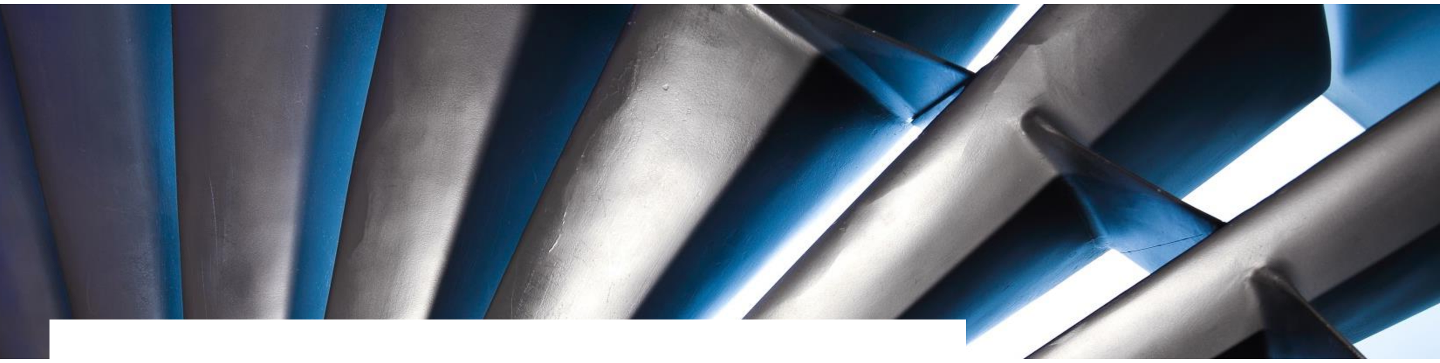

9 FEBRUARY 2018

How Deep can this Correction Go?

US stocks fell 3.8% on Thursday amid a continuation of recent volatile market moves. The S&P 500 is now down 10% from its January high.

How deep can this correction go?

- Citi analysts looked at past corrections in the current bull market cycle. They note that peak to trough corrections (corrections after the S&P500 reached a new high) only exceed 10% during growth shocks. Specifically, those growth shocks were associated with the Greek crisis in 2010, the broader Eurozone crisis and US growth scare in 2011 and China worries/global growth recession in 2016.

- In the current market correction, the 10-year US Treasury yield is at its 4-year highs and metal prices have not declined sharply. This suggests that the recent correction is driven by inflation fears, rather than growth concerns.

- Citi's Bear Market Checklist comprises of 18 factors that have provided warning signs for investors before sustained market sell-offs. Currently only 3.5 factors are flashing sell compared to 17.5 in 2000 and 13 in 2007, which had marked the start of the equity bear markets in those years. According to the Checklist, it is still too early to call the end of this equity bull market.

- While healthy growth and earnings fundamentals may limit the market's decline over the medium term, fragile investor sentiment can drive market volatility higher in the near term.

- While the VIX, the market's fear gauge, is now at 33, down from its recent peak of 50, it is still 65% above its 10-year average. The spikes in the implied volatility for bonds and other asset classes have been more muted. This appears to be in line with the view that a number of complex exchange-traded notes and algorithmic trading strategies have been responsible for the recent outsized moves in the VIX. This week's liquidation of several Exchange Traded Products (ETP) which had bet on a continuation of low market volatility, is likely to raise questions about other potential risks from financial innovation. The risks to financial stability from ETPs that employ leverage and invest in underlying markets that have low liquidity may be the source for additional market volatility in the weeks ahead, especially given the reduced liquidity during next week's Lunar New Year holidays.

What does this mean for investors?

- Ride through the volatility. Trying to time the market is often a futile process. Citi analysts' research shows that if you had missed the ten best days in the market in the last five years*, the returns from being invested in global equities falls by 25%. Staying diversified across regions and asset classes can help investors mitigate potential risks ahead.

- If we are shifting into a higher growth and higher inflation environment, equities and commodities, in particular industrial metals, have historically outperformed bonds during these periods.

*MSCI World from July 2012 to July 2017

- Investors can consider taking advantage of market corrections to gradually gain exposure to selective equity markets. Markets with attractive valuations such as Europe and Emerging Markets, which are trading at a 20% and 34% discount respectively to the US market, may be better supported over the medium term. Macro trading strategies are also likely to be able to add value to investment portfolios as we move away from a low volatility world.

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