VIEW POINTS

Market Outlook | 1st Quarter 2016

Tactical Assessment: Macro ▶ Bonds ▶ Equities ▶ Other Asset Classes ▶

Executive Summary

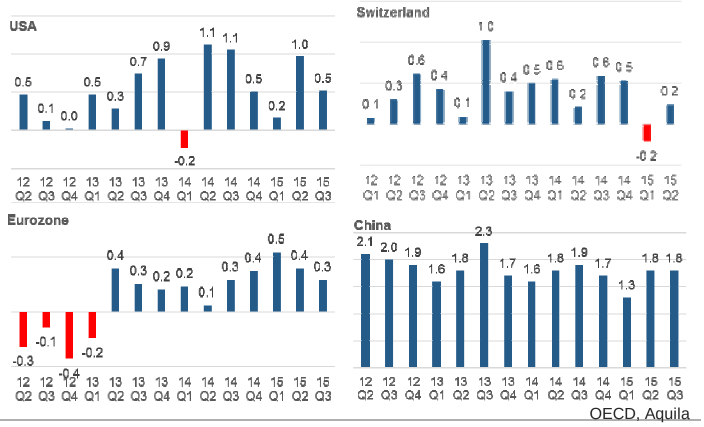
- We forecast 3% growth for the world economy in 2016.
- The American economy will grow at a moderate pace – around 2% – in 2016.
- While growth rates will vary across countries and regions, the Eurozone as a whole should grow at least 1.5% in 2016.
- US interest rate moves will depend on how inflation in the US develops.
- The ECB will remain in expansionary mode in 2016.
- As at the start of the year we have a neutral weighting in equities.
- The yield curve in the US will stay flat.
- We expect yields on shorter dated bonds in EUR and CHF to decline and some steepening at the shorter end of the yield curve in these currencies.
- The US dollar is only appreciating moderately.
- Commodities continue to perform poorly.

Our macroeconomic assessment

Business cycle

- The American economy is performing fairly well and the latest Beige book from the Federal Reserve points to a measured improvement in recent months. We expect that the US economy will grow by 2% in 2016.
- The Eurozone economy is on a steady growth path. The Economic Sentiment Index (ESI) for the Eurozone now stands at its highest level since May 2011, indicating a current growth rate of almost 2%. We forecast growth for the Eurozone in 2016 at around 1.5%.
- We forecast 3% growth for the world economy in 2016. Relative to other published forecasts we are somewhat cautious as we can't see factors which would cause world growth to accelerate.

Quarterly GDP growth rates since 2012, %



OECD, Aquila

Monetary policy

- The Fed's FOMC kept its rate forecasts for end-2016 and end-2017 unchanged at 1.375% and 2.625% respectively. Market forecasts – derived from the Fed funds futures curve – show a lower trajectory with rates at 0.875% for end-2016 and 1.35% for end-2017. The difference between policy-maker forecasts and the market's is thus 0.5% for end-2016 and 1.28% for end-2017.
- The market was disappointed by the ECB's last press conference, even though the Eurozone central bank had just announced further measures of monetary easing. Officials indicated that they had concerns regarding inflationary developments and would be following these very closely. Despite this, we do not rule out further measures of monetary expansion in the early months of 2016.

The Federal Reserve's HQ in Washington

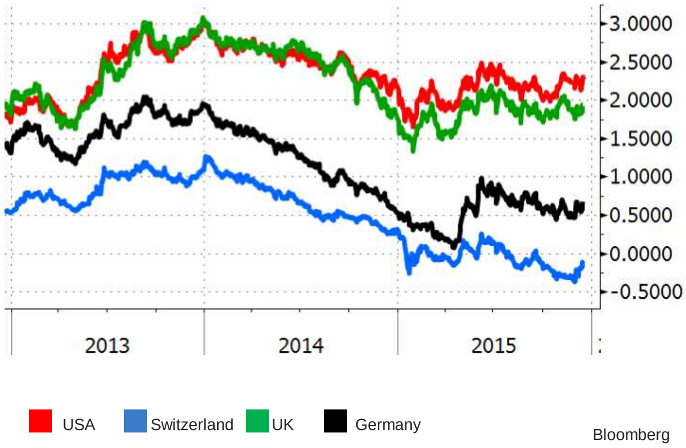
Google

Our investment strategy conclusions

Bonds

- It looks as though the Fed will be rather cautious in raising interest rates further in 2016 and therefore the long end of the US yield curve will probably not face strong upward pressure.
- But the flow of US inflation data will need to be carefully monitored.
- There will be no rate rises in key European bond markets for a long time to come. Meanwhile, many European bonds now post negative yields on account of the ECB's massive bond-buying program. It's hard to find attractive investments in these circumstances.
- Led by the US, the correction of high yield bond markets has intensified in recent weeks. We think this correction is overdone and advise purchases, though not of issues in the energy sector.
- We also view emerging market bonds denominated in EUR and USD as attractive.

10 year government bond yields since 2013, %



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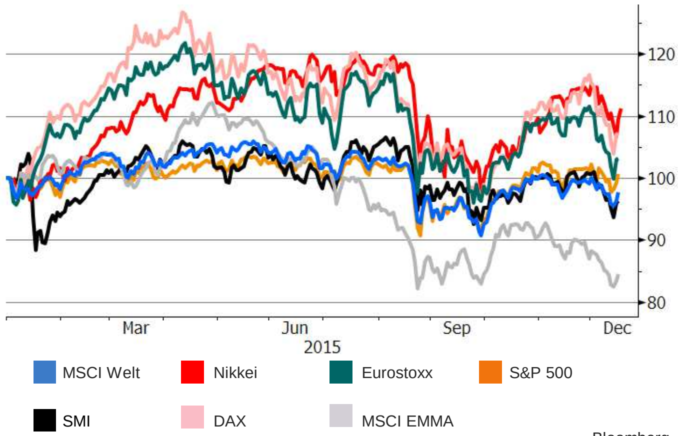
Equities

- Against the background of the Fed's first interest rate move, equity markets have been volatile in recent weeks, both on the up and the down side. Also, the market had held very high expectations in advance of the ECB's December monetary policy meeting. In the event, the ECB's announcements fell short of those expectations and markets promptly fell. By contrast, the Fed did what had been expected and did not fail when it came to communicating its thinking. Confidence was boosted as a result and the markets rose.
- With central banks continuing their policies of financial repression, equities still look relatively attractive. Valuations in line with long-term averages, and dividend yields that are attractive in the current low interest rate environment, continue to suggest that equities can be bought.
- At the start of 2016 we are running portfolios with a neutral equity weighting because we don't see factors which would cause the global economy to strengthen further and because any rise in corporate earnings will be modest at best.

The major equity markets, performance in 2015



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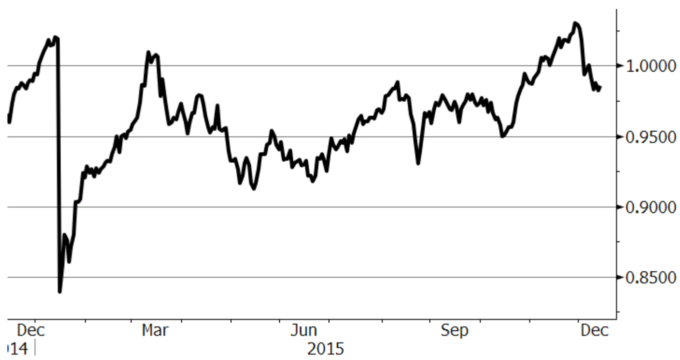
Forex

- With the Fed likely to raise rates, the market had gone into December positioned for a rising US dollar. It is therefore not surprising that, when the Fed moved as expected, the US dollar only reacted marginally.
- The divergence between US monetary policy on the one hand and ECB policy on the other is unlikely to extend as quickly as many in the market had hoped. It looks as though the central banks are coordinating their policies closely with one another. After all, the Fed needs to consider the impact of its decisions on those US companies which face external competition.
- In the end, one can only observe that the major currencies continue to compete to some extent in the direction of weakness. "Competitive devaluation" is seen as one way of boosting economic growth from uncomfortably low levels.

USD/CHF in 2015



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