

Interest rates/Bond markets

Divergence in the rate outlook

USA

- The statement following the latest FOMC meeting indicates that the Fed wants to retain all options as concerns the continuation of rate normalisation
- Financial conditions have loosened substantially to reach levels seen before December 2015
- We expect a moderate increase of long-term rates due to rising inflationary pressures and due to the fact that we expect more Fed hikes than what is currently priced in Fed Funds Futures

Euro Area

- In their last press conference the ECB stressed that they could ease policy further if needed
- The interesting thing to note is the emphasis on all tools which seems to suggest deeper negative rates is still an option – they seem increasingly uncomfortable with the appreciation of the Euro

Japan

- The Bank of Japan disappointed markets as they kept their policy unchanged and abstained from easing monetary policy further
- So far, additional monetary easing proved ineffective as the Yen appreciated notwithstanding

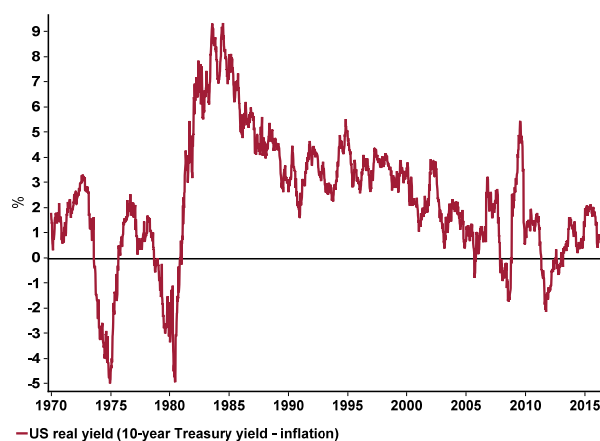
United Kingdom

- Since President Obama's warnings of a Brexit, the odds for a status quo outcome have risen notably
- Given the Brexit uncertainties, the 10-year sovereign rate had climbed by almost 30 basis points since the beginning of April

Switzerland

- Given the ultra-loose monetary stance of the ECB and the resulting pressure on EUR/CHF, the SNB continues to intervene in markets
- Political risks may urge the SNB to deploy other instruments to weaken the CHF

US real yield holds above the zero line



Source: **Macrobond**

Analysts interpret the Fed's statement following the latest FOMC meeting on 27 April very differently. As a matter of fact, the US central bank kept the door open to still pursue the rate normalisation path in June, but sounded less hawkish than we would have expected given the economic framework, the strong increase in crude oil prices and the loosening of financial conditions over the past weeks. In our view, in order to expect a rate hike in June of this year, we will have to see strong macroeconomic data out of the US and further reassurance that the advocates for a Brexit lose further ground. For the calendar year, we still expect two more hikes by the US central bank. Across the Atlantic and the Pacific, the ECB and the BoJ continue to hold on to their highly accommodative monetary policy, although the Bank of Japan refrained from loosening policy further in their April meeting. That caused disappointment among market participants and led to renewed appreciation of the Yen, which moves actual inflation even further away from the BoJ's target. Yet, the divergence of monetary policies between the stance of the Federal Reserve and other major central banks is reflected in our expectation as regards the directional move of long-term interest rates. While we anticipate a modest increase of US long-term rates over the next weeks, we view the continued sovereign bond purchases of the ECB as a major obstacle for rates in the Euro Area to actually move higher. Furthermore, Brexit concerns weigh relatively more on interest rates in Europe. Therefore, we view the risk of Swiss bond yields to also move slightly lower from here as fairly high.

Stock markets

Volatility measures suggest market complacency

USA

- Sentiment indicators and low volatility measures suggest that the equity market is overbought for the time being
- Price/earnings measures have reached a peak for the last three years
- Yet, as we continue to expect two more rate hikes by the Fed in 2016, valuation multiples should contract as they typically do in tightening cycles

Euro Area

- Stock market valuations in the Euro Area are neutral relative to the long-term average and attractive when compared with fixed income
- We expect the Euro to weaken against the US Dollar (and also the British Pound, once Brexit risk is off the table); this should support European stocks
- Renewed weakness in the oil price and return of deflation fears pose a risk for equity markets

Japan

- Over the past month, Japan's stock market remained the worst performing of all regions discussed in this paper
- It is broadly expected that the authorities announce further fiscal and/or monetary policy measures to boost domestic demand in May

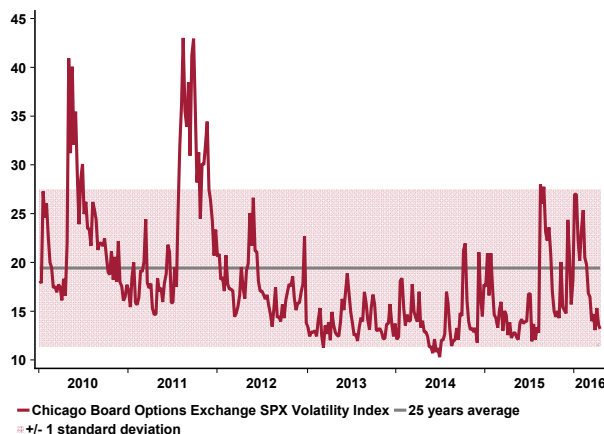
United Kingdom

- As Brexit fears have eased substantially in calendar week 16, UK stocks with strong exposure to Europe should find some support in the weeks ahead
- The less likely a victory of the "Leave" campaign gets, the more markets should start preparing for a normalisation of monetary policy by the Bank of England over the next twelve months

Switzerland

- Analysts' earnings growth expectations have been reduced to a sufficiently prudent range by now
- A repricing by market participants of future Fed monetary policy and the related stock market correction in the US poses the most important short-term risk on Switzerland's stock market

Volatility: From stress to complacency in just a few weeks



Source: **Macrobond**

We stick to our prudent view that equity markets should correct modestly until mid-2016. After the impressive rally since early February, which resulted in double digit percentage point gains, we think that the US market is overbought. Although interest rates have corrected slightly over the past month, we continue to think that future Fed policy action this year is not yet fully priced in. We keep expecting two more rate hikes by the Fed in 2016 and conclude that stock markets may correct modestly, once this view is being adopted by a growing number of investors. The triple combination of fears about a recession in the US, confusing market interventions by Chinese authorities and a dramatic fall in energy prices, triggered a spike in volatility during the first weeks of the year. With evidence rising that economic data have improved both in the US and China by the end of the first quarter and the oil price gaining more than 60% since late January, stock markets overreacted to the opposite side of the trade and look currently overbought according to our own assessment. Valuation measures seem particularly stretched in the US, where the price/earnings ratio has reached a peak for more than three years. This measure usually corrects to the downside during a monetary policy tightening cycle by the US central bank. Investors should prepare for more headwinds going forward: Although, we think that British voters will eventually decide to remain in the EU, the campaign ahead of the referendum bears the potential to make global investors nervous over the weeks ahead. Medium-term, rising inflation and the related monetary policy response by the Fed and possibly later the Bank of England sets limits to the latest stock market rally.

Currencies

Central banks still dominate the scene

USA

- USD found a bottom in the second half of April as risk sentiment improved further
- We expect the USD to move higher in coming weeks as markets should start to reprice Fed expectations and as economic data should continue to be solid

Euro Area

- EUR/USD traded between 1.12 and 1.14 in April
- Despite the ECB's easing measures in last weeks, the Euro did not depreciate against the USD
- Mario Draghi disappointed some market participants by not adding further sings of future easing measures during the ECB's April meeting

Japan

- The BoJ held off from expanding monetary stimulus further in its April meeting
- As market participants were surprised that the BoJ did not ease monetary policy further, the Yen soared after the meeting of 28 April
- Since the beginning of the year, the Yen appreciated by 10% against the USD

United Kingdom

- GBP/USD increased by roughly 3% compared to March levels
- As we expect uncertainty regarding a Brexit to persist we expect GBP/USD to move sideways
- Our base case is that Britain stays in the EU and hence that the Pound rallies after the referendum vote in late June

Switzerland

- Towards end of April, EUR/CHF hovered around 1.10
- The balance sheet of the SNB keeps growing as the Swiss National Bank continuously buys EUR to avoid the CHF to appreciate against the EUR

USD depreciation to come to an end



— USD, Effective exchange rate index

Source: **Macrobond**

The evolution of the trade-weighted US Dollar since mid-2014 can be described by three phases: A sharp appreciation during the second half of 2014, a mild appreciation during the year 2015 and a sharp depreciation since the beginning of 2016. These moves have to a large extent been driven by expectations about the Fed hiking cycle. The recent depreciation of the USD started in January when markets panicked. Despite the substantial improvement of US economic data since the beginning of the year the depreciation continued. We believe that the USD found a bottom in the second half of April as risk sentiment improved further with a higher oil price, better economic data out of China and further signs of easing by the ECB and the Bank of Japan. We expect the USD to turn and appreciate in the coming weeks due to positive economic data and repricing of expectations regarding the pace of the current hiking cycle. We do not see any further upside potential for EUR/USD. Despite further easing by the ECB the Euro appreciated against the Dollar. 1.14 seems to be an important barrier for the cross. Since the beginning of 2015, EUR/USD never passed this threshold on a sustained basis. We have a neutral view for GBP/USD. Uncertainty due to a potential Brexit pushed the cable lower. During recent weeks, the Pound recovered a bit. We do not see further upside potential as we expect the polls to remain close and the number of undecided people to stay high. Our base case is that Britain stays in the EU. Thus, we expect a relief rally after the vote in June.

Released and approved by the Economics Department, Swiss Life Asset Management AG, Zurich

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