Q4 2017

GENERALI INVESTMENTS

Investment View

A slowly rising tide of rates

Content

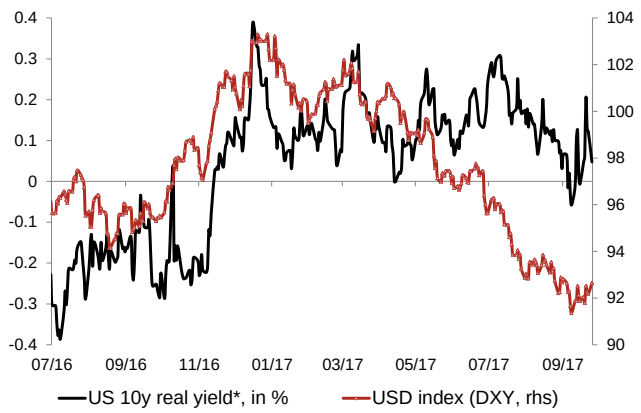
Global View

- **Despite rising geopolitical tensions around North Korea and political turmoil in Washington, the globally synchronized expansion still has legs. Inflation pressures, by contrast, will remain subdued. Even in the US, where the labor market is already tight, evidence of more visible price increases will become apparent only in 2018.**
- **In this setting, major central banks – with the exception of the Bank of Japan – will continue to proceed gradually on their path towards monetary policy normalization.**
- **While the looming decision by the ECB to taper its asset purchases in 2018 has already lifted European yields and triggered a rally in the euro, the pace of due rate increases in the US is still widely underpriced by markets.**
- **We anticipate moderate upside pressures on yields to prevail, with a preference for euro area IG corporate bonds over government bonds. We see scope for further gains on European and Japanese equities, while the US dollar seems headed for a temporary recovery phase.**
- **Southern European sovereign debt is likely to face some headwinds over the coming months on Catalan independence ambitions and political uncertainties in Italy ahead of 2018 elections.**

Market skepticism on the US contrasts striking optimism regarding the euro area

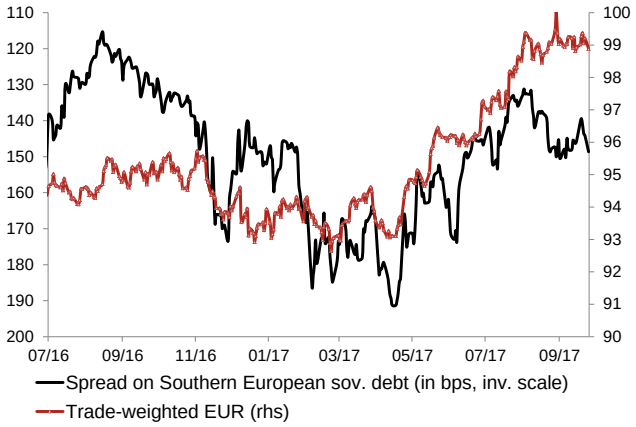
Geopolitical tensions between the US and North Korea and political turmoil within the US administration have been weighing on financial markets over the past quarter. The threat of an outright military conflict with potentially the devastating deployment of nuclear weapons have triggered repeated risk-off spells on financial markets, even though more recently, markets have tended to shrug off the war of words between US President Trump and his North Korean opponent, Kim Jong-Un. That said, amid mounting doubts among investors that the US administration will achieve to agree on a 2018 budget and to raise the US debt ceiling, a striking degree of US pessimism is visible, reflected in a weak US dollar and US yields struggling to rise (even though equities have been performing decently, also thanks to the softer US dollar).

US REAL YIELDS AND US DOLLAR



Graph 1; * difference 10y UST yields minus inflation swaps

EUROPEAN RISK AND EURO



Graph 2

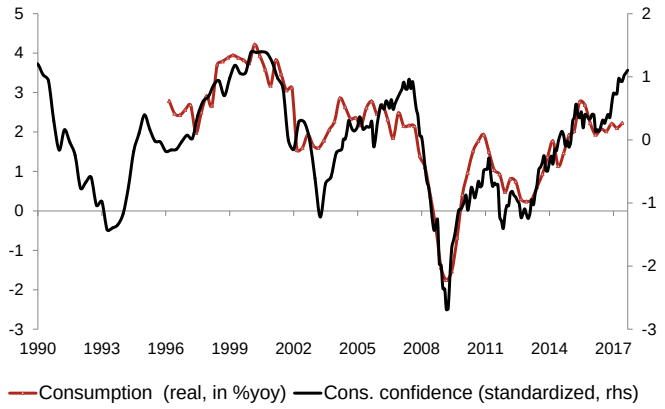
This contrasts with a persistent market confidence on the euro area. Solid economic data and optimism about the European integration progress after Macron's victory in French elections have helped to keep Southern European risk premia contained while the euro soared in anticipation of an ECB tapering decision expected for autumn. The outcome of German elections may well temper this optimism over the coming months, with prolonged coalition talks looming, including an FDP that will remain very reluctant to accept any burden-sharing initiatives at the European level.

Global growth on track, subdued inflation recovering only slowly

Solid domestic demand in the advanced economies still has legs

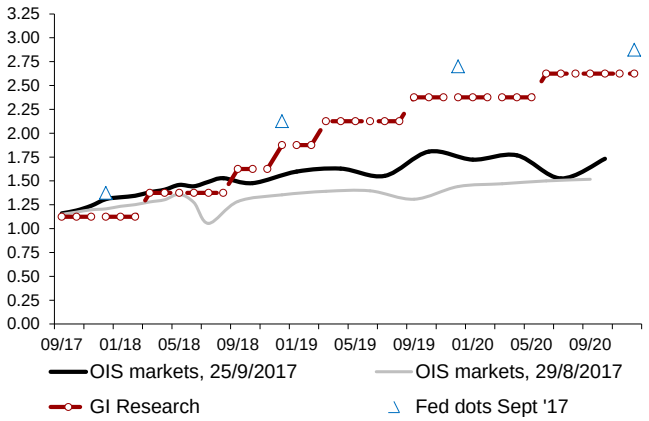
Strikingly, the global economy is weathering recent political uncertainties strikingly well and the outlook remains bright. Over the coming months, we anticipate solid consumption in the advanced economies to keep demand afloat, with consumer confidence supported by rising employment and moderate wage increases. Investment activity will be kicking in, although very gradually only. At the same time, price pressures will remain subdued, with low inflation expectations, international competition and the retirement of higher paid baby boomers and the entrance of cheaper younger workers holding back wage demands. In the US, the labor market has tightened substantially, with the unemployment rate close to a 16-year low. This will ultimately bring up wages and inflation, too, following several months of disappointing inflation. However, this acceleration in price pressures is likely to become visibly more clearly only over the course of next year.

CONSUMPTION AND CONSUMER SENTIMENT



Graph 3; weighted avg. for US, euro area and Japan

US KEY RATE EXPECTATIONS



Graph 4; fed funds rate implied by OIS and GIE and Fed projections

Central banks' gradual and transparent policy normalization

Orderly announcement of Fed's balance sheet reduction

In this environment, the major central banks – except for the Bank of Japan – are proceeding with their gradual removal of their ultra-accommodative monetary policy. Thanks to still low inflation, however, they can act very prudently and communicate their next steps very carefully. In stark contrast to the 2013 "taper tantrum", the Fed's September decision to start reducing its balance sheet by gradually seizing reinvestment of maturing papers has not caused any market disorder thanks to careful market guidance over the past months.

Pace of rate normalization by the Fed still underestimated by markets

However, we observe still strong market skepticism about the Fed's willingness to proceed with further rate hikes. Despite some recent re-pricing, markets are currently discounting still only 1½ further Fed rate hikes until end-2018. While the prospect of a December rate hike is indeed a close call, we still see a strong case for three further rate hikes next year. By contrast, hints by the ECB to a decision to taper its asset purchases in 2018 have lifted European yieds and triggered a rally in the euro. While an ECB tapering announcement is likely at its Oct. 26 meeting, we anticipate a very carefully weighted decision. The ECB will likely announce to reduce its asset purchases from January onwards, but refrain from presenting a full schedule for completely running down its QE. Instead, we expect the ECB to stress the data-dependency of its proceedings, potentially undermining to some extent the hawkish market reception of ECB comments and statements over the past weeks.

European equities to shine amid poor return on fixed income

Upside pressure on core yields to prevail, in particular in the medium term

In this setting, we expect upside forces on global yields to prevail over the next quarter, but only moderately so. Going into next year, rising US inflation is likely to trigger a more meaningful repricing of Fed rate hike expectations, adding to upside pressures on US yields. Euro area yields are likely to rise, in parts driven by higher US rates, but also due to the ECB's gradual policy normalisation. Spreads on Southern European spreads have remained rather stable over the past weeks, also helped by a surprise rating upgrade of Portugal by S&P. Going forward, however, we see the risks tilted towards moderately wider spreads amid higher uncertainties around the general elections in Italy due at latest by May 2018, which may well result in a hung parliament in the base case and in a Eurosceptic government in a risk scenario.

MACRO FORECASTS

	Growth			Inflation		
	2016	2017f	2018f	2016	2017f	2018f
US	1.5	2.1	2.3	1.3	1.9	2.0
Euro area	1.8	2.1	1.7	0.2	1.5	1.3
Germany	1.9	2.1	1.7	0.4	1.7	1.6
France	1.1	1.7	1.7	0.3	1.1	1.2
Italy	1.0	1.4	1.1	- 0.1	1.4	1.1
Non-EMU	2.0	1.8	1.6	0.7	2.4	2.5
UK	1.8	1.6	1.4	0.7	2.7	2.7
Japan	1.0	1.5	1.1	- 0.1	0.3	0.5
Asia ex Japan	6.4	5.9	5.9	2.6	2.2	3.1
China	7.1	6.7	6.3	2.0	1.6	2.3
CEE	1.4	3.4	3.2	5.2	5.0	4.7
Latin America	- 1.5	1.0	1.9	6.3	4.3	3.7
World	3.1	3.5	3.5	2.3	2.4	2.7

Table 1; annual changes, in %

FINANCIAL MARKETS FORECASTS

10-Year Bond Yields	**Current***	**3M**	**6M**	**12M**
US	2.25	2.35	2.50	2.75
Germany	0.44	0.50	0.60	0.80
Italy	2.17	2.30	2.60	2.70
Japan	0.03	0.05	0.10	0.15
Forex	**Current***	**3M**	**6M**	**12M**
EUR/USD	1.19	1.17	1.16	1.22
USD/JPY	112	114	116	118
EUR/GBP	0.88	0.90	0.92	0.92
Equities	**Current***	**3M**	**6M**	**12M**
S&P500	2500	2485	2475	2460
MSCI EMU	125.4	125.5	126.5	128.0

Table 2; *current as of Sept. 25, 3-day average

Tougher times ahead for corporate bonds

Equities in the euro area and Japan still with upside, thanks to decent valuations and support from fundamentals

Exposure to high-quality euro area credit should remain protected by the ECB's purchases and the sound fundamentals, despite the compressed spread levels already reached. Further out, however, we see risks of rising risk premia. This could become visible even earlier in the high-yield segment, where valuations look quite stretched already after the rally seen over the past years. Equities in the US are dear and look vulnerable to a correction. However, European stocks appear still fairly valued and are likely to continue to benefit from the solid economic recovery, decent profits and on balance still very supportive monetary policy and low yields. In Japan, we expect stocks to also receive support from continued weakness in the yen. On the FX side, the US dollar has been written off somewhat too fast by markets in our view, with yield differentials and valuation models pointing at a significant overshoot in the EUR/USD. We anticipate a moderate correction over the coming months. This will offer better opportunities for unwinding existing US dollar exposure than current pricing ahead of a more sustained support to the euro we are foreseeing for the coming year.

Preference for European credit and equities, with government bonds likely to underperform

Overall, for the coming quarter we see value in positioning portfolios below benchmarks in government bonds both in core and Southern Europe, compensated by a moderate overweight in European investment grade credit and an elevated exposure to European and Japanese equities.

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Macroeconomic Outlook

- **Despite political risks, global economic growth remained on track as recovering labor markets supported private consumption. Looking ahead, investment demand should gradually kick in, while inflation will likely remain subdued.**
- **In the US, steady growth and record low unemployment have not been matched by a pickup in inflation, mostly due to temporary factors. Stronger inflation in 2018 will allow the Fed to deliver on its plan of gradual monetary tightening.**
- **The euro area recovery is footed on strong domestic activity. Growth will likely be above potential in 2017 as well as 2018. We expect the ECB to embark on a soft tapering path in January 2018 and see a first rate hike only in 2019.**
- **After the end of China's 19th Party Congress, we conjecture policy to shift more to structural issues. Nevertheless, we expect only a gradual slowing of GDP growth as fiscal policy stands ready to buffer any stronger cooling.**

Global upturn largely defied political risks

Despite substantial political worries (North Korea, US politics especially on trade and the fiscal package), global growth has remained well on track. This was most visible in the global PMIs which continued to move sideways on a comfortable level, led by the recovery in advanced economies while Emerging Markets still showed less momentum. While international trade had been an important driver in H2 2016, the sources of the current expansion shifted more to the domestic side. Amid declining unemployment rates and favorable consumer sentiment, private consumption has become more and more important and is expected to stay this way. However, for the recovery to be sustained, investment also needs to kick in. Currently, investment dynamics look still rather limited, but with more reliable consumer demand, rising profits and continued support from still very favorable financing conditions, we see leeway for a gradually strengthening on business investment. By contrast, inflation remained subdued so far. Even in the US, which looks the most advanced in the cycle, inflation has temporarily slowed again and is expected to softly awaken only next year again. Notwithstanding differences in quantity and timing, the continued recovery combined with slowly rising inflation rates will generally lead central banks to withdraw some of their monetary support, step-by-step normalizing their ultra-loose policies that were introduced about ten years ago after the beginning of the Great Financial Crisis.

US: Solid activity, but politics remain a risk

Sentiment surveys point to solid US growth in H2

In Q2, US GDP increased by a better than expected 3% qoq annualized. Job creation continued steadily, pushing the unemployment rate close to a 16-year low of 4.4%. Leading indicators and bullish business and consumer surveys point to solid growth also in the second part of the year, and we expect real GDP to expand by 2.1% in 2017. Expectations of a sizeable tax reform, able to significantly boost growth in 2018 have cooled amid heightened political tensions in Washington. Still, our base scenario includes a small package of tax cuts helping growth to reach 2.3% in 2018. A tight labor market and demand pressures have yet to translate into higher inflation. Low productivity and feeble inflation expectations are limiting wage growth and sizeable one-off factors have compressed core inflation to below 2% over the last few months. We expect inflation to remain weak until early next year. This will be followed by an upward push on positive base effects, the belated impact of stronger demand and a tighter labor market, resulting in a headline inflation rate at above 2% at the end of 2018.

US inflation to pick up in 2018, Fed sticks to its planned tightening

In its September meeting, the Fed announced to start reducing its stock of Treasury bonds and Mortgage Backed Securities from October on, stressing that this will happen in a very gradual and predictable way. The Fed stuck to its path of interest rates normalization, envisaging one more rate hike this year and three ones in 2018. While we deem a rate increase this year a close call, we expect the Fed to deliver on its plan for 2018, contrasting market pricing of only 1½ rate increases by end-2018.

Euro area: Above potential growth and ECB soft tapering in 2018

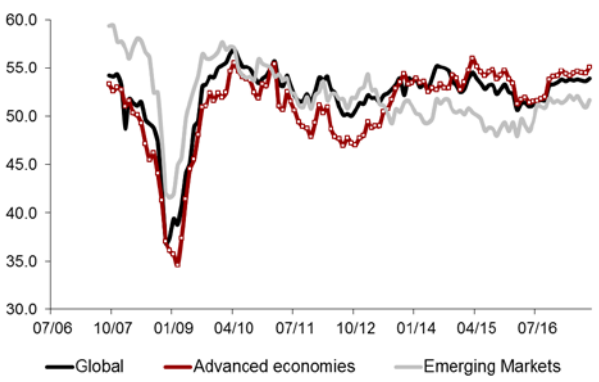
Euro area to be driven by domestic activity

In the first half of this year euro area growth powered ahead with rates of 0.5% qoq in Q1 and 0.6% qoq in Q2, both clearly above potential. What is more, activity is now considered self-sustaining as investment activity has started to complement consumption as a key driver of growth. Over the coming quarters we expect investment activity to broadly maintain its strength (+0.9% qoq in Q2/2017) as capacity utilization as well as production expectations are strongly above normal, financing conditions remain extremely favorable – with long-term real yields still negative – and profit growth having advanced. Ongoing employment expansion and high consumer confidence are the major factors why we expect consumption activity to also stay strong, albeit a higher savings rate will be a drag. That said, we also see some headwinds to growth: First, the latest euro appreciation will drag on export growth in the quarters to come. Second, the credit impulse (the change in the yoy growth rate of private loans) weakened from 1.3 pp in January to 0.7 pp in July implying some moderation of growth. Third, domestic demand will keep imports strong. Last, high political uncertainty (e.g. Catalan independence woes, Italian election in 2018, Brexit) will be a headwind to growth. All in all, while we do not expect that the stellar growth rates of the first half of the year can be maintained, we see growth clearly above potential also next year. Growth will likely average 2.1% in 2017 and 1.7% in 2018.

ECB to start tapering in January 2018 and likely complete it by September 2018

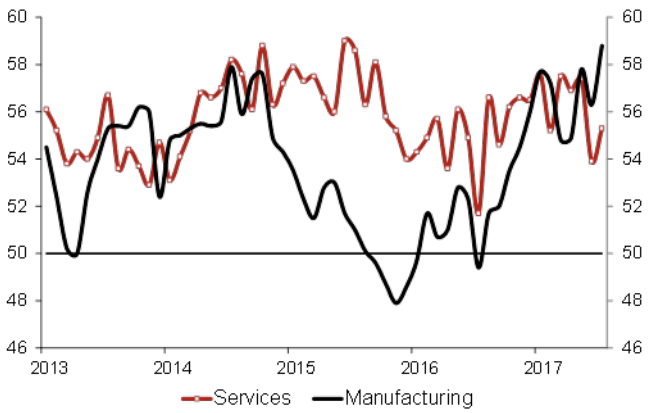
Headline inflation was at 1.5% yoy in August, down from the 2.0% yoy high seen in February as weaker base effects and the euro appreciation left their mark. Underlying inflation has embarked on an upward trajectory, albeit at slow pace. Its latest reading was 1.3% yoy, up from 0.9% yoy in January. With the inflation environment improving and strong activity ahead, the ECB announced to calibrate its policy instruments at the October meeting. Moreover, the scarcity problem will become binding in H1 of 2018 (see also Fixed Income Part). The ECB also made clear that it will have to walk a fine line between starting to withdraw the extraordinarily strong policy stimulus on the one hand and preventing a kind of taper tantrum on the other hand. Also, the ECB will be aware of the potentially disinflationary consequences of a further euro appreciation and the implications for its policy stance. Given the above mentioned uncertainties we do not expect that a pre-established path for tapering will be announced but that the ECB will maintain some flexibility in order to make tapering as soft as possible. We expect the ECB to announce a reduction of its monthly QE purchases from currently € 60 bn to € 40 bn from January onwards. We deem it most likely that tapering will be completed in October 2018 and that in 2018 the ECB will still buy € 270 bn under its QE program. Key rates will not be lifted before 2019 in our view.

GLOBAL COMPOSITE PURCHASING MANAGER INDICES



Graph1; combined indices for man. and services output

US: PURCHASING MANAGER INDICES



Graph 2; index points

Monetary policy in CEE diverges due to inflation outlook

The Czech central bank is in tightening mode while Hungary maintains a dovish stance

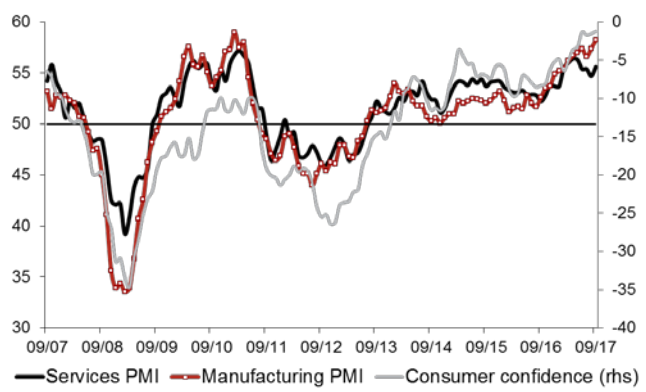
Central Europe maintained strong GDP growth rates, but the inflationary picture varies. The Czech Republic is the only country with inflation above the central bank's target, which led the CNB to raise its interest rates in August. Another rate hike will likely follow in November. On the other hand, the Hungarian central bank kept its dovish stance and recently cut its O/N deposit rate further into negative territory. It also uses non-standard tools in order to ease monetary conditions. The Polish NBP indicated to likely keep interest rates unchanged also in 2018. Russia continued to benefit from the recovering economy, falling inflation and rising commodity prices. However, the tightening of US sanctions, though not material, prompted S&P to postpone its decision to upgrade Russia's rating back to investment grade. We expect the upgrade in 2018.

China's growth to show some softening but no major slowing

China's growth expected to soften slightly as policy focus shifts more to structural issues

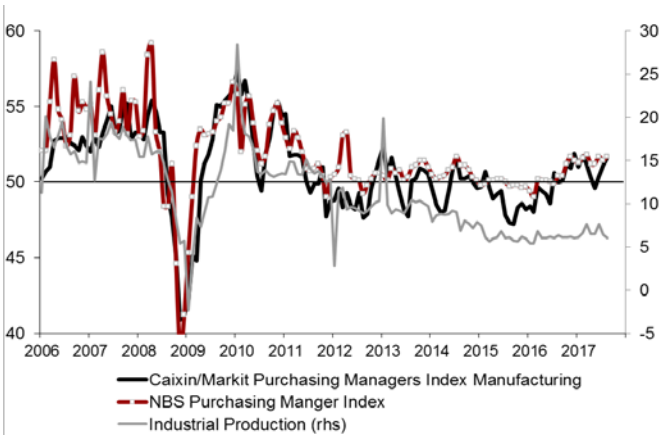
In Q2 2017, China's economy continued its relatively vivid expansion with a growth rate of 6.9% yoy, unchanged from the previous quarter and driven by ongoing support from the international environment as well as from fiscal policy. While both manufacturing PMIs (around 51.5 index points) suggest this stance to be continued, the latest real activity data surprised slightly on the downside. Industrial production growth receded to 6.0% yoy, the lowest level recorded so far this year. Urban investments decreased to 7.8% yoy ytd, down from around 8.5% yoy ytd in Q2. The latter was especially driven by a strong drop in central government projects. Recently, there was also some weakness visible in property sales so that the corresponding GDP component is likely to also come off in the near future. Generally, history shows that fiscal policy has tended to stabilize growth ahead of the Communist Party Congress, which takes place every five years and will start on October 18. Therefore, after the Congress, the policy focus is likely to shift back a bit from growth stabilization to the important structural issues in China, ranging from stabilizing the already high debt-to GDP ratio, improving productivity and reforming SoEs as well as regulating excessive risk-taking in financial markets and the banking sector. However, growth will remain an important target and consequently, we expect fiscal policy to stand ready in case GDP should cool too strongly. All in, we expect growth at 6.7% this year and 6.3% in the next.

EURO AREA KEY SENTIMENT INDICATORS



Graph 3; index points

CHINA: MANUFACTURING PMI AND INDUSTRIAL PRODUCTION



Graph 4; index points, yoy as %

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Fixed Income

- **US and euro area government bond markets moved in tandem through much of the third quarter. On balance, the US curve flattened slightly and the euro area curve steepened marginally.**
- **While the fundamental factors driving yields upwards on both sides of the Atlantic will remain in place, we foresee only a small increase in yields in the fourth quarter.**
- **Peripheral bond spreads moved in calm waters in the third quarter – except for Portuguese ones which benefitted from a surprising rating upgrade. The forthcoming political events are seen to increasingly weigh on Southern European government bonds. The current complacency is unlikely to prevail and spreads are expected to widen.**

Bond markets on both sides of the Atlantic largely moving in tandem in Q3 - 'Sintra effect' not lasting

The changes in US and euro area government bond yields remained contained in the third quarter. The US curve flattened slightly as long-dated yields fell marginally (10-year Treasury yield down by around 5 bps) and the short end moved up by around 5 bps (2-year Treasury yield up from 1.38% to 1.43%). As particularly short-dated US inflation expectations increased not least due to a higher oil price, real yields decreased considerably in the course of the third quarter. 10-year real yields around 0% and 5-year real yields at -0.20% point at fundamentally too low levels.

Euro area core yields fell across all maturities in the third quarter – though the downward shift remained limited. Therewith, the effect of the perceived hawkish speech of ECB President Draghi in Sintra at the end of June did not last. As short-dated yields fell a bit more than yields at the long end of the curve, the euro area yield curve steepened marginally. Compared to the US, the increase in inflation expectations was more limited. Consequently, the drop in real yields was less pronounced. Still, 10-year real yields at -1.0% are close to the historical low and are at odds with the robust economic situation of the euro area economy.

Capital preservation difficult to achieve

Priced Fed hikes until the end of 2018 have not changed since the end of 2016 – Expected market adjustment in the medium term

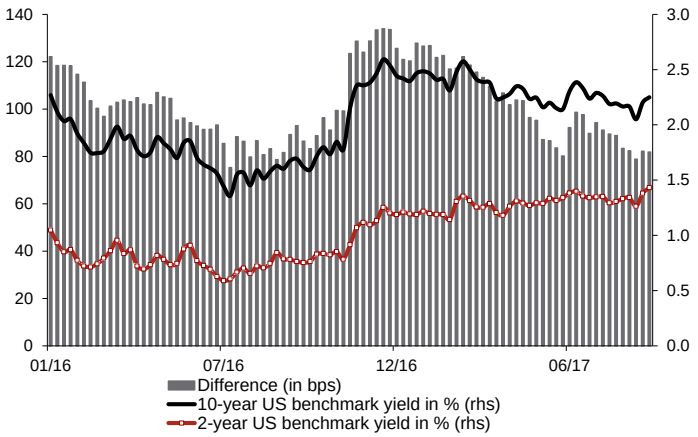
From various viewpoints, current yield levels appear too low and the risks going forward are skewed to the upside. To start with, financial markets are too cautious regarding future Fed hikes. Although the central bank stressed only recently that it intends to hike one more time this year and aims for three additional hikes in 2018, less than two hikes are priced in until the end of next year. The benign financial conditions and the forecast upturn in inflation are seen to pave the way to significantly higher key rates. While we regard the December hike as a close call, we subscribe to the Fed's view of three hikes in 2018. Hence, the expected adjustment of market expectations is likely to trigger a significant upward pressure on yields. However, given the more uncertain step in December 2017, this might not happen in the near term, but most probably in 2018.

What is more, the US term premium fell back to 0% in recent months. This is striking given the uncertain economic and political environment. In light of the outlook for an uptick in inflation, a possible credit-financed tax reform and the uncertainty about the future monetary policy stance a normalization is likely. Empirically, a term premium at such a low level is a clear indicator for significantly higher yields further down the road. Finally, the net-long positioning of speculative traders remained on a high level in recent months. Although the positioning does not appear crowded any longer, a future unwinding of long positions should go hand in hand with higher US yields.

All in, on a 12-month horizon the preconditions for higher US Treasury yields are given. We forecast a considerable upward shift of the US curve from current levels by around 50 bps. This implies that the total return across the curve will be negative. However, the scope for an increase of US yields in the short term appears more limited. As US inflation rates are likely to remain low in the months to come, a December

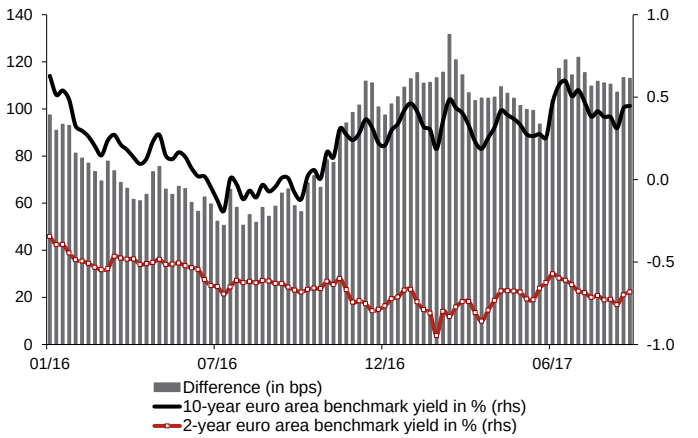
hike by the Fed is far from certain and the discussion about the debt ceiling is only postponed, the leeway for higher yields on a 3-month horizon is more limited.

US: SHORT- AND LONG-DATED GOVERNMENT BOND YIELDS



Graph1

EURO AREA: SHORT- AND LONG-DATED GOVERNMENT BOND YIELDS



Graph 2

Scarcity to remain an important supporting factor for German Bunds over the forecast horizon

While the robust economic situation and the increasing (core) inflation pressure apply to the euro area as well, the stance of the ECB will be still quite different. Although the central bank is expected to announce its exit strategy soon, the ECB will likely continue to purchase government bonds until H2 2018. Meanwhile, the central bank holds more than €400 bn of German papers (>26% of outstanding eligible bonds). Although the ECB is likely to start tapering in January, there is only scope to continue the QE program until spring 2018. However, assuming the weight of the Corporate Sector Purchase Program will increase and the ECB will deviate further from the capital keys, the central bank should be able to complete the program. Still, the corresponding scarcity of German Bunds will limit any upward pressure on yields.

Consequently, the leeway for higher German Bund yields appears limited in the short run and even on a 12-month horizon the increase in Bund yields is unlikely to keep up with US yields. Still, the direction is upwards and 10-year Bund yields are likely to rise to 0.80% in one-year's time. As the accommodative ECB policy is expected to anchor the short end of the curve for the time being, this increase is likely to trigger a somewhat steeper yield curve.

Forthcoming elections to trigger wider peripheral spreads

Generally, Southern government bond spreads moved sideways over the third quarter. Noteworthy, Spanish Bonos came under moderate pressure as tensions about the Catalan referendum grew and Portuguese bonds outperformed on the back of a surprising rating upgrade by S&P to BBB-.

BTPs still sailing in calm waters, but forthcoming elections to trigger an underperformance of Italian debt in the months to come

However, we sound a note of caution as financial markets appear rather complacent with respect to the forthcoming elections in Italy. Already in November there will be regional elections, but even more important in spring 2018, the general elections will take place. As a hung parliament is the most likely outcome and even a majority for eurosceptical parties cannot be excluded, it is striking that the economic policy uncertainty index is on an all-time low. If history is any guide, the approaching elections will trigger a higher BTP/Bund spread. However, once elections are over, there is scope for BTPs to recover. This applies all the more in case new political initiatives towards a deeper European integration will be launched.

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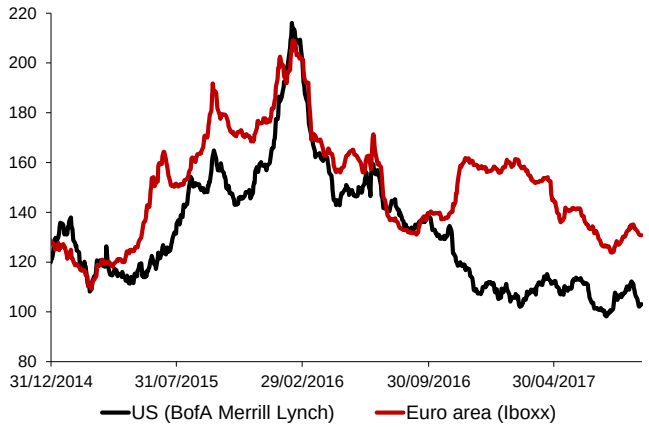
Corporate Bonds

- **Corporate bond markets on both sides of the Atlantic showed a similar pattern in Q3. While spreads moved basically sideways, the corporate yield level fell further due to decreasing underlying yields.**
- **In the short term, corporate bonds are expected to remain in calm waters. Further down the road, however, the vanishing support from the ECB and the forecast increase in government bond yields are likely to trigger a spread widening.**
- **Senior Financial bonds are more exposed to the projected rise in sovereign spreads in the run-up to the Italian general election. We therefore expect them to keep underperforming Non-Financials until later in 2018.**

Decent performance of IG corporate bonds in Q3 due to marginally tighter spreads, decrease in underlying yields and carry

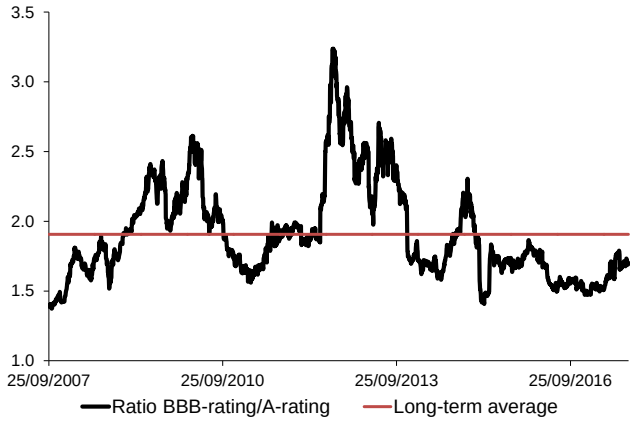
IG corporate bond markets in the euro area and in the US were characterized by a high positive correlation in Q3. In both regions, the initial spread tightening in July was not sustained and spreads widened again in August to finish the period under review marginally below the starting level (Europe: -2 bps to 131 bps, US: -2 bps to 103 bps). At the same time, government bond yields fell and triggered a positive performance. Due to the higher carry, the local currency total return of US corporates was slightly above their European counterparts in Q3 (1.6% vs. 1.3%).

DURATION ADJUSTED IG CORPORATE YIELD SPREADS



Graph1; in bps, versus Treasuries and Bunds

NON-FINANCIAL BOND SPREADS: RATIO BBB/A-RATED



Graph 2; Iboxx spreads versus German sovereigns, not duration adjusted

In the short term, euro area IG corporate bonds are expected to perform decently, but there are hurdles in the way further down the road

In the short run, euro area IG corporate bonds are forecast to perform well. The fundamental situation is solid with defaults on a low level and a positive rating drift. What is more, the strong return triggered a positive fund inflow which helped to take down the high issuance. Finally, the ECB continues to support the market. Although the overall amount of the QE programme was lowered, the Corporate Sector Purchase Programme (CSPP) is less affected and the share in the overall amount has risen.

In the medium term, the high supply will meet less demand as the absolute volume of ECB purchases will come down (irrespective of the CSPP's higher share). We estimate that the central bank will buy less than €40 bn in 2018, compared to an amount of around €85 bn this year. What is more, the relative attractiveness of IG corporates has come down as e.g. the yield advantage versus 5-year sovereign bonds has declined by around 50 bps to less than 100 bps since the start of 2016. Hence, we forecast IG corporate bond spreads to widen by around 10-15 bps on a one year's time.

High quality non-financials preferable in tough environment

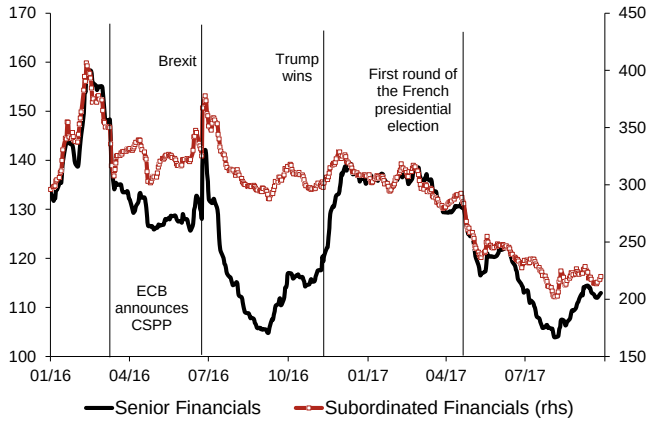
Although a considerable spread widening might be some way off, given the unattractive risk/return profile it does not pay off to go long risk. In fact, adjusted by the

historical volatility non-financial corporate bond spreads are rather low and not far from the historical trough. This applies particularly to low-rated IG non-financials. While the historical average of volatility adjusted BBB-rated non-financials spread is 1.7, the current spread is only at 0.8.

Given the unattractive risk/return profile, we recommend focusing on short-dated and high-rated non-financials

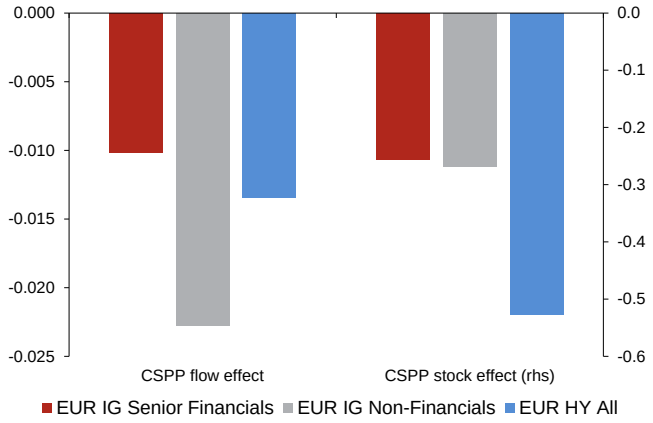
In addition, in an environment of widening spreads, low-rated bonds generally underperform. As the current spread ratio BBB/A is at 1.7 (historical average 1.9), there is scope for an increase at least towards the average. Hence, given the asymmetric risk profile and to reduce risks, we recommend investors overweighting higher-rated non-financials over lower-rated ones. Furthermore, as underlying yields are forecast to rise, long-dated non-financials should be avoided to limit potential losses.

IBOXX EUR-DENOMINATED IG FINANCIAL BOND SPREADS



Graph 3; Spread vs German Bund (duration-adj.), in bps

IMPACT OF ECB'S CSPP ON CREDIT SPREADS



Graph 4; Partial correlation coefficient based on internal models

Financials to outperform Non-financials only later in 2018

EUR IG Senior Financial corporate bonds slightly underperformed Non-Financials in Q3 (+1.06% vs +1.30%), mainly due to their lower carry, while both duration-adjusted spreads remained on net unchanged compared to end-June (at 113 and 127 bps respectively). On the contrary, EUR IG Subordinated Financials kept outperforming (+1.97%), although to a far lesser extent compared to what seen in the first part of the year (ytd the total return for Subordinated bonds is +6.14% vs +1.47% for Senior Financials). The duration-adjusted spread for Subordinated Financials temporarily fell to 202 bps, the lowest level since November 2007, before widening back to 220 bps (-14 bps since end-June).

Senior Financials are more exposed than Non-Financials to the projected rise in sovereign spreads in the run-up to Italian election

In the short-term, we expect Senior Financial bond spreads to move only marginally up (3M target: 115 bps), while a more significant widening looks likely in the run-up to the Italian general election (6M target: 125 bps) in H1 2018. As a result, Senior Financials should keep mildly underperforming Non-Financial bonds for the time being. Moving further into 2018, however, we would favor Senior Financials over Non-Financials again. According to our analysis, the sensitivity of the Non-Financial bond spreads to the changes in the monthly pace of purchases under the ECB's CSPP is more than twice as large as the one of Financials (see Graph 4, "CSPP flow effect"). Moreover, rising yields will be supportive of banks' profitability, and consequently will benefit Financial bonds the most.

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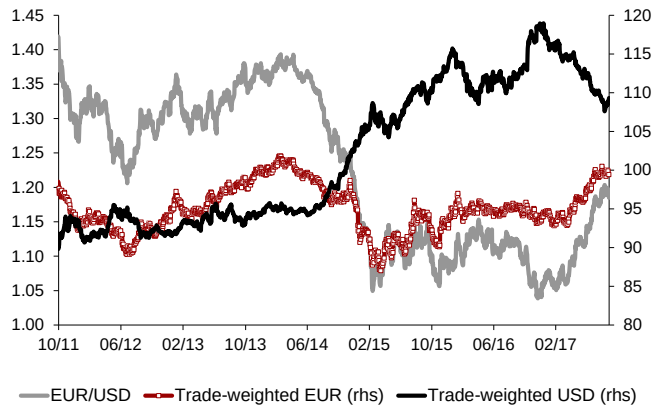
Currencies

- **The more than 10% rise in the EUR/USD since mid-April looks too far, too fast compared to moves in yield differential and broader valuation approaches. We see the EUR/USD prone for a moderate correction over the next quarter.**
- **Going into next year, however, the euro is likely to resume its strength. This means that we deem a temporary recovery in the US dollar as an opportunity to further unwind existing USD exposure.**
- **Against the British pound, the euro is likely to trend stronger, with Brexit uncertainties to overshadow the rate hike by the Bank of England expected for November.**
- **The Japanese yen remains inversely tied to US yields, which is the key reason for our outlook of a further rise in the USD/JPY over the coming quarters.**

The US dollar has been beaten by perhaps excessive pessimism regarding US politics

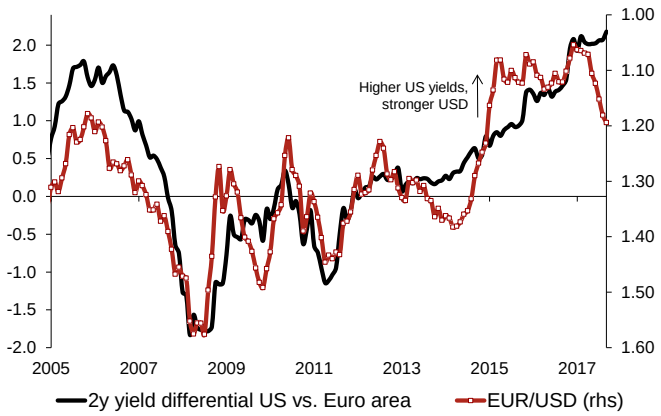
Concerns about political turmoil in the US administration have weighed on the USD. Investors severely doubt Trump's ability to deliver on a tax reform, to strike a deal with the Congress to pass the 2018 budget and to raise the debt ceiling. While Trump achieved to prolong the deadline for the latter into December with the help of the Democrats, tensions with Republicans in Congress will linger. Nevertheless, markets have penalized the dollar with too much of a discount in our view. The trade-weighted US dollar is down by 8% this year despite sound US growth and despite the leading role of the Fed in normalizing monetary policy in the advanced world.

US DOLLAR AND EURO



Graph 1; TWI Indices: 01/2005 = 100

YIELD DIFFERENTIAL AND EURUSD



Graph 2

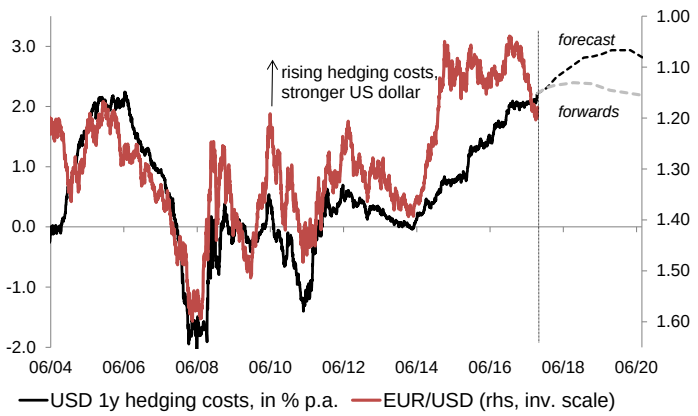
Conversely, the euro was boosted by high expectations regarding the ECB and hopes on political progress in the EU

Conversely, expectations of an announcement by the ECB to taper its asset purchases over the course of 2018 propelled the euro into stretched regions. Following more than a year of stability, the trade-weighted euro has soared by almost 7% since mid-April. Therefore, also the euro looks vulnerable to a temporary correction. First, the euro strength on ECB tapering speculation is to some extent self-defeating, given that the stronger euro dampens sluggish euro area inflation and leads to a more careful proceeding by the ECB. Second, the ECB is still far away from a first rate move (unlikely before early 2019) while an ECB announcement of tapering QE will be a 'dovish' one in our view: It will highlight data-dependency and avoid a commitment to a fully detailed plan of running down asset purchases. Third, Macron's victory in France has helped to significantly reduce the political risk premium on the euro. Uncertainties ahead of next year's Italian elections have been put to the backburner, but are not solved. Following the German general election, government formation will prove very complicated and the Liberals will oppose EU integration plans involving more risk

sharing. So part of the political optimism in Europe looks vulnerable to at least a temporary reversal.

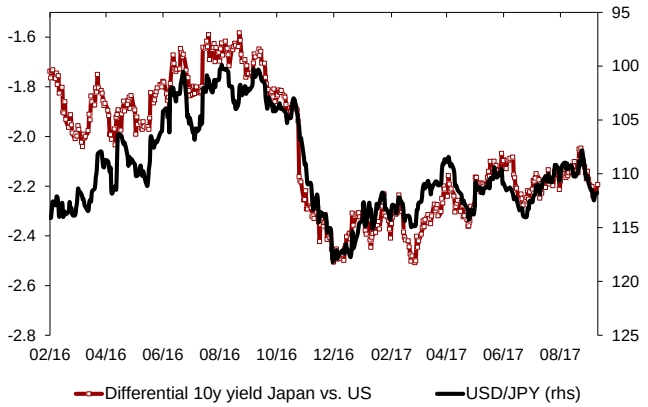
The stretched pessimism on the USD and the optimism regarding the euro is also reflected in a wide gap between the EUR/USD and yield differential as well as in stretched speculative positions. Broader-based valuation models point to a 5% overshooting in the EUR against the USD. For the coming months, we therefore anticipate a leg lower in the EUR/USD.

COSTS OF HEDGING USD EXPOSURE INTO EUR



Graph 3

JPY/USD AND 10-YEAR YIELDS



Graph 4; 10-year yield differential: JGBs vs. US Treasuries

This will be a good opportunity to further unwind USD exposure in our view. For next year, we anticipate the euro to resume its strengthening trend, helped by a large C/A surplus, easing market concerns after some likely EUR underperformance in the run-up to Italy's elections and market speculation focusing on the timing of a first ECB rate hike. Sticking to USD exposure on a hedged basis will also further lose its appeal. With the Fed providing further rate hikes, hedging costs will continue to rise to levels around 2.8% by end-2018 in our view (from currently slightly above 2.2% p.a.), more than erasing the yield advantage of longer-dated bonds.

Yen to weaken on higher US yields, Brexit still burdening sterling

Yen to slide on rising US yields…

…while Brexit concerns will prevent a sustained recovery of sterling

Regarding other currencies, we stick to the view of a weaker JPY/USD based on our expectation of rising US yields. With the Bank of Japan set to maintain its yield curve control, the yield gap between the US and Japan will widen, leading the USD/JPY higher (see Graph 4). The recent relief to the British pound is unlikely to prove the start of a protracted recovery. The Bank of England (BoE) surprised markets by giving strong hints to a rate hike as soon as in November. This pushed the EUR/GBP to levels around 0.88 lately after approaching 0.93 in late August. Looking ahead, the more hawkish tone by the BoE will indeed help to stabilize the British pound. However, given a still significant C/A deficit of almost 4% of GDP and the British brinkmanship in the Brexit negotiations with the EU, we do not expect the BoE rate hike to trigger a prolonged GBP recovery. On the contrary, we still deem market concerns that no Brexit deal will be struck in time ahead of March 2019 the prevailing force – which should help the EUR/GBP to surpass the 0.90 threshold again over the coming months.

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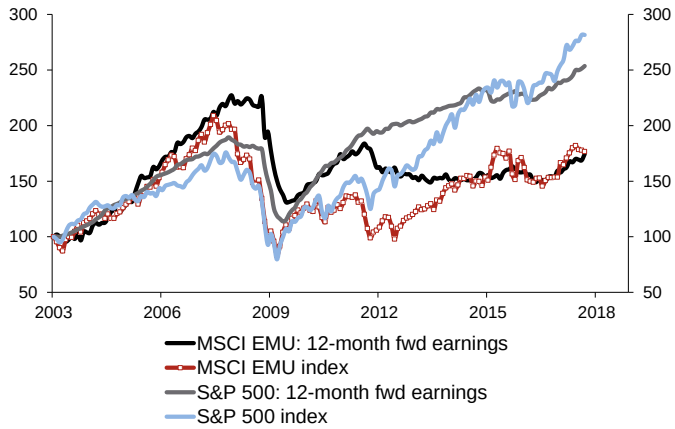
Equities

- **Notwithstanding higher market multiples, we remain positive on equities on a 12-month horizon.**
- **The euro area (EA) and Japan are our favorite areas as they are more cyclical and cheaper. An additional support comes from monetary policies, earnings growth and stabilizing inflation expectations.**
- **We are neutral on the EM in the short term but still constructive mid-term, due to attractive valuations and faster GDP growth. We favor India, Korea and the smaller CEE countries and maintain a prudent stance on China.**
- **The US market will suffer from a decreasing monetary stimulus and higher unit labor costs. Shorter term, low real yields and decent growth provide some cushion. We remain underweight.**
- **Risks: higher than expected yields, geopolitical tensions and rise in populist parties in Italy.**

The EA and Japan are to benefit from good financial conditions, benign global growth and reduced tail risks

The MSCI World achieved a strong performance year-to-date, yielding a total return of +15.5%. This in turn causes us to remain prudent as higher market multiples along with increased investors' complacency raise risks. Having said this, we continue to see equities to get support from improved macro and earnings growth, a low cost of capital, low oil prices and attractive free-cash-flow yields. US equities are expensive, but euro area (EA), Japanese and Asia's valuations are not too far from their averages. They are to benefit from benign financial conditions and reduced tail risks. Projected earnings growth and dividend yields (in the EA 6% and 3.4%, respectively) back total

PRICE AND EARNINGS PERFORMANCE



Graph 1; (01/01/2003 = 100)

EQUITY MARKETS VALUATION DASHBOARD

Markets	Price / Earnings *		Price / Book *		Price/ Cash Flow *		Dividend Yield *		Avg.
	current	hist. avg.	current	hist. avg.	current	hist. avg.	current	hist. avg.	Discount, %
WORLD	16.5	16.0	2.2	1.9	10.6	8.6	2.6	2.7	11.6
USA	17.8	15.3	2.9	2.3	12.1	9.8	2.1	2.2	18.0
JAPAN	14.3	15.7	1.3	1.3	7.9	7.0	2.1	1.9	-1.8
UK	14.3	13.8	1.8	1.8	9.1	7.8	4.2	4.0	3.4
SWITZERLAND	16.9	15.4	2.4	2.2	12.3	11.2	3.5	3.3	4.9
EMU	14.2	14.2	1.6	1.5	8.0	6.4	3.4	3.9	10.8
FRANCE	15.0	14.3	1.5	1.5	9.0	6.8	3.3	3.8	13.4
GERMANY	13.4	15.1	1.6	1.5	8.4	6.6	3.0	3.4	9.2
GREECE	12.7	12.8	1.5	1.6	6.9	5.9	3.8	3.9	2.8
ITALY	13.4	15.4	1.3	1.2	5.7	4.6	4.2	4.7	6.3
PORTUGAL	17.4	12.5	1.8	1.7	6.8	5.8	4.3	4.5	16.4
SPAIN	13.1	13.0	1.3	1.6	5.3	5.1	4.0	5.1	1.6
EURO STOXX 50	14.1	13.2	1.5	1.5	8.0	6.1	3.6	4.3	15.1
STOXX SMALL	16.2	14.2	1.9	1.7	10.6	8.1	2.9	3.2	16.4
EM, $	12.3	14.6	1.5	1.6	7.7	7.7	2.7	3.1	-2.0
BRAZIL	12.5	8.9	1.6	1.7	7.8	14.3	3.5	4.3	2.9
RUSSIA	6.0	7.1	0.6	0.9	3.6	4.6	6.0	3.5	-35.1
INDIA	18.2	14.3	2.7	2.7	12.3	11.5	1.6	1.6	9.2
CHINA	13.1	13.0	1.7	1.7	8.2	7.5	2.1	3.1	9.5

Note: The first four markets are based on the main local indices, the rest on the corresponding MSCI indices.
Multiples are based on 12m forward estimates; PEs are since 1987, the rest is since 2003.
Discount in % to historical average: blue and neg. numbers = undervaluation. Red and pos. numbers = overvaluation.
Source: Thomson Reuters Datastream, IBES estimates.

Table 1

returns (TR) for both the EA and Japan of almost 5% in 12 months. Such returns are still attractive vs. bonds' ones which we forecast to be in negative territory. On the contrary, for the US we expect only a TR of 0.5%. The good macro momentum and higher yields should promote rotation from bonds into equities. Furthermore, fund managers declare cash positions above historical average and funds' outflows have recently mitigated their EA's overweight. Temporary setbacks due to higher political risk and spikes in yield volatility should represent an opportunity to buy.

Equities: supported by macro conditions and low cost of debt

We expect the US to under-perform, yielding over one year a total return of only 0.5%

In the last three months earnings estimates continued to expand in line with the improved macro picture and contained unit labor costs. We increased our estimates for the US, Japan, and only slightly for the EA (due to an appreciating nominal trade-weighted euro (+7% YTD). The Q2 reporting season saw the continuing good yearly growth of global earnings and sales, which in turn helps to sustain higher free-cash-flow yield (5%, US and EA) and dividend yield. Corporate cash positions in percent-

age of total assets (10-13%) are the highest since 1998 at least in the US, Japan and the EA. This bodes well for an increasing buy-back and M&A activity, which in time can represent ad additional source of equity return, especially in the EA and Japan.

We expect decent earnings growth in Q3, although the yearly momentum should start to slow. Cyclical markets like Japan and the EA have room to prolong the described positive trend, given our benign GDP growth forecasts for this year and the next. While remaining below consensus, our forecasts of earnings growth in 2017 see 6%, 7.8% and 7.9% in the EA, Japan and the US, respectively. As expected, US NIPA profits rebounded in Q2 (+7% yoy) recovering some of the weakness experienced in Q1 (flat yoy). They tend to lead global IBES earnings growth. Mid-term, higher wages growth will cause US margins to decline.

Valuation and regional markets: still overweight the EA and Japan

While the US equities are temporarily sustained by low real yields, they are more at risk (having 12-month forward PE at 18 and 30X CAPE). For the EA and Japan, we continue to expect positive 12-month returns, despite a limited scope for their market

ANALYSIS OF THE MEDIAN STOCK: Q2 2017 REPORTING SEASON

Median stock	Earnings Growth		Sales Growth	
	Q1 2017	Q2 2017	Q1 2017	Q2 2017
S&P	9.8 %	9.3 %	5.4 %	5.6 %
Stoxx	13.5 %	7.7 %	7.7 %	6.2 %
Euro Stoxx	13.5 %	5.8 %	7.8 %	5.9 %
Topix	19.8 %	20.9 %	2.9 %	5.1 %

Median stock	Earnings Surpr		Sales Surpr	
	Q1 2017	Q2 2017	Q1 2017	Q2 2017
S&P	4.5 %	3.4 %	0.9 %	0.8 %
Stoxx	5.2 %	1.7 %	1.7 %	0.4 %
Euro Stoxx	3.4 %	1.3 %	1.8 %	0.2 %
Topix	6.6 %	9.2 %	0.5 %	0.9 %

Table 2

US CAPE-BASED VALUATION (ADJ. FOR INFLATION)

US CAPE-based valuation (adj. for inflation)	10Y	CPI	Real 10Y Rate	EPS	Current (e/p - 10y real)
Scenario 1 (current input, our 2017 eps)	2.15	1.90	0.25	125.0	4.63
Scenario 2 (current input, consensus eps 2017)	2.15	1.90	0.25	129.0	4.79
Scenario 3 (2017 base)	2.30	1.70	0.60	127.5	4.38
Scenario 4 (2017 downside)	1.90	1.60	0.30	110.0	3.99
Scenario 5 (2017 upside)	2.90	1.80	1.10	141.5	4.42
Scenario 6 (2018 base, 12m fwd eps)	2.90	2.20	0.70	139.0	4.73

using assumptions above	Scen. curr1	Scen. curr2	Scen. base 2017	Scen. down	Scen. up	Scen. base 2018
Implied PE Trailing IBES	19.3	19.9	18.4	16.8	18.6	19.7
Avg S&P500 valuation	2,380	2,456	2,268	2,073	2,301	2,427
	-2.2%	1.0%	-6.7%	-14.7%	-5.4%	-0.2%

Note: Target ERP (4.7) is calculated assuming CPI in the range b/w 1% and 4%.
Scenarios 4-6 use our inputs for end of 2017

Table 3

multiples to expand from current levels (14.2X PE for the EA). Threats are represented by much higher real rates or recession, which we do not forecast yet. A theoretical fair value both for the EA and Japan corresponds to a total return of 5%. It is based on earnings growth which is forecast to be below consensus by 6% in 2017 and 6.7% in 2018. The theoretical downside for the S&P500 is in the range of 5-15% (earnings discount model). Thus, the downside of 6.7% arises from using real rates, which are higher by 60 bps than current levels. Until wages and real rates move substantially higher, the downside potential for the US would remain contained. Besides, the relative upside looks capped, when a less supportive monetary policy is taken into account.

Topix to benefit from decent growth and a weaker yen

Given the cyclical recovery and the low cost of capital, cyclical markets can perform well, especially where valuations are not elevated. We prefer Japan, EA and the MSCI Asia over the defensive Switzerland and the expensive US. While the EA is characterized by higher political risk, it is supported by growing profits, low cost of debt, lower valuations and a dovish ECB. Being cyclical, it should benefit more from the cyclical recovery. The projected 2017 earnings growth resulting from higher GDP growth and higher margins is notable. Market multiples are not too distant from historical average while the cost of debt is much lower. The stronger trade-weighted euro is affecting the EA equities. It should induce some negative earnings revisions (-4%) but would not

limit their upside potential (TR) in 12 months. We are neutral on the UK and the Emerging Markets (EMs). In the mid-term we remain positive on EMs. Inside Europe, we favor value-cyclical sectors (including financials) and the discretionary sector, while staying short staples and defensive and being neutral on commodity sectors.

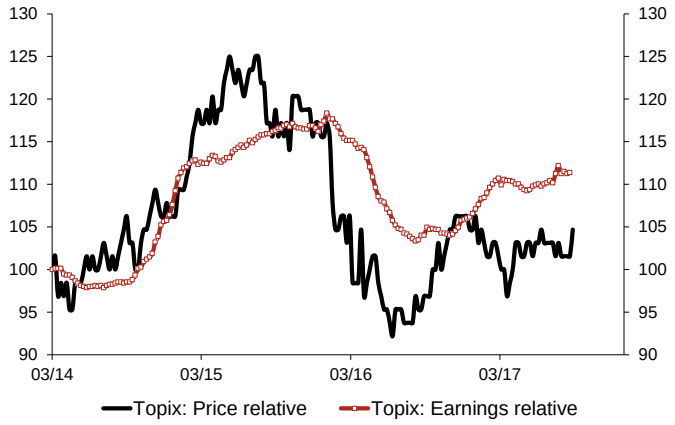
EM: External factors are playing more positively

We are currently neutral on EMs, favoring India, CEE and Korea

Over the last three months, Emerging markets (EM) have increased by 6% (YTD 25%), outperforming the MSCI World in USD dollars terms by 3.1 pp. This outperformance was brought about by improving macro conditions, a weaker US dollar, decreasing yields, increasing commodity prices, and tighter spreads.

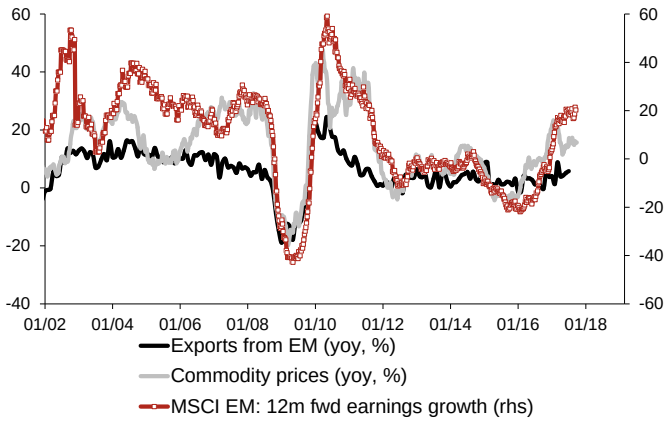
While the EM stocks have become slightly more expensive, they are - based on multiples – still slightly undervalued (discount of 2.0% to history, the multiples of the developed markets are at a premium of 12%). Looking ahead, the EMs are to benefit from supporting macro development, improved global trade momentum, relatively lower valuations, stabilizing oil prices and a weaker US dollar. Risks come from geopolitical tensions, a sudden substantial re-appreciation of the USD and spiking US yields. The Chinese market has become more expensive versus other EM indices. Its

TOPIX: PROFIT TREND RELATIVE TO S&P 500



Graph 2

EM: EXPORTS VS. FORWARD EARNINGS



Graph 3

valuations are at a premium of 10% versus its own history. The market's PE is almost one standard deviation above average since 2003. The strong tailwinds behind China's recovery since early 2016 are likely to wane in the coming months. China remains at risk, given its slowing GDP momentum and the need to reduce the high credit-to-GDP ratio. The Indian market is currently characterized by a slowdown in activity but some initial signs of structural benefit from the implementation of the goods and services tax are visible. We remain constructive beyond the short-term as reforms implemented should start paying off after near-term disruption. The fundamentals for S. Korean market remain supportive. The market is undervalued compared to its fundamentals. Korea's valuations remain at a discount of 12% versus its history. While a later escalation of geopolitical tensions cannot be excluded, we do not see tensions with N. Korean crisis escalate to military action. Overall, we continue to be constructive mid-term on EMs and still favor India along with Korea and CEE countries. In the shorter term, we maintain a neutral positon due to increased valuations and the possible pressure coming from higher US yields.

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Asset Allocation

- **Geopolitical tensions between the US and North Korea and the political turmoil in Washington remain key political risks, which argues for a generally cautious allocation stance.**
- **With the Fed and the ECB continuing their course back to normality, we anticipate some upside pressures on yields in the US, and to a lesser extent also in the euro, to prevail for the time being. Furthermore, inflation is expected to remain muted.**
- **The risk premia on Southern European debt might rise again in view of the Catalan independence endeavors and political imponderables in Italy.**
- **Only moderately elevated valuations and a decent earnings outlook let us expect equities in the euro area and Japan to still hold up well.**
- **From a total return perspective we continue to primarily favor real assets at the expense of euro area and US government bonds.**

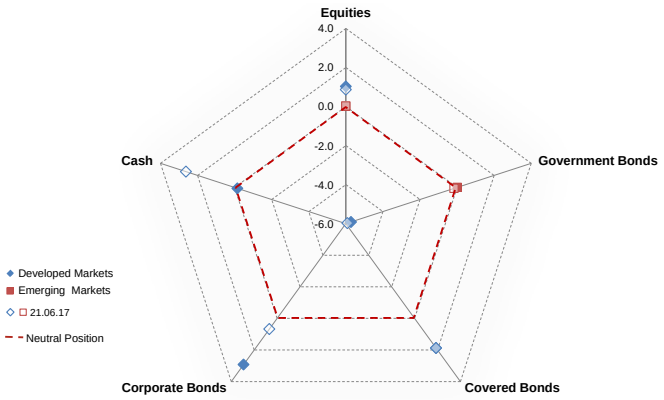
Global economic backdrop remains solid despite geopolitical tensions and political uncertainties

We deem the global macroeconomic conditions still favorable, with global growth primarily driven by the advanced economies, in spite of rising geopolitical tensions and political uncertainties in Washington. Inflation pressure is espected to remain muted. Thus, we anticipate the Fed and the ECB to continue their very gradual able course of monetary policy normalization.

Moderate upside pressure on yields and favorable outlook for euro area and Japanese equities

As a consequence, we expect some upside pressures on yields in the US, and to a lesser extent also in the euro are, to prevail. Having said that said, these pressures should remain moderate, particularly in the near-term. The risk premia on Souhtern European debt might rise again in view of the Catalan inde-pendence endeavors and Italian elections. Euro area IG credit spreads are likely to stay contained in the short-run. Fair valuations and a solid earnings outlook let us expect equities in the euro area and Japan to still hold up well.

MODELPORTFOLIO: TAA – RADAR SCREEN



Graph1; active positions in percentage points

Prefer selected equity markets and euro area credit over government bonds

Under these conditions, an overweight in equities – more precisely, Japan and the euro area – and euro area credit still appears most promising over the course of the next months. In return, the anticipated yield increases favor an underweight in euro area and US government bonds and a shortened duration.

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Forecasts

GROWTH

	2015	2016	2017f	2018f
US	2.9	1.5	2.1	2.3
Euro area	1.9	1.8	2.1	1.7
Germany	1.5	1.9	2.1	1.7
France	1.0	1.1	1.7	1.7
Italy	0.7	1.0	1.4	1.1
Non-EMU	2.4	2.0	1.8	1.6
UK	2.2	1.8	1.6	1.4
Switzerland	1.2	1.4	0.8	1.8
Japan	1.2	1.0	1.5	1.1
Asia ex Japan	6.2	6.4	5.9	5.9
China	6.9	7.1	6.7	6.3
CEE	1.3	1.4	3.4	3.2
Latin America	- 0.5	- 1.5	1.0	1.9
World	**3.5**	**3.1**	**3.5**	**3.5**

INFLATION

	2015	2016	2017f	2018f
US	0.1	1.3	1.9	2.0
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	2.4	2.5
UK	0.0	0.7	2.7	2.7
Switzerland	- 1.1	- 0.4	0.4	0.6
Japan	0.8	- 0.1	0.3	0.5
Asia ex Japan	2.4	2.6	2.2	3.1
China	1.4	2.0	1.6	2.3
CEE	9.2	5.2	5.0	4.7
Latin America	6.2	6.3	4.3	3.7
World	**2.3**	**2.3**	**2.4**	**2.7**

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

FINANCIAL MARKETS

3-month LIBOR	**Current**	**3M**	**6M**	**12M**
USD	1.33	1.50	1.65	2.00
EUR	-0.38	-0.35	-0.35	-0.30
JPY	-0.03	0.00	0.05	0.05
GBP	0.33	0.55	0.60	0.75
CHF	-0.73	-0.75	-0.75	-0.75
10Y Government Bonds	**Current**	**3M**	**6M**	**12M**
US	2.25	2.35	2.50	2.75
Euro-Area	0.44	0.50	0.60	0.80
France	0.72	0.80	0.90	1.10
Italy	2.17	2.30	2.60	2.70
Japan	0.03	0.05	0.10	0.15
UK	1.35	1.40	1.50	1.60
Switzerland	-0.05	0.00	0.05	0.10
10Y Spreads	**Current**	**3M**	**6M**	**12M**
Covered Bonds	76	75	75	75
GIIPS	145	150	165	160
Corporate Bond Spreads	**Current**	**3M**	**6M**	**12M**
IBOXX Non-Financial	126	125	130	140
IBOXX Sen-Financial	112	115	125	125

EM Gvt. Bonds Spreads	**Current**	**3M**	**6M**	**12M**
Latin America	415	425	435	440
Asia ex Japan	154	170	175	180
CEE	106	105	105	110
Forex	**Current**	**3M**	**6M**	**12M**
EUR/USD	1.19	1.17	1.16	1.22
USD/JPY	112	114	116	118
EUR/JPY	134	133	135	144
GBP/USD	1.35	1.30	1.26	1.33
EUR/GBP	0.88	0.90	0.92	0.92
EUR/CHF	1.16	1.17	1.18	1.20
Equities	**Current**	**3M**	**6M**	**12M**
S&P500	2500	2485	2475	2460
MSCI EMU	125.4	125.5	126.5	128.0
TOPIX	1669	1680	1675	1715
FTSE	7292	7290	7255	7360
SMI	9137	9175	9115	9260

As of 25.09.17 (3-day-average)

FORECAST-INTERVAL* – 3-MONTHS HORIZON

Government Bonds (10Y)	US	2.02	2.35	2.68
	Germany	0.43	0.50	0.57
	UK	1.20	1.40	1.60
	Switzerland	-0.04	0.00	0.04
Spreads	10Y-GIIPS Spread	127	150	173
	EUR Covered Bond Spread	63	75	87
	Euro Corporate Spread (Non-Fin)	111	125	139
	Euro Corporate Spread (Sen-Fin)	103	115	127
	EM Latin America Spread	380	425	470
	EM Asia Spread	151	170	189
	EM Europe Spread	93	105	117
Forex	EUR/USD	1.13	1.17	1.21
	USD/JPY	109	114	119
	EUR/GBP	0.87	0.90	0.93
	EUR/CHF	1.14	1.17	1.20
Equities	S&P500	2,381	2,485	2,589
	MSCI EMU	118.1	125.5	132.9
	TOPIX	1,558	1,680	1,802
	FTSE 100	6,941	7,290	7,639
	SMI	8,761	9,175	9,589

FORECAST-INTERVAL* – 12-MONTHS HORIZON

Government Bonds (10Y)	US	2.13	2.75	3.37
	Germany	0.67	0.80	0.93
	UK	1.20	1.60	2.00
	Switzerland	0.04	0.10	0.16
Spreads	10Y-GIIPS Spread	116	160	204
	EUR Covered Bond Spread	54	75	96
	Euro Corporate Spread (Non-Fin)	114	140	166
	Euro Corporate Spread (Sen-Fin)	101	125	149
	EM Latin America Spread	346	440	534
	EM Asia Spread	136	180	224
	EM Europe Spread	87	110	133
Forex	EUR/USD	1.14	1.22	1.30
	USD/JPY	108	118	128
	EUR/GBP	0.86	0.92	0.98
	EUR/CHF	1.14	1.20	1.26
Equities	S&P500	2,254	2,460	2,666
	MSCI EMU	113.0	128.0	143.0
	TOPIX	1,446	1,715	1,984
	FTSE 100	6,687	7,360	8,033
	SMI	8,388	9,260	10,132

* 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, equally weighted in the case of the 12-month forecast and exponentially weighted in the case of the 1 month forecast. The length of the bars within each asset group is proportional to the relative deviations from their mean forecasts.

Imprint

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