Monthly Asset Allocation
Private Banking Europe Investment Committee

May 16, 2018

In a nutshell

- **Late stage economic growth should continue in the coming months with momentum**
- **Companies report strong results for the first quarter of 2018 and confirm the continued positive outlook**
- **Emerging market bonds in local currency remain in the focus**

Late cycle global economic growth

The latest positive macroeconomic figures suggest that the global economy is growing at a late stage, especially in the USA, and there is still no sign of an imminent end. For the coming months, leading indicators point to a further strong growth momentum. In the coming quarters, US inflation could surprise on the upside, not only due to higher commodity prices, but also due to high capacity utilization and the strong labor market. The Federal Reserve remains in a comfortable situation and does not seem to be under pressure to raise interest rates faster than the market currently expects. The geopolitical tensions, such as those between the USA and China regarding punitive tariffs, seem to be of little interest to capital markets at the moment. The current focus is on profit dynamics and margin stability for companies that are increasingly confronted by a rising interest rate environment. We continue to see positive return prospects for global stocks and confirm our overweight at the asset allocation level. The described economic momentum and global monetary policy have a supportive effect on equities, although the path through rising US wage inflation is likely to be steeper. In Europe and Switzerland in particular, stocks are relatively attractive compared to government bonds, also due to a dividend yield of over 3%. We are maintaining our underweight in the segments bonds and alternative investments.

Table 1: Generic Tactical Asset Allocation LGT Private Banking Europe (May 16, 2018)

	Asset Class	SAA	underweight — Strategic (SAA) vs. tactical allocation (TAA) in USD — overweight	TAA		
		USD	-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%		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%**		**2.0%**	**2.0%**	**2.0%**
			-8% -6% -4% -2% +2% +4% +6% +8%			
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: June 11, 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	▪ Insurance linked bonds	▪ Listed private equity
Currencies	▪ Japanese yen	▪ US dollar

Sources: LGT Investment Services Europe

Equities: strong company figures in the first quarter and continued positive outlook

The eagerly awaited corporate reporting season has exceeded the high expectations of market participants. The outlook of the companies for the rest of the year also seems to suggest a further continuation of the profit momentum. The US tax reform boosted profits by over 20% in the first quarter of 2018. However, the sustainability of this profit trend is viewed rather sceptically by various market players. Therefore, a continuation of the consolidation phase should come as no surprise. This behavior can often be observed in a late-cycle economy. Traditionally, markets such as Switzerland or the UK are gaining in popularity in such a situation, as they should benefit most from the index composition in a global comparison. Market participants are currently focusing on these late-cycle characteristics and seem to be ignoring the challenges for the UK around the Brexit. We are therefore increasing our weighting in UK equities from "underweight" to "neutral". In the long term, we maintain our positive assessment of emerging market equities. In the short term, however, we will reduce our overweight to "neutral", as we see more potential in emerging market bonds at the asset allocation level. Within our equity allocation, the euro zone (attractive valuation) and Switzerland (defensive market) remain our preferred investment regions at a global level.

Fixed Income: emerging market bonds in local currency as preferred investment category

As expected, ten-year US government bonds have cracked the three-percent mark in recent weeks. This threshold may not be worth mentioning in historical terms, but in today's low interest rate environment, reaching the three-percent level seems to herald a possible turnaround in long-term interest rates in the USA. The euro zone and the Swiss bond market will not be able to escape this trend either, although the absolute interest rate level – ten-year German government bonds are at +0.6% and those from Switzerland at +0.05% – remains drastically below the one of US bonds. In the coming months, we expect further steady upward pressure along the entire US yield curve and markets can expect yields of 3.25% to 3.5% on ten-year US government bonds. Due to the still flat yield curve, we prefer securities with a short remaining term. In recent months, yields on emerging market bonds have also risen in local currency. We regard this movement as an attractive opportunity to enter the market and are further expanding our existing overweight in this investment category. In the case of high-yield securities, we continue to see little attractive return potential for private investors at the asset allocation level.

Currencies: the yen with tailwind against the US dollar

The recent countermove of the US dollar is likely to be short-term in nature, as the medium to long-term fundamentals of the greenback have hardly improved. The twin deficit and the overvaluation of the dollar in terms of purchasing power parity should provide a considerable headwind in the coming months and thus lead to the loss of recent profits. Especially against the Japanese yen, we currently see the greatest depreciation potential and would use exchange rates of over 110 yen against the US dollar to reduce the greenback. In contrast to the Fed, which has more or less already laid its cards on the table with regard to further monetary policy, there is certainly potential for surprise regarding the Bank of Japan's policy, which could give the yen a tailwind against the US dollar in the second half of the year.

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

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