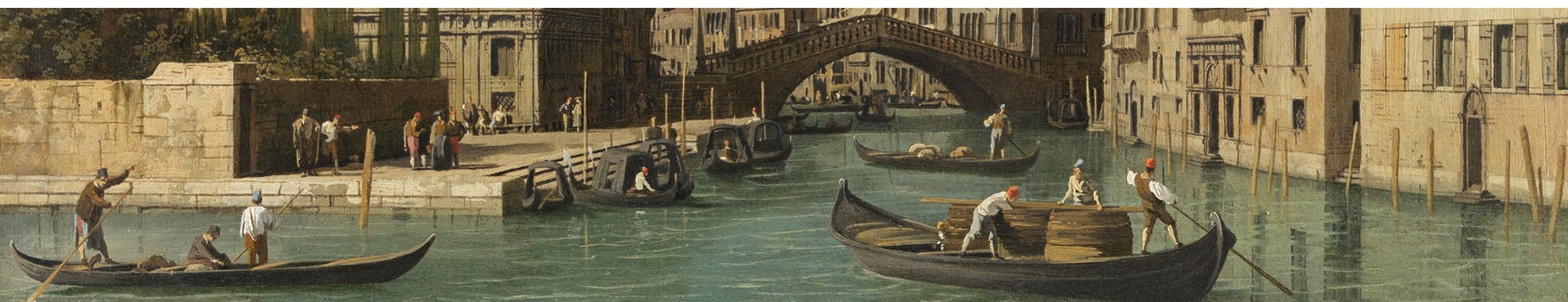
Monthly Asset Allocation
Private Banking Europe Investment Committee

September 04, 2019



In a nutshell

- **We expect the US Federal Reserve to take a further interest rate cut in September**
- **We confirm our defensive positioning with underweight in bonds and overweight in liquidity and gold**
- **Relative attractiveness and cautious positioning continue to favor risk taking in equities**

All eyes on the US Federal Reserve

In the past month, the economic environment has stabilized, but hardly improved at all. In the US-Chinese trade war, there is little hope for a resolution in the near future. Market participants are thus focusing again on the currency guardians, now above all on the central bank that still has room for maneuver in monetary policy – the US Federal Reserve (Fed). The mandate could not be more complex. On the one hand, the Fed, led by its Chairman Jerome Powell, is under constant attack from the US President, which calls the independence of the Federal Reserve into question. On the other hand, the US economy has cooled to potential growth after the late cyclical fiscal stimulus. For the right dosage of the next monetary policy measures, Powell will have to proceed with great sensitivity. The domestic economy being in a precarious position and having to face aggravating geopolitical tensions at the same time is a challenge that last occurred during the Asian crisis 22 years ago. Against this backdrop, we expect a further rate cut on 18 September. However, the communication of the Fed will be more important than the effective rate cut. On an asset allocation level, we have not built up risk due to seasonality, although some indicators have improved in recent weeks. We maintain our defensive positioning with an overweight in liquidity and gold, a neutral equity exposure and an underweight in bonds. However, rebalancing will occur in all investment profiles, resulting in selective profit taking in gold and a further expansion of European equities. Following the massive bond rally, positions will also be reduced selectively in favor of liquid assets.

Table 1: Generic Tactical Asset Allocation LGT Private Banking Europe (September 04, 2019)

	– – –	– –	–	+	++	+++
Equities (total)						
USA						
Europe						
UK						
Switzerland						
Japan						
Asia-Pacific ex. Japan						
Emerging markets						
Fixed Income (total)			■			
Government bonds		■	■			
Investment Grade bonds				■		
Inflation-linked bonds						
High yield bonds	■	■	■			
Emerging markets bonds						
Alternatives (total)						
Hedge Funds	■	■	■			
Listed Private Equity	■	■	■			
Real estate trusts						
Insurance-linked bonds				■		
Commodities						
Precious metals				■		
Cash (total)				■		

Source: LGT

Table 2: Current asset allocation preferences

	What we like	What we dislike
Equities	German stock index (DAX) Staples Healthcare	
Fixed Income	Low duration Shortterm US Treasuries Investment grade bonds	Swiss government bonds EU government bonds High-yield bonds
Alternatives	Gold Insurance-linked bonds	Hedge Funds Listed Private Equity
Currencies		

Sources: LGT

Equities: relative attractiveness and a cautious positioning continue to speak in favor of equities

The month of September traditionally represents a time of increased volatility as companies announce possible profit warnings for the third quarter or even the full year. Therefore, by historical standards, autumn has a weak seasonality for the year as a whole. We expect this pattern to continue this year, although two other factors are having a strong impact on the equity market at the moment: on the one hand, relative attractiveness compared to other asset classes, especially bonds. Compared to government bonds, which are mutating into interest-free risk investments, equities continue to offer potential due to their attractive earnings and dividend yields. On the other hand, the current cautious positioning of market participants in the coming months speaks in favor of equities. We regard this cautious assessment as a counter-indicator and therefore expect that the potential for setbacks – despite the difficult seasonality – will be limited. In such a phase of weakness, positions should then be strategically built up successively.

Fixed income: bonds with negative interest rates reach new record levels

After the turnaround of the most important central banks in the first half of the year and a further, already announced ECB stimulus program, the hunt for a positive return has accelerated in the last weeks and months. As a result, most developed country government bonds have negative yields up to a residual maturity of five years. Only US and UK government bonds still have positive nominal yields in this maturity band. Government and corporate bonds worth over USD 17 trillion, representing almost 30% of the total market, are already showing a negative yield. In view of this situation, the temptation is obvious to take greater risks than the portfolio allows in order to at least generate a positive return. We stick to our assessment and take risks primarily on the equity side. In a pure bond mandate, we prefer subordinated bonds to high-yield securities. Emerging market hard-currency bonds are equally attractive in the medium term.

Alternative investments: focus on gold and the US dollar

The yellow precious metal has continued to fly high in recent weeks and is widely talked about. In the medium to long term, we maintain our positive assessment of gold, as it serves as excellent portfolio diversification and risk insurance for assets. In the short term, we are taking a more cautious position and would wait with new engagements or an increase until there is a correction. The challenges for the US dollar will remain in the medium term due to the further increase in the US twin deficit. However, the interest rate differential and the status as a safe haven speak in favor of the Greenback in the short term, with the result that it is unlikely to tend to weaken significantly.

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

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