
# Market Outlook

## Opportunities in Rising Volatility

February 2015

# Equities Markets

## Feature

**Low oil prices, the Swiss National Banks (SNB)'s surprising actions, China's control on margin financing and concerns over the aftermath of Greece's elections have all increased market volatility so far, resulting in negative investor sentiment.**

**However, Citi analysts note that Q4 earnings reports are sending a positive signal though not many people appear to have noticed it. Also equities are relatively cheap to bonds when measured by the yields. Against this backdrop, Citi analysts believe once fundamentals take the driving seat, equities may grind higher and outperform fixed income.**

**While geopolitical or policy risks may weigh the market from time to time, the bigger risk appears to be on the upside to equity markets, and the risk that investors will miss it. With short-term volatility and a longer term positive outlook ahead, they would buy on weakness.**

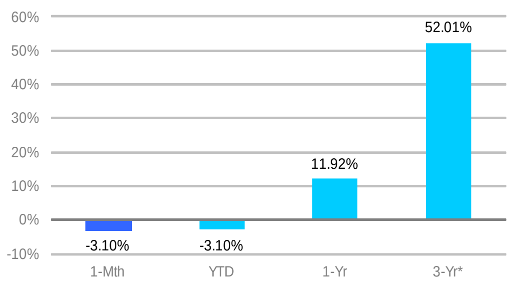
## United States

– Citi analysts expect an extra lift to US growth from the decline in crude oil prices. As a significant net oil importer, the US economy may benefit by about $140 billion in net foreign transfers. Consequently, Citi analysts recently raised their 2015 growth forecast to 3.6% from 3.0% previously, led by a pickup in consumer spending. They anticipate a return to a slower, albeit still above-potential, pace in 2016.

- Citi analysts think the Federal Reserve may use the temporary boost to growth from lower oil prices to begin raising rates sooner than their Dec-15 call.

- From an equity perspective, they remain constructive and expect 7% Earnings-Per-Share growth in 2015 to drive markets higher. In terms of sectors, capital spending is expected to grow double digits in the technology sector.

**S&P 500 Index**




*Denotes cumulative performance
Performance data as of 31 January 2015
Source: Reuters

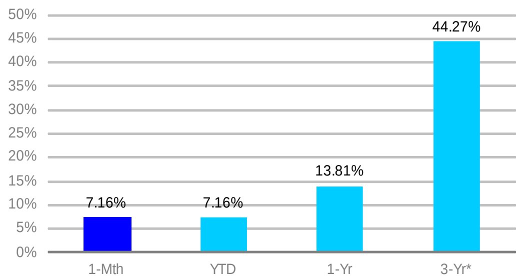
## Euro-Area

– The European Central Bank (ECB) announced a €60-billion-a-month program of bond purchases (QE), including Eurozone government bonds. The program will run from March until at least September 2016—implying total purchases of more than €1 trillion—helping to lift the ECB's balance sheet back toward €3 trillion.

- Citi analysts remain optimistic on European equities and believe that aggressive policy action from the ECB will be a key driver, trumping macroeconomic / earnings concerns. They expect 10% earnings growth in 2015, supported by: 1) ECB QE, 2) higher nominal GDP, 3) modest operating leverage, 4) weaker euro, 5) improving bank earnings.

- That said, Citi analysts note political risks remain, with 2015 elections in Portugal and Spain and reverberations from the Greek vote, all offering the potential to rile the markets.

**DJ Eurostoxx 600 Index**



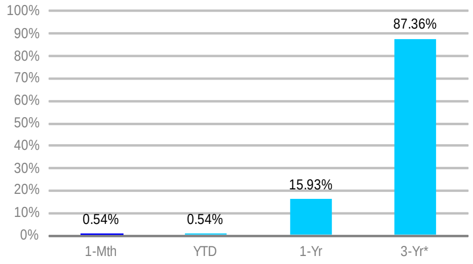

*Denotes cumulative performance
Performance data as of 31 January 2015
Source: Reuters

# Equities Markets

## Japan

- Citi analysts expect 2015 to be a year of solid growth. Japanese companies and consumers could enjoy an improvement in the terms of trade, driven by sharply lower oil prices in 2015. Most notably, consumer spending, the main culprit behind the technical recession of 2014, is likely to recover at a relatively solid pace, with steady growth in employment.
- The halving of oil prices is a game changer for the inflation outlook. Core inflation may approach 0% and turn negative, albeit temporarily, depending upon oil prices and the yen/dollar rate in coming months. In this context, Citi analysts continue to expect the Bank of Japan (BoJ) to implement additional easing measures in July 2015.

**Topix Index**

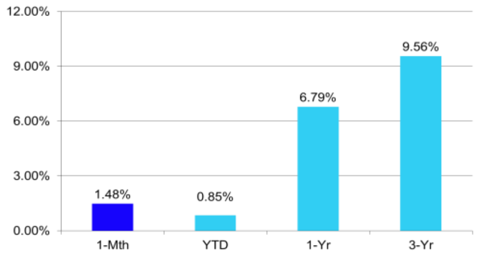



*Denotes cumulative performance
Performance data as of 31 January 2015
Source: Reuters

## Asia Pacific

- Economic data are generally supportive of a more pro-growth angle in Asia. Indeed, amongst the Emerging Markets (EM), Asia is likely to expand at a faster rate than other Emerging Markets.
- Given current account surpluses, Asian markets are less exposed to further US$ strength than their Latin America or Emerging Europe peers. Similarly, the EM Asian economies are generally commodity importers and so they should benefit from commodity price weakness.
- Within the region, Citi analysts favour China, Taiwan and Singapore. In terms of sector, the more cyclical sectors such as IT, Financials and Consumer Discretionary are preferred.
- In terms of valuations, the region is either at or around 1 standard deviation below the historic mean. China, Korea and Singapore offer the most value both in absolute terms but also relative to their own history. The most expensive markets on an absolute basis are India, Indonesia and the Philippines.

**MSCI Asia Pacific ex-Japan Index**

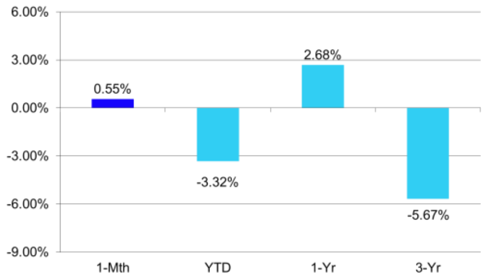



*Denotes cumulative performance
Performance data as of 31 January 2015
Source: Reuters

## Emerging Markets

- Emerging Europe is caught between strongly disinflationary pressures of falling oil prices, and the appreciation of the US dollar. As a region Citi analysts expect growth to face further downgrades over coming months.
- Divergent valuations are seen through the region. South Africa and Poland trade on premium multiples. By contrast Russia's low single digit Price to Earnings ratio is merely a reflection of its poor growth prospects in the face of oil price weakness.
- Citi analysts cut their 2015 Brazilian GDP growth expectation from 1.0% to 0.1% citing risks to the downside from high interest rates, slow credit growth and fiscal contraction. In Mexico, they expect real GDP growth to accelerate to 3.4% in 2015 and expect some monetary tightening later in the year.
- Citi analysts are neutral Mexico and underweight Brazil given the stronger US$ bodes poorly for commodities and current account issues.

**MSCI Emerging Markets Index**




*Denotes cumulative performance
Performance data as of 31 January 2015
Source: Reuters

# Currencies and Bonds Markets

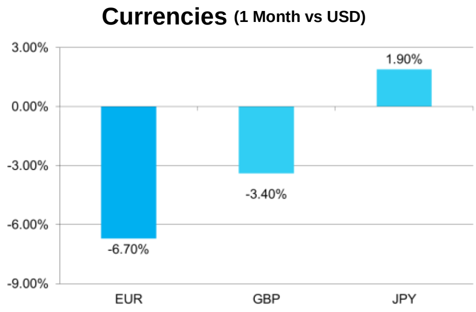
## Currencies

- Citi analysts see significantly more downside in EUR/USD in the medium term both because of generalized USD strength and due to EUR weakness as a result of ECB monetary easing via balance sheet expansion. Ultimately, the spot is seen heading below parity as Europe continues to suffer from weak real growth, slack labour markets and weak and falling inflation/ inflation expectations.

- After an impressive acceleration, a variety of UK economic indicators now appear to have levelled off albeit from a high base and likelihood of negative readings in terms of macro surprises on the have risen. This being said, political risk, the EU referendum and sizeable current account/budget deficits might continue to cap cable.

- USD/JPY seems to have entered another consolidation range, with the pull-back so far to just over 115 but recent moves in relative rates and the 2013 precedent suggest to Citi analysts a pull-back as far as 109-111. Medium to long term, they see much further upside, driven partly by expectations that further US economic outperformance will raise front end yields.

.




*Denotes cumulative performance
Performance data as of 31 January 2015
Source: Reuters

## Bonds

### US Treasuries

Citi analysts expect the US rates curve to flatten in excess of forwards, with the long end outperforming in an environment of low inflation risk premium and lower term premiums. The front end of the curve is expected to sell off in excess of forwards. However, the selloff is likely to be tempered by expectations of a more gradual pace of hikes.

### Investment Grade Corporates

Potential total returns in high-grade corporate bonds are likely to be modest. Indeed, low absolute yields and fully-valued spreads – especially in the US – are unlikely to sufficiently offset declines in principal value as interest rates rise. Citi analysts prefer European investment grade debt over US corporate bonds, and financial over non-financial credits.

### High-Yield

Recent sell-off provides attractive entry point for new exposures. In particular, Citi analysts favour Single-B credits in US and Europe as they appear poised to generate relatively impressive returns in 2015 as stable fundamentals, low default rates and the demand for higher yields support further gains.

### Emerging Market Debt

Citi analysts favour hard currency sovereigns/corporates over local debt given improving prospects for stronger USD. They prefer manufacturing vs. commodity exporters, and surplus over deficit countries.

### Euro Bonds

Citi analysts continue to see a very mild rise in Bund yields for 2015 (0.65% by Dec 15), reflecting both the negligible risk of a spike in inflation as well as the weak potential growth environment. Other factors such as demographics, productivity trends, real interest rates and political risks may likely contribute to Citi analysts' medium-term scenario ("low-for-longer"), despite a short-term expectation of a post- QE sell off in core Euro Government Bonds.

# Disclaimer

"Citi analysts" refers to investment professionals within Citi Research ("CR"), Citi Global Markets Inc. ("CGMI") and voting members of the Citi Global Investment Committee. For important disclosures concerning companies covered by Citi's Equity Research analysts, please refer to the attached link: https://www.citivelocity.com/cvr/eppublic/citi_research_disclosures.

This document is based on information provided by Citigroup Investment Research, Citigroup Global Markets, Citigroup Global Wealth Management and Citigroup Alternative Investments. It is provided for your information only. It is not intended as an offer or solicitation for the purchase or sale of any security. Information in this document has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on the information, consider its appropriateness, having regard to their objectives, financial situation and needs. Any decision to purchase securities mentioned herein should be made based on a review of your particular circumstances with your financial adviser.

Investments referred to in this document are not recommendations of Citibank or its affiliates. Although information has been obtained from and is based upon sources that Citibank believes to be reliable, we do not guarantee its accuracy and it may be incomplete and condensed. All opinions, projections and estimates constitute the judgment of the author as of the date of publication and are subject to change without notice. Prices and availability of financial instruments also are subject to change without notice. **Past performance is no guarantee of future results. Investment products are (i) not insured by any government agency; (ii) not a deposit or other obligation of, or guaranteed by, the depository institution; and (iii) subject to investment risks, including possible loss of the principal amount invested.** All forecasts are expressions of opinion, are not a guarantee of future results, are subject to change without notice and may not meet our expectations due to a variety of economic, market and other factors.

The document is not to be construed as a solicitation or recommendation of investment advice. Subject to the nature and contents of the document, the investments described herein are subject to fluctuations in price and/or value and investors may get back less than originally invested. Certain high-volatility investments can be subject to sudden and large falls in value that could equal the amount invested. Certain investments contained in the document may have tax implications for private customers whereby levels and basis of taxation may be subject to change. Citibank does not provide tax advice and investors should seek advice from a tax adviser. Citibank N.A., London Branch is authorised and regulated by the Office of the Comptroller of the Currency (USA) and authorised by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of regulation by the Prudential Regulation Authority are available from us on request. Our firm reference number with our UK regulators is 124704. Citibank International Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Our firm reference number with our UK regulators is 122342. Citibank N.A., London Branch is registered as a branch in the UK at Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB. Registered number BR001018. Citibank International Limited has its registered office at Citigroup Centre, Canada Square, Canary Wharf, London E14 5LB. Registered number 01088249. In Jersey, this document is communicated by Citibank N.A., Jersey Branch which has its registered address at PO Box 104, 38 Esplanade, St Helier, Jersey JE4 8QB. Citibank N.A., Jersey Branch is regulated by the Jersey Financial Services Commission. Citibank N.A. Jersey Branch is a participant in the Jersey Bank Depositors Compensation Scheme. The Scheme offers protection for eligible deposits of up to £50,000. The maximum total amount of compensation is capped at £100,000,000 in any 5 year period. Full details of the Scheme and banking groups covered are available on the States of Jersey website www.gov.je/dcs, or on request. Citibank N.A. is incorporated with limited liability in the USA. Head office: 399 Park Avenue, New York, NY 10043, USA.  Calls may be monitored or recorded for training and service quality purposes.