Q4 2019

GENERALI INVESTMENTS

Investment View
Upside down

Content

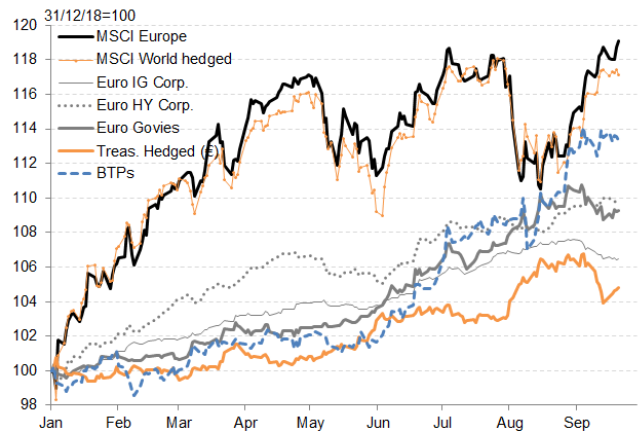
Global View – Upside Down

- **The negative yield disease is spreading in a way that radically alters portfolio considerations. We argue that the economic pain threshold justifying a switch away from risky assets is higher than it used to be. Investors have been punished for rushing away from equities into bonds.**
- **The million dollar question is whether the global economy, now on a dangerous slope, will fall into recession. This is not our core scenario, but policy support – not just monetary – is required. We assume none of the three major risks (Brexit, US/China trade war, Middle East tensions) will materialize in the worst way.**
- **In the upside-down world of negative yields, IG Credit is a new safe haven – symbolized by the outright and relative low IG yield volatility. Equities remain cheap relative to bonds, and the Fed will remain supportive (we do not believe in the FOMC's hawkish dot plot).**
- **We reduce our long duration following sharp EUR 10-30y flattening. Credit duration offers more value. We stay underweight short-dated EUR Govies. With the USD looking toppish, EM equities and bonds offer selective opportunities.**

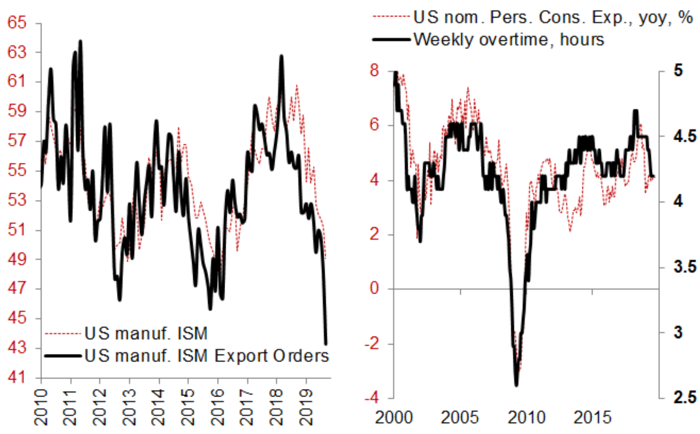
More bonds are trading at negative yields, leaving investors torn between punitive safety and taking risk at a dangerous phase of the cycle

Bye-bye summer, hello deep negative yields. 'The law of diminishing return' continues to wreck the global economy and markets. Yields have plunged further over the past three months, particularly so when the US-China trade war erupted again. This eruption caused temporary havoc in equity markets, yet the early August sell-off was quickly reversed, reinforcing our view that, until it is clear that the global economy is falling in recession, There Is (virtually) No Alternative (TINA) to equities in a world of deep negative yields. As such, many investors, traumatized by the December 2018 debacle, are still paying the price of excessively cautious investment positions. European equities have delivered nearly 19+% year-to-date (dividends included), almost 10 points more than the record-breaking EUR government bond market (Graph 1).

Graph 1: YEAR-TO-DATE TOTAL RETURNS



Graph 2: US EXPORTS FALLING AND PULLING THE MANUFACTURING SECTOR DOWN; KEY RISK IS CONTAGION TO CONSUMERS



The R word. The central question is whether the global economy is headed to recession, which we discuss in more detail in the next article of this report. Our assumption is that it is not, but the risks have increased further. Germany is probably there already, and growth in the Eurozone as a whole has virtually ground to a halt. The ECB is helping a bit, but policy effectiveness is questioned. The hopes really are in the hands of fiscal policy – and we expect some (limited) support from the cash-rich Dutch and German governments. China's economy is suffering from the trade war but the credit impulse, sharply negative last year, is now contributing to a stabilization in economic surprises. By now President Trump must realize the heavy short-term costs associated with his tariffs policy: falling exports are at the root of a

US manufacturing slump (Graph 2). The key risk is that the latter will soon infect employment growth and, at the end of the chain, the mighty US consumer. There are early signs of softening there - enough for Trump to reconsider his trade policy strategy?

All eyes on Middle East, US/China trade talks and Brexit. Our core scenario does not foresee an accident for any of those.

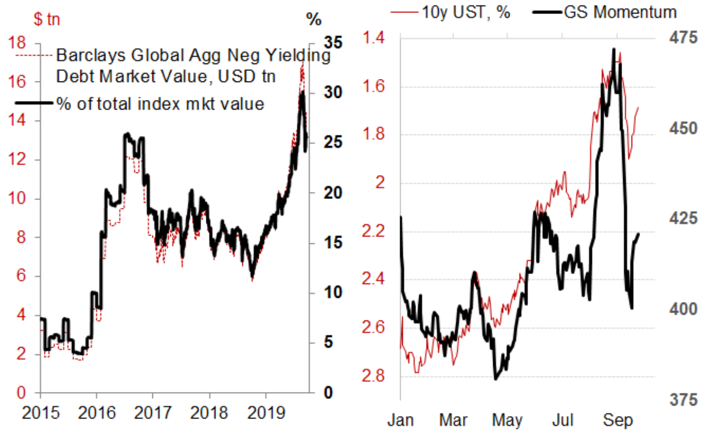
Three elephants in the room. The global economy is thus now in a more fragile state, and the risk is that another shock would tip it into recession. There are three elephants in the room, yet in our central scenario none of them will cause fatal damage. 1/ We expect President Trump to embrace a more pragmatic approach into the Nov. 2020 US election. A recession would hurt his reelection chances. We're not looking for a grand deal with China, but a truce. 2/ We do not expect escalation in the Middle East, following the strikes on two major Saudi oil facilities. While the volatile temperament of the three leaders involved (US, Iran, Saudi Arabia) is a source of uncertainty, each of them has vested interest in avoiding escalation. 3/ We do not foresee a Hard Brexit in 2019. We are confident that, in the case PM Johnson fails to agree to a deal with the EU on 18 October or UK Parliament rejects the deal, a three-month extension will be asked. The worst-case scenario (for markets) lies in a November election, where the Tories would possibly consider a non-aggression pact with the Brexit Party, while the anti no-deal camp stays divided. Yet it is possible that parliament would choose another route, with a caretaker government putting a deal to a referendum first. All these deserve careful watching, but our base case is that no major accident happens this year.

The upside-down world

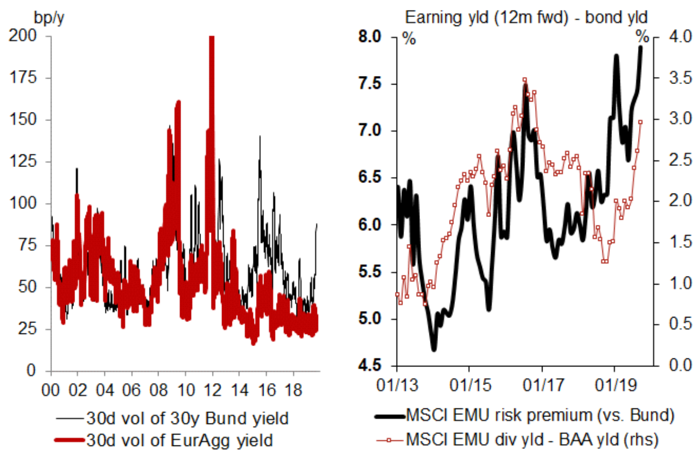
Record inflows into global bond funds highlight fear factor among final investors

The negative yield disease is spreading. About 25% of the whole Bloomberg Global Aggregate index is trading at negative yield. The share even peaked above 30% by mid-August (Graph 3). This creates a massive challenge for the whole asset management industry, not least for LDI businesses with guaranteed engagements. Investors are torn between rushing out of the negative yield space and embracing risk at a dangerous phase of the economic cycle. Clearly investors have been on the cautious side this year, with global Fixed Income funds enjoying nearly $600bn of inflows, while equity funds suffered about $160bn of outflows. Which brings the question: How have equity markets performed so well when so much money has been flying out? Corporate buybacks and M&A are part of the answer.

Graph 3: 25% OF THE GLOBAL AGGREGATE IS TRADING AT NEGATIVE YIELD; HUGE SWING IN EQUITY 'MOMENTUM'



Graph 4: GERMAN 30Y BUND YIELD HAS BEEN 3 TIMES MORE VOLATILE THAN EUR IG YIELD TO WORST OVER PAST MONTH



Positioning is still defensive. The summer has seen an extraordinary swing in equity factor performance. The Momentum style rallied sharply in August, i.e. investors were buying stocks that had performed well and selling those that had lagged. We see this as a lack of conviction investment, more so in the less busy month of August, making it ever easier for the machines to dominate the market. Momentum

Huge swing in equity factor performance: not a U-turn in sentiment. Investors are still positioned defensively

just crashed in September. We have no space for speculating here about what caused the sharp reversal (warming in US/China vibes is a credible suspect, among others), but we reject the idea that it was driven by a true turn in economic sentiment. The associated rise in bond yields was much smaller indeed (Graph 3); if anything yields were a minor victim of the momentum reversal, rather than a trigger. Overall, investor surveys and flows still indicate a cautious positioning and sentiment, which if anything emboldens our bias towards a pro-risk allocation.

The negative yield disease will lead investors to push the frontier of perceivably safe assets: Credit IG the winner

A new paradigm? We are always wary of claiming that 'this time is different'. Typically, we would still expect credit and equities to suffer from an economic recession. That said, stocks have been very resilient to the (NIPA) profit recession. We do expect much resilience until the evidence of the recession is overwhelming. Indeed the negative yield environment may be pushing the frontier of 'safe assets'. IG corporations have extended the maturity of their issuance, and can now refund at very low cost. Leverage is elevated, but the debt service / profit ratio is very low at an aggregated level. The ECB is about to start CSPP2 (November) and it is now almost a given that in the next global downturn central banks will be big buyers of IG credit. Already we note that the 30-day realized volatility of the 30y Bund yield is almost three times that of the EUR Corporate IG yield (Graph 4). So EUR HY offers more yields than 30y Bund and a lower volatility. True, 30y Bund would be a better safe haven, but in contrast to IG Credit it is exposed to the risk of a fiscal stimulus. Equities are not particularly cheap on a historical perspective, but standard measures such as 12-month forward PE ratios ought to be much higher when the discount rate is some 400bp below historical average. Surely stocks still look very cheap vs bonds. We would still expect European equities (a laggard) to deliver some 5% annual return over the next 5-10 years, which clearly bonds will not offer. Barring a very negative short-term trigger, this makes the equity case rather compelling.

Allocation recommendations

Three-pronged strategy revisited. Over summer our allocation combined three features, which generally paid off: 1/ Short cash, amid upcoming central bank support (generally good for asset performance; 2/ Long duration, given the weak economic data; 3/ Long risk, on the expectation of a supportive central bank stance. Those views mostly hold, but we take a less aggressive stance on the first two.

We keep but reduce the long duration; still long credit and equity. Avoid cash, short-dated EUR Govies and covered bonds.

Long duration but less so. Our long duration over summer was partially achieved through a large overweight (OW) in the 10y+ sector of government bonds. But 10-30y EUR has flattened sharply through the summer, making the call less exciting. We keep a small long duration nevertheless, on the basis of the weak economic data likely to persist and start to spread (watch US employment in particular). We do not believe in the hawkish dot plot released by the FOMC in the December meeting, and expect one more cut this year (risk is two) and one in Q1 next year. We continue to strongly underweight short-dated EUR Govies and covered bonds.

We continue to prefer Credit (OW) over Govies, and Credit duration over rates duration. Corporate bond yields are dangerously low of course, but on a relative basis Credit still offer much appeal. EUR IG spreads for instance look large relative to peripheral sovereign spreads. Also the credit spread curve appears very steep relative to the rates curve. As we argue above, the low volatility of corporate bond yields will encourage asset allocators.

Finally, we stick to the long position in equities, on the basis of expected policy action (US, China, Europe) offsetting the poor economic data and capital flows turning less aggressively negative for stocks. With the US losing its growth and rates advantage, the US dollar looks toppish; this supports a cautious and selective preference for EM markets (equities and bonds).

Vincent Chaigneau
+33 1 5838 1826

Recession ahead?

- **US yield curve inversion, a slump in global manufacturing activity and faltering growth in the industrial economies have brought recession concerns to the fore.**
- **Indicators that predicted past recession suggest that this risk has indeed increased. Also, unprecedented high uncertainty from the trade conflict and the Brexit drama are hinting in this direction.**
- **That said, more fundamental drivers of the recession risk like credit creation paint a less concerning signal.**
- **In the unlikely case of a recession the Fed has, in contrast with the ECB, still room for maneuver while the euro area has more fiscal leeway than the US. Yet both regions will not be able to replicate the post GFC policy boost.**

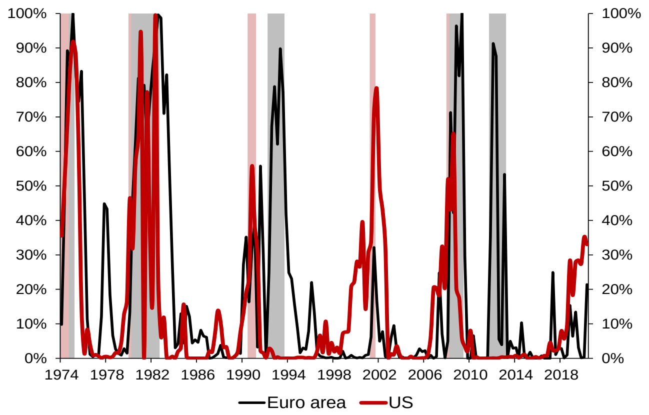
Financial markets price a higher risk of recession than that warranted by fundamentals…

Market-based measures such as the US yield curve are indicating a high and rising risk of recession over the next twelve months. However, the lack of visible financial imbalances appears as a strong mitigating factor. On the other side trade frictions and a crash Brexit may fragilize the whole economic environment. Also, key sentiment indicators like the PMIs show that the domestic backbone has been hit by negative spillovers. All in all, while a recession in advanced economies is not our baseline, questions remain on the extent to which fiscal and monetary policymaker could respond.

Recession indicators flash red: is this time different?

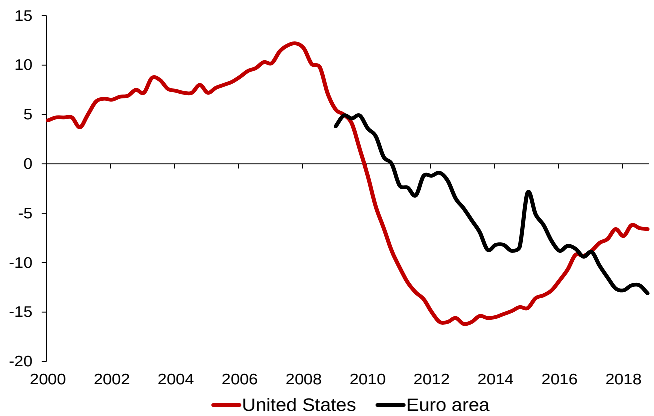
The marked deterioration of the growth outlook over the last months has raised the fears of an imminent recession in advanced economies. Worries are particularly acute in the US, despite GDP still growing at 2% yoy. The signals coming from the steep inversion of the yield curve match those coming from other financial market

Graph 1: PROBABILITY OF A RECESSION IN 12 MONTHS



Probability derived from GIAM proprietary models

Graph 2: CREDIT TO GDP GAP



Deviation of total credit to non-bank private sector to GDP from a trend. Source BIS

prices and with the souring mood of consumers as well as firms. Our US models indicate a nearly 35% probability within 12 months. In the euro area, the probability rose too, driven by a marked worsening in business sentiment. The information coming from an inverted yield curve may be somehow blurred by the zero bound on interest rates; if one considers the euro area short term shadow rates, the yield curve is much steeper.

However these models are silent about the factors that can turn a downturn into an outright recession. The first among the usual suspects is financial imbalances. Here, the situation is much less worrisome than in the wake of the 2008 global re-

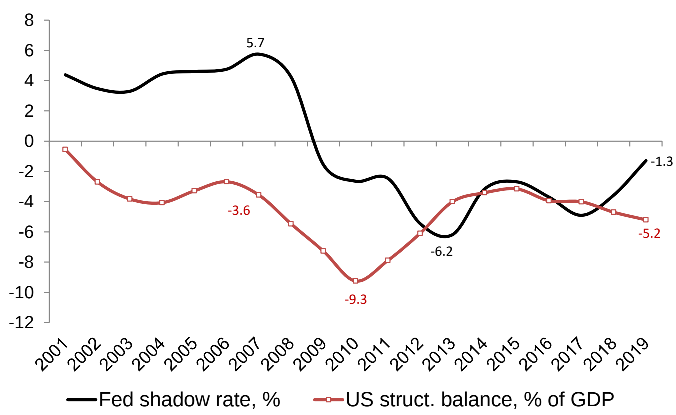
…but the distruption created by the trade war will fragilize the global economy

cession. While corporate debt is high, overall credit to the private sector is much lower than before the 2008 crisis and, moreover, low interest rates cap debt servicing costs at favorable levels. An aggravating factor is, however, what is happening to world trade; the sharp rise in tariffs offset a downward trend that started more than 50 years ago and will to some extent disrupt global value chains. As a consequence, the low inflation environment that has accompanied global growth over the last 30 years many not survive; a more fragile global economy would then be more prone to recessions. All in all, for the immediate future the mitigating factors prevail and reckon that the probability of a recession over the next twelve months is 30% in the US and 20% in the euro area.

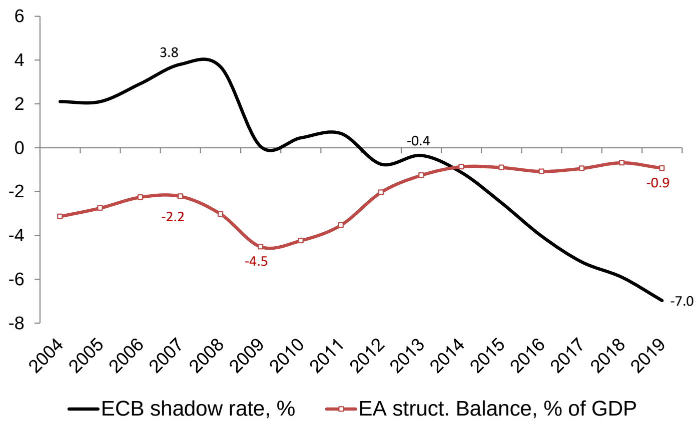
Next recession will be difficult to fight

While not our base case, markets bear in mind that the policy leeway is now significantly more limited than before the last recession. The unprecedented monetary policy stimulus in response to the GFC on both sides of the Atlantic pushed shadow rates – which take into account also unconventional policy measures – to new lows.

Graph 3: US MONETARY AND FISCAL POLICY STANCE



Graph 4: EURO AREA MONETARY AND FISCAL POLICY STANCE



US has more monetary policy leeway than the euro area…

Only the Fed had temporarily embarked on rate hikes and reduced its balance sheet. On the contrary the ECB will soon have reached its limits. Further deposit rate cuts are limited by the nominal zero bound at which cash instead of asset holding becomes attractive, the reversal rate at which bank profitability falls on balance as well as the ECB' own restrictions like the 33% issuer limit and QE capital key buying. Even if the ECB were to sacrifice some its holy cows, increasing risks to financial stability would also limit further action.

… while the euro area has more fiscal policy leeway than the US

In contrast, given the 2017 US stimulus package against ongoing consolidation in the euro area, the scope for fiscal policy action is higher in the euro area. That said, within the euro area it would mainly be Germany which has the capacity for a larger fiscal stimulus while respecting the fiscal rules. Here, the willingness of the German government to embark on bold fiscal action would be key in case of a recession.

Bottom line, we think that the US (primarily using monetary policy) and the euro area (primarily using fiscal policy) could weather a short-lived and not too deep recession. However, in the even more unlikely case of another GFC-like recession both regions would probably reach its policy limits and the borders between fiscal and monetary policy would increasingly have to be blurred. In a forthcoming Focal Point we will address these issues in more detail.

Martin Wolburg / Paolo Zanghieri
+49 (0)221 / 4203-5061

Credit resilience in current cycle

- **Usually credit spreads widen in anticipation to a slowdown or a recession. Credit spreads are not yet pointing to an end cycle but the impact of central banks might be a distorting signal sent by markets.**
- **Short term default rates are less responsive to the macro environment since the European government bond crisis.**
- **The cheap debt era has led corporates to take on more debt, raising both liquidity and solvability issues on credit.**
- **But comfort can be taken in better idiosyncratic liquidity profiles of corporates that are due to meet structurally strong demand for their bonds, even more as the ECB is purchasing bonds in an open-ended manner.**

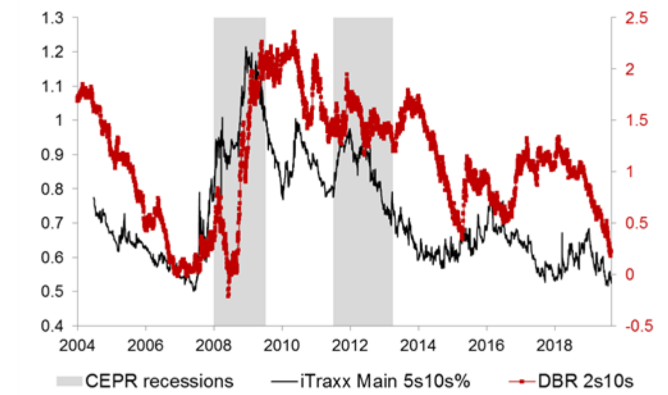
Central banks activism has possibly denied credit spreads their leading indicator characteristics

Ahead of recessions, usually we see credit curves flatten. Logically spikes in short-term default rates become discounted up-front. In current markets, credit curves remain relatively steep vs historical standards, therefore not yet pointing to an imminent recession. The question is whether we can still read into market data to forecast the imminence of a recession.

Short-term default rates less responsive to macro environment

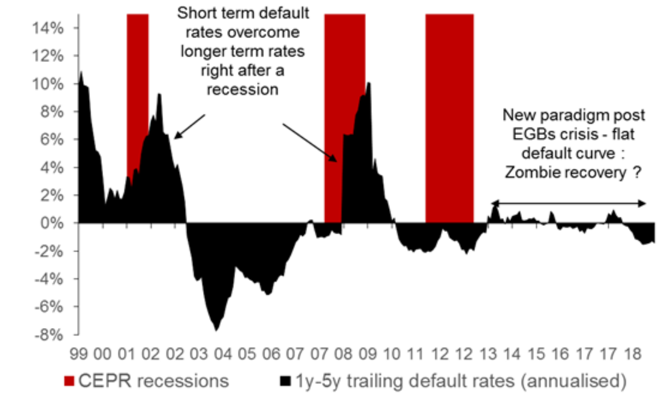
Interestingly enough the last recession in Europe has not responded to the above described text-book credit market behavior. Indeed in 2012-2013 short-term default rates have not significantly overcome longer term rates making credit far less responsive to the macroeconomic background compared to previous cycles. Although it is difficult to point to a particular reason for disconnection, it is clear that the ECB super-activism since 2012 has been a strong support for near-death businesses in the Euro zone by proving a high level of liquidity.

Graph 1: CREDIT MARKET CURVES STEEPNESS USUALLY SIGNALLING RECESSION EARLY



Source : Bloomberg, CEPR, own calculations

Graph 2: EUROPEAN CORPORATE DEFAULT RATE CURVE: 1Y VS 5Y TRAILING ANNUALISED DEFAULT RATES



Source : Bloomberg, CEPR, own calculations

Default rates may remain low past the end of this cycle but recovery rates will also be lower

Rating transition, Leveraged loans and Liquidity are the three weak spots in this credit cycle

Ever decreasing interest rates have induced a trending interest in lower quality investment since the 2008 recession. Consequently corporates have been opportunistic and took advantage of the low-rate environment to take-on more debt. Although the debt coverage ratio remains extremely strong and is not worrying per se, this led to an overall downward rating migration making the share of BBB rated instruments

at record high levels. The question will be the resilience of those BBB issuers when the cycle turns and whether they will manage to remain investment grade.

Simultaneously the new regulation regime applied to banks has incentivized them to further offload risk from balance sheet, pushing corporates to issue leverage loans sold to asset managers instead of classical bank loans. Those loans have reached a marked standard with extremely few covenants (cov-lite structure) leading to a strong exposure to the credit cycle by non-banks financial institutions which could have systemic consequences if default rates start to pick-up. Overall the absence of covenants will probably leave default rates lower compared to previous cycles but recovery rates will also be lower. The liquidity issue could also affect the traditional bond market as the Basel III framework is also incentivizing banks to reduce their trading inventories of corporate bonds mechanically reducing the liquidity in this space to an unprecedented level.

Table 1: CREDIT MARKETS INDEX MATURITY DISTRIBUTION : CORPORATES HAVE EXTENDED THEIR DEBT MATURITY

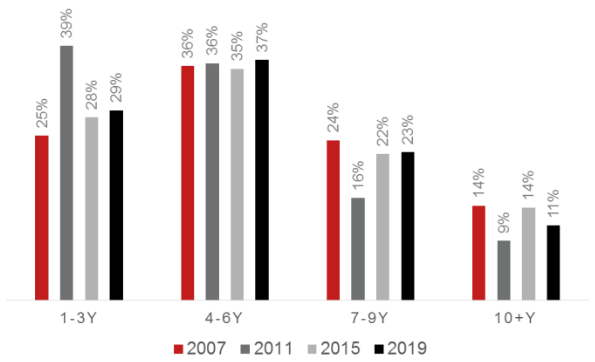
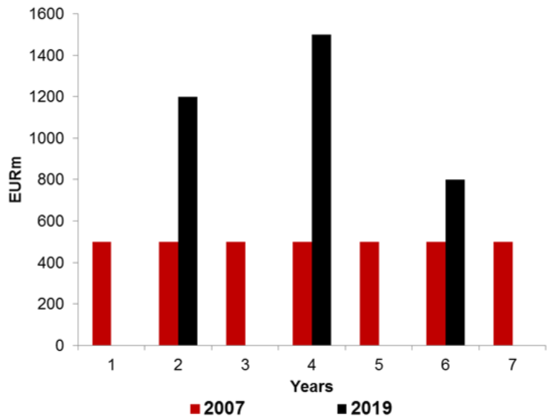


Table 2: TYPICAL DEBT MATURITY DISTRIBUTION FOR IG CORPORATES 2019 VS 2007



Source : Markit, own calculations

Corporate have worked hard to improve their liquidity profile and demand for bonds will remain structurally high

Corporates are better prepared to face a market closure

Issuers have worked since the great financial crisis to improve their funding profile, both by extending the duration of their financial debt and by smoothing over time the maturity of their debt to avoid refinancing walls. This will allow them to better resist a corporate bond market closure.

Moreover in Europe the demand for corporate bonds is currently enhanced by the strong search-for-yield environment but is structurally high because of the structure of the institutional investors. This is even more the case since the ECB has announced that it intends to resume its asset purchase program in an open-ended manner, mechanically reducing the liquidity risk in credit markets likely for as long as the economy will remain weak.

Elisa Belgacem
+33 (0)1 5838 1797

Macroeconomic Outlook

- **Consumers in the advanced economies are still on a spending spree. But the stiff tailwinds from trade uncertainties, Brexit risks and tensions in the Middle East keep the risk to our guardedly constructive outlook for the global economy tilted to the downside.**
- **Uncertainty is taking its toll in the US and the euro area. While in both economies the domestic drivers of activity are still intact, investment activity weakened contributing to a more muted growth outlook. China suffers from trade war effects amid a structural slowing of activity.**
- **Central banks have increased their degree of policy accommodation, with the ECB even linking QE and rate adjustments to the inflation development. The Fed has started to cut its key rate and we look for further cuts.**

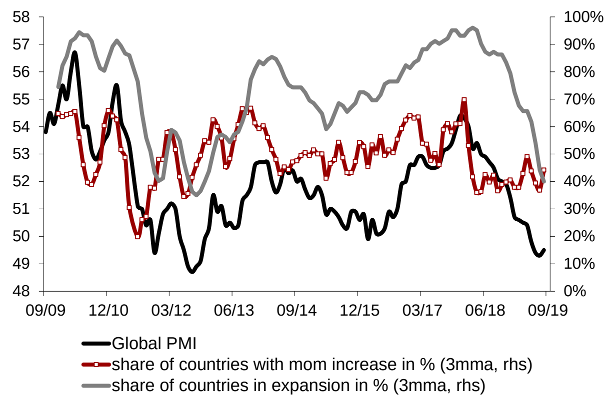
Consumers are still on a spending spree…

To start with the good news, consumers in the advanced economies – and the US in particular – are still on a spending spree. Defying a plethora of global risks, consumer confidence remains upbeat. Supported by healthy labor markets and solid wage gains, consumption remains the backbone of the global economy. Elsewhere, however, the data flow is unsettling. Trade and manufacturing are experiencing a serious slump amid an intensifying US/China trade war. On Aug. 1, President Trump dashed hopes of a trade truce or compromise, announcing to impose tariffs on all remaining imports from China. This triggered a tit-for-tat, including a depreciation of the Chinese yuan and significant mutual tariff hikes.

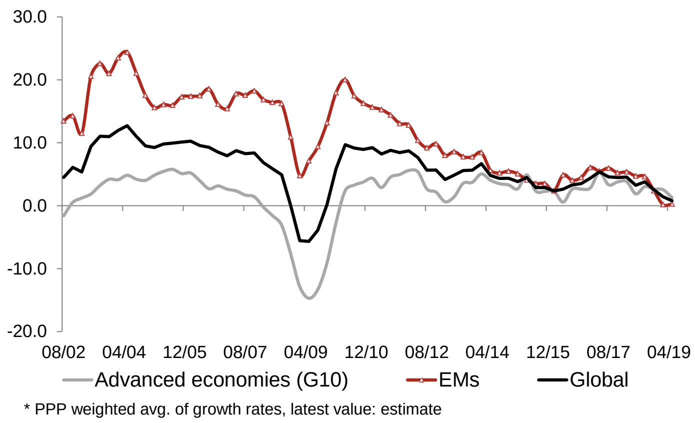
… but the headwinds from trade and slowing investment are mounting.

The mounting uncertainty is poison for business sentiment, investment and trade alike. Global trade already contracted by 1.6% yoy in June. More timely indicators point to an extended contraction over summer. Globally, investment has come almost to a stand-still, with emerging markets particularly affected. And 60% of key advanced and emerging economies are now witnessing contraction in manufacturing, the highest value since 2012. Several recession indicators are flashing red, even though we still see good chances that a sharp global slowdown will be avoided (see separate chapter).

Graph 1: GLOBAL MANUFACTURING PMI



Graph 2: INVESTMENT SPENDING



Gross fixed capital formation, in %yoy

Much will depend on trade policy. According to estimates, measures taken by summer have the potential to shave off a full percent from global GDP by next year. The risk of a no-deal Brexit adds to the strains in Europe, even though we think that there are still decent chances that a chaotic divorce on Oct. 31 can be avoided. Finally, the attacks on Saudi Arabian oil infrastructure and the ensuing rise in oil prices have added to the geopolitical concerns. An outright military conflict in the region could be the last straw that pushes the global economy into deeper trouble.

Trump should ultimately soften his stance to avoid recession ahead of next year's elections

Monetary policy has started to react, with the Fed already having cut rates by cumulative 50 bps over summer. The ECB announced bold easing measures in September (see below). The case for fiscal help is growing, too. China is carefully stepping up efforts. Germany – which is particularly affected by the trade woes – has the leeway to do more, but is warming only reluctantly to the idea of opening the fiscal war chest. Ultimately, much of the outlook is in the hands of the US President. Concerns about a US recession ahead of next year's elections should ultimately make the US side more ready for compromise, helping to stabilize sentiment, trade and the industrial slump. In the meanwhile, however, the risks to our still guardedly constructive outlook for the world economy are tilted to the downside.

Meanwhile, the risks to our outlook remain tilted to the downside

The US consumer is key

GDP grows at around 2% but it is driven almost solely by household consumption

In the US, economic data during the summer show a widening split between trade-oriented sectors and those more linked to domestic demand. In August the manufacturing ISM dropped into contractionary territory for the first time since 2015. Other business surveys also highlight how uncertainty about the evolution of the trade war with China is compressing exports and leading to a postponement or cancellation of investment projects. On the contrary, business sentiment in the service sector, while softening, remains consistent with an expansion in activity. Private consumption continues to proceed at a brisk pace, growing at nearly 3% annualized in the first half of the year, as the beneficial impact from a strong labor market is magnified by moderate inflation. Growth remains steady (we expect GDP to increase by 2.1% in 2019), but is getting increasingly dependent on consumers and can become more fragile if for example job creation slows markedly down or confidence falters. On this front sentiment indicators remain near cycle highs but have shown some cracks in recent months as uncertainty on trade developments spill over into the consumer sector.

Fed easing will support consumption and construction but will not do much for capex

The Fed has started a series of cuts in July that will likely end in the first months of 2020, with the Fed funds rate bottoming at 1.25-1.5%, 100 bps below the levels prevailing at the start of this year. This is meant to support the most interest rates sensitive part of consumption (durables) and construction activity. It is unlikely to bring about any strengthening in nonresidential investment as capex is reacting to global uncertainties, while financial conditions remain supportive.

Vulnerability of euro area increased

Euro area recession risks have increased

The combination of uncertainties and weaker global growth has started to take its toll also in the euro area. With the manufacturing sector in recession, production expectations have come down sharply thereby harming investment. Also, employment growth has moderated so that the domestic backbone of the recovery has clearly weakened. While we still see the ingredient for solid growth in place, the expansion has become much more vulnerable and the risk of recession have increased (see separate chapter). We look for very meagre growth in the quarter ahead and annual growth at 1.1% in 2019 and 0.9% in 2020.

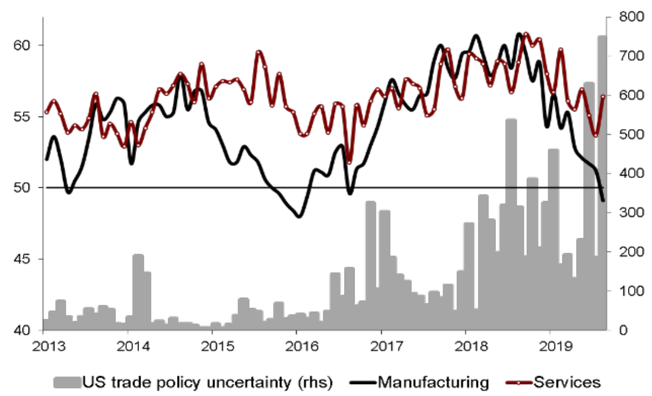
Against this backdrop the outlook for underlying inflation (Aug: 1.1% yoy) has also deteriorated. The ECB walked President Draghi's Sintra talk and embarked on bold policy measures. The deposit rate was cut by 10 bps to -0.50%, QE will restart in November with a monthly volume of € 20 bn and the forthcoming TLTRO conditions were eased. Most important, however, is that an unwinding of the first two measures

Bold ECB action in September has exhausted much of its policy leeway

will only take place once the outlook for underlying inflation improves lastingly. By tying its policy to the development of inflation the ECB made a very strong commitment towards lifting inflation.

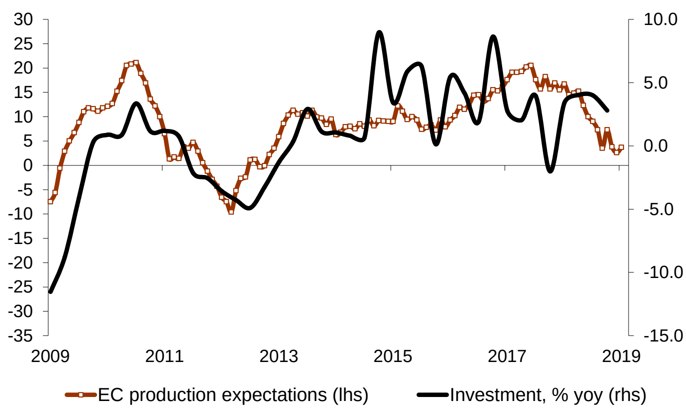
Looking ahead, we see only limited space for further monetary policy easing. In case of a recession, a substantial fiscal policy impulse will be needed in the first place. Unless the rules of the Fiscal Compact would be altered, mainly German fiscal policy would have to turn expansionary.

Graph 3: TRADE UNCERTAINTY AND US BUSINESS SENTIMENT



Values below/above 50 signal contraction/expansion

Graph 4: EURO AREA INVESTMENT PROSPECTS



China and Japan suffer from slowing exports

China has already started to suffer from the headwinds of the trade war, slowing global growth and repercussions of past regulatory tightening. We expect Beijing to adjust economic policy as to reach its growth target, implying more fiscal policy easing (by another 0.81 pp of GDP on top of the 2 pp alrady provided in early 2019) and the PBoC to cut RRR by another 50 bps this year, followed by 100 bps in 2020. The reform of the Prime Loan rate opens more space that credit cost will also recede more strongly.

More easing in China and Japan

In Japan, forward-looking indicators like the composite leading indicator or the Reuters Tankan suggest that the economy has been suffering from slowing exports, which also started to spill over to investment. However, in terms of GDP, the sales tax hike from 8% to 10% on October 1st will induce large fluctuations. A Q3 surge in private consumption before that date will be followed by a slump thereafter. Given the negative impact of receding international and domestic demand on inflation, we see it more likely than not that the BoJ cuts its short term policy rate by 10 bps in December, unless important sources of international uncertainty would be removed. We do not expect the targeted 10-year rate to be cut from its current zero percent level, in order to allow the yield curve to steepen slightly as a mitigating measure for banks' profitability. Other compensating measures could include an extension of the loan support program which could also be used as to stabilize bank profits.

Thomas Hempell/ Christoph Siepmann/ Martin Wolburg/ Paolo Zanghieri
+49 (0)221 4203-5023

Fixed Income

- **A further worsening of the economic outlook and the accomplished shift of monetary policies triggered an additional downward shift of government yields in Q3, particularly at the long end of the curve.**
- **Going forward, there is no substantial increase in yields on the cards. While there is limited downside potential from an extremely low yield level in the euro area, further key rate cuts by the Fed are expected to drive US yields even lower.**
- **While Iberian sovereign bond spreads trended sideways in Q3, BTP/Bund spreads tightened strongly. As we forecast the new euro-friendly Italian government to survive at least until 2020 and given the investors' search for yield, we expect the BTP risk premium to decrease further in the months to come.**

As expected in the last Investment View, sovereign bond yields fell across the board in Q3. The decrease was particularly pronounced at the long end of the curve, triggering a significant flattening of international yield curves. The drop in yields was mainly due to lower real yields, signaling increasing concerns about the future economic outlook. Long-dated inflation expectations declined slightly (by 6 bps since the end of June) and short-dated ones remained even stable.

Continuation of bond rally triggered new historical lows for Bund yields across the curve

A number of facts contributed to the continuation of the bond market rally. To name a few, macroeconomic data releases surprised on balance on the downside. This exacerbated existing concerns about a future recession (see for more details chapter on recession). These were aggravated by increasing tensions in the trade conflict and mounting fears of a no-deal Brexit. All in, 10-year US yields have fallen by more than 30 bps to 1.77% since the end of Q2. Temporarily, 10-year US yields even fell below 1.50%. Their euro area counterparts decreased from -0.30% to around -0.50%. In the meantime, 10-year Bund yields marked a new historical low below -0.70%.

No lasting upward movement in government bond yields in sight

Looking further down the road, there is no lasting upward trend in yields in sight. Given the existing growth worries and more dovish central banks the very low yield environment is likely to persist for the time being. To start with, US economic data are unlikely to improve in the short term and the uncertainty of the lingering trade conflict (even if not escalating further) will affect growth going forward. Still, financial markets' economic forecasts remain too optimistic. While we expect US growth to average 1.7% until the end of 2020, the consensus forecasts around 2.0% over the same period. In addition, the Fed has just started cutting key rates. Currently, financial markets expect three more cuts until the end of next year. If history is any guide, the trough in yields is only reached towards the end of the cutting cycle (and not right after the start of the cycle). Accordingly, the dovish monetary stance is likely to pave the way to lower US yields as well. Moreover, the rather high yield level by international standards (and the expectations of a stable US-dollar for the time being) is attractive for non-domestic investors. Hence, there is a tendency for US yields to catch down.

US economic forecasts still too optimistic – room for disappointment

Still, the downward trend in US yields is unlikely to be a one-way street. US economic surprises improved and the easing of financial conditions in recent months is likely to soften the economic slowdown as well. Finally, the rising US fiscal deficit will ultimately trigger a higher bond supply. On balance, however, we still forecast US yields to fall to 1.65% and 1.60% on a 3-month and 12-month horizon, respectively.

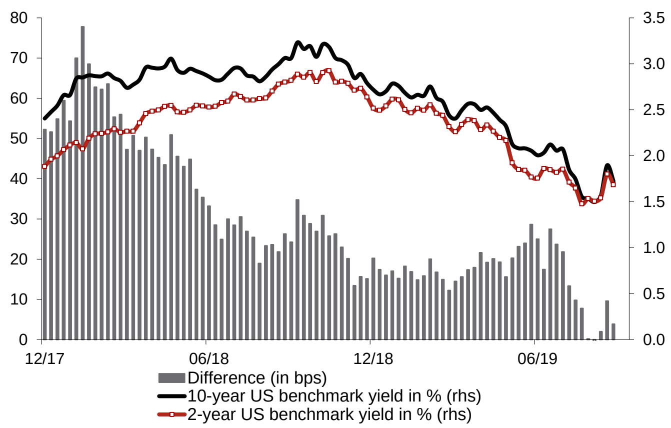
A sustainable upward trend is unlikely for euro area core yields, too. But, the yield level is even more depressed and given the proximity to a reversal rate, the

risk/reward ratio is different. Hence, the leeway for even lower yields appears limited. Currently, financial markets price negative euro area key rates until at least 2027. Although we forecast the ECB to remain dovish and do not expect any hike before 2022, the current pricing appears too cautious – opening up space for disappointments. This applies even more as we see only a limited risk of an outright recession in the euro area. What is more, there are mounting signals of fiscal easing in the euro area. Not least the incoming new EU Commission appears to be more relaxed regarding the budget discipline.

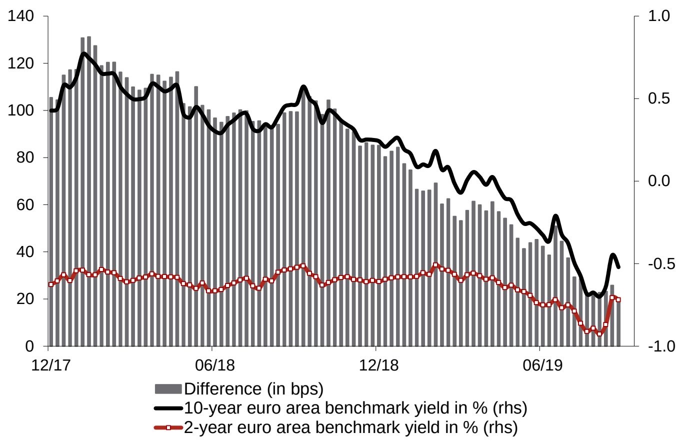
At current levels, the scope for lower euro area core yields appears limited. History suggests that 10-year Bund yields will rise in 2020.

From a technical point of view, there is a high probability of slightly higher euro area core yields as well. Historically, the fourth quarter is a good time for a shorter duration as on average yields tend to increase in the last quarter. What is more, long-dated euro area core yields use to rise after a year with a strong performance. Over the last 20 years, there were 5 years with a total annual return above 8%. In each case, 10-year Bund yields rose in the subsequent year. With the total return of euro area government bonds at close to 9.5% year-to-date, there is considerable evidence that 10-year Bund yields will rise next year. Finally, the gap between the dividend yield on EMU equities and sovereign bond yield is close to 4% – the highest

Graph 1: US: SHORT- AND LONG-DATED GOVERNMENT YIELDS



Graph 2: EA: SHORT- AND LONG-DATED GOVERNMENT YIELDS



difference ever. As realized volatility is comparable, investments in sovereign bonds have become very unattractive. All in, we forecast 10-year Bund yields to be around -0.50% and -0.45% on a 3-month and 1-year horizon, respectively.

Calmer political waters to support BTPs for the time being

High-yielding non-core euro area sovereign bonds to remain the preferred investment alternative in Q4

On balance, euro area non-core sovereign spreads hardly moved over the summer months. Only high-yielding Italian (and even more Greek) bonds performed very well. The 10-year BTP/Bund spread is back to the levels of spring 2018 (before the former government took over) and the yield level marked a new historical trough at 0.81%.

The near-term outlook for BTPs remains positive as the new government is expected to prevent a new clash with the EU Commission and will likely show a higher fiscal discipline (although a moderate fiscal loosing seems probable). The lower yield level increases the fiscal leeway. A drop in yields by 100 bps reduces Italy's interest burden by at least €2.5 bn in the subsequent year alone. Eventually, the dovish ECB stance will support non-core bonds as well.

Florian Späte
+49 (0)221 / 4203-5052

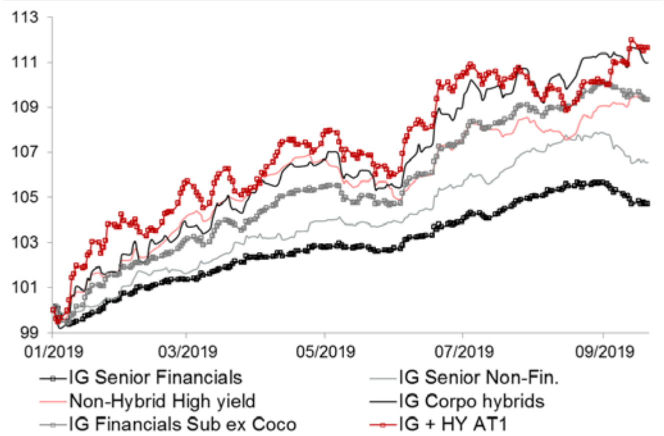
Corpore Bonds

- **Euro area corporate bond spreads are displaying a very strong year-to-date performance in total return terms led by the riskiest segments of the market namely high yield and subordinated bonds.**
- **At the peak end of August this year nearly 40% of the market was trading in negative yields territory**
- **Credit spreads are sensitive to the economic background which becomes less and less supportive but the restart of CSPP will provide additional support going forward.**
- **Hence, spreads have further scope to tighten in Q4, we keep our OW stance on non-financials versus financials well on subordinated instruments vs senior HY.**
- **Accordingly, the near-term total return outlook is good. However, we keep a less constructive stance on medium term outlook for HY if economic landscape continues to deteriorate.**

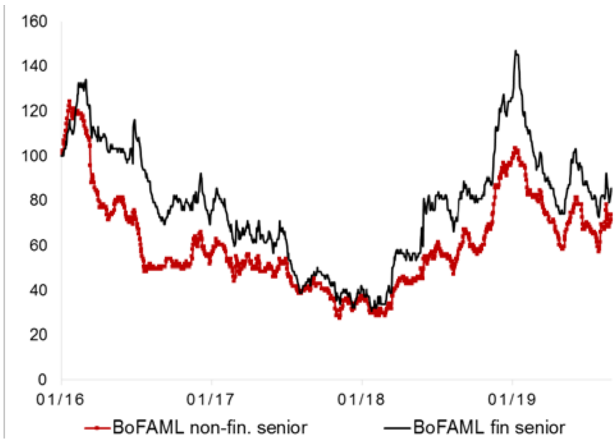
CSPP expectations have largely driven Q3 credit market performance

After a good start into the year, corporate bonds continued to perform led by the riskiest segment of the market namely high yield and subordinated instruments. In spread terms we are seeing some sideways evolution since August underlying yields have recorded record low levels possibly seeting a psychological floor for credit yields. We note that the strong demand for credit has been largely underpinned by

Graph 1: CORPORATE BONDS TOTAL RETURN PERFORMANCE BY SEGMENT - BASE 100= 01/01/2019



Graph 2: FINACIALS VS NON-FINANCIALS SENIOR BASE 100 = 01/01/2016



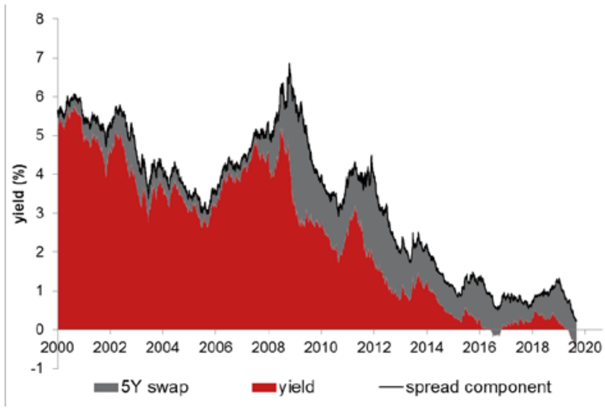
ECB's guidance on the recently announce redemption of the CSPP program. Indeed since Draghi's Sintra's speech, we have seen the CSPP eligible landscape out-performing with the non-financial vs financials.

Forthcoming ECB purchases to trigger further spread tightening

At peak end of August nearly 50% of credit markets were displaying negative yield. Despite already tight valuation, the technical situation of euro area corporate bonds will support this asset class, going forward. Over the past months, fund in-flows have been positive signaling the healthy demand for corporate bonds. This is likely to remain the case as despite the drop in corporate bond yields the decrease was even more pronounced for many other fixed income classes. Hence, the relative attractiveness of corporate bonds increased. This has helped over the recent months (and will continue to do so) to take down the large supply. Net issuance has been positive in every month and gross supply is running well ahead of last years'

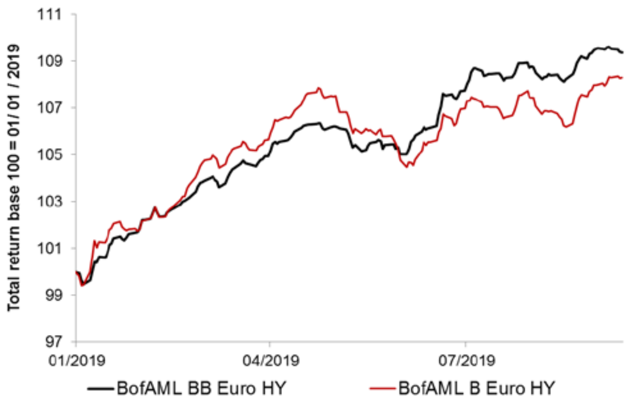
volume. Nonetheless some signs show that investors feel uncomfortable with current market valuation as for instance BBs have out-performed Bs year-to date in total return terms despite the strong rush into risky assets.

Graph 3: SPREAD VERSUS UNDERLYING YIELD



Source: Bank of America Merrill Lynch, Bloomberg, GIAM

Graph 4: HIGH YIELD PERFORMANCE BY SEGMENT



Source: Bank of America Merrill Lynch, Bloomberg, GIAM

We expect IG to out-perform when the cycle turns

The next question will be the size of the second Corporate Sector Purchase Programme (CSPP). Although President Draghi did not explicitly mention it, we expect CSPP 2.0 to be a part of the coming € 20 bn asset purchase program to start in November. In history the CSPP has fluctuated roughly between 10% to 20% of the total program which would leave us with € 2 bn to € 4 bn credit purchased by the ECB each month. At peak during CSPP 1.0 the ECB bought over € 11 bn. Given the contsraints faced on other programs, we suspect the share of the CSPP in the program could be greater this time and amount possible € 5-6 bn net corporate bonds each month. If economic outlook was to deteriorate further and the new targeted measure announced to bolster banks profitability would prove insufficient we could see banks preferred senior bonds included to the program.

Accordingly, we expect euro area corporate bond spreads to tighten further in the fourth quarter – particularly at the long end of the curve. Generally, spreads of long-dated corporate bonds tend to tighten more than spreads of short-dated ones in such an environment. Moreover, the credit curve flattening is lagging the sovereign bond curve. The intensified search for yield will force investors to extend the maturity, triggering a further flattening of the credit curve. We keep our OW stance on non-financials versus financials well on subordinated instruments vs senior HY.

We play the IG HY divergence, but not in 2019

ECB CSPP should provide further support for credit spreads into year-end.

Hence, the short-term outlook for euro area corporate bonds appears rather bright as underlying yields are unlikely to rise. The ECB presence in the market is providing some relief on the liquidity concerns for IG it is not the case for high yield. When the cycle will turn we expect at some point some disconnection between IG and HY even if default rates fail to pick-up. Beside these fundamental issues, the achieved corporate yield level will prevent any meaningful return, going forward.

Elisa Belgacem
+33 (0)15838 1797

Currencies

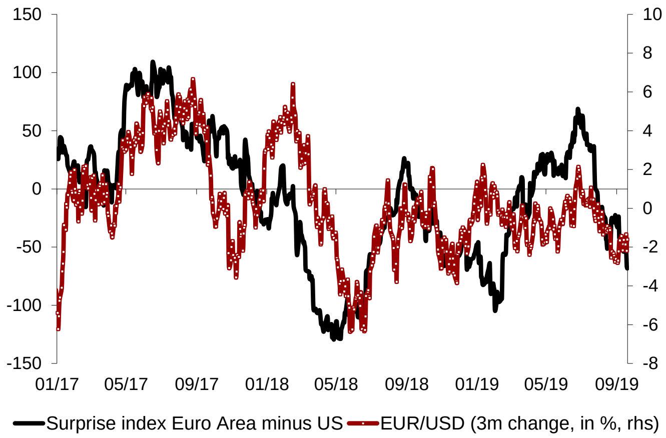
- **In the longer view, we still deem the US dollar toppish amid persistent overvaluation and structural headwinds from reserves diversification and the current account deficit.**
- **Short term, however, the EUR/USD may fall slightly further, with the fallout from this summer's intensifying trade war weighing even more strongly on growth in China and the euro area.**
- **The yen is set to remain tightly linked to US yields. We expect a more volatile USD/JPY to trend lower**
- **The Chinese yuan is prone for some further weakness amid persistent trade strains. That said, even after USD/CNY breaking above 7.00, the bar for a sharp devaluation by China remains high.**

We had argued in summer that an the economic fallout from the trade war and Brexit uncertainty as well as renewed accommodation by the ECB will likely weigh on the EUR/USD near term. This move came even stronger than expected. With the trade war intensifying in August and the ECB resuming – this time open-ended – QE, the EUR/USD temporarily even fell below 1.10 more recently.

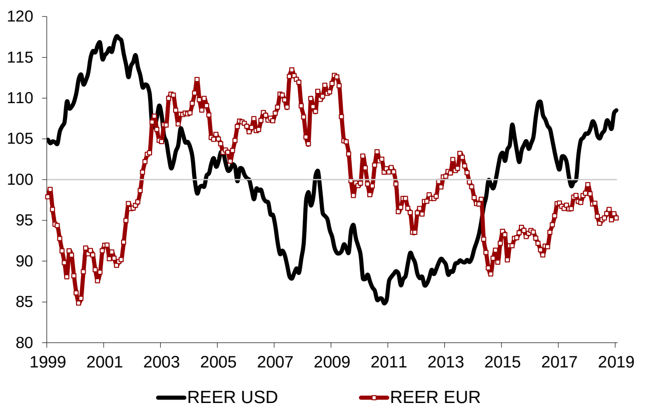
After the Fed has turned more responsive to global risks, USD is benefitting less from global trade uncertainties

In our longer term view, we still deem the USD toppish. The Greenback is substantially overvalued on several metrics (e.g. against longer-term effective levels, see Graph 2). Furthermore, we are likely to see at least two more rate cuts over the next year. The persistent current account is a structural drawback, while also capital inflows should moderate once the US economy starts slowing more visibly amid a fading fiscal stimulus and receding investment activity. We also expect international reserves managers to increasingly diversify away from the USD, with US politics increasingly exploiting the dollar's still dominant role for exerting political pressure. Conversely, the undervalued EUR has catch-up potential once political pressures around a hard Brexit and trade war starts to subside. Also, the EUR/USD has been lagging the unwinding of speculative positions (see Graph 3 overleaf).

Graph 1: ECONOMIC DATA SURPRISES AND EUR/USD



Graph 2: REAL EFFECTIVE EXCHANGE RATES

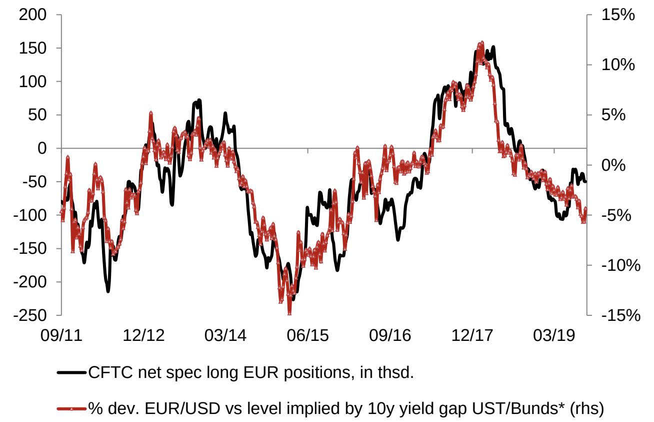


based on CPI, long-term avg. = 100; last month approximated by chg. in nominal eff. exch. rate

And yet, we have lowered the whole path of the EUR/USD outlook (now 1.09 on 3 month, 1.15 on 12-month). Following the recent mutual US/China tariff hikes, the European export and manufacturing sector will continue to suffer. Further risks arise from looming car tariffs which Trump may impose once the EU/US trade truce expires in November. Germany is likely already in a technical recession, and we no

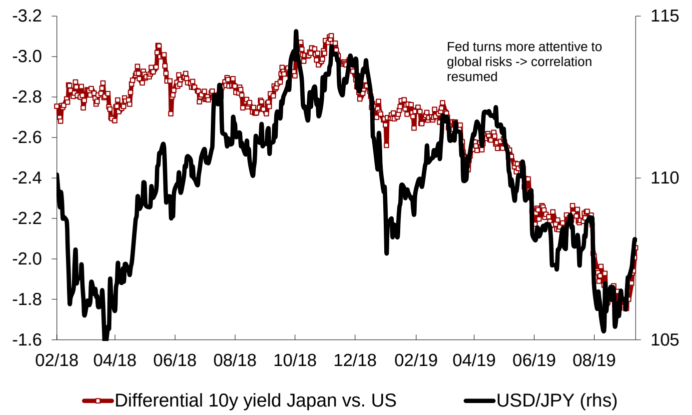
longer expect a marked rebound near term. Amid a global search for yield, the outlook of protracted QE will also continue to weigh on the euro, underpinning its funding currency status. So very tactically, it may still pay off to maintain some open USD exposure with tight stop losses, also for foregoing the still elevated hedging costs of 2.6% p.a.. Going into next year, however, the risks of a drawback in the USD are rising, warranting a more cautious stance.

Graph 3: SPECULATIVE POS. AND EUR/USD DEV. FROM YIELD GAP



* based on 3y rolling regression coefficient EUR/USD vs. 10y yield gap

Graph 4: USD/JPY AND 10-YEAR YIELDS



yield differential: JGBs vs. US Treasuries

Yen with upside on lower US yields

Our view of a more volatile but higher-trending yen has paid out until August, before USD/JPY bounced back to levels around 108. Yet the outlook remains tilted towards a stronger yen. For one, the yen's overvaluation points to a partial reversal. Furthermore, with a moderate fall in US yields now in our books, the yen is set to benefit as the strong correlation between US yields and USD/JPY (Graph 4) is unlikely to weaken. The Fed has turned more susceptible to global risks and the impacts of the trade war and Brexit while the BoJ has largely exhausted its interest rate tools. As a result, safe haven flows into the yen are exacerbated by falling yield Japan/US differentials in times of mounting trade concerns and risk aversion.

Risk premium to sterling still high also after last August/September relief rally

The British pound has recovered more than 4% vs. EUR from the lows seen in August, with the UK parliament increasingly tying PM Johnsons hands in his no-deal Brexit brinkmanship, even though the risk premium attached to the pound remains high. Uncertainties may drag into winter if – as currently seems likely amid the fluid situation – the Oct. 31 deadline is postponed once more into next year, with a volatile GBP lacking direction near term. Any clearer signs of a deal, though, have the potential to trigger a meaningful rally in sterling.

CNY to weaken further, but sharp devaluation still unlikely

CNY to weaken further after recent trade war intensification, but the bar for a sharp deliberate devaluation remains high

The risk of a further escalating trade war flagged in our last edition materialized in August, with China indeed tolerating USD/CNY to break through the symbolically important 7.00 threshold in a widely noticed move. Given the risk of capital outflows and deteriorating financial conditions, we still see the bar for China resorting to a strong deliberate devaluation as high. That said, amid severe trade strains and weaker Chinese growth, we now deem China open to a controlled further depreciation toward levels around 7.30 by year-end.

Thomas Hempell
+49 (0)221 / 4203-5023

Equities

- **Equities experienced another good quarter, albeit investors maintained a cautious stance and low positioning.**
- **Political risks do linger (not escalating in our view) and weak macro momentum maintains earnings revisions weak.**
- **That said, global central banks will remain highly dovish, rendering subdued cost of capital. Extremely high risk premia tend to support positive relative returns of equity vs fixed income and more contained worst Sharpe ratios.**
- **Contrarian tactical indictors are also in buy territory. We maintain a positive outlook with total returns of 3-5% in 12 months. We are neutral EMU vs USA. OW UK, Switzerland, Utilities, discretionary, Momentum and Low Leverage.**

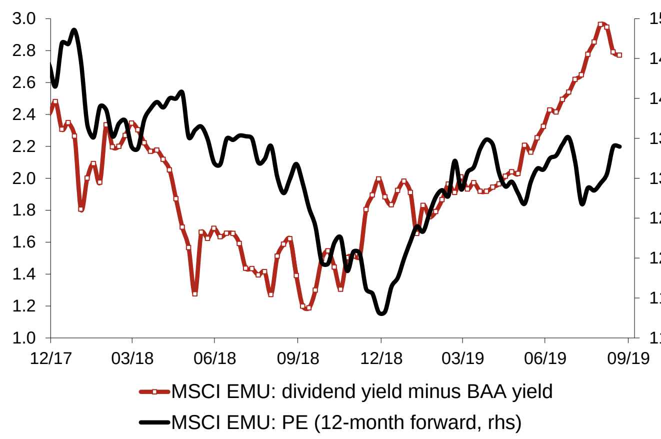
Developed markets have already started to respond to easing central banks.

In the last three months equities extended their good performance helped by dovish central banks inducing lower yields and lower credit and sovereign spreads. This came against a soft macro momentum and lingering geopolitical risks. EA equities outperformed US ones (+2.7 vs +1.8%) while the two defensive markets, UK and Switzerland, underperformed. After a substantially meager year-to-date return (+10% vs 19% of the MSCI World), the Japanese Topix came out the best in the quarter (+3.8%) thanks to a stabilization of the USD/JPY and bottoming US 10-year rates. On the contrary, a lingering weakness in EM currencies vs the USD, caused EM equities to post a negative return (-2%). European style performances were almost aligned with exception of Quality (overperforming) and Momentum (underperforming). The latter suffered, in particular, due to bottoming US yields.

Constructive stance: dovish central banks and low valuations

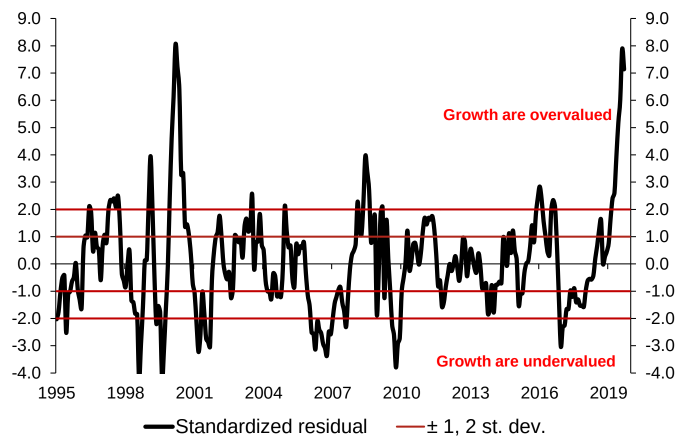
It is the story of two tales: the market prices in slower economy plus risks, which maintain EA earnings revisions in negative territory, causing equity funds' outflows and subdued positioning. US NIPA profits (usually leading S&P 500's ones) are also showing an anemic growth. In sum, 2020 profit estimates for the US and the EA are

Graph 1: MSCI EMU: RISK PREMIUM



using BAA yields

Graph 2: GROWTH VS VALUE: MODEL VALUATION



distance from fair value model, in standard deviations

increasingly at risk (being above 10% yoy each vs 1-2% for 2019). That said, low inflation expectations and dovish central banks are triggering a lower cost of capital (COE) and extremely high equity risk premium. Furthermore, very poor sentiment and extreme low positioning are inducing contrarian tactical indicators to signal a buy opportunity.

Low yields combined with low positioning are to offset risks and slower growth.

At times of such low yields, history suggests equity vs bonds returns tend to show both positive returns and more contained worst Sharpe ratios, although we see fu-

ture returns lower vs history. We maintain a constructive outlook on equities (3-5% 12-month total returns), while acknowledging lingering risks in the short term.

Neutral EMU vs USA. OW UK, Utilities, discretionary, Momentum and Low Leverage

We are neutral EMU vs US and Growth vs Values, waiting for concrete sigs of macro stabilization.

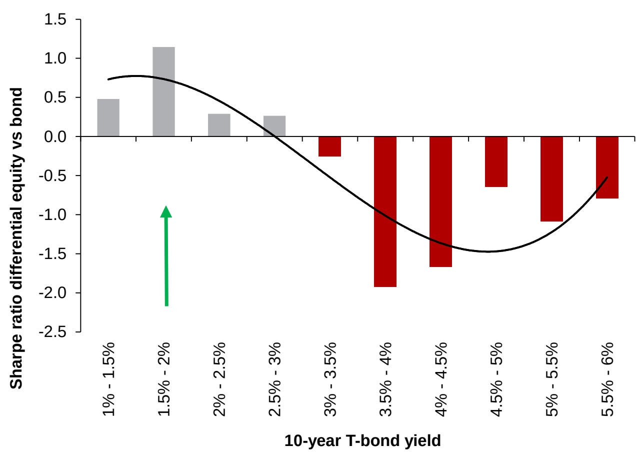
A world of extremes: Value vs Growth and banks vs the EU index have reached extreme relative valuations (only similar to year 2000), mirroring lower yields and risks of economic weakness (weak global export and negative revisions). We may need to see a convincing stabilization in macro surprises and progresses on the fiscal stimulus debate in order to see stabilization in 10-year rates and by this way a better performance of banks and Value in general: we might not be there yet.

For the time being, we recommend a neutral position on EMU vs the US, Cyclicals vs. Defensives, Growth vs Value, EM, Japan and Quality. We are slightly overweight on UK and Switzerland, Small cap Growth vs Large cap Value, Utilities, discretionary ex-auto, Momentum and Low Leverage. Materials and IT are underweight.

EM: pressured by tug of war, strong USD, and weak export momentum. Mid-term positive outook.

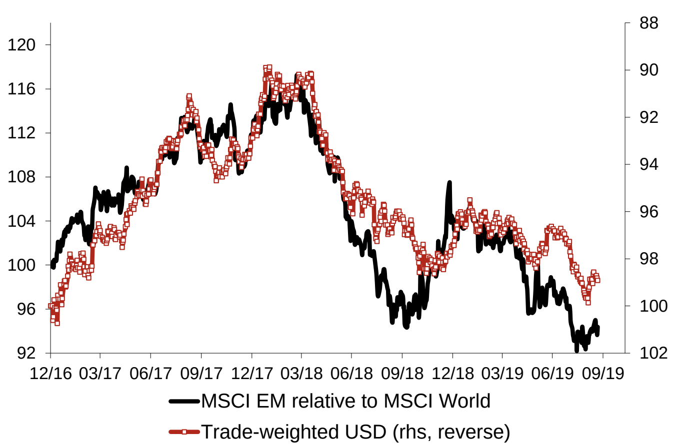
In the quarter, the MSCI EM index has decreased by 2% (mounting trade tensions b/w US and China), underperforming the MSCI World by 3 pp. Fundamental valuations are cheap: multiples are trading at a discount of 6% vs historical average, while the cyclically-adjusted PE is almost one standard deviation below average. In

Graph 3: US: RISK ADJ. WORST LOSS EQUITY VS BOND



using 3-month returns, 1° percentile

Graph 4: EM RELATIVE TO DM AND TRADE-WEIGHTED USD



the shorter term, the EM equities are to be subject to increased volatility coming from a strong USD and the expected tug of war between softer and harsher tones in the US-China trade negotiations.

EM: volatility to rise due to the tug of war in the short term.

In the longer term, weakening US dollar, low valuations and structurally superior GDP growth would be drivers of future outperformance of EM equities.

We remain mid-term positive. We favor Brazil and CEE markets (ex. Turkey). We tactically adopt a neutral stance on Korea and India, waiting for a better entry point (fiscal stimulus or lower entry prices).

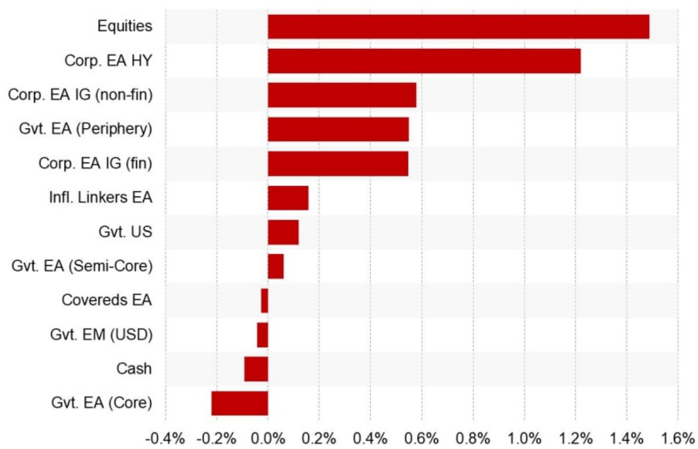
Michele Morganti +39 040 / 671-599, Vladimir Oleinikov +49 (0)221 / 4203-5036

Asset Allocation

- **Trade war and policy uncertainties are taking their toll on global growth. Unforeseeable events like the attack on Saudi Arabia's oil infrastructure act in the same direction.**
- **Negative yields have meanwhile become the rule rather than the exception, with the prospect of not recovering noticeably, at least for the time being. Thus, the search for yield will generally continue to be supportive for risk assets albeit against the backdrop of risen risks.**
- **In a nutshell, we recommend extending the overweight in credit at the expense of core govies and covered bonds. The overweight in equities should be slightly decreased.**
- **The exposure to cash should be reduced to a small underweight. The long duration stance should be lowered further towards neutral.**

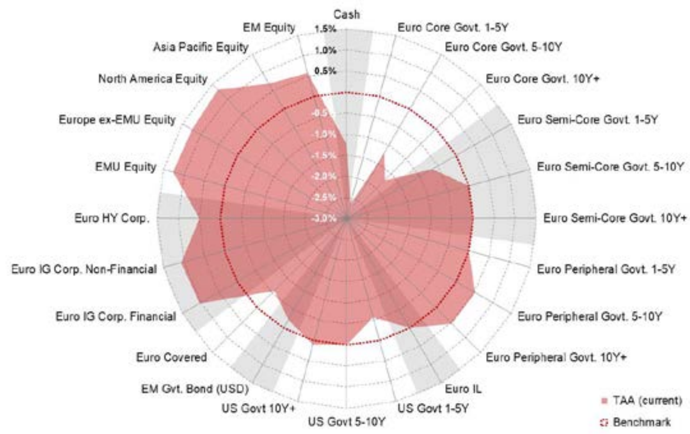
Trade war, policy uncertainties, and unforeseeable events like the attack on Saudi Arabia's oil infrastructure burden global growth. So far, private consumption has been able to escape this pressure and counteract a slide into recession. Though cracks are mounting, this should remain for some time. Thus, against the backdrop of a confirmed accommodative tilt by central banks, credit is about to remain underpinned by the search for yield. Together with a cautious investor positioning this should also be beneficial to equities. Furthermore, the low yield environment will help to underpin valuations. All in, the overall situation remains rather favourable for risk assets. Notwithstanding, risen risks resulting from a potential military conflict in the Gulf region must not be disregarded.

Graph 1: SELECTED AGGREGATED TOTAL RETURN FORECASTS



3-months horizon; Hedged into EUR; Semi-Core = Spain; Periphery = Italy

Graph 2: RECOMMENDED ACTIVE POSITIONS



In pp; Semi-Core = Spain; Periphery = Italy

Given these conditions, core bonds in general and short-dated bonds in particular as well as cash remain the least attractive asset classes. Whereas long-dated fixed income assets and fixed income assets providing a yield pick-up like credit and periphery as well as equities still appear to be the most promising investments in the near term. Consequently, we advise to increase the overweight in credit at the expense of core govies and covered bonds. Cash should be underweighted. We slightly reduce the overweight in equities due to the aggravated risk scenario. Duration-wise we recommend reducing the long stance further towards neutral.

Thorsten Runde
+49 (0)221 / 4203-5044

Forecasts

GROWTH

	2018	2019f	2020f	2021f
US	2.9	2.1	1.6	1.8
Euro area	1.9	1.1	0.9	1.1
Germany	1.5	0.5	0.7	1.3
France	1.6	1.1	0.9	1.8
Italy	0.7	- 0.1	0.3	0.6
Non-EMU	1.5	1.2	1.2	1.5
UK	1.4	1.1	1.1	1.4
Switzerland	2.5	0.7	1.5	1.6
Japan	0.8	0.8	0.2	0.8
Asia ex Japan	6.2	5.5	5.5	5.6
China	6.6	6.2	5.9	5.8
CEE	3.0	1.8	2.7	2.9
Latin America	0.1	0.1	1.9	2.0
World	**3.6**	**2.9**	**3.0**	**3.2**

INFLATION

	2018	2019f	2020f	2021f
US	2.4	1.9	2.0	2.1
Euro area	1.7	1.3	1.4	1.4
Germany	1.8	1.5	1.5	1.5
France	1.9	1.2	1.4	1.6
Italy	1.1	0.8	1.1	1.1
Non-EMU	2.3	1.8	1.9	1.8
UK	2.5	1.9	2.0	1.8
Switzerland	0.9	0.6	0.7	1.0
Japan	1.0	0.7	0.9	0.8
Asia ex Japan	2.6	2.7	2.7	2.7
China	2.1	2.4	2.3	2.2
CEE	6.1	6.8	5.5	5.2
Latin America	4.0	4.0	3.7	3.6
World	**2.7**	**2.6**	**2.6**	**2.5**

Regional and world aggregates revised to 2015 IMF PPP weights; Latin America Inflation excluding Argentina and Venezuela

FINANCIAL MARKETS

3-month LIBOR	**Current**	**3M**	**6M**	**12M**
USD	2.15	1.90	1.70	1.70
EUR	-0.42	-0.45	-0.50	-0.50
JPY	-0.09	-0.10	-0.30	-0.30
GBP	0.78	0.80	0.80	0.80
CHF	-0.78	-0.85	-0.85	-0.85
10Y Government Bonds	**Current**	**3M**	**6M**	**12M**
US	1.77	1.70	1.65	1.60
Euro-Area	-0.51	-0.50	-0.50	-0.45
France	-0.22	-0.20	-0.20	-0.15
Italy	0.89	0.90	0.90	0.85
Japan	-0.21	-0.25	-0.25	-0.30
UK	0.64	0.55	0.55	0.60
Switzerland	-0.76	-0.75	-0.75	-0.75
Spreads	**Current**	**3M**	**6M**	**12M**
GIIPS	110	110	110	105
BofAML Covered Bonds	43	45	45	40
BofAML EM Gvt. Bonds (in USD)	309	320	330	335

Corporate Bond Spreads	**Current**	**3M**	**6M**	**12M**
BofAML Non-Financial	110	100	90	80
BofAML Financial	111	105	100	90
Forex	**Current**	**3M**	**6M**	**12M**
EUR/USD	1.10	1.09	1.12	1.15
USD/JPY	108	106	105	104
EUR/JPY	119	116	118	120
GBP/USD	1.25	1.24	1.29	1.35
EUR/GBP	0.88	0.88	0.87	0.85
EUR/CHF	1.10	1.09	1.10	1.11
Equities	**Current**	**3M**	**6M**	**12M**
S&P500	3002	3045	3060	3090
MSCI EMU	125.4	126.5	126.0	125.0
TOPIX	1613	1630	1625	1620
FTSE	7338	7420	7390	7320
SMI	10047	10215	10180	10120

As of 20.09.19 (3-day-average)

FORECAST-INTERVAL* – 3-MONTHS HORIZON

Government Bonds (10Y)	US	1.51	1.70	1.89
	Germany	-0.62	-0.50	-0.38
	UK	0.43	0.55	0.67
	Switzerland	-0.95	-0.75	-0.55
Spreads	10Y-GIIPS Spread	87	110	133
	BofAML Covered Bonds	38	45	52
	BofAML IG Non Financial	86	100	114
	BofAML IG Financial	91	105	119
	BofAML EM (in USD)	289	320	351
Forex	EUR/USD	1.06	1.09	1.12
	USD/JPY	102	106	110
	EUR/GBP	0.85	0.88	0.91
	EUR/CHF	1.07	1.09	1.11
Equities	S&P500	2,903	3,045	3,187
	MSCI EMU	119.8	126.5	133.2
	TOPIX	1,534	1,630	1,726
	FTSE 100	7,066	7,420	7,774
	SMI	9,768	10,215	10,662

FORECAST-INTERVAL* – 12-MONTHS HORIZON

Government Bonds (10Y)	US	1.18	1.60	2.02
	Germany	-0.66	-0.45	-0.24
	UK	0.35	0.60	0.85
	Switzerland	-1.12	-0.75	-0.38
Spreads	10Y-GIIPS Spread	63	105	147
	BofAML Covered Bonds	25	40	55
	BofAML IG Non Financial	54	80	106
	BofAML IG Financial	64	90	116
	BofAML EM (in USD)	273	335	397
Forex	EUR/USD	1.08	1.15	1.22
	USD/JPY	96	104	112
	EUR/GBP	1.08	1.15	1.22
	EUR/CHF	96	104	112
Equities	S&P500	0.79	0.85	0.91
	MSCI EMU	1.05	1.11	1.17
	TOPIX	2,825	3,090	3,355
	FTSE 100	110.6	125.0	139.4
	SMI	1,412	1,620	1,828

*The forecast range for the assets is predetermined by their historical volatility. The volatility calculation is based on a 5 year history of percentage changes, equally weighted in the case of the 12-month forecast and exponentially weighted in the case of the three month forecast. The length of the bars within each asset group is proportional to the relative deviations from their mean forecasts.

Imprint

Head of Research Vincent Chaigneau (vincent.chaigneau@generali-invest.com)

Head of Macro & Market Research: Dr. Thomas Hempell, CFA (thomas.hempell@generali-invest.com)

Team:
Elisabeth Assmuth (elisabeth.assmuth@generali-invest.com)
Elisa Belgacem (elisa.belgacem@generali.com)
Radomír Jáč (radomir.jac@generali.com)
Jakub Krátký (jakub.kratky@generali.com)
Michele Morganti (michele.morganti@generali-invest.com)
Vladimir Oleinikov, CFA (vladimir.oleinikov@generali-invest.com)
Dr. Martin Pohl (martin.pohl@generali.com)
Dr. Thorsten Runde (thorsten.runde@generali-invest.com)
Dr. Christoph Siepmann (christoph.siepmann@generali-invest.com)
Dr. Florian Späte, CIIA (florian.spaete@generali-invest.com)
Dr. Martin Wolburg, CIIA (martin.wolburg@generali-invest.com)
Paolo Zanghieri, PhD (paolo.zanghieri@generali.com)

Issued by: Generali Insurance Asset Management
Macro & Market Research

Version completed on June 21st, 2018

Sources for charts and tables: Thomson Reuters Datastream, Bloomberg, own calculations

In Italy:
Generali Insurance Asset Management
S.p.A. Società di gestione del risparmio

Piazza Tre Torri
20145 Milano MI, Italy

Via Niccolò Machiavelli, 4
34132 Trieste TS, Italy

In France:
Generali Insurance Asset Management
S.p.A. Società di gestione del risparmio

2, Rue Pillet-Will
75009 Paris Cedex 09, France

In Germany:
Generali Insurance Asset Management
S.p.A. Società di gestione del risparmio

Tunisstraße 19-23
50667 Cologne, Germany

www.generali-investments.com