Quarterly Investment Outlook

3rd Quarter 2016 June 2016

ameliora
WEALTH-MANAGEMENT

Fixed Income

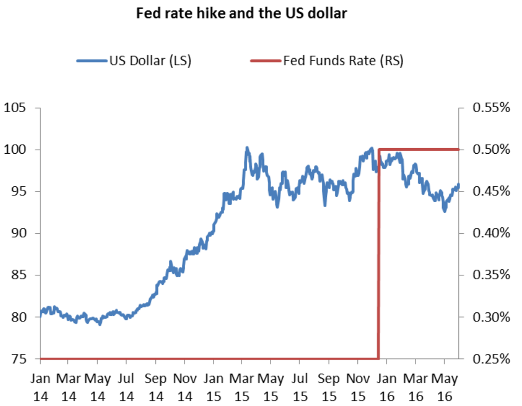
We reduce our bond allocation exposure

Starting this summer a slew of market sensitive events will occur that will add to the heightened uncertainties of future asset price developments. The agenda starts with whether the Federal Reserve will continue raising interest rates, followed by a referendum on the United Kingdom's European Union membership. Thereafter Spain will hold their general elections to see if the country can form a government. In between all this the ECB will decide whether to allow Greek banks cheap funding so to continue rehabilitating its financial system. Better to hold off any decision making until all this has settled, right? We don't think so.

Since December 2015 - the first rate hike in seven years - the US dollar has weakened. Prior to that the currency had rallied over a period of 18 months in anticipation of future rate hikes. The policy change was supposedly the inflection point for 1) further dollar strength, 2) a bond market sell-off, and 3) an equity market disaster. Yet the whole synopsis turned out to be the complete opposite. Consensus measures point to another rate hike in July. Whether that happens is somewhat irrelevant and is likely to have marginal impact on asset class developments. What matters is the velocity of future rate hikes and explanations as to why monetary tightening is warranted. A puzzling observation is the fact that the Federal Reserve committee have reduced their own growth and inflation projections whilst adamantly communicating that monetary policy should be tightened. To us, this seems somewhat counterintuitive as policy tightening risks stymieing off the current anemic growth and inflation developments. As such, we think a plausible next step by the committee would be to lower their interest rate path projections. That would not benefit the US dollar.

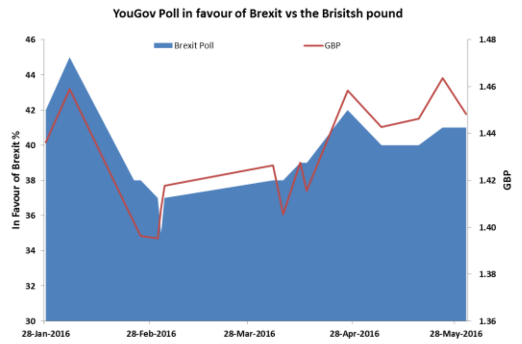
The British pound was the ultimate victim when polling services started publishing hypothetical referendum results. When the Brexit banter exploded late last year, the pound weakened substantially on potential devastating outcomes an EU membership exit would cause. However, as the referendum date for this uncertainty is approaching (with certainty), developments have reversed. With the population of "leavers" increasing so is the strength of the pound. This is an exact reversal of the developments at the start of the year when the "leave" camp gained traction. Those voting for an exit - and everybody else for that sake - can with absolutely no certainty phantom how a break out of the membership would transgress. Neither can anybody predict with any precision what the future outcome for the UK would look like. As such, it is fair to deduce that the British will likely chose to stay with the current situation than any other future uncertain environment.

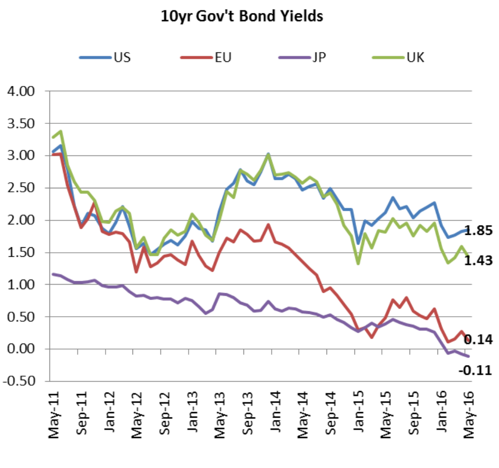
Global bond yields have traded lower. Even with diverging monetary policies and no newly announced quantitative easing, interest rates have not changed course. However, the current low nominal yield levels increase duration risk, especially for longer dated bonds where the coupons remain relatively attractive. We reduce bond holdings and keep interest rate risk modest and continue to keep laddering the bond portfolios in order to benefit from any increase in interest rate volatility.



FOMC Economic Projections

Variable	2016	2017	2018	Longer run
Change in real GDP	2.2	2.1	2.0	2.0
December projection	2.4	2.2	2.0	2.0
PCE inflation	1.2	1.9	2.0	2.0
December projection	1.6	1.9	2.0	2.0
Memo: Projected appropriate policy path				
Federal funds rate	0.9	1.9	3.0	3.3
December projection	1.4	2.4	3.3	3.5





Sources: Bloomberg, Federal Reserve

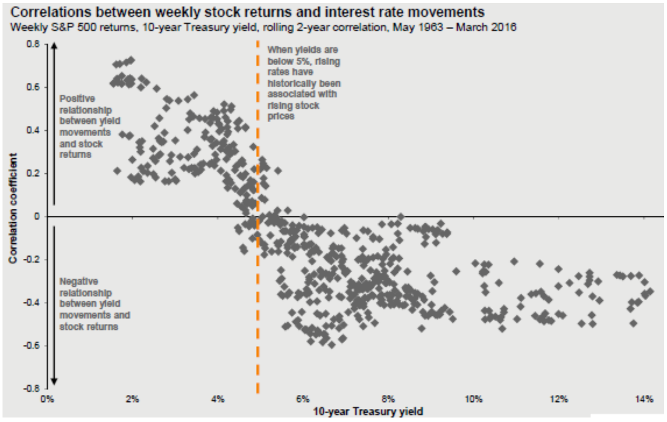
Equities

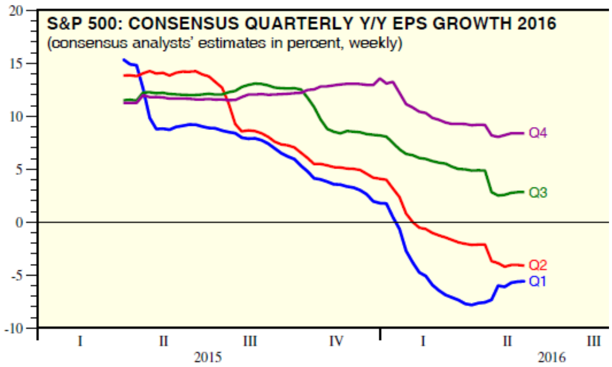
We shift allocations within select sectors

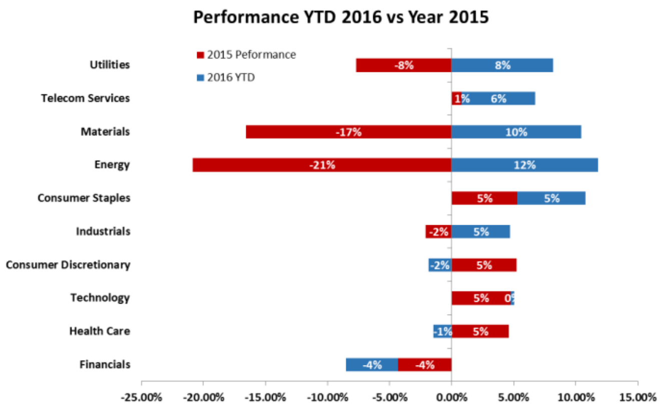
The idea that changes to interest rates policy would put pressure on equity prices were evident prior to the Federal Reserve's decision to raise rates in mid-December. Equities were volatile in anticipation of a rate hike and indeed sold off for a brief period after the announcement was made. However, since then equity markets have staged a profound rally and US equities are now higher than after the rate hike. This development might be explained by the actual level of interest rates and the magnitude of the increase and of potential successive increases. Empirically, when nominal interest rates have been historically low - similar to today's environment - rising rates have coincided with rising equity prices. If rates were to increase marginally over an extend period before reaching an "equilibrium" level, we think it is fair to assume that monetary tightening will not have such an expected detrimental effect on equity pricing.

The earnings malaise that has befallen global equity markets for the past 12 months looks to have hit an inflection point. The earnings estimate revisions for the remainder of 2016 have become less negative. Considering that analysts' forecasts mainly take their cue from company's management and adjust their estimates accordingly, we think that slightly improved revisions is a token for a through in the earnings weakness. Accordingly, we have noticed a remarkable re-pricing of global equity sectors. Some of the worst performing industries of 2015 - such as Utilities, Telecom Services, Materials, and Energy - have reversed and looks as if they have passed their nadirs. However, measured by more common equity indexes it looks as if global equities have done hardly anything this year. That stems from the fact that the normally quoted and regional indexes have a large weighting towards financial companies (mostly banks) which continue to be the weakest sector of them all. These broad indexes will in such instances mask some truly rewarding opportunities in bespoke sectors.

We stay adamant to our methodical and fundamental research process identifying valuable companies within specific sectors and have therefore moved parts of the exposure towards European financial companies.







Alternative Investments

We increase our allocation to real estate securities

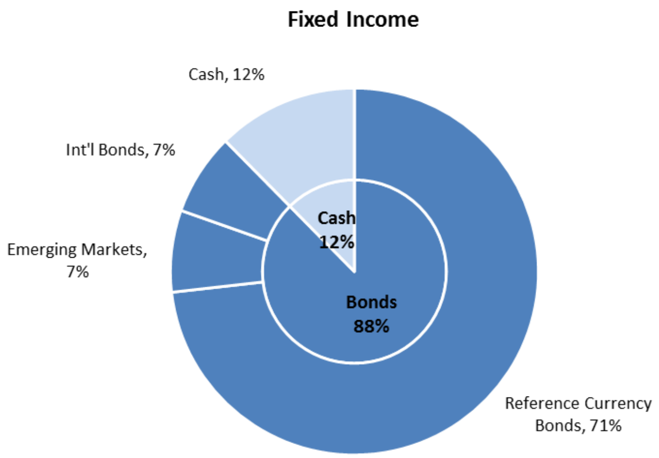
Mortgage real estate investment trusts have been trading below their book values ever since initial tapering talks started in May 2013. Although the discount has narrowed somewhat, select mortgage REITs trade 5-10% below their book values and at 10% distribution yields. And even with a slightly flatter yield curve – a spread of around 150bp - companies in the mortgage market still earn a healthy net interest rate margin. Compared to equity REITS, which have been some of the strongest performers in the real estate space, mortgage trusts offer significantly better income properties and at much better valuations.

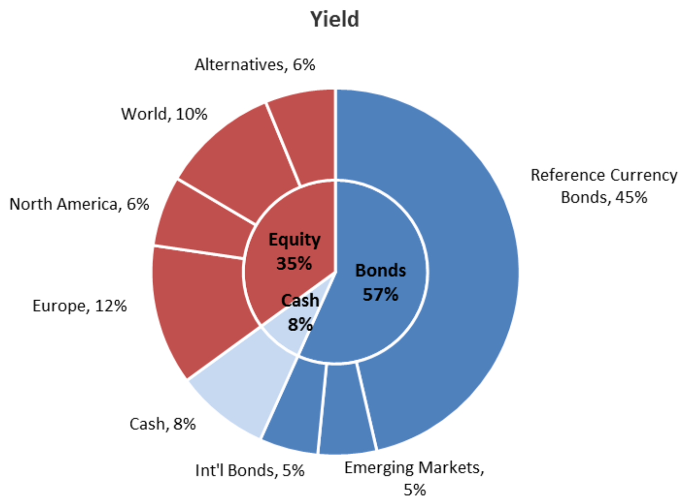
	Real Estate Investment Trusts	
	Mortgage	Equity
Dividend Yield	10.93%	4.22%
Free Cash Flow Yield	6.13%	-2.66%
Price to Book	0.95x	2.52x

Sources: JP Morgan Asset Management, Yardeni Research, Inc., Bloomberg

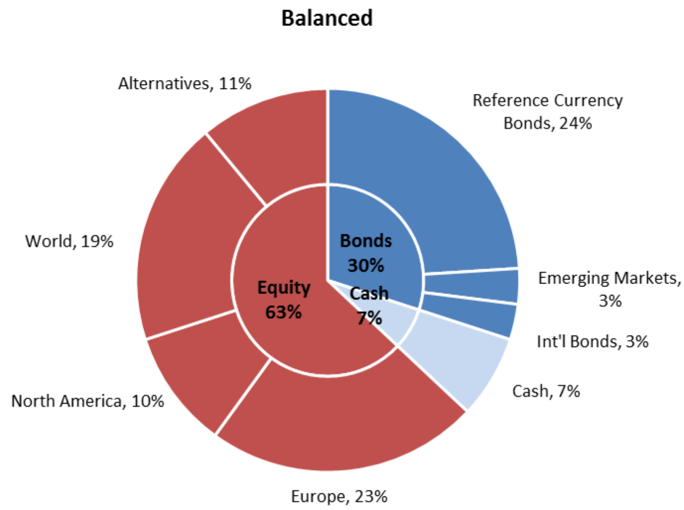
Asset Allocations

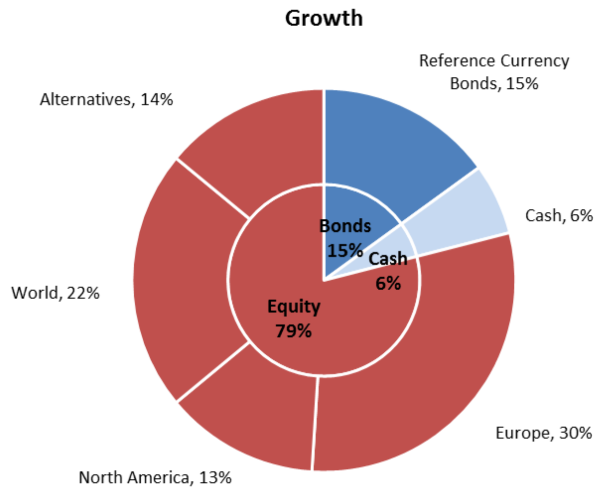
Income Strategies



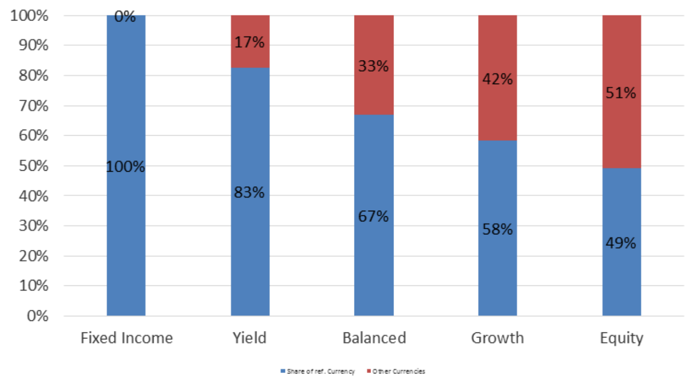


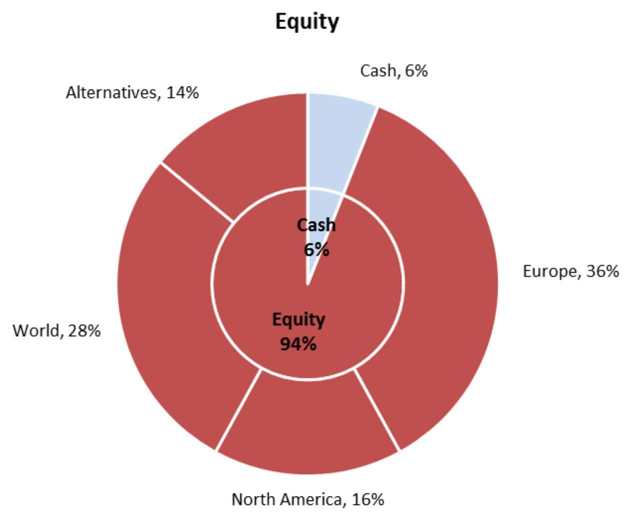
Growth Strategies





Currency Exposure





Source: Ameliora Wealth Management as of 10th June,, 2016
Note: Tactical asset allocations are subject to change without notice. The asset allocations represents Ameliora's investment strategies in USD

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