

# Asset Allocation Dashboard

■ Positive    
 ■ Neutral    
 ■ Negative

Asset class	View	Change	Comments		
Equities			Positive	Negative	Our view
Developed equities	■	↔	<p>Corporates continue to generate reasonable levels of profit and earnings per share have been quite robust.</p> <p>Valuations are slightly rich by historical standards but low yields warrant the higher multiple.</p> <p>Central Bank activity continues to provide a boost to markets.</p>	<p>The global macroeconomic environment is more uncertain than risk markets might suggest and risk looks under-priced in some sectors and regions.</p> <p>Markets have continued to perform strongly and there is a risk of momentum stalling and profits being taken in the absence of improving sales or profit margins to push stocks higher.</p> <p>Unfolding political risk following the election of Donald Trump as US president is increasing volatility in some regions and sectors, with further important elections taking place in 2017.</p>	<p>At these valuation levels we view a broadly neutral allocation as appropriate. Valuations are not cheap but central bank policy remains supportive for risk assets and on a relative value basis equity returns remain attractive over the medium term, even if nominal expectations are quite low.</p> <p>Short term volatility should be expected with policy and politics central to risk pricing.</p>
UK equities Relative to developed	■	↔	<p>Valuations look a little extended following the post Brexit rally in UK equities but the continued pressure on sterling will support UK businesses, more so the exporters and those that earn their revenues overseas, but the market is discounting a decent rebound in earnings at these levels.</p> <p>Low base rates and the re-firing of the asset purchase program should keep risk appetite buoyed in the near term, but the UK is less of an outright buy today.</p>	<p>Uncertainty remains in the UK economy at this time as the Brexit process struggles to find a course.</p> <p>In the smaller cap indexes where businesses are more domestically exposed, one could argue that this risk remains under-priced today.</p> <p>The UK market remains disproportionately exposed to moves in commodity prices.</p> <p>If the earnings rebound fails to materialise then the market looks expensive.</p>	<p>Following the strong rally in UK equities and weakness in sterling, return expectations have fallen back to more modest levels. With sterling at its cheapest level in decades further sustained weakness seems unlikely.</p> <p>The immediate Brexit risks have faded but are being replaced by exit uncertainty and negotiation risks.</p> <p>The market remains disproportionately sensitive to commodity prices and we are cognisant of the recent strength in oil markets.</p>
European equities Relative to developed	■	↓	<p>The Central Bank remains committed to its QE program which includes the purchase of corporate debt.</p> <p>Some businesses may stand to gain from Brexit fallout if capital flows to the region and investment moves to the continent.</p> <p>Valuations remain attractive against the backdrop of low yields.</p>	<p>The intervention of the ECB has been well received, but the longer term efficacy remains to be seen and the ECB disappointed recently on expectations for future QE. Low rates in Europe and beyond puts pressure on the banking sector which remains under pressure, notably in Italy.</p> <p>We are mindful of politics in Europe including the knock on effects of the UK Brexit vote, and elections in France and Germany this year.</p>	<p>European equity looks reasonably valued at current levels, especially when viewed against corporate and sovereign European bond markets.</p> <p>However with forthcoming political headwinds and a growing recognition that increasingly negative rates may do more harm than good, we take a more neutral position today as the potential near term risks outweighs the valuation.</p>
US equities Relative to developed	■	↔	<p>The broad US economic outlook remains amongst the best of the major economies and arguably the region warrants a premium at a time of uncertainty elsewhere. Consumer confidence remains high, jobs growth continues and economic indicators suggest reasonable growth over the medium term. The election of Donald Trump as president continues to provide a fillip for US companies and an expected program of fiscal spending and tax cuts will benefit certain corporates and sectors as well as the consumer.</p> <p>Equities may be better placed over the longer term to capture any reflationary policy fallout.</p>	<p>The US remains one of the most expensive equity regions, with high investor expectations already priced in. With profit margins having peaked, US equity requires meaningful earnings growth to justify today's valuation and against a slow global backdrop this may prove hard to realise.</p> <p>The Fed's interest rate policy will remain a source of volatility and an inflation surprise could see yields move higher than markets have discounted.</p> <p>Undefined policy objectives of the incoming Trump administration maintain uncertainty and could increase risk premia for equities.</p>	<p>Still the most expensive regional equity market in our valuation framework.</p> <p>Monetary policy remains a key swing factor for the US and on the political front we prefer for now to observe how the Trump administration settles and its policies unfold. There are still many unknowns.</p> <p>Recent renewed strength in the dollar and the re-pricing of forward labor curves may serve to cool the economy and could lead earnings to disappoint versus their bullish implied levels.</p>

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Japanese equities Relative to developed (continued)	■	↔	<p>Negative rates should be constructive for equities despite creating bouts of volatility in the near term. BoJ purchases of equity through ETF structures, as well as the continuing purchase of JGBs, should support prices. Investors expect additional accommodative measures from the BoJ, perhaps in the form of 'helicopter money'.</p>	<p>A strengthening yen is a problem for exporters and the recent sharp weakening leaves equities exposed to any reversal.</p> <p>In real terms the currency is not expensive so there is room for this to happen, but it is likely to come in a risk off situation when the yen traditionally offers some protection. Longer term, Japan remains in a difficult position with an ageing population and little or no economic growth. This could hold domestic equities down.</p>	<p>We continue to rate this market as a green today with attractive valuations and a continuing program to increase equity allocations within pension portfolios.</p> <p>The government's pro liquidity policies are welcome but inconsistent data readings, habitual disappointment and the yen's safe haven currency status warrant some caution.</p>
Emerging market equities	■	↔	<p>Valuations remain attractive in emerging markets with much of the negative news surrounding commodity exporting countries having been priced in and their respective currencies having adjusted. Post-election dollar strength has made the currencies more attractive and with a strong repricing higher in US rates, the currencies may start to find some support. Leading indicators continue to support reasonable growth expectations. Global and localised policy action remains supportive towards riskier assets.</p>	<p>The asset class may face near term headwinds from any continued US dollar strength and the moderation in Chinese growth which heavily influences the EM asset class.</p> <p>The fallout from the US election may continue to provide a headwind to certain companies and countries should trade agreements be revoked or tariffs introduced. Considerable political risk remains.</p>	<p>Valuations are attractive in absolute and relative terms. With slowly improving fundamentals and a noticeable repositioning in risk appetite among investors, we like the prospective long term returns offered by the asset class today. This remains a volatile section of the equity market: care is required on position sizing. Caution is warranted until the path of US trade policy becomes clearer, but at current levels we see good return prospects from this region.</p>

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Fixed income			Positive	Negative	Our view
Government	■	↔	<p>DM policy remains accommodative in aggregate across DM economies but with inflation and rates having repriced sharply higher in recent weeks, bond yields today are under less upward pressure. High quality government paper remains the ultimate haven in times of elevated risk aversion. Real treasury yields do not look unreasonable if growth remains muted and inflation is contained.</p>	<p>Extraordinary monetary policy has brought about artificially low bond yields and long term government bonds remain expensive in our view. Fundamentals have crept back into US bond valuations following Trump's election and may continue to re-price rate risk higher. There is currently a strong reflationary theme playing out in markets and whilst it may prove to be overstated, it does have mark to market implications for rate sensitive securities including treasury debt.</p>	<p>Despite on-going supportive policy actions, on a medium term outlook the majority of government bond yields remain unattractive and the asymmetric risk of potential returns from this asset class remains elevated. There are some relative value opportunities for the more sophisticated investors but it is mostly the diversifying attributes of the higher quality sovereign bonds that warrants a holding today.</p>
Index-linked Relative to government	■	↔	<p>Realised levels of inflation in the developed world remain low while forward looking basis inflation expectations have started to edge higher. Inflation breakevens in aggregate look reasonably attractive. Given the historical stickiness of inflation at levels above breakeven inflation rates, inflation linked bonds in select markets look better value today than fixed rate government bonds. US inflation and inflation surprise across the G4 economies has increased.</p>	<p>Linkers remain vulnerable to weak economic news flow and renewed weakness in commodity prices. Real yields in the UK are extremely negative and should be expected to rise as monetary policy normalises, causing MTM losses. It is difficult to use inflation linked bonds without accepting the higher duration risk that comes with most inflation linked bond funds. Inflation linked bonds can be more technically driven and do not always imply a true measure of future realised inflation.</p>	<p>Like their nominal counterparts, linkers are ultimately expensive. Nonetheless, compared to a conventional government bond, at these levels they are likely to provide some protection against future inflation. We think inflation linked bonds are more fairly valued overall today.</p>

Note: Each asset class is reported on in isolation and should not be used as a relative comparison, unless otherwise stated. These views should not be interpreted as investment advice. Views as at December 2016.

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Fixed in-come			Positive	Negative	Our view
Investment grade Relative to government	■	↔	<p>Investment grade spreads – a measure of relative value compared to government bonds – remain relatively attractive.</p> <p>At current levels we think investors are adequately paid for the fundamental risk.</p> <p>IG bonds also provide some diversification to riskier assets with their embedded rate risk</p> <p>UK investment grade bonds should stay well supported with the Bank of England now a marginal buyer in the market for select bond issuers.</p>	<p>In absolute terms the duration component of investment grade bonds may prove to be a headwind, should government bond yields move higher than what is currently priced in. There are market concerns over liquidity but investors are somewhat compensated for this in the current spread. Financials make up a large part of the investment grade bond universe and we recognise the impact of lower sovereign rates on banks margins and profitability if base rates fall further. The US market – the largest regional allocation within the global asset class – is more progressed through the credit cycle today and leverage, whilst not at punitive levels, has been rising.</p>	<p>Investment grade debt remains a decent play against government bonds and an efficient way to earn a higher quality spread whilst retaining some underlying rate protection.</p> <p>We are cognisant of debt issuance to support share buybacks and the high aggregate debt levels.</p> <p>We retain a neutral rating today and like the balance it provides in a multi asset portfolio.</p>
High yield	■	↔	<p>High yield spreads in both the US and Europe look fair at current levels vs what is on offer elsewhere but valuations have deteriorated as spreads have tightened. Default rates remain low in non-energy sectors. Recovery rates are below long term averages but this is a function of the market having become bifurcated between energy and non-energy sectors. Interest remains well covered. HY risk premia look reasonably attractive vs equity and IG.</p>	<p>The large proportion of energy related issuers could again impact US index returns if the oil price fails to hold current levels and default rates remain high in the sector. Furthermore, the credit cycle is now somewhat extended in the US. The asset class has rallied hard recently and spreads at or under 4% look fully priced, though it can run further.</p>	<p>High yield debt at present spread and yield levels just about warrant a position today. We prefer short duration to core high yield today as scenario analysis suggests a better risk return. We are mindful spreads could 'overshoot' before stabilising or tightening and valuations look fair today. On the basis of expected total returns we prefer US over Europe.</p>
Loans	■	↔	<p>Long term value remains and the spread available on loans is attractive with the additional benefit of a floating rate coupon. Seniority over unsecured high yield bonds also provides additional capital security if defaults pick up unexpectedly. Loans have limited exposure to the energy sector where the risk of capital impairment is higher. A higher exposure to the healthcare sector could benefit from healthcare policy changes in the US.</p>	<p>Loans sit in a less liquid part of the corporate debt market with wider bid/offer spreads. Fundamental risks are much the same as for high yield in the sense that a significant pickup in defaults may negatively impact the asset class. This is less liquid than high yield and this risk should be borne in mind when considering investments. Covenant protection remains low. We are mindful of sector concentration in healthcare and technology and the use of new issue loan proceeds for acquisitive purposes.</p>	<p>We retain a neutral view on the asset class and at the margin would prefer to high yield bonds. Hold exposure if appropriate to mandate. Similar to high yield, with the exception that investors need to consider the less liquid nature of this market and lack of an embedded rate component. The floating rate nature of the asset class will be accretive when interest rates do eventually rise above the embedded LIBOR floor, a level which is approaching.</p>

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Fixed income			Positive	Negative	Our view
Emerging market debt	<span style="color: green;">■</span>	↔	<p>Spreads today on hard currency denominated emerging markets remain attractive when considering duration and reinvestment risks. All in yields are also reasonable following the recent re-pricing in US rates.</p> <p>In aggregate the sovereign issuers that comprise the EMD universe today have higher currency reserves and more free floating currencies that should prevent a meltdown like that seen during previous EM debt crises, and aggregate rating quality is better</p> <p>The worst of the EM currency depreciation looks to be behind us and this should provide some support to hard currency spreads, and will benefit from any dollar weakness.</p>	<p>In the short term, EMD remains sensitive to disappointing growth, bad economic data, a stronger dollar and 'risk aversion' trades as witnessed post-election.</p> <p>Oil price falls will benefit net oil importers to the detriment of EM economies that export and a strong US dollar makes these obligations more difficult to service, although not unmanageably so yet. The large weight of the resources sector in a number of EM economies leaves them exposed to the slowing of the Chinese economy. The quality of the universe remains investment grade overall but has been deteriorating.</p>	<p>EMD is sensitive to global macro news, especially markets with current account deficits or a reliance on oil exports.</p> <p>Moderate allocations are recommended following the recent weakness in the asset class. Local EMD has optically attractive yields but dollar strength and currency risks may overwhelm the carry opportunity in the near term.</p> <p>Hard currency continues to look more attractive at the margin but both should provide reasonable real returns over the longer term.</p>
Convertible bonds	<span style="color: orange;">■</span>	↔	<p>Convertible valuations remain reasonably attractive today following some underperformance versus straight equity.</p> <p>We expect some pick up in volatility over the next year following several years of suppressed vol, due both to policy action/inaction and geopolitical events.</p>	<p>Systemic risks remain. The call optionality embedded in converts ultimately only has real value if markets increase and the particular stocks in question participate in these moves.</p> <p>Some equity markets look quite fully priced and convertibles will be impacted if equities come under pressure.</p>	<p>Convertible bonds are priced about fair value to their constituent parts. The asset class should always have a place in a multi asset portfolio given the upside participation and downside bond floor and the asymmetric properties they possess.</p>

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Alternatives			Positive	Negative	Our view
Commodities	■	↔	<p>Although global growth rates remain subdued commodity prices will continue to be influenced by broader risk appetite which remains buoyant at present.</p> <p>As inflation starts to surprise to the upside in some countries commodities can provide an inflation hedge in client portfolios.</p> <p>Gold can also provide a hedge against event risk in what has become a macro environment sensitive to policy error and newsflow.</p>	<p>Strength of final demand is still questionable especially with respect to China where it is clear commodity imports have slowed and growth continues to moderate.</p> <p>It is difficult to take a direct exposure to commodities and commodity curves will influence returns vehicles that invest via commodity futures, often negatively.</p> <p>The asset class more broadly remains prone to bouts of dollar strength .</p>	<p>Commodities remain sensitive to negative news on growth.</p> <p>They could rally further from here but volatility and on-going economic uncertainties suggest caution and the market still prices little inflation risk.</p> <p>The significant recent moves in the oil price demonstrate how volatile these prices can be.</p> <p>The dollar will be critical and whilst it has been on a tear of late its future direction is less clear.</p>
Property (UK)	■	↔	<p>Yields and returns remain reasonably attractive in selective regional locations and will have improved as commercial valuations have come back.</p> <p>Reasonable vacancy rates still remain in certain areas.</p> <p>Active management remains key in this sector as is the avoidance of expensive 'legacy positions' in overly mature funds.</p> <p>The weakness in sterling has revived some foreign flow into the UK property asset class and any further weakness should see support for property from the overseas buyer.</p>	<p>The UK's economic outlook remains uncertain in light of the vote to leave the EU and ensuing negotiations.</p> <p>The traditional British high street remains under pressure from the continuing growth of online retailing and high street chain closures are testament to this.</p> <p>We have warned in the past of the dangers of liquidity mismatch and this continues to be a risk that the sector is exposed to</p> <p>As a longer duration asset class property remains susceptible to any repricing in long terms bond yields which have moved sharply lower in recent months.</p>	<p>Income is attractive versus gilts but there is limited room for capital growth.</p> <p>On the positive side, rental growth outside of London is likely to provide a positive impetus due to a lack of new supply.</p> <p>We also recognise the 'search for yield' lends support to the asset class.</p>

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<b>Currencies</b>			
USDGBP	■	↔	<p>Fed pricing remains under the committee's 'dots' but the two have converged as forward US rate expectations have shot higher. This has been constructive for the dollar more broadly but is unlikely to continue at this pace..</p> <p>In the UK we continue to feel this, together with extreme positioning against Sterling and a low valuation, could see a more balanced outlook for this currency pairing but until there is a clearer picture of how Brexit is implemented it is difficult to call directionally.</p>
EURGBP	■	↓	<p>ECB policy remains accommodative - if less than expected - and will continue to keep rates low. Rate differentials across geographies provide little to no carry advantage so the currency will not find any support there in the near term. Financial and political newsflow in Europe will likely only serve as a near term headwind for the currency And whilst sterling is under its own pressure there could be a case to be made for saying that the Euro area risk is underpriced in this pairing.</p>
JPYGBP	■	↔	<p>In recent months the BoJ's message has lost much of its punch and they have now moved away from a target bond purchase to a yield target which may ultimately be akin to a tapering of bond purchases. We have also moved past the US election which could have been a catalyst for Yen strength</p> <p>This pair remains sensitive to risk news but with both currencies looking somewhat cheap and no imminent rate events likely to upset the cross, it is difficult to take a strong directional view at this juncture.</p>



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