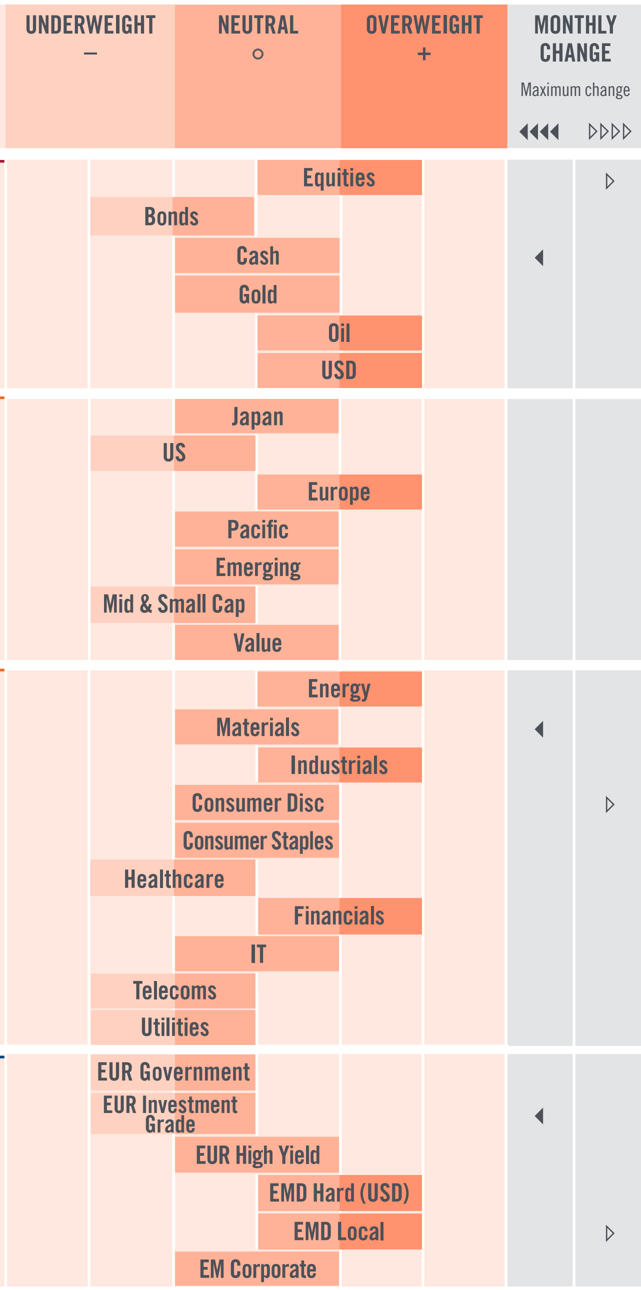
PICTET 1805

GLOBAL ASSET CLASSES
We move equities to single overweight and move cash to neutral as stock valuations have become attractive and economic momentum is set to improve.

EQUITY REGIONS AND STYLES
European equities remain our top picks as a weak euro should support exports and credit lending is likely to improve gradually.

EQUITY SECTORS
We upgrade consumer discretionary to neutral on the improved outlook for consumer spending; materials move down to neutral.

FIXED INCOME
We increase local currency EM debt to single overweight as emerging currencies are likely to rebound; we cut investment grade to underweight.



Improving environment for equities towards year-end

Pictet Asset Management Strategy Unit

Monthly euro investor outlook on a 3 month view

Barometer

November 2014

Monthly outlook

Pictet Asset Management
Strategy Unit

Issued 3 November 2014

Global market overview

Global markets overview: Stocks get last-minute BOJ boost; oil slumps

World stocks ended higher in October, having sharply recovered from a steep correction at the start of the month. A rise in risk aversion was triggered earlier in the month by concerns that the US – the sole engine of global growth – may not be strong enough to lift economies in the rest of the world where conditions remain sluggish. Assurances by the US Federal Reserve that it would not rush to raise interest rates following the end of its five-year quantitative easing programme stabilised investor morale, helping equities erase losses at a global level. Global stocks made further gains after the Bank of Japan unexpectedly increased the size of its monetary stimulus.

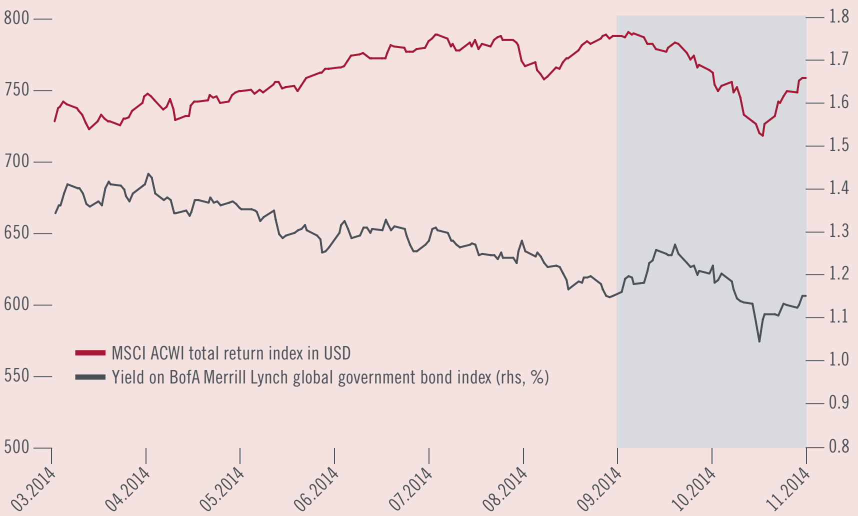
Crude oil fell below USD80 a barrel for the first time in more than two years, extending a month-long rout as worries intensified about global growth and rising supply.

Emerging equities ended the month higher, but there was a stark divide in fortunes. Turkey and South Africa gained, benefiting from a sharp decline in oil prices. Their currencies also ended the month in positive territory. Russia and Brazil were the worst performers; concerns about slowing growth pushed Russian stocks and the rouble down more than 6 per cent. In Brazil, equities fell sharply after the re-election of President Dilma Rousseff over an opponent seen as more pro-business sent the benchmark stock index to seven-month lows and pushed the real close to a 9-1/2 year low against the USD.

Global bond yields fell to an all-time low of 1.05 per cent (see chart). US Treasuries rose 1.3 per cent, bringing gains this year to 4.5 per cent. US dollar emerging debt remains the best performing fixed income asset this year with a gain of over 9 per cent.

In the currency markets, the USD's rally over the past few months came to a halt as the currency ended the month slightly lower against major currencies. Weak US inflation data and sluggish global growth boosted expectations that any hike in US interest rates is still a long way off even after the Fed has ended its bond-buying programme.

GROWTH WORRIES DRIVE EQUITIES, BONDS IN RECENT MONTHS



Source: Thomson Reuters Datastream

Asset allocation

Turning more optimistic on equities towards year-end

We increase our equity allocation to overweight as a drop in oil prices and ongoing monetary support from central banks are likely to boost economic momentum and risk appetite towards the year end. We remain underweight bonds and overweight the USD while we reduce cash to neutral.

Our **business cycle** readings show a persistent gap in momentum between the US and the rest of the world. While growth in the US manufacturing sector has slowed, consumer confidence has reached levels not seen since August 2007. This, coupled with a recent decline in energy prices, is likely to support retail sales as the US heads into the holiday season. A solid housing market and strong industrial goods orders point to economic growth of 3 per cent in the July-September period, a level which we think can be sustained in the coming quarters.

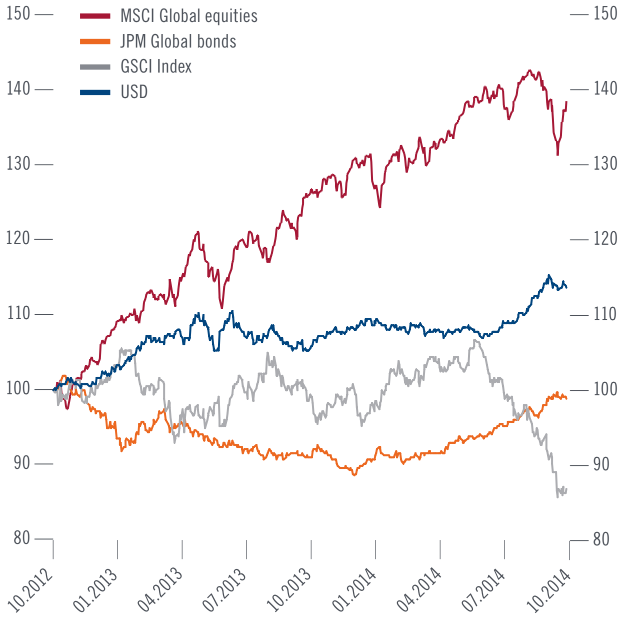
Inflationary pressures in the US have eased in the short term, largely due to a decline in oil prices; consumer price inflation is likely to be most affected by the decline in oil prices as some 9 per cent of household spending is energy-related. However, a tightening labour market and other cyclical factors should contribute to rising prices over the next six months. Given these conflicting forces, we have pushed back our expectation of the first US interest rate hike to the summer of 2015.

In Europe, growth continues to weaken, with a sharp decline in the German manufacturing sector indicative of the economic impact of the EU's worsening relationship with Russia. Given downside risks to growth and stubbornly low inflation that is far below the European Central

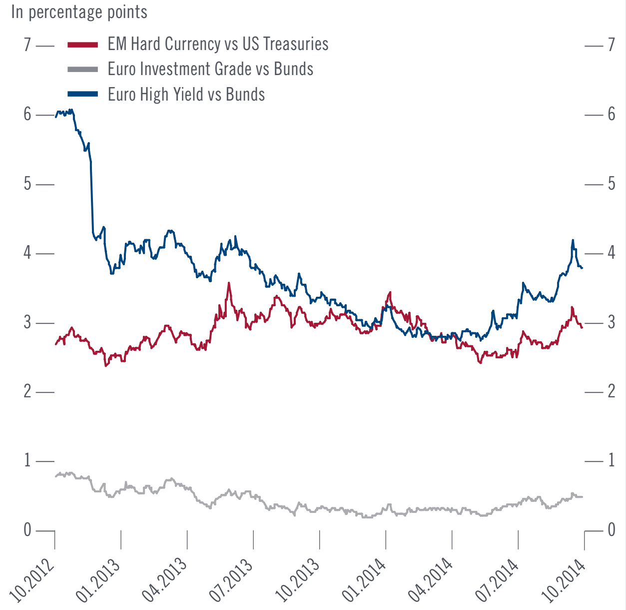
Source: Pictet Asset Management, Thomson Reuters Datastream / JPM and BoA Merrill Lynch

MAJOR ASSET CLASSES

PERFORMANCE: ASSET CLASSES

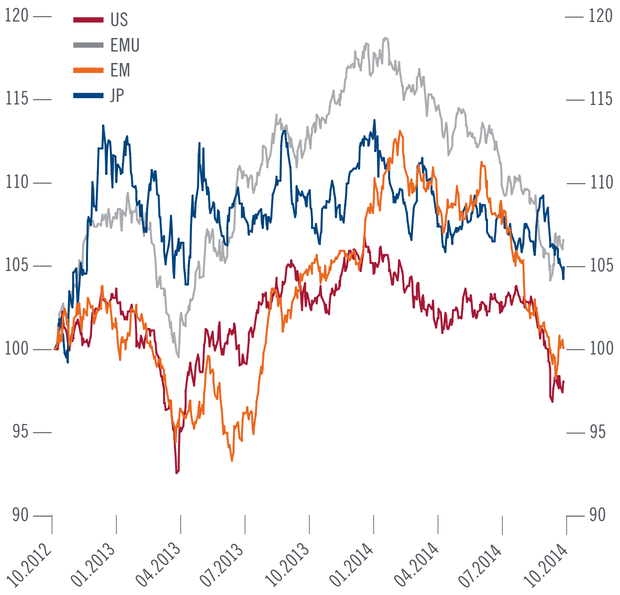


BONDS: ASSET CLASS SPREADS

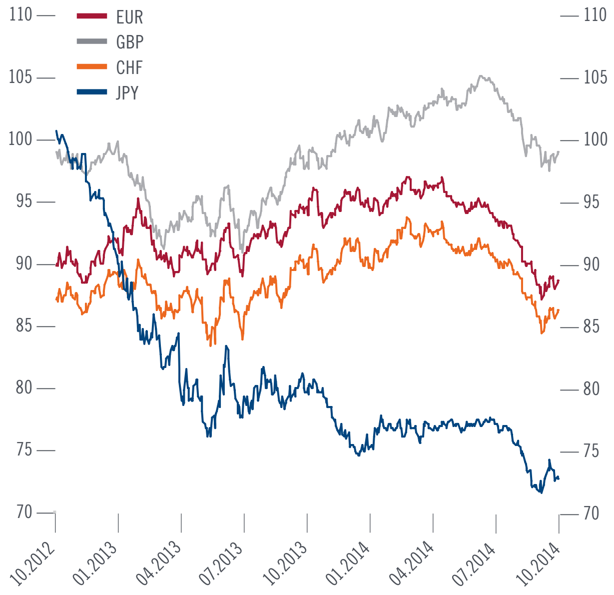


EQUITY SECTOR ROTATION AND CURRENCY PERFORMANCE

GLOBAL EQUITY SECTOR ROTATION:
PERFORMANCE OF CYCLICAL VS DEFENSIVE STOCKS

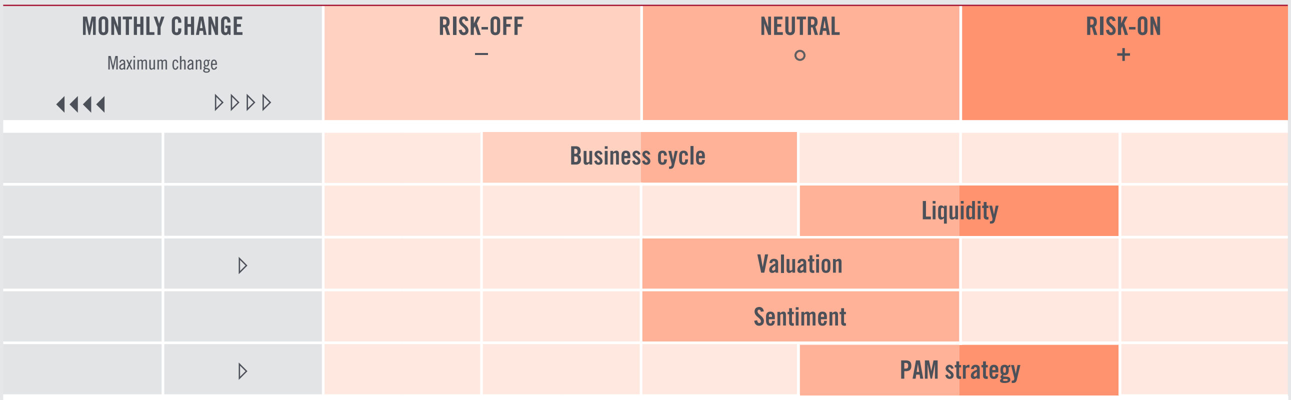


PERFORMANCE: CURRENCIES VS USD



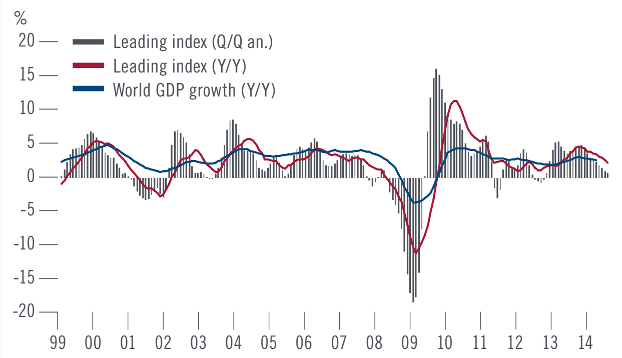
Source: Pictet Asset Management, Thomson Reuters Datastream

RISK BIAS INDICATORS

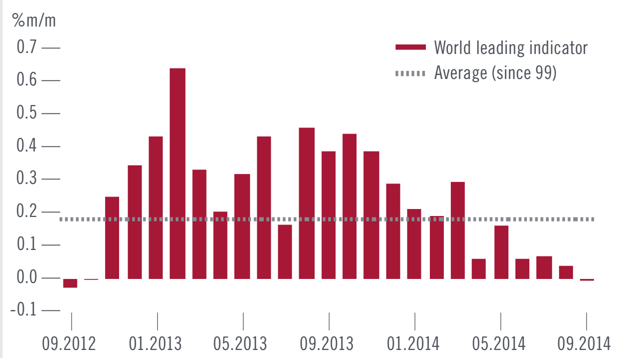


BUSINESS CYCLE: WORLD ECONOMIC GROWTH BECOMING SUBDUED

WORLD LEADING ACTIVITY INDEX & REAL GDP GROWTH

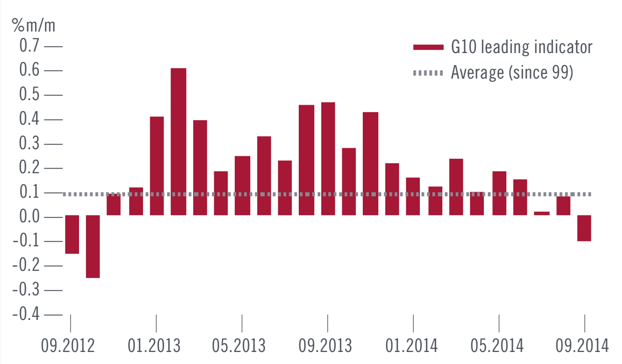


WORLD LEADING ACTIVITY SEQUENTIAL GROWTH (M/M)

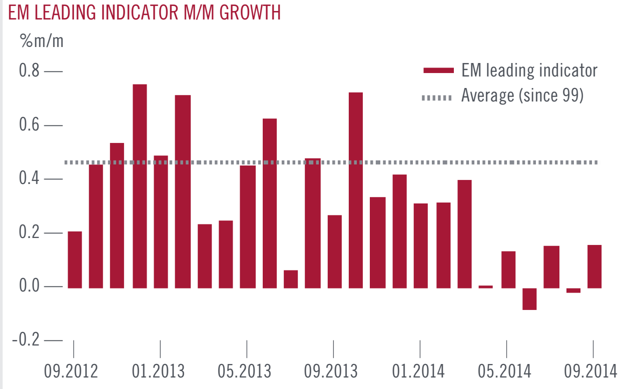


ECONOMIC MOMENTUM DETERIORATING IN G10; SLIGHT IMPROVEMENT IN EMERGING ECONOMIES

G10 LEADING INDICATOR M/M GROWTH



EM LEADING INDICATOR M/M GROWTH



Source: Pictet Asset Management, Thomson Reuters Datastream

VALUATION: EQUITY MARKETS AND SECTORS

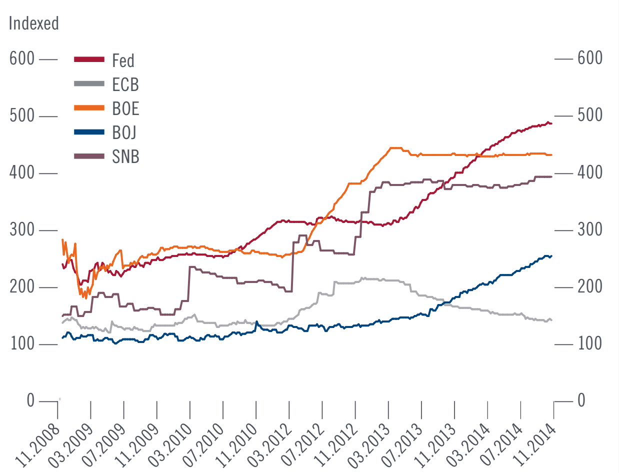
COUNTRIES AND SECTORS

MSCI REGIONS	EPS GROWTH 2014	EPS GROWTH 2015	SALES GROWTH 2014	SALES GROWTH 2015	PE 2014	PE 12M	PB 2014E	P/SALES 2014E	DY 2014E
US	7%	11%	4%	4%	17.0	15.6	2.4	1.6	2.1%
Europe	5%	12%	0%	3%	14.7	13.3	1.6	1.0	3.6%
EMU	8%	17%	0%	3%	14.7	12.9	1.4	0.8	3.5%
Switzerland	0%	11%	2%	4%	17.2	15.7	2.4	2.1	3.1%
UK	1%	7%	1%	2%	13.4	12.7	1.7	1.0	4.0%
Japan	5%	13%	2%	3%	14.2	13.2	1.1	0.6	2.0%
EM	4%	12%	6%	7%	11.6	10.5	1.3	0.7	2.9%
NJA	9%	12%	6%	7%	12.2	11.2	1.3	0.6	2.8%
Global	**6%**	**11%**	**4%**	**4%**	**15.4**	**14.0**	**1.8**	**1.2**	**2.6%**

MSCI GLOBAL SECTORS	EPS GROWTH 2014	EPS GROWTH 2015	SALES GROWTH 2014	SALES GROWTH 2015	PE 2014	PE 12M	PB 2014E	P/SALES 2014E	DY 2014E
Energy	5%	4%	2%	2%	11.7	11.3	1.3	0.6	3.6%
Materials	3%	15%	1%	4%	15.0	13.3	1.5	0.9	3.0%
Industrials	9%	14%	4%	5%	16.0	14.5	2.0	0.8	2.5%
Consumer Discretionary	-1%	16%	4%	6%	16.5	14.6	2.3	1.0	2.1%
Consumer Staples	3%	9%	3%	5%	19.2	17.6	3.2	1.1	3.0%
Health care	11%	11%	8%	6%	18.5	17.0	3.4	2.0	2.0%
Financials	6%	13%	5%	5%	12.9	11.6	1.1	1.6	3.5%
IT	12%	11%	4%	7%	16.2	14.7	2.7	2.0	1.7%
Telecoms	-4%	8%	2%	3%	15.5	14.6	2.0	1.3	4.4%
Utilities	0%	10%	2%	2%	15.8	14.5	1.4	0.9	4.0%

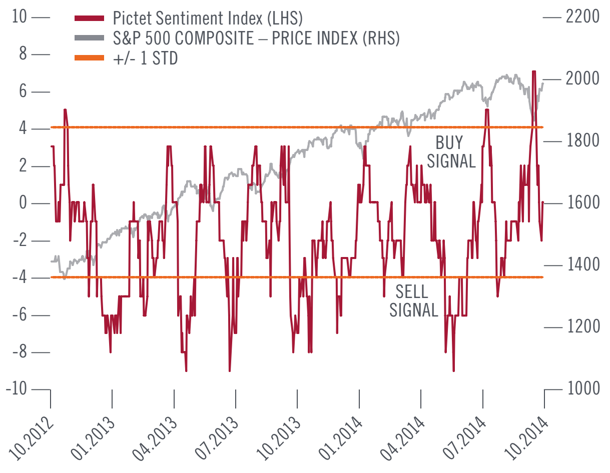
LIQUIDITY: FED TAPERS BUT MONETARY STIMULUS CONTINUES ELSEWHERE

SIZE OF CENTRAL BANKS' BALANCE SHEETS



SENTIMENT INDICATOR SHIFTS TO NEUTRAL

PICTET SENTIMENT CYCLE INDEX



Bank's 2 per cent target, policymakers are under pressure to do more to boost the economy. Broad-based quantitative easing still remains a possibility next year.

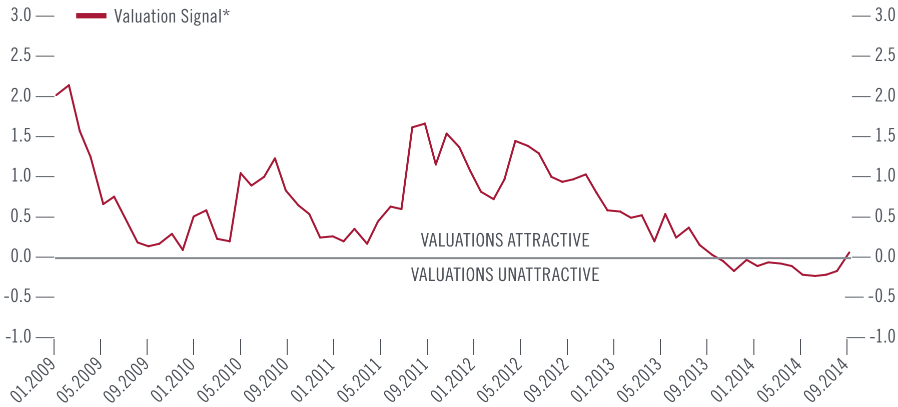
Looking ahead, however, sentiment should stabilise as tensions between Russia and Ukraine have eased. We also expect credit growth to improve – albeit gradually – after bank health checks showed the region's top lenders have substantially strengthened their balance sheets.

Japan is also experiencing subdued growth as leading indicators have contracted further, with confidence among the country's small and medium-sized enterprises falling unexpectedly in the month.[1] The economy has also had to contend with political uncertainty. A string of government scandals has dented public support for Prime Minister Shinzo Abe and it is not yet clear whether Abe will press ahead with a proposed second sales tax hike. The government is due to decide on the tax plan in December.

Against this backdrop, and with inflation unlikely to hit policymakers' 2 per cent target this year, the BOJ's surprise move to expand its monetary stimulus is a welcome development which should lift sentiment and growth.

In China, economic momentum remains below its long-term trend but there are some signs of improvement. Construction activity increased for the fourth consecutive month, while the People's Bank of China's recent measures to boost the property sector should help stabilise house prices in the medium term. The country's nominal export growth has been rising while new export orders have hit their highest level since December 2010. This is likely to underpin the manufacturing sector, encouraging business investment.

STOCK VALUATIONS POSITIVE FOR THE FIRST TIME SINCE FEBRUARY



* Based on a composite score of the deviation from average and trend for earnings yield and price to book for MSCI World stocks

Source: Thomson Reuters Datastream, Pictet Asset Management

Elsewhere, we see a growing divergence in growth across the rest of the emerging world. Manufacturing exporters in Asia have benefited from a decline in oil prices, while Latin American commodity producers have seen lacklustre growth, mostly driven by Brazil, which is in recession. A sharp fall in emerging currencies – which are now nearly 16 per cent undervalued according to our model – should lift exports.

Our **liquidity** readings remain mildly positive at a global level. Notably in the euro zone, money supply has risen at the fastest pace in two years[2], thanks in part to the ECB's programme of providing cheap long-term loans to banks. This is offset by the US, where private lending conditions are healthy but central bank liquidity could become less supportive for investors with the end of the Fed's quantitative easing programme. However, the BOJ's latest monetary expansion is likely to ensure global liquidity will grow next year at a similar pace to this year, at USD1.1 trillion.

Sentiment indicators have returned to a neutral level after a volatile month saw equities rebound somewhat after a sell-off.

Valuation readings have improved after a market correction in October. However, corporate earnings revisions are still largely negative across the world, apart from Japan. This is a worrying picture, but equities remain more attractive than bonds with the equity risk premium – the extra return on equity over the risk-free rate – holding near 6 per cent. Emerging market stocks look cheap compared with the asset class's average price-earnings ratio of the last 10 years and our own fair value estimate. The USD, US Treasuries and investment grade bonds are expensive on both these measures.

[1] Shoko Chukin small business confidence index
[2] Euro zone M3, three-month annualised

Equity region and sector allocation

Long Europe, underweight the US

Our regional allocation remains unchanged and we keep our preference for European equities over US stocks; Japan and emerging markets are maintained at benchmark weights.

In our view, the case for European equity markets is boosted by improving liquidity conditions, favourable valuations adjusted over the business cycle and overly pessimistic assumptions about the region's growth prospects.

Liquidity conditions are certainly becoming more supportive in Europe. Monetary aggregates in the region continue to improve while bank lending appears to have stopped contracting. The completion of European banking health checks and the provision of cheap money under the TLTRO programme in December should go some way towards stabilising credit growth. However, the market seems to have taken an extremely dim view of economic prospects in Europe, with growing worries about deflation – a view which we believe is overly pessimistic. Against this backdrop, European equity valuations look appealing, particularly on measures of long-term value such as the cyclically-adjusted price-earnings ratio. This can be partly explained by the fact that earnings per share in the region stand as much as 30 per cent below their 2007 peak, an unusually low level that is unlikely to persist.

By contrast, US stocks do not look particularly cheap. The region's economic momentum remains strong and offers a solid backdrop for US firms - 75 per cent of the companies reporting third-quarter results so far have beaten market expectations, versus 67 per cent in the previous quarter. However, this seems to have already been discounted. Valuations of 15.2 times 12-month earnings or a price-to-book ratio of 2.4 make US equities the most expensive on our regional scorecard. What is more, liquidity conditions are likely to turn less supportive as the Fed has terminated its asset-buying programme.

Elsewhere, Japanese equities are attractively valued and supported by favourable liquidity conditions after the Bank of Japan 's latest monetary easing. However, this is offset by mixed macroeconomic data, particularly in the manufacturing sector. Also, it is not clear how the BOJ's move might affect government plans for a second sales tax hike. A more expansive BOJ could feasibly give Abe the wiggle room he needs to raise consumption taxes again.

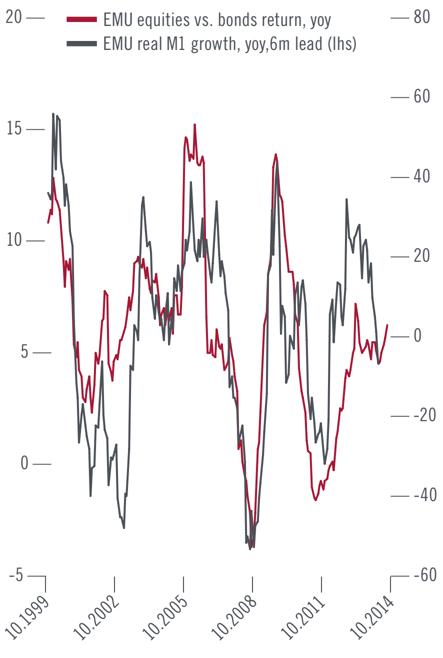
In emerging markets, economic momentum is improving and low valuations are another positive, but countries show divergent performance. A slide in commodity prices will be a drag on the growth of commodity exporters such as Brazil, while economies dominated by manufacturing such as India and Turkey stand to benefit the most from US growth.

When it comes to sectors, our forecast for improving global growth supports a preference for the most cyclically-exposed sectors. Our largest overweight positions are in industrials and energy - the cheapest on our scorecard, which shows the potential for a rebound, particularly now that the price of oil has stabilised around USD80 a barrel. We have brought our long exposure to materials back to neutral to reflect an economic slowdown in China.

Cyclical stocks also look attractive relative to defensive sectors. We would be cautious about utilities and healthcare which look expensive following their recent outperformance.

We close our short position in consumer discretionary stocks, now at benchmark weight. The sector should benefit from rising US consumer spending on the back of improving labour markets and lower energy costs.

EUROPEAN STOCKS COULD BENEFIT FROM IMPROVING MONETARY CONDITIONS



Source: Thomson Reuters Datastream

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Fixed Income

Upgrading local emerging market debt

Local currency emerging market debt is becoming increasingly attractive as valuations for both bonds and currencies and a likely continuation of a benign interest rate environment support high-yielding asset classes.

We acknowledge that emerging growth is slowing, especially in Latin America. The growth differential between developing and advanced economies has narrowed, although it is still positive.

However, given a sharp fall in energy prices, there seems to be a growing divergence in the financial fortunes of many emerging economies. Manufacturing exporters and energy importers such as Turkey, Korea and India are benefiting from the decline in energy costs, while commodity exporters especially those in Latin America are struggling. Manufacturers are also better positioned to benefit from the US economy, which is the sole engine of global growth at the moment.

After losing nearly a fifth of their value in the past three years, emerging market currencies are two standard deviations away from what our models indicate as fair value – the lowest reading ever. This suggests that there is a scope for emerging currencies to rebound in the medium term, which, together with high carry and attractive valuation, makes local debt in developing markets attractive. We are long local currency debt in Brazil and Turkey, while we take tactical long positions in currencies in South Africa, Turkey, Korea and India.

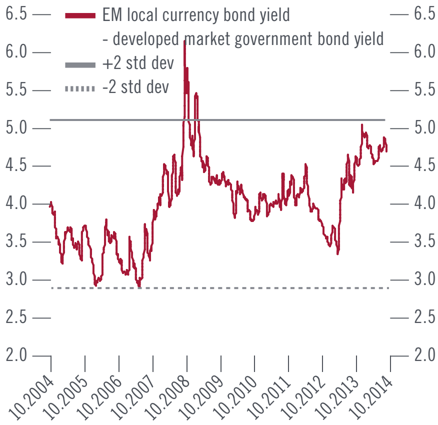
In contrast, the outlook for investment grade debt is not positive. Valuation looks stretched after the yield spread between European high-grade bonds and benchmark euro zone government debt - as measured by the Barclays Euro Aggregate Corporate Index - has fallen to just about 70 basis points. As a result, we downgrade European investment grade bonds to a single underweight. We remain neutral on high-yielding debt, where volatility has risen against the backdrop of deteriorating liquidity; moreover, investors have become cautious about the credit risk within non-investment grade companies.

We keep our underweight positions in government bonds, where yields are already very low, having moved too far in discounting slow growth and weaker inflation relative to our own expectations.

Olivier Ginguené, Chairman
Pictet Asset Management Strategy Unit

Luca Paolini, Chief strategist
Pictet Asset Management

ATTRACTIVE RELATIVE YIELDS FOR EMERGING LOCAL DEBT



Source: Thomson Reuters Datastream

ABOUT THE PSU

The Pictet Asset Management Strategy Unit (PSU) is the investment group responsible for providing asset allocation guidance across stocks, bonds, cash and commodities.

Each month, the PSU sets a broad policy stance based on its analysis of:

- **business cycle:** proprietary leading indicators, inflation
- **liquidity:** monetary policy, credit/money variables
- **valuation:** equity risk premium, yield gap, historical earnings multiples
- **sentiment:** Pictet sentiment index (investors' surveys, tactical indicators)

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