Monthly Asset Allocation
Private Banking Europe Investment Committee

February 14, 2018

In a nutshell

- **Equities: Constructive outlook remains, even after long overdue correction**
- **Fixed Income: First rise at the long end – further underweighting of bond ratio**
- **Currencies: US dollar under pressure – technical countermovement expected**

The return of volatility on the stock markets

After more than 400 days without a correction of over 5%, the anticipated correction in stock markets materialized at the beginning of February. This means that after almost two years of no significant consolidation, the bull market in equities is finally taking a breather. However, the macroeconomic environment remains positive even in these turbulent times, although the leading indicators are likely to have peaked in the short term, at least in developed economies. It remains to be seen how the now foreseeable fiscal stimulus will affect the US economy that is already in a late cycle, especially the US labor market, which has practically reached full employment. This could well lead to overheating, which would result in rising wage inflation and thus break the Fed's target. This scenario would severely restrict the Fed's flexibility and lead to more interest rate hikes than the previously announced three steps of 25 basis points each. The Investment Committee of LGT Private Banking Europe remains positive in its assessment of equities at an asset allocation level, as the fundamental data continue to support this asset class. Despite the recent rise in interest rates, we still see little yield potential for private investors in government bonds and confirm our underweighting on a portfolio basis. In the coming weeks we expect to see increased volatility on the capital markets – until higher interest rates and inflation expectations are factored in by the markets.

Table 1: Generic Tactical Asset Allocation LGT Private Banking Europe (February 14, 2018)

	Asset Class	SAA	underweight -8% -6% -4% -2%	Strategic (SAA) vs Tactical Asset Allocation (TAA) in USD	+2% +4% +6% +8% overweight	TAA		
		USD				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%				2.0%	2.0%	2.0%
	Emerging markets equities	6.0%				8.0%	8.0%	8.0%
	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%				2.0%	2.0%	2.0%
	Precious metals	2.0%				2.0%	2.0%	2.0%
	Total Alternatives	**19.0%**				**17.0%**	**17.0%**	**17.0%**
	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%
	Others (incl. EM)	13.5%				16.5%	16.9%	16.3%

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: March 12, 2018	What we like	What we dislike
Equities	European equity Emerging markets equity 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: Constructive outlook remains, even after long overdue correction

Despite a sharp correction, our constructive outlook for equities remains unchanged as well as the positive economic environment for companies. Following the solid revenue and earnings figures of the past quarter and the consistently strong outlook for the current year, we are maintaining our overweight for equities at the asset allocation level. We remain firmly convinced that the record low volatility we saw in 2017 will be a phenomenon of the past and that global stock market volatility will normalize in the coming quarters. The earnings outlook for 2018 and the coming year remain intact, and the positive economic environment continues to make equities appear to be an attractive investment category. Within the equity allocation, we see the most interesting risk/return mix in emerging market securities and selectively in euro zone companies on a global basis. The increased volatility should be used in the coming months as an opportunity to build up positions in high-quality companies with attractive dividends. We continue to prefer sectors or industries that benefit from the cyclical global upturn and have stable margins in addition to strong sales growth.

Fixed Income: First rise at the long end – further underweighting of bond ratio

In recent weeks, long-term interest rates in developed countries have risen for the first time, especially in the case of 10-year US government bonds. Since the beginning of the year, yields have increased by almost 50 basis points to 2.85%. There was a similar increase in German and British government bonds. Even Swiss government bond yields are above zero after this move, but remain unattractive for private investors with a yield of only 0.2%. Bond markets are slowly but surely starting to prepare for an end of the quantitative easing of major central banks around the globe. While the first rapid increase has yet to be digested, we expect yields to rise in the coming months. In a bond portfolio, we continue to recommend maintaining a short duration. The credit risk premium for high-yielding bonds remains unattractive by historical standards. We prefer subordinated securities of first-class debtors. Moreover, we are keeping the ratio of emerging market bonds at a tactical overweight, as the fundamentals for this region remain excellent and investors can benefit from attractive returns. There is a slight preference for securities denominated in local currency, as we have identified selective appreciation potential for emerging market currencies.

Currencies: US dollar under pressure – technical countermovement expected

The US dollar got off to a very weak start into this year, despite an attractive interest rate differential with most developed countries and the expected three Fed interest-rate hikes this year. In 2018, however, we are sticking to our assessment of a weaker US currency. The current account deficit and the overvaluation at purchasing power parity level should weigh on the greenback. In addition to the Canadian dollar, we also see potential for the Swedish krona in the coming months. The outlook for economic growth and inflation are supportive for the Scandinavian currency: the Riksbank, the Swedish central bank, will probably soon have to alter its expansionary monetary policy and align with the ECB's policy.

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

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