PICTET
1805

	UNDERWEIGHT –		NEUTRAL ○		OVERWEIGHT +		MONTHLY CHANGE Maximum change ◀◀◀◀ ▷▷▷▷
GLOBAL ASSET CLASSES We retain our overweight stance on equities as monetary stimulus should continue to fuel an economic recovery.				Equities			
			Bonds				
		Cash					
				Gold			
			Oil				
			USD				
EQUITY REGIONS AND STYLES Our overweight position in European and Japanese stocks remains in place; both regions stand to benefit from continued central bank support and economic reforms.				Japan			
	US						
				Europe			
			Pacific				
			Emerging				
				Mid & Small Cap			
			Value				
EQUITY SECTORS We continue to prefer cyclical sectors; both information technology and industrials stocks boast attractive valuations while the opposite is true for defensive sectors such as health care and telecoms.			Energy				
			Materials				
				Industrials			
				Consumer Disc			
		Consumer Staples					
		Healthcare					
				Financials			
				IT			
		Telecoms					
		Utilities					
FIXED INCOME EUR high-yield and EM hard currency debt are our favoured asset classes.		EUR Government					
		EUR Investment Grade					
				EUR High Yield			
				EMD Hard (USD)			
			EMD Local				
			EM Corporate				

Central banks to extend stock market rally

Pictet Asset Management Strategy Unit

Monthly euro investor outlook on a 3 month view

Barometer

May 2015

Monthly outlook

Pictet Asset Management
Strategy Unit

Issued 4 May 2015

Global market overview

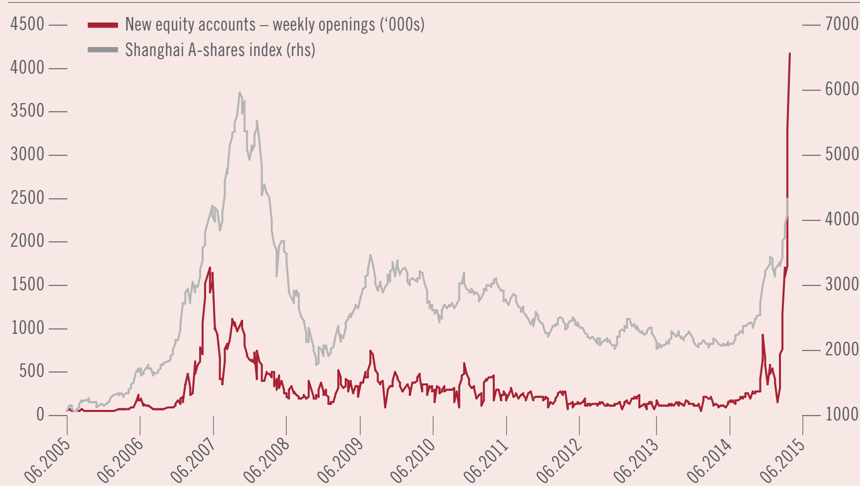
Chinese stocks grab spotlight as equities outpace bonds

Equities outperformed bonds in April as measures by the Chinese authorities to stimulate economic growth and dovish rhetoric from the US Federal Reserve outweighed concerns over weak US data.

China was the best-performing market, rising by more than 15 per cent over the month, bringing its year-to-date gain to some 40 per cent. Stocks rallied strongly after the People's Bank of China lowered banks' mandatory reserve ratios by 100 basis points, the largest cut since 2008 (see chart). The measure came in response to signs that the pace of economic growth was slowing, and raised hopes for further monetary and fiscal stimulus. Weak data from the US – the economy grew just 0.2 per cent in the first three months of 2015 – reinforced expectations that the Fed will hold off from hiking rates until at least the third quarter of this year. As a result, the USD retreated from recent highs, boosting emerging market assets and commodities. Emerging market equities outperformed their developed counterparts, with the MSCI EM Index climbing to its highest level since September 2014, before easing back slightly.

In fixed income, government bond yields spent most of the month edging lower on the back of weak US data and central bank stimulus. But that move abruptly reversed course in the final days of the month as investors appeared to cut positions after an auction of five-year German bonds failed, with the total value of bids for the note falling short of the amount offered. The yield on the 10-year Bund subsequently snapped higher after hitting an all-time low of 0.05 per cent. US Treasuries also ended lower following a four-day losing streak. Elsewhere, the retreat of the USD had a positive effect on emerging fixed income markets and currencies, helping local currency emerging market sovereign debt outpace most other bonds. High-yield bonds also ended the month higher. Brent crude oil prices reached their best levels since September on signs that US oil inventories may be peaking. Soaring oil prices lifted energy and material stocks, the best-performing equity sectors.

RETAIL INVESTORS FUEL HUGE RALLY IN CHINESE STOCKS



Source: Thomson Reuters Datastream

Asset allocation

Equities remain an attractive proposition

The outlook for global equities is encouraging as central banks continue to provide considerable amounts of monetary stimulus and the world's economic prospects remain positive on the whole. Even though a number of stock indices have hit record levels in recent weeks, equities are not expensive compared to bonds. With this in mind, we retain our overweight stance on stocks.

We also remain neutral on bonds as the European Central Bank's quantitative easing programme and improvements in economic growth should exert opposing forces on government debt, keeping yields in a narrow range. Our stance on the USD is unchanged at neutral.

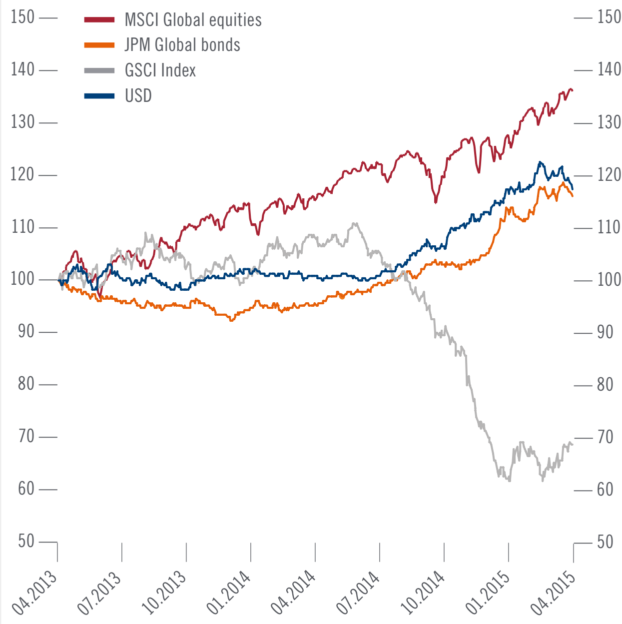
One potential risk to financial markets is the outcome to Greece's increasingly fraught negotiations with its creditors. The probability of the country's exit from the euro zone has risen in recent weeks but we continue to believe that the parties will eventually come to an agreement. Should talks fail and push Greece futher towards an exit from the euro zone, we believe the region is better equipped to deal with such an eventuality even if market stress is inevitable in the short term.

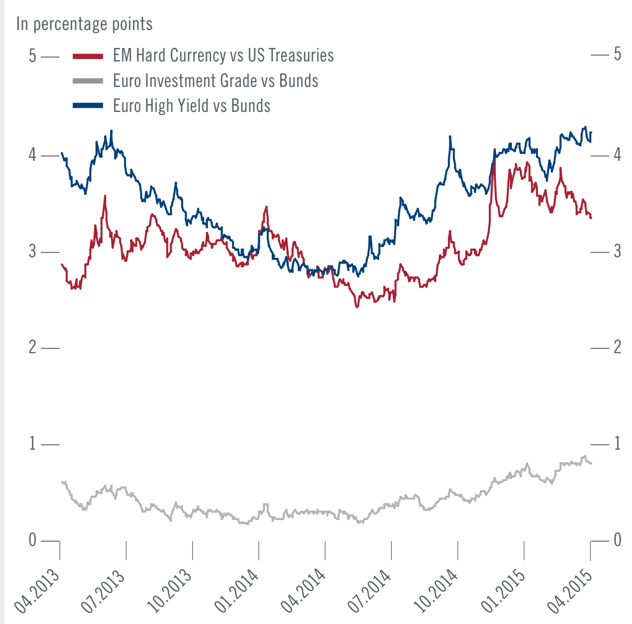
Our **business cycle** indicators leave us optimistic on the outlook for growth. The European economy remains firmly in expansion mode, with banks having increased lending for the third month in a row, exports enjoying a boost from a weak EUR and consumer and business sentiment at healthy levels. Another plus is that retail sales are rising at just over 2 per cent year-on-year among the countries in the euro zone's periphery – the highest rate in almost five years.

Conditions in the US are less buoyant. Even though low oil prices can normally be expected to boost US consumer spending, retail sales have remained sluggish. What is more, capital expenditure and net exports are weak – thanks, respectively, to low oil

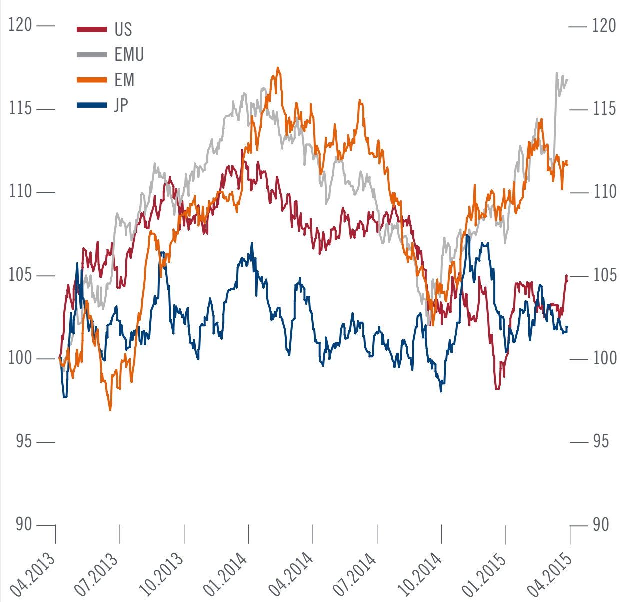
Source: Pictet Asset Management, Thomson Reuters Datastream / JPM and BoA Merrill Lynch

MAJOR ASSET CLASSES





EQUITY SECTOR ROTATION AND CURRENCY PERFORMANCE



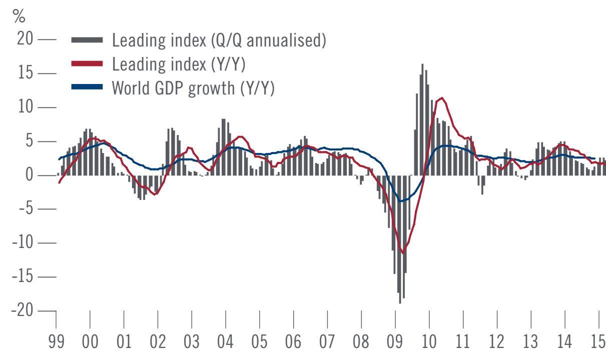
Source: Pictet Asset Management, Thomson Reuters Datastream

RISK BIAS INDICATORS

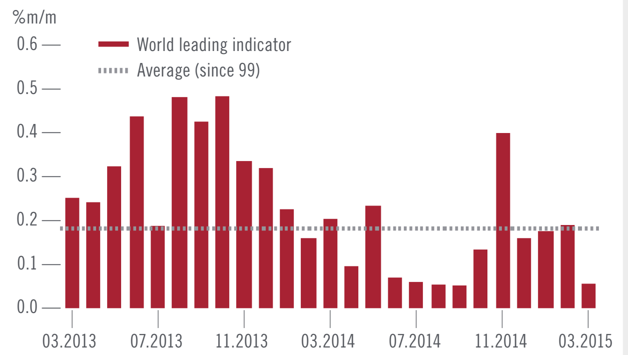
MONTHLY CHANGE Maximum change ◀◀◀◀	▷▷▷▷	RISK-OFF –		NEUTRAL ○		RISK-ON +	
					Business cycle		
					Liquidity		
	▷			Valuation			
				Sentiment			
					PAM strategy		

BUSINESS CYCLE: WORLD ECONOMIC GROWTH REMAINS SUBDUED

WORLD LEADING ACTIVITY INDEX & REAL GDP GROWTH

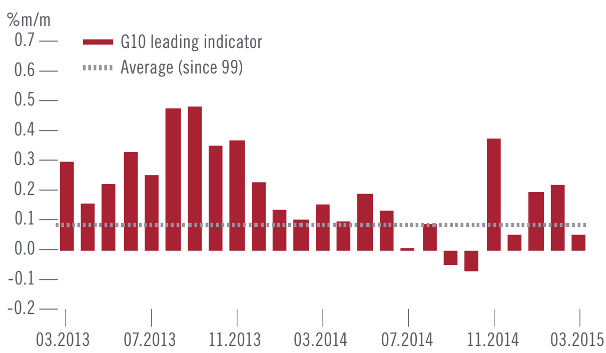


WORLD LEADING ACTIVITY SEQUENTIAL GROWTH (M/M)

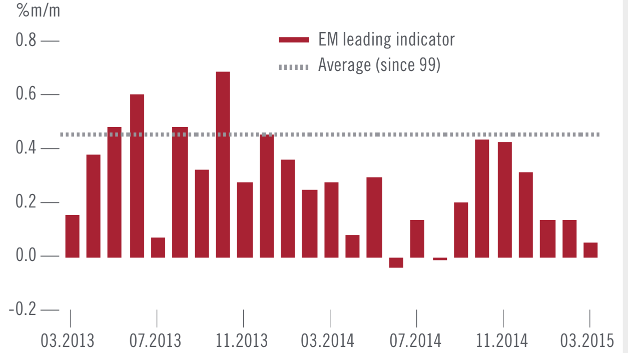


ECONOMIC MOMENTUM SLOWS DOWN ACROSS THE WORLD BUT STILL POSITIVE

G10 LEADING INDICATOR M/M GROWTH



EM LEADING INDICATOR M/M GROWTH



Source: Pictet Asset Management, Thomson Reuters Datastream

VALUATION: EQUITY MARKETS AND SECTORS

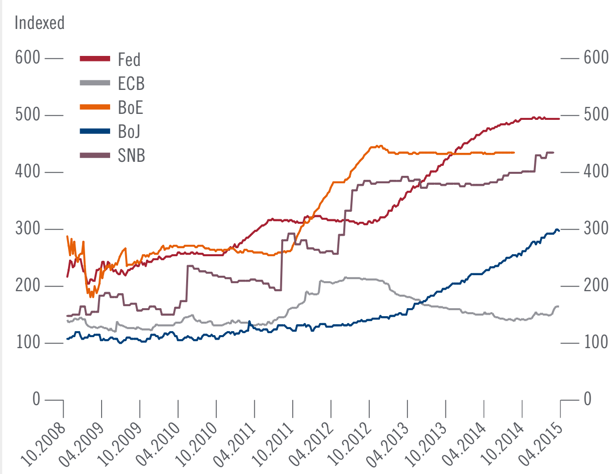
COUNTRIES AND SECTORS

MSCI REGIONS	EPS GROWTH 2015	EPS GROWTH 2016	SALES GROWTH 2015	SALES GROWTH 2016	PE 2015	PE 2016	PB 2015E	P/SALES 2015E	DY 2015E
US	1%	13%	-2%	6%	18.1	16.0	2.7	1.9	2.0%
Europe	3%	13%	-1%	5%	17.4	15.4	1.9	1.3	3.2%
EMU	16%	14%	3%	5%	16.8	14.8	1.6	1.1	3.0%
Switzerland	-5%	9%	-1%	4%	18.6	17.0	2.6	2.4	3.0%
UK	-11%	14%	-8%	7%	16.6	14.6	1.9	1.2	4.0%
Japan	15%	9%	2%	3%	15.9	14.6	1.5	0.8	1.8%
EM	8%	13%	2%	8%	13.2	11.8	1.5	0.8	2.6%
NJA	11%	10%	2%	8%	13.5	12.3	1.6	0.8	2.5%
Global	**3%**	**13%**	**0%**	**6%**	**17.3**	**15.4**	**2.1**	**1.4**	**2.4%**

MSCI GLOBAL SECTORS	EPS GROWTH 2015	EPS GROWTH 2016	SALES GROWTH 2015	SALES GROWTH 2016	PE 2015	PE 2016	PB 2015E	P/SALES 2015E	DY 2015E
Energy	-46%	35%	-22%	13%	23.7	17.5	1.4	0.9	3.3%
Materials	-4%	19%	-2%	4%	18.0	15.2	1.9	1.1	2.6%
Industrials	10%	11%	2%	4%	17.4	15.6	2.5	1.0	2.2%
Consumer Discretionary	15%	14%	6%	6%	18.1	15.9	2.9	1.2	1.8%
Consumer Staples	2%	9%	4%	5%	21.2	19.4	3.7	1.3	2.6%
Health care	7%	13%	6%	6%	19.9	17.6	3.9	2.2	1.8%
Financials	12%	10%	5%	6%	13.5	12.3	1.3	1.9	2.9%
IT	9%	11%	7%	5%	17.3	15.5	3.3	2.3	1.5%
Telecoms	8%	9%	3%	2%	17.4	15.9	2.4	1.4	3.8%
Utilities	7%	-1%	0%	2%	15.4	15.6	1.5	1.0	3.7%

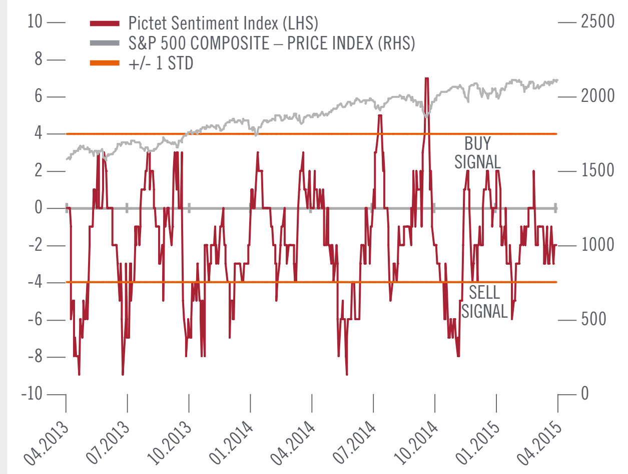
LIQUIDITY: FED ENDS QE BUT MONETARY STIMULUS CONTINUES ELSEWHERE

SIZE OF CENTRAL BANKS' BALANCE SHEETS



SENTIMENT INDICATOR SHIFTS TO NEUTRAL

PICTET SENTIMENT CYCLE INDEX



prices and a strong USD. We estimate that the annualised 50 per cent drop in oil and mining capital expenditure reduced GDP growth by 0.4 percentage points in the first quarter of this year.

This is certain to weigh on the Fed, lowering the probability of a summer interest rate hike.

Looking further ahead, we are more encouraged – not only because bank lending continues apace but also because the labour market remains resilient.

Japan's recovery is sluggish despite the Bank of Japan's monetary stimulus efforts. Manufacturing surveys point to a decline in industrial output while consumer spending continues to undershoot economists' forecasts. Should this situation endure, the BoJ can be expected to step up the pace of bond purchases.

China's economic momentum continued to deteriorate last month, with year-on-year growth of 7 per cent the lowest reading since 2009. Both consumption and net exports showed signs of weakness.

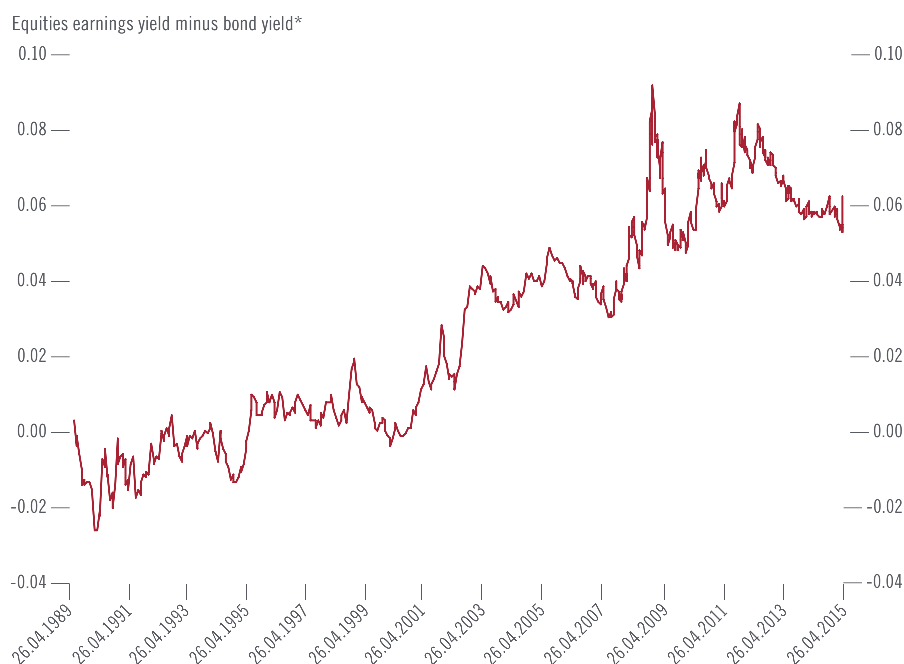
Nevertheless, with Chinese authorities keen to underpin growth – we expect the central bank to ease monetary policy further in the months ahead – the economy should soon begin to stabilise. Tentative signs of a recovery in the housing market reinforce our view.

Our **liquidity** readings suggest conditions are positive for riskier asset classes. Bank lending is picking up smartly in the euro zone and US.

US banks' loan losses have fallen to a record low – to just 0.2 per cent on industrial and commercial loans – as have loan-to-deposit ratios, suggesting credit expansion should continue.

Meanwhile, in the euro zone, bank loan surveys indicate demand for bank loans is rising.

Elsewhere, China continues to boost liquidity through various measures.



* Equity yield of MSCI World Index, bond yield of Citigroup World Bond Index

Source: Thomson Reuters Datastream

Valuations for riskier asset classes have deteriorated over the past few weeks.

Still, relative to bonds, equities look good value – stocks' earnings yields are still comfortably above bond yields (see chart). Our valuation model also shows that stocks' equity risk premium – the extra compensation investors can expect for taking on equity risk – is considerably above the long-term average.

US earnings figures show that 70 per cent of companies have reported forecast-beating profits. (That said, the bar is lower than it has been for some time: consensus forecasts are for profits to grow by just 1 per cent in 2015).

Our gauge of market **sentiment** remains in neutral territory.

Although stocks have rallied smartly in recent weeks, investor positioning does not suggest excessive bullishness. Indeed, hedge funds have been paring back their equity exposure over the past month or so in favour of bonds.

Meanwhile, the cost of insuring against market falls, as measured by levels of implied volatility, has continued to rise from the lows hit in 2014 and is now in line with the long-term average.

Equity region and sector allocation

Preference for Europe and Japan over US

In our regional equity allocation, we keep our preference for Europe and Japan, where we see stronger earnings momentum and more favourable liquidity conditions than in the US.

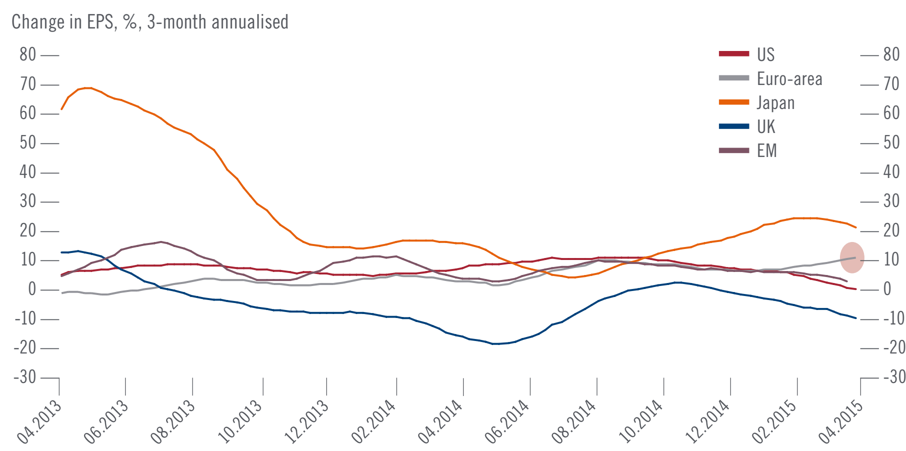
Economic activity is brisk in Europe and this bodes well for corporate earnings. Indicators have improved across the board in the past month; measures of household consumption, business investment and exports have all picked up. But perhaps the most encouraging development is fresh evidence that the ECB's efforts to ease the region's three-year credit squeeze, including the decision to launch a EUR60bn-a-month bond purchase programme in March, seem to finally be paying off. Latest data for the M3 measure of money in circulation – the broadest indicator which includes deposits and short-term debt - showed that money supply growth rose above the central bank's target rate for the first time since 2009, while lending to businesses was positive for the first time in three years. The massive easing programme appears to have removed one of the last obstacles to an economic recovery in the euro zone.

That is not to say the risks hanging over the region have dissipated completely. Uncertainty remains about the fate of Greece while the conflict in Ukraine is also unresolved.

However, the region's earnings picture is the most compelling of all the major markets, in our view. While European stocks may no longer be cheap after their recent rally, at a price-earnings ratio of 16.7 times next year's expected earnings, the single currency bloc is in fact the only region where earnings growth is accelerating. Our figures show that forecasts for European company profits for the next 12 months (ex energy) have risen some 11 per cent on an annualised basis (see chart). What is more, with euro zone company earnings still some 35 per cent below their previous peak, we see plenty of scope for a further improvement in profitability, particularly as a weak EUR should continue to support exports.

The overall earnings outlook in Europe contrasts with that of the US, where companies are feeling the pinch of a strengthening USD on their exports. Domestic economic activity has also slowed amid the harsh winter.

EURO ZONE PROFIT RECOVERY CONTINUES



Source: Thomson Reuters Datastream, Pictet Asset Management

US company valuations continue to look expensive when compared with other developed equity markets, and all the more so considering the Fed is preparing to tighten liquidity conditions.

Japanese stocks are benefiting from conditions similar to those prevailing in Europe, in the shape of an abundant central bank stimulus and a weaker currency. Even though earnings growth has decelerated somewhat, the picture is healthier than in other parts of the world. The Japanese market is also underpinned by favourable structural trends. For one thing, efforts to improve corporate governance appear to be bearing fruit. Companies are starting to improve communication with shareholders and are using their cash piles to pay dividends and buy back stock. The latest example of this trend is Japanese robot maker Fanuc, which said this month it would double its dividend and pay 60 per cent of its net profits to shareholders.

Emerging equities rallied in April, helped by a fall in the USD, but with corporate profits showing no sign of recovery, stock valuation multiples do not appear to be especially attractive at this juncture. Until we see evidence of a recovery in company earnings, we will not increase our exposure to the asset class.

When it comes to sectors, we maintain a cyclical tilt in our portfolio, with a preference for sectors that stand to benefit from any increase in capital spending. This is expressed through an overweight in industrials, a sector that also exhibits attractive valuations. Technology is another attractively-valued sector that should draw support from increased business investment. We also like banks, which have repaired their balance sheets and are poised to capitalise on the upturn in the credit cycle. Defensive sectors such as telecom and healthcare look expensive.

PICTET
1805

Pictet Asset Management Limited
Moor House
120 London Wall
London EC2Y 5ET

www.pictet.com
www.pictetfunds.com

Fixed Income

EM sovereigns remain attractive in a yield-starved world

With yields on benchmark government bonds at unsustainably low levels, the continued monetary stimulus provided by central banks worldwide should disproportionately benefit areas of the fixed income market where valuations are either close to or below fair value.

This is why we continue to favour USD denominated emerging market debt and European high-yield bonds. Our models show that valuations for USD emerging market debt are clearly at odds with sovereign borrowers' credit credentials. With the exception of Ukraine and Venezuela, there is nothing to suggest sovereign borrowers are finding it more difficult to service their external debt even if emerging market growth remains sluggish.

By our reckoning, the market's aggregate yield spread is one standard deviation higher than what we consider to be fair value. What is more, supply and demand dynamics should also support the asset class. The data we monitor show that USD emerging market debt has attracted some 80 per cent of the investments that have flowed into emerging market fixed income so far in 2015. Also, the volume of sovereign bond issuance in emerging markets has been eclipsed by the amount of cash investors have received from bond redemptions and coupon payments.

We remain neutral local currency emerging debt. Although we expect the asset class to draw support from an easing of monetary policy in many parts of the emerging world, the outlook for developing world currencies is not yet clear. Lower interest rates, weak demand for commodities and a slower-growing China will weigh on emerging market growth for some time, placing downward pressure on many currencies. We have established underweight positions in the RMB, the COP and the HUF.

Elsewhere, we continue to hold an overweight position in European high-yield bonds. To us, the asset class is the standout beneficiary of the ECB's QE policy. Moreover, with economic conditions in the region improving, speculative-grade companies should experience little difficulty in servicing their debts. Default rates can therefore be expected to remain well below the long-term average. Against this backdrop, the yield spread such bonds offer over Bunds – 150 basis points, above the levels seen in the Summer of 2014 – looks attractive.

Olivier Ginguené, Chairman
Pictet Asset Management Strategy Unit

Luca Paolini, Chief strategist
Pictet Asset Management

BUND YIELDS HOVER CLOSE TO HISTORICALLY LOW LEVELS

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)

This material is for distribution to professional investors only. However it is not intended for distribution to any person or entity who is a citizen or resident of any locality, state, country or other jurisdiction where such distribution, publication, or use would be contrary to law or regulation.

Information used in the preparation of this document is based upon sources believed to be reliable, but no representation or warranty is given as to the accuracy or completeness of those sources. Any opinion, estimate or forecast may be changed at any time without prior warning. Investors should read the prospectus or offering memorandum before investing in any Pictet managed funds. Tax treatment depends on the individual circumstances of each investor and may be subject to change in the future. Past performance is not a guide to future performance. The value of investments and the income from them can fall as well as rise and is not guaranteed. You may not get back the amount originally invested.

This document has been issued in Switzerland by Pictet Asset Management SA and in the rest of the world by Pictet Asset Management Limited, which is authorised and regulated by the Financial Conduct Authority, and may not be reproduced or distributed, either in part or in full, without their prior authorisation.

For UK investors, the Pictet and Pictet Total Return umbrellas are domiciled in Luxembourg and are recognised collective investment schemes under section 264 of the Financial Services and Markets Act 2000. Swiss Pictet funds are only registered for distribution in Switzerland under the Swiss Fund Act, they are categorised in the United Kingdom as unregulated collective investment schemes. The Pictet group manages hedge funds, funds of hedge funds and funds of private equity funds which are not registered for public distribution within the European Union and are categorised in the United Kingdom as unregulated collective investment schemes.

For Australian investors, Pictet Asset Management Limited (ARBN 121 228 957) is exempt from the requirement to hold an Australian financial services license, under the Corporations Act 2001.

For US investors, Shares sold in the United States or to US Persons will only be sold in private placements to accredited investors pursuant to exemptions from SEC registration under the Section 4(2) and Regulation D private placement exemptions under the 1933 Act and qualified clients as defined under the 1940 Act. The Shares of the Pictet funds have not been registered under the 1933 Act and may not, except in transactions which do not violate United States securities laws, be directly or indirectly offered or sold in the United States or to any US Person. The Management Fund Companies of the Pictet Group will not be registered under the 1940 Act.

© Copyright 2015 Pictet - Issued in May 2015.