



positioning for better but unspectacular growth investment strategy

19 August 2016

Economic growth looks set to improve, albeit at a modest pace. Meanwhile, equity market sentiment remains benign, with major US indices trading near all-time highs. We maintain our preference for stocks over bonds, although we advocate a selective approach towards both asset classes.

Economic developments in 2016 have been disappointing so far. ABN AMRO Group Economics, however, believes a modest improvement is on the cards. Somewhat stronger growth in the US is expected, which should be beneficial to the global economy. In addition, various indicators, such as Taiwanese exports and data from ports and airports in key economic areas, suggest that the global manufacturing cycle is gaining some momentum.

Fed leaves its options open

As for the timing of interest rate hikes by the Federal Reserve (Fed), the minutes of the Fed's July meeting – published this week – did not provide too many clues. According to the minutes, Fed members continued “to leave their policy options open,” emphasizing that “the actual path of the federal funds rate would depend on the economic outlook as informed by incoming data.”

Our economists, for now, remain of the view that the Fed will keep interest rates on hold for the remainder of this year, although acknowledging that chances of a rate hike in 2016 have increased. Regardless of the exact timing of Fed rate hikes, we believe that the Federal Reserve will only lift interest rates at a very slow pace.

Equities: overly ambitious earnings expectations

Equity markets have been remarkably resilient in the past few weeks. General concerns have been abating and investors are confident that central banks will remain supportive. Markets seem to be anticipating double-digit earnings growth

in 2017, which may turn out to be too ambitious. As valuation levels are around historical averages and room for multiple expansion is limited, we maintain our neutral stance towards equities. At a sector level, we see opportunities in health care, information technology and consumer staples.

Bonds: central banks acting carefully

Bond markets still rely on gentle central banks. The European Central Bank (ECB) is expected to step up its asset purchases programme in September and the Fed will follow a very prudent tightening path. Against this background, bond yields are expected to remain low for longer. Meanwhile, the economic recovery may have a positive impact on corporate bonds, through narrowing credit spreads. We maintain our negative overall view on bonds. Selective positioning, however, may be rewarding.

We like European corporate bonds, both in the investment-grade and high-yield segments, as company balance sheets are healthy and the ECB's asset purchases programme provides support. Bond investors seeking diversification outside Europe may consider taking a position in emerging market debt. Yields on emerging market bonds are attractive, especially when compared to yields on core government bonds such as German Bunds. Bear in mind though, that higher yields come with higher risks.

Commodities: rising oil prices

We still view commodities positively. The third quarter started on a weak footing, mainly as a result of falling oil prices. However, we expect commodity prices to stabilise in the near future. Oversupply continues to be an issue for oil markets, creating downside risks. Nevertheless, we see upside potential for oil prices in the fourth quarter, as the effects of reduced corporate investments (capital expenditure) in the oil sector will still be felt and inventories are bound to decline gradually. We also expect gold and silver prices to rise.

Real estate: strong momentum

Strong momentum, attractive dividend yields and solid fundamentals are the main reasons for our positive stance towards real estate. The sector also benefits from low interest rate levels, as low interest rates put a lid on funding costs. The anticipated economic uptick should have a positive effect on real estate as well.

Conclusion

In our investment strategy, we continue to prefer stocks over bonds. This does not mean that we are overly positive about stocks. We see selective opportunities in stocks, while maintaining our neutral stance on this asset class as a whole. Our overall view on bonds is negative, although specific segments of the bond market can be attractive for investors with a higher appetite for risk. Within alternative investments, we like commodities and real estate.

Global Investment Committee

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