Standpoint

Q2 | 2015
Global Market Analysis by Citi EMEA Consumer Bank

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Domesticating Volatility

After more than two years of absence, the return of volatility is a key investment theme Citi analysts started to highlight during the last quarter of 2014. Looking at the VIX Index that tracks a market estimate of future volatility, it seems there is nothing to worry about. The VIX Index closed the quarter at 15, exactly in line with the average of the last two years. Risky assets delivered decent returns for the period. Market trends are largely rewarding the various consensual plays such as stronger US Dollar or equities, which tend to be a reassuring factor for investors. However, it is also worthwhile to remember that volatility doesn't rise in a gentle and continuous way, it peaks.

"Although volatility measures are notyet showing alarming signs of rising risks and consensual plays are largely rewarded, there are plenty of sources of volatility in the markets for which investors should be prepared for"

Citi analysts observe some severe changes have occurred over the last few months. Oil prices have collapsed by 50%, the US Dollar index has increased by 25%, the US yield curve has started to flatten on the back of higher short term yields, monetary policy divergences have driven major equity return divergences and the trend of relative economic surprises between the US and the other parts of the world has suddenly and sharply reversed. On the back of these events, bulls and bears are increasingly voicing their case, and it begins to transpire in the market trend. Indeed, Citi analysts have observed that although the VIX index remained relatively low on average, it experienced 5 jumps above 20 during the last 6 months, which is as many as during the previous 18 months. This observation is mirrored by the number of days during which US equity indices rose or decreased by more than 1%, which has significantly increased.

Opinions, forecasts, and weightings expressed by Citigroup Global Consumer Group Investments may not be attained or suitable for all investors. Past performance is no guarantee of future results. There are additional risks associated with international investments, including foreign, political, currency and economic factors to consider. Please contact your financial professional to determine what is suitable for your individual situation

Citi Outlook

A snapshot of Citi analysts global market views across a select group of asset classes, regions and currencies over the next three to six months.

The Market Outlook reflects Citi analysts assessment of each asset class independently.

The Global Investment Committee ('GIC') made no changes to recommended portfolio weightings at its latest asset allocation meeting. The Committee decided to maintain its existing overall equity/bond asset allocation. The allocation remains overweight risk assets and underweight interest rate risk. The GIC maintains overweight in equities, with overweights in US, Japan, Asia ex-Japan and Europe. This is offset with an underweight in fixed income, concentrated in a heavy underweight in developed sovereign bonds. Within its fixed income portfolio, the GIC has small overweight position in high-yield while positions in emerging market debt are underweight and investment grade corporate bonds are neutral.

The committee noted that the global backdrop of both continued growth and substantial additional easing provides context to the instability and costs of foreign exchange volatility. Quantitative easing (QE) in the Eurozone has catalyzed a financial market recovery that could mirror Japan's of recent years. The "bigger picture" for the Fed is that the central bank is almost certain to tighten very modestly.

Global equities	
Market	**Outlook**
	Positive
US	Positive
Europe	Positive
Japan	Positive
Latin America	Negative
Asia Pacific	Positive
Emerging Europe	Neutral

Global fixed income	
Market	**Outlook**
	Negative
Global Government	Negative
Global IG Corporate	Neutral
Developed High Yield	Positive
Emerging Market Debts	Negative

Global currencies	
Currency	**Outlook**
Euro	Negative
Yen	Negative
British Pound	Neutral

Data Source: Citigroup Global Markets Inc. Weighting provided by Citi EMEA Consumer Bank as of April 2015.

"Rising volatility is often accompanied by waves of panic and rising concerns. For those prepared, volatility is not an enemy but an opportunity to enhance relative returns."

One of the most common mistakes investors make is not thinking holistically about their portfolio. Instead, they examine each individual investment and overreact to holdings which are performing poorly or experiencing volatility. Many times, perhaps even most of the time, this is a serious mistake that can disrupt the effectiveness of an investment plan.

When a spike of volatility occurs, investors should first keep in mind that risk appetite is different from panic, or greed. A good understanding of one's risk appetite will help to design a long term investment strategy, while panic and greed can let short term noise derail the portfolio from its objectives. Investors keeping that in mind will actually be able to take advantage of periods of heightened volatility to increase their relative returns. Indeed, such periods provide interesting opportunities for time diversification by implementing dollar-cost averaging strategies for example. Also, investors can make use of volatility as a rebalancing signal. It is also during these periods that income focused investments make plain sense as income tend to offer protection against price swings.

In a maturing bull market period, the portfolio management focus progressively shifts from an opportunity seizing stance to a risk management stance despite ongoing equity outperformance.

Citi analysts consider that over the course of the second half of 2014, equity markets entered a new period of their cycle known as "Maturing Bull". During that period, typically characterized by a normalization of monetary policy and higher yields, risky assets are expected to continue to outperform whilst safe assets like bonds suffer from yields pressure. However, this expected equity outperformance is no longer as straightforward and generous as during the rebound phase. Indeed, during the maturing bull period concerns related to the sustainability of the bull market and of the economic expansion arise which generates also more volatility. Prices swings occur more often and their amplitude increases as well. From a portfolio management perspective, it means the maturing bull phase is a period during which the risks related to misallocation are potentially larger. Sure, government bonds are not attractive.

"Bonds and government bonds in particular have not been so unattractive in decades, but don't underestimate their diversification power."

Whether on an absolute or relative basis, government bonds appear more expensive than ever. Not only are they expensive, but also, the income level offered is extremely low, which also reduces the compensation received for the duration risk taken. However, the fundamental features of bonds, government bonds in particular, makes them the best diversifier to risky assets. In any market context, government bonds correlation to equities is extremely low which means they offer protection against the spikes of volatility arising during a maturing equity bull market.

As the equity bull markets keeps developing, supported by liquidity, de-equitisation, valuations and a favourable global economic context, keep an close eye on volatility which has been absent for almost three years. Don't surrender to panic when it arises or to greed when it recedes, but make sure you have included appropriate strategies in your portfolio. In particular, don't underestimate the importance of non-risky asset in a portfolio, they might not necessarily provide upside support the portfolio, but they will definitely mitigate downside risks and bring sustainability to the trend of the portfolio.

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Europe and North America

Europe equities

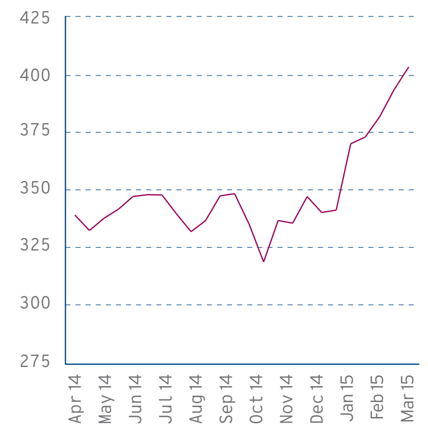
ECB Easing Drives Equity Outperformance

So far, the European Central Bank's asset purchase program (reinforced by other ECB measures) seems to be having a bigger effect on financial markets – in terms of lower bond yields, weaker currency and higher equity prices – than the average seen around asset purchase programs by the US Fed, the Bank of England and the Bank of Japan in recent years. As this stimulus feeds through, Citi analysts expect that euro area growth and inflation will both exceed consensus next year.

TheGDP growth estimate unchanged at 1.5% for this year but rose their 2016 GDP to 2.0% as more evidence is emerging from surveys and hard data that the euro area is on the cusp of faster economic activity. In addition, currency weakness is likely to boost exports and indirectly lift corporate profits and fixed investment. Fiscal policy is also turning more supportive. Barring an accidental euro exit by Greece, Citi analysts believe the buffer provided by the ECB's Asset Purchase Program will continue to insulate euro area periphery member states from contagion risk.

In that context, Citi analysts continue to back growth and re-rating of European equities over the next 1-2 years. They raised their prospects for European equities on the back of 10% to 25% cumulative dividend growth expectations, market payout ratios heading back towards average levels over 3 years and a Dividend Yield re-rating from 3.1% to between 2.25% and 3%. They highlight two key risks:

1) growth cycle interrupted/broken,
2) upside CPI risk and hence sharply higher rates. Within the market, they continue to favour strategies which align with liquidity, i.e. quantitative easing strategies and de-equitisation.



DJ Stoxx 600

Data source: Bloomberg as of 31 March 2015

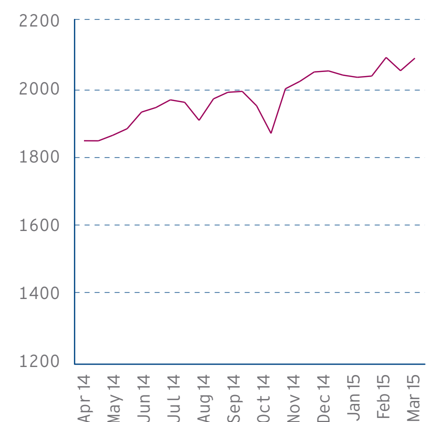
North America equities

First Half Profits Growth Dampened

Citi analysts revised their GDP growth forecast for the year to 3.1% as recent data have shown weaker-than-expected consumption and a pullback in construction. Although milder than last year, harsh weather may have dampened (temporarily) Q1 auto and retail sales. With solid employment and income gains continuing, and gasoline prices remaining low for a prolonged period this year, they expect healthy consumption growth to resume in coming quarters. They expect the temporary boost from lower energy prices to dissipate in 2016, but GDP should still grow at an above-potential pace. The drag induced by the strong dollar remains a notable downside risk to Citi analysts' outlook.

Headline inflation this year is likely to decline temporarily toward zero, and core inflation will remain well below the Fed's 2% target until 2017. While lower energy prices have dampened headline inflation, the appreciating US dollar and deflation abroad will help cap core inflation. Domestic wage pressures remain muted by substantial economic slack and firms' reluctance to raise the pace of hiring, which has historically preceded wage hikes. Citi analysts believe that the uncertainty about the outlook for inflation and GDP growth will prevent rate hikes until year end.

The market outlook is unchanged as the 2015 target was never designed to be a stretch and multiple expansion was not considered in the base case. However, Citi analysts trimmed their Earnings-per-Share (EPS) expectations for the year and forecast now 6% profit growth. They think the drop in oil and gas prices, sharp appreciation of the US dollar and slightly weaker 4Q14 EPS will weigh on profit but they also expect the consumption to step up later this year, benefitting from lower energy bills plus more jobs and higher wages



S&P 500 Index

Data source: Bloomberg as of 31 March 2015

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Global Sovereign and Corporate Bonds

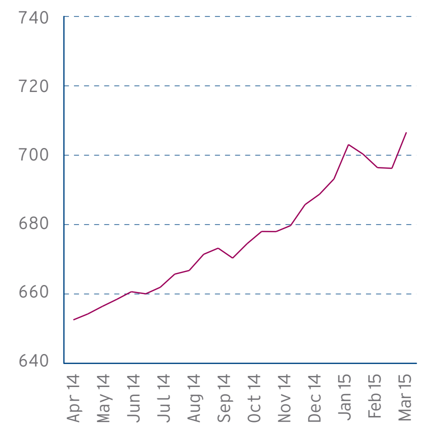
Global Sovereign Bonds

European Central Bank Weighs on Yields

The launch of the 60 billion euros government bonds purchase plan of the European Central Bank (ECB) in an effort to jumpstart sluggish activity in the region drove interest rates across the Eurozone to record lows. European sovereign yields in the Core Euro countries already trade below zero- through five-years-to maturity and feature rates at (or below) 1.0% for 30-year debt. In Switzerland, the term structure is negative through 10-years, and 30-year sovereigns are below 50bp. While some indicators suggest that Eurozone activity is beginning to improve, Citi analysts expect a combination of positive technicals (ECB purchases) and dormant inflation pressures to keep core rates anchored near these very unattractive levels.

The most attractive prospective returns for Eurozone investors remain in peripheral debt despite prevailing uncertainties about Greece. Although spreads have compressed materially since the beginning of February, current levels still do not reflect the potential impact of unconventional ECB actions underway and strong investor appetite.

In the US, economic releases continue to generate compelling evidence that the recovery is intact and raises the possibility that the Federal Reserve will initiate rate hikes during the second half of this year. Despite improving fundamentals in the US and policy rate hikes later this year, the potential backup in US bond yields is likely to be fairly benign. The spread between the US and German 10-year is currently at a record wide, highlighting the attractiveness of Treasury debt along with a stronger dollar. These factors are compounded by a global deflationary trend and compressed term premium, suggesting that the magnitude of any backup in rates at the long end of the curve will be contained.



Citigroup World Government Bond Index

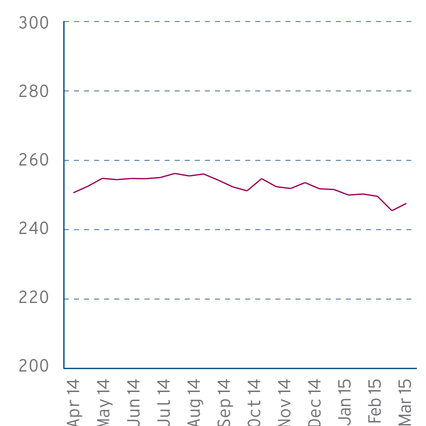
Data source: Bloomberg as of 31 March 2015

Corporate Bonds

Oil Prices Offer a Breather to High Yield

Spreads in US and European investment grade corporates compressed during the 1Q15 with US credit outpacing euro-denominated corporates. Despite heavy new supply in recent months, spread performance has been supported by solid 4Q14 earnings, strong bond fund/ETF inflows, and easing in Europe and Japan. That said, the relationship between USD and EUR credit markets had been decoupling for the last six months, reaching its widest levels in six years. This has been fueled by Federal Reserve and ECB monetary policy moving in vastly different directions. Given more attractive yield propositions in the US, and inflows supported by a weaker euro, Citi analysts expect this differential to compress. They therefore prefer USD over EUR corporates.

US and European high yield (HY) outperformed as stabilizing oil prices dampened volatility in the energy sector. As Western Texas Intermediate (WTI) and Brent crude bottomed, USD and euro high yield spreads tightened with US HY yields have dipping below 6.0%. While European HY index composition is vastly different (e.g., no energy exposure, shorter duration), yields continue to breach new lows. Despite stable fundamentals (ex-energy) and a return to positive bond fund flows, the prices of oil remain the biggest concern to Citi analysts. In their view, if oil prices decline sharply, positive momentum will reverse course. Although current market positioning may not be as crowded (i.e., in energy), spreads will likely widen. Given Citi analysts' positive fundamental view on the sector, any sharp corrections that improve valuations should be viewed as an opportunity to add exposure.



Citigroup World Corporate Bond Index

Data source: Bloomberg as of 31 March 2015

Forecasts may not be attained. Past performance is no guarantee of future results. There are additional risks associated with foreign investments.

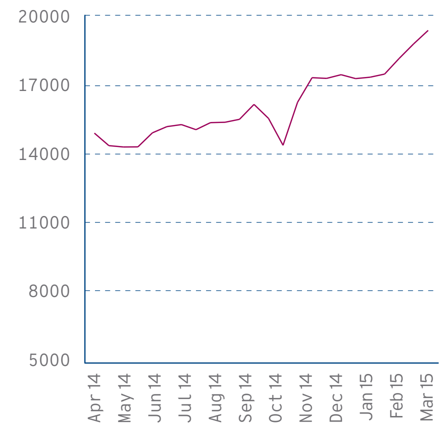
Japan and Asia Pacific

Japan equities

Strong Earnings Growth Expected

Citi analysts expect the Japanese economy will continue to grow at an above-trend pace in coming quarters. Most importantly, consumer spending will likely recover with solid growth in employment, a modest rise in per-capita wages and sharply lower energy prices expected to lift real total employment income. In the spring wage negotiation this year, representative companies generally decided to raise base salaries more than last spring, in part reflecting the government's persuasion. Moreover, export volumes have started to show clear signs of picking up. Resilience in the US economy and a pick-up in the global high-technology cycle appear to be boosting Japan's exports, especially those of capital goods and electronic components. Finally, Citi analysts expect business investment to return to an upward track in 2015. They think the Bank of Japan (BoJ) will implement additional easing measures around July this year. Market focus has been on the impact of lower oil prices on core inflation (excluding fresh food) and its implication for monetary policy in recent months. However, they think the BoJ remains overly optimistic about underlying inflation.

In this environment, corporate profits will likely increase markedly in fiscal 2015 (starting in April). Based on their macroeconomic projections, Citi analysts estimate that operating profits at manufacturers (including small businesses) will rise more than20%. Manufacturers should enjoy solid top-line sales growth driven by a cyclical rebound in economic activity and continued yen weakness, plus cost savings from the sharp fall in oil prices. They believe that the positive impact of lower energy prices has not been reflected adequately in profit estimates by individual companies.



NIKKEI 225 Index

Data source: Bloomberg as of 31 March 2015

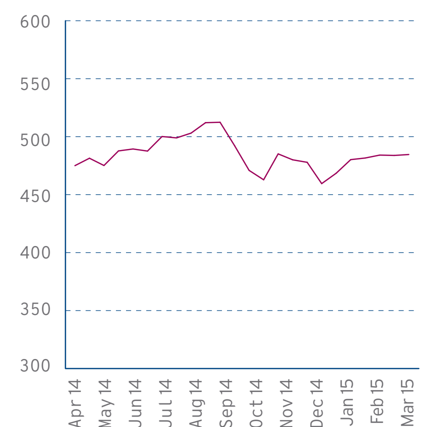
Asia Pacific equities

Divergences Between Sentiments and Economic Surprises

The Chinese economy observed a weak start for 2015, dragged down by elevated cost of capital, the property downturn and over-capacity. The National People's Congess conference pointed to an accommodative policy stance while the reform agenda was vaguely defined. Citi analysts maintain their below-consensus 1Q15 GDP forecast at 6.7% and expect two more policy rate cuts and 2-3 more rate cuts in 2015. Currency policy will remain stable in the near term.

India's reforms momentum picked up in the budget session of the parliament with significant changes in the tax regime, passage of the insurance bill and institutionalization of a flexible inflation targeting framework. With reforms gaining momentum and continued reduction in investment bottlenecks, Citi analysts expect economic activity to pick up to 8.1% in 2016 from 7.4% last year. The growth revival is likely to be supported by more accommodative monetary conditions as inflation trends remain benign. In the rest of the region, economic data have generally disappointed. Korea and Thailand are expected to cut rates while Citi analysts think Singapore will ease via band widening soon. Not everyone will ease – Malaysia, Philippines and Taiwan probably will stand pat amid already accommodative stance.

Citi analysts continue to consider Asia as suffering from a lack of risk appetite from investors. Indeed sentiments readings for the region remain poor though Asia continues to enjoy double-digit positive economic surprises. Also, consistent with their view that lower oil prices will benefit manufacturing exporters and be negative for commodity exporters, Citi analysts remain overweight China, Taiwan and India - and underweight Malaysia. Citi analysts remain overweight EM Asia as a whole.



MSCI Asia Pacific Ex-Japan

Data source: Bloomberg as of 31 March 2015

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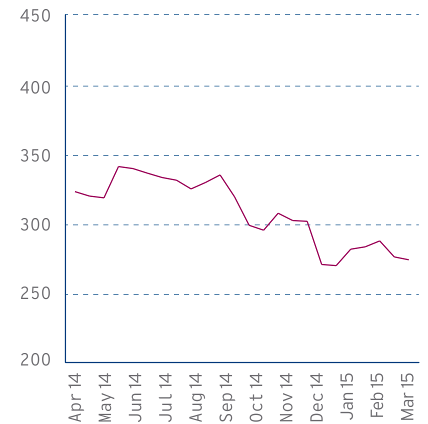
Emerging Europe and Latin America

Emerging Europe equities

Increasing Liquidity Concerns

A benign US Fed and an easing ECB create a favourable environment for portfolio flows to Emerging Europe in the near term, particularly in the wake of sharp exchange rate adjustments during recent months which had weakened currencies dramatically. Investors could see the combination of this near-term benign global monetary environment and depressed sentiments as a buy signal. Although sentiment readings are indeed reaching levels seen at the bottom of the Global Financial Crisis, Citi analysts warn that the short-term potential relief should not mask the persistence of cyclical weakness and structural challenges the region is facing.

There is indeed still so much uncertainty about the 'growth model' in Emerging Europe – especially for commodity exporters - that it is very difficult to call an end to the repricing of risk in the region. In particular, like the rest of Emerging Markets (EM), Emerging Europe continues to suffer from weakening export growth which can find cyclical causes in a strong US$, weak growth in Developed Markets and a decline in commodity prices. Citi analysts highlight exports are important not just for GDP growth but for liquidity creation as there is no quantitaive easing in the region. At present, weakness in the commodity space continues to be a real issue for the region. However, Citi analysts observethat the earnings revision trend has improved in Emerging Europe compared to other EM as downwards pressures receded in the Energy sector. Such improvement combined with particularly depressed sentiments reading could bring support to markets like Russia, South Africa and Hungary, according to Citi analysts.



MSCI EM EMEA

Data source: Bloomberg as of 31 March 2015

Latin America equities

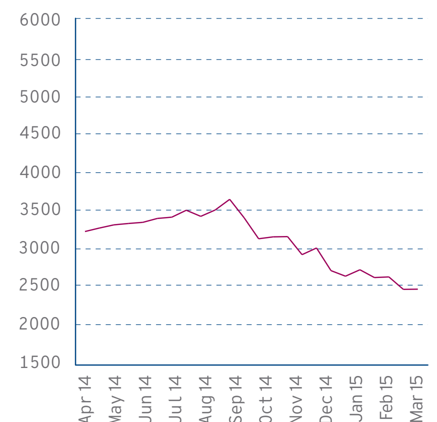
Too Early To Be Contrarian

Citi analysts are keeping their 2015 GDP forecast at -0.8% for Brazil though they once again raised their inflation forecast, on the back of which they expect a final 50bps hike in the Selic rate in April. For Mexico they maintain their real GDP growth forecast for this year at 3%, while they see annual inflation at 3.2% by yearend. They continue to expect Banxico to begin to tighten monetary policy in June. Economic imbalances continue to worsen in Argentina and Venezuela in an important elections year.

Citi analysts observe the weighting of LatAm in EM has fallen to a (new post-1990) low of 15%. This has got the attention of contrarians, with some proposing to overweight LatAm on the back of a long term positioning opportunity.

However, Citi analysts continue to disagree with this view and remain firmly underweight.

Citi analysts observe that US$-based earnings in LatAm are now lower than the Global Financial Crisis (GFC) low and have fallen by 35% from the pre GFC peak. In LatAm, 49% come from commodities and then a further 46% from staples or telecoms, but Citi analysts don't expect these two sectors to compensate for the decline in commodity earnings power in a general context of economic slowdown and tightening monetary conditions. Furthermore, given that commodity prices are still down compared to a year ago, it is too early to suggest that a bottom has been put in place as far as the earnings cycle is concerned. Also, long-term shows that in real terms, it is not as if commodity prices have put in a long-term low yet. It is totally feasible that commodity prices continue their long term decline for a while.



MSCI EM Latin America

Data source: Bloomberg as of 31 March 2015

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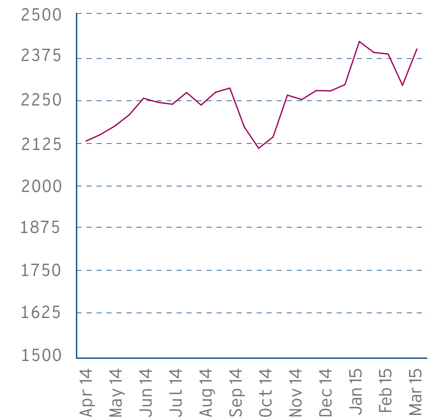
Global REITs and Commodities

Real Estate Investment Trusts (REITs)

Beware of Rising Yields

Listed real estate generally outperformed broader equity markets in 1Q15, led by US REITs. Fundamental trends in real estate generally remain positive as the US and the UK economies remaining on their generally positive trajectory, with further improvements noted in labour markets and domestic demand. Monetary conditions remain supportive, though increased higher yield volatility and flattening of the US yield curve on the back of nearing rate hike by the Federal Reserve could weigh on performance stability going forward. In the listed markets investment demand is demonstrated in continued public offerings and mergers and acquisitions activity, which included new listings in the US and China and further merger activity among the German residential companies.

In particular, Lodging continues to drive the sector with the US delivering strong revenue per available room (RevPAR) growth though now being outpaced by recovery in Europe. Citi analysts think this pattern looks set to continue. They expect the limited US supply growth to support further mid-single-digit RevPAR gains. Indeed, Citi analysts estimate 1Q15 is pacing at +6.9%, reflecting a strong New Year's weekend as well as relatively robust trends over the quarter. Operating momentum appears strong heading into the important Spring business travel season. Gains have been rate-driven in the luxury and upper-upscale segments, which should support continued margin improvement. The recovery in European



EPRA/NAREIT Global Index

Data source: Bloomberg as of 31 March 2015

RevPAR appears to gaining momentum but remains patchy, with France in particular not benefiting as yet. Asia Pacific remains weak and continues to be impacted by slowing growth in China and exchange rate headwinds.

Commodities

Supply/Demand Imbalances keep Prices Under Pressure

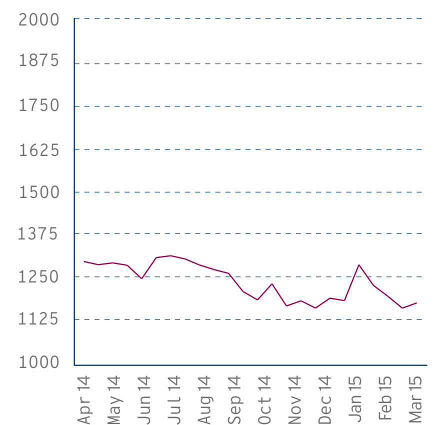
In the wake of the 23% energy-led price collapse in 2H14, commodity markets have had a choppy start to 2015. Petroleum price swings have been driving much of this volatility, particularly as moves in crude prices are driving market correlations and swaying investor sentiment across the asset class.

Commodities remain under pressure and should be exposed to even further price weakness in 2Q15 amid generally tepid macroeconomic data, loose supply/demand balances for a wide range of commodities (petroleum, grains, cocoa, iron ore) and with the US dollar index trading to new 12 year highs.

The combination of resilient US production growth, despite approaching a 50% cut in rig count, and the seasonal downturn in both petroleum product demand and crude demand should see inventory builds continue. Citi analysts expect crude oil markets to post new lows, but by year-end Brent is expected to return to above $60 /bbl.

Price correlations among the industrial base metals appear to have broken down in March, with tin, lead and nickel prices collapsing, zinc prices effectively treading water, while the larger copper and aluminum contracts have found some degree of support. To some extent, the divergence is macro-related and the more dovish tone of the US Fed prompted fund short covering.

Citi analysts do not expect a sustained uptrend in gold over the short-to-medium term on the back of a continued US recovery, as they



Golds US$/troy oz.

Data source: Bloomberg as of 31 March 2015

expect the current inverse USD/Gold relationship to remain a key market driver in coming months. From a fundamental perspective they also remain cautious on the outlook for gold, as demand strength remains uncertain.

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Currencies

Euro

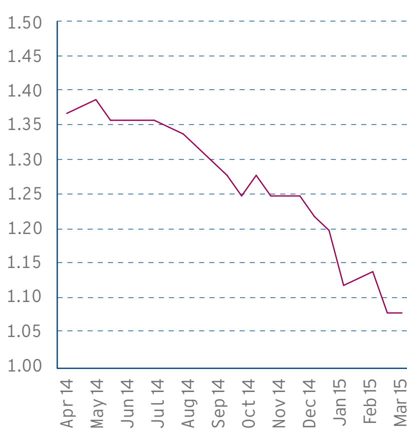
Medium term, Citi analysts expect further downside in EUR/USD because they believe that a weak EUR is an important intermediate policy objective of the ECB in using QE to stabilise inflation/inflation expectations. As such, should the EUR trend threaten to reverse, the ECB policy might unravel, and to prevent that, Citi analysts would anticipate even more aggressive ECB action. That said, after such a sharp move lower in EUR/USD since mid- 2014, it is reasonable to ask how much further the exchange rate could go. Citi analysts believe first sign of any reversal in EUR/USD will come from the data and policymakers' response to it. Interestingly in light of sharp USD appreciation, the Citi US Economic Surprise Index has slumped and the Euro Area version has recently been rising sharply. Citi analysts have also noted the improvement in the short term Euro Area inflation but think such effects of QE/EUR depreciation may be temporary and insufficient to drive a change in the ECB policy. In the absence of policy reversal, Citi analysts' base case remains a multi-year rally of the USD and they envisage EUR/USD at 0.90-0.95.

Yen

Since November, USD/JPY has traded in a broad sideways consolidation range from around 116 to 122. This somewhat repeats the experience around the April 2013 QE announcement when the run up in USD/JPY was strongest before the announcement and there was consolidation in the exchange rate thereafter. For now, spot seems elevated relative to short term yield differentials, market speculative positioning seems short and recent high marked a pull back from multi-decade resistance on long term charts. Furthermore, lower oil prices boosting the trade balance/current account back to surplus, market sentiment may remain more positive JPY for a period. Medium to long term, they expect cyclical and policy divergence between the US and Japan to continue to drive USD gains. Citi analysts expect Fed tightening to begin towards year end and also that further BoJ easing moves, centred on buying risk assets, will be forthcoming around July amidst low inflation Their 6-12m and longer term forecasts continue to assume that this is the case. Citi analysts' forecasts over this horizon remain 130-135.

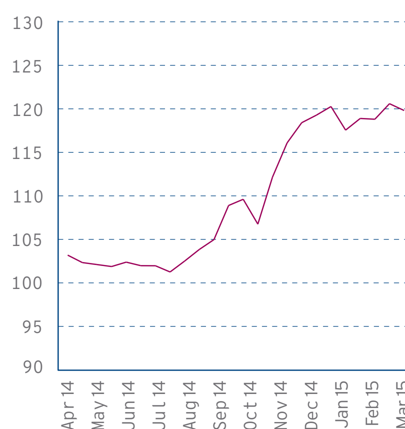
Pound Sterling

Sterling has been strong against the Euro but, like most currencies, has weakened substantially against the USD. Citi analysts expect these trends to continue over the next 0-3 months and 6-12 months. Labour market tightening has taken time to turn into wage growth, but that it is happening alongside broad based economic strength. However, conventional wisdom and indeed Citi analysts' view is that the Bank of England will begin hiking after the Fed starts. This should help keep GBP/USD on a downward trajectory. Although tensions around elections are rising, Citi analysts think the UK election has been a minor driver of the rise in GBP FX implied volatility, which is according to them is a USD-related phenomenon. Insofar as UK political risk is concerned, recent polls suggest the result could not be more finely balanced, which suggest a doubly hung parliament where neither Conservator not Labour win a majority, nor does any other smaller party hold the balance of power. But this need not be as disastrous as it sounds as Citi economists highlight post-election economic policy risks (Brexit and fiscal) are receding. Citi analysts see GBP/USD at 1.49 over 0-3 months, falling to 1.37 in 6-12m.



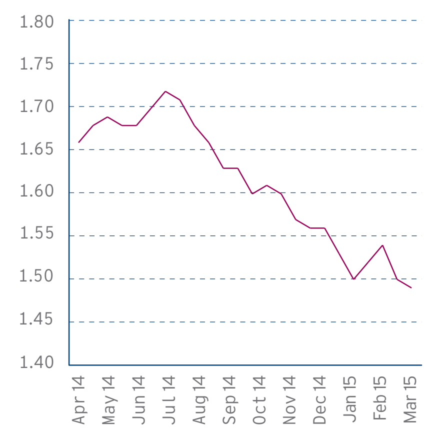
Euro-Dollar (USD/EUR)

Data source: Bloomberg as of 31 March 2015



Dollar-Yen (JPY/USD)

Data source: Bloomberg as of 31 March 2015



Pound-Dollar (USD/GBP)

Data source: Bloomberg as of 31 March 2015

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Guest Corner

Citi Global Perspective: The Changing Nature of Innovation

By Carl Benedikt Frey and Michael Osborne, University of Oxford, with the contribution of Citi Research

The 21st century has already brought remarkable technological achievements. The leading corporations of the digital age – including YouTube, Facebook and eBay – barely existed only a decade ago. The Human Genome Project was completed in 2003, the year Skype was first released. The first iPhone was launched in 2007 and in 2010 Google announced their first fully autonomous car.

Yet, the benefits of these developments have not been widely shared. Real median wages have stagnated in about half of all OECD countries since 2000, and have fallen even further behind growth in productivity. Between 1980 and 2000, each pound of UK gross domestic product (GDP) growth, for example, was accompanied by around 90 pence of median wage growth. Over the period 2000 to 2007, the equivalent number was 43 pence.

As a result, many countries have witnessed significant declines in labour's share of GDP. According to a 2013 study by Loukas Karabarbounis and Brent Neiman, 42 out of 59 countries experienced a fall in the share of GDP accruing to labour – a trend that is also found in emerging economies like China. Crucially, about half of this decline can be explained by the decrease in the relative price of investment goods, which in turn is driven by advances in computer-driven technologies, leading companies to substitute labour for capital in production. In the United States the decline in the labour share has been even more substantial when a small group of highly skilled workers with soaring income is excluded.

Instead of labour, the greatest beneficiaries of the digital age have been shareholders. According to a recent estimate, the three leading companies of Silicon Valley employed some 137,000 workers in 2014 with a combined market capitalisation of $1.09 trillion.4 By contrast, in 1990 the three largest companies in Detroit had a market capitalisation of $36 billion while collectively employing about 1.2 million workers.

To be sure, an important feature of the Industrial Revolution was that it benefited people both as producers and consumers over the long-run. In particular, the adoption of the assembly line created vast employment opportunities for low-skilled workers and enabled corporations such as the Ford Motor Company to manufacture the Model-T at a sufficiently low price for it to become the people's vehicle. By contrast, the digital revolution has mainly benefited ordinary people as consumers. While the World Wide Web provides many things for free, new employment opportunities have mainly been created for highly skilled workers. At the same time, the potential scope of automation has rapidly expanded, substituting for ordinary workers in a variety of domains. In short, while the digital age has been a blessing to consumers, it is changing the world of work in ways that may make a growing share of workers worse off (in their capacity as producers) over the longrun.

There is reason to be concerned that we are experiencing an era in which innovation benefits the few rather than the many. Because most individuals are consumers and producers, new technologies will have an impact on people's living standards in both capacities, positively or negatively. In the past, some innovations have benefited ordinary people both as producers and consumers. Others have negatively impacted workers in production while helping consumers.

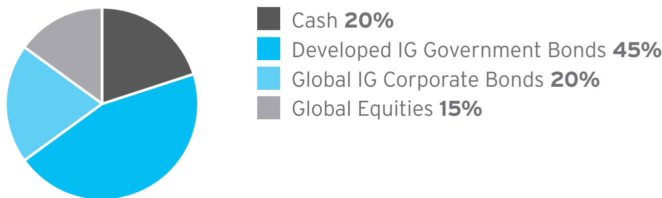
The digital age has brought indisputable gains to consumers, including the World Wide Web and smartphones, but its impact on the world of work has arguably been more disruptive than anything seen in the past. Thus, less than 20% of American workers now believe that the generation currently entering the workforce will have better lives than themselves. A recent report even predicts that living standards for many low-to-middle income households in the United Kingdom are likely to be lower by 2020 than they were in 2008.

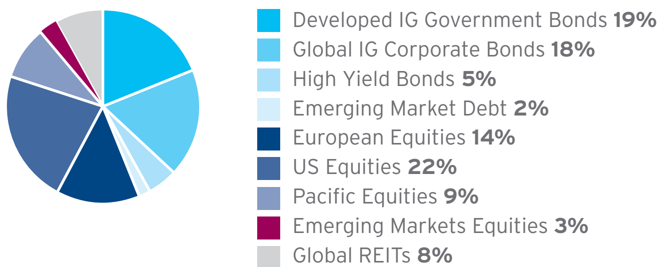
Forecasts may not be attained. Past performance is no guarantee of future results. There are additional risks associated with foreign investments.

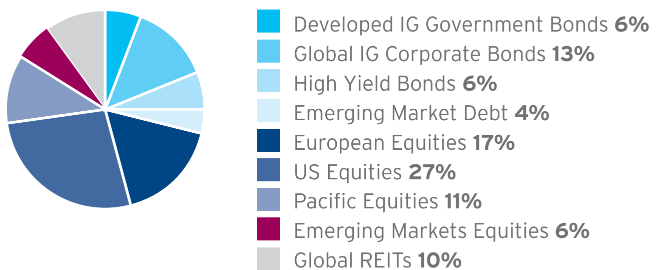
The suggested allocations are intended to be general in nature and are not to be construed as specific investment advice. Investors are encouraged to consult with their Financial Professional to determine their allocation needs based on their risk tolerance, suitability and goals.

Spotlight on allocations

Global model portfolios







About the Citi Asset Allocation Process

The Citibank tactical portfolio allocations are based on the work of the Global Investment Committee (GIC) of Citi Private Bank. The membership of the committee is comprised of experienced investment specialists from across Citi. The GIC deliberates on the macroeconomic and financial market environment in order to formulate an outlook across multiple asset classes and is responsible for maintaining tactical model portfolios based on this outlook. The tactical weights that are applied to the Citibank portfolios are aligned to the decisions of the GIC.

Allocation to bond and equity markets

The Global Investment Committee (GIC) has decided to maintain positions across asset classes with an overall Overweight stance in Global equities.

Overall the GIC now stays overweight on equities, neutral on commodities and underweight on fixed income.

The GIC believes that medium term outlook for equities remains favourable though short term risks have increased on the back of falling oil prices and rising deflation risks across Developed Markets. Overall, equities continue to offer better risk/reward than credit this year while both returns are likely to be below last year's gains as the attractiveness of valuations has somewhat deteriorated.

Allocation to regional equity markets

The GIC maintained its overweight in US, Europe and Japan and Asia ex-Japan. Emerging Market equities continue to be underweight.

Within the equity universe, the GIC has the largest overweight positions to US equities with a brightening outlook given signs of growing corporate capital expenditure combined with improving housing and job markets feed through into economic growth although the Fed's taper process could generate periods of volatility. Exposure to Asian equities has been maintained on the basis of valuation not reflecting the strong earnings growth momentum in the region.

And the GIC believes that Japan may resume grinding higher even though at a slower pace supported by new political leadership taking a more aggressive stance on fiscal and monetary policy. Also the GIC maintains its position in Europe equities given still attractive valuations and improving monetary support from the ECB. Meanwhile the GIC is now Neutral on Emerging Europe and Underweight Latin America equities with selectiveness suggested with regards to country allocation.

Allocation to government and credit markets

The GIC is heavily underweight sovereign bonds, with US Treasuries bearing the brunt of the underweight, and Emerging Market debt on the back of increasing yields and currency risks. They have small overweight position in High yield bonds. Investment grade allocation of the GIC are now neutral on the basis of narrower spreads capping the scope for gains in a period of rising yields.

Forecasts may not be attained. Past performance is no guarantee of future results. There are additional risks associated with foreign investments.

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