



# investment strategy

Investment

Strategy

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Financial markets have been under severe pressure during the first two weeks of 2016, as worries about China and a further decline in oil prices led to a deterioration in sentiment among investors. The ABN AMRO Global Investment Committee acknowledges there are significant uncertainties linked to China, given the complex nature of the Chinese economy and the fact that it is going through a transitional phase. The committee, however, believes current market sentiment to be at odds with global economic fundamentals. Therefore, and despite recent market turmoil, the Global Investment Committee decided to maintain the existing asset allocation at its meeting on 14 January 2016. The asset allocation continues to call for a moderate overweight position in equities and a strong underweight position in bonds.

- ▶ Fears of a 'hard landing' of the Chinese economy do not seem warranted; our economists consider a 'soft landing' – even when it is a bumpy one – to be the base scenario.
- ▶ Recent equity market upheaval seems to be strongly driven by sentiment; we continue to expect modest economic growth and an improvement in global corporate earnings momentum as 2016 progresses. We therefore maintain our modestly positive stance on fairly valued equities.
- ▶ We remain underweight in bonds; the only areas that are able to (slightly) beat cash are peripheral government bonds and corporate bonds.
- ▶ The price of oil is expected to stabilize in 2016; we hold on to our overweight positioning in commodities.

## Recent market turbulence

A global sell-off in equities marked a historically bad start to the new year, as worries about China and a further decline in oil prices led to a deterioration in sentiment among investors. A further depreciation of the yuan fuelled speculations among market players that a currency war is ongoing. Moreover, fears of a 'hard landing' of the Chinese economy – and the adverse impact of such a slowdown on the world economy – resurfaced. While Chinese equity markets took the severest beatings (having dropped by 18% so far this year), global developed markets declined as well (by 9%).

## Macroeconomic backdrop to asset allocation decisions

A 'soft landing' of the Chinese economy remains the base scenario of ABN AMRO Group Economics. Chinese imports, for instance, declined significantly early in 2015 but appeared to have stabilised in recent months. The Chinese housing market seems to be recovering as well. From this perspective, the recent fall of Chinese equities does not fully reflect the economic reality.

Meanwhile, the eurozone is growing at a reasonable pace. Recent macro data was upbeat, suggesting that the eurozone economy is not particularly affected by the problems in emerging economies, as domestic demand is now strengthening and growth has become broad-based. Financial market turmoil spilling over from China could upset this picture, but we expect the turmoil to subside. In the US, we have witnessed a softening of the manufacturing sector, most likely as a result of dollar appreciation and problems in emerging economies. But domestic demand remains robust and we expect conditions in the manufacturing sector to improve anytime soon.

## Equities overview

In the first weeks of 2016, equity markets declined across the board. Despite investor sentiment being shaky, we maintain

our overweight in equities, as we expect global GDP growth and earnings momentum to gain more traction in the course of 2016.

### Positioned for defensive growth

At a sector level, the cyclicals – including energy, materials and consumer discretionary – were among the segments most affected by the recent sell-off. Within our sector allocation, we remain positioned for defensive growth, with a preference for health care and information technology. The health care sector is expected to benefit from structural growth drivers, such as ageing. The IT sector is favoured, as it remains a major source of innovation and productivity improvement.

### Room for upside earnings surprises in 2016

Last week marked the start of the fourth-quarter earnings season. Healthy growth trends in the consumer-related sectors are expected to be overshadowed by sluggish results in the commodity-related sectors. During 2015, earnings growth expectations have been revised downwards. However, earnings momentum is expected to improve as 2016 progresses, leaving room for upside surprises. Moreover, relative valuations still speak in favour of equities, especially when compared to bonds and cash.

### Bonds overview

As we are still in a low-yield environment, we maintain our strong underweight positioning in bonds. Our bond allocation continues to consist of peripheral government bonds (including inflation linkers), corporate bonds and high yield. Risk aversion pushed 10-year Bund yields towards 50 basis points again in the first week of this year, as last year's theme

of falling commodity prices, in combination with worries about China, continued. So far this year, the impact on bond markets is more limited than in 2015, with the epicentre much more located in equity and currency markets. Like last year, emerging market debt remained remarkably resilient compared with other emerging market assets, certainly in growth areas such as Asia.

### Preference for peripheral government bonds

Up to maturities of five years, Bund yields are negative. Bunds will only be able to keep up with cash if yields fall further, which makes cash a better alternative to provide downside protection in portfolios. We prefer peripheral government bonds with long maturities to benefit from tighter spreads and a relatively steep yield curve. We prefer inflation-linked bonds over nominal bonds. Although low oil prices may push inflation below zero again for some months, we believe the market is far too pessimistic now about the longer-term inflation outlook.

### High yield attractively valued

Substantial issuance of new corporate bonds hurt performance of this market last year, but also led to a value increase in euro-denominated corporate debt. Yield spreads are high and should tighten somewhat towards the summer. The issuance of US companies is set to continue, but eurozone companies are still way behind in terms of re-leveraging and M&A activity. US high-yield bonds fell already towards the end of last year, as oil prices dropped and default worries spread from the energy sector to other low-quality segments. We believe that these worries are overdone and that high yield is attractively valued now, as credit spreads are pricing in a US recession (which, in our view, is an unrealistic scenario).

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.

## Emerging market debt: from underweight to neutral

In 2015, we saw a lot of weakness surrounding emerging markets, fuelled by worries about economic growth developments (China / South America) and the consequences of Fed rate hikes. Emerging market currencies and equities reacted, but a crisis in emerging market debt did not surface. This month, we decided to move our allocation to emerging market bonds from underweight to neutral. For 2016 and beyond, we expect more stable emerging markets, which should support the performance of this fixed income sub-asset class. The shift from underweight to neutral has no consequences for our portfolios, as the actual positioning in emerging market debt remains 0%. It is, however, a signal that we are taking a more positive stance towards this bond segment. Continued resilience in emerging market debt would confirm our assumption that this bond segment offers a strategic investment opportunity.

## Alternatives overview

Within alternative investments, we maintain our overweight allocation to commodities. Commodities – including oil – have been under downward pressure for a significant amount of time. We do, however, expect commodity prices to stabilise before recovering later in 2016, due to an improvement in supply and demand dynamics and – in the case of oil – closure of speculative short positions. We remain overweight hedge funds, for diversification purposes. Last year, we took profit in real estate, moving our allocation to underweight in balanced portfolios. Given the strong correlation between real estate and equity markets and the fact that we are overweight in equities, we maintain our current positioning in real estate.

## Global Investment Committee

**Gerben Jorritsma**

Global Head of Investment Strategy & Portfolio Expertise

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