GENERALI INVESTMENTS

Market Perspectives

March 2018

Content

Global View

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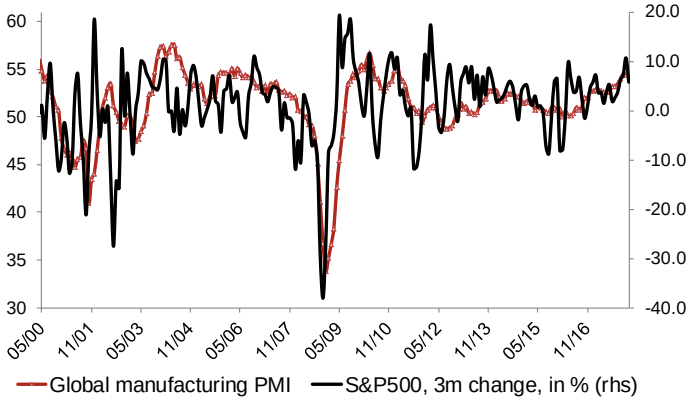
- **Goldilocks are getting tested: Rising inflation and toppish economic sentiment make both fixed income and risky assets vulnerable to setbacks.**
- **The ongoing repricing of central banks' policies leaves Fixed Income assets in the firing line.**
- **We still expect euro area equities to deliver positive returns this year, but acknowledge growing risks from rising volatility. Both EA stocks and bonds have delivered negative returns year-to-date; such poor performance and positive correlation could cause further de-risking in the near term.**
- **Euro area corporate bond spreads (especially IG) and EM assets (especially currencies) have shown resilience. Dollar weakness and ECB buying should offer further support there in 2018.**

The flash crash on global equity markets in early February – VIX hit 50 for the second time only since the GFC – was a reminder that the goldilocks environment may be nearing its limits. Healthy global expansion, tempered price pressures and cautious/predictable monetary policy normalization are giving way to a more challenging environment for investors. Price and wage data in the US were a wake-up call: monetary policy normalization should not be underestimated. Meanwhile economic data – especially in the euro area – have disappointed admittedly elevated expectations. US equities are on course to post their first monthly losses in almost a year in February.

➔ After a prolonged period of very benign markets, the environment is turning more challenging, as we predicted ion our 2018 Outlook. With the outlook for monetary policy getting more uncertain, we are likely to see volatility rising with more frequent and deeper setbacks in risk sentiment.

Global economy and equities



Prudent overexposure to euro area risky assets

The growth/inflation mix may be deteriorating but only slowly so. US equities pared more than half of their drop (almost 9% in early February) over the rest of the month, defying fears of follow-through selling. Corporate spreads widened only moderately, with euro area IG spreads remaining close to their post-crisis lows despite the sharp increase in implied equity volatility. EM assets overall are also showing resilience, amid ongoing dollar weakness and signs that EM ex-China growth is improving.

Bonds	26/02/18*	3M	6M	12M
10-Year Treasuries	2.88	2.95	3.00	3.10
10-Year Bunds	0.67	0.80	0.90	1.05
Corporate Bonds				
IBOXX Corp. Non Fin	106	110	120	130
IBOXX Corp. Sen. Fin	97	105	110	120
Forex				
EUR/USD	1.23	1.22	1.25	1.27
USD/JPY	107	107	108	110
Equities				
S&P500	2744	2730	2760	2775
MSCI EMU	125.4	123.0	126.0	129.5

* avg. of last three trading days

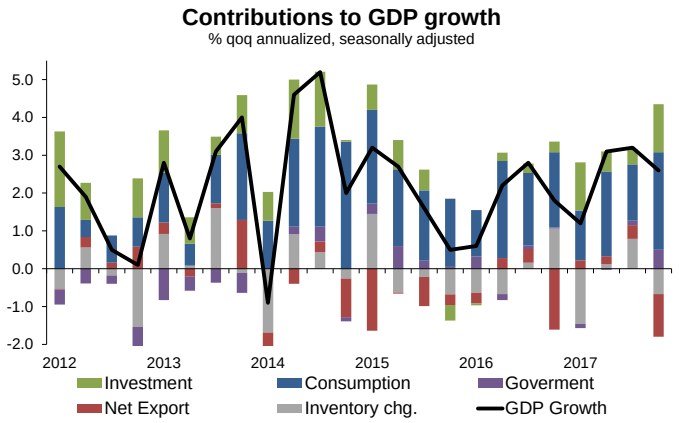
➔ It would be premature to dump risky assets after February's warning shot. The global economy still has legs, with current readings in the global PMIs still consistent with gains in equities (see chart). Furthermore, there are few places to hide. Piling up cash locks in negative yields. And increasing exposure to 'safe' core government bonds seems set to suffer from both a low carry and rising yield levels. We have limited appetite for countering the government bond sell-off, as there is room for further policy repricing (e.g. 3-mth Eonia in 2 years are priced around 0.30% only). We stick to a short duration stance and a moderate overweight in cash to protect the portfolio against a further increase in underlying yields.

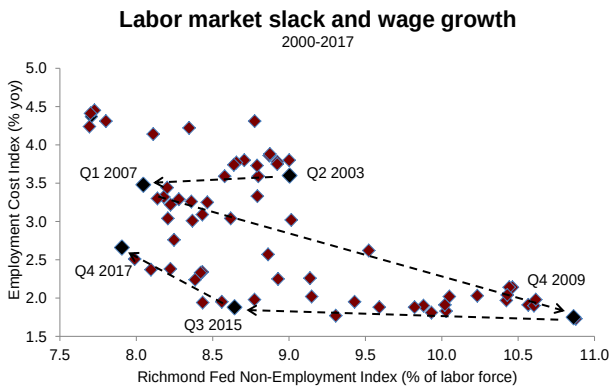
In this more challenging environment, we continue to advertise a small preference for euro area credit over Govies; IG corporate bonds remain underpinned by decent fundamentals, ECB purchases and a solid economic outlook. Resilient spreads and the pickup from the higher carry will help to cushion the headwinds from rising yield levels. We also favor a slight overweight exposure to European equities, although we acknowledge that risks related to this exposure have risen.

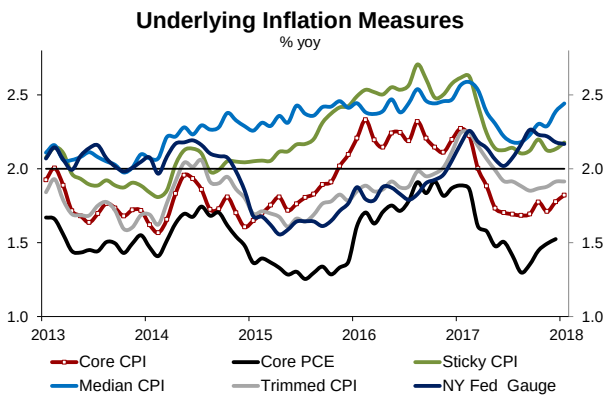
We favor financing this overexposure largely by an underweight in low-yielding and long-duration core government bonds. We are guardedly cautious also on Southern European bonds in the run-up to the general elections in Italy. That said, with 'Italexit' off the agenda also for the Eurosceptic parties and the economic recovery well underway, we are not overly concerned. There is room for the 5y5y Italy-Spain spread, around +80bp, to cool off, barring an unexpected populist push.

USA

Paolo Zanghieri







- **We revised upward our US growth forecast for 2018 and 2019, to respectively 2.7% and 2.4% (from 2.6% and 2.2%), as the extra government spending and strong capex will allow for a longer upswing.**
- **Record low unemployment starts feeding though core inflation, which will increase towards 2% from March onwards.**
- **We confirm our view of the Fed raising rates three times this year (with the first in March), with a non-negligible upside risk.**

First indications for Q1 point to a stronger than expected growth. This, and the impact of the increase in federal spending decided by the Congress led us to mark slightly up the growth forecast. We now see GDP up by 2.7% this year and 2.4% in 2019, Government spending and fixed investment will compensate for slower consumption, as household expenditure is likely to ease slightly due to higher inflation and the need to restore the savings rate from the current very low level.

Upside surprises on prices and wages

January data on the labor market and prices both surprised on the upside. The 200k increase in nonfarm jobs kept the unemployment rate at 4.1%, a 17-year low. The 2.9% yoy increase in hourly earnings was probably affected by seasonal factors. Nevertheless, in conjunction with Q4 data for labor costs, it indicates not just that wages are responding to labor market tightening but also that this response is getting stronger. We expect the unemployment rate to slide to 3.8% this year, adding to wage growth. Higher wages may stimulate participation, but the demographic evolution would limit such an increase in the labor force.

Core CPI inflation was stable at 1.8% yoy in January, but it came up slightly higher than expectations, raising market concerns about a faster progression in price increase. Yet the recent readings remain fully consistent with a very gradual build up of pressures, as inflation strengthens in all the main sectors. It is likely that data for the coming months will show some volatility, as the negative base effect from the fall in mobile phone prices in March last year unwind.

Base effects will be responsible for a big part of the rebound in inflation we expect for Q2, when the core rate will rise to to just above 2.0% in Q2, before crawling up to 2.3% by the end of the year, on the back of sustained labor market and demand pressures. The strengthening of global prices, partly magnified by the weakness of the dollar, will also play an important role.

USA

Financial conditions remain highly supportive

The turmoil which hit markets at the end of January has proved, so far, short lived and mostly confined to equities and HY. The overall impact on overall financial conditions has been all in all contained. Most of the recent tightening is due to the rebound in long term yields, partially offset by a weaker dollar.

While tighter, conditions are still much looser than at the start of the Fed tightening cycle (December 2016), and they will continue to benefit growth in the following quarters. The tightening we are observing and expecting for the following months will not be strong enough to result in a material drag to economic activity.

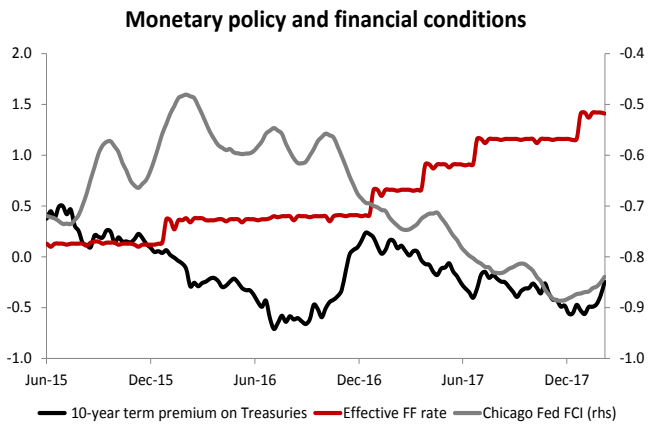
Non negligible risk of a fourth rate hike this year

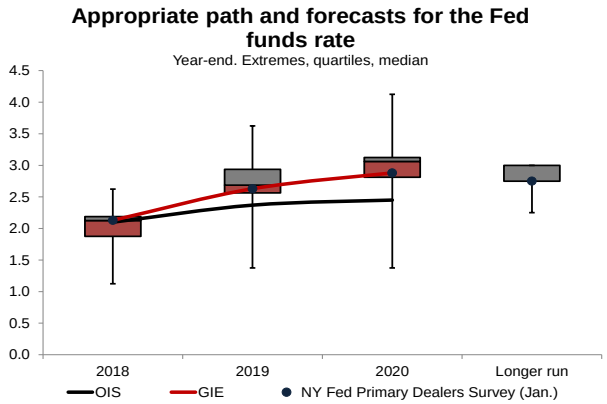
The most recent data on wages and inflation have raised concerns on whether and when the Fed would revise upward the path for interest rate it deems appropriate.

Several FOMC members have reacted stating that the new data remain fully in line with their expectations and a change in the course of monetary policy is premature. We stick to our baseline of three rate increases this year (in March, June and September), but we acknowledge that there is a at least 20% probability that the Fed will add a further hike either this year, in December, or in 2019 (when two hikes are foreseen).

For this to happen, the Fed should be convinced that the pick up in core inflation is durable and stronger than expected. Data for Q1 will remain quite volatile, therefore reliable information on inflation is more likely to come from later releases. The Fed expects the core PCE inflation rate to end the year at 1.9% (against the 1.5% posted in December). A quicker increase to that level by the end of Q2 (when we expect it to be around 1.7%) would likely become a trigger for faster normalization, to be announced already at the June meeting. The unemployment rate, at 4.1% is already very close to the level the FOMC expects for the end of the year (3.9%). If this threshold is crossed earlier this year, this could trigger an upward revision of the 'dots'. However, uncertainties about the evolution of labor supply may lead FOMC members to simply mark down their estimate of the long term unemployment rate, as they did in March last year.

We expect the March meeting to be important for the widely anticipated rate increase and the tone of the communication. On top of the outlook for inflation and unemployment, considerations on the equilibrium interest rate will be important for the assessment of the policy stance. The ticking up of growth is consistent with a mild increase in the equilibrium rate going forward. However an upward revision of the expected long run value of the Fed funds rate may point to a faster pace of monetary tightening in the offing.



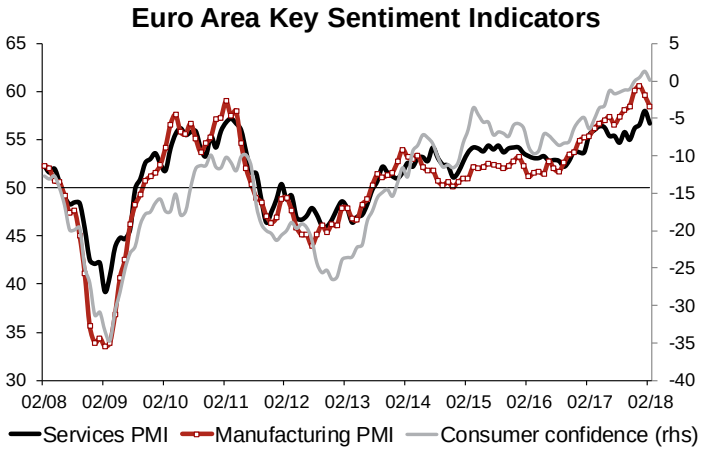


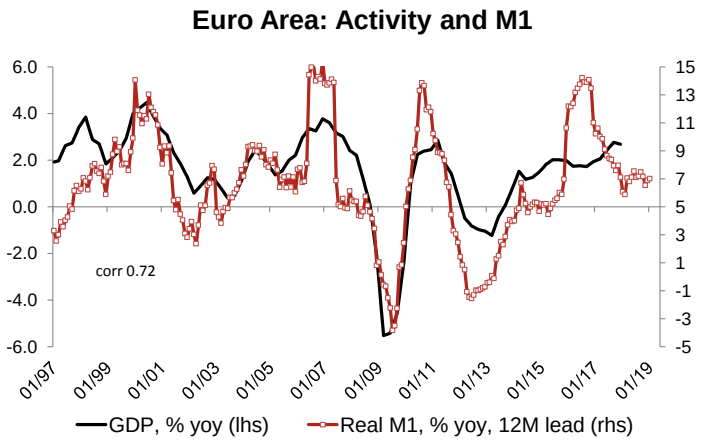
Main Forecasts[1)]	2016	2017	2018f	2019f
GDP	1.5	2.3	2.7	2.4
Consumer spending	2.7	2.7	2.4	2.2
Gov. consumption	0.8	0.1	2.7	2.6
Investment	0.6	4.2	5.2	3.5
- residential inv.	5.5	1.7	4.7	3.2
- structures	-4.1	5.3	2.5	2.2
- intell. property production	6.3	4.2	4.3	3.5
- equipment/software	-3.4	5.2	7.3	4.1
Inventories	-0.3	-0.1	0.4	-0.2
Exports	-0.3	3.4	3.3	4.0
Imports	1.3	3.9	5.1	4.3
Net trade	-0.2	-0.2	-0.3	-0.3
Domestic demand	2.0	2.5	2.9	2.5
Consumer prices	1.3	2.1	2.2	2.3
Unemployment rate[2)]	4.8	4.4	3.7	3.6
Budget balance[3)]	-3.1	-3.5	-4.0	-5.3
Fed Funds Rate[4)]	0.66	1.38	2.13	2.63

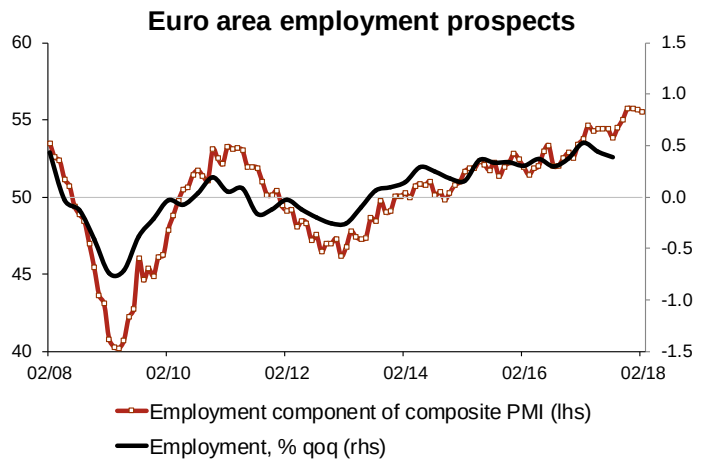
1) Unless noted otherwise, annual % changes, net trade and inventories: growth contribution to GDP 2) yearly average as %, 3) in terms of GDP, federal deficit 4) as %; year-end

Euro Area

Martin Wolburg







- **In February, key sentiment indicators came down from their peaks heralding a plateauing of growth in Q1.**
- **However, the pillars of economic activity stay strong and the latest dataflow is in line with our 2018 growth forecast of 2.3%.**
- **We expect the ECB to drop the APP easing bias at its March meeting and to give some indication about the road towards policy normalization.**

Following months of almost continuously improving sentiment, February showed a broad-based softening of euro area key indicators from their peaks. The composite PMI receded from the highest level for more than ten years to 57.5. The Economic Sentiment Indicator had already started to soften in January and continued to do so in February. Also, the Ifo index came down from the all-time high marked in January. Consumer confidence weakened significantly after having been on an uptrend since September 2016.

Euro area growth toppish …

Looking ahead, the crucial question is whether or not there is leeway for a recovery of sentiment again and, if not, to which extent activity will moderate. There are various factors hinting at a softening of growth.

First, the euro area recovery has left its infancy stage. With the output gap being closed this year, the catch-up potential peters out. Instead, when operating above normal, output increases will more and more go hand in hand with higher prices thereby dampening real growth. While inflation will likely remain clearly below the ECB's norm, we expect it to somehow increase from 1.2% yoy in February to on average 1.5% from Q2 to Q4.

Second, the euro area recovery was significantly fostered by the ECB's exceptionally monetary policy stance. It helped to overcome financial fragmentation and to create very favourable financing conditions. However, the growth enhancing effect of the monetary policy measures (last key rate cut in March 2016 and reduction of monthly APP purchases by € 30 bn to € 30 bn from January 2018 onwards) has largely run its course. Real M1 growth (see mid chart) as well as the credit impulse have come down thereby indicating softer growth.

Third, export activity will be dampened. In the February PMI survey, new export orders receded close to the level of March 2017. Here, the appreciation of the effective euro (by 1.1% since November) likely left its mark and we expect the euro to continue to rise over the coming twelve months (by cum. about 3%).

Last, forward looking indicators within the sentiment surveys weakened on a broad base which is consistent with a slightly slower growth momentum.

Euro Area

… but to remain clearly above potential

For the reasons just outlined we look for a moderation of growth. That said, this does by no means imply a sharper correction as economic expansion continues to be build on a sound footing. Most importantly, employment growth will stay strong, even though some mild moderation is implied by indicators (see bottom chart, page before). Moreover, we see wage growth trending up. In the current German wage round the agreement in the electricity and metal industry (3.5 mn employees), which traditionally also sets the tone for other agreements, foresees a wage rise of 4.2%. While we look among the euro area economies for the strongest wage increase in Germany there is also indication for higher wages in the other EMU member states. Hence, solid income growth will serve as a buffer against headwinds.

Another stabilizing factor is that the external environment is still supportive. The announced US fiscal stimulus even improve the situation while growth in emerging economies is set to stay solid. Therefore, the exchange rate induced weakening of exports is likely to remain contained.

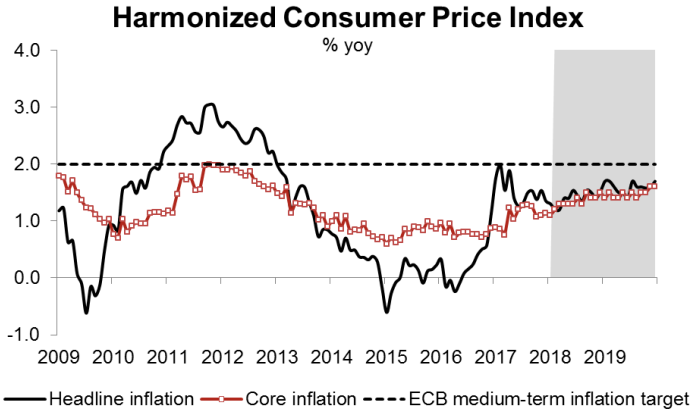
All in all, while we see growth coming down from the 0.6% qoq reading that we foresee to be sustained in Q1/2018, we also expect it to stay above potential thereafter. We see no need to adjust our 2018 growth expectation of 2.3%.

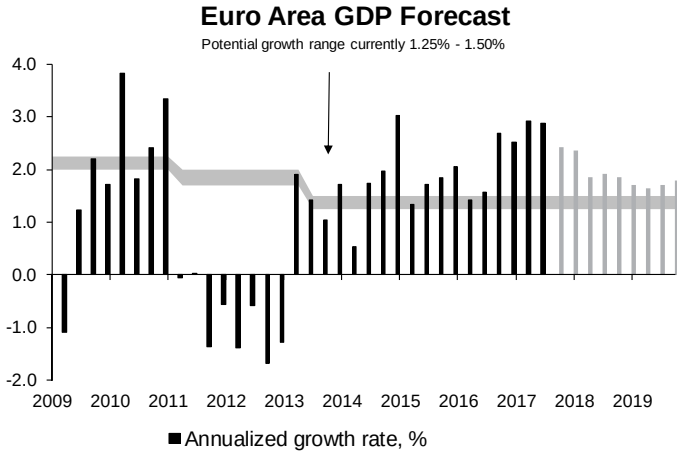
ECB starts preparing markets for policy normalization

The minutes from the January Governing Council meeting revealed that some members had a preference for dropping the APP easing bias but the majority rebuffed the idea as premature. But there was broad agreement that the exchange rate development requires monitoring.

At the meeting on March 8, the ECB staff will present new macro projections. The confidence on higher trending inflation will increase as the oil price outlook has moved up compared to December, there are mounting signs of higher wages and growth followed the message from indicators turning out to be strong. In recent comments, however, President Draghi cautioned that the slack in the economy might be bigger than previously thought. Also, Governing Council members continuously repeated that an unwarranted tightening of financial conditions shall be avoided.

We expect the ECB to cautiously prepare markets for a normalization of its policy stance. At the March meeting the APP easing bias will likely be dropped and in the accompanying press conference Draghi might even give some indication whether, after ending the current APP commitment, a sudden stop or a gradual tapering will be most likely. Moreover, it will be interesting how the ECB assesses the latest exchange rate developments. In any case, the ECB will continue its attempt to engineer an orderly tapering and hence maintain a dovish tone.



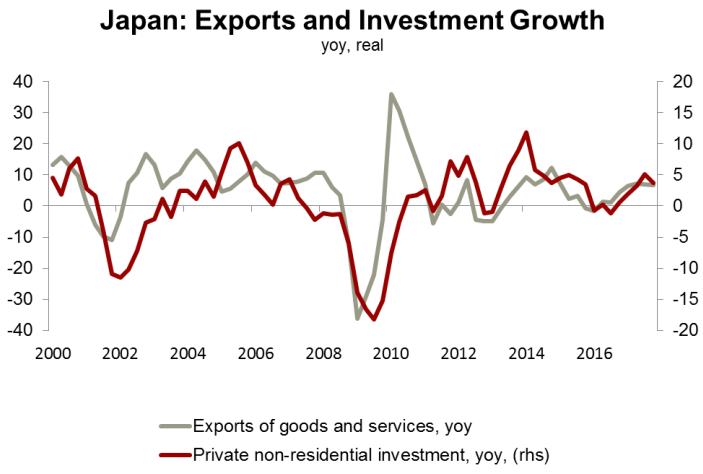


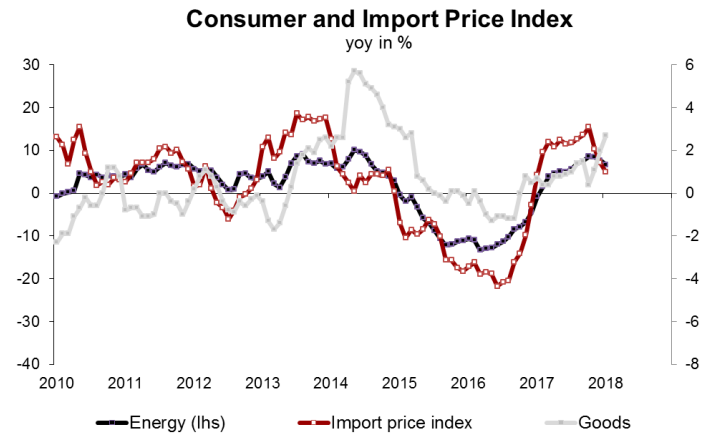
Main Forecasts[1)]	2016	2017	2018f	2019f
GDP	1.8	2.5	2.3	1.8
Consumer spending	2.0	1.8	1.7	1.6
Gov. consumption	1.7	1.1	0.9	0.8
Total fixed investment	4.5	3.2	3.5	2.9
Inventories	-0.1	0.1	0.2	0.1
Net trade	-0.4	0.5	0.3	0.0
Domestic demand	2.3	1.9	1.8	1.6
Consumer prices	0.2	1.5	1.4	1.6
Unemployment rate[2)]	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	1.6	1.4	1.3
Consumer spending	0.1	1.0	0.9	1.2
Government consumption	1.3	0.1	0.5	1.1
Investment	1.1	2.5	1.5	1.9
Inventories	-0.2	-0.2	0.2	0.0
Net trade	0.5	0.5	0.3	0.0
Domestic demand	0.6	1.2	1.0	1.3
Consumer prices	-0.1	0.5	1.0	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

- **Japan's Q4 GDP growth surprised on the downside. However, going forward, Japan is likely to continue to benefit from the solid global cycle.**
- **Headline CPI inflation has recently accelerated to 1.4% yoy. Core inflation is likely to stay around 1% yoy over the next months.**
- **Governor Kuroda has been proposed for a second term, implying monetary policy is unlikely to shift in the short run.**

According to the first print, Japan's Q4 GDP growth surprised on the downside with a rate of 0.5% qoq annualized. While private consumption came in only slightly lower than expected and the growth contribution of net exports was close to neutral as anticipated, government consumption and investment diminished. The latter was likely caused by the supplementary budget for FY 2017 being implemented only with a delay. Moreover, the inventory contribution turned negative. As a result (notwithstanding further revisions), GDP growth averaged 1.6% in 2017 (instead of the 1.8% previously expected) which is still double the growth rate of 2016. The weakness in the fourth quarter also implies a slight downward revision of our 2018 growth forecast to 1.4%. However, we continue to foresee a moderately expanding private consumption, supported by a tight labor market (while base wage hikes have been rather small so far) but held back to some extent by the increasing share of pensioner households. Business investment should also gradually turn more positive, typically benefitting from a good export performances against the background of solid global growth. However, industrial production is likely to see further fluctuations and could see a slight negative reading in Q1. Further out, a discussion in Japan already started, how to dampen the negative effects of the planned second part of the sales tax hike from 8% to 10% in October 2019 via a large fiscal package.

BoJ Governor Kuroda to garner a second term

Meanwhile, headline CPI accelerated to 1.4% yoy in January, mainly driven by fresh food prices which turned up by 12.5% yoy. Excluding this component, core inflation Japanese style remained unchanged compared to the previous month at 0.9% yoy, while core-core inflation (additionally excluding energy) advanced to 0.4% yoy. The up-tendency in core-core inflation was mainly driven by goods prices while domestic service prices remained almost flat. This suggests that domestic demand forces still play a minor role, compared to energy prices and the previous depreciation of the yen. Looking ahead, we expect core inflation to stay around 1% over the next months, but the recent appreciation of the yen vs the US-dollar will tend to dampen the effect again medium term. Governor Kuroda has been officially proposed for a second term, so that the current monetary policy stance is unlikely to shift near-term.

China

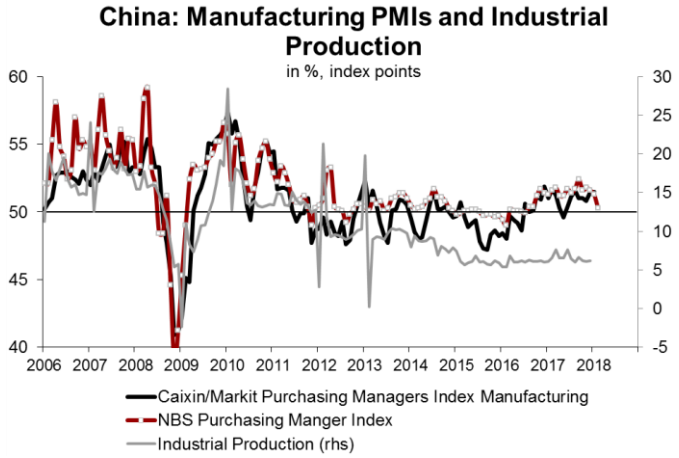
Christoph Siepmann

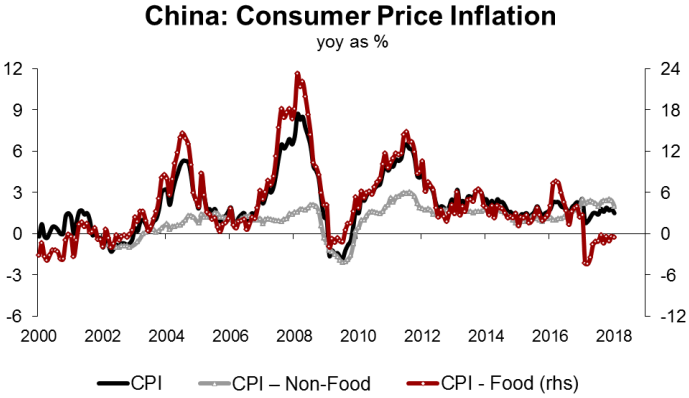
- **While the NBS PMI lost pace, China's limited macro data set continued to signal solid growth.**
- **CPI inflation is expected to shift higher, due to the end of favorable base effects.**
- **However, we see risks to inflation as limited and, accordingly, monetary policy to stay "neutral". New yuan loans rose to a record high in January.**

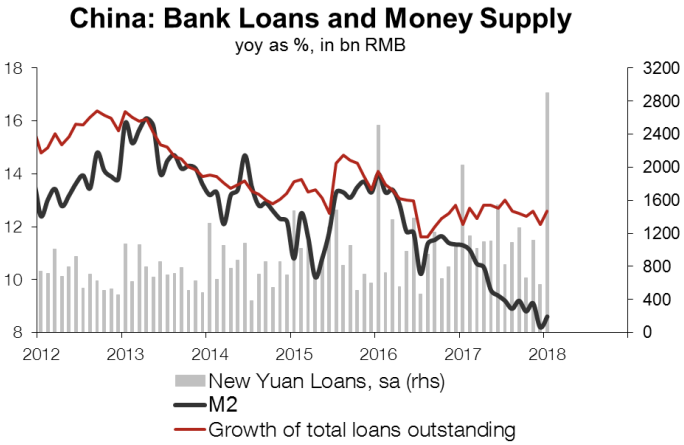
As usual, China's statistical office published only a limited data set in February. In order to avoid large fluctuations following the shifting Chinese New Year holidays (the Year of the Dog began on Feb. 16), data are confined to PMIs, international trade, inflation and some monetary indicators. To begin with, the February NBS manufacturing PMI lost one index point to 50.3, weakening more than expected. The main downward driver was PMI new export orders which dropped (for the second time) to now 49 points, clearly in contractionary territory. The development is most likely reflecting the marked depreciation of the US-dollar versus the yuan (in line with the broader USD weakness, and accordingly, a similar effect could be observed in the euro area). On the other hand, the January Caixin service PMI reached one of its highest readings on record and the February NBS non-manufacturing PMI remained on a high level. Thus, China's domestic demand seems well supported, a view which can be corroborated by actual import data. January import growth accelerated to almost 37% yoy, more than levelling off the weak December 2017 result. Realized exports (as opposed to PMI survey data) also remained very firm. Given this solid background, this year's growth target – to be published on the annual session of the National People's Congress (NPC) starting on March 5 – has already been leaked to be around 6.5%, which looks reachable despite the still pressing structural issue of the high credit-to-GDP ratio. The NPC will also likely abolish the two 5-year-terms in office rule for China's Presidents, showing Xi's firm grip on power.

CPI inflation to shift up due to base effects

On the monetary side of the economy, CPI inflation slowed to 1.5% yoy in January, after 1.8% yoy in the month before. Low inflation rates over the last year were mainly the effect of receding food prices, a development that set in in February 2017. Accordingly, next month will see the end of these base effects, and thus the inflation rate will shift upwards again. We expect February inflation to rise to around 2.7% yoy and 2018 average CPI inflation to 2.4%. PPI inflation receded to 4.3% yoy, while its subcomponent regarding consumer goods still does not signal higher CPI inflation pressures in the pipeline. Thus, we do not expect monetary policy to respond to this shift in inflation but to basically stay with its announced "neutral" stance while a tightening bias mainly exists on the regulatory level. In fact, typically very strong new loans in January surged to a record high this time (2.9 tr. yuan), likely in part to compensate for the recent regulatory moves.

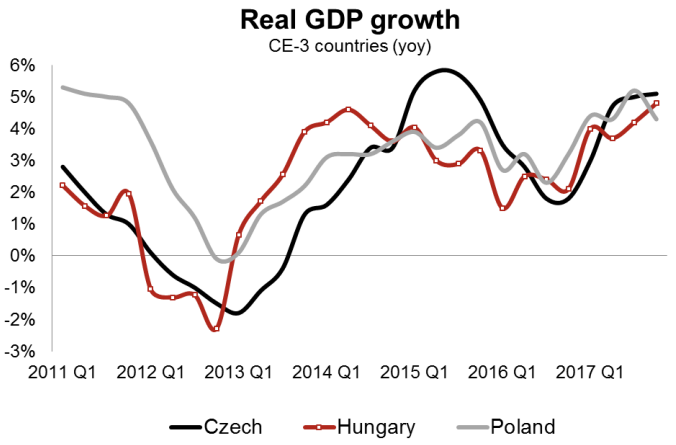


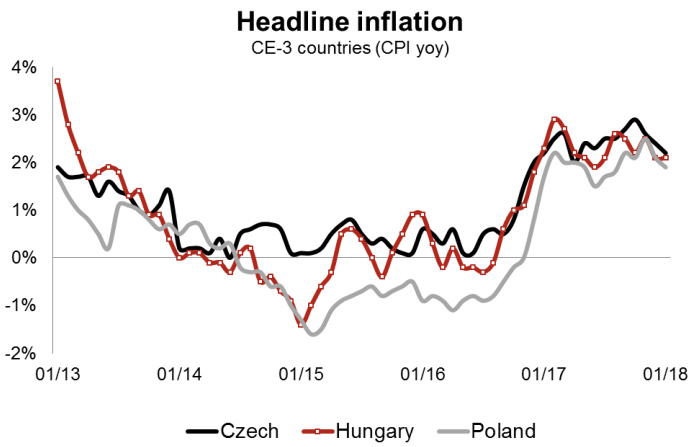




Central and Eastern Europe

Radomír Jáč





Main Forecasts	2016	2017	2018f	2019f
Czech Republic				
GDP	2.5	4.5	3.2	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	2.1	4.2	3.8	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	4.6	3.9	3.2
Consumer prices	-0.7	2.0	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 region reports strong GDP growth for Q4 2017 and positive signals are also coming at start of 2018. The CEE economies are operating above their potential and this will be also the case in 2018 despite the expected slowdown in growth.**
- **Commodity prices drove inflation lower at start of 2018 but the closing output gap should lead to higher price pressures during the year.**
- **The Czech CNB raised rates in February but its forecast implies stability for the rest of 2018.**

The CEE region kept strong GDP growth in Q4 with the full-year 2017 increase well above the dynamics recorded in 2016. The last year‘s growth was driven by all major expenditure items, including consumption, investment and exports. Particularly the strong pace of investment growth is unlikely to be maintained this year and GDP growth is thus expected to slow somewhat in 2018. That said: the growth should remain strong and the regional economies will continue to operate above their potential, which will lead to growing price pressures this year and in 2019.

Czech inflation moderated to 2.2% yoy in January, slightly below the CNB forecast. The moderation was driven by food and fuel prices, and also by core inflation. These data are supportive to the view that the CNB will keep its interest rates on hold for some time after the February hike. In Hungary, headline inflation remained unchanged at 2.1% yoy but core CPI slightly moderated and the central bank is likely to maintain its view that headline CPI will reach the 3% target in a sustainable manner only by mid-2019. Polish inflation moderated to 1.9% yoy, i.e. stands below the target set at 2.5% and the NBP keeps its wait-and-see attitude on the monetary policy outlook.

Monetary policy: Divergence in the region prevails

The Czech CNB raised its key rate by 25bps to 0.75% at its February meeting, which was, as expected, the third hike in the current cycle. The CNB published the fresh quarterly forecast, which operates with steady interest rates until end of 2018, as the monetary conditions should tighten mainly via the CZK appreciation this year. We expect one more hike this year, in August, as we think that the CZK firming may lag behind the CNB forecast.

The Hungarian MNB maintains its dovish stance with the aim to spread the impact of the loose monetary conditions over the whole yield curve with the usage of new non-standard tools that were launched in January. We do not expect the MNB to extend its tools further but we at the same time think that any reduction of the current list of tools is unlikely before late 2018.

The Polish NBP keeps a wait-and-see stance and says that the key policy rate may stay unchanged at 1.50% in 2018. We continue to expect the first rate hike in late 2018, as the labor market developments should lead core inflation in the Polish economy higher.

Bonds/Fixed Income Strategy

Florian Späte

- **While US yields continued to move upwards, euro area core yields took a breather and receded moderately in February. As inflation expectations moved broadly sideways, the development is due to a change in real yields.**
- **Southern European government bond spreads widened in recent weeks. But the robust economic situation should pave the way to tighter spreads further down the road.**
- **The setback for euro area core yields is unlikely to last. Hence, we recommend an even shorter duration for core bonds. In light of the constructive view on peripheral bonds, a slightly longer duration is recommended.**

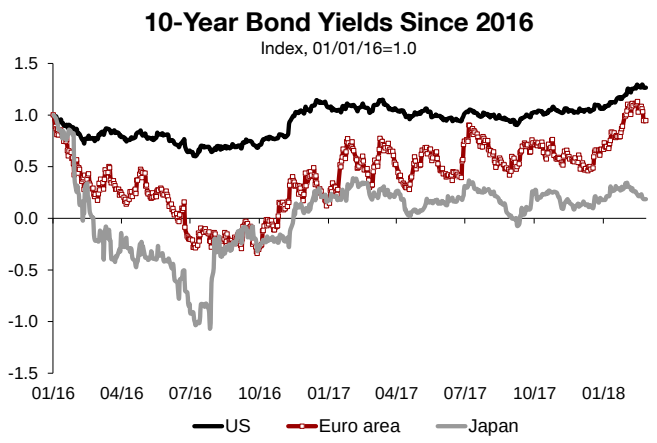
The sell-off in bond markets continued unabated until the mid of February. Since then, yields have receded on both sides of the Atlantic. On balance, euro area yields fell across the curve. In contrast, US yields receded only marginally towards the end of February and finished the month on a higher level. Consequently, the transatlantic yield spread widened further and marked – particularly at the short end of the curve – new long-term highs. As inflation expectations on balance hardly moved, the nominal yield development in February is similar to the change in real yields. While real 10-year US yields have climbed to the highest level since 2014 (0.50%), euro area yields remain in deeply negative territory (-0.90%).

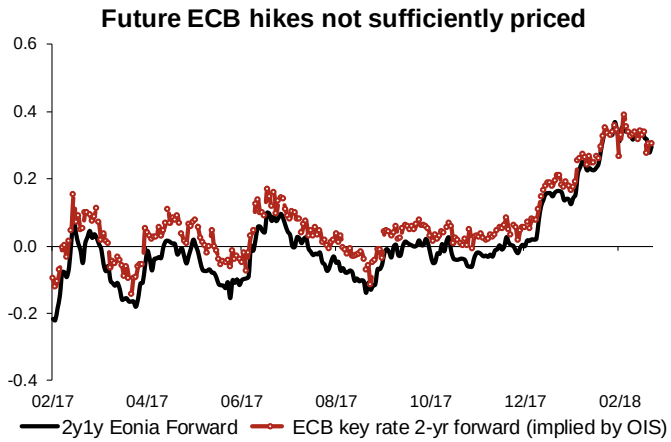
Way is paved to higher yields

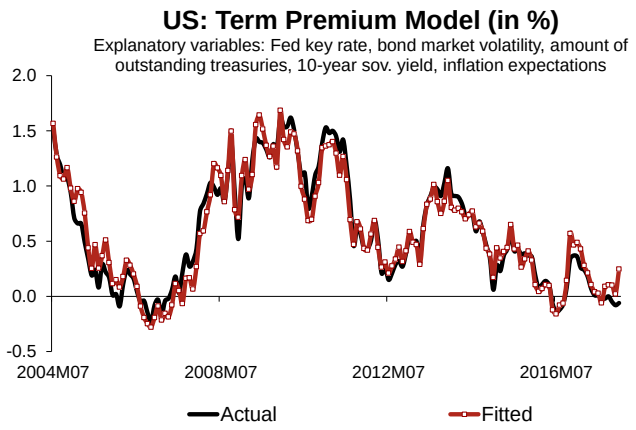
Going forward, there is scope for yields to increase in the months to come. However, the market rout on financial markets in the first half of February is a reminder that bond market volatility was on an exceptionally low level until the end of January. Despite the strong increase in recent weeks, the volatility is still below the long-term average. Given the ongoing normalization of monetary policy and the increasing inflation pressure, market participants should prepare for higher volatility going forward.

Although forecasts are plateauing, growth rates are seen to remain above trend. Particularly macroeconomic indicators are toppish (EA economic surprise indicator on the lowest level since September 2016), but this is unlikely to derail the further normalization of monetary policy. Meanwhile, financial markets have priced almost three hikes by the Fed in 2018, but future ECB hikes appear to be not adequately priced. The 2y1y Eonia Forward at 0.3% is too cautious as we forecast three repo rate hikes (each by 25 bps) until the end of 2020. If anything, central banks have struck a more hawkish tone in recent weeks.

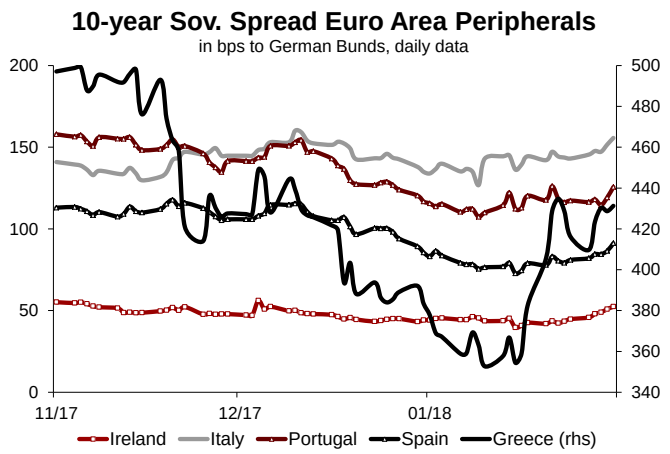
This stance is supported by increasing underlying inflation pressure. In order to not fall behind the curve, particularly the Fed will continue already in the short term its normalization of monetary policy. Hence, the regime shift is

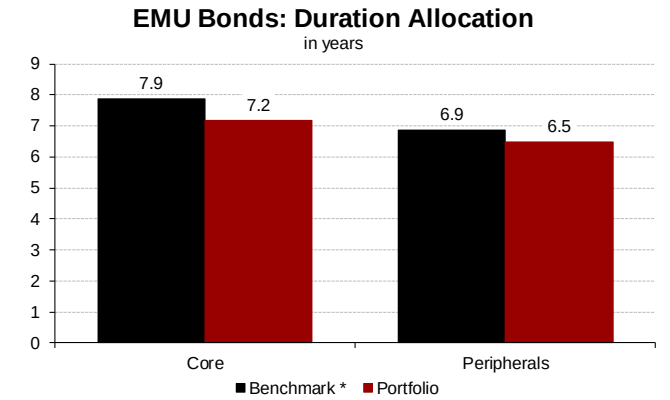




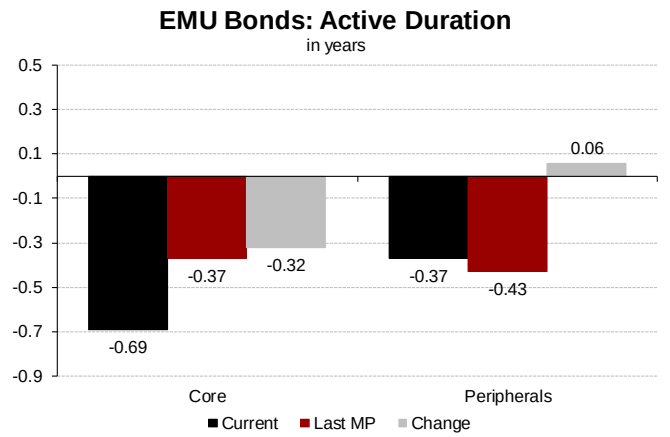


Bonds/Fixed Income Strategy





* JPMorgan EMU Government Bond Index



in full swing. While the US fiscal policy shifted to an easing mode and US deficit spending will increase significantly going forward, the Fed will stick to a cautious tightening cycle (if anything, there is a risk of four instead of three key rate hikes in 2018). This will contribute to a higher US term premium as well. According to our calculations the current term premium is already 15 bps below the fair value and it is seen to inch slightly further upwards in the months to come.

All in, euro area and US yields across the curve are likely to increase in the months to come. While volatile risky asset prices can might down the yield increase and the current short positioning in the US is an obstacle in the near term, the robust growth environment in combination with higher core inflation are expected to gain the upper hand. On a 12-month horizon, 10-year euro area yields are likely to exceed the 1%-threshold and their US counterpart is forecast to reach 3.10%.

Moderate correction in the run up to Italian elections

Southern European government bonds were very resilient in the first half of February and spreads did not widen during the market rout. But, later on spreads widened and finished February on a higher level than a month before. However, the total return is still in positive territory and substantially above the one of euro area core bonds.

In the near term, the outcome of the general election in Italy will be the main driver for Italian BTPs. However, this is forecast to partly spill over to other bond markets. According to recent polls a hung parliament remains the base case triggering a difficult and potentially lengthy government formation. In case the euro-sceptic Five Star Movement (M5S) will not be part of the new government, the impact on bond markets however is expected to be muted (if M5S will join the government, conflicts with the EMU governance are expected to be fuelled leading to a considerable spread widening). Overall, the current BTP risk premium (indicated by the BTP/Bono spread) is seen to shrink modestly later on.

Our portfolios

As outlined above, the way is paved for higher euro area government yields in the medium term. To limit losses and given the still rather low carry, we advise to keep the duration structurally short.

Given the recent setback, we advise to shorten the duration for euro area core government bonds again (-0.69 years from -0.37 years before). In light of the moderately higher carry and the expected moderate tightening after the general elections in Italy (and the likely formation of a grand coalition in Germany), we are a bit more constructive on peripheral bonds and recommend lengthening the duration marginally (from -0.43 year to -0.37 years).

Corporate Bonds (Non-Financials)

Florian Späte

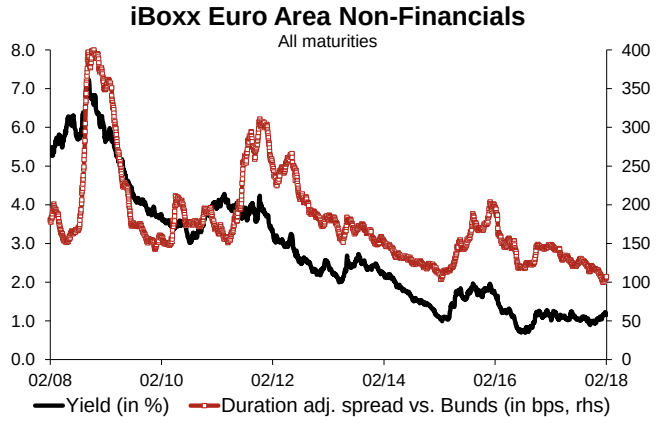
- **After remaining resilient initially, non-financial corporate bond spreads widened over the course of February by 5 bps to 107 bps. Nevertheless, falling underlying yields resulted in an unchanged yield level.**
- **Given ongoing ECB purchases, a lackluster issuance activity and a very robust economic background, the short-term outlook for non-financials remains rather benign.**
- **In the longer run, however, the environment will become more challenging. The combination of rising underlying yields and widening spreads will force total returns into the red.**

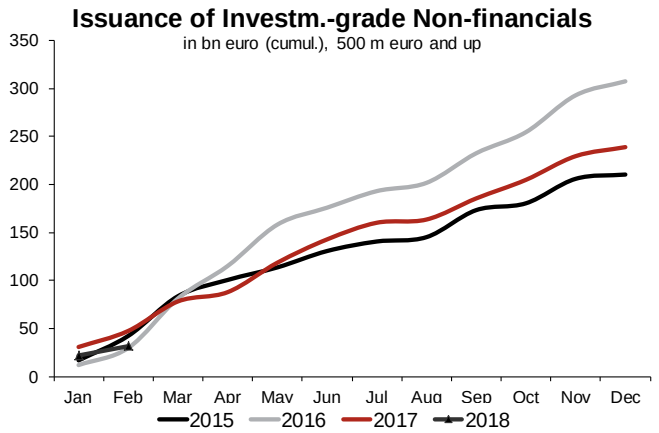
Despite the rout on equity markets, non-financials held up well in the first days of February. The reaction was delayed and muted anyway. On balance, (duration-adjusted) non-financial spreads widened by 5 bps to 107 bps. This is still well below the level at the end of last year (115 bps). In addition, due to falling underlying yields, the non-financial yield level did not change (constant at 1.15%). All in, the total return in February was marginally positive and year-to-date it is only slightly in negative territory (-0.2%).

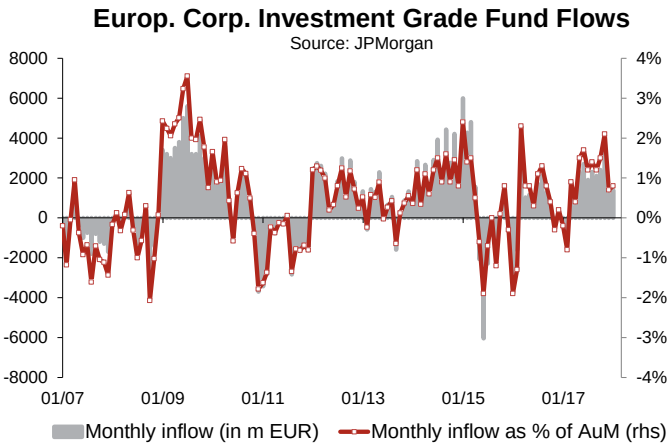
In light of economic growth above potential, strong earnings and ongoing ECB purchases (although weekly data point to a somewhat lower volume in February compared to January) we adhere to our rather constructive short-term view on non-financials. However, the robust performance of non-financials conceals some early warning signals which have emerged over recent weeks. To start with, the activity on primary markets was extraordinarily weak. Restricting the analysis to non-financials with an issuance volume of at least €500 m, there was a gross issuance of less than €10 bn in February. Hence, net issuance dived deeply into the red (€-9 bn). What is more, already in recent weeks inflows slowed significantly. According to weekly data, the fund inflows will likely be negative for the first month since February 2017. As inflows are highly correlated with past total returns, the outlook does not appear very benign.

Regime shift likely in the medium term

Although we see the risk of a more significant sell-off as limited in the short run, the medium term prospects are rather bleak. The goldilock environment is expected to subside. As the valuation of non-financials is quite ambitious, a deterioration of factors determining the outlook for non-financials will trigger a spread widening (at latest in H2 2018). The withdrawal of the ECB, increasing leverage in times of higher capacity utilization, higher underlying yields and lower inflows into this asset class are seen to trigger wider spreads further down the road. Accordingly, we remain committed to our year-end forecast of 130 bps (and a further moderate widening in 2019).

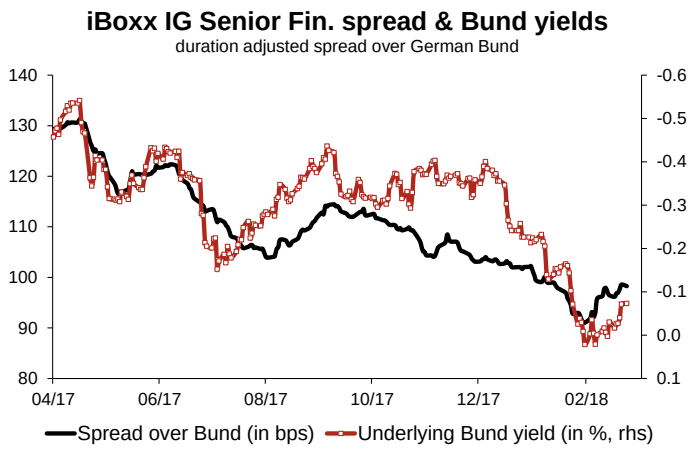


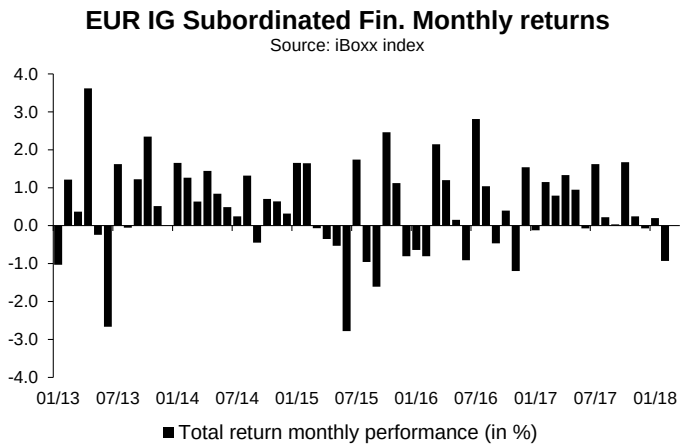


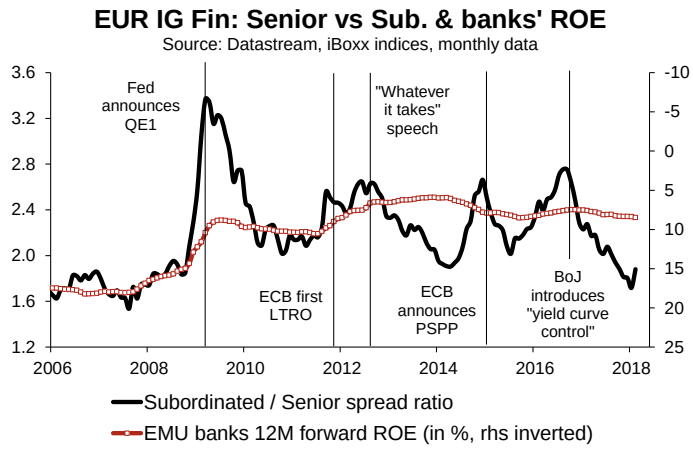


Corporate Bonds (Financials)

Luca Colussa







- **The total return of EUR Investment Grade Senior Financial bonds was barely positive in February, as the mild spread widening was mostly offset by the decline in the underlying Bund yields.**
- **Subordinated Financials posted the worst monthly return (-0.93%) since November 2016 due to the repricing caused by the spike in equity volatility.**
- **Looking ahead, while the overall macro scenario is likely to remain benign, we continue to recommend a slight underweight on Subordinated Financials vs Senior bonds due to the reduced buffer against tail-risk events.**

EUR Investment Grade (IG) Senior Financial bonds posted a muted total return performance in February (+0.07% according to the iBoxx index). The widening in the duration-adjusted spread (+7 bps to 98 bps) was largely offset by the decline in the underlying Bund yields, resulting in an only minor increase in the overall yield (+2 bps to 0.91%). The performance was broadly in line with the one of Non-Financial bonds.

Subordinated bonds faced risk repricing

While Senior Financials proved resilient in the current phase, the jump in volatility and the correction in equity markets put pressures on Subordinated Financials. The latter posted the worst monthly total return performance (down by 0.93%) since November 2016 as the duration-adjusted spread over Bunds widened by 28 bps since end-January to 189 bps. Following the recent correction, the year-to-date total return for Subordinated Financials is lower than the one of Senior bonds (-0.74% vs -0.26%).

We have stressed the less attractive risk-reward profile of Subordinated Financials vis-à-vis Senior bonds and recommended a slight underweight in relative terms since end-October 2017. While somewhat premature, the recommendation proved correct on a risk-adjusted basis as the two indices posted the same cumulative total return, but with Subordinated bonds showing a realized volatility 50% higher than Senior bonds.

Keep the slight underweight on Sub. bonds vs Senior

Going forward, expect Senior Financial bond spreads to increase only gradually (3M target: 105 bps, 12M: 120 bps) as systematic risks appear overall contained. That said, we maintain the cautious stance on Subordinated Financials. Several measures of relative valuation (e.g. the Sub/Senior ratio vs banks' ROE) remain at stretched levels in our view. While this reflects the solid growth momentum, lower sovereign risk premiums, stronger banks' balance sheets and improving profitability, we deem the buffer over Senior as too low to deal with potential new spikes in market volatility.

Currencies

Thomas Hempell

- **Political uncertainties in Europe and rate increases by the Fed will help to stabilize the USD near term.**
- **Further out, however, the looming increase in the US twin deficit (fiscal plus current account) will burden the US dollar, while the euro will likely be boosted by a more hawkish ECB.**
- **With correlations between FX and yield gaps easing and fundamentals in markets' spotlight, we revise our USD/JPY lower to 1.10 on a 12m view.**

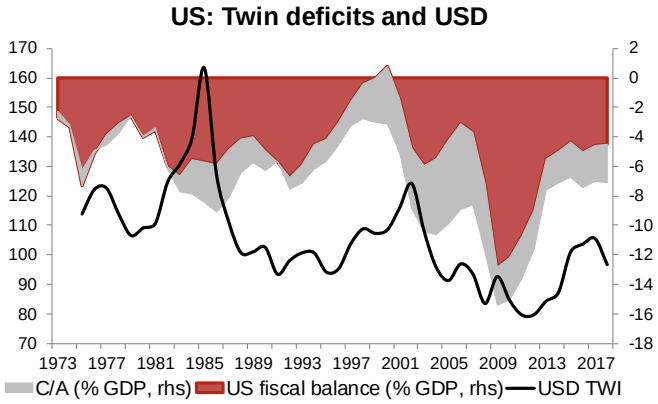
Following a dismal start into the year, the USD has recovered moderately in February against most currencies (with the notable exception of the Japanese yen). Very short-term, we expect the USD to hold up well, also thanks to the Fed's reassurance on its determinedness to raise rates further. Uncertainties around a likely hung parliament in Italy after general elections on March 4 will also keep a lid on EUR/USD near term, especially since stretched long EUR speculative positions are vulnerable to a correction. And the rising global growth momentum, which boosted many currencies vs. the USD, now looks toppish.

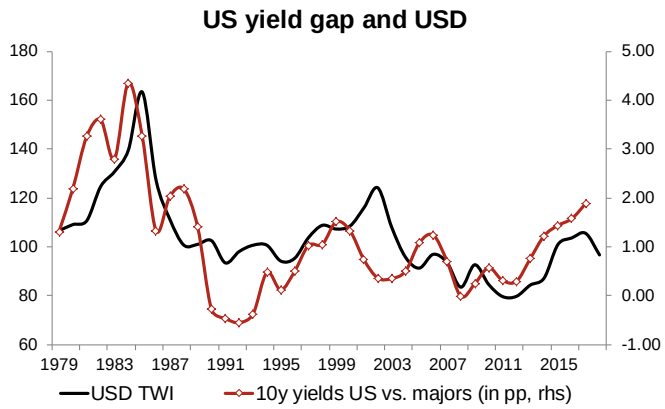
US twin deficit a burden to the USD

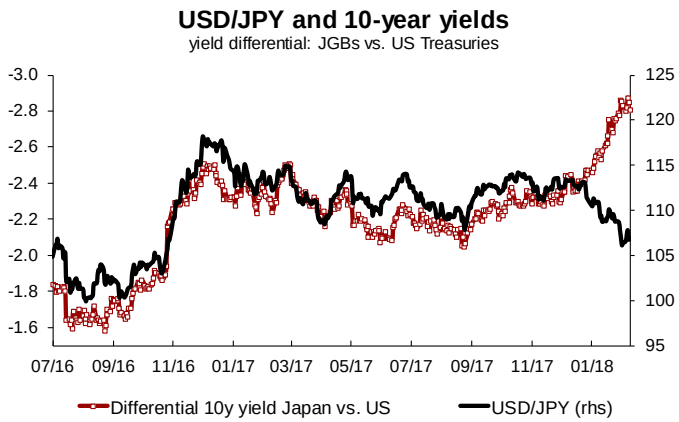
Further out, however, we continue to anticipate the EUR/USD to trend higher. Apart from likely ECB signals towards tighter monetary policy and an increase of EUR assets by global reserve managers, the USD is looking vulnerable to a rising US twin deficit. The fiscal stimulus from the US tax reform will not only increase the fiscal deficit. It will also add to aggregate demand of an economy already at full capacity, resulting in a visibly wider US C/A deficit.

Longer term evidence suggests that the role of the twin deficit for the USD must be seen in conjunction with the Fed. In the 1980s, the dollar even soared *despite* a sharply widening twin deficit, largely thanks to a very hawkish Fed. Furthermore, US twin deficits seem to affect the USD only with a 2-year lag (which is hard to square with standard economic models, indeed). Our upshot is that the dollar is likely to remain under some structural pressures from a rising required risk compensation for investors to finance the rising US twin deficit. These pressures will be partially offset, though, by the still widening gap between US rates and most other major regions.

The USD/JPY has completely decoupled from rate differentials this year and continued to suffer in February. Given the backing from a high and rising Japanese C/A surplus and still sizeable speculative shorts on the JPY, we do not see much upside to USD/JPY near term. Further out, the extreme reluctance of the BoJ to adjust its monetary policy stance is likely to come back into play again. We are revising our USD/JPY forecast to stable near term and higher to 1.10 (from 1.15) on a 12-month view.

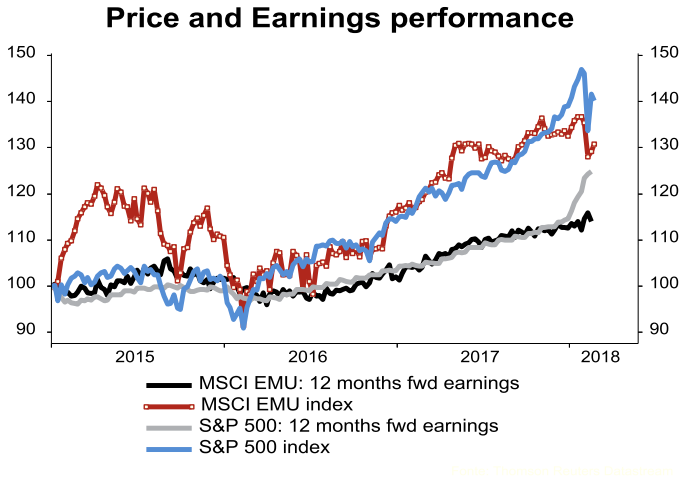






Equities

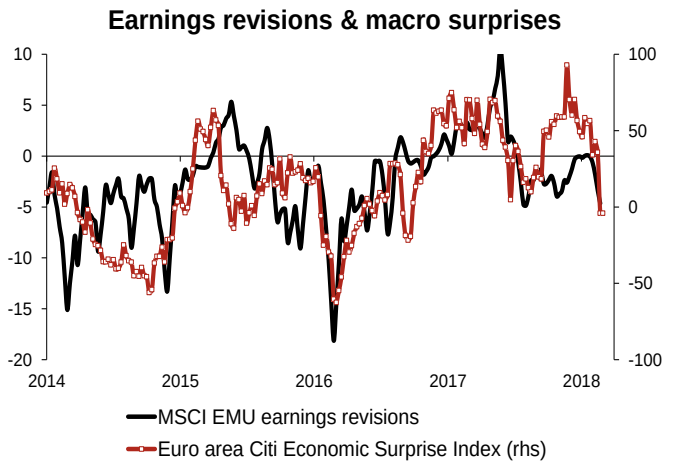
Michele Morganti



Analysis of the median stock: Q4 2017 reporting season

Median stock	Earnings Growth		Sales Growth		availability
	Q3 2017	Q4 2017	Q3 2017	Q4 2017	Q4 2017
S&P	9.37 %	13.85 %	5.78 %	7.72 %	86.2%
Stoxx	6.05 %	10.70 %	4.21 %	3.68 %	66.1%
Euro Stoxx	9.06 %	14.34 %	4.26 %	3.52 %	57.5%
Topix	11.43 %	6.98 %	6.42 %	7.28 %	96.4%

Median stock	Earnings Surpr		Sales Surpr		availability
	Q3 2017	Q4 2017	Q3 2017	Q4 2017	Q4 2017
S&P	3.53 %	3.96 %	0.93 %	1.42 %	86.2%
Stoxx	2.29 %	2.71 %	(0.09)%	0.77 %	66.1%
Euro Stoxx	0.65 %	5.52 %	(0.06)%	0.66 %	57.5%
Topix	6.86 %	8.15 %	1.09 %	1.40 %	96.4%



- **February was a turning point for markets. Volatility surged and the equity performance went into negative territory.**
- **Indeed, due to continuing strong macro data, investors started repricing inflation expectations and future central banks' stance.**
- **The global reporting season for Q4 2017 shows very strong results but business confidence indicators are peaking, so sentiment on profits should turn less euphoric from now on.**
- **As volatility stay higher compared to the last 12 months, the equity risk premium could trend higher, too, putting pressure on prices. Short term we remain cautious, with a lower overweight on equites and a defensive sector tilt.**
- **For the next 12 months, however, we expect total returns of nearly 7% in the EA and Japan due to contained overvaluation, good earnings growth and still limited pressure from higher yields.**

Since January's peak, markets experienced a "V-shaped" trend and a spike in volatility (VIX). After an initial 9.5% setback, the Stoxx 50 rebounded by 4%. Overall it lost 4% in February, as the Nikkei, while the S&P 500 outperformed (-1.4%). Year-to-date (YTD), the total return (TR) for the World index is +3%, +5.6% for the MSCI EM index and 4.3% for the US. The EMU's TR is flat while the UK one is -4.5%. The strong euro and yen are not helping the respective equity indices. The EA underperformance vs. the US, is also explained by a stronger US earnings momentum (US tax reform and stronger US macro surprises) which should abate a bit from here.

The VIX remains quite high at nearly 18% which compares to an average of 11.5% in the last year. Indeed, the reasons which triggered the setback have not abated yet and reflect in great part the fears we expressed one month ago. In particular, investors have realized that inflation can really increase from here. Secondly, and as a consequence of the first point, the global central banks' plan to reduce the monetary stimulus has gained credibility. Indeed, the recent spike in volatility was driven by higher inflation data, consequently rising yields (+45 bps for the US 10-year rate YTD), expectations of a change in central banks' stance (more hawkish) and peaking macro surprises. All this happens at the time when assets' valuations look more expensive, both for equities (in the US especially) and credit.

Strong reporting season but peaking macro surprises

More than 450 US firms have reported results for the Q4 2017. Growth numbers look increasingly good as the season proceeds and are also higher when compared to Q3 2017, when the same number of firms reported.

Equities

US earnings' surprise versus analysts' expectations is higher too, while the sales' one is in line with Q3. Japanese results are also healthy while the euro area's (EA) ones less so, probably due to the strong euro. Looking at Emerging Markets, India shows stronger earnings growth in qoq terms and much higher than analysts' expectations. In Brazil, earnings growth slowed from impressive levels in Q3 2017, while sales growth increased significantly.

Overall, the global earnings picture remains encouraging and it already triggered positive analysts' revisions, in the US and in the EMs in particular. But, as business confidence indicators look toppish, we could also expect the earnings' revision momentum to be less upbeat, from now on. This does not mean equity returns should suffer for this reason only, (earnings' growth should remain healthy in 2019, at around mid-single digit growth) but it means that the support coming from earnings will be less strong. In sum, while the picture for earnings will likely remain good also in Q1 2018, much of this is already discounted in analysts' forecasts, so sentiment on profits should turn less euphoric.

Cautious short term, still constructive in 12-months

On January 23rd we advised for a possible higher volatility on equity markets. Today, we are nearly 4% below those market levels. Short term, we continue to expect markets to be volatile and the equity risk premium to possibly trend higher. Once investors will better incorporate the new inflation expectations and factor in the central banks' plan to reduce the monetary stimulus, we think European and Japanese equities could experience a total return of around 6% in 2018, with US equities likely to underperform. For the time being, we hold our slightly overweight in equities, buying around previous February's lows and selling around January highs. We favor a balanced allocation between EMU and the US and a defensive sector tilt. We slightly overweight UK, Japan and SMI. We favor also European oils, household, discretionary, telecoms, insurance (neutral on banks), and underweighting chemicals, healthcare equip., IT and neutral capital goods. On setbacks 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 yields not able to hurt equity valuations yet. We think a 7% total return to be achievable in the EA and Japan in the next 12 month.

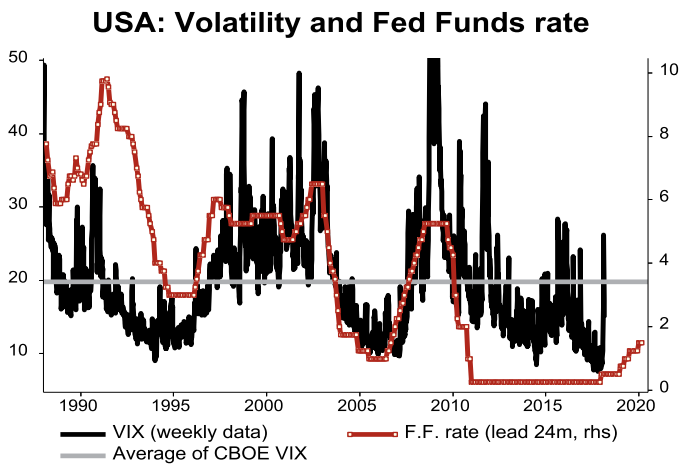
Italian equities: valuation premium at risk short term

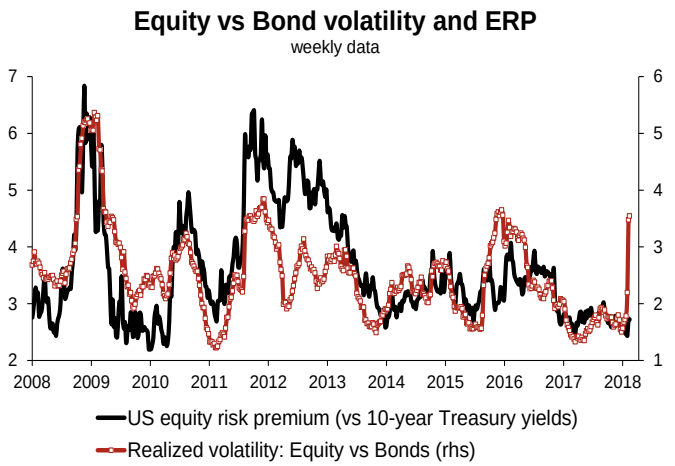
Italian market multiples (FTSE MIB) are slightly dear and aligned to EMU ones (10% premium to history for both). Italian small caps look more expensive with a 17% premium. That said, when calculated since 2009, the Italian premium vs. the EMU index is 6%. With stalling macro surprises and possible higher political uncertainty after the elections, we prefer to maintain a neutral stance on Italy.

Markets	PE		PB		PCF		DY		Avg.	Avg.
	12m f	Discount	12m f	Discount	12m f	Discount	12m f	Discount	Discount	Disc. (-1M)
WORLD	16.1	0.7	2.3	17.4	10.8	24.3	2.5	-8.2	12.6	20.2
USA	17.1	11.8	3.0	30.6	12.2	24.1	2.0	-8.5	18.8	26.8
JAPAN	14.0	-10.8	1.3	1.0	8.0	13.7	2.1	12.4	-2.1	8.8
UK	13.6	-2.1	1.8	-1.3	8.7	10.3	4.3	9.3	-0.6	6.6
SWITZERLAND	15.9	3.0	2.4	5.3	11.5	2.7	3.6	9.7	0.3	7.0
EMU	13.9	-2.1	1.6	4.0	8.1	25.9	3.4	-11.1	9.7	17.2
FRANCE	14.6	1.6	1.5	4.6	8.7	27.2	3.4	-10.4	11.0	16.1
GERMANY	12.9	-14.4	1.6	8.1	8.3	25.5	3.2	-5.6	6.2	15.7
GREECE	14.5	13.2	1.8	12.6	8.0	34.5	3.8	-2.5	15.7	24.3
ITALY	12.3	-19.9	1.2	0.3	5.6	20.8	4.4	-6.1	1.8	10.7
PORTUGAL	16.4	29.8	1.7	0.5	6.4	8.7	4.5	0.9	9.5	15.7
SPAIN	12.4	-4.1	1.3	-22.9	5.5	8.3	4.2	-16.8	-0.5	4.0
EURO STOXX 50	13.3	0.5	1.5	1.8	7.8	27.0	3.8	-10.1	9.9	17.0
STOXX SMALL	16.8	17.3	1.9	14.8	10.1	22.9	2.9	-8.4	15.8	21.3
EM, $	12.6	-13.8	1.6	1.1	7.8	1.3	2.7	-11.5	0.0	5.2
BRAZIL	13.9	55.2	1.8	9.3	8.5	-39.8	3.4	-21.8	11.6	8.0
RUSSIA	6.7	-6.1	0.8	-17.3	4.1	-10.0	5.9	64.4	-24.5	-27.1
INDIA	17.9	24.1	2.7	1.2	11.9	3.9	1.6	-0.8	7.5	17.4
CHINA	13.5	3.8	1.8	4.7	8.5	13.2	2.0	-32.4	13.5	21.8

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

Source: Thomson Reuters Datastream, IBES estimates.



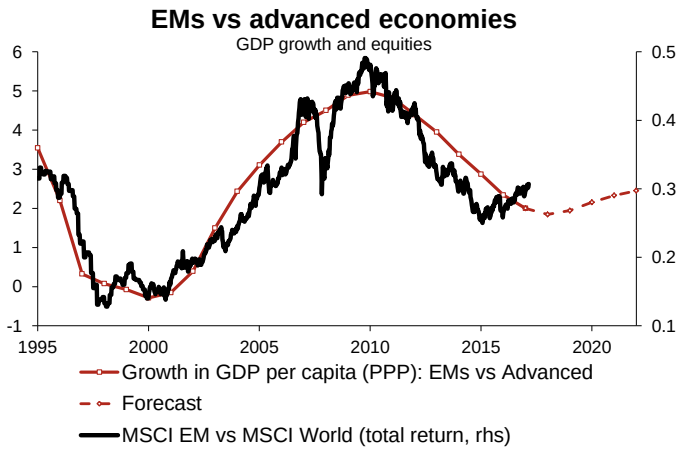


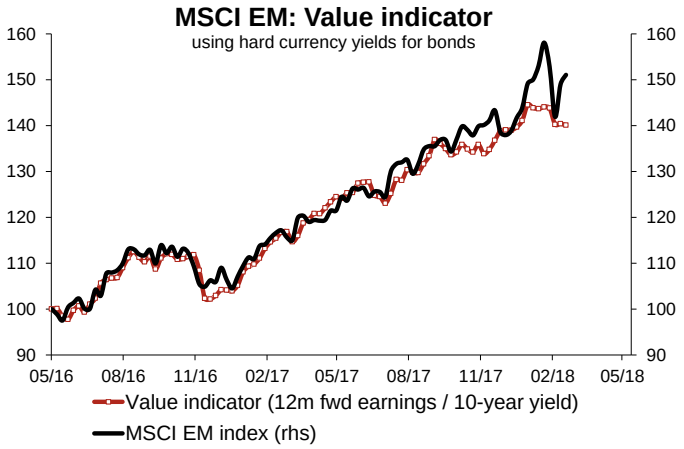
Emerging Markets Equities

Vladimir Oleinikov

Markets	price, %-chg -1M	price, %-chg YTD	earnings, %-chg -1M	earnings, %-chg YTD	10y yld chg, YTD	FX (TW), %-chg MTD	FX (TW), %-chg YTD
WORLD ($)	-4.0	2.7	1.8	6.6			
US	-3.2	4.0	3.5	8.9	45	0.8	-2.3
EMU	-4.3	-0.3	0.9	1.7	15	-0.4	0.3
GREECE	-6.2	1.6	0.6	3.9	25	-0.4	0.3
CZECH REP.	-2.7	2.2	0.7	1.0	32	-0.7	0.7
HUNGARY	-4.3	0.3	0.1	1.3	50	-1.3	-1.0
POLAND	-7.2	-1.7	1.1	3.4	2	-0.7	0.2
EM ($)	-4.1	5.4	0.4	3.8	37		
BRAZIL	1.6	14.2	3.2	5.1	-61	-1.4	1.1
CHINA	-5.0	8.8	1.6	6.1	-3	0.0	1.4
INDIA	-4.9	-1.0	1.0	2.3	38	-1.3	-3.4
INDONESIA	-2.5	0.9	1.8	3.4	19	-1.7	-2.9
KOREA	-4.6	-1.2	-2.2	-0.8	30	-0.2	-2.5
MALAYSIA	-0.5	2.9	0.5	1.4	13	0.4	1.6
MEXICO	-4.7	-1.3	0.9	0.6	-7	0.2	4.2
RUSSIA	3.9	14.3	-1.0	7.0	-57	1.4	0.8
TAIWAN	-3.0	2.6	1.4	1.0	10	0.0	-0.9
THAILAND	1.7	6.4	1.0	2.9	6	0.3	1.8
TURKEY	-1.9	3.2	1.6	3.5	11	-0.2	-2.0
VIETNAM	-1.3	11.0	-0.2	13.7	-80	0.3	-2.2
SHANGHAI	-6.4	0.7	1.1	2.5	-3	0.0	1.4

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





- **EM markets have decreased by 4.1% (-1M) due to increasing financing costs and higher risk aversion globally.**
- **The repricing of Fed expectations is to exert more pressure on EM stocks in the short term.**
- **We remain constructive mid-term on EMs and still favor India along with Korea and CEE countries, while maintaining a prudent stance on China (a relatively expensive market with some signs pf property market heating).**

MSCI EM declined by 4.1% over the last month, in line with developed equities. The top performer was the MSCI Russia (+3.9%), followed by Thailand (1.7%) and Brazil (1.6%). The worst performing ones was Poland (-7.2%), Chinese A shares (-6.4%) and Greece (-6.2). The Brazilian and Russian equities have continued to benefit from lower rates. An additional factor for Russian equities was the recent Russia's Sovereign upgrade to IG rating by S&P. However, the Brazil's rating from the Fitch agency was downgraded at the same time to BB-. The Poland's performance resulted from global sentiment impact.

Overall, EM 2018 earnings have remained flat during the last month. The markets for which they have been upgraded significantly are: Brazil (+1.8%), Hong Kong (+1.3%) and Taiwan (+1.0%). The earnings of the Korean companies have been downgraded by 1.9%. Given rolling over exports from EM countries and low macro surprises, earnings may come under pressure in the short term.

EMs to remain under pressure in the short term

Based on multiples, the EM stocks have become somewhat cheaper but remain at a slight premium of 1.6% vs their history. While resilient oil and commodity prices are supportive for EM equities, the higher financing costs represent an appreciable burden. Thus, over the last month yields and EMBI spreads have increased by 26 and 16 bps, respectively, while the trade-weighted dollar has risen by almost 1%. Judging by the "value" indicator (12-month forward earnings / 10-year bond rates), EM equities have gotten somewhat dear. The Fed hike expected in March should put EM stocks even more under pressure. That said, we reckon the extent of the Fed hike's impact to be less pronounced than during the taper tantrum in 2013 as the situation with credit, oil and growth is in much better shape now. Besides we expect only a gradual rise in US rates. Furthermore, stronger DM growth should become an offsetting factor, helping to revive EM exports. Globally synchronized expansion should bring about EM exports growth for longer, which is to reduce pressure on EM policy-makers to support domestic demand growth with loose fiscal/monetary policy. EMs should benefit from higher earnings growth and relatively lower valuations in the medium term.

Asset Allocation

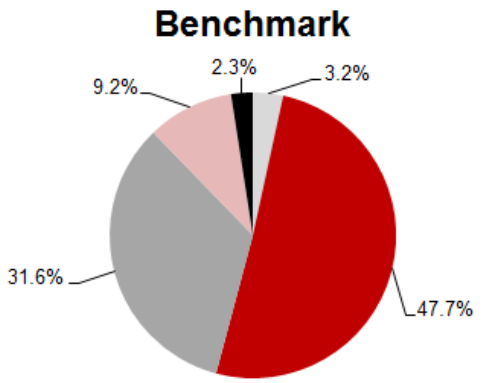
Thorsten Runde

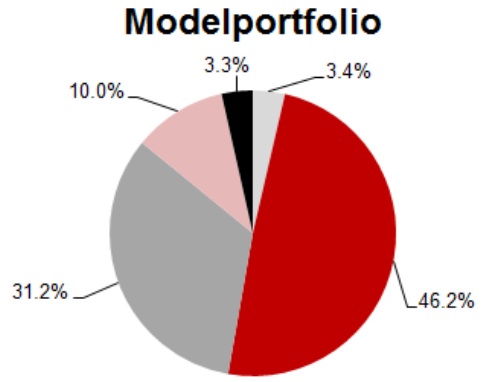
- **During the course of February the developed equity markets of our investment universe lost roughly 3.5% on average.**
- **Global government bond yields have continued to rise markedly on average, keeping the majority of the total return figures for that asset class in negative territory.**
- **Risk on overall peripheral debt increased again by a good 10 bps, preserving the pressure on the overall total return.**
- **Spreads on corporate bonds moved rather sideways. The resulting total return is close to zero, at least for the investment grade section in the euro area.**
- **Our central scenario remains unchanged, as the growth and earnings outlook remains buoyant, notwithstanding the recent deterioration in financial conditions.**
- **Having already reduced the aggressiveness of our allocation stance last month, we leave our pro-risk tactical positioning in favor of selected equity and credit markets, unchanged.**

After an impressing start into the year equity markets were hit by a flash crash not less noteworthy in the first half of February. This crash was technically rooted in the volatility markets, which crested record highs at an unprecedented speed. Such a sharp repricing in risk inevitably infected global financial markets, through a flight-to-quality that primarily hurt equities. But also government bond markets suffered as concerns about the removal of monetary policy accommodation on the part of central banks are bothering markets. Although the correction on equity markets did hurt the model portfolio performance, our largest active positions turned out to be on the correct side, ensuring an added value of TAA over the past month.

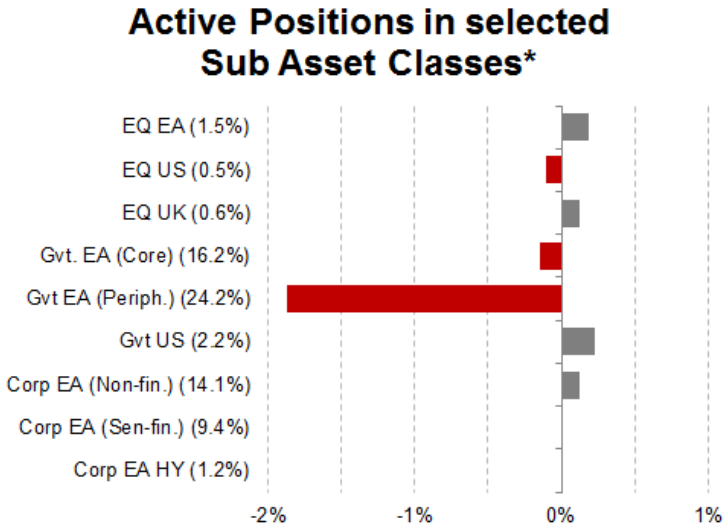
Modest pro-risk stance to be maintained

The immediate market outlook appears uncertain as such a technically driven sharp market correction might induce further rather mechanical reactions. Having said that, the macro / fundamental / earnings outlook remains positive over 2018. We retain a defensive view towards fixed Income markets. Any short-term pullback in government bond yields (e.g. on flight-to-quality) will be a selling opportunity. On equities, we continue to expect low but positive returns this year. We recommend retaining an overweight flanked by hedging strategies to limit negative effects of potential further drawbacks, which at the same time will provide buying opportunities for long-term investors. Thus, for the time being, we do not see a good reason to change our last month's tactical recommendation.





Equities
Government Bonds
Corporate Bonds
Covered Bonds
Cash



Benchmark weights in parentheses

Forecast Tables

Growth

	2016	2017	2018f	2019f
US	1.5	2.3	2.7	2.4
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	2.0	1.8	1.6
UK	1.9	1.8	1.6	1.5
Switzerland	1.4	0.9	1.9	1.8
Japan	1.0	1.6	1.4	1.3
Asia ex Japan	6.4	6.1	6.0	5.9
China	7.1	6.9	6.5	6.2
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	2.2	2.3
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	2.2
UK	0.7	2.7	2.7	2.3
Switzerland	- 0.4	0.5	0.8	1.0
Japan	- 0.1	0.5	1.0	1.1
Asia ex Japan	2.6	2.2	3.1	2.9
China	2.0	1.6	2.4	2.1
Central/Eastern Europe	5.2	5.0	4.8	5.0
Latin America	6.3	4.3	3.8	3.6
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

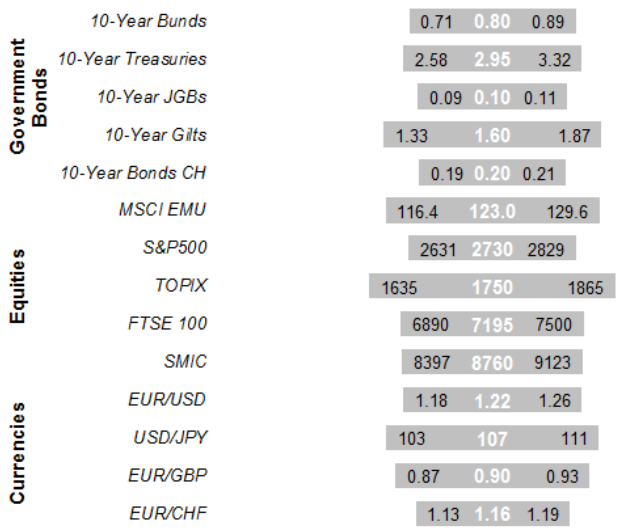
Financial Markets

3-month LIBOR	**26/02/18***	**3M**	**6M**	**12M**
USD	1.95	2.00	2.10	2.45
EUR	-0.38	-0.38	-0.38	-0.35
JPY	-0.07	-0.05	0.00	0.05
GBP	0.57	0.75	0.80	1.05
CHF	-0.74	-0.75	-0.75	-0.75
10-Year Bonds	**26/02/18***	**3M**	**6M**	**12M**
Treasuries	2.88	2.95	3.00	3.10
Bunds	0.67	0.80	0.90	1.05
BTPs	2.15	2.20	2.25	2.35
OATs	0.95	1.10	1.20	1.35
JGBs	0.05	0.10	0.15	0.25
Gilts	1.53	1.60	1.65	1.70
SWI	0.11	0.20	0.25	0.35
Spreads	**26/02/18***	**3M**	**6M**	**12M**
GIIPS	118	110	105	100
Covered Bonds	66	65	65	70

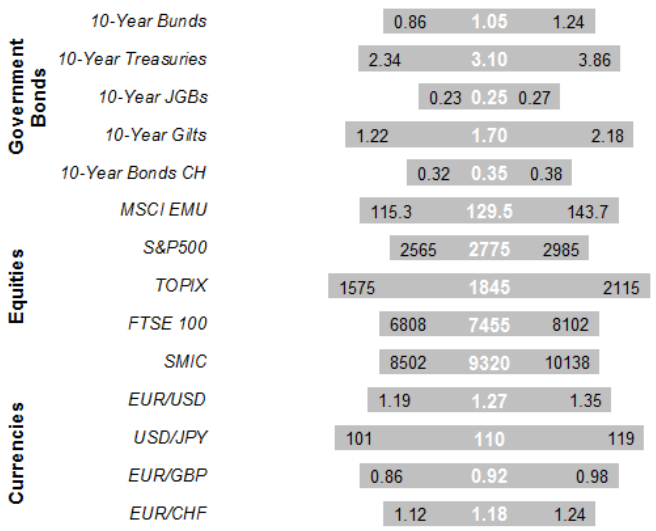
*average of last three trading days

Corporate Bond Spreads	**26/02/18***	**3M**	**6M**	**12M**
IBOXX Non-Financial	106	110	120	130
IBOXX Sen-Financial	97	105	110	120
Forex	**26/02/18***	**3M**	**6M**	**12M**
EUR/USD	1.23	1.22	1.25	1.27
USD/JPY	107	107	108	110
EUR/JPY	131	131	135	140
GBP/USD	1.39	1.36	1.37	1.38
EUR/GBP	0.88	0.90	0.91	0.92
EUR/CHF	1.15	1.16	1.17	1.18
Equities	**26/02/18***	**3M**	**6M**	**12M**
S&P500	2744	2730	2760	2775
MSCI EMU	125.4	123.0	126.0	129.5
TOPIX	1761	1750	1800	1845
FTSE	7262	7195	7330	7455
SMI	8981	8760	9020	9320

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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