



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 |
|---------------------------|----------|---|-----------|
| <b>United States</b>      |          |   |           |
| 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 <sup>1</sup> | 72 bp  | ↗ | 100 bp        |
| <b>Europe</b>  |        |   |               |
| German Bunds (10-year)                               | 0.75%  | ↗ | <b>1.00%</b>  |
| UK Gilts (10-year)                                   | 1.57%  | → | 1.40%         |
| Euro investment-grade corporates <sup>2</sup>        | 84 bp  | ↘ | 75 bp         |
| Euro high-yield corporates <sup>2</sup>              | 291 bp | → | 260 bp        |
| Securitized: covered bonds                           | 36 bp  | ↗ | 65 bp         |
| Italy (10-year) <sup>2</sup>                         | 130 bp | ↘ | <b>120 bp</b> |
| <b>Asia-Pacific</b>                                  |        |   |               |
| Japanese government bonds (10-year)                  | 0.07%  | → | 0.1%          |
| Asia credit  | 219 bp | ↘ | 210 bp        |
| <b>Global</b>  |        |   |               |
| 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)

<sup>1</sup> Current-coupon spread vs. 7-year U.S. Treasuries

<sup>2</sup> 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) <sup>1</sup>        | 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  | ↗ | <b>3,150</b> |

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<sup>1</sup> 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)

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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)**

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## **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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