

Press Release

Asia Pacific, 18 January 2018

AllianzGI: Solid Recovery Enters Stage of Maturity in 2018

- *Adjustments to monetary policy continue against a backdrop of low interest rates and low-volatility environment*
- *Protecting purchasing power to remain a priority for investors*
- *Active management key as geopolitical risks and business disruption persists*

Allianz Global Investors (AllianzGI) anticipates global economic recovery to continue to be solid in 2018 despite signs of slowing momentum. As central banks, led by the US Federal Reserve, gradually scale back their support and continue to adjust their monetary policies, AllianzGI cautions on an increased risk of liquidity shortfalls and volatility spikes, and reminds investors to continue to be wary of financial repression and keep an eye on inflation.

Central banks have had a dominant influence on markets for the past decade and AllianzGI expects this to continue in 2018. "The Fed will likely raise rates further, with up to three hikes this year. The ECB, however, is focussing on slowing its bond-buying programme and the Bank of Japan has started to reduce its monthly asset purchases," said **Neil Dwane, Global Strategist at AllianzGI**. "Positioning for central banks' next moves will become more complex as policies start to diverge globally."

Even as the direction of monetary policy reverses, the pace will be extremely slow. Therefore, interest rates are expected to stay low and financial repression will continue. Consequently, protecting purchasing power will remain critical. "Investors would do well to understand how rising prices are impacting their income requirements, given that even relatively low levels of inflation can erode purchasing power over time," continued Dwane.

Against this backdrop, several dominant themes, including geopolitical risks and business disruption, will persist in 2018. Therefore, active management and selectivity will figure strongly in the quest for return potential and to manage risk.

Doug Forsyth, CIO US Income & Growth Strategies, explained: "With the U.S. tax reform bill coming into effect in 2018, the associated tax reductions could lift corporate profitability and consumer/ business spending though more fiscal stimulus could trigger more rate rises. With the possibility of treasury yields rising moderately, our performance expectation of high yield bonds is that they will provide coupon-like returns of mid-single digits. As spreads are forecast to tighten, they should cushion the rise in treasuries. For U.S. equities, we expect market opportunities to broaden to more industries including banks, heavy equipment, defence, aerospace, and within technology: memory and storage. Convertible opportunities include semiconductor-related industries and fintech within the technology sector; and medtech and

biotech within the healthcare sector.” Overall, markets are expected to be flat in 2018 in the U.S., with more downside than upside risks.

“Europe has positively surprised in 2017 and could even be stronger in 2018,” **Joerg de Vries-Hippen, CIO Equity Europe**, notes, “As corporate earnings pick up, the euro has shown to be a minor headwind so far.” The euro has been buoyed by stronger economic indicators and the successful pushback against the populist tide in 2017. “And we expect continued gains in 2018.” While domestic GDP growth is expected to support local consumption, political risks have not gone away entirely. As Brexit negotiations loom, it remains to be seen whether the Bank of England will be swayed more by Brexit-related inflation or Brexit-induced lower growth.

The theme of economic differentiation continues in Asia, where trans-regional trade – particularly with China – will become increasingly important if globalization loses steam elsewhere. **Raymond Chan, Chief Investment Officer, Equity Asia Pacific**, remarked: “Asian equities outperformed equities in other regions. Valuations remain supportive as earnings contribute to stronger performance. Larger countries in particular can boast of attractively valued equity markets,” China will continue its importance as a strategic asset class. “Through the ‘One Belt, One Road’ initiative and its mega-cap tech firms, China’s geopolitical and economic influence is expected to continue to grow,” continued Chan, “China-A shares are currently under-represented relative to China’s economic influence but this is set to change.”

Asia continues to offer good yield pick-up with the best fundamentals within emerging markets but investors may need to accept a lower rate of return in 2018. **David Tan, Chief Investment Officer, Fixed Income Asia Pacific**, commented: “Given the strong rally in Asian local currency bonds in 2017, we expect consolidation of Asian currencies to follow.” As bond yields have started to rise, making them more attractive, “We see potential investment opportunities in Asian local markets,” he said. As far as macroeconomic indicators are concerned, news flow has improved considerably in recent months. However, key threats such as those arising from faster Fed rate hikes, policy uncertainty, trade protectionism and geopolitical risks, remain. “Yield-seeking bond investors may find some relatively attractive opportunities in sovereign debt in Asia,” concluded Tan.

In 2018, investors will need to be increasingly selective. AllianzGI believes there are five investment implications which would matter most to investors:

Hunt for income: Monetary policy normalization won’t be good for benchmark bonds. Select opportunities in emerging-market debt and dividend-paying equities, particularly in Europe, can help. Overall, credit-based investments should remain attractive despite expensive valuations.

Protect purchasing power: The underlying trend inflation rate is drifting upward. Consider inflation-linked bonds in Europe and the US. Equities offer a real hedge against inflation. Also consider real assets with stable long term yields, such as infrastructure.

Watch valuations: Some valuations appear stretched. Equities in Europe and emerging markets aren’t overly expensive and have the potential to deliver attractive yields and real returns.

Seek growth: Look for growth stocks that benefit from the compounding returns of their business models. A contrarian call would be for cyclical value stocks to lead the way in 2018.

Stay active: Be selective in countries, sectors and currencies. Consider tail-risk hedging strategies. Aim to capitalize on volatility spikes and prepare to trim exposure to risky assets if cyclical data start to lose momentum.

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Data as at 30 September 2017 (*Data as at 30 June 2017).

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