



investment strategy

23 May 2016

At the meeting of the Global Investment Committee on 19 May, the decision was made to keep the asset allocation unchanged. It continues to consist of a moderate overweight in equities and an underweight in bonds and a significant overweight in cash. Commodities are overweight, with neutral allocations to both real estate and hedge funds.

No US hike expected this year, but risks have increased

The minutes from the latest meeting of Federal Reserve policy-makers revealed that the central bank may be more inclined to hike rates than had been expected. The minutes reported that the majority of policymakers believed that data appeared to show economic growth picking up, the labour market strengthening and inflation making progress toward the 2% target.

ABN AMRO Group Economics believes that the Fed is in a difficult position. While domestic factors may support raising rates, the international situation is more complicated, given that the US economy affects everything related to the US dollar, including the large amount of US-dollar-denominated debt. Group Economics continues to believe that the Fed will remain on hold in 2016, but that the risks related to a rate hike later this year have increased.

The GIC view is that the Fed will remain careful before taking any decision to hike rates. This is because the conditions for more normal rates are not completely in place. Instead, the minutes distributed this week could be interpreted as “testing the waters” for a hike later. The Fed is also believed to be sending more positive signals regarding a hike because risk signals have improved, in terms of oil prices, equity market confidence and stabilisation in currency markets.

Equities preferred relative to other assets

Equities continue to be preferred in the asset allocation compared with other asset classes, such as bonds. In an

environment of moderate economic growth, earnings-growth forecasts are moderately positive, although expectations were reduced at the end of last year. The equity market rally is also maturing, with several markets trading near all-time highs.

The forecast for average global earnings growth for 2016 is 2%, rising to 13% in 2017; and equity returns are expected to be in line with earnings growth. Defensive growth companies continue to be favoured. The health care and information technology sectors are the most-preferred sectors, utilities and financials are the least-preferred sectors.

Cautious approach to bond markets

The bond market's reaction to the signal by the US Federal Reserve that it might be becoming more inclined to hike rates has so far been modest. Credits have not responded materially. They remain at levels reached after some strengthening, based in part on the European Central Bank's announcement that corporate credits would begin to be part of its asset purchase programme—a move that has not yet been implemented.

In a fragile bond market, the allocation uses investment-grade and high-yield credits to add return combined with a core (US, German and Japanese) government bond strategy emphasising diversification, duration management and protection.

Improving fundamentals in commodity markets

Improving fundamentals in the oil market, including higher demand, lower supply (particularly in the US) and the possibility of increased volatility (because of new supply) is expected to support oil prices.

The Group Economics forecast calls for an average price of USD 55 per barrel in 2016 and USD 60 per barrel in 2017. Gold is expected to continue rallying through 2016 and 2017. Growing demand for cyclical metals, such as copper and zinc, should also support these commodities.

Conclusion

After a sharp correction and recovery of risky assets in the first quarter, it is time to explore new facets of risk mitigation and return. The potential for volatility to erupt calls for a cash buffer; and political risks, higher inflation and a possible resurgence of currency volatility support a large geographical diversification and currency hedging.

Global Investment Committee

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