



GLOBAL MARKETS OUTLOOK - UPDATE

April 2018

CAUTION, DRIVE SLOWLY

Our expectations for 2018 were centered on anticipation of higher volatility, driven by rising growth and inflation expectations that would in turn support equity markets which would in turn become susceptible to higher interest rates as markets and central banks increasingly responded to the improved economic backdrop. The first quarter of 2018 has provided a rollercoaster start, incorporating all of the above with plenty of political intrigue to boot.

Our estimates for market price action and event risk for the year were almost fulfilled within January itself. A flying start for equities saw US bourses extend the rally of the fourth quarter with the S&P 500 advancing 7% in the first few weeks of year. After taking a large step forward, risk appetite endured a sharp two steps back as the market fell almost 12% from its highs in a little less than a fortnight. The key impetus for price retrenchment came from the sharp rise in interest rates that was particularly pronounced in response to US employment data from early February that suggested wages were finally starting to rise more aggressively.

Subsequent data releases have inferred a more contained inflation backdrop and to some degree this has helped stabilize the sell-off in longer term interest rates in the US whilst bond markets in the rest of the world have actually recovered to some degree. Equity markets have continued to gyrate relatively aggressively. This has partly been driven by on-going political uncertainty in the US that has seen President Trump change a lot of his key personnel whilst at the same time increasing the pressure on trade negotiations with various announcements on imposition of trade tariffs. Currency markets have also experienced some sharp moves, particularly in January where the dollar lost over 4% on a trade weighted basis. The Japanese yen has performed strongly across the quarter.

Looking forward, we continue to anticipate the generally supportive global economic backdrop to foster an environment conducive to risk taking where equity markets progress as long as financial conditions don't tighten too quickly. In this regard, markets have moved into a new higher volatility regime and they will be extremely sensitive to forthcoming data flow. Any signs that inflation is taking a firmer hold will likely undermine interest rate markets, particularly in the US where there are signs of nervousness about the market's ability to digest forthcoming supply as a function of the fiscal expansion remains. In contrast, moderation in growth momentum may raise fears that the rise in interest rates witnessed to date may already be taking its toll given the extent of the global debt burden. Key focus in this regard should be paid to Asia where the lagged impact of the credit tightening that started in China last year may start to become visible, particularly in old world industrial sectors that are increasingly pressured by the migration to a more service oriented economy.

The FED has kept unchanged the number of rate hikes in 2018, as well as the dot plot showing a persistent weak link between unemployment and inflation (flatter than expected Phillips Curve). In Japan, Kuroda said inflation is far from the 2% target and that the BOJ will continue with stimulus until it achieves the goal. During the last ECB press conference, Draghi praised the strong domestic economic growth momentum currently in place, and expressed faith that higher employment will eventually lead to higher productivity and inflation, without hinting to any imminent tightening of the QE program.

Investors will also have to contend with an increasingly contentious geopolitical backdrop. Rising tensions seem likely to be augmented with Trump's latest appointment of John Bolton as National Security advisor given the hawkish tilt of historic commentary vis-à-vis both North Korea and Iran.

DISCLAIMER: Please see details on page 3

	As of 03/29/18	Net Px Chg in Q1 18 (%)	2017 Perf %
Equities			
MSCI WORLD	2,065.53	-1.80	20.11
S&P 500 INDEX	2,640.87	-1.22	19.42
NASDAQ COMPOSITE INDEX	7,063.45	2.32	28.24
Euro Stoxx 50 Pr	3,361.50	-4.07	6.49
FTSE 100 INDEX	7,056.61	-8.21	7.63
NIKKEI 225	21,159.08	-7.05	19.10
MSCI EM	1,169.27	0.93	34.35
HANG SENG CHINA ENT INDX	11,998.34	2.47	24.64
MSCI EM EASTERN EUROPE	172.48	4.16	12.85
MSCI EM LATIN AMERICA	3,032.91	7.24	20.83
TADAWUL ALL SHARE INDEX	7,870.87	8.92	0.22
Fixed Income			
US Generic Govt 2 Year Yield	2.27	20.35	58.46
US Generic Govt 10 Year Yield	2.74	13.86	-1.59
Germany Generic Govt 10Y Yield	0.50	16.39	105.29
Liquid Investment Grade	274.21	-2.92	7.29
Liquid High Yield	266.35	-1.04	6.32
Citi EuroBIG Index	232.89	0.75	0.53
Pan-Euro HY Unh Eur	380.42	-0.26	6.24
EM USD Aggregate	1,079.89	-1.48	8.17
Currencies			
DOLLAR INDEX SPOT	90.15	-2.14	-9.87
EUR-USD X-RATE	1.23	2.46	14.15
USD-CHF X-RATE	0.96	-1.84	-4.39
GBP-USD X-RATE	1.40	3.74	9.51
AUD-USD X-RATE	0.77	-1.68	8.34
USD-TRY X-RATE	3.94	3.80	7.80
USD-BRL X-RATE	3.31	-0.19	1.76
Commodities			
BBG Commodity	87.47	-0.79	0.75
Oil (Brent)	70.27	5.08	17.69
Gold Spot \$/Oz	1,325.50	1.74	13.53
Silver Spot \$/Oz	16.38	-3.30	6.34
Platinum Spot \$/Oz	931.95	0.40	2.78
Generic 1st 'TIO' Future	69.70	-2.22	-10.62
LME ALUMINUM 3MO (\$)	2,004.50	-11.62	33.96
LME COPPER 3MO (\$)	6,714.00	-7.35	30.92
Generic 1st 'NG' Future	2.73	-7.45	-20.70

GLOBAL ASSET CLASSES

	-	=	+
Equities			
Bonds			
Commodities			
Cash			

EQUITY REGIONS

	-	=	+
US			
Europe			
Japan			
Emerging Markets			

FIXED INCOME

	-	=	+
Sovereign			
Aggregate			
IG Corp			
High Yield			
Emerging Debt			
Convertibles			

This table is meant as a reference

Investment Strategy and Asset Class Review

- We continue to expect supportive macroeconomic data to underpin appetite for risk assets, absent abrupt tightening of financial conditions.
- Equities should continue to trade sideways for now, by opposing forces, amidst a higher volatility regime.
- In Fixed Income, we are very selective and prefer to stay short duration. Focus on active and targeted strategies for bond investments.
- We like strategic exposure to under-owned and/or safe haven FX such as JPY.
- Oil remains a buy-on-dips while base and industrial metals are to be treated with caution given their higher volatility. Silver is an opportunistic buy given stretched positioning and high Gold to Silver ratio.

From an asset allocation perspective, safe haven options are diminishing and it has become increasingly difficult to hedge risk. This is why we consider cash as part of the asset allocation, alongside gold and Japanese yen.

EQUITIES

We expect continued choppiness and sideways trading in the equity space, as opposing forces should be driving the market direction. On one hand, persistent fears of higher yields and geopolitical risks remain swords of Damocles hanging on the aging bull market. On the other hand, what is expected to be another strong earnings season, with 18% EPS growth estimated for the S&P500, should ease investor nervousness and hopefully lift stock prices.

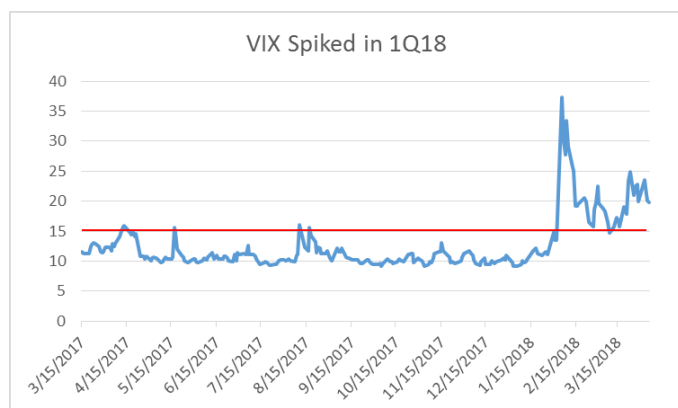
The first effects of the US tax reform should indeed start impacting the companies' bottom line, offsetting –for now – the adverse effects of wage growth and higher commodity prices. Record levels of announced buybacks YTD are also a major support for equities in the near term.

In the US, we continue to like industrials given the increase in capex coupled with a very ambitious US military budget. However, stock picking is key in this sector in order to avoid sensitivity to Chinese tariffs. We have become more wary of Big Techs with regard to increasing regulatory risks (taxing revenues, controlling data use) which we had highlighted in our FY 2018 outlook. We tend to prefer Software, and as a minor theme, cybersecurity.

European markets have once again lagged their US counterparts, in both USD and local terms. Yet the strong euro headwind for exporters should ease with the stabilization of the single currency's TWI. This doesn't necessarily mean they would outperform given the slowdown in economic indicators (industrial production, PMIs).

In the MENA region, the Saudi market has seen a positive catalyst with FTSE upgrading Saudi Arabia to its Emerging Market status. Inclusion will be done gradually until year end. This event should bring about USD 5bn of passive inflows and increases the likelihood of a June MSCI EM inclusion.

Small caps continue to look attractive on a relative basis as they look under-owned and are more immune to any considerations related to trade disruption or currency movements.



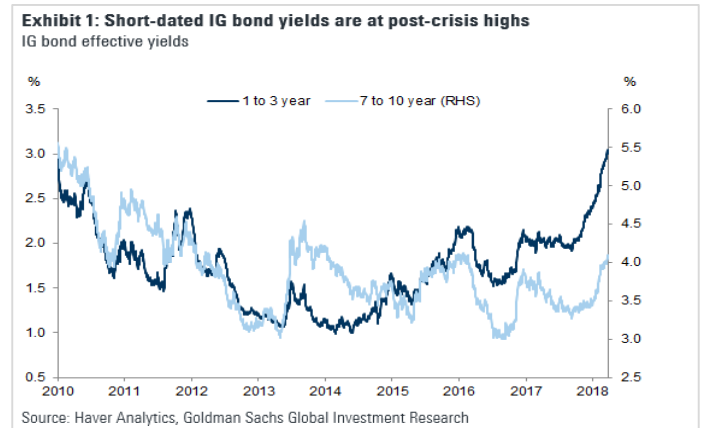
As we seem to have moved in a new volatility regime, with the VIX remaining well above 15 since the beginning of February, performance dispersion has increased inter- and intra-sectors,

leaving room for bottom up selection and stock picking to make a difference in portfolio performance. This is why the combination of single line and ETFs would make sense to benefit from favorable themes and particularly attractive growth or value stories. In addition, an option overlay is currently an interesting add-on for yield enhancement in equity portfolios when investor risk profile allows it.

FIXED INCOME

Almost one quarter into the year, the FOMC raised rates and gave us a steeper profile in the dots with expectations of hikes once a quarter for 2018 and 2019. Eventually, the pace of tightening will be determined by inflation figures and the overall assessment on the economy. Nevertheless, the market does not seem to be entirely convinced of the return of Goldilocks scenario especially after the recent risk-off reaction. Indeed, treasuries traders were watching for déjà vu signs from 2017, when expectations for higher yields were bashed by March. Last year, it was a disappointment regarding inflation misses and the Trump administration's inability to make progress on its fiscal agenda. Today, it might just be the flight to quality due to volatility in tech stocks, US trade actions and further turnover in the Trump administration.

Even though this flight to safety eased the upward track in yields but overall we are still witnessing an acceleration in the sell-off on the front-end of the curve. Indeed, the significant spread widening which was mainly due to the "repatriation overhang" and waning demand from foreign investors due to higher funding and FX hedging costs, has created opportunities in short-dated bonds. Although, these headwinds can obviously persist but short-end of the curve is looking cheap on relative value basis vs the medium- long end (Refer to exhibit 1). Moreover, the excess premium provided by the HY market vs IG in both USD and EUR remains low.



FX

The combination of trade war escalation, tight short term US dollar funding conditions, persistent negative credit impulse in China and weaker global growth is weighing on risk sentiment. This setting is conducive of buy-the-dips approach for safe haven (JPY, CHF) or under-owned (GBP, JPY, SEK etc.) FX.

Given its reserve currency status, the US dollar is likely to be supported against high-beta/EM FX such as BRL, TRY, AUD, etc., but

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should be at a disadvantage versus G4 and safe haven assets (JPY, gold/silver, CHF, EUR, etc.).

A clearer buy-on-dips remains the JPY. The Yen is our favorite haven currency as the largely under-owned trade-weighted JPY “only” rose 6.1% YTD, in line with seasonal fiscal year end appreciation trend since 2015. The risks to further JPY strengthening could stem from any accentuation of global market selloff (watch for a break of 200-day moving averages), weakening of Abe’s leadership over the Moritomo scandal, or increased speculation that the BoJ could end QQE sooner than in 2019.

Looking at the EUR, it appears economic momentum is peaking in the short term, which combined with a dovish ECB, is likely to keep the single currency a sell on rallies against major peers. In the euro’s case, technicals should play a stronger role, with EURUSD needing a break above 1.24 to confirm further upside, and EURGBP requiring a move close above 0.8843 to test the 0.9 area. From a more fundamental standpoint, we like buying EURCHF on dips towards 1.15 as the CHF remains strongly overvalued v. EUR.

In the UK, the absence of negative Brexit headlines with EU showing a will to negotiate, as well as a nascent recovery in economic surprises have lent support to GBP. Political risks continue to surround the Pound, but the under-owned currency with a hawkish central bank and tight labor market, is at an advantage against the US Dollar on days during which the greenback is on the back foot.

CAD and NOK have recently recovered, as the deteriorating Venezuelan oil production as well as rising risks of re-Iran sanctions pushed Brent to print higher highs over the past few sessions. A break above the 50% Fibonacci retracement of the 2014-2015 downtrend, would imply a leg higher for NOK and CAD, especially against other commodity FX. For instance, as long as AUDCAD holds below 1.012, AUDCAD target would be 0.96.

Commodities

In the commodity space, oil price has benefited from three main supports: Geopolitical risks in the Middle East in light of President Trump’s new appointment of Iran hawk John Bolton, strong demand from China, and last but not least, the significantly positive yield resulting from the futures curve backwardation.

WTI remains a buy on dips as long as price is above 55\$/bl, with an initial support near 60\$/bl. While earnings season is likely to be favorable for oil producers, we continue to prefer the commodity futures to those companies which dividend is below the 5-6% roll yield of oil futures.

Gold is another commodity that held up well (+2% YTD) in spite of higher 10-year US real yield, as well as a negative yield. Financial demand for gold recently rose to multi-year highs as market volatility and a weaker US dollar are giving gold back its shine. From a technical perspective, while we strategically like to hold gold at an average cost of 1,250\$/oz, we also like to tactically trade the 1,305-1,370\$/oz range. A break on the downside would drive gold towards 1,240\$/oz, while a move above 1,370 would take gold to the 1,410-35\$/oz area.

Silver is expected to underperform versus gold in times of higher volatility. However, given stretched short speculative positioning, as well as a gold-to-silver ratio near historical highs make it an appealing asset to hold for a higher-return (higher risk as well) asset.

Industrial and base metals were negatively impacted YTD by trade war rhetoric, fears of future supply, and take profit activity after an average 14% performance YoY. We prefer to be cautious on the commodities themselves and continue to like long term holdings in some diversified and strategically positioned miners.

