Market Perspectives

February 2017

Content

Global View

Thomas Hempell

- **Risky assets had a decent start into the new year, underpinned by solid economic data and hopes on tax and regulation relief in the US. Core bond yields rose further, whereas the US dollar pared roughly half of its gains seen in the wake of the US elections.**
- **Looking ahead, market optimism about reflationary policies by the new US administration may run into mounting concerns about the detrimental effects of protectionist measures.**
- **Given surprisingly strong economic data globally, however, a moderate trend increase in global core yields is likely to prevail over the coming weeks.**
- **A still resilient outlook in particular for European equities favors a moderately elevated exposure to risky assets. This should help to cushion the headwinds to government bonds from rising global yields and a somewhat higher risk premium on Southern European bonds.**

Globally strong economic data and hopes of tax and regulation relief by the new US administration under Donald Trump helped global yields to rise over the first weeks of the year, while equities extended their rally initiated in November. The increase in yields was particularly pronounced in the euro area, with 10-year Bunds yields up by 25 bps close to 0.50%, the highest level in almost a year. Yields of Italian BTPs with the same maturities rose by more than 40 bps also due to rising political concerns about early elections. Spreads on investment grade corporate bonds in the euro area proved stable, while the US dollar retreated, paring almost half of the gains against the euro seen in the wake of the US elections on November 8.

	Growth			Inflation		
	2016f	2017f	2018f	2016f	2017f	2018f
US	1.6	2.4	2.5	1.3	2.3	2.5
Euro area	1.7	1.5	1.3	0.2	1.6	1.5
China	6.7	6.4	6.1	2.1	2.4	2.2
World	3.0	3.4	3.5	2.4	2.8	2.8

f= forecast

Over the coming weeks, we anticipate global financial markets to be underpinned by solid economic data, but capped by a more critical assessment of new policies by the Trump administration by investors.

The global economy has entered the new year on a strong note, with upbeat data in the US mirrored by robust indicators in the euro area and China. High purchasing manager indices and rising consumer confidence will likely continue to underpin reflation hopes, also helped by a (temporarily) stronger rise in headline inflation on base effects from the oil price.

At the same time, the recently upbeat mood on global financial markets will remain repeatedly challenged by persistently high political uncertainties. Following a strong spell of market optimism in the wake of the sweep victory of Donald Trump in the US elections (with the MSCI world up by almost 7% since Nov. 8), the effective policy agenda of the US administration may be scrutinized more critically by investors going forward. In particular, the risks from protectionist measures to global growth are likely to receive more attention amid rising tensions between the US on the one hand and China and Mexico on the other. We also anticipate the Fed to reinforce its intention to further normalize monetary policy, likely faster than the two rate hikes currently anticipated by markets for 2017. In Europe, meanwhile, we expect concerns about political stability to keep a lid on risk sentiment while the risk premium on Italian sovereign debt may edge higher.

Bonds	**Current**	**3M**	**6M**	**12M**
10-Year Treasuries	2.50	2.60	2.70	2.90
10-Year Bunds	0.47	0.50	0.55	0.60
Corporate Bonds	**Current**	**3M**	**6M**	**12M**
IBOXX Corp. Non Fin	144	140	140	145
IBOXX Corp. Sen. Fin	134	135	135	140
Forex	**Current**	**3M**	**6M**	**12M**
USD/EUR	1.07	1.04	1.02	1.05
JPY/USD	114	117	120	125
Equities	**Current**	**3M**	**6M**	**12M**
S&P500	2297	2270	2270	2240
MSCI EMU	116.2	116.5	116.5	115.5

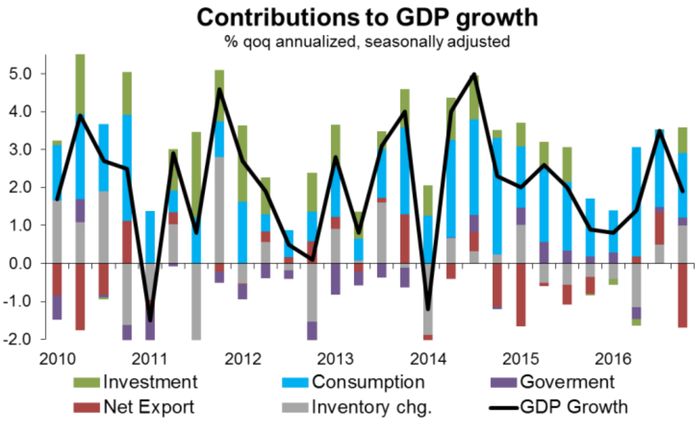
Current Values = average of closings Jan 25-27

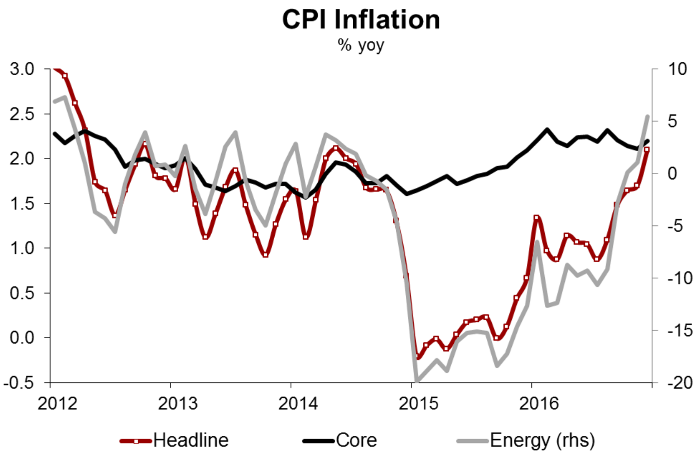
In this setting of robust economic data and policy uncertainties, we expect a moderate further increase in yields on US and Southern European sovereign debt. By contrast, the continued asset purchases by the ECB and political uncertainties in Europe are likely to keep a lid on euro area core yields. Despite the political risks, we anticipate European risky assets in the private sector, including equities and corporate bonds, to prove resilient amid a reassuring combination of solid economic data, decent valuations and the outlook of continued ECB support. In the US, the upside to equities appears much more limited. Following the rally over recent months, a more critical assessment of new policy measures by the Trump administration and stronger awareness about the easing financial market support from the Fed will likely countervail the upbeat string of economic data.

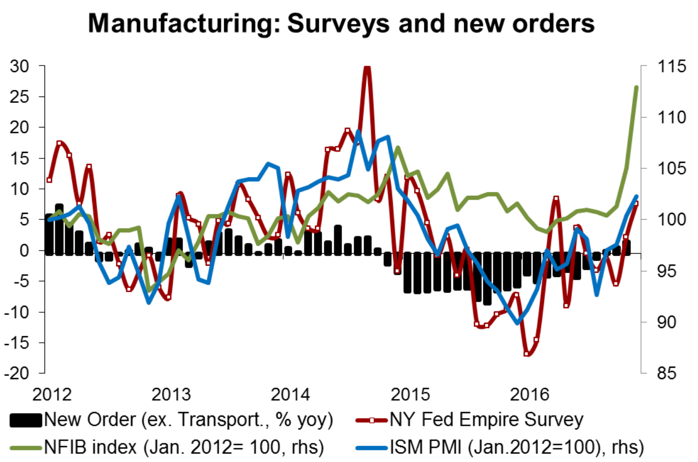
Overall, we therefore favor a moderately stronger exposure in European corporate bonds and equities and a more cautious exposure to sovereign bonds both in the US and Southern Europe.

USA

Paolo Zanghieri







- **GDP was up by 1.9% annualized in Q4 2016. Surveys point to 2% growth in Q1 2017. Fuels lifted inflation to 2.1% yoy in December, with further evidence of labor market tightening.**
- **The new administration started legislating on healthcare, immigration and infrastructures, but concrete measures on the economy will be fleshed out in March at the earliest.**
- **After the Fed's December rate hike, we expect three increases in 2017 (the first one in June), in line with the Fed's preferred policy stance.**

According to preliminary estimates, GDP grew in Q4 2016 by a slower than expected 1.9% qoq annualized. This was due to a large extent to one off-factors, such as the retrenchment in agricultural export after an unusually strong Q3 and a temporary reduction in defense expenditure. Consumption continued to grow relatively fast (2.5%) and was accompanied by a rebound in non-residential investment (2.4%). In the year as a whole GDP increased by 1.6%. Looking ahead, the underlying strength of domestic demand will be supported by the fiscal package in the second half of this year, likely resulting in 2.4% growth in 2017.

In December, fuels lifted headline inflation back to above 2% (2.1%), for the first time in one year and a half. Core inflation continued to fluctuate at just above 2%. A further push in the core rate, on higher healthcare prices and rents, and the pick up in the energy component will lift inflation to 2.4% by the end of the year.

The new Administration's first decisions

President Trump has swiftly started issuing executive orders. Many of them (on healthcare and oil related infrastructure) were largely symbolic. The notable exceptions were the rulings on immigration. The order to proceed with the construction of a wall on the Mexican border and the temporary ban on immigration from seven mostly Muslim countries sparked widespread criticisms. However, the actual implementation of the economic agenda (especially the promised tax cuts and incentives for infrastructure investment) requires the approval of the Congress. A full picture will start to appear by March, and we expect the first measures to be passed into law by October. In his hearing before the Senate, the Treasury Secretary candidate stressed his preference for a strong US dollar, contradicting a previous statement by the President, and highlighting that the uncertainty the new administration could trigger.

Business surveys' wave of optimism

Business surveys are showing a marked improvement in sentiment, especially those on manufacturing. This can be attributed to both the positive news flow on demand (both domestic and foreign), and the positive impact of some of the measures promised by President Trump.

USA

Unlike other bouts of optimism seen in the recent past, the current one is being backed by better hard data on orders. In November, orders to the manufacturing sector (excluding Transportation) were up by 1.4% yoy, after +0.5% in October, the first annual increase since autumn 2014. Economic fundamentals are supportive for a further expansion in manufacturing activity, with positive repercussion on capex. However, growth may be dampened by a strong appreciation of the dollar.

Consumer surveys were upbeat too. Both the University of Michigan and the Conference Board confidence index have reached the highest levels since mid 2007. The Michigan and NY Fed surveys, moreover, show that expected inflation is increasing fast, catching up with the trend already visible in bond rates.

Employment edges further up

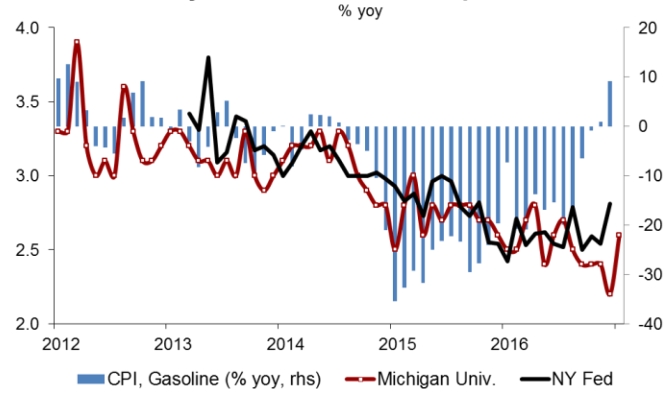
Beside the post election boost, consumer sentiment is being supported by the ongoing improvement in the labor market. In December, 158k new jobs were added to the economy. Higher labor market participation pushed the unemployment rate slightly up (to 4.7%), but it remained close to the nine year low of 4.6% posted in November. A tighter labor market is exerting an increasingly strong pressure on wages, with hourly earnings increasing at the fastest rate since 2008 (2.9%yoy). In the medium term, private employment is set to continue to increase, but at a slower rate as surveys point to bottlenecks due to skill shortage. Moreover, the freeze in federal hiring announced by Trump will possibly lead to weaker overall employment growth. All in all, we expect the unemployment rate to fall to 4.5% by the end of the year. The latest figures of the NFIB small business survey show a sharp increase in the number of firms expecting both higher employment and wages in the next three months. A further boost to wages would come from the upward revision in inflation expectations.

Three rate hikes expected in 2017

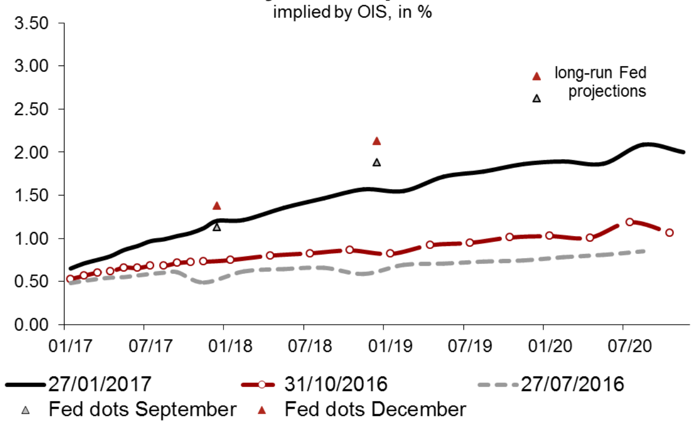
Against this background, the Fed has signaled, at the December meeting, its intention to increase rates three times this year. Market expectations have quickly aligned to this path of monetary policy normalization. In terms of timing, we do not expect the first increase before June, as the Fed will wait for more details on the new fiscal stimulus and its impact.

Recently, FOMC members have repeatedly raised the issue of reduction in the stock of assets the Fed holds. We think the Fed is just preparing well in advance markets for actions that will be taken no earlier than in 2018, when monetary normalization will have lifted the fed fund rate within the 1% to 2% range.

One-year ahead inflation expectations



US Key Rate Expectations

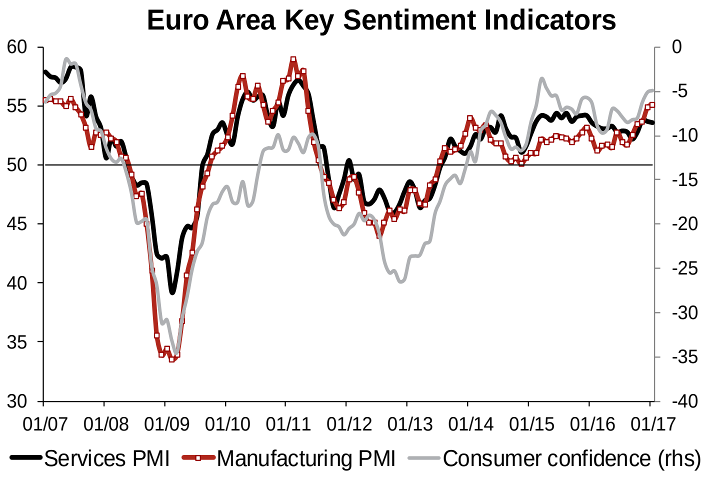


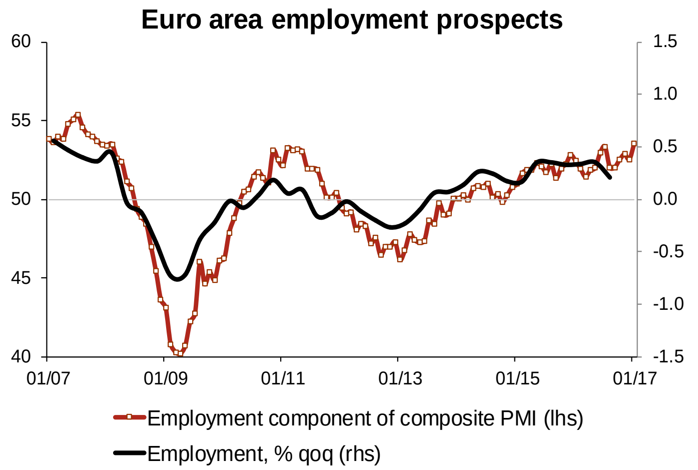
Main Forecasts[1)]	2015	2016f	2017f	2018f
GDP	2.6	1.6	2.4	2.5
Consumer spending	3.1	2.8	2.5	2.7
Gov. consumption	0.7	0.9	0.9	0.5
Investment	5.4	1.8	5.0	5.8
- residential inv.	8.9	7.8	5.1	4.5
- structures	-1.5	-2.3	5.1	4.2
- intell. property production	5.7	1.9	4.2	6.2
- equipment/software	3.1	0.4	5.5	6.9
Inventories	0.4	-0.3	-0.1	-0.2
Exports	1.1	2.7	3.9	3.6
Imports	4.9	4.2	4.9	5.4
Net trade	-0.6	-0.3	-0.3	-0.3
Domestic demand	3.2	2.3	2.6	2.8
Consumer prices	0.1	1.3	2.3	2.5
Unemployment rate[2)]	5.3	4.8	4.5	4.5
Budget balance[3)]	-2.5	-2.9	-3.4	-4.5
Fed Funds Rate[4)]	0.38	0.63	1.38	2.13

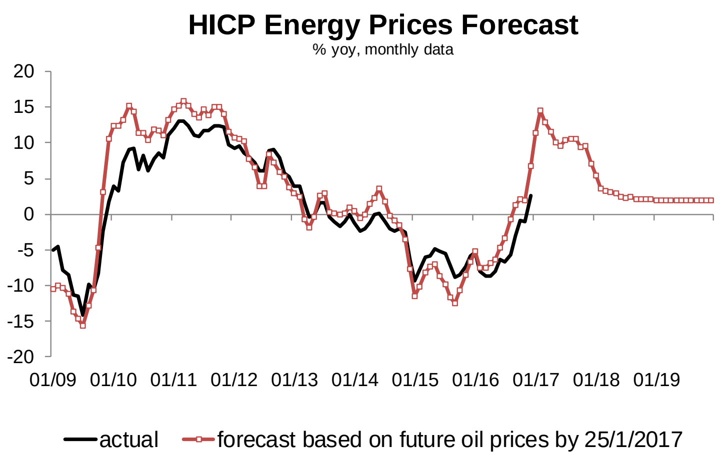
1) Unless noted otherwise, annual % changes, net trade and inventories: growth contribution to GDP 2) yearly average as %, 3) in terms of GDP, federal deficit 4) as %; year-end

Euro Area

Martin Wolburg







- **Key indicators confirmed that the euro area had a strong start into the year.**
- **That said, over the coming months we expect dampening effects from higher inflation, the exchange rate and politics, and to take their toll.**
- **Due to an upward shift in future energy prices, we revised our 2017 inflation forecast up to 1.6%.**
- **We expect the ECB to look through the inflation spike at the outset of the year and not to discuss tapering before summer.**

The release of the January flash PMIs for the euro area indicated that euro area activity maintained its strength at the outset of the year. The composite PMI was reported at 54.3, only marginally down from 54.4. To put things into perspective, overall sentiment had risen to the highest level since May 2008 in December. The January reading is still historically strong and 0.6 standard deviations above average. Moreover, the employment component advanced to the highest level since February 2008 suggesting that solid to strong employment creation will continue to back activity. Against the backdrop of a favorable labor market development, the further rise of consumer confidence in January did not come as a surprise. Another key reason behind the high PMI reading is the recovery of sentiment in the export-oriented manufacturing sector that rose to the highest level since April 2011. All in all, the first set of sentiment indicators for 2017 implies a quarterly growth rate of 0.5% qoq.

Goldilocks situation will not last

We deem the euro area in a kind of goldilocks scenario at the moment. It is still benefitting from the extraordinary monetary policy measures, some fiscal support and the fact the kick start of the labor market induced some endogeneity to the recovery. In contrast, headwinds remained surprisingly contained so far. Looking ahead, we expect these headwinds to become stronger.

First, inflation will pick up significantly in the months to come. In January headline inflation already soared to 1.8% yoy on the back of accelerating energy price inflation. With current as well as future energy prices further up and due to base, headline inflation could temporarily even exceed 2% in the months to come. Later on, inflation will moderate again. For 2017, we revised our inflation forecast to 1.6%, from 1.3% before. Higher inflation dampens especially consumption activity.

Second, over the course of last year the euro has risen against the currencies of its main trading partners. We expect the euro not to weaken over the course of the year and see some headwinds from the exchange rate to be increasingly felt.

Euro Area

Third, the Brexit decision has so far only impacted activity via the depreciation of the pound. More recently, following speeches of UK PM May, it has become most likely that the UK is going for a hard Brexit. We expect activity in the UK to decelerate over the course of the year thereby dampening import demand additionally.

Fourth, the first days of the new US administration have shown a high willingness to adopt protectionist measures and there is a risk that these measures as well as retaliation measures dampen world trade and euro area export activity.

Fifth, forthcoming elections in the Netherlands (March), France (April and July) and Germany (September) keep the risk of populism high. Moreover, the chances for new elections – most likely in Q2 - in Italy have risen in our view following the recent ruling of the Constitutional Court on the electoral law.

Growth to moderate over the course of the year

So far economic activity and sentiment has proven resilient against these headwinds. GDP advanced by 0.5% qoq in Q4/2016 implying an annual growth rate of 1.7% for 2016. With growth in Q1/2017 of likely similar strength, we adjusted our 2017 growth outlook to 1.4%, from 1.3%. That said, for the factors mentioned above we expect growth to moderate over the course of the year.

ECB to look through inflation spike

Positive macro surprises as well as higher inflation have triggered a discussion of the further course of ECB monetary policy. However, President Draghi mentioned in its January press conference four conditions that have to be fulfilled before the policy stance can be changed:

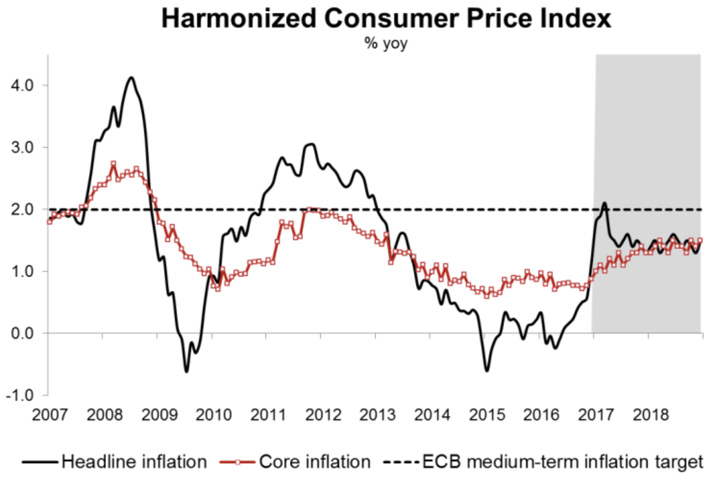
First, the medium term objective has to be fulfilled. Inflation expectations have improved but are still far below their historical averages.

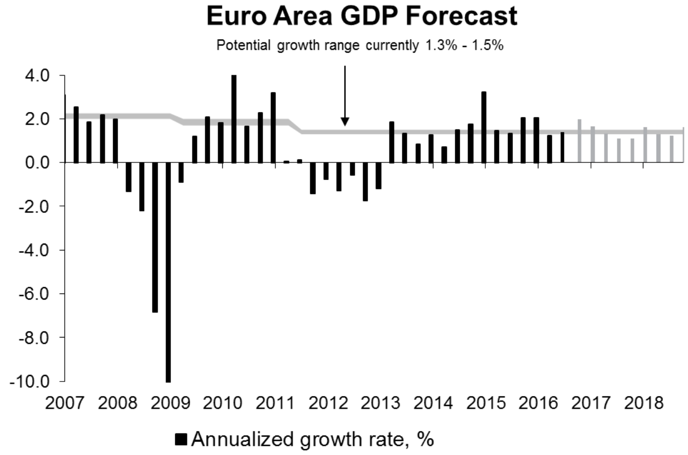
Second, the conversion to the inflation target has to be durable. This implies that the ECB will look through the temporary energy price-related spike in headline inflation we will see over the next months. In contrast, core inflation (currently 0.9% yoy) is still far too low.

Third, inflation has to be self-sustained, meaning that it shall persist even in the absence of monetary policy measures. Here, the ECB still thinks that "*a very substantial degree of monetary accommodation is needed for euro area inflation pressures to build up and support headline inflation in the medium term*".

Fourth, these criteria have to be met for the whole euro area.

The upshot is that the ECB feels quite comfortable with the current situation. Tapering is not in sight yet and in our view it will become a topic only over the course of the second half of the year.



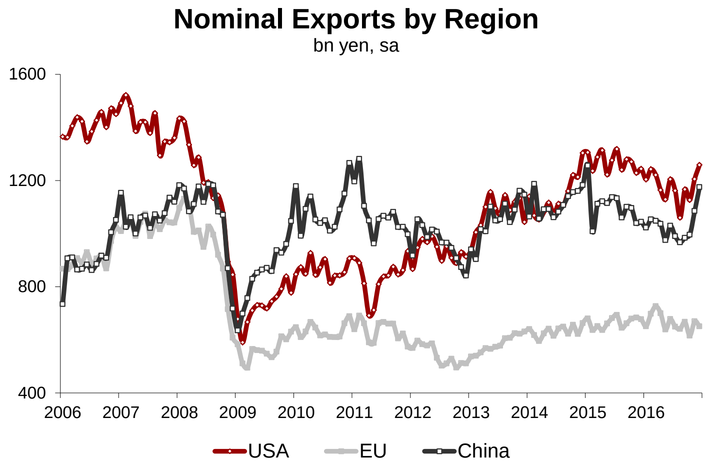


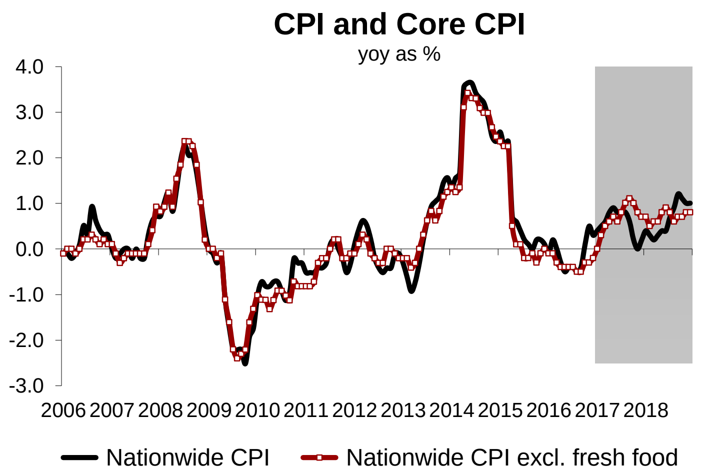
Main Forecasts[1)]	2015	2016	2017f	2018f
GDP	1.9	1.7	1.5	1.3
Consumer spending	1.8	1.7	1.2	1.1
Gov. consumption	1.4	1.9	0.9	0.8
Total fixed investment	2.9	2.7	1.5	1.4
Inventories	-0.2	0.0	0.2	0.2
Net trade	0.2	-0.2	0.1	0.1
Domestic demand	1.9	1.9	1.2	1.0
Consumer prices	0.0	0.2	1.6	1.5
Unemployment rate[2)]	10.9	10.0	9.7	9.3
Budget balance[3)]	-2.1	-1.9	-1.6	-1.6
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	2016e	2017f	2018f
GDP	1.2	0.9	1.0	0.9
Consumer spending	-0.4	0.4	0.9	0.8
Government consumption	1.6	1.5	0.6	0.8
Investment	0.1	1.0	1.7	2.0
Inventories	0.4	-0.1	-0.1	-0.2
Net trade	0.4	0.1	0.2	0.1
Domestic demand	0.7	1.0	0.9	1.0
Consumer prices	0.8	-0.1	0.6	0.7
Unemployment rate[2]	3.4	3.1	2.9	2.9
Budget balance[3]	-5.2	-5.2	-5.1	-4.1

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 Q4 quarterly annualized GDP growth is likely to come in around 1%.**
- **Given possible trade conflicts with the US (directly or indirectly via China), we are skeptical that Japan will accelerate much, going forward.**
- **CPI inflation is likely to rise, giving the BoJ the opportunity to also increase its yield targets over the medium term.**

In Q4, Japan has likely benefitted from the combination of an improving international business cycle combined with the re-depreciation of the yen, which took place until mid-December. Although real exports decreased by 1.5% mom in December, the quarterly result rose to 2.3% qoq, more than doubling the reading of Q3. Accordingly, industrial production also went up, reaching a plus of 2% qoq in Q4. It thereby significantly accelerated over the second half of last year, after retreating in H1 2016. The lower yen and the cyclical upturn should also have led via improved profits and a higher capacity utilization to rising investment demand. So far however, core machinery orders only moved sideways at best, which is likely due to a very cautions behavior of the non-manufacturing sector. According to the December BoJ Tankan report, business conditions for large manufacturers went up by four index points, while across the non-manufacturing sectors, they remained unchanged (albeit on a relatively high level). Especially the retail sector went more pessimistic. Retail sales in yoy terms accelerated over the course of the last months, but mainly due to base effects. According to the real consumption index, consumer demand will likely fall short again of the Q3 result of 0.3% qoq, advancing only around 0.1% qoq. In sum, we expect GDP growth in Q4 to come in around 1.0% qoq ann.

Trade surplus to US might become a problem

Looking ahead into Q1, the international business cycle is likely to remain solid. However, the export/ production driven upturn in Japan is contingent also on US President Trump's trade policies. Japan's exports to the US amount to a share of about 20%, while its real imports are only less than 10%. Thus, there might be room for a trade conflict. In 2016, exports to the US amounted to 2.6% of GDP. Against this background, Japan already said it is preparing for all trade contingencies. Against this background and the rising yen, we are skeptical that growth will accelerate much. Instead, we see growth averaging about 1% qoq ann. over the next quarters. However, inflation is likely to rise due to base effects and the past depreciation of the yen. December headline (core) inflation came in at 0.3% yoy resp -0.2% yoy. However, we see core inflation to rise to close to 1% in late summer 2017, then opening up the possibility for the BoJ to raise its yield target rates over the medium term.

China

Christoph Siepmann

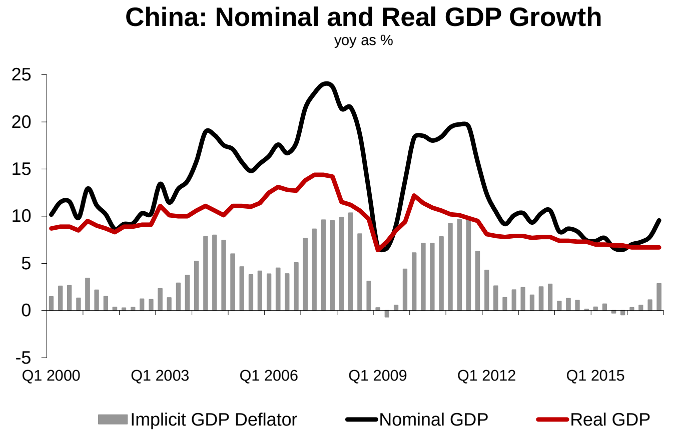
- **China's GDP growth surprised with 6.8% yoy in Q4 2016 slightly on the upside.**
- **Given the risk of a trade conflict with the US, we expect Beijing to withdraw its support only very limitedly. Thus growth is likely to move sideways in the near term. We expect monetary policy to also keep its current stance.**

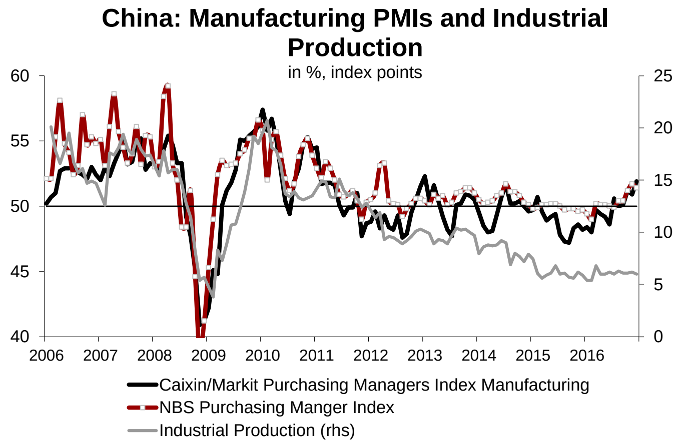
China's Q4 2016 real GDP expanded by 6.8% yoy, thereby surprising slightly on the upside, after three previous quarters with a constant rate of 6.7% yoy. Thus, growth for total 2016 was also 6.7%. In contrast to the real figures, nominal GDP continued to accelerate from 7.0% yoy in Q1 2016 to 9.6% yoy in Q4. This reflected primarily the recovery of the industry (secondary) sector, in both manufacturing and construction. Accordingly, also the GDP deflator rose during the year to 2.9% of late, again mainly driven by the secondary sector. Overall, we attribute this stable real and rising nominal growth to strongly supportive fiscal policies and rising real estate investment, which benefitted from lighter regulatory requirements. By contrast, exports continued to decline.

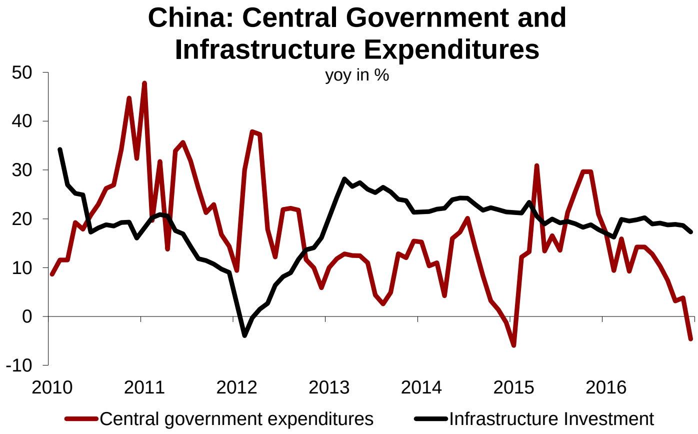
China's growth stable in the short run

Looking ahead, manufacturing as well as service PMIs do not suggest any major change in growth short-term. The Caixin manufacturing PMI improved one full index point to 51.9 points in December amid rising output and new orders subcomponents. However, the official NBS manufacturing PMI, which had seen a substantial spike already before, slowed 0.3 index points to 51.4. Nevertheless, both indices are in firmly expansionary territory. Judged by previous cycles from 2013 on (see middle chart), the current cycle is much more drawn out, but previous PMI levels for the government to withdraw some of its support have already been reached. Indeed, central government expenditure growth dropped already into slightly negative territory while infrastructure investment growth remained strong. Housing sales also lost pace, responding to tightening measures on local levels to limit high property price inflation. Accordingly, the sector should start to soften again. However, given the risk of a trade conflict with the US amid already substantially negative export growth rates, the government is likely to withdraw its support only very cautiously. Thus, we expect GDP growth to continue to move sideways in Q1 2017 and beyond, until the US President Trump's position on trade will have become clearer.

For the same reason, we expect the monetary policy stance to also remain broadly constant. The PBoC recently raised the interest rates for the 6-month and one-year medium term lending facilities by 10 bps. We interpret the move as to removing some of the high liquidity previously injected over the turn of the year and to limit also excessive risk taking in the month of January that typically sees the highest credit growth within the total year.

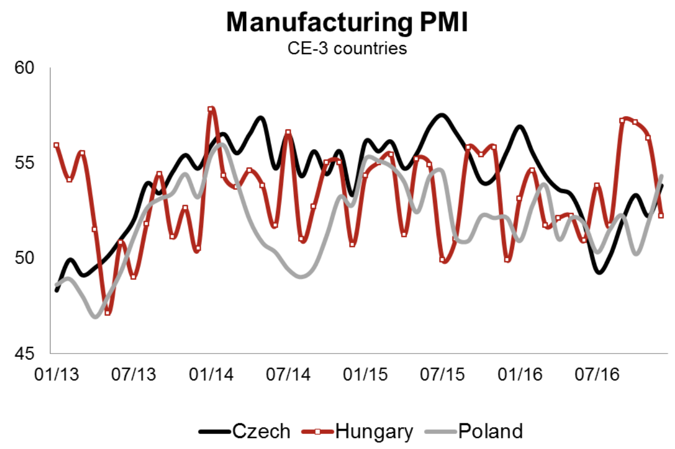


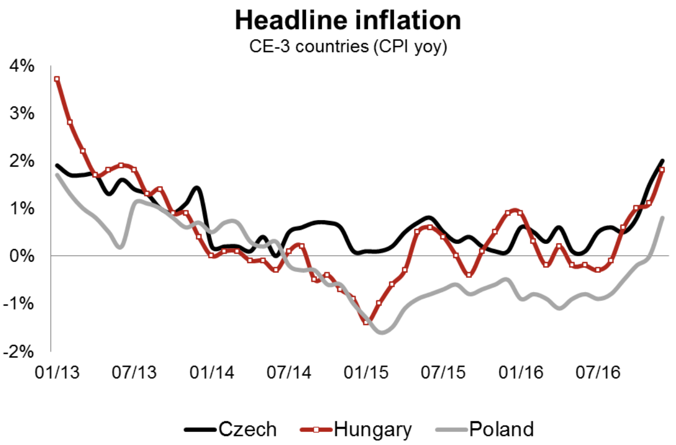




Central and Eastern Europe

Radomír Jáč





Main Forecasts	2015	2016e	2017f	2018f
Czech Republic				
GDP	4.6	2.3	2.0	2.6
Consumer prices	0.3	0.7	2.1	2.0
Central bank's key rate	0.05	0.05	0.05	0.05
Hungary				
GDP	2.9	1.8	3.0	2.7
Consumer prices	-0.1	0.4	2.2	2.8
Central bank's key rate	1.35	0.90	0.90	1.50
Poland				
GDP	3.9	2.5	3.0	3.0
Consumer prices	-0.9	-0.6	1.3	2.0
Central bank's key rate	1.50	1.50	1.50	1.75

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

- **Signals on economic activity were mixed in CEE in late 2016 but the region should benefit from the positive momentum seen in Euro Area.**
- **Inflation increased in the CEE region but is still likely to remain below central banks‘ targets with the Czech Republic being a notable exception.**
- **Speculations on exit from Czech FX commitment are mounting and the CNB intervenes in large volumes in order to keep EURCZK above 27.**

Signals on economic activity remain mixed. While data from the Czech Republic and Poland indicate that growth dynamics improved in Q4, data from Hungary are less convincing with industrial output failing to regain stronger growth momentum. Nevertheless, we expect the region to benefit from positive signals on economic activity that have been coming from the Euro Area. Economic growth in CEE countries should accelerate during 2017, also thanks to the stronger inflow of funds from the EU budget and related recovery in investment expenditure following the temporary slowdown seen in 2016.

Labor market developments remain supportive to the household consumption growth, which remains the key driver of the overall economic growth in the region. Core inflation has been recovering gradually across the CEE, while increase in the headline CPI was more noticeable in Q4 due to impact of fuel and food prices. Both commodity prices and the core CPI are likely to act pro-inflationary also in the upcoming months, but headline inflation is likely to stay below central banks‘ targets in most cases. The only notable exception is the Czech Republic, where inflation reached the 2% target already in December, some six months ahead of the central bank‘s forecast. This fuels expectations that the CNB will terminate its FX commitment to keep EURCZK > 27 as soon as possible.

Czech crown at spotlight: exit from FX pledge nears

The CNB made a pledge that its FX commitment will not be abolished before Q2, i.e. before April 2017. In other words, the CNB will continue to oppose the CZK firming in Q1. Available data indicate large volumes of FX interventions since start of January. This at the same time means that speculative positions, betting on the future gains of the Czech crown, are growing massively. This means that the CZK may temporarily have problems to firm once the FX commitment terminates, although economic fundamentals are supportive to the CZK appreciation.

The Hungarian central bank keeps a dovish bias in comments on monetary policy and is still likely to support oversupply of free liquidity in financial system via cuts in limits for volumes in the MNB‘s 3-month deposit tender. Further reduction in the MNB‘s interest rates is unlikely. Polish central bank keeps firm wait-and-see stance. Its key policy rate stands at 1.50% and the Polish MPC indicates no change in policy rates before 2018.

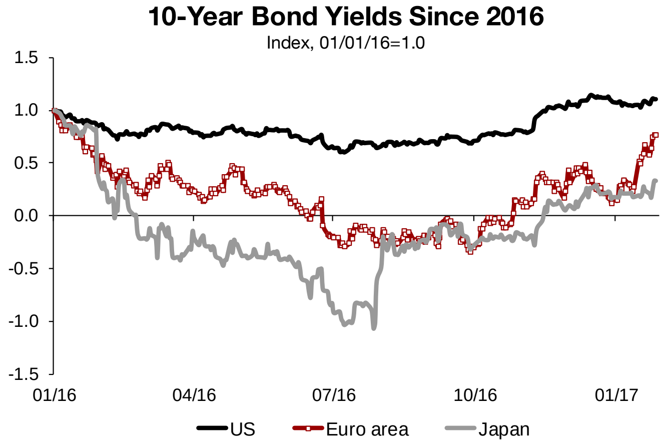
Bonds/Fixed Income Strategy

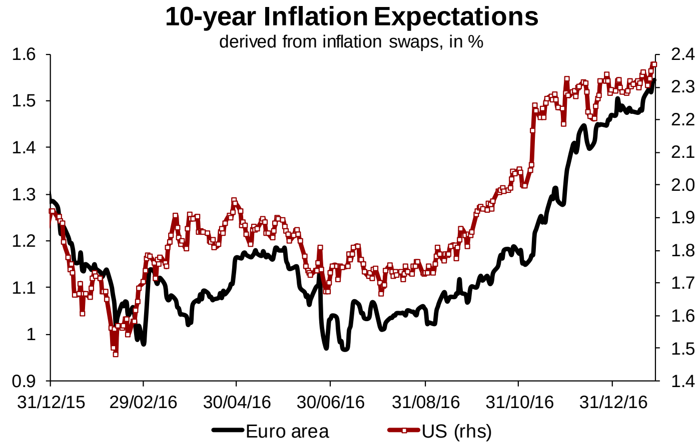
Florian Späte

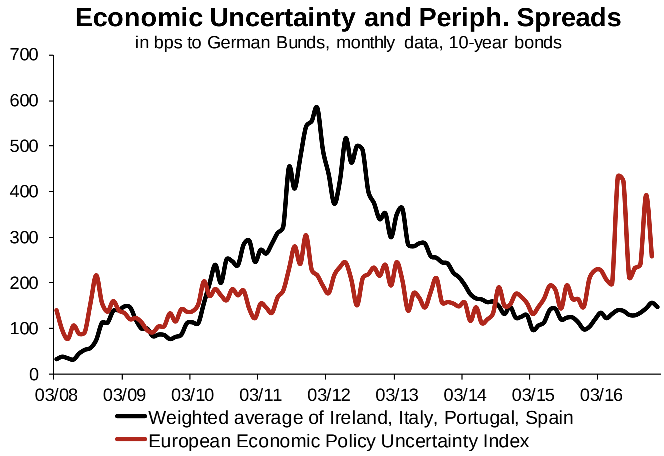
- **After a moderate setback, core government bond yields have started increasing again since the mid of January. Driven by solid economic data and a rising oil price, long-data euro area yields have reached the highest level since the start of 2016.**
- **Italian BTPs came under increased pressure as an end of the political uncertainty is still not in sight. On the contrary, the Constitutional Court's ruling on the Italian electoral law increases the likelihood of snap elections.**
- **As the scope for a significant increase in euro area core yields appears limited, we adhere to our current neutral duration allocation. However, we continue to recommend a short duration for Southern European bonds.**

The trend towards higher core government bond yields, which has started at the end of September 2016 and has been given new impetus after the US elections, is still unbroken. While government bond markets rebounded between mid-December and mid-January moderately, core yields have started increasing again since then. 10-year US yields are still trading below the peak marked in December (2.60%), but 10-year Bund yields have reached the highest level since the start of 2016. Short-dated yields tracked this development to some extent, but in recent weeks yield curves on both sides of the Atlantic steepened.

The yield increase in euro area core yields is almost exclusively due to higher inflation expectations. 10-year inflation expectations have increased by around 45 bps, accountable for around 80% of the nominal yield increase since September 2016. In the US, inflation expectations have risen by 50 bps since then. However, in contrast to the euro area, the real yield rose considerably as well. As real yields have started rising only after the US elections, it is obvious that the expected shift in the US economic policy towards a more expansive fiscal policy is mainly responsible for this divergence.





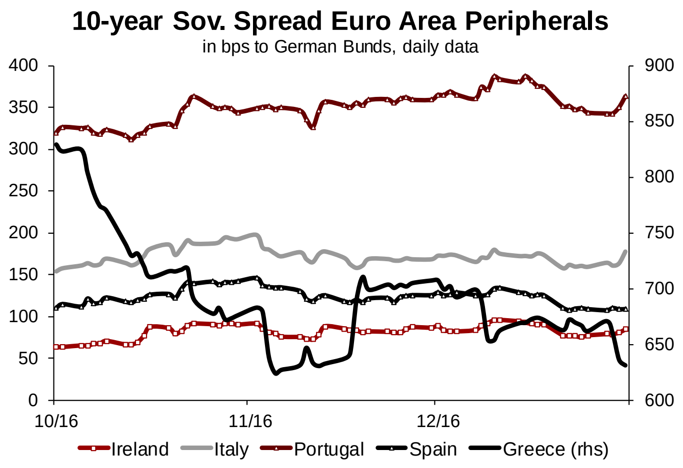


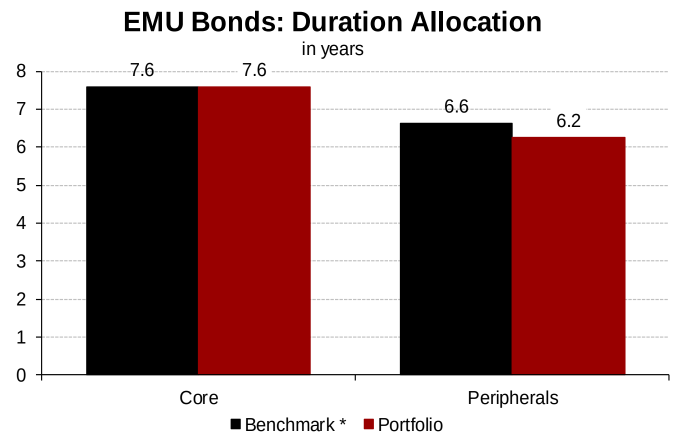
Transatlantic yield spread to rise again going forward

There are strong arguments for a continuation of the upward trend in US yields. The looming shift in US economic policy will trigger higher US growth and an increase in inflation rates in the months to come. We expect the Fed to react and to hike by 75 bps in the course of the year. As this is not completely priced by financial markets, it requires an adjustment further down the road. Moreover, the term premium, which was close to zero before the US elections, has soared to 40 bps. But, this is still well below the historical average and taking into account the policy uncertainty there is leeway for a further rise.

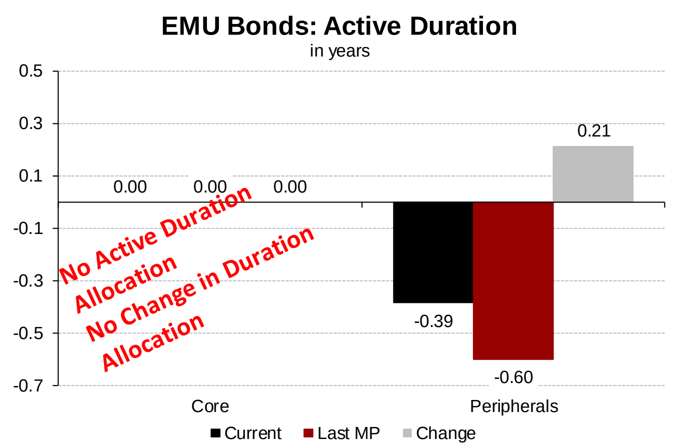
While some of these arguments also apply to the euro area, there are also significant differences.

Bonds/Fixed Income Strategy





* JPMorgan EMU Government Bond Index



To start with, euro area growth will not accelerate this year but moderate compared to 2016. In addition, the ECB will remain accommodative in 2017 and a first rate hike is still a long way off. Finally, the busy euro area political agenda is likely to trigger safe haven flows in the course of the year. Hence, euro area core yields are forecast to rise as well in 2017, but to a lesser extent than in the US.

All in, 10-year US yields are seen to rise by around 40 bps on a one year horizon. The Fed hikes will lift the short end of the curve even more. Ultimately, the US curve is likely to flatten. The scope for higher 10-year Bund yields is more limited. We expect them to rise to 0.60% on a 12-month horizon. However, as the short end is seen to move even less, the euro area yield curve is forecast to steepen slightly. In conclusion, the transatlantic yield spread will widen across all maturities.

Peripheral bonds to suffer from political uncertainty

While Spanish bond spreads have tightened since the start of the year and Portuguese spread moved sideways, Italian BTPs came under pressure. Particularly, the ruling of the Constitutional Court on the Italian electoral law triggered a considerable underperformance. The essential harmonization of the electoral systems between the two chambers of the Italian parliament increased the chances of snap elections in late Q2. While early elections are far from being a done deal (we estimate the probability just shy of 50%), the risk unnerved financial markets. According to current polls, Eurosceptic parties are likely to win nearly half of the seats. This would result in a very difficult government formation and a reduced governability. Hence, the necessary structural reforms would likely not be tackled.

Besides the cautious view regarding BTPs, the outlook is rather fragile in general. The political agenda for the euro area is crowded and will keep uncertainty on a high level. Although a victory of a euro-sceptic party in France, Germany or the Netherlands is unlikely, negotiations and agreements on the European level will become more difficult. As financial markets have hardly reacted to this yet, we continue recommending a prudent approach for the time being.

Our portfolios

As the leeway for higher core yields appears limited, we prefer a neutral duration stance. Given the steepened yield curve a short duration does not appear appropriate. With respect to peripheral bonds, a short duration is still first choice. Not only Italian BTPs but also other peripheral bonds are likely to be burdened by the upcoming elections and the related uncertainty. Accordingly, we continue to prefer a duration below benchmark, but – given the recent underperformance – to a lesser extent than before (-0.39 years).

Corporate Bonds (Non-Financials)

Florian Späte

- **Since the end of November, non-financial corporate bond spreads remained in a very tight trading range moving between 143 bps and 147 bps. In the same period, non-financial yields inched slightly up from 1.20% to 1.26%.**
- **Given the strong issuance activity since the start of 2017 and the rising yield level, we regard the decent performance as a sign of strength.**
- **Going forward, sound fundamentals and ongoing ECB purchases will support non-financials. In the longer run, however, the long-term spread tightening trend is expected to partially reverse.**

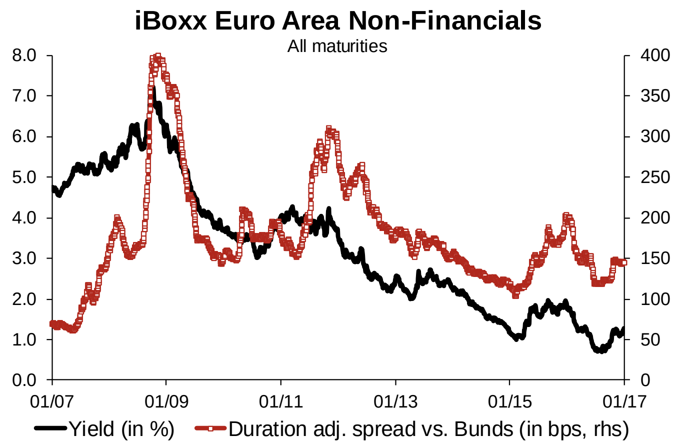
Over the last two months, non-financial corporate bonds moved in very calm waters. The spread remained in a tight trading range between 143 bps and 147 bps. On balance, non-financial yields crept up by 6 bps. However, this hides a strong upward movement since the start of the year. Since then, yields increased by 17 bps to 1.26%. As a result, the total return since the start of the year is -0.8% (after a very decent total return of 5.5% in 2016).

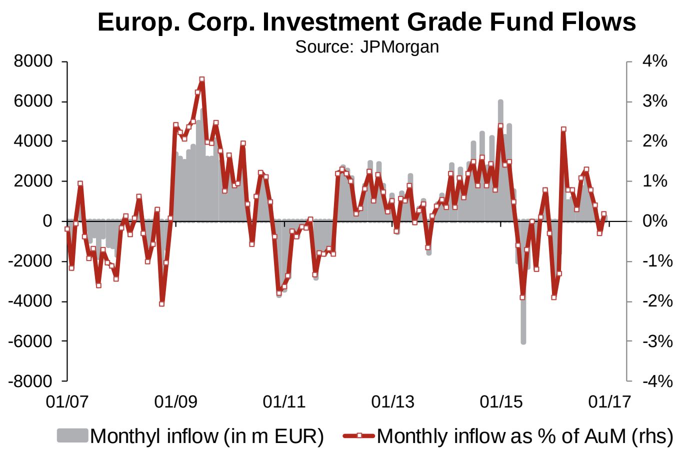
Non-financials brave a challenging market setting

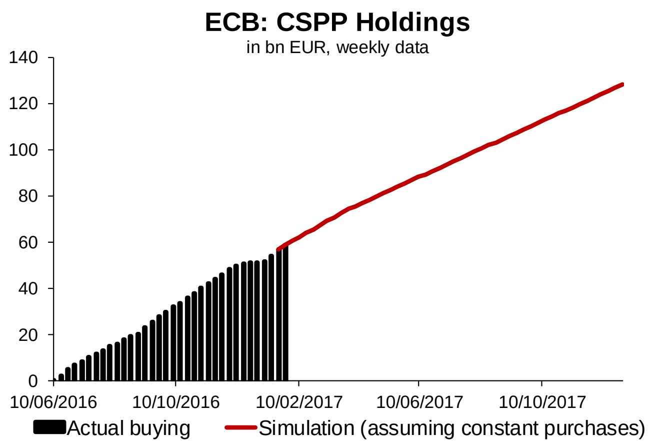
The stable spread development since the start of 2017 should be seen as a sign of strength. Generally, the rising yield level (and the consensus view of a continuation of this trend) burdens corporate bonds as it reduces the investors' need to allocate funds into riskier assets. What is more, primary markets got off to a good start to the new year. According to preliminary data, more than € 30bn of new non-financials were issued in January. This is the strongest data on record and represents a considerable burden.

However, there are also some balancing factors which are likely to support non-financials in the months to come. To start with, the solid economic situation will continue to keep defaults on a low level. In December, the 12-month default rate fell to a long-term low of 2.1%. It will remain on a low level in 2017 and is expected to fall even below 2% in the course of 2017. What is more, the ECB has speeded up its purchases in recent weeks again. On average, the central bank bought around € 2.5bn per week of non-bank IG corporates since the start of the year. Although the monthly inflow of funds into this asset class has slowed in recent months, they were positive in December and according to preliminary data will remain in positive territory in January as well. This provides some tailwind, too.

Accordingly, we remain cautiously optimistic for the time being and expect some (limited) spread tightening going forward. However, the total return potential is limited given the forecast slight increase in underlying yields. In addition, further down the road, non-financial spreads are seen to widen moderately. On balance, spreads are expected to move about sideways on a 12-month horizon.

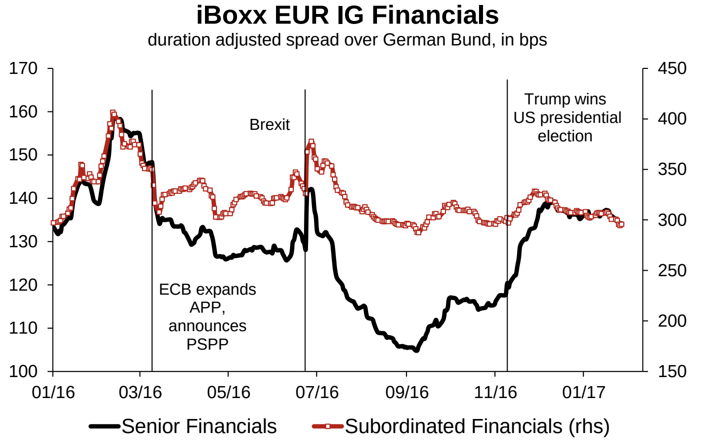


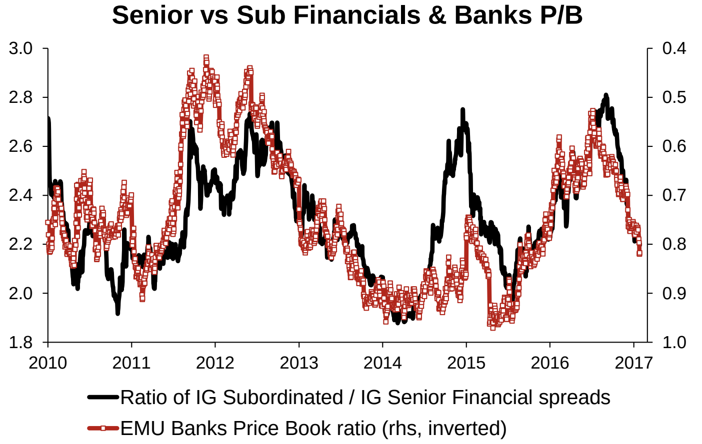


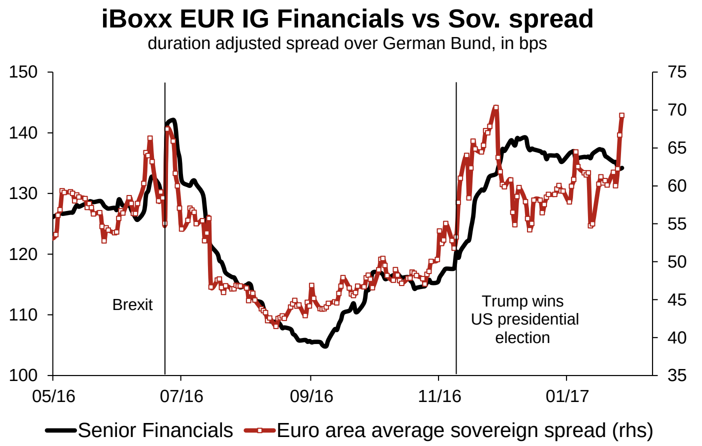


Corporate Bonds (Financials)

Luca Colussa







- **EUR IG Senior Financial spreads moved sideways in January, but the rise of the underlying Bund yields pushed the total return into negative territory.**
- **IG Subordinated bonds continued to outperform thanks to the strong performance of banks and the ongoing rebound of price/book (P/B) ratios.**
- **Looking forward, the renewed increase in sovereign risk premia should reverberate on Financial bond spreads, offering possible entry points.**

EUR-denominated Investment Grade (IG) Senior Financial bond spreads moved sideways in January, ending the month at 134 bps, one basis point lower compared to end-2016 levels. However, the further increase in the underlying German Bund yields (up 17 bps to -0.33%, the highest level since mid-November) pushed the year-to-date total return into negative territory (-0.60%). Lower rated bonds (BBB) performed better than A- and AA-rated ones for the second month in a row.

Higher equity valuation helped subordinated bonds

IG Subordinated Financials proved more resilient in the context of rising government yields. The duration-adjusted spread over the underlying Bund yield tightened by 12 bps to 295 bps, and this supported monthly total return, which was basically flat (-0.02%).

A key driver in the over-performance of Subordinated compared to Senior Financials was the improving equity market valuation of euro area banks. The ratio between the spreads of Subordinated and Senior bonds is highly correlated with banks' P/B ratio (see second graph). The steady recover in the latter since last summer was favored by improving macro conditions and rising rates, which have eased concerns over banks' profitability.

High sovereign risk premia to weigh in the short-term

The increased risk of early elections in Italy and the concerns over the outcome of the French presidential elections (to be held on April 23, with the run-off on May 7) have recently ignited a new spike in sovereign risk premia. The 10-year OAT-Bund spread rose to the highest level since spring 2014.

Senior Financial bond spreads have not incorporate this movement yet and we believe that they could experience some volatility in the coming weeks. That said, we would consider excessive spread widening as an entry point as the underlying conditions – increased capital levels, lower leverage, reduced concerns over banks' profitability, abundant excess liquidity in the system thanks to ECB's accommodative stance – remain supportive, favoring a broadly stable spread level and slightly positive (between 0.5% and 1%) total returns over a 1-year horizon.

Currencies

Thomas Hempell

- **After a strong rally in the US dollar in the wake of US elections, the Greenback started the year on a softer tone, partially reversing earlier gains against most major currencies, including the euro.**
- **Looking ahead, we anticipate the EUR/USD resume its weakening trend on further monetary policy divergence and higher political concerns about Europe.**
- **Later during the year, however, mounting speculation about tapering by the ECB should help the EUR/USD to bottom.**
- **Notwithstanding, hedging costs on USD investment are likely to rise markedly further after having surpassed 2% p.a. in January.**

Following the strong rally in the US dollar in the wake of the US elections towards the end of last year (+4.6% in trade-weighted terms), the Greenback pared some of these gains (-1.3%) this year by Jan. 27. Defying a key speech by British PM Theresa May, in which she laid out a tough strategy for Brexit negotiations, the British pound gained some ground over the first weeks of the year. Emerging market currencies generally held up well, except for the Mexican peso which continued to suffer on political tensions between the new US administration and Mexico, and the Turkish lira that plummeted 9% against the US dollar on political tensions and political worries.

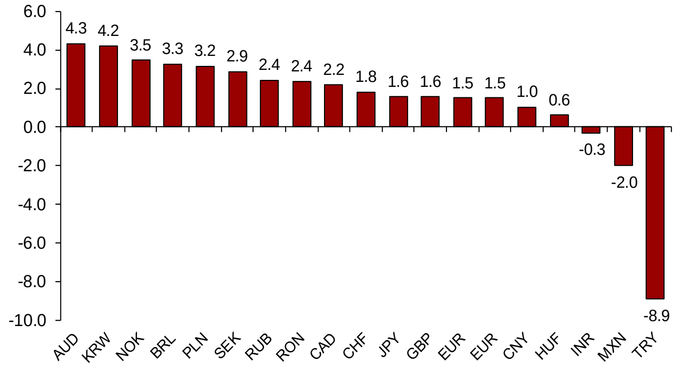
Prospects of US rate hikes to underpin the US dollar

The US dollar rallied further in December, also against the euro, but has slightly more than pared these gains in January, trading at levels close to 1.06 USD/EUR. This came despite the fact that speculators continued to remain positioned for a stronger US dollar, with USD long positions at the CFTC remaining at high levels above US$ 20 bn (see lower chart). A key driver, instead, remained the evolution of short-term yield differentials. While the yields of 2-year Treasury yields did not change much in January, 2-year Bund yields recovered 11 bps to -0.68%, proving the main force behind the tighter transatlantic yield gap.

Looking ahead, however, we anticipate the yield gap to widen more visibly again over the coming months to the favor of the US dollar. While continued ECB asset purchases and political wobbles in the euro area make a continued further uptick in short-term yields in the euro area little likely, we anticipate US yields to trend higher (see also our Bond section). Amid mounting prices pressures and solid economic data, we anticipate the Fed to continue to prepare markets for three rate hikes this year (compared to just two currently discounted by markets), following just two rate hikes over the two previous years. Furthermore, Fed officials will step up their talk about cautiously shrinking its balances sheet from next year on by weakening its reinvestment policy of maturing papers.

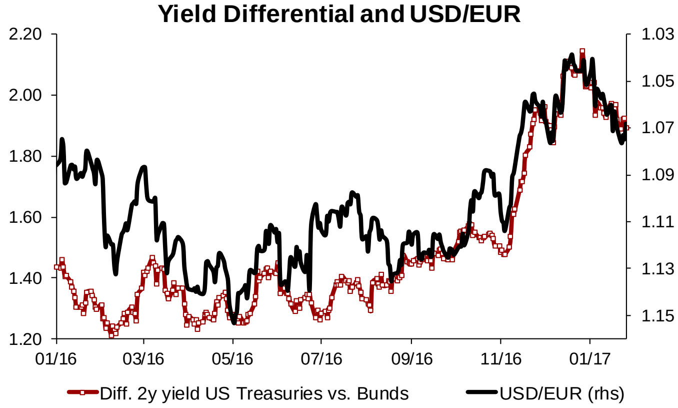
FX performance

vs. US dollar 30/12/2016 to 27/1/2017, in %



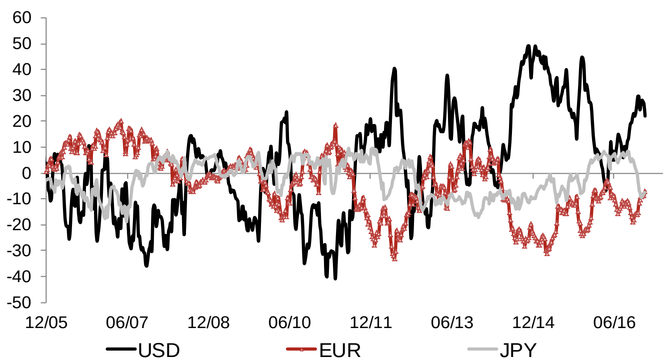
Data as of 27/1/2017

Yield Differential and USD/EUR

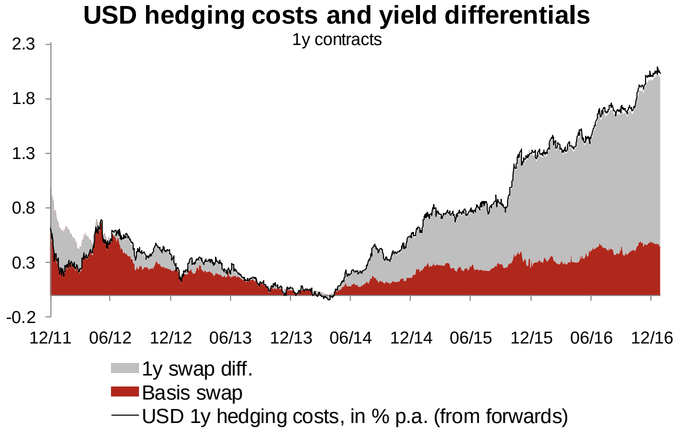


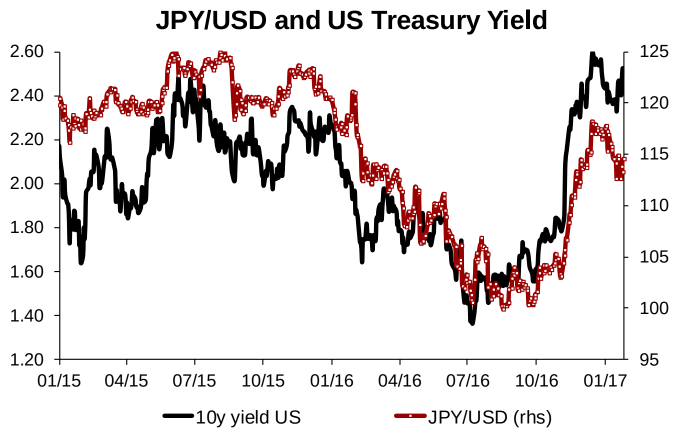
Speculative positions

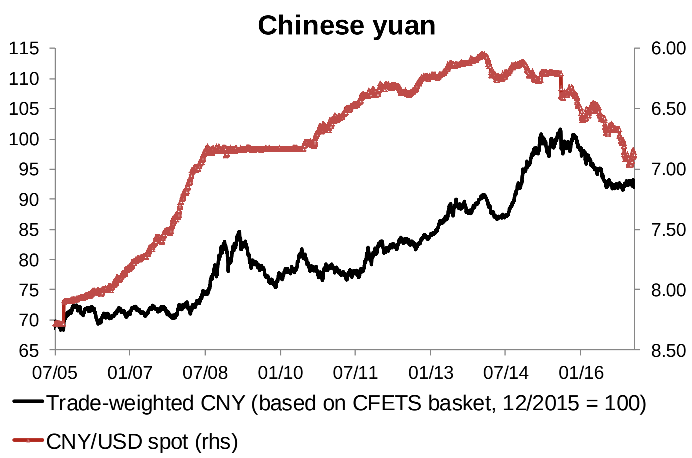
Value of net positions in bn USD (CFTC data, own calculations)



Currencies







Rising yields differentials will also push up USD hedging costs which have already surpassed 2% p.a. for 1-year contracts.

Upside risks to US dollar from border tax adjustment

A significant tail risk for US dollar strength so far barely discounted by markets is the tax reform envisaged by the new US President. In case this reforms entails a proposed border tax adjustment (effectively resulting in the taxation of imports and a subsidy to exports both by 20%), the US dollar would rally significantly.

Even not integrating this tax adjustment fully into the base line, we anticipate the US dollar to resume its strength over the coming weeks, envisaging levels closer to parity around mid of the year. Against the euro, however, this episode of dollar strength is likely to fade in H2, once speculation about ECB tapering its assets purchase program starts to mount.

Yen to remain burdened by rising US yields

The yen, which had weakened from levels close to 100 JPY/USD in autumn to 118 in December, gained some ground over the past weeks, trading around 114 JPY/USD towards the end of January. With the BoJ, which is now targeting the level of yields, however, rising US yields will continue to widen the yield gap between the two economies, thereby weakening the yen. With the BoJ so far showing no signs of a policy change, we anticipate an episode of more protracted yen weakness against the US dollar over the coming months.

Weakness in CNY/USD after resilient start into 2017

In stark contrast to 2016, when devaluation fears about the Chinese yuan triggered a sell-off in EM assets globally, the Chinese currency started the new year resiliently. Following a stronger decline against the US dollar over the second half of last year amid strong capital outflows, the yuan slightly recovered against the Greenback over the first weeks of the year. In parts, this was likely the result of continued FX intervention by the Chinese central bank (PBoC) and tighter capital controls. To the largest extent, however, the stable CNY/USD was also a reflection of tamed dollar strength more generally. As illustrated in the lower chart, the trade-weighted yuan remained barely changed around levels prevailing since mid of last year.

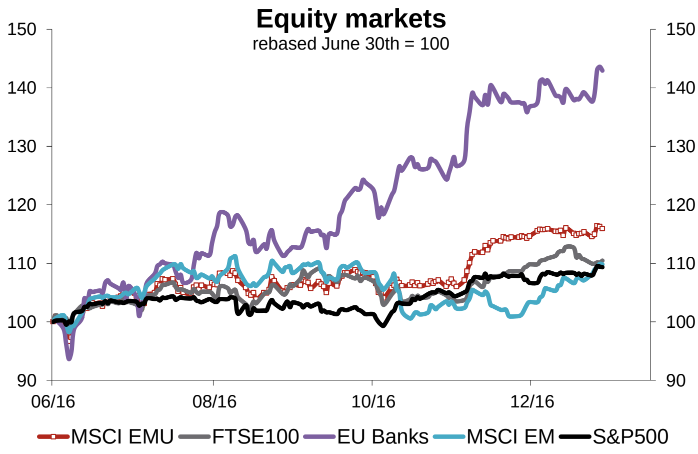
Looking ahead, broader strength of the US dollar is likely to be also reflected in the Chinese currency. Over the course of the next month, we anticipate the CNY/USD to pass the symbolic threshold of 7.00 CNY/USD and to depreciate by at least 5% until the end of the year. Mounting political tensions between China and the Trump administration would exacerbate these forces. We stick to our view, however, that China is not interested in a fast and uncontrolled devaluation, making ongoing intervention and a gradual path of yuan weakening likely.

Equities

Michele Morganti

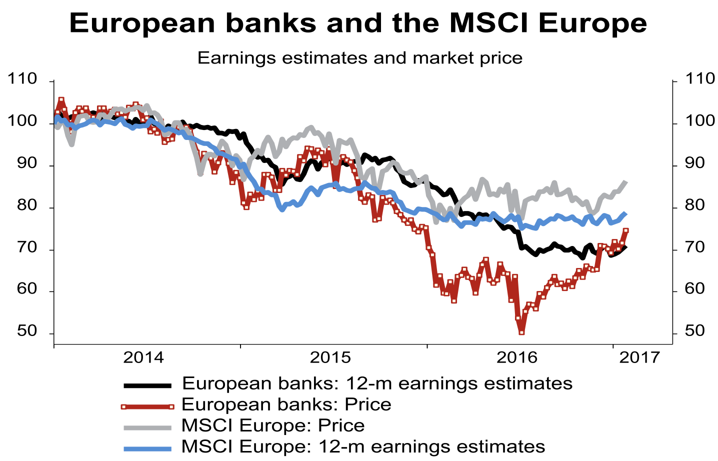
- **Global equities performed well in the last two months. Financials continued to outperform.**
- **The outlook for global earnings remains encouraging after the cyclical trough experienced in Q1 2016. The reporting season in the US is giving reassuring signs from this point of view.**
- **While valuations are slightly higher than the historical average, we overall remain constructive on euro area equities, Japan and selected EMs.**
- **Within Europe, we favor the value-cyclical sectors, including financials and stay short staples.**

In the last two months, equities posted a positive performance of around 5% (MSCI World). The euro area (EA) index outperformed with a price return of 8.5%, while US equities underperformed with a 4% increase. Year-to-date, the equity performance is positive; particularly emerging markets (EM) have returned +6%.



Earnings perspectives remain encouraging

In the last weeks the financial and energy sectors continued their positive earnings momentum which ultimately contributes to sustain that of the broader index. For example, the European banking sector overperformed the MSCI Europe by +2% over the last two months. Since July 2016, the performance gap is +28%. Banks first recovered from the trough in their valuation discount, reached in June (see chart). More recently, they have been enjoying an earnings revision, as the economic cycle started stabilizing and yields began trending up. Turning to the energy sector, the 12-month moving average of the Brent oil price increased from 44.8$ to 48$ over the last two months. This has had, of course, positive effects on the sector's earnings forecasts, up by 5% over the same period. Since June, earnings have increased by a full 40%. The metal and mining sector shares a similar pattern. As the price of the metal index surged by 27% since June 2016, and that of the Iron Ore one by 63%, analysts have revised the sector's earnings estimates on the upside by no less than 170% (albeit from very depressed levels).



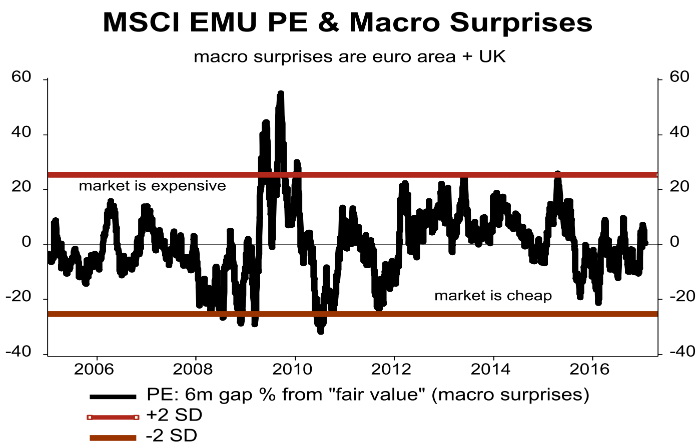
These three sectors should continue to see earnings upgrades at least in the short term, helping global earnings to stabilize further this year and the next, after the cyclical trough experienced in Q1 2016. The financial and energy sectors alone represent 22% of the S&P 500 and 28% of the MSCI Europe.

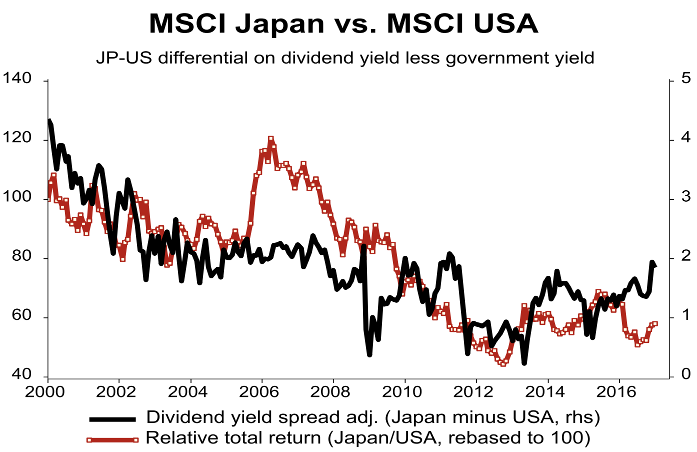
Area	past earnings growth, p.a.	expected yoy growth 2017, GIE	expected yoy growth 2017, Consensus	difference * 2017
US	7.3%	2% - 5%	11.5%	-8.0 pp
Euro Area	4.4%	4% - 6%	12.2%	-7.2 pp
Japan	3.1%	5% - 7%	11.7%	-5.7 pp
EMs	9.6%	6% - 9%	14.8%	-7.3 pp

* Midpoint of GIE forecasts minus consensus

Overall, we remain below analysts' forecasts for 2017 but we expect at least a mid-single digit earnings growth for this year and the next. While muted, global macro conditions are supportive: the index of macro surprises remains and business confidence remain high. This has already triggered a rebound global sales growth (in nominal terms) and US NIPA profits.

Equities





last available date: 24/01/17

Markets	PE 12m f	PE Discount	PB 12m f	PB Discount	PCF 12m f	PCF Discount	DY 12m f	DY Discount	Avg. Discount	Avg. Disc. (-1M)
USA	17.2	13.3	2.7	18.9	11.5	18.6	2.2	-1.4	13.1	13.3
JAPAN	14.3	-9.2	1.2	-4.4	7.7	9.6	2.1	13.9	-4.5	-12.0
UK	14.4	3.9	1.7	-3.6	8.7	12.3	4.3	7.7	1.2	0.7
SWITZERLAND	16.2	5.4	2.2	-0.6	12.9	16.3	3.8	15.7	1.4	1.4
EMU	14.3	1.3	1.5	-0.3	7.8	23.7	3.4	-12.7	9.4	9.9
FRANCE	14.5	1.0	1.4	-2.2	8.4	25.7	3.5	-7.9	8.1	8.5
GERMANY	13.7	-9.8	1.6	11.7	8.3	27.8	3.0	-11.4	10.3	10.4
GREECE	13.6	6.7	1.5	-5.1	7.1	21.9	3.2	-18.7	10.5	12.8
ITALY	13.1	-14.7	1.0	-15.0	5.0	10.9	4.5	-3.3	-3.9	-3.9
PORTUGAL	15.5	24.3	1.7	1.1	6.3	8.3	4.6	2.6	7.8	10.3
SPAIN	13.2	1.8	1.2	-28.7	5.0	-1.4	4.2	-18.5	-2.4	-2.2
EURO STOXX 50	13.9	5.6	1.5	0.7	7.6	27.5	3.7	-13.6	11.8	12.4
STOXX SMALL	16.0	13.3	1.7	3.4	8.2	2.5	2.9	-8.4	6.9	5.8
EM, $	12.1	-17.4	1.4	-11.5	7.4	-3.1	2.8	-20.9	-2.8	-6.6
BRAZIL	12.5	42.6	1.5	-12.3	7.5	-49.1	3.5	-20.3	0.4	-5.7
RUSSIA	5.9	-17.7	0.7	-27.6	3.7	-19.9	4.9	44.0	-27.3	-27.4
INDIA	16.5	16.2	2.6	-2.6	11.4	0.1	1.7	3.5	2.6	-2.8
CHINA	11.7	-9.7	1.4	-19.2	7.5	-0.1	2.3	-24.7	-1.1	-5.8

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

The Q4 reporting season started on the right foot

Given a resilient macro environment, the reporting season for Q4 is giving encouraging signs. In the US, 162 firms have already published their data, showing a 5.2% yoy earnings growth versus 4.1% in Q3. Sales growth is +2.9% yoy vs. 1.3% in Q3. The earnings surprise versus estimates one is a little lower, but positive at 3.2% (6.2% in Q3) for earnings and is unchanged for sales at +0.5%. While in Europe we have only 30 results, in Japan we have already 260. Here, the earnings growth went back into positive territory (+18% yoy) and the sales confirmed a +3% yoy expansion. The surprises versus estimates turned also positive for both earnings and sales. The negative effects of the strong yen are fading away and we expect the positive earnings momentum to continue this year.

EA valuations have increased but are still not at risk

The upward move in yields seen in the last months has started to reduce the positive valuation cushion for European, Japanese and, especially, EMs equities. However, for the time being, real rates remain sufficiently low, so that price earnings levels are not particularly affected by higher yields (especially in Europe and Japan).

In the EA, the 12-month price-earnings (PE), at 14.3, is a little higher than the historical average. At its peak in 2015, it reached 16.4. Furthermore, while the current PE level is essentially aligned to the macro surprise index level (and therefore appears fairly valued, see chart), in Q1 2015 it was 2 standard deviations above the theoretical fair value derived from the level of the macro surprise index. As for Japan, current multiples are slightly below the historical average and the dividend yield is attractive vs. the US one (when adjusted for the level of the 10-year rate, see chart). On the contrary, US equities' valuations look stretched. That said, three caveats are in order for the short term. First, real 10-year rates are still low and do not yet represent a particular threat to current multiples. Second, the macro momentum remains strong and, third, Trump's fiscal plan may add to earnings forecasts (+5% or more) in the second half of the year. That said, we still prefer EA and Japan as we expect increasing US wages to hurt profit margins at some point. Furthermore, given the expectation of three Fed Funds rate hikes in 2017, real rates should increase by the end of the year. Finally, Trump's policies could add to market volatility as details on the fiscal expansion are not clear yet. Moreover, trade tensions and a stronger dollar could raise risk aversion, leading to a higher equity risk premium. We remain constructive on EA and Japanese equities as well as on value-cyclicals, including financials. For the time being, we also maintain our trades of being long Italy and Germany versus Switzerland, pharma and financials versus staples and the EA versus the US.

Emerging Markets Equities

Vladimir Oleinikov

- **EM stocks are still relatively cheap and likely to benefit further from stabilizing oil and commodity prices. Higher yields and stronger dollar could put pressure closer to H2 2017.**
- **We continue to be constructive mid-term on EMs, while remaining tactically neutral for the moment.**
- **We still favor India along with Korea and CEE countries.**

Over the last two months, EM equities have bounced back by 5.7% in US dollar terms. The top performer was Poland (+15.4%), followed by Turkey (+12.0%), and Hungary (+10.5%). The Shanghai index has shown the worst performance (-2.8%). The Polish market was influenced by the run-up of financials and materials (significantly higher earnings expectations). The financials (having a market weight of 47%) have rallied on hopes the current government would step a bit back from their election campaign promises to restructure the banking sector (affected by Swiss frank denominated mortgages).

Overall, EM 2017 earnings have been revised up over the last two months (+1.5%). The markets for which they have been upgraded significantly are: Brazil (+10.2%), Poland (+4.7%), and Korea (+4.1%). The MSCI China's earnings have been revised up only slightly by 0.6%, with A-share earnings (Shanghai index) experiencing a drop by 1.5%. Further downward revisions cannot be excluded on account of falling Chinese industrial earnings.

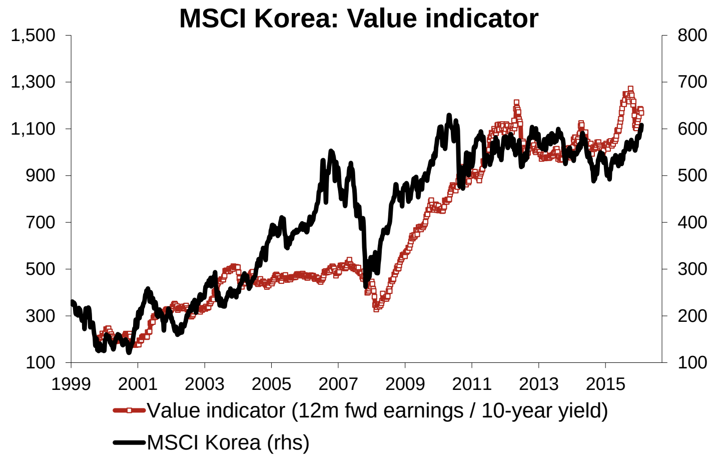
EM stocks have benefitted from improving macro surprises and increasing prices for oil (+7.6%) and commodities (+5.5%). Stabilizing commodity prices and relatively cheap valuations should continue to support the market short term. Starting from June, the Fed is expected to hike its policy rate (3 times in total in 2017) and that would put pressure on EM equities. Another negative factor is an eventual US trade protectionism: Mexico and China / Taiwan should be more affected.

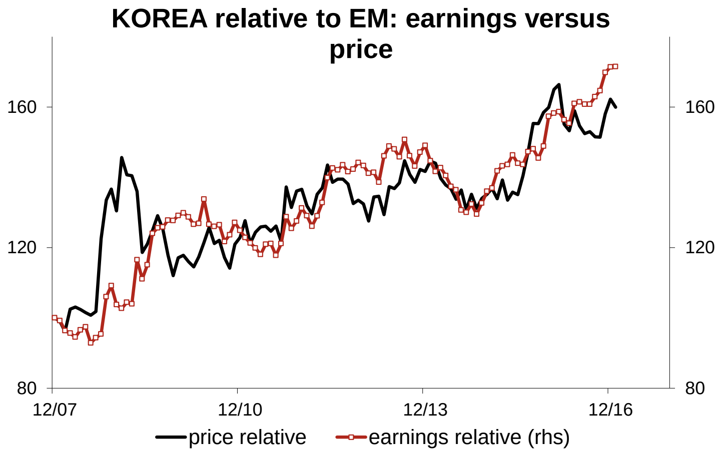
Korea: no drag from corruption scandals expected

Overall, the market has been hardly affected by recent corruption scandals. In effect, the Korean equities have slightly outperformed the MSCI EM (+10 bps since the beginning of December). The market is supported by solid fundamentals and in our view, the scandals could serve as a catalyst to further improve the overall transparency of the Korean business culture, calling for more restructuring. Korea's valuations are at a discount of 11.5% versus its history, whereas the EM equities are almost fairly valued (showing a discount of only 2%). Apart from a better earnings trend versus price development relative to the EM universe, the market is characterized by increasing margins, return on equity (ROE), and payouts. For an export-oriented economy, the downside risks come from lower global trade (e.g. as a result of greater tensions between the US and China).

Markets	price, %-chg		earnings, %-chg		10y yld	FX (TW), %-chg	
	-1M	YTD	-1M	YTD	chg, YTD	MTD	YTD
WORLD ($)	2.4	3.0	2.0	1.6			
US	1.1	2.5	1.1	1.1	3	-0.9	-0.9
EMU	1.1	1.1	0.9	1.0	35	0.0	0.0
GREECE	-1.3	-3.5	2.1	0.7	12	0.0	0.0
CZECH REP.	1.8	1.7	-0.8	-0.5	-1	0.1	0.1
HUNGARY	3.6	3.2	1.9	2.2	30	-0.6	-0.6
POLAND	8.0	7.4	0.6	3.1	20	1.9	1.9
EM ($)	8.4	6.2	4.1	3.2	-12		
BRAZIL	12.1	9.2	10.9	-1.6	-61	2.4	2.4
CHINA	9.4	6.9	2.5	2.5	30	-0.3	-0.3
INDIA	7.8	5.5	0.5	0.9	-11	-0.6	-0.6
INDONESIA	5.7	0.2	0.8	0.9	-36	-0.3	-0.3
KOREA	4.0	4.7	3.8	3.3	10	1.5	1.5
MALAYSIA	4.0	2.7	0.4	0.4	-7	-1.0	-1.0
MEXICO	4.8	4.0	4.0	3.8	5	-2.6	-2.6
RUSSIA	3.4	1.0	5.8	6.3	-11	1.2	1.2
TAIWAN	3.5	2.1	0.9	0.9	-5	0.9	0.9
THAILAND	5.3	3.2	1.7	1.6	4	-0.6	-0.6
TURKEY	9.6	7.8	1.0	1.0	-10	-9.9	-9.9
VIETNAM	2.1	2.0	17.5	17.8	-9	-0.6	-0.6
SHANGHAI	1.4	1.8	1.6	1.6	30	-0.3	-0.3

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



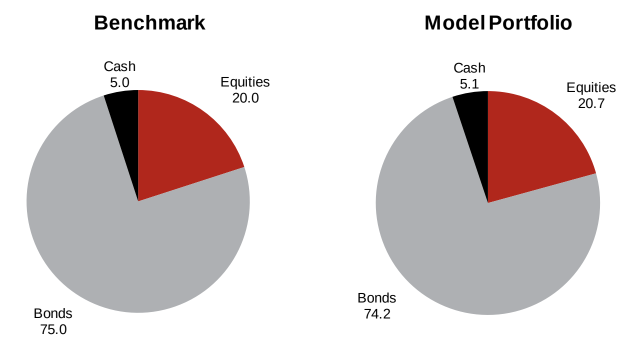


Mark to Market Allocation

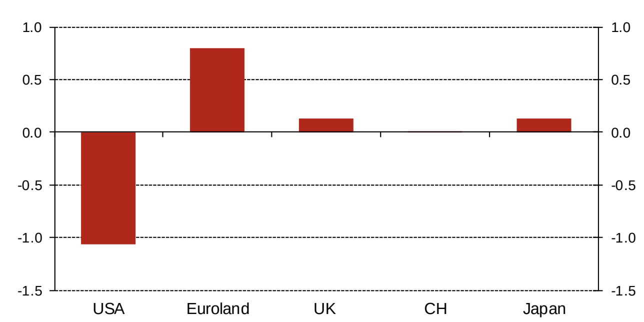
Thorsten Runde

Asset Class	Benchmark	Model Portfolio	Previous Allocation
Equities	***20.0***	***20.7***	***19.5***
Bonds	***75.0***	***74.2***	***75.5***
Cash	***5.0***	***5.1***	***5.0***
Equities, US	3.0	**2.9**	2.8
Equities, EMU	12.0	**12.6**	11.9
Equities, UK	2.0	**2.1**	2.0
Equities, Switzerland	1.0	**1.0**	1.0
Equities, Japan	2.0	**2.1**	1.9
Bonds, Gvt. US	11.3	**11.4**	11.7
Bonds, Gvt. EMU Core	27.0	**26.0**	27.2
Bonds, Gvt. EMU GIIPS	18.0	**18.0**	17.8
Bonds, Gvt. UK	7.5	**7.6**	7.7
Bonds, Gvt. Switzerland	3.8	**3.6**	3.8
Bonds, Gvt. Japan	7.5	**7.6**	7.4
Cash, Euro 3-Mth.	5.0	**5.1**	5.0

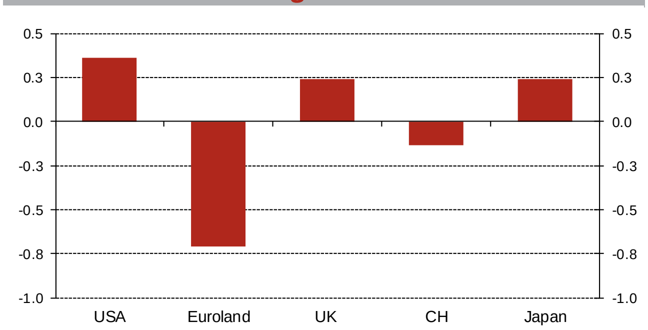
Asset Classes



Equities - Regional Structure



Bonds - Regional Structure



- **Since our last publication at the end of November 2016, equity markets performed quite strongly throughout, with the euro area being the most attractive one.**
- **Long-dated government bond yields have also risen significantly, pushing all performance figures into negative territory.**
- **The risk premia on Southern European sovereign debt tightened.**
- **Currently, a reassessment of new policy measures in the US may well continue for a while and thus lead to uncertainty on financial markets.**
- **Looking forward, we expect doubts about Trump's economic plans to keep equity volatility high even though economic data are likely to remain supportive.**
- **Given the low yield levels in the euro area and the expectation of rising yields in the US, equities appear more attractive on balance.**
- **The allocation stance recommended, is thus primarily characterized by a moderate overweight in equities at the expense of core government bonds.**

In the course of December 2016 and January 2017, equity markets performed quite strongly throughout. Rising slightly less than 9%, the euro area turned out to be the most attractive market. The same is true for the yields of long-dated government bonds which also increased across all markets, thus pushing the total return figures on the fixed income side into negative territory.

Solid economics vs nebulous 'Trumponomics'

On the one hand, the global economy has entered the year on a strong footing, underpinned by several robust indicators across all important countries and regions. On the other hand, markets' strong discounting of growth-enhancing measures by the incoming Trump administration in the US might be vulnerable to second thoughts after Trump's first disappointing press conference after his election in the first half of January.

Cautious overweight in European equities

Against this backdrop, equity volatility is likely to remain elevated, with euro area stocks better positioned for slight gains than already expensive US stocks. With the Fed continuing its hiking cycle, a renewed rise in US yields seems likely, whereas the ECB is expected to keep a lid on euro area core yields. All in, this argues for a tactical alignment primarily characterized by a moderate overweight position in euro area equities at the expense of core government bonds.

Forecast Tables

Growth

Growth	2015	2016e	2017f	2018f
US	2.6	1.6	2.4	2.5
Euro area	1.9	1.7	1.5	1.3
Germany	1.5	1.7	1.3	1.3
France	1.2	1.2	1.2	1.1
Italy	0.6	0.9	0.5	0.6
Non-EMU	2.4	2.1	1.7	1.5
UK	2.2	2.0	1.5	1.3
Switzerland	0.8	1.0	1.3	1.4
Japan	1.2	0.9	1.0	0.9
Asia ex Japan	6.1	6.0	5.9	5.9
China	6.9	6.7	6.4	6.1
Central/Eastern Europe	0.1	1.1	2.4	2.8
Latin America	- 0.5	- 1.5	0.8	1.7
World	**3.3**	**3.0**	**3.4**	**3.5**

Inflation

Inflation	2015	2016f	2017f	2018f
US	0.1	1.3	2.3	2.5
Euro area	0.0	0.2	1.6	1.5
Germany	0.1	0.4	1.8	1.7
France	0.1	0.3	1.2	1.1
Italy	0.1	- 0.1	1.2	1.0
Non-EMU	0.1	0.7	2.6	2.6
UK	0.0	0.7	3.0	2.9
Switzerland	- 1.1	- 0.4	0.2	0.6
Japan	0.8	- 0.1	0.6	0.7
Asia ex Japan	2.4	2.7	3.0	3.0
China	1.4	2.1	2.4	2.2
Central/Eastern Europe	9.3	5.1	4.5	4.4
Latin America	6.2	6.2	4.5	4.0
World	**2.3**	**2.4**	**2.8**	**2.8**

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

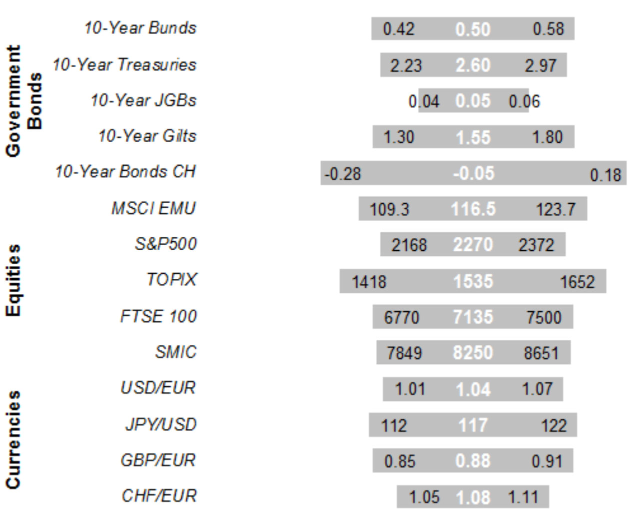
Financial Markets

3-M Money Market Rates	**27.01.17***	**3M**	**6M**	**12M**
USA	1.04	1.10	1.30	1.80
EUR	-0.34	-0.35	-0.35	-0.35
JPN	-0.01	-0.05	0.00	0.00
UK	0.36	0.40	0.40	0.40
SWI	-0.73	-0.75	-0.75	-0.75
10-Year Bonds	**27.01.17***	**3M**	**6M**	**12M**
Treasuries	2.50	2.60	2.70	2.90
Bunds	0.47	0.50	0.55	0.60
BTPs	2.20	2.30	2.35	2.50
OATs	1.02	1.05	1.05	1.05
JGBs	0.08	0.05	0.10	0.15
Gilts	1.49	1.55	1.60	1.75
SWI	-0.06	-0.05	0.00	0.10
Spreads	**27.01.17***	**3M**	**6M**	**12M**
GIIPS	156	160	165	170
Covered Bonds	82	80	80	80

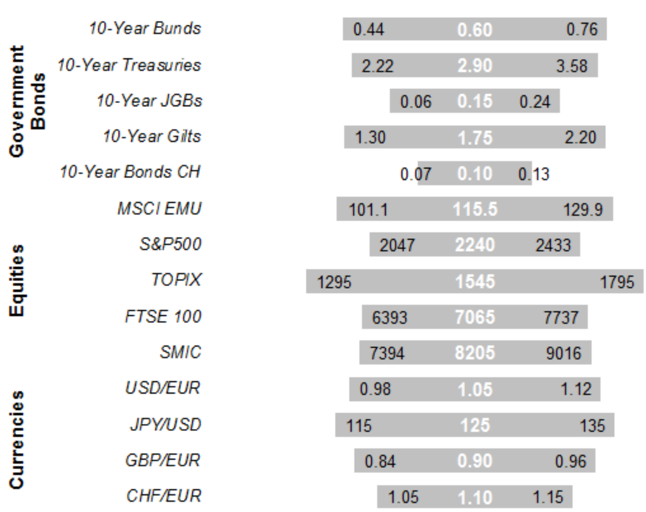
Corporate Bond Spreads	**27.01.17***	**3M**	**6M**	**12M**
IBOXX Non-Financial	144	140	140	145
IBOXX Sen-Financial	134	135	135	140
Forex	**27.01.17***	**3M**	**6M**	**12M**
USD/EUR	1.07	1.04	1.02	1.05
JPY/USD	114	117	120	125
JPY/EUR	123	122	122	131
USD/GBP	1.26	1.18	1.15	1.17
GBP/EUR	0.85	0.88	0.89	0.90
CHF/EUR	1.07	1.08	1.09	1.10
Equities	**27.01.17***	**3M**	**6M**	**12M**
S&P500	2297	2270	2270	2240
MSCI EMU	116.2	116.5	116.5	115.5
TOPIX	1539	1535	1550	1545
FTSE	7170	7135	7190	7065
SMI	8391	8250	8275	8205

*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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