Monthly Asset Allocation
Private Banking Europe Investment Committee

November 14, 2018

In a nutshell

- **Following the risk-reallocation in our strategy, we increase our exposure to US equities**
- **Risk-adjusted returns for equities seem superior to those of high-risk credit markets**
- **We move into a modest risk-on mode while keeping the strengthened fixed income defense**

We expect a positive year end financial statement for stock markets

The marked downward correction in prices, especially on the equity markets, provides a good opportunity to reduce the increased cash quota and, in return, to slightly increase the risk in the portfolio on the equity side. Our decision is based on a continued solid economic environment, in which on the one hand we expect more stable returns from developed markets than from emerging markets affected by trade conflicts, and on the other prefer equities to bonds in a comparison of the large asset classes. There are other reasons for the current increase in the equity exposure: 1) Following the recent US Midterm Elections, the House of Representatives is falling to the Democrats, who will thus have a greater influence on the feasibility of President Donald Trump's political agenda. The now divided US government power is likely to have less of an impact on the capital markets; 2) equities are valued more attractively than other investments (e.g. high yield); 3) the positioning of institutional market participants (they had to massively reduce their equity exposure in October). Overall, we are maintaining a more defensive approach to the holdings of bonds and alternative investments in the portfolio. In more volatile market phases or in a crash scenario, we expect consistent positive returns with reduced negative surprise potential, such as could result from a liquidity shortage in some submarkets.

Table 1: Generic Tactical Asset Allocation LGT Private Banking Europe (November 14, 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%		24.0%	19.0%	19.0%
	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%		3.0%	3.0%	3.0%
	Emerging markets equities	6.0%		6.0%	6.0%	6.0%
	Total Equities	**43.0%**		**49.0%**	**49.0%**	**49.0%**
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%		16.0%	16.0%	20.0%
	High yield bonds	6.0%		0.0%	0.0%	0.0%
	Subordinated Debt	0.0%		0.0%	0.0%	0.0%
	Emerging markets bonds	6.0%		8.0%	8.0%	8.0%
	Total Fixed Income	**36.0%**		**33.0%**	**33.0%**	**33.0%**
Alternatives	Hedge funds	7.0%		0.0%	0.0%	0.0%
	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%		4.0%	4.0%	4.0%
	Total Alternatives	**19.0%**		**13.0%**	**13.0%**	**13.0%**
	Cash	**2.0%**		**5.0%**	**5.0%**	**5.0%**
			-8% -6% -4% -2% +2% +4% +6% +8%			
Currencies	USD	86.5%		82.5%	8.0%	8.0%
	EUR	0.0%		0.0%	74.1%	0.0%
	CHF	0.0%		0.0%	0.0%	74.7%
	GBP	0.0%		0.0%	0.0%	0.0%
	JPY	0.0%		2.0%	2.0%	2.0%
	Others (incl. EM)	13.5%		15.5%	15.9%	15.3%

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: Dec 10, 2018	What we like	What we dislike
Equities	US equities European equities	
Bonds	Low duration Investment Grade bonds	Sovereign bonds High yield bonds
Alternative Investments	Gold Insurance linked bonds	Hedge Funds Listed private equity
Currencies	Japanese yen	

Sources: LGT Investment Services Europe

Equities: "Shocktober" for global equity markets

Global equity markets experienced a "shock" in October, as investors witnessed the strongest correction of the past ten years, starting from a US stock market that had been extremely resilient until then. The trigger was a combination of causes, one of which was a statement by US Federal Reserve Chairman Jerome Powell: the Fed could tighten monetary policy beyond a "neutral" level, although "neutral" was far from being achieved. While the US has had uninterrupted employment growth for 97 months, the lowest unemployment rate since the 1960s and the highest wage inflation in ten years – which should support a further tightening of monetary policy – the statement coincided with emerging concerns about global economic growth as well as the suspension of US stock buy-back programs due to the reporting season, which turned out to be unfortunate. Meanwhile, the US Midterm Elections have brought the expected outcome. Historically, it has often laid the foundation for a year-end rally. The share buy-back programs in the US are resuming and the reporting season was solid, with profit growth of around +24% compared with the previous year. We therefore expect stock markets to calm down.

Fixed Income: US yields show upward trend

The bond weakness is continuing after October saw a temporary strength in longer-term US government bonds, i.e. a period of falling yields and rising prices. For example, the US equity index S&P 500 lost over -10% due to exaggerated concerns about potentially fundamentally unjustified interest rate hikes by the Fed, leading to an increase in realized volatility (fluctuation band). Ten-year US government bond yields reached a new annual high of 3.24% based on closing prices. Two-year Treasuries also set a new record of 2.97% for 2018, demonstrating market participants' belief in further US rate hikes. Due to ongoing uncertainties surrounding the Brexit and the Italian budget, neither Germany's bonds, i.e. the lowest-credit-risk bonds in the euro zone, nor the Swiss Confederation bonds were able to maintain the direction of US yields.

Currencies: Political uncertainties in the "old" world keep the US dollar strong

With increasing volatility in almost all capital market segments, the US dollar (USD) continued to appreciate – a typical development in phases of increasing risk aversion. After the US Midterm Elections, other currencies appreciated too, partly due to the Democrats' greater influence on the implementation of the Republican US President's political agenda, and partly because of a possible easing of the smouldering trade conflicts. Contrary to the weakening fundamental outlook for the US economy relative to other currency areas, the more capital-needy US budget management and, ultimately, the purchasing power parity valuation – which together would point to a USD at the end of its period of strength – the renewed Brexit worries and the dispute over the Italian state budget led to new USD highs in the course of the year. In our allocation, we maintain our overweight in the yen, which has upward potential with the expected weakening of the US dollar in the medium term.

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

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