Investment Strategy

January 2018


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Graph sources: Bloomberg/BBGI Group

INTRODUCTION

Letter to Investors – Investment Climate

- Good international macro-economic prospects in 2018
- Upward cycle on global rates and inflation likely to gain momentum
- High valuations and low risk premia reduce the appeal of risky assets
- Bitcoin's spectacular rise demonstrates the growing, and worrying, speculative euphoria
- Financial markets could finally feel the pinch of long rate increases

In the end, 2017 drew to a close amid calm, despite the many sources of political, geopolitical, and financial concern which punctuated the year as a whole, and especially the last few months. The first year of the Trump presidency gave ample opportunity to question presidential style, methods, and decisions, up until the last quarter, in which the long-awaited fiscal reform finally materialised. This raised fundamental uncertainty as to how the reform would be financed, and its impact on increasing the budgetary deficit. Geopolitical crises, serial dismissals within the presidential team, the issue of Russian interference in the US elections, and Trump's countless diplomatic affronts have not had any lasting effect on the evolution of the market. Investors have focused more on macro-economic data and statistics, which have shown a very clear improvement in the international economic situation since the second quarter. Ten years on from the start of the last financial crisis, financial assets gained ground again in 2017, extending the bull market which started in 2009. As it stands at the start of 2018, this is the longest bull market since the early 1970s.

The global economy is in ever better shape, propped up by relatively robust US fundamentals, which are independent of politics, as well as by an improvement in the economic situation of most other economies. US growth has picked up the pace, hitting +3%, but the Eurozone also stood out, surprising observers with GDP growth that now stands at nearly +2%. Japan and emerging economies also contributed to this faster pace of global growth. Prospects still look good for 2018, thanks to a likely recovery in private spending and the investment cycle. However, the risk of the current dynamic weakening in the second half of the year cannot be ruled out.

Global liquidity remained plentiful in 2017, but it should shrink with ongoing normalisation of US monetary policy, and the probable end to the Eurozone's QE programme at the end of the year. In parallel, in a growing number of countries, developments in employment could now finally be enough to spark wage rises, buoy up spending and the economy, and trigger a gradual rise in inflation. In this context, rate markets should undergo much more stark adjustments in 2018 than over previous quarters, more accurately reflecting economic fundamentals, particularly in the Eurozone. After the Euro rose nearly +10% against the Swiss franc in 2017, and the exchange rate returned to close to 1.20, the SNB could soon consider relaxing its negative rates policy. The Swiss bond market would then react more readily to a recovery in the global rate cycle than before. International bond markets were weak in the 4th quarter and should undoubtedly be weaker still in 2018.

The last quarter was once again favourable for equity markets, despite them having lost momentum overall after an annual increase which pushed valuations to extreme levels. US companies now have historically high multipliers, and will need to post results which meet expectations in 2018 in order not to prove disappointing and spark profit-taking by investors. In terms of bond risk premia, the yield differential between Treasury bonds and BBB bonds has come back down to the extreme low seen just before the financial crisis struck in 2008. The situation is similar for VIX indices, which are seen as a yardstick for future stock market fluctuations. They are demonstrating unshakeable optimism, which is rather worrying in terms of managing risk and opportunities. Euphoria has seized on digital currencies, and Bitcoin in particular provides further evidence of the speculative climate which currently reigns on the stock market.

The exchange rate should affect Swiss investors to a lesser degree in 2018, with the Euro likely to stabilise at around 1.20, and the US dollar set for a modest rise. The ongoing improvement in the international economic situation will go hand in hand with a clearer reversal of the interest rate cycle and a new phase of adjustments to long-term inflation forecasts and the levels required on long rates. The forecast rise in commodities should continue thanks to a rise in demand and stabilisation of supply. We had forecast that crude oil prices would likely rise to around US $50, which did happen, but the geopolitical context could further contribute to supporting an ongoing rise in crude oil.

At current valuation levels for equity and bond markets, there remains very little margin for potential disappointments. The expected impact of the tax reform on company profits may well already be incorporated into current prices. In the short-term, our analysis of market conditions suggests growing risks regarding investment opportunities, which are now scarcer. 2018 could prove more economically than financially favourable. We recommend exercising some caution in such a context.

Alain Freymond
Partner
CIO BBGI Group

Graph sources: Bloomberg/BBGI Group

BIG PICTURE

Key convictions

- The global economic cycle will be bolstered in 2018
- End of expansionary monetary policy, and contraction of global liquidity
- Recovery for inflation and the upward long rate cycle
- Renewed volatility on financial markets
- Positive fundamentals for energy and precious metals

The global economic cycle intensifies

2018 should see the macro-economic trends that have taken hold over the past few months continue. The international economic trend is intensifying, having received an initial boost from the acceleration in the United States, which benefits many other industrialised and emerging economies. US growth could still head north of +3% in the first few months of the year, whilst most developed economies will post performances higher than +2%. In China, 2018 will certainly be a little less strong than 2017, but +6.5% GDP growth is not impossible.

In 2018, India should once again post growth higher than that of China, climbing around +7.4%. Most emerging countries are also benefiting from this more favourable economic climate, and oil and commodity exporting countries, in particular, should post better results in 2018 than in previous years, thanks to the increased value of their exports. With the exception of a few countries, such as the United Kingdom, which are losing momentum, overall, we should see an increased pace of growth in the global economy. This forecast does not incorporate any potential positive effects that the US tax reform could have once it really starts to have an impact.

End of expansionary monetary policy, and contraction of global liquidity

US monetary policy will continue to normalise in 2018 with a new chief at the helm of the Federal Reserve. Jerome Powell should continue Janet Yellen's policy of gradually increasing key rates. They could rise to 2%-2.25% over the coming year. In the Eurozone, the ECB has announced that it will keep its bond purchase policy until September, but depending on the performance of the European economy, the bank has not ruled out making adjustments before the end of the year, though not a key rate hike.

The status quo should be maintained in the UK and Japan, whilst in China, on the other hand, it is likely that the Central Bank will decide to increase its rates in order to keep a stable differential with US rates; this is despite relatively modest inflation for the time being. In India, inflation increasing from 1.4% to 4.8% in the second half of the year could be the sign they were waiting for to increase rates, although for now it seems they have chosen more of a wait-and-see policy.

Recovery for inflation and the upward long rate cycle

Inflationary pressures were limited in 2017 and mostly linked to external factors. In most economies, the rise in inflation was due to the rise in crude oil prices, which started in 2016, but the effects of which spilled over into 2017. Equally, in some countries, inflation was the result of specific situations relating to changes in exchange rates. For example, the fall in the pound sterling and the yen propped up a rise in imported inflation. 2017 will remain the year of successful central bank policies to put an end to deflation and pull inflation up to the targets, generally of 2%, they had set themselves. Inflation has therefore recovered to "normal" levels, whilst employment is improving, and tensions are yet to make themselves felt on the jobs market.

2018 could well be the year of surprises relating to inflation, influenced by a combination of factors. The macro-economic context should foster new wage negotiations as well as tensions on commodity prices; this will prop up a rise in production and consumer prices. Renewed inflation within a robust economic context should rapidly lead to changes in long-term nominal rates. After a few quarters of stabilisation, US long rates should be the first to relaunch this trend. Most bond markets should also see rate rises, and globally yield curves should adjust by 50 to 100 basis points in 2018.

Renewed volatility on financial markets likely

2018 might see the celebration of the 10th year of one of the longest bull markets in the last 50 years, without even a temporary correction of more than 20%. Rises on equity markets in 2017 were certainly propped up by robust economic fundamentals, but valuations are now relatively high in past comparison. The S&P 500 has risen +50% over the past two years in a context of much lower than average historic volatility. Options' implicit volatility has even hit extreme lows (9%), lower than those before the financial crisis struck in 2008 (10%), and far from average values, which generally sit around 20%. Today, this indicator is pointing to extremely high investor confidence and complacency- they can see no risk of an upcoming correction to financial markets.

Investor optimism can also be seen on bond markets, the risk premia of which are once again particularly low. The yield differential between American Treasury bonds and BBB bonds is only 1.3%, which is very much below the nearly 2% average of the last decade. The yield of two-year Greek government bonds (1.6%) is lower than that of US Treasury bonds with the same maturity (2.4%). These two examples underscore the contraction of risk premia across several bond segments.

Graph sources: Bloomberg/BBGI Group

Optimism still seems to reign in 2018, but it is undoubtedly more the absence of alternative investments which is pushing the valuations of financial assets to extreme levels. It is certainly also this lack of an alternative paired with optimism buoyed up by an influx of positive economic news, which is feeding the various forms of speculation, such as the entirely irrational fervour for digital currencies.

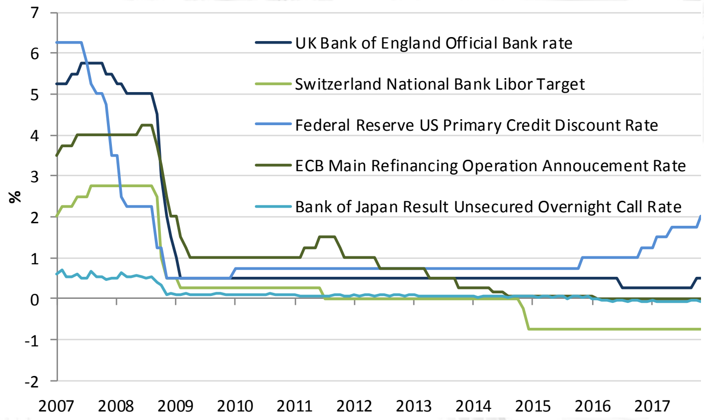
Improved fundamentals for energy and precious metals

After six years of negative performances and the longest bear market since the 1970s, commodities have finally been posting positive performances since 2016. It is true that these results are still modest in past comparison, but the increased pace of global economic activity in 2018 should create particularly positive conditions for commodity prices. Generally considered an end-of-cycle financial asset, commodities out-perform bond markets and equity markets when the economy picks up the pace. In the current economic cycle, regional cycles have finally converged, having been nudged by the US recovery. Demand for commodities should therefore grow in this context, whereas investments have fallen away considerably over the past few years. The fall in CAPEX has not only affected the energy sector, but has also had broad implications for the basic materials and precious metals sectors, thus creating the conditions for a stabilisation, or even a reduction, in production capacities and supply.

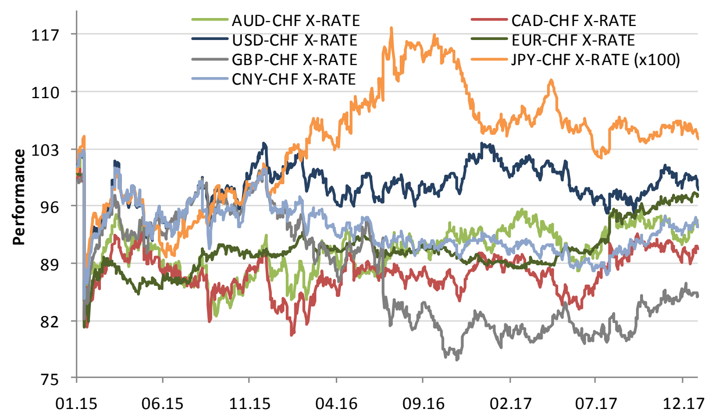
In the **energy** segment, crude oil supply finally stabilised in 2017, thanks to decisive action by OPEC members and Russia, who have committed to keeping in place a policy of limiting supply in 2018. In the United States, production also stabilised at around 9.5 million barrels per day, despite a recovery in non-conventional oil production. The consolidation of crude oil prices at around US $50 per barrel has certainly benefited shale oil producers, who increased their overall production in the United States in 2017 by 1.6 million barrels. In this context, overall global supply is nonetheless stabilising, whilst global demand in 2017 rose by 1.3 million barrels per day. We believe that demand could exceed supply in 2017, and prop up continued price rises, which would go hand in hand with a trend of regular falls in inventories. If there is no major policy change in OPEC countries, crude oil prices could continue to increase in 2018, hitting US $80 in 2019.

As regards **precious metals**, the rise in gold prices in 2016 and 2017 only partially reflects the development of particularly positive fundamental factors, which should sustain further increases in 2018. Despite the attention investors lavished on digital currencies, digital assets, and equities in general in 2017, gold prices have risen rather pleasingly (+13%) in the face of interest rate rises. Renewed volatility on financial markets would temporarily favour gold and silver prices, and it is certainly one of the fundamental factors, along with an increase in investment demand, which might push prices higher on the physical gold market in 2018. The global supply of physical gold remains restricted by limited production capacities and by dwindling supplies of recycling. In terms of demand, central banks will still be net purchasers in 2018, but there will undoubtedly be a clearer recovery of demand for jewellery in China and India, as well as in the United States. Investment demand should increase in 2018's financial, economic, and geopolitical context. The influx of investments in ETFs in physical gold should rise, and perhaps once again hit their highest level, seen in 2013, as early as 2018-2019. Gold and silver prices stand to benefit from this favourable environment, and increase from US $1,300 to US $1,500 and from US $17 to US $22 respectively.

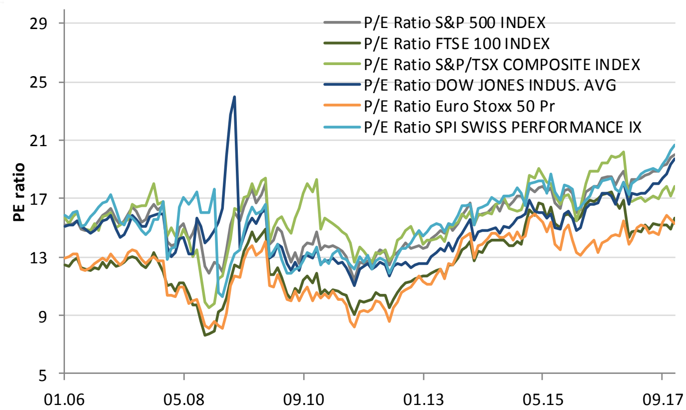
Central Bank rate (EUR, CHF, GBP, USD, JPY)



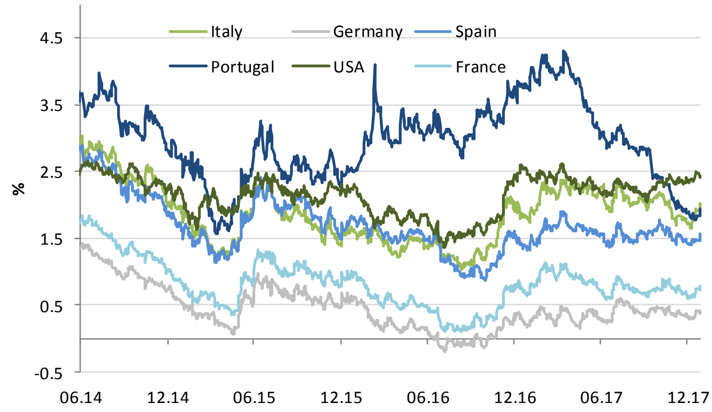
7 Major currencies against CHF (Normalized at 100)



Price/Earning Ratios in developed Markets



Government Bond yield (10 year)



Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

Global Outlook

- It will be difficult to sustain US growth beyond +3%
- The European economy is becoming more powerful
- British GDP crumbles despite a 50 billion agreement
- Economic recovery continues in Japan
- Swiss GDP to pick up to +1.8% in 2018

It will be difficult to sustain US growth beyond +3%

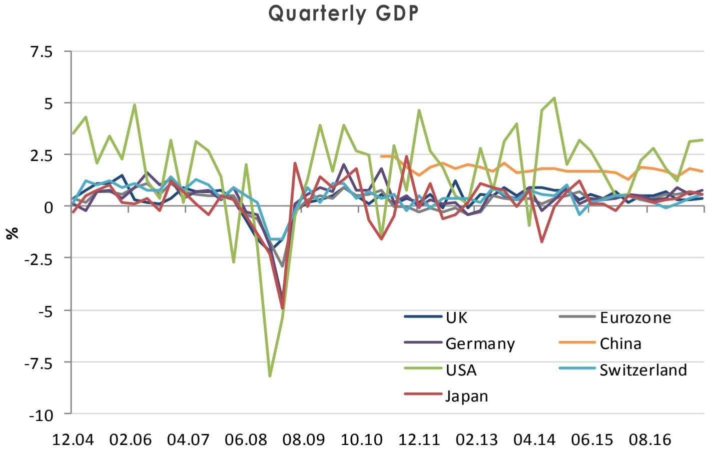
The US economy will certainly finish 2017 with year on year growth of around +3% in the 4th quarter, in line with our forecasts at the beginning of the year. Recently, we once again underscored the likely improvement in US growth, buoyed up by private spending, investment, and exports, which should once again all support the economy at the start of 2018. The Federal Reserve's growth target for 2017 was +2.4%; this should therefore be hit thanks to the faster pace of growth in the second half of the year. We still believe it likely that GDP growth for the year will come in at +2.6%. Leading indicators are very much pointing to economic activity picking up the pace at the end of 2017 and the start of 2018.

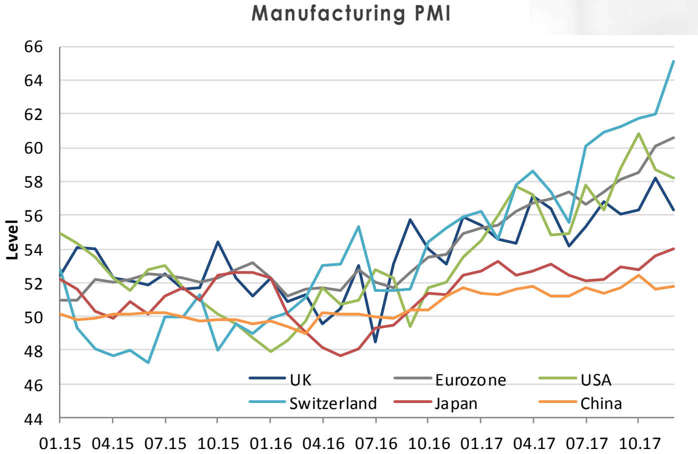
Equally, most economic indicators give grounds for hope of the trend continuing beyond the start of the year. Firstly, American consumers should be reassured by the influx of positive economic news and by the increasingly positive situation on the jobs market. The rise in personal revenue should provide more long-term support for household spending. In terms of investment, recent economic developments have affected all levels of production capacity, which will certainly trigger new investment in a context which is more favourable for companies' margins. The US economy seems to have settled into a relatively high growth rate at +3%. However, it is worth highlighting that since 2000, the US economy has only rarely been able to post two consecutive quarters with year on year growth above +3%. As such, the current pace may not be able to be sustained for long in 2018, even though the forecasts of the White House's economic advisors are holding out for the recently approved fiscal measures to have a lasting impact. Although it is likely that introducing new fiscal measures will indeed be positive for economic growth, it is difficult to evaluate the truly tangible impact in 2018. We believe it more sensible to count on the current trend continuing over the coming quarters, propped up by factors already at play.

This should be done without hiding the potential negative effects on GDP of the Fed's key rate normalisation policy and the rise in long rates, which will certainly intensify in 2018 as economic fundamentals and the risks of a hike in inflation are taken into account. Expectations are now running high, and will undoubtedly only be met if the US consumer meets those expectations. Nonetheless, our forecasts for the first half of the year remain optimistic, and we believe that the +3% growth rate can be kept up a while longer.

The Eurozone economy is becoming more powerful

Our growth forecasts for the Eurozone, as well as for the Euro, were certainly amongst the most optimistic at the start of 2017, but today we are rather pleased to see that the forecast trend is gaining in strength. The ECB were pleased to highlight the fact that Eurozone growth was robust and showed very clear signs of picking up the pace. However, forecasts of an inflation recovery have remained much more prudent, and have not been significantly revised upwards. Inflation forecasts for 2017 have not changed (+1.5%) and those for 2018 (+1.4%) and 2019 (+1.5%) have hardly increased, pushing back the moment inflation will hit its +2% target to after 2020.





Graph sources: Bloomberg/BBGI Group

Key rate policy should not change for the time being and asset purchases should continue as planned until September 2018, and beyond that if necessary. The ECB seems confident in the success of its policy to revitalise growth and bolster inflation's upward trajectory. However, a substantial degree of monetary expansion will be essential given the lack of any real inflationary pressure.

The Euro's recent rise against the US dollar could be source of uncertainty, also providing grounds for maintaining sufficient quantitative policy to exploit the programme's room for manoeuvre, retain the ability to take action, and allow the interest rate yield differential to grow with the ongoing process of normalising US rates. It seems particularly logical that the Euro would strengthen with the economy picking up the pace, but the ECB remains prudent so as not to allow this rise to endanger the quality of the current economic recovery. As such, in 2018 the ECB will be very cautious in announcing any potential tweaks to its programme, the scope of which is the only unknown quantity. However, we believe it is likely that the programme will be reduced from 60 to 40, or even 30, billion Euros per month as of January 2018 due to "purchasable" assets drying up. In this context, we still do not predict a rise in key rates over the coming quarters as this should only come into play several months after the asset purchase programme has ended.

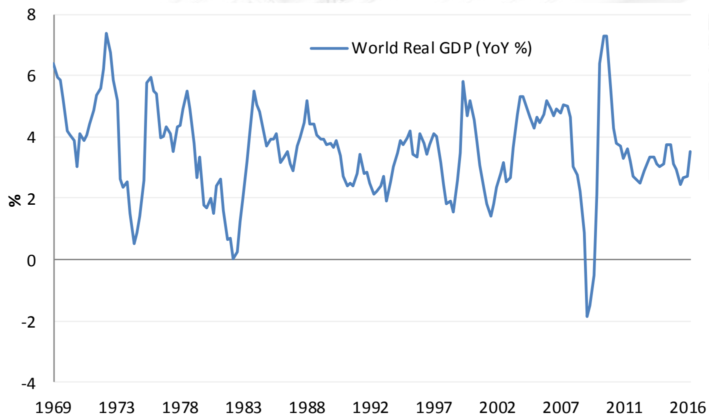
Aggregated Eurozone GDP stood at +2.6% in November, and our forecasts for 2018 predict still-sustained growth of +2.5%. The two main European economies will surpass the +2% threshold (+2.2% for France, +2.4% for Germany), but other economies which are seeing a clear recovery will considerably boost growth. Spain will certainly see a robust trend in 2018, in line with the higher than +3% growth that will undoubtedly be posted for 2017.

British GDP crumbles despite a 50 billion agreement

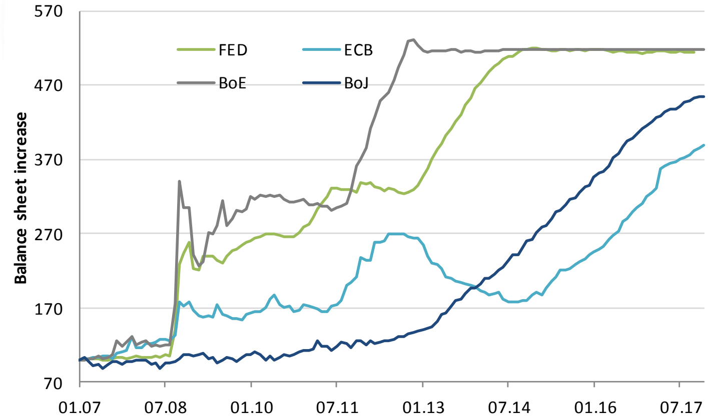
3rd quarter GDP (+0.4%) once again confirmed that the economic trend in the United Kingdom is crumbling, though without any noticeable worsening of the trend. Year on year performance stabilised at +1.5%, which backs up our forecast of overall lower growth in 2017. Exports' contribution fell from +1.7% in the 2nd quarter to -0.7% in the 3rd quarter. Consumption proved something of a pleasant surprise, moving up from +0.2% to +0.6%, which clearly enabled GDP to bolster its growth rate, also propped up by a +0.3% recovery in public spending. Leading indicators support the contention that GDP resilience has lessened, giving rise to less optimistic growth forecasts for the British economy for the next few months. 4th quarter growth could still come in at +0.3%, but the slowdown should be starker in 2018.

In the end, the British government had to accept a 50 billion bill in order to revive Brexit negotiations with the EU. This capitulation opens the door to the essential second stage of negotiations, but it is far from guaranteeing success within the deadlines. There are still countless legal difficulties to be hammered out before a trade agreement setting out the type of relationship between the two partners can be completed. The Bank of England is rather satisfied with this agreement, which decreases the likelihood of the United Kingdom crashing out of the EU. The resumption of negotiations will certainly have a positive impact on the confidence of both consumers and entrepreneurs. The latest hike in key rates to 0.5% could be followed by a long period of inaction. The BoE should maintain this rate or apply minor increases in 2018.

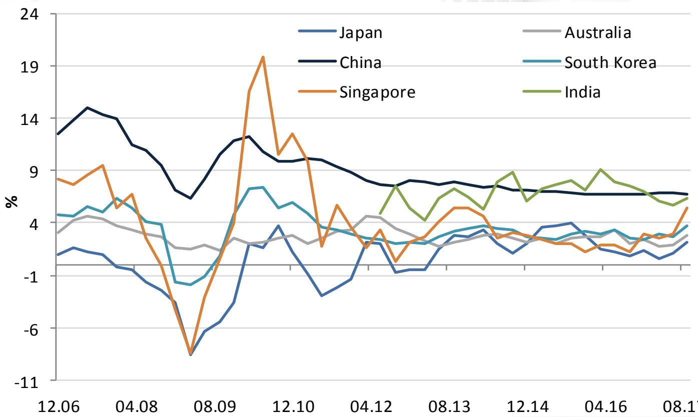
World Real GDP Growth



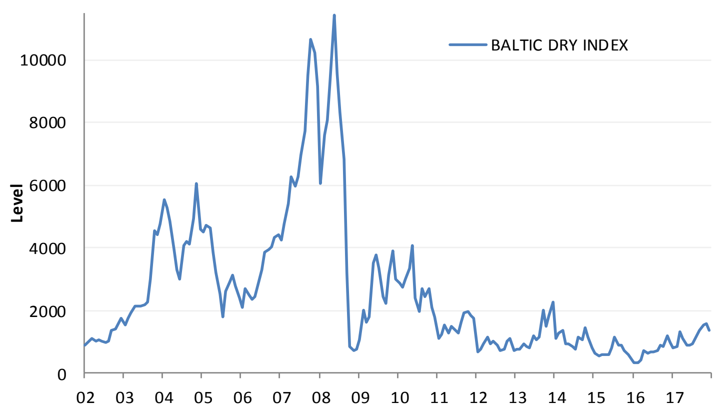
Balance sheet increase



GDP Growth rates in Asia



Baltic Dry Index



Graph sources: Bloomberg/BBGI Group

Economic recovery continues in Japan

After a particularly good result in the 2nd quarter (+2.5% year on year), 3rd quarter GDP growth seemed a little less inspiring at first glance. GDP seemed to have posted a further +0.3% rise (+1.4% year on year)- its seventh consecutive increase- and one of the most significant periods of growth over the past ten years, but the performance showed a slight downturn in the country's economic performance, until the latest revision posted much higher growth (+0.6% for the quarter, once again +2.5% year on year).

As such, this result does not cast doubt on expectations of a clearer recovery in 2017, perhaps able to carry annual growth beyond expectations at the start of the year. Japanese GDP growth seemed to have lost some of its vigour, despite the global economic context being rather better and the yen having weakened, but in the end it did well and posted growth higher than its potential. The Japanese economy has been boosted by the ongoing export recovery already seen in previous quarters, and by an investment recovery.

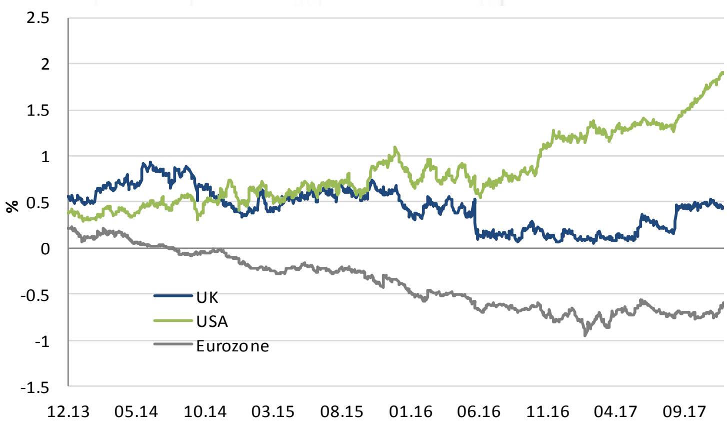
As such the trend was stronger than at first glance. Exports rose +1.5% over the quarter, to give +14.1% year on year, but the Japanese economy is still not reaping enough benefit from domestic demand, which is struggling to make itself felt. Public spending weighed down GDP figures, due to a -2.5% contraction following the +5.8% rise in the previous quarter. Private spending, represented by household spending, also trod water, remaining stable (0%), after having contributed +0.7% in the 2nd quarter. Excluding inventories, private spending dropped -0.5%, undoubtedly due to weak wage rises and adverse meteorological conditions. These developments are rather disappointing, and call into question forecasts for the second half of the year.

We had predicted more favourable economic development for Japan in the second half of the year due to an expected spending recovery, which could still materialise. GDP growth cannot be exclusively borne on the shoulders of foreign demand. The good export results should continue, but doubts remain as to domestic demand's ability to once again make a sufficient, and above all lasting, contribution to overall growth in 2018. However, despite everything, our forecasts predict growth again, and it should be a little better balanced between the three factors mentioned above. Japanese GDP should still grow +2.5% in 2018.

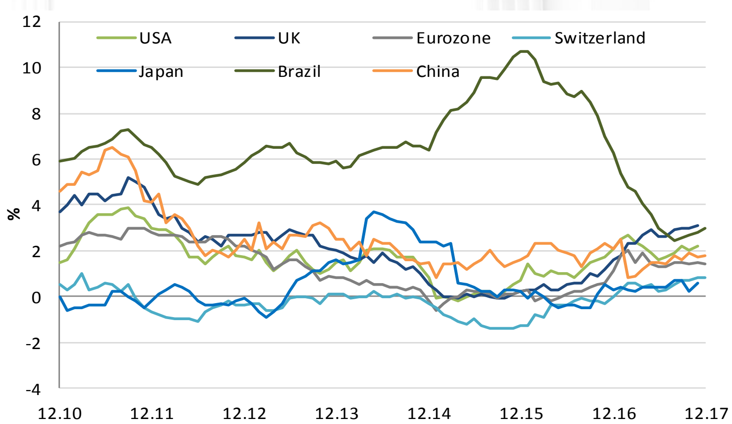
Swiss GDP to pick up to +1.8% in 2018

Swiss GDP grew slightly in the 3rd quarter (+0.6%), posting its best growth rate since the 4th quarter 2014, just before the SNB's change in monetary policy on the 15th January 2015. Growth for 2017 should come in at +1.5% in the end, after another robust 4th quarter. This result is particularly encouraging for 2018. Swiss GDP has recovered to a growth rate of more than +0.5% per quarter, in line with the more favourable trend in Europe and in most other industrialised countries. Since 2012, quarterly growth has only come in higher than last quarter three times, underscoring how positive this result is. The Swiss economy is therefore considerably picking up the pace of its growth, giving us glimmers of better prospects for 2018, particularly if the global economy continues to improve as expected and exchange rate conditions remain favourable. After briefly wavering, at the end of the year, leading indicators were pointing to the Swiss economic trend intensifying. We therefore expect GDP to have risen around +1.5% in 2017, thanks to the positive trend of the last few months continuing into the 4th quarter. This will undoubtedly foreshadow a further increase in pace to +1.8% in 2018 thanks to recoveries on spending and foreign trade.

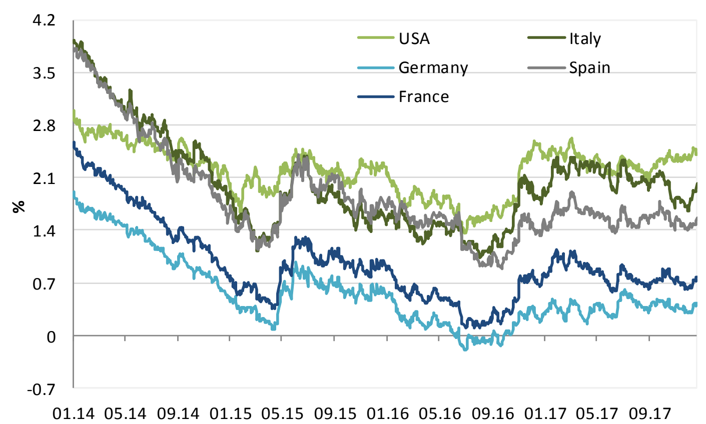
2-year Government Bond yield



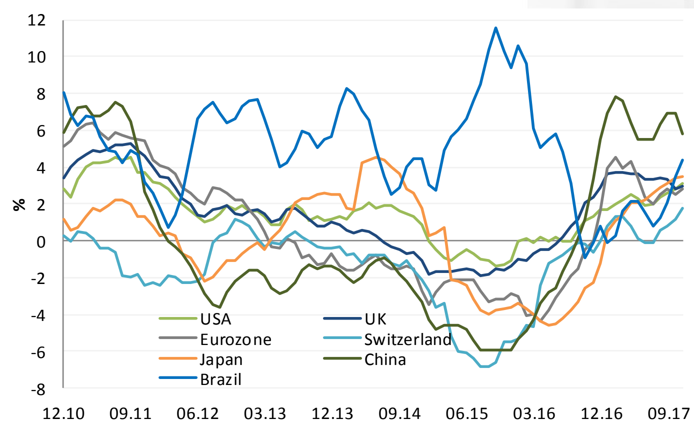
Inflation - CPI Indices



10-year Government Bond yield



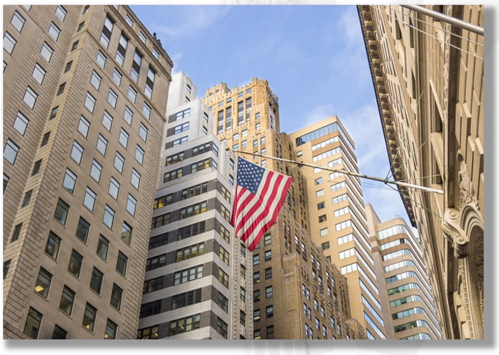
Inflation - PPI Indices



Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

United States



- Difficult to sustain growth exceeding +3%
- Two further rate hikes in 2018
- Upturn in inflation could be the surprise of the year
- Rate hikes and flattening yield curve
- Pressure on multinational corporate profits
- Inflection point for multiples... and for the S&P 500

Difficult to sustain US growth exceeding +3%

The US economy will likely close out 2017 with annualised growth of around +3% in Q4, in line with our forecasts at the beginning of the year. Still recently we evoked the likely strengthening of US growth, carried by private consumption, investment and exports, which will likely remain positive factors as 2018 kicks off. The growth target set by the Federal Reserve was +2.4% in 2017 – a result that will likely be achieved thanks to the upturn observed in the second part of the year. We still believe that a +2.6% GDP growth rate for the year is likely.

Leading indicators clearly point to increased economic activity at the end of the year and in the beginning of 2018. Most economic indicators suggest that the current uptrend will persist. First, US consumers should take comfort in the flow of positive economic news and the ever more favourable situation of the job market. An increase in personal income will likely provide a lasting boost to household consumption in 2018.With regards to investment, recent economic developments have had an impact on levels of production capacity, which will undoubtedly trigger new investments in a rather favourable context for corporate margins. Economic conditions in the US seemed to have settled into a relatively high rate of growth of +3%.

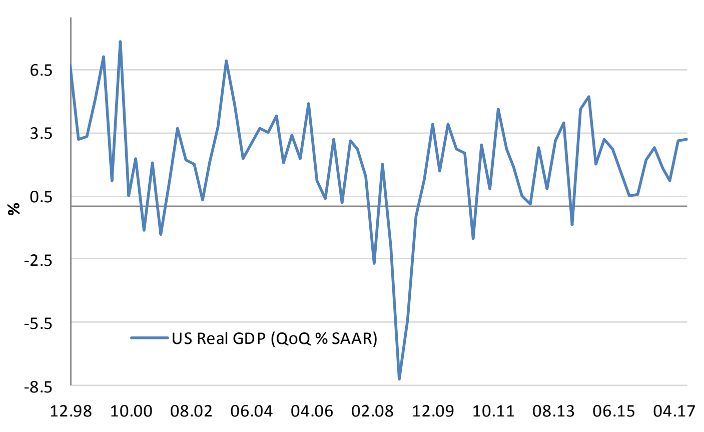
Nevertheless, it is interesting to note that since 2000, the US economy has only very rarely recorded two consecutive quarters of annualised growth over +3%. Thus, the current rate may not be sustainable over the long term in 2018, even if the White House economic advisors' estimates point to the expected long-term impact of the tax measures that were recently passed. Nevertheless, it is likely that the introduction of new tax measures will indeed be positive for economic growth, although it is difficult to assess the effects that are already truly visible in 2018. It is likely more reasonable to table on a continuation of the current trend in the next quarters, supported by factors already at play. All this without forgetting the possible negative effects on GDP growth of the Fed's key rates normalisation policy and the increase in long-term rates, which will most likely intensify in 2018, taking into account economic fundamentals and the risks of a rise in inflation. Expectations are now high and will likely only be met if US consumers play their part.

Nevertheless, our forecasts for H1 remain optimistic, and we believe that an economic growth rate close to +3% will likely persist for a while before subsequently dropping.

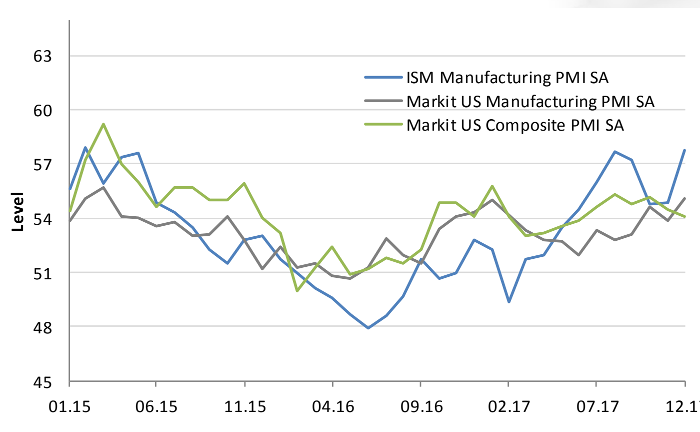
Two more rate hikes in 2018

During its last meeting, the Federal Reserve proceeded with a further rate hike to 1.5%, as expected. New chair Jerome Powell will take office after the next meeting in January with no risks of significant change in the stated policy. Balance sheet normalisation will remain very moderate, not to say imperceptible. In parallel, the target for key rates (Fed Funds) will likely increase to 2-2.25% in 2018. FOMC members' analysis of the economic conditions and the state of the US economy remained relatively unchanged in December. Remarks regarding the possible effects of the tax reforms have been rather surprising, most of them finding the long-term effects of these measures to be relatively limited.

Quarterly US Real GDP Growth

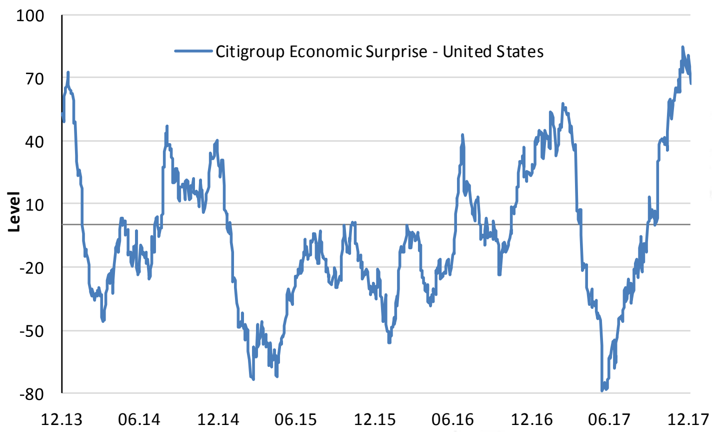


PMI Indices

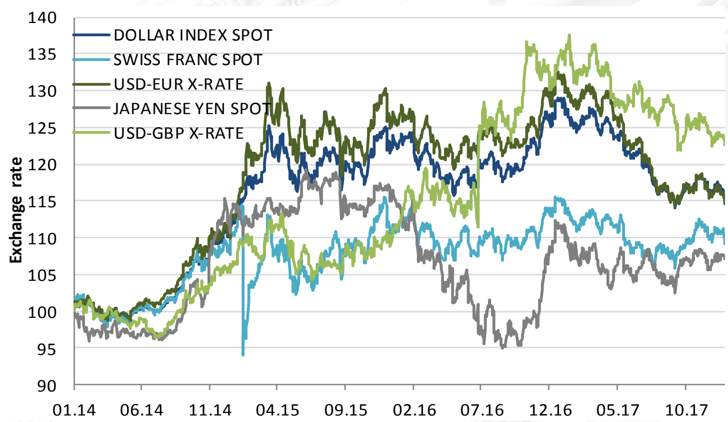


Graph sources: Bloomberg/BBGI Group

Citigroup economic surprise index USA



Dollar trade-weighted index and currencies



The central bank's position on this matter seems particularly divergent from that of the White House, which considers the tax reform as a major and long-term factor boosting the GDP growth rate. At the moment, the Fed actually seems to view this reform as a short-term stimulus whose effects will remain limited in time. It also does not appear convinced of the reform's impact on consumption and has actually evoked the risk that listed multinationals will not increase their investments significantly, on the contrary opting to use the resulting cash-flow to implement debt reduction and merger and acquisition strategies.

With regards to inflation, it is likely that the Fed would like to see price indices grow at a slightly stronger and faster rate than the targeted 2%. However, it still seems convinced of future inflation trends. While hoping for an impact on wages triggered by the decline in the unemployment rate, the Fed undoubtedly considers that pressures will remain limited and pose few risks requiring the need for abrupt and unexpected monetary policy actions. The monetary policy will likely remain very clear in Q1 2018 with an expected 0.25% hike in Q2, which will then be followed in the last quarter by a further 0.25% increase.

Upturn in inflation could be the surprise of the year

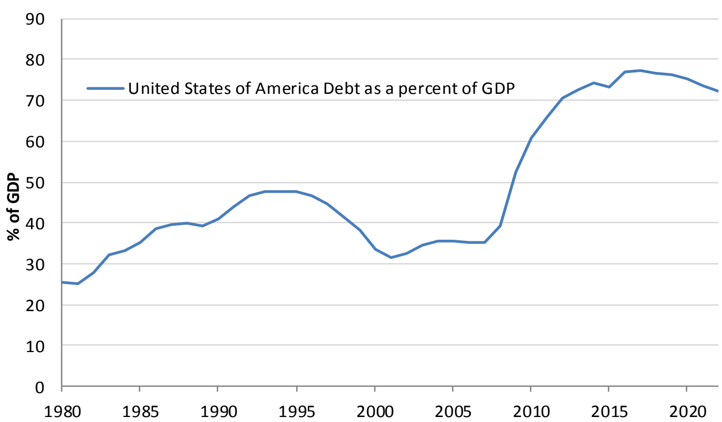
The latest inflation figures published in November (+2.2%) pointed to a stabilisation of price indices slightly above the Federal Reserve's targeted +2%. The yoy rise of the index excluding food and energy (+1.7%) was slightly below expectations and still under 2%. This shows that inflation has clearly struggled to gain greater momentum in H2 2017, despite statistics that indicated accelerating economic growth in the US. Nevertheless, the central bank is not showing any signs of worry or impatience, noting instead that temporary factors have for the moment held back an increase in prices. Nevertheless, the strength of the economy and an unemployment rate at a 16-year low will almost certainly trigger tensions and price increases enabling inflation to exceed the set targets. Pressure on wages is slow to materialise despite a continuously improving job market.

Contrary to theory, inflationary pressures are still weak, while the unemployment rate has steadily dropped to a historic low of 4%, de facto approaching its full employment level. Nevertheless, the Fed remains relatively serene and convinced that the relation between employment and inflation still exists, even if it appears that the Phillips curve is for the moment clearly flatter than before. Import prices have surged 3.7% yoy mainly due to the increase in oil prices in November. This trend will likely continue in 2018 with the upswing in business activity. Forecasts for expected inflation have progressed at the end of the year, reaching +2.7% yoy and +2.4% on a 5 to 10-year time horizon.

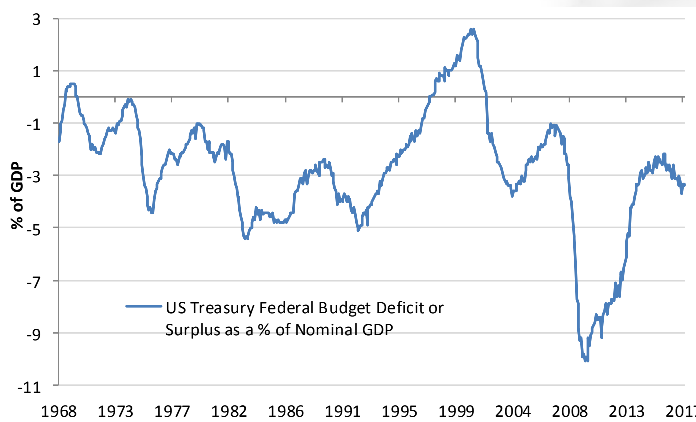
Inflationary pressures were limited in 2017 and mainly linked to external factors. In the US as in most economies, rising inflation was indeed triggered by the increase in crude oil prices that began in 2016 and continued to have an effect in 2017 – a year that was marked by successful policies carried out by central banks to put a stop to deflation and to bring the rate of inflation back towards their targets generally set at 2%. Thus, inflation has returned to a "normal" level, while employment has improved and tensions on the job market have yet to appear.

A series of surprises could mark 2018 owing to multiple factors acting in combination. Indeed, the macroeconomic environment will likely be conducive to wage negotiations and pressures on commodity prices, supporting an increase in production and consumption prices.

Debt (% GDP)

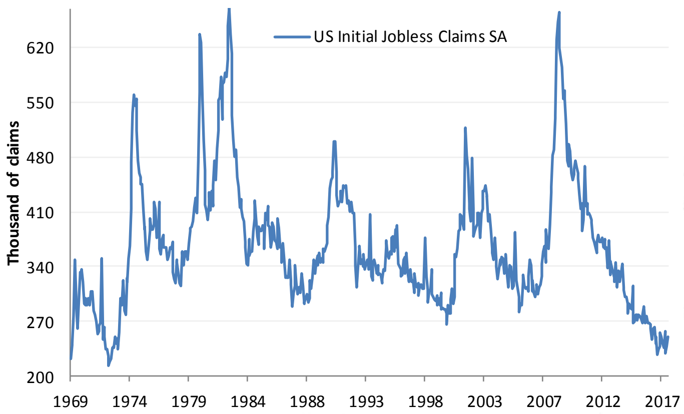


Deficit/Surplus

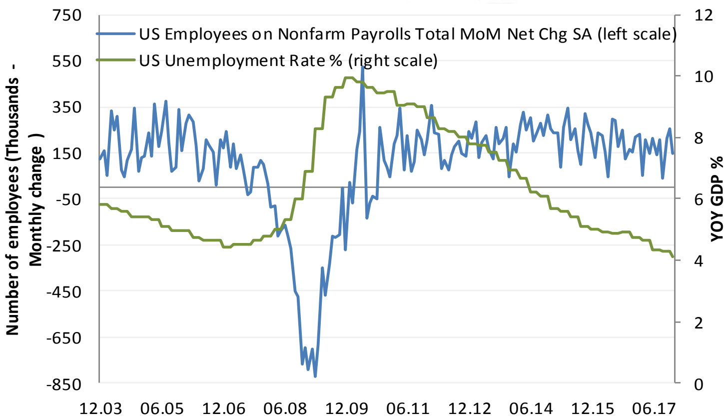


Graph sources: Bloomberg/BBGI Group

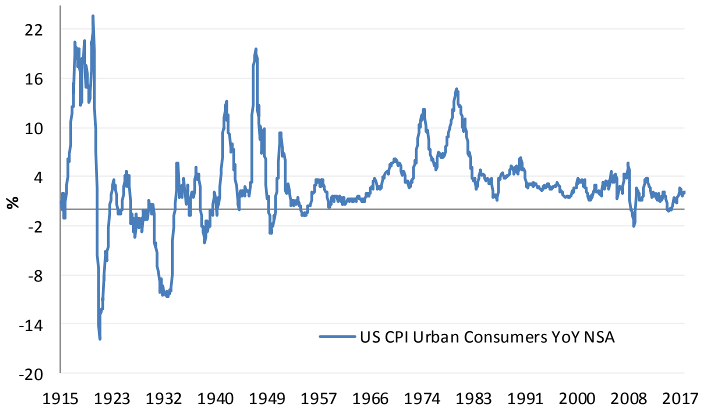
US Jobless Claims



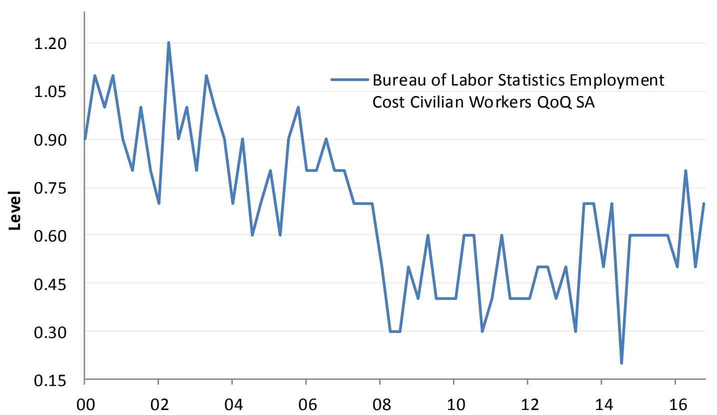
Non-farm Payrolls (MoM) and Unemployment rate



US Inflation (1914-2017)



Employment Cost Index



Graph sources: Bloomberg/BBGI Group

Rate hikes and flattening yield curve

A return of inflation in a robust economic environment will likely see long-term nominal rates being adjusted once again in the next few months. After a few quarters of stabilisation, US long rates will likely be the first to kick-start the trend once again. Already several months ago, we noted that the adjustment in 10-year Treasury rates from 2.6% to 2.1% observed until the end of the summer was not at all compatible with our economic growth expectations in the area of +3% and with a normalisation of the Fed's regular monetary policy. We then believed that an increase in long rates would very likely be observed in the second part of 2017. This took the shape of an increase in 10-year rates from 2.1% to 2.5% as of 31 December. Thus, long-term rates are once again close to the highs they had reached in March and in the upper section of their fluctuation band for 2017.

In H1 2018, confirmation of strong economic data will probably be accompanied by an increase in crude oil prices and commodities prices likely to trigger valuation adjustments in the interest rate markets. We believe that most maturities will be subject to a 0.5% adjustment in the next few months that will push 10-year Treasury rates above 3%.

Rise of the dollar after three years of consolidation

US economic momentum will likely most often be superior to that of other developed economies in H1 2018. Consequently, the interest rate spread will likely widen further across the yield curve and benefit the greenback. In this environment, the weakness of the dollar in 2017 seems unjustified. The depreciation of around -10% of the trade weighted USD index against a basket of currencies erased almost half of the dollar's gains between 2014 and 2015. The value of the US currency will thus undoubtedly adjust in the coming months, unless expectations of deteriorating public finances linked to the tax reform start to prevail and hurt the dollar. Ultimately, our forecasts are positive and support an increase above 1 Swiss franc to the dollar.

Likely pressure on the evolution of corporate profits

It seems that nothing will stop the rise of US stocks. It is true that corporate margins are excellent and close to historical highs at around 10%. Profit growth was also satisfactory in 2017, and analysts expect a +11% increase in 2018 and +10% in 2019. The overall value of US corporate earnings has reached almost 10% of GDP against a historical average of 6.5% over the last 70 years. The distribution of wealth creation as represented by GDP has actually been more favourable for companies in recent years. The overall wage bill in 2017 represented 43% of GDP, significantly lower than the historical average of 47%.

Recent developments in the job market point to likely future adjustments that will undoubtedly weigh on the level of corporate margins and profits. Labour costs represent between two thirds and three quarters of corporate expenditure; an increase in wages will thus have a significant impact on margins. Profit growth for multinationals may thus have peaked and ultimately be lower than expected in 2018, drawing closer to the economic growth rate.

The tax reform, which is so positive for corporate profits, may well be less significant for S&P 500 multinationals than for more domestic and mid-sized companies. However, beyond the fundamental issue of profit growth, it should be noted that the rise in US equities was mainly triggered by a strong phase of multiples expansion. While US stocks traded at less than 10x earnings in 2009, they are now trading at close to 18x earnings. Price/earnings (P/E) expansion phases are generally linked to periods of declining interest rates; conversely, in periods of rising rates, we tend to see the P/E ratio contract.

Inflection point for multiples and for the S&P 500

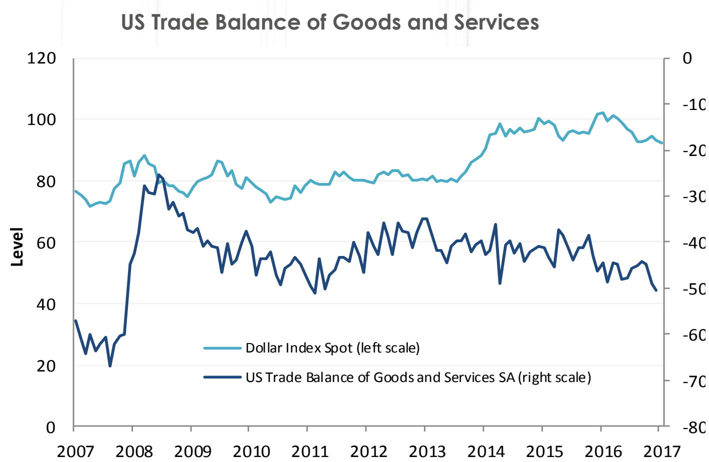
In 2018, the normalisation of monetary policies and interest rates will likely mark a turning point in the growth of multiples. Indeed, it is probable that rising interest rates will put an end to the 10-year expansion phase, regardless of the evolution of corporate profits.

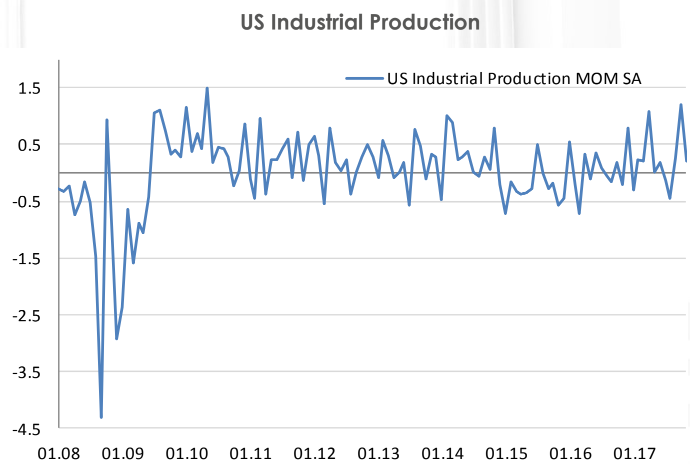
This P/E expansion, especially in the technology and digital sectors, has reached extreme levels similar to those observed in 2000 before the burst of the TMT bubble and the 50%correction in the global market. The valuation levels of these stocks and of GAFA in particular should at least act as a brake on their future development.

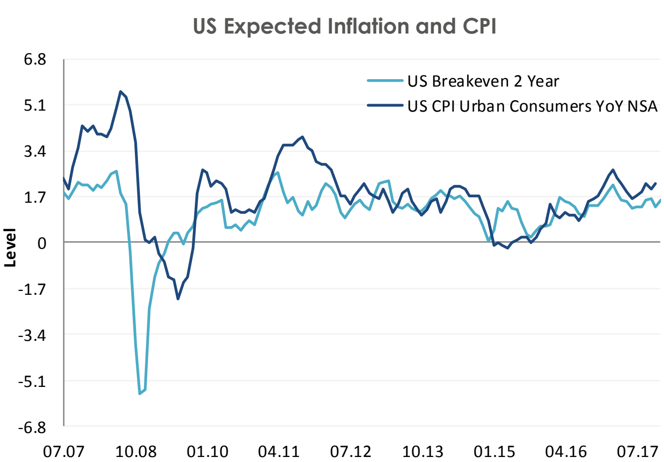
The banking/financial sector, another S&P 500 heavyweight, may also face new difficulties in meeting expected results. Indeed, the current flattening of the yield curve is not a favourable factor for the evolution of their margins, which could lead to some disappointment.

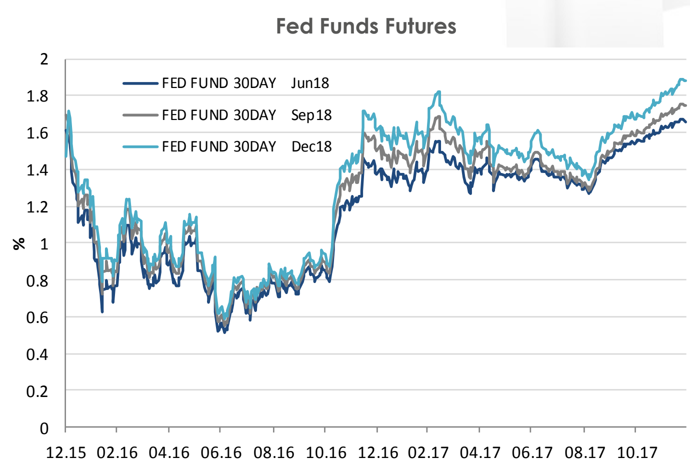
In 2018, energy will likely be one of the rare sectors that will truly be able to post exceptional profit growth rates. However, given the weight of the sector in the global index, this will not have the significant impact required to support global growth in market profits.

In conclusion, the rise of equity markets probably incorporates the favourable impact on profits that all have been expecting from the tax reform for over a year, although as we mentioned multinationals will undoubtedly feel the impact less than other companies. We believe that the two least expected effects at this time are those that may be triggered by the contraction of margins and of P/E ratios, which may well weigh on prices in 2018. Thus, we would advocate a more cautious approach as well as underexposure to US stocks in early 2018.



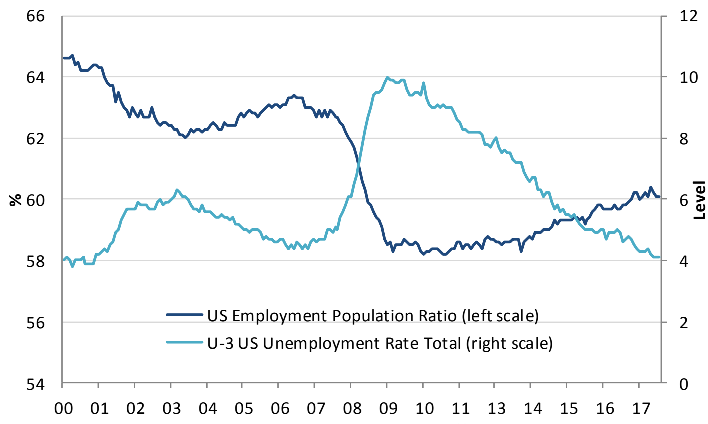




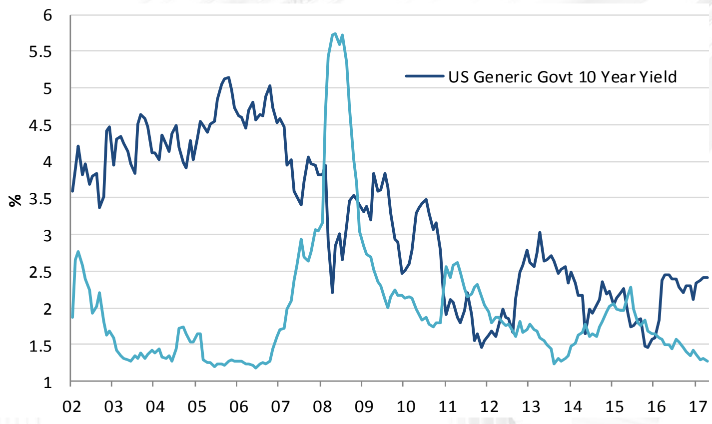


Graph sources: Bloomberg/BBGI Group

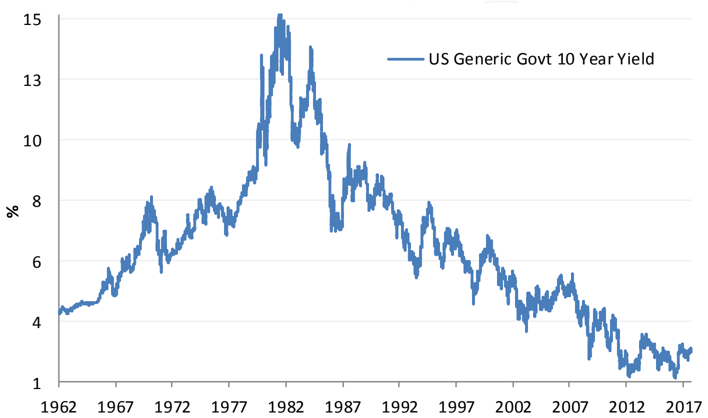
US Unemployment rate and Employment Population Ratio



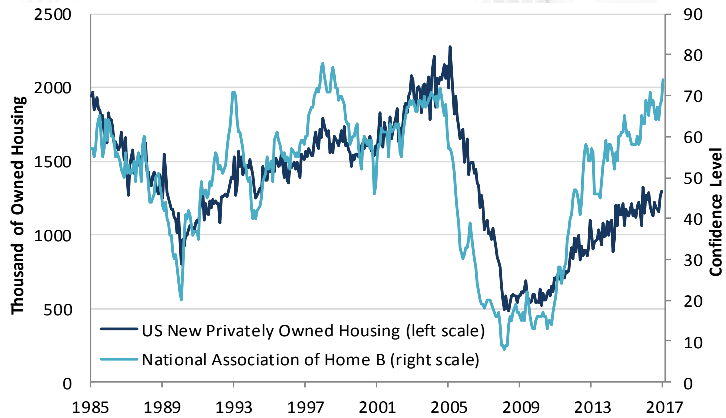
Yield spread Us Treasury - BBB 10 year



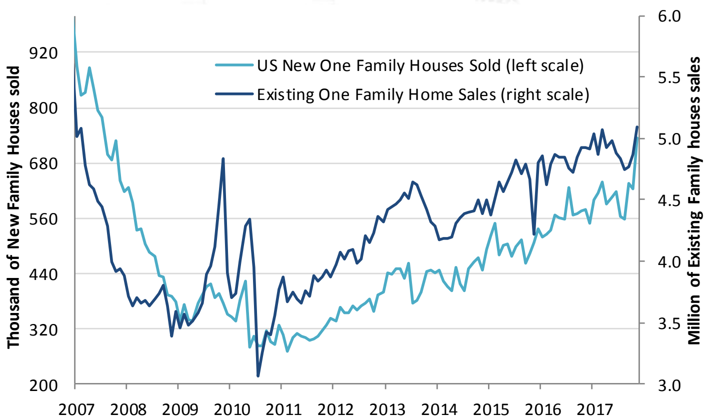
US Government Bonds 10 year yield



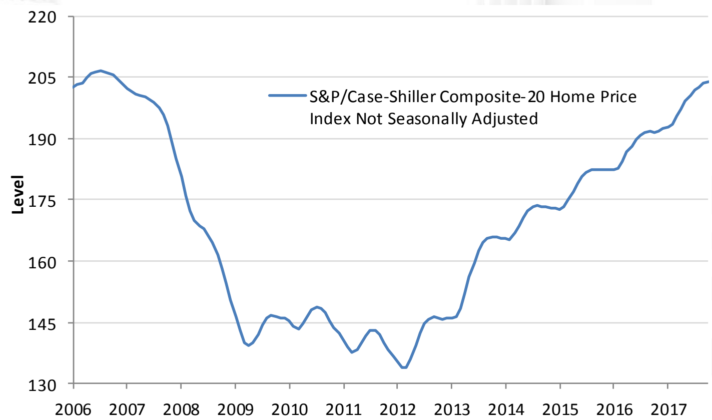
US New Privately Owned Housing and NAHB USA



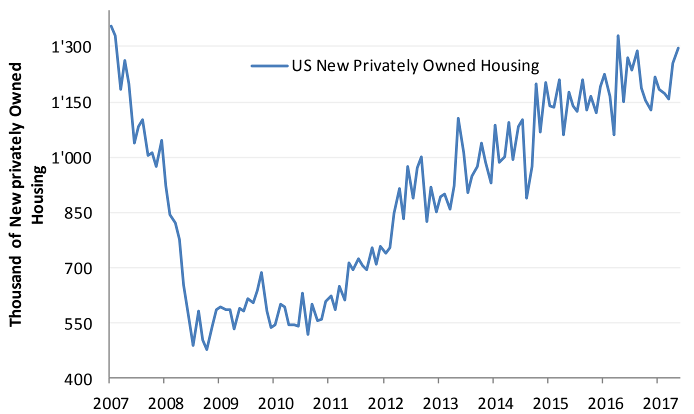
Sale of US New and Existing Family Houses



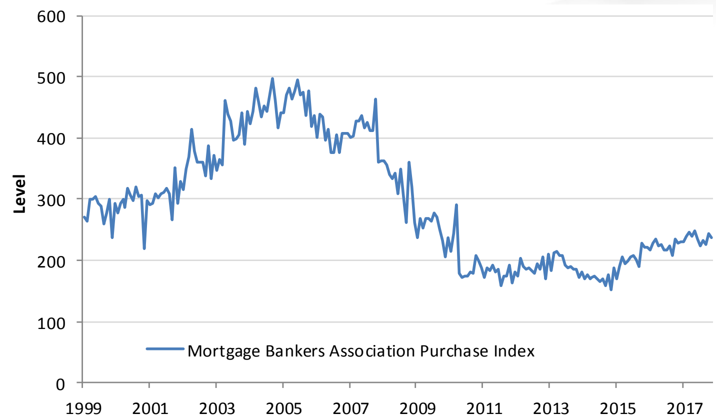
Real Estate Prices - S&P Case-Shiller Index



Housing Starts



New Mortgage Applications - MBA



Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

SWITZERLAND

- GDP picks-up in H2 and should continue to do so in 2018
- Leading indicators also suggest an improvement for 2018
- Cautious optimism for consumption
- 54 billion in profit for the SNB in 2017
- Renewed risks for equities and real estate

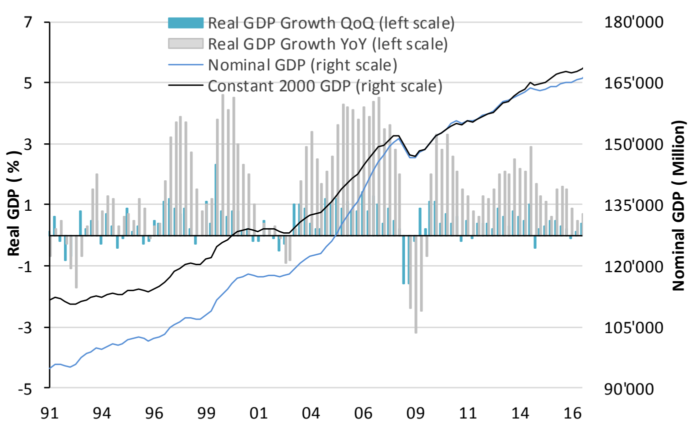
Swiss GDP is expected to have picked up the pace in the second half of the year and should continue to do so in 2018

Swiss GDP slightly picked up the pace in the 3rd quarter (+0.6%) as compared to the previous quarter, the results of which had been revised upwards from +0.3% to +0.4%. As such, the Swiss economy has posted its best growth rate since the 4th quarter 2014, before the SNB (Swiss National Bank) changed its monetary policy on 15th January 2015. In the end, growth could come in at +1.5% for 2017, after another robust 4th quarter. This result is particularly encouraging for 2018. Swiss GDP has recovered to a growth rate greater than +0.5% per quarter, and also seems to be benefiting from the positive trend over the past few quarters in Europe and in most industrialised countries. In fact, since 2012, quarterly growth has only come in higher than that of the previous quarter three times, which shows just how positive the current trend is. The Swiss economy is therefore significantly picking up the pace of its quarterly growth, giving a glimpse of better prospects for 2018, particularly if the global economy continues to improve as expected and exchange rate conditions remain favourable. Having been a bit behind the European and global trend in the 2nd quarter, the 3rd quarter results seems better in line with Swiss economy's growth capacity within a more robust international context over the summer. The disappointment that came with the publication of 2nd quarter figures can now give way to satisfaction grounded in results which came in better than most forecasters' expectations. Year on year growth (+1.2%) has pushed past the +1% threshold, which is a very clear improvement compared to June's result (barely +0.3%), and well above the average analyst forecast of +0.8%. This rise was propped up by domestic sectors (consumption, investment, etc.) as well as international sectors (exports). The manufacturing sector was the largest contributor, likely buoyed up by the weakness of the Swiss franc, which fell nearly -8% against the Euro in a period of a few weeks. The +2.2% growth is particularly significant in light of other sectors whose contributions to growth were lesser. Trade (+0.6%) and healthcare (+0.5%) posted positive developments, whilst finance and construction each slid -0.6%. Domestic demand was still the mainstay of growth, thanks to a very positive combination of private spending (+0.4%) and public spending (+0.6%). However, the performance of these two sectors is not exceptional, and is not in the same league as average historic contributions. One must turn to capital goods for higher-than-average performance. With +0.9% growth, this segment contributed considerably to the quarterly GDP result, thanks in particular to positive developments in the machinery sector. The trade balance for goods and services is enjoying a particularly favourable situation, as demonstrated by a rise in exports (+2.1%) and a fall in imports (-1.6%). The quarter was particularly important for the Swiss economy in terms of currency, due to the Swiss franc weakening against the Euro, in the end rather considerably. The exchange rate correction, which we had predicted in the immediate aftermath of the Euro floor being dropped, is now materialising, propping up growth. We believe that the revaluation of the Euro from 1.06 to 1.174 (on 5/12/2017) has significantly helped to improve economic conditions and the perception of risks and opportunities. After having stood strong in the face of the Swiss franc's appreciation, the Swiss economy is now benefiting from exchange rate normalisation. We believe that this situation should continue in 2018, bringing a little more stability to the external value of the Swiss franc.

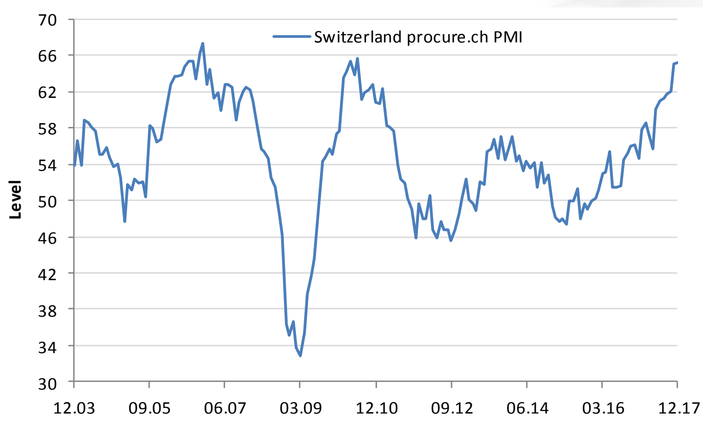
Very favourable forecasts for 2018

The current economic trend should continue, enabling the Swiss economy to make sure it is sticking even more firmly with the front peloton of the main European economies, who are set to close 2017 with +2.5% growth.

Nominal GDP - Nominal and Real GDP Growth rate

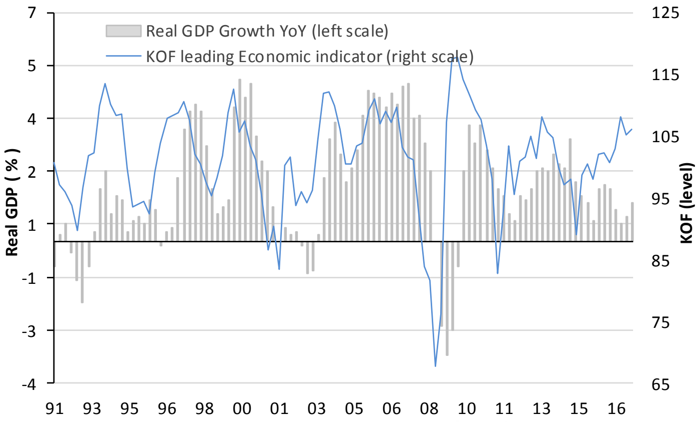


Swiss Purchasing Manager Index (PMI)

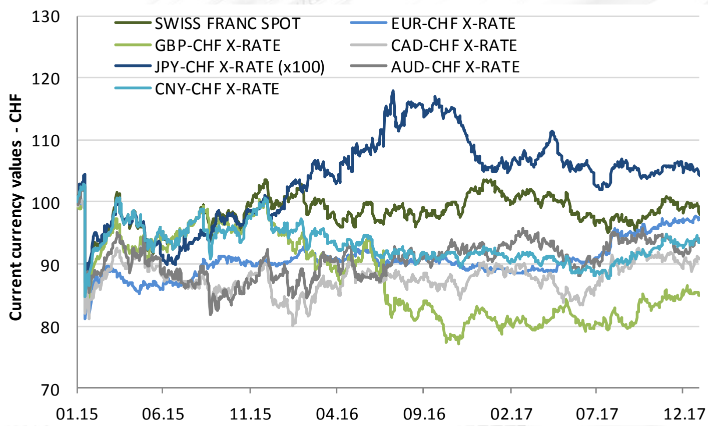


Graph sources: Bloomberg/BBGI Group

Real GDP Growth YoY - KOF leading economic indicator



CHF Exchange rate (Normalized at 100)



As such, we are expecting an approximately +1.5% rise in GDP in 2017, thanks to the positive trend of the last few months continuing into the 4th quarter. This will certainly precede a further acceleration to +1.8% in 2018. The 1st half of the year was rather disappointing due to the unexpected slump in spending in the 2nd quarter. However, we had thought it likely we would see a recovery in the second half of the year, as well as an improvement in exports, which would contribute to the overall acceleration seen in the 3rd quarter. The end of the year should still favour the Swiss economy due to the stronger trend in the Eurozone and a robust export recovery, both propped up by the fall in the Swiss franc against the Euro, as well as revived private spending.

Leading indicators also suggest that things are looking bright for 2018

The latest leading indicators are pointing to economic activity picking up the pace. The KOF index came in at 110.3 for November, which is up 4.3 points compared to the end of September, and at its highest level since 2010. The hesitancy of summer is gone; leading indicators are clearly positive and suggest that 2018 is looking bright.

The manufacturing PMI index literally leapt, from 55.5 in May to 65.1 in November. This is absolutely extraordinary, as it demonstrates the sector's recovery, which was already clearly visible in the 3rd quarter GDP figures. Two years after the shock of dropping the Euro exchange rate floor, the Swiss manufacturing sector seems to be finding its place again, as is suggested by the manufacturing index hitting a ten-year high. The purchasing managers index is showing enthusiasm such as has rarely been seen. Order books are full, which bodes well for a robust trend in 2018, particularly if the exchange rate stabilises at around 1.20 Swiss francs to the Euro, and above 1.05 to the US dollar. Moreover, the consumption climate is improving, as can be inferred from SECO and UBS measures, as well as the considerably increased investor confidence.

After wavering for a brief period, at the end of the year leading indicators are pointing to the economic trend in Switzerland intensifying.

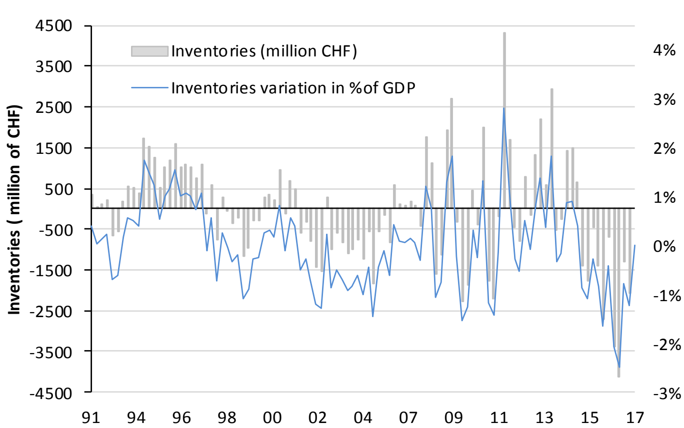
Cautious optimism for consumption

The latest drop in the unemployment rate to 3.1% still leaves it far from the record low of 2.5% in 2008, but the jobs market is showing enough vim and vigour for consumption to gradually increase. Household confidence has been gradually increasing since 2015, though without hitting levels seen in 2014. The improvement in growth prospects and the rise in the Euro should have a greater and more positive influence on the economic climate in Switzerland over the coming months. Private spending should therefore continue to prop up GDP. Public administrations' consumption spending will remain volatile in 2018, but the national and cantonal accounts are in rather good health, and the debt-to-GDP ratio (34%) remains low when compared internationally. We see no reason to predict a fall in public spending in 2017, and reckon on it making a positive contribution.

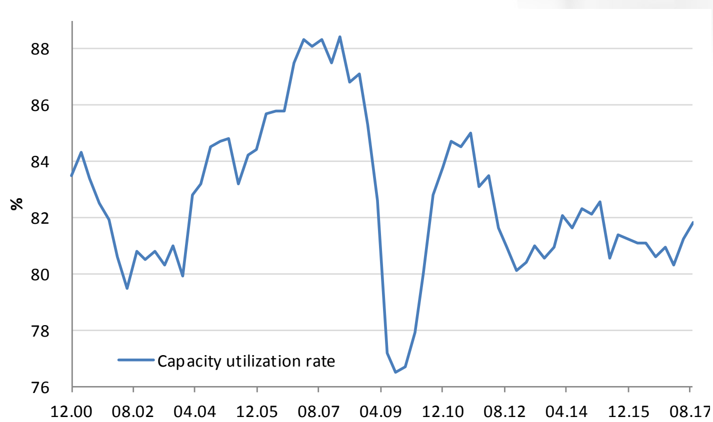
Recovery expected for foreign trade

Despite the rise in the Euro over the summer, the trade balance has yet to benefit from the increased competitiveness of Swiss exports to the Eurozone. Although it still has a clear surplus, the trade balance has seen no further positive developments like those seen in January 2017. In fact, the monthly foreign trade balance has stabilised at between 2 and 3 billion Swiss francs. However, we believe that the improvement in international conditions and the weakness of the Swiss franc should finally combine to support an export recovery. The watchmaking recovery has got back on track, posting a +9.3% increase in sales year on year at the end of October. With the exception of the United States (2nd largest market), which was down slightly, growth to Hong Kong (largest market) stood at +5.4%, and came in at +17.3% for China (3rd largest market).

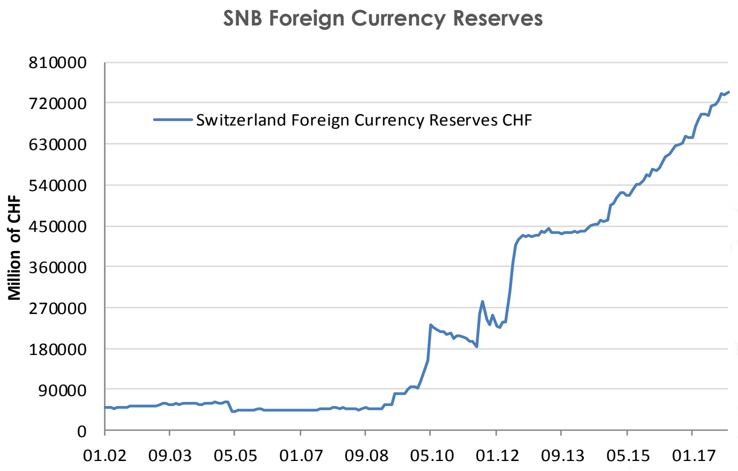
Inventories - variation in % of GDP

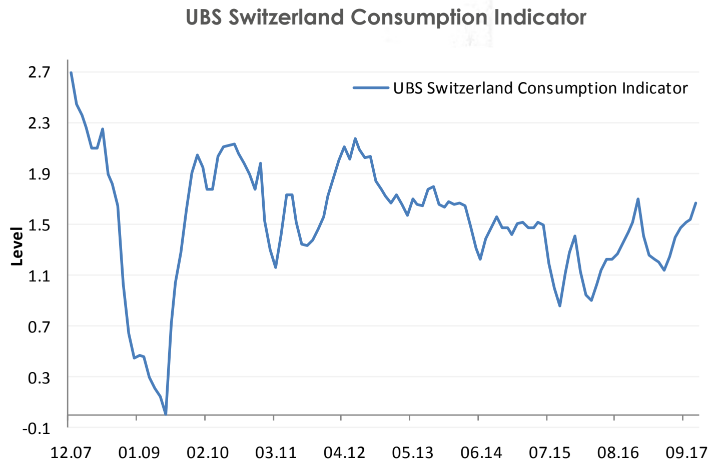


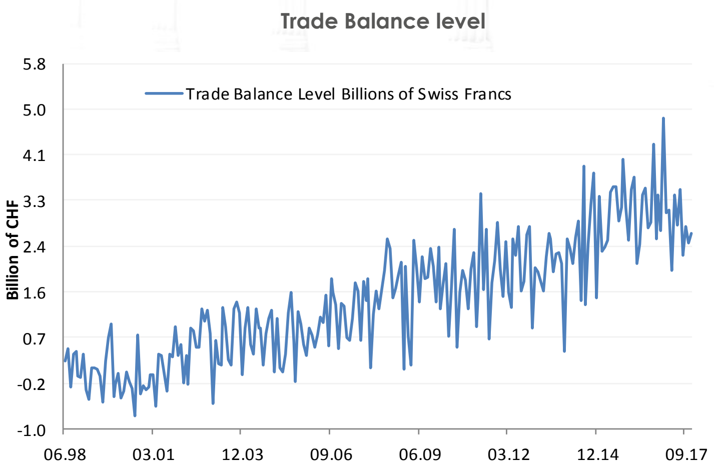
Capacity utilization rate

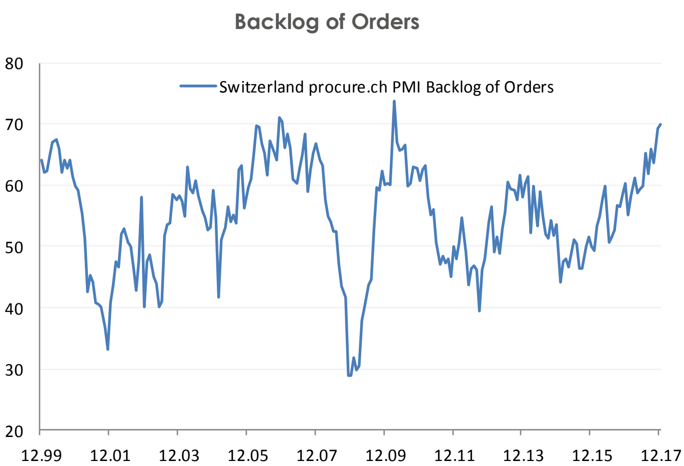


Graph sources: Bloomberg/BBGI Group









Graph sources: Bloomberg/BBGI Group

The SNB has the champagne on ice

Since January 2015, we have regularly maintained in strategy analyses that the SNB's monetary policy would be a success. We have frequently mentioned that the EUR/CHF exchange rate would return to the 1.20 level it was at when the Euro floor was in place. Introducing negative rates quickly stabilised the exchange rate, though it remained inflated, and only gradually adjusted. We had to await a clear improvement in the European economic situation in 2017 and the prospect of the end of ECB liquidity injections in 2018 for normalisation to begin and then speed up. Today, the exchange rate has hit 1.175 and is barely 2% away from the Euro floor rate in place in January 2015.

The SNB can therefore be pleased with its policy over the last few years, which is increasingly proving to be a major success in terms of monetary strategy. Let us hope that they can pop the cork on the champagne on the 15th January 2018 with a 1.20 exchange rate exactly 24 months after their intervention, which in 2015 was mistakenly viewed as them abandoning the Swiss franc.

54 billion in profit for the SNB in 2017

The SNB currency reserves accumulated over the last few years have brought the total assets held in foreign currencies to 741 billion Swiss francs.

The success of its policy will certainly have a significant impact on its financial results and its ability to make a positive contribution to the national and cantonal budgets when it distributes its profits, which will undoubtedly be higher than in 2017, linked to the 24 billion in profit for the 2016 tax year. Although the SNB has mainly provided support for the EUR/CHF exchange rate, it ensures it keeps a balanced distribution in its currency reserves between the US dollar (35%), Euro (40%), pound sterling (7%), yen (8%), Canadian dollar (3%), and other currencies, including the yuan, at 7%. The SNB estimates that 2017 profit will reach 54 billion Swiss francs.

The weakness of the Swiss franc is not over

The Euro is rising well again after the +20% change in the exchange rate. Stronger growth in the Eurozone and a widening of the interest rate differential will support the Euro in rising to a 1.20 exchange rate with the Swiss franc. In the United States, too, the trend is picking up the pace, and the interest rate curve is increasingly working in the US dollar's favour. In this context, if the US dollar recovers some momentum, it could rise above 1.05.

The rate curve is steepening

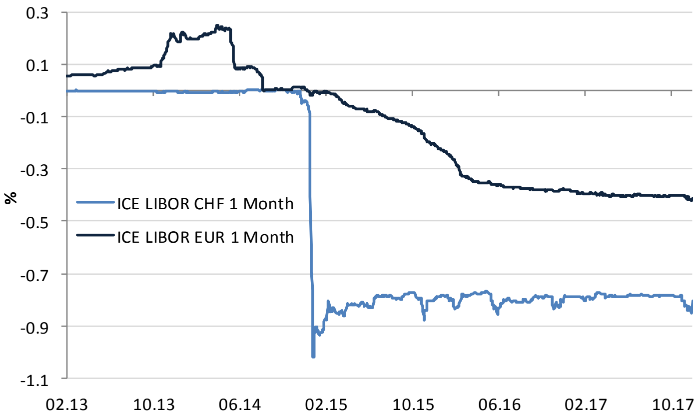
Long-term rates in Switzerland started to normalise in summer 2016 in the wake of the change of trend in the United States. 10-year Swiss rates have bounced back since their -0.6% levels at the start of July, stabilising at just below zero. In this context, the long-term rate differential between the German Bund and Swiss bonds is stable at 0.5%, which is certainly still not enough to push the Euro to rise beyond 1.20. Swiss inflation has now headed north of 0.7%, and should be bolstered by the weakening of the Swiss franc in 2018. As such, it will prop up upcoming rate normalisation in 2018. The bond bubble should therefore start to deflate, with no immediate signs of panic, before picking up again.

Renewed risks for equities and real estate

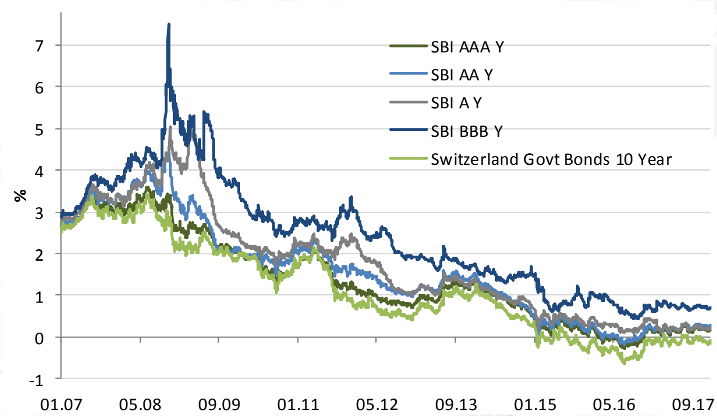
Equity markets and Swiss real estate investments have benefited from this favourable economic and financial context, but with roughly +15% growth in equities, valuations already seem high enough to spark some profit-taking. The same holds true for investment funds (+6.5%) and real estate companies (+12%), which have already seen some adjustments, making yield, which is now once again close to 3%, seem more appealing once again.

We are maintaining our positive forecasts for these two asset classes in 2018, but it seems increasingly likely that we will see a temporary price consolidation.

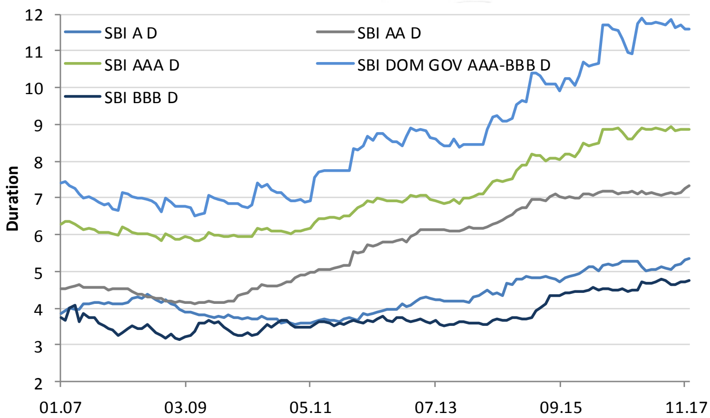
Libor spread rates 1 month



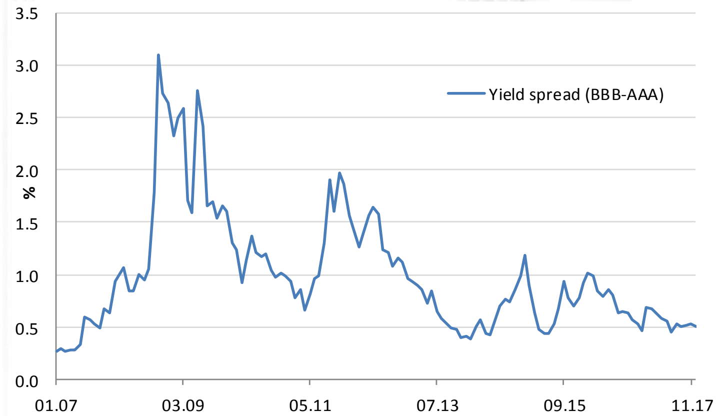
Yield (Government, AAA, AA, A, BBB)



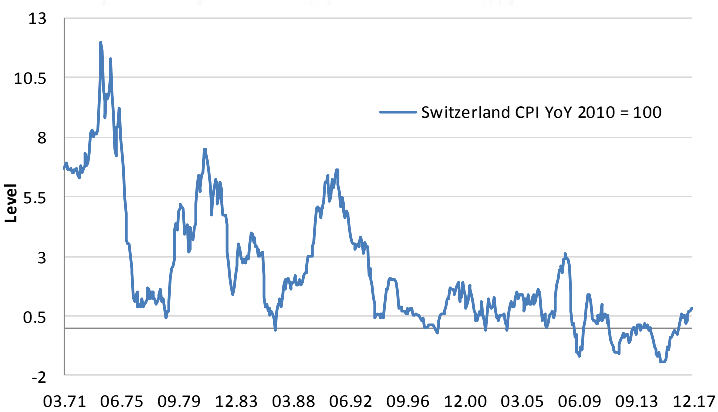
Duration of Swiss bonds



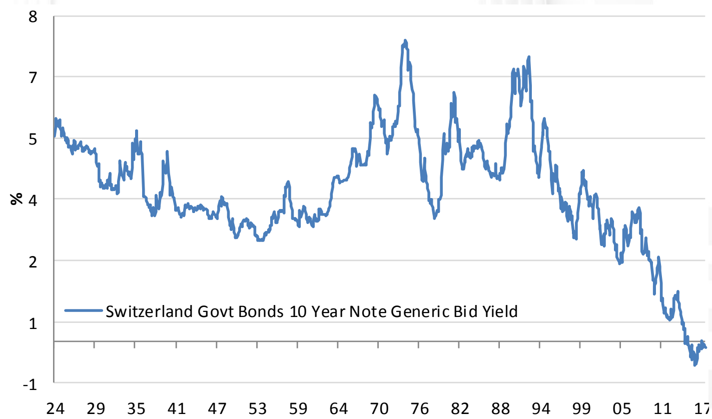
Yield spread



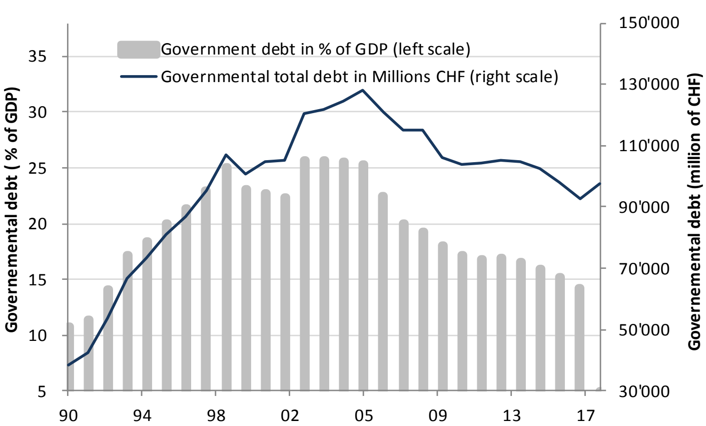
Inflation CPI



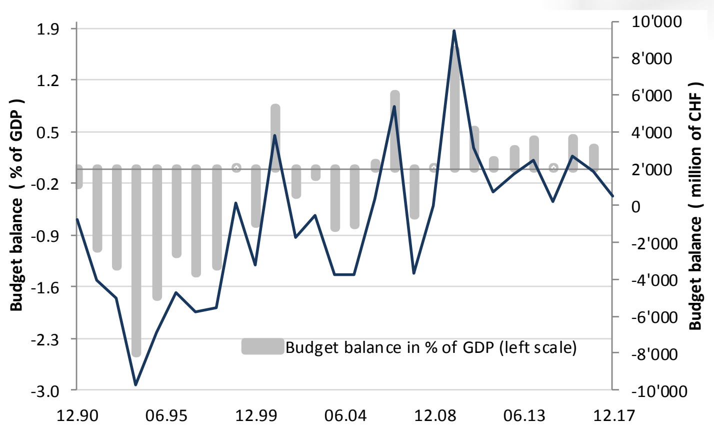
Government Bonds 10 year yield since 1924



Switzerland Government total debt



Switzerland Budget Balance



Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

Eurozone

- The ECB is optimistic and sticks to its monetary policy
- The rise in the Euro is legitimate but it should now be limited
- Almost euphoric climate of confidence
- A rise in long-term rates is on the cards for 2018
- European equities have the advantage

The ECB seems particularly optimistic and is sticking to its monetary policy

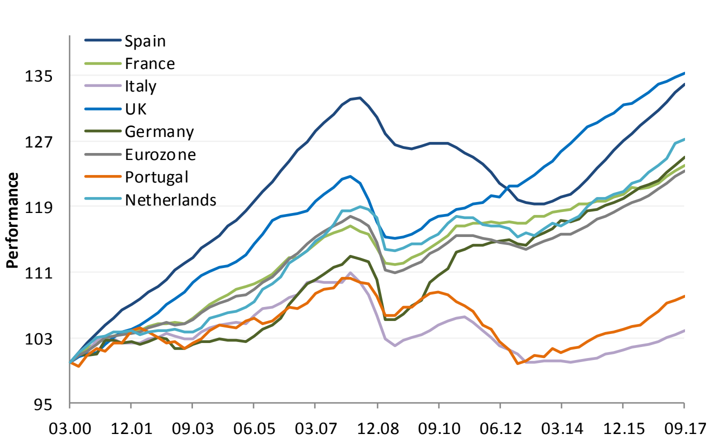
The ECB sent out a particularly optimistic message during its latest press conference on Thursday 14th December. In particular, it considerably increased its Eurozone growth forecasts for 2017, and even more so for the next two years. The ECB is now predicting +2.4% growth for 2017, +2.3% in 2018, and +1.9% in 2019. After having long been cautious as to the quality of the Eurozone economic recovery, there seemed to be a clear change of tone just a few weeks before 2017 draws to a close. Indeed, Mario Draghi spoke of substantial progress in growth forecasts. Our growth forecasts, both for the Eurozone and the Euro, were certainly amongst the most optimistic at the start of 2017. However, today we note with some satisfaction that this forecasting trend is gaining strength. The ECB was therefore happy to underscore that Eurozone growth was robust and showed very clear signs of picking up the pace. However, prospects of an inflation recovery remained much more tentative and were not revised upwards to any considerable degree. Inflation forecasts for 2017 remain unchanged (+1.5%) and those for 2018 (+1.4%), and 2019 (+1.5%) have hardly risen. This pushes back the moment when inflation will hit its +2% target to beyond 2020. As such, unsurprisingly, Mario Draghi announced that key rates policy would not change for now. As we had also expected, he confirmed that asset purchases would continue as announced until September 2018, and beyond then if necessary. The bank is confident in the success of its policy to revitalise growth and bolster the upward trajectory of inflation. Nonetheless, it will still undoubtedly be essential to keep a substantial degree of monetary accommodation given the lack of any real inflationary pressure.

The Euro's recent rise against the US dollar could, however, be considered a source of uncertainty, and the reason for keeping in place quantitative policy with enough room for manoeuvre to exploit the programme's flexibility, retain the ability to take action, and let the interest rate differential grow with the ongoing normalisation process for US rates. It very much makes sense for the Euro to strengthen as the economy accelerates, but the ECB will remain prudent in not allowing this rise to endanger the quality of the current economy recovery. As such, in 2018, the ECB will very cautiously announce any potential tweaks to its programme, the breadth of which is still the only real question mark. We believe that it is likely that the programme will be reduced from 60 to 40, or even 30 billion Euros per month as of January 2018, due to "purchasable" financial assets drying up. In this context, we still do not predict a rise in key rates for the next few quarters. It is only predicted that this will happen several months after the asset purchase programme is stopped.

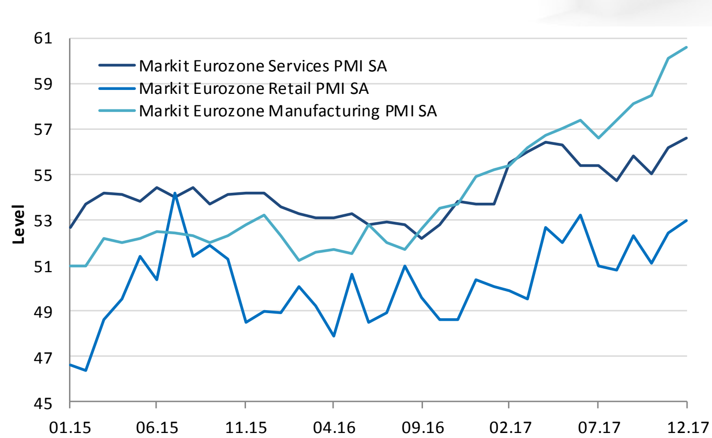
There are grounds for the rise in the Euro but it should now be limited

The rise in the Euro may already be an issue for the ECB, which might start worrying about its undesired effects on inflation prospects and European industry's competitiveness. The changes in the Euro/US dollar exchange rate has been one of the major trends in 2017. The approximately +15% growth in the Euro was certainly partly down to the weakness of the dollar, but it is first and foremost thanks to the, for many surprising, improvement in economic conditions in the Eurozone, making the single currency more attractive again. As such, the Euro has appreciated against many currencies, particularly against the Swiss franc. From the change in SNB monetary policy in 2015 onwards, we had forecast that the introduction of negative interest rates would in the long term lead to a gradual loss of interest in the Swiss franc, which could once again push the exchange rate towards 1.20. We are now getting ever closer. Despite the good results expected for the European economy in 2018, we believe that the phase of revaluation of the Euro is now strong enough to justify some profit-taking. We believe that the rise in the Euro should become less intense at the start of 2018, particularly against the Swiss franc and the US dollar.

GDP Growth - Eurozone

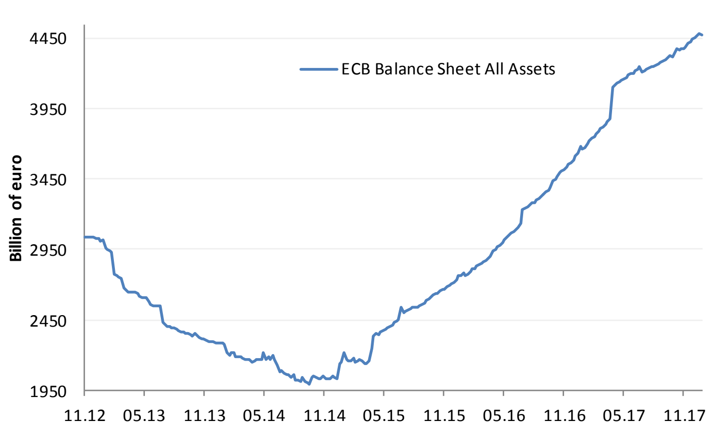


PMI (Manufacturing, Services and Retail) - Eurozone

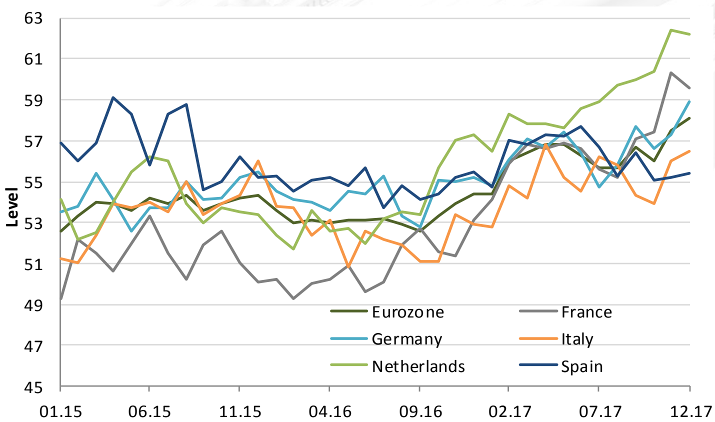


Graph sources: Bloomberg/BBGI Group

ECB Balance Sheet



Composite PMI



However, after a period of stabilisation, it is likely that the undeniable improvement in Eurozone economic fundamentals and the prospect of an about-turn in monetary policy will rekindle investors' interest in the single currency.

European growth is picking up the pace but will still remain behind the United States

Our forecasts at the start of the year that the European trend would improve in 2017 are still being confirmed at the end of the year. Aggregated Eurozone GDP now stands at +2.6% in November, and our 2018 forecasts predict still sustained growth of +2.5%. The two main European economies will surpass the +2% threshold (France +2.2%, Germany +2.4%), but the contributions of other economies which are seeing a strong recovery will boost growth considerably. Spain will certainly experience robust growth in 2018, in line with the higher than +3% growth that will undoubtedly be posted for 2017. We were expecting a stronger second half of 2017, which seems to be being confirmed, and is still supported by leading indicators' higher levels. PMI indices for December confirm the still strong recovery of activity in Europe. Composite PMI improved further in December (58), and is now at its highest level since 2011; similar movements have been seen on leading manufacturing indicators (60.6), underscoring the recovery of an industrial trend which should continue at the start of 2018. Services PMI is following the same trend, growing a little more to 56.2. GDP is therefore showing a new phase of sustained growth, which should continue at the start of 2018.

Almost euphoric climate of confidence

The European Commission's indicator for household confidence grew slightly again, hitting its highest levels for the last ten years. Sentiment has improved quite significantly, and the improvement is still buoyed up by job market conditions. Indeed, we have seen the greatest growth in employment since 2008, after long having seen negative growth until 2014. As such, this is the 4th consecutive year of employment growth. This has considerably reduced the overall unemployment rate from 12% in 2013 to less than 9% today. Beyond this, it is one of the main factors propping up consumer confidence, which is also at its highest point for ten years.

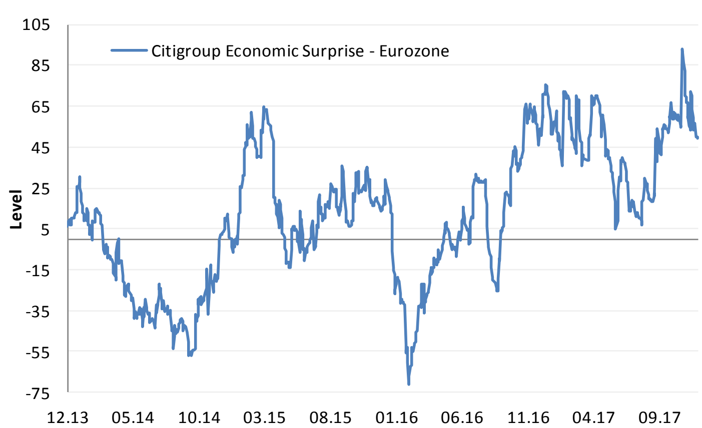
Household confidence is now higher than the average of the last twenty years, and at its highest point since 2008. The consumer and business confidence survey is also showing renewed optimism, with it posting its highest levels since the start of the financial crisis. In most countries we are seeing a welcome return of increasingly assured optimism, which should then prop up consumption and GDP growth.

A rise in long-term rates is on the cards for 2018

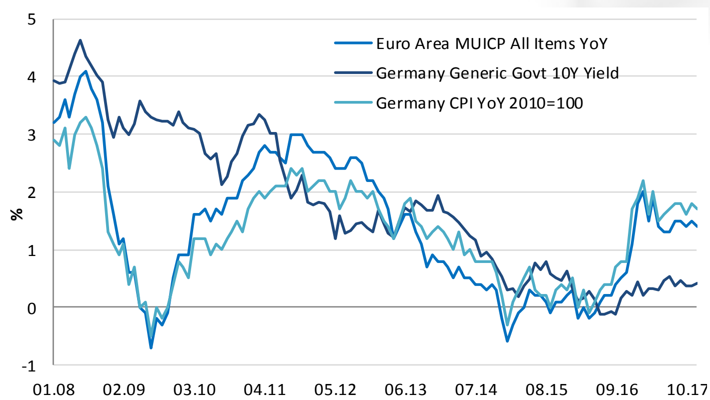
For now, the rise in long-term rates is still entirely hampered by the ECB maintaining the status quo in terms of monetary policy. The position set out by Mario Draghi of continuing the bond purchasing strategy until September 2018, and perhaps beyond that, is extinguishing even the vaguest hopes of long rates changing in step with the changes in fundamental and macroeconomic data.

Equally, as changes in inflation are not showing any clear signs of a surge, the need to change interest rates is not overwhelming. Indeed, for a few months inflation has stabilised at around +1.5%, after a clear recovery from 0% to 2% between June 2016 and February 2017. The rise in the Euro has undoubtedly been key in this recent development, as it was in stabilising energy prices before their latest increase from US $42 to US $58. It is certainly too early to see a clear inflation recovery linked to the jobs market, which is still too far from is friction point for wage rises to lead to an increase in prices. The ECB's 2% inflation target will certainly be difficult to hit, even if the central bank continues with its expansionary monetary policy in 2018, and particularly if the Euro stays strong in the long term.

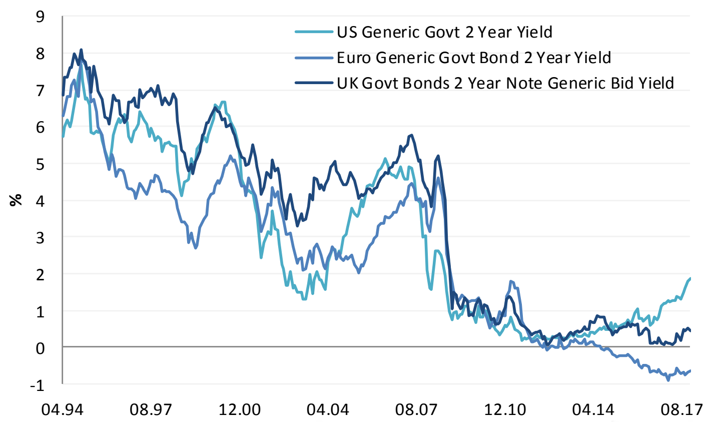
Citigroup Economic Surprise Index - Eurozone

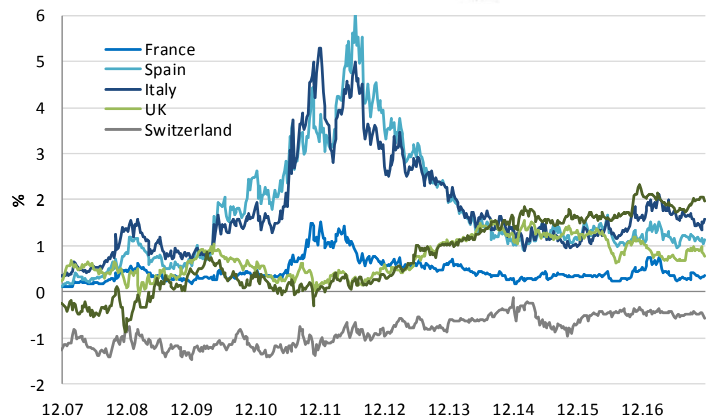


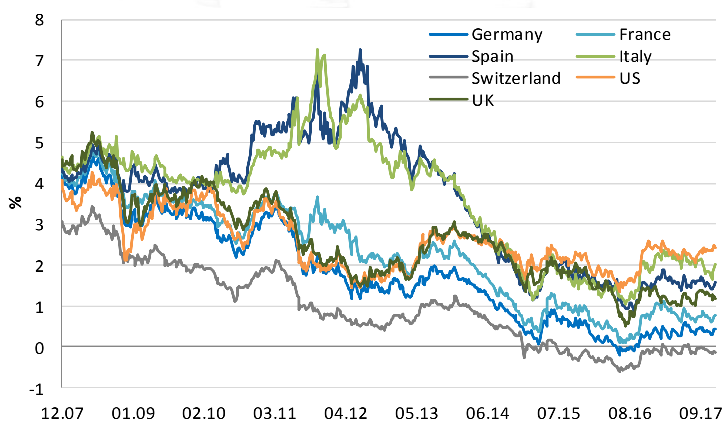
10 year Government Bond yield - CPI



Graph sources: Bloomberg/BBGI Group







Salary costs are developing slowly, and despite the considerable fall in the Eurozone unemployment rate, it is still high in absolute terms. Unless inflation picks up the pace and there are prospects of price rises, long rates will still be able to be influenced by ECB action.

Developments on long rates are now increasingly constrained to a narrow valuation band of less than 20 basis points for German government 10-year rates. They will close the year close to 0.3%.

We do not believe that bringing inflation back above +2% is essential in supporting a rise in long term interest rates in Euro.

European rates should certainly enjoy an upward trend, sparked by US monetary policy normalisation and a recovery of long rates in the United States. The long rate differential seems increasingly less-well founded, given the way in which the European economy is catching up. Although the first quarter should still be shaped by some stability on long rates, we believe that it is likely that we will then finally see a stark change in investors' perception of risk. We recommend not to wait before considerably reducing the bond risk in Euro.

European equities have the advantage

The revaluation phase is not yet over for European equities. Abandoned due to political risks in 2016, European equities have enjoyed a period of revaluation, although this has not meant that they have outperformed US stocks in local currencies. The latter had been boosted by prospects of fiscal reform and by the trend on digital stocks, particularly in the 3rd quarter. However, the valuation of European equities is not particularly high when compared historically. Indeed, it is significantly lower than that of US equities. At 14x 2018 profits, the current valuation of European stocks offers a discount of 4 valuation points as compared to US equities (P/E 18x 2018).

We do not believe the 30% higher valuation of US equities as compared to European equities to be justified given the macroeconomic context for 2018, which is also favourable for European equities. In terms of dividend yield, European equities also seem much more attractive, offering 4.3% yield, which is twice the yield of US equities (2%). Profit growth consensus is now much more optimistic, and rightly so, we believe, as the improvement in the Eurozone's economic situation is increasingly tangible.

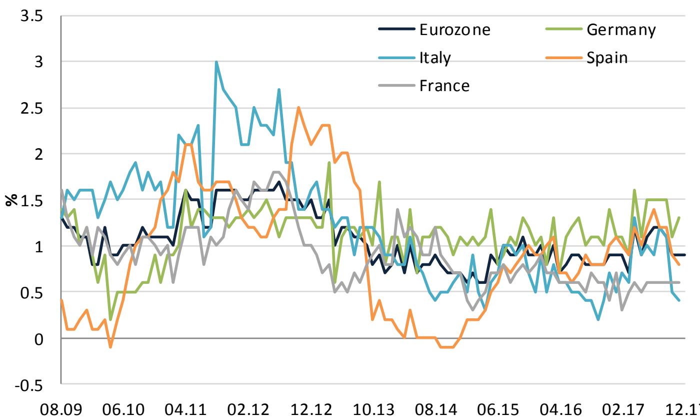
The recovery in growth and company profitability are key factors, which are then further helped by other favourable factors, such as a decline in major political and systemic uncertainty, and the improvement in banking sector conditions. These factors are making European equities more attractive; foreign investors should soon return, benefiting European equities. Profit growth per equity in the Eurozone is now increasingly close to that of US companies for 2018 (+10.5% versus +11.9%).

We believe that the difference in valuation is far from justified. The current approximately 30% discount on European equities should at least halve in 2018.

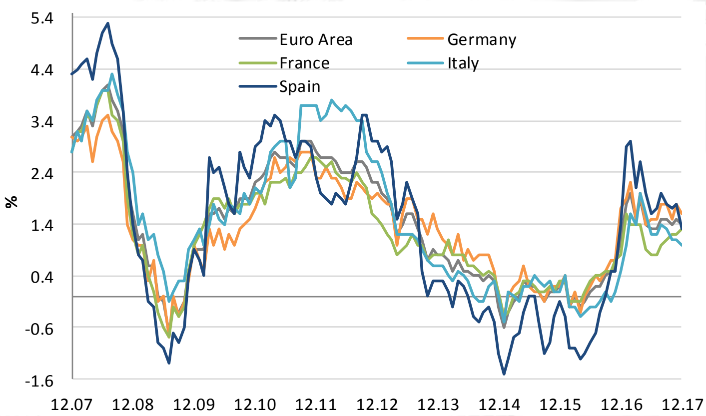
As such, European equities should considerably outperform US equities in 2018 in local currencies.

Graph sources: Bloomberg/BBGI Group

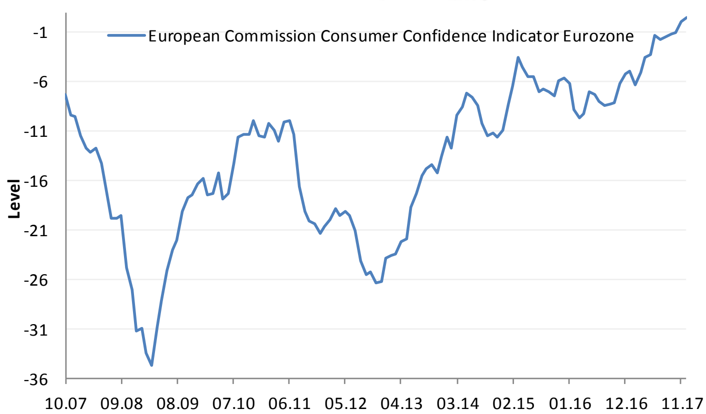
Eurostat CPI - Core Inflation (Eurozone, YoY)



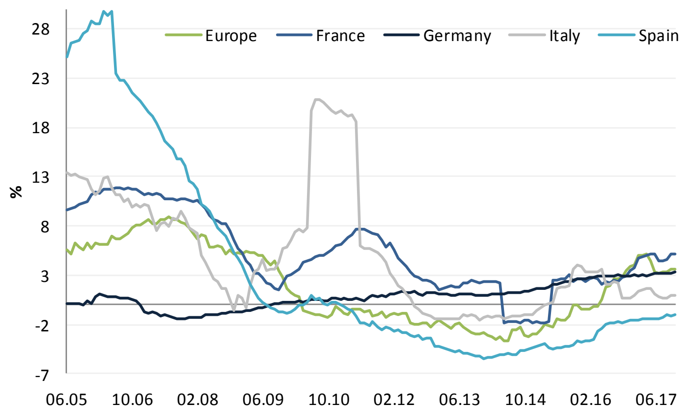
Eurostat CPI - all items (Eurozone, YoY)



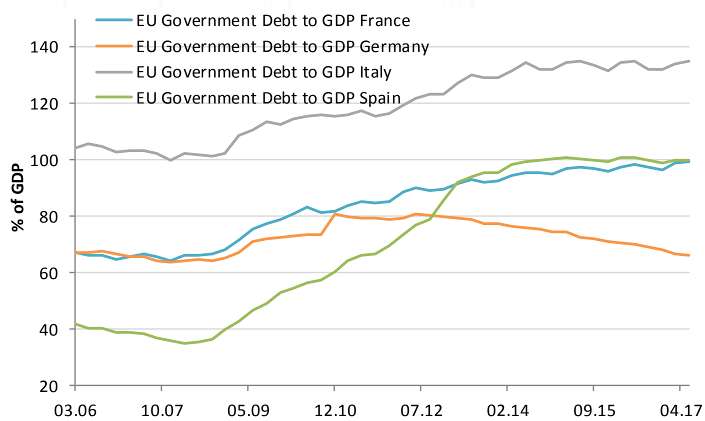
Consumer Confidence - Eurozone



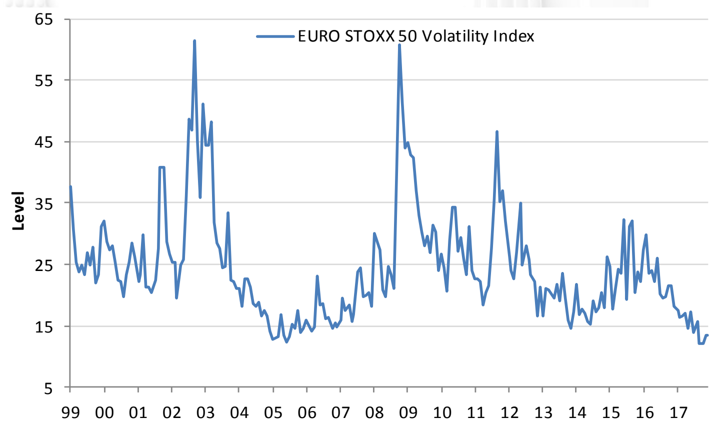
Loans to households (Eurozone - YoY)



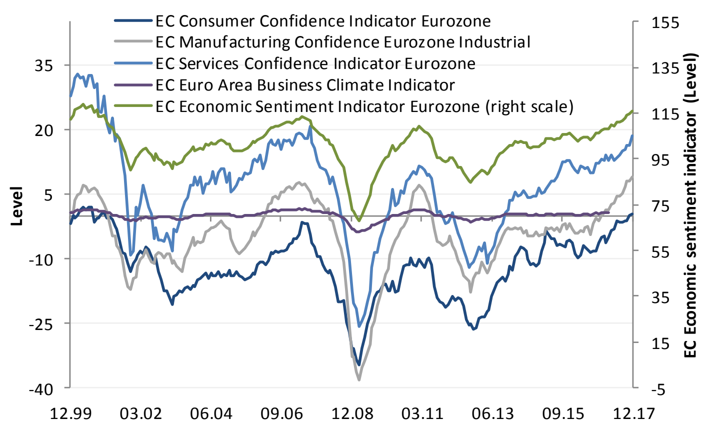
EU Government Debt



Euro Stoxx 50 Volatility Index



Economic Confidence Index



Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

United Kingdom

- Finally sufficient progress to move on to the 2nd phase of the negotiations
- All sectors of the British economy are worried about regulatory risk
- The pound should benefit from the resumption of the negotiations process
- Monetary policy likely to remain unchanged
- The bond market cannot remain indifferent to the pick-up in inflation

Finally sufficient progress to move on to the second phase of the negotiations

The European position had been firm for several months, requiring a preliminary financial agreement with the UK in order to initiate the second phase of Brexit negotiations. The absence of any significant progress in talks with the British had greatly frustrated the Europeans, although they finally triumphed, hailing an agreement on 13 December setting out a number of requisite terms for the divorce requested by the British people. The European parliament thus adopted a resolution with regards to Brexit, noting that progress had finally been made after several months of negotiation and a compromise reached that opens the door to the next phase of talks, which will nevertheless be conducted with great vigilance. However, this preliminary agreement remains fragile; indeed, in the opinion of Mr David Davis, the UK's Brexit minister, the agreement between Theresa May and Michel Barnier, the European Commission's chief negotiator, who hardened his stance several months ago in the face of British prevarication, is described as merely a "declaration of intent". The resolution, which garnered a majority of the votes (552), temporarily eases MPs' irritation. However, they are not dropping their guard and have stated that the next steps would have to be carried out in a constructive atmosphere of mutual good faith. Doubts clearly persist with regard to the UK government representatives' true intentions in terms of honoring their commitments. Michel Barnier noted that Theresa May made a commitment on behalf of the UK government and that reneging on the agreement to pay approximately 45 to 50 billion euros would very quickly result in a legally binding withdrawal agreement.

Is the UK giving up? The hardest is yet to come

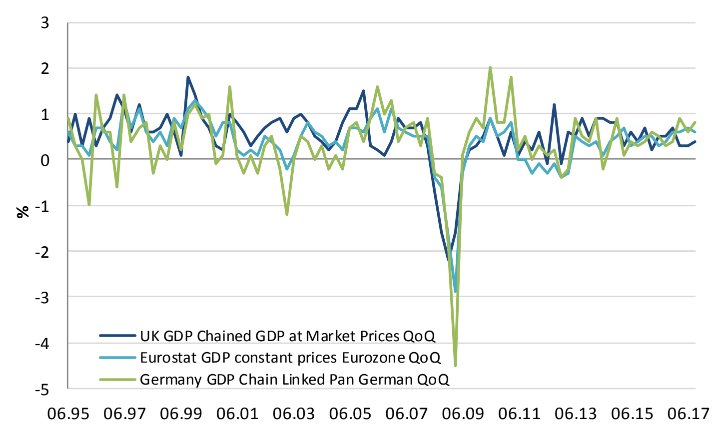
Thus, the issue of the UK's financial obligations was and remains a key focus of the negotiations. Initially estimated at between 60 and 100 billion euros, the final bill could ultimately be much lower for the UK, even though it will still be a considerable sum. With a divorce bill currently estimated at 50 billion euros, Theresa May was forced to double the 20 billion euro offer made just a few weeks prior, thereby accepting the Europeans' calculation methodology. The political reversal is likely to hurt, as the Prime Minister ultimately had to give in to European demands. She will probably obtain for payment to be spread over many years, but that is cold comfort, as the deadline for Brexit (March 2019) approaches.

Nevertheless, this surrender opens the door to the crucial second phase of the negotiations, although it certainly does not guarantee its success within the deadlines. Countless legal and regulatory difficulties will still have to be worked out for a trade agreement to be reached setting the terms of the relationship between the two partners. The form of this agreement remains to be determined of course, but it is up to the British to propose a draft to be discussed. Given the UK's firm stance on certain elements and in particular with regard to their determination not to be subjected to the strictures of free movement of persons, goods, services, and capital, it would seem like the future agreement will be similar to that negotiated by the EU with Canada.

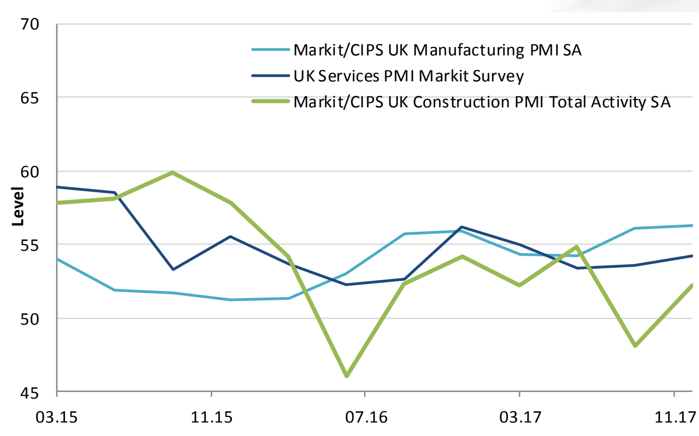
All sectors of the British economy are worried about regulatory risk

The City appears calm, but it is asking for a period of transition. The chief lobbyist of the British financial industry still appears confident but is demanding that an agreement be found with regard to a period of transition that would postpone the application and impact of Brexit for several years. If this were to happen, for two years starting on 29 March, the UK would remain in the single market but would no longer be a member of the EU. A two-year delay would allow current regulations to stay in place temporarily before new rules are introduced, adapted to the new situation. Meanwhile, banks and financial institutions are assessing the risks and opportunities, although some are already implementing backup plans.

Quarterly GDP Growth - UK

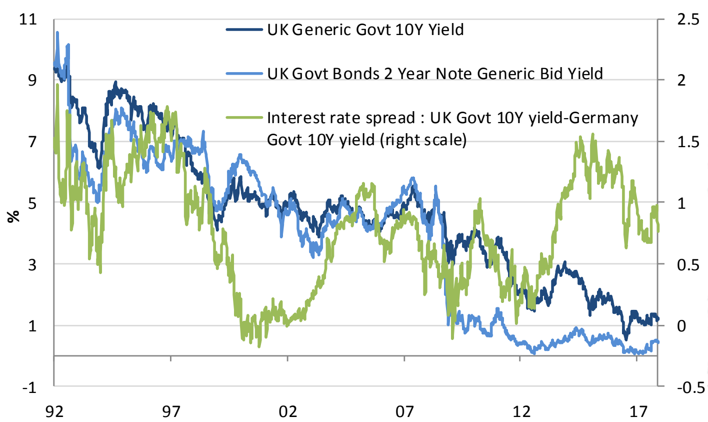


Manufacturing, Services and Construction PMI - UK

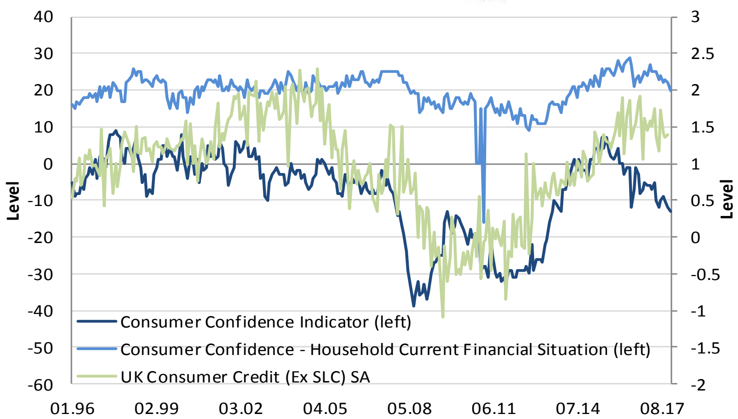


Graph sources: Bloomberg/BBGI Group

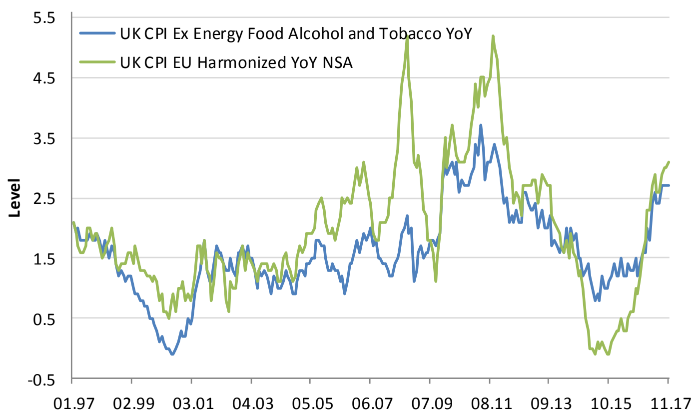
UK Government Bonds - 10 year and 2 year yield



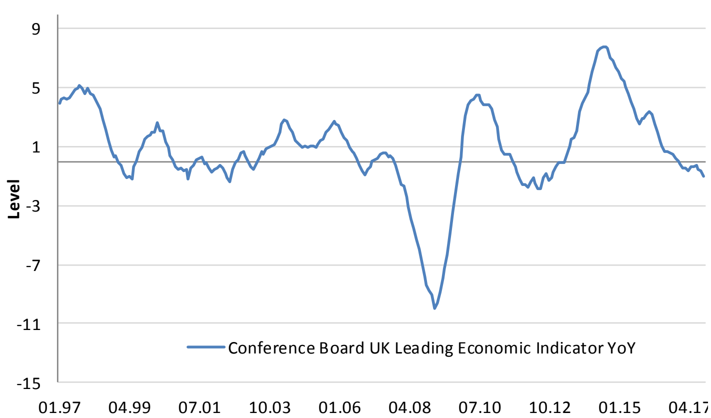
Consumer Confidence



Inflation CPI



UK Leading Economic Indicator



Graph sources: Bloomberg/BBGI Group

The financial services industry is not the only one speaking out to defend its interests. All sectors in the UK are worried about the risks of future regulatory divergence, which will involve challenging adjustments for companies. A sudden and complete withdrawal from the European regulatory framework would have severe consequences that could call into question years of investments. The pharmaceutical, chemicals, aeronautics, and auto sectors are all taking the same tack, recommending to the government that it limit current rules as much as possible. The main objective is clearly to minimise the negative impact on British exports of withdrawing from the customs union.

The pound should benefit from the resumption of the negotiations process

The British currency was not really impacted by the vagaries of the negotiation process over the past quarter. We have been noting for several months that the pound has entered a stabilisation phase against most major currencies, after its record drop following the Brexit vote. In 4Q16 already we noted that the pound had likely reached a valuation level enabling a more lasting consolidation pending greater visibility with regard to the country's economic outlook. Since then, the currency's volatility has decreased, and the exchange rate has actually risen against the franc (from 1.20 to 1.30) and the dollar (from 1.20 to 1.35) in particular. It stabilised above 1.10 against the euro in a context favouring the single currency. As the next phase of the negotiations gets under way, we continue to expect the exchange rate to further stabilise over the next several months.

Monetary policy likely to remain unchanged

The Bank of England did not alter its key rates in December, after raising them in November for the first time since 2007 from 0.25% to 0.5%. GDP growth is slowing down but remains positive, while inflation is slowly rising. We continue to believe that the November hike will not be hastily followed by further monetary tightening, although it is likely that key rates will trend upward, possibly from 0.5% today to 1% in 2019 in a context of sluggish growth and moderate inflation.

Indeed, growth is likely to slow down further in 2018, as negotiations with the EU will probably generate additional uncertainty likely to cause a steeper drop in consumption. As for inflation, current momentum could be sufficient to push the price index ex food and energy above 3%.

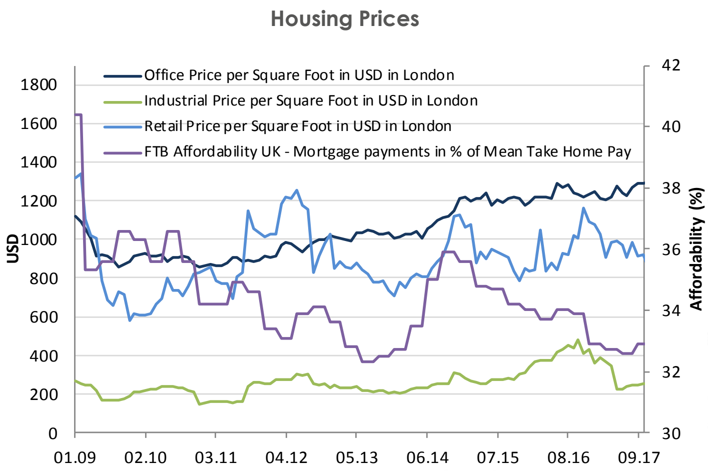
However, as we mentioned in our previous analysis, the rate hike to 0.5% could well be followed by a long period of inaction. Indeed, the BOE will likely keep rates unchanged or proceed with only minor hikes in 2018.

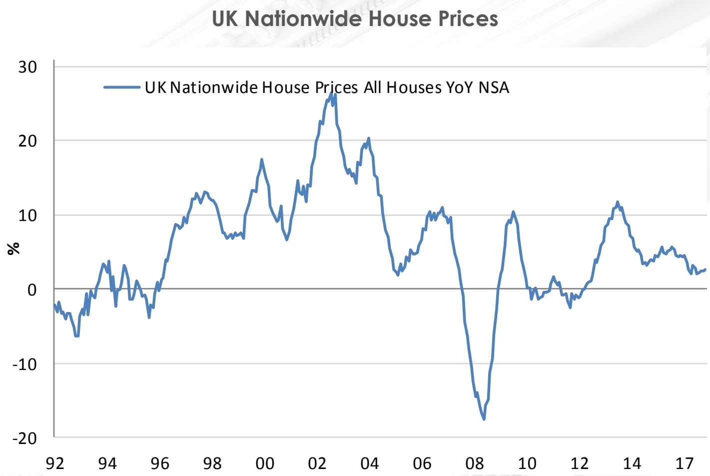
The Bank of England appears rather satisfied with the agreement reached with the EU, which should diminish the likelihood of a disorderly withdrawal from the EU. The resumption of negotiations will likely have a positive impact on consumer sentiment and on business confidence. GDP is thus rather likely to stabilise.

GDP is eroding, while leading indicators are pointing to an economic slump

Q3 GDP (+0.4%) reconfirms the previously noted erosion of economic momentum in the UK without, however, pointing to a drastic deterioration. Yoy growth stabilised at +1.5%, which bolsters our expectations with regard to reduced growth for 2017 as a whole. Exports' contribution decreased from +1.7% in Q2 to -0.7% in Q3. Consumption generated a somewhat positive surprise by progressing from +0.2% to +0.6%, which clearly helped GDP stabilise its growth rate, also boosted by a +0.3% uptick in public spending.

Leading indicators point to GDP's weakening resilience. Indeed, the most recent indicators point to growth in the manufacturing sector, as the manufacturing PMI increased further from 56.3 to 58.2, its highest level of the year. As for services, the picture is somewhat less rosy, as the services PMI slid from 55.6 to 53.8, though remaining well within the growth zone.





With regard to the construction sector, the leading indicator strengthened from 50.8 to 53.1, suggesting increasing activity over the next few months. Nevertheless, overall the composite index weakened, declining from 55.8 to 54.9. Consumer confidence is underwhelming, and dropped further in November. The business barometer saw no major changes, remaining in the same dispirited trend since early 2016.

In this context, the unemployment rate offered a positive surprise by remaining relatively stable (4.3%), although the labour market deteriorated, shedding 56,000 jobs in October. This confirms our previous forecast, whereby the earlier upturn was unlikely to last. The labour market participation rate declined further, which has a rather negative impact on the economic outlook for the beginning of 2018 but also leads to a reduction in the risk of upward pressure on wages. Industrial production slipped in October (+0.1%), as did manufacturing production (+0.1%). The growth prospects of the British economy are less sanguine. 4Q growth could still reach +0.3%, but the slowdown will likely be sharper in 2018.

Real estate prices increased +3.9%

We reiterate our recent comments suggesting that the stabilisation of the pound could boost residential demand given the sustained interest of international investors and as domestic demand still exceeds supply. The past few months have confirmed this prediction, as real estate prices posted their fifth consecutive increase in November according to Halifax, indeed their highest three-month increase since January.

Overall, however, annualised price growth declined from 4.5% to 3.9%. The real estate market cooled down this year, but we are not seeing any real changes in market conditions. Supply will likely remain lower than demand in 2018.

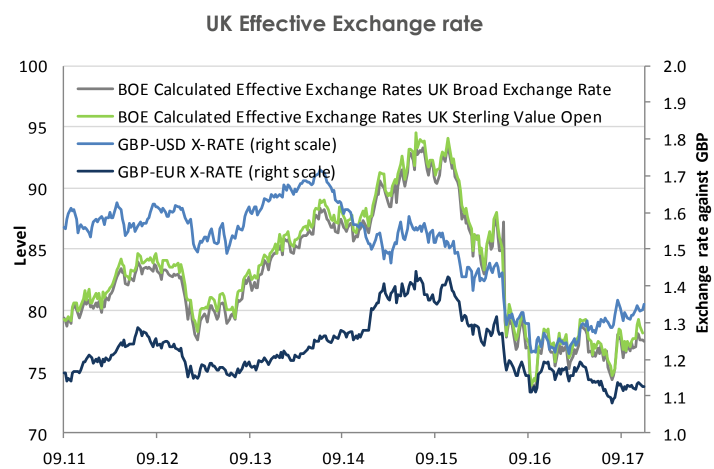
The bond market cannot remain indifferent to the pick-up in inflation

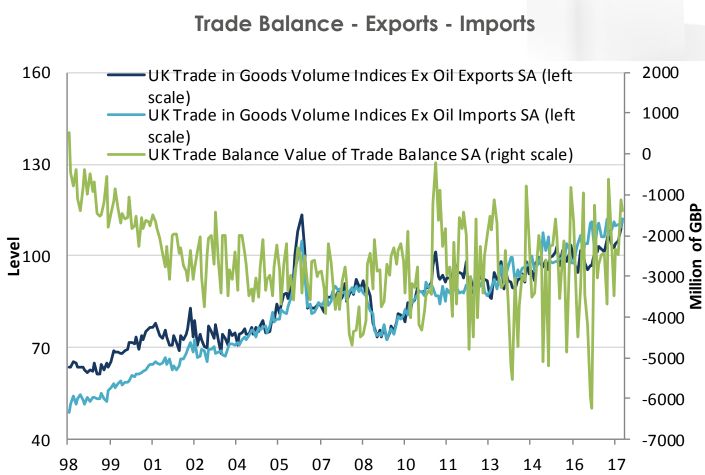
Inflation is rising slowly but surely in the UK. By November, the consumer price index had doubled over twelve months, reaching +3.1%. The CPI index had reached a low in April 2015 at -0.1%. The upturn is significant and even clearer when looking at the trend in the production price index over the same period.

We continue to predict that inflation will exceed the BOE's 2% target in the next several quarters and could even reach 4% by 2020. It is surprising in the context of general price increases that long-term interest rates are not more affected by changes in expectations. Indeed, despite the increase in prices, the yields on UK government debt seem to have followed the trends in international bond markets and do not appear to be reflecting the increase in domestic inflation. Real yields in pounds are thus relatively stable, even declining slightly from 1.4% in October to 1.3% at the end of November. The UK bond market will likely be more impacted by domestic fundamentals in the near future, which will likely nudge long-term rates back up.

Lethargic equities market

The UK equities market entered a long phase of horizontal consolidation in 2017, which could last another few months. Performance in local currency stands at a mere +2% YTD, which is well below the results of most EU markets. At approximately 14x 2018 earnings, the UK market is still somewhat expensive, but its yield remains slightly higher (4.3). The stabilisation of the pound stopped the progression of UK shares, as we had expected. We continue to recommend caution with regard to this market, which could subsequently be penalised by the more tangible effects of Brexit negotiations on corporate earnings.





Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

Japan

- Longest economic expansion phase since the mid-90s
- GDP cannot expand without the recovery of domestic demand
- Private consumption will hopefully pick up
- Several leading indicators are faltering
- The yen will likely continue to weaken

Longest economic expansion phase in Japan since the mid-90s

After particularly solid results in Q2 (+2.5% yoy), Q3 GDP growth seemed somewhat less inspiring at first glance. GDP appeared to have progressed a further +0.3% (+1.4% yoy), marking its seventh consecutive quarter of growth in one of its most significant expansion phases in the past ten years, although this latest advance actually pointed to a slight slump in the country's economic performance before today's revision. The revised figures show much higher growth, with GDP ultimately rising +0.6% over three months, or +2.5% yoy, as in Q2. These results thus do not call into question expectations of a sharper recovery in 2017 that could push annual growth beyond what had been expected at the beginning of the year. The Japanese economy continued to be bolstered by a sustained upswing in exports, already observed in the previous quarters, and by an upturn in investment. Growth thus turned out to be more solid than upon first analysis. Exports increased +1.5% over the quarter, i.e., 14.1% yoy.

GDP cannot expand without the recovery of domestic demand

The contribution of domestic demand to the Japanese economy is still insufficient, and indeed domestic demand has struggled to take off. GDP growth was impacted by a -2.5% decrease in public spending following a +5.8% increase in the previous quarter. Private demand, represented by household spending, also stalled, remaining stable at 0% after rising +0.7% in Q2. Aside from inventory, private consumption actually declined by -0.5%, likely due to persistently slow wage growth and adverse weather conditions. These developments are in fact relatively disappointing and liable to call into question H2 forecasts. We were expecting more positive economic developments for the Japanese economy in H2, as we were anticipating an upswing in consumption – which could still materialise. GDP growth cannot be supported exclusively by domestic demand. Exports should continue to perform well, but doubts remain with regard to domestic demand and its ability to pull its weight with regard to overall growth in 2018, especially over the long run. However, we are anticipating growth to nevertheless be once again somewhat more balanced with respect to the three factors mentioned above.

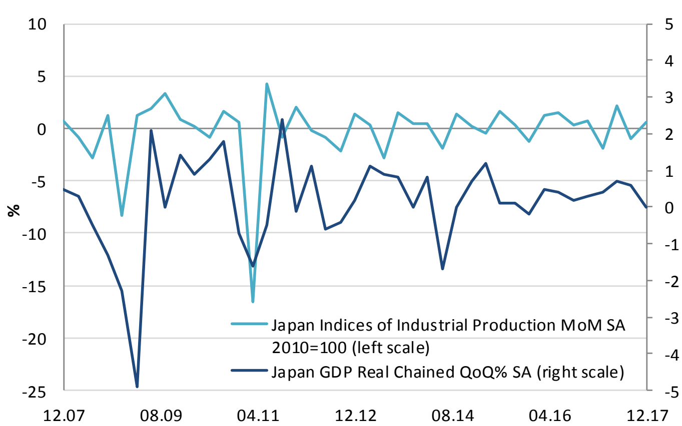
Revenue redistribution is too unequal

Private and public consumption is likely to pick up and support further positive contributions by the industrial and export sector bolstered by a weak yen and a more robust global demand. However, caution is warranted with regard to the persistent issue in Japan of unequal revenue redistribution. The current economic upturn is of course welcome, but it still has not generated the expected impact on the job market and on rebalancing income distribution. Corporate profitability is high, but its benefits are not trickling down to employees as the BOJ had been hoping. Growth is structurally weak due to households' inability to increase their consumption levels. This persistent weakness cannot be directly stimulated by Abenomics. In the absence of a fairer distribution of revenues, for instance via an increase in wages, the BOJ's monetary policy will remain expansionary, interest rates will remain near zero, and public debt will likely increase further. In this context, we temper our optimism regarding Japanese GDP growth, even though it is still likely to progress by +2.5% in 2018.

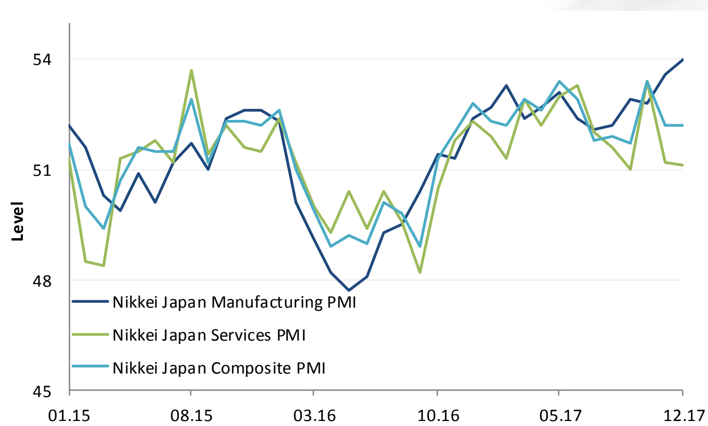
Private consumption will hopefully pick up

Japanese consumers remain cautious overall. Indicators are not really revealing any solid trend, although consumption should gain some momentum in conjunction with positive developments in the job market and the economy. The slow progression of incomes and wages remains a significant cause of consumers' lack of enthusiasm. Consumption will thus remain only a weak driver of GDP growth, pending a clearer progression of household income.

GDP and Industrial Production

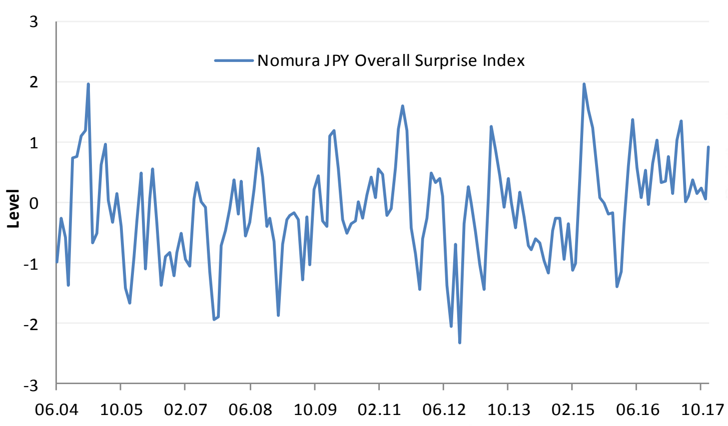


Composite, manufacturing and Services PMI - Japan

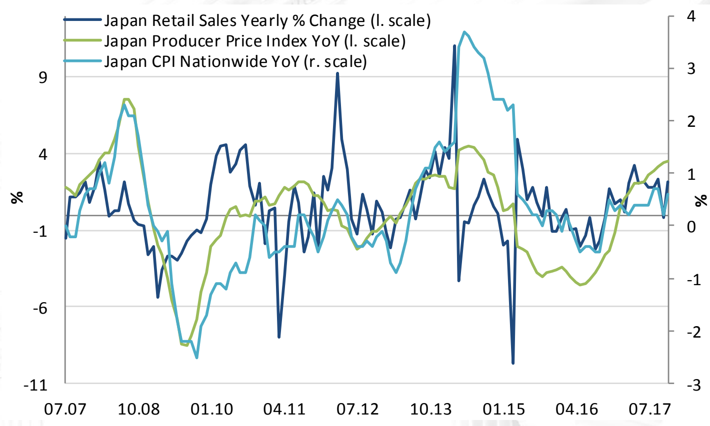


Graph sources: Bloomberg/BBGI Group

Economic Surprise Index



Inflation (CPI and PPI) and retail sales



Overall, the growth in real household expenditures is disappointing; after a sharp upswing of +0.6% in August, spending stagnated in October. The good surprise is the positive change in household confidence, which increased sharply over three months from 43.3 to 44.9, and which is thus nearing the ten-year high it reached in 2013. The job market situation is likely contributing to the improvement in household sentiment, as the unemployment rate seems to have reached a floor (2.8%) and perhaps even a level indicating full employment. The job offers to applicant ratio is at its highest level in the last thirty years at 1.55, a slight increase over the previous quarter. Consumption is structurally weak due to unequal redistribution of revenue. Corporate earnings were excellent in 2017, but this significant improvement had limited effects on workers' incomes. Wages increased by only +0.5%, which is completely insufficient to stimulate domestic demand. However, it is this redistribution of revenues that the BOJ was counting on to revive inflation and consumption. While these conditions are not yet in place, we believe they are presently more likely to materialise.

Several leading indicators are faltering

Q3 figures are thus rather positive, the world's third largest economy is doing better, and leading indicators also seem to point toward further improvement in this situation, despite a few temporary hesitations. The upswing in exports and external demand, bolstered in part by a more favourable global economic cycle and by the growth of investment in Asia, is now having a visible effect on industrial production and on the outlook for the sector, although this outlook does not seem to be fully supported by leading indicators as far as an acceleration in Q4 and at the beginning of 2018 is concerned. In October, industrial production progressed by +0.5%, or +5.9% yoy. Leading indicators were already suggesting that the economic upswing would continue in Q3 in Japan, as indeed it did. However, in the past several months, these indicators have seemed to be flagging. The rise in inventories in the past few months points to a reduction of future economic activity and industrial production. The manufacturing PMI for November reached 53.6, which is slightly higher than in February, but the combined index (52.2) is feeling the impact of the correction in the services PMI, which contracted from 53.4 to 51.2.

The yen will likely continue to weaken

The Bank of Japan still does not have much room to act in terms of reaching its 2% inflation target. It has not changed its assessment of economic conditions and is maintaining its monetary policy unchanged, i.e., low interest rates and monetary injections. The Bank is still hoping that economic growth in Japan will be sufficient to drive inflation up toward the desired target. The short-term interest rate target is also unchanged (-0.1%), as is the aim of steering 10-year rates toward 0%. The correlation observed with movements in long-term rates will necessitate a slight definitional change in objectives, whereby the BOJ will likely set the lower limit of its target range at 0%. Governor Kuroda is unlikely to change the Bank's policies, which will remain a significant factor in the future decline of the Japanese currency. We continue to believe that the improvement in fundamentals will not have an immediate impact on the yen, which will continue to be disregarded by investors due to an utterly unfavourable interest rate environment.

The government's policy is thus still to weaken the yen, as interest rate spreads are likely to widen and penalise the currency. The on-going normalisation of US monetary policy along with expectations of further increases in long-term rates in the US will likely further weigh on the yen in 2018. A weaker exchange rate has been one of the key elements of the government's policy to boost inflation and exports. This policy remains relevant.

The yen will likely revert to fluctuating within a range of 115 to 120 against the dollar over the next few quarters.

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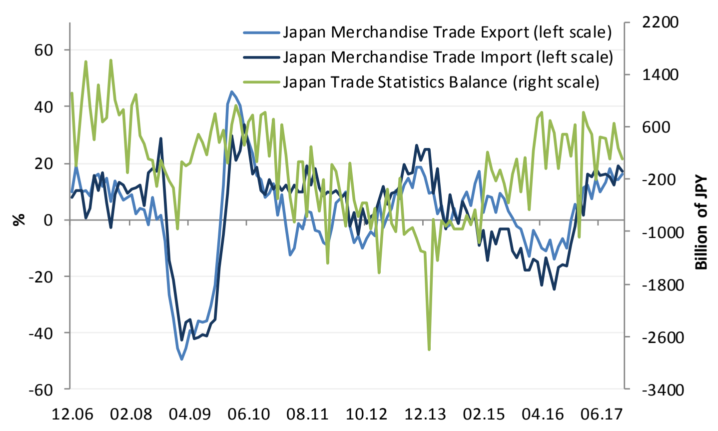
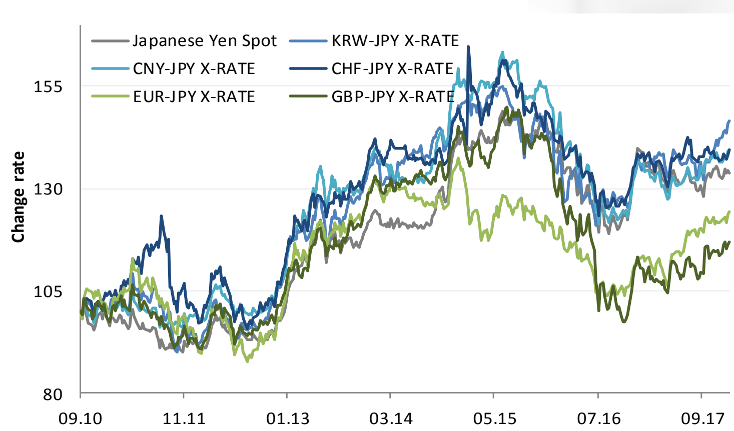
Trade Balance (Billion of yen)



Exchange rate (Normalized at 100)



Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

China

- China is on course for +6.5% growth
- Leading indicators are still on the right track
- Will we see reforms to reduce debt levels?
- Equity market still on the front foot in 2018

Chinese GDP is on course for +6.5% growth in 2018

The Chinese economy should finish the year with growth of nearly +6.8%, posting a +1.6% rise in the last quarter. We believe that Chinese GDP should grow +6.5% again in 2018. Industrial production remained strong at the end of the year, stabilising at a similar growth level of +6.6%. Spending maintained its growth rate, with retail sales increasing +10% year on year. The government's economic targets for the next three years remain at +6.5%, and they should be hit thanks to favourable domestic and international factors.

The real estate sector is still making a positive contribution; real estate prices rose in November, whilst construction was pleasingly robust. At the 19th Party Congress, President Xi Jinping reminded those listening that "houses are for living in, not for speculation", once again highlighting the fact that one of the government's aims is to reform the real estate market by introducing appropriate mechanisms for the long-term.

Chinese foreign trade figures show an improvement in the export trend - it grew +10.3% (+12.3% in US dollars), a clear leap compared to the previous month, surpassing expectations. Naturally, in this context the trade balance in yuan also gained ground, hitting 253.7 billion yuan (40.2 billion US dollars). At the end of the year, the improvement in the global economic situation was of slightly more benefit to the Chinese economy, which is also encouraging in terms of the trend continuing in 2018.

Inflation under control

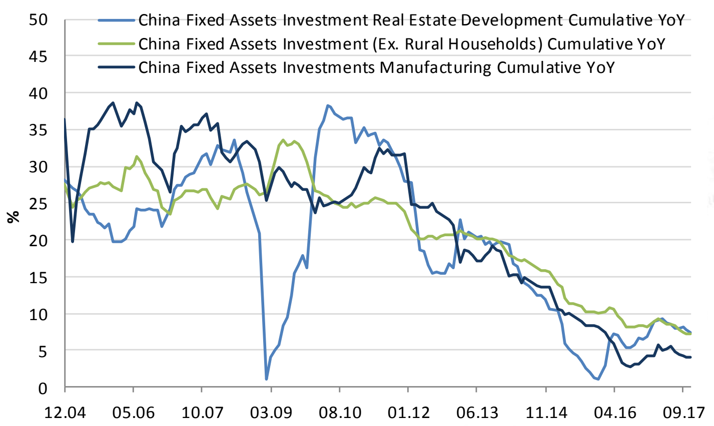
Inflationary pressures dropped slightly at the end of the year. Consumer price indices are still well below the government's +3% target for 2017, and even slid from +1.9% year on year in October to +1.7% in November due to more modest developments in food prices (-1.1%) compared to other goods (+2.5%). Production price indices reacted to changes in commodity prices, dropping their growth from +6.9% to +5.8% year on year. The more tentative changes in price indices give the central bank more room for manoeuvre in adjusting its monetary policy. These results should certainly compel it not to hike its key rates too quickly.

Leading indicators are still on the right track

Whilst not spectacular, the latest leading PMI indicators are still pointing to sustained activity at the start of 2018. Official manufacturing PMI indicators remain relatively stable (51.6), whilst the Caixin manufacturing PMI indicator was bolstered in December. The non-manufacturing PMI indicator improved slightly, whilst the services PMI index posted a considerable rise, from 51.9 to 53.9, and is at its highest level since 2015. Other leading indicators are also suggesting that the Chinese economy will be in good shape in 2018, particularly the flash manufacturing PMI indicator, which is indicating continued high foreign demand at the start of the year. The PBOC's survey on evolutions in doing business also showed a clear trend reversal from 2016 onwards.

Graph sources: Bloomberg/BBGI Group

Real Estate, Infrastructure and Industrial Investments (YoY)



Exports and Imports (YoY)

Will we see reforms to reduce debt levels?

The Chinese government seems very much decided to ensure ongoing economic growth, by speeding up the reforms that will ensure quality development and better control of financial risks. Specifically, their aim to reduce leverage and debt levels has been announced as one of the core tasks that should gradually affect businesses, households, and the real estate sector, after first having focused on the financial sector.

China's debt levels are already close to 260% of GDP, so will certainly not be able to be brought down without any impact on growth rates. As laudable an aim as it is, it is therefore relatively unlikely that the government will accept sacrificing growth in order to deleverage. We believe that debt levels should still rise over the next three years.

Credit growth turned out to still be high, and above forecasts, in November. This mirrored the evolution in new loans, which hit 1.12 trillion yuan, compared to the forecast 800 billion.

This growth demonstrates the challenges in reconciling the aim of retaining the liquidity needed for the economy to function properly whilst at the same time reducing credit growth.

Exchange rate and monetary and budgetary policy

The government seems reluctant to alter its language regarding the exchange rate, and is still speaking of stabilising the yuan. In parallel, China's currency reserves grew +4.7% in 2017 thanks to a combination of several factors, including the trade surplus, capital controls, the strength of the yuan, and strong growth. After the fall in reserves seen since 2014, they should continue to stabilise in 2018.

The current context should enable the PBOC to implement its cautious, neutral monetary policy strategy in 2018. Any potential interest rate rises to counter leverage will certainly be very gradual. The PBOC's required reserve rate for major Chinese banks will not change from 17%, and the key rate target, currently at 4.35%, should also remain stable in 2018.

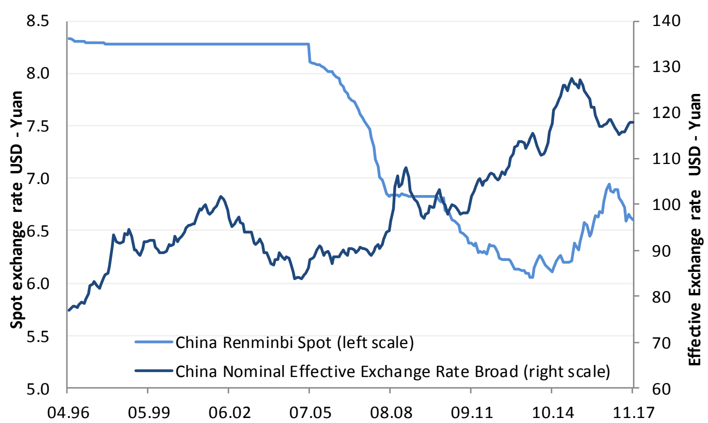
Fiscal policy should be a little less decisive in 2018; the government will need to walk the line between its desire to support some specific areas of development and to reduce overall spending. As such, infrastructure spending should grow in 2018, albeit at a slower real terms rate of 15%, as compared to 18% in 2017.

Equity market still on the front foot in 2018

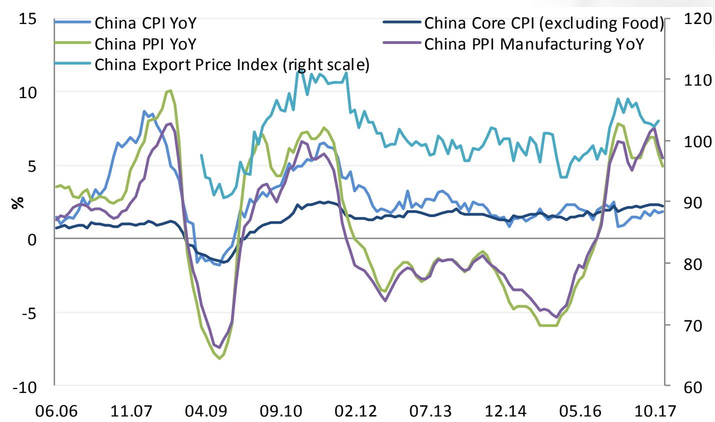
The profits of Chinese industrial companies showed excellent growth in November, at +21.9%, propping up a rise on the Chinese equity index. Profit growth should be weaker in 2018, whilst still keeping up a good pace. In 2018, the Chinese equities bull market should still be fed by higher profit growth compared to other countries.

We have already mentioned the positive effects of international investors' perception of Chinese equities following the MSCI's decision to include A equities on its emerging markets index. This will remain a positive factor at the start of 2018, and will bolster the growing demand of foreign investors. In 2018, investors should focus on the improvement in the quality of Chinese growth, which is also a useful weathervane for measuring the lifespan of company profits.

Effective Exchange rate and USD/Yuan



Inflation CPI - Core CPI



Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

United Arab Emirates

- 2017 proved to be a challenging year for the UAE and the GCC
- Economic Recovery for the UAE in 2018
- Abu Dhabi Main Contributor to UAE's GDP Growth in 2018
- Another challenging year for UAE Stock Markets?
- Introduction of a Value Added Tax and Inflationary Pressure

2017 proved to be a challenging year for the UAE and the wider GCC

2017 marked a year of subdued economic performance for the UAE with the Real GDP Growth expected to settle at only1.3% which marks the country's lowest Real GDP Growth rate since 2009 on the wake of the global financial crisis. Meanwhile, the overall GCC growth is expected to bottom-up at 1.3% in 2017, which marks a sharp decline compared to 5.7% GDP growth achieved by the region in 2016. Meanwhile, inflation eased to 1.8% in 2017, down from 4.1% in 2015 reflecting softer domestic demand and declining rents. Despite a challenging year, the UAE economy has demonstrated that it cops relatively well with the new oil market realities. In fact, the country's exports of oil (including oil products and gas) declined by nearly half between 2014 (USD 101,9 Bn) and 2016 (USD 52.4 Bn) before benefiting from a welcomed recovery in oil prices in 2017 which is expected to yield the country 57.5 billion in oil revenues. Decline in oil revenues for the UAE and for most Middle East oil exporter countries resulted from a combination of weaker oil prices and slower oil output growth.

Reduced oil prices resulted which led the government to take some drastic steps towards balancing its budget leading in postponement or delaying of some major infrastructure projects and public spending. However, despite continued fiscal consolidation on the part of the government, lower oil revenues widened the overall deficit to 4.3% of GDP from 3.4% of GDP in 2015. Correspondingly, the current account surplus shrank to 2.4 of GDP from 4.7% of GDP in 2015. Weaker economy obviously translated into elevated level of risks for local banks, leading to higher provisioning, but generally speaking, local banks remain well capitalized and benefit from UAE's financial buffers, safe-haven status in the Middle East and the country's diversified and business friendly economy.

Economic Recovery in 2018

In wake of reduced oil revenues, resulting in large budget deficits and slower growth, the government remains at the forefront of the regional efforts in balancing its current budget deficit whilst insuring that it creates more jobs for its young population. These efforts should translate in reducing further the country's reliance on oil, strengthening its budget, and most importantly encouraging a more vibrant private sector to diversify its economy and lead to less reliance on government expenditure. The conjunction of governmental reforms, globally favorable economic indicators and the recovery in oil prices, which for the first time since 2015 raised above USD 60/barrel mark towards the end of December 2017, should strengthen gradually the economy in 2018 despite the introduction of a 5% VAT Tax which could ease the pace of fiscal consolidation.

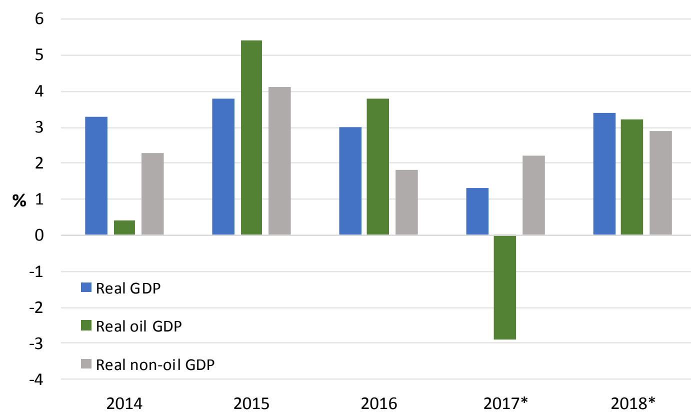
The IMF expects the United Arab Emirates' economic growth to nearly triple in 2018 and surge to 3.4% as the country's largest emirate, Abu Dhabi, is expected to benefit from an expected recovery in oil prices. In fact, most of the recovery is expected to result from a positive contribution of the oil related GDP growth expected to reach 3.2% instead of –2.9% in 2017 - whilst the Nonoil growth is projected to raised modestly from 3.3% in 2017 to 3.4% in 2018 reflecting overall stability in public investment and global trade volumes. Meanwhile, inflation is expect to raise modestly from 2.2% in 2017 to 2.9%.

Abu Dhabi Main Contributor to UAE's GDP Growth in 2018

The expected expansion of the UAE's gross domestic product from 1.3% in 2017 to 3.4% in 2018 is largely built on expectations that growth in oil-rich emirate of Abu Dhabi, which holds about 6% of the world's proven oil reserves, will surge from 0.3% in 2017 to 3.2% in 2018 according to the latest IMF forecast.

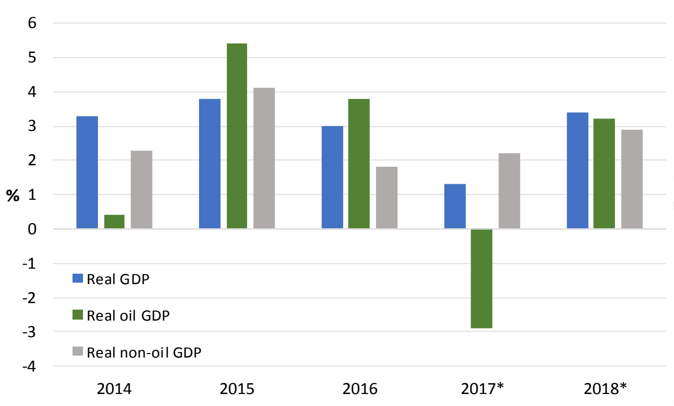
Real GDP growth (United Arab Emirates)

Oil sector (United Arab Emirates)

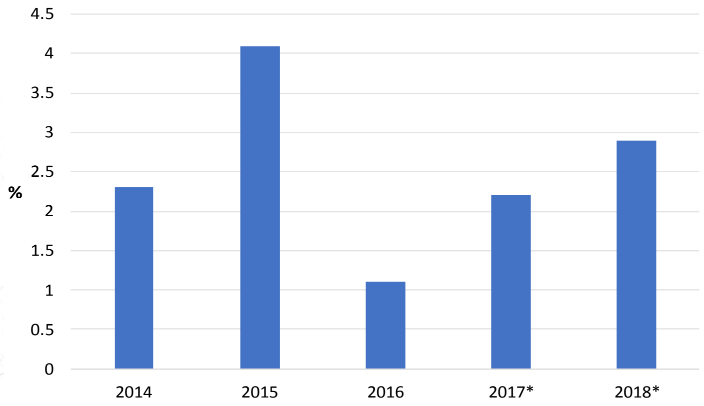


Graph sources: Bloomberg/BBGI Group

Oil / non-oil sectors (United Arab Emirates)



Inflation (United Arab Emirates)



The recovery in the Abu Dhabi's economic performance should be mainly attributed to a recovery in oil output in 2018 after the OPEC-led agreement to reduce production caused exports to decline in 2017. Meanwhile, Dubai's output is expected to accelerate on a more moderate pace to 3.5% from 3.3% in 2017. Encouragingly, the non-oil sectors both in Abu Dhabi and Dubai are expected to grow by around 3.3% in 2018 demonstrating the country's non-oil sector resilience to oil price volatility.

Another challenging year for Stock Markets?

Looking forward, we expect the UAE's economic momentum to gather pace helped by an overall healthy global economic conditions and mainly thanks to a gradual stabilisation of oil prices around USD 55-65. Even though, this expected price range for oil price is still not high enough to slow down the pace of structural reforms initiated by the UAE government, it would ease its austerity programs which should help creating a favourable climate for the UAE stock markets. Accordingly, the UAE cabinet has approved a record federal budget of USD 54.7 billion for the years 2018-2021, of which USD 13.9 billion for the year 2018, which represents a 5.6% increase when compared to 2017 budget, with no deficit forecast.

The equity market performance in the coming year should articulate around four major variables: earnings, inflation and interest rates and political environment. Positive GDP growth and less austerity measure should boost equity markets by improving earnings. However, despite improving outlook for the economy, one should bear in mind that the GCC region overall still faces significant challenges. Regional inflation is expected to rise in the wake of the introduction of the VAT Tax and as for as the UAE is concerned, we believe that the expected marginal decline in rents will not offset the higher import prices and translate into higher than expected inflation rate. On the interest rate front, the US dollar peg will also translate into higher interest rates in line with the gradual normalisation of the USA monetary policy which should constitute a negative backdrop for the UAE stock markets that are expected to underperform the MSCI Emerging Markets index unless the oil prices settle at a higher than projected prices.

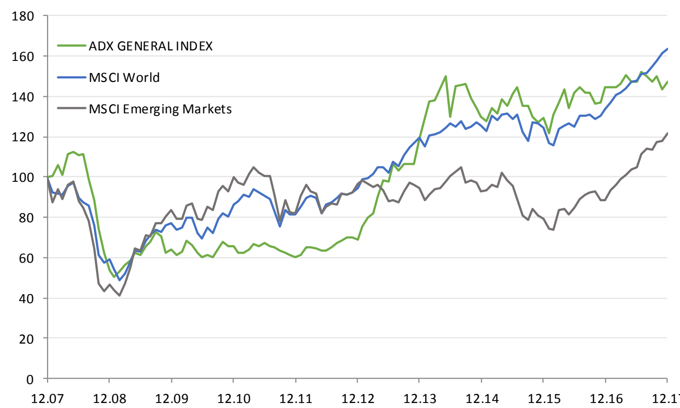
On the political front, the ongoing regional tensions and political uncertainty should constitute another hurdle for the UAE stock markets which are likely to further deter both domestic and global investors considering that disagreements with Qatar remain unsolved for the foreseeable future and the war in Yemen seems to get bogged down with no political solution at sight. Therefore, heading into 2018, it is once again important to remember some time-tested principals for successful long-term investing: cash isn't always king, diversification is essential with global markets offering very competitive risk adjusted returns when compared to GCC equity markets overall.

Introduction of a Value Added Tax and Inflationary Pressure

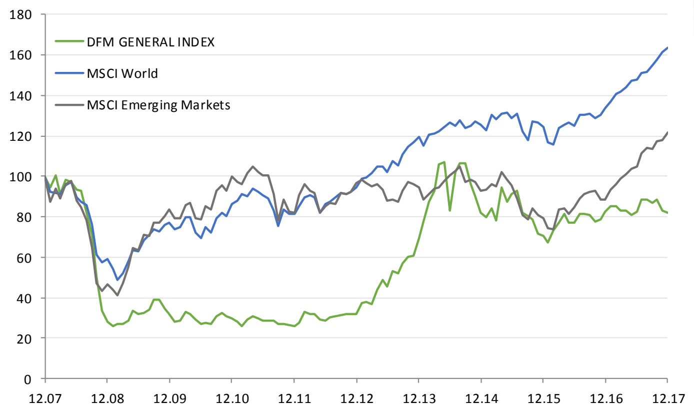
The United Arab Emirates' federal government has implemented a 5% Value Added Tax (VAT) in 2018 in compliance with an initial agreement signed between all six of the Gulf Cooperation Council (GCC) countries paving the way for the introduction of a Unified Value Added Tax throughout the GCC in 2018. The implementation of the VAT constitutes a fundamental transformation for businesses based in the UAE and a major shift in the country's tax policy. The implementation of the VAT is in line with the fast-track diversification of the UAE economy aimed at further reducing its reliance on crude oil revenues. Thus, the implementation of a 5% VAT tax is expected to add USD 3.27 billion to UAE government's coffers in 2018 and adding around 1.5% to GDP, rising as much as 5.45 billion in 2019 according to the Minister of State for financial affairs. The introduction of VAT should also help bringing transparency and help the financial sector in the UAE to differentiate between businesses thus making it easier for banks to finance small and medium enterprises.

That being said, as mentioned above, we believe that the introduction of the VAT tax will increase inflationary pressure on prices despite the a marginal softening anticipated by most experts on rental values across the UAE.

ADX vs. MSCI World and MSCI Emerging Markets



DFM vs. MSCI World and MSCI Emerging Markets



Graph sources: Bloomberg/BBGI Group

MACROECONOMIC SCENARIO

Emerging Markets

- Excellent results for emerging markets in 2017
- Widespread improvement in fundamentals
- Election year for many countries in 2018-beware political risks

With +37.46% growth in 2017, emerging market equities considerably outperformed international equities (+22.40%), though the latter were themselves very dynamic. Stock market developments reflect the widespread improvement in fundamentals. Most countries should continue this trend in 2018.

Economic situation by country

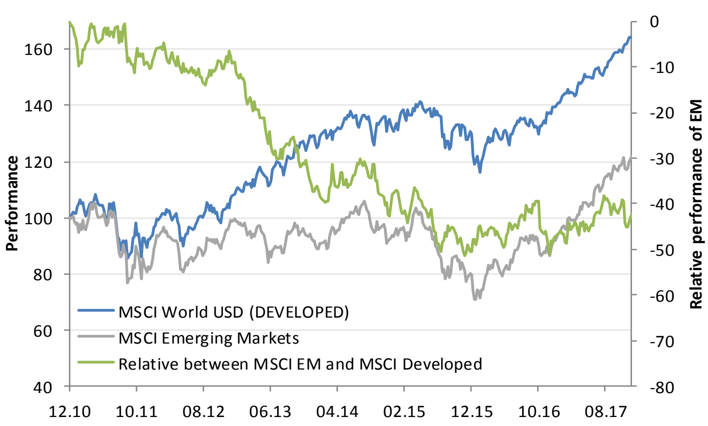
Brazil – In our last issue, we highlighted the fact that year on year GDP growth had headed back into the black in the second quarter (+0.3%), after twelve quarters in the red. In the third quarter, year on year GDP growth hit +1.4%, although quarterly growth (+0.1%) nonetheless came in under forecasters' expectations (+0.3%). Industrial production is getting back on its feet- the latest data show a +0.2% monthly rise and a +5.3% rise year on year in October. These levels had not been seen since April 2013. The Markit manufacturing PMI index was also posting 53.5 in November, the highest since this statistic started being calculated in January 2015; it then slightly tailed off in December (52.4). However, composite and services indices are posting more tentative trends- after having hit 51.1 and 50.7 respectively in September, the two indices each fell to 48.9 and 46.9 in November. With inflation still contained (+2.80% year on year for IBGE inflation), the central bank was again able to drop its key rates in December, from 7.50% to 7%. We should not forget that just a year ago the Selic rate still stood at 13.75%.

Despite the modest improvement in economic conditions, ten months shy of the presidential election, considerable challenges remain for the victor. Economists are underscoring efforts to reform, which should continue, especially from a fiscal point of view. Specific measures to foster a return to growth are still expected.

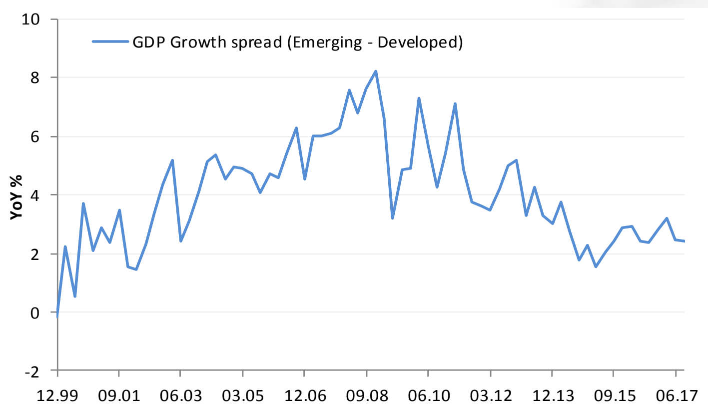
China – The first indicators of the year, the Caixin purchasing managers indices paint a picture of faster growth in economic activity in 2018. At 51.5, the manufacturing PMI index has returned to its highest level for four months, whilst at 53.9, the services indicator is posting its highest level since it was established in January 2015. Exports also bounced back considerably in November (+12.3% year on year in yuan). Although cautious, optimism is gaining ground among forecasters for the year ahead. There are now more observers predicting that growth will be maintained in 2018, despite the effort required to contain the financial risk. It has escaped nobody's notice that since the financial crisis the central government has committed to a debt-based growth model, using expansionary monetary policy to stimulate infrastructure spending and real estate development. Xi Jinping consolidated his power at the Communist Party's National Congress at the end of last year, which has significantly shored up his room for manoeuvre in pursuing debt-reduction, which is a key pillar of the structural reforms on the supply side.

Although there is still much to be done in terms of debt-reduction, requiring high-precision management from the authorities, one of the advantages for China of abandoning its traditionally manufacturing-based economy is that it will be less dependent on credit in the future; the transition to the "new economy" will also help debt-reduction efforts in China. The vigour of American growth and the ECB's caution in hiking interest rates are propping up foreign demand. The threat of trade disputes with the United States and Europe still remains. The Chinese Academy of Social Sciences forecasts that GDP will increase by around +6.7% in 2018, as compared to the +6.8% forecast in 2017. In 2018, Beijing should set the same +6.5% growth target as in 2017.

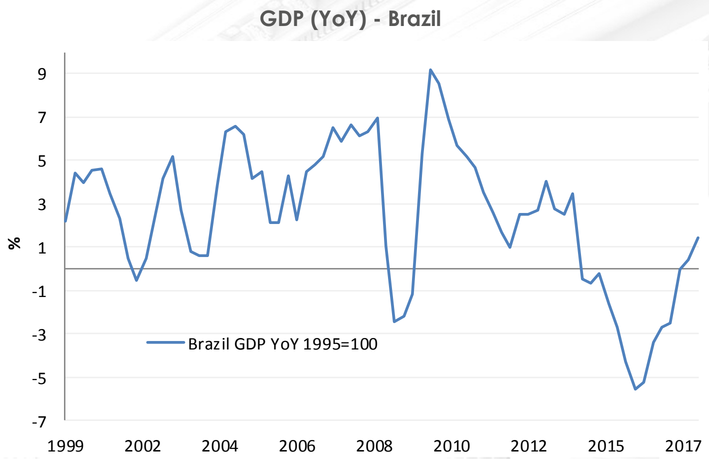
Emerging and Developed Markets - Performance



GDP Growth spread



Graph sources: Bloomberg/BBGI Group



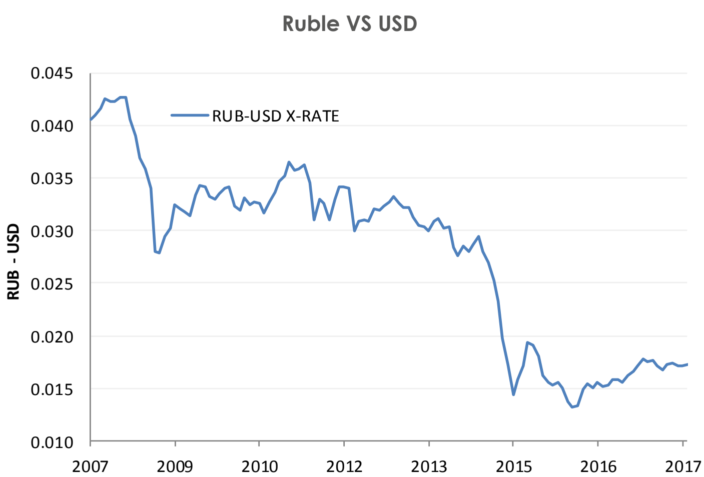
Colombia – The Colombian economy has under-performed compared to most emerging markets since the fall in crude oil prices in 2014, but could get back on its feet in 2018. Although GDP grew +0.2% year on year in the third quarter- the best result since June 2016- most macroeconomic data remain disappointing. The consumer confidence indicator has been in negative ground since the start of 2016. Industrial production was also disappointing, sliding -0.3% year on year in October. Inflation has remained under control since the central bank further dropped key rates from 5.0% to 4.75% at its October meeting, but rose from its 3.40% low point in July to 4.12% year on year in November.

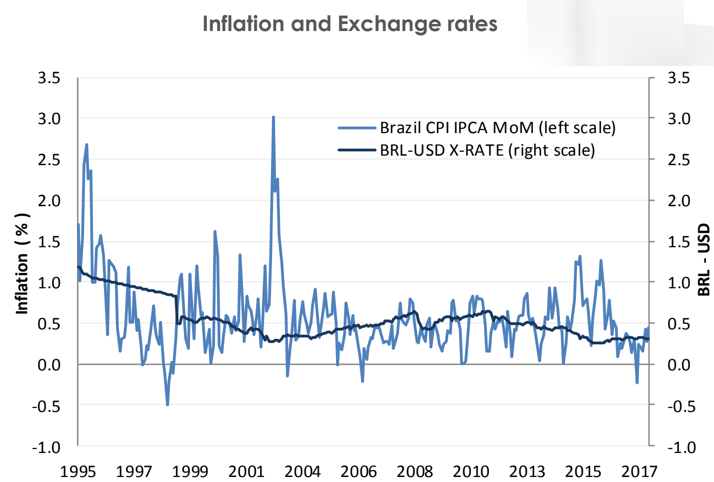
India – Just a year ago, India was on the right track to become a real catalyst for growth in the global economy. Indeed, the Indian economy posted the highest growth rates in 2016, even overtaking China, which was experiencing a slowdown. Between January and December 2016 GDP grew +7% year on year in each quarter. In the second quarter 2017, growth fell to +5.7%, its lowest rate for three years, before slightly picking up again to +6.3% in the third quarter 2017. The economy had been affected by two major economic policy decisions- demonetisation, and difficulties linked to implementing the greatest fiscal review since independence. On the good news front, 2017 also welcomed major achievements, in particular the 30-point leap to join the top 100 countries on the World Bank's Ease of Doing Business index, and the revision of India's credit rating by Moody's from Baa3 to Baa2, which was the country's first revision since 2004.

There are still more challenges for Mr Modi to overcome in 2018, and speeding up economic growth will be the federal government's main aim in 2018. Job creation remains crucial, but small businesses have been severely affected by the fiscal reform, and many have decided not to open up any new positions. However, the consensus points to a recovery in the growth rate in 2018. The International Monetary Fund forecasts that the Indian economy will grow +7.5% over the coming year. The latest data from leading indicators showed that the manufacturing PMI indicator had risen from 52.6 to 54.7, and the services PMI indicator from 48.5 to 50.9. Inflation headed back north of the central bank's 4% target, standing at 4.88% year on year in November, compared to 3.58% the previous month. It was pulled upwards by the rise in crude oil prices in particular.

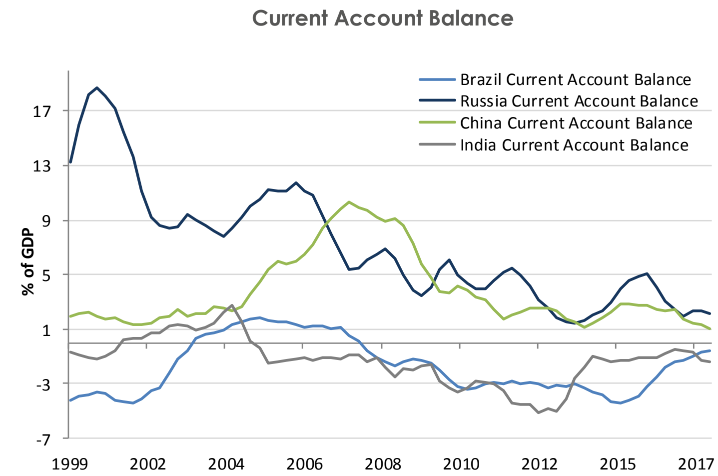
Indonesia – The Indonesian economy grew +5.06% year on year in the third quarter, after a +5.01% rise in the second quarter. GDP crossed an important threshold, hitting US $1,000 billion last year, but there was no atmosphere of celebration, as the government continued to miss its revenue targets. Economic growth for 2017 will probably come in under the +5.2% initially forecast. Fiscal reform is essential, as the government receives very little tax from its citizens. Public revenue stood at 14% of GDP in 2016, which is lower than that of similar countries, and constitutes a major barrier to creating growth and bringing credit up to scratch. However, the government must walk the tightrope of not putting extra pressure on businesses, especially as the rise in Islamic conservatism is a major challenge for both Indonesia and President Jokowi.

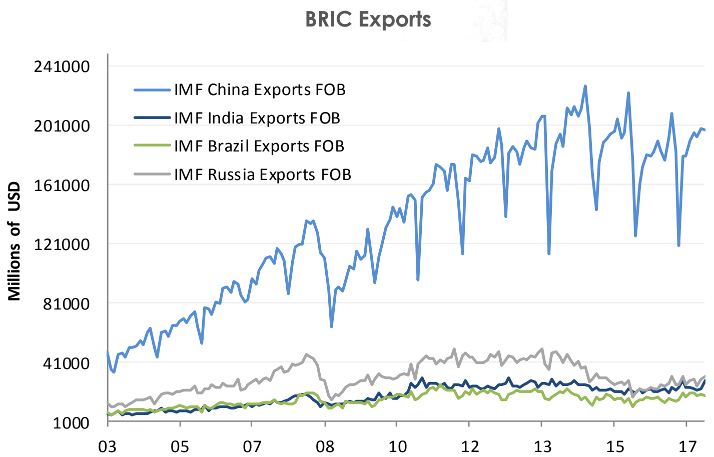
Mexico – The Mexican economy has been affected by two earthquakes in quick succession in September and generally unfavourable conditions. Nonetheless, it has piggy-backed on the vigour of the US economy, on which it is dependent for almost all of its exports. However, the economy grew +1.5% year on year in the third quarter, which is still its slowest growth rate since the fourth quarter 2016. According to the latest data, industrial production is still flagging (-1.1% year on year in October), as are retail sales (-0.1% year on year). After three hikes on the trot in March, May, and June, the central bank once again increased its key interest rates by +0.25 points to 7.25% in November, in an attempt to bring inflation (which still stood at 6.63% year on year in October) under control. This decision will not make it any easier for growth to recover in 2018, especially given that it is an election year in Mexico, and the favourite, Andrés Manuel López Obrador, is a left-wing nationalist candidate who hates NAFTA as much as Donald Trump does.

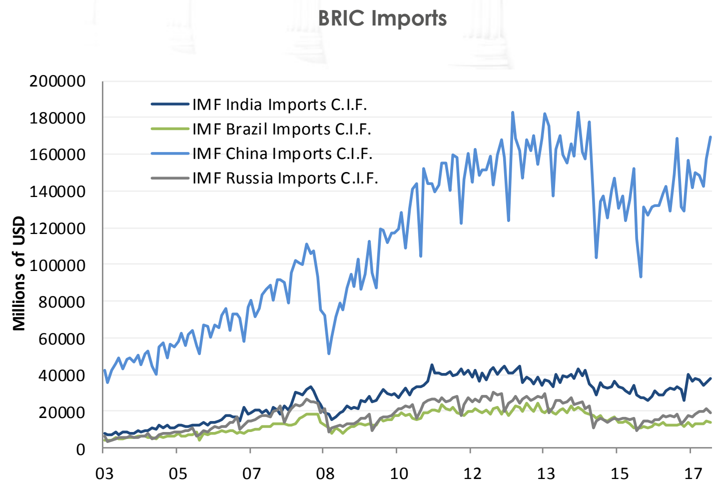




Graph sources: Bloomberg/BBGI Group







Taiwan – After a +2.13% rise in the second quarter, GDP posted +3.10% growth in the third quarter 2017. In our last publication, we highlighted the positive impact the production of new smartphone models is having for Taiwan, which produces some of the components, especially for Apple. Exports bounced back considerably in 2017, more than they have since 2010; they were up +14.8% compared to December 2016.

Russia – 2017 was the year that the Russian economy headed back into the black. After seven quarters of recession, GDP recovered to better levels in the fourth quarter 2016. Following on from +2.5% year on year growth in the second quarter 2017, the third quarter came as something of a disappointment, posting +1.8%, which was under forecasts of 2.0%. Inflation is still under control (+2.5% year on year in December), which enabled the central bank to continue to reduce its key interest rates. After several drops in March, April, and June, and then again in September, October and November, rates were brought down from 10% in January 2017 to 7.75% in December.

Leading PMI indicators were also pointing to more positive prospects for the Russian economy. The manufacturing PMI indicator stood at 52.0 in December, which was up from 51.5 in November. The services indicator remains very high (56.8), although it has slid slightly compared to the impressive figures for the previous month (57.4). Although the fall in inflation led to a real-terms salary increase (+5.4% in November), real-terms disposable income (excluding food and public services) stagnated (-0.3% year on year), and should only increase slightly in 2018. It should not be forgotten that 2018 is an election year in Russia, although there is little doubt that Vladimir Putin will be re-elected when the ballots are counted.

Turkey – Turkish GDP leapt +11.1% year on year in the third quarter, far outstripping forecasters' expectations (+8.5%). In particular, the economy is benefiting from foreign tourists returning as of the start of the year- year on year growth has been positive since April, and was even up +46.4% year on year in August, although this fell back to +22.1% in November- as well as an export recovery, with +11.2% year on year growth in November.

Romania, Poland, Hungary, Czech Republic – Romania's GDP rose +8.8% in the third quarter (on first reading), a growth rate that had not been seen for nine years. The country is now the most dynamic EU country, driven by the IT and manufacturing sectors, as well as high levels of foreign investment.

In the Czech Republic, GDP increased +5.0% in the third quarter, and has been recovering since the start of 2017 after five quarters of slowdown in 2016. The Polish economy is also posting dynamic growth figures, at +4.9% year on year in the third quarter, particularly helped by robust spending (retail was up +10.2% year on year in December). In Hungary, GDP grew +3.9 in the third quarter. Industrial activity should continue to improve if the 60 points on the manufacturing PMI indicator in December 2017 are to be believed.

Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

Graph sources: Bloomberg/BBGI Group

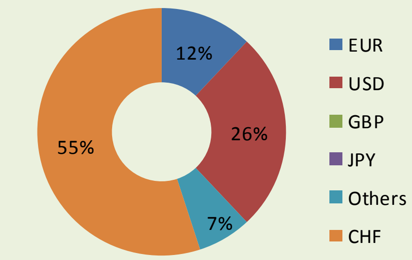
PROSPECTS AND STRATEGIES

Currencies

- Rise of the dollar after three years of consolidation
- Momentum slowdown for the euro, weakening of the yen
- Positive surprises for the Australian dollar, currencies linked to commodities as well as for the Swedish krona and Norwegian krone

LIQUIDITY/ CURRENCY	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
EUR vs CHF	↗	↗							
USD vs CHF	↗	↗↗							
GBP vs CHF	→	→							
JPY vs CHF	→	→							
EUR vs USD	↘	→							
USD vs JPY	→	→							
GBP vs USD	→	→							

Currency allocation - CHF portfolio



Tactical Allocation

- Underweight CHF
- Favor the USD
- Overweight EUR and AUD
- Avoid JPY

Rise of the dollar after three years of consolidation

US economic momentum will likely most often be superior to that of other developed economies in H1 2018. Consequently, the interest rate spread will likely widen further across the yield curve and benefit the greenback.

The tax reform adopted no longer seems to be considered an accelerator of economic dynamics that may require a radical change in monetary policy, at least by the members of the FOMC. It remains unclear whether this reform will support consumption or whether companies will invest more. The pace of rate hikes will certainly remain contained in two or three decisions. Inflationary pressures will remain limited and should not motivate a toughening of the Fed's action.

In this environment, the weakness of the dollar in 2017 seems unjustified. The depreciation of around -10% of the trade weighted USD index against a basket of currencies erased almost half of the dollar's gains between 2014 and 2015. The value of the US currency will thus undoubtedly adjust in the coming months, unless expectations of deteriorating public finances linked to the tax reform start to prevail and hurt the dollar.

Ultimately, our forecasts are positive and support an increase above 1 Swiss franc to the dollar and close to 1.15 to the euro.

Recent rebound in speculative positions from their lowest levels since 2011

In this rather dollar-friendly environment, "Long dollar" CFTC speculative positions are still low, showing strong disinterest from investors. Yet this indicator deserves closer attention, as over the last decade every significant dollar increase has been preceded by a surprisingly low ratio. The last time the current level was reached in March 2014, the dollar appreciated +25% in the following twelve months. For the past few weeks, there has been a slight rebound in this indicator, suggesting a timid comeback of positive positioning. We believe it is likely that the dollar will rise against most major and emerging currencies.

The rise of the euro is justified but it should now be limited

The rise in the Euro may already be an issue for the ECB, which might start worrying about its undesired effects on inflation prospects and European industry's competitiveness. So, if we estimate that the rise of the euro has certainly reached its zenith in the short term, it is likely that the undeniable improvement in Eurozone economic fundamentals and the prospect of an about-turn in monetary policy will rekindle investors' interest in the single currency in a second step.

The changes in the Euro/US dollar exchange rate has been one of the major trends in 2017. The approximately +15% growth in the Euro was certainly partly down to the weakness of the dollar, but it is first and foremost thanks to the, for many surprising, improvement in economic conditions in the Eurozone, making the single currency more attractive again. As such, the Euro has appreciated against many currencies, particularly against the Swiss franc.

From the change in SNB monetary policy in 2015 onwards, we had forecast that the introduction of negative interest rates would in the long term lead to a gradual loss of interest in the Swiss franc, which could once again push the exchange rate towards 1.20. We are now getting ever closer. Despite the good results expected for the European economy in 2018, we believe that the phase of revaluation of the Euro is now strong enough to justify some profit-taking.

We believe that the rise in the Euro should become less intense at the start of 2018, particularly against the Swiss franc and the US dollar.

However, after a period of stabilisation, it is likely that the undeniable improvement in Eurozone economic fundamentals and the prospect of an about-turn in monetary policy will rekindle investors' interest in the single currency.

The credit spread is now much more favorable after rising dollar rates, but remains relatively unchanged against the franc at around 50 basis points. However, we believe that it is now more likely to see rates normalize faster in the euro zone than in Switzerland and thus favor the Euro.

Graph sources: Bloomberg/BBGI Group

The Yen should continue to weaken

The Bank of Japan still does not have much room to act in terms of reaching its 2% inflation target. It has not changed its assessment of economic conditions and is maintaining its monetary policy unchanged, i.e., low interest rates and monetary injections. The Bank is still hoping that economic growth in Japan will be sufficient to drive inflation up toward the desired target. The short-term interest rate target is also unchanged (-0.1%), as is the aim of steering 10-year rates toward 0%. The correlation observed with movements in long-term rates will necessitate a slight definitional change in objectives, whereby the BOJ will likely set the lower limit of its target range at 0%. Governor Kuroda is unlikely to change the Bank's policies, which will remain a significant factor in the future decline of the Japanese currency. We continue to believe that the improvement in fundamentals will not have an immediate impact on the yen, which will continue to be disregarded by investors due to an utterly unfavourable interest rate environment.

The government's policy is thus still to weaken the yen, as interest rate spreads are likely to widen and penalise the currency. The on-going normalisation of US monetary policy along with expectations of further increases in long-term rates in the US will likely further weigh on the yen in 2018. A weaker exchange rate has been one of the key elements of the government's policy to boost inflation and exports. This policy remains relevant.

The change in monetary policy is indeed not for 2018, even though it can be seen that the BoJ has significantly reduced the pace of its purchases of securities to the point that its balance sheet recorded its first almost imperceptible contraction in December. We do not think this event is a harbinger of a new monetary policy.

The yen will likely revert to fluctuating within a range of 115 to 120 against the dollar over the next few quarters.

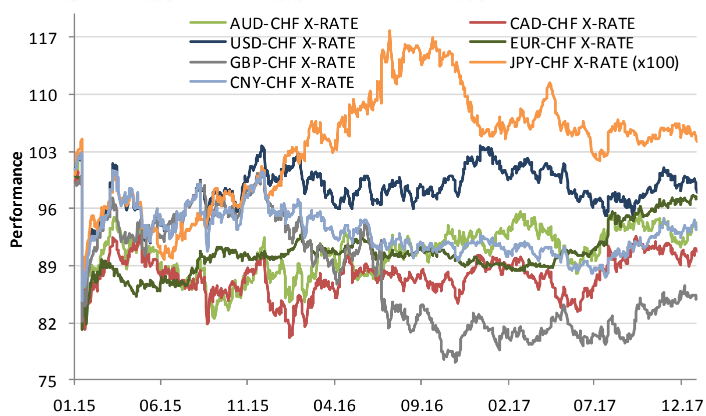
The pound should benefit from the resumption of the negotiations process

The British currency was not really impacted by the vagaries of the negotiation process over the past quarter. We have been noting for several months that the pound has entered a stabilisation phase against most major currencies, after its record drop following the Brexit vote. In 4Q16 already we noted that the pound had likely reached a valuation level enabling a more lasting consolidation pending greater visibility with regard to the country's economic outlook. Since then, the currency's volatility has decreased, and the exchange rate has actually risen against the franc (from 1.20 to 1.30) and the dollar (from 1.20 to 1.35) in particular. It stabilised above 1.10 against the euro in a context favouring the single currency.

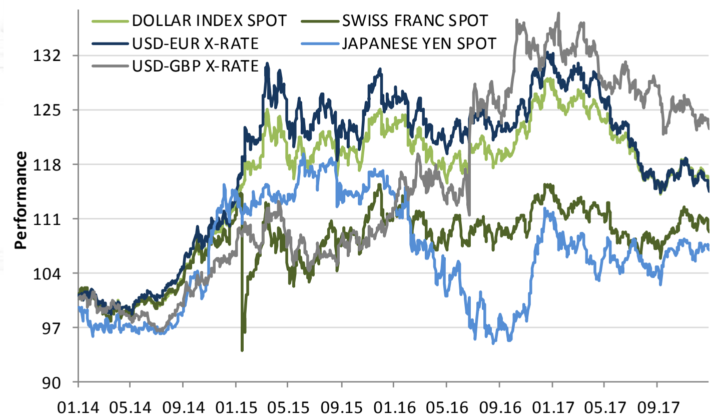
Australian dollar likely to rise further

The Australian dollar was rather volatile in 2017, and although it rose +6% against the US dollar, it depreciated against the euro and the yuan, while remaining relatively stable against the franc. The Australian central bank could possibly proceed with a surprise initial rate hike in June given the country's excellent economic performance and a tight job market. The increase in commodities prices expected in 2018 will likely contribute to positive developments in the exchange rate against most currencies.

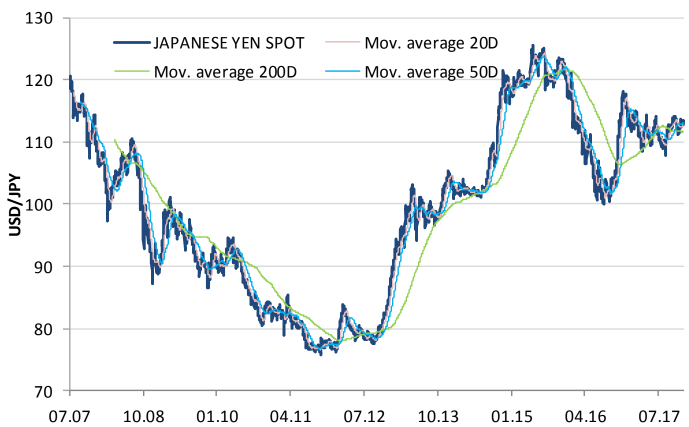
7 currencies against CHF (Normalized at 100)



Dollar Trade-weighted index & cross rates (Normalized at 100)



JPY/USD



EUR/USD

Graph sources: Bloomberg/BBGI Group

Positive surprises with regard to the Norwegian and Swedish crowns

In Europe, the Norwegian crown and the Swedish crown could also rise against the dollar and the euro. Policy rates in Norway may also be raised more quickly than expected in 2018, given GDP growth of +3.2% in 2017. A readjustment of policy rates would be surprising with regard to a currency that appears to be among the most undervalued in real terms. In Sweden, the Riksbank could even adjust its rates twice, boosting the appeal of the Swedish crown, which is also rather undervalued against the dollar and the euro.

Positive scenario for currencies linked to commodities

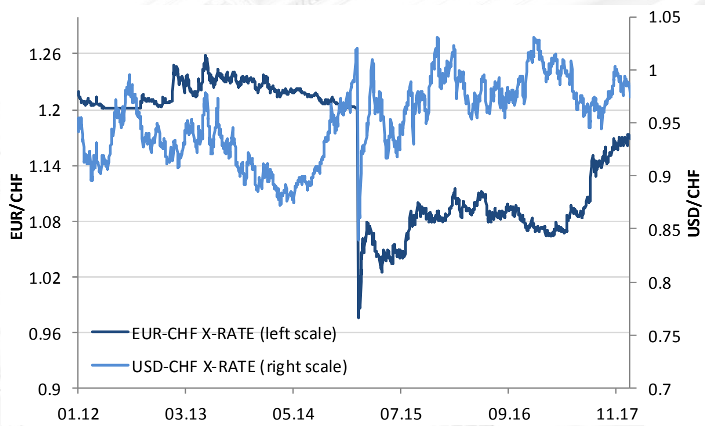
In Russia, Brazil, and Indonesia and in commodities-producing countries more generally, the upswing in the prices of industrial metals, precious metals, and crude has reversed downward trends and initiated a more robust course. The improvement in the general context driven by the upswing in commodities and a more solid global economic outlook will have an increasingly positive impact on the valuation of these countries' currencies. In contrast to the situations described above, in these countries it is the combination of factors such as improving GDP growth coupled with a better control of inflation and a reduction in policy rates that will drive the rise in exchange rates.

CURRENCIES

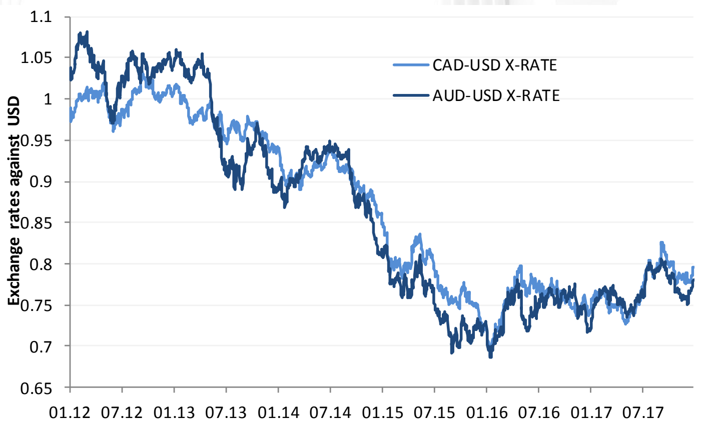
31.12.2017

Name	Last price	7 d %	1 m %	3 m %	6 m %	YTD %
AGAINST DOLLAR						
EUR-USD X-RATE	1.2	1.2	0.9	2.3	5.8	14.1
CHF-USD X-RATE	1.0	1.4	0.2	0.0	-0.9	4.5
GBP-USD X-RATE	1.4	1.1	0.3	1.8	4.6	9.5
JPY-USD X-RATE	0.0	0.5	-0.4	0.1	0.5	3.8
CAD-USD X-RATE	0.8	1.2	0.9	-0.5	2.9	6.9
AUD-USD X-RATE	0.8	1.3	2.6	-0.2	2.7	8.3
RUB-USD X-RATE	0.0	1.1	2.1	0.4	3.0	6.7
CNY-USD X-RATE	0.2	0.8	1.2	2.3	4.4	6.7
INR-USD X-RATE	0.0	0.2	1.0	2.8	1.3	6.5
BRL-USD X-RATE	0.3	0.7	-1.7	-4.8	-0.1	-1.8
AGAINST SWISS FRANC						
USD-CHF X-RATE	1.0	-1.4	-0.2	0.0	0.9	-4.4
EUR-CHF X-RATE	1.2	-0.2	0.8	2.3	6.9	9.2
GBP-CHF X-RATE	1.3	-0.4	0.1	1.8	5.6	4.7
JPY-CHF X-RATE (x100)	0.9	-0.9	-0.6	0.0	1.4	-0.7
CAD-CHF X-RATE	0.8	0.0	0.9	-0.4	4.0	2.4
AUD-CHF X-RATE	0.8	-0.2	2.4	-0.2	3.7	3.6
RUB-CHF X-RATE	0.0	-0.4	2.0	0.4	4.0	2.4
CNY-CHF X-RATE	0.1	-0.5	1.1	2.3	5.4	2.1
INR-CHF X-RATE	0.0	-1.3	1.3	2.7	2.7	2.0
BRL-CHF X-RATE	0.3	-0.7	-2.0	-4.9	0.7	-6.1

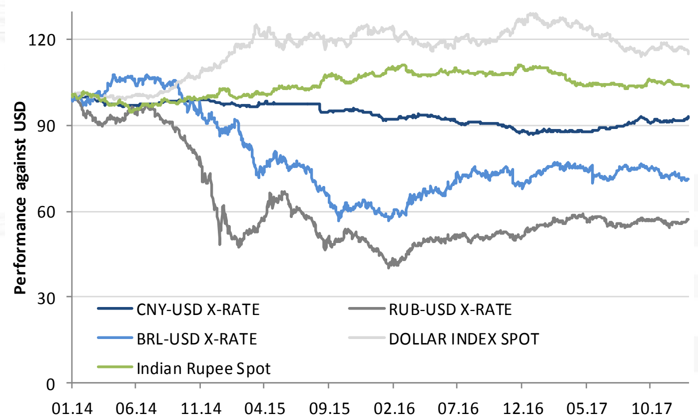
EUR/CHF - USD/CHF



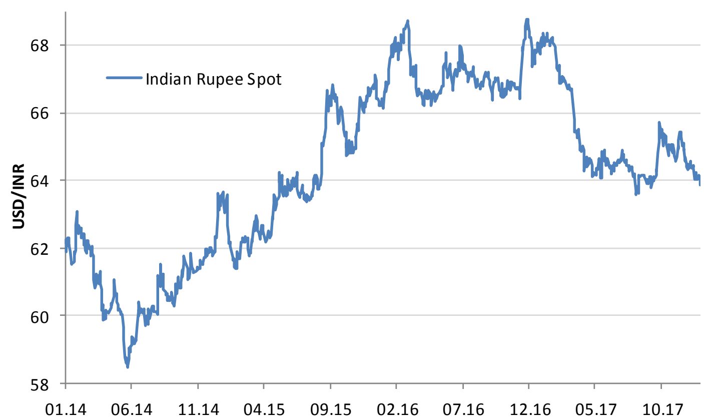
CAD/USD - AUD/USD



Emerging Currencies VS USD (base 100)



Indian Rupee

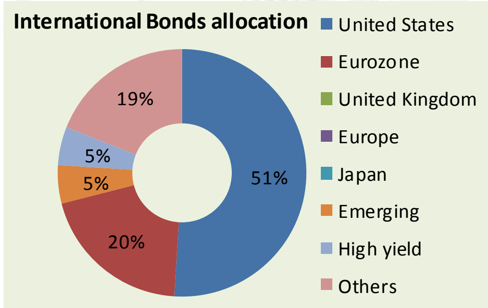


Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

International bonds

- Upturn in inflation could be the surprise of the year in the US
- A rise in long-term rates is on the euro zone
- UK : Bond markets cannot remain indifferent to the rise in inflation
- Japan: bonds are not providing any opportunities



BONDS (Areas/currency)	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Switzerland	↘	↘↘							
United States	↘	↘							
Eurozone	↘	↘↘							
UK	↘	↘							
Europe	↘	↘↘							
Japan	↘	↘							
Emerging	→	→							
Other (AUD, CAD, NOK...)	→	→							

Tactical Allocation

- Reduce exposure to Eurozone
- Reduce duration again
- Diversify exposure to CAD, AUD and commodity-related currencies
- Reduce exposure to Emerging and High Yield Bonds

Upturn in inflation could be the surprise of the year

The latest inflation figures published in November (+2.2%) pointed to a stabilisation of price indices slightly above the Federal Reserve's targeted +2%. The yoy rise of the index excluding food and energy (+1.7%) was slightly below expectations and still under 2%. This shows that inflation has clearly struggled to gain greater momentum in H2 2017, despite statistics that indicated accelerating economic growth in the US.

The central bank is not showing any signs of worry or impatience, noting instead that temporary factors have for the moment held back an increase in prices. Nevertheless, the strength of the economy and an unemployment rate at a 16-year low will almost certainly trigger tensions and price increases enabling inflation to exceed the set targets. Pressure on wages is slow to materialise despite a continuously improving job market. Contrary to theory, inflationary pressures are still weak, while the unemployment rate has steadily dropped to a historic low of 4%, de facto approaching its full employment level. Nevertheless, the Fed remains relatively serene and convinced that the relation between employment and inflation still exists, even if it appears that the Phillips curve is for the moment clearly flatter than before. Import prices have surged 3.7% yoy mainly due to the increase in oil prices in November. This trend will likely continue in 2018 with the upswing in business activity. Forecasts for expected inflation have progressed at the end of the year, reaching +2.7% yoy and +2.4% on a 5 to 10-year time horizon.

Inflationary pressures were limited in 2017 and mainly linked to external factors. In the US as in most economies, rising inflation was indeed triggered by the increase in crude oil prices that began in 2016 and continued to have an effect in 2017 – a year that was marked by successful policies carried out by central banks to put a stop to deflation and to bring the rate of inflation back towards their targets generally set at 2%. Thus, inflation has returned to a "normal" level, while employment has improved and tensions on the job market have yet to appear. A series of surprises could mark 2018 owing to multiple factors acting in combination. Indeed, the macroeconomic environment will likely be conducive to wage negotiations and pressures on commodity prices, supporting an increase in production and consumption prices.

Rate hikes and flattening yield curve

A return of inflation in a robust economic environment will likely see long-term nominal rates being adjusted once again in the next few months. After a few quarters of stabilisation, US long rates will likely be the first to kick-start the trend once again. Already several months ago, we noted that the adjustment in 10-year Treasury rates from 2.6% to 2.1% observed until the end of the summer was not at all compatible with our economic growth expectations in the area of +3% and with a normalisation of the Fed's regular monetary policy. We then believed that an increase in long rates would very likely be observed in the second part of 2017 and in 2018. This took the shape of an increase in 10-year rates from 2.1% to 2.5% as of 31 December. Thus, long-term rates are once again close to the highs they had reached in March and in the upper section of their fluctuation band for 2017. In H1 2018, confirmation of strong economic data will probably be accompanied by an increase in crude oil prices and commodities prices likely to trigger valuation adjustments in the interest rate markets.

BOND INDICES (local currency)

31.12.2017 — Total Return Performance

	Name	Last price	Curr.	7 d%	1 m %	3 m %	6 m %	YTD %
SWISS BONDS	SBI AAA-BBB	136.4	CHF	0.1	0.1	0.5	0.5	0.1
UE BONDS	Barclays EuroAgg	248.7	EUR	-0.3	-1.0	0.5	1.2	0.7
UE BONDS - SHORT DURATION	ISHARES EURO GOV BND 1-3	144.4	EUR	-0.2	-0.3	0.0	0.0	0.0
US BONDS	JPM U.S. Aggregate Bond Index	632.7	USD	0.5	0.2	0.4	1.5	3.7
US BONDS - SHORT DURATION	BGF-USD ST DURATN BOND-USDA1	8.5	USD	0.0	0.0	-0.1	0.3	1.3
EMERGING BONDS	JPMorgan Emerging Markets Bond	551.8	USD	0.3	0.7	1.1	4.0	10.5
INTERNATIONAL BONDS (DIVERSIFIED) - USD	JPM Global Aggregate Bond Index	570.0	USD	0.8	0.2	1.3	3.1	7.0
INTERNATIONAL BONDS (DIVERSIFIED) - EUR	JPM Global Aggregate Bond Index	623.3	EUR	-0.7	-0.9	-1.0	-2.5	-6.0
INTERNATIONAL BONDS (DIVERSIFIED) - CHF	Barclays Global Agg Corporate	144.8	CHF	-0.6	-0.4	1.7	5.0	4.6
CONVERTIBLE BONDS (UE)	Exane Europe Convertible Bond	7731.3	EUR	-0.3	0.3	0.7	1.4	3.5
HIGH YIELD BONDS	Markit iBxx Gbl Dev Lq HY USD	144.5	USD	0.6	0.4	0.9	3.6	10.4
HIGH YIELD BONDS - SHORT DURATION	AB SHORT DURATION HI YD-AT	15.0	USD	0.0	0.1	0.0	0.9	3.1

1) Short & Medium-term (1-5 years)
2) Emerging Bonds (Corporate)
3) Emerging Bonds - Eastern Europe

Graph sources: Bloomberg/BBGI Group

During its last meeting, the Federal Reserve proceeded with a further rate hike to 1.5%, as expected. New chair Jerome Powell will take office after the next meeting in January with no risks of significant change in the stated policy. Balance sheet normalisation will remain very moderate, not to say imperceptible. In parallel, the target for key rates (Fed Funds) will likely increase to 2-2.25% in 2018. FOMC members' analysis of the economic conditions and the state of the US economy remained relatively unchanged in December. We believe that most maturities will be subject to a 0.5% adjustment in the next few months that will push 10-year Treasury rates above 3%.

A rise in long-term rates is looming in the euro zone

For now, the rise in long-term rates is still entirely hampered by the ECB maintaining the status quo in terms of monetary policy. The position set out by Mario Draghi of continuing the bond purchasing strategy until September 2018, and perhaps beyond that, is extinguishing even the vaguest hopes of long rates changing in step with the changes in fundamental and macroeconomic data. Equally, as changes in inflation are not showing any clear signs of a surge, the need to change interest rates is not overwhelming.

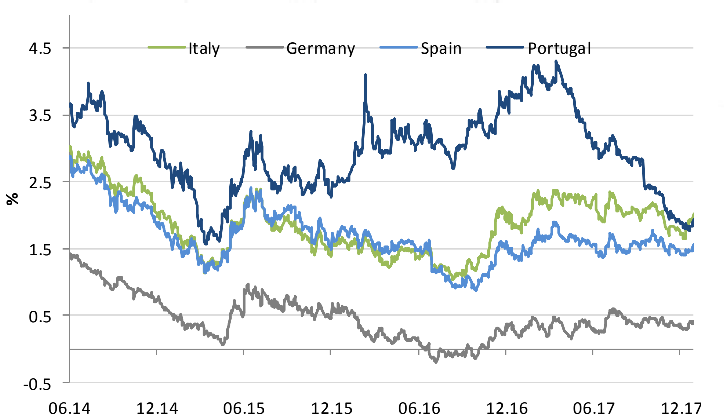
Indeed, for a few months inflation has stabilised at around +1.5%, after a clear recovery from 0% to 2% between June 2016 and February 2017. The rise in the Euro has undoubtedly been key in this recent development, as it was in stabilising energy prices before their latest increase from US $42 to US $60.

It is certainly too early to see a clear inflation recovery linked to the jobs market, which is still too far from is friction point for wage rises to lead to an increase in prices. The ECB's 2% inflation target will certainly be difficult to hit, even if the central bank continues with its expansionary monetary policy in 2018, and particularly if the Euro stays strong in the long term. Salary costs are developing slowly, and despite the considerable fall in the Eurozone unemployment rate, it is still high in absolute terms.

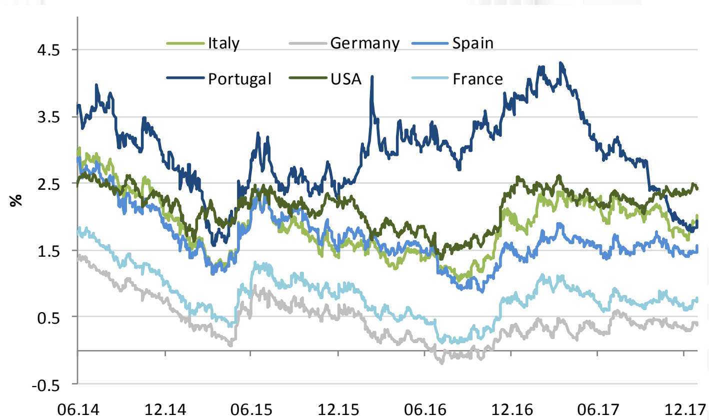
Unless inflation picks up the pace and there are prospects of price rises, long rates will still be able to be influenced by ECB action. Developments on long rates are now increasingly constrained to a narrow valuation band of less than 20 basis points for German government 10-year rates. They will close the year close to 0.3%. We do not believe that bringing inflation back above +2% is essential in supporting a rise in long term interest rates in Euro.

European rates should certainly enjoy an upward trend, sparked by US monetary policy normalisation and a recovery of long rates in the United States. The long rate differential seems increasingly less-well founded, given the way in which the European economy is catching up. Although the first quarter should still be shaped by some stability on long rates, we believe that it is likely that we will then finally see a stark change in investors' perception of risk. We recommend not to wait before considerably reducing the bond risk in Euro.

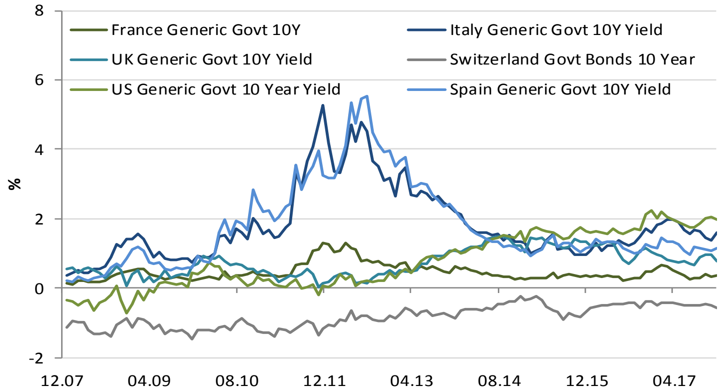
European Bonds (10 year yield)



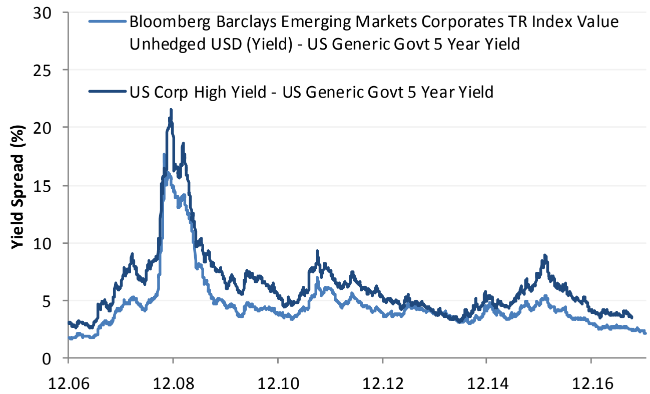
10 year yield



Risk premium over Bund



Risk premium over Treasury



Graph sources: Bloomberg/BBGI Group

UK : The bond market cannot remain indifferent to the pick-up in inflation

Inflation is rising slowly but surely in the UK. By November, the consumer price index had doubled over twelve months, reaching +3.1%. The CPI index had reached a low in April 2015 at -0.1%. The upturn is significant and even clearer when looking at the trend in the production price index over the same period.

We continue to predict that inflation will exceed the BOE's 2% target in the next several quarters and could even reach 4% by 2020. It is surprising in the context of general price increases that long-term interest rates are not more affected by changes in expectations. Indeed, despite the increase in prices, the yields on UK government debt seem to have followed the trends in international bond markets and do not appear to be reflecting the increase in domestic inflation. Real yields in pounds are thus relatively stable, even declining slightly from 1.4% in October to 1.3% at the end of November.

The UK bond market will likely be more impacted by domestic fundamentals in the near future, which will likely nudge long-term rates back up.

Japan: bonds are not providing any opportunities

The upswing in price indices is already losing momentum, with the domestic CPI index dropping from +0.7% to +0.2% in October. Inflation has thus once again moved away from reaching the BOJ's target. Any hope of a long-term increase in prices still most likely depends on a further decline of the yen. The change in circumstances with regard to inflation is still too recent and too restricted in amplitude to have a significant impact on interest rates. The slowdown in growth and a diminished outlook for 2018 will certainly not contribute to an improvement in price index forecasts.

The Bank of Japan still does not have much room to act in terms of reaching its 2% inflation target. It has not changed its assessment of economic conditions and is maintaining its monetary policy unchanged, i.e., low interest rates and monetary injections. The Bank is still hoping that economic growth in Japan will be sufficient to drive inflation up toward the desired target. The short-term interest rate target is also unchanged (-0.1%), as is the aim of steering 10-year rates toward 0%. The correlation observed with movements in long-term rates will necessitate a slight definitional change in objectives, whereby the BOJ will likely set the lower limit of its target range at 0%. Governor Kuroda is unlikely to change the Bank's policies, which will remain a significant factor in the future decline of the Japanese currency. The Japanese bond market still fails to offer any interesting opportunities for foreign investors.

Focus on short maturities and take a cautious stance on peripheral debt

2018 will therefore be the year of the rebound in interest rates and probably also of the widening of credit spreads. Prudence will be decisive in order to avoid significant losses during this shift in paradigm. The yield on short-term Greek debt is now lower than that of the US Treasury. The performance of the European peripheral debt will certainly be disappointing. Overall, risk premiums are expected to increase in 2018 with the rebound in interest rates. We prefer investment grade bonds in US, Canadian and Australian dollars to the detriment of bonds in euro and yen.

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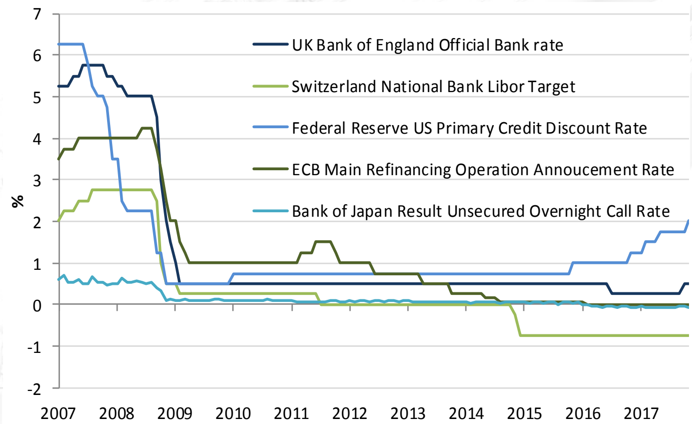
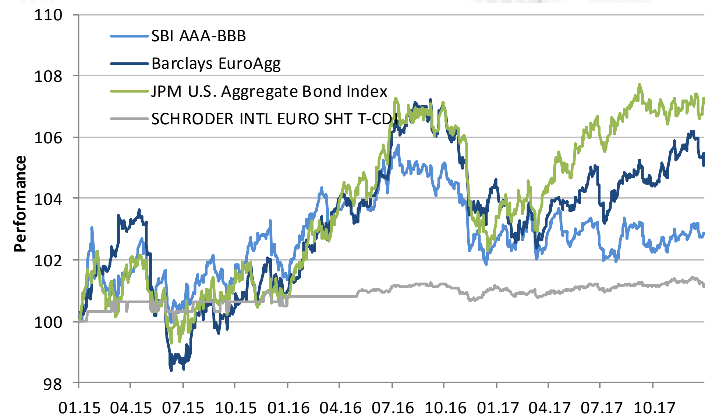
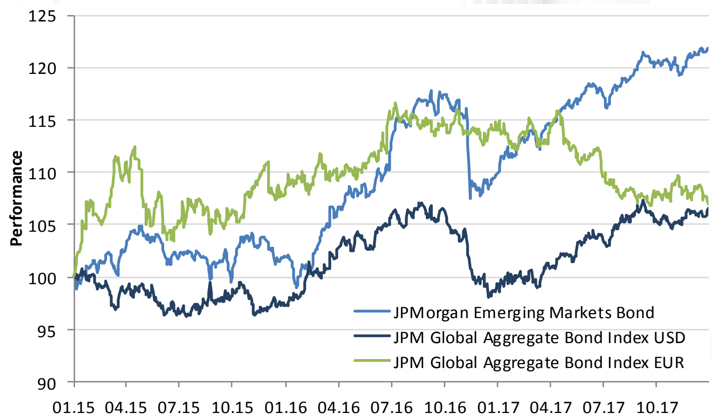
Central Bank rate (EUR, CHF, GBP, USD, JPY)



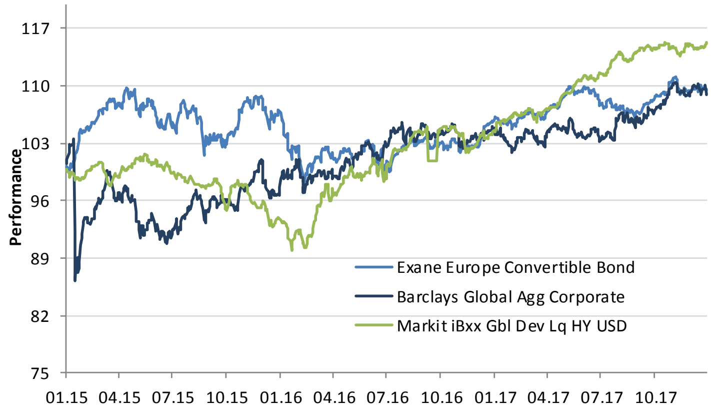
YTD Performance of Bond Indices 1- 5 years (Normalized at 100)



Emerging Bonds - Performance (Normalized at 100)



Eastern Europe Bonds - Performance (Normalized at 100)



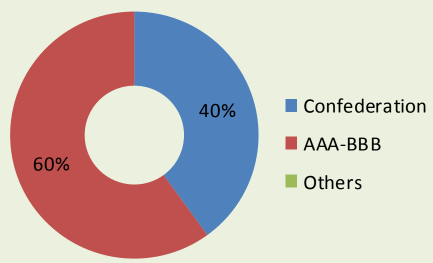
Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

Swiss bonds

- Global economic context to affect the fixed income market
- Inflation finally positive in 2017 after 5 years of deflation
- Rising long-term interest rates and steepening yield curve
- The SNB maintains a wait-and-see stance
- Focus on quality and short maturities

Swiss Bonds allocation



BONDS Type of Debtor	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Governement	↘	↘							
Corporate (IG)	↘	↘							
Others	↘	↘							

Tactical Allocation

- Underweight Swiss Government Bonds
- Overweight the "IG" segment
- Prioritise short durations on all segments

The global economic context is affecting the Swiss fixed income market

The normalisation of long-term rates in Switzerland started in the summer of 2016, in the wake of the trend reversal in the US. The Swiss government's 10-year rates bounced back from the levels they had reached at the beginning of July (-0.6%), stabilising slightly below zero. In this context, the spread between German and Swiss government long-term rates has remained relatively stable at 0.5%, which is likely still not sufficient to push the euro above 1.20. However, economic conditions in the Eurozone already appear sufficiently positive to drive an increase in long-term rates in 2018, which will cause this yield spread to widen. The exchange rate has already reacted to this paradigm shift and is rapidly approaching 1.20. The rise of the euro is thus already well under way following the +20% adjustment in the exchange rate since the 15 January close. An intensification of growth in the Eurozone and a widening interest rate spread will drive the continued rise of the euro to 1.20. Macroeconomic developments in the Eurozone, movements in the exchange rate, and the behaviour of euro-denominated fixed income markets will likely impact long-term interest rates in Switzerland.

Inflation finally positive in 2017 after 5 years of deflation

Inflation has presently exceeded 0.8% in Switzerland and will likely strengthen as the franc weakens in 2018. Rising prices will thus facilitate the next interest rate normalisation push in 2018. The bond bubble will hence likely start by deflating, with no immediate sign of panic, before swelling once again.

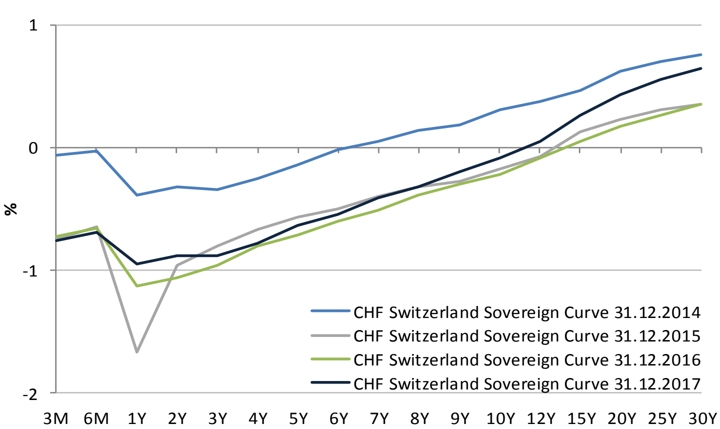
Rising long-term interest rates and steepening yield curve

The yield curve in Switzerland was relatively stable in 2017, but we do not believe this phenomenon will persist in 2018. The lack of any swift action by the SNB should indeed keep short-term rates in negative territory, while due to the influence of long-term rate increases in most markets and of the weakening franc, long-term rates will likely tighten in Switzerland. The rise of the euro will also allow the SNB to consider altering its monetary policy, but we do not anticipate a very rapid change in this regard, as the bank will for a time remain in wait-and-see mode. Policy rates are unlikely to change quickly, but the expectations of a change in policy could already push long-term rates up over the next several months.

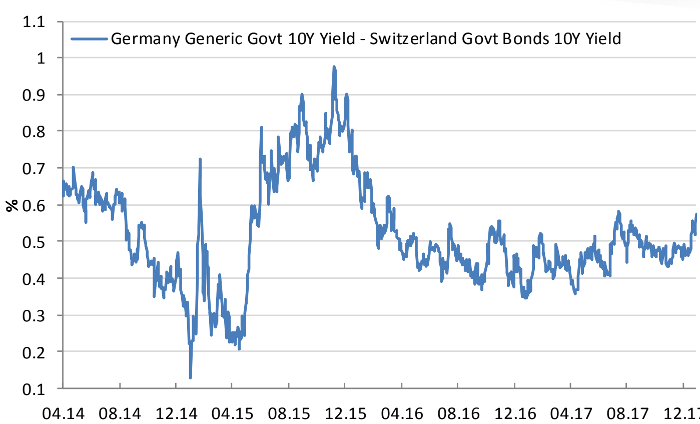
Focus on quality and short maturities

Negative real interest rates should be temporary and gradually correct as long-term rates rise above inflation. However, they will remain negative in 2018, foretelling another upcoming correction in the valuation of bond markets. We favour quality and short maturities.

Switzerland Sovereign Yield Curve

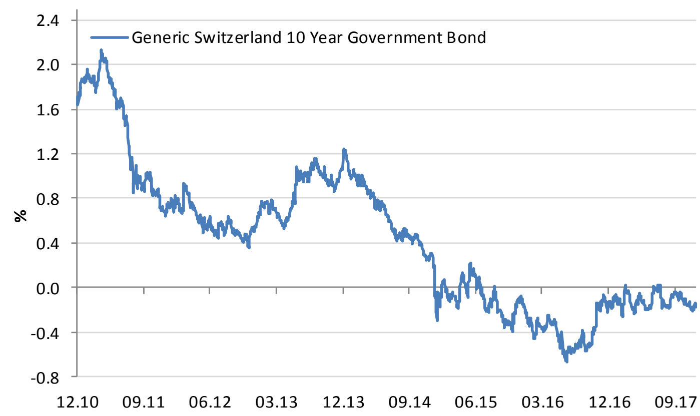


Long rates Yield Spread (German Bund - Swiss Confederation)

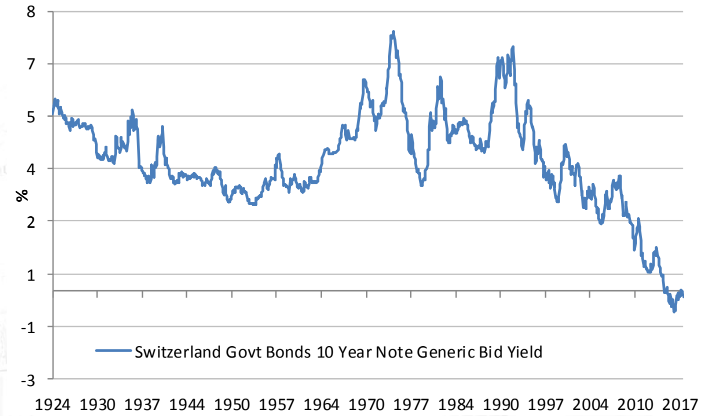


Graph sources: Bloomberg/BBGI Group

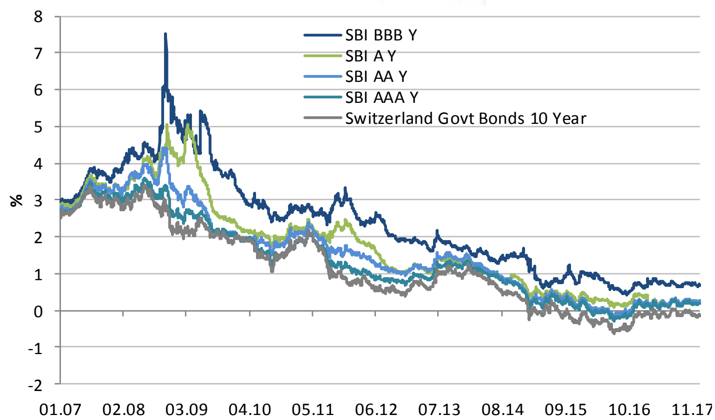
Switzerland Government Bond yield (10 year)



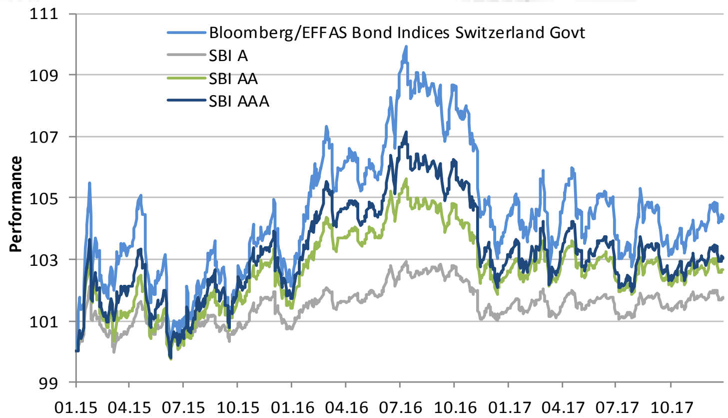
Switzerland Government Bond yield (10 year) since 1924



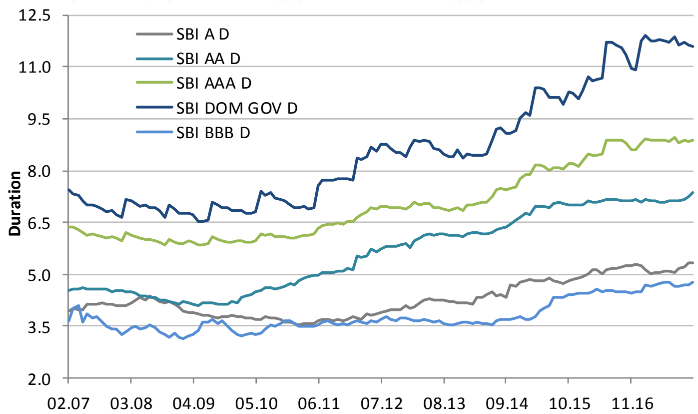
Yield by debtor type



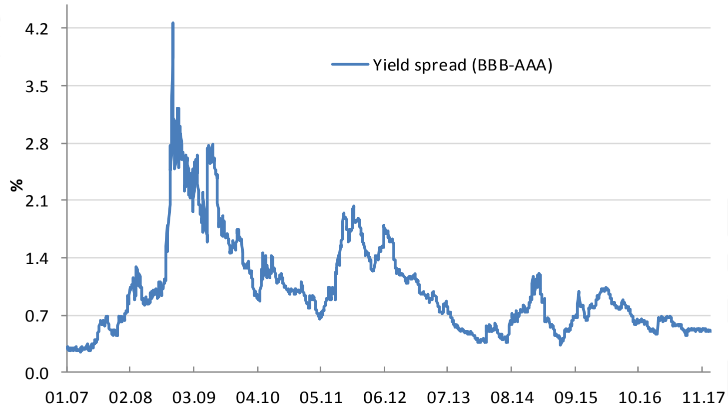
Performance of Swiss Bonds (Normalized at 100)



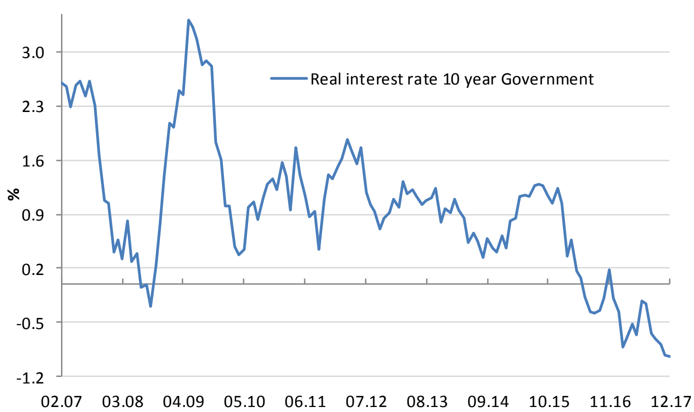
Duration of Bond Indices



Yield spread



Real Interest Rates



SWISS BOND INDICES (CHF)

31.12.2017 — Total Return Performance

N° ISIN	Last price	Curr.	7 d %	1 m %	3 m %	6 m %	YTD %
Bloomberg Barclays Series-E Switzerland Govt All > 1 Yr Bond Index	261.3	CHF	0.1	0.2	0.9	0.7	-0.1
SBI A-BBB	136.2	CHF	0.1	0.1	0.3	0.5	0.8
SBI AA-BBB	134.7	CHF	0.1	0.1	0.4	0.5	0.4
SBI AAA-AA	136.0	CHF	0.1	0.1	0.5	0.5	-0.1
SBI BBB	147.7	CHF	0.0	0.1	0.3	0.6	1.4
SBI AAA-BBB	136.4	CHF	0.1	0.1	0.5	0.5	0.1
SBI DOM GOV AAA-BBB 1-3P	70.9	CHF	0.0	-0.2	-0.7	-1.4	-3.5
SBI DOM GOV AAA-BBB 3-7P	89.5	CHF	0.0	-0.1	-0.4	-0.9	-2.8
SBI DOM GOV AAA-BBB 7+ P	129.0	CHF	0.1	0.2	1.1	0.2	-1.8

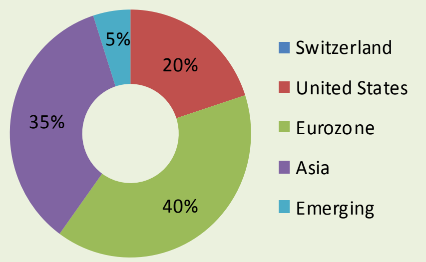
Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

International Real Estate

- Real estate continues to rise in 2018
- Interest rates are not yet a threat
- Real rates at record lows
- The Eurozone and Asia are benefitting from better fundamentals

International Real Estate allocation



Tactical Allocation

- Overweight Europe and Asia
- Cash 0%

REAL ESTATE Areas	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Switzerland	↗	↗							
United States	↗	↗							
Eurozone	↗	↗↗							
United Kingdom	↗	↗							
Asia	↗	↗↗							
Emergents	↗	↗↗							
Liquidity									

Upward trend in real estate continues in 2017 and 2018

In the last quarter, international real estate benefited from an improvement in overall investor sentiment and a stronger global growth outlook for 2018. The global real estate index (Epra Nareit Global Index TR in USD) posted a further progression of +4% in Q4 and thus closed out 2017 with an outstanding performance of +15% in USD (+10% in CHF), its highest annual increase since 2012. Since the beginning of 2017 our strategy had favoured the Eurozone in terms of regional allocation, thus making a key positive contribution to the success of our investment policy. Indeed, the contribution of the Eurozone was particularly favourable in 2017 (best international market) thanks to an increase of +17.8% in euros and +29.1% in USD (best performance since 2009). This market segment contributed significantly to the rise of the global index to these higher levels.

In local currencies, the Eurozone posted a significantly higher increase than the UK (+8.6% and +4.4% in euros), which made out relatively well considering the Brexit context, which continues to be extremely uncertain. Developed markets in Asia progressed +12.2% in dollars, while markets in the Asia Pacific region grew 22.6%. The performance of Asian markets thus also exceeds that of US real estate (+2.3%), which generally lagged behind securitised real estate in 2017.

The normalisation of policy rates in the US and higher yields in dollars have reduced the appeal of diversifying into US real estate securities. In the Eurozone, Italy benefitted greatly from diminishing political uncertainty, posting the strongest progression (45.8%) in the region. Germany was up +28.7% over the year, and the French market was mainly notable for vigorously catching up in Q4 with +9.9% growth. In the UK, the stability observed is surprising: indeed, listed real estate shares are not seeing any disinvestment and posted respectable results given the Brexit context.

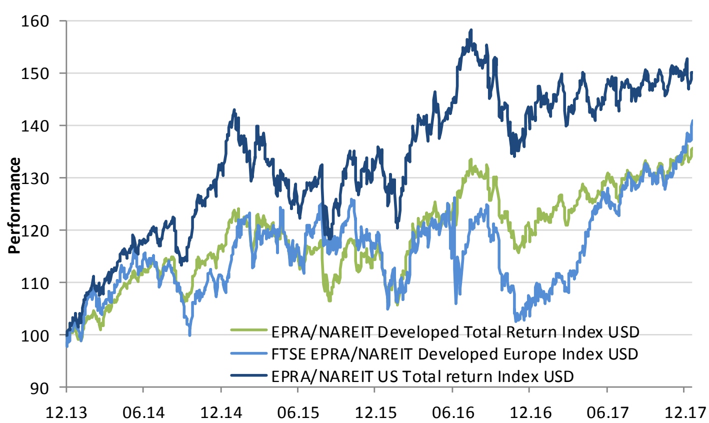
The overall performance of global securitised real estate is thus particularly satisfactory in 2017 and will likely again be positive in 2018.

Indeed, macroeconomic factors seem like they will continue to support positive developments in 2018, and the risks for the most part related to the new paradigms in terms of liquidity and interest rate cycles are unlikely to generate negative effects before 2019.

Global growth accelerates to +3.7%

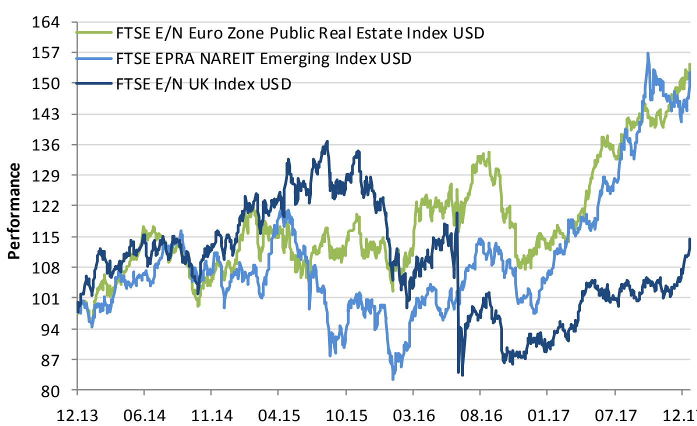
Global growth in 2018 will likely be the highest since 2011 and will benefit from the synchronisation of regional business cycles. According to experts at the OECD, global growth will thus likely exceed +3.7% in 2018. Both developed and emerging countries will participate in this stronger growth. These upward revisions in expectations will also be advantageous to long-term real estate investments, which will benefit from the improvement in economic factors and from the likely increase

EPRA Nareit - USA, Europe, Global (USD)



Graph sources: Bloomberg/BBGI Group

EPRA Nareit - Eurozone, United Kingdom, Emerging (USD)



in global demand will have a relatively significant impact on both occupancy rates and rents given an environment characterised by sluggish supply. The macroeconomic environment will thus likely support real estate investments in view of the positive combination of several factors.

Interest rates are not yet a threat in 2018

2018 will likely be the year of a global paradigm shift regarding monetary policy. The Federal Reserve has already initiated a normalisation process, which is leading it to both progressively raise its rates and very gradually withdraw some of the liquidity injected over the past decade into the economy. This trend will be followed by the ECB and the BOJ and will at that point mark a significant change in the evolution of international monetary policies. Long-term interest rates will also follow an upward trend in 2018, but we believe this upturn in long-term rates will remain entirely insufficient to impact the valuation of real estate investments or even to compete with this asset class in terms of diversification strategies.

Yield spreads (or risk premiums) between long-term interest rates and the yields on indirect real estate investments have tightened slightly but remain attractive by historical comparison, in particular in the Eurozone.

The normalisation of interest rates has not even been truly initiated in several economic zones (Eurozone and Japan). It is thus premature to worry about its negative effects on real estate capitalisation rates in 2018 in general. At the current stage in the global business cycle, this phenomenon is unlikely to have a lasting impact on real estate fundamentals except in the US market, whose growth cycle is already well under way.

Real rates will remain at record lows due to Inflation

The surprise of 2018 could well be the more positive trend in price indices. This trend could intensify and have an even greater impact on real interest rates. In spite of the normalisation of monetary policy currently under way in the US and forthcoming in the Eurozone, the upturn in inflation will likely be swifter that that of long-term rates in our view.

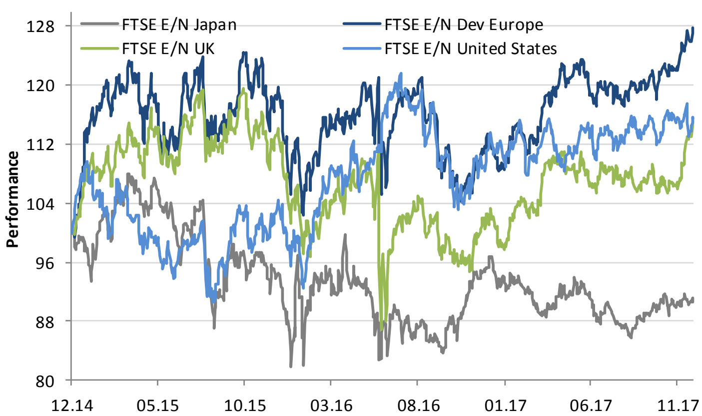
Over the next few quarters, real interest rates are thus likely to drop, which would be favourable to real estate markets in the US, Europe, and Japan in particular. The steady increase in inflation will only further reinforce this trend, which we believe will indeed benefit the sector. The performance of real estate markets should thus be stronger when real interest rates are low and when the growth outlook is equal to or better than its historical average. The acceleration of global economic momentum will be accompanied by expectations of higher rent growth, which should benefit the valuation of real estate assets.

US real estate is losing momentum

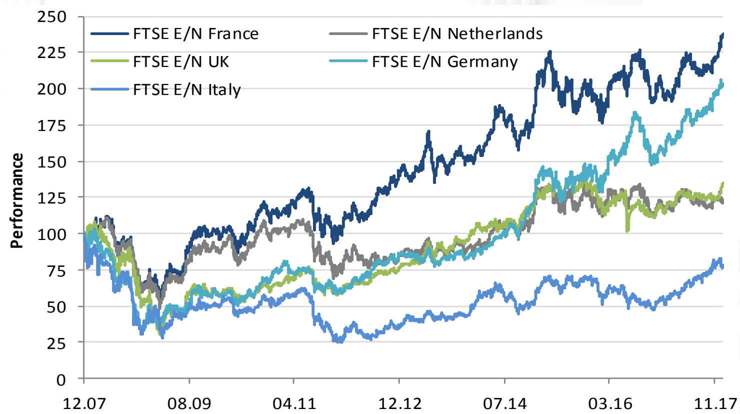
The US real estate cycle is ahead of most other regional cycles. Real estate prices (S&P CoreLogic Case-Shiller Index) progressed another +5.9% in 2017 for the sixth consecutive year, posting overall growth of +45%, which is on average 6% above the levels reached before the real estate bubble burst in 2007. In the US, short-term interest rates will be above +2% in 2018 and could exceed +3% for 10-year terms.

Mortgage rates are already above 4% (10-year) and could also reach 4.5% by the end of the year. Overall, the increase in borrowing costs could have some constraining effects on demand and slow the rise in prices.

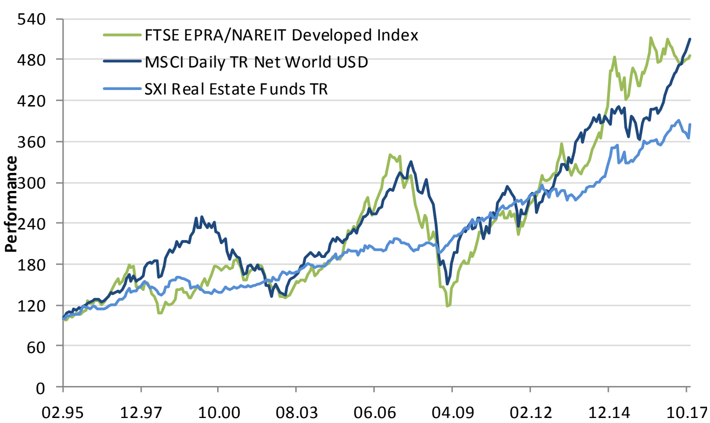
Performance (local currency)



Performance (local currency)



Long-term Performance (local currency)



INTERNATIONAL REAL ESTATE INDICES (local currency)

31.12.2017 — Total Return Performance

	Name	Last price	Curr.	7 d %	1 m %	3 m %	6 m %	YTD %
GLOBAL	FTSE EPRA/NAREIT Glb TR	2687.5	USD	1.9	1.9	4.0	6.7	15.0
DEVELOPED	EPRA/NAREIT Dev TR USD	4984.9	USD	1.6	1.5	4.1	5.2	11.4
DEVELOPED EUROPE	FTSE E/N Dev Europe	2244.3	EUR	1.4	4.7	6.1	7.8	13.3
EUROZONE	FTSE E/N Euro Zone	2676.0	EUR	0.8	3.3	6.7	9.2	17.8
USA	FTSE E/N United States	2929.4	USD	1.4	-0.2	1.8	0.8	3.9
DEVELOPED ASIA	FTSE E/N Dev Asia	1518.0	EUR	-0.3	0.6	3.3	2.6	2.0

Graph sources: Bloomberg/BBGI Group

In parallel, the effects of fiscal reform on the real estate sector will be rather negative, as mortgage loans are less likely to be tax-exempt. With regard to the commercial segment, the increase in rents will likely also slow down. The supply that should hit the market will probably prevent greater rent increases. The growth rate of rents and prices will thus continue to be significantly lower than that in other regions, the Eurozone in particular. The underperformance of listed US real estate shares reflects the real estate sector's loss of momentum. In spite of a positive economic outlook, US securitised real estate is doubtless ahead in the growth cycle.

Although it does have growth potential, the US market will likely under-perform other developed and emerging markets over the next few quarters. We recommend underexposure to the US market in the context of an internationally diversified investment strategy.

The Eurozone continues to benefit from a more positive outlook

In our previous outlook reviews, we forecast that economic growth in Europe would accelerate, and indeed it did; in fact it seems like it may well strengthen further in 2018 and 2019. Our positive outlook on European economic growth and in particular with regard to those drivers of growth such as Germany, Spain, and even France should have a positive impact on these countries' respective real estate markets. Political risks have diminished, even if several months after the German elections Chancellor Angela Merkel is still struggling to form a coalition government.

The resumption of talks between the European Union and the British government has also eased political tensions without entirely removing the uncertainty stemming from Brexit. It is important to note that for now the prospects of Brexit have no impact on the future improvement of economic conditions in the Eurozone.

Inflation in the Eurozone remains below the ECB's stated target, and even if the trend for 2018 continues as expected, the only change the ECB is initially likely to make to its monetary policy is to adjust its share repurchasing programme. With regard to interest rates, the probability that policy rates will increase, even modestly, in 2018 is thus low. With regard to long-term rates, we expect them to rise due to the correlation that should persist among developed countries' fixed income markets.

Thus, even if the Eurozone is very clearly not at the same exact point in its business cycle as the US, pressure on long-term rates in dollars will likely spread to long-term rates in euros. Moreover, the acceleration of European growth already warrants an adjustment of long-term rates, which will doubtless be more brutal than in the US.

For the European real estate market, the economic context in 2018 will likely boost demand for commercial real estate and gradually reduce excess supply in certain large cities. The uncertain context of previous years had somewhat hampered development projects especially given the environment already presented excess supply.

These developments will allow rents to continue rising in Europe.

The trend reversal with regard to interest rates will likely increase borrowing costs, but real costs (after inflation) and the lack of alternatives will enable the European real estate market to attract new investors. We do not believe that rising borrowing costs will be enough to impede real estate investment in 2018. The yield spread between real estate investments and government bonds in euros at the beginning of 2018 remains at 20-year highs. More particularly, the spread for investments in premium real estate is approximately 250 basis points, while for less central areas the yield spread is much higher and more attractive by historical comparison. We continue to maintain that European real estate investments thus provide a very attractive alternative to bonds.

With regard to securitised real estate, we believe that the increasing risk of capital losses on bonds will support a reallocation of assets to real estate in institutional portfolios more broadly in 2018.

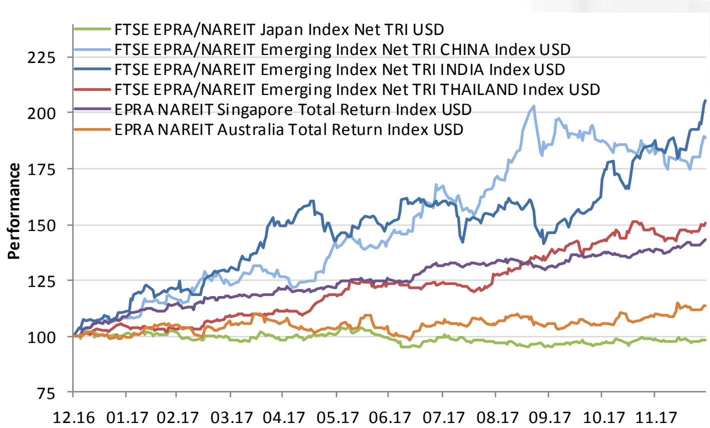
In terms of regional allocations, the Eurozone will continue to present a higher likelihood of rent growth and of more sustained price increases

Asian real estate is benefitting from more dynamic growth

In Asia, economic growth will be even more robust in 2018, thanks to positive regional momentum. It will continue to be much stronger than in Europe or the US; however, it is unlikely that interest rates will rise significantly. There is a real likelihood that rents will rise, although constrained in part by the increase in supply. The likelihood of price increases is certainly limited. The progression of rents for the office segment in Asia will benefit from positive developments in the Australian and Indian markets. In China, rents seem to have decreased somewhat due to the arrival on the market of new capacity. In Singapore, relocation demand has remained relatively strong, without significantly impacting rents.

In Hong Kong and Tokyo, however, demand has weakened somewhat. In India, demand for office and retail space will likely remain solid and will boost rent growth. Asia continues to benefit from better economic conditions and remains overweight in our regional allocation.

Real estate markets (USD)



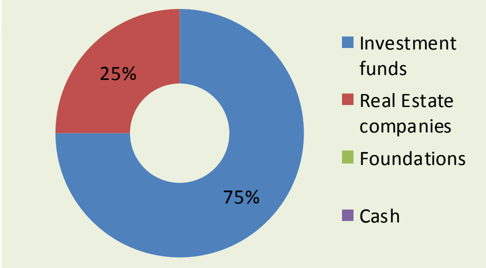
Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

Swiss Real Estate

- Real estate investments will remain attractive in 2018
- Securitised real estate yields slightly lower returns
- The rise in interest rates will be limited and will not impact real estate prices in 2018

Swiss Real Estate allocation



REAL ESTATE Switzerland	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Investment funds	↗	↗							
Real Estate companies	↗	↗↗							
Foundations	→	→							
Cash									

Tactical Allocation

- Favor Funds 75%
- Increase exposure to Real Estate Shares : 25%

Real estate investments will remain attractive in 2018

Swiss real estate investment funds ultimately progressed a further +6.6% in 2017, slightly below the performance of listed real estate companies (+9.86%), though significantly better than that of real estate foundations (approximately +4%). However, these particularly satisfactory results were not obtained without some volatility. Indeed, strong growth in the first six months was followed by a period of profit-taking during the summer, both for real estate investment funds and listed companies. After first suggesting a reduction of risk before this period of temporary decline over the summer, we then deemed it appropriate once again to selectively increase exposure to the Swiss real estate sector to take advantage of more attractive pricing as well as lower premiums. The consolidation of securitised real estate prices occurred in the context of a slight upturn in long-term interest rates in Switzerland. However, we believe that fundamentals were not really affected during this period by the very marginal increase in long-term rates of around 40 basis points in September. This increase temporarily triggered short-term profit-taking. Today, it seems that residential real estate market fundamentals in Switzerland will continue to sustain certain imbalances between supply and demand.

As 2018 kicks off, we maintain our positive outlook with regard to Swiss real estate as a diversification play and as the most appropriate alternative to yieldless bonds and recommend reinvesting in this asset.

Securitised real estate yields slightly lower returns

The yields of real estate funds are currently slight below 3%, while the net yields of residential real estate investments are slightly higher. The yield spread on long-term bonds remains significant and attractive. We are still not seeing any genuine signs of a speculative bubble with regard to Swiss real estate. Final demand will remain robust but rational over the next few quarters. Asset allocation transfers between bonds and real estate shares will likely continue, but not at any price.

The rise in interest rates will not impact real estate prices in 2018

The rise in rates in 2018 will not be sufficient to have a significant impact on real estate prices and capitalisation rates. The risk of price corrections for these assets in this case should thus not be overestimated.

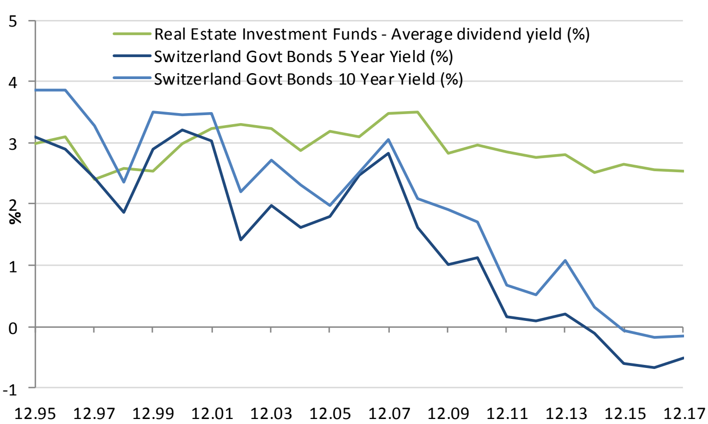
SWISS REAL ESTATE

31.12.2017 — Total Return Performance

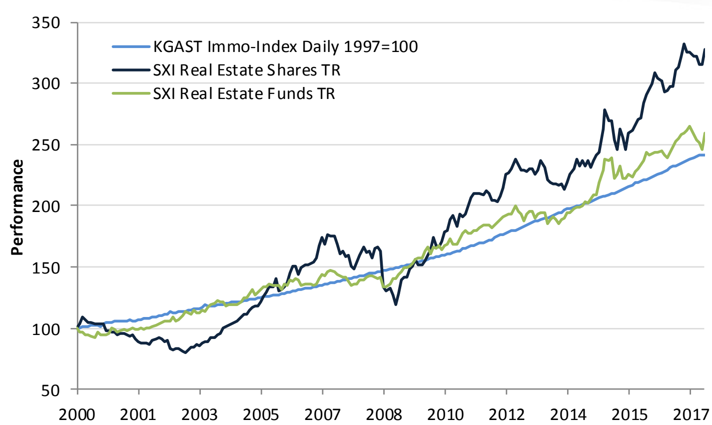
Name	Last price	7 d %	1 m %	3 m %	6 m %	YTD %
SXI Real Estate Funds TR	381.8	0.6	5.7	3.1	0.6	6.6
SXI Real Estate Idx TR	2440.6	1.3	4.5	2.0	1.3	10.1
KGAST Immo-Index*	272.5				3.0	5.4

* subject to one-month lag

Government and Real Estate Yield



Performance of Swiss Real Estate



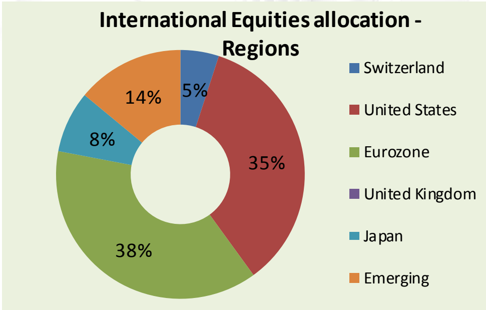
Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

International equities by region

- Likely pressure on the evolution of corporate profits in the US
- Inflection point for multiples and for the S&P 500
- Cheaper European equities have an advantage in valuation
- Time to take profits on the Nikkei

EQUITIES REGIONS	Expected Return		ALLOCATION (CHF Portfolio)						
			underweight			neutral	overweight		
	3months	1year	---	--	-	=	+	++	+++
Switzerland	↘	↗							
United States	↘	↗							
Eurozone	↘	↗							
United Kingdom	↘	↗							
Europe	↘	↗							
Japan	↘	↗							
Emergents	↘	↗							



Tactical Allocation

- Favor Eurozone and Emerging markets
- Avoid UK
- Keep Japan exposure hedged
- Reduce active deviations

Likely pressure on the evolution of US corporate profits

It seems that nothing will stop the rise of US stocks. It is true that corporate margins are excellent and close to historical highs at around 10%. Profit growth was also satisfactory in 2017, and analysts expect a +11% increase in 2018 and +10% in 2019. The overall value of US corporate earnings has reached almost 10% of GDP against a historical average of 6.5% over the last 70 years. The distribution of wealth creation as represented by GDP has actually been more favourable for companies in recent years. The overall wage bill in 2017 represented 43% of GDP, significantly lower than the historical average of 47%.

Recent developments in the job market point to likely future adjustments that will undoubtedly weigh on the level of corporate margins and profits. Labour costs represent between two thirds and three quarters of corporate expenditure; an increase in wages will thus have a significant impact on margins. Profit growth for multinationals may thus have peaked and ultimately be lower than expected in 2018, drawing closer to the economic growth rate. The tax reform, which is so positive for corporate profits, may well be less significant for S&P 500 multinationals than for more domestic and mid-sized companies.

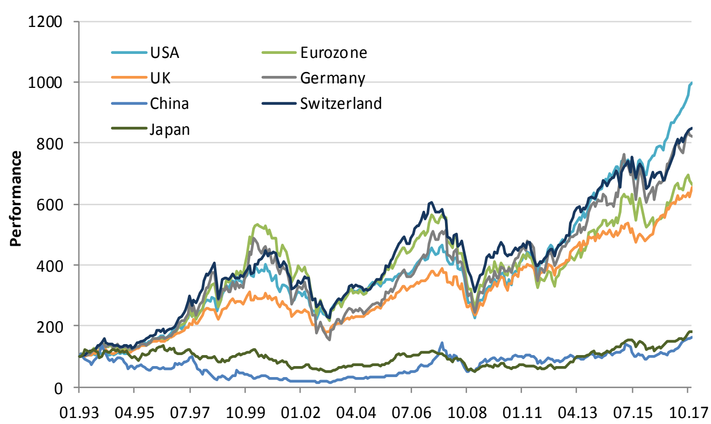
However, beyond the fundamental issue of profit growth, it should be noted that the rise in US equities was mainly triggered by a strong phase of multiples expansion. While US stocks traded at less than 10x earnings in 2009, they are now trading at close to 18x earnings. Price/earnings (P/E) expansion phases are generally linked to periods of declining interest rates; conversely, in periods of rising rates, we tend to see the P/E ratio contract.

Inflection point for multiples and for the S&P 500

In 2018, the normalisation of monetary policies and interest rates will likely mark a turning point in the growth of multiples. Indeed, it is probable that rising interest rates will put an end to the 10-year expansion phase, regardless of the evolution of corporate profits. This P/E expansion, especially in the technology and digital sectors, has reached extreme levels similar to those observed in 2000 before the burst of the TMT bubble and the -50% correction in the global market. The valuation levels of these stocks and of GAFA in particular should at least act as a brake on their future development. The banking/financial sector, another S&P 500 heavyweight, may also face new difficulties in meeting expected results.

Indeed, the current flattening of the yield curve is not a favourable factor for the evolution of their margins, which could lead to some disappointment. In 2018, energy will likely be one of the rare sectors that will truly be able to post exceptional profit growth rates. However, given the weight of the sector in the global index, this will not have the significant impact required to support global growth in market profits.

Long-term Performance (Normalized at 100)



Chinese Equities - A and B (Normalized at 100)

Graph sources: Bloomberg/BBGI Group

In conclusion, the rise of equity markets probably incorporates the favourable impact on profits that all have been expecting from the tax reform for over a year, although as we mentioned multinationals will undoubtedly feel the impact less than other companies. We believe that the two least expected effects at this time are those that may be triggered by the contraction of margins and of P/E ratios, which may well weigh on prices in 2018. Thus, we would advocate a more cautious approach as well as underexposure to US stocks in early 2018.

Cheaper European equities have an advantage in terms of valuation

The revaluation phase is not yet over for European equities. Abandoned due to political risks in 2016, European equities have enjoyed a period of revaluation, although this has not meant that they have outperformed US stocks in local currencies. The latter had been boosted by prospects of fiscal reform and by the trend on digital stocks, particularly in the 3rd quarter. However, the valuation of European equities is not particularly high when compared historically. Indeed, it is significantly lower than that of US equities. At 14x 2018 profits, the current valuation of European stocks offers a discount of 4 valuation points as compared to US equities (P/E 18x 2018). We do not believe the 30% higher valuation of US equities as compared to European equities to be justified given the macroeconomic context for 2018, which is also favourable for European equities.

In terms of dividend yield, European equities also seem much more attractive, offering 4.3% yield, which is twice the yield of US equities (2%). Profit growth consensus is now much more optimistic, and rightly so, we believe, as the improvement in the Eurozone's economic situation is increasingly tangible.

The recovery in growth and company profitability are key factors, which are then further helped by other favourable factors, such as a decline in major political and systemic uncertainty, and the improvement in banking sector conditions. These factors are making European equities more attractive; foreign investors should soon return, benefiting European equities. Profit growth per equity in the Eurozone is now increasingly close to that of US companies for 2018 (+10.5% versus +11.9%). We believe that the difference in valuation is far from justified. The current approximately 30% discount on European equities should at least have in 2018.

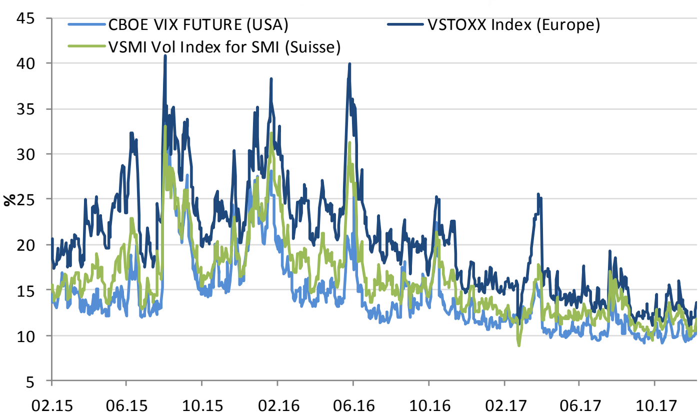
As such, European equities should considerably outperform US equities in 2018 in local currencies.

Further consolidation of the equity market in the UK

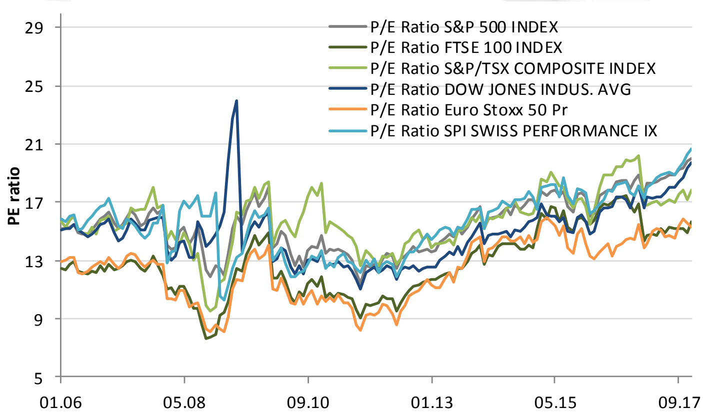
The UK equities market entered a long phase of horizontal consolidation in 2017, which could last another few months. Performance in local currency stands at a mere +2% YTD, which is well below the results of most EU markets. At approximately 14x 2018 earnings, the UK market is still somewhat expensive, and its yield is now similar (4.3%). The stabilisation of the pound stopped the progression of UK shares, as we had expected.

We continue to recommend caution with regard to this market, which could subsequently be penalised by the more tangible effects of Brexit negotiations on corporate earnings.

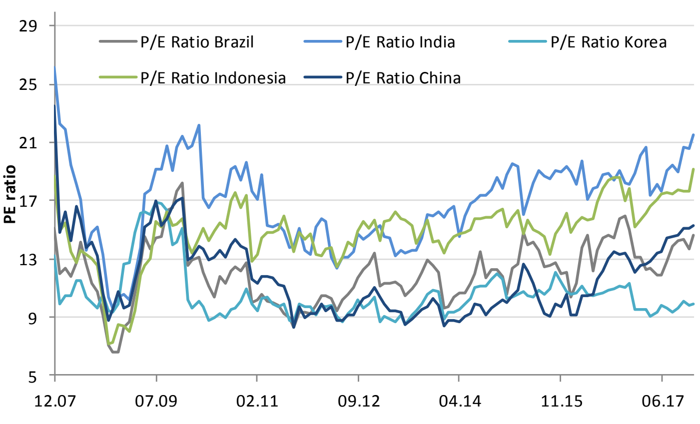
Volatility (USA, Europe, Switzerland)



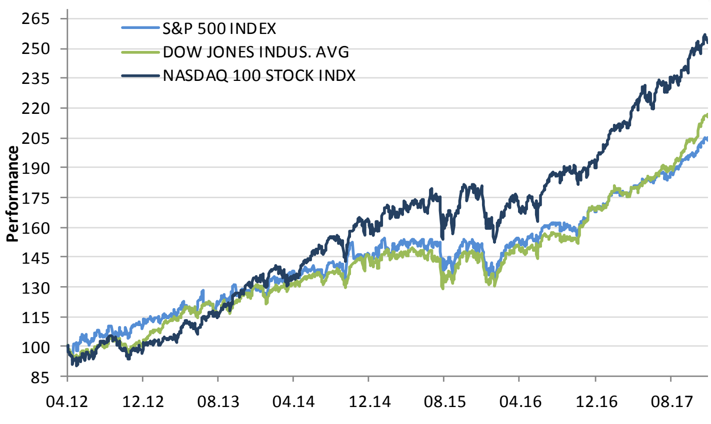
Price/Earnings



Price/Earnings Emerging markets



US Equities (Normalized at 100)



Graph sources: Bloomberg/BBGI Group

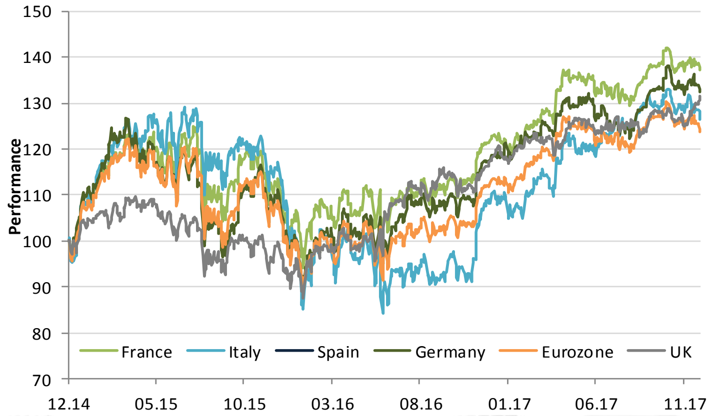
Time to take profits on the Nikkei

At the beginning of the year, we believed that an acceleration in the growth of corporate earnings in Japan was highly likely, due in particular to the upturn in the global economy and to a weaker yen. Results were indeed better than expected, and earnings forecasts for the next 12 months are consequently being revised upward. The latest earnings season thus leads us to anticipate that earnings will continue to grow in 1Q18 and will likely exceed the 13-15% consensus forecast stemming from a forward guidance context that is likely somewhat cautious. The distributed dividends of listed companies could increase for the fifth consecutive year. Several months ago, we mentioned that a decline in the yen would likely be the key factor in the Nikkei's next growth phase, potentially pushing Japanese share prices toward highs previously reached in 2015. This is now the case, as the Nikkei has exceeded its previous high of 21,000 by +8.5%. Following this extraordinary increase (+12%) since our last forecast in September, the Nikkei's YTD progression has reached +19.1% in local currency, namely, slightly lower than the results achieved by the S&P500 (+19.4%). By international comparison, Japanese equities are now trading at 19x expected 1Q18 earnings (17x 2019 earnings), which is not unreasonable given the likelihood of positive surprises over the FY. Their valuation is in fact similar to that of US shares. Overall, balance sheets are solid, and the changes resulting from better governance are significant. However, it should be noted that the future progress of the Nikkei remains at least partly dependent on maintaining a weak exchange rate against the dollar. Currency risk should thus be taken into account in any exposure to Japanese equities. The market still offers opportunities for positive surprises and for adjusting expectations over the next few quarters. However, given market valuations are rather high, we consider it an appropriate time to take profits pending more attractive opportunities.

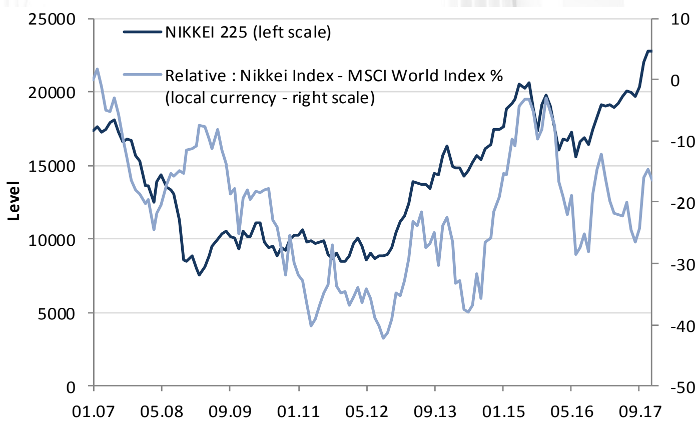
It's tempting to take profits in emerging markets

Emerging markets (+37.5%) have largely outperformed developed markets (+22.4%) since the beginning of the year on the basis of significantly improved fundamentals. Growth prospects are often much higher than in developed countries, and improved confidence benefits risk-taking and diversification outside developed markets. Above all, Asian emerging markets benefited the most from improved global growth prospects. China recorded an exceptional result of +51.2%, ahead of India up +37% in dollars. We believe that the outlook may still warrant exposure to emerging markets, but in the context of expected profit-taking in developed markets, we suggest reduced exposure.

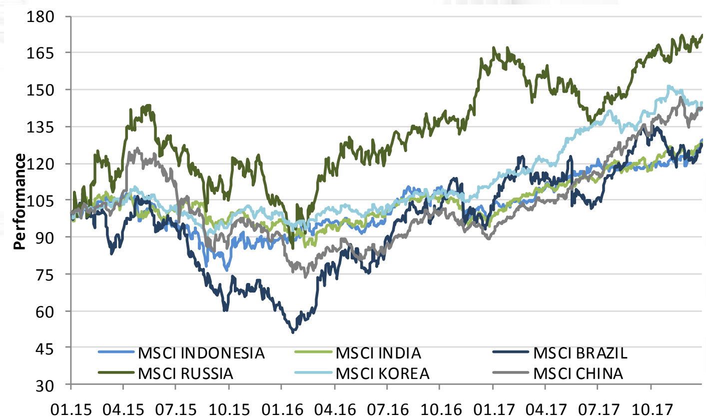
Performance of Stock markets (Normalized at 100)



Japanese Equities VS MSCI World



Emerging Markets (Normalized at 100)

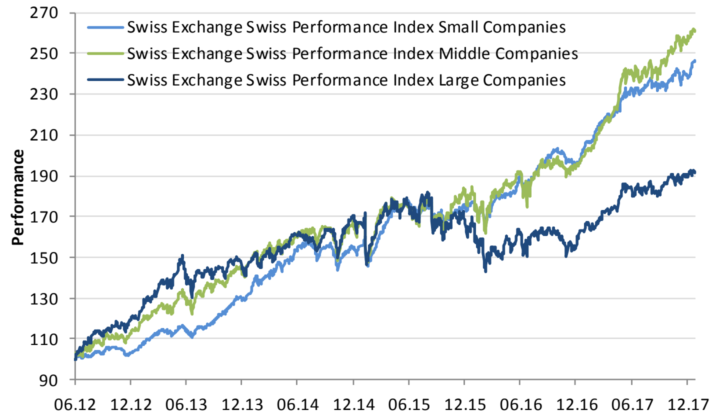


EQUITIES - BY REGION (local currency)

31.12.2017 — Total Return Performance

	Name	Last price	Curr.	7 d %	1 m %	3 m %	6 m %	YTD %
SWITZERLAND	SPI Swiss Performance Index	9443.1	CHF	0.0	1.3	2.0	5.5	19.9
SWITZERLAND SMALL-MID CAPS	SPI Extra Total Return	2903.8	CHF	0.2	2.3	4.5	9.8	29.7
EUROPE	STXE 600 € Pr	394.6	EUR	-0.3	1.5	0.1	2.6	11.2
EUROPE SMALL-MID CAPS	MSCI Europe Small Cap Net TR E	352.7	EUR	0.8	3.0	2.2	7.7	19.0
UK	FTSE All-Share Index	3595.9	GBP	1.3	5.2	4.1	6.7	13.1
USA	S&P 500 Index	2673.6	USD	-0.3	1.3	6.2	11.1	21.8
USA SMALL-MID CAPS	RUSSELL 2500	606.1	USD	-0.1	0.6	4.2	9.5	16.8
JAPAN	NIKKEI 225	22764.9	JPY	-0.5	-0.1	11.7	14.6	21.3
JAPAN SMALL-MID CAPS	Russell/Nomura Mid-Small Cap I	936.1	JPY	-0.1	2.0	9.5	15.3	25.4
ASIA EX-JAPAN	MSCI AC Asia Pac Ex Japan	569.6	USD	1.3	3.2	7.5	15.1	37.5
ASIA EX-JAPAN SMALL-MID CAPS	MSCI AC Asia Pacific Ex Japan Small Cap	1088.9	USD	1.8	3.2	9.4	14.3	29.5
EMERGING	MSCI EM	910.4	USD	1.6	3.9	7.2	16.3	37.5
INTERNATIONAL EQUITIES -DIVERSIFIED USD	MSCI Daily TR Net World	4693.2	USD	0.2	1.7	5.3	10.5	22.4

Swiss Equities (large - middle - small caps/Normalized at 100)



Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

International equities by sector

- Overweight cyclical, industrial and materials stocks
- Excessive valuations for technology and GAFA stocks
- Value stocks back in favour
- Positive surprises and higher EPS growth for energy stocks

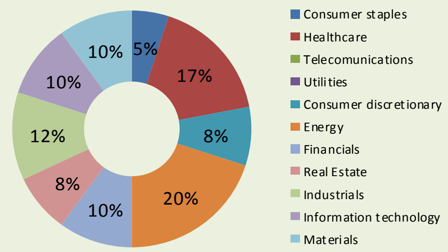
EQUITIES Sectors	Expected Return 3months	Expected Return 1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Consumer staples	↘	↗							
Healthcare	→	↗							
Telecommunications	↘	→							
Utilities	↘	→							
Consumer discretionary	→	↗							
Energy	↗	↗↗							
Financials	→	↗							
Real Estate	↗	↗							
Industrials	→	↗							
Information technology	↘	↗							
Materials	↗	↗↗							

EQUITIES - BY SECTOR

31.12.2017 — Total Return Performance

	Name	Last price	Curr.	7 d %	1 m %	3 m %	6 m %	YTD %
CONSUMER DISCRETIONARY	MSCI WORLD/CONS DIS	200.9	USD	-0.1	2.6	7.6	11.6	24.2
CONSUMER STAPLES	MSCI WORLD/CON STPL	208.3	USD	0.7	2.2	5.9	5.9	17.8
ENERGY	MSCI WORLD/ENERGY	206.3	USD	1.1	4.0	7.1	15.0	5.9
FINANCIALS	MSCI WORLD/FINANCE	105.4	USD	0.2	2.3	5.5	10.4	23.5
HEALTHCARE	MSCI WORLD/HLTH CARE	222.5	USD	0.2	0.3	0.1	3.6	20.4
INDUSTRIALS	MSCI WORLD/INDUSTRL	196.5	USD	0.5	2.6	5.0	11.0	25.9
MATERIALS	MSCI WORLD/MATERIAL	208.5	USD	1.4	4.5	7.4	16.6	29.5
REAL ESTATE	MSCI WORLD/REAL ESTATE	192.1	USD	1.5	0.9	4.9	6.5	15.6
TECHNOLOGY	MSCI WORLD/INF TECH	145.5	USD	-0.9	0.6	8.3	18.7	38.7
TELECOMMUNICATION	MSCI WORLD/TEL SVC	71.1	USD	0.1	1.5	2.4	6.0	6.8
UTILITIES	MSCI WORLD/UTILITY	113.8	USD	0.6	-4.2	-0.3	3.6	14.8

International Equities allocation - sectors



Tactical Allocation

- Underweight digital stocks
- Overweight Value stocks
- Overweight Energy, Materials and Real Estate

Stronger global growth in 2018 will likely continue to boost corporate earnings overall. More **cyclical sectors** will benefit more than others from this situation. The global paradigm shift with regard to monetary policy and a more negative interest rate environment will likely weigh on **banks**' results due in particular to flattening yield curves.

Growth stocks will likely lose momentum to the benefit of **value stocks** and **cyclical sectors** given the current stage in the global business cycle.

The **finance and insurance sector** will likely see some downward revisions of earnings expectations. We thus stay underweight in this sector to the benefit of the **real estate** sector, which offers better visibility.

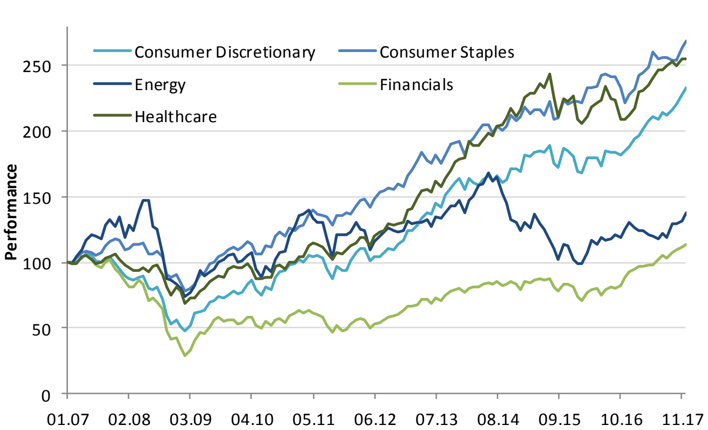
Valuation levels of key **technology stocks** remain high and continue to warrant an underweight position. We thus maintain reduced exposure to stocks in the tech sector.

The **industrial, energy, and materials sectors** offer the strongest opportunities for earnings growth in 2018. These sectors are thus overweight within our sector diversification strategy.

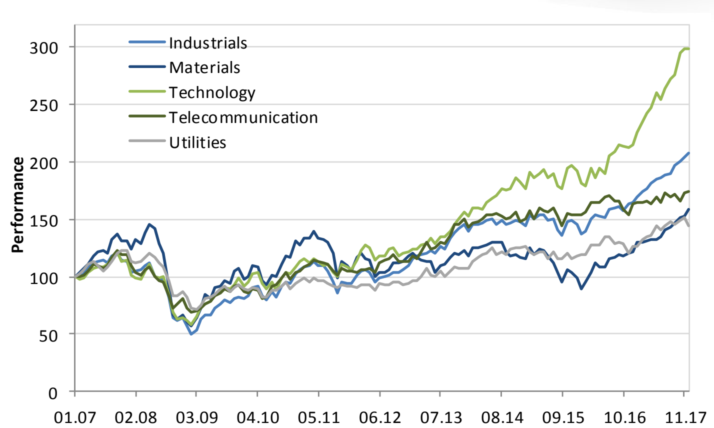
Among cyclical sectors, the energy sector remains the most undervalued given the positive surprises and positive outlook with regard to energy prices and thus warrants more significant exposure.

With regard to **defensive stocks**, we favour the **healthcare sector**.

Sectors - MSCI World (Normalized at 100)



Sectors - MSCI World (Normalized at 100)

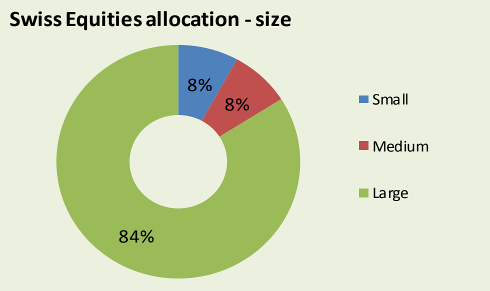


Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

Swiss Equities

- Positive outlook constrained by valuation levels
- Bottom-up consensus forecast overly cautious?
- The risk of correction depends on external factors



Tactical Allocation

- Favor stocks sensitive to exchange rates and to European economic dynamics

EQUITIES capitalization	Expected Return 3months	1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Small	↗	↗							
Medium	↗	↗							
Large	↗	↗							

Positive outlook, but constrained by valuation levels

Swiss equities closed the year up +19.9% overall. This expansion essentially occurred during the first five months of the year (+14.5%), before a long stabilisation period, as well as during the last six weeks of the year (+3.5%). The progression of Swiss shares in 2017 was bolstered by an upswing in the organic growth of sales and profits, by the improvement in global economic conditions, and finally by the weakening of the Swiss franc against the euro.

These macroeconomic factors will likely persist and have a positive impact on Swiss companies in 2018. Positive trends in the global economy and in exchange rates against the Swiss franc will remain significant factors affecting earnings in 2018. However, the current valuation level of 16.7x 2018 earnings is already somewhat high by historical comparison (the average over the past 10 years is 15x).

While it is still somewhat early to bring up the risk of a reversal in the multiples expansion cycle in Switzerland toward a contraction phase, the trend reversal in global monetary policies and in interest rates will also affect Switzerland, with the same effects on valuation ratios. We do not expect the SPI's PE ratio to continue to increase in 2018 and prefer to consider earnings growth as essentially the main factor determining price movements.

Bottom-up consensus forecast overly cautious?

The bottom-up consensus forecast currently leaves little room for any growth in the earnings, dividends and especially the prices of Swiss shares. Indeed, SMI stocks have in most cases reached the average price targets of Swiss analysts. Swiss indices would thus seem unlikely to continue advancing; however, the consensus may not fully have taken into account the monetary factor. Indeed, the appreciation of the euro is certainly not sufficiently incorporated into the growth outlook.

Our exchange rate forecasts published just after 15 January 2015 already suggested that the euro would bounce back toward 1.20, but we note that the anticipated appreciation occurred in 2017 to the surprise of most forecasters and analysts. Accelerating growth in the Eurozone will likely also have a significant impact on the results of Swiss shares in 2018, which could thus be subject to adjustments in growth expectations for 2018 in the future.

Don't disregard a 3% yield

The dividend yield of Swiss shares is still 3% on average. This yield is attractive by historical comparison but also compared with yields on Swiss bonds, which remain close to zero. A number of major Swiss firms show higher yield levels and are thus relatively attractive.

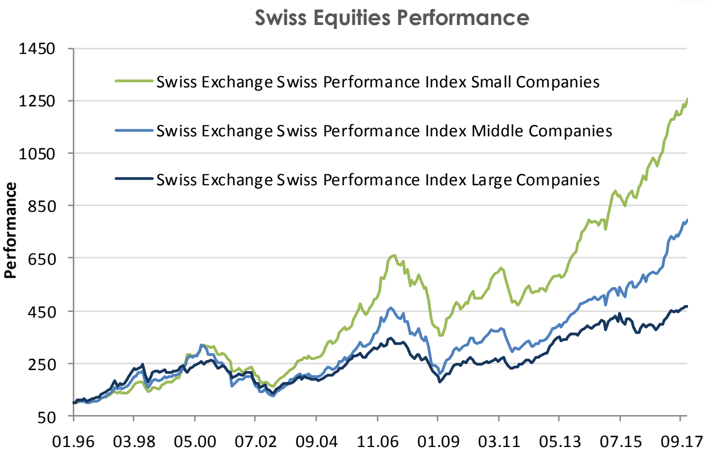
The risk of correction depends on external factors

We maintain our positive outlook on Swiss equities for 2018. However, it now seems increasingly probable that share prices will consolidate significantly though temporarily. The element that will trigger profit-taking in the Swiss market is more likely to be an external than a domestic factor.

SWISS EQUITIES - Capitalization

31.12.2017 — Total Return Performance

Name	Last price	7 d %	1 m %	3 m %	6 m %	YTD %
SPI SWISS PERFORMANCE IX	10751.5	0.0	1.3	2.0	5.5	19.9
SPI SMALL COMPANIES INDX	27688.0	0.6	3.0	4.4	6.4	21.1
SPI MIDDLE COMPANIES IDX	16559.3	0.1	2.5	4.5	9.7	30.7
SPI LARGE COMPANIES INDX	9990.8	-0.1	1.0	1.4	4.7	17.8

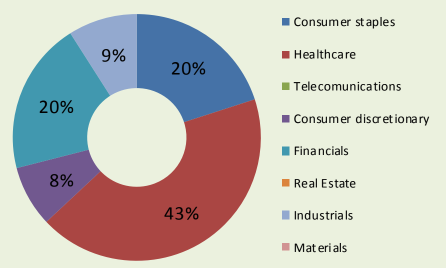


Graph sources: Bloomberg/BBGI Group

Swiss Equities - Sectors

SWISS EQUITIES Sectors	Expected Return 3months	1year	ALLOCATION (CHF Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Consumer staples	→	↗							
Healthcare	→	↗							
Telecommunications	→	↗							
Consumer discretionary	→	↗							
Financials	→	↗							
Real Estate	→	↗							
Industrials	→	↗							
Materials	→	↗							

Swiss Equities allocation - sectors



Tactical Allocation

- Favor sectors and stocks sensitive to exchange rates
- Favor high-yield stocks
- Positive situation for exporters

Stocks sensitive to improvements in European economic momentum

In 2017, it is above all the strengthening of the US business cycle that had a positive effect on the revenues of Swiss companies. In 2018, we expect that acceleration of growth in Europe will likely have a further impact on the sales and earnings growth of Swiss firms. European economic momentum should strengthen further and have a favourable effect on trade and growth in Switzerland. The Swiss economy will thus be boosted by European momentum as well as by positive currency effects in 2018. These developments will mostly benefit exporters overall, and in particular exporters of capital goods. Major listed companies will also benefit from the overall impact of the improvement in economic conditions globally. Domestic shares will benefit from more robust growth and from a more optimistic sentiment, which will bolster investment and consumption.

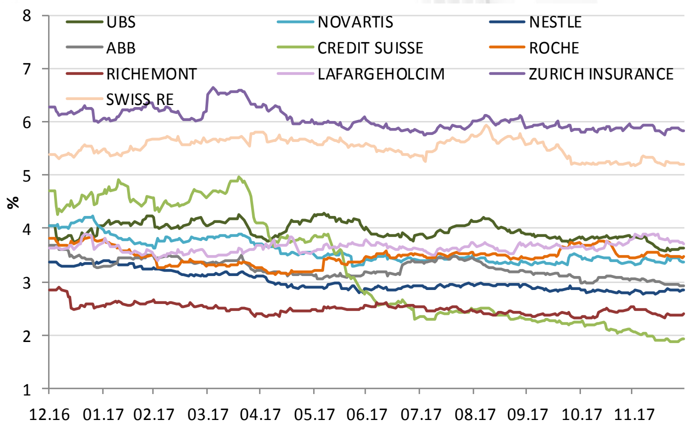
Stocks sensitive to exchange rates

In 2018, shares with exposure to the Eurozone will likely benefit more from the euro's appreciation that was the case in 2017, even though momentum will slow and the exchange rate should stabilise around 1.20. Shares with more exposure to the dollar will also likely benefit from a stronger US currency. The general weakness of the franc in 2018 will have stronger positive effects for most companies listed on the Swiss stock exchange.

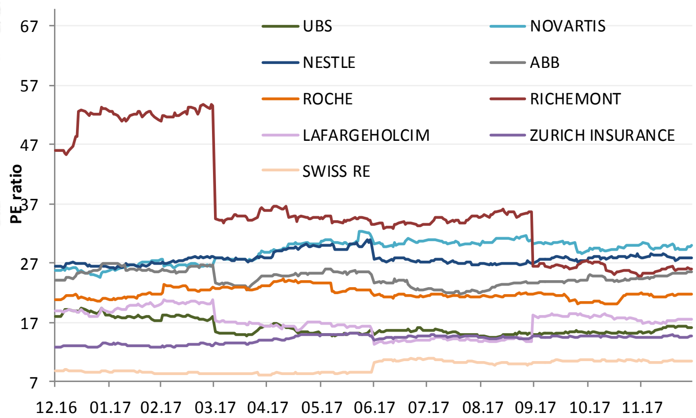
High-yield stocks

Swiss stocks characterised by high yields and growth rates will likely also benefit from their relative attractiveness given low bond yields, which will persist in 2018.

Dividend Yield



PE ratio

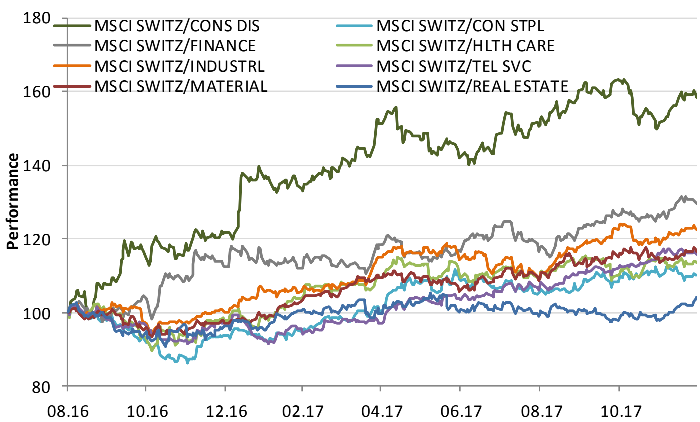


SWISS EQUITIES - BY SECTOR

31.12.2017 — Total Return Performance

Name	Last price	7 d %	1 m %	3 m %	6 m %	YTD %
MSCI SWITZ/CONS DIS	349.2	-0.4	4.5	-1.2	11.2	30.3
MSCI SWITZ/CON STPL	276.8	0.3	0.4	2.4	1.7	17.8
MSCI SWITZ/FINANCE	61.6	-0.8	3.2	5.5	8.5	15.3
MSCI SWITZ/HLTH CARE	145.2	0.2	-1.0	-1.5	2.9	15.8
MSCI SWITZ/INDUSTRL	200.0	-0.2	3.5	3.5	6.9	22.4
MSCI SWITZ/MATERIAL	294.1	0.1	2.7	3.1	9.1	20.2
MSCI SWITZ/REAL ESTATE	1040.5	2.1	6.5	3.6	4.0	8.0
MSCI SWITZ/TEL SVC	98.0	-0.2	0.0	4.5	10.7	19.4

Performance

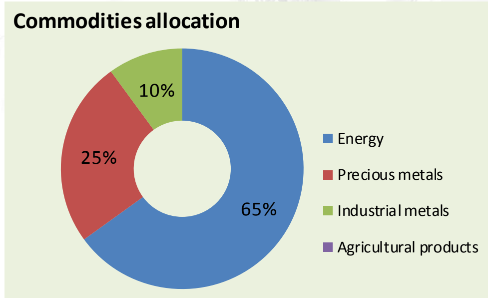


Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

Commodities

- Outperformance in the context of accelerating economic growth
- Reduction in positive momentum for industrial metals
- Oil sees sharp improvement in fundamentals
- Precious metals will benefit from investment inflows into ETFs



COMMODITIES	Expected Return		ALLOCATION (CHF Portfolio)						
			underweight			neutral	overweight		
	3months	1year	---	--	-	=	+	++	+++
Energy	↗	↗↗							
Precious metals	↗	↗↗							
Industrial metals	↗	↗↗							
Agricultural products	→	↗							

Tactical Allocation

- Large Energy exposure
- Overweight Precious Metals

Commodities to outperform given the current economic context

After six years of negative performances and the longest bear market since the 70's, commodities have since 2016 finally been posting positive results. While these remain modest by historical comparison, intensifying economic activity globally in 2018 will likely create particularly positive conditions for the evolution of commodities prices. Generally considered a financial asset that outperforms later in the business cycle, commodities are effectively outperforming bond and equities markets in a phase of economic acceleration. In the current business cycle, the convergence of regional cycles has finally occurred, driven by the US recovery.

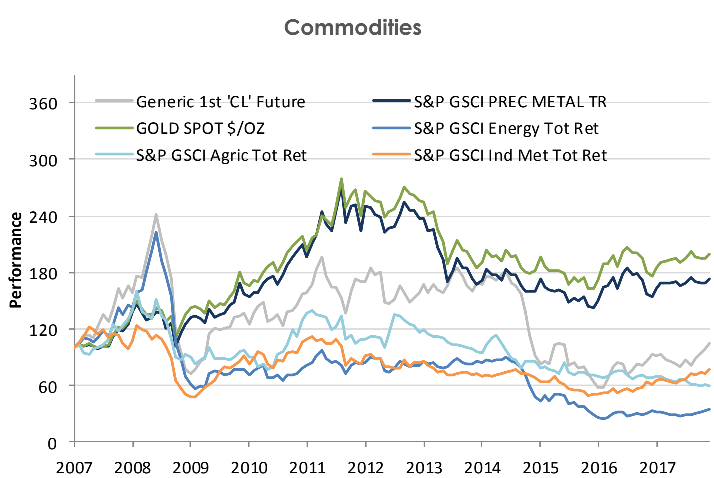
The demand for commodities will thus likely grow in this context, given that for several years investments were strongly reduced. The drop in capex affected not only the energy sector, but it also greatly affected the materials and precious metals sectors, thus leading to a stabilisation and even a decrease in production capacity and supply. The acceleration of growth expected in 2018 will greatly benefit various commodities, materials, and energy products. As an asset class, it is important to underscore the historical merits of diversifying into commodities given its rather negative correlation with equities and bonds. Over the long term, commodities' annualised performance has been approximately +7%, but these results were significantly negatively impacted but underperformance in 2008 (-49.65%) and in 2014-2015 (-58%).

For rolling 10-year periods since 1970, commodities have posted average annualised growth of +7%, with no negative results except for the last four periods, which were affected by the 2014-2015 drop.

The current business cycle is thus favourable in terms of commodities outperforming other asset classes and its own average historical performance.

Reduction in positive momentum for industrial metals

Industrial metals made out well once again in 2017, outperforming the global index with growth of +26% (Bloomberg Base Metals SPCI). Most base metals posted increases of over +10%, thereby reflecting a very robust global environment notwithstanding the particular conditions of specific markets. The weakness of the dollar was also likely a supporting factor, even though the increase in metals occurred in the second half of the year. Industrial metals are often considered an indicator of the health of the global economy, so it is not surprising to note that in 2017 they benefitted from the alignment of regional business cycles as we had predicted. In 2018, economic growth in China and India will be significant factors boosting global demand for commodities. The issue of securing supply with regard to commodities is crucial for China, which will continue its efforts to control its sources while reinforcing its influence. We expect industrial metals prices to move in a positive direction in 2018, although this trend will likely lose some momentum.



Graph sources: Bloomberg/BBGI Group

COMMODITIES (USD)

31.12.2017 — Total Return Performance

Nº ISIN	Name	Last price	Curr.	7 d %	1 m %	3 m %	6 m %	YTD %
	MSCI Daily TR Net World USD	5928.59	USD	0.22	1.74	5.29	10.46	22.40
GLOBAL	S&P GSCI Tot Return Indx	2556.7	USD	3.1	3.1	11.4	16.2	5.8
WTI CRUDE	Generic 1st 'CL' Future	60.4	USD	3.3	3.5	19.5	28.4	12.5
BRENT OIL	Generic 1st 'CO' Future	66.9	USD	2.5	4.9	19.2	34.8	17.7
NATURAL GAS	Generic 1st 'NG' Future	3.0	USD	10.7	-3.5	1.3	0.1	-20.7
OR	GOLD SPOT $/OZ	1303.1	USD	2.2	1.8	2.5	6.5	13.1
ARGENT	Silver Spot $/Oz	16.9	USD	3.7	3.0	2.1	5.3	6.3
AGRICULTURE	S&P GSCI Agric Indx Spot	282.1	USD	1.0	-1.4	1.0	-7.6	-3.0
INDUSTRIAL METALS	S&P GSCI Ind Metal Spot	394.0	USD	2.4	6.5	9.1	19.9	31.0

Oil sees sharp improvement in fundamentals

In the energy segment, the supply of crude finally stabilised in 2017 due to the decisive action of the OPEC countries and Russia, which have vowed to maintain their policy of limiting supply in 2018. In the US, production also stabilised at around 9.5 million barrels per day, in spite of an upswing in non-conventional oil production. The consolidation of crude prices around $50 per barrel certainly benefited shale oil producers, which increased overall production in the US by 1.6 million barrels in 2017. Nevertheless, global supply is stabilising overall, while global demand grew by 1.3 million barrels per day in 2017.

In 2018 we expect that demand could already come to exceed supply and drive prices up further as well as progressively reduce stocks. The increase in demand will likely be greater than the ability of the US to expand its production of shale oil in particular. The production of shale oil could potentially increase by 500 million barrels in 2018 without changing the likelihood of a supply deficit.

Global demand in 2018 will still be heavily influenced by the growth in China's demand for crude. Overall, we believe that the increase in global demand in likely underestimated due to various factors, in particular those directly affecting the level of supply and demand in China. Chinese demand has no reason to dampen given GDP growth of +6.5% in 2018. Moreover, Chinese oil imports increased further in 2017 and will likely increase at a sustained pace in 2018. Chinese crude production is struggling, and it appears likely that China is rapidly nearing peak crude extraction. China will inevitably make up for its production deficit by increasing crude imports, which will also be boosted by an increase in substitution demand due to China's policy of decreasing coal extraction for energy production. Note that energy derived from coal currently represents two thirds of China's energy production. In the medium-term the conclusion of these forecasts is that China will make up for its production deficit by continuing to import oil, thus bolstering global demand for crude.

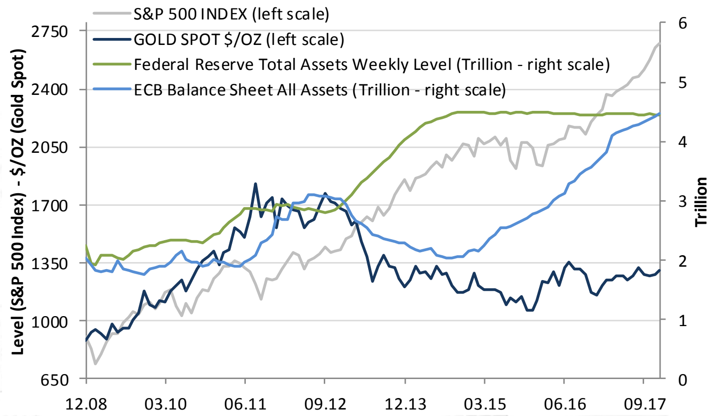
Unless OPEC drastically changes its policy, crude prices could thus continue to rise in 2018 and reach $80 in 2019.

Precious metals will benefit from investment inflows into ETFs

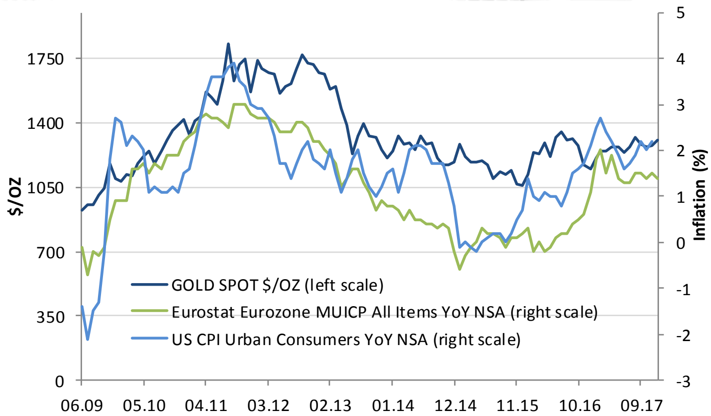
With regard to precious metals, the increase in the price of gold in 2016 and 2017 is only partially reflecting positive fundamentals, which are likely to drive further increases in 2018. In spite of all the attention paid by investors to cryptocurrencies, tech stocks and equities in general in 2017, gold prices posted rather attractive growth (+13%) despite rising interest rates. A return of volatility in financial markets would be temporarily favourable to gold and silver prices, but it is the fundamentals of the physical market that will most likely drive prices higher in 2018, along with an increase in investment demand. The global supply of physical gold remains constrained by limited production capacity and by declining supply from recycling. With regard to demand, central banks will remain net buyers in 2018, while the demand for jewellery is also likely to increase significantly in China and India as well as the US. Investment demand will likely strengthen given the financial, economic and geopolitical context of 2018. Investment flows into physical gold ETFs will likely increase and perhaps return in 2018-2019 to the highs reached in 2013.

The prices of gold and silver will likely benefit from this favourable environment and progress from $1,300 to $1,500 and from $17 to $22, respectively, in 2018.

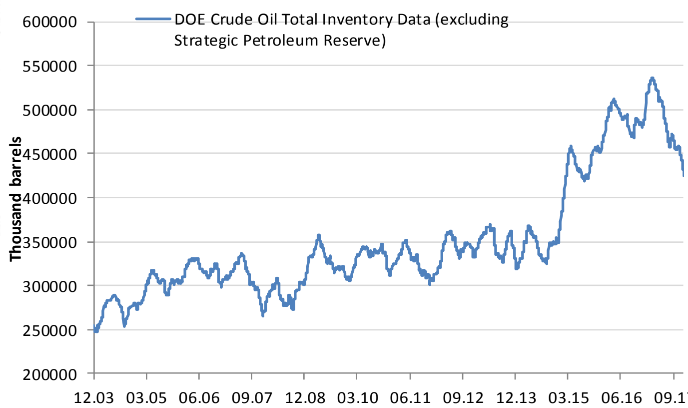
Gold and Global liquidity



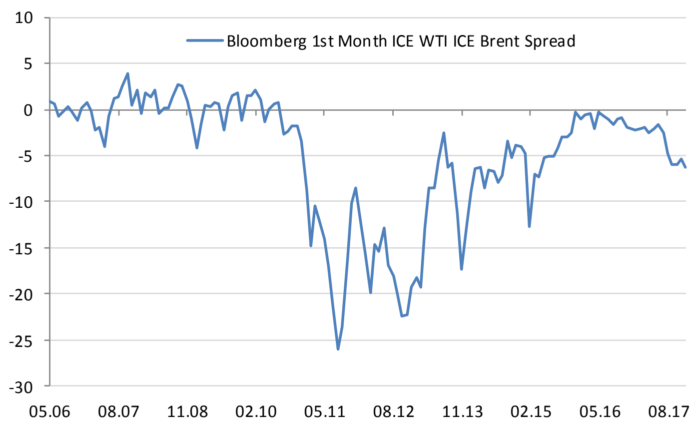
Gold and Inflation



Crude Oil Inventory (USA)



WTI - Brent Price Spread



Graph sources: Bloomberg/BBGI Group

PROSPECTS AND STRATEGIES

Hedge Funds

- Alternative Hedge Funds do not stand out against the rally in stock markets in 2017

Private Equity

- The Private Equity Composite index rose by +10.2% in 2017

Hedge Funds do not stand out against the rally in stock markets in 2017

2017 ends on a positive note for all Hedge Funds strategies. However, the results of the best strategies remain well below the impressive growth of equity markets in 2017 (+22.40% for Global Equities).

Regarding different management styles, the "equity hedge" style naturally shows the strongest growth in 2017 (+10.0%), against +6.5% for "event driven" strategies or +2.5% for "macro/CTA" strategies. The HFRX Global index, a composite, rose by +6.0%.

Geographically, the "Asia ex-Japan" region recorded the best performance (+19.1%), against +12.6% for the "Asia" region and +12.2% for the "Latin America" region.

The Private Equity Composite index rose by +10.2% in 2017

Private equity performed well in 2017, but results are quite disparate depending on geographical areas.

In Europe, improved fundamentals and growth recovery fueled investor interest in the private market. European private equity thus shows +18.9% in 2017.

Globally, the "Composite" index shows +10.2%, against +10.1% for the index including only the main companies.

It is in the United States that the results disappoint the most (+0.4%), impacted by the exchange rate effect since the index is calculated in EUR.

In the United Kingdom, the index gains +4.5%.

HEDGE FUND INDICES (USD)

31.12.2017

	Name	Last price	Curr.	Total Return Performance 7 d %	1 m %	3 m %	6 m %	YTD %
GLOBAL	HFRX Global Hedge Fund Index	1275.6	USD	0.0	0.8	1.4	3.3	6.0
EQUITY HEDGE	HFRX Equity Hedge Index	1270.8	USD	0.1	1.2	2.5	5.8	10.0
EVENT DRIVEN	HFRX Event Driven Index	1665.8	USD	-0.2	0.4	-0.2	1.8	6.5
MACRO/CTA	HFRX Macro/CTA Index	1163.9	USD	0.2	1.1	2.8	3.5	2.5
RELATIVE VALUE ARBITRAGE	HFRX Relative Value Arbitrage	1184.8	USD	0.0	0.6	0.7	2.0	3.8
LATIN AMERICA*	HFRX Latin America Index	2184.7	USD	-	0.0	-0.9	5.8	12.2
ASIA COMPOSITE*	HFRX Asia Composite Hedge Fund Index	2466.7	USD	-	0.0	2.4	5.9	12.6
NORTHERN EUROPE*	HFRX Northern Europe Index	1992.9	USD	-	0.0	0.2	1.8	5.8
ASIA EX-JAPAN*	HFRX Asia ex-Japan Index	2756.1	USD	-	0.0	3.8	8.8	19.1
MULTI-REGION	HFRX Multi-Region Index	1365.3	USD	0.2	0.9	2.0	3.3	5.3

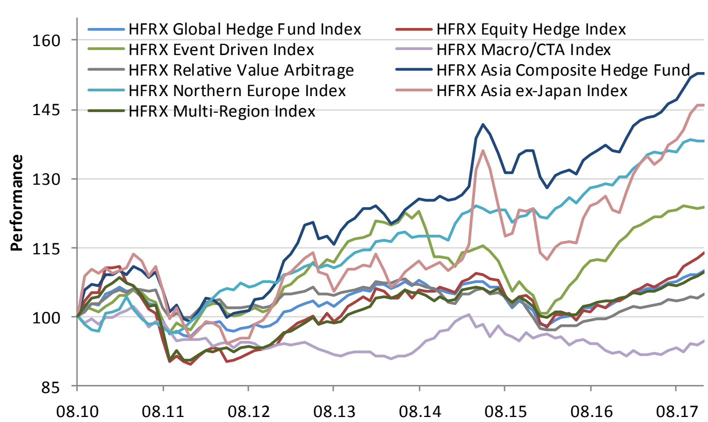
* Subject to one-month lag

PRIVATE EQUITY INDICES (EUR)

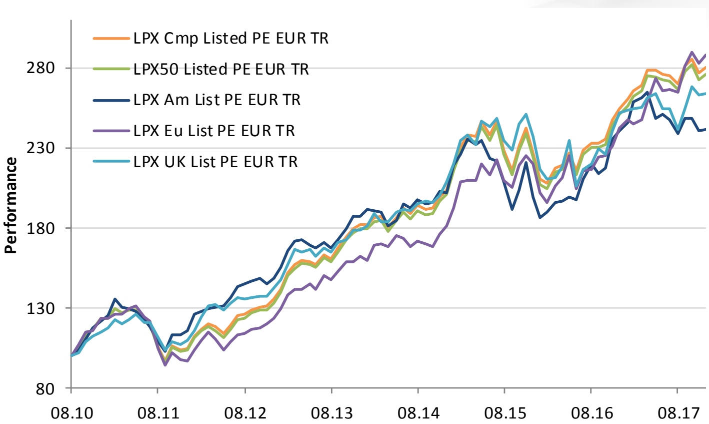
31.12.2017

	Name	Last price	Curr.	Total Return Performance 7 d %	1 m %	3 m %	6 m %	YTD %
COMPOSITE	LPX Cmp Listed PE EUR TR	233.0	EUR	-1.0	1.3	-0.7	1.7	10.2
MAJOR COMPANIES	LPX50 Listed PE EUR TR	2187.4	EUR	-1.0	1.4	-0.9	1.5	10.1
USA	LPX Am List PE EUR TR	321.2	EUR	-2.5	0.1	-3.6	-4.4	0.4
EUROPE	LPX Eu List PE EUR TR	919.5	EUR	0.3	2.4	2.2	9.1	18.9
UK	LPX UK List PE EUR TR	294.6	EUR	0.1	0.5	3.1	4.2	4.5

Hedge funds



Private Equity



Graph sources: Bloomberg/BBGI Group

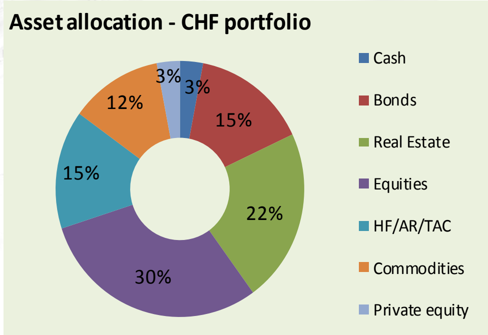
GLOBAL STRATEGY & ASSET ALLOCATION

Graph sources: Bloomberg/BBGI Group

GLOBAL STRATEGY I ASSET ALLOCATION

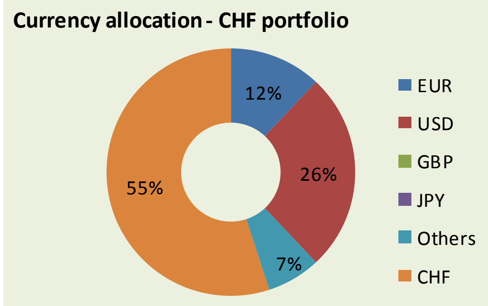
Diversified portfolio: medium risk - CHF

- The rise in long-term rates should be widespread in 2018
- Real estate remains the preferred alternative to bonds
- More neutral strategy for equity markets
- Positive outlook for commodities and currencies



Tactical Allocation

- More cautious stance on equities
- Overweight real estate, commo, currencies
- Underweight bonds



ASSETS	Expected Return		ALLOCATION (CHF Portfolio)						
			underweight			neutral	overweight		
	3months	1year	---	--	-	=	+	++	+++
Cash	↘	↘							
Bonds	↘↘	↘↘							
Real Estate	↗	↗							
Equities	↘	→							
Hedge funds	→	→							
Commodities	↗↗	↗↗							
Private equity	↗	↗							

Asset allocation

The core of our investment strategy is made up of traditional liquid assets (liquidities, bonds, equities and real estate), which is then complemented by other diversified, tradable assets (commodities, hedge funds, private equity).

Bonds

Global growth will be strong in 2018, and the risks of rising inflation, beyond central bank objectives, are not negligible. These prospects suggest a resumption of long-term rate adjustment dynamics in the United States, but also in the euro zone in particular. The normalization of key interest rates will continue in the United States and the asset buyback program in Europe should be discontinued in 2018. In Switzerland, the weakness of the euro/chf exchange rate offers new prospects that could also provoke tensions on the interest rate markets. Emerging markets and high yield are less attractive. Bond risks are more present; we recommend reducing maturities and overall exposure.

Real Estate

Real estate benefits from improved global business cycle and still low interest rates. In most countries, real estate yields remain attractive and still represent an alternative to fixed income investments. After recommending some profit taking in the course of 2017, we remain overweight and focus on the European and Asian markets.

Equities

Economic fundamentals are positive, but financial markets are increasingly showing high valuation levels. The risk assessment measures suggest a confidence that is no doubt excessive with regard to the evolution of corporate profits. There are, however, not yet any obvious signs of nervousness, but the extremely low levels of volatility point to an excess of optimism. Despite a lack of alternatives in this low interest rate environment, we recommend a reduced equity exposure.

Commodities

Continued strengthening of the global economy will fuel adjustments to long-term expectations of inflation and long-term interest rates. The rise in commodities' prices is expected to continue as demand grows and supply stabilizes.

We announced a likely increase in crude prices to $60, which has materialized, but the geopolitical context could still help to support a continuation of the trend. Rising volatility in the financial markets would be a temporarily favorable factor for gold and silver prices, but what will really drive prices higher in 2018 is the physical market fundamentals, together with a rise in investment demand.

Currencies

The fresh rise of the euro should lose some momentum in early 2018, with the exchange rate now approaching the 1.20 level. We recommend a decrease in the exposure to the euro, in favor of the US dollar, Canadian dollar and Australian dollar. The franc should remain generally weak, due to the continuation of the SNB's monetary policy. We recommend significant exposure to currencies.

Market performances - Q4 2017

		Q4 2017 local	Q4 2017 CHF	YTD local	YTD CHF
Exchange rates					
USD/CHF		0.6%		-4.4%	
EUR/CHF		2.3%		9.2%	
GBP/CHF		1.5%		4.7%	
JPY/CHF		0.5%		-0.7%	
Equity markets					
World	MSCI World USD	5.5%	6.2%	22.4%	17.0%
Europe	DJ Stoxx 600	0.6%	2.9%	10.6%	20.7%
Eurozone	DJ Eurostoxx 50	-2.5%	-0.3%	6.5%	16.2%
	MSCI Europe S.C.	2.4%	4.7%	16.6%	27.3%
Germany	Dax 30	0.7%	3.0%	12.5%	22.8%
France	Cac 40	-0.3%	2.0%	9.3%	19.3%
United Kingdom	FTSE 100	4.3%	5.8%	7.6%	12.6%
Switzerland	SPI	2.9%	2.9%	19.9%	19.9%
	SMI	2.5%	2.5%	14.1%	14.1%
	MSCI Swiss S.C.	7.2%	7.2%	39.2%	39.2%
North America	SP500	6.1%	6.8%	19.4%	14.2%
	Nasdaq	6.3%	6.9%	28.2%	22.6%
	Tse 300	3.7%	3.6%	6.0%	8.6%
	SP600 Small C.	3.6%	4.2%	11.7%	6.8%
Japan	Nikkei 225	11.8%	12.4%	19.1%	18.3%
Emerging	MSCI EMF USD	7.1%	7.8%	34.3%	28.5%

		Q4 2017 local	Q4 2017 CHF	YTD local	YTD CHF
Interest rates (3 months)		*(level)*			
CHF		-0.75%			
EUR		-0.38%			
USD		1.69%			
JPY		-0.02%			
Bonds markets					
World	Citi Gr Global Govt.USD	1.0%	1.7%	7.5%	2.8%
Europe	Euro Ser-E Gov > 1	0.6%	2.9%	0.2%	9.4%
United Kingdom	UK Ser-E Gov > 1	2.2%	3.7%	2.0%	6.7%
Switzerland	SBI Général AAA-BBB	0.5%	0.5%	0.1%	0.1%
	SBI Govt.	1.1%	1.1%	-0.4%	-0.4%
USA	US Ser-E Gov > 1	0.1%	0.7%	2.4%	-2.1%
Japan	Japan Ser-E Gov > 1	0.4%	0.8%	0.2%	-0.6%
Emerging	J.P. Morgan EMBI Global	0.5%	1.2%	9.3%	4.5%
Miscellaneaous					
	LPP 25 Index	1.9%	1.9%	5.9%	5.9%
	LPP 40 Index	2.7%	2.7%	8.8%	8.8%
	LPP 60 Index	3.7%	3.7%	12.7%	12.7%
Real Estate CH	DB RB Swiss Real Est Fd	3.5%	3.5%	7.9%	7.9%
Hedge Funds	Hedge Fund Research USD	1.0%	1.6%	4.8%	0.2%
Commodities	GS Commodity USD	9.9%	10.6%	5.8%	1.1%

Graph sources: Bloomberg/BBGI Group

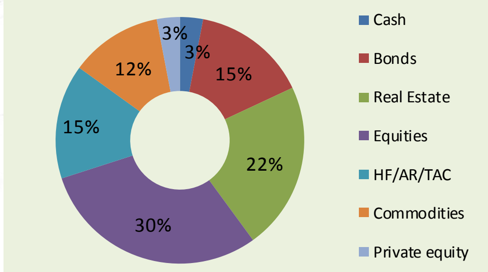
GLOBAL STRATEGY I ASSET ALLOCATION

Diversified portfolio: medium risk - EUR

- The rise in long-term rates will not spare the Eurozone
- Real estate remains the preferred alternative to bonds
- More neutral strategy for equity markets
- Positive outlook for commodities and currencies

ASSETS	Expected Return 3months	Expected Return 1year	ALLOCATION (EUR Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Cash	→	→							
Bonds	↘↘	↘↘							
Real Estate	↗	↗							
Equities	↘	→							
Hedge funds	→	→							
Commodities	↗↗	↗↗							
Private equity	↗	↗							

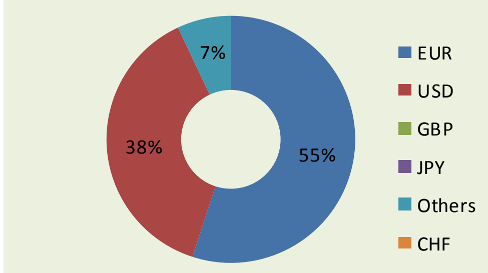
Asset allocation - EUR portfolio



Tactical Allocation

- More cautious stance on equities
- Overweight real estate, commo, dollar
- Underweight bonds

Currency allocation - EUR portfolio



Asset allocation

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Bonds

Global growth will be strong in 2018, and the risks of rising inflation, beyond central bank objectives, are not negligible. These prospects suggest a resumption of long-term rate adjustment dynamics in the United States, but also in the euro zone in particular. The normalization of key interest rates will continue in the United States and the asset buyback program in Europe should be discontinued in 2018. The euro bond market may no longer be constrained by the ECB's action and begin an adjustment justified by the level of growth and inflation. Emerging markets and high yield are less attractive. Bond risks are more present; we recommend reducing maturities and overall exposure.

Real Estate

Real estate benefits from improved global business cycle and still low interest rates. In most countries, real estate yields remain attractive and still represent an alternative to fixed income investments. After recommending some profit taking in the course of 2017, we remain overweight and focus on the European and Asian markets.

Equities

Economic fundamentals are positive, but financial markets are increasingly showing high valuation levels. The risk assessment measures suggest a confidence that is no doubt excessive with regard to the evolution of corporate profits. There are, however, not yet any obvious signs of nervousness, but the extremely low levels of volatility point to an excess of optimism. Despite a lack of alternatives in this low interest rate environment, we recommend a reduced equity exposure.

Commodities

Continued strengthening of the global economy will fuel adjustments to long-term expectations of inflation and long-term interest rates. The rise in commodities' prices is expected to continue as demand grows and supply stabilizes.

We announced a likely increase in crude prices to $60, which has materialized, but the geopolitical context could still help to support a continuation of the trend. Rising volatility in the financial markets would be a temporarily favorable factor for gold and silver prices, but what will really drive prices higher in 2018 is the physical market fundamentals, together with a rise in investment demand.

Devises

The rapid rise of the euro should lose some momentum in early 2018 against the dollar in particular. The level of 1.20 should not be quickly exceeded. We recommend an increase in foreign currency exposure to the detriment of the euro, in favor of the US dollar, Canadian dollar and Australian dollar.

Market performances - Q4 2017

		Q4 2017 local	Q4 2017 EUR	YTD local	YTD EUR
Exchange rates					
USD/EUR		-1.6%		-12.4%	
CHF/EUR		-2.2%		-8.4%	
GBP/EUR		-0.7%		-4.0%	
JPY/EUR		-1.7%		-9.0%	
Equity markets					
World	MSCI World USD	5.5%	3.8%	22.4%	7.3%
Europe	DJ Stoxx 600	0.6%	0.6%	10.6%	10.6%
Eurozone	DJ Eurostoxx 50	-2.5%	-2.5%	6.5%	6.5%
	MSCI Europe S.C.	2.4%	2.4%	16.6%	16.6%
Germany	Dax 30	0.7%	0.7%	12.5%	12.5%
France	Cac 40	-0.3%	-0.3%	9.3%	9.3%
United Kingdom	FTSE 100	4.3%	3.5%	7.6%	3.3%
Switzerland	SPI	2.9%	0.7%	19.9%	9.9%
	SMI	2.5%	0.2%	14.1%	4.6%
	MSCI Swiss S.C.	7.2%	5.5%	39.2%	22.0%
North America	SP500	6.1%	4.4%	19.4%	4.6%
	Nasdaq	6.3%	4.6%	28.2%	12.4%
	Tse 300	3.7%	1.2%	6.0%	-0.6%
	SP600 Small C.	3.6%	1.9%	11.7%	-2.1%
Japan	Nikkei 225	11.8%	9.9%	19.1%	8.3%
Emerging	MSCI EMF USD	7.1%	5.4%	34.3%	17.7%

		Q4 2017 local	Q4 2017 EUR	YTD local	YTD EUR
Interest rates (3 months)		*(level)*			
CHF		-0.75%			
EUR		-0.38%			
USD		1.69%			
JPY		-0.02%			
Bonds markets					
World	Citi Gr Global Govt.USD	1.0%	-1.2%	7.5%	-1.5%
Europe	Euro Ser-E Gov > 1	0.6%	0.6%	0.2%	0.2%
United Kingdom	UK Ser-E Gov > 1	2.2%	1.5%	2.0%	-2.1%
Switzerland	SBI Général AAA-BBB	0.5%	-1.7%	0.1%	-8.3%
	SBI Govt.	1.1%	-1.2%	-0.4%	-8.8%
USA	US Ser-E Gov > 1	0.1%	-1.5%	2.4%	-10.3%
Japan	Japan Ser-E Gov > 1	0.4%	-1.4%	0.2%	-8.9%
Emerging	J.P. Morgan EMBI Global	0.5%	-1.1%	9.3%	-4.2%
Miscellaneaous					
	LPP 25 Index	1.9%	-6.6%	5.9%	-3.0%
	LPP 40 Index	2.7%	-5.9%	8.8%	-0.3%
	LPP 60 Index	3.7%	-5.0%	12.7%	3.3%
Real Estate CH	DB RB Swiss Real Est Fd	3.5%	3.5%	7.9%	-1.1%
Hedge Funds	Hedge Fund Research USD	1.0%	-0.6%	4.8%	-8.2%
Commodities	GS Commodity USD	9.9%	8.2%	5.8%	-7.3%

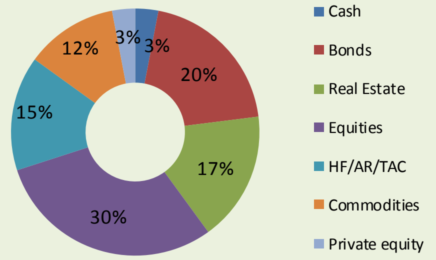
Graph sources: Bloomberg/BBGI Group

GLOBAL STRATEGY I ASSET ALLOCATION

Diversified portfolio: medium risk - USD

- Overall increase in long-term rates in 2018
- Real estate remains the preferred alternative to bonds
- More neutral strategy for US equities in particular
- Positive outlook for commodities and the dollar

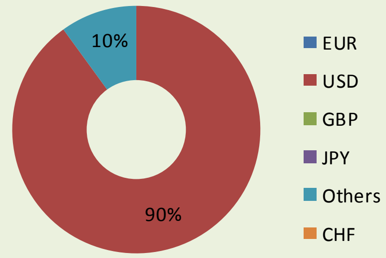
Asset allocation - USD portfolio



Tactical Allocation

- More cautious stance on equities
- Overweight real estate and commodities
- Concentrate on USD assets

Currency allocation - USD portfolio



ASSETS	Expected Return 3months	Expected Return 1year	ALLOCATION (USD Portfolio) underweight ---	--	-	neutral =	overweight +	++	+++
Cash	→	→							
Bonds	↘↘	↘↘	X						
Real Estate	↗	↗						X	
Equities	↘	→			X				
Hedge funds	→	→				X			
Commodities	↗↗	↗↗						X	
Private equity	↗	↗				X			

Asset allocation

The core of our investment strategy is made up of traditional liquid assets (liquidities, bonds, equities and real estate), which is then complemented by other diversified, tradable assets (commodities, hedge funds, private equity).

Bonds

Global growth will be strong in 2018, and the risks of rising inflation, beyond central bank objectives, are not negligible. These prospects suggest a resumption of long-term rate adjustment dynamics in the United States, but also in the euro zone in particular. The normalization of key interest rates will continue in the United States and the asset buyback program in Europe should be discontinued in 2018. The euro bond market may no longer be constrained by the ECB's action and begin an adjustment justified by the level of growth and inflation. Emerging markets and high yield are less attractive. Bond risks are more present; we recommend reducing maturities and overall exposure.

Real Estate

Real estate benefits from improved global business cycle and still low interest rates. In most countries, real estate yields remain attractive and still represent an alternative to fixed income investments. After recommending some profit taking in the course of 2017, we remain overweight and focus on the European and Asian markets.

Equities

Economic fundamentals are positive, but financial markets are increasingly showing high valuation levels. The risk assessment measures suggest a confidence that is no doubt excessive with regard to the evolution of corporate profits, in particular for US equities. There are, however, not yet any obvious signs of nervousness, but the extremely low levels of volatility point to an excess of optimism. Despite a lack of alternatives in this low interest rate environment, we recommend a reduced equity exposure.

Commodities

Continued strengthening of the global economy will fuel adjustments to long-term expectations of inflation and long-term interest rates. The rise in commodities' prices is expected to continue as demand grows and supply stabilizes.

We announced a likely increase in crude prices to $60, which has materialized, but the geopolitical context could still help to support a continuation of the trend. Rising volatility in the financial markets would be a temporarily favorable factor for gold and silver prices, but what will really drive prices higher in 2018 is the physical market fundamentals, together with a rise in investment demand.

Currencies

The dollar's weakness is not expected to continue in 2018. Fundamentals are favorable for the greenback, which should benefit from attractive yield spreads. We recommend a currency exposure that is more focused on currencies linked to commodities and, with less exposure to the euro.

Market performances - Q4 2017

		Q4 2017 local	Q4 2017 USD	YTD local	YTD USD
Exchange rates					
CHF/USD		-0.6%		4.5%	
EUR/USD		1.6%		14.1%	
GBP/USD		0.9%		9.5%	
JPY/USD		-0.1%		3.8%	
Equity markets					
World	MSCI World USD	5.5%	5.5%	22.4%	22.4%
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North America	SP500	6.1%	6.1%	19.4%	19.4%
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Real Estate CH	DB RB Swiss Real Est Fd	3.5%	3.5%	7.9%	12.8%
Hedge Funds	Hedge Fund Research USI	1.0%	1.0%	4.8%	4.8%
Commodities	GS Commodity USD	9.9%	9.9%	5.8%	5.8%

Graph sources: Bloomberg/BBGI Group

INVESTMENT THEMES

Graph sources: Bloomberg/BBGI Group

INVESTMENT THEMES:

Bitcoin: lack of an objective value is fuelling speculation. Will the bubble burst in 2018?

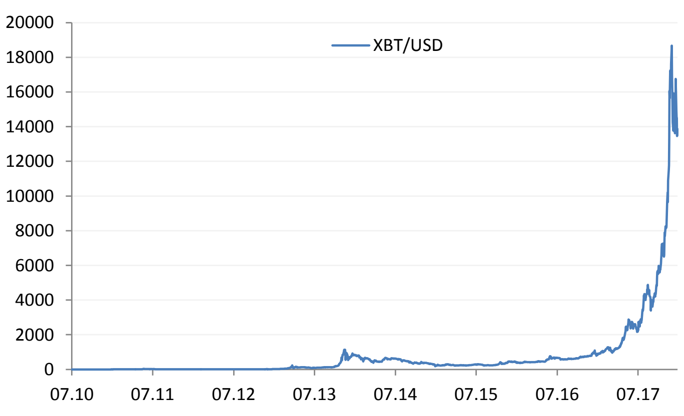
- The mysterious Bitcoin success story
- Users are first and foremast drawn in by the deregulated nature of Bitcoin
- Algorithm ensures increasing scarcity of supply
- Bitcoin is not and will not become a legal currency in its current form
- Speculative bubble to burst in 2018?

The mysterious Bitcoin success story

On the **19th August 2008,** Satoshi Nakamoto, an unknown element, registered the domain name bitcoin.org, and announced the birth of Bitcoin on 31st October, to utter indifference. On the 9th November, the concept of Blockchain first appeared, and two months later the first transaction between Satoshi Nakamoto and Hal Finney was carried out in block 170, marking the start of Bitcoin on the **12th January 2009**. To start with, Bitcoin was shrouded in mystery, with its creator remaining unknown to this day (Satoshi Nakamoto is just a pseudonym), but it also embodied transparency, with Satoshi Nakamoto publishing a first open version of his software on the P2Pfoundation website. At the time, Bitcoin was worth around 0.001 USD.

In **2010**, Satoshi changed Bitcoin Core's settings and limited mining to 990,000 octets. A vulnerability in the protocol enabled 92 billion Bitcoins to be created, and required the Blockchain to be corrected. A few months later, Satoshi changed the Bitcoin Consensus Rules in order to restrict the size of blocks, and then left the project on the 12th December 2010. In **2011**, Bitcoin achieved parity with the US dollar, and the market already started to speak of a speculative bubble when it hit 23 USD. In **2012**, the European Central Bank published its first report on virtual currencies, in which it mentioned that due to the extremely small size of existing systems, the risks only affect their users and do not represent an imminent systemic threat or a threat to monetary policy. However, it cautiously highlighted that the risk evaluation could be different if the use of virtual currencies spread due to technological developments. In **2013**, there were further incidents linked to version 8.0 not being backwardly compatible with a previous version of Blockchain. It was nonetheless a key year for Bitcoin, with Germany giving it a "status" as a private currency, and Ben Bernanke expressing his positive stance regarding Bitcoin in a letter to the Senate Committee.

Bitcoin price 2010-2017



Graph sources: Bloomberg/BBGI Group

Prices soared, hitting 500 USD, as the US Federal Reserve and the American Justice Department ventured relatively positive opinions on the topic. However, it was also at this point that we saw the first negative stances being taken by other, more hostile banks, as well as comments by former Federal Reserve Chief Alan Greenspan speaking of a speculative bubble. Whilst a growing number of online traders were allowing payment in Bitcoin, the network was victim of another massive, organised attack by several trading platforms. Bitcoin reacted with a new development- the release of Bitcoin Core 9.0.

The United States gave Bitcoin fiscal status on the **24th March 2014**, with it being treated as an asset from then on. Any gains would therefore be taxed as capital gains. Miners' revenue would also be taxable on the payments received in Bitcoin. Japan adopted a similar position, giving it status as a commodity. The Federal Reserve Board of Governors published a report which made Bitcoin climb even further, stating that Bitcoin is more of a curiosity than a threat as the transactions only represent a tiny fraction of global financial flows. It is therefore not currently a threat to the banking system. It did, however, point out that deposits are not guaranteed and that various security problems are proving a barrier to more users. More surprisingly still, the Board of Governors played down its role in financing criminal activities, stating that the illicit applications and uses of Bitcoin are common, but not endemic.

In **2015**, the winds changed, becoming even more favourable for Bitcoin. No doubt thanks to the support of US politicians, Bitcoin was receiving an ever more enthusiastic welcome from the media and the public, as well as from legislators who were trying to structure the use of the crypto-currency, unable to fight against it. Despite further Bitcoin thefts on trading platforms, as well as collapses and cases of fraud, surprisingly Bitcoin still exudes high security. On the 17th September that year, the CFTC (Commodity Future Trading Commission) started to consider Bitcoin as commodity, in the same way as one would consider wheat, gold, or crude oil.

The attacks continued on trading sites in **2016**, without wearing away at the confidence of the public, who seemed increasingly hungry for Bitcoins. At the same time, the European Commission was trying to subject virtual currency trading platforms and stock portfolio service providers to directives on fighting money laundering.

In **January 2017**, Bitcoin hit 1,000 USD, before dropping -30% following control measures for trading platforms put in place by the Chinese authorities. The Japanese authorities' reaction was the polar opposite; they recognised virtual currencies as a legal form of payment in April. On 31st October, the CME Group (Chicago Mercantile Exchange) announced its intention to create contracts in Bitcoin in the long term.

In November, Bitcoin hit 10,000 USD, with its valuation having increased ten-fold in less than ten months, amounting to around 170 billion US dollars. As such, it has surpassed Mastercard's stock market capitalisation (160 billion USD) and would be the 25th biggest stock on the S&P 500. The upturn continued as Bitcoin reached 19,500 USD on December 18, before dropping -26%. On December 31, Bitcoin closed at 14,310 USD. Nevertheless, although Bitcoin's popularity has only grown over the past ten years, making it one of the best known "brands" in the world today, the general public, and indeed the financial community, is largely unaware of how it functions. The very valuation of Bitcoin continues to be very problematic for the platform, as there is no valuation model adapted to this highly unusual asset.

Users are first and foremast drawn in by the deregulated nature of Bitcoin

The development of digital technologies and mobile applications has made it very easy to access Bitcoin, allowing users to easily carry out certain transactions or stock an asset without using the banking system. Bitcoin is increasingly used to pay for purchases with traders who accept the crypto-currency as an alternative means of payment. Although initially it was thought that these transactions could be processed without any additional charge, as is the case for some classic credit cards, this is no longer entirely true. Transactions fees tend to increase. Users clearly appreciate the supposedly guaranteed anonymity of transactions, lower transaction fees, and the freedom to take part in the network with no constraints and no intermediary for trading, stocking or transferring sums with no real limits. Indeed, security and discretion are often cited as key factors. When a user spends their Bitcoin, the network checks and ensures that the private key corresponds to the Bitcoins spent. The process remains completely private and does not reveal any user information. Here, it should be pointed out that the concept of anonymity of transactions has likely already hit certain walls, due in particular to the emergence of transaction identification and tracing software. It is an organised peer to peer system in which each participant in the network incorporates their transaction and checks those of other participants. This means that participants are entirely free of the constraints and the specific features required by the banking system.

Crises and uncertainty benefit Bitcoin

Bitcoin was certainly initially perceived as an independent means of payment which was safer than the US dollar or the Euro when it was created in 2009 and systemic risks were lashing the financial markets, causing both a fall in markets and increased volatility on currency markets. Certain participants have consistently temporarily used Bitcoin as a safe haven asset during each financial crisis, causing spikes in prices due to excessive, concentrated demand. In 2011, the collapse of stock markets in the wake of the Greek public debt crisis and its implications on the Eurozone helped to fuel a 2600% rise in Bitcoin in a few months. In 2013, when the Cypriot crisis was at its height, Bitcoin grew 920% in less than six months.

No need to be an expert to speculate

The old adage that there is no need to be an expert to speculate also holds true for Bitcoin. In the case of Bitcoin, it is perhaps also one of the fundamental reasons to participate with no fear and no reserve in the current frenzy gripping the rise of this crypto-currency. Indeed, it is really not necessary to understand the technical ins-and-outs of how Bitcoin works to speculate on its rise, and, in doing so, risk waving goodbye to the sums that have been converted. All any user needs to do is create a Bitcoin portfolio on their computer or mobile telephone to get a Bitcoin address. Sometimes this type of system is compared to an email exchange. A Bitcoin address seems to work like an email address, the difference being that it is only used for one transaction. The user has a private key, their digital signature, which is stored on their computer or an online server, and which enables them to buy, sell, and spend the Bitcoins in their portfolio with no difficulty.

This key is supposed to be unbreakable and prevent all fraud or corruption of the Blockchain, which provides another layer of security for speculation. Access to speculation on Bitcoin is very democratic and simple, thanks to specialised trading software having been developed.

Algorithm ensures increasing scarcity of supply

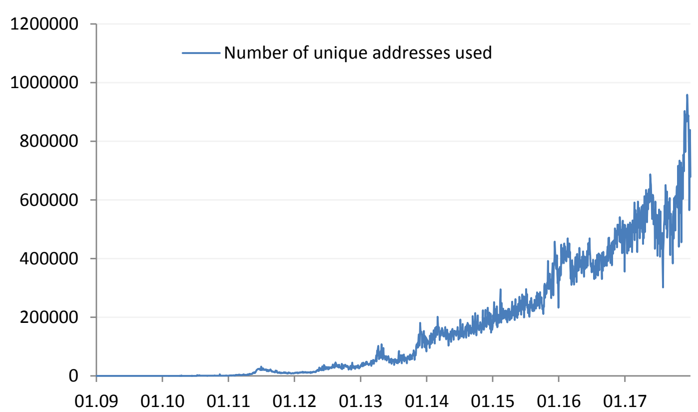
One cannot forget the basic Bitcoin algorithm when trying to understand the process that creates units. The software and function used to create Bitcoins will eventually limit the number of Bitcoins to 21 million units. The mathematical process can be summarised as limited creation by a fixed number of Bitcoins at 10-minute intervals, which will be halved every four years until the total maximum number of 21 million is hit in around the year 2140. In other words, between 2008 and 2012, 50 Bitcoins were created every 10 minutes, to give 10,500,000 units, whilst between 2012 and 2016 only 25 Bitcoins were created over the same interval, giving 5,250,000 units. Between 2016 and 2020 only 2,650,000 Bitcoins will be created, and so on.

As such, fewer and fewer Bitcoins will be created over time, despite the fact that demand seems to be growing. This explains the magic rise in Bitcoin.

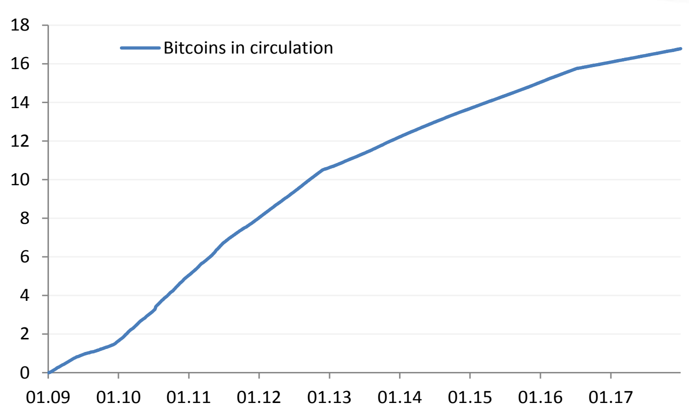
+1900%, without anyone really being able to give Bitcoin an "objective" value

In reality no valuation model exists to value an asset of this type. Bitcoin remains an abstract concept, which network participants want to be able to give a value at a particular moment in time, but which seems very considerably swayed by supply and demand. As the basic Bitcoin algorithm limits the creation of units to an absolute number (maximum 21,000,000), and in time (number of units per 10-minute interval halving after each four-year cycle), supply is, by definition, finite. As such, all that is needed is for Bitcoin to gain in notoriety and in investors' estimation for the Bitcoin market to be systematically imbalanced.

Unique addresses



Number of Bitcoins in circulation



Graph sources: Bloomberg/BBGI Group

This is exactly what has been happening since its creation, and this effect was magnified in 2017. Bitcoin's current valuation is high, and is already showing some of the characteristics of a speculative bubble. However, for now the current trend is firmly rooted and persuading those holding Bitcoins to hold on a little longer before taking profit…is a crash on the cards for 2018?

Bitcoin is not and will not become a legal currency in its current form

In the mind of users, Bitcoin is clearly a virtual currency. They think of it and use it as such. They exchange their dollars and other currencies for Bitcoins, in the belief that the virtual currency is essentially equivalent to legal currencies, without considering the crucial differences that will in all likelihood prevent Bitcoin, Ethereum, and other such currencies from becoming legal currencies.

Thus, users convert their legal currency deposits into virtual Bitcoin deposits, de facto accepting to forego the guarantees provided by a secure banking system as well as the interest rate typically paid, believing they now possess a novel and modern method of payment better adapted to globalisation and the digitalisation of consumption.

The latter factor is obviously not a significant concern in a context where interest rates are close to zero. Bitcoin and other cryptocurrencies are thus increasingly becoming an easily accessible method of payment and more credible, as an increasing number of merchants are accepting to transact using digital currencies.

Is it sufficient to assume that Bitcoin is gradually becoming a currency, or is the term "cryptocurrency" itself creating confusion?

In the US, land of the Bitcoin, the media refer to cryptocurrencies, even though the government clearly considers Bitcoin an asset subject to taxation when capital gains are realised by the bearer. The definition of legal tender has changed over time, but today a legal currency is expected to fulfil a number of essential criteria, including in particular that of enabling commercial exchange and having the capacity to extinguish debt and fiscal obligations, thus representing the discharge power of a currency.

The currency must also act as a store of value and a unit of account for economic, accounting and fiscal purposes. It must be able to assure economic agents with regard to its permanence as a medium of exchange recognized and accepted by all. Modern states thus established a monopoly with respect to issuing currency by exerting permanent control on banks' creation of money via banking laws and the actions of their central banks.

While governments and central banks are indeed interested in the concept of blockchain and virtual currencies, they seem more inclined to develop their own cryptocurrencies and obviously do not appear ready to give up the privilege of being the only entities that can issue currency.

Central banks hostile to private cryptocurrencies

Central banks have long considered cryptocurrencies as microphenomena with no significant impact and no potential risks for financial and banking systems. Recent developments with regard to Bitcoin in particular, whose value currently exceeds 250 billion dollars, are starting to raise concerns. While central banks have certainly not yet taken full stock of the situation, some of them have already put in place very restrictive measures prohibiting the use of cryptocurrencies. Others have chosen to gradually regulate the use of what they consider an "asset" rather than a virtual currency.

China's central bank is among the first to have taken a clear stance on the subject. In 2017 it prohibited issuance of and transactions in Bitcoin and other cryptocurrencies, stating that current technology was not appropriate and that conditions were not ripe for the development of a digital currency.

Nevertheless, the PBOC may be examining the opportunity of creating a digital currency to facilitate payments and currency control. The announcement prohibiting Bitcoin in 2017 temporarily led to a -30% drop in Bitcoin's value. In India, the message is similar. The central bank is staunchly opposed to the use of this type of instrument, clearly citing the risk of such currencies becoming a channel for money laundering and financing terrorism. Although the Indian central bank is likewise investigating the possibility of developing a legal digital currency, for now it has also prohibited the use of cryptocurrencies. In South Korea, the central bank has prohibited the use of cryptocurrencies, deemed to facilitate organised crime.

In Japan, Governor Haruhiko Kuroda recently mentioned the principle of creating a digital currency, stating that there is no current plan to establish a central bank digital currency (CBDC) that would make central bank accounts accessible to individuals.

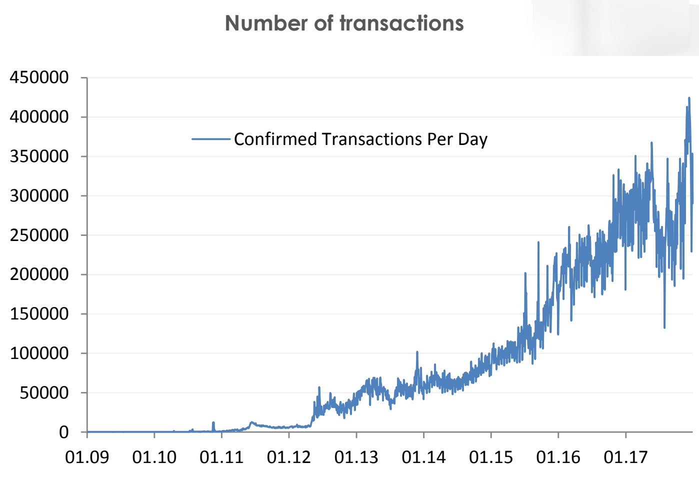
In Europe, the German central bank has probably provided the clearest view of its assessment of the role of cryptocurrencies, citing growing concerns with regard to the indirect effects that may arise should the use of these virtual currencies intensify. A member of the Bundesbank explained this sentiment several weeks ago, claiming that the hype and the rise in Bitcoin's value had more to do with the speculative behaviour of investors that with a genuine interest in a new form of payment. The fear is that a transfer from dollar or euro deposits to cryptocurrencies could affect the banking system and the effectiveness of monetary policy.

France seems to share this stance, given the comments of the governor of the French central bank, who noted that all the examples of private currency creation in history ended badly. According to him, those who use Bitcoin today do so at their own risk, pointing out that no institution is backing Bitcoin or guaranteeing its safety or permanency.

In the UK on the other hand, Governor Carney spoke of a revolution in the world of finance, referring to blockchain technology as a way to strengthen the fight against financial cybercriminality and to revolutionise the way transactions are conducted between consumers and institutions – cautious remarks, which do not truly address the issue of the systemic risks that would arise from the use of cryptocurrencies on a larger scale.

In Canada, studies are under way. The lead researcher noted in an interview that cryptocurrencies are clearly not genuine currencies but should rather be considered an asset or a security and be treated as such. However, the researcher's views on the prospects of blockchain technology were rather positive.

In Russia, the concern is very clearly about Ponzi schemes, which they certainly do not want legalised. The president of the central bank, Elvira Nabiullina, thus declared herself firmly opposed to any private currency, whether physical or virtual, and prohibited any website allowing consumers to trade in Bitcoin.



Graph sources: Bloomberg/BBGI Group

The Netherlands and the Scandinavian countries are innovating

One central bank in Europe is experimenting with a virtual currency. The DNBcoin was indeed created by the central bank of the Netherlands in 2015 to examine the possible implications of a virtual currency, restricted to internal use for now. Initial results indicate that blockchain technology could be applied in the settlement of complex financial transactions. The views of the Norwegian and Swedish central banks are similar. The Swedish central bank is exploring the creation of a registered digital currency and seems to think that an e-krona would not pose a problem for monetary policy.

The BIS and IMF are advising caution

The Bank of International Settlements – the central bank of central banks – sums up the situation by emphasising that central banks cannot ignore the evolution of technology and people's perhaps reckless enthusiasm for cryptocurrencies, which should cause central banks to consider what position to adopt with regard to these developments. In other words, central banks have to determine what are the opportunities and consequences of creating digital currencies issued and controlled directly by central banks. However, this eventuality would also have an indirect impact on the banking system. The IMF notes in its latest report on virtual currencies that the latter can provide distinct benefits but also present considerable risks as potential vehicles for money laundering, tax evasion, financing of terrorism and fraud.

The regulatory response to these issues is only in its initial stages and will have to take into account all the various aspects involved in the development of virtual currencies. Legislation will be necessary to create a regulatory framework around these virtual currencies, which they are currently partially sidestepping.

The influence of factors supporting Bitcoin will likely wane

Bitcoin's success seems to be due in large part to the combination of several factors that probably came into alignment simultaneously to constitute an optimal juxtaposition favouring the emergence of what many erroneously consider a new currency. This alignment is unlikely to persist in the sense that most of these factors are surely about to reach the limits of their influence. However, for the time being Bitcoin is benefitting from growing enthusiasm, broadly relayed by the media, which regularly report on the record increases in value and on the enthusiasm shared by part of the population for this new phenomenon so closely in sync with the technological advances accompanying the advent of the digital age. The oft-mentioned defiance of part of the public with regard to government policies stemming from the financial crisis of the past ten years remains alive and likely still constitutes a factor supporting the demand for Bitcoin.

In fact, it fosters hopes or fantasies regarding sustainable alternative solutions that would eliminate the regulatory constraints on financial transactions, in particular by facilitating the emergence of non-controlled currencies as alternatives to the main currencies with the status of legal tender, while providing all the guarantees of discretion and anonymity that no longer prevail in the financial system of developed countries.

The development of cryptocurrencies in 2017 has likely exceeded the stage at which most governments and central banks believe they must start to intervene.

It now seems increasingly likely that governments and central banks will see the need to more heavily restrict the use of Bitcoin and other cryptocurrencies, or even to prohibit their use by the public. Bitcoin has indeed benefitted from an insufficiently specific regulatory environment that is naturally poorly adapted to the accelerated evolution of technology. The future regulatory framework will likely impede the development of cryptocurrencies by eliminating the attributes that have allowed them to circumvent the efforts of the international community to put in place an international framework capable of effectively combatting suspicious financial transactions. Bitcoin is increasingly accepted as a means of payment and has become an alternative method of storing value for an ever larger number of users. However, it its present form, it cannot be deemed a currency, nor even a virtual currency. At most governments will define it as an asset, as is already the case in a number of countries, subject to tax laws mandating the collection of taxes on capital gains. The advent of Bitcoin has undoubtedly caused governments to become more conscious and concerned about not sharing their exclusive prerogative in regard to issuing currency with private, non-controlled systems that are insufficiently regulated. In the near future we will thus likely see legal virtual currencies created by central banks based on blockchain technology, which will then spell the end of the current cryptocurrencies.

Speculative bubble to burst in 2018?

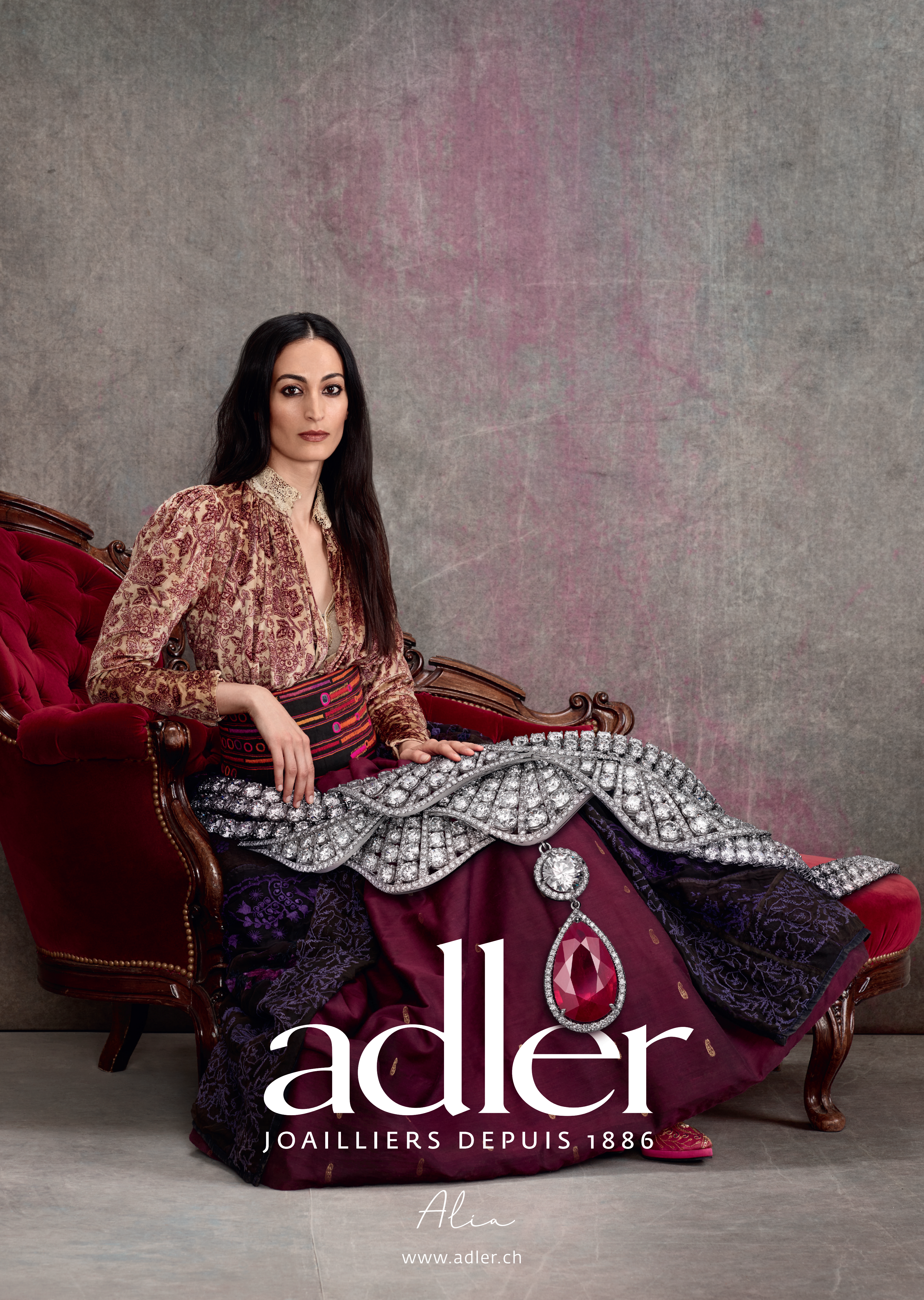
In the shorter term, the future of Bitcoin as an investment vehicle remains rather uncertain. First, while Bitcoin is indeed increasingly used as a means of payment, it would be simplistic to simply associate its development with that of e-commerce. Even though Bitcoin is used by more and more people, thereby increasing demand, it seems unlikely that e-commerce businesses will take the risk in the long term of holding on to Bitcoin obtained via sales. They should instead almost immediately exchange it for legal currency, thus increasing supply by the same amount. This factor is likely positive, but it is not the most determining factor in the equation. Speculative demand thus likely remains one of the factors bolstering the current rise of Bitcoin. It is not a new phenomenon, and it is worth recalling that, while Bitcoin's value during the past decade has experienced several phases of expansion such as the one under way in 2017, these were followed by brutal corrections.

In 2011, Bitcoin's value plummeted -91%, and in 2013 it dropped -50%, while it plunged -85% between 2014 and 2015. Bitcoin's value thus seems to be extremely dependent on the level of demand in terms of transactions and speculative activities, since as mentioned above the creation of new Bitcoin units is marginal. Thus, as long as current Bitcoin holders remain confident and hold on to their units, it is likely that increasing demand bolstered by a still favourable media environment will be sufficient to push Bitcoin's value up just a little higher. However, we must of course encourage network participants to pay attention to the risks inherent to speculation, which in our view is becoming frenzied. The increase in the value of Bitcoin continues to appear unfounded to us, and the speculative bubble clearly appears set to burst, as probably foreshadowed by the flash crash in November and December. The consequences of the bursting of the third speculative Bitcoin bubble of the decade in 2018 would inevitably be more significant than those of the previous bubbles given the number of participants and the sums involved.

Indeed, the previous Bitcoin crashes (2011, 2013, 2015) affected only a limited number of users, and the sums involved remained rather marginal, as even central banks concede. Recent developments in the market have completely changed the context and the potential risks. Cryptocurrencies now represent over 500 billion dollars, namely, around 10% of the ECB's balance sheet by comparison. An increasing number of financial products are linked to cryptocurrencies, whose value is still limited, but which could grow rapidly with the introduction in the US of a Bitcoin futures market and the development of regulation opening the door to the creation of ETFs. In such an environment, it is difficult to predict when the enthusiasm of participants in this market will wane and when the desire to take profits will produce a lasting reversal in the current upward trend. That said, once this process gets under way, the correction will likely be swift and brutal.

Bitcoin at USD 5,000 or 1,000 in 2018 is just as likely as an increase to USD 20,000, since it is difficult to obtain an objective valuation. Holders or buyers of Bitcoin for the purposes of investment or speculation will have to draw the necessary conclusions themselves before simply betting on the future.

Graph sources: Bloomberg/BBGI Group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