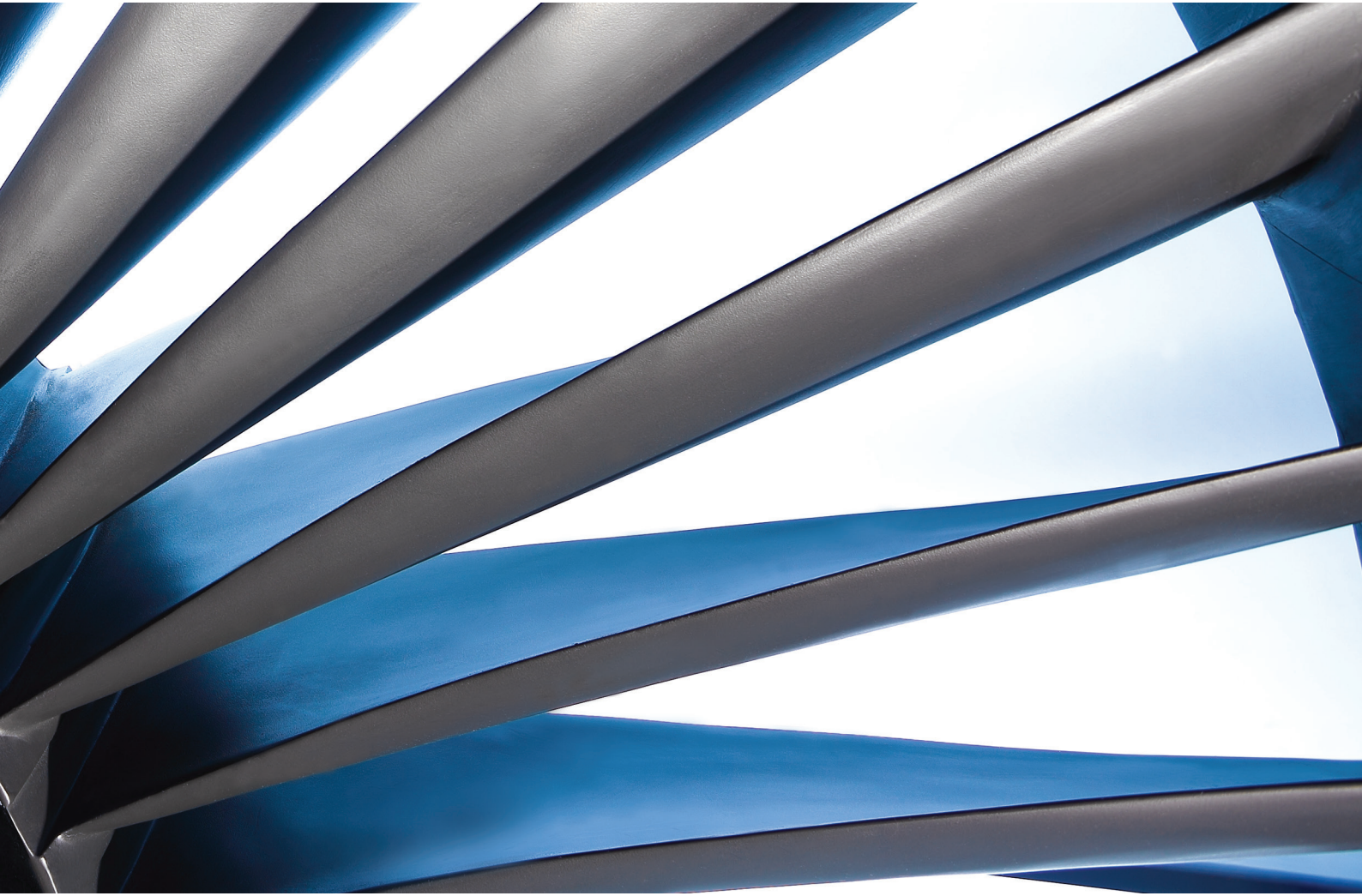


Citigold

2017 ANNUAL OUTLOOK



INVESTING IN A NEW ERA:

REFLATION, ROTATION AND RISKS



CITI'S TOP 8 THEMES

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INVESTING IN A NEW ERA

Reflation, Rotation and Risks

In 2017, the global economy and investment markets are expected to experience fundamental changes. Citi analysts expect global growth to rise 2.7% in 2017, driven by an increasingly expansionary fiscal policy in the Developed Markets (DM) and stronger Emerging Market (EM) growth.

Higher inflation is expected to accompany an increasingly expansionary fiscal policy. This puts a pause to the extraordinary monetary easing cycle which we have seen across the developed economies since the Global Financial Crisis. However, outside of moderate rate rises in the US, other DM central banks are unlikely to raise rates any time soon.

EM is expected to grow 4.3% in 2017, up from 3.8% in 2016 as recessions fade in Brazil and Russia. China is likely to try minimising economic uncertainty in the lead up to the 19th Communist Party Congress in late 2017. EM is vulnerable to a stronger US dollar, higher US interest rates and potential trade restrictions from the US.

In 2016, the Leave vote in the UK's EU referendum and the US election outcome reflect the rise of anti-establishment and anti-globalisation sentiment. Elections in Europe may raise these political risks in 2017.

These political and economic changes have important implications for investors. Expectations of higher bond yields suggest that bond investors shorten their bond duration and become more selective. In equities, cyclical sectors such as Technology, Energy and Financials are likely to outperform. Citi analysts are underweight Europe given high political risks. They also believe that selected opportunities still lie in more commodity-reliant EM sectors.

Against expectations of a strong US dollar, US policy uncertainty suggests that periods of currency volatility can potentially create short term tactical opportunities for currency investors.

Given the changes in the global growth outlook and policy mix, investors may want to review their portfolios in light of the potential risks and opportunities 2017 brings. Please reach out to your Citibank relationship manager to discuss what the developments in financial markets mean for your individual portfolio.

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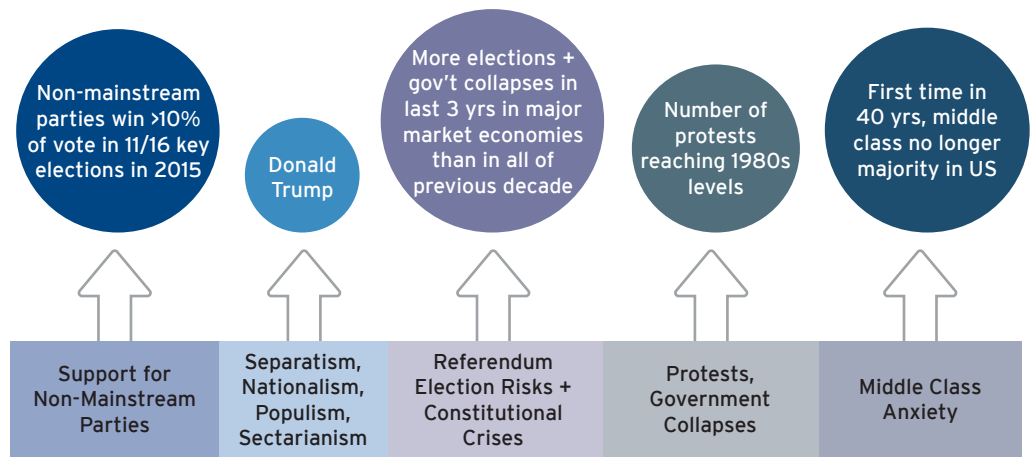
POLITICS & POLICIES

OPPORTUNITIES AND CHALLENGES

Vox Populi risk is expected to rise, particularly in Europe and the US. However, Citi analysts believe that this presents both risks and opportunities for investors in 2017.

In 2016, the Leave vote in the UK's EU referendum and the victory of Republican candidate Donald Trump in the US election reflected the rise of the anti-establishment and anti-globalisation sentiment in Europe and the US. In Citi analysts' view, Vox Populi risks continue to rise given sluggish growth, rising inequality and low social mobility. See Figure.

Vox Populi Risks High and Gathering Steam in Developed Markets



Source: Citi Research. As of 28 November 2016.

In 2017, a number of events on the political calendar may crystallize these risks. They include the general election in the Netherlands, the presidential election in France and the general election in Germany. See Figure. Citi expects mainstream parties to win these elections, although we have learnt that surprises happen and perhaps increasingly so. Polls of voting intentions are unreliable guides to actual voting or voter turnout in a Vox Populi world. As such, the risks of major upsets would be material.

Against the rising tide of anti-establishment sentiment, mainstream parties are seen to adopt some of the policies of the non-mainstream parties. The main policy implications include a shift towards gradually looser fiscal policy, a shift away from globalisation and towards nationalism and regionalism.

Political Calendar in 2017 and 2018



Source: Citi Research. As of 28 November 2016.

Although rising political risks appear most striking in the advanced economies, similar risks are also high and rising across a number of Emerging Markets such as Turkey, South Africa

RISKS AND OPPORTUNITIES

The prospect of higher policy uncertainty in the US and rising political risks in Europe presents opportunities as well as risks for financial markets in 2017. Unexpected outcomes can raise market volatility in the short term but as experiences post the UK's EU referendum and the US elections show, investment opportunities are likely to arise.

For example, in the UK, the 16% drop in the Sterling post the EU referendum led to a 11% rally in UK equities as investors expected the weak currency to underpin earnings and dividend payouts for internationally exposed UK companies. Likewise, post the US election, the US dollar strengthened and the US equity market reached fresh record highs on expectations of stronger US growth and earnings. On the other hand, bonds and Emerging Markets underperformed on concerns over higher US interest rates and a stronger US dollar.

INVESTMENT IMPLICATIONS

In general, unexpected political outcomes can trigger periods of market volatility as well as asset class and sector rotations. However, investors who attempt to time the market and exploit key events run the risk of severely underperforming when markets turn. We advocate that investors stay invested, maintain a diversified portfolio and keep a long term perspective.

1 / OPPORTUNITIES AND CHALLENGES

Following the US election outcome, fixed income markets have already moved to price in stronger US growth and higher inflation. Citi analysts feel that the probability of further interest rate pressures cannot be ruled out. While Citi analysts remain overweight Developed Market Investment Grade and High Yield Credits as well as Emerging Market Sovereigns, investors may want to keep bond durations short around 7 years. The risk of higher bond yields lead Citi analysts to remain underweight in low yielding developed market government bonds.

Stronger US economic growth and potential corporate tax cuts can boost earnings for US equities. Potential repatriation of overseas profits could also lead to higher share buybacks and dividend payouts by large US companies although historically, a strong USD tends to benefit small and mid-caps more.

The backdrop is also positive for the Financial sector with higher rates expected to boost net interest income, while a stronger macro backdrop improves credit quality and lower provision expenses. The Energy sector could enjoy increased deregulation while the Infrastructure/Defense sectors may benefit from higher spending.

Conversely, Citi analysts believe that the UK referendum and US presidential election highlight pending political risks in Europe, where inter-country cooperation is of greater financial importance than elsewhere. The long list of political hurdles in 2017 has led Citi analysts to move European equities to an underweight.

Key Takeaways

- **Unexpected political outcomes can trigger asset class and sector rotations.** Investors who attempt to time the market and exploit key events run the risk of severely underperforming when markets turn. We advocate that investors stay invested, maintain a diversified portfolio and keep a long term perspective.
- **Following the US election outcome, the risk of higher bond yields suggests that investors reduce their bond duration.** However, US equities and selected sectors may benefit from Trump's reflationary policies.
- **Citi analysts are underweight European equities given the long list of political hurdles in 2017.**

2 GLOBAL GROWTH A MODEST PICKUP

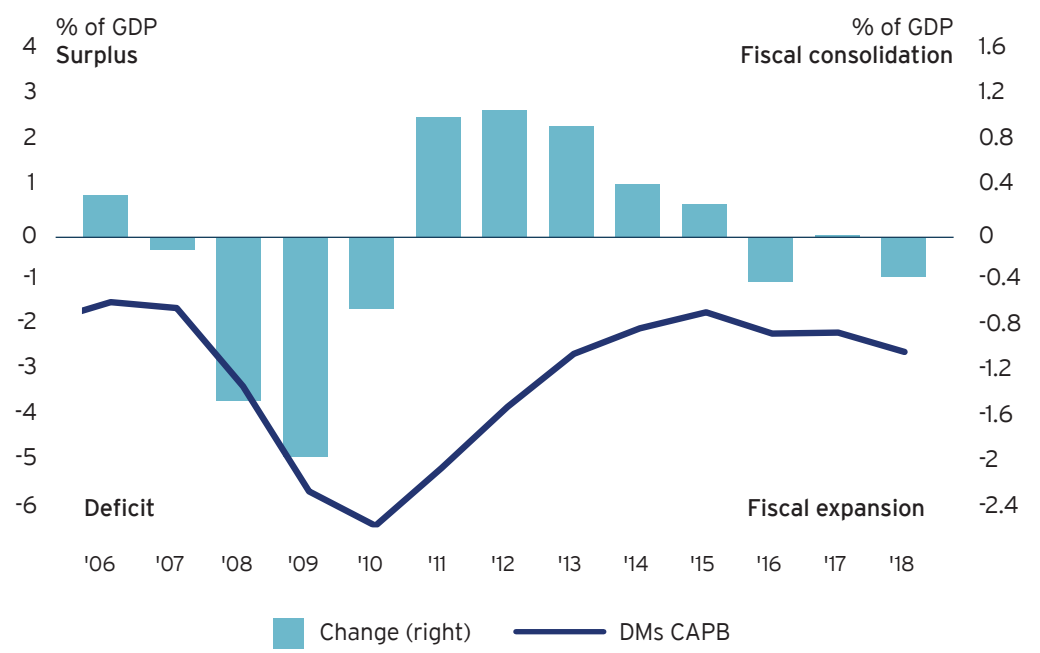
An increasingly expansionary fiscal policy in the developed market (DM) economies and fading recessions in a number of emerging markets (EM) are expected to drive global economic growth higher in 2017.

Citi analysts expect a pickup in global real GDP growth from 2.5% in 2016 to 2.7% in 2017, as fiscal policy turns increasingly expansionary in the developed markets. Indeed, fiscal policy in the developed markets became expansionary in 2016 for the first time since 2010.

INCREASINGLY EXPANSIONARY FISCAL POLICY IN THE DEVELOPED ECONOMIES

The trend of a more expansionary fiscal policy is likely to continue and could perhaps gain further momentum. Citi analysts expect a smaller fiscal impulse (as measured by the government primary balance) in 2017 compared to 2016, before ramping up again in 2018. See Figure.

Cyclically Adjusted General Government Primary Balance Level and Change (% of GDP, % of GDP), 2006-2018F



CITI ANALYSTS EXPECT A PICKUP IN GLOBAL GDP GROWTH FROM

2.5%

IN 2016 TO

2.7%

IN 2017

Source: Citi Research and IMF. As of 28 November 2016.

In Citi analysts' view, the trend towards incrementally looser fiscal policy is partly based on the thinking on Vox Populi (See "1. Politics & Policies - Opportunities and challenges amid rising Vox Populi risk"). The perception that monetary policy is increasingly ineffective also supports the case for more fiscal easing.

Following the US election, a fiscal stimulus, involving personal income and corporate income tax cuts and an increase in infrastructure spending, is highly likely, even if its exact size, nature and timing remain uncertain. Citi analysts believe that most of the stimulus is likely to materialise in 2018 and that the fiscal impulse would roughly amount to 1.5% of GDP in 2018-2020 in the US.

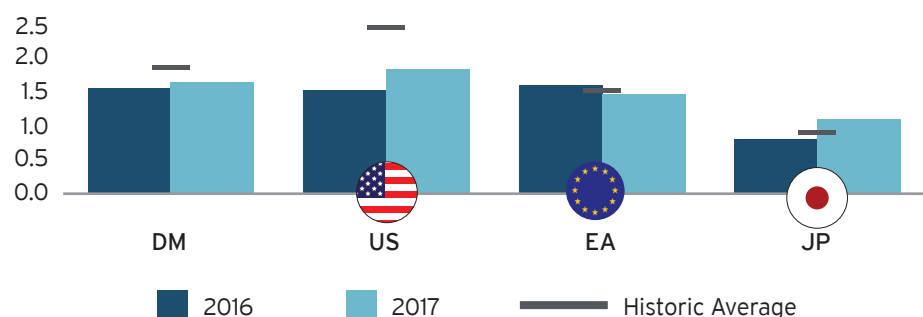
The US example will probably be followed by other countries. Citi analysts expect moderate fiscal loosening in 2017 in the euro area, Japan and Norway, although they stress that the move towards fiscal stimulus is not likely to be uniform or universal across the developed economies nor dramatic.

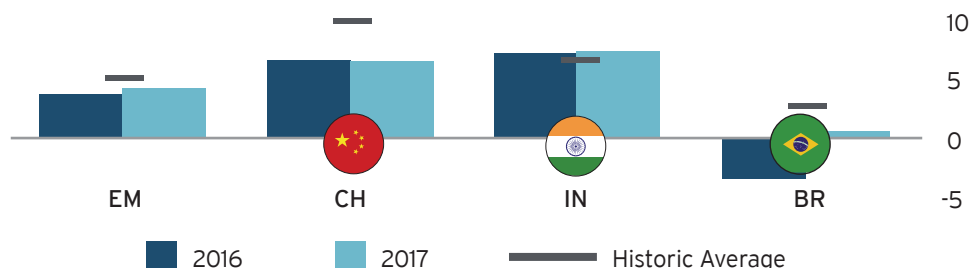
STRONGER EM GROWTH

The forecasted rise in global growth in 2017 is also partly driven by a pickup in EM growth. EM is expected to grow 4.3% in 2017, up from 3.8% in 2016. This is largely due to fading recessions in a small number of large EM economies such as Argentina, Brazil, Nigeria and Russia. Stabilisation in Chinese growth and steady commodity prices also support an end to the multi-year EM slowdown.

More active fiscal policy in the developed economies, particularly in the US, should boost global growth and therefore increase demand for EM exports. Citi analysts estimate that a 1% standard deviation shock to US GDP growth boosts EM growth by around 0.3% over six quarters. However, at the same time, more active fiscal policy can raise long term interest rates in the developed economies and tighten EM financial conditions. In such a scenario, EM economies may need to resort to currency depreciation to loosen financial conditions. Therefore the implications of more DM fiscal easing on EM are mixed.

Real GDP Forecasts vs. Historical Averages*





Source: Citi Research and IMF, * Historical averages using IMF data: 1990 to 2015 for DM, 1996 to 2015 for EM. As of 28 November 2016.

INVESTMENT IMPLICATIONS

The modest pick-up in global growth is expected to drive a rise in DM inflation and a marginal increase in DM policy rates. This would have an impact for bond investors while increasing the attractiveness of equities within the Financial sector. (See “3. Inflation - Navigating higher bond yields”).

Stronger growth is also likely to help boost company earnings. Earnings revisions turned positive in the week of 6 December, recording the best weekly revision since May 2011. Since the Trump victory, weakness in the Euro and the Yen has helped boost earnings revisions in Europe and Japan. In the US, potential corporate tax cuts are expected to more than offset the negative impact of a strong US dollar on earnings.

Citi analysts continue to advocate a neutral allocation in most regional equity markets such as US and Japan, although they are underweight Europe given the political risks. They are also overweight cyclical sectors such as Technology, Energy and Financials.

However, Citi analysts caution that the risks are towards the downside for both growth and inflation. Among the main risks are tightening financial conditions as the dollar and US interest rates rise, an increase in international tensions (including possible trade wars) and political risks in Europe. Against this backdrop, a diversified portfolio is likely to provide investors with attractive risk-adjusted returns. Investors looking for a deeper level of diversification can also consider gaining exposure to non-traditional asset classes to further lower portfolio volatility.

Key Takeaways

- Citi analysts expect a pickup in global real GDP growth to 2.7% in 2017, driven mostly by higher EM growth and moderate fiscal expansion in DM.
- Higher inflation and bond yields are likely to accompany stronger global growth. Bond investors will need to be more selective and keep bond durations short.
- Stronger growth is likely to boost company earnings and create opportunities in selected regional equity markets and sectors.

3 CHINA POLICY CONTINUITY VERSUS EXTERNAL RISKS

The Chinese authorities are likely to minimise short term economic uncertainty in 2017 in the lead up to the 19th Communist Party Congress in late 2017. The risk is their efforts could be thwarted by external shocks originating from changes in US trade policies.

Investors have been surprised by the resilience of the Chinese economy in 2016. Policy stimulus, together with financial market stabilisation, has led to a recovery in real economic activity. But the recovery still has an 'old economy' bent, with the rebounding property sector and infrastructure investment making significant contributions. In Citi analysts' view, the debt-fuelled character of much of this growth has increased future risks and worsened the prospects for sustainability.

STEADYING THE BOAT

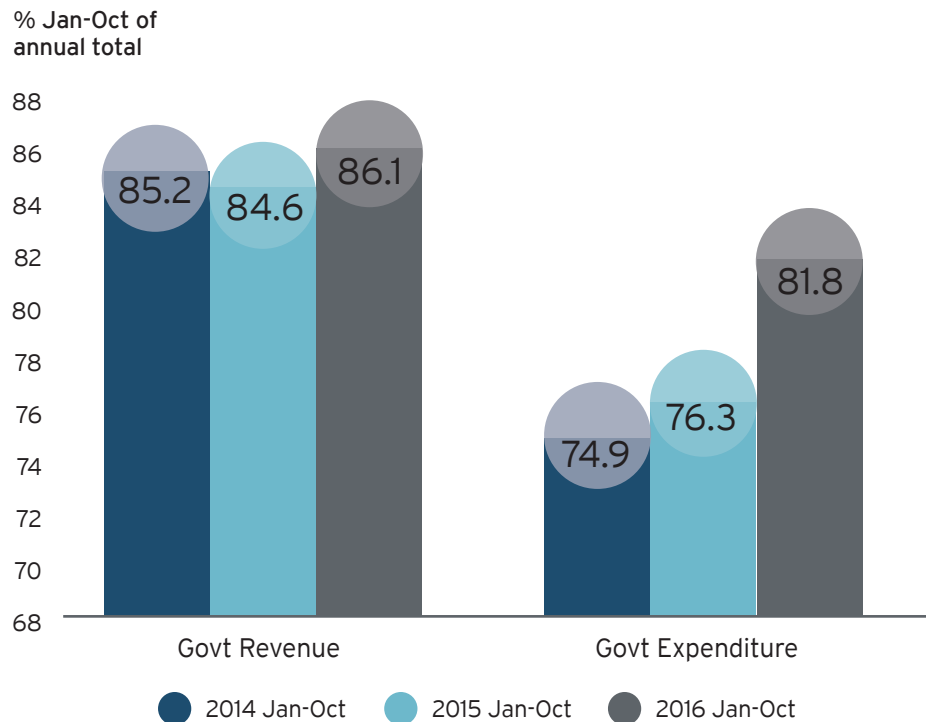
With the lead up to the 19th Communist Party Congress in late 2017, the Chinese authorities are expected to adopt policies to ensure that GDP growth would be around 6.5% to 7%, in order to ensure a smooth political transition.

This implies that to the extent possible, significant financial volatility and major financial asset booms, bubbles and busts will be prevented, despite the continued reliance on rapid credit growth and rising leverage. There will be little substantive structural economic reform to rebalance the economy towards consumption-led growth. There is also likely to be little attempt to address excessive leverage and excess capacity.

Old style fiscal policy will lead the way with the central government financial deficit likely to be raised to 3.5% of GDP. 2017's public investment program is likely to exceed that of 2016, helping to offset the modest slowdown in property investment. Citi analysts estimate that infrastructure investment will also be maintained at 20%, leading the overall fixed asset investment growth at 9.1%.

Monetary policy is expected to remain accommodative, and Citi analysts factor in two 50 basis points cuts in the Reserve Requirement Ratio (RRR) in 2017.

Fiscal Expenditure and Revenue as of the Total Year



Source: CEIC and Citi Research. As of 28 November 2016.

EXTERNAL RISKS

The US election outcome presents new risks to China. China's Renminbi (RMB) fell to a near 8-year low on concerns of capital outflows as the US Dollar (USD) advanced following the election. China is also vulnerable to potential impact on trade if the new US administration imposes trade restrictions.

Potential trade conflicts: The US could renegotiate existing trade agreements and challenge China on its currency policy. These acts would be negative for China's growth and its currency. Citi analysts, however, think that a trade war scenario is unlikely to play out although some form of trade restrictions is possible. For example, the US may impose anti-dumping duties or a quota system to reduce the bilateral trade imbalances. Any disruption to bilateral trade between the world's largest and second largest economies will likely lead to significant negative impact for both countries adding a material downside risk for the global economy as well.

3 / POLICY CONTINUITY VERSUS EXTERNAL RISKS

CITI'S TARGETS FOR END 2017

70

MSCI CHINA

4,000

CSI300

11,000

HSCEI

RMB volatility: Following the US elections in November, the RMB fell to a near 8-year low against the USD. In the short term, investors may see higher RMB volatility with the USD finding support as the US policy mix shifts towards expansionary fiscal policies and away from accommodative monetary policy. The RMB's weakness may be accentuated given the uncertainty around US-China relationships under President-elect Trump. Citi analysts expect the USD-CNY to average 7.05 in 2017. Capital outflows are likely to remain manageable given the level of China's reserves.

In the medium term, Citi analysts believe the opening of China's RMB bond market to international institutional investors as well as the RMB's inclusion in the Special Drawing Right (SDR) currency basket, an international reserve asset created by the IMF, may stem expectations of further RMB depreciation. MSCI's decision on whether to include China A-shares in its Emerging Market indices could also influence the direction of the RMB.

A BUMPY RIDE UP

In 2017, the Chinese authorities' desire for policy continuity may be thwarted by external risks. This potentially implies a bumpy ride up for Chinese equities in 2017. Citi analysts have set their 2017 targets for the MSCI China and CSI300 at 70 and 4,000 respectively while they forecast H-shares may reach 11,000 by the end of 2017. Chinese equities currently trade at 20% below their historical average valuations and Citi analysts expect the current low valuations to gradually normalize over the long term.

Citi analysts continue to favour H shares over A shares and prefer the Financials, Industrials, Technology and Health care sectors. They remain neutral on Property, Energy, Materials and Consumer Discretionary while staying underweight Consumer Staples, Utilities and Telecoms.

Key Takeaways

- With the lead up to the 19th Communist Party Congress in late 2017, the Chinese authorities are expected to adopt policies to ensure that GDP growth would be around 6.5% to 7%, in order to ensure a smooth political transition.
- The US election outcome presents new risks to China. A stronger USD may spur greater capital outflows while potential trade restrictions can hurt growth.
- Despite relatively attractive valuations, Chinese equities may be in for a bumpy ride up in 2017 as external risks loom. Citi analysts favour H shares over A-shares and prefer the Financials, Industrials, Technology and Healthcare sectors.

EMERGING MARKETS

STAYING SELECTIVE

Politics and monetary policies in the developed countries will continue to be key drivers for Emerging Market (EM) assets in 2017. While rising US interest rates and a stronger US dollar are less supportive for EM, higher commodity prices could provide a buffer for selected EM markets.

Post the US election, two kinds of uncertainty have risen for EM. The first comes from the potential policy mix shift towards more expansionary fiscal policies and less accommodative monetary policy. The second relates to the potential 'de-globalizing' trade policies under the new US administration.

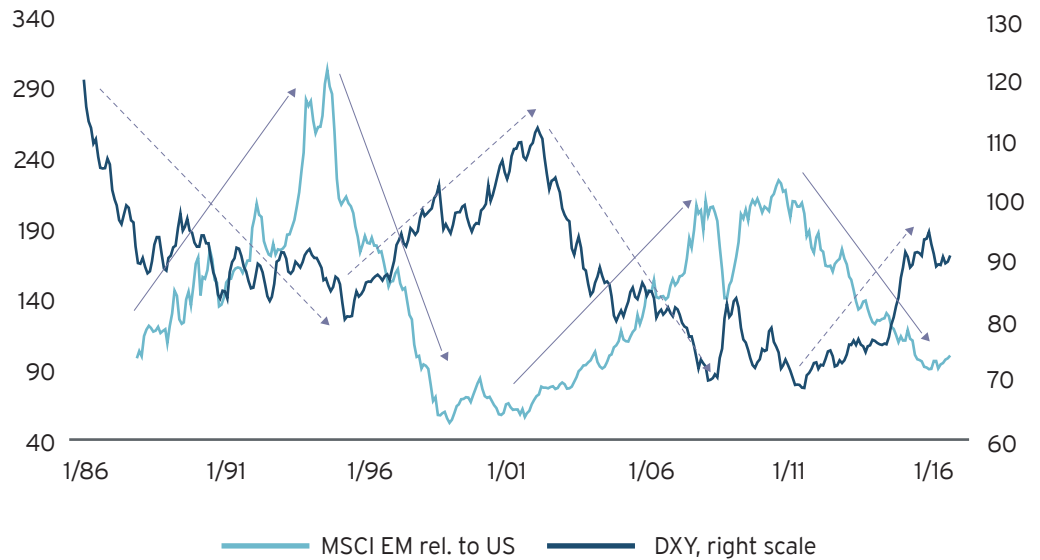
US DOLLAR STRENGTH REMAINS A KEY RISK FOR EM

Fiscal stimulus and a tightening monetary policy imply higher US bond yields and a stronger US dollar (USD). Citi analysts believe the ongoing appreciation of the USD will continue, possibly rising by another 3% versus the EM currencies over 2017. Historically, this backdrop is negative for EM, as investors worry about capital outflows.

In the early 1980s, the surge in the USD led to significant capital outflows from EM. However, Citi analysts note that many EM are arguably more resilient now than they were in the 1980s. Notably, foreign direct investment accounts remain stable, while current account deficits are smaller in aggregate. More importantly, upcoming Fed rate hikes are expected to be more modest with two 25 basis points hikes expected in 2017. In the 1980s, the Fed Funds rate rose from around 10% to almost 20%, as US inflation reached double-digit levels.

More recently, in August 2015 and January 2016, China's sharp RMB devaluation caused global market turbulence. Citi analysts do not expect a disruptive RMB devaluation given China's sufficient reserves and the government's efforts to curb capital outflows. However, the risk that renewed dollar appreciation could trigger greater RMB volatility and higher risk aversion towards EM cannot be ruled out.

USD vs. MSCI EM Performance Relative to US



Source: Citi Research. As of 9 November 2016.

DE-GLOBALIZATION IN GLOBAL TRADE

Another pressing concern for EM would be potential US policies under the new US administration which may restrict the free movement of goods, people and capital. During his campaign, President-elect Trump’s key policy proposals had included introducing import tariffs on Mexico and China as well as renegotiating or exiting certain free trade agreements. While there is still uncertainty about how the new administration will implement such policies, a rise in protectionism will have a negative impact on global trade, thereby hurting profits, liquidity and capital flows for EM.

The adverse effects of de-globalization may vary across EM countries depending on each country’s savings ratio, degree of openness and the strength of their external balance sheets. New tariffs are likely to hurt EM economies with high export shares in manufacturing most.

BRIGHT SPOT AND GREEN SHOOTS

Although US trade policy uncertainty and de-globalisation could threaten the long-term growth outlook for EM, a large US fiscal stimulus could be supportive for EM growth. While the size and timing of the fiscal stimulus in the US is uncertain,

4.3%

EM GDP GROWTH
EXPECTED IN 2017 AND

4.8%

IN 2018

President-elect Trump had advocated spending US\$550 billion over the next 10 years on infrastructure. This could boost demand for commodities, lending support to EM commodity producers.

In addition, the growth momentum in the EM has already picked up, with growth running at 4% in 2H16 versus 3.7% in 2015. EM PMIs have been strengthening as firmer commodity prices lend support to EM exports. This may offer some resilience amid unfriendly external conditions. Citi analysts expect EM GDP to grow 4.3% in 2017 and 4.8% in 2018.

NOT ALL EMERGING MARKETS ARE ALIKE

Although a policy mix of expansionary fiscal policy and tightening monetary policy in the US could dampen investor risk appetite for EM assets, Citi analysts see potential opportunities in selected markets.

Stable commodity prices in 2017 have helped improve the fiscal balances of many EM commodity exporters. Citi analysts believe commodity producers may continue to benefit from higher prices in 2017 and remain insulated from potential US-led trade conflicts, compared to export-oriented manufacturers.

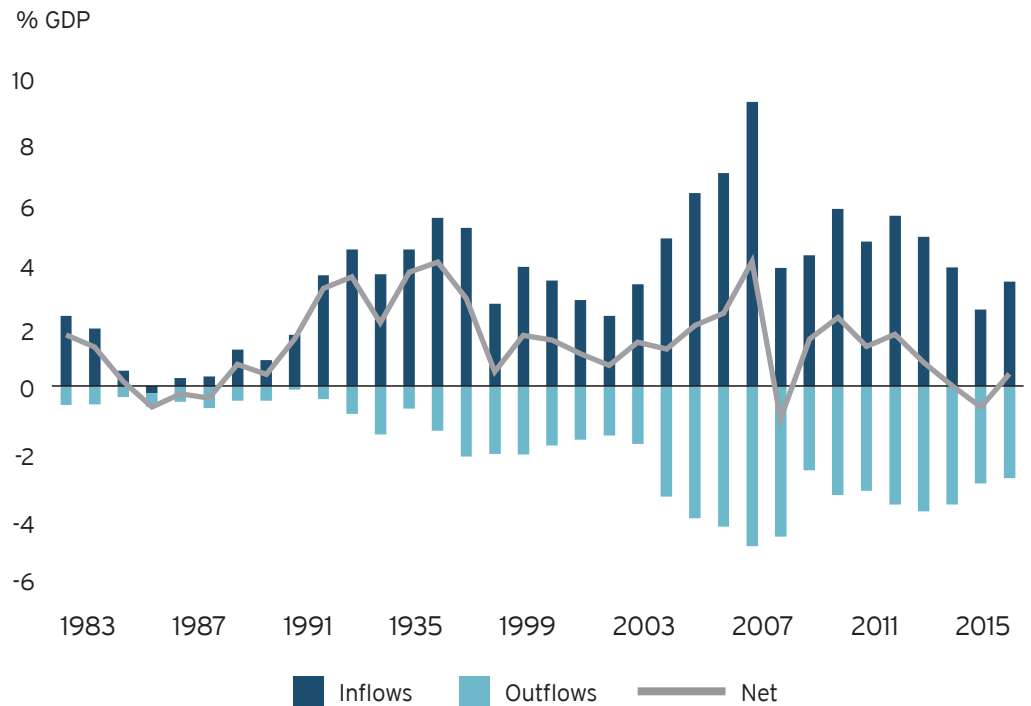
A strong USD is likely to cause most pain to open economies with low savings ratios, low levels of reserves and high levels of dollar denominated debt. Countries with high consumption to GDP are relatively less vulnerable compared with export-driven economies.

Citi analysts maintain an overweight position in EM debt as credit ratings are likely to improve in 2017 amid fading recession risks for commodity producers.

As for EM equities, Citi analysts maintain a modest overweight in Latin America given compelling valuations and the potential benefit from higher commodity prices. On the other hand, Citi analysts remain neutral on EMEA equities as a heavy political calendar may give rise to greater volatility. Citi analysts are underweight ASEAN equities given relatively rich valuations. High levels of foreign ownership, particularly in bonds, also make the region more vulnerable to potential capital outflows.

4 / STAYING SELECTIVE

Capital flows to EM



Source: Citi Research. As of 9 November 2016.

Key Takeaways

- Although higher US interest rates and a stronger USD are less supportive for EM, Citi analysts see potential opportunities in selected markets.
- Citi analysts maintain an overweight position in EM debt as credit ratings are likely to improve in 2017 amid fading recession risks for commodity producers.
- Within equities, Citi analysts maintain a modest overweight in Latin America given compelling valuations and the potential benefit from higher commodity prices. They are neutral EMEA and underweight ASEAN.

5

INFLATION NAVIGATING HIGHER BOND YIELDS

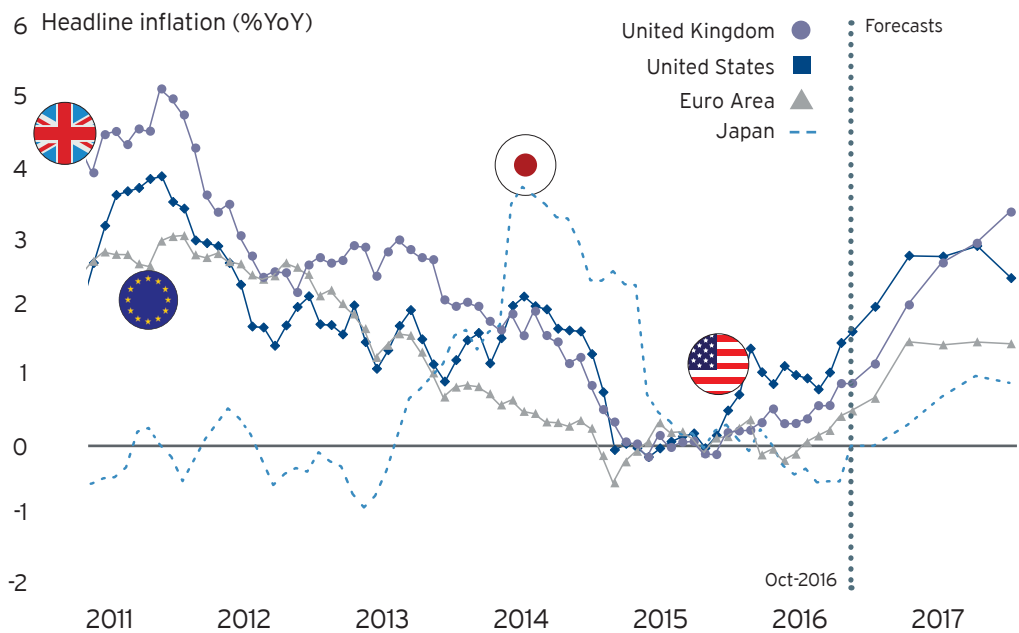
Expectations of rising inflation have driven bond yields higher but policy and growth uncertainties are reasons to still own bonds. Investors would need to keep bond durations shorter and be more selective.

Citi analysts forecast Developed Market (DM) average inflation to come in at 2% in 2017, up from 0.8% in 2016. Some of the drivers of this uptick are temporary such as positive base effects, higher commodity prices and a diminishing drag from earlier currency appreciation. However, other factors may be more durable. These include above potential DM economic growth, smaller output gaps and loosening fiscal policy across the developed economies.

Political developments in the UK and US have also contributed to a pickup in inflation. The 16% fall in the sterling since the UK referendum has led Citi analysts to raise their 2017 and 2018 CPI inflation forecasts for the UK to 2.7% and 3.4% respectively, up from 0.6% in 2016. Meanwhile, following the election of Trump as US President, Citi analysts note that the combination of fiscal loosening, trade restrictions and anti-immigration policies could raise US inflation.

However, Citi analysts do not expect inflation to run away anytime soon. Core inflation in the DM remains quite low and disinflationary forces continue to be powerful in Japan and the euro zone. Dollar strength could also cap US inflation in 2017.

Headline CPI Inflation (%), 2011-2017F



IMPLICATIONS FOR MONETARY POLICY: LOWER NO LONGER?

2017 potentially heralds the end of the extraordinary DM monetary easing cycles. That said, outside of the US, most DM central banks are unlikely to tighten monetary policy anytime soon.

The Fed has increased interest rates by 25 basis points in December and Citi analysts expect another two more rate hikes in 2017. Accordingly, Citi analysts have revised up their forecasts and now expect the 10-year US Treasury yield to reach 2.60% by end 2017.

Outside of the US, while rate hikes are unlikely, the prospects for further significant easing measures by major central banks are diminishing. Both the Bank of Japan and European Central Bank have expressed greater tolerance for a temporary overshoot in inflation. In Japan, Citi analysts have pushed back the timing of the next expected policy rate cut to July 2017 from January 2017. In the Eurozone, the ECB announced an extension to its purchase programme by nine months in December but lowered the monthly purchase amount to €60bn. In the UK, accelerating inflationary pressures potentially raises the hurdle for further monetary easing and the next BoE policy rate cut may only take place in February 2017.

WHAT DOES THIS MEAN FOR INVESTORS?

After years of navigating a low inflation environment and even overcoming deflationary concerns, investors will now need to adjust their portfolios to take into account the potential of higher inflation and rising bond yields.

Given the risk of inflation, bond investors can consider keeping bond durations shorter around 7 years and avoid low yielding government bonds. However, the possibility of longer term downside risk to the global economy suggests that investors may want to retain some exposure to fixed income, although investors would need to be selective.

Citi analysts favour US corporate bonds as well as the metals & mining sectors globally. Credit spreads have widened among the European banks reflecting market uncertainty surrounding Brexit and the upcoming elections in Europe. Citi analysts believe that politically-induced volatility could present opportunities to gain exposure to selected banks which are likely to benefit from the steady capital build and steeper yield curve. Citi analysts favour the French, Swiss, Dutch and UK international banks.

The risk premium in the Emerging Markets (EM) is likely to rise given concerns over potential capital outflows and trade protectionism. Within EM, Citi analysts believe that large, relatively closed economies such as India could outperform. Indonesia also looks attractive given the potential for a credit rating upgrade. Russia could also benefit if diplomatic relations with the US improve. Finally, Brazil and the Gulf Cooperation Council (GCC) are likely to gain from the constructive energy outlook although investors may want to wait for valuations to become more attractive.

10-YEAR US TREASURY
MAY REACH

2.60%

BY END OF 2017

NAVIGATING HIGHER BOND YIELDS / 5

Within equities, rising yields are expected to benefit the Financials sector. Citi's analysis highlights that in most developed markets, the Banking sector usually outperforms when 10-year government bond yields rise. See Figure.

US 10 Yr Govt Bond Yield vs Bank Sector Performance Relative to Market (2001-2015)



Source: Citi Research. As of 6 October 2016.

Key Takeaways

- After years of navigating a low inflation environment and even overcoming deflationary concerns, investors will now need to adjust their portfolios to take into account higher inflation and rising bond yields. Citi analysts forecast 10-year US Treasury yields to reach 2.60% by end-2017.
- Bond investors may want to consider keeping bond duration shorter around 7 years and look for opportunities in US corporate bonds, European banks as well as the global metals and mining sectors.
- Within equities, rising yields are expected to benefit the Financials sector. Citi's analysis highlights that in most developed markets, the Banking sector usually outperforms when 10-year government bond yields rise.

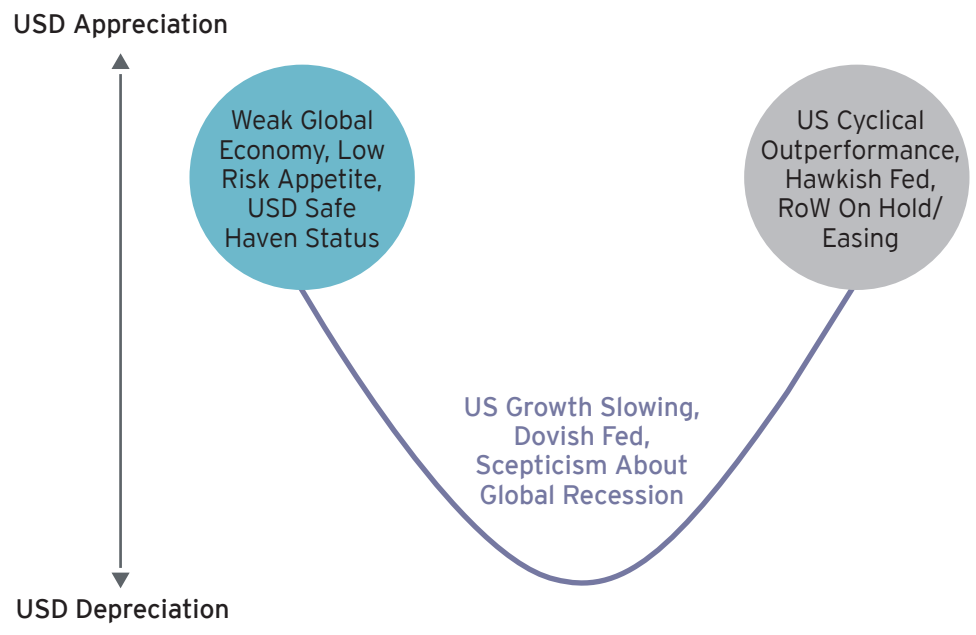
CURRENCIES
6 MAKING THE DOLLAR GREAT AGAIN

Over the next 6-12 months, Citi analysts expect the USD to be around 6-7% and 3% higher versus G10 and EM currencies respectively.

Relative to Citi’s USD “smile analogy”, President-elect Trump’s victory likely raises the risk of the tails on both sides. See Figure. Fiscal stimulus via infrastructure spending and tax cuts is likely to provide a much needed short to medium boost to global and US economic growth. If Fed policy becomes less dovish in this scenario, higher US interest rates and an easier fiscal policy can be very positive for the USD.

On the other hand, uncertainty surrounding US economic policies, possible anti trade/globalization initiatives, and heightened geopolitical tensions could present a short term downwards shock to global growth. If this reached recessionary magnitude, USD appreciation is likely.

Trump Increases Tail Risks on Either Side of USD Smile



Source: Citi Research. As of 18 November 2016.

Over the next 6-12 months, Citi analysts expect the USD to be around 6-7% and 3% higher versus G10 and EM currencies respectively. See Figure.

DM & EM - Forecasts Paths

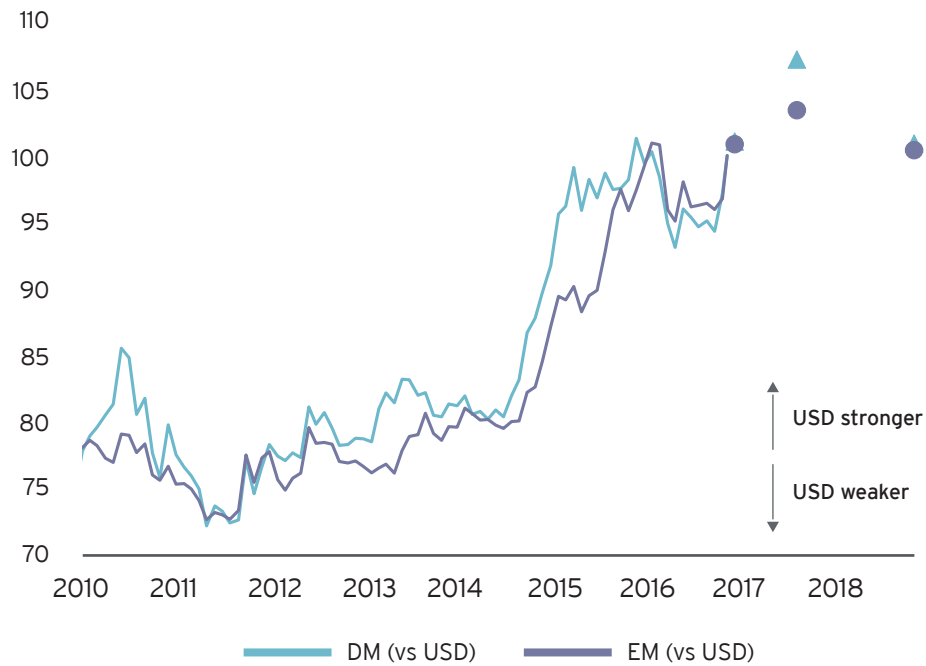


Chart shows GDP weighted baskets. Today = 100
Source: Citi Research. As of 18 November 2016.

EUR & JPY: Prospects for major additional easing measures by the ECB and BoJ in 2017 appear to be diminishing. This is because of the growing concerns surrounding further large-scale central bank balance sheet expansion and more negative policy rates.

Despite the aggressive easing measures employed by the ECB and BoJ, disinflationary forces remain quite powerful in Japan and the Eurozone. Meanwhile, the negative side effects of the large bond purchase programmes are starting to show. For example, there have been frequent liquidity shortages in both the European and Japanese bond markets. Bonds are also becoming increasingly unattractive to end investors as yields head into negative territory. With the BoJ currently owning more than 40% of the JGB market and ECB around 20% of the euro zone sovereign debt market, both central banks are finding it increasingly difficult to buy more bonds. Finally, negative rates have hurt the banks which have been unable to pass on the cost of negative rates to their depositors.

Hence, short of cutting rates further, which would continue to weigh on Europe's banking sector, the ECB may be left with few options other than to start unwinding its QE program. This could lead to EUR strengthening, possibly further out in 2018.

OVER THE NEXT 12 MONTHS, USD MAY BE

6-7%

HIGHER VS GIO AND

3%

HIGHER VS EM CURRENCIES

6 / MAKING THE DOLLAR GREAT AGAIN

OVER THE NEXT
12 MONTHS, RMB MAY
WEAKEN

4.2%

FROM CURRENT
LEVELS

In Japan, the BoJ has already resorted to buying assets other than JGBs such as stocks and Exchange Traded Funds (ETFs) but this is unlikely to offset any potential tapering that may be announced. Citi analysts expect the BoJ to ease in July 2017 along with an announcement for a new economic stimulus package. Such a scenario could extend the weakening bias in the JPY.

GBP: The Sterling has been relatively resilient in the face of recent USD strength. This can be attributed to the London High Courts' recent ruling that triggering Article 50 would require a parliamentary vote. While this may delay Brexit, it is unlikely to prevent it, in Citi's view.

Other bright spots for the Sterling include the currency-induced strength in the UK's export/manufacturing sectors. This coupled with stronger imported inflation and the fiscal stimulus announced by Chancellor Hammond may make the BoE more reluctant to cut rates further.

On balance, while the Sterling may still be vulnerable to further USD strength, the currency may have seen its lows on non-USD crosses and especially against commodity and Asia EM currencies.

COMMODITY BLOC & ASIA EM: Increased currency and rate volatility is potentially negative for commodity and Asia EM currencies. This is so even though Citi analysts expect the RBA to refrain from cutting rates further this year and for the RBNZ to cut rates only once in Q2 2017.

Outside of Mexico, trade with Asia has been the key focus of President-elect Trump. Asian currencies would be vulnerable to any rise in trade protectionism. While China is currently running the largest trade account surplus with the US globally, China has sufficient reserves and a relatively closed capital account to be in a position to smooth any exchange rate moves. Over the next 12 months, we expect the RMB to weaken by 4.2% from current levels. On the other hand, the Malaysian Ringgit, Indonesian Rupiah and the Korean won are likely to be more vulnerable to any rise in trade protectionism.

Key Takeaways

- Further easing by the BoJ could extend the JPY's weakening bias. An unwinding of the ECB's QE program could lead to EUR strengthening, possibly further out in 2018.
- Sterling may still be vulnerable to further gains in USD, though the currency is likely to have seen its lows on non-USD crosses.
- Increased currency and rate volatility is potentially negative for commodity (AUD, NZD and CAD) and Asia EM currencies.

7

COMMODITIES
MOVING HIGHER

Following on the momentum of 2016, commodity prices are likely to move higher in 2017, as oversupply conditions are finally being balanced.

Citi analysts believe that the oversupply in the commodity sector which was induced by high prices in this century's first decade is finally being balanced. Cost structures have ended a period of record deflation and are starting to reflate. However risks to continued commodity positive performance include risks to global growth and uncertainties over US policy.

There are a few major commodities which Citi analysts are bearish on in 2017. Market forces for bulk commodities such as thermal and coking coal as well as iron ore remain inherently bearish. Soybean supply is likely to be boosted significantly by exceptional weather and crop conditions. Gold is also expected to be weighed down by a strong US dollar (USD) and higher interest rates.

OIL: PRICES TO TREND HIGHER THROUGH 2017

Non-OPEC countries also agreed to reduce output by 0.558 m b/d, short of the initial target of 0.6 m b/d but still the largest-ever contribution by Non-OPEC countries. On the back of this, Citi analysts expect oil prices to trend higher and a backdrop of elevated geopolitical tensions could lead Brent and WTI prices to average \$57/bbl and \$55/bbl respectively in 2017.

BRENT CRUDE OIL
COULD AVERAGE

US\$ 57

A BARREL IN 2017

WTI COULD AVERAGE

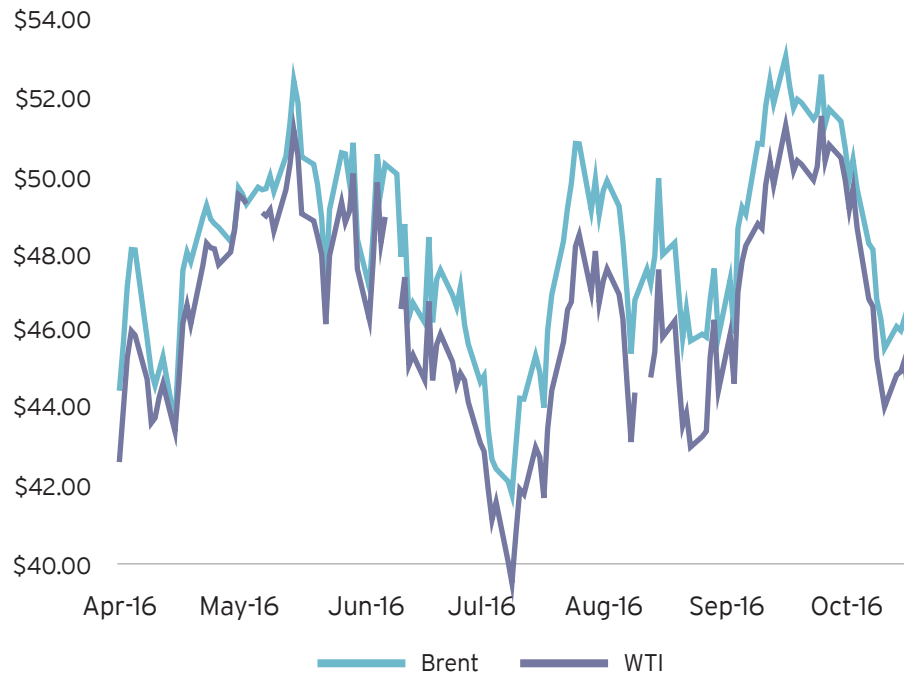
US\$ 55

A BARREL IN 2017

Even without the OPEC deal, oil supply growth is expected to temper as material declines are expected to continue in Colombia, China, Mexico and Venezuela. This should be offset in part by growing supplies in Brazil and Kazakhstan but ongoing oil demand growth of 1.1-m b/d is likely to leave the market in deficit. The evolution of US shale will remain important. Citi analysts expect US crude production to grow at 300-k b/d by 4Q17, with the risk that higher output could weigh on 2018 crude prices.

More aggressive strategic stockpiling by China would also be bullish for oil.

Benchmark crude oil prices (\$/bbl)



Source: Bloomberg, Citi Research. As of 11 November 2016.

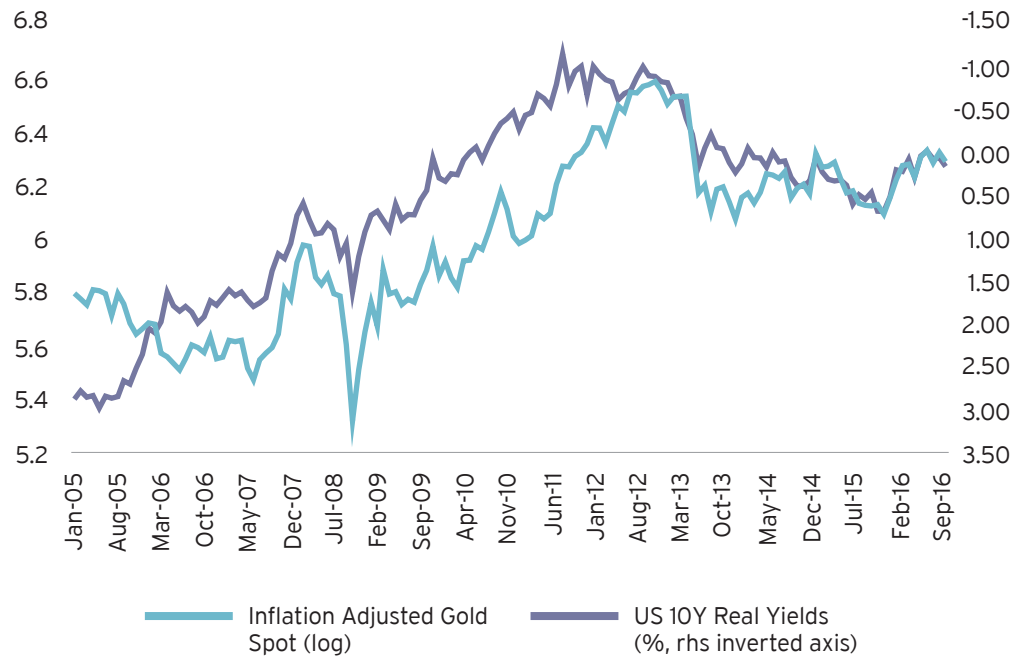
PRECIOUS METALS: GOLD REMAINS AN IMPORTANT PORTFOLIO DIVERSIFIER

Gold: With the US elections and the Fed’s December rate hike behind us, Citi analysts think investor focus may shift to Europe where elections in Germany and France could influence investor sentiment and flows for gold in 2017. With Citi expecting a stronger US dollar outlook in the year ahead amid higher US yields, gold may continue to weaken, especially if inflation remains muted. While fiscal and monetary policy clarity with the new US administration remains elusive, the transition has been far smoother than expected. Citi analysts expect the precious metal to average \$1,160/oz in 2017.

GOLD MAY AVERAGE
US\$1,160/oz
 IN 2017

While the upside for gold appears limited in Citi’s base case scenario, gold has maintained a significant negative correlation with traditional risk assets. As such, gold remains an important diversifier to help manage portfolio risk should market volatility rise.

Lognormal Real Gold Prices and Real US Yields



Source: Bloomberg, Citi Research. As of 11 November 2016.

BASE METALS: CONSTRUCTIVE ON COPPER

Citi analysts remain constructive on Copper over a 12 month horizon as new mine supply has reached capacity. Moreover, Chinese copper consumption has held up relatively well, defying bearish expectations, largely due to a resurgent housing market. The Japanese Government also announced a 6.3 trillion Yen Infrastructure investment plan in August, which has already prompted stronger copper demand. Citi's 2017 average price forecast for copper stands at \$5,575/t.

BULK COMMODITIES: IRON ORE RALLY RUNNING OUT OF STEAM

Citi analysts expect iron ore prices to find some support in the next 1-2 months, but should face strong headwinds thereafter through 2017. The rally in iron ore prices in 2016 had little to do with market fundamentals. Instead, prices rose as the Chinese government curtailed supply. Citi remains bearish and expect iron ore prices to average \$54/t for the full year of 2017.

AGRICULTURE; PRICES LIKELY TO STAY LOW

With another year of record US crop yields, a worldwide wheat glut and sizable US and global inventory overhang, staple grain prices are expected to stay low in 2017. Grain acreage cuts would be needed to tighten supply and lift prices. Citi also remains bearish cocoa as the market shifts from large old-crop deficit to potentially a surplus in 2016/17. In contrast, sugar prices could remain supported due to production declines. The same applies to coffee where supply is likely to be affected by El Nino.

Key Takeaways

- Citi analysts forecast Brent and WTI prices to average \$57/bbl and \$55/bbl respectively in 2017.
- While higher real interest rates and a stronger USD are likely to weigh on gold prices, it remains an important diversifier in investment portfolios.
- Copper prices are likely to find support from stable China demand and slowing mine supply while Citi analysts remain bearish on iron ore.



TECHNOLOGY

PREPARE TO BE DISRUPTED

Amid slow growth and narrowing margins in multiple industries, the fight for market dominance continues to intensify. Technological advances have contributed to this disruption and Citi believes that Technology companies that can take advantage of these trends are likely to be well positioned for the future.

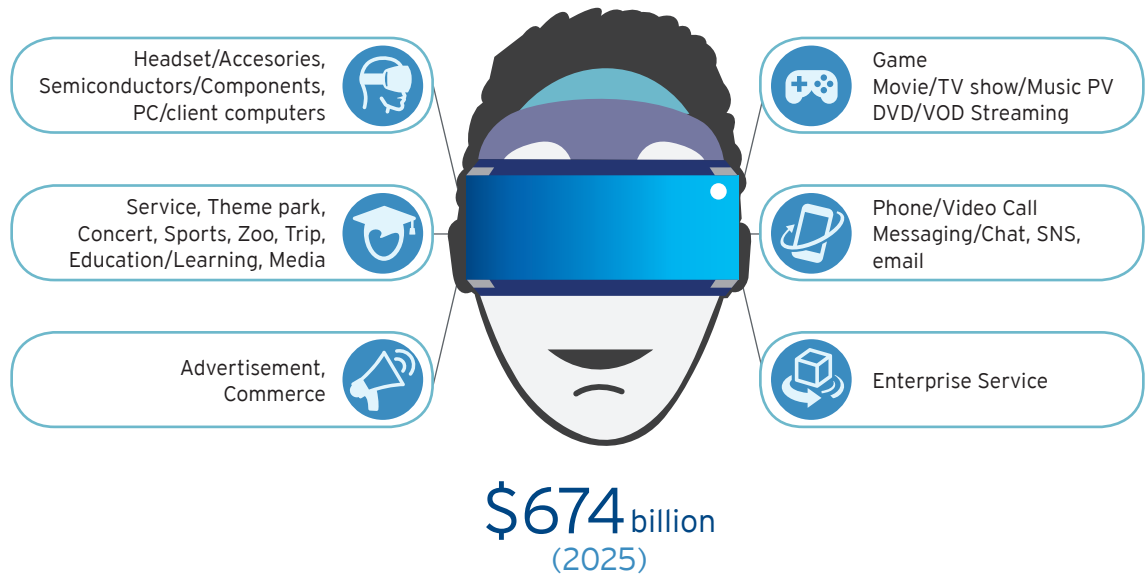
Citi analysts are overweight the technology sector, although investors will need to be selective. Citi analysts see opportunities in mobile payments, software security and cloud technology. While demand for wearables has been slow to pick up, virtual reality headsets and drones are gradually emerging as new kinds of gadgets. Smart phone producers are likely to continue to face strong competition and price pressures, thereby impacting selected component makers. However, companies that produce components for new smartphone functions are likely to outperform. Meanwhile, demand for personal computers is expected to continue to languish.

In this report, we highlight 2 emerging trends in the technology sector.

VIRTUAL AND AUGMENTED REALITY

While the concept of virtual reality (VR) was born as early as the 1960s, most consumers have yet to experience wearing a headset. Augmented reality (AR), which blends digital images with the real world, recently experienced greater success only after “Pokémon Go” became a viral phenomenon. Momentum appears to be picking up, with usage going beyond gaming. Newspapers are experimenting with different formats via immersive journalism. There is also the potential to leverage VR and AR as educational tools, letting users immerse themselves in different situations or embark on virtual tours. The VR and AR markets will grow rapidly across a range of applications including entertainment, vehicle navigation, lifestyle information and a variety of work situations. See Figure. These new spheres of technology are likely to have a major impact on the future of e-commerce and mobile commerce, whose value is estimated at \$3 trillion annually. This market looks set to ramp up for the next 10 years and Citi analysts estimate the potential size of the market at \$674 billion by 2025. While companies that develop hardware may benefit in the near term, software companies that develop VR and AR applications are likely to benefit more in the longer term.

VR/AR Market



IT SECURITY SPENDING MAY REACH

US\$101 billion

IN 2018 AND

US\$170 billion

IN 2020

CYBER SECURITY

Cyber security and data protection is a rapidly evolving material risk for companies.

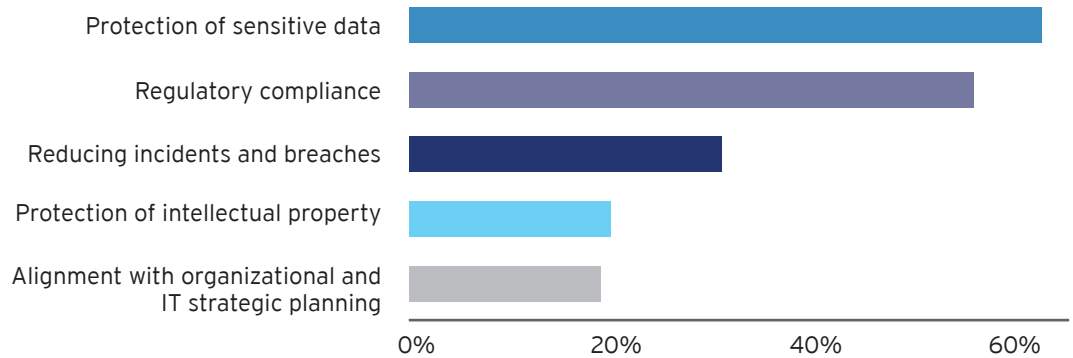
The term “cybersecurity” refers to the technical, physical, administrative, and organizational safeguards that a corporation implements to protect, among other things, “personal information”, trade secrets and other intellectual property, the network and associated assets, or as applicable, “critical infrastructure”.

Motivations for cyber-attack include theft, activism or sabotage. A key motivation for attacks to date includes theft of customer credit or debit card details.

The IT Security market is an area Citi analysts see growing above the overall IT and software market as the private and public sector continue to take measures to mitigate the risks associated with conducting business online. See Figure. As more and more value is shifted to online commerce and business interactions, security is likely to continue to grow along with the trend. The market is also highly competitive as technology is constantly changing to keep pace with the evolution of the threat online.

According to Gartner, worldwide spending on information security products and services will reach US\$81.6b in 2016, up 7.9% from 2015. IT security spending is expected to soar to US\$101 billion in 2018 and potentially reach US\$170 billion by 2020. Security testing, IT outsourcing, and data loss prevention (DLP) could present significant opportunities for growth through the end of 2020.

Key reasons why companies spend on information security



Source: Sans Institute. As of February 2016.

Key Takeaways

- Technology will continue to change the way business is conducted in multiple industries. Citi believes that Technology companies that can take advantage of these trends are likely to be well positioned for the future.
- Virtual & Augmented Reality markets are projected to grow rapidly across a range of applications, from entertainment, to vehicle navigation and lifestyle information. Companies exposed to VR / AR trends could benefit.
- Cyber security and data protection is a rapidly evolving material risk for companies. IT security spending is expected to soar to US\$101 billion in 2018 and potentially reach US\$170 billion by 2020. Security testing, IT outsourcing, and data loss prevention (DLP) could present significant opportunities for growth through the end of 2020.

ECONOMIC GROWTH & INFLATION FORECASTS

	GDP			Inflation		
	2016F	2017F	2018F	2016F	2017F	2018F
Global	2.5%	2.7%	3.1%	2.2%	2.8%	2.6%
US	1.5%	1.8%	2.5%	1.1%	1.8%	1.9%
Europe	1.6%	1.5%	1.6%	0.2%	1.5%	1.4%
Japan	0.8%	1.1%	1.1%	-0.3%	0.6%	0.9%
Latin America	-0.6%	1.6%	2.8%	10.4%	6.9%	5.7%
Emerging Europe	1.3%	2.3%	2.7%	5.4%	4.6%	4.4%
Asia	5.8%	5.8%	6.0%	2.2%	2.9%	2.9%
China	6.6%	6.5%	6.5%	2.0%	2.6%	2.5%
Hong Kong	1.5%	1.8%	2.2%	2.6%	2.0%	2.2%
India	7.2%	7.4%	7.9%	4.6%	4.9%	5.1%
Indonesia	5.0%	5.3%	5.3%	3.5%	4.3%	4.4%
Malaysia	4.2%	4.5%	4.7%	2.1%	2.8%	2.3%
Philippines	6.9%	6.8%	7.0%	1.7%	3.0%	3.3%
Singapore	1.1%	1.2%	1.2%	-0.4%	1.0%	1.9%
South Korea	2.7%	2.4%	2.6%	1.0%	1.8%	2.0%
Taiwan	1.2%	1.6%	2.0%	1.5%	1.6%	1.8%
Thailand	3.0%	3.3%	3.6%	0.2%	1.7%	2.7%

Source: Forecasts from Citi Research. As of 28 November 2016.

EXCHANGE RATE FORECASTS (VS. USD)

	1Q17	2Q17	3Q17	4Q17
Europe	1.02	0.99	0.99	1.00
Japan	113	114	115	114
UK	1.19	1.16	1.15	1.16
Australia	0.71	0.70	0.69	0.70
China	7.03	7.11	7.12	7.05
Hong Kong	7.77	7.78	7.78	7.78
India	67.8	68.1	68.4	68.7
Indonesia	13585	13660	13681	13641
Malaysia	4.43	4.47	4.47	4.43
Philippines	49.7	49.9	49.8	49.3
Singapore	1.44	1.45	1.46	1.45
South Korea	1200	1209	1203	1180
Taiwan	32.2	32.4	32.6	32.7
Thailand	35.9	36.0	35.9	35.5

Source: Forecasts from Citi Research. As of 28 November 2016.

INTEREST RATE FORECASTS

	Current	1Q17	2Q17	3Q17	4Q17
US	0.75%	0.75%	1.00%	1.00%	1.25%
Europe	0.00%	0.00%	0.00%	0.00%	0.00%
Japan	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%
Australia	1.50%	1.50%	1.50%	1.50%	1.50%
UK	0.25%	0.25%	0.25%	0.25%	0.25%

Source: Forecasts from Citi Research. As of 28 November 2016. Current rates as of 14 December 2016.

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