INVESTMENT OUTLOOK

FEBRUARY 2018

MACRO-ECONOMICS

Developed and Emerging Markets

Last year, the world economy enjoyed a synchronized growth and the strength of this widespread upswing has taken many market observers by surprise. More specifically however, it appears that the U.S. economic cycle shows signs of maturing and is closing in the fastest on its peak but so far does not show signs of nearing its turning point yet. Monetary conditions have remained accommodative and expectations are that it will remain so during 2018 as inflation is only picking up from a low level. The momentum leading into 2018 was solid, and it should persist throughout the year, assuming that it will be driven by continued gains in capital expenditures, and moderate progress in consumption and housing. Capitalizing on this underlying optimism, financial markets have started the year more or less the way they have ended it, namely with further impressive gains in most risk asset markets. For most of January, rising prices were the flavor of the day but as the selloff in government bonds deepened and yields were taken higher to levels last seen since 2014, profit taking in equities set in after one of the best starts to a year in recent history. Short-term price-return oriented market participants felt more secure being absent during the last hectic week of economic data releases, President's Trump State of the Union address and Janet Yellen's last Federal Reserve policy decision meeting.

Currencies

The Yen climbed as traders unwound short positions in the wake of the Bank of Japan paring back purchases of long-dated bonds. Meanwhile the U.S. Dollar resumed its decline, forcing central bankers to issue warnings about the cost of local currency appreciation on their domestic economies. The Euro, which was one of the major currencies showing persistent strength against the Greenback, weakened only for a short period of time after ECB vice-president, Vítor Constâncio, joined the queue of central bank policy makers to question the sharp rise of the Euro and its deviation from fundamentals.

Energy and other commodities

WTI oil extended its gains to close highest in more than three years, supported by U.S. industry data signaling a drop in crude stockpiles, OPEC supply cut extensions, geopolitical tensions and a weaker U.S. Dollar.

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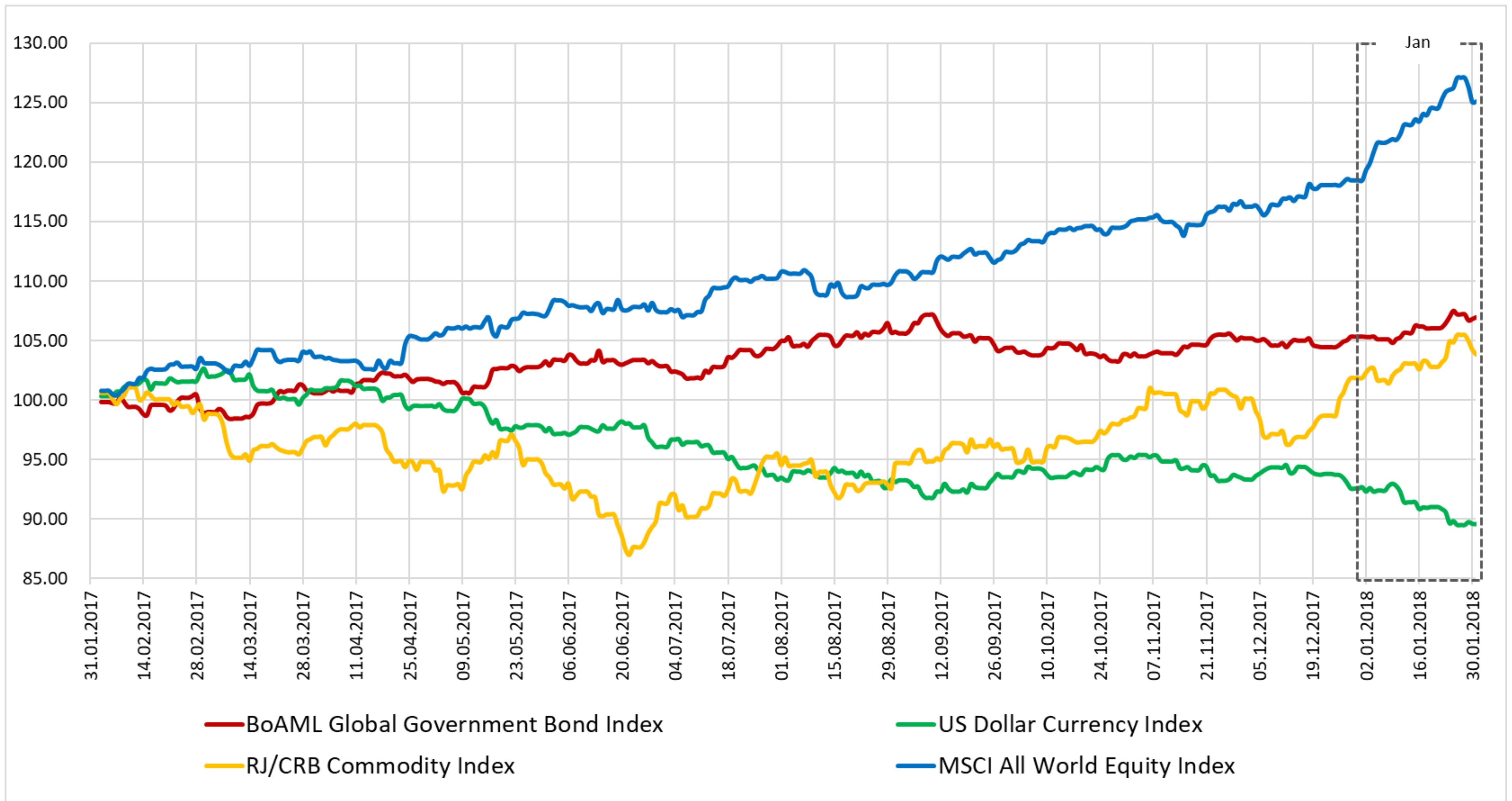
MACRO-ECONOMICS AND CURRENCIES

Illustration (Section "Macro-Economics and Currencies"):

Commodities vs. Equities, Government Bonds and US Dollar



Source:	Bloomberg Finance L.P.	
Graph:	Quantum Global Investment Management (1-year rolling, daily, indexed)	
Indices:	Commodities:	RJ/CRB Commodity Index Total Return Price Index. The base currency is USD.
	Equities:	MSCI All Country World Index includes both developed and emerging world markets. The base currency is USD.
	Govt. Bonds:	The Bank of America Merrill Lynch Global Government Index tracks the performance of investment grade sovereign debt in local currency. The base currency is USD.
	USD:	U.S. Dollar Index indicates the general international value of the USD by averaging the exchange rates between the USD and major world currencies.

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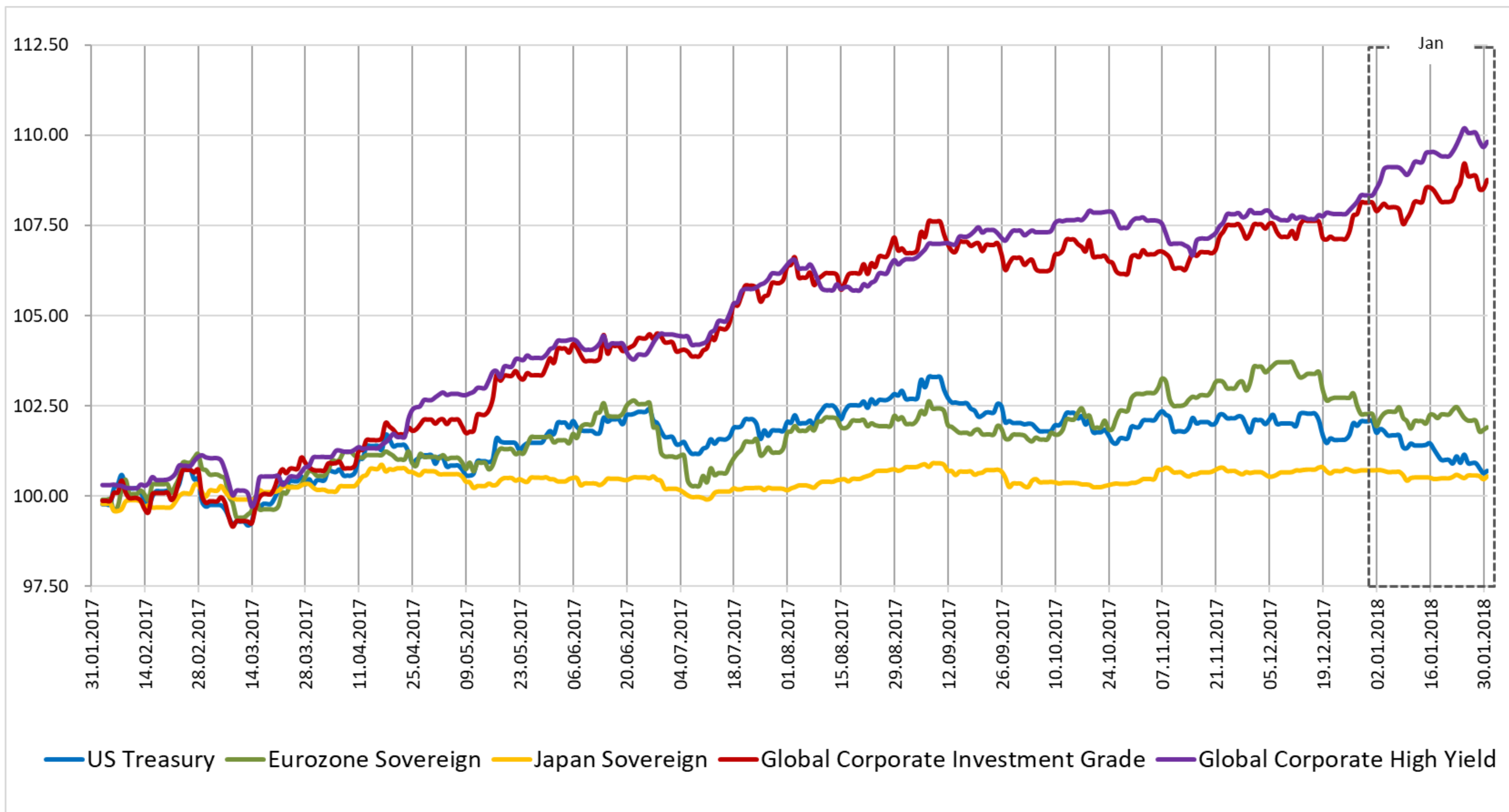
FIXED INCOME

Global Bond Markets

Global Sovereign yields have risen during January, initially prompted by rumours of the Chinese Treasury slowing purchases, but ultimately propelled by the sentiment of improving global activity and growth. Economic data continues to firm and as such, this ongoing cyclical upswing has provided an ideal landscape, to consider tighter monetary reforms. The US Treasury yield curve was much in focus as 2y-30y maturity points experienced an intra-month upwards shift of approximately 20bps each. Such a move is a clear signal that market participants are now understanding that the Federal Reserve may follow through on at least the three suggested rate increases for 2018. Core European Governement bond yields also trended higher. The European Central Bank maintain an official stance on monetary policy in that rates should remain low for longer, and there will be no immediate announcements of tapering the asset purchase program. Investors clearly question this as the Union continues to deliver ever improving economic measures. Italy and Spain were the outliers, due to there being less apparent fallout expected, from the upcoming Italian elections. Inflation remains a troublesome topic for the Bank of Japan, who have maintained negative policy rates for some time now and continue to manipulate the domestic bond curve and support equities. Japanese yields were allowed to rise but this move was muted in comparison to its peers in the West.

Highly accomodative conditions and generally improving credit metrics support the Credit universe. As safe haven assets sell-off, investors look to build up risk and participate in the great credit spread compression. Credit spreads are currently trending below their long-term averages and have returned to pre-2008 levels. Investors seek greater potential returns by decresing the credit quality of their portfolios and thus have larger alloactions to High Yield and Emerging Market debt. Spread compression from the lower rated bond universe has helped mitigate losses during January, as High Yield and Emerging Markets posted outright positive returns, unlike Investment Grade alternatives.

Government Bonds vs. Corporate Investment Grade and Corporate High Yield



Source:	Bloomberg Finance L.P.	
Graph:	Quantum Global Investment Management (1-year rolling, daily, indexed)	
Indices:	US Treasury:	The US Treasury Bond Index includes fixed rate coupon U.S. Treasuries with maturities greater than 12 months. The base currency is USD
	Eurozone Sovereign:	The Eurozone Sovereign Bond Index includes fixed-rate local currency securities issued by Eurozone countries. The base currency is EUR
	Japan Sovereign:	The Japan Sovereign Bond Index includes fixed-rate JPY securities issued by Japan. The base currency is JPY.
	IG Corp:	The Global Investment Grade Corporate Bond Index includes investment grade, fixed rate securities issued in major domestic and Euro-bond markets. The base currency is USD
	HY Corp:	The Global High Yield Corporate Bond Index includes non-investment grade, fixed-rate, taxable securities issued by global corporates. The base currency is USD.

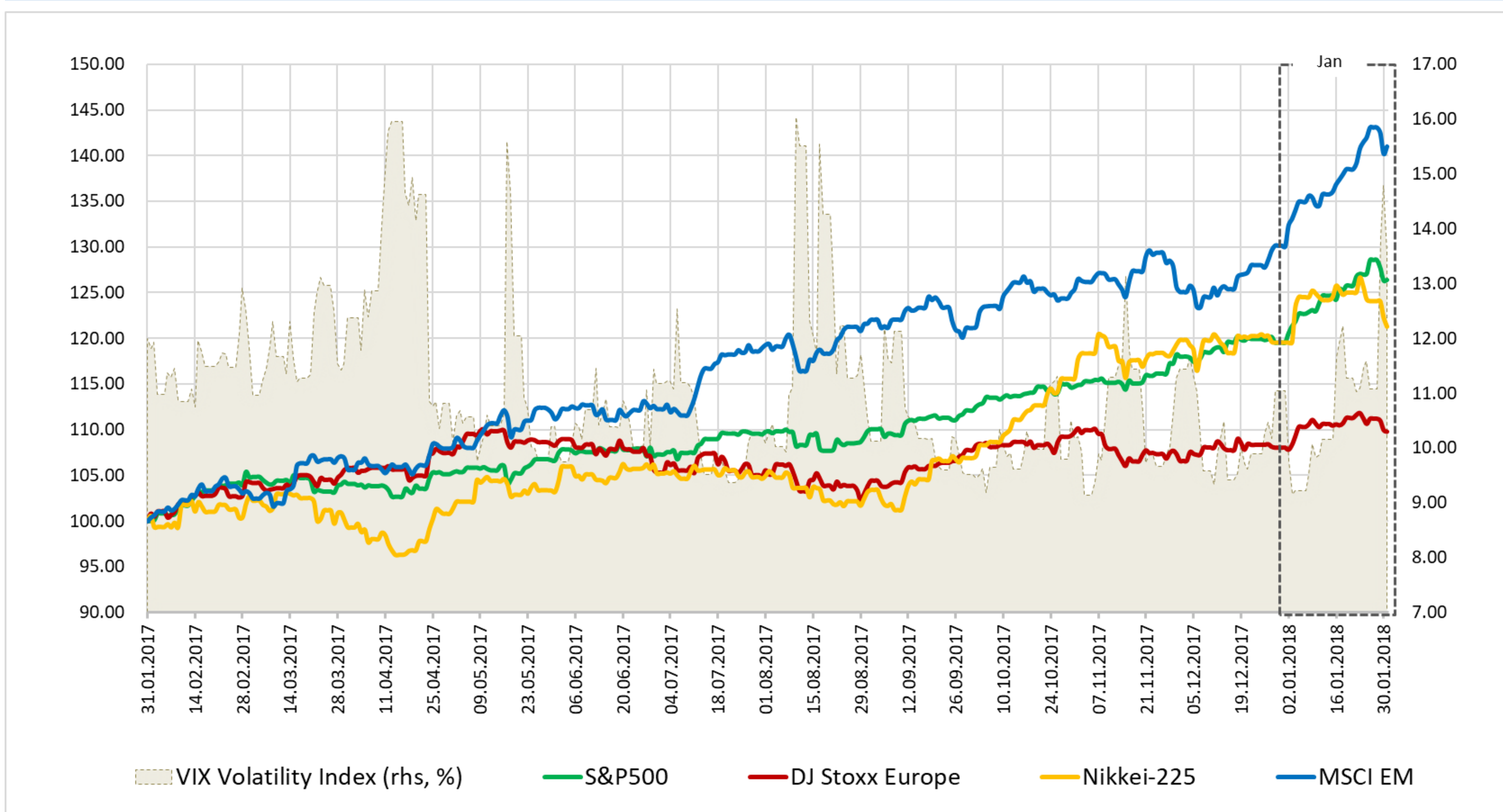
EQUITIES

Global Equity Markets

Global stock markets continued the strong rally that had started in the aftermath of the Presidential election in November 2016. In fact, following the U.S. tax bill passage late last year, the markets accelerated their rise well into the new year as investors were discounting positive earnings trends, sustaining the momentum from late-2017. Led by the U.S. and the boost from new tax cuts, global corporate earnings expectations have climbed significantly, and have further boosted equity market sentiment. The rise in earnings and economic expectations has driven stock prices to one of the best starts to a year in recent history. Towards the end of the month, as a selloff in government bonds deepened, investors retreated from risk assets and took profits.

Overall, January proved to be an exceptional month for equities as accelerating prices drove some indices to new record highs. Regionally, advanced Asian and Emerging Market stocks were amongst the leading performers, closely followed by the broad-based U.S. indices. Local returns in European and Japanese equities, albeit firmly positive, could not match the other regions' performances. The sector laggards of late such as Consumer Discretionary and Health Care delivered an above benchmark reading. Much expected outperformances were generated in Information Technology and Financial sectors, driven by earnings growth and large cash balances which are expected to be re-distributed to stakeholders via increased dividend payout and/or share buybacks. Materials and Energy stocks profited from Chinese demand for industrial metals and oil. Once more, defensive sectors such as Consumer Staples, Telecoms and Utilities were not sought-after and delivered a subpar return.

MAJOR EQUITY INDICES & VOLATILITY



Source: Bloomberg Finance L.P.
Graph: Quantum Global Investment Management (1-year rolling, daily, indexed)
Indices:
S6P 500: The Standard & Poor's 500 Index includes 500 U.S stocks representing all major industries. The base currency is USD
Stoxx Europe: The STOXX Europe 600 Index includes 600 stocks across 18 countries of the European region. The bas currency is EUR.
Nikkei-225: The Nikkei-225 Index includes 225 top-rated Japanese companies. The base currency is JPY.
MSCI EM: The MSCI Daily Total Return Net Emerging Market index captures the large and mid cap representation with 832 stocks across 23 Emerging Markets countries. The base currency is USD
VIX Index: The Chicago Board Options Exchange Volatility Index reflects a market estimate of future volatility and includes an average of the implied volatilities for a wide range of option strikes. The base currency is USD.

OUTLOOK

Market Implication

The world economy is forecasted to grow at an average rate of 3.7% this year, topping the already stronger-than-expected rise in 2017. The underlying story being, that Asian and Emerging Market economies (especially India and China) will once more drive global growth with a forecasted 4.9% rise in 2018 as commodity exporters such as Brazil and Russia continue to recover. We believe, that cyclical growth risks remain benign as the current expansion has been long in duration but not large in terms of magnitude. Inflation data starts to show indications of being at a turning point and stagflation concerns might arise if rising inflation coincides with weaker manufacturing index readings.

Asset Allocation

This year is not likely to duplicate the stellar returns of 2017, and bond markets are particularly vulnerable as monetary conditions gradually become less supportive. Equity, bond and currency market volatility will rise in response to a gradual unwinding of monetary accommodation and rising global interest rates. We expect returns on a balanced portfolio will be much more moderate this year and volatility is likely to rise.

Fixed Income:

Central Banks should be poised to tighten monetary policy in 2018, with the US Federal Reserve leading the way. Three Federal Funds Rate increases have been suggested with rumors of a fourth, should the US economy surprise to the upside. Many expect the European Central Bank to curb purchases further and reduce stimulus, in-line with the area's rapid economic recovery. Government bond yields will continue to rise in response to solid growth and higher inflation expectations. The risk to this is stalling and subdued inflation measures. We have witnessed higher short-term yields in the US and a less dramatic move in the longer-dates, thus creating a flattened curve. We expect this trend to continue. We maintain a bias to short-duration and continue to overweight credit risk from the Developed and Emerging economies. Lower-rated credit spread contribution should compensate for some losses experienced from higher benchmark yields.

Equities:

This will be a more challenging year but earnings should carry equities higher in 2018. The risk of a pullback is real as the accelerated price rise trajectory in January is not sustainable. However, a correction in equities would (subject to an unchanged fundamental picture) present a buying opportunity for all investors who missed last years' rally and are still waiting to deploy their cash balances. Regionally, we stay overweight in Europe, Developed Asia and Emerging Markets and selected sectors in the U.S. but stress that individual corporate fundamentals such as sound, unlevered balance sheets, strong cash flow generation ability and sustainable profit margins remain at the core of our equity selection investment process.

Currencies:

An accelerating U.S. economy and rising interest rate differentials should theoretically point to a firmer U.S. Dollar. However, forex investment volumes are still driven towards other major currencies such as the Yen and Euro and it is unlikely that the U.S. Dollar will escape the probability of another leg down.

Commodities:

The strong rise in commodity prices, especially oil and industrial metals, carries a short-risk of disappointment if expectations of a slowdown in China are met. The longer-term upside potential for oil is geared towards further supply restrictions resulting from lower upstream investments.

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