



investment strategy

Investment

Strategy

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The Global Investment Committee confirmed its conviction in the existing asset allocation at its meeting on 15 October. The allocation consists of an overweight in equities, a strong underweight in bonds and overweights in commodities and hedge funds. The GIC also decided to lift the short euro versus long US-dollar hedge for US-dollar portfolios, given a muted outlook for the US dollar.

The committee's discussion centred on the main macroeconomic scenario, calling for a continued global recovery, while also considering the potential for an adverse alternative scenario, involving a recession.

Moderate recovery expected

The main macroeconomic scenario calls for a moderate recovery and a cyclical pickup from now into 2016. In the past weeks, economic growth forecasts have been revised downward by Group Economics, first for emerging markets and thereafter for developed economies. Group Economics forecasts are now in line with the IMF and general consensus. The downward revisions were owing to the potential "knock-on effect" from the slowdown in China. While China remains on track according to official data, there is a clear loss of momentum.

The US and Europe have shown resilience to the slowdown in emerging markets, but it is beginning to have an impact. Solid domestic demand, however, continues to support growth. The Fed's delay in hiking rates, with the first hike now expected in July, is positive for global growth and risky assets. So far, the impact of the delay has included stabilising capital outflows and a rebound in emerging markets currencies and commodities markets. While the slowdown in China remains a threat, there is confidence that policymakers will use their arsenal of financial tools to ensure that the slowdown is gradual.

When considering risks that could impact the investment allocation, it is considered very unlikely that there would be a recession in the next 12 months. While the possibility of a recession is considered remote, potential triggers, including a collapse in China, a deflationary shock, collapse of the commodity markets and policy errors, were discussed and evaluated by the GIC.

Equities overweight maintained

Equity markets have stabilised and risk has declined. The main scenario calling for recovery in Europe supports the overweight equities position, with a preference for Europe and Asian emerging markets. Pricing power has been hurt by the decline in oil and commodities prices, which have now stabilised. Equity markets are believed to have priced in the news stemming from the worries about China and emerging markets in general. In terms of earnings, there is divergence between companies linked to commodities, which have been hurt, and companies that are insulated from low oil and commodities prices. The strengthening US dollar is expected to continue to be a drag on 2015 US earnings.

Strong underweight in bonds maintained

Bond markets remain volatile, influenced by the possibility of more stimulus from the ECB and the conflicting signals around the US Federal Reserve's delay in hiking rates. The allocation to government bonds consists of bonds from the eurozone periphery, which are expected to benefit from the continued asset purchases of the ECB. For yield and diversification, there are allocations to investment-grade and high-yield bonds. Despite yields having risen from very low levels, uncertainty related to changes in central banks' policies has increased uncertainty. Liquidity in euro bond markets also remains a concern.

Euro/US dollar hedge removed for US-dollar portfolios

The short euro versus the long US-dollar hedge for US-dollar portfolios was lifted. This was based on the expected delay

of the first Fed rate hike into 2016, which is reducing the attraction of the US dollar relative to other major currencies. The US dollar is now expected to fluctuate in a range. The hedge has performed well, having been entered at around 1.27 and exited at around 1.13. The short Japanese yen long US-dollar hedge remains in place.

Alternatives are expected to support investment strategy

No changes were initiated relative to the overweight allocations to commodities and hedge funds or the underweight allocation to real estate. For real estate, which moves in line with equities, profits were taken and risk reduced with the move to underweight in June 2015. No change in the hedge fund strategy was considered. Favoured strategies continue

to be long-short equity, event-driven and macro/commodity trading advisors. After the summer period, when commodities had a negative impact on performance, the committee's decision to continue with the overweight allocation was based on the expectation that oil prices will continue to recover as the supply/demand balance improves. In the last month, US crude production has dropped and global demand has been revised upward.

Global Investment Committee

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