield advantage) remain our favorites on a global basis.

Fixed Income: long maturities remain unattractive

Interest rates on long-term government bonds are in a phase of consolidation in the USA, after having risen sharply in the first half of 2018. However, the yield curve is so flat that it does not pay off for investors to extend duration. The interest rate differential between ten- and two-year bonds fell to below 30 basis points (bp). We recommend a short duration in a portfolio. The situation in the euro zone and Switzerland looks even less attractive: Interest rates have even fallen, triggered by political disagreements in the euro zone - the formation of a government in Italy and the coalition crisis in Germany. The entire Swiss yield curve up to ten years is now again in the negative interest rate range. The ten-year German bonds – the Bund – also bear no yield for private investors at 30 bp. Also on this side of the Atlantic the yield curves are so flat that a short remaining term is recommended. Emerging market bonds in local currency have had a difficult second quarter in 2018. After more than six strong quarters in a row, the pending trade conflict and the countermove in the US dollar have put pressure on emerging market bonds. However, we continue to view the fundamental situation as positive and therefore continue to see yield potential in this investment category. Volatility should remain high.

Currencies: US dollar driven by sentiment

The fundamental outlook for the Greenback has not improved in recent weeks. In the medium to long term the US twin deficit will weigh on the US dollar. At the purchasing power parity level, too, there is still an overvaluation between 10-20% against the most important currencies. In the short term, the US dollar may be strongly sentiment driven, especially if, as in the second quarter, it is seen as a safe haven in view of the nascent trade conflict or the "Italian flu". We believe that the appreciation potential is currently low and recommend reducing the US dollar to its current strength. At the asset allocation level, we remain overweight in the Japanese yen, not least because of the Bank of Japan's surprise potential.

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

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