



time to increase equities investment strategy

Investment
Strategy

23 February 2016

The fear of recession is overdone, the US Federal Reserve is expected to be “on hold” in terms of rate hikes in 2016 and central banks worldwide are expected to continue to support growth, having plenty of fiscal and monetary policy levers left to use. Against this background, the Global Investment Committee decided it was time to increase equity risk across the board at their meeting on 18 February.

The increase will be at the expense of cash in cash-rich portfolios (profiles 2, 3 and 4) and, in addition, at the expense of existing exposure to hedge funds in the equity-dominated portfolios (profiles 5 and 6).

The asset allocation now calls for an even stronger overweight in risky assets and equities in particular, with unchanged positions in bonds (underweight), commodities (overweight) and underweight allocations to real estate in balanced profiles. The allocation to hedge funds remains an overweight with the exception of the equity-dominated portfolios, which now have a neutral allocation.

The increase in equities was driven by rebalancing after downward market drift and an expectation for selected equity sectors to outperform broader markets. This increase is a

continuation of the GIC’s previous recommendation, which called for clients who were significantly underweight in equity risk to selectively begin to add to equity holdings. The GIC’s recommendation of 18 February goes one step further, by advising all clients to selectively rebuild and increase risk and, in particular, rebuild equity positions.

For portfolio profile 3, the 5% increase in equity risk comprises an increase of 3% to return to the early December tactical asset allocation of 38%, from the current level of 35%, due to recent market drift, and an additional 2% increase in equity risk. As a result, the tactical equity allocation has increased to 40%. For more information on the composition of the six profile portfolios, see Figure 1.

Extended soft patch but no recession

The decision to increase equities came after a downward revision in economic growth forecasts by Group Economics. The revisions recognise an unexpected and extended soft patch in the global economy. Group Economics, however, does not expect it to worsen or to result in recession. The new scenario expects a longer period of weaker global growth followed by a modest recovery later in the year.

Central bankers are also expected to help improve market sentiment and to take steps to support global economic

Figure 1: Asset allocation across risk profiles

	Profile 1			Profile 2			Profile 3			Profile 4			Profile 5			Profile 6		
	SAA	TAA	Δ	SAA	TAA	Δ	SAA	TAA	Δ	SAA	TAA	Δ	SAA	TAA	Δ	SAA	TAA	Δ
Money market	5	41	36	5	20	15	5	12	7	5	3	-2	5	1	-4	5	0	-5
Bonds	90	51	-39	70	39	-31	55	30	-25	35	18	-17	15	11	-4	0	0	
Equities	0	0		15	23	8	30	40	10	50	61	11	70	79	9	85	86	1
Alternatives	5	8	3	10	18	8	10	18	8	10	18	8	10	9	-1	10	14	4
FoHF	5	8	3	5	11	6	5	11	6	5	11	6	5	5	0	5	5	0
Real Estate	0	0		3	0	-3	3	0	-3	3	0	-3	3	0	-3	3	5	2
Commodities	0	0		2	7	5	2	7	5	2	7	5	2	4	2	2	4	2
Total exposure	100	100	0	100	100	0	100	100	0	100	100	0	100	100	0	100	100	0

SAA is strategic asset allocation; TAA is tactical asset allocation; Δ is TAA minus SAA.

The ABN AMRO Private Banking Global Investment Committee (GIC) has weekly discussions to review key macroeconomic drivers, risk factors and market prospects in relation to the tactical asset allocation of client risk profiles. For more information, contact your Investment Advisor.

growth. The Federal Reserve is no longer expected to hike rates in 2016; the ECB is expected to move interest rates deeper into negative territory and to increase monetary stimulus; and more easing is also expected by the Bank of Japan.

Time to position for a recovery in equity markets

The decision to increase the equity allocation came after a market correction and a significant downward revision of earnings growth forecasts. The committee believes that the market has exaggerated the risk of a recession. Market sentiment is expected to improve, as central banks take steps to support growth. Signs of stabilisation are already being seen, in terms of positive earnings surprises and the up/down ratio of analyst expectations. Given the speed at which markets can react, clients are advised to begin now to selectively rebuild equity exposure. The recommended sectors in which to invest are health care and information technology. The energy and materials sectors should be avoided, as the bottom may not have been reached. See the equity sector allocation in Figure 2.

Why to invest in equities

Fourth-quarter earnings show a modestly positive trend, with a pronounced difference among sectors and industries. Energy and materials producers and related industries (engineering, infrastructure providers) are suffering from price declines, overcapacity and slowing demand.

Financials are reporting mostly in line with expectations, but the earnings outlook is disappointing, given persistent low interest rates and dented margins. Companies that benefit from the ongoing investment trend in automation, robotisation and the increased use of the internet are doing very well, as are consumer-related firms, especially related to consumer staples and luxury goods. The health care sector is experiencing good earnings growth, based on demographic trends related to aging and a rising middle class in emerging markets. Most of these companies also have strong financials, with regular share buybacks, and are announcing dividend increases.

The appreciating US dollar hurt US companies in 2015, while it benefitted European companies. In Europe and the US, valuations are in line with historic trends, while earnings growth is expected to be positive, but modest in 2016. Dividend yields in Europe are markedly higher than in the US, by 200 basis points. The sustainability of European dividends, however, is less convincing, as banks, insurance companies, energy producers and utilities have recently started to cut dividends. Driven by good and improving (in Europe) employment levels, low prices and low costs for both consumers and producers, along with continuing high growth in Asia, the margins

Figure 2: Equity allocation: overweight

Sector	
Energy	Neutral
Materials	Neutral
Industrials	Neutral
Consumer discretionary	Neutral
Consumer staples	Neutral
Health care	Overweight
Financials	Neutral
Information technology	Overweight
Telecommunication	Underweight
Utilities	Underweight

and returns earned by goods and services provided by the majority of US and European companies should remain attractive in 2016.

Bond allocation is underweight: yields to remain low

The underweight in bonds was maintained. Fixed income markets have shown signs of the strong risk-off sentiment. Core government bond yields are lower, yield curves have flattened and peripheral and credit bond spreads have widened. The recent equity rally triggered a reversal, but it was small. Bond markets appear to lack conviction that central banks can influence the growth and inflation outlook.

Low government bond yields overall justify our continued underweight stance in bonds. Core government bond yields have limited potential to rally further from this point forward. We expect the ECB to deliver even more than a -10 basis point rate cut and EUR 10 billion in additional bond purchases a month in March, followed by additional action in June. This is a little more than the market is currently expecting. The Fed is no longer expected to hike rates this year, as markets are already pricing by now. Bund and US Treasury yields can therefore still fall first before rising again, but opportunities in safe government bonds will be very short term. The allocation to government bonds consists of peripheral government bonds only, where yields are relatively attractive and spreads are expected to converge. For further yield enhancement and diversification purposes, positions are maintained in investment-grade and high-yield corporate debt. Figure 3 shows the current bond allocation.

The slump in equity markets and the general risk-off stance has elevated credit spreads to higher levels this year. This segment of the fixed income market is concerned that a deteriorating economic growth outlook and sustained low oil prices will translate into higher defaults. We believe that these fears are overdone and that at these spread levels, investment-grade and high-yield bonds are attractive. In both markets Europe is preferred over the US.

US-dollar portfolios recommended to hedge exposure to British pound

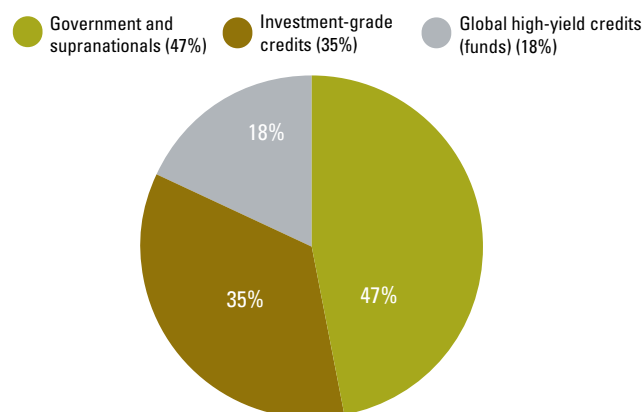
Given increased uncertainty regarding the British referendum to stay in the European Union and a delay in tightening monetary policy by the Bank of England, the decision was made to recommend a hedge of the British pound in US-dollar equity portfolios. The goal is to reduce currency risk in US-dollar equity portfolios.

Global Investment Committee

Didier Duret

didier.duret@nl.abnamro.com

Figure 3: Bond allocation: underweight



Source: ABN AMRO Private Banking

Disclaimer

© Copyright 2016 ABN AMRO Bank N.V. and affiliated companies ("ABN AMRO"), Gustav Mahlerlaan 10, 1082 PP Amsterdam / P.O. box 283, 1000 EA Amsterdam, The Netherlands. All rights reserved. This material was prepared by ABN AMRO. It is provided for informational purposes only and does not constitute an offer to sell or a solicitation to buy any security or other financial instrument. While based on information believed to be reliable, no guarantee is given that it is accurate or complete. While we endeavour to update on a reasonable basis the information and opinions contained herein, there may be regulatory, compliance or other reasons that prevent us from doing so. The opinions, forecasts, assumptions, estimates, derived valuations and target price(s) contained in this material are as of the date indicated and are subject to change at any time without prior notice. The investments referred to in this material may not be appropriate or suitable for the specific investment objectives, financial situation, knowledge, experience, or individual needs of recipients and should not be relied upon in substitution for the exercise of independent judgement. ABN AMRO or its officers, directors, employee benefit programs or co-workers, including persons which were involved in preparing or issuing this material, may from time to time hold long- or short-positions in securities, warrants, futures, options, derivatives or other financial instruments referred to in this material. ABN AMRO may offer and render at any time investment banking-, commercial banking-, credit-, advice-, and other services to the issuer of any security referred to in this material. Pursuant to offering and rendering such services, ABN AMRO may come into possession of information not included in this material and ABN AMRO may prior or immediately after publication thereof have acted based on such information. In the past year, ABN AMRO may have acted as lead manager or co-lead manager with regard to a public offering of securities from issuers as mentioned in this material. The stated price of any securities mentioned herein is as of the date indicated and is not a representation that any transaction can be effected at this price. Neither ABN AMRO nor other persons shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way from the information contained in this material. This material is for the use of intended recipients only and the contents may not be reproduced, redistributed, or copied in whole or in part for any purpose without ABN AMRO's prior express consent. This document is solely intended for dissemination amongst private/retail customers in a PC country. Distribution to private/retail customers in any jurisdiction that would require registration or licensing of the distributor which the distributor does not currently have, is not permitted. Material means all research information contained in any form including but not limited to hard copy, electronic form, presentations, e-mail, SMS or WAP.

US Securities Law

ABN AMRO Bank N.V. is not a registered broker-dealer under the U.S. Securities Exchange Act of 1934, as amended (the "1934 Act") and under applicable state laws in the United States. In addition, ABN AMRO Bank N.V. is not a registered investment adviser under the U.S. Investment Advisers Act of 1940, as amended (the "Advisers Act" and together with the 1934 Act, the "Acts"), and under applicable state laws in the United States. Accordingly, absent specific exemption under the Acts, any brokerage and investment advisory services provided by ABN AMRO Bank N.V., including (without limitation) the products and services described herein are not intended for U.S. persons. Neither this document, nor any copy thereof may be sent to or taken into the United States or distributed in the United States or to a US person.

Other jurisdictions

Without limiting the generality of the foregoing, the offering, sale and/or distribution of the products or services described herein is not intended in any jurisdiction to any person to whom it is unlawful to make such an offer, sale and/or distribution. Persons into whose possession this document or any copy thereof may come, must inform themselves about, and observe, any legal restrictions on the distribution of this document and the offering, sale and/or distribution of the products and services described herein. ABN AMRO can not be held responsible for any damages or losses that occur from transactions and/or services in defiance with the restrictions aforementioned.

Company disclosures

ABN AMRO may beneficially hold a major shareholding or a significant financial interest of the debt of these companies. ABN AMRO currently maintains a market in the security of these companies and otherwise purchases and sells securities of these companies as principal. ABN AMRO may have received compensation for investment banking services from these companies, its subsidiaries or affiliates during the previous 12 months. All disclosures made herein refer to ABN AMRO and its affiliates.

Personal disclosures

The information in this opinion is not intended as individual investment advice or as a recommendation to invest in certain investments products. The opinion is based on investment research of ABN AMRO Research & Strategy. The analysts have no personal interest in the companies included in this publication. Their remuneration for this work is not, was not and will not be related directly or indirectly to the specific recommendations or views expressed in this opinion.

