# Market Outlook

## Euro equities: Beyond political risks

March 2015

By Citi EMEA Consumer Bank

# Equities Markets

## Feature

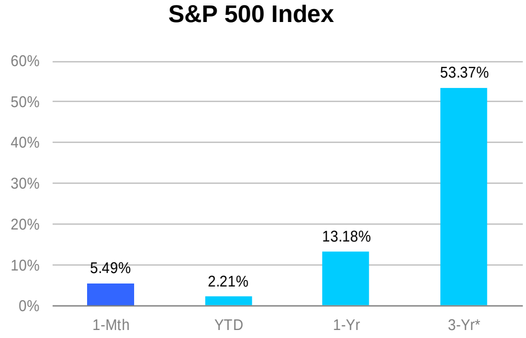
**On 22 January 2015, the European Central Bank (ECB) announced its long-awaited large quantitative easing (QE) programme to stimulate the economy and boost inflation expectations. The ECB QE has been Citi analysts' key point in the bull case for European equities, supporting their view of improving economic performance in the Eurozone and a growth in Europe ex-UK earnings for 2015.**

**Unless hostilities in Ukraine, and accompanying sanctions/rise in systemic risk, worsen and/or Greece moves closer to exiting the Euro Area, Citi analysts continue to favour European equities. On the sector front, Citi analysts' strategy is skewed towards Cyclicals/Financials over Defensives. Indeed, they overweight the Autos, Banks, Basic Resources, Health Care, Insurance and Tech sectors.**

## United States

– Recent US economic data have been mixed, but solid employment and income gains, plus an extra boost from lower oil prices, should power healthy growth in coming quarters. Citi analysts continue to expect that the Fed will begin hiking rates late this year. There is little doubt that the current policy stance is not appropriate for an economy projected to grow at an above-potential pace.

- From an equity perspective, Citi analysts remain generally constructive longer term while preferring to buy on weakness rather than chase the tape. Better hiring and capital spending intentions are encouraging as is merger and acquisition activity. Also, stock buyback activity has stepped up and money has begun to edge into equity funds.



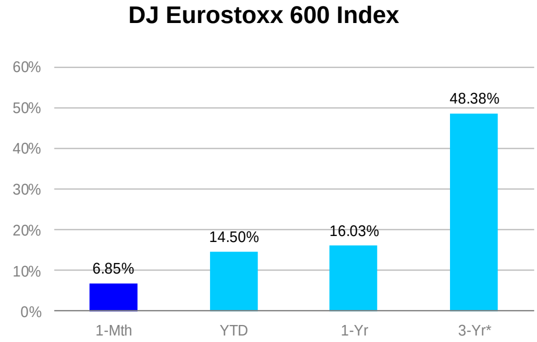

*Denotes cumulative performance
Performance data as of 28 February 2015
Source: Reuters

## Euro-Area

– Citi analysts revised up their 2015 real GDP forecast to 1.5% from 1.3% last month, but left 2016 estimate at a six-year high of 1.9%. With sentiment surveys moving above their long-run averages, Citi analysts believe the recovery will gain momentum.

- The longer the delay in reaching an agreement between the new Greek government and its creditors, the greater the risk of damage to the anemic euro area recovery, in Citi analysts' view. Yet, the economic situation now is arguably less worrying than in 2012, given, in particular, the European Central Bank's decision to announce a major quantitative easing program and the boost to real incomes from lower oil prices.

- Citi analysts retain their strong positive view on European equities for 2015 and skew their strategy towards Cyclicals/Financials over Defensives. They overweight Autos, Banks, Basic Resources, Health Care, Insurance and Technology sectors.



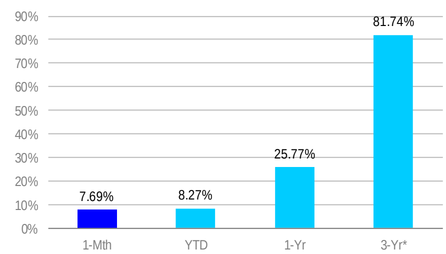

*Denotes cumulative performance
Performance data as of 28 February 2015
Source: Reuters

# Equities Markets

## Japan

- Citi analysts expect the economy to continue to grow at an annual rate of around 2% in coming quarters. First, consumer spending will likely pick up with solid growth in employment, a modest rise in per-capita wages and sharply lower energy prices expected to lift real total employment income. Second, export volumes have started to show clear signs of picking up.
- Furthermore, Citi analysts expect the Bank of Japan (BoJ) to implement additional easing measures in July as a gap between the BoJ's bullish inflation forecasts and actual inflation emerges. In a context of weak yen, US economic recovery, Abenomics and capex recovery, Citi analysts prefer Financials, Industrials, and Consumer Cyclicals.

**Topix Index**

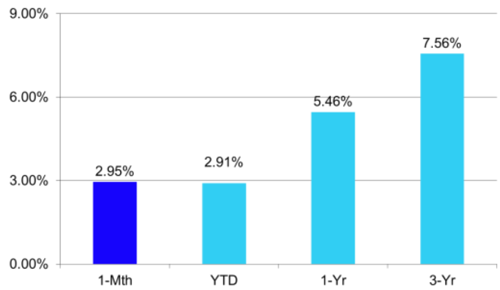



*Denotes cumulative performance
Performance data as of 28 February 2015
Source: Reuters

## Asia Pacific

- Citi analysts remain overweight Asia at the expense of other Emerging Markets. Value-wise, Asia still comes out ahead. Price Earnings for Asia are far below mean, while EMEA is at mean and far above mean in Latin America. Also, Asia is the biggest beneficiary of low oil prices and they may get a marginal lift from the lower input cost. In particular, China remains one of the favourites. Indeed, the central bank recently announced its second policy rate cut since November 2014. It lowered the 1-year lending rate by 25bps to 5.35%, and lowered the 1-year deposit rate by 25bps to 2.50%.
- On the back of this accommodative environment, Citi analysts reiterate their positive stance on China. Chinese equities are likely to be supported by: 1) EPS growth; 2) Re-rating from cyclical easing; and 3) Rerating from structural reforms.

**MSCI Asia Pacific ex-Japan Index**

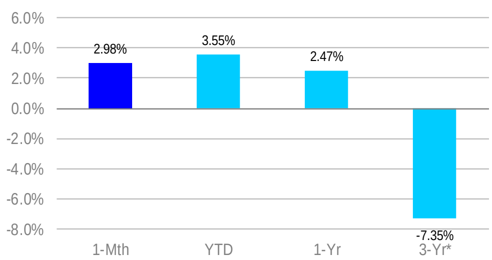



*Denotes cumulative performance
Performance data as of 28 February 2015
Source: Reuters

## Emerging Markets

- In some ways the fall in oil prices had a predictable effect on the current account balances in CEEMEA: oil exporters lose -Russia, Nigeria, South Africa. But weak commodity prices and a strong dollar are historically associated with low risk appetite, so countries that might be thought to be benefit from lower commodity prices — Turkey, Poland, Hungary for example — might suffer if risk aversion rises against the background of weak commodity prices/strong dollar.
- 2015 appears to be a very difficult one for the Brazilian economy. The high public debt/GDP ratio will likely lead to a gradual fiscal consolidation. Also external conditions (commodity prices and dollar strength) are also negative. Given the worsening growth outlook. Citi analysts cut their GDP growth forecast from 1.0% to 0.5% for 2015 and from 2.8% to 1.8% for 2016.
- Citi analysts are neutral on Mexico and underweight on Brazil given that stronger USD bodes poorly for commodities and current accounts.

**MSCI Emerging Markets Index**




*Denotes cumulative performance
Performance data as of 28 February 2015
Source: Reuters

# Currencies and Bonds Markets

## Currencies

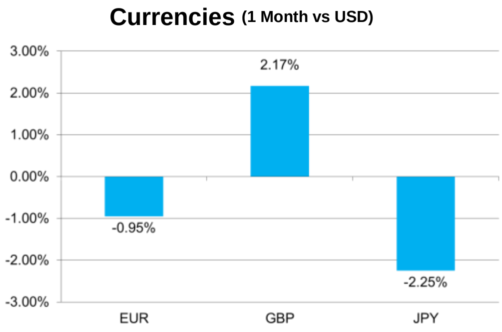
– Over the medium term, Citi analysts continue to expect significantly more downside in EUR/USD both because Citi analysts expect generalised USD strength as described above and because they expect EUR weakness as a result of ECB monetary easing via balance sheet expansion and possibly rate cuts.

– Citi analysts remain GBP bearish over the next 6-12 months. Notwithstanding the recent better growth data they are worried about UK political risk and the elephants-in-the-room which are the twin deficits.

Now that political campaigning has kicked off, the fiscal tightening debate might take a backseat, but that doesn't mean it won't return.

- Near term, Citi analysts think it is possible that spot USD/JPY may continue to range trade or even pull back somewhat. This might reflect both a delay to any Fed action beyond current market expectations of mid-year and a reaction to recent unnamed BoJ officials who told the financial media that further monetary easing may be counter-productive by weakening consumer sentiment as prices rise.

.




*Denotes cumulative performance
Performance data as of 28 February 2015
Source: Reuters

## Bonds

### US Treasuries

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

### Investment Grade Corporates

High grade corporates have benefitted from the decline in core rates and expectations for ECB quantitative easing. In Citi analysts' view, the direction of risk-free rates will continue to have a significant impact on prospective returns this year. Citi analysts favour USD over Euro issuers given attractive valuations and inflows supported by a weaker euro.

### High-Yield

Fundamentals have not materially weakened, debt maturities have been extended, default rates should remain low (even in energy), and the appetite for higher yields has not waned. US and Euro HY markets appear poised to outperform and Citi analysts see value among higher-quality Single-B or Double-B credits.

### Emerging Market Debt

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

### Euro Bonds

Citi analysts expect that the combination of negative rates and QE will be a powerful driving force for lower core yields. Improving growth is unlikely to have an impact, unless there is overheating because global output gaps remain wide. They would turn more cautious if (a) inflation trends turn; (b) the ECB thinks inflation trends are turning and the latter is a focus on quarterly inflation projections.

# Disclaimer

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

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

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

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