» INVESTMENT STRATEGY INSIGHTS JAN: 2016

MICHAEL J. KELLY, CFA
Managing Director, Global Head of Multi-Asset

IS THIS YEAR'S OIL PRICE PLUNGE AND RENEWED YUAN DEVALUATION DÉJÀ VU OR SOMETHING DIFFERENT?

In August, copper – known as "Doctor Copper" for its forecasting ability – was plunging in unison with aluminum and oil, signaling a pothole in global demand. China's growth was stumbling, according to non-government-sourced data. Markets panicked until stimulus became evident, after which growth assets recovered. By then, the yuan's surprise devaluation was beginning to be understood as a move to replace its crawling peg to a surging US dollar with a new goal of seeking stability versus a trade-weighted basket.

Another plunge in oil and softness in the yuan feels like déjà vu. Yet copper and aluminum are strengthening this time. So this episode is not about global demand. Instead, there appears to be a spike in oil supply. The removal of OPEC's production ceiling has unleashed incremental supply from OPEC and Russia. The marginal shale producers have been able to hold on due to hedges that roll off by June. Innovation has also cut marginal costs to $40 per barrel. Oil's recent drop below this is accelerating a slowdown in US shale and North Sea production. Capital spending is plunging. Despite today's surprise increase in production, some are already calling for supply shortages by 2017.

High yield remains the fault line. While a summer spike in US high yield defaults has been evident for some time, the path to $60 oil is fortified by first breaching $30. Fortunately, the US high yield market still appears to be the primary holder of shale producer debt. This is not a case of systemic risk spreading throughout the banking system. Unlike a global demand shortfall, which was threatened in August and is fundamentally bearish in an intermediate-term sense when it actually transpires, supply-driven commodity weakness is bullish for global growth, even though short-term losers respond faster than longer-term winners. So what is bothering markets?

Unlike August's yuan devaluation, which was instigated by the People's Bank of China (PBOC), market forces are now encroaching on China's ability to seek a stable yuan versus a trade-weighted basket. The offshore yuan is expressing the view that it should be weaker as long as China's economy is at risk of a hard landing. The PBOC is burning through massive currency reserves in an attempt to defend its currency and maintain stability versus a basket. Like us, the PBOC apparently believes China's economy will soon turn for the better, and private indicators of China's true GDP are beginning to support this expectation. Meanwhile, until more convincing data arrive, the PBOC is arm-wrestling with powerful market forces. If it fails to provide stability versus a basket of trading partners (forget the US dollar), this would be bearish for sentiment on emerging markets, whose currencies will also decline in sympathy. Yet a redistribution of currency winners and losers is not fundamentally bullish or bearish for global assets – it's merely another reason to own developed markets.

DIFFERENCES OF OPINION

THE WHOLE SHALL BE GREATER THAN THE SUM OF ITS PARTS:
PineBridge believes that not only do differences of opinion make markets, but they also foreshadow substantial moves ahead as these differences are resolved. As a multi-asset firm with investment professionals in nearly two dozen countries, we have a special platform to elevate and nurture debate across investment teams and regions. Such debate hones in on our internal differences of opinion in an attempt to develop well-rounded views within PineBridge, seeking an edge on other market participants. The objective of our Investment Strategy Insights meeting is that all our teams will contribute to, and benefit from, the firm's investment strategy ecosystem.

ABOUT THIS REPORT

Once a month, investment leaders from our Global Multi-Asset, Equities and Fixed Income teams meet to share information, opinions and viewpoints. They are joined once a quarter by our Alternative Investments teams. This cross-asset class discussion allows us to learn from differences of opinion.

THE PINEBRIDGE MULTI-ASSET SERIES:

CAPITAL MARKET LINE
Quarterly five-year forecast of relative risk and return across asset classes.

MULTI-ASSET STRATEGY
Monthly asset class convictions and risk positioning.

INVESTMENT VIEWS & CONVICTION SCORE (CS)

Economy

Markus Schomer, CFA, Chief Economist

CS 2.75 (unchanged)

The most surprising outcome of the December Federal Reserve meeting was the unchanged hawkish rate hike "flight path." The median forecast still shows the Fed expecting four rate hikes per year in both 2016 and 2017. This is at least double the amount of rate hikes we are forecasting. We expect global monetary policy, especially from the European Central Bank (ECB) and Bank of Japan (BOJ), to remain stimulative and supportive of risk assets. We expect global growth to accelerate to 3.4% in 2016 from 3.0% in 2015, a key driver being the rebound of emerging market (EM) growth on the back of modestly rising commodity prices.

Rates

Amit Agrawal, Senior Portfolio Manager, Government and Inflation-Linked Credit

CS 3.5 (+0.5)

Lower Treasury market volatility and longer-dated yields suggest the market does not share the Fed's inflation optimism. We see risk that the market is too sanguine on US inflation, and think higher wages may be a bigger inflation story than the impact of oil in 2016. We expect the 10-year Treasury yield to remain in a 2.1%-2.6% range in 2016, ending the year closer to the higher end.

We advocate an overall "short" portfolio duration with a bias for a steeper curve and continue to like the four-, six-, and eight-year parts of the curve for attractive roll down. We continue to tactically play the 10-year range. We maintain an overweight in US Treasuries in shorter to intermediate maturities relative to other G3 countries given attractive yield pickup and an expectation of one Fed rate hike (maximum two) in 2016.

Credit

Steven Oh, CFA, Head of Global Credit and Fixed Income

CS 2.0 (-0.75)

The recent credit selloff, particularly in US high yield, has created attractive valuations outside of commodities. However, we see downside tail risk in the near term, and technical pressures may create a crisis not warranted by fundamentals. In 2016, credit should be at its most attractive point since 2011.

We continue to favor loans over high yield on a risk-adjusted basis, but find the non-commodity segment of high yield attractive. We still prefer developed markets non-investment grade over investment grade and developed over emerging markets. European credit appears to have the best technicals and fundamentals and should provide some portfolio stability, but tight spreads make it difficult to overweight.

Currency (USD Perspective)

Tim Fox, Portfolio Manager, Emerging Markets Fixed Income

CS 3.0 (unchanged)

We like non-US dollar securities on a hedged basis except for the euro and yen. Developments from China are consistent with our expectations that the trade-weighted US dollar will continue to appreciate (mainly against the yuan, Mexican peso, and Canadian dollar). The performance of the US dollar versus the G10 may be more mixed, with commodity currencies (Australian, New Zealand, and Canadian dollars and Norwegian krone) underperforming the euro and yen.

Poor year-end liquidity and downside threat to risk sentiment in the wake of the recent Fed decision make owning local EM assets on an outright basis undesirable. That said, we are looking for weakness to buy into among select EM stories that offer good risk reward (Russia, Mexico, and Malaysia).

CONVICTION SCORE (CS)

Investment team views on how portfolios should be positioned for the next six to nine months.

1 = Bullish 5 = Bearish

Change from prior month is indicated in parenthesis.

INVESTMENT VIEWS & CONVICTION SCORE (CS)

EM Fixed Income

John Bates, Research Analyst, Emerging Markets Fixed Income

CS 2.5 (-0.50)

Several headwinds have hurt risk assets: continued lower commodities prices, the knock-on impact of the Brazilian "car wash" scandal, rating downgrades, and the retreat of secondary market liquidity into year end. The turmoil in the US high yield market added to the pressure. Overall valuations in the EM corporate "B" rating band look cheap versus developed markets, although at the "BB/BBB" level they look more like fair value. The positive technical picture remains, with 2015 primary issuance lagging 2014 levels by 40% and supportive high cash balances.

We see pockets of value amid year-end volatility and await signals of an EM growth revival in the first half of 2016, as well as continued proof that fundamentals are holding up in the face of, among other things, lower commodities prices in 2016.

Multi-Asset

Tatsushi Maeno, CFA, Head of Investments, Multi-Asset

CS 1.8 (unchanged)

Next year, economic stimulus packages should help China rebound from the sluggish growth path of 2015. Europe will follow a stable recovery path in 2016 due to quantitative easing, a weaker euro, and lower energy prices.

We continue to favor European and Japanese equities, shifting toward Japan this quarter, which has macro and micro catalysts. Within US equities, our view of the business cycle favors value over growth. In EM, we prefer those with a visible reform initiative effect, such as India and Mexico. As rates begin to rise, we favor bank loans to EM asset classes in fixed income. We are neutral on commodities, private equity, and hedge funds of funds.

Global Equity

Jason Weiss, Portfolio Manager, Equities Fundamental

CS 2.75 (unchanged)

A continued cyclical recovery in Europe, as well as domestic Japan opportunities, supports domestic market exposure. Further stimulus in Europe and Japan, plus Chinese stimulus and reform actions, suggests interesting investment opportunities will continue to emerge. The weak and uncertain economic outlook over the past several years has led investors to focus on companies with structural growth opportunities, or those augmenting weak top-line growth with capital return strategies. We are interested in more mature stable businesses with value that can be unlocked through mergers and acquisitions or activism, typically late in the cycle.

US equities continue to become less attractive, while we favor Asia-based technology and consumer-facing companies. Attractive sectors remain those with structural tailwinds in industries such as media and telecom, as well as in parts of IT. We remain skeptical on base metals and bulk commodities given ongoing weak demand trends, but underlying prices are falling significantly.

Global Emerging Markets Equity

Andrew Jones, Portfolio Manager, Emerging Markets Equities

CS 3.0 (-0.50)

Sentiment on emerging equities has turned pessimistic again despite the Fed finally raising rates. Recent developments are mainly negative, particularly for Bihar and South Africa. We remain concerned about structural challenges for several EMs but believe valuations are neutral.

We find consumer-oriented capital markets products attractive. Among countries and regions, we like Mexico, central Europe, and China and are negative on Colombia, Thailand, and Malaysia.

Quantitative Research

Sheedsa Ali, CFA, Portfolio Manager and Head of Quantitative Equity Alpha Research
Haibo Chen, Quantitative Analyst, Quantitative Research

Value premia, the strategy that profits from the long-term tendency of cheap stocks to outperform expensive stocks, has exhibited a stagnant return since 2007-2008 (as measured by the price-to-book, or B/P, ratio). This year within the Russell 1,000 universe, the B/P strategy returned around -15% while the earnings-to-price (E/P)-based strategy in the same universe returned around 13%. This splintered performance of value factors has amplified since the global financial crisis. Value has become entangled with default risk and profitability. Barring a few episodes of risk taking, we have been in a long stretch of high risk aversion post 2008. In these periods, stocks with high default probability – stocks that screen "cheap" by B/P – tend to underperform.

DISCLOSURE STATEMENT

PineBridge Investments is a group of international companies that provides investment advice and markets asset management products and services to clients around the world. PineBridge Investments is a registered trademark proprietary to PineBridge Investments IP Holding Company Limited.

For purposes of complying with the Global Investment Performance Standards (GIPS®), the firm is defined as PineBridge Investments Global. Under the firm definition for the purposes of GIPS, PineBridge Investments Global excludes some alternative asset groups and regional legal entities that may be represented in this presentation, such as the assets of PineBridge Investments.

Readership: This document is intended solely for the addressee(s) and may not be redistributed without the prior permission of PineBridge Investments. Its content may be confidential. PineBridge Investments and its subsidiaries are not responsible for any unlawful distribution of this document to any third parties, in whole or in part.

Opinions: Any opinions expressed in this document may be subject to change without notice. We are not soliciting or recommending any action based on this material.

Risk Warning: All investments involve risk, including possible loss of principal. Past performance is not indicative of future results. If applicable, the offering document should be read for further details including the risk factors. Our investment management services relate to a variety of investments, each of which can fluctuate in value. The investment risks vary between different types of instruments. For example, for investments involving exposure to a currency other than that in which the portfolio is denominated, changes in the rate of exchange may cause the value of investments, and consequently the value of the portfolio, to go up or down. In the case of a higher volatility portfolio, the loss on realization or cancellation may be very high (including total loss of investment), as the value of such an investment may fall suddenly and substantially. In making an investment decision, prospective investors must rely on their own examination of the merits and risks involved.

Information is unaudited, unless otherwise indicated, and any information from third party sources is believed to be reliable, but PineBridge Investments cannot guarantee its accuracy or completeness.

PineBridge Investments Europe Limited is authorised and regulated by the Financial Conduct Authority ("FCA"). In the UK this communication is a financial promotion solely intended for professional clients as defined in the FCA Handbook and has been approved by PineBridge Investments Europe Limited. Should you like to request a different classification, please contact your PineBridge representative. Approved by PineBridge Investments Ireland Limited. This entity is authorised and regulated by the Central Bank of Ireland.

In Australia, this document is intended for a limited number of wholesale clients as such term is defined in chapter 7 of the Corporations Act 2001 (CTH). The entity receiving this document represents that if it is in Australia, it is a wholesale client and it will not distribute this document to any other person whether in or outside of Australia.

In Hong Kong, the issuer of this document is PineBridge Investments Asia Limited, licensed and regulated by the Securities and Futures Commission ("SFC"). This document has not been reviewed by the SFC. PineBridge Investments Asia Limited holds a Representative Office license issued by the Central Bank of UAE and conducts its activities in the UAE under the trade name PineBridge Investments Asia Limited– Abu Dhabi. This document has not been reviewed by the Central Bank of UAE nor SFC. In UAE, this document is issued by PineBridge Investments Asia Limited – Abu Dhabi Representative Office.

PineBridge Investments Singapore Limited is licensed and regulated by the Monetary Authority of Singapore (the "MAS"). In Singapore, this material may not be suitable to a retail investor and is not reviewed or endorsed by the MAS.

PineBridge Investments Middle East B.S.C.(c) is regulated by the Central Bank of Bahrain as a Category 1 investment firm. This document and the financial products and services to which it relates will only be made available to accredited investors of PineBridge Investments Middle East B.S.C. (c) and no other person should act upon it. The Central Bank of Bahrain takes no responsibility for the accuracy of the statements and information contained in this document or the performance of the financial products and services, nor shall it have any liability to any person, an investor or otherwise, for any loss or damage resulting from reliance on any statement or information contained therein.

Last updated 16 June 2014