MACRO HIGHLIGHTS

WEEK OF 29 AUGUST 2016

OUR HIGHLIGHTS:

- Economists' insight: Way paved for a Fed hike
  - Expectations have jumped for one or even two Fed upticks by end-2016. The decision will be based on job creation.
  - Meanwhile fiscal stimulus and ECB support are likely to spur economic activity in the Eurozone.
- Focus on emerging markets: Marching in time with global parameters
  - Equity benchmarks are largely disconnected from local fundamentals.
  - They march in time with the dollar and US interest rates instead.

ECONOMISTS' INSIGHT

WAY PAVED FOR A FED HIKE

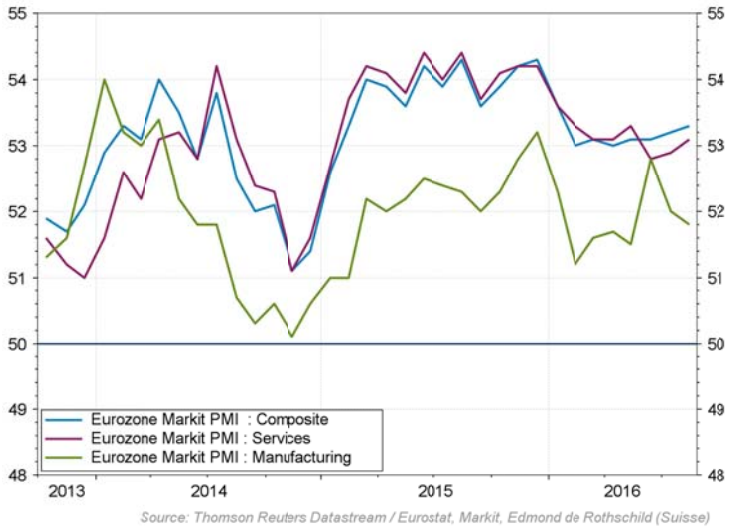
All eyes were on the US Fed Chair Janet Yellen last Friday as she addressed other central bankers gathered for their annual conference at Jackson Hole. The statement and minutes of the 27 July FOMC meeting had shown that the members of the Fed's monetary policy committee saw fewer short-term risks facing the American economy than in the spring. In particular, they were less concerned about the recent developments. Moreover, the financial stress in the wake of the UK's Brexit referendum decreased. In addition, recent comments, most notably by FOMC Vice-Chairman William Dudley on 16 August, seemingly pointed to a rate hike in the coming months.

With this in mind, investors were expecting Yellen to reiterate the prospect of further monetary tightening. In fact she did so, but only to a point. She confirmed that an uptick was possible considering the improvement in jobs data and the outlook for growth and inflation observed in recent months. **This, she said, had strengthened the case for a rate hike**. However, she gave no indication for the timing of such an accommodative move. Investors therefore failed to react immediately to her message. It was the speech by her deputy, Stanley Fischer, a few minutes later that shed real light on the prospects of a forthcoming uptick. For him **Yellen's words set the stage for a hike in the federal funds rate in September and**

perhaps even a second one by the end of the year. In Fischer's view it would all hinge on the August employment report to be published this Friday.

So in the end it was Fischer's address, more than Yellen's, that provided a clear answer for investors. Expectations of further monetary tightening in the US jumped. By Friday evening, based on trading in Fed funds futures contracts, the probability of an uptick at the FOMC's 21 September meeting rose to 42.0% from 32.0% at Thursday's close and the odds of a further hike in December also rose, to 64.7% from 57.4%. As a consequence, **the dollar appreciated against most other currencies**. The DXY index, which tracks the greenback's nominal effective exchange rate, was up 1.1% on Friday compared with its week-earlier level.

GDP growth in the Euro Zone continues to be driven by services



Meanwhile in the Eurozone, the latest PMI surveys showed an improving economic outlook in August. The composite index edged up to 53.3 points, a seven-month high, from 53.2 in July (see chart above). Although the Brexit vote has not dented the morale of purchasing managers in the 19-member currency zone, they are still worried about the weakness of economic growth worldwide. New orders in the manufacturing sector were down significantly this month and the recent upturn in commodity prices has started pushing up the prices of finished products. However, **the rise in public expenditure that we expect to see in the second half of 2016 should spur GDP growth in the Euro Zone**. The area's low inflation rate (0.2% yoy in July) moreover gives the European Central Bank (ECB) enough leeway to step up its programme of corporate and sovereign bond purchases, providing another fillip for economic activity.

Despite political uncertainties, Euroland's GDP growth could therefore deliver pleasant surprises in the coming quarters.

FOCUS ON EMERGING MARKETS

MARCHING IN TIME WITH GLOBAL PARAMETERS

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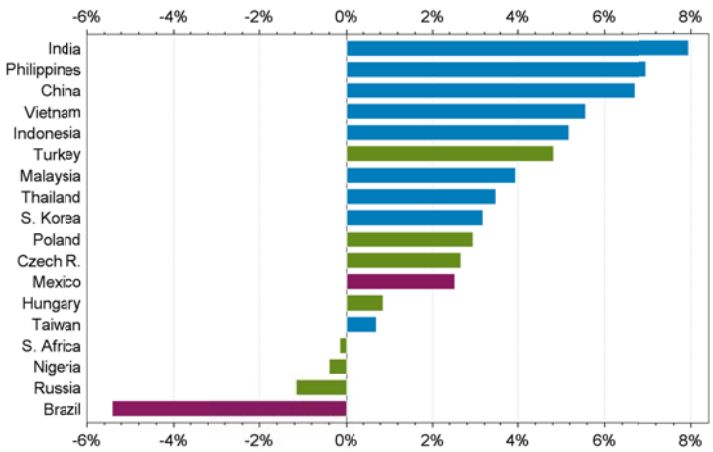
The emerging stockmarkets are often regarded, rightly or wrongly, as harbingers of trends in macroeconomic variables. If they did have this predictive power, **the recent run-up in share prices across most countries in this category would portend a marked improvement in the underlying economies' fundamentals** after five years fraught with severe structural difficulties.

The latest leading indicators are in line with our macroeconomic forecasts. Growth in the emerging regions as a whole is expected to gain pace in the latter half of 2016 after bottoming out in the second quarter. While encouraging, this outlook needs to be put in proper perspective. **Most of the upturn will be led by accelerating expansion in the weakest economies**: Russia, Brazil and South Africa. After sinking to -0.6%, -5.4% and -1.2% respectively in the first quarter of the year, GDP growth in these countries is benefiting from a recent bounce in commodity prices that will shore up their current-account balances. Two other countries, Malaysia and Turkey, which have large borrowing requirements, are being helped by the glut of liquidity created by central banks around the world.

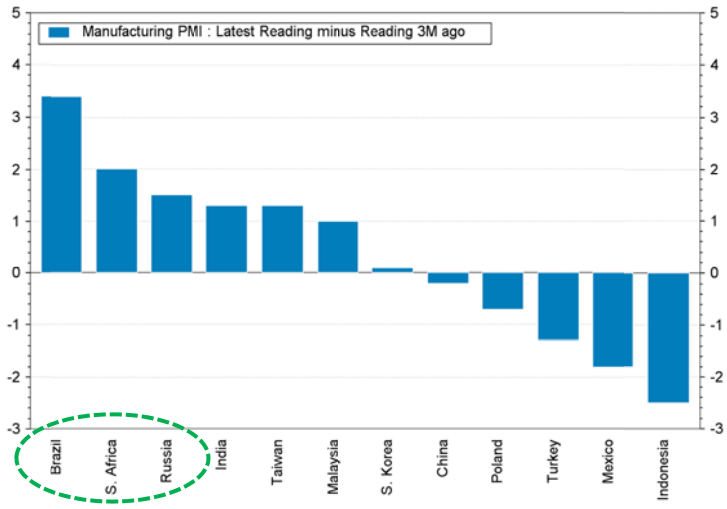
Meanwhile China and India, the emerging heavyweights, will not see their GDP growth rates stray much current levels. Fuelled by robust domestic activity and remarkable progress in the area of structural reforms, India is the emerging world's main driver with expansion clocked at a sizzling 7.9% last year. But China, with a long-term plan aimed at rebalancing its economy, has slowed its pace down to 6.7%.

Real GDP growth of selected emerging countries



Source: Thomson Reuters Datastream / Edmond de Rothschild (Suisse)

The upturn will be confined to the weaker economies

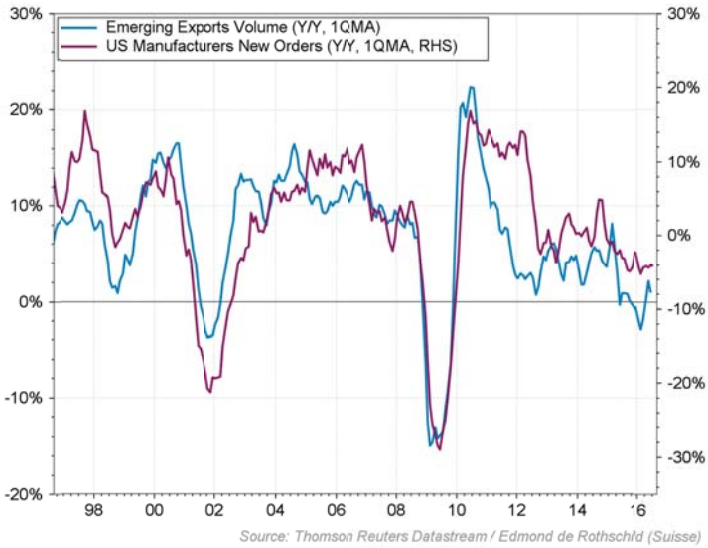


Source: Thomson Reuters Datastream / Edmond de Rothschild (Suisse)

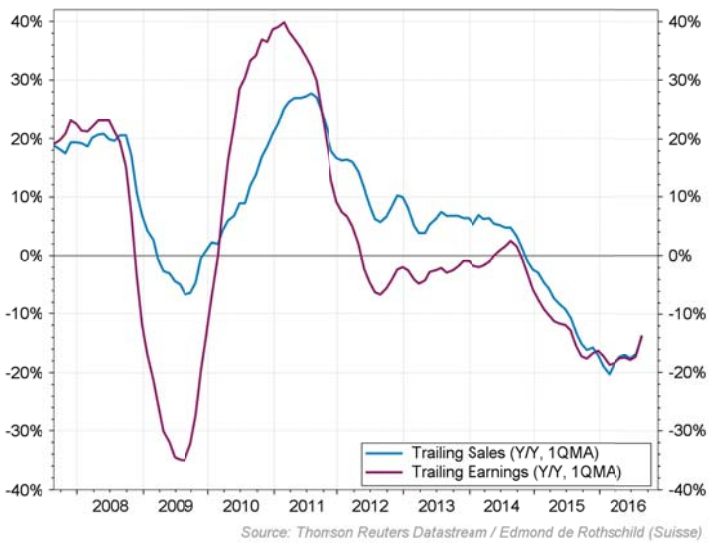
The upswing expected in the weaker emerging economies, along with the relative stability in India and China, will combine to boost the bloc's overall expansion in the second half of 2016. This breakdown will moreover continue to shape growth throughout 2017 as well, since China accounts for almost 50% of overall GDP and thus casts a very long shadow. Beijing leveraged growth in the first half of this year by encouraging borrowing, but with a rising tide of non-performing loans in its banking sector and a debt-to-GDP ratio that has soared to 255%, lending in the People's Republic is set to slow of its own volition. Growth in bank loans has already slackened to 10.9% year on year (from 12.5% in March) and the authorities have resorted to more restrictive measures lately, such as keeping key interest rates unchanged and clamping down on shadow banking. In industry efforts to reduce overcapacity will eventually pay off, but in the meantime they are weighing on growth and will raise the issue of finding new jobs for idled workers. **In this context there is little likelihood of a strong, sustainable economic recovery in China and, thus, in the emerging bloc as a whole**.

After leading their economic boom of the 2000s, international trade no longer provides much of a leg up for the emerging countries. Positive momentum in the developed world is not benefiting their exporters to any great extent. Depressed capital investment in the US, Europe and the emerging regions themselves has dimmed the prospects of countries, chiefly in Asia, that export manufactured goods (see left-hand chart below). Moreover, the offshoring of production facilities to China has reduced Chinese demand for imported goods, mainly from other emerging countries. From a structural standpoint, expanding services generally means fewer imports of equipment, thereby changing the momentum of global trade.

Weak US capex is weighing on emerging exports



Emerging companies' sales and profits remain depressed

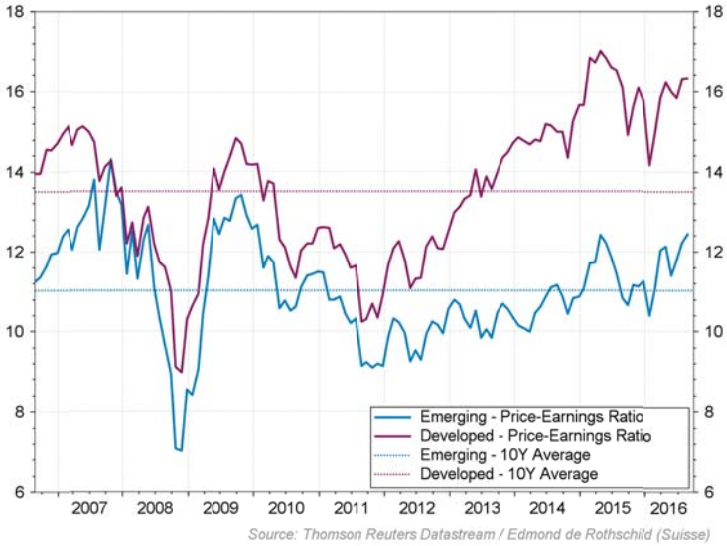


Actually, the impetus of the emerging upturn stems more from exogenous factors (the rebound in commodity prices, easing borrowing terms and a weaker dollar) than from a genuine rise in organic growth. This is true in the corporate sector as well, where growth in revenues and earnings is extremely low (see

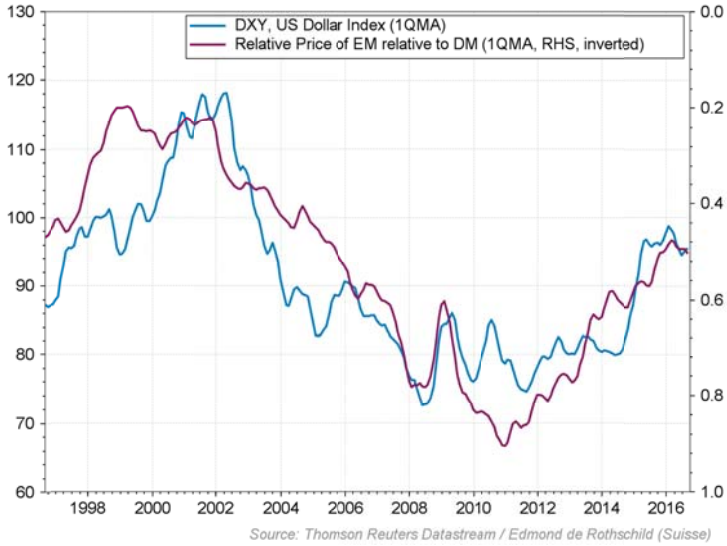
right-hand chart on previous page). Up to now the improving international outlook has provided scant benefits for emerging companies, prompting investors to eye these regions warily.

Knowing this, the hefty returns chalked up recently by emerging markets is puzzling. On the face of it **the turnaround in equities stems more from warming sentiment, and from hunger for added performance in a liquidity-laden environment, than it does from a significant, sustainable improvement in these economies' fundamentals**. While emerging stocks remain comparatively attractive in terms of valuation ratios, they are also highly dependent on trends in external variables. For example, dollar appreciation or rising US interest rates could put an end to the current run-up (see charts below). This has already been illustrated by the more hawkish tone of Fed officials at the Jackson Hole conference.

P/E ratios are lower in emerging countries



Historically a strong dollar has hurt emerging markets



OUR GROWTH AND INFLATION FORECASTS

REAL GDP GROWTH (%)	2013	2014	2015	2016f	Consensus	2017f	Consensus
United States	1.5	2.4	2.4	1.9	1.5	2.2	2.2
Japan	1.4	-0.1	0.6	0.7	0.5	1.3	0.7
Eurozone	-0.2	0.9	1.5	1.7	1.5	1.1	1.2
Germany	0.4	1.6	1.4	1.6	1.6	1.2	1.3
France	0.6	0.6	1.3	1.4	1.3	0.9	1.1
Italy	-1.8	-0.3	0.6	1.1	0.8	1.1	0.9
Spain	-1.7	1.4	3.2	2.8	2.8	2.2	2.0
Portugal	-1.1	0.9	1.5	1.2	1.1	1.6	1.3
Luxembourg	4.4	4.1	4.9	3.7	3.4	4.1	2.7
Europe ex-Eurozone							
United Kingdom	1.9	3.1	2.2	1.0	1.5	-0.2	0.6
Switzerland	1.8	1.9	0.9	1.1	1.0	1.2	1.4
Sweden	1.2	2.4	3.8	3.6	3.2	2.9	2.4
Israel	3.2	2.7	2.5	2.8	2.6	3.0	3.1
Emerging Markets							
China	7.7	7.3	6.9	6.5	6.5	6.0	6.3
Brazil	3.0	0.1	-3.9	-4.3	-3.5	0.7	1.0
India	6.3	7.0	7.3	7.5	7.5	7.3	7.7

CONSUMER PRICE INDEX (%)	2013	2014	2015	2016f	Consensus	2017f	Consensus
United States	1.5	1.6	0.1	1.3	1.3	2.3	2.2
Japan	0.4	2.7	0.8	0.2	-0.1	0.6	0.7
Eurozone	1.4	0.4	0.0	0.2	0.3	1.1	1.3
Germany	1.6	0.8	0.1	0.5	0.4	1.3	1.5
France	1.0	0.6	0.1	0.3	0.3	0.8	1.2
Italy	1.2	0.2	0.1	0.1	0.0	0.8	1.0
Spain	1.5	-0.2	-0.6	-0.1	-0.4	0.9	1.2
Portugal	0.4	-0.2	0.5	0.6	0.6	1.3	1.2
Luxembourg	1.7	0.7	0.1	0.7	0.0	1.4	1.7
Europe ex-Eurozone							
United Kingdom	2.6	1.5	0.0	1.4	0.7	3.5	2.2
Switzerland	-0.2	0.0	-1.1	-0.5	-0.5	-0.1	0.3
Sweden	0.4	0.2	0.7	0.9	0.9	1.5	1.6
Israel	1.5	0.5	-0.6	-0.3	-0.3	1.2	1.2
Emerging Markets							
China	2.6	2.0	1.4	2.1	2.0	2.4	2.0
Brazil	6.2	6.3	9.0	8.9	8.6	7.3	5.6
India	9.9	6.7	4.9	5.1	4.9	4.8	5.3

OUR MONETARY POLICY FORECASTS

KEY RATES (%)	2013	2014	2015	2016f	Consensus	2017f	Consensus
United States	0.25	0.25	0.50	0.75	0.70	1.25	1.00
Japan	0.10	0.10	0.10	-0.10	-0.10	-0.10	-0.20
Eurozone	0.25	0.05	0.05	0.00	0.00	0.00	0.00
Europe ex-Eurozone							
United Kingdom	0.50	0.50	0.50	0.25	0.10	0.25	0.10
Switzerland	0.00	-0.25	-0.75	-1.00	-0.80	-1.00	-0.85
Sweden	0.75	0.00	-0.35	-0.50	-0.55	0.00	-0.50
Israel	1.00	0.25	0.10	0.10	0.15	0.50	0.75
Emerging Markets							
China	6.00	5.60	4.35	3.85	4.15	3.35	4.10
Brazil	10.00	11.75	14.25	14.00	13.60	13.50	11.30
India	7.75	8.00	6.75	6.50	6.40	6.50	6.35

OUR CURRENCY FORECASTS

FOREIGN EXCHANGE*	2013	2014	2015	2016f	Consensus	2017f	Consensus
Dollar							
EUR/USD	1.37	1.20	1.08	1.08	1.09	1.04	1.10
USD/JPY	105	120	120	116	105	121	110
GBP/USD	1.66	1.56	1.47	1.24	1.27	1.20	1.32
USD/CHF	0.89	0.99	1.00	1.00	0.99	1.00	1.00
USD/CNY	6.05	6.21	6.49	6.70	6.75	6.90	6.80
Euro							
EUR/JPY	144	144	130	125	114	126	121
EUR/GBP	0.83	0.77	0.73	0.87	0.86	0.87	0.83
EUR/CHF	1.23	1.20	1.09	1.08	1.08	1.04	1.10
EUR/SEK	8.85	9.44	9.17	9.53	9.29	9.60	8.90

*end of period data

RETURNS ON FINANCIAL ASSETS

Major benchmarks and currencies

Markets Performances (local currencies)	Last Price	1-Week (%)	1-Month (%)	Year-to-Date (%)	Last Year (%)
Equities					
World (MSCI)	418	-0.4%	0.7%	6.7%	-1.8%
United States (S&P 500)	2'174	-0.1%	0.5%	8.2%	1.4%
Euro Area (DJ EuroStoxx)	327	1.0%	0.8%	-3.1%	11.2%
United Kingdom (FTSE 100)	6'825	-0.3%	2.6%	13.1%	-1.4%
Switzerland (SMI)	8'236	0.3%	0.7%	-3.9%	1.1%
Japan (NIKKEI)	16'725	1.0%	1.1%	-11.1%	11.0%
Emerging (MSCI)	896	-0.9%	2.8%	15.0%	-14.6%
Bonds (Bloomberg/EFFAS)					
United States (7-10 Yr)	1.57%	-0.1%	-0.8%	7.0%	2.1%
Euro Area (7-10 Yr)	-0.09%	-0.1%	-0.2%	6.7%	1.0%
Germany (7-10 Yr)	-0.09%	0.0%	-0.3%	7.7%	0.9%
United Kingdom (7-10 Yr)	0.64%	-0.1%	0.7%	11.1%	0.7%
Switzerland (7-10 Yr)	-0.50%	-0.2%	-0.6%	3.7%	3.7%
Japan (7-10 Yr)	-0.08%	0.0%	-1.1%	2.9%	1.4%
Emerging (5-10 Yr)	4.17%	0.2%	1.7%	13.0%	1.6%
United States (IG Corp.)	2.77%	0.0%	0.3%	9.5%	-0.8%
Euro Area (IG Corp.)	0.45%	0.0%	0.1%	6.0%	-0.5%
Emerging (IG Corp.)	3.44%	0.0%	1.2%	11.7%	-2.3%
United States (HY Corp.)	6.41%	0.2%	2.1%	14.8%	-3.5%
Euro Area (HY Corp.)	3.15%	0.3%	1.3%	7.1%	0.3%
Emerging (HY Corp.)	7.39%	0.0%	1.9%	16.8%	3.6%
United States (Convert. Barclays)	46	0.0%	1.5%	9.0%	-0.8%
Euro Area (Convert. Exane)	7'301	0.4%	0.5%	-2.6%	7.6%
Real Estate					
World (MSCI)	206	-0.4%	-2.6%	10.9%	1.0%
United States (MSCI)	217	0.1%	-3.4%	10.8%	4.6%
Euro Area (MSCI)	238	-0.4%	-0.3%	17.5%	16.1%
United Kingdom (FTSE)	6'546	0.3%	0.6%	-0.7%	9.4%
Switzerland (DBRB)	3'814	-0.2%	0.1%	5.7%	4.6%
Japan (MSCI)	234	2.0%	-2.5%	-12.3%	0.9%
Emerging (MSCI)	106	-3.2%	2.1%	9.1%	-6.8%
Hedge Funds (Dow Jones)					
Hedge Funds Industry	547	n.a	1.1%	-0.5%	-0.7%
Distressed	735	n.a	1.1%	1.0%	-5.3%
Event Driven	587	n.a	1.5%	-1.0%	-6.3%
Fixed Income	305	n.a	1.1%	0.9%	0.6%
Global Macro	874	n.a	0.3%	-1.3%	0.2%
Long/Short	652	n.a	1.3%	-3.8%	3.6%
Managed Futures (CTA's)	328	n.a	1.6%	3.7%	-0.9%
Market Neutral	262	n.a	0.9%	-2.7%	1.7%
Multi-Strategy	530	n.a	1.1%	1.7%	3.8%
Short Bias	26	n.a	-8.1%	-14.7%	2.4%
Commodities					
Commodities (CRB)	412	-1.5%	-1.2%	9.5%	-15.2%
Gold (Troy Ounce)	1'318	-1.8%	-2.6%	24.1%	-10.6%
Oil (Brent, Barrel)	48	1.2%	18.7%	36.2%	-35.9%
Currencies					
USD	96.0	1.6%	0.5%	-2.7%	9.3%
EUR	1.12	-1.4%	-0.1%	2.7%	-10.2%
GBP	1.31	-0.9%	-0.7%	-11.2%	-5.4%
CHF	0.98	-1.9%	-1.4%	2.0%	-0.8%
JPY	102.9	-2.6%	-0.5%	16.8%	-0.4%

Source : Bloomberg Momentum (1-week / 1-month / 3-month) Performance (Negative \ Positive)

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