TACTICAL ASSET ALLOCATION MONTHLY

January 2017

In this number:

REFLECTIONS

Muddle through or muddle on?

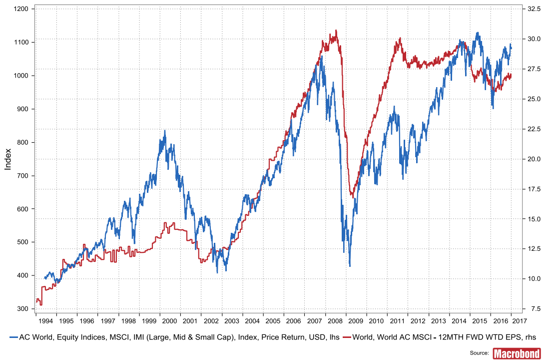
A new year has been born and into that we all have different expectations. Old themes will be tested and some will perish, others will arrise. As we see it there are a couple of obvious ones that might or might not be issues for the markets during the year.

1) Mr Trumps politics will be implemented – and it will be debated!
2) The major central banks are diverging in their monetary policy – will they hold the line or not?
3) 2017 is Europes year as we have several important elections, the one in Netherlands, the one in France (most important) and then the one in Germany – we hope for the best but are prepared for the worst.
4) Inflation expectations have bottomed out and are moving up, pushing long term bond rates up – the risk of an overshooting should not be underestimated!
5) A potential trade-war between US and China could emerge – there is no winners in that!

To predict markets is always difficult and should be done with the respect of a materia that is constantly changing and evolving. But one rule of thumb is that equity markets most often moves in the direction of earnings. And they have started to move up after several years of downward revisions.

As one can see in below chart earnings expectations bottomed out globally in 2016 and are indicating support for markets going into 2017. For sure expectaions have been raised after Mr Trump won the election, but we believe that the trend is more important than the absolute levels. There is actually a good chance we will see raised estimates during the year, which supports risky assets even more.

Earnings expectations vs MSCI World



Source: Macrobond

An interesting note is that smaller companies stand better off since an fiscal stimulus era supports domestic rather than global companies. And we have also seen higher revisions in small caps than we have in larger companies.

So, despite above themes, we have a positive view on the investment year 2017.

But then again, trends are for breaking and we expect the optimism that ended 2016 soon will be met by pessimism. Possibly from above themes but maybe just because markets tend to over- and undershoot.

As an investor we always seek the easy explanation, and we often let ourself construct one afterwards. Precisely for that reason we think it is of outmost importance, not only to understand basic economical fundamentals, but also to understand what other investors are doing based on the enormous amount of financial and political information that our digitalized life has created.

As an investor it is often wise not to swim against the flow, but then again not to follow a to strong current because then it will be crowded when one must leave the water. One important definition of risk is the inability to sell when one have to. Therefore one must treat crowded trades with care.

Now 'everybody' likes USD, Small Caps, US-equities, equities in general, and cyclicals. And on the opposite side we see unfavoured long bonds, European equities, gold and Emerging Markets.

We expect to see swings between these extremes during 2017. But we want to note that positioning isn't that extreme, meaning risky assets could expand into more positive space than we dare to hope for, in an asset allocation perspective. On the other hand, there is a flip-side to that. It might turn quickly the other way around, coming from above themes, or others.

So, we expect muddle-through at first, then a more muddle-on scenario.

As it now becomes the year of the Rooster according to the Chinese horoscope, a more inspiring quotation is hard to find than this:

"-I am alert,
Ready to take action,
The first on the scene,
The last to leave,
I take chances,
But I am precise,
I know where things belong,
I am orderly and fastidious,
Nothing escapes me,
I am always prepared,
I never give up or in,
I AM THE ROOSTER"

Welcome to a new interesting investment year, the year of the Rooster!

Jonas Olavi
Nordic Head of Asset Allocation, Alfred Berg

Our house view

On bonds we expect inflation expectation to keep gaining ground and put upward pressure on interest rates, although we expect a good portion is already in the prices. We are more confident on credits and especially high yield as they both have shorter duration and a higher yield to start with, and its better roll down-effect.

On equities we expect them to outpace bonds during 2017 as the later stands pressure from raising rates.

We expect FED to raise rates which will be $-positive. Mr. Trump's fiscal spending will have both negative and positive implications on the dollar, but as he also plans to introduce an tax-amnesty for companies, we expect this to be $-supportive. This will act as headwind on exporting companies but a tailwind for smaller companies. So, net neutral to positive for US-equities.

We expect ECB to continue supporting EU-growth by continued QE, possibly beyond the end of 2017. This will put relative pressure on the Euro which also has broken long term trend-support just recently. The year 2017 will contain important elections and we anticipate a more fiscal spending-friendly environment, which will act as further headwind for the Euro. We expect smaller companies on balance to outperform larger companies also in Europe.

In Japan the QE will most probably continue, and perhaps intensify. We also see an option in a more aggressive stance where helicopter-money is one of many solutions. On balance this will put pressure on the Yen, which will act as fuel for Japanese equities.

On emerging markets we see both positives and negatives during 2017. A clear negative is a strengthening US-dollar, since many economies have $-pegged currencies and also sometimes large dollar-debt. On the other hand we see the potential for both Russia and Brazil to leave recession. A stabilized oil-price after the, so far successful, new policy by OPEC will support oil-producing countries, i.e. Brazil and Russia even further.

We also expect upward pressure on commodity prices which last year ended a 5-year bear-cycle. This will further support EM. Net-net we expect EM to continue outperforming other markets as valuation is lower and momentum is picking up. The question is of course the uncertainty Mr. Trump brings in his strives to make better deals, as he alleged has a Master in the art of deal-making. So initiating a more aggressive overweight becomes a matter of timing.

On the Nordics we see more positives than negatives. For instance we have a positive view on Finland on two merits, first on the support by the weakening Euro and secondly on an economy that is finally showing signs of improving. With Russia on a comeback trend, this is positive for Finnish companies.

In Norway we see the stabilized oil-price as the best medicine after the prior collapse, which hit the oil-industry hard. The economy is also recovering and we expect this to continue going forward.

In Sweden we expect the undervalued SEK to keep supporting companies. Although the Swedish economy is losing speed in its growth, this is partly a chimera as GDP was boosted by the large immigration influx earlier. On negatives we find the increased taxes imposed by the minority government, which will put pressure on growth. But this will be a minor hinder for the attractiveness on Swedish equities.

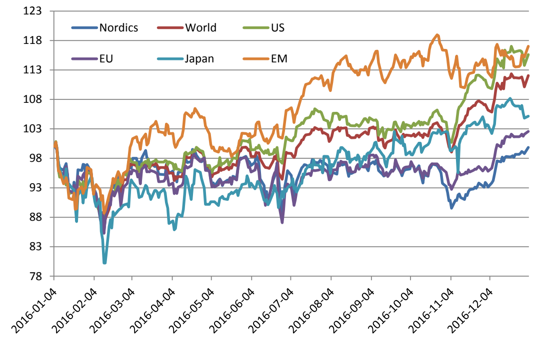
In Denmark we also see support to the economy from their pegging to the weakening Euro. This will add to a healthy private consumption as well as fiscal spending, enough to keep interest afloat. Danish equities are more defensive than the other three markets in the Nordics, which will weight on the negative side though.

Our allocation – January

We have decided to enter the year with a continuous overweight in equities, underweight in cash and a neutral exposure towards bonds. Within bonds we keep our underweight position in long government bonds and overweight in selected credits.

Within equity regions we take down the tactical overweight in US to be able to fund an upgrade in the Nordics, EU and Japan. The latter becomes overweight. The rationale is that we are becoming a bit cautious on the surge in US-equities as we approach the installation of Mr. Trump on the 20th. We are more positive on US small caps than large caps though. We see tactically better potential in both EU and Japan as the central banks there continues their QE whereas FED has ended and has commenced a hiking phase. This will continue to weaken the Euro and the Yen and strengthen the US-dollar. We will lift the Nordics on the back of more positive than negative drivers going forward.

Global equity markets, -1y



Source: Bloomberg, MSCI, Alfred Berg

Next month we will return with a more thorough publication on the different asset classes and regions.

IMFs GDP-forecasts

	Year over Year	Projections (from Oct. 2016)		Deviations (from Jul. 2016)	
	2015	2016	2017	2016	2017
World	**3.2**	**3.1**	**3.4**	**0.0**	**0.0**
Advanced economies	2.1	1.6	1.8	-0.2	0.0
Euro area	2.0	1.7	1.5	0.1	0.1
Emerging market and developing countries	4.0	4.2	4.6	0.1	0.0
Argentina 1/	2.5	-1.8	2.7	-0.3	0.6
Australia	2.4	2.9	2.7	0.1	-0.1
Brazil	-3.8	-3.3	0.5	0.0	0.0
Canada	1.1	1.2	1.9	-0.2	-0.2
China	6.9	6.6	6.2	0.0	0.0
France	1.3	1.3	1.3	-0.2	0.1
Germany	1.5	1.7	1.4	0.1	0.2
India 2/	7.6	7.6	7.6	0.2	0.2
Indonesia	4.8	4.9	5.3	0.0	0.0
Italy	0.8	0.8	0.9	-0.1	-0.1
Japan	0.5	0.5	0.6	0.2	0.5
Korea	2.6	2.7	3.0	0.0	0.0
Mexico	2.5	2.1	2.3	-0.4	-0.3
Russia	-3.7	-0.8	1.1	0.4	0.1
Saudia Arabia	3.5	1.2	2.0	0.0	0.0
South Africa	1.3	0.1	0.8	0.0	-0.2
Spain	3.2	3.1	2.2	0.5	0.1
Turkey	4.0	3.3	3.0	-0.5	-0.2
United Kingdom 3/	2.2	1.8	1.1	0.1	-0.2
United States	2.6	1.6	2.2	-0.6	-0.3
European Union	2.3	1.9	1.7	0.0	0.1

Sources: IMF, *Wolrd Economic Outlook* July 2016; and October 2016 Update.
1/See country-specific notes for Argentina in the "Country Notes" section of the Statistical Appendix.
2/See country-specific notes for India in the "Country Notes" section of the Statistical Appendix.
3/Based on Eurostat's harmonized index of consumer prices.

Source: IMF, October update

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IMPORTANT INFORMATION