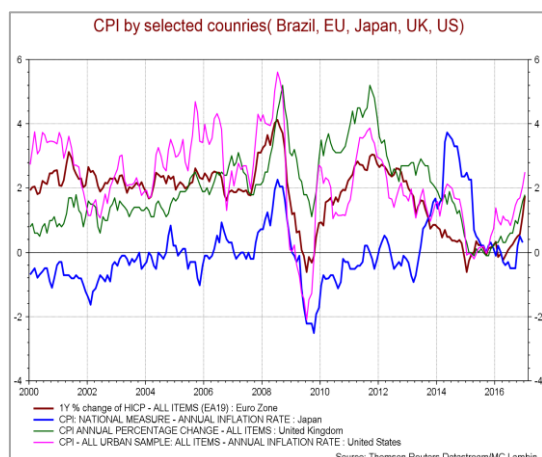
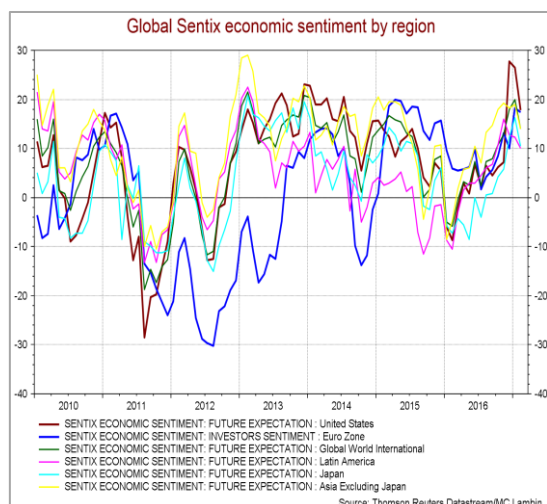
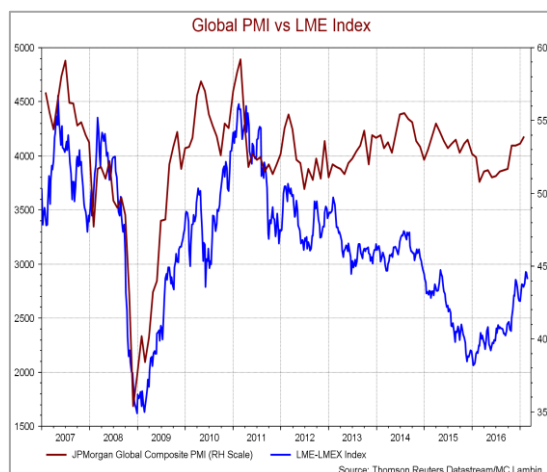


## Global economic backdrop

### What's new?



### The first synchronized recovery since 2009

- **Global PMI data** point to a general pick-up in world economic activity driven a steady upturn the pace of manufacturing growth.
- **Emerging markets** continue to trail behind the developed world with a PMI of 51.2 compared with 54 for the developed world, but the growth differential that has been narrowing since 2013 is starting to widen again.
- **Economic sentiment indicators** are showing some signs of ebbing but remain elevated, boding well for economic activity in the months ahead.
- **Domestic demand** remains the cornerstone of the economies.
- **Global growth** is seen to accelerate slightly to 3.4% in 2017 and 3.6% in 2018, from 3.1% in 2016. In the near term, the possible package of U.S. fiscal stimulus could provide a stronger boost to global GDP than currently expected. However, in the medium term potential disruptions associated with US positions on trade policy could damage international trade.
- **The world potential growth** is widely expected to remain weak due to structural factors such as lower productivity, ageing population, a slowdown in global trade.
- **High level of uncertainty** persists about the path of future growth due to:
  - Geopolitical risks: Trump's immigration and trade policies, elections in Europe, uncertainty about Brexit negotiations, Greece, Russia/Ukraine conflict
  - Rising Chinese debt
  - Higher interest rates and tighter financial conditions to have adverse effects on some emerging market countries that depend heavily on external financing (eg Mexico and Brazil).

### A general pick-up in headline inflation

- **Consumer prices (CPI) and Producer prices (PPI)** are creeping up globally, driven a recovery in oil and other commodity prices. This is more a reflation environment from very low levels than the beginning of an outright inflationary scenario. The rise in inflation related to the favourable base effect is expected to be temporary.
- **Core inflation** (excluding food & energy prices) remains stable, particularly in the US and Europe, indicating underlying inflationary pressures remain muted so far.

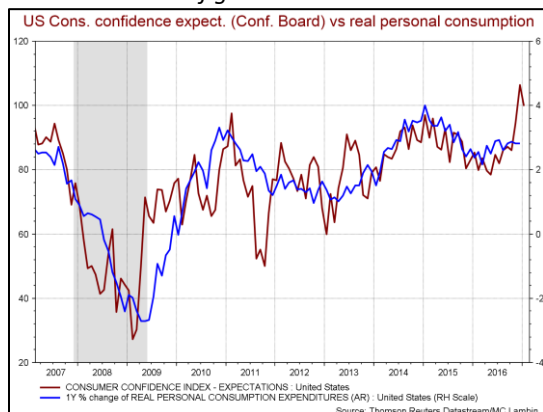
## Economic backdrop by country

### USA

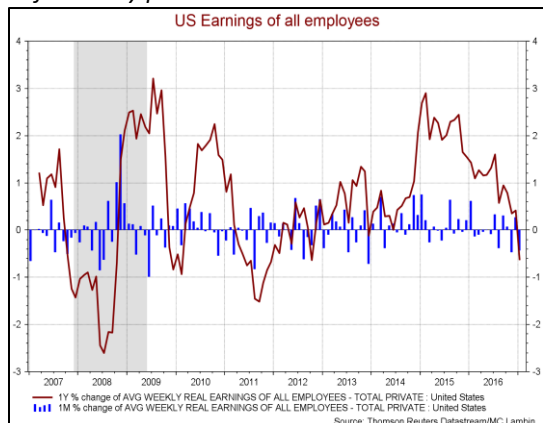
#### Trump inherits an already rebounding economy



#### Upbeat consumers boding well for consumption, the main driver of growth



#### Disappointing wage growth keeping a lid on inflationary pressures

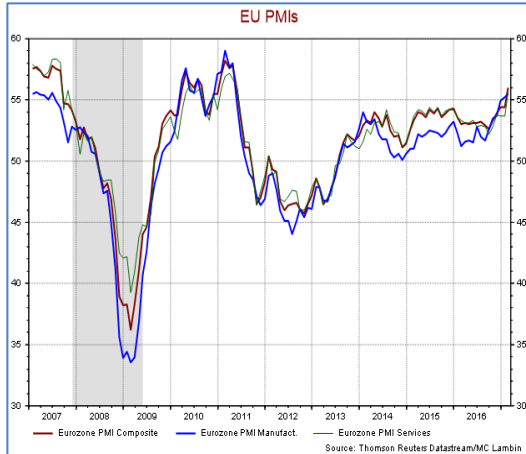


- Signs of economic strength are piling up.** Factory activity accelerated in January with ISM rising to 56.0 amid sustained gains in new orders as domestic demand strengthens. Business spending on equipment increased at a 3.1% annualized rate in Q4 after four straight quarterly declines. Job creation remains solid. Private employers added 246,000 jobs in January, up from 151,000 in December. The four-week average of weekly jobless claims fell to a 43 ½ year low in a sign of tightening labor market conditions. Still, there is an unusual discrepancy between the unemployment rate and the capacity utilization rate in the manufacturing sector. The latter is still nearly 5 pp below its long-term average and using the historical relationship between the two this implies an unemployment rate a little above 6%. Existing and new home sales figures continue to point to a strengthening housing market despite higher prices and mortgage rates. Consumer confidence retreated from a 15-year high in January likely as some of the election euphoria fizzled, but households remained upbeat about the labor market, encouraging them to spend. The University of Michigan consumer sentiment index suggested a 2.7% annualized growth pace in consumer spending this year. The NFIB index of small Business Confidence rose to its highest since Dec 2004. Surging optimism forms the basis of the economic acceleration many expect this year. Rising optimism is critical for the economy to expand, as the public and businesses often spend more when confidence is on the rise. Existing home sales continue to shine with home prices crimping higher as fewer homes are available for sale. Wage growth remains moderate so far (+0.5% in Q4, +2.3% yoy). The consensus is for GDP growth in a range of 2.1-2.5% in each quarter.

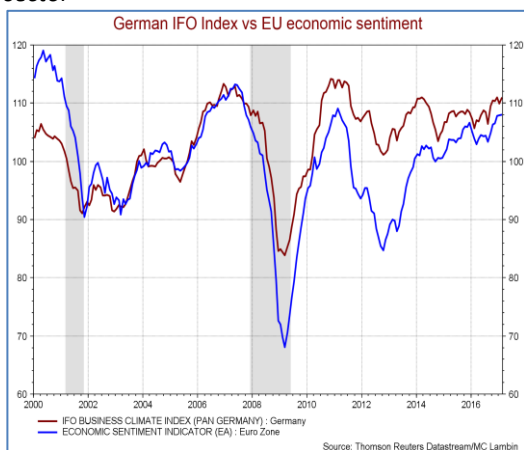
- Details on Trump's economic policies remain scarce, giving the Fed less clarity on the direction of US economic policy.** Trump's frequent tweeting in lieu of providing details about his policy priorities cast doubt on the breadth and depth of his economic program. It is unclear how impactful changes to tax policy and infrastructure spending can be on worker productivity which remains low at +0.2% in 2016 (vs +0.9% in 2015) still well below the long-term rate of 2.1% from 1947 to 2016. Too much fiscal stimulus could drive inflation sharply higher, pushing the Fed into a steeper path of rate increases. But Trump's threatened trade barriers could crush global growth. Recent comments from the Trump administration indicated its pro-growth policies may have a longer route to implementation. Treasury Secretary Mnuchin said growth effects from tax reform and less business regulation would not likely start to take hold until next year. The pace of rate hikes will probably depend on how much inflation is generated from Trump's proposed measures to bolster economic growth. Most analysts expect a rate increase in June. A reduction in the balance sheet is not expected until mid-2018.

## Euro zone

*Euro zone starting the year on a strong note*



*Improvement in economic sentiment driven by more optimism in industry and the services sector*

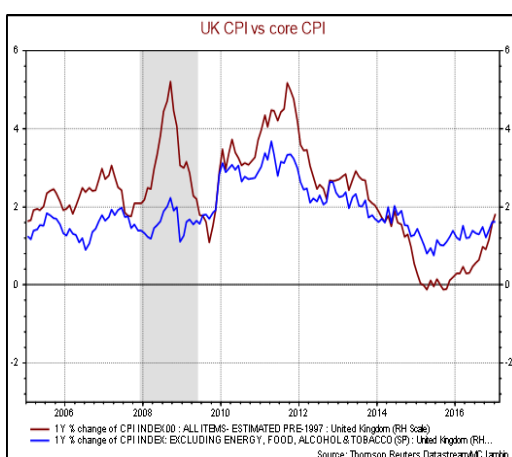
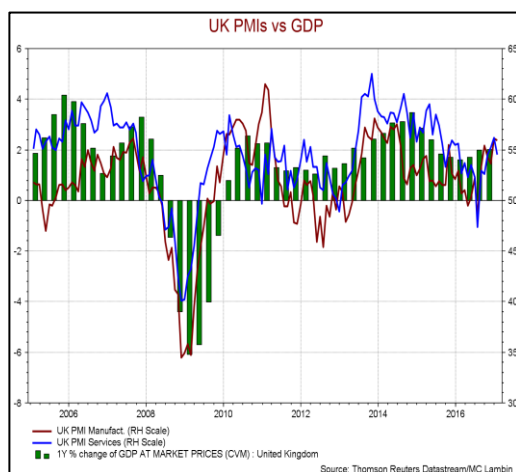
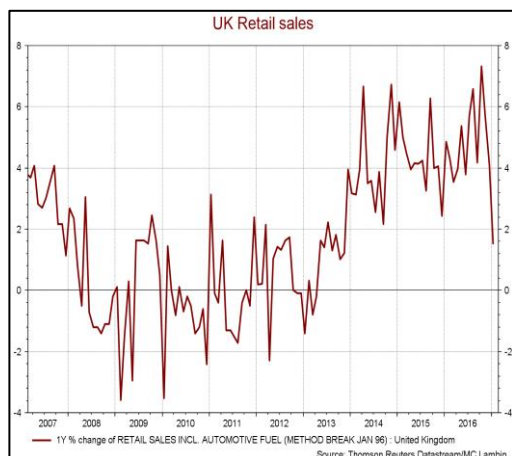


*Lending activity remains subdued*



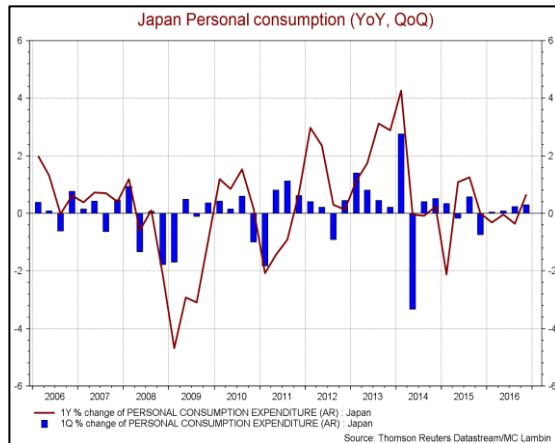
- A broad based upturn.** Eurozone private sector growth accelerated more than expected in February (Composite PMI up sharply to 56.0 from 54.4 in January near a six-year high). Both manufacturing and services were buoyant with domestic demand strengthening and a weaker euro boosting orders from abroad. Job creation reached its fastest since August 2007, propelled by strong demand and optimism about the future. France finally joined the party with a composite PMI of 56.2, higher than Germany's 56.1. Germany's IFO business remained surprisingly buoyant in February despite worries about US trade policies and the French elections. German industrial orders posted their biggest monthly increase in around 2 1/2 years, driven mainly by higher demand at home and abroad. The Bundesbank said in its latest monthly report that the German economy will stay on a strong footing in the coming months thanks to high industrial and construction activity. French industrial morale rose to 5 1/2 year high in February, above expectations. The broad-based acceleration suggests that if sustained, euro zone economic growth could hit 0.6 % in Q1 17, above predictions of 0.4% earlier in the year. There is however a disconnect between bullish businesses and consumers. The euro zone final consumer confidence index fell in February, as did the GfK German consumer confidence index looking ahead at March, posing a threat to future growth.
- Inflationary pressures contained so far.** The Commission predict consumer prices in the euro zone will pick up this year to 1.7% from 0.2% last year, above the ECB's forecasts of 1.3%. Euro zone inflation is expected to slow again in 2018 to 1.4% and core inflation, which excludes more volatile prices, is set to rise only gradually. Wages in the euro zone are stagnant.
- The ECB to remain on the sidelines.** While the renewed strength in the PMIs should come as a welcome relief to the ECB, no substantial policy review is expected in March and the first discussion on the next move is not likely until June, after the French and Dutch elections. No decision is likely until autumn, possibly after the German election in September. Arguing that the recent inflation surge was temporary and threats to growth remained, policymakers widely agreed in January to continue with their bond purchase program but cut its monthly purchases to 60 billion euros from 80 billion euros starting April 2017, saying they would go on until the end of 2017. However we cannot expect current monetary stimulus to last forever
- Risks tilted to the downside:** the European Commission said uncertainty about US policies, Brexit and elections in Germany and France would take their toll on the euro zone economy this year. It forecast the euro would slow to 1.6% this year from 1.7% in 2016, but would gain speed in 2018 (+1.8%). Lending has been on a steady upward path since early 2015 but picked up speed only gradually, leading to concerns that ECB measures were taking too long to work and were perhaps ineffective.

## UK



- On course to slow this year albeit less sharply than previously expected.** Consumer spending, adjusted for inflation, rose just 0.4% yoy in January, down sharply from 2.5% in December, the weakest annual growth rate in over three years, Visa said. Robust consumer spending helped Britain's economy to outpace its peers last year, even after June's Brexit vote, but rising inflation as a result of sterling's hefty slide will eat into growth in 2017. British GDP growth is forecast to decline from 2.0% in 2016 to 1.5% in 2017 and to further slow down to 1.2% in 2018 as business investment is likely to be adversely affected by persisting uncertainty while private consumption growth is projected to weaken as growth in real disposable income declines. The British unemployment rate is seen rising slightly to 5.6% in 2018 from 4.9% last year, while inflation will increase steeply to 2.5% this year and 2.6% in 2018.
- The Bank of England may curtail previously anticipated rate cuts due to relatively resilient post-Brexit economic performance** and concerns about currency depreciation, which is already leading to heightened inflation. Consumer inflation hit its highest level since mid-2014 in December at 1.6% yoy. Most economists expect consumer inflation to climb towards 3%, overshooting the Bank of England's target. The BoE has predicted that inflation will hit a peak of 2.8% in the first half of 2018. Yet, British policymakers have said they will not be rushed into an interest rate hike because they expect the pick-up in inflation prices will be driven by temporary effects from the fall in the pound after June's vote to leave the European Union. If the trends of higher inflation and higher pay growth continue, the BOE may have to sharpen its rhetoric, providing support for sterling.
- Still plenty of Brexit unknowns.** PM Teresa May confirmed that Britain will leave the EU single market, stressing that the UK was not seeking "partial, or associate membership – nothing that leaves the UK half in, half out of the European Union. May said she wanted Britain to be able to negotiate its own trade agreements, as well as tariff-free trade with Europe. May also revealed that Britain would take back power to make its own laws, decided in Westminster rather than the European Court of Justice in Luxembourg. Because Britain will no longer be members of the single market, it will no longer be required to contribute huge sums to the EU budget, except for some specific EU programs. Brexit must mean control of the number of people who come to Britain from Europe, ensuring that the government can control immigration to Britain from Europe. A hard Brexit could constrict the foreign investment needed to fund Britain's huge current account deficit, one of the biggest in the developed world.

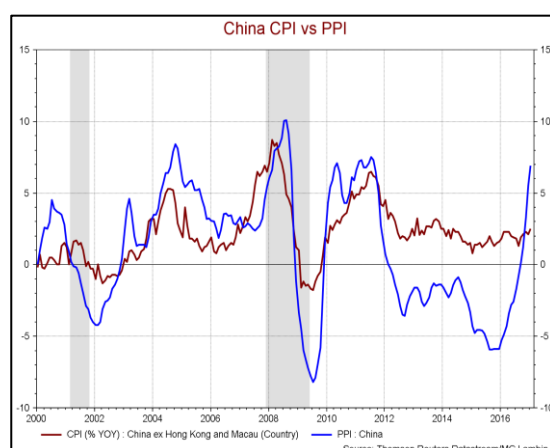
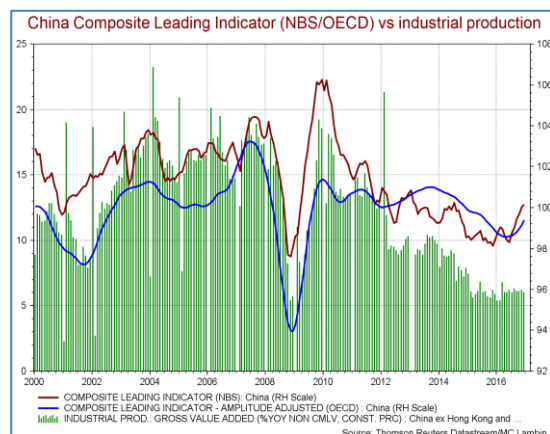
## Japan



- Tepid private consumption casting doubts over a sustainable recovery.** GDP grew at an annualized 1% in Q4 as a weaker yen supported exports, but private consumption, which accounts for roughly 60 percent of GDP, showed no growth. Manufacturing activity expanded in February at the fastest pace in almost three years (at 53.5) but inflation-adjusted real wages dropped in December for the first time in a year, boding ill for consumer spending. GDP growth is expected to remain among the lowest in developed countries (+1.2% in the fiscal year starting April and 1.0% for fiscal 2018).
- Growing trade protectionism clouding the outlook.** Japan's exports rose in January at a slower pace than the previous month due to a decline in shipments to the US (-6.6% yoy due to fewer shipments of auto and electronic parts) and slower shipments to China (+3.1% yoy from 12.4% yoy). Japan's largest trading partner, rose 3.1 percent year-on-year in January. Japan's trade surplus with the United States fell to 399.3 billion yen (\$3.54 billion). If the trade surplus with the United States starts rising again, it could become a flashpoint after Trump singled out Japan, China and Germany for their high exports into the U.S. market. But the summit between Prime Minister Shinzo Abe and U.S. President Donald Trump earlier this month was largely positive. The two leaders agreed to establish a bilateral economic dialogue, focusing on issues such as economic policies, infrastructure, energy and trade.
- The likelihood of more BOJ stimulus is diminishing.** The central bank has lowered short-term interest rates to -0.1% and bought billions of yen worth of bonds and other assets in a campaign to boost inflation and growth. With signs of inflation pick-up, the BOJ is likely stay the course this year. Japanese policymakers are starting to see fiscal stimulus as the most likely next step to spark economic growth.



## China

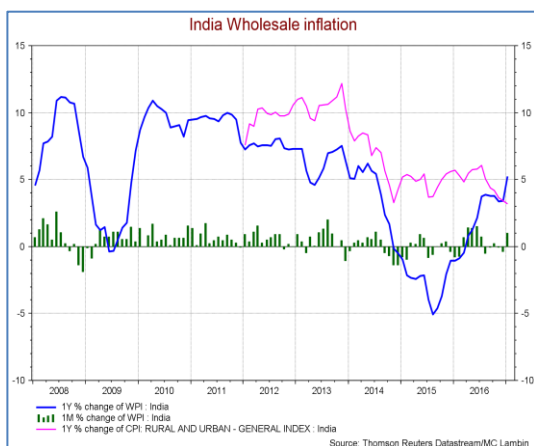
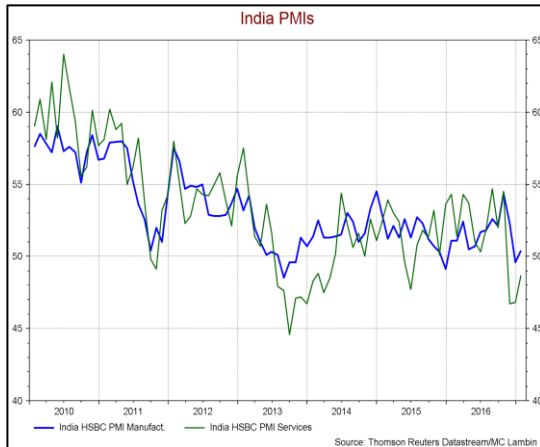


### Slower investment is weighing on GDP growth



- Economic activity is stabilizing.** Services PMI accelerated to 53.4 in December, a 17-month high mirroring improvements in manufacturing surveys. New business for services firms rose at the fastest pace in 17 months, though an employment sub-index remained stubbornly weak and input prices rose the fastest in nearly two years. China is slowly making progress in shifting its economic growth model away from a heavy reliance on exports and investment, with consumption contributing 71% of growth in the first nine months of 2016.
- The momentum is driven by the recovery in prices,** especially rather than any real return of real demand. Producer prices (PPI) surged 6.9% yoy in January. Consumer prices accelerated to 2.5% yoy mainly due to a seasonal rise in food and travel costs ahead of the Lunar New Year holiday, still within the government's comfort zone of 3%, and showing few signs yet that the jump in producer prices is filtering through to the broader economy. Auto sales are forecast to slow to single-digit growth this year, home sales are on a downward trend and even China's red-hot film industry grew only 3.7% last year. Private investment has remained stubbornly weak, leaving the economy dependent on government spending
- Even as fears of an economic hard landing have greatly diminished, other risks have become more pronounced.** The foreign trade environment looks increasingly uncertain amid threats by US President Trump to impose tariffs on China's shipments into its largest export market, and to brand Beijing a currency manipulator. Credit is growing significantly faster than GDP, hitting a record of 250% of GDP last year. January's new yuan loans were the second-highest on record as banks stepped up lending, indicating policymakers' efforts to rein in risks have not reduced bank credit to the highly-indebted corporate sector. Credit risks in the financial sector continue to increase and the performance of commercial banks deteriorates gradually, increasing the risk of a banking crisis in the next three years. Speculation in housing, commodities and even government debt markets have raised the risks of asset bubbles as overall leverage in the economy is still rising. Capital outflows from China surged last year to a record \$725 billion and could pick up further if U.S. firms face political pressure to repatriate profits. The outflows caused a \$320 billion decline last year in Chinese foreign exchange reserves.
- These risks have led to expectations that financial and monetary conditions will be tighter this year.** China's central bank raised short-term interest rates in recent weeks as it looks to contain risks from an explosive growth in debt.

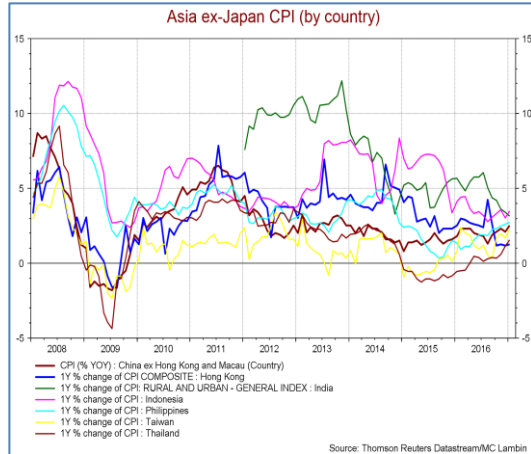
## India



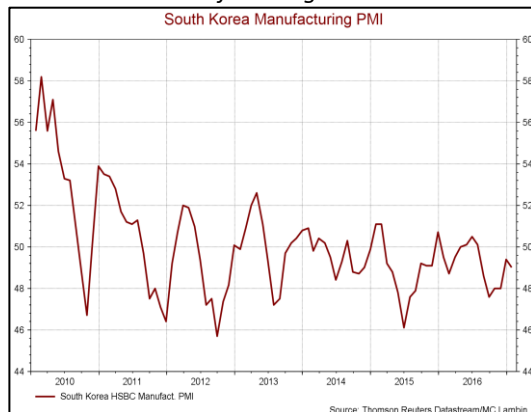
- Demonetization, a temporary pain.** In November last year Prime Minister Modi announced the cancellation of large-denomination banknotes (500-rupee and 1000-rupee), which account for 86% of the cash circulating in India, to fight corruption and illegal activities. The move disrupted daily life, depressing consumer demand for most of the sectors. Industrial output contracted in December. The composite PMI rose to 49.4 in January from 47.6 in December. Services PMI rebounded but remained below the 50 mark while the factory activity returned to modest growth. Consumer confidence has fallen sharply with households uncertain about their income, employment and spending capability. With factories running nearly 30% below capacity, companies are not ready for fresh investments until demand roars back to life. GDP growth is expected to slow to 6.4% in Q4 from 7.3% in Q3. The Reserve Bank of India (RBI) has called the slowdown a transitory phenomenon and expects a sharp rebound in economic growth in the next fiscal year as cash conditions improve. Currency in circulation increased to 7.2% of GDP in mid-February from 5.9% in early January, albeit lower than the 12% before the cash crackdown began. A majority of economists are confident the demonetization measures will boost consumption and investment in the longer run.
- Structural reforms.** Modi's government has brought a significant change in the focus of federal spending, moving from benefits and subsidies to investment in long-term assets – particularly infrastructure, including roads, railways, power transmission, rural infrastructure, warehousing and ports – which should help modernize India's economy. Administrative, legislative and supply-side reforms are taking place at a national level. Modi's attempts to foster 'co-operative federalism' to spur state-driven projects are gaining traction.
- Fiscal stimulus.** To support those most impacted by demonetization, Finance Minister Jaitley unveiled an annual budget that increased government spending and cut income and small enterprise taxes.
- Inflation risks growing.** Wholesale prices rose 5.25% yoy in January as fuel prices climbed. Retail inflation cooled to 3.17% but core inflation, which excludes volatile goods and fuel prices, accelerated.
- The Royal Bank of India signaled end to its easing cycle** saying inflation poses a bigger threat to the economy than a crackdown on "black money." The RBI kept its repo rate on hold at 6.25% at its February meeting for a second straight policy meeting, opting to wait for more clarity on inflation trends and on how demonetization is impacting economic growth. Most economists now expect the RBI to hold rates until at least the second half of next year.

## The rest of Asia

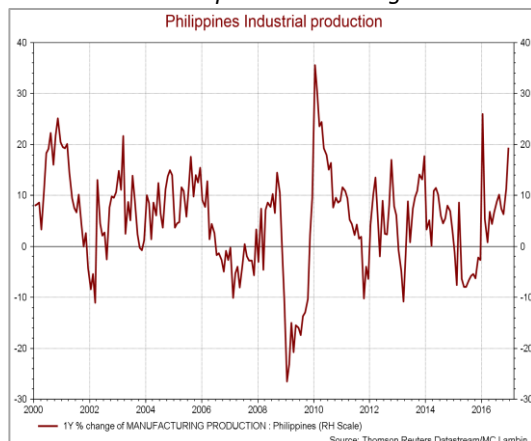
### Inflation creeping up across the region



### South Korean manufacturing still in contraction



### South East Asian exports rebounding



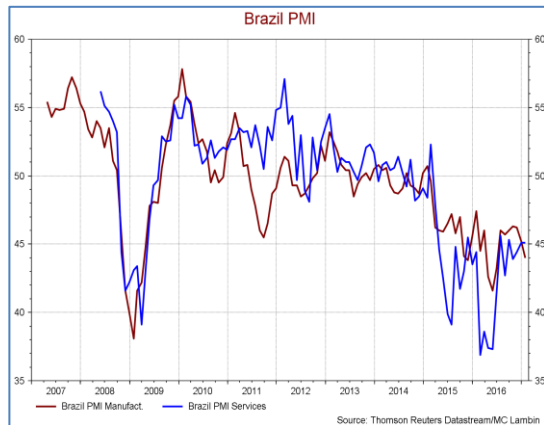
### Not an homogenous region

- South Korea** is struggling to emerge from recession. The manufacturing sector contracted for a sixth straight month in January due to quicker falls in output and new orders, amid unstable economic conditions and weak demand, prompting some companies to cut back further on staffing. Consumer sentiment has plunged to multi-year lows as the country grappled with a political scandal involving President Park Geun-hye, who was impeached by parliament in December. Retail sales fell in December by the fastest drop since September 2016.
- In Malaysia**, whose the ringgit currency has fallen sharply due to capital outflows, the PMI fell to a five month low, hurt by falls in production and new orders.
- Taiwan, the Philippines, Indonesia and Vietnam** are showing stronger PMI data amid solid recovery in exports and production.
- Ramp up in government spending.** Governments in from Thailand to Malaysia, states are boosting budgets for railways, roads and other infrastructure projects to help bolster growth in a region facing uncertain global markets and the threat of a pullback in trade under U.S. President Donald Trump.





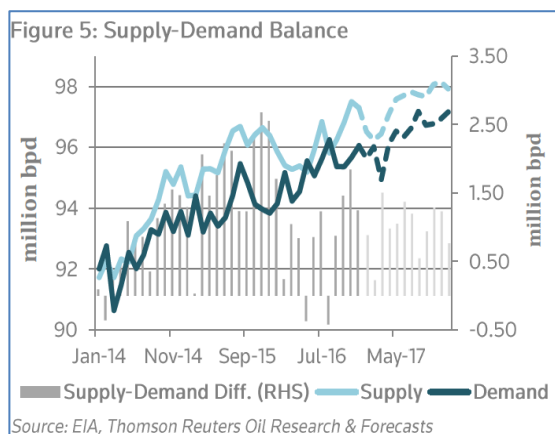
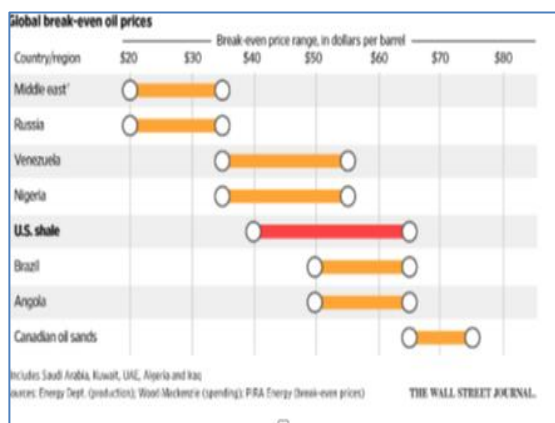
## Brazil



- **Still struggling to rebound from two years of deep recession.** The Composite PMI fell to a five-month low of 44.7 in January from 45.2 in December. Companies hold some hopes that the situation will improve in 2017, but concerns towards the speed of the economic rebound weigh on overall confidence.

## Commodities

*Rising commodity price are contributing to positive sentiment.*



- China's massive imports of coal, crude oil, iron ore and industrial materials have helped fuel a sharp rebound in global resources prices in recent months, boosting profits for producers and processors. Price gains in China have been further amplified by government efforts to reduce industrial overcapacity.

### Oil prices to remain supported by a more balanced market.

- Oil prices remain well above 50 USD, supported by tightening fundamentals (rising demand, production cuts). Oil prices however look unlikely to surge from here. If oil price goes up to around \$60, we will likely see a resumption in investments from the US and elsewhere and supply will grow again, keeping a lid on oil prices. Over the past two years, US shale producers have increased efficiency substantially and can now survive at much lower prices and be competitive with other large producers worldwide. Much uncertainty remains about the sustainability of China's growth, the main consumer of oil.
- According to recent Thomson Reuters polls, WTI crude prices are seen to average \$58/bbl in 2017, \$60.61 in 2018, \$64.81 in 2019, \$66.71 in 2020.

### Gold as a worthy insurance asset against political and policy uncertainty.

- In the short term, gold looks technically stretched as it is sensitive to any increase in the probability of an early Fed rate hike. Gold is highly sensitive to US economic data, and greenback strength. An unexpected March and May hike by the Fed could weigh on prices.
- Gold fundamentals are strengthening. Central bank purchases, better Asian physical demand prospects and new interest from investors, largely as a hedge against elevated political and policy uncertainty, falling US real rates and a weaker US dollar, should bring support to gold prices in the months ahead (\$1300 on UBS view)
- According to recent Thomson Reuters polls, gold crude prices are seen to average \$1239 in 2017, \$1317 in 2018.

## Interest rates outlook

### A gradual increase in interest rates

#### ❑ Central bank interest rates

- Central banks are widely expected to remain accommodative given the low growth environment and limited inflationary pressures.
- Persisting slack in the US economy as evidenced by the slow pace of wage growth and the subdued level of capacity utilization rate suggests inflationary pressures should remain contained, allowing for a gradual pace of rate increases.

Source: Bloomberg 27/02/17

Central banks	Current	Q117	Q217	Q317	Q417	Q118	Q218
ECB	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Fed	0.75	0.75	1.00	1.10	1.35	1.50	1.70
BOE	0.25	0.25	0.25	0.25	0.25	0.30	0.30
BOJ	-0.10	-0.10	-0.13	-0.13	-0.13	-0.14	-0.12

Source: Bloomberg 27/02/17

#### ❑ Government bond yields

- While U.S. GDP growth may appear to be on the upswing for the next year or two, the lack of clarity beyond could keep a lid on Treasury yields, particularly at the long end of the curve.
- Structural factors like aging population and low productivity also suggest global government bonds yields will edge moderately higher.

Central banks		Current	Q117	Q217	Q317	Q417	Q118	Q218
US 30-Y		2.98	3.06	3.17	3.26	3.35	3.43	3.55
US 10-Y		2.36	2.47	2.58	2.69	2.78	2.87	3.00
Euro zone 10Y		0.20	0.36	0.46	0.58	0.69	0.84	0.96
Japan 10Y		0.05	0.07	0.08	0.09	0.09	0.12	0.11
UK 10 Y		1.15	1.36	1.47	1.53	1.64	1.80	1.93

Source: Bloomberg 27/02/17

#### ❑ Potential surprises

- “Trumponomics” or Trump’s pledges to push through \$ 1trillion in tax cuts and public spending may spark growth and inflation above expectations, and hence bond yields.
- Conversely, bonds yields could stagnate at best if current euphoria around “Trumponomics” fades due to a disconnect between policy rhetoric and action. It seems very difficult to get Congressional approval for an increase in government spending if it entails a sharp deterioration in budget deficits. Therefore, the final package could be much smaller or take longer to be agreed upon. On the medium-term, the negative effects from more protectionism and a tougher immigration policy may dominate possible positive effects from less regulation, lower taxes and infrastructure spending. Protectionist trade views may weigh on foreign investment and be a significant impediment on global growth.

## Corporate outlook

### A cyclical rebound in earnings

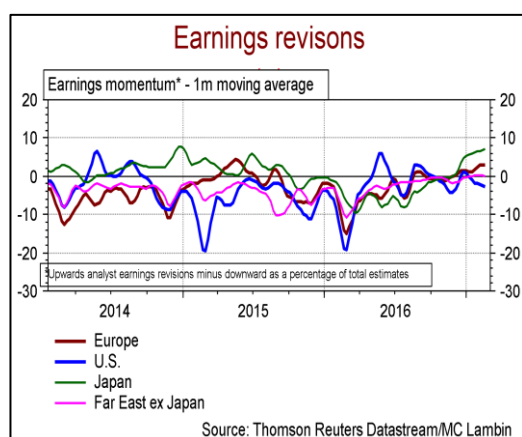


EXHIBIT 8C. S&P 500: CY 2017 EARNINGS GROWTH

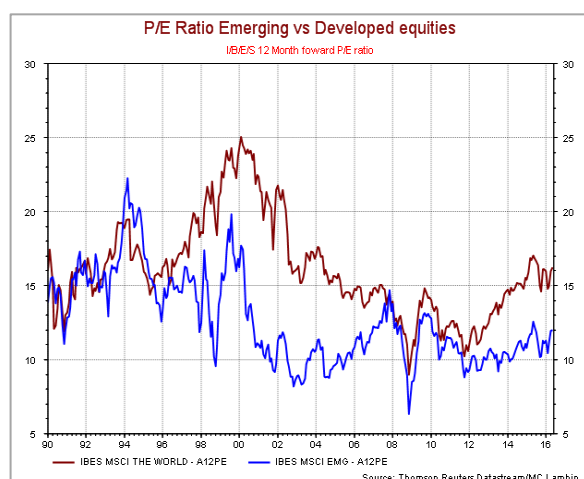
Sector	Today	1 Jan
Consumer Discretionary	7.9%	9.3%
Consumer Staples	6.0%	7.3%
Energy	403.5%	357.7%
Financials	12.7%	11.3%
Health Care	5.3%	8.6%
Industrials	4.7%	4.9%
Materials	12.9%	15.5%
Real Estate	2.4%	6.5%
Technology	8.7%	12.1%
Telecom	0.7%	3.4%
Utilities	-0.3%	0.3%
S&P 500	10.9%	12.5%

Source: Thomson Reuters I/B/E/S

- USA:** Of the 460 companies in the S&P 500 that have reported earnings to date for Q4 2016, 67.8% have reported earnings above analyst expectations. In aggregate, companies are reporting earnings that are 2.2% above estimates. According to IBES estimates, Q4 earnings are expected to increase 7.7% from Q4 1 (vs +6.1% expected at the start of the year), +7.8% excluding the energy sector. Technology (+12.2 %) and Financials (+11.6%) have the highest growth rates. Earnings growth is expected to accelerate further, largely due to much easier comparisons in the depressed energy sector. For all of 2017, S&P 500 earnings and revenue expected up 11.5% and 5.9%, respectively. President Donald Trump has promised a "phenomenal" plan by early March to cut business taxes. But some Republican senators have criticized a House Republican plan to levy a 20% tax on imports aimed at encouraging more U.S. production and exports and raising \$1 trillion in revenue over a decade to offset lower business tax rates. U.S.
- Europe:** Of the 164 companies in the Stoxx 600 that have reported earnings to date for Q4 2016, 53.7% have reported earnings above analyst expectations. In aggregate, companies are reporting earnings that are 3.7% above estimates. According to IBES estimates Q4 earnings are expected to grow by 14.4% from Q415 (+11.6% ex-energy). The Consumer Cyclical sector has the highest earnings growth rate (83.7%) of any sector. For all of 2017, earnings and revenue are expected to be up 11.5% and 5.9%, respectively.
- UK:** Consensus forecasts for 2017 expect strong earnings growth of 19%, which would mark the first year of earnings growth since 2011, to large extent driven by commodity sectors. They account for 20% of the market capitalization of the UK index and. Downside risk; a significant strengthening of the pound in 2017 versus 2016.
- Japan:** Corporate profits have been revised up on a weaker yen. Big manufacturers based their profit estimates on an assumed average dollar/yen rate of 104.90 for the current fiscal year.
- China:** Profit of industrial firms slowed sharply in December to +2.3% y/y, from +14.5% in the previous month (vs +8.5% y/y in 2016).
- India:** Following the recent demonetization and the likely related FY2017 GDP dent, estimates have widely been cut to high single digits for FY17 ending in March. A rebound is expect by mid-year, with a strong double digit growth in FY18 due partly to the low demonetization base and also asset quality improvements in the financial sector.

## Valuations

### No longer cheap but far from exuberance



- Developed markets exhibit valuations slightly above average but still look reasonable given the low rates environment and muted inflationary pressures.
- Major Wall Street indexes have rallied to record levels since the election of Donald Trump as U.S. president, boosted by pledges of tax reforms, reduced regulations and increased infrastructure spending. Details however remain scarce on Trump's plans and investor sentiment is improving faster than the actual activity. Ultimately we need to see those fundamental changes come through to validate that improved sentiment and higher valuations.
- Provided companies earnings growth accelerate in 2017 as forecast, we think forward PE ratio have still some room to expand as long as inflation remain below 3%. The forward price-to-earnings ratio of the S&P 500 is currently at 17.8.

Index	Last price (26/02/17)	PE 2017	Target forward PE	Index target price
Euro Stoxx 50	3304.09	14.11	14	3612
STXE 600 € Pr	370.01	15.16	14.5	387
DAX INDEX	11804.03	13.65	14	13175
CAC 40 INDEX	4845.24	14.29	14	5272
FTSE 100 INDEX	7243.70	14.75	15	7929
SWISS MARKET	8525.62	17.23	16	8798
FTSE MIB INDEX	18596.66	12.91	13	22059
DOW JONES INDUS.	20821.76	17.36	17	22527
SPX Index	2367.34	18.27	17	2465
NASDAQ	5845.31	22.30	20	6128
NIKKEI 225	19107.47	18.30	17	21329
TOPIX INDEX	1534.00	15.79	14	1662

Source: Bloomberg, Bolero Capital Sarl

Inflation range (%)	Affordable PE multiples
○ 0-3	18-19
○ 3-4	17
○ 4-5	15.9
○ 5-6	15.4
○ Deflation	13.6 (sources Raymond James)



## Investment conclusions

### Global Asset Allocation

*Reflation policies should support equity prices this year, particularly in the US but also in the rest of the world.*

*Bonds are at risks of rising US inflation prompting the Fed to raise rates.*

*Still, there will be no shortage of events in 2017 that could trigger bouts of panic in financial markets.*

*We think that the best course is not to let politics get in the way of your portfolio, focus on fundamentals and keep a well-diversified strategy.*

Global allocation	current	Neutral
Equities US	39.21%	28.49%
Equities Europe	20.63%	10.23%
Equities Japan	0.00%	3.92%
Equities GEM	7.90%	7.37%
<b>total equities</b>	<b>67.74%</b>	<b>50.00%</b>
Futures US	0.00%	0.00%
Futures EU	0.00%	0.00%
Futures JP	0.00%	0.00%
Futures EM	0.00%	0.00%
<b>total futures</b>	<b>0.00%</b>	<b>0.00%</b>
Equities net US	39.21%	28.49%
Equities net EU	20.63%	10.23%
Equities net Japan	0.00%	3.92%
Equities net EM	7.90%	7.37%
<b>Total equities net</b>	<b>67.74%</b>	<b>50.00%</b>
Bonds DM Sovereign	1.13%	29.50%
Bonds DM corporate IG	5.89%	14.00%
Bonds DM Corporate High Yield	14.96%	3.50%
Bonds EM sovereign + corp	7.34%	3.00%
<b>Total bonds net</b>	<b>29.31%</b>	<b>50.00%</b>
Gold	0.00%	0.00%
Mixed	0.00%	0.00%
Cash	2.95%	0.00%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>

### Overweight equities versus bonds

#### The risk-on sentiment triggered by the US elections may have further to go

- **Equities** offer the best risk/reward over the next 12 months.
- Confidence indicators among both corporate and households remain elevated, suggesting the global economy should stay in a positive momentum in the months ahead, paving the ground for an acceleration in corporate earnings growth, the main driver of equity return.
- Valuations still look supportive given the low rate environment. A slight expansion in valuation multiples still look appropriate if inflation remain moderate between 2-3%.

- **Overweight US, Europe, Asia ex-Japan,**
- **Underweight Japan,**
- **Overweight Technology, Industrials, Healthcare, US Financials,**
- **Neutral Energy, Consumer Discretionary, Telecoms, Basic Materials,**
- **Underweight Utilities, Real Estate**

- **The overall fixed income outlook** remains uncertain. Government bonds in the developed world are likely to deliver negative total returns in 2017 if interest rates increase on the perceived risk of rising inflation and less support from monetary policies.

- **Prefer credit over sovereign**
- **Overweight USD and EUR High Yield, Emerging Debt**

#### The road to higher stock prices is likely to remain bumpy

- **The macroeconomic environment is complex and political risks abound.**
- **In the US,** it remain to be seen whether Trump's policies will succeed in matching market expectations. Additional fiscal stimulus is already largely priced in and concrete steps towards government investment and

corporate tax review are required to justify an extension of the rally. The US is now at full employment, which creates the potential for a faster FED rate hiking cycle. The details of Trump's economic policies remain largely unknown. Trump's frequent tweeting in lieu of providing details about his policy priorities has increased the skepticism on the breadth and depth of his economic program. With a Republican House of Representatives and Senate, Trump should be able, in theory, to implement his program. In practice, it seems very difficult to get Congressional approval for an increase in government spending if it entails a sharp deterioration in budget deficits. Therefore the final package could be much smaller or take longer to be agreed upon. On the medium-term, the negative effects from more protectionism and a tougher immigration policy may dominate possible positive effects from less regulation, lower taxes and infrastructure spending.

- **Europe faces a wave of elections** in the coming months which could result in anti-euro political parties gaining significant ground or even taking office, leading to market turmoil, which could spread to the real economy and prompt the ECB to cut rates and ramp up quantitative easing (QE). The fact that the world can change in unexpected ways underlines the need for a flexible and diversified portfolio.
- **Many uncertainties remain about the Brexit negotiations.** The Brexit vote has had little initial impact on global economies so far. It will take time before its ultimate effects became clear and to determine whether the damage to the UK and euro area economies will lead to a significant global downturn, or something milder and regional in nature
- **Chinese debt** remain a concern.
- Given Trump's penchant for unexpected comments and aggressive negotiating style, we expect another year of increased **volatility** will likely lead to increased sentiment swings and swift sector rotations.

## Equity strategy

## By country

### USA (+)

- The economy appears well-positioned to remain on a sustained growth path in 2017: increasingly enthusiastic consumers supported by strong labour and housing market suggest household's demand will help economic growth in the months ahead.
- Trump's growth agenda is quite positive for the US economy and businesses. The prospect for fiscal stimulus, massive infrastructure spending, tax cuts and lighter regulation will provide a major support to several sectors like technology, financial services, energy, consumer discretionary, consumer staples, and industrials. The sharp corporate tax cuts will boost corporate earnings.
- Small businesses in particular could thrive, as they may benefit from those factors without also being punished by the anti-trade rhetoric and strong US dollar impacting large multinationals.

### Europe (+)

- Solid domestic consumer demand and ongoing monetary easing are supporting the recovery.
- The European Central Bank (ECB) is continuing its monthly asset purchases, albeit at a reduced rate of EUR 60bn from April.
- After five years of stagnating earnings, EPS growth should return in 2017, helped by a pick-up in nominal GDP growth. Leading economic indicators for manufacturing and service sector activity are signaling continued expansion.
- A strong US economy is also proving a bone to European markets. European companies derive around 40% of their revenues from the US. Political uncertainties related to upcoming elections in France, Germany and perhaps Italy may cap ongoing enthusiasm. Brexit negotiations with the EU may bring volatility and additional political instability within not only the U.K. but also the broader Eurozone. The full economic impact of the Brexit will take years to materialize. British multinational companies with significant international earnings will benefit from a lower pound.
- The risk of significant P/E compression should be limited, unless higher-than-expected US inflation forces the Fed to tighten policy aggressively

### Japan (-)

- We have no exposure to Japan equities. The economic recovery remains weak and fragile. Abenomics policy has failed to prop up domestic demand and inflation.
- A weaker yen triggered by Trump's victory could boost company profits over the near term.
- The Japanese equity market is highly sensitive to reversal in currency. Weaker dollar/stronger yen has the potential to hurt Japanese corporate profit.

### Emerging markets (+)

Upgraded to a slight  
Overweight from  
Neutral

- The anticipated increase in US infrastructure spending helps support certain commodity markets.
- Short-term sentiment may remain negatively impacted by revised expectations for the pace of Fed tightening in 2017 and fears of trade protectionism under Trump administration.
- Most emerging economies however look well placed to weather a gradual increase in US rates. Growth differential between emerging and developed economies is showing signs of bottoming out with further improvements awaited. Most EM countries have made further progress on implementing structural reforms in the past year. EM GDP is expected to grow by 4.0% this year and 4.8% in 2017, compared to 1.5% in each year for DM.
- Asia remains our favourite play, India in particular.

## Equity strategy

## By country

### China (-)

- In 2016, China's industrial sector has benefited from infrastructure and housing spending, which has spurred demand for materials from cement to steel. But the economy will face challenges in 2017 as the impact of previous stimulus wears off and as the property sector slows. Government effort to cut excess industrial capacity and restructure state-owned enterprises are posing risks to near-term growth.
- A credit bubble burst is a tail risk.
- China's massive export sector also faces risks as Trump has threatened tariffs on Chinese imports. The Chinese government should set a more flexible target for economic growth this year to give more space for reform efforts

### India (+)

- Demonetization measures will likely continue to disrupt economic activity over the near term, with a rebound seen in H217.
- India remains one the best structural growth stories within the emerging world driven by consumption-led growth, favourable demographics, rising income levels, a revival in government expenditure and falling inflation. The government continues to focus on initiatives targeting improvements in efficiency.
- Valuations in line with their long-run average. One of the best potential earnings growth in the coming year in the region

### The rest of Asia (=/+)

- Structural reforms have put ASEAN on a strong foundation for recovery and sustainable growth. Regional inflation set to climb but not a big enough jump to lead Asian central banks to tighten monetary policy significantly and threaten easy financial conditions

## Equity strategy

## By sector

### Industrials (+)

- Global industrial activity is proving more resilient than expected. Receding fears about a hard landing in China and a pick-up in nominal world GDP growth is providing support to the sector.
- Infrastructure related stocks (industrials, materials, transportation, construction and house builders) should be supported by Trum's pro-growth agenda and its huge financial pledges to upgrade the US infrastructure.
- The need for infrastructure development is a global phenomenon. While developed countries need to repair, upgrade or completely replace aging infrastructure, emerging countries need to develop new infrastructure to meet the needs of their growing populations, economies and urban centres. This create opportunity for cement companies.
- Resource-rich countries that benefit from higher commodity prices could invest more in infrastructure.
- Defence companies should benefit from increased defence budget. Security and safety themes should also get a boost.
- Risk: the potential US fiscal stimulus under Trump is largely priced in.

### Technology (+)

- Technology has been one of the most consistent earnings generators in recent quarters. Enterprise IT spending has remained solid, growing at a mid-single digit pace, driven by strong software spending and data center-related investments in developed markets. Cloud-related investments continue to be robust. Cyber security has above-average growth prospects.
- With large offshore cash balances, US tech companies will be one of the biggest beneficiaries of the foreign profit tax breaks reform. The US Technology sector is expected to take advantage of high FCF generation to increase dividend growth. In Europe the sector's premium rating reflects above-average ROEs and steady cash flow generation in software.

### Financials (+)

- The US banking sector will benefit from deregulation as Trump is likely to scale back the most "anti-business" parts of the Dodd-Frank Act which was passed in the wake of the financial crisis. Banks and insurance should benefit from a rise in the short end of the yield curve (due to higher inflation expectations and Fed normalization. Wait for price consolidation or pullbacks before making tactical moves.
- More caution about European banks (Italian in particular)

### Basic Materials (=)

- Reductions in China's excess capacity + Trump's reflationary policies have buoyed prices of raw materials in the second half of 2016.
- Further price appreciation may be limited as the Chinese economy will face challenges in 2017 as the impact of previous stimulus wears off and as the property sector slows.

### Healthcare (=)

- Near term outlook clouded by lingering challenges: debate about drug pricing likely to stay (particularly in the US); patent expiries and generic competition for certain players; rising bond yields (pharma tend to underperform during periods of rising rates).
- Long term drivers: strong cash generation and growing dividends, aging population (especially in more mature markets) and improving access to care in developing markets; valuations below historical average; gearing generally low, providing companies flexibility to pursue acquisitions.



## Equity strategy

## By sector

### Energy (=)

- Oil fundamentals have improved but much of this is already priced in.
- The US energy sector should benefit from less regulation and the removal of restrictions to increase oil exploration and production. Joint effort between OPEC and certain Non-OPEC producing countries to cut production could lead to a supply shortage in early 2017, providing support to crude oil prices.
- Merger and acquisition activity may continue to accelerate in the space driven by opportunistic consolidations and restructurings.
- North American energy capex is expected to grow by 27% in 2017, boding well for oil services companies. North America could become a net crude exporter by 2025.

### Consumer Discretionary (=/+)

- The consumer environment in the US and Eurozone remain supportive. Consumer confidence is relatively high on a historical basis, helped by improving employment figures, an increase in consumer purchasing power stemming from lower oil prices.
- Successful online operators with strong brands will continue to outgrow the market. Without the cost burden of physical stores, e-commerce can price below traditional rivals and drive recurring traffic online.
- Luxury goods shows strong earnings momentum despite a difficult trading environment (weaker tourist flows to Europe due to terrorist attacks, marked slowdown of Chinese consumers but travel to the UK looks more promising). The rising middle class in Asia, remains intact, although sales growth has slowed down.
- Fast food restaurant likely to suffer from margin pressure due to rising wages.

### Consumer staples (-)

- Consumer staples have recently underperformed due sector rotation into financials and cyclicals.
- The sector's high valuation is vulnerable to a further de-rating amid rising bond yields.
- Increasing production costs a headwind: Consumer staples often lack the ability to pass on higher input prices to their customers.
- Still a defensive sector due to attractive high and stable cash generation, supported by solid growth prospects in emerging. Markets. Branded products typically benefit from higher margins and shelf resilience compared to private label products. Consumer personal care, particularly anti-aging products benefitting from aging population. European companies with high exposure to the US, should benefit from a high consumer confidence and good economic momentum;

### Real Estate (-)

- Trump's victory spurred a rotation away from yield towards cyclicals.
- Real estate is sensitive to rising to rising rates.
- In the US, new supply is expected to rise in the coming quarters, which will be a drag on values.
- In Europe, the current low interest rate environment will persist into the foreseeable future, supporting the somewhat elevated valuations but will not stay immune to the US trend. Their dominant retail and residential real estate companies are generally viewed as defensive proxies, and hence, more vulnerable to selling pressure.

## Fixed Income strategy

### DM government bonds (-)

- US Treasuries will likely continue to suffer from the higher perceived risk of inflation, higher budget deficits, and uncertainty surrounding the conduct of monetary policy
- Still, longer-maturity US Treasuries still provide some degree of both diversification and protection in what remains a highly volatile investment environment. US GDP growth appears to be on the upswing for the next year or two, but the lack of clarity beyond could keep a lid on Treasury yields, particularly at the long end of the curve. Trump's protectionist tendencies could provide a headwind for growth, offsetting any fiscal spending effect.
- Core European government bonds look unattractive with no coupon cushion available to dampen capital losses.
- Weak productivity and excess global savings should ensure bond yields rise at only a gradual pace in the few coming years.

### Corporate investment grade bonds (-)

- Moderate economic growth is supportive for credit, protecting FCF generation and keeping financial engineering and credit ratios in check.
- **Prefer US over EU:** EU IG is supported by ECB bond purchase program but yield has become unattractive. This could benefit US credit with increased demand from European and Asian investors in search for yield.
- Fundamentals remain strong for US credit as economic data has been supportive along with potential tailwinds from the Trump administration's planned tax reform, deregulation and repatriation tax relief for foreign-held cash.
- While the steepening of the yield curve may continue - in anticipation of greater fiscal stimulus and higher potential for inflation - the magnitude will ultimately depend on the scope of infrastructure spending and tax cuts that President-elect Trump is proposing.

### US High Yield (+)

- Moderate global economic growth will lead to gradual rate hikes, which should be constructive for HY bonds. Attractive yield (6.3.0% to maturity and 6.0% to worst) compensating for the risks associated to the oil price. Given strong corporate fundamentals and the continued stabilization of commodity prices, we anticipate a decline in defaults this year. Outside the energy sector, defaults are expected to remain well below historical averages (at 3-4% over the next 12 months) g. Downside risk: credit cycle more advanced than in Europe.

### EUR High Yield (+)

- Monetary support by the ECB an important tailwind.
- Spreads have tightened recently to 370 bps, still fairly compensating for low default (expected at around 2% over 12 months).
- Shorter duration (typically between 3 and 3.5 years) and a better credit quality than their American counterparts.
- Its lower exposure to commodity-sensitive sectors limits its default risk. Near-term risks from the banking sector.

### Emerging Debt (+)

- Barring any extreme scenario including a sudden spike in US rates and outflows, we expect the asset class to outperform other FI assets. Yields remain attractive in a world of negative rates across several DM.
- While the near term outlook for the asset class is clouded by rising Fed hike expectations, and potentially negative trade developments under Trump's administration, EM fundamentals have improved with higher commodity prices and

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the sharp EM FX depreciation of the past years having resulted in current account improvements in EM countries.

- EM sovereign credit quality remains supported by strong public sector balance sheets and low external debt ratios.
  - EM corporate defaults may have peaked. History has shown EM corporates market is quite immune to rising rates and commodity price volatility.
  - EM is not heterogeneous asset class, differentiation remains a decisive factor of excess returns.
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