Julius Bär

ECONOMIC AND FINANCIAL MARKET OUTLOOK FIRST HALFYEAR 2015

Media Conference, Zurich, 19 November 2014

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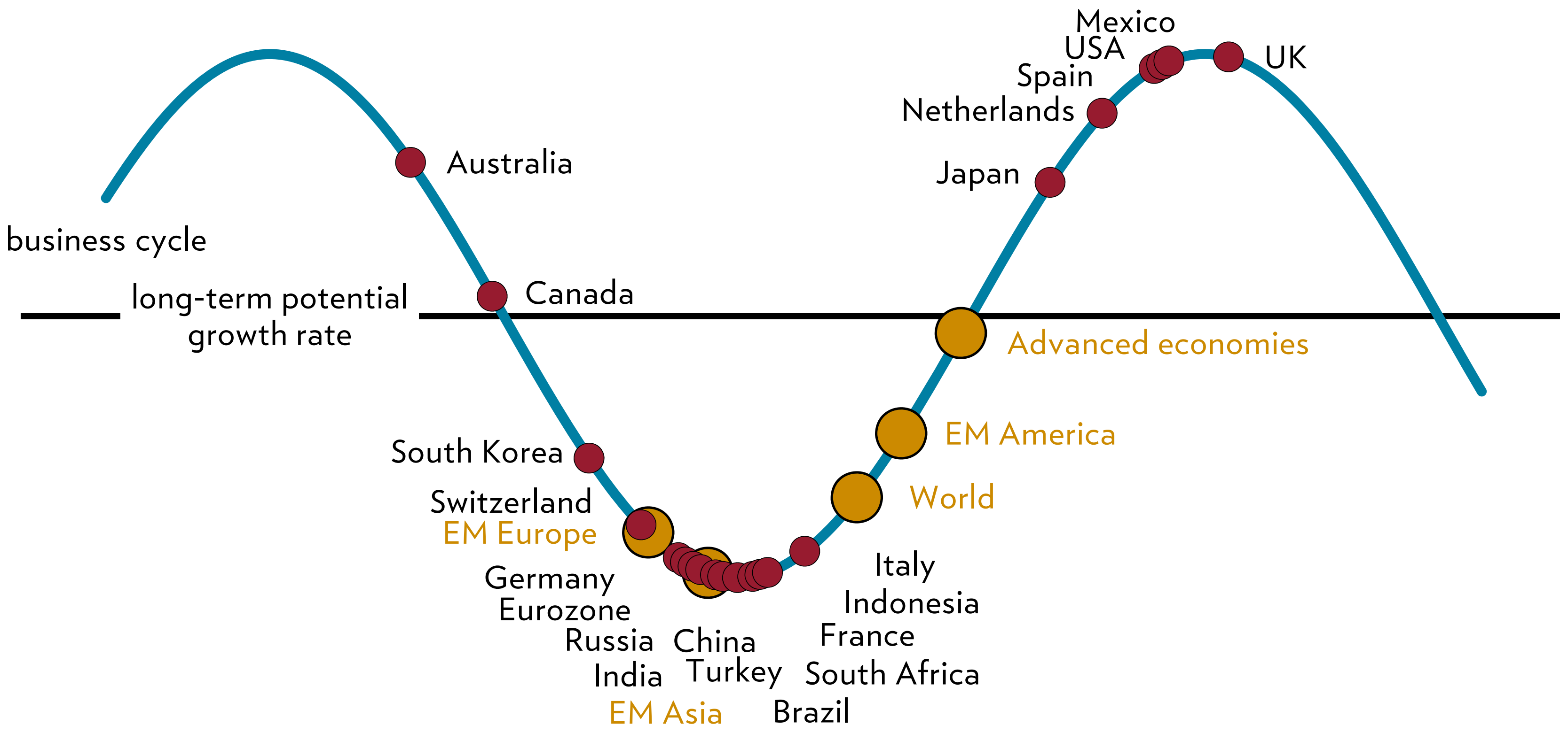
GLOBAL BUSINESS CYCLE OVERVIEW – NOVEMBER 2014

Only a gradual cyclical change can be observed.
The slowdown in France and Germany, has become more pronounced.

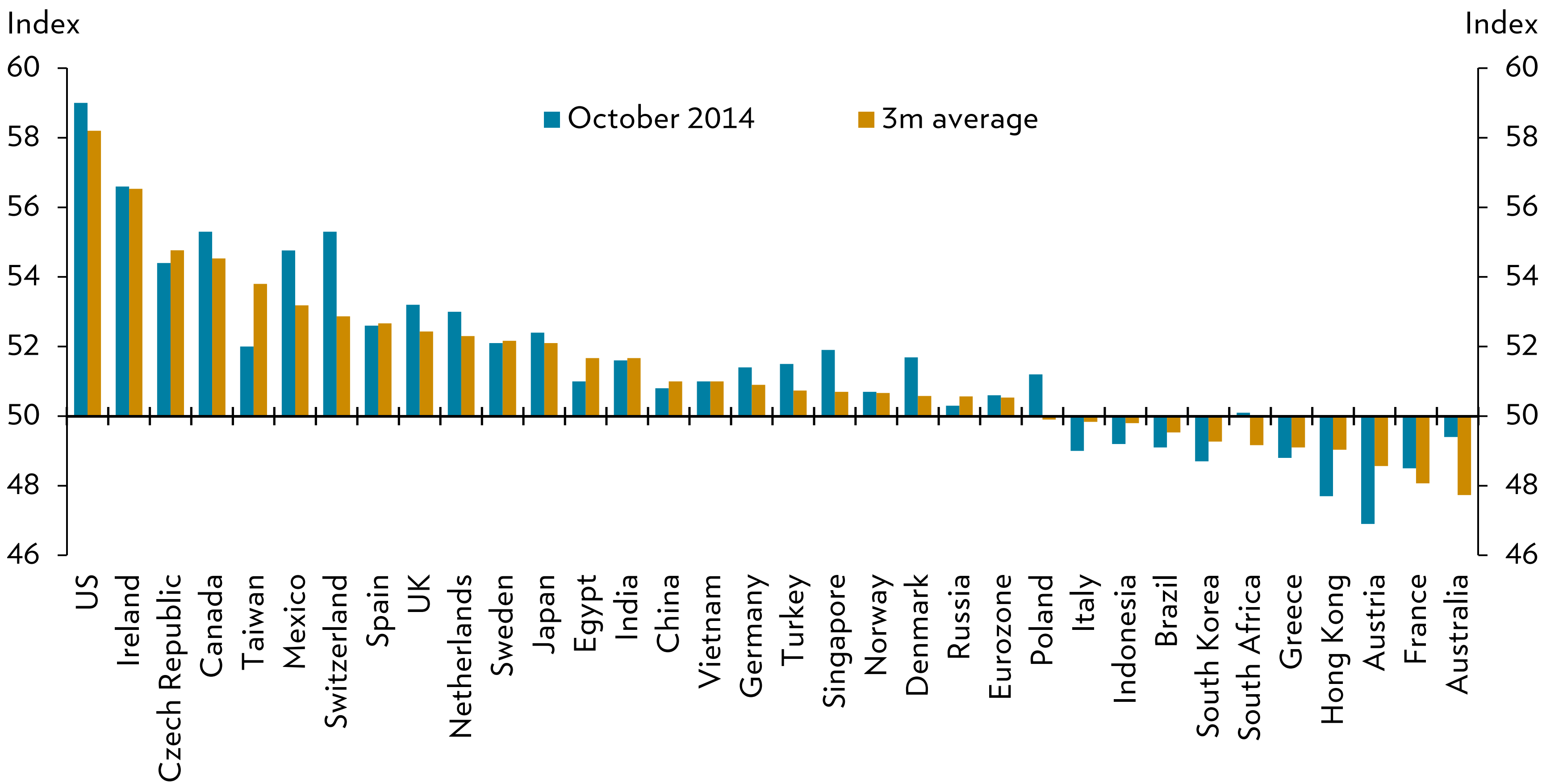


Source: Julius Baer

LEADING INDICATORS – PMI MANUFACTURING

A slight cyclical strengthening for the months ahead can be perceived, where growth momentum was lately positive. Already weak economies remain a matter of concern.

Manufacturing PMIs in an overview

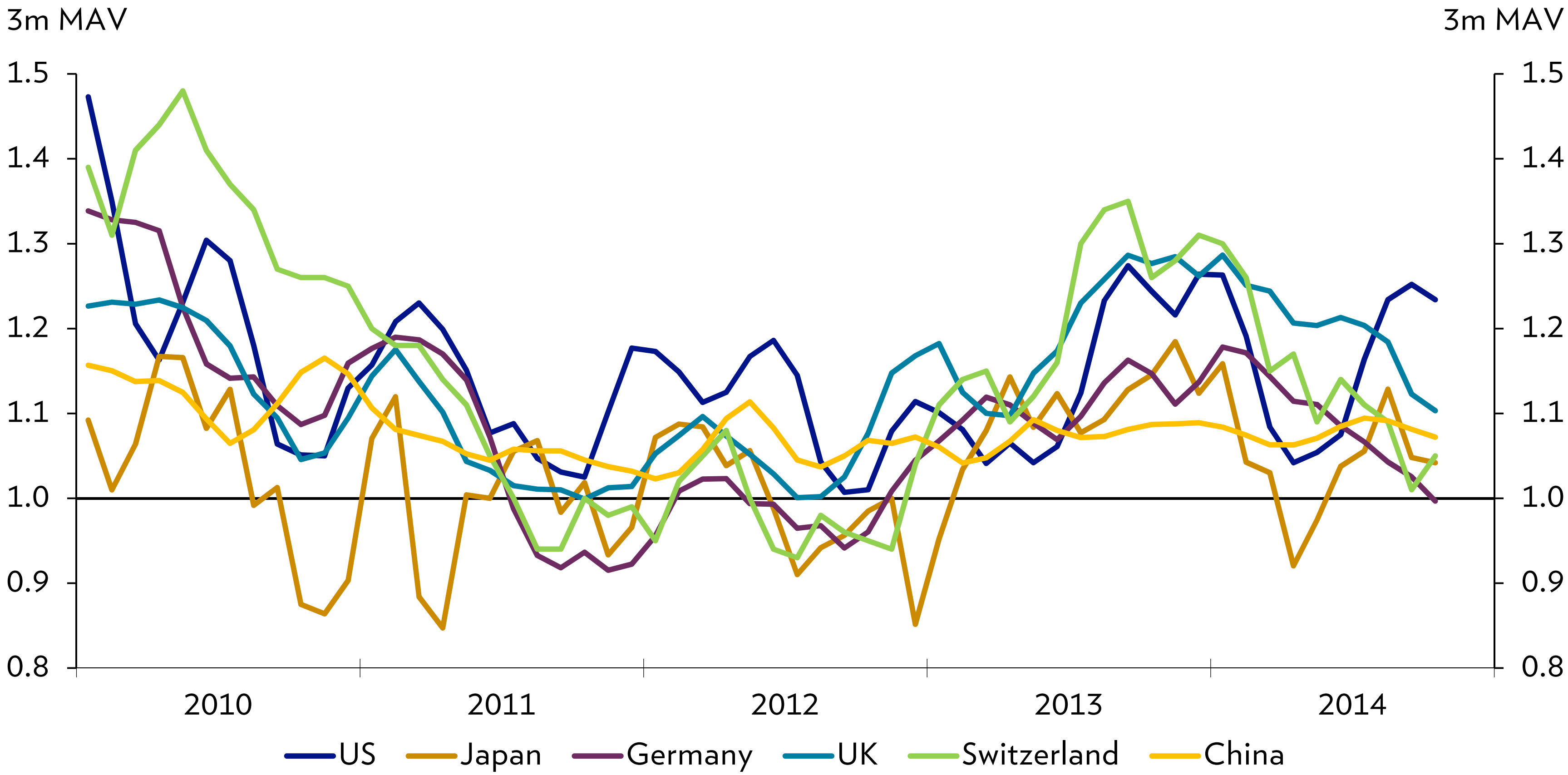


Source: Markit Economics, Bloomberg Finance L.P., Julius Baer

PMI MANUFACTURING: NEW ORDERS ARE SLOWING

Slowing dynamics of new orders to inventories continue, indicating decelerating levels of production growth ahead. Even the US has now topped.

Manufacturing PMIs - new orders to inventories ratios

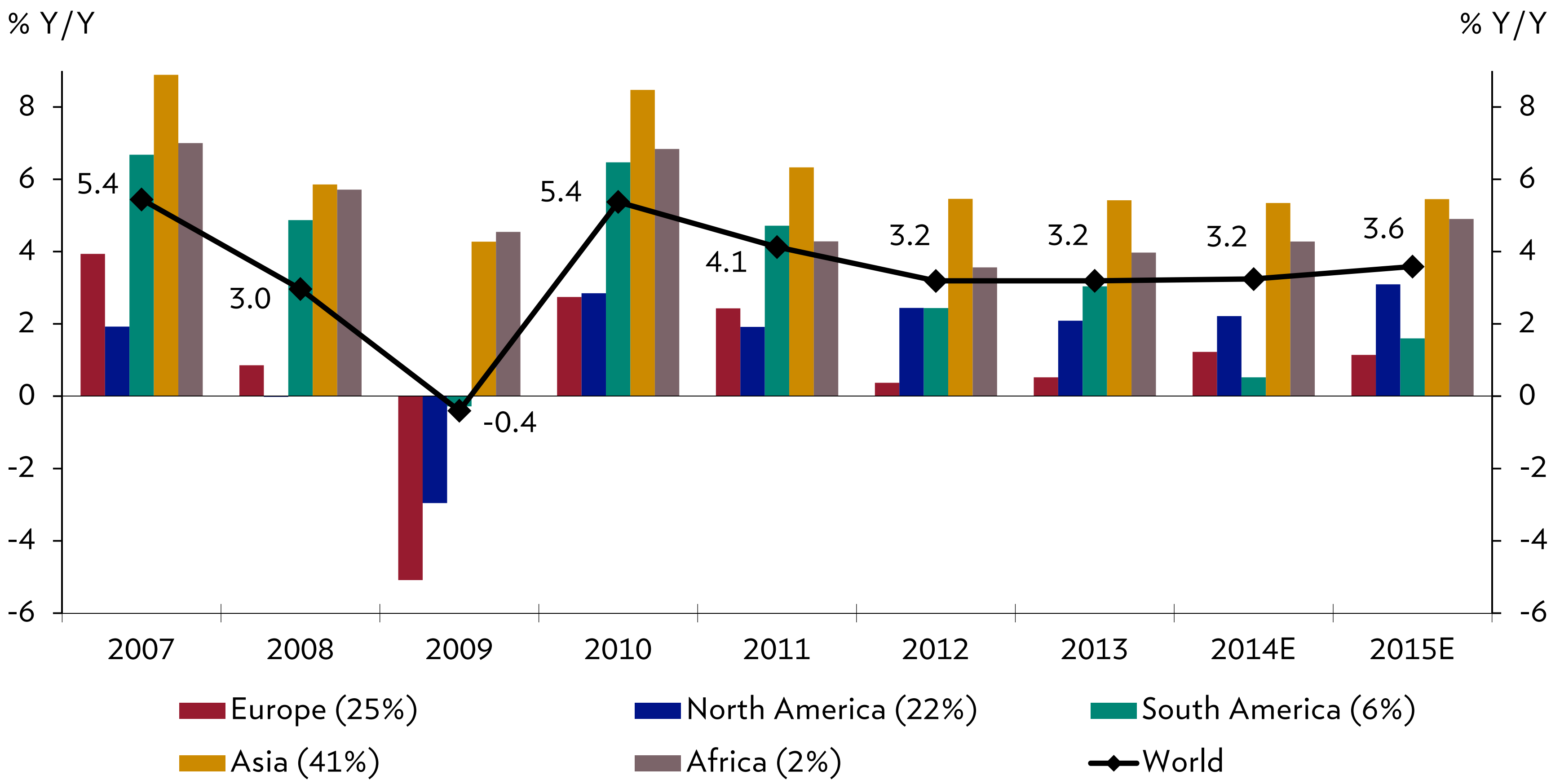


Source: Markit Economics, Bloomberg Finance L.P., Julius Baer

ASIA WILL REMAIN THE GLOBAL GROWTH CHAMPION

Global growth trends below the pre-crisis levels since 2011, with the most accentuated weakness in Europe.

World growth perspectives (real GDP)



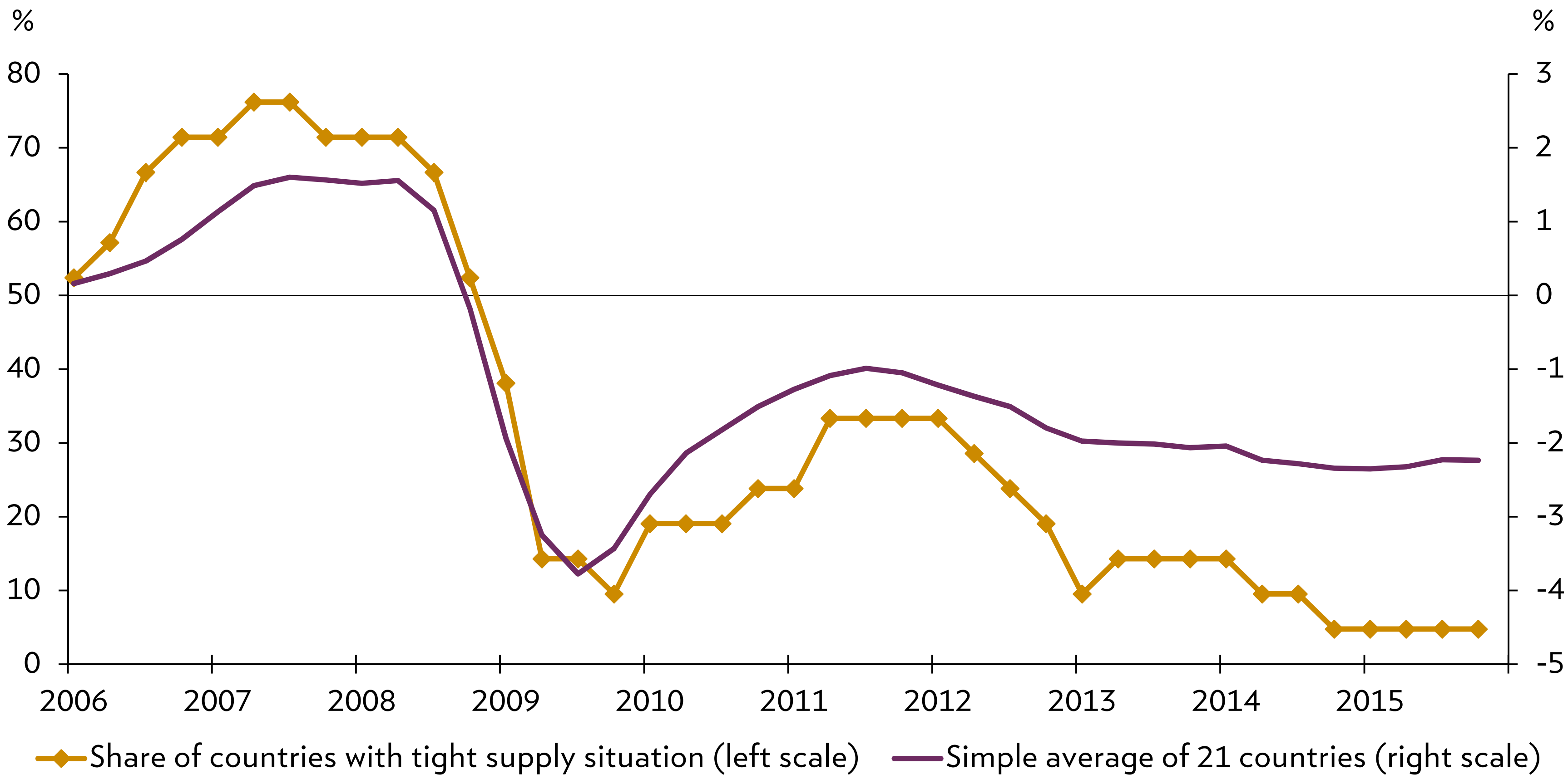
Source: Datastream, Julius Baer
In brackets: Percentage of global GDP

GLOBAL BACKDROP FOR LOW INFLATION

Just China is expected not to have a negative output gap in 2015. With supply exceeding demand nearly everywhere, inflation continues to be difficult to achieve.

Global* output gap

(11 advanced and 10 emerging economies)



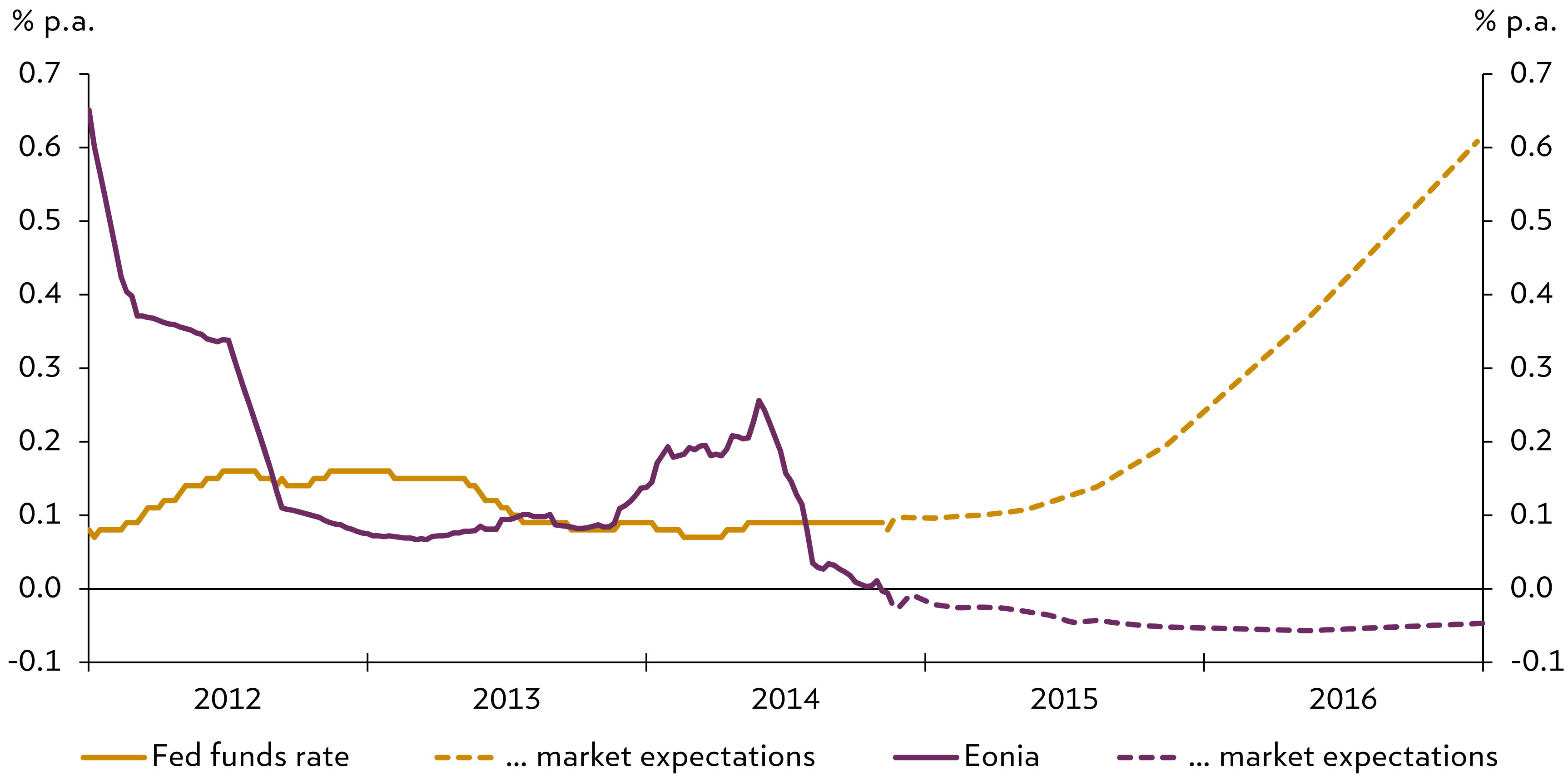
Source: Datastream, Julius Baer

THE ECB'S DRAGHI IS TALKING DOWN THE EURO

Mario Draghi: "… the fundamentals for a weaker exchange rate are today much better than they were two to three months ago." (ECB Press conference, Q&A transcript, August 7, 2014)

Central bank rates and market expectations

(derived from the OIS curve)



Source: Bloomberg Finance L.P., Julius Baer

EURONZONE LOAN GROWTH, A DRAG ON THE RECOVERY

As loan growth is recovering from 2013 lows, globally, the uneven development and still modest proportion of eurozone loan growth remains a major cyclical drag.

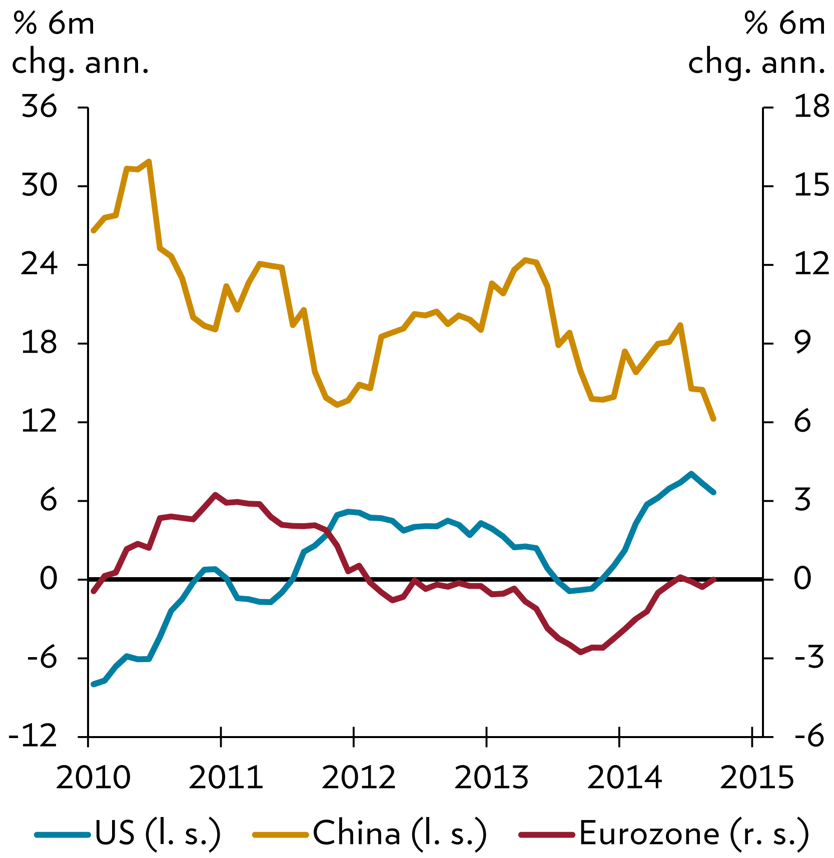
North-south divide of eurozone bank loan growth to the private sector is still massive

* Greece, Italy, Ireland, Portugal, Spain

** Belgium, Germany, Finland, France, Netherlands

Source: ECB, Eurostat, Julius Baer

Despite a recovery of total loan growth, the eurozone trails China and the US by far



Source: PBoC, Fed, ECB, Julius Baer

EUROPEAN CENTRAL BANK'S FULL BUSINESS CALENDAR

Ambitious goals, to end the credit crunch, increase its balance sheet by EUR 1trn and launch the European Banking Union, put the ECB under pressure to succeed.

- ✓ **18 September 2014**: First TLTRO[1] auction yields only EUR 82.6bn.
- ✓ **2 October 2014**: ECB published only a few details on its ABS[2] and Covered Bonds purchase program.
- ✓ **26 October 2014**: Publication of the Asset Quality Review and stress tests of the 130 system-relevant eurozone banks. Only 25 banks “fail” and show a shortfall of equity by EUR25bn.
- ✓ **4 November 2014**: Start of the European Banking Union, with the ECB as supervisor.
- **11 December 2014**: Second TLTRO auction.
- **1 January 2015**: Lithuania becomes 19th member of the eurozone group, triggering a rotation system of voting rights in the ECB council.
- **22 January 2015**: First monetary policy meeting of the new ECB council in the new year. Meetings will henceforth be held in 6-week intervals.
- **29 January 2015**: First 3-year LTRO[3] of 21 December 2011 will be due for repayment.
- **26 February 2015**: Second 3-year LTRO of 29 February 2012 will be due for repayment.
- **March, June, September, December 2015**: (third to sixth) TLTRO auctions.
- **March and June 2016**: Last (seventh and eighth) TLTRO auctions.

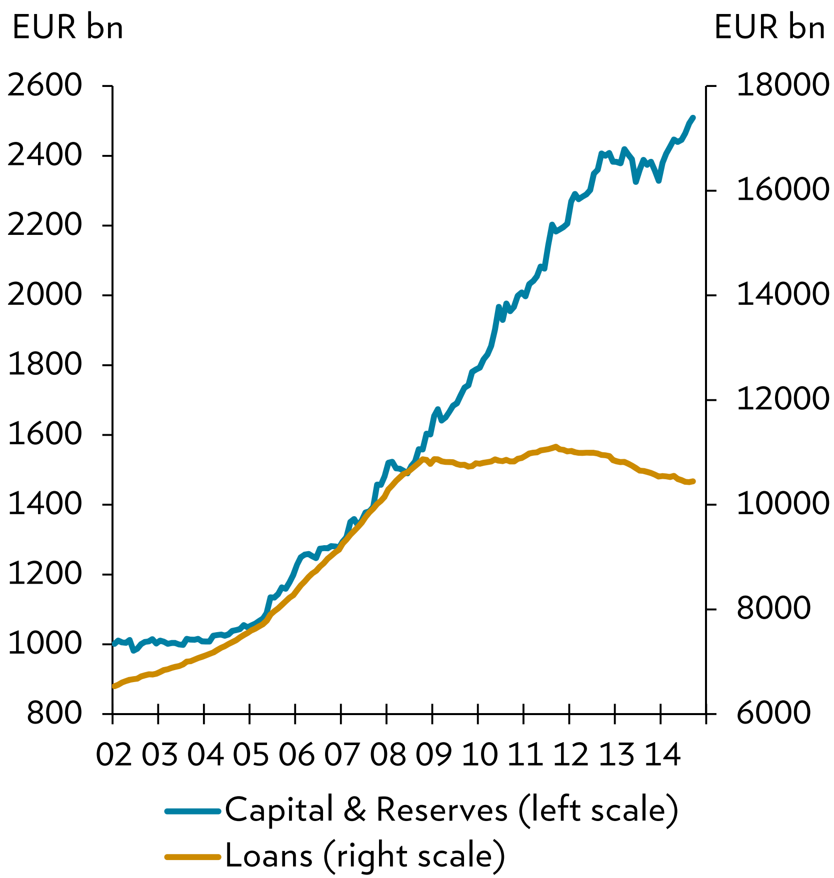
Source: European Central Bank, Julius Baer

1) Targetet long-term refinancing operations, 2) Asset-backed securities, 2) Longer-term refinancing operations

ECB STRATEGY – A CONUNDRUM

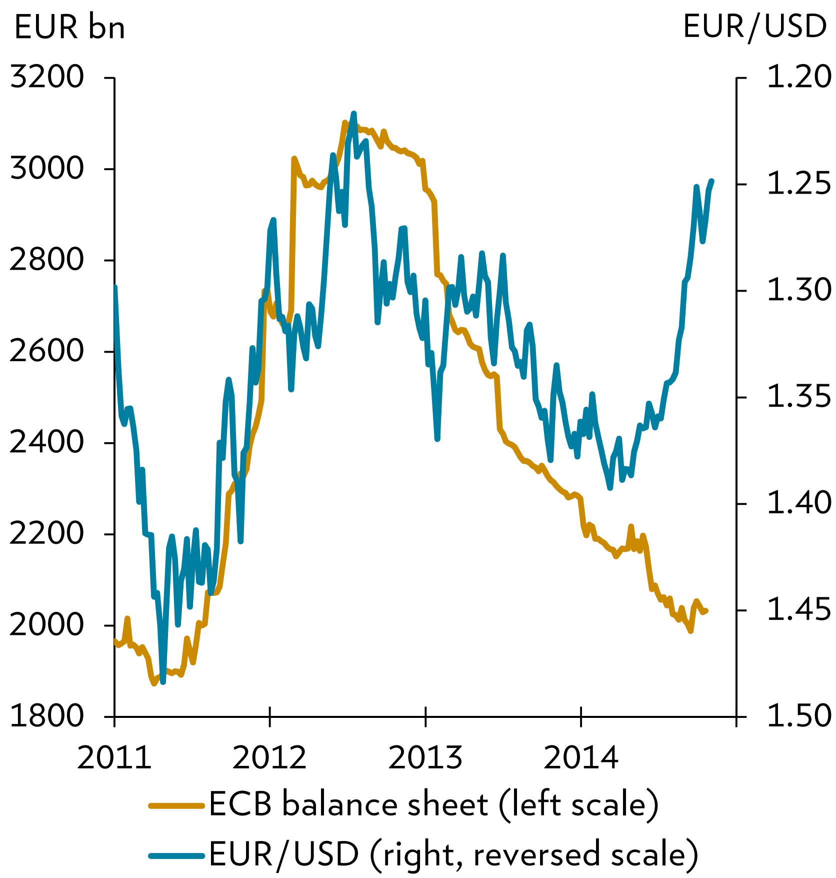
ECB is concentrating on expanding its balance sheet, in order to boost central bank liquidity. However, eurozone banks already show that they dispose of excess liquidity.

Eurozone banks balance sheet items



Source: ECB, Julius Baer

ECB balance sheet and EUR exchange rate

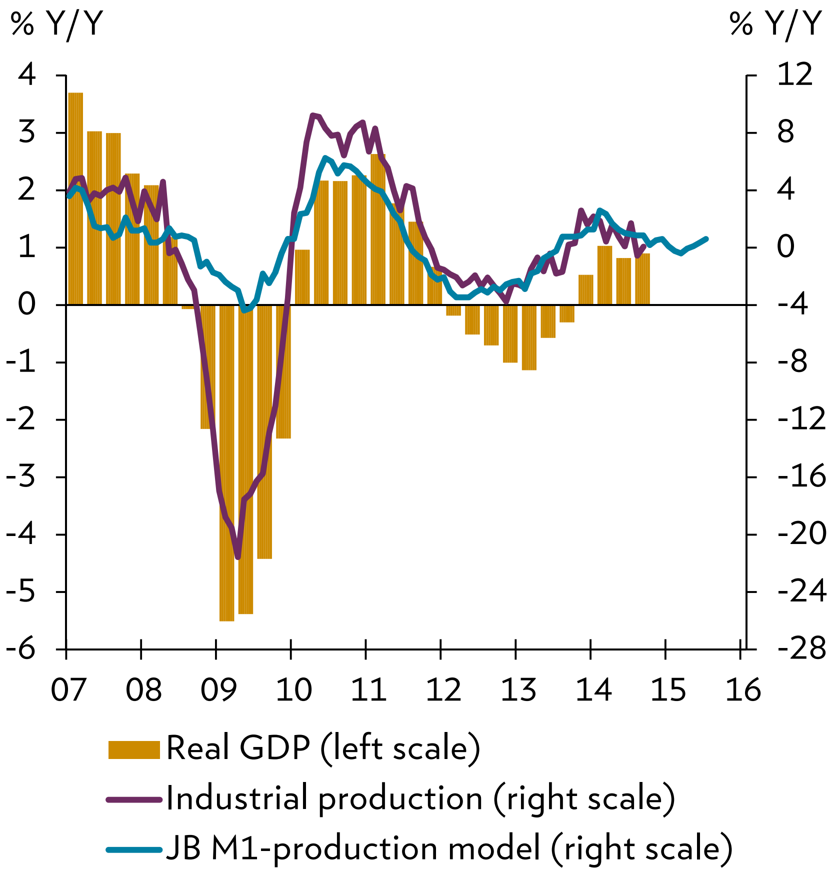


Source: ECB, Julius Baer

EUROZONE: A DEMAND, NOT A STRUCTURAL WEAKNESS

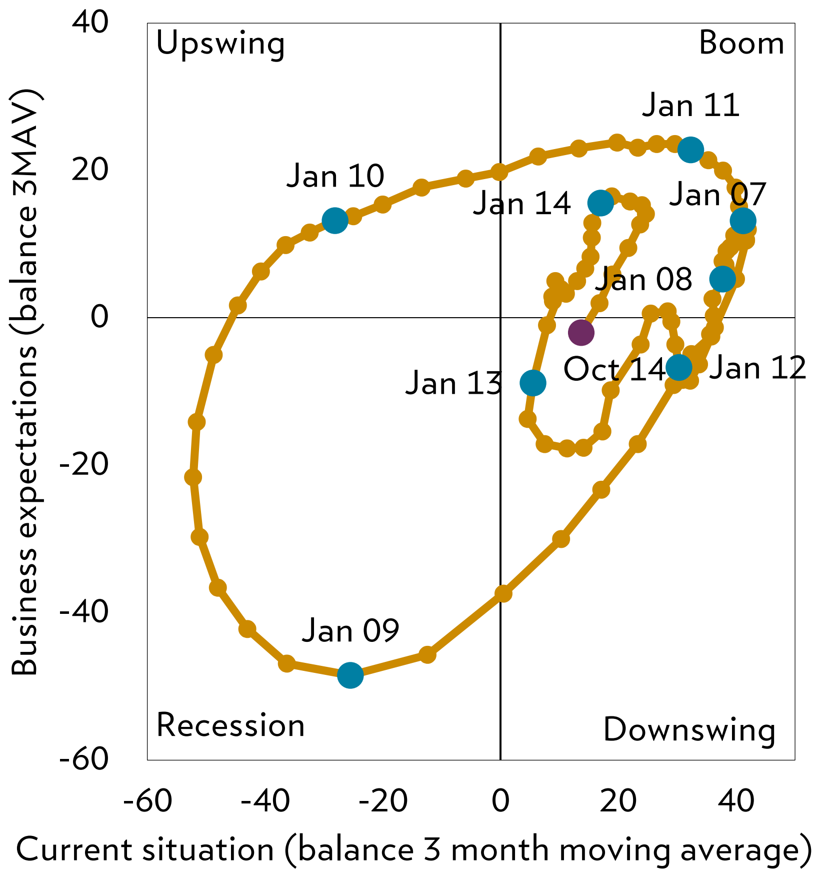
Industrial production growth points to a structural weakness of demand, i.e. GDP growth, in the eurozone, a phenomenon the ECB can only relieve as of next spring.

M1 growth precedes industrial production growth by approx. 9 months



Source: Eurostat, ECB, Julius Baer

Growth-engine Germany is sputtering

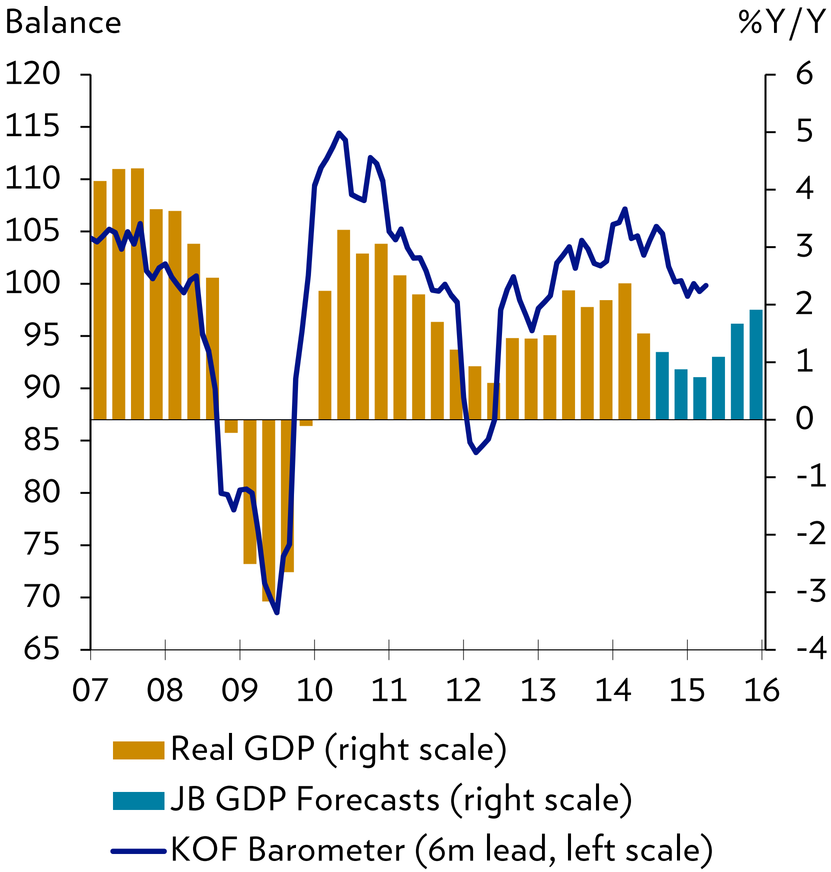


Source: ifo Institute, Julius Baer

SWITZERLAND: DECELERATED BY A WEAK EUROZONE

So far, the solid domestic demand compensated much of the export volatility. The weak eurozone business cycle and the strong EUR/CHF rate decelerate Swiss growth.

KOF Barometer and real GDP growth



Source: KOF, Seco, Julius Baer

Decomposition of Swiss GDP

	2012	2013	2014	2015
GDP	1.1	1.9	1.5	1.4
+ Private consumption	2.8	2.2	0.8	1.3
+ Public consumption	2.9	1.4	0.8	1.6
+ Construction invest.	2.9	1.3	0.7	1.5
+ Equipment invest.	2.3	2.1	0.7	3.3
+ Exports (goods & services)	1.0	15.4	3.0	3.3
- Imports (goods & serv.)	-2.5	13.3	2.8	4.2
Unemployment rate	2.9	3.2	3.2	3.2
Employment*	1.7	1.3	0.8	0.5

Source: Julius Baer
* = Full time equivalent

JULIUS BAER BASELINE SCENARIO

Perspectives 2014 – 2015

Growth

Gross domestic product, real, % year-on-year

Year average	2011	2012	2013	2014E	2015E
World	4.1	3.2	3.2	3.2	3.6
United States	1.6	2.3	2.2	2.2	3.1
Eurozone	1.6	-0.6	-0.4	0.9	0.8
Germany	3.6	0.4	0.1	1.4	1.2
France	2.1	0.4	0.4	0.4	0.5
Italy	0.7	-2.3	-1.9	-0.3	0.4
Spain	0.1	-2.1	-1.2	1.5	2.0
United Kingdom	1.6	0.7	1.7	3.0	2.5
Switzerland	1.9	1.1	1.9	1.5	1.4
Japan	-0.5	1.5	1.5	0.3	0.7
Brazil	2.7	1.0	2.5	0.0	1.0
Russia	4.3	3.4	1.3	0.0	-0.6
India	7.7	4.8	4.7	5.5	6.0
China	9.3	7.7	7.7	7.3	6.9
Australia	2.6	3.6	2.3	3.1	2.9

Inflation

Consumer price index, % year-on-year

Year average	2011	2012	2013	2014E	2015E
World	4.8	3.6	3.3	3.7	3.7
United States	3.2	2.1	1.5	1.7	1.4
Eurozone	2.7	2.5	1.3	0.5	0.9
Germany	2.5	2.1	1.6	0.9	1.7
France	2.3	2.2	1.0	0.6	1.0
Italy	2.9	3.3	1.3	0.2	0.9
Spain	3.1	2.4	1.5	-0.1	0.4
United Kingdom	4.5	2.8	2.6	1.5	1.1
Switzerland	0.2	-0.7	-0.2	0.0	0.6
Japan	-0.3	0.0	0.4	2.8	1.5
Brazil	6.6	5.4	6.4	6.5	6.5
Russia	8.5	5.1	6.7	7.5	7.0
India	9.5	7.5	6.3	8.0	7.0
China	5.4	2.7	2.6	2.0	2.2
Australia	3.3	1.8	2.4	2.8	2.9

Exchange rates

Year end	2011	2012	2013	2014E	2015E
EUR/CHF	1.22	1.21	1.23	1.21	1.24
USD/CHF	0.94	0.92	0.90	0.96	0.95
JPY/CHF	1.22	1.06	0.85	0.84	0.86
GBP/CHF	1.47	1.49	1.48	1.53	1.49
EUR/USD	1.30	1.32	1.37	1.26	1.30
EUR/JPY	100.0	114.6	144.3	144.9	144.3
EUR/GBP	0.83	0.81	0.83	0.79	0.83
USD/JPY	76.9	86.8	105.3	115.0	111.0
GBP/USD	1.57	1.63	1.65	1.59	1.57

Short-term interest rates

Central bank key target rates, % p.a.

Year end	2011	2012	2013	2014E	2015E
US Fed Funds	0.25	0.25	0.25	0.25	0.50
ECB Main Refi	1.00	0.75	0.25	0.05	0.05
BoJ Overnight	0.10	0.10	0.10	0.10	0.10
UK Base Rate	0.50	0.50	0.50	0.50	0.75
3m CHF Libor	0.00	0.00	0.00	0.00	0.00

Long-term interest rates

Model-based 10-year government bond yields, % p.a.

Year end	2011	2012	2013	2014E	2015E
US 10y T-Notes	1.95	1.78	3.04	2.25	2.45
Euro 10y Bund	1.87	1.27	1.96	0.80	1.10
JP 10y Gov't Bond	0.99	0.79	0.74	0.50	0.75
UK 10y Gov't Bond	1.98	1.83	3.02	2.20	2.80
Swiss Conf. 10y Bond	0.67	0.46	1.09	0.40	0.65

Commodity prices and trade

%year-on-year

Year average	2011	2012	2013	2014E	2015E
Total	28.6	-2.8	-2.0	-5.1	-12.5
Total ex energy	18.3	-12.8	-5.3	-4.1	-4.3
Energy	31.4	-0.4	-1.4	-6.0	-15.1
Food & beverages	29.2	-5.1	-10.9	-3.1	-8.7
Ind. raw materials	14.4	-15.8	-2.7	-4.5	-2.4
Crude oil (Brent, USD/bbl)	110.9	112.0	108.8	101.2	83.2
Crude oil (Brent)	39.3	1.0	-2.8	-7.0	-17.8
World trade	6.2	2.1	2.6	2.4	4.4

Source: Julius Baer

JANWILLEM ACKET
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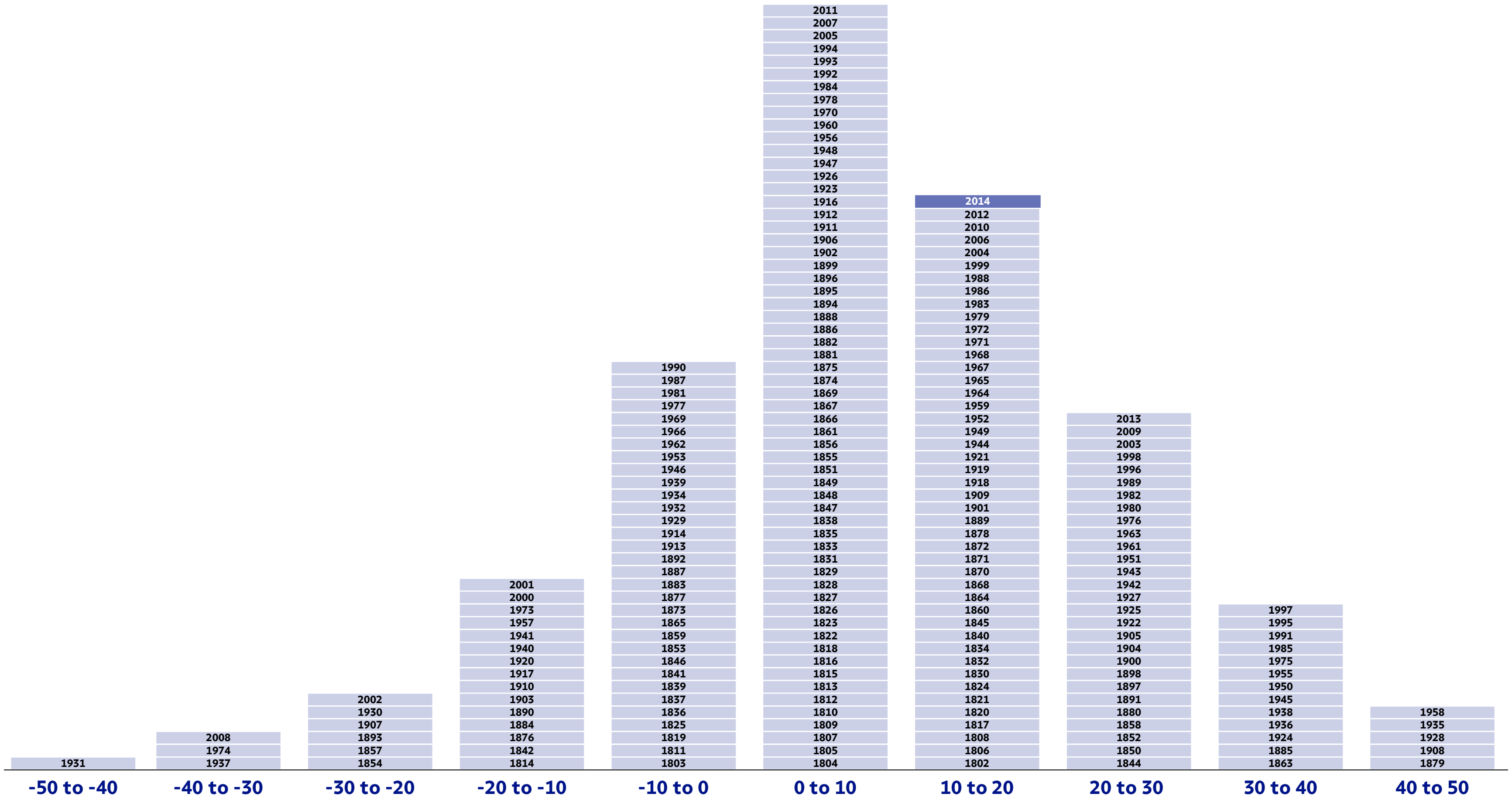
2014 – A SOLID YEAR AFTER ALL

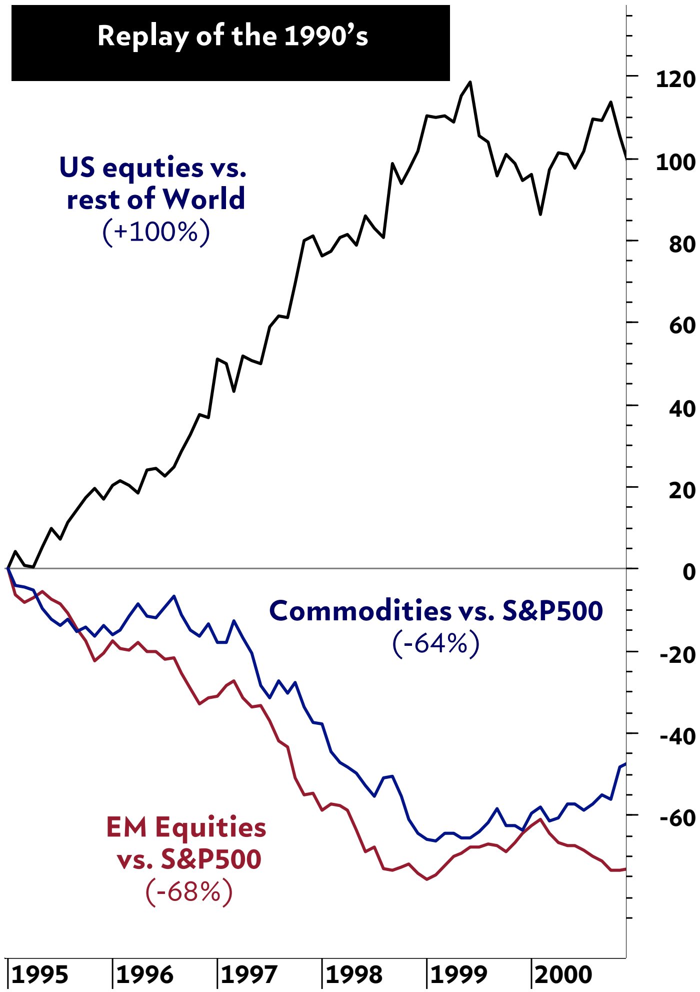
Slightly above average returns for equities

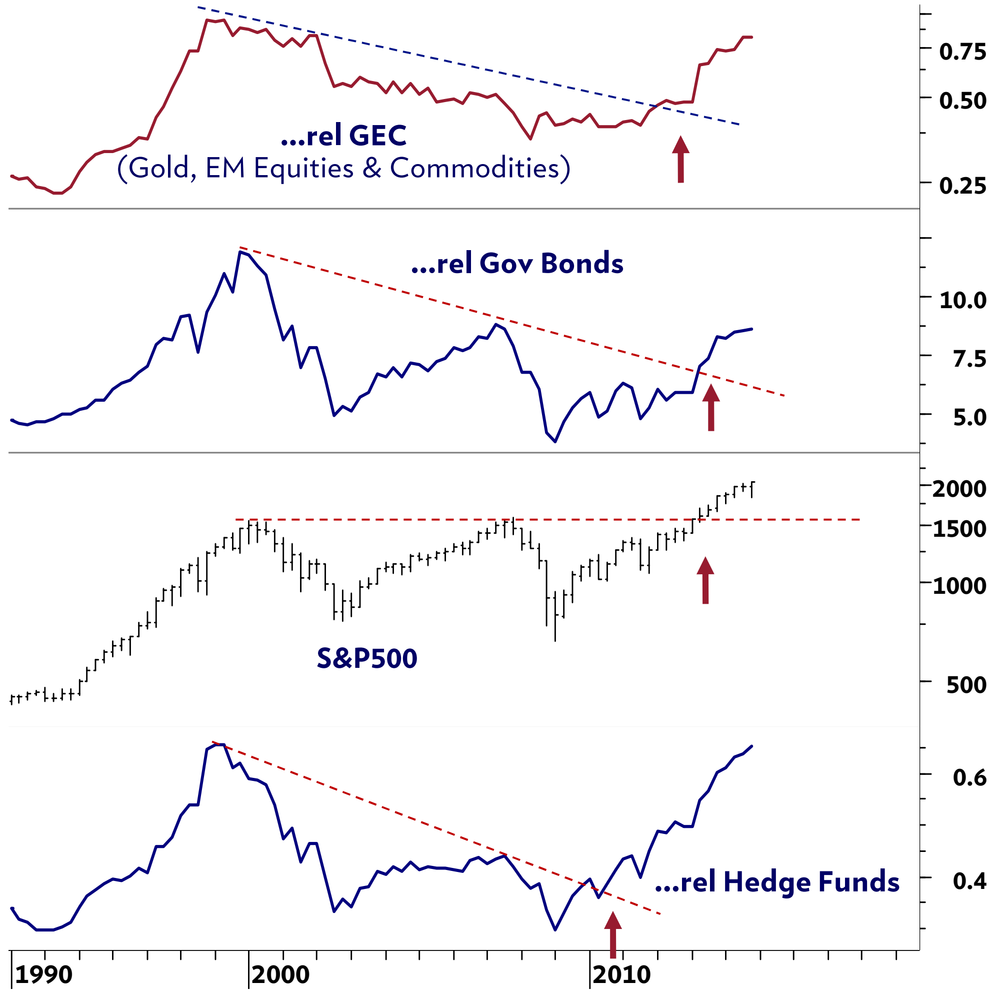


Source: 1802 to 1961 "Indices of United States stock prices from 1802 to 1987," Journal of Business, 63 (July 1990) 399 – 426; 1962 to 1973 R. Shiller "From efficient markets theory to behavioral finance«; 1974 to 2013 Datastream

2015: S&P500 BEATS EVERYTHING

A repeat of the late 1990s – GEC resumes bear market, while the S&P 500 climbs the wall of worry



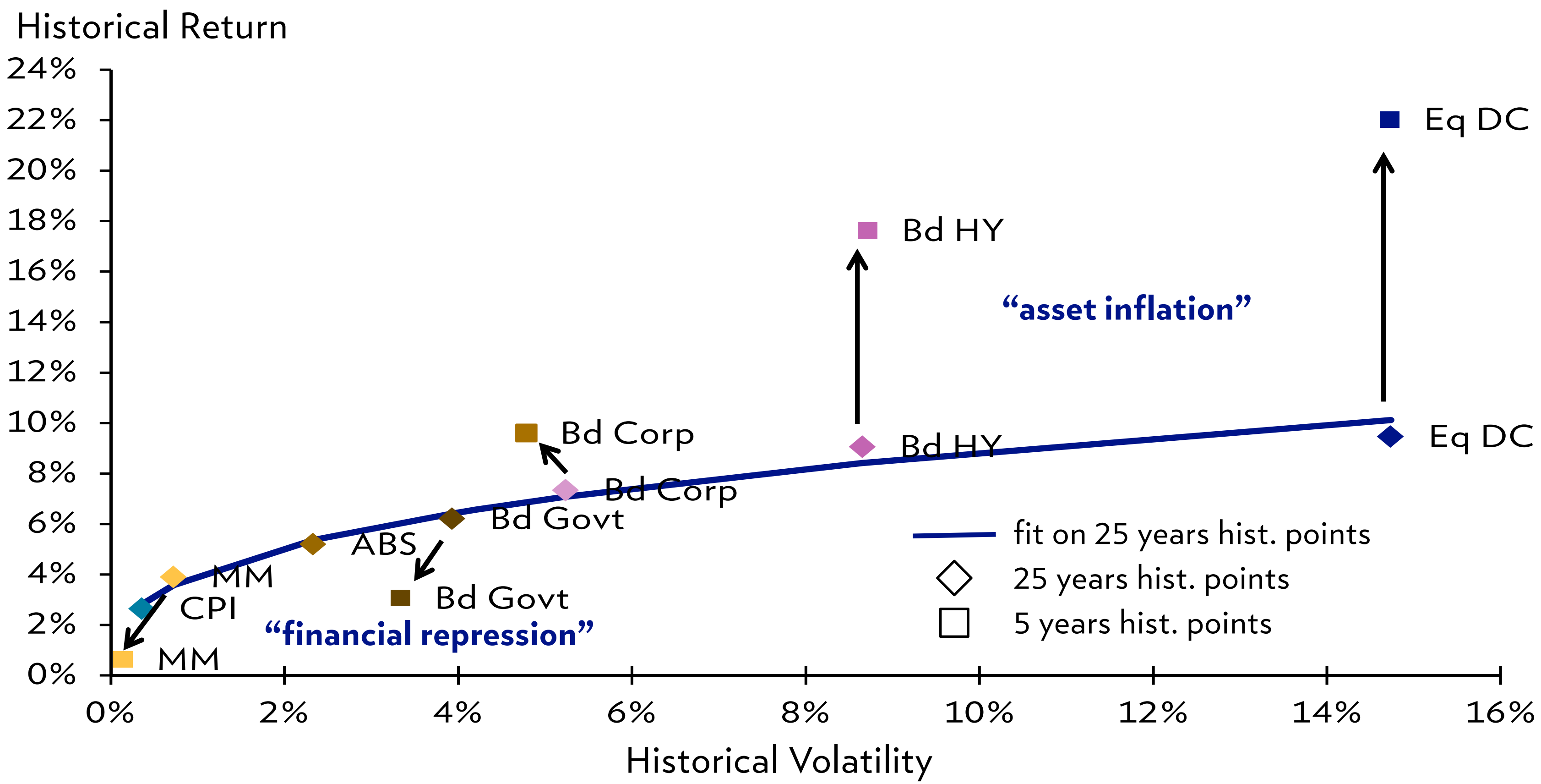


Source: Bloomberg Finance L.P., Julius Baer

HISTORICAL DEVELOPMENT

After 2008: Low bond returns vs. high equity returns

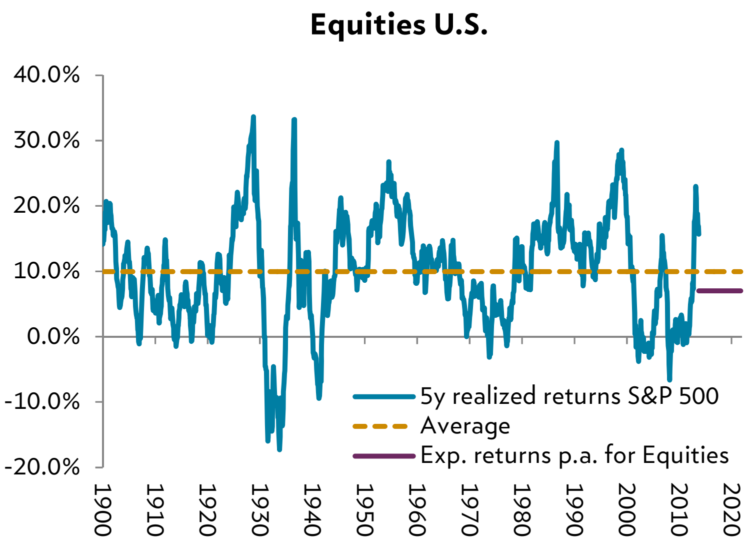
Historical risk vs. return of selected asset classes in USD (last 25 years and 5 years)

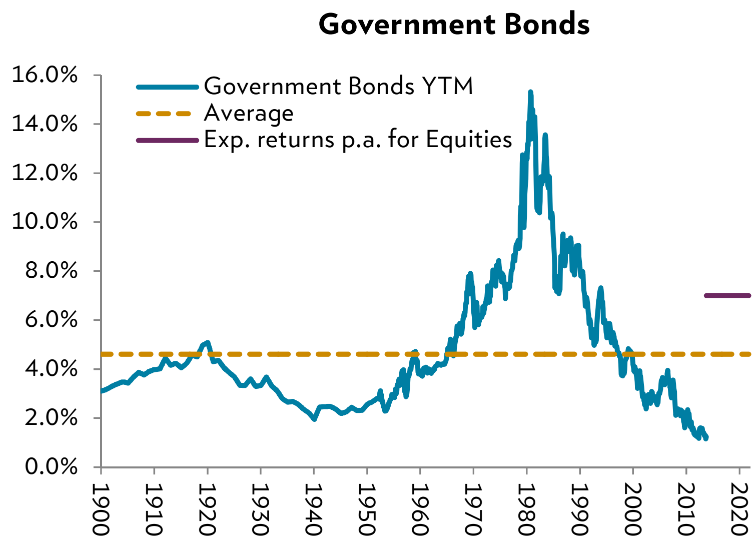


Source: Datastream, Bloomberg finance L. P. , Julius Baer

EQUITIES OR BONDS – LONG TERM MODEL

Attractiveness of equities, relative to historical returns and relative to bonds





	Realized returns p.a. over a 5y horizon	Global Government Bonds YTM
Average since 1900	**9.9%**	**4.6%**
Average last 20y	**9.0%**	**3.4%**
Average last 10y	**4.4%**	**2.4%**
Expected return / current yield	**7.0%**	**1.2%**

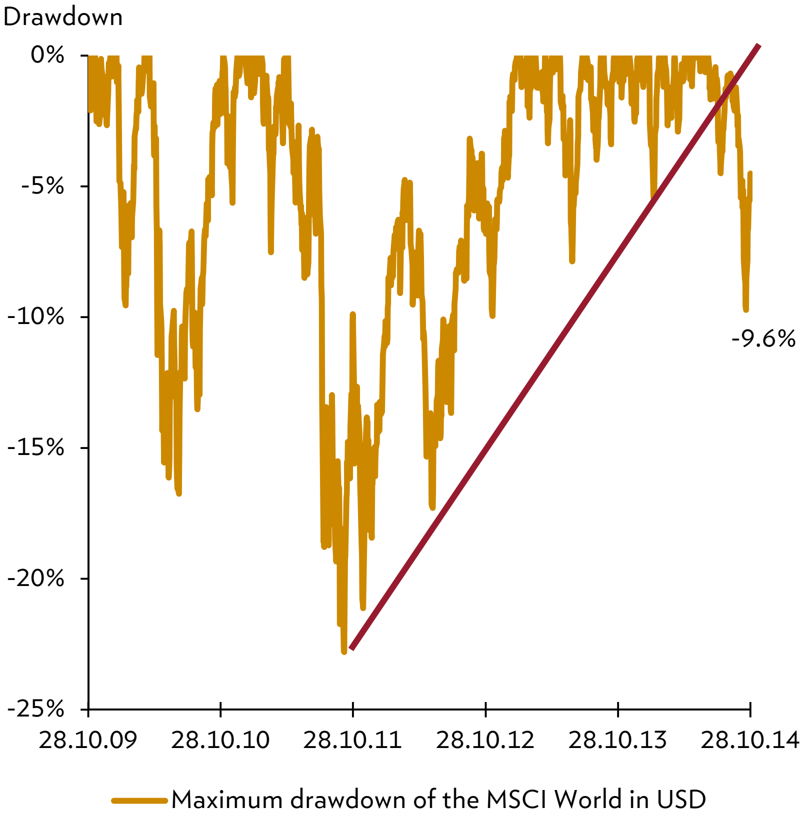
- The expected return for equities over the next 5 years, is slightly below the observed long term average but higher the average over the last 10 years. Relative to their **own history** equities look **moderately attractive**.
- Current bond yields are at record low levels compared to historical average levels. **Relative to bonds** equities look very attractive, i.e. **attractive as hardly ever before**.

Data: Monthly time series for equities US (S&P 500) and Government Bonds (Merrill Lynch Global Government Index) from January 1900 to September 2014.
Source: Julius Bär / Datastream / Robert J. Shiller

SHIFTS IN INVESTMENT REGIMES

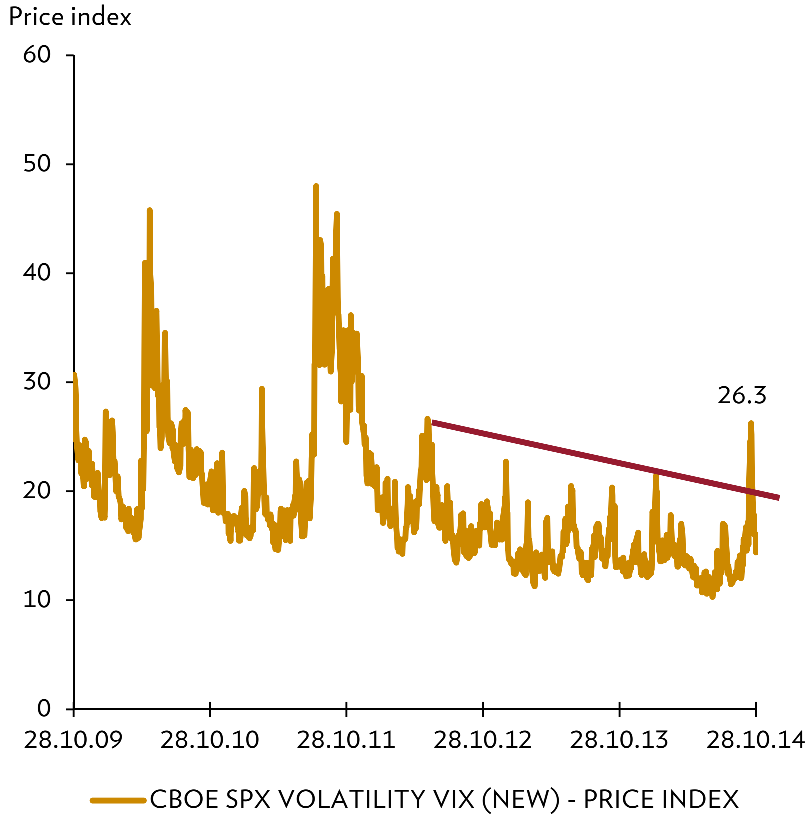
Learning from the October correction - sharper set-backs ahead

Maximum drawdown – a sharper set-back



Source: Datastream, Julius Baer

Volatility – the fever curve breaking out

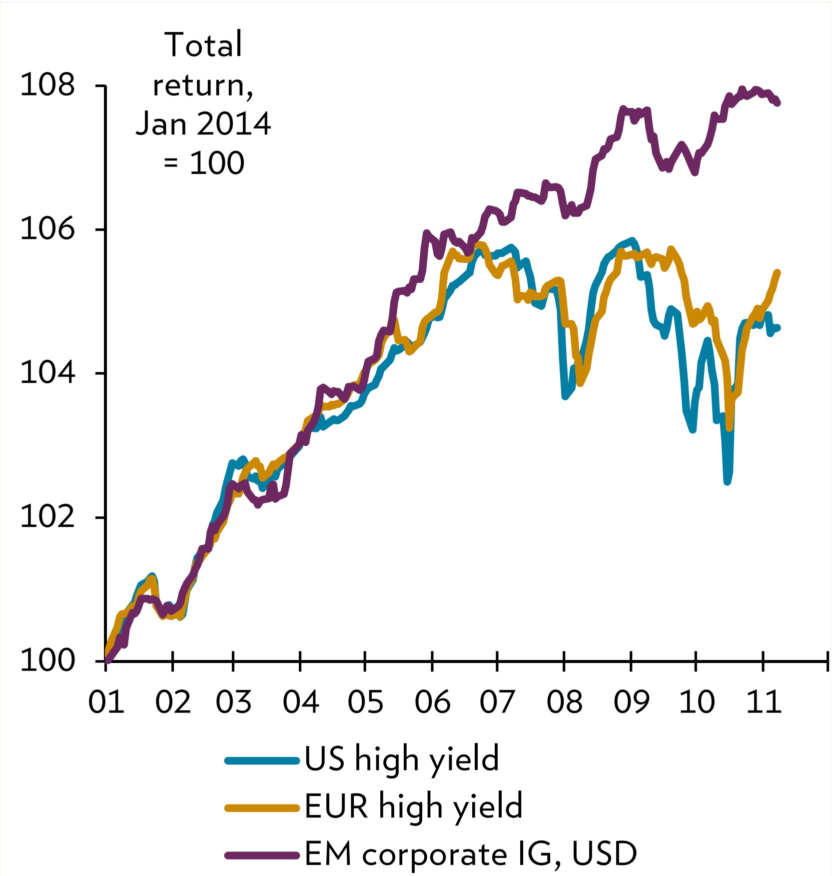


Source: Chicago Board Options Exchange, Datastream, Julius Baer

US HIGH YIELD: FED CAUSES SHORT DISRUPTION

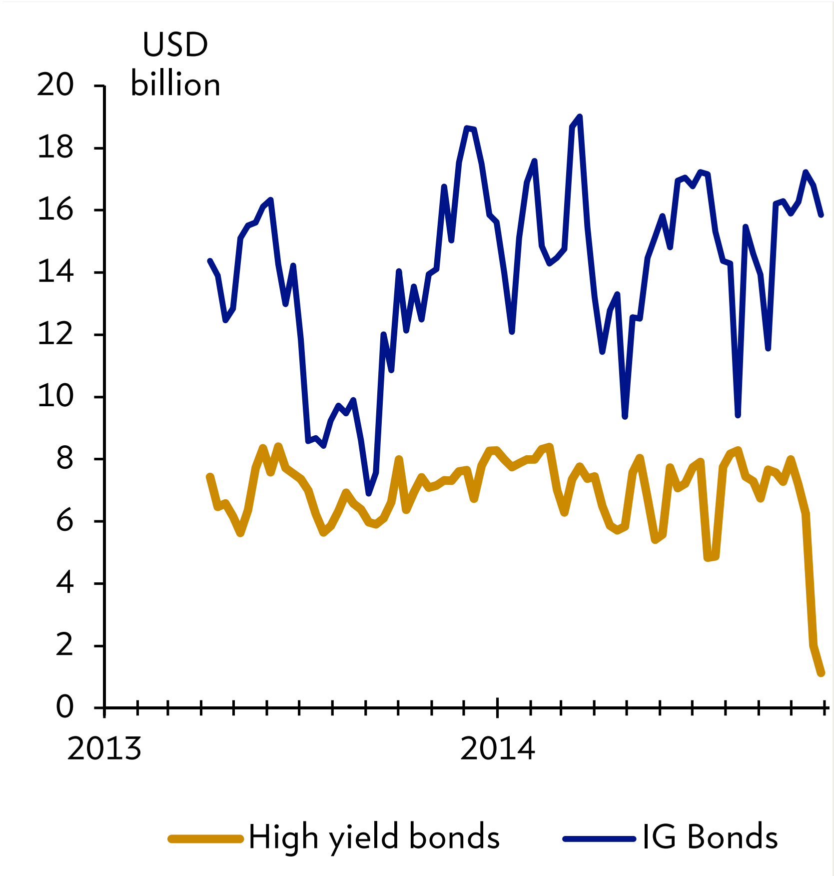
Fed issues details for forthcoming stress test, asking dealers to value high yield bonds at prices of 2007-09, which triggers massive sell-off in October

Riskier segments still consolidate



Source: BoA Merrill Lynch, JP Morgan, Julius Baer

US primary dealer positions of investment grade and below-IG corporate bonds

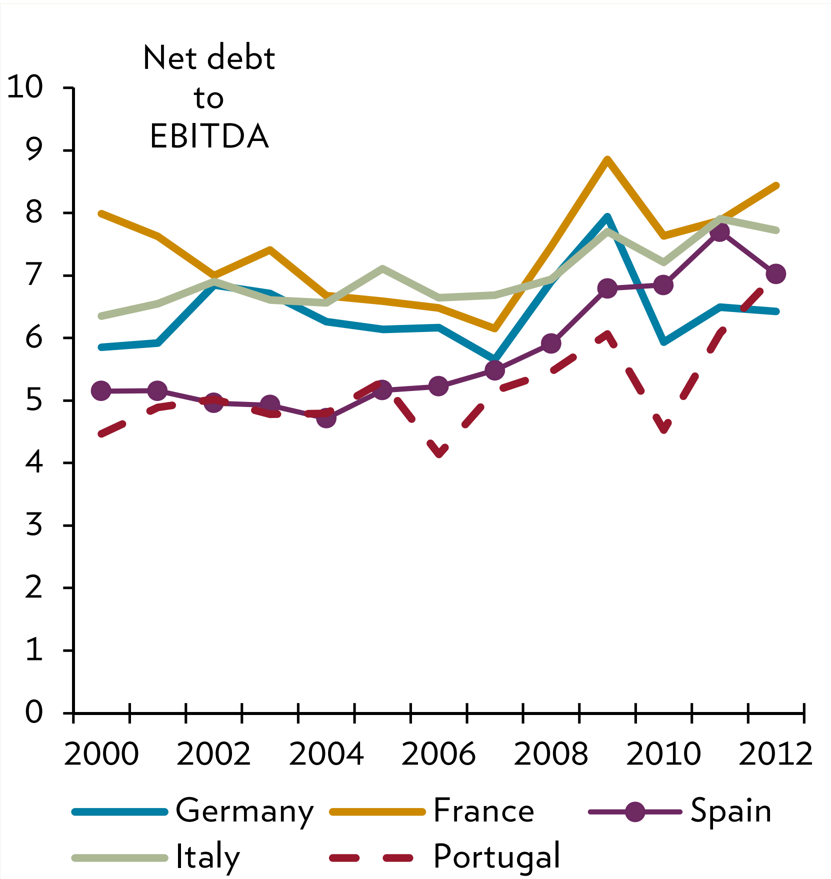


Source: Federal Reserve Bank of New York, Julius Baer

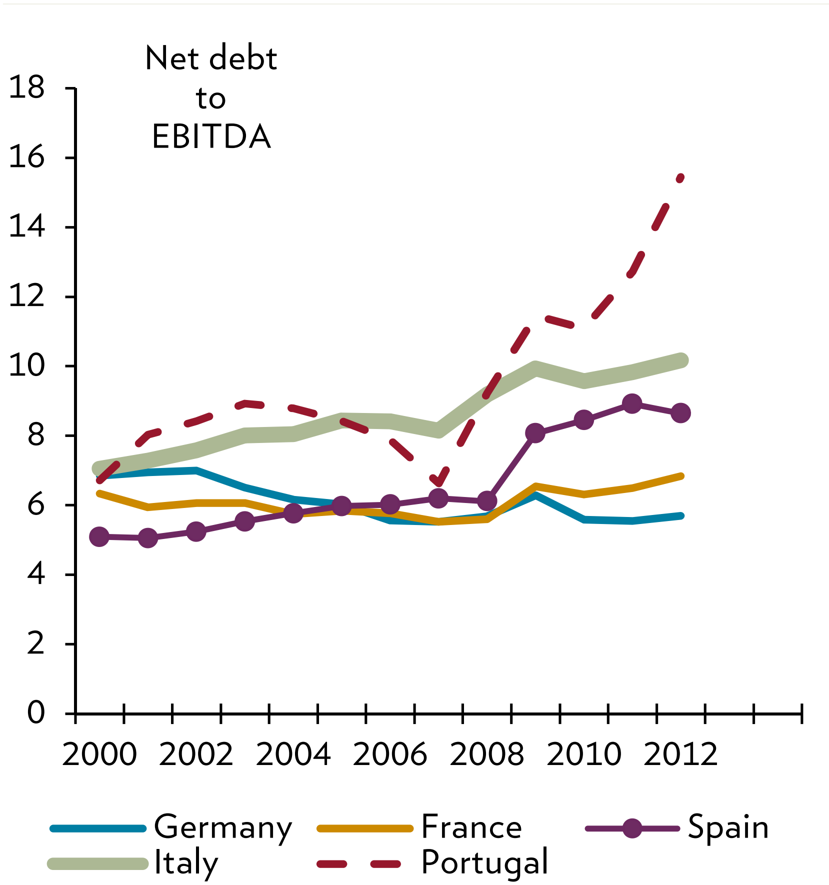
NET DEBT/EBITDA: TRUE PROBLEM OF CREDIT CRUNCH?

BACH data need to be better analysed but the trend is clear: lower profitability leads to higher leverage, even without ABS purchases of the ECB

Large companies



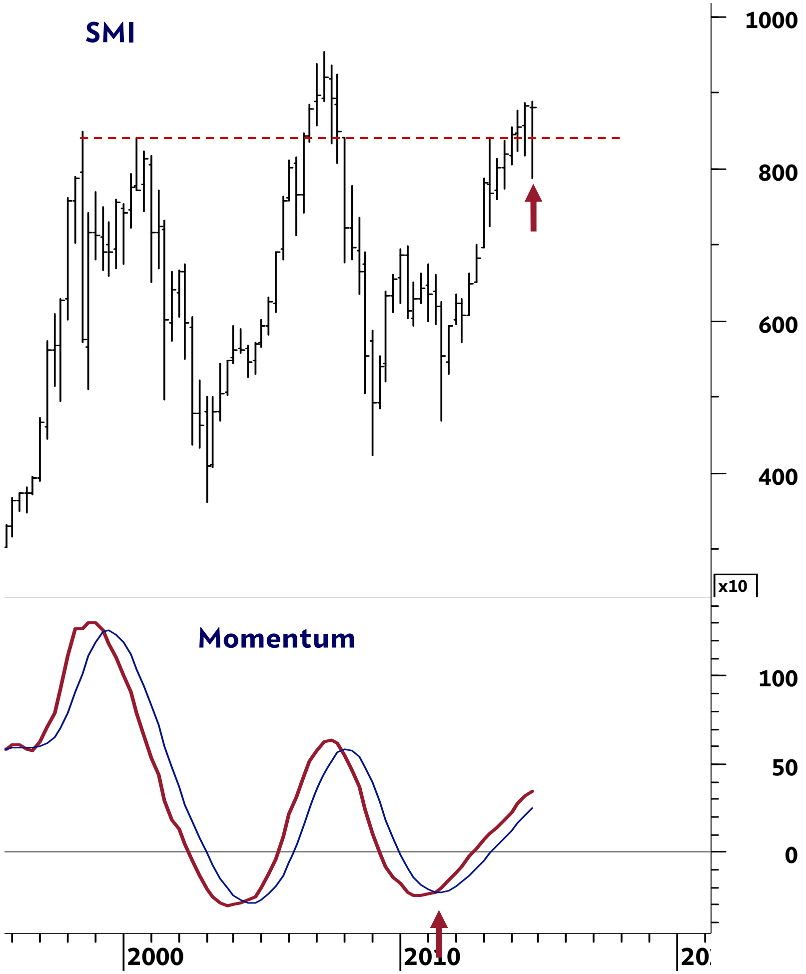
Small and mid caps: higher leverage despite lower bank liabilities

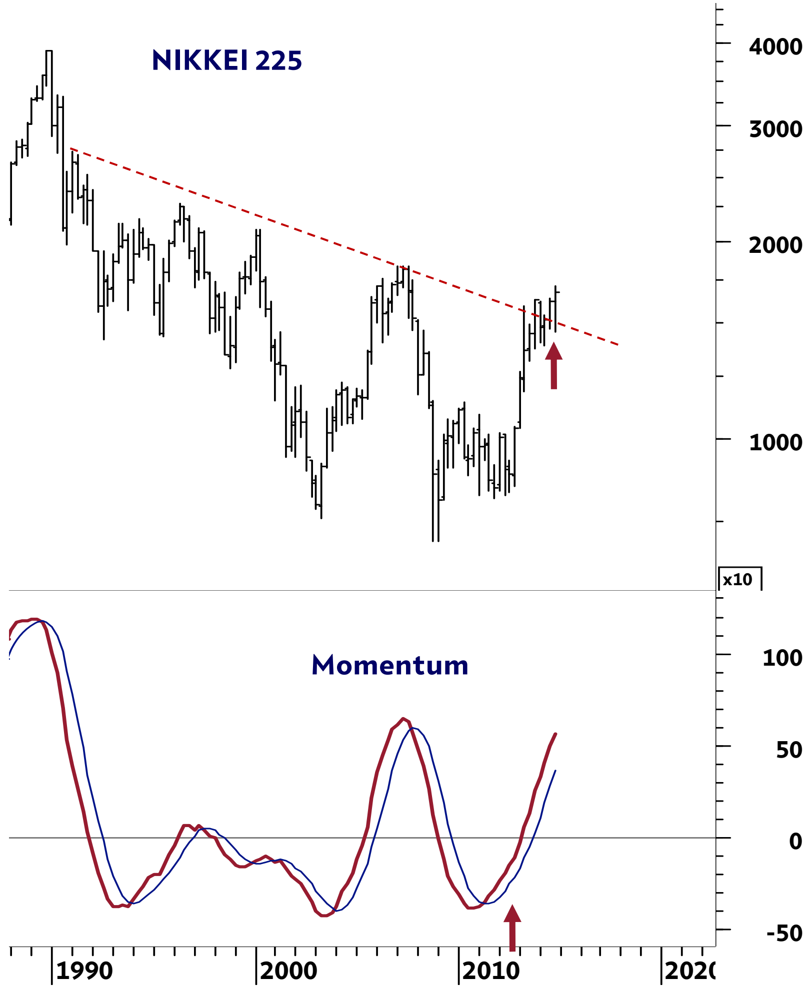


Source: Banque de France, Julius Baer

2015: JAPAN & SWITZERLAND

SMI best market in Europe.
Japan – devaluation led rally resumes.

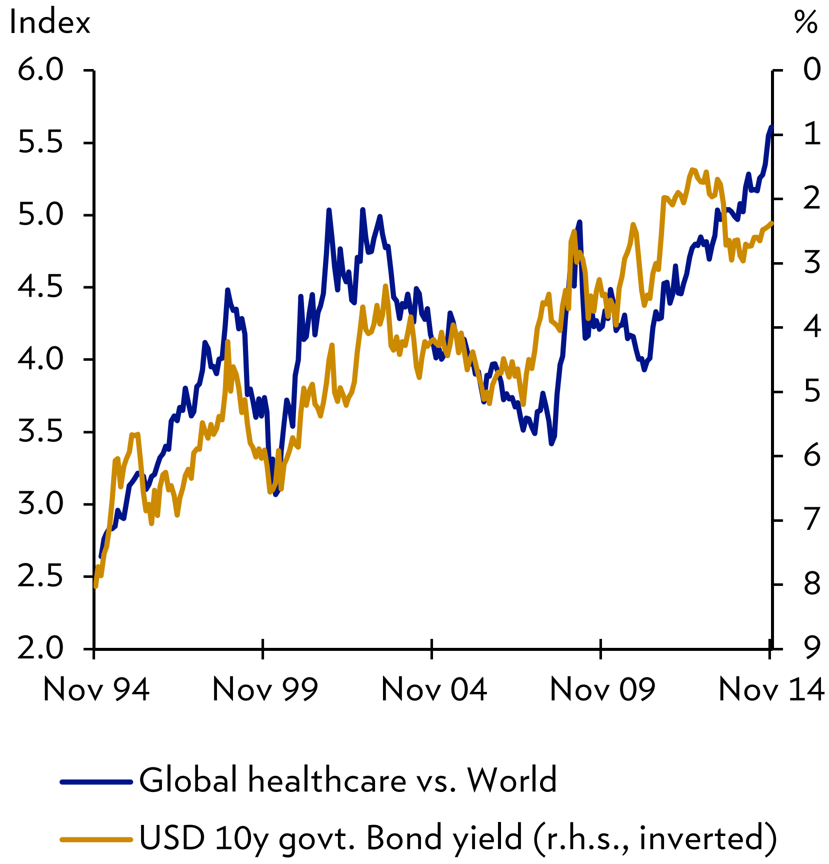




HEALTHCARE

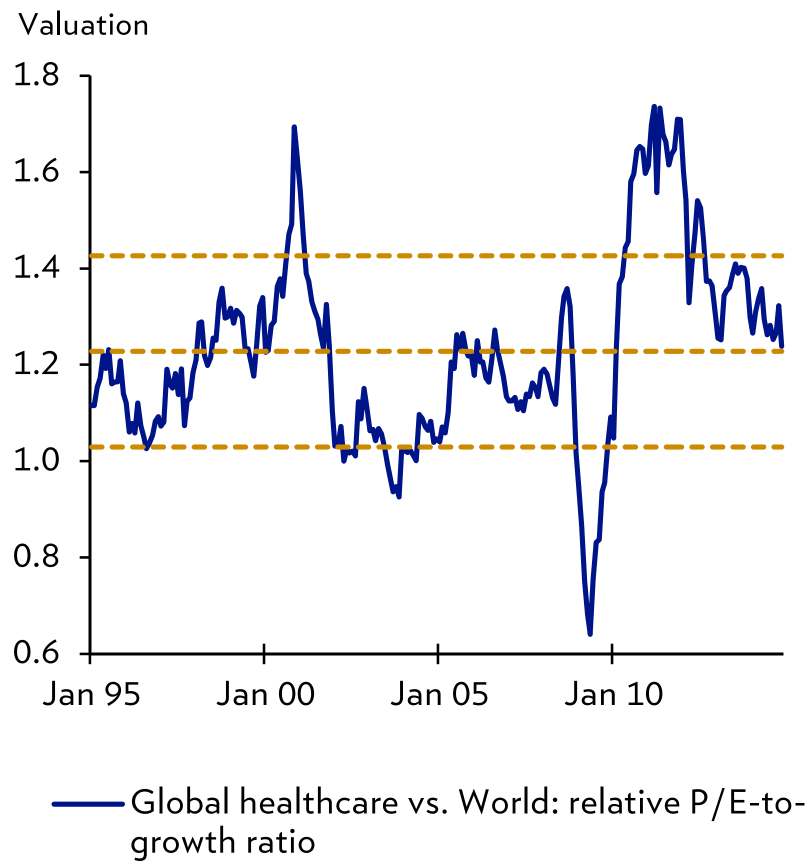
The most attractive defensive sector: we expect further outperformance driven by an ongoing accomodative bond yield environment and an attractive PEG ratio

A low bond yield environment is supportive for healthcare equities



Source: Datastream, Julius Baer

Despite the strong outperformance the valuation (PEG) remains under control

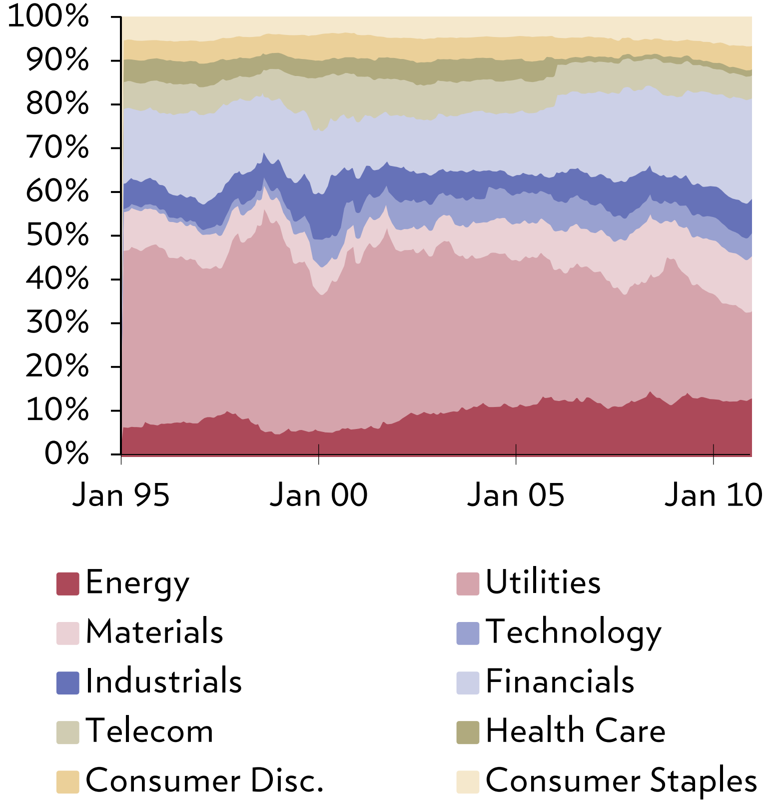


Source: Datastream, Julius Baer

EMERGING MARKETS

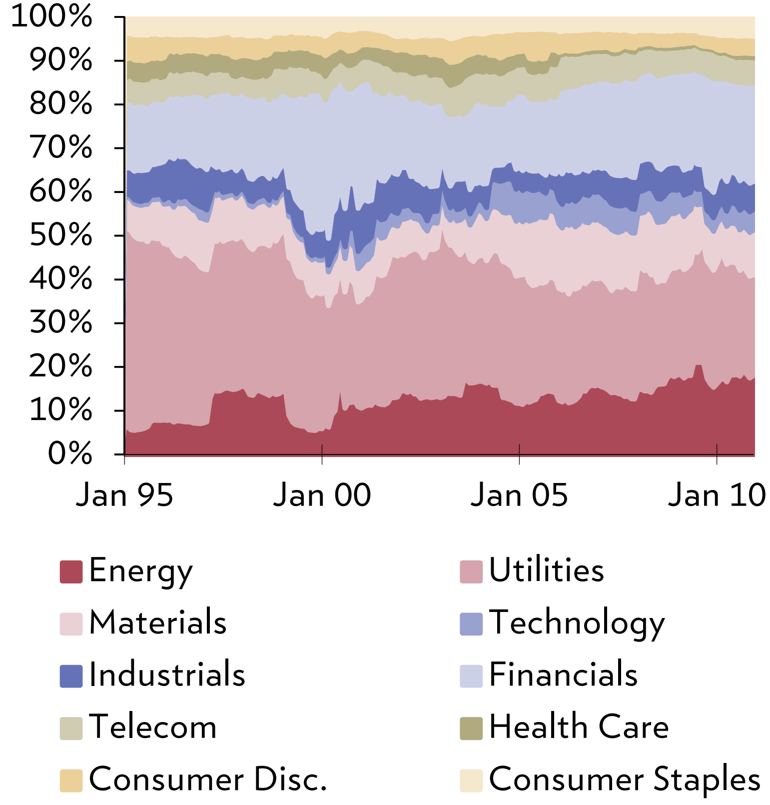
No passive investment – still a commodity proxy on aggregate level

Global emerging markets – market weight of sectors



Source: Datastream, Julius Baer

Global emerging markets – earnings weight of sectors

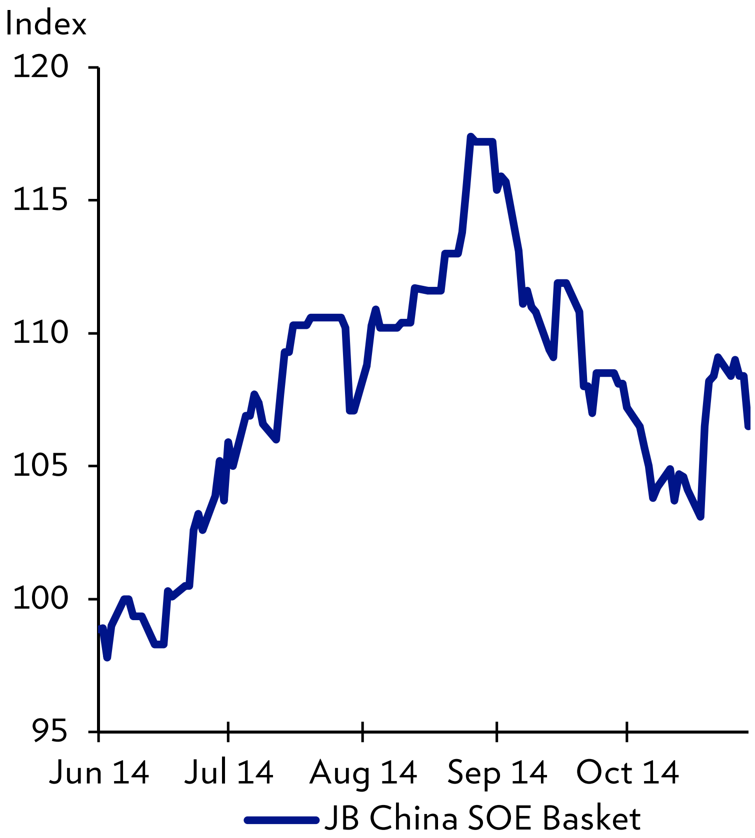


Source: Datastream, Julius Baer

CHINA SOE INDEX

High on the government's agenda: Increase corporate governance, efficiency and profitability of state-owned enterprises.

JB China SOE Index since launch in June 2014



Source: Bloomberg Finance L.P., Julius Baer

Examples of real reform in China

- **Sinopec -** Asia's largest oil refiner will sell up to 30% of its 30,000 petrol station business to private investors by September.
- **PetroChina** will sell all its assets in the eastern part of 2 major transmission pipelines to outside investors.
- **China Telecom,** the 3rd-largest carrier, is seeking private investment to help it develop new businesses like online payment systems and social networking. It will also jointly invest in infrastructure with China Mobile and China Unicom.
- **China CNR Corp. and CSR Corp,** two large railcar markets, will merge.

Conclusion

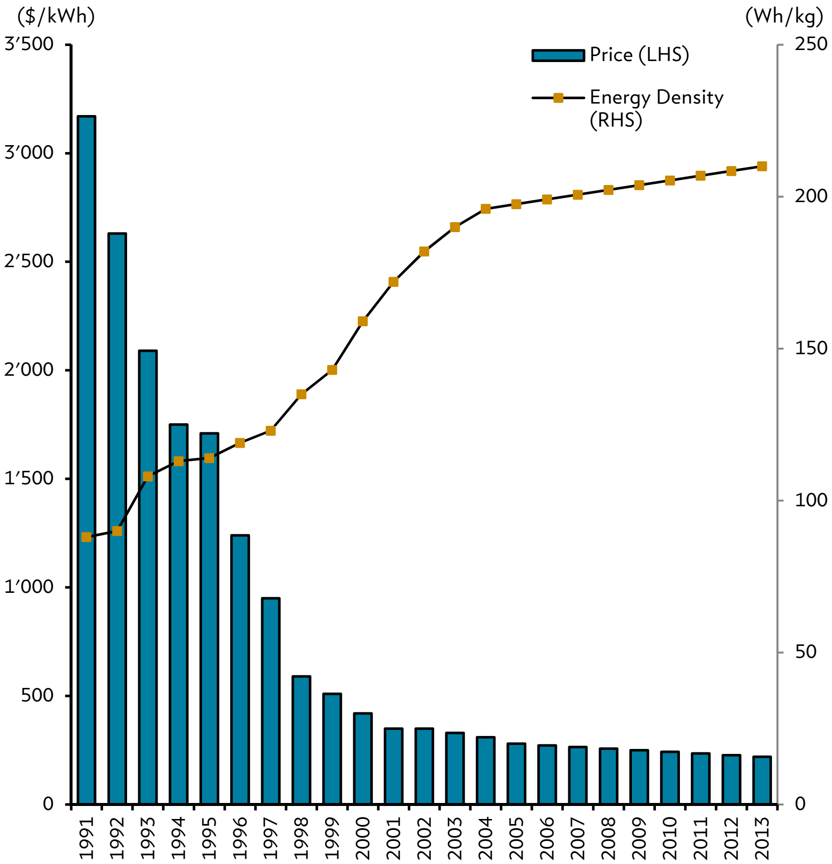
- Government's committment to reform the sector

ENERGY TRANSITION: CAR INDUSTRY

The electrification of the car engine is only just taking off.

NEXT GENERATION

Cheaper batteries = a brighter electric future



Source: Bernstein Research, Julius Baer

New global regulations calling for lower CO2 emissions means that the race for alternative propulsion car engines is only in its infancy.

Electrification must be adopted by automakers to achieve the regulatory 2020 goals.

Consumers prefer more fuel efficient cars especially as they (e.g. battery technology) come down in price.

Sports (e.g. Formula E – the world's first fully electric car racing championship) is setting the trend. Electric cars to account for 6% of global car market by 2020.

The development of Advanced Driver Assistance Systems (ADAS) is paving the way for a safer and less driver-dependent journey.

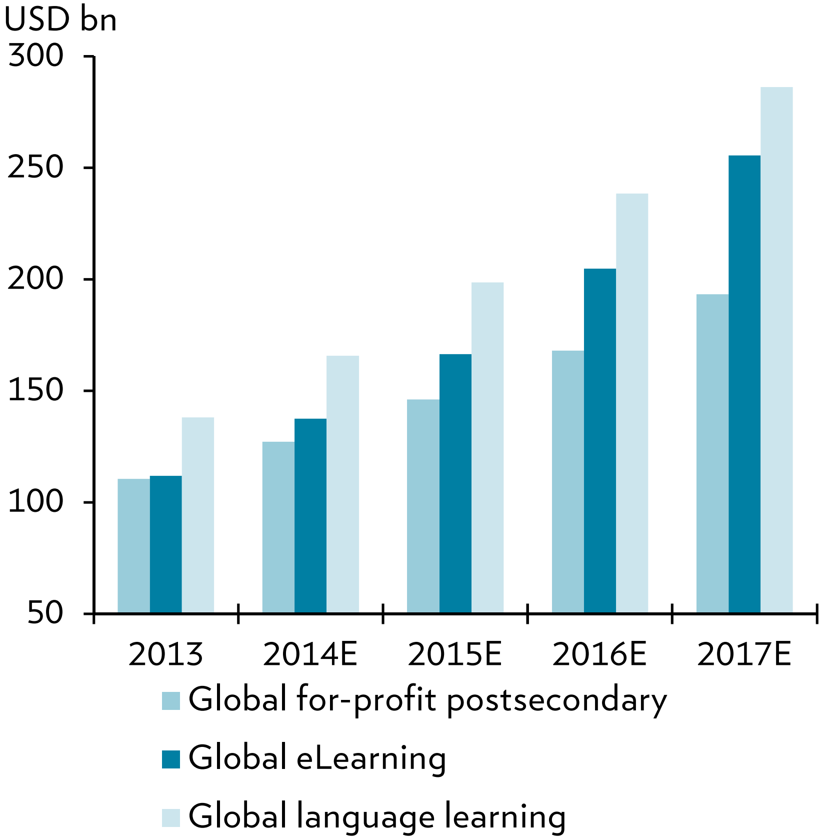
The auto supplier industry is best placed to benefit from these structural shifts within the car industry.

SHIFTING LIFESTYLES: GLOBAL EDUCATION

Digitalisation is transforming the way we learn.

NEXT GENERATION

Education market, 2nd only to healthcare



Source: GSV Advisors, Julius Baer

Globally we spend 5 trillion USD on education today. By 2017 that number will grow to almost 8 trillion.

Cash-strapped governments are resulting in an increased private spend.

EMs are leading the way with an uptick in enrolment.

The online space brings quality education to all at a fraction of the cost.

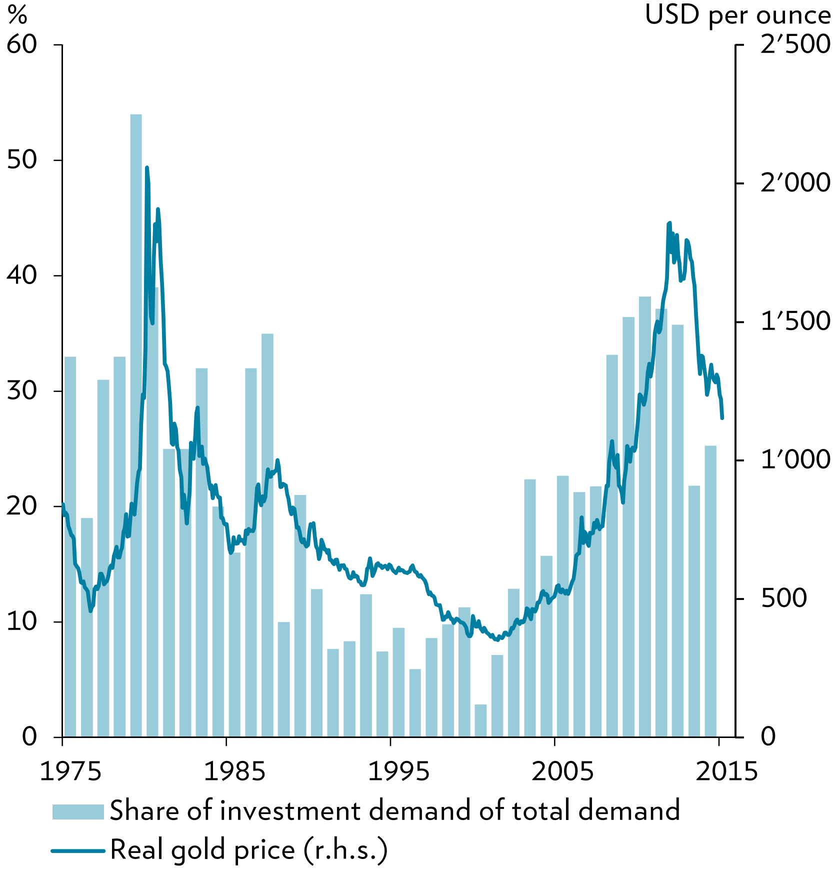
Social change encourages us to train and learn over a lifetime not just at school age.

OUTLOOK 2015: “GOLD NOT YET BACK INTO BALANCE”

Still dominated by investors, fading safe-haven demand and a lower willingness to pay should weigh on gold also in 2015 as the economic recovery progresses.

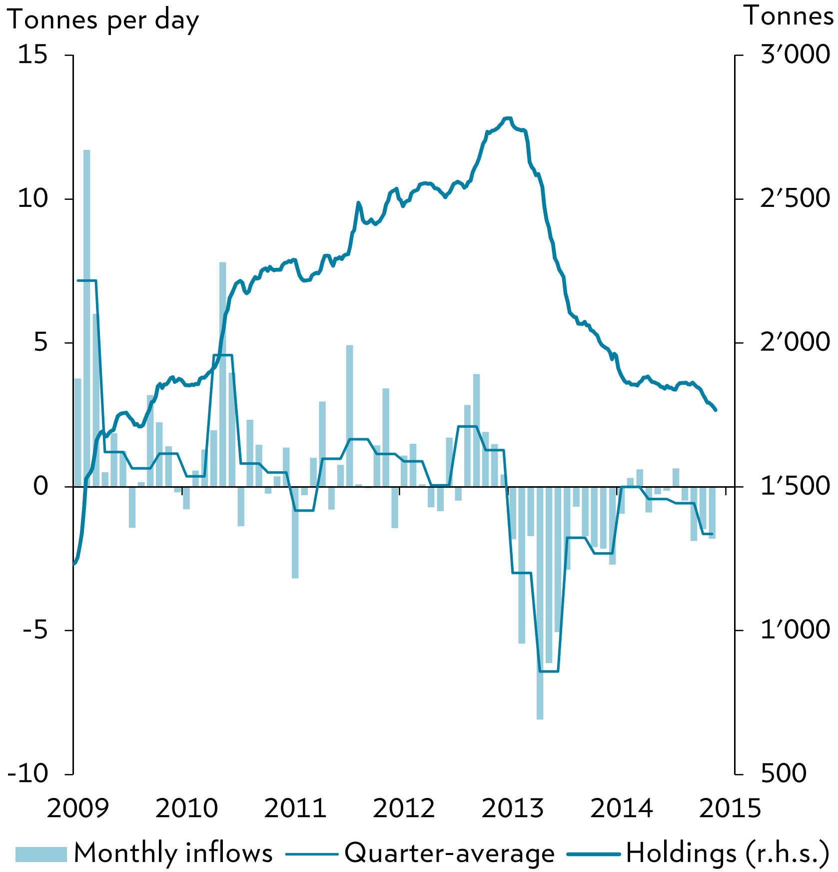
Investors’ share of gold demand

(Non-commercial net-length to open interest)



Source: CPM Group, Thomson Reuters GFMS, Julius Baer

Holdings of physically backed products



Source: Bloomberg Finance L.P., Julius Baer

SUMMARY

Outlook 2015 – «The year of the US dollar? The all-in moment for the euro»

Macro: Solid but not stellar growth – the US filling in for China / Europe. Eventual re-distribution after currency shifts. Inflation rates steady, but not accelerating.

Central banks: still loose monetary reins globally; first potential tightening in H2 2015

Risks: Fed tightening, inflation pick-up, China hard landing, geopolitics, pandemics, asset bubbles

Main topics

Asset allocation: another year of equity outperformance – lack of alternatives speaks for some duration exposure and for alternative risk premia

Currency woes: further US dollar strength against Emerging Market currenciesy will create opportunities; the euro may be facing another "all-in moment" if current measures do not trigger growth effects

Political leadership: Japan, China, India – changed for the better

Geopolitics: more of a tailwind - multipolar world faces less contagion risks

Where to find structural growth: e-cars, e-commerce, e-payments, and e-ducation.

Commodities: less of a bear market; oil to continue to struggle with oversupply; gold market not in balance yet; agriculturals bottoming.

Best ideas: e-growth, New China, China SOE basket, Dividend growers, Spain, Healthcare (orphan drugs) , Research Top 15, energy infrastructure

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