IRISOS

Knowledge is power.

Q 04 / 2017

Quarterly Investment Review and Outlook

Quarterly Report – Q04/2017

At a glance

Review – 4th quarter of 2017

1. Prolonged period of end-cycle

- In the US, the employment rate fell to the lowest it has been since 2007, while in Europe, unemployment rates have begun to decrease only very recently.
- When new jobs are created, they are primarily jobs at the low-end of the income scale.
- The reservoir of non-registered unemployed individuals (in the US) and structural unemployment rate (in Europe) remains particular high, which is a clear drag to solid and lasting wage inflation.

2. Brexit

- Beginning in December, negotiations have quickly advanced. The bill is now subject to finding consensus regarding the commercial facet of the future relationship. We believe that continental Europe would suffer more than England itself if a deal is not struck.

3. Germany

- Mrs. Merkel did not obtain a majority in the past election; a coalition between the major parties (SPD-CSU-CDU) is now likely; such an assembly is very much in favor for progressivity in Europe.

4. US corporate tax reform

- A deal is now most likely possible, yet the question of how its implementation will be handled remains open.

5. Asset Rotation

- As the result of the tax deal for US corporations, an asset rotation (out of technology in favor of the old economy) took place in the first weeks December 2017.

6. Interest Rate

- The Fed started the interest cycle this autumn. However, in the absence of wage inflation and in light of stable energy prices, the interest rate curve should remain flattish in 2018.

7. Credit risk

- The credit cycle has reached maturity; given this, credit spread began to increase during the 4th quarter of 2017. Still, further deterioration would be required to signal the start of a possible recession.

8. Consumer satisfaction

- Consumer sentiment has improved throughout 2017; however, that consensus forecast view for 2018 might be overly optimistic.

US core inflation rates

Outlook 2018

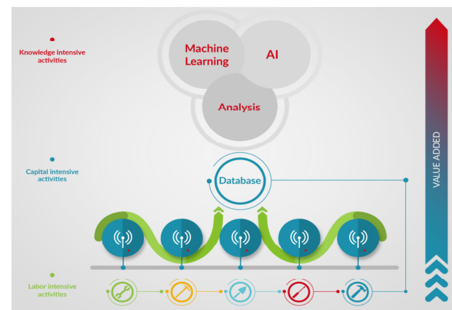
1. Economy 4.0

Digitally connected companies are driving greater returns than those still lingering in the hard-wired world of investment. Successful 4IR companies make most of their sales thanks to their strong intellectual property assets. They operate in cyber-security, advanced robotics, automation, IOT and IOE, cloud operations, next-generation genomics, and mobile internet and connectivity, among other emerging fields.

The digital transformation is far-reaching and will reshuffle the existing economic set-up. The technical revolution is best described as a combination of multiple factors, including aging demographics, fast and cheap transfer of products and services, and an ever-shorter product life cycle. If the factors above are correct, only companies with a forward-looking view will be equipped to capitalize on the trend. As the adage goes: "The winner takes all."

Robotics: Number of robots to increase by up to 20 % p.a.

IIOT – Value creation segments



2. Americas

Ever since the FT in 2007/2008, expansive central bank policy and low interest rates have supported the market. Unemployment rates have continuously decreased, and the US has reached full employment.

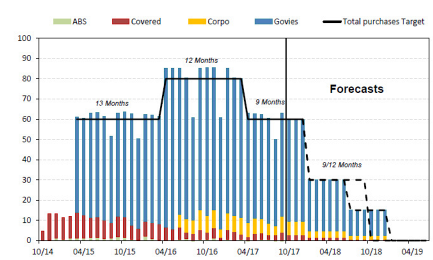
The rate of inflation and global growth are expected to stay low for a prolonged period of time, given the disruption in industrial activities, i.e., an ever-increasing use of artificial intelligence and robotics, a shrinking middle-class, and an aging population with different consumption behavior.

The current economic cycle is maturing, lead by the US. Currently, late-cycle companies should benefit most from the present condition of capex recovery. This occurs in sectors of oil and gas, power transmission and distribution, electrification of cars, digitalization, and agricultural and mining equipment. We are less favorable on early cyclicals, where sales growth is expected to stagnate in the quarters ahead.

3. Europe

The ECB has decided to extend its quantitative easing (QE) program, but to cut it starting January of 2018 from EUR 60bn to 30bn. The official QE is set to expire in September of 2018. However, we believe that some kind of QE will always exist, with the aim of temporarily flattening out—directly or indirectly—funding costs for companies, supporting earnings, and valuations, etc.

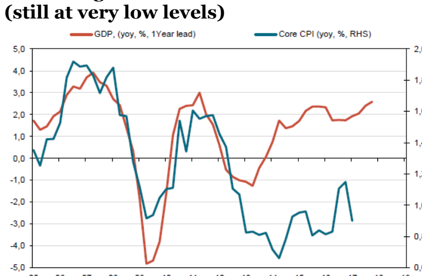
ECB: Step-by-step QE ending



With the central bank's policy changes, the so-called "bond proxy trades" could expire, while financials could grab back some of their lost splendor.

Europe is lagging behind the economic recovery of the US by about 18 months. Pockets of concern still exist all across Europe. However, we believe that economic fundamentals, ever-shrinking unemployment rates in all EU countries, improving consumer satisfaction, and attractive market valuations, offer a highly fertile investment case.

EU: GDP growth and core inflation rate (still at very low levels)



Our key attention goes to the Scandinavia, Germany, and Switzerland. On average, companies within these regions and countries add the most value (worldwide measures) to their products and services, and therefore offer the best risk/reward opportunities.

4. Asia

The uptrend of positive news flowing from EM has come to an end; however, the level of the economic indices in emerging markets remains solid.

In the past years, lowflation has been one of the main macroeconomic concerns. Part of the cause is likely found in the massive ramp-up of overly cheap industrial capacities in EM. However, that cycle may have peaked in September of 2016, when China—on the back of higher commodity prices—started to export inflation.

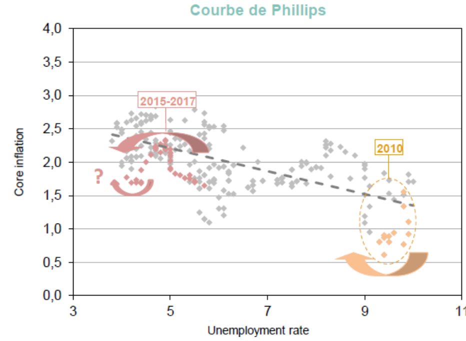
5. Latam

In an environment of accommodative global liquidity conditions, rising consumer confidence and lower unemployment rates in DM, the favorable outlook for Latam continues.

This translates into higher commodity prices, which will help most EM countries to balance their budgets. Additional support for the market may come from calmer political fronts. Brazil is finding a way out of the chaos, while broader events like NAFTA negotiations may temporarily add drag.

Latam and Asia should continue to benefit from the structural tailwind the US offers. On average, the USD devalues by around 5-7% annually. In environments with more or less stable political conditions, a stable interest rate environment, and favorable exchange rate developments, value add can be created in a more efficient manner than in developed markets.

US: CPI (core) and unemployment: comparison between 2010 and 2015/2017



Key concerns for 2018

We have identified at least 12 known potential sources of risk that could impact the market in 2018 and beyond. In addition, issues that are not yet considered as potential sources of risk will be added to the list.

Breakdown in US industrial activity

Possible consequences:

- US stocks drop
- EUR appreciates strongly
- Yield curve steepening

Sharp rise in commodity prices, and in particular, energy

Possible consequences:

- EUR GDP underperformance
- General risk-off by investors
- Yield curve flattening

Revival of the Philips curve (core inflation up)

Possible consequences:

- Term premiums up
- Yield curve steepening
- Debt (Gov't, Corp., and Private) sustainability issues

Brexit:

Possible consequences:

- Disruption of industrial activities across Europe. For instance, the automobile industry
  has on average an on-site production reserve of less than 1 day.
- Higher prices for consumer staples
- Renewed QE

Increase in HY credit spread and subsequent increase of default rates

Possible consequences:

- US stocks down
- Wider credit spreads for HG issues
- Volatility up

Downturn in Chinese economic activity

Possible consequences:

- Emerging market downturn
- Commodity prices down
- Forced liquidation of US Treasury, accompanied by a weak USD

Unexpected increase in US public deficit

Possible consequences:

- Term premiums up
- US downgrade
- Weak USD

Other areas of concern:

FED loses independence with the arrival of the new Chairman

Possible impacts:

- The independence of the US Federal Reserve has historically fluctuated according to the needs and policies of the federal government. In 2018, it may lose significant ground, as the new Chairman will have a different economic view than his predecessors.
- The pendulum swings away from the Fed's favor as the Treasury takes on powers and forces the central bank to cap US government yields to prevent a bond market meltdown.

Bank of Japan forced to abandon yield curve control

Overview of present situation:

- The Bank of Japan is maintaining a similar peg as the SNB did (to support the EUR versus CHF; it finally gave up).
- The Bank of Japan's yield curve control policy is a luxury conditional upon interest rates remaining orderly elsewhere in the world. After all, a continued rise in global yields would eventually mean that maintaining the 10-year JGB "peg" would transfer all of the pressure onto the yen.

Roll out of the Petro-Renminbi

Preamble:

- China is by far the world's largest oil importer, and many producer nations are already more than happy to transact in yuan terms. With the waning of US global power and reach, and given the success of CNY-based commodity futures in general, the Shanghai International Energy Exchange's decision to launch a yuan-based crude oil future is a runaway success.
- 2018 marks the year in which the Shanghai International Energy Exchange finally launches an oil contract denominated in Chinese yuan, a move with tremendous geopolitical and financial consequences.

Flash crash

Present situation:

- World markets are increasingly full of different signs, and yet the market is powering ahead. In general, the market applies the terminology "consolidation" or "correction" for value variations from 0 to -15%; beyond those limits, the term "crash" is used.
- The market performance in 2017 was above average and some correction would be opportune.
- A one-off event such as a Flash-Crash with a +25% correction (as in 1987) would be spectacular, but we believe that an immediate rebound would take place as main operators are cash rich and there are not that many places where they park assets.

Political risks (Mexico, Brazil, Middle East, Impeachment, Spain)

Possible consequences:

- Credit spread widening
- General risk-off
- Renewed QE

The year ahead

Is the industry supposed to work without crutches?

What happens to liquidity will probably be the central theme in coming quarters, if not years. The balance sheet expansion overseen by central banks is reaching a turning point.

In late 1960, Fedchair William McChesney Martin explained that the central bank is in the position of the chaperone. He further explained that the central bank has the power to order the punch bowl to be removed just as the party really is warming up. Today, that is exactly what the Fed and ECD are doing, almost surreptitiously, by embarking on a balance sheet shrink that will accelerate in 2018 (two further hikes and a near €300 bn reduction in its balance sheet). The ECB will exit QE (probably next September). Interest rate hikes are on the agenda in developed countries, on a scale not seen in a decade. Interest rates will still be well below average, but are expected to rise to a higher level than is seen today.

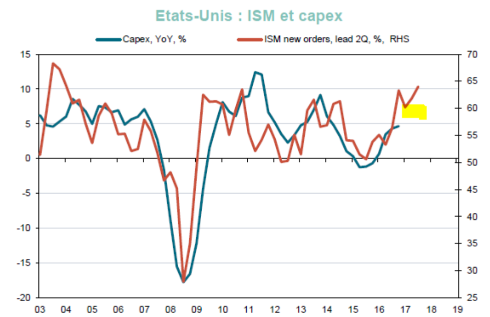
In a post-crisis, abundant global liquidity has been the main reason for the ever-lower level of volatility, low interest rates, the compression of spreads, and the capital inflows into emerging markets. The synchronized action has led the world's economy out of the doldrums.

Our view is that liquidity has indeed reached a turning point, yet it will not disappear. In a recent discussion with a member of the ECB steering committee, we learned that a nascent form of QE will not disappear. Therefore, we expect liquidity conditions for 2018 to be similar to those seen in 2017, but bearing in mind that there is an ever-lower quantity available. The question remains of whether investors should stay or run away.

In 2017, markets benefited from an exceptional combination of favorable factors: a recovery in global trade, the start of a new investment cycle, low interest rates, the decline of the US dollar, the Chinese stimulus plan and effective capital controls, an upturn in crude oil prices, etc. In the absence of any remarkable inflation, staying with the market is a remarkable opportunity, even though the wage cycle is in a very advanced stage and crude oil prices are settling between USD 60 to USD 65 with higher economic activity. All in all, we see the above factors carrying over—at least for several more quarters—with the Goldilocks effect to remain in play.

We therefore foresee the continuation of the search for yields. Nonetheless, as valuations have increased, the risk-yield profile is becoming more and more asymmetrical everywhere (reduced carry and all-time low volatility). To sum up, while we continue to favor pro-growth assets (stocks), we also advocate careful attention to strategies that can safeguard values achieved in 2017, thereby accepting some potential underperformance until more clarity has been obtained.

US: The impact of the tax deal, ISM is up!
Estimates suggest that, as a result of the full implementation of the tax deal, GDP will grow by 1 % annually while public debt will increase by 5 %.



What do investors need to look out for?**

A rise in volatility will be the precursor of a shift in the trend.

Save for rare exceptions this year, volatility remained scotched at extremely low levels—in fact, the lowest observed since 2006-2007. Illustrating this, the VIX spent almost 20% of the year below the 10% mark, and 50% of the year below the 11% mark. This low volatility characterized all assets and all markets, whether by actual or implied volatility, as highlighted by the right-hand chart showing average cross-asset volatility (main foreign exchange, equity and bond markets).

Such low levels of volatility reflect first and foremost the current macroeconomic environment, as indicated by our estimates of the VIX long-term determinants.

The stability of the macroeconomic fundamentals, measured by both PMI and the standard deviation for macroeconomic surprises, was the main contributor to the decline in volatility displayed by the US market since 2012. The absence of surprises was even more a feature this year, with growth back in sync, subdued inflation and still accommodating central banks.

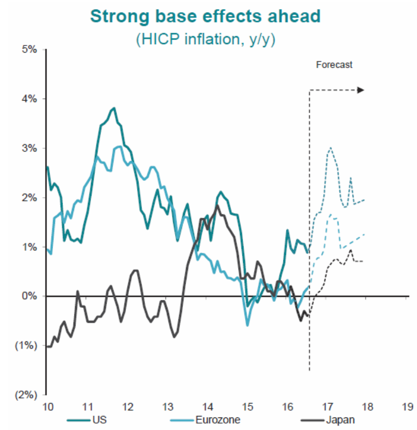
Liquidity, as measured both by financing costs and by the central banks' balance sheets, is obviously another major explanation for the compression of volatility. An annual increase of 10% in liquidity leads, all other things being equal, to a 2% decline in the level of the VIX. On top of that, there are the indirect effects stemming from the following factors:

- The absence of macroeconomic volatility, as mentioned above; and
- The market's capacity to come more rapidly to terms with spikes in risk aversion.

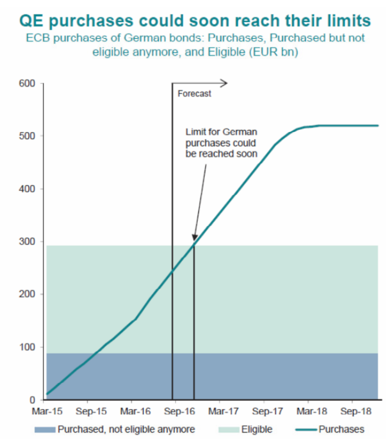
The rosy health of the corporate sector—in particular a low dispersion of EPS forecasts, low default rates, and a rise in the payout ratios—also played a significant role.

In light of these fundamentals, we expect volatility to remain low in 2018, due to the still abundant liquidity. This is notwithstanding the monetary normalization, and to what will remain an upward leg in the cycle.

Higher inflation in the coming quarters. Excellent news!



Extending QE = Removing barriers = Junker-Plan to take shape



Are equities expensive?

In contrast to previous years, this year's equity performances stemmed largely from earnings moving back onto the growth track, a trend seen around the globe.

Can this momentum be maintained?

Yes, we believe so, and for good reason! Relevant factors include robust growth that is in sync between the G7 and emerging countries, a modest rise in interest rates, still abundant liquidity and crude oil prices that are set to rise in H2. As a result, we anticipate EPS growth of +8.5% in Europe and +8.0% for the S&P 500 (before the effects of the tax reform, but including share buybacks). These forecasts are below the market consensus, but would lift equity returns in local currencies to 12.5% in Europe and about 10% in the USA, with no expansion of multiples.

Choices in terms of sector and investment styles will be discriminating. Sector composition explains almost 4% of the underperformance of the Stoxx 600 versus the S&P 500 (of a total of 9% YTD); the ratios are about the same when S&P 500 is being considered. We continue to prefer cyclical sectors over non-cyclical sectors. Despite everything, the technology sector is now very richly valued in all geographies, after an impressive performance in 2017. The sector's significant weighting in the S&P 500 (25%) also justifies our cautious recommendation for the US index.

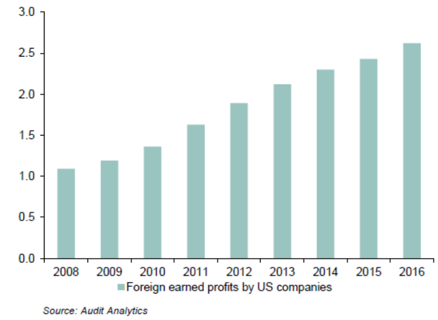
Why we emphasize overweight equities versus everything?

The US curve's flattening is not yet over, but will gradually disappear. As a result, given this situation, further equity out-performance versus fixed income and versus credit is possible. With the monetary normalization about to start, one can expect a somewhat jagged performance trajectory.

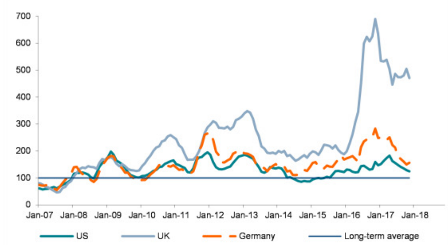
In this context, a traditional diversification between equities, bonds, and credit may not be enough to generate performance. That is why we are working on alternative solutions with bonds as a hedge against equity exposures.

While we have had very positive stance on credit over the past few years, we now are more prudent as to this investment class. While credit fundamentals remain favorable, default rates have decreased to below 2%. We believe that the last leg of positive performance has been engaged and that there is now little room for an upside. This view is supported by an ever-increasing leverage of US companies, coupled with rising interest rates. This situation will primarily imperil those with the most debt, as well as the lowest rated companies.

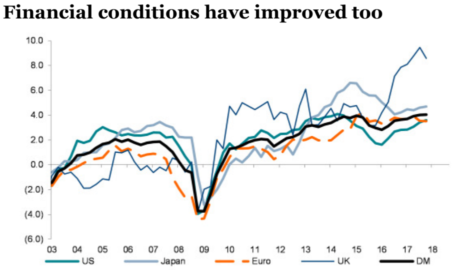
US: The impact of the tax deal, the ongoing of the share buy-back program
During the past years, foreign earned profits have constantly increased. The tax deal favors the repatriation of foreign held profits. Consequently and the absence of valid investment opportunities for corporations, shareholders should benefit by means of higher dividend payments and ongoing share buybacks programs.



Economic uncertainty has eased in the US, Germany, and in the UK.
Because of Brexit concerns, economic uncertainty remains particular high in the UK.



Financial conditions have improved too



Where are our preferences?

Key takeaways for 2018

General:

1. Interest rates on the rise in developed markets
2. US-driven economic revival expected to continue
3. QE to be reduced to the lowest possible level in G-7 nations
4. Inflation likely to stay below expected levels
5. No particular tail-risk

Americas:

6. Two interest rate increases in 2018 and at least one in 2019
7. Tightening financial conditions and drag on the economy could lead the FED to reverse the intended course of action
8. US Equities appear to be expensive; share buyback generate some kind of self-entertained value appreciation of around 10-12% per annum
9. Consensus view is that GDP growth is over-estimated (tax reform special effects are most likely trigger-based)
10. USD is expected to lose some of its present attractiveness, in favor of EM currencies

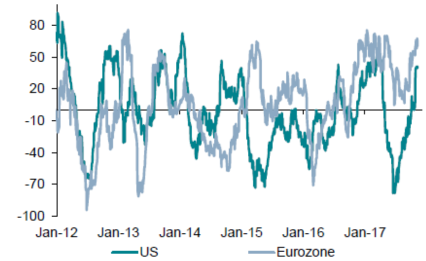
Asia:

11. China's industrial production to slow down after surprisingly solid economic expansion, particularly in China
12. Global investors have consistently underestimated the Chinese government's ability to control events through regulation. In this respect, we believe that financial leverage is well managed and that bad debtors will be cleaned out in a smooth manner.

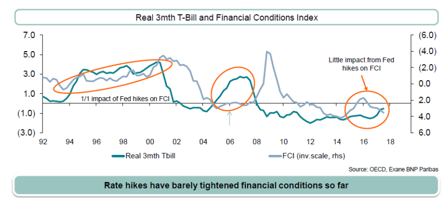
Europe:

13. Consumer sentiment and PMI's climbed to higher levels once more
14. Retail sales are expected to continue to advance, on the back of a stronger employment market
15. After the Spanish and German spike, political risks in Europe remain low
16. Those who will compose the new German government have expressed their support for deep reform of the European framework

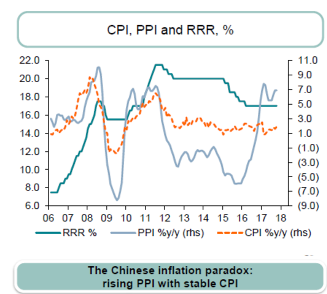
Leading indicators continue to make progress:



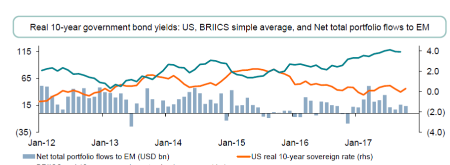
Little impact seen by tightening financial conditions



China: CPI and PPI, a surprising development



EM: The asset flow to EM will continue as the yield differential is at historic high levels.



Sector Analysis

Basic Materials

With the market now being highly efficient, price changes are immediately moved to end-consumers. The price surge experienced in 2016 and at the beginning of 2017 was due to a supply disruption and increased demand from China. However, we now expect that China-based metal consumption will weaken in the next 12 months. This market segment will therefore become less attractive.

Throughout 2017 and on the back of an improving global economy, operators achieved higher volumes in the subsector "Chemicals." This trend is expected to continue, especially for companies with a strong exposure to Europe where the economic recovery is still in the making. This allows the industry to pass rising costs on to its clients with relative ease. For other sectors, such as agricultural chemicals, we note a strong oversupply; such companies should thus remain relatively unattractive.

Consumer Staples

The entire sector is subject to broad-based changes and deep disruptive actions. It is therefore not surprising that the sector has underperformed the larger market in the past few years; we do not expect a sector turnaround in the years to come. Digital awareness across the sector is only just taking shape. Given the timeframe that will be required in order to implement, adjust, regain consumers, and capitalize on the new strategy, better performance from the sector should only be expected towards 2020.

However, the battle against all digital is in the making. Some traditional players have succeeded by putting in place aggressive digitalization strategies and capitalizing on their existing infrastructure in connection with exclusive offers, buying online with facilitated store pick-up, and improved after sales arrangements. Additionally, some companies are good at replicating the business models of Apple Store and Nespresso, where no frontier between digital and physical stores exists. These successful businesses normally run high-end product lines.

Technology

Despite the profit taking in recent weeks, the technology sector remains highly attractive, and the main segments of this industry are on a very solid footing with strong prospects. Secular drivers like IIOT, Economy 4.0, cloud computing, mobile applications of all sorts, as well as all kind of businesses and online advertising should help the industry sector to improve EPS quality. This should propel share prices to higher levels.

However, in the short-term, the market is concerned about the continual, successful extension of the Apple universe. The launch of the latest Apple phone threw a number of questions into the arena that no one was able to answer. Evidence now suggests that estimates for the iPhone supply chain were far too optimistic, and that the sell-off seen in November/December was partly due to that. However, investors will eventually pay less attention to this and the market volatility experienced should decline.

The sector continues to offer one of the best trade-off opportunities across all sub-sectors and all geographies. Attractive valuations, above-average earnings growth, and rising cash distribution make the stocks of this sector a first choice for investors. In particular, market volatility, along with general weakness at structurally high-quality companies due to earnings volatility should be used as a buying opportunity. This is because the long-term opportunity of Economy 4.0 and IIOT is not priced-in.

Key figures for Europe:

Target values:

Present fair value (DJStoxx600): 390
E12 months value (DJStoxx600): 445
Upside potential: +14%

Key economic ratios:

P/E 2017 (E):	15.7
P/E 20178(E):	14.3
Div. Yield 2017:	3.1
Div. Yield 2018:	3.3

Most likely next short-term move:

DJStoxx600	flat/down
DJStoxx50	flat/down
SMI	flat/down
DAX	flat/down

Key names to look at:

Strong intellectual property:
- Roche
- Novartis
- Amadeus

High competitiveness:
- Siemens
- Daimler
- Gemalto
- Richemont
- Swatch

Sustainable dividends:
- ABN-Amro
- Imperial Tobacco
- Altria
- Philip Morris

Energy

The energy sector has underperformed in 2017. In addition, investors remain skeptical that barrel prices will remain above the threshold of US 50/bbl. We believe that economic recovery will extend well into 2019 and that, in particular, energy-hungry emerging market countries will push ahead and make even further progress into 2020. Also, we understand that OPEC countries and other key energy producers will undertake more coordinated actions in order to avoid oversupply. At present, global oil inventories are close to historic average levels, and the number of online production units remains stable.

Shale oil and gas companies require little time to achieve the breakeven point per rig, whereas major down and upstream operators require more time to reach the breakeven point. In the case of shale oil operators, profitability is more a function of the day-to-day quote of the barrel price, while major operators are less vulnerable to short-term price fluctuations. Strong balance sheets and the capacities to reduce massively running costs allow major operators to run a profitable operation even with barrel prices well below USD 30-. Considering that capital investments having dropped to almost a 10-year low, new production capacities are limited, which in turn will sustain the barrel prices. All-in-all, this creates a solid foundation for a new round of EPS extensions. Our preference goes with pure play operators in the Bakken oil play to major service companies (SLB), as well as major down and upstream operators where dividend payments are sustainable.

Financial Services

Financials, banks in particular, are the main beneficiaries of higher interest rates, the pick-up in nominal growth, and—in the US—the tax deal. Consensus views of banking stocks are positive; however, higher operating efficiencies are required in order to unlock share price appreciations.

Indeed, this is part of our concern. On both sides of the Pond, financial institutions are subject to strong regulations, with little room to maneuver. However, there is light at the end of the tunnel: US operators might benefit from a government decision to lift some of the restrictions that were implemented following the financial crash in 2007. In Europe, operators are busy preparing to implement MiFIDII procedures, to be activated in January of 2018. Once done, their attention can return to new business.

While our baseline scenario is relatively straightforward, risks are pervasive. One such risk is a delay in the interest rate hiking process. A delay in that process would now be interpreted to mean that the economy is not sufficiently viable to run in normalized conditions, and that the economic revival has come to an end.

Industrials

The Industrial sector is the sector most exposed to IIOT, robotics, and automation; in other words, the sector faces unprecedented challenges ever since the introduction of steam engines. In fact, in a little over 10 years, about ¼ of the worldwide GDP will be generated by artificial intelligence. There are four distinct avenues where progress is accelerating:

- Automatization and robotics: Human interventions will be reduced to the bare minimum.
- Self-learning: Prototypes of applications with the capacity to react to past events are now available.
- Image and vocal recognition: Newly made available chatbots can talk to prospects and guide them to specific products and services. The same applies

Key figures for USA:

Target values:
Present fair value S&P 500: 2675
E12 months value S&P 500: 2850
Upside potential: +6.5%

Key economic ratios:

P/E 2017 (E):	20.1
P/E 2018 (E):	18.2
Div. Yield 2017:	1.9
Div. Yield 2018:	2.0

Most likely next short term move:
S&P 500 down
Nasdaq down

Key names to look at:

Strong intellectual property
- VISA
- Mastercard

Technology:
- Microsoft
- Micron Technology
- Nvidia
- Apple
- IBM

Financials:
- VISA

for image recognition, in which an existing image can be associated with a future task.

- Discrete manufacturing facilities are built upon the industry model of hardware and software. Industry 4.0 will also be built upon this model, but with software being moved to the cloud, enabling a seamless coordination between end-users and factory units. The successful management of these opportunities creates a leap in productivity.

The industrial disruption is about to start, and we may expect a number of global moves by major companies to take control over an ever-greater part of their value chain.

Telecommunication

For quite some time now, we have been reluctant to engage in the Telecom sector. Global concerns such as rapidly changing consumer preferences, a difficult competitive environment, and capital-intensive upgrades, have left investors disappointed. The near future of Telecom operators is not much different; consumers shop around for better deals (resulting in a decline in the customer retention ratio), new developments on the regulatory and tax fronts add uncertainties to the existing business model, and rising interest rates increase the financial burden. For these reasons, we continue to be absent from this sector.

Utilities

In recent years, the Utility sector has garnered particular attention, because the underlying companies were by definition low volatile instruments. This, coupled with attractive dividend yields, allowed for the implementation of bond proxy deals. The tide is turning, however, and utility investors are exposed to the prevailing economic conditions of a) rising interest rates, and b) ever-changing business conditions, in which alternative energy resource pose a real threat. All of this suggests that the sector will remain unattractive, and further underperformance should be expected. We are absent from this sector.

Healthcare

The Healthcare sector is composed of several sub-sectors, such as Biotechnology, Life Sciences Tools and Services, Healthcare Equipment and Supplies, Healthcare Providers and Service, and Healthcare Technology. Traditional pharmaceutical companies account for about 34% of the Healthcare-Index.

The year 2017 was a dull year for pure pharmaceutical investors, generating on average only an 8% performance. Biotechnology, another heavyweight in the S&P 500 Healthcare sector, accounts for 21%; on average in 2017, these companies underperformed the index as well.

Investors seeking outperformance versus a well-balanced index are advised to seek exposure to index segments with a low market capitulation. Life Science is in this sub-sector, representing about 6%. Companies in this space produce tools, instruments and diagnostic equipment for a broad range of industries (pharmaceutical, agricultural, etc.), government agencies, and academic institutions, as well as labs and healthcare providers. Investors engaging this segment seek multiple opportunities, such as high value innovations in the field of next-generation sequencing, genomics testing, proprietary diagnostics, and liquid biopsies. While opportunities abound, investors are advised to consider external elements such GDP growth, since organic growth is dependent on broad economic factors.

Key figures for Asia:

Target values:
Present fair value MXAPJ: 694
E12 months value MXAPJ: 750
Upside potential: +8 %

Key economic ratios:

P/E 2017 (E):	14.4
P/E 2018 (E):	12.8
Div. Yield 2017:	2.4
Div. Yield 2018:	2.5

Most likely next short term move:
MXAPJ down

Key names to look at:

- Tencent
- Alibaba

Foreign exchange

Currencies

Higher US interest rate expectations and the possibility of a slight rise in political uncertainty in Europe are short-term headwinds for the EUR/USD to surpass the 1.20 barrier. All things being equal, the lower limit of the current and future trading range is around 1.15. At this level, we do see buying orders, as the monetary divergence between the US and the EU is already priced-in.

The Pound Sterling will remain driven by political developments and Brexit talks. In the event of a "soft Brexit" scenario, the GBP is expected to appreciate by around 10-15%.

Later in the year, the EUR/USD is likely to stabilize around 1.20 in reaction to several factors, notably:

- Still very weak core inflation (i.e., excluding energy and food)
- An accommodating ECB, that will result in interest rates to stay and below the US rates, this in turn stoking capital outflows by investors reaching out for higher yields
- Political uncertainties subsiding in the run-up to general elections (between March and May) for Italy, and in the creation of a strong coalition in Germany
- A likely build-up of long euro positions

In 2019, the EUR/USD can be expected to recover towards 1.25/1.30, once the market's attention shifts to the prospects of a tightening of the ECB's key policy rates, bearing in mind the Federal Reserve's monetary cycle will be nearly over by then.

Energy/Commodities

The annual increase in energy resources is around 2%; at the same time, new and better exploitation methods enable energy companies to meet this demand. Additionally, the present state of the shale production allows the industry to respond to new conditions relative quickly and this without the negative effects of mothballing a rig.

Therefore, for the time being, the barrel price should stay within a range of USD 55.- to USD 60.-.

Target values in 3 months:

EUR/USD:	1.1500 - 1.2000
GBP/USD:	1.3000 - 1.3500
USD/CHF:	0.9750 - 1.00

Target values in 12 months:

EUR/USD:	1.25 - 1.30
GBP/USD:	1.20 - 1.30
USD/CHF:	1.00 - 1.05

Purchase power parities:

EUR/USD:	1.25
GBP/USD:	1.58
USD/CHF:	1.00
EUR/CHF:	1.25

Most likely next move:

EUR/USD	down
GBP/USD	down
USD/CHF	down

Target values in 3 months:

Oil:	\$55 - \$60
Gold:	\$1,250

Target values in 12 months:

Oil:	\$60 - \$70
Gold:	\$1,350

Upside potentials:

S&P GSCI	down
Oil	down
Gold	down

Next most likely move:

S&P GSCI	flat
Oil	flat
Gold	flat

Commodity related stocks:

Bitcoin

Commodity? Currency? Or What? And what is it for?

An asset can be considered as a commodity if it is listed on the CME[1] and / or if it is deliverable! If it is a currency then it should be issued by a central bank and be connected to an economic system and people who live and produce something. Bitcoin complies with neither requirement; nevertheless, since December of 2017, derivative products of bitcoin have been traded at the CME.

At present, bitcoin supply is limited to 21 million, with 17 million having been issued. By 2021, global supply should exceed 18 million. For the time being, only a few intersystem applications truly exist, and there are a few e-commerce sites accepting bitcoins, but none of the major e-commerce platforms accept it. Today, there are around 400,000 bitcoin transactions a day, with a daily average volume of USD 6.5 billion. However, much of these volumes are attributed to inter-country payments from regions where strong exchange controls exist.

Other crypto-currencies based on blockchain technology exist and enable the construction of financial assets (bond options, etc.) or the staging of fundraisers (initial coin offerings). However, bitcoin has by far the largest capitalization, with NPV of $200bn, while for all crypto-currencies this figure reaches $365bn.

Because of the particular trading conditions of bitcoin, the volatility observed is well above average. Intraday swings can reach as much as 40%, and have, until now, been followed by even stronger recoveries.

[1] CME = Chicago Mercantile Exchange

Asset Allocation Preferences – December 2017

Sectors	Region	Fundamenta attractiv.	Risk/Reward	Investment case
Basic Materials	Americas Europe EM	○●○○○ ○○○●○ ○○●○○	■■■ ■■■■ ■■	The price surge experienced in 2016 and at the beginning of 2017 was due to a supply disruption and increased demand from China. However, we now expect that China-based metal consumption will weaken in the next 12 months. This market segment will therefore become less attractive. Within the sector, there are some pockets of good value such as special chemicals, while others such as agricultural chemicals suffer from a strong oversupply and therefore should remain relatively unattractive.
Consumer Staples	Americas Europe EM	○○●○○ ○●○○○ ○○○●○	■■■ ■■■ ■■■	The entire sector is subject to broad-based changes and deep disruptive actions. It is therefore not surprising that the sector has underperformed the larger market in the past few years; we do not expect a sector turnaround in the years to come. Digital awareness across the sector is only just taking shape. Given the timeframe that will be required in order to implement, adjust, regain consumers, and capitalize on the new strategy, better performance from the sector should only be expected towards 2020. The sector's average valuations are cheap compared to long-term figures. Investors with a higher degree of risk appetite should focus on drivers such as industry consolidation, restructuring and cost-cutting. There are a few activities that could appear to be immune versus disruption; there are: tobacco, health, and wellness.
Consumer Discretionaries	Americas Europe EM	○○○●○ ○○●○○ ○○○●○	■■■ ■■■ ■■■	Overall, the macroeconomic backdrop for consumers is more favorable, and financial conditions are also supportive for increased consumer spending. The stock market is nearing record highs, and home prices are steadily rising, providing a boost to household budgets. There are also some negatives, such as increasing household indebtedness in many countries, and political uncertainty. Last but not least, private equity investors' withdrawing of assets from passive orientated investment vehicles to proceed with DIY strategies demonstrates that private individuals have excessive confidence in the system.
Energy	Americas Europe EM	○○○●○ ○○○○● ○○○●○	■■■■ ■■■■ ■■■■	Shale oil and gas companies require little time to achieve the breakeven point per rig, whereas major down and upstream operators require more time to reach the breakeven point. In the case of shale oil operators, profitability is more a function of the day-to-day quote of the barrel price, while major operators are less vulnerable to short-term price fluctuations. Strong balance sheets and the capacities to reduce massively running costs allow major operators to run a profitable operation even with barrel prices well below USD 30-. Considering that capital investments having dropped to almost a 10-year low, new production capacities are limited, which in turn will sustain the barrel prices and subsequently EPS expansion.
Financial Services	Americas Europe EM	○○○●○ ○○○●○ ○○●○○	■■■■■ ■■■■ ■■■	On both sides of the Pond, financial institutions are subject to strong regulations, with little room to maneuver. However, there is light at the end of the tunnel: US operators might benefit from a government decision to lift some of the restrictions that were implemented following the financial crash in 2007. In Europe, operators are busy preparing to implement MiFIDII procedures, to be activated in January of 2018. Once done, their attention can return to new business.
Healthcare	Americas Europe EM	○○●○○ ○○○●○ ○○○●○	■■■ ■■■■ ■■■	Within the healthcare sector, there are from time to time important performance discrepancies. Therefore, investors seeking outperformance versus a well-balanced index are advised to seek exposure to index segments with a low market capitalization. Life Science is one of this sub-sector and it is representing about 6%. Companies in this space produce tools, instruments and diagnostic equipment for a broad range of industries. Investors engaging this segment seek multiple opportunities, such as high value innovations in the field of next-generation sequencing, genomics testing, proprietary diagnostics, and liquid biopsies. While opportunities abound, investors are advised to consider external elements such GDP growth, since organic growth is dependent on broad economic factors.
Industrials	Americas Europe EM	○○○●○ ○○○●○ ○○●○○	■■■■ ■■■■■ ■■■	The Industrial sector is the sector most exposed to IIOT, robotics, and automation; in other words, the sector faces unprecedented challenges ever since the introduction of stem engines. In fact, in a little over 10 years, about ¼ of the worldwide GDP will be generated by artificial intelligence. There are four distinct avenues where progress is accelerating: Automatization and robotics, self-learning, image and vocal recognition, discrete decision taking proces upon consumer input.
Information Technology (IT)	Americas Europe EM	○○○○● ○○○○● ○○○○●	■■■■■ ■■■■■ ■■■■	The sector continues to offer one of the best trade-off opportunities across all sub-sectors and all geographies. Attractive valuations, above-average earnings growth, and rising cash distribution make the stocks of this sector a first choice for investors. In particular, market volatility, along with general weakness at structurally high-quality companies due to earnings volatility should be used as a buying opportunity. The run-up of the performance in Q4/2017 across the entire sector was extraordinary; it has closed part of the sector underperformance. Yet, we believe that the long-term opportunity of Economy 4.0 and IIOT is not price-in.
Tele-communication	Americas Europe EM	●○○○○ ●○○○○ ●○○○○	■ ■■ ■■	The telecommunication a sector is completing is multi-year-long healing process, with significant progress made in business reorganization, cost cutting, and infrastructure adjustments. The sector is now in progress of rolling out 4G, and is preparing for the launch of 5G. However, these two upgrades require relatively high investment capacities; as a result, only large players may be able to fully implement them in time. On the positive side, we recognize that the economic background is perfect for these upgrades; one can therefore expect that free cash flows should ultimately get a boost.
Utilities	Americas Europe EM	●○○○○ ●○○○○ ●○○○○	■ ■ ■	Surprisingly, the Utility sector is keeping up with average market returns despite unfavorable conditions for the future, such as rising costs for debts, stronger competition from 3rd party power providers, and strongly rising infrastructure replacement costs. Past performance of utility stocks was good because of: a) Ongoing low interest rates help lock-in future financial engagement at low financial costs, b) From an investment point of view, because they are low volatility stocks, utility stocks were an excellent cash and bond-substitute, c) Restructuring benefits. Going forward, it is important for investors to focus on future-proof companies such as water utilities wherein competition is low and extremely high entry barriers for newcomers exist.

For the full sector comments, please refer to the quarter investment report available here.

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Sources:
Analysis and comments: Bloomberg, Reuters, Natixis, UBS, BNP-Parisbas.
Data and graphical items: Bloomberg, Reuters.

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