GENERALI INVESTMENTS

Market Perspectives

May 2017

Content

Global View

Thomas Hempell

- **Financial markets, especially in Europe, reacted with great relief to the outcome of the first round of the presidential elections in France. Equities soared and risk premia on French and Southern European sovereign debt declined sharply.**
- **While not a done deal yet, a fairly likely victory by Emmanuel Macron in the run-off on May 7 to the French presidency will help to further dissolve fears of EU disintegration.**
- **Amid an overall still solid macro backdrop, the Fed will proceed with its gradual rate normalization.**
- **In the resulting environment of gradually rising yields, euro area equities and corporate bonds are likely to outperform US assets as well as low-yielding Bunds.**

Largely triggered by relief over the outcome of the first round of the French presidential elections, financial markets terminated the past month with gains in European equities and a stronger euro. Yields on German Bunds rose, while the risk premium on French and Southern European sovereign debt fell noticeably.

	Growth			Inflation		
	2016e	2017f	2018f	2016f	2017f	2018f
US	1.6	2.2	2.3	1.3	2.3	2.4
Euro area	1.7	1.6	1.4	0.2	1.6	1.5
China	6.7	6.5	6.2	2.1	2.3	2.3
World	3.1	3.4	3.5	2.4	2.7	2.8
f= forecast						

The first round of French presidential elections was clearly the most prominent market event. The centrist and pro-European candidate Emmanuel Macron secured most of the votes (24%) while the far-right Marine Le Pen, who favors a 'Frexit', also secured a share high enough to enter the run-off on May 7. For markets, the result was nevertheless very reassuring in at least three aspects. First, a worst-case scenario, in which the second round of the elections would be decided between anti-European candidates from the far right (Le Pen) and far left (Mélenchon) was avoided. Second, the result still saw Mr. Macron faring first, highlighting his good chances for the run-off. Finally, after the reliability of polls had been repeatedly questioned in particular after the unforeseen UK Brexit vote last year, French surveys matched the outcome well.

Jointly, these aspects make it fairly likely that Emmanuel Macron will emerge as the next President of France. In the polls, he has been leading consistently by a margin of 20-30 pp this year for a projected run-off between the two. This would help greatly to further soothe concerns that the calling for a Frexit referendum may trigger an accelerated process of European disintegration. And while it remains unclear to what extent Macron will be able to pursue his agenda of economic reforms under a likely 'cohabitation' with other parties in parliament, greater economic damage from sharp protectionist measures envisaged by Le Pen will be avoided.

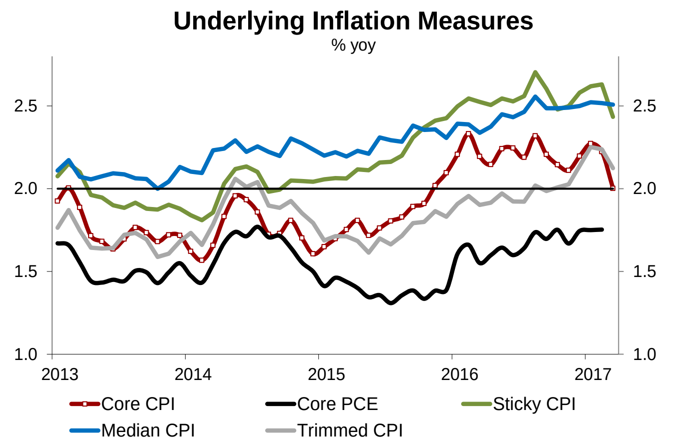
This may well bring the overall decent global economic environment to the forefront again for investors over the coming weeks. While recent indicators in the US came in on the softer side, we anticipate a moderate growth acceleration over the coming months. This will also keep the Fed in a position to proceed with its measured but more steady normalization of monetary policy, with the next rate hike likely in mid June. The odds that US President Trump will succeed in quickly proceeding with promised tax cuts have come down recently after the failure to go ahead with overhauling health care. But some fiscal relief and solid consumption will be strong enough to lift growth above 2% this year and lower the unemployment rate even somewhat further. The ECB will pursue its very accommodative stance for longer, but the recent surprisingly decent upswing in the euro area will gradually pave the way for the ECB to announce the tapering of its asset purchases – € 60 bn per month since April – for 2018 later this year.

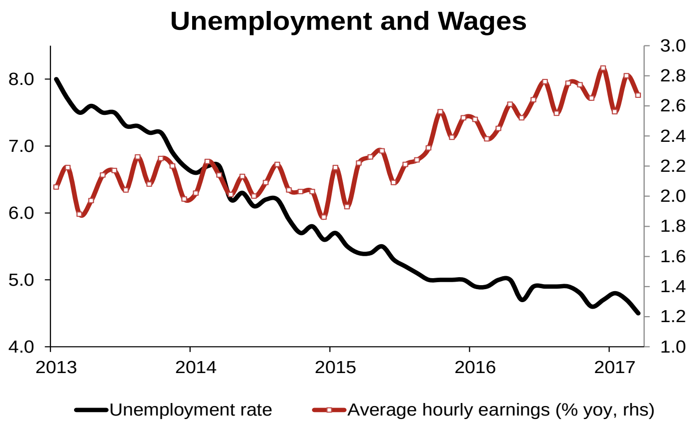
Bonds	**Current**	**3M**	**6M**	**12M**
10-Year Treasuries	2.30	2.40	2.55	2.80
10-Year Bunds	0.36	0.45	0.55	0.70
Corporate Bonds	**Current**	**3M**	**6M**	**12M**
IBOXX Corp. Non Fin	137	135	140	145
IBOXX Corp. Sen. Fin	126	125	130	135
Forex	**Current**	**3M**	**6M**	**12M**
USD/EUR	1.09	1.08	1.09	1.10
JPY/USD	111	113	115	120
Equities	**Current**	**3M**	**6M**	**12M**
S&P500	2383	2380	2375	2355
MSCI EMU	125.4	126.0	126.5	126.5
Current Values = average of closings April 24-26				

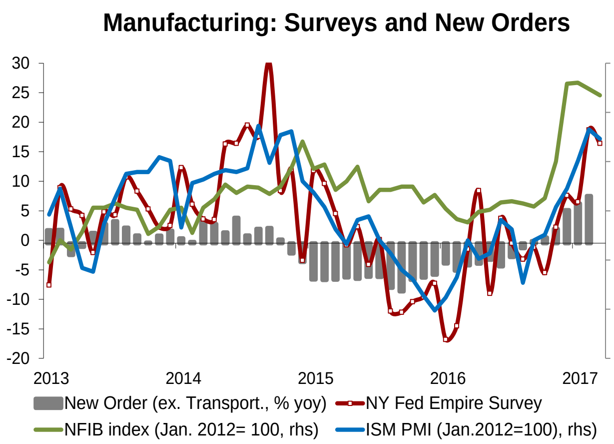
Against this background of decent economic data and gradually unwinding central bank support led by the Fed (and barring an escalation of geopolitical tensions around North Korea), upside forces on yields are likely to prevail again, led by US Treasuries. At the same time, we anticipate spreads on European corporate bonds to tighten slightly, providing decent returns amid overall still depressed yield levels. We also continue to favor European equities thanks to recovering profits and overall still decent valuations. By contrast, very low-yielding Bunds may suffer from rising yields, while the euro is likely to hold up fairly well over the coming weeks.

USA

Paolo Zanghieri







- **The expectation of a smaller and delayed fiscal stimulus led us to revise down the GDP forecast for this year (2.2%) and 2018 (2.3%)**
- **Despite temporary setbacks, job creation continues and core inflation remains steadily above 2%, with some upside potential.**
- **Against this backdrop, we still anticipate the Fed to proceed with normalizing rates, with the next rate hike by 25 bps likely in June, followed by another move in H2.**

High frequency data point to a somehow weaker than expected growth in Q1 (around 1.3% qoq annualized). This is mostly due to a strong negative effect of rising inflation on consumption. However, economic fundamentals, first of all those of the labor market, remain consistent with an underlying GDP growth of around 2%. The setback suffered in March by the administration on the healthcare reform has reduced the likelihood of a far reaching tax reform capable of permanently boosting growth. We still expect some tax cuts and incentives to infrastructure investment, but on a lower scale than what projected just after Mr. Trump's election and which will start bearing fruit around the turn of next year, slightly later than expected. As a consequence we marked down our GDP forecast for 2017 (from 2.4% to 2.2%) and 2018 (from 2.5% to 2.3%).

The weakening in March inflation, with the headline rate down from 2.8% to 2.4% and the core rate from 2.2% to 2.0%, was due to both a stabilization in the energy component and a large, one-off decrease in TLC prices. However, the key drivers of core inflation (rents, healthcare and non oil import prices) do not show any signs of weakening. Moreover, labor market tightening (in March the unemployment rate fell to 4.5% the lowest level in ten years) is expected to sustain wage growth at or slightly above the 2.7% yoy seen in March, supporting core inflation. Therefore, we do not change much our outlook; headline inflation will average 2.3% this year and 2.4% in 2018.

Strong sentiment and higher orders

Higher inflation is lowering household purchasing power leading to a slowdown in consumption growth. However, we expect it to be relatively mild, as labor income will continue to grow steadily. The increase in interest rates should not affect much purchases, as borrowing costs for households are at their historical low. However, the durability of the cyclical rebound requires a sustained pick up in investment. In this sense the evidence from the manufacturing sector is overall positive. In March, the manufacturing PMI retrenched a bit (to 57.3) from the post crisis peak of 57.7 recorded in February, which, together with positive signals coming from other surveys, still indicates a convincing rebound in the industry.

USA

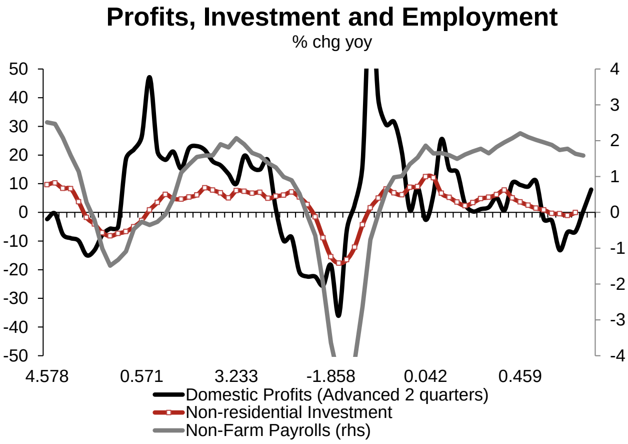
Optimism reflects not just expectations of lower taxes and looser regulation, but also hard data signaling an improved outlook for manufacturing. For example, after 19 months of contraction industrial production first stabilized in year on year terms in November before rebounding (it was up 1.5% yoy in March). Moreover, the mild appreciation of the USD halted by the turn of the year. Stronger foreign and domestic sales and still contained input costs are in turn supporting profits. Better sentiment is being matched by stronger orders. In February, new orders excluding transportation were up by 7.5%, the largest gain in over five years.

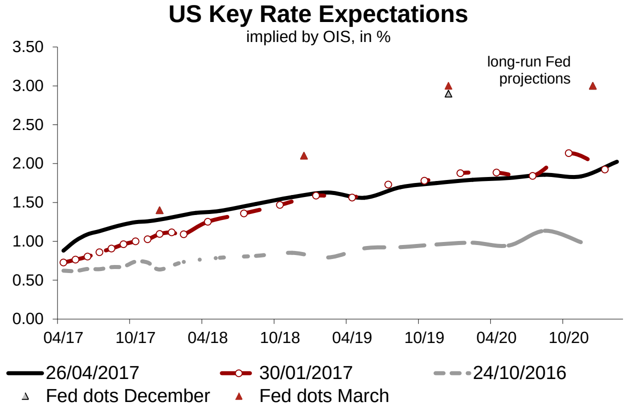
A scaled down fiscal stimulus remains likely

On April 26 the administration presented its view on the tax reform. In line with the pledge made during the campaign, it foresees a 20 bps reduction of the statutory tax rate on corporate income, to 15%, the scrapping on some wealth taxes and lower rates on personal income tax. No mention was made of two crucial points: the border adjustment tax (which would rule out deductions on imported inputs) and changes in the regime for interest payments and investment. The lack of details on how these cuts would be financed and the strong aversion to a larger deficit by a substantial part of the Republican majority in the Congress greatly reduce the likelihood of their full approval. We still expect a tax reduction to be passed into law by the end of the year or in the first months of 2018. It will entail just a relatively small (no more than 10 pp) cut in the statutory corporate tax rate and limited measures in terms of deductibility, while reductions in personal taxes should proceeded more smoothly. The official budget proposal, to be presented to the Congress by mid-May will provide more clarity on the future fiscal stance. However, divisions within the majority, amid record-high political polarization in the Congress (which reduces the scope for bipartisan agreements) introduce uncertainty on the timing and scale of the tax cuts.

Rate normalization to continue

Despite some volatility, the recent data on inflation and labor market remain consistent with interest rate tightening. We expect the Fed to increase rates by 25 bps in June, barring some very large adverse surprises (like escalating geopolitical tensions). Therefore, and in line with what happened at the beginning of this year, the Fed will start, over the coming weeks, to adapt the communication in order to nudge markets towards a rate hike. We expect another rate increase in the second half of the year. The issue of balance sheet reduction will come to the fore no earlier than in the second half of the year. In order to prepare markets to that, an announcement of a gradual ceasing of reinvestment policy may come even as soon as at the FOMC September meeting.



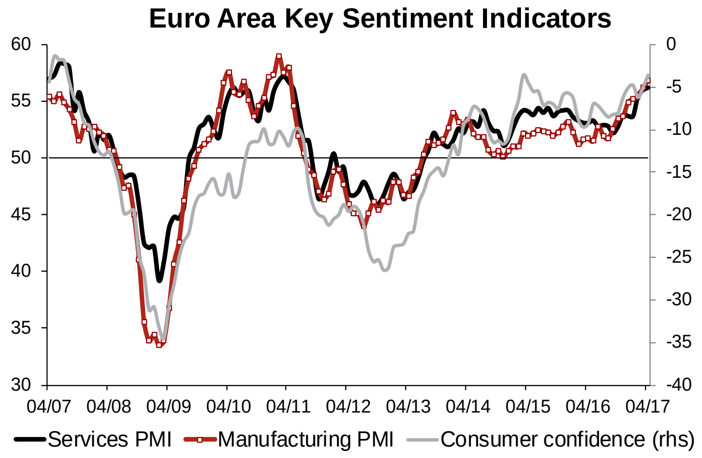


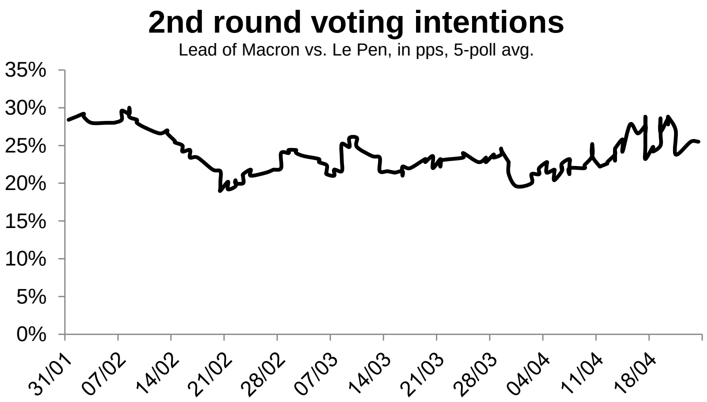
Main Forecasts[1)]	2015	2016	2017f	2018f
GDP	2.6	1.6	2.2	2.3
Consumer spending	3.1	2.8	2.3	2.4
Gov. consumption	0.7	0.9	0.8	0.5
Investment	5.4	1.8	4.9	4.6
- residential inv.	8.9	7.8	5.1	4.2
- structures	-1.5	-2.3	4.2	3.8
- intell. property production	5.7	1.9	4.2	5.4
- equipment/software	3.1	0.4	5.5	4.6
Inventories	0.4	-0.3	-0.2	-0.2
Exports	1.1	2.7	4.1	3.6
Imports	4.9	4.2	5.2	5.4
Net trade	-0.6	-0.3	-0.3	-0.3
Domestic demand	3.2	2.3	2.5	2.4
Consumer prices	0.1	1.3	2.3	2.4
Unemployment rate[2)]	5.3	4.8	4.5	4.4
Budget balance[3)]	-2.5	-2.9	-3.3	-4.4
Fed Funds Rate[4)]	0.38	0.63	1.38	2.13

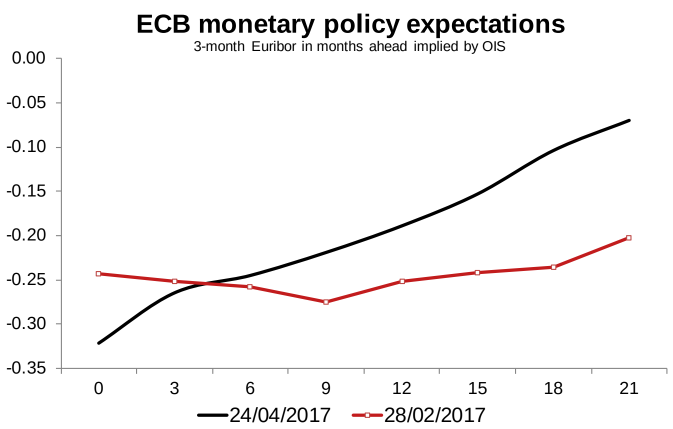
1) Unless noted otherwise, annual % changes, net trade and inventories: growth contribution to GDP 2) yearly average as %, 3) in terms of GDP, federal deficit 4) as %; year-end

Euro Area

Martin Wolburg







- **The April flash composite PMI reached the highest level since April 2011 indicating that the good start into 2017 carries over into Q2.**
- **Concerns surrounding the French presidential elections have not materialized. We expect the center candidate Macron to win also the second round of election on May 7.**
- **The ECB maintained its policy stance at the April meeting. Looking ahead, we expect the tapering discussion to start after the June meeting.**

In April, the surge in sentiment continued in the euro area. The composite flash PMI advanced to 56.7, the highest level since April 2011 and well one standard deviation above average. Also, a look at the details confirms the positive message provided by the headline number: First, sentiment improved in the more domestically oriented service sector (to 56.6, from 55.5) as well as in the export oriented manufacturing sector (to 56.2, from 55.4). Second, forward-looking components like business expectations and new export orders also advanced. Third, the latest PMI survey suggests that the pick up of employment (Q4 2016: +0.3% qoq) continues so that the backbone of the euro area recovery stays intact.

The positive tone of the PMI survey was also mirrored by national surveys like the Ifo for Germany or the ISAE for France. Moreover, flash consumer confidence further improved in April. This defies concerns that higher inflation (of 1.9% yoy in April according to the flash estimate) as a result of fading disinflationary effects from oil prices or political risks may eat into real consumption activity.

France on track to get a reformist president

The outcome of the first round of the French presidential elections that took place on April 23 was taken with relief. The reformist candidate Macron got the highest share of votes (24.0%), followed by the right-wing candidate Le Pen (21.3%). The fact that the outcome was in line with latest polls eases concerns that Le Pen would become France's next president. Polls on a run-off between Macron and Le Pen consistently show a lead of the former of at least 20 pps over the latter (see mid-chart).

With Macron becoming president the risk of a French EU referendum and hence of a EMU breakup in the aftermath of a Frexit is off the table for the time being. Moreover, the agenda of Macron foresees measures to improve the flexibility of the labor market, lower social security contributions as well as corporate taxes and boosting innovation. To what extent he will be able to push through his agenda will also depend on the outcome of the parliamentary election to be held in June (June 6 and June 18). The party of Macron (En marche, EM)

Euro Area

has been newly founded. Therefore we deem it questionable that he will be backed by a majority of his own party in parliament. We rather expect him to form alliances with the more centrist MPs from the Socialists and the center-right. After the presidential election, polls on the share of EM in the new parliament will hence serve as an indicator for the future degree of reform in France.

Growth risks shifted to the upside

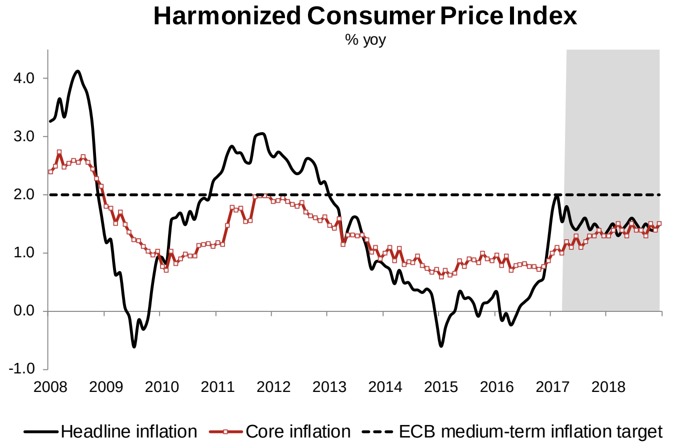
Against the backdrop of continuously improving sentiment and the Frexit risk off the table, our growth outlook of 1.6% for 2017 might look shy. PMIs would suggest quarterly growth rates of 0.6% to 0.7% qoq in the first and the second quarter. However, the hard data flow displays a less enthusiastic picture so far. Based on data until February, industrial production weakened (- 0.1% qoq), retail sales advanced moderately (+0.2% qoq) while construction output soared (+1.1% qoq). These data argue for a Q1 growth rate of only 0.3% to 0.4% qoq. Therefore, we refrain from lifting our growth outlook now but will reassess it after the release of the Q1 GDP flash estimate on May 3. In any case, the risks for growth outlook have shifted to the upside.

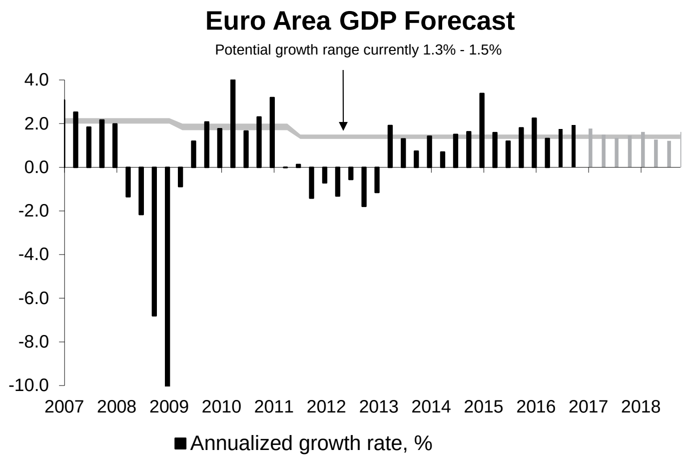
ECB to focus on tapering after June meeting

As we had already stressed before, with the composite PMI having passed the threshold of 55, sentiment has reached a territory historically consistent with key rate hikes. This together with higher headline inflation numbers as well as inflation expectations and hawkish comments from some Governing Council members contributed to a shift in monetary policy expectations. Whereas two months ago markets were looking for a broadly unchanged policy stance there are now pricing higher future money market rates (see bottom chart previous page).

At the April 27 meeting the ECB continued to send a dovish message while acknowledging that the balance of growth risks has improved. The current policy stance was still seen as adequate. The ECB maintained its forward guidance as well as the easing bias. It was once again emphasized that underlying inflation is key in determining the policy outlook. We expect underlying inflation (0.8% yoy in March) to only slowly trend upwards over the coming months on the back of solid growth, import prices and higher oil prices. Towards the end of the year it likely stabilizes at above 1%, still way below target.

We continue to look for the start of the tapering discussion in the second half of the year. Here, the update of the ECB growth and inflation outlook in June is likely to be pivotal. However, in our view the ECB does not want to tighten financial conditions already now and the current deposit rate of -0.4% facilitates QE. Therefore, we do not expect any change in short term rates in 2017.



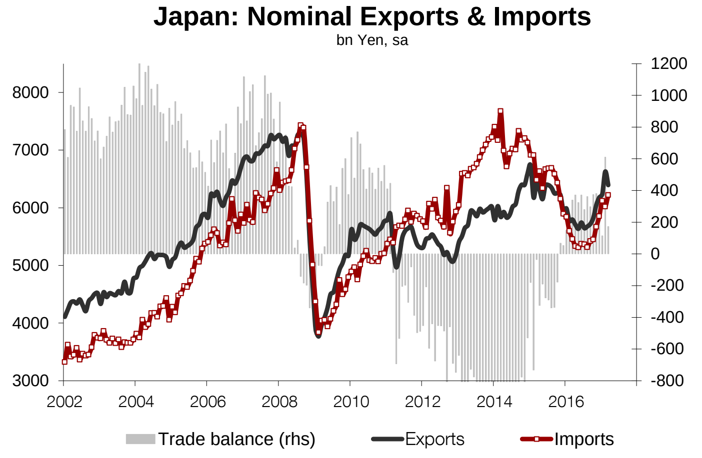


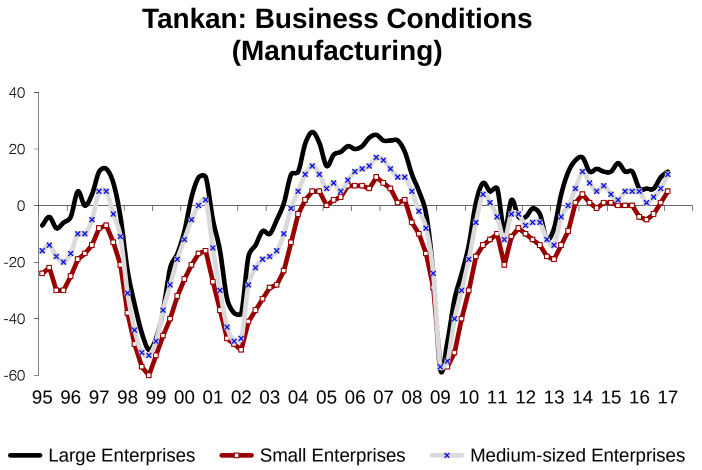
Main Forecasts[1]	2015	2016	2017f	2018f
GDP	1.9	1.7	1.6	1.4
Consumer spending	1.8	1.9	1.4	1.2
Gov. consumption	1.3	1.8	1.2	1.0
Total fixed investment	3.0	3.5	4.2	1.7
Inventories	-0.1	0.0	0.3	0.2
Net trade	0.2	-0.3	-0.5	0.1
Domestic demand	1.9	2.1	1.9	1.2
Consumer prices	0.0	0.2	1.6	1.5
Unemployment rate[2]	10.9	10.0	9.5	9.3
Budget balance[3]	-2.1	-1.7	-1.5	-1.5
ECB refi rate[4]	0.25	0.00	0.00	0.00

1) unless noted otherwise, annual % change, net trade and inventories: growth contribution to GDP, 2) yearly average as %, 3) ratio of budget balance to nominal gdp, 4) as %; year-end

Japan

Christoph Siepmann





Main Forecasts[1]	2015	2016	2017f	2018f
GDP	1.2	1.0	1.3	1.0
Consumer spending	-0.4	0.4	0.7	0.8
Government consumption	1.6	1.5	0.6	0.8
Investment	0.1	1.0	2.0	2.0
Inventories	0.4	-0.1	0.1	0.0
Net trade	0.4	0.1	0.2	0.1
Domestic demand	0.7	1.0	0.9	0.8
Consumer prices	0.8	-0.1	0.7	0.8
Unemployment rate[2)]	3.4	3.1	2.9	2.8
Budget balance[3)]	-3.5	-4.3	-3.9	-3.3

1) unless noted otherwise, annual % changes, net trade and inventories: growth contribution to GDP 2) yearly average as %, 3) in terms of GDP, general government 4) as %; year-end

- **Japan's economy currently benefits significantly from the international business cycle upturn while consumption continues to look soft.**
- **The BoJ maintained its yield curve targets and – given soft inflation – is likely to keep its policy stance constant at least until late this year.**

In the first quarter of 2017, Japan's exports continued to benefit from the international business cycle upturn. Apart from monthly fluctuations (likely a side effect of the Chinese New Year holidays), nominal exports increased on a seasonally adjusted basis by 6.7% qoq in Q1, after 5.9% qoq in Q4. Real exports went up by 2.9% qoq in Q1, also slightly higher than in Q4. Deliveries to neighboring Asia, incl. China were especially strong, while Q1 export growth to the US halved to about 1.5% qoq. As a consequence of the rising export performance, industrial production also continued to go up, although its rate diminished compared to the strong H2 2016. This was also visible in the manufacturing PMI which came in in April exactly on the Q1 average reading of 52.8 index points. In addition, the export-driven improvement also led to a better business confidence as represented in the BoJ's March Tankan report. While in the segment of large enterprises manufacturers and non-manufacturers reported the same absolute improvement, business conditions of medium and small-sized manufacturing firms improved much more than their service sector counterparts. Thus, the manufacturing upturn has broadened and international supply-demand conditions were more positively judged than domestic conditions. Rising production and business confidence typically also leads to higher investment over time. However, indications from the Tankan report or current machinery orders are still faint. Looking ahead, we expect the export upturn to continue although likely with less speed. This will also have a positive impact on production and over time on business fixed investment. Finally, regarding private consumption, recent indicators point at only a slight improvement of household demand compared to a flat a reading in Q4 2016. All in, we revised our GDP growth forecast up by 0.2 pp to 1.3% in 2017.

BOJ maintained its policy stance

In March, Japan's core inflation (CPI excluding fresh food) increased by 0.2% yoy, unchanged from February. Energy inflation has turned positive, while local utility prices have mitigated the impact. Of late, the yen has appreciated again, softening import price pressures which were mainly responsible for the slightly positive inflation rates. This constitutes a downside risk to our inflation outlook. In any case, the BoJ is still far away from its inflation targets and reduced again slightly its forecasts. Accordingly, it did not move its yield targets and we do not expect any change until late in this year.

China

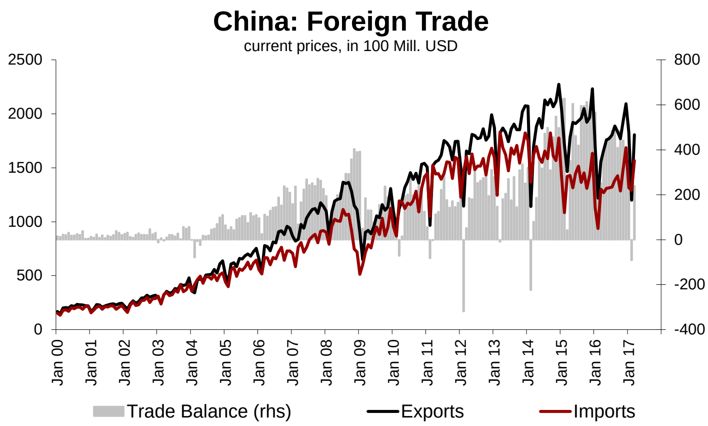
Christoph Siepmann

- **China's GDP growth came in at 6.9% yoy in Q1.**
- **Hard data improved in March while manufacturing PMIs were a bit more mixed. Overall, we forecast growth to remain broadly stable in Q2.**
- **We expect more small hikes of the BPoCs liquidity interest rates, in order to contribute to some de-risking of the financial sector.**

China's economy grew by 6.9% yoy in Q1 2017, slightly improving from the 6.8% yoy in the previous quarter. According to the breakdown by sector (which is the only one available short-term), the ongoing upturn can be completely attribu-ted to the manufacturing sector, including construction. Here, real growth advanced to 6.4% yoy, while the primary and the service sectors lost slightly pace. In nominal terms, the improvement is even much more visible. Growth of the industry sector shot up to 14.4% yoy, after 4.8% in Q4 2016. Construction accelerated to 12.0%, after 6.2% in the previous quarter. As these data imply, a re-inflation of the secondary sector contributed significantly to this develop-ment. This was already visible before in the strong rise of the producer price inflation to 7.6% yoy of late. Re-inflation is mainly located in the coal, ferrous metals and steel sectors, benefitting from the upturn in the real estate market, the governmental infrastructure projects and from capacity cuts. Consequently, worries regarding the debt-sustainability of these sectors have also receded.

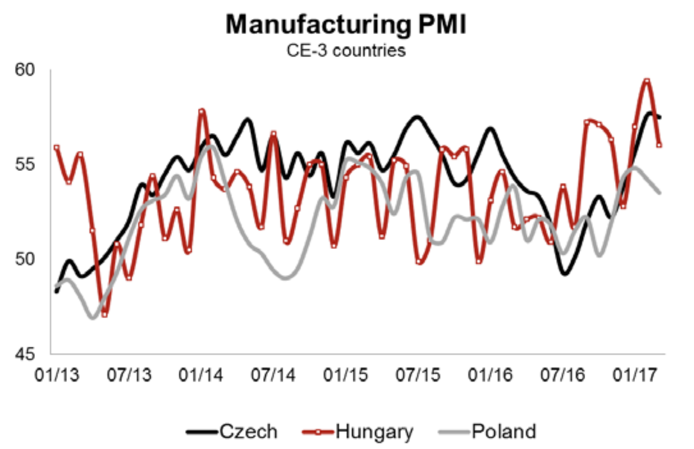
March data suggest ongoing stable growth

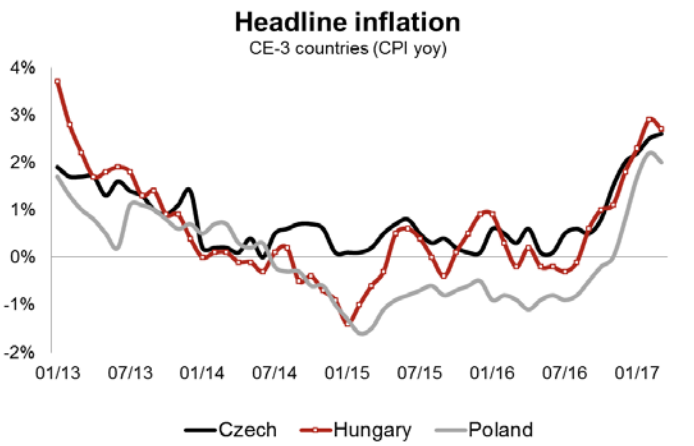
Looking ahead, March data as well as manufacturing PMIs point to overall stable growth in Q2. Industrial production as well as investment accelerated. Exports more than com-pensated the disappointing data at the beginning of the year. Property sales remained on high levels. However, property prices are still rising strongly at a rate of 11.3% yoy. Therefore, local governments will become even more restrictive, going forward. With regard to the central government, its overall investment growth has stayed in mildly negative territory since the start of 2017. However, infrastructure investment remained strong so far, but we expect fiscal policy to adjust expenses according to the GDP growth target of about 6.5%. SoE investment also moderated from last year's very strong readings. Finally, manufacturing PMIs were a bit more mixed. While the official NBS PMI advanced by 0.2 ip to 51.8, the Caixin manufacturing version receded by 0.5 ip to 51.2. However, both PMIs are still in comfortably expansionary territory, thus confirming the view of stable growth ahead near-term. On the monetary side, M2 growth has receded by 0.5 pp to 10.6% yoy, possibly signaling some effect of the liquidity tightening measures of the PBoC over the last months. However, total social financing grew by 4.3% in Q1, in-cluding slightly receding bank loans but still strongly rising more risky credit forms. Therefore, we continue to expect additional small moves of the PBoC to limit liquidity and thus contribute to some de-risking of the financial sector.



Central and Eastern Europe

Radomír Jáč





Main Forecasts	2015	2016	2017f	2018f
Czech Republic				
GDP	4.6	2.3	2.0	2.6
Consumer prices	0.3	0.7	2.4	2.0
Central bank's key rate	0.05	0.05	0.05	0.75
Hungary				
GDP	3.1	1.8	3.6	3.2
Consumer prices	-0.1	0.5	2.7	3.0
Central bank's key rate	1.35	0.90	0.90	1.50
Poland				
GDP	3.8	2.7	3.0	3.0
Consumer prices	-0.9	-0.6	2.0	2.0
Central bank's key rate	1.50	1.50	1.50	2.00

GDP and consumer prices: annual % change; CB interest rate: in %, year-end

- **Confidence surveys have been sending upbeat signals about economic activity in the region.**
- **Inflation started to moderate after the increase seen in early 2017, as pro-inflationary base effects of commodity prices is fading out.**
- **Czech CNB terminated its FX commitment but the CZK volatility is limited. Monetary policy outlook remains stable in Hungary and Poland.**

PMI surveys paint a positive picture of the economic activity in the CEE countries in 1Q. The economic growth is driven by household consumption, which is supported by positive developments in the labor market. Positive external environment, including economic performance of the euro area, is another key contributor to the growing activity in the CEE region. Investment expenditure should recover in this environment. The recovery of investment spending should also be supported by the increase in the funds' inflow from the EU budget used for projects co-financed by the government. The usage of these funds was relatively weak in 2016, which was caused by the start of a new financing period.

Inflation started to moderate in some of the CEE countries at the end of 1Q after the sharp increase seen in the first months of 2017, as pro-inflationary base effect of commodity prices (oil, food) is fading out. This factor may lead to further moderation of the headline inflation in 2Q. It is worth noting that only the Czech Republic has its headline CPI (2.6% yoy in March) above 2% central bank's target. We believe that this will be a local peak for Czech inflation for some time. However, Czech core inflation also stands above the 2% level (2.2% yoy in March) and exceeded CNB's forecast in 1Q. This contributed to the CNB's decision to terminate its commitment to keep EURCZK > 27. The exit should lead to tighter monetary conditions in Czech economy.

Czech crown allowed to firm below 27 vs. euro

The CNB terminated its FX commitment on 6 April. The CNB introduced its commitment to keep EURCZK > 27 in November 2013 and it had to intervene in the FX market heavily in past months in order to defend this level. The EURCZK has remained in a 26.55-27.00 range since the exit, i.e. the volatility is limited so far. The CNB expects somewhat sharper CZK gains, which should lead to tighter monetary conditions but the CNB indicates that the CZK firming may take some time (i.e., several months).

Hungarian central bank reduced limits for its 3-month deposit tender for 2Q in order to maintain loose monetary conditions. At the same time, it indicates that conditions should not be relaxed beyond the current level unless inflation moderates more than expected.

Polish central bank maintains a firm wait-and-see attitude and does not expect its key policy interest rate to be raised from the current level of 1.50% before 2018.

Bonds/Fixed Income Strategy

Florian Späte

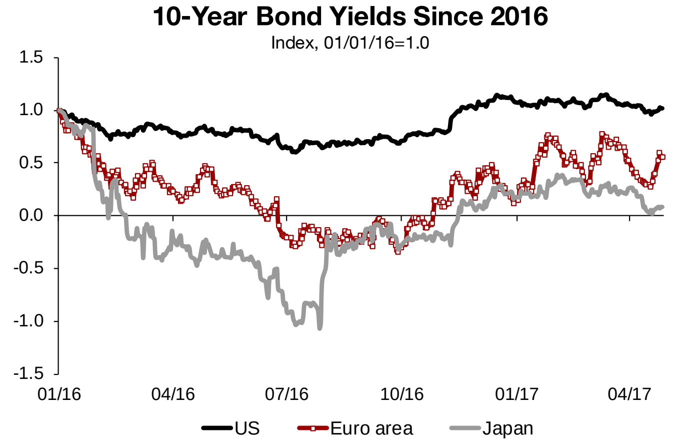
- **International bond markets were on a roller coaster ride in April. While weaker US economic data and uncertainty about reform plans triggered lower long-dated US yields, euro area core yields were dominated by the French election concerns. On balance, Bund yields hardly changed.**
- **French elections were the main driver for euro area sovereign spreads as well. Overall, spreads widened modestly with Italian BTPs once again underperforming.**
- **With an ongoing solid data flow and the reassuring result from the first round of French elections, preconditions for higher euro area core yields are in place. Accordingly, we recommend an even shorter duration for the months to come. In contrast, Southern European bonds' maturity should be aligned with the benchmark duration.**

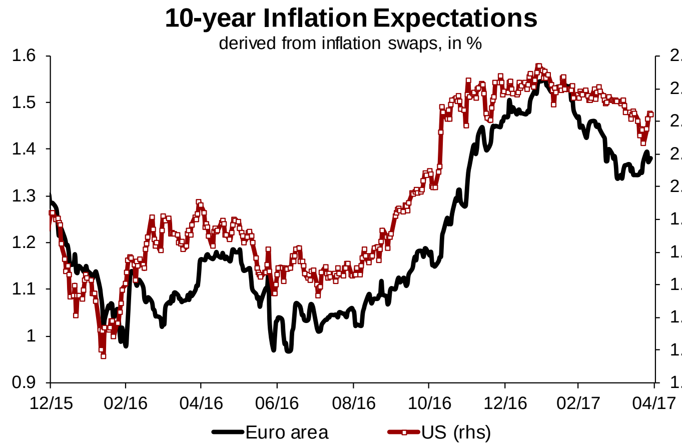
Politics were in the focus of international bond markets in April. On the one hand, concerns about the ability of the new US administration to deliver on the promised reform steps supported long-dated US Treasuries. On the other hand, the first round of the French presidential elections triggered safe haven flows in the first half of the month – only to be reversed later on. On balance, 10-year Treasury yields fell by 9 bps to 2.30% and 10-year Bund yields increased slightly from 0.33% to 0.36%. While the shape of the Bund yield curve did not change considerably in April, the US curve flattened with short-dated yields rising a bit.

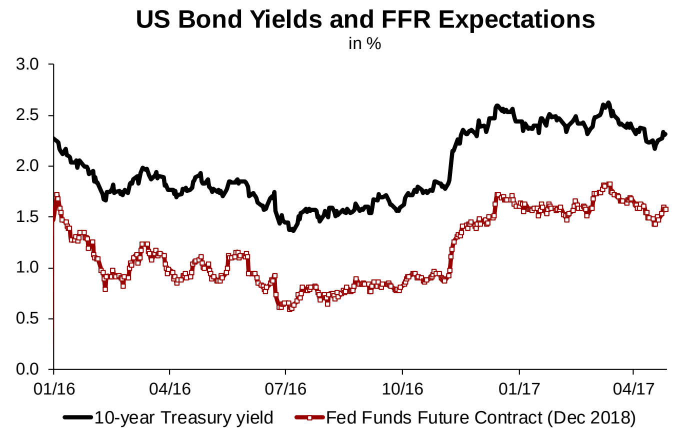
Transatlantic yield spread tightening unlikely to last

Going forward, we expect a bearish sentiment to prevail on international bond markets. First, the likely election of Macron as new French president should give further tailwind to risky assets and safe haven considerations are likely to take a backseat for the time being. Second, the macroeconomic data flow is still sound. Although some US data came in on the weaker side recently, an acceleration of US growth after a likely slowing in Q1 is on the cards. Euro area macroeconomic data continue to surprise on the upside indicating ongoing solid growth. Third, financial markets have got ahead of themselves regarding the future Fed monetary policy. Although Fed officials stressed that further key rate hikes are on the cards in the months to come and statements signalled a reduction of the Fed's balance sheet sooner rather than later, priced key rate expectations have fallen recently. Meanwhile, less than two 25 basis points key rate hikes and only a further one further in 2018 are discounted. Given the strong correlation of key rate expectations and sovereign yields, the likely correction is seen to drive up US yields as well.

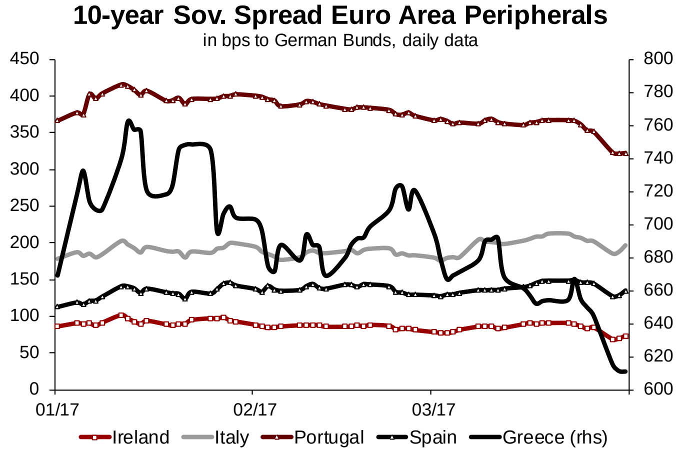
Particularly the diverging monetary policy stance is expected to trigger a re-widening of the transatlantic yield spread. We forecast five further key rate hikes by the Fed

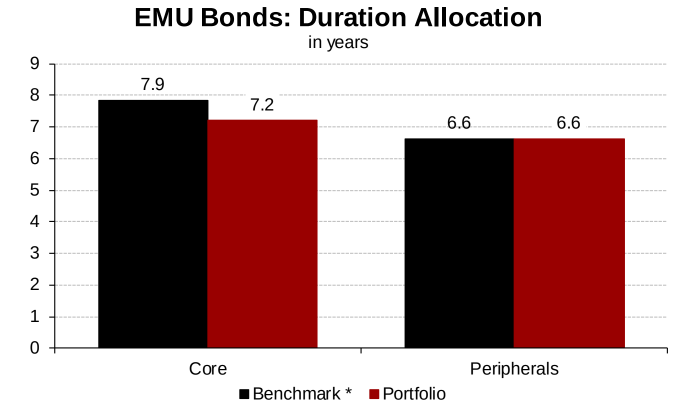




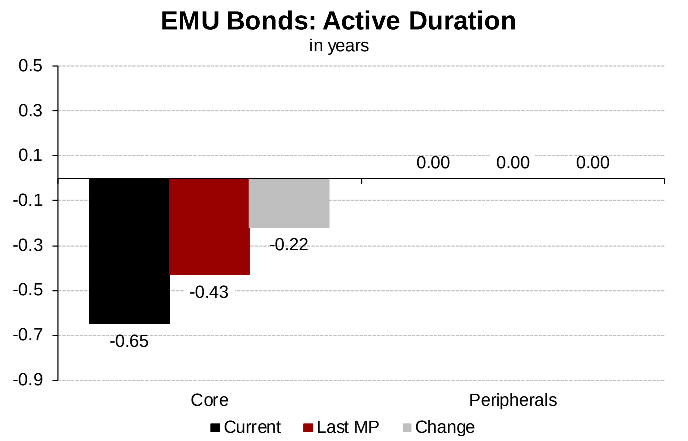


Bonds/Fixed Income Strategy





* JPMorgan EMU Government Bond Index



until the end of 2018 whereas the ECB is unlikely to start a new rate cycle already in 2018. While 2-year and 10-year US Treasuries are currently yielding around 200 bps more than Bunds, this spread should widen in H2.

Tailwind for non-core bonds by French elections

French elections were the main driver for non-core euro area sovereign bonds, too. While the expectation of a market benign outcome (and the actual result) led spreads lower, some profit taking towards the end of the month prevented a better performance of non-core euro area sovereign bonds. It is noteworthy that Portuguese and Greek bonds performed significantly better than Spanish and (even more) Italian bonds.

Assuming that Macron will become the new French president, non-core bonds are likely to get some tailwind in the weeks to come. In combination with solid economic data and a positive market sentiment, sovereign spreads have some leeway to tighten. However, this will not be sufficient to offset the forecast increase in Bund yields. Hence, yields of Southern European bonds will likely creep upwards as well – but peripherals will in our view still perform better than Bunds.

While concerns regarding the debt sustainability of Greece remain, progress between the Greek government and its creditors will likely trigger tighter Greek spreads. While the details of an agreement are still not known, recent statements indicate that the willingness to find a compromise is obvious. There is a good chance that the funds for Greece will be unblocked at the Eurogroup meeting on May 22. Hence, the good performance of Greek bonds has legs and can continue for a while.

In contrast, the political situation in Italy remains uncertain. While, in the short run, the good market environment might keep a lid on the BTP/Bund spread, further down the road the general elections which will take place at latest in Q1 2018 (but the risk of early elections in 2017 is not negligible) will come to the fore again. According to current polls, the political fragmentation can increase and even the formation of a government led by Euro-sceptic parties cannot be excluded.

Our portfolios

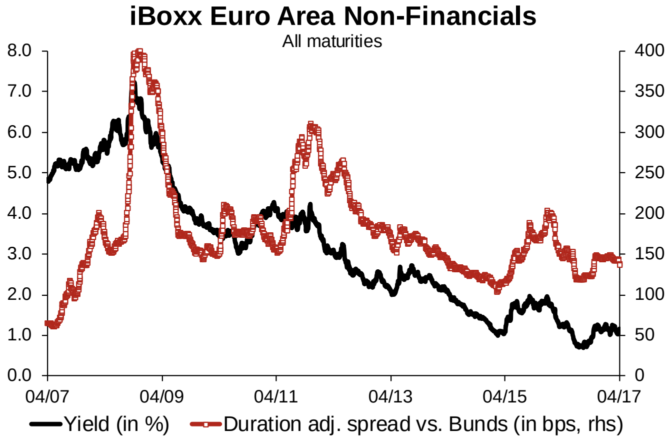
In this environment euro area core bonds are seen to underperform on a three month horizon (expected total return: -0.6%). While the short end of the curve is to a large extent still anchored by the ECB, the long end is expected to inch up. Accordingly, we recommend a short duration and even lower it to -0.65 years versus the benchmark. The higher carry and some spread tightening should support peripheral bonds (expected total return: -0.2%). Consequently, we refrain from a short duration and advise a duration in accordance with the benchmark.

Corporate Bonds (Non-Financials)

Florian Späte

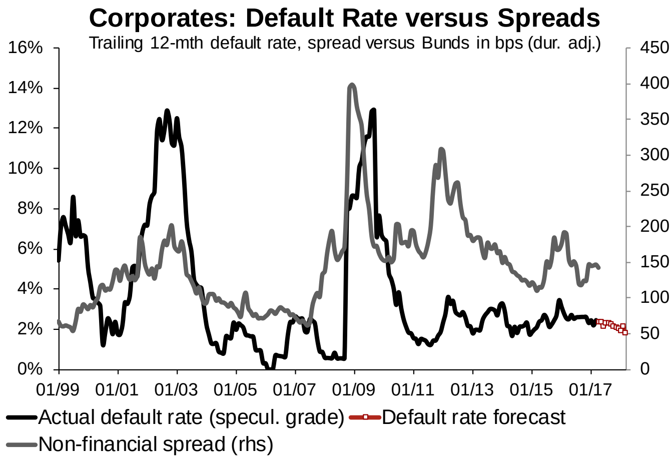
- **Non-financial corporate bond spreads broke out of their trading range in April. On balance, spreads tightened by 6 bps to the lowest level since November 2016.**
- **Political tailwind, ECB support and sound fundamentals should trigger a further moderate spread tightening in the weeks to come. Higher underlying yields and speculations about ECB tapering are likely to trigger wider spreads again further down the road.**
- **Given the low yield level and the forecast increase in underlying yields, the total return is seen to remain meagre.**

Euro area non-financial Investment Grade corporate bond spreads traded in a very tight trading range despite looming French presidential elections in the first weeks of April, but the actual result triggered a considerable tightening. Overall, non-financial spreads tightened from 142 bps to 136 bps. This is the lowest level since mid of November 2016. At the same time, the non-financial yield level decreased by 2 bps to 1.13%. Year-to-date the total return of non-financials is slightly positive at 0.3%.



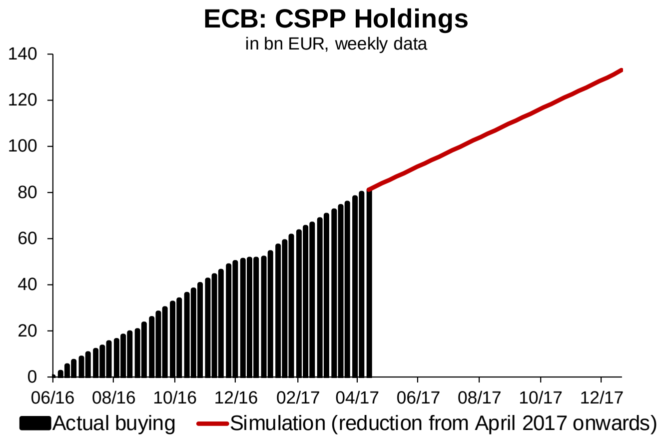
Impact of lower ECB purchases on CSPP uncertain

Going forward, there is scope for a continuation of the rally. First, the likely election of Macron should wipe off remaining concerns about a “Frexit” and should bring fundamentals to the fore again. Second, the balance sheets of European non-financials are solid and the already low default rate is expected to decrease further in the course of the year. Third, the ECB will continue to purchase non-bank IG corporates.



The impact of the reduced ECB purchases (from € 80bn/month to € 60bn/month) on the volume of non-bank bond buying is not clear yet. Although ECB purchases were reduced in the course of April, this can be attributed to the Easter holidays as well. Even if the ECB were to scale down corporate bond purchases proportionally (to around € 6bn/month), it would remain an important buyer in the market.

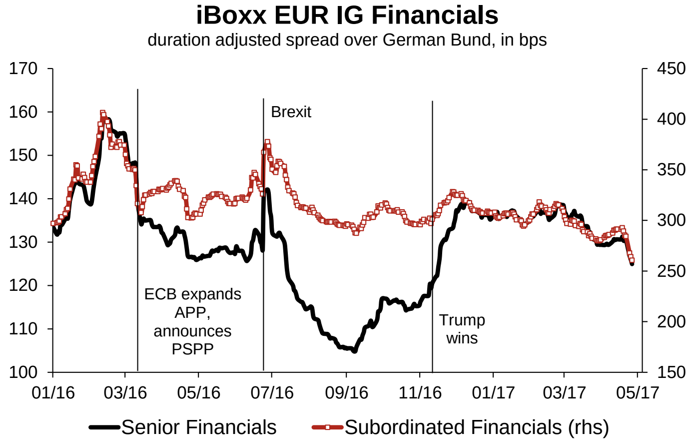
Despite the expected moderate spread tightening, the non-financial yield level is unlikely to fall, as underlying yields are seen to rise. In conclusion, the total return will remain meagre going forward. The carry (less than 0.3% on a three month horizon) is seen to constitute an upper limit.

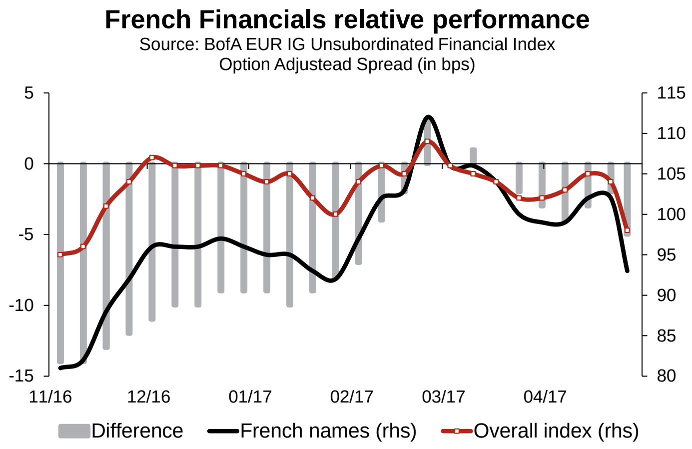


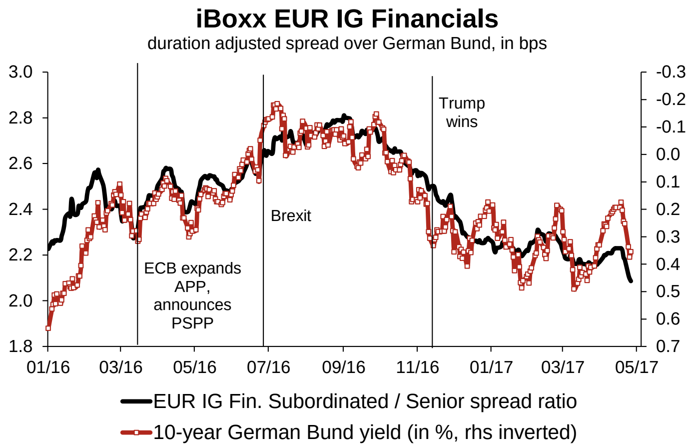
In the longer run, the situation is likely to become even more difficult. On the one hand, underlying yields are expected to trend further up in H2. On the other hand, the potential for a continued spread tightening appears limited as speculations about QE tapering will start and the looming Italian elections might hurt the market sentiment. Accordingly, the total return in H2 is likely to be negative.

Corporate Bonds (Financials)

Luca Colussa







- **EUR IG Senior Financial bond spreads declined slightly in April thanks to the solid macro momentum and the increased confidence over a favorable outcome in French presidential run-off.**
- **The total return performance was barely positive amid a mild rise in the underlying Bund yields. The latter trend will keep limiting the total return potential in the coming months.**
- **Barring a surprising outcome in French presidential run-off, we see little value for EUR IG Senior Financials in total return terms, while subordinated bonds can still offer better returns.**

After the significant tightening in March, the iBoxx EUR-denominated Investment Grade (IG) Senior Financial bond spreads declined slightly in April. The duration-adjusted spread over Bunds fell by 4 point to 125 bps, with the bulk of the decline taking place after the first round of French presidential election. Earlier in the month, the supportive macro environment had mostly offset the uncertainty over the vote outcome. The mild rise in the underling Bund yields limited the monthly performance to a mere +0.08%, while the year-to-date total return moved to +0.28%. Subordinated Financials outperformed, with the spread down 20 bps (-23 bps after the French first round) and the total return at +1.02%.

French banks can keep outperforming if Macron wins

French financial bonds moved in line with the benchmark ahead of the vote – Option Adjusted Spread up by 3 bps vs 2 bps for the overall Bank of America Unsubordinated Financial index – and outperformed thereafter (-9 bps vs -6 bps), reflecting investors' increased confidence over a Macron's victory in the run-off on May 7. Should such a scenario prevail, we see room for the recent outperformance to continue, though we expect it to be limited. French Financials bond spreads could tighten by 5 to 10 bps in relative terms, thus reversing the underperformance suffered between early November 2016 and February 2017.

Subordinated bonds to be preferred on rising yields

Even in case of a Macron's victory, we do not see much room for a further significant spread tightening for Senior Financial bonds over the medium-term. Moreover, rising underlying yields could even result in a slightly negative total return over the next months.

EUR IG Subordinated Financial bonds look more attractive in this environment. Their higher carry can compensate for the projected rise in Bund yields, and a further spread tightening is feasible amid the ongoing focus on cost cutting and the reduced concerns over banks' profitability. We consequently expect a continuation of the good performance seen year-to-date (total return of +2.86%)

Currencies

Thomas Hempell

- **Relief over the first-round French presidential election result helped to boost the EUR/USD to the strongest levels since the US election in November.**
- **While the base case of a Macron victory in the run-off on May 7 may further support the euro, this should be offset by clearer indications of another Fed rate hike in June.**
- **Against the Japanese yen and the British pound, however, the euro is likely to strengthen further.**

After the centrist candidate Emmanuel Macron secured to enter the run-off for the French presidency, the euro rallied temporarily by more than 2%, with the EUR/USD reaching the highest levels in five months. Earlier in the month, the announcement of a snap election in the UK by Theresa May sent the British pound soaring. The Czech National Bank abandoned its cap to the koruna, which pared parts of initial gains against the euro over the course of April.

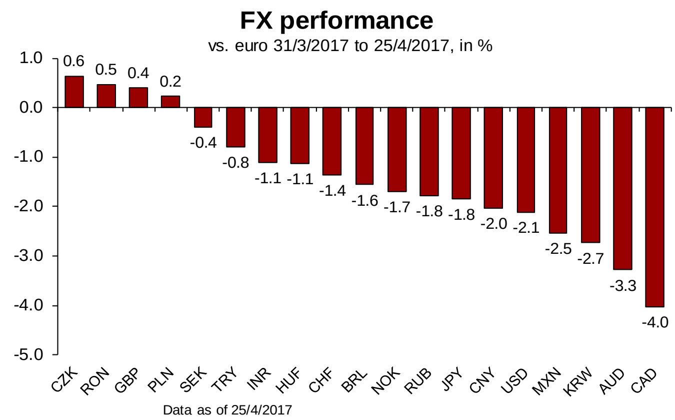
EUR/USD relief on France to be offset by the Fed

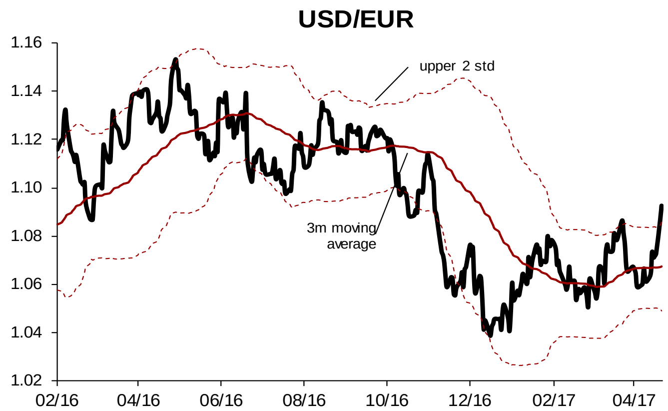
Looking ahead, the euro may strengthen somewhat further in our base case that Macron ultimately also prevails in the second round of the elections on May 7. That said, EUR/USD risk reversals, which reflect the relative costs of insuring against a euro depreciation on option markets, have sharply reversed to normal levels while speculative short-positions had already been unwound gradually since autumn last year (see lower chart). We therefore anticipate a Macron victory to underpin the euro vs. safe haven currencies like the Swiss franc and the Japanese yen. Regarding the EUR/USD, we anticipate further support to the euro to be offset by a reversal in currently underpriced odds of monetary tightening near term. With the Fed likely to prepare the ground for a rate hike in June, short term yield differentials are more likely to widen again.

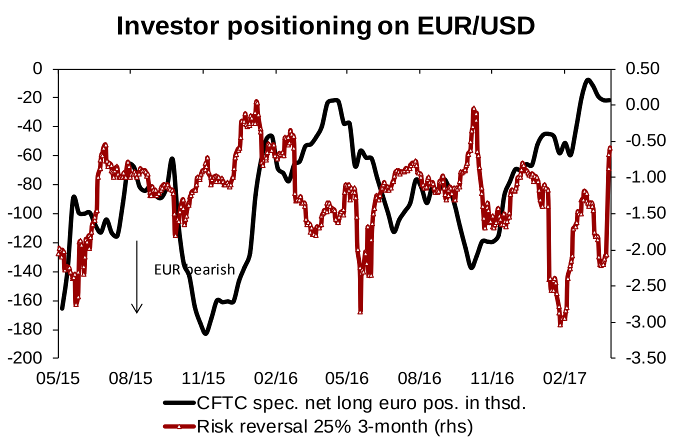
The euro is also likely to gain further ground again against the British pound. The announcement of snap elections in the UK are likely to provide PM Theresa May with a broader majority in parliament, reducing the threat from radical backbenchers within the party and thus providing the PM with more leeway for a compromising stance in the Brexit negotiations. That said, the uncertainties around the negotiations and the large current account deficit will continue to weigh on sterling. Furthermore, with the ECB likely to gradually prepare markets for a tapering of its asset purchases in 2018, the euro is likely to also trend stronger against the British currency.

Recent yen strength to prove temporary

Meanwhile, the earlier rally of the Japanese yen is more likely to prove temporary. While geopolitical tensions especially between North Korea and the US may keep demand for the safe haven currency high, a renewed increase in US yields and relief over French elections are more likely to reinstate the weakening trend in the JPY/USD.

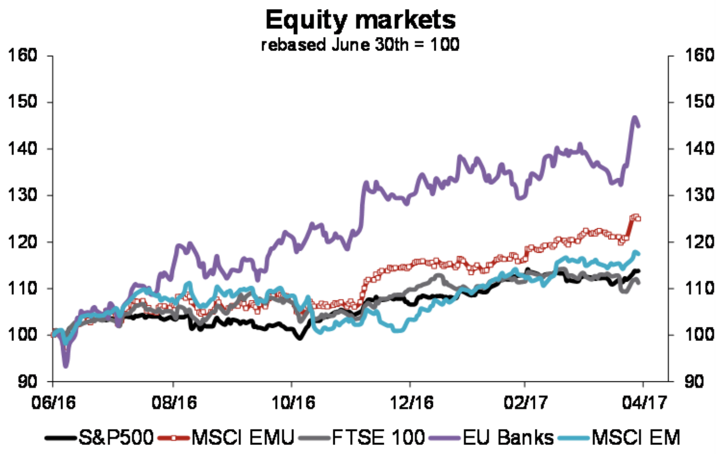


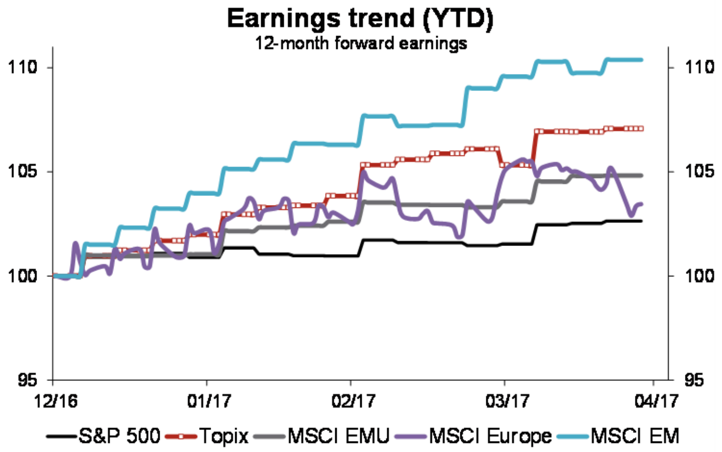


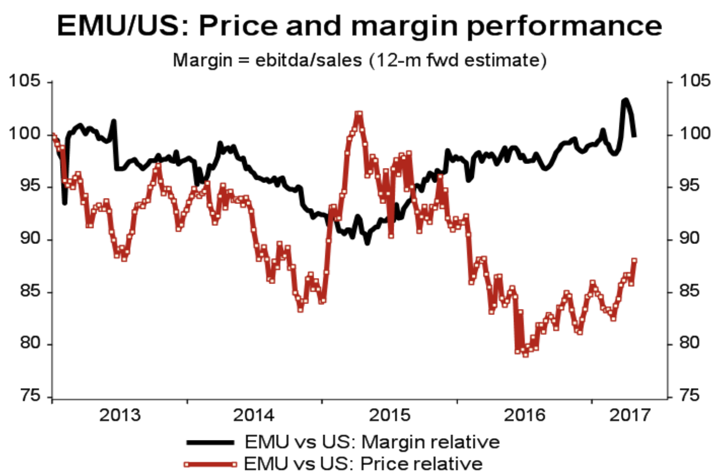


Equities

Michele Morganti







- **Global equities prolonged their positive tone in the month thanks to good macro data and, more recently, reduced political risk.**
- **Euro area (EA) earnings continue to increase in absolute and relative terms, as shown by positive revisions and improved Q1 results.**
- **Valuations are above historical averages but not markedly so. We remain constructive on equities.**
- **We favor EA and Japan over the defensive Switzerland and the expensive US and are neutral on the UK and EMs. Inside Europe, we overweight value-cyclical sectors, including financials, TLC and media, while staying short staples.**

Equities have continued their positive trend in April. The MSCI World index returned +1.4%, almost aligned to the Topix and the S&P 500. The MSCI EMU and the EMs increased by +2.7% (the FTSE MIB +2.2%).

Still in a recovery mood: increasing EA earnings

The first leg of recovery after the recession of the commodity and manufacturing sectors happened quickly, looking like a V-shaped rebound, starting from Q2 2016. Since then, the upturn in macro fundamentals and earnings momentum extended from the US to include EMs, Europe and finally Japan. As a result, earnings, equities and yields reacted on the upside quite visibly. As 2017 approached, yields consolidated at a time when the headline inflation finally peaked. In this context, while the MSCI EMU prolonged its positive momentum (total return of 10%) the financial sector was unable to extend its outperformance (+27% from July 6th to December 8th, 2016) and moved sideways vs. the broader index.

Two other factors, other than low yields, are worth mentioning: the reduced risk related to the upcoming French elections and the downward revision in expectations on US policies, both on the fiscal side, and as a source of geopolitical risk. Before the setback on the healthcare reform, the fiscal package proposed by the Trump Administration was expected to boost GDP growth and inflation, leading to at least 5% earnings growth in the US alone with positive global repercussions. That said, despite such less supporting factors, the EA equities have been able to perform decently both in absolute terms and relative to the US. This was possible thanks to EA macro environment which remains supportive. Confidence indicators linger at relatively high levels and the labor market maintains signs of improvement. The consensus nominal GDP growth for the EA has been revised up by +50bp year-to-date. Since then, earnings have enjoyed positive revisions, too: +5% the 12-month earnings forecast and +1.5% the 2017 estimate. We are describing a better macro scenario, although growth remains below historical average due to structural reasons which are going to stay in the foreseeable future.

Equities

That said, given the lingering good global macro environment, the corporate profit resurgence, favorable financial conditions together with banks more prone to expand credit, we should also see some increase in corporate investments in the future. Of course, it is still not a kind of growth seen in the past but more an improvement compared to the sluggish capex momentum of the last few years. The labor market should continue to show some improvement, too, with core inflation continuing to strengthen and wages to show a less anemic growth if compared to the last quarters. This benign environment would provide the second leg of recovery for nominal growth and corporate cash flows after the first phase which was led by commodities and manufacturers.

Q1 reporting season shows improved growth figures

While also due to easier comps, the Q1 reporting season is confirming such a positive outlook, after 36% of the S&P 500 index and 23% of the EURO STOXX firms reported. The median stock is showing better growth figures, especially on sales and in particular in the EA. Here the ratio of positive-to-total surprises improved sizably towards 65.5% for earnings (from 54% in Q4) and 87% for sales (from 71%). We expect decent Q1 final results due to good macro data and confidence indicators, favorable base effect, and improved US NIPA profits. The positive revisions experienced in the quarter and quite high consensus forecasts for this year and the next should induce analysts to increasingly focus on the future guidance. That said, we deem risks to be limited as we continue to be relatively optimistic about the ongoing recovery and the margin expansion (especially in the EA).

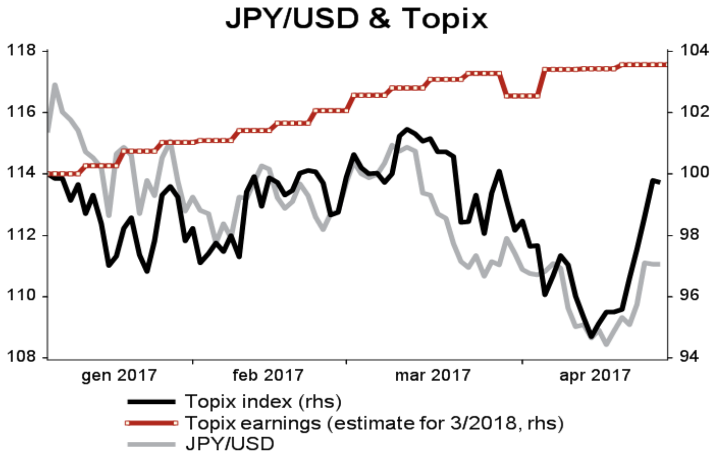
The French elections: an additional catalyst for the EA

The first positive results coming from the French elections, are accelerating the transition to the second leg of recovery as it lowers the political risk premium. Trump's difficulties could also turn US investors' interest to European assets. At the moment market multiples in the EA are not markedly above their historical averages and do not represent an obstacle to future positive total returns in the next months. Low yields, which keep the cost of capital low, and our short-term models (based on an econometric approach which uses macro variables) back our constructive view on the EA equities. Japanese equities are cyclical as well but are slightly cheaper. Furthermore, we continue to forecast a weaker yen by the end of this year. US ones are favored by a still decent growth and low yields. But being more expensive, less cyclical and less supported by the monetary policy, they may underperform. We are less positive on Switzerland (underweight, a defensive market) and now also on the UK (neutral). Inside Europe, we favor value-cyclical sectors, including financials, TLC and media, while staying short staples and defensive. Neutral on commodity sectors. Oils and telecoms are the most undervalued.

Analysis of the median stock

Median stock	Earnings Growth		Sales Growth		availability
	Q4 2016	Q1 2017	Q4 2016	Q1 2017	Q1 2017
S&P	9.13 %	9.76 %	3.71 %	5.02 %	36.2%
Stoxx	5.88 %	14.06 %	5.17 %	6.73 %	26.9%
Euro Stoxx	7.19 %	12.05 %	4.80 %	6.60 %	22.7%
Topix	13.48 %	16.72 %	1.40 %	2.67 %	13.1%

Median stock	Earnings Surpr		Sales Surpr		availability
	Q4 2016	Q1 2017	Q4 2016	Q1 2017	Q1 2017
S&P	2.02 %	3.79 %	0.18 %	1.12 %	36.2%
Stoxx	1.49 %	4.42 %	0.91 %	1.34 %	26.9%
Euro Stoxx	0.76 %	2.38 %	0.76 %	1.34 %	22.7%
Topix	10.61 %	10.99 %	(0.56)%	(0.80)%	13.1%



last available date: 26/04/17

Markets	PE		PB		PCF		DY		Avg.	Avg.
	12m f	Discount	12m f	Discount	12m f	Discount	12m f	Discount	Discount	Disc. (-1M)
USA	17.8	16.7	2.8	23.5	11.9	22.5	2.1	-4.0	16.7	16.1
JAPAN	13.9	-11.8	1.2	-4.6	7.6	8.4	2.2	15.0	-5.7	-14.5
UK	14.5	4.5	1.8	-0.1	9.1	16.1	4.2	6.1	3.6	3.4
SWITZERLAND	17.2	12.0	2.4	7.7	12.8	14.2	3.5	7.3	6.7	5.0
EMU	15.2	7.6	1.6	7.9	8.4	33.3	3.2	-19.3	17.0	13.2
FRANCE	15.3	6.6	1.6	6.1	9.0	34.2	3.2	-14.3	15.3	11.1
GERMANY	14.1	-6.1	1.7	15.1	8.8	35.8	2.9	-14.8	14.9	-9.9
GREECE	14.6	14.1	1.6	4.3	7.7	30.5	3.2	-17.3	16.5	14.6
ITALY	13.2	-14.1	1.1	-12.3	5.0	9.0	4.1	-12.5	-1.2	-1.7
PORTUGAL	16.7	33.7	1.8	4.5	6.4	9.4	4.3	-4.3	13.0	11.8
SPAIN	14.4	11.6	1.3	-18.1	5.6	11.4	3.7	-27.6	8.1	5.5
EURO STOXX 50	14.7	11.4	1.6	8.0	8.2	37.5	3.5	-19.3	19.0	16.4
STOXX SMALL	17.0	20.4	1.9	13.2	11.1	38.5	2.8	-13.5	21.4	10.1
EM, $	12.2	-16.5	1.5	-8.7	7.6	-1.9	2.7	-12.2	-3.7	-3.9
BRAZIL	11.4	29.0	1.4	-20.1	6.9	-52.3	3.6	-16.7	-6.7	-5.6
RUSSIA	5.6	-22.3	0.6	-33.9	3.4	-25.5	5.5	61.9	-35.9	-33.9
INDIA	18.0	26.3	2.7	3.2	12.1	5.4	1.6	-1.8	9.2	8.0
CHINA	12.4	-4.3	1.5	-12.7	7.7	3.4	2.3	-26.9	3.3	3.2

Note: Discount in % to long-run norm; blue and negative numbers = undervaluation. Red and pos. numbers = overvaluation; PEs are since 1987, the rest is since 2003. In case of DY, a discount means the market had a higher DY, meaning the market is at premium for this multiple. 12m f = expected in 12 months

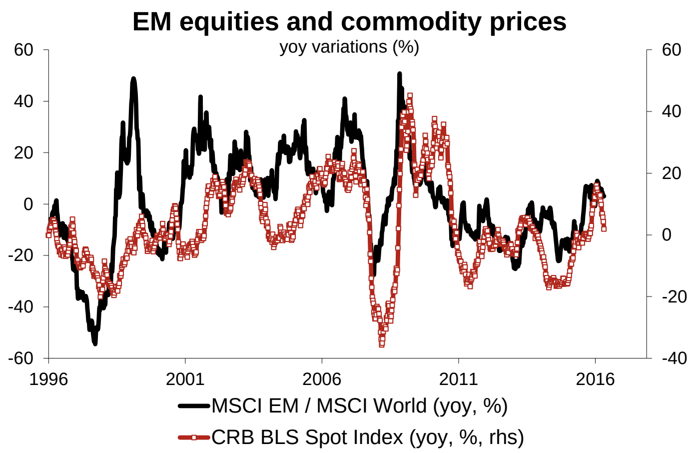
Source: Thomson Reuters Datastream, IBES estimates.

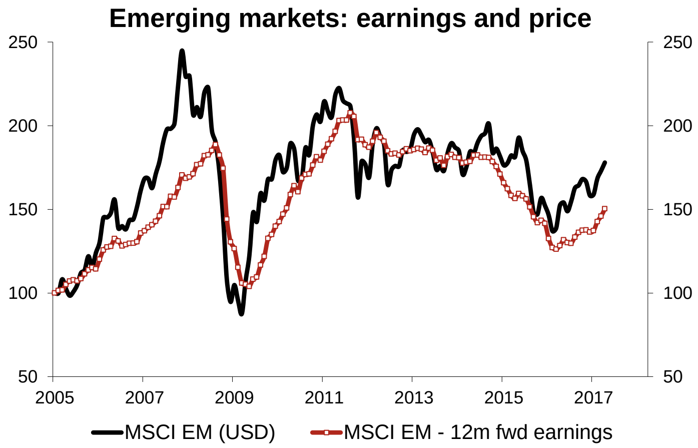
Emerging Markets Equities

Vladimir Oleinikov

Markets	price, %-chg -1M	price, %-chg YTD	earnings, %-chg -1M	earnings, %-chg YTD	10y yld chg, YTD	FX (TW), %-chg MTD	FX (TW), %-chg YTD
WORLD ($)	2.0	7.5	1.5	5.0			
US	1.9	6.6	1.2	2.6	-14	0.1	-2.8
EMU	4.2	9.4	1.5	4.8	26	1.2	0.7
GREECE	**14.1**	2.4	**4.6**	**-1.6**	-57	1.2	0.7
CZECH REP.	1.6	8.4	-0.3	**-2.3**	**54**	0.9	0.4
HUNGARY	3.0	3.0	3.4	9.5	**41**	-0.8	-1.1
POLAND	6.6	**22.5**	2.3	14.5	-28	0.8	4.5
EM ($)	1.4	13.9	1.3	10.4	-45		
BRAZIL	1.3	6.6	0.5	5.9	**-98**	-1.5	-0.5
CHINA	1.9	16.7	1.8	6.7	**41**	-0.4	-2.6
INDIA	2.2	13.2	0.4	1.3	**44**	0.9	3.6
INDONESIA	3.7	9.6	1.8	5.0	**-91**	0.2	-1.3
KOREA	1.8	10.6	**4.7**	16.8	12	-1.6	3.9
MALAYSIA	1.5	7.9	0.9	1.8	-15	**1.7**	0.5
MEXICO	0.9	8.1	**-1.0**	3.0	-24	-1.8	**6.3**
RUSSIA	-1.1	**-9.8**	-0.1	8.8	-64	**-2.3**	4.3
TAIWAN	0.1	6.5	0.7	4.1	-10	0.9	**5.3**
THAILAND	0.0	3.7	1.0	5.1	6	-0.7	1.2
TURKEY	4.9	**22.0**	3.7	11.2	**-86**	0.7	**-4.6**
VIETNAM	-0.3	8.3	**-1.3**	**25.6**	-32	0.0	-2.3
SHANGHAI	**-3.9**	1.2	**-1.0**	5.5	**41**	-0.4	-2.6

All the markets are represented by MSCI indices, except for US (S&P500) and Shanghai.





- **Looking ahead, we see the EM performance to be muted. While higher oil prices are supportive for EM stocks, tumbling commodity prices should hurt.**
- **Risks also come from possible (lesser) US trade protectionism, a strong USD and higher US yields. The geopolitical risks around North Korea are especially relevant for the Asian region.**
- **We continue to be constructive mid-term on EMs and still favor India along with Korea and CEE countries.**

Over the last month, EM equities have increased only slightly (+1.4% in US dollar terms). The top performer was Greece (+14.1%), followed by Poland and Philippines (around +6.5%). The Shanghai index has shown the worst performance (-3.9%). The Greek market has had a rally on increased chances for the funds to be unblocked at the Eurogroup meeting on May 22. The Polish market is still influenced by the run-up in energy stocks and, to a lesser degree, financials. In case of the Shanghai index, stocks have fallen as a result of money market rates pushed higher by the Chinese central bank and a regulatory crackdown on trading activities.

Overall, EM 2017 earnings have been revised up by 0.8% over the last month. The markets for which they have been upgraded significantly are: Korea (+4.3%), Hungary (+3.0%), Turkey (+2.9%), and Poland (+2.0%). The earnings of the Mexican companies have, on the other hand, been downgraded by 2.2% (materials and industrials by 5.0%). The Korean market has experienced the highest cumulated earnings revisions compared to its linear trend since the recent trough of 2017 earnings estimates.

Based on multiples, the EM stocks are only slightly undervalued (discount of 3.7% to history). While higher oil prices are supportive for EM stocks, the tumbling commodity prices (see chart) are hurting. The unfavorable gap between price and earnings performance (esp. since 2016) weighs on EM equities. Furthermore, a tighter US monetary policy and higher 10 year rates from current levels should put pressure on EM stocks in the short term.

China: lesser trade concerns, remains unattractive

Following the recent President Xi-Trump meeting and their inclination to find a way to resolve the US-China bilateral trade imbalance, trade protectionism seems to be less of an issue. The Chinese market remains, however, relatively unattractive. Based on multiples, Chinese valuations are at a premium of 3.3% versus its own history. While earnings have been improving, their trend vs EM, the EA or the US is not favorable and our macro-based models indicate a negative potential.

Mark to Market Allocation

Thorsten Runde

- **Over the past two months all equity markets have shown positive developments, with the euro area being the most attractive one so far.**
- **Disregarding Bunds, long-dated government bond yields remained nearly unchanged on the main markets, thus lifting nearly all performance figures into positive territory.**
- **The risk premia on Southern European sovereign debt remained came down considerably.**
- **Looking forward, with reduced risks from the French presidential election outcome, global financial markets will focus on the US and speculations about future Fed policy action.**
- **We expect Bund and treasury yields to rise while French and Southern European sovereign spreads may tighten near term.**
- **We thus stick to our last recommendation to moderately overweight equities at the expense of core government bonds, thereby preferring European markets to the US.**

Over the past two months, the equity markets of our investment universe have once again performed positively, with return figures ranging from around 1% for the US and the UK to a good 8.5% in the euro area. Disregarding Bunds, the yields of long-dated government bonds have fallen on the main markets, as well as the risk premia on Southern European sovereign debt. Overall, the government bond markets under consideration also performed positively, led by the UK with roughly 0.8%. All in, the recommended allocation stance in favor of equities paid off well since the end of February. In particular, the correct active positioning in the best performing asset class (euro area equities) and the worst (euro area core government bonds) contributed positively to the TAA result.

Favorable macroeconomic environment

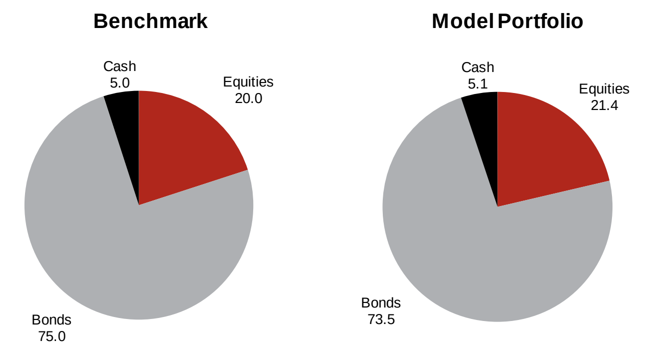
Global growth momentum remains solid. The continued improvement of sentiment in the euro area stands out. In the US, more recent data came in somewhat weaker and the chances of a meaningful tax reform have diminished. That said, we act on the assumption of a somewhat stronger momentum going into the second half of the year. Core government bond yields are expected to inch higher on both sides of the Atlantic, mainly on back of Fed rate hikes and the start of the ECB tapering discussion.

Europe to be preferred to the US

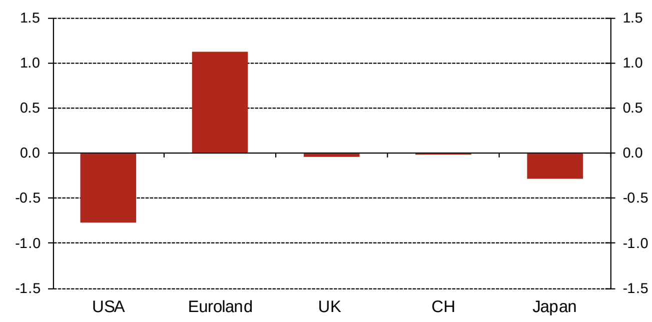
All in, this argues for a focus on real assets and here in particular on European equities. In contrast to the US, macro and earnings momentums look more favorable here and with Frexit threat off the table, political risks are deemed negligible in the short-term.

Asset Class	Benchmark	Model Portfolio	Previous Allocation
Equities	***20.0***	***21.4***	***21.1***
Bonds	***75.0***	***73.5***	***73.8***
Cash	***5.0***	***5.1***	***5.1***
Equities, US	3.0	**3.0**	3.0
Equities, EMU	12.0	**13.1**	12.8
Equities, UK	2.0	**2.1**	2.2
Equities, Switzerland	1.0	**1.1**	1.1
Equities, Japan	2.0	**2.1**	2.1
Bonds, Gvt. US	11.3	**11.3**	10.5
Bonds, Gvt. EMU Core	27.0	**25.7**	26.2
Bonds, Gvt. EMU GIIPS	18.0	**18.4**	18.2
Bonds, Gvt. UK	7.5	**7.3**	7.6
Bonds, Gvt. Switzerland	3.8	**3.6**	3.6
Bonds, Gvt. Japan	7.5	**7.2**	7.6
Cash	5.0	**5.1**	5.1

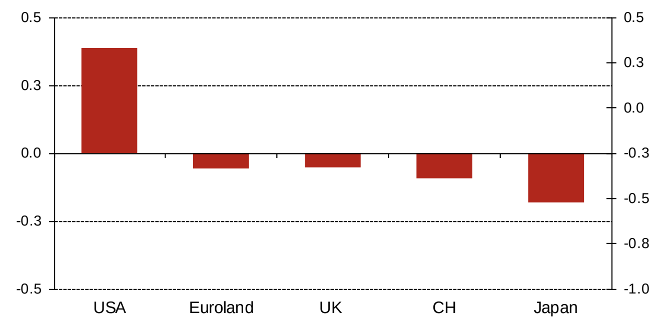
Asset Classes



Equities - Regional Structure



Bonds - Regional Structure



Forecast Tables

Growth	2015	2016e	2017f	2018f
US	2.6	1.6	2.2	2.3
Euro area	1.9	1.7	1.6	1.4
Germany	1.5	1.7	1.6	1.4
France	1.2	1.1	1.2	1.3
Italy	0.6	0.9	0.6	0.6
Non-EMU	2.4	2.1	1.7	1.5
UK	2.2	2.0	1.5	1.3
Switzerland	0.8	1.4	1.6	1.4
Japan	1.2	1.0	1.3	1.0
Asia ex Japan	6.2	6.0	6.0	5.9
China	6.9	6.7	6.5	6.2
Central/Eastern Europe	0.2	1.0	2.3	2.9
Latin America	- 0.4	- 1.4	0.9	1.9
World	**3.4**	**3.1**	**3.4**	**3.5**

Inflation	2015	2016f	2017f	2018f
US	0.1	1.3	2.3	2.4
Euro area	0.0	0.2	1.6	1.5
Germany	0.1	0.4	1.8	1.7
France	0.1	0.3	1.5	1.3
Italy	0.1	- 0.1	1.3	1.0
Non-EMU	0.1	0.7	2.6	2.7
UK	0.0	0.7	3.0	2.9
Switzerland	- 1.1	- 0.4	0.4	0.8
Japan	0.8	- 0.1	0.7	0.8
Asia ex Japan	2.4	2.7	2.7	3.1
China	1.4	2.1	2.3	2.3
Central/Eastern Europe	9.3	5.2	4.9	4.5
Latin America	6.2	6.2	4.3	3.8
World	**2.3**	**2.4**	**2.7**	**2.8**

Regional and w orld aggregates revised to 2015 IMF PPP w eights; Latin America Inflation excluding Agentina and Venezuela

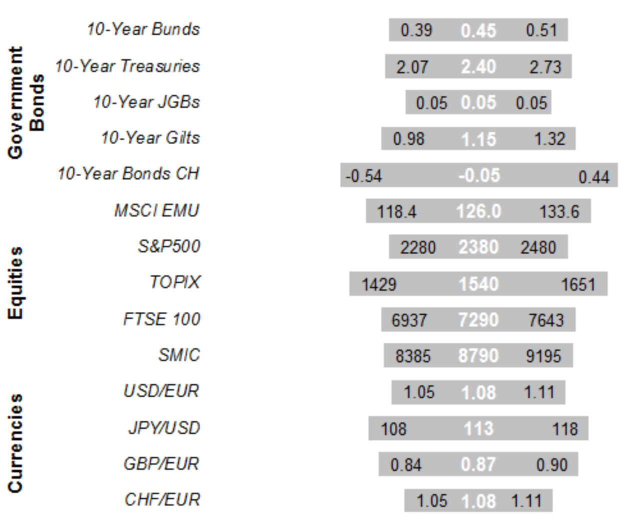
Financial Markets

3-month LIBOR	**26.04.17***	**3M**	**6M**	**12M**
USD	1.17	1.40	1.55	1.90
EUR	-0.36	-0.35	-0.35	-0.30
JPY	0.01	0.00	0.00	0.05
GBP	0.33	0.40	0.40	0.40
CHF	-0.73	-0.75	-0.75	-0.75
10-Year Bonds	**26.04.17***	**3M**	**6M**	**12M**
Treasuries	2.30	2.40	2.55	2.80
Bunds	0.36	0.45	0.55	0.70
BTPs	2.25	2.35	2.50	2.70
OATs	0.80	0.90	1.00	1.15
JGBs	0.02	0.05	0.10	0.15
Gilts	1.07	1.15	1.20	1.35
SWI	-0.09	-0.05	0.00	0.20
Spreads	**26.04.17***	**3M**	**6M**	**12M**
GIIPS	170	170	175	180
Covered Bonds	79	80	80	85

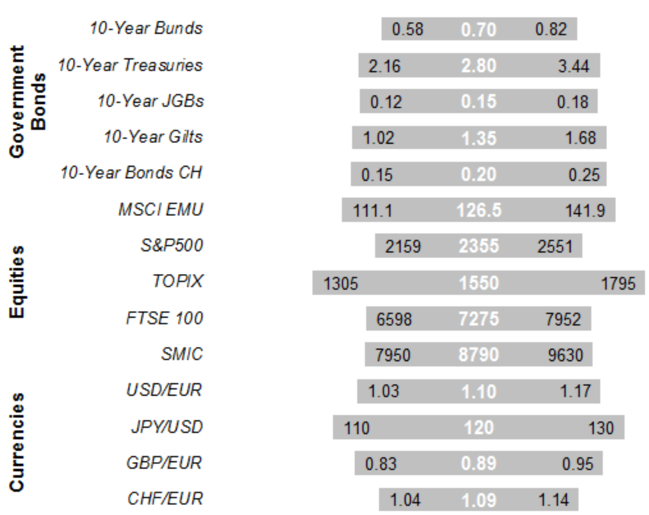
Corporate Bond Spreads	**26.04.17***	**3M**	**6M**	**12M**
IBOXX Non-Financial	137	135	140	145
IBOXX Sen-Financial	126	125	130	135
Forex	**26.04.17***	**3M**	**6M**	**12M**
USD/EUR	1.09	1.08	1.09	1.10
JPY/USD	111	113	115	120
JPY/EUR	121	122	125	132
USD/GBP	1.28	1.24	1.24	1.24
GBP/EUR	0.85	0.87	0.88	0.89
CHF/EUR	1.08	1.08	1.09	1.09
Equities	**26.04.17***	**3M**	**6M**	**12M**
S&P500	2383	2380	2375	2355
MSCI EMU	125.4	126.0	126.5	126.5
TOPIX	1520	1540	1545	1550
FTSE	7276	7290	7290	7275
SMI	8772	8790	8825	8790

*average of last three trading days

3-Months Horizon



12-Months Horizon



*The forecast range for the assets is predetermined by their historical volatility. The volatility calculation is based on a 5 year history of percentage changes, exponentially weighted. The length of the bars within each asset group is proportional to the relative deviations from their mean forecasts.

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