



CIO Flash

We remain constructive

Our December 2018 targets, slightly revised

Despite recent market turbulence we reiterate our key themes, albeit with minor adjustments

Economic outlook:

We see solid economic momentum in both Europe and the United States, but few signs as yet of inflation sharply accelerating. For now, no significant impact on real economic activity from financial-market events.

Monetary policy:

We expect three rate hikes by the U.S. Federal Reserve by the end of 2018. Towards the end of the year, attention is likely to shift to the European Central Bank (ECB) following the Fed's path towards normalization.

Currencies:

We believe that the recent dollar weakness has been overdone. Yield differentials, high net long euro positions and technical factors should leave some scope for a dollar rebound. For December 2018, we are sticking to our call of \$1.15 per euro.

Fixed income:

- We are raising our rates forecasts for U.S. Treasuries (2-, 10- and 30-year) and German Bunds (2- and 10-year).
- For the Eurozone periphery, we expect a tightening of spreads (vs. Bunds) for Italy to 120 basis points (bps), and are reducing our spread forecast for Spain to 90 bps (roughly where markets are currently trading).
- No changes to other spread targets.

Equities:

- We are sticking to our view that there is significant upside from current levels.
- All our year-end targets for developed markets remain intact. Within developed markets this suggests larger upside outside the United States.
- Within emerging markets, we are actually raising our targets for Latin America.

Fixed income

	Current*		Dec 2018F
United States			
U.S. Treasuries (10-year)	2.85%	↗	3.00%

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U.S. municipal bonds	86.1%	→	85%
U.S. investment-grade corporates	88 bp	↘	80 bp
U.S. high-yield corporates	369 bp	→	350 bp
Securitized: mortgage-backed securities ¹	72 bp	↗	100 bp
Europe			
German Bunds (10-year)	0.75%	↗	1.00%
UK Gilts (10-year)	1.57%	→	1.40%
Euro investment-grade corporates ²	84 bp	↘	75 bp
Euro high-yield corporates ²	291 bp	→	260 bp
Securitized: covered bonds	36 bp	↗	65 bp
Italy (10-year) ²	130 bp	↘	120 bp
Asia-Pacific			
Japanese government bonds (10-year)	0.07%	→	0.1%
Asia credit	219 bp	↘	210 bp
Global			
Emerging-market sovereigns	287 bp	→	285 bp
Emerging-market credit	282 bp	→	270 bp

* Source: Bloomberg Finance L.P. as of 2/9/18

F refers to our forecasts as of 2/12/18 (changed forecasts are highlighted in bold)

¹ Current-coupon spread vs. 7-year U.S. Treasuries

² Spread over German Bunds

bp = basis points

For sovereign bonds, ↗ denotes rising yields, → unchanged yields and ↘ falling yields. For corporates, securitized/specialties and emerging-market bonds, the arrows depict the option-adjusted spread over U.S. Treasuries: ↗ depicts a rising spread, → a sideways trend and ↘ a falling spread.

The **arrows' colors** illustrate the return opportunities for long-only investors. ↘ Positive return potential for long-only investors. → Limited return opportunity as well as downside risk. ↗ Negative return potential for long-only investors.

Currencies

Currencies	Current*		Dec 2018F
EUR vs. USD	1.23	↘	1.15
USD vs. JPY	109	↗	115
EUR vs. GBP	0.89	→	0.88
GBP vs. USD	1.38	↘	1.3
USD vs. CNY	6.3	↗	6.8

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Equities

Equity markets (index value in points)	Current*		Dec 2018F
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United States (S&P 500)	2,620	↗	2,750
Europe (Stoxx Europe 600)	369	↗	405
Eurozone (Euro Stoxx 50)	3,326	↗	3,780
Germany (Dax) ¹	12,107	↗	14,100
United Kingdom (FTSE 100)	7,092	↗	7,500
Switzerland (Swiss Market Index)	8,682	↗	9,450
Japan (MSCI Japan Index)	1,030	↗	1,120
MSCI Emerging Markets Index (USD)	1,143	↗	1,210
MSCI AC Asia ex Japan Index (USD)	697	↗	760
MSCI EM Latin America Index (USD)	2,952	↗	3,150

* Sources: Bloomberg Finance L.P. as of 2/9/18

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¹ Total-return index (includes dividends)

For currencies and equities, the arrows signal whether we expect to see an upward trend ↗, a sideways trend → or a downward trend ↘.

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Glossary

Basis point

One basis point equals 1/100 of a percentage point.

Bunds

Bunds is a commonly used term for bonds issued by the German federal government with a maturity of 10 years.

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Chinese yuan (CNY)

The **Chinese yuan (CNY)** is legal tender on the Chinese mainland and the unit of account of the currency, Renminbi (RMB).

Covered bonds

Covered bonds are securities similar to asset-backed securities (ABS) which are covered with public-sector or mortgages loans and remain on the issuer's balance sheet.

Dax

The **Dax** is a blue-chip stock-market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange.

Emerging markets (EM)

Emerging markets (EM) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

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EUR

EUR is the currency code for the euro, the currency of the Eurozone.

Euro (EUR)

The **euro (EUR)** is the common currency of states participating in the Economic and Monetary Union and is the second most held reserve currency in the world after the dollar.

Euro Stoxx 50

The **Euro Stoxx 50** is an index that tracks the performance of blue-chip stocks in the Eurozone.

European Central Bank (ECB)

The **European Central Bank (ECB)** is the central bank for the Eurozone.

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Eurozone

The **Eurozone** is formed of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

FTSE 100

The **FTSE 100** is an index that tracks the performance of the 100 major companies trading on the London Stock Exchange.

Gilts

Gilts are bonds that are issued by the British Government.

High Yield (HY)

High-yield bonds are issued by below-investment-grade-rated issuers and usually offer a relatively high yield.

Inflation

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

Investment grade (IG)

Investment grade (IG) refers to a credit rating from a rating agency that indicates that a bond has a relatively low risk of default.

Japanese yen (JPY)

The **Japanese yen (JPY)** is the official currency of Japan.

Mortgage-backed security (MBS)

A **mortgage-backed security (MBS)** is a special type of asset-backed security where the holder receives interest and redemption payments from pooled mortgage debtors, secured by the underlying mortgages.

MSCI Asia ex Japan Index

The **MSCI AC Asia ex Japan Index** captures large- and mid-cap representation across 2 of 3 developed-market countries (excluding Japan) and 8 emerging-market countries in Asia.

MSCI Emerging Markets (EM) Latin America Index

The **MSCI Emerging Markets (EM) Latin America Index** captures large- and mid-cap representation across five emerging-market countries in Latin America.

MSCI Emerging Markets Index

The **MSCI Emerging Markets Index** captures large- and mid-cap representation across 23 emerging-market countries.

MSCI Japan Index

The **MSCI Japan Index** is designed to measure the performance of the large- and mid-cap segments of the Japanese market.

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Municipal bonds (Munis)

Municipal bonds (Munis) are debt securities issued by a state, municipality or country.

Periphery

Periphery countries are less developed than the core countries of a specific region. In the Eurozone, the euro periphery consists of the economically weaker countries such as Greece, Portugal, Italy, Spain and Ireland.

Pound sterling (GBP)

The **pound sterling (GBP)**, or simply the pound, is the official currency of the United Kingdom and its territories.

S&P 500

The **S&P 500** is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

Spread

The **spread** is the difference between the quoted rates of return on two different investments, usually of different credit quality.

Stoxx Europe 600

The **Stoxx Europe 600** is an index representing the performance of 600 listed companies across 18 European countries.

Swiss Market Index (SMI)

The **Swiss Market Index (SMI)** is Switzerland's most important equity index, consisting of the 20 largest and most liquid large- and mid-cap stocks.

Treasuries

Treasuries are fixed-interest U.S. government debt securities with different maturities: Treasury bills (1 year maximum), Treasury notes (2 to 10 years), Treasury bonds (20 to 30 years) and Treasury Inflation Protected Securities (TIPS) (5, 10 and 30 years).

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U.S. dollar (USD)

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U.S. dollar (USD)

The **U.S. dollar (USD)** is the official currency of the United States and its overseas territories.

U.S. Federal Reserve Board (the Fed)

The **U.S. Federal Reserve Board**, often referred to as "**the Fed**", is the central bank of the United States.

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