GENERALI INVESTMENTS

Market Perspectives

February 2018

Content

Global View

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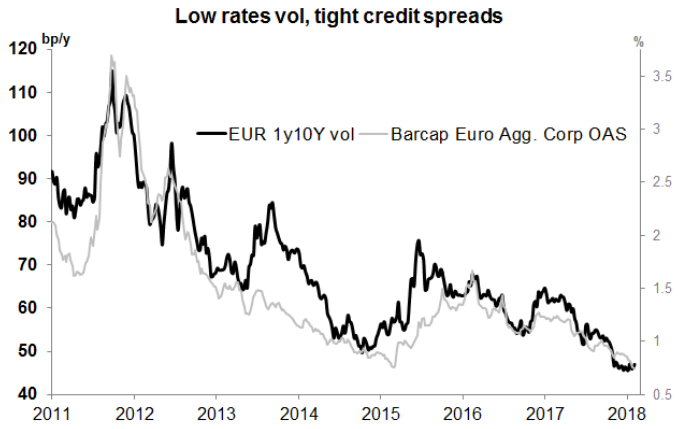
- **Global yields are finally rising, propelled by a solid global expansion, recovering inflation and the gradual withdrawal of central banks as massive buyers of sovereign debt.**
- **A portfolio tilt towards riskier assets should still pay off over the coming weeks.**
- **Given the strong performance of equities and lower rated bonds and a still sanguine market stance towards central banks' policy normalization, however, we favor a somewhat more prudent stance in active exposure than in December.**

Embracing risky assets and avoiding duration continued to pay off well over the past weeks. Year-to-date global equities have rallied (MSCI World up by roughly 5%) while global yields have soared, with 10-year USTs surging beyond 2.70% for the first time since 2014. Credit products have shown resilience in this unfavourable environment, thanks to a substantial contraction in risk premia. Also Southern European bonds have held up well, with demand shrugging off political concerns ahead of the Italian election on March 4.

The recent increase in global yields was overdue, given the solid expansion of the global economy, recovering inflation and the case for monetary policy normalization strengthening. In the euro area, business sentiment is particularly bullish: the closely watched composite PMI in January was the strongest since June 2006, and the German ifo hit another all-time high. Price pressures are building, too. But with core inflation still only at around 1% in the euro area, inflation is likely to build only gradually (stronger euro also cushioning the upside pressures). Rising yields may eventually infect "goldilocks" and the riskier assets. But with rates volatility still low for now, a switch to a defensive risk posture looks premature.



The upward pressure on bond yields is unlikely to reverse. Inflation expectations have leeway to recover further. And rising investment spending will likely help to improve potential growth and the leeway for higher real yields. We do not expect yields to keep soaring at the same speed as over the first weeks of this year. But the trend is clearly to the upside. This is a key reason why in mark-to-market portfolios, we still prefer a moderate tilt towards riskier asset classes (euro area equities and corporate bonds) and cash at the expense of an underweight in government bonds. Importantly, another key development in early 2018 has been a sharp pullback of the US Dollar (trade weighted index down by more than 3%). This tends to be positive for commodity prices and EM markets, hence tends to support the global reflation theme.

Bonds	**29/01/18***	**3M**	**6M**	**12M**
10-Year Treasuries	2.66	2.75	2.80	2.90
10-Year Bunds	0.64	0.70	0.75	0.95
Corporate Bonds				
IBOXX Corp. Non Fin	103	110	120	130
IBOXX Corp. Sen. Fin	94	105	105	115
Forex				
EUR/USD	1.24	1.22	1.25	1.27
USD/JPY	109	110	112	115
Equities				
S&P500	2855	2845	2845	2860
MSCI EMU	131.2	130.5	130.5	133.0

* avg. of last three trading days

No reason for complacency

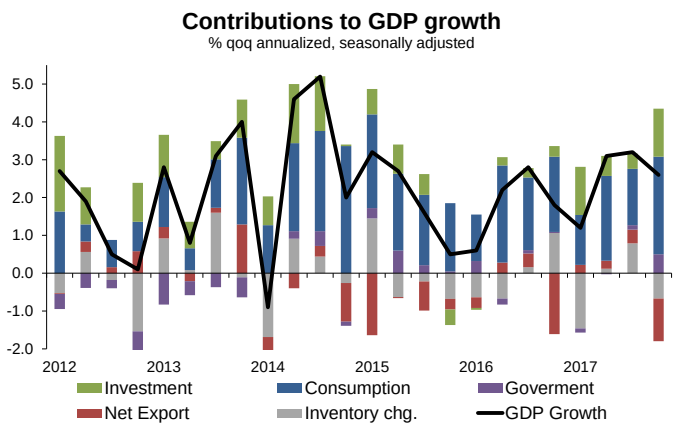
There is no reason for complacency, though. While economic fundamentals remain supportive, financial markets have already discounted a lot of good news. The cyclically adjusted price-earnings ratio for US equities has reached 34.5, a level seen in history only during the late 1990s dotcom bubble. And implied volatility remains depressed by historical standards.

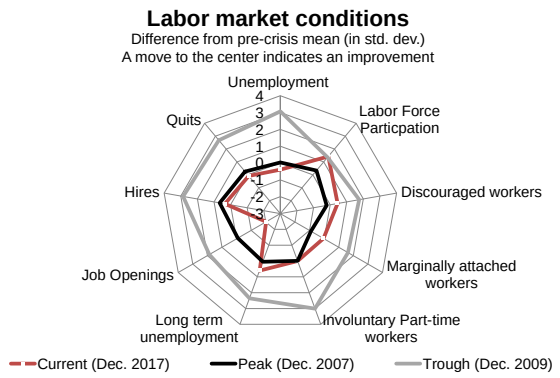
These high valuations and low volatilities owe much to widespread market confidence in only a very gradual removal of central bank support. With key measures of underlying inflation still well below targets in the US, the euro area and Japan, there is indeed no pressures yet for monetary authorities to proceed fast. But this may change. The ECB is already considering to revisit its forward guidance in the near future. The Fed continues to hike rates, likely three more times this year. And even the BoJ, the permanent laggard in normalizing rates, struggles to convince markets that it is not envisaging any change to its ultra-accommodative stance.

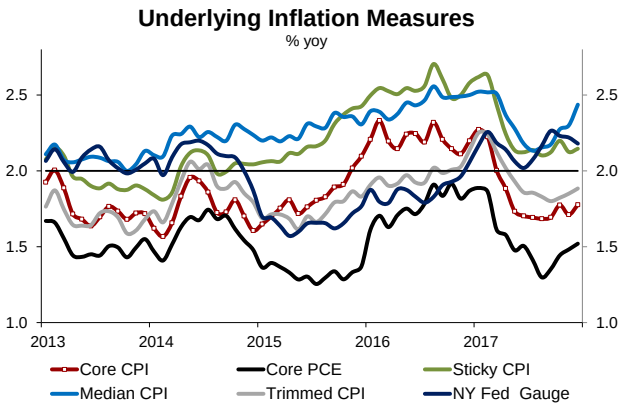
A key risk is that the very benign global growth environment will translate into inflation faster than currently expected. This would also make the response by central banks harder to predict, increasing uncertainty and volatility. This is not our base case for the comings weeks. But with the risks of this happening rising, we recommend to reduce the pro-risk positioning in the portfolios.

USA

Paolo Zanghieri







- **GDP grew by 2.3 % in 2017 as a whole. Tax reform will likely lead to an acceleration to 2.6% in 2018, with some upside risk.**
- **Record low unemployment will start feeding more meaningful into core inflation, which should increase towards 2% from Q1 onwards.**
- **After the December hike, we confirm our view of the Fed raising rates three times this year. The first hike is expected for March.**

After the better than expected 3.2% annualized growth posted in Q3, GDP decelerated to 2.6% annualized in Q4, according to the preliminary estimates. Consumption continued in its steady growth and the contribution of investment (especially by the oil sector) was markedly higher, leading to a deterioration in net trade. The speed and drivers of growth will remain broadly the same during at least over the first half of 2018. A strong labor market will continue to support disposable income, limiting the adverse impact of higher inflation on purchasing power. However, the sharp fall in household saving is likely to limit consumption growth to below that of 2017. On the corporate side, the pick up in profitability will more than offset the mild increase in financing costs brought about by higher interest rates, resulting in still healthy investment growth. On top of that, the tax reform should further stimulate capex and, to a lesser extent, consumption, allowing GDP growth to accelerate to 2.6% in 2018 (against the 2.4% we expected in December).

Labor market tightening only partially seen in wages

Strong job creation continued in December. The 148k payroll growth kept the unemployment rate at 4.1%, the lowest figure since January 2001. Moreover, job openings and new hirings remain above the pre crisis peak, and anecdotal evidence from the latest Fed's Beige Book added to the view of increasing labor scarcity for the most skilled jobs. Yet hourly earnings growth stopped at 2.5% yoy. We expect labor costs to increase in line with a further labor market pressures and the recovery in inflation feeding through to expectations and wage demand.

Core inflation strengthens

A strong December reading (1.8% yoy) showed that the one-off effects that have depressed core inflation in most of 2017 are gradually fading. Inflation gains were broad based, boding well for a further acceleration in the coming months, over and above the unwinding of the negative base effect, expected for the end of Q1. Moreover, the weaker dollar will spur import price inflation.

Moreover, stronger energy prices will contribute to both the headline rate and expected inflation. All this and the end of the negative base effects will likely push core CPI inflation to above 2% by the end of Q1 2018.

USA

Fiscal policy to prop up demand

The impact of the tax reform passed into law at the end of December is the main reason behind our upward revision of the 2018 GDP forecast. It will add around US$ 1.5 trillion to the deficit over the next decade (excluding any offset due to higher growth). The impact of fiscal policy on GDP growth is estimated to be roughly 0.3%-0.4% on average in the next two years, equally split between consumption and investment, a considerable increase from the current zero stimulus. Fiscal policy constitutes an important source of upside risk to our growth and inflation forecast for 2018 and 2019: measures to increase federal expenditure on defense and infrastructures are being discussed, and further outlays may be decided as part of a compromise to find a durable solution for the funding of federal activities, after the January 20th temporary government shutdown.

Yet, consistent with the evidence of past corporate tax cuts, the effects on the supply side and potential growth are likely to be modest. Higher capex will bring about only a limited increase in the capital stock, but the reform is not expected to have a visible impact neither on labor force participation nor productivity.

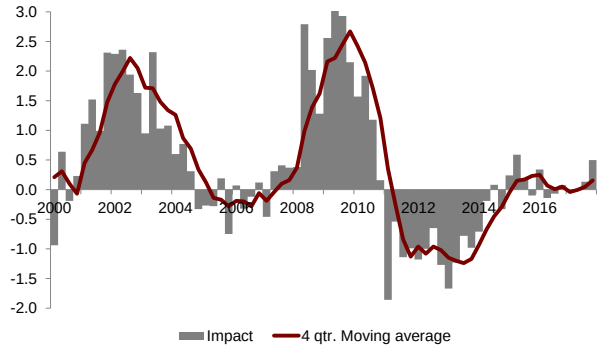
The Fed: three rate hikes with some upside risk

In the December meeting, the Fed increased rates to 1.25%-1.50%, revised upward their outlook for growth and employment, but did not alter its view of a very gradual increase in inflation. It reiterated that three rate hikes will be appropriated for this year. Our baseline scenario sees the Fed deliver on this plan. The first hike is expected for March (it has a nearly 90% probability, according to futures), followed by one each in June and September. Risks are tilted to the upside and the December meeting could be the occasion to deliver a fourth hike. Indeed, as a result of the fiscal stimulus, the unemployment rate could undershoot the Fed forecast (3.9% by Q4 2018, against 4.1% in December). Moreover, the sharp increase in oil price may lead to an upward revision in expectations. On top of that, the turnover in the voting members of the FOMC, and the new components to be appointed over the next year will likely shift the balance between doves and haws in favor of the latter. Moreover, the ongoing increase in equity prices and a weaker dollar have further loosened financial conditions, adding to the case for a rate tightening.

A hearing by Randal Quarles, the Fed vice chairman responsible for financial regulation, outlined the government strategy to ease the burden on financial intermediaries. In particular he stressed the intention to make banks' stress tests more transparent and to reduce capital and liquidity requirements for large but not systemically important lenders.

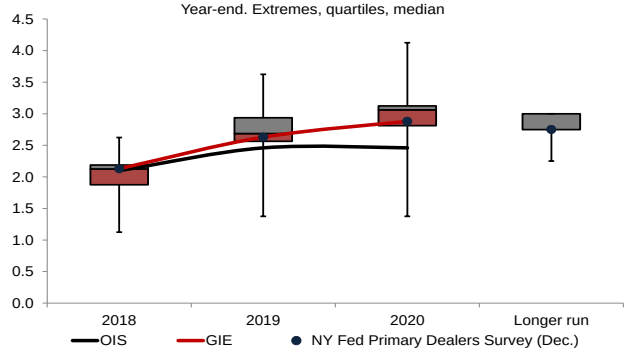
Impact of fiscal policy on GDP

% of GDP. Source Brookings Institution.



Appropriate path and forecasts for the Fed funds rate

Year-end. Extremes, quartiles, median

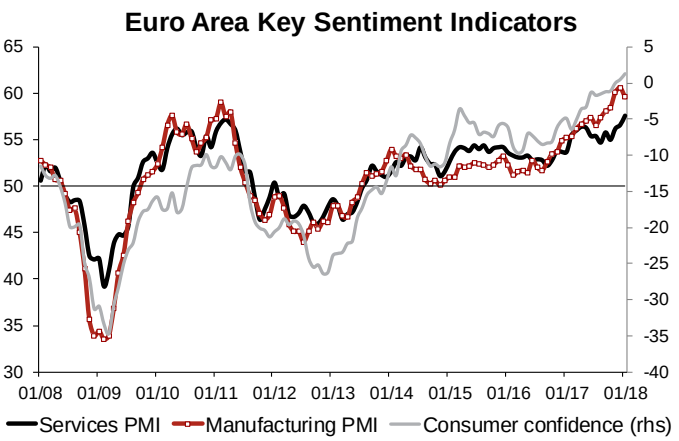


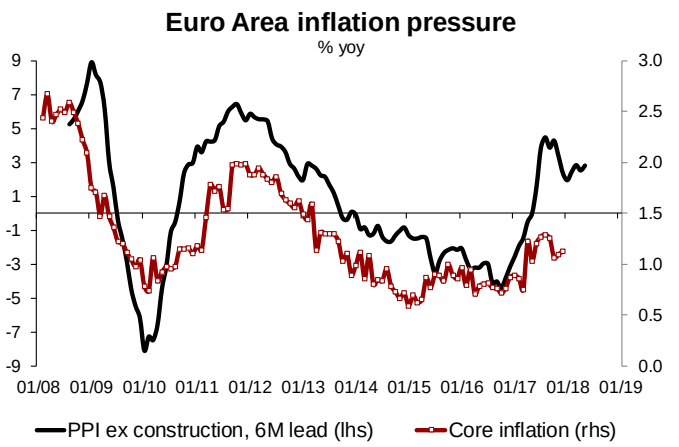
Main Forecasts[1)]	2016	2017	2018f	2019f
GDP	1.5	2.3	2.6	2.3
Consumer spending	2.7	2.7	2.4	2.1
Gov. consumption	0.8	0.1	2.5	2.6
Investment	0.6	4.2	5.1	3.4
- residential inv.	5.5	1.7	4.6	3.2
- structures	-4.1	5.3	1.7	2.8
- intell. property production	6.3	4.2	4.3	3.5
- equipment/software	-3.4	5.2	7.3	3.8
Inventories	-0.3	-0.1	0.3	-0.2
Exports	-0.3	3.4	3.6	4.0
Imports	1.3	3.9	5.0	4.3
Net trade	-0.2	-0.2	-0.3	-0.3
Domestic demand	2.0	2.5	2.8	2.4
Consumer prices	1.3	2.1	2.3	2.1
Unemployment rate[2)]	4.8	4.4	3.8	3.7
Budget balance[3)]	-2.9	-3.3	-4.1	-4.3
Fed Funds Rate[4)]	0.66	1.38	2.13	2.63

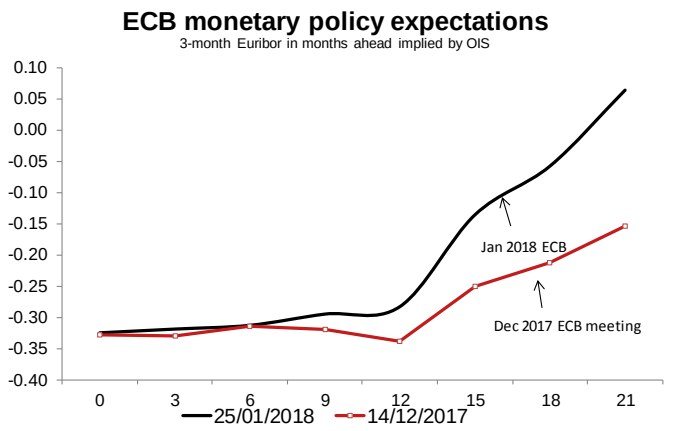
1) Unless noted otherwise, annual % changes, net trade and inventories: growth contribution to GDP 2) yearly average as %, 3) in terms of GDP, federal deficit 4) as %; year-end

Euro Area

Martin Wolburg







- **At the outset of the year, key sentiment indicators once again surprised on the upside, thereby again defying political risks.**
- **While we have increased our 2018 GDP forecast to 2.3% yoy, weaker forward-looking indicators and a stronger euro suggest toppish growth.**
- **The ECB has not yet started to discuss the road towards policy normalization. We stick to our view that QE ends in 2018 and that the repo rate will be at 0.25% at year-end 2019.**

The prospects for the euro area recovery remain bright. The release of the Q4/2017 GDP showed growth of 0.6% qoq, unchanged from the quarter before. What is even more, the January composite flash PMI soared to the highest level since June 2006. Its reading of 58.5 is 1.6 standard deviation above average. Likewise, the French Insee reached a 17-year high and the German ifo even reached an all time high.

Looking ahead, the prospects for economic activity remain bright. Confidence in the very much domestically-oriented service sector advanced further and with employment being built up with a strength last seen in September 2000 the way for a continuation of the recovery is well paved. The unemployment rate was at 8.7% in December and with employment expansion (Q3/2017 +0.4% qoq) set to accelerate, it will trend down further. Against this backdrop, the surge in consumer confidence to the highest level since August 2000 is well founded and will contribute to keep consumption strong (we see Q4/2017 consumption at 0.6% qoq).

Euro area growth looks toppish

The January key sentiment indicators once again confirmed that dampening effects from political uncertainties (e.g. Italian elections, German government formation, Catalan issue) were more than offset by strong economic fundamentals. That said, there is indication that the economic tailwind from exports may ease. The January manufacturing PMI survey recorded less buoyant export orders as the effective euro continued to appreciate (by 0.9% since Nov.). Moreover, in the ifo survey the expectation component weakened again and the credit impulse also heralds some softening. All in all, while activity will remain strong growth also looks toppish.

In sum, annual growth was at 2.5% in 2017, the highest since 2007 and for the third consecutive year above potential. With a growth rate of 2.3% in 2018, we expect annual growth to broadly maintain its strength albeit we look for some easing of quarterly growth rates. Next year, we foresee a more meaningful weakening of annual growth but continue to look for above potential readings. Given the strong underlying momentum of the economy, we still see risks tilted to the upside.

Euro Area

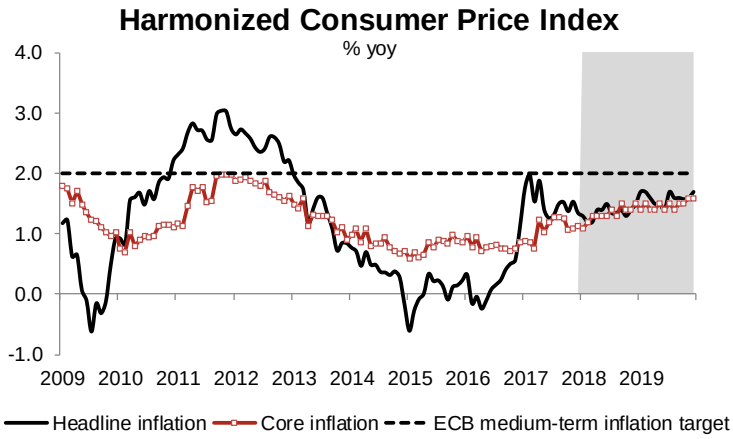
Mounting pressure to push core inflation higher

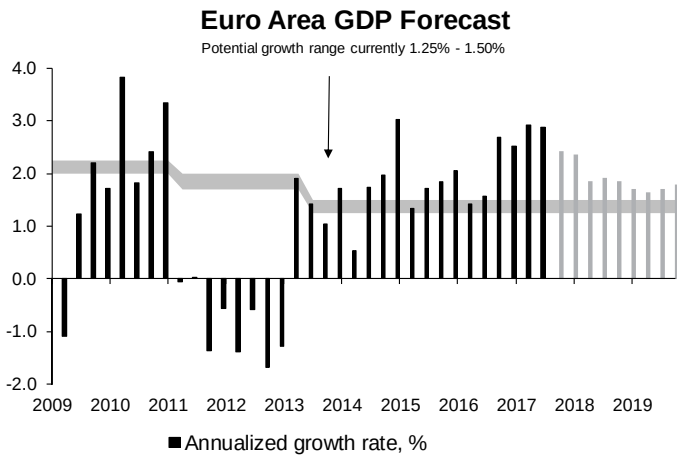
As the recovery proceeds, the pressure for inflation to trend higher is rising. With growth clearly above potential, the euro area economy likely moves from a situation of idle capacity to one of capacity overutilization this year. As we had already highlighted before, we see the unemployment rate approaching its equilibrium level of 8.4% over the year. For the evolution of inflation, it is key whether this also leads to stronger wage increases. Among the bigger economies wage pressure exists according to this measure in the Netherlands and Germany. For the euro area, the wage development in Germany (28% of GDP) is key. In 2018, the trade unions will negotiate new tariffs for 9.7 mn employees (out of about 41 mn) and thereby also significantly impacting the evolution of overall wages. Here, the negotiation in the electricity and metal industry (3.5 mn employees) with a requested wage increase of 6% and the right to reduce working hours by 20% have entered their final phase and are of special importance. Euro area negotiated wages stayed at 1.5% yoy in Q3 2017 but are expected to rise over the course of the year. Moreover, rising commodity prices have contributed to an ongoing margin squeeze of firms implying a need to increase prices to restore profits. In the latest PMI survey output prices moved further up reaching the highest level since April 2011. Although the stronger euro dampens imported inflation, inflation pressure has built up (see mid-chart, previous page) that will drive core inflation up from the 1.2% yoy reading recorded for January. At the end of the year we still look for a core rate reading of around 1 ½ % yoy.

ECB to start discussing policy normalization in March

The key message from the January ECB Governing Council meeting was that it had not yet started to discuss the road towards policy normalization in greater detail. President Draghi still adopted a cautious tone on inflation and expressed his concern about the exchange rate development which requires "*monitoring with regard to its possible implications for the medium-term outlook for price stability*". However, the minutes of the December meeting also revealed that the ECB is thinking about tweaking its forward guidance. In an environment of strong growth and recovering inflation this discussion will become more pressing in the months to come. We expect it to start at the meeting on March 8 when the ECB staff will also have updated its growth and inflation projections.

In the meantime, markets have more and more accustomed to the idea of rate increases in 2019. While the further course of monetary policy will clearly be path dependent we continue to expect that the ECB will stop its QE purchases in late 2018 and envisage depo as well as a repo rate (to 0.25%) hikes in 2019. For the 2020 and 2021 we foresee further key rate hikes of 50 bps in each year.



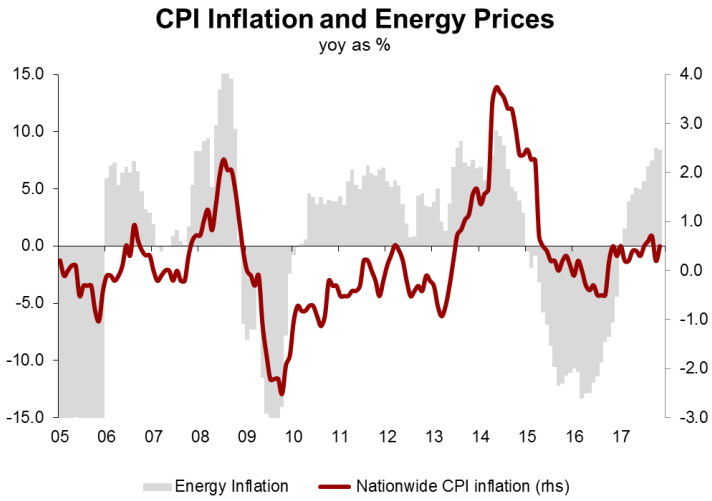


Main Forecasts[1)]	2016	2017	2018f	2019f
GDP	1.8	2.5	2.3	1.8
Consumer spending	2.0	1.8	1.7	1.6
Gov. consumption	1.7	1.1	0.9	0.8
Total fixed investment	4.5	3.2	3.5	2.9
Inventories	-0.1	0.1	0.2	0.1
Net trade	-0.4	0.5	0.3	0.0
Domestic demand	2.3	1.9	1.8	1.6
Consumer prices	0.2	1.5	1.4	1.6
Unemployment rate[2)]	10.0	9.1	8.6	8.4
Budget balance[3)]	-1.7	-1.2	-0.9	-0.8
ECB refi rate[4)]	0.00	0.00	0.00	0.25

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)]	2016	2017e	2018f	2019f
GDP	1.0	1.8	1.6	1.3
Consumer spending	0.1	1.2	1.0	1.2
Government consumption	1.3	0.2	0.8	1.1
Investment	1.1	2.7	1.8	1.9
Inventories	-0.2	0.0	0.2	0.0
Net trade	0.5	0.5	0.3	0.0
Domestic demand	0.6	1.4	1.2	1.3
Consumer prices	-0.1	0.5	0.9	1.1
Unemployment rate[2)]	3.1	2.8	2.7	2.7
Budget balance[3)]	-4.2	-4.1	-3.3	-2.9

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

- **With an expected Q4 GDP growth rate in the 1½% range, Japan's economy likely expanded by 1.8% in 2017, double the pace of 2016. Growth will probably slow this year slightly to 1.6%.**
- **The recent rise in oil prices will increase core inflation Japanese style, but core-core inflation to stay relatively low.**
- **The BoJ rejected market speculations of an early exit from its ultra-loose monetary policy stance.**

After a strong growth rate of 2.5% qoq annualized (ann) in Q3, we expect Japan's GDP to have expanded in Q4 at a more "normal" pace (data to be released on Feb. 14). Strong one-off or base effects dominated the result in Q3 and will still influence Q4 readings. According to BoJ data, real merchandise exports and imports rose markedly, but much more in line, so that their net contribution to GDP should come in close to neutral. Nevertheless, looking back at 2017, Japanese exports were able to participate strongly in the international business cycle upturn, being responsible on net for 0.5 pps of the expected (upward revised) total 2017 growth rate of 1.8%. Looking ahead, as we forecast world growth to remain robust, we also see Japan's exports to continue to rise solidly. However, with imports catching up, the net contribution will slightly recede. With regard to domestic factors, available data of the real consumption index until November (revisions likely) point to a private consumption growth in Q4 of around 2.5% qoq ann, resulting in a 2017 rate of 1.2%. After three years of negative or almost no growth of private consumption, following the sales tax hike in April 2014, this would be the first "reasonable" expansion again. However, despite a tightening labor market amid a moderate pickup in inflation, we consider a better but still rather mild (non-seniority) wage increases and a rising share of pensioner households to prevent a much stronger expansion of private consumption. Finally, the December BoJ Tankan report supports the long-standing experience that investment typically responds positively to rising exports with a time-lag. All in, we see growth in 2018 to slow only limitedly to 1.6%.

BoJ rejected early exit

Meanwhile, the recent rise in crude oil prices has changed Japan's inflation outlook, as Japanese core inflation excludes food, but not energy. Currently, fresh food inflation as well as the recent yen appreciation versus the US-dollar are mitigating the impact. We expect core inflation to stay around 1% yoy in summer, before falling back again in autumn. Regarding the BoJ, Governor Kuroda (who we expect to catch a second term at the helm of the BoJ) rejected market speculations that the BoJ – given good growth and rising inflation – might exit early from its ultra-loose monetary policy stance. However, with the Fed normalizing monetary policy further, we see some scope towards the end of the year.

China

Christoph Siepmann

- **China's Q4 real GDP growth surprised slightly on the upside with 6.8% yoy, raising the total 2017 result to 6.9% (after 6.7% in 2016).**
- **December real activity data were broadly stable. Moreover, with PMIs on comfortable levels, growth looks rather resilient short-term.**
- **China will likely adopt again a growth target of "around 6.5%" this year.**

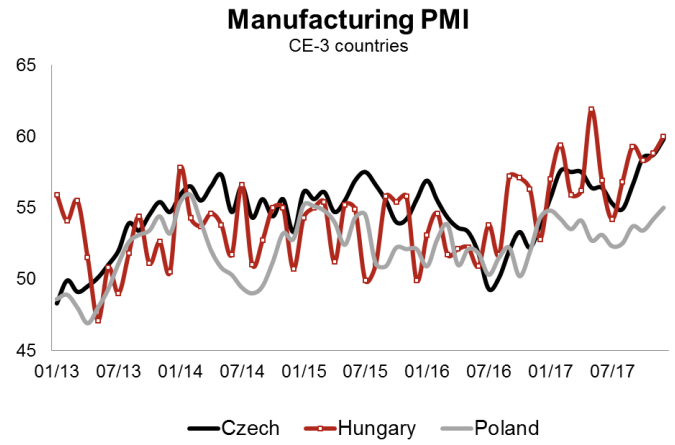
China's real GDP came in slightly better than expected in Q4 at 6.8% yoy. This pushed up the economic expansion in China in total 2017 to 6.9%, the first albeit marginal increase in growth since the Great Financial Crisis. Moreover, December data were broadly stable compared to the month before. Industrial production edged up to 6.2% yoy, defying any further mild slowing, which is in line with reports that China softened its stance on the actual implementation of the anti air-pollution regulations. Investment growth came in constant at 7.2% yoy ytd, given less projects from the central government and weaker investment growth of local governments and SOEs. Nevertheless, infrastructure expenditures stayed on high levels. Moreover, real estate investment expanded by about 7% in 2017, broadly unchanged from 2016. Meanwhile, property sales increased for the second month in a row, ending the period of negative rates in autumn and thereby suggesting less slowing of the real estate sector, going forward. Together with PMIs on comfortable levels (the latest NBS manufacturing PMI for January came in at 51.3) China's growth looks rather resilient in the short term. Rumors from the Economic Work Conference in mid-December also suggest, that China will adopt again a growth target of "around 6.5%" for this year. While the final wording will not be known prior to National People's Congress in March, and the target will be amended by a focus on the quality of growth, it clearly shows that the government is not intending to tighten policy harshly with regard to the high credit-to-GDP ratio, SoE restructuring or capacity cuts. In addition, help will probably also come from international demand, given robust global growth. In sum, we revised our 2018 growth forecast slightly up to 6.5% (from 6.4%).

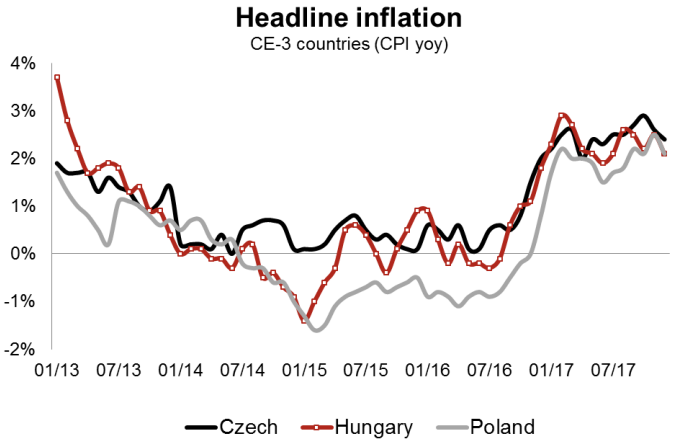
China's high credit-to-GDP ratio likely stabilized 2017

On the monetary side of the economy, new bank loans increased by 7% in 2017, compared to 7.9% in 2016. Total Social Financing, the most comprehensive credit measure available, rose by 9.1% last year. This implies (of course on a preliminary basis) that China's high credit-to-GDP ratio could have stabilized in 2017 from the denominator side as nominal GDP rose by 11.2% (due to the reflation of the secondary sector). This stabilization may also explain why the Chinese government tends to look more relaxed towards the high credit-to GDP ratio while it massively tries to limit risks in the financial sector, most recently again by a flurry of new regulations.

Central and Eastern Europe

Radomír Jáč





Main Forecasts	2016	2017e	2018f	2019f
Czech Republic				
GDP	2.5	4.4	3.0	2.9
Consumer prices	0.7	2.5	2.3	2.0
Central bank's key rate	0.05	0.50	1.00	1.50
Hungary				
GDP	2.2	3.9	3.3	3.0
Consumer prices	0.4	2.4	2.7	3.0
Central bank's key rate	0.90	0.90	0.90	1.50
Poland				
GDP	2.9	4.5	3.7	3.5
Consumer prices	-0.7	1.9	2.3	2.7
Central bank's key rate	1.50	1.50	1.75	2.50

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

- **The CEE economic activity remains strong. The economies have been operating at full capacity utilization, which leads to labor force shortages and upward pressures on wages.**
- **Price pressures are mixed and so is the monetary policy stance among the regional central banks.**
- **The Czech CNB is expected to raise its interest rates further in February, while the Hungarian MNB tries to ease monetary conditions. In Poland, the NBP says that its interest rates may stay on hold in 2018.**

Both the confidence surveys and hard data on economic activity are indicating that the CEE region will keep its strong growth momentum also in early 2018. Capacity utilization within the economies has been growing, which is reflected by the falling unemployment rate and by an upward pressure on wages. However, headline inflation moderated at the end of 2017 due to disinflationary base effects from commodity prices (food, fuel) and also thanks to the impact of an appreciation of regional currencies.

Czech inflation moderated to 2.4% yoy in December, a 6-month low, but is likely to stay above the 2% target for most of 2018, as the economy is overheated and generates demand-side inflationary pressures. Inflation stands below monetary policy targets in both Hungary (current CPI at 2.1% yoy vs. target set at 3%) and Poland (CPI also at 2.1% vs. target at 2.5%). The Polish NBP expects inflation to approach the target level only in late 2018, while the Hungarian MNB keeps its view that the inflation target will be reached in a sustainable manner only by mid-2019.

Monetary policy: Czech rate hike awaited in February

The Czech central bank raised its key rate twice in H2 2017 and its own projection pencils in two rate hikes (25bps each) for 2018. The key rate currently stands at 0.50% and the next hike is expected at the upcoming meeting on February 1. We share the view that the CNB will raise its key rate to 0.75%. It will also publish the fresh quarterly forecast but the projected interest rate trajectory should be similar to the forecast published in November.

The Hungarian MNB launched unconditional IRS facilities in mid-January as a new tool aimed to further ease monetary conditions in the economy. However, the first tender led to volatility and to increases in the HUF IRS and HUF government bond yields and the MNB announced technical adjustments aimed to contribute to bull flattening of the yield curve.

The Polish NBP keeps a wait-and-see stance and says that its key policy rate may stay unchanged at 1.50% in 2018. Worth noting is that monetary conditions in the Polish economy tightened recently due to the PLN firming. We continue to expect the first hike in the NBP interest rates in late 2018.

Bonds/Fixed Income Strategy

Florian Späte

- **International sovereign yields have risen sharply since the mid of December. While inflation expectations crept upwards, the bulk of the increase is due to higher real yields.**
- **Southern European government bonds performed reasonably well in this environment. Even the spread widening of BTPs turned out temporary.**
- **At these yield levels, the air grows thinner and the leeway for a further upward movement appears more limited. Still, the medium-term outlook remains for higher government yields across the curve.**

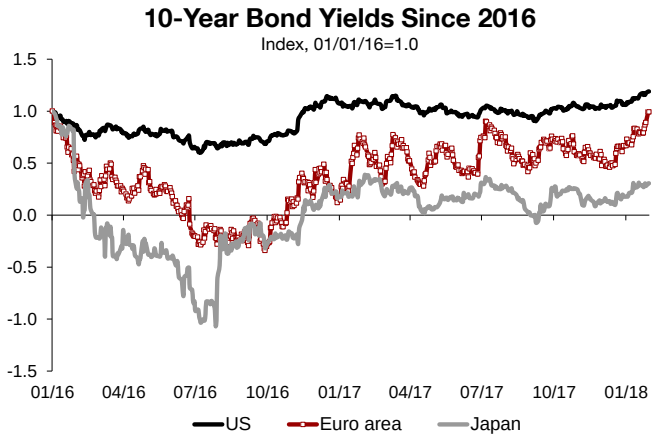
Across all maturities international core yields have trended strongly upwards since the mid of December. Both, euro area and US yields have risen by around 30 bps to 0.67% (highest level since November 2015) and 2.70% (highest level since Spril 2014), respectively. This movement occurred across all maturities. While short-dated US yields have been on an upward trend since September 2017 already (reaching the highest level since the collapse of Lehman Brothers), 2-year Bund yields have inched upwards in recent weeks.

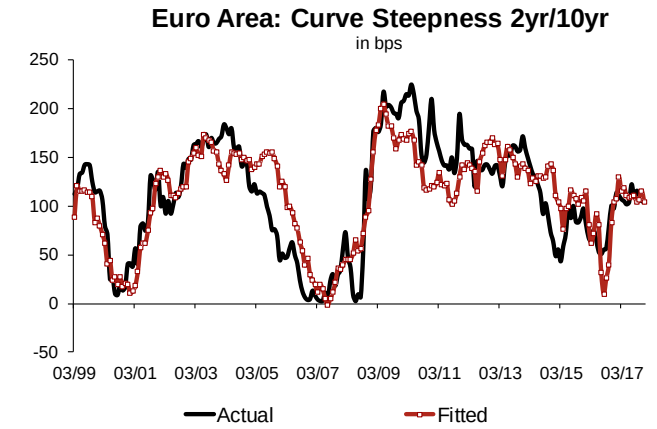
The bulk of the increase is due to higher real yields. Although US inflation expectations rose moderately in line with higher commodity prices, euro area inflation swaps hardly moved. Hence, 10-year real yields in the euro area recovered from their long-term lows and rose from around -1.25% to around -0.90%. Their US counterpart increased by around 25 bps to 0.40%. This is still low by historical standards and is at odds with the strong economic background – particularly in the euro area.

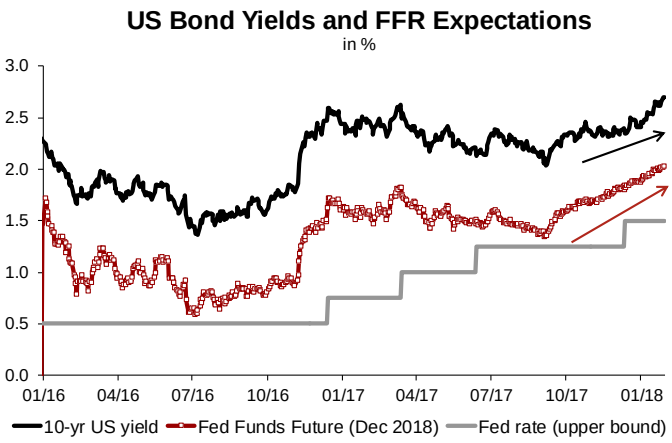
Further upside potential in the medium term

Going forward, the factors which triggered the sell-off will continue to drive sovereign yields upwards. To start with, although market expectations regarding forthcoming ECB key rate hikes have already adjusted strongly, there is more leeway. 2y1y EONIA forward trades around 0.30%. Given that a first ECB repo rate hike is expected in 2019, followed by two more steps in 2020, there appears to be more leeway for an upward adjustment. In the US, only four key rate hikes are priced until the end of 2019. This is at odds with the Fed's own view and our forecast of five 25 bps hikes until the end of next year. Hence, an adjustment of central bank expectations is likely to push yields upwards going forward. This applies particularly to the Fed given that the US rate cycle has already started and the robust macroeconomic data flow in combination with the recent depreciation of the US-dollar (leading to easier financial conditions) implies upside risks to our forecast of three hikes by the Fed in 2018.

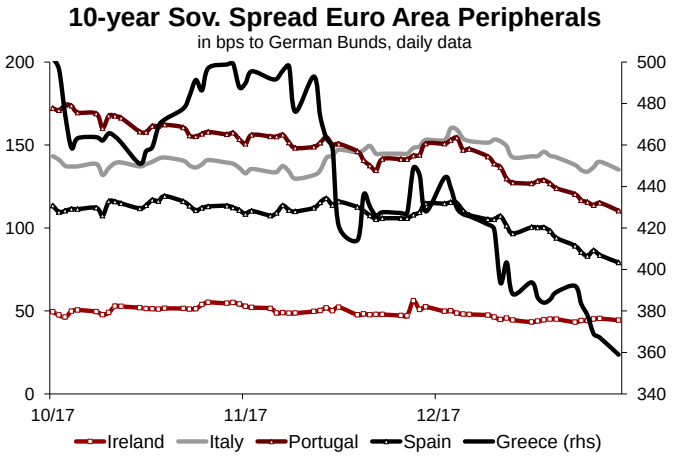
Nevertheless, after the strong upward movement in yields risks for a setback are rising. There are a number of potential catalysts. Without claiming completeness, given

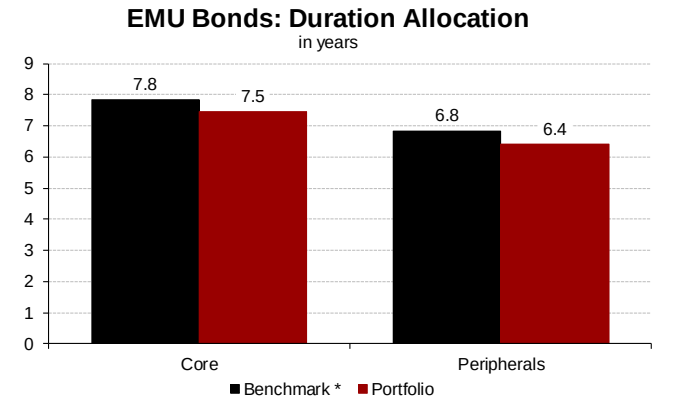




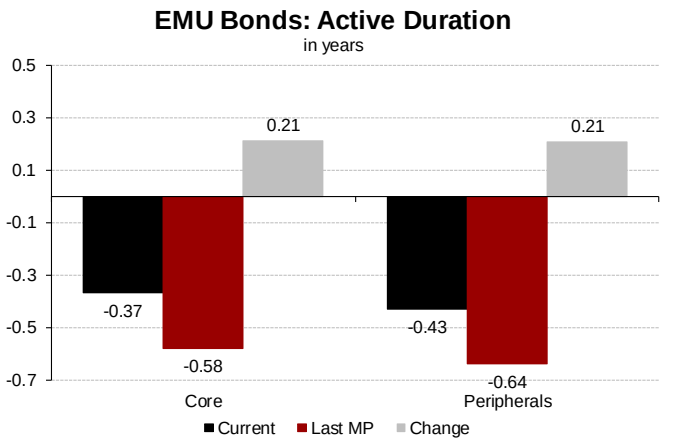


Bonds/Fixed Income Strategy





* JPMorgan EMU Government Bond Index



high expectations there is a risk that future macroeconomic data can fall short of expectations, financial markets could get caught on the wrong foot by the sideways movement of euro area inflation expectations in 2018 and/or political disturbance can lead to a deterioration of financial market sentiment.

Further down the road, however, the way is paved for higher yields. Our forecast on a 12-month horizon for 10-year euro area and US government yields is 0.95% and 2.90%, respectively. This bearish bond market environment is forecast to trigger a flattening of the US curve. Both, the 2-yr/10-yr and the 10-yr/30-yr spread is seen to decrease on a one year horizon. However, respective flattening trades have a negative carry and we do not recommend setting up flattening trades currently. Financial markets expect a flattening of the euro area curve as well. While we agree on the 10-yr/30-yr part of the curve, we do not share the view for the 2-yr/10-yr spread. Given the depressed level of long-dated real euro are yields, we expect the spread to remain broadly unchanged on a one year horizon. As a respective steepening trade has a positive carry of around 10 bps, setting up a respective trade appears attractive.

Strong performance of Southern European bonds

Due to declining risk premiums, Southern European bonds were able to partly disconnect from the strong upward trend in core yields (10-year Spanish and Portuguese spread versus Bunds on the lowest level since 2010). In fact, Italian, Spanish and Portuguese sovereign bonds have achieved a positive total return year-to-date (in contrast e.g. to -1.2% for German Bunds).

In the run-up to the Italian election, we recommend caution regarding BTPs. A possible negative news flow and the uncertainty about the election outcome (a hung parliament remains our base scenario) is likely to burden Italian government bonds. Although the macroeconomic environment has improved, structural problems remain unresolved. This is unlikely to change substantially after the election and there is a substantial risk that the fiscal discipline will be relaxed.

Our portfolios

Our cautious stance payed out well as the lower duration helped to protect against the increase in yields and contributed to the preservation of capital. Given the higher yield levels, we recommend a longer duration (but still lower than the benchmark duration) going forward.

For euro area core government bonds, we recommend a duration of -0.37 years (from -0.58 years before). For Southern European bonds we are even a bit more cautious as the Italian election is approaching and has the potential to burden these bonds (-0.43 years vs. -0.64 years before).

Corporate Bonds (Non-Financials)

Florian Späte

- **Non-financial corporate bond spreads have tightened to the lowest level since November 2007. Nevertheless, the yield level increased to 1.15% in January due to higher underlying yields.**
- **In the short run, the outlook remains benign given the sound environment. However, the expected increase in government yields dampens the total return outlook.**
- **Looking further down the road, the withdrawal of ECB purchases and the ambitious valuation is seen to trigger wider spreads.**

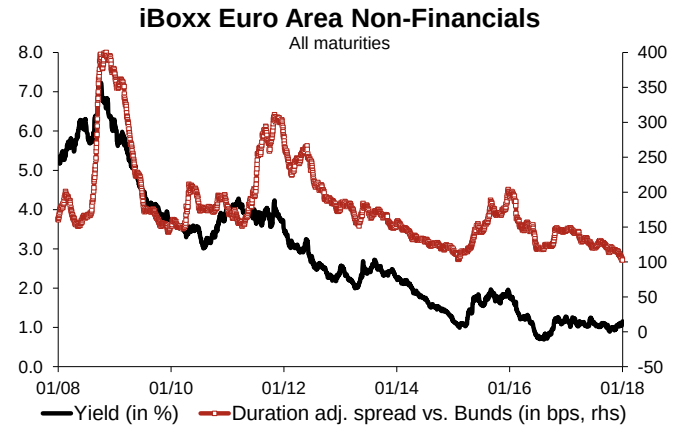
The rally on corporate bond markets continued unabated and triggered a further tightening of non-financial spreads. Since the start of the year they have narrowed 12 bps to 103 bps. This is the lowest level since 2007. However, the increase in underlying yields triggered higher non-financial yields. Since the end of December, the yield level has risen by 9 bps to 1.16% – the highest level since July 2017. Consequently, the total return year-to-date is in slightly negative territory (-0.4%).

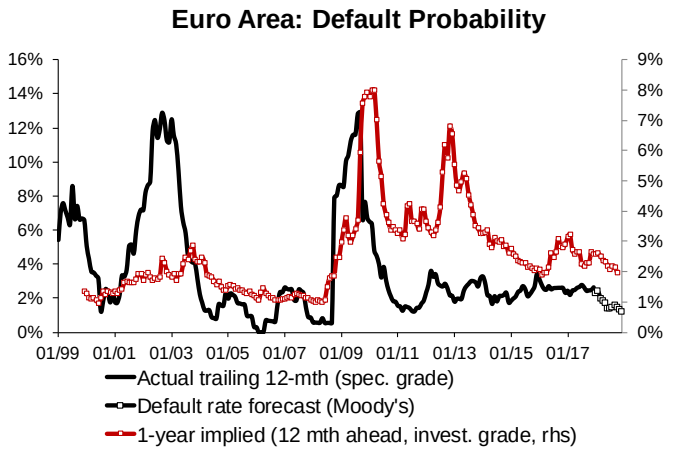
The strong spread tightening is due to a very benign environment. To start with, the economic situation is very robust and economic indicators show that the main global regions all contribute to the strong environment. Consequently, the 12-month trailing default rate is on a low level and forecast to fall towards 1% over the course of 2018. In addition, the fundamentals of European corporates are still in good shape and the cautious approach in recent years pays off with key balance sheet figures not signaling any imbalance yet. The appetite for this asset class remains strong with positive fund inflows for the tenth consecutive month. At the same time, new issuances have slowed in the second half of January and the overall amount will not reach last year's January level.

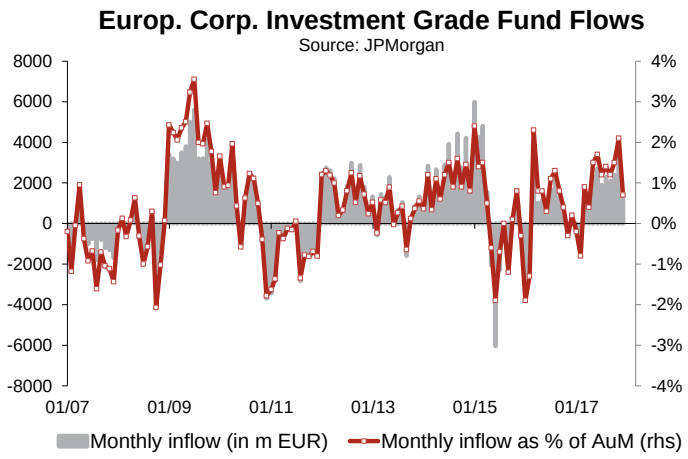
More caution further down the road

This environment is unlikely to change in the near term. Weekly data confirm our view that the ECB shifted its QE purchases strongly towards the corporate sector and the decrease of monthly purchases will remain manageable. For the time being, we are comfortable with our expectation of €5.5 bn of monthly purchases (vs. around €6 bn before).

In the medium term, however, the environment will change. The increase in government bond yields will reduce the search for a pick-up. What is more, the QE programme is likely to be terminated by the end of Q4 at the latest. Finally, the economy will return towards trend growth in the long term. By that time, current valuations do not appear sustainable any longer and non-financial corporate bond spreads are expected to widen. Accordingly, we forecast spreads to rise to 130 bps (from 103 bps currently) and non-financials to yield a negative total return in 2018.

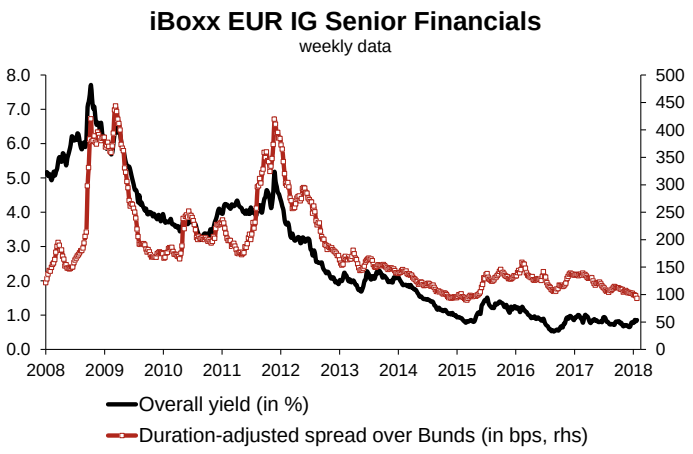


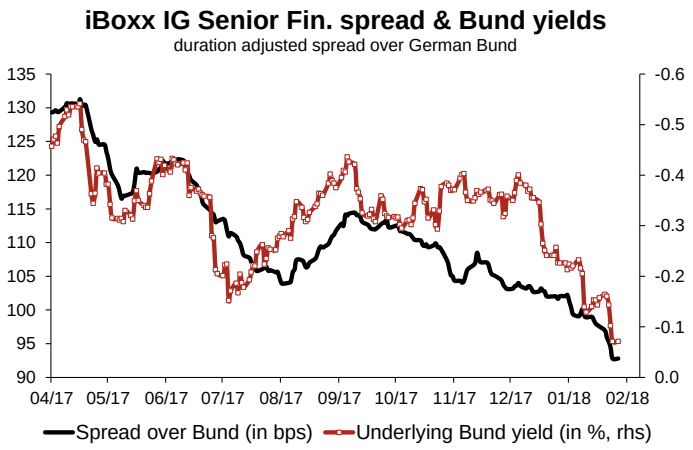


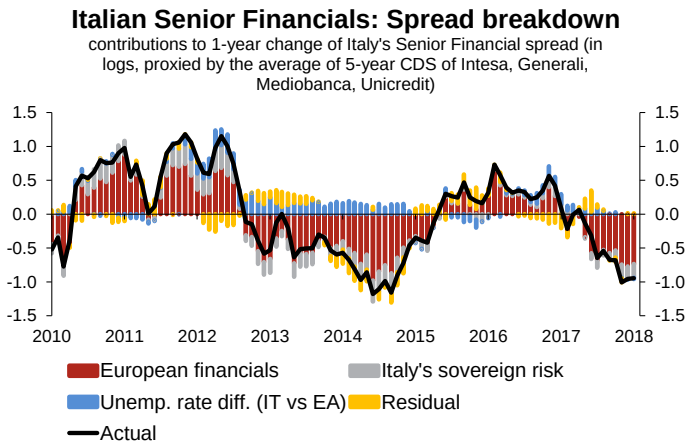


Corporate Bonds (Financials)

Luca Colussa







- **The total return of EUR Investment Grade Senior Financial bonds was negative for the third month in a row as the rise in the underlying Bund yields more than offset the drop in the spread, which hit the lowest level since February 2015.**
- **We still expect Financial bond spreads to creep higher later this year, but the short-term outlook looks more benign than previously expected.**
- **The less severe impact of the looming election in Italy on sovereign spreads, the further upgrade in growth forecasts and the faster rise in Bund yields will limit the extent of spread widening.**

EUR Investment Grade (IG) Senior Financial bond spreads fell by 9 bps to 93 bps, the lowest level since February 2015. However, this was more than offset by the rise in the underlying Bund yields (+20 bps). As a result, Senior Financials posted the third negative monthly total return in a row (-0.41%).

Limited concerns from the Italian election

Despite a minor underperformance in duration-adjusted terms vs Non-Financials, Senior Financials proved more resilient than expected. Investors seem not worried of the looming Italian election (Mar 4). Eurosceptic parties have softened their stance on the euro membership and opinion polls suggest that a Eurosceptic government is a tail event (we believe the probability is around 5%). These positive developments, along with the further upside revision in growth forecasts and the compression caused by higher Bund yields, have contributed to the drop in Financial bond spread year-to-date and supported Subordinated bonds in particular (total return: +0.39%, spread down by 24 bps to 158 bps).

Our analysis suggests that Italian IG Senior Financial bonds (proxied by the average of 5-year CDS of Intesa, Generali, Mediobanca and Unicredit) are slightly expensive, but the drop in risk premiums seen over the last year is largely justified by the overall solid performance of the European Financial sector and the decline in Italy's sovereign risk.

Financials to underperform slightly in the short term

While the overall picture looks more benign than previously though, we still expect some moderate spread widening ahead of the Italian vote, with Senior Financials likely to keep underperforming Non-Financials, although to a limited extent. We forecast the duration-adjusted spread of iBoxx Senior Financials to creep higher to 100 bps over three months. Later in the year, however, we envisage a more contained spread widening (12-month target: 115 bps) compared to Non-Financials, which are more sensitive to the expiration of the ECB's Corporate Sector Purchase Programme.

Currencies

Thomas Hempell

- **USD weakness has strikingly defied rate differentials, both against the euro and the yen.**
- **Apart from troubling US politics, the weak greenback is largely about economic strength outside the US amid a synchronized global recovery.**
- **Short-term, the favorable US outlook and some uncertainties in Europe should stabilize the USD. Further out however, the EUR/USD is likely to end the year at higher levels.**
- **With the BoJ struggling to convince markets of its dovish forward guidance, USD/JPY strength is likely to prove more gradual than assumed so far.**

Why is the US dollar so weak? As the initial hype about Trumponomics has faded since early 2017, the USD has lost ground broadly, losing 18% against the euro and 7% vs. the yen. The weakness defies a yawning yield gap versus most other economies thanks to the advanced rate normalization by the Fed (see top chart).

Apart from political uncertainties in the US and a rising budget deficit, rate developments have not properly reflected economic dynamics. The US has kept growing healthily over the past years, but the world (and the euro area in particular) has caught up strongly. Thus dollar weakness is reflecting stronger currencies elsewhere. In fact, the closing lead of the US manufacturing PMI over the global one has been closely correlated to mounting USD weakness over the past years (see mid chart).

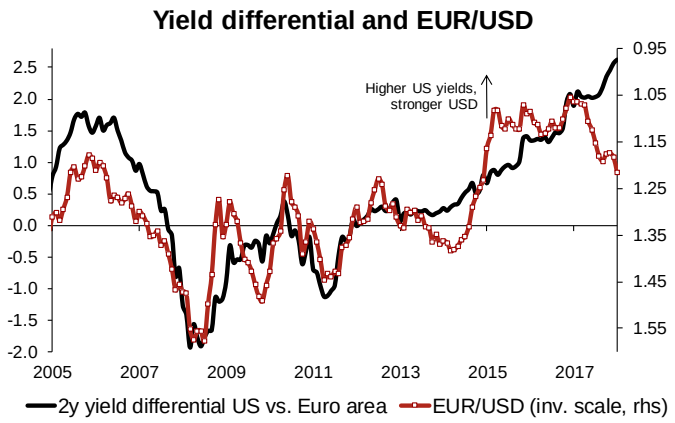
Also the ECB has boosted the euro much earlier than we had expected. The ECB minutes signaled that forward guidance will be revisited in early 2018 and this has kicked off investors' speculation about the first ECB rate hike (which we still anticipate for early 2019). Surprising verbal support to dollar weakness by US Treasury Secretary Mnuchin (triggering hardly veiled criticism by Draghi) has added to the rise in the EUR/USD by 3.5% year to date.

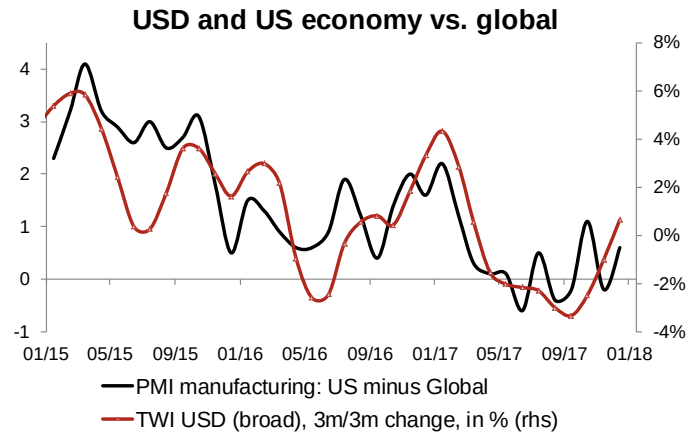
After a pause, EUR/USD with more upside

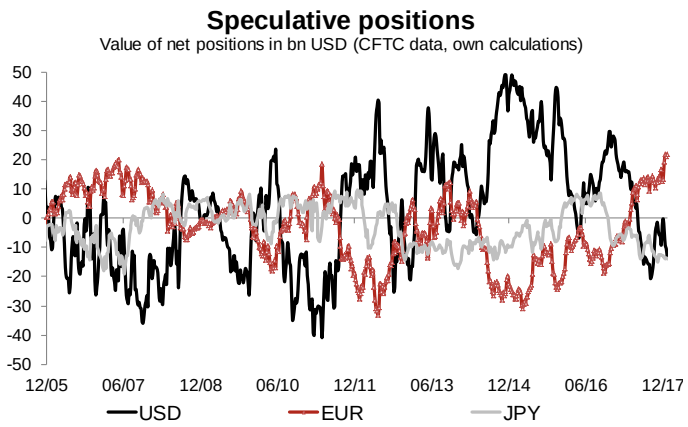
Short term, a slight acceleration in US growth on the tax reform should help to underpin the US dollar. Political uncertainties ahead of Italian elections may also keep the euro at bay. And historically stretched long-EUR speculative positions (lower chart) point to a higher vulnerability of the euro after its recent rise.

That said, until year end, the euro has further leeway to the upside, with the end of the ECB's QE (likely in Q4) bringing the ECB's rate normalization in the focus. We thus upgraded our 12m EUR/USD forecast from 1.23 to 1.27.

Also the path to a weaker yen will prove more challenging. The BoJ will stick to its QE and yield curve control for longer. But with markets growing more skeptical about this, the yen weakness is likely to prove more gradual than we anticipated before. We lowered our 12-month USD/JPY to 115, from 118 before.

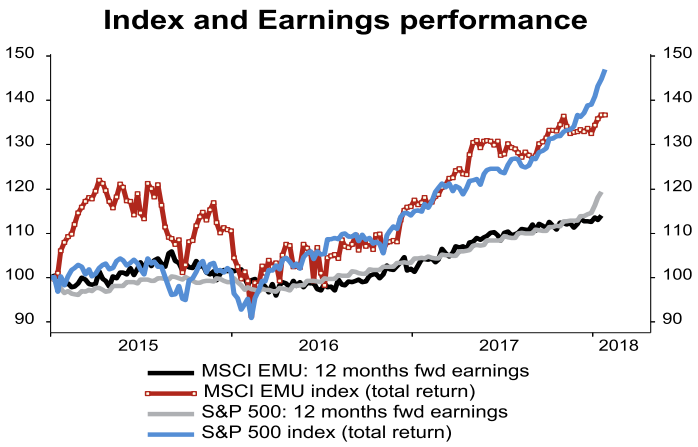


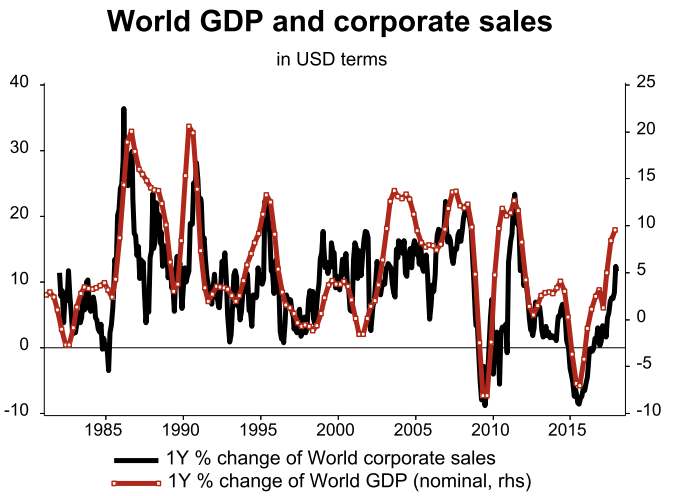




Equities

Michele Morganti





S&P	138 reported		133 reported	
Sector	earnings growth, yoy		sales growth, yoy	
	Q3 2017	Q4 2017	Q3 2017	Q4 2017
Energy	87,9%	105,4%	28,3%	23,2%
Materials	5,3%	37,7%	15,9%	15,1%
Industrials	1,9%	-1,5%	8,6%	6,7%
Consumer Discretionary	-4,5%	10,6%	-7,0%	7,1%
Consumer Staples	3,5%	6,2%	6,4%	7,8%
Health Care	16,0%	10,8%	7,4%	12,7%
Financials	2,9%	5,0%	3,8%	4,7%
Information Technology	35,8%	33,5%	11,2%	11,2%
Telecommunication Services	-1,4%	0,1%	-0,6%	5,0%
Utilities	2,0%	12,7%	3,8%	4,2%
Real Estate	2,6%	7,7%	-0,9%	9,5%
S&P	**7,2%**	**10,9%**	**5,1%**	**8,0%**
Median (all sectors)	2,9%	10,6%	6,4%	7,8%
Median, ex. Energy & Materials	2,6%	7,7%	3,8%	7,1%

- **January was a positive month for equities. The MSCI World posted a total return of 7%. Macro surprises stayed upbeat, leading also to positive GDP and earnings revisions.**
- **The US reporting season shows a sustained earnings' growth, higher than in Q3. On the contrary, the strong trade-weighted euro puts some pressure on earnings growth for the euro area (EA) equities, and should continue to do so.**
- **Short term we remain cautious, lowering our overweight on equites. US valuations and investors' bullish sentiment are risky. Bond yields volatility increased and investors could be challenged by less dovish central banks.**
- **For the next 12 months, however, we expect total returns of nearly 5% in the EA and Japan due to contained overvaluation, good earnings growth and still limited pressure from higher yields.**

January experienced another strong equity rally. Total returns of the MSCI EM and the S&P500 ranked the highest (10% and 7.5%, respectively), while the MSCI EMU index increased by 4.2%, also due to a continuing appreciation of trade-weighted euro by nearly 3.4%.

Still good macro and supportive reporting season

Macro news flow stayed benign, with global business confidence lingering at cyclical highs together with supportive financial conditions. While the US macro surprise index began declining from very high levels, the Chinese one improved, after the bottom experienced in November. A capex recovery looks more plausible and corporate cash flow in the G4 countries can easily cover it. Higher investment growth, good services momentum and improving labor markets will help to prolong the current global economic expansion and firms' sales growth. Due to continuing positive business confidence data, we are revising up our US and euro area (EA) GDP growth estimates for this year, with some positive effects also to our earnings forecasts (+1-2% ceteris paribus).

In this regard, as we correctly guessed at the end of the last year, the US reporting season started on the right foot. Numbers for Q4 look very promising for both earnings and sales. The year-on-year (yoy) earnings growth is 11%, higher than that reported by the same number of firms in Q3 (7.2%). Sales growth is 8% yoy, higher than Q3 (5%) and it is only slightly lower (7%) when we exclude the commodity sectors (3.8% in Q3). This positive outcome is supported by many macro factors such as the accelerating US economy, a weaker USD, higher oil prices, the tax reform and still contained unit labor costs. Yearly earnings and sales growth is even accelerating versus Q3 in Q/Q basis and both preannouncements and guidance are healthy.

Equities

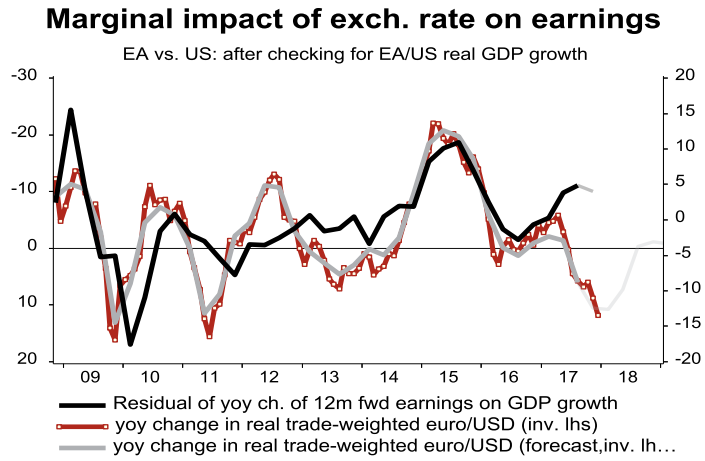
The US surprise ratio (positive-to-total surprises) is higher than in Q3 for both sales and earnings (above 80%). US firms are planning to increase, on average, their capex and expect higher wages growth, more buy-backs, and M&A activity. The tax reform will help to provide the necessary financing, at least for this year. In sum, the Q4 reporting season should remain a strong one, with high chances to see also a decent Q1 season. This represents a supporting factor for equities, triggering positive analysts' revisions, especially in the US and the EMs.

The strong euro will continue to weigh on EA equities

EA macro conditions are very supportive, too, and should trigger double digit earnings growth in Q4. That said, the strengthening euro represents a cap for the positive earnings revisions relative to the US. Other reasons for the EA underperformance vs. the US are weaker macro surprises and weaker EA banks' earnings revisions, the US tax reform and a less positive momentum of the ECB assets' growth vs. Fed's ones. The current high US valuation premium would suggest a possible reversal of the relative performance. But as we maintain a cautious view on equities in the short term, we would, for the time being, rather prefer a balanced allocation between EA and US equities.

Cautious short term, still constructive in 12-months

We see increasing reasons to be prudent and less overweighed in equity in the short run. At current expensive prices, US equities discount super earnings growth (+20% in 2018) and 10-year yields to remain low (2.5%). The positive tax reform's impact will be discounted soon as the reporting season matures. Confidence indicators are going to stall (being at cyclical highs) and increasing 10-year rates should ignite higher volatility in the credit market and in the equity space, at least temporarily. Investors show a strong confidence that central banks remain slow and cautious for longer in reducing the monetary stimulus, representing a risk for financial conditions and risk taking. Indeed, as inflation continues to slowly increase (negative output gaps decline and labor markets improve), central banks can surprise investors with a more hawkish communication stance. Sentiment remains bullish and flows into equities have recently substantially accelerated. We stay slightly overweight on UK, Japan and SMI. More balanced in European sectors, favoring oils, telecoms, insurance (neutral on banks), and underweighting chemicals, healthcare equip., IT and neutral capital goods. Our view on equities for the next 12 months is constructive. On possible set-backs we would buy again cyclical names, banks and Europe plus Japan vs. the US. Valuations in Japan and the EA are less extreme, monetary policy more dovish, with high earnings growth and yields not able to hurt equity valuations yet. We think total returns of 5% to be achievable in the EA and Japan in the next 12 months.



Markets	PE		PB		PCF		DY		Avg.
	12m f	Discount	12m f	Discount	12m f	Discount	12m f	Discount	Discount
WORLD	17,7	10,4	2,4	25,9	11,6	33,4	2,3	-15,0	21,2
USA	19,0	24,3	3,2	39,3	13,2	34,2	1,8	-15,3	28,3
JAPAN	15,2	-3,1	1,4	9,6	8,7	23,5	1,9	2,8	6,8
UK	14,5	4,5	1,9	3,3	9,3	18,0	4,1	3,0	5,7
SWITZERLAND	16,9	9,7	2,5	11,4	12,3	9,6	3,4	4,3	6,6
EMU	15,0	6,0	1,7	11,9	8,6	34,4	3,2	-18,1	17,6
FRANCE	15,3	6,5	1,6	9,1	9,1	32,9	3,2	-14,8	15,8
GERMANY	13,9	-8,2	1,7	15,9	9,0	35,9	2,9	-12,4	14,0
GREECE	15,3	19,2	1,8	16,9	8,5	42,1	3,2	-17,0	23,8
ITALY	13,6	-11,0	1,3	8,4	6,1	31,8	4,0	-13,9	10,8
PORTUGAL	17,2	36,3	1,9	6,9	6,5	11,5	4,3	-4,7	14,9
SPAIN	13,4	3,2	1,3	-17,7	5,4	7,1	3,9	-23,3	4,0
EURO STOXX 50	14,2	7,4	1,6	8,2	8,1	33,2	3,6	-16,3	16,3
STOXX SMALL	17,3	21,0	2,0	20,2	10,5	28,6	2,8	-13,0	20,7
EM, $	13,4	-7,9	1,7	7,6	8,4	8,4	2,5	-18,9	6,8
BRAZIL	14,3	59,6	1,9	9,9	8,6	-39,1	3,3	-24,8	13,8
RUSSIA	6,5	-9,1	0,7	-26,5	3,8	-16,6	5,5	55,4	-26,9
INDIA	19,2	33,8	2,9	9,9	13,1	13,7	1,5	-8,6	16,5
CHINA	14,8	13,9	2,0	15,5	9,5	26,3	1,9	-38,9	23,6

Note: Discount in % to long-run norm; blue and negative numbers = undervaluation. Red and pos. numbers = ove
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.

US CAPE-based valuation (adj. for inflation)	10Y	CPI	Real 10Y Rate	EPS	Current (e/p - 10y real)
Scenario 1 (current input with our 2017 eps estimate)	2.45	2.00	0.45	128.7	4.18
Scenario 2 (base 2018)	2.80	2.20	0.60	152.6	4.89
Scenario 3 (downside 2018)	1.90	1.70	0.20	114.0	3.90
Scenario 4 (upside 2018)	3.20	2.50	0.70	160.0	5.06
Scenario 5 (goldilocks)	2.45	2.20	0.25	152.6	5.24

	Scen. 1	Scen. 2	Scen. 3	Scen. 4	Scen. 5
Implied PE Trailing IBES	18.3	21.1	17.0	21.7	22.6
Avg S&P500 valuation	2,356	2,714	2,192	2,794	2,905
	-10.7%	2.9%	-16.9%	5.9%	10.1%

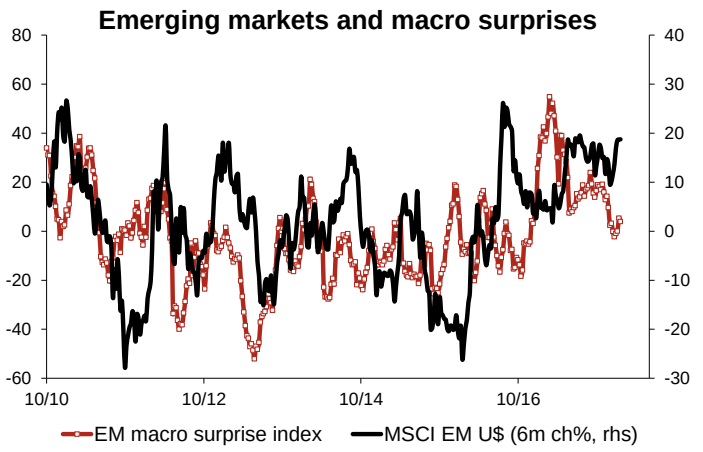
Note: Target ERP (4.7) is calculated assuming CPI in the range b/w 1% and 4%.

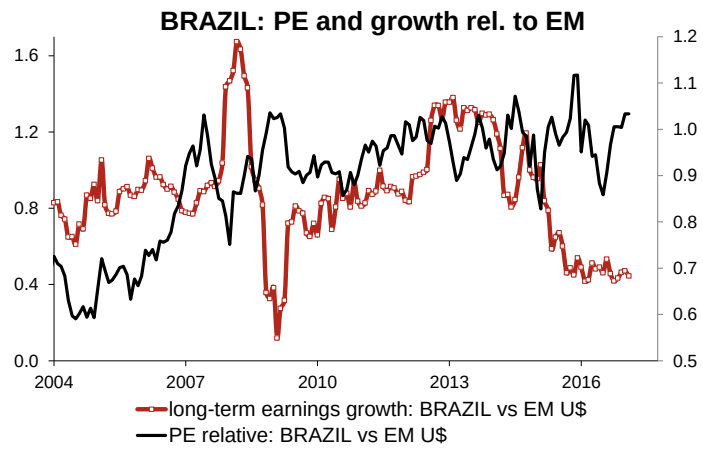
Emerging Markets Equities

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 ($)	6.2	6.2	3.3	3.3			
US	6.7	6.7	4.1	4.1	**29**	**-2.7**	**-2.7**
EMU	4.0	4.0	0.8	0.8	13	0.5	0.5
GREECE	9.1	9.1	3.4	3.4	-49	0.5	0.5
CZECH REP.	4.9	4.9	**0.3**	**0.3**	**29**	1.0	1.0
HUNGARY	4.2	4.2	1.6	1.6	**25**	0.3	0.3
POLAND	5.7	5.7	1.7	1.7	18	0.9	0.9
EM ($)	9.5	9.5	3.0	3.0	15		
BRAZIL	11.2	11.2	1.6	1.6	-43	3.2	3.2
CHINA	**13.6**	**13.6**	3.7	3.7	4	0.9	0.9
INDIA	4.5	4.5	1.6	1.6	13	-1.7	-1.7
INDONESIA	**3.2**	**3.2**	1.3	1.3	-10	-0.7	-0.7
KOREA	4.8	4.8	1.4	1.4	**28**	**-2.5**	**-2.5**
MALAYSIA	4.2	4.2	0.7	0.7	0	2.1	2.1
MEXICO	**2.7**	**2.7**	**-0.2**	**-0.2**	-18	**4.5**	**4.5**
RUSSIA	9.7	9.7	7.8	7.8	-16	-0.3	-0.3
TAIWAN	6.6	6.6	**-0.5**	**-0.5**	10	-0.6	-0.6
THAILAND	5.2	5.2	1.8	1.8	2	1.3	1.3
TURKEY	5.1	5.1	1.4	1.4	**23**	**-2.4**	**-2.4**
VIETNAM	10.7	10.7	**12.8**	**12.8**	**-98**	-2.1	-2.1
SHANGHAI	6.5	6.5	2.0	2.0	4	0.9	0.9

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





- **EM markets have increased, benefitting from the Trump effect, rising oil and commodity prices and a weaker US dollar.**
- **We see the EM performance to be muted in the shorter term due to the repricing of Fed and USD expectations, even though resilient commodity prices should provide further support.**
- **We remain constructive mid-term on EMs and still favor India along with Korea and CEE countries, while maintaining a prudent stance on China.**

In the last month, EM equities have rallied (+9.5%), benefitting from increasing oil and commodity prices (8.7% and 4.1%, respectively) and still low financing costs. The top performer was the MSCI China (+13.6%), followed by Brazil (11.2%) and Russian (9.7%). The worst performing ones was Argentina (-0.2%). The Chinese rally has resulted from growing investors' optimism over the somewhat more stable economic data coupled with Yuan appreciation speculation (+2.7% over the month). The risks of a trade war between China and the US, however, seem to have increased. The Brazilian and Russian equities, on the other hand, have benefitted from increasing oil prices and lower rates.

Overall, EM 2018 earnings have slightly increased (+0.6%) during the last month. The markets for which they have been upgraded significantly are: Russia (+3.4%), MSCI China (+2.4%) and Greece (+2.3%). The earnings of the Taiwanese and Argentinean companies have been downgraded by 1.8%.

Based on multiples, the EM stocks have become even more expensive (brought about by higher oil prices and the Trump effect) and are now at a premium of 6.4% vs their history. Corporate margins have as of late decreased a bit and the macro surprises have been at a low level. In the medium term, the EMs should benefit from higher earnings growth resulting from globally synchronized expansion and relatively lower valuations but the repricing of Fed expectations should exert more pressure on EM stocks.

Brazilian equities not supported by fundamentals

The Brazilian market has recently additionally benefitted from a lower political uncertainty and become - based on multiples - quite expensive. Brazilian valuations are at a premium of 13% versus its own history, whereas the EM ones, judged by the same measure, are only at a slight premium of 6%. The Brazil's PE is now more than two standard deviations above the historical average of 9.1x. This high level of PEs is not supported by either relatively low long-term earnings growth of 10% (EMs having on average a long-term earnings growth of 23%) or still high yields of around 10% (average for EMs being at 4.8%).

Asset Allocation

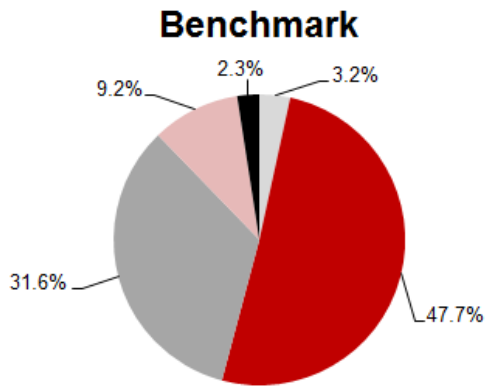
Thorsten Runde

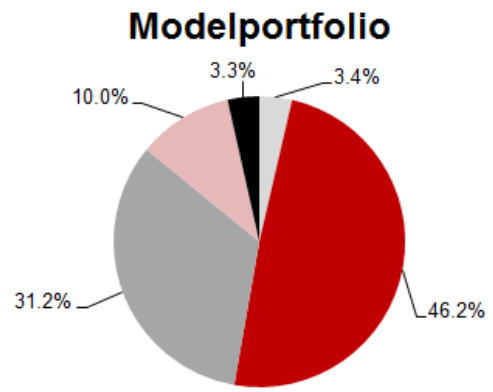
- **Since the beginning of December equity markets have rallied across the board. First and foremost emerging markets have done extremely well representing the top three performance ranks in our investment universe.**
- **Global government bond yields have risen significantly driven by solid economic perspectives and more hawkish signals by central banks. Thus total return figures for that asset class clearly dropped back into negative territory.**
- **Risk on overall peripheral debt decreased by roughly 20 bps, but still not enough to reveal a positive total return on the whole.**
- **Spreads on corporate bonds tightened too. Again, the resulting total return remained negative, at least for the investment grade section.**
- **Amid strong economic data, a recovering inflation, and a less favorable supply/demand outlook for 2018, the case for gradually rising yields remains intact.**
- **Thus, we basically confirm our pro-risk tactical positioning in favor of selected equity and credit markets, but, with economic surprises looking toppish, to a further reduced extent.**

Since the beginning of December equity markets have rallied quite impressively across the board. Emerging markets even revealed total return figures clearly located in the two-digit area. But also in the developed world, equity market returns ranged between three and roughly 10%. The rise in underlying yields over the past weeks has been too strong to be compensated by tighter credit spreads, for euro area peripherals as well as for investment grade corporates. Thus, apart from euro area and US high yield, all fixed income markets in our investment universe revealed negative total returns figures. With values around -1.5% core government bonds of the euro area and US treasuries generated the worst total return figures overall. Against this backdrop the recommended pro-risk tactical allocation stance could at least add some small value.

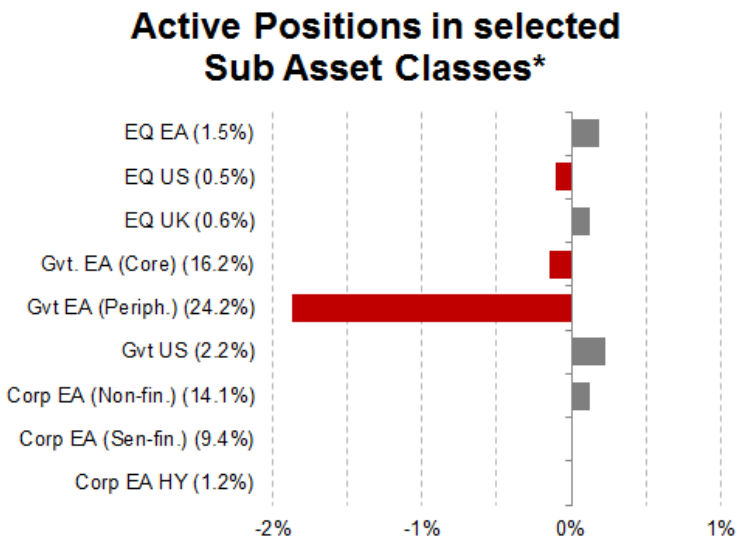
Pro-risk stance more vulnerable

Macro data should generally continue to come in strong. Having said that, against the backdrop of recent positive surprises in key economic indicators the leeway for further economic figures beating expectations appears limited. Together with central banks pursuing their path to monetary policy normalization the environment for risky assets becomes increasingly challenging although the case for gradually rising yields should remain intact overall. All in, we recommend to basically leave the investment focuses unchanged on selective equity and credit markets with further reduced active positions.





Equities
Government Bonds
Corporate Bonds
Covered Bonds
Cash



Benchmark weights in parentheses

Forecast Tables

Growth

	2016	2017	2018f	2019f
US	1.5	2.3	2.6	2.3
Euro area	1.8	2.5	2.3	1.8
Germany	1.9	2.5	2.3	1.7
France	1.1	1.7	1.9	1.7
Italy	1.1	1.5	1.3	0.8
Non-EMU	2.1	1.8	1.6	1.7
UK	1.9	1.6	1.4	1.6
Switzerland	1.4	0.8	1.8	1.7
Japan	1.0	1.8	1.6	1.3
Asia ex Japan	6.4	6.1	6.0	6.0
China	7.1	6.9	6.5	6.3
Central/Eastern Europe	1.4	3.8	3.2	3.2
Latin America	- 1.3	0.9	1.8	2.3
World	**3.1**	**3.7**	**3.7**	**3.6**

Inflation

	2016	2017	2018f	2019f
US	1.3	2.1	2.3	2.1
Euro area	0.2	1.5	1.4	1.6
Germany	0.4	1.7	1.7	1.9
France	0.3	1.1	1.2	1.5
Italy	- 0.1	1.3	1.1	1.2
Non-EMU	0.7	2.5	2.5	2.1
UK	0.7	2.7	2.7	2.2
Switzerland	- 0.4	0.5	0.8	1.0
Japan	- 0.1	0.5	0.9	1.1
Asia ex Japan	2.6	2.2	3.0	2.9
China	2.0	1.6	2.3	2.1
Central/Eastern Europe	5.2	5.0	4.8	5.0
Latin America	6.3	4.3	4.0	3.7
World	**2.3**	**2.3**	**2.7**	**2.7**

Regional and world aggregates revised to 2015 IMF PPP weights; Latin America Inflation excluding Agentina and Venezuela

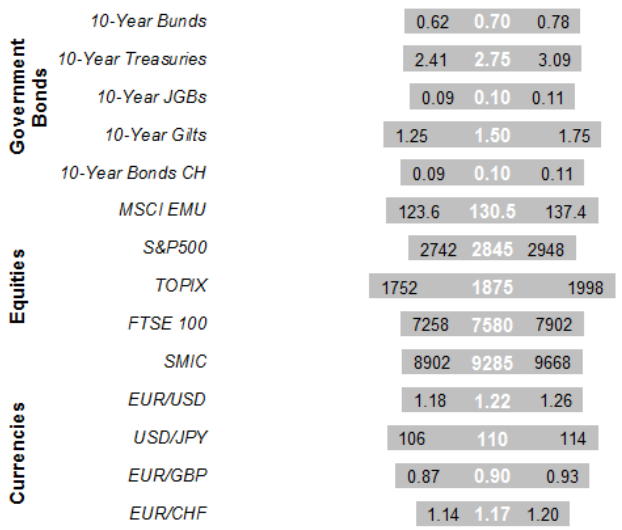
Financial Markets

3-month LIBOR	**29/01/18***	**3M**	**6M**	**12M**
USD	1.76	1.80	2.00	2.40
EUR	-0.38	-0.38	-0.38	-0.35
JPY	-0.04	0.00	0.00	0.05
GBP	0.53	0.55	0.60	0.80
CHF	-0.74	-0.75	-0.75	-0.75
10-Year Bonds	**29/01/18***	**3M**	**6M**	**12M**
Treasuries	2.66	2.75	2.80	2.90
Bunds	0.64	0.70	0.75	0.95
BTPs	1.99	2.20	2.15	2.25
OATs	0.92	1.00	1.05	1.25
JGBs	0.08	0.10	0.15	0.25
Gilts	1.44	1.50	1.55	1.60
SWI	0.08	0.10	0.15	0.25
Spreads	**29/01/18***	**3M**	**6M**	**12M**
GIIPS	106	120	115	110
Covered Bonds	62	65	65	70

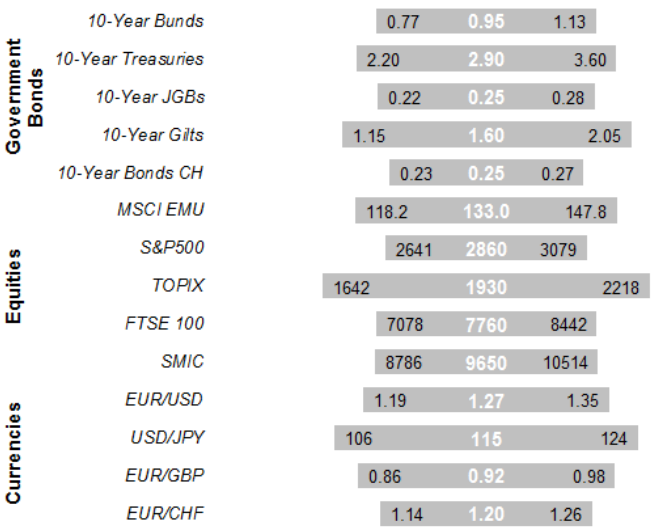
*average of last three trading days

Corporate Bond Spreads	**29/01/18***	**3M**	**6M**	**12M**
IBOXX Non-Financial	103	110	120	130
IBOXX Sen-Financial	94	105	105	115
Forex	**29/01/18***	**3M**	**6M**	**12M**
EUR/USD	1.24	1.22	1.25	1.27
USD/JPY	109	110	112	115
EUR/JPY	135	134	140	146
GBP/USD	1.42	1.36	1.37	1.38
EUR/GBP	0.88	0.90	0.91	0.92
EUR/CHF	1.16	1.17	1.19	1.20
Equities	**29/01/18***	**3M**	**6M**	**12M**
S&P500	2855	2845	2845	2860
MSCI EMU	131.2	130.5	130.5	133.0
TOPIX	1881	1875	1900	1930
FTSE	7651	7580	7650	7760
SMI	9485	9285	9410	9650

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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