

Stocks rally amid improving sentiment

- Federal Reserve Chair Janet Yellen said last week an interest rate hike is "probably" appropriate in the coming months if economic data improve. Against this backdrop, Citi analysts expect stronger USD, particularly against JPY, CNY and broader EM. Short term rates are likely to rise, while longer term rates may still be well anchored. Equities could see greater differentiation, with more rate sensitive sectors under pressure.
- Meanwhile, the media is reporting that PM Abe may postpone the consumption tax hike that was planned for April 2017. If the hike is postponed, we see far less risk that the Japanese equity market would adjust in early 2017. Citi analysts believe postponing the consumption tax hike and implementing stimulus measures could help stabilize earnings in the construction, real estate, retail, and pharmaceuticals sectors.
- Finally, Japan's potential stimulus, PMIs and the US employment report are likely to be in key focus this week. OPEC and ECB are also meeting this week, but are not expected to produce major new information.

Performance

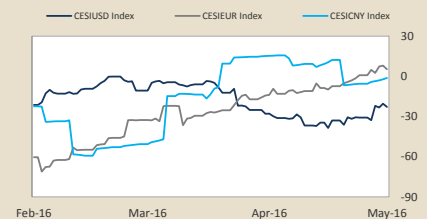
- Global equities managed strong weekly gains with the MSCI World index up 2.28%. In the US, the Dow Jones Industrial Average ascended 2.13%, the S&P 500 Index rallied 2.28% and the Nasdaq Composite surged 3.44% respectively. European equities finished higher to extend a strong rally that saw the Stoxx Europe 600 Index rising 3.44%, its best since February and allowed it to post its third-straight weekly gain. Japanese equities added to a modest weekly gain, with the Nikkei 225 index and Topix index advancing 0.59% and 0.49% respectively.
- Finally, the MSCI Emerging Markets index rose 2.93% led by MSCI Emerging Europe (2.45%) and MSCI Asia ex Japan (3.47%). In contrast, MSCI Latin America fell 1.01%. Within Asia, India's Sensex 30 posted its best weekly gain in nearly three months, climbing 5.34%.

Asset Allocation

- **Equities** — We are still concerned about global growth risks, the valuations in DM equities and waning policy efficacy. EM equities may have attractive valuations but we remain neutral given the fading impact of China's stimulus and a more hawkish Fed.
- **Credit** — To mid-2017, we do not see too much spread movement from current levels. European credit may outperform its US counterparts in both HY and IG.
- **Rates** — Across the major government bonds, forecasts to mid-2017 are mostly for higher yields. Return expectations are fairly mixed. EMU bonds may outperform.
- **Commodities** — Fundamentals support positive outlook for the rest of year. The key risks are Fed rate hikes and signs of weakness in China.

Upbeat US economic data

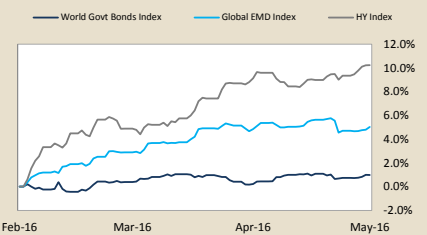
Citi Economic Surprise Index



Source: Bloomberg as of 27 May 2016

HY buoyed by rally in crude oil

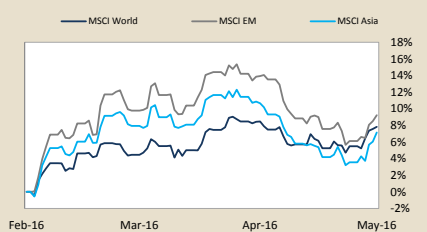
Accumulated 3-month Bond Index Returns



Source: Bloomberg as of 27 May 2016

Equities managed strong weekly gains

Accumulated 3-month Equity Index Returns



Source: Bloomberg as of 27 May 2016

Week Ahead Key Data and Event

Date	Country	Data & Event	Period	Survey	Prior	Citi Fct
30-May	EC	Economic Confidence	May	104.4	103.9	104.4
31-May	JN	Industrial Production MoM	Apr P	-1.5%	3.8%	-0.7%
31-May	EC	Unemployment Rate	Apr	10.2%	10.2%	10.1%
31-May	EC	CPI Estimate YoY	May	-0.1%	-0.2%	-0.1%
1-Jun	EC	Markit Eurozone Manufacturing PMI	May F	51.5	51.5	51.5
1-Jun	CH	Manufacturing PMI	May	50.0	50.1	50.0
1-Jun	CH	Caixin China PMI Mfg	May	49.2	49.4	--
2-Jun	SK	GDP YoY	1Q F	2.7%	2.7%	--
3-Jun	US	Change in Nonfarm Payrolls	May	160k	160k	140k
3-Jun	EC	Markit Eurozone Services PMI	May F	53.1	53.1	53.1
3-Jun	EC	Markit Eurozone Composite PMI	May F	52.9	52.9	52.9
3-Jun	EC	Retail Sales MoM	Apr	0.4%	-0.5%	0.7%

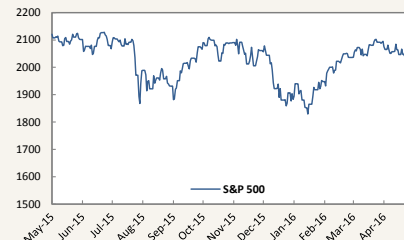
Source: Bloomberg as of 27 May 2016

Drivers and Risks by Market

United States

- **Driver:** Recently many investors have asked about the likelihood of a Fed hike at the next FOMC meeting in June, and more importantly how the markets might respond. Citi economists believe that there is unlikely to be a rate hike in June, and that the next tightening may most likely be at the September meeting.
- **Risk:** The second look (of three) at 1Q Gross Domestic Product (GDP) revised upward to a 0.8% seasonally adjusted annual rate from the 0.5% expansion reported in the first report but still represented a deceleration from a 1.4% expansion seen in the fourth quarter of 2015.
- **Implication:** If one believes that the Fed will hike as the economy looks healthy enough, bond yields may be headed even higher and cyclical stocks are likely to do better. With rate changes likely to be a catalyst, monitoring the Fed's moves via respectable growth data (as opposed to powerfully stronger guideposts) may further the upside in the equity market.

End-2016 Target: 2150

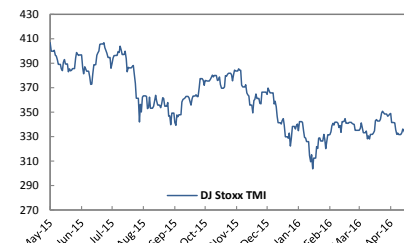


Source: Bloomberg as of 27 May 2016

Europe

- **Driver:** Reducing Germany's large current account surplus could boost Eurozone growth and alleviate a "global savings glut" according to the EU. Germany's surplus remains 8.5% of GDP in 2015 thanks to a rising goods trade surplus as well as excess savings and subdued investment in both private and public sectors.
- **Risk:** Citi analysts believe that the current account surplus has adverse implications for the economic performance of the euro area and warned that weak domestic investment hampers potential growth and strong reliance on external demand entails macroeconomic risks in a context of subdued foreign demand.
- **Implication:** Germany's CA surplus may fall as its intra-Eurozone competitiveness erodes with the temporary effects of cheap commodities and a weak euro likely to fade due to a more advanced cyclical position than other countries.

End-2016 Target: 380

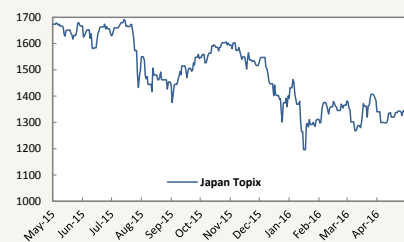


Source: Bloomberg as of 27 May 2016

Japan

- **Driver:** According to the media, PM Abe may postpone the consumption tax hike that was planned for April 2017. Citi analysts expect the postponement of the tax hike, if it happens, to be positive for Japanese equities. If there is no hike, economic stimulus package of ¥5-6trn is likely to be announced in Citi's view.
- **Risk:** PM Abe said at the G7 summit last week that the current global economic conditions look similar to the situation before Lehman's bankruptcy. His statement is creating ripples at home and abroad. While he seemingly aims to justify a postponement of the planned consumption tax hike, policy mishap remains a risk.
- **Implication:** Citi analysts believe that a combination of the postponement of the tax hike and the stimulus could help stabilize earnings in domestic demand-driven sectors.

End-2016 Target: 1500

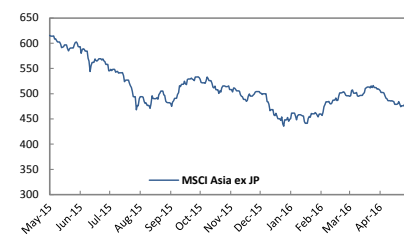


Source: Bloomberg as of 27 May 2016

Emerging Markets

- **Driver:** GDP growth in EM (ex-China) fell below DM growth late last year, for the first time since 1998. This period of economic underperformance is now very likely to be coming to an end, largely thanks to the fact that growth in Russia and Brazil – whose deep recessions were at the root of EM's weakness on average – probably have upside risks now. Stable oil prices support risk appetite towards EM.
- **Risk:** Ironically, higher oil price is producing the upside risks to inflation that might bring us closer to the most obvious threat to EM asset prices: Fed hikes. Also rising protectionism may hurt EM exporters.
- **Implication:** Assuming a zero chance of a 50bp hike, a 25bp move by July is priced with a 68% probability based on the Fed Fund Futures, Citi analysts expect EM currencies to grind weaker into the June/July FOMC but the strength in USD may be more gradual than what we observed earlier this year.

End-2016 Target: 530



Source: Bloomberg as of 27 May 2016

Currency Forecast

Currency	Last price 27-May-16	Forecasts					
		Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
G10-US Dollar							
Euro	EURUSD 1.11	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 1.46	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 0.67	0.65	0.66	0.67	0.67	0.68	0.68
Canadian Dollar	USDCAD 1.30	1.33	1.31	1.29	1.28	1.27	1.27
EM Asia							
Chinese Renminbi	USDCNY 6.57	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	USDIDR 13,587	13,604	13,642	13,679	13,709	13,729	13,749
Indian Rupee	USDINR 67.0	67.5	67.9	68.3	68.6	68.9	69.2
Korean Won	USDKRW 1,179	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 46.7	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 32.5	33.0	33.2	33.4	33.5	33.4	33.3
EM Europe							
Russian Ruble	USDRUB 65.9	65.6	64.0	62.4	61.6	61.6	61.7
South African Rand	USDZAR 15.73	15.81	15.88	15.96	16.00	16.00	16.00
EM Latam							
Brazilian Real	USDBRL 3.61	3.51	3.62	3.74	3.82	3.86	3.90
Mexican Peso	USDMXN 18.5	18.2	18.3	18.4	18.4	18.2	18.0

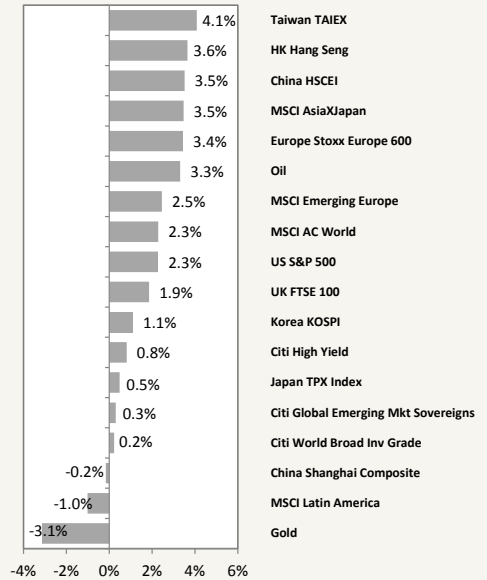
Source: Citi Research and Bloomberg as of 27 May 2016

Short Rates and 10-Year Yield Forecasts

	Last price 27-May-16	Forecasts				
		3Q16	4Q16	1Q17	2Q17	3Q17
Short Rates (End of Period)						
US	0.50	0.75	0.75	1.00	1.00	1.25
Japan	-0.10	-0.30	-0.30	-0.30	-0.30	-0.50
Euro Area	0.00	-0.05	-0.10	-0.25	-0.25	-0.25
10-Year Yield (Period Average)						
US	1.85	1.90	2.00	2.10	2.15	2.20
Japan	-0.11	-0.20	-0.25	-0.20	-0.20	-0.25
Euro Area	0.14	0.15	0.20	0.20	0.25	0.30

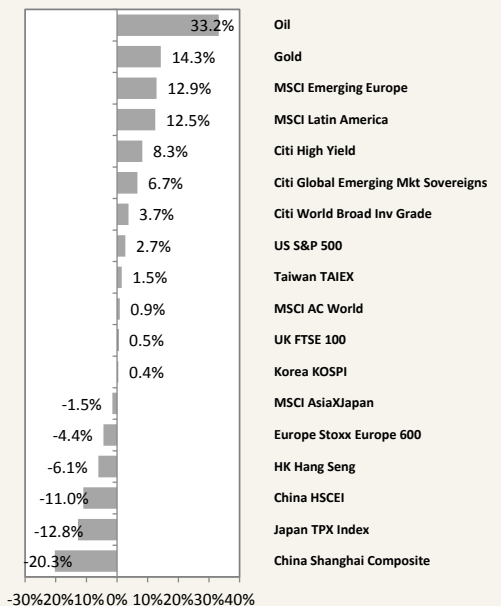
Source: Citi Research and Bloomberg as of 27 May 2016

Weekly Market Performance (23 - 27 May 2016)



Source: Bloomberg as of 27 May 2016

Market Performance (Year-To-Date) (As of 27 May 2016)



Source: Bloomberg as of 27 May 2016

World Market At Glance

	Last price	52-Week	52-Week	Historical Returns (%)				Year-to-date (USD)
	27-May-16	High	Low	1 week	1 month	1 year	Year-to-date	
US / Global								
MSCI World	402.93	438.45	351.25	2.28%	-0.94%	-8.07%	0.89%	0.89%
Dow Jones Industrial Average	17873.22	18188.81	15370.33	2.13%	-0.93%	-1.60%	2.57%	2.57%
S&P 500	2099.06	2132.82	1810.10	2.28%	0.19%	-1.15%	2.70%	2.70%
NASDAQ	4933.51	5231.94	4209.76	3.44%	1.45%	-3.39%	-1.48%	-1.48%
Europe								
MSCI Europe	403.93	470.83	355.54	2.67%	-1.58%	-13.37%	-1.71%	-1.71%
Stoxx Europe 600	349.64	408.73	302.59	3.44%	0.38%	-14.49%	-4.42%	-2.04%
FTSE100	6270.79	7069.93	5499.51	1.86%	-0.78%	-10.84%	0.46%	-0.21%
CAC40	4514.74	5217.80	3892.46	3.69%	-0.98%	-12.89%	-2.64%	-0.21%
DAX	10286.31	11802.37	8699.29	3.73%	-0.13%	-12.61%	-4.25%	-2.27%
Japan								
NIKKEI225	16834.84	20952.71	14865.77	0.59%	-2.64%	-17.77%	-11.55%	-2.96%
Topix	1349.93	1702.83	1193.85	0.49%	-2.48%	-18.74%	-12.76%	-4.28%
Emerging Markets								
MSCI Emerging Market	808.29	1012.35	686.74	2.93%	-4.14%	-20.69%	1.78%	1.78%
MSCI Latin America	2058.53	2596.00	1550.47	-1.01%	-9.08%	-18.87%	12.50%	12.50%
MSCI Emerging Europe	124.58	148.02	91.09	2.45%	-2.73%	-15.38%	12.90%	12.90%
Brazil Bovespa	49051.49	54977.70	37046.07	-1.35%	-9.96%	-9.56%	13.15%	24.08%
Russia RTS	917.52	1009.21	607.14	2.74%	-1.03%	-9.35%	21.20%	21.20%
Asia								
MSCI Asia ex-Japan	492.48	616.78	434.84	3.47%	-3.16%	-20.83%	-1.49%	-1.49%
Australia S&P/ASX 200	5405.91	5803.00	4706.70	1.02%	4.21%	-5.58%	2.08%	0.82%
China HSCEI (H-shares)	8595.28	14433.72	7498.81	3.51%	-4.89%	-41.54%	-11.03%	-11.22%
China Shanghai Composite	2821.05	5178.19	2638.30	-0.16%	-4.49%	-42.91%	-20.29%	-21.20%
Hong Kong Hang Seng	20576.77	27854.74	18278.80	3.65%	-3.67%	-26.72%	-6.10%	-6.30%
India Sensex30	26653.60	28578.33	22494.61	5.34%	2.26%	-3.31%	2.05%	0.95%
Indonesia JCI	4814.73	5252.21	4033.59	2.18%	-0.64%	-8.35%	4.83%	6.91%
Malaysia KLCI	1637.19	1755.82	1503.68	0.52%	-3.26%	-6.72%	-3.27%	2.14%
Korea KOSPI	1969.17	2123.39	1800.75	1.10%	-2.29%	-6.56%	0.40%	0.03%
Philippines PSE	7411.68	7697.33	6084.28	1.54%	3.22%	-2.46%	6.61%	7.20%
Singapore STI	2802.51	3403.66	2528.44	1.40%	-2.51%	-18.17%	-2.78%	0.22%
Taiwan TAIEX	8463.61	9747.27	7203.07	4.09%	-1.16%	-12.69%	1.51%	2.66%
Thailand SET	1412.67	1524.59	1220.96	1.93%	0.06%	-5.87%	9.68%	10.86%
Commodity								
Oil	49.33	61.82	26.05	3.31%	8.82%	-14.22%	33.18%	33.18%
Gold spot	1212.95	1303.82	1046.43	-3.13%	-2.64%	2.10%	14.28%	14.28%

Source: Bloomberg as of 27 May 2016

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