



# fear replaced by cautious optimism investment strategy

21 March 2016

**Recession fears have receded and investors are beginning to focus again on fundamentals. As markets stabilize, risky assets such as stocks are favoured over bonds.**

A gradual market recovery is underway, with stabilisation and improvement seen in equity, bond, commodity and currency markets. Volatility is declining and financial conditions are improving. The adverse market conditions that contributed to the worst start of the year on record are gradually retreating. Fundamentals are coming more into focus with investors, and this trend is expected to continue.

The Global Investment Committee, after increasing the equity allocation at its monthly meeting in February, made no change to the asset allocation at its meeting on 17 March. The committee continues to believe that the investment environment remains favourable for risk taking. The asset allocation therefore consists of an overweight in stocks, a strong underweight in bonds and overweight allocations to hedge funds and commodities.

## Modest economic improvement and ongoing challenges

Market fears regarding recession have receded in the face of a recovery in oil and commodity prices and improvements in industrial production. The European Central Bank's increase in monetary policy easing has also provided support to both equity and bond markets. While economic growth cannot be described as strong, it is broad based. Growth, however, is still not expected to really take off vigorously.

Group Economics expects the global industrial cycle to see modest improvement. Recent US and eurozone indicators suggest that this has already started, although more evidence is needed. The consumer in both regions is in a relatively strong position. Economic recession is not expected, given sustained growth in consumer spending and other signs of growth.

## US equities become more attractive

The outlook for equities is described as cautiously optimistic. While challenges remain related to the slow global recovery

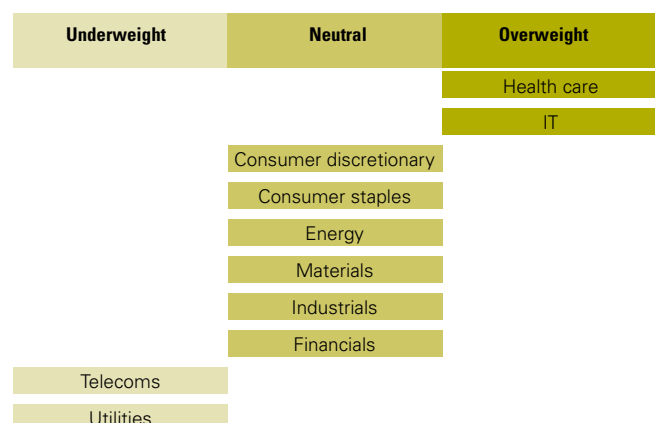
and modest earnings growth, there are clear arguments in favour of stocks. Valuations remain modest, central bank policies are supportive and decent growth is expected in selected consumer-oriented segments, such as technology, health care, consumer discretionary and consumer staples. (See Figure 1 for the recommended sector allocation.)

The preference for European equities compared with US equities has declined. The decision was made to move the tactical allocation for both regions to a neutral position relative to the strategic asset allocation set by the Global Investment Committee<sup>1</sup>. The adjustment involved a 5% decrease in European stocks and a 5% increase in US stocks. See Figure 2 for the new regional tactical asset allocation. The main reasons for increasing the portion of US stocks include:

- Stronger economic growth is expected in the US than in Europe.
- The earnings outlook is more resilient for US stocks than European stocks. Moreover, the advantage of a lower euro versus the US dollar is declining.

<sup>1</sup> The tactical asset allocation (TAA) reflects active strategies that account for medium- and short-term views and represent a deviation from the longer term strategic asset allocation.

**Figure 1: Equity sector allocation**



Source: ABN AMRO Private Banking

- Political risk is seen as greater in Europe than in the US, given the EU referendum in the UK, political issues in Spain and budget discussions in Spain, Portugal and Greece.

### Bond market improves but issues remain

US and German government bond yields have remained low despite a turnaround in market sentiment. Credit spreads have tightened since the low point of 11 February. The bond market has benefited from the rebounding oil price, actions of Chinese policymakers and the decline in recession fears. The ECB's expansion of its bond buying programme has also supported bond markets, and, in particular, government bonds from peripheral eurozone countries and eurozone corporate bonds.

The investment strategy continues to avoid the government bonds of core European countries, given very low yields. Instead, the government bonds of peripheral eurozone countries continue to be favoured. Investment-grade and high-yield corporate debt is also preferred. See Figure 3 for the current bond allocation.

The inclusion of corporate bonds in the ECB's asset purchasing programme has increased their attractiveness. Although it is not yet clear what bonds will be selected, the target is clearly non-financial bonds from eurozone-based companies.

In the high-yield bond segment, European high-yield bonds are preferred over global high-yield bonds. This protects the portfolio from the problems and potential defaults in the US energy sector, which is a dominant component of the global high-yield bond market.

### Alternatives add diversification and stabilisation

Commodity markets are continuing to recover, and a virtual circle is being seen between improvements in commodities and stabilisation in emerging markets currencies. The oil and base metals markets, in particular, have seen a turnaround. Volatility in commodity markets (and across all risky assets) has also decreased. Hedge funds remain sensitive to developments in equity markets, although macro CTA strategies have performed better than equity markets since the beginning of the year. Hedge funds are fulfilling their role to diversify and stabilize portfolios. The asset allocation continues to call for an overweight allocation to commodities and hedge funds.

### USD/yen currency hedge removed for US-dollar portfolios

The weakening of the US dollar against a range of developed and emerging markets currencies prompted the committee to remove the USD/Japanese yen hedge that had been in place for US-dollar-based portfolios. The hedge was lifted with

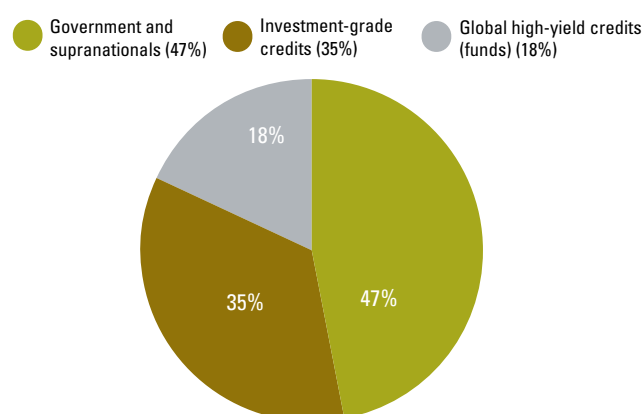
**Figure 2: Regional sector allocation (euro-based profiles)**

	in %		
	SAA	TAA	Δ
Europe	50.0	50.0	
World ex-Europe	40.0	40.0	
North America	33.0	33.0	
Pacific ex-Japan	2.4	2.4	
Japan	4.6	4.6	
Emerging Markets	10.0	10.0	
EM Asia Pacific	7.0	8.0	1.0
Latin America	1.3	1.0	-0.3
EMEA	1.7	1.0	-0.7

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

Source: ABN AMRO Private Banking

**Figure 3: Bond allocation (profile 3)**



Source: ABN AMRO Private Banking

a profit. This move comes in the wake of Group Economics revising their US dollar forecasts lower.

### Conclusion

The Global Investment Committee continues to believe that there are rewards for risk taking in the market and that the investment strategy is positioned to benefit from the returns of risky assets in the medium term. The risk distribution was modified with the increase in US equities and the reduction in European equities. The change represents a reduction in risk exposure to events that could negatively impact the European Union and, in turn, the stocks of European companies.

### Global Investment Committee

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