Citigold Private Client

1Q 2015

Asset Allocator

citibank

SPOTLIGHT ON ALLOCATIONS

After a volatile start to the year, the Citibank Asia Model Portfolio Committee maintains its pro-risk stance with an overweight position in global equities and underweight in fixed income. While monitoring key macro developments, including plunges in oil prices, policy divergence among key central banks and geopolitical risks, we believe that our asset allocation is well positioned to benefit from quantitative easing (QE) driven liquidity support, low energy costs and gradually improving global growth. For a fine turning, we have scaled back Euro exposure, while we remain overweight on European equities and credits, and upgraded allocations to both Asian credit and equity, given geopolitical tensions and heightened volatility in Europe.

Oil, QE, Growth and Political Risks

Since the start of this year, a lot of headline risks have fuelled rising market volatility across asset classes, and investor sentiment is now negative. Uncertainty over the timing of the Federal Reserve's (the Fed's) rate hike, volatile commodity prices, deflation risks, mounting debt and increased geo-political tensions are all concerns. The biggest risk in our view, however, appears to be the upside risk in the equity markets, and the fear that investors will miss it.

We notice that fourth quarter (Q4) earnings reports are sending a positive signal and not many people appear to have noticed it. Moreover, equities are cheaper relative to bonds, measured by the yield ratio. Geo-political headline events may continue to dominate the market in the near-term, but we believe that the most important factor for markets over the remainder of the year will prove to be global growth and an accommodative policy stance, which is a helpful combination for global equities. While growth recovery and policy support, along with low oil prices give us a hint as to where to invest, headline may likely provide us with buying timings. Therefore, with short-term volatility and a longer term positive outlook ahead, we would like to buy on weakness.

Asset Class Views

ASSET CLASS	WEIGHT (-2, -1, 0, 1, 2)
Fixed Income	UNDERWEIGHT (-1)
US / Global Sovereign	UNDERWEIGHT (-2)
US / Global Investment Grade	Neutral (0)
US / Global High-Yield	OVERWEIGHT (1)
APAC ex Japan / EM	UNDERWEIGHT (-1)
Equity	OVERWEIGHT (1)
US / Global	OVERWEIGHT (1)
Europe	OVERWEIGHT (1)
Japan	OVERWEIGHT (1)
Asia ex Japan	OVERWEIGHT (1)
EM ex Asia / Global EM	UNDERWEIGHT (-1)

-2 = Underweight; -1 = Moderate Underweight; 0 = Neutral, 1 = Moderate Overweight; 2 = Overweight

Relative weights as of 5 February 2015 with respect to base case/ benchmark allocation. Arrows indicate changes from allocations for the last quarter.

Oil Price War: Focus on Winners

Crude oil's fall of more than 50% since mid-2014 is the largest outside of a recession in almost 30 years. In 2008, oil prices fell from US$146 per barrel in July to US$36 per barrel in December, as global demand sharply fell. However, the current collapse in oil prices is different from 2008-2009 because it is mainly supply-driven, due to a positive supply shock from expansion of US shale oil production and OPEC's weakness as a cartel.

Saudi Arabia refused to reduce supply so as to avoid a loss of market share, and the global oil market has reflected a price battle since the second half of 2014. Amid a price war, projecting its bottom price is anybody's guess given that there is little incentive for low cost producers to pull back output with prices above their operating costs.

* This section is based on the Citibank Asia Model Portfolios published on 5 February 2015.

A sub-US$50 price is allegedly unsustainable and supply cuts are inevitable: (1) with oil prices below US$50/bbl, most of future projects globally are uneconomical; (2) US$50/bbl is not enough for highly leveraged shale companies to meet debt requirements; and (3) most oil exporting counties can meet their government budgets with the current levels. The biggest revision to oil supply growth is coming out of the US, followed by declines in non-OPEC supply, while low-cost producers or cash rich producers with deep pockets will be the last to join the cut. Despite the drop in US rig count and continuing cuts in upstream capital expenditure, short-term market factors – including oversupply and the economics of storage – look even more bearish, pointing to more downward pressure over the next few months. This means that supply cuts are on the way, and the lower oil prices are likely to stay for the time being. Citi analysts believe that markets may see a bottom sometime between the end of the first quarter (Q1) and beginning of Q2, at a significantly lower price level; in the US$40 range, and as low as the US$20 range at worst.

In addition to downward revisions in early-2015, Citi analysts again reduced their 2015 forecasts for Brent and WTI to US$54 and US$46 per barrel respectively. In the longer-term, however, they maintain the earlier call for Brent in 4Q 2016 now at US$75, closer to a 'V-shaped' recovery. While lower oil prices have weighed market sentiment, we focus on the positive impact of low energy prices on global growth. In fact, the plunge in oil prices has a wide range of lasting impacts: (1) a major redistribution of income from oil producers to oil consumers; (2) lower global inflation; and thus (3) a greater chance of further stimulus or low interest rates for a longer time. A low oil price supports growth, and is also reallocating income. Consumers will enjoy savings, while petroleum producers will lose income in 2015. Historically, oil producers such as Russia, Norway, Canada and Brazil tend to underperform, while net oil importers such as the US and Japan have outperformed when oil prices fall.

Major declines in oil prices are also likely to benefit oil-importing Asian emerging markets (EMs), such as India and Indonesia. The elimination of subsidies in India and Indonesia represents a significant budgetary reform and we expect further spending gains in these markets and a further upside.

The most obvious sectoral rotation is towards stronger consumer demand. Citi analysts highlight Retail, Transportation and Chemicals stocks as potential beneficiaries of low oil prices, while the negative ripple effect has been felt most in the US High yield market and Energy sector.

Deflation War: QE positive for risk assets

Away from the Fed, the tide continues to run strongly in favour of QE, with the fear of deflation and slow growth having led to a range of more aggressive monetary easing in EM as well as developed markets (DM).

In January 2015, the European Central Bank (ECB) launched a QE programme that exceeded market expectations. The programme set a pace for asset purchases of €60 billion per month, beginning in March 2015, and including Euro area government bonds, agencies and supranationals, as well as the existing covered bond and ABS purchases. The purchases will continue until at least September 2016 and until there is a sustained adjustment in the inflation path towards the ECB's medium-term target. The potentially open-ended nature of the purchases is the most significant aspect of the announcement. **Larger than expected ECB QE and dovish policy rate surprises should further drive the global search for yield and boost sentiment**.

Also in EMs, the easing cycle is broadening as a favourable market backdrop and low inflation rates set the cause for central banks' rate cuts. At the beginning of February 2015, the People's Bank of China cut the Reserve Requirement Ratio (RRR) for the first time since 2012.

The RRR ratios were lowered by 50bps to 19.5% for all commercial banks in China, effective from 5 February 2015. The PBoC is becoming more aggressive in supporting growth and we expect two rate cuts in 1H (a 25-bp rate cuts in 1Q15 and 2Q15 respectively) and an additional two-to-three RRR cuts in 2015. In our view, given the current deposit base, the 50bps of RRR cut would unlock at least RMB600 billion of liquidity, likely to be injected into the economy. **The broad-based cut will be positive for risk assets (equities and credits), boosting market sentiment as well as smoothing short-term interest rates in China.**

Growth and Corporate Earnings

In the second half of the year, market focus will likely be shifted to global economic and earnings growth from energy given that the collapse in crude oil prices reinforced by monetary easing is lifting global growth. Citi now expects global growth of 3% this year and 3.4% in 2016 (after 2.7% growth in 2014). This reflects the recent major upward revision to their 2015 US growth forecast (to 3.6% from 3%) and modest upgrades to forecasts for the Euro area and Japan, driven by the real income boost from lower oil prices, and support from loosening monetary policies. Although Citi economists made a relatively large downgrade to major commodity exporting EMs, economic growth is likely to accelerate in Asian EMs, with the low oil price and lower inflation continuing to reverberate through the region.

The Q4 2014 earnings season is well underway and supportive of our medium-term bullish view on equities. With low oil prices having boosted spending, consumer discretionary and cyclical sectors have reported stronger earnings growth than other sectors. In the US, almost 70% of S&P companies beat expectations so far as of 15 Feb 2015. Fourth quarter 2014 share-weighted earnings are beating expectations by around 5% and have grown by 4% compared to a year ago. Consumer Discretionary, Energy, Information Technology, and Materials appear to be leading the way in terms of topping estimates, while Oil and gas, Financials suffered negative earnings and sales growth.

Although Fed policy concerns may limit multiple expansions and add volatility in 1H15, we remain generally constructive on US equities in the longer term, given modest growth in corporate earnings. Meanwhile, in Japan, 64% of Topix companies that have reported earnings beat estimates, with earnings growth of 6% year-on-year. In Europe, earnings release is still at early stages with only 20% of the SXXP companies having reported, and with 60% beating estimates and showing 10% earnings growth from the previous year. While weakness in EM currencies and earnings keeps us underweight for EMs broadly for now, we continue to stay bullish on net oil importing Asia.

Geopolitics may provide a buying opportunity

Financial markets have shown their vulnerability to headline news, as political developments in Greece, Ukraine and Russia, and the Middle East have weighed on sentiment. However, we believe that none of these will have significant impacts on fundamentals or a contagion risk to broad markets.

As the far-left opposition party Syriza won the elections in Greece, the spotlight is on the possibility of a Grexit from the Eurozone and on the Greek banking system. While a difficult path lies ahead to find agreement on a follow-up bailout with Greece's 'troika' creditors, in our view, an agreement may eventually be found due to the strong mutual incentives of both parties to avoid the worst-case scenarios of Greek government default or Grexit. Markets are anxious for a quick resolution to the uncertainty, but the negotiations may be lengthy and bumpy.

While the fundamental story of earnings, economic growth and fund flows, provide an indication of where to invest, geopolitics may also drop a hint of when to take more risk. It is difficult to predict the best market timing, but evidence suggests buying on dips would work well in a volatile market when fundamentals send a green light.

About the Citibank Model Portfolios

The Citibank Asia Model Portfolio is based on the work of the Citibank Asia Model Portfolio Committee, comprised of experienced investment specialists from across Citibank. The committee deliberates on the macroeconomic and financial market environment in order to formulate an outlook across multiple asset classes and is responsible for maintaining Model Portfolios based on this outlook. The weights in asset allocations are aligned with the decisions of the Citibank Asia Model Portfolio Committee..

Allocation to bond and equity markets

The committee remains overweight in equities and underweight in bonds. Despite a difficult start to the year, we maintain our pro-risk stance in our asset allocations and remain overweight on equities and underweight on fixed income given that healthy earnings and low interest rates favour further gains in risk assets and lower returns in government bonds. For a fine turning, while we remain underweight in bonds, we upgraded allocations to net oil importing Asian credit and equity to benefit more from low energy prices and low rates for a longer time. We have also scaled back Euro exposure by cutting to the UK, in which the equity market has a heavy energy sector weight, while we remain overweight on European equities and credits.

Allocation to regional equity markets

The committee maintains its overweight positions in US, Europe and Japan equities. While the return potential for equities remains strongest across asset classes, our allocation to equities focuses on sectoral and regional trades. Regionally, we prefer QE markets, including Europe and Japan, and expect QE-driven liquidity to lower equity risk premium. A caveat for global investors is that these markets have the strongest upside potential but currencies have a huge weakening bias. Thus FX hedging will play a key role to secure equity returns. Although political developments in Greece remain a major source of concern, Citi analysts maintain a positive view in European equities and would buy on dips. In Europe, we overweight Autos, Banks, Basic Resources, Health Care, Insurance and Tech sectors.

As for Japanese equities, we prefer the beneficiaries of the weak Yen, US growth and capex recovery in US and Japan and remain overweight on Consumer cyclicals, Financials, and Industrials. Moreover, we overweight REITs, given that yield search may support REITs prices. In terms of US equities, we remain constructive over the longer term, but Fed's policy concerns may restrain multiple expansion prospects. Given that low oil prices and strong US dollar provide benefits to US households and boost spending, we like Retailing, Banks, Household & Personal Products, Technology, and Real Estate.

Within our EM portfolio, the only overweight is Asia. Asia is the single biggest beneficiary of lower commodity prices and this may continue to be the case. In Asia, the net income contribution from commodities is just 23% compared with 77% and 49% for EMEA and Latin America respectively. Moreover, Asia's earnings are growing, while valuations are more favourable in Asia over other EMs. We remain neutral on EMEA and underweight on Latin America.

Allocation to government and credit markets

Within fixed income, we stay underweight on fixed income with underweights on global government bonds and EM debt. Within fixed income, the only overweight is high-yield bonds both in the US and Europe. Our focus is more on the relatively higher-yielding bonds while we stay away from energy-related issuers. Although expected Fed hikes later this year are bearish for US and global bonds, aggressive monetary easing and a dovish message in the rest of the world offsets this.

(1) ECB sovereign QE; (2) sustained above-trend growth in the US and the start of the Fed rate-hike cycle; and (3) recovery in oil prices may eventually push long-term bond yields higher. Citi economists, however, have revised down their DM bond yield forecasts given low inflation for longer time than previously expected. Citi expects US 10-year Treasuries to be 2.55% and Euro Area Bunds trading at 0.65%, UK Gilts at 2.25%, and JGBs at 0.45%.

We believe that the carry-friendly environment may continue in 2015 given that the ECB's QE driven search for yield is supportive for credit spreads. Furthermore, the stronger dollar and potential rate differential between US and other DM markets, should drive demand for US credit.

ASIA MODEL PORTFOLIO

This section shows asset allocation decisions on Citibank Asia Model Portfolios published on 5 February 2015.

Citibank's Asia Model Portfolios provide a guide to possible diversification of investment portfolios and serve as an asset allocation reference tool both for periodic evaluation and prospective investments. Citibank Model Portfolios are developed by Citibank's in-house Global and Regional investment specialists to cater to investors with various risk profiles (based on Citibank's risk assessment) and provide them with:

- Diversified asset allocations, made uniquely relevant for Asian investors
- Up-to-date asset allocations which are reviewed and revised periodically by Citibank's Research teams to reflect changing market conditions in respect of relevant asset classes
- Access to our best-in-class research from the Global Investment Committee

It is important to note that while Citibank Model Portfolios represent Citibank's best thinking in terms of asset allocation and diversification, they serve only as a guideline for investors based on certain risk profiles. Market movements, changing market views, time horizons and liquidity constraints (among others) may result in a portfolio's asset allocation deviating from the model allocation.

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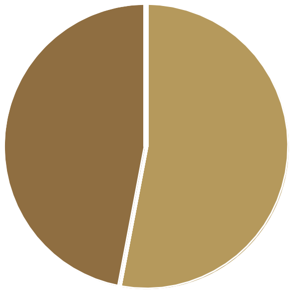
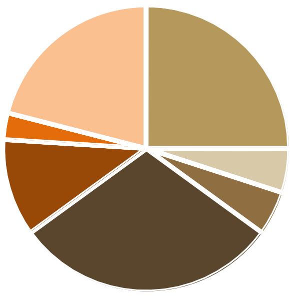
Risk level 2: Model Portfolio



Changes from 4Q 2014	
Fixed Income	No change
Equity	No exposure

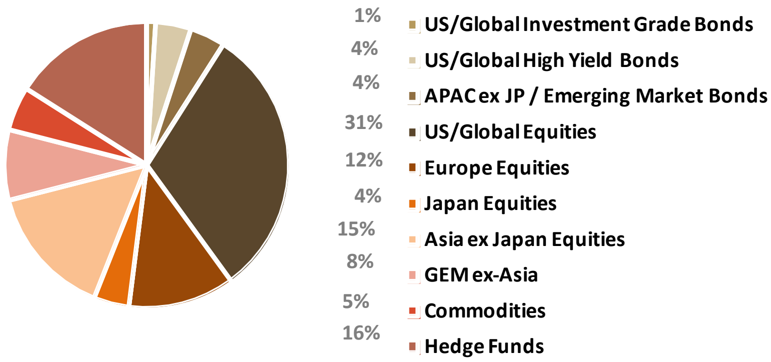
Risk level 3: Model Portfolio



Changes from 4Q 2014	
Fixed Income	⇧ **+2%**
US/Global Investment Grade Bonds	⇧ +1%
APAC ex JP / Emerging Market Bonds	⇧ +1%
Equity	⇩ **-2%**
Europe Equities	⇩ -1%
Asia ex Japan Equities	⇩ -1%

Risk level 4: Model Portfolio

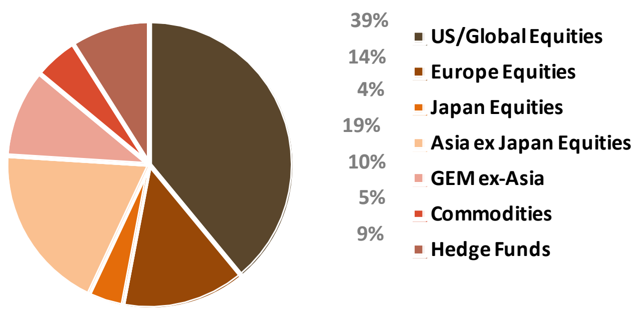
AGGRESSIVE



Changes from 4Q 2014	
Fixed Income	**+1%**
US/Global Investment Grade Bonds	+1%
Equity	**-1%**
Europe Equities	-1%

Risk level 5/6: Model Portfolio

VERY AGGRESSIVE / SPECIALIZED



Changes from 4Q 2014	
Fixed Income	No exposure
Equity	No change

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