Catching the Winds of Change

It had been in the air for a while, exceptional resilience of risky assets to political and fiscal uncertainties, dropping yields in the wake of Quantitative Easing programs, or falling gold prices, winds of change had started to blow on global markets in the first half of the year. So far these winds had been particularly generous to investors serenely riding on a sea of liquidity. However, any sailor knows that high tides do not last forever, and for those who had been tempted to put off the idea, the warning sent by US Fed’s Chairman Ben Bernanke after the June Federal Open Monetary Committee meeting must have resonated has a harsh wake-up signal.

Wind of change indeed, harsh indeed. After the announcement of the likely agenda for the Fed’s QE tapering, global markets experienced a sharp turn and all trends, in equities, fixed income and currencies suddenly reversed. Economic good news being interpreted as monetary bad news, equity prices dropped, erasing most of the gains recorded since the beginning of the year. Once again, the prospect of the end of a Quantitative Easing program sparked a market selloff, just like after the Fed terminated QE1 and QE2. At that time, Citi analysts had claimed that the QE programs had failed to achieve their goals: unemployment was still too high, housing market had not rebounded and credit had not been revived, which could only result in a market correction, dropping yields and renewing expectations for bolder actions. Why would it be different this time, why wouldn’t asset allocator once again revise their strategy?
“It is becoming harder and harder for investors and capital allocators to resist the siren call of the equity market as the financial logic of buying equity is strong: sharp fall in systemic macro risk vs year ago and sharp fall in political risk, especially in US.”

Jonathan Stubbs, Europe Equity Strategist
Citi Research

It has often been repeated that with so large QE actions, central banks were evolving in a monetary “Terra Incognita”, learning as they act. A cornerstone of any learning process is to never repeat the same mistakes. In that respect, the set up current QE programs rectified a major weakness of the previous programs: the constraint of their scope. Indeed, while QE1 and 2, based on a defined amount and a determined time frame, actually focused on bringing sufficient cash to the financial system, the current easing program is focusing on its objectives which not only means bringing sufficient cash to the system but also doing it long enough to build up the confidence required to make it work and eventually flow into the economic system.
With that in mind, it is understandable that easy money “addicted” markets feel the pain of the future termination of the cash injections, but from a fundamental perspective, the sooner QE3 will be stopped, the better. Indeed, the sooner the housing market will be sustainably growing, the sooner the unemployment rate will be supportive and the sooner credit will drive investment and consumption, the better the prospects will be for longer term sustainable investment returns, and for equities in particular.

Another illustration of these winds of change is the rout observed in the so-called safe-haven investments. A market correction or a downturn characterised by a reversal of risk appetite is usually accompanied by an outperformance of assets considered to be safe by investors.

During the last 5 years, the prospect of QE ending meant stronger dollar, rally in Treasuries and surge of gold prices. None of that this time, quite the contrary: the US Dollar declined, gold prices fell by another 13%, bringing the total retreat from 2012 peak to more than 30% and US Treasury bonds erased 14 months of returns in just 4 weeks. Basically, the yield shock of May-June affected investors exposed to safe assets more profoundly than investors exposed to risky assets.

“The end of the “givens – USD ever falling, petroleum ever rising, global investor outflows from dollar-denominated investments – is upon us and the Market in the Mirror will give way to new and fundamentally important trend reversals paving the way for new opportunities. It is time to look forward again”.

Steven Wetting, Chief Investment Strategist Citi Private Bank

Citi analysts think that the current changes go beyond the short term turn of the economic cycle in the US as what they observe is that major financial trends of the past decade are reversing. Important trends including the falling US dollar, rising petroleum and commodity prices and global investor outflows from dollar-denominated investments are at an end.

The global bond rally has reached its apex. Similarly, Emerging Markets can no longer be looked at like they were during the early 2000 through the prism of commodities, infrastructure and cheap production costs. What Citi analysts observe is that the growth dynamic in Emerging Markets and China in particular is shifting from a more commodity-intensive fixed asset investments and industrial production driven model to an increasingly household-based and service sector growth model.

Citi analysts believe these new trends will provide opportunities that will differ from the recent past and will drive distinct and potentially profitable outcomes for investors who will be able to detach their views from the past decade’s direction.
Fixed income

Lower Bund Yields Expected
The reaction of global fixed income markets to the June US Fed meeting has been severe, with European core and periphery sovereign bonds being no exception. Indeed, from the last FOMC June meeting to the recent high in yields, Citi analysts note that Bunds have moved with a beta of approximately 0.6 versus US Treasuries, which appears to be too high from a purely fundamental perspective. In fact, over the longer-term, Citi analysts see scope for Bunds to outperform US Treasuries, as not only the underlying bond market structure but the broad orientation of economic policy differs significantly between the US and the Eurozone. Based on their fair value estimate of the 10-year bund yield, Citi analysts think yields should trade lower going forward, with a target of around 1.50% near year-end.

Regarding the impact of the June US Fed meeting on UK rates, Gilt yields have followed Treasuries sharply higher. Citi analysts highlight that the market seems to be overreacting, especially in terms of re-pricing rate hike expectations, with the gilt sell-off looking increasingly overdone. They also note that Gilts are likely to rally as soon as domestic drivers are able to reassert themselves and perhaps new BoE Governor Carney’s arrival may be the catalyst.

In credit markets, Citi analysts note that the recent sell-off has been very pronounced, with large players in the market rushing to hedge positions via synthetic products. More worryingly, large outflows in the cash market have appeared for the first time since November 2008, with aggregate long positions in credit now at their lowest level in over a year. With all players in the market being in “alert” mode already, and hedge unwinding to continue to take place, Citi analysts expect the market to continue stabilizing in the near future.

Equities

Firmer Earnings Growth Expected
European equities underperformed global equities during the second quarter of the year, with the MSCI Europe index posting negative returns. Despite the recent pullback, European equities have returned 20-25% since the summer lows in 2012. Even though concerns over rising bond yields, volatility in Japan and EM growth risks have driven the second 5%+ pull back in 2013, Citi analysts believe that this dip represents an attractive buying opportunity, for several reasons.

Global macroeconomic environment is likely to remain supportive for equities, with slow but firm GDP growth, low inflationary pressures and super-accommodative Central Bank policies. Although it may be too soon to dismiss macro risks altogether, the current situation compares favorably versus the recent past: Indeed, a year ago, investors were kept busy with major issues such as the Euro break-up scenarios, the China hard-landing, and US “fiscal cliff” stall speed worries.

From an earnings perspective, Citi analysts expect a turn in the European earnings cycle. While the recent earnings season was poor in Europe, Citi analysts have highlighted that there has been a turn in European earnings. Indeed latest data have shown that the year-on-year growth in 12-month forward earnings appears to have troughed. With PMIs improving in Europe and expected to pick up in the US in 2H13, Citi analysts find it hard to see year-on-year earnings growth not turning positive in the coming six months.

Most interestingly, to be properly bearish on equities, rather than calling for a short term pull-back, Citi analysts point out that there needs to be either a GDP, and hence earnings, cliff or interest rates would have to rise aggressively. Citi analysts think both scenarios are unlikely.

Finally, attractive valuations supports rising risk appetite from investors, which supports Citi analysts’ further re-rating thesis and expected strong returns to end-2014.
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Fixed income

US Treasuries rates may remain range-bound as sluggish growth prospects, political uncertainties, and the US fiscal debate weigh heavily on the yield curve. As uncertainties dissipate, rates will likely seek higher ground later this year to reflect lower tail risks and improving growth prospects.

While credits are still poised to outperform within fixed income universe this year, Citi analysts believe that the credit cycling is likely turning, with increasing signs that corporates are re-levering across regions and sectors. Furthermore, valuations are less compelling now as yields trade near historic lows and spreads hover around post-crisis tights.

US High yield returns have been more resilient than investment grade securities due to better carry and resumed fund inflows as a result of improved risk appetites. Actually the high yield fund outflows that occurred from late January through February received much attention. However, the outflows were driven primarily by ETFs, which tend to attract more fast money and more shorting interest than the broader market. In addition, those outflows have partially reversed since then.

Thus Citi analysts believe that credit spreads may tighten only modestly from here and expect low single digit returns from investment grade bonds below historical average and project 7% and 5% returns for high yield and leveraged loans this year, respectively.

Fed may begin to taper pace of asset purchase in 2H13

Citi analysts continue to expect economic growth of 2.1% this year and picking up further in 2014 to 2.8%. Support for expansion has improved with widespread hiring, more effective monetary accommodation as reflected in buoyant financial markets, and the rippling effects of reviving housing. But fiscal drag may likely check upside momentum now that the full budget sequester is going into effect. Slow implementation is expected to further delay the larger fiscal drag, while the recovery’s underlying momentum may also be buffering the impact of deficit reduction.

The Federal Reserve’s (Fed) aggressive forward guidance and open-ended bond-buying have yielded the longest stretch of accommodative financial conditions since the late-1990s. The drag from fiscal restraint and policymakers’ high bar for satisfactory job growth will likely sustain QE at an elevated pace through 1H13 but may begin to taper the pace in 2H13. High unemployment and low inflation suggest no start to exit strategies through 2014.

From an equity perspective, new highs for the Dow Jones and the S&P 500 are met with deep concerns about the sustainability of the advance and questions regarding any opportunity for more appreciation.

According to Citi’s latest client survey, US investors seem most focused on 4 issues: 1) Corporate margins sitting near previous highs; 2) Valuation continues to come up as being relatively high; 3) Potential Fed policy reversal as many believe that all of the gains in stock prices have been “liquidity” driven; and 4) Allegedly frothy investor sentiment.

Citi analysts continue to believe that 2H13 may prove more challenging as political drama in the form of another debt ceiling fight or elections in Germany could be problematic. In the interim, the S&P 500 could exceed our year-end 2013 target of 1,615 before slipping in the second half.
Asia-Pacific equities

Equities priced for a catch-up
Citi analysts believe that China’s economic transition to a more domestic consumption driven slower growth will continue to weigh on economic activity in other Asian countries while general Asian currencies appreciation against Japanese yen will further cap their export competitiveness. Citi analysts now anticipate 6.4% GDP growth for the region with notable downgrades for Taiwan, South Korea and Malaysia. Citi analysts think rates cuts are possible though less likely in countries facing escalating private debt ratios or increasing current account deficits. In particular, they think credit policy will remain accommodative in China amid benign inflation.

Though still strong compared to Developed Markets, slower GDP growth across the region has largely contributed to the underperformance of Asian equities during the last 12 months. Citi analysts observe that this underperformance has in turn contributed to significantly improve the attractiveness of local stocks. Indeed, compared to previous peak levels in 2007, Asian ex-Japan earnings are 20% higher while stocks prices are 20% lower whilst in the US, stock prices are 6% higher while earnings are now 12% higher. Going forward, Citi analysts expect earnings per share to grow by 17% this year in a neutral revision context which is likely to offer strong rerating opportunities, particularly with trailing Price-to-Earnings ratio significantly below average. They also observe that the monetary context remains accommodative in the region with generally negative real rates and ongoing central banks assets growth. Citi analysts believe that current fundamentals are attractive enough to overweigh the region as they think it shouldn’t take a significant catalyst to change investors’ sentiments to catch-up some of the recent underperformance. In particular, Citi analysts have a preference for Hon-Kong, South Korea, Taiwan and Singapore.

Japan equities

Recent correction a buying opportunity?
After the strong correction Japanese equities experienced in the end of May and the first half of June accompanied by JPY strengthening, the market seems to have stabilized in the following days.

Citi analysts think that this sharp correction is likely to provide buying opportunity. They believe that the government and central bank will not be keen on further JPY appreciation taking into consideration 2% inflation target set up by BoJ in April. If the target is to be achieved it is likely that the monetary policy will need to be expanded. Additionally, Citi analysts assume that the government might provide additional fiscal stimulus to reduce the negative impact of consumption tax hike scheduled for April 2014.

Japanese stocks can also win on a relative policy support as Federal Reserve prepares to scale back its QE3 program and ECB is reluctant to provide more stimulus for the Eurozone economies.

According to Citi analysts all these factors should support Japanese equities in the medium term. Price-to-book favors Japan compared to Europe or the US, while on a price-to-earnings basis (estimated 12M earnings) Japan looks a bit more expensive than Europe and in line with the US, but still below its long-term average.

In the short term however, Citi analysts think that the most likely scenario for Japanese indices is to trade range bound. To see the rally recommencing, more monetary and fiscal stimulus accompanied by the improvement in the Japanese economic data are needed. Citi’s analyst raised their GDP growth forecasts for 2013 and 2014 by 0.2% and 0.4% respectively to 2.2% in 2013 and 1.9% in 2014 and expect to see some additional support from the officials.
Standpoint Q3 | 13

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Emerging Europe equities

Sentiment game
The generally poor sentiment towards all emerging markets has been in evidence almost from the very beginning of this year. Emerging Europe was not an exception. The underperformance relative to the developed market was largely driven by the recent fears of the scale and timing of the FED’s quantitative easing tapering.

Although disappointing, the last quarter’s equity performance in Emerging Europe was still a little bit better than in other emerging markets. Poland turned out to be exceptionally strong in the last couple of weeks, however Citi analysts see it as a rather catching-up process and do not expect the outperformance to last. On the other side was Turkey, where on the back of social unrest the local equity indices slumped significantly making it the worst market in the region recently.

The economic growth outlook for the Emerging Europe remains subpar. Citi analysts forecast the GDP growth below the potential and emphasize that most markets are facing domestic challenges of varying degrees. The still relative weak local private sector combined with unpromising economic activity in the Euro Area suggest that the road to the full economic recovery for the region might be bumpy. Nevertheless, Citi analyst expect modest gains in the region to year-end and highlight dividend yields as an attractive feature of equity markets in the Emerging Europe.

The attention is drawn particularly to the Russian market, which was neglected by many investors and continued to underperform during the 1H13. However, it seems attractive as the de-rating in the last months brought the market to the point where it is trading on 3.9x forward PE - the lowest multiple since the global financial crisis in 2009.

Latin America equities

Challenging Economic Context
Citi analysts think that Latin America will continue to suffer from the weakening or even more probably end of the so called commodity supercycle. They indeed cut again their GDP growth forecasts to 3.1% for this year and 3.8% for 2014 with downgrades in particular for Brazil and Mexico, the two locomotives of the region. Brazil appears vulnerable after activity indicators came out relatively weak during the first quarter while inflation forecasts at 5.8% for this year and 5.7% for next are higher than the central bank’s range target midpoint of 4.5%. Citi analysts expect 3 further rates increase of 25b bps each, which will drive the SELIC at 8.25%.

Citi analysts maintain a neutral view on Latin America equities despite their improving outlook for global equities in general. Indeed, despite double-digit Earnings-per-Share growth expectations, they observe that the relative earnings momentum in the region remains weak in a context of bearish commodity prices outlook and scarce liquidity. They also point out that Latin America equities valuations stand out as relatively expensive compared to other emerging markets. Within the region, Citi analysts have a preference for Mexican equities which have benefited of a strong momentum driven by the implementation of ambitious structural reforms and which they think may remain in place going further.

On the other hand, they maintain a negative view on Brazil equities as they think the negative mood consecutive to a poor macro framework, slipping inflation and public interference in various sectors will continue to weigh on investors’ appetite for Brazilian stocks in the coming months.
Real Estate Investment Trusts (REITs)

REITs Can Work in a Moderate Rising Rate Environment

In June, REITs have reversed their previously impressive quarterly (and YTD) gains. Citi analysts note that REITs have underperformed the broad market by this much this quickly 11 times over the last 20 years with 5 of those instances occurring during the tech boom in the late 90s when REITs were clearly out of favor and 4 during late 2008/early 2009 when REITs’ existence was being questioned. However, the average relative return +30, +90, +180 days and 1 year following these months of underperformance averaged +84bps, -104bps, +316bps and +553bps respectively.

Citi analysts believe that REITs can withstand a moderate rise in interest rates, especially under the context of an improving economic environment.

They indeed observe favorable historical precedent for this (i.e. 1996, 2003, 2004-07, 2009 etc). Particularly, REITs sold off 14.6% back in April 2004 - underperforming the broad market by 1,300bps – on fears of the Fed raising rates. What followed was indeed higher rates, but also strong returns in the REITs sector. Citi analysts are not necessarily implying that history will repeat itself, but for them the key is what is driving rates higher than the actual increase per se.

They also highlight that REITs are not a static yield investment like bonds for example. Whilst REITs may have bond characteristics, they also offer a larger exposure to growth. Their cash flows continue to rise from increases in Net Operating Income (NOI) and debt refinancing while dividend payout ratios are low by historical standards which implies that REITs are retaining significant free cash flow that lifts NAVs. Citi analysts estimate that all these factors could lift REITs implied cap rate by c. 70bps to 6.6% over the next 3 years. And yet again, this assumes constant REIT share prices with shareholders earning c. 3.5% in annualized dividend yield that is also forecast to grow.

Commodities

Increasing divergences

Citi analysts see increasing signs that the commodity supercycle has come to an end. They expect generally lower prices, and they see each commodity more likely to be sitting on its individual supply/demand fundamentals than on more general factors affecting all of them. Indeed, Citi analysts believe investors need to gain a greater understanding of demand conditions. Shifts in underlying investment patterns in China and other emerging markets are a critical source of change for aggregate consumption as China and other EM growth shifts from more commodity-intensive fixed asset investments and industrial production growth to household-based and service sector growth.

Citi analysts are of the view that gold prices could struggle to maintain current levels in the second half of the year, as there appears to be little in the way of short- or medium-term risk, with inflation concerns being pushed further forward into the future, while low interest rates and growing liquidity have tended to favour other asset classes such as equities over gold.

Base metals have declined significantly per Citi’s expectations: lead down 10%, zinc down 9% and aluminium off 8% in the first quarter. Going forward, Citi sees price declines looming in virtually all base metals as China moves from investment-heavy +10.5% annual economic growth to a long-term consumption-heavy +6.7% growth.
While the relative EUR-USD rate differential has tightened somewhat in tandem with the falling EURUSD after the June Federal Open Monetary Committee, Citi analysts observe that euro money market rates continued to move closer to their February highs. This trend looks very similar to the tightening of the financial market conditions evident in the run up to the rather dovish ECB meeting in February when Mr. Draghi warned that excessive currency moves could lead to persistent inflation undershoot. In addition, the ECB president addressed the unwelcomed tightening in the money market condition trying to reign in the pickup in short-term rates. Citi analysts think a potential repetition of these events could make investors rather cautious on the near term outlook for EURUSD from here. In the very near term, potential disappointments from the M3 Eurozone data next week could add to the cyclical headwinds for EUR. Citi analysts forecasts EURUSD at 1.36 in a 6 to 12 months horizon.

USDJPY has reverted to the standard pattern of trading reliably off rate differentials after a sudden drop driven by volatility and liquidity. June has been a negative shock to Japan with higher rates, lower equity markets and stronger currency, Citi analysts think that the issue for Japanese policymakers and in particular for the BoJ is how to address these negatives and get the cyclical component of Abenomics back on track. They believe the immediate upside for USDJPY is a strong BoJ commitment to stabilizing the JGB market but another big commitment so soon after their April 4 move seems uncertain. Citi analysts expect USDJPY to move to 110 and beyond, as the combination of monetary expansion, debt burdens and deteriorating fundamentals put sharp pressure on JPY. The move may stall in the very short term in the 98-100 range, unless further yield moves in the US or a credible BoJ response to stabilize JGBs are observed.

Citi analysts observe that the post FOMC bounce in US short-term yields has put an end to sterling strength for the time being. However, the rally in gilt yields continues and this could increase the chances of more policy action from the BoE. Indeed, the June minutes seemed to suggest that continuing back up in UK yields may encourage a growing part of the MPC to consider additional easing measures before long. Citi economists expect that the August policy meeting and Inflation Report to be the venue for Dr. Carney to unveil his plans for how to shape BoE’s monetary policy. That said, they think that if the selloff in UK FI markets intensifies, investors will increasingly focus on the July meeting looking for indications of growing policy activism. Sterling shorts could become increasingly attractive again in the near term especially if the upcoming UK data does not surprise significantly on the upside. Citi analysts forecasts GBPUSD at 1.58 in a 6 to 12 months horizon.
Are Key Sectors Regaining Momentum?

Robert DiClemente, US Economist Citi Investment Research & Analysis

Although it has been a rocky end to the quarter in financial markets, economic conditions have fared well enough to suggest prospects at midyear remain relatively upbeat. Fed officials have been out cleaning up after themselves, reassuring the public that they have not turned more hawkish. A tentative decision to scale back QE has been in the works for some time, conditioned on evidence that their forecasts are playing out. And, as some signs of resilience are surfacing as the drag from fiscal tightening begins to run its course, the need to clarify the policy course will only become more urgent with time.

We have been arguing that much of the recent back up in bond yields reflects a response to favorable economic readings and their policy implications and not a changed attitude among Fed officials. This process began with the sharp upward revisions to employment in early May at a time when many were speculating that the budget sequester was already gutting job growth. In late April, ten-year Treasury yields were about as disconnected from the fundamentals as some seem to think they are now at 2.6%. But there are still scant signs that fiscal tightening has overwhelmed the job market and that the clock is ticking on the fiscal pessimists.

Senior Fed officials this week have cautioned that a timetable for tapering asset purchases is still data-dependent and not a changed attitude among Fed officials. This process began with the sharp upward revisions to employment in early May at a time when many were speculating that the budget sequester was already gutting job growth. In late April, ten-year Treasury yields were about as disconnected from the fundamentals as some seem to think they are now at 2.6%. But there are still scant signs that fiscal tightening has overwhelmed the job market and that the clock is ticking on the fiscal pessimists.

Recent data were encouraging despite headlines that the gain in Q1 GDP was pulled down to a subpar 1.8%. Much of what weighed on this latest estimate is backward-looking, while other high-frequency updates point to an economy that may be picking up heading into 3Q.

- Core capital goods orders were up 1.1% in May, the third gain like that in a row and a good sign that the dip in business equipment investment for Q2 is unlikely to persist.
- The housing recovery shows signs of shifting into higher gear with mortgage purchase applications up in the first three weeks of June despite a 40bps rise in rates. New home sales have broken out into a new range at 476,000 for May, up almost 30% year-to-year.
- Although the downward revision to Q1 GDP will probably shave some estimates for overall growth this year, there’s some consolation that a big chunk of the shortfall occurred in consumer spending. Income growth has been relatively solid in recent months and the saving rate has risen through a period that included large-scale gains in household wealth. The most cyclically sensitive segments of consumer outlays make up about a third of spending and have recovered nicely in this cycle. That rebound halted abruptly with the January tax hikes and the latest revisions have magnified the apparent drag and concentrated it early in the year. Monthly PCE data for May show discretionary spending rising a solid 0.4%, suggesting the biggest part of fiscal drag is beginning to fade and a key cyclical driver may be poised for stronger gains.

On balance, the economy appears to be riding out the fiscal headwinds. Key elements of demand suggest the conditions for better growth may be forming as the second quarter winds down. We see another marginally soft reading on payrolls for June in the 160,000 range. By itself, that along with another subpar GDP reading for Q2 may not propel the Fed closer to tapering. But as part of the weakest stretch of gains this year, these data may be suggestive of stronger underlying momentum that will gain visibility with each month that fiscal restraints dissipate. Barring a more severe setback to financial conditions, we would expect healthier demand and more impressive employment readings over the subsequent few months.
Asset allocations

Defensive
Seeking primarily capital preservation over time and only willing to accept very minor portfolio value fluctuations from month to month.

Income-oriented
Seeking growth of wealth over time but unwilling to accept significant fluctuations in the value of portfolio from month to month.

Growth and income
Seeking long-term capital growth foremost but unwilling to accept significant losses on value of portfolio over the medium term.

Growth oriented
Seeking long-term capital appreciation and willing to tolerate measured medium-term volatility in order to enhance longer-term performance.

Aggressive Growth
Seeking long-term capital appreciation and can accept potentially large losses on portfolio over the near-to-medium term in order to maximise long-term performance.

Forecasts may not be attained. Past performance is no guarantee of future results. There are additional risks associated with foreign investments.
The suggested allocations are intended to be general in nature and are not to be construed as specific investment advice. Investors are encouraged to consult with their Financial Professional to determine their allocation needs based on their risk tolerance, suitability and goals.

Data Source: Citibank NA as of March 2013

Spotlight on allocations

About the Citi Asset Allocation Process
The Citibank tactical portfolio allocations are based on the work of the Global Investment Committee (GIC) of Citi Private Bank. The membership of the committee is comprised of experienced investment specialists from across Citi. The GIC deliberates on the macroeconomic and financial market environment in order to formulate an outlook across multiple asset classes and is responsible for maintaining tactical model portfolios based on this outlook. The tactical weights that are applied to the Citibank portfolios are aligned to the decisions of the GIC.

Allocation to bond & equity markets
- The Global Investment Committee (GIC) has decided to bring its position in Asian equities. This has been funded by reducing exposure to Emerging Markets debt and investment grade corporate bonds.

Overall the GIC now stays overweight on equities, neutral on commodities and underweight on fixed income.
- The GIC believes that medium term outlook for equities is likely brightening and equities may offer better risk/reward than credit this year while both returns are likely to be below last year's gains.

Allocation to regional equity markets
- The GIC recently moved to overweight in Asia while remaining overweight in US, Europe and Japan. Emerging Market equities continue to be neutral.

- Within the equity universe, the GIC has the largest overweight positions to US equities with a brightening outlook given signs of growing corporate capital expenditure combined with improving housing and job markets feed through into economic growth. Exposure to Asian equities has been increased on the basis of valuation not reflecting the strong earnings growth momentum in the region.

- And the GIC believes that Japan may continue to grind higher even slower pace supported by new political leadership taking a more aggressive stance on fiscal and monetary policy. Also the GIC maintains its position in Europe equities given still attractive valuations. Meanwhile the GIC remains neutral position in emerging markets.

Allocation to government and credit markets
- The GIC is heavily underweight sovereign bonds and have small overweight position in High yield bonds. Investment grade bonds and Emerging Market debts allocations of the GIC are now neutral on the basis of narrower spreads capping the scope for gains in a period of rising yields.

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Important Disclosure

“Citi analysts” refers to investment professionals within Citi Investment Research and Analysis, Citigroup Global Markets and voting members of the Global Investment Committee and Global Portfolio Committee of Citi Private Bank.

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