



Investment Strategy

# Still a preference for stocks

Investment Strategy  
& Portfolio Expertise

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The global economy and equity markets in general continue to be supported by a number of positive factors. ABN AMRO's preference for stocks over bonds remains in place.

Global economic conditions continue to improve. Confidence indicators strengthened gradually in the second half of 2016 and, despite having reached a level considered high by historical comparison, they have recently gained further ground. Hard data remains less impressive, but it is clear that a material strengthening of economic activity is unfolding.

The Dutch elections on 15 March did not disrupt markets, and the outcome was instead overshadowed by the Federal Reserve's hike in interest rates on the same day. The Federal Reserve's decision is an acknowledgement of the strength of the US economy and job market. Two further rate hikes have been signalled by the US central bank for 2017, and ABN AMRO believes a third additional hike is a possibility. The European Central Bank, on the other hand, is likely to maintain an accommodative stance through this year and to end its asset purchase programme in 2018.

Political risk has clearly declined in Europe. In addition to the moderate political outcome of the Dutch election, polls in France also suggest a market-friendly result. Moreover, the path to more normal interest rates will be at a cautious and gradual pace. Central bankers are unlikely to take any action that would jeopardise economic growth.

In this environment, the ABN AMRO Investment Committee decided to leave the asset allocation unchanged at its meeting on 16 March. The euro hedge on US-dollar denominated portfolios, however, was lifted. This is owing to stabilisation of the dollar and expected range-trading for the euro versus the US dollar.

Within the asset allocation, equities are preferred over bonds; and within alternatives, real estate is preferred, while a neutral stance is taken to hedge funds. In February, ABN AMRO recommended reducing commodity holdings to zero.

## Positive fundamentals continue to support equities

Global stock markets continue to respond to a range of positive conditions: a synchronised worldwide upturn is underway, interest rates remain low in absolute terms and double-digit

earnings growth continues to be expected this year. Longer-term earnings-per-share expectations are also growing, based on an increase in fiscal spending, which could potentially fuel higher multiples. Stock valuations are not cheap. Higher valuations, however, are counterbalanced by low interest rates, which could help margin expansion.

### Bond markets remain challenging

The bond market remains challenging for investors. Bond yields have stabilised, but expected returns are poor, and there is little margin for error. This is owing to the bias for (base) rates to move higher. This trend is due to the cyclical economic recovery being led by the US. The Federal Reserve's move toward more "normal" interest rates is healthy, as it reflects economic growth. It also supports continuing to take on credit risk, in the form of investment-grade and high-yield bonds.

### Real estate supported by economic recovery

Real estate markets continue to underperform equity markets, but the asset class returns more than cash. Real estate is also viewed positively given an improving business environment, which supports occupancy rates. Moreover, dividend yields are attractive and valuations are acceptable.

### Conclusion

Fundamentals continue to drive equity markets and the pricing of risky assets. The stabilisation of bond yields and the US dollar, combined with the Fed's moderate approach to rate hikes adds conviction to risk taking and equity investments. Possible risks to the favourable economic outlook would be a slowdown in China, but it is not expected that Chinese policymakers would allow this. Another risk would be faster-than-expected rate hikes in the US, but this is also not expected, given the Fed's cautious approach. In this environment, investors are well positioned to continue to benefit from positive market conditions, driven by improving economic conditions and solid company fundamentals.

### Global Investment Committee

**Didier Duret, Chair**

[didier.duret@nl.abnamro.com](mailto:didier.duret@nl.abnamro.com)

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