4th January 2019

2019 Outlook

2018 has ended with a very volatile quarter, with most risk assets coming under significant pressure. The sell-off appears to be triggered on fears of a recession, potential trade wars, geo-political threats, or an overly hawkish Fed. In our opinion there is little evidence of a looming recession, we expect the potential for trade wars to diminish in Q1'19 , but not disappear. We expect the Fed will meet its forecasts, and hike two more times in 2019, while the ECB begins a slow hiking process of their own in Q4'19. These hikes will be warranted, based on continued economic expansion, and economies moving well past full employment.

While we do not have a crystal ball, our economic outlook is more upbeat than the prevailing sentiment at year end, but our forecasts for some asset classes are not as rosy as consensus.

Global equities are approximately fair value. Countries outside of the US have been sold off much more aggressively, and should outperform regardless of the overall direction of markets.

In the final month of 2018 Fed fund futures have fallen to levels pricing in no hikes from the Fed in 2019. Inflationary pressures will grow, and market expectations will align with the Fed forecasts as the year progresses.

Global Economy p.2

Growing, but slowing.

Central Banks p.4

The Fed will hike interest rates twice, surprising markets which are pricing in no hikes in 2019 and a cut in 2020. The Eurozone economy will grow enough to allow a Q4 hike from the ECB.

Politics p.7

A Trump administration facing gridlock domestically, may focus on foreign policy and unhelpful tweets. UK Brexit path should become more clear in January 2019…

Equities p.10

Following the Q4 sell-off we are becoming moderately more positive global equities outside of the US. Cyclical risks and value will outperform growth.

Fixed Income p.16

The bond bear market will resume. Yields will move higher as the economy avoids a recession, tight conditions keep inflationary pressures building, and central banks withdraw liquidity. Spread products will outperform government bonds.

FX p.17

The US dollar will weaken over the year, as market focuses on the twin deficits, increased political risks.

Commodities p.18

Gold prices should be supported by political risks, large debt levels, and a potential diversification of reserves.

Global economic dashboard

Indicator	Derivative 1st	Derivative 2nd	Interpretation & outlook
Growth			
Global leading economic indicator	0	–	Slightly more positive than negative, but slowing throughout Q4
ZEW/IFO	–	–	Moved lower and negative throughout 2018 in US and Germany
US ISM manufacturing new orders	+	–	Significantly expansionary, but off of early year highs
Consumer confidence	+	–	Very strong but showing signs of peaking in Q4
Business confidence	+	0	Positive
G7 employment	+	0	Positive and no signs of slowing yet
Global trade volume	0	–	Sluggish and weakening in Q4
Oil prices	–	0	Lower oil prices may indicate slowing demand, but will be boost for consumers
Policy			
Real policy rate	+	–	Negative real interest rates reflationary. US tightening, and ECB ending QE
Nominal GDP-bond yield gap	+	0	Positive gap is reflationary
G7 credit growth	+	0	Positive and stable
Financial stress	+	–	Low, loans showing warning signs
Fiscal thrust	0	+	Fiscal drag disappeared, with US stimulus, while Europe may be moving away from austerity
Inflation			
Core CPI	0	+	Rising from low levels. Deflation risks have dissipated
Wage growth	+	0	Finally turned positive in US

Source: Bloomberg, PIM

Global Economy — Growing but slowing

Our global economic dashboard shows a global economy which is expanding, but past peak growth. Policy rates remain supportive for growth, but will likely continue the slow path towards neutral. Most leading indicators continue to point to further expansion, but have steadily fallen below Q4'18 levels. In the US growth indicators have been softer in recent months, but the current high personal saving rate, income growth running higher than inflation, lower oil prices, and a Fed which has become more dovish should provide enough fuel to keep the US economy leading the developed world in 2019. We expect modest cooling in the US economy in 2019, with annual growth of 2.4%. Still above long term potential but significantly below >3% rate in 2018. China will continue to rebalancing it economy, and is likely to provide enough fiscal stimulus to meet its targets, barring an escalation of a trade war with the US. Emerging markets PMI readings have also been strengthening in recent months. Expectation for Europe are now so depressed, we think there is scope for the Eurozone economy to surprise to the upside, barring a hard Brexit scenario. German auto is showing signs of growth again, and Italy seems to have agreed a budget which will be agreed by the European Commission.

Barring trade wars or a hard Brexit we expect the global economy to positively surprise in 2019

From synchronous growth to significant questions

The Global synchronised expansion, where all major economies showed accelerating growth, ended in Q1 last year. Our economic research consultants, MRB have characterised the economy as a three legged stool. In 2018 the US economy fuelled by a late cycle stimulus continued with robust growth, while Europe and China growth began to cool. As we enter 2019 investors seem concerned that as the US cools, the global economy will fall into recession. We expect the global economy will see stabilisation from China and Europe as the US economy decelerates, but still deliver strong growth. The Eurozone economy is set to positively surprise in 2019, as the lagged impacts of a significantly weaker euro and much lower oil prices will give the economy a needed boost. The ECB policy remains very accommodative, and we expect this to continue throughout 2019.

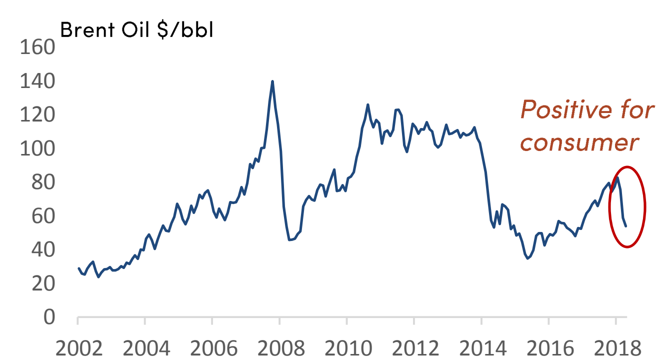
Overall the global economy will slow moderately from about 3.7-3.8% in 2018 to about 3.4% in 2019. Consensus has completely ruled out inflation moving higher in 2019, but our forecasts show growth significantly above the potential in the developed world, so we expect labour market tightening, higher wages, and gradually rising inflation.

World GDP growth

	2017	2018e	2019e
World	3.8	3.8	3.4
Developed	2.4	2.3	2.1
Emerging	5.0	5.1	4.7
US	2.2	2.9	2.4
Euro	2.5	1.9	1.7
China	6.9	6.6	6.0
India	6.2	7.5	7.3

Source: Bloomberg OECD, PIM

The global economy will see some stabilisation from China and Europe as the US economy decelerates



Source: Bloomberg

Central Banks

The Fed keeps hiking

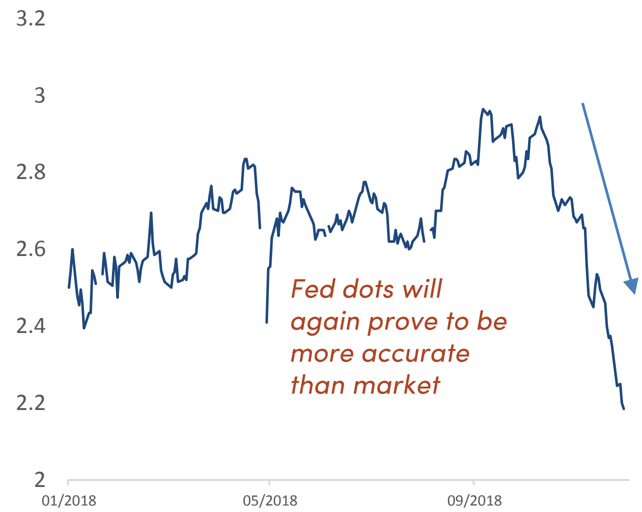
Major developed market central banks will continue to gradually unwind monetary stimulus through the coming year. Investors want dovish central banks, that allow them to buy every dip and make carry trade profitable, but 2019 will make investors realise that central bank put options are far out of the money. As equities have sold off in Q4'18 there has been a chorus of shouts for easier policy. Many are claiming the Fed is making a policy mistake by continuing to hike. Inflation expectations also fell dramatically in December. We think this is driven by poor liquidity, in a rush to bonds, rather than being driven by changing economic expectations.

Fed funds futures expectations have also fallen and are now discounting less than one rate hike in 2019. We expect the Fed has its eyes on the real economy, and will not be swayed by nervous investors. Falling equity prices, and no support from central banks will likely be the biggest shock of 2019 for many investors.

We expect the Fed to deliver the two hikes it is indicating. While we anticipate US growth to slow, it will but remain well above the economy's potential rate of about 1.9%. We expect inflation to rise modestly, as the economy continues to add workers, and grow wages. Should growth slow more markedly than our forecasts the Fed will pause, but it will be in response to economic data, not a reaction to risk asset prices.

In 2019 every FOMC meeting will be followed by a press conference. This will give the central bank more flexibility in changing the policy path if data warrants. The Fed has become more dovish as 2018 progressed, but should inflation firm we think the Fed will focus on economic data, rather than market weakness to drive its decision function.

January 2021 Fed futures are far too low



Source: Bloomberg

Falling equity prices, lack of support from central banks may be the biggest shock of 2019 for most investors.

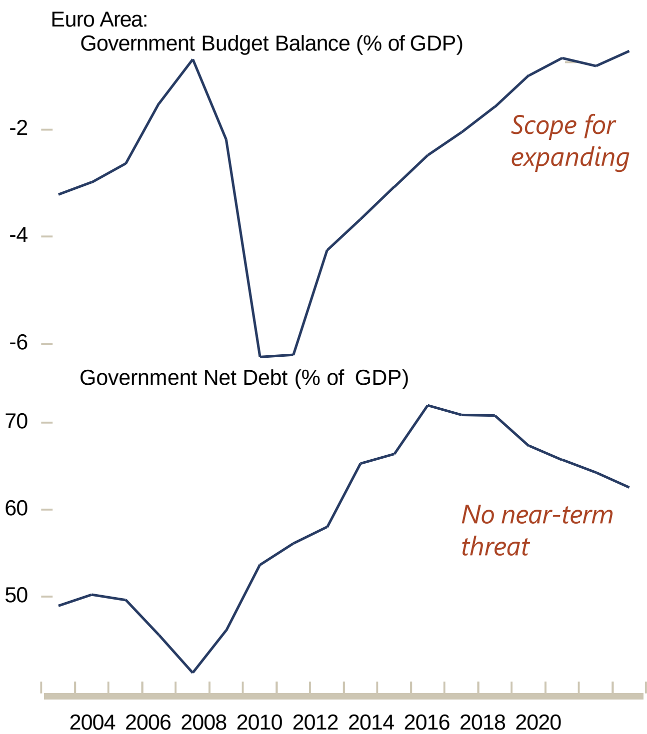
Inflation expectations fell dramatically

Source: Markit Bloomberg

Other major central banks will be on the side-lines for most of 2019. The ECB ended QE in 2018, and it will begin normalization as it hopes to see evidence that the last year's soft-patch was temporary, and firmer growth will be delivered in 2019. We expect a rate hike in Q4'19, as the Eurozone sees unexpected growth. Leading indicators weakened throughout 2018, but we expect to see some improvement now that some political risks have dissipated. The Italian budget has been agreed, trade tensions between the US and Europe seem to have been pushed into the background for now. One area which looks positive, is the employment outlook. Eurozone businesses are more confident in their hiring plans than any time in the past 10 years. One other point to note, is ECB President Draghi is being replaced in October. We expect a clear outline of the monetary unwind will be given before his departure. The debt dynamics of the Eurozone are also much more positive than they have been in the past ten years. Net debt has been brought down , and there are some positives coming out of the turmoil in France and Italy, which may be fiscal stimulus.

The PBOC will continue to facilitate economic growth, but will likely want to keep its currency loosely linked to the price of the US dollar. Should the USD weaken slightly in 2019, as we expect, the PBOC will have no problems with this strategy, but should the USD strengthen against its trade weighted basket, the PBOC may need to let the renmimbi fall to keep competitive with the rest of Asia, and to support the manufacturing sector.

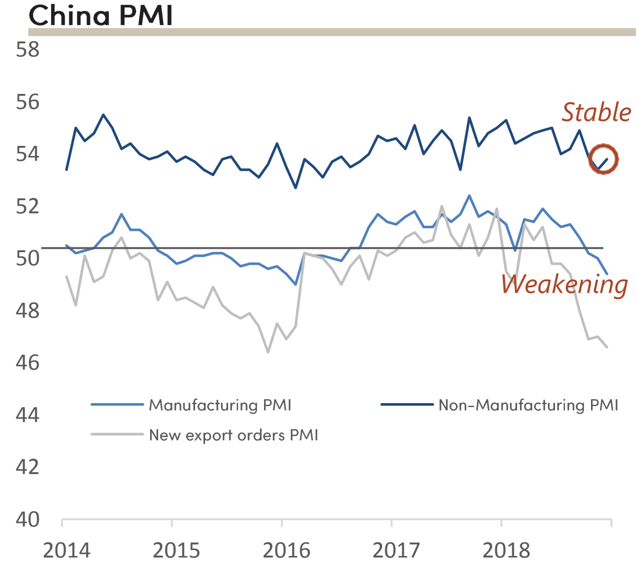
The Euro Area can ease fiscal policy



Source: Bloomberg MRB OECD

China's manufacturing has fallen into contraction, but the more important services sector remains strong

China PMI



Source: Markit Bloomberg, MRB

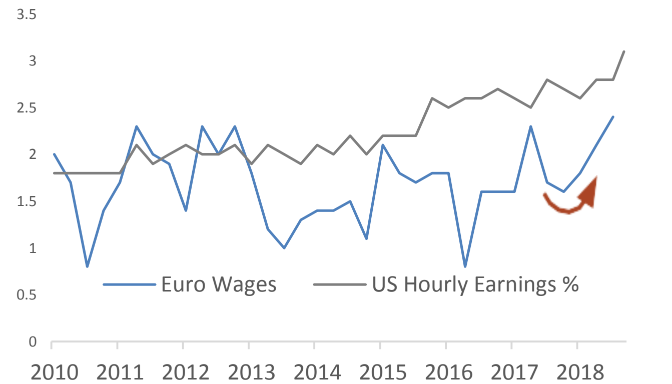
Inflation Sticky in the US

2019 will see a range of late cycle economic pressures. Some economies still have significant slack, and other regions are growing past capacity. On average, core inflation in OECD economies will remain low and stable.

Lower oil prices will be a drag on headline inflation, around the world. The US economy is the one economy with no slack at all. The unemployment rate is at 50 year lows, wages are rising, and small business surveys show that filling vacancies with qualified people is the biggest issue they face as we enter 2019. A US consumer, which is seeing wages grow faster than inflation, high consumer confidence and benefitting with a stimulus in the form of lower oil prices is a very powerful driver of continued expansion, even as the fiscal benefit from tax cuts fade.

The UK is the other country which may see some inflationary pressures as well. As risks of a hard Brexit increase, lower sterling and stagflationary consequences of moving away from free trade may see higher prices with a weak economic backdrop.

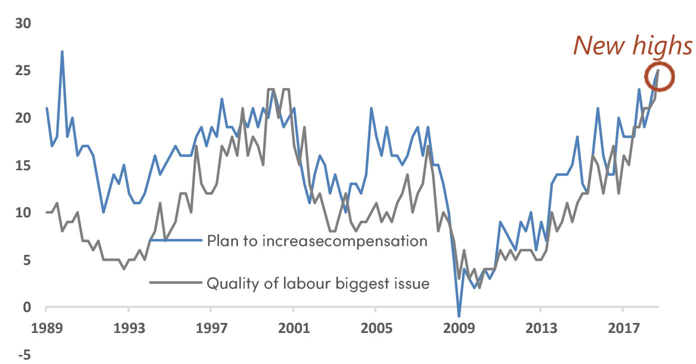
Wage pressures are picking up



Source: Goldman Sachs, Haver

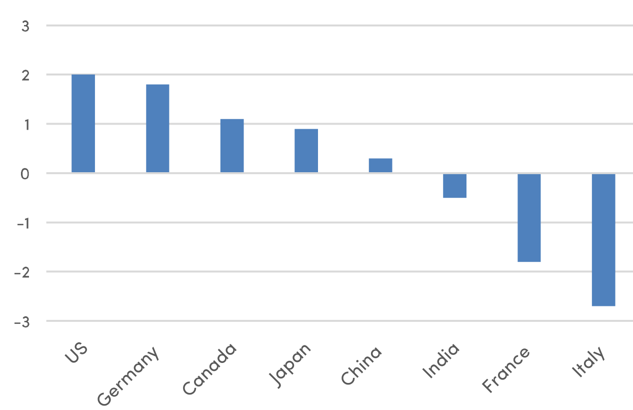
Higher wages, and strong consumer confidence will drive growth

NFIB surveys show tight US labour market



Source: MRB, NFIB, Bloomberg

Output Gap estimates



Source: IMF

Global Politics

Impossible to ignore

Politics is always a potential wild card to the direction of both capital markets and the global economy. 2018 saw a massive late cycle stimulus in the US in the from of tax cuts, which boosted the economy and stock markets. It also saw the continued rise of populism as a successful election strategy around the world. The repercussions were felt in increasing global trade tensions, protectionist policies.

Positive surprises to some of the specific risks are likely, but big picture issues around populism, and global alliances may worsen.

The main geo-political risks for 2019 are:

US / China trade: Should the threatened US tariffs materialise, we would need to lower our economic outlook, and the consequences would be stagflationary globally. We expect some positive developments in the first quarter of 2019, but find an all encompassing deal, a very low probability A truce is the most likely outcome. This should remove a significant overhang on the economic outlook for the world, but for China in particular. Flare ups throughout 2019 are likely, but given both sides desire for trade we do not expect a deterioration.

US Mueller / Gridlock: A White house which is facing gridlock with a democratic controlled house, and headline grabbing risks coming from the end of the Mueller investigation will be a distraction at a minimum, and may force Trump into a very defensive mode. The potential for impeachment is low, but it will be a risk which overhangs US politics throughout 2019. Distraction could see deregulation and pro-growth policies that the market responds to favourably forgotten as other matters are deemed to have greater priority. There is also a risk Trump's focus moves to foreign policy where he will not need Congress approval, or attacking the institutions which he sees as treating him unfairly.

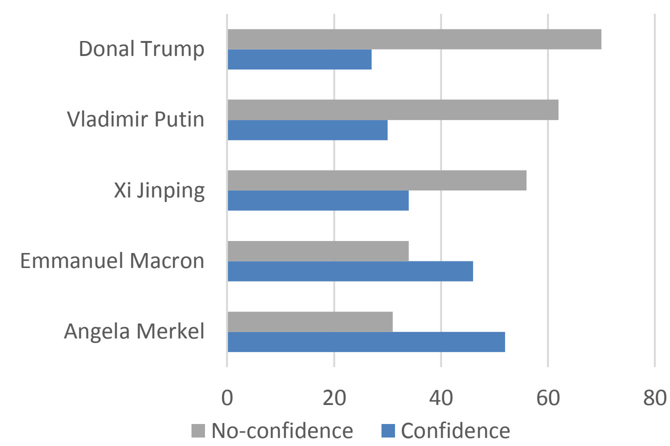
We expect the US and China to reach a trade truce even if underlying strategic political tensions persist

Brexit : The majority of British MPs and the public do not want a 'No Deal' Brexit, but it is difficult to get any agreement on an alternative. A no deal Brexit will push the UK into a recession, and be a significant negative for all of Europe. It is almost impossible to predict what will happen next, but we continue to expect something which avoids a crashing out scenario. Parliamentary approval of Prime Minister May's proposal, extending article 50 with a view to a new referendum, a general election with Brexit as the centrepiece are all possibilities. The chaos the UK has faced around this issue may drag on for years to come, as the only thing there is a consensus on, is there are not any great solutions to this issue.

EU: Italy and France have populist led discord. Risks around continuity of leadership of the CDU party in Germany have now passed, but the post Merkel era nears. Most of what ails the Eurozone comes from the anaemic growth it has delivered. Should growth improve, we expect political risks will quiet, but another year of disappointing growth or recession and these risks will only intensify.

Global leadership: As the US exits its role of influencing global hot spots, a vacuum is created. Russia and China seem most willing to fill the void, but this may not always be achieved with market friendly results. The world on average now has less confidence in Donald Trump than any other major leader. We expect volatility from the US White House will lead to a continued diversification of global reserves away form the US dollar.

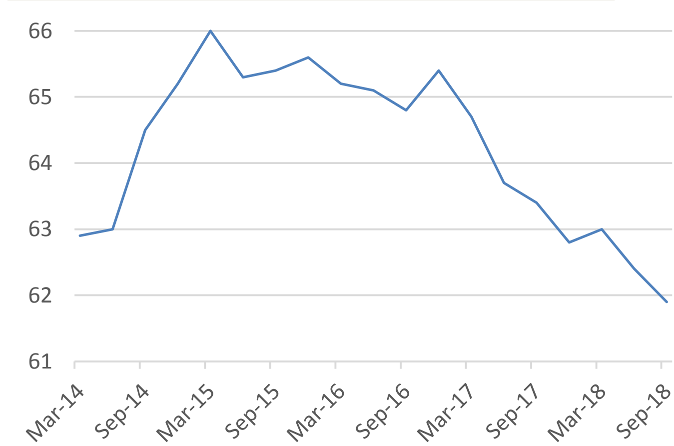
Pew Research global survey



Source: Pew Research Centre. Medians based on 25 countries

We expect to see a continued diversification of reserves away from the US dollar

USD percentage of allocated reserves



Source: IMF

Long term outlook

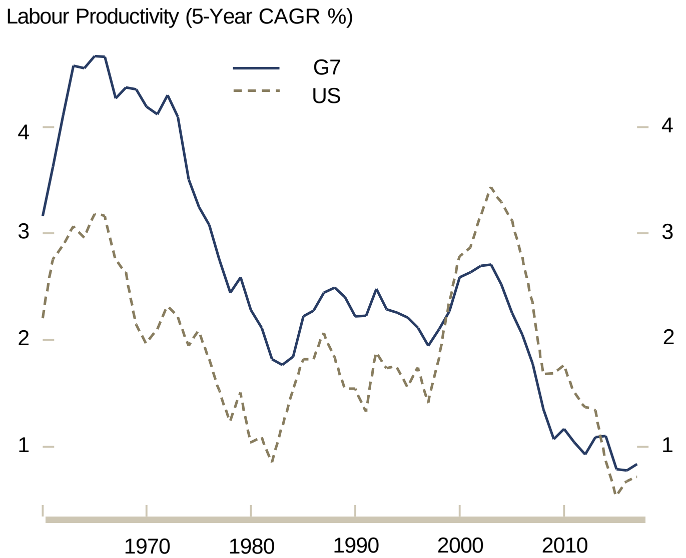
	Economic Forecasts (2019-2026)			Historical 2008-2018
Country/Region	Real GDP (% CAGR)	Population (% CAGR)	GDP Deflator (% CAGR)	Real GDP (% CAGR)
Brazil	3.0	0.6	3.7	1.5
China	4.4	0.2	2.0	8.2
Euro Area	1.2	0.1	1.8	0.6
India	6.9	1.0	3.9	7.0
Japan	0.4	-0.4	1.0	0.5
Switzerland	1.3	0.6	1.3	1.4
UK	1.4	0.5	2.0	1.1
US	1.9	0.7	2.0	1.5
Developed Markets	1.4	0.3	1.8	1.1
Emerging Markets	4.1	1.1	3.5	5.1
Global	2.5	1.0	2.6	2.6

Sources: IMF World Economic Outlook, MRB and Plurimi calculations. Population forecasts from UN, Compound annual growth rate

Our risk premia analysis utilises a long-term economic outlook of 2.5% per annum. This is in line with the previous 10 years. Growth will continue to be led by the emerging market economies, while developed market economies improve from the previous decade, but lag emerging markets.

The potential for economic growth has been constrained by very low labour productivity this decade. Our base case assumes continued muted improvements, but this could be an area which unlocks higher growth potential in the developed economies.

Productivity gains have constrained GDP growth

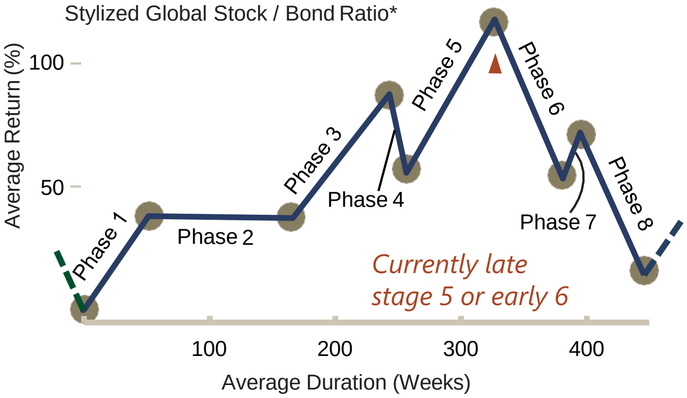


Source: US Conference Board, MRB

Asset Allocation

Late in the cycle, but too late?

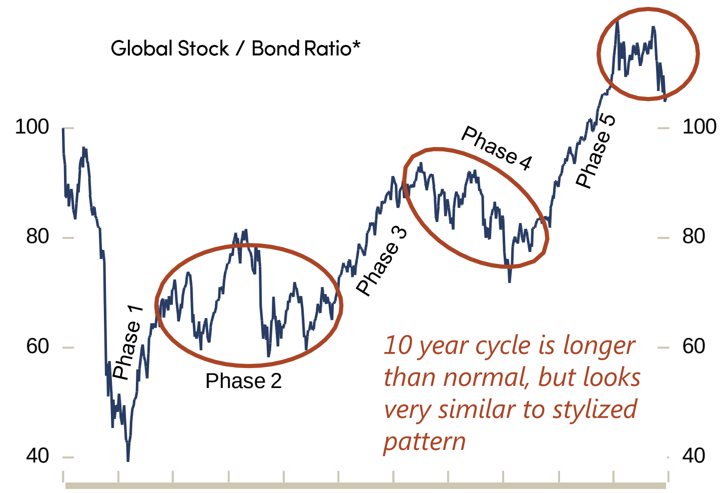
MRB's Stylized investment cycle



Phase 1: **Policy-Induced Rally**
Phase 2: **Awaiting Validation**
Phase 3: **Lower-Conviction Rally**
Phase 4: **Countertrend Pullback**
Phase 5: **Higher-Conviction Rally**
Phase 6: **First Bear Market Downleg**
Phase 7: **Countertrend Bounce**
Phase 8: **Final Flush**

Source: MRB, Based on the four cycles in the global stock/bond ratio between 1974 and 2009

Past 10 years



Global MSCI stock market total return index divided by 10-year G7 government bond total return index; rebased

The global economic expansion and equity bull market is now long in the tooth. This is not necessarily a reason to call an end, but as markets have moved higher, risks have also increased. Offsetting this we believe many risk assets are oversold as we enter 2019. Asset prices are now often discounting an overly pessimistic outlook. We think the markets which have had the weakest performance in 2018, now generally offer greatest value. Overall our global multi-asset allocation is conservative (low net position in equities) but also positively cyclically biased. We are short bonds due to poor value based on our positive view on the global economy. Our long positions in equities, are in traditional value sectors, which come with cyclical risks. As we enter 2019 excessive amount of economic weakness is discounted in risk asset prices. There is significant scope for positive surprises if our base-case of a slowing in global growth, rather than a plummeting global growth plays out. Overall equities are offering a normal implied risk premia, higher than normal outside of the US, and below normal in the US.

Many risk assets are oversold and prices are discounting an overly pessimistic outlook for 2019

Forecast returns

Equities	Forecast 1 Year Return	Forecast 7 Year Return (Annualised)
SP500	4	4.1
Stoxx 600	12	6.2
Topix	11	5.0
EM	16	6.9
10 Year Bonds		
US	-2.3	1.8
Germany	-4.0	-1.2
Japan	0.0	-1.3
UK	-2.0	-1.1
Commodities		
Brent	0	
Gold	10	

Equities World

MSCI WORLD	Current	Percentile	Average	Median
Price Earnings Ratio (P/E)	15.89	16	21.11	20.10
BEst P/E Ratio	13.83	23	15.81	15.71
Long Term Price Earnings Ratio	21.51	50	22.05	21.49
Price to Book Ratio	2.17	36	2.38	2.33
Price/EBITDA	8.55	73	7.58	7.19
Price to Sales Ratio	1.48	77	1.29	1.30
Enterprise Value/EBITDA	10.55	48	10.63	10.60
Profit Margin	9.13	98	6.08	6.45
Operating Margin	12.14	88	10.31	10.32
Dividend Yield	2.69	86	2.24	2.22
10Y Yield	2.70	27	3.99	3.97

Source: Bloomberg. Jan 1995 to Jan 2019

Globally equities are now trading at much more attractive multiples than they were in September. The broad based sell off has seen the market become cheap on an earnings, and book value basis. On ebitda the market continues to trade at higher than normal multiples. We expect earnings growth will slow in 2019. The rapid growth of 2018, particularly in the US which was boosted significantly by the US tax cut. If our macro scenario broadly pans out, we expect equity market leadership to shift away from the US market.

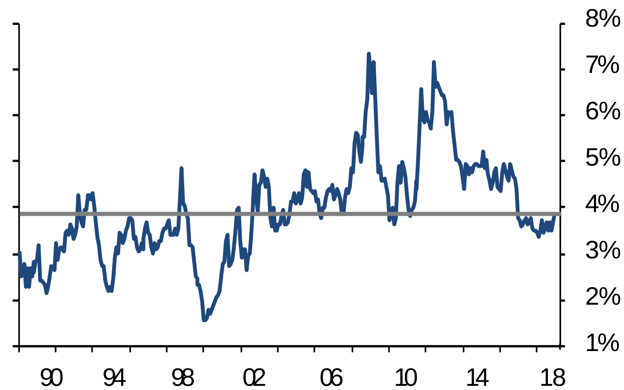
Earnings outside of the US should look better. We we expect US corporate profit growth will be very low as the US tax cut drops out of earnings growth, and margins are squeezed by higher labour costs and interest rates.

Overall global equities are offering a normal risk premia. The direction of markets will be more dependant on economic growth, and central bank policy than on a normalisation of valuation.

Key inputs for Global ERP

Risk premium	3.9%	Consensus growth '18	17.0%
Normal	4.0%	Consensus growth '19	8.6%
Min	1.5%	Medium-term growth	3.0%
Max	7.3%	Long-term growth	2.9%
10 year bond	2.0%	Payout ratio	39%
IRR	5.8%		

Global equity risk premium



Source: Bloomberg SocGen, PIM

Equity returns assuming normal ROE in 7 years

Equity Market Forecasts							
Country/ Region	Real Earnings Growth (%CAGR)	ROE (%, 2025)	P/E Ratio (2025)	Real Stock Price (%CAGR)	Dividend Yield (%)	Real Total Return (%CAGR)	Nominal Total Return (USD, %CAGR)
Brazil	2.0	11	15	0.0	3.4	3.4	6.3
China	3.3	13	14	5.0	2.4	6.4	10.4
Euro Area	2.8	11	15	3.8	3.5	7.3	10.3
Germany	3.0	12	17	4.7	3.2	7.9	10.9
Hong Kong	3.0	10	13	4.5	3.3	7.8	9.9
India	5.7	14	17	2.8	1.4	4.2	7.6
Japan	0.4	9	16	2.7	2.3	5.0	6.9
Switzerland	2.6	13	15	-0.7	3.2	2.5	5.6
UK	3.4	13	14	3.2	3.8	7.0	8.1
US	1.4	14	17	0.3	2.0	2.3	4.3
Developed Markets	2.0	13	16	1.9	2.5	4.0	5.8
Emerging Markets	2.7	13	15	5.4	2.9	8.1	10.4
Global	1.9	12	16	2.2	2.6	4.1	6.0

Source: MRB, PIM   Compound annual growth rate from 2018 to 2025

Our implied risk premia and long-run return expectations are a function of economic forecasts, a 'normal' ending multiple or yield and and the current starting point for valuations. The long-run economic outlook is one of moderate growth with some inflation. Our 7-year return projections are designed to look beyond the cycle. Starting valuation, and mean reversion of ROE are important determinants of expected returns, rather than the cyclical outlook. The normalisation of ROE approach favours regions which are trading at low starting p/e, and depressed ROE's. Europe looks most attractive on this approach, but it may be questionable if Europe an normalise profitability in such a time frame.

EM markets offer good value AND better economic growth

The US equity market produces the lowest returns over the coming cycle. Lower level of dividend yield, and a mean reversion of a high starting ROE depress earnings growth. The EU benefits from the same effect, with a high starting yield and low return on equity.

Equities US

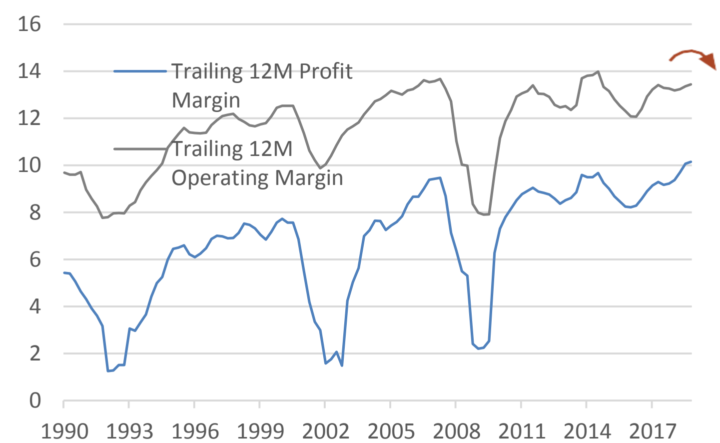
S&P 500 INDEX	Current	Percentile	Average	Median
Price Earnings Ratio (P/E)	17.41	33	19.63	18.70
BEst P/E Ratio	14.94	26	16.94	16.35
Long Term Price Earnings Ratio	24.49	72	22.17	21.24
Price to Book Ratio	3.05	72	2.86	2.76
Price/EBITDA	10.22	86	7.68	7.34
Price to Sales Ratio	1.95	85	1.47	1.50
Enterprise Value/EBITDA	11.86	70	10.52	10.65
Profit Margin	10.15	100	6.64	7.17
Operating Margin	13.45	93	11.56	12.02
Dividend Yield	2.12	63	2.09	1.97
10Y Yield	2.70	23	4.55	4.48

Source: Bloomberg. Jan 1995 to Jan 2019

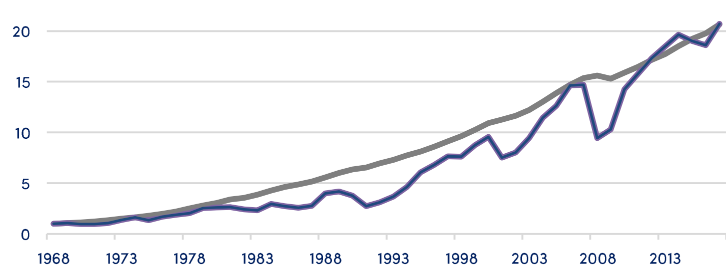
US equities have fallen to undemanding valuations on earnings measures. Even the long term cyclically adjusted earnings have fallen to 70th percentile, but this must be considered with the fact that there has not been a cycle over the past 10 years, and earnings and the economy have steadily expanded over the past decade that this measure considers. US equities remain unambiguously expensive on ebitda, sales and book value. We expect the continued global expansion will see US companies meeting revenue forecasts, but worry profits may miss expectations as margins decline. Higher interest rates, wage costs, and possibly regulatory costs for large cap technology could be the surprises in 2019.

Investors have become used to eps growth at much higher levels than economic growth in recent years. Over the past 14 years, and past 50 year, eps growth and nominal GDP growth have essentially been the same.

US profit margin is a record high...may mean revert



US eps growth has matched nominal GDP growth



Source: Bloomberg

Equities Europe

STXE 600 € Pr	Current	Percentile	Average	Median
Price Earnings Ratio (P/E)	14.70	28	22.66	19.14
BEst P/E Ratio	13.01	44	13.37	13.30
Long Term Price Earnings Ratio	17.91	55	17.52	17.23
Price to Book Ratio	1.62	23	1.86	1.84
Price/EBITDA	6.81	66	6.45	6.18
Price to Sales Ratio	1.08	50	1.07	1.08
Enterprise Value/EBITDA	8.96	44	9.10	9.15
Profit Margin	8.20	76	6.09	6.13
Operating Margin	10.90	74	9.70	9.20
Dividend Yield	3.93	87	3.37	3.36
10Y Yield	0.25	5	2.52	3.02

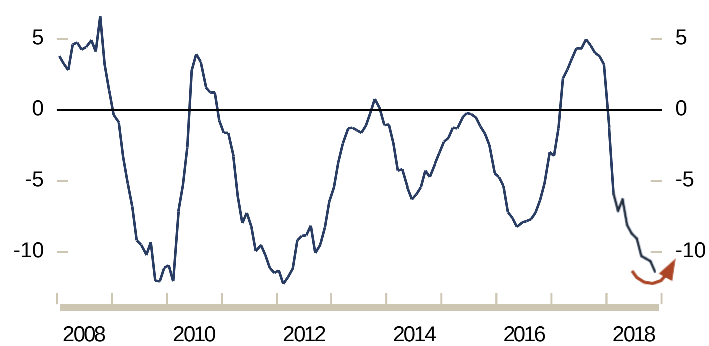
Source: Bloomberg. Jan 1995 to Jan 2019

European equities are cheap vs other regions and cheap vs. their own history. The question remains, are they cheap enough given the lacklustre growth, and political issues facing the region. A dividend yield nearing 4% should support equity prices while interest rates stay near zero throughout 2019. The potential for growth will be driven primarily by earnings expectations. We believe the selloff in equities in the fourth quarter is already pricing in a mild recession. Any positive outcomes that result in the EU muddling through with growth of 1.6-1.7% will be viewed as a positive surprise for markets.

A relaxation of the US trade threat that has weighed on European cyclical stocks is our base case. This assumes no new issues on US trade, but this continues to be a risk that needs to be monitored. This is also an area where Europe may deliver a positive surprise in 2019. We expect Europe will be a major beneficiary of a rotation from more expensive US equities to equities which are pricing in a very pessimistic economic outlook.

US outperformance has reached levels which have led to mean reversion in the past

Global Ex-US / US



Local currency; Source: MSCI. Bloomberg, MRB

Equities | Emerging markets

MSCI EM	Current	Percentile	Average	Median
Price Earnings Ratio (P/E)	11.46	21	14.64	13.45
BEst P/E Ratio	11.24	34	11.66	11.87
Long Term Price Earnings Ratio	15.65	47	16.63	15.90
Price to Book Ratio	1.46	36	1.56	1.54
Price/EBITDA	5.45	51	5.13	5.45
Price to Sales Ratio	1.13	55	1.14	1.10
Enterprise Value/EBITDA	7.47	59	6.85	7.19
Profit Margin	9.87	68	9.09	8.84
Operating Margin	13.34	60	13.15	13.00
Dividend Yield	3.05	91	2.42	2.42
10Y Yield	2.78	29	3.99	3.97

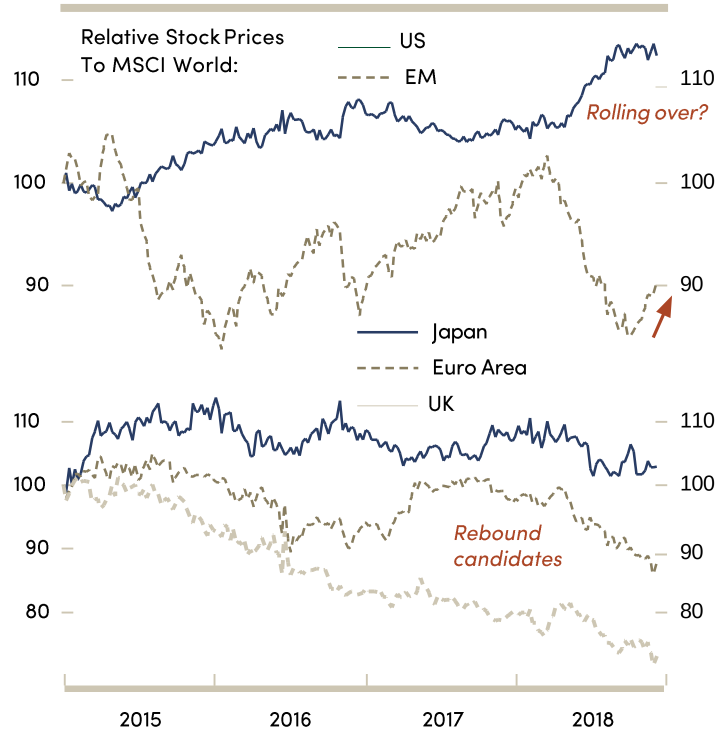
Source: Bloomberg. Jan 1995 to Jan 2019

In our opinion equities outside of the US, in particular emerging markets, offer the best potential equity returns in 2019.

EM equities weakened for much of 2018, but they have outperformed since early-October, despite investor concerns about the global growth outlook. All non-US markets have been hurt by the US threat of protectionist trade measures, and should be the main beneficiaries if this threat diminishes in 2019 as we expect.

While our long term outlook is positive for emerging markets, the climate will likely be choppy in the near term until some potential threats to global growth fade.

Relative Equity Performance will shift



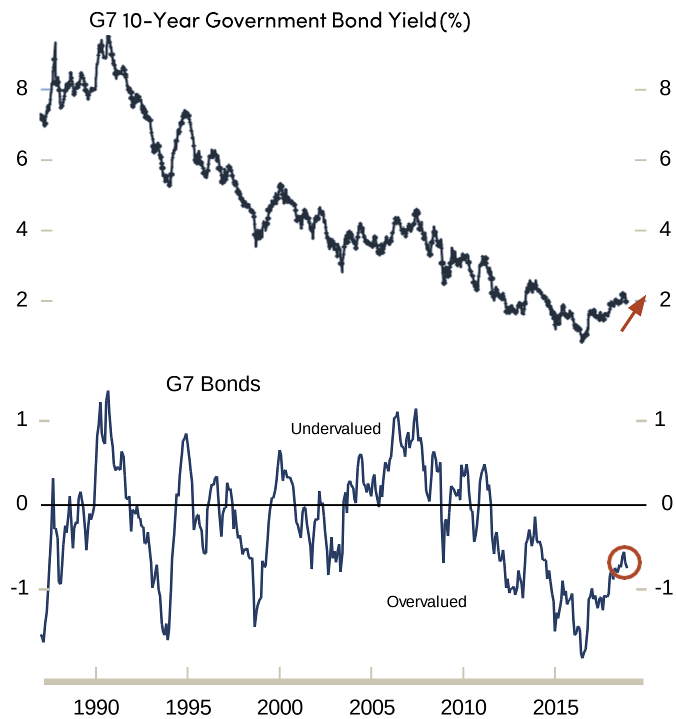
Source: MRB, Bloomberg

Fixed Income

Bond Bear market

We remain negative on the cyclical and structural outlook for G7 government bonds. One of our longstanding themes has been that the deleveraging drags in the global economy have progressively faded over the past decade, with the healing of household and bank balance sheets in the US and euro area. In turn, the global economy has progressively shifted to a macro roadmap characterized by firmer growth conditions and a gradual uptrend in underlying inflation pressures. This is consistent with a slow but persistent monetary unwind and should continue to expose the inappropriateness of the secular stagnation or new normal narrative. G7 government bonds will remain vulnerable until their pricing adjusts to the healthier macro backdrop and valuation distortions are unwound. The bond bear market may continue to pause for a while longer but should resume in 2019. The rise in yields will continue to be led by US treasuries, but German Bunds should also move higher.

G7 bonds remain expensive



GDP-weighted aggregate. Yield deviation from Fair Value Estimate
Source: PIM, MRB

Global Bonds

Scenario		Current	2025	GDP deflator (% CAGR)	Real return rolling into 10 years
Base case	US	2.7	4.5	2.2	-0.4
	Germany	0.2	3.0	1.6	-2.8
	UK	1.2	4.0	2.0	-3.1
	Swiss	-0.2	3.2	1.1	-4.5
	Japan	0.0	1.6	1.0	-2.3
1% higher inflation	US	2.7	5.6	3.2	-3.8
	Germany	0.2	4.5	2.6	-5.9
	UK	1.2	5.4	3.0	-5.8
	Swiss	-0.2	4.7	2.1	-6.9
	Japan	0.0	3.1	2.0	-4.7
1% lower inflation	US	2.7	2.2	1.2	1
	Germany	0.2	0.3	0.6	-0.3
	UK	1.2	2.0	1.0	-0.1
	Swiss	-0.2	-0.2	0.1	-0.3
	Japan	0.0	0.1	0.0	0.0

Source: PIM, Bloomberg

The US economy is set to slow in the coming year, and will provide support to the bond market in the near run. Longer term we expect 10 year yields to converge with the US expected nominal economic growth potential. Roughly 4-4.5%

Spread product looks attractive to us over a market cycle, given its carry and re-investment benefits, but low level of starting spread increase risk in a slowing economy. Should the economy avoid recession as we expect, high yield and leveraged loans will continue to see low levels of defaults.

Spread looks better than government bonds

Asset	Current Yield (%)	Projected Yield 2025	Real Total Return	Nominal Total Return
EM USD Debt	7.2	7.0	5.5	7.6
Euro Area High-Yield	3.9	5.0	1.5	4.1
US Investment Grade Debt	4.2	5.0	2.0	4.1
US High-Yield Debt	6.7	6.8	3.8	5.9

Source: Bloomberg. PIM

Foreign Exchange

USD starting to fade

We do not forecast any major moves in currencies in 2019. The bounce in the US dollar from its February 2018 lows has been driven by better economic growth, interest rate differentials. Looking ahead to next year, fundamental support is likely to gradually erode for the US dollar. Last year's rally has made the US dollar expensive, and political risks may dampen demand for both US dollar and treasuries.

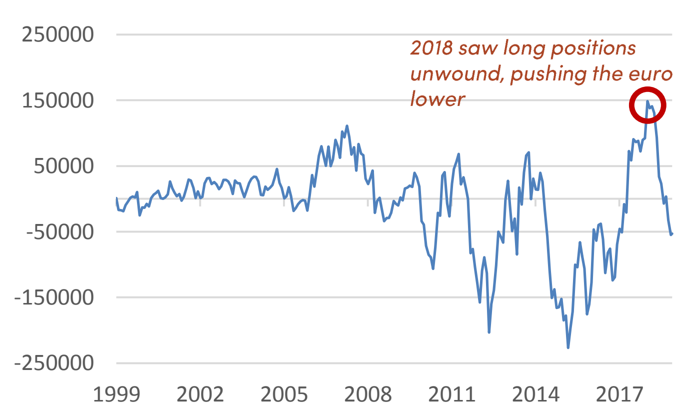
We expect US economic growth to continue to lead the rest of the developed world, and the Fed to continue to lead the normalisation path, but prefer to be long currencies which offer better value, and the potential to surprise on pessimistic economic outlooks. In 2018 speculative positioning in the euro was very long. As we enter 2019, investors are short the euro. Given its significant current account surplus, this may quickly reverse on any positive surprises in the euro economy.

Major currency vs USD on PPP

	PPP Consumer	PPP Producer	BIG MAC
CHF	8.73	-6.63	19.26
GBP	-4.58	-24.76	-22.00
EUR	-2.9	-7.78	-13.79
JPY	-29.64	-29.11	-34.34

Source: Bloomberg. PIM

Speculative positions in Euro



Source: Bloomberg. PIM

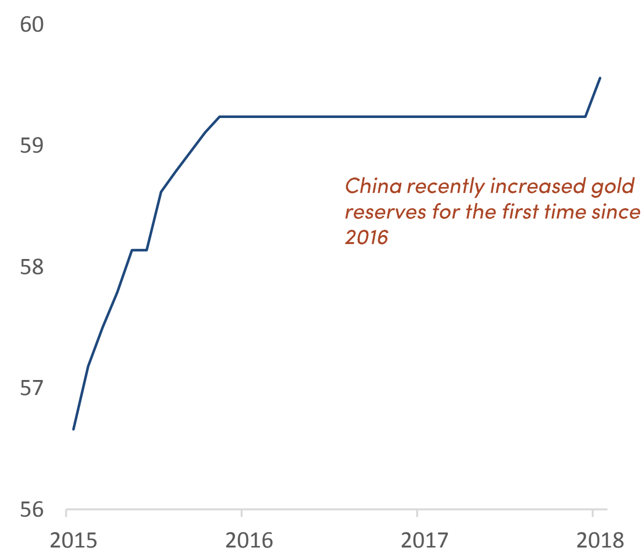
Commodities Gold is preferred long exposure

The prospects for most industrial commodities are not compelling as we enter 2019. Demand growth will continue, but will likely slow. Manufacturing PMI's are slowing around the world and below 50 in China. Supply in oil is very elastic, as US Shale and OPEC can produce more if prices rise.

Gold is the one commodity we have a positive view on for 2019. We are attracted to the safe haven aspects of gold. We expect a weakening US dollar and a Fed that pauses for the first half of 2019 to support gold prices. Economic and geo-political risks are higher than normal, and should inflationary pressure build in the US economy as we expect, the head wind from rising real yields on treasuries may diminish, even with high interest rates overall. We also expect gold will see increased demand as a reserve due to political risk in US.

Both industrial metals and oil prices should be range bound in 2019

Chinese monthly Gold reserves (m Ounces)



Source: Bloomberg. PIM

All data unless indicated is as of 31/12/2018.