BBGI GROUP Global Investments

Investment Strategy

April 2019

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Graph sources: Bloomberg/BBGI Group

INTRODUCTION

Letter to Investors - Investment Climate

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- Leading indicators soon to turn positive?

The US equity market closed out Q1 2019 on an exceptional performance, posting its strongest first quarter progression since 1998. Up +14.55% since 1 January, US equities also posted among the strongest results of all developed equity markets. The panic at the end of 2018 thus gave way to a resurgence of optimism and to a renewed propensity by investors to take risks. This shift in attitude was immediately discernible at the beginning of the quarter in regard to all risky assets globally (equities, real estate, commodities, private equity, etc.) and persisted through the quarter. Most asset classes thus rapidly resumed trending upwards, although they regained most of their value over the first two months. Volatility fluctuated more significantly in March, calling into question the general upward momentum, though most markets ultimately posted positive performances, if only just. Q1 2019 was thus the mirror image of Q4 2018, perhaps already indicating that panic had given way to euphoria within a matter of months, a factor to consider in the assessment of risks and opportunities for Q2.

On the macroeconomic front, there has not been much good news over the past few months supporting this shift in risk perception. Indeed, economic figures have mostly pointed toward an overall downturn, stemming in particular from a global slowdown in the manufacturing sector. In this rather glum context, hopes of a resolution of the dispute between China and the US have not lead to concrete action either. However, the absence of an agreement is not perceived as a failure, given the declarations of goodwill by both parties in the past weeks. Nevertheless, while risky assets benefited from a more optimistic stock market climate at the beginning of the year, capital markets remained impacted by the flow of mediocre macroeconomic news. Long-term rates thus tumbled further in March in many countries. The performance of the German economy, for instance, has raised concern and pushed 10-year euro rates below zero, while US Treasury yields fell to 2.4%. This drop of over 80 basis points within six months occurred in the context of a slowdown, although GDP growth is expected to be +1.5% in Q1. Although the outlook is still relatively positive in the US, the uncertainties affecting Europe and the challenges besetting the global manufacturing sector have weighed on long-term rates. Rate markets thus do not seem prepared to consider that fundamentals may follow a more positive trend globally in Q2 and refuse to believe in an economic upturn. With regards to central banks, the decisions announced at the beginning of the year mark an understandable and expected reversal in monetary policy given the current context. In the Eurozone, the quasi recession in Germany was sufficient to amend the liquidity injection policy.

In the US, the notion of a yield curve inversion signalling a recession is no more credible today than it was in December, but it was likely an additional factor motivating the Fed's decision to abstain from any rate hike in 2019. The fears of an overly rapid normalisation of monetary policy will likely be allayed by these decisions, especially since the Chinese government also announced measures to boost growth, in particular via a tax cut worth 300 billion dollars. These policies will benefit the global economy and contribute as will the future agreement between China and the US to lifting the uncertainties currently hampering investment and industrial demand. It is in the obvious interest of both presidents to put an end to these uncertainties as quickly as possible. The US elections in 2020 are approaching, and President Trump will likely want to take credit for an agreement demonstrating the success of his China policy and leave enough time for economic activity to pick up in the US. In the meantime, financial assets have already posted significant gains in all regions of the globe, which could trigger some warranted profit taking in the spring. Swiss and international equity markets (up +14.3% and +12.5%, respectively) returned to and sometimes even exceeded their 2018 highs, thus warranting caution once again, as earnings growth forecasts for 2019 could be revised during the upcoming reporting season in the next few weeks.

With regard to real estate, price increases have been exceptional, exceeding +14% globally. The Swiss market reached new heights, even though it increased by only +8.5%, while emerging markets benefited most from the paradigm shift with a +18% gain. Investors also returned to commodities, which rebounded by +15% (+32% for oil). Private equity also rose sharply (+16.5%), while alternative asset management lagged behind (+2.8%) with a performance barely topping that of Swiss (+1.8%) and international (+2.2%) bonds. Optimism is peaking as the quarter comes to a close, but it will take a little longer to confirm that the trend has truly reversed, leading to an improved macroeconomic outlook, which will support further growth in financial markets. In the meantime, we expect financial assets will likely consolidate somewhat in the wake of some welcome profit taking. Subsequently, PMIs will likely have to improve in order to drive risky assets back up and may also mark the inflection point for rate markets.

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Graph sources: Bloomberg/BBGI Group

BIG PICTURE

Key Convictions

- Global economic upturn in Q2
- Central banks slow their normalisation process
- Inflation sustained by job market and commodities
- Political tensions lessen
- Loss of momentum and temporary profit taking

Global economic upturn in Q2

Q1 GDP growth in Europe and Japan will likely be lacklustre, according to figures published thus far as well as leading indicators. The Eurozone has been impacted by the downturn in the German economy bordering on recession and by the drop in exports, which is also affecting the ailing Japanese economy to a large extent. In the US, the anticipated slowdown will likely be limited, and GDP growth should still reach +1.5%, mainly driven by consumption. In China, the dip is unlikely to be too pronounced, in spite of the decline in manufacturing PMIs in January and February, and GDP will likely grow at an annual rate of +6.0-6.5%. Domestic demand is expected to stay resilient and compensate for weak foreign demand and the sluggish industrial sector. While the wrestling match still underway between the US and China no longer seems to be a major source of uncertainty in terms of investors' mindset and the stock market climate, it continues nevertheless to weigh on decision-makers' morale. A formal agreement is obviously necessary in order for the outlook and confidence to improve. We anticipate that a negotiated solution satisfactory to both parties is not far off. In particular, China has already announced several significant concessions implying an agreement is forthcoming. The latter may not have the desired effect on financial assets immediately, but at least it will lift some uncertainty and allow for a more serene outlook on the future of global trade. Consumer and business confidence should then rise, which will contribute to an improvement in the global growth outlook.

Central banks slow their normalisation process

As 2019 kicked off, we had already been expecting central banks to be more flexible in dealing with somewhat more challenging economic conditions, in particular in the euro area and the US. This has now been confirmed by the Fed's decision to leave rates unchanged in 2019 and the ECB's announcement of a resumption of liquidity injections. The fears that monetary policies would be normalised too quickly, which had rocked financial markets in December when the Fed last raised its target rate, should thus recede. While the Fed was pressured politically by the US president, in our view it is because of pressure from the financial markets that Fed Chair Jerome Powell changed his tune and FOMC members rather significantly modified their economic forecasts between December 2018 and March 2019. Nevertheless, the Fed's assessment of the domestic economy is not negative. Indeed, the job market is behaving as expected, a factor that is essential to and tied up with the expected trajectory of the US economy. We had predicted that, if necessary, the Fed would hold back on raising rates, which is indeed what happened in March given the prevailing uncertainty. This decision will have lasting consequences in 2019, as it now seems unlikely that the Fed would choose to drastically change its strategy if the economy picks up in Q2. Thus, if our scenario materialises and growth resumes, it may be difficult for the Fed to once again upend its monetary policy. We thus anticipate that the context over the next few quarters will be especially favourable for both financial assets and the economy, as a global economic upturn could take shape without the threat of further rate hikes.

Inflation sustained by job market and commodities

Naturally, inflation decelerated over the past few months due chiefly to the energy factor. As crude prices corrected by -44% in three months, price indices fell below central banks' targets. In the US, the CPI progressed by only +1.5% yoy in February, although the index excluding food and energy remained above +2%. The rally in oil prices, which increased by over +32% since the beginning of the year, will no doubt soon have an impact on energy costs and inflation. This factor had temporarily slowed the progression of price indices, and it should thus now help push inflation back up. In our view, the resilience of the index excluding food and energy highlights the increasing role of domestic inflation, which is accelerating as a result of a robust job market. The decline in the unemployment rate is only one of the factors confirming the positive momentum in the job market, where new jobs continue to be created and wage growth is finally significant enough, we believe, to have a lasting impact on core inflation. One of the likely surprises of the second half of 2019 could thus be a gradual increase in inflation to above the Fed's target, while the overall CPI index could even exceed 3%. This context will not be favourable to rate markets, which will have to adjust their yield requirements to account for these new circumstances. We expect that these adjustments may for instance push 10-year US yields up to close to 3%.

Political tensions lessen

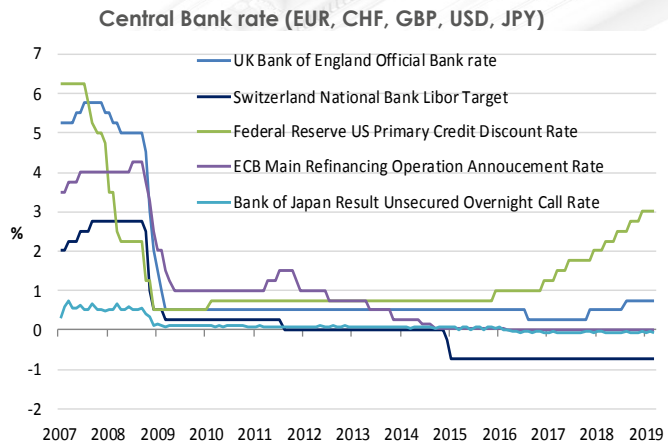
Political uncertainties still abound at the beginning of April, in particular with regard to the absence of a solution to the crucial Brexit issue in Europe and to the Sino-American trade dispute, which has global ramifications. For several quarters the latter issue has regularly been mentioned as the main risk factor with respect to global economic growth. This factor has gradually become less important in financial markets, although its influence continues to be felt in the real economy, hampering investment, industrial output, and consumption. This threat to global economic health has not disappeared and has forced governments and central banks to change their policies to bolster economic activity. We are convinced that this threat will soon be removed in the interest of both parties and of global trade more broadly. However, it is not impossible that, should the China-US trade dispute be resolved, a new threat may rapidly take its place. As the next US presidential election is just a few quarters off, President Trump's mood may be a determining factor with regard to these new threats. Germany could indeed be the next foe against which Trump will want to test his mettle, unless the US president starts to think ahead about the elections and how to optimise the likelihood of an economic upturn in the US, which would no doubt increase his odds of winning a second mandate.

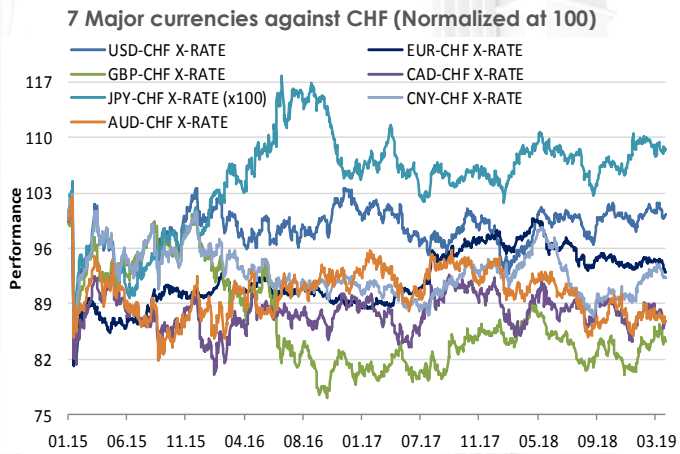
Graph sources: Bloomberg/BBGI Group

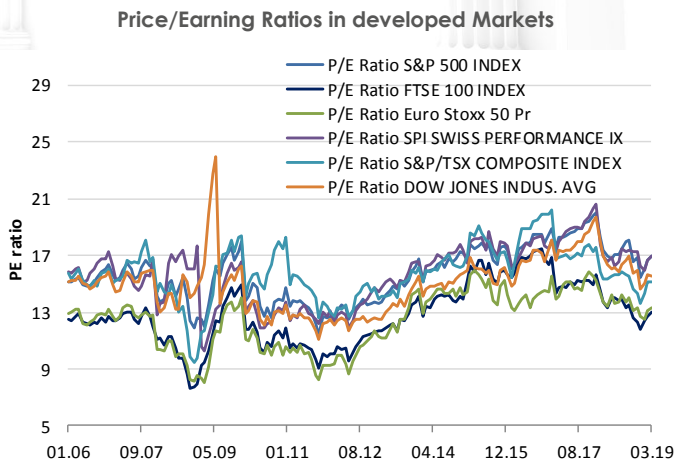
Loss of momentum and temporary profit taking

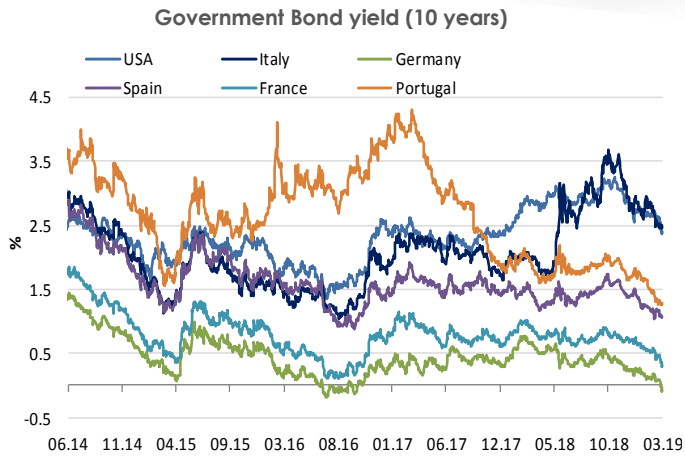
In January we mentioned that the valuation levels of equities and most financial assets had become more attractive following the swift and massive price corrections seen in December 2018. We noted that, barring a marked downturn in global growth in 2019, the outlook for equities in particular but more broadly for most asset classes was favourable. We anticipated an upswing in equities, real estate, commodities, and any assets especially impacted by the scenario, deemed excessive, involving a collapse of US and global growth. Three months later, the investment opportunities mentioned above mostly came to fruition with increases of around +10% almost across the board in all markets. The upswing in financial assets thus lived up to expectations. Note, however, that these gains occurred extremely rapidly, offsetting sometimes entirely the losses incurred at the end of year. The investment climate thus went from panic to euphoria in only a few weeks. The valuations of assets heavily devalued in December bounced back very quickly, in some cases presently reaching generous and potentially risky levels. While the low and arguably inadequate risk premiums seen in certain markets such as high yield bonds before the December correction then improved, they were once again flattened by the stock market performance over the past few months. The situation is similar with regard to securitised real estate investments, which posted exceptional results over three months ranging from +8.5% in Switzerland to +18% for listed emerging market real estate. The downward trend in interest rates that accelerated at the end of the quarter likely bolstered the performance of the real estate sector and the reconstitution of premiums. In equity markets, the low PEs seen in December are obviously long gone after the widespread share price increases of close to +15%. The SPI index reached new heights, even though the earnings growth outlook for 2019 has not changed significantly, and is once again trading at 15.7x expected earnings (13.9x at the end of December). In terms of risk assessment, over the past three months our models have been impacted more significantly by the "valuation, quantitative, technical, and sentiment" risk factors, which means, once again, higher scores, and places most equity markets in a zone of potential turbulence. Valuations levels have thus rapidly become less attractive in the short term, given a context of moderate economic growth in 2019 and in the absence of positive earnings revisions.

In our strategy note at the beginning of the year, we warned that a rapid increase in share prices, in particular if the S&P500 once again reached levels close to 2,900 points (September 2018), would prompt a careful reassessment of risks. Given that the index closed the quarter at 2,822 points, we believe that such a reassessment is now called for. Looking at risk/return ratios, we now consider that the valuation levels of risky assets offer profit-taking opportunities on most assets that posted significant gains over the past few months. Rates markets could in the very short term benefit somewhat from asset reallocation and rebalancing of positions in baseline strategies, but the improvement in the global economic scenario in Q2 will likely shift the growth outlook and be particularly negative for fixed income investments. Real estate investments, which benefited significantly from decreasing interest rates, have also become more risky, as has private equity. Volatility is thus likely to return in the short term, but the improvement in the global economic outlook will be conducive to a subsequent reinvestment of realised gains.









Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

Global Outlook

- Upturn in Q2 in the US after a weaker Q1
- Germany still a source of concern in the Eurozone
- The Chinese prime minister is anticipating growth of +6.5% in 2019
- Japanese GDP still under the influence
- Swiss GDP boosted by manufacturing and consumption

Upturn in Q2 in the US after a weaker Q1

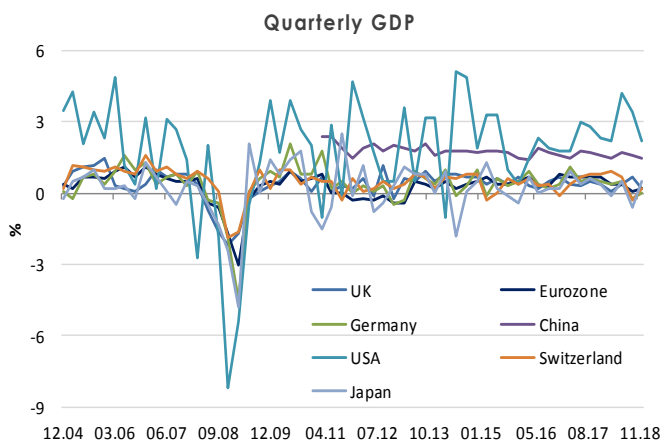
US GDP growth clocked in at an annual rate of +2.2% in Q4, which is obviously somewhat less robust than in Q2 and Q3 (+3.4%) 2018. However, this result is in line with the consensus forecast (+2.2%). The economy slowed less than expected due to several positive factors. Consumption grew by +2.5%, contributing significantly to the economy's strong showing. Capital expenditure progressed by +6.2% in the equipment, software, and research segments. Public spending (+0.4%) and rising inventories also contributed positively (+0.13%) to GDP growth, while real estate and foreign trade (-0.22%) contributed negatively. The impact of the government shutdown was ultimately estimated to be -0.1% of GDP. This negative impact notwithstanding, the performance of the economy remains excellent and above the historical average, as well as substantially higher than the Fed's longer-run potential growth rate (+1.9%). In light of these economic results, the fears of a recession that rocked financial markets in Q4 again clearly appear to a very large extent unfounded. Yoy GDP growth at the end of the year (+3.1%) thus slightly exceeded Trump's 3% objective.

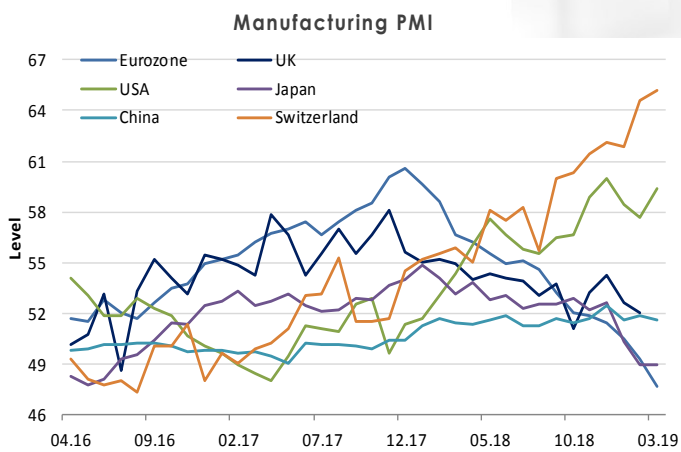
The strong growth of private consumption is heartening and in line with expectations following an already significant increase of +3.5% in the previous quarter. Consumption does not seem to have been affected too negatively by the uncertainty caused by the fall in financial markets and will likely be further bolstered by a robust job market in 2019. Inventories, which rose relatively substantially at the end of the year, will likely decline in Q1 2019, which could affect industrial production and manufacturing jobs in the short term. In our view the growth outlook for Q1 2019 remains unquestionably positive, even though a temporary slowdown remains likely before an upturn in Q2. Several factors that will likely penalise economic performance at the beginning of the year include the shutdown that took place during the first quarter, which will have a non-negligible impact, the persistence of tensions between China and the US, which continue to hamper overall consumer and business confidence, and a decline in the manufacturing sector. However, US GDP will likely grow by +1.5% in Q1 before resuming a more sustained pace of +2.6%.

Germany still a source of concern in the Eurozone

The largest economy in Europe is at a standstill and is threatening growth in other countries and regions in Central and Eastern Europe, which depend on German industry. The new European standards to which the German auto industry must conform are often mentioned as factors impacting the manufacturing sector along with the pressure exerted by Donald Trump. More generally, Germany has been more substantially impacted by the downturn in global demand for industrial goods of all sorts (equipment, machines, tools, vehicles, etc.) than its European partners. Global industrial production has thus contracted over the past few quarters, and this trend is also impacting intermediary goods and consumption goods. The weight of the industrial sector in Germany is significant and accounts for the country's poor performance compared to other EU members.

However, it is still somewhat premature to talk about a change in uropean growth drivers. We believe that the contraction in global industrial activity is more cyclical than structural for now and mostly tied to the uncertainty resulting from the US president's attitude towards his trade partners. An agreement is still expected between China and the US, which should result in a significant shift in economic sentiment and have a positive impact on global economic momentum in 2019. Eurozone manufacturing indicators still have not improved and instead have decreased further in March 2019. Concerns are lingering and have even intensified substantially in view of the mediocre macroeconomic performance since the beginning of the year.





Graph sources: Bloomberg/BBGI Group

The manufacturing sector is struggling, and leading indicators suggest that the sector's negative contribution to GDP growth may even intensify over the first three months of the year and in Q2. Consumers, like businesses, seem to be increasingly concerned by the trade dispute between the world's leading economies. Yet, the ZEW Euro indicator, which reflects the economic outlook for the next six months, improved for the fifth consecutive month in Germany, although it remains in the negative zone, suggesting that pessimism is likely receding. Given the risk of an economic downturn in the Eurozone, the ECB decided to postpone raising target rates until 2020 and to resume policy loans to the banking sector. Q1 growth will likely be disappointing, although it may improve in Q2 in the euro area if the uncertainty affecting the German manufacturing sector can be reduced, in particular by a negotiated solution between China and the US.

The Chinese prime minister is anticipating growth of +6.5% in 2019

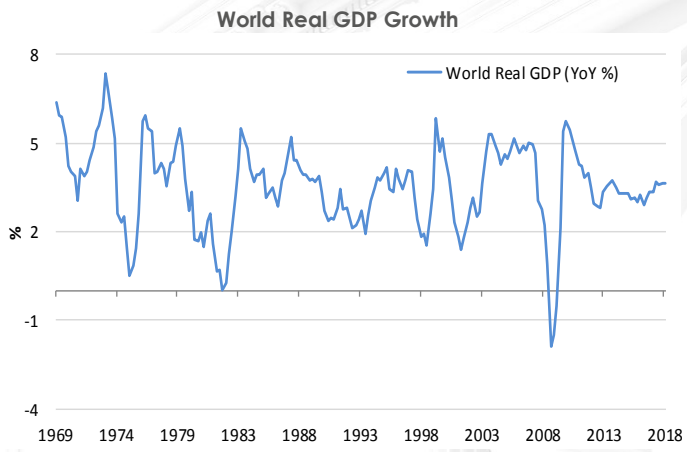
The Chinese economy is showing signs of stabilising several months after the government took measures to counteract an economic slowdown. The government further intensified its efforts in March, announcing its largest tax cuts ever, worth close to 300 billion dollars. Lending has been redirected towards the private sector and smaller businesses, which already seems to have had a very positive and measurable impact on confidence according to a survey of 500 small and medium-sized enterprises. Optimism is growing, reaching its highest level in ten months. Credit conditions have also improved significantly according to one indicator that reached its highest level since 2017, as Beijing has promised some easing though not an uncontrolled explosion of lending. The implementation of growth-enhancing monetary and fiscal policies has started to bear fruit, but it will be some time yet before the Chinese economy can do away with government stimulus measures. The domestic economy is in good shape according to Chinese Prime Minister Li Keqiang, who notes that the risks of a downturn stem mainly from global economic conditions and weaker foreign demand. The Chinese government expects growth of +6 to +6.5% in 2019, slightly below the latest forecasts.

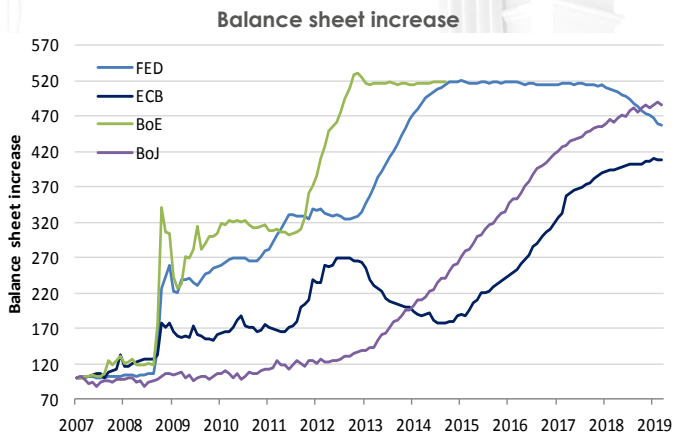
Japanese GDP still under the influence

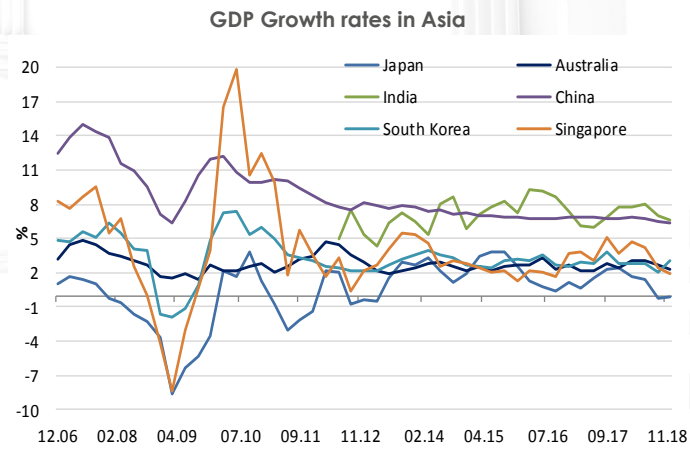
Japan's quarterly economic results were rather variable throughout 2018. The upward revision of Q4 GDP growth to +0.5% (+1.9% annualised) offset the shock of the previous quarter's -0.6% contraction, the economy's worst performance since 2014. The Japanese economy thus expanded faster than expected over a quarter that was rather challenging for most economies globally and for the Eurozone in particular. Thanks to this sharp upswing in economic activity, Japan was able to avoid entering a technical recession after a challenging third quarter. These results exceeded forecasters expectations but remain fragile given that the global economic context has remained uncertain thus far in 2019. 2018 thus closed on a positive note, underscoring, however, the volatility and instability of the economy, which alternated, each quarter, between expansion and contraction.

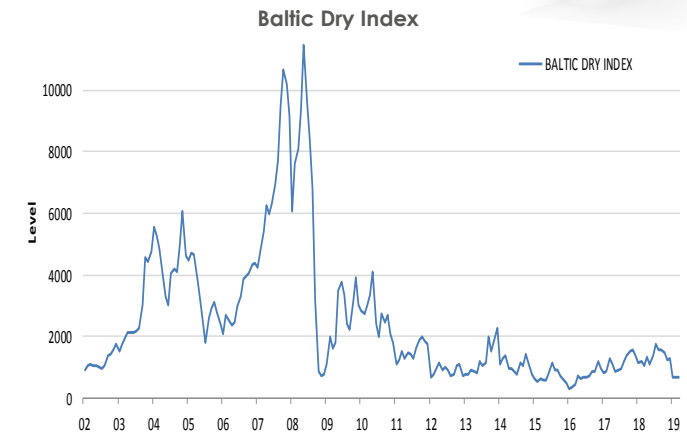
Exports, an essential driver of GDP growth for Japan, fell once again in Q4 due to a decrease in foreign demand. The continuing uncertainty tied to the trade dispute between the US and China is weighing on confidence and affecting the Japanese economy. This uncertainty continues to be the main threat to GDP growth, particularly given the yen is expected to continue to depreciate over the next few months. Indeed, the currency factor remains one of the key elements necessary for more positive GDP growth. Sentiment among Japanese business leaders is still not improving and remains impacted by the absence of a solution to the Sino-American crisis, which continues to affect the Japanese economy.

The composite PMI index continues to fluctuate and shows no clear signs of recovery. In this sense it is broadly impacted by the manufacturing PMI index, which has contracted sharply since the beginning of the year, falling from 52.5 to 49.0, which is worrisome, as it suggests a sharp slump in industrial activity at the beginning of 2019.









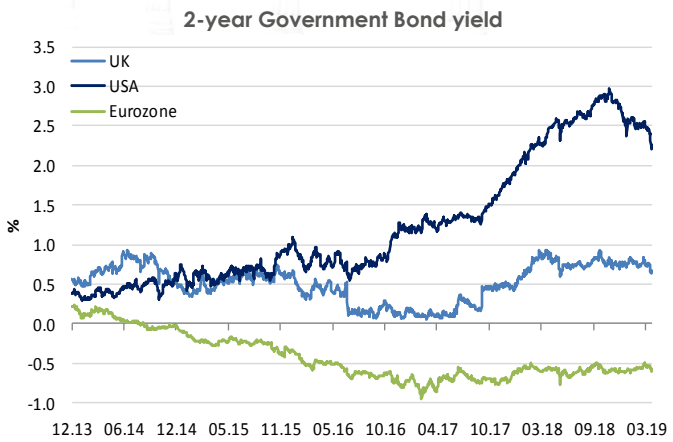
Graph sources: Bloomberg/BBGI Group

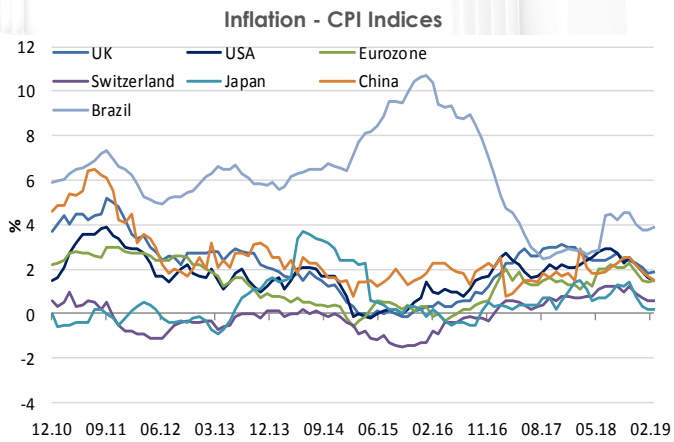
The Japanese central bank has left its monetary policy unchanged but is concerned with respect to global demand and its implications regarding the likelihood that exports and industrial production will bolster GDP growth in Q1 2019. The BOJ has thus revised its GDP growth forecast downwards. Governor Haruhiko Kuroda expressed concern with regard to the country's economy given the current context, but he does not seem to be considering further measures to support the economy. He likely deems the slowdown in external demand to be temporary, as essentially due to the lack of solution to the trade crisis. Domestic demand continues to grow, which is a positive factor sufficient to maintain the status quo with regard to monetary policy. The central bank's baseline scenario remains relatively stable, anticipating moderate GDP growth in 2019. Measures to shore up the economy implemented by Beijing should have a more significant impact in H2 on global demand and on Japanese exports.

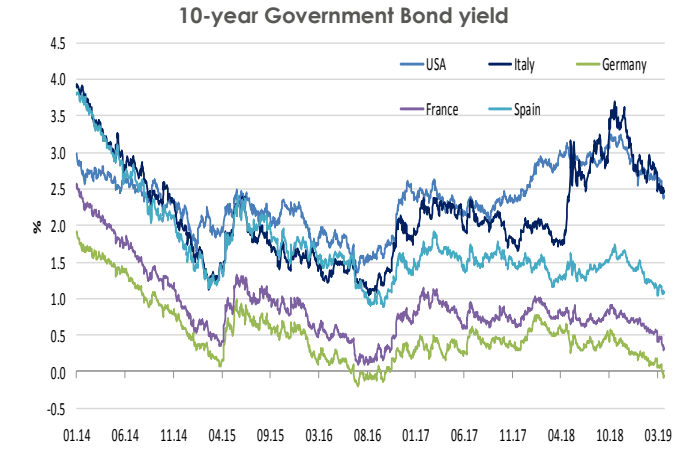
We have not changed our outlook for the yen, which remains bearish for 2019. For several quarters already we have been noting that the yen's weakness is a key condition to boosting economic growth and inflation in Japan. A weak yen would breathe some life into the Japanese economy and enable it to resume a more sustained pace of growth. Monetary policy still aims to weaken the yen, but means available to the BOJ remain limited. We continue to expect that investors will shun the yen given a totally unfavourable interest rate environment and rate spreads that are likely to continue to penalise the Japanese currency.

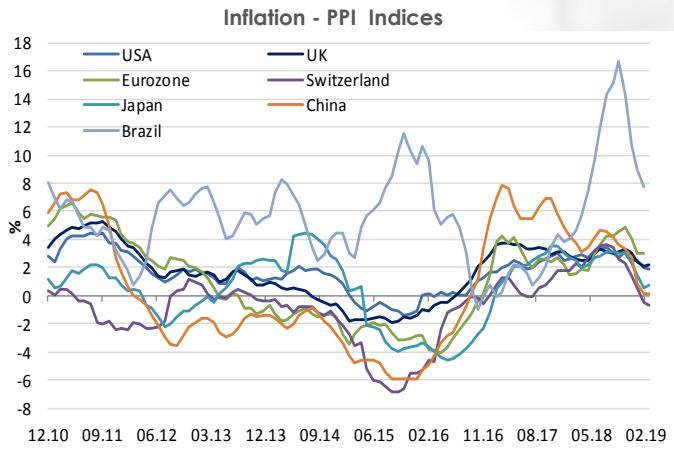
Swiss GDP boosted by manufacturing and consumption

The economic forecast of the Federal Government's Expert Group was revised downward, as the context remains rather uncertain thus far in 2019. Our baseline scenario for the Swiss economy remains reasonably optimistic following the economic upturn – however modest – of Q4 2018. Global economic conditions were clearly less favourable over the past few months, in particular in the euro area and in Germany more specifically. Our economy thus relied on stronger foreign demand from other economic regions and on resilient domestic activity. The economic downturn in Germany continues to be a factor of uncertainty in Q1 2019 that could negatively impact our foreign trade over the next several months. However, we think that the outlook for Q2 2019 should improve and bolster demand for Swiss goods and services. Uncertainty remains high in the absence of a trade agreement between China and the US. Nevertheless, we believe that it is in the two parties' best interest to reach an agreement that would dispel this uncertainty and boost confidence, consumption, and investment. The stabilisation of the Swiss franc against the dollar close to parity and against the euro above 1.13 will also benefit Swiss foreign trade. Aside from exports, domestic demand will likely also continue to strengthen with slightly more robust growth in consumption in 2019. Consumption strengthened slightly in Q4 but has yet to benefit from the unemployment rate, which has been at a historic low (2.4%) for several months, likely because nominal wages have increased only slightly. Disposable income did rise, however, as did household debt, which increased by +1.63% in 2018. Consumer confidence did not change much but we expect private consumption to continue on a positive trend, bolstering GDP. In this context, Swiss GDP is expected to grow by +1.5% in 2019.









Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

United States

- Sustained pace of growth in the US
- Growth expected to accelerate in Q2 2019
- No further rate hikes by the Fed in 2019
- Leading indicators persistently anaemic
- Employment numbers are strong
- Pace of wage increases accelerates

Sustained pace of growth in the US

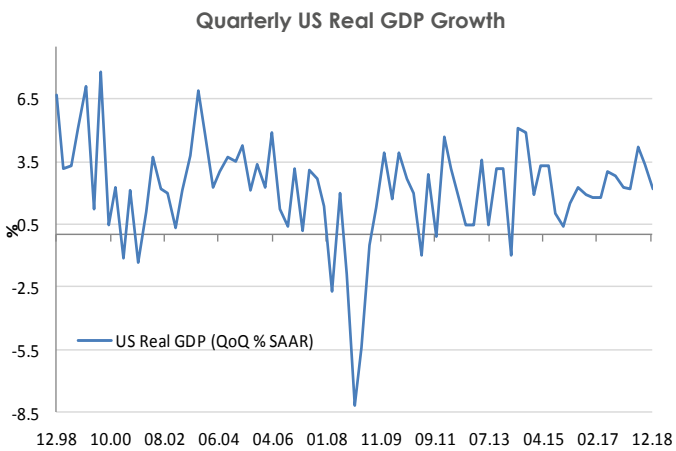
US GDP growth clocked in at an annual rate of +2.2% in Q4, which is obviously somewhat less robust than in Q2 and Q3 (+3.4%) 2018. However, this result is in line with the consensus forecast (+2.2%). The economy slowed less than expected due to several positive factors. Consumption grew by +2.5%, contributing significantly to the economy's strong showing. Capital expenditure progressed by +6.2% in the equipment, software, and research segments. Public spending (+0.4%) and rising inventories also contributed positively (+0.13%) to GDP growth, while real estate and foreign trade (-0.22%) contributed negatively. The impact of the government shutdown was ultimately estimated to be -0.1% of GDP. This negative impact notwithstanding, the performance of the economy remains excellent and above the historical average, as well as substantially higher than the Fed's longer-run potential growth rate (+1.9%). In light of these economic results, the fears of a recession that rocked financial markets in Q4 again clearly appear to a very large extent unfounded. Yoy GDP growth at the end of the year (+3.1%) thus slightly exceeded Trump's 3% objective.

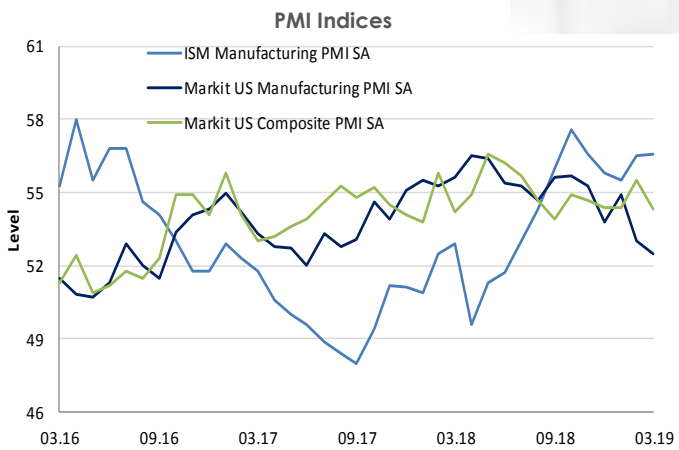
Growth expected to accelerate in Q2 2019

The strong growth of private consumption is heartening and in line with expectations following an already significant increase of +3.5% in the previous quarter. Consumption does not seem to have been affected too negatively by the uncertainty caused by the fall in financial markets and will likely be further bolstered by a robust job market in 2019. Inventories, which rose relatively substantially at the end of the year, will likely decline in Q1 2019, which could affect industrial production and manufacturing jobs in the short term. In our view the growth outlook for Q1 2019 remains unquestionably positive, even though a temporary slowdown remains likely before an upturn in Q2. Several factors that will likely penalise economic performance at the beginning of the year include the shutdown that took place during the first quarter, which will have a non-negligible impact, the persistence of tensions between China and the US, which continue to hamper overall consumer and business confidence, and a decline in the manufacturing sector. However, US GDP will likely grow by +1.5% in Q1 before resuming a more sustained pace of +2.6%.

No further rate hikes by the Fed in 2019

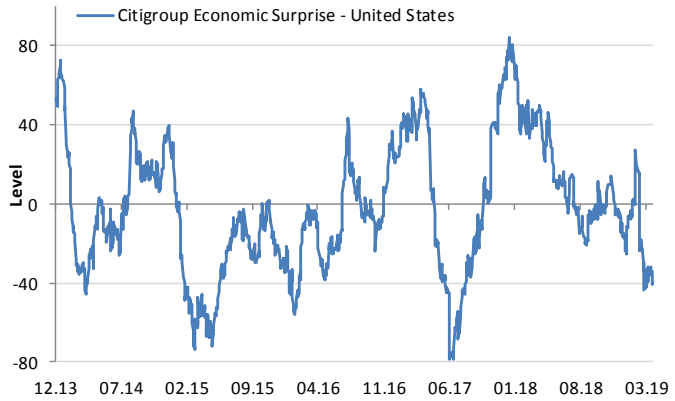
The US Federal Reserve, already discomfited by its ninth rate hike in December 2018, will have to adopt a particularly prudent policy in 2019 to avoid any risk of slippage of the economy. FOMC members will likely have to wait quite some time before proceeding with a tenth increase. The target rate's current level is now termed 'neutral'. There is thus very little risk that the Fed will raise rates given the likely temporary economic downturn in Q1. President Powell remained positive with regard to the economic situation in the US during the Fed's last press conference, but he also succumbed to the general tendency to revise the outlook for 2019 downwards and significantly recalibrated his monetary policy projections, announcing a time horizon of three years for the next rate hike. The Fed lowered its GDP growth forecast from +2.3% to +2.1% and its inflation forecast from +1.9% to +1.8%. Its unemployment forecast remains unchanged at 3.7%. In our view, this change in attitude reflects increasing concern with regard to the potentially negative implications of continuing to normalise monetary policy in the current slightly more uncertain context. However, this caution is consistent with our belief that the Fed will prefer to delay reacting to any future upswing in inflation than to implement a normalisation policy prematurely.



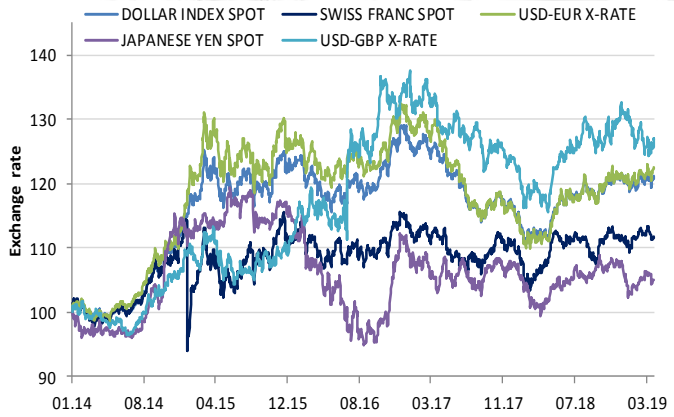


Graph sources: Bloomberg/BBGI Group

Citigroup economic surprise index USA



Dollar trade-weighted index and currencies



The recent decline in price indices since the highs of 2018 will bolster the Fed's wait-and-see approach. We continue to anticipate that the Fed will exercise considerable flexibility in managing its monetary policy in 2019, although we discard for now the possibility of a rate cut, which is nevertheless suggested by the fed funds futures curve, which shows a 50% chance of a cut at the beginning of 2020.

In our view the flattening of the US yield curve following the decline in long-term rates does not signal a recession in the current context as we have been hearing too often. However, this situation is clearly an inhibiting factor for FOMC members, who are not willing to risk taking action in the absence of an upturn in the economy. According to the Fed, it is thus no longer necessary to tighten rates in order to check inflation. The Fed also decided to slow its balance sheet reduction programme by lowering the amount it is unwinding from $30 to 15 billion per month. It is also prepared to simply stop unwinding if necessary as of September. In so doing, the Fed is clearly demonstrating its willingness to interrupt its normalisation process to factor in the risks of a downturn in global growth. The fed funds target range is still 2.25 - 2.50%.

Leading indicators persistently anaemic

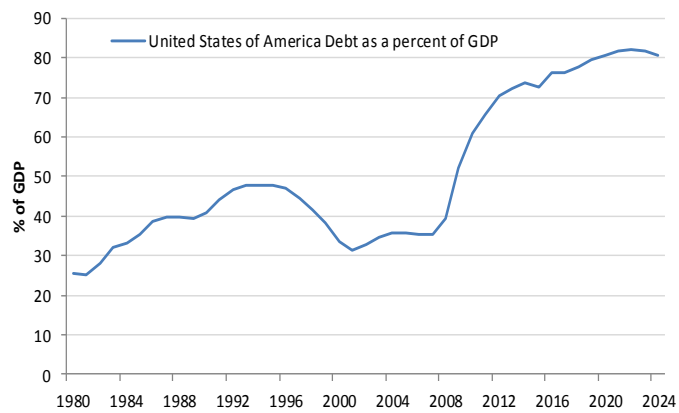
At the end of the current quarter leading indicators are still declining steadily as they have over the past five months since the trend reversal that occurred in November. The manufacturing PMI index lost yet more ground in March (52.5) compared to the preceding month (53), reaching its lowest level in 21 months. The services PMI also slipped from 56 to 54.8, thus unable to prevent a further decline of the composite index. However, while according to these indicators confidence does not seem to have returned, it is interesting to point to several signs of improvement, such as the Philadelphia Fed's manufacturing index, which rebounded sharply, jumping from -4.1 to +13.7 in March.

Employment numbers are strong

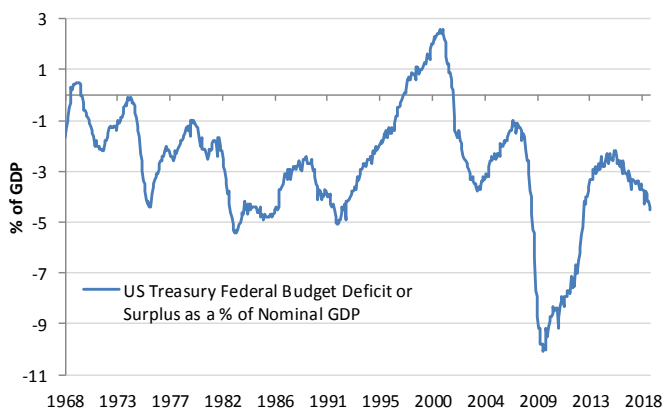
The job market continues to strengthen in spite of several temporary surprises and is very likely to be a key factor boosting consumption, GDP, and inflation in 2019. Sluggish job creation in February (20,000) after the extraordinary number of jobs created in January (311,000) is likely temporary. The volatility of these figures is primarily a result of the government shutdown and weather conditions, which had a significant impact on the construction sector (-31,000 jobs). Overall, the number of unemployed workers decreased by 300,000 to 6.2 million, while the unemployment rate dropped further to 3.8%.

Job creation in March will likely be robust and amount to close to 175,000 new jobs. Jobless claims fell to 211,000, highlighting the continued strength of the job market. At 0.86, the ratio of job-seekers to vacancies, an indicator of job market tightness, continues to suggest that supply exceeds demand, signalling a vigorous job market. There are currently 7.581 million job vacancies, namely +4.7% more than in the previous month. The pace of hiring also progressed from +3.8% to +3.9% month on month.

Debt (% GDP)

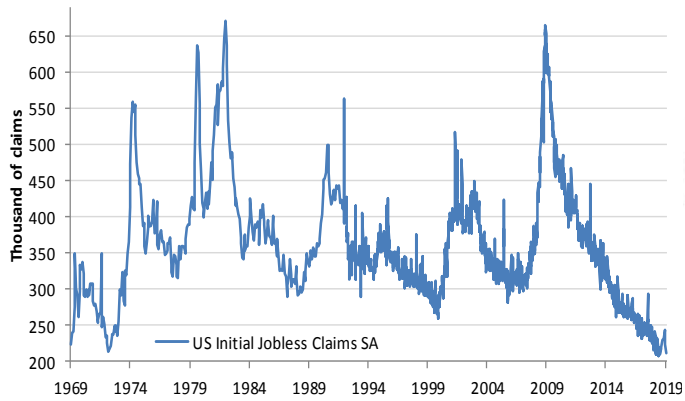


Deficit/Surplus

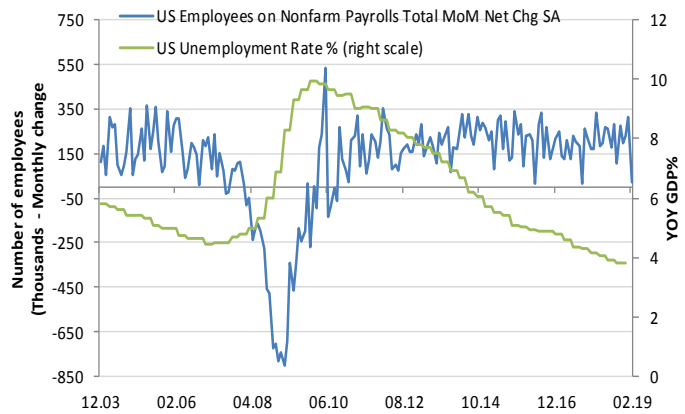


Graph sources: Bloomberg/BBGI Group

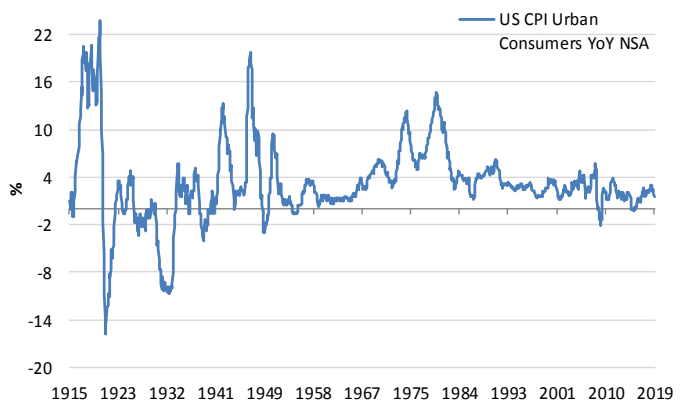
US Jobless Claims



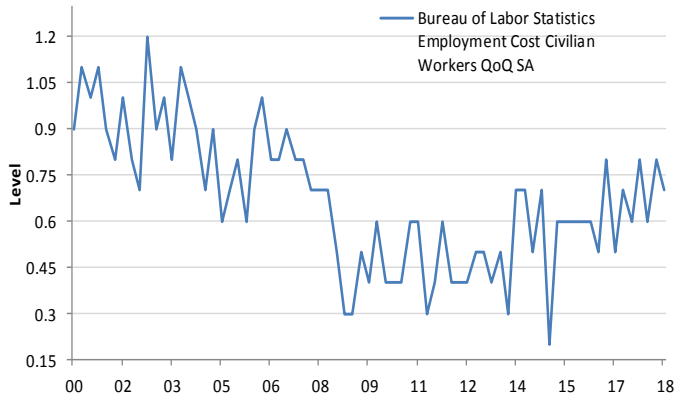
Non-farm Payrolls (MoM) and Unemployment rate



US Inflation (1914-2018)



Employment Cost Index



Graph sources: Bloomberg/BBGI Group

Pace of wage increases accelerates

Given the relatively tight job market, wages continue to increase in the US, bolstering the outlook for private consumption, which remains the main driver of economic growth. The average hourly wage jumped by +3.4% yoy in February, its largest increase since 2008. Adjusted for inflation, real weekly earnings progressed by +1.6% with a parallel increase in real hourly wages of +1.9%, thus substantially expanding US households' purchasing power. This is the largest increase in real hourly wages since November 2015 (+2%). The job market thus does not seem to be affected by the rising uncertainty often mentioned in the media.

The current state of quasi full employment will continue to impact wages in 2019. Indeed, upward pressure is likely merely to get stronger, assuming that job creation continues to exceed demand in the job market. The Fed will likely pay close attention to developments in the job market in spite of its recent position affirming a monetary policy status quo in 2019. We believe that, despite its recent shift in perspective, the Fed remains convinced that the expected strength of the job market will have two main impacts on its monetary policy. The first impact will be to rapidly strengthen the outlook for consumption, while the second impact will have a less immediate effect on price index increases.

Upswing in inflation and long-term rates

The decline in inflation over the past few months stemmed mainly from the fall in energy prices and will only be temporary. At the beginning of the year, we expected that the positive economic outlook would rapidly lead to a trend reversal with regards to fuel prices and push price indices back up.

Since 1 January, crude prices have surged +33% and should thus start to have an effect on inflation. Rising household income is increasing consumers' purchasing power and businesses' ability to increase their sales prices, thus intensifying inflationary pressures. We expect that before long inflation will once again exceed the Fed's stated target, although the Fed is unlikely to respond. Wage inflation will thus be a key factor in price index growth in 2019, which could be discernible more rapidly in the service sector.

For now, the leading economic scenario in the rates market still seems to be that growth will flag. The outlook for Q1 has indeed deteriorated slightly (+1.5%), but the upturn anticipated in Q2 (+2.6%) could be bolstered by the announcement of a solution to the on-going trade dispute between the Americans and the Chinese. The correction in long-term rates from 3.2% to 2.6% between November and December continued through the last days of March. This decline in long-term rates now seems excessive given the current economic context. We expect 10-year rates to rise concurrently with an improvement in economic figures before summer.

Consumption further confirmed as the main driver of growth

The outlook for consumption will continue to be tied to the evolution of households' disposable income, access to credit, and consumer confidence. The strength of the job market has contributed to improving consumer confidence, but a change in sentiment with regard to US economic conditions and in particular the uncertainty still weighing on international trade could have a significant additional impact on Americans' propensity to consume. US consumers are confident, and the decline in the sentiment indicator in March is probably just temporary. Private consumption will very likely be a key factor boosting GDP growth in Q1 2019.

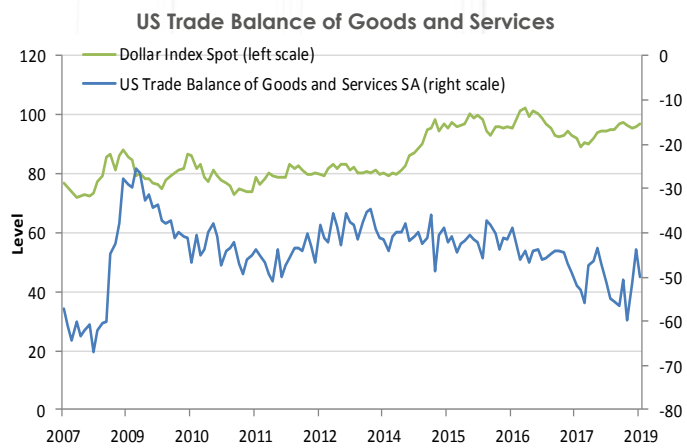
Moderately positive outlook for the dollar

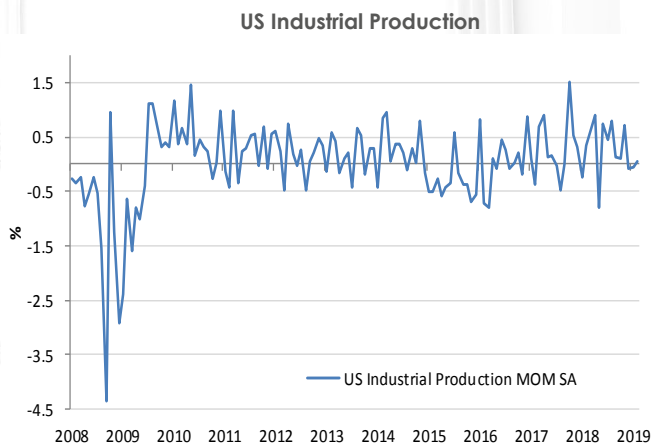
The dollar is still benefiting from attractive economic growth and interest rate differentials, in particular against the Swiss franc and the euro. This situation should persist and even intensify over the next few months, barring a huge surprise. However, in the longer run, yield spreads will likely be challenged by rising rates in the euro area and in other developed and emerging countries. We continue to forecast an increase in the dollar/Swiss franc exchange rate, which could reach 1-1.05 francs.

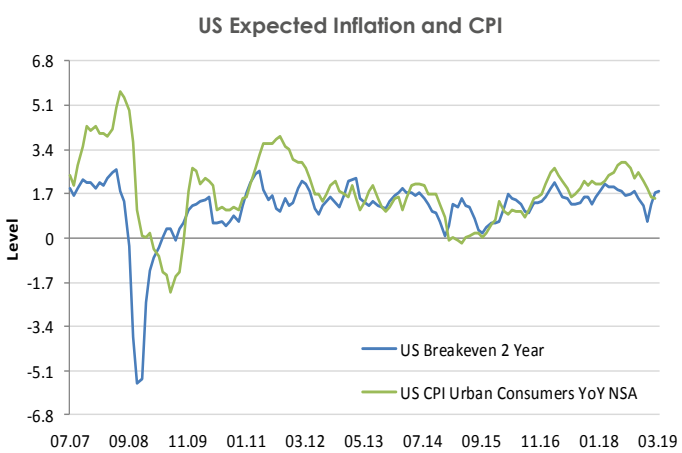
The US currency will likely very gradually become less attractive compared to the euro and emerging currencies, assuming the economic climate improves.

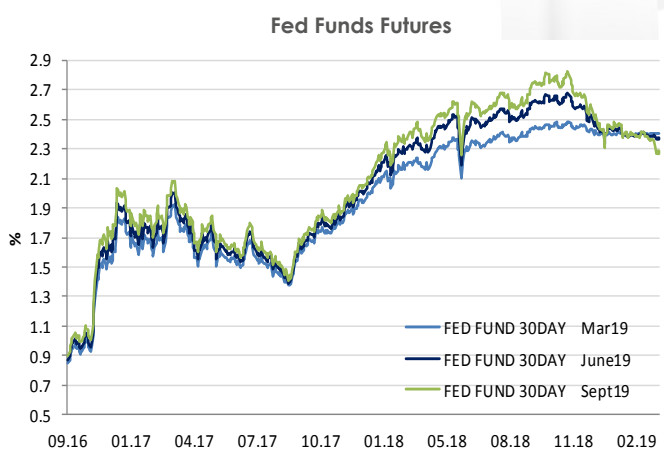
Take profits on equities

In our analysis earlier this year, we mentioned the positive outlook for US equities in 2019, noting however that an increase of the S&P500 back up to 2,900 would likely raise questions with regards to valuations. US equities closed the quarter up nearly +14%, the best quarterly performance since March 2013 (+14.14%) as well as the fifth best performance since 2000. The context is not negative for equities. Nevertheless, we recommend at least some profit taking after such a significant progression over barely a quarter.



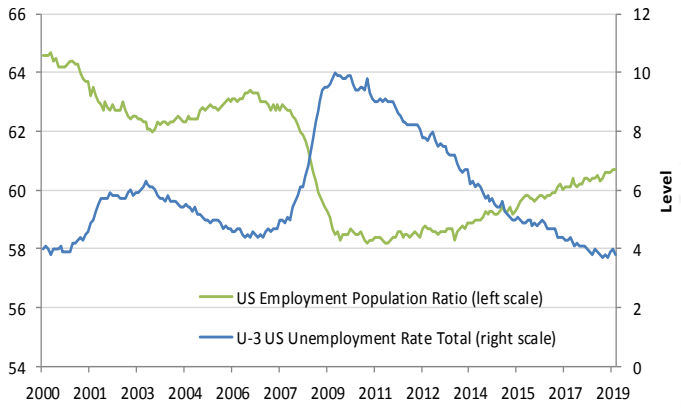




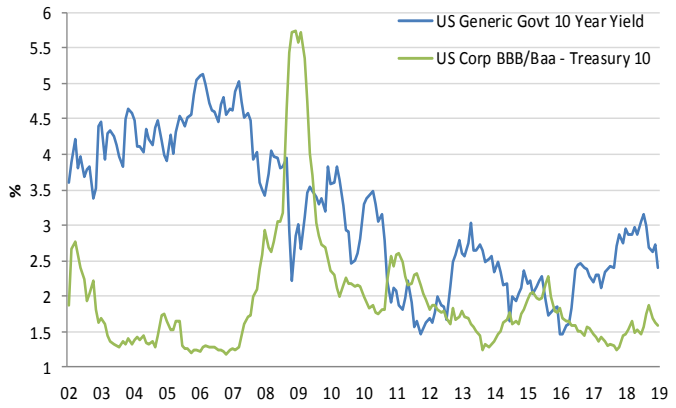


Graph sources: Bloomberg/BBGI Group

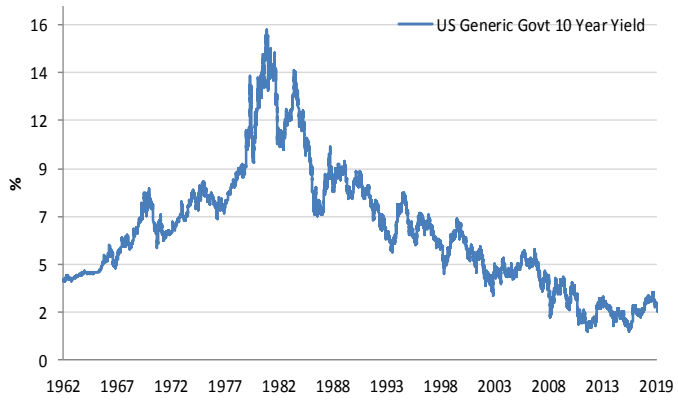
US Unemployment rate and Employment Population Ratio



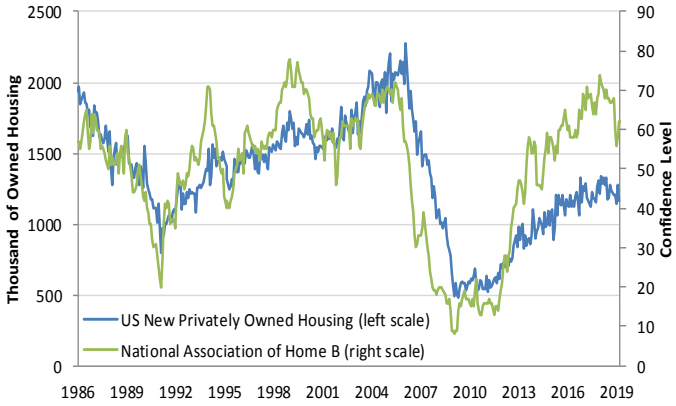
Yield spread Us Treasury - BBB 10 year



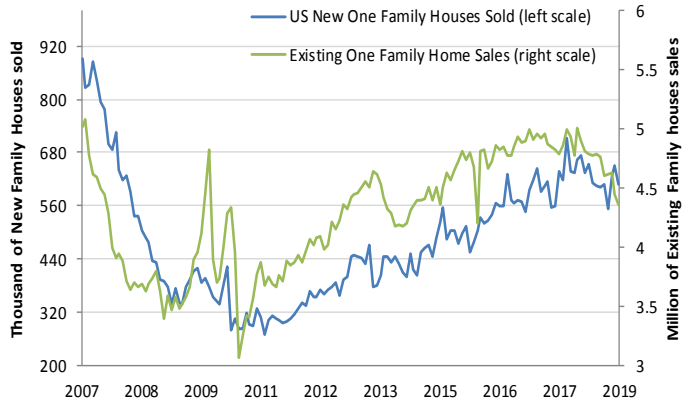
US Government Bonds 10 year yield



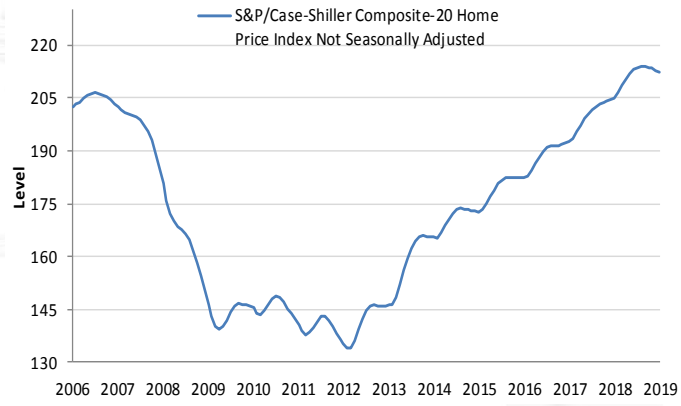
US New Privately Owned Housing and NAHB USA



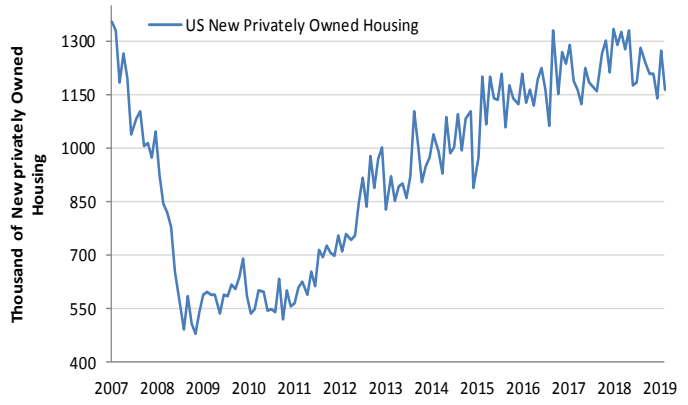
Sale of US New and Existing Family Houses



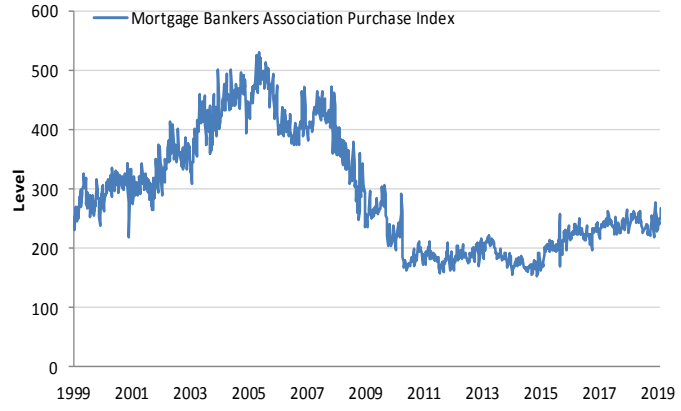
Real Estate Prices - S&P Case-Shiller Index



Housing Starts



New Mortgage Applications - MBA



Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

Switzerland

- Growth resumes in Q4 2018
- The manufacturing sector is the main driver of growth
- Improved outlook for Q2 2019
- Stabilisation of the Swiss franc favourable to foreign trade
- Long-term interest rate trends once again atypical

Growth resumes in Q4 2018

After the surprise contraction in Q3, the State Secretariat for Economic Affairs (SECO) released reassuring growth figures for our country showing a resumption of growth in Q4 2018. Indeed, Swiss GDP expanded by a welcome +0.2% on an actual basis adjusted for seasonal and calendar effects. After the -0.2% contraction in the previous quarter, the Swiss economy was able to avoid a second negative quarter and closed out 2018 on real GDP growth of +2.5% as estimated by the SECO. While this is a far cry from the exceptional results of June 2018 (+3.4%), it is still a satisfactory outcome given the slowdown in the European economy, a key economic partner for Switzerland.

Growth was well above average during the first half of 2018 but slowed down considerably during the second half. The Swiss economy was thus not able to dodge the global downturn. Switzerland's nominal GDP grew from 172.7 to 173.3 billion Swiss francs in Q4. For the full year, it came in at CHF 689.9 billion compared to 668.6 billion for 2017.

The Swiss economy thus returned to a growth rate comparable to that of 2014. Its growth path seems moderate, but given the difficult economic climate in Europe in the last quarter, Switzerland stayed remarkably resilient, while Germany just barely avoided a recession in Q4, posting growth of 0%, well below the country's average.

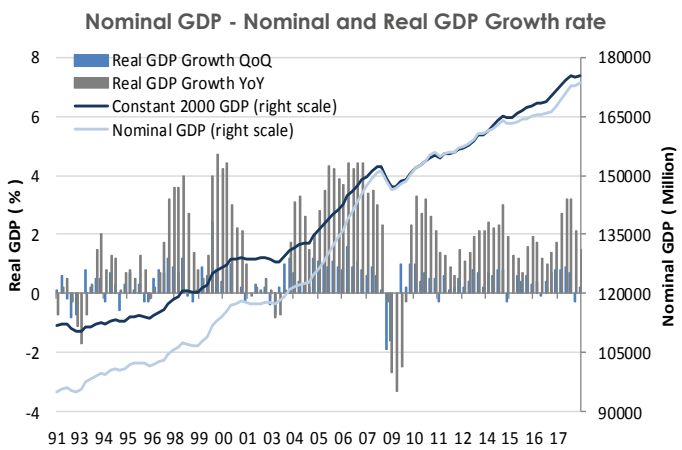
The economic forecast of the Federal Government's Expert Group was revised downward, as the context remains rather uncertain thus far in 2019. The 1.5% GDP growth forecast was reduced to +1.1% due to the slowdown in global economic activity and the latter's expected impact on Swiss exports.

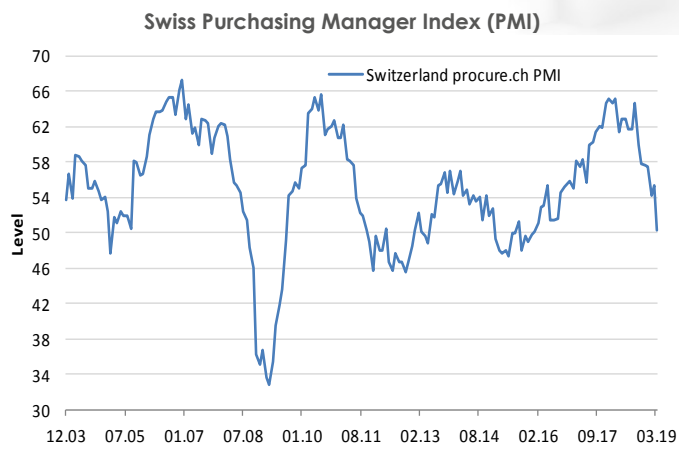
The manufacturing sector is the main driver of growth

Switzerland's real GDP reverted to positive growth in Q4 with a modest expansion rate of +0.2%. As domestic demand stayed relatively stable over the period, the increase in GDP was thus essentially caused by merchandise export growth and by the positive contribution of the manufacturing sector. While the latter had declined by -0.6% in the previous quarter, it recovered sharply in Q4, posting growth of +1.5%, thus contributing positively to GDP growth. The chemical and pharmaceutical segments performed particularly well. Other industrial sectors, such as watch-making and precision tools, as well as food, also posted higher revenues. Overall, the manufacturing sector benefited from improving global demand for Swiss products. This trend was highlighted by the sharp +5.6% increase in merchandise exports.

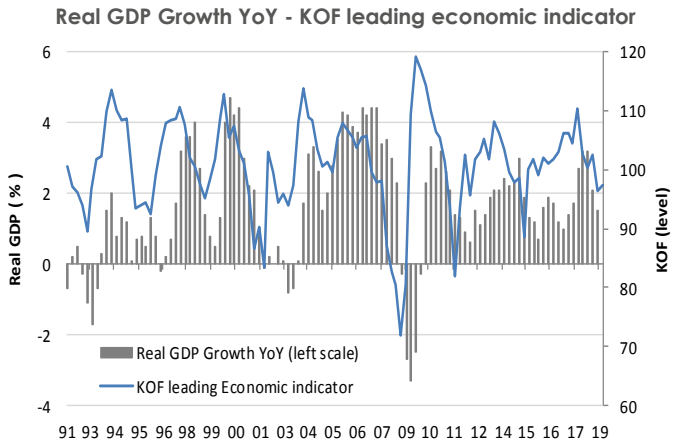
The consumption climate remained relatively glum with consumer confidence failing to show any real improvement. While private households did increase spending by +0.3%, which is significantly higher than in Q3 (+0.1%), this increase was mainly related to healthcare spending. A healthy job market and an unemployment rate at a 10-year low undoubtedly contributed to the positive trend in consumption, whose growth was nevertheless slightly below average.

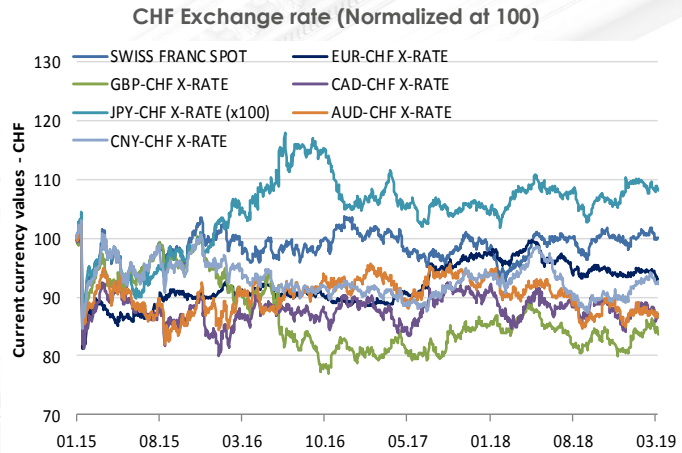
The services sector produced uneven results in Q4. While value added further increased in healthcare (+0.9%) and business services (+0.4%), it decreased for the third consecutive quarter in trade (-0.6%), as the slight improvement seen in retail was not able to offset the decrease in wholesale. The financial sector also continued to trend downward (-0.8%). Hampered by a decline in services exports (-2.6%) and still sluggish final domestic demand (0.0%), the services sector overall continued to perform below its historic average.





Graph sources: Bloomberg/BBGI Group





Investment in the construction sector dipped slightly (-0.4%) due in particular to the decline in building activity. The decrease in investment in equipment was significantly steeper (-1.1%), mostly due to the volatile R&D component, although investment was limited in other categories as well. Weak domestic demand translated into a slight decrease in goods and services imports (-0.5%).

For FY2018, the preliminary GDP growth estimate indicates a real GDP growth rate of +2.5%.The manufacturing industry was the main driver of growth. The sector benefited from strong global demand for Swiss industrial goods. Most other segments also displayed positive trends, with one significant exception: for the first time since 2011, trade posted a decrease in value added. On the demand side, foreign trade provided the main impetus for growth. In contrast, trends in domestic demand were less dynamic. Growth in private consumption in particular remained below average, hampered by weak improvement in real purchasing power. Similarly, investment in construction and equipment lost momentum compared to 2017.

Improved outlook for Q2 2019

Our baseline scenario for the Swiss economy remains reasonably optimistic following the economic upturn – however modest – of Q4 2018. Global economic conditions were clearly less favourable over the past few months, in particular in the euro area and in Germany more specifically. Our economy thus relied on stronger foreign demand from other economic regions and on resilient domestic activity. The economic downturn in Germany continues to be a factor of uncertainty in Q1 2019 that could negatively impact our foreign trade over the next several months. However, we think that the outlook for Q2 2019 should improve and bolster demand for Swiss goods and services. Uncertainty remains high in the absence of a trade agreement between China and the US. Nevertheless, we believe that it is in the two parties' best interest to reach an agreement that would dispel this uncertainty and boost confidence, consumption, and investment.

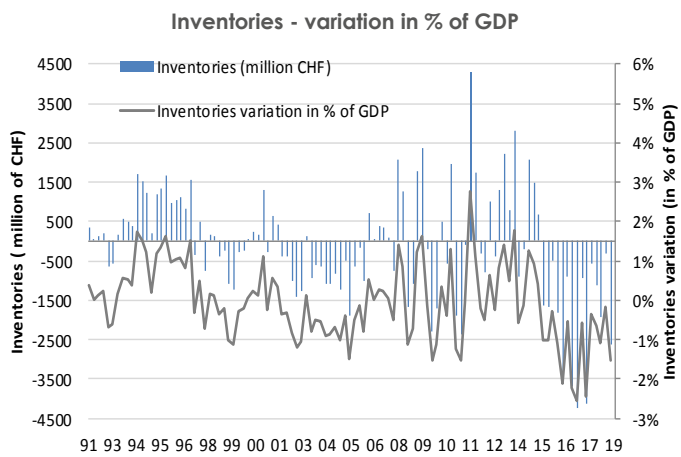
The stabilisation of the Swiss franc against the dollar close to parity and against the euro above 1.13 will also benefit Swiss foreign trade. Aside from exports, domestic demand will likely also continue to strengthen with slightly more robust growth in consumption in 2019. In this context, Swiss GDP is expected to grow by +1.5% in 2019.

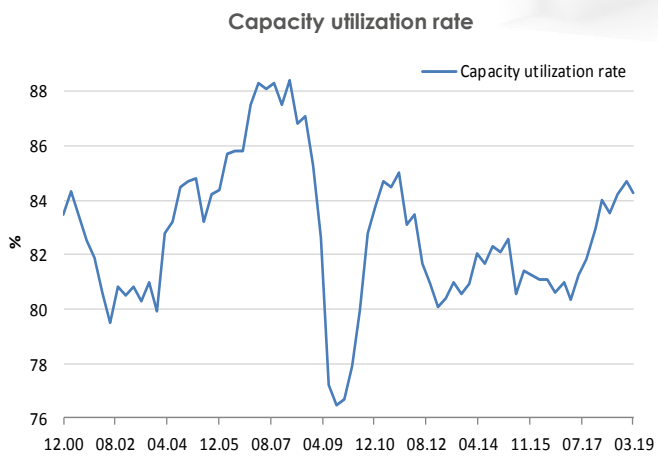
Leading indicators remain uncertain

The KOF leading indicator has continued to fall in the first months of 2019 – rather sharply, as the index dropped -16% from its December 2017 high (110.1), which marked the highest level of optimism since 2010, to its February 2019 level of only 92.4. The manufacturing PMI posted a slight uptick in February (55.4) over January (54.3), though it remains well below the 64.6 it reached in August 2018. Growth in the Swiss industrial sector should stay robust, however, as order books seem relatively full, indicating strong results with regard to production. In spite of these declines, the indicators remain in the growth range and continue to indicate Swiss GDP growth in the order of 1.5%. The likely slowdown in economic activity and results implied by weaker leading indicators suggests that economic performance will be slacker than expected several months ago.

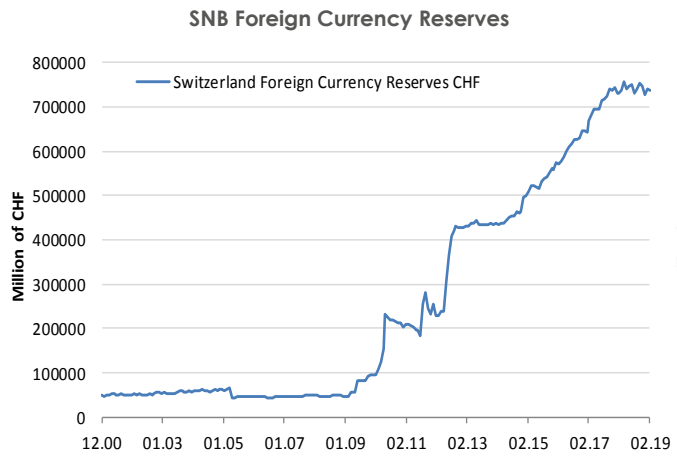
Consumption will likely also bolster GDP

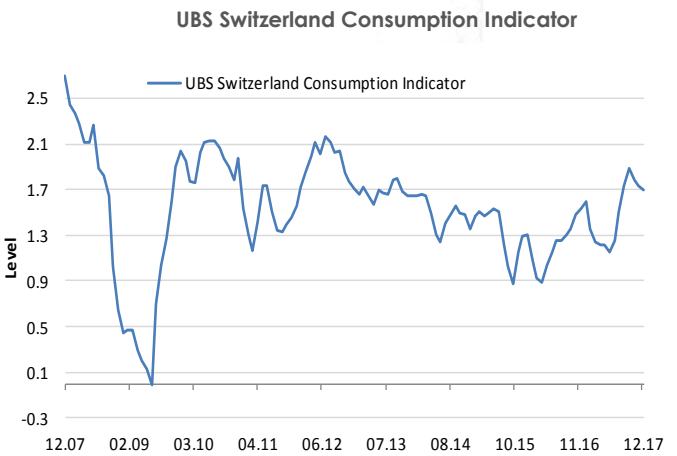
Consumption strengthened slightly in Q4 but has yet to benefit from the unemployment rate, which has been at a historic low (2.4%) for several months, likely because nominal wages have increased only slightly. Disposable income did rise, however, as did household debt, which increased by +1.63% in 2018. Consumer confidence did not change much but we expect private consumption to continue on a positive trend, bolstering GDP.

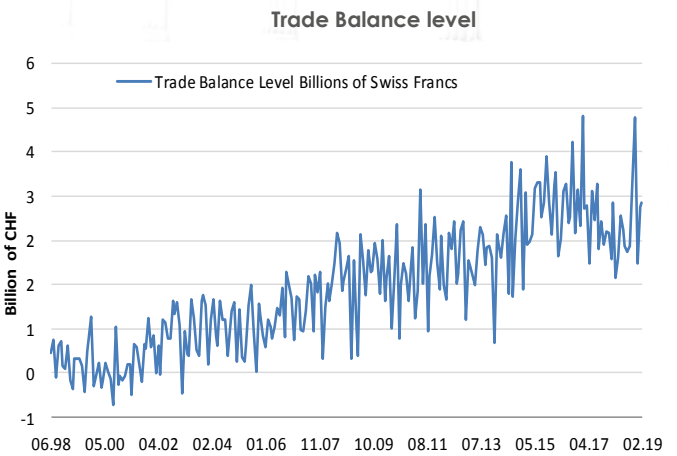


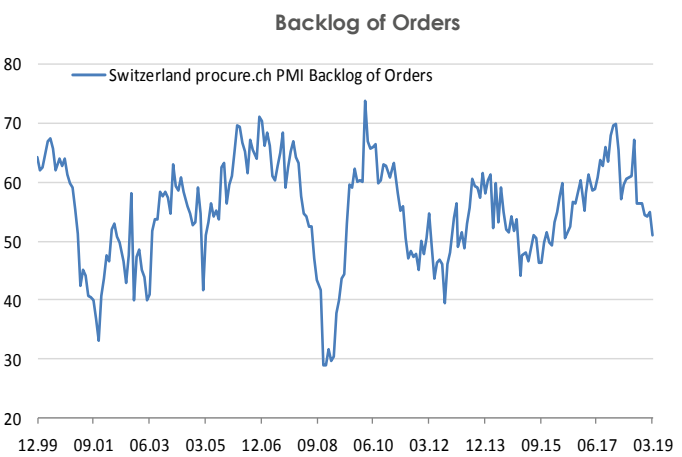


Graph sources: Bloomberg/BBGI Group









Graph sources: Bloomberg/BBGI Group

Stabilisation of the Swiss franc favourable to foreign trade

The Swiss economy grew at a pace comparable to that of the Eurozone in Q4, although it expanded significantly faster over the year as a whole. The growth differential was thus not an adjustment factor for the exchange rate, and in the absence of pronounced trends on the interest rate front, the franc continued to stabilise. We still believe that further depreciation of the franc will depend on the relative economic performance and interest rate spread between the franc and the euro. We do not expect the SNB to raise rates as rapidly as the ECB, which now seems unlikely in 2019. In the meantime, the exchange rate will likely stabilise between 1.12 and 1.17 against the euro. With regard to the US dollar, the rate spread and growth differential remain positive factors for the dollar. While this state of affairs is not new, it could be sufficient to further bolster trends favourable to the dollar.

Long-term interest rate trends once again atypical

While the normalisation of long-term interest rates in Switzerland started in the summer of 2016, the initial phase of adjustment rapidly stabilised at the 0% level for 10-year government rates before undergoing a significant further adjustment over the past five months. The surprise slowdown of growth in the Eurozone and in Switzerland along with the decline in inflation seen in our country from +1.2% in August to only +0.6% in February 2019 pushed 10-year government bond yields back into negative territory. The selloff in financial markets obviously benefited fixed income investments as volatility increased. What is more surprising so far this year is that interest rate markets have not yet reacted to the improvement in the stock market climate and investors' return into risky assets. Indeed, long-term interest rates are even slightly lower in February than they had been in December, which seems totally abnormal given the current context. Acceleration of the normalisation process will thus likely have to wait for an improvement in economic figures in Switzerland as well as in the euro area. In that respect, we expect Swiss long-term rates to climb back up over the next few months to their levels from the beginning of 2018. The performance of Swiss franc bond markets will thus likely be negative over the next several months.

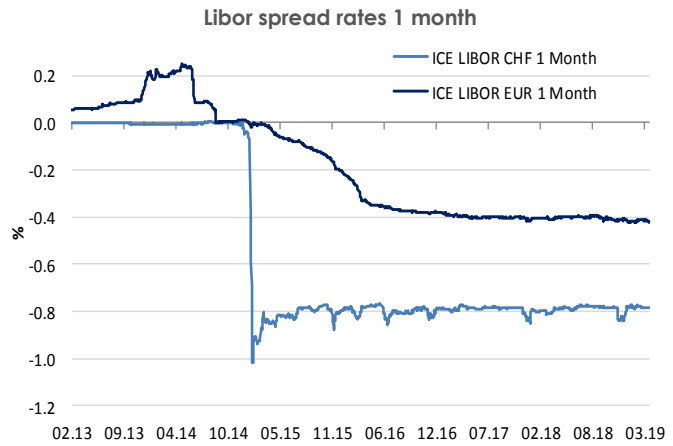
New record for Swiss equities

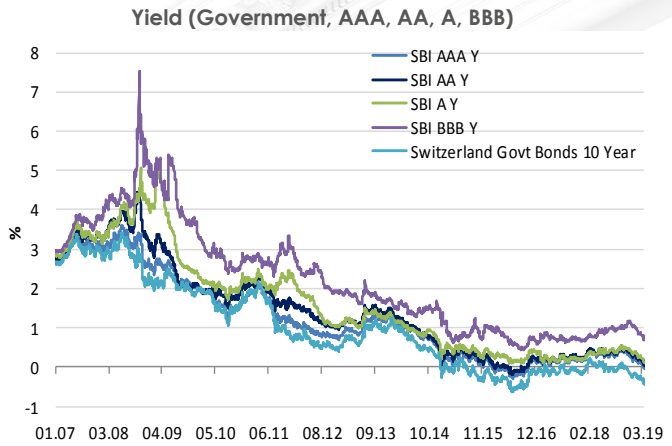
At the end of the year, following the sharp correction in the Swiss equity market, we noted that, barring a marked slowdown in global growth in 2019, the outlook for Swiss equities was favourable, in particular with regard to SPI stocks and to small and mid caps, which had been particularly impacted by the recent increase in volatility. The beginning of 2019 will have been as extraordinary as the end of 2018 for equity markets overall and for the Swiss market in particular.

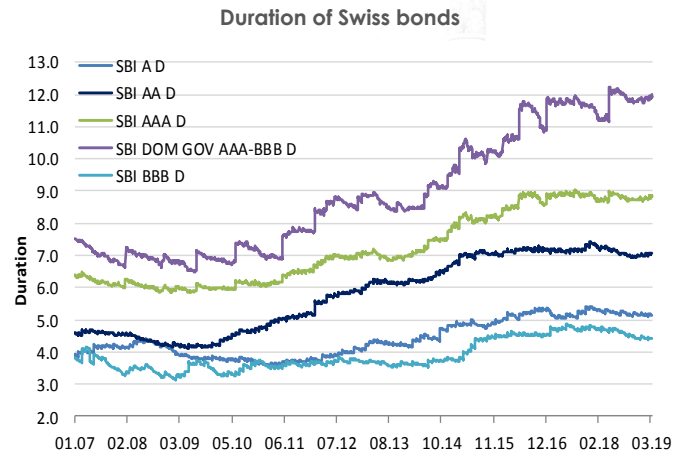
The correction of close to -10% of the SPI, reduced to -6.7% as of 31 December, rapidly gave way to a spectacular rally of +6.9% in January followed by a further increase of +4.28% in February and a promising start to the month of March, up +2.36% to date. Panic gave way surprisingly quickly to a certain euphoria, which nevertheless has no solid economic basis. The SPI index has thus exceeded the level it had reached prior to the sharp correction in December and is furthermore achieving new records in March, topping its January 2018 highs. Share prices have now risen +17% since the low of 27 December 2018. We now recommend a less exposed and somewhat more defensive strategy following the uninterrupted growth in share prices over the past ten weeks.

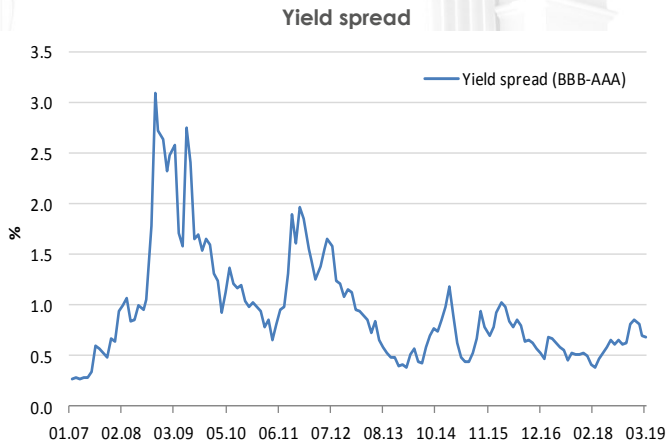
New record for securitised real estate

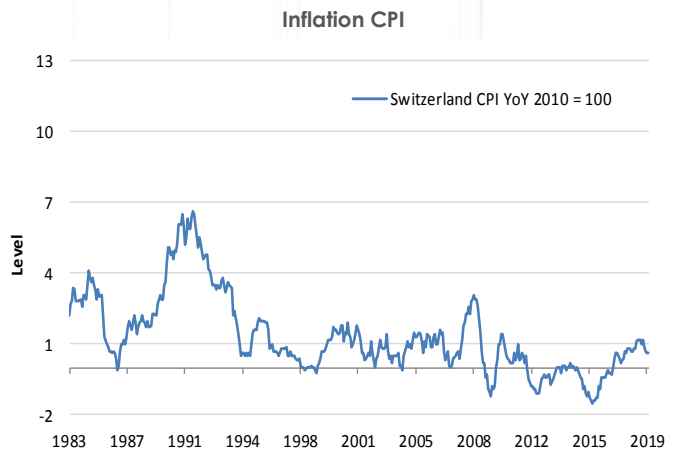
Swiss securitised real estate paints a similar picture, with the SXI Real Estate Funds TR and the SXI Swiss Real Estate Shares TR (real estate companies) indices posting new records of 390 and 2783, respectively. Securitised real estate remains an excellent alternative to Swiss franc fixed income investments, although recent momentum will likely decelerate in the short term. Prices are likely to consolidate temporarily in these two market segments after the 10% increases posted since the beginning of the year.

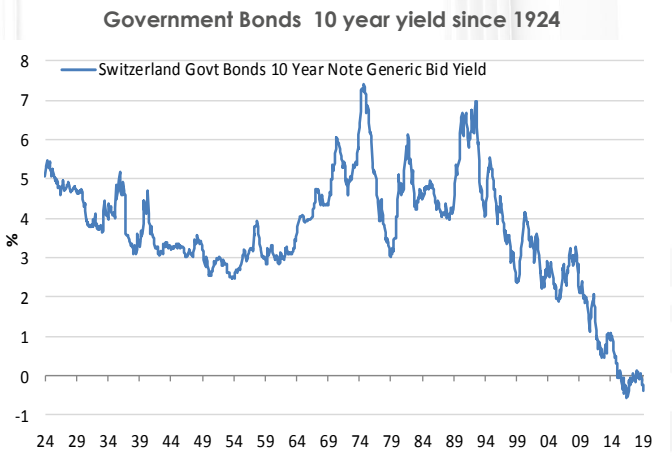


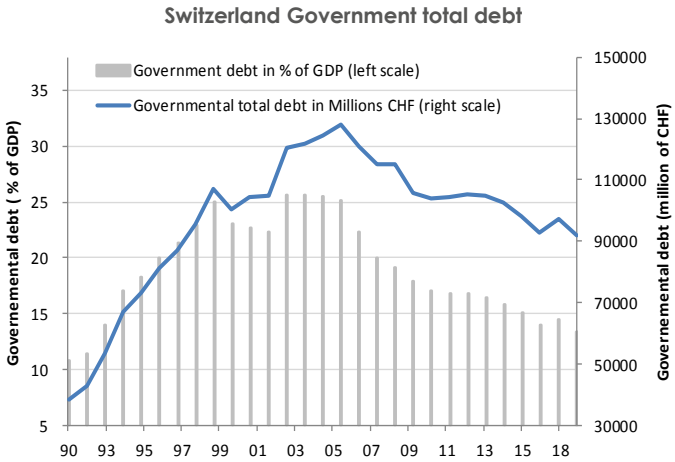


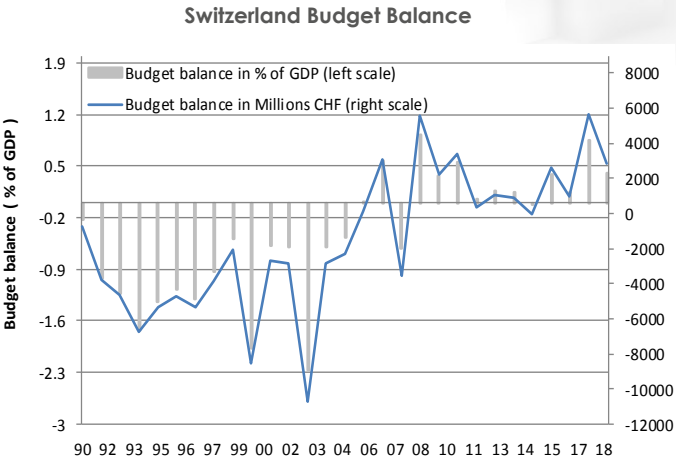












Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

Eurozone

- European growth still very weak in Q4 2018 (+0.2%)
- Situation in Germany hampering confidence
- Euro stays resilient
- ECB announces a new series of TLTROs
- Bond market yields temporarily vanish

European growth still very weak in Q4 2018 (+0.2%)

Signs of an economic slowdown in the euro area multiplied in Q4 2018, with a sharp downturn in Germany in particular. Indeed, the economic outlook for the Eurozone as a whole worsened due to legitimate concerns hampering economic activity in Germany and the latter's impact on growth in the Eurozone overall. GDP in the Eurozone and the EU ultimately progressed very slightly (+0.2%) after Q3 2018 growth was revised downward to only +0.1%.

The German economy narrowly dodged entering a technical recession thanks to nonnegative growth (+0.0%) in Q4, an outcome that Italy was unable to avoid following a second consecutive quarter of economic decline. Year over year, euro area GDP grew by +1.2%, slightly below the economic performance of the EU (28) (+1.4%).

The pace of growth thus slowed considerably in H2, mainly because of the weak performance of the German economy. Indeed, other European countries were more resilient, although they were not able to boost growth sufficiently to fully offset the German downturn, in spite of growth of +0.7% in Spain, +0.5% in the Netherlands, +0.4% in Portugal, and +0.3% in France. The German economy, which for a long time was the main engine of growth in Europe, is today significantly impacted by the decrease in international industrial demand.

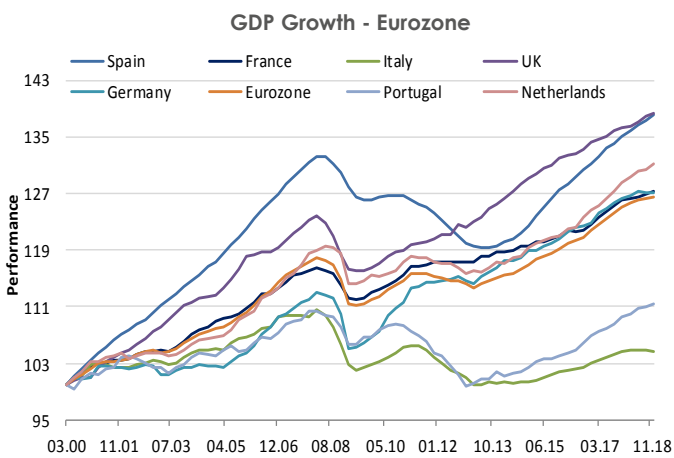
The largest economy in Europe is at a standstill and is threatening growth in other countries and regions in Central and Eastern Europe, which depend on German industry. The new European standards to which the German auto industry must conform are often mentioned as factors impacting the manufacturing sector along with the pressure exerted by Donald Trump. More generally, Germany has been more substantially impacted by the downturn in global demand for industrial goods of all sorts (equipment, machines, tools, vehicles, etc.) than its European partners. Global industrial production has thus contracted over the past few quarters, and this trend is also impacting intermediary goods and consumption goods. The weight of the industrial sector in Germany is significant and accounts for the country's poor performance compared to other EU members.

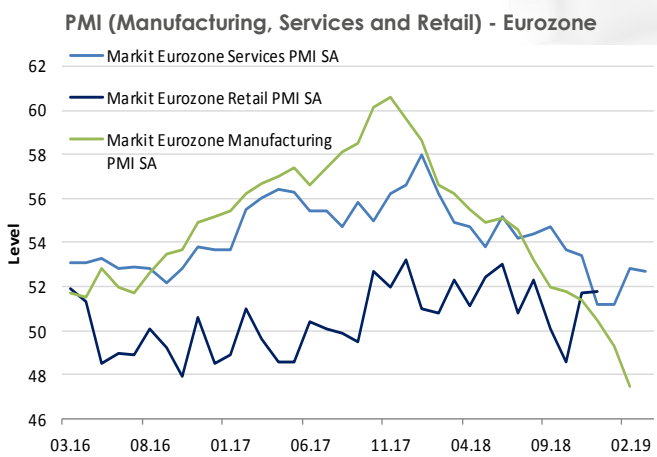
However, it is still somewhat premature to talk about a change in European growth drivers. We believe that the contraction in global industrial activity is more cyclical than structural for now and mostly tied to the uncertainty resulting from the US president's attitude towards his trade partners. An agreement is still expected between China and the US, which should result in a significant shift in economic sentiment and have a positive impact on global economic momentum in 2019.

Leading indicators may have already seen the worst but fail to bounce back

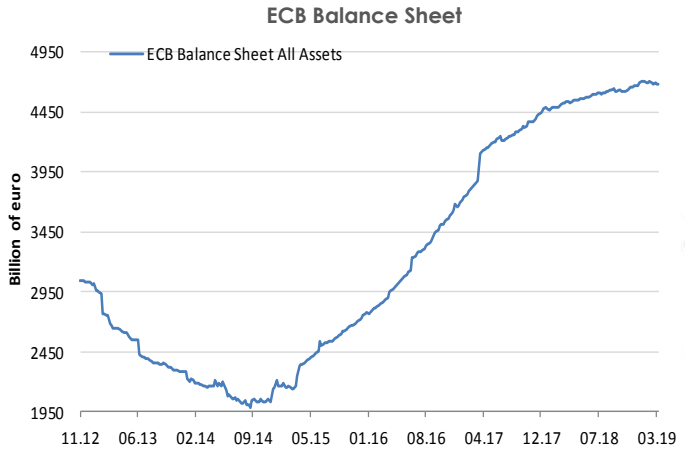
Eurozone manufacturing indicators still have not improved and instead have decreased further in March 2019. Investors' concerns were already palpable when the Markit PMI manufacturing index dropped below 50 in February (49.3), and the index's fall to 47.6 in March is likely to further stoke concerns with regard to growth in Europe in Q2. Indeed, the index's current level is its lowest since April 2013. The composite index was also impacted, slipping from 51.9 to 51.3, but stayed in the growth range overall thanks to the relatively strong performance of the services segment.

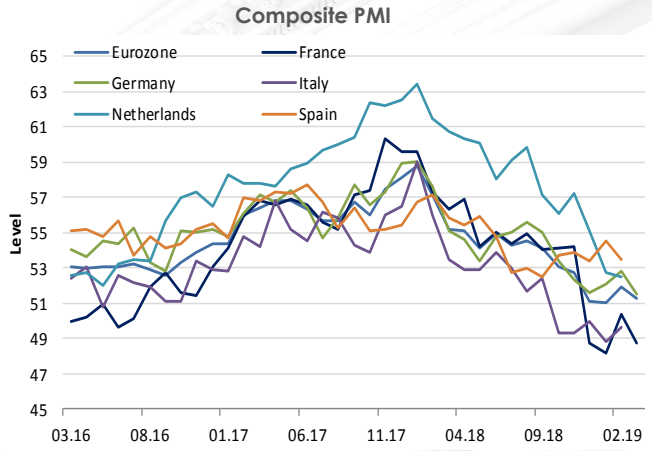
The performance of the Eurozone's economy is obviously suffering from its dependence on Germany, whose manufacturing PMI index fell even more sharply in February to 44.7, its lowest level since July 2012. The German industrial sector does not seem to be out of the woods yet. Industrial production contracted by -0.8% in February, and orders fell by -2.6%; no trend reversal is thus in sight. This is the third consecutive monthly contraction of industrial production.





Graph sources: Bloomberg/BBGI Group





Concerns are lingering and have even intensified substantially in view of the mediocre macroeconomic performance since the beginning of the year. The manufacturing sector is struggling, and leading indicators suggest that the sector's negative contribution to GDP growth may even intensify over the first three months of the year and in Q2.

Situation in Germany hampering confidence

Positive momentum in the job market is steadily building. Unemployment in euro area countries (7.8%) continued to decrease, returning to its year-end 2008 level, namely a decrease in unemployment of 35% compared to the high of 12% reached in 2013. However, this has not been sufficient to improve household confidence, as consumers are justifiably worried about the negative trend reversal that occurred in H2 2018, which seems to be persisting in 2019.

Similarly to the PMI indices, various measures of consumer and business confidence remain negative. The European Commission indicator gauging economic sentiment is only slightly less negative in March (-7.2) than it was in February (-7.4). Consumers, like businesses, seem to be increasingly concerned by the trade dispute between the world's leading economies. With Brexit just a few days away, the absence of a negotiated settlement is not helping in terms of calmly considering a withdrawal of the UK with no impact on the continent's economy. Yet, the ZEW Euro indicator, which reflects the economic outlook for the next six months, improved for the fifth consecutive month in Germany, although it remains in the negative zone, suggesting that pessimism is likely receding.

Euro stays resilient

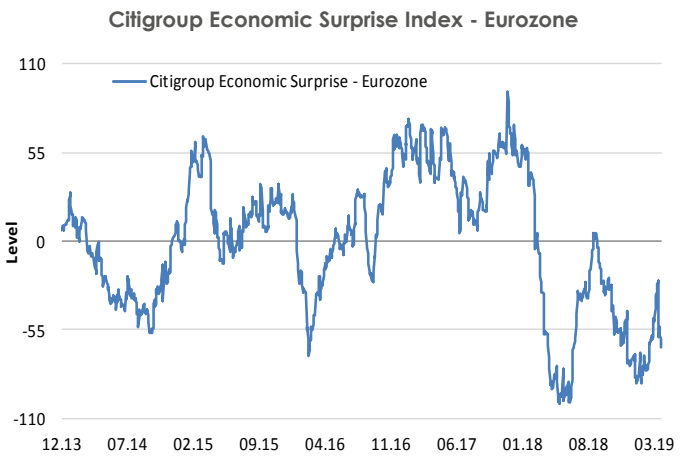
The economic environment has not improved in the Eurozone over the past several months. Nevertheless, the single currency has remained relatively stable despite an increasingly uncertain context. The decrease in euro-denominated yields has not really affected the currency, which stabilised at between 1.12 and 1.15 against the US dollar. Indeed, the interest rate spread to the US dollar and the divergence in economic performances have not caused any significant movements in the currency. The current exchange rate of 1.13 USD to the euro likely already incorporates the known risks of a downturn in the Eurozone.

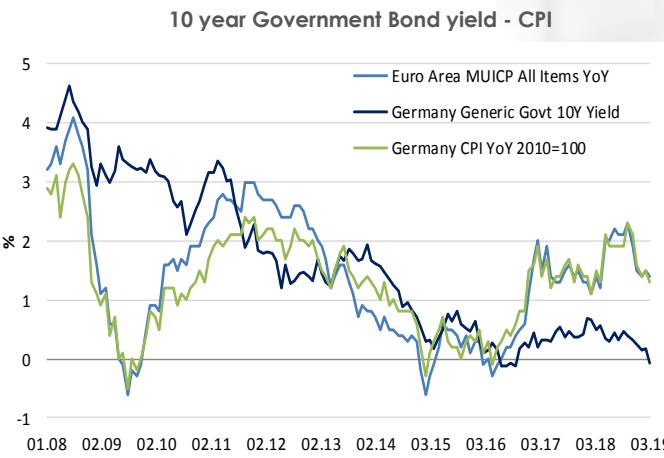
The current stabilisation could then give way to an appreciation of the euro in 2019, if the growth outlook normalises, which seems difficult to imagine currently. Otherwise, it appears likely that the euro/dollar exchange rate will fall in an environment characterised by strong downward pressure on long-term euro rates and a likely stabilisation of long-term US dollar rates.

ECB announces a new series of TLTROs

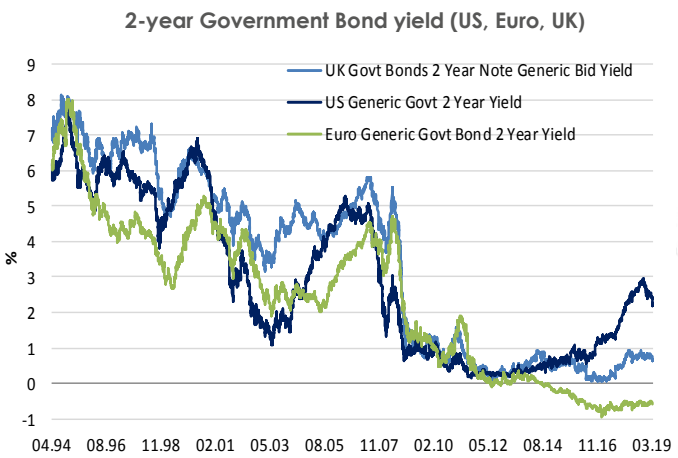
It is obviously not a huge surprise that the ECB changed its perception of the economic situation in Europe somewhat in light of the slowdown in the manufacturing sector and the weakness of the German economy. The growth forecast for the European economy announced at the ECB's most recent press conference was revised downwards from +1.7% (December forecast) to only +1.1%. Given the risk of an economic downturn in the Eurozone, the ECB decided to postpone raising target rates until 2020 and to resume policy loans to the banking sector.

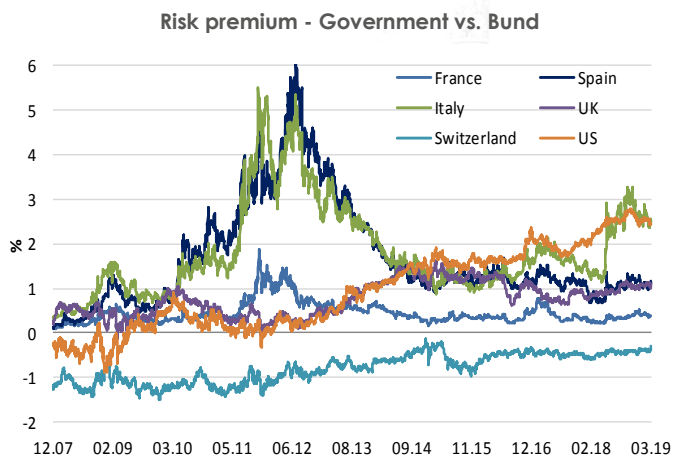
This announcement does not come as a surprise, as we already expected the economic slowdown at the end of 2018 to result in a deferral of any rate hike to Q4 2019 at the earliest. As for the second announcement, the ECB changed its position rather radically, announcing a resumption of liquidity injections to start in September after terminating its asset purchasing programme in January 2019. These liquidity injections will take a new form, as they will be targeting the banking sector, aiming to boost economic activity via an increase in loans to businesses and households. These new bank refinancing operations (TLTROs) could amount to up to 700 billion euros and aim in particular to avoid a contraction in credit.

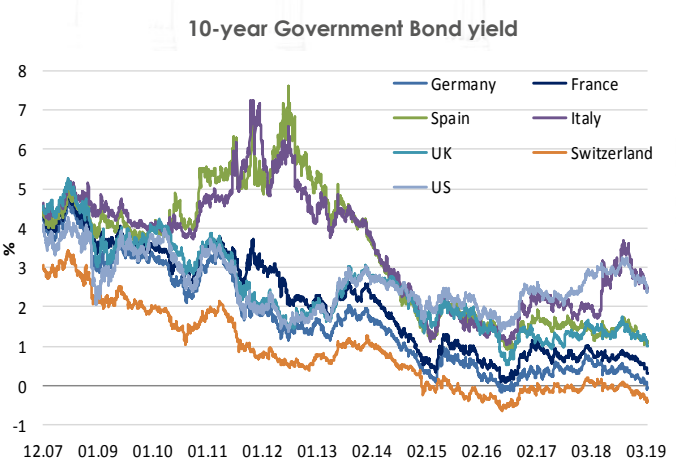


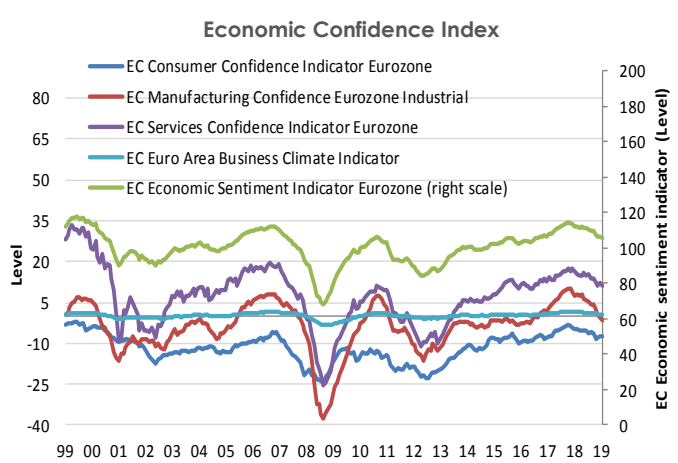


Graph sources: Bloomberg/BBGI Group









Graph sources: Bloomberg/BBGI Group

Bond market yields temporarily vanish

The economic slump in the EU has had a major impact on euro interest rate markets over the past six months. While the growth outlook steadily declined as leading manufacturing sector indicators dropped, euro long-term rates suddenly changed course, resuming a downward trend reinforced by a concurrent correction in price indices. Indeed, inflation has been decreasing rather sharply in the euro area in the past few months due mainly to the fall in energy prices. The CPI index contracted from its October 2018 high of +2.3% to only +1.5% in February of this year. Excluding food and energy, however, the decline in the core CPI index from +1.2% to +1% is less significant.

Investors' perception of where long-term rates should be at the beginning of 2019 shifted significantly as a result of these developments. Following European manufacturing PMI indices, euro long-term rates returned to their historic lows of 2016. The 10-year Bund yield is once again close to zero, indicating a rather extreme degree of pessimism among investors. President Draghi finally had to revise his expectations regarding inflation as well, in spite of his view that the vigour of the job market will put increasing upward pressure on wages, which will ultimately lead to an increase in underlying inflation over the next several months. The ECB forecast was thus lowered to +1.2% for 2019. Current trends point downwards, and the likelihood that long-term rates may rise has for now clearly receded in light of the economic weakness of the euro area. However, current levels of pessimism may already be extreme and are motivated in particular by the poor performance of the manufacturing sector. Leading indicators for the industry will have to stabilise and turn around in order for expectations regarding long-term rates to shift. More than ever we recommend avoiding euro-denominated bonds, as their medium-term outlook is mediocre.

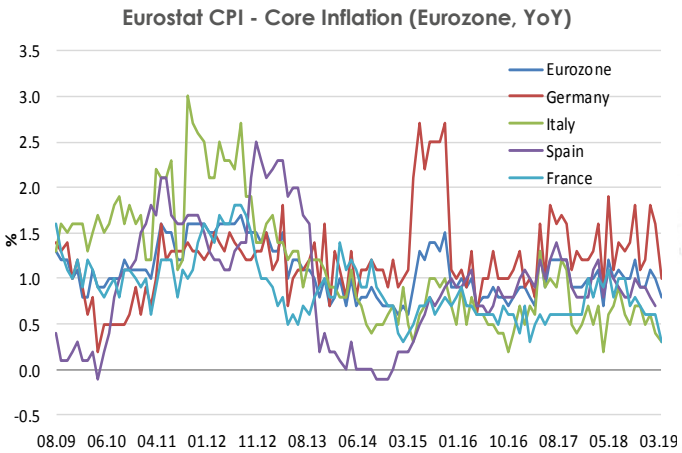
Profit taking in equity markets

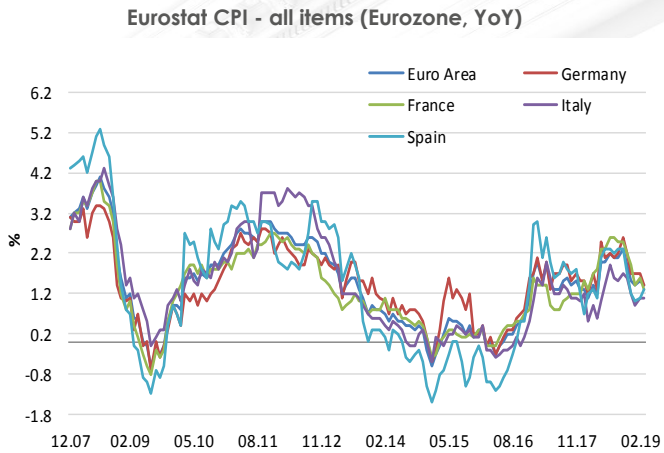
Several months ago we noted that European equities would likely benefit from a probable decrease in international tensions at the beginning of 2019 and from favourable arbitraging by investors due to the European market's positive risk premium. Indeed, the performance of European equities was boosted by a more positive investment climate at the beginning of the year. The Euro Stoxx 50 index of the largest European blue chips, the Euro Stoxx index and the STX Europe 600 all posted performances of close to +13% in under three months. By climbing back to their September levels, European markets rapidly recouped losses posted in Q4 2018.

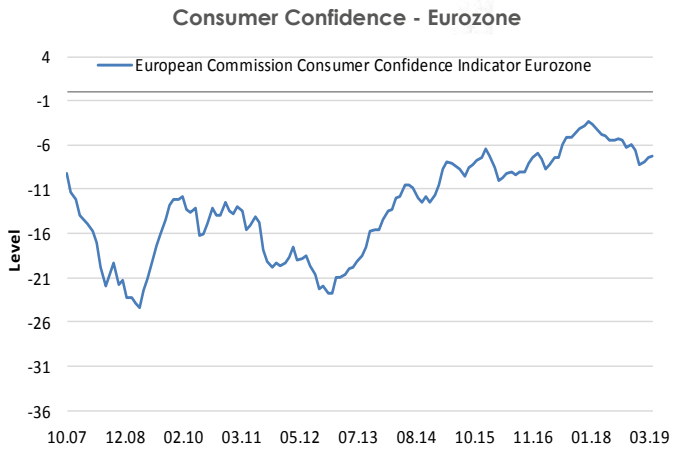
Following this encouraging growth, the European market's overall PE ratio bounced back sharply (13.2x 2019 earnings). However, given the rise of other equity markets, its valuation remains attractive on a comparative basis. The PE ratio of the S&P500 is already at 16.9x 2019 earnings, while that of the Swiss equity market is 15.3x. The valuation gap is holding at around 25%, a relatively significant risk premium, which has remained stable for several quarters. European shares maintain a valuation and yield advantage (3.6% vs. 1.9%), while the earnings outlook for 2019 is converging with that of US shares.

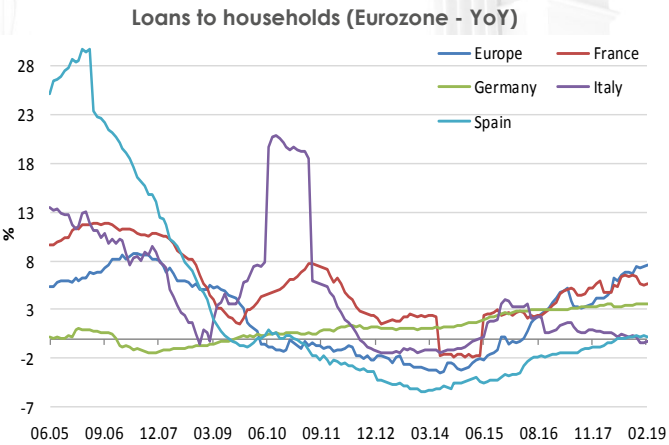
In spite of these positive factors, European equities are currently burdened by an uncertain macroeconomic environment and a discouraging news flow. The uncertainty tied to the protectionist threats by the US are, however, likely to gradually subside once an agreement is reached between the parties. Nevertheless, the European economy will also have to offer better prospects to warrant real outperformance by Eurozone stocks.

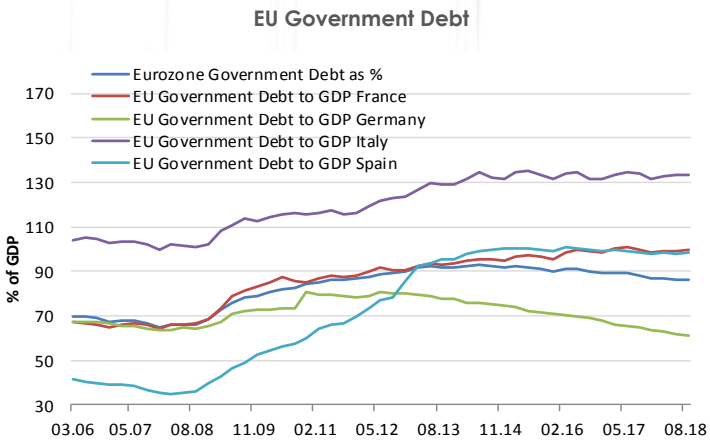
In this context, we recommend taking profits temporarily on European markets as a whole.

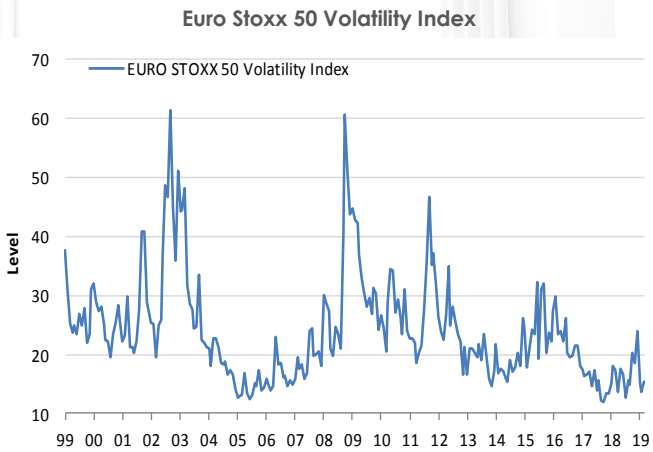












Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

United Kingdom

- The deadline has come and gone, now what?
- More time to avoid a no-deal withdrawal
- No-deal risks not factored into interest rates
- Brexit-related uncertainty further threatens growth
- Is the BOE prepared to hike rates?

The deadline has come and gone, now what?

Since 2016, 29 March had been widely proclaimed as the last possible moment to reach an agreement with the EU, in the absence of which a no-deal Brexit would be the default outcome. Close to three years of challenging talks have yet to produce a solution to the legal and political mess that was entirely to be expected in the aftermath of the referendum.

Today, while a swift resolution seems unlikely, almost no one wants a no -deal exit. There are thus only two solutions left to explore: a temporary extension or a new vote.

After having tried several times and without success to gain approval from Parliament for the agreement reached with the EU, Theresa May is taking a different tack, reaching out to the opposition Labour Party in an attempt to achieve a broader political consensus. This last-minute overture may have come into play too late in terms of reaching a compromise that Parliament might accept.

The British prime minister is thus attempting the improbable feat of bridging the gap between Conservatives and Labour to reach a compromise on Brexit. At time of writing, talks with the opposition le ader have started but have not yet produced any tangible results. It will likely be difficult to reconcile seemingly opposing views, such as Labour's demand to keep the UK in a customs union with the EU, which is clearly not an option for the Eurosceptics among the Conservative Party who want total discretion in terms of managing the country's trade policy.

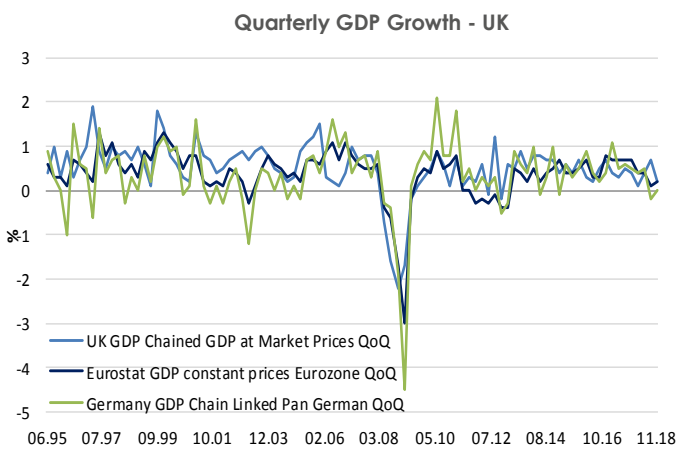
Theresa May was ultimately able to obtain from the EU an extension of the 29 March withdrawal deadline to allow sufficient time for talks to succeed. She had requested that the initial postponement to 12 April be further extended until the end of June. The EU finally accepted to push the deadline back much further (to avoid bringing the Brexit issue back to the fore too quickly).

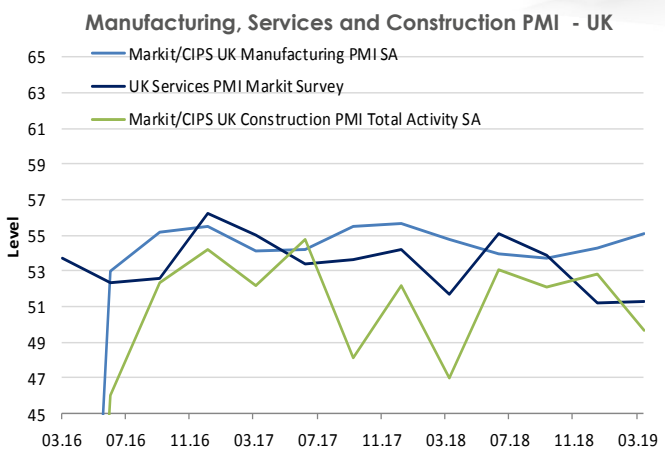
More time to avoid a no-deal withdrawal

What seems clear at this stage is the shared desire to avoid a no-deal Brexit. To this end, the EU has been willing to make minor concessions, such as extending the withdrawal deadline. Recall in this respect that, at the time of the June 2016 vote, we had already predicted that Brexit would take time and that the deadline would likely have to be extended by two years beyond the timeline provided in the EU treaty.

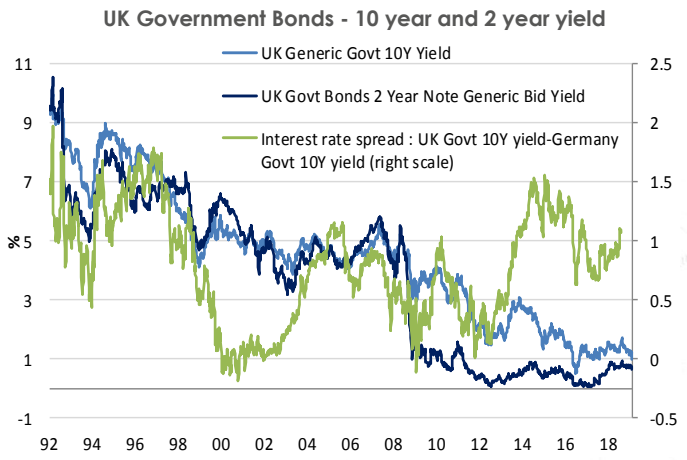
This possibility has now become an absolute necessity. The likelihood of an extension was thus never really in question. What had to be determined was essentially its duration and the terms and conditions set by the 27 EU members in order to give the UK time to come up with a clear and acceptable policy. As European institutions should be able to come out stronger from this process, the constraints placed on the UK for an extension were likely to be relatively strict. While Theresa May would likely prefer to come up with a solution sooner rather than later, namely before 23 May, the EU wanted to give itself some time, considering the challenges of the undertaking, and thus offered a longer extension until 31 October 2019.

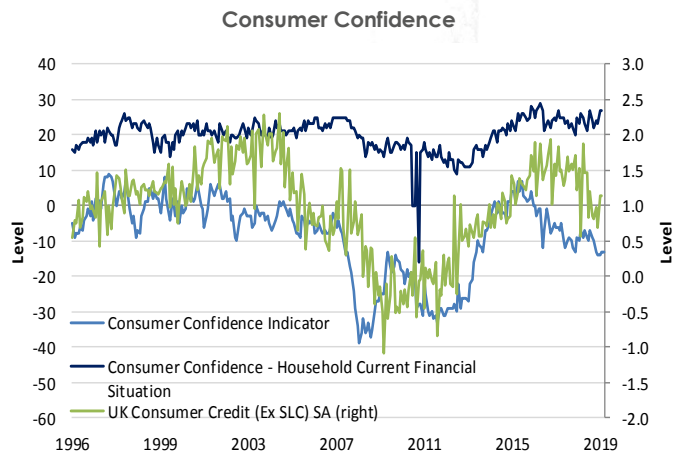
While a one-year extension was occasionally mentioned, our feeling that ultimately the EU would grant a six-month extension was confirmed. Indeed, following the European summit on 10 April, Theresa May was given over six months to find a credible solution to the current crisis. The issue of the European elections, which had still been up for debate, was finally settled, and the British government will organise European elections on 23-26 May, even if the stated objective remains to withdraw from the EU before this date.

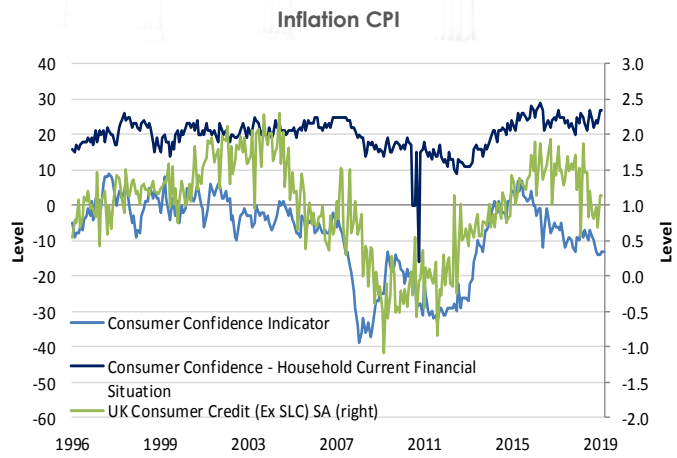


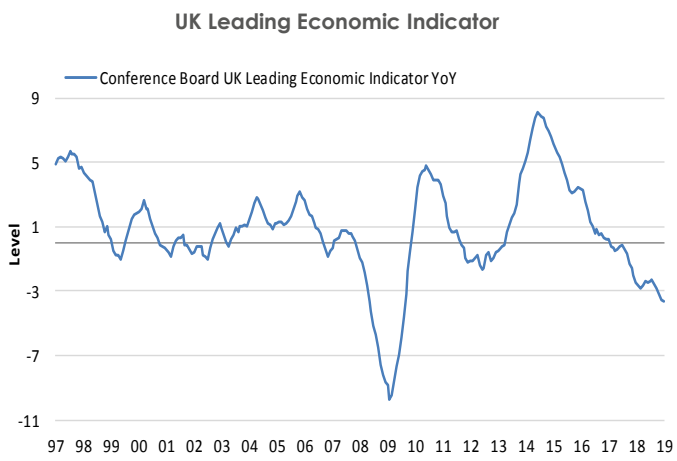


Graph sources: Bloomberg/BBGI Group









Graph sources: Bloomberg/BBGI Group

No-deal risks not factored into interest rates

The first Brexit deadline on 29 March 2019 came and went without an agreement being reached between the UK and the EU. The country's complex political situation prevented Prime Minister Theresa May from gaining approval from Parliament for her proposed solution. A no-deal withdrawal on 13 April or 23 May is increasingly likely. The impact of such a political failure does not seem to have been genuinely factored in by financial markets, which prefer not to consider this outcome, which would be particularly negative for the British currency and the country's economic growth, as well as for inflation most likely, to mention just the key points. Given the circumstances we fear that the current level of long-term rates (1%) is absolutely not suited to an economy that could very quickly fall into stagflation, i.e., slower growth and rising CPI and PPI indices. Especially low yields in pounds are indeed tied to a risk of sudden capital losses and a devaluation of the pound as well as a likely loss of investor confidence.

This environment is not particularly attractive, and we recommend discontinuing any exposure to the British rate market. Inflation in the UK had reached 3.1% in 2017 with the fall of the pound before gradually sliding back down to 1.8% in March. The risk that inflation will climb back up following Brexit obviously depends on how the issue is resolved and will certainly be much higher in the case of a no-deal exit.

Currency could still be hit by a no-deal Brexit

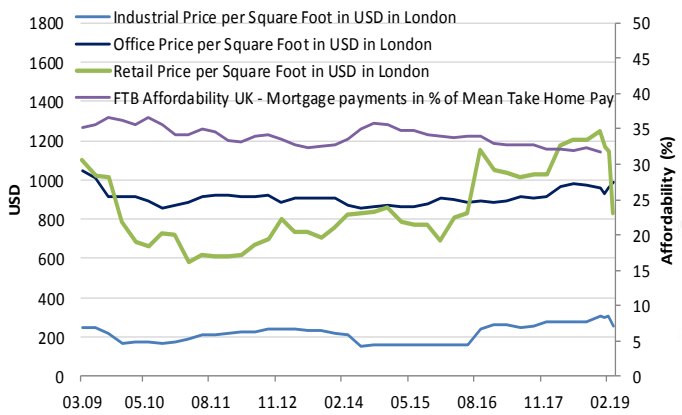
The pound is more than ever hostage to the complex political situation surrounding Brexit. The UK should already have withdrawn from the European Union on 29 March without a deal. As a no-deal exit is unquestionably the worst possible outcome for both the UK and the EU, Theresa May was granted an extension so she could attempt some last-minute political manoeuvring to avert the looming disaster. On 13 April, or ultimately on 23 May, a solution will have to be approved. At time of writing, the situation has reached a political deadlock, which surprisingly no longer seems to be affecting the pound. The British currency has indeed been stabilising for the past nine months pending a negotiated Brexit solution. The likelihood of a no-deal outcome seems not to have been factored in for now, even though the risk of devaluation is far from negligible. Given this context, we remain cautious on the pound.

Brexit-related uncertainty further threatens growth

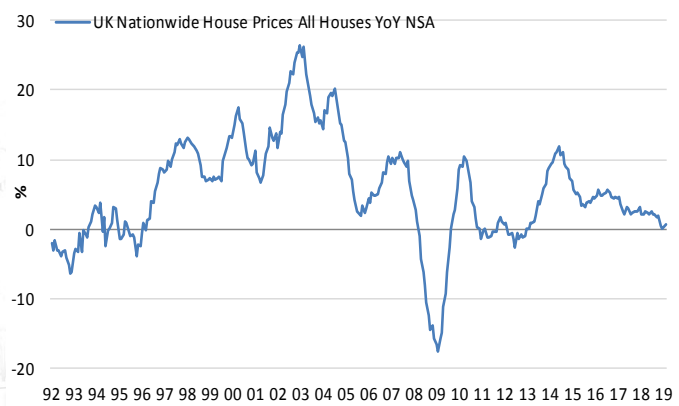
Months are going by with no solution in sight, as the British economy remains mired in a political crisis that is heightening the uncertainty facing businesses and consumers day by day. The latest release of the PMI Markit/CIPS UK Composite indicator in March points to a continuation of the trend underway over the past several quarters. The 50-point level reached in March (51.4 in December 2018) indicates that the British economy is now on the threshold between growth and recession. In contrast to other countries, in the UK it is the manufacturing sector that seems to be recovering after declining fairly steadily in 2018, jumping from 52 to 55.1 in March. With regards to services, which have been more resilient in other economies over the past several months, the UK PMI dropped below the growth threshold, coming in at 48.9 in March, among the lowest levels reached in the past decade.

With the decline of the services indicator, the risks of economic contraction in the UK have intensified and could predict a recession in the next few months. The 29 March deadline set in 2016 likely slowed down various projects and decisions pending better visibility, but as of April the situation is not any clearer, and confidence levels and the outlook for the coming quarters are likely to decline further. The relative resilience of the composite index is of no great comfort either, given that the main reason it did not drop below the growth threshold was because businesses have been stockpiling materials, concerned with regards to possible supply disruptions following Brexit.

Housing Prices



UK Nationwide House Prices



Recession or major shock to follow no-deal Brexit

Leading indicators thus seem to be pointing towards a contraction of GDP following near-zero growth in Q1 2019. The postponement of Brexit, possibly to 30 June, should not be considered a positive factor in terms of the UK's GDP in the immediate future. Growth of +0.2% in Q4 2018 will likely be followed by zero growth in Q1. However, risks are increasing with regards to Q2 2019 and the year as a whole. Nevertheless, British consumers seem not to have been overly affected by the Brexit mess so far. Since 2016, they have been shoring up domestic demand, without however being able to generate enough momentum to significantly boost consumption. The unemployment rate remains close to 4% and is one factor supporting an increase in wages and purchasing power, as inflation is in fact rather moderate at this stage (+1.8%). Households' real disposable income increased, but household debt also rose for the ninth quarter in a row. The public sector may be able to shore up growth, as was the case in Q4 2018 with a +1.3% contribution. The most forceful reaction has come from businesses –unsurprisingly given the highly uncertain context, they are slashing or at least postponing investments. The contribution of business investments was thus once again negative in Q4 (-2.5%) for the fourth consecutive quarter, the longest period of contraction since the beginning of the financial crisis. This trend is rather unlikely to reverse given the current context. The current account deficit grew further to over 30 billion US dollars, or close to 4.4% of GDP. Yet initial GDP growth figures in January were showing a strong recovery (+0.5%), a volatile result offsetting the -0.4% drop in December. However, figures for February also suggest an economic upturn in Q1 2019, as GDP was up +0.2% over the month, confirming a slight upswing. Industrial output is back in positive territory yoy (+0.1%) after sliding -0.9% in January. Manufacturing and construction also seem to be faring somewhat better (+0.6% and +3.3% yoy in February, respectively). However, the IMF warned that the British economy risks a serious shock if the UK leaves the EU without a deal. The IMF, considering the possible impact of a no-deal exit, concluded that there is a considerable risk of significant disturbances at the border as well as substantial increases in the prices of imported goods, impacting both businesses and consumers. The IMF estimates the negative impact on GDP growth to be 1.4% in the first year and 0.8% in the next year.

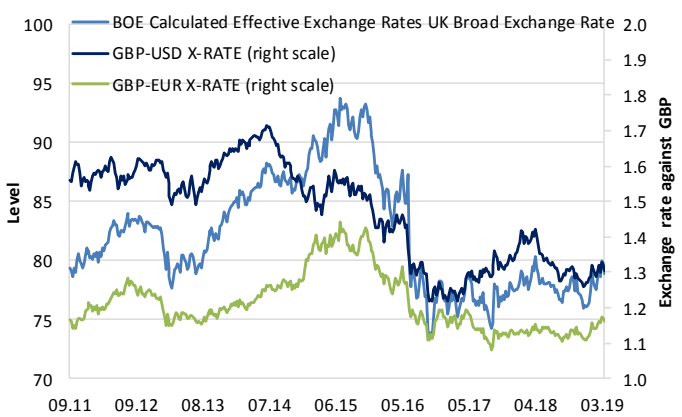
Is the BOE prepared to hike rates?

The recent decrease in inflation, which dropped back below the 2% threshold, gives the BOE a little more room to breathe. The Bank had had to raise its policy rates twice in 2017 and then abstained from any further action given the stabilisation of the pound, the decrease in inflation, and the economic slowdown. The Bank remains particularly attentive to political developments related to Brexit, most likely hoping that a no-deal withdrawal can be avoided. If such is the case, the BOE will likely want to 'normalise' its monetary policy, raising rates toward its long-range target of 2-3%. Nevertheless, should this be the case, we expect the BOE will be unlikely to act hastily and will likely leave its rate unchanged at 0.75% in 2019. If no agreement is reached, the BOE will have limited room to manoeuvre. However, it has already indicated that in this event it would probably have to raise rates to counter the inflationary pressure likely to be caused by a depreciation of the pound, the introduction of customs tariffs, and supply disruptions. Nevertheless, it is not clear that the BOE would implement this policy immediately, as the economy would need any help it could get. It is thus entirely conceivable that the Bank would initially lower policy rates.

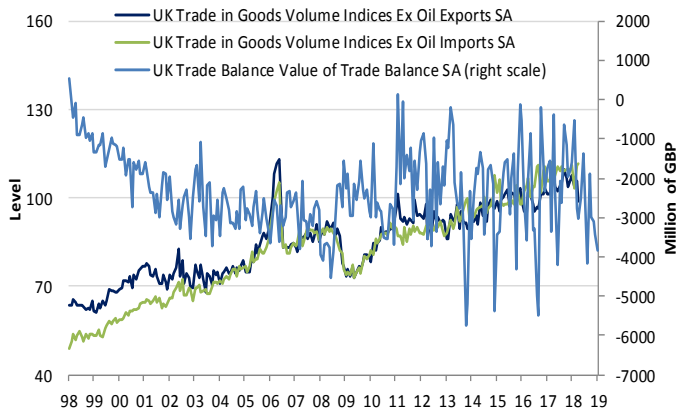
Caution on equities and real estate

Given the still uncertain context surrounding the Brexit talks, the equity market's expected risk/return ratio still seems unattractive. While the pound seems to be withstanding the uncertainty, we continue to recommend caution with regards to UK equities, in spite of reasonable valuation levels and an attractive dividend yield. The uncertainty surrounding the unresolved issue of what shape Brexit will take continues to weigh on real estate prices in the UK, which are increasingly volatile this year. The recent publication of residential property prices for March (-1.6%) stands in contrast to the February upswing (+6%), which had been preceded by a -2.6% drop. Housing prices fell more sharply in London than in the rest of the country. Brexit continues to cast a shadow over the British market, which still does not offer any repositioning opportunity. We recommend staying away from this market for now, as the Bank of England is suggesting that real estate prices may plunge -25% in the case of a pessimistic no-deal Brexit scenario.

UK Effective Exchange rate



Trade Balance - Exports - Imports



Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

Japan

- Positive surprise with uptick in GDP in Q4
- Increase in wages not sufficient to boost consumption
- Leading indicators under pressure from the manufacturing sector
- The BOJ revises expectations for recovery
- Necessary depreciation of the yen

Positive surprise with uptick in GDP in Q4

Japan's quarterly economic results were rather variable throughout 2018. The upward revision of Q4 GDP growth to +0.5% (+1.9% annualised) offset the shock of the previous quarter's -0.6% contraction, the economy's worst performance since 2014. The Japanese economy thus expanded faster than expected over a quarter that was rather challenging for most economies globally and for the Eurozone in particular. Thanks to this sharp upswing in economic activity, Japan was able to avoid entering a technical recession after a challenging third quarter. These results exceeded forecasters expectations but remain fragile given that the global economic context has remained uncertain thus far in 2019.

2018 thus closed on a positive note, underscoring, however, the volatility and instability of the economy, which alternated, each quarter, between expansion and contraction. The impact of natural disasters on GDP were significant in Q3, causing a drop in firms' capital expenditure (-2.8%) and industrial production. In contrast, private consumption increased by +0.6% in Q4, while capital spending jumped by +2.7%. The latter figure seems to indicate that the upward trend in capex is structural, which should be confirmed by continued investments in 2019, unless foreign demand falls once again. Japan is feeling the effects of the labour shortages resulting from its ageing population. Exports, an essential driver of GDP growth for Japan, fell once again in Q4 due to a decrease in foreign demand. The continuing uncertainty tied to the trade dispute between the US and China is weighing on confidence and affecting the Japanese economy. This uncertainty continues to be the main threat to GDP growth, particularly given the yen is expected to continue to depreciate over the next few months. Indeed, the currency factor remains one of the key elements necessary for more positive GDP growth.

Trade surplus back on the rise (339 billion)

The trade balance returned into positive territory in February with a surplus of 339 billion yen (116 billion seasonally adjusted) and will contribute positively to GDP growth. These results notwithstanding, Japanese exports continued to decline, dropping by -1.2% following a decrease in Asian demand, which represents close to 50% of Japanese exports. Fortunately, exports to the US and Europe delivered a more solid performance. Ultimately, exports fell by only -1.2% yoy, mainly due to a decrease in exports of vehicles and semi-conductors (-14% to South Korea). Japanese exports to China grew +5.5% yoy in February, following a -17.4% correction in January. The -6.7% fall in imports in February contributed significantly to the positive outcome in foreign trade, concealing the continuing weakness of the export sector.

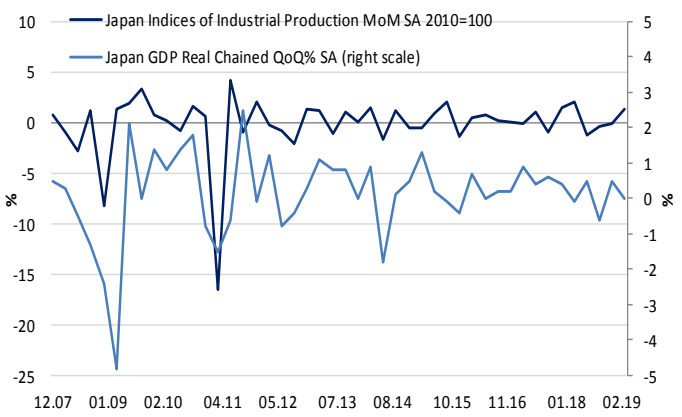
Increase in wages not sufficient to boost consumption

Wage negotiations currently underway in Japan seem less promising than last year's, although the Japanese prime minister is putting pressure on large corporations to raise salaries and contribute to fighting deflation. However, the global economic context and the fall in exports are not favourable to wage hikes at present. Large corporations will likely prefer more flexible solutions such as paying out bonuses rather than increasing their fixed costs. Wages are thus unlikely to increase by more than +2% in 2019, or slightly less than average wage growth in 2018. In this context, Japanese consumers remain especially cautious, in spite of still very low unemployment (2.4%). Consumer confidence has been declining steadily for over a year (44.6) and did not seem to stabilise in February (41.5). More will likely be required for a more marked and lasting trend to take hold. While household spending did increase by +2% yoy in January, clearer im provement in the job market and a broader translation of corporate earnings growth into wage increases are required to boost household confidence and spending in Japan.

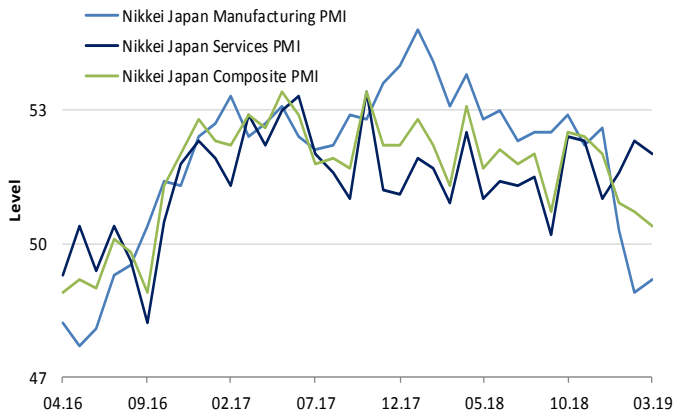
Leading indicators under pressure from the manufacturing sector

Uncertainty continues to weigh on leading indicators, which slid back further in February. Sentiment among Japanese business leaders is still not improving and remains impacted by the absence of a solution to the Sino-American crisis, which continues to affect the Japanese economy.

GDP and Industrial Production

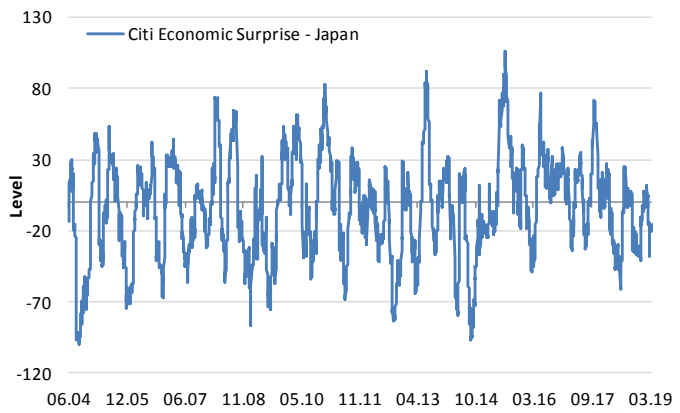


Composite, manufacturing and Services PMI - Japan

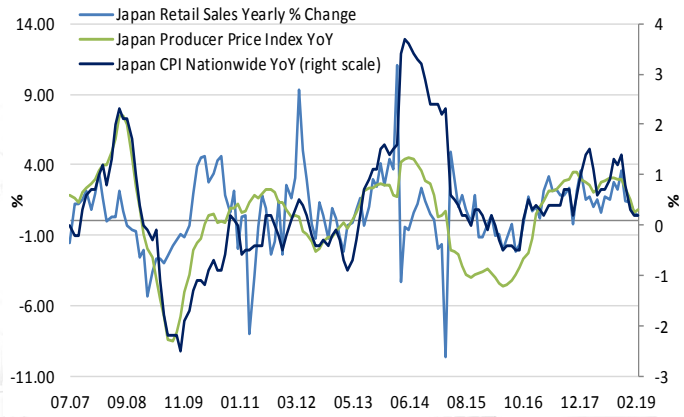


Graph sources: Bloomberg/BBGI Group

Economic Surprise Index



Inflation (CPI and PPI) and retail sales



The stabilisation of the yen following a -10% correction, though favourable to large export-sector companies, was followed by a swift +5% appreciation. The upswing to 112 yen to the dollar over the past few weeks is welcome but does not appear to be sufficient to allay the concerns of purchasing managers, who prefer to remain cautious. For now the latter are ignoring political signals suggesting a trade agreement, which should offer better visibility on the economic front, is forthcoming. The composite PMI index continues to fluctuate and shows no clear signs of recovery. In this sense it is broadly impacted by the manufacturing PMI index, which has contracted sharply since the beginning of the year, falling from 52.5 to 49.0, which is worrisome, as it suggests a sharp slump in industrial activity at the beginning of 2019.

The -3.7% contraction in industrial activity in January is the sharpest in a year and confirms purchasing managers' scepticism. Government forecasts of a +5% upswing in February are likely too optimistic. The auto sector in particular is struggling. The composite index is holding steady thanks to a sharp upturn in confidence as indicated by the upward trend in the services PMI, which increased from 51 to 52.3.

The BOJ revises expectations for recovery

The Japanese central bank has left its monetary policy unchanged but is concerned with respect to global demand and its implications regarding the likelihood that exports and industrial production will bolster GDP growth in Q1 2019. The BOJ has thus revised its GDP growth forecast downwards. Governor Haruhiko Kuroda expressed concern with regard to the country's economy given the current context, but he does not seem to be considering further measures to support the economy. He likely deems the slowdown in external demand to be temporary, as essentially due to the lack of solution to the trade crisis.

Domestic demand continues to grow, which is a positive factor sufficient to maintain the status quo with regard to monetary policy. The central bank's baseline scenario remains relatively stable, anticipating moderate GDP growth in 2019. Measures to shore up the economy implemented by Beijing should have a more significant impact in H2 on global demand and on Japanese exports.

The BOJ is also facing a complicated situation on the inflation front. Its 2% target remains a priority, but the current context is likely to further delay any significant increase in price indices in Japan. Recall that the domestic CPI index clocked in at barely +0.2% in January. Finance Minister Taro Aso noted that he did not think meeting the 2% target was so critical, but the BOJ remains convinced that maintaining this objective is key and that its strategy with respect to discontinuing the ultra-accommodative monetary policy it has implemented over the past several years must be clearly communicated.

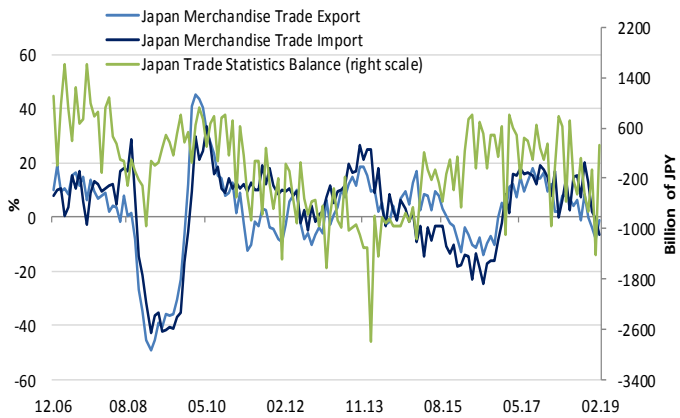
Necessary depreciation of the yen

We have not changed our outlook for the yen, which remains bearish for 2019. For several quarters already we have been noting that the yen's weakness is a key condition to boosting economic growth and inflation in Japan. A weak yen would breathe some life into the Japanese economy and enable it to resume a more sustained pace of growth. Monetary policy still aims to weaken the yen, but means available to the BOJ remain limited. We continue to expect that investors will shun the yen given a totally unfavourable interest rate environment and rate spreads that are likely to continue to penalise the Japanese currency. The implementation of monetary policy normalisation in the US, even at a slower pace, along with a moderate growth outlook for long-term rates globally will thus likely weigh more heavily on the yen in 2019. The yen's exchange rate turned out to be particularly variable between the end of last year and the beginning of 2019, appreciating by +5% over a few weeks and then falling by close to -4% over Q1 2019. We expect the yen to rise back up to 115 against the US dollar and then to stabilise above this rate.

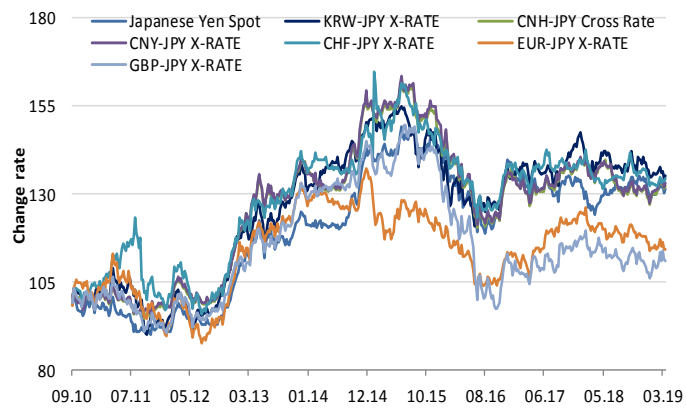
Avoid Japanese bonds

Economic conditions prevented inflation (CPI) from maintaining a faster pace. Indeed, inflation fell swiftly from +1.4% in October 2018 to only +0.2% in January 2019. An upswing in prices was conditioned upon on a depreciation of the yen, but inflation is still far from the BOJ's target (2%). Production prices followed the same downward trend, falling from +3% to +0.8%. The current context is clearly not favourable to the bond market, which still fails to offer attractive prospects to foreign investors in terms of yields, while the risk of capital losses is high over the long term.

Trade Balance (Billion of yen)



Exchange rate (Normalized at 100)



Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

China

- The Chinese prime minister is anticipating growth of +6.5% in 2019
- Deflation threat returns
- Mixed signals from PMI leading indicators
- Decrease of trade surplus with the US
- Still no firm trade agreement in sight

The Chinese prime minister is anticipating growth of +6.5% in 2019

The Chinese economy is showing signs of stabilising several months after the government took measures to counteract an economic slowdown. The government further intensified its efforts in March, announcing its largest tax cuts ever, worth close to 300 billion dollars. Lending has been redirected towards the private sector and smaller businesses, which already seems to have had a very positive and measurable impact on confidence according to a survey of 500 small and medium-sized enterprises. Optimism is growing, reaching its highest level in ten months. Credit conditions have also improved significantly according to one indicator that reached its highest level since 2017, as Beijing has promised some easing though not an uncontrolled explosion of lending. The implementation of growth-enhancing monetary and fiscal policies has started to bear fruit, but it will be some time yet before the Chinese economy can do away with government stimulus measures. The domestic economy is in good shape according to Chinese Prime Minister Li Keqiang, who notes that the risks of a downturn stem mainly from global economic conditions and weaker foreign demand. The Chinese government expects growth of +6 to +6.5% in 2019, slightly below the latest forecasts.

Deflation threat returns

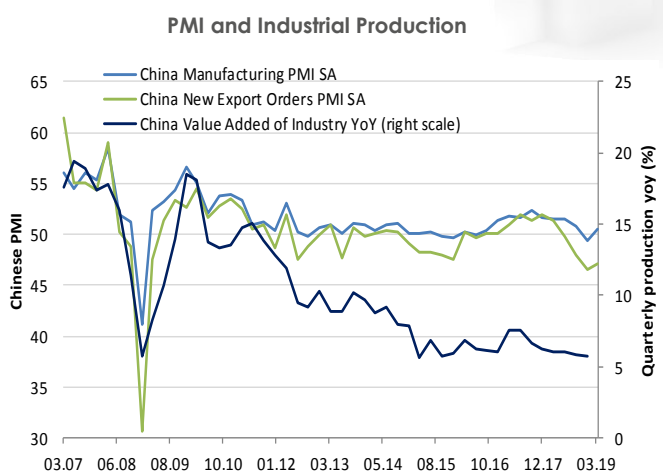
Inflation remains very moderate in China. The consumer price index slid from +1.7% to +1.5% yoy in February. Production prices were stable (+0.1%) due mainly to the drop in commodities prices (steel, oil, etc.). The services sector contributed to rising prices with gains of +2.1% overall. The government's latest announcement with regards to reducing the VAT on manufactured products from 16% to 13% will likely reinforce this trend.

Mixed signals from PMI leading indicators

The manufacturing PMI contracted further in February to below 50, thus pointing to a more significant risk to industrial production in Q1. While the new orders component of the index did improve, the export segment continued to decline. Global conditions are problematic, but China seems to be more resilient than most. The non-manufacturing index representing construction and the services sector also slipped from 54.7 to 54.3 in February. Domestic demand is growing, while inventories are declining.

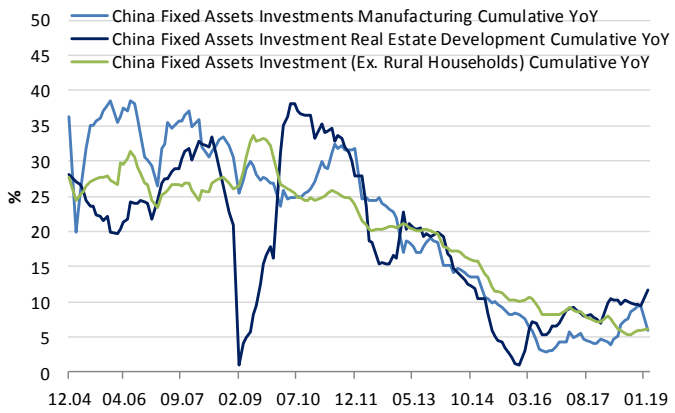
Decrease of trade surplus with the US

The deterioration in the global economic environment and global demand is weighing on Chinese exports, down -20.7% yoy, reversing the +9.1% gains of the previous month. This drop was steeper than anticipated (-5%) and unexpectedly significant. Over the past two months, exports actually contracted by -4.7% yoy, in clear contrast to the moderate increase of +3.9% in Q4 2018. Imports also declined by -5.2% in February, after dropping -3.1% over the first two months of the year following a +4.4% increase in Q4. The absence of a trade agreement is also weighing on demand and on European and Japanese PMIs, which likely indicates that Chinese exports will continue to struggle for a time. Given this context, the Chinese trade surplus with the US decreased from 27.3 billion in January to 14.7 billion in February. Overall the Chinese trade balance fell from 39.16 billion dollars to 4.12 billion in February, which along with March statistically is typically an unfavourable month.



Graph sources: Bloomberg/BBGI Group

Real Estate, Infrastructure and Industrial Investments (YoY)



Exports and Imports (YoY)

Still no firm trade agreement in sight

As the month of March comes to an end, there is still no formal trade agreement between China and the US, including with regards to foreign companies' access to the Chinese market. However, both China and the US need to put an end as quickly as possible to the uncertainties that initially were just a threat to global growth but have now, in the absence of an agreement, started to have a material impact on the industrial sector worldwide. China has of course been affected by these uncertainties and by the decline in global demand. Its manufacturing sector is hurting, and leading indicators are still not providing any clear sign of an upturn. The deadline, first set for the end of February, was pushed back in the hopes that a negotiated solution could be announced before the end of March, although this unfortunately appears not to be the case. In a worrying turn, the global economy looks to be posting another quarter of slowing growth. While talks continue, no tangible agreement seems to be forthcoming in the short term. China is aware of the risks to its economy, but it is not prepared to make just any concession. Beijing has already accepted the notion of a new law banning the forced transfer of technology, putting an end to the requirement to enter joint ventures with Chinese partners. While Beijing may also consent to drastically increasing its imports of US products by over 1,000 billion dollars over six years, it is certainly not clear that it would accept to curtail its subsidies to Chinese state enterprises. A new round of negotiations concluded with no concrete results, and while as usual mention was made of the progress achieved, significant disagreements still remain. Unfortunately, comments by US officials seem to imply that Washington is in no hurry to reach an agreement, declaring that it is not a question of time but a question of policy and implementation, which could postpone a potential resolution to May or June.

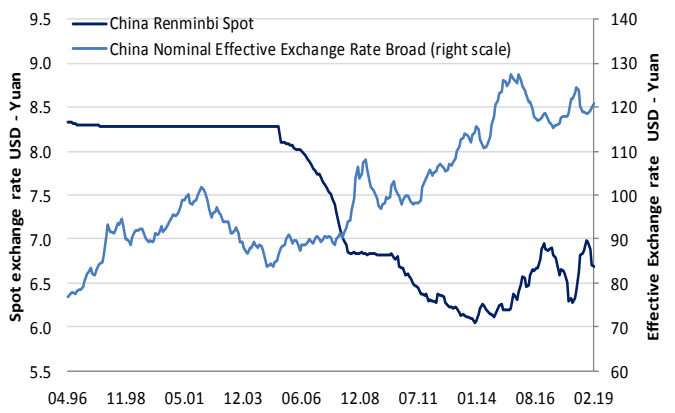
The yuan once again a strong currency?

Several months ago we noted that the yuan, which had suffered due to the conflict between Washington and Beijing through November 2018, would most likely benefit from an easing of tensions and from the parties' stated resolve to find a solution to their dispute. Although no agreement has yet been signed, the concessions made by Beijing seem to show its willingness to reach an agreement. The yuan appreciated by approximately +2.5% against the dollar in Q1 2019 in spite of the deterioration in China's foreign trade. We expect that the hopefully forthcoming trade agreement will be positive for the yuan, which is increasingly recognised by investors globally as a significant international currency.

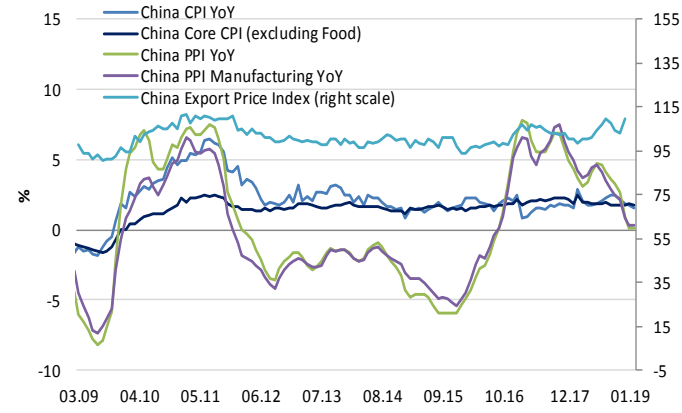
The Bloomberg-Barclays bond indices add Chinese government debt

The Chinese bond market has grown to an impressive 13 trillion US dollars and will soon exceed the size of the Japanese bond market, second largest in the world after the US. For the first time, Chinese bonds will be included in the Bloomberg-Barclays global bond indices as of 1 April 2019. Securities to be added include Chinese government bonds and well as those of three state-owned banks. Foreign investment in Chinese debt had already doubled between 2016 and 2018, exceeding 1,500 billion yuan. This decision is thus quite likely to increase the proportion of foreign investors, which currently hold around 2% of total Chinese debt. The Chinese government will likely continue its efforts to facilitate foreign investors' access to its capital markets. The flow of funds into Chinese capital markets can be expected to exceed 100 billion dollars per year over the next ten years, gradually increasing the share of foreign investment to 20% of Chinese government debt.

Effective Exchange rate and USD/Yuan



Inflation CPI - Core CPI



Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

United Arab Emirates

- Acceleration of GDP Growth
- Activity in the construction sector remains strong in 2019
- Adjustment of the real estate supply in 2020
- Dubai government manoeuvring
- Downturn in property prices in 2019

Fiscal stimulus focused on infrastructure investment in preparation for Expo 2020

The non-oil economy appears to have started 2019 on a solid footing. The PMI rebounded to a seven-month high in January after a lull at the end of 2018, signaling solid prospects in the non-oil sector thanks primarily to strong domestic demand. Employment growth, however, remains low due to ongoing pressure on firms' margins. Meanwhile, though OPEC+ cuts weighed on oil production so far in Q1, crude oil prices consequently rebounded, which should buttress the government's coffers going forward. Furthermore, the public sector will likely be a key driver of growth in Q1 and throughout the year, as the large fiscal stimulus approved both at the federal and emirate level have already had to begun lifting economic activity in the quarter. A strong fiscal stimulus focused on infrastructure investment in preparation for Expo 2020 should power growth this year. A recent landmark investment law and other business-friendly reforms also appear poised to attract qualified foreign workers and to boost FDI inflows. Nevertheless, slower global growth, trade protectionism and financial volatility constitute important downside risks. Focus-Economics panelists expect GDP to increase 3.0% in 2019, which is down 0.1 percentage points from last month's forecast, and 3.3% in 2020.

Acceleration of GDP Growth

Based on the latest official figures, the UAE economy grew by 1.7% in 2018 which compares favorably to the growth rate of 0.9% the country recorded the previous year. That being said, the final figure announced came short of the initial growth estimates which was forecasting the annual growth rate to settle at 2.8%.

The UAE Central Bank on its part is forecasting a GDP growth of 3.5% in 2019 largely thanks to the AED 50 billion stimulus package announced by the government late last year alongside a host of measures taken for the ease of doing business in each emirate across the country to boost the private sector.

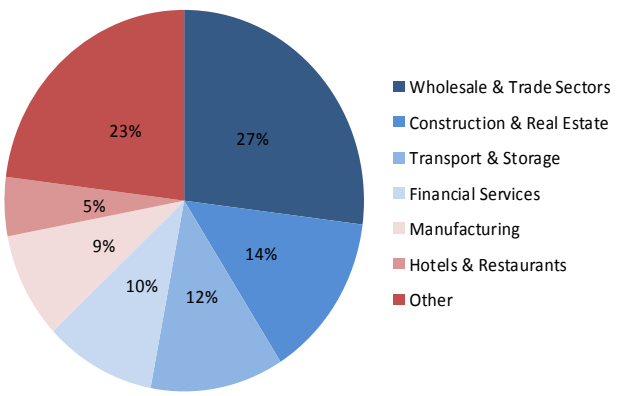
Our expectation is that the recent measures taken by the UAE government should have a positive influence on the UAE's growth prospects in 2019 with the non-oil expected to benefit from the announced "ease of doing business" measure underpinned by stronger fundamentals of the economy and improved market sentiments as the country is getting ready to host the World Expo 2020.

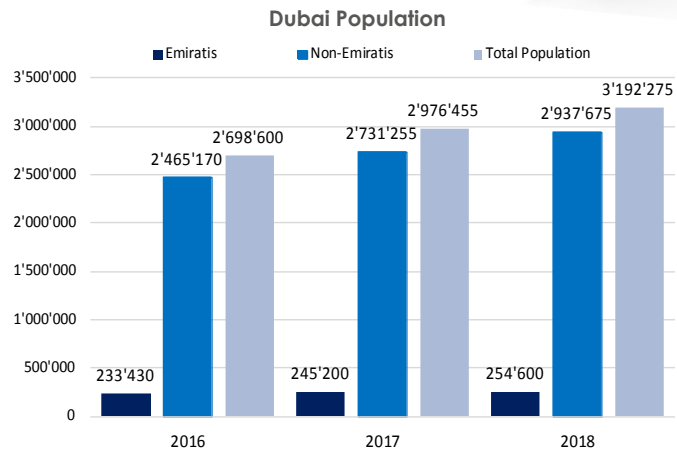
Activity in the construction sector remains strong in 2019

In line with lower than expected GDP figures announced by the UAE government for year 2018, Dubai's GDP grew by 1.94% which came short of the expected 2.8% growth rate by most analysts. This puts the Emirate's total GDP output at USD 108.38bn vs 106.32bn in 2017. Based on the latest data available to date, in 2017 the UAE's GDP in 2018 is expected to stand at USD 432.61bn, hence Dubai' economy alone represents over a quarter of the UAE's economy and houses a third of its population.

Looking at the GDP contributors, the biggest contributor to Dubai's growth last year were the wholesale and retail trade sector (27%), the construction and real estate (14%), Transport and storage (12%) closely followed by the financial services sector (10%).

Looking at the real estate services and construction components of the GDP, it grew 7.0% year on year, up from 4.4% in 2017, while construction sector grew 4.5% in 2018, the fastest growth rate since 2008. In fact, while real estate prices declined last year, the construction sector's activity remained buoyant. Looking forward, the construction activity is expected to remain solid backed by current construction pipeline and Dubai Government's fiscal stimulus focused on infrastructure investments in preparation for Expo 2020.





Graph sources: Bloomberg/BBGI Group /Dubai Statistics Centre (DSC) / Knight Frank / Euromonitor International

Adjustment of the real estate supply in 2020

Population growth figures constitute the most important parameter to gauge future demand for real estate. Looking closely at the latest data on the evolution of the population in Dubai, one can observe that it has constantly increased in recent years despite lower GDP growth figures and negative headlines.

Indeed, as shown in the graphic illustration, the total population of Dubai has increased by 10.3% between 2016 and 2017 and by 3.83% between 2017 and 2018. Looking closely, the population growth came both from the growth in the indigenous population and the expatriate population. Between 2017 and 2018, the indigenous population grew by 7.25% against a growth rate of 7.56% in expatriate population based on the latest data released by Dubai Statistics Centre (DSC).

Almost anyone in Dubai or across the world has often a strong opinion about Dubai real estate market and its future prospects. Once again, the views either tend to be overly optimistic or very pessimistic. There is no doubt that the construction activity in Dubai has been very sustained over the last few years and perhaps too many real estate projects have been launched over the same period as real estate developers were ferociously fighting for market share.

2016 and 2017 recorded a significant amount of new project launches and deliveries resulting in steady drop in sales prices and rental rates despite Dubai's high single digit annual population growth. That being said, in 2018 we already witnessed fewer new project announcements and looking forward the pipeline for new mega projects being launched in Dubai is expected to reduce in order to better match demand.

Construction activity in 2019, for projects that have already been launched, is expected to continue at a sustained pace since construction-linked and post completion-payment plans means that developers only get paid based on construction milestones.

Currently Dubai's housing stock, estimated by Knight Frank, totals circa 525'719 units and circa 42'000 units are likely to be delivered in 2019. This represents in fact a staggering 8% of the current total stock of residential assets in Dubai. Meanwhile, according to Asteco, commercial supply in 2019 is earmarked to account 3.6 million sq.ft. of office space.

Residential property supply is therefore expected to peak this year with remaining supply scheduled to be delivered in 2020 since a significant number projects have been launched in anticipation of the Expo2020. However, as shown in the graph below, supply beyond 2020 is expected to reduce considerably while the market will obviously consolidate further and adjust to absorb the upcoming supply.

Dubai government manoeuvring

Looking forward, once again the reality is far more nuanced than just rough figures pointing at an oversupply situation in the property sector. As new supply is expected to hit the market, one can rightly assume that sale price declines will continue into 2019. Meanwhile, Dubai's Real Estate market is maturing in line with increased transparency and improved regulatory framework. Both Dubai's government and Dubai Land department are well aware of the challenges caused by the real estate projects that will arrive soon in the market.

Considering the strategic importance of the real estate sectors in Dubai's economy, one can assume that Dubai Government will do "whatever it takes" to support the Emirate's property sector and enable it to compete at the global level with other mega cities such as New York, Paris, Hong Kong or Singapore to attract more talent and wealthy residence.

Downturn in property prices in 2019

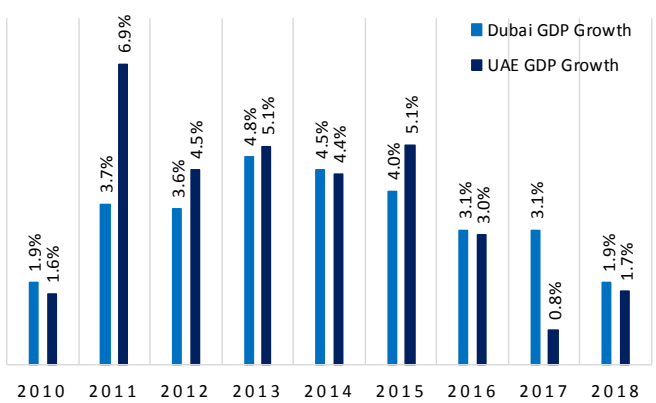
Dubai economy is without doubt going through a phase of consolidation, but as during any challenge, it also offers opportunities for those who are willing to invest seriously in Dubai's vibrant property market.

We believe that going forward, and as the market matures, investors will increasingly need to discriminate between properties located in prime areas, benefiting from established infrastructure and amenities, versus those built mainly for speculation purposes.

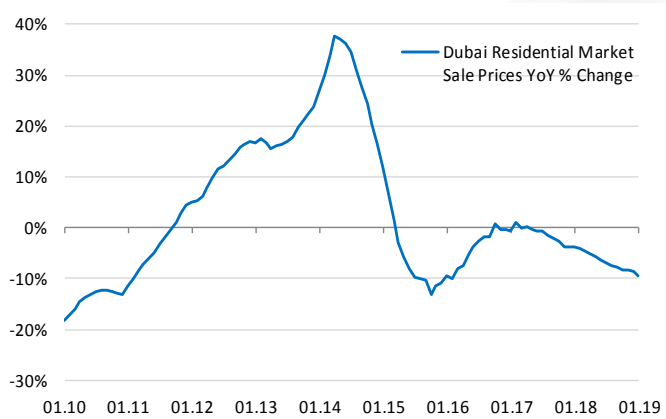
Now more than ever, one has to bear in mind that Dubai is one of the most vibrant global cities worldwide and remain the leading financial, touristic, logistic and business hub of the Middle East. Dubai benefits from solid fundamentals and should continue to attract new talent and HNW residents going forward. That being said, the era where Investors/speculators could buy any property anywhere in Dubai and double their investment in no time is clearly over. However, for real investors, not speculators, that are willing to look at the big picture and adopt a longer investment horizon, we are seeing some one-in-a-lifetime investment opportunities to secure prime assets based on very attractive valuations and significant upside potential.

Dubai, alike Singapore and Hong Kong, has been through other challenges but it has always recovered stronger and leaner. Recent consolidations in employment and vacancy rates will lead to better positioned companies and real estate markets that ultimately should position Dubai in a position to best face future challenges and maintain its regional competitive edge. We are seeing early signs of a bottoming out in the property sector and look forward to take advantage of current pricings to secure attractive long-term investments for our investors.

UAE and Dubai GDP Growth



Dubai Residential Market Sale Prices YoY % Change



Graph sources: Bloomberg/BBGI Group /Dubai Statistics Centre (DSC) / Knight Frank / Euromonitor International

MACROECONOMIC SCENARIO

Emerging Markets

- Monetary policy status quo
- Emerging equities up +11.3% in Q1
- Some consolidation expected in the short term

Economic Situation by Country

Russia – In March, the annual growth rate for consumer prices remained below the Russian Central Bank's forecasts. It hit 5.3%, compared to 5.2% in February and 5.0% in January 2019. The impact of the VAT hike was seen across the board. It contributed to year on year inflation to the order of around 0.6-0.7 percentage points. This corresponds to the lower limit of the range that the Bank of Russia was expecting. Given that some slower-to-develop effects of the VAT rise could still emerge in the months to come, a precise evaluation of the effect of the increase in VAT on inflation could be carried out in the second quarter of 2019.

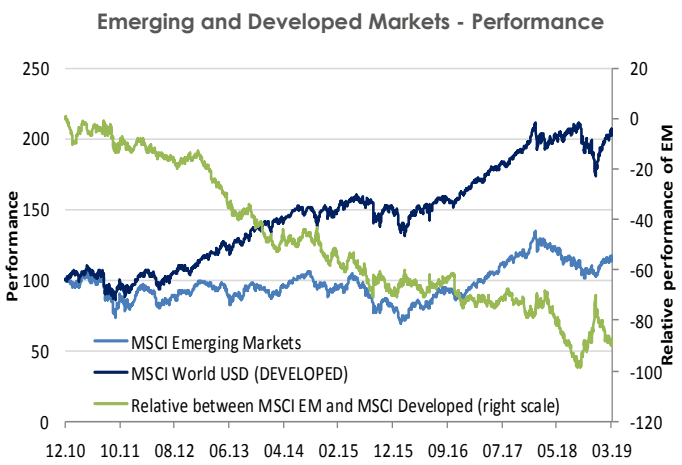
Faster growth on food product prices, which came in at 5.9% (compared to 5.5% in January 2019), played an important role in pushing up inflation in February. Food product inflation is bouncing back significantly, after a considerable drop in the second half of 2017 and the first half of 2018. Prices for non-food goods and services have risen less than the prices of food products over the last 12 months. Compared to January, the increase in the pace of annual inflation slowed in February due to consumer demand and revenue, the appreciation of the rouble, the fall in fuel prices, and some food products. Inflation was also curbed by the Bank of Russia's decision to increase the key rate in September and again in December 2018 as a preventative measure. Although inflationary forecasts for households and businesses fell sharply in February and March, they remain high. Whilst year on year inflation should hit its peak in March-April 2019, the Bank of Russia has dropped its annual inflation forecast from 5.0%-5.5% to 4.7%-5.2% for the end of this year.

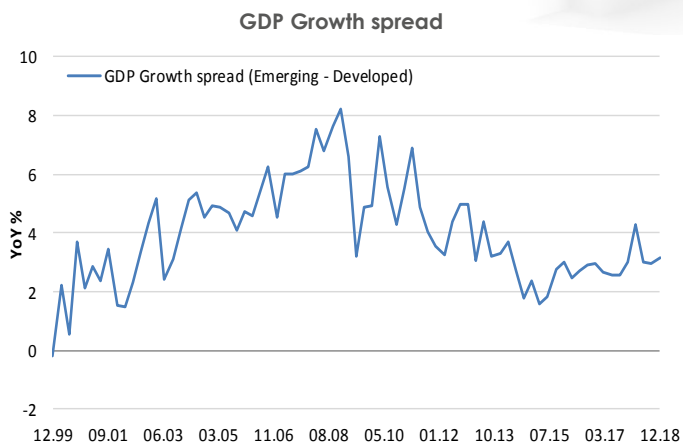
Quarterly year on year consumer price growth should slow down to 4% from the second half of 2019 onwards. Year on year inflation should return to 4% in the first half of 2020 once the effects of the slowdown on the rouble in 2018 and the VAT hike have eased off. Short-term inflationary risks have therefore decreased. On the domestic side of things, the side effects of the VAT rise and increased growth in the prices of certain food products have become less risky. Further afield, the interest rate trajectory revisions by the Fed and other developed country's central banks have reduced the risk of persistent capital outflow from emerging markets. That said, the Bank of Russia has hardly altered its evaluation of risks linked to changes in salaries, possible changes in consumer behaviour, and budgetary spending. The latter remains modest.

At the start of this year, Russian economic activity has been developing at close to its potential. Current consumer demand and labour market conditions are not creating excessive inflationary pressures. In February, annual industrial production growth posted the same figures as the last quarter of last year. As forecast by the Bank of Russia, annual retail sales growth slowed in February due to the rise in VAT and the slowdown in wage growth. The Bank of Russia is maintaining its GDP growth forecasts for 2019 at between 1.2% and 1.7%, while VAT is creating a temporary stumbling block for business activity. As of this year, new budgetary resources will need to stimulate public spending. As such, we could see economic growth accelerate in the years to come as new national projects are implemented.

On 22nd March 2019, the Bank of Russia's Board of Directors decided to leave its key rate at 7.75% per year. However, the Bank has suggested it might drop its key rate in 2019 if the situation develops in line with base-line forecasts.

Brazil – Global growth forecasts remain tricky. On the one hand, risks relating to interest rate normalisation in some developed economies have fallen since the previous Copom meeting. On the other hand, the risks linked to a slowdown in global growth due to uncertainty from various sources are higher. Inflation forecasts for 2019, 2020 and 2021, collected by the Focus Survey, stand at 3.9%, 4.0% and 3.75% respectively. The Copom Committee underscored that there are still risks linked to its base scenario in either direction. The considerable economic slump could lead to a lower inflation trajectory forecast than expected. Equally however, frustrated expectations regarding ongoing reforms and adjustments that the Brazilian economy needs could affect risk premia and widen the inflation trajectory within the timeframe for implementing the monetary policy. This risk will worsen if global prospects for emerging economies deteriorate.





Graph sources: Bloomberg/BBGI Group

The Committee believes it is important to look at the future behaviour of the Brazilian economy in the long-term, within a less uncertain climate than over the past few quarters, and without the various shocks which hit the economy last year. According to Copom's analysis, the way in which the benchmark scenario has developed and the balance of risks demand that the key rate be left as is (6.50%). Copom has repeated that current economic conditions require expansionary monetary policy, with interest rates that are lower than the structural level. Developing the reforms and adjustments needed by the Brazilian economy is essential in order to keep inflation low in the medium to long term, reduce the structural interest rate, and sustain a lasting economic recovery. Copom has stated that "caution, perseverance and serenity" in monetary policy decisions have played a key role in pursuing its main objective of keeping inflation on target.

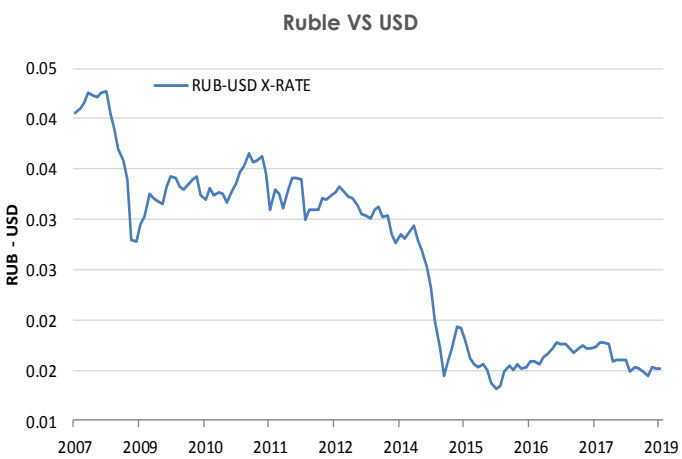
India – Third quarter 2018 inflation (+2.6%) came in slightly under forecasts. Inflation forecasts were revised downwards over the year, mainly due to the unprecedented weakness of inflation across all food product sub-groups. Inflation continued to surprise on the downside with ongoing deflation on several items and significant curbing of prices, particularly for grain products. There is excess supply of several food groups, both domestically and internationally. As such, short-term food product inflation prospects seem particularly low. Taking all of this into account, and based on the supposition that the monsoon will be nothing out of the ordinary in 2019, inflation for the last quarter 2018 (2.8%), the first half of 2019 (3.2%-3.4%) and the third quarter 2019 (3.9%) has been revised downwards.

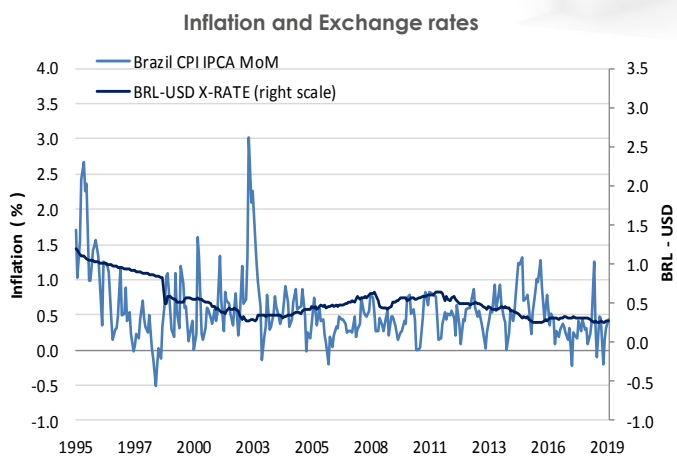
In the long-term, there are several factors which could influence Indian growth prospects. Firstly, banking credit and financial flows to the trade sector are still robust but are not yet working across the board. Secondly, despite low crude oil prices and the delayed effect of the recent depreciation of the Indian Rupee on net exports, the slowdown in global demand could create stumbling blocks. In light of all of this, the Central Bank believes that GDP growth should stand at 7.4% for 2019. The Monetary Policy Committee has highlighted that the output gap has widened slightly, real output having come in slightly lower than potential. Investment activity is picking up, but is mainly propped up by public infrastructure spending. Private investment activity and private expenditure need to be shored up over the coming months. In this context, the Monetary Policy Committee has decided to change its monetary policy, moving from calibrated tightening to a neutral position, and reducing the repo rate by 25 basis points.

South Africa – The inflation forecast generated by the South African Central Bank's quarterly projection model has hardly changed since the last meeting. Headline inflation should come in at 4.8% on average in 2019, before hitting 5.3% in 2020 and 4.7% in 2021. The risks that could potentially affect inflation prospects are considered to be relatively balanced. Upward risks include rises in water and electricity prices, increases in food prices and higher crude oil prices. On the flipside, downward risks include a drop in global inflation or a prolonged period of expansionary monetary policy in developed economies.

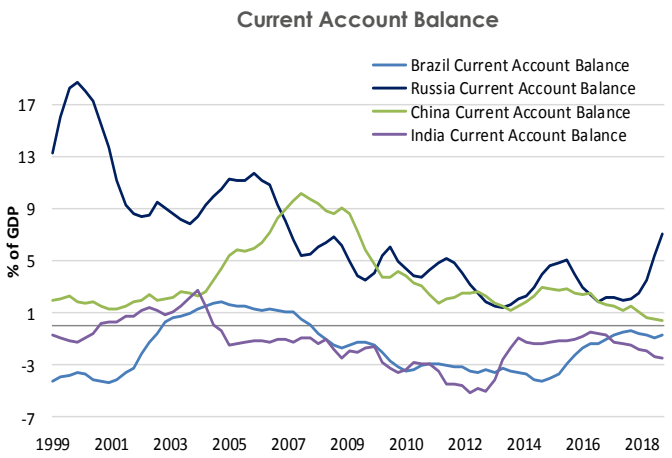
South African gross domestic product rose by 1.4% over the first quarter 2018, giving 0.8% year on year growth. The SARB (South African Reserve Bank) is now expecting GDP growth to hit 1.3% in 2019, compared to the 1.7% originally forecast in January. Forecasts for 2020 and 2021 are close to 2%, at 1.8% (compared to 2.0%) and 2.0% (compared to 2.2%) respectively. The global slowdown has been more serious than expected, and this, along with a drop in business confidence and the growing pressure on disposable household income, is responsible for the falling forecasts.

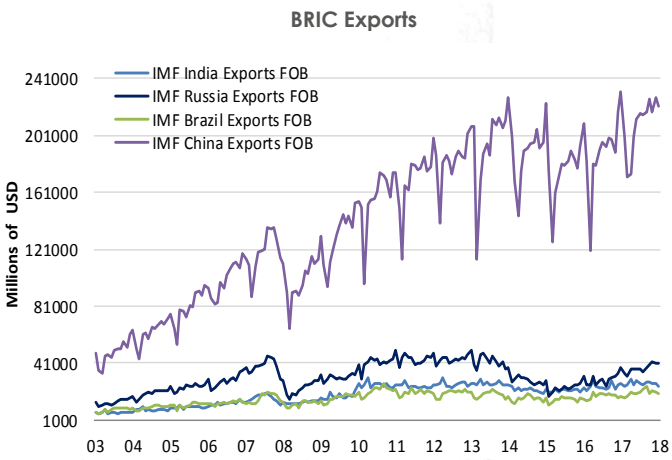
Given the current economic uncertainty, a cautious macroeconomic policy combined with structural reforms aiming to speed up the pace of growth and reduce the economic cost structure have become all the more urgent. In this context, the Monetary Policy Committee unanimously decided to maintain their key rate at 6.75% per year and to continue with expansionary monetary policy. Monetary policy measures will still aim to draw inflation forecasts closer to the median point of their inflation target in order to ensure balanced and lasting growth. The MPC believes that there is little proof of demand creating pressure on the economy. In the medium term, rising prices on electricity, fuels and food stuffs could have a knock-on effect on costs.

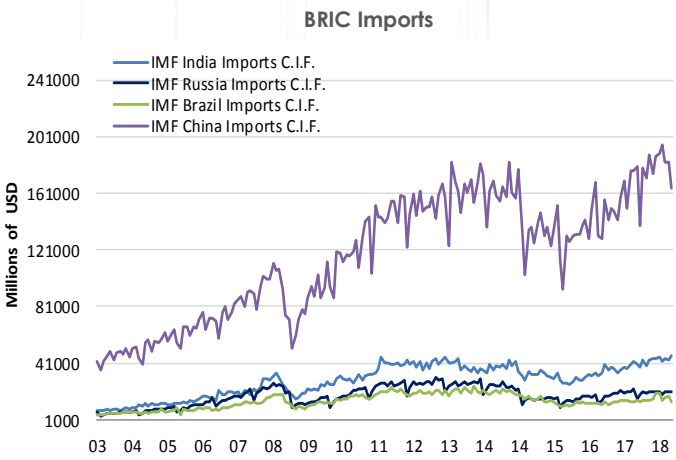




Graph sources: Bloomberg/BBGI Group







Colombia – In February, the consumer price index dropped to 3.01%. Inflation forecasts fell, but nonetheless stayed just north of 3.0%. Analysts' forecasts for the coming years stand at between 3.0% and 3.5%.

In the last quarter 2018, Colombian economic growth (2.9%) was slightly higher than forecast, thanks in particular to domestic demand contributing more. The latest economic activity figures for the first quarter 2019 suggest that the economy is growing at a faster pace than at the end of 2018. As such, the technical staff at the Central Bank are proposing 3.5% growth for 2019 and predict that the amount of unutilised economic capacity will continue to shrink.

The Colombian Central Bank therefore considers it appropriate to leave its key rate untouched at 4.25%.

Indonesia – The Central Bank left its benchmark rate unchanged at 6%. Decision-makers asserted that this decision is fully in line with efforts to reduce the current account deficit to around 2.5% of GDP in 2019 and is intended to ensure that national financial markets remain attractive for foreign investors. The Central Bank is forecasting inflation below the median of the 2.5%-4.5% target bracket for 2019, while GDP growth should come in at between 5.0% and 5.4%.

Mexico – The Mexican Central Bank has maintained its benchmark interest rate at 8.25%, its highest rate for 10 years. In line with market expectations, Mexico's annual inflation rate fell from 4.37% in January to 3.94% in February 2019- its lowest level since December 2016.

Taiwan – The Taiwanese Central Bank has left its key rate at 1.375%, as the market was anticipating. It is expected that the Taiwanese economy will develop a little more slowly this year due to weaker global growth and ongoing uncertainty regarding international trade. The Central Bank predicts that Taiwanese GDP will grow 2.13% in 2019, which is lower than last year. Inflation is expected to stand at 0.91% by the end of this year.

Turkey – The Turkish Central Bank kept its key rate at 24% on 6th March, indicating that the risks regarding price stability remain despite some improvement to inflation forecasts. The country's annual inflation rate fell to 19.67% in February. This is its lowest point for six months, but still well above the 5% target that the Central Bank has set itself.

Romania, Czech Republic, Poland, Hungary – The Romanian National Bank has left its key rate at 2.5%, in line with market expectations. In February 2019, annual inflation (3.8%) came in above forecasts and hit a four-month peak outside of the upper bound of the Bank's 1.5%-3.5% target.

The Czech National Bank did not change its 1.75% key rate at its latest meeting. In February, national inflation hit a 16-month high considerably above the 2% target.

The Polish National Bank kept its benchmark rate historically low (1.5%), in line with market expectations. The country's GDP increased 4.9% in Q4 2018. This is the weakest growth rate since Q2 2017, and is due inter alia to the slowdown in household spending (3% compared to 3.3% in Q3) and public spending (2.2% compared to 2.7%).

The Hungarian National Bank left its benchmark rate unchanged at 0.9% in March. The inflation rate surpassed the 3% target in February (compared to 3.2% in January).

Graph sources: Bloomberg/BBGI Group

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PROSPECTS AND STRATEGIES

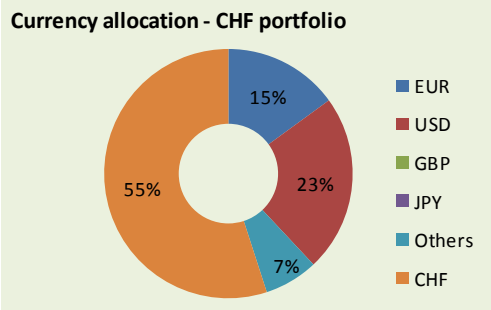
Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

Currencies

- The SNB will not change its weak franc policy in 2019
- Resilient euro
- Mixed outlook for the US dollar
- Trade agreement tied to strong yuan
- Pound could still be hit by a no-deal Brexit
- Trend reversal for Australian dollar

LIQUIDITY/ CURRENCY	Expected Return		ALLOCATION (CHF Portfolio)						
			underweight			neutral	overweight		
	3months	1year	---	--	-	=	+	++	+++
EUR vs CHF	↗	↗							
USD vs CHF	↗	↗							
GBP vs CHF	↘	↘							
JPY vs CHF	↘	↘							
EUR vs USD	↗	↗							
USD vs JPY	↗	↗							
GBP vs USD	↘	↘							



Tactical Allocation

- Underweight CHF
- Favor USD
- Overweight EUR
- Avoid JPY

The SNB will not change its weak franc policy in 2019

The Swiss economy grew at a pace comparable to that of the Eurozone in Q4, although it expanded significantly faster over the year as a whole. The growth differential was thus not an adjustment factor for the exchange rate, and in the absence of pronounced trends on the interest rate front, the franc continued to stabilise. We still believe that further depreciation of the franc will depend on the relative economic performance and interest rate spread between the franc and the euro.

We do not expect the SNB to raise rates as rapidly as the ECB, which now seems unlikely in 2019. In the meantime, the exchange rate will likely stabilise between 1.12 and 1.17 against the euro. With regard to the US dollar, the rate spread and growth differential remain positive factors for the dollar. While this state of affairs is not new, it could be sufficient to further bolster trends favourable to the dollar.

Resilient euro

The economic environment has not improved in the Eurozone over the past several months. Nevertheless, the single currency has remained relatively stable despite an increasingly uncertain context. The decrease in euro-denominated yields has not really affected the currency, which stabilised at between 1.12 and 1.15 against the US dollar. Indeed, the interest rate spread to the US dollar and the divergence in economic performances have not caused any significant movements in the currency.

The current exchange rate of 1.13 USD to the euro likely already incorporates the known risks of a downturn in the Eurozone. The current stabilisation could then give way to an appreciation of the euro in 2019, if the growth outlook normalises, which seems difficult to imagine currently. Otherwise, it appears likely that the euro/dollar exchange rate will fall in an environment characterised by strong downward pressure on long-term euro rates and a likely stabilisation of long-term US dollar rates.

Mixed outlook for the US dollar

The dollar is still benefitting from attractive yield spreads against most currencies. In 2019, these spreads will likely be hit by rising interest rates in the Eurozone and other developed and emerging countries. We continue to expect the dollar/Swiss franc exchange rate to trend upward, potentially reaching 1 to 1.05 francs. The US currency will likely once again lose its attractiveness, very gradually, against the euro and emerging currencies assuming the stock market climate improves. The dollar should also weaken against the yuan.

Trade agreement tied to strong yuan

We have not changed our outlook for the yen, which remains bearish for 2019. For several quarters already we have been noting that the yen's weakness is a key condition to boosting economic growth and inflation in Japan. A weak yen would breathe some life into the Japanese economy and enable it to resume a more sustained pace of growth. Monetary policy still aims to weaken the yen, but means available to the BOJ remain limited. We continue to expect that investors will shun the yen given a totally unfavourable interest rate environment and rate spreads that are likely to continue to penalise the Japanese currency.

The implementation of monetary policy normalisation in the US, even at a slower pace, along with a moderate growth outlook for long-term rates globally will thus likely weigh more heavily on the yen in 2019.

The yen's exchange rate turned out to be particularly variable between the end of last year and the beginning of 2019, appreciating by +5% over a few weeks and then falling by close to -4% over Q1 2019. We expect the yen to rise back up to 115 against the US dollar and then to stabilise above this rate.

Graph sources: Bloomberg/BBGI Group

Pound could still be hit by a no-deal Brexit

The pound is more than ever hostage to the complex political situation surrounding Brexit. The UK should already have withdrawn from the European Union on 29 March without a deal. As a no-deal exit is unquestionably the worst possible outcome for both the UK and the EU, Theresa May was granted an extension so she could attempt some last -minute political manoeuvring to avert the looming disaster. On 13 April, or ultimately on 23 May, a solution will have to be approved. At time of writing, the situation has reached a political deadlock, which surprisingly no longer seems to be affecting the pound. The British currency has indeed been stabilising for the past nine months pending a negotiated Brexit solution. The likelihood of a no-deal outcome seems not to have been factored in for now, even though the risk of devaluation is far from negligible. Given this context, we remain cautious on the pound.

Trend reversal for Australian dollar

The Australian dollar will likely be bolstered by positive economic news on both the domestic front (particularly robust job market) and the international front (foreign trade and Chinese demand expected to pick up). Australia's trade surplus grew to a record 4.8 billion US dollars in February following an increase in exports and a decrease in imports.

Improving commodity prices have boosted the Australian economy and will likely continue to have a positive impact on GDP over the next few quarters, as will better Chinese economic data. In addition, the RBA continues to implement an accommodative monetary policy. Overall, the Australian economy remains relatively dependent on China, and an improvement in the Chinese economic outlook would also enhance the Australian economy's prospects and demand for Australian dollars. These improvements will boost the currency, which will appreciate to its three-year average of 0.76 AUD to the USD.

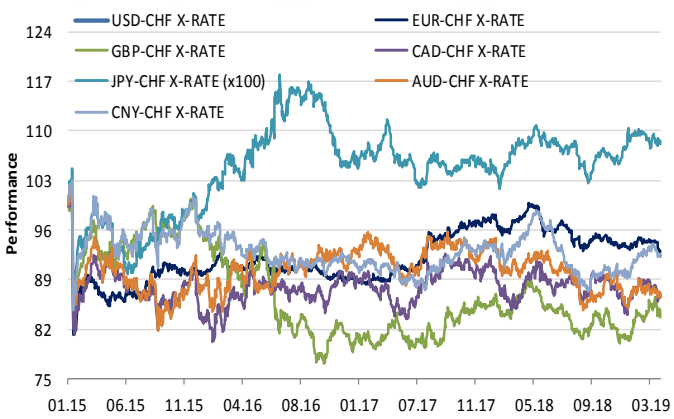
Trade agreement coupled with a strong yuan

Several months ago we noted that the yuan, which had suffered due to the conflict between Washington and Beijing through November 2018, would most likely benefit from an easing of tensions and from the parties' stated resolve to find a solution to their dispute. Although no agreement has yet been signed, the concessions made by Beijing seem to show its willingness to reach an agreement.

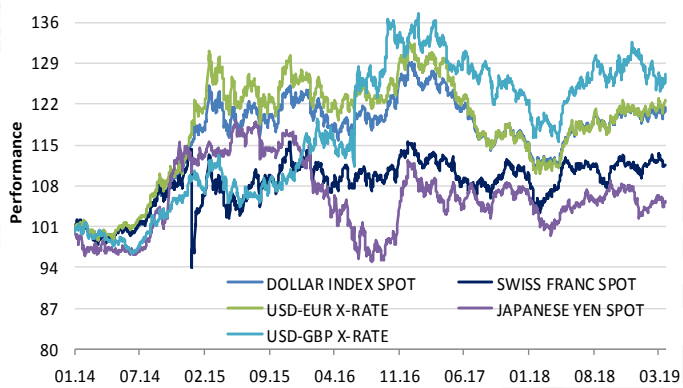
The yuan appreciated by approximately +2.5% against the dollar in Q1 2019 in spite of the deterioration in China's foreign trade. We expect that the hopefully forthcoming trade agreement will be positive for the yuan, which is increasingly recognised by investors globally as a significant international currency. However, it is not impossible that the yuan's valuation may be an issue indirectly or directly impacting the talks underway between the two countries.

The US is likely expecting the Chinese government to commit to not letting the yuan devalue in order to finalise an agreement. The yuan/USD exchange rate has already shifted this quarter, reaching the equilibrium level of 6.7 yuan to the dollar, consistent with our short-term prediction in the event that talks were successful. A temporary stabilisation at this level will likely be followed rather quickly by further appreciation of the yuan against the dollar.

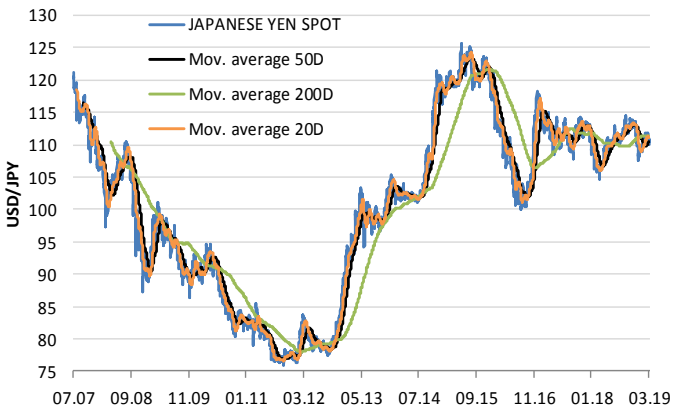
7 currencies against CHF (Normalized at 100)



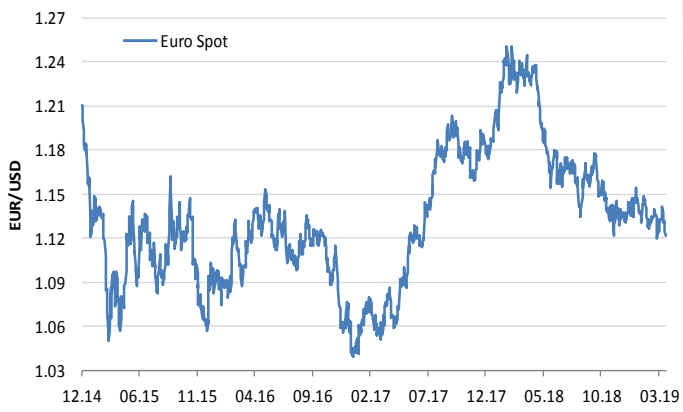
Dollar Trade-weighted index & cross rates (Normalized at 100)



JPY/USD



EUR/USD

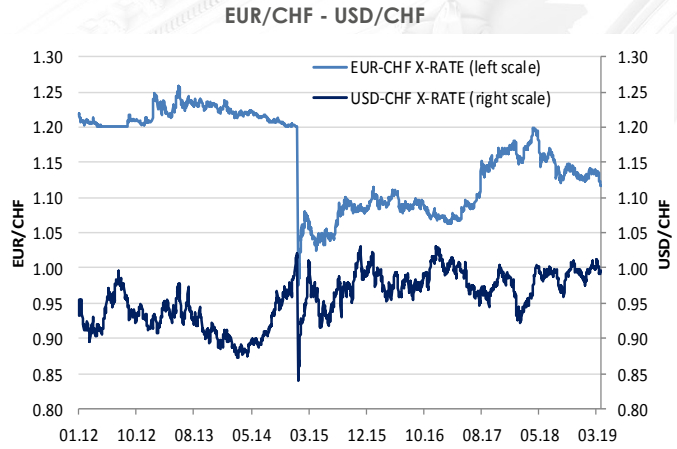


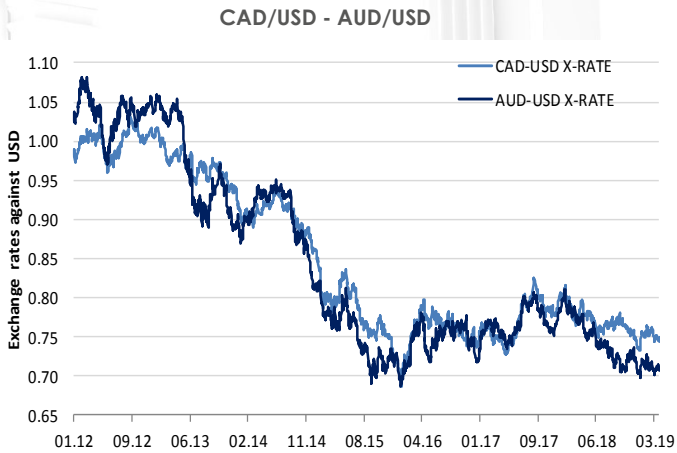
Graph sources: Bloomberg/BBGI Group

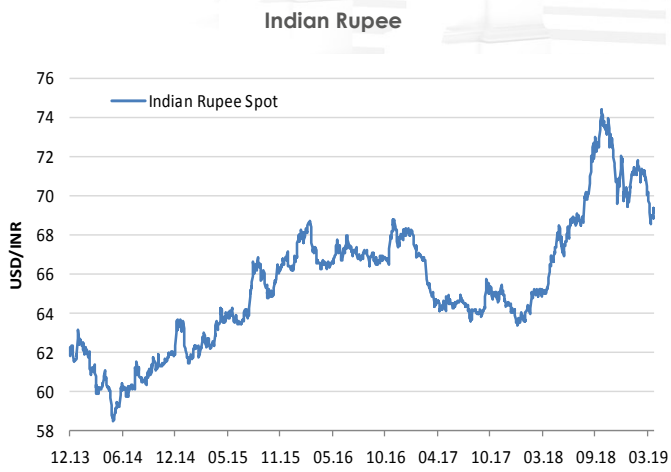
CURRENCIES

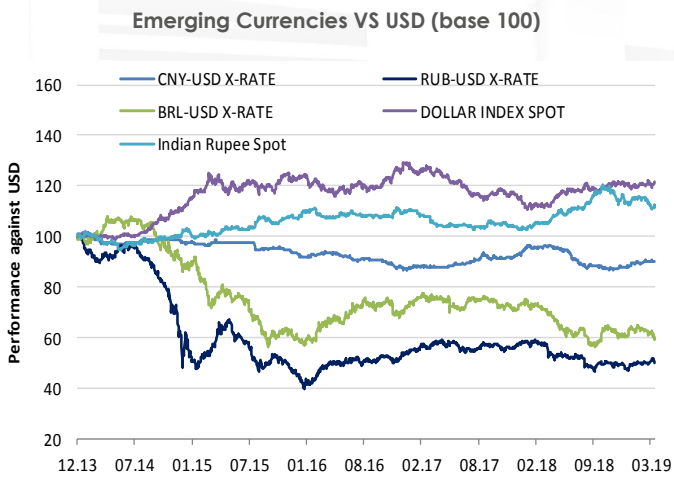
31.03.2019

Name	Last price	7 d %	1 m %	3 m %	6 m %	YTD %
AGAINST DOLLAR						
EUR-USD X-RATE	1.1	-0.7	-1.3	-2.2	-2.9	-2.2
CHF-USD X-RATE	1.0	-0.2	0.4	-1.4	-1.1	-1.4
GBP-USD X-RATE	1.3	-1.3	-1.3	2.2	0.4	2.2
JPY-USD X-RATE	0.0	-0.8	0.9	-1.1	2.5	-1.1
CAD-USD X-RATE	0.7	0.6	-0.4	2.2	-3.9	2.2
AUD-USD X-RATE	0.7	0.2	0.2	0.7	-1.3	0.7
RUB-USD X-RATE	0.0	-1.7	0.3	5.3	-0.3	5.3
CNY-USD X-RATE	0.1	0.1	-0.1	2.5	2.3	2.5
INR-USD X-RATE	0.0	-0.3	2.3	0.4	5.7	0.4
BRL-USD X-RATE	0.3	-0.4	-3.7	-1.0	0.5	-1.0
AGAINST SWISS FRANC						
USD-CHF X-RATE	1.0	0.2	-0.4	1.3	1.1	1.3
EUR-CHF X-RATE	1.1	-0.6	-1.7	-0.8	-1.8	-0.8
GBP-CHF X-RATE	1.3	-1.2	-1.7	3.6	1.6	3.6
JPY-CHF X-RATE (x100)	0.9	-0.7	0.6	0.2	3.7	0.2
CAD-CHF X-RATE	0.7	0.8	-0.8	3.5	-2.8	3.5
AUD-CHF X-RATE	0.7	0.4	-0.2	1.7	-0.1	1.7
RUB-CHF X-RATE	0.0	-1.5	-0.1	6.7	0.8	6.7
CNY-CHF X-RATE	0.1	0.3	-0.5	3.9	3.6	3.9
INR-CHF X-RATE	0.0	-0.7	1.4	1.4	6.7	1.4
BRL-CHF X-RATE	0.3	0.0	-4.2	0.4	1.6	0.4









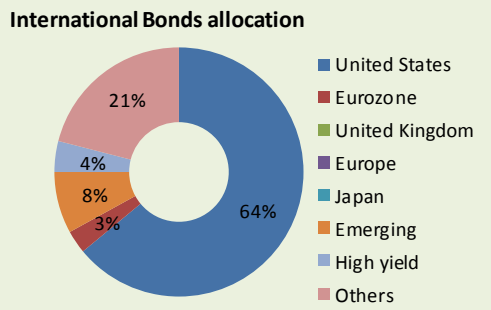
Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

International Bonds

- The Fed will keep rates steady for the remainder of the year
- Upswing in inflation and long-term rates
- Yields in euro bond markets temporarily vanish
- Stay overweight the US market

BONDS (Areas/currency)	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Switzerland	↘	↘↘							
United States	↘	↘							
Eurozone	↘	↘↘							
UK	↘	↘							
Europe	↘	↘↘							
Japan	↘	↘							
Emerging	↘	↘							
Other (AUD, CAD, NOK...)	→	→							



Tactical Allocation

- Reduce exposure to Eurozone
- Overweight US bonds
- Diversify risks through an exposure to CAD, AUD and emerging debt
- Reduce exposure to high yield

The Fed will keep rates steady for the remainder of the year

The US Federal Reserve, already discomfited by its ninth rate hike in December 2018, will have to adopt a particularly prudent policy in 2019 to avoid any risk of slippage of the economy. FOMC members will likely have to wait quite some time before proceeding with a tenth increase. The target rate's current level is now termed 'neutral'. There is thus very little risk that the Fed will raise rates given the likely temporary economic downturn in Q1. President Powell remained positive with regard to the economic situation in the US during the Fed's last press conference, but he also succumbed to the general tendency to revise the outlook for 2019 downwards and significantly recalibrated his monetary policy projections, announcing a time horizon of three years for the next rate hike.

The Fed lowered its GDP growth forecast from +2.3% to +2.1% and its inflation forecast from +1.9% to +1.8%. Its unemployment forecast remains unchanged at 3.7%. In our view, this change in attitude reflects increasing concern with regard to the potentially negative implications of continuing to normalise monetary policy in the current slightly more uncertain context. However, this caution is consistent with our belief that the Fed will prefer to delay reacting to any future upswing in inflation than to implement a normalisation policy prematurely. The recent decline in price indices since the highs of 2018 will bolster the Fed's wait-and-see approach. We continue to anticipate that the Fed will exercise considerable flexibility in managing its monetary policy in 2019, although we discard for now the possibility of a rate cut, which is nevertheless suggested by the fed funds futures curve, which shows a 50% chance of a cut at the beginning of 2020.

In our view the flattening of the US yield curve following the decline in long-term rates does not signal a recession in the current context as we have been hearing too often. However, this situation is clearly an inhibiting factor for FOMC members, who are not willing to risk taking action in the absence of an upturn in the economy. According to the Fed, it is thus no longer necessary to tighten rates in order to check inflation. The Fed also decided to slow its balance sheet reduction programme by lowering the amount it is unwinding from $30 to 15 billion per month. It is also prepared to simply stop unwinding if necessary as of September. In so doing, the Fed is clearly demonstrating its willingness to interrupt its normalisation process to factor in the risks of a downturn in global growth. The fed funds target range is still 2.25 - 2.50%.

Upswing in inflation and long-term rates

The decline in inflation over the past few months stemmed mainly from the fall in energy prices and will only be temporary. At the beginning of the year, we expected that the positive economic outlook would rapidly lead to a trend reversal with regards to fuel prices and push price indices back up. Since 1 January, crude prices have surged +33% and should thus start to have an effect on inflation. Rising household income is increasing consumers' purchasing power and businesses' ability to increase their sales prices, thus intensifying inflationary pressures. We expect that before long inflation will once again exceed the Fed's stated target, although the Fed is unlikely to respond. Wage inflation will thus be a key factor in price index growth in 2019, which could be discernible more rapidly in the service sector. For now, the leading economic scenario in the rates market still seems to be that growth will flag. The outlook for Q1 has indeed deteriorated slightly (+1.5%), but the upturn anticipated in Q2 (+2.6%) could be bolstered by the announcement of a solution to the on-going trade dispute between the Americans and the Chinese. The correction in long-term rates from 3.2% to 2.6% between November and December continued through the last days of March. This decline in long-term rates now seems excessive given the current economic context. We expect 10-year rates to rise concurrently with an improvement in economic figures before summer.

BOND INDICES (local currency)

31.03.2019

	Name	Last price	Curr.	Total Return Performance 7 d%	1 m %	3 m %	6 m %	YTD %
SWISS BONDS	SBI AAA-BBB	139.0	CHF	0.0	1.3	1.8	3.1	1.8
UE BONDS	Barclays EuroAgg	256.0	EUR	0.1	1.7	2.5	3.5	2.5
UE BONDS - SHORT DURATION	ISHARES EURO GOV BND 1-3	144.2	EUR	0.0	0.2	0.2	0.9	0.2
US BONDS	JPM U.S. Aggregate Bond Index	651.5	USD	0.3	2.2	3.1	4.8	3.1
US BONDS - SHORT DURATION	BGF-USD ST DURATN BOND-USDA1	8.5	USD	0.4	0.8	1.9	2.2	1.9
EMERGING BONDS	JPMorgan Emerging Markets Bond	562.1	USD	0.4	1.8	7.4	5.9	7.4
INTERNATIONAL BONDS (DIVERSIFIED) - USD	JPM Global Aggregate Bond Index	577.3	USD	-0.1	1.6	2.3	3.9	2.3
INTERNATIONAL BONDS (DIVERSIFIED) - EUR	JPM Global Aggregate Bond Index	675.1	EUR	0.4	3.1	4.2	7.0	4.2
INTERNATIONAL BONDS (DIVERSIFIED) - CHF	Barclays Global Agg Corporate	148.7	CHF	0.4	1.5	5.2	4.6	5.2
CONVERTIBLE BONDS (UE)	Exane Europe Convertible Bond	7789.0	EUR	0.6	1.9	5.9	-0.2	5.9
HIGH YIELD BONDS	Markit iBxx Gbl Dev Lq HY USD	147.4	USD	0.1	0.4	5.9	1.2	5.9
HIGH YIELD BONDS - SHORT DURATION	AB SHORT DURATION HI YD-AT	14.7	USD	0.3	0.7	5.2	2.6	5.2

1) Short & Medium-term (1-5 years)
2) Emerging Bonds (Corporate)
3) Emerging Bonds - Eastern Europe

Graph sources: Bloomberg/BBGI Group

ECB announces a new series of TLTROs

It is obviously not a huge surprise that the ECB changed its perception of the economic situation in Europe somewhat in light of the slowdown in the manufacturing sector and the weakness of the German economy. The growth forecast for the European economy announced at the ECB's most recent press conference was revised downwards from +1.7% (December forecast) to only +1.1%. Given the risk of an economic downturn in the Eurozone, the ECB decided to postpone raising target rates until 2020 and to resume policy loans to the banking sector. This announcement does not come as a surprise, as we already expected the economic slowdown at the end of 2018 to result in a deferral of any rate hike to Q4 2019 at the earliest. As for the second announcement, the ECB changed its position rather radically, announcing a resumption of liquidity injections to start in September after terminating its asset purchasing programme in January 2019. These liquidity injections will take a new form, as they will be targeting the banking sector, aiming to boost economic activity via an increase in loans to businesses and households. These new bank refinancing operations (TLTROs) could amount to up to 700 billion euros and aim in particular to avoid a contraction in credit.

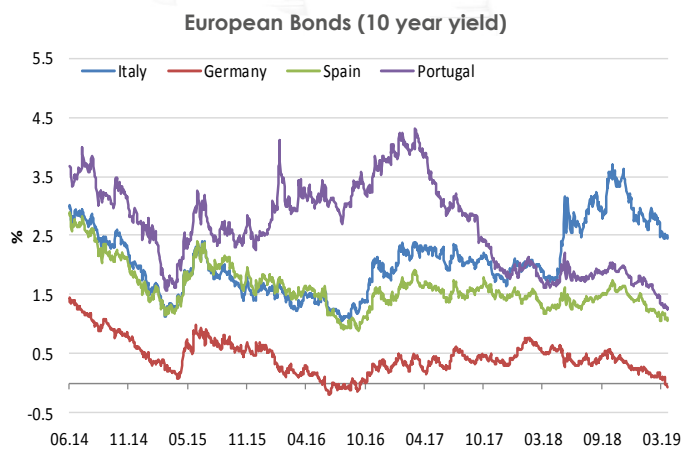
Bond market yields temporarily vanish

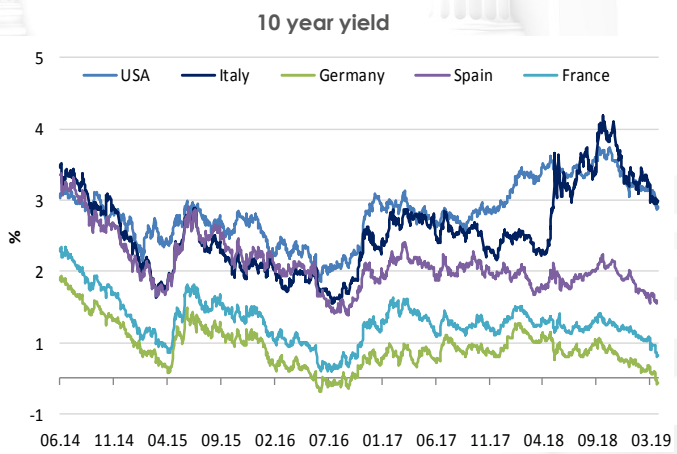
The economic slump in the EU has had a major impact on euro interest rate markets over the past six months. While the growth outlook steadily declined as leading manufacturing sector indicators dropped, euro long-term rates suddenly changed course, resuming a downward trend reinforced by a concurrent correction in price indices. Indeed, inflation has been decreasing rather sharply in the euro area in the past few months due mainly to the fall in energy prices. The CPI index contracted from its October 2018 high of +2.3% to only +1.5% in February of this year. Excluding food and energy, however, the decline in the core CPI index from +1.2% to +1% is less significant.

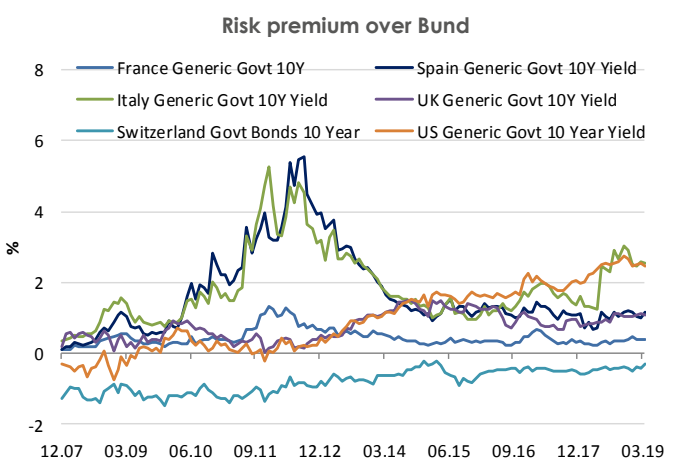
Investors' perception of where long-term rates should be at the beginning of 2019 shifted significantly as a result of these developments. Following European manufacturing PMI indices, euro long-term rates returned to their historic lows of 2016. The 10-year Bund yield is once again close to zero, indicating a rather extreme degree of pessimism among investors. President Draghi finally had to revise his expectations regarding inflation as well, in spite of his view that the vigour of the job market will put increasing upward pressure on wages, which will ultimately lead to an increase in underlying inflation over the next several months. The ECB forecast was thus lowered to +1.2% for 2019. Current trends point downwards, and the likelihood that long-term rates may rise has for now clearly receded in light of the economic weakness of the euro area. However, current levels of pessimism may already be extreme and are motivated in particular by the poor performance of the manufacturing sector. Leading indicators for the industry will have to stabilise and turn around in order for expectations regarding long-term rates to shift. More than ever we recommend avoiding euro-denominated bonds, as their medium-term outlook is mediocre.

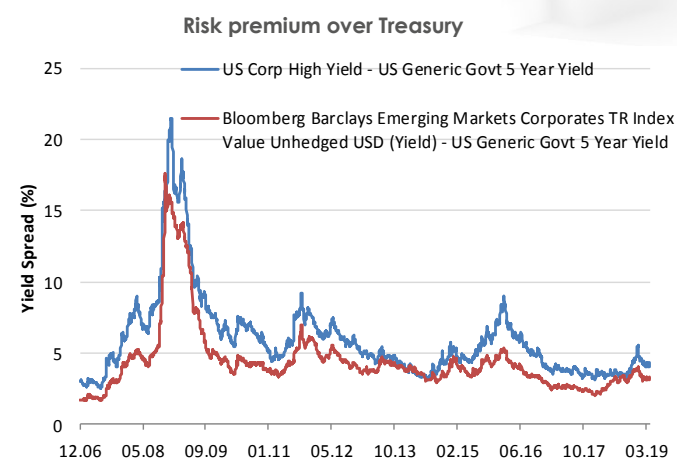
Risks of a no-deal Brexit not factored into UK interest rates

The first Brexit deadline on 29 March 2019 came and went without an agreement being reached between the UK and the EU. The country's complex political situation prevented Prime Minister Theresa May from gaining approval from Parliament for her proposed solution. A no-deal withdrawal on 13 April or 23 May is increasingly likely. The impact of such a political failure does not seem to have been genuinely factored in by financial markets, which prefer not to consider this outcome, which would be particularly negative for the British currency and the country's economic growth, as well as for inflation most likely, to mention just the key points. Given the circumstances we fear that the current level of long-term rates (1%) is absolutely not suited to an economy that could very quickly fall into stagflation, i.e., slower growth and rising CPI and PPI indices. Especially low yields in pounds are indeed tied to a risk of sudden capital losses and a devaluation of the pound as well as a likely loss of investor confidence. This environment is not particularly attractive, and we recommend discontinuing any exposure to the British rate market.









Graph sources: Bloomberg/BBGI Group

Avoid Japanese bonds

Economic conditions prevented inflation (CPI) from maintaining a faster pace. Indeed, inflation fell swiftly from +1.4% in October 2018 to only +0.2% in January 2019. An upswing in prices was conditioned upon on a depreciation of the yen, but inflation is still far from the BOJ's target (2%). Production prices followed the same downward trend, falling from +3% to +0.8%. The current context is clearly not favourable to the bond market, which still fails to offer attractive prospects to foreign investors in terms of yields, while the risk of capital losses is high over the long term.

The Bloomberg-Barclays bond indices add Chinese government debt

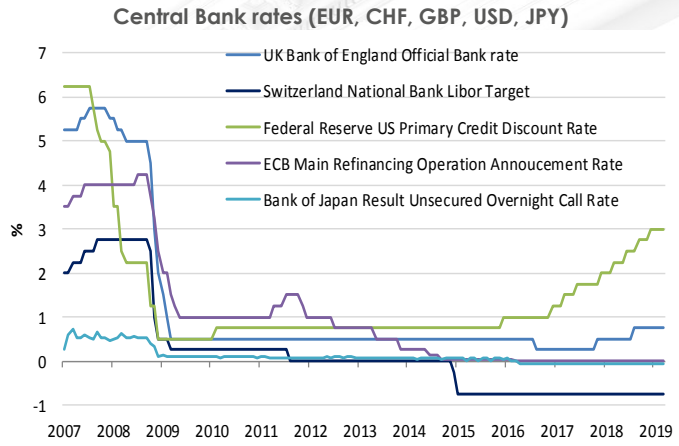
The Chinese bond market has grown to an impressive 13 trillion US dollars and will soon exceed the size of the Japanese bond market, second largest in the world after the US. For the first time, Chinese bonds will be included in the Bloomberg-Barclays global bond indices as of 1 April 2019. Securities to be added include Chinese government bonds and well as those of three state-owned banks. Foreign investment in Chinese debt had already doubled between 2016 and 2018, exceeding 1,500 billion yuan. This decision is thus quite likely to increase the proportion of foreign investors, which currently hold around 2% of total Chinese debt. The Chinese government will likely continue its efforts to facilitate foreign investors' access to its capital markets. The flow of funds into Chinese capital markets can be expected to exceed 100 billion dollars per year over the next ten years, gradually increasing the share of foreign investment to 20% of Chinese government debt.

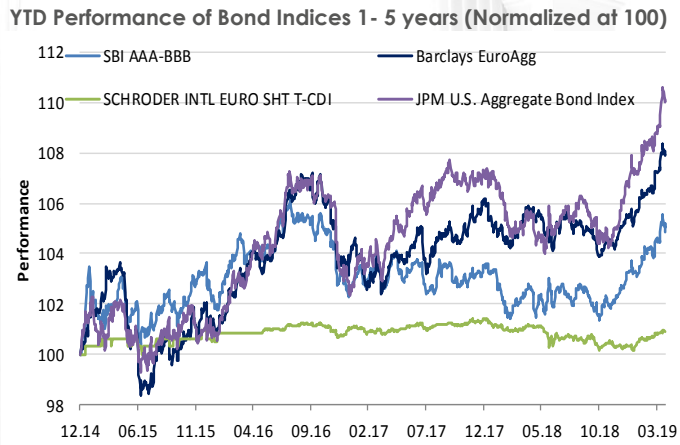
High yield bonds and emerging market debt

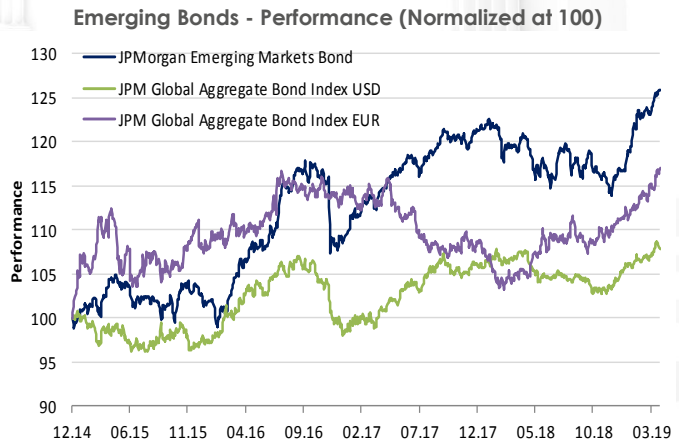
The improvement in the stock market climate in Q1 was particularly beneficial for non-investment grade bond markets (+5.4%) and emerging markets (+6.3%), which outperformed. Indeed, these markets benefited from several positive factors in the short term, which led to several significant upswings since the lows of December 2018. Indeed, these market segments had been hit hard by the stock market panic, in contrast to developed bond markets, which benefited from fears of a recession due to their defensive nature. Risk premiums on high yield bonds in particular, which had been partially reconstituted during the panic, contracted once again as prices rose over the past three months, further reducing the yield spreads of emerging debt. Nevertheless, these two market segments still offer superior and attractive returns from a relative perspective, and will remain sought after by investors looking for yield pick up in spite of flattening risk premiums. The improvement in the economic outlook for the next few months will further compress risk premiums due to the increase in yields on investment grade issuance. This situation will likely have a negative impact on these markets, although they do have positive yield spreads that could partially compensate for the yield adjustments that will inevitably have to occur.

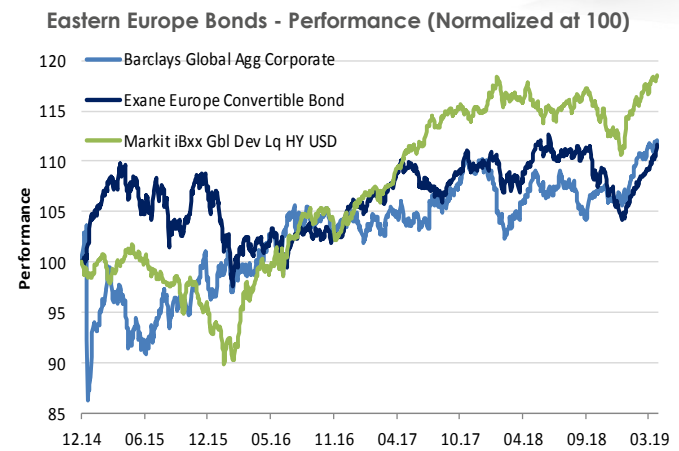
Stay overweight the US market

The latest fall in yields in March was driven by fears of a sharp economic slowdown as early as Q1 2019. Similarly to the fall in long-term rates in Q4 2018, this latest drop does not appear to reflect a less pessimistic economic outlook. An improvement in PMIs, leading indicators and economic statistics over the next few months will likely cause a significant readjustment in interest rates and a fairly generalised steepening of yield curves in most countries. Overall, this context is not favourable to bond markets, in particular those with low yields in absolute terms. In our international bond allocation we are overweight rate markets with high enough yields to offset, at least partially, the impact of rising rates and steepening yield curves. In the investment grade segment of developed countries, we are overweight the US and short durations.









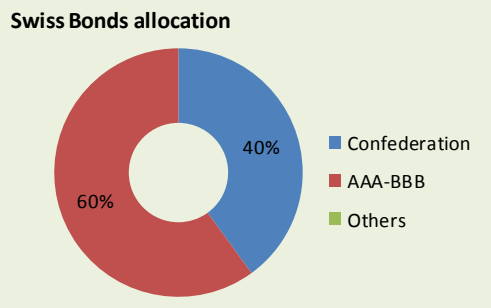
Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

Swiss Bonds

- New anomaly on long rates
- Swiss rates still under Europe's influence
- Slight rise in Swiss yields
- Real-terms yields still negative in 2019

BONDS Type of Debtor	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Governement	↘	↘							
Corporate (IG)	↘	↘							
Others	↘	↘							



Tactical Allocation

- Underweight Swiss Government Bonds
- Overweight the "IG" segment
- Short duration

New anomaly on long rates

Normalisation of Swiss long rates started in summer 2016, but the first phase of adjustment quickly stabilised at 0% on Swiss ten-year rates, before seeing further significant adjustment over the past five months. The unexpected slump in Eurozone and Swiss growth and the slowdown on inflation from +1.2% August to just +0.6% in February 2019 have once again pushed long-term yields on Swiss ten-year bonds into negative ground.

The fall on financial markets clearly benefited fixed-yield investments in a period of increased volatility. More surprisingly, for the time being, at the start of this year rate markets are not reacting to the improvement in the stock market climate and investors returning to risky assets. Indeed, long rates were still a little lower in February than they were at the end of December, which we believe to be rather abnormal given the current context. We will almost certainly have to wait for economic data to improve both in Switzerland and the Eurozone before the pace of normalisation picks up. As such, we believe that Swiss long rates should rise over the coming months, recovering to the levels seen at the start of 2018. The performance of bond markets in Swiss francs should therefore be negative over the next few months.

Swiss rates still under Europe's influence

In 2019, changes in the Swiss yield curve will remain very much dependent on the economic situation in the Eurozone and developments in the Euro-Swiss franc exchange rate. Although the very short sections of these two curves have seen no change as the ECB and the SNB have made no change to their monetary policies, the middle and long sections have seen clear corrections amid the uncertain economic context over the past few months.

Naturally, ten-year Swiss rates slipped below zero in November when the risk of a recession in Germany became greater. The two rate markets kept step with each other until the end of March, with yield in Swiss francs reflecting the fall in that of German rates. As such, the ten-year rate differential remained steady, oscillating within a very narrow range of 40 basis points. However, the strongest correction of rates in Euros to below zero was not mirrored in the Swiss market, thus reducing the yield differential to 0.28%.

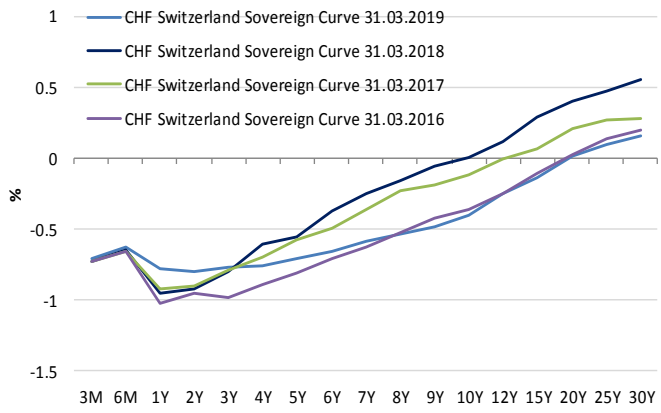
Slight rise in Swiss yields

We find the current pessimistic outlook affecting both of these markets to be both extreme and excessive. Growth forecasts for the Eurozone and Switzerland should improve from the 2nd quarter onwards, turning the current trend on its head. In this context, yields in Swiss francs should once again head into positive ground, probably during the 3rd quarter.

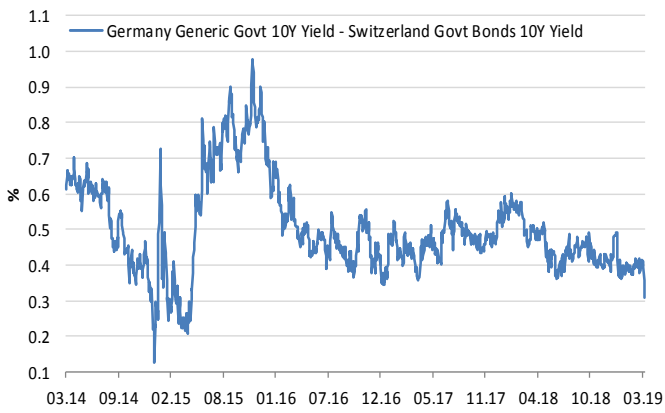
Real-terms yields still negative in 2019

The fall in nominal yields (-0.45%) was closely matched by the fall in Swiss inflation (-0.5%) over the past five months. With long-term yield at -0.4% and Swiss one-year rates at -0.5%, this was not enough to compensate for inflation; although waning, it still stood at +0.7% year on year in March. Real-terms yields therefore remain very much in the red. This situation still will not right itself in 2019 and, though abnormal, it is positive for GDP growth.

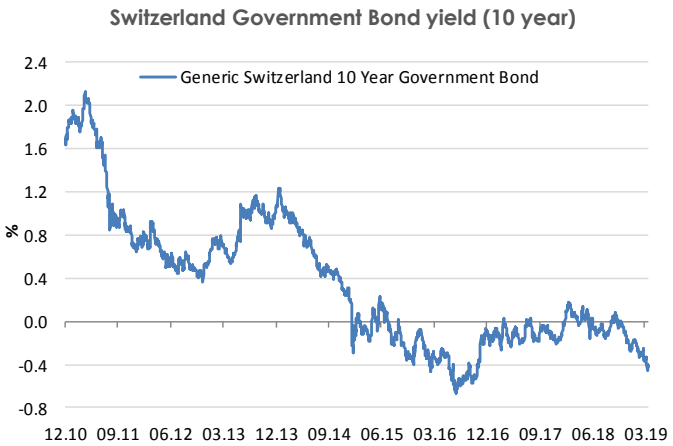
Switzerland Sovereign Yield Curve

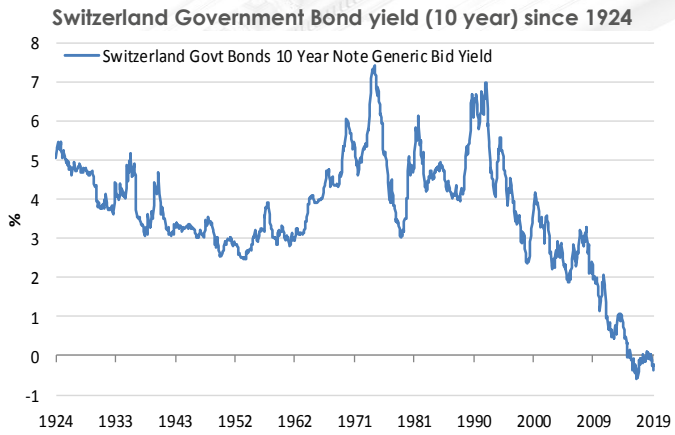


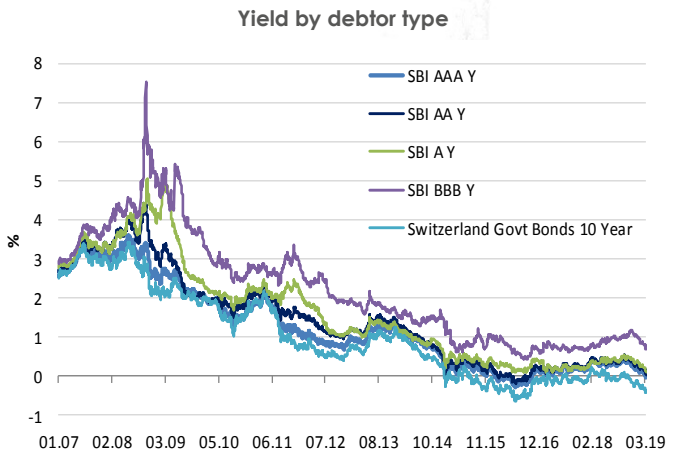
Long rates Yield Spread (German Bund - Swiss Confederation)

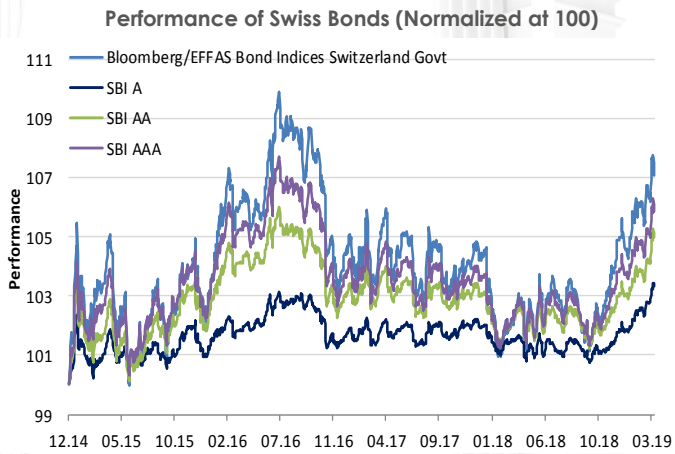


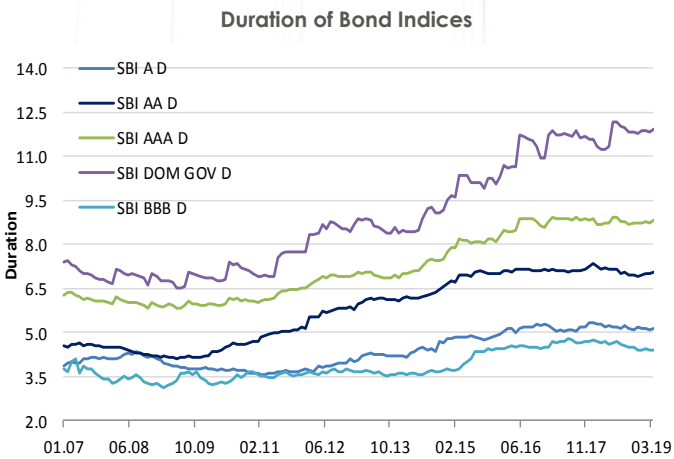
Graph sources: Bloomberg/BBGI Group

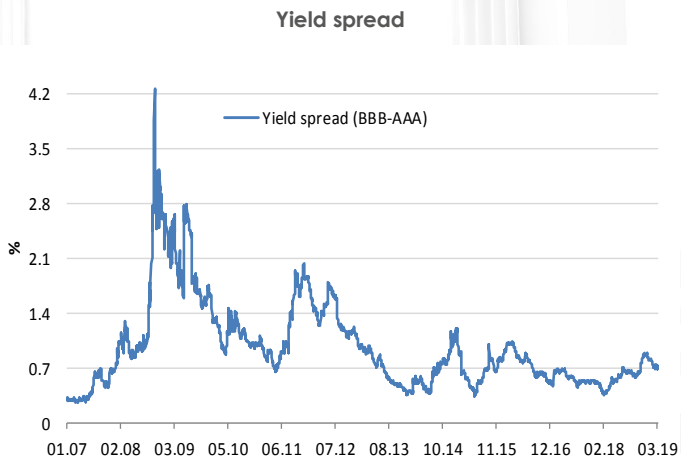


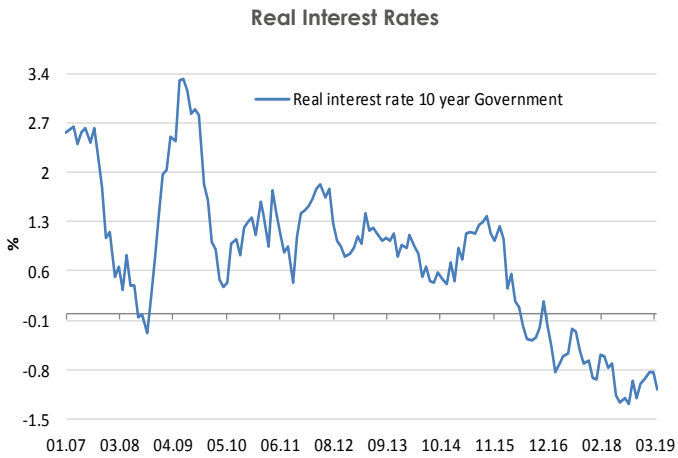












SWISS BOND INDICES (CHF)

31.03.2019

	Last price	Curr.	Total Return Performance 7 d %	1 m %	3 m %	6 m %	YTD %
Bloomberg Barclays Series-E Switzerland Govt All > 1 Yr Bond Index	268.2	CHF	-0.5	1.6	2.0	4.8	2.0
SBI A-BBB	138.0	CHF	0.1	0.9	1.7	2.0	1.7
SBI AA-BBB	136.9	CHF	0.1	1.2	1.8	2.5	1.8
SBI AAA-AA	138.8	CHF	-0.1	1.5	1.9	3.5	1.9
SBI BBB	149.8	CHF	0.1	0.8	2.0	1.9	2.0
SBI AAA-BBB	139.0	CHF	0.0	1.3	1.8	3.1	1.8
SBI DOM GOV AAA-BBB 1-3P	68.3	CHF	-0.1	-0.2	-0.7	-1.2	-0.7
SBI DOM GOV AAA-BBB 3-7P	87.7	CHF	-0.2	0.2	-0.2	0.3	-0.2
SBI DOM GOV AAA-BBB 7+ P	131.3	CHF	-0.8	2.2	2.5	6.1	2.5

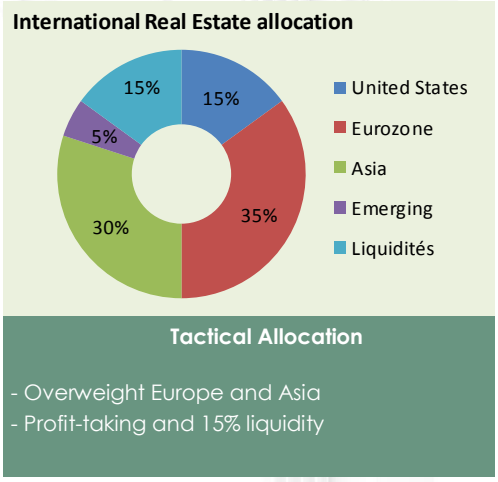
Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

International Real Estate

- Exceptional quarter for indirect real estate
- More moderate increase in direct real estate prices
- Economic growth boosts real estate investments
- Interest rates not threatening valuations yet
- Reduce tactical allocation in US

REAL ESTATE Areas	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Switzerland	↗	↗							
United States	↗	↗							
Eurozone	↗	↗↗							
United Kingdom	↘	↘							
Asia	↗	↗↗							
Emergents	↗	↗↗							
Liquidity									



Exceptional quarter for indirect real estate

At the end of last year we described the situation in various securitised real estate markets as a major boon and a genuine investment opportunity in view of the sell-off by panicked investors alarmed by the emergence of an extreme scenario involving a US recession combined with a collapse of global growth in 2019.

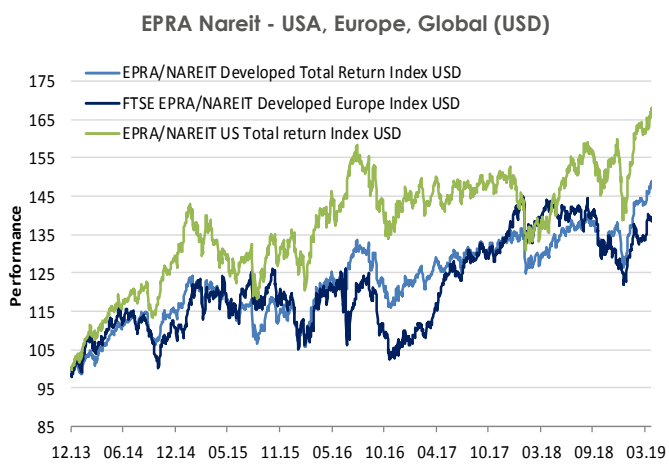
The drop in listed real estate exceeded -6% in 2018, most of which (-5%) occurred in December. We noted then that this correction was irrational and would be temporary, likely due to the wave of panic that overtook financial markets rather than to a real change in conditions in global real estate markets. Our recommendation at the time was to take advantage of this opportunity to reposition on the cheap, focusing on Asian markets while also taking larger stakes in the US and European markets. This strategy proved effective in Q1 2019, as listed real estate rose, in some cases significantly.

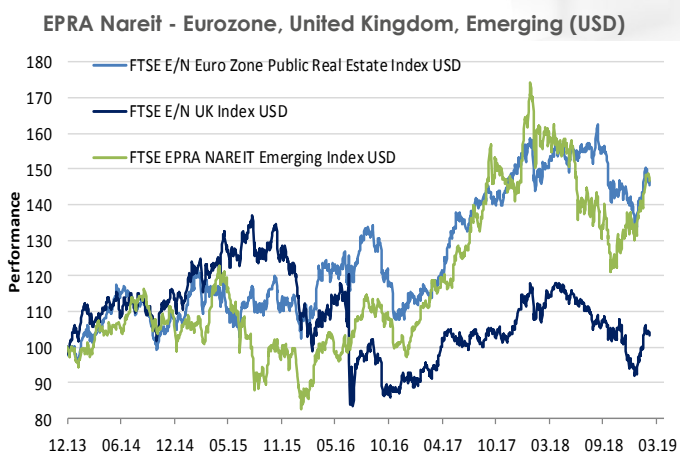
From a global point of view, international securitised real estate progressed by an impressive +14.7% in just three months, more than compensating for the -5% correction in December. The performance of international real estate indices thus exceeded that of equity indices (+12.5%), which is particularly significant given the still uncertain – albeit more serene – context prevailing so far this year. All the large securitised real estate markets rose sharply.

Emerging markets (+18%) and Asia (+14.4%) posted the best results, but the US (+15.5%), Europe (+13.1%) and the UK (+11.3%) also bounced back significantly.

The first significant decrease in long-term rates, in some cases to below zero, which occurred in December, did not have a positive impact on listed real estate, quite the contrary. However, over the past few months, in a more optimistic stock market climate, this factor certainly contributed to the increase in real estate share prices. Nevertheless, we don't think it will reprise this positive role over the next few months because of the trend reversal we are anticipating in rate markets given the improving economic environment in the coming quarters.

With regard to investment policy, we expect that securitised real estate investments will continue to offer much more attractive returns than bonds. International securitised real estate thus remains an attractive form of diversification for investors. Expected returns over the next quarters will inevitably be lower than those achieved thus far this year, but in most geographic regions we anticipate yields much higher than those on bonds as well as additional capital gains. Risk premiums are high enough to motivate being overweight this asset class.





Graph sources: Bloomberg/BBGI Group

More moderate increase in direct real estate prices

The US real estate market has been stabilising for several months already. While the residential segment was still decelerating at the beginning of the year, yoy real estate price growth was still approximately +3.6% in January, significantly less than the previous year's increase over the same period. Interim results seem to suggest that prices have picked up over the past months. The residential market should be bolstered by the recent decrease in mortgage rates and the visibility provided by the Fed Chair's shift in attitude with regard to monetary policy.

This situation will likely boost demand and cause prices to rise by approximately +5% by 2020. Demand will also likely strengthen due to an increasingly robust job market, a high level of confidence, and growing disposable income, which means households are increasingly able to purchase residential property. There is no doubt regarding US economic momentum, which will drive further price growth, albeit at a much slower pace.

The uncertainty surrounding the unresolved issue of what shape Brexit will take continues to weigh on real estate prices in the UK, which are increasingly volatile this year. The recent publication of residential property prices for March (-1.6%) stands in contrast to the February upswing (+6%), which had been preceded by a -2.6% drop. Housing prices fell more sharply in London than in the rest of the country.

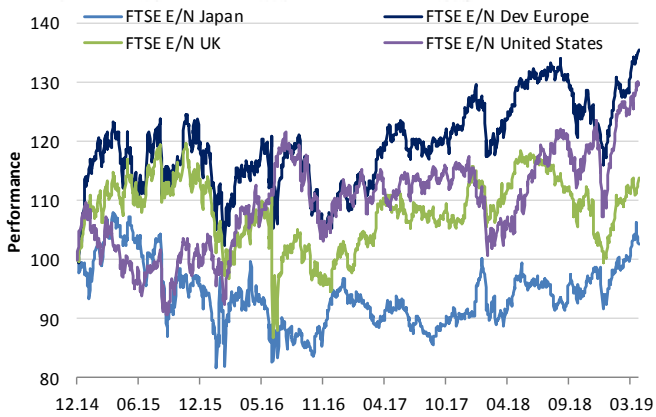
Brexit continues to cast a shadow over the British market, which still does not offer any repositioning opportunity. We recommend staying away from this market for now, as the Bank of England is suggesting that real estate prices may plunge -25% in the case of a pessimistic no-deal Brexit scenario. While a hard or no-deal Brexit would likely cause UK real estate prices to fall, the outcome for European markets could be positive.

A significant number of workers returning to their countries could boost demand and prices. In Europe, the Portuguese market is thus well positioned to be in high demand, although almost all countries that are benefiting from particularly advantageous borrowing conditions are in fact likely to see increases in real estate prices in 2019.

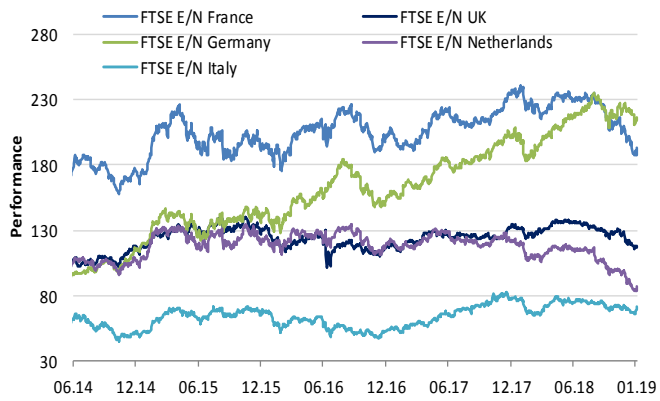
In China, real estate prices progressed by +11.1% yoy in January 2019, while prices continued to rise by a decent +0.53% over the previous month in February. Prices in nearly all cities across the country have been trending upwards, with the National Bureau of Statistics noting that prices rose in 57 out of 70 cities month on month. In Hong Kong, real estate prices finally declined after rising steadily for two years.

The slide started in summer 2018 and has continued until now, resulting from trade tensions, rising interest rates, and the volatility of the Hang Seng index. The situation seems to have improved in Q1, as prices stabilised and could now benefit from a more positive environment. However, from a relative point of view, Hong Kong real estate remains unaffordable for the large majority of residents.

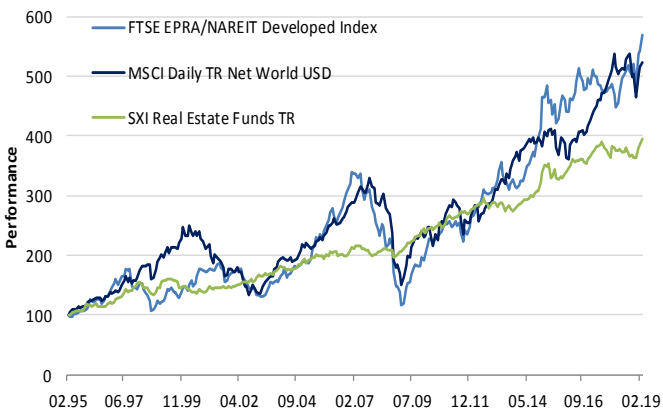
Real estate markets (local currency)



European real estate markets (local currency)



Long-term Performance : international real estate, swiss real estate and international equities (local currency)



INTERNATIONAL REAL ESTATE INDICES (local currency)

31.03.2019				Total Return Performance				
	Name	Last price	Curr.	7 d %	1 m %	3 m %	6 m %	YTD %
GLOBAL	FTSE EPRA/NAREIT Glb TR	2918.7	USD	1.0	4.3	15.0	10.9	15.0
DEVELOPED	EPRA/NAREIT Dev TR USD	5454.1	USD	0.9	4.0	14.9	10.0	14.9
DEVELOPED EUROPE	FTSE E/N Dev Europe	2246.6	EUR	0.3	4.5	13.8	4.8	13.8
EUROZONE	FTSE E/N Euro Zone	2644.5	EUR	0.0	6.0	13.1	3.3	13.1
USA	FTSE E/N United States	3106.2	USD	1.3	4.0	15.9	10.3	15.9
DEVELOPED ASIA	FTSE E/N Dev Asia	1752.8	EUR	1.3	6.2	16.6	18.7	16.6

Graph sources: Bloomberg/BBGI Group

Economic growth boosts real estate investments

Fears of a recession were irrational and largely attributable to the unusual stock market climate at the end of the year. The risks of a slowdown are primarily related to the current quarter and seem to be already mostly factored into economic forecasts. Statements made by US and Chinese negotiators seem to imply that an agreement will be reached, even if it will take a few more weeks to iron out the details.

Meanwhile, economic fundamentals seem to be showing signs that confidence may be stabilising and even improving. The manufacturing sector may thus have reached the bottom of its short-term cycle. Our scenario assumes a limited global economic slowdown with no significant impact on construction and real estate. The global economy will continue to expand in 2019 with positive effects on international real estate.

Interest rates not threatening valuations yet

The beginning of the year was marked by a fairly radical shift in the strategies of the major central banks. The latter had previously been rather optimistic with regard to the vigour of the economy and the necessity of continuing to normalise monetary policy, as shown by the Fed's latest rate hike in December and the ECB's plan to terminate its government debt purchase programme as of 1 January 2019. Indeed, central banks, probably somewhat concerned with regards to developments in financial markets and the emergence of a negative economic scenario that caused a general market panic in Q4 2018, shifted gears.

The Fed stated that it would not change its rates in 2019 and would end its balance sheet reductions. In the Eurozone, the ECB is not planning to raise rates and announced a further wave of TLTRO loans to inject liquidity into the banking system. The drop in long-term rates is no doubt excessive given the economic slowdown. They are thus likely to start trending back up towards levels prevailing in September 2018. Fears of rising interest rates are often mentioned as one of the main risks with regard to the valuation of real estate assets, and rightly so. However, in the current context, it is unlikely that this factor will have a significant impact on real estate prices.

Persistently low real interest rates have positive impact on real estate

Real estate markets are typically expected to perform better when real interest rates are low and the growth outlook is equal to or exceeds its historical average. Excessive fears of a slowdown affected year-end expectations, but global economic momentum will likely turn out to be more resilient than anticipated in 2019, enabling global GDP growth of close to +3.5%. In this context, we continue to think the environment remains favourable to moderate growth in rents and in real estates prices more generally.

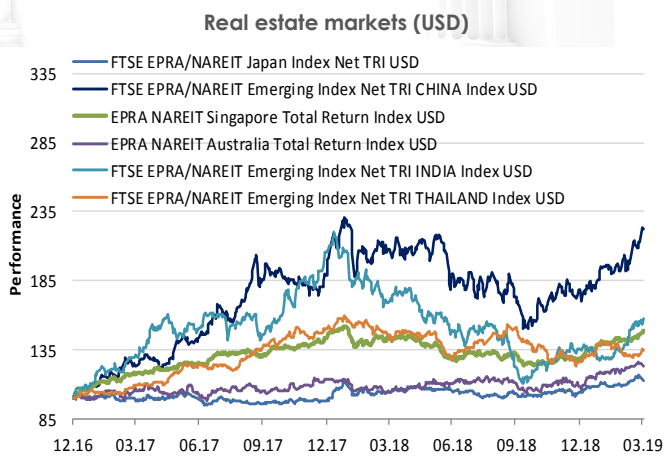
With regard to real interest rates, decelerating inflation, as indicated by consumer price indices in most developed countries, has been accompanied by similar decreases in long-term yields. In the US, inflation slid from +2.2% to +1.5% in February, while 10-year US Treasury yields fell from 3.1% to 2.4%. Similar decreases occurred in the euro area, where inflation slid from 2% to 1.5% in February and 10-year German Bund yields fell from 0.55% to 0%. Barring an actual recession, inflation will likely be bolstered in 2019 by increasingly robust job markets, hourly wage increases, and rising commodity and energy prices.

Current real yields are negative not only in the Eurozone but in other developed countries such as Japan as well. In emerging markets, this factor will be less favourable due to positive real yields. This is the case in China in particular, where inflation (+1.5%) is lower than government bond yields (3.2%).

Reduce tactical allocation in US

Given the extremely rapid increase in securitised real estate in Q1, it has become more challenging to justify a continuation of this trend in the immediate future. The outlook remains positive overall, as we mentioned, but going forward growth is less likely to be linear and will impact various regional markets in different ways.

The correlation among markets was especially high over the past three months because real estate prices overall were in fact recalibrating after the December panic. Indeed, most markets increased by around +14%, except for emerging real estate, which rose by +18%. Over the next few months, the correlation among securitised real estate markets will likely diminish once again, and there will be a wider disparity in performance. With regard to investment policy, the most mature market seems to be the US market. At this stage we recommend a higher exposure to European and Asian markets, underweighting the US in our regional allocation grid.



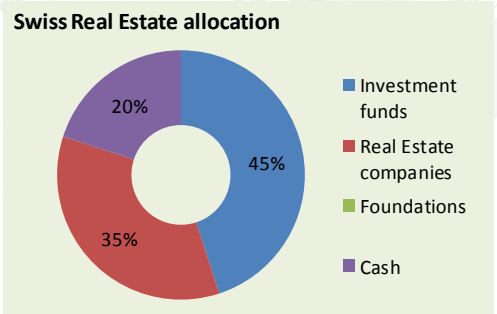
Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

Swiss Real Estate

- New record for securitised real estate
- Yield still attractive, but beware of premia
- Sentiment affected by interest rates

REAL ESTATE Switzerland	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Investment funds	↘	↗							
Real Estate companies	↘	↗↗							
Foundations	→	→							
Cash									



Tactical Allocation

- Underweight investment funds
- Overweight listed real estate companies
- Profit-taking and 20% liquidity

New record for securitised real estate

The performance of both types of accessible investments in the Swiss real estate market was exceptional over the first quarter, radically turning around 2018's trend. The +8.46% rise in investment funds fully compensated for the negative performance in 2018 (-5.3%), as did growth in real estate companies (+9.8%), which more than recovered the ground they had given in 2018 (-1.9%). Securitised Swiss real estate posted a new record on the SXI Real Estate Funds TR index, at 390, as well as for the SXI Swiss Real Estate Shares TR index, at 2,783. Securitised real estate still represents an alternative to fixed income investments in Swiss francs, but it should now tread water in the short term. We will now likely see a temporary price consolidation on these two market segments after the +10% rises posted since the start of the year.

Yields still attractive, but beware of premia

The price rise for investment funds and real estate companies naturally reduced the yield on offer. Nonetheless, it remains high in absolute terms, and clearly still very attractive relatively speaking. Average yield (2.7%) for the funds is below 3% and comes in far below that of real estate companies, which are closer to 3.5%. The average premium has grown from around 15% in the 4th quarter to 24.4% at the end of March. It is still a way off the valuation peaks hit in 2015 and 2016 (around 30%), but is nevertheless within the upper half of its fluctuation bounds of past 25 years. The average premium of real estate companies (21.5%) is lower than for funds but sits closer to its historical average of the last 15 years. Yield levels for these two types of investment remain very attractive, justifying investors' interest in this asset class in 2019. That said, the rise in premia could put the brakes on price rises in the short term.

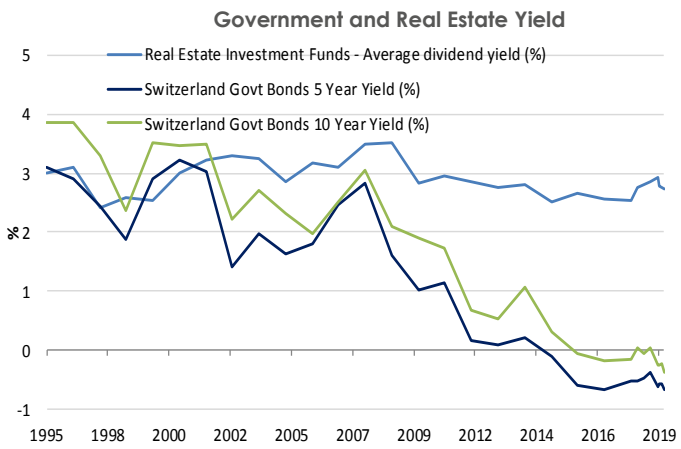
Sentiment affected by interest rates

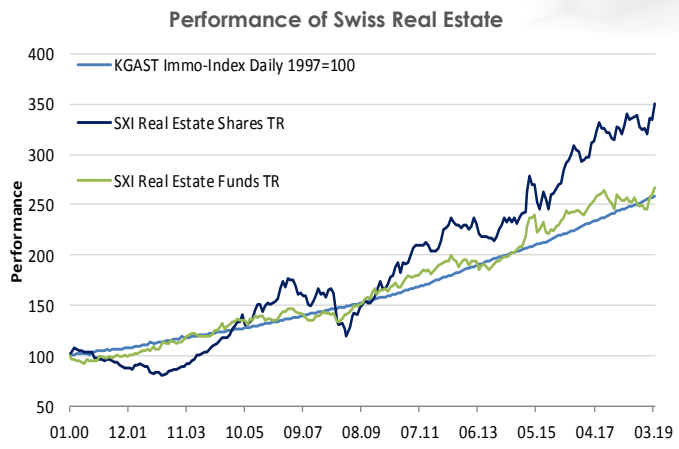
Interest rate developments have certainly had a greater impact on listed real estate assets over the past three months than over the whole of 2018. The improvement in the stock market climate and renewed investor interest in taking risks after the panic in December have propped up listed real estate assets. However, the fall in bond yields over the past five months and the slide on ten-year Swiss bond yields to back below zero have undoubtedly had a greater hand in the reinvestment process and in investors' renewed interest in a Swiss alternative which produces comparatively high yield. Investor sentiment has once again improved under the influence of a fall in bond yields. Risks of a short-term consolidation are once again higher given the expectation that interest rates will gradually start to rise again soon.

SWISS REAL ESTATE

31.03.2019 — Total Return Performance

Name	Last price	7 d %	1 m %	3 m %	6 m %	YTD %
SXI Real Estate Funds TR	392.1	0.5	2.2	8.5	7.0	8.5
SXI Real Estate Idx TR	2605.6	0.7	5.0	9.0	7.0	9.0
KGAST Immo-Index	288.7				2.5	1.0





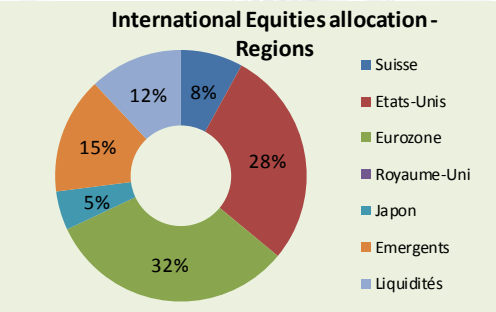
Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

International Equities - Regions

- Euphoria may already be taking over from panic
- A price consolidation is on the cards
- Europe still has a lot of potential to catch up
- Company profits hold back growth on the Nikkei
- Emerging markets should be chosen with care

EQUITIES REGIONS	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Suisse	→	↗↗							
Etats-Unis	→	↗							
Eurozone	→	↗↗							
Royaume-Uni	→	↗							
Japon	→	↗							
Emergents	→	↗							
Liquidités									



Tactical Allocation

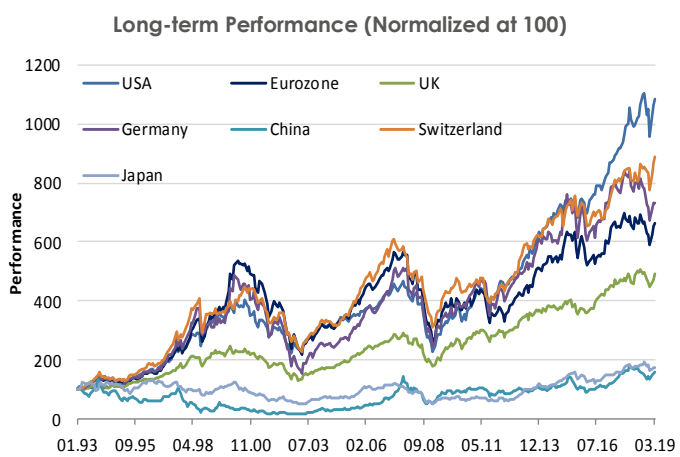
- Overweight Europe and emergent
- Underweight United Kingdom and Japan
- Neutral United States
- Profit-taking and 12% liquidity

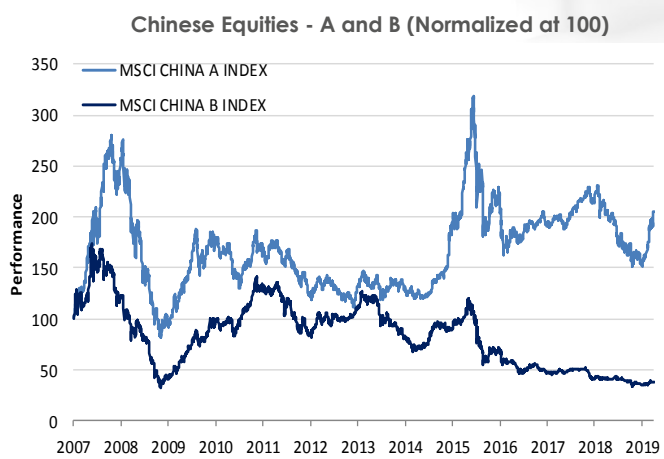
Euphoria may already be taking over from panic

In January, we spoke of the more attractive equity valuation levels in the wake of huge, fast-paced corrections to prices in December 2018. At the time, we had stated that, in the absence of any marked slowdown in global growth in 2019, prospects were favourable for equities. We predicted a price recovery for those assets specifically affected by the apparently overstated forecast of a collapse in US and global growth. Three months on, the investment opportunities highlighted generally materialised thanks to almost systematic price rises of around +10% across all markets. The bounce back in financial assets met our expectations, but it should be pointed out that this revaluation process happened very quickly, at times entirely compensating for the losses at the end of the year. As such, the investment climate went from panic to euphoria in just a few short weeks. The American Association for Individual Investors was showing excessively pessimistic investor sentiment in mid-December. This indicator was almost at its lowest level of optimism for twenty years, at around just 20% bulls, but has bounced back and headed very much north of the 40% threshold. This situation could perhaps not qualify as euphoria, but confidence levels are nonetheless higher than the average of the past few years.

A price consolidation is on the cards

The valuation of assets that depreciated particularly sharply in December have quickly bounced back, sometimes to the point of being generous and potentially risky today. The low PE in December are obviously no longer an issue after price rises of nearly +15% almost across the board. The SPI index posted new highs, with no considerable revaluation of profit growth forecasts for 2019, and is once again trading at 15.7x expected profits (13.9x at the end of December). In terms of evaluating risk, our models have been affected by "valuation, quantitative, technical and sentiment" risk factors to a greater degree. This once again suggests higher scores that place most equity markets in a potentially volatile zone. As such, valuation levels quickly became less attractive in the short term, in a context of modest economic growth for 2019, and in the absence of any upward profit revisions. In our Strategy at the start of the year, we warned that a quick rise in equity prices, particularly if the S&P 500 headed back towards 2,900 points (September 2018), should trigger a careful risk evaluation. With the quarter having closed at 2,822 points, we believe that the time has already come to carry out this evaluation. Our analysis of yield/risk ratios now leads us to believe that the valuations of risky assets point to a profit-taking opportunity on most of the assets that underwent revaluation over the past few months. It is likely we will see fresh volatility in the short-term, but the improvement in the international economic situation will provide a timely opportunity to subsequently reinvest the profits made.





Graph sources: Bloomberg/BBGI Group

In December, our quantitative risk analysis model was suggesting a drop in the risk level and an improvement in the likelihood of a rise on equities. Its reaction to the exceptional growth on equity markets in the 1st quarter was sizable and quick. Risk scores rose and now place most regional markets in the "neutral" zone or in the zone with "significant risk of temporary consolidation" of prices. In the medium-term, risk seems to be reasonable, but the upward trend on indices is unlikely to continue in the immediate future. We believe that equity markets have already anticipated a positive resolution to the conflict between China and the USA and an upcoming improvement in economic prospects. They have also been buoyed up by central banks' change in attitude; banks have assured the markets that their rate normalisation policies are coming to an end. However, although the current context seems favourable, we believe that a temporary price consolidation is likely before we see any real economic progress that would revive the trends seen in the 1st quarter.

Europe still has a lot of potential to catch up

Several months ago we noted that European equities would likely benefit from a probable decrease in international tensions at the beginning of 2019 and from favourable arbitraging by investors due to the European market's positive risk premium. Indeed, the performance of European equities was boosted by a more positive investment climate at the beginning of the year. The Euro Stoxx 50 index of the largest European blue chips, the Euro Stoxx index and the STX Europe 600 all posted performances of close to +13% in under three months. By climbing back to their September levels, European markets rapidly recouped losses posted in Q4 2018. Following this encouraging growth, the European market's overall PE ratio bounced back sharply (13.2x 2019 earnings). However, given the rise of other equity markets, its valuation remains attractive on a comparative basis. The PE ratio of the S&P500 is already at 16.9x 2019 earnings, while that of the Swiss equity market is 15.3x. The valuation gap is holding at around 25%, a relatively significant risk premium, which has remained stable for several quarters. European shares maintain a valuation and yield advantage (3.6% vs. 1.9%), while the earnings outlook for 2019 is converging with that of US shares. In spite of these positive factors, European equities are currently burdened by an uncertain macroeconomic environment and a discouraging news flow. The uncertainty tied to the protectionist threats by the US are, however, likely to gradually subside once an agreement is reached between the parties. Nevertheless, the European economy will also have to offer better prospects to warrant real outperformance by Eurozone stocks. In this context, we recommend taking profits temporarily on European markets as a whole. European equities still have relatively good potential to catch up, but this should only happen gradually, and after a period of consolidation prior to any improvement in growth forecasts for the second half of the year.

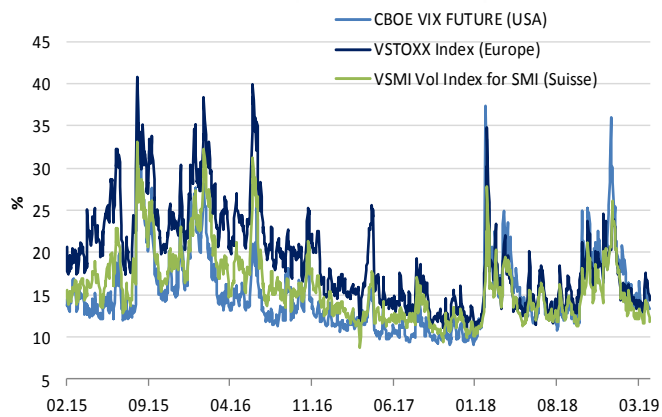
Caution a few weeks shy of Brexit

In the still uncertain context of the Brexit negotiations, the forecast yield/risk ratio for equity markets still does not seem attractive to us. The pound sterling does seem to be standing strong in the fact of uncertainty. Despite this, we are sticking to our recommendation of caution on British equities, despite reasonable valuation and attractive dividend yield.

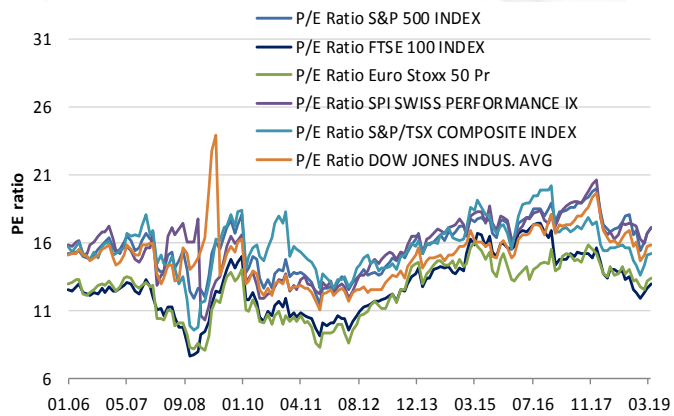
Company profit is holding back growth on the Nikkei

Japanese corporate earnings ended up falling -7% yoy in Q4 2018, which was a brutal shock compared to the positive results posted in June (+17.9%). The volatility of Japan's economic performance and the fall in exports had a significant impact on corporate earnings in H2. An economic upturn is now necessary for Japanese corporate earnings growth to resume, but this seems unlikely without an upswing in the global business cycle. Yet Japanese firms invested significantly in physical capital, with capital expenditure growing by +5.7% yoy, likely in reaction more to the structurally low unemployment rate than to a positive economic outlook for the immediate future. The poor performance of Japanese firms could, however, be followed by a significant rally once an agreement is reached by China and the US with regard to their trade dispute. Chinese and Asian demand is then expected to recover and boost profit growth in 2019 and 2020. The worst may already be over for Japanese corporates, which could once again benefit from a change in international investors' risk perception, whose investments in Japanese securities have been broadly negative over the past several months. Investors' earnings expectations for 2019 are low, leaving room for adjustment that might boost a continuation of the increases in share prices seen since the beginning of the year.

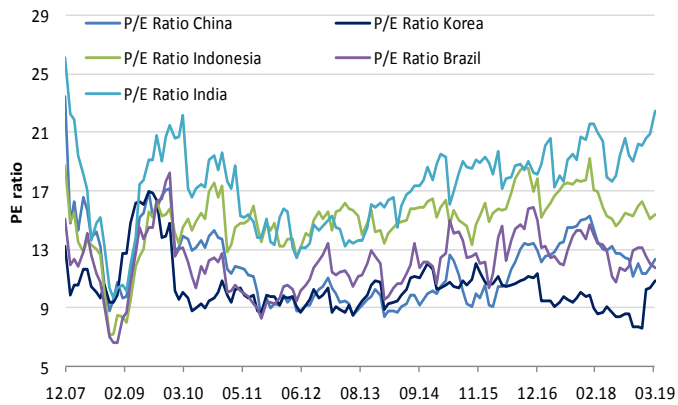
Volatility (USA, Europe, Switzerland)



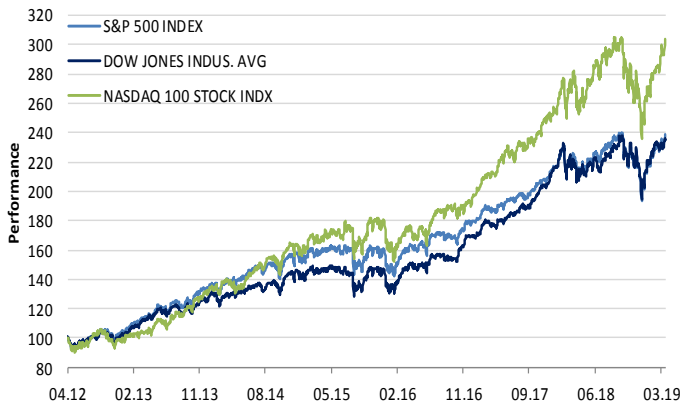
Price/Earnings Developed markets



Price/Earnings Emerging markets



US Equities (Normalized at 100)



Graph sources: Bloomberg/BBGI Group

The Japanese stock market is benefiting only modestly at this stage from the improvement in the market climate, progressing by only +7.8% in yen, one of the poorest performances among developed markets in Q1 2019. Further depreciation of the yen will thus likely sustain a further upswing of the Nikkei, provided that the investment climate improves and that the risks that are currently weighing on the global growth outlook recede. The outlook is positive for 2019, but we are maintaining a relatively neutral strategy with regard to Japanese equities.

Better prospects for semi-conductors, electronic components, and the car industry should prop up a recovery on the Nikkei index at the start of 2019. The latest Tankan poll by the Bank of Japan suggested a slight improvement in the confidence yardstick for large companies at the end of the year. Companies' average exchange rate forecasts for the end of the year stood at 109.4 yen to the US dollar, almost at the exchange rate seen at the end of the year (109.7). The yen has temporarily enjoyed Japanese investors flocking back to it, but we do not believe that fundamentals are strong enough for the yen to appreciate at the start of 2019. The yen weakening, in tandem with a recovery on export forecasts, should allow Japanese companies' forecasts to be revised upwards. The +17.9% year on year profit growth announced at the end of the June fizzled away to just +2.2% at the end of September. As such, Japanese companies' profit growth cannot pick up the pace unless risks of a trade war can be ruled out. Bearing that in mind, the fall in equity valuations to 14.5x profits offers an interesting opportunity to reposition.

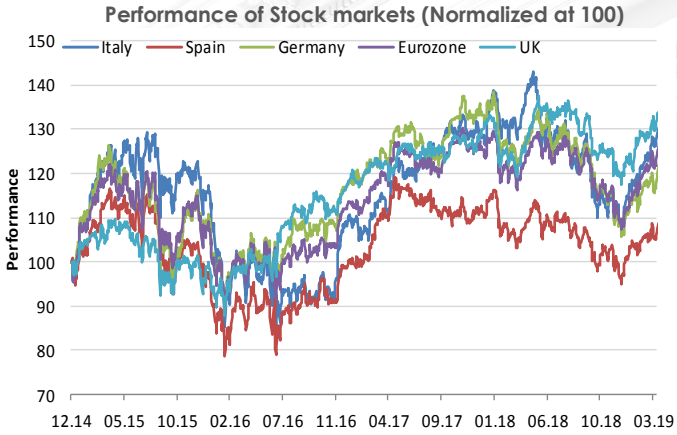
Emerging markets should be chosen with care

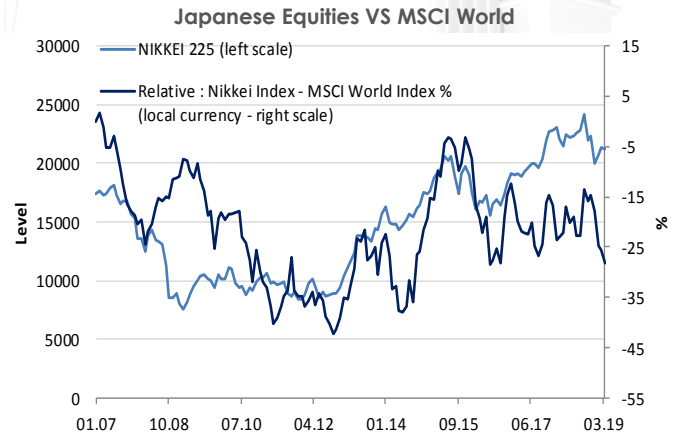
The first quarter was extremely strong for most emerging markets; the MSCI Emerging Market index posted +11.3% growth. However, our forecasts were highest for Asia, and it was this region, especially China, that benefited the most from the change in investor sentiment. Despite the conspicuous absence of an agreement between China and the United States, optimism has made a come-back on Chinese equity markets. The forecast outperformance of this market turned out to be considerable thanks to the exceptional +33.3% growth achieved in the 1st quarter; this rise was the third greatest of the last ten years. Chinese assets had nosedived throughout 2018 (-28.5%), but have completely made up this fall, and are trading at just about 7% under their peak in January 2018. Our positive forecasts were quickly realised, despite the lack of any clear development in world trade. Further, today we believe that although long -term prospects for emerging markets remain positive, the risk of seeing profit-taking in the short-term is now very high. We now predict that in all likelihood there will be a temporary phase of consolidation, which could start at the beginning of the second quarter. The Chinese market will be affected by profit-taking to the greatest degree. Korea, Taiwan, India and Indonesia posted less impressive performances and will certainly benefit more from an upcoming revaluation of equities.

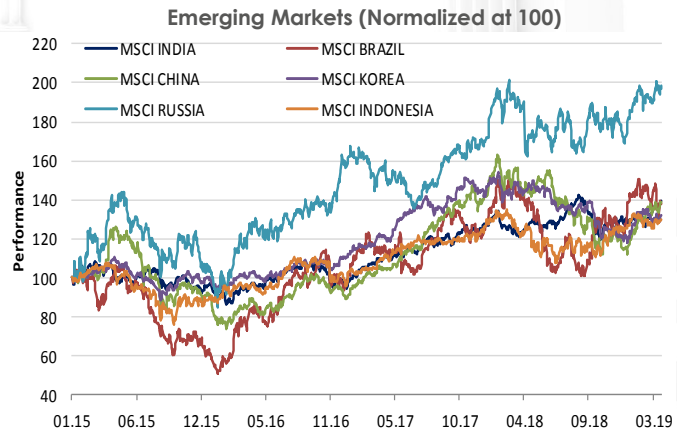
EQUITIES - BY REGION (local currency)

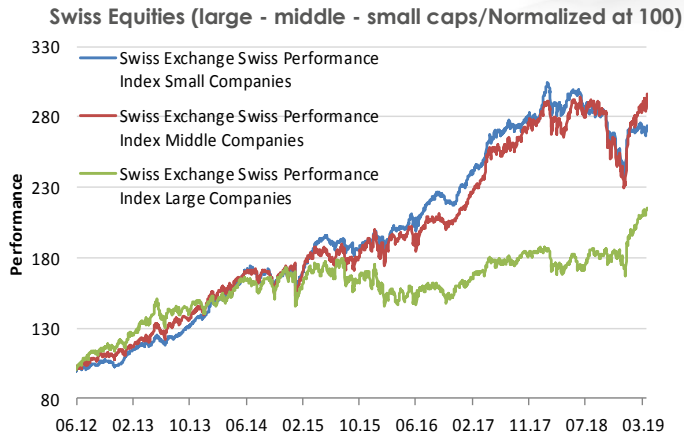
31.03.2019				Total Return Performance				
	Name	Last price	Curr.	7 d %	1 m %	3 m %	6 m %	YTD %
SWITZERLAND	SPI Swiss Performance Index	11241.2	CHF	1.6	2.2	14.4	4.0	14.4
SWITZERLAND SMALL-MID CAPS	SPI Extra Total Return	4018.5	CHF	1.0	0.2	12.9	-7.6	12.9
EUROPE	STXE 600 € Pr	379.1	EUR	1.0	1.8	13.3	0.6	13.3
EUROPE SMALL-MID CAPS	MSCI Europe Small Cap Net TR E	404.6	EUR	0.8	0.5	14.2	-4.6	14.2
UK	FTSE All-Share Index	3978.3	GBP	1.0	2.1	9.4	-1.4	9.4
USA	S&P 500 Index	2834.4	USD	1.2	1.2	13.6	-2.0	13.6
USA SMALL-MID CAPS	RUSSELL 2500	619.8	USD	2.1	-1.6	15.8	-4.0	15.8
JAPAN	NIKKEI 225	21205.8	JPY	-1.2	-1.1	6.9	-11.7	6.9
JAPAN SMALL-MID CAPS	Russell/Nomura Mid-Small Cap I	835.7	JPY	-0.3	-0.3	7.4	-11.2	7.4
ASIA EX-JAPAN	MSCI AC Asia Pac Ex Japan	529.2	USD	-0.1	1.1	11.6	3.8	11.6
ASIA EX-JAPAN SMALL-MID CAPS	MSCI AC Asia Pacific Ex Japan Small Cap	952.6	USD	-0.2	1.1	9.2	-0.4	9.2
EMERGING	MSCI EM	1058.1	USD	-0.1	0.8	9.9	3.2	9.9
INTERNATIONAL EQUITIES -DIVERSIFIED USD	MSCI Daily TR Net World	6087.5	USD	0.7	0.8	12.5	-2.6	12.5

Graph sources: Bloomberg/BBGI Group





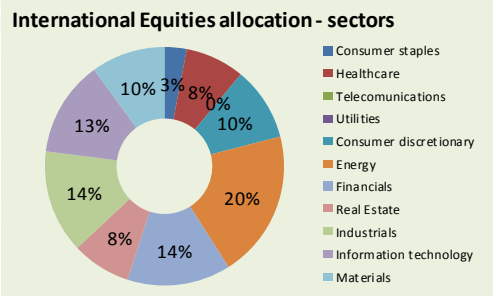




PROSPECTS AND STRATEGIES

International Equities - Sectors

- Overweight cyclical sectors (finance, industrials, energy)
- Overweight tech stocks
- Overweight consumer discretionary
- Small caps expected to outperform



Tactical Allocation

- Overweight digital stocks and technology
- Overweight energy, materials, consumer discretionary and financials

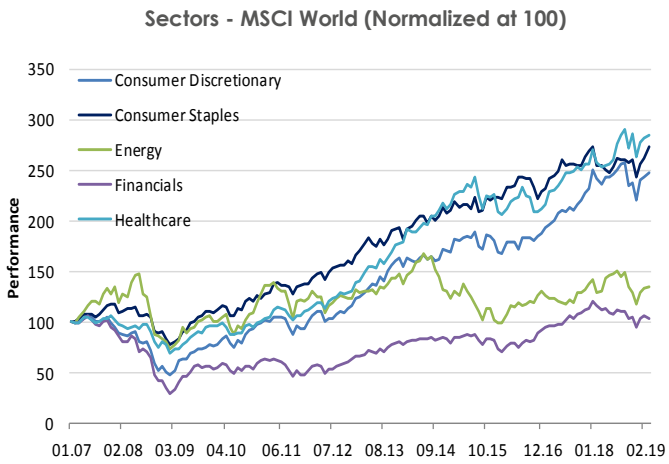
EQUITIES Sectors	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Consumer staples	↗	↗							
Healthcare	→	↗							
Telecommunications	→	→							
Utilities	→	→							
Consumer discretionary	→	→							
Energy	↗	↗							
Financials	↗	↗							
Real Estate	→	↗							
Industrials	↗	↗							
Information technology	→	↗							
Materials	↗	↗							

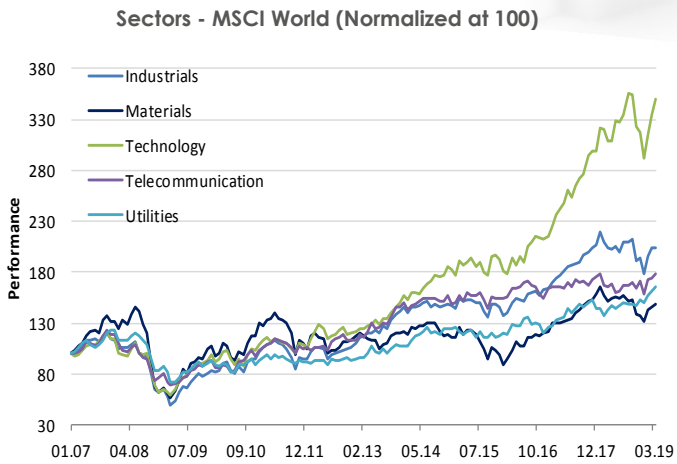
EQUITIES - BY SECTOR

31.03.2019

(in CHF)	Name	Last price	Curr.	Total Return Performance 7 d %	1 m %	3 m %	6 m %	YTD %
CONSUMER DISCRETIONARY	MSCI WORLD/CONS DIS	249.3	USD	1.2	0.9	12.2	-3.2	12.2
CONSUMER STAPLES	MSCI WORLD/CON STPL	232.9	USD	1.2	4.1	12.1	4.6	12.1
ENERGY	MSCI WORLD/ENERGY	207.5	USD	0.1	0.1	14.7	-11.0	14.7
FINANCIALS	MSCI WORLD/FINANCE	110.9	USD	0.6	-2.9	8.6	-5.7	8.6
HEALTHCARE	MSCI WORLD/HLTH CARE	247.3	USD	1.0	-0.2	8.3	-2.1	8.3
INDUSTRIALS	MSCI WORLD/INDUSTRL	250.5	USD	1.6	-0.3	14.6	-4.2	14.6
MATERIALS	MSCI WORLD/MATERIAL	251.9	USD	1.2	1.1	12.4	-3.9	12.4
REAL ESTATE	MSCI WORLD/REAL ESTATE	222.8	USD	0.9	4.7	16.3	12.7	16.3
TECHNOLOGY	MSCI WORLD/INF TECH	253.9	USD	0.9	3.6	19.7	-1.6	19.7
TELECOMMUNICATION	MSCI WORLD/TEL SVC	68.6	USD	-0.8	1.4	11.6	4.4	11.6
UTILITIES	MSCI WORLD/UTILITY	137.7	USD	-0.7	2.2	10.4	10.6	10.4

Following the stock market crash in December, we recommended a sector reallocation into certain tech stocks (+19.7%), as their weighting had been reduced several months prior. We also increased our recommended weightings for more cyclical sectors such as energy (+14.7%), industrials (+17.1%), consumer discretionary (+!2.2%), and f inancials (+8.6%). These sector picks turned out to be particularly judicious in view of the recent market rally, as defensive stocks in sectors such as healthcare (+8.3%) were underweight in our sector allocation and underperformed overweight sectors. While growth expectations deteriorated significantly over the past few months, fundamentally we still consider that these negative views will be called into question in Q2 2019 by a likely improvement in PMIs, economic sentiment, and the outlook for H2. In this context, the positioning mentioned above remains compelling and should be maintained. However, it is not inconceivable that the short-term consolidation of equity markets mentioned in our 'Investment Strategy' may have a more significant impact on our overweight sectors in the short run. Nevertheless, at this stage we anticipate the equity market dip to be merely temporary, resulting from profit taking rather than a further deterioration in the baseline economic scenario. Thus, we recommend some moderate profit taking in the short term without radically changing our medium-term outlook or our international sector allocation. With regard to the allocation between blue chips and small & mid caps, the trend that was initially favourable to the former should gradually come to benefit the latter. We thus stay overweight small & mid caps.





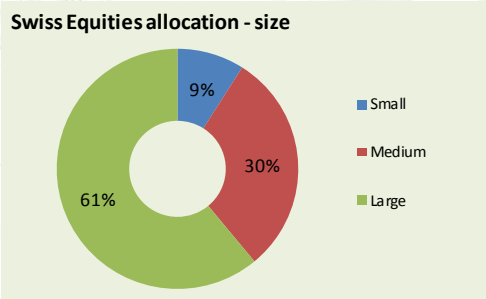
Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

Swiss Equities

- New records for Swiss equities
- Attractive yields but high valuations
- Investment strategy: take profits in the short term

EQUITIES capitalization	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Small	↗↗	↗							
Medium	↗↗	↗↗							
Large	↗	↗							



Tactical Allocation

- Strengthening mid-sized capitalizations
- Decrease exposure to « ultra blue chips »

New records for Swiss equities

At the end of the year, after the sharp correction in Swiss equities, we noted that, barring a marked slowdown in global growth in 2019, we expected the outlook for Swiss equities to be favourable, in particular with regard to SPI stocks and small & mid caps, which where particularly impacted by the recent upswing in volatility. The beginning of 2019 was as extraordinary as the end of 2018 for all equity markets, and for the Swiss market in particular. While the SPI corrected by close to -10%, reduced to -6.7% as at 31 December, it then shot up by +6.96% in January, followed by further increases of +4.28% in February and +2.52% in March, as confidence has remained strong. Panic gave way to euphoria surprisingly fast, even though there is no solid economic justification for the shift. The SPI index thus exceeded the level it had reached prior to the brutal correction in December and even reached new heights in March, topping its January 2018 highs and posting quarterly growth of +!4.4% (+12.4% for the SMI). The market has now risen by +18% between the low on 27 December 2018 and 31 March 2019, its best quarterly performance since Q1 2015 (+15.2%). Investors seem to have very quickly given in to optimism or even euphoria at the beginning of the year, only a few weeks after a wave of panic had triggered a drop in Swiss share prices and caused general alarm.

Yields remain attractive but valuations are high

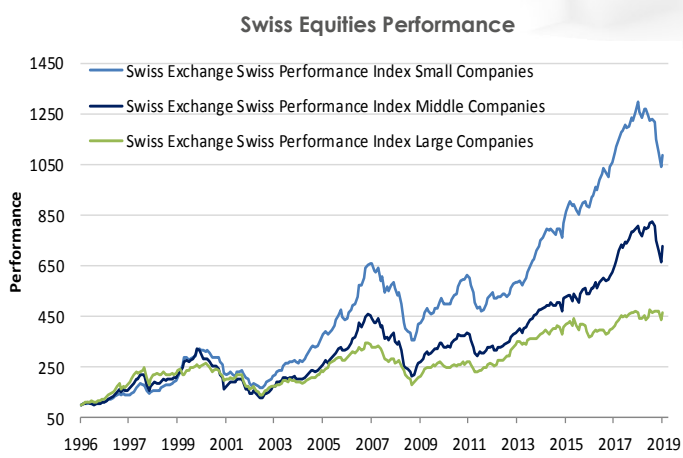
The risk factors that drove the Swiss market down in December were essentially external and macroeconomic issues. The abrupt economic slowdown in Germany, which narrowly avoided a technical recession, the fear of a yield curve inversion in the US perceived as a leading indicator of a recession in 2019, and finally investors' shift in risk perception a few days before the end of the fiscal year caused a massive sell-off in a worldwide wave of asset allocation risk reduction. The sentiment at the beginning of the year was completely different, even though economic activity in Q1 is likely to remain weak overall including in Switzerland. Investors' optimism is thus for now based only on the expectation that global economic conditions will improve. The valuation levels of Swiss stocks, as mentioned in our year-end strategy note, offered particularly attractive investment opportunities in the medium term. Valuation levels are presently once again rather generous by historical comparison. The Swiss market PE is once again close to 16x expected 2019 earnings, that is, significantly above its December level of around 13x. The SPI index is also trading at above 17x earnings, namely over 10% above its long-term average. With regard to yields, conditions are still attractive thanks to dividends that should allow SPI stocks to offer yields of close to 3% and leading SMI stocks to offer 3.5% (the long-term average is approximately 2.5%). Caution is thus warranted with respect to these latest developments, which are perhaps too positive given the current context, after all still very uncertain.

Investment strategy: take profits in the short term

As noted in our strategy note at the beginning of the year, we were indeed expecting the market expansion of the past few weeks. However, share prices seem to be rising particularly swiftly and are thus liable to cause disappointment or even just incur some profit taking over the next few weeks. The exceptional quarterly increase likely already incorporates positive expectations regarding a global economic upturn and a depreciation of the franc, which will likely materialise in the medium term. However, in the short term, we anticipate that the Swiss market could stabilise and consolidate somewhat pending confirmation of the positive expectations that drove the market rally. Given the more fragile present context, we recommend adopting a less exposed and somewhat more defensive strategy following the uninterrupted market progression over the past 12 weeks.

SWISS EQUITIES - Capitalization

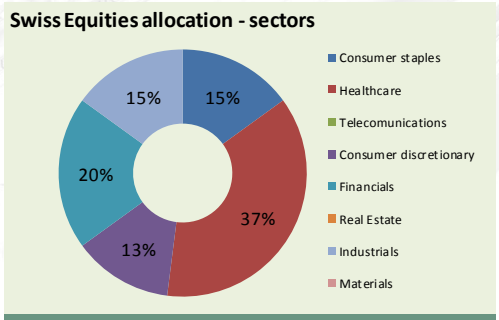
31.03.2019		Total Return Performance				
Name	Last price	7 d %	1 m %	3 m %	6 m %	YTD %
SPI SWISS PERFORMANCE IX	11241.2	1.6	2.2	14.4	4.0	14.4
SPI SMALL COMPANIES INDX	23829.6	0.3	-1.6	3.9	-11.2	3.9
SPI MIDDLE COMPANIES IDX	15755.1	1.0	0.4	13.7	-5.8	13.7
SPI LARGE COMPANIES INDX	10715.2	1.8	2.6	14.8	6.6	14.8



Graph sources: Bloomberg/BBGI Group

Swiss Equities - Sectors

SWISS EQUITIES Sectors	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Consumer staples	↗	↗							
Healthcare	↗	↗							
Telecommunications	↗	↗							
Consumer discretionary	↗	↗							
Financials	↗	↗							
Real Estate	↗	↗							
Industrials	↗	↗							
Materials	↗	↗							



Tactical Allocation

- Decrease consumer staples sector
- Increase consumer discretionary sector

A positive start to the year for very large blue chips

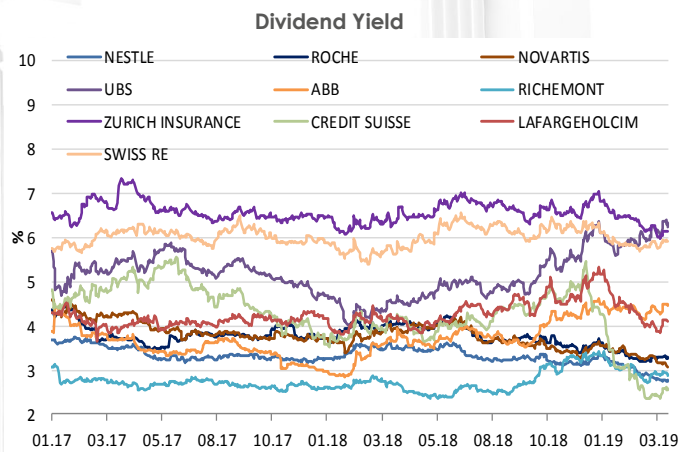
The change in sentiment in Q1 was broadly favourable to very large caps. Investment flowed into the main stocks in the Swiss equity market and in particular into leading defensive stocks such as Nestlé (+18.9%), Novartis (+17.6%), and Roche (+16.3%). Following the drop in share prices and multiples in December, the uncertainty still prevailing in the market at the beginning of the year offered attractive entry points to medium- and long -term investors. The latter naturally focused primarily on the three stocks mentioned above, considered to be less risky, aiming to take advantage of the correction. The three major Swiss blue chips thus slightly outperformed the SMI and SPI indices. However, their upside potential now seems very limited given their earnings growth outlook for 2019.

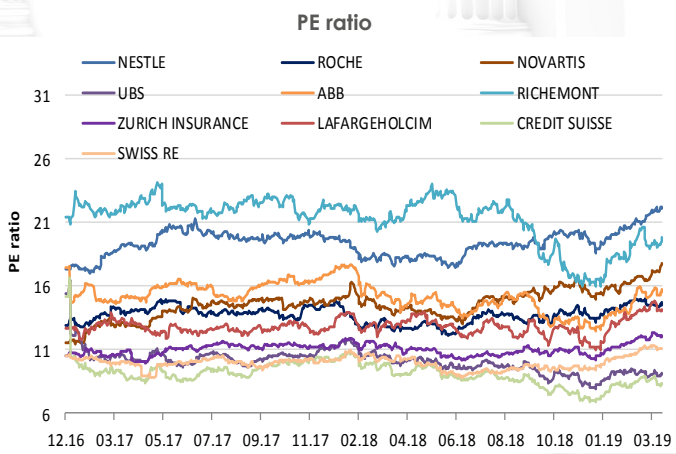
Diversification outside of large stocks is profitable

Valuations (2019) for Nestlé (22.1x), Novartis (17.5x), and Roche (14.7x) already seem very generous, and thus they now have very limited upside potential. The PE ratios of the SMI and the SPI are of 14.5x and 15.6x, respectively, while the PE ratio of the Swiss Middle Companies index is a little higher at 17.8x, but a typically lower dividend yield may still discourage investors attracted by the higher yields offered by large blue chips. This issue will likely remain relevant in 2019, but a concrete improvement in the global economy will no doubt trigger renewed interest in other Swiss stocks.

Caution on growth outlook

The consensus earnings growth forecast for Swiss companies in 2019 is still relatively high for SMI stocks (+8%) following an exceptional performance in 2018. The growth outlook for SPI stocks is significantly lower (+5%), while the consensus forecast for medium caps predicts earnings will contract by -10%.

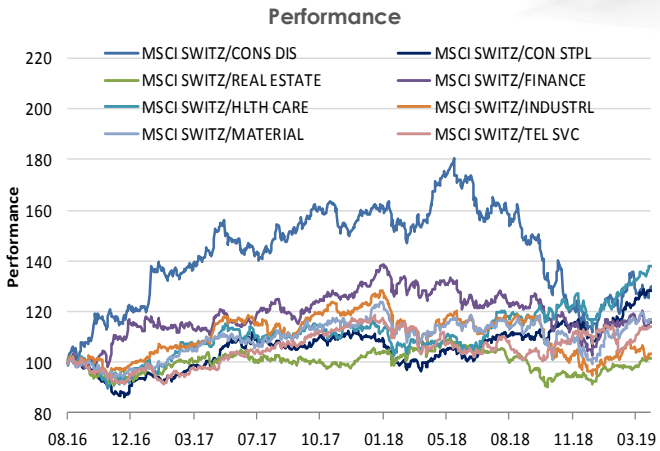




SWISS EQUITIES - BY SECTOR

31.03.2019 — Total Return Performance

Name	Last price	7 d %	1 m %	3 m %	6 m %	YTD %
MSCI SWITZ/CONS DIS	275.9	2.1	-5.6	10.9	-13.0	10.9
MSCI SWITZ/CON STPL	312.2	1.1	4.4	18.4	14.3	18.4
MSCI SWITZ/FINANCE	53.7	1.2	-2.7	8.7	-6.1	8.7
MSCI SWITZ/HLTH CARE	165.9	2.6	5.5	17.7	14.2	17.7
MSCI SWITZ/INDUSTRL	162.3	1.4	-2.0	6.4	-11.3	6.4
MSCI SWITZ/MATERIAL	290.2	0.3	0.2	15.1	-1.0	15.1
MSCI SWITZ/REAL ESTATE	1015.6	0.8	4.4	9.7	5.2	9.7
MSCI SWITZ/TEL SVC	92.0	0.8	5.7	3.7	11.2	3.7



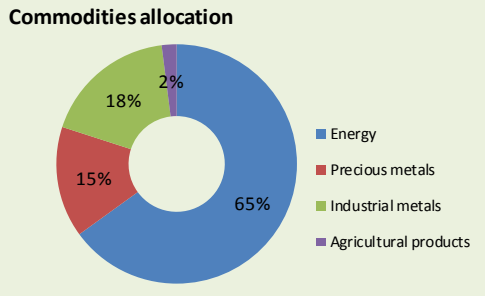
Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

Commodities

- More rational outlook finally boosts energy prices
- Prices of petroleum products bounce back
- Industrial metals bolstered by Chinese demand
- Investment demand for gold and silver picks up

COMMODITIES	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Energy	↗	↗							
Precious metals	↗	↗↗							
Industrial metals	↗	↗↗							
Agricultural products	→	↗							



Tactical Allocation

- Large energy exposure
- Overweight precious metals
- Overweight industrial metals
- Underweight agricultural products

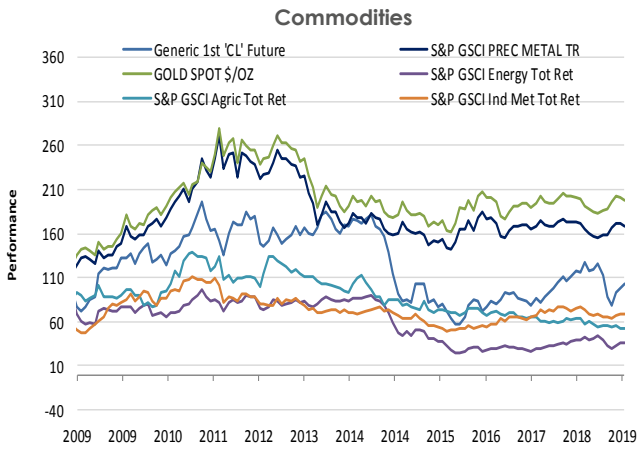
More rational outlook boosts energy prices

The wave of panic and totally irrational expectations that had overwhelmed commodity market segments worldwide subsided in Q1 2019. While we had not ruled out the possibility of an economic downturn in 2019 in our earlier analysis of the outlook for commodities, the scenario that ultimately prevailed in Q4 stemmed more from an unlikely worst-case scenario than from a serious and realistic analysis of the economic and political conditions that would likely prevail in 2019. The drop in commodity prices during this period, and in particular the abrupt correction in oil prices of close to -45%, was completely irrational in our view. In our strategy memo three months ago, we noted that the fundamentals of most commodity sectors were expected to be positive, even if economic activity were to slow, as global supply was still restricted by the decline in capex over the past few years, and demand was concurrently expected to strengthen barring a major global economic shock. At the time we expected Chinese growth to remain sufficiently strong and revved up by government stimulus measures to bolster demand for industrial metals and petroleum products and drive up prices in Q1 2019. Indeed, the past few months showed that the year-end 2018 scenario was extreme and that, given a less pessimistic economic context, commodity markets should reach price equilibrium levels much higher than those established at the end of the year. Commodity indices thus rallied sharply in Q1, spearheaded by three petroleum products. Petrol (+43.2%), WTI crude (+32.44%), Brent crude (+27.1%) and diesel (+18.5%) posted robust increases generally exceeding those of industrial metals such as nickel (+21.4%), zinc (+18.4%), copper (+8.6%) and aluminium (+3.5%). Precious metals, which had benefited from the stock market uncertainty, did not take part in the general recovery, while agricultural products posted rather negative results.

Commodities thus rebounded by +16.4% (S&P Goldman Sachs) this quarter, following a year that seemed to progress well until September (+11.8%) but ultimately closed on a -13% drop. Thus far this year, commodity markets have been benefiting from investors' return to sanity and a more rational economic outlook, which should allow current trends to continue.

Prices of petroleum products bounce back

A quick review of conditions in the oil market in Q4 is necessary to highlight once again the particularly irrational nature of movements in prices in the past while. The -38% drop in crude prices seemed to be based on the irrational expectation of a collapse in global demand following a US recession in 2019 and an abrupt slowdown of the global economy. We noted then that crude prices were extremely undervalued and that a floor had likely been reached at $45/barrel, which would lead to a swift initial revaluation of energy prices in Q1, before additional price adjustments would enable further price increases up to the average level of $70/barrel seen in September 2018. At the time, our predictions were far from consensus, but the robust upward trend that we had been expecting did indeed take shape at the beginning of the year. At time of writing, WTI prices ($62/barrel) have risen by +47% since the $42.3 low of 24 December. Although they have not yet completely erased their Q4 drop, prices once again exceed levels reached at the beginning of 2018. Our $70/barrel target, which certainly seemed very ambitious at the end of 2018 given the quasi stock market panic and extremely negative economic outlook, is nevertheless about to be achieved.



Graph sources: Bloomberg/BBGI Group

COMMODITIES (USD)

31.03.2019	Name	Last price	Curr.	Total Return Performance 7 d %	1 m %	3 m %	6 m %	YTD %
	MSCI Daily TR Net World USD	6087.54	USD	0.74	0.80	12.48	-2.60	12.48
GLOBAL	S&P GSCI Tot Return Indx	2533.2	USD	0.0	2.8	15.0	-13.5	15.0
WTI CRUDE	Generic 1st 'CL' Future	60.1	USD	1.9	7.8	32.4	-20.1	32.4
BRENT OIL	Generic 1st 'CO' Future	68.4	USD	2.0	5.1	27.1	-19.4	27.1
NATURAL GAS	Generic 1st 'NG' Future	2.7	USD	-3.3	-6.9	-9.5	-15.9	-9.5
OR	GOLD SPOT $/OZ	1292.3	USD	-1.6	-0.1	0.8	7.4	0.8
ARGENT	Silver Spot $/Oz	15.1	USD	-2.0	-0.6	-2.4	2.9	-2.4
AGRICULTURE	S&P GSCI Agric Indx Spot	273.2	USD	-2.5	-1.9	-3.8	-4.1	-3.8
INDUSTRIAL METALS	S&P GSCI Ind Metal Spot	345.5	USD	1.7	-0.1	8.2	-1.3	8.2

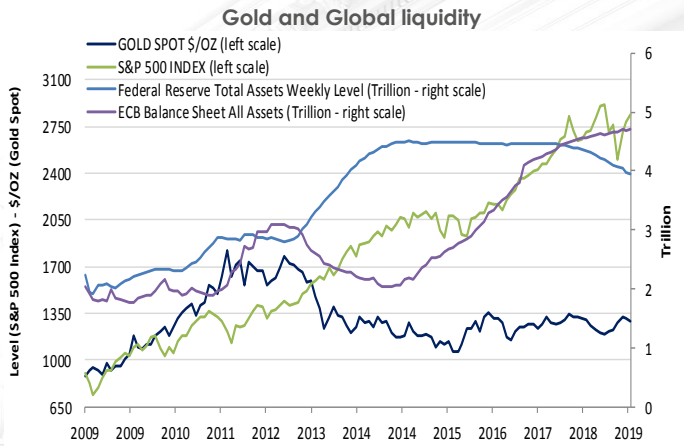
Our economic scenario remains relatively unchanged so far this year and is based in particular on the assumption that a forthcoming agreement between China and the US will not radically change the situation with regard to supply and demand for petroleum products. The slowdown in global growth will likely be limited to +3.5% in 2019, based on which growth in global demand for crude oil should come in at over 1 mbd, while supply will likely increase by less than 1 mbd. OPEC members and partners will continue to restrict supply, as will US sanctions against Iran and Venezuela. According to the IEA, energy demand grew by +2.3% in 2018, its fastest progression of the decade. China, India, and the US make up over 70% of this growth. The US posted the strongest growth in demand for oil and gas, up +10% over the previous year. Demand for oil increased by +1.3 mbd, driven by US demand stemming from strong growth in the petrochemical industry, industrial output, and road transport. The IEA estimates that global demand for oil will increase by +1.4 mbd in 2019. Fundamentals of the energy and oil markets continue to point to a rebalancing between supply and demand, which will likely help keep WTI and Brent crude oil prices above $70 and $80, respectively. US oil production, mostly focused on shale oil, is currently creating market distortions due to the shorter production cycle of unconventional oil. Periods of high prices cause a rapid rise in shale oil production, which increases global supply and causes prices to drop. Conversely, the fall in prices in the last quarter makes shale oil production less worthwhile and reduces global supply with concomitant effects on prices. This phenomenon, which increases the volatility of WTI prices, will likely persist for a while yet.

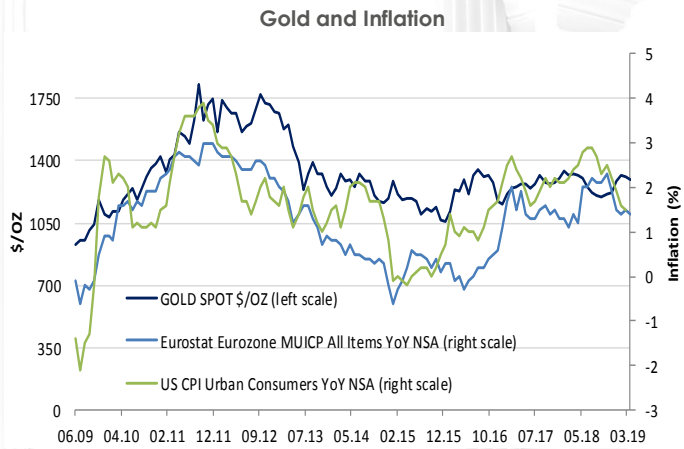
Industrial metals bolstered by Chinese demand

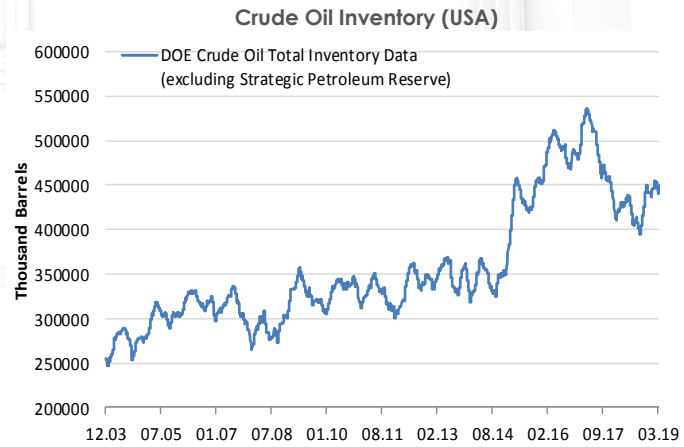
The performance of industrial metals in Q1 was positive but more modest than that of the energy sector. The upswing in industrial metals such as nickel (+21.4%), zinc (+18.4%), copper (+8.6%) and aluminium (+3.5%) is still nowhere close to offsetting the losses incurred in 2018 in most cases except for nickel, whose rise in the past three months exceeded its fall in 2018 (-16.2%). As for the other metals – zinc (-25.6%), copper (-17.6%) and aluminium (-18.6%) – current trends must persist in order for prices to return to levels that prevailed at the beginning of 2018. The Chinese economic stimulus programme and the resilience of the country's economic growth more generally should soon clearly prove to be sufficient factors to drive up demand for industrial metals. Once leading indicators in China point to an upswing in industrial output and a trade agreement is finally reached, industrial metals will benefit from a clear change in conditions conducive to further price increases.

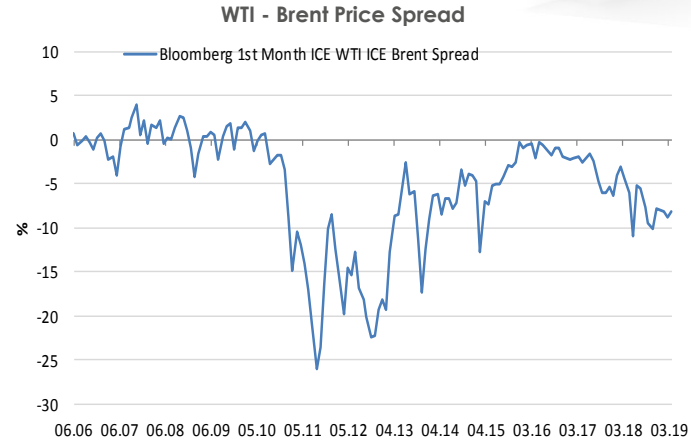
Investment demand for gold and silver picks up

The key factors driving precious metal prices are investment demand and inflation. Investment demand, which had progressed by approximately +5.2% in Q4 in the context of a stock market crisis and high volatility of financial assets, continued to grow (+1.7%) in Q1 2019, in spite of a much more optimist stock market environment. It is interesting to note that, as the worst-case scenario fell away and inflation declined in most economies during this period, gold prices were not significantly affected and progressed by a further +0.77% following the significant +7.54% increase of the last quarter. Note also that the trade-weighted dollar appreciated over these two periods. Going forward, gold prices will likely be more closely correlated to inflation in the US than they have been recently. Employment figures and especially purchasing power, disposable income, and wage growth in the US will likely drive an upswing in price indices (CPI) over the next few months. Inflation rising above the Fed's target will constitute one factor driving gold prices above $1,100/oz.









Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

Hedge Funds

- Best quarter for the past six years

Best quarter for the past six years

The global hedge fund index posted its best quarterly result since Q1 2013 (+2.60%). In spite of everything, this result was very much below the bounce back seen on international equities (+12.5%), securitised real estate (+15%) and private equity (+16.42%). As such, over the first three months of the year, alternative management has only partially made up for the previous year's correction (-6.72%), unlike other segments, most of which have recovered to levels seen at the start of the year. The various management styles have posted different performances over this quarter. The equity hedge strategy benefited most from the climate at the start of the year (+5.95%). Relative value arbitrage and event driven management also grew over the period, by +2.62% and +0.80% respectively. However, the macro/CTA strategy finished the quarter in the red, having slid -0.87%.

Private Equity

- More than +16% bounce back over the quarter

More than +16% bounce back over the quarter

The panic of the end of 2018, which caused a -17.87% drop in private equity, gave way to optimism and investors' willingness to take risks making quite a come-back. The first three months of the year proved very favourable for private equity (+16.42%). We can now no longer rule out further temporary volatility due to profit taking, but the improvement in the international economic situation will be conducive to any profits made being reinvested subsequently. The United States posted the best performance (+16.43%). Europe and the United Kingdom also climbed more than +10%, with quarterly results of +13.48% and +11.72% respectively.

HEDGE FUND INDICES (USD)

31.03.2019 — Total Return Performance

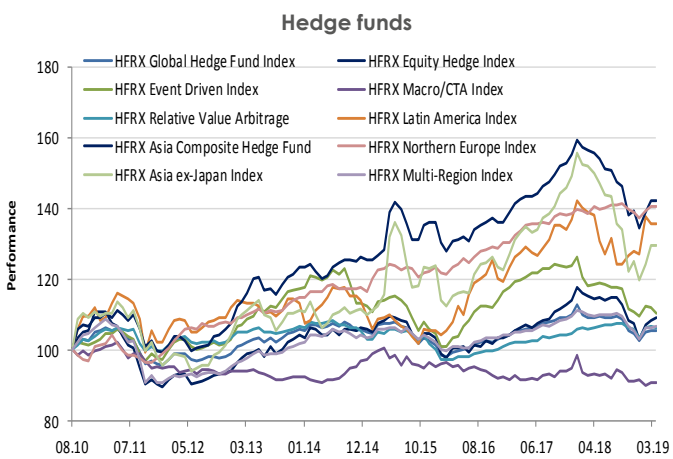
	Name	Last price	Curr.	7 d %	1 m %	3 m %	6 m %	YTD %
GLOBAL	HFRX Global Hedge Fund Index	1220.8	USD	-0.3	-0.3	2.6	-3.0	2.6
EQUITY HEDGE	HFRX Equity Hedge Index	1219.6	USD	0.0	0.2	6.0	-2.6	6.0
EVENT DRIVEN	HFRX Event Driven Index	1483.0	USD	-0.1	-1.6	0.8	-5.9	0.8
MACRO/CTA	HFRX Macro/CTA Index	1116.3	USD	-1.3	0.4	-0.9	-3.1	-0.9
RELATIVE VALUE ARBITRAGE	HFRX Relative Value Arbitrage	1201.6	USD	0.0	0.0	2.6	-1.1	2.6
LATIN AMERICA*	HFRX Latin America Index	2222.0	USD	-	0.3	7.2	9.7	7.2
ASIA COMPOSITE*	HFRX Asia Composite Hedge Fund Index	2329.9	USD	-	1.6	7.4	-1.1	7.4
NORTHERN EUROPE*	HFRX Northern Europe Index	2040.1	USD	-	0.6	2.9	-0.1	2.9
ASIA EX-JAPAN*	HFRX Asia ex-Japan Index	2527.8	USD	-	3.3	12.0	-0.1	12.0
MULTI-REGION	HFRX Multi-Region Index	1330.6	USD	0.0	0.3	3.6	-2.2	3.6

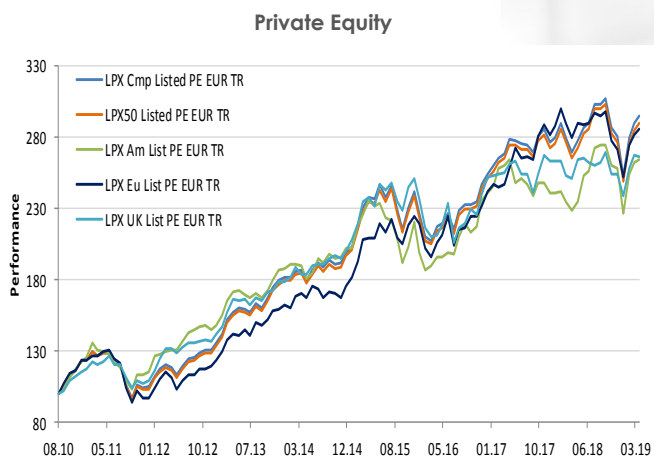
* Subject to one-month lag

PRIVATE EQUITY INDICES (EUR)

31.03.2019 — Total Return Performance

	Name	Last price	Curr.	7 d %	1 m %	3 m %	6 m %	YTD %
COMPOSITE	LPX Cmp Listed PE EUR TR	245.2	EUR	1.0	1.5	16.4	-4.4	16.4
MAJOR COMPANIES	LPX50 Listed PE EUR TR	2300.4	EUR	1.0	1.5	16.5	-4.8	16.5
USA	LPX Am List PE EUR TR	351.8	EUR	1.0	1.0	16.4	-4.5	16.4
EUROPE	LPX Eu List PE EUR TR	915.4	EUR	0.4	0.8	13.5	-3.7	13.5
UK	LPX UK List PE EUR TR	298.6	EUR	-0.8	-0.5	11.7	-0.9	11.7





Graph sources: Bloomberg/BBGI Group

GLOBAL STRATEGY & ASSET ALLOCATION

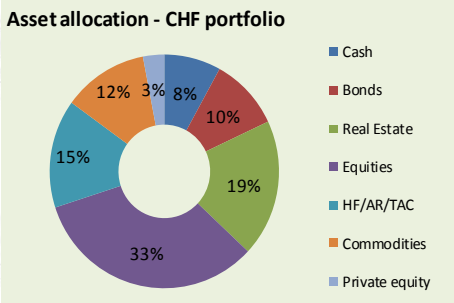
Graph sources: Bloomberg/BBGI Group

GLOBAL STRATEGY I ASSET ALLOCATION

Diversified portfolio: Medium Risk - CHF

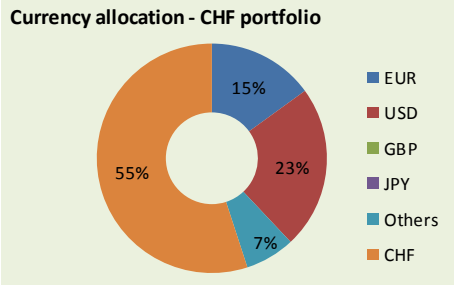
- Prioritise bonds in USD and short maturities
- Real estate yield remains competitive
- Reduce overweighting in equities
- Overweight commodities

ASSETS	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Cash	↘	↘							
Bonds	↘	↘							
Real Estate	→	↗							
Equities	→	↗							
Hedge funds	→	↗							
Commodities	→	↗							
Private equity	→	↗							



Tactical Allocation

- Profit-taking, underweight equities and real esate and favor liquidity



Asset allocation

The core of our investment strategy is made up of traditional liquid assets (liquidities, bonds, equities and real estate), which is then complemented by other diversified, tradable assets (commodities, hedge funds, private equity).

Bonds

The fall in bond yields in the 1st quarter seems excessive given the lack of any real risk of recession and the more positive context of a likely growth recovery in the 2nd quarter. In the United States, the interest rate curve still offers relatively good opportunities in fixed income investments, particularly compared to the bond market in euro, yen, Swiss francs and sterling. Long rates are likely to bounce back in most markets thanks to labour market tensions which could influence inflation and push energy prices north again. We believe that yields in US dollars are attractive enough to move away from high yield investments, the risk premia of which are now too low to give grounds for any significant allocation. We are prioritising a cautious bond strategy and reduced overall exposure, favouring investments in US dollars and short maturities.

Equities

Last quarter we recommended shoring up equity investments in a position of weakness and overweighting Swiss and international equities. This was followed by a quarter of remarkable growth. The volatility that we had predicted in September materialised in the 4th quarter. Forecasts of an economic slowdown, or even a recession in 2019, were overblown and presented fresh opportunities to invest at by then attractive valuations. Today, we would suggest some caution after the excellent growth since the start of the year; we are proposing temporary, partial profit taking.

Commodities

We were expecting a strong recovery on crude oil prices at the start of the year; prices have indeed risen by more than +32% over the past few months. The sudden emergence of the prospect of a recession in December gave way to more rational forecasts, thus ruling out the disaster scenario. The start of 2019 has not brightened up on all of the fronts that one might have hoped, but commodities should nonetheless benefit from a more constructive situation, particularly once China and the United States have signed an agreement. The trend is turning around; industrial and precious metals should also benefit from fewer fears linked to trade tensions.

Graph sources: Bloomberg/BBGI Group

Real estate

Real estate is still the main alternative to rate markets. Yields are attractive and the risk of a price correction due to a rate hike still seems low given the context of often negative real-terms yields. Our strategy prioritises Swiss real estate; Asia and Europe are favoured internationally.

Currencies

The quarter saw no great exchange rate movements. The US dollar has entered a phase of stabilisation, whilst the euro has hardly moved. The Swiss franc should weaken in light of better visibility in terms of business and the global economy.

Market performances - Q1 2019

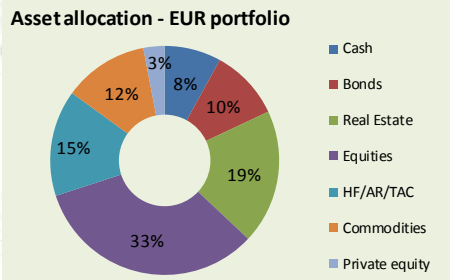
		Q1 2019 local	Q1 2019 CHF	YTD local	YTD CHF
Exchange rates					
USD/CHF		1.3%		1.3%	
EUR/CHF		-0.8%		-0.8%	
GBP/CHF		3.6%		3.6%	
JPY/CHF		0.2%		0.2%	
Equity markets					
World	MSCI World USD	12.5%	14.0%	12.5%	14.0%
Europe	DJ Stoxx 600	13.0%	12.1%	13.0%	12.1%
Eurozone	DJ Eurostoxx 50	11.7%	10.8%	11.7%	10.8%
	MSCI Europe S.C.	13.9%	12.9%	13.9%	12.9%
Germany	Dax 30	9.2%	8.3%	9.2%	8.3%
France	Cac 40	13.1%	12.2%	13.1%	12.2%
United Kingdom	FTSE 100	8.2%	12.1%	8.2%	12.1%
Switzerland	SPI	14.4%	14.4%	14.4%	14.4%
	SMI	12.4%	12.4%	12.4%	12.4%
	MSCI Swiss S.C.	9.7%	9.7%	9.7%	9.7%
North America	SP500	13.1%	14.6%	13.1%	14.6%
	Nasdaq	16.5%	18.0%	16.5%	18.0%
	Tse 300	12.4%	16.3%	12.4%	16.3%
	SP600 Small C.	11.2%	12.7%	11.2%	12.7%
Japan	Nikkei 225	6.0%	6.2%	6.0%	6.2%
Emerging	MSCI EMF USD	9.6%	11.0%	9.6%	11.0%

		Q1 2019 local	Q1 2019 CHF	YTD local	YTD CHF
Interest rates (3 months)	*(level)*				
CHF		-0.71%			
EUR		-0.35%			
USD		2.60%			
JPY		-0.06%			
Bonds markets					
World	Citi Gr Global Govt USD	1.7%	3.1%	1.7%	3.1%
Europe	Euro Ser-E Gov > 1	2.5%	1.7%	2.5%	1.7%
United Kingdom	UK Ser-E Gov > 1	3.5%	7.2%	3.5%	7.2%
Switzerland	SBI Général AAA-BBB	1.8%	1.8%	1.8%	1.8%
	SBI Govt	2.0%	2.0%	2.0%	2.0%
USA	US Ser-E Gov > 1	2.1%	3.5%	2.1%	3.5%
Japan	Japan Ser-E Gov > 1	1.5%	1.7%	1.5%	1.7%
Emerging	J.P. Morgan EMBI Global	6.6%	8.0%	6.6%	8.0%
Miscellaneaous					
	LPP 25 Index	4.8%	4.8%	4.8%	4.8%
	LPP 40 Index	6.6%	6.6%	6.6%	6.6%
	LPP 60 Index	9.0%	9.0%	9.0%	9.0%
Real Estate CH	DB RB Swiss Real Est Fd	9.6%	9.6%	9.6%	9.6%
Hedge Funds	Hedge Fund Research USD	1.0%	2.3%	1.0%	2.3%
Commodities	GS Commodity USD	15.0%	16.5%	15.0%	16.5%

GLOBAL STRATEGY I ASSET ALLOCATION

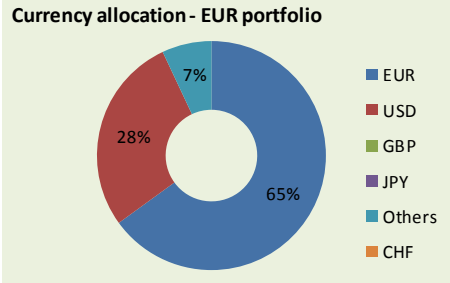
Diversified portfolio: Medium Risk - EUR

- Reducing risk in the euro zone
- Real estate yield remains competitive
- Reduce overweighting in equities
- Overweight commodities



Tactical Allocation

- Profit-taking, underweight equities and real esate and favor liquidity



ASSETS	Expected Return 3months	Expected Return 1year	ALLOCATION (EUR Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Cash	→	→							
Bonds	↘	↘							
Real Estate	→	↗							
Equities	→	↗							
Hedge funds	→	↗							
Commodities	→	↗							
Private equity	→	↗							

Asset allocation

The core of our investment strategy is made up of traditional liquid assets (liquidities, bonds, equities and real estate), which is then complemented by other diversified, tradable assets (commodities, hedge funds, private equity).

Bonds

The fall in bond yields in the 1st quarter seems excessive given the lack of any real risk of recession and the more positive context of a likely growth recovery in the 2nd quarter. In the United States, the interest rate curve still offers relatively good opportunities in fixed income investments, particularly compared to the bond market in euro, yen, Swiss francs and sterling. Long rates are likely to bounce back in most markets thanks to labour market tensions which could influence inflation and push energy prices north again. We believe that yields in US dollars are attractive enough to move away from high yield investments, the risk premia of which are now too low to give grounds for any significant allocation. We are prioritising a cautious bond strategy and reduced overall exposure, favouring investments in US dollars and short maturities.

Equities

Last quarter we recommended shoring up equity investments in a position of weakness and overweighting European and international equities. This was followed by a quarter of remarkable growth. The volatility that we had predicted in September materialised in the 4th quarter. Forecasts of an economic slowdown, or even a recession in 2019, were overblown and presented fresh opportunities to invest at by then attractive valuations. Today, we would suggest some caution after the excellent growth since the start of the year; we are proposing temporary, partial profit taking.

Commodities

We were expecting a strong recovery on crude oil prices at the start of the year; prices have indeed risen by more than +32% over the past few months. The sudden emergence of the prospect of a recession in December gave way to more rational forecasts, thus ruling out the disaster scenario. The start of 2019 has not brightened up on all of the fronts that one might have hoped, but commodities should nonetheless benefit from a more constructive situation, particularly once China and the United States have signed an agreement. The trend is turning around; industrial and precious metals should also benefit from fewer fears linked to trade tensions.

Graph sources: Bloomberg/BBGI Group

Real estate

Real estate is still the main alternative to rate markets. Yields are attractive and the risk of a price correction due to a rate hike still seems low given the context of often negative real-terms yields. Our strategy prioritises European real estate; Asia is favoured internationally.

Currencies

The euro stayed surprisingly stable, although weaker (-2.2%), against the US dollar over the quarter despite worrying economic data in Germany and no solution to Brexit. The German economy needs to improve in order for the euro's valuation to change.

Market performances - Q1 2019

Exchange rates	Q1 2019 local	Q1 2019 EUR	YTD local	YTD EUR
USD/EUR	2.2%		2.2%	
CHF/EUR	0.9%		0.9%	
GBP/EUR	4.5%		4.5%	
JPY/EUR	1.1%		1.1%	

Interest rates (3 months)	(level)
CHF	-0.71%
EUR	-0.35%
USD	2.60%
JPY	-0.06%

Equity markets		Q1 2019 local	Q1 2019 EUR	YTD local	YTD EUR
World	MSCI World USD	12.5%	15.0%	12.5%	15.0%
Europe	DJ Stoxx 600	13.0%	13.0%	13.0%	13.0%
Eurozone	DJ Eurostoxx 50	11.7%	11.7%	11.7%	11.7%
	MSCI Europe S.C.	13.9%	13.9%	13.9%	13.9%
Germany	Dax 30	9.2%	9.2%	9.2%	9.2%
France	Cac 40	13.1%	13.1%	13.1%	13.1%
United Kingdom	FTSE 100	8.2%	13.0%	8.2%	13.0%
Switzerland	SPI	14.4%	15.4%	14.4%	15.4%
	SMI	12.4%	13.5%	12.4%	13.5%
	MSCI Swiss S.C.	9.7%	12.2%	9.7%	12.2%
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	Nasdaq	16.5%	19.1%	16.5%	19.1%
	Tse 300	12.4%	17.4%	12.4%	17.4%
	SP600 Small C.	11.2%	13.6%	11.2%	13.6%
Japan	Nikkei 225	6.0%	7.2%	6.0%	7.2%
Emerging	MSCI EMF USD	9.6%	12.0%	9.6%	12.0%

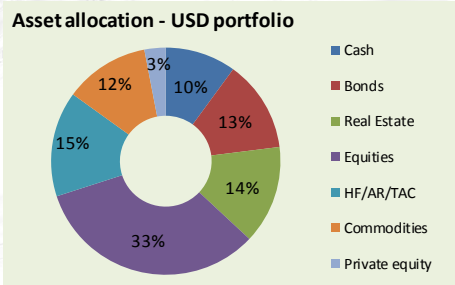
Bonds markets		Q1 2019 local	Q1 2019 EUR	YTD local	YTD EUR
World	Citi Gr Global Govt.USD	1.7%	2.7%	1.7%	2.7%
Europe	Euro Ser-E Gov > 1	2.5%	2.5%	2.5%	2.5%
United Kingdom	UK Ser-E Gov > 1	3.5%	8.1%	3.5%	8.1%
Switzerland	SBI Général AAA-BBB	1.8%	2.8%	1.8%	2.8%
	SBI Govt.	2.0%	3.0%	2.0%	3.0%
USA	US Ser-E Gov > 1	2.1%	4.4%	2.1%	4.4%
Japan	Japan Ser-E Gov > 1	1.5%	2.6%	1.5%	2.6%
Emerging	J.P. Morgan EMBI Global	6.6%	8.9%	6.6%	8.9%

Miscellaneaous		Q1 2019 local	Q1 2019 EUR	YTD local	YTD EUR
	LPP 25 Index	4.8%	5.8%	4.8%	5.8%
	LPP 40 Index	6.6%	7.6%	6.6%	7.6%
	LPP 60 Index	9.0%	10.0%	9.0%	10.0%
Real Estate CH	DB RB Swiss Real Est Fd	9.6%	9.6%	9.6%	10.6%
Hedge Funds	Hedge Fund Research USD	1.0%	3.2%	1.0%	3.2%
Commodities	GS Commodity USD	15.0%	17.5%	15.0%	17.5%

GLOBAL STRATEGY I ASSET ALLOCATION

Diversified portfolio: Medium Risk - USD

- Attractive yields in the United States
- Real estate yield remains competitive
- Reduce overweighting in equities
- Overweight commodities



Tactical Allocation

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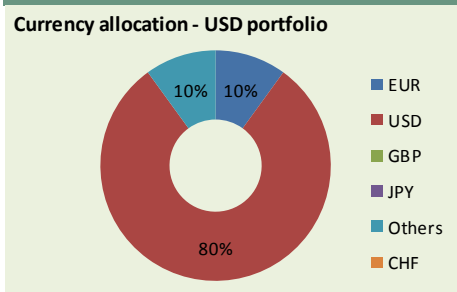

ASSETS	Expected Return 3months	Expected Return 1year	ALLOCATION (USD Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Cash	↗	↗							
Bonds	↘	↘							
Real Estate	→	↗							
Equities	→	↗							
Hedge funds	→	↗							
Commodities	→	↗							
Private equity	→	↗							

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The core of our investment strategy is made up of traditional liquid assets (liquidities, bonds, equities and real estate), which is then complemented by other diversified, tradable assets (commodities, hedge funds, private equity).

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The fall in bond yields in the 1st quarter seems excessive given the lack of any real risk of recession and the more positive context of a likely growth recovery in the 2nd quarter. In the United States, the interest rate curve still offers relatively good opportunities in fixed income investments, particularly compared to the bond market in euro, yen, Swiss francs and sterling. Long rates are likely to bounce back in most markets thanks to labour market tensions which could influence inflation and push energy prices north again. We believe that yields in US dollars are attractive enough to move away from high yield investments, the risk premia of which are now too low to give grounds for any significant allocation. We are prioritising a cautious bond strategy and reduced overall exposure, favouring investments in US dollars and short maturities.

Equities

Last quarter we recommended shoring up equity investments in a position of weakness and overweighting American and international equities. This was followed by a quarter of remarkable growth. The volatility that we had predicted in September materialised in the 4th quarter. Forecasts of an economic slowdown, or even a recession in 2019, were overblown and presented fresh opportunities to invest at by then attractive valuations. Today, we would suggest some caution after the excellent growth since the start of the year; we are proposing temporary, partial profit taking.

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We were expecting a strong recovery on crude oil prices at the start of the year; prices have indeed risen by more than +32% over the past few months. The sudden emergence of the prospect of a recession in December gave way to more rational forecasts, thus ruling out the disaster scenario. The start of 2019 has not brightened up on all of the fronts that one might have hoped, but commodities should nonetheless benefit from a more constructive situation, particularly once China and the United States have signed an agreement. The trend is turning around; industrial and precious metals should also benefit from fewer fears linked to trade tensions.

Real estate

Real estate is still the main alternative to rate markets. Yields are attractive and the risk of a price correction due to a rate hike still seems low given the context of often negative real-terms yields. Our strategy prioritises American real estate; Asia and Europe are favoured internationally.

Currencies

The quarter was rather stable for the US dollar. It is still prioritised in our currency allocation. Yield differentials still often favour the US dollar. However, it should weaken a little against the yuan and emerging currencies.

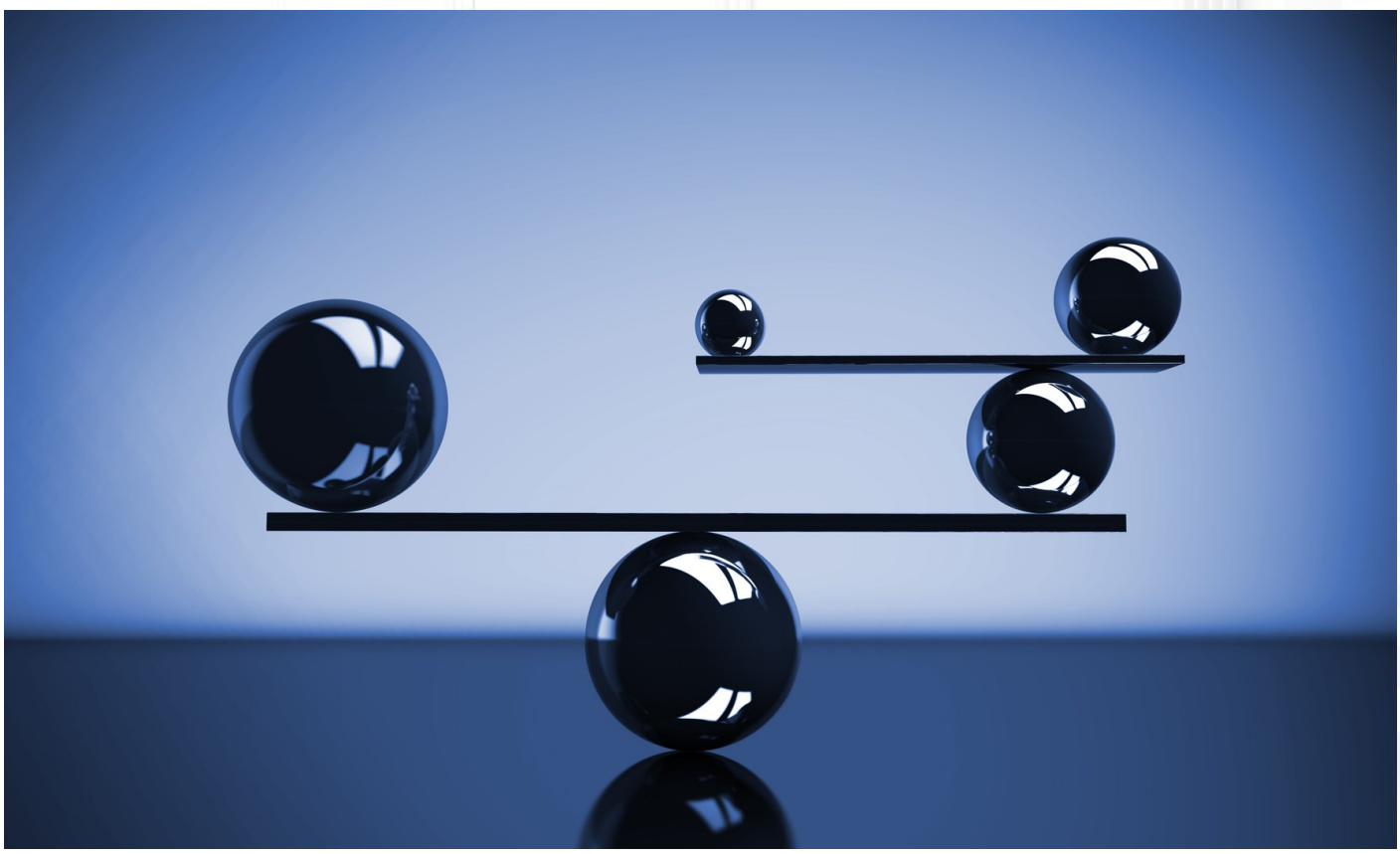
Market performances - Q1 2019

		Q1 2019 local	Q1 2019 USD	YTD local	YTD USD
Exchange rates					
CHF/USD		-1.4%		-1.4%	
EUR/USD		-2.2%		-2.2%	
GBP/USD		2.2%		2.2%	
JPY/USD		-1.1%		-1.1%	
Equity markets					
World	MSCI World USD	12.5%	12.5%	12.5%	12.5%
Europe	DJ Stoxx 600	13.0%	10.6%	13.0%	10.6%
Eurozone	DJ Eurostoxx 50	11.7%	9.2%	11.7%	9.2%
	MSCI Europe S.C.	13.9%	11.4%	13.9%	11.4%
Germany	Dax 30	9.2%	6.8%	9.2%	6.8%
France	Cac 40	13.1%	10.6%	13.1%	10.6%
United Kingdom	FTSE 100	8.2%	10.6%	8.2%	10.6%
Switzerland	SPI	14.4%	12.8%	14.4%	12.8%
	SMI	12.4%	10.9%	12.4%	10.9%
	MSCI Swiss S.C.	9.7%	9.7%	9.7%	9.7%
North America	SP500	13.1%	13.1%	13.1%	13.1%
	Nasdaq	16.5%	16.5%	16.5%	16.5%
	Tse 300	12.4%	14.9%	12.4%	14.9%
	SP600 Small C.	11.2%	11.2%	11.2%	11.2%
Japan	Nikkei 225	6.0%	4.8%	6.0%	4.8%
Emerging	MSCI EMF USD	9.6%	9.6%	9.6%	9.6%

		Q1 2019 local	Q1 2019 USD	YTD local	YTD USD
Interest rates (3 months)	*(level)*				
CHF		-0.71%			
EUR		-0.35%			
USD		2.60%			
JPY		-0.06%			
Bonds markets					
World	Citi Gr Global Govt USD	1.7%	0.3%	1.7%	0.3%
Europe	Euro Ser-E Gov > 1	2.5%	0.3%	2.5%	0.3%
United Kingdom	UK Ser-E Gov > 1	3.5%	5.8%	3.5%	5.8%
Switzerland	SBI Général AAA-BBB	1.8%	0.4%	1.8%	0.4%
	SBI Govt	2.0%	0.6%	2.0%	0.6%
USA	US Ser-E Gov > 1	2.1%	2.1%	2.1%	2.1%
Japan	Japan Ser-E Gov > 1	1.5%	0.3%	1.5%	0.3%
Emerging	J.P. Morgan EMBI Global	6.6%	6.6%	6.6%	6.6%
Miscellaneaous					
	LPP 25 Index	4.8%	3.4%	4.8%	3.4%
	LPP 40 Index	6.6%	5.1%	6.6%	5.1%
	LPP 60 Index	9.0%	7.5%	9.0%	7.5%
Real Estate CH	DB RB Swiss Real Est Fd	9.6%	9.6%	9.6%	8.1%
Hedge Funds	Hedge Fund Research USI	1.0%	1.0%	1.0%	1.0%
Commodities	GS Commodity USD	15.0%	15.0%	15.0%	15.0%

Graph sources: Bloomberg/BBGI Group

INVESTMENT THEME FOCUS



Graph sources: Bloomberg/BBGI Group

INVESTMENT THEME

Focus on Swiss real estate

- Direct real estate yields still attractive
- Shifting power dynamics between tenants and lessors
- Three-room housing units account for a third of all building activity
- Rise in co-working curtails need for office space
- Fixed or variable mortgages?

Direct real estate

As at 31 December, rental property data showed an overall return for the sector of +5.75% for FY2018. Indeed, in spite of a fall in rental revenues, and thanks to transaction price growth in particular, investors have been able to maintain returns in excess of +5%, which is still significantly lower than in 2017 (+9.53%). The stagnation of not only residential but also commercial real estate prices over the past nine months is the reason returns tied to property values have decreased. Nevertheless, demand for rental property remains high, not because there is any upside potential in rental revenues but because of the lack of investment alternatives given the negative rate environment. Note that the average annualised return of the sector over the past 30 years has been +4.92%.

The yield spread of direct real estate over 10-year Swiss government bonds was +3.61% at the end of February. Risk is thus still rewarded with a premium of over 300 basis points. We expect that, as long as this premium does not decrease significantly due to rising long-term interest rates or further contraction of rental income, direct real estate investments will remain attractive to investors.

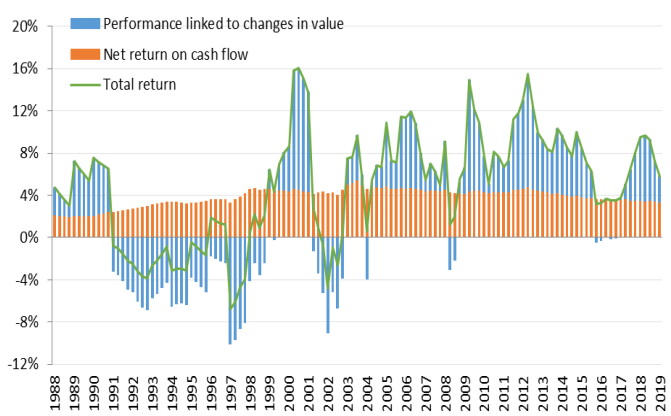
The SNB will likely wait for the ECB to raise its policy rates so as to generate the rate spread needed for the franc to depreciate before normalising its own monetary policy. The recent economic slowdown in the Eurozone will postpone any action on rates, allowing the spread between real estate and bonds to remain favourable for a time yet.

Rents

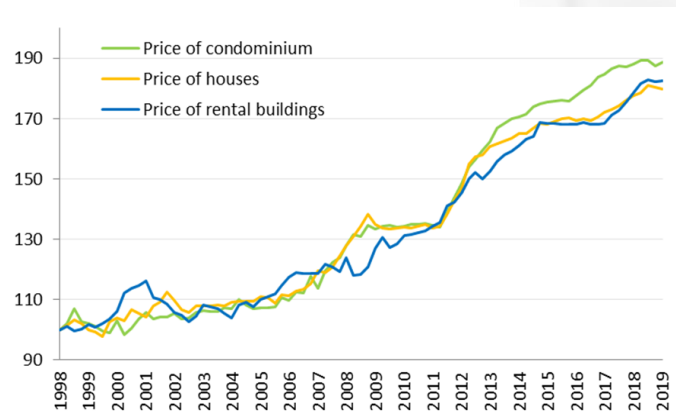
Swiss rents are unlikely to fall further. Indeed, the benchmark mortgage rate remained unchanged from the previous quarter (1.5%). In fact it has been at this level – its lowest since the benchmark was created in September 2008 – for seven consecutive quarters and will only change if and when the average interest rate, currently at 1.45%, rises above 1.625% or falls below 1.375%. The average interest rate is determined based on the average interest rate on mortgages in Swiss francs on the balance sheets of Swiss banks with an overall amount exceeding 300 million. Every quarter, the average interest rate is rounded up or down to the closest quarter of a percentage point, setting the benchmark rate for the next three months. Thus, since the benchmark rate remained unchanged from the previous quarter, renters will not have the opportunity to request a decrease in rent for the next quarter, while lessors will not be able to ask for a rent increase.

The imbalance between supply and demand, caused by a high level of building activity combined with a fall in net migration, among others, continued to drive up rental property vacancy rates. Thus, as at 30 June 2018, the national vacancy rate was 1.62%, a not insignificant +13% increase over the previous year (1.45%). On a cantonal level, the analysis highlights the difference between major centres and peripheral regions. Indeed, while the vacancy rates in Geneva (0.53%) and Zurich (0.99%) are under 1%, the situation in the cantons of Soleure (2.98%) and Schaffhouse (2.47%) is much less favourable.

Annual return of rental properties

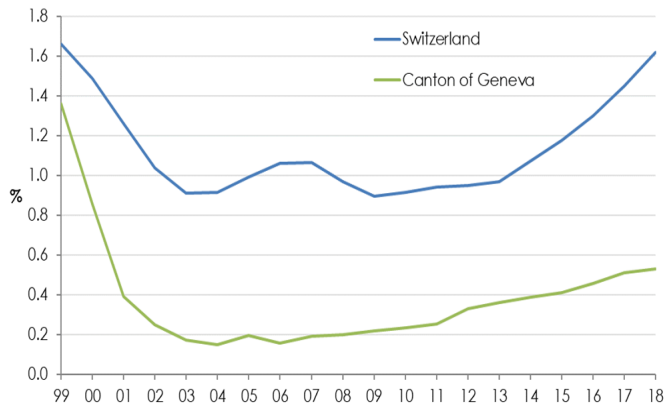


Residential real estate prices

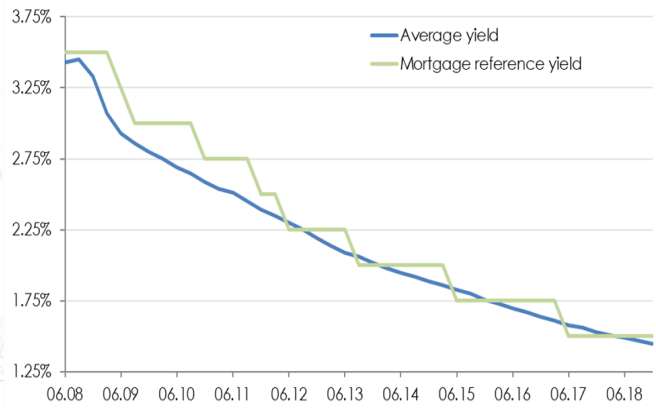


Graph sources: Bloomberg/BBGI Group

Vacancy rate



Average and benchmark mortgage rate



The challenges facing the rental segment are also evidenced by the increase in the duration of vacancies, in particular outside the major centres. The balance of power is increasingly shifting towards renters, as lessors seek new marketing concepts, aiming to increase the attractiveness of their properties. Thus, it is more and more frequent for renters to be offered lower or even free rent for an initial period.

Interest rates

In its March press release, the Swiss National Bank announced, as expected, that it would stay the expansionist course with regard to its monetary policy, maintaining a negative interest rate of -0.75% on sight deposits. This rate, unchanged for over four years, thus remains useful to counter the strength of the Swiss currency, reducing the attractiveness of deposits at the SNB.

The global economic downturn has been more pronounced than expected over the past few months, lowering expectations with regards to policy rates in the main monetary zones. The 2019 growth (+1.3%) and inflation (1.4%) forecasts for the euro area, Switzerland's largest trade partner, were thus reduced from +1.9% and 1.8%, respectively. In this context, the European Central Bank is unlikely to raise rates before 2020. The interest rate spread with Switzerland will thus not grow in the immediate future, impacting analysts' forecasts, which now anticipate no further rate hikes in Switzerland before 2021.

As is the case globally, the latest inflation forecast for Switzerland is lower than in December. Thus, for the current year, inflation is expected to be slightly lower, at 0.3%, compared to 0.5% in the previous quarter. The SNB is now anticipating inflation to be 0.6% in 2020 and 1.2% in 2021.

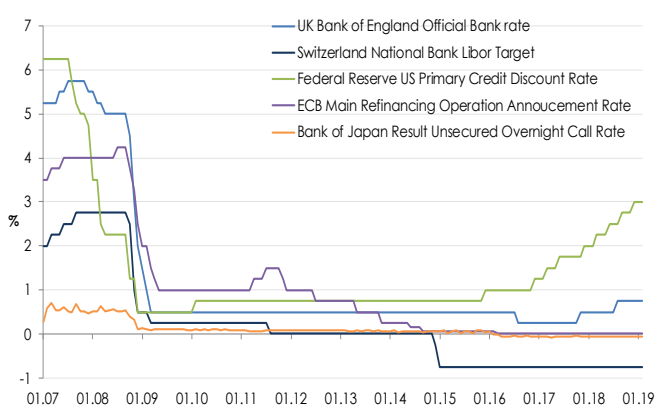
After having spent most of 2018 in positive territory, 10-year Swiss government bond yields fell from +0.04% in September to -0.24% at the end of February, penalised by less vigorous growth and inflation rates, both domestically and internationally. We now expect these long-term rates to rise once again over the next several months. In addition, as the SNB's monetary policy affects the very short end of the Swiss yield curve in particular, the spread between long- and short-term rates will likely grow and result in a steepening of the yield curve.

Construction

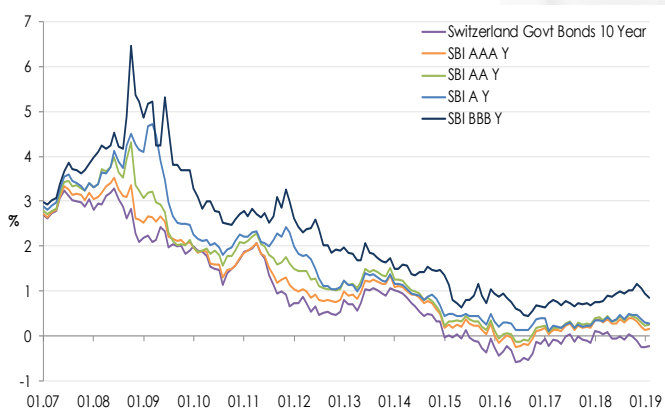
Due to the shortage of space in major centres, the construction of rental buildings has moved to the outskirts and to more rural areas. However, because of lower demand and an already high vacancy rate, the absorption capacity of these zones remains limited, thus curbing investors' interest in developing new projects. To counter these negative developments, an amendment to the land use law was passed in 2008. In 2013, Switzerland ratified the amended land use law, which among others calls for further development of downtown areas. The main objective is to meet future needs for space and to slow the urbanisation of rural communities.

Every municipality in Switzerland must identify zones of higher potential density. The assumption is that zones with a high density potential tend to be located closer to the centre, with good access to public transportation. Real estate portfolios including buildings in these locations could thus benefit from a higher utilisation rate in future. Additional floors or extensions could be considered in these cases, without having to build on additional land. Rental property owners should thus keep a close eye on changes in zoning plans, as in many cases potential added value is often hidden in the existing portfolio.

Policy rates

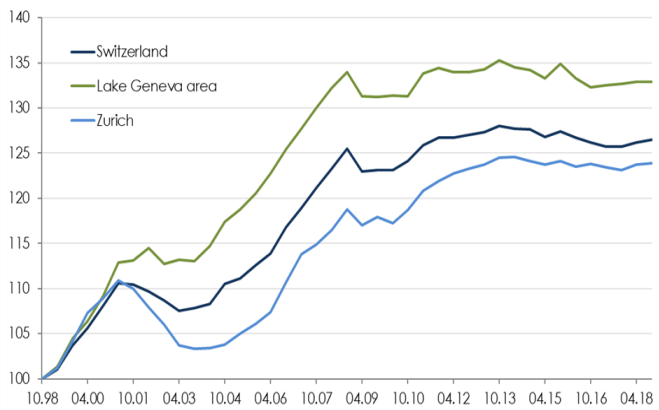


Interest rates (Swiss government, AAA, AA, A, BBB)

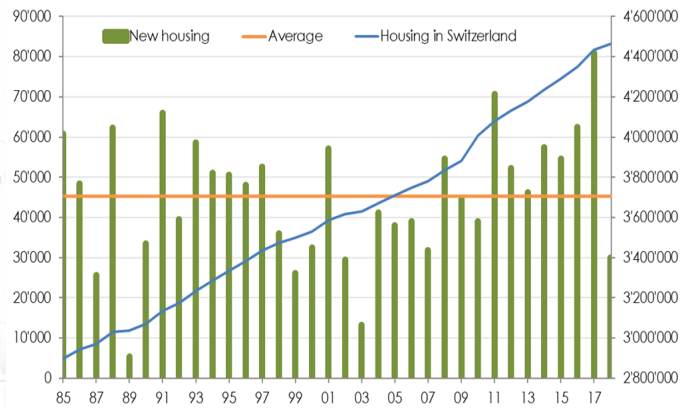


Graph sources: Bloomberg/BBGI Group /SSF

Swiss construction cost index



Housing stock



Commercial real estate

In spite of satisfactory economic growth in Switzerland for 2018 as a whole (+2.5%), given the slowdown in the global and in the European economy in particular, growth in H2 was less robust. This environment is likely to persist throughout 2019, due in particular to the negative impact of the global economic downturn on Switzerland's foreign trade and on investment. The State Secretariat for Economic Affairs thus forecasts GDP growth of +1.1% in 2019 and +1.7% in 2020. The KOF Economic Barometer, an indicator providing a reading on shorter-term Swiss GDP growth, is also pointing towards an economic slowdown, declining for the fifth month in a row in February.

In view of persistently high supply along with demand that cannot keep pace, only sustained economy growth boosting demand for space might be able to stabilise the market for office space. The trend in employment growth is less positive, with only limited expansion of the workforce over the past few half-year periods. Businesses seem cautious with regard to hiring, even though conditions remain favourable overall, preferring to attend to their profits threatened by the strength of the Swiss franc. Nevertheless, job vacancies are up, which is a positive sign in terms of developments over the next few months.

We should point to a number of elements of uncertainty with regard to the long-term outlook. People born after World War II, more commonly called baby-boomers, make up the largest age group in Switzerland, and they are reaching retirement. As a result, the size of the labour force will decrease as will undoubtedly the need for office space. The decline in space used per worker, due among others to the rise of co-working and of the home office, is expected to continue, supporting the argument made above.

In contrast, tertiarisation, a well-known phenomenon, should intensify further, boosting businesses' demand for office space.

Residential real estate

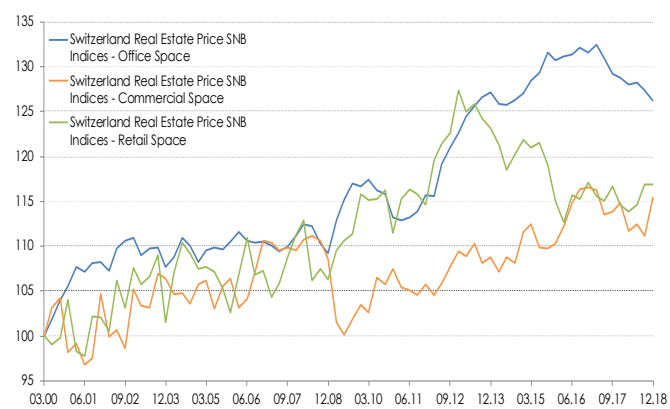
The situation in the residential real estate market has changed significantly over the past few years. Indeed, continuing excess supply has fuelled a increase in vacancies. As renters' attitudes and needs evolve, new builds have to adapt. Indeed, as the average household size decreases because of young adults' more itinerant lifestyle, increased female participation in the workforce, and an overall increase in living standards, among others, investors have stepped up the construction of two- and three-room apartments. Thus, over the past few years, we have noted a significant increase in this type of housing, which makes up a significant portion of Swiss construction activity. Three-bedroom housing units have accounted for over 30% of construction activity over the past four years, thus supplanting the previously favoured four-room units.

Three-room apartments are favoured because of their versatility, supposedly suitable for a small family as well as a two-person household. But do they really fulfil this objective? High rents are not always affordable for young couples, while families typically look for housing with at least one more room. A combination of two- and four-room housing units thus perhaps seems more appropriate.

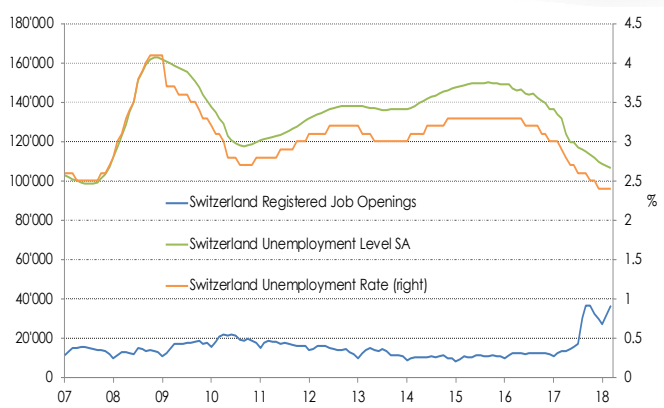
Whatever the magic solution may be, if it even exists, investors have likely overestimated the market's capacity to absorb three-room housing units. Indeed, among all rental sizes, three-room units have the highest vacancy rate and the fastest-growing number of empty units.

Three-room units have thus had the highest vacancy rate since 2015 when it was 1.34%. This rate continued to rise over the next three years, reaching 1.51% in 2016, 1.74% in 2017 and 1.95% in 2018. The vacancy rate for Swiss residential property overall has increased less sharply, reaching 1.62% at the end of 2018. Note that the average vacancy rate in Geneva, where demand is high due to its status as a major centre, is much lower (0.53%).

Commercial space prices



Employment and unemployment



Graph sources: Bloomberg/BBGI Group

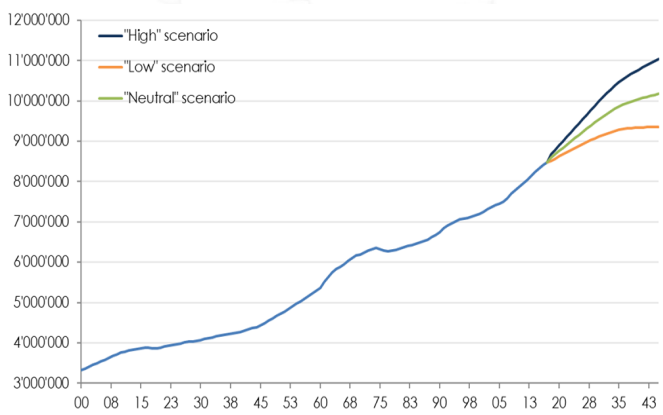
Access to property

Even though mortgage rates have been at historically low levels for several years now, and although they are expected to trend up, it is not unreasonable to consider the potential usefulness of LIBOR mortgages. Indeed, from a historical perspective, LIBOR mortgages have turned out to be more profitable in the great majority of cases than fixed mortgages, due in particular to the downward trend in mortgage rates since the beginning of the 90s. For over 35 years now, fixed-rate mortgages have only been advantageous for short periods.

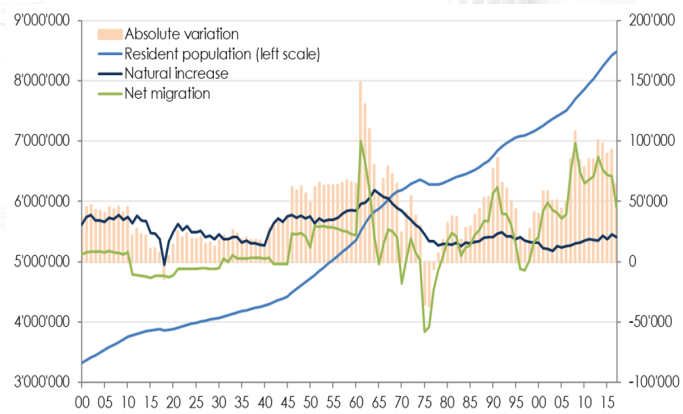
The rapid rise in interest rates at the end of the 80s was indeed favourable, due to variable-rate mortgages' strong sensitivity to interest rate fluctuations. This factor is among the most significant for a great many borrowers who are not prepared to withstand a significant and rapid increase in interest costs. Borrowers will then switch to fixed-rate mortgages, which provide more security in exchange for a premium. In the current economic environment, this premium is at a historical low, and it may thus be judicious to choose a fixed-rate mortgage, subject to trends in economic activity, inflation, and policy rates in Switzerland over the next months and years. Indeed, LIBOR mortgages will not start to rise until policy rates are back in positive territory.

Thus, given the uncertainty surrounding future policy rates, the best solution may fall somewhere in between: a combination of fixed- and variable-rate mortgages with different maturities.

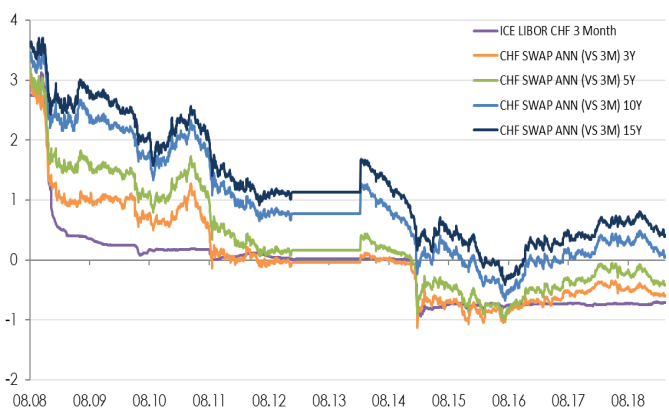
Resident population and projections



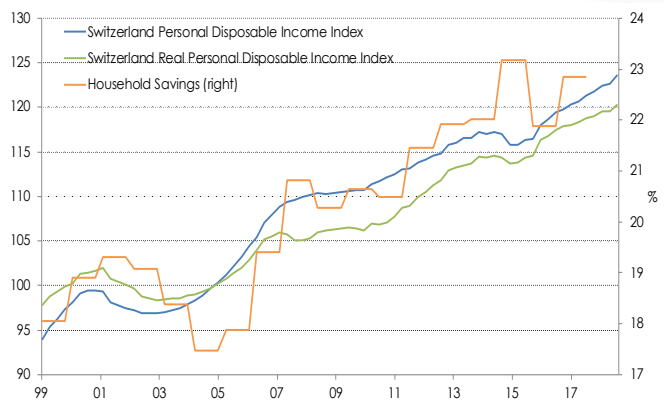
Net migration



Swap rate



Household income



Graph sources: Bloomberg/BBGI Group

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