Multi Asset View Americas

Taking some chips off the table

Activity on the political stage around Iran, North Korea and tariffs continued to attract a lot of attention. Since the topics came to the forefront, investors had some time to digest and analyze the effect on relevant variables for investment decisions like economic growth, company earnings and trade.

Focusing on fundamentals, the global macro and micro picture didn't change materially over the last weeks. We see the macroeconomic environment of the world economy as solid. However, we acknowledge that recent data seems to point towards an economic outperformance of the United States. As there might be an impact on the performance of various asset classes across regions, as well as on monetary policy and currencies, it needs to be closely monitored. We see the market environment in a transition phase to late-cycle after a period commonly described as goldilocks. Our systematic indicators monitoring macroeconomic, financial-market data and global data surprises continue to show a slightly more fragile mix than at the beginning of the year. Investors have become more risk averse resulting in higher volatility and higher risk premiums for asset classes that can be described as more risky. The high expectations from analysts about the future macroeconomic development become harder to beat by actual data releases. On the one side, it stands out that economic data releases in Europe and Asia are clearly disappointing analysts' expectations, while on the other side, U.S. data releases still surprise to the upside.

The described set up already did and will probably continue to lead towards higher realized volatility, but doesn't automatically trigger a sustained downturn. From an asset-allocation perspective, this requires a higher degree of tactical activity and a stronger focus on diversification and relative-value positioning.

As expected, the strengthening of the dollar over the last weeks triggered a significant outperformance of global **equities**. Given the more fragile sentiment in the market overall, and taking into consideration some seasonal patterns for equity markets as well, we used the strength of the Japanese market to reduce our overweight and go back to a neutral position for this region. We continue to be underweight in U.S. small caps to counterbalance the overweight in Europe and emerging markets. The development of the exchange rate will be crucial for the relative development of these regions, therefore we will closely monitor it and take actions should the momentum of the dollar strength fade.

In the **fixed-income** space, our strategy to underweight sectors like investment-grade credit and high yield in order to add some diversification benefit to the overall portfolio continues to work out nicely. Especially so because credit spreads continue to widen on

Werner Eppacher
Head of Multi Asset Strategies Americas

In a nutshell

- Back to neutral from overweight Japanese equities and commodities
- Stay underweight credit
- Reduce portfolio risk to a more neutral stance

the back of heightened risk aversion. The current regime of rising rates, observed in the United States, is supporting our strategy as well. We continue to believe that, from a relative-value perspective, these sectors might underperform equities in a late-cycle scenario, and might even suffer substantial losses in the case of increasing risk aversion.

Emerging-market bonds were negatively impacted by the dollar strength, as flows into these regions tend to be negatively correlated with the appreciation of the dollar. Nevertheless, we think this should be of a temporary nature since the positive growth environment should support this sector. The Fed is expected to reduce its support for the MBS market, thus we continue to use this asset class as a funder.

After the recent rise in yields, we keep a more neutral stance on duration for now. Strategically, we expect yields to move higher. However, from a cross-asset point of view, we see little value from a total-return as well as from a risk-contribution perspective in having on a directional position.

The significant increase in **commodity** prices is mainly driven by rising oil prices. Many factors that have a positive impact on the oil price, like the expected strong demand due to ongoing global growth and the fear of geopolitical events, seem to be priced in, so we take profit on this position.

Currencies were the strongest driver behind recent relative-market movements. Strategically, we think that the dollar still has some room for appreciation, but do not believe that the current levels offer an attractive risk/reward ratio to implement a position.

Active allocation changes since last publication:

- Reduced Japanese equities to neutral
- Neutralized long 10-year U.S. Treasuries vs. short German Bunds (neutral duration)
- Closed the overweight position in commodities

Portfolio metrics

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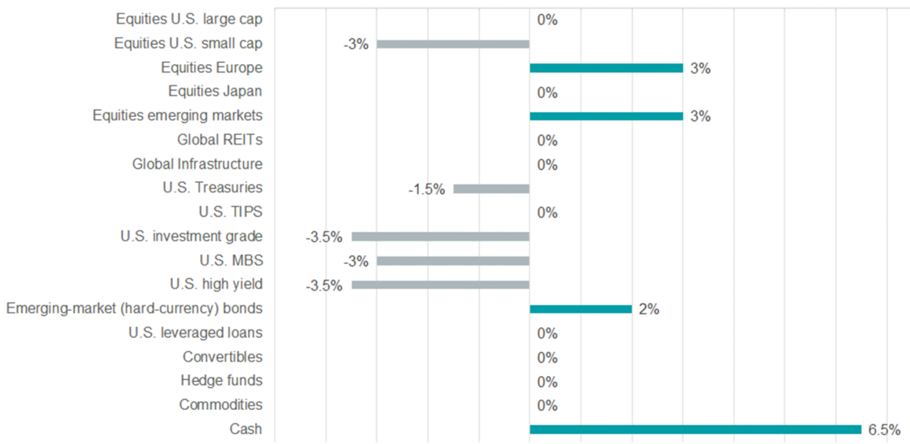
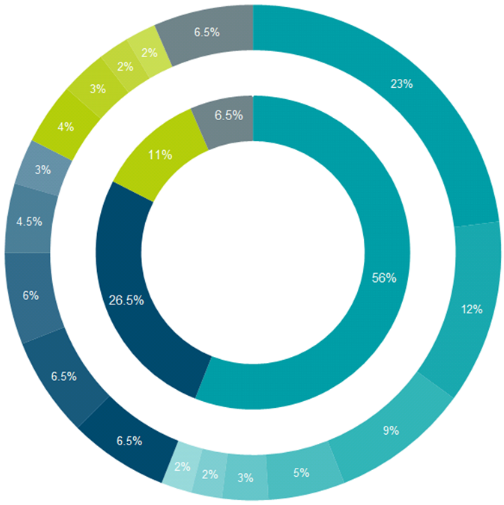
Active positioning



Portfolio allocation



Equity	**56%**
Equities U.S. large cap	23%
Equities Europe	12%
Equities emerging markets	9%
Equities Japan	5%
Global Infrastructure	3%
Equities U.S. small cap	2%
Global REITs	2%
Fixed Income	**26.5%**
U.S. Treasuries	6.5%
Emerging-market (hard-currency) bonds	6.5%
U.S. TIPS	6%
U.S. investment grade	4.5%
U.S. MBS	3%
Alternatives	**11%**
U.S. leveraged loans	4%
Convertibles	3%
Hedge funds	2%
Commodities	2%
Cash	**6.5%**
Cash	6.5%

Source: Deutsche Investment Management Americas, Inc. as of 5/9/18

Glossary

Correlation

Correlation is a measure of how closely two variables move together over time.

Duration

Duration is a measure expressed in years that adds and weights the time periods in which a bond returns cash to its holder. It is used to calculate a bond's sensitivity towards interest-rate changes.

Fundamentals

Fundamentals are data giving information about the general well-being of companies, securities or currencies and serving for the subsequent valuation of these as an investment opportunity.

Goldilocks economy

The term **Goldilocks economy** refers to a state of the economy, where there is neither a threat of inflation due to an overheating economy, nor a threat of a recession.

Monetary policy

Monetary policy focuses on controlling the supply of money with the ulterior motive of price stability, reducing unemployment, boosting growth, etc. (depending on the central bank's mandate).

Mortgage-backed security (MBS)

A **mortgage-backed security (MBS)** is a special type of asset-backed security where the holder receives interest and redemption payments from pooled mortgage debtors, secured by the underlying mortgages.

Risk premium

The risk premium is the expected return on an investment minus the return that would be earned on a risk-free investment.

Spread

The **spread** is the difference between the quoted rates of return on two different investments, usually of different credit quality.

Systematic indicator

Text

Volatility

Volatility is the degree of variation of a trading-price series over time. It can be used as a measure of an asset's risk.

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