VIEW POINTS

Market Outlook | 2nd Quarter 2016

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

Executive Summary

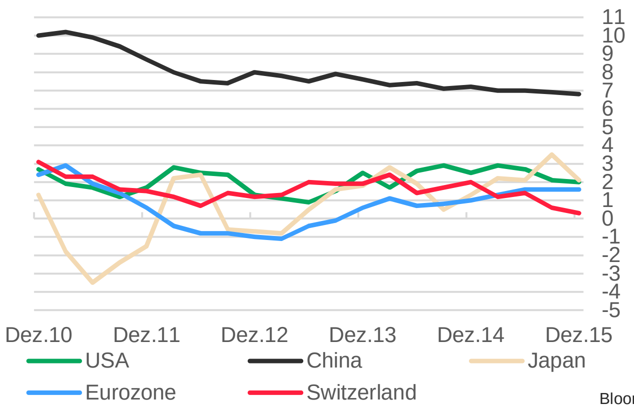
- Overall, the world economy should grow around 3% in 2016.
- Macro data continue to give mixed signals on the US economy.
- We expect the Eurozone to grow around 1.5% this year.
- The Fed's forecast path for rising US rates is starting to approach the expectations of the market.
- After its March announcement the ECB has gained for itself greater freedom to act.
- As we don't see any indication of a developing recession we are sticking with our neutral weighting in equities.
- Despite recent good performance we remain invested in investment grade corporate bonds.
- We continue to be invested in high yield bonds through our exposure to actively managed funds.
- Volatility in forex markets is set to increase.
- Recent gains in the commodity markets are not sustainable.

Our macroeconomic assessment

Business cycle

- US growth slowed in the fourth quarter of last year to 1.4%, although the loss of momentum was less dramatic than had been feared. We now forecast a growth rate around 2% for the US economy this year.
- The Eurozone economy also showed some loss of momentum in the fourth quarter of last year, posting a growth rate of just 0.3%. The Economic Sentiment Indicator (ESI) and the Purchasing Manager indices suggest a growth rate for this year of 1.2%. At 1.4% (revised down from 1.7%), the ECB's latest growth estimate is somewhat higher. We now expect the Eurozone to grow between 1% and 1.5% in 2016.
- We forecast world economic growth at 3% this year.

Quarterly GDP growth rates since 2011, %



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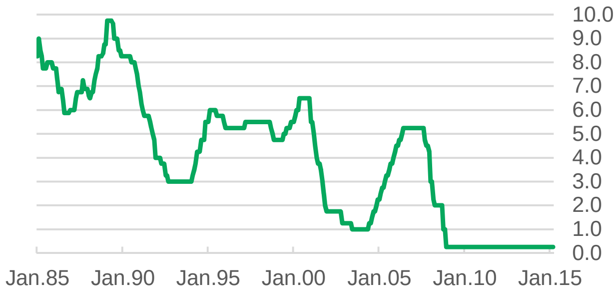
Monetary policy

- The Fed's monetary policy-makers have cut their projection for US interest rates at the end of 2016 by 0.5% to 0.875%. Their forecast for end-2017 is now 1.875% . Fed fund futures put the market's expectations for end-2016 and end-2017 at, respectively, 0.6% and 0.9%. The expectations indicated by these forecast paths still differ significantly.
- With the expansion of its securities purchase program to include corporate paper, the ECB is set to buy an additional Euro 800bn. worth of bonds. It is interesting to learn that the ECB does not intend to lower interest rates further. In saying this, the Eurozone central bank is indicating that its focus will be on implementing its additional liquidity creation facilities.

US Fed funds rate since 1985, %



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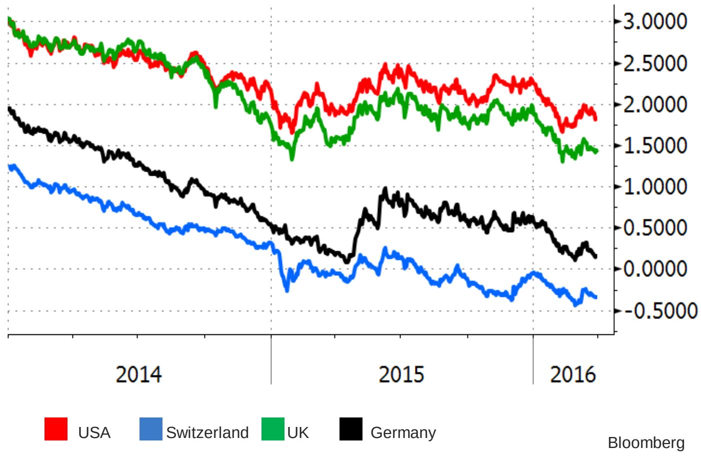
Our investment policy conclusions

Bonds

- Investor concerns about growth trends and a reduction in inflation expectations have pushed yields back down towards their all-time lows. Some two thirds of Eurozone government bonds outstanding now post negative yields.
- European investment grade corporate bonds have posted strong gains. However, heavy demand is balanced by high levels of bond issuance. We remain committed to this area of the bond market.
- High yield bond prices have risen some 10% since their low point in mid-February. We continue to have positions in this area but in only externally-managed active funds.
- Emerging market bonds have also recovered. Credit spreads relative to the risk-free rate have fallen by some 0.8% since mid-February. We remain invested in this area through externally-managed active funds but our exposure is limited to bonds issued in hard currencies.

Yields on 10 year government bonds since 2014, %



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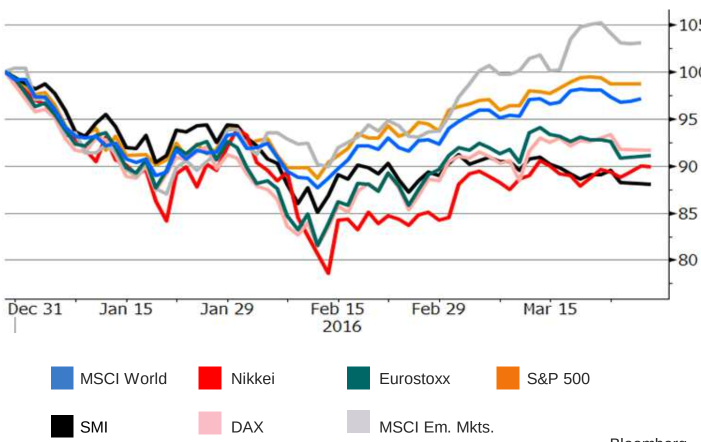
Equities

- By the end of the first quarter the major markets had recovered much of the ground they lost in the first few weeks of the year. We notice the better performance of US equity indices relative to European ones. This may reflect better US economic performance and the more cautious Fed tone on interest rates.
- Emerging markets now show a positive return, year to date. This is linked to the strong performance of Brazil's stock market and the growing likelihood that Brazil's President Rousseff will be removed from office.
- We don't believe that the broad environment for equities has changed much. Intermittent fears as to the health of the global economy are balanced by the tendency on the part of the central banks towards an ever more expansionary policy stance. We don't see any signs of a global recession.
- Setbacks in stock markets should be seen as opportunities to buy quality Swiss and other European companies. We retain our neutral weighting in the equity asset class.

The major regions, performance in 2016, indexed



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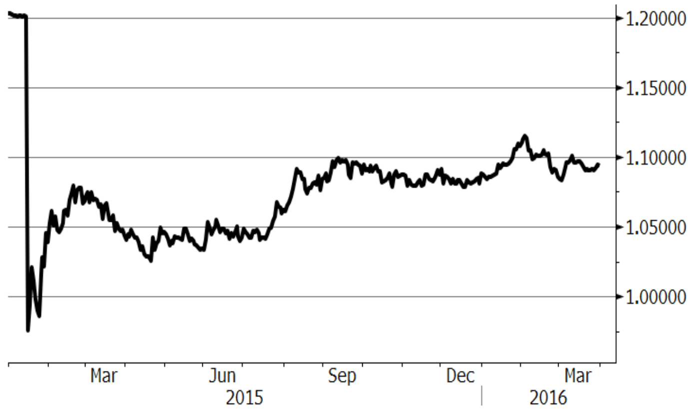
Forex

- The US dollar has recently been rather stable relative to the other major currencies – a trend which is certainly welcome to the large US multinational companies. Concerned about their overseas earnings, these companies had been pressuring the Fed not to raise rates in an aggressive way.
- If Brexit were seen as becoming more likely we would expect the euro to weaken initially. This should not be a surprise as no country has previously withdrawn from the EU and the new situation would likely fuel anxiety. The pound fell significantly in the wake of London Mayor, Boris Johnson announcing his support for the "Out" campaign.
- The EUR/CHF has been rather stable of late at around 1.09. SNB data show that the Swiss central bank purchased some CHF 80bn. worth of foreign currencies in 2015 to stabilize the franc. Since the start of 2016 commercial bank sight deposits with the SNB have risen by some CHF 20bn., indicating a fairly stable trend in SNB purchases of foreign currencies.

EUR/CHF, since 2015



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