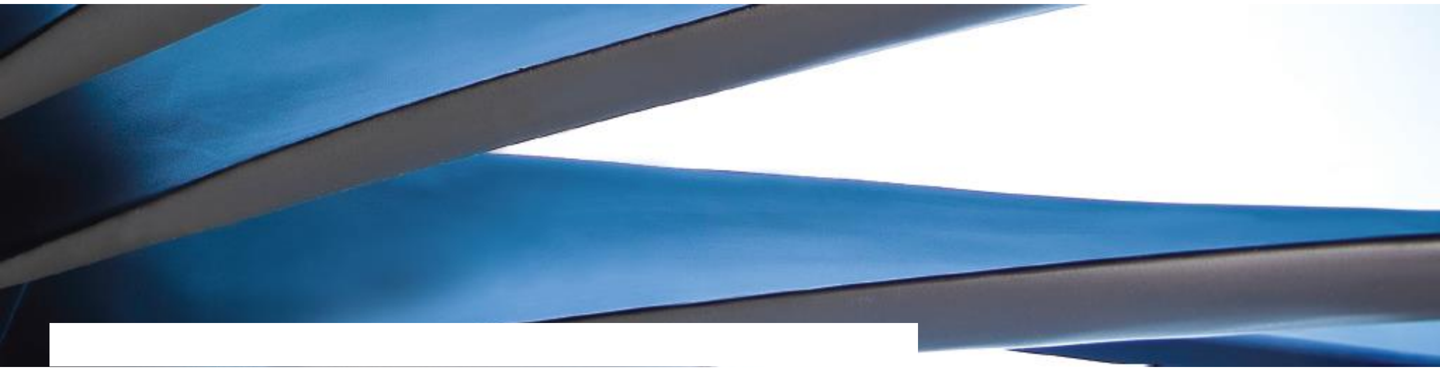

1 FEBRUARY 2017

Opportunities and Risks

By Florence Tan, Tae Hyon Ahn, Celestee Tan

With the new US administration taking office while global growth is expected to pick up modestly, investors will experience both opportunities and risks in 2017.

While being slightly underweight equities, Citi analysts identify several markets and sectors that still look attractive. In fixed income, while we are cautious on low yielding developed market government bonds, we are positive on US high yield bonds and emerging market debt.

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Market Performance

In the US, the Dow Jones Industrial Average rose 0.51%, the S&P 500 advanced 1.79%, while the Nasdaq Composite jumped 4.30%. The Stoxx Europe 600 declined a meagre 0.36% while Japanese stocks were slightly mixed with the Nikkei 225 falling 0.38% and the Topix gaining 0.20% in January.

MSCI Emerging Markets soared 5.45% in January, led by MSCI Latin America (7.51%), MSCI Asia ex Japan (6.19%) and MSCI Emerging Europe (2.03%). Within Emerging Markets, Brazilian stocks were the biggest outperformers, gaining 7.38% on rising commodities.

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Opportunities and Risks (continued)

Equities

US: Neutral. US earnings are rebounding slightly and could benefit further from a large, one-time corporate tax cut. However, valuations look stretched with US equities having risen 8% more than earnings over the past 12 months.

Europe: Underweight. Despite low interest rates and reasonable valuations, the long list of political hurdles in 2017 led Citi to reduce the allocation to Europe to underweight.

Japan: Neutral. Japanese exporters margins are likely to benefit from a weak yen. However, domestic structural challenges remain.

Emerging Markets (EM): Overweight Latin America. Attractive valuations and stabilizing commodity prices lead Citi to maintain a modest overweight. Neutral EMEA: Earnings are recovering and valuations are the cheapest within EM. However, the region is most exposed to Europe where political issues may take center stage. Underweight Asia: In anticipation of further USD appreciation and interest rate pressures, Citi analysts reduced the allocation to Southeast Asian equities to an underweight.

Credit

Investment Grade: Overweight. Valuations have become less compelling, though the sector still offers relative value versus other high quality assets. Prefer USD over EUR issues.

High Yield: Overweight. Low default rates, higher oil prices and resilient investor risk appetite may support another year of outperformance.

Emerging Market Debt: Overweight. Higher US rates, a stronger USD and political uncertainty are potential negatives for EM assets. However, selected markets have attractive valuations. Citi analysts are overweight Latin America. We are also overweight local Asian bonds but are neutral EMEA.

Commodities

Gold – Overweight. Higher interest rates and a stronger USD are likely to weigh on gold prices. However, gold remains an important diversifier to help manage portfolio risk as it has maintained a significant negative correlation with traditional risk assets.

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India's war on cash: A catalyst for future growth

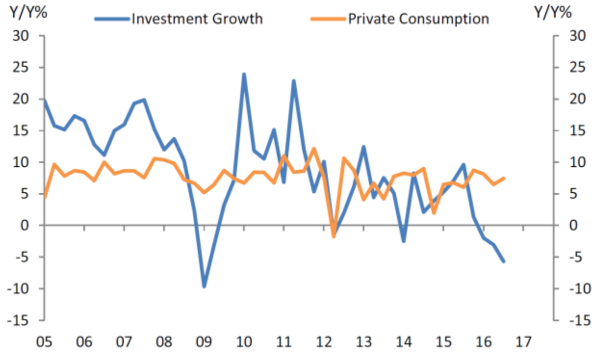
India appears the most resilient among Asian EM in terms of trade and the level of external debt. The recent war on cash also provides a catalyst for future growth.

- On 8 November 2016, the Government of India recalled existing 500 and 1,000 rupee notes and replaced with newly printed 500 and 2,000 rupee notes. The removal of 85% of the nation's cash aimed to reduce money laundering and cash hording but caused monetary conditions to tighten sharply in 4Q16. Growth of private consumption slowed to 5.9% in the second half of the current financial year from 7.1% in the first half.

- Trillions of previously unbanked savings have now been forced into the banking system, providing a much expanded base for credit creation. The instant need for a transaction medium also helped India to take a giant leap into digital payments and other financial services. These, along with the other reforms in 2016 may create tailwinds for the Indian economy. Citi analysts expect the Indian economy to grow 6.8% and 7.5% in fiscal year 2017 and 2018 respectively.

"Citi analysts prefer India within EM Asia given the country's resilience to external trade"

Consumption may see a major rebound after the initial shock



Source: Citi Research as of 13 January 2017.

- Externally, India is the least exposed to exports to either the US or China. Its current account deficit is relatively small at 0.8% of GDP in 2016 and it has little external debt. Indian equities are not cheap at 16.2x 2017 consensus earnings but valuations are actually at the lower end of the range of past 3 years. Indian earnings are also expected to grow 17% next year. Citi analysts maintain their Sept 2017 Sensex target of 30,000.

- During past episodes of RMB weakness, the Indian Rupee (INR) was among the most resilient currency in Asia. With interest rates remaining the second highest in the region, this may help support the currency going forward.

- Key Risks: Given the landslide victory of the ruling party in the National elections, and the size and importance of Uttar Pradesh (largest state in India by population), this state election will be keenly watched in February - March.

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What's in store for China in the Year of the Rooster?

As China approaches its 19th Party Congress, stability is likely to become the top priority. But potentially rising trade friction with the US and a weaker CNY may pose downside risks.

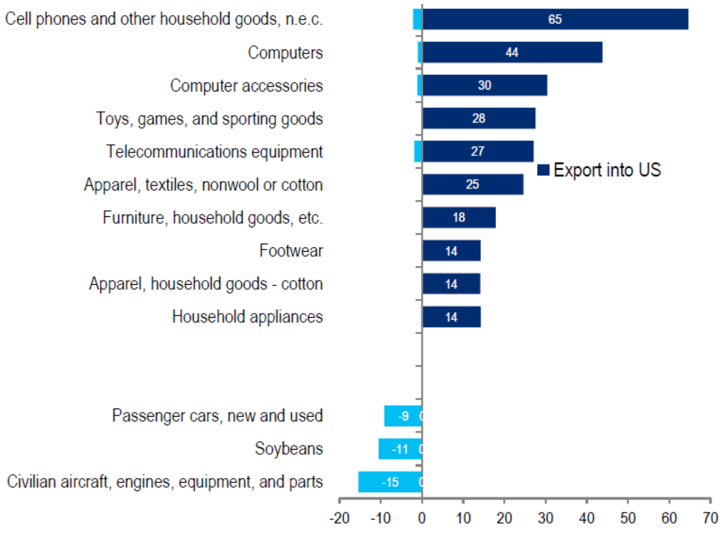
- Although China managed to restore policy credibility in 2016 with stronger growth and an improved balance sheet, risks have returned in the form of renewed CNY depreciation, higher interest rates, and potential trade friction with the US. This time, the need for stability is even greater than usual as the 19th Party Congress approaches.

- Given the authorities' desire to have a more expansionary fiscal policy and for monetary policy to continue its neutral and prudent stance, Citi analysts believe that the Chinese economy can grow 6.5% in 2017.

- Risks are in trade and a weaker CNY. While Citi's base-case is for trade re-negotiation rather than trade wars with the US, China's exports may still face some pressure. As for the Chinese Yuan (CNY), Citi expects another 3-4% depreciation in 2017. Compared to the 6-7% CNY devaluation in early 2016, the impact on China equities may be more muted.

> "Citi analysts expect the Chinese economy to grow 6.5% in 2017 but potential trade friction with the US and a weaker CNY may pose downside risks."

China-US Trades by Product (FY2015, $bn)



Source: Citi Research as of 25 November 2016.

- Be prepared for a bumpy ride. Citi's MSCI China end-2017 target is 70, while the targets for HSCEI and CSI300 are set at 11,000 and 4,000 respectively. Citi analysts prefer to be selective in this environment and favour sectors such as Financials (Insurance, Brokers and Banks), Industrials, IT and Health Care.

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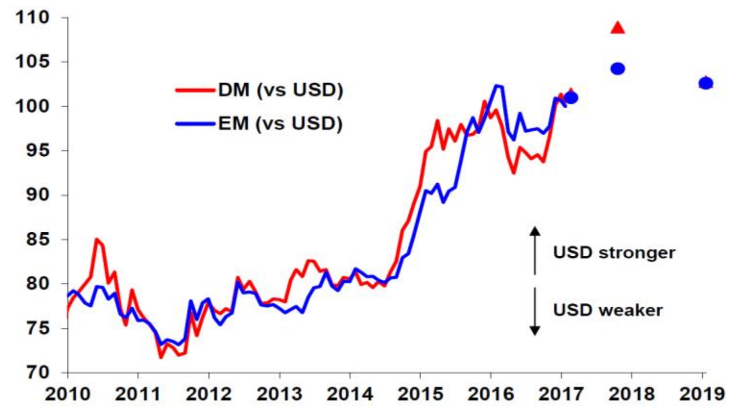
Dollar strength: More to go?

Citi analysts remain positive on the USD in the medium term and expect around 8-9% appreciation vs G10 currencies over the next 6-12 months.

- One medium term USD support is the likely shift in the US policy mix towards greater fiscal spending and higher interest rates. President Trump has promised increased infrastructure spend, tax cuts/ reform and a higher military spend. Furthermore, tax reforms and the repatriation of USD may be additional positives for the greenback.

"The pullback in the USD appears temporary. Citi expects further upside for the greenback."

Developed Markets (DM) & Emerging Markets (EM) – Forecasts Paths



Source: Citi Research as of 20 January 2017.

- Citi analysts expect the EUR to trade down to, and probably below parity over the next 6-12m on the back of dollar strength.
- Higher US yields and robust investor risk appetite are likely to be drivers of a weaker JPY in our view. USDJPY may hit 120+ over 6-12m.
- Under our base case for broad USD appreciation, Citi analysts' forecasts suggest all 3 currencies (AUD, NZD, and CAD) depreciate 5-8% in the medium term.
- Sterling appears cheap, but there may be more downside given deteriorating fundamentals. Citi analysts expect GBP/USD at 1.08 in 6-12m.
- In an environment of strong USD and higher US yields, Emerging Market (EM) currencies are likely to weaken further in our view. Within the region, Commodity currencies may outperform the currencies of manufacturing exporters. We see USD/CNY at 7.15 in 6-12m.

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