ABN·AMRO Private Banking

navigating expectations in 2016

Investment Outlook

December 2015

Contents

A pragmatic course

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December 2015

Setting the direction for 2016 is not enough. We also need to navigate the changes in market expectations that are, by nature, fleeting. The economic recovery in the US and Europe will eventually lift emerging economies, but the level of market confidence in this scenario will fluctuate. We, and the financial community, expect that the Federal Reserve will finally raise its official rates and that the ECB will move in the direction of negative deposit rates. Any small deviation from this course will likely be magnified by market sentiment and affect financial market prices.

Our asset allocation aims to provide stable future returns, driven by our fundamental convictions and with attention to new challenges to diversify assets. The unfolding recovery and the persistence of low funding costs remain the driving forces behind equities, and in particular, for those of Europe and emerging Asia. We remain significantly overweight in equities, but the seven-year bull market is maturing. This reduces the potential for the broad market indexes to move ahead of corporate earnings progression. The bull market's maturity argues for a residual diversification into corporate bonds (strongly underweight) and hedge funds (overweight), which are less vulnerable to market volatility. This was the essence of a move taken in November, where a small portion of our equity allocation was shifted into corporate bonds. We also recognise that fears of a slowdown in growth or geopolitical events can cause disruptions; there will be occasions when judgement and agility will make a difference, as our key convictions can be challenged in the short term.

Our favourite sector choices, information technology and health care, as well as companies benefiting from new trends in travelling (see our equity theme page), are based on innovations and demographic and societal changes. We expect them to be less sensitive to the ebbs and flows of the economic cycle.

Changing expectations in 2016 will also see moments when risk reprices, paving the way for new opportunities. We expect commodity prices to reverse in the first half of 2016, while higher US rates will start to make bonds attractive later in the year.

ABN AMRO Private Banking's investment team, who are responsible for this Investment Outlook 2016, provides more information on their recommendations in the pages that follow. Your Relationship Manager or local investment professionals stand ready to assist you to prepare for what is ahead in 2016.

Navigating expectations in 2016

Prospects for equities are positive for 2016, but ever-changing expectations regarding the direction of the major economies and the actions of central banks call for a pragmatic course.

The response by central banks and the market's reactions in the years since the 2008 financial crisis illustrate the power of expectations to move markets. So while ABN AMRO's investment policy is anchored to a positive medium-term economic scenario, it remains exposed to changing market expectations regarding growth and policy actions.

We recommend steering a pragmatic course. Add equities (currently overweight) when the fears of recession recede, and reduce equities when market sentiment becomes too optimistic. Continue to avoid bond markets (strong underweight), except for the few segments offering returns over cash with reasonable risk. And use hedge funds (overweight) and commodities (overweight) for diversification.

Spotting the trend reversals

- **The US and eurozone are stable pillars of global growth.** A moderate recovery is unfolding, supported by strong domestic demand, improving labour markets and receding fiscal austerity.
- **China and India are leading the reversal in emerging economies.** The effects of stabilising commodity markets, currency depreciation and policy measures could revive exports and reverse the negative influence emerging markets have had on world growth.
- **Central bank activism is insurance against systemic risks and recession.** Central banks are alternating between divergence (higher rates in the US, easing elsewhere) and unified vigilance. Higher US rates will be engineered with care, supporting risky assets.

Challenges to build an effective mix

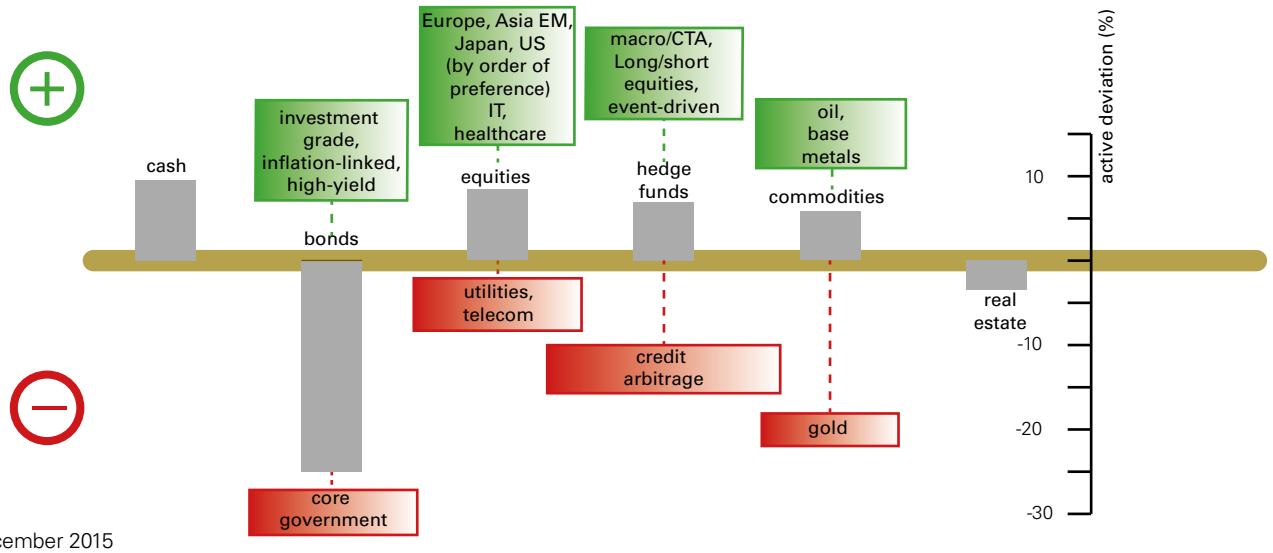
- **A moderate growth scenario has little margin to cope with shocks.** Any demand vulnerability or external shocks can compromise the recovery process.
- **Coaxing inflation to 2% is a tedious process.** A strategy to raise rates in the US and quantitative easing elsewhere can induce foreign-exchange and bond-market volatility or asset price bubbles and busts.
- **A new age of diversification.** Traditional diversifying assets, such as government bonds, precious metals and safe-haven currencies, are no longer completely effective. Bond market illiquidity is now structural.

Opportunities derived from the reward from risk

- **Higher risk reward in European, Chinese and Indian equities.** Earnings expectations and expanding margins are supporting European equities. Past risks and excessive pessimism have led to higher rewards for risk in China and India. Earnings growth in the information technology and health care sectors is driven by innovation and generational changes.
- **Corporate bonds remain a source of return.** Low rates for longer and muted default rates are prolonging opportunities in lower investment-grade and high-yield bonds, especially European bonds. Inflation-linked bonds benefit from policy moves to support inflation.
- **Hedge funds can be less vulnerable to market gyrations.** Select managers with the skill to implement short positions (long/short equity) or the agility to play trend reversals (commodity trading advisors).

Didier Duret – Chief Investment Officer

Active strategies



A more convincing recovery ahead

- The global recovery is continuing at a moderate pace
- Emerging economies are an important factor
- Financial conditions remain supportive

The global economy disappointed again in 2015. Emerging economies, in particular, have performed poorly, while Europe performed in line with earlier expectations, and the US and Japan fell somewhat short.

The slowdown of the Chinese economy and the sharp drop of oil and other commodity prices over the last 18 months have been the dominant forces driving the global economy. Looking ahead to 2016, the question is whether the recent disappointing trends will continue.

Known vulnerabilities to progressively abate

The global recovery is progressing at a moderate pace, with significant divergence between regions. (See Graphic.) It also remains vulnerable. Various challenges and risks stand out. In addition to the issues with Chinese growth and commodity prices, a number of important emerging economies are facing serious problems with public finances. It is also unclear how financial markets and economies will respond to the tightening of US monetary policy. Moreover, geopolitical tensions remain high while the domestic political situation in a range of countries is complicated.

There are also some important positives to highlight. The advanced economies of Europe and North America are experiencing broad-based growth, with domestic demand finally contributing significantly in Europe. The process of reducing financial vulnerabilities in these economies is also progressing. The role of central banks also remains crucial to managing macroeconomic risks and stabilising negative market forces.

Also decisive for the 2016 outlook is how emerging economies will fare. Here, too, we think some important positives deserve attention. Chinese imports have been weaker in 2015 than is justified by the overall slowdown of the economy. This would appear to be a process that cannot continue for long. The most recent Chinese trade data suggest some improvement is underway. Data on car sales and construction are also improving. Commodity prices appear to have overshot their lows, and we are expecting, at least, some stabilisation.

Positive effect from currency moves to come

There were significant moves in exchange rates in 2015. Many emerging economies currencies have lost 20% or more against the US dollar over the last 18 months. (This is also true for the euro and the yen.) We view this as the correct response to the drop of commodity prices.

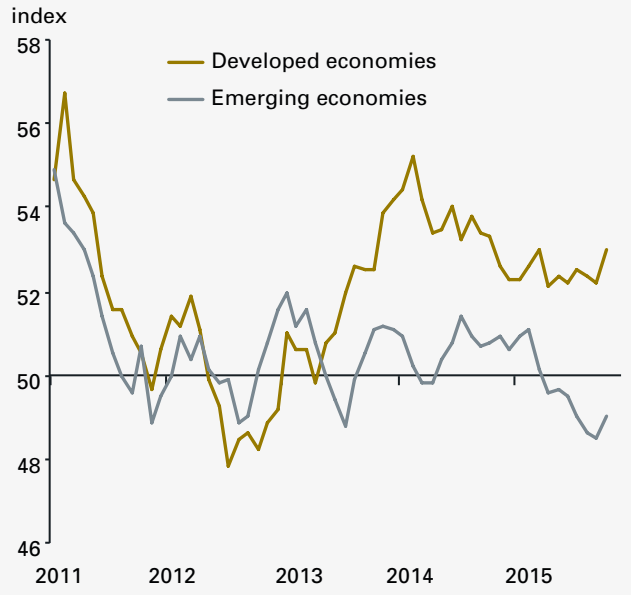
In the short term, the depreciation of currencies adds to the pressure on these economies, resulting from the related deterioration of the terms of trade. It will take a while before these countries start benefiting from improved competitiveness.

For the world as a whole, exchange rate movements merely redistribute economic growth. There is, however, an issue of timing. In the short term, losers respond more quickly than winners. As a result, the short-term effect of big currency moves tends to be negative for the world as a whole. More positive effects should emerge in the next phase. We expect 2016 will see these more positive effects, as well as some stabilisation of commodity prices, stronger Chinese imports, a more favourable development for many emerging economies and continued moderate growth in advanced economies.

While risks remain and the timing is uncertain, the global economy should show more stability and growth in 2016.

Group Economics
Han de Jong – Chief Economist

Manufacturing strength differs among regions



Source: Markit PMI
Readings above 50.0 signal an improvement; readings below 50.0 signal deterioration.

Equity rally maturing

- Equities remain attractive
- European and emerging-markets Asia are favoured
- Health care and IT sectors are benefiting from innovation and growth

Equities remain attractive relative to other asset classes. The main reason is the outlook for moderate global growth, on the back of growing consumer demand in developed markets and low commodity prices. This should provide an impetus to revive future corporate earnings growth, following lacklustre growth in 2015. This is relevant, as we expect equity performance to be in line with earnings growth, especially after a seven-year progression.

Global equities are currently valued at a reasonable forward price/earnings (P/E) ratio of 15.5x. We expect liquidity to remain ample and for the hike in US interest rates to have a limited impact on equities, although it may spark a performance difference between regions that favours Europe.

Equities should continue to attract institutional and private inflows, as their expected yield is higher than bonds. That said, there has been price-earnings expansion over the last five years or so, a sign that the equity rally is maturing. Hence, we recently trimmed the equity allocation. We remain overweight, but to a lesser extent.

Preference for Europe and emerging-markets Asia over US

We prefer European stocks over the US. Within emerging markets, we prefer Asia. The US is more advanced in its economic cycle, which limits US company earnings growth. Europe is also better positioned, based on the potential to expand low operational margins, the ongoing economic improvement in the eurozone and a weak euro, all of which support earnings. Forward 2016 P/E in Europe is also more attractive at 14.8x versus the US at 16.5x (see Graphic). We expect this advantage in favour of European stocks to continue in 2016, given the divergence in the monetary policies between the European Central Bank and the US Federal Reserve.

Emerging-market equities offer the highest earnings growth and are attractively valued at a P/E of 11.2x, but there are risks, so we recommend a neutral positioning. Within emerging markets, there are diverging country dynamics. We favour emerging-markets Asia, and, in particular, China and India, which should benefit from a policy focus on growth and the effect of lower commodity prices on input prices and internal demand.

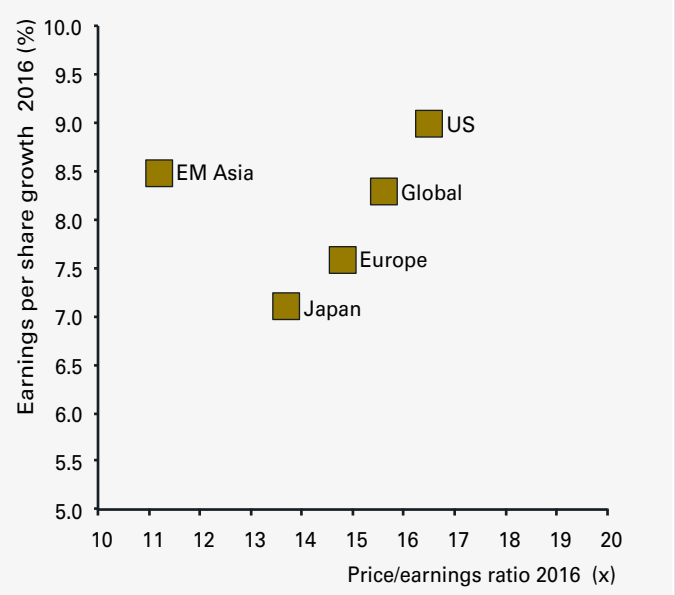
Defensive growth sectors: health care and IT favoured

As global growth progresses, we recommend investing in the "defensive" growth and innovation found in the health care and information technology (IT) sectors. Health care is expected to do well, based on continued innovation in areas such as biotechnology, and growing demand, driven by ageing populations. In the IT sector, valuations remain attractive considering the progressive earnings outlook compared to other sectors.

So far, there has not been enough stabilisation in commodities markets or sufficient improvement in global manufacturing to improve the prospects of cyclical sectors, such as industrials and materials. Consumer-oriented companies have recently reported good results, but appear expensive in terms of valuations. In general, we recommend industry leaders and companies offering diversified exposure to growth.

Investment Strategy & Portfolio Expertise
Annemijn Fokkelman - Global Head Equity Strategy & Portfolio Management

Earnings and valuation comparison by region



Source: Bloomberg, Datastream

Equity theme: travelling the globe

- Upswing in travelling and tourism
- Middle class growth spurs tourism from emerging markets
- Online players are transforming the travel landscape

Travelling and tourism are picking up, as consumers in developed economies feel increasingly comfortable to start spending again. Growth in travelling and tourism also has a strong demographic underpinning, including a retiring generation that is financially well off. In addition, consumer access to cheap travelling is increasing.

Within emerging economies, the rise of the middle class has a strong impact on travelling and tourism. In China, for instance, a growing part of the population has the means to travel internationally. As a result, the Chinese travel and tourism industry is turning into a mass market, where it used to be only for the happy few. Foreign departures from Chinese airports have increased by 800% since 2000. This has led to 116 million trips abroad in 2014, and it is expected to grow. Several countries have loosened their visa requirements for Chinese tourists which may encourage more travel. Shopping is an important element to travelling as well. In 2014, a staggering USD 200 billion was spent by Chinese tourists shopping abroad (source: Fung Business Intelligence Centre).

Consumer sentiment within the developed economies is also improving. Employment is strengthening, and declining energy and interest costs give an additional boost to spending power. More leisure time and much lower prices for airline tickets and accommodations are tempting consumers to go out and explore.

New business models

The global travel and tourism industry is going through a transformation, as new entrants disrupt traditional business models. The trend of so-called budget airlines challenging often unprofitable national flagship airlines is accelerating, as the mass market develops. Low costs for fuel and personnel and more efficient airplanes put a cap on prices, while volumes for budget airlines such as easyJet and Ryanair keep on rising.

New entrants in the global hotel business are also putting pressure on existing business models. Established chains such as Intercontinental Hotels and Hyatt have been very US-oriented and only command around 20% market share in global total hotel rooms. These chains are now rushing to acquire more internationally-oriented groups. New business models introduced by companies such as AirBnB and Expedia/HomeAway pose a threat to the established players, as does Uber to the traditional taxi business. These new entrants add flexible and affordable capacity to the travel industry and are gaining in popularity, including among travellers from emerging markets. Expedia, Priceline and Marriott are our favoured investment recommendations here.

Booking trips, hotels and cruises – Carnival Corporation is our favourite cruise company – is increasingly done online, at low cost and in an increasingly competitive market. Consolidation is taking place in the online travel industry as well, creating larger groups with expanded international reach and more bargaining and marketing power. This leads to interesting investing opportunities in companies such as Priceline and Baidu (both with stakes in Ctrip, the Chinese market leader in online travel services) and Expedia/HomeAway.

Investment Strategy & Portfolio Expertise
Edith Thouin - Senior Equity Thematic Expert

DEPARTURES 出港

COMPANY	SECTOR	COUNTRY
BAIDU	IT	CHINA
EXPEDIA	CONSUMER DISCRETIONARY	US
FACEBOOK	IT	US
PRICELINE	CONSUMER DISCRETIONARY	US
WALT DISNEY	CONSUMER DISCRETIONARY	US
ACCOR	CONSUMER DISCRETIONARY	FRANCE
WYNN MACAU	CONSUMER DISCRETIONARY	HONG KONG
LVMH MOET	CONSUMER DISCRETIONARY	FRANCE
CARNIVAL	CONSUMER DISCRETIONARY	US
MARRIOTT	CONSUMER DISCRETIONARY	US
ROYAL CARIBBEAN	CONSUMER DISCRETIONARY	US

Finding value in bond markets

- Returns from high-quality government bonds are limited
- Corporate credits offer more reward than the government bonds of eurozone periphery countries
- ECB monetary easing is prolonging the search for yield in Europe

In 2016, central banks will continue to dominate bond markets. The long-awaited hike in interest rates by the US Federal Reserve is in the offing, while the European Central Bank is intent on expanding its asset purchasing programme. In this environment, we believe it is best to focus on areas of potential excess investment return.

Still underweight bonds, but less so

In November, we increased the allocation to bonds, although we remain at a strong underweight. In particular, we see increasing value in corporate credits. Inflation-linked government bonds are also part of our recommended bond portfolio, providing protection in an environment of heightened inflation. We also think that a re-entry point for emerging markets bonds may appear in 2016.

Corporate credits offer yield

The government bonds of European peripheral countries have had a good run. But after benefitting from the largesse of the ECB, their yield spreads have narrowed, and they offer a shrinking margin relative to Bunds and cash. We believe corporate credits, both investment grade and high yield, are a better alternative to periphery bonds in the search for return.

As shown in the Graphic, the yields for corporate credits are better than that of European periphery bonds. We also believe that corporate credits have more to gain from the ECB's monetary policy easing, low financing rates and the unfolding economic recovery. Low energy prices and a strong US dollar versus the euro are additional positive factors for European corporate credits.

High-yield bonds, and, in particular, European high yield, offer significant return potential. Valuations are now attractive, as spreads widened on earlier fears over the global recovery. We prefer Europe over the US, because of the large exposure to energy companies in the US high-yield universe.

Inflation-linked bonds offer protection from rising rates

Inflation-linked bonds, where the principle and coupon are indexed to inflation, provide protection if the economy recovers faster than expected and inflation rises. Inflation-linked bonds are also attractively priced, as the inflation premium is low. We recommend inflation-linked bonds not so much for their intrinsic return, as for their potential for return in an adverse scenario of runaway inflation.

A re-entry point for emerging-markets bonds may be nearing

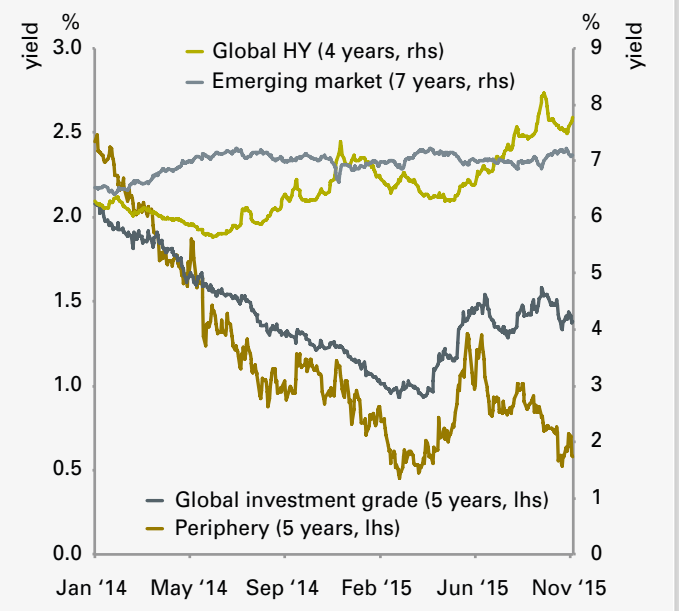
Looking forward to 2016, once the hike in US interest rates is fully priced in, emerging markets could begin to outperform developed markets. A decline in emerging-markets currencies, as occurred since mid-2014, is typically followed by a financial debt crisis. As this has not materialised and valuations are attractive, we believe that there is value in the corporate credits in emerging-markets growth areas, such as Asia.

Value in selected segments of bond market

We remain cautious on bonds as an asset class, as the absolute level of yields is still very low and the Fed is raising its base rate. There are, however, selected segments with potential for excess return. There will no doubt be moments of market illiquidity and volatility as bond markets navigate waters troubled by diverging monetary policies. We therefore continue to advise building a resilient portfolio based on return potential, quality and liquidity.

Investment Strategy & Portfolio Expertise
Mary Pieterse-Bloem – Global Head Fixed Income Strategy & Portfolio Management

Comparison of bond yields



Source: Bloomberg

Diversification opportunities

- Hedge funds (overweight): offer a wide playing field for targeted diversification
- Property (underweight): turning more positive
- Private equity: competition increasing for best deals

Hedge funds

Investment Products & Wealth Solutions
Wilbert Huizing - Specialist Investment Products

Hedge funds for diversification
Dispersion in asset price valuations, divergence among central bank policies and trend reversals in energy or foreign-exchange markets can create opportunities for hedge-fund managers. Equity, fixed-income and trading strategies are favoured.
Equity strategies. The growing divergence between undervalued and overvalued companies could become a key source of return for long/short equity managers. The conditions for merger arbitrage strategies, which aim to benefit from mergers and takeovers, should improve in 2016, after merger & acquisition premiums declined in the third quarter.
Fixed income. Shorting opportunities in the US fixed income market increased with the end to the Federal Reserve's quantitative easing programme. While there are risks, including sudden rate spikes and the lack of liquidity present in long-only fixed-income retail funds, fixed-income-focused hedge funds could act as a buffer against disruptions in bond markets.
Trading strategies. In 2016, trading strategies will depend on the capacity of managers to find trends with sufficient momentum. Increased volatility, divergence between central bank monetary policies and possible trend reversals in the energy, fixed income and foreign-exchange markets could create such opportunities.

Property

Investment Strategy & Portfolio Expertise
Ralph Wessels – Equity Research & Advisory Expert

The underlying fundamentals for real estate are strengthening, particularly in Europe. We expect this trend to continue in 2016. Cyclical improvements in advanced economies and low mortgage rates are having a positive effect on the residential sector and vacancies in commercial real estate are declining.

The sector is less leveraged than before the financial crisis, although leverage is increasing again. Dividends are backed by cash flows. By the end of the third quarter, global dividends amounted to 3.63%, according to the European Public Real Estate Association. These elements are attractive for investors searching for yield. Real estate valuations are rising, but remain undemanding. Valuations offer a 5-10% discount to net asset value. The fact that property investments are backed by real, tangible assets is part of the sector's appeal. The sector is, however, vulnerable to US rate hikes. We took profit on real estate in the first half of 2015, moving our allocation to underweight. Valuations and market circumstances may provide new entry opportunities in 2016.

Private equity

Investment Products & Wealth Solutions
Eric Zuidmeer – Senior Specialist Private Equity

The private equity market is in harvesting mode, locking-in profits by exiting investments. Indeed, 2015 will be the fourth year in a row that fund distributions total more than capital calls for new investments. That said, there is significant capital available for investments: capital from old and new funds is estimated at around USD 1,188 billion. This money is competing for the best deals. With acquisition multiples on the high side and plenty of mergers & acquisitions activity, current market circumstances are favourable for exiting investments. By the same token, buying cheap may be more difficult. This creates a challenge for private equity managers who will need to rely even more on their operational and financial skills to create value.

Private equity managers focus on actively managing concentrated investment portfolios, where each investment is the result of a careful bottom-up assessment. This approach is particularly suited for targeted pockets of value or growth in specific sectors. The retail sector is a striking example: while many traditional retailers are struggling, value and e-commerce concepts can be used as buy-and-build platforms for growth, as they benefit from a shift in business models.

Commodities & currencies

- Oversupply of commodities is receding
- Diverging central bank policies drive currencies
- Chinese yuan increasingly international

Commodities

Group Economics
Hans van Cleef - Senior Energy Economist

Low commodity prices affect fundamentals

Commodity prices are expected to moderately appreciate in 2016, after having been pressured by fears of a recession in China, a stronger US dollar and, for many commodities, a situation of more supply than demand. Metals, oil, agricultural and "soft" commodities, such as coffee, cocoa and sugar, have all been negatively affected. If concerns regarding China start to fade and the oversupply situation diminishes, a modest recovery in commodities could be possible during the coming months. Given that the dollar has already significantly rallied, we expect its negative effect on commodities to be more muted in 2016.

Oil prices could recover

The anticipation of a better balance between supply and demand could already be triggering some support for oil prices. The oversupply situation does not have to be solved completely, market expectation of an improvement is enough. The effect on oil prices from the lifting of the sanctions against Iran has already been priced in. If investors start to believe that it will be hard to push prices much lower, a switch from short- to long-positioning could support oil prices. These factors convince us that oil (WTI) prices will recover to an average price of USD 60 per barrel in 2016.

Currencies

Group Economics
Georgette Boele - Coordinator FX & Precious Metals Strategy
Roy Teo - Senior FX Strategist

Case remains for stronger dollar

We remain positive on the US dollar compared against a wide range of currencies. In 2016, we expect the dollar to achieve parity with the euro and forecast an exchange rate of 135 for the dollar versus the Japanese yen. Monetary policy divergence, ongoing recovery in the US and a positive investor climate are the main factors that will push the US dollar higher. It is likely that the start to the Fed rate hike cycle will go hand in hand with improving investor sentiment. As such, the US dollar should fully profit from monetary policy divergence between the US and the rest of the world. If investor sentiment in financial markets were to deteriorate, the US dollar's rise will likely be capped. We also believe that the European Central Bank's expansion of its monetary easing policies will weigh on the euro.

Gradual depreciation of the Chinese yuan expected

Sentiment towards the yuan improved after Chinese authorities stated that an annual growth rate of at least 6.5% is necessary for the government to meet its target of doubling the size of the economy by 2020. We expect the Chinese yuan to depreciate at a modest pace, which will support exports. In addition, a tighter monetary policy in the US will support the US dollar and weigh on the yuan. While the yuan is being considered for inclusion in the International Monetary Fund's basket of key international currencies, its use as a reserve asset by central banks is likely to increase only gradually and from a low base. We expect the yuan to moderately decline versus the US dollar to 6.40 and 6.57 by the end of 2015 and 2016, respectively.

Forecasts

Macro indicators (%)[1]

25 November 2015	Real GDP growth 2016		Inflation 2016	
	ABN AMRO	Market view	ABN AMRO	Market view
US	2.5	2.6	1.8	1.8
Eurozone	1.9	1.7	1.2	1.1
UK	2.6	2.4	1.9	1.4
Japan	1.2	1.3	1.0	0.8
Other countries*	2.2	2.1	1.7	1.8
EM Asia	6.0	6.0	3.0	3.1
Latin America	0.8	0.6	16.3	19.4
Emerging Europe**	1.7	1.4	6.3	6.2
World	3.3	3.3	3.9	4.1

Equity indexes

	24 Nov 2015	Active strategy	Forward P/E 2016
MSCI ACWI	409.08	Overweight	15.1
S&P 500	2,077.13	Underweight	16.1
Euro Stoxx 50	3,396.47	Overweight	14.1
FTSE-100	6,259.07	Overweight	14.8
Nikkei 225	19,924.89	Neutral	17.4
DAX	10,931.68	Overweight	13.1
CAC 40	4,804.80	Overweight	14.5
AEX	459.48	Overweight	15.4
Hang Seng Index	22,587.63	Neutral	10.8
Shanghai SE Comp.	3,616.11	Overweight	14.0
Straits Times Index	2,923.49	Neutral	12.1
Sensex	25,775.74	Overweight	14.3

Interest rates and bond yields (%)

	25 Nov 2015	Q2 2016	Q4 2016
United States			
US Fed	0.25	0.75	1.25
3-month	0.38	1.00	1.30
2-year	0.93	1.25	1.40
10-year	2.20	2.90	3.00
Germany			
ECB Refi	0.05	0.00	0.00
3-month	-0.09	-0.15	-0.15
2-year	-0.41	-0.25	-0.21
10-year	0.40	0.80	1.00

Forecasts for major developed-markets currencies

FX pair	24 Nov 2015	Q2 2016	Q4 2016
EUR/USD	1.0649	0.95	0.95
USD/JPY	122.56	130	135
EUR/JPY	130.51	124	128
GBP/USD	1.5123	1.28	1.27
EUR/GBP	0.7042	0.74	0.75
EUR/CHF	1.0844	1.12	1.15
AUD/USD	0.7216	0.66	0.62
NZD/USD	0.6526	0.60	0.58
USD/CAD	1.3338	1.37	1.41
EUR/SEK	9.2810	9.50	9.50
EUR/NOK	9.2176	9.25	9.00

Commodities

26 November 2015	Spot index	2015 average	2016 average
Brent USD/bbl	46	60	65
WTI USD/bbl	43	55	60
Gold USD/oz	1071	1106	950
Silver USD/oz	14.2	15.9	14.1
Platinum USD/oz	851	1075	819
Palladium USD/oz	551	700	535
Aluminium USD/t	1460	1675	1700
Copper USD/t	4687	5600	5400

Forecasts for major emerging-markets currencies

FX pair	24 Nov 2015	Q2 2016	Q4 2016
USD/CNH (offshore)	6.4280	6.53	6.57
USD/INR	66.3988	67.00	67.00
USD/SGD	1.4142	1.47	1.50
USD/TWD	32.6460	33.70	34.00
USD/IDR	13711	14800	15000
USD/RUB	65.6882	60.00	55.00
USD/TRY	2.8605	2.95	2.90
EUR/PLN	4.2541	4.15	4.10
EUR/CZK	27.5000	27.00	26.50
EUR/HUF	311.80	300.00	300.00
USD/BRL	3.7323	3.70	3.60
USD/MXN	16.5149	16.25	15.75

[1]All forecasts are annual averages of quarterly year-on-year changes.
* Australia, Canada, Denmark, New Zealand, Norway, Sweden and Switzerland.
** Belarus, Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Russia, Slovakia, Slovenia, Turkey, Ukraine.
Source: ABN AMRO Group Economics, Consensus Economics, EIU.

Performance overview

- Positive absolute year-to-date returns achieved in all risk profiles in a turbulent market
- A strong overweight position in equities was the main performance driver
- The strengthening US dollar boosted euro-denominated portfolios

We took a deliberate "risk on" approach in 2015, as evidenced by our strong overweight allocation to equities, with an emphasis on Europe and Emerging Asia. In April, we took profits in our listed real estate position and on equity positions above the target allocation – a situation that had been created by the equity rally in the first quarter. We also reduced the bond allocation to a minimum. The allocation to commodities was increased in February and June. The position in hedge funds was also moved to overweight. At the end of May, all profiles had a positive absolute year-to-date performance, driven by equities. After a turbulent summer, however, this strong performance had evaporated.

Most asset prices started to recover sharply in October, and, by the end of October, the year-to-date performance was positive again in all profiles, varying from 0.5% in profile 1 to 8.2% in profile 6. Except for profile 1, all our profiles are back above their long-term expected returns.

US-dollar denominated profiles had returns significantly less than the euro profiles. They were partially hedged against the euro and the yen. Performance year-to-date varies from -0.8% in profile 4 to 0.8% in profile 1 for the US-dollar profiles. (See Graphic).

Performance outlook

Equities should remain the main performance driver in 2016, as the expected return from bonds is largely exhausted. The chief risk to our base-case scenario, calling for a moderate economic recovery, is fear of recession. And, if this occurs, the risk of not being properly diversified.

Correlations between asset classes tend to rise in tandem in correction phases, as herd behaviour leads to investors selling risky assets at the same time, with the inflows going to more liquid, safe-haven assets. This effect has been amplified since the financial crisis in 2008. While central banks have been able to tame volatility and stabilise markets with forceful interest rate cuts and financial liquidity programs, they have not been able to re-establish a normal diversification pattern between bonds, equities, commodities and real estate.

The good news is that the correlation between stocks has reduced substantially, even below the level before the beginning of the financial crisis. This means that investors can replace the diversification that has been lost among asset classes by diversifying equity portfolios across individual stocks, sectors, regions and industries. A buffer of cash is also effective, and targeted hedge funds can also mitigate these risks.

Investment Strategy & Portfolio Expertise
Hans Peters – Head Investment Risk
Paul Groenewoud – Quant Risk Specialist

Performance (%) of the tactical asset allocation vs. the strategic asset allocation

	EUR						USD					
	22 May 2003 to 30 October 2015*			2015 YTD (30 October 2015)			22 May 2003 to 30 October 2015*			2015 YTD (30 October 2015)		
	Strategic	Tactical	Excess Return	Strategic	Tactical	Excess Return	Strategic	Tactical	Excess Return	Strategic	Tactical	Excess Return
Profile 1	70.91	75.14	2.48	1.26	0.48	-0.77	58.36	73.28	9.42	1.53	0.79	-0.73
Profile 2	80.72	92.05	6.27	2.79	2.13	-0.64	68.48	85.09	9.86	1.11	-0.46	-1.55
Profile 3	104.61	131.03	12.91	4.11	3.75	-0.35	95.32	120.84	13.06	0.97	-0.57	-1.52
Profile 4	118.72	145.60	12.29	5.83	5.59	-0.23	110.04	133.81	11.32	0.70	-0.76	-1.45
Profile 5	140.31	175.12	14.49	7.48	7.40	-0.08	130.58	160.28	12.88	0.36	-0.32	-0.67
Profile 6	152.17	184.27	12.73	8.68	8.24	-0.40	142.56	169.08	10.93	0.06	-0.35	-0.40

* Profiles 1 and 2 are linked to the "old" Conservative profile, profiles 3 and 4 to the "old" Balanced profile and profiles 5 and 6 to the "old" Growth profile.

Asset allocation profiles

ABN AMRO's Global Investment Committee model portfolios showing EUR/USD risk profiles in percent, starting with our most conservative (Profile 1) and ending with that most exposed to market risks (Profile 6).

Asset allocation	Profile 1					Profile 2				
Asset class	Strategic			Tactical	Deviation	Strategic			Tactical	Deviation
	Neutral	Min.	Max.			Neutral	Min.	Max.		
Money markets	5	0	60	41	36	5	0	70	21	16
Bonds*	90	40	100	51	-39	70	30	85	39	-31
Equities	0	0	10	0		15	0	30	22	7
Alternative investments	5	0	10	8	3	10	0	20	18	8
Funds of hedge funds	5			8	3	5			11	6
Real estate	0			0		3			0	-3
Commodities	0			0		2			7	5
Total Exposure	100			100		100			100	

Asset allocation	Profile 3					Profile 4				
Asset class	Strategic			Tactical	Deviation	Strategic			Tactical	Deviation
	Neutral	Min.	Max.			Neutral	Min.	Max.		
Money markets	5	0	70	14	9	5	0	70	6	1
Bonds*	55	20	70	30	-25	35	10	55	18	-17
Equities	30	10	50	38	8	50	20	70	58	8
Alternative investments	10	0	20	18	8	10	0	30	18	8
Funds of hedge funds	5			11	6	5			11	6
Real estate	3			0	-3	3			0	-3
Commodities	2			7	5	2			7	5
Total Exposure	100			100		100			100	

Asset allocation	Profile 5					Profile 6				
Asset class	Strategic			Tactical	Deviation	Strategic			Tactical	Deviation
	Neutral	Min.	Max.			Neutral	Min.	Max.		
Money markets	5	0	70	2	-3	5	0	60	0	-5
Bonds*	15	0	40	11	-4	0	0	25	0	
Equities	70	30	90	75	5	85	40	100	83	-2
Alternative investments	10	0	30	12	2	10	0	30	17	7
Funds of hedge funds	5			8	3	5			8	3
Real estate	3			0	-3	3			5	2
Commodities	2			4	2	2			4	2
Total Exposure	100			100		100			100	

*Recommended duration: long. Benchmark: Bank of America, Merrill Lynch Government Bonds 1-10 years.

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