



Investment Strategy

Taking profits and raising cash for the future

Investment Strategy
& Portfolio Expertise

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After an 11% run-up in global equity markets over the last three months, ABN AMRO suggests that clients consider taking some profits in their stock portfolios. The ABN AMRO Investment Committee also suggests selling commodity positions and shifting positions in European high-yield bonds to US high-yield bonds.

Time to take some profits in equities

After recommending to increase equity positions in mid-October before the US Presidential elections, and suggesting a further increase in mid-November after the elections, ABN AMRO suggests that clients take some profits after the market's rise over the past few months and add the proceeds to their cash positions.

Stock market performance has been positive since the US election of Donald Trump, driven by an expected increase in US fiscal spending, solid macroeconomic momentum and a slightly better-than-expected earnings season. Valuations are also reasonable. In this environment, equity market fundamentals and important indicators, such as earnings

and valuations, continue to be solid and supportive of stock investments. Nonetheless, politics can be a source of risk. It is therefore suggested that clients heavily invested in stocks consider paring back these positions.

When reducing stock portfolios, ABN AMRO suggests cutting positions in interest-rate sensitive parts of the market, such as stocks in the telecoms, consumer staples and utility sectors, while retaining a balanced regional approach that includes US, European and emerging-markets stocks.

Cash is better than commodities

The outlook for commodities in the short term, but also for the following six to twelve months, is negative. This diminished outlook is based on lower oil prices, as well as declining prices for some important agricultural "soft" commodities, such as soybeans.

Forecasts for crude oil prices have been revised downwards, and, at the same time, US oil producers are producing more oil than expected, offsetting production cuts by OPEC. Inventories are at all-time highs. Commodities are also expected to be hurt by a strengthening US dollar, as the Federal Reserve continues its rate-hiking cycle in 2017.

ABN AMRO therefore recommends that clients consider selling their commodity positions completely and putting the proceeds into cash.

Higher rates hang over bond markets

Bond markets are sensing the return of more normal interest rates, given that macroeconomic data is increasingly positive and the US president is again focused on fiscal stimulus. There are risks that Treasury yields may go higher, dragging eurozone core yields higher too. This is negative for bond prices, which move conversely to bond yields.

Benchmark bond yields, however, are moving higher for the right reasons, such as better economic growth and higher inflation. Bond markets are also taking the view that central banks, and foremost the US Federal Reserve, are not going to upset the fine balance between rates and growth. This provides support to more risky fixed-income asset classes, such as credits.

Clients are encouraged to avoid core government bonds, while seeking exposure to credit risk through developed market corporate bonds. European investment-grade bonds are preferred, given the support provided by the European Central Bank's asset-purchase programme.

Outlook for US high-yield improves relative to Europe

ABN AMRO suggests that clients retain their exposure to high-yield bonds, but switch from European to US high yield. This will diversify the geographical risk in the corporate bond portion of the bond portfolio, which is warranted, based on rising political risks in Europe versus a pro-growth, America-first policy agenda. Given an expected strengthening in the US dollar, it is suggested that euro-investors consider not hedging their US dollar exposure from investing in US high-yield bonds. (For more information on this switch, see the sidebar.)

More about investing in US High Yield

Clients are encouraged to consider shifting their positions in European high-yield bonds to US high-yield bonds, based on better return prospects and the opportunity to diversify the bond portfolio.

With Donald J. Trump's recent announcement of a new tax plan and his interest in increasing infrastructure spending, ABN AMRO suggests replacing European high-yield debt with US high-yield debt. This will avoid the consequences of political risk in Europe, while gaining exposure to Trump's pro-growth, "America-first" agenda, which is prolonging the credit cycle in the US. Moreover, US high yield offers a spread of 400 basis points versus US Treasuries.

US high-yield is also positioned to benefit from a US border tax, if one is implemented. (This tax would likely be detrimental to European corporates.) Eliminating the tax deductibility of interest payments, which is part of the plans to finance the reduction in the US corporate tax rate, would also benefit existing high-yield bonds, and would most likely be grandfathered-in.

Fears that the US high-yield asset class would be hurt given the large representation of energy companies, have also abated. The risk profiles of European and US high-yield corporate markets are now broadly similar in terms of expected default rates, although the differences in terms of duration and ratings remain the same. (US high-yield debt has a duration that is 0.5 year longer and a one-notch lower credit rating.)

Given similar risk characteristics, US high yield is therefore preferred, based on the extra spread and the possibility that Trump introduces protectionist taxes. In the event that the border tax becomes reality, US spreads are expected to tighten, and European spreads to widen.

It is suggested that clients retain the exposure to the US dollar that is involved in investing in US high yield, given the expense of hedging and an expected increase in the US dollar versus the euro. Because of a negative view regarding US Treasuries, clients should consider hedging the duration risk of their US high-yield investments.



More cash increases agility

ABN AMRO retains a clear preference for stocks as the engine of portfolio growth and relative to other asset classes. Nonetheless, the run-up over the past three months presents an opportunity to lock-in profits and to increase client cash positions. While equity market fundamentals remain positive, global growth continues to gain momentum and volatility remains low, there is a perception that politics is adding a dimension of unknown risk and that a larger stockpile of cash will improve future maneuverability. The idea is not to sit on the sidelines, but instead to temporarily create a larger cash position to increase flexibility and to grasp opportunities as they appear.

Equities remain the engine of portfolio growth

As a result of the changes introduced by the ABN AMRO Investment Committee, clients following ABN AMRO's recommended investment strategy would be positioned, relative to their benchmark, with a moderate overweight in equities, a large underweight in bonds and an overweight in cash. Within alternative investments, commodities are removed from the portfolio; real estate remains at an overweight; and there is a neutral stance toward hedge funds.

To see how this change affects the six client profiles, see Figure 1. The profiles are arranged starting with the most conservative (profile 1) and ending with that most exposed to risk (profile 6). For clients invested in the "balanced" profile 3, today's changes represent cash being increased from 15% to 24%; equities reduced from 40% to 35%; and commodities are now reduced to 0% across the board.

Global Investment Committee

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Figure 1: Before and after: model portfolio risk profiles

Client profiles before changes

	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	44	39	5	24	19	5	15	10	5	7	10	5	2	-3	5	2	-3
Bonds	90	51	-39	70	39	-31	55	30	-25	35	18	-17	15	7	-8	0	0	0
Equities	0	0	0	15	22	7	30	40	10	50	60	10	70	76	6	85	86	1
Alternatives	5	5	0	10	15	5	10	15	5	10	15	5	10	15	5	10	12	2
FoHF	5	5	0	5	5	0	5	5	0	5	5	0	5	5	0	5	5	0
Real Estate	0	0	0	3	6	3	3	6	3	3	6	3	3	6	3	3	3	0
Commodities	0	0	0	2	4	2	2	4	2	2	4	2	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.

Client profiles after changes

	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	44	39	5	31	26	5	24	19	5	16	11	5	8	3	5	6	1
Bonds	90	51	-39	70	39	-31	55	30	-25	35	18	-17	15	7	-8	0	0	0
Equities	0	0	0	15	19	4	30	35	5	50	55	5	70	74	4	85	86	1
Alternatives	5	5	0	10	11	1	10	11	1	10	11	1	10	11	1	10	8	-2
FoHF	5	5	0	5	5	0	5	5	0	5	5	0	5	5	0	5	5	0
Real Estate	0	0	0	3	6	3	3	6	3	3	6	3	3	6	3	3	3	0
Commodities	0	0	0	2	0	-2	2	0	-2	2	0	-2	2	0	-2	2	0	-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.

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