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Global

Global Asset Allocation

February 2013

Citi Global Asset Allocation
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Editor

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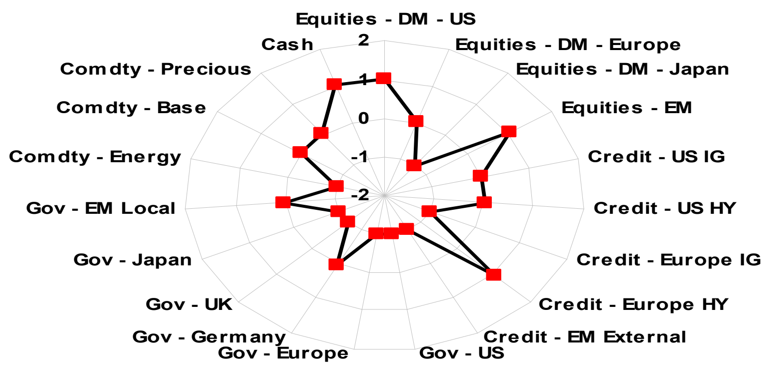
- **Asset Allocation & Macro Overview**
  - We still like equities, despite this year's rally and an abundance of risks. We overweight the US on economic/ earnings performance grounds and also like markets where easy money/ FX weakness is not yet priced in (e.g. UK). Equities likely outperform credit/ rates over 2013.
  - Medium term, we raise cash as long equity exposures are outweighed by neutral credit and underweight government bonds and commodities.
- **Citi Strategy Views by Asset Class**
  - **Equities** — On balance, a world of easy money, low bond yields and attractive equity valuation trump concerns about systemic risk. Global high dividend equities should outperform.
  - **Credit** — Medium term, liquidity still dominates weak fundamentals. Spreads have come in a long way and we see only 10-15bps of further tightening.
  - **Rates** — Higher yields forecast over 12m with the US leading the sell-off. Germany and EM local rates outperform.
  - **Commodities** — The super-cycle is over, as Chinese growth is lower and less commodity-intensive. Correlations with other risk assets to remain low.
  - **Foreign Exchange** — As the pure risk on/risk off model fades, the USD should be 'less weak', despite strong risk appetite. JPY and GBP underperform.

Figure 1. Medium-Term Recommended Asset Allocation



	Medium Term*				
	-2	-1	0	+1	+2
Equities					
Credit					
Governments					
Commodities					
Cash					

Source: Citi Research

-2 = very underweight; -1 = underweight; 0 = neutral; +1 = overweight; +2 = very overweight; Allocations do not necessarily sum to zero.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Contents

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Global Asset Allocation – February 2013

This is the February 2013 issue of a new cross market research product targeted at asset allocators. On a monthly basis, this document will allow clients to access a basic summary of: (i) Citi asset market research and economic, exchange rate and interest rate forecasts; (ii) single asset class views, forecasts and returns projections; and (iii) Citi recommendations on both short- and medium-term allocations across asset classes.

Short-term Asset Allocation: Long equities, with US overweight. Also like UK. Neutral corporate credit overall but bias for HY over IG. Neutral EM external. Neutral government bonds overall but overweight EMU, after spread widening, and selective EM local markets. Neutral commodities, but suggest longs in oil for convexity/ diversification. Underweight cash.

Medium-term Asset Allocation: Bullish risk assets but bias for equity over credit. Equities stay long via US and EM but neutral Europe and underweight Japan. Underweight all government bonds except Bunds and EM local. Underweight commodities, especially energy. Increase cash to overweight.

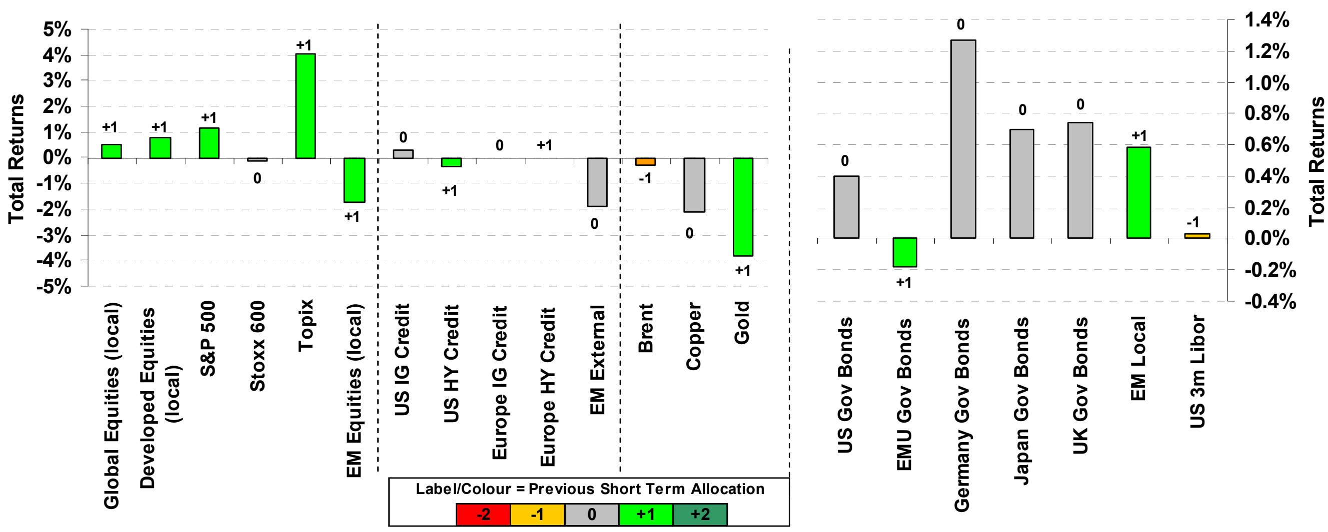
Cross-Asset Returns since Last Allocation

Figure 2 compares our last short-term allocation published in late January 2013 to the total returns across assets since then. Recent volatility caused many equity markets to give back most of their earlier gains and global equities are more or less flat. In absolute terms, Japanese stocks (one of our overweights) have been the best-performing market. European stocks, our only neutral within the asset class, underperformed. But EM markets took us by surprise as they lost 2%.

Credit market returns over the past month were close to zero but counter to our expectations IG outperformed HY, albeit with returns below 0.5%. Commodity markets were also weak in the past month. While our underweight in crude oil was correct in a directional sense, copper and gold (neutral/ overweight respectively) took as by surprise as they underperformed and fell by around 2-4%.

Finally, most sovereign bond markets offered tiny positive returns since late January 2013. Our EM local overweight offered positive returns but was not the outperformer. EMU bonds, our other overweight, sold-off post Italian elections and Germany outperformed within fixed income, something we failed to anticipate.

Figure 2. Total Returns Since Last Publication (25 Jan 2013) vs. Previous Short-Term Allocation*



Source: Citi Research and Bloomberg
* Short term = 3m horizon. Allocation measured in units of under/overweight: -2 = very underweight; -1 = underweight; 0 = neutral; +1 = overweight; +2 = very overweight.

Cross-Asset Considerations: Raising Cash

First quarter asset market rallies have to some extent eaten into available expected returns for 2013 while a number of new uncertainties have raised risk levels. As a result, we have raised cash levels in long term portfolios. But the broad thrust of recommended investor positioning remains intact. And most of the medium term themes we identify as likely to impact returns remain unchanged and are reiterated here.

On the uncertainties first, we identify four possible negatives for markets.

1. **European political uncertainty is back:** Initially, it was corruption scandals in Spain. But then came the surprising results of Italian Elections on 24-25 February. The latter suggest Italians have rejected austerity. Fatigue with never ending public spending cuts/ tax hikes remains a risk across a number of European countries. Naturally, this has led to a rise in sovereign and financial spreads. Our bias had been to think that EMU spreads would be range bound over coming months with poor fundamentals limiting the downside and the OMT threat containing the upside. The problem with the latter is that countries need to apply for a programme to trigger the OMT and Italy may not be in a strong position to do this for some time. Clearly, these developments leave us less positive on periphery credit and Southern European equities. But we remain reluctant to think that recent developments will turn out adverse enough to sabotage positives coming from the recovery in Chinese growth and more and more signs that the US cycle is gathering momentum. Instead, our base case is that Europe is unhelpful but low beta for the global asset market story.

2. **US fiscal policy:** The biggest risk here was the fiscal cliff. Failure to address the cliff would have been disastrous for asset markets and for US and global growth. In comparison, the sequester is small beer. According to Citi economists, the full year impact of this issue remaining unaddressed is to reduce economic growth by around 0.25ppt in 2013. But strengthening fundamentals for household income and net worth and a more positive impact from housing are offsets. The US economy has already been dealing with fiscal drag of around 1% of GDP over the past couple of years offset by corporate re-leveraging. Recent news on durable goods orders suggest this trend may also be accelerating, so our concerns here are limited.

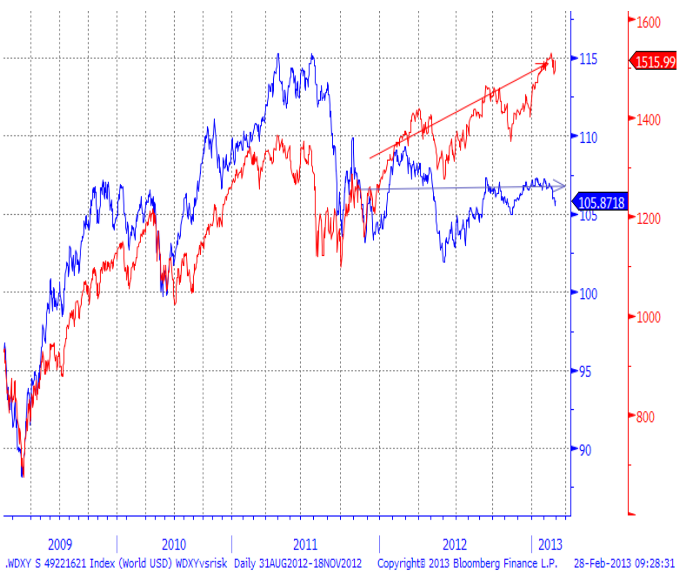
3. **USD trend and EM asset markets:** We have highlighted how macro correlation is gradually breaking down. One aspect of this is the trend in the USD. In recent years, since the GFC began, the USD trend has tended to be inversely related to risk appetite. When risk aversion rises, US investors pull in their horns and supply fewer funds externally, including to EM markets. At the same time, foreigners struggle to get funding for USD assets. Conversely, with risk appetite strong, usually encouraged by Central Bank liquidity, the USD has tended to be weak. USD weakness in risk on periods then tends, in turn, to drive either easier monetary policies in EM countries or intervention. The latter boosts domestic liquidity and asset markets, the former drives higher returns in EM local rates markets. However, we have noted how the USD beta to risk assets recently has been falling significantly compared with the last few years and, indeed, there has been no discernible weakness in the USD at all over the past six months despite rising equity markets (Figure 3). This has limited the

knock-on benefits in EM asset markets. EM equities have not, therefore, performed as well as we had hoped. Furthermore, corporate earnings developments have been less favourable relative to expectations in EM markets too, especially when compared to the US. Meanwhile, trends in EM local rates too have become a lot more idiosyncratic with a mixture of some expected tightening and some easing, sometimes even in the same regions (e.g. Brazil and Mexico respectively).

4. **Higher oil prices:** Oil prices have been firming, raising the 'gasoline tax', especially for pressed DM country consumers. Our commodity strategists remain bearish on oil market trends so we are reluctant to play this up too much as a negative. However, oil demand and supply trends have been tightening up reflecting output cuts in Saudi Arabia in particular and the earlier build up in global oil inventories is likely close to an end. Medium term, we keep asset allocations to commodities as underweight. But short term we suggest reviving an old idea to hold some commodities, especially oil, as diversification. Correlations to risk assets are unstable (and average zero longer term) but near term risks of a further rise in oil prices warrant some exposure to oil given the potential adverse impact on asset markets.

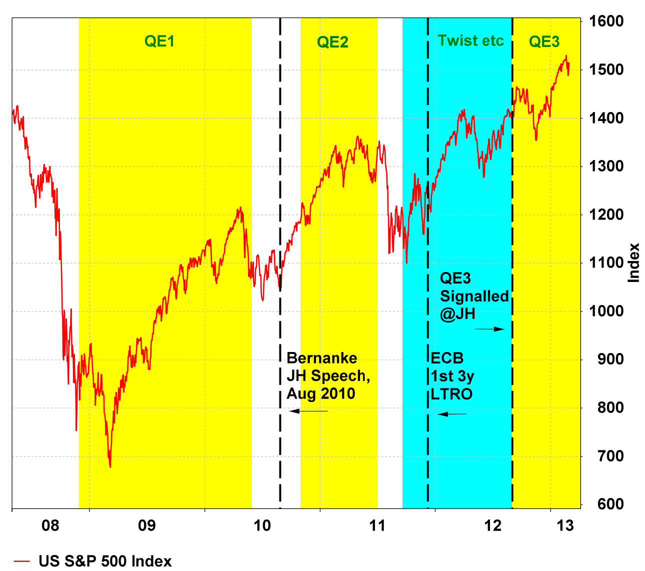
All these risks are important but do not change our base case for asset market returns. We expect some equity market returns over the rest of 2013 to be in double figures and we think equity returns will be better than credit market returns. We see government bonds as likely to lose money and expect a rather mixed performance from commodities.

Figure 3. US Equities (Red) and the USD vs. Global Currencies (Blue, Evenly Weighted, Higher= Weaker USD)



Source: Citi Research and Bloomberg

Figure 4. US Equities and Fed QE Periods



Source: Citi Research and Reuters EcoWin

Here we reiterate the themes we see as major drivers.

1. **Easy Money:** While some FOMC members have expressed doubts about QE3 recently, we expect asset purchases to continue and, ironically, all the more so if European events remain unhelpful near term. Medium term, we do expect some scaling back of the size of monthly LSAPs before end

2013 but this will be in the face of a more noticeable acceleration in US real GDP growth. We think asset markets may lose momentum as monetary stimulus is reduced (Figure 4) but, given the context, are only likely to correct significantly if economic data also turn lower. It is also likely that additional monetary stimulus in the form of QE may be forthcoming from the BoE and BoJ and rate cuts from the ECB.

2. **Less macro correlation/ more alpha:** In equities, we see more evidence that company and sector specific news is again driving share price movements. As such, index correlation is also declining as divergent cyclical strength would warrant. And there is also less correlation between equities and credit, equities and commodities and between risk assets generally and FX movements. However, one area where we expect increased correlation in level terms is between equities and rates. The benchmark 10y UST yield has recently failed to break above 2% as a result of the uncertainties listed earlier but we do expect this break to come in 2013 and for returns to most government bond markets to be negative. Fixed income markets already price a much more dovish path for medium term forward rates even than given in FOMC guidance so any hint that QE is being scaled back may well send bond yields higher.

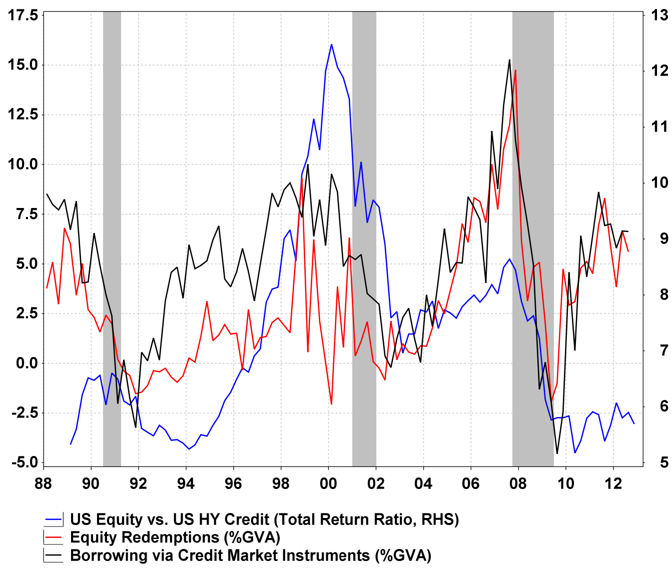
3. **Equity to outperform credit:** Last year, equity and credit returns were similar but volatility adjusted returns much better in credit. With core bond yields likely rising this year, credit will need significant spread compression to repeat this performance and we are not sure enough will be forthcoming, even with strong liquidity support from Central Banks. Furthermore, US flow of funds data show corporates using cheap debt financing to either retire equity, to finance M&A or to pay dividends (Figure 5). With valuations arguably also more stretched in credit than equity markets, we see equity markets materially outperforming credit.

4. **US economic outperformance:** The US recovery has been poor by the standards of past upturns. But compared with other developed regions, the US recession was shallower, the rise in GDP from the trough steeper and the Citi forecast through early 2014 shows a widening divergence to real GDP trends in Europe and Japan. This is bullish for US equities relative to other developed markets. We think this will also mean underperformance by US government bonds as bear steepening leads a bigger rise in US yields this year than elsewhere.

5. **Impact of FX trends:** Several aspects of FX market movements may also have a wider asset market footprint. We have already mentioned the recent lack of discernible USD weakness despite strong risk appetite. This means less upside in EM equities and local rates markets as discussed. Other DM currencies that have been weak recently are JPY and GBP, both in anticipation of much greater monetary ease by their respective Central Banks. In both cases, too, equity market outperformance may be associated with this. This is already very evident in the case of Japan and we have held overweight allocations to Japan in our short term asset allocation over the past three months but have now scaled this back after strong Topix performance. In the case of the UK, equities have outperformed, especially in the European context, but less noticeably so far than in Japan (Figure 6). Historically, UK equities have tended to outperform both with sterling weak and when markets correct. This suggests there is convexity in holding over-weight UK equity positions. If the risk factors covered above turn out worse than expected, UK stocks

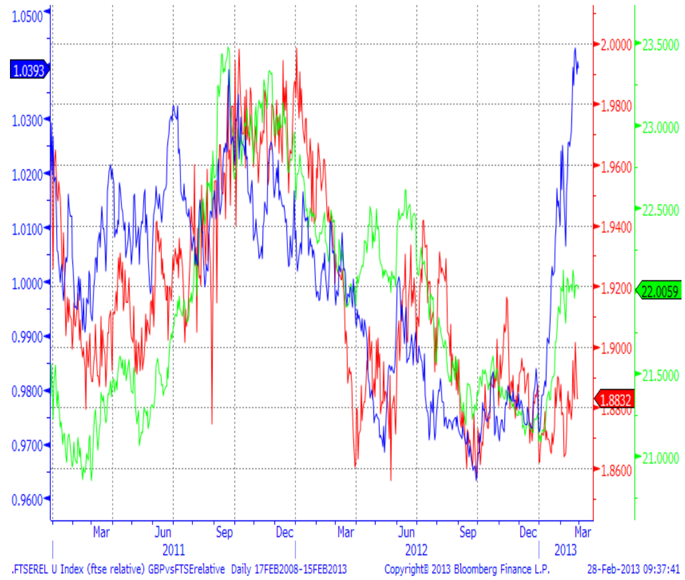
could be a good defensive asset. And, even if not, sterling weakness could allow strong UK performance.

Figure 5. US Corporates are Borrowing to Return Capital to Shareholders



Source: Citi Research and Reuters EcoWin

Figure 6. UK: Equities vs. Europe (Green), vs. Global (Red) and GBP FX Performance vs. Average EUR and GBP (Blue, Higher = Weaker GBP)



Source: Citi Research and Bloomberg

In forming our asset allocation recommendations, especially over the medium term, we consider the combined forecasts of Citi research strategists in our equity, credit, rates and commodity groups. Return forecasts from these specialists are shown in Figure 7.

Figures 8-9 put these forecast returns, and associated Sharpe ratios, into an historical perspective, while Figures 10-13 rank both returns and Sharpes for an easy comparison. Finally, Figures 14-16 lay out our recommended allocations for short- and medium-term horizons, which also take into account the following considerations:

- **Short-Term Considerations and Allocation:** Near term, despite new risks in Europe and elsewhere, we remain bullish risk assets. Our bias is for equity outperformance to continue but investors who have benefited from low volatility credit funds will likely take a while to be persuaded to return to equities and flows are not large yet (see p.27). We like US stocks on economic and earnings outperformance and also suggest buying easy money/ weak currency equity markets. Japan has had a good run and we move back to neutral but the UK is certainly worth consideration. Lack of USD downside and weak earnings news makes us more cautious on EM stocks near term. In rates we like some EM local markets still and think the back up in EMU spreads may allow an overweight to this asset class. Elsewhere in rates we are neutral or underweight. In commodities we are neutral precious and base metals but see a convexity/ diversification case for long oil as the demand supply balance is tightening and higher oil prices would be a DM growth risk.

- **Medium-Term Considerations and Allocation:** Here we expect equity outperformance over credit to become more marked, partly as risk-free yields also tend to rise. We suggest keeping overall credit allocations at neutral but

have government bonds overall shifting to underweight with only Bunds and EM local staying at neutral. Our commodity price forecasts are bearish medium term, especially energy. This suggests we have to take oil back to underweight medium term with the others remaining neutral. We end up long equities, neutral credit and underweight both government bonds and commodities. As a result we raise cash to overweight.

Citi Expectations for Returns to End-2013

- Whilst equity returns are expected to be above historical averages, they are unlikely to match 2012. Europe and EM outperform with the US close to their heels. After strong recent gains, Japanese equities are near year end targets.
- Credit returns are low single digit and will likely be below last year's and historical averages. Even volatility-adjusted, returns are not too exciting.
- Returns to G10 government bonds are likely to be weak and mostly negative. Germany outperforms whilst the US leads the sell-off.
- EM local rates to outperform DM government bonds. EM external debt spreads tighten slightly, but total returns are close to zero due to the UST back-up.
- Commodity returns weak compared with historical averages, especially energy.

Figure 7. Citi Strategist End-2013 Targets and Implied Total Returns

	Citi Forecast End-2013	Spot	Implied Total Return to End-2013	*Implied Total Return to End-2013 (USD)*
Equities[2]				
MSCI ACWI	**375**	353	**8.6%**	*8.6%*
S&P 500	**1615**	1516	**8.4%**	*8.4%*
DJ Stoxx 600	**330**	289	**17.4%**	*17.0%*
Topix	**940**	976	**-2.0%**	*-5.3%*
MSCI EM	**1150**	1047	**12.3%**	*12.3%*
Rates[3]				
US	**2.60**	1.89	**-2.9%**	*-2.9%*
DE	**1.55**	1.46	**1.2%**	*0.8%*
JP	**1.00**	0.66	**-2.4%**	*-5.8%*
UK	**2.40**	1.97	**-1.4%**	*-4.1%*
EM Local	**n/a**	n/a	**1.6%**	*1.3%*
Credit[4]				
Citi US BIG Corp	**110**	137	**1.3%**	*1.3%*
Citi US HY	**450**	495	**2.6%**	*2.6%*
iBoxx EUR Corp	**145**	140	**1.1%**	*0.7%*
iBoxx EUR HY	**480**	490	**3.9%**	*3.5%*
Citi ESBI EM $	**225**	264	**0.2%**	*0.2%*
Commodities[5]				
ICE Brent	**95**	106	**-10.6%**	*-10.6%*
LME Copper	**7900**	7918	**-0.2%**	*-0.2%*
Gold	**1650**	1607	**2.7%**	*2.7%*
Foreign Exchange[6]				
Global USD	**n/a**	n/a	**-0.3%**	*-0.3%*
USD vs. DM	**n/a**	n/a	**1.4%**	*1.4%*
USD vs. EM	**n/a**	n/a	**-3.0%**	*-3.0%*
Cash[7]				
3m USD Libor	**0.45**	0.29	**0.3%**	*0.3%*

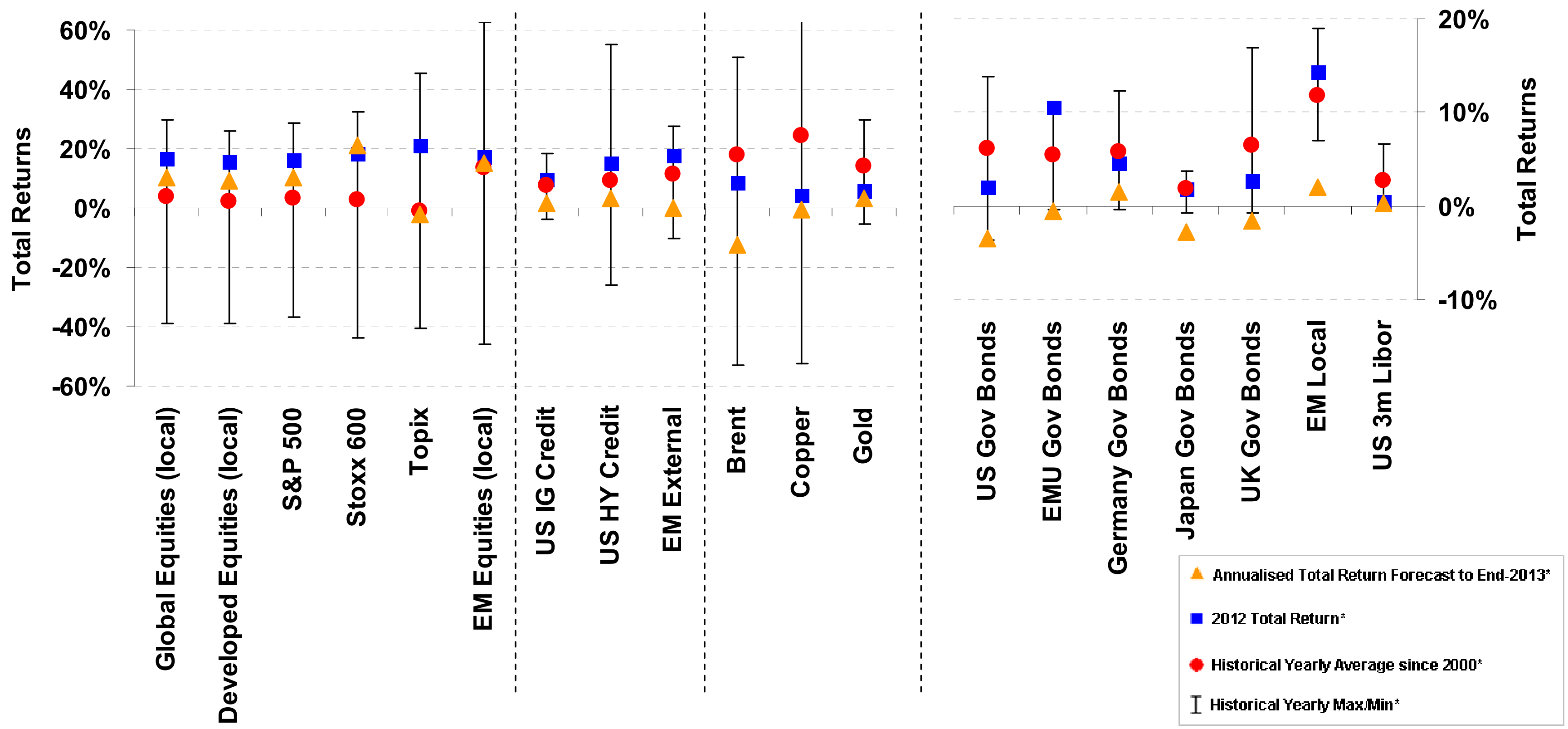
Source: Citi Research and Bloomberg

[1] Non-USD returns converted using Citi FX forecasts versus spot; [2] Only index targets set by Citi strategists, Bloomberg consensus forward dividend yield used to calculate implied total return; [3] G4 targets shown are on 10yr yields. Return forecasts are weighted across the curve. EM Local Debt forecast derived from views on Malaysia, Mexico, Brazil, Poland, Hungary, Turkey, South Africa; [4] Targets are on spreads, implied total return includes bond return (based on Citi 5yr and 10y yield forecasts) less expected default loss derived from Moody's 12m trailing default rates (0.0% for US and EUR IG, 3.0% in US HY, 1.4% in EUR HY, 0.0% for EM per year) and a 60% LGD; [5] Targets are price forecasts vs. equivalent futures price; [6] FX returns are GDP weighted USD returns vs. forwards; [7] 3m USD Libor return calculated from quarterly forecast path shown in the G10 rates section below

Historical Comparison of Return Forecasts

Figure 8 compares Citi Research total return forecasts across asset classes to their historical averages and ranges.

Figure 8. Citi Strategist End-2013 Targets in Historical Context



Source: Citi Research and Bloomberg

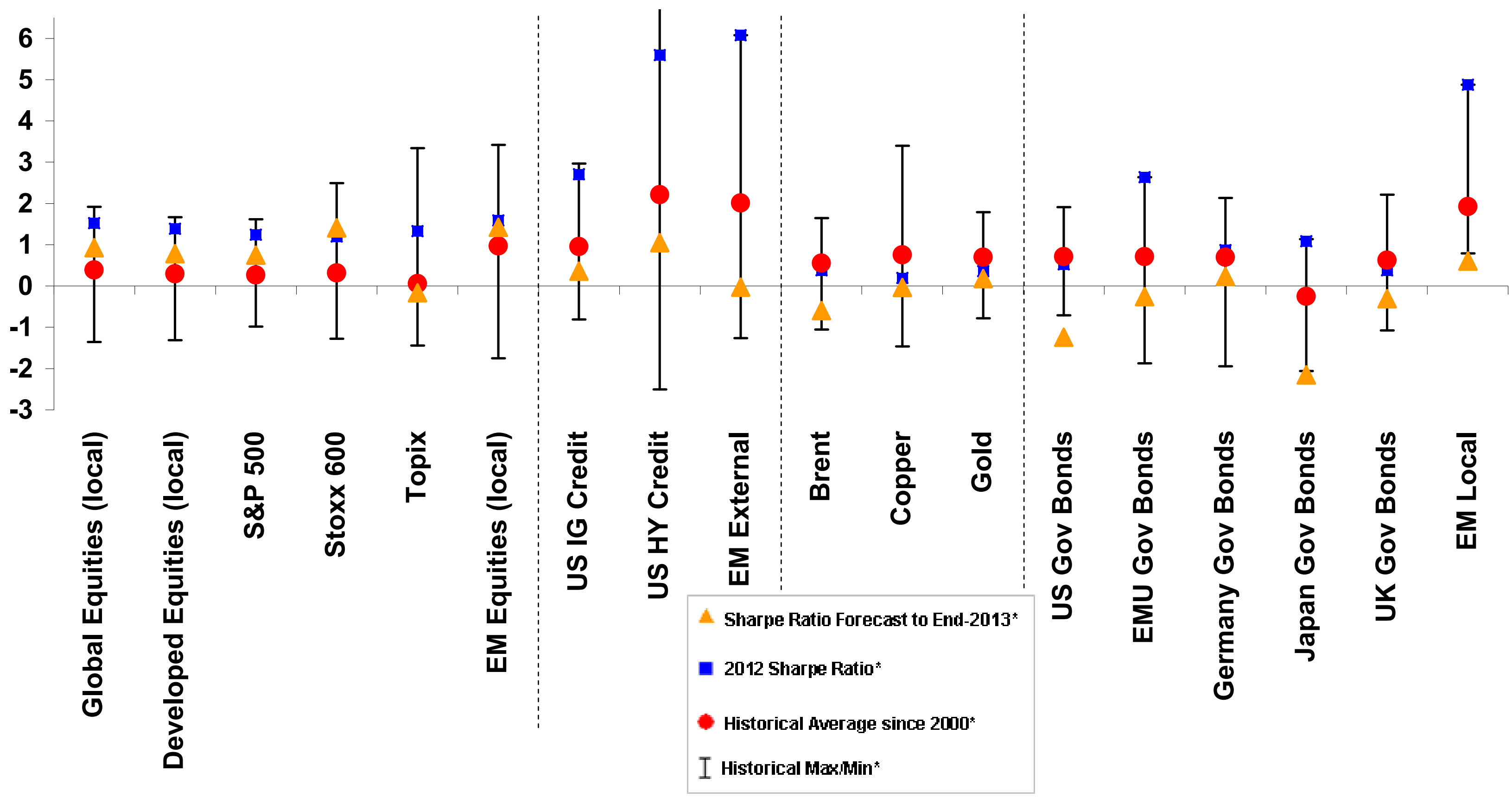
* Total return to forecasts shown on previous pages. See notes below

[1] Equity total returns based on total return indices in local ccy. Forecast total return calculated using index forecasts and Bloomberg consensus forward dividend yield. DM equity forecast derived from global and EM equity forecasts (taking into account market cap).
[2] Historical returns on credit based on Citi total return indices for all maturities, whereas Citi forecasts are on spreads and thus implied total return includes bond return (based on Citi 5yr and 10y yield forecasts) less expected default loss derived from Moody's 12m trailing default rates (0.0% for US and EUR IG, 3.0% in US HY, 1.4% in EUR HY, 0.0% for EM per year) and a 60% LGD
[3] European credit, included in our asset allocation on the following pages, has too little historic data to be included in the above chart
[4] Historical returns on G10 Government Bonds based on Citi WGBI indices for all maturities. Forecast for EMU Gov bond returns implied from 10y forecasts for constituent countries
[5] EM Local rate forecast based on views on Malaysia, Mexico, Brazil, Poland, Hungary, Turkey, South Africa. Historical returns data based on Citi GBI Local FX data spliced with JP Morgan GBI-EM USD less FX return using a static weight assumption for the countries listed above. Data available since 2002
[6] 3m USD Libor return calculated from quarterly forecast path shown in the G10 rates section below

Historical Comparison of Volatility Adjusted Return Forecasts

Figure 9 compares Citi Research Sharpe ratio forecasts across asset classes to their historical averages and ranges.

Figure 9. Implied Sharpe Ratios of Citi Strategist End-2013 Targets and Historical Volatility Adjusted Performance



Source: Citi Research and Bloomberg

* All returns and volatilities are calculated from total return indices and are annualised. See previous page for notes on return calculations.
Risk-free return used in historical calculations is US 1m deposit whereas Citi's US 3m Libor projections are used for forecast Sharpe ratios
Forecast Sharpe ratios assume future volatility equal to 12m rolling realised volatility

Ranking of Return and Sharpe Ratio Forecasts

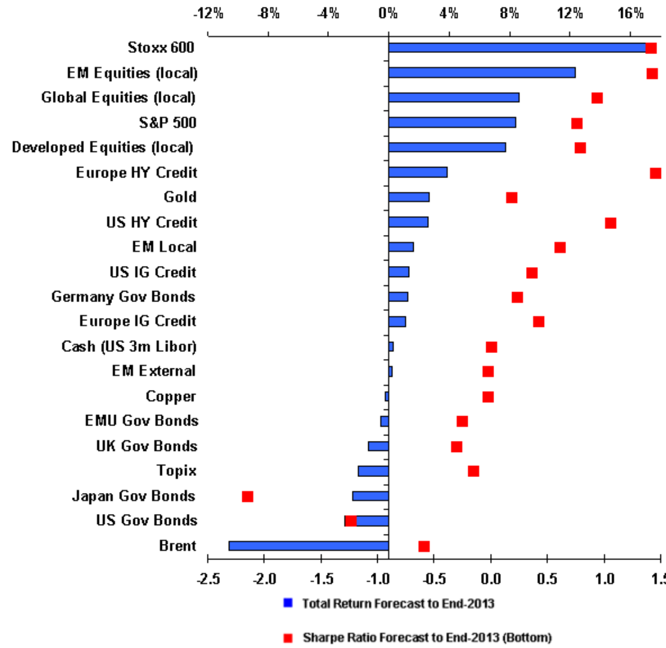
Ranking Citi strategists' total return forecasts to end-2013 (Figure 10 & Figure 11), equity markets occupy all of the top 5. Brent oil and government bonds rank worst.

Figure 10. Assets Ranked by Total Return Forecast

Rank	Asset	Forecast Return to End-2013	Sharpe Ratio to End-2013
1	Stoxx 600	17.4%	1.4
2	EM Equities (local)	12.3%	1.4
3	Global Equities (local)	8.6%	0.9
4	S&P 500	8.4%	0.8
5	Developed Equities (local)	7.7%	0.8
6	Europe HY Credit	3.9%	1.5
7	Gold	2.7%	0.2
8	US HY Credit	2.6%	1.1
9	EM Local	1.6%	0.6
10	US IG Credit	1.3%	0.4
11	Germany Gov Bonds	1.2%	0.2
12	Europe IG Credit	1.1%	0.4
13	Cash (US 3m Libor)	0.3%	0.0
14	EM External	0.2%	0.0
15	Copper	-0.2%	0.0
16	EMU Gov Bonds	-0.5%	-0.3
17	UK Gov Bonds	-1.4%	-0.3
18	Topix	-2.0%	-0.2
19	Japan Gov Bonds	-2.4%	-2.2
20	US Gov Bonds	-2.9%	-1.2
21	Brent	-10.6%	-0.6

Source: Citi Research

Figure 11. Assets Ranked by Total Return Forecast



Source: Citi Research

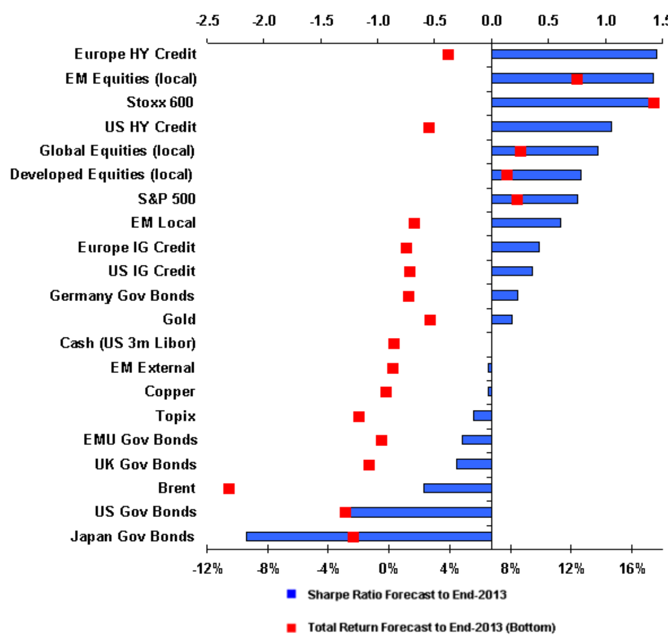
On a Sharpe ratio basis (Figure 12 & Figure 13) European and EM equities and HY credit are the winners. Core rates and commodities are weak on this basis also.

Figure 12. Assets Ranked by Sharpe Ratio Forecast

Rank	Asset	Sharpe Ratio to End-2013	Forecast Return to End-2013
1	Europe HY Credit	1.5	3.9%
2	EM Equities (local)	1.4	12.3%
3	Stoxx 600	1.4	17.4%
4	US HY Credit	1.1	2.6%
5	Global Equities (local)	0.9	8.6%
6	Developed Equities (local)	0.8	7.7%
7	S&P 500	0.8	8.4%
8	EM Local	0.6	1.6%
9	Europe IG Credit	0.4	1.1%
10	US IG Credit	0.4	1.3%
11	Germany Gov Bonds	0.2	1.2%
12	Gold	0.2	2.7%
13	Cash (US 3m Libor)	0.0	0.3%
14	EM External	0.0	0.2%
15	Copper	0.0	-0.2%
16	Topix	-0.2	-2.0%
17	EMU Gov Bonds	-0.3	-0.5%
18	UK Gov Bonds	-0.3	-1.4%
19	Brent	-0.6	-10.6%
20	US Gov Bonds	-1.2	-2.9%
21	Japan Gov Bonds	-2.2	-2.4%

Source: Citi Research

Figure 13. Assets Ranked by Sharpe Ratio Forecast



Source: Citi Research

Asset Allocation Framework

Based on the above discussion/ projected returns, our Asset Allocation recommendations are shown in Figure 14. Our allocation framework deliberately avoids specific allocations of capital budget to individual asset classes and markets since we anticipate that investors will operate under many different benchmark mandates and regulatory regimes. Rather, our framework uses a scaling of -2 through +2 to indicate preferences based on our assessment of likely risk-adjusted returns over both the short- and medium-term horizons shown here.

We also offer allocations at a relatively macro level of granularity. For more details on how to allocate within each asset class (for example, in EM equities), see the sector specialists listed in the latter part of this document.

Figure 14. Short- (3m) and Medium-Term (End-2013) Asset Allocation

	Short Term*					Medium Term*				
	-2	-1	0	+1	+2	-2	-1	0	+1	+2
EQUITIES				■					■	
DM				■				■		
US				■					■	
Europe			■					■		
Japan			■				■			
EM			■						■	
CREDIT			■					■		
US IG			■					■		
US HY				■				■		
Europe IG		■					■			
Europe HY			■						■	
EM External			■				■			
GOVERNMENTS			■				■			
US		■					■			
Europe				■			■			
Germany			■					■		
UK		■					■			
Japan			■				■			
EM Local				■				■		
COMMODITIES			■				■			
Energy				■			■			
Base			■					■		
Precious			■					■		
CASH		■							■	

Source: Citi Research

* Asset allocation measured in units of under/overweight:
-2 = very underweight; -1 = underweight; 0 = neutral; +1 = overweight; +2 = very overweight.
These measures do not formally take into account market capitalisation or liquidity.
They do not necessarily sum to zero across the allocation.
Short term assumes a 3m horizon, medium term assumes a roughly 12m horizon.

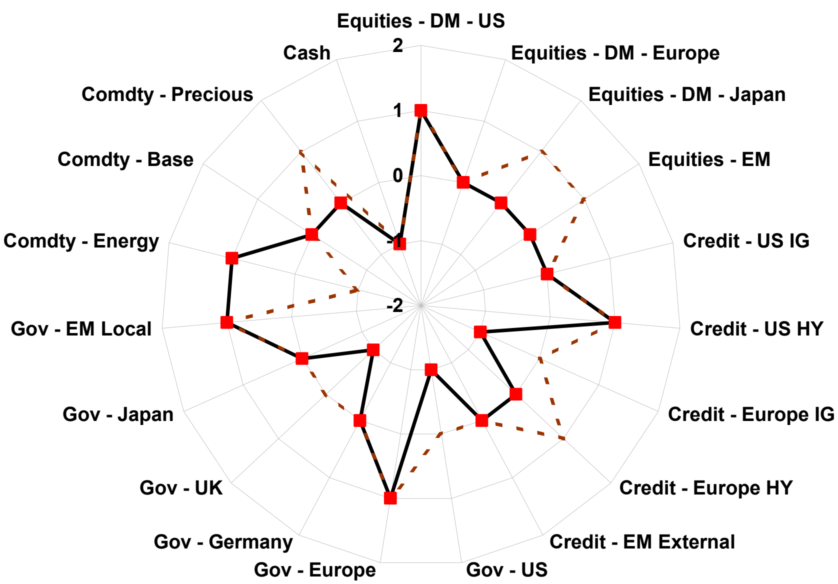
Changes to Our Recommended Allocations

Compared to our last publication in January 2013, our broad asset class allocations have remained broadly unchanged, still expecting equity markets to outperform credit and government bonds.

In our short-term allocation (Figure 15), having had a strong run in recent months, we have pulled back Japanese equities to neutral. The underperformance of EM equities continues and we prefer neutral exposure here too. In credit markets, given recent EMU volatility, we have downgraded European IG and HY by one step to underweight and neutral respectively. We are now underweight both US and UK government bonds. Finally, in commodities we go overweight energy given the tightening supply/ demand balance and with momentum clearly to the downside, pull back precious metals to neutral.

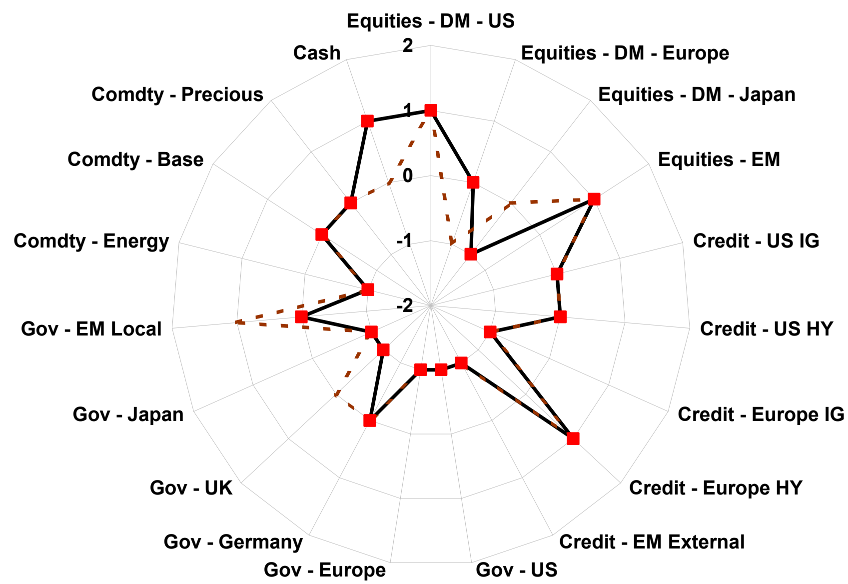
In the medium-term allocation (Figure 16), European equities are upgraded to neutral and Japanese stocks downgraded to underweight. In government bond markets we downgrade the UK to underweight and are now neutral in EM local. Our cash allocation is increased to overweight.

Figure 15. Short-Term Asset Allocation & Last Allocation (Dash)



Source: Citi Research

Figure 16. Medium-Term Asset Allocation & Last Allocation (Dash)



Source: Citi Research

Citi Strategy Views by Asset Class

The following contains a summary of the views of Citi Economists and Strategists (see Figure 49). Please see the original research reports for their entire views as summarised here.

Economic Outlook

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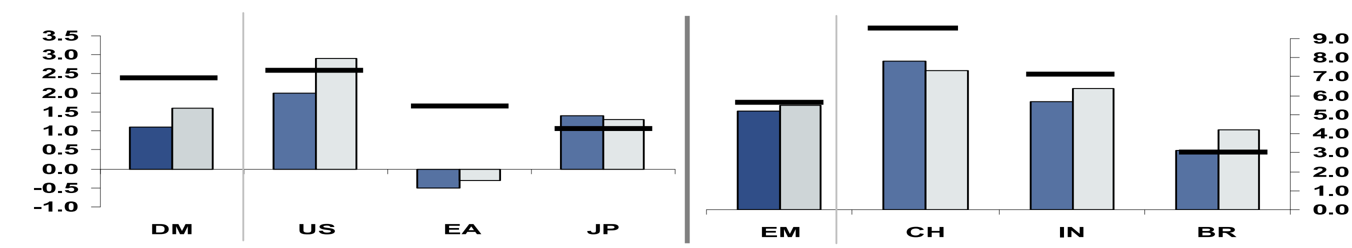
Please see the latest Global Economic Outlook and Strategy publication for full descriptions of the views summarised here.

Global growth remains close to its long run average, supported by loose monetary policy. Big disparities between regions and large medium-term uncertainties exist.

- Overall, we are edging up our 2013 global growth forecast by 0.1% to 2.7% and leaving our 2014 forecast at 3.2%, at current exchange rates.
- Within this, we are making minor upgrades to our 2013-14 forecasts for Japan and EMU. In the US, there are tail risks around the debt ceiling crisis but our medium-term outlook is relatively optimistic. The US should outperform the EA by 2-3ppt in coming years.
- In the euro area, break up risks continue to recede, but we believe that the EMU crisis is not over. We expect that Italy, Spain, Portugal and Ireland will all request ECCL programmes in the next 12-18 months. Debt restructuring remains likely further ahead for Portugal, Italy, Spain and Greece. Finally, we continue to expect that Greece will probably exit EMU eventually.
- We expect China's economic growth to level off at 7-8% this year and at 7-7½% per year in 2014-2017.

Consumer inflation trends remain benign with Global CPI inflation at 2.8% in 2013 and 3.0% in 2014.

Figure 17. Real GDP Forecasts vs. Historical Averages*



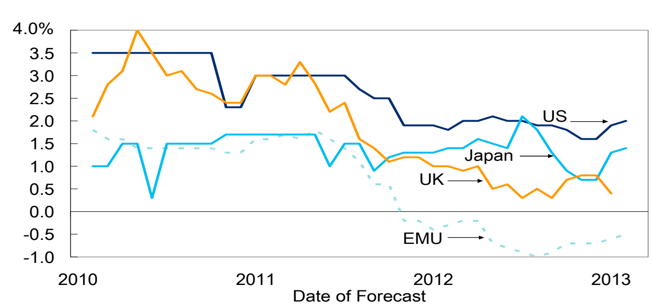
Source: Citi Research and Bloomberg * Historical averages using IMF data: 1990 to 2010 for DM, 1996 to 2010 for EM

Figure 18. Citi Forecast For Major Economies

	Current Account (%GDP), 2013F	Fiscal Balance (%GDP), 2013F	Government Debt (%GDP), 2013F
United States	-2.8	-7.2	110
Japan	0.3	-9.8	244
Euro Area	3.0	-2.7	95
Germany	5.9	-0.1	82
France	-1.5	-3.7	96
Italy	-0.3	-2.8	131
Spain	2.1	-6.4	99
Greece	-3.3	-5.7	180
Portugal	-1.4	-5.4	136
United Kingdom	-4.2	-7.9	98
China	2.0	-2.0	43
India	-4.3	-8.3	67
Brazil	-3.0	-2.4	57

Source: Citi Research

Figure 19. Citi Forecasts for 2013 Real GDP Growth, 2010-13

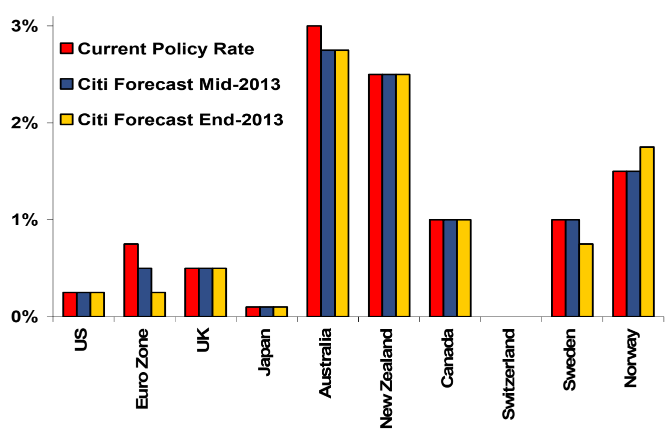


Source: Citi Research

Major central banks are likely to keep monetary policy loose and loosen further:

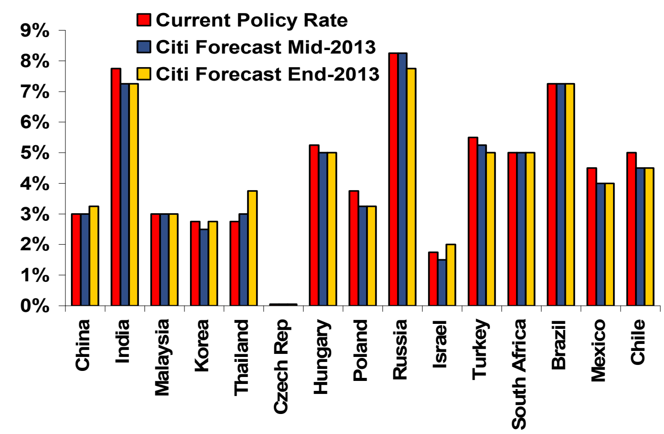
- The drag from fiscal restraint and policymakers' high bar for satisfactory job growth will likely sustain QE at an elevated pace through the first half. Beyond that, officials may begin to taper the pace of QE in the second half of 2012. High unemployment and low inflation suggest no start to exit strategies through 2014.
- We continue to believe that the ECB will do whatever it takes to save the euro, even if this requires new innovations in monetary tools. We also expect the ECB will cut rates further in response to the strong euro and weak growth prospects.
- The new BoJ governor will focus initially on expanding purchases of JGBs and extending the maximum maturity of JGBs purchased. Depending on economic and financial developments, the BoJ also may consider lowering policy rates and/or interest on excess reserves.
- In the UK, we suspect that the MPC will stay biased to loosen further, encouraging a weaker pound and probably also modestly expanding QE further. Their flexibility may well be reinforced with a change in the inflation target from a 2% point to a more flexible 1-3% band.

Figure 20. DM Policy Rate Forecasts



Source: Citi Research and Bloomberg

Figure 21. EM Policy Rate Forecasts



Source: Citi Research and Bloomberg

Policy Rate Forecasts

Developed Markets

- Citi economists see low US rates throughout the forecast horizon. The ECB will likely cut the refi rate to 0.5% by mid-year and to 0.25% in Q3 2013.
- Swedish rates are likely to be cut by 25bps in Q3 2013. The RBA is expected to deliver one more rate cut in H1 2013, but be on hold from there.
- Further out, some tightening is expected in Norway, Canada and New Zealand.

Emerging Markets

- The general bias in EM countries is for stable to lower policy rates in H1 2013.
- Outliers are mostly in Asia: Thailand and Indonesia are expected to hike first, followed by China and Korea in the second half. Israel is also seen to hike in H2.

Global Foreign Exchange Outlook

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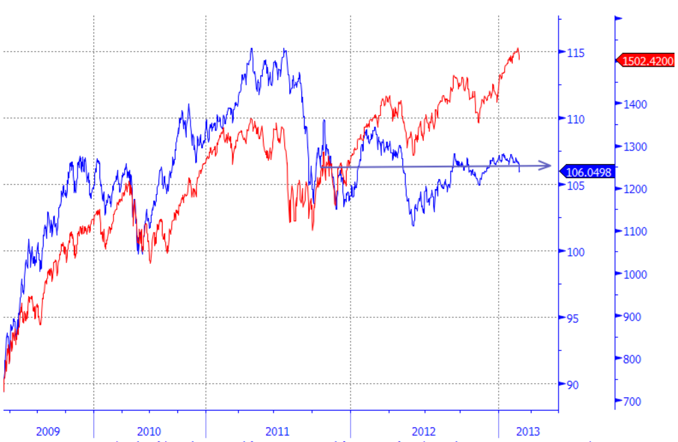
Please see the latest Foreign Exchange Forecasts for full descriptions of the views summarised here.

A feature of global asset markets in recent months has been the resumption of macro alpha, or decline in macro correlation, as the pure risk-on/ risk-off model fades. One specific feature of this has been that the USD has been much less weak in the face of strong risk appetite/ rising equity markets than would have been the case in 2009-2011. In part, this may be down to the highly accommodative monetary policies now being followed not just in the US, although US economic outperformance is an important driver too.

Our forecasts anticipate full Fed accommodation remaining in place over the near term with the USD losing ground. Over 6-12 months, the picture is more mixed, with the dollar gaining in G10 and some EMs but Asian currencies strengthening.

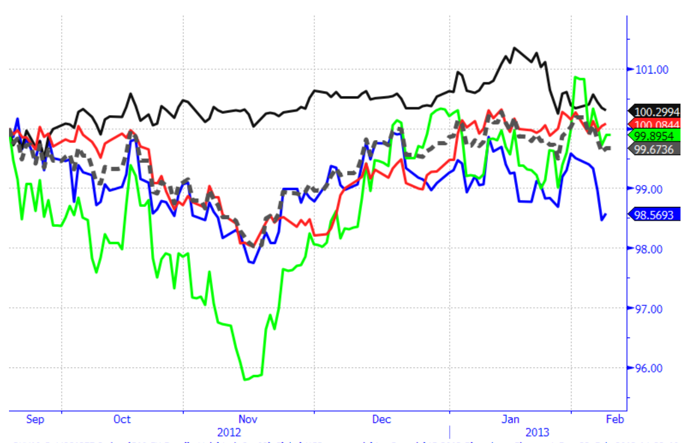
- Our call on the euro remains a tussle between relative risk and relative monetary policies. We forecast the cross at 1.35 near term, 1.31 in 6-12 months.
- The USD/JPY move is losing momentum. Overall we forecast a 95-100 range over the next 12 months.
- GBP has been the worst performing major since our last *Forecasts*, weakening sharply against both the USD and EUR. Over 6-12 months we see GBP extending losses and also trading materially below long term fair value.
- EUR/CHF will likely continue trending above 1.20 and we have raised our 6-12 month forecast to 1.25, in line with our short term view.
- We don't see EM FX as a sure fire winner in the near term and EM FX may continue to do less well than suggested by moves in risk appetite.
- All three EM regions are seen stronger vs. the US dollar, but only modestly, by between 0.5% and around 1% in the next three months. Over this period, RUB is forecast to give the best returns vs. the USD, and HUF and MYR the worst.

Figure 22. USD Global Index (Blue, Including EM, Higher = Weaker USD) and SPX (Red)



Sources: Citi Research and Bloomberg

Figure 23. USD vs. Regions, Normalised to 17 Sep 2012=100. Blue=G10, Green=CEEMEA, Red=LATAM, Black=Asia, Grey Dash=Global. Higher = Weaker USD. All indices evenly weighted



Sources: Citi Research and Bloomberg

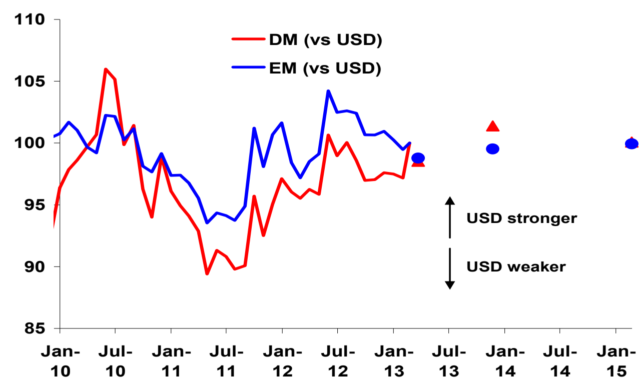
Figure 24. Citi Foreign Exchange Forecasts

		Market data			Forecasts			Returns***	
		spot*	3m Fwd	12m Fwd	0-3 mos	6-12 mos	long-term	3 mos rtn	12 mos rtn
G10									
Euro	EURUSD	1.32	1.32	1.32	1.35	1.31	1.30	2.5%	-0.8%
Japanese yen	USDJPY	93	93	93	95	96	90	1.8%	3.2%
British Pound	GBPUSD	1.53	1.53	1.52	1.57	1.47	1.53	2.9%	-3.5%
Swiss Franc	USDCHF	0.93	0.93	0.93	0.93	0.95	1.00	-0.5%	3.0%
Australian Dollar	AUDUSD	1.03	1.02	1.00	1.04	1.00	0.96	1.2%	-0.3%
New Zealand Dollar	NZDUSD	0.84	0.83	0.81	0.86	0.84	0.72	3.6%	3.2%
Canadian Dollar	USDCAD	1.02	1.03	1.03	1.01	1.03	0.97	-1.5%	-0.2%
Dollar Index**	DXY	81.51	81.51	81.43	80.01	82.55	81.51	-1.8%	1.4%
G10 Crosses									
Japanese yen	EURJPY	123	123	123	128	126	117	4.3%	2.4%
Swiss Franc	EURCHF	1.23	1.23	1.22	1.25	1.25	1.30	2.0%	2.1%
British Pound	EURGBP	0.86	0.86	0.87	0.86	0.89	0.85	-0.4%	2.8%
Swedish Krona	EURSEK	8.48	8.50	8.57	8.30	8.45	8.40	-2.3%	-1.4%
Norwegian Krone	EURNOK	7.48	7.52	7.62	7.35	7.30	7.25	-2.2%	-4.2%
Norwegian Krone	NOKSEK	1.13	1.13	1.12	1.13	1.16	1.16	-0.1%	2.9%
Australian Dollar	AUDNZD	1.23	1.23	1.23	1.20	1.19	1.33	-2.3%	-3.4%
Australian Dollar	AUDJPY	96	95	93	98	96	86	3.0%	2.8%
Asia									
Chinese Renminbi	USDCNY	6.24	6.30	6.33	6.19	6.10	6.05	-1.7%	-3.6%
Hong Kong Dollar	USDHKD	7.76	7.75	7.75	7.75	7.76	7.75	-0.1%	0.2%
Indonesian Rupiah	USDIDR	9707	9795	10143	9750	9800	9660	-0.5%	-3.4%
Indian Rupee	USDINR	54.2	55.3	57.8	53.0	55.0	54.5	-4.2%	-4.9%
Korean Won	USDKRW	1085	1092	1105	1060	1030	995	-3.0%	-6.8%
Malaysian Ringgit	USDMYR	3.10	3.12	3.17	3.18	3.00	3.05	1.9%	-5.4%
Philippine Peso	USDPHP	40.7	40.7	40.7	40.2	39.9	40.8	-1.3%	-2.0%
Singapore Dollar	USDSGD	1.24	1.24	1.24	1.23	1.22	1.19	-0.6%	-1.4%
Thai Baht	USDTHB	29.9	30.0	30.4	29.6	30.5	29.9	-1.3%	0.5%
Taiwan Dollar	USDTWD	29.6	29.6	29.3	29.7	28.5	28.2	0.4%	-2.6%
EMEA									
Czech Koruna	EURCZK	25.5	25.5	25.6	25.8	26.1	24.9	1.0%	2.1%
Hungarian Forint	EURHUF	294	298	305	310	300	290	4.2%	-1.7%
Polish Zloty	EURPLN	4.17	4.20	4.30	4.15	4.30	3.90	-1.3%	0.0%
Israeli Shekel	USDILS	3.72	3.73	3.76	3.60	3.90	4.20	-3.5%	3.6%
Russian Ruble	USDRUB	30.4	30.9	32.2	29.4	31.6	33.0	-5.0%	-1.9%
Russian Ruble Basket		34.8	35.3	36.9	34.0	36.0	37.5	-3.8%	-2.3%
Turkish Lira	USDTRY	1.80	1.82	1.89	1.80	1.85	1.90	-1.2%	-1.9%
South African Rand	USDZAR	8.88	8.99	9.32	9.00	9.10	9.50	0.1%	-2.3%
LATAM									
Brazilian Real	USDBRL	1.97	1.99	2.09	1.95	1.98	2.10	-2.2%	-5.1%
Chilean Peso	USDCLP	474	480	496	470	480	490	-2.1%	-3.2%
Mexican Peso	USDMXN	12.8	12.9	13.2	12.5	12.3	12.3	-2.9%	-6.8%
Colombian Peso	USDCOP	1803	1818	1862	1775	1800	1800	-2.4%	-3.3%

* market data including spot as of 4:22 PM London time on 22-Feb-2013
** The DXY forecasts are implied from the forecasts of the constituent crosses. *** Returns are relative to forwards

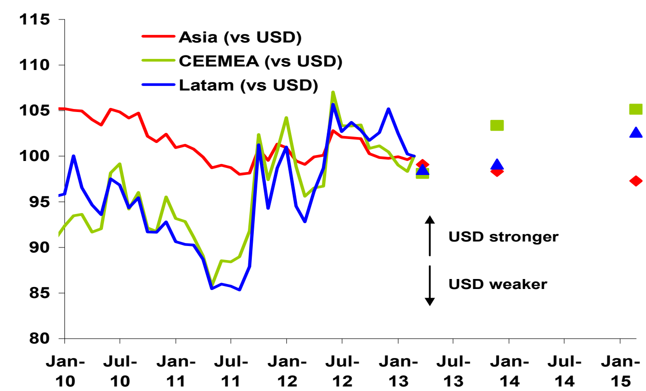
Source: Citi Research and Bloomberg

Figure 25. DM & EM – Forecasts Paths



Sources: Citi Research and Bloomberg

Figure 26. EM Regions – Forecasts Paths



Source: Citi Research and Bloomberg

Developed Markets Rates Strategy

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Please see the latest G10 Rates Weekly, the latest European Rates Weekly, the latest US Rates & MBS Weekly and the last edition of the APAC Developed Markets Rates Strategy publication for full descriptions of the views summarised here.

US Households and pension funds are not overinvested in fixed-income relative to recent or longer historical benchmarks. We hence do not expect a major multi-year sustained reallocation out of fixed-income into equities. However, a small flush out of momentum retail investors is likely in a treasury sell-off.

Europe

- Near-term event risks suggest a tactical bullish bias. Further out, bunds are likely range-bound and our forecasts show the 1.35/1.75% range holding.
- Recent MPC minutes reinforced the message that policy will be kept accommodative. The medium-term risks facing gilts are increasingly bearish.
- We see only negatives from the Italian election: the big question is how many materialize. We fear there is a lot more selling to come as risk appetite continues to weaken, the market is caught long, and even bulls are wary of being too early.

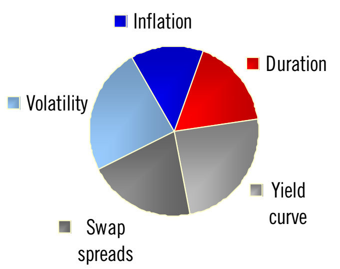
US

- We see a shift forward in the QE timeline as a bear steepening event. We also expect rates to rise more fundamentally throughout 2013 but will be tactical given the negative carry of short positions.
- We expect 10yr Treasury yields to rise to 2.60% by year-end.

APAC

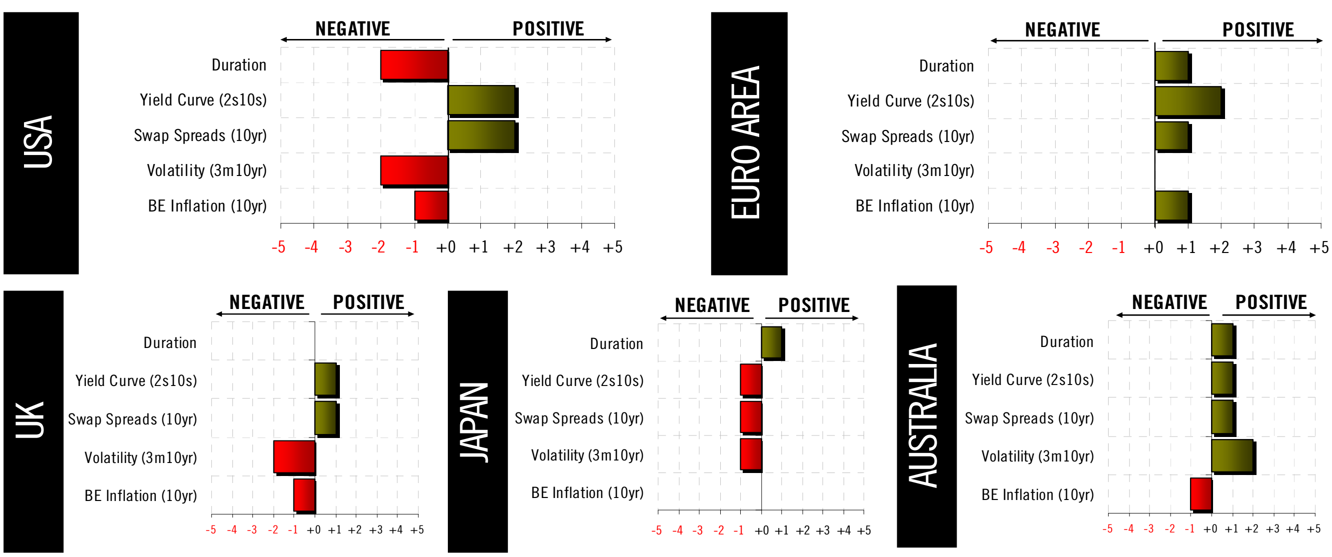
- Selling of JGBs has been limited, even as yen weakened, equities rallied and UST yields rose. We expect JGBs to maintain this bullish trajectory short term.
- Sell rallies in the Antipodean markets. We recommend entering low-cost OTM payer spreads in the AUD gamma sector.

Figure 27. Near-Term Global Risk Allocation



Source: Citi Research

Figure 28. Near-Term Strategy Views*



Source: Citi Research *a positive score across the categories means i) lower rates ii) steeper curve iii) wider swap spreads iv) higher volatility v) higher breakevens

Figure 29. Interest Rate and Bond Market Forecasts

		Quarterly Average					
	Current	1Q 13	2Q 13	3Q 13	4Q 13	1Q 14	2Q 14
US							
Policy Rate (Fed Funds) End Quarter	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3-Month Libor	0.29	0.30	0.30	0.35	0.40	0.50	0.60
2 Year Treasury Yield	0.24	0.30	0.30	0.40	0.50	0.60	0.75
5 Year Treasury Yield	0.78	0.95	0.95	1.10	1.25	1.55	1.75
10 Year Treasury Yield	1.89	2.05	2.05	2.30	2.60	2.85	3.00
30 Year Treasury Yield	3.09	3.30	3.30	3.60	3.95	4.15	4.30
2-10 Year Treasury Curve	189	175	175	190	210	225	225
2 Year Swap Spread (Swap Less Govt.), bp	15	15	15	17	20	20	20
10 Year Swap Spread (Swap Less Govt.), bp	9	8	8	7	5	0	0
30 Year Swap Spread (Swap Less Govt.), bp	-15	-15	-20	-20	-25	-30	-35
30 Year Mortgage Yield	3.77	3.75	3.75	3.90	4.05	4.35	4.45
10 Year Breakeven Inflation	253	255	255	250	245	240	240
Euro Area							
Policy Rate	0.75	0.75	0.50	0.25	0.25	0.25	0.25
Overnight Rate (EONIA)	0.06	0.07	0.00	-0.05	-0.05	-0.05	-0.05
3-Month Libor	0.13	0.14	0.05	0.05	0.00	0.00	0.00
2 Year Treasury Yield	0.07	0.14	0.05	0.05	0.00	0.05	0.05
5 Year Treasury Yield	0.45	0.57	0.50	0.75	0.50	0.55	0.60
10 Year Treasury Yield	1.46	1.55	1.40	1.75	1.55	1.35	1.55
30 Year Treasury Yield	2.32	2.35	2.10	2.40	2.20	2.20	2.30
2-10 Year Treasury Curve	139	142	150	170	150	120	145
10 Year BTP-Bund Spread	334	300	420	350	400	400	400
10 Year Bono-Bund Spread	377	365	450	380	400	400	400
2 Year BTP-Schatz Spread	200	165	240	240	240	240	240
2 Year Bono Schatz Spread	260	235	250	250	250	250	250
10 Year Swap Spread (Swap Less Govt.), bp	31	23	25	20	35	45	45
10 Year Breakeven Inflation	177	185	180	190	185	180	185
Japan							
Policy Rate	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3-Month Libor	0.16	0.15	0.15	0.15	0.15	0.15	0.15
2 Year Treasury Yield	0.05	0.05	0.05	0.05	0.10	0.10	0.05
5 Year Treasury Yield	0.12	0.15	0.20	0.15	0.25	0.25	0.20
10 Year Treasury Yield	0.66	0.75	0.85	0.80	1.00	1.00	0.90
30 Year Treasury Yield	1.83	1.95	2.05	2.00	2.15	2.15	2.10
2-10 Year Treasury Curve	61	70	80	75	90	90	85
2 Year Swap Spread (Swap Less Govt.), bp	16	16	20	18	22	22	20
10 Year Swap Spread (Swap Less Govt.), bp	7	4	7	5	10	10	7
UK							
Policy Rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-Month Libor	0.51	0.51	0.51	0.52	0.52	0.52	0.55
2 Year Treasury Yield	0.23	0.33	0.25	0.45	0.35	0.25	0.35
5 Year Treasury Yield	0.78	0.90	0.85	1.15	1.10	1.00	1.10
10 Year Treasury Yield	1.96	2.10	2.10	2.50	2.40	2.30	2.45
30 Year Treasury Yield	3.28	3.35	3.40	3.60	3.55	3.50	3.60
2-10 Year Treasury Curve	173	177	185	205	205	205	210
10 Year Swap Spread (Swap Less Govt.), bp	5	1	5	0	10	20	10
10 Year Breakeven Inflation	312	295	315	355	345	340	345
Australia							
Policy Rate	3.00	3.00	2.75	2.75	2.75	2.75	3.00
3-Month Libor	3.17	2.90	2.90	2.90	3.00	3.00	3.20
2 Year Treasury Yield	2.67	2.70	2.80	3.00	3.15	3.20	3.40
5 Year Treasury Yield	2.92	2.95	3.05	3.25	3.40	3.46	3.60
10 Year Treasury Yield	3.35	3.40	3.50	3.65	3.80	3.90	4.00
2-10 Year Treasury Curve	68	70	70	65	65	70	60
10 Year Swap Spread (Swap Less Govt.), bp	60	55	60	60	65	70	75

Source: Citi Research and Bloomberg

Emerging Markets Rates Strategy

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Please see the latest Global Economic Outlook and Strategy publication for full descriptions of the views summarised here.

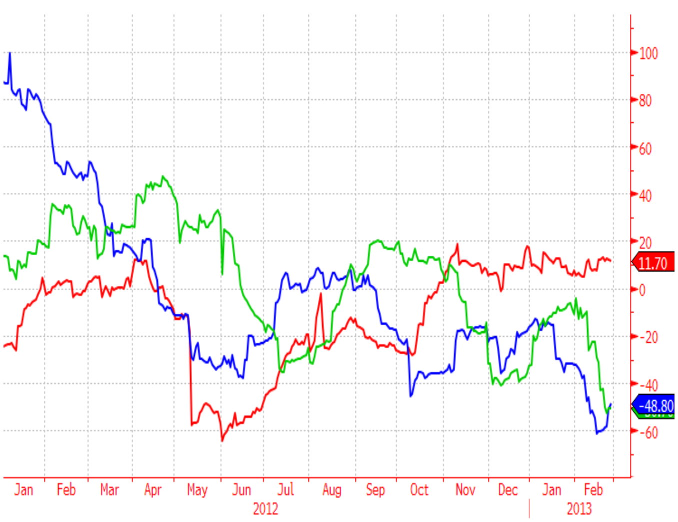
For the majority of EM countries, inflationary pressures have been absent so far. Powerful base effects for food prices kick in soon and should keep a lid on inflation pressures, given the hefty weight of food in most EM inflation baskets. Furthermore, and particularly in CEE and Latam, weakening domestic backdrops – as suggested, for example, by recent disappointing data prints (Economic Surprise Indices are negative and falling) – suggest continued reliance on stimulative policies. Whilst not our base case, we do note that EM FX has been less strong than expected, and that, if sustained, this may reduce the need for offsetting ease in interest rate policy.

Further out, as output gaps disappear, core pressures may re-emerge. This is most pronounced in Asia, where ESIs have been much stronger and we see several central banks, including China, turning more hawkish/hiking in H2 2013.

- In H1, most EM central banks are forecast to cut interest rates or stand pat.
- In H2, four EMs are expected to hike, predominantly in Asia, against two that we expect to continue easing from H1.
- In India, Brazil and Mexico, Citi economists' forecasts suggest a more dovish stance by the authorities than what's priced into markets currently. In Korea, Thailand, Hungary and Turkey forecasts are hawkish compared to market pricing.

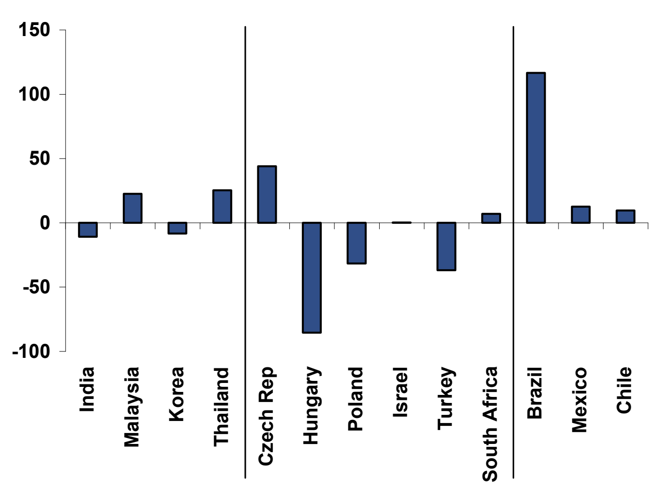
While we anticipate some investor "rotation" away from fixed income to equities, we also expect a continued rotation within fixed income towards higher yielding countries. We therefore forecast further modest spread compression in local rates vs. US rates. Local EM debt continues to outperform EM dollar debt, given much more attractive yields and lower sensitivity to moves in the US yields. At the country level, returns on high yielding Turkish and Brazilian local currency debt are expected to be most attractive. Poland and Hungary look the least appealing, with steeper curves expected in each.

Figure 30. EM ESIs – Asia (Red), Latam (Green) and CEEMEA (Blue)



Sources: Citi Research and Bloomberg

Figure 31. Interest Rate Moves Priced In Over 12m*



Source: Citi Research and Bloomberg *relative to current market fixings

Global Equity Strategy

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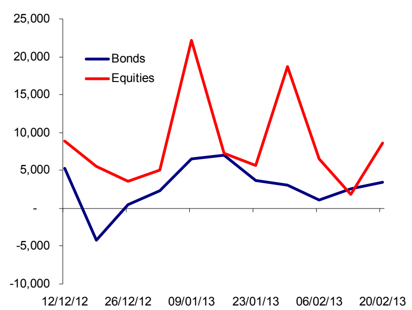
Please see The Road Ahead 2013: Global Equities and The Road Ahead 2013: EM Equities publications for full descriptions of the views summarised here.

Global equities have made an impressive start to 2013 and we expect just under 9% total returns by end-2013. On balance, a world of easy money, low bond yields and attractive equity valuation trump concerns about systemic risk. That said, a short term pause for breath might be imminent.

- We remain concerned that After the First 20% gain in equity markets further gains require: 1) lower starting valuations, 2) double digit EPS growth, 3) rising PMIs 4) rising core govt bond yields and 5) sustained flows into equity funds.
- As "The Bond Refugees" love yield we think that global high dividend equities should outperform. Equally they tend to hate drawdowns in risk off periods so we advocate a global blue-chip portfolio selection that matches these criteria.
- We regard the media driven optimism that the recent flow of cash into equity funds is evidence of a major shift in investment orientation with some skepticism. As we argue in The Rotation Consternation Meets Equity Visitation we would need to see inflows sustained through a correction before we are convinced.
- Globally, we prefer US equities that should benefit from GDP and EPS outperformance. We also like Australia. With weaker GDP and EPS we are less tempted to chase Japan and Europe ex UK.

Figure 32. Weekly Fund Inflows ($mn)



Source: Citi Research and EPFR

Figure 33. Global Equity Strategy Regional Recommendations

Global Equity Strategy Regional Allocation		
Overweight	**Neutral**	**Underweight**
US	Global Emerging Markets	Europe ex UK
Australia	Asia Pac ex-Japan	Japan
	UK	

Source: Citi Research

Globally, we continue to like IT and Utilities and Energy in the commodity sector. We are underweight Consumer Discretionary, Industrials and Telecoms, as our least preferred defensive.

Figure 34. Sector Recommendations by Region (O = Overweight, N = Neutral, U = Underweight)

Sector Allocations	Global	US	Pan-Europe	UK	Japan	Asia ex Japan	Austr.	GEMs
Energy	O	N	U	U	N	O	O	N
Materials	N	U	N	N	N	U	O	O
Industrials	U	O	N	N	N	O	U	N
Consumer Discretionary	U	U	N	N	O	U	O	O
Consumer Staples	N	U	O	O	U	U	U	U
Health Care	N	U	O	O	U	U	N	U
Financials	N	O	O	O	O	O	N	O
IT	O	O	N	N	N	O	N	N
Telecoms	U	O	U	U	N	U	U	U
Utilities	O	O	U	U	U	U	U	U

Source: Citi Research

Credit Strategy

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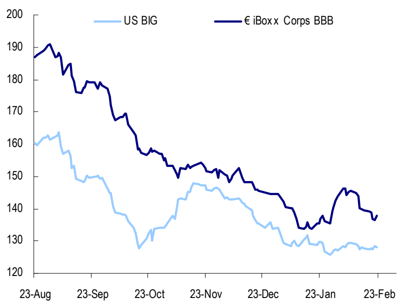
Please see our latest European credit outlook, European Credit Sector Recommendations, 2013 US Credit Outlook and our US High Grade Sector Recommendations for a full description of the views summarised here.

The Italian election has again reminded markets of the latent lingering risks. While reaction in credit spreads reflects the perception that systemic risks remains bounded by the OMT and excess liquidity, it reinforces our view that underlying risk/reward in credit is comparatively poor.

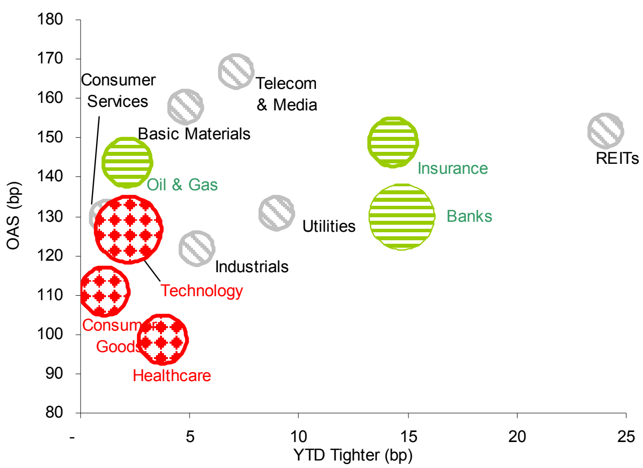
Figure 35. IG Cash Index Spreads (bp)



Source: Citi Research and YieldBook

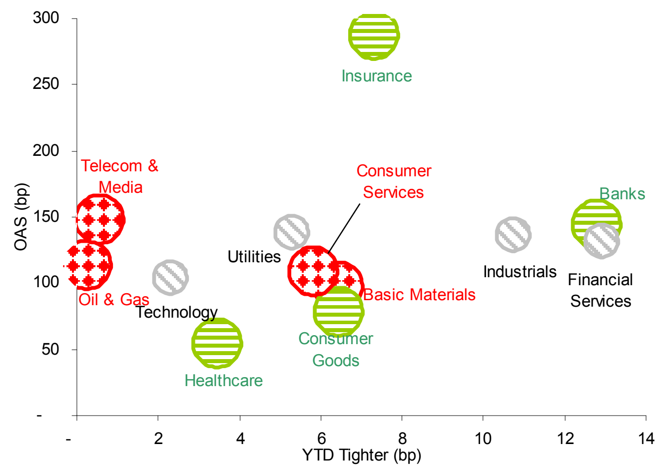
- In the next couple of months we recommend being neutral or underinvested in anticipation of better entry points on the back of: ratings downgrades, fear of stimulus ending, political divisions, weak data etc.
- More medium term, liquidity will still dominate weak fundamentals and cash spreads will end the year 10-15bps tighter than they are currently. Some reallocation from credit to equities will take place but not in enough volume to offset the positive technicals from the excess liquidity.
- 2013 should be a less difficult year to generate alpha but still challenging by historic norms. In the US our strategists favour US-domiciled Banks, Life Insurers and Energy. They dislike Healthcare, Consumer Goods and Tech. In Europe, they like Insurance, Banks, Consumer Goods and Healthcare. However, they favour rotating out of some of the better-performing peripherals into core names as the spread give-up is small at the moment relative to the risk.
- Some spreads have already traded tighter than our 2013 year-end forecasts but we expect to see a correction later in the year and stick by our current forecasts as we expect markets to demand greater risk compensation, especially in Europe.

Figure 36. US Sector Preferences, Current Spread and Performance (blue stripe = o/w, grey diagonal = neutral, red diamond = u/w)



Source: Citi Research and YieldBook

Figure 37. EUR Sector Preferences, Current Spread and Performance (blue stripe = o/w, grey diagonal = neutral, red diamond = u/w)



Source: Citi Research and MarkIt

Commodities Strategy

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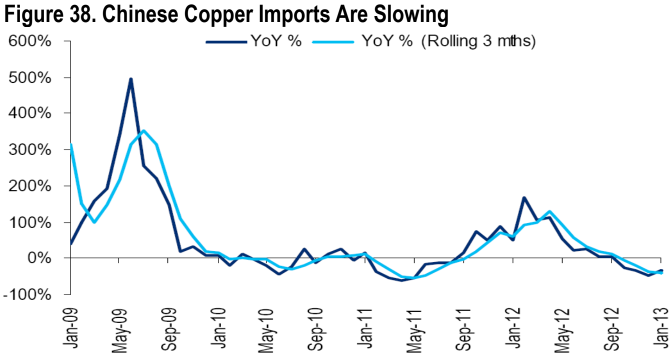
Please see the 2013 Commodities Outlook, the publication entitled US Crude Glut, One Step Closer To Brent, the latest Industrial Commodities publication, the latest PGM Update and the recent Agriculture Digest for full descriptions of the views summarised here.

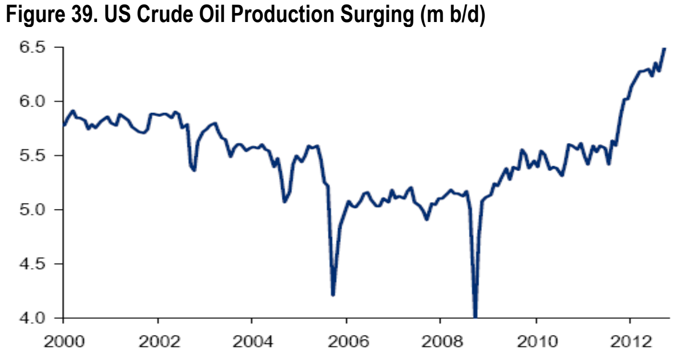
- The commodities super-cycle is over and market conditions approximating those of the last decade won't return in 2013 or any time soon, in our view.
- On the demand side, two structural shifts in China are paramount to the demand outlook: lower-paced growth and a far less commodity-intensive economy. In the meantime, supply remains ample for many commodities.
- The impressive rally in crude oil over the past month belies indifferent fundamentals. Citi's moderately bearish base case scenario for 2013, in which the ongoing surge in US shale and other supply helps the market to normalize, is playing out on the ground if not (yet) on the screen. Although immediate tensions have receded, geopolitics continue to pose a risk to the oil market.
- Expected Chinese structural shifts remain a key driver for base metals. The Chinese buying post the Lunar New Year holidays many expected, has so far failed to materialize. China is now 'over- supplied' with copper and we expect Chinese copper imports to continue the month-on-month declining trend.
- Gold continues to trade as a risk asset rather than a risk hedge. The dollar's likely trajectory will remain the key driver of gold returns. Expected central bank buying 'on dips' will act to limit further downside however.
- For agricultural commodities, normalized weather, back-to-trend yields and improved sowing and pollination conditions should loosen crop balance sheets. High prices that have dominated markets since 3Q'12 are likely to last for the next three to six months before falling hard later in the year.

Figure 38. Chinese Copper Imports Are Slowing



Sources: Citi Research China Customs and Wind

Figure 39. US Crude Oil Production Surging (m b/d)



Source: Citi Research, IEA and Bloomberg

Figure 40. Strategy Outlook*

	Overall	Bullish	Neutral	Bearish
Energy	Neutral		WTI, HH Natural Gas	Brent
Precious Metals	Bearish	Palladium	Platinum	Silver, Gold
Base Metals	Slightly Bearish	Nickel	Aluminum, Zinc	Lead, Copper
Bulk Commodities	Neutral		Coal, Iron Ore	
Agriculture	Slightly Bullish	Corn, Wheat	Soybeans, Cotton	Sugar

Source: Citi Research *subject to revision

Figure 41. Citi Commodity Price Forecasts*

		0-3M	6-12M	5Y Cyclical	Q1 2012	Q2 2012	Q3 2012	Q4 2012E	2012E	Q1 2013E	Q2 2013E	Q3 2013E	Q4 2013E	2013E	2014E
Energy															
NYMEX WTI	USD/bbl	85.0	85.0	81.0	103.0	93.3	92.2	88.2	94.1	85.0	85.0	85.0	85.0	85.0	83.0
ICE Brent	USD/bbl	105.0	97.0	85.0	118.4	108.8	109.4	110.1	111.7	105.0	95.0	100.0	95.0	99.0	93.0
Henry Hub Natural Gas	USD/MMBtu	3.50	3.70	N/A	2.47	2.27	2.87	3.54	2.83	3.50	3.50	3.60	3.70	3.55	4.10
Base Metals															
LME Aluminum	USD/MT	2,100	2,125	2,200	2,216	2,019	1,944	2,017	2,049	2,100	2,050	2,100	2,150	2,100	2,175
LME Copper	USD/MT	8,160	7,850	6,200	8,314	7,833	7,711	7,921	7,945	8,160	8,000	7,800	7,900	7,965	7,775
LME Lead	USD/MT	2,150	2,075	2,200	2,118	1,987	1,984	2,200	2,072	2,250	2,050	2,000	2,150	2,115	2,200
LME Nickel	USD/MT	19,000	19,775	20,000	19,721	17,228	16,383	17,036	17,592	19,000	21,000	19,000	20,550	19,890	22,725
LME Tin	USD/MT	25,000	22,500	18,600	22,986	20,619	19,281	21,547	21,108	23,500	22,500	22,000	23,000	22,750	22,875
LME Zinc	USD/MT	1,950	2,090	2,100	2,040	1,933	1,902	1,979	1,963	2,050	2,000	2,080	2,100	2,060	2,125
Precious Metals															
COMEX Gold	USD/T. oz	1,700	1,650	1,050	1,691	1,613	1,654	1,718	1669	1705	1685	1665	1650	1675	1655
Silver	USD/T. oz	33	30	16.5	32.6	29.6	29.9	32.6	31.2	32.5	31.5	30.0	30.0	31.0	26.5
Platinum	USD/T. oz	1,675	1,715	1,531	1,604	1,505	1,500	1,600	1552	1675	1700	1700	1725	1700	1775
Palladium	USD/T. oz	725	810	680	683	630	613	653	645	725	755	790	825	775	925
Bulk Commodities															
Hard Coking Coal (benchmark Asia)	USD/MT	165	180	200	235	215	225	170	211	165	170	180	180	174	213
Thermal Coal Asia (NEWC)	USD/MT	95	103	105	113	88	88	86	94	95	95	100	105	99	111
Iron Ore Spot (TSI)	USD/MT	135	113	81	142	139	112	121	128	135	120	110	115	120	122
Agriculture															
CBOT Corn	USd/bu	750	625	N/A	641	618	783	737	695	770	750	655	620	700	625
CBOT Wheat	USd/bu	800	850	N/A	643	641	870	846	751	900	900	825	825	860	775
CBOT Soybeans	USd/bu	1,425	1,275	N/A	1,272	1,426	1,675	1,485	1,466	1,625	1,550	1,430	1,400	1,500	1335
CBOT Rice	USD/cwt	15.2	15.3	N/A	14.3	14.8	15.3	15.1	14.9	15.2	15.2	15.3	15.5	15.3	N/A
NYB-ICE Cotton	USd/lb	80	90	N/A	93	81	73	73	80	65	65	70	70	68	N/A
Sugar#11	USd/lb	20.0	21.0	N/A	24.5	21.2	21.0	19.6	21.6	21.0	21.0	21.0	21.0	21.0	N/A
ICE Coffee	USd/lb	160	167	N/A	205	171	172	152	175	160	165	165	170	165	N/A
ICE Cocoa	USD/MT	2,200	2,450	N/A	2,308	2,221	2,440	2,420	2,348	2,200	2,200	2,425	2,475	2,325	N/A

Source: Citi Research   *subject to revision

Alternative Investments Watch

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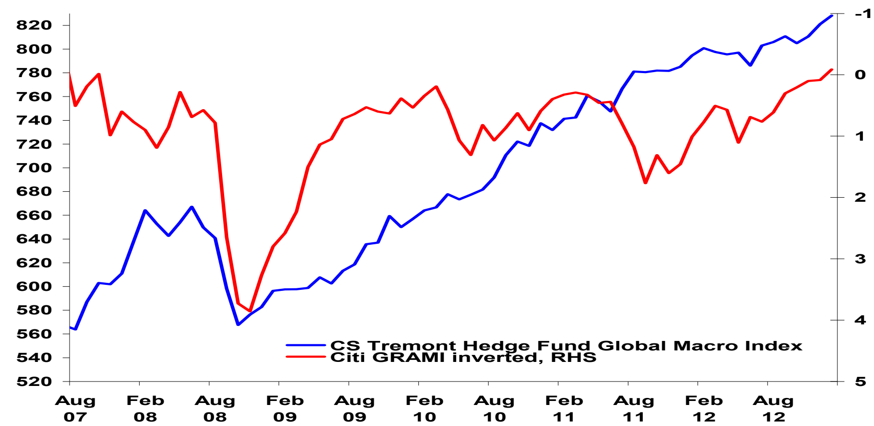
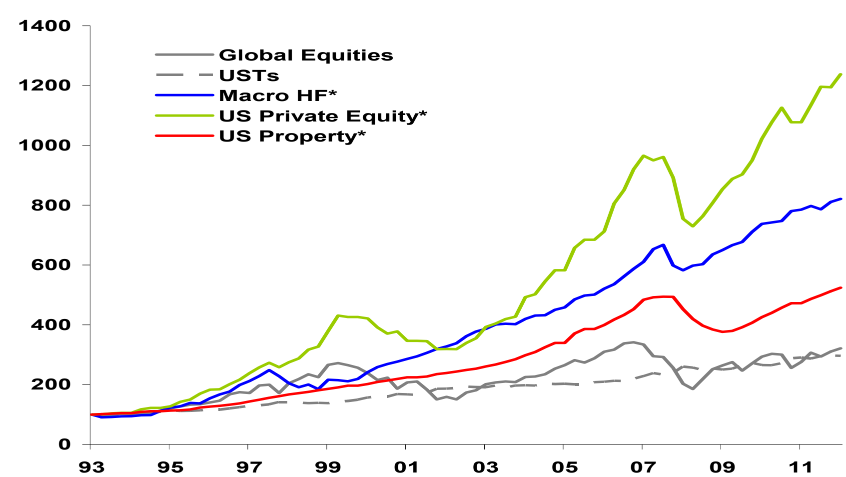
Alternative Investments such as Macro Hedge Funds, Private Equity and Property have historically outperformed other risky assets and have also provided much better volatility adjusted returns. Over time, we hope to add these asset classes to our allocation framework.

Figure 42. Macro Hedge Fund Returns Independent Of Risk Appetite?



Source: Citi Research and Bloomberg

Figure 43. Alternatives Have Outperformed



Source: Citi Research and Bloomberg
* Macro HF = CS Tremont Macro HF Index; US Private Equity = Cambridge Associates Private Equity Index ; US Property = NCREIF Property Index

Figure 44. Historical Return & Sharp Ratio Comparison

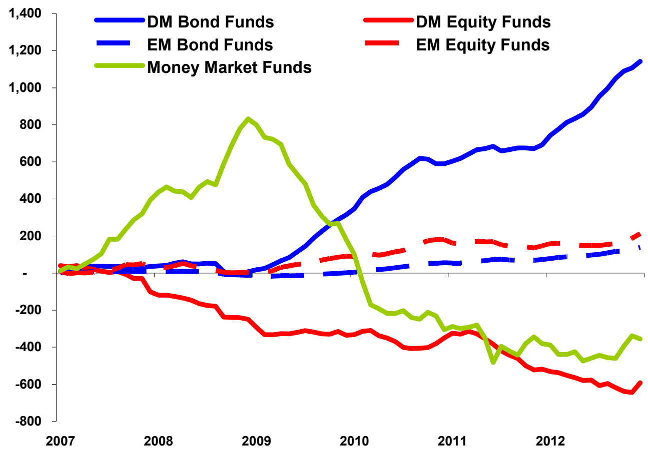
	Annualised Total Returns			Sharpe Ratios**		
	94 to Q3'12	99 to Q3'12	06 to Q3'12	94 to Q3'12	99 to Q3'12	06 to Q3'12
Global Equities	6.2%	1.2%	0.0%	0.2	0.0	-0.1
Macro HF*	11.8%	10.9%	8.0%	0.9	1.5	1.0
US Private Equity*	14.3%	9.7%	7.7%	1.0	0.7	0.6
US Property*	9.2%	8.5%	4.0%	1.3	1.1	0.4

Source: Citi Research
** Sharpe Ratios on quarterly data using 1m US Treasury Bill as the risk free rate

Fund Flow Data by Asset Class

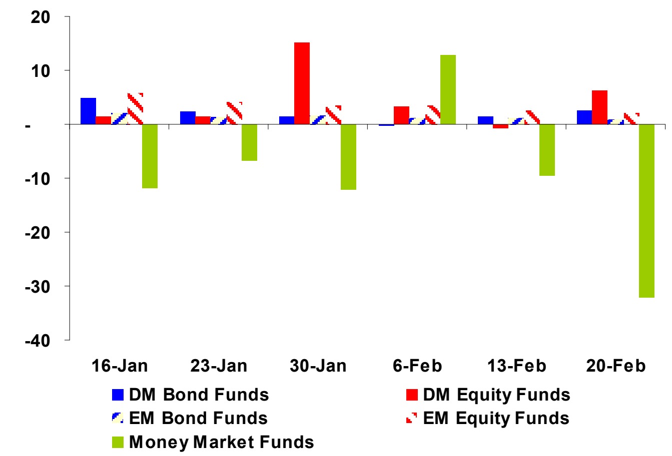
Here we monitor EPFR fund flow data by asset class. While the “great rotation” theme has definitely caught the attention of the media recently, flow data actually show both equity *and* bond funds are seeing inflows recently.

Figure 45. Cumulative Monthly Fund Flows by Asset Class (bn $)



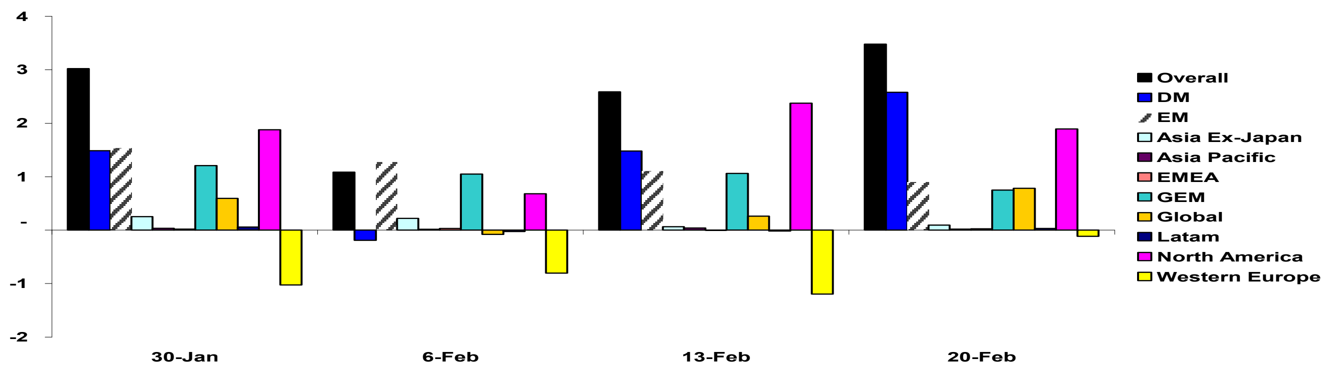
Source: Citi Research and EPFR

Figure 46. Weekly Fund Flows by Asset Class (bn $)



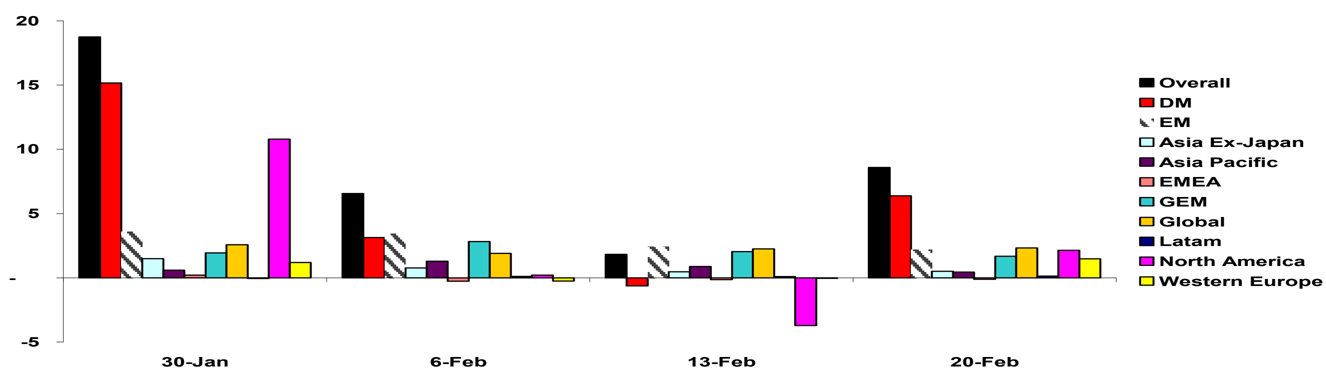
Source: Citi Research and EPFR

Figure 47. Weekly Fixed Income Fund Flows (bn $)



Source: Citi Research and EPFR

Figure 48. Weekly Equity Fund Flows (bn $)



Source: Citi Research and EPFR

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Source: Citi Research.

Appendix A-1

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The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

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