FINANCIAL MARKET ANALYSIS

Volume 14, Issue 4 **January 27, 2014**

Global sentiment remains uneasy

Highlights

Last week's weaker flash PMIs disappointed markets as investors appeared to have little patience to stay with risk assets or ride market volatility. The PMI weakness comes from the US and China, while Europe positively surprised the market. The US PMI was mainly affected by cold weather not a structural weakness but Chinese numbers appear more worrisome. The preliminary HSBC/Markit Flash Manufacturing PMI Index fell to 49.6 for January, from 50.5 in Dec, which is below the consensus expectation of 50.3. The preliminary manufacturing report was the first reading below 50 in six months with a reading below 50 denoting a contraction in output. Even worse, a sign that the first large wealth management product might default has been increasing fears about a hard landing in China.

Performance

Risk markets sold off this week and bonds rallied on modestly weaker PMIs and credit concerns about China. The global stock market posted sharp losses with the MSCI World sliding 2.34%. The S&P lost 2.63% while European equities finished lower, with the Stoxx Europe 600 Index down 3.3%. Japanese stock also closed the week down with the Topix losing 2.53%. Stocks in Asia finished mostly to the down with the MSCI Asia ex Japan posting a weekly loss of 1.84%. Albeit concerns on weak growth and credit tightening in China, onshore Chinese markets post positive weekly returns (Shanghai Composite +2.47% and Shenzhen A +5.19%).

The Week Ahead

In the US, the FOMC meeting will be the main focus. On the macro front, new home sales, durable goods orders, consumer confidence, personal Income and consumption and Q4 GDP will be released. In the euro area, the main economic releases this week will be the euro area flash inflation figure, UK's Q4 GDP and the German IFO survey, while money and credit data will also be in focus. On the political front, there is a Eurogroup meeting. Japan will see the trade data and core CPI. China's NBS manufacturing PMI will be in focus. Elsewhere in emerging Asia, Korea's industrial production and Philippines's Q4 GDP will be among key economic data this week while central banks in India and Malaysia will decide on interest rates.

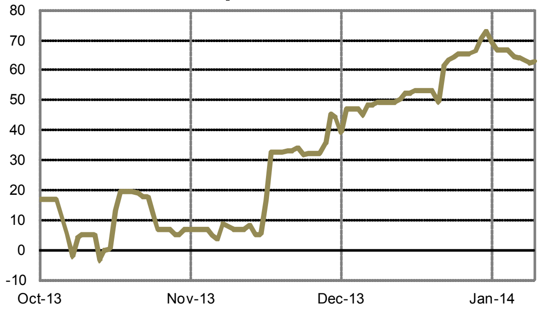
	Jan 24 Close	Last week's return	YTD Return	YTD return (USD)
S&P 500:	1790.29	-2.63%	-3.14%	-3.14%
Stoxx Europe:	324.75	-3.30%	-1.07%	-1.83%
Topix:	1264.60	-2.53%	-2.89%	-0.26%
MSCI Asia ex Japan:	530.18	-1.84%	-3.86%	-3.86%

Citigold

citibank

US/NORTH AMERICA

Citi Economic Surprise Index - US



Source: Bloomberg

Economic Outlook

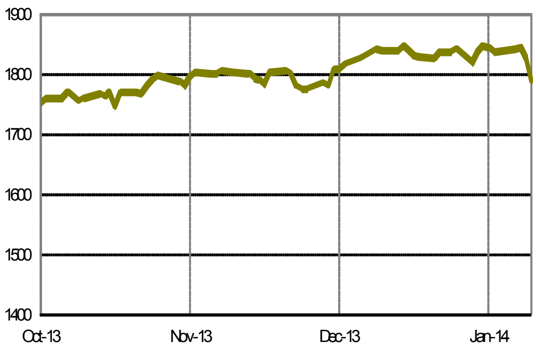
The Fed's Unemployment Conundrum

Citi analysts expect continued Fed tapering this week from $75 billion to $65 billion along with continued emphasis that rate hikes are unlikely until unemployment is well below 6.5% and especially as long as inflation forecasts remain below 2%. Stronger growth has likely bolstered confidence in officials' forecasts, while guidance has successfully anchored forward rates in the face of initial tapering.

With unemployment declining rapidly amid moderate job growth, officials cannot credibly judge where full employment is. The most recent plunge in participation despite stronger growth and solid job gains highlights the role that demographic, structural and other non-cyclical forces are likely playing in labour supply. Officials could eventually lower estimates of sustainable unemployment but may sharpen their focus on wage trends as a dual signal of labour market health and price stability.

Citi analysts think that GDP expanded at a 3.5% annual rate in Q4 and would have been stronger if not for slowing government spending and the partial federal shutdown. The severe start to winter could take a bite out of their 2.5% Q1 growth forecast and may delay a timely bounce back in job growth for January.

S&P 500 (24/10/2013 to 24/1/2014)



Source: Bloomberg

	Last week's close	Last week's return	YTD return
S&P 500	1790.29	-2.63%	-3.14%
DJIA	15879.11	-3.52%	-4.21%
Nasdaq	4128.17	-1.65%	-1.16%

- **End-2014 S&P500 Index Target: 1975**

Equities

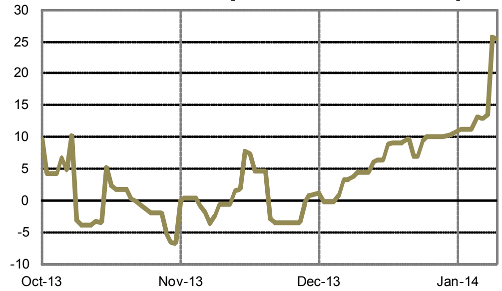
Not just focusing on valuations

The investment community has struggled of late as P/E ratios have climbed leading some to question the potential for further share price appreciation. Add in growing worries about the sustainability of corporate profit margins it is easy to see why there is resonance to the argument that stock indices have little more to advance.

It seems far more useful to focus on lead indicators for subsequent market trend rather than opining about valuation in the abstract. Indeed, a number of metrics such as normalized earnings yield gaps to price/book suggests that further upside is quite plausible even as the present value of flat earnings into perpetuity would imply more of a fair value mantra.

Equity risk premiums and inflation also affect the value of stocks and therefore there is still some potential for further multiple expansion even if it is not the base case view. Finally, earnings remain the primary driver for this year's anticipated rise in the S&P 500 such that centering discussions around valuation may thoroughly miss the point.

Citi Economic Surprise Index - Europe



Source: Bloomberg

Economic Outlook

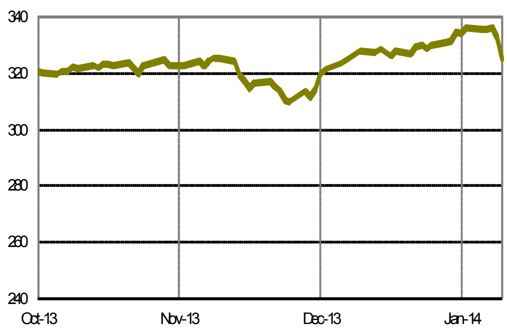
Spain Is Becoming More German

Citi analysts are raising their Spanish 2014 GDP growth forecasts to 0.9% (from 0.2%) and to 1.1% (from 0.8%) in 2015, on evidence that the recovery is already creating jobs, much earlier than in previous episodes.

Corporates' balance sheets have improved on stronger profits and collapsing labour costs, while improving financial market conditions help offset the negative effects of ongoing private debt deleveraging. Citi analysts expect job creation to support a pick-up in private consumption, although the acceleration in GDP may likely be capped by the ongoing housing adjustment and adverse demographic trends.

Spain's recovery may be a template for upside growth surprises from nearby Portugal, though a larger fiscal drag in 2014 should delay the Portuguese recovery until 2015. On the other hand, Citi analysts think Spain may likely continue to outperform Italy, because of the latter's more limited progress on structural reforms, ongoing political uncertainty and long-standing competitiveness issues.

STOXX (24/10/2013 to 24/1/2014)



Source: Bloomberg

	Last week's close	Last week's return	YTD return
STOXX	324.75	-3.30%	-1.07%
FTSE 100	6663.74	-2.42%	-1.26%
DAX	9392.02	-3.60%	-1.68%

Equities

Preference for Financials and Cyclicals over Defensives

Last year saw the beginning of a new investment regime. This is likely to be characterized by lower macro risk, rising growth opportunity and rising risk appetite.

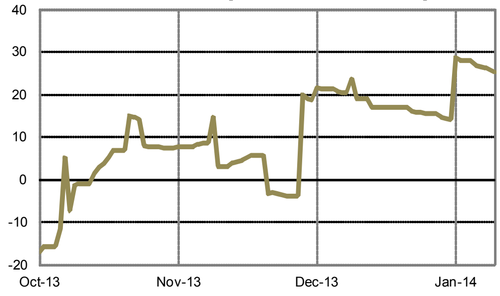
Indeed, given an improving macro backdrop in both the US and across Europe, Citi analysts favour companies which can benefit from stronger economic growth and which are operationally geared. Additionally, we expect companies to raise financial leverage.

This makes sense with a combination of: 1) macro risks significantly lower, 2) growth opportunities still capped, 3) wide funding gap between cost of debt and equity. This also suggests a pick-up in corporate actions in 2014.

So overall, Citi analysts prefer companies which can benefit from: 1) economic leverage, 2) operational leverage, and 3) financial re-leveraging. These companies are likely to be part of the earnings leadership group in the coming 12-18 months. This suggests a clear preference for Financials and Cyclicals over Defensives.

- **End-2014 Stoxx Index Target: 370**

Citi Economic Surprise Index - Japan



Source: Bloomberg

Economic Outlook

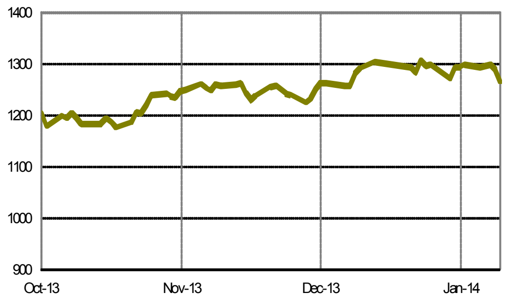
Implications of pay hikes and tax hike

Major companies are expected to raise base salaries for the first time in six years in the upcoming spring wage negotiations. Major companies (with capital of more than ¥1bn and 1,000 or more employees) may raise wages by more than 2% including a yearly pay increase. That said, the potential wage increase this spring may have a substantially smaller impact on the economy than widely expected. Even if major companies agree to raise gross pay by 1%–2%, macroeconomic income would increase an estimated 0.2%–0.4%, as the pay increase would affect only 20% of overall employees.

Also, the consumption tax rate hike from the current 5% to 8% in April is expected to lift the CPI, living costs for households in general, by 2% YoY. In Citi analysts' view, the nominal income increase envisioned this spring may therefore be insufficient to offset a drop in households' purchasing power.

This, together with an aging society, might make the tax hike's adverse impact on the real economy more severe. The consumption tax hike could curb the purchasing power of both income and financial assets. In particular, seniors who are generally more dependent on financial assets (and property income generated by those assets) may feel a proportionately larger impact from a decline in real value of financial assets.

Topix (24/10/2013 to 24/1/2014)



Source: Bloomberg

	Last week's close	Last week's return	YTD return
Nikkei	15391.56	-2.18%	-5.52%
Topix	1264.60	-2.53%	-2.89%

- **End-2014 Topix Index Target: 1520**

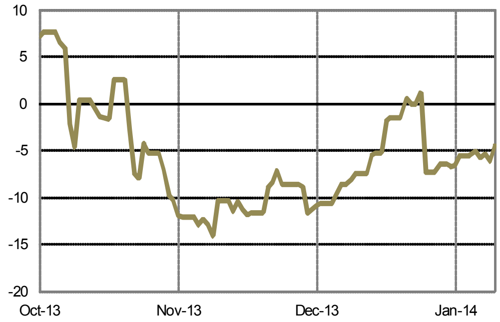
Equities

Impact of Worker Dispatch Law revisions

The government plans to submit a bill to revise the Worker Dispatch Law to the ordinary Diet session in 2014. In the new system that is being mulled, major staffing agencies that can offer dispatch workers indefinite employment may have the advantage and oligopolization may advance. With union permission, companies would be able to use temporary workers for more than the current maximum if a given temporary employee is replaced by another temporary employee within three years. Citi analysts think this amendment may make it easier for firms to take on temporary workers and are optimistic that the temporary worker market could grow.

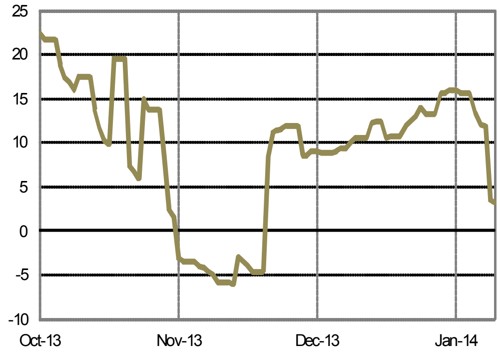
The government is also looking at revising the Employment Insurance Law and beefing up education and training benefits. Specifically, the discount on course fees for those attending courses designated by the Ministry of Health, Labour and Welfare as specialist or practical training courses would be lifted to 40% from 20%, and an additional 20% discount would be offered if the acquisition of the qualification(s) leads to employment. The upper benefit limit would be raised to ¥480,000 from ¥100,000. Citi analysts think firms that provide educational services in the areas of national qualifications and foreign languages may benefit.

Citi Economic Surprise Index – Asia Pac Ex Japan



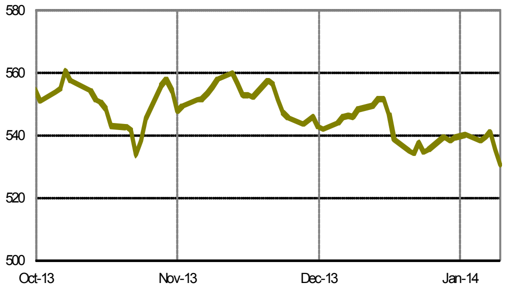
Source: Bloomberg

Citi Economic Surprise Index – China



Source: Bloomberg

MSCI AC Asia ex Japan (24/10/2013 to 24/1/2014)



Source: Bloomberg

	Last week's close	Last week's return	YTD return
MSCI AC Asia ex Japan	530.18	-1.84%	-3.86%

- **End-2014 MSCI AC Asia ex Japan Index Target: 660**

Economic Outlook

Selective EMs may see a pickup in export growth

The 'Fragile 5 (F5)' – Brazil, India, Indonesia, South Africa and Turkey – were at the heart of EM's underperformance in 2013, but investors have become more discriminating lately: the IDR, BRL and INR have been the best-performing EM currencies since the start of the year, while the ZAR and TRY have been the worst.

No one seems to have a full 'theory' of this divergence in the future for now but some trends are becoming clear. One of the most important trends is around the issue of policy credibility. Current account adjustment in the F5 is only really evident in India, partly thanks to the contribution of declining gold imports. While all of the F5 have depreciated real exchange rates, that doesn't yet seem to have translated into robust export growth.

Historically, where PMIs go, there goes the EM export cycle. However, this has not been the case. There is much debate about the export cycle and Citi economists have suggested that maybe EM has lost its beta to global growth. Or maybe it is just the nature of the current US recovery being more housing- than consumption-driven that has led to a greater lag in the export recovery. Although the positive spillover of DM import growth to EM export might not be as big as before, Citi economists expect Selective EM (so called Solid 5 such as Korea, China, Taiwan, Poland and Mexico) to see a pickup in export growth come Q2 of this year based on historical lags.

Equities

What could be a positive catalyst for EM equities

EM equity markets are much more retail-driven than global peers or their local fixed income markets, so it has a much higher tendency to sentiment swings.

EM equities are cheap. Indeed value is the first consideration to judge medium- to-longer-term returns. But value has not been a good timing signal, as its reversion to the mean is slow. Investors want to see a positive catalyst, such as an upward risk to EM growth or earnings growth. EPS revisions, historically the single best way to outperform when it comes to stock-picking in EM. Since late 2009, EM EPS revisions have underperformed those of DM. Consequently, EM has underperformed since then. However, since Nov13, EM EPS revisions have turned the corner and are now similar to those found in DM.

How about the export cycle in EM? It has been linked to the direction of global PMIs. Citi analysts believe that this relationship has now broken down. The global PMIs picked up late last year and there is nothing to suggest that better global PMIs may not lead to an improvement in the EM export cycle. Better PMIs used to lead to a swing toward greater cyclicality and vice versa. Even within the EM world, improving PMIs used to be risk/cyclical friendly. In Citi's view, this should be viewed as a positive for the EM equity asset class.

Developed Markets

27 January (Monday)

- **US** — New home sales probably edged down in December (460K), holding most of the gains from in the autumn.
- **Europe** — Citi analysts expect a slightly stronger reading for the German ifo business climate in December (108.3), owing to a small increase in the current conditions indicator and an unchanged expectations index.
- **Japan** — The customs-clearance trade balance likely came to a ¥1.4451trn deficit before seasonal adjustment and a ¥1.5803trn deficit after it in December.

28 January (Tuesday)

- **US** — Durable goods orders probably rose again in December (1.3%) as transportation took center stage.
- **US** — Consumer confidence likely rose in January to 80.0.
- **Europe** — Partial 4Q GDP data in UK so far show solid growth in industrial production, but a modest gain in retail sales and little change in construction output (0.7% QoQ, 2.7% YoY).

29 January (Wednesday)

- **Europe** — Net exports are expected to contribute to a sizeable increase in Belgian 4Q GDP, which Citi analysts forecast may show a 0.4% QoQ gain.
- **Japan** — December housing starts may stand at 1,001k (+13.7% YoY) on a seasonally adjusted annualized basis.

30 January (Thursday)

- **US** — Initial jobless claims for the week ending January 25 probably fell by 11K to 315K, even after three consecutive weeks of relatively low prints.
- **US** — The economy finished 2013 strong, rising by about 3.75% in the second half. But Citi analysts believe that 4Q113 actually was better than the headline reading suggests at 3.5%.
- **Europe** — Citi analysts expect the preliminary 4Q GDP reading (+0.3% QoQ, highest quarterly rate since 1Q 08) to confirm the end of recession in the Spanish economy, after two years of QoQ contractions.
- **Europe** — The Euro Area overall economic sentiment indicator probably continued to rise in January to 100.8, moving above its long term average for the first time since July 2011.
- **Japan** — Retail sales probably increased 3.8% YoY in December. Already available industry statistics indicate department store sales rose 1.7% YoY in the month, for a second consecutive monthly gain, while chain store sales dropped 0.8% YoY, for the first fall in four months.

31 January (Friday)

- **US** — Consumer spending increased at a moderate pace in December (0.2%), with the total restrained by a weather-related decline in motor vehicle purchases.
- **US** — The early January decline in consumer sentiment probably was reversed by the close of the month (82.5).
- **Europe** — Italian unemployment rate may have remained unchanged in December at 12.7%, after a 0.2pp increase in November.
- **Europe** — Ahead of the January 1, 2014 VAT rate hike, Citi analysts expect French consumer spending to have risen by 0.6% in December, boosted by household purchases of big-ticket items.
- **Japan** — The nationwide core CPI (the CPI excluding fresh food) likely rose 1.2% YoY in December.
- **Japan —** The core CPI in Tokyo may rise 0.8% YoY in January, picking up from a 0.7% YoY gain in December.
- **Japan —** December real spending of all households probably increased 1.2% YoY and 0.1% MoM. Consumer spending was probably lifted by rush demand before the tax hike.
- **Japan —** In December, Citi analysts expect improvement both in the unemployment rate (3.9%) and the effective job-offers-to-seekers ratio (1.01) from November.
- **Japan —** December industrial production likely increased 1.4% MoM (-0.1% MoM in November). The official projection points to a 2.8% MoM gain.

Asia ex-Japan

During the week

- **Thailand —** Positive exports (customs) growth likely returned (1.1% YoY) in December on improving tech demand and fewer supply constraints on food manufacturing.

27 January (Monday)

- **Hong Kong —** Citi analysts expect some trade recovery in December (exports: +3.6% YoY; imports: 3.3% YoY) despite the high base effects.

28 January (Tuesday)

- **India —** January monetary policy may remain status quo, although it could be a close call, especially in the light of the recent Urjit Patel committee recommendation.
- **Taiwan —** 4Q13 GDP may come in at 2.2% YoY and 1.1% QoQ s.a., improving slightly from 3Q's 1.7% YoY.
- **Thailand —** The growth in manufacturing output likely remained in red (-2.2% YoY) due to base effects in December.

29 January (Wednesday)

- **Malaysia —** Slowing domestic demand may probably lead MPC to keep the policy rate unchanged.
- **Korea —** December IP growth likely returned to positive territory (3.5% YoY) on the export recovery.
- **Singapore —** Jobless rate for 4Q13 probably stayed flat at 1.8% s.a. as the economy saw only a small sequential contraction even as labour supply likely tightened.

30 January (Thursday)

- **China —** The official manufacturing PMI may decline further to 50.3 in January on the back of weakened demand.
- **Philippines —** 4Q13 GDP growth likely came in 5.5% given upbeat signals from key indicators to offset the impacts from typhoon Yolanda.

1 February (Saturday)

- **Korea —** The recovery trend may continue in January though YoY export growth may come in red (-0.9% YoY) due to fewer working days.

WORLD MARKETS AT A GLANCE

	Previous Week's Close	52-Week High	52-Week Low	Weekly Return	YTD Return	YTD Return (USD)
UNITED STATES						
Dow Jones Industrial Average	15879.11	16588.25	13784.01	-3.52%	-4.21%	-4.21%
S&P 500	1790.29	1850.84	1485.01	-2.63%	-3.14%	-3.14%
Nasdaq	4128.17	4246.55	3105.37	-1.65%	-1.16%	-1.16%
EUROPE						
DJ Euro STOXX	324.75	337.65	274.97	-3.30%	-1.07%	-1.83%
FTSE 100	6663.74	6875.62	6023.44	-2.42%	-1.26%	-1.62%
DAX	9392.02	9794.05	7418.36	-3.60%	-1.68%	-2.51%
JAPAN						
Nikkei 225	15391.56	16320.22	10751.01	-2.18%	-5.52%	-2.96%
TOPIX	1264.60	1308.08	909.55	-2.53%	-2.89%	-0.26%
ASIA						
MSCI Asia ex Japan	530.18	566.88	475.70	-1.84%	-3.86%	-3.86%
Hong Kong Hang Seng	22450.06	24111.55	19426.36	-2.95%	-3.67%	-3.79%
Shanghai Composite Index	2054.39	2444.80	1849.65	+2.47%	-2.91%	-2.85%
Taiwan Weighted Index	8598.31	8668.95	7637.20	+0.03%	-0.15%	-1.55%
Korea KOSPI	1940.56	2063.28	1770.53	-0.20%	-3.52%	-6.24%
Mumbai Sensex	21133.56	21483.74	17448.71	+0.33%	-0.18%	-1.52%
Singapore Straits Times Index	3075.99	3464.79	2990.68	-2.27%	-2.89%	-4.12%
Kuala Lumpur Composite	1802.57	1882.20	1597.00	-0.58%	-3.45%	-5.44%
Thai Stock Exchange	1314.63	1649.77	1205.44	+1.48%	+1.23%	+1.27%
Jakarta Composite Index	4437.34	5251.30	3837.74	+0.57%	+3.82%	+4.22%
Philippines Stock Exchange Index	6191.50	7403.65	5562.13	+3.41%	+5.12%	+2.66%
Australia All Ordinaries	5254.34	5453.10	4610.60	-1.17%	-1.84%	-4.15%
EMEA						
Russia MICEX Index	1494.58	1566.42	1271.48	+0.52%	-0.63%	-5.01%
South Africa JSE All Shares Index	46462.14	47348.48	37717.78	-0.46%	+0.45%	-4.74%
Turkey ISE National 100 Index	64427.52	93398.33	61150.17	-1.84%	-4.98%	-12.18%
LATIN AMERICA						
Mexico Bolsa Index	40979.80	46075.04	37034.30	-2.22%	-4.09%	-6.64%
Brazil Bovespa Index	47787.38	62249.42	44107.06	-2.84%	-7.22%	-8.84%
COMMODITIES						
Gold	1270.07	1684.95	1180.50	+1.28%	+5.34%	+5.34%
Oil	96.64	112.24	85.61	+2.41%	-1.81%	-1.81%
FIXED INCOME						
Citi Treasury Index	1357.57	1392.61	1331.45	+0.39%	+1.03%	+1.03%
Citi World Big Index	196.82	198.49	190.96	+0.28%	+1.16%	+1.16%
Citi World Govt Index	644.94	650.43	627.83	+0.31%	+1.16%	+1.16%
Citi High Yield	824.96	828.46	767.09	-0.30%	+0.74%	+0.74%
Citi Global Emerging Mkt Sovereigns	636.35	688.93	612.40	-1.20%	-0.48%	-0.48%
Citi GEM Sovereign Asia	552.12	607.61	509.39	-0.34%	+0.21%	+0.21%

Source: Bloomberg (As at January 24, 2014)

CURRENCY FORECASTS

Currency		27-Jan-14	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
G10											
Euro	EURUSD	1.37	1.37	1.39	1.40	1.40	1.40	1.41	1.41	1.41	1.41
Japanese yen	USDJPY	102	105	106	107	108	110	111	113	115	115
British Pound	GBPUSD	1.65	1.70	1.72	1.75	1.76	1.76	1.77	1.78	1.78	1.78
Swiss Franc	USDCHF	0.89	0.90	0.90	0.89	0.90	0.90	0.91	0.91	0.91	0.91
Australian Dollar	AUDUSD	0.87	0.87	0.86	0.85	0.85	0.85	0.85	0.85	0.85	0.85
New Zealand	NZDUSD	0.82	0.84	0.85	0.87	0.87	0.86	0.86	0.85	0.85	0.84
Canadian Dollar	USDCAD	1.11	1.11	1.12	1.12	1.12	1.12	1.12	1.12	1.12	1.12
Swedish Krona	USDSEK	6.44	6.28	6.28	6.29	6.27	6.26	6.24	6.23	6.21	6.18
Norwegian Krone	USDNOK	6.14	5.97	5.85	5.74	5.67	5.62	5.57	5.52	5.47	5.43
EM Asia											
Chinese Renminbi	USDCNY	6.05	6.03	6.02	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Hong Kong	USDHKD	7.76	7.75	7.76	7.76	7.76	7.76	7.75	7.75	7.75	7.75
Indonesian Rupiah	USDIDR	12245	11916	11954	11992	11937	11858	11779	11698	11618	11464
Indian Rupee	USDINR	62.8	60.50	61.60	62.80	62.20	61.20	60.20	59.20	58.20	57.70
Korean Won	USDKRW	1084	1047	1039	1032	1023	1014	1005	996	987	985
Malaysian Ringgit	USDMYR	3.34	3.30	3.23	3.16	3.14	3.13	3.12	3.11	3.10	3.09
Philippine Peso	USDPHP	45.4	45.80	45.40	44.90	44.20	43.40	42.60	41.80	41.00	40.70
Singapore Dollar	USDSGD	1.28	1.27	1.27	1.27	1.27	1.26	1.25	1.25	1.24	1.24
Thai Baht	USDTHB	32.9	33.30	33.00	32.60	32.10	31.60	31.10	30.50	30.00	29.80
Taiwan Dollar	USDTWD	30.4	29.90	29.70	29.50	29.40	29.30	29.20	29.10	29.00	28.90
EM Europe											
Czech Koruna	USDCZK	20.08	19.76	19.55	19.33	19.15	18.98	18.82	18.65	18.48	18.36
Hungarian Forint	USDHUF	223	222	222	222	221	221	221	220	220	220
Polish Zloty	EURPLN	3.07	2.98	2.95	2.92	2.89	2.86	2.83	2.8	2.77	2.77
Israeli Shekel	USDILS	3.50	3.42	3.45	3.49	3.54	3.59	3.64	3.69	3.74	3.73
Russian Ruble	USDRUB	34.6	33.6	33.9	34.2	34.5	34.7	35	35.2	35.4	35.5
Turkish Lira	USDTRY	2.32	2.28	2.25	2.21	2.21	2.22	2.23	2.24	2.25	2.23
South African Rand	USDZAR	11.12	11.17	11.09	11.02	10.89	10.75	10.61	10.47	10.33	10.27
EM Latam											
Brazilian Real	USDBRL	2.40	2.46	2.48	2.50	2.52	2.54	2.56	2.58	2.60	2.58
Chilean Peso	USDCLP	551	531	522	512	512	514	516	518	520	518
Mexican Peso	USDMXN	13.4	13.20	12.90	12.70	12.60	12.50	12.40	12.40	12.30	12.30
Colombian Peso	USDCOP	1994	1954	1963	1973	1975	1975	1975	1975	1975	1964

Source: CR, Bloomberg (As of January 27, 2014; Forecasts as of January 20, 2014)

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