

Emerging markets take a breather amid Fed fears

- A more hawkish Fed provoked a rebound in the dollar, a flatter US yield curve with higher long term rates and weakness in EM assets. Also positive data has refocused the market on the possibility of near-term rate hikes. The FOMC lists three conditions for resumption of policy normalization: (1) more robust real GDP growth; (2) firmer labour market conditions; and (3) greater confidence that consumer inflation may converge upon the 2% target over the medium-term.
- Citi analysts believe that these conditions may soon be met. June may be "on the table", but not a "done deal," thus we still expect only one rate hike this year in September. With the UK referendum taking place on 23 June and inflation still running below the central bank's target, the Fed may prefer to wait another month or two. Nonetheless, markets are still underpricing the possibility of Fed action, although to a lesser degree. If US data continues to beat expectations, then the rising anticipation of further Fed rate hikes could trigger more market volatility.

Performance

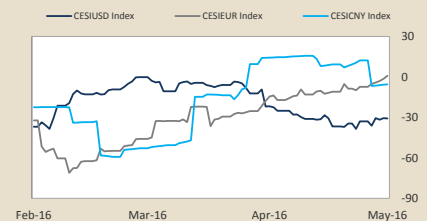
- Global equities finished the week mixed with the MSCI World index slightly up 0.08% as hawkish Fed minutes hurt equities in the US and Emerging Markets while equities in Europe and Japan held up. In the US, the Dow Jones Industrial Average was lower 0.20% while the S&P 500 Index and the Nasdaq Composite gained 0.28% and 1.10% respectively. European equities finished higher, with the Stoxx Europe 600 Index up 0.99%. Japanese equities also rebounded with the Nikkei 225 index and Topix index gaining 1.97% and 1.76% respectively, buoyed by speculations around further easing by the Bank of Japan.
- Finally, the MSCI Emerging Markets index fell 1.36% led by the MSCI Latin America (-3.62%) and the MSCI Emerging Europe (-3.25%) as EM equity funds saw rising outflows with a more hawkish Fed weighing on EM currencies. Closer to home, the MSCI Asia ex Japan held up relatively better (-0.60%). Within Asia, Singapore was the outperformer (FSSTI: +1.06%).

Asset Allocation

- Equities** — Since Feb 2015, global earnings per share (EPS) have fallen 11%. But Dividends per share (DPS) have risen 5%. Citi analysts believe this has helped to limit the downside, resulting in a range-trading market.
- Credit** — We remain overweight both US and European high yield debt. Energy-related sectors remain attractive, though reliant upon stability in crude oil prices.
- Rates** — Modest growth, benign inflation and negative policy rates could keep core rates low; Favour longer duration in the US and Eurozone.
- Commodities** — A boost in energy prices could help to secure a floor under all commodities, where signs are strong that bottoms were reached at the start of the year.

Softer Chinese data

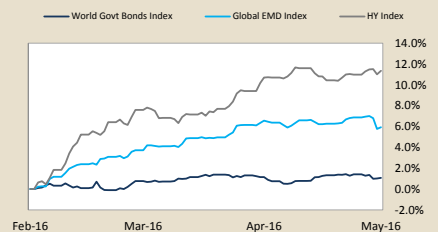
Citi Economic Surprise Index



Source: Bloomberg as of 20 May 2016

Dollar rally hurt EM debts

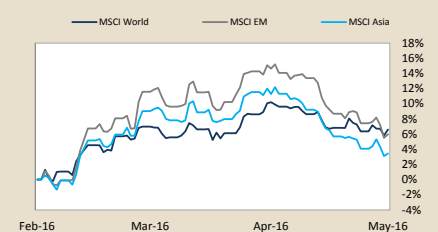
Accumulated 3-month Bond Index Returns



Source: Bloomberg as of 20 May 2016

A hawkish Fed weighed on sentiment

Accumulated 3-month Equity Index Returns



Source: Bloomberg as of 20 May 2016

Week Ahead Key Data and Event

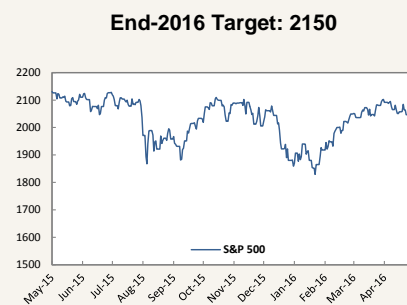
Date	Country	Data & Event	Period	Survey	Prior	Citi Fct
23-May	EC	Consumer Confidence	May	-9.0	-9.3	-8.5
23-May	JN	Exports YoY	Apr	-9.9%	-6.8%	-11.0%
23-May	TA	Industrial Production YoY	Apr	-1.6%	-3.6%	-0.8%
23-May	EC	Market Eurozone Composite PMI	May	53.2	53.0	52.8
24-May	US	New Home Sales	Apr	521K	511K	517K
25-May	SI	GDP YoY	1Q	1.9%	1.8%	2.0%
26-May	US	Durable Goods Orders	Apr	0.4%	0.8%	2.5%
26-May	US	Initial Jobless Claims	21-May	275K	278K	275K
27-May	JN	Nat'l CPI YoY	Apr	-0.4%	-0.1%	-0.4%
27-May	US	GDP Annualized CoQ	1Q	0.9%	0.5%	0.9%
27-May	US	U. of Mich. Sentiment	May	95.5	95.8	--
27-May	CH	Industrial Profits YoY	Apr	--	11.1%	--

Source: Bloomberg as of 20 May 2016

Drivers and Risks by Market

United States

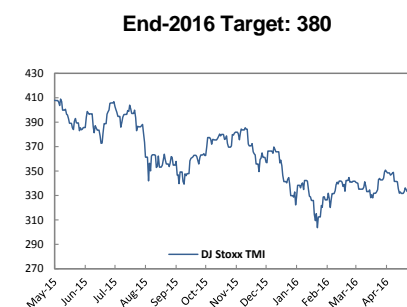
- **Driver:** The FOMC lists three conditions for resumption of policy normalization: (1) more robust real GDP growth; (2) firmer labour market conditions; and (3) greater confidence that inflation will converge upon the 2% target over the medium-term.
- **Risk:** Possible deterrents to tightening include domestic data disappointments; financial market volatility surrounding the June Brexit vote; renewed concerns about China's FX markets and pace of structural adjustment; commodity price gyrations; and political and economic uncertainty ahead of the November US Presidential and Congressional elections.
- **Implication:** Citi analysts anticipate one interest rate hike this year, in September, even though the Fed has signalled that both the upcoming June and July meetings are live. We also expect a very gradual pace of monetary policy normalization thereafter and project Fed funds rates of 0.75% in 2016, 1.25% in 2017, 2.25% in 2018, and 3.00% in 2019.



Source: Bloomberg as of 20 May 2016

Europe

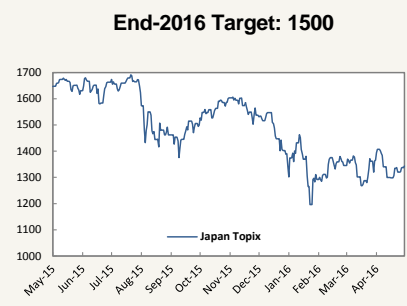
- **Driver:** Private debt-to-GDP ratios in the Euro Area have barely fallen since the peak in 2010, in contrast with the sharp reduction in the UK and the US. A subdued economic recovery and low-inflation, as well as few debt writedowns, are behind the limited progress.
- **Risk:** We think concerns around public debt sustainability may well resurface if nominal GDP were to decelerate, if past achievements in fiscal primary balances reverse meaningfully, and/or when signs start to emerge about a potential change in the current accommodative monetary policy stance.
- **Implication:** Asset accumulation, alongside supportive financing conditions, large private sector savings and reduced interest burdens, could make deleveraging easier and less costly for growth, in our view. Pending deleveraging needs, however, may likely continue to cap a significant rebound in the Eurozone credit cycle in the years ahead.



Source: Bloomberg as of 20 May 2016

Japan

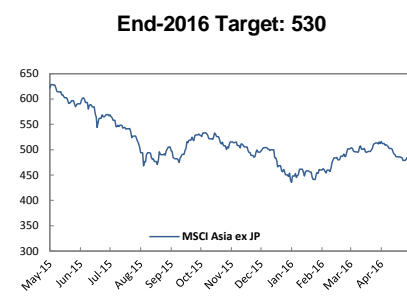
- **Driver:** In Citi's view, the government may hold off on announcing its economic measures until after next week, given that a major political event, the G7 summit, is coming up on May 26-27.
- **Risk:** Postponing the consumption tax hike could mean weaker fiscal discipline, which may raise the bar for immediate additional easing by the BoJ.
- **Implication:** The risk of another leg of sharp yen appreciation versus the US dollar seems to have receded for now following the announcement of the latest FOMC minutes. This reduces the likelihood of additional monetary easing in June. Citi's base-case scenario assumes more easing in July.



Source: Bloomberg as of 20 May 2016

Emerging Markets

- **Driver:** Based purely on value, the cheapest markets are Russia, Taiwan, Brazil, Chile and Turkey. At the other end of the distribution, India, Mexico, the Philippines and Indonesia are the most expensive markets in EM. In terms of sectors, the cheapest in EM is banks, followed by tech hardware, utilities and then energy.
- **Risk:** Downward EPS revisions still more plentiful than upward revisions. In EM, the majority of downward revisions are due to lowered sales forecasts as opposed to lower margins. In Lat AM, sales have been revised up but margins have been cut. In EMEA, margins are up but sales are down.
- **Implication:** In US\$ terms, the asset side of EM central-bank balance sheets has shown signs of improvement, but it has continued to decelerate in local currency terms. As we progress through 2H16, the yoy comparison may get easier for a wide range of indicators such as export growth. A better global growth environment in 2H16 could filter through into stronger liquidity, lending support to equity markets.



Source: Bloomberg as of 20 May 2016

Currency Forecast

Currency	Last price 20-May-16	Forecasts					
		Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
G10-US Dollar							
Euro	EURUSD 1.12	1.11	1.13	1.15	1.16	1.16	1.16
Japanese yen	USDJPY 110	114	112	111	110	109	109
British Pound	GBPUSD 1.45	1.50	1.51	1.52	1.52	1.51	1.49
Swiss Franc	USDCHF 0.99	0.99	0.97	0.96	0.95	0.95	0.95
Australian Dollar	AUDUSD 0.72	0.70	0.71	0.72	0.74	0.76	0.79
New Zealand	NZDUSD 0.68	0.65	0.66	0.67	0.67	0.68	0.68
Canadian Dollar	USDCAD 1.31	1.33	1.31	1.29	1.28	1.27	1.27
EM Asia							
Chinese Renminbi	USDCNY 6.55	6.61	6.66	6.72	6.77	6.82	6.87
Hong Kong	USDHKD 7.77	7.76	7.77	7.78	7.78	7.78	7.78
Indonesian Rupiah	USDIR 13,608	13,604	13,642	13,679	13,709	13,729	13,749
Indian Rupee	USDINR 67.4	67.5	67.9	68.3	68.6	68.9	69.2
Korean Won	USDKRW 1,190	1,199	1,192	1,184	1,173	1,157	1,141
Malaysian Ringgit	USDMYR 4.08	4.10	4.06	4.02	3.97	3.90	3.83
Philippine Peso	USDPHP 46.8	47.0	47.4	47.8	48.0	47.9	47.8
Singapore Dollar	USDSGD 1.38	1.38	1.38	1.39	1.39	1.39	1.39
Thai Baht	USDTHB 35.7	36.0	36.2	36.4	36.5	36.5	36.5
Taiwan Dollar	USDTWD 32.7	33.0	33.2	33.4	33.5	33.4	33.3
EM Europe							
Russian Ruble	USDRUB 66.8	65.6	64.0	62.4	61.6	61.6	61.7
South African Rand	USDZAR 15.63	15.81	15.88	15.96	16.00	16.00	16.00
EM Latam							
Brazilian Real	USDBRL 3.52	3.51	3.62	3.74	3.82	3.86	3.90
Mexican Peso	USDMXN 18.3	18.2	18.3	18.4	18.4	18.2	18.0

Source: Citi Research and Bloomberg as of 20 May 2016

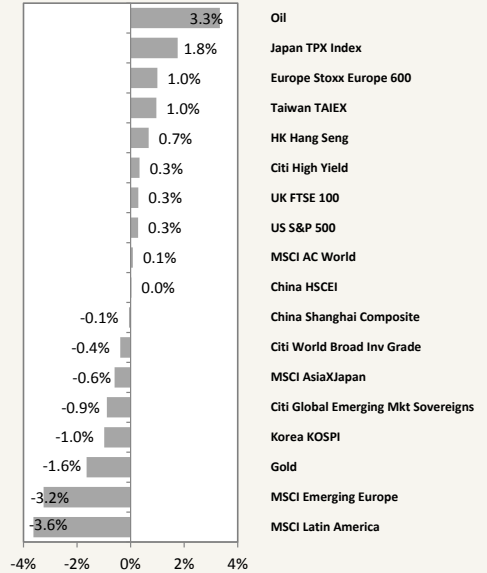
Short Rates and 10-Year Yield Forecasts

	Last price 20-May-16	Forecasts				
		2Q16	3Q16	4Q16	1Q17	2Q17
Short Rates (End of Period)						
US	0.50	0.50	0.75	0.75	1.00	1.00
Japan	-0.10	-0.10	-0.30	-0.30	-0.30	-0.30
Euro Area	0.00	0.00	-0.05	-0.10	-0.25	-0.25
10-Year Yield (Period Average)						
US	1.84	1.85	1.90	2.00	2.10	2.15
Japan	-0.10	-0.15	-0.20	-0.20	-0.25	-0.20
Euro Area	0.17	0.15	0.15	0.20	0.20	0.25

Source: Citi Research and Bloomberg as of 20 May 2016

Weekly Market Performance

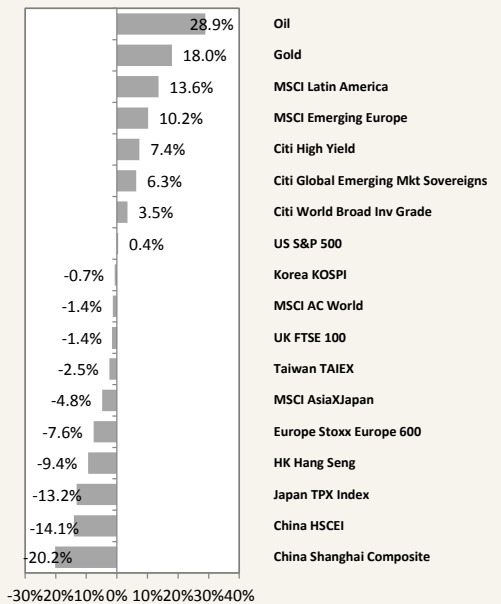
(16 - 20 May 2016)



Source: Bloomberg as of 20 May 2016

Market Performance (Year-To-Date)

(As of 20 May 2016)



Source: Bloomberg as of 20 May 2016

World Market At Glance

	Last price	52-Week	52-Week	Historical Returns (%)				Year-to-date (USD)
	20-May-16	High	Low	1 week	1 month	1 year	Year-to-date	
US / Global								
MSCI World	393.95	443.75	351.25	0.08%	-3.69%	-10.74%	-1.35%	-1.35%
Dow Jones Industrial Average	17500.94	18286.87	15370.33	-0.20%	-3.29%	-4.29%	0.44%	0.44%
S&P 500	2052.32	2132.82	1810.10	0.28%	-2.38%	-3.46%	0.41%	0.41%
NASDAQ	4769.56	5231.94	4209.76	1.10%	-3.61%	-5.96%	-4.75%	-4.75%
Europe								
MSCI Europe	393.44	478.12	355.54	0.03%	-5.10%	-16.92%	-4.27%	-4.27%
Stoxx Europe 600	338.01	409.48	302.59	0.99%	-3.63%	-16.83%	-7.60%	-4.65%
FTSE100	6156.32	7069.93	5499.51	0.29%	-3.96%	-12.14%	-1.38%	-2.84%
CAC40	4353.90	5217.80	3892.46	0.78%	-5.18%	-15.18%	-6.11%	-3.11%
DAX	9916.02	11920.31	8699.29	-0.37%	-4.85%	-16.31%	-7.70%	-5.14%
Japan								
NIKKEI225	16736.35	20952.71	14865.77	1.97%	-1.01%	-17.13%	-12.07%	-4.02%
Topix	1343.40	1702.83	1193.85	1.76%	-1.64%	-18.25%	-13.18%	-5.23%
Emerging Markets								
MSCI Emerging Market	785.26	1041.45	686.74	-1.36%	-7.56%	-24.21%	-1.12%	-1.12%
MSCI Latin America	2079.56	2652.78	1550.47	-3.62%	-7.40%	-21.49%	13.65%	13.65%
MSCI Emerging Europe	121.60	154.10	91.09	-3.25%	-7.65%	-19.98%	10.19%	10.19%
Brazil Bovespa	49722.75	55223.01	37046.07	-4.02%	-7.29%	-9.43%	14.70%	28.23%
Russia RTS	893.09	1053.94	607.14	-3.12%	-5.31%	-13.46%	17.97%	17.97%
Asia								
MSCI Asia ex-Japan	475.97	631.83	434.84	-0.60%	-7.04%	-23.76%	-4.79%	-4.79%
Australia S&P/ASX 200	5351.31	5803.00	4706.70	0.42%	2.59%	-4.62%	1.05%	0.05%
China HSCEI (H-shares)	8303.58	14962.74	7498.81	0.03%	-9.10%	-41.67%	-14.05%	-14.25%
China Shanghai Composite	2825.48	5178.19	2638.30	-0.06%	-4.95%	-36.45%	-20.17%	-20.98%
Hong Kong Hang Seng	19852.20	28524.60	18278.80	0.67%	-6.52%	-28.03%	-9.41%	-9.62%
India Sensex30	25301.90	28578.33	22494.61	-0.74%	-2.10%	-9.11%	-3.12%	-4.78%
Indonesia JCI	4711.88	5347.13	4033.59	-1.05%	-3.38%	-10.97%	2.59%	4.62%
Malaysia KLCI	1628.79	1798.46	1503.68	0.03%	-4.69%	-10.02%	-3.76%	1.59%
Korea KOSPI	1947.67	2148.70	1800.75	-0.98%	-2.90%	-8.97%	-0.70%	-1.38%
Philippines PSE	7299.03	7870.42	6084.28	-1.85%	1.36%	-7.40%	4.99%	5.59%
Singapore STI	2763.82	3467.10	2528.44	1.06%	-6.31%	-19.65%	-4.12%	-1.67%
Taiwan TAIEX	8131.26	9766.21	7203.07	0.96%	-4.50%	-16.05%	-2.48%	-1.84%
Thailand SET	1385.86	1536.30	1220.96	-0.63%	-2.06%	-8.83%	7.60%	8.68%
Commodity								
Oil	47.75	61.82	26.05	3.33%	12.01%	-19.04%	28.91%	28.91%
Gold spot	1252.15	1303.82	1046.43	-1.64%	0.63%	3.50%	17.97%	17.97%

Source: Bloomberg as of 20 May 2016

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