

Tough start to 2016

- Stocks closed solidly lower to end the dismal first week of 2016 as renewed declines in Chinese stocks, Renminbi, and oil prices re-ignited fears over slow global growth. Chinese authorities suspended a circuit breaker system, which was finalized last month to smooth market movements, after the mechanism halted trading for two days and created the opposite effect as investors rushed to sell whenever the benchmark index fell close to the 7%.
- In the US, December payroll employment posted a solid 292K gain, with substantial historical revisions totaling 50K. Mirroring developments in the rapidly-growing sectors of the overall economy, payroll gains in December were largest in the service sectors, although manufacturing was surprisingly robust.
- Against this backdrop of strong US growth, Citi economists believe the next rate increase may likely occur at the March FOMC meeting, and a subsequent pair of increases could occur in the second half of 2016. Thus, our end-2016 forecast for the federal funds rate is 1.25% and end-2017 target is 1.75%.

Performance

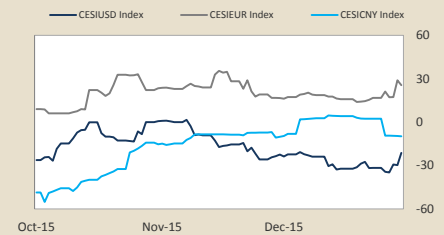
- Global equity finished the first week sharply lower with the MSCI World index losing 6.16%. In the US, the S&P 500 and the Dow Jones Industrial Average declined 6.16% and 6.19% respectively while the Nasdaq was down 7.26%. Europe also posted a negative weekly return as the benchmark Stoxx Europe 600 Index lost 6.69%. Meanwhile, Japan's Nikkei 225 and Topix finished lower 7.02% and 6.46% respectively.
- Finally, the MSCI Emerging Markets index plunged 6.82% dragged by the MSCI Latin America (-8.49%), the MSCI Asia Pacific (-6.31%) and the MSCI Emerging Europe (-4.78%). Chinese equities were among the weakest with the Shanghai Composite index and HSCEI indices correcting 9.97% and 8.44% respectively. In contrast, equities in Indonesia (JCI: -1.02%) and Malaysia (KLCI: -2.06%) held relatively better.

Asset Allocation

- **Equities** — Decent EPS momentum and continued central bank support mean that we prefer Europe ex UK and Japan equities to US equities.
- **Credit** — Citi analysts expect HY markets to outperform IG in both US and Europe.
- **Rates** — Citi's strategists forecast divergent yield paths for the major government bond markets to end-2016. EMU bonds are expected to outperform; Japan and US likely to underperform.
- **Commodities** — Rising geopolitical tensions would seemingly warrant a higher oil premium, yet this is unlikely so long as oil markets remain materially oversupplied and inventories at extreme highs.

Improving data out of US

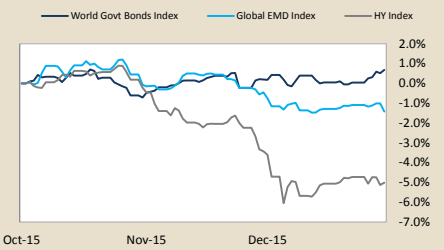
Citi Economic Surprise Index



Source: Bloomberg as of 8 January 2016

Low confidence in spread direction

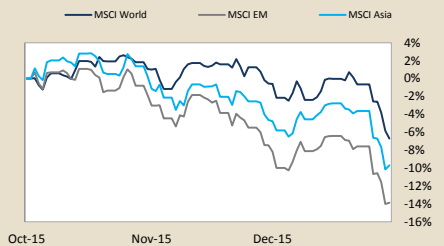
Accumulated 3-month Bond Index Returns



Source: Bloomberg as of 8 January 2016

Negative narrative gains traction

Accumulated 3-month Equity Index Returns



Source: Bloomberg as of 8 January 2016

Week Ahead Key Data and Event

Date	Country	Data & Event	Period	Survey	Prior	Citi Fet
11-Jan	CH	New Yuan Loans CNY	Dec	700B	709B	642B
12-Jan	IN	CPI YoY	Dec	--	5.4%	5.2%
13-Jan	EC	Industrial Production SA MoM	Nov	-0.3%	0.6%	-0.4%
13-Jan	CH	Exports YoY	Dec	-7.5%	-6.8%	9.9%
14-Jan	JN	PPI YoY	Dec	-3.5%	-3.6%	-3.3%
14-Jan	US	Import Price Index MoM	Dec	-1.4%	-0.4%	-1.1%
14-Jan	SK	BoK 7-Day Repo Rate	14 Jan	1.5%	1.5%	1.5%
14-Jan	US	Initial Jobless Claims	9 Jan	275K	277K	293K
15-Jan	US	Retail Sales Advance MoM	Dec	-0.1%	0.2%	-0.2%
15-Jan	US	Industrial Production MoM	Dec	-0.2%	-0.6%	-0.1%
15-Jan	US	Business Inventories	Nov	-0.1%	0.0%	-0.1%
15-Jan	US	U. of Mich. Sentiment	Jan P	92.6	92.6	93.0

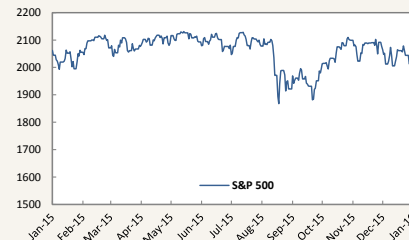
Source: Bloomberg as of 8 January 2016

Drivers and Risks by Market

United States

- **Driver:** December payroll employment posted a solid 292K gain. The December data show evidence of ever-strengthening labour markets, and has caused us to reconsider the balance of risks to our outlook. We believe upside risks to the medium-term inflation trajectory may be increasing.
- **Risk:** The FOMC is unlikely to delay normalization just because of the recent bout of global market volatility. Indeed, based on implied volatility measures, the bond market reactions appear much less disruptive compared to those during 2013, and the China-based episode in August 2015.
- **Implication:** Therefore, we believe the next rate increase may likely occur at the March FOMC meeting, and a subsequent pair of increases may be implemented in 2H16. This implies our trajectory for the federal funds rate may be 1.25% by end-2016, 1.75% by end-2017, and 2.5% by end-2018.

End-2016 Target: 2200

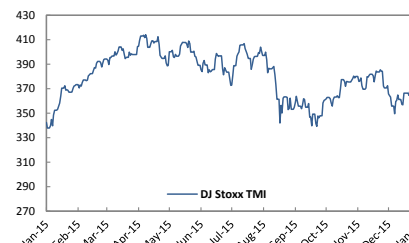


Source: Bloomberg as of 8 January 2016

Europe

- **Driver:** We expect the euro area to experience slightly faster and above-trend growth in 2016-17, thanks to the continued support from three main tailwinds: lower oil prices, fiscal policy loosening and an accommodative ECB.
- **Risk:** The main downside risks to our slightly below-consensus GDP forecasts are likely to stem from a much more negative EM growth outlook and some unravelling of the EU framework, either due to Brexit and/or a poorly-managed migration crisis.
- **Implication:** Given additional stress in commodities and volatility in key FX markets, Citi analysts lower their top-down expectation for 2016-17E European earnings growth to 4-7% and lower their end-2016 target for Stoxx to 400 (from 440). Also their end-2016 FTSE 100 target is lowered to 6600 (from 7100). Nevertheless, we stick with our key investment themes – align with: 1) fundamentals, 2) liquidity, 3) balance sheets. This means delivery strategies, eg earnings/dividend momentum, backing Planet QE, eg search for yield.

End-2016 Target: 400

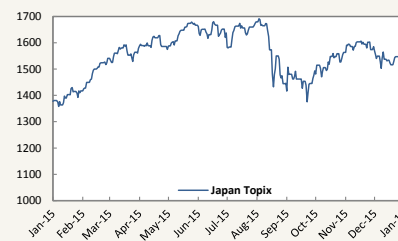


Source: Bloomberg as of 8 January 2016

Japan

- **Driver:** We think that from 2016 onwards the equity market may be influenced by the general election results and subsequent economic policy stance of the Abe government. Our upside scenario is the formation of a solid foundation for a long-term government and a commitment to accelerated structural reform by the Abe government, particularly labour market reform.
- **Risk:** The key downside risk is continued slowing global growth and we see relatively larger risk for EPS growth at export-related and cyclical names.
- **Implication:** We think investors may continue to favour domestic demand-related names, defensives, and financials. In these sectors, we suggest looking for stocks with 1) a unique growth story; 2) a proactive approach on governance reforms and shareholder returns; and 3) a likelihood of benefitting from economic policy moves.

End-2016 Target: 1850

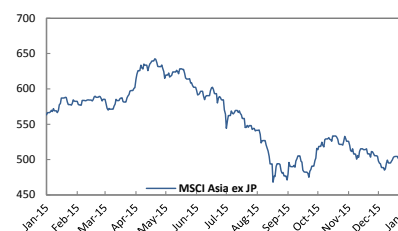


Source: Bloomberg as of 8 January 2016

Asia

- **Driver:** China's "new economy" may continue to decouple from "old economy" malaise, showing continued vibrancy on a) diversified consumption-driven strength in key sectors, supported by rising labour income, and b) innovation-driven upgrades to manufacturing competitiveness in key sectors. SOE reforms and financial reforms are the most critical actions to facilitate the healing process.
- **Risk:** China's economy is sick, suffering from excess capacity of "old economy." Given the ineffectiveness of credit easing, we view 2016 as the first year to see real supply-side surgery: de-capacity with rising defaults.
- **Implication** We set an end-2016E MSCI China / CSI300 target at 69 / 3,300, both 0.5x st dev below 10-year average P/E, mainly given lower earnings growth (3% in 2016E vs. 10-year average 11%). Citi's preferred sectors include Consumer Discretionary, I.T., Health Care, Property, Insurance, Transportation and Utilities.

End-2016 Target: 610



Source: Bloomberg as of 8 January 2016

Currency Forecast

Currency	Last price 08-Jan-16	Forecasts					
		Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	
G10-US Dollar							
Euro	EURUSD	1.09	1.09	1.06	1.03	1.03	1.04
Japanese yen	USDJPY	117	120	122	124	124	124
British Pound	GBPUSD	1.45	1.48	1.46	1.45	1.46	1.47
Swiss Franc	USDCHF	0.99	0.98	1.01	1.03	1.03	1.04
Australian Dollar	AUDUSD	0.70	0.72	0.70	0.69	0.69	0.69
New Zealand	NZDUSD	0.65	0.68	0.66	0.65	0.65	0.65
Canadian Dollar	USDCAD	1.42	1.41	1.39	1.38	1.36	1.35
EM Asia							
Chinese Renminbi	USDCNY	6.59	6.66	6.73	6.80	6.76	6.72
Hong Kong	USDHKD	7.76	7.76	7.78	7.79	7.78	7.78
Indonesian Rupiah	USIDR	13,923	14,141	14,328	14,500	14,500	14,500
Indian Rupee	USDINR	66.64	67.3	67.7	68.0	68.0	68.0
Korean Won	USDKRW	1,198	1,189	1,208	1,224	1,215	1,206
Malaysian Ringgit	USDMYR	4.39	4.43	4.47	4.50	4.46	4.42
Philippine Peso	USDPHP	47.20	47.8	48.2	48.5	48.2	47.9
Singapore Dollar	USDSGD	1.44	1.45	1.46	1.47	1.47	1.46
Thai Baht	USDTHB	36.33	36.7	37.0	37.3	37.1	37.0
Taiwan Dollar	USDTWD	33.34	33.7	34.0	34.2	33.9	33.7
EM Europe							
Russian Ruble	USDRUB	74.75	69.3	70.2	70.9	69.8	68.7
South African Rand	USDZAR	16.30	15.64	15.83	15.98	15.78	15.58
EM Latam							
Brazilian Real	USDBRL	4.02	4.33	4.37	4.39	4.31	4.23
Mexican Peso	USDMXN	17.94	17.0	17.0	17.0	16.9	16.8

Source: Citi Research and Bloomberg as of 8 January 2016

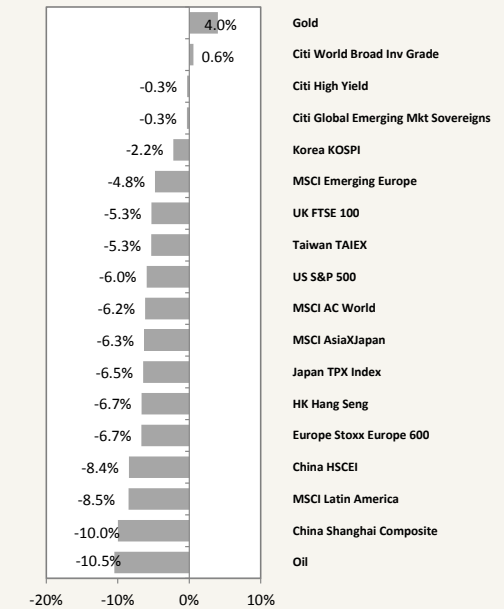
Short Rates and 10-Year Yield Forecasts

	Last price 08-Jan-16	Forecasts				
		1Q16	2Q16	3Q16	4Q16	1Q17
Short Rates (End of Period)						
US	0.50	0.75	0.75	1.00	1.25	1.25
Japan	0.10	0.10	0.10	0.10	0.10	0.1
Euro Area	0.05	0.05	0.05	0.05	0.05	0.05
10-Year Yield (Period Average)						
US	2.12	2.20	2.25	2.30	2.30	2.33
Japan	0.25	0.25	0.35	0.45	0.50	0.50
Euro Area	0.51	0.20	0.20	0.30	0.40	0.50

Source: Citi Research and Bloomberg as of 8 January 2016

Weekly Market Performance

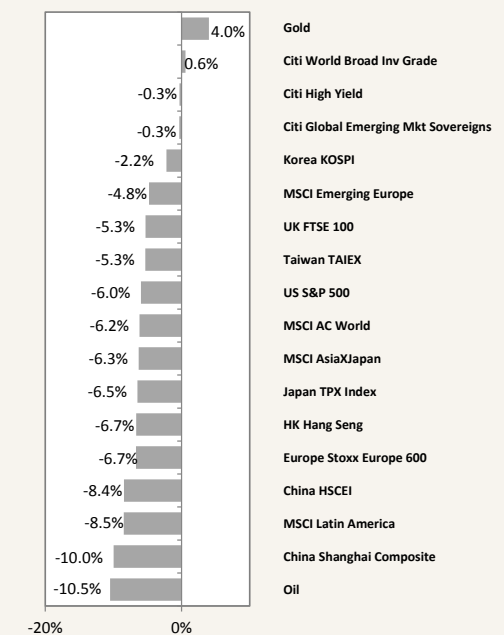
(4 - 8 January 2016)



Source: Bloomberg as of 8 January 2016

Market Performance (Year-To-Date)

(As of 8 January 2016)



Source: Bloomberg as of 8 January 2016

World Market At Glance

	Last price	52-Week	52-Week	Historical Returns (%)				Year-to-date (USD)
	08-Jan-16	High	Low	1 week	1 month	1 year	Year-to-date	
US / Global								
MSCI World	374.75	443.98	372.91	-6.16%	-6.58%	-9.45%	-6.16%	-6.16%
Dow Jones Industrial Average	16346.45	18351.36	15370.33	-6.19%	-6.95%	-8.72%	-6.19%	-6.19%
S&P 500	1922.03	2134.72	1867.01	-5.96%	-6.86%	-6.79%	-5.96%	-5.96%
NASDAQ	4643.63	5231.94	4292.14	-7.26%	-8.92%	-1.95%	-7.26%	-7.26%
Europe								
MSCI Europe	384.75	478.94	382.08	-6.38%	-6.52%	-9.57%	-6.38%	-6.38%
Stoxx Europe 600	341.35	415.18	331.98	-6.69%	-6.67%	-0.29%	-6.69%	-6.50%
FTSE100	5912.44	7122.74	5768.22	-5.28%	-3.63%	-10.01%	-5.28%	-6.67%
CAC40	4333.76	5283.71	4119.35	-6.54%	-7.44%	1.73%	-6.54%	-6.35%
DAX	9849.34	12390.75	9325.05	-8.32%	-7.72%	0.12%	-8.32%	-8.51%
Japan								
NIKKEI225	17697.96	20952.71	16592.57	-7.02%	-9.21%	3.09%	-7.02%	-4.80%
Topix	1447.32	1702.83	1343.29	-6.46%	-7.74%	5.06%	-6.46%	-4.23%
Emerging Markets								
MSCI Emerging Market	740.07	1069.13	736.77	-6.82%	-6.96%	-22.82%	-6.81%	-6.81%
MSCI Latin America	1674.47	2776.68	1672.03	-8.49%	-11.18%	-37.72%	-8.49%	-8.49%
MSCI Emerging Europe	105.07	159.85	104.44	-4.78%	-5.33%	-17.08%	-4.78%	-4.78%
MSCI EM Middle East & Africa	194.93	300.26	194.93	-7.27%	-8.21%	-29.57%	-7.27%	-7.27%
Brazil Bovespa	40612.21	58574.79	40463.49	-6.32%	-8.62%	-18.68%	-6.32%	-8.21%
Russia RTS	736.82	1092.52	708.25	-2.67%	-5.19%	-9.26%	-2.67%	-2.67%
Asia								
MSCI Asia ex-Japan	468.46	644.14	464.92	-6.31%	-5.93%	-16.82%	-6.30%	-6.30%
Australia S&P/ASX 200	4990.84	5996.90	4880.10	-5.76%	-2.31%	-7.26%	-5.76%	-9.60%
China HSCEI (H-shares)	8845.89	14962.74	8489.33	-8.44%	-8.44%	-26.43%	-8.44%	-8.60%
China Shanghai Composite	3186.41	5178.19	2850.71	-9.97%	-8.17%	-3.25%	-9.97%	-11.44%
Hong Kong Hang Seng	20453.71	28588.52	19865.18	-6.67%	-6.63%	-14.19%	-6.67%	-6.83%
India Sensex30	24934.33	30024.74	24598.90	-4.69%	-1.49%	-8.58%	-4.53%	-5.50%
Indonesia JCI	4546.29	5524.04	4033.59	-1.02%	1.84%	-12.77%	-1.02%	-1.43%
Malaysia KLCI	1657.61	1867.53	1503.68	-2.06%	-0.70%	-4.08%	-2.06%	-4.60%
Korea KOSPI	1917.62	2189.54	1800.75	-2.23%	-1.61%	0.68%	-2.23%	-4.64%
Philippines PSE	6575.43	8136.97	6314.53	-5.42%	-3.85%	-10.75%	-5.42%	-6.14%
Singapore STI	2751.23	3549.85	2690.45	-4.56%	-4.34%	-17.75%	-4.56%	-6.17%
Taiwan TAIEX	7893.97	10014.28	7203.07	-5.33%	-5.39%	-14.55%	-5.33%	-6.81%
Thailand SET	1244.18	1619.77	1224.83	-3.40%	-4.80%	-18.23%	-3.40%	-4.16%
Commodity								
Oil	33.16	62.58	32.10	-10.48%	-11.60%	-32.04%	-10.48%	-10.48%
Gold spot	1104.05	1307.98	1046.43	4.02%	2.71%	-8.66%	4.02%	4.02%

Source: Bloomberg as of 31 December 2015

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