Market Perspectives

August 2017

Content

Global View

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- **Euro area core government bond yields continued to trend higher in July. However, the uncertainty around US politics led to a further tightening of the Transatlantic yield spread, with the euro reaching a 30-month high vs the US dollar.**
- **Looking ahead, the gradual turn to the exit from highly accommodative policies by major central banks will set the tone for financial markets over the coming weeks.**
- **With the ECB having prepared the ground for a QE tapering announcement in fall, the recent rise in European yields may well extend somewhat further.**
- **We still prefer European risky assets and credit over sovereign debt, but favor a slightly more prudent active exposure after the recent yield rise.**

Euro area (EA) core government bond yields kept rising in July on the back of a less dovish communication by ECB officials and ongoing solid economic data. In contrast, US Treasuries yields moved sideways due to the uncertainties surrounding politics and the further slowdown in inflation data. The Transatlantic yield spread fell to the lowest level since Trump's election, while the euro appreciated up to 1.17 against the US dollar, a 30-month high. The solid macro backdrop and record-low volatility kept supporting risky assets, both in equities and fixed income. EA public and private spreads tightened further, with the BTP-Bund spread falling to 156 bps (the lowest level since January) as the risk of snap elections in Italy faded.

	Growth			Inflation		
	2016	**2017f**	**2018f**	**2016**	**2017f**	**2018f**
US	1.6	2.1	2.2	1.3	2.1	2.2
Euro Area	1.7	2.0	1.6	0.2	1.5	1.3
China	6.7	6.7	6.3	2.0	1.8	2.1
World	3.0	3.4	3.5	2.3	2.6	2.7
f=forecast						

After the sharp rise following ECB president Draghi's speech in late June, German Bund yields extended their upward movement into the first half of July, with the 10-year yield hitting 0.60%, the highest level since the start of 2016. At the ECB policy meeting on Jul 20, president Draghi confirmed the improved growth outlook but also adopted a moderate tone trying to calm down concerns over a taper tantrum. The easing bias regarding the Asset Purchase Programme was maintained and the timing on future policy changes was deliberately left open.

That said, Draghi stated that the tapering discussion will start in fall. Given the latest dollar strength, the announcement of tapering will probably be postponed towards October, right after the next Fed meeting.

The situation in the US is somewhat more complicated. Ongoing investigation over "Russiagate" and the repeated failed attempts to repeal the Obamacare raised doubts about the ability of the Trump administration to stimulate economic activity. In addition, inflation data in June surprised again on the downside, although mainly due to lower energy prices. In contrast, macro surprises kept recovering after having bottomed out in mid-June and real GDP growth accelerated in Q2 to 2.6% qoq annualized, from disappointing 1.2% in Q1.

The Fed acknowledged the recent weakness in price dynamics at its policy meeting on Jul 26. That said, the press statement affirmed that the FOMC "expects to begin implementing its balance sheet normalization program relatively soon". This is consistent with our view that the Fed will likely make this announcement at the next policy meeting in September. We also continue to expect a further rate hike this year, most likely in December. However, we acknowledge that investors remain skeptical over the future course of policy normalization, with only one and a half rate hikes priced in until end-2018.

Bonds	**27.07.17***	**3M**	**6M**	**12M**
10-Year Treasuries	2.31	2.45	2.60	2.80
10-Year Bunds	0.55	0.60	0.70	0.85
Corporate Bonds				
IBOXX Corp. Non Fin	121	120	125	135
IBOXX Corp. Sen. Fin	107	110	115	120
Forex				
USD/EUR	1.17	1.14	1.16	1.16
JPY/USD	112	114	117	120
Equities				
S&P500	2477	2460	2455	2445
MSCI EMU	123.8	126.0	127.0	128.0

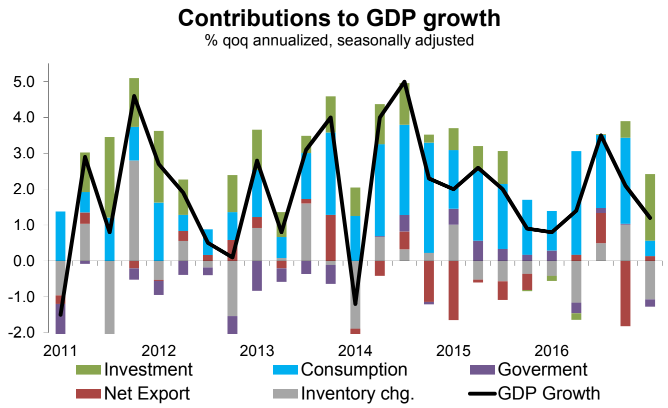
* avg. of last three trading days

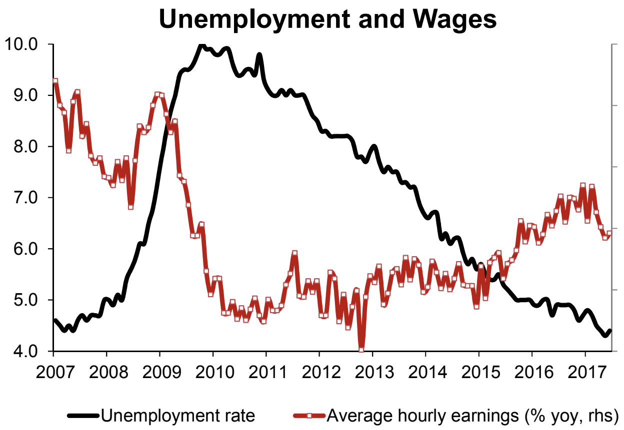
In this environment, we still see leeway for higher core yields in the EA, although in the short-term we do not anticipate major upside movements along the Bund yield curve. Despite the heightened political uncertainty, US yields should eventually drift higher along with the Fed's policy normalization and we foresee a moderate re-widening of the Transatlantic yield spread. This should help to limit the upside potential for the euro against the US dollar, after the strong rally seen year-to-date.

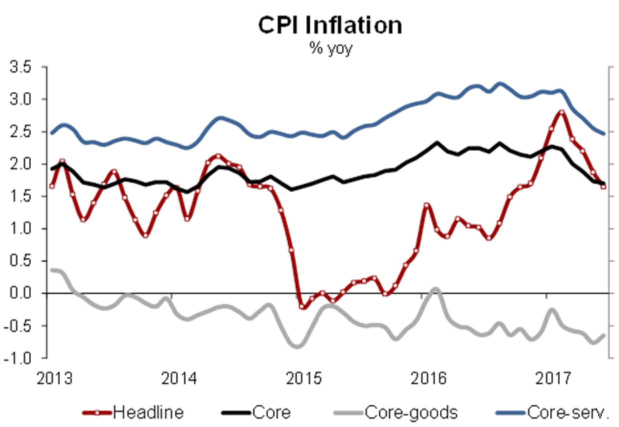
We expect risky assets to continue to perform well thanks to the solid macro backdrop and the only gradual unwinding of the monetary stimulus globally. The risk of temporary setbacks (especially in the US) has, however, increased due to the stretched valuation and record-low market volatility. We still prefer European (and Japanese) equities and credit over sovereign debt, but favor a slightly more prudent active exposure after the recent yield rise.

USA

Paolo Zanghieri







- **Steady consumption and recovering investment will lead GDP to increase by 2.1% this year. A smaller than initially expected fiscal boost will likely underpin slightly stronger growth in 2018.**
- **The unemployment rate is near to a 16-year low, but temporary factors prevent a quick return of inflation to 2%.**
- **At its July meeting, the Fed continued to prepare markets for the reduction of its balance sheet, expected to be announced in September.**

In Q2 real GDP grew at 2.6% qoq annualized: the rebound in consumption and the steady growth in investment confirms the view that the weak Q1 figures were mostly the results of one-off events. Going forward, the strength of the labor market will continue to underpin relatively strong growth, given the late stage of the business cycle: we expect GDP to increase by 2.1% for the year as a whole. We still think that the Congress will be able to pass a financial stimulus package capable of pushing growth up to 2.2% in 2018, but the very confused political outlook has markedly increased the downside risk to our forecast for next year.

Temporary factors continue to drag on inflation, however, the labor market and imported goods prices will exert significant upside pressure on inflation, and we see core CPI back to around 2% by the end of the year.

Employment growth continues steadily

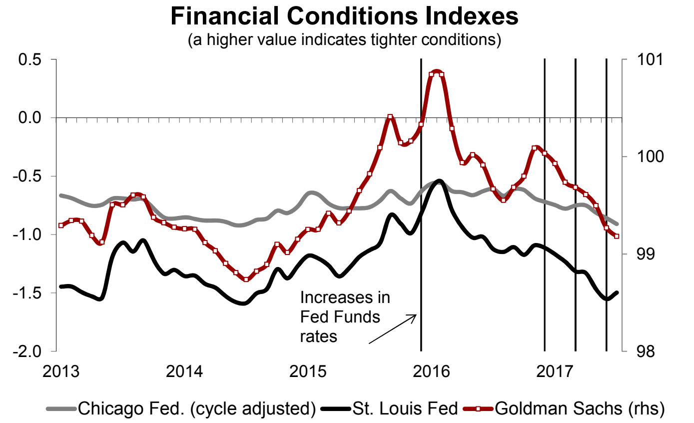
The surprisingly high (222k) payroll growth posted in June and the upward revision of the past month figures show that the economy continues to create jobs. The unemployment rate hit 4.4% nearing a 16-year low. The pace of job creation has slowed down from the second half of 2016, but this can be interpreted as evidence of labor market tightening, with firms facing shortages of skilled workers, as shown by business surveys and highlighted in the FOMC minutes of the June meeting. Yet, wage growth remains muted, as hourly compensations were up by just 2.5% yoy in June. This can be the result of still some slack remaining in the labor market, low productivity compressing real wage growth and subdued inflation expectations leading to moderate wage demand by employees. Still, we expect some acceleration in the month to come.

This will underpin inflation, which has been experiencing a slowdown as of late. In June, the headline rate slumped to 1.6%, while the core rate remained stable at 1.7%. The fall in mobile phone services prices (-13.2% yoy) and a weak market for second hand cars remain the key driver. Going forward, we expect the recovery of non-oil goods prices and higher healthcare inflation to support the core rate, while the headline figure should increase slightly on edging up energy prices.

USA

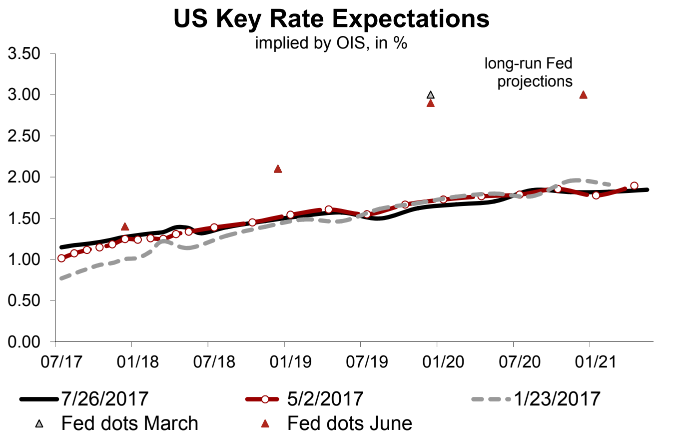
Financial conditions conductive to growth

Despite expectations of higher policy rates in the future, the stabilization in long-term yields, strong equity prices and a weakening dollar resulted in a further easing of financial conditions. Moreover, evidence from business and banking surveys points to no constraints to credit. This will provide a favorable environment to capex growth; however, over the recent weeks Fed officials have raised concern about financial stability, and this consideration should support higher rates in the future. Nevertheless, we think that the strength of household and corporate balance sheets reduces the risk that a sharp tightening in financial conditions could harm sizably the real economy.



Political gridlock continues

Politics continues to be the biggest downside risk to our solid growth outlook. The repeated failures to reform healthcare have delayed tax legislation and the window of opportunity for a far-reaching overhaul in personal and corporate income taxation is closing fast. Moreover, earlier this week the Congressmen in charge of steering the tax reform have announced that the border adjusted tax will not be part of their proposal. The need that Republican Congressmen have to deliver some concrete fiscal measures before the November 2018 election remains the key reason for which we still stick to our view of a scaled down tax cuts package, to become effective no earlier than at the beginning of 2018. Its discussion will take place between September and October, and will overlap with that of other important fiscal measures, like the budged for next year and the increase of the debt ceiling. This increases the risk of too timid a fiscal boost with adverse repercussion on growth in 2018.



The Fed: balance sheet reduction is approaching

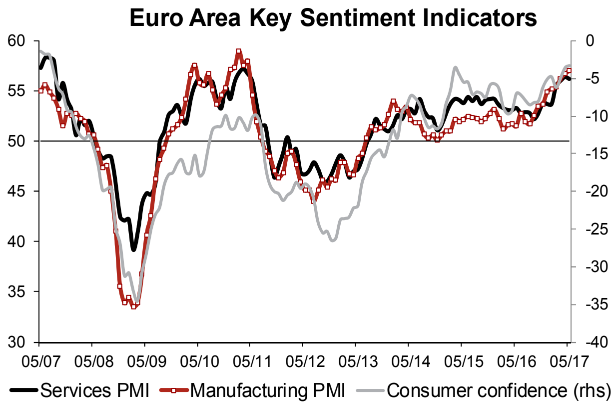
Against this macroeconomic backdrop, we continue to expect the Fed to proceed with its gradual monetary policy normalization. The press release after the July FOMC meeting showed no significant changes in the Fed's assessment of the economic conditions. Therefore, consistent with the slightly more hawkish tone of the July press release, we expect the Fed to announce its plans for the gradual reduction of its balance sheet at the September meeting. While a significant symbolic step, the initial impact on the monetary policy stance will be moderate. The Fed will not sell securities, but will cease reinvesting maturing bonds. The monthly amount of this run-off will be capped at US$ 10 bn initially (US$ 6 bn in Treasuries, US$ 4 bn in MBS) and these caps will be gradually increased over one year to a maximum of US$ 50 bn. Regarding further rate hikes, we anticipate the next move in December, followed by three further hikes in 2018. However, this will require a recovery of wage and price increases which have so far failed to react to the mounting tightness of the US labor market.

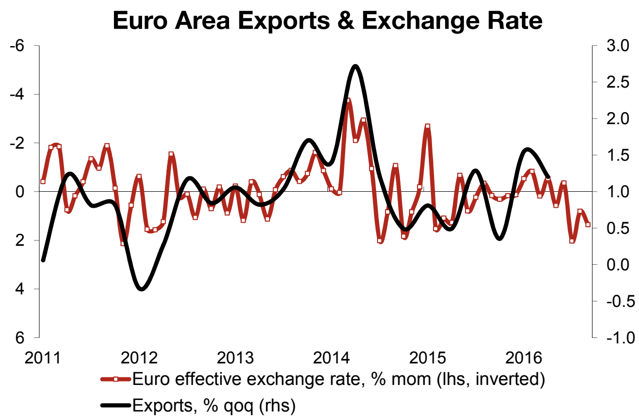
Main Forecasts[1]	2015	2016	2017f	2018f
GDP	2.6	1.6	2.1	2.2
Consumer spending	3.1	2.8	2.3	2.4
Gov. consumption	0.7	0.9	0.8	0.5
Investment	5.4	1.8	4.9	4.6
- residential inv.	8.9	7.8	5.1	4.2
- structures	-1.5	-2.3	4.2	3.8
- intell. property production	5.7	1.9	4.2	5.4
- equipment/software	3.1	0.4	5.5	4.6
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	2.1	2.2
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

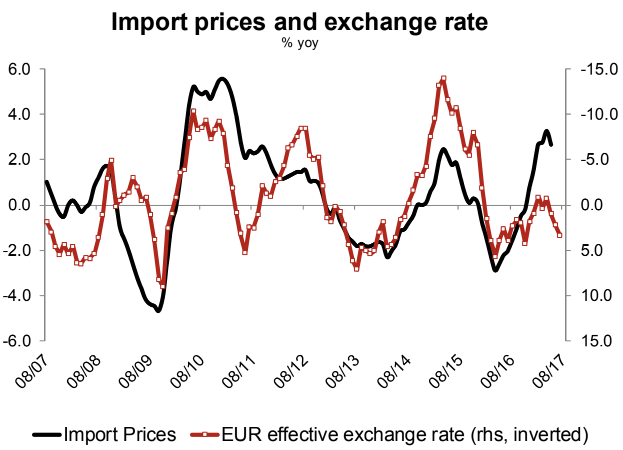
1) Unless noted otherwise, annual % changes, net trade and inventories: growth contribution to GDP 2) yearly average as %, 3) in terms of GDP, federal deficit 4) as %; year-end

Euro Area

Martin Wolburg







- **The July flash composite PMI reading implies a softening of the growth momentum but remains in line with growth above potential.**
- **Over the past two months, the oil price fall and the appreciation of the euro have lowered the inflation outlook.**
- **The ECB will discuss tapering in fall. While the expected date of tapering announcement is uncertain, we continue to see tapering starting in January 2018.**

The July flash composite PMIs for the euro area indicated a softening of the growth momentum. It was reported at 55.8, down from 56.3. However, overall sentiment is still above the January level. The July reading is still historically strong and 1.0 standard deviations above average. Also, unchanged sentiment in the more domestically-oriented service sector and very high consumer confidence is in line with our view that domestic activity stays firm. Likewise, forward-looking indicators took a hit but clearly stayed above their respective long term averages, thereby staying consistent with ongoing future expansion. Finally, the weaker July PMI is also due to a strong fall of confidence in Germany (by 1.3 points to 55.1) which is at odds with the Ifo Index soaring to an all time high in the same month.

We conjecture that imperfect seasonal adjustment related to the start of the holiday season played an important role for the weaker sentiment, especially in Germany. Looking ahead, we deem a recovery of sentiment to the previous highs equally unlikely: First, over the past months the EUR appreciated against the currencies of its major trading partners (+4.1% Apr./July, monthly averages). This will dampen the export outlook. Second, in Germany the so called Diesel-scandal gains momentum. The car industry contributes about 20% of the German manufacturing output and employs 650k persons. There is a risk that firms will have to adjust their production plans to the downside. Also, the latest set of US sanctions against Russia will affect European manufacturing activity negatively.

With the domestic economy remaining strong and global economy doing well, we continue to look for strong growth also in the second half of the year. However, we continue to doubt that the growth rate of 0.6% in Q1 can be maintained. For 2017/18 we GDP expect growth of 2.0% respectively 1.6%.

EUR appreciation and oil price lower inflation outlook

Over the past months, the inflation outlook has deteriorated. As a result of the EUR strengthening import price inflation already started to moderate (+2.7% yoy in May, down from peak of 3.3% before). This will impact core inflation the more negatively, the longer the euro

Euro Area

appreciation lasts. Furthermore, the oil price has come down from a monthly average of € 49 per barrel Brent in April to € 41.5 in July and we hardly see leeway for any stronger rise soon. That said, with activity expected to remain strong and output prices rising, we continue to see the way paved for higher underlying inflation. All in all, we have lowered our headline inflation forecast to 1.5% (from 1.6%) for 2017 and to 1.3% (from 1.4%) for 2018.

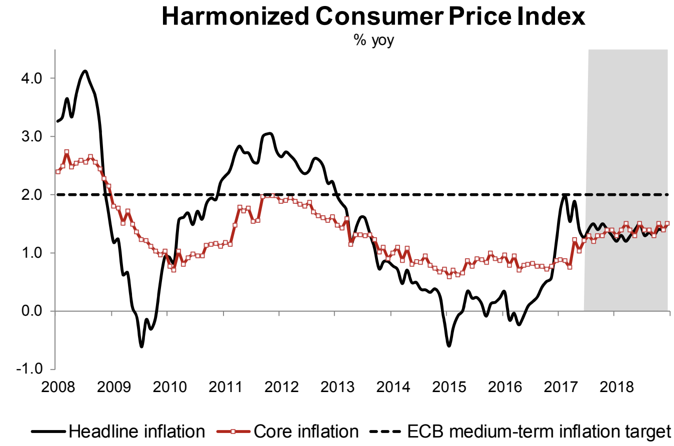
ECB to make tapering announcement in autumn

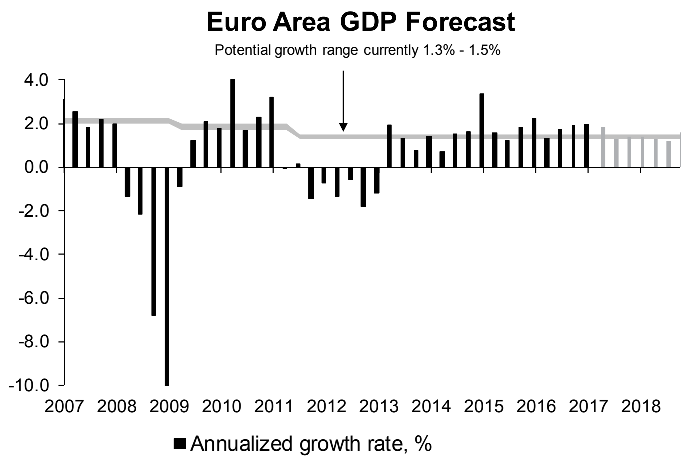
At the end of June, ECB President Draghi rattled markets by a speech in Sintra that culminated in the statement that "*deflationary forces have been replaced by reflationary ones*" which was perceived as a hint that tapering is about to come rather sooner than later. However, at the press conference following the July Governing Council meeting he adopted a more dovish tone. Most importantly, the ECB still saw the need for ongoing monetary policy support, had not discussed tapering, and the Governing Council was unanimous in setting no precise date for discussing tapering. Draghi merely mentioned that the discussion were to take place in autumn. Moreover, "*the last thing that the Governing Council wants is actually an unwanted tightening of the financial conditions*" implying that the ECB will try to avoid a repeat of the 2013 taper tantrum.

Looking ahead, we still expect that tapering is about to start in January 2018. However, the recent exchange rate development that "*has received some attention*" by the Governing Council as well as a lower future oil price trajectory argue for a more prudent approach than otherwise. Therefore and in order to smooth the effect of tapering on financial markets a gradual, monthly tapering lasting at least until September 2018 appears most likely to us. However, if the uncertainty surrounding the economic situation increases strongly or the inflation outlook deteriorates further, the ECB might also decide to adjust its QE purchases discretionary (e.g. on a quarterly basis), leaving open when tapering will be completed.

Furthermore, the ECB will likely let its balance sheet shrink only very gradually so that it seems most likely to us that there will be a (maybe flexible) cap on the amount of redemptions that will not be reinvested once tapering will be completed.

The next ECB Governing Council meeting will take place on September 7 and comprise an update of the growth and inflation projections. At least internally, the discussion how to exit QE will then start. Given the latest dollar strength, the announcement of tapering will probably be postponed towards October, right after the Fed will likely have announced its balance sheet normalization plan.



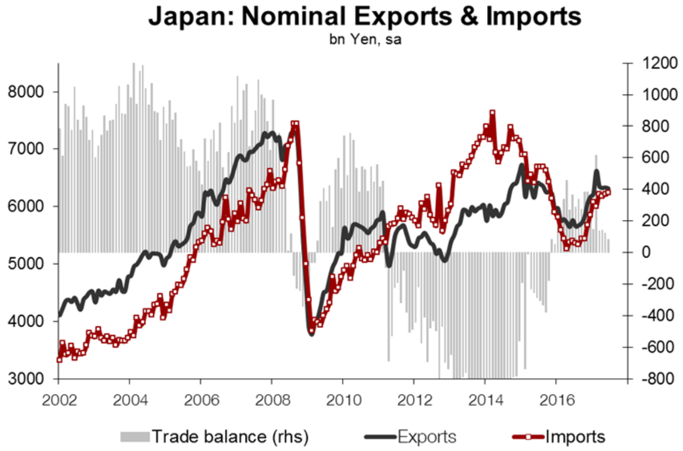


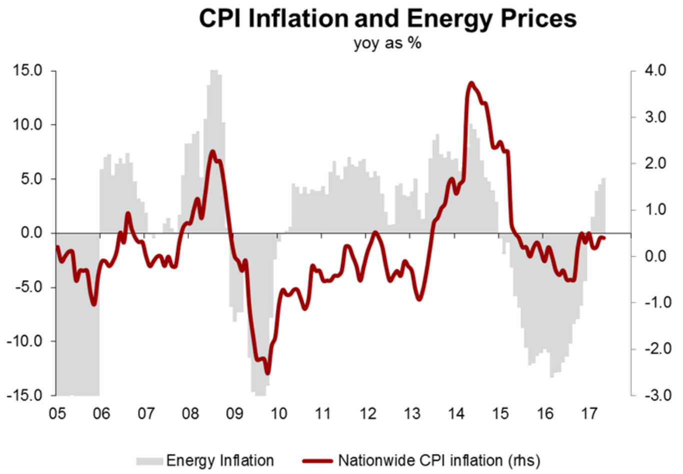
Main Forecasts[1]	2015	2016	2017f	2018f
GDP	1.9	1.7	2.0	1.6
Consumer spending	1.8	2.0	1.5	1.3
Gov. consumption	1.3	1.8	1.3	1.1
Total fixed investment	3.0	3.4	5.7	3.6
Inventories	-0.1	0.0	0.1	-0.1
Net trade	0.2	-0.4	-0.4	0.0
Domestic demand	1.8	2.1	2.2	1.7
Consumer prices	0.0	0.2	1.5	1.3
Unemployment 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	1.1	1.0	1.4	1.0
Consumer spending	-0.4	0.4	0.9	0.8
Government consumption	1.6	1.5	0.4	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	0.3	0.1
Domestic demand	0.7	1.0	0.9	0.8
Consumer prices	0.8	-0.1	0.5	0.8
Unemployment rate[2)]	3.4	3.1	2.8	2.7
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

- **After a strong Q1 GDP downward revision, we expect Japan's GDP growth to have re-accelerated to around 1½% qoq annualized in Q2.**
- **The BoJ held its monetary policy constant in July but revised down its inflation forecast, rendering any short-term policy changes unlikely.**

With its second print, Japan's statistical office revised down its Q1 2017 GDP estimate from initially 2.2% qoq annualized to 1.0%. This lower growth was mainly due to softer private demand and a strongly negative inventory contribution, but showed net exports – the most important driver of growth since mid-2016 – on a weakening but still positive expansion path. In Q2, these driving forces seem to have changed. According to monthly data, real exports receded slightly in Q2, while imports continued to rise, rendering the growth contribution from net exports significantly negatively. However, we attribute this result mainly to fluctuations in IT-related goods, whereas Japan should be generally able to continue to participate further in the global industrial upturn. By contrast, monthly real consumption data point at a stronger growth in Q2 at about 2% qoq annualized. Nevertheless, we consider the uptrend in consumption to generally remain soft. Despite the very good labor market and the ageing society (which reduces household's labor supply), base pay increases (excluding the seniority pay) rose only by 0.48% in 2017, after 0.44% last year. Thus, wage increases will also have only a very little impact on inflation. With regard to capex, machinery orders have trended down of late. However, historically business investment increased with rising exports and capacity utilization. Finally, given that IP reaccelerated from 0.2% qoq in Q1 to 1.9% qoq in Q2, we expect inventories to have improved again. In sum, we expect GDP growth in Q2 to come in around 1½% qoq annualized. Therefore, we also stick to our 2017 growth forecast of 1.4%.

BoJ to stick to its policy in the short run

Japan's headline inflation remained unchanged in June at 0.4% yoy. Currently, the headline index sees a mild support from energy prices and the food components. Excluding both components, the CPI was flat. Looking ahead, we expect a mild uptick over the next month, from the yen exchange rate which depreciated on average compared to the second half of last year. Nevertheless, we see the headline inflation to average only 0.5% in 2017. Accordingly, the BoJ stuck to its monetary policy at its July meeting but corrected its inflation outlook down. This also likely implies an unchanged policy outlook near-term, although scarcity issues will gain prominence over the medium term. PM Abe has come under political pressure of late amid a favoritism scandal. However, even in case he were to step down, we would see no major impact on the monetary policy part of Abenomics.

China

Christoph Siepmann

- **China's Q2 GDP growth surprised slightly on the upside with 6.9% yoy. Moreover, monthly data ended the quarter on a high note.**
- **Important support came from the real estate sector, while the central government has already begun to reduce its regular but not its infrastructure expenses.**
- **We continue to expect China's growth to moderate going forward. However, in a year of leadership reshuffle, Beijing will not risk a stronger cooling.**

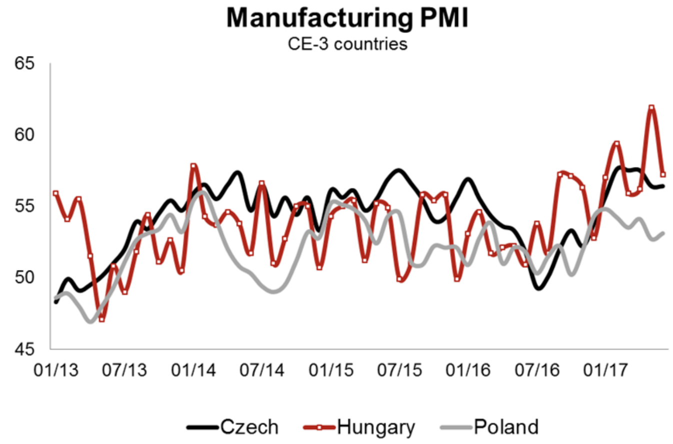
China's real GDP growth came in at 6.9% yoy, unchanged from the previous quarter and outpacing the official 2017 NPC target of 6.5% for the second time in a row. Moreover, IP rose in June to 7.6% yoy, 1.1 pp higher than in May, while urban fixed asset investment remained unchanged at 8.6% yoy ytd. June manufacturing PMIs had already predicted some improvement in real activity towards the end of last quarter, as the Caixin version increased back into expansionary territory and the official NBS PMI rose further to 51.7 index points. Nevertheless, the Caixin PMI Q2 average had slowed significantly compared to Q1, thereby capturing the "official" business cycle only in part. Help for the monthly upturn and the strong GDP figure was especially coming from the real estate sector. Residential housing sales surprisingly reaccelerated despite tightening measures on the local levels. Accordingly, real estate investment did not show the widely expected weakening so far, but held up comparably well (see graph).

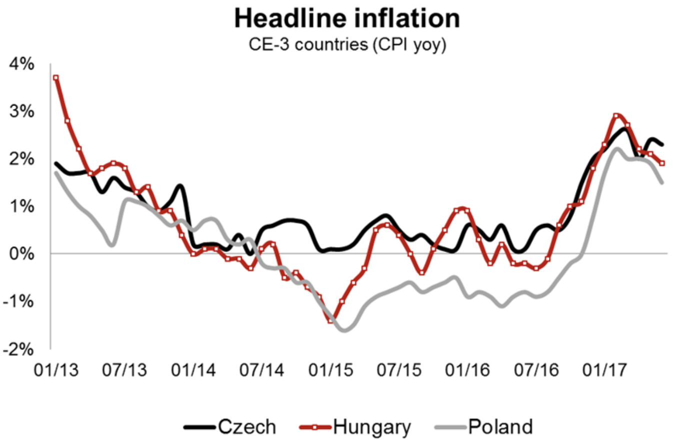
Less government support no threat for growth target

Fiscal support declined instead, as far as central government projects are concerned, by -10.9% yoy ytd while infrastructure investment was broadly unchanged compared to last month (at 20.3% yoy ytd). Finally, help was also coming from external demand as export growth clearly surprised on the upside in June with 11.3% yoy whereas imports even went up by 17.0% yoy. Although there are still large base effects from last year's export slump involved, the figures clearly exceeded expectations. Nevertheless, the trend-cycle component suggests that the bulk of the export acceleration is already behind us. In trade policy, the first US-China Comprehensive Dialogue – intended to tackle China's large current trade surplus with the US – ended with a canceled news conferences and no joint statement. Thus, trade frictions are still not off the cards. Looking ahead, we expect China's fiscal policy to decelerate its support but without risking too strong a cooling ahead of the leadership reshuffle in autumn. Similarly, monetary policy is likely to pursue its aim of deleveraging and de-risking financial markets and the economy, again without risking an abrupt shift. With regard to the inflation rate, the PBoC is in no hurry as headline inflation remained constant at 1.5% yoy (due to receding food prices), while core inflation increased, but is still limited at 2.2% yoy.

Central and Eastern Europe

Radomír Jáč





Main Forecasts	2015	2016	2017f	2018f
Czech Republic				
GDP	5.4	2.5	2.8	2.7
Consumer prices	0.3	0.7	2.2	2.0
Central bank's key rate	0.05	0.05	0.25	0.50
Hungary				
GDP	3.1	2.0	3.6	3.2
Consumer prices	-0.1	0.5	2.5	2.8
Central bank's key rate	1.35	0.90	0.90	0.90
Poland				
GDP	3.8	2.7	3.4	3.0
Consumer prices	-0.9	-0.6	2.0	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

- **Both surveys and hard data imply continuation of a solid economic growth across the region in Q2.**
- **Growing capacity utilization is forming an upward pressure on prices but headline inflation rates remain below central banks‘ targets in most cases, thanks to disinflationary impact of the oil price and only gradual increases in core inflation.**
- **Development of inflation makes monetary policy tightening relevant only in the Czech Republic: a rate hike may come already in August.**

Economic activity data and surveys are pointing to solid growth across the region in Q2. Although the strong GDP increases reported for Q1 will most likely not be repeated, the picture is positive thanks to growing consumption, recovering investment expenditure and strong exports. Most of the economies are already operating close to their potential or even above, which results in labor market shortages with upward pressure on wages.

The growing capacity utilization and the generally strong demand lead core inflation higher. That said: core CPI remains relatively low in most cases, which means that monetary policy outlook points to stability in central banks‘ interest rates for the rest of 2017. The Czech Republic is the only exception as both the headline inflation (2.3% yoy in June) and core inflation (2.5% yoy) stand above the inflation target set at 2% and monetary policy tightening is thus a relevant issue for the Czech central bank.

Czech CNB likely to increase interest rates in August

At its board meeting held in late June, the Czech CNB surprised the market with a very clear indication of an interest rate hike in Q3. A rate hike for this summer was predicted by the CNB forecast published in May but the market was expecting that the Czech crown strengthening and the fact that headline inflation stood below the CNB forecast in Q2 would lead to a delay of rate hikes beyond Q3. The CNB says that economic developments are broadly in line with its forecast and that monetary policy should also act in line with the prediction in such a case, i.e. interest rates should rise. The CNB will meet on August 3: a rate hike now looks the most likely scenario. At the same time, we expect the CNB to be cautious, i.e. to hike its key rate only by 20 bps, from current 0.05% to 0.25%, with the next rate increase following only in 2018.

The monetary policy outlook for Hungary and Poland remains unchanged, i.e. interest rates should stay stable in 2017, amid both central banks indicating a preference to keep key rates also on hold in 2018. Worth noting is that for the Hungarian MNB, the base rate (now at 0.90%) is not the key policy instrument anymore and monetary conditions are being fine-tuned via liquidity management tools (here the MNB wants to keep the loose conditions already achieved). For Poland, we now expect only one rate hike in 2018 (in H2): by 25 bps to 1.75%.

Bonds/Fixed Income Strategy

Florian Späte

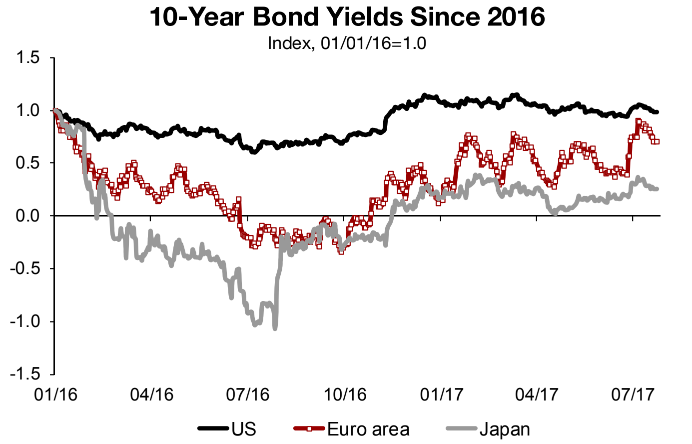
- **Initially, the correction on international bond markets continued until the mid of July. However, the higher yield levels were not maintained and on balance core yields were little changed.**
- **Southern European bonds continued their strong performance. Amid a rather dovish ECB outlook, peripheral bond spreads reached long-term troughs.**
- **Going forward, the way is paved to higher yields. Particularly, US yields are expected to trend upwards. In this environment, a less aggressive duration stance appears appropriate. However, a short duration for euro area core and peripheral government bonds is still recommended.**

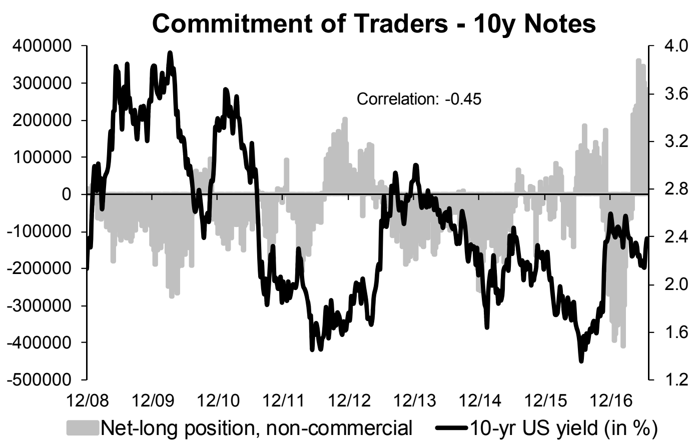
Triggered by a speech given by ECB President Draghi perceived as hawkish, long-dated core yields in the euro area (and to some extent also in the US) started to increase at the end of June. This correction continued until the mid of July, with 10-year Bund yields reaching 0.60% and 10-year Treasury yields marking almost 2.40%. Since then, international bond markets have rebounded a bit not least due to dovish ECB comments after the last Governing Council meeting. On balance, 10-year Bund yields rose by 5 bps to 0.52% and 10-year Treasury yields fell by 1 bp to 2.29%. Therewith, the transatlantic yield spread fell to 177 bps – the lowest level since the US Presidential election.

At the short end of the curve, a downtrend prevailed. Since the end of June, 2-year Bund yields decreased by 10 bps to -0.67% and their US counterparts fell by 2 bps to 1.36%. Thereby, the transatlantic spread at the short end is above 200 bps again. Noteworthy, the euro area curve steepened considerably and is almost back to the long-term average (120 bps). In contrast, the US curve flattened further and is still well below the long-term average (180 bps).

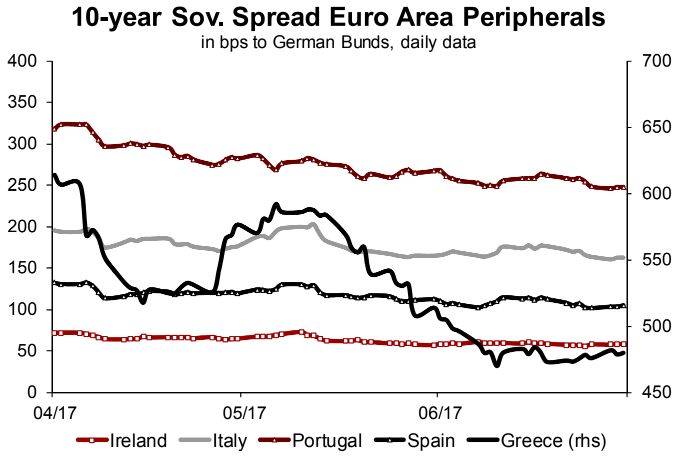
Particularly US yields prone to upward correction

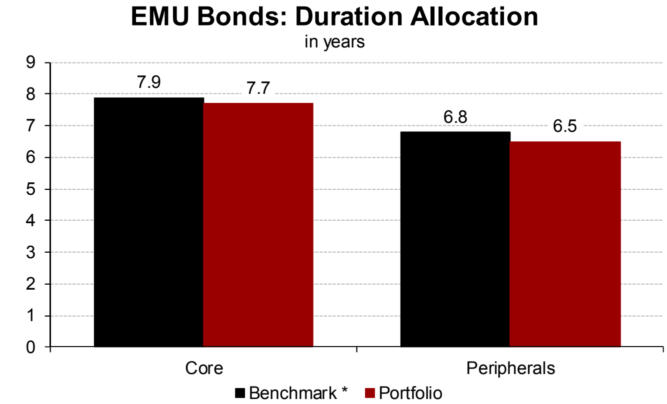
Looking ahead, the conditions for higher core yields are in place. Particularly, US yields have scope to increase. To start with, currently less than two further hikes until the end of 2018 are discounted. As the inflation rate is forecast to rebound and taking into account the strong labor market, financial markets' expectations appear too low. We regard four hikes until the end of next year as likely. Although the level of inflation is seen to remain moderate going forward, the forecast adjustment of expectations will impact the complete US curve. What is more, there has been a strong build-up in speculative US Treasury long positions (see chart). This does not appear sustainable and a normalization is usually accompanied by an increase in yields. Finally, amid disappointment on the US political front and macroeconomic data surprising on the downside, markets have become too negative on the US economic outlook. Against it, economists still expect the US economy



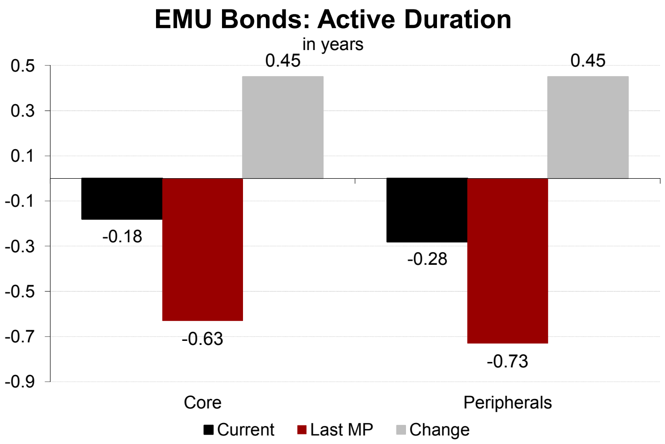


Bonds/Fixed Income Strategy





* JPMorgan EMU Government Bond Index



to reach a growth rate of more than 2% in the years to come. Accordingly, the way is paved to higher US yields in the months to come. On a 3-month horizon, we expect 10-year US yields to reach 2.45% and on a 12-month horizon 2.80%.

In this environment, long-dated Bund yields have leeway to rise, too. While we do not regard the increase as the start of a lasting sell-off, the medium-term trend is upwards. The ECB is expected to announce an exit strategy from its QE program in fall. Although this is widely expected, entering the exit phase will have an impact on bond markets. What is more, the underlying inflation pressure in the euro area will increase in an environment of stable growth. In addition, technical reasons are also worth mentioning. The bond market volatility is currently on unsustainably low levels and the term premium is hardly positive (+10 bps). Both, volatility and term premium are expected to normalize in the future. This is usually accompanied by higher yields. All in, 10-year Bund yields are likely to rise to 0.60% on a 3-month horizon. The still running QE program and the increasing scarcity of Bunds is expected to keep a lid on yields for the time being. On a one-year horizon, we see scope for a further upward movement to 0.85%.

ECB triggers strong performance of peripheral bonds

After some widening at the beginning of July, Southern European bond spreads tightened significantly in the course of the month and reached new long-term lows. The low volatility, the friendly cash flows in combination with the well-advanced issuance activity supported peripheral bonds. But, most of all, the dovish ECB press conference and the signal that a QE exit strategy will likely only be announced in October helped. While the 10-year BTP/Bund spread has fallen to the lowest level since the start of the year, the 10-year-Bono-Bund spread has even marked the lowest level for more than two years.

Going forward, we sound a note of caution. While a strong widening is not on the cards and peripheral bonds might enjoy the friendly environment for some time, the risks are skewed to the downside. Given the upcoming elections in Italy (H1 2018), the QE tapering and still unresolved structural problems in some countries, spreads are seen to widen further down the road.

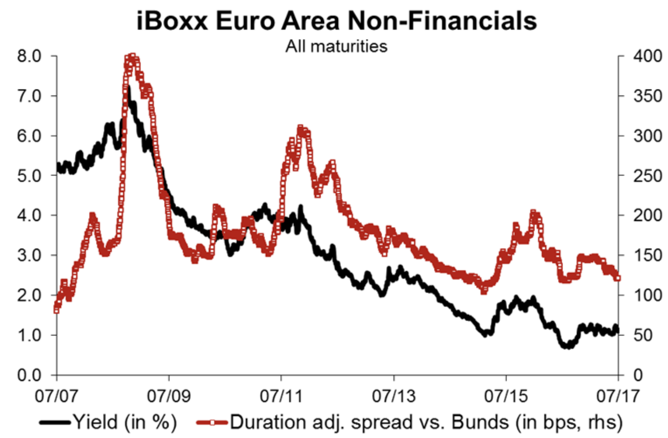
Our portfolios

The risks regarding the short-term outlook for euro area core bonds have become more symmetric. Hence, we recommend a less aggressive duration stance. Still, we prefer to trade the market from the short side and suggest a duration of -0.18 years (from -0.63 before). The same applies to peripheral bonds. However, taking into account the forecast spread widening, we advise a somewhat shorter duration (-0.28 years from -0.73 years before).

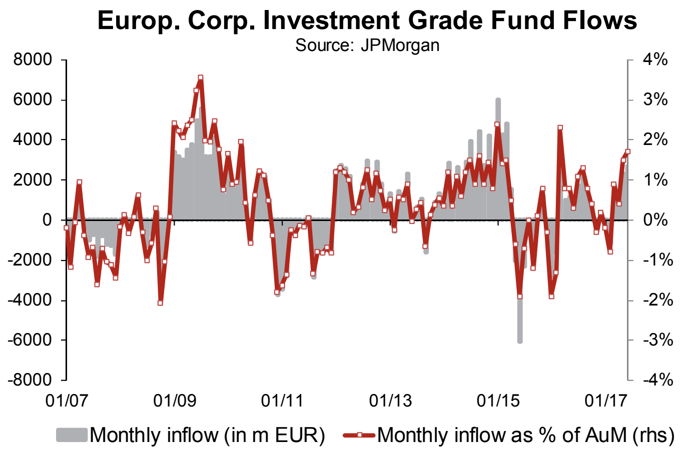
Corporate Bonds (Non-Financials)

Florian Späte

- **Non-financial corporate bonds performed very well in July. Driven by a friendly market environment, spreads have reached the lowest level since fall 2016.**
- **Therewith, non-financials weathered the yield increase and the strong issuance activity well. Supported by ongoing ECB purchases and fund inflows non-financials yielded a positive total return.**
- **An immediate end of the rally is not in sight, but risks for a setback are increasing. Valuations look somewhat stretched. In combination with higher underlying yields they are likely to pave the way to a moderate spread widening.**

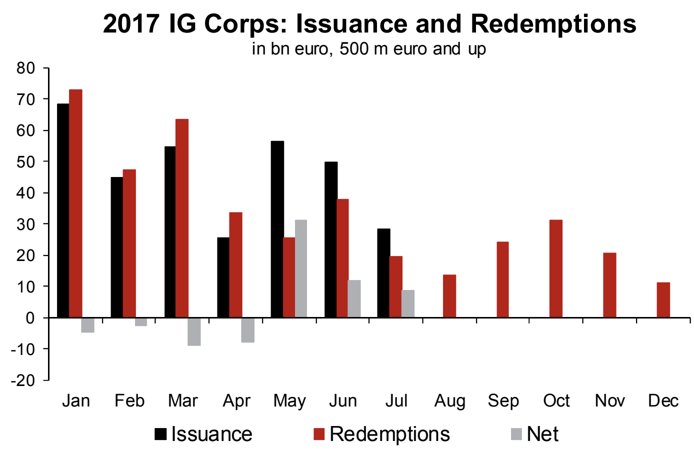


Non-financial corporate bonds continued their strong performance in July. The (duration adjusted) spread tightened by 5 bps to 122 bps. This is close to the trough marked in fall 2016 (before the US election). As underlying yields did not move much, the spread narrowing is reflected in lower corporate yields. At 1.13%, however, the yield level remained in a trading range between 1.0% and 1.3% - effective since mid of November 2016. The total return in July was 0.6%, lifting the total return year-to-date to 0.8%.



The spread tightening was rather steady due to a bunch of positive factors. To start with, the fund inflow remained in positive territory and has even reached the highest level since spring 2016. What is more, the ECB continued its QE program. Although purchases slowed towards the end of the month (due to the forthcoming summer break), the central bank still bought around €6 bn of IG non-bank bonds in July. In addition, the rating agencies once again raised their assessment of European corporates.

No end of the rally in sight, but risks are increasing



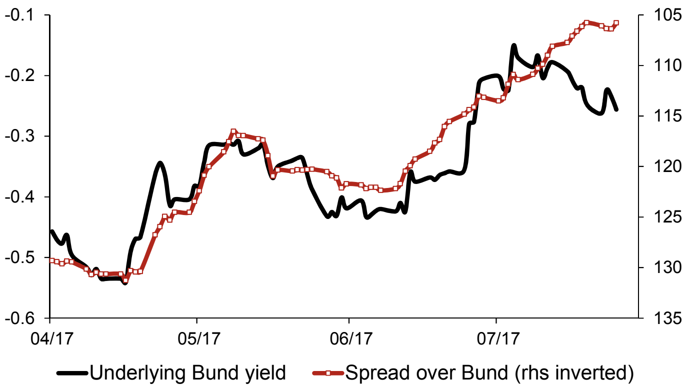
The friendly market environment is expected to last for the time being as there are no political hurdles in the near term and the macroeconomic situation is forecast to remain solid. Hence, a further moderate spread tightening cannot be excluded in the short term.

However, given the reached spread levels the scope for a continuation of the rally appears to be limited. Moreover, although the recent ECB comments were rather dovish, we still expect the ECB to announce an exit strategy in fall and to start tapering in 2018. Furthermore, net issuance has turned positive and a trend reversal is not in sight. Beyond that, the forecast rise in underlying yields is likely to reduce the search for a pick-up and should take the shine off corporates. All in, non-financial corporate spreads are forecast to widen moderately further down the road. On a 12-month horizon, we expect spreads to increase from 122 bps to 135 bps.

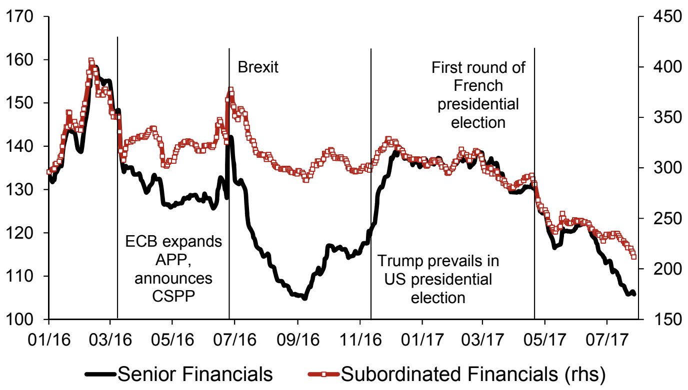
Corporate Bonds (Financials)

Luca Colussa

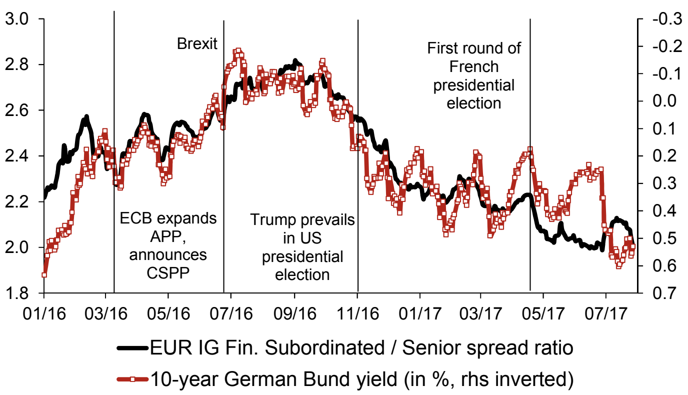
iBoxx IG Sen Fin: Bund yields & spreads
duration adjusted spread over German Bund, in bps



iBoxx EUR IG Financials
duration adjusted spread over German Bund, in bps



IG Fin Sub / Sen spread ratio & Bund yield
spread ratio calculated on iBoxx indexes, duration adjusted spread



- **After the negative total return performance in June, EUR IG Senior Financial bonds recovered as the ongoing spread tightened was not offset by higher Bund yields.**
- **Also, Subordinated Financials performed well thanks to the solid macro momentum in the euro area, recovering bank profitability and lower sovereign spreads.**
- **Going forward, we see limited scope for further spread tightening, unless Bund yields surprise again sharply on the upside. We adopt a neutral stance regarding Senior vs Subordinated bonds.**

After the negative total return performance in June – down by 0.49% vs end-May – EUR Investment Grade (IG) Senior Financial bonds recovered in July as the upswing in Bund yields came to a halt and the duration-adjusted spread over Bunds fell to the lowest level since September 2016. Indeed, the underlying Bund yield was basically unchanged (after having risen by 23 bps in June), while the spread fell by 7 bps to 106 bps. The month-to-date total return is +0.70%, with the year-to-date performance at +1.10%.

Decline in spreads mirror the increase in Bund yields

In the past four months, the spread of Senior Financials has been inversely correlated with the underlying Bund yield (see upper chart). The negative correlation has been as high as 92%. This explains why the overall yield of Senior Financial bonds has fluctuated in a rather narrow trading range since April (between 0.77% and 0.96%, latest: 0.80%). This short-term relationship suggests that the decline in the spread of Senior Financials has gone a bit too far. Barring a further rapid increase in Bund yields (we project only a mild increase going forward), we see limited scope for Senior Financial spreads to narrow further, and we expect a marginal widening to 110 bps over a 3-month horizon. Total returns are likely to be slightly negative.

Neutral stance between Sub. and Senior Financials

After some weakness in the first part of July, Subordinated Financials started to outperform Senior ones again. The monthly total return gain is +1.51% (vs +0.70% for Senior bonds), which brings the year-to-date outperformance to 456 bps. Higher Bund yields helping banks' profitability, lower sovereign risk premiums and the solid macro momentum in the euro area were the key drivers of the outperformance. Going forward, while we expect economic growth to remain solid, the projected increase in sovereign spreads (driven by the Italian political situation) will likely weigh on Subordinated Financials. Consequently, we recommend a neutral stance regarding Subordinated vs Senior bonds.

Currencies

Thomas Hempell

- **Following the rally in the EURUSD in Q2, the euro strengthened significantly in July.**
- **Short-term, the single currency looks vulnerable to a temporary setback.**
- **Medium term, however, the euro's outlook is solid, thanks to a likely tapering of QE by the ECB, less political risks in the euro area and the euro area's sizeable current account surplus.**
- **We anticipate the Japanese yen to weaken further on the back of rising US yields.**

Over the past month the euro strengthened significantly against the US dollar. The main driver were skepticism about the ability of the Trump administration to stimulate growth and the nearing ECB tapering.

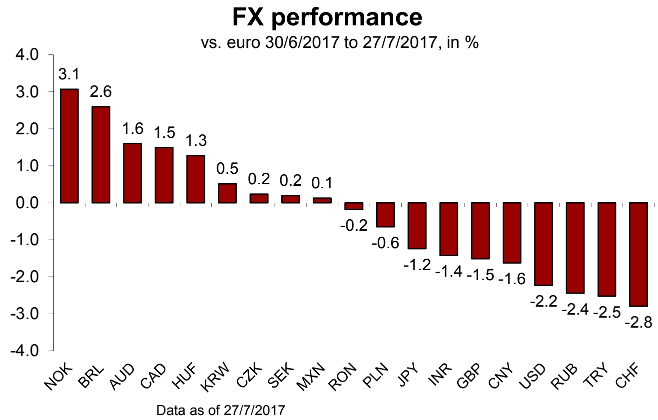
Looking ahead, the euro looks vulnerable to temporary setbacks in the near term. For one, the surge against the USD in Q2 has been accompanied by strong swing in speculative positioning. CFTC data show that speculative positions on the euro have turned net long in spring and are now at their highest since September 2013 (see mid chart). The quick pace of the shift incurs the risk of a partial reversal. Second, a substantial gap has opened between yields differentials and the level of the EURUSD (see lower chart), which historically have been a reliant guide for the EURUSD. Finally, the pace of monetary policy normalization remains substantially underpriced in our view, bearing the potential for an adjustment.

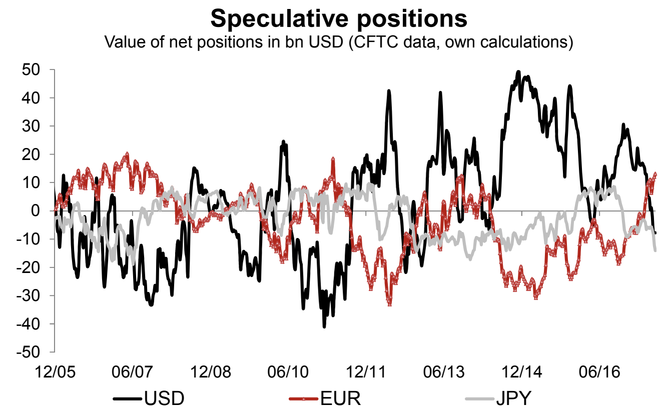
That said, any correction is unlikely to be very sizeable. One reason is that the US dollar is currently very much burdened by fears of a more persistent political controversy around ties between president Trump's team and Russia. This controversy increasingly bears the risks to jeopardize reform efforts by the Trump administration, weighing on the US dollar.

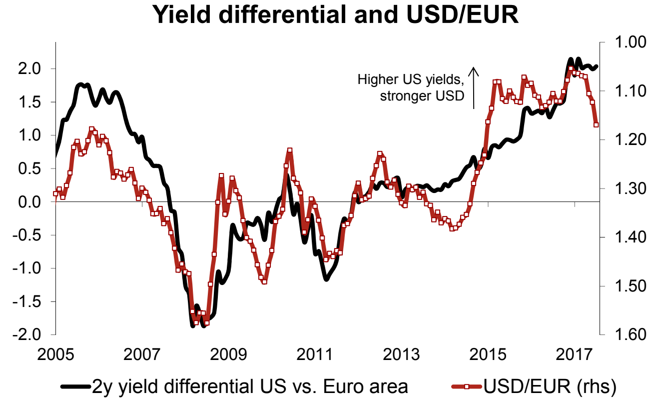
Solid medium-term outlook for the euro

The medium term outlook for the euro remains overall constructive. Recent macroeconomic data for the euro area have been pretty upbeat, strengthening the case for a tapering of the ECB's asset purchase program going into next year. The euro has reacted very strongly to the upbeat assessment of the growth and inflation prospects by Mario Draghi in late June. And while uncertainties about a political gridlock in Italy after the next elections remain, political risks over a potential 'Frexit' and EMU breakup have turned into outright reform hopes after the French elections. Finally, the persistently high current account surplus in the euro area (3.5% of GDP) contrasts a sizeable deficit (2.4% of GDP) in the US.

We continue to anticipate further weakness in the Japanese yen. Amid the continued yield curve control by the BoJ, any move higher in US Treasury yields translates into a respective change in the yield gap between the US and Japan and guide the JPYUSD weaker.

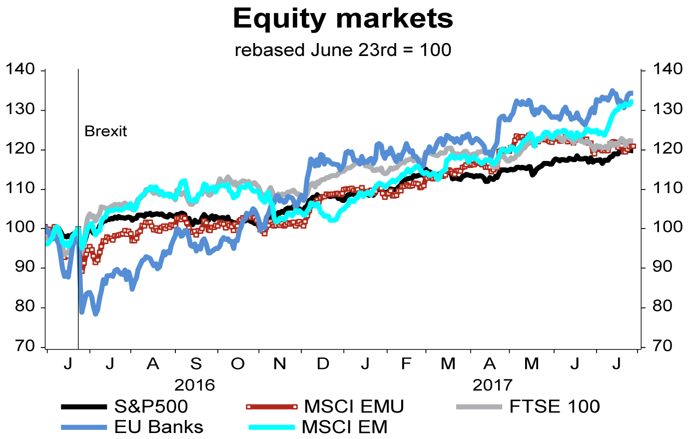






Equities

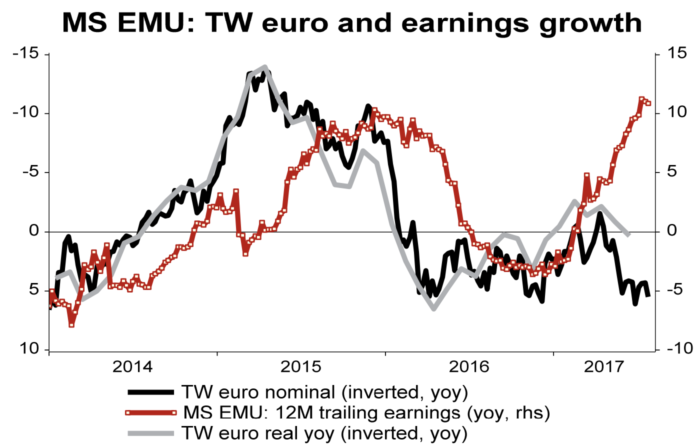
Michele Morganti



Analysis of the median stock

Median stock	Earnings Growth Q1 2017	Earnings Growth Q2 2017	Sales Growth Q1 2017	Sales Growth Q2 2017	availability Q2 2017
S&P	8.03 %	9.74 %	6.18 %	5.74 %	19.2%
Stoxx	14.70 %	9.59 %	6.13 %	8.03 %	21.2%
Euro Stoxx	10.50 %	(0.38)%	6.02 %	7.14 %	10.4%
Topix	12.02 %	17.60 %	2.54 %	4.57 %	10.5%

Median stock	Earnings Surpr Q1 2017	Earnings Surpr Q2 2017	Sales Surpr Q1 2017	Sales Surpr Q2 2017	availability Q2 2017
S&P	2.66 %	3.54 %	0.94 %	1.11 %	19.2%
Stoxx	5.24 %	(1.14)%	1.68 %	0.36 %	21.2%
Euro Stoxx	2.04 %	(4.94)%	1.68 %	(0.21)%	10.4%
Topix	2.24 %	1.17 %	(1.43)%	0.08 %	10.5%



- **Equities stayed upbeat in July due to good global macro data, especially in the US where macro surprises eventually rebounded.**
- **Notwithstanding a stronger euro, positive signs came also from the Q2 reporting season. Finally, bottoming 10-year rates helped to mitigate disinflationary fears.**
- **While higher market multiples deserve a more prudent approach to equities, we think that EA and Japanese valuations remain affordable and total returns could reach 6-7% in 12 months.**
- **We favor the EA and Japan over Switzerland and the US and are neutral on the UK and EMs. Inside Europe, we overweight discretionary, financials, TLC and media, while staying short staples.**

Equities prolonged their positive trend in June. The MSCI World index and the S&P 500 returned +2.5%. The MSCI EMU and the Topix gained too but less (1% and 0.3% respectively), while EMs outperformed (+5.6%).

Equities still supported by a good macro momentum

The macro surprise indices lingered at high levels during the month. The US one bounced back after having reached quite depressed levels. For example, the ISM index rebounded and it is historically relevant for the sustainability of a good earnings momentum. In China, real data were satisfactory and above consensus, as a result the Chinese macro surprise index is now higher than the US, Japanese or the euro area (EA) ones. This means that the global recovery theme is still supportive for equities. Furthermore, 10-year yields rebounded from the June lows, confirming that we are not in a disinflationary scenario. We forecast inflation and bond yields to move up even if only gradually so. This in time should continue to support the most cyclically and undervalued sectors and equity indices, like the ones in EA and Japan.

Good Q2 reporting season despite the stronger euro

When we analyze the first 20% results in the US, we are reassured by the lingering decent earnings' growth trend which we expected. This is not only true at an index level but also when we look at the results of the median stock. The latter are indeed respectable and even better than the index ones. Firms' margins (ratio of earnings on sales) are holding well for the time being, even in the US. This is due to a resilient good macro momentum and subdued wages growth. We acknowledge that the Q2 results are less brilliant than the Q1 ones, for the following reasons: 1) a less favorable base effect, 2) stronger currencies in the EA and Japan, and 3) lower oil price. Nevertheless, such negative issues should not affect equity returns in the next months in the EA and Japan.

Equities

Of course they are producing some negative analysts' revisions, which looked too bullish anyway.

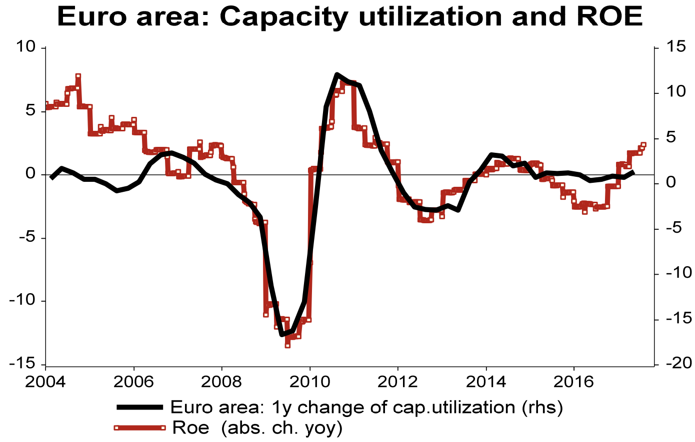
In detail, the US earnings growth in Q2 is so far lower than in Q1, but still running at a reasonable +6.9% yoy vs 7.8% in Q1. The same is true for the sales growth: 4.4% vs 5.2%. In terms of surprises versus analysts' forecasts, US sales continue to look better than in Q1 (+1.4% vs. 0.8) as earnings do (7.5% vs. 4.9%). The ratio of positive-to-total surprises remains very high, although marginally declining, towards 81.3% for earnings (from 83.2%) while for sales the ratio continued to improve to 77.1% from 72.9% in Q1.

For US firms, the impact of the weaker currency and lower oil prices broadly offset each other. Indeed, a positive factor for the US was represented by the nominal trade-weighted (TW) dollar which has depreciated by 4.3% year-to-date (YTD). The corresponding theoretical earnings uplift is 1%, other variables being constant, of course. But the oil price declined by 14% YTD (-8$ for the WTI) and by 7% from Q2 to Q1. The negative earnings impact, for both the US and the EA earnings, could be nearly -1% YTD.

For the EA, the trend of firms' margins is improving versus the US, notwithstanding the negative impact of a stronger euro. Furthermore, we forecast the euro to stabilize due to the continued policy normalization by the Fed and a partial reversal of the current euro net long positions, which look stretched. In addition to this, the EA companies' ROE should continue to increase due to firm macro data, higher capacity utilization, subdued wages as well financing costs. That said, a stronger TW euro (4% YTD) could take off a 2-3% from the earnings growth. This comes on top of a consensus (IBES) growth at 11% and 9% in 2017 and 2018, which compares to our more prudent estimates of +7.4% and +5%. Since early June, the earnings estimate for the MSCI EMU for 2017 and 2018 has already lost 0.5% and 0.7% respectively. Having said that, even with more prudent than analysts assumptions, we are able to justify a 6% total return in 12 months for EA equities.

Still constructive on the mid-term

While higher market multiples deserve a more prudent approach to equities, we think that EA and Japanese valuations remain affordable and total returns could amount to 6-7% in 12 months (see our "value indicator" which still points to some upside). Furthermore, fund managers declare a cash position which is higher than historical average. This in time could help rotate from bonds into equities. US valuations are expensive (we underweight the US) but such risk is mitigated in the short-term by low yields, better macro surprises, contained positioning and, possibly, a tax cut and financial deregulation by the end of the year or Q1 2018. We keep financials, telecoms and discretionary in overweight, due also to their lower sensitivity to a stronger euro.



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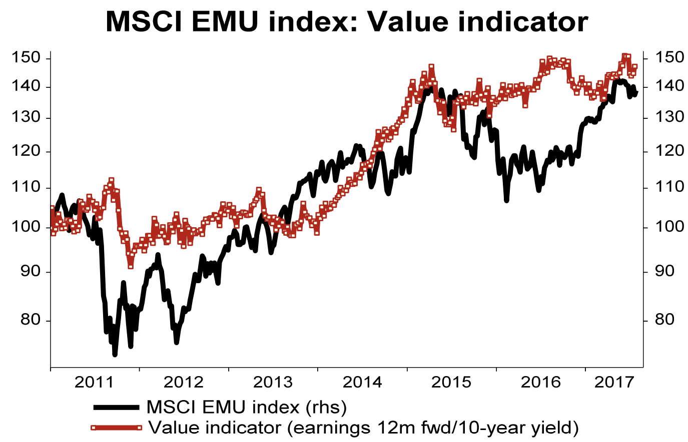
Markets	PE		PB		PCF		DY		Avg.	Avg.
	12m f	Discount	12m f	Discount	12m f	Discount	12m f	Discount	Discount	Disc. (-1M)
USA	18.0	17.8	2.9	25.4	12.1	24.3	2.1	-5.4	18.2	16.2
JAPAN	14.2	-9.3	1.2	-1.7	7.9	13.0	2.1	12.6	-2.7	-12.3
UK	14.7	5.9	1.8	0.0	9.2	17.4	4.2	5.3	4.5	3.3
SWITZERLAND	16.9	9.8	2.4	6.0	12.7	13.3	3.5	7.6	5.4	6.8
EMU	14.4	2.0	1.6	5.1	8.1	28.1	3.3	-15.0	12.6	15.3
FRANCE	14.7	2.5	1.5	2.2	8.7	29.2	3.4	-10.7	11.2	13.0
GERMANY	13.2	-12.8	1.6	9.0	8.3	26.4	3.1	-8.6	7.8	11.7
GREECE	14.9	16.4	1.7	10.7	8.0	34.8	3.3	-16.0	19.5	18.8
ITALY	13.2	-14.2	1.2	0.2	5.5	19.9	4.2	-9.2	3.8	1.8
PORTUGAL	16.3	30.0	1.7	-0.5	6.3	7.4	4.5	0.3	9.2	6.9
SPAIN	13.7	6.1	1.3	-18.7	5.5	8.3	3.9	-24.5	5.1	6.6
EURO STOXX 50	14.0	5.8	1.5	4.1	7.9	30.2	3.6	-14.9	13.8	16.0
STOXX SMALL	16.5	15.9	1.8	9.3	10.6	30.6	2.9	-10.2	16.5	16.8
EM, $	12.6	-14.0	1.5	-3.4	7.8	1.5	2.7	-14.6	-0.3	-2.0
BRAZIL	11.3	28.2	1.5	-13.2	7.1	-50.7	3.8	-12.2	-5.9	-11.6
RUSSIA	5.4	-24.3	0.6	-37.6	3.3	-27.3	6.4	84.1	-43.3	-46.3
INDIA	18.5	29.8	2.8	4.8	12.5	9.4	1.6	-3.7	11.9	6.8
CHINA	13.3	2.3	1.7	-5.0	8.3	10.6	2.1	-31.7	9.9	7.9

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.

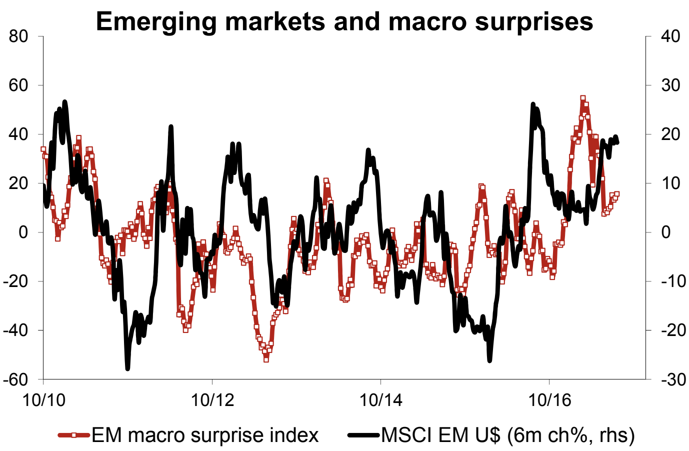


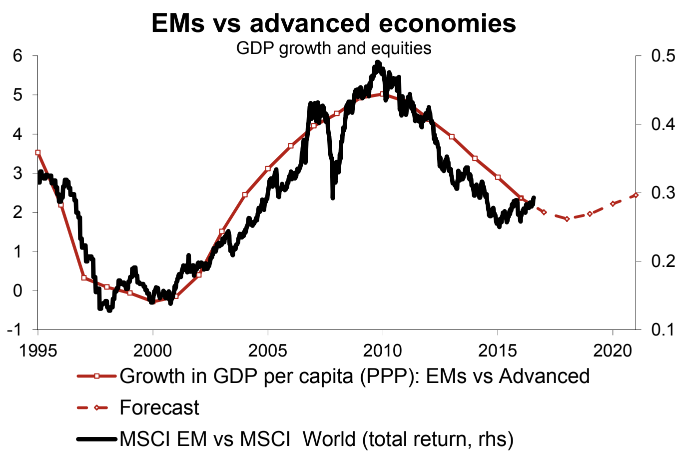
Emerging Markets Equities

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 ($)	2.4	12.1	1.0	8.5			
US	2.3	10.6	0.5	5.4	-14	-1.5	-6.7
EMU	-0.8	8.2	0.2	7.6	22	1.2	4.6
GREECE	-1.0	17.3	3.4	15.2	-178	1.2	4.6
CZECH REP.	4.0	10.1	0.2	-0.2	42	0.9	5.9
HUNGARY	0.7	10.6	0.5	17.2	24	1.7	3.0
POLAND	0.2	20.7	0.5	18.7	-32	0.0	6.0
EM ($)	5.1	24.0	2.5	16.0	-43		
BRAZIL	5.6	7.3	-1.2	7.6	-142	4.3	-0.8
CHINA	6.6	33.7	3.1	12.9	57	-0.6	-2.6
INDIA	6.2	20.6	0.9	4.5	-8	-0.3	0.7
INDONESIA	-0.4	12.6	1.0	7.7	-98	-0.9	-3.7
KOREA	2.6	25.1	4.2	32.2	12	1.7	3.2
MALAYSIA	-0.3	7.7	0.6	4.9	-27	-0.7	-0.1
MEXICO	4.6	11.2	-0.9	3.9	-61	1.3	13.1
RUSSIA	3.8	-14.5	-3.3	-0.1	-60	-1.7	-4.2
TAIWAN	0.3	15.4	0.4	5.4	-17	-0.3	2.6
THAILAND	0.4	4.7	0.6	7.9	-21	0.9	2.7
TURKEY	7.8	38.3	2.4	21.0	-74	-1.9	-7.1
VIETNAM	0.2	9.9	1.4	22.8	-83	-1.0	-4.6
SHANGHAI	1.8	4.7	-0.1	3.5	57	-0.6	-2.6

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





- **The outperformance of EMs vs DMs was supported by relative valuations, 2017 EPS growth, and less bearish positioning.**
- **The EMs are to benefit from stabilizing macro surprises, higher (even though rolling over) exports, the continuation of the world trade recovery, and lower spreads. Risks come from possible (lesser) US trade protectionism, a reappreciation of US dollar, and higher US yields.**
- **We continue to be constructive mid-term on EMs and still favor India along with Korea and CEE countries. China remains, in our view, at risk due to tightening amid the credit excesses.**

Over the last month, EM equities have rallied, increasing by 5.1% in US dollar terms. The top performer was Turkey (+7.8%), followed by MSCI China and India (6.6% and 6.3%, respectively). The worst performing ones were Argentina (-3.8%) and Greece (-1.0%). Both the Turkish and the Chinese markets have benefitted from improving earnings. The advance of the Indian stock market is led by a rally in engineering and construction companies.

Overall, EM 2017 earnings have been revised up only slightly during the last month (+0.2%). The markets for which they have been upgraded significantly are: Greece (+4.2%), Korea (+2.0%), Turkey (+1.4%), and MSCI China (+1.2%). The earnings of the Brazilian and Russian companies have been downgraded by around 2.3%.

EMs to benefit from stabilizing macro surprises

EM inflation is undershooting due to, among other things, strong FX appreciation. This is bringing about higher real interest rates. To combat the resulting lower nominal GDP, EM policymakers would have to cut nominal rates (to keep real rates at least unchanged), which is not impossible, given healthy external surpluses. The resulting lower yields would be positive for EM equities.

Based on multiples, the EM stocks have become more expensive, becoming fairly valued (+0.3% vs its history). The increased commodity prices are getting more supportive, but the gap in performance between oil and EM prices is still unfavorable.

Nonetheless, EM equities remain relatively cheap compared to their DM counterparts and various multiples continue to trade below their historical means, which suggests more upside.

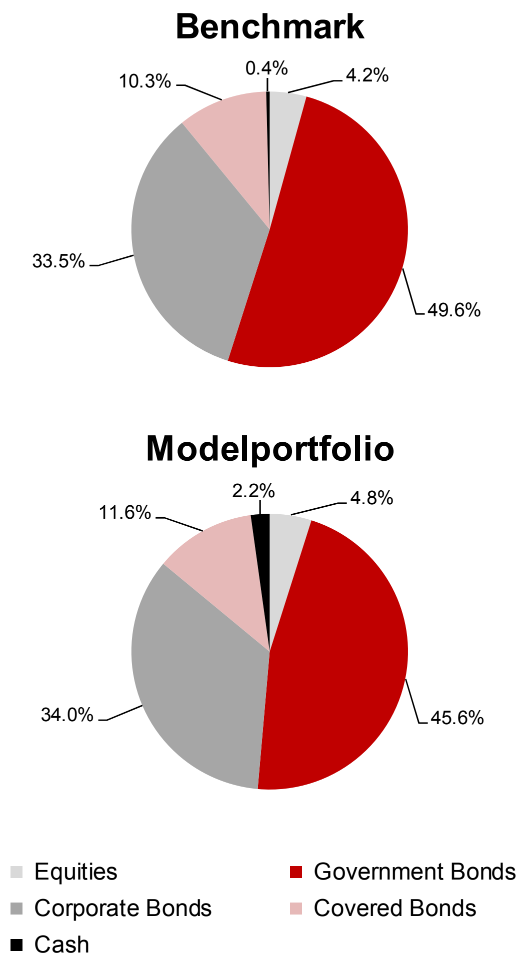
Following a mitigated phase, US yields are expected to trend upwards and higher 10-year rates from current levels should put pressure on EM stocks in the short term. But it should be noticed that Fed hiking cycles weigh more on EM when macro conditions are vulnerable, which is currently less the case.

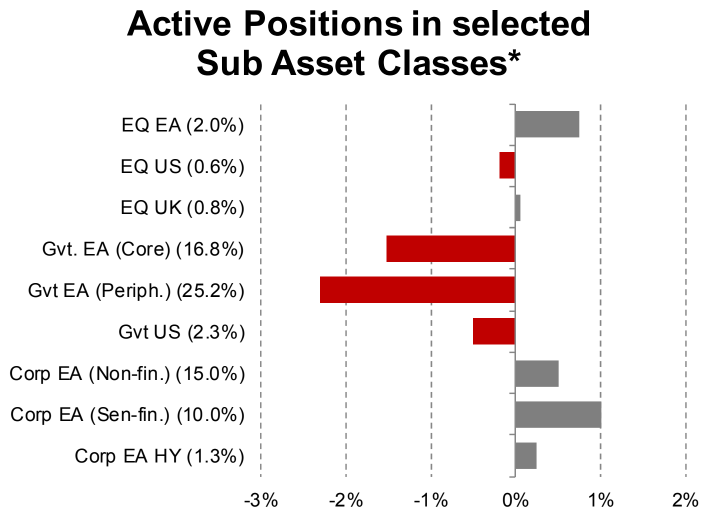
Asset Allocation

Thorsten Runde

- **Over the past weeks, long-dated government bond core yields on both sides of the Atlantic increased significantly – especially in the euro area.**
- **Despite the rise in underlying yields, corporate bond spreads fell further reaching long-term lows.**
- **Spreads on Southern European sovereign bonds hardly changed on balance.**
- **The development of international equity markets was heterogeneous. While developed European equities lost almost 1.5% on average, the remaining markets of our investment universe revealed positive return figures.**
- **Looking forward, the global macroeconomic backdrop remains supportive and a significant change of the monetary policy is not on the cards.**
- **Amid this outlook, the recent leg higher in global yields is likely to prove lasting and international equities are seen to hold up well.**
- **All in all, we still prefer European risky assets and credit over sovereign debt, but favor a slightly more prudent active exposure after the recent yield rise.**

Over the past weeks, the performance of the developed equity markets in our investment universe was particularly heterogeneous. Whereas the euro area equities, together with the UK and Switzerland bring up the rear of the overall return ranking so far, US and Japan are currently amongst the best performing asset segments. Corporate bonds, in particular the High Yield segment, clearly outperformed the government bond markets. Thus, preferring corporates and cash to government bonds has proven rewarding so far. Having said that, preferring Europe to the US did not really pay up to now, in particular when comparing the positions in euro area and US equities. On balance, benchmark and modelportfolio performance do not differ too much.





*Benchmark weights in parentheses.

Slightly more prudent allocation stance advisable

After the recent strong rise in yields, risks from summer illiquidity, and political uncertainties around the further evolution of the 'Russiagate' controversy in the US, we deem a slightly more prudent allocation stance advisable, maintaining the focus on European risky assets and credit.

Although less dynamically, core government yields should continue to trend upwards in the coming weeks. Slowly increasing inflation pressure, gradual monetary policy normalization, and a continuation of the economic rebound argue in that direction.

Particularly, euro area and Japanese equities will remain supported by solid macroeconomic data. US equities are expected to underperform moderately amid the reached levels and the corresponding high valuations.

Forecast Tables

Growth

	2015	2016	2017f	2018f
US	2.6	1.6	2.1	2.2
Euro area	1.9	1.7	2.0	1.6
Germany	1.5	1.8	1.8	1.6
France	1.0	1.1	1.7	1.6
Italy	0.7	1.0	1.1	0.7
Non-EMU	2.4	1.9	1.7	1.6
UK	2.2	1.8	1.6	1.4
Switzerland	0.8	1.3	1.5	1.6
Japan	1.1	1.0	1.4	1.0
Asia ex Japan	6.2	6.1	6.0	6.0
China	6.9	6.7	6.7	6.3
Central/Eastern Europe	1.2	1.4	2.6	3.0
Latin America	- 0.5	- 1.5	0.9	1.8
World	**3.4**	**3.0**	**3.4**	**3.5**

Inflation

	2015	2016	2017f	2018f
US	0.1	1.3	2.1	2.2
Euro area	0.0	0.2	1.5	1.3
Germany	0.1	0.4	1.7	1.6
France	0.1	0.3	1.1	1.2
Italy	0.1	- 0.1	1.4	1.1
Non-EMU	0.1	0.7	2.6	2.5
UK	0.0	0.7	2.9	2.7
Switzerland	- 1.1	- 0.4	0.5	0.7
Japan	0.8	- 0.1	0.5	0.8
Asia ex Japan	2.4	2.6	2.5	3.1
China	1.4	2.0	1.8	2.1
Central/Eastern Europe	9.2	5.2	5.1	4.7
Latin America	6.2	6.3	4.2	3.6
World	**2.3**	**2.3**	**2.6**	**2.7**

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

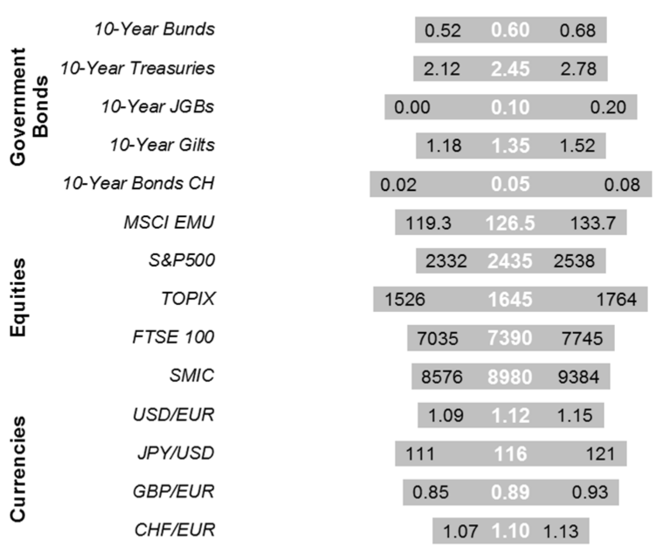
Financial Markets

3-month LIBOR	**27.07.17***	**3M**	**6M**	**12M**
USD	1.31	1.40	1.65	2.00
EUR	-0.38	-0.35	-0.35	-0.30
JPY	-0.01	0.00	0.05	0.05
GBP	0.29	0.40	0.45	0.60
CHF	-0.73	-0.70	-0.70	-0.70
10-Year Bonds	**27.07.17***	**3M**	**6M**	**12M**
Treasuries	2.31	2.45	2.60	2.80
Bunds	0.55	0.60	0.70	0.85
BTPs	2.11	2.30	2.55	2.85
OATs	0.81	0.90	1.00	1.15
JGBs	0.07	0.10	0.15	0.15
Gilts	1.23	1.35	1.40	1.50
SWI	0.03	0.05	0.10	0.25
Spreads	**27.07.17***	**3M**	**6M**	**12M**
GIIPS	134	145	160	170
Covered Bonds	74	70	75	75

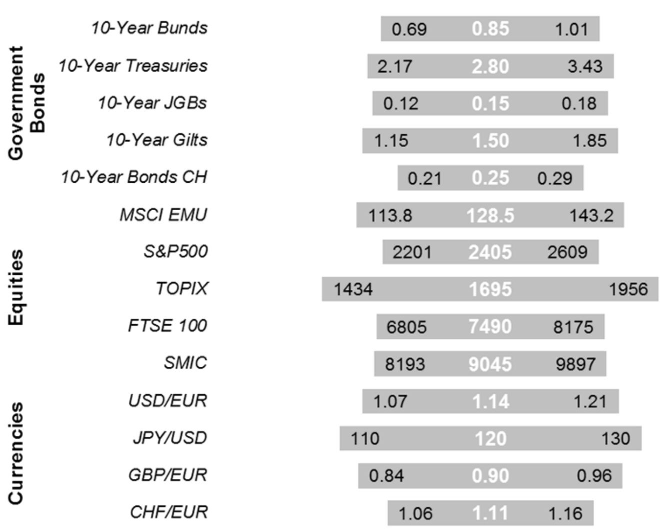
Corporate Bond Spreads	**27.07.17***	**3M**	**6M**	**12M**
IBOXX Non-Financial	121	120	125	135
IBOXX Sen-Financial	107	110	115	120
Forex	**27.07.17***	**3M**	**6M**	**12M**
USD/EUR	1.17	1.14	1.16	1.16
JPY/USD	112	114	117	120
JPY/EUR	130	130	136	139
USD/GBP	1.31	1.28	1.29	1.29
GBP/EUR	0.89	0.89	0.90	0.90
CHF/EUR	1.12	1.12	1.13	1.13
Equities	**27.07.17***	**3M**	**6M**	**12M**
S&P500	2477	2460	2455	2445
MSCI EMU	123.8	126.0	127.0	128.0
TOPIX	1622	1640	1665	1695
FTSE	7443	7455	7530	7550
SMI	8982	8980	9100	9060

*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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