Monthly Asset Allocation
Private Banking Europe Investment Committee

June 13, 2018

In a nutshell

- **Strong profit growth triggers normalization of stock market valuations**
- **Bond yields should continue their upward trend despite volatility**
- **Commodities develop positively and go hand in hand with global growth and inflation**

Global capital markets seem unaffected by geopolitical uncertainties

Neither the turbulences surrounding the new Italian government nor the impending trade conflicts between the USA and the rest of the world have had a lasting effect on the capital markets. A risk-on-scenario appears to be emerging for the coming months, being also plausible from today's point of view: the latest US economic data show another acceleration of the world's largest economy. The leading indicators in the euro zone have also stabilized, and the emerging markets are showing a solid set of data, too, despite some turbulences in Latin America and Turkey. The further course of the trade dispute between the USA and China is likely to be particularly important for Asia. A strengthening US dollar and rapidly rising US interest rates at the long end could lead to considerable headwind for emerging market investments in the short term. From today's perspective, we regard this risk scenario as rather unlikely. At the asset allocation level, we are maintaining an overweight position for global equities at the expense of the bond ratio and alternative investments. The economic data and the ongoing friendly financing environment for companies should continue to be an important driver for equities in the coming months. Due to the late cyclical environment, volatility on the stock markets will continue to rise and normalize in the course of the year. We are increasing the commodity rate within alternative investments at the expense of the hedge fund rate. Scarce capacities and tightening wage pressure are a positive environment for commodities.

Table 1: Generic Tactical Asset Allocation LGT Private Banking Europe (June 13, 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%**
			-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: July 9, 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	▪ **NEW: Commodities** ▪ Insurance linked bonds	▪ **NEW: Hedge Funds** ▪ Listed private equity
Currencies	▪ Japanese yen	▪ US dollar

Sources: LGT Investment Services Europe

Equities: strong earnings growth triggers normalization of valuations

Profit and sales growth continues to be solid on a global basis and makes the temporarily high valuation level on the stock markets, especially in the USA, look more normal again by historical standards. Spurred on by the technology sector, the profit momentum remains extraordinarily strong, especially in the USA. To date, there has been hardly any profit warning from this sector and a strong second quarter of 2018 can be expected. However, some of the FAANG stocks (Facebook, Amazon, Apple, Netflix and Google) have already discounted a lot in their prices. The outlook for the second half of the year is expected to be the decisive litmus test of 2018 for many US technology companies. The return potential for equities remains intact, but we still expect a global equity market in a consolidation phase within a wide range. At country level, we prefer the euro zone (valuation and dividend yield) and Switzerland (defensive market).

Fixed Income: volatility unlikely to change the direction of yields

The past weeks brought many turbulences and uncertainties. The spikes in broad market volatility they created, however, did not change the most important market levels materially. With economic data coming in strong, US ten-year yields are already close to 3% again, German Bunds with similar maturity bounced off the 0.18% yield-low from March 29 to trade now at 0.5%, and credit spreads excluding Italian names exchange hands just a few basis points (1bp = 0.01%) higher. Even corporate high yield credit risk premiums on aggregate settled just 20bp higher following an almost 50bp spike. We reiterate our preference for emerging markets local currency debt and subordinated paper over classic high yield debt, which we better approximate via equity market exposure, while keeping the interest rate sensitivity of our portfolio below benchmark.

Commodities: positive development hand in hand with global growth and inflation

Commodities have a reasonably good record of performing well in a later stage of the economic cycle. Usually, such periods are characterized by good, even accelerating growth and a demand-driven rise in prices, hence inflation. After the economic US soft-patch in Q1 and the euro zone following suit, recent hard as well as survey data suggest that the global economy regains traction in a well synchronized manner. Moreover, the US Fed remains comfortably behind the curve, meaning it still implements more monetary looseness than necessary; China might ease the already tightened monetary conditions in the second half of the year, and the ECB is expected to taper (reduce extraordinary monetary efforts, i.e. bond purchases) toward year-end. Given the sound economic backdrop and the expectation of sustained political supply-side management (i.e. output curbs) in both energy and metals, we expect broad commodities prices to take another demand-driven leg higher.

Currencies: USD strength to fade after rally

We suggest selling the recent USD rally. The strength of the Greenback had come on the basis of a more pronounced growth slowdown in US peer economies as well as higher volatility driven by increased political risks. We expect both drivers to fade, and we reiterate our long JPY position against the USD. Additionally, we recommend a diversified emerging market local currency overweight. We expect the global economy to rebound from the soft-patch and emerging markets to benefit disproportionately.

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

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