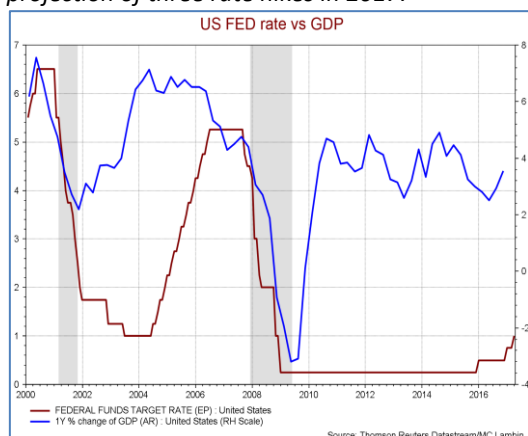


## What's new?

*No indication yet there will be a pick-up in the pace of US monetary tightening. Fed sticks with projection of three rate hikes in 2017.*



## Monetary policy divergence increasing

### The Fed increasingly confident in the trajectory of the US economy

- As widely expected, the US Federal Reserve raised interest rates by 25 bps to a range of 0.75% to 1.00% at its March 15 meeting, encouraged by steady economic growth, strong job gains and confidence that inflation is rising to the central bank's target. Chair Yellen said the Fed will stick to a gradual path of interest rate rises even if inflation runs above its 2pct target, signalling that the central bank is willing to use low rates to push down even harder on unemployment. Yellen did not specify how much of an inflation overshoot the Fed would tolerate, though past policymaker comments suggest that 2.25% or 2.5% inflation would be acceptable. The Fed stuck to its outlook for two additional rate increases this year and three more in 2018. The median estimate of the long-run interest rate, where monetary policy would be judged as having a neutral effect on the economy, held steady at 3.0%.
- Minutes from the Fed's mid-March meeting showed most policymakers expected to start reducing the Fed's \$4.5 trillion bond portfolio later this year as long as the economic data holds up. Policymakers also appeared to see upside risks to the economy.
- The Fed is widely expected to raise interest rates again in June.

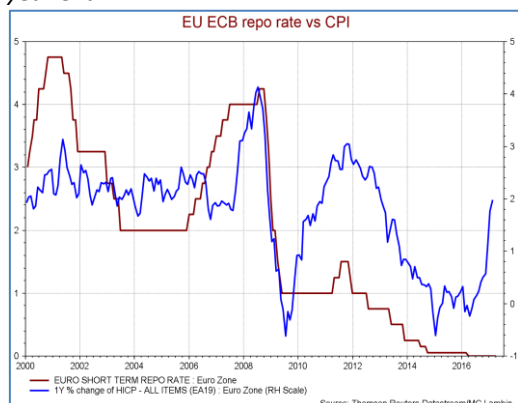
### Rate hikes embraced by a few other central banks

- Following the Fed's move, *The People's Bank of China* raised short-term interest rates in a bid to stave off capital outflows and keep the yuan currency stable.
- The Hong Kong's central bank* raised interest rates for the second time in three months.
- Four Gulf central banks* (Saudi Arabia, the United Arab Emirates, Kuwait and Bahrain) raised their benchmark interest rate by a quarter point, pressured by the need to protect their currencies even though an economic slowdown in the region calls for loose monetary policy. Growth in the Gulf has slowed sharply in the past couple of years as low oil prices have forced governments to cut spending and reduced flows of petrodollars through the banking system. But all six Gulf states have currencies that are pegged or closely linked to the U.S. dollar, obliging central banks to tighten policy along with the United States or risk capital outflows and downward pressure on their currencies.

### Still some caution elsewhere, but optimism rising

- The European Central Bank* at its March 9 meeting pledged to keep its aggressive stimulus policy in place at least until the end of the year but signalled a diminishing urgency for more policy

*ECB pledged to remain accommodative until year end*



action that was prompted by the risks of deflation. Still President Draghi pledged that if the outlook becomes less favourable, or if financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation, the Governing Council stands ready to increase the programme in terms of size and/or duration. Draghi said there is no sign yet of a convincing upward trend on underlying inflation, adding that inflation was expected to rise "only gradually" in the medium term. The ECB now sees headline inflation of 1.7 % this year compared to earlier estimate of 1.3%, 1.6% next year compared to a previous 1.5% estimate, and 1.7% in 2019. The ECB is keen not to move too early. The ECB is scheduled to cut the pace of its bond purchases by a quarter from next month but continue them at least until year-end, or longer if it thinks inflation is below target. With economic sentiment at a six-year high, trade rebounding, services and manufacturing output rising, and unemployment at its lowest since 2009, Draghi announced small upgrades to euro zone growth forecasts, now seen at 1.8% this year and 1.7% next. German Finance Minister Schaeuble said he was in favour of a "timely start to the exit" from the ECB's loose monetary policy. Economists in a Reuters poll said the ECB's next move would be either a tweak of its guidance in the second half of this year or a gradual reduction in its asset-buying next year.

- *The Bank of England* is widely expected to keep interest rates at their record low throughout this year and possibly until 2019 as it steers the British economy through the uncertainty linked to the exit from the EU. To consider a rate hike, BOE member Vlieghe said he would need to see evidence that inflation pressures were spreading beyond the effect of sterling's depreciation, or that there was a pick-up again in household spending and borrowing. Vlieghe also warned that a "more material" fall in business spending might take place in response to uncertainty around Brexit, given the two-year clock on the negotiations with the European Union had just started.
- *The Bank of Japan* kept its policy unchanged and made it clear it would not follow the Fed's footsteps any time soon, saying that Japan still needed massive monetary support with inflation distant from the bank's 2 % target and risks to growth skewed to the downside.
- *The Swiss National Bank* stuck to its ultra-loose monetary policy, as it awaits the outcome of elections across Europe which could trigger an upsurge in demand for the safe-haven Swiss franc should nationalists perform well. The SNB said it remained committed to negative interest rates and currency interventions to rein in the Swiss franc, which it said remained "significantly overvalued".
- *South Korea's central bank* kept interest rates unchanged at a record low of 1.25% but raised its growth outlook for this year.

## Populism showing cracks

*Vote on healthcare reform pulled*

### Trump's campaign promises at risk

*Questions rising about whether Trump's war on regulation can increase domestic oil and gas output*

*Risks of a trade war with China are waning*

*Trump open to reappointing Yellen as Fed chair*

- The House of Representatives were forced to withdraw their healthcare legislation as Trump failed to close the deal with two different factions within his party. Comments from the administration and party leaders indicate plans to move on to tax reforms rather quickly but doubt is rising about Trump's ability to fully implement its ambitious agenda. Nomura economists assume Trump administration will pass a tax cut later this year (Q3) that is about one-third the size of the House's proposal. Such a tax cut would be more consistent with most of the tax cuts implemented since 1950 and more in line with what would be expected in the current economic environment.
- Trump signed an order to undo Obama-era climate change regulations, keeping a campaign promise to support the coal industry and calling into question U.S. support for an international deal to fight global warming. Trump said his plans to slash environmental regulations will trigger a new energy boom and help the United States drill its way to independence from foreign oil. But in annual reports to the U.S. Securities and Exchange Commission, 13 of the 15 biggest U.S. oil and gas producers said that compliance with current regulations is not impacting their operations or their financial condition. The dissonance raises questions about whether Trump's war on regulation can increase domestic oil and gas output, as he has promised, or boost profits and share prices of oil and gas companies, as some investors have hoped.
- President Donald Trump said that his administration will not label China a currency manipulator, backing away from a campaign promise, even as he said the U.S. dollar was "getting too strong" and would eventually hurt the economy.
- Trump said he had not ruled out reappointment of Janet Yellen to a new four-year terms, a noticable turnaround from his frequent criticism of Yellen during his campaign, when he said she was keeping interest rates too low. Trump said he would like to see US interest rates stay low because higher rates would strengthen the dollar and hurt American exports and manufacturers. In complimenting Yellen and citing the advantages of loose policy, Trump appeared to downplay the likelihood he intends to reshape U.S. monetary policy along the lines called for by some of the more conservative voices in the Republican party in favour of much higher interest rates.

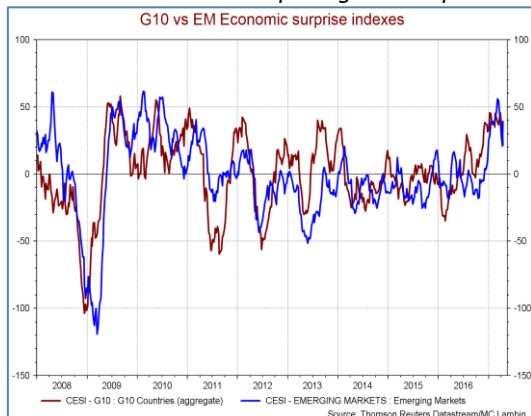
### In Europe

- *In the Netherlands*, the elections did not provide the big win for euro-sceptic Geert Wilders that polls had suggested.

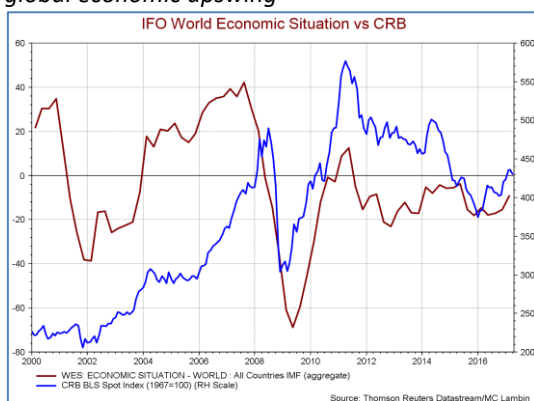
## Brexit formally triggered

- On March 29, Minister Theresa May officially invoked Article 50 of the Treaty of the European Union, so triggering **formal EU divorce proceedings**.
- The Brits no longer united.** The Edinburgh government has proposed a deal for Scotland to stay in the single market while the rest of the United Kingdom - England, Wales and Northern Ireland - leaves.
- Theresa May has called a surprising general election for 8 June.** There will be "no turning back" on the Brexit referendum outcome, she said. 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. A clear mandate from the British people could help Brexit negotiations.

### Global economic data surprising to the upside



### A rebound in commodity prices mirroring the global economic upswing

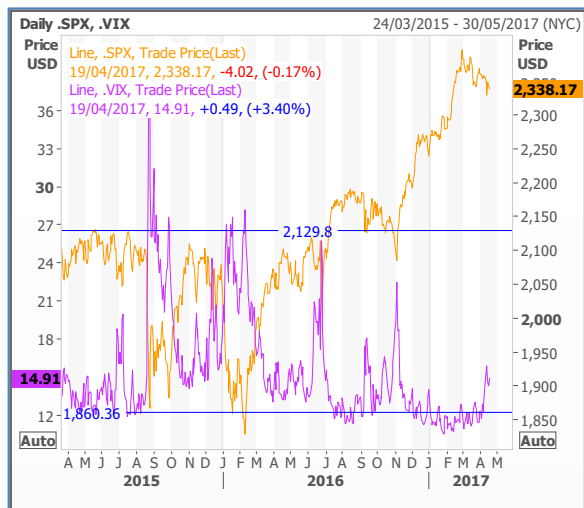


## Global growth forecast revised up

- In its latest World Economic Outlook, the International Monetary Fund raised its **2017 global growth forecast** to 3.5% from 3.4% due to manufacturing and trade gains in Europe, Japan and China. The Fund said that chronically weak advanced economies are expected to benefit from a cyclical recovery in global manufacturing and trade that started to gain momentum last summer. Growth is strengthening broadly among advanced and emerging market economies as well oil and commodity exporters that are starting to benefit from a commodity price recovery, including Russia and Brazil,
- The IMF lifted Japan's 2017 growth projection to 1.2% from 0.8%, while the eurozone and China both saw a 0.1 percentage point growth forecast increase to 1.7% and 6.6% respectively. The IMF also revised Britain's growth forecast to 2.0% for 2017, up a half percentage point from January. U.S. growth forecast were kept steady at 2.3% which still represents a substantial jump from 1.6% growth in 2016, partly due to expectations that President Donald Trump will cut taxes and increase government spending.
- The recovery however remains fragile.** The outlook faces headwinds from chronically weak productivity growth and policies that could constrict trade. A turn toward protectionism would lead to higher prices for consumers, lower productivity and therefore, lower overall real income for households. China's strong growth is clouded in the medium term by "growing vulnerabilities" associated with its reliance credit-fueled growth.

## Investment conclusions

*Rising volatility (VIX) indicative of increasing stress in the markets*



*It's all about growth!*

**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.**

*The world economy is on a stronger footing than at the start of 2016, supporting a recovery in base material prices*



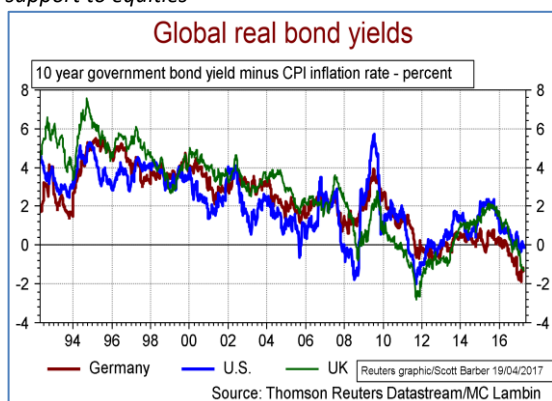
## Short term: Equities ripe for a pause

- **In the short run, headline risk is back.** Trump's failure to gather enough support from his own Republican party to repeal and replace Obamacare spurred a rush to safe haven assets such as gold, the Japanese yen and the Swiss franc as investors started to reset expectations about how easily the Trump administration will be able to deliver on other campaign pledges - namely tax and spending policies, which have underpinned asset prices since the US elections. In the UK, the triggering of Article 50 was well anticipated, but the fact that negotiations are now live means financial markets may become more vulnerable to commentary from European and/or UK officials as to how well, or poorly, the initial discussions are going. Britain's snap elections to be held on June 8 together with uncertainty about the outcome of the French elections (second run off on May 7) might cap performance in European equities over the coming month.
- **Volatility** is on the rise (VIX at 14.9) indicating renewed stress in the markets.

## Medium term: improving economic momentum to remain supportive

- We think that **focussing solely on political dramas will lead to miss the most important story**, the improvement in the global economic picture. The rally in risk assets following the US elections does not just come from potential policy stimulus, but rather reflects improvement in global economic momentum. After six years of disappointing growth, the world economy is gaining strength amid increases in US, EU and Chinese growth. Growth in emerging economies, coming from a low base, is supported by stable commodity prices and improving domestic demand. The majority of central banks and governments globally are keen to support growth and look set to remain accommodative, albeit less than in the past.
- While the long cycle of falling interest rates is coming to an end, we believe the **very gradual path of US rate hikes** will continue to **bring support to risky assets**. Let's not forget that at the end rising rates are confirmation that things are getting better. The March data will be crucial to assess the trend of the current economic cycle. We don't think that over the near term the US economy will get disrupted by a moderate rate tightening.
- 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.

Real interest rates are still in negative territory, a major support to equities



*The fact that the world can change in unexpected ways underlines the need for a flexible and diversified portfolio.*

Global allocation	current	Neutral
Equities US	31.49%	28.49%
Equities Europe	22.21%	10.23%
Equities Japan	0.00%	3.92%
Equities GEM	8.51%	7.37%
<b>total equities</b>	<b>62.21%</b>	<b>50.00%</b>
Futures US	-19.26%	0.00%
Futures EU	-10.86%	0.00%
Futures JP	0.00%	0.00%
Futures EM	0.00%	0.00%
<b>total futures</b>	<b>-30.12%</b>	<b>0.00%</b>
Equities net US	12.23%	28.49%
Equities net EU	11.35%	10.23%
Equities net Japan	0.00%	3.92%
Equities net EM	8.51%	7.37%
<b>Total equities net</b>	<b>32.09%</b>	<b>50.00%</b>
Bonds DM Sovereign	1.18%	29.50%
Bonds DM corporate IG	6.56%	14.00%
Bonds DM Corporate High		
Yield	13.94%	3.50%
Bonds EM sovereign + corp	7.43%	3.00%
<b>Total bonds net</b>	<b>29.10%</b>	<b>50.00%</b>
<b>Gold</b>	<b>0.00%</b>	<b>0.00%</b>
<b>Mixed</b>	<b>0.00%</b>	<b>0.00%</b>
<b>Cash</b>	<b>8.69%</b>	<b>0.00%</b>
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>

- **Valuations** are no longer cheap but still look supportive given the low level of interest rates. Real interest rates are still in negative territory, even in the US. A slight expansion in valuation multiples still look appropriate if inflation remain moderate between 2-3%.
- Fed's comments also eased pressure on **fixed income markets**. The Fed is keen to avert a tightening of financial markets. Four years ago, then-Fed Chair Bernanke triggered a bond selloff when he hinted at curtailing the central bank's bond-buying stimulus sooner than markets had expected.
- **Downside risks persist and the road to higher stock prices is likely to remain bumpy**: The macroeconomic environment is complex and political risks abound. 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 needed to allow an extension of the equity rally. The sword of protectionism is hanging and tighter global financial conditions could trigger disruptive capital outflows from emerging and developing economies. Slow productivity growth is a concern.

## Global Asset Allocation

- With a relatively strong performance achieved so far this year (+3.55% as of 30/03/17) and with elections looming in France and the UK, we have decided to reduce the risk profile of the portfolio cutting the net equity exposure to 32% from 68% with the sale of future contracts on the S&P500 and Eurostoxx 50.
- **Over the medium term**, we believe equity markets will remain underpinned by the first synchronized economic recovery since 2009, although there will be bumps on the road ahead.
- **Overweight Equities**. Equities offer the best risk/reward over the next 12 months. Equities are the greatest beneficiaries in an inflationary environment. Upside potential however appears limited in our view (+/-5% for MSCI AC World).
  - **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**
- **Underweight bonds**. 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**



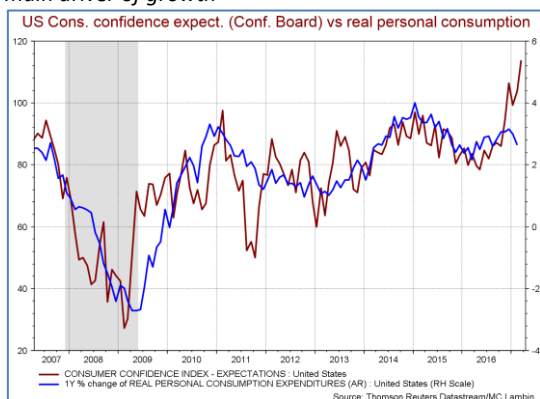
## Global economic backdrop

### USA

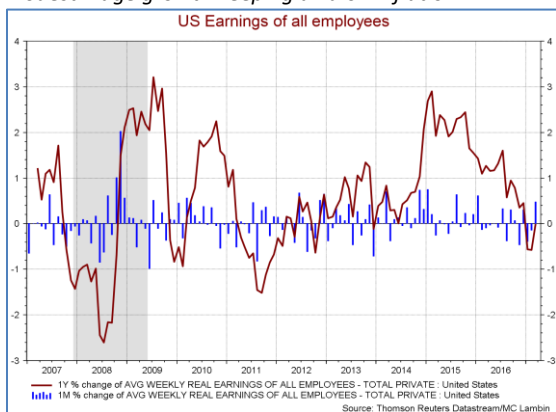
*Business activity still strong despite a slight slowdown in March*



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



*Modest wage growth keeping a lid on inflation*

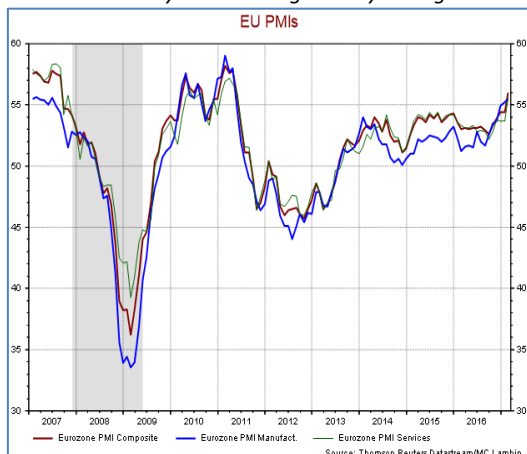


- **Business conditions continues to improve albeit at a softer pace.** The ISM non-manufacturing index fell to 55.2 in March from 57.6 in February, below expectations but remained comfortably above 50. New orders dropped to 58.9 from 61.2. The manufacturing sector also decreased slightly to 57.2. The Empire State Manufacturing Survey said that manufacturing activity slowed in April but manufacturers remain very upbeat about the next 6 months.
- **Labour market is tightening further.** Nonfarm payrolls showed job growth slowed sharply in March (+98,000) amid continued layoffs in the retail sector while the ADP report showed US companies added 263,000 workers in March. Job growth averaged 178,000 per month in Q1, well above the 75,000 to 100,000 needed to keep up with growth in the working-age population. Initial claims for state unemployment benefits slipped to 234,000 for the week ended April 8. Claims have now been below 300,000, a threshold associated with a healthy labor market. The unemployment rate fell to a near 10-year low of 4.5%, a level consistent with full employment.
- **Consumer spending remains strong despite apparent slowdown.** Retail sales dropped 0.2% in March but increased by a solid 5.2% yoy. The Conference Board showed its consumer confidence index surged in March to its highest reading since December 2000, suggesting consumer spending could accelerate in Q2 after an apparent slowdown at the start of the year. The question is whether or not consumers will remain upbeat if Trump have difficulties in implementing other policies, including tax reform. The NY Fed revised down its Q1 GDP forecasts to 2.09% from 2.56%.
- **The housing recovery remains on track.** Overall building permits increased 3.6%, driven by a 13.8 percent jump in the multi-family segment. House prices increased further in January. A tightening labour market and high level of confidence supports housing demand even as mortgage interest rates rise.
- **Inflation remains contained.** The personal consumption expenditures (PCE) price index rose in February to +2.1% yoy (up from +1.9% in January). Core PCE, the Fed's preferred gauge of inflation increased to 1.8%, but remains below the central bank's target of 2% as disappointing wage growth, running at 2.5-3% yoy pace, is keeping a lid on on inflationary pressures. Average hourly earnings increased 0.2% in March (+2.7% yoy). Producer prices (PPI) slipped in March to +2.3% yoy. Consumer Prices (CPI) fell by to 2.4% from 2.7% yoy, the first decline in 13 months amid falling prices for gasoline and mobile phone services, which offset rising rents and food costs. Core CPI slowed to +2.0% from 2.2% in February.

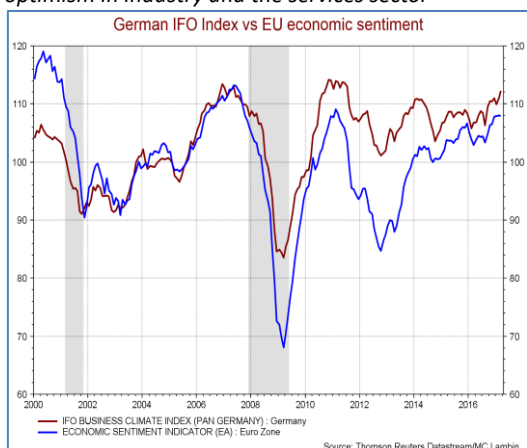
## Global economic backdrop

### Euro zone

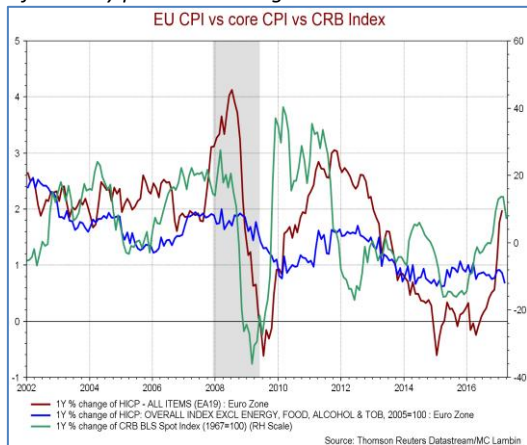
*Euro zone activity accelerating to a 6 year high*



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



*Inflationary pressures easing*



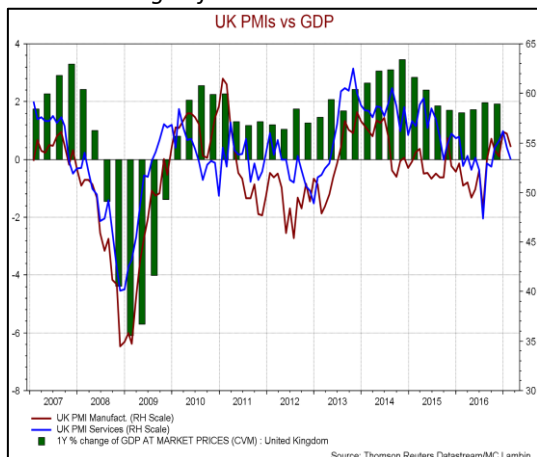
- **A strong Q1.** Economic activity is accelerating. The euro zone final Composite PMI, regarded as a good guide to growth, rose to a near-six year high of 56.4 in March from February's 56.0. The upturn was broad-based. Germany and France showed growth accelerated. While the rates of expansion slowed in Italy and Spain they remained robust. Services PMI rose to 56. The employment index rose to 54.4, marking the fastest rate since the end of 2007 as firms ramped up hiring to meet growing demand services. In Germany, the private sector was driven mainly by strong demand for manufactured goods from the United States, China, Britain, and the Middle East
- **Increasing optimism boding well for Q2.** German ZEW index of investor morale brightened in April to its highest level since August 2015, buoyed by a strong first quarter for Europe's largest economy and fading concerns about protectionism taking hold under U.S. President Donald Trump. German IFO business morale hit its highest level in nearly six years, indicating German firms look unfazed by "America First" protectionist rhetoric in Washington, European politics and even Germany's own election cycle. Merkel's conservatives lead in polls, though the formation of the next government is unclear. Capital Economics research group revised up its growth forecast for the German economy to 1.8% from 1.3% pointing to the strong Ifo figures. Nordea economist was even more optimistic, saying he now expected a growth rate of some 2%.
- **Inflationary pressures easing.** Euro zone inflation plunged to 1.5% in March from 2% in February, the first slowdown in annual inflation in nearly a year, backing ECB President Draghi's cautious policy stance and proving the bloc may be years away from a sustained rise in consumer price
- **Outcome of the French elections still uncertain.** The First round of French elections runoff remains too close to call with around 30% of undecided voters. The race for the Elysee has been one of the most unpredictable in memory, with twists and surprises in which some big players have been marginalised and scandal has tainted others. Macron himself is a former banker who has never held elected office and heads a political movement called En Marche ! (Onwards!) which has no seats in parliament. Marine Le Pen, the leader of the National Front who wants to leave the euro, hold a referendum on European Union membership and curb immigration, is expected by many to lead in the first round before being beaten by Macron in the May runoff.



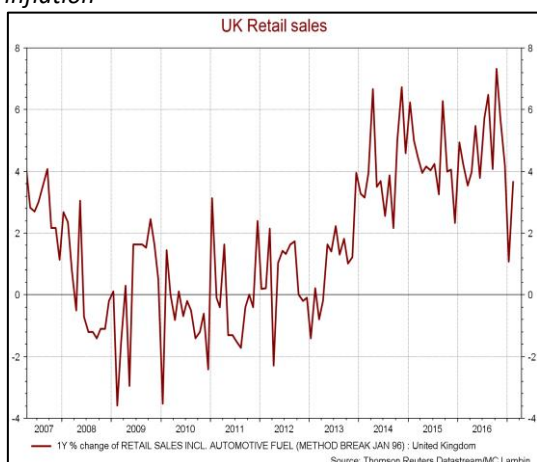
## Global economic backdrop

### UK

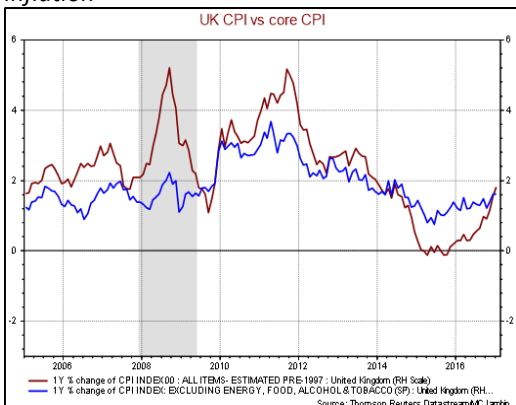
*The surprising economic strength after the Brexit vote is starting to fade*



*Retail sales already feeling the pinch of rising inflation*



*Depreciation of the pound leading to higher inflation*

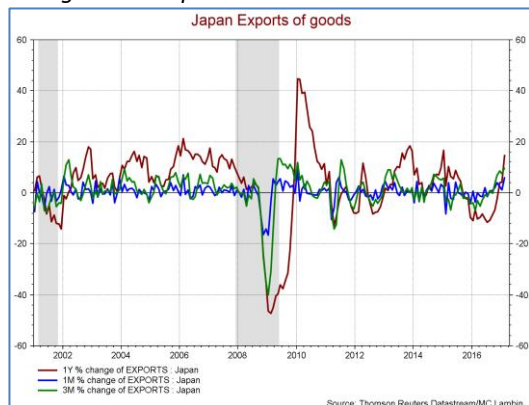


- **The slowdown which initially did not materialize after the Brexit vote now appears underway.** British consumer spending increased at the slowest annual pace in more than three years in the first three months of 2017, indicating that one of the economy's main engines is losing steam due to rising inflation caused in part by the pound's post-Brexit vote tumble. Given the hit to real income from a mix of subdued wage growth and rising inflation, the slowdown is more likely to intensify than fade away, BOE member Vlieghe said. A "more material" fall in business spending might take place in response to uncertainty around the ,Brexit negotiations.
- **Much uncertainty remains on how the Brexit negotiations will go and what the final outlines will be.** The first area which will be debated will be the "exit bill", the cost of leaving based on the existing liabilities of the UK. A "Hard Brexit" situation, meaning the unilateral withdrawal from the EU, without any agreement on trade or any other aspect of the relationship would be a negative outcome for all sides. 44% of the UK's trade in goods and services goes to the EU, and the UK is the EU's largest trading partner receiving around 16% of the all goods exported. It is in both sides economic interest to strike an amicable agreement.
- **The decision to call a snap election on June 8 is not without risk,** but given a 20-point lead in the polls, the Conservatives should be able to increase their working majority in parliament. It would dilute the influence of MPs pushing for hard Brexit and give the government more room to negotiate and organise a slower, more orderly Brexit.

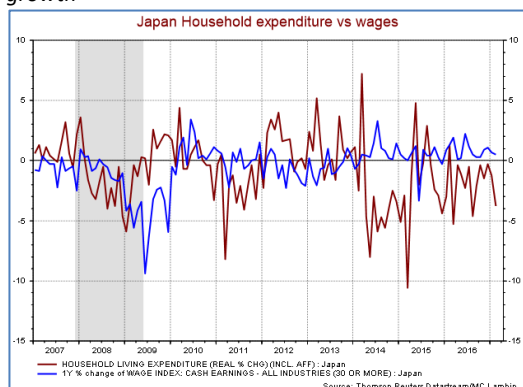
## Global economic backdrop

### Japan

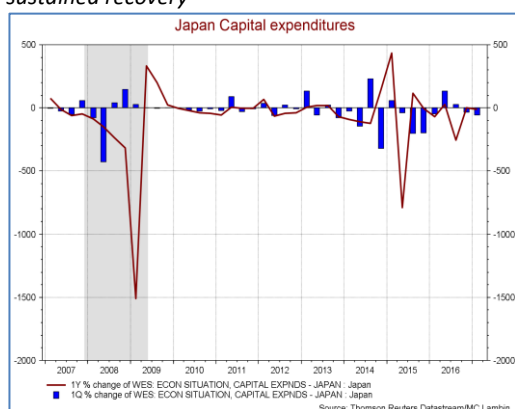
*Japan subdued recovery driven mainly by a resurgence in exports*



*Sluggish private consumption keeping a drag on growth*



*Weak capital spending casting doubt about a sustained recovery*

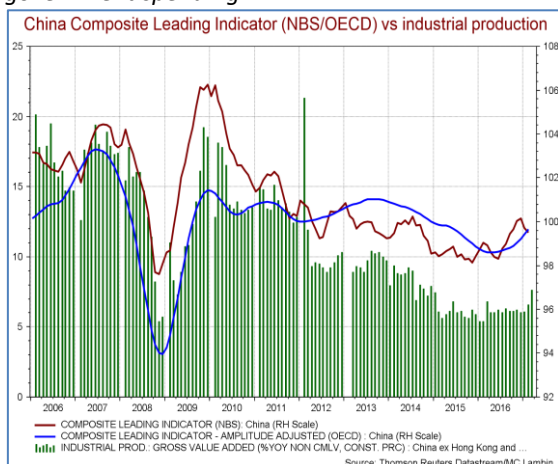


- **A fragile recovery.** Manufacturing activity expanded at a slower pace in March (PMI down to 52.4 from 53.3) as growth in new export orders and output slowed. Japan's modest economic recovery has been driven largely by a resurgence in exports, which are helping to offset stubbornly sluggish demand at home. Trump abruptly set aside campaign pledges to force Tokyo to pay more for U.S. defense aid. President Trump and Japanese Prime Minister Abe agreed to launch a bilateral economic dialogue to discuss issues such as macroeconomic policies, trade and infrastructure investment. The Services PMI rose to 52.9, expanding at its strongest pace in 19 months
- **Private consumption remains soft.** Household spending fell 3.8% yoy in February, a bigger decline than market forecasts, suggesting a tightening labour market has yet to drive up wages enough to boost consumption. Jobless rate hit a 22-year low of 2.8% in February,. Consumer price index that excludes the effect of volatile fresh food and energy costs rose just 0.1% in February, suggesting that weak consumption was preventing companies from raising prices of non-energy items.
- **Four years of aggressive money printing by the BOJ have failed to pull Japan sustainably out of deflation.** PMI showed output prices were flat from February, suggesting the Bank of Japan continues to face headwinds as it tries to get inflation to its 2%. Consumer price index that excludes the effect of volatile fresh food and energy costs rose just 0.1% in February, suggesting that weak consumption was preventing companies from raising prices of non-energy items. Tokyo core CPI fell 0.4% yoy in March. That was bigger than a 0.3 percent drop in February.
- Japanese policymakers hope a recovery in **capital spending** will help drive growth in the world's third-largest economy and pull it out of deflation and stagnation. But here also data remains weak.
- **The BOJ to pull back from stimulus.** According to a majority of economists polled by Reuters, the BOJ will signal a move away from its accommodative policy by raising the 10-year Japanese Government bond yield target, which it currently wants to keep at around zero. The BOJ is also likely to trim its bond buying as early as this year.

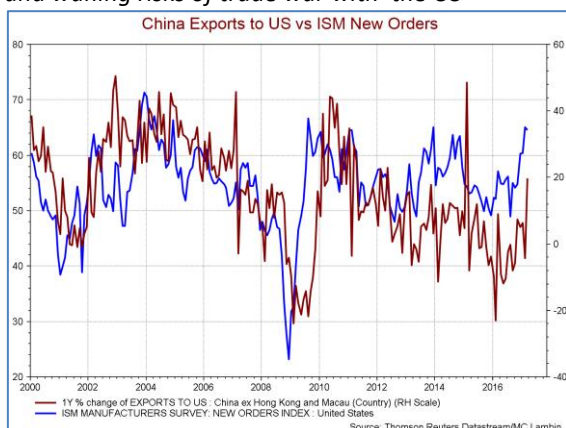
## Global economic backdrop

### China

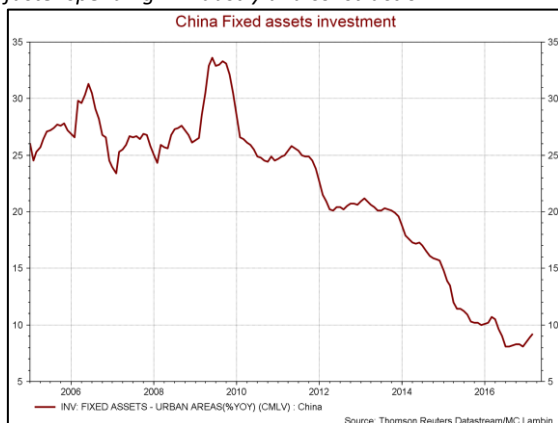
*Industrial production boosted by increased government spending*



*Chinese exports reviving on rising global demand and waning risks of trade war with the US*



*Investment showing signs of bottoming out, driven by faster spending in industry and construction*

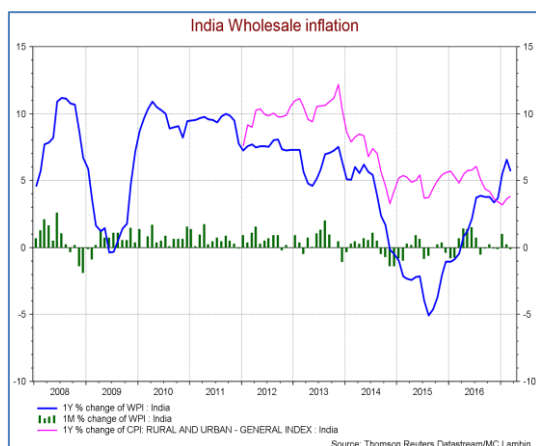
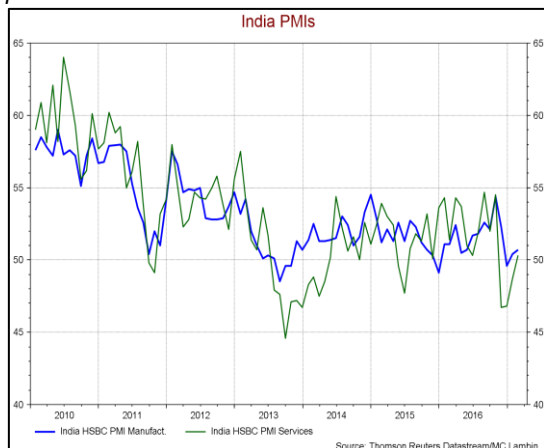


- Economic activity picking.** Q1 GDP grew by 6.9%, due to a surprise rebound in home sales and strong government infrastructure investment. The official manufacturing PMI rose to 51.8, expanding at the fastest pace in nearly 5 years. The Caixin/Markit services PMI for March fell to 52.2 from February's 52.6, but remained above the 50-level that separates expansion from contraction. The result contrasted with official surveys showing services PMI growth for March accelerating at the fastest pace in almost three years. Fixed asset investment rose 9.2% yoy due entirely to faster spending in industry and construction. Real estate investment remained robust (+9.1%) while new construction quickened despite intensifying government measures to cool soaring home prices. China produced a record amount of steel in March, buoyed by a near 12% increase in housing starts. Even as top officials vowed to crack down on debt risks, total social financing, a broad measure of credit and liquidity in the economy, reached a record 6.93 trillion yuan (\$1 trillion) in Q1. Spending by the central and local governments rose 21% yoy. The M2, a broad measure of the money supply that covers cash in circulation and all deposits, grew 10.6% yoy in March. GDP could accelerate to 7% in Q1.
- Positive signs on the consumer front.** Retail sales rebounded 10.9% yoy. Private investment growth accelerated to 7.7%, disposable income growth picked up to 7.0 percent, the fastest since late 2015.
- Export outlook brightening.** Trade growth in March came in above forecast (exports + 16.4% yoy in March, the fastest pace in a little more than 2 years, imports +20.3% driven by China's strong demand for oil, copper, iron ore, coal and soy beans), while US President Trump softened his anti-China rhetoric saying he would not declare China a currency manipulator, a U-turn from his campaign promises.
- Inflationary pressures contained.** Consumer prices edged up slightly in March to 0.9% yoy. Non-food inflation rose 2.3% yoy with costs for health care, housing, transportation and communication all rising, suggesting stronger demand from an increasingly wealthy and rapidly ageing population. Producer prices cooled to 7.6% from 7.8% as iron ore and coal prices tumbled.
- Signs of weakening may emerge from Q2.** The rapid credit expansion might trigger further hikes in short-term interest rates as policymakers remain concerned about high leverage in the economy. The government has also pledged to further cut excess capacity. A hard landing however looks unlikely as the Chinese government is keen to keep a high level of growth to avoid any social unrest.
- Increasing vulnerabilities.** Corporate debt has soared to 169% of GDP. China's total debt rose to 277% at the end of 2016 from 254% in 2015, with an increasing share of new credit being used to pay debt servicing costs.

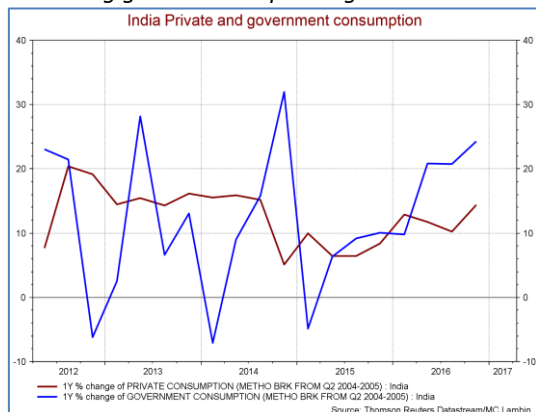
## Global economic backdrop

### India

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



*Increasing government spending*

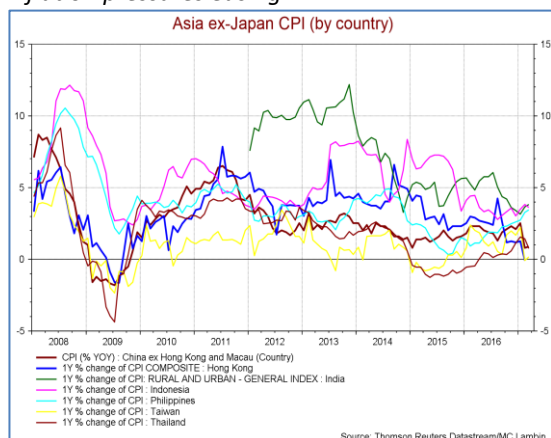


- Demonetization, a temporary pain.** Manufacturing expanded at the fastest pace in five months (PMI rose to 52.5 from 50.7) as output and new orders accelerated, suggesting the world's fastest growing major economy has largely recovered from Prime Minister Narendra Modi's shock decision in November to ban high-value currency notes, a move which caused huge disruptions to daily life and businesses in the largely cash-based economy. 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. To support those most impacted by demonetization, Finance Minister unveiled an annual budget that increased government spending and cut income and small enterprise taxes.
- Structural reforms, a long term gain.** India's lower house of parliament on passed key legislations paving the way for implementation of a nationwide goods and services tax (GST) from July, which is expected to spur economic growth by 1 to 2 percentage points. Most manufacturing and services items will be taxed at standard rates of 12% and 18%. 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.
- Price pressures easing.** The Input prices of the manufacturing PMI rose at a slower pace compared to February. The pace of output price rises slowed as well, which likely helped increase demand.
- The Reserve Bank of India shifted its stance to neutral from accommodative** and kept the policy repo rate unchanged at 6.25 percent in its February meeting, opting to wait for more clarity on inflation trends and the impact of demonetization. The RBI has outlined monsoon outturn as one of the key upside risks to inflation

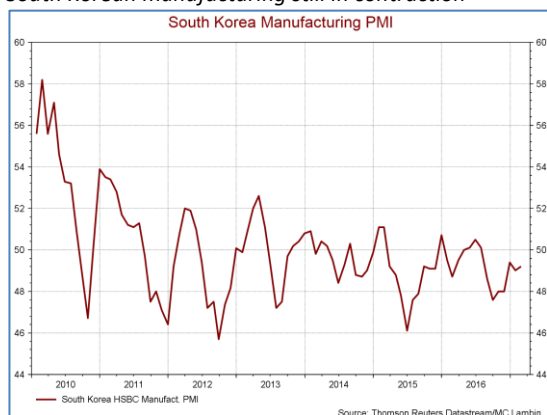
## Global economic backdrop

### The rest of Asia

#### Inflation pressures easing



#### South Korean manufacturing still in contraction



#### Asian exports driven by a recovery in commodity prices



- **A clear resurgence in exports.** Export-reliant Asian economies are benefitting from a general uptick in global demand. Higher commodities prices have helped boost the value of exports, along with a global thirst for electronic gadgets, but many countries are reporting stronger sales volumes as well. In Singapore, export growth beat expectations in March (+16.5% yoy). In South Korea, exports grew more than expected (+13.7% yoy) despite souring relations with China.
- **Domestic demand improving.** South Korean imports surged in March, signalling a rebound in domestic demand after months of weakening sentiment.
- **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.
- **Weak spots.** South Korea: manufacturing PMI slipped to 48.4 in March, contracting for an eighth straight month. With business conditions still deteriorating, manufacturers slashed jobs by the most since late 2008. An immediate recovery looks unlikely, given that the possible stimulus measures will only arrive in the second half of this year after the election is completed and a new government takes office. South Korea will elect a new president on May 9 after ex-leader Park Geun-hye was ousted last month over a corruption scandal. Consumer prices increased at the fastest pace in nearly five years in March as the prices of fresh food and services rose. Borrowing from non-bank institutions continued to grow rapidly. Rising household debt remains an issue for the central bank, as previous interest rate cuts by the BOK have been identified as a key reason behind feverish borrowing.

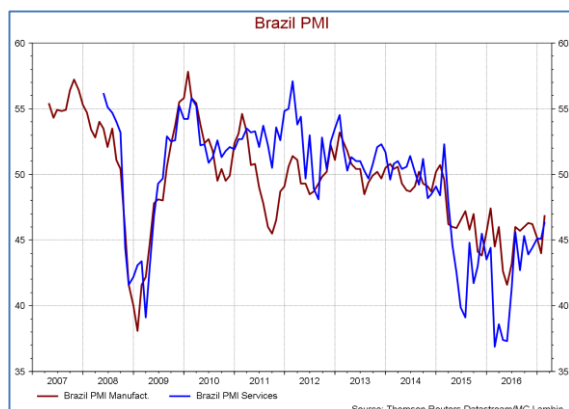
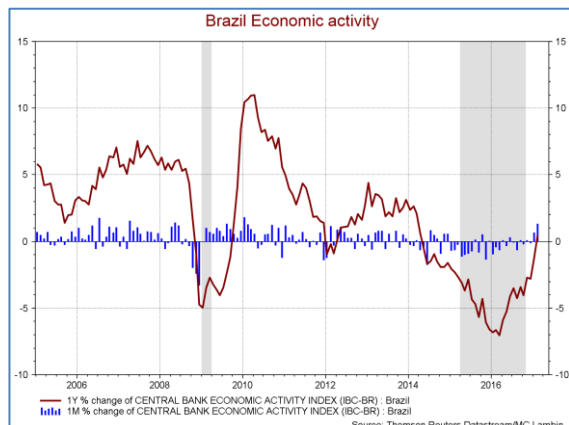




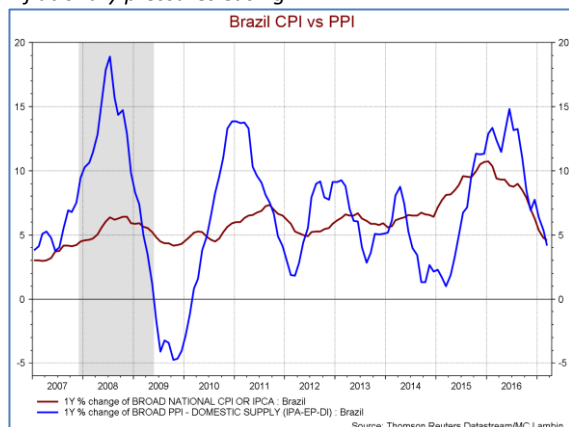
## Global economic backdrop

### Brazil

*Economic activity emerging from two years of deep recession*



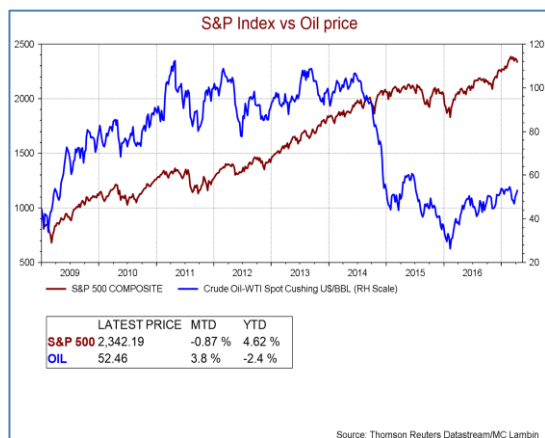
*Inflationary pressures easing*



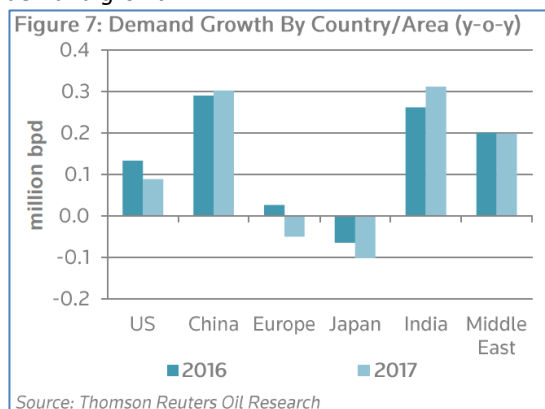
- Emerging from two years of deep recession.** Economic activity grew in February at the fastest pace since January 2010, a central bank indicator showed. Bumper harvests are expected to have lifted agricultural production in Q1, while industrial output improved on a pick-up in car exports, suggesting that government efforts to bolster growth through deep interest rate cuts and market-friendly reforms could be starting to bear fruit. Commerce and services are forecast to take longer to recover due to record-high unemployment, but nevertheless grew in the beginning of the year. The central bank index is considered an advance indicator of GDP data. Brazil's GDP is forecast to grow 0.4% in 2017 from -3.6% in 2016.
- Downside risks:** Economists warn that the economic recovery could falter if President Michel Temer fails to pass a landmark pension reform through Congress in coming months or is hit by a massive corruption scandal. The reform is seen as a crucial step to keeping Brazil's debt under control in the long term. Without the reform or with the approval of a weakened proposal, chances are high that the government will not be able to enforce its spending cap and public debt will become unsustainable,

## Global economic backdrop

### Commodities



### China and India as the main contributors to oil demand growth



### Oil prices look unlikely to surge much from here

- Oil prices have been locked within a range during the first quarter as traders searched for signals that the Organization of the Petroleum Exporting Countries' production cuts are effective or that U.S. production is continuing to offset efforts to rebalance the market.
- Concerns about the glut linger as OPEC grapples to tighten the oil market because inventories in many parts of the world are at, or near record highs and US production has been rising. US rig counts have doubled over the past 10 months, undermining efforts led by OPEC to rein output. US shale producers have increased efficiency substantially over the past two years and can now survive at much lower prices and be competitive with other large producers worldwide. If U.S. producers keep on increasing output at the same pace, then rebalancing in the oil markets is expected to get delayed beyond 2017.
- With a better-supplied oil market, analysts have revised down their price forecasts. According to recent Thomson Reuters polls, WTI crude prices are seen to average \$55.29 a barrel in 2017, revised down from previous projections of \$58/bbl in 2017 earlier in March.

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

- 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.

Central banks	Current	Q217	Q317	Q417	Q118	Q218	Q318
ECB	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Fed	1.00	1.15	1.35	1.50	1.65	1.85	2.00
BOE	0.25	0.25	0.25	0.30	0.30	0.30	0.35
BOJ	-0.10	-0.10	-0.10	-0.10	-0.10	0.00	0.00

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	Q217	Q317	Q417	Q118	Q218	Q318
US 30-Y	2.87	3.17	3.27	3.36	3.44	3.53	3.66
US 10-Y	2.22	2.56	2.68	2.81	2.89	2.99	3.12
Euro zone 10Y	0.20	0.46	0.58	0.72	0.81	0.93	1.07
Japan 10Y	0.00	0.07	0.08	0.09	0.12	0.10	0.10
UK 10 Y	1.06	1.37	1.43	1.56	1.62	1.77	1.90

Source: Bloomberg 18/04/17

□ **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.
- 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 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

Earnings as the main driver of equity returns

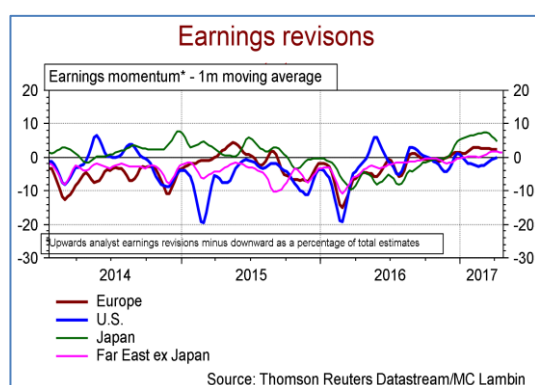


EXHIBIT 7C. S&P 500: CY 2017 EARNINGS GROWTH

Sector	Today
Consumer Discretionary	6.8%
Consumer Staples	6.0%
Energy	407.8%
Financials	12.7%
Health Care	4.7%
Industrials	4.9%
Materials	13.3%
Real Estate	2.9%
Technology	10.5%
Telecom	0.3%
Utilities	-0.1%
S&P 500	10.9%

Source: Thomson Reuters I/B/E/S

Exhibit 8C. STOXX 600: CY 2017 Earnings Growth

Sector	Today
Basic Materials	20.2%
Cyclical Consumer Goods & Services	16.6%
Non-Cyclical Consumer Goods & Services	12.7%
Energy	56.1%
Financials	35.5%
Healthcare	5.5%
Industrials	6.7%
Technology	8.5%
Telecommunications Services	2.3%
Utilities	-0.8%
STOXX 600	19.5%
Number of Companies Included in Estimate	506

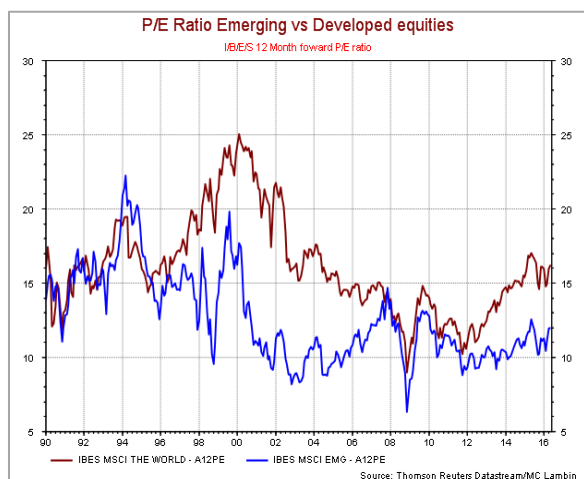
Source: Thomson Reuters I/B/E/S

- USA:** According to IBES estimates, Q117 earnings are expected to increase 10.4% from Q116 (+6.5% excluding energy). The estimated earnings growth rates for Q117 through Q118 are 10.4%, 10.0%, 9.4%, 13.3%, and 14.2% respectively. For all of 2017, S&P 500 earnings expected to rise 10.9% (revised down from 13.8% seen in January). Revenues +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:** Q4 earnings the STOXX 600 grew by 12% from Q415 (+10.9% ex-energy). Revenues rose by 3.7% yoy. The estimated earnings growth rates for Q117 through Q118 are 7.2% (2.9% ex-energy), 12.3%, 12.0%, 28.3%, and 22.6%, respectively. For all of 2017, earnings are expected to increase by 12.5% compared to -6.3% in 2016. Revenues + 5.9%.
- 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. According to IBES estimates, corporate earnings are expected to grow by 12.5% in both 2017 and 2018.
- 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). Profit margins are under threat because labour costs are rising every year. Corporate underperformance is worrisome as the private sector is vital to China's economic health, accounting for 80% of employment in urban areas and more than 60% of investment.
- 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 expected 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 (%)	Reasonable PE multiples
○ 0-3	18-19
○ 3-4	17
○ 4-5	15.9
○ 5-6	15.4
○ Deflation	13.6

(sources Raymond James)

World stock indices	Last price	last price date	EPS growth FY0 2016	EPS growth FY1 2017	EPS growth FY2 2018	PE 16E FY0	PE 17E FY1	PE 18E FY2	Traget fwd PE	index target 2017	potential
Euro Stoxx 50 Pr	3409.78	18/04/2017	-7.70%	10.77%	9.89%	16.10	14.53	13.22	14	3610	5.86%
STXE 600 € Pr	376.35	18/04/2017	-6.99%	14.96%	9.83%	17.66	15.36	13.99	15	404	7.25%
DAX INDEX	12000.44	18/04/2017	-1.14%	10.35%	7.89%	14.88	13.49	12.50	14	13438	11.98%
CAC 40 INDEX	4990.25	18/04/2017	2.52%	7.89%	11.05%	15.89	14.72	13.26	14	5269	5.59%
FTSE 100 INDEX	7147.50	18/04/2017	6.05%	16.77%	8.56%	17.00	14.56	13.41	14.5	7727	8.11%
SWISS MARKET INDEX	8529.28	18/04/2017	-8.79%	5.04%	11.22%	18.18	17.31	15.56	16	8769	2.82%
FTSE MIB INDEX	19442.71	18/04/2017	-35.13%	83.67%	18.34%	24.92	13.57	11.47	13	22045	13.39%
DOW JONES INDUS. AVG	20523.28	18/04/2017	-1.94%	9.97%	10.26%	18.79	17.09	15.50	17	22516	9.71%
SPX Index	2342.19	18/04/2017	1.14%	8.51%	12.20%	19.70	18.15	16.18	17	2461	5.07%
NASDAQ COMPOSITE	5849.47	18/04/2017	8.33%	8.97%	17.29%	24.31	22.31	19.02	20	6151	5.15%
NIKKEI 225	18432.20	19/04/2017	-3.09%	26.09%	9.46%	18.59	16.14	14.75	15	18750	1.72%
TOPIX INDEX (TOKYO)	1471.42	19/04/2017	-6.44%	24.29%	7.94%	15.37	13.35	12.37	13	1547	5.12%

Source: Bloomberg, Bolero Capital Sarl

## Equity strategy

## By country

### USA (+)

#### Overweight

- 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 (+)

#### Overweight

- 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 (-)

#### Underweight

- 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 (+)

#### Overweight

- Most developing countries have better fundamentals than 2-3 years ago. Emerging markets are now growing at their fastest pace in almost three years, with the recovery largely driven by Brazil, Russia and China. EMD fundamentals have strengthened on the back of higher commodity prices and the sharp EM FX depreciation of the past years having resulted in current account improvements. Most EM countries have made further progress on implementing structural reforms in the past year. The anticipated increase in US infrastructure spending helps support certain commodity markets
- 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.
- 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 (-) Underweight

- 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 (+) Overweight

- 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 (+) Overweight

- 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.
- **Technicals** are supportive. The size of the US and European high yield markets is declining, while the picture in Emerging Markets (EM) is more nuanced. Much of the new issuance in the US and Europe has been for refinancing purposes and so does not represent net-new supply. An increase in rising stars – or the phenomenon of high yield companies being upgraded to investment grade, thereby exiting the high yield universe – has led to a decline in the size of the high yield market. The implication of a shrinking market (shrinking supply) is that technicals should be supportive on the supply side, a positive for spreads. While the size of the broad EM high yield market has grown over the last few years, this apparent growth results most directly from the downgrading of challenged companies largely in the energy and other commodities sectors.
- **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 is 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 (+)

- Investor sentiment towards emerging markets remain positive, helped by improving global economic data, a weaker US dollar and milder trade war rhetoric from the new US administration.
- Technical factors to be supportive: flows into the asset class have been strong year-to-date after sharp outflows in the immediate aftermath of the US election
- EM sovereign credit quality remains supported by strong public sector balance sheets and low external debt ratios. The sharp EM FX depreciation of the past years having resulted in current account improvements in EM countries. EM economies continue to move through a deleveraging cycle.
- Yields remain attractive on a relative basis to similar rated developed market bonds. Emerging market spreads were 310 basis points end-March from 342 basis points end-December. The index yield went from 5.8% to 5.47%.
- **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. History has shown EM corporates market is quite immune to rising rates and commodity price volatility. EM corporate defaults is likely to have peaked.
- EM is not heterogeneous asset class, differentiation remains a decisive factor of excess returns.
- Unless we face extreme scenario including a sudden spike in US rates and outflows, we expect the asset class to outperform other FI assets.

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