GENERALI INVESTMENTS

Market Perspectives

December 2016/ January 2017

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Global View

Thomas Hempell

- **Bonds markets came under pressure after the sweep victory of Donald Trump in the US elections, while US equities and the US dollar rallied.**
- **We anticipate a modest acceleration of US growth from the second half of 2017. Price pressures will build more visibly, underpinning the case of higher yields in the US.**
- **In Europe, however, uncertainties from a potential "No" vote in the constitutional referendum in Italy, a prolongation of assets purchases by the ECB and an only very sluggish normalization of underlying inflation will keep a lid on core yields.**
- **We continue to deem the risk of setbacks on equity markets as elevated. Overall, we still prefer a cautious allocation stance characterized by a moderate overweight in European bonds with a shortened US duration exposure.**

The victory of Donald Trump in the US elections, supported by a Republican majority in Congress, have triggered strong moves on global financial markets. Following a very strong and brief initial spell of global risk aversion, Treasury bonds sold off sharply with the yields of 10-year US soaring by more than 50 bps in November, triggering a broader increase in global bonds. Spreads on Southern European sovereign bonds widened by almost 30 bps, led by pronounced losses on Italian BTPs in the run up to the constitutional referendum. US equities rallied by 4% while the US dollar soared broadly, gaining more than 3% against the euro and 7% vs. the Japanese yen.

	Growth			Inflation		
	2015	**2016f**	**2017f**	**2015**	**2016f**	**2017f**
US	2.6	1.6	2.2	0.1	1.2	2.2
Euro area	1.9	1.6	1.3	0.0	0.2	1.3
China	6.9	6.7	6.3	1.4	2.1	2.0
World	3.3	3.0	3.3	2.3	2.4	2.7

f= forecast

The sweep victory of Donald Trump in the US elections has quickly nourished market hopes of a broader reflationary environment globally. Long-term US inflation expectations rebounded sharply, accelerating the increase already seen over the previous weeks since September. Market hopes are centered around the idea that bold fiscal policy in the US could compensate for the fading support from the Fed, reflating the US economy and setting a policy example for the rest of the world. In fact, inflation expectations in the euro area have recovered as well, despite the fact that the benefits from a US policy mix motivated by the idea of 'America first' (including fiscal stimulus, repatriation of profits by US firms, protectionist measures and curbs on immigration) are ambiguous.

Amid very high uncertainties about actual policy measures by the Trump administration, we tend to anticipate a fiscal stimulus via tax cuts that could become effective in H2 2017, lifting US annualized growth in the range of 0.2 to 0.3%. Inflation pressures in the US – already recovering anyhow – will likely be affected more visibly only in 2018 by the new measures, strengthening the case for US rates normalization, with a rate hike in December to be followed by two further steps in 2017.

Bonds	**Current**	**3M**	**6M**	**12M**
10-Year Treasuries	2.35	2.40	2.50	2.70
10-Year Bunds	0.23	0.20	0.35	0.50
Corporate Bonds	**Current**	**3M**	**6M**	**12M**
IBOXX Corp. Non Fin	147	140	140	145
IBOXX Corp. Sen. Fin	133	130	130	135
Forex	**Current**	**3M**	**6M**	**12M**
USD/EUR	1.06	1.04	1.06	1.08
JPY/USD	113	114	115	117
Equities	**Current**	**3M**	**6M**	**12M**
S&P500	2207	2170	2170	2140
MSCI EMU	106.7	106.0	106.0	105.5

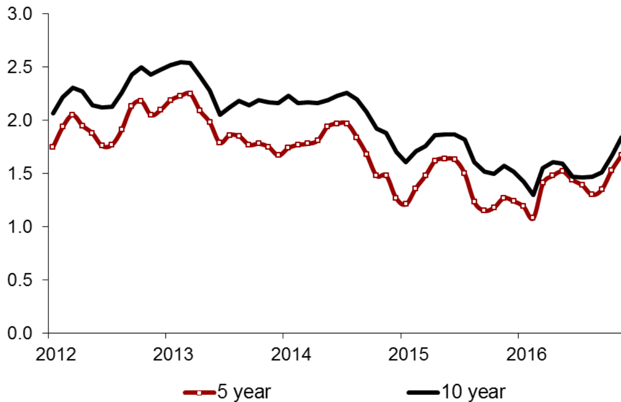
Current Values = average of last three trading days

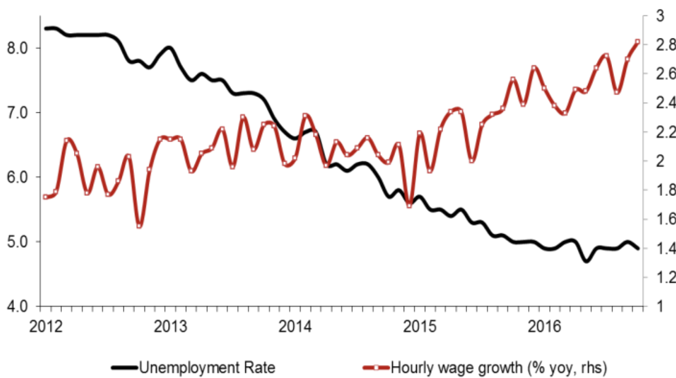
Markets will also remain encouraged by solid data from the euro area, where quickly rising sentiment indicators have proven fears of a strong economic fallout from the Brexit decision in June wrong. That said, hopes that fiscal expansion may substitute for monetary stimulus also in the euro area are prone for disappointment. A "No" vote in the Italian referendum on December 4 may add to political uncertainties in the euro area just ahead of a year rich of elections in major EU members, including France and Germany. The German government will refrain from fiscal thrift amid low unemployment and an election campaign heavily influenced by the Eurosceptic AfD party. At the same time, new fiscal measures by Southern European members would not only raise concerns about debt sustainability, but also increase intra-European tensions. In Europe, it will thus remain the ECB which will continue to bear the key responsibility of persistent policy stimulus – which the ECB is likely to deliver in December by prolonging its QE program beyond March 2017.

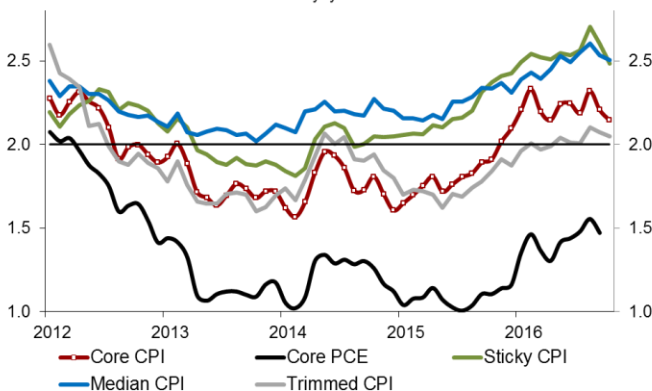
In this environment US yields are likely to trend higher while continued purchases by the ECB will keep a lid on Bund yields; Southern European bonds will prove sensitive to the outcome of the Italian referendum. Equities remain vulnerable to corrections amid further policy normalization by the Fed and an already sizeable premium on anticipated US fiscal stimulus. Overall, we still prefer a cautious allocation stance characterized by a below-benchmark weight on equities and a moderate overweight in European corporate bonds.

USA

Paolo Zanghieri







- **The outcome of the November election has fueled expectations of a large fiscal stimulus, lifting up equity and bond yields, even though several crucial details on the policies are still missing.**
- **Employment continues to grow and wages were up by 2.8% yoy in October. CPI inflation reached 1.6% due to stronger energy prices.**
- **The macroeconomic environment has become even more conductive to a Fed Fund rate increase in December. We continue to expect two hikes in 2017.**

Trump's victory and the Republican majority in the Congress have radically changed the outlook for fiscal policy. Expectations of lower taxes, higher infrastructure expenditure and a cut in regulation have led markets to price higher growth and inflation for 2017 and 2018, even though crucial details on how and when the stimulus will be delivered are still missing. We expect the new expansionary policy stance to affect the economy no earlier than in the second half of 2017.

In October headline inflation ticked up to 1.6%, as the fuel component recorded the first yoy increase since July 2014. Further pressures on the core rate are likely to come form the labor market, as evidence of tightening is piling up. Wages were up by 2.8% yoy, the largest increase in more than four years.

Fiscal boost to growth from H2 2017

Trump's economic plan features a large reduction in corporate and personal income tax, estimated, at face value of around 2.5% of GDP. This is to be complemented by tax credits aimed at incentivizing private spending in infrastructures. However, several economic and financial constraints make a full implementation unlikely. First of all, a large part of the Republican majority in the Congress is opposed to large increases in the federal deficit given the upward trend in debt forecast for the next years. Moreover, the Republicans would need a compromise with the Democrats in the Senate to pass any legislation which increases the deficit. This is likely to lead to a much reduced size of tax cuts and some public money spent directly on infrastructure. In terms of timing, we expect the President-elect to prioritize the fiscal boost over trade restrictions and curbs to immigration. Therefore, tax cuts will be decided and acted on in the second half of 2017, followed by the step up in infrastructure investment at the beginning of 2018. The bargain with Congress would yield a fiscal package worth just above 1% of GDP. Measures on trade and immigration would wait until mid-2018, and are likely to be less extreme than those proposed during the campaign.

USA

This will lead to reversal of the mild deceleration in growth we penciled in for the second half of next year, when growth will average 2.2%. The full impact of the measures will increase growth to 2.4% in 2018.

This also means higher inflation, but we do not expect any major pick up before mid-2018, when the surge in demand will fully impact an economy already running at, or slightly above potential. CPI inflation is set to increase from 2.2% in 2017 to at least 2.4% in 2018, as stated above. A quicker than expected implementation of trade restrictions (especially if enacted via higher tariffs) is clearly a major upside risk for inflation in the medium term.

New order data point to improving manufacturing

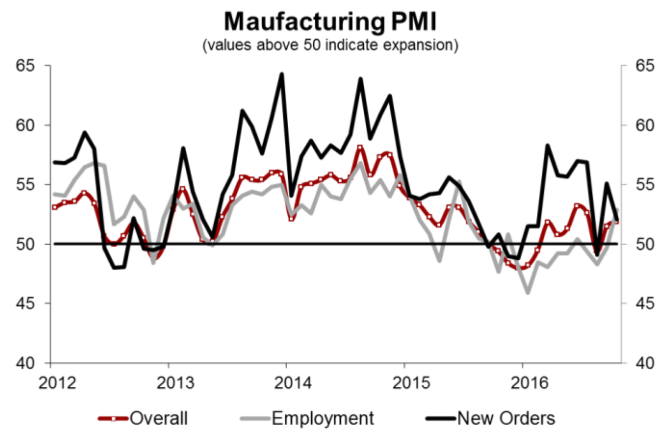
Meanwhile, the outlook for the manufacturing sector continues to improve. Excluding transportation equipment, new orders increased 1.0% mom. Core (nondefense, ex-aircraft) capital goods orders were up by 0.4% and shipments in the same category rose by 0.2%, consistent with an awaited pick up in investment in Q4. The ISM manufacturing PMI climbed to 52.9 in October, with a sharp increase in the new order component. The improvement reflects, to a large extent, the unwinding of the negative effect of the past dollar appreciation. Clearly this implies the possibility of a setback, should the post-election upward trend in the USD against most EM currencies prove long lived. Moreover, uncertainty on the new administration's trade and tax policies may weigh temporarily on capex in the first part of 2017.

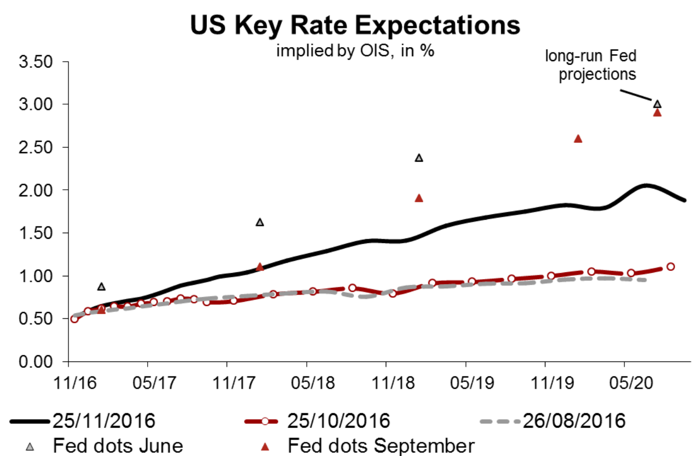
Consumption strength unabated

With the recovery in investment at its early stages and a few quarter before the fiscal stimulus, growth over the next quarters will continue to rely mostly on consumption. Data show that it remains resilient. In Q3 it grew by 2.1% annualized (2.6% yoy). Going forward, the tailwind from low oil prices will gradually fade, but consumption will remain strong, supported by the ongoing increase in labor income, complemented by positive wealth effects from record high stock prices and the recovery in housing prices bringing back households into positive equity. It is too early to say what role expectations can play. In November, consumer confidence increased markedly, but spikes are not uncommon in election months, as uncertainty related to the electoral campaign abates.

Rates to increase in December

A tight labor market, firming core inflation and the absence of any financial turbulence following Trump's election have further lifted the probability of a rate increase in the December meeting to above 90%. Moreover, the radical change to the outlook for medium term growth and inflation has led market to reprice the future path of monetary stabilization, with the forward curve steepening and getting closer to the one implied by the dots. Given our outlook for inflation, we maintain our call of two rate increases in 2017.



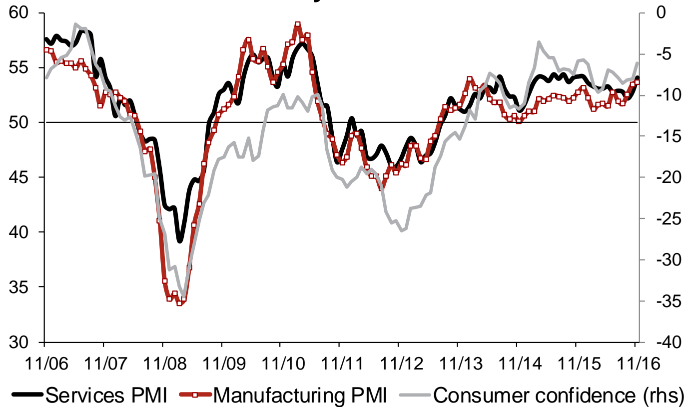


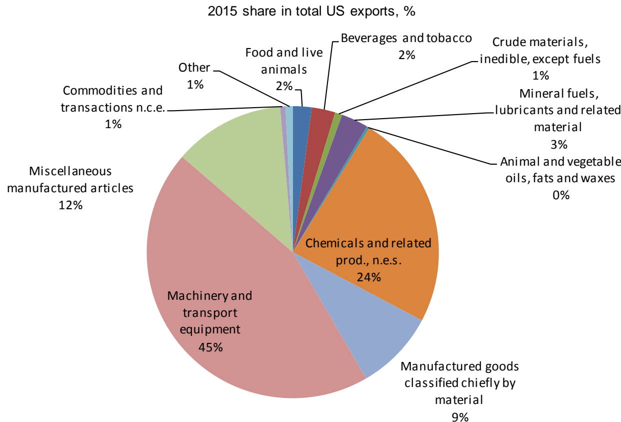
Main Forecasts[1)]	2014	2015	2016f	2017f
GDP	2.4	2.6	1.6	2.2
Consumer spending	2.7	3.1	2.8	2.6
Gov. consumption	-0.6	0.7	0.9	0.9
Investment	5.3	5.4	1.8	3.5
- residential inv.	1.8	8.9	7.8	4.8
- structures	8.1	-1.5	-2.3	3.4
- intell. property production	5.2	5.7	1.9	2.6
- equipment/software	5.8	3.1	0.4	3.4
Inventories	-0.0	0.4	-0.3	-0.1
Exports	3.4	1.1	2.7	4.1
Imports	3.8	4.9	4.2	4.9
Net trade	-0.2	-0.6	-0.3	-0.3
Domestic demand	2.5	3.2	2.3	2.4
Consumer prices	1.6	0.1	1.2	2.2
Unemployment rate[2)]	6.2	5.3	4.8	4.5
Budget balance[3)]	-2.8	-2.5	-2.9	-3.2
Fed Funds Rate[4)]	0.13	0.38	0.63	1.13

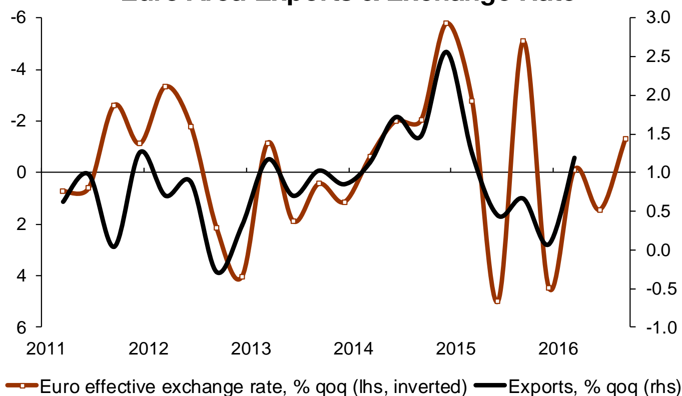
1) Unless noted otherwise, annual % changes, net trade and inventories: growth contribution to GDP 2) yearly average as %, 3) in terms of GDP, federal deficit 4) as %; year-end

Euro Area

Martin Wolburg







– **With the November composite PMI at the highest in 2016 activity stays firm in Q4 and we continue to expect solid growth.**

– **However, the Italian referendum outcome, forthcoming elections France and the Netherlands, as well as new US President, contribute to uncertainty.**

– **We expect the ECB to announce an extension of its QE program by another six months in December but then to start tapering.**

Weathering concerns firstly about the effects from the Brexit and, earlier this month, of a negative effect of the Trump victory on confidence, key euro area sentiment indicators continued to do very well. The November composite PMI surprised with a reading of 54.1 (from 53.3) again on the upside. Also, the forward-looking indicators are in line with ongoing solid activity.

The latest news flow fits very well with our view that euro area activity is largely domestically driven. With the labor market improvement continuing, financial conditions very favorable and even a mild support from fiscal policy, there is a high degree of resilience against shocks at the moment. Private loans were up by 2.0% yoy in October, a five-year high. Behind the improvement over the last months stand higher loans to non-financial corporates, an indication that investment activity is improving.

Trump victory adds to uncertainty

With the new US President-elect Trump coming into power, much depends on the effect of his actual policy on growth and trade. We expect US growth to be largely unaffected in 2017 and do not look for trade sanctions against Europe either (see part on the US). Exports to the US primarily comprise machinery and transport equipment, as well as chemicals. Exports to the US amounted 2.7% of euro area GDP in 2015 with Ireland (10.2%), Belgium (5.2%) and Germany (3.8%) being most exposed. Hence, if US growth surprises on the upside these countries will benefit in the first place. Moreover, depending on the policy Trump finally adopts the US dollar might stay strong or even strengthen (reflationary scenario) or weaken (protectionist scenario). As of late, the effective euro weakened. If the dollar strength were to prevail, it would offset some of the appreciation pressure stemming from the Brexit-induced weakening of the British Pound. All in all, given the high uncertainty surrounding US economic policy, the outlook for the euro area also became more uncertain.

Political woes ahead

That said, within the euro area, the Trump victory gave support to populist movements, thereby increasing the risk of short-sighted and nationalistic policies. Here, the forthcoming Italian constitutional referendum on

Euro Area

December 4 is of special importance. In case of a "No" vote – which according to polls is most likely – investors would become more skeptical about the further course of reforms in Italy and the implications for the euro area. Moreover, the final round of Presidential elections (Dec 4) in Austria is also a neck-and-neck race between a populist right-wing and a Green candidate. Looking into 2017, general elections in the Netherlands (March) and Presidential elections in France (April) will be a litmus test for the power of populism in Europe. In our base case we do not expect populists to come into power and be able to call referenda on EU-membership. That said, a risk is still given and it remains to be seen whether and how populism nevertheless impacts on decision making, especially on topics affecting the monetary union. All in all, these political uncertainties will be a major topic in the months to come impacting negatively on activity.

Growth outlook slightly up

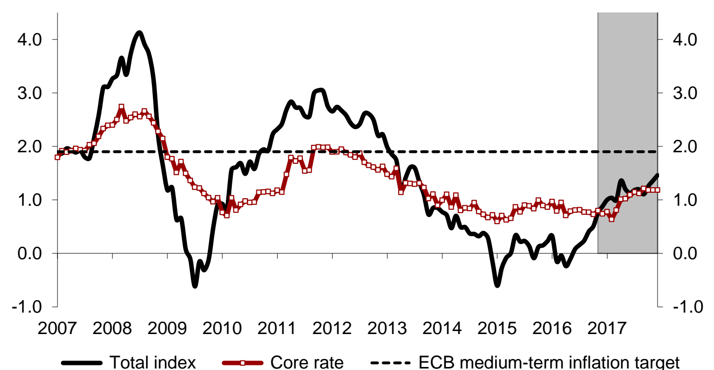
With Q3 2016 GDP up by 0.3% qoq and survey indications that the pace of growth remains undampened, the growth outlook remains solid. We deem the underlying domestic forces strong enough to weather the various uncertainties ahead. We revised our 2017 growth expectation slightly up to 1.3% (from 1.2%). The 2016 growth forecast of 1.6% was also slightly adjusted to the upside (from 1.5%).

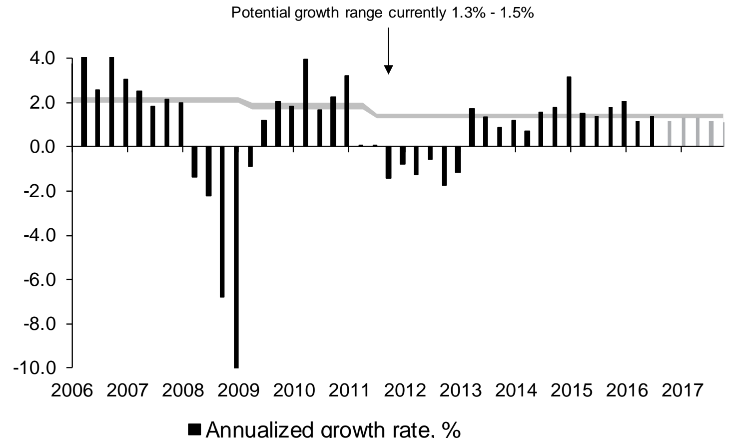
ECB to adjust APP and extend QE in December

With the energy price component of the CPI no longer being disinflationary, so that headline inflation will come close to 1% yoy towards year-end, inflation expectations up and solid growth ahead, the macro setting changed to the positive. However, to us, the ECB is still too optimistic on growth and underlying inflation. The current projection sees core inflation averaging 1.5% in 2018. The new projection will cover 2019 for the first time and we think that it will put core inflation on a lower trajectory. Additionally, we deem the ECB's annual growth expectations of 1.6% for 2017/18 too optimistic. Moreover, the ECB is aware that the current financing conditions reflect expectations that the extraordinary monetary policy support remains in place.

All in all, apart from the needed adjustment of the APP, we expect the ECB to announce an extension of its QE program by six month at the December 8 meeting. Given the recent good data flow we see the risk that the current volume of € 80 bn/month could be reduced. As it stands now, we expect the ECB to start reducing the volume of its monthly asset purchases from October 2017 onwards.

In as much as the above mentioned political risks in the end deteriorate the macro outlook or lead to severe systemic stress, the ECB will become more hesitant in indicating that tapering is ahead and might even stick longer to QE than otherwise.



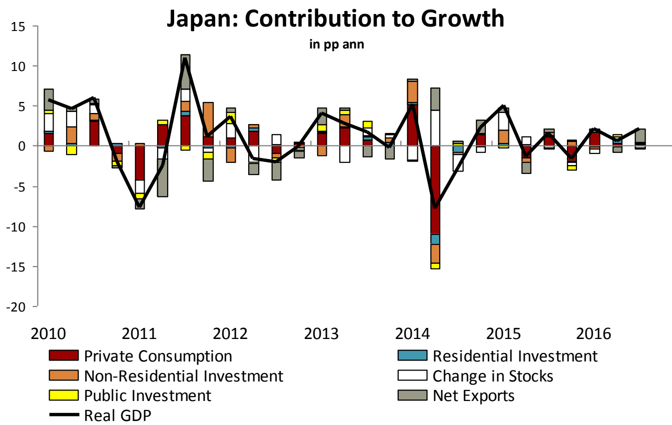


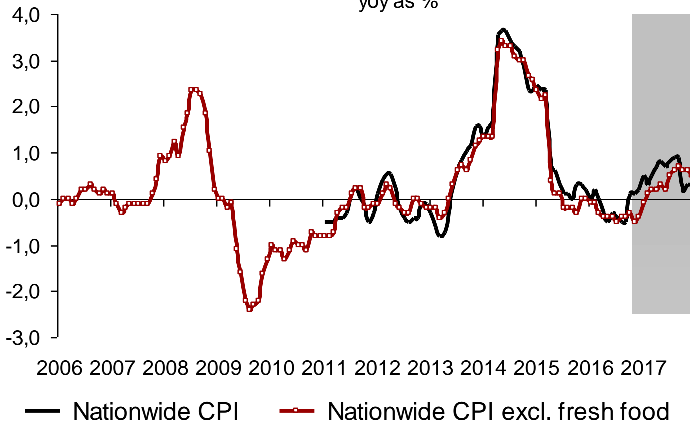
Main Forecasts[1)]	2014	2015	2016f	2017f
GDP	1.2	1.9	1.6	1.3
Consumer spending	0.8	1.8	1.6	1.1
Gov. consumption	0.6	1.4	1.6	0.7
Total fixed investment	1.4	2.9	2.9	1.5
Inventories	0.4	-0.2	0.0	0.1
Net trade	0.0	0.2	-0.1	0.1
Domestic demand	0.9	1.9	1.7	1.0
Consumer prices	0.4	0.0	0.2	1.3
Unemployment rate[2)]	12.0	11.6	10.1	10.0
Budget balance[3)]	-2.6	-2.1	-1.9	-1.7
ECB refi rate[4)]	0.25	0.05	0.00	0.00

1) unless noted otherwise, annual % change, net trade and inventories: growth contribution to GDP, 2) yearly average as %, 3) ratio of budget balance to nominal gdp, 4) as %; year-end

Japan

Christoph Siepmann





Main Forecasts[1)]	2014	2015	2016f	2017f
GDP	-0.1	0.6	0.6	0.8
Consumer spending	-1.0	-1.2	0.4	0.7
Government consumption	0.1	1.1	1.9	0.9
Investment	1.1	0.1	1.0	2.1
Inventories	0.1	0.4	-0.1	-0.1
Net trade	0.3	0.4	-0.1	-0.1
Domestic demand	-0.3	-0.5	0.8	0.9
Consumer prices	2.7	0.8	-0.2	0.6
Unemployment rate[2)]	3.6	3.4	3.1	3.0
Budget balance[3)]	-5.2	-5.2	-5.5	-5.5

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 Q3 growth surprised with 2.2% qoq ann. on the upside, but domestic demand stayed weak.**
- **The re-depreciation of the yen combined with base effects from the past oil price development should lead to a more positive inflation outlook.**
- **Accordingly, we expect the BoJ to stick to its current wait-and-see stance.**

According to the first print, Japan's GDP expanded by 0.5% qoq (2.2% ann.) in Q3 2016. However, the up-side surprise was almost entirely due to net exports. Exports rose by 2% qoq, on the back of improved demand for IT components from Asian countries while, imports diminished by 0.6% qoq at the same time. By contrast, domestic demand remained weak. Private consumption grew only by 0.1%, which was an unchanged pace from the previous quarter. More-over, private business investment also remained flat after two slightly negative quarters before. It was probably held back by the past strong appreciation of the yen and rising international uncertainties.

Apart from temporary fluctuations, real exports have been on a rather flat expansion path. Looking ahead, the announcement of US President-elect Trump to withdraw from the Trans-Pacific Partnership (TPP) does not bode well for international trade impulses; the recent strong re-depreciation of the yen against the US dollar should help to mitigate these factors. Furthermore, the lower yen should again benefit enterprise profits and may thus allow for higher wages, thereby restoring to some degree the central concept of Abenomics to re-inflate the Japanese economy. However, converting higher income into actual demand obviously remains challenging in Japan's ageing society. Nevertheless, support from the fiscal package will be felt more and more markedly from around the turn of the year. In sum, growth should likely outpace its low potential rate by around 0.5% yoy.

Monetary policy to remain on hold

The yen re-depreciation – if sustained – together with positive base effects from oil prices should also have an upside impact on inflation. In October, headline inflation rose to 0.1% yoy from -0.5% yoy in September, due to strongly increasing fresh food prices (11.5% yoy). Details show fresh (imported) vegetables and fruit prices to be the main reason for the jump, likely reflecting the currency depreciation. Core inflation ex fresh food remained at -0.4% yoy. However, the depreciation will gradually feed through the economy and then also be felt in the core measures. Against this backdrop, we currently see the BoJ to maintain its current wait-and-see stance.

China

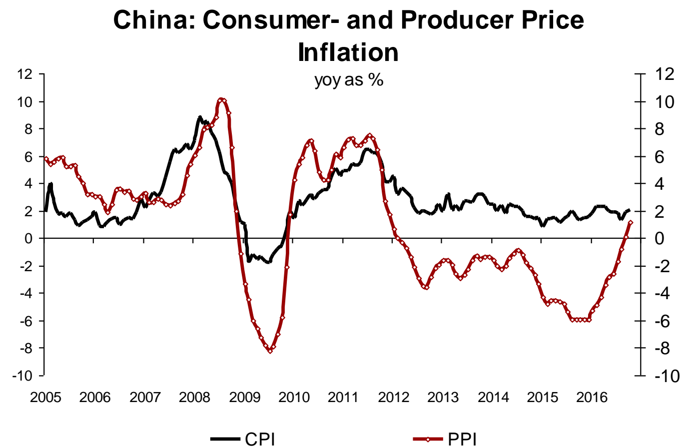
Christoph Siepmann

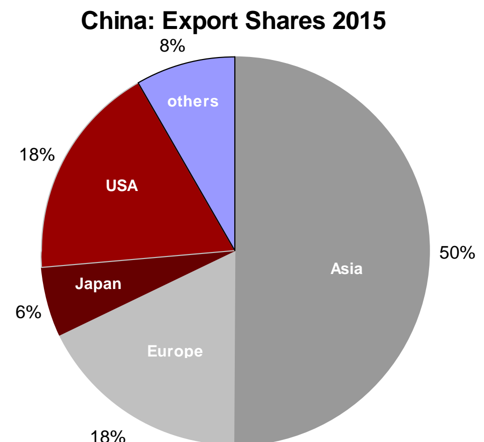
- **China's manufacturing PMIs surprised on the upside in November, suggesting the period of stable growth likely to go on over the coming months.**
- **Serious trade frictions between the US and China have become a considerable risk. However, we would expect Beijing to extend its policy support to mitigate their impact on growth.**

China's manufacturing PMIs surprised on the upside in November, both increasing to 51.2 index points from 50.1 before in the Caixin version and 50.4 in the official NBS measure. The upturn was in part driven by higher readings for the subcomponents of production and new orders, while new export orders fell again below the 50-index point line. However, the dominant contribution came again from the raw material purchase prices' sub-index which continued its strong upward trajectory, to a reading of now 62.2 index points. This development reflects the further increase of PPI inflation to 1.2% yoy, after a still strong deflation at the end of last year by about - 6.0% yoy. China announced of late that this year's capacity reduction targets in coal and steel had basically already been achieved (with illegal expansion and shifts in production to other idle capacities still a problem), which certainly - amid world market developments - contributed significantly to the end of the deflationary process in these sectors. The sector consolidation should also help to stabilize return on assets over the medium term. Furthermore, as the graph shows, PPI and CPI decoupled for quite some time, therefore we see the impact on CPI inflation as manageable for now. The PMI outlook of stable growth over the short-term was confirmed by industrial production (IP) and urban investment data. IP growth was unchanged at 6.1% yoy; urban investment even ticked up slightly to 6.3% yoy on a cumulative basis. As before, the real estate sector and government support contributed significantly.

Trade frictions could lead more domestic support

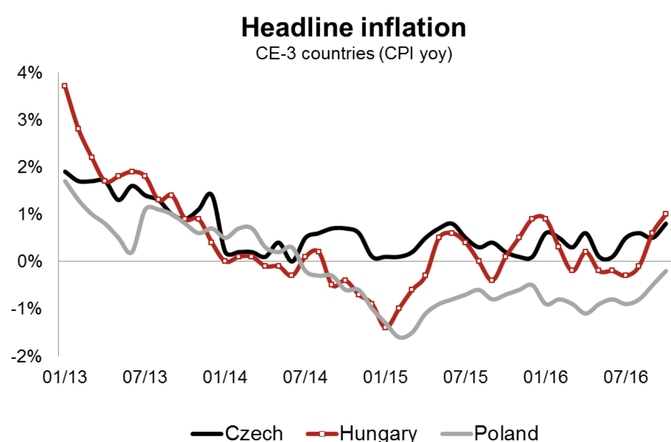
Although the current stability of China's growth is built on domestic (government) forces, additional headwinds to already weak exports would be clearly unwelcome. US President elect Trump has threatened China during his campaign with punitive tariffs. This could hurt China as it still has a sizeable trade surplus with the US. Beijing, in turn, already hinted at possible retaliation targets (Boing aircraft, I-Phones, soybeans) and to fight any case in the WTO. The risk of a trade war has clearly risen. Moreover, as IT exports involve subcomponents from around the region, restrictions to China could backfires within all of Asia. This would increase support for the China-led "Regional Comprehensive Economic Partnership" after Trump already announced to withdraw from TPP (from which China was excluded) and lead to less US influence in the region.





Central and Eastern Europe

Radomír Jáč



Main Forecasts	2015	2016f	2017f	2018f
Czech Republic				
GDP	4.6	2.3	2.0	2.6
Consumer prices	0.3	0.6	1.8	2.0
Central bank's key rate	0.05	0.05	0.05	0.05
Hungary				
GDP	2.9	1.8	2.7	2.5
Consumer prices	-0.1	0.4	2.1	2.7
Central bank's key rate	1.35	0.90	0.90	1.50
Poland				
GDP	3.6	2.5	3.0	3.0
Consumer prices	-0.9	-0.6	1.3	2.0
Central bank's key rate	1.50	1.50	1.50	1.75

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

- **Flash estimates for Q3 are pointing to weaker than expected GDP growth in the region. While this was caused by one-off factors, the outlook for the full-2016 growth should be revised down.**
- **Inflation recovers mainly due to the oil price, while core inflation is increasing only moderately.**
- **Czech CNB is the only central bank in the CE-3 region which sees inflation on target in 2017 and which plans to tighten monetary conditions.**

Data on economic activity provide a mixed picture. Growth slowed down in Q3 (the Czech Republic and Poland) or improved only marginally (Hungary), which still left the growth well behind central bank's forecast. While we believe that the Q3 performance was hit by an extra-ordinary mix of negative seasonal factors, other drivers were also at work since the start of the year. A weaker inflow of EU funds is related to the start of the EU's new financing period. Besides reducing public investment expenditures, it had a worse than expected impact also on private investment. While manufacturing PMIs indicate that growth momentum in the region may improve in Q4, the full 2016 GDP growth is likely to come below central banks' forecasts in all three CE-3 countries.

The weaker than expected GDP growth may be reflected by a somewhat slower increase in core inflation than projected by the central banks. On top of that, in their recently published forecasts, only the Czech CNB expects country's headline inflation to reach the 2% target on the monetary policy horizon (in mid-2017). The Hungarian central bank expects inflation to approach the 3% target only in late 2018, while the Polish NBP sees inflation well below the 2.5% target in both 2017 and 2018.

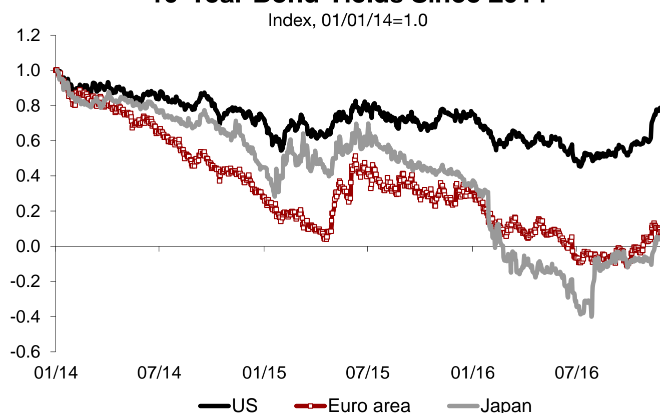
Czech central bankers will closely watch ECB's steps

Central banks' inflation projections mean that only the Czech CNB anticipates tighter monetary policy in 2017 via abolition of its FX commitment, likely in mid-2017 according to the CNB forecast. However, the CNB admits that assumptions of its forecast will change if the ECB extends its QE, as monetary conditions in the euro area are an important factor for the CNB policy outlook. The ECB's decision at the upcoming meeting on December 8 may thus significantly impact sentiment in the Czech market. The Hungarian MNB further reduced its O/N lending rate by 15 bps to 0.90%, and although it indicated that interest rates will most likely not fall further, it remains ready to ease its policy via non-conventional measures if needed. We think that adjustments in the 3-month deposit tender would be the first choice in such case. The Polish NBP kept its wait-and-see stance (with the key rate at 1.5%) and indicated that interest rate hikes are unlikely in 2017. The weaker than expected Q3 GDP data actually led to dovish remarks from several members of the Polish MPC. That said, we expect the NBP interest rates stable in 2017 with the first rate hike only in late 2018.

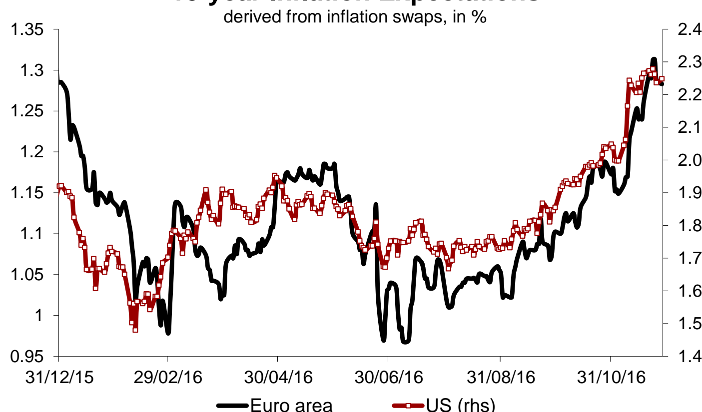
Bonds/Fixed Income Strategy

Florian Späte

- **In recent weeks, core government bond curves have bear steepened significantly. In the course of the unexpected victory of Donald Trump in the US elections inflation expectations have, in particular, increased strongly.**
- **Peripheral government bonds came under pressure and spreads widened considerably. The yield of long-dated Southern European bonds has reached the highest level since summer 2015.**
- **For the time being, we stick to our neutral duration allocation for core euro area government bonds. The looming Italian referendum and future political risks make us switch from a neutral duration to a short duration stance for peripheral bonds.**



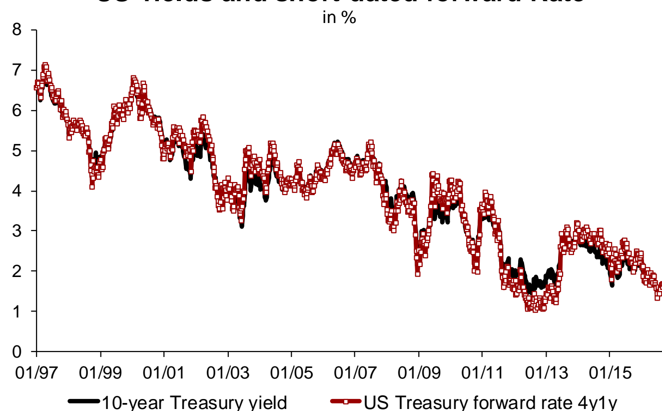
While the trend towards steeper yield curves in a bearish market environment on both sides of the Atlantic was established already in September, the tendency became more pronounced in November. Particularly after the surprising victory of Donald Trump in the US elections in combination with Republicans gaining a majority in Congress, bond markets sold off. Over the last two months the 2-year/10-year spread has increased by 40 bps in the US and by 42 bps in the euro area. The steepening was mainly driven by higher long-dated yields. 10-year US yields rose to 2.36% – the highest level since summer 2015 – and 10-year Bund yields increased to 0.26% – they even temporarily traded well above 0.30%.



Although real yields increased as well, the bulk of the higher nominal yield level is due to higher inflation expectations. Since summer, 10-year inflation expectations have risen by 60 bps and 25 bps in the US and in the euro area, respectively. The tendency sped up significantly after the US elections.

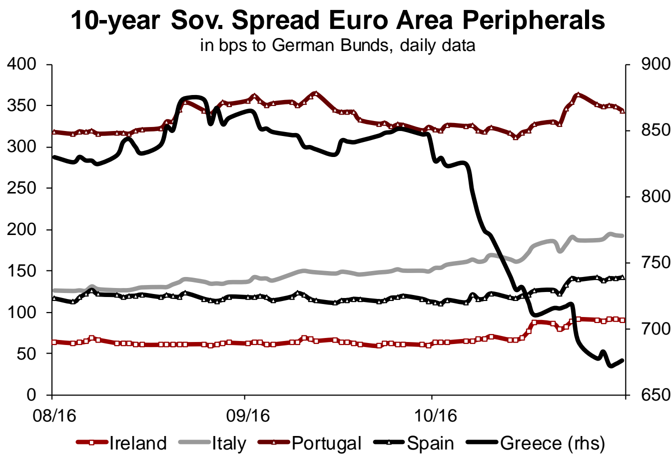
Trump's victory marks a regime shift for bond markets

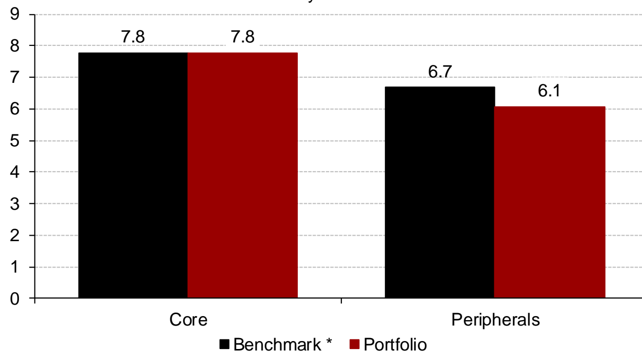
For a long time we have stressed that government bond yields are too low from a fundamental point of view. They remained on a very low level due to a disinflationary environment, subdued growth, low key rates and a negative term premium. Although these factors will not vanish completely and not in all countries, Trump's presidency is likely to trigger a sharp departure from the status quo. This is true in particular for the US, but to some extent this will spill over to other bond markets as well.



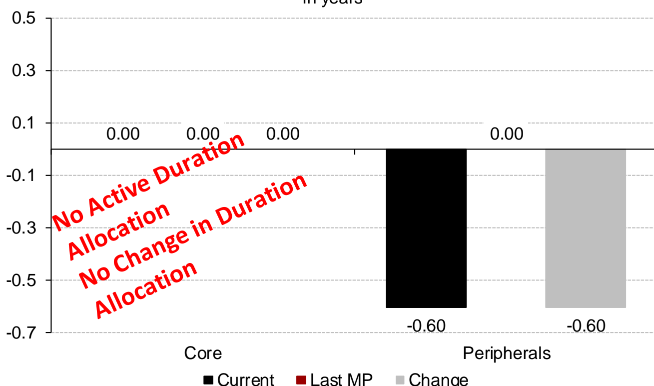
Notwithstanding a high level of uncertainty about the future political course of the new US administration, some main features are likely to be part of the new policy. First, the US will switch to a more expansionary fiscal policy with higher deficits. Second, Trump is expected to change the trade policy towards a more protectionist stance. Third, a more restrictive policy on immigration is expected to drive up wages – particularly wages of low skilled-workers. All these factors will trigger higher inflation rates. Moreover, the more expansionary fiscal policy in combination with a

Bonds/Fixed Income Strategy





* JPMorgan EMU Government Bond Index



higher debt level will increase the fiscal premium. As a result, the term premium, which was on a very low level or even in negative territory over the last years, is forecast to normalize. To sum up, the US is at the start of a lasting regime shift which is characterized by a higher yield level. While the short end of the curve is driven upwards by future key rate hikes, the long end will be impacted by the higher term premium and a less benign inflation environment.

However, US yields are unlikely to rise beyond measure. The short-dated forward rates point to a terminal key rate of around 2.5%. Hence, the leeway for long-dated yields to rise significantly more is limited and the bulk of the increase has probably already gone. We forecast 10-year US yields to rise to 2.4% on a 3-month horizon and to 2.7% on a 12-month horizon.

The described regime shift is likely to spill over to some extent to euro area bond markets. But, in the short term the likely rejection of the Italian referendum on December 4 and the expected extension of the ECB's QE program is forecast to offset any lasting increase in Bund yields. Hence, on a 3-month horizon euro area core yields can even drift downward slightly. Further down the road, the way is paved for a moderate increase in core yields. Not only the robust economic growth and the increasing inflation are likely to trigger higher yields, but also the looming tapering of the QE program in the course of 2017 is expected to contribute to a creeping up of euro area core yields.

Southern bonds under control of political uncertainty

Peripheral bond spreads have been widening since summer, but in November the pressure increased once more markedly. Particularly, Italian BTPs underperformed again in November. The 10-year BTP/Bund spread climbed to nearly 190 bps – the highest level since spring 2014.

Going forward, we see the risk of even higher spreads. According to current polls, a rejection of the Italian referendum is likely, which is forecast to trigger a further spread widening given the heightened political uncertainty and the situation of the banking sector. Although a loss of the investment grade rating is not on the cards, rating agencies would consider a further downgrade. However, a re-run of the 2011/12 crisis seems unlikely for the time being.

Our portfolios

We recommend a more cautious approach for peripheral bonds and shorten the duration by 0.6 years (from 0.0 years to -0.6 years). Therewith, we voice our concerns regarding the referendum and the likely market reaction. Although Italian BTPs are seen to be the hardest-hit bonds, the negative sentiment is forecast to spill over to other Southern European bond markets as well.

Corporate Bonds (Non-Financials)

Florian Späte

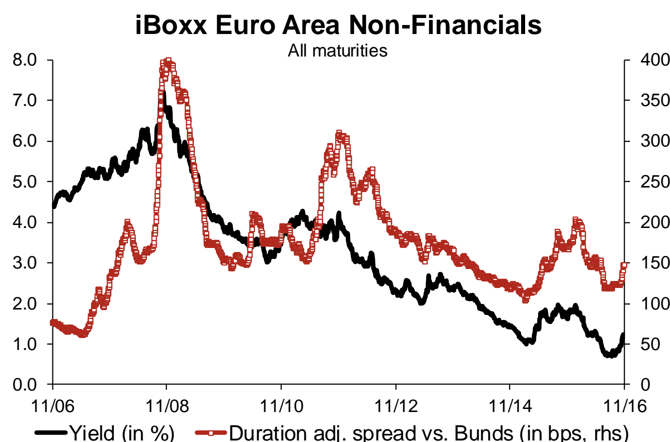
- **Non-financial corporates came under selling pressure in November. Without signs of recovery, non-financial spreads widened to 147 bps. As on balance underlying yields hardly changed, the non-financial yield level rose to 1.18%.**
- **We regard the political uncertainties in the euro area as the main reason for the weak performance of non-financials in November.**
- **Going forward, the Italian constitutional referendum can trigger a further widening, but ongoing ECB purchases and the benign default cycle are seen to gain the upper hand.**

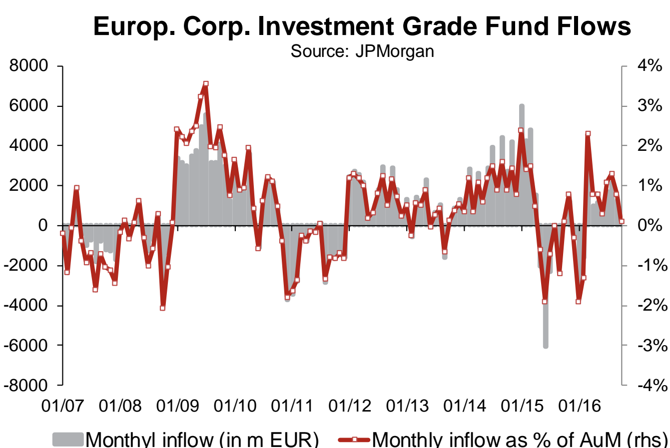
There was only one direction for non-financial spreads in November. They widened almost on a daily basis and gave up nearly all their gains of early summer when the Corporate Sector Purchase Program (CSPP) started. On balance, spreads widened by 24 bps to 147 bps. In the same period, the non-financial yield level rose from 0.94% to 1.18%. Temporarily, non-financials even yielded more than 1.2%, but decreasing underlying yields pulled down the non-financial yield level as well.

Non-financials burdened by political environment

We do not regard Trump's forthcoming presidency as the main reason for the weakness, but see the political uncertainty in the euro area – which is only to a limited extent triggered by Trump – as the driving factor. In the short term, there is a substantial risk that the Italian referendum will be rejected. This would destabilize the political scene in Italy, and even concerns about a new debt crisis could resurface. Moreover, there are several important elections in the euro area in 2017, including France and Germany. The rise in support of euro-sceptical parties in combination with concerns about the ECB's ability to keep a lid on Southern European government bond spreads resulted in a widening of non-financial spreads.

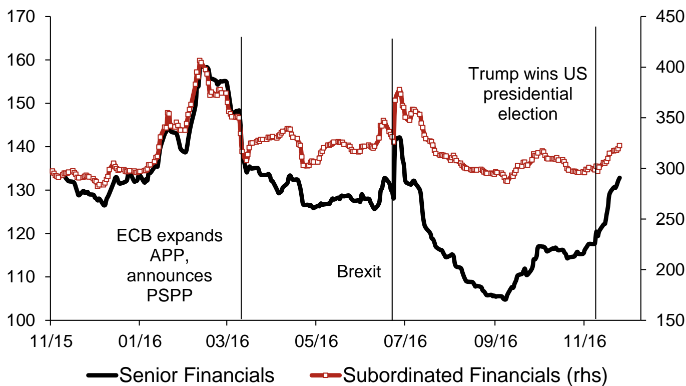
Hence, in case of a "No" vote in the forthcoming referendum a further spread widening is expected. However, a strong market reaction could be a good entry point as several other factors should support non-financials in the months to come. To start with, the ECB is expected to extend its QE program by at least six months. This implies that the central bank will continue its purchases of non-bank corporates in the course of 2017. Moreover, inflows slowed significantly in October (but remained in positive territory). This is likely to improve again towards the turn of the year. Finally, the recent default report by Moody's showed that the default rate in Europe has fallen further. At 2.3% the 12-month default rate is well below the historical average. Importantly, this is unlikely to change in the months to come. All in, notwithstanding some volatility in the course of the Italian referendum, we remain constructive on non-financials on a 3-month horizon.

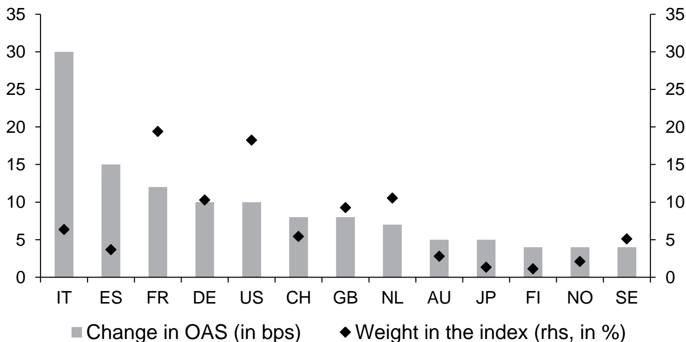


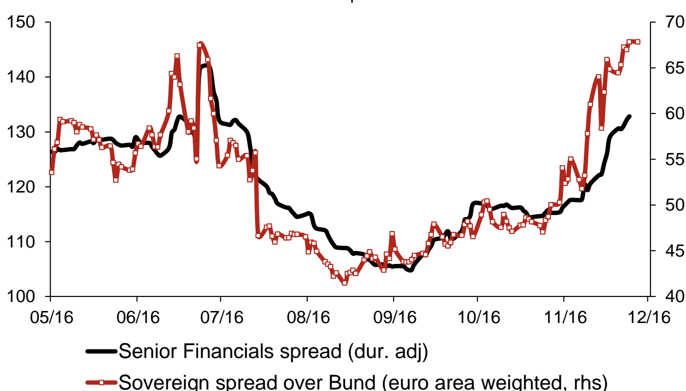


Corporate Bonds (Financials)

Luca Colussa







- **IG Senior Financial spreads widened significantly in November, with Italian and, to a lesser extent, Spanish and French names under pressure amid widening sovereign spreads.**
- **The Italian referendum represents a key source of risk in the short-term. A "No" victory will likely trigger a further widening in spreads as concerns on the Italian banking system would mount.**
- **That said, we remain slightly constructive on a 3-month horizon. The likely extension of ECB's QE, the appointment of a caretaker government in Italy (if "No" wins) and a re-tightening of the French spread should support Senior Financials.**

EUR-denominated Investment Grade (IG) Financial bond spreads widened markedly in November, albeit the sell-off more contained compared to Non-Financial bonds. The duration adjusted spread on Senior Financials rose 18 bps to 133 bps, while the one on Subordinated bonds increased by 26 bps. The negative month-to-date total return performance of Senior Financials (-0.57%) was partly offset by the decline in the underlying Bund yield, which had hit the highest level since May following Trump's victory before, falling 3 bps below the levels prevailing at end-October (-0.44% vs -0.41%).

Wider sovereign spreads hit Senior Financials too

The widening in Senior Financial spreads was mainly driven by a repricing of sovereign risk premia. The worst performers among Senior Financials were Italian, Spanish and French names (see graph in the middle), whose 10-year sovereign spreads over Bund widened by 35, 30 and 24 bps respectively. Concerns over Italian banks – which represents a share of just 6.4% in the IG index though – escalated ahead of the upcoming constitutional reform referendum (Dec 4), as opinion polls showed a stable lead for the "No" camp. Moreover, press reports over a series of defaults in the Italian banking system in case of the "No" victory have contributed to the recent underperformance.

If "No" camp wins, sell-off could offer a entry point

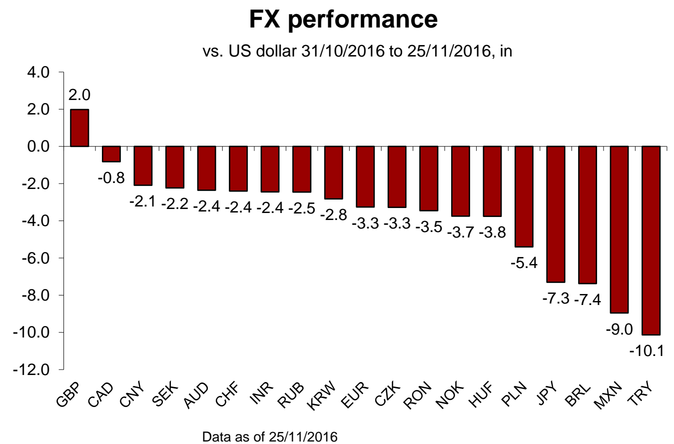
In the short-term, the Italian referendum will drive the performance of Senior Financials. Should the "No" win, a continuation in the sell-off and wider corporate spreads look likely. That said, the market may overreact to the news, offering an interesting entry point. Indeed, we expect a caretaker government to be rapidly appointed if the "No" prevails, thus easing the concerns over early elections and a rise of populist parties. In addition, we see leeway for lower OAT-Bund spreads, which should benefit French banks (20% of the index). Finally, the ECB will likely extend QE at the December meeting, easing the upward pressure on yields and supporting the total return performance over a 3-month horizon.

Currencies

Thomas Hempell

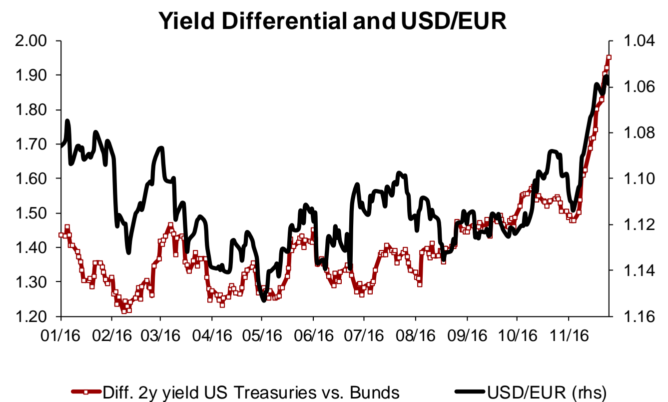
- **The US dollar has posted strong gains in the wake of the US elections on hopes of a stronger US fiscal stimulus and in anticipation of a continued normalization of US monetary policy.**
- **Looking ahead, we anticipate the EUR/USD to ease moderately further on monetary policy divergence and rising political concerns about Europe.**
- **Also the yen may ease further, with the yield targeting by the BoJ making the Japanese currency particularly sensitive to further increases in US yields.**
- **EM currencies are likely to remain under pressure, including some controlled further weakening in the CNY/USD.**

The outcome of the US elections left a strong mark on global FX markets. In the wake of the victory of Donald Trump, the US dollar rallied strongly against a broad set of currencies. EM currencies suffered the most owing to fears of trade restrictions and higher US rates, led by declines in the Turkish lira (TRY, -10%) and the Mexican peso (MXN, -9%). But also against other major currencies, the US dollar advanced further, with the euro falling by more than 4% and the yen even by almost 7%. Only the pound recovered, supported by financial links to the US economy but also the outlook of tax cuts in the UK.



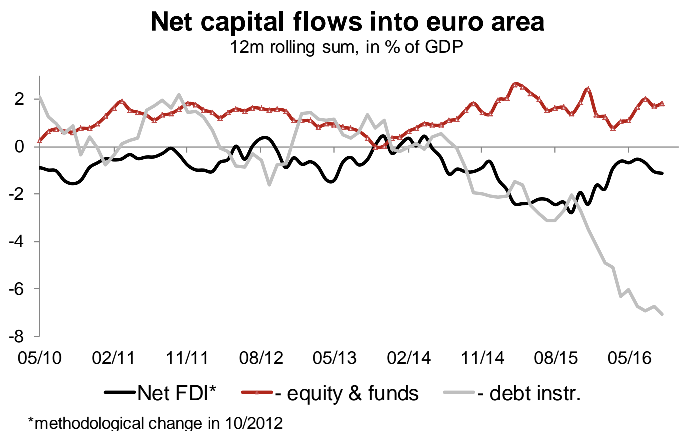
Further downside in EUR/USD near term

Despite the strong move already seen, we deem the outlook for the coming weeks tilted towards further US dollar strength, also against the single currency. The yield gap between the US and the euro area may yet widen a bit further on the divergent monetary policy outlook. The Fed will likely not only hike its key rate but also point to further monetary policy normalization in 2017. The ECB, by contrast, is on course to prolong its quantitative easing program to September 2017.

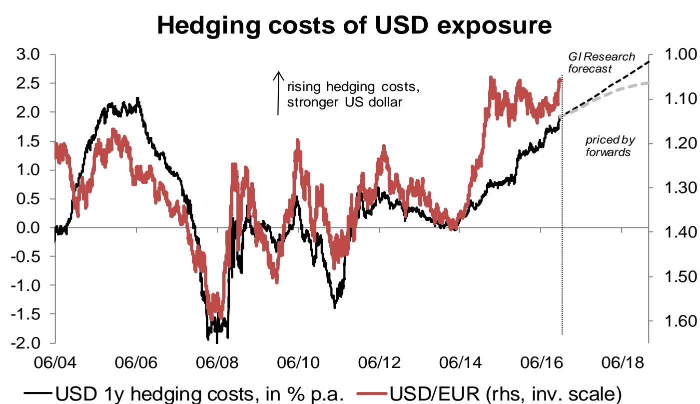


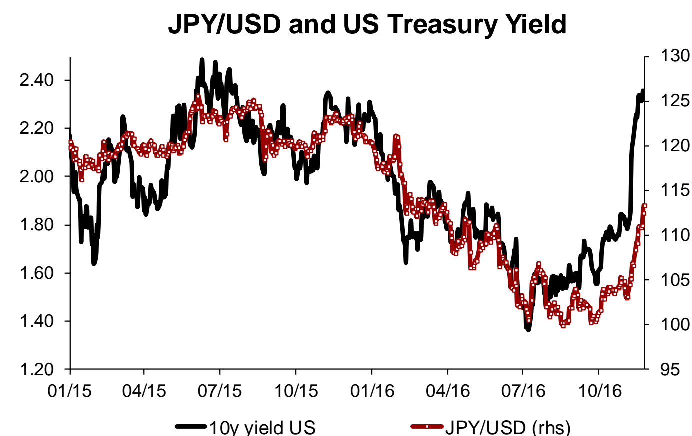
We also expect the euro to remain burdened by political uncertainties for a while. A key event will be the Italian constitutional referendum on Dec. 4. Polls point to a "No" vote, which would hurt the single currency on mounting concerns about the delivery of the needed further economic reforms, debt sustainability in Italy amid a still very subdued growth outlook and, most imminently, the ability to recapitalize ailing banks in Italy quickly. By contrast, a "Yes" outcome would be broadly supportive for the euro, but would unlikely be sufficient to pare recent losses against the US dollar.

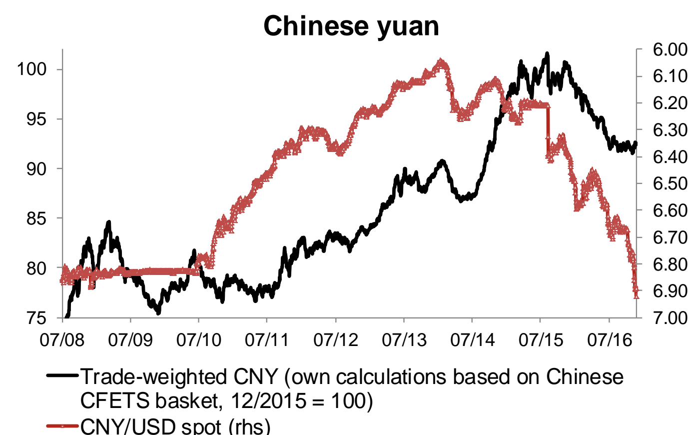
Finally, the euro area has seen massive net outflows of more than €700 bn (7% of GDP) in long-term debt over the twelve month to September (see chart). The relatively muted reaction in the euro to these outflows suggests that to a large extent these investments outside the euro area had been currency hedged, taking advantage of steeper yield curves abroad. Hedging costs on the US dollar,



Currencies







however, are set to continue to rise further from the 1.9% p.a. for 1-year contracts currently to well above 2% next year, owing to the prospective further gradual increase in US rates. This may induce investors to unwind parts of the hedges, adding to the support to the US dollar. Overall we thus expect the EUR/USD to weaken somewhat further before later, over the course of 2017, mounting talk about QE tapering by the ECB should help the euro to bottom.

Yen to remain burdened by rising US yields

The rise in the US dollar has been particularly pronounced against the Japanese yen. In fact, the yields of Japanese government bonds have increased only by less than 10 bps since the Trump elections, despite the big sell-off in US Treasuries. This is also due to the new policy by the BoJ, which now targets the level of yields, implying rising bond purchases when global yields tend to increase. As a result, the yen is currently particularly sensitive to moves in US yields. With the Fed continuing its gradual policy normalization and inflation rising further in the US, we anticipate some further yen weakness going into the next year.

Some further weakness in CNY/USD

Emerging markets currencies remain under selling pressures, with the threat of trade sanctions by the new US administration and tighter US monetary policy likely to prove a headwind over the coming weeks. Also the Chinese yuan weakened substantially further, even though presumed dollar sales by the PBoC prevented an even sharper depreciation. Since the US election, the CNY/USD has weakened by 1.5%, extending the losses since end-September to more than 3%.

However, this move has not been associated with financial market concerns about a looming sharp devaluation of the Chinese currency, as was the case in August last year and in January this year. The forward volatility of the CNY/USD – a gauge of depreciation fears – rose only moderately.

In fact, over time, the Chinese authorities have achieved to convince markets that the key target is not sharp depreciation of the yuan, but rather overall stability in the trade-weighted exchange rate, following a controlled weakening earlier this year (see lower chart). In fact, the trade-weighted value of the yuan has barely changed since early July, implying that the CNY/USD weakness seen over recent weeks is more a reflection of a stronger Greenback than a devaluated yuan. Looking ahead, we anticipate some further controlled weakness in the yuan to levels slightly above 7.00 CNY/USD over the next three months. However, the Chinese central bank will likely intervene on FX markets in case stronger headwinds to the yuan are building, in order to ward off self-enforcing depreciation pressures.

Equities

Michele Morganti

- **Trump's victory accelerated the rotation into value-cyclicals from expensive and defensive sectors and markets. This trend should continue.**
- **Short term, we remain cautious due to stretched US valuations, political risk in Europe and optimistic 2017 earnings estimates.**
- **We reiterate an overweight position on the euro area (on set-backs) and the FTSE 100, a neutral position on Japan and EMs and an underweight on US and Switzerland.**

Trump's victory generated both winners and losers. US equities outperformed (+4%) on expectations of future reflationary policies, which include lower taxes for corporates and infrastructure spending. On top of this, US economic momentum is accelerating (retail sales, the housing sector and finally improving orders' momentum) meaning that also the rebound of NIPA profits, which started at the end of 2015, could continue in Q4. On the contrary, EM bonds and equities (-5.5%) came under pressure due to a higher US dollar and US yields and increased chances of a Fed policy normalization. The threat to global trade coming from the announced Trump program added to worries.

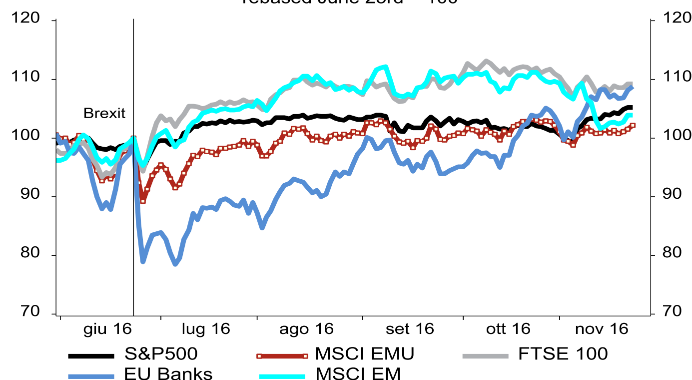
Japanese equities went up by 5.5%, due to a depreciating yen while the euro area (EA) performance was more subdued (-0.5%) as political uncertainty weighed on sentiment: the Italian referendum and the expectation of an European political impasse in general, which might last until the next German elections in autumn 2017. A possible victory of Mrs. Le Pen in France in spring 2017 could be seen as destabilizing.

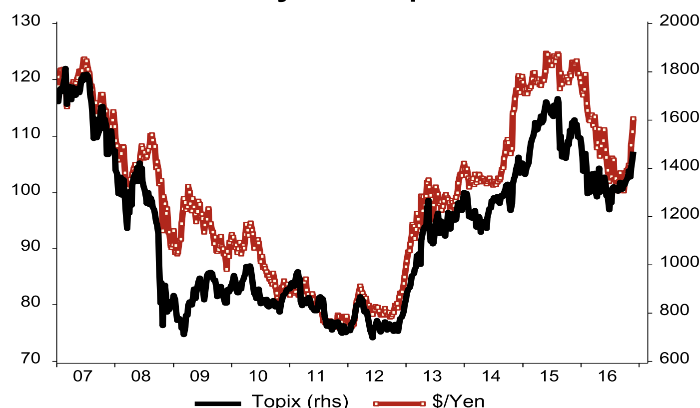
Trump's program favors the value-cyclical stocks

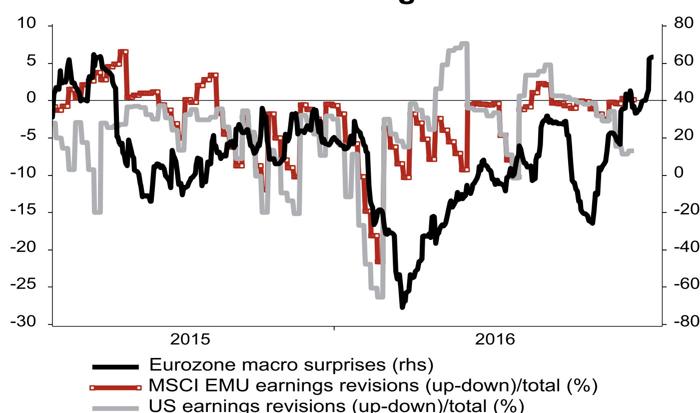
The current environment is characterized by an improved economic momentum, increasing yields and import prices, steeper yield curves and higher US inflation. As a consequence, the rotation inside the equity space has scope to continue: from expensive and defensive sectors and markets towards more value, cyclicals and financials. The Trump's election accelerated this process thanks to the expectation of a greater use of fiscal policy during his presidential mandate.

We expect a decent Q4 reporting season

Earnings revisions remain positive together with macro surprises worldwide. The Q3 reporting season confirmed the earnings rebound which started in Q2 (especially yoy growth). For the next reporting season we can expect the positive earnings' momentum to linger. In the US we should experience some positive effects coming from a resilient macro outlook, high commodity prices and increasing earnings forecasts for Financials (higher interest margins due to a steeper yield curve). Some drag could originate from the stronger dollar which could weigh on the most US export-oriented companies (negative guidance).

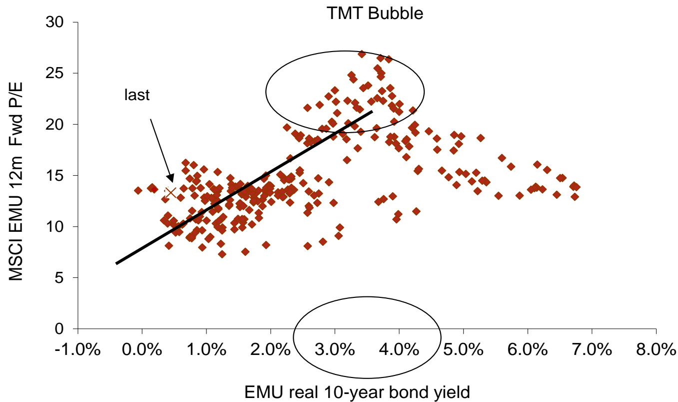






Equities

EMU PEs and Real Long Yields since 1993



Area	past earnings growth, p.a.	expected yoy growth 2017, GIE	expected yoy growth 2017, Consensus	difference * 2017
US	7.3%	1% - 4%	13.0%	-10.5 pp
Euro Area	4.4%	4% - 6%	13.1%	-8.1 pp
Japan	3.1%	5% - 7%	9.0%	-3.0 pp
EMs	9.6%	6% - 9%	13.2%	-5.7 pp

* Midpoint of GIE forecasts minus consensus

last available date: 25/11/16

Markets	PE		PB		PCF		DY		Avg.	Avg.
	12m f	Discount	12m f	Discount	12m f	Discount	12m f	Discount	Discount	Disc. (-1M)
USA	17.1	12.3	2.6	15.8	11.3	17.3	2.2	-0.1	11.4	8.5
JAPAN	14.5	-49.4	1.2	-5.8	7.5	7.5	2.2	14.8	-15.6	-21.1
UK	14.5	4.6	1.7	-6.7	8.5	9.0	4.2	7.2	-0.1	2.6
SWITZERLAND	15.7	2.7	2.1	-4.3	12.6	13.2	3.9	19.6	-2.0	-1.6
EMU	13.4	-5.5	1.4	-8.5	7.2	14.8	3.7	-5.1	1.5	3.1
FRANCE	13.9	-3.2	1.4	-7.6	7.9	19.2	3.7	-2.5	2.7	2.8
GERMANY	12.9	-15.1	1.5	4.4	8.0	23.8	3.2	-4.8	4.5	5.1
GREECE	14.5	13.7	1.6	0.6	7.5	29.2	3.0	-24.9	17.1	3.3
ITALY	11.3	-26.6	0.8	-31.2	4.2	-7.4	5.2	11.1	-19.1	-15.4
PORTUGAL	14.9	19.7	1.7	-4.1	6.0	2.8	4.8	6.4	3.0	10.9
SPAIN	12.4	-4.2	1.1	-34.5	4.6	-9.4	4.7	-8.7	-9.9	-4.9
EURO STOXX 50	13.2	0.1	1.4	-5.4	7.2	20.5	4.0	-7.1	5.6	7.2
STOXX SMALL	15.4	9.6	1.7	3.7	6.6	-17.0	3.1	-2.7	-0.2	0.2
EM, $	11.9	-18.6	1.4	-15.0	7.1	-6.9	2.8	-19.2	-5.3	-1.1
BRAZIL	13.3	51.7	1.4	-16.7	7.2	-51.0	3.4	-22.4	1.6	6.9
RUSSIA	5.9	-18.0	0.6	-31.7	3.8	-18.1	5.1	51.4	-29.8	-33.2
INDIA	16.2	13.8	2.5	-5.5	11.0	-3.6	1.7	7.0	-0.6	7.6
CHINA	11.8	-9.2	1.4	-20.4	7.5	-0.5	2.3	-25.3	-1.2	1.5

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.

In the EA, the macro momentum looks decent, too (albeit characterized by a lower growth path), and better than expected few months ago. The euro has started to weaken and both Financials and Energy companies could experience the continuation of the earnings estimates' uptrend after the deep trough seen in Q1. As for Japan, the huge negative pressure which came from the stronger yen should have come to an end. As a result, the worst momentum for the Japanese earnings is probably over. Valuations are not expensive and the index is a "cyclical" one; it therefore benefits from the above mentioned sector rotation. Finally, the Topix can enjoy a positive scarcity effect as EMs remain temporarily under pressure (we remain constructive mid-term, see next page), the euro area suffers from political uncertainty and US market valuations are relatively expensive.

Real yields not a threat yet for equity. US more at risk

The recent marked upward move in yields has started to reduce the valuation cushion of European and Japanese equities and, even more so, EM ones. However, real rates so far remain sufficiently low so that the price/earnings levels are not particularly affected by higher yields (in Europe and Japan). On the contrary, US equities can be more affected as their valuations look stretched. While an additional earnings acceleration could materialize only from the end of the next year (when Trump's plan starts to be implemented), the current consensus expectations are already quite high. Furthermore, wages and unit labor costs should continue to increase (lowering corporate margins) together with 10-year yields. Finally, the stronger dollar could have a negative impact, too. EA equities are in a different situation. While the political risk could represent a cap in the short term, we also see some positive factors. EA valuations are indeed cheaper (see table) and the index is more cyclical (having a higher presence of Financials, which are experiencing a partial relief of their structural negative trends). Furthermore, the euro is weakening and the ECB remains strongly on the dovish side.

In conclusion, we overall remain on the cautious side for the time being due to the US valuations, high consensus earnings forecasts, the European political uncertainty and the imminent Italian referendum. The economic and profit momentum looks decent, yields and yield curves are on the way up and fears of disinflation are receding. Therefore, we think that the rotation towards value cyclicals, Financials, Transportation and Pharma at the expense of staples should continue. Of course, such sectors also deserve a higher risk profile. We overweight cyclical markets and the UK (still expecting the pound to stay weak) at the expense of more defensive and expensive ones like the US and Switzerland. As to the EA, we would accumulate on setbacks triggered by policy uncertainty.

Emerging Markets Equities

Vladimir Oleinikov

- **We continue to be constructive mid-term on EMs, while remaining tactically neutral for the moment.**
- **Short term, higher yields and stronger dollar could continue to hurt. That said, stocks are cheap, and likely to benefit from stabilizing oil and commodity prices.**
- **We still favor Taiwan along with India, Korea, and smaller CEE countries.**

Over the last month, EM equities have fallen sharply by 6.8% in US dollar terms. The top performer was Greece (+12.2%), being followed by Russia (+5.8%) and Shanghai (+4.2%). The Indonesian and Indian markets have finished the race last (-9.1% and -7.5%). While the Greek market has benefitted from the significant decrease in key rates (-150 bps) and the positive surprise of the Q3 real GDP, the Russian market seems to benefit from pricing-in the end of sanctions on Russian energy and financials as a result of a Trump Presidency. The expectations of the launch of the Shenzhen Connect program have served as a catalyst for Chinese investors' increasing risk appetite towards small-caps.

Overall, EM 2017 earnings have been revised slightly down over the last month (-0.4%). The markets for which they have been upgraded are: Hungary (+2.4%), Mexico (+1.1%), Taiwan (+1.1%). The MSCI China's earnings have, on the other hand, been revised down by 2.3%.

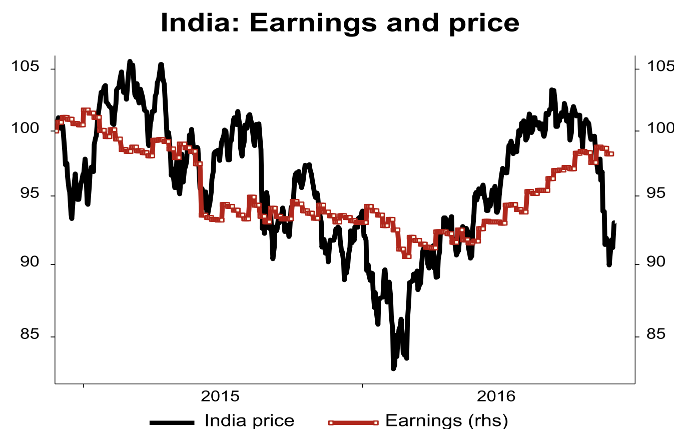
One of the major factors accounting for recent poor performance of EM stocks is the expectations of a Fed hike later in December of this year together with increasing 10-year rates, which caused the Emerging Market Bond Index spreads to widen. Pressures on global trade could also linger for a while. That said, we reckon the extent of the Fed hike's impact to be less pronounced than in 2013 as the situation with credit, oil and growth is in much better shape now. Looking ahead, the EMs should benefit from cheap valuations, improved macro fundamentals and stabilizing commodity prices.

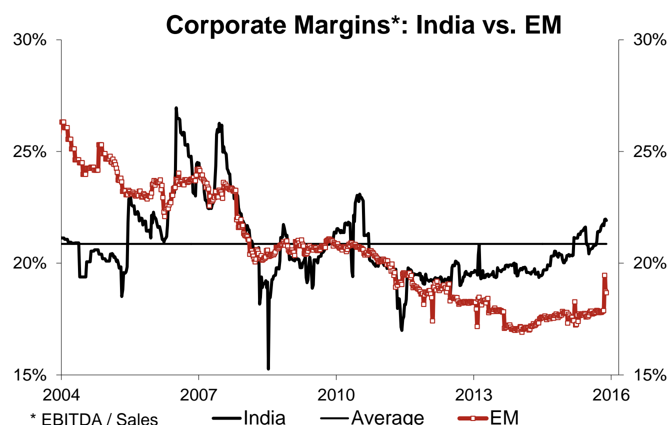
India: elevated political uncertainty

In order to fight corruption the Indian government has recently made a radical decision to demonetize the 500 and 1,000 rupee notes. This step, along with the announced a 200% penalty in addition to the tax levied on any unexplained income, has created some short-term uncertainty. The originally introduced tax rate of 90% was reduced to 60% only some days later, leading to an increase in political uncertainly. In our view, the recent setback of the Indian market presents a mid-term buying opportunity as both fundamentals and the monetary policy remain supportive along with higher corporate margins, as compared to the EM average. Coherently to this picture, the results of our models show an upside of around 7%.

Markets	price, %-chg		earnings, %-chg		10y yld	FX (TW), %-chg	
	-1M	YTD	-1M	YTD	chg, YTD	MTD	YTD
WORLD ($)	1.2	3.5	0.1	1.3			
US	3.3	8.3	0.6	3.5	10	**3.8**	4.1
EMU	-1.3	-4.9	1.0	0.0	-14	-1.3	1.7
GREECE	**12.2**	**-14.3**	**-1.7**	**-53.6**	-143	-1.3	1.7
CZECH REP.	-4.9	-7.1	**-1.5**	-18.9	1	-0.2	0.8
HUNGARY	0.6	24.7	**3.2**	**24.2**	-2	-0.6	2.7
POLAND	0.0	-3.9	0.5	-1.6	61	-2.7	-2.3
EM ($)	-6.8	7.8	**-1.9**	1.3	-82		
BRAZIL	-4.2	**36.8**	0.8	1.0	**-429**	-4.7	**20.6**
CHINA	-4.7	2.4	**-1.4**	-8.1	1	1.0	-5.7
INDIA	**-7.5**	-0.8	-0.1	5.6	-153	0.0	-0.9
INDONESIA	**-9.1**	6.9	0.9	6.2	-57	-0.4	3.6
KOREA	-2.2	6.4	1.5	9.2	10	0.4	2.2
MALAYSIA	-3.0	-2.8	0.1	-3.7	15	-3.3	-2.2
MEXICO	-5.3	5.2	**3.4**	8.3	**118**	**-7.3**	**-15.7**
RUSSIA	5.8	20.0	**-1.8**	6.4	-87	0.5	16.9
TAIWAN	-3.2	12.1	2.2	0.8	26	2.1	5.9
THAILAND	-1.7	18.7	0.0	0.3	15	1.6	2.5
TURKEY	-6.6	3.1	2.2	8.9	51	**-7.0**	-12.4
VIETNAM	-2.3	-3.5	2.6	4.4	-99	1.0	1.2
SHANGHAI	4.2	-7.8	1.1	-9.9	1	1.0	-5.7

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



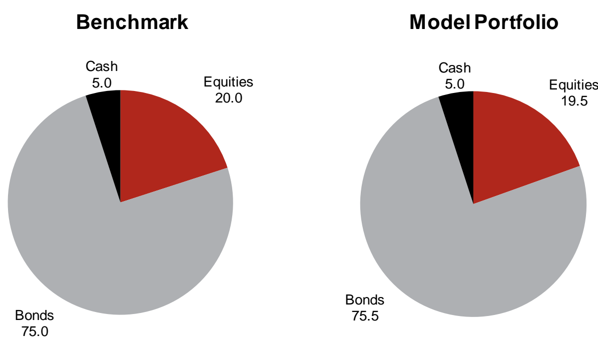


Mark to Market Allocation

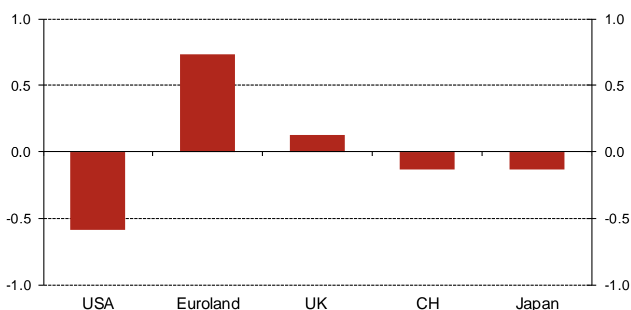
Thorsten Runde

Asset Class	Benchmark	Model Portfolio	Previous Allocation
Equities	***20.0***	***19.5***	***19.5***
Bonds	***75.0***	***75.5***	***76.0***
Cash	***5.0***	***5.0***	***4.4***
Equities, US	3.0	**2.8**	2.9
Equities, EMU	12.0	**11.9**	11.9
Equities, UK	2.0	**2.0**	2.0
Equities, Switzerland	1.0	**1.0**	0.9
Equities, Japan	2.0	**1.9**	1.9
Bonds, Gvt. US	11.3	**11.7**	11.5
Bonds, Gvt. EMU Core	27.0	**27.2**	27.1
Bonds, Gvt. EMU GIIPS	18.0	**17.8**	18.2
Bonds, Gvt. UK	7.5	**7.7**	7.7
Bonds, Gvt. Switzerland	3.8	**3.8**	3.8
Bonds, Gvt. Japan	7.5	**7.4**	7.7
Cash, Euro 3-Mth.	5.0	**5.0**	4.4

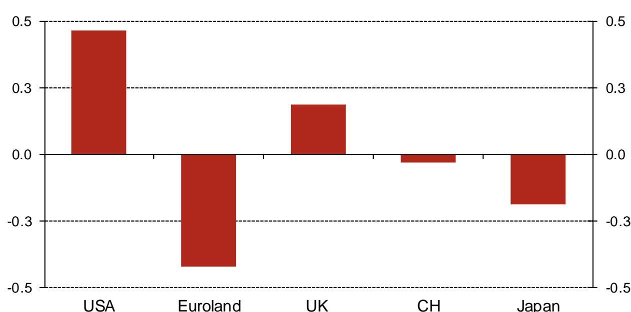
Asset Classes



Equities - Regional Structure



Bonds - Regional Structure



- **The development of equity markets was quite mixed in the course of November. While the US and Japan rallied, the performance of euro area equities has been flattish so far.**
- **In particular long-dated government bond yields have risen significantly in the aftermath of the US election, pushing the performance figures into negative territory throughout.**
- **With Italian bond strongly underperforming due to political concerns, euro area peripheral bonds turned out to be one of the worst performing asset class in our investment universe.**
- **Currently, the Italian constitutional referendum is imposing a lot of uncertainty to an appropriate tactical positioning.**
- **Looking forward, we continue to see risks for a setback on equity markets. Thus, we basically stick to our recommended allocation stance, primarily characterized by a moderate underweight in equities in favor of core government bonds.**

In the course of November, the performance picture painted by equity markets has been quite mixed so far. The US and Japan rallied with more than +4% and even more than +5% respectively. Thus, Japanese equities are once again clearly leading the return ranking in our investment universe. Euro area equities moved more or less sideways. Yields across all government bond markets of our asset universe continued rising, led by US Treasury yields fuelled by rising inflation expectations. Spreads on Southern European debt rose further, owing to concerns with respect to the Italian constitutional referendum.

Leeway for further rising yields in the US

A modest acceleration of US growth as well as rising inflation expectations provide leeway for US yields to rise further. The international yield connection can lift euro area yields as well. However, the low inflation rate and the forecast extension of the QE program are forecast to keep a lid on euro area yields. Southern European spreads are expected to widen, due to the uncertain outcome of the Italian constitutional referendum. Amid political risks and due to stretched valuations in the US, international equities remain exposed to setbacks.

Cautious active positioning still advisable

Under these conditions, we still deem a continued cautious active positioning advisable. The allocation stance is again characterized by a by a small tactical overweight in bonds at the expense of equities, particularly the US ones, where valuations are now even more stretched.

Forecast Tables

Growth

	2014	2015	2016f	2017f
US	2.4	2.6	1.6	2.2
Euro area	1.2	1.9	1.6	1.3
Germany	1.6	1.5	1.7	1.3
France	0.7	1.2	1.2	1.0
Italy	0.2	0.6	0.8	0.5
Non-EMU	2.9	2.4	2.1	1.5
UK	3.1	2.2	2.0	1.3
Switzerland	2.0	0.8	1.0	1.3
Japan	- 0.1	0.6	0.6	0.8
Asia ex Japan	6.4	6.1	6.1	5.9
China	7.3	6.9	6.7	6.3
Central/Eastern Europe	1.8	0.1	1.3	2.5
Latin America	0.6	- 0.6	- 1.4	0.9
World	**3.5**	**3.3**	**3.0**	**3.3**

Inflation

	2014	2015	2016f	2017f
US	1.6	0.1	1.2	2.2
Euro area	0.4	0.0	0.2	1.3
Germany	0.8	0.1	0.4	1.5
France	0.6	0.1	0.2	1.2
Italy	0.2	0.1	0.0	1.0
Non-EMU	1.2	0.1	0.8	2.7
UK	1.5	0.0	0.8	3.1
Switzerland	- 0.0	- 1.1	- 0.4	0.2
Japan	2.7	0.8	- 0.2	0.6
Asia ex Japan	3.3	2.4	2.8	2.9
China	2.0	1.4	2.1	2.0
Central/Eastern Europe	5.8	9.3	5.1	4.6
Latin America	5.1	6.2	6.3	4.8
World	**2.8**	**2.3**	**2.4**	**2.7**

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

Financial Markets

3-M Money Market Rates	**28.11.16***	**3M**	**6M**	**12M**
USA	0.93	1.25	1.35	1.60
EUR	-0.33	-0.35	-0.35	-0.35
JPN	-0.07	-0.05	-0.05	-0.05
UK	0.40	0.40	0.40	0.40
SWI	-0.75	-0.75	-0.75	-0.75
10-Year Bonds	**28.11.16***	**3M**	**6M**	**12M**
Treasuries	2.35	2.40	2.50	2.70
Bunds	0.23	0.20	0.35	0.50
BTPs	2.10	2.15	2.30	2.50
OATs	0.78	0.75	0.85	0.90
JGBs	0.03	0.00	0.00	0.00
Gilts	1.41	1.40	1.50	1.70
SWI	-0.18	-0.20	-0.15	-0.05
Spreads	**28.11.16***	**3M**	**6M**	**12M**
GIIPS	171	175	175	180
Covered Bonds	84	80	75	75

Corporate Bond Spreads	**28.11.16***	**3M**	**6M**	**12M**
IBOXX Non-Financial	147	140	140	145
IBOXX Sen-Financial	133	130	130	135
Forex	**28.11.16***	**3M**	**6M**	**12M**
USD/EUR	1.06	1.04	1.06	1.08
JPY/USD	113	114	115	117
JPY/EUR	119	119	122	126
USD/GBP	1.24	1.20	1.18	1.21
GBP/EUR	0.85	0.87	0.90	0.89
CHF/EUR	1.07	1.07	1.08	1.10
Equities	**28.11.16***	**3M**	**6M**	**12M**
S&P500	2207	2170	2170	2140
MSCI EMU	106.7	106.0	106.0	105.5
TOPIX	1465	1440	1440	1435
FTSE	6823	6760	6760	6715
SMI	7834	7720	7720	7655

*average of last three trading days

3-Months Horizon

Government Bonds	*10-Year Bunds*	0.17	0.20	0.23
	10-Year Treasuries	2.11	2.40	2.69
	10-Year JGBs	-0.01	0.00	0.01
	10-Year Gilts	1.14	1.40	1.66
	10-Year Bonds CH	-0.83	-0.20	0.43
Equities	*MSCI EMU*	99.1	106.0	112.9
	S&P500	2069	2170	2271
	TOPIX	1326	1440	1554
	FTSE 100	6413	6760	7107
	SMIC	7347	7720	8093
Currencies	*USD/EUR*	1.01	1.04	1.07
	JPY/USD	109	114	119
	GBP/EUR	0.84	0.87	0.90
	CHF/EUR	1.04	1.07	1.10

12-Months Horizon

Government Bonds	*10-Year Bunds*	0.43	0.50	0.57
	10-Year Treasuries	2.10	2.70	3.30
	10-Year JGBs	-0.04	0.00	0.04
	10-Year Gilts	1.25	1.70	2.15
	10-Year Bonds CH	-0.12	-0.05	0.02
Equities	*MSCI EMU*	91.9	105.5	119.1
	S&P500	1955	2140	2325
	TOPIX	1196	1435	1674
	FTSE 100	6081	6715	7349
	SMIC	6894	7655	8416
Currencies	*USD/EUR*	1.01	1.08	1.15
	JPY/USD	108	117	126
	GBP/EUR	0.84	0.89	0.94
	CHF/EUR	1.05	1.10	1.15

*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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