

Global Investment framework

What's new?

A speech and not a tweet is more suitable when you are president of the US

Trump more presidential than ever before

- **US President Donald Trump showed a different side in his first address to Congress.** Trump said he was open to immigration reform, shifting from his harsh rhetoric on illegal immigration in a speech that offered a more restrained tone than his election campaign and first month in the White House, appealing to Republicans and Democrats to work together on immigration reform. He once again promising to build a "great wall" on the border with Mexico.
- Trump gave some guiding principles on healthcare reform. He promised to expand access, lower costs and provide better healthcare. However, it remains unclear what plan, if any, could actually be passed by both houses of Congress. The leaked plan has already attracted a lot of Republican opposition and seems very unlikely to make it through the Senate.
- Trump repeated his promise of a "big cut" on corporate taxes and "massive tax relief for the middle class," but again it's unclear what could pass Congress.
- Trump reiterated his USD 1 trillion public-private partnership plan for infrastructure spending, to rebuild degraded roads and bridges, again offering nothing new.
- The president's speech however was long on promises but short on specifics on how to achieve a challenging legislative agenda that could add dramatically to budget deficits.
- Democrats remain troubled, among other things, by Trump's pledge to slash domestic programs to increase military spending, his plans to reduce taxes for the wealthy and corporations, as well as his aggressive deportation policy.

A Fed rate hike in March most likely

Rising inflation expectations backing the view that the Fed's long-stalled 'liftoff' of interest rates may finally get airborne this year



- Policymakers from Chair Janet Yellen to regional leaders across the United States signalled that the era of easy money is drawing to a close. New York Fed President Dudley. Yellen cemented the view that the Fed will raise interest rates at its next meeting on March 14-15, and likely be able to move faster after that than it has in years. The breadth and consistency of the Fed's statements seemed to suggest a deliberate effort to shift markets in line with what policymakers see as the new reality - a stronger world economy, steady U.S. growth, and the possibility of fiscal and tax plans that may edge inflation and growth even higher.
- The normalization process will likely remain very gradual. Fed Governor Brainard argued that the central bank should not move rates too high until economic conditions improved overseas. 2017 may be the year the Fed is able to follow through on its forecast of three rate hikes.

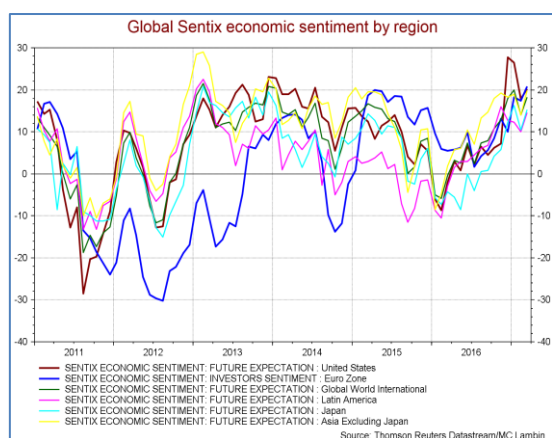
ECB to remain steady for now

The ECB is keen not to move too early.

- While the renewed strength in the PMIs should come as a welcome relief to the ECB, no substantial policy review is expected in March although calls are mounting, particularly in Germany, for the bank to scale back its 2.3 trillion euro bond buying scheme and raise its negative interest rates.
- Draghi will likely stick to his line that the inflation surge is temporary, growth is fragile and political risks clouds the outlook, requiring stimulus. With just weeks to go before French and Dutch elections, the ECB will be keen not to rock the boat, so it is likely to give just a token nod to robust growth figures.
- If the French presidential election also passes without turbulence, and growth and inflation data remain solid, the ECB might turn more hawkish in its meeting on June 8. No decision is likely until autumn, possibly after the German election in September.
- 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. 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.

Investors and purchasing managers not worried yet by political uncertainty

Investor sentiment is boosted by improving economic fundamentals. Markets have now moved from low growth, disinflation and a negative interest rate environment a year ago on to reflation, higher interest rates and fiscal stimulus.



- **Investors responded positively to Trump's** surprisingly conventional presidential address to Congress which lacked any real detail but importantly scaled back his usual combative tone. Rather than betting on Trump as a source of near-term stimulus, the market seems to be simply keen that he does not spoil expectations.
- **Recent PMI data** indicate that despite the risks to the euro zone economy entailed by the possible upsets in those elections in the Netherlands (March 15), France (April 23, May 7) and Germany (October), along with a rise in protectionism worldwide, manufacturers are currently eschewing political uncertainty and growing their businesses on the back of buoyant demand.
- **We believe the risk on mode is likely to stay, at least until the French elections.** The improving economic environment is paving the ground for an acceleration in corporate profit, the main driver of equity return. Moreover, a gradual US rate hike should prevent a major disruption in financial markets. At the end, higher rates would signal the Fed's growing confidence in the economy.

Rising populism as a threat to EU bond yields

- In the Netherlands, the 2015 refugee crisis has led to a sharp rise in voting intentions for Geert Wilders' right-wing populist Party for Freedom (PVV). A landslide victory of EU-skeptic populists could set a strong precedent for elections in France, Germany, and potentially Italy. As a consequence, it may result in a further widening of French and Italian government bond risk premiums.

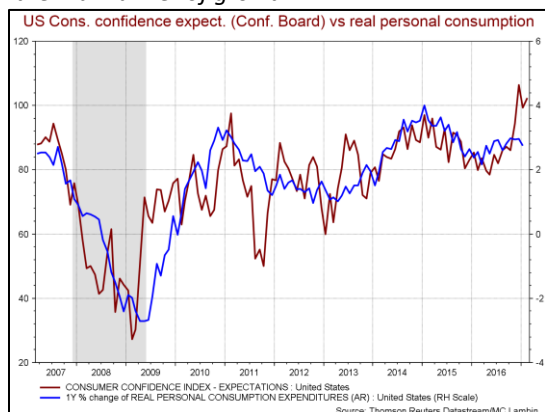
Economic backdrop

USA

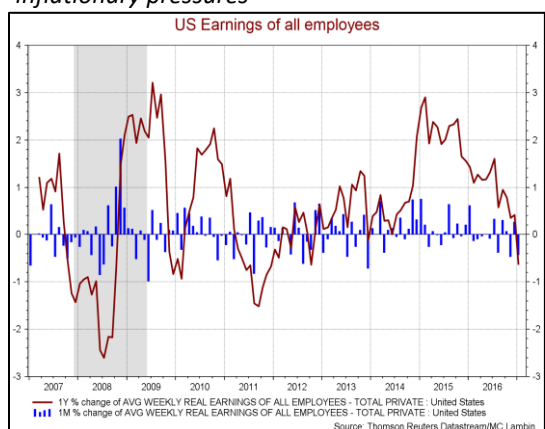
Trump inherits an already rebounding economy



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



Disappointing wage growth keeping a lid on inflationary pressures



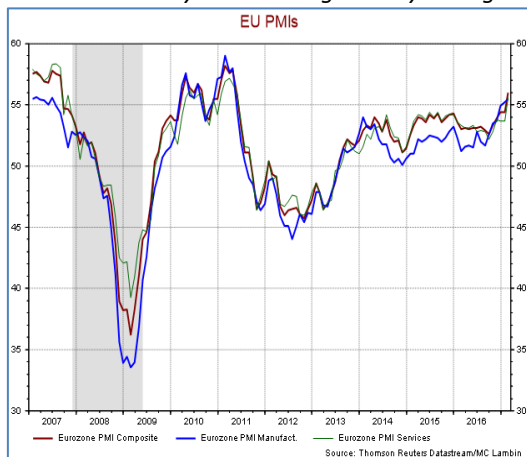
- Signs of economic strength piling up.** US Q4 GDP growth was revised down to 1.9% defying analysts' expectation for an upward revision to 2.1%. Business investment was not as strong as initially thought. Spending on equipment increased at a 1.9% instead of the previously estimated 3.1%. The increase in residential construction spending was lowered to 9.6% from 10.2%. Spending on mining exploration, wells and shafts rose at a 23.6% in Q4 after declining at a 30.0% in the prior period. Durable goods orders rose 1.8% mom in January, ahead of the 1.6% prior estimate. The ISM Chicago business index surged to 57.4 in February, the strongest level since January 2015, driven by robust new order growth and production. The ISM-Chicago report mirrored other regional surveys that have offered an upbeat assessment of the manufacturing sector. The Dallas Fed manufacturing index climbed to the highest level since April 2006. House prices surged 5.6% yoy in December driven by a shortage of properties for sale. New home sales rose less than expected in January, likely held back by heavy rains and flooding in California, but continued to point to a strengthening housing market despite higher prices and mortgage rates. The Conference Board consumer confidence showed consumers remained upbeat about the labor market amid expectations of income gains. 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. The consensus is for GDP growth in a range of 2.1- 2.5% in each quarter

- Persisting slack in the economy suggests the Fed will remain cautious.** 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%.

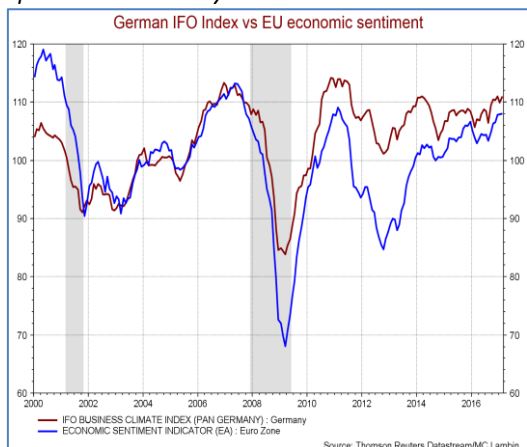
- Inflation rising but still contained so far.** Personal income rose a bit more than expected in January (+0.4%). Private-sector wage and salary income rose 0.4% (+4.8% yoy). Government wage and salary income rose 0.5% (+3.0% yoy). Rental income rose 1.0% (+7.3% yoy). Farm income rose 2.1% (-42.1% yoy). Disposable income rose 0.3% (+4.0% yoy), down 0.2% adjusting for inflation. Personal spending rose less than expected reflecting a drop in auto sales and lower home energy consumption (unseasonably warm weather). Inflation-adjusted consumer spending (about 70% of GDP) fell 0.3% (+2.8% yoy). The PCE Price Index rose 0.4% in January (+1.9% yoy). The PCE Price Index ex-food & energy rose 0.3% (+ 1.7% yoy, still below the Fed's goal of 2.0%, but not by a lot).

Euro zone

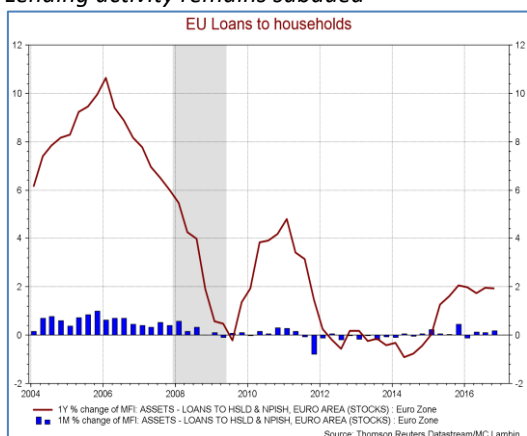
Euro zone activity accelerating to a 6 year high



Economic sentiment is improving, driven by more optimism in industry and the services sector



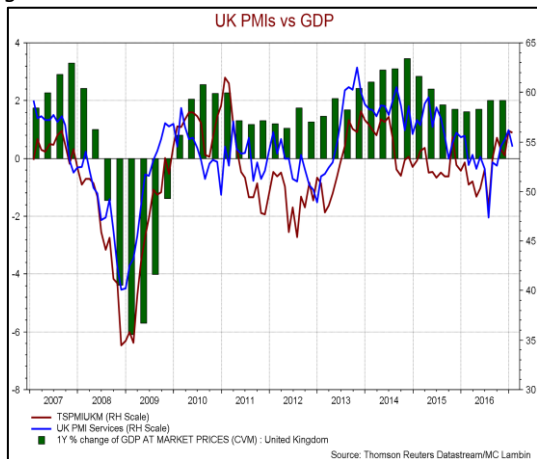
Lending activity remains subdued



- A broad based acceleration.** Eurozone private sector growth accelerated in February with the Final composite PMI rising to 56.0 from 54.4 in January. 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. the European Commission forecast the euro would slow to 1.6% this year from 1.7% in 2016, but would gain speed in 2018 (+1.8%).
- Euro zone inflation past ECB target.** Consumer inflation rose to 2% in February from 1.8% in the previous month, just above the ECB's target of a rate just below 2%. Producer price inflation, which feeds into overall inflation with a lag, meanwhile surged to an annual 3.5 percent rate from 1.6 percent, hinting at building pressure for underlying price growth. Core CPI however held steady at 0.9%, suggesting that once the oil price surge passes through the numbers, inflation will fall back down, staying below the ECB's target possibly through 2019.
- ECB to remain on the sidelines for now.** The acceleration in growth, employment and prices suggests that analysts will begin to pull forward their expectations of when the ECB could begin tapering its stimulus. Still, the ECB is likely to resist any call to step off the accelerator when it meets next week, arguing that the oil price fuelled inflation surge is temporary, growth is fragile and the outlook is fraught with uncertainty given elections in France, Germany, the Netherlands and possibly Italy.

UK

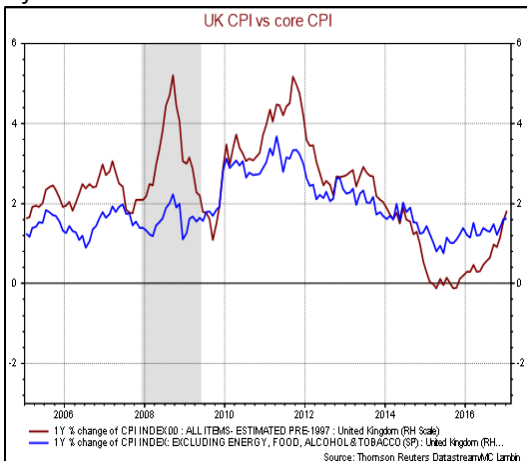
UK factory growth slowing but still set for strong growth in Q1



Retail sales already feeling the pinch of rising inflation



Depreciation of the pound leading to higher inflation



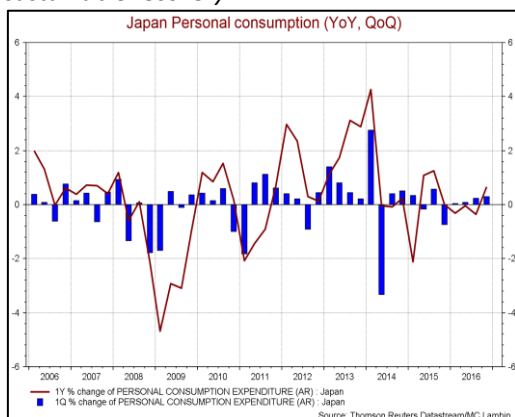
- Unexpectedly strong economic growth since last June's Brexit starting to fade albeit less sharply than previously expected.** The manufacturing PMI slipped to 54.6 in February from 55.7, below expectations, but still showing relatively solid expansion. Slower growth in new orders and a drop in backlogs of work suggested a slowdown, but high levels of optimism among firms, job creation, a recovery in export orders and rising levels of purchasing suggested it would be mild. Manufacturing accounts for around 10% of Britain's economy, a fraction of the size of the dominant services industry. The services PMI fell to a five-month low of 53.3 from 54.5 in January and suggested the economy is now expanding at a quarterly pace of around 0.4% - much slower than the 0.7% expansion during Q416. Although growth slowed in February, services firms remained confident about their prospects in the next 12 months, with optimism running just below January's eight-month high.
- The big question remains as to whether robust growth can be sustained** or whether it will continue to wane in the coming months. Many economists say the manufacturing strength is unlikely to offset fully the impact on the economy of slower consumer spending as sterling's fall pushes up inflation and reduces real disposable income. Consumer inflation hit 1.6% yoy in December and is widely expected to climb towards 3%, overshooting the BOE's target of 2.8% in the first half of 2018. Economists polled by Reuters expect British GDP growth to decline from 2.0% in 2016 to 1.5% in 2017 and to 1.2% in 2018. The British unemployment rate is seen rising slightly to 5.6% in 2018 from 4.9% last year, while inflation will increase to 2.5% this year and 2.6% in 2018.
- The Bank of England in a wait and see mode.** The BOE is watching closely for signs of a slowdown in Britain's economy this year, caused by rising inflation and weaker spending power among consumers. However, the central bank 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. It has forecast growth of 2.0%, above economists' forecast.
- UK no longer united** The Edinburgh government has proposed a bespoke deal for Scotland to stay in the single market while the rest of the United Kingdom - England, Wales and Northern Ireland - leaves. British Prime Minister Theresa May has repeatedly said she is determined to negotiate a deal that works for all parts of the country, which she wants to hold together.

Japan

Manufacturing activity picking up

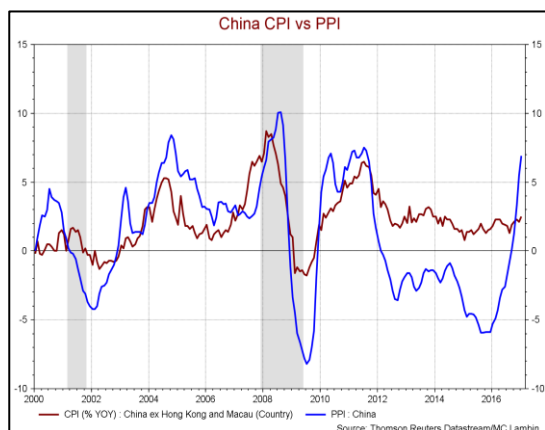
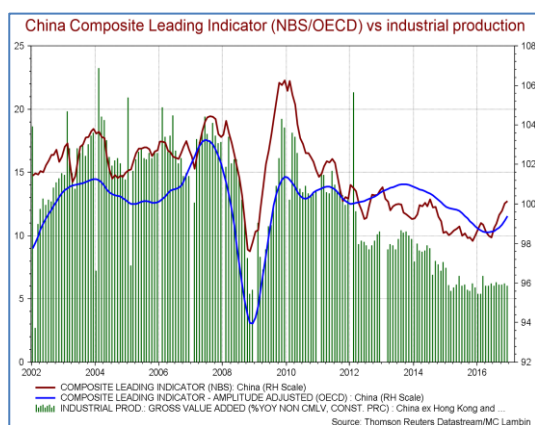


Weak private consumption casting doubts over a sustainable recovery

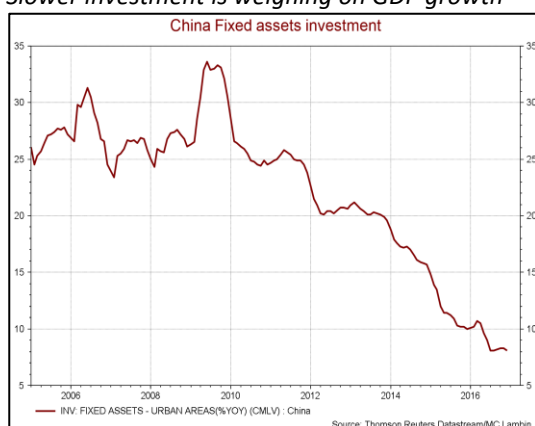


- **A mixed picture.** Business expenditure rose in the final quarter of last year (+3.8% after a 1.3% decline in the previous quarter). Industrial output unexpectedly fell in January for the first time in six months, pressured by a slowdown in shipments of cars to the United States. Exports to the U.S. fell 6.6% yoy. The outlook allowed for little cheer as manufacturers surveyed by the ministry tipped output to rise 3.5% in February and then decrease by a bigger 5.0% in March. Manufacturing activity picked up in February at its fastest pace in three years, driven by strong export order.
- **Question marks remain about domestic demand.** Retail sales rose a mere 1% yoy in January on-year. Inflation-adjusted real wages dropped in December for the first time in a year, boding ill for consumer spending. A preliminary estimate showed the Japanese economy grew an annualised 1% in the October-December quarter. Japanese growth is expected to remain among the lowest in developed countries (+1.2% in the fiscal year starting April 2017 and 1.0% for fiscal 2018).
- **Uncertainty over U.S. economic policies clouding the outlook.** President Trump's pledges to pull back from free trade have raised concerns that protectionism will spread. The summit between Prime Minister Shinzo Abe and U.S. President Donald Trump earlier this in February was largely positive. The two leaders agreed to establish a bilateral economic dialogue, focusing on issues such as economic policies, infrastructure, energy and trade.
- **Japan still distant from achieving his 2% inflation target.** Four years of aggressive money printing by the BOJ have failed to pull Japan sustainably out of stagnation. The BOJ blamed an unexpected slump in oil prices, the hit to household spending from a sales tax hike and Japan's sticky deflationary mindset for pushing back the timeline for achieving its price target. Bank of Japan Governor Haruhiko Kuroda said low profitability at financial institutions could sow the seeds of a new financial crisis, offering his strongest warning to date of the demerits of aggressive monetary easing pursued by major central banks.
- **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 to stay the course this year. Japanese policymakers are starting to see fiscal stimulus as the most likely next step to spark economic growth.

China



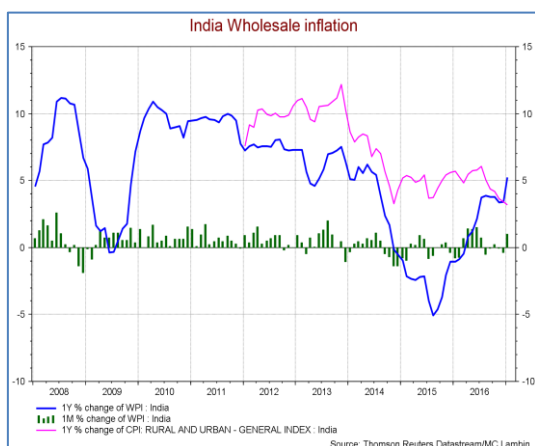
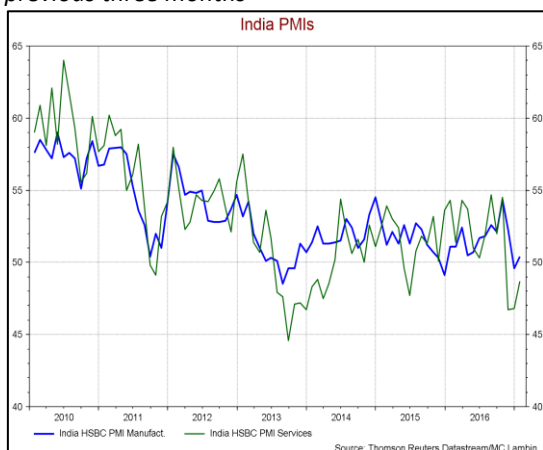
Slower investment is weighing on GDP growth



- Growth momentum maintained in Q1.** Factory activity expanding faster than expected in February after a slight dip in January. Official manufacturing PMI rose to 51.6, beating consensus' expectation of a mild deterioration. The output sub-index jumped the most, while new orders also improved. The employment index continued to rise but remained just below 50. The strong pick-up in the Caixin-Markit PMI, a smaller, independent gauge, also echoes the improvement. The PMI in the services sector, which is more dependent on domestic demand, eased to 52.6, with new business still growing at a solid rate but increasing competition making it harder for companies to raise prices. Service companies continued to add job at a solid pace, and remained optimistic about growth in the next 12 months. 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.
- Signs of weakening may emerge from Q2.** Auto sales are forecast to slow to single-digit growth this year, home sales are on a downward trend. Private investment has remained stubbornly weak at 3.2% last year after double-digit growth in previous years, leaving the economy dependent on government spending. The government has pledged to further cut excess capacity. China said it will cut 65 million tons of steel capacity last year and plans to cut another 50 million tons this year, though some market watchers say the cuts included a large amount of already-idled capacity.
- A Hard Landing unlikely.** The Chinese government is keen to keep a high level of growth to avoid any social unrest. The government has cut its growth target to 6.5% for 2017, from 6.5-7%. Officials said China will take further steps to support private investment.
- 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. 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. 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.

India

Indian businesses recovering from the demonetization-related disruptions seen in the previous three months



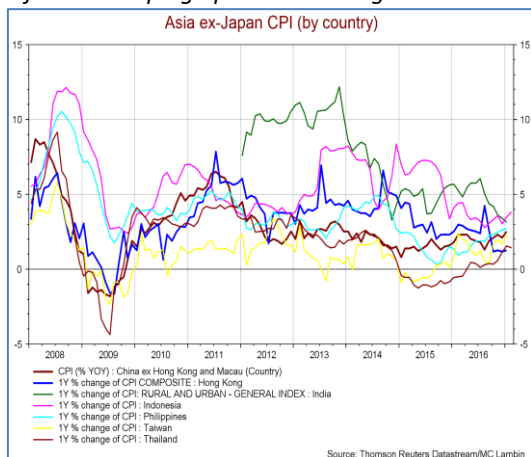
Increasing government spending



- Demonetization, a temporary pain.** India's dominant services industry returned to growth in February for the first time in four months as demand slowly recovers after the government's cash crackdown late last year. 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. Manufacturing activity also expanded further in February, though at a lackluster pace. 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. Indian GDP slowed to 7.0% in the December quarter from 7.4% in the previous quarter but less sharply than the 6.4% expected by economists and still higher than China's growth of 6.8% in Q4. A majority of economists are confident the demonetization measures will boost consumption and investment in the longer run.
- Structural reforms, a long term gain.** 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 help growth.** 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

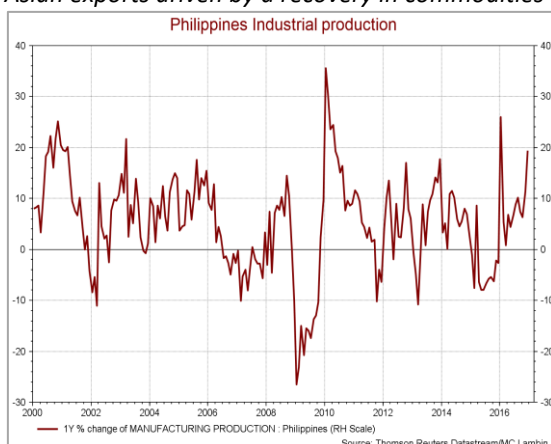
Inflation creeping up across the region



South Korean manufacturing still in contraction



Asian exports driven by a recovery in commodities



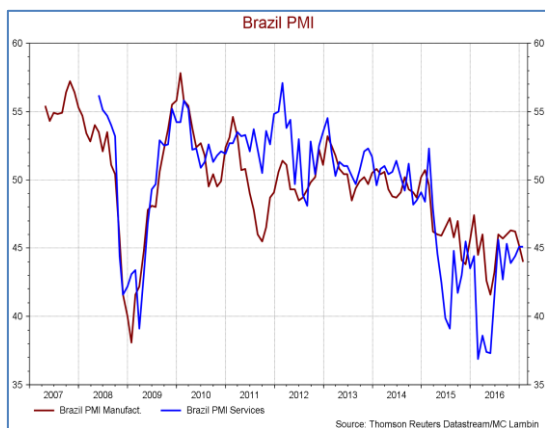
A clear export resurgence

- In South Korea**, exports grew at their fastest pace in 5 years, supported by a pick-up in global demand and from China, as exports in terms of both price and volume seem to be increasing. Semiconductor exports posted their best monthly performance on record, riding on a months-long rally in electronics. Both exports and imports grew more than expected, jumping 20.2 percent and 23.3 percent respectively, and both at the strongest pace since February 2012. South Korea said that it plans to diversify markets and products for exports to reduce its reliance on its two biggest customers: China and the United States. Some local companies have also decided to boost investment in the United States to prevent their businesses from getting hit by any disruptive measures from Trump, who has vowed to create more jobs in the United States. Manufacturing activity still shrank for a seventh consecutive month in February, albeit at a slower pace, new export orders and employment,
- Taiwan, the Philippines, Indonesia and Vietnam** are showing stronger PMI data amid solid recovery in exports and production.
- 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.
- 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.



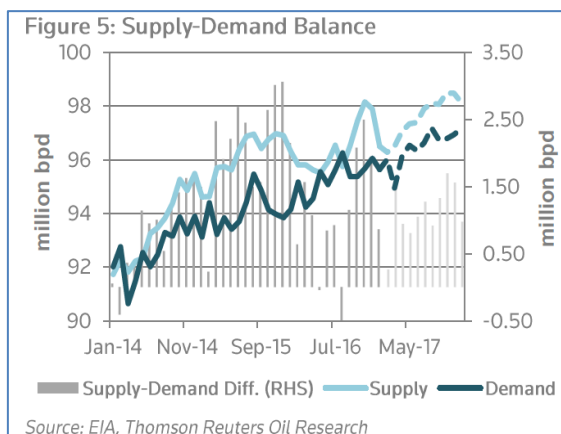
- **In Australia**, the economy rebounded sharply in Q4 (+1.1% qoq) thanks to a boom in commodity exports. Household consumption, at the expense of lower savings, was another main driver.

Brazil

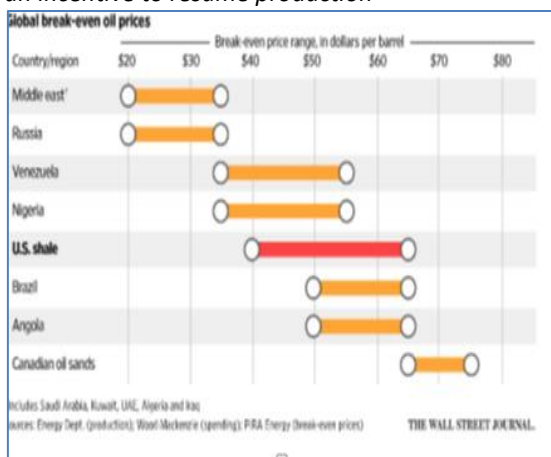


- **Still struggling to rebound from two years of deep recession.** The Composite PMI fell to a five-month low of 44.7 in January from 45.2 in December. Companies hold some hopes that the situation will improve in 2017, but concerns towards the speed of the economic rebound weigh on overall confidence.

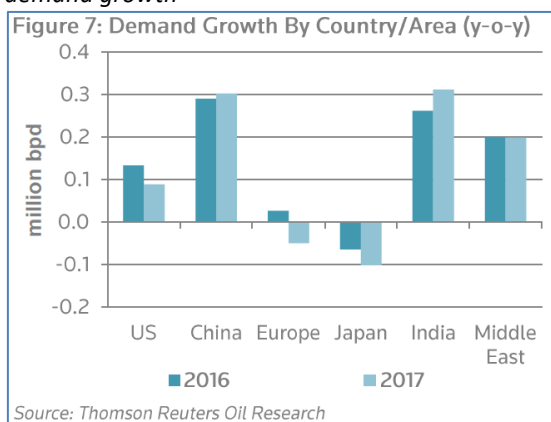
Commodities



Lower breakeven levels for US shale producers as an incentive to resume production



China and India the main contributors to oil demand growth



Oil prices supported by a more balanced market

- Oil prices have continued trading in range of \$52/bbl to \$57\$/bbl, underpinned by higher compliance with OPEC's agreed production cuts alongside more recent speculation of a possible deal extension beyond the current 6-month period. The OPEC has so far surprised the market with its discipline. The reduced supply from OPEC and Russia is likely to move the oil market into deficit in 1H17.
- Global oil demand rose to 96.02 million bpd in February, from 95.64 million bpd in January, a 380,000 bpd increase. March will likely see a decline of intake as refinery maintenance unfolds. Demand will likely pull back to 94.95 million bpd.
- UBS expect OECD oil inventories to fall toward the five-year average by mid-year and Brent oil prices to peak to USD 60-65/bbl in 1H17.
- If oil price goes up to around \$60, we would likely see a resumption in investments from the US and elsewhere and supply will grow again, keeping a lid on oil prices. The decline in US crude production has already been arrested in recent weeks by a rise in drilling activity. 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.
- With a better-supplied oil market, UBS expect Brent to trade at USD 55-60/bbl in 2H17. 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.
- In the US, 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.
- 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. It also remains 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.
- The pace of US rate hikes will probably depend on how much inflation is generated from Trump's proposed measures to bolster economic growth.
- A reduction in the Fed's balance sheet is not expected until mid-2018.

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	0.85	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 06/03/17

❑ Government bond yields

- While US 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.

US TIPS already priced for rising inflation

- UBS believes the scope for further gains on US Treasury Inflation Protected Securities (TIPS) may be limited in the near term. The US 5-year breakeven inflation rate, an indicator of inflation expectations embedded in TIPS, has doubled over the past 18 months (see Chart of the Day) and stands close to the Federal Reserve's price stability target of 2%. The catalysts for a further rise in breakevens - more reflationary policies of the Trump administration like tax reform and higher fiscal spending - may only come later this year.

Central banks		Current	Q117	Q217	Q317	Q417	Q118	Q218
US 30-Y		3.10	3.06	3.17	3.26	3.35	3.43	3.55
US 10-Y		2.49	2.48	2.59	2.70	2.79	2.88	3.00
Euro zone 10Y		0.34	0.38	0.47	0.59	0.69	0.84	0.96
Japan 10Y		0.07	0.07	0.08	0.09	0.09	0.12	0.11
UK 10 Y		1.21	1.35	1.44	1.51	1.62	1.76	1.87

Source: Bloomberg 06/03/17

❑ Potential surprises

- “Trumponomics” or Trump’s pledges to push through \$1 trillion in tax cuts and public spending may spark growth and inflation above expectations, and hence bond yields.
- JPM expects the 10-year US Treasury yield to rise to 3.0%-3.5% by the end of this year, but for now it remains range bound at 2.2%-2.5% as the market digests the latest economic data and the shift in policy emphasis from the Trump administration.
- 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

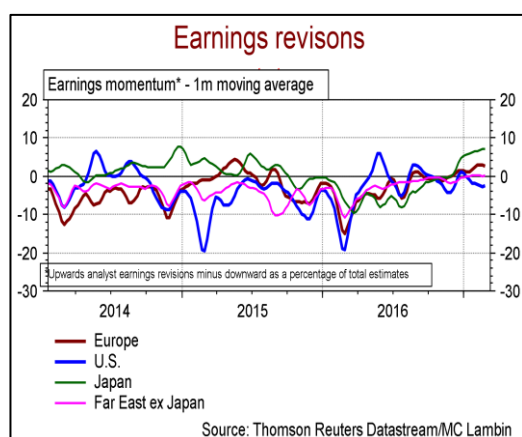
A cyclical rebound in earnings



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%

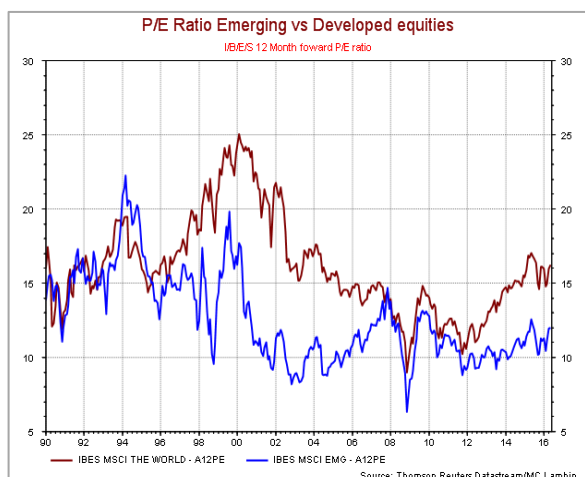
Source: Thomson Reuters I/B/E/S



- USA:** Of the 483 companies in the S&P 500 that have reported earnings to date for Q4 2016, 67.9% 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 7.8 % from Q4 (vs +6.1% expected at the start of the year, +7.9% 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% (down from 13.8% seen in January) 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 11.5% from Q415 (+3.7% 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.

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)

Index	Last price (03/03/17)	PE 2017	Target forward PE	Index target price
Euro Stoxx 50	3403.39	14.11	14	3612
STXE 600 €	375.23	15.16	14.5	387
DAX INDEX	12027.36	13.65	14	13175
CAC 40 INDEX	4995.13	14.29	14	5272
FTSE 100 INDEX	7374.26	14.75	15	7929
SWISS MARKET	8670.06	17.23	16	8798
FTSE MIB INDEX	19664.45	12.91	13	22059
DOW JONES INDUS.	21005.71	17.36	17	22527
SPX Index	2383.12	18.27	17	2465
NASDAQ	5870.75	22.30	20	6128
NIKKEI 225	19379.14	18.30	17	21329
TOPIX INDEX	1554.90	15.79	14	1662

Source: Bloomberg, Bolero Capital Sarl

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.

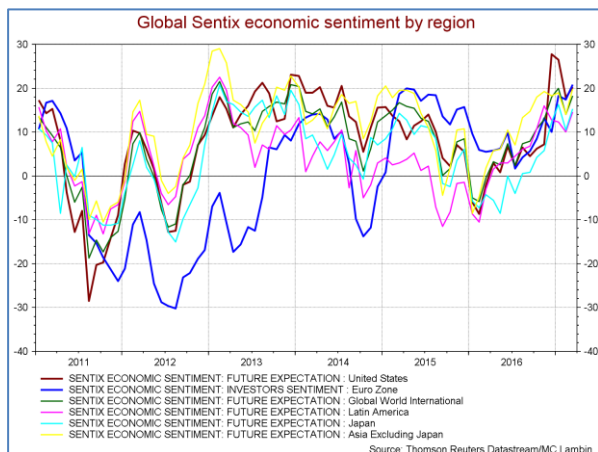
Global allocation	current	Neutral
Equities US	39.21%	28.49%
Equities Europe	20.63%	10.23%
Equities Japan	0.00%	3.92%
Equities GEM	7.90%	7.37%
total equities	67.74%	50.00%
Futures US	0.00%	0.00%
Futures EU	0.00%	0.00%
Futures JP	0.00%	0.00%
Futures EM	0.00%	0.00%
total futures	0.00%	0.00%
Equities net 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%
Total equities net	67.74%	50.00%
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%
Total bonds net	29.31%	50.00%
Gold	0.00%	0.00%
Mixed	0.00%	0.00%
Cash	2.95%	0.00%
Total	100.00%	100.00%

Overweight equities versus bonds

- **Equities offer the best risk/reward over the next 12 months.**
- Equities are the greatest beneficiaries in an inflationary environment.
- 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 and investors may start to take risk off the table. 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. 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

- **Higher rates at the Fed also mean companies spend more on credit.** After a period of nearly a decade in which the Fed did not raise rates, increases can creep up in a company's expenses and generate unwanted risk for investors.
- **There is uncertainty over how the Fed will shape its policy in the coming year**, as six of the eight permanent-voting positions at the Fed could all have new occupants due to term endings and currently open spots.
- **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.

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. Expectation are growing that Trump's push for massive infrastructure spending, tax cuts and lighter regulation will spur economic growth - and company earnings and provide a major support to several sectors like technology, financial services, energy, consumer discretionary, consumer staples, and industrials.
- 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**

- Most developing countries have better fundamentals than 2-3 years ago. 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.
- The anticipated increase in US infrastructure spending helps support certain commodity markets.
- Revised expectations for the pace of Fed tightening in 2017 and fears of trade protectionism under Trump administration are the main headwinds. Most emerging economies however look well placed to weather a gradual increase in US rates.
- 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.
- Rising debt increasing the risk of credit bubble burst. China's corporate debt has climbed from around 60% of GDP to 150% over the past decade. Concern is growing that official efforts to control leverage by tightening conditions in the interbank market will lead to a credit crunch, compelling more vulnerable banks to sell bonds. (The yield on 10-year government bonds has climbed by close to 40 basis points since the start of 2017 to 3.44%) UBS believes the government retains sufficient control over the market to avoid a crunch.
- The perennial threat of a housing bubble has not gone away. Prices in some of China's hottest markets climbed by as much as 40% last year, increasing the risk of a disruptive crash that could slow overall GDP growth and harm the banks. UBS believes the housing situation deserves close attention, but the government continues to have the tools to avert a crisis – controlling the availability of credit to avoid further overheating or an abrupt cooling of the market.
- Capital flight: The central bank's foreign exchange reserves fell for the seventh consecutive month in January, to below USD 3 trillion. Investors and companies, eager for international diversification or fearing a fall in the yuan, have been seeking to move capital overseas. This demand is unlikely to abate anytime soon. The worst case scenario here is that a vicious cycle could develop, leading to a sharp yuan depreciation that would cause alarm in global markets. UBS believes the risk remains limited. China retains the ability to impose stricter capital controls. Reserves should still end 2017 at around USD 2.7 trillion. And reserves remain comfortably above the level the IMF deems safe for a country that uses capital controls (USD 1.75 trillion)
- 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 (+)

- It is relevant to mention that the sector has a number of varying subsectors, which each have different drivers and challenges. These include transportation equipment, aerospace and defense, machinery and manufacturing, and electrical equipment
- Receding fears about a hard landing in China together with improving earnings momentum provide support to the sector.
- The Q4 earnings season was relatively positive for most industrial names due to good performance in China and the US and a slight improvement in Europe. The outlook statements were mixed, with most companies highlighting macroeconomic uncertainties as the main factor that could derail the ongoing recovery. The six-quarter-long organic sales contraction in the sector is seen to reverse in the first half of 2017 and to continue growing throughout the year. The recovery should follow increased capital spending, improved sentiment in the capital goods end markets and higher commodity prices, especially in the metals and energy sectors.
- **Infrastructure related stocks** (machinery, materials, transportation, construction and house builders) should be supported by Trump's pro-growth agenda, its US fiscal stimulus 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 centers. This creates opportunity for cement companies. Resource-rich countries that benefit from higher commodity prices could invest more in infrastructure.
- **Defense companies** should benefit from increased defense budget. Security and safety themes should also get a boost.
- **Risk:** valuations already largely reflect the positive trend and the potential US fiscal stimulus under Trump. The industry performance can be somewhat dampened in the case of new trade restrictions being put in place and political uncertainty weighing on capital spending.

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.
- European banks (Italian in particular) look less appealing given political uncertainties and secular profit pressures

Basic Materials (=)

- 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.

- Growth resurgence expectations in the US should continue to be supportive for the sector if the Trump administration delivers on its promises.
 - Q4 earnings season showed nice progress in order momentum in the shaken oil and gas and mining sectors
 - Steel and building materials producers are facing overcapacity in Western Europe
 - The European graphic paper industry is in the midst of a structural decline as consumers continue shifting toward electronic platforms. Despite a number of mill closures since 2010, the sector still suffers from overcapacity and related pricing issues.
 - 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.
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Equity strategy

By sector

Healthcare

(=)

- The healthcare sector traditionally has been one of the more defensive sectors that benefits from stable demand in mature markets and ongoing growth in emerging markets with strong cash generation and growing dividends
- **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).
- **Over the medium term** the healthcare sector is set to benefit from a number of factors, including an aging population (especially in more mature markets) and improving access to care in developing markets. US healthcare reforms continue to provide positive benefits for certain healthcare providers, especially those that have historically suffered from bad debts arising from the treatment of uninsured patients. The pharmaceutical segment should remain stable, growth continues to be driven by new product launches as well as entry into new geographies and emerging markets although patent expiries and generic competition will continue to challenge certain players. For healthcare providers, challenges come in the form of government budget constraints and plans to reduce reimbursements for services over time (particularly in the US), thus a need to manage and reduce costs, which has driven recent M&A activity as companies seek to benefit from scale as well as growing the top line.
- **Valuations** below historical average and gearing is generally low, providing companies flexibility to pursue acquisitions.

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.
- **E-commerce:** 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 restaurants** likely to suffer from margin pressure due to rising wages.
- **The automotive sector** (automobile manufacturers and suppliers) looks attractive despite its large regional variations. For 2017, UBS expect annual automobile sales up 3.7% from 2016. 0.9% growth in Western Europe driven by Southern Europe and Germany while UK sales could be impacted by uncertainty surrounding plans to leave the EU. North American sales to grow by 1% including 2.3% growth in the US while South American sales should see a modest recovery of around 3.5% including a stabilization of the Brazilian market. 7% growth in China based on the assumption

that incentives for small cars remain in place. Automobile manufacturers with the youngest fleets as being better positioned to attract consumer interest through design and performance. Suppliers exposed to megatrends will likely continue to outperform global auto production on content growth and we expect technological and safety features to be key differentiators. We expect emissions regulations to remain high on the agenda ahead of new testing standards coming into force in 4Q 2017 which could impact demand for diesel cars.

- **Downside risks:** gradually rising oil prices could increase costs and reduce disposable incomes.

Consumer staples (-)

- Often seen as 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.
- **Risks and challenges:** thin margins and high leverage compared to other sectors and an ongoing price war in supermarkets. Increasing production costs a headwind: Consumer staples often lack the ability to pass on higher input prices to their customers.
- The sector's high valuation is vulnerable to a further de-rating amid rising bond yields.

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.

Telecoms (-)

- The sector faces headwinds from tough competition and regulator interference.
- In the US, the intense competitive environment is set to persevere and will likely increase in the coming years putting pressure on pricing, as cable operators gradually enter the wireless market. We expect further convergence of the wireless and cable sectors with bundling and ongoing content diversification set to help to reduce churn and shield margins.
- In Europe, growth is expected to accelerate after a sluggish expansion in 2016. Revenues should be supported by the increasing mobile data demand and service bundling, partially offset by the abolishment of EU roaming tariffs (the magnitude of which will vary depending on how much outbound roaming carriers experience). Fixed-mobile convergence, scale and cost efficiencies will remain to be major themes, and are likely to drive further consolidation.

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.
- Current yield at 6.3.0% to maturity and 6.0% to worst is attractive and compensating for the risks associated to the oil price.
- Given strong corporate fundamentals and the continued stabilization of commodity prices, the US default rate should continue to trend lower this year. Outside the energy sector, defaults are expected to remain well below historical averages (at 3-4% over the next 12 months).
- Smaller and weaker-rated companies in the energy sector have either restructured or built up liquidity buffer to weather through the next two years. We therefore expect limited further bankruptcies unless prices head back to last year's levels.
- **Downside risk:** credit cycle more advanced than in Europe. Many oil companies are still struggling to meet their profitability targets. Investment and cost reductions will remain in the front seat for such companies if the oil price remain subdued. Credit metrics will likely remain stretched should oil prices fail to recover to at least USD 60/bbl in the near term. A recovery in gas prices has helped credit profile of most of the shale operators as well. However, such a stable pricing environment along with persistent low exploration and servicing costs may encourage a resurgence or investments, which is the key credit risk.

EUR High Yield (+)

- Monetary support by the ECB an important tailwind.
- Current yield at 3.7% to maturity and 3.0% to worst still fairly compensate for the risk. Default rates in Europe are expected to remain low 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 (+)

- EM is not heterogeneous asset class, differentiation remains a decisive factor of excess returns.
 - 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 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 has so far remained defiant against the policy decisions revealed on the US presidential twitter feed. EM corporate credit spreads tightened further, supported by a stabilization in commodity prices as the Chinese economy's growth momentum shows signs of continuation.
 - EM corporates will continue to benefit from supportive factors like commodity price stabilisation, improving political backdrops and local reform agendas.
 - Issuance by most EM corporates is ultimately opportunistic as these best-in-class companies can usually fund themselves in their local markets when capital market conditions do not suit them.
 - EM corporate defaults may have peaked. History has shown EM corporates market is quite immune to rising rates and commodity price volatility.
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