The Inflation Conundrum

بنك الامارات للاستثمار
EMIRATES INVESTMENT BANK

Asset Class	View	Current Allocation*	Benchmark Allocation*
Equities	Cautious	30.0%	40.0%
Fixed Income	Neutral	40.0%	40.0%
Real Estate	Neutral	5.0%	5.0%
Commodities	Neutral	2.5%	5.0%
Low Vol / Alternatives	Overweight	15.0%	5.0%
Cash	Favour	7.5%	5.0%

Overweight, Favour, Neutral,
Cautious, Underweight

* Allocations are based on a Moderate Risk Profile

About Emirates Investment Bank

EIBank is an independent private bank based in Dubai. It offers a wide-range of investment and banking services to an exclusive, but diverse, client base of high-net-worth individuals from across the region and around the world.

Emirates Investment Bank seeks to build long-term partnerships based on a foundation of trust, stability and integrity, which allows it to appreciate the unique circumstances and objectives of each of its clients. This personalised approach guides the Bank when providing its clients with bespoke banking solutions in connection with their wealth, business, and every day affairs.

2018 OUTLOOK

- A balance of optimism and apprehension prevails across all major asset classes. The US is currently enjoying robust growth as its economy enters into later stages of its business cycle, while Europe outperformed consensus expectations in 2017 as political risks abated there. Asset valuations are already pricing in the sound economic backdrop in our view and we currently do not see a market dislocation between asset prices and global economics.
- Inflation has continued to mysteriously undershoot consensus expectations. A potentially lower price environment for the secular horizon may give less impetus for central banks to raise rates than their stated intentions. Should this materialize, then the bull-run in risk assets, which some are starting to question due to its record-length, actually has more legs going into 2018.
- Although global asset prices have benefitted from a loose monetary backdrop, markets are ultimately underpinned by sound economic forces which are already reasserting themselves. In 2018, we expect monetary policy to start making way for a market more driven by fundamentals and aided by more generous fiscal policies.

MONTH IN BRIEF

DEC 2017

- 2017 ended on a positive note as we saw a synchronized global upswing in economic activity across the US, Europe, Japan and Emerging Markets (EM). Record low levels of unemployment, rising corporate profits and still broadly accommodative monetary policy underpin the sanguine outlook for developed economies. Robust domestic demand from developed economies and receding worries over a Chinese "hard landing" created a positive ripple effect on EM.
- After weeks of deliberation, Trump finally signed the USD1.5 trillion tax-overhaul bill, delivering a major tax cut to US businesses and individuals. Meanwhile, in Europe the Flash Eurozone Manufacturing PMI reached 60.6 in December, an all-time high, as other leading indicators are also pointing to sustained positive momentum in 2018.

THE 2018 OUTLOOK

EXECUTIVE SUMMARY :

As we look into the horizon of 2018 and determine the forces driving the global economy today, an overriding phenomenon continues to manifest itself at the forefront. Inflation has continued to undershoot consensus expectations. At the surface, lower than expected inflation helps us better understand how central banks will react and whether asset prices have more room to run from a rate path perspective. Upon deeper analysis though, the market is presenting us with other clues that are allowing us to form a more wholesome picture of the global economy. By looking at these clues in unison, we begin to understand why inflationary forces have been benign and why they can remain benign for the secular horizon.

Lower than expected inflation from 2014 – 2016 was mainly attributed to spare commodity capacity, falling energy prices, high or underemployment, and fragile consumer and business confidence, which led to weak global aggregate demand. However, these same factors have not held true in 2017 yet we still see inflation undershooting expectations. Energy prices have rebounded, many developed countries are boasting record-low unemployment rates, while the year ended with consumer and business confidence on a high note. In the latter part of last year, Janet Yellen acknowledged this, saying that sub-par inflation in 2017 has been "more of a mystery" compared to prior years. While the Fed's current working hypothesis is that inflationary pressures are building and that many of the factors keeping prices low are temporary, we cannot disregard the fact that something else is brewing beneath the surface.

We believe that technology's role in keeping inflation low has not garnered enough attention by market pundits. Technological advances have led to significant efficiency gains across multiple sectors, resulting in market disruptions, lower barriers to entry, higher competition, ultimately leading to lower prices. Much of this has been widely discussed such as the 'Amazon effect' on the brick-and-mortar, retail sector. However, less attention is being given to knock-on effects that such disruptions are having on other sectors of the economy through the changes in consumer behaviour that they are causing.

For example, it has been widely documented that Americans are driving less as the percentage of people with driving licenses has steadily declined since 2011, where the decrease has been especially pronounced for Millenials. While there are various theories behind this decline, a lead explanation attributes the decrease to a shifting attitude towards more efficient, alternative forms of transportation that allow young professionals to work on their smartphones or laptops during their commute to the office. Better computing technology, increased wifi coverage, and mobile applications that improve public transportation timing reliability have caused some demand destruction for the automobile industry. While auto manufacturers have been adversely affected, less driving would also cause less wear and tear on your car, lower demand for gas and cause less impulse purchases at the convenience store at the gas station, where items are sold at higher margins than the local supermarket.

The same can be said for social media platforms. Much attention has been given to their role in disrupting the traditional advertising industry, reallocating some marketing revenues from agencies, newspapers, and television providers. The switch to online advertising and the associated reduction in demand for physical, print media and billboards has resulted in a lower demand for such raw materials than would otherwise have been the case. In other words, online advertising is much more efficient, not only from a profiling perspective, but also from a direct cost perspective. We need to be consciously aware of the direct but more importantly the indirect effects that technology is having on our world today.

Recognizing that the largest seven corporations in the world today in terms of market capitalization are all technology companies, including the likes of Apple, Google, Amazon, Facebook, and Ali Baba, is significant in and of itself. Together, the technology companies account for a market capitalization of USD4.5 trillion at today's valuations and account for approximately USD200 billion in free-cash-flow (FCF) per year. The next seven largest companies in the world include the likes of Johnson & Johnson, JP Morgan, Exxon Mobile, Bank of America and Walmart. Together, these more traditional companies account for approximately USD2.3 trillion in market cap and approximately USD150 billion in free-cash-flow (FCF). Through this vantage point and by looking at these simple figures, we realize that technology companies are playing an even more dominating role in our world today than most market observers seem to comprehend.

So where do we stand today. We know that inflation has been lower than expected and that the traditional forces driving inflationary pressures seem to be less significant than they have been in the past. We also know that technology lowers barriers to entry and creates a more competitive playing field across many traditional industries, allowing for a lower price environment. Lastly, we know that technology companies are playing a materially larger role in our world today, even more-so than most people realize. By looking at these three factors in unison, we realise that they can potentially create a lower price environment for the secular horizon, which may give less impetus for central banks to raise rates than their stated intentions. Should this materialize, then the bull-run in risk assets, which some are starting to question due to its record-length, actually has more legs going into 2018. Two rate hikes in each of 2018 and 2019 may likely be the case, raising the Fed Funds Rate to only 2.5% and propelling the equity and fixed-income markets to even higher levels.

THE 2018 OUTLOOK

We need to be equally aware that a secular, lower price environment can have severe repercussions on the global economy from a risk perspective. With the exception of Japan, major central banks are normalizing ultra-accommodative policies with the expectation that inflationary pressures eventually reach their stated objectives. Should a higher rate environment in 2018/2019 dampen inflation expectations, then central banks may have more difficulty exiting QE programs and reducing the size of their bloated balance sheets. Overall, central banks have less tools at their disposal today when compared to the aftermath of the Global Financial Crisis (GFC) and the effectiveness of these tools can be reaching maturation.

In light of all of the above, we will position our investment portfolios with the intention of continued participation in market uptrends but will simultaneously maintain a defensive stance in order to mitigate downside risks and potential market drawdowns.

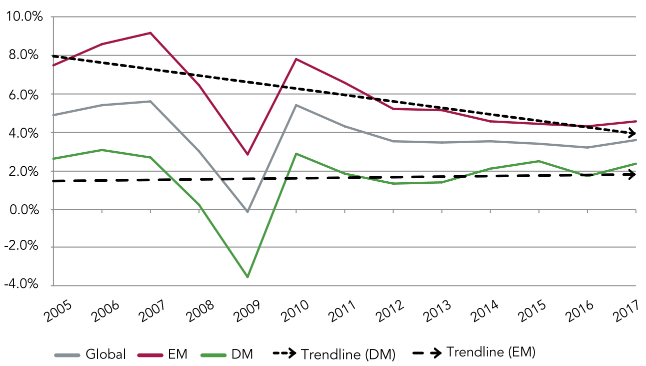
2018 THEMES:

I. Synchronized global economic growth

In contrast to the start of last year, where investors where trepid about the sustenance of the global economy's strength, 2017 ended on a positive note as we saw a synchronized global upswing in economic activity across the US, Europe, Japan and Emerging Markets (EM). Despite repeated protectionist rhetoric from Trump alongside geopolitical tensions, the acceleration in global manufacturing PMIs to multi-year highs reflects optimism that the global economy has really picked up pace and whose growth is becoming more evenly distributed. In its October World Economic Outlook, the IMF increased its 2018 global growth projection to 3.7%, from 3.6% previously, with upward revisions to the Eurozone, Japan, Russia and China, citing a broad-based recovery and a strong pickup in both business and consumer confidence.

While policy missteps always remain a factor, political risk across Europe and the US has dissipated, with underlying economic fundamentals largely overshadowing the political noise. Record low levels of unemployment, rising corporate profits and still broadly accommodative monetary policy underpin the sanguine outlook for developed economies. Robust domestic demand from developed economies and receding worries over a Chinese "hard landing" created a positive ripple effect on EM, primarily from the commodity front. 2018 should see a moderate continuation of this coordinated pickup as central banks tread cautiously on their path to monetary policy normalization as inflation continues to undershoot official targets. In the US, the recently passed tax bill and prospects of future deregulation should provide a continued boost to growth in 2019, while the Eurozone is expected to sustain its growth momentum with a much lighter political agenda this year.

DM - EM growth convergence

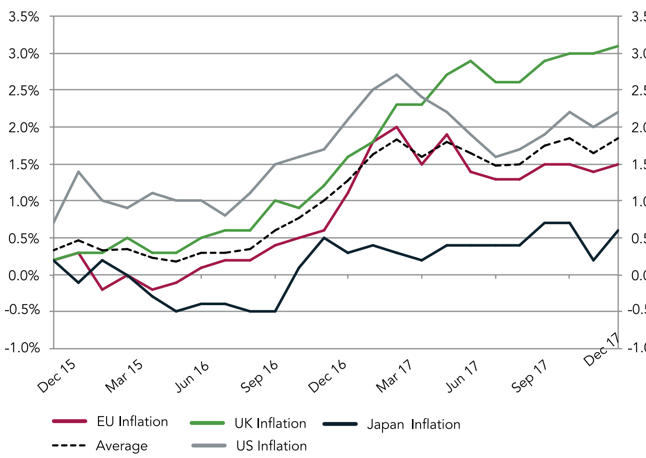


Source: Bloomberg, EIBank

II. A new normal for inflation

Historically low unemployment rates in the US, Germany and Japan, rising energy prices, and a slightly weaker USD have translated into slightly higher prices across the globe throughout 2017. However, markets continue to underprice the Fed's stated intention of three 25bps hikes in 2018, as the market implied probability currently stands at two rate hikes for this year. The markets also appear calm about the ECB's taper trajectory and are currently pricing in expectations from the BoJ to continue its ultra-loose monetary policy indefinitely. The spread between rates on 2-year and 10-year Treasuries ended 2017 below 52bps and the gap between 5-year and 30-year yields narrowed to 53bps. The persistent flattening of the US yield curve comes as expectations

Average headline inflation below 2%



Source: Bloomberg, EIBank

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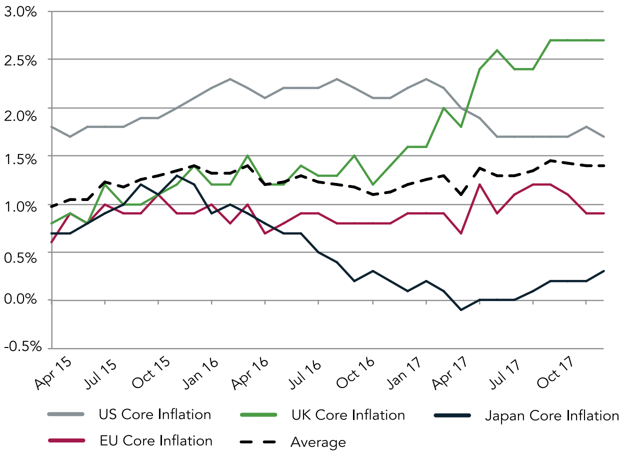
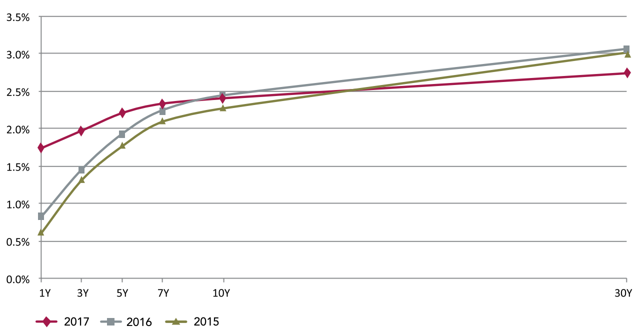
Core inflation remains benign



Source: Bloomberg, EIBank

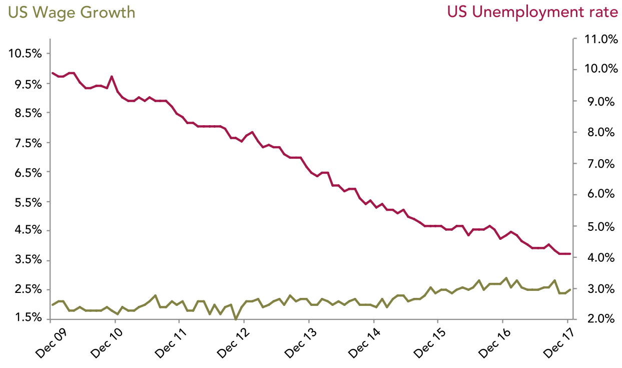
for the Fed's tightening have buoyed shorter-term rates, while subdued forward inflation expectations have weighed on longer-maturity yields. Although the direction of monetary policy is reversing, the pace of normalization will be cautious as inflation remains stuck at sub-par levels, given muted wage growth and technological advances that are leading to efficiency gains across various sectors. CPI figures continue to undershoot and remain well below central bank targets of close to 2.0% across most developed markets. However, tight labour markets and firming economic activity may gradually generate inflationary pressures and central banks are likely to respond by raising short-term interest rates and further wind down stimulus programs. Although global central banks will continue to remain largely accommodative, they will have to play a delicate balancing act of tightening monetary policy without derailing the ongoing recovery. The winding down of QE in the US and Eurozone has the potential to withdraw approximately USD1 trillion of liquidity from the bond market. While this will put upward pressure on interest rates, a larger than expected spike in yields may adversely affect borrowing rates and fixed-income and equity valuations.

Flattening US Yield Curve



Source: Bloomberg, EIBank

Wage growth muted despite low unemployment



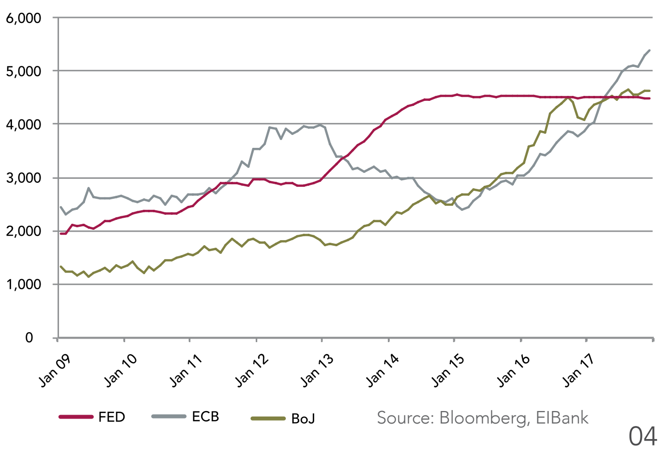
Source: Bloomberg, EIBank

III. Monetary to fiscal transition

2018 may well turn out to be an inflection point for global financial markets, given that central banks are set to incrementally withdraw support to risk assets after years of ultra-accommodative policies to spur economic growth and employment. While the global expansion has gained strength, there hasn't been any substantial resurgence in inflation expectations during 2017, which allows individual central banks to plan an orderly exit of easy monetary policies without disrupting the ongoing upsurge in global economic activity. Although global asset prices have benefitted from a loose monetary backdrop, markets are ultimately underpinned by sound economic forces which are already reasserting themselves. In 2018, we expect monetary policy to start making way for a market more driven by fundamentals and aided by more generous fiscal policies. As central banks start to withdraw monetary stimulus, fiscal policy in the form of tax cuts and infrastructure spending will need to step up to sustain and carry forward the burden of supporting business and consumer spending. This has, to some extent, already started in the US with Trump's tax cuts and infrastructure

Bloated central bank balance sheets

USD billion



Source: Bloomberg, EIBank

THE 2018 OUTLOOK

spending plan. Indeed, in December of last year and after weeks of deliberation, Trump finally signed the USD1.5 trillion tax-overhaul bill, delivering a major tax cut to US businesses and individuals, which should provide a modest boost to growth in the coming years. The focus will now shift onto the infrastructure spending plan for which the government is expected to allocate USD200 bn in federal funds, to be complemented by private participation and with details of the plan still unclear and likely difficult to pass. Meanwhile, Europe, which pushed for fiscal austerity after the 2008 financial crisis, has yet to move towards fiscal expansion. Greater integration and the implementation of structural reforms will be a significant challenge given the fragmentation of Europe's political landscape. In September, French President Macron unveiled an ambitious plan to reform the Eurozone in which he is pushing for more EU integration, the harmonization of tax regimes and the creation of a European Monetary Fund. However, this would require the full support of Germany, where Chancellor Merkel recently struck a deal to enter into formal talks with the Social Democratic Party (SDP) after several failed attempts to form a coalition government.

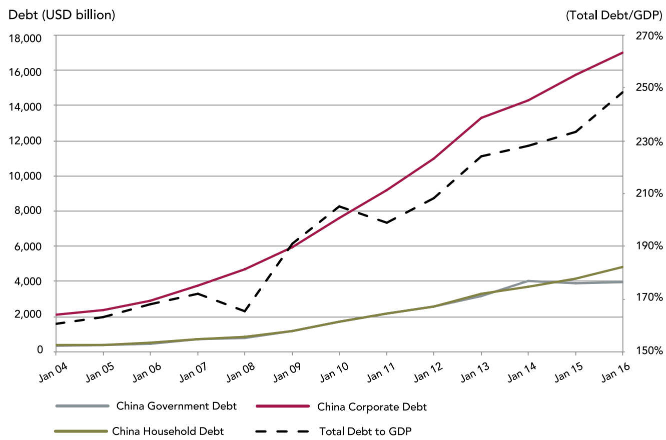
IV. China debt, a growth concern and not a credit concern

The Chinese authorities have raised the alarm bell in 2017 about the country's high debt levels, setting the tone for a more sustainable, higher quality growth path for the foreseeable future. High corporate debt levels, on a standalone basis, may cause room for concern but when looking at the Chinese economy, investors must realize that the final liability in many cases starts with and ends with the Chinese government. We prefer to analyze Chinese debt levels, not only from a credit perspective per se, but from a growth perspective and where a controlled slowdown by the authorities has the potential to limit global growth. Risks of a slowdown remain, but stability in the CNY and firming growth in 2017 have reduced the immediate prospect of a "hard landing" and provided authorities much needed elbow room to continue efforts to rein in credit and accelerate deleveraging.

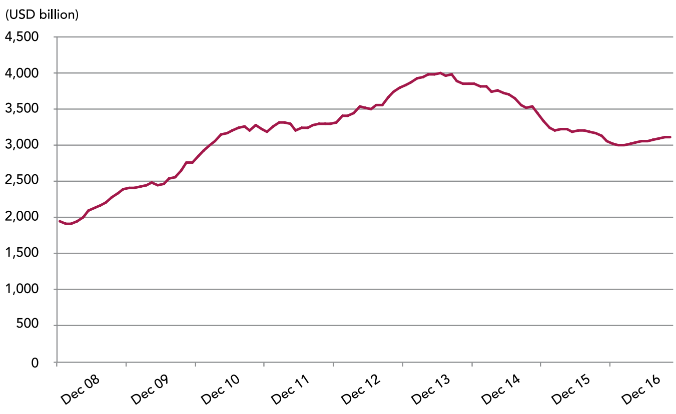
Longer-term, the main risk for China remains in the exponential rise in corporate debt levels which remain high as credit continued to outpace GDP growth in 2017. Meanwhile, the World Bank (WB) noted that while the Chinese economy grew at a faster than expected pace in 2017, concerted efforts to reduce financial risks have pushed up borrowing costs, raising concerns of a slowdown going into 2018. Slowly rising borrowing costs due to the government's crackdown on financial excesses and pollution are expected to make it more costly to service outstanding debt and rollover maturing loans. With more than USD1 trillion of local currency bonds maturing in 2018-19, it will become expensive for firms to roll over debt, creating a divergence in performance between bond categories and lead to a greater differentiation in price.

We believe fears over Chinese debt are exaggerated as the government has the resources to navigate an orderly process of deleveraging, finely balancing GDP growth targets with lingering financial risks. With a government determined to re-orientate the economy from export dependence to more domestic consumption amid a rising middle class, domestic consumer spending continues to grow allowing China's economy to slow down moderately in 2018 without derailing global growth materially.

Chinese debt levels to weigh on growth



Stabilizing Chinese FX Reserves



Source: Bloomberg, EIBank

V. High but manageable debt levels

Despite soaring debt levels on the back of easy money supply globally since the Global Financial Crisis (GFC), the ratio of debt-to-GDP actually fell in 2017 as economic growth accelerated. According to the Institute of International Finance (IIF), the ratio now stands at around 318%, lower by 3% compared

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to Q3 2016. A synchronized pickup in global growth alongside efforts by authorities to rein in financial excess (China) and structural reforms have ensured some pullback in the debt build-up. Nevertheless, global debt remains uncomfortably high and poses a systemic risk to policy missteps.

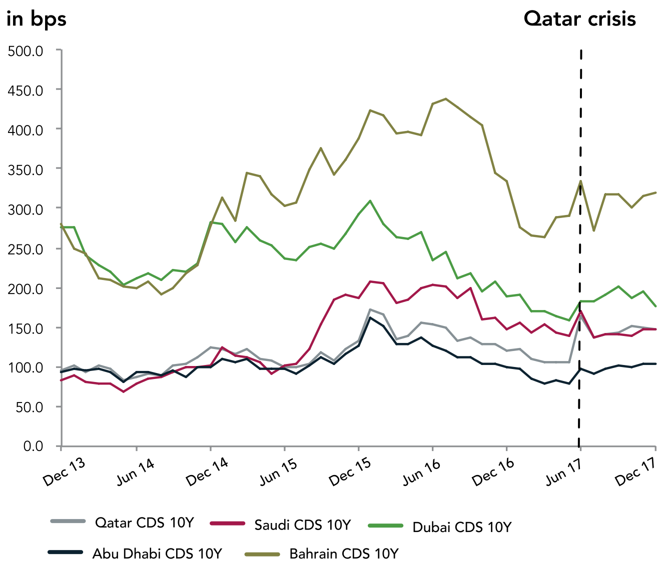
This topic deserves special attention as major central banks start unwinding unconventional monetary stimulus, which was used to lower borrowing costs, revive growth, and reflate asset prices. Monetary policy normalization alongside expansionary fiscal policy in the US will eventually push yields higher, potentially boosting the USD and worsening the debt-servicing ability of USD-denominated debtors. According to the IIF, total debt levels (household, government and corporate) climbed by more than USD70 trillion in the last 10 years. Tightening global liquidity poses a challenge to the ability of emerging economies to service hard-currency debt going into 2018, as a result of higher borrowing costs. However, the ability of major emerging economies to withstand financial shocks is much better now, as these economies display stronger balance sheets, more sustainable growth policies, stabilizing commodity prices and healthy forex reserves than before.

Within emerging markets, China stands out given the country's size and heavy debt burden following rapid credit growth since 2008. That said, we believe China's targeted deleveraging is the right way forward as it improves the quality of its growth. Furthermore, Chinese households have a high savings rate and much of China's debt is held by state-owned enterprises which make a severe debt crisis less likely. At a global level, we believe central banks will have to bear in mind the overall level of debt in the financial system and tighten monetary policy in a very gradual manner. For investors, credit selectivity will be key as overleveraged companies, which relied on cheap financing, might face liquidity issues in an environment of rising rates.

VI. Geopolitical risks

A steady and improving global macroeconomic backdrop ensured that geopolitical shocks only caused temporary sell-offs in risk assets as investors have been conditioned to "buy the dip", relying heavily on the liquidity and support provided by central banks. In the US, policy uncertainty, Trump's protectionist rhetoric against trade partners as well as warmongering with North Korea continue to hover as latent risks as we enter 2018. Overall, political risk looks less of an issue than in 2017, but has not disappeared. Italian elections in March and possible geopolitical tensions given shifts in US foreign policy need to be monitored. Elsewhere in Europe, the political landscape almost reversed by the end of 2017 as populism struggled to capitalize on the initial euphoria with Eurosceptic parties failing to deliver in key elections across the continent. A win for Macron in the French elections was the single biggest turnaround that rekindled pro-European sentiment and allowed the establishment fresh opportunity to address growing resentment among Europeans. However, a reduced mandate to Germany's Merkel and upcoming federal elections in Italy do create headwinds to a strong growth momentum underway in Europe. Regionally, a proxy war between Saudi and Iran, alongside a Saudi-led standoff with Qatar both pose considerable risks to the MENA region. Broadly, there remain too many places in the geopolitical landscape where a misstep could trigger grave international conflict. While not our base case, cyber warfare, North Korea, the Middle East and terrorism remain key risks going into 2018 and have the potential to adversely affect macro fundamentals overnight.

MENA default spreads not alarming



Source: Bloomberg, EIBank

MONTHLY INVESTMENT OVERVIEW

As we enter 2018, the global economy stands on a sound footing after 2017 witnessed synchronized global growth across the US, Europe, Japan and most emerging markets. Inflation has started to rise albeit at a slow pace, allowing central banks to gradually normalize ultra-accommodative monetary policies, while a balance of optimism and apprehension prevails across all major asset classes. While the US is enjoying robust growth as the economy enters into later stages of its business cycle, Europe finally caught up in 2017 and outperformed expectations as political risks abated. Meanwhile, strong global demand and Abenomics allowed the Japanese economy to grow at a brisk pace with unemployment at more than 2-decade lows. Rising global trade, the Fed's cautious approach to monetary tightening and a weaker USD helped emerging-market equities and currencies post strong returns in 2017, as they played catch-up to their developed peers. Emerging market equities are still trading at roughly a 20 – 25% discount relative to developed markets compared to 35% two years ago.

> " The Fed's cautious approach to monetary tightening and a weaker USD helped emerging-market equities and currencies post strong returns in 2017 "

After weeks of deliberation, Trump finally signed the USD1.5 trillion tax-overhaul bill, delivering a major tax cut to US businesses and individuals. Meanwhile, some positive economic data and the prospect of faster growth and wider deficits pushed the US 10-year Treasury yield to 2.5%, its highest level since March 2017. At the time of this writing, the US economy added 148k jobs in December with the unemployment rate unchanged at 4.1%. The data was below expectations but was strong enough to maintain the country's seven-year streak of adding at least 2 million jobs. Earlier in the month, the Fed expectedly announced a 25bps rate hike while keeping its rate outlook intact, anticipating three more hikes in 2018. However, markets currently seem to have a different view and continue to underprice the Fed's stated intention to deliver three 25bps hikes in 2018. Overall, slowly rising inflation, robust GDP figures and tightening labor market conditions continue to underpin the S&P500, which is up 19.4% in 2017, its strongest annual performance since 2013. Meanwhile, the US 10-year Treasury yield finished the year almost flat at 2.4% with the Dollar Index losing ground in 2017 finishing lower by 9.9%.

Europe has outperformed expectations in 2017, both economically and politically. The Flash Eurozone Manufacturing PMI reached 60.6 in December, an all-time high. Most macroeconomic data have exceeded expectations with leading indicators pointing to sustained positive momentum going into 2018. Despite a solid outlook, the ECB appeared cautiously hawkish and ensured monetary policy support at a tapered pace for most of 2018. At its December meeting, the central bank kept its interest rate policy unchanged while raising its growth and inflation forecasts through 2020. While pointing out that inflation developments remain subdued, the ECB exhibited confidence that inflation will gradually reach its target of "below, but close to 2.0%" and the planned reduction in the monthly asset purchases is consistent with this view. Meanwhile, political uncertainty rose when Spanish PM Rajoy suffered a major blow as separatists narrowly won Catalonia's regional election called by him in hopes of calming the country's constitutional crisis. Earlier in the month, the Greek government struck an agreement with its creditors for a third bailout review, paving the way for the next tranche of funds to be disbursed in mid-February 2018, subject to the implementation of all the measures previously agreed with its creditors. In Italy, President Mattarella dissolved parliament to pave the way for a general election on March 4. Italian government bonds sold off on the political uncertainty with the yield on 10-year bonds rising to around 2.0%, its highest level in two months. A stronger EUR, which gained 0.9% against the USD in December, and increased political uncertainty weighed on the EuroStoxx50 which lost 1.9% in December.

After raising interest rates for the first time in a decade in November, the Bank of England (BoE) kept its benchmark rate unchanged at 0.5% at its December meeting. Despite a higher than expected rise in the November inflation reading, the bank stated inflation "is likely to be close to its peak" while also noting the recent progress on Brexit negotiations have lessened the chances of a disorderly exit from the European Union (EU). Earlier, the UK government and the EU agreed to a deal on the contentious Brexit terms, allowing negotiations to move to the next stage. The agreement includes

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the financial settlement figure that the UK will have to pay as well as protocols to protect the rights of EU citizens in the UK and vice versa. The outlook for the BoE is highly dependent on developments of the Brexit negotiations. Growth and inflation could be significantly impacted by how the UK leaves the EU. The GBP also remains vulnerable to Brexit negotiations, but could outperform if a long transition period is agreed upon. The GBP was flat against the USD while the FTSE100 gained 5.0% in December alone.

Amid a strong global growth backdrop, the Japanese economy enters 2018 on a strong footing. Despite Q3 GDP data showing moderation from Q2, the Cabinet Office revised its fiscal year 2017 GDP growth target to 1.9% from 1.5%. It also raised its GDP growth estimate for fiscal 2018 to 1.8% from 1.4%. Meanwhile, core CPI remains very low, but is likely to pick up modestly as the effects of robust expansion and record low unemployment levels begin to take effect. Despite labor shortages, a surging stock market, and a promising economic outlook, wages have so far remained stagnant. At its December meeting, BoJ Governor Kuroda stressed patience and left its ultra-loose monetary policy unchanged, unfazed by criticism about diminishing returns from the easy-money policy. In an expected move, the BoJ left the short-term interest rate target at -0.1% and the 10-year JGB yield target at about 0.0%. The Nikkei225 has gained an impressive 19.1% in 2017 in local currency terms, while the JPY strengthened by 3.7% versus the USD over the same period.

After broadly defying slowdown projections for most of 2017, China's economy is showing some signs of moderation as housing market activity continues to cool. The government is trying to tighten financial conditions to over-leveraged sectors in the economy while finely balancing slowdown risks. China is a very centralized, command-based economy where government related entities were forced to take on debt to boost productivity. While certain sectors and corporates are highly leveraged, the final liability in many cases ends with the government. Economic indicators remain positive and PMIs suggest that the expansion is likely to continue at a modestly slower pace next year. The monetary policy environment is likely to remain broadly supportive as authorities mitigate the impact of deleveraging via targeted easing measures. China is attempting to transition to a more open, service-based economy, recognizing the need for cuts in overcapacity while addressing environmental issues. The CNY has appreciated nearly 6.3% against the USD in 2017, while the country's foreign reserves increased by USD109 bn over the same period, alleviating fears of a hard landing.

> " A disciplined adherence by members to the OPEC production cut agreement have gradually reduced global oil inventories "

In India, improving fundamentals, signs of a turnaround in corporate earnings, a government intent on reforms, and political gains for the PM Modi-led party in key regional elections led the NIFTY to rally 3.0% in December and a solid 28.7% in 2017. Meanwhile in Turkey, despite pressure from President Erdogan to lower rates to spur the economy, Turkey's central bank raised rates by 50bps to 12.75%, lower-than-expected and perhaps insufficient to slow down inflation which hit a 14-year high in November. In South Africa, equities and the ZAR rose after reformist Ramaphosa was elected leader of the ruling ANC party. As a result, the ZAR recorded a 9.9% gain against the USD in December. This political development is a clear positive for the struggling economy but fears that Moody's will downgrade the country's debt rating to junk status in March remain a headwind.

In the MENA, Saudi unveiled an expansionary 2018 budget announcing it will boost spending to SAR1.1 trillion in 2018 from SAR926 billion in 2017 to counter revenue-boosting measures, such as the VAT and a levy on expat workers. The budget tries to revive an economy struggling in a lower-for-longer oil price environment while diversifying the government's revenue base. In the oil markets, supply disruptions caused by a pipeline explosion in Libya resulted in a loss of roughly 90k bbl/day and led oil prices to more than 2-year highs. For the year, a disciplined adherence by members to the OPEC production cut agreement and the agreement's extension through the end of 2018 have gradually reduced global oil inventories with a 17.7% gain for Brent.

Asset Class Views

Asset Class	November	December	View / Rationale
Equities	↘	↘	
US	↘	↘	Strong earnings momentum and tax cuts underpin elevated equity valuations.
Europe	↔	↔	Above-trend economic expansion positive for equities.
UK	↘	↘	GBP weakness balances muted growth prospects.
Japan	↔	↔	Solid earnings and firming domestic demand boosts equities.
China	↔	↔	Deleveraging efforts expected to lead to a gradual slowdown.
India	↘	↘	Lofty valuations limit upside in equities.
Brazil	↘	↘	Faltering progress on fiscal reforms and lingering political uncertainty.
Russia	↔	↔	Economy showing signs of slowdown, but higher oil prices should be supportive.
MENA	↘	↘	Markets may find support with oil price rebound but earnings growth is muted.
Asset Class	**November**	**December**	**View / Rationale**
Fixed Income	↔	↔	
US	↔	↔	Sustained economic expansion, widening fiscal deficit due to tax cuts to put upward pressure on yields.
Europe	↘	↘	Yields vulnerable to the improving growth outlook as ECB considers QE exit.
UK	↔	↔	Weak growth limits scope for rate hikes.
Japan	↘	↘	Despite zero-bound rate targets, yields vulnerable to upside risks amid firming growth.
China	↔	↔	Moderating growth and increasing borrowing costs amid deleveraging calls for selectivity.
India	↔	↔	Fiscal pressures due to rising oil prices to push yields higher.
Brazil	↔	↔	Data-dependent central bank expected to remain dovish to consolidate nascent recovery.
Russia	↔	↔	Central bank has room for further rate cuts as inflation remains below target.
MENA	↔	↔	Uncertain geopolitics keep MENA fixed-income a risk-off trade.

↑ Overweight, ↗ Favour, ↔ Neutral, ↘ Cautious, ↓ Underweight

Asset Class Views

Asset Class	November	December	View / Rationale *
Currencies	NA**	NA**	
USD / EUR	↔	↔	Maintain a Neutral view between the USD and EUR at this time.
USD / CHF	↗	↗	Favour the USD as markets underprice Fed's normalization plans.
USD / GBP	↗	↗	Favour the USD as Brexit uncertainty to weigh on the GBP.
USD / JPY	↗	↗	Accommodative monetary policy keeps pressure on JPY against the USD.
EUR / CHF	↗	↗	Favour the EUR on the Eurozone's growth outlook.
EUR / GBP	↗	↗	Favour the EUR on growth outlook and Brexit uncertainty.
EUR / JPY	↗	↗	Favour the EUR on the Eurozone's growth outlook and an accommodative BoJ.
CHF / GBP	↗	↗	Favour the CHF vs the GBP as UK growth outlook remains uncertain.
CHF / JPY	↗	↗	Favour the CHF as the BoJ remains accommodative.
GBP / JPY	↔	↔	Inflation-concerned BoE provides support to GBP versus the JPY.

* Reference currency is the USD

**NA - Not applicable

↑ Overweight, ↗ Favour, ↔ Neutral, ↘ Cautious, ↓ Underweight

FOR MORE INFORMATION, PLEASE CONTACT:

Emirates Investment Bank pjsc
PO Box 5503, Dubai
Dubai Festival City, UAE

+971 4 231 7777

+971 4 231 7788

www.eibank.com

ASSET MANAGEMENT TEAM:

Nadi Bargouti, CFA
Managing Director – Head of Asset Management
nadi.bargouti@eibank.com

Yaser Al-Nimr
Director – Asset Management
yaser.alnimr@eibank.com

Fabien Paturaud, CFA
Associate Director – Asset Management
fabien.paturaud@eibank.com

Hamad Al Majidi
Senior Associate – Asset Management
hamad.almajidi@eibank.com

Joyson D'Souza, CFA
Associate – Asset Management
joyson.dsouza@eibank.com

IMPORTANT INFORMATION