



Positive trends and shifting indicators

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Investment Strategy

We turn modestly more cautious for the third quarter of 2017 as we find evidence that the positive macro trends are largely priced into equity markets and that economic trends may be shifting. We continue to highlight better broad-based gross domestic product (GDP) growth in 2017 which is supported by strong global corporate earnings. However, valuations are climbing and leading indicators are less impressive with the reflation theme appearing to be fading.

In previous quarters, we had highlighted that the trend in "reflation", or the normalisation of inflation, growth and interest rates was a trend that was very favourable for equities and a headwind for fixed income. Over recent months, economic growth has remained favourable and has been supportive of equities. However, as inflation trends have disappointed, long term government bond yields have declined and global fixed income markets have been performing well. As the reflation theme fades, the risk of normalisation of interest rates decreases and the outlook for fixed income looks more attractive.

Thus, as equities start to look a little less attractive and the fixed income outlook turns more stable, we think it is prudent to neutralise portfolios after a healthy run. Each investor should have some balanced asset allocation between the various asset classes that would be recommended by a financial advisor. Our tactical recommendation is now to get back in line with that balanced position after recommending an overweight on equities for the previous quarters.

Global Asset Allocation

Sector Allocation	View	Notes
Equities 	■	<p>Rationale: Solid broad-based global economic growth continues for 2017. Corporate earnings are growing at healthy rates across most regions.</p> <p>Risks: Market valuations continue to climb, while leading economic indicators appear to be peaking and economic trends are starting to surprise on the downside.</p>
Fixed Income 	■	<p>Rationale: Inflationary trends have appeared to stall while corporate credits remain healthy and interest rate hikes will be slower.</p> <p>Risks: Inflation trends could bounce back up again in coming months and re-ignite pressures on rate hikes.</p>
Commodities 	+	<p>Rationale: Strong supply and demand trends for gold, oil and copper.</p> <p>Risks: Softer economic data could lead to underperformance in commodities.</p>
Cash 	--	<p>Rationale: We underweight on cash in a pro-growth environment that should lead to strong returns in equities and commodities.</p> <p>Risks: Any correction, even a temporary one, would benefit from having extra cash to deploy.</p>

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

We are bullishly neutral between equities and fixed income. However, the relative attractiveness of strong equity outperformance over fixed income will fade until the reflation theme returns. We remain with an overweight position in commodities as we think the outlook over the coming quarter for both gold and oil looks attractive. We are overweight on alternatives (hedge fund strategies) which target more stable returns and are less volatile than equities. As the upside in risk assets such as equities is more muted, we think more market neutral strategies such as hedge funds are looking more attractive.

The risks to our outlook include political risks in the US, weaker trends in China on credit tightening, elections in Germany and Italy, and geopolitical risks from North Korea and the Middle East.

Global Investment Strategy

Positive trends in the price, economic indicators are shifting

The first five months of 2017 have been strong for most asset classes, particularly for equity markets. Global equities increased by 11% in US dollar terms for 2017 as of the end of May and Asia ex-Japan equities were up 20%. Global fixed income markets, while less exciting, performed adequately gaining 4%. Overall, the first half of 2017 has been shaping up to be a fairly “Goldilocks” environment with enough growth to support equities but not too hot so as to be a headwind to fixed income markets.

While our overweight position in equities over the past two quarters has performed well, we are now seeing signs that the outlook for equities is more balanced. There are several strong supportive trends for equities as we look towards the second half of the year along with several worrisome trends. With a reflation theme which disappointed and a stable fixed income outlook, the latter offers more of a stable alternative if the equities outlook is becoming more balanced. This explains our shift to a neutral positioning for portfolios between the equities and fixed income allocations.

There are still many positive trends that could continue to support equities for the third quarter. Most broadly we would argue that the global expansion cycle appears strong enough to continue for at least another year. Growth appears stronger in 2017 compared to 2016 and appears more broad based with all regions contributing to positive growth. In the past several years, there has always been one major region, whether it be Europe, China or Latin America, that has economically struggled and dragged global growth. Currently, all regions are arguably doing better than in 2016. Finally and maybe most importantly, corporate earnings trends are positive with growth rates above 10% in 2017.

“In the past several years there has always been one major region that had struggled economically, whether it be Europe, China or Latin America. Currently growth is now more broad based compared to what we have seen in a long time.”

However, there are sufficient unfavourable trends which leads us to a more balanced and neutral overall outlook. Firstly, while leading indicators remain at healthy levels, there are signs that most of them are not as favourable as they were a few months ago, especially in the US and China. In particular, manufacturing indices appear to have peaked and have begun to decline from previous levels. Furthermore, economic surprise indicators have started to decline across most regions. This implies that expectations have increased and the data is not matching up to these raised expectations. Hence the reflation trend that had been a big theme in markets in the first half of the year, appears to have mostly faded. There are scant signs of inflation picking up across the major markets in 2017, implying that interest rate normalisation from central banks is less likely. Hence, the overweight on equities against fixed income is less necessary. Finally, we would also note that potential policy support in the US from tax cuts and infrastructure spending appear less likely than ever with a US political environment appearing more gridlocked than anticipated.

On the whole, despite the many positives, the strong equity performance in 2017 leaves us with the view that much of the positive factors have already been priced in. Valuation of the global market has been trending up to above average levels, implying that markets might be outpacing earnings improvements and counting positive surprises to maintain the performance. This leaves it harder for economic and earnings trends to surprise on the positive side.

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Country Allocation	View	Notes
US 	■	Rationale: Leading economic indicators improve while fundamental conditions remain supportive. Proposed corporate and income tax cuts looks to be delayed into 2018. Risks: Uncertainty over proposed Trump policies such as border adjustment taxes, renegotiation of trade treaties and increased protectionism.

Summary

We remain neutral on the US as it remains attractive for selective value plays. Earnings growth is expected to pick up again with improving economic conditions. Labor conditions remain resilient and the US Federal Reserve (Fed) remains dovish which is positive for equities. We retain the view that the US remains on a strong recovery trajectory.


Europe Equity

Country Allocation	View	Notes
Europe 	+	Rationale: Leading economic indicators continue to improve in Europe even as conditions in the UK decline. The earnings gap between Europe and US has remained wide since the global financial crisis and the region remains highly leveraged to an earnings upswing. Risks: Geopolitical risks have moderated but the region still faces a heavy political calendar for many countries as well as uncertainty for the UK after its exit from the European Union.

Summary

We have an overweight position in Europe as economic recovery continues with positive corporate earnings revisions. A weaker euro has helped lift confidence and boost economic activity. The region also has significant operating leverage for an upturn in economic activity with profit margins currently at trough levels. However, we are cautious against the backdrop of potential geopolitical risks in the region.

Japan Equity

Country Allocation	View	Notes
Japan 	-	Rationale: Economic conditions remain mixed in Japan as monetary policies continue to be supportive. Inflation appears to be picking up which should evict deflationary fears. Risks: Structural issues such as demographic trends remain an overhang on the country.

Summary

We have an underweight position in Japan. Economic data remains mixed but we believe that the Bank of Japan (BOJ) will remain accommodative, which would help to support the market. Despite disappointments with policy and the anaemic economic backdrop, there are some positive developments in corporate governance and corporate performance.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

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Country Allocation	View	Notes
China 	–	<p>Rationale: Economic data has moderated from a peak in March 2017. The government continues to tighten monetary conditions in a bid to rein in financial leverage and prevent overheating.</p> <p>Risks: Strong trade recovery and a buoyant property market mitigate an investment slowdown. Government infrastructure investment has also re-accelerated alongside lower non-performing bank loans.</p>
Hong Kong 	■	<p>Rationale: A soft US interest rate outlook gives the property sector more breathing room. Central office rental trends remain healthy, while visitor arrivals to Hong Kong and Macau are improving.</p> <p>Risks: Sky-high prices of residential properties and government tightening measures remain as headwinds.</p>
India 	–	<p>Rationale: High market valuations alongside risks to economic growth from a demonetisation policy as corporate earnings are revised downwards.</p> <p>Risks: In the event of better-than-expected growth or if low inflation encourages monetary easing. Any softening of the USD also encourages fund inflows to India.</p>
Indonesia 	■	<p>Rationale: Moderating inflation puts less pressure on the central bank to raise rates. The recent ratings upgrade from Standard and Poor's encourages strong portfolio inflows.</p> <p>Risks: The arrest of former Jakarta governor 'Ahok' could weaken President Jokowi's position.</p>
Malaysia 	+	<p>Rationale: Upside to economy and earnings growth from strong construction orders, growth in palm oil volumes and drop in bank provisions as non-performing loans peak. Strong foreign direct investments from China's One Belt One Road initiative. Restructuring of government-linked companies and upcoming elections catalyst.</p> <p>Risks: Weaker oil prices could worsen current account position. Foreign investor sentiment still fragile over the 1MDB corruption scandal.</p>
Philippines 	–	<p>Rationale: Lacklustre corporate earnings due to competitive intensity. Valuations are still on the high side.</p> <p>Risks: Execution of tax reforms could boost infrastructure spending next year.</p>
Singapore 	■	<p>Rationale: Singapore is leveraged to global economic recovery and corporate earnings should register a mild recovery in 2017. The property market is showing signs of recovery.</p> <p>Risks: Market valuations are on the high side after a recent strong performance. The soft US rate outlook could dampen banks' net interest margins.</p>

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South Korea 	++	Rationale: Strong corporate earnings and trade recovery. More evidence of corporate restructuring and shareholder-friendly policies. Risks: Uncertainties from North Korea's tests on its nuclear program.
Taiwan 	■	Rationale: The upcoming iPhone 8 launch continues to support the Taiwanese component supply chain. Corporates have strong free cash flows and high dividend yields. Risks: Earnings in the technology sector are cyclical and possible delay of the iPhone 8 launch.
Thailand 	■	Rationale: Economy should witness a broad-based recovery in GDP from government spending and consumption. Risks: External events may disrupt tourism sector. Market valuations still on the high side after a strong performance last year.

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Summary

Asia continues to benefit from global growth recovery. The recent economic indicators have shown improvement, including purchasing manager indices (PMI) and exports led by a commodity price rebound, which should lead to improving earnings and profitability. Meanwhile, inflation has also picked up, putting an end to the monetary easing cycle for Asian central banks. However, we believe it is too early in the region for central banks to enact monetary tightening measures as inflation is coming up from a low base and remains within the target range.

Despite the strong start to Asian markets, valuations remain reasonable and below the mean level on a price-to-book basis. The earnings revisions have also turned positive led by cyclicals in Korea and Singapore. As the Fed raises interest rates, we expect the US dollar to strengthen against Asian currencies and this could be a short term headwind for Asian markets. However as global economic recovery broadens out, Asian economies should benefit and history has shown that there are many periods where Asian markets have performed well despite US dollar strength. We prefer export-oriented North Asian markets over domestic-led ASEAN economies. The impact of US President Trump's trade policies on Asian exports remains a key risk.

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Sector Allocation	View	Notes
Developed Market (DM) 	–	<p>Rationale: The UST yield curve had flattened on expectations of rate hikes which pushed up the front end of the curve. Meanwhile disappointments from Trump's policy reforms and muted inflationary pressures have pushed down the longer dated Treasury bonds. To some extent, the Fed's gradual unwinding of its balance sheet would put the unease about the impact to rest. A further reduction in asset purchases from the European Central Bank (ECB) could potentially push up government bonds yields and of other developed markets as a result.</p> <p>Risks: A slowdown of global growth and other risk events that could extend accommodative monetary policy.</p>
DM Government 	--	<p>Rationale: Central banks had been very accommodative with their monetary policy. The Fed is likely to reduce the size of its balance sheet at a measured pace when it starts to do so. Even as the ECB keeps policy rates low, it could signal gradual reduction of asset purchases. Meanwhile BOJ's maintenance of yield curve control reduces volatility at the long end of the yield curve.</p> <p>Risks: Should economic data be skewed to the downside or if political risk escalates, that would discourage central banks from tightening.</p>
DM Credit 	–	<p>Rationale: Relative to EM and Asia markets, we are underweight on DM credits.</p> <p>Risks: Should the reflation theme revive and the USD strengthens, we could see funds flowing back to DM credits.</p>
Emerging Market (EM) 	■	<p>Rationale: EM is expected to be one of the drivers of global growth. Growth in EM is broad based and synchronised, creating a positive feedback loop. Accelerating growth lowers EM sensitivity to shifts in any one particular region's growth. A reduction in external vulnerabilities and increased resilience to potential external shocks reinforces the positive EM growth story. Valuations are fair to attractive.</p> <p>Risks: Potential US protectionist policies. Lack of follow-through on US business-friendly policies and attendant risk off. Chinese hard landing and sharp commodity price declines.</p>
EM Government 	■	<p>Rationale: Generally more positive policy tone emanating from EM. Fundamentals have improved in aggregate since 2013. Most countries have deployed both monetary tools (currency depreciation, rates) and fiscal tools (subsidy cuts, VAT taxes) to improve their imbalances.</p> <p>Risks: Sensitivity to sharp commodity price declines and/or sharply higher USD funding costs. The search for yield may become more discerning, with investment flows to countries who undergo difficult macro-economic adjustments attracting the bulk of foreign direct investment.</p>

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Sector Allocation	View	Notes
EM Corporate 	■	<p>Rationale: While EM corporate fundamentals showed improvement as net leverage trended down slightly, there remains a lack of relative value against sovereigns and quasi-sovereigns.</p> <p>Risks: Protectionist US trade policies, downsides to EM growth and potential recovery in the capex cycle that requires utilising cash.</p>
EM Local Currency 	-	<p>Rationale: Risky assets had a strong performance year to date and we remain positive in selected high yielding bonds for carry and neutral on low yielding bonds. We are neutral on FX.</p> <p>Risks: Fed balance sheet unwinding and Chinese tightening are important factors to monitor. We do not think this will derail the rally this quarter as flows should continue to be supportive.</p>
Duration 	■	<p>Rationale: While the major central banks are on tightening bias, the pace is expected to be gradual and carefully communicated to the market. The Fed could mitigate shocks to the market by gradually increasing caps of securities to run off each month in reducing its securities holdings. The ECB could prepare the market for a tapering of asset purchases. BOJ yield curve control keeps long end bond yields within a tight range.</p> <p>Risks: Geopolitical risks may extend a dovish outlook or delay tightening measures from major central banks.</p>
Yield Curve 	■	<p>Rationale: The UST yield curve may flatten with the front end of the yield curve pricing in hikes from the Fed while increases on the back end may be hampered by the possibility of hikes dampening growth and inflation to some extent.</p> <p>Risks: The German government bond yield curve may steepen from gradual tapering of asset purchases.</p>

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

The recent disappointing US economic data and increasing concerns of political instability in Washington saw 10-year US Treasuries (UST) yields moving below 2.3%. Hence we have recently neutralised our short duration strategy.

We hold the view that 10-year UST rates will trend above 2.5% for the second half of 2017. With the Fed likely taking a gradual and predictable approach to reducing its balance sheet, this would mitigate the risk of spikes in UST yields.

Further deleveraging in the Chinese economy with tighter liquidity conditions have pushed up interest rates domestically in China, leading to slower economic growth in the months ahead. This does not bode well for the commodity exporting emerging economies. Under these circumstances, we expect a subdued economic backdrop to be conducive for a defensive carry fixed income strategy.

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Regional Allocation	View	Notes
Latin America 	■	<p>Rationale: The region has gone through difficult macro adjustments in recent years and is thus in better shape to deal with potential domestic and external shocks. Current account deficits have narrowed and inflation has declined. Within the region, we balance our overweight position in Chile, Mexico and Argentina with underweight position in Colombia and Paraguay</p> <p>Risks: A renewed political crisis in Brazil might slow down reform pace. The region will see elections in Colombia and Mexico in mid-2018 and in Brazil in October 2018.</p>
CIS/EE* 	■	<p>Rationale: There is a broad-based stabilisation in the region, with oil and commodity exporters showing improvements in their public finances and broadly in the region's external accounts. However, valuations overall are not compelling.</p> <p>Risks: Regional geopolitical risks including Russia's alleged involvement in US politics could result in further sanctions.</p>
Middle East/Africa 	■	<p>Rationale: Moderate strengthening of oil and resource prices in wake of OPEC production cuts have moderately eased pressure on oil exporters. Many countries have deployed both monetary tools and fiscal tools (subsidy cuts, taxes) to improve their imbalances.</p> <p>Risks: Any weakening of oil prices would negatively impact fiscal budgets. However, Middle Eastern sovereigns have the lowest debt/GDP ratios and strong access to capital markets. Other risks include a China economic slowdown and commodity price weaknesses.</p>
Asia 	■	<p>Rationale: Slightly softer macroeconomic numbers in the region may hurt risk sentiment. However, risks of spiking interest rates and inflation numbers are diminished which will offset negative sentiments. The main driver of demand is likely to come from long-term investors.</p> <p>Risks: Event risks from geo-political tensions and US-Russia relations may dampen overall risk appetite. Overly aggressive financial reforms from Chinese policymakers may counteract market bubbles.</p>
Singapore 	■	<p>Rationale: UST yields declined on the back of mixed US economic data and lack of fiscal policies from the Trump administration. Downward pressure on UST yields could be offset by gradual Fed unwinding of its balance sheet.</p> <p>Risks: New fiscal initiatives from the Trump administration, or a hawkish Fed resulting in a faster-than-expected pace of interest rate hikes leading to higher interest rates.</p>

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

* Commonwealth of Independent States and Central and Eastern Europe

Currencies

FX Allocation	View	Notes
US Dollar US\$	■	<p>Rationale: Recent economic data has softened, putting downward pressure on the UST yields and interest rate differentials. Tax and regulatory reforms that were meant to be pro-growth have led to an unwinding of dollar strength.</p> <p>Risks: The USD may strengthen should there be positive developments in reform agenda or should there be a faster pace in Fed rate hike expectations.</p>
Euro €	+	<p>Rationale: The Euro has survived political risks and the results from the French Presidential election have reduced fears of Euroscepticism. Stronger Eurozone PMIs suggest a broadening of growth.</p> <p>Risks: The Euro may surprise to the downside if the ECB maintains a dovish bias over a longer timeframe.</p>
Japanese Yen ¥	■	<p>Rationale: Lack of delivery in US policy reforms have worked in favour of the Japanese yen. The momentum from Abenomics seems to be fading, however Japan's external position is improving on external demand and low energy prices.</p> <p>Risks: The Japanese yen would appreciate from the flight to safety bid if global geopolitical risks escalate or if energy prices decline.</p>
Singapore Dollar SG\$	+	<p>Rationale: Against the backdrop of resilient GDP and firmer inflations, we expect SGD to stay in the upper half of the Singapore Dollar Nominal Effective Exchange Rate (\$\$NEER) policy band.</p> <p>Risks: In the event that improvements in macro data weaken, or with an increase in USD volatility.</p>
China Renminbi CNY	■	<p>Rationale: Continued financial deleveraging will undermine any robust strength in CNY against its regional peers. The recent tightening of liquidity conditions is likely to persist for another quarter. Nonetheless, there will be efforts to ensure market stability as China prepares for the important plenary meeting in the fourth quarter.</p> <p>Risks: The risk of capital flight out of China could force the central bank to intervene in the FX market which would result in a stronger CNY against the USD.</p>







Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

US dollar strength has been suppressed by increased concerns of policy risks from the Trump administration and disappointing US economic data. Hence we have recently neutralised our strong dollar stance as a short term tactical move. We hold the view that the dollar will resume moderating its strength by the end of the year.

Meanwhile with signs of political risk somewhat subsiding in Europe and stronger Eurozone economic data, the ECB's potential tapering of assets purchases will continue to provide support to the Euro currency in the near term.

Commodities

FX Allocation	View	Notes
Commodities 	+	<p>Rationale: Global economic data indicates expansion, supporting overall demand growth. Supply growth is constrained due to lower capital expenditure on expansionary projects and also from China's moves to close low quality domestic production.</p> <p>Risks: Further US interest rate increases may lead to a stronger USD and undermine commodity demand in China and emerging markets. Credit restrictions may also result in slower Chinese economic growth.</p>
Gold 	+	<p>Rationale: Gold continues to benefit from mixed US economic data and uncertainty over Trump's policy agenda. Investment demand remains strong with continued buying from central banks.</p> <p>Risks: The Fed continues to hike interest rates, based on improving US economic data or as pre-emptive action to stem US inflation. Higher interest rates are negative for physical gold prices, since gold does not pay interest.</p>
Base Metals 	■	<p>Rationale: Strong global industrial production figures are supportive of solid demand, while new supply is likely to be constrained by the lack of new investment into mines in recent years.</p> <p>Risks: Weaker-than-expected demand caused by slowing economic data, or metal consumers destocking inventory on growth concerns. Country-specific risks on taxation and ownership remain a concern.</p>
Bulk Commodities 	-	<p>Rationale: The Chinese government continues to close inefficient, low quality domestic production of iron ore, coal and steel. This benefits overseas producers with higher quality product specifications.</p> <p>Risks: Chinese demand may slow, particularly if the domestic housing market slows down.</p>
Energy 	+	<p>Rationale: OPEC has extended its production cuts to March 2017. Although US onshore production is increasing, non-OPEC production from other countries is stagnant. Global crude oil demand growth remains bullish, particularly from China and India.</p> <p>Risks: Faster-than-expected rate of US shale oil production, poor OPEC production discipline, disappointing emerging market demand.</p>
Agriculture 	-	<p>Rationale: Agricultural prices are trading at historically low levels, making them vulnerable to weather-related events that could result in poor harvests and supply shocks.</p> <p>Risks: Favourable weather continues to produce a bumper harvest, while poor supplier discipline results in oversupplied fertilizer markets.</p>

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

With global economic growth in expansionary territory, demand growth for commodities remains supported. In addition, the US dollar continues to weaken alongside mixed economic data and uncertain policy signals from the Trump administration which are generally positive for commodity prices. On the supply side, the outlook is constrained from reduced global mining investment and by efforts from the Chinese government to reduce pollution by closing inefficient, low quality production facilities.

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