Outlook for Financial Markets
April 2017

Interest rates/Bond markets
Moderate rise of long-term rates

USA
- Although the Fed has hiked rates twice over the past 4 months, financial conditions have loosened - rate normalisation hardly leaves traces
- Long-term rates move in a relatively narrow range - over the next 3 months we expect a moderate increase only
- The peak in headline inflation lies behind us

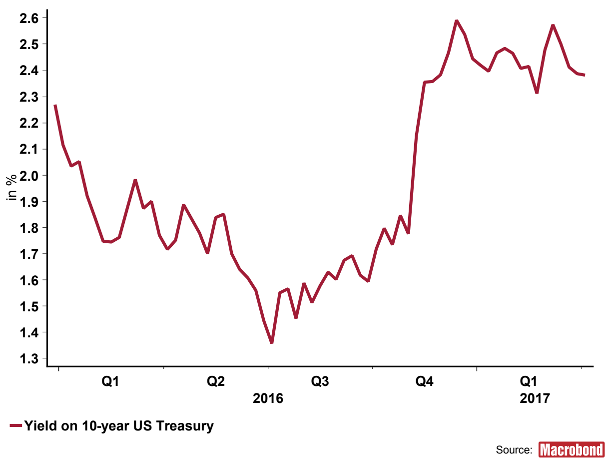
Eurozone
- The report on GDP growth in the first quarter will reveal a very strong momentum
- Concerns about the outcome of the French elections have calmed down a bit - the risk premium on French government paper has consequently diminished
- Inflation surprised to the downside in March - the ECB will not be in a hurry to tighten policy

Japan
- The yield on a 10-year government bond has fluctuated between 0.05% and 0.10% over the past 4 months
- Towards the end of the year, the inflation rate is bound to drop below zero again

United Kingdom
- Prime Minister May triggered Article 50 and negotiations about the exit from the EU will be launched
- The hard Brexit will increase uncertainties in particular as concerns the outlook for monetary policy - the BoE has to balance between weakening growth and rising inflation pressure

Switzerland
- Catalysts for a clear rate move are missing - at the short end of the curve, the SNB is in the side car of the ECB and will not change its target rate
- At the start of the year, the inflation rate managed to move into positive territory for the first time in two years

The quite after the storm: sideways move of long-term rates



After the pronounced increase of long-term rates in the developed world since summer 2016 - additionally boosted by the alleged Trumpflation - markets have calmed down somewhat. Rates are moving in a fairly narrow range. While we expect two more rate hikes by the Fed this year, the raising of rates over the past four months has done nothing to tighten financial conditions, on the contrary. In fact, financial conditions have loosened due to higher equity markets and a weaker USD on a trade-weighted basis. Thus, the normalisation of monetary policy in the US seems to be possible without negatively affecting financial markets. Since the new administration again faced difficulties in implementing one of the major campaign promises, a certain sobering of market participants can be observed. Nevertheless, sentiment indicators from the corporate as well as consumer side seem to be driven by hopes rather than political reality. Favourable financial conditions as well as a moderate tightening cycle by the Fed will drive long-term rates slightly higher over the next three months in our view. This assessment also relates to rates in Europe. Economic data from Eurozone member countries justify this expectation and the report on GDP growth in the first quarter will underline the good performance of the economy. Finally, one needs to stress that inflation rates have surpassed their peak in the developed world and will not be a driver for rates to go higher from this point onwards.

Stock markets

Sobering of investors?

USA

- Trump's setbacks as regards the implementation of his campaign promises caused sideways movement of equity indices in March
- The two rate hikes by the Fed since December 2016 were easily digested however
- Valuation measures such as the P-E ratio are elevated as compared to their long-term average and may be vulnerable in case of a swift rate increase

Eurozone

- Corporate earnings develop positively due to the synchronous global upswing
- Uncertainty as regards the elections in France is a burden - a defeat of Marine Le Pen would allow risk premia to contract
- A fundamental renunciation of the ECB from its current policy stance seems unlikely

Japan

- Japan's export values profit from rising demand out of neighbouring Asian economies
- Fears of a trade war with the US have not found justification thus far

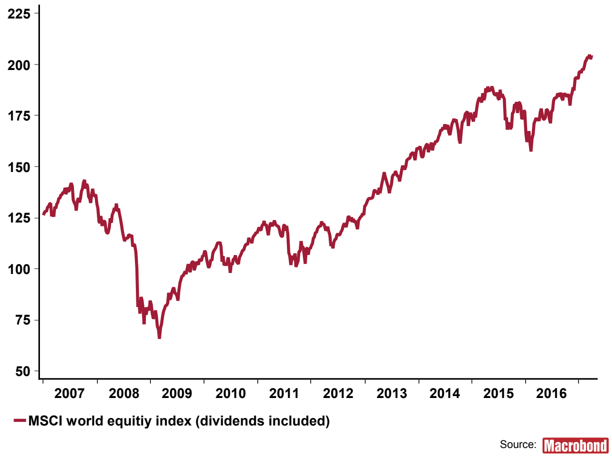
United Kingdom

- Depreciation of the British Pound by 11% since the first quarter 2016 adds to the boost which British exporters get from the global economic upswing
- The start of the negotiations with the EU on the future relationship is accompanied by restrained corporate investments and a loss of purchasing power of private households

Switzerland

- The purchasing managers index illustrates that Swiss industry benefits from the global upswing
- US rate hikes and the defeat of populists in European elections do not yet alleviate the upward pressure on the Swiss Franc
- Compared to fixed income instruments, dividend papers remain attractive

Equity markets rally has started its ninth year



The current equity market rally has started more than eight years ago. Neither the confidence crisis in Europe nor the elevated volatility of commodity markets or occasional fears about a recession in the US or China could stop the upward trend on a sustained basis. One of the key drivers for this impressive evolution is without doubt the long-lasting accommodative monetary policy stance of the major central banks. The ample bond purchase programmes provide an artificial cap for nominal interest rates in the US, Europe and Japan. In this low or negative rates environment, equities are the most attractive asset class for many investors, besides real estate. In Europe and Japan, we do not expect a decisive change in monetary policy in the near future. This is one of the reasons why equity markets have well digested the two interest rate hikes of the Federal Reserve since December 2016. Sound economic data around the globe imply robust quarterly results in the corporate sector. Yet, after the strong rally which followed the US election result, we expect a further consolidation phase in equity markets. In the short-term, investors need to watch the presidential elections in France: European stocks, and in particular equities of the banking sector, have priced in a certain risk premium for the case that Marine Le Pen would win the elections. If she does not become the new President of France this would, at least in the short-term, imply positive reactions of European equities. Politics in the US, however, could weigh on equity markets if the new administration cannot meet expectations regarding the tax reform.

Currencies

Politics in the driving seat

USA

- Only short lived support for the USD after the Fed's rate hike in March – the statement of the central bank about future monetary tightening was too prudent for market participants
- In our base case scenario, we expect two further rate hikes in 2017 and a moderate appreciation of the USD against other major currencies

Eurozone

- ECB surprised markets with hints about a marginally tighter monetary policy stance – EUR could appreciate moderately against USD
- As long as the obstacle of the French elections is not overcome, the EUR cannot appreciate clearly, even though economic data are robust

Japan

- Yen remains undervalued, even after a notable appreciation phase – divergent monetary policy is however a sign for a weakening of the Yen against the USD

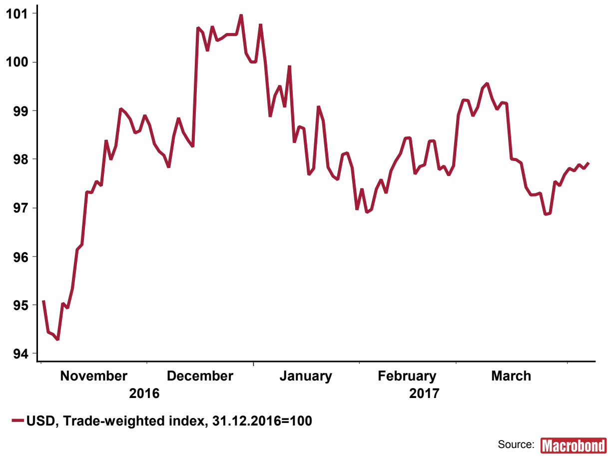
United Kingdom

- Since October, Pound has been surprisingly stable against USD, the cross fluctuates around 1.25
- After triggering Article 50, negotiations between the UK and the EU take centre stage – strong negative expectations are already priced in the currency
- We expect a stable exchange rate for GBP/USD going forward

Switzerland

- Thanks to strong interventions, the Swiss National Bank (SNB) could bring EUR/CHF back to 1.07
- The SNB should be able to reduce its interventions somewhat if Marine Le Pen fails to win the French elections

Disillusionment about US policy also reflected in US Dollar



Immediately after the election of Donald Trump, the US Dollar appreciated considerably. Since the beginning of December, however, the Greenback has moved more or less sideways. The hopes regarding the new US President cannot push the Dollar further up. On the contrary, after the setback regarding the health care reform, concerns among investors have risen. They fear that he will finally implement a lot less than announced. We have always been prudent with regards to our expectations of political implementation of the new US administration as the system of checks and balances is well anchored in the US. Nevertheless do we anticipate a stronger US Dollar. The driver is not economic or trade policy but monetary policy. The Federal Reserve will continue its rate hiking cycle while other major central banks remain very accommodative. In the US, we expect two further increases of the target rate until the end of the year. In our view, the European Central Bank will continue with its asset purchase programme, without any changes, until December. Also the Bank of Japan is still very accommodative. Thus, diverging monetary policies remain a key theme for foreign exchange markets. The other major driver is politics. In Europe, the presidential elections in France will again be in the focus for the next few weeks. We do not believe that Marine Le Pen will be the next President. Yet, should the survey results move in her favour, this will again exert downward pressure on the Euro. In the Eurozone, politics is currently a more important driver for the currency than the robust economic data.