GENERALI INVESTMENTS

Market Perspectives

December 2017 / January 2018

Content

Global View

Thomas Hempell

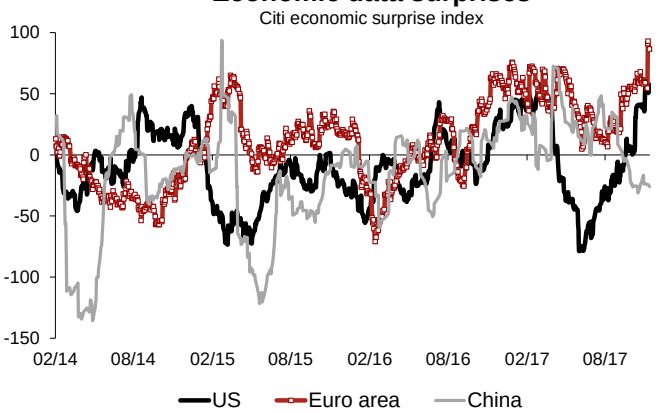
- **Strong economic data, especially for the euro zone, are likely to continue to underpin financial markets over the coming weeks, helping to navigate assets through political uncertainties.**
- **That said, economic surprises now look toppish. And just ahead of the likely next Fed rate hike in December, the recent rise in high-yield corporate spreads sends a warning signal for riskier asset classes.**
- **While still favoring a pro-risk tilt in the portfolios in anticipation of rising core yields, we recommend to scale back overexposure to equities and high yielding corporate bonds.**

Strong economic data remain a key support to the overall risk-friendly environment on financial markets. Activity in China has been softening somewhat, but there are no indications of a looming sharper slowdown. By contrast, activity in the advanced economies continues to power ahead. Strong readings of leading indicators in the euro area suggest that the economic expansion (+0.6% qoq in Q3) still has legs. The composite PMI for the region rose to its highest level since April 2011 and the widely watched German Ifo index even hit a new record in its almost 26-year history. Also in the US, data point to solid growth, with the consumer sentiment hitting a near 17-year high and capex intentions by firms pointing to strengthening investment.

Underpinned by these tailwinds, financial markets continued to weather political risks – lately emanating from failed coalition talks in Germany – very well in November. Global equities advanced further (MSCI World: +1.5%, as of Nov 28), even though euro area equities suffered from a rebound in the EUR/USD. Government bonds (both in core and Southern Europe) remained well bid, with the yields on 10y Bunds hovering around 0.35%.

Economic data surprises

Citi economic surprise index



That said, some data have sent warning signals, too. Coming from very tight levels, spreads on EUR high-yield bonds widened by more than 20 bps over the past weeks. At the same time, government bond yields in China have soared to levels close to 4%, up by nearly 40 bps since late September.

More challenging environment for risky assets

This nervousness in some market segments may extend somewhat further over the coming weeks. Macro data should continue to come in strong, but economic surprises look toppish. Furthermore, major central banks will proceed on their paths of gradual monetary policy normalization. The Fed is set to deliver its third rate hike this year on Dec. 13 and seems likely to proceed with its quarterly hikes also in the first half of next year, a scenario not fully embraced by markets yet. Furthermore, the ECB will half its monthly asset purchases to € 30 bn in January, while other central banks (such as in the UK, Canada, Czech Republic) have already started their tightening cycles. This means that the benign environment for risky asset will rest even more on favorable macro economic data. Following the strong positive data surprises from the past weeks (see chart), however, this will prove increasingly challenging.

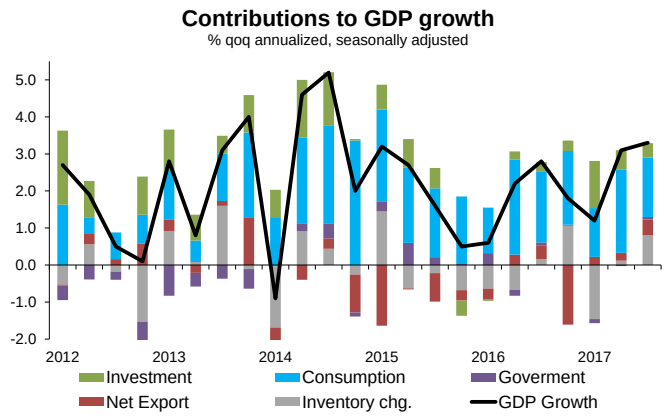
Bonds	**28/11/17***	**3M**	**6M**	**12M**
10-Year Treasuries	2.34	2.50	2.60	2.80
10-Year Bunds	0.35	0.50	0.70	0.90
Corporate Bonds				
IBOXX Corp. Non Fin	118	120	125	140
IBOXX Corp. Sen. Fin	105	115	120	120
Forex				
EUR/USD	1.19	1.16	1.16	1.22
USD/JPY	111	114	117	119
Equities				
S&P500	2610	2600	2590	2580
MSCI EMU	127.4	127.0	128.5	130.5

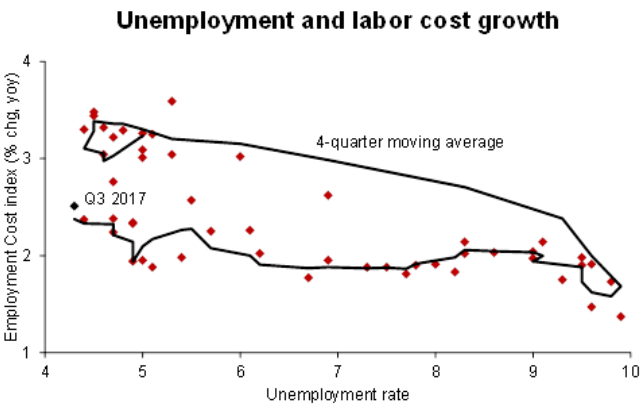
* avg. of last three trading days

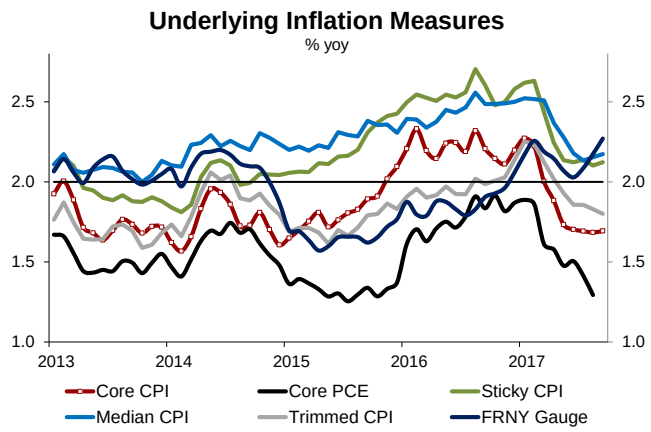
Against this backdrop, we recommend to further scale back active exposure to risky assets in the portfolios. We still see moderate value in a slight overexposure to equities and selected corporates, with safe fixed income segments likely to suffer from rising yields. But with risk sentiment in our view more vulnerable now, we favor a very prudent stance. We are also cautious on Southern European spreads ahead of the Dec 21 vote in Catalonia and general elections in Italy due at the latest by May 2018. We continue to favor European high-quality corporate bonds thanks to the higher carry, but are more cautious on high-yield corporate bonds. The EUR/USD has potential to post stronger gains next year. Near term, however, we still see the odds of another setback prevailing, which will offer the opportunity to further unwind existing USD exposure.

USA

Paolo Zanghieri







- **Strong Q3 growth is likely to have continued in the final quarter of the year, consistent with a 2.2% full-year forecast. Tax reform will likely lead to an a acceleration in 2018.**
- **The record low unemployment has just started feeding through inflation, which should increase towards 2% from the first quarter of 2018 onwards.**
- **The choice of Mr. Powell as new chair of the Fed will guarantee continuity in the current monetary policy stance. We confirm our view of a rate hike in December, followed by three more in 2018.**

After the better than expected 3.3% annualized growth posted in Q3, GDP has continued to expand steadily in Q4, as shown by the overall healthy evolution of sales, orders and the PMIs remaining well above 50. We therefore confirm our forecast of 2.2% growth for 2017. The speed and drivers of growth will remain broadly the same during at least the first half of 2018. A strong labor market will continue to support disposable income, limiting the adverse impact of higher inflation on purchasing power, while the pick up in profitability and favorable financial conditions will favor investment. The proposed tax reform will provide a marginal and temporary positive support, allowing growth to accelerate to 2.4% next year.

Tighter labor market starts showing up in labor costs

The labor market data for October were still influenced by the fallout of the late-August hurricanes. Nonfarm payrolls were up by 261k, thanks to the payback from a 18k increase in September, while hourly earnings growth stopped at 2.4% yoy, a correction from the strong 2.8% yoy of September. Q3 data for employment costs provide a less volatile picture. The employment cost index accelerated to 2.5% yoy, the second fastest increase since 2009. The acceleration of productivity growth to 1.5% yoy (from 1.2% in Q2) kept unit labor costs stable. Labor market tightening (the unemployment rate, at 4.1%, is at its lowest since Q1 2001) is eventually driving up wages, and this will feed through to core inflation.

Core inflation eventually picks up

October data, indeed, show that inflation has started to reverse more convincingly the weakness seen since Q2. Core inflation edged up to 1.8% after having remained stable at 1.7% for three months, staging a 2.4% three month annualized increase. Inflation gains were broad based, and occurred also in those sectors (like wireless communication and drugs) that were largely responsible for the slowdown in prices seen during the spring. We expect this process to gather speed over the next months, as indicated by the rebound in several measures of underlying price pressures. Moreover, stronger energy prices will contribute to both the headline rate and expected inflation. All this and the end of the negative base effects will push CPI inflation to above 2% by the end of Q1 2018.

USA

A heavy fiscal policy agenda

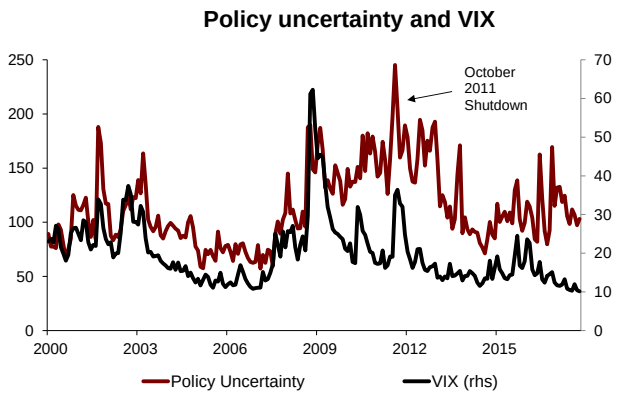
The first half of December will be important for fiscal policy. The bill passed in September extended government funding until December 8 and will have to be replaced in order to avoid a partial shutdown of federal government activities. The need of an agreement with the Democrats amid record high party polarization makes a quick deal difficult to reach. We think that a partial shutdown is possible, but a much more likely solution will be another short term extension of funding, until the Christmas break, followed by a longer term agreement including an increase in expenditure in areas favored by the opposition, such as Children Health Insurance. In case of a shutdown, looking at the 2011 experience we think that volatility may spike temporarily, but the economic fallout is likely to be limited, as long as funding is restored within a quarter or so.

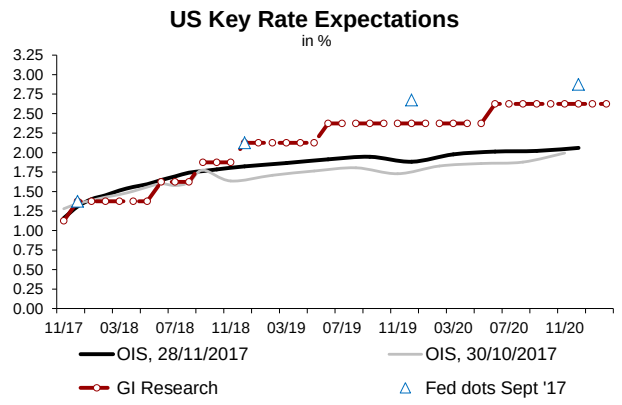
Anyway, discussion in the Congress on this issue will reduce the time available to proceed with the tax reform. The House of Representatives has approved a proposal later in November and a vote by the Senate is expected by mid-December, in time for the final draft to be approved by the whole Congress and signed into law by the President by the end of the year. A quick approval, however is far from a done deal, given the extremely small lead the Republicans have in the Congress and the disagreement some of them still have on key issues. We expect the negotiations to extend into Q1 and give a 80% probability of approval by the end of that quarter. The final version should feature a permanent reduction in the statutory tax rate on corporation and temporary (up to 10 years) measures on household taxation and capex expensing, providing a boost of at most 0.3% to GDP in 2018 and 2019 but no sizeable support to long term growth.

The Fed: new chairman, unchanged monetary policy

The latest development on inflation and the labor market, plus the further loosening in financial conditions are fully consistent with a 25bps rate increase during the December 12-13 meeting; markets assign to it a more than 90% probability. We also stick to our view of a gradual increase in rates during 2018.

In his statement before the Senate Banking Committee, Jerome Powel, the nominee Fed chairman to replace Janet Yellen from February 2018, highlighted the commitment to gradually increasing interest rate and reducing the Fed's balance sheet, confirming his alignment with his predecessor. On financial market regulation, he vowed to preserve the basic tenets of the current framework (strong liquidity and capitalization, stress test and resolution planning), but, in accordance with past statements he made, appeared open to easing regulation on banks, especially smaller and local ones.



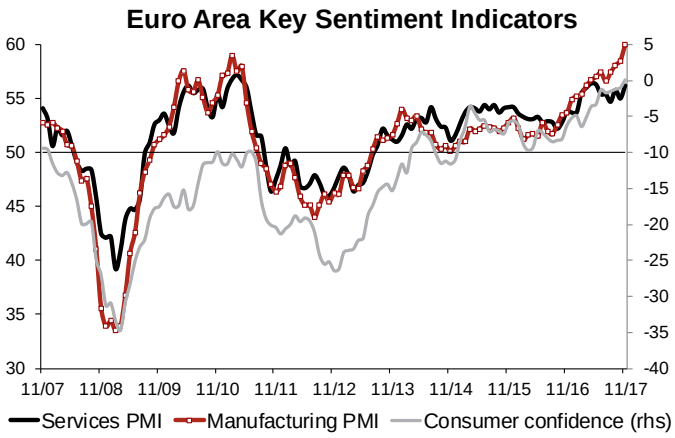


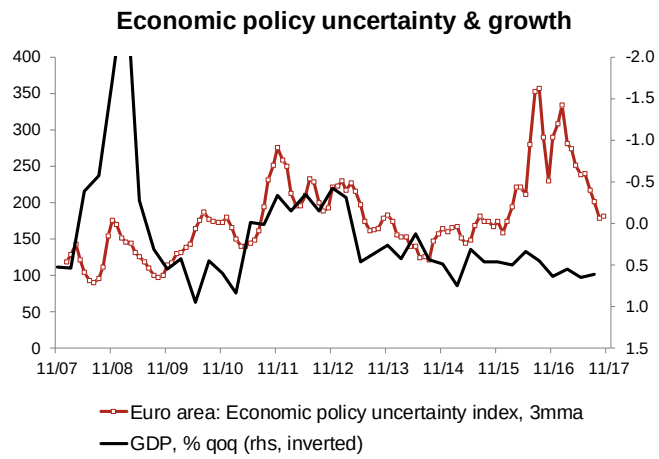
Main Forecasts[1)]	2015	2016	2017f	2018f
GDP	2.9	1.5	2.2	2.4
Consumer spending	3.1	2.8	2.6	2.4
Gov. consumption	0.7	0.9	0.8	1.2
Investment	5.4	1.8	5.1	4.4
- residential inv.	8.9	7.8	5.7	4.9
- structures	-1.5	-2.3	4.9	4.8
- intell. property production	5.7	1.9	4.6	4.3
- equipment/software	3.1	0.4	5.2	4.1
Inventories	0.4	-0.3	-0.1	0.3
Exports	1.1	2.7	4.6	4.8
Imports	4.9	4.2	5.2	5.0
Net trade	-0.6	-0.3	-0.3	-0.3
Domestic demand	3.2	2.3	2.7	2.6
Consumer prices	0.1	1.3	2.1	2.2
Unemployment rate[2)]	5.3	4.8	4.4	3.9
Budget balance[3)]	-2.5	-2.9	-3.3	-4.3
Fed Funds Rate[4)]	0.38	0.66	1.41	2.16

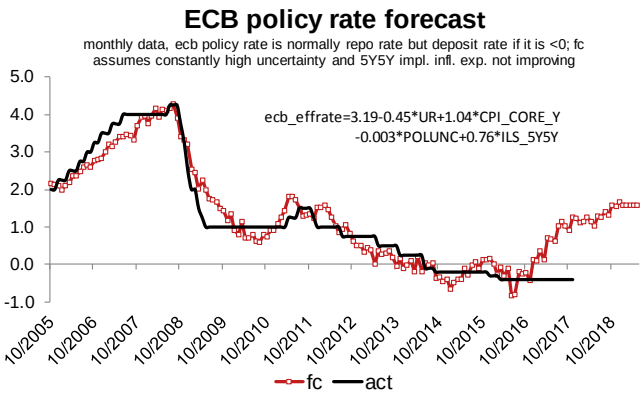
1) Unless noted otherwise, annual % changes, net trade and inventories: growth contribution to GDP 2) yearly average as %, 3) in terms of GDP, federal deficit 4) as %; year-end

Euro Area

Martin Wolburg







- **The November flash PMI soared to the highest level since April 2011 implying undampened growth at the end of the year.**
- **Headline inflation was at 1.5% yoy in November and we see underlying inflation recovering more meaningfully in the months to come.**
- **The good macro outlook is in line with the ECB's QE exit plans confirming us in our view that an QE extension beyond September 2018 is unlikely.**

The prospects for the euro area recovery remain bright. The release of the Q3 GDP showed growth of 0.6% qoq, only marginally lower than the quarter before. What is even more, the November composite flash PMI soared to the highest level since April 2011. It's reading of 57.5 is 1.4 standard deviation above average.

Moreover, looking below the surface the latest PMI release exhibits two encouraging observations. First, we previously expressed our concerns that the appreciation of the (effective) euro seen from May to August might dampen exports. This was not the case as the subcomponent new export orders trended up and even reached an all-time high as of late. The latest reversal of the euro appreciation might have helped (Sep/Nov -0.5%) but in the first place, it mirrors the strength of the global upswing.

Second, PMI sentiment improved across countries. It advanced most strongly in France where it jumped to the highest reading since May 2011 (from 57.4 to 60.1) and also improved significantly in Germany (from 56.6 to 57.6). The forward-looking new order component was more than one standard deviation above average in both economies implying strong activity in both of the largest two euro area economies in the months to come. The PMI readings also imply that in Italy, Spain and Ireland (no release so far) sentiment also advanced on average. Hence, the recovery will remain broad-based.

Recovery firm enough to weather political risks

That said, as of late a new political risk emerged. The bust of the German coalition talks among conservatives, greens and liberals came as a surprise with the future road to government formation still uncertain. Relevant alternatives are a relaunch of the grand coalition, a minority government or snap elections. In any case, we expect no quick fix of the issue and see it lasting until well into Q1/2018. Moreover, there will be general elections in Italy, most likely around March. Polls show that there is a risk of eurosceptic parties gaining the majority. All in all, political uncertainty will likely increase in the months to come. However, activity has largely proven resilient as of late (see mid-chart). Looking ahead, we view the fundamentals of the recovery as strong enough to remain largely unimpressed by higher political uncertainty.

Euro Area

Euro area growth outlook improved further

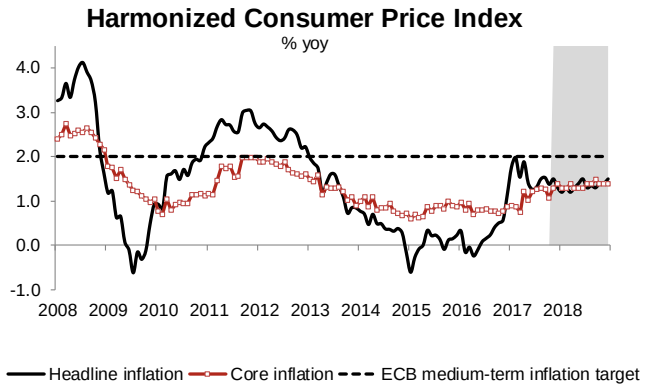
With growth expected to average 0.6% qoq also in Q4, the 2017 growth rate will likely be be at 2.3%. Looking into 2018, we envisage a continuation of the favourable macro situation characterized by strong employment as well as investment driving domestic demand in an environment of supportive global growth and still highly accommodative monetary policy. Therefore, we deem it most likely that quarterly growth of around 0.5% qoq will be maintained over the whole year lifting our annual growth outlook to 2.1% (from 1.9% before).

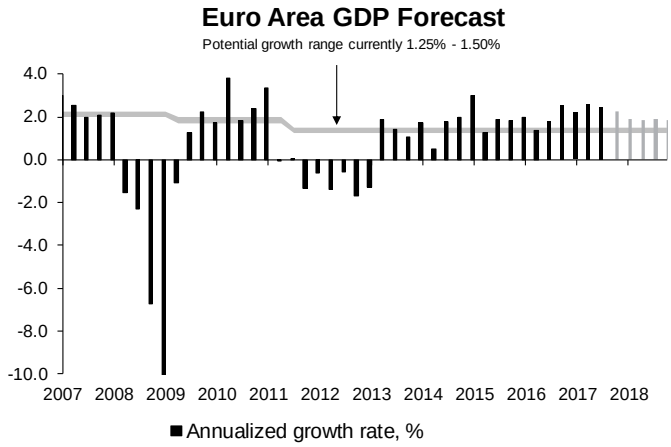
Underlying inflation to trend higher

The year 2017 will be the fourth consecutive one with euro area growth above potential (which we see in the 1.25% to 1.5% range). According to calculations by the European Commssion (EC) and the IMF 2018 will be the year in which actual output catches up with potential output. As the closing of the output gap marks the transition out of capacity underutilization, it also alters the fundamentals for inflation. With no slack in the economy any longer, an increase in production will more swiftly go hand in hand with higher prices. The core PPI (ex energy) was already at 2.2% yoy in September and in the PMI survey rising input prices led to lower margins as of late suggesting the need for firms to also increase output prices further. A wild card remains the (euro denominated) oil price development which could prove disinflationary next year. What is crucial for underlying inflation to lastingly trend higher is wage growth. Wages per employee are currently expanding by 1.6% yoy. While we see potential for wages to rise, the current unemployment rate of 8.9% is still above the equilibrium level which the EC sees at 8.4% for 2018. All in all, we expect underlying inflation to increase from its November flash reading of 1.1% yoy slowly towards 1 ½ % yoy at the end of next year.

ECB to go into hibernation until well into 2018

The growth and inflation outlook will confirm the ECB in its decision to half its monthly QE purchases from January onwards to € 30bn. If contrast, we see leeway for the ECB to lift its 2018 growth (+1.8%) and inflation (+1.2%) outlook. Still, we do not expect the ECB to change its rhetoric and to maintain a cautiously optimistic tone with a dovish tilt. In previous press conferences President Draghi had emphasized the importance of wage increases for underlying inflation to go sustainably higher. A repitition of this message at the December 7 meeting appears very likely to us. We foresee the ECB to adopt a wait-and-see policy stance for the time being and to seriously enter the discussion about the further course of monetary policy in mid-2018. We deem it most likely that QE will not be extended beyond September 2018 and that a first repo rate hike is not the cards before September 2019.



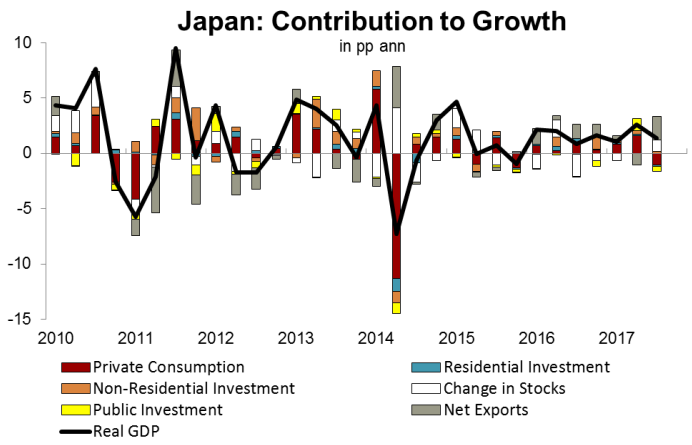


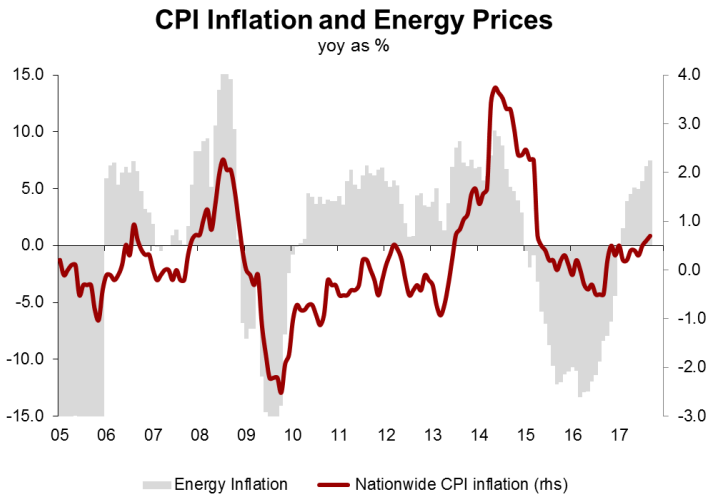
Main Forecasts[1)]	2015	2016	2017f	2018f
GDP	2.0	1.8	2.3	2.1
Consumer spending	1.8	2.0	1.8	1.8
Gov. consumption	1.3	1.7	1.2	1.1
Total fixed investment	3.0	4.5	3.9	4.2
Inventories	0.0	-0.1	0.0	0.1
Net trade	0.1	-0.4	0.3	0.0
Domestic demand	1.9	2.3	2.0	2.0
Consumer prices	0.0	0.2	1.5	1.3
Unemployment rate[2)]	10.9	10.0	9.1	8.6
Budget balance[3)]	-2.1	-1.7	-1.2	-0.9
ECB refi rate[4)]	0.25	0.00	0.00	0.00

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

Japan

Christoph Siepmann





Main Forecasts[1)]	2015	2016	2017f	2018f
GDP	1.2	1.0	1.5	1.3
Consumer spending	-0.4	0.4	1.1	0.8
Government consumption	1.6	1.5	0.3	0.9
Investment	0.1	1.0	2.5	1.7
Inventories	0.4	-0.1	-0.3	0.2
Net trade	0.4	0.1	0.6	0.3
Domestic demand	0.7	1.0	1.2	0.9
Consumer prices	0.8	-0.1	0.4	0.7
Unemployment rate[2)]	3.4	3.1	2.8	2.7
Budget balance[3)]	-5.2	-4.8	-3.9	-3.3

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

- **According to the first estimate, Japan's Q3 GDP growth came in at 1.4% qoq ann., broadly in line with market expectations.**
- **Monthly data were a bit more mixed of late, but still support the view of solid growth to continue.**
- **Core inflation (ex fresh food) will likely stay near 0.8% yoy over the next months, but inflation ex food and energy remains rather low.**

Japan's statistical office published in mid-November its first estimate of Japan's GDP growth in Q3. It came in at 1.4% qoq annualized, broadly in line with the consensus forecast. As expected, private consumption saw a strong drop by 1.8% qoq ann., basically due to a payback effect from a buoyant rise by 2.8% qoq ann. in Q2. Accordingly, the contribution from private demand to GDP growth was also substantially negative as private investment growth disappointed again while public investment dropped from last quarter's high. However, exports recovered from the slight decrease in Q2 while imports saw the opposite effect, resulting in a large positive contribution from net trade. On top, inventories built up substantially, supporting GDP growth by 1.1 pp.

With regard to the latest monthly data, the November manufacturing flash PMIs rose to the highest level since late 2013. Forward looking subcomponents like new orders and new export orders also sped up, which bodes well for Q4. However, real activity data have been more mixed of late. Real exports dropped by 5.4% mom in September, but rose back by 2.6% mom in October. Volatility on the import side was less strong. Nevertheless, we expect exports to keep a mild uptrend in Q4 on average and to contribute (although less) positively to GDP growth in Q4. This will also have a positive impact on investment, but so far only on a mild level (machinery orders softened again of late). Finally, private consumption will probably normalize again from its drop in Q3.

Core inflation around 0.8% yoy over the next months

On the monetary side of the economy, the headline October CPI inflation rate will likely drop a bit due to a base effect. However, nationwide core inflation excluding fresh food is expected to rise slightly to 0.8% yoy, after 0.7% yoy in the month before. The higher rate is basically due to the energy component which turned up markedly during the year. Core-core inflation (excluding food and energy) will probably increase marginally to 0.3% yoy). This does not warrant a move of monetary policy in the near term. However, in a speech in Zurich, BoJ Governor Kuroda mentioned the side-effect of the large increase in money supply, attracting lots of market attention. Nevertheless, we consider the tightening/less accommodative international environment an important argument for the BoJ but only from H2 2018 onwards, in order to not completely decouple from its peers.

China

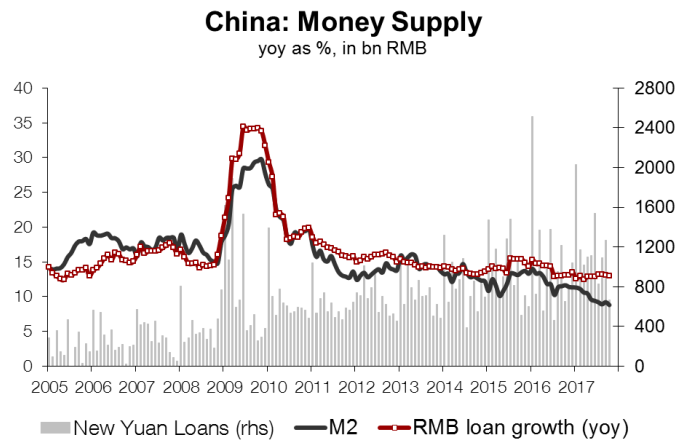
Christoph Siepmann

- **China's real activity softened further in October, a development that we expect to continue over the next months.**
- **The marked rise in 10-year government bond yields is most likely due to market fears of further regulatory tightening.**

China's real activity data continued to soften on balance in October, but especially both PMIs do not suggest any stronger cooling in the near future. The Caixin manufacturing PMI remained unchanged from the previous month, with the forward looking subcomponents – new orders and new export orders – even increasing slightly. By comparison, the official NBS manufacturing PMI slowed to 51.6 points. Thus, both PMIs stayed in comfortable expansionary territory. Broadly in line, industrial production slowed to 6.2% yoy, after 6.6% yoy in September, but still well within the range of readings in H2 this year. Nevertheless, the weakening could announce some of the widely expected output cooling following the implementation of stricter anti-pollution regulations over the winter half year. In contrast to the fluctuating industrial production, urban investments kept weakening to a cumulative 7.3% yoy in October. While the monthly impact was small, the overall slowing is much more visible compared to the beginning of the year with growth rates of around 9%. Outright dragging sectors were mining (in line with the capacity cuts in the industry) and less support from central government projects (weaker fiscal policy stance). Investments of local governments and SOEs also receded, but much less dramatic while infrastructure investment remained on high levels. Real estate investments were only mildly softer. However, property sales, which precede the investment component by about 2 quarters, have dropped significantly. This suggests real estate investments to follow early next year. In sum, we expect China's real activity data to continue to soften over the next months.

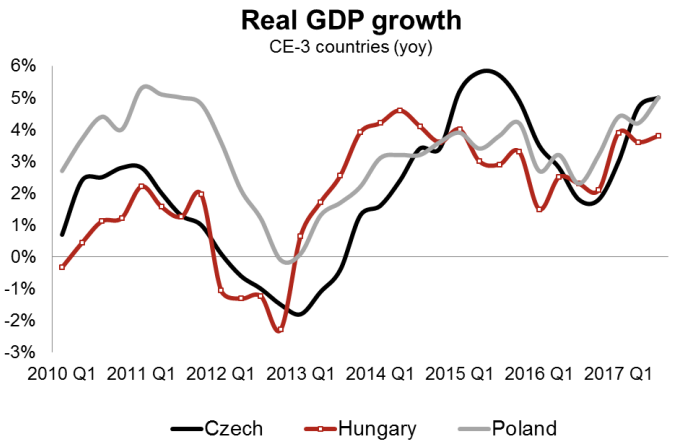
Regulatory fears lift CGB yields

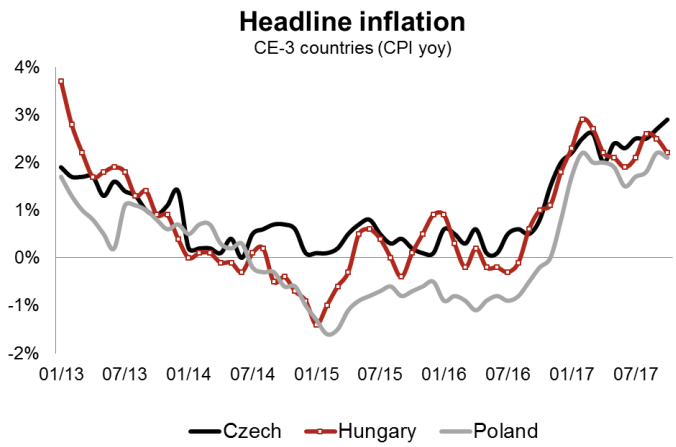
On the monetary side, CPI inflation rose to 1.9% yoy, basically on a less negative food price inflation. Non-food (2.4% yoy) and core inflation (2.3% yoy) were unchanged from the previous month. The same was true for PPI inflation, with rising oil prices having yet no significant effect. Looking ahead, the oil price and the supply effect of the anti-pollution campaign could tend to lift PPI inflation further but a near-term spill-over to CPI inflation is unlikely. With regard to new credit, new yuan loans were relatively low on seasonal grounds, but bank credit was still up by 9.4% yoy ytd, compared to 7.9% last year. Total Social Financing rose by 16.4% yoy ytd, dominated by bank and trust loans. However, 10-year government bonds rose markedly, flirting with 4%, about 30 bps up from early October. This move is largely due to market fears of further regulatory measures, while short-term rates do not show special stress in the PBoC's liquidity provision.



Central and Eastern Europe

Radomír Jáč





Main Forecasts	2016	2017f	2018f	2019f
Czech Republic				
GDP	2.5	4.4	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	2.0	3.8	3.2	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	4.3	3.6	3.4
Consumer prices	-0.7	1.8	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 Q3 GDP data confirm strong growth across the CEE region. Strengthening domestic demand and the favorable situation in key export markets imply a solid growth outlook also for 2018.**
- **The inflation outlook remains mixed, which leads to a diverging monetary policy stance of the regional central banks.**
- **The Czech CNB raised interest rates in November and more hikes are in the pipeline. The Hungarian central bank announced new tools aimed to ease monetary conditions. The Polish NBP is likely to keep a wait-and-see stance well into 2018.**

Flash estimates for Q3 report a stronger-than-expected GDP increase in all CE-3 countries. Czech GDP jumped by 5% yoy (0.5% qoq). The data support the view that the Czech economy operates above its potential, which has pro-inflationary consequences. The GDP figure was at the same time in line with the CNB forecast, i.e. it should not shift the central bank‘s opinion on intensification of price pressures in the economy. Czech inflation reached 2.9% yoy in October, a 5-year high, and is likely to stay above the 2% target for most of 2018. Hungary reported a Q3 GDP growth of 3.8% yoy (0.8% qoq) and the full-year growth may exceed the central bank‘s forecast of 3.6%. However, Hungarian inflation moderated more than expected in October, to 2.2% yoy, and the MNB sees inflation at the 3% target on a sustainable basis only in Q2 2019. Polish GDP growth accelerated to 5.0% yoy in Q3 (1.1% qoq) and the full-year growth may come at 4.3% or 4.4%, i.e. slightly above the NBP forecast. Polish CPI stood at 2.1% yoy in October and particularly the core inflation remains low (0.8% yoy).

Monetary policy: Czech rate hikes, easing in Hungary

The Czech central bank raised its key rate by 25bps to 0.50% in November. Its latest forecast exhibits two rate hikes for 2018 (with the first one in February, which is also our expectation) but there is a risk that the CNB will act already at its Board meeting scheduled for December 21. The debate on the CNB interest rate outlook led to further firming of the Czech crown in the past few weeks.

The Hungarian MNB kept an easing bias and announced new measures that will become effective at the start of 2018. The MNB will launch unconditional IRS facilities (5-year and 10-year) and will start to purchase mortgage bonds with a maturity of 3 years and more. The MNB remained explicit on its intention to further depress yields of HGB government bonds, mainly with longer maturities.

In Poland, the NBP keeps a wait-and-see stance, which implies a stable key policy rate of 1.50% well into 2018. We continue to expect the first hike in the NBP rates in late 2018. This would be consistent also with the forecast published recently by the Polish central bank, which sees inflation slightly above the 2.5% target in 2019.

Bonds/Fixed Income Strategy

Florian Späte

- **International bond markets sailed in calm waters in November. Long-dated bond yields were little changed, but short-dated ones moved considerably upwards.**
- **In this environment, Southern European government bond spreads remained in a tight trading range. Portuguese bonds were once again the best performing class.**
- **As the ingredients for higher yields are given for euro area core and peripheral yields, government bonds are likely to suffer losses in the months to come. Accordingly, we recommend a short duration.**

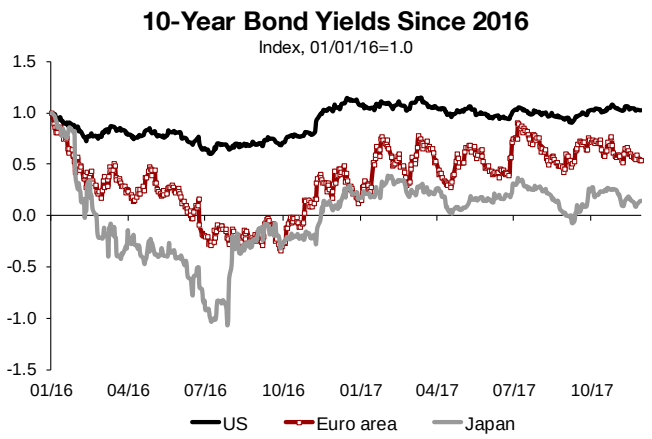
Long-dated government bond yields on both sides of the Atlantic moved in a tight trading range in November. On balance, 10-year US Treasury and Bund yields hardly changed. As long-dated euro area inflation expectations have risen to the highest level since February, the real 10-year Bund yield fell further to -1.18%. In contrast, real long-dated US yields moved slightly up.

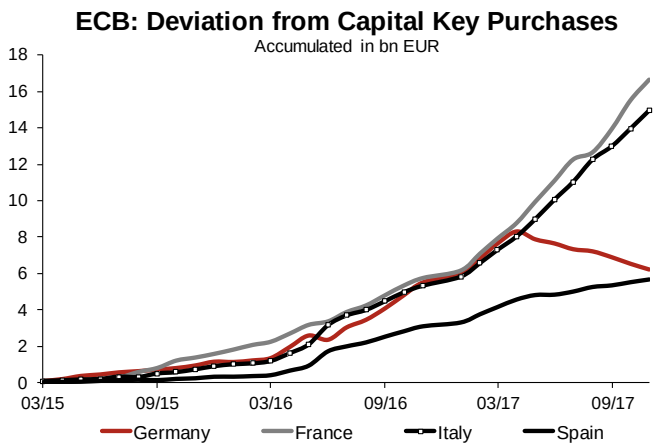
Short-dated yields rose across the board, but mainly in the US. As 2-year US yields rose to 1.77% – the highest level since 2008 – the transatlantic yield spread widened further to 245 bps.

Bond market environment to normalize further in 2018

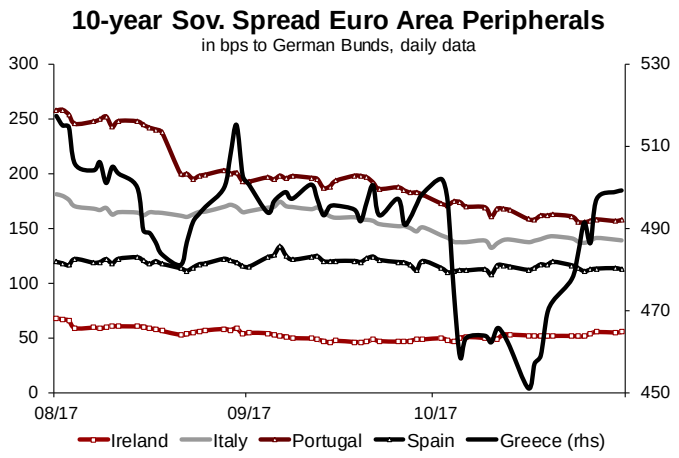
Although on balance long-dated government bond yields have hardly moved so far in H2, we remain convinced that the way is paved for higher yields. Despite overall slightly hawkish comments from central banks in recent weeks, financial markets are still too complacent regarding future rate hikes. For the Fed only three hikes until the end of 2018 are priced. The Fed's Dots and our own forecasts indicate four hikes. Although the link between 10-year US yields and Fed futures has weakened a bit of late, an adjustment of market expectations over the course of next year to the upside would imply an upward move of the 10-year Treasury yield by 15 bps. Notwithstanding that the ECB stressed its forward guidance last month, we expect a first repo rate hike in H2 2019. Against it, financial markets price a first repo rate hike only in 2020. Again, markets are likely to be caught on the wrong foot.

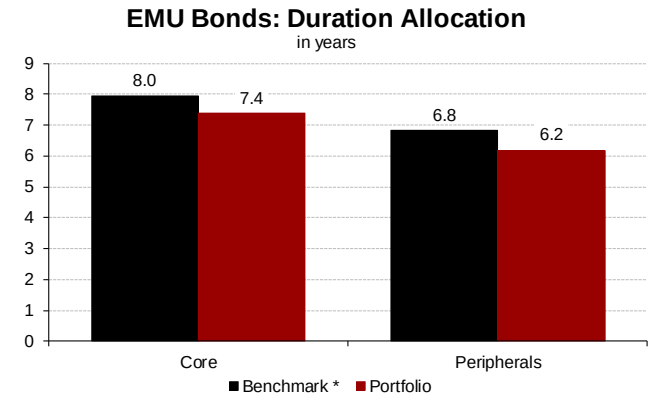
The macroeconomic environment supports an upward trend for yields as well. Not only growth is likely to stay above the trend rate in the US and in the euro area, but also the inflation rate is seen to rise going forward. Already in Q2 2018, US core and headline inflation is forecast to be above the 2% threshold. This is likely to push the US term premium upwards. For the time being, it remains stubbornly low, but higher key rates in combination with rising inflation rates should ultimately trigger a higher US term premium. Accordingly, 10-year US yields are expected to rise to 2.50% on a 3-month horizon.



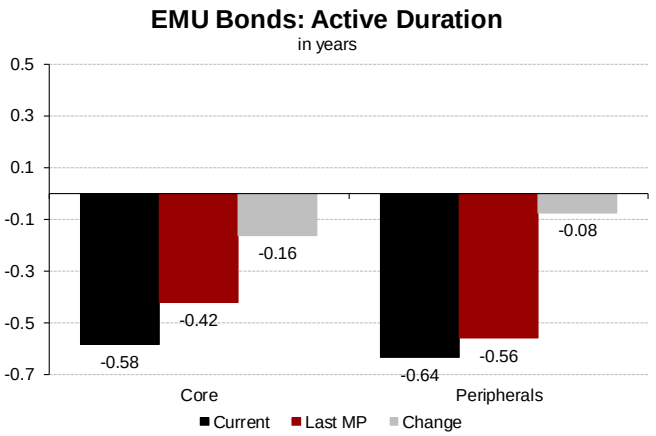


Bonds/Fixed Income Strategy





* JPMorgan EMU Government Bond Index



The announced scaling down of the ECB's QE programme will burden euro area government bonds from January onwards. The monthly amount spent on government bonds will decrease from around €45 bn to roughly €20 bn in 2018. As the scarcity issue will become increasingly binding, it is hardly possibly that the ECB will stick to purchases according to the capital keys. As a result, monthly purchases of German paper are forecast to decrease from almost €12 bn to around €5 bn. Hence, 10-year German yields are expected to rise to 0.50% on a 3-month horizon.

Looking further down the road, international bond markets are forecast to normalize further in the course of 2018. The withdrawal of central bank purchases in combination with healthy nominal growth rates will pave the way to higher yields. We expect 10-year yields in the US and in the euro area to rise until the end of 2018 to 2.80% and 0.90%, respectively.

BTPs untouched by approaching national elections

Southern government bonds moved broadly sideways in November. Most noteworthy was the strong performance of Portuguese bonds which extended the rally. Since March the 10-year Portuguese/German spread has fallen by more than 230 bps to around 150 bps (the lowest level since spring 2015).

BTPs continued to perform well, too. The 10-year Italian/Spanish bond spread fell to around 30 bps. This is particularly noteworthy as it is increasingly likely that the forthcoming national election will take place already in March 2018. With less than four months to go, the election campaign and a possible eurosceptical election outcome (a hung parliament remains our base scenario) should return on the markets' radar screens soon. What is more, the reduction in ECB purchases will burden BTPs as well. Although the ECB will likely buy more BTPs than implied by the capital key (to make up for less purchases of other bonds), the absolute volume will shrink anyway. According to our calculations, from January onwards the central bank will buy only €4 bn of BTPs each month (down from €9 bn). All in, we see a rather strong spread widening of 10-year BTPs to German Bunds to 180 bps on a 3-month horizon.

Our portfolios

In the expected bearish bond market environment, investors are unlikely to evade losses. However, to preserve capital as far as possible, we recommend a short duration for core and peripheral government bonds. For core bonds, we shorten the duration to -0.58 years (from -0.42 years in November). Regarding peripheral bonds, we are even more aggressive taking into account the forecast spread widening and suggest a duration of -0.64 years (down from -0.56 years last month).

Corporate Bonds (Non-Financials)

Florian Späte

- **Non-financial corporate bond spreads widened by 4 bps in November and the yield level drew near to the 1% threshold again.**
- **The near-term outlook remains benign on the back of ongoing ECB purchases and a generally sound fundamental picture.**
- **Looking ahead, however, the shrinking safety net in combination with an ambitious valuation calls for caution. Particularly in H2 2018, investors are recommended to position for a spread widening.**

The rally triggered by the perceived dovish ECB announcement at the end of October stalled at the beginning of November. Since then, non-financial spreads have widened by 5 bps to 119 bps (+4 bps in November). The slight increase in underlying yields contributed to the rise in non-financial corporate yields as well. On balance, non-financial yields increased by 7 bps to 0.99%. The carry was not sufficient to balance the price loss. Hence, the total return in November was -0.1%. However, year-to-date the performance remains in positive territory (+2.3%).

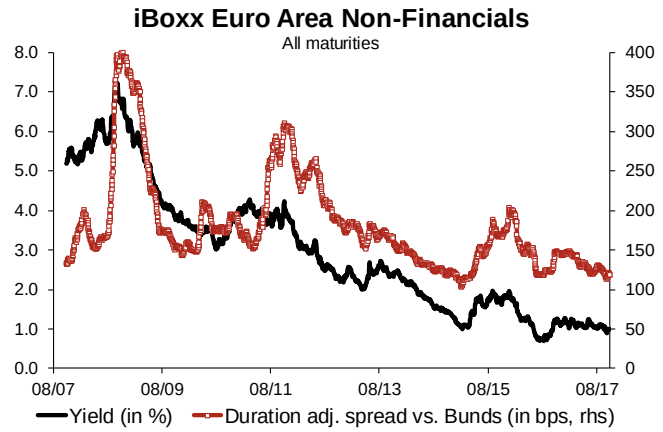
The revival of primary markets was noteworthy in November. More than €40 bn of new corporates were issued (thereof almost €25 bn of non-financials). The net issuance of non-financials amounted to more than €16 bn. However, the strong demand helped to absorb the supply smoothly. The ECB purchased almost €7 bn of non-bank IG bonds in November and also the inflow of funds into this asset class remained positive in recent weeks. Barring any major political interference, the way is paved for a calm year-end and non-financial corporate spreads are expected to finish 2017 close to the annual low of 114 bps.

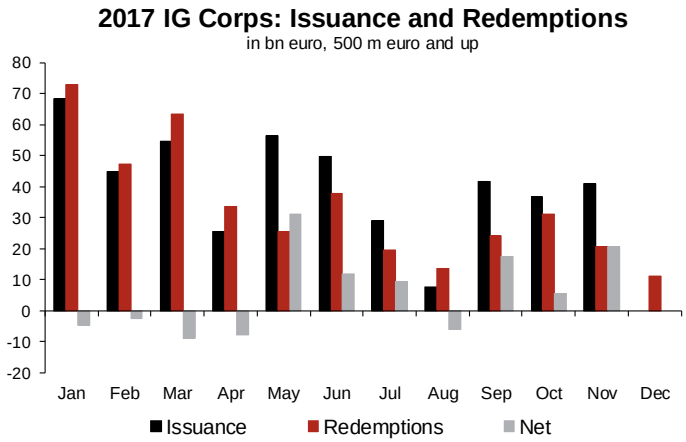
Shrinking safety net to trigger spread widening

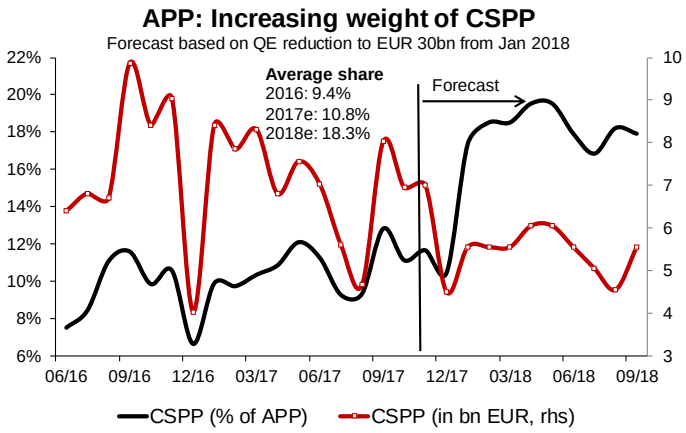
Further ahead, however, the road is likely to become bumpier. Although a deterioration of the fundamental situation of non-financials is not on the cards and the economic tailwind is seen to continue in 2018, we confirm our more cautious stance for next year.

To start with, the ECB support will decrease. Although the central bank has signaled that it will rely to a greater extent on corporate bond purchases to meet its targets, the absolute monthly amount of net purchases will come down. Even taking into account an increase of the share of the Corporate Sector Purchase Programme to more than 18% (from less than 11% currently), the monthly amount will drop to around €5.5 bn (from €7 bn currently). Furthermore, government bond yields are forecast to rise meaningfully in 2018, thereby reducing the search for a yield pick-up.

In combination with the ambitious valuation of non-financials, these headwinds tend to drive spreads upwards. While in H1 the ECB purchases could contain any widening, the environment is forecast to worsen in H2.

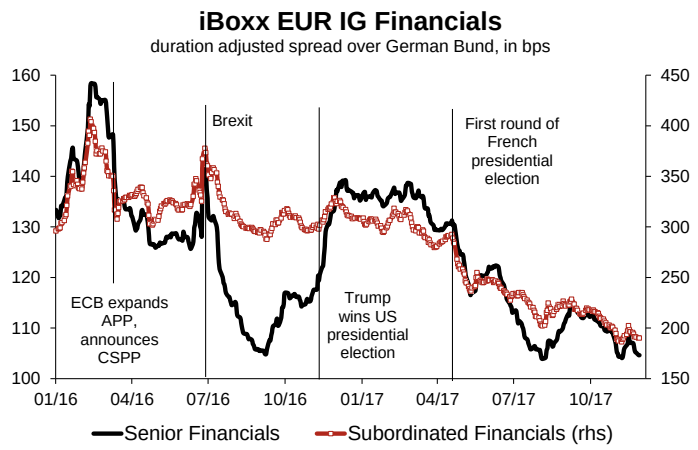


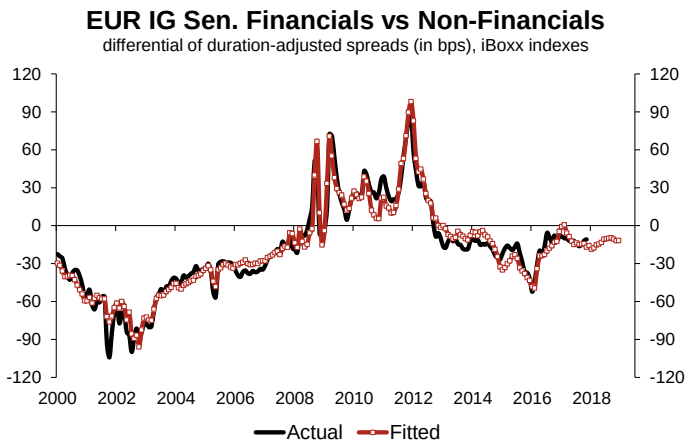


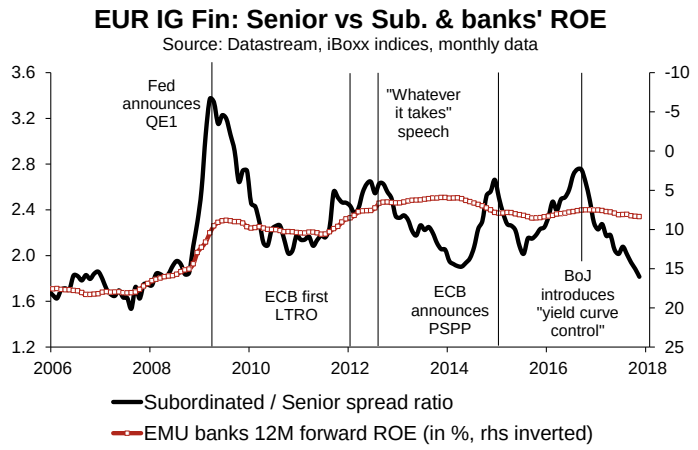


Corporate Bonds (Financials)

Luca Colussa







- **After a temporary correction in the middle of the month, EUR Investment Grade Senior Financial bond spreads retightened and ended the month marginally down.**
- **Senior Financials outperformed Non-Financials for the first time since June, as euro area sovereign spreads kept trending lower following Italy's upgrade in late October.**
- **Going forward, we expect concerns over the looming Italian elections to weigh on sovereign spreads and to trigger an underperformance of Financials vs Non-Financials. We also keep our underweight on Subordinated bonds vs Senior.**

EUR Investment Grade (IG) Senior Financial bond spreads tightened marginally in November (-2 bps to 104 bps) as the temporary widening experienced in the middle of the month was then reversed on solid macro data and the renewed risk-on mode. The month-to-date total return has been barely positive (+0.10%), as the underlying Bund yields moved mildly up. The year-to-date total return for Senior Financials rose to 2.16%.

Senior Fins to underperform again until Italy's vote

IG Senior Financials outperformed Non-Financial bonds for the first time since June. An important driver for the outperformance was the ongoing tightening in euro area sovereign spreads (the 10-year GDP-weighed differential vs Bunds is at the lowest level since September 2016) following Italy's upgrade by S&P in late October.

Going forward, we anticipate Senior Financials to underperform again in the run-up to the Italian general elections (most likely to be held in March). Indeed, Financial bonds are more sensitive to higher euro area sovereign spreads, which are expected to rise markedly over the next three months. We project the duration-adjusted spread of Senior Financials to widen by 10 bps to 115 bps. Later in 2018, however, we expect a reversal in the underperformance vs Non-Financials, which are more exposed to a reduction of CSPP purchases by the ECB and to the potential negative spillovers from the more mature credit cycle in the US. We expect Senior Financials to widen only by further 5 bps (to 120 bps) until end-2018.

Maintain the slight underweight on Subs vs Senior

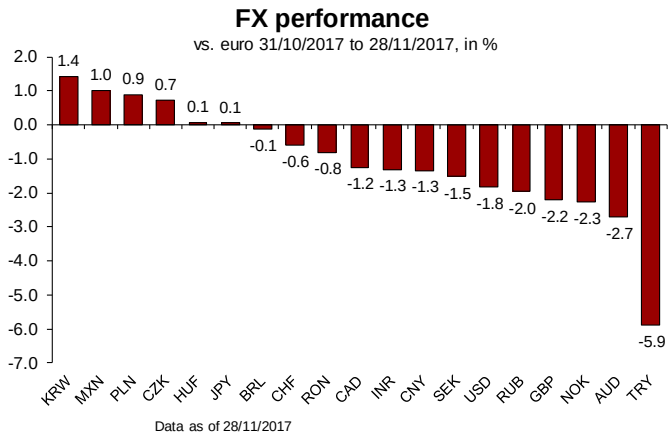
EUR IG Subordinated Financials slightly outperformed Senior bonds in November (spread down by 6 bps to 189 bps, total return: +0.29%). This reflects also the strong macro surprises in the euro area. That said, we remain cautious and reiterate our slight relative underweight on Subordinated bonds vs Senior ones, especially in the run-up to the Italian elections due to their stretched valuation and the toppish level of macro surprises in the euro area.

Currencies

Thomas Hempell

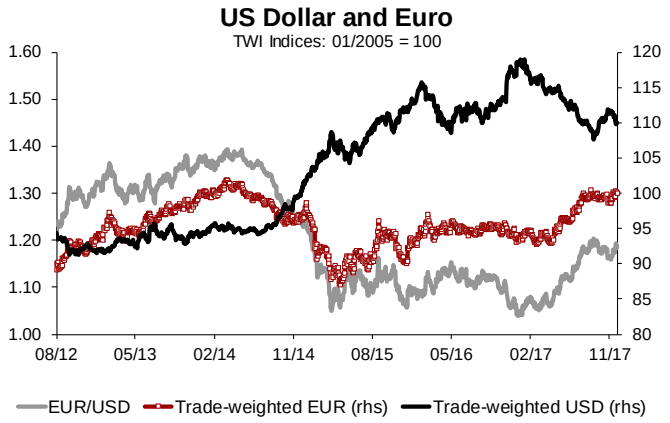
- **The euro is underpinned by strong economic expansion, but political risks may feature more prominently amid protracted coalition talks in Germany as well as elections in Catalonia (Dec. 21) and Italy next year.**
- **Short term, we see the US dollar supported against the single currency also by further Fed rate hikes and progress on the tax reform.**
- **Over the course of 2018, however, we anticipate the robust euro area economy and mounting speculation about ECB rate hikes to drive the EUR/USD up beyond 1.20 again.**

Strong economic data continue to underpin the euro, even though the ECB proceeds only very cautiously towards normalizing its monetary policy. Over the course of November, the EUR/USD recovered some ground, gaining almost 2%, while the US dollar generally retreated on uncertainties about President Trump's tax reform agenda.

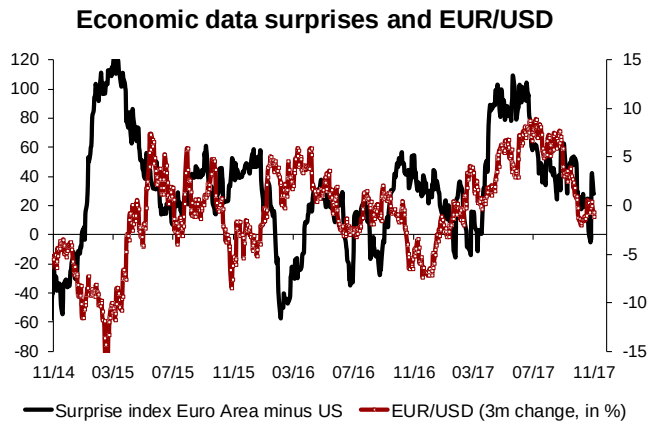


Divergent rate outlook still caps EUR/USD near term

Looking ahead, however, the EUR/USD will struggle to post further gains in the near term. The Fed is likely (and widely anticipated) to deliver its third rate hike this year on Dec. 13. Prospective rate hikes in 2018 remain under-priced, with markets discounting 1½ further hikes, just half the speed that we are anticipating. The ECB, will reduce its asset purchase program to € 30 bn/month from January onwards, but a first rate hike is still distant (unlikely before 2019). Finally, with coalition talks in Germany likely to extend well into next year, Catalan elections on Dec. 21 and Italian voters going to the ballots likely in March, market progress on EU integration matters is unlikely to show up any time soon. And while uncertainties remain high, a final deal on a bolder US tax reform in Congress has the scope to support the US dollar. Overall, we thus see the risks tilted towards a slightly lower EUR/USD in the near term.



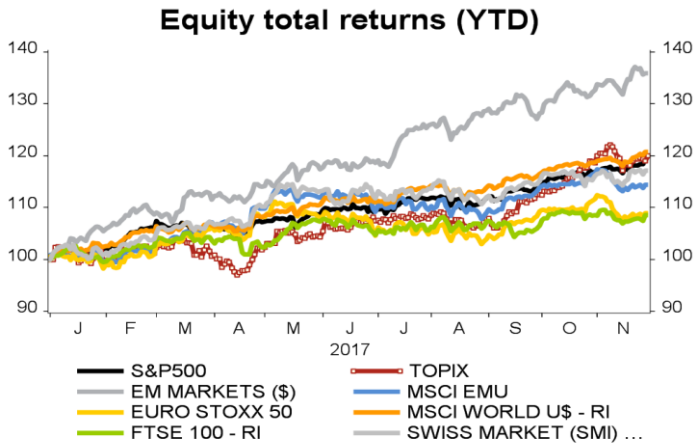
The picture is likely to change, though, over the course of next year. The euro should benefit from structural forces, such as the high capital inflows due to the C/A surplus (>3% of GDP). We also see scope that reserve mangers at central banks will start to increase their euro exposure from currently still very low levels (20% of global central bank reserves are held in euro, compared to a peak at 28% in 2009). Also on fundamental grounds, the euro still looks cheap, with the real-effective exchange rate 5% below its long-term average. And a strong euro area economy will lead to mounting speculation about a first ECB rate hike. On these grounds, we anticipate the EUR/USD to more visibly pass the 1.20 threshold; but this is likely to happen only later over the course of next year.



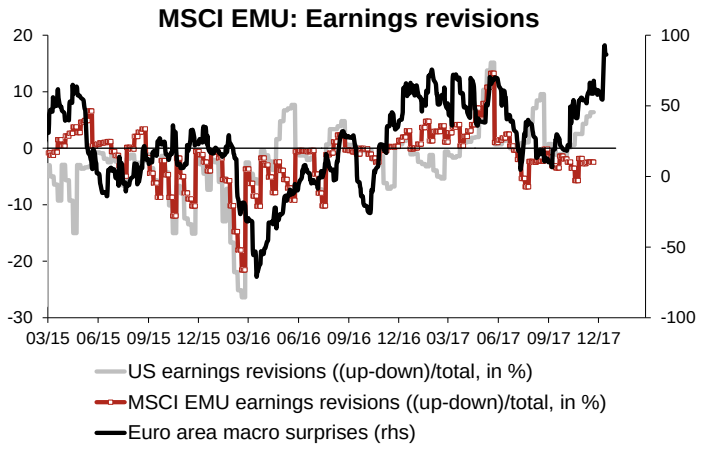
We continue to see a weaker JPY/USD on rising US yields, while the GBP/EUR is likely to weaken, burdened by the high uncertainties about the Brexit negotiations and their impact on the economic outlook for the UK.

Equities

Michele Morganti



Sector	S&P earnings growth, yoy: Q3 2017	Euro Stoxx earnings growth, yoy: Q3 2017	Topix earnings growth, yoy: Q3 2017	S&P sales growth, yoy: Q3 2017	Euro Stoxx sales growth, yoy: Q3 2017	Topix sales growth, yoy: Q3 2017
Energy	138.0%	65.1%	430.9%	17.0%	15.1%	20.3%
Materials	10.9%	29.0%	33.4%	8.6%	8.2%	14.7%
Industrials	-0.5%	3.9%	52.9%	6.3%	7.7%	7.6%
Cons. Discretionary	1.3%	0.2%	17.6%	2.6%	5.9%	9.0%
Consumer Staples	3.3%	67.0%	21.5%	4.6%	4.5%	6.8%
Health Care	7.6%	-8.9%	11.4%	4.6%	-7.8%	5.2%
Financials	-8.9%	-9.1%	-7.8%	1.7%	3.8%	11.8%
IT	24.6%	27.1%	19.0%	10.4%	5.2%	12.0%
Telecoms	-2.2%	7.8%	-37.1%	-1.0%	-0.4%	2.5%
Utilities	-3.5%	30.5%	-6.7%	-2.7%	2.3%	9.3%
Market	7.0%	6.7%	12.9%	5.4%	5.1%	9.2%
Median (all sectors)	3.3%	17.4%	17.6%	4.6%	5.2%	9.0%
Median, ex. Energy & Materials	1.3%	5.9%	11.4%	4.2%	4.5%	7.6%



- **November was a positive month for equities. The MSCI World posted a +1.6%. Macro news flow remained upbeat but stronger trade-weighted euro weighed on euro area (EA) equities.**
- **Higher valuations and investors' exuberant sentiment could be challenged in the short term by less dovish central banks, possibly higher geopolitical risks, toppish macro surprises and stronger focus on credit and Chinese risks. We favor a less pronounced overweight position on equities, compared with the past quarters.**
- **For the next year, however, we expect total returns of nearly 6% in the EA and Japan due to contained overvaluation, good earnings growth and limited pressure from only slightly higher yields. The S&P500 should underperform due to expensive valuations and rising unit labor costs.**

November was another positive month for equities. The MSCI EM, the S&P500 and the SMI outperformed (3.3%, 1.8% and 1.5%, respectively), while the MSCI EMU index decreased by 1.5% (resulting from stable yields and the appreciation of trade-weighted euro by nearly 1%). On the contrary, the US, Swiss and Chinese as well Indian and Russian trade-weighted currencies weakened by 1%, benefitting the respective equity indices. Stable yields usually support defensive markets such as US, SMI and the FTSE 100 (lower financials' weight in the index) together with EMs.

Positive macro flows, supporting earnings' revisions

As said, 10-year rates remained on average unchanged supporting equity valuations. In an environment of stable yields, the "growth "style is favored at the expense of the "value " one. The former includes US equities and, in particular, the IT sector which has so far shown a superior relative earnings momentum. Among the "value" stocks we include the EA equities characterized by a higher weight on financials: they need higher bond yields in order to outperform. In the month, the macro news flow surprised on the upside. In particular, business confidence indicators remained very strong in the EA, giving rise to future positive earnings' revisions. We upgraded our EA GDP forecasts further, for this year and the next. This reassures us on the sustainability of the current earnings growth till the next year. The last quarter reporting season, which refers to profits realized in Q3, was indeed quite strong. The yearly earnings' growth for the US, EA and Japan was high at 7%, 6.7% and 12.9%, respectively: on average, commodity, staples and IT outperformed. To note is also the strong sales' growth which probably reflects some pricing power kicking in other than good volume growth. That said, the earnings momentum came stronger than the sales' one.

Equities

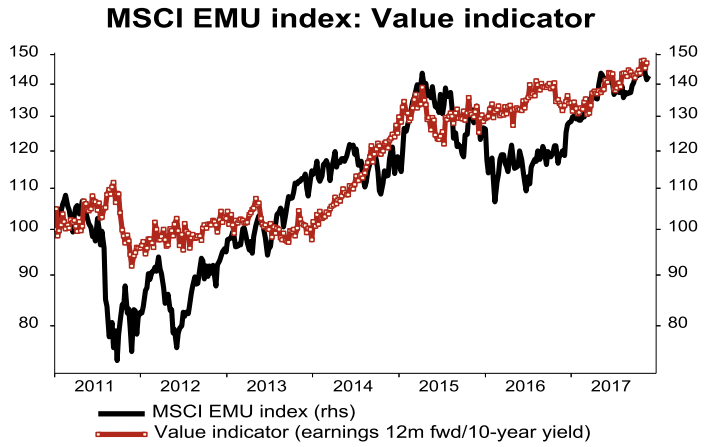
This signals ongoing higher corporate margins and represents the confirmation of what we have already observed when looking at the increasing US margin proxy (momentum of the ratio of headline inflation to unit labor costs) or the higher capacity utilization in the EA.

But we remain more cautious in the short term

As a result of the market rally year-to-date (YTD), current global market multiples (see table) are higher than historical average by 14.5% but the S&P 500 stands out with a premium of 20.5%. The multiples for the EA, Japan and EMs are higher by 14.8%, 3.5% and 2.2%, respectively. Our "value momentum" (based on consensus 12-month forward earnings estimates and 10-year yields) and our quant models show that most markets are fairly valued, but the US is very expensive. In Europe, the ratio of PEs between cyclical and defensive sectors has reached a cyclical high and EA confidence indicators look toppish, too. Furthermore, investors show a strong confidence that central banks would remain slow and cautious for longer in reducing the monetary stimulus. But, given our expectation of slightly higher inflation, we believe that central banks can surprise investors with a more hawkish communication stance in the next few months. Lastly, in recent surveys, global fund managers declared a higher appetite for risk, lowering their cash position to a level which corresponds to a neutral signal for riskier assets and no longer a contrarian-buy one. For these reasons, we have turned more cautious short term, favoring a more balanced allocation between EA and US equities and a tilt towards more defensive sectors. We would recommend to put banks at neutral, keeping insurance, oil, telecoms and retailers in overweight. Underweighting is advised for the more expensive cyclicals like commercial services and IT, together with HC services.

Decent 12-month returns in the EA and Japan

All in all, we remain constructive on equities on a 12-month horizon. Our projections see an earnings growth of 8% on average in 2018 (consensus: 11.3% for the US and 9.5% for the EA). Using a long-term approach to valuations (discount models, risk premium assessment, etc.) we can expect total returns of 5-6% from both the EA and the Japanese markets, and a subdued one (1%) for the US. Such returns are definitively appealing if compared with fixed income's ones. Higher core yields in 12 months (+50 bps) should contribute to an outperformance of EA equities, unless the EU political risk escalates. Earnings growth will keep the current dividend yield sustainable at more than 3% in the EA. The US market clearly shows signs of valuation exuberance, pointing to weak-to-negative returns ahead. EMs should experience a slightly higher total return than the EA, in local currency, but this will be offset by high hedging costs of around 4%.



Markets	Price / Earnings *		Price / Book *		Price/ Cash Flow *		Dividend Yield *		Avg.
	current	hist. avg.	current	hist. avg.	current	hist. avg.	current	hist. avg.	Discount, %
WORLD	16.9	16.0	2.2	1.9	10.9	8.6	2.5	2.7	14.5
USA	18.2	15.3	3.0	2.3	12.4	9.8	2.0	2.2	20.5
JAPAN	14.7	15.7	1.3	1.3	8.5	7.0	2.0	1.9	3.5
UK	14.1	13.8	1.8	1.8	8.9	7.9	4.3	4.0	1.5
SWITZERLAND	16.7	15.4	2.4	2.2	12.3	11.2	3.5	3.3	5.0
EMU	14.7	14.2	1.6	1.5	8.4	6.4	3.3	3.9	14.8
FRANCE	15.0	14.3	1.6	1.5	9.0	6.8	3.3	3.8	13.6
GERMANY	13.8	15.1	1.7	1.5	8.9	6.6	3.0	3.4	12.9
GREECE	13.2	12.8	1.5	1.6	6.8	5.9	3.7	3.9	5.6
ITALY	12.9	15.3	1.2	1.2	5.6	4.6	4.3	4.7	3.7
PORTUGAL	17.3	12.6	1.8	1.7	6.8	5.9	4.4	4.5	15.5
SPAIN	12.8	13.0	1.3	1.6	5.2	5.1	4.1	5.1	0.2
EURO STOXX 50	14.1	13.2	1.6	1.5	8.1	6.1	3.6	4.3	15.3
STOXX SMALL	16.2	14.3	1.9	1.7	10.5	8.2	2.9	3.2	15.6
EM, $	12.8	14.6	1.6	1.6	7.9	7.7	2.6	3.1	2.2
BRAZIL	12.2	8.9	1.6	1.7	7.6	14.2	3.4	4.3	1.7
RUSSIA	6.6	7.1	0.7	0.9	3.8	4.6	5.6	3.5	-28.0
INDIA	18.6	14.3	2.8	2.7	12.7	11.5	1.5	1.6	12.4
CHINA	14.0	13.0	1.8	1.7	8.7	7.5	2.0	3.0	15.9

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

US CAPE-based valuation (adj. for inflation)	10Y	CPI	Real 10Y Rate	EPS	Current (e/p - 10y real)
Scenario 1 (current input with our 2017	2.45	2.00	0.45	127.0	4.22
Scenario 2 (base 2018)	2.80	2.20	0.60	138.0	4.47
Scenario 3 (downside 2018)	1.90	1.70	0.20	114.0	3.99
Scenario 4 (upside 2018)	3.20	2.50	0.70	147.0	4.70
Scenario 5 (goldilocks)	2.45	2.20	0.25	147.0	5.15

	Scen. 1	Scen. 2	Scen. 3	Scen. 4	Scen. 5
Implied PE Trailing IBES	18.1	19.1	17.0	19.9	21.8
Avg S&P500 valuation	2,324	2,455	2,192	2,567	2,799
	-10.0%	-4.9%	-15.1%	-0.6%	8.4%

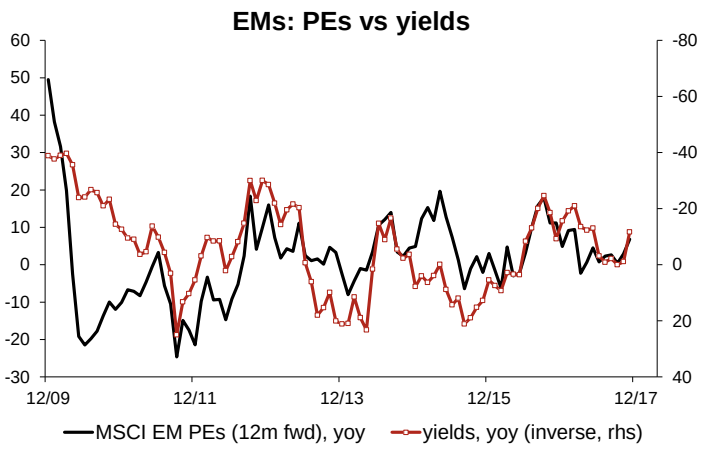
Note: Target ERP (4.7) is calculated assuming CPI in the range b/w 1% and 4%.

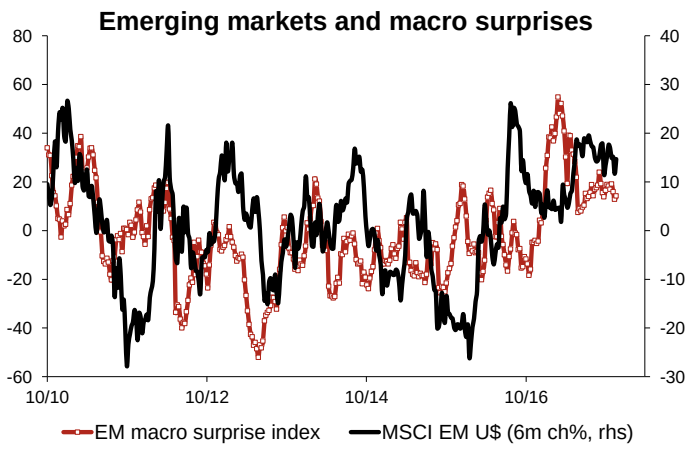
Emerging Markets Equities

Vladimir Oleinikov

Markets	price, %-chg -1M	price, %-chg YTD	earnings, %-chg -1M	earnings, %-chg YTD	10y yld chg, YTD	FX (TW), %-chg MTD	FX (TW), %-chg YTD
WORLD ($)	1.6	18.0	1.0	13.1			
US	1.8	17.3	1.1	9.1	-12	-1.4	-6.9
EMU	-1.5	11.3	0.5	9.9	1	1.1	5.5
GREECE	-2.9	**-6.3**	**-2.5**	**-2.2**	**-170**	1.1	5.5
CZECH REP.	-0.8	14.3	-0.1	**-3.0**	**130**	1.2	**8.9**
HUNGARY	**-3.6**	19.0	1.7	32.6	-77	0.5	1.7
POLAND	0.3	28.0	0.9	26.6	-31	1.4	**8.0**
EM ($)	3.3	33.0	1.4	22.3	-51		
BRAZIL	-2.5	20.6	1.5	11.9	-128	1.0	-3.2
CHINA	5.5	**53.8**	1.5	24.9	91	-0.9	-1.3
INDIA	0.5	25.7	1.2	9.3	52	-0.5	-0.8
INDONESIA	3.3	16.5	0.9	10.8	-134	-0.8	-6.2
KOREA	0.7	31.1	**3.1**	**44.9**	39	**2.4**	5.6
MALAYSIA	-1.9	4.2	0.7	6.0	-27	**2.1**	3.2
MEXICO	**-4.1**	3.2	-0.4	7.7	-21	**2.5**	**7.1**
RUSSIA	6.0	**-2.7**	**-2.4**	**-3.3**	-75	-1.3	-3.3
TAIWAN	-0.9	16.2	1.8	9.4	-22	-0.6	2.0
THAILAND	0.9	14.1	0.7	9.9	-32	0.8	4.2
TURKEY	**-5.1**	29.4	1.7	34.1	**111**	**-5.1**	**-18.0**
VIETNAM	**18.2**	**50.2**	**-2.4**	17.7	-69	-1.2	-5.7
SHANGHAI	-2.4	7.4	0.8	9.5	91	-0.9	-1.3

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





- **Since the start of the year, the MSCI EM index showed a spectacular performance of 36%, benefiting from the recovery in global trade, a weaker USD and low financing costs.**
- **In the short term, the EMs are to be pressured by the Fed and FX backdrop, along with low macro surprises and a stronger focus on credit and Chinese risks.**
- **We are constructive mid-term on EMs (once Fed and USD expectations are repriced) and still favor India along with Korea and CEE countries, while maintaining a prudent stance on China.**

In the last month, EM equities have increased (+3.3%), benefitting from increasing commodity prices and low financing costs. The top performer was Vietnam (+18.2%), followed by Russia and the MSCI China index (6% and 5.5%, respectively). The worst performing ones were Turkey (-5.1%) and Mexico (-4.1%). As it looks the recent APEC summit in Vietnam caused an increase in investment sentiment, which in turn brought about the rally of the Vietnamese stock market. The Russian equities, on the other hand, have benefitted from increasing oil prices and lower rates.

Overall, EM 2018 earnings have slightly increased (+0.5%) during the last month. The markets for which they have been upgraded significantly are: Korea (+2.2%), Taiwan (+1.5%) and Hungary (+1.3%). The earnings of the Greek companies have been downgraded by 3.8%.

Getting even more cautious in the short term

Based on multiples, the EM stocks have become more expensive and are now at a premium of 2.4% vs their history. In this year alone the MSCI EM's PE expanded by around 8%. While there is still room for further expansion, the repricing of Fed and USD expectations in the short term should hurt. In the medium term, the EMs should benefit from higher earnings growth and relatively lower valuations. Furthermore, healthy demand expansion in the advanced economies is gradually spilling over into EMs, underpinning growth outlook via better exports.

The high MSCI China's valuations – multiples having a premium of 15.9% – appear problematic. The strong tailwinds behind China's recovery since early 2016 are likely to wane in the coming months. In addition to this, Chinese 10-year rates moved higher recently mostly due to concern of PBoC limiting leverage and excesses in wealth and asset management industry. Negative spillovers could also affect the real estate market. On the other hand, Indian valuations, while relatively high, seem to be justified: We see reforms to start paying off as acknowledged recently by the rating upgrade by Moody's.

Asset Allocation

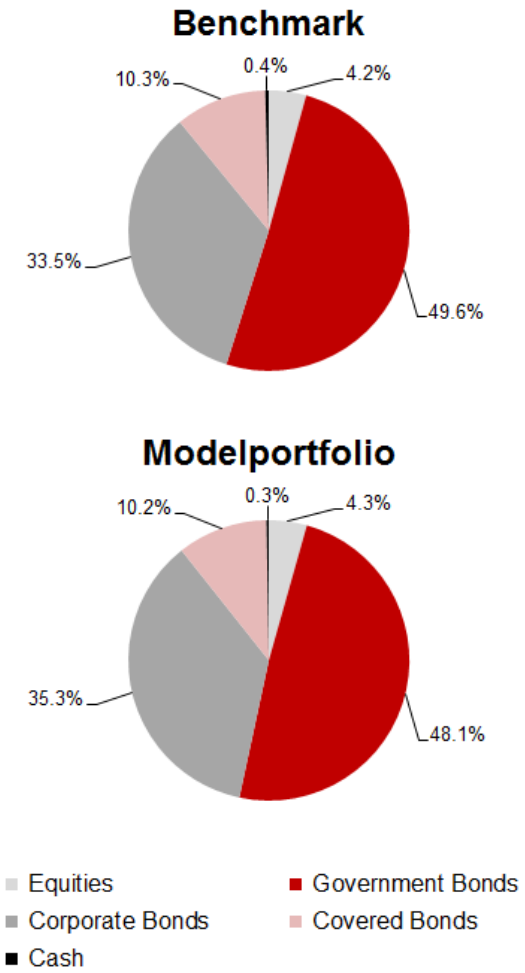
Thorsten Runde

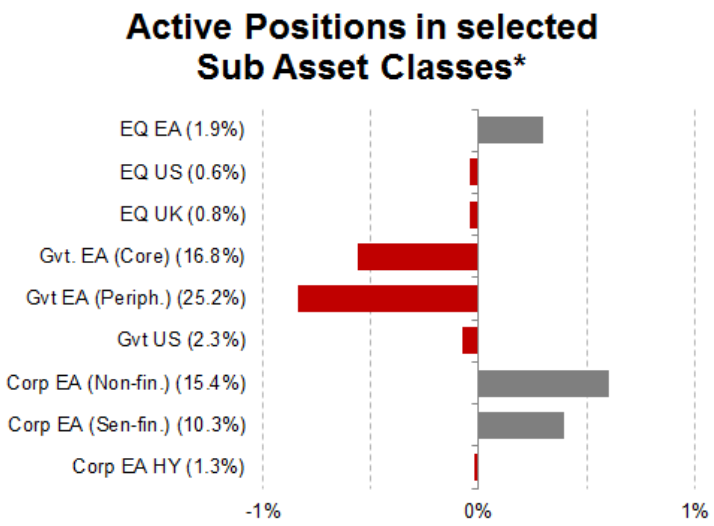
- **In the course of November, the performance of equity markets has been quite diverse so far, with the US leading the performance ranking of our asset universe and the euro area bringing up the rear.**
- **Yields on developed government bond markets as well as Southern European spreads have fallen throughout, lifting total return figures into positive territory.**
- **Risk premia on euro area IG corporate bonds remained fairly unchanged, with senior-financials outperforming non-financials.**
- **Spreads on high yield corporates, in the euro area as well as in the US, have widened, resulting in negative total returns ranging at the lower end of our asset universe.**
- **The global macro backdrop should continue to provide a favorable setting for financial markets. That said, some signs of stress could be witnessed (HY spreads, Chinese yields…).**
- **Thus, we basically confirm our pro-risk tactical positioning, but once again to a further reduced extent.**

During the last four weeks, global financial markets preserved their overall sanguine attitude. Equity markets clearly outperformed bonds although the overall picture was quite diverse. US equites are leading the performance ranking of our asset universe (+2%) whereas the euro area is bringing up the rear (-2%). Yields on developed government bond markets as well as Southern European spreads have fallen throughout, lifting total return figures into positive territory, ranging from +0.9% for the UK over +0.4% for core euro area and Southern Europe to +0.1% for US Treasuries. The spread widening of high yield corporate credit, in the euro area as well as in the US, is pushing total returns for both market segments below the zero line with -0.3% and -0.5% respectively. Unfortunately, last month's recommended tactical alignment of the model portfolio did not capture these developments well enough to be able to add value.

Risky assets to be challenged even more

Although the global macro backdrop should continue to provide a favorable setting for financial markets, first tentative signs of stress should not be ignored. We basically confirm our constructive view on equities, in particular for the euro area, and on Investment Grade credit, given the solid growth outlook. We remain skeptical for Southern Europe due to the vote in Catalonia and general elections in Italy. Thus, we are maintaining the investment focus of our model portfolio, but at the same time recommend to further reduce the aggressiveness of the stance.





Benchmark weights in parentheses

Forecast Tables

Growth

	2015	2016	2017f	2018f
US	2.9	1.5	2.2	2.4
Euro area	2.0	1.8	2.3	2.1
Germany	1.5	1.9	2.5	2.0
France	1.0	1.1	1.7	1.8
Italy	0.9	1.1	1.5	1.3
Non-EMU	2.6	2.0	1.8	1.6
UK	2.4	1.8	1.6	1.4
Switzerland	1.2	1.4	0.8	1.8
Japan	1.2	1.0	1.5	1.3
Asia ex Japan	6.2	6.4	5.9	5.9
China	6.9	7.1	6.8	6.4
Central/Eastern Europe	1.3	1.5	3.4	3.2
Latin America	- 0.5	- 1.5	0.8	1.9
World	**3.5**	**3.1**	**3.5**	**3.6**

Inflation

	2015	2016	2017f	2018f
US	0.1	1.3	2.1	2.2
Euro area	0.0	0.2	1.5	1.3
Germany	0.1	0.4	1.7	1.6
France	0.1	0.3	1.1	1.2
Italy	0.1	- 0.1	1.3	1.0
Non-EMU	0.1	0.7	2.5	2.5
UK	0.0	0.7	2.7	2.7
Switzerland	- 1.1	- 0.4	0.5	0.7
Japan	0.8	- 0.1	0.4	0.7
Asia ex Japan	2.4	2.6	2.2	3.1
China	1.4	2.0	1.6	2.3
Central/Eastern Europe	9.2	5.2	5.0	4.7
Latin America	6.2	6.3	4.3	3.8
World	**2.3**	**2.3**	**2.4**	**2.7**

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

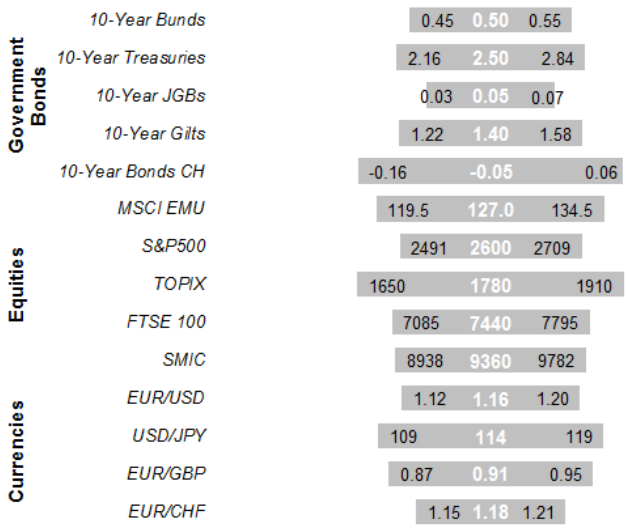
Financial Markets

3-month LIBOR	**28/11/17***	**3M**	**6M**	**12M**
USD	1.47	1.60	1.70	2.20
EUR	-0.38	-0.38	-0.38	-0.35
JPY	-0.03	0.00	0.00	0.05
GBP	0.52	0.55	0.60	0.80
CHF	-0.75	-0.75	-0.75	-0.75
10-Year Bonds	**28/11/17***	**3M**	**6M**	**12M**
Treasuries	2.34	2.50	2.60	2.80
Bunds	0.35	0.50	0.70	0.90
BTPs	1.80	2.30	2.40	2.60
OATs	0.69	0.85	1.00	1.20
JGBs	0.03	0.05	0.10	0.25
Gilts	1.25	1.40	1.50	1.60
SWI	-0.13	-0.05	0.05	0.15
Spreads	**28/11/17***	**3M**	**6M**	**12M**
GIIPS	126	155	150	150
Covered Bonds	71	70	70	75

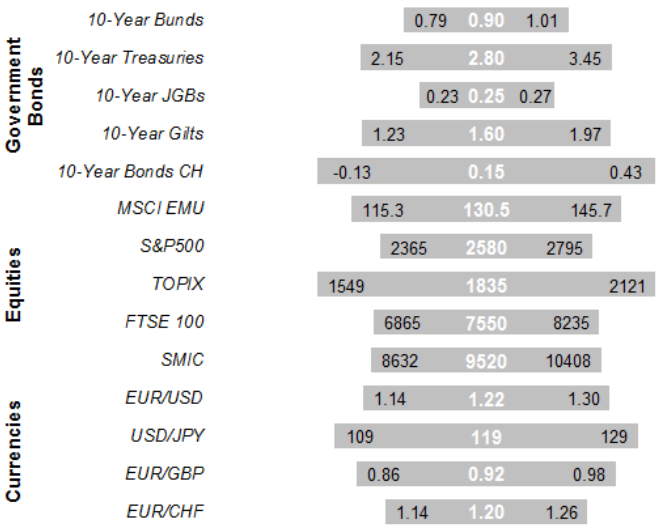
Corporate Bond Spreads	**28/11/17***	**3M**	**6M**	**12M**
IBOXX Non-Financial	118	120	125	140
IBOXX Sen-Financial	105	115	120	120
Forex	**28/11/17***	**3M**	**6M**	**12M**
EUR/USD	1.19	1.16	1.16	1.22
USD/JPY	111	114	117	119
EUR/JPY	133	132	136	145
GBP/USD	1.33	1.27	1.26	1.33
EUR/GBP	0.89	0.91	0.92	0.92
EUR/CHF	1.17	1.18	1.19	1.20
Equities	**28/11/17***	**3M**	**6M**	**12M**
S&P500	2610	2600	2590	2580
MSCI EMU	127.4	127.0	128.5	130.5
TOPIX	1776	1780	1805	1835
FTSE	7418	7440	7490	7550
SMI	9303	9360	9330	9520

*average of last three trading days

3-Months Horizon



12-Months Horizon



*The forecast range for the assets is predetermined by their historical volatility. The volatility calculation is based on a 5 year history of percentage changes, exponentially weighted. The length of the bars within each asset group is proportional to the relative deviations from their mean forecasts.

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