



investment strategy

Investment

Strategy

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The investment strategy of ABN AMRO Private Banking is aimed at providing stable future returns. The asset allocation, as determined by the Global Investment Committee, remains tilted in favour of equities with a cautious stance toward bonds. Alternative investments, consisting of hedge funds and commodities, add diversification and return potential in volatile markets.

- The unfolding recovery in the US and Europe and the persistence of low funding costs will drive equity returns in 2016, particularly in Europe and emerging Asia.
- Given very low bond yields and rising rates in the US, bond markets require caution, except for a few segments, such as corporate bonds, where returns outweigh risks. The asset allocation for bonds remains underweight.
- Hedge funds and commodities, which can provide diversification in volatile markets, are overweight.
- Real estate is underweight, except in the most aggressive investor portfolio profile, where a small portion of the equities allocation was shifted into real estate to reduce equity risk.

Macroeconomic backdrop to asset allocation decisions

The US, Europe and, to a lesser extent, Japan remain the pillars of domestic demand that will support moderate global growth in 2016. A reversal is expected in emerging economies, as global industry and commodity headwinds abate. The policy measures taken in emerging markets in 2015 to stabilise financial conditions and devalue currencies should lead to a reversal of the trade imbalances in 2016.

Fixed income markets will be strongly dependent on the diverging monetary policies of the US Federal Reserve and the other central banks, and, in particular, the European Central Bank. This divergence may, however, reach its limit, if it threatens the stability of the US recovery, for example, through a rapid appreciation of the US dollar.

Moderate global growth arising from increasing consumer demand in developed markets and low commodity prices are supporting equities. This support should revive corporate earnings growth after lackluster growth in 2015.

Equities overview

Equity markets are entering a mature phase, where rotations within sectors and among styles will be the key return drivers in 2016. We recommend a defensive growth orientation. In terms of regions, the allocation is neutral regarding developed markets versus emerging markets, but within developed markets Europe is preferred over the US and within emerging markets, Asia is preferred. Against a background of a seven-year and maturing bull market, a small portion of the equities allocation was shifted into corporate bonds in November, except for profile 6, where it was shifted into real estate.

Economic growth to support European equities

Within developed markets, the allocation to European equities is overweight, as economic growth is expected to improve further and valuations remain attractive. The low euro is also favourable for export-oriented European companies. Within emerging markets Asia, selective opportunities are seen, and, in particular, in India and China.

The underweight position in US equities reflects diminishing earnings growth potential, as profit margins are already high from a historical perspective. Valuations are also demanding and US equities are expected to be hurt by rising rates in the US.

Investing in the defensive growth found in the health care and IT sectors

The health care sector is expected to benefit from structural growth drivers, such as ageing and, in emerging markets where wealth is rising, from increased spending on health care products and services. The IT sector is favoured, as it remains a major source of innovation and productivity improvement. Within IT, there is a preference for modern software/web-oriented companies, such as Google (now known as Alphabet), over more mature, hardware-based companies, such as HP and IBM.

There are underweight allocations to the utilities and telecommunications sectors. Utility companies are suffering due to low electricity prices and the necessity of making significant investments to switch to renewable energy production. Within the telecoms sector, prospects are unexciting, as competition, especially among US operators, is keen. In Europe, no material growth is expected in the telecom sector, as consumers continue to focus on costs. For all the other sectors (energy, materials, industrials, consumer discretionary and consumer staples) the allocation is neutral.

Looking ahead to 2016

Looking forward to the year ahead, investment opportunities may arise in the value or cyclical market segments. Before entering these segments, however, there would need to be confirmation of an uptick of the industrial cycle and stabilisation in commodity markets.

Bond outlook

Bond markets continue to require caution. The absolute level of yields remain very low and the Fed is raising its base rate. The asset allocation has been at a strong underweight, throughout 2015 and particularly since April when Bunds hit an absolute low. The bond allocation is invested in government bonds (47%, predominantly peripheral eurozone countries), corporate credits (35%) and high yield (18%).

Cash is preferred over core eurozone government bonds

Up to maturities of five years, German government bond yields remain negative. There is very limited room for any return on core eurozone government bonds in general. Instead, cash is a better alternative to stabilize portfolios and provide protection and diversification. The only bond categories that may be able to return more than cash, if only slightly, are peripheral government bonds (including inflation-linked government bonds). Corporate bonds, both investment grade and high yield, have the potential to deliver considerable excess returns over cash.

Peripheral government bonds benefit from ECB

Peripheral government bonds, such as from Spain and Italy, are expected to benefit from a general recovery of investor' risk appetite, while remaining fully protected and directly supported by the asset purchase programme of the European Central Bank. The programme was recently extended well into 2017. Longer maturities are preferred within the peripheral bond allocation, as a steep yield curve and the potential for these spreads to tighten increase their relative attractiveness.

We are investing in inflation-linked government bonds in the periphery, as break-even inflation rates are inexpensive, compared with expected inflation over the next 12 months and beyond. The ECB is expected to be successful in coaxing inflation higher.

European corporate and high-yield bonds offer excess investment returns

The yields for corporate credits are better than that of European periphery bonds. In the future, corporate credits will likely have more to gain from monetary policy easing, low financing rates and the unfolding economic recovery. Low energy prices and a strong US dollar versus the euro are additional positive factors for European corporate credits. In particular, European high-yield bonds offer significant return potential. Valuations are particularly attractive, after spreads widened based on fears over the economic recovery. European high-yield credits are preferred over those of the US, given the large exposure to energy companies in the US high-yield universe.

Looking ahead to 2016

A re-entry point into emerging markets bonds may be nearing. Once the US hike in interest rates is fully priced in, emerging markets could begin to outperform developed markets. Given attractive valuations, we believe that there is value in corporate credits in emerging-markets growth areas, such as Asia.

Alternatives

Hedge funds offer diverse opportunities for diversification

Hedge funds are overweight in the asset allocation, based on the wide variety of targeted diversification that they offer. In light of higher expected volatility, the divergence between monetary policies of the US and the eurozone as well as an increase in corporate activity, hedge funds are able to fulfill their role of contributing returns and mitigating portfolio risk.

Real estate market is turning more positive

The real estate market in the US is vulnerable to the rate hikes underway by the Federal Reserve. The fundamentals of the asset class are strengthening, however, driven by the improving world economy. Profits in real estate were taken in 2015, when the allocation was moved to underweight. Valuations and market circumstances may provide new entry opportunities in 2016.

between supply and demand. It should be noted that the oversupply situation does not have to be solved completely. Market expectation of an improvement is probably enough. We expect oil (WTI) prices to recover to an average price of USD 60 per barrel in 2016.

Commodity oversupply is receding

Commodity markets have recently been under the spell of year-end volatility. We expect oil prices to reverse in the course of 2016. This will be based on a better balance

Global Investment Committee

Didier Duret, Chair

didier.duret@nl.abnamro.com

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	21	16	5	14	9	5	6	1	5	2	-3	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	22	7	30	38	8	50	58	8	70	75	5	85	83	-2
Alternatives	5	8	3	10	18	8	10	18	8	10	18	8	10	12	2	10	17	7
FoHF	5	8	3	5	11	6	5	11	6	5	11	6	5	8	3	5	8	3
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.

About the portfolio profiles

In the six risk profiles shown above, there is exposure to a large variety of active strategies. The asset allocation reflects an overweight allocation to equities (profiles 2 to 5) and commodities (profiles 2 to 6) and a strong underweight in bonds (profiles 1 to 5), with no bond allocation in profile 6. Real estate, which is strongly correlated to equities, is underweight (profiles 2 to 5), but overweight in profile 6. There is no real estate allocation in profile 1. Hedge funds are overweight in all profiles, to mitigate risks. Cash is overweight in profiles 1, 2, 3 and 4 and underweight in profiles 5 and 6.



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