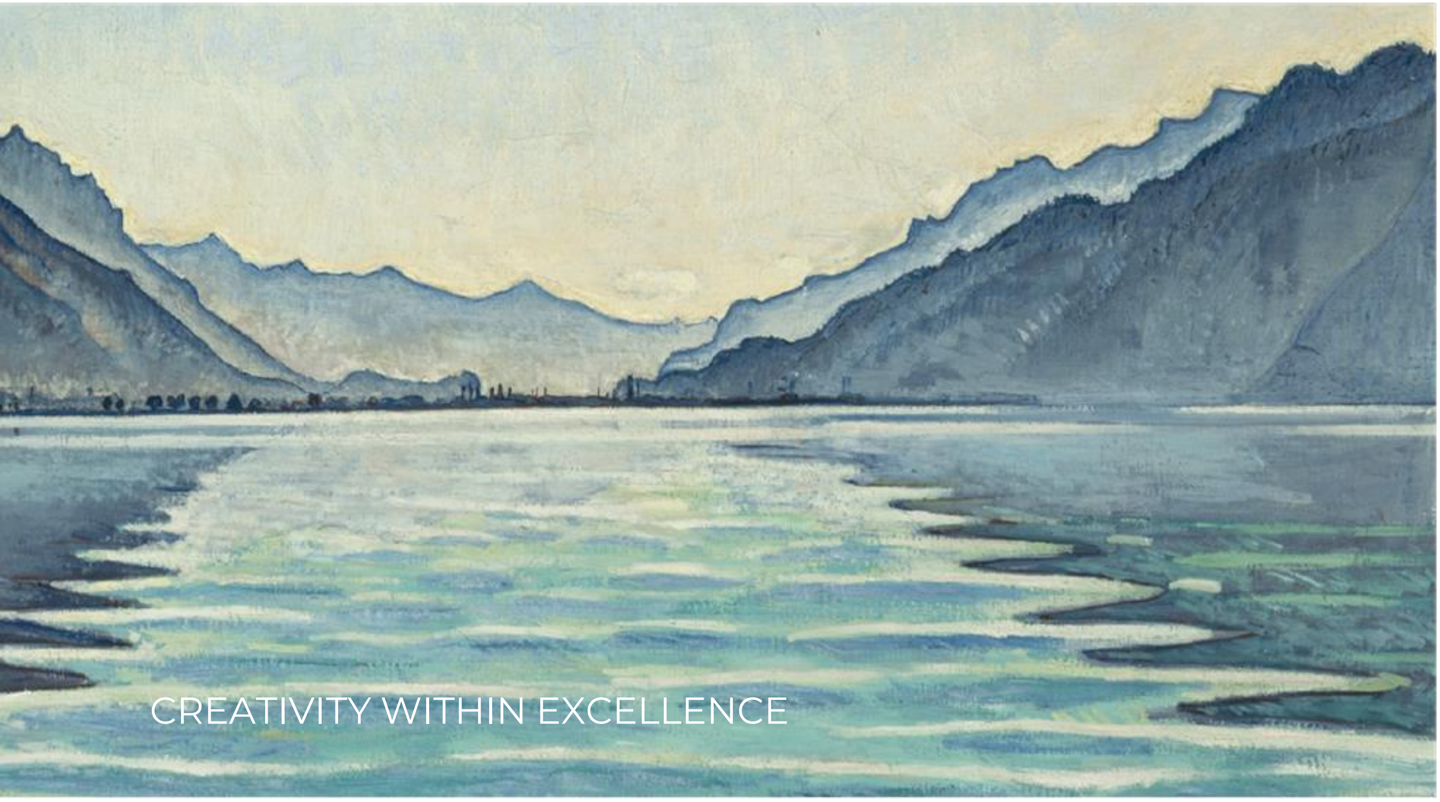
CBH | Asset Management

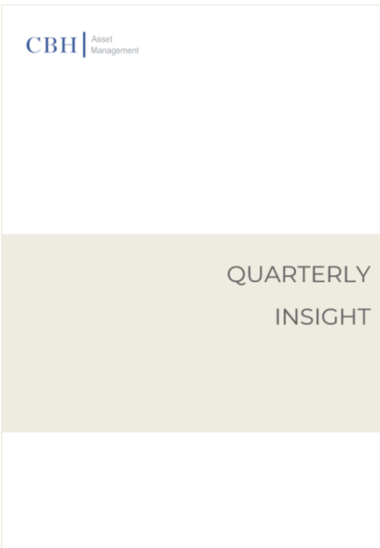
Quarterly Insight

Winter 2019



In this edition of the Quarterly Insight, our senior asset class and allocation experts assess the potential challenges and opportunities for investors in the quarter ahead.

This publication brings you distinct viewpoints, drawn from our local specialists, to help meet your investment challenges.



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Imprint

Publication date	January 4, 2019
Prices as of	December 31, 2018

Asset Allocation

		Benchmark	Underweight	Neutral	Overweight	Change
CASH	**$**	**5%**		**2%**		
	€			**19%**		
Libor 3m	USD	5%	2%			
Euribor 3m	EUR				19%	
CORE BONDS	**$**	**50%**		**38%**		**4%**
	€			**21%**		**-3%**
Government 1 - 5 years	USD	15%	12%			6%
	EUR		1%			
Government 5 - 10 years	USD	10%		10%		
	EUR		4%			
Investment Grade 1 - 5 years	USD	15%	10%			-2%
	EUR		10%			-2%
Investment Grade 5 - 10 years	USD	10%	6%			
	EUR		6%			-1%
SATELLITE BONDS				**15%**		**-2%**
High Yield 1 - 5 years					4%	-1%
EM Hard currency					2%	
EM Local currency					3%	1%
Senior loans					2%	
Convertible					4%	-2%
EQUITIES		**40%**		**35%**		**-3%**
North America		15%		15%		-2%
Europe		10%	6%			-3%
Japan		5%	2%			
Asia Pacific (ex-Japan)		3%			4%	
China		3%		3%		1%
Latin America		2%			3%	1%
Emerging Markets		2%		2%		
OTHERS		**5%**		**10%**		**1%**
Gold		2%			3%	1%
Other investments		3%			7%	

Despite an upward trending real economy and positive corporate earnings growth, the negative momentum of risky assets and the emergence of end-of-cycle signs bring us to maintain a conservative investment approach. Because of technical factors and geopolitical risks, we even decided to further reduce our exposure to risky assets over the first quarter of 2019, keeping some dry powder to be reinvested later in the year when positive catalyst will be identified.

With the current US expansion destined to become the longest in post-war history, an increasing number of end-of-cycle signs appear, and financials markets seem to be scared by them.

Even if the economic backdrop for the global economy remains healthy for 2019, eroded corporate profit margins, rising interest rates, flat interest rate curves and the risk of higher inflation driven by wage increases will eventually slow down global growth.

The last quarter of 2018, the worst since the financial crisis, has shown the current fragility of the financial markets. Moreover, for the first time since 1992, cash outperformed stocks, bonds and all other major asset classes.

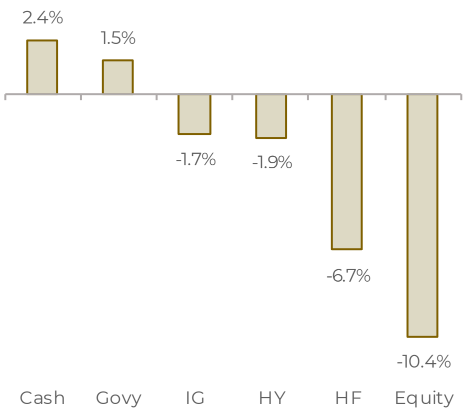
We can no longer refute the side effects of monetary policy normalization, generating more volatile and less directional markets, also more sensitive to exogenous risks of increasing importance.

In addition to the risks of an almost certain slowdown in global growth, concerns about trade-tariffs, the current US partial shutdown, the emergence of social tensions over the redistribution of wealth, Brexit, European debacles around the budget deficits and a high rate of corporate debt on the back of rising capital costs are all factors that could weigh heavily on the evolution of the price of risky assets.

Nevertheless, our analysis do not point toward a recession scenario for 2019, and therefore believe that recent market corrections are overdone. Volatility is back and will stay for a while, but we consider that there is still value on risky markets and estimate a growth rate of 2.1% for the global economy.

While the real economy is still in upward trend and corporate earnings remain positive, a negative momentum and signs of a global slowdown are prompting us to take a cautious investment approach.

2018 Asset classes performances (in $)



Regarding our allocation to the different asset classes, this situation leads us to adopt an even more conservative positioning than at the time of our last publication.

In our global bond portfolio, we will underweight government bonds and investment grade corporate bonds in the euro zone with a preference for cash.

As US yields are higher, we are positioning ourselves on the whole curve but maintaining a cautious outlook on the High Yield segment, which could remain under pressure given the evolution of the oil price (this sector having a significant weight within the asset class).

For dollar portfolios, despite the decline in the 10-year government rate in the last quarter, we continue to strengthen our exposure, with the objective of protecting ourselves against extreme risks.

In our pursuit of returns, we remain invested in crossover (whose rating oscillates between BBB- and BB-) and convertible bonds, which, although riskier, continue to offer an attractive risk and return profile. Nevertheless, we further reduce our exposure to the asset class as an oversupply is expected to maintain pressure on prices.

After the massive sell-off at the end of the year, we consider attractive the bottom end of the capital structure (subordinated bonds) of companies with a strong balance sheet and a dominant market position. In this segment, we focus on large financial institutions.

In the emerging country debt segment, whether denominated in hard or local currency, we are slightly strengthening our exposure in the face of healthier metrics.

In the commodity markets, we are adopting a more constructive position on gold and agricultural products but maintaining negative expectations on industrial metals and oil.

Concerning the equity allocation, we further reduce our exposure due to the high level of risk we are already exposed to in the bond universe. For the geographical allocation, our positioning is more defensive vis-à-vis Europe and Japan. We prefer Emerging markets, Asian countries and the United States.

Normalization should be the word of 2019, carrying turmoil in asset prices and headaches for investors: the normalization of the US trade balance leading to a potential global trade war; the normalization of FED monetary policy generating an inverted rate curve; and a normalization of US asset prices that could lead to significant repricing.

Even if the fundamental backdrop for the US economy remains healthy, with our models anticipating the GDP to growth at a pace of 2.2% in 2019, economic challenges are rising.

With the current US expansion cycle positioned to become the longest in post-war history (114 months at the time of writing), fiscal policy supporting economic activity to a lesser extent than in 2018 and trade tariffs anticipated to become a more noticeable drag on growth, an increasing number of late-cycle forces are converging.

Labor market and private companies debt will also lower the profitability of US companies. The first will keep upward pressure on wages and the second will increase the cost of capital, both compressing margins.

From a technical and fundamental point of view, a possible inversion in the interest rate curve is also increasing the odds of a recession, or at least of a slow-down, in the coming years.

In summary, monetary, fiscal, and trade policies all are turning somewhat less positive for growth, and several exogenous factors (Trump's impeachment, oil price collapse, credit & liquidity crunch and trade war) exist and should not be ignored.

Despite a technical pattern that could still bring the US dollar toward the 1.12 level over the short term, lower long term yields, lower GDP growth and a potential impeachment of the US President are catalysts explaining current weaker dollar forecasts over a mid term horizon.

Trade deficit

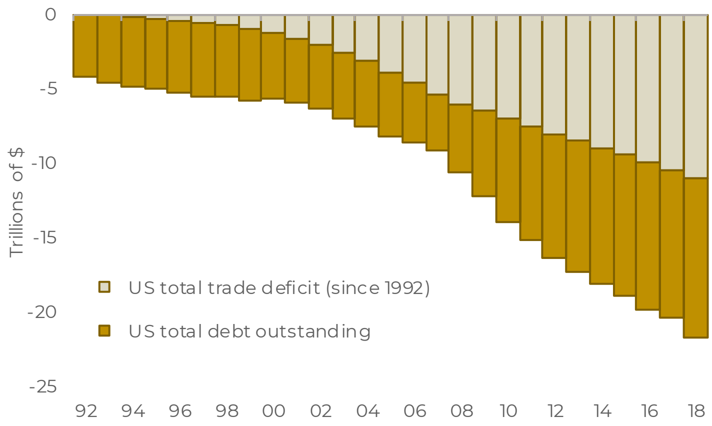
The 17th of February will be crucial for the USA and for Trump's trade policy.

This is the deadline for the special commission asked to determine if the activation of Section 232 (based on the Trade Expansion Act of 1962, it allows the president to impose tariffs, on the recommendation from the US Secretary of Commerce, if an article is being imported into the United States in such quantities or under such circumstances as to threaten or impair the national security) is applicable as per the beginning of 2018.

The American President wants to reduce the trade deficit (which reaches 600 billion dollar per year) with all countries in the world and mainly with China, Mexico, Germany and Japan.

If the activation of Section 232 is validated, Trump will have the opportunity to justify new tariffs towards all the trading partners in the world, fueling the trade deficit of his country but weakening financial markets. Defensive stocks, and especially those not impacted by a slowdown in world trade, should be favored in this context.

US Total debt outstanding and Trade deficit



The investment in US equities should be split in two phases with the 17th of February as the pivotal point. Before this deadline, Value and Min Volatility equity styles should be favored versus Growth stocks. In terms of sectors, Telecom and Utilities should both benefit from lower long term yields and reduced exposure to the global trade. After this deadline, and depending on the outcome, we could reverse some trades and return to Growth stocks if Section 232 is withdrawn.

Anyway, if Trump and Xi Jinping fail to find a durable trade peace agreement, Energy, Auto and Technological sectors should be underweighted.

Rate curve inversion

The ugly market reaction following the last FOMC meeting in December wasn't initiated by the 25bps rate hike, but by Jerome Powell's communication.

By reducing the number of expected rate increases from 3 to 2 in 2019 (estimating that everything is fine) and by adding that the reduction of the balance sheet of the FED was not a problem, he sent a somewhat messy message.

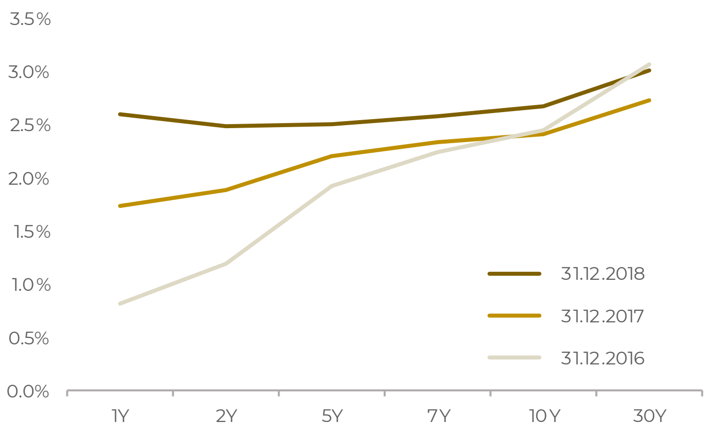
This mixed message has been badly received by investors who started a flight to quality movement that drove the US 10 years interest rate 0.5% lower, from 3.2% at the beginning of November to 2.7% at the end of the year, flattening the US yield curve.

The flattening of the curve suggests three things :

- a higher volatility in the quarters to come;
- more challenging times for the financial sector on lower interest rate margins;
- a potential interest rate curve inversion that historically materialize in a recession in the following year.

In this environment, yield curve spreads could become interesting investments. As we consider the five year maturity as the optimum on the US yield curve, floating rate notes should be considered for shorter maturities, while above this optimum point, the 10Y and longer duration could be considered. Avoiding any directional risk, bear the long 10Y / short 5Y strategy in mind as a possible investment.

US Government interest rate curve evolution



Credit, a giant who falters

Boosted by trillions of liquidity dumped by the FED, the indebtedness of US companies massively increased and ended the year at a record level of 9'000 billions USD (vs. 4'500 in 2007).

This increase has been driven by BBB rated companies, and almost 1 trillion of this debt is currently exposed to the risk of a downgrade to junk bonds.

Should this happen, we could face a credit crunch that can lead to excessive balance sheet pressures, making them more fragile and laying the foundation for higher financial contraction. This in turn can weigh on the economy and put additional pressure on the financial system.

In 2014-2015, the drop of 70% in oil prices impacted US High Yield bond market that retracted by 13% as the oil sector is ranked at 2nd place in term of index weighting. Considering that in the last quarter, WTI lost 40% of its value, the US High Yield could continue its correction movement.

We thus further reduced our exposure to High Yield bonds and to credit globally, favoring Emerging Market bonds. We also continue to believe and to invest into US government bond as an hedge against potential market corrections.

An internal hull fight

Never in history has an Administration launched a fiscal easing so late in the economic cycle, and never at this level of the cycle has a Central Bank had to withdraw liquidity on the backdrop of a trade war.

Unfortunately, the two entities do not seem to work together, and we even see clear tensions between the two corporations.

On one hand, we have the Trump's Administration willing to impose tariffs to sustain the local economy and to reduce the trade deficit. If they continue in this process we could see a slowdown in international trade exchanges, which will directly contract the global economic growth, putting further pressure on financial markets. Trump would like to limit the negative impacts of his measures by a more collaborative FED attitude, but Powell isn't giving him support as this would reduce the FED's capacity to normalize its monetary policy.

On the other hand, we have the FED willing to continue the normalization process by further increasing interest rates and reducing the central bank's balance sheet, which could be motivated to hike rates in order to force the Trump's Administration to manage an agreement with China.

We adhere more to the second scenario which we consider as more realistic and more probable should Section 232 not be activated. Nevertheless, Trump's reactions are difficult to anticipate, and he could dismiss FED chairman Jerome Powell. Should this happen, US Treasury secretary Steven Mnuchin would probably resign, increasing concerns among investors.

The worse is never sure, but we need to assess omens written on the "wall of debt". With credit spreads back to the 2016 level, we can get another 10% correction for the S&P 500 in the quarter to come. At the same time, the US 10Y yield could drop to 2.5%, paving the way to an inversion of the US yield curve.

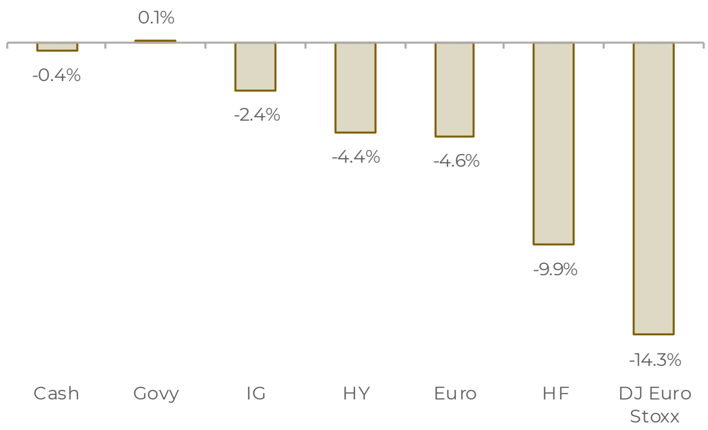
Europe

2018 was a difficult year for European financial markets. 2019 will be another difficult year, marked by higher volatility and greater returns dispersion. We believe markets will face disruption stemming from diverging monetary policies, geopolitical uncertainty and technology amplifying valuation disparities.

2018 will be remembered by investors as being one of the worst years in modern history to make money. In fact, almost no asset class was able to deliver a positive return, a phenomenon last observed in 1972. In terms of losses, investors have seen far worse. But going by the breadth of assets failing to deliver upside, 2018 is looking historic.

EU equites registered double-digits losses, long-term IG and HY EU bonds lost respectively more than 2.4% and 4.4% and the EUR devalued by more than 5% against the greenback. Only long-term core government bonds registered a small positive performance, but the picture is different looking at peripheral countries.

Performances of major asset classes in EUR



Unfortunately, we think 2019 could be another difficult year for EU investors. Disruptions stemming from diverging monetary policies, geopolitical uncertainty and technology amplifying valuation disparities are likely to keep volatility at high levels.

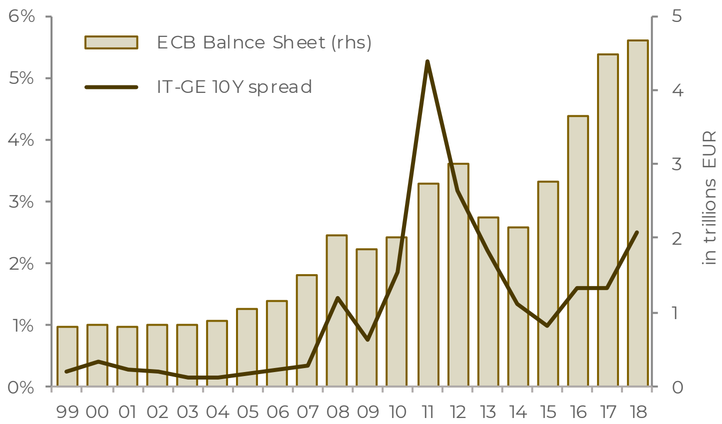
On the macroeconomic front, we expect EU to make a soft landing in 2019. Recent data confirms that the EU economy continues to cool, even if remaining in expansionary territory. Also the ECB reckons that risks are tilted on the downside and recently downgraded both 2019 growth and inflation forecasts respectively to 1.7% and 1.6%.

Multiple risks are clouding the outlook, namely: a weaker global macroeconomic backdrop, trade tensions, political (Italy, France, German leadership) and geopolitical uncertainties (Brexit), and a less dovish ECB. Similarly, in the UK, evidence of the negative drag from Brexit uncertainty is steadily mounting, rendering even more difficult the policy backdrop for the BoE. In this environment, we prefer to adopt a cautious stance on EU & UK financial markets.

Starting with EU fixed income markets, government bond yields are expected to gradually rise in coming quarters. EU core government yields have been artificially depressed by the ultra-dovish ECB monetary policy, which is gradually coming to an end, and from recent risk-off mode of financial markets. Peripheral EU bonds are likely to show a more volatile trajectory, negatively impacted by political developments (i.e.: Italy).

Even if interest rates are likely to remain unchanged at least until after the summer, markets are already anticipating a future normalization of interest rates. Similarly, in the UK, current yields seem to be unappealing considering still unresolved Brexit risks and a relatively more "hawkish" BoE, which has already started to normalize its monetary policy stance. Therefore, we keep our long dated bearish stance on EU & UK government bonds, but we are ready to tactically play some dislocations.

ECB Balance Sheet an Italian 10Y spread evolution



For credit markets, we also adopt a cautious view for the coming quarter. Even if the ECB maintains an accommodative stance in the near future, multiple factors continue to put pressure on EU credits. Growth is likely to make a soft landing in 2019 and political risks could resurface.

Moreover, EU, being one of the most open global economies, is likely to suffer the most in the case global trade disputes should accentuate in the future. This could put renewed pressure on sectors more exposed to the global economy (like autos, financials, etc.). An hard Brexit can also have strong negative consequences not only for UK papers, but for EU credits.

Other factors that can cloud the EU outlook are continued budget leakages in some key EU members (i.e.: Italy, France) and the forthcoming May 2019 EU elections, which could push some governments to adopt more populist behaviors.

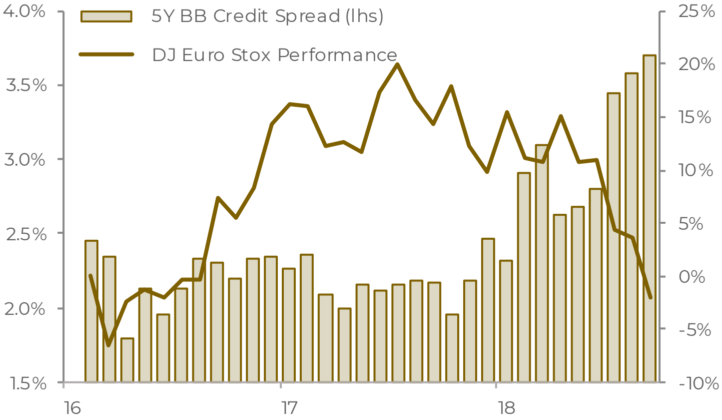
After the recent sell-off, EU investment grade (IG) credits are now offering higher yields, better compensating investors for the many risks that have grown last year. However, current levels are still not compelling enough to adopt a positive view. In fact, higher investment-grade yields also spotlight a looming risk: the nearly EUR 1 trillion of BBB-rated corporate debt lurking just above Europe's modest junk-bond market. Widespread downgrades could swamp the EUR non-financial junk bond market, which at the moment totals around EUR 250bn. Furthermore, the technical backdrop is likely to remain tough at the start of 2019.

In fact, the start of the year is usually the busiest period of the year in terms of new issuance. Yet, demand looks to be decisively weaker compared to the norm, especially with the ECB stopping its net purchases. Fund outflows have also exacerbated the recent correction and left dedicated vehicles with less cash available to invest in primary markets. This negative technical backdrop is therefore likely to put pressure on the asset class at the start of the year.

Finally risk premia are on the rise, pushing asset prices below fundamental valuations in a non-uniform manner, making investment opportunities more idiosyncratic than systematic. In conclusion, we keep our underweight stance in EU investment-grade bonds, suggest to keep a relatively short duration and prefer floaters over fixed rate.

Looking at EU high yield bonds, the 2018 correction was strong (with the asset class loosing 4.4%), especially considering that we are not facing an imminent recession, which would lead to an increase in default rates. If this scenario proves to be correct, the increased systematic risk premium is unjustified as default rates stay low, company earnings continue to grow, higher yields stimulate demand for credits and confidence in the market increase liquidity.

EUR 5Y BB Credit spread & equity Market evolution



Unfortunately, we think that this scenario has more chance to materialize later in the year, but 1Q19 is likely to be again "complicated". In fact, EU HY is likely to face many headwinds in coming quarters. The continuing bleak economic outlook, united with unstable political climate and more volatile equity markets, are likely to cap any meaningful spread compression in future months.

Supply of HY bonds is expected to be higher than demand and dedicated mutual funds outflows are expected to continue. However, anecdotal evidence suggests that funds' cash balances have improved, mitigating the spread impact of future outflows, especially considering that global HY funds might have already de-risked from EU HY.

Furthermore, on a spread basis, EU HY is now much more attractive than US HY. This could attract investors' interest in the future (also foreigners, thanks to the positive contribution from hedging currency risk derived by positive interest rates differential).

That said, the previously discussed risks are likely to remain alive during the first quarter, undermining investors' sentiments. Therefore, we suggest to adopt an underweight stance, where the majority of risks seem to be centered, but we think that EU HY has the potential to represent a compelling investment opportunity later in the year if the recessionary scenario don't materialize.

Finally, passing in review EU stock markets, 2018 finished with double-digits losses for EU stocks. For the 1Q19, our message still call for caution. The EU fundamental backdrop remains unexciting. Growth momentum is slowing and a plethora of idiosyncratic risks continue to trouble inventors.

EU equity markets have seen significant outflows and are a "consensus underweight". That said, valuations are attractive, with P/E trading near record-low relative to the US. But this is for a good reason, considering the much higher level of risks affecting the Old Continent.

At the same time, domestic drivers of activity are still well-oriented: financing conditions remain favorable, fiscal policy is becoming less restrictive and unemployment is at cycle lows. Technical factors have likely played a role in exacerbating the recent equity market sell-off, with investors adopting a defensive asset allocation, shifting away from equities and bonds into cash.

Investors' deleveraging may not be over, but equities seem now pretty oversold and sentiments appear to be stabilizing. In conclusion, we think that the risk-reward matrix is now more compelling, but we still prefer to reduce exposure on EU equities entering the 1Q19. We think other equity markets (like EM) are offering better risk-adjusted opportunities.

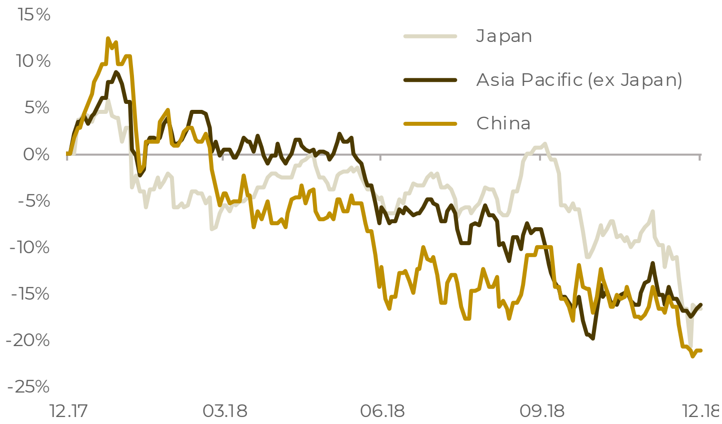
Chinese economy continues to be the world's growth engine supported by an emerging middle class. More attention to its domestic policies should help stabilize growth and accelerate reform programs to enhance corporate profitability. In that context, we expect a potential China fiscal policy easing and improvement with the U.S. China trade tension will trigger the flows from development markets back to emerging markets

In 2018, the Asian Pacific region was overshadowed by the hawkish US monetary policies coupled with the negative sentiment from the trade dispute uncertainty between the U.S. and China which drove down asset prices for the region.

Although we do not anticipate the trade dispute to uncover a resolution soon, Beijing is becoming more motivated to reach an agreement with the U.S. trade discussions as both the Chinese stock markets and industrial sectors were deteriorating. Chinese industrial profit growth fell to -1.8% y/y in November from +3.6% in October with November marking the seventh consecutive monthly decline and the lowest reading since January 2016.

In addition, tensions seem to have eased with China gradually resuming its purchases of soybeans as the first step of progressively resuming commodity imports from the U.S. and signaled its willingness to allow a level playing field for state-owned, private and foreign companies in its highly controversial "Made in China 2025" program. A symbolic win for the U.S. which may shift investors' attention back to the fundamentals and provide a positive backdrop for Asian currencies.

Asian equity markets returns



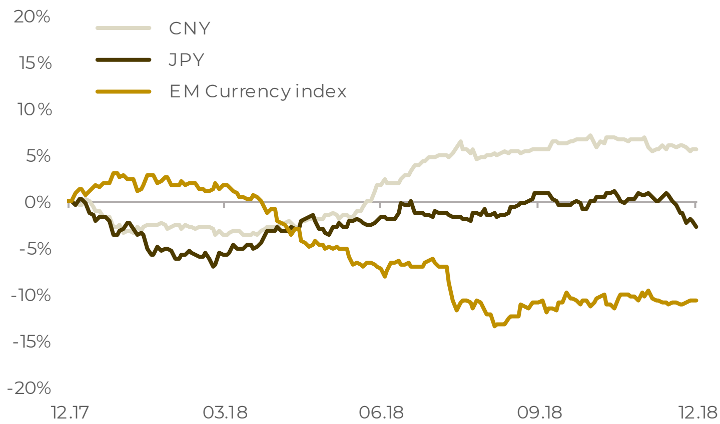
Despite a slowing Chinese economy due to the deleveraging efforts in the nations for the past two years, the Asian Pacific region continue to be the world's growth engine supported by an emerging middle class.

Accordingly to the OECD projections, Asian-Pacific (APAC) countries will experience a growth of middle-classes by over 500% in the 20 years up to 2030, compared with the 2% growth in Europe and a decline of 5% in America.

Among the APAC region, we are cautious about Australia as the economy is supported by a large run-up in household debt rather than income growth and was already suffering from an increase in interest rate without the central banking hiking its benchmark rates.

In addition, following a year of natural disasters in 2018, the Japanese economy should see a lift from the reconstruction efforts and the construction work in preparation of the 2020 Olympics due to an increase in capital expenditures.

Currency performances (vs $)



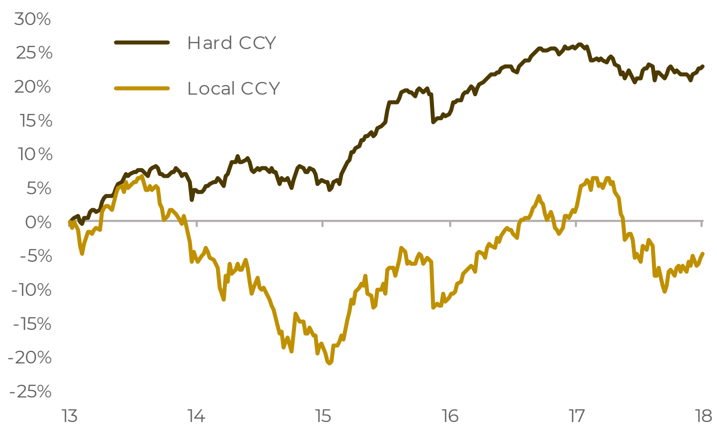
In 2019, as the Chinese yuan continues to stabilize, we anticipate China to place more attention to its domestic policies targeted to stabilize growth and accelerate its reform programs to enhance corporate profitability. This was supported by the announcement during the Central Economic Work Conference by establishing strong expectations on policy easing designed for counter-cyclical and pre-emptive policy adjustment along with fiscal policies such as significant tax/fee reduction as the core economic agenda for the coming year.

In addition to the regular reductions of reserve ratio requirement, the People Bank of China also launched new targeted medium-term lending facility and 100 billion in Chinese yuan to provide additional credit to the private sector. The targeted stimulus and incentives from the Belt & Road initiative to support the economy can also serve as positive catalysts for other trade partners in the Asia Pacific region.

After the recent sell-off, and despite we can not grant we reached a bottom, we are positive on Asian Pacific equities for 2019Q1 as slower U.S. growth and deceleration of Fed rate hike would weaken the USD index (DXY) which has inversed correlation with emerging market equities. Moreover, valuations are attractive, with consensus forward P/E trading close to one standard deviation below the 5-year average. Potential China fiscal policy easing and improvement with the U.S. China trade tension could also trigger the flows from development markets back to emerging markets particularly in Chinese equities.

Among the Asia Pacific region, we would overweight Asia ex Japan but underweight Japan due to a stronger JPY against USD outlook and the relatively rich valuation in the region.

Local and Hard currency bonds returns



For the Asian hard currencies bond markets, our preference remain short maturities corporate credits or floating rate bonds. We continue to believe the sweet spot is to invest in investment grade bonds and selectively quality high yield bonds in China as our latest observations were pointing to a slow down with the deleveraging process. In addition, potential policy easing would provide support to the property and infrastructure segments along with further Government spending that could provide overall support to the Chinese credit markets.

Furthermore, Asia investment grade yield bond could be peaking out (currently trading at its 8 years high in reference to the Barclays EM Asia USD credit high grade), a potential reflection point for improving bond price in the medium term if sentiment continue to stabilize.

We would however avoid issuer that are heavily dependent on oil import as oil prices as we anticipate volatility to persist given the uncertainty with supply reduction in Russia, Saudi Arabia and the U.S.

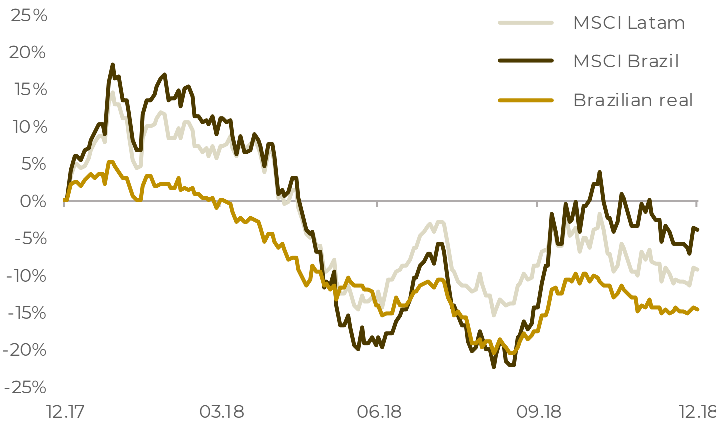
Asian currencies have also been vulnerable in 2018 due to the capital outflow led by the strength of the U.S. dollar, forcing some central banks to hike interest rates to protect their currencies which penalized corporate profitability and competitiveness. As we foresee the strength of the US dollar to diminish, central banks in Asia would have greater flexibilities to adjust their monetary policy to promote economic growth and would benefit the Asian local currencies bond markets.

The yield on selected sovereign bond in Asian emerging economies with strong fundamental are also currently offering attractive valuation. For example, the 10 years Indonesia sovereign bond which is currently offering a yield of 8% supported by an economic growth north of 5% along with stable inflation. Lastly, foreign holdings of local Asian bonds have come off their high after the outflow in 2018, the risk from foreign outflow is now lower and any pick up in risk asset sentiment can result in a reverse trend.

Brazil has the advantage of being in a good political transition, a new government with a liberal and reformist agenda and beginning a new economic cycle. If the reformist intention of the economic team proves to be effective in the first months, there is room for a significant appreciation of Brazilian assets, whose relative prices are quite attractive.

For Brazil, the last quarter was a transition period with a new government. The recently elected president Jair Bolsonaro has assumed and is now trying to implement a new model by selecting the top government jobs and the right names, without the usual bargaining-based in exchange for parliamentary support. In the economy side, Paulo Guedes, the future Minister, has centralized the decision power and so far he has a good reform agenda with fiscal adjustment on the radar, although it is worth remembering that it still depends on Congress approval.

Brazil, better positioned for the rebound



Besides the good news for this government, even after the elections, the outlook for local assets is still driven by the local political agenda. The market follows the transitional government appointments of the economic team. So far, the news have been positive: the good technical profile has been predominant, both among ministries and key positions in state-owned enterprises. Also contributed for a better perspective the first post-election confidence indicators. This new model has reduced uncertainty and led to a sharp rise in consumer confidence, leading a path for economic activity to resume.

On the other hand, the prospects for fiscal reforms are still uncertain. The new government's economic team has shown constructive intentions regarding the pension reform. However, given the urgency of Brazil's fiscal challenge, a consolidation of this plan and stronger signs of its approval at the congress are still required to sustain optimism in Brazil.

Preliminary polls suggest that the future government should begin its mandate with popular approval at a very high level. This legitimacy confers greater bargaining power on the government vis-à-vis the legislature.

Thus, if the reformist intention of the economic team proves to be effective in the first months, there is room for a significant appreciation of Brazilian assets, whose relative prices are quite attractive.

This perspective is reinforced by the potential for accelerated growth recovery, with confidence increase, from an economy that is coming from a severe recession, with plenty of spare productive capacity and far from full employment, in a context with historically low interest and inflation rates, a very attractive scenario for risk assets.

Regarding the pension reform, the main agenda item for 2019 is the consensus formed in the Congress about the need for an approval. There is little gain for the future government to reveal its details today on what it intends to take to the vote in 2019 - since it generates a lot of noise in the media. We believe the chances of a good project being presented for voting are very good, which should be positive for the markets.

Economic activity remains in a slow recovery, just as the level of unemployment also falls slowly. The services sector has already showed signs of improvement, but the industry continues to disappoint, which we attribute to the slowdown in global industrial activity. Although private credit has improved, it has only offset the smaller share of public credit.

The balance of payments remains stable, requiring a strong external shock in the capital account to change this scenario. However, given the more difficult scenario for emerging markets in 2019 and Brazil no longer having such an attractive level of interest rates for the carry trade, we do not see a clear path of appreciation of the Brazilian currency against the dollar, becoming more dependent on the external scenario.

Still in the topic of interest rates after the elections, given the indication of the fiscal adjustment, the benign scenario of inflation and the still slow economic recovery, some market players wonder about a new neutral equilibrium rate for the Brazilian economy. The labor reform carried out last year and the decline in the participation of state-owned banks with subsidized rates for some segments are causing a structural change in the economy's neutral rate.

In this sense, the Central Bank has given indications that will keep the rate at 6.5% for a long period of time. A view that reinforces the attractiveness of investments in local stocks and reduces the prospect of good performance of the Brazilian currency. We believe Brazil may be in a good turning point which sustains an exposure to the local economy in a diverse portfolio, especially if the global economy shows a soft-landing.

Among the other Latin American countries, in most cases, the stories are not as convincing as for Brazil and the volatility-adjusted carry is far from attractive. Except for Chile, where the economy is operating with excess demand and the central bank responding to the height, the others have relevant policy components that make the stories very uncertain, especially because of their leaders. Mexico with a populist Andrés Manuel Lopez Obrador and Argentina with Mauricio Macri heading for a reelection campaign during a very strong recession are sources of concern.

Mexican and Argentinian markets returns

Brazil has the advantage of being in a good political transition, a new government with a liberal and reformist agenda and beginning a new economic cycle. Undoubtedly a promising and constructive situation. Even though the fiscal challenge is enormous, once a more detailed economic plan is presented and the President-elect clearly manifests in its favor, we believe that Brazilian assets, particularly the stocks market, should perform well over the next quarter. Still, we will keep an eye in the external environment and monitor the liquidity conditions.

Commodities

Economically, with a fading global growth, the environment does not seem favorable to commodities over the first quarter, but geopolitically, pressure on dollar could become a positive catalyst. This two opposite forces would draw a huge dispersion in prices.

Amid fading US economic exceptionalism and slowing Chinese growth, the global macro environment will likely not get any easier for commodities in 2019.

End-of-cycle market dynamics are more like a step change in risk markets and could overwhelm as 2019 progresses, supporting precious metals but pushing oil and industrial metals lower.

In general, industrial metals prices should climb higher to catch up with much higher spot physical conditions but also helped by Chinese policy support in 1H. Nonetheless, the macro cycle rolling over in 2H19 motivates bearish forecasts over the year.

In Agriculture, the risk profile for prices going into 2019 is skewed to the upside. Grain market fundamentals remain bullish and futures continue to trade at a discount to fundamentals.

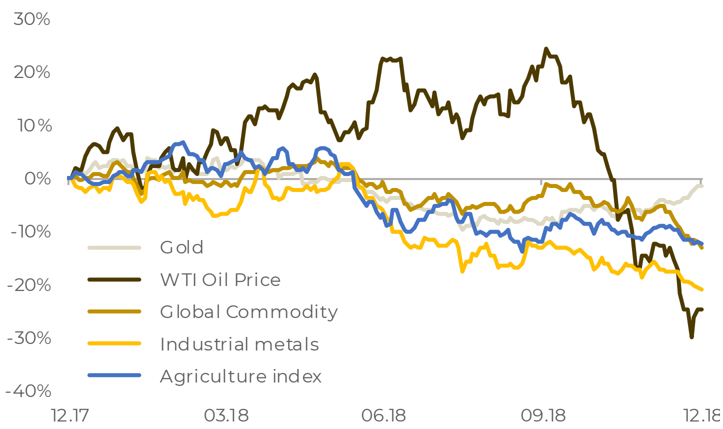
Preliminary stock projections for 2019/2020 show consecutive draws in world corn and cotton stocks, while sugar, soybean and palm stocks will likely draw after many years of surplus production. 2018 was the warmer year since 100 years, and climate deregulation should carry a tragic sequences of events raising soft commodity prices.

Oil and Gold would be the most contrasted commodities in term of price developments.

In the long term, they need to make their portfolios profitable against low break-even prices.

Oil should not be an exception, it would be able to reach 2016 lows, meaning 30-35$ for the WTI. Lower demand and higher stocks are geopolitical collateral damages. A bounce could occur during the H1 only if Trump/Jinping sign a trade peace and if the US rate curve will not turn inverted.

Commodity price performances



Oil, the new era of Discipline and Volatility

The oil price is a structural short mainly due to the rise of alternative energies to mitigate the climate warming, the lower global growth and the potential recession in the US in 2020 suggested by the US rate curve flattening, the greater adoption of the consumption by internet, the OPEC reduced coordination and credibility (budget needs will dictate the oil production.

After the exit of the Qatar, the new Mexican president asked PEMEX to produce as much oil as possible for the country to become self-sufficient and Russia admitted late 2018 to produce more than quota) and the fact that the US are, for the first time in the history, net exporters.

The fundamental challenge is the intrinsic volatility in the sector. Producers need time to address the vagaries of an over – or – under supplied market.

They also need to grapple with the pace and magnitude of the transition to energy from non-fossil fuel sources.

In short term, oil sector companies must maintain capital discipline, focus on productivity improvements and apply new technology.

Gold, shining again

Gold price fell by 4.5% in 2018 mainly due to a steady USD appreciation and the persistently low inflation. However, the recent equity sell-off revives the role of gold as a hedge against negative movements on stock markets and puts the yellow metal likely to shine more in 2019. The surge of volatility in equity markets has given a new breath to the yellow metal that rallied 7% during the last quarter.

The FED will play again a key role on the performance of gold in 2019 since a slowdown in the US economy would encourage it to adopt a more dovish stance towards its interest rate policy. A hypothetical USD depreciation would boost the performance of gold.

Central banks around the world are beginning to turn back to gold driven by the desire of diversifying their holdings, de-dollarization and because of rising geopolitical tensions. We advice investors to add some gold to their portfolios as a long-term buy-and-hold position.

Currencies Market Expectations

			Q1-19	Q2-19	Q3-19	Q4-19	Q4-20
MAJOR CURRENCIES	EURUSD	1.14	1.15	1.17	1.19	1.20	1.24
	EURCHF	1.12	1.14	1.15	1.15	1.16	1.19
	EURGBP	0.90	0.88	0.89	0.88	0.88	0.89
	EURJPY	124	129	130	131	132	130
	EURNOK	9.80	9.55	9.45	9.40	9.30	9.00
	USDCAD	1.33	1.32	1.30	1.29	1.29	1.29
	USDCHF	0.98	0.99	0.99	0.98	0.98	0.96
	USDJPY	108	112	111	110	108	104
	USDCNY	6.85	6.94	6.90	6.85	6.80	6.70
	GBPUSD	1.28	1.30	1.32	1.34	1.35	1.39
	NZDUSD	0.68	0.68	0.68	0.69	0.70	0.73
	AUDUSD	0.71	0.72	0.73	0.74	0.75	0.76
OTHER CURRENCIES	USDMXN	19.3	20.0	19.9	20.0	19.8	19.2
	USDBRL	3.70	3.81	3.85	3.83	3.85	3.70
	USDARS	37.36	40.00	42.80	45.90	46.50	48.00
	USDTRY	5.36	5.58	5.72	5.93	6.00	6.20
	USDILS	3.69	3.69	3.71	3.67	3.65	3.45
	USDHKD	7.84	7.82	7.81	7.80	7.80	7.80
	USDINR	69.7	71.3	71.0	71.0	70.3	69.4
	USDRUB	66.8	68.2	67.4	67.3	67.0	67.0
	USDPLN	3.75	3.72	3.65	3.57	3.50	3.33

The table above provides an overview of market forecasts for major currencies. It is composed of dozens of individual forecast providers and delivers a consensus forecast. These consensus forecasts represent a median number and all forecasts evaluated correspond to calendar quarter-end dates.

Market Performances

	Name	QTD *	YTD **	2017	2016	2015	2014	2013	2012
Cash	LIBOR 3m Total Return	0.7%	2.4%	1.1%	0.6%	0.2%	0.1%	0.2%	0.4%
	EURIBOR 3m Total Return	-0.1%	-0.4%	-0.4%	-0.2%	-0.1%	0.3%	0.2%	1.0%
Government bonds	US 3-5	2.4%	1.5%	1.0%	1.3%	1.6%	2.2%	-1.0%	1.6%
	Eurozone 3-5	1.3%	0.1%	0.1%	1.5%	1.8%	5.6%	2.4%	8.7%
	US 7-10	3.7%	0.9%	2.6%	0.8%	1.7%	8.8%	-5.9%	4.0%
	Eurozone 7-10	1.9%	1.4%	1.3%	3.5%	2.1%	16.9%	2.9%	14.9%
Corporate bonds IG	USD Corp 1-5	0.8%	1.0%	2.6%	2.9%	1.2%	2.1%	1.5%	6.2%
	EUR Corp 1-5	-0.4%	-0.5%	1.2%	2.6%	0.6%	4.0%	2.6%	10.0%
	USD Corp 5-10	0.3%	-1.7%	5.6%	5.6%	0.9%	7.3%	-1.6%	11.6%
	EUR Corp 7-10	-0.7%	-2.4%	4.2%	7.0%	-1.5%	15.3%	2.0%	22.0%
Corporate bonds HY	USD Corp 1-5	-4.4%	-1.8%	7.0%	16.5%	-4.5%	1.9%	7.6%	15.2%
	EUR Corp 1-5	-3.7%	-3.8%	6.9%	9.1%	1.0%	5.8%	10.1%	27.3%
	USD Corp 5-10	-4.0%	-1.9%	7.6%	7.3%	1.8%	4.8%	16.9%	15.8%
	EUR Corp 5-10	-4.0%	-4.4%	8.0%	10.8%	0.4%	7.3%	9.7%	28.0%
EM bonds (in $)	Hard currency	-0.2%	-2.5%	8.2%	9.9%	1.3%	4.8%	-4.1%	17.9%
	Local currency	2.5%	-3.4%	14.3%	5.9%	-10.4%	-1.9%	-4.3%	15.1%
	Chinese Yuan	3.9%	3.0%	5.0%	-4.7%	3.6%	8.0%	0.0%	4.7%
Other	S&P Senior Loan Index	-3.5%	0.4%	4.1%	10.2%	-0.7%	1.6%	5.3%	9.7%
	Global Convertible	-5.4%	-1.2%	7.2%	4.6%	-0.8%	3.8%	15.0%	
Equities	North America	-14%	-6%	19%	9%	-1%	11%	30%	14%
	Europe	-12%	-13%	7%	0%	5%	4%	16%	13%
	Japan	-17%	-17%	18%	-3%	8%	8%	52%	19%
	Asia Pacific (ex Japan)	-9%	-16%	39%	3%	-11%	2%	1%	19%
	China	-13%	-21%	32%	-7%	-7%	62%	-15%	11%
	Latin America	0%	-9%	21%	28%	-33%	-15%	-16%	5%
	Emerging Markets	-8%	-17%	34%	9%	-17%	-5%	-5%	15%
Other investments	HFRX Alternative	-6%	-7%	6%	3%	-4%	-1%	7%	4%
	VIX	110%	130%	-21%	-23%	-5%	40%	-24%	-23%
	G7 Currency Volatility	15%	21%	-36%	22%	-6%	14%	5%	-34%
	DJ Global Commodity	-10%	-13%	1%	11%	-25%	-17%	-10%	-1%
	Gold	7%	-2%	14%	8%	-11%	-1%	-28%	7%
	Industrial metals	-9%	-21%	28%	20%	-27%	-7%	-14%	1%
	Agriculture index	0%	-13%	-12%	2%	-16%	-9%	-14%	4%
	WTI Oil	-38%	-25%	12%	45%	-30%	-46%	7%	-7%
Currencies (vs. $)	Dollar Index	1%	4%	-10%	4%	9%	13%	0%	-1%
	EM Currency Index	0%	-11%	6%	0%	-16%	-12%	-7%	3%
	Euro	-1%	-5%	14%	-3%	-10%	-12%	4%	2%
	British Pounds	-2%	-6%	10%	-16%	-5%	-6%	2%	4%
	Swiss Francs	0%	-1%	5%	-2%	-1%	-11%	3%	3%
	Japanese Yen	4%	3%	4%	3%	0%	-12%	-18%	-11%
	Australian Dollar	-3%	-10%	8%	-1%	-11%	-9%	-14%	2%

* Last quarter

** Year to date

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