Standpoint

Q4 | 2015
Global Market Analysis by Citi EMEA Consumer Bank

What Volatility Can Do For You

After weeks of Fed and China-watching, it is probably worth spending a moment to take a breather, step back and try to assess whether there is anything good to take from this horrible third quarter. And it was a horrible quarter indeed with global equities ending 12% from their peak and volatility surging across all asset categories. Typically, during such a period, investors shaken by the brutality of the sell-off start wondering what they can do against volatility, but this time we invite you to take a different view of volatility: for smart investors, volatility can be a friend. Like a friend, volatility reminds us some very important principles that might not necessarily be easy to follow in a period of stress, but essential to maintain longer term goals on track.

Stocks for Sale!

Many strategists argue that during a selloff, stocks essentially go on sale. Obviously, if you're ready to hold an asset at a price of USD100, you would definitely want to buy it at USD75 Beyond the simplistic example of a price discount, a sell-off improves valuations and risk premia. These factors don't say anything about short-term movements, but they matter most for long-term returns. Risk premia in particular tell you to what extent you will be compensated for holding risks. The last thing you want to hold is a risky asset without a decent risk premium.

Measure of Self-Discipline

Fearing volatility basically means fearing changes of market drivers or fearing to be wrong in identifying them. Suddenly, markets are no

Citi Outlook

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

Our Market Outlook reflects Citi's 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 and investment grade corporate bonds while positions in emerging market debt are underweight

The committee noted that the global backdrop of both continued growth and substantial additional easing provides context to the current markets instability. Markets' focus moved to economic risks in China during the third quarter and to its possible spillovers to the global economy. For the Fed, the "bigger picture" is that the central bank is almost certain to tighten very modestly though the timing remains uncertain which generates volatility across markets.

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	Positive
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 October 2015.

longer rewarding the views you had. It generates uncertainty as markets might price something you missed. If an investor mixes views and strategy (like considering EM equities should make up the majority of an equity allocation back in 2007) it is obviously a problem, because volatility reduces visibility while the portfolio is probably overloaded in an over-concentrated trade. However, if the portfolio is diversified, there is no reason to fear changes because whatever comes next, you already have it in your portfolio. In that regard, it is no wonder that while it took 7 years for the MSCI World to return back to its 2007 peak, while Emerging Markets haven't recovered yet. By comparison, it only took 4 years for a Citi Growth Oriented Portfolio composed of 60% stocks and 40% bonds out which a large majority is in asset classes like US equities, European equities and Corporate bonds which were completely out of favour during the 2004-07 bull market. There are no sure things in the investment world, but, history has shown that holding a balanced portfolio over the long term has generated consistent, solid returns most of the time.

Humility Call

While having an opinion is great, letting an opinion supersede a strategy is a dangerous and unfortunately common mistake. At all times, investors' favourite sport has been monetary policy prognostication and for the last few years, it's been a pretty easy win.

However, although the US Fed didn't hike rates in September, monetary policy has entered a new phase and in absence of reliable forward guidance, humility should tell you that there won't be easy wins any longer. Another "humility call" can be found in the degree of homogeneity of the consensus. In particular, widely split views, like just before the September Fed meeting, should be seen as a warning that, first of all, there is simply no consensus view (in other words, no one knows what is going to happen) and secondly, that a large number of investors are not prepared or positioned for whatever is going to come, which will eventually lead to larger short term markets swings on the back of allocation adjustments.

Sorting out threats

As the ascent of asset prices becomes steeper or longer, investors start pondering the potential risks that lay ahead and which asset classes might be the most vulnerable. In that regard, corporate bonds arriving at the turn of a cycle after 5 years of continuous yields decline and spreads tightening stood out as a one of the most likely candidates. In particular, declining brokers' inventories raised fears of illiquidity in a scenario where a market sell-off would trigger panicked withdrawals from mutual funds, bond managers who used exchange-traded funds as their liquidity instrument would dump those ETFs, leading those funds to dump illiquid corporate bonds, causing prices to go down, leading to more withdrawals in a vicious cycle that would massively exacerbate any fundamental credit worries. Looking at the worst quarter since the Global Financial Crisis and some of the largest intraday selloffs, corporate bonds took a toll but no more than what a bad day or period looks for a bond market and obviously, no sign of a deadly spiral. On the other hand, equities are where liquidity is crazy. During the worst day of the quarter, the S&P 500 lost about USD700 billion worth of value in one day: that's a liquidity concern.

Volatility is definitely an unnerving period, but listen to its messages like those of a friend giving you warnings. Volatility clearly helps sorting out threats, offers long term opportunities and highlights the importance of strategy over views. However, if you are still looking for near term signals, for the first time in a while markets reacted negatively to no interest rates increase, finally pricing that good news is good news, and bad news is bad news. If you were looking for a signal, this is a major and positive one.

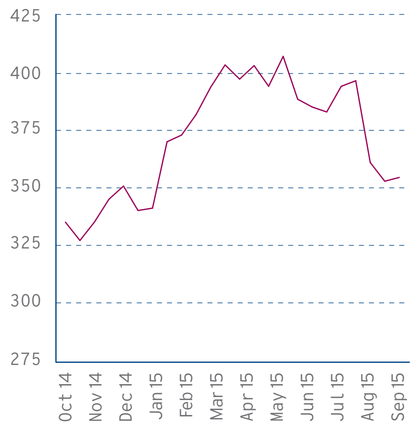
Europe and North America

Europe equities

Positive Forward Indicators

Citi analysts are raising their 2015 GDP forecast by 0.2pp to 1.5% after Eurostat revised up the pace of GDP growth in 1H-15. However, they are shaving some 0.4pp from their 2016 GDP estimate to 1.5%. Their revised GDP baseline incorporates some slowdown in external demand, identifying Emerging Asia as a key threat to our upward trajectory of euro area exports. They also lower our capital expenditures forecasts slightly to incorporate the impact of greater uncertainty on firms' investment decisions despite the support provided by cheap credit and improved availability of bank finance. However, low oil prices – and indeed low inflation as a whole – will continue to lift real incomes and a modest recovery in domestic demand remains our central scenario. The prospect of an extended inflation undershoot is likely to prompt another round of monetary policy easing by end-2015. Citi analysts estimate that the amount of additional government bond purchases could be as large as EUR345 billion, allowing extra purchases at the current rate of roughly EUR60 billion per month for around six months.

Citi analysts observe that recent data that showed strength in areas such as: car sales, Italian consumer confidence, improving credit markets, loan growth, rebounds in Spain and Ireland as well as better than expected EU Commission economic sentiment indicator. They therefore consider that although equities are neither cheap nor expensive, EPS growth has been largely priced out during the market selloff of the third quarter. Their models suggest 12-month forward returns tend to be positive from current correlation and sentiment levels, which suggests investors should be strategically bullish although a synchronised global recession remains the key threat.



DJ Stoxx 600

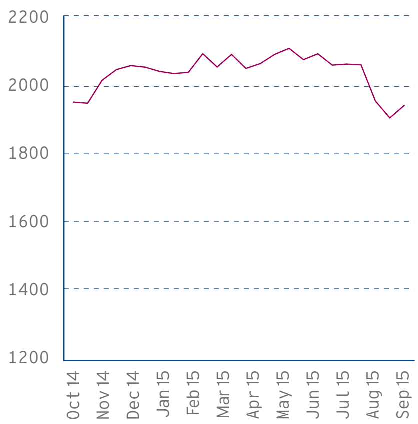
Data source: Bloomberg as of 30 September 2015

North America equities

Looking for Monetary and Earnings Guidance

Citi analysts continue to expect above-trend US growth, but have lowered their 2016 forecast slightly (to 2.6% from 2.8%) assuming an increased likelihood of an Emerging Markets led global recession. While the US economy likely could take slower global growth in its stride, they expect that the attendant deterioration in financial conditions associated with the ongoing slowdown in China and emerging markets will magnify the drag on domestic activity. Notwithstanding prospects of slow global growth, the US economy continues to display healthy momentum, evident in solid payroll gains, construction activity, and consumer spending. Citi analysts believe incoming evidence continue to support the Fed's desire to see "further improvement" in the labor market, and the ensuing income growth should support spending. Indeed, the better-than-expected increase in August retail sales (including upward historical revisions) shows that consumer demand continues to expand at a healthy clip.

The underlying environment for the stock market is pockmarked with unknowable potholes currently. Insight into the inner workings of Fed policy has been off and China (plus it more far-reaching repercussions) has been confusing with a mix of okay and poor data. In this regard, the upcoming earnings reporting season will be somewhat helpful and may ease some of the newfound anxiety that is manifesting itself in lower share prices. Our analysts think that the earnings guidance coming out of the reporting season is likely to be a bit better than the current anxiety presumes. Indeed, the rolling 10 weeks of guidance has shown some improvement in terms of the percentage of companies providing upward views and Citi analysts suggest that investors really can relate to that development.



S&P 500 Index

Data source: Bloomberg as of 30 September 2015

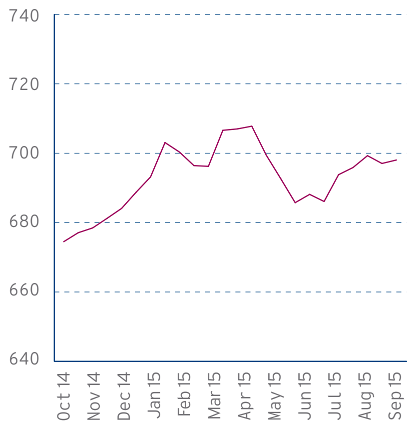
Global Sovereign and Corporate Bonds

Global Sovereign Bonds

Range-Bound Trend amid Market Volatility

Market volatility increased wildly over the last quarter, as an unexpected devaluation of the Chinese Renminbi and the lack of forward guidance from the US Federal Reserve begat fear over slowing global growth. Global equities fell sharply, prompting strong demand for high quality core sovereign debt. Despite the nervousness in risk assets, Citi analysts expect core sovereign rates to remain range-bound over the near-term.

Regardless of the timing of the first US rate hike, the pace of tightening is what Citi believe matters most. A maturing US recovery, declining energy prices, US dollar strength and benign inflation pressures, lead our analysts to believe that the path of future rate hikes will be slow and data dependent. Citi analysts think U.S. Treasury yields offer a poor return as a standalone investment, but provides value as a risk hedge in a diversified portfolio. Rates in the Euro Area (EA) are also poised to remain lower for longer, as the recently announced revamp of the European Central Bank's (ECB) quantitative easing (QE) program continues to suppress bond yields. In September, ECB President Mario Draghi announced downward revisions to growth and inflation forecasts, while raising caps on the share of bonds the ECB can purchase. Though the size of the QE program will stay intact, these changes enhance the central banks flexibility. Especially if, at some point, the ECB decides to expand the size of their QE program or extend the program. Citi analysts remain underweight Euro government bonds overall given very low yields. On the Emerging Debt front, Citi analysts



Citigroup World Government Bond Index

Data source: Bloomberg as of 30 September 2015

remain underweight given improving prospects for a stronger USD and commodity challenges, although they expect Asia to be the most resilient as it is a major beneficiary of lower oil prices.

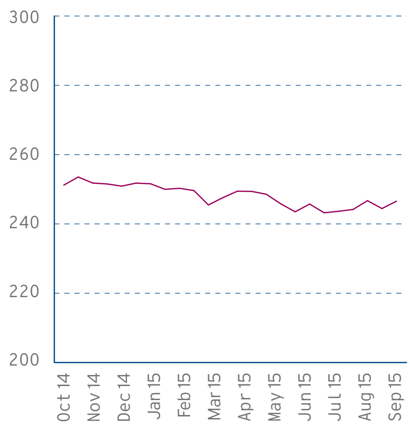
Corporate Bonds

Repositioning on the back of higher spreads

Global investment grade (IG) credit was weaker over the last month, as growth concerns, declining energy prices and persistent new issuance (primarily in the US) weighed heavily on spreads and pushed index yields higher. Not surprising, sectors with the largest declines were in oil/gas and metals/mining. New issue supply in US IG credit markets is likely to remain a near-term overhang on spreads, but Citi analysts think valuations have become attractive. With nearly USD1 trillion in new supply thus far this year, US IG index spreads have moved to their widest levels since 2012. Index yields are also at their highest level since the 2013 "taper-tantrum". Though Fed and growth uncertainties remain, current levels more appropriately reflect fundamentals. They favor subordinated financials and remain cautious on energy-related sectors.

In euro IG, China growth concerns, fund outflows and lower Bund yields have contributed to recent spread weakness. While euro credit index yields remain anaemically low, spreads have widened significantly over the last six months. Though fund outflows have picked up, growing anticipation of additional QE by the ECB should provide added support for IG credit overall. Further weakness from unfounded growth concerns may present an opportunity to add to positions according to Citi analysts.

Excluding energy, Citi analysts remain constructive on US high yield debt. Valuations are attractive, and fundamentals have remained relatively stable. An improving US outlook and seasonality effects on risk assets should



Citigroup World Corporate Bond Index

Data source: Bloomberg as of 30 September 2015

benefit HY in the near-term. That said, periods of higher volatility and lower liquidity should be expected. In Europe, QE and limited exposure to energy will remain supportive for risk assets over the longer-term.

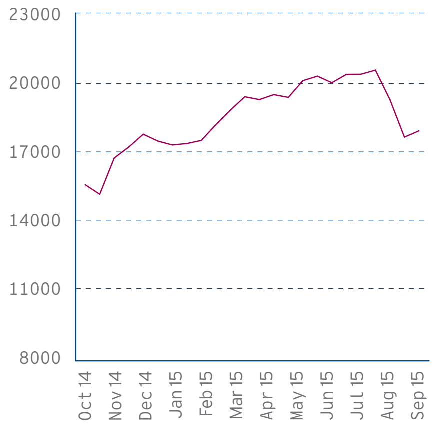
Japan and Asia Pacific

Japan equities

Technical Recession Possible

Citi analyst are revising down their estimates of Q3 GDP growth from +1.0% Quarter to Quarter annualized at the previous forecast round in August to 0.1% this month, reflecting weaker-than-expected July data and upward revisions to inventories in the second print of the Q2 GDP report. At this point, Citi analysts don't dismiss the possibility of technical recession – negative GDP growth for a second consecutive quarter. Indeed, the Japanese economy is facing significant challenges on two fronts. On the external front, China and other Asian economies, which account for more than half of Japan's exports, continue to slow. On the domestic front, consumer spending remains lacklustre despite the ongoing improvement in labour and income conditions. In this environment, they expect the Bank of Japan (BoJ) to ease policy again at one of four policy meetings scheduled between late October and next January. In their view, higher wage growth is even more important in the current economic setting if the 2% inflation target is to be achieved. They thus expect policymakers to try to lift inflation expectations through further easing before the spring wage negotiations in order to facilitate wage hikes.

As Citi analysts forecast an early policy response from the government and the BoJ, they think the Japanese equity market is already at or close to a major bottom. However, they sense that subsequent share price upside momentum is likely to be sluggish. Our analysts had been of the view that the corrective phase we have been in since August would come to an end by year-end but they now conclude that the timing has slipped out to the first half of 2016.



NIKKEI 225 Index

Data source: Bloomberg as of 30 September 2015

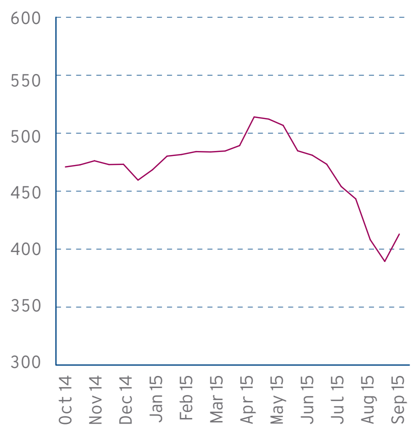
Asia Pacific equities

Severe growth drag but no crisis

Weak growth remains the dominant concern, with trade recovery remaining elusive and China a serious drag to the region. With the US Fed delaying its rate hike, this should give more room for monetary easing – Taiwan, India and Korea are likely to cut sooner, with weaker FX as part of it transmission tool. Meanwhile, the central banks of Indonesia and Malaysia remain constrained, with Indonesia tightening liquidity to stabilize FX and the central Bank no longer expected to cut rates in 2016.

In China, the growth in the old economy almost halted in August despite policy support. Fixed asset investment slowed to 9.1% YoY, the lowest since 2012, led by modestly negative investment growth in property and upstream industries of the manufacturing sector. Exports remained merely flat year-to-date (-1.3% YoY), but net exports still rose 83.6% YoY thanks to import price deflation. Considering the possibly delayed – but positive – impact of policy easing and favourable base effects, the old economy may still see a mild recovery in Q4 this year. As Citi analysts argued before, this will likely be a slow stabilization process. While they keep our forecast of 6.3% for official GDP growth in 2016, the actual growth rate may remain at 4-5% assuming policy paralysis is appropriately addressed in coming months.

Citi analysts overweight Asia and prefer China (offshore), Taiwan and Singapore. They think Asia remains the main beneficiary of lower commodity prices and improving US growth while the region continues to have the best earnings with its EPS now at 119% above Global Financial Crisis low. EPS growth is also forecast to be 12% for 2015.



MSCI Asia Pacific Ex-Japan

Data source: Bloomberg as of 30 September 2015

Emerging Europe and Latin America

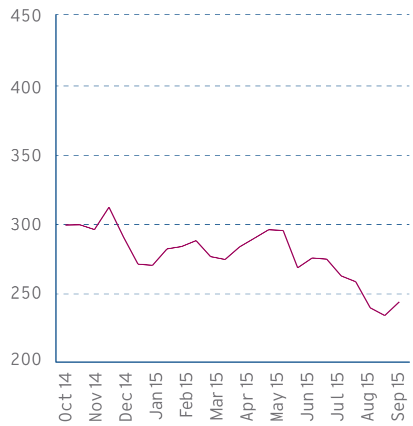
Emerging Europe equities

Diverging Sensitiveness to external shocks

CEEMEA was rather well-protected from the shock of China's new exchange rate policy, mainly because most markets benefited from lower US Treasury yields and a weaker US dollar. However, for commodity exporters – Russia and South Africa in particular – we have still to see the full economic consequences of slower Chinese growth and a more consumer-driven Chinese economy. These are both negative shocks that it may take much time to adjust to.

After a relatively mild decline of 2.2% YoY in 1Q, Russia's GDP fell 4.6% YoY in 2Q, according to preliminary data. The recent slide in oil prices is now adding downward pressure to growth, and Citi analysts are cutting their forecasts to -3.7% in 2015 and +0.5% in 2016 from -3.0% and +1.6% previously. If their baseline scenario materializes, 2015 will be the 5th consecutive year of decelerating GDP performance. More broadly, Russia was affected by a myriad of structural problems well before the Ukraine crisis and the current sanctions-based backdrop is likely to exacerbate the weakness in the economy, in Citi analysts' view. After five rate cuts totaling 6pp, the Central Bank of Russia kept the REPO rate unchanged at 11% in September as RUB depreciation boosted inflation in August. The oil-driven weakness in the RUB – and highly volatile external backdrop – have made the case for more cuts until year-end somewhat less compelling, despite worsening economic performance.

Valuation divergences within Emerging Europe countries and sectors remain stretched. South African equities look very expensive, whilst Russia appears cheap. Polish equities may maintain their premium valuations due to safe-haven characteristics. Within the region, Citi is Overweight on Poland, Neutral on Russia and Turkey and Underweight on South Africa.



MSCI EM EMEA

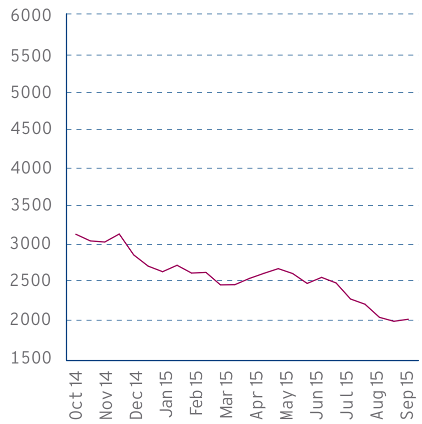
Data source: Bloomberg as of 30 September 2015

Latin America equities

Further Earnings Downside

Citi analysts are cutting our 2015 growth forecast for Brazil, and also expect negative growth for 2016. Indeed, besides confirming the recession, the 2Q15 GDP figure showed a sharper-than-expected contraction, leading them to reduce further their 2015 GDP growth estimate to -2.7%. For 2016, scepticism regarding the fiscal accounts consolidation means that Brazil's risk premium and the BRL will remain under pressure, keeping CPI inflation above the midpoint target (6.2%) even with a stable Selic rate at 14.25%. Under these conditions, Citi analysts now envisage GDP to decline by 1.1% in 2016. They have also cut their growth forecast for Mexico, but continue to expect Banxico to follow the Fed and hike the policy rate by 25bps in September.

In the region, earnings in USD terms are already below their Global Financial Crisis low and the consensus at 3.6% is already quite subdued. However, we could see the analysts' consensus taking earnings down by another 15-20%. This would imply that the region has lost more than a decade worth of earnings in this downturn. If the downgrades occur in 2015, the 2016 growth of 21% looks about right and may even be a little on the low side. Citi's key concern for LatAm remains that the currency on a real exchange rate basis still looks overvalued and adjustments here could lead to further declines in LatAm earnings. Also, Citi analyst think political developments in Brazil will continue having a crucial role in driving domestic asset prices. After the formal impeachment request, attention will be on President Rousseff's ability to keep the government coalition unified. Citi analysts are underweight on Brazil and neutral on Mexico.



MSCI EM Latin America

Data source: Bloomberg as of 30 September 2015

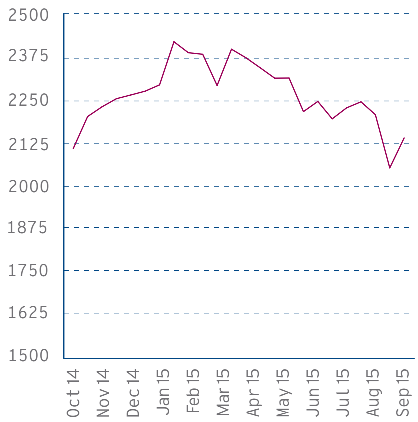
Global REITs and Commodities

Real Estate Investment Trusts (REITs)

Solid Fundamentals in an uncertain world

Returning from a remote island, an investor sees that REITs were essentially flat in 3Q. I guess not much happened, they say. Then they bring up the quarterly chart: REITs up 7.5%, then down 10%, then back up 5%, with considerable outperformance vs the broad market. Global growth concerns, widening credit spreads and the Fed's indecision on rates were the primary drivers. While Citi analysts acknowledge the heightened risk environment and uncertainty in the debt markets, they continue to maintain a positive stance on the REIT sector with valuations attractive relative to Net Asset Valuations (NAV), bonds and broad equities and still offering solid cash flow and dividend growth.

They believe a few trends can help drive REITs further. First of all, they observe that significant amount of capital from all parts of the world is chasing real estate which will likely keep capitalization rates low and in some cases actually headed lower. Second, they believe that NAVs should grind higher with increases in Net Operating Incomes and re-investment of free cash flow. Then, they anticipate continued REIT privatizations given the widening gap between public and private market values which would highlight REITs NAV discounts and provide funds for reinvestment into the space. Citi analysts also consider that REITs offer reasonable valuations, solid balance sheets and are largely domestic & stable – all positive attributes in an uncertain global macro context. Finally the market's Fundamentals remain solid with increasing demand and low supply.



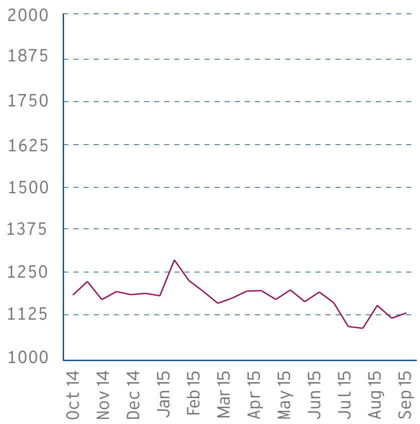
EPRA/NAREIT Global Index
Data source: Bloomberg as of 30 September 2015

Commodities

Further Downside Pressures

If bearish commodities market outlooks have sounded like a broken record over the past few quarters, this winter should hum a similar if not distorted tune for an asset class that has for yet another consecutive year substantially underperformed other risk assets. Indeed, Citi analysts' most likely scenario to year end is further downside pressure across all commodities, especially if Chinese growth continues to decelerate or rolls over.

Citi analysts think the underlying story for large index components such as petroleum and grains is still much about oversupply triggered by investments over the last decade. In particular, the US oil production boom and financial developments have generated the largest drop in the petroleum price away from a global recession in almost 30 years. But over the past quarter global growth concerns, emanating more recently from China, are also weighing on the demand-side of the ledger. The circa 20% Year on Year appreciation of the US dollar has also played a role in the commodities rout which has seen the global benchmark commodity index hit fresh 12 year lows this summer. While Citi analysts would expect an eventual rebound in the price, caution is warranted. Indeed, the oil market is in the early stages of rebalancing, but so far not enough is being done on the supply side at least; with Saudi Arabia maintaining high levels of production and with Iraq hitting new record highs and finally with Iranian barrels looming in 1Q 2016, the 3-6 month outlook remains bearish. On the demand side, US demand seasonally is declining. Furthermore, the tempered outlook for China and Emerging Markets as a whole going into 2016 is leading to downside risks to global oil demand growth.



Golds USD/troy oz.
Data source: Bloomberg as of 30 September 2015

Currencies

Euro

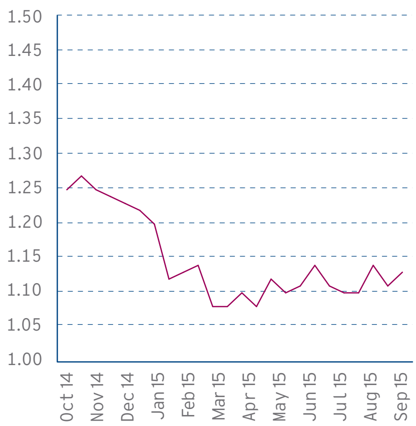
Citi analysts have observed the EUR rallying from its 1.05 low of March. Sizeable (and apparently still rising) current account surplus continue to support flows while continuing low inflation, falling commodity prices and associated weakness in key EM economies has led markets to price less and later Fed tightening which stopped the falling trend of yield differentials. They think these trends may persist a while longer and pencil in 1.16 for their 0-3m EUR/USD forecast. However, as speculative positions get closer to clean/ neutral, ongoing portfolio outflows, especially in debt markets where investors are crowded out by ECB QE into higher yielding assets in the US and elsewhere, will likely eventually drive EUR weakness medium term. Citi economists actually expect additional QE or other monetary easing announcements before year end and this may stem, or reverse, EUR appreciation by encouraging further debt investor outflows and also by reducing the policy gaps. All the more so if Fed tightening is by then underway, raising the US term structure. For their 6-12m forecast Citi analysts now estimate 1.05 but this is reliant on further divergence in ECB and Fed monetary policy.

Yen

Citi analysts expect further upside in USD/JPY over the medium term, marking in 128 for our 6-12m forecast. This is actually close to the current output of a model estimated over the 2005 to 2015 period and explaining about 94% of USD/JPY movements. The main drivers are as follows. First, US cyclical outperformance and generalised US dollar gains on the back of this. Second, rising yields in the US relative to Japan. Third, continued expansion of the Japanese monetary base (QE) in contrast to stability in the US monetary base. And fourth a more broad-based rise in credit and money in the US as shown by aggregates such as M2. In other words, while the Bank of Japan is adding more narrow liquidity (JPY negative) the US has a more powerful money multiplier at work (US economy and USD positive). Other factors are also important, such as the extent to which QE/ money base expansion are priced in, positioning, risk appetite and sentiment are all likely to play a role in USD/JPY developments.

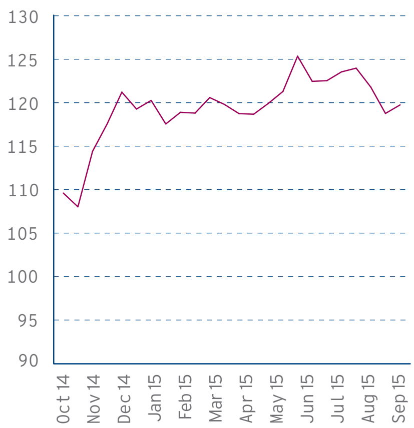
Pound Sterling

Broadly speaking, sterling has moved sideways since May. EUR/GBP is higher, reflecting the broader EUR rally rather than anything specifically to do with the UK. Sterling has recently gained a bit against the USD, continuing the trend where sterling trades between the EUR and USD. Part of the reason for the GBP consolidation is that rate hike expectations have been pushed out though this is happening everywhere of course in the face of global economic slowdown, weak commodity prices and low inflation. Citi economists have regularly highlighted the dilemma facing UK policymakers at the moment. Domestically generated inflation is being offset by disinflationary forces from overseas. With overseas risks escalating, and financial market volatility following suit, the MPC may be persuaded to stand pat for a while longer. However, UK should still be comparatively ahead of many other G10s in the rate hike cycle. In this light, with UK rate hike expectations slowly getting pushed out Citi analysts think GBP will still struggle against the USD, but rally against the EUR and JPY where they expect additional monetary ease, not any tightening, over the forecast horizon.



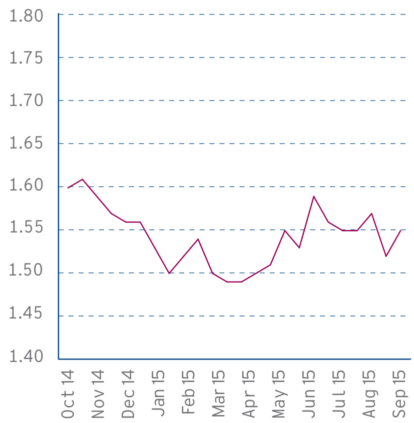
Euro-Dollar (USD/EUR)

Data source: Bloomberg as of 30 September 2015



Dollar-Yen (JPY/USD)

Data source: Bloomberg as of 30 September 2015



Pound-Dollar (USD/GBP)

Data source: Bloomberg as of 30 September 2015

Guest Corner

Refugees, Migrants and Asylum-Seekers: The Politics of People Flows

By Tina Fordham, Citi Chief Global Political Analyst

Dramatic scenes in Europe and the Middle East have highlighted the plight of the estimated 60 million forcibly displaced persons worldwide, the highest level since World War II. The uptick in refugee flows underscores the deterioration of the security situation in the Middle East, with the Syria conflict entering its 5th year, amid the wider proliferation of weak and failed states globally, a key driver of flows of people. It is also presents a major policy challenge, bringing together concerns about security, the economy, demographics and identity.

Compounding concerns about sluggish economic growth and unemployment and amid fears of a global slowdown, the refugee crisis will force leaders' attention and demand more of their limited political capital. It also comes at a time when geopolitical risk is at a 25-year high but has – thus far – been masked by low oil prices (the typical transmission mechanism for political risk) and central bank action.

In our view, the refugee crisis represents a non-negligible source of macro political risk, and one that is likely to persist in an environment where, after a long period of globalisation, the freeflow of people, goods and services, as well as capital, information and perhaps even ideas is increasingly being questioned. As with other elements of globalisation, such flows risk popular backlash, yet reinstating controls is likely to prove highly problematic. The role of immigration, especially in countries with shrinking, greying populations, is well-documented—yet it remains deeply unpopular politically in many countries, including some of those who could benefit most. Will the politics of re-instating barriers and controls trump the economics of globalisation? In this respect, we regard public attitudes and policymakers' responses to the refugee and migration crisis as another crucial signpost in a wider post-crisis backlash toward globalisation.

Key Implications of the Refugee Crisis

The political, economic and market impact stemming from the failure to address the refugee crisis is largely asymmetric and indirect – with some notable exceptions:

Vox Populi Risk: Although the "Refugees Welcome" campaign has prompted an outpouring of popular support in some countries, the crisis could exacerbate anti-immigration sentiment over the medium-to long-term if sympathy for the plight of refugees from war-torn countries collides with tensions over austerity policies and challenges in integration, housing and unemployment. Europe in particular has seen a spike in support for political parties espousing an anti-immigration stance over the last several years while opposition to immigration has contributed to the rise in Donald Trump's favourability ratings in his candidacy for US president.

Security Risk in the Middle East: The refugee crisis is a symptom of the worsening security situation in the Middle East and could reinforce pressure for military intervention. The end of the cease-fire between Turkey and the PKK has witnessed the escalation of hostilities. While we do not expect large-scale "boots on the ground" operations, further conflict, such as drone or air strikes on terrorist-held territory, could upset the fragile dynamics in the region--and spark more outflows of people to safe havens.

Brexit Risk: The refugee crisis may raise the risk of Brexit, either by reducing the likelihood that the UK government secures the reforms it seeks ahead of the referendum, or by undermining public support for remaining in the EU, or both. However, there is still considerable time ahead of the referendum, expected in 2016, and other factors will undoubtedly have influence.

Economic Implications: Refugees (which unlike voluntary migrants rarely begin gainful employment soon upon arrival) tend to be a burden on public finances in the near-term. Even though moderate numbers of refugees should limit the scale of the fiscal impact, sometimes the logistical and organizational challenges of housing, feeding and processing refugees can exceed the arrival countries' capabilities. In countries with little fiscal space, even modest additional strain on public finances could be problematic. However, in the EU we expect that potential budget deficit overshoots due to increased expenditures to deal with the unexpectedly large number of refugees will be condoned by the European Commission in its application of the EU's fiscal rules. The increased expenditure of course implies a modest fiscal easing and should therefore modestly boost GDP growth.

In the medium-term, the economic implications of the arrivals will depend on how well the refugees and other migrants will be integrated into the labour market, the skill levels and composition of the arrivals and the needs of the destination country. In principle, fast-aging Europe could well benefit from the arrival of young, often relatively well-educated migrants, but the mixed success of many European countries in integrating migrants highlights that such economic benefits are by no means automatic.

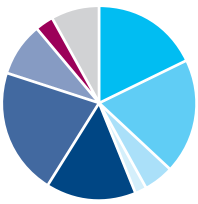
The suggested allocations are intended to be general in nature and are not to be construed as specific investment advice. Investors are encouraged to consult with their Financial Professional to determine their allocation needs based on their risk tolerance, suitability and goals.

Spotlight on allocations

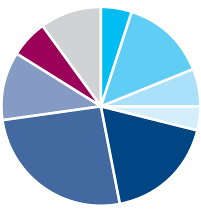
Global model portfolios

- Cash **20%**
- Developed IG Government Bonds **44%**
- Global IG Corporate Bonds **21%**
- Global Equities **15%**

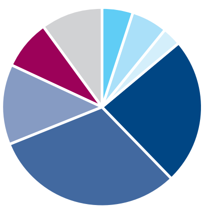
- Developed IG Government Bonds **33%**
- Global IG Corporate Bonds **26%**
- High Yield Bonds **6%**
- European Equities **7%**
- US Equities **11%**
- Global Equities **12%**
- Global REITs **5%**



- Developed IG Government Bonds **18%**
- Global IG Corporate Bonds **19%**
- High Yield Bonds **5%**
- Emerging Market Debt **2%**
- European Equities **15%**
- US Equities **21%**
- Pacific Equities **9%**
- Emerging Markets Equities **3%**
- Global REITs **8%**



- Developed IG Government Bonds **5%**
- Global IG Corporate Bonds **14%**
- High Yield Bonds **6%**
- Emerging Market Debt **4%**
- European Equities **18%**
- US Equities **26%**
- Pacific Equities **11%**
- Emerging Markets Equities **6%**
- Global REITs **10%**



- Global IG Corporate Bonds **5%**
- High Yield Bonds **6%**
- Emerging Market Debt **3%**
- European Equities **24%**
- US Equities **31%**
- Pacific Equities **13%**
- Emerging Markets Equities **8%**
- Global REITs **10%**

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 & 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 markedly on the back of falling oil prices, economic risks in China and the potential impact on global growth. 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.

The GIC left its allocation to global equities unchanged conflicting influences. Sizeable share price declines raise future return prospects, particularly as the calendar shifts from the seasonally weakest return period to the strongest. However, their longer-term assessment of a late stage bull market fits their existing strategy of gradually reducing portfolio risk over time. By waiting, the Fed remains a forward-looking risk.

And the GIC believes that a solid US economy will offer a sound base for earnings growth despite increasing global risks and sharp cuts in the commodity sectors. 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 Neutral on Emerging Europe and Underweight Latin America equities with selectiveness suggested with regards to country allocation on the back of US rates and commodity sensitiveness.

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 moved to overweight to take advantage of higher spreads after the risk selloff in Q3.

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

Important Disclosure

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