

INVESTMENT PRODUCTS: NOT A BANK DEPOSIT. NOT GOVERNMENT INSURED. NO BANK GUARANTEE. MAY LOSE VALUE

# 2018 2H Market Outlook

Citibank Wealth Management

Investment Strategy & Portfolio Management

July 9, 2018



# Performance Review – 2018 1H

## Total returns for different asset classes

%	1Q17	2Q17	3Q17	4Q17	2017	1Q18	2Q18	1H18
<b>Global Equities</b>	6.5	4.2	5.0	5.6	23.1	-1.1	1.9	0.7
<b>US</b>	6.1	3.1	4.5	6.6	21.8	-0.8	3.4	2.6
<b>Europe</b>	6.3	1.2	2.8	0.6	11.2	-4.0	4.3	0.1
<b>Asia</b>	13.4	8.4	6.7	8.3	42.1	0.6	-5.4	-4.8
<b>Japan</b>	-0.3	6.1	2.4	12.0	21.3	-4.9	4.1	-1.1
<b>Hong Kong</b>	10.1	8.5	8.6	8.8	41.3	0.9	-2.5	-1.6
<b>China A</b>	4.4	7.0	5.8	5.1	24.3	-3.3	-9.0	-12.0
<b>Emerging Markets</b>	11.5	6.4	8.0	7.6	37.8	1.4	-7.9	-6.6
<b>Global IG</b>	0.9	1.8	1.1	1.0	4.9	-1.7	-0.7	-2.3
<b>US HY</b>	2.4	2.0	1.9	0.5	7.0	-0.7	1.1	0.3
<b>EM Sovereigns</b>	3.7	2.1	2.5	0.7	9.3	-1.8	-3.7	-5.5
<b>Gold</b>	8.9	-0.6	3.1	1.8	13.5	1.7	-5.5	-3.9
<b>Oil (Brent)</b>	-6.6	-9.4	12.2	16.3	10.6	7.3	11.7	19.9
<b>Dollar Index</b>	-1.8	-4.7	-2.7	-1.0	-9.9	5.0	5.0	2.5
<b>EURUSD</b>	1.3	7.3	3.4	1.6	14.1	-5.2	-5.2	-2.7
<b>GBPUSD</b>	1.7	3.8	2.9	0.9	9.5	-5.8	-5.8	-2.3
<b>AUDUSD</b>	5.8	0.8	1.9	-0.3	8.3	-3.6	-3.6	-5.2

Source: Bloomberg L.P., as of Jun 29, 2018; Performance is referred to total return

Please note and carefully read the Important Disclosure on the last part

# Political and Economic Risks May Rattle Markets

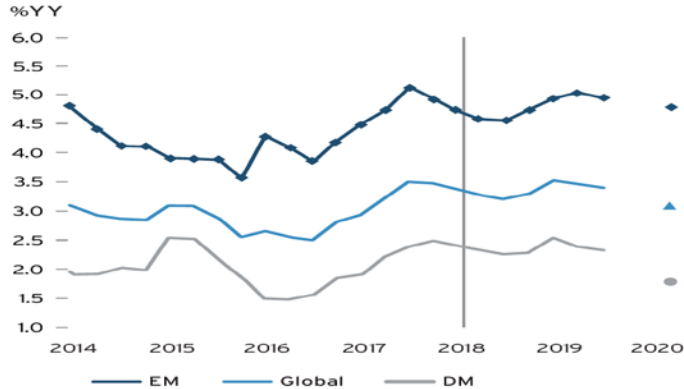
Global is still facing uncertainties



# Global Economy Slows Slightly

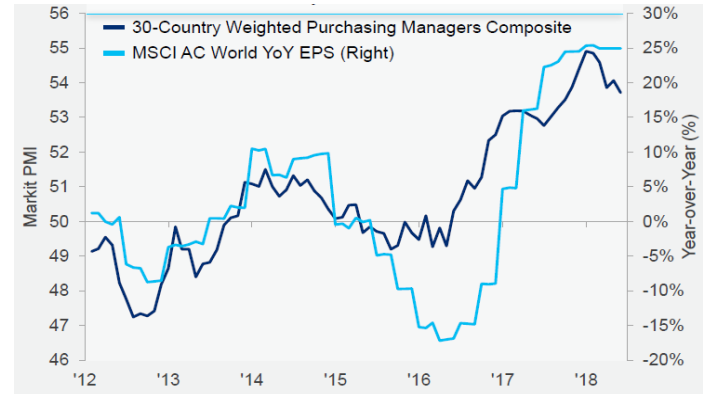
But Markets Assume Worse, Creating Opportunities

## Global GDP YoY Forecasts



Source: Citi, as of May 8, 2018

## 30-Country Weighted PMI and EPS

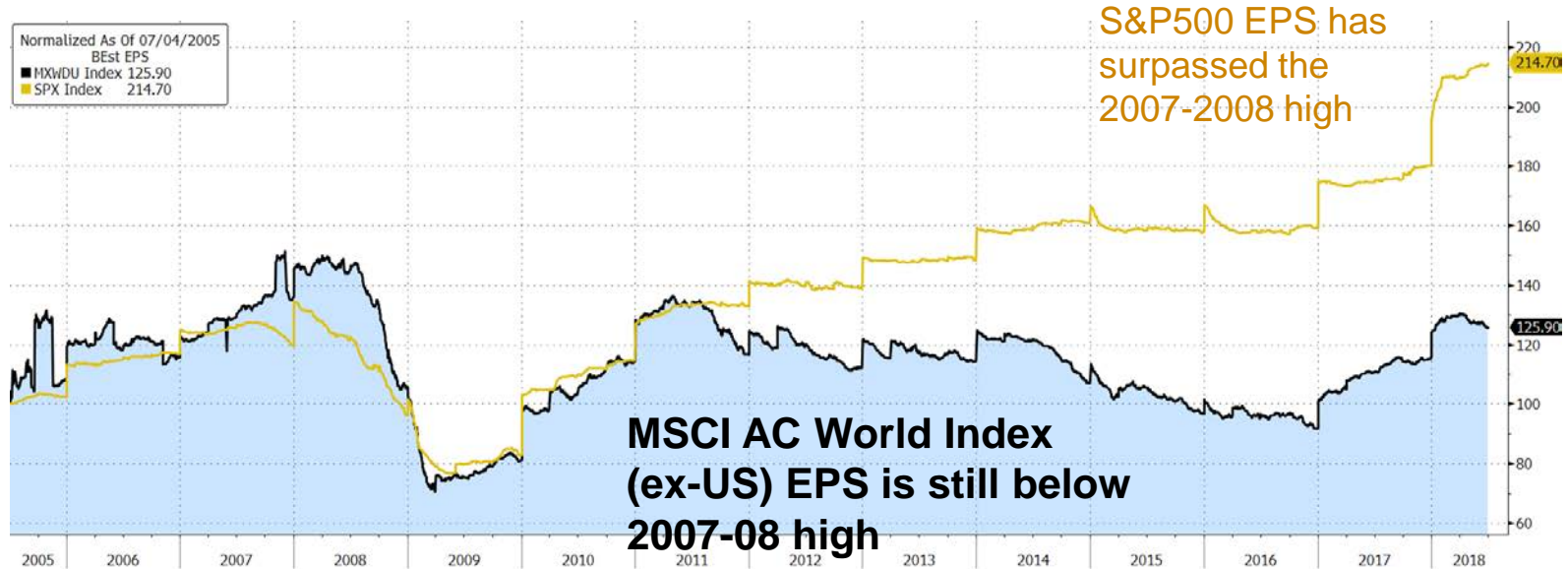


Source: Citi, as of Jul 3, 2018

- ❖ Global growth indicators have edged off from an absolute peak, but remain strong.
- ❖ Global equities have fallen more than future growth indicators, suggesting equities are pricing in sharper growth slowdown than we expect.

# Earnings Forecasts

Below the highs in 2007-2008, corporate earnings outside the US are expected to grow



Source: Bloomberg LP, as of July 4, 2018

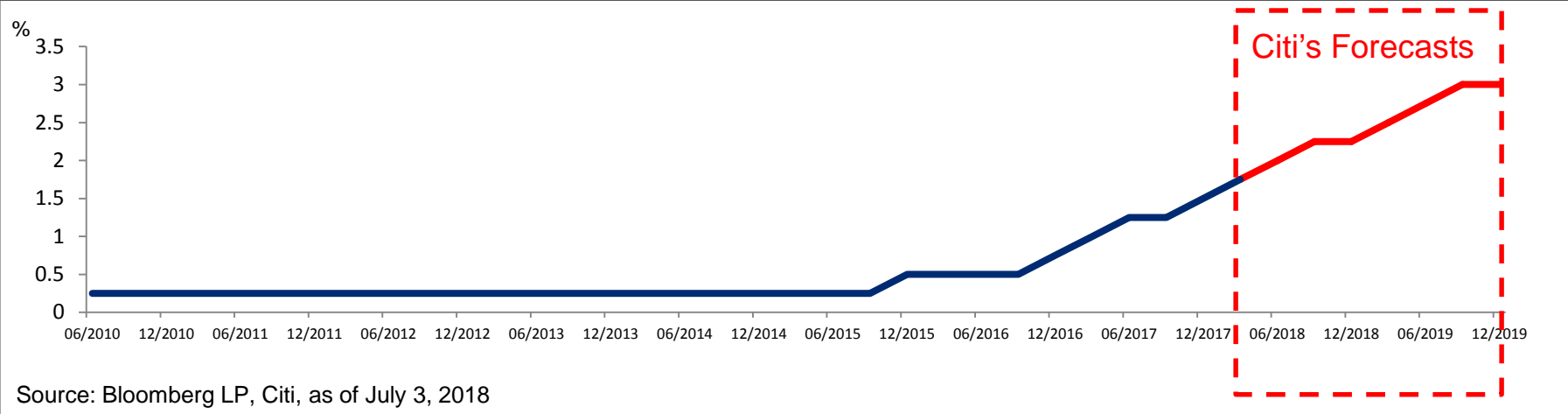
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# US Interest Rate Forecast

Interest rate may edge up

## Citi's USD Rate Forecast

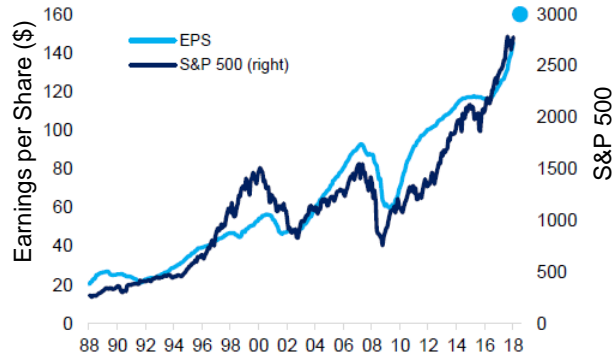


- ❖ In Citi's view, Federal Reserve may raise US rates three times in 2018 with the federal funds target rates reaching to 2.00-2.25% at the year end.
- ❖ We forecast three rate hikes in 2019 and the federal funds target rates may rise to 2.75-3.00% in 2019

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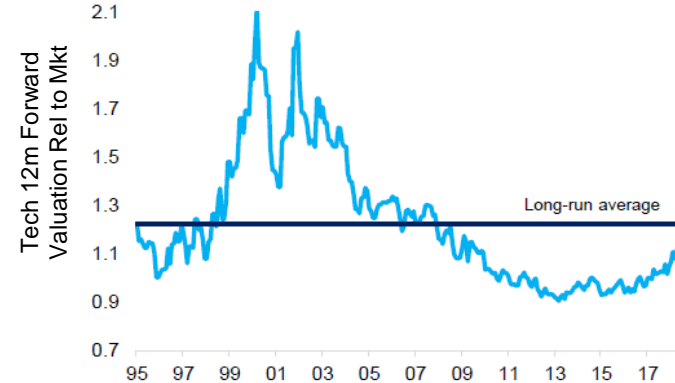
## Neutral on US Equities

### S&P500 and 2018 EPS Forecasts



Source: Thomas Reuters, Datastream, as of Jun 28, 2018

### IT stocks still look inexpensive



Source: Datastream, as of Jun 18, 2018

- ❖ Benefiting from the tax reform, the US corporate earnings is expected to outperform other markets and record a YoY growth of 20%. Supported by robust earnings growth, target price of S&P500 index is 2865 in mid-2019.
- ❖ S&P500 forward profit margins reached 12% post tax-reform. Limited improvement space leads to our neutral view on the US equities.
- ❖ IT Sector recorded strong earnings growth. Shares that sell off in a sector rotation from tech may prove strong, long-term investment opportunities.

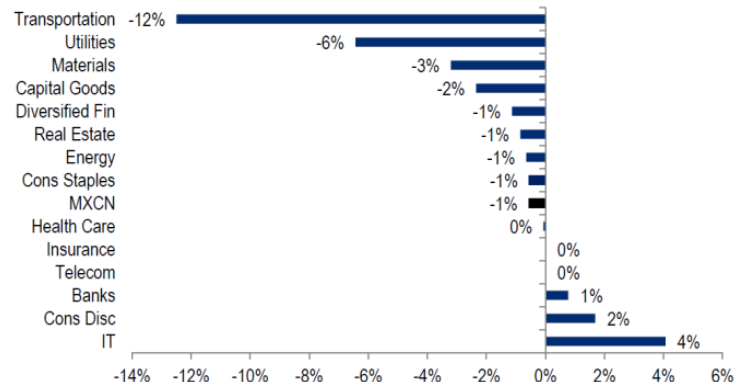
## Stay Defensive amid RMB Weakness

### Key Economic Data Forecasts

%	2017	2018F	2019F
Nominal GDP Growth	11.2	9.4	10.7
Real GDP Growth	6.8	6.6	6.4
IP Growth	6.5	6.7	5.8
Service Sector Growth	7.8	7.8	8
CPI	1.6	2.0	2.1
Exports	5.5	5.7	5.1
Imports	10.7	5.9	3.1
Retails Sales	10.4	10.0	10.6
FAI	7.2	6.8	7
M2	8.9	9.0	9.8

Source: CEIC and Citi, as of Jun 27, 2018

### Earnings Impact assuming 5% RMB Depreciation vs USD



Source: Bloomberg L.P., as of Jul 3, 2018

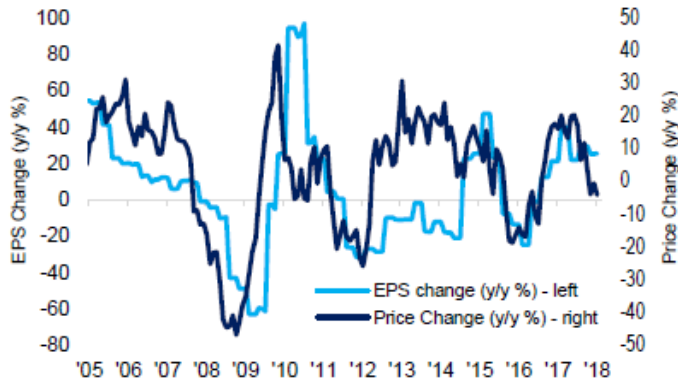
- ❖ 2H GDP growth is expected to slow to 6.5% YoY. Fiscal and monetary policies are likely to become more proactive in supporting domestic demand. Provincial governments still have more than RMB 2trn of debt issuance quota left. We expect one more 50bp RRR cut in 2H.
- ❖ The weakening of Chinese Yuan and US-China trade friction are likely to persist, which may weigh on Chinese equities. We suggest defensive strategies in volatile market.
- ❖ Consumer Discretionary, Health Care and Telecommunication may act like a haven in market tumbles.

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## Long-term Investment Opportunities After Corrections

### Equities have fallen more than justified by earnings



Source: Thomas Datastream, as of Jun 18, 2018

### 12m Ahead Return When CESI Falls Below -50

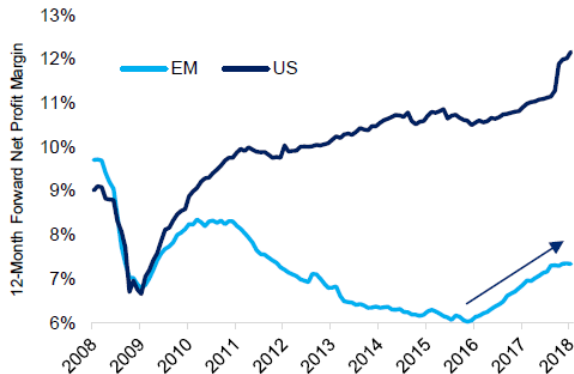
CESI <-50	Europe ex UK	European Banks
23/05/2003	22%	24%
12/11/2004	19%	25%
22/04/2005	35%	40%
22/09/2006	16%	2%
27/07/2007	-23%	-34%
06/06/2008	-34%	-43%
19/08/2011	15%	-11%
01/06/2012	34%	50%
26/04/2013	19%	39%
10/10/2014	14%	0%
26/02/2016	14%	12%
<b>Average return</b>	<b>12%</b>	<b>9%</b>

Source: Bloomberg L>P., as of Jun 18, 2018

- ❖ Citi's Eurozone Economic Surprise Index fell below -100 in June and is still below -50 now although with some rebound recently. Historically, when Eurozone economic surprises have fallen to -50, European equities' 12-month return has subsequently averaged 12%.
- ❖ European equities have fallen more than justified by earnings.
- ❖ Target prices for Stoxx 600 Index is 440 in mid-2019.

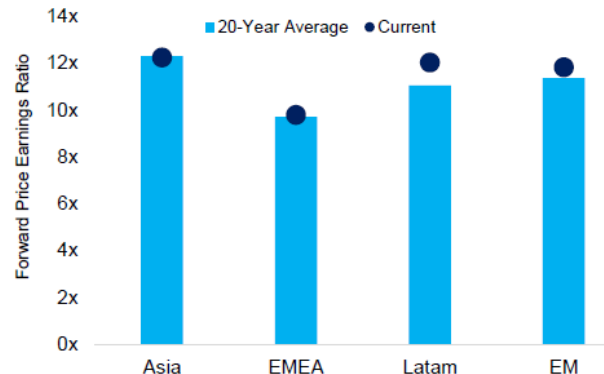
## Corporate Earnings Recovery May Continue After Corrections

### EM Margins only Start Recovering



Source: Thomson Reuters, as of Jun 18, 2018

### EM Forward PE(X)



Source: Thomas Reuters, Datastream, as of Jun 18, 2018

- ❖ Emerging markets have predictably underperformed while the USD has strengthened since mid-April. EM fundamentals remain solid. No downward spiral in fundamentals is likely from a rebound in the USD. The majority of EM countries show manageable levels of USD debt while the EM corporate recovery story still has much further to run with margins and profitability significantly below previous peaks.
- ❖ We do not expect the USD strength to continue with the deterioration of fiscal and monetary deficits and the further monetary tightening after 2020. We hold bearish view on USD in mid- and long-term.

## 6 New Housing Measures To Stabilize Property Market

### 6 New Housing Measures

#### HK Government New Housing Measures

Revising the pricing policy for SSFs

Inviting the Urban Renewal Authority to assign its project at Ma Tau Wai as an SH pilot project

Reallocating private housing sites for public housing

Setting up a task force to assist the community to take forward transitional housing projects

Introducing “special rates” on vacant first-hand private residential units

Amending the Consent Scheme to improve sales practices

Source: Citi, as of Jun 29, 2018

### Centaline HK Property Index



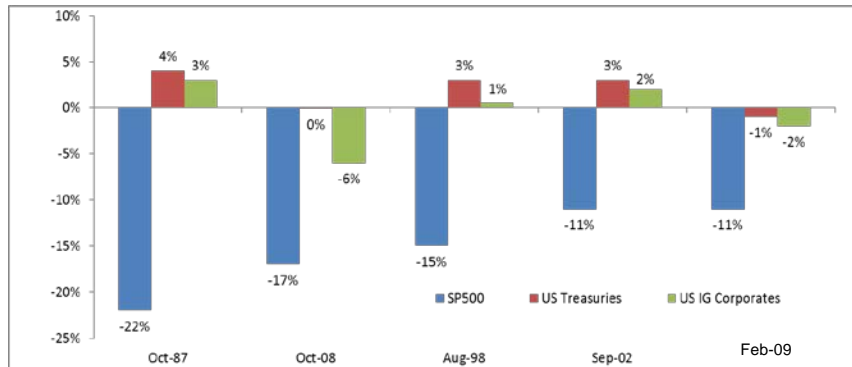
Source: Bloomberg L.P., as of Jul 3, 2018

- ❖ Under the new scheme, measures are strong enough to speed up launches. The vacancy tax rate of home price at 5% is higher than expectations. Developers are unable to achieve higher ASP by launching small batches as each batch of launches are required to sell at least 20%.
- ❖ Subsidized housing would enjoy a higher discount from the market price. However the measures may have limited impact on the private housing market.
- ❖ We expect home prices to drop by 5% in 2H18 after a strong rally of 10% in 1H18. Share prices of developers may be associated with policy risk concerns so we remain our underweight call on HK developers.

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## Bond Investment in volatile markets

### Bond performance when S&P500 drops



Source: Factset, as of Jun 28 2018

### US IG corporate bond yields and spread

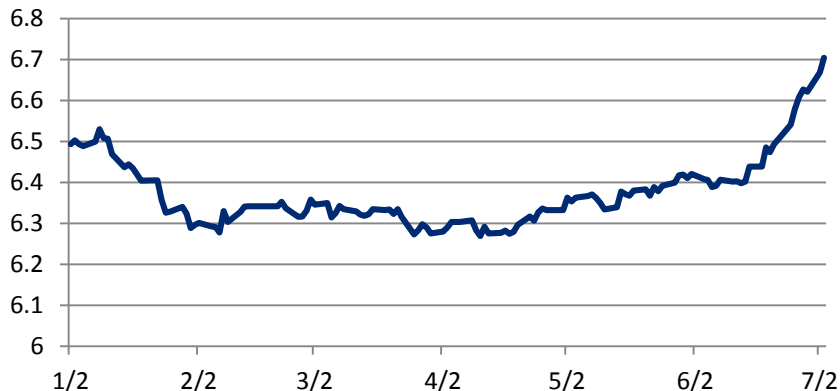


Source: Bloomberg. L.P., as of Jun 27 2018

- ❖ High credit rating and government bonds performed well in the past when equity markets dropped.
- ❖ We remain overweight on US IG bonds; in particular the finance (both banks and non-banks) and energy sectors.
- ❖ But be aware of risk of US national debt yield increasing

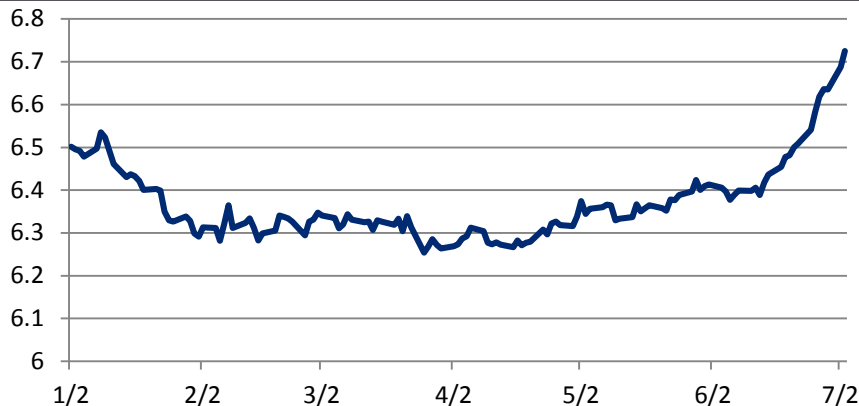
USDCNY onshore rate is expected to stabilize at 6.60 in 2H

## USDCNY



Source, Bloomberg. L.P., as of Jul 3 2018

## USDCNH



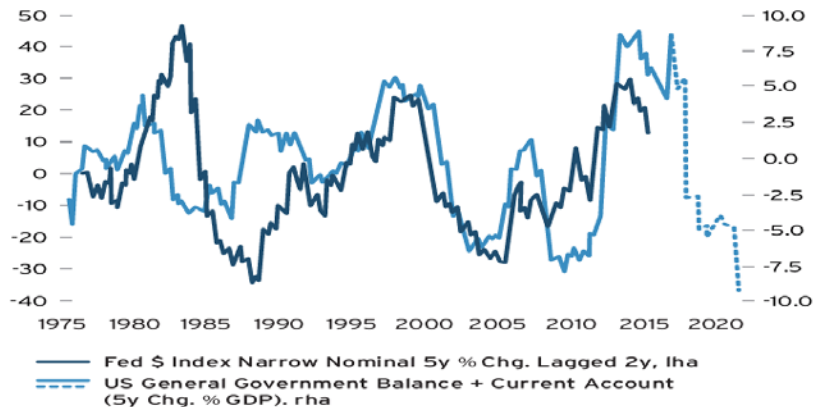
Source, Bloomberg. L.P., as of Jul 3 2018

- ❖ US trade war tensions continue to worsen, coupled with pressure regarding uncertainty in China's economy, leading to threat of capital outflow.
- ❖ If related risks increase, It is likely the PBoC may tighten or suspense capital controls on outflows again.
- ❖ Thus, we expect the USDRMB to average at 6.6 in 2H.
- ❖ Interventions will likely return to stem one-way depreciation expectations if the rate moves too fast.

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## Bearish on mid- and long-term USD

### Downside risk on mid-term USD



Source: Citi, as of May 5 2018

### Citi's USD Forecasts

	0-3 months	6-12 months
DXY	94.72	91.86
EUR/USD	1.16	1.20
GBP/USD	1.33	1.35
USD/JPY	110	108
USD/CHF	0.99	0.98
AUD/USD	0.75	0.77
NZD/USD	0.69	0.73
USD/CAD	1.33	1.26

Source: Citi, as of Jun 18 2018

- ❖ The US fiscal and current account deficit may continue to worsen, which, according to previous experience, may be bearish for USD
- ❖ US Dollar index forecast 0-3 months: 94.72; 6-12 months: 91.86
- ❖ EUR: The ECB may reduce bond purchase. We expect rates to rise in 3Q19, which may support EUR in medium to long run.
- ❖ AUD: Australia economic growth may return above the trend level, and the RBA may increase interest rates in 2Q19, which may support AUD.

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# Appendix



# Appendix : Economic Forecasts

	GDP Growth (%)			CPI Inflation (%)			Current Balance (% of GDP)			Fiscal Balance (% of GDP)		
	2018F	2019F	2020F	2018F	2019F	2020F	2018F	2019F	2020F	2018F	2019F	2020F
<b>Global</b>	3.4	3.3	3.1	2.7	2.5	2.5	0.4	0.3	0.1	-3.0	-3.3	-3.0
<b>U.S.</b>	3.0	2.8	1.8	2.1	1.8	2.0	-2.7	-3.0	-3.5	-5.3	-6.9	-6.4
<b>Japan</b>	1.1	1.1	0.9	1.3	0.9	1.4	3.4	3.3	3.0	-3.8	-3.3	-3.4
<b>Euro Area</b>	2.1	1.9	1.8	1.8	1.6	1.5	3.5	3.3	3.3	-0.8	-0.7	-0.8
<b>U.K.</b>	1.3	1.5	2.0	2.5	2.2	2.0	-3.7	-3.4	-3.1	-1.7	-1.7	-1.3
<b>Canada</b>	2.0	2.1	2.0	2.3	1.9	2.0	-2.7	-2.3	-2.5	-0.8	-0.7	-0.7
<b>Australia</b>	2.9	2.8	2.8	2.2	2.0	2.1	-2.5	-2.7	-3.2	-1.0	-0.8	0.1
<b>New Zealand</b>	3.0	3.2	2.9	2.0	2.3	2.1	-2.2	-2.2	-2.5	0.9	0.9	1.6
<b>EM Asia</b>	6.0	5.9	--	2.5	2.5	--	1.4	1.4	--	-2.6	-2.6	--
<b>Latin America</b>	2.2	2.5	--	6.9	6.2	--	-1.8	-2.1	--	-4.9	-4.9	--
<b>EM Europe</b>	3.2	2.9	--	5.1	5.1	--	-0.3	-0.3	--	-1.0	-1.4	--
<b>China</b>	6.7	6.4	6.3	2.1	2.1	2.2	1.2	1.2	1.2	-2.6	-2.5	-2.4
<b>Hong Kong</b>	3.6	2.9	--	2.3	2.4	--	2.9	2.7	--	3.0	2.6	--
<b>South Korea</b>	2.9	2.7	2.5	1.8	2.2	2.0	3.9	3.6	3.3	1.1	0.3	-0.3
<b>India</b>	7.0	7.5	8.1	4.7	4.3	4.2	-2.9	-2.5	-2.5	-5.8	-5.6	-5.0
<b>Indonesia</b>	5.1	5.2	5.4	3.5	3.9	4.3	-2.7	-2.6	-2.6	-2.5	-2.5	-2.6
<b>Brazil</b>	1.7	2.5	2.5	3.6	4.1	4.1	-1.0	-1.8	-2.0	-7.5	-7.2	-6.2
<b>Russia</b>	2.0	2.3	2.3	2.7	3.8	3.6	3.9	3.3	2.9	0.5	0.0	0.0

Source: Citi, as of Jun 20, 2018

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# Appendix : Interest Rate Forecasts

	Citi analysts' forecasts - Interest Rate (%)					
	3Q18F	4Q18F	1Q19F	2Q19F	3Q19F	4Q19F
<b>Developed Market</b>						
<b>U.S.</b>	2.25	2.25	2.50	2.75	3.00	3.00
<b>Japan</b>	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
<b>Euro Area</b>	0.00	0.00	0.00	0.00	0.00	0.25
<b>U.K.</b>	0.75	0.75	0.75	0.75	1.00	1.00
<b>Canada</b>	1.50	1.75	2.00	2.25	2.50	2.50
<b>Australia</b>	1.50	1.50	1.50	1.75	1.75	2.00
<b>New Zealand</b>	1.75	1.75	1.75	1.75	2.00	2.00
<b>Emerging Market</b>						
<b>China (1-year deposit rate)</b>	3.60	3.60	3.60	3.60	3.60	3.60
<b>Hong Kong (3-month Hibor)</b>	2.10	2.20	2.35	2.50	2.65	2.80
<b>India</b>	6.25	6.50	6.50	6.50	6.50	6.50
<b>Indonesia</b>	5.25	5.25	5.25	5.25	5.50	5.50
<b>Brazil</b>	6.50	6.50	6.50	6.50	7.50	8.50
<b>Russia</b>	6.75	6.75	6.75	6.75	6.50	6.50

Source: Citi, as of Jun 20, 2018

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	Citi analysts' forecasts - Bond Yield (%)					
	3Q18F	4Q18F	1Q19F	2Q19F	3Q19F	4Q19F
<b>U.S. 5 Year Treasury</b>	2.60	2.60	2.60	2.65	2.70	2.75
<b>U.S. 10 Year Treasury</b>	2.65	2.65	2.65	2.75	2.80	2.85
<b>U.S. 30 Year Treasury</b>	2.90	2.90	2.95	3.10	3.15	3.15
<b>Germany 5 Year Bobl</b>	0.10	0.20	0.25	0.40	0.50	0.75
<b>Germany 10 Year Bund</b>	0.60	0.65	0.80	0.80	0.85	1.00
<b>Germany 30 Year Bund</b>	1.30	1.35	1.40	1.40	1.40	1.40
<b>Japan 5 Year JGB</b>	-0.08	0.10	-0.10	-0.08	-0.05	-0.08
<b>Japan 10 Year JGB</b>	0.05	0.05	0.07	0.07	0.05	0.07
<b>Japan 30 Year JGB</b>	0.70	0.75	0.75	0.80	0.85	0.85
<b>U.K. 5 Year Gilt</b>	1.15	1.15	1.15	1.20	1.25	1.35
<b>U.K. 10 Year Gilt</b>	1.45	1.45	1.45	1.50	1.55	1.70
<b>U.K. 30 Year Gilt</b>	1.80	1.80	1.80	1.85	1.85	1.95
<b>Australia 5 Year Treasury</b>	2.20	2.40	2.75	3.10	3.15	3.15
<b>Australia 10 Year Treasury</b>	2.45	2.65	2.95	3.25	3.30	3.30

Source: Citi, as of Jun 20, 2018

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# Appendix : Equity Indices Forecasts

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Region / Index	Past Performance			29-Jun Close	Citi forecasts			Valuation		
	1-Week	3-Month	YTD		Mid-2019	Expected Change	Forecast 2017	P/E ratio 2018	Forecast 2017	P/B ratio 2018
<b>Global</b>										
MSCI AC World Index (Local)	-1.2%	2.1%	-0.3%	586	640	9.2%	15.2	13.9	2.1	2.0
MSCI EM Index	-1.7%	-8.5%	-7.7%	1,070	1,275	19.2%	11.8	10.6	1.5	1.4
<b>US</b>										
S&P 500 Index	-1.3%	2.9%	1.7%	2,718	2,865	5.4%	17.0	15.4	3.1	2.9
DJ Industrial Average	-1.3%	0.7%	-1.8%	24,271			15.6	14.4	3.6	3.4
Russell 2000 Index	-2.5%	7.4%	7.0%	1,643			25.9	20.6	2.0	1.9
<b>Europe</b>										
STOXX Europe 600	-1.3%	2.4%	-2.4%	380	440	15.8%	14.5	13.3	1.8	1.7
FTSE 100 Index	-0.6%	8.2%	-0.7%	7,637	8,200	7.4%	13.7	12.8	1.8	1.7
DAX Index	-2.2%	1.7%	-4.7%	12,306			12.8	11.6	1.6	1.5
CAC 40 Index	-1.2%	3.0%	0.2%	5,324			14.4	13.2	1.6	1.5
<b>Japan</b>										
Topix	-0.8%	1.6%	-4.8%	1,731	1,890	9.2%	13.3	12.2	1.2	1.1
Nikkei 225	-0.9%	5.4%	-2.0%	22,305			15.8	13.8	1.6	1.5
<b>Asia</b>										
MSCI Asia ex Japan	-2.4%	-6.0%	-5.8%	672	800	19.0%	12.4	11.1	1.5	1.4
Shanghai Composite	-1.5%	-9.9%	-13.9%	2,847			11.0	9.7	1.3	1.2
CSI 300	-2.7%	-9.8%	-12.9%	3,511			11.4	9.9	1.5	1.4
Hang Seng Index	-1.3%	-3.8%	-3.2%	28,955			11.3	10.2	1.2	1.1
HS China Enterprise Index	-2.4%	-7.7%	-5.4%	11,073			7.5	6.8	0.9	0.8
MSCI China	-3.6%	-4.4%	-2.2%	87			12.6	10.8	1.7	1.5
S&P/ASX 200	-0.5%	7.6%	2.1%	6,195	6,650	7.4%	15.8	15.2	2.0	1.9
Taiwan TAIEX Index	-0.6%	-0.1%	1.8%	10,837			13.8	13.0	1.7	1.7
Kospi Index	-1.3%	-4.5%	-5.7%	2,326			8.9	8.2	1.0	0.9
BSE Sensex 30 Index	-0.7%	7.4%	4.0%	35,423			18.4	15.2	2.7	2.4
Jakarta Composite Index	-0.4%	-6.3%	-8.8%	5,799			14.4	12.8	2.2	2.0
Straits Times Index	-0.6%	-4.6%	-3.9%	3,269			12.9	11.8	1.1	1.1
FTSE Bursa Malaysia KLCI	-0.2%	-8.9%	-5.9%	1,692			16.1	15.0	1.7	1.6
SET Index	-2.4%	-9.7%	-9.0%	1,596			14.9	13.6	1.9	1.7
<b>Latin America</b>										
Brazil Ibovespa Index	3.0%	-14.8%	-4.8%	72,763			11.1	9.7	1.5	1.4
Mexico IPC Index	2.0%	3.3%	-3.4%	47,663			16.5	14.2	2.2	2.0
<b>Emerging Europe</b>										
Russia RTS Index \$	2.6%	-7.4%	0.0%	1,154			5.9	5.7	0.8	0.7

Source: Citi, as of Jun 29, 2018 and Bloomberg L.P., as of Jun 29, 2018

Please note and carefully read the Important Disclosure on the last part



# Appendix : Commodity Forecasts

		Citi analysts' forecasts					
		3Q18F	4Q18F	1Q19F	2Q19F	3Q19F	4Q19F
<b>Energy</b>							
<b>NYMEX WTI Crude</b>	USD/bbl	72	73	70	66	57	56
<b>ICE Brent Crude</b>	USD/bbl	78	79	76	74	67	62
<b>NYMEX Natural Gas</b>	USD/MMBtu	2.50	2.60	2.60	2.50	2.50	2.70
<b>Base Metals</b>							
<b>Aluminum (LME)</b>	USD/MT	2,200	2,100	2,100	2,150	2,200	2,200
<b>Copper (LME)</b>	USD/MT	7,200	6,800	6,600	6,600	6,800	6,800
<b>Lead (LME)</b>	USD/MT	2,500	2,400	2,300	2,300	2,200	2,200
<b>Nickel (LME)</b>	USD/MT	15,000	14,500	14,500	14,500	14,500	14,500
<b>Zinc (LME)</b>	USD/MT	3,100	3,000	2,800	2,800	2,500	2,500
<b>Precious Metals</b>							
<b>Gold (Comex)</b>	USD/oz	1,315	1,315	1,330	1,340	1,350	1,350
<b>Silver (Comex)</b>	USD/oz	17.2	17.0	17.0	17.0	17.2	17.5
<b>Platinum (NYMEX)</b>	USD/oz	950	950	975	1,000	1,000	1,000
<b>Palladium (NYMEX)</b>	USD/oz	1000	1000	1000	1000	1000	1000
<b>Agriculture</b>							
<b>Corn (CBT)</b>	USD/bu	415	420	425	425	425	425
<b>Soybean (CBT)</b>	USD/bu	985	990	1,025	1,050	1,075	1,150
<b>Wheat (CBT)</b>	USD/bu	500	505	510	505	500	525
<b>Cotton (NYB-ICE)</b>	USD/lb	13	14	NA	NA	NA	NA
<b>Coffee (NYB-ICE)</b>	USD/lb	122	122	NA	NA	NA	NA
<b>Cocoa (NYB-ICE)</b>	USD/MT	2,540	2,500	NA	NA	NA	NA

Source: Citi, as of Jun 20, 2018

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