



Market Outlook 2016

Europe and United States

Emerging Markets, Commodities and Japan

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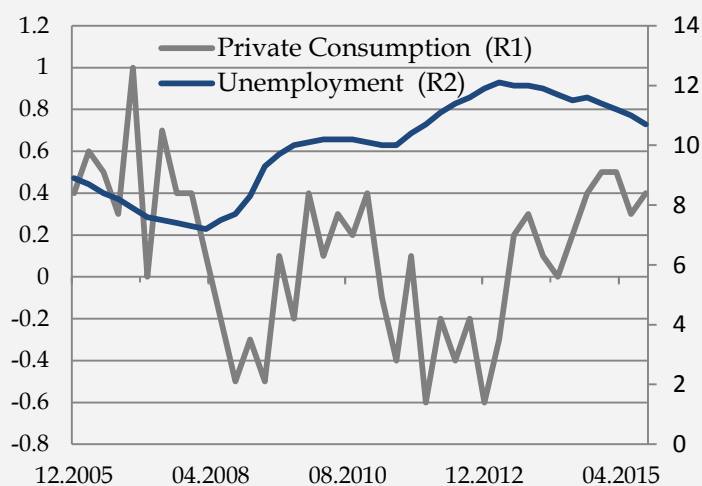
The outlook for 2016 proves to be a real challenge, as economic developments at the beginning of the year threatened also the few certainties consolidated in the investors' strategies in the course of 2015. In regards of 2016, we don't expect major changes in terms of economic cycle, but we take into account for our asset allocation the negative influence of various signals, which include low growth rates in developed countries and extensive complications in the emerging markets. Specifically, China jeopardizes current and future global growth. In this scenario, the European equity sector seems to have the best prospects based on macroeconomic indicators, business cycle and corporate fundamentals. The US stock market instead is going through a much later stage of the cycle and financial statements may already have seen the best results. In this case our view is neutral. From the point of view of the fixed income, government bonds are unattractive because the low returns don't leave room for maneuver, while there may be some opportunities in the credit sector after the last correction. The analysis process will be crucial in such difficult environment. In any case the high volatility will be difficult to eliminate, for which reason flexibility and alternative strategies will be the key to be successful.

*The view described in the paper
refers to a period of one year.*

Europe and United States

Investors are strongly concerned about the health of the economy. The emerging market crisis has been weighing on global growth by negatively affecting the current account of the exporting countries, particularly Germany. The lack of a firm trend increases the uncertainty.

However, the euro area finds itself in the early stages of a business cycle expansion, whose characteristics are a growing demand, improving unemployment rates and both fiscal and monetary incentives by governments and the ECB. **This picture highlights the European equity segment**, as the economy is expected to remain on the growth track and the liquidity offered by the central bank is supposed to improve the companies' EPS in the next release. Furthermore, Europe is backed by positive macroeconomic data, which reflect PMIs firmly above the critical threshold of 50 and supported by the confidence of consumers. Also some researches show that the collapse in oil prices has brought significant improvements in **consumer spending**, indispensable for a solid recovery. Even Mario Draghi, during the conference in December, argued that the collapse of the oil was for the most part due to the supply side, rather than weakening demand. Although less exposed than the US, it should be kept in mind, however, that the European market could be impacted by the crisis in the energy sector.



Source: Bloomberg

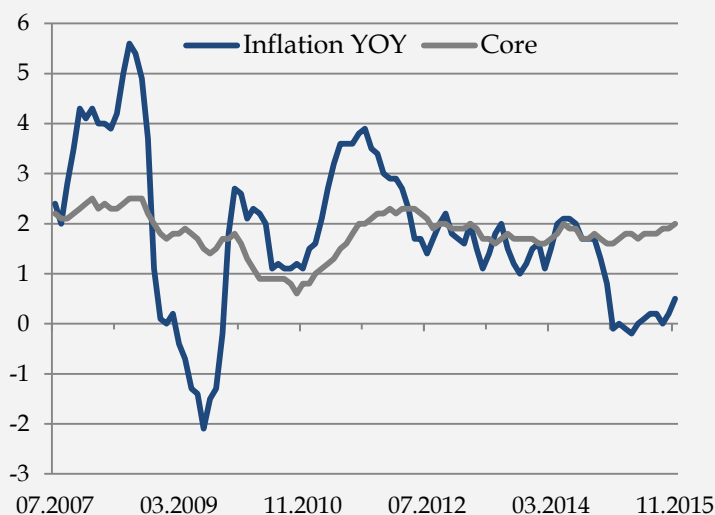
Having said that, once gone the effects of the commodities, inflation should return towards 2%, the ideal level to underpin the recovery. Another surprise could come from investments, practically zero last year.

In this respect, indicators of credit demand show signs of improvement. In any case, the volatility will remain at high levels throughout the year, especially in light of the less accommodating than expected attitude of the ECB and GDP growth rates sometimes disappointing, which fuels the general pessimism.

The view on the US stock market is neutral.

It's no news that the US labor market is healthy and the condition should not change in the course of 2016. With the unemployment rate close to the natural value, wages are expected to keep growing and intensify a process already set in motion in recent months. In this context, consumption should be positively influenced and maintain the good levels seen in 2015. Also inflation is likely to be stimulated if you look at the core measure (without food and energy) and the gap is expected to narrow once faded the effect of the commodities.

It is interesting to note that the inflation differential of inflation-linked instruments still do not discount this scenario and therefore could be a prominent theme over the year.

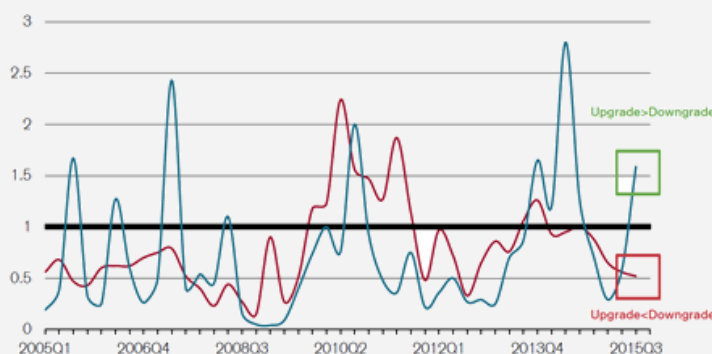


Source: Bloomberg

However, unlike in Europe, the US market is in a more advanced business cycle and the monetary policy of the Fed is expected to keep the dollar strong against the major currencies, especially those of the emerging markets. In particular, **the exposure to the energy sector concerns a lot**. There is no doubt that oil manufacturers were hit hard, but the positive effects that low energy costs have had on the real economy should be higher, although it is very difficult to have the full assurance. In this regard, it is always to keep in mind the possibility that the crisis in the energy sector might infect also the other parts of the economy. Even if such circumstance now seems remote and away from the catastrophic scenario of 2008, it should be remembered that a further escalation could lead to consequences quite unexpected.

The impact of the strong dollar is evident in the growth trend of 2015: while domestic demand grew at a rate of 2.5%, net exports did not contribute to the calculation of GDP. The **strong dollar** along with high unit labor costs should weigh on profits and worsen key indicators for equity evaluation such as the ROE. The situation is likely to continue, but not necessarily get worse. The current valuations remain high, although the sell-off at the beginning of the year may have already discounted a slowdown in growth. In any case, before considering an entry strategy, investors should have greater clarity on future developments.

From the point of view of credit, there might be some opportunities with attractive returns after an initial period of volatility. More specifically, it could be interesting to invest in “safe bets” like food and pharmaceutical companies, while banks subordinated should be avoided. In fact, taking into consideration the performance of the last months, they provide a risk/return profile no longer adequate. Also for the credit segment the European market looks more attractive. In 2015, many more European companies have been upgraded than those downgraded, indeed the opposite of what happened in America as a result of the energy sector. The trend should continue. The neutral opinion on the asset class is due to the fact that it is difficult to find decent credit quality with decent yields. The attractiveness of the equity over the fixed income is emphasized by the Credit Suisse Outlook 2016, according to which the dividend yields of the companies in developed markets are higher than bond yields.



--- US HY Upgrade-to-downgrade ratio

--- Western Europe HY Upgrade-to-downgrade ratio

Source: Bloomberg, Credit Suisse
Data as at 30.09.2015

Government bonds are not very tempting.

Their valuation concerns because yields are now fallen so much that it is difficult to see room for maneuver. The US Treasuries are an exception since they still have an acceptable return. In details, we expect a further flattening of the curve, as short rates follow the raising of the Fed, while the long-end could go up only in case of inflation out of control.

Not to be forgotten it is the fact that the danger of political contagion is latent, especially in Europe. Although nobody talks about Greece anymore (which still cannot yet count on a stable parliament with a strong majority), the recent geopolitical developments regarding immigration and terrorism could question the stability of the European Union. The rise of political parties notoriously anti-euro is proof of that and the result is absolutely unpredictable.

Emerging Markets, Commodities and Japan

Pessimism on emerging markets is perhaps the only thing in common to almost all investors. The crisis of the commodities and the strong dollar have cut growth expectations and there don't seem to be any big changes on the horizon.

China is the biggest concern: the disappointing growth rates in the second world power have prompted the government to carry out unconventional measures that have frightened investors and their trust. The devaluation of the renminbi in order to help exports, in particular, is seen as one of the greatest risks given its unpredictable nature. Indeed, a material devaluation may inevitably lead to a currency war between the other Asian countries that could be potentially destabilizing for the global economy in terms of growth and inflation. Recall that just a few months ago, the PBOC said that further write-downs of the renminbi would be very unlikely, we saw that it was not so.

The Chinese economy is undergoing a process of transition from a model based on industrial investments and exports towards an economy linked to domestic consumption. As you might have expected, the process takes time and it will take long before seeing the first results.



Source: Bloomberg









The Chinese slowdown becomes extremely important when considering the high amount of corporate and private debt, which is a prevailing feature of many other developing countries. In such countries the combination of overcapacity, the collapse in commodity prices and high levels of debt in USD may lead to a wave of defaults of the companies most exposed. Accordingly investors may be inclined to recall the capital and decrease the exposure starting in this way a vicious circle based on leakage of assets, depreciation of currencies and financial contagion.

The context does not anticipate any positive change for the **commodities sector** in the coming semesters and the price of oil in the area 30-40 may be the new reality, in the absence of production cuts and/or defaults of the producers. In fact, the pressure on prices is due to the oversupply and fragile demand in the oil market, which weigh on any commodities segment. The gravity of the situation is highlighted by the fact that one of the Saudi largest producers is considering the stock exchange to counter the erosion of capital and reserves.

The level of inventories provides additional pressure and it has been estimated they will reach the maximum in the second half of 2016, the period in which the risks of ground storage should approach the apex. Moreover the lifting of sanctions on Iran increases the uncertainty in the market and further worsen the current state of oversupply. Not to mention data from the London Metal Exchange show that the strong closing of positions during the first days of 2016 has not yet netted the entire short position built over the last few months. This indicates that there is not yet a signal of rebound.

Exception is made for **Japan**, whose economy grew in 2015, but still too **affected by low demand from China and the other emerging countries**. The government seems not to be able to implement the reforms needed to boost growth and the monetary policies implemented by the central bank seem to be ineffective. What does worry about is the **level of debt**. The government set itself the goal of achieving a primary surplus by 2020 in order to reduce the public debt, which is now at extreme levels at 230% of GDP. In any case, fiscal sustainability can only be achieved through structural reforms. Considering these internal difficulties and the exposure to emerging markets, our **position on Japan is negative**.

In summary, based on the current macroeconomic scenario and possible future developments, our views for 2016 on the major asset classes are:

Asset Class	View
US Equity	
EU Equity	
Japan Equity	
Credit	
Govies US	
Govies EU	
Emerging Markets	
Commodities	

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Investment decisions shall be made after careful examination of the complete and simplified Information Memorandum, together with the latest authorized year and six-month Reports and the Subscription Form, inclusive of the relevant annex, which all represent the binding documents in order to purchase shares of the fund in Italy.

The aforementioned documents are freely available from the agents authorized to the distribution and agents responsible for payments.

The Information Memorandum contains detailed information on the risks. All given opinions herein included reflect current assessments by Banca Zarattini & Co.

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