VP BANK

Tactical positioning

October 2018 – market commentary

The side effects of monetary policy

Normalisation of monetary policy has long been a major talking point on the markets. But recent weeks have shown that a return to higher interest rates is not plain sailing. In the short term we believe that the scope for further interest rate increases is exhausted. The resultant breathing space should be good for emerging market bonds.

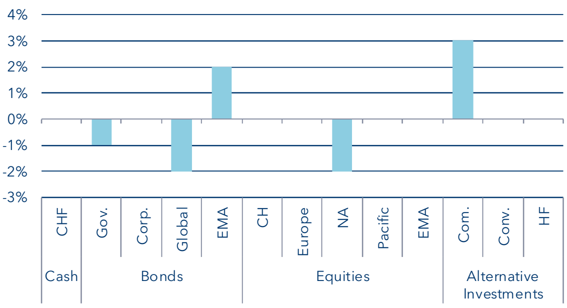
Yields on 10-year US Treasuries have surged in recent days to 3.25% – a level not seen in over seven years. With US interest rates on the up, rates in Europe have also been dragged higher.

The latest yield backup was fuelled by statements by Fed Chairman Jerome Powell, who characterised America's economic outlook as "remarkably positive". Fine though this upbeat assessment is, in combination with the publication of positive economic numbers it sent tremors through the financial markets. Rising interest rates mean capital losses on bond holdings, while worries about higher borrowing costs have also infected the equity markets.

In the short term we think there is a good chance that interest rates will stabilise. That should provide the markets with a breathing space.

Stabilisation is also now observable on the emerging markets after the hefty setbacks suffered this year. The risk of an imminent Turkish default has not materialised, and risk spreads on emerging market bonds have generally steadied. Against this background we regard present yields to maturity as attractive and have tactically increased our position in USD-denominated emerging market bonds. Conversely we have reduced our allocation in US equities, which are highly valued and ripe for consolidation in the short term.

Tactical positioning



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Asset Allocation

- Underweight in equities
- Underweight in bonds
- Overweight in alternative investments

Bonds

- Underweight in government bonds
- Underweight in global bonds
- Overweight in emerging market bonds

Duration is being kept below benchmark in all reference currencies. We are underweight in government bonds and global bonds and neutrally weighted in corporate bonds. Following our latest reallocation we are now overweight in USD-denominated emerging market bonds. Inflation-linked bonds are held as a supplementary position.

Equities

- Underweight in US equities
- Neutrally weighted in other equity markets

US equities have been the big winners so far this year. In the present environment, however, we believe that higher interest rates in USD and the elevated valuation level compared with other equity markets make US equities less attractive.

Alternative investments

- Overweight in commodities (gold)
- Neutrally weighted in convertible bonds and hedge funds

Gold is attractive as a portfolio diversifier in the present market environment.

Currencies

Due to risk considerations, we remain strategically hedged in developed country currencies, while the USD is partly unhedged in EUR- and CHF-based portfolios.

Important legal notices