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Emerging Markets to Continue Outperforming

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The MSCI Emerging Market (EM) Index has gained 17% in the first half of 2017, with the index hitting a record high in local currency terms.

After a challenging period post the 2013 taper tantrum, EM equity funds are enjoying fund inflows again. Citi analysts continue to find Emerging Market (EM) equities attractive given attractive valuations and improving economic fundamentals.

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Market Performance

In the US, the [Dow Jones Industrial Average](#) advanced 2.54%, the [S&P 500](#) gained 1.93%, while the [Nasdaq Composite](#) jumped 3.38%. [European Stoxx 600](#) slipped 0.40%, for its second straight monthly loss while Japanese markets were mixed ([Nikkei 225](#): -0.54% and [Topix](#): 0.42%).

[MSCI Emerging Markets](#) outperformed in July, [soaring 5.48%](#), led by [MSCI Latin America \(8.17%\)](#), [MSCI Asia ex Japan \(4.90%\)](#) and [MSCI Emerging Europe \(3.46%\)](#). Within Asia, Hong Kong's [Hang Seng index](#) rallied 6.05% in July.

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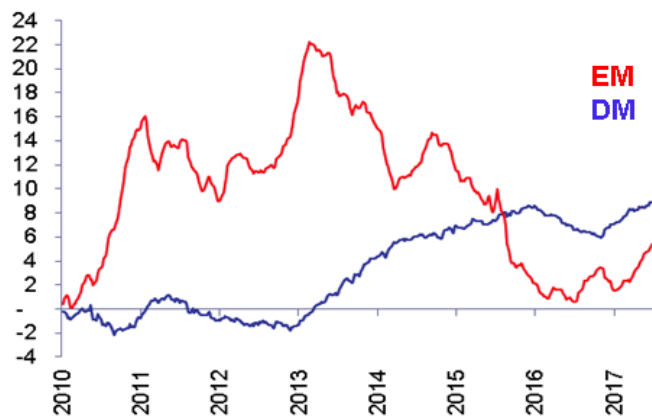
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Emerging Markets to Continue Outperforming (continued)

- Within EM, Asia has been the outperformer, helped by the improving growth backdrop in China. Europe and Africa (EMEA) has underperformed, weighed down by political uncertainty in Russia and lower oil prices.
- In terms of valuation, EM equities are still cheaper compared to Developed Market (DM) equities. EM equities are also currently trading below their average historical levels.

Cumulative Flows as a % of Assets Under Management



Source: Citi Research as of 20 July 2017.

“EM has attracted around \$160 billion in portfolio flows in the first half of the year.”

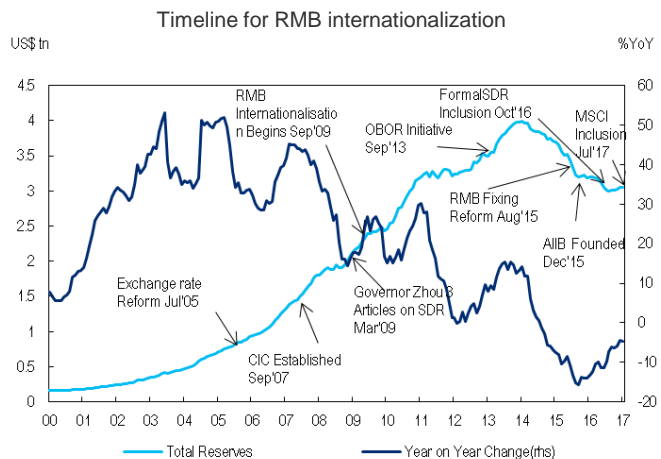
- Would the upcoming reduction of asset purchases by the Federal Reserve and European Central bank hurt EM equities? In 2006, policy tightening by the G4 policymakers and the People’s Bank of China (PBoC) caused EM equities to correct 25%, underperforming DM equities by 15%.
- Citi analysts note that back in 2006, EM equities had enjoyed sustained inflows and valuations were also much higher. On the other hand, **EM fundamentals, especially external account balances are healthier now.**
- Since late 2015, reforms have also helped to improve the underlying fundamentals in many developing countries.
- **Given attractive valuations and improving economic fundamentals, Citi analysts continue to favour EM equities, in particular EM Asia.**

China: Reshaping Global Capital Flows (Part 1 of 5)

After the setback for RMB internationalization in the last two years, China is now focusing on opening its domestic capital markets to greater foreign participation, with significant implications for investors.

- RMB internationalization officially began in September 2009 with the launch of a pilot scheme that allowed cross-border trade settlement using RMB. By 2011, settlement of trade in goods and services was fully liberalized between the Mainland and the rest of the world.
- Despite its rapid progress, China’s RMB internationalization was disrupted by sudden devaluation during the Aug 11th 2015 exchange rate reform. Foreign exchange reserves declined by US\$600bn in less than two years.
- Learning from this experience, the Chinese authorities have since shifted their strategy towards opening China’s financial markets to greater foreign participation while slowing capital account liberalization.

“Reform of China’s capital markets has the potential to reshape the allocation of global assets.”



Source: Citi Research as of 17 July 2017.

- Greater foreign participation can help develop China’s financial and capital markets, after which liberalization of the capital account will potentially follow. Citi analysts believe that this change in policy sequence can help China avoid the financial crises that have hurt other economies.
- Removal of restrictions to entry, together with eventual inclusion of China in various global capital market indexes, will raise foreign ownership of Chinese assets, likely creating further momentum for market broadening and deepening. Citi analysts estimate that China’s financial markets will become as large as those of the US by 2025.

NAFTA Talks May Influence Other Trade Deals

The renegotiation of the North American Free Trade Agreement (NAFTA) begins on August 17 and is expected to be successfully renegotiated by early 2018. The talks are significant and may act as a blueprint for other trade deals, with implications for global trade.

- **What is NAFTA?** NAFTA is a trilateral, free trade and economic integration agreement that was entered into force in 1994. By 2008, the agreement achieved its goal of essentially duty-free merchandise trade among US, Canada and Mexico.

“Citi analysts continue to expect NAFTA to be renegotiated in a trilateral format.”

Canada and Mexico among the top US partners

US International Trade Shares (Percent): 2016

	Exports		Imports	
	Goods, Services and Income	Goods Only	Goods, Services and Income	Goods Only
NAFTA	20.6	34.2	19.9	26.4
Canada	11.8	18.4	10.0	12.8
Mexico	8.7	15.8	9.9	13.6
Asia & Pacific	25.0	28.3	35.4	42.9
Japan, China, Hong Kong of Which: China	12.5	14.8	21.4	27.4
	5.9	8.0	14.4	21.0
Korea, Singapore, Taiwan	5.9	6.6	5.3	5.8
Other Asia	6.6	6.9	8.7	9.7
European Union	28.3	18.6	24.6	19.0
Euro Area	19.6	13.7	17.9	14.8
LATAM (Excluding Mexico)	14.8	9.3	9.6	4.8
Other	11.3	9.6	10.5	6.9

Source: Citi Research as of 30 June 2017.

- Citi analysts expects the agreement to be ratified by early 2019 following a “time out” called by all three parties after signing the agreement.
- The risks to our base case is that the Trump Administration may include more controversial items during the negotiations. There is also risk that a new Mexican President or new US Congress may take a different stance on NAFTA. The US Administration may also end up preferring a bilateral agreement to the current trilateral format.
- In Citi’s view, the NAFTA renegotiation is significant, both because it is the earliest major trade renegotiation for the new Administration and could serve as a template for other renegotiations. US trade policy is important for the outlook for global trade and the global economy. Growth in global trade appears to have peaked in March after a strong start this year.

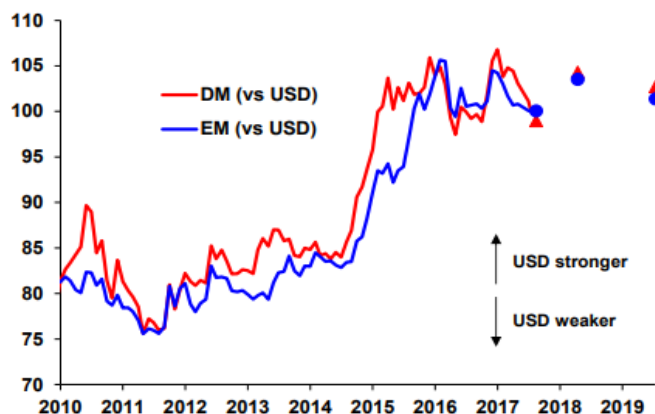
USD May Rebound Modestly in the Next 6 to 12 Months

Doubts over the US administration's ability to progress on its economic reforms has weighed on the USD. At the same time, the relative strength in the Euro Area economy has led the EUR to strengthen. These dynamics could change in the medium term.

- Citi analysts believe that eventual tax cuts may help the USD stage a modest recovery in the next 6-12 months. The EUR may face downward pressure if investor risk aversion rises as the Italian election approaches and the European Central Bank starts to reduce its asset purchases.
- The Yen is likely to weaken in the medium term as the Fed reduces its balance sheet while the Bank of Japan continues its asset purchase program. Potential tax cuts in the US in 2018 may also cause the USD to strengthen, exerting further pressure on the JPY.

“Eventual tax cuts may help the USD stage a modest recovery in the next 6-12 months”

DM & EM – Forecasts Path



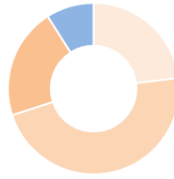
Source: Citi Research as of 17 July 2017.

- Citi analysts believe that there are risks that the GBP may weaken in the near to medium term as uncertainty persists in the Brexit negotiations.
- The AUD could benefit in the near term if volatility remains low. But as more developed market central banks become less accommodative, AUD may suffer eventually if investor risk appetite falls.
- Citi analysts expect Emerging Market currencies to continue outperforming in the near term as the higher yields offered by these currencies remain attractive in a low volatility environment. In China, the central bank is unlikely to tolerate a fast appreciation of the CNY. This is likely to keep the CNY between 6.7 and 6.9 in the second half of the year.

3Q17 Model Portfolios

Defensive

Seeking primarily capital preservation over time and only willing to accept very minor portfolio value fluctuations from month to month.



Cash	22%
Developed Govt Bonds	45%
Global IG Corp Bonds	21%
Global Equities	12%

Income Oriented

Seeking growth of wealth over time but unwilling to accept significant fluctuations in the value of portfolio from month to month.



Developed Govt Bonds	35%
Global IG Corp Bonds	26%
HY Bonds	6%
US Equities	9%
European Equities	6%
Global Equities	13%
Global REITs	5%

Growth And Income

Seeking long-term capital growth foremost but unwilling to accept significant losses on value of portfolio over the medium term.



Developed Govt Bonds	19%
Global IG Corp Bonds	19%
HY Bonds	5%
Emerging Market Debt	4%
US Equities	19%
European Equities	13%
Pacific Equities	8%
EM Equities	5%
Global REITs	8%

Growth Oriented

Seeking long-term capital appreciation and willing to tolerate measured medium-term volatility in order to enhance longer-term performance.



Developed Govt Bonds	6%
Global IG Corp Bonds	14%
HY Bonds	6%
Emerging Market Debt	6%
US Equities	24%
European Equities	16%
Pacific Equities	10%
EM Equities	8%
Global REITs	10%

Aggressive Growth

Seeking long-term capital appreciation and can accept potentially large losses on portfolio over the near-to-medium term in order to maximise long-term performance.



Global IG Corp Bonds	5%
HY Bonds	6%
Emerging Market Debt	6%
US Equities	29%
European Equities	22%
Pacific Equities	12%
EM Equities	10%
Global REITs	10%

World Market at a Glance

	Last price 31-Jul-17	52-Week High	52-Week Low	Historical Returns (%)			
				1 week	1 month	1 year	Year-to-date
US / Global							
Dow Jones Industrial Average	21891.12	21929.80	17883.56	1.76%	2.54%	18.77%	10.77%
S&P 500	2470.30	2484.04	2083.79	0.02%	1.93%	13.65%	10.34%
NASDAQ	6348.12	6460.84	5034.41	-0.98%	3.38%	22.97%	17.93%
Europe							
MSCI Europe	464.11	468.23	374.45	0.94%	2.97%	16.56%	16.01%
Stoxx Europe 600	377.85	396.55	327.02	-0.36%	-0.40%	10.52%	4.55%
FTSE100	7372.00	7598.99	6615.83	-0.08%	0.81%	9.63%	3.21%
CAC40	5093.77	5442.10	4293.34	-0.66%	-0.53%	14.73%	4.76%
DAX	12118.25	12951.54	10092.53	-0.74%	-1.68%	17.23%	5.55%
Japan							
NIKKEI225	19925.18	20318.11	15921.04	-0.25%	-0.54%	20.25%	4.24%
Topix	1618.61	1636.53	1262.86	-0.18%	0.42%	22.37%	6.58%
Emerging Markets							
MSCI Emerging Market	1066.23	1072.50	837.12	0.18%	5.48%	22.07%	23.65%
MSCI Latin America	2751.96	2765.68	2194.50	0.58%	8.17%	15.08%	17.57%
MSCI Emerging Europe	145.89	153.21	121.87	1.24%	3.46%	17.68%	-0.57%
Brazil Bovespa	65920.36	69487.58	55695.52	1.26%	4.80%	15.03%	9.45%
Russia RTS	1007.14	1196.99	898.05	-0.65%	0.62%	8.58%	-12.60%
Asia							
MSCI Asia ex-Japan	656.04	659.20	505.03	0.34%	4.90%	24.51%	27.55%
Australia S&P/ASX 200	5720.59	5956.52	5052.10	0.57%	-0.02%	2.84%	0.97%
China HSCEI (H-shares)	10827.84	11039.31	8971.47	0.06%	4.46%	20.86%	15.25%
China Shanghai Composite	3273.03	3301.21	2931.96	0.69%	2.52%	9.86%	5.46%
Hong Kong Hang Seng	27323.99	27541.42	21488.82	1.78%	6.05%	24.82%	24.20%
India Sensex30	32514.94	32672.66	25717.93	0.83%	5.15%	15.91%	22.12%
Indonesia JCI	5840.94	5910.24	5022.85	0.68%	0.19%	11.98%	10.27%
Malaysia KLCI	1760.03	1796.75	1614.11	-0.11%	-0.21%	6.46%	7.21%
Korea KOSPI	2402.71	2453.17	1931.07	-1.99%	0.46%	19.17%	18.57%
Philippines PSE	8018.05	8106.74	6499.00	0.70%	2.23%	0.69%	17.21%
Singapore STI	3329.52	3354.71	2760.97	0.57%	3.19%	16.06%	15.58%
Taiwan TAIEX	10427.33	10545.70	8879.69	-0.32%	0.31%	16.06%	12.69%
Thailand SET	1576.08	1600.79	1343.13	-0.04%	0.09%	3.41%	2.15%
Commodity							
Oil	50.17	55.24	39.19	8.26%	8.97%	20.60%	-6.61%
Gold spot	1269.44	1367.68	1121.03	1.12%	2.25%	-6.04%	10.17%

Source: Citi Research as of 31 July 2017.

Currency Forecasts

	Currency	Last price	Forecasts			
		31-Jul-17	Sep-17	Dec-17	Mar-18	Jun-18
G10-US Dollar						
Euro	EURUSD	1.18	1.15	1.12	1.09	1.09
Japanese yen	USDJPY	110	114	115	117	117
British Pound	GBPUSD	1.32	1.29	1.25	1.22	1.23
Swiss Franc	USDCHF	0.97	0.96	0.97	0.98	0.98
Australian Dollar	AUDUSD	0.80	0.77	0.76	0.75	0.75
New Zealand	NZDUSD	0.75	0.72	0.73	0.73	0.72
Canadian Dollar	USDCAD	1.25	1.26	1.28	1.30	1.30
EM Asia						
Chinese Renminbi	USDCNY	6.73	6.92	6.96	6.99	6.95
Hong Kong	USDHKD	7.81	7.82	7.83	7.83	7.82
Indonesian Rupiah	USDIR	13,325	13,319	13,357	13,394	13,417
Indian Rupee	USDINR	64.2	64.3	64.9	65.4	65.7
Korean Won	USDKRW	1,119	1,152	1,165	1,178	1,166
Malaysian Ringgit	USDMYR	4.28	4.06	4.08	4.10	4.05
Philippine Peso	USDPHP	50.4	50.6	50.8	51.1	51.0
Singapore Dollar	USDSGD	1.36	1.35	1.35	1.35	1.35
Thai Baht	USDTHB	33.3	33.7	33.9	34.2	34.3
Taiwan Dollar	USDTWD	30.2	30.4	30.7	31.0	31.2
EM Europe						
Czech Koruna	USDCZK	22.03	22.59	22.96	23.33	23.28
Hungarian Forint	USDHUF	257	271	278	285	287
Polish Zloty	USDPLN	3.59	3.69	3.74	3.80	3.79
Israeli Shekel	USDILS	3.56	3.54	3.55	3.56	3.55
Russian Ruble	USDRUB	59.8	58.3	61.4	64.3	64.2
Turkish Lira	USDTRY	3.52	3.67	3.71	3.74	3.81
South African Rand	USDZAR	13.19	13.10	13.29	13.47	13.58
EM Latam						
Brazilian Real	USDBRL	3.13	3.23	3.29	3.34	3.36
Chilean Peso	USDCLP	651	658	664	669	670
Mexican Peso	USDMXN	17.8	17.9	18.3	18.6	18.5
Colombian Peso	USDCOP	2984	3019	3057	3094	3066

Source: Citi Research as of 31 July 2017.

EMEA Model Portfolio

This section shows the revisions to asset allocations decided by Citibank EMEA Model Portfolio Committee on 29 June 2017.

Citibank's EMEA Model Portfolios provide a guide to possible diversification of investment portfolios and serve as an asset allocation reference tool both for periodic evaluation and prospective investments. Citibank Model Portfolios are developed by Citibank's in-house Global and Regional investment specialists to cater to investors with various risk profiles (based on Citibank's risk assessment) and provide them with:

- Diversified asset allocations, made uniquely relevant for EMEA investors
- Up-to-date asset allocations which are reviewed and revised periodically by Citibank's Research teams to reflect changing market conditions in respect of relevant asset classes
- Access to our best-in-class research from the Global Investment Committee

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