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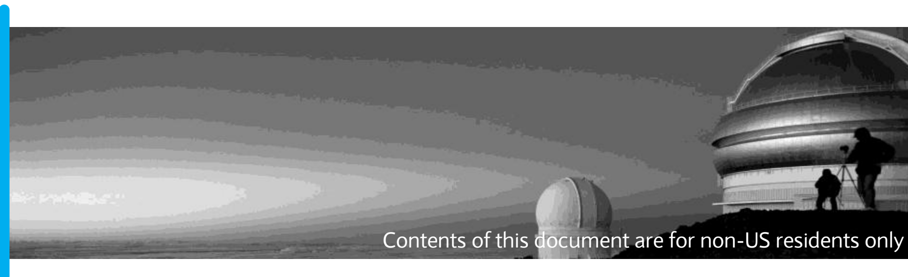
Wealth and Investment Management

In Focus: Markets as we see them

Lessons from 2016



09 December 2016

For EMEA and Asia distribution only

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Lesson 1 – 'The economy, stupid' Those who tuned out a lot of the hysteria surrounding the political backdrop would have stood to gain from their composure

Lesson 2 – Stay invested Investors are usually better off tuning out the multitude of talking heads and making sure they are fully invested in a range of assets – the details of the future, good and bad, will always elude us, but over time optimism, and being invested, have tended to be handsomely rewarded

Lesson 3 – Correlation doesn't imply causation We as investors will be served well by always remembering that correlation and causation are often not the same

Investment conclusion These are obviously not the only lessons to be learnt this year. However, these three are likely to be helpful for us all to remember as we go into another year with a crowded political calendar and a few more grey hairs

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"Sometimes you eat the bar, and sometimes the bar eats you."
(The stranger, The Big Lebowski)

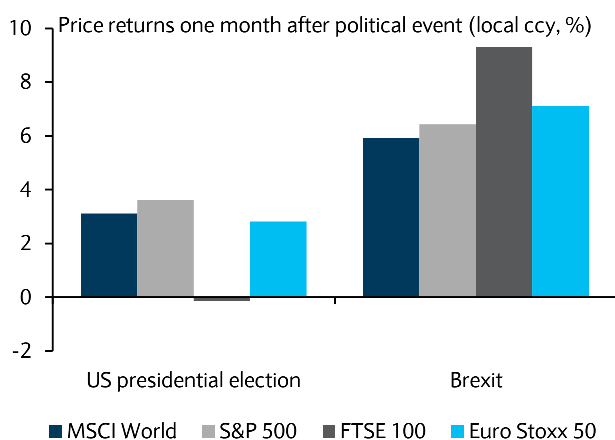
Lesson 1 – 'The economy, stupid'

This year the commentariat have variously and collectively pronounced the beginning of the end of Pax Americana, the liberal consensus, the European Union, and globalisation. However, through all this the global economy has continued to chug along creating jobs, credit and profits. Those who tuned out a lot of the hysteria surrounding the political backdrop would have stood to gain from their composure (Figure 1). This isn't to say that political risk doesn't matter for corporate profitability – a trade war between the US and China for example would have serious implications as we've explored in *In Focus – Trick or Treat?* – but we should nonetheless continue to be wary of giving political trends a dominant role in our investment thinking.

Lesson 2 – Stay invested

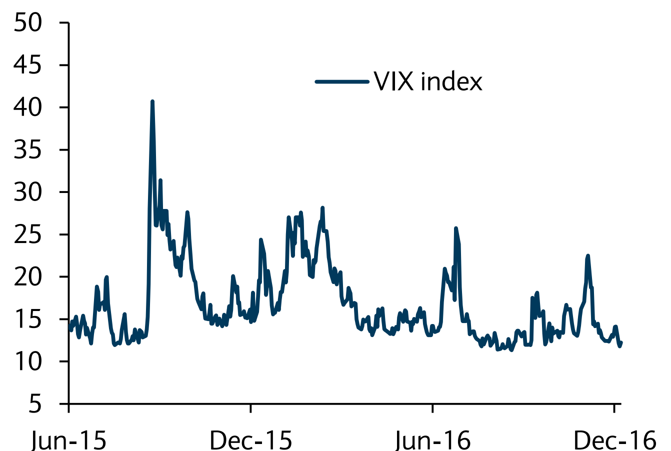
One infamous headline from a competitor research note in January, covered in gory detail by all the major UK newspapers, urged investors to "sell everything except high quality bonds"[1]. At the time, a range of economic indicators were darkening materially, the next European banking crisis seemed to be upon us and the Chinese economy was almost universally believed to be imploding. Figure 2 shows the stress that markets were under at that point. The consensus among economists and market experts seemed to chime with this extreme cry. The next US and global recession was

Figure 1: Equity markets after political risk events



Source: Datastream, Barclays

Figure 2: VIX (volatility index)

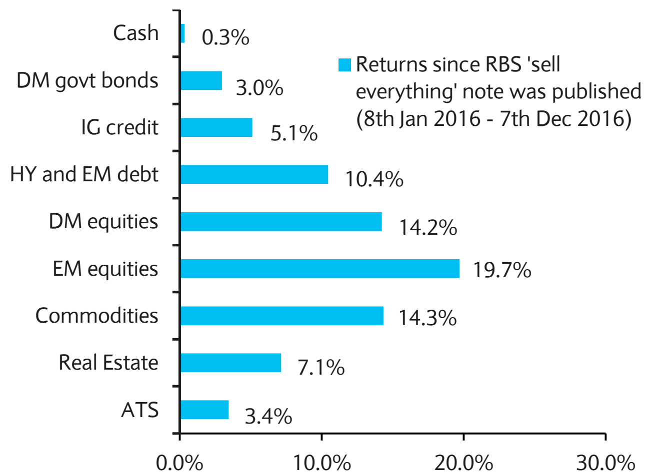


Source: Datastream, Barclays

[1] *The bears have killed Goldilocks, European Rates Weekly – RBS European Rates Research, 8th Jan 2016*

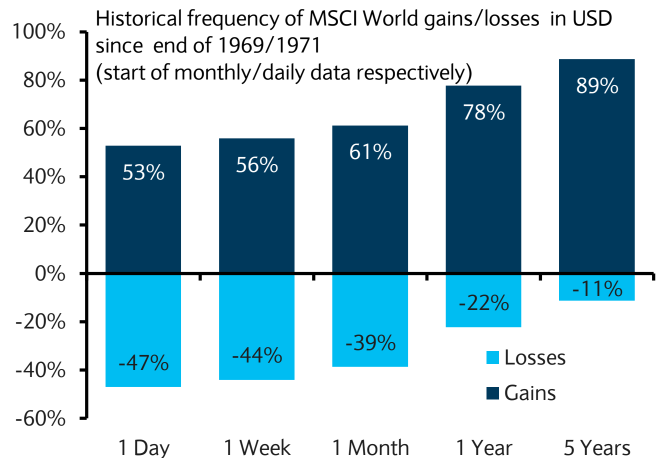
Important Information: Please note that the contents of this document are intended for non-US residents only.

Figure 3: Asset class returns post 'sell everything'



Source: Factset, Barclays

Figure 4: Historical frequency of equity gains/losses



Source: Datastream, Barclays

imminent, baton down the hatches and own only that which you can more or less guarantee will be returned.

However, Figure 3 also clearly illustrates that this was precisely the wrong moment to sell everything. In fact, a note screaming "buy everything" might have been more apposite. The primary lesson from this is really that investors are usually better off tuning out the multitude of talking heads and making sure they are fully invested in a range of assets – the details of the future, good and bad, will always elude us, but over time optimism, and being invested, have tended to be handsomely rewarded (Figure 4).

No indicator should be used without context...

It is also a reminder that no indicator should be used without context. Even our trusted desert island statistic started to point to darker times ahead at exactly this moment. However, the ISM manufacturing survey, like many other indicators, was simply being warped by the commodity price plunge[2]. In this sense, the most important question investors could ask themselves this year was whether they believed lower oil prices, when all was said and done, would be a net negative or a net positive for the world economy. Our view has long been that lower oil prices should, at worst, be a zero sum game - rich producers on the high end of the income distribution suffer, while lower income consumers gain. The differing marginal propensities to consume of these two groups actually pointed to lower oil prices being slightly positive sum, which in turn helped to provide important context for the slump in corporate profits[3], inflation, inflation expectations, industrial production, investment and oil exporting emerging market countries to name a few.

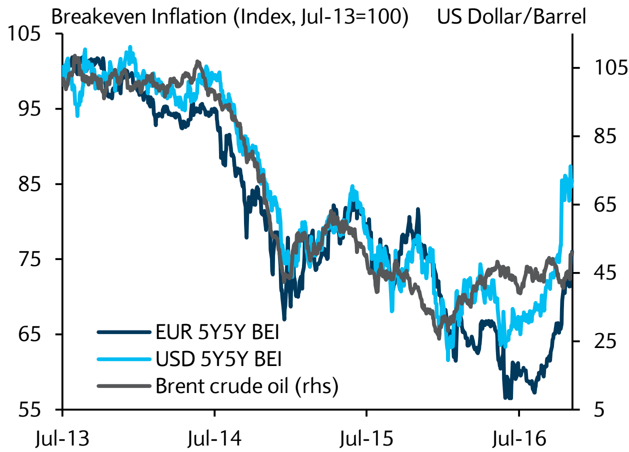
Lesson 3 – Correlation doesn't imply causation

Within the investment management industry, a lot of time is spent scouring the world for new correlations on which to found investment strategies. Such an empirically based approach towards investing is commendable, and generally useful in aiding our understanding of how the market works. However, 2016 has again shown us the limitations of such an approach if it is not supported by fundamental theory and intuition.

Here, two examples from the first half of 2016 are instructive (Figure 5 and 6). As shown in Figure 5, long-term developed market inflationary expectations had been falling in tandem with oil prices from 2014. We chose to downplay this puzzling correlation, reasoning that long-term inflationary expectations shouldn't be fundamentally altered by oil price changes (where the impact on inflation is merely transitional as the last few months have proved)[4]. The influence of this temporary correlation was profound and widespread all the same,

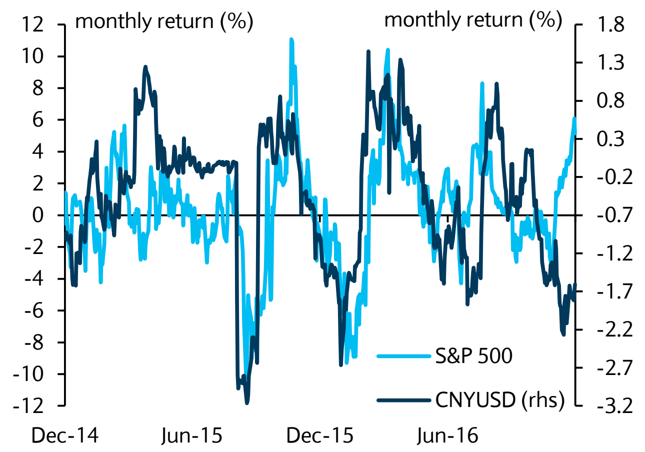
[2] *In Focus – A tale of two lead indicators, 15th Jan 2016*
[3] *Compass Q2 2016 – Equities: the full medical*
[4] *In Focus – The pied piper, 29th Feb 2016*

Figure 5: Long-term inflationary expectations and oil



Source: Datastream, Barclays

Figure 6: Chinese yuan and US equities



Source: Datastream, Barclays

helping to fuel the melee around deflation and negative interest rates that has dominated the capital markets discussion for the much of the year.

At around the same time, the apparently strong relationship between the Chinese yuan and S&P 500 was encouraging an unhealthy, and again temporary, global obsession with any data point or news item remotely suggestive of a Chinese economic slowdown (Figure 6). However, we suspected a fundamental misunderstanding of the sources of capital outflows driving the yuan depreciation[5], a theory later confirmed by the BIS, and opted to remain overweight US equities at a time when most were moving in the other direction. As often happens, the correlation eventually broke as market attention simply shifted away from China onto political risk in the Europe and US, even as the yuan continued depreciating.

Markets are always teaching us humility…

There will surely be plenty more of the same as we look into 2016, but we as investors will be served well by always remembering that correlation and causation are often not the same. A strong fundamental understanding of how markets and economies tend to interact should help us ensure that the relationships we rely on for investment ideas are both robust and useful.

Investment conclusion

These are obviously not the only lessons to be learnt this year, markets are always teaching us humility for one thing. However, these three are likely to be helpful for us all to remember as we go into another year with a political calendar that appears littered with investment accidents waiting to happen. We will be publishing our quarterly Compass next week, meaning that this is this year's last edition of In Focus. We wish all our readers a happy and peaceful Christmas, and a prosperous 2017.

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[5] *In Focus – China's capital flight, 12th Feb 2016*

Market calls – summary

Macro economy summary

- The world economy continues to defy its many doubters, appearing increasingly less vulnerable now that the effects of lower oil prices are washing through the system. Inflation expectations have hardened amidst conjecture on the next US administration's potentially inflationary agenda. The more visible pick up in nominal wages suggest that underlying inflationary pressure is already on an upward trajectory.

- The post-Brexit global confidence slump feared by many has so far failed to materialise. Nonetheless, Bank of England agent surveys for business investment suggest that the horizon is darkening a little for the UK economy. We retain our view that Brexit will have a more or less localised effect, with any potential headwind to UK activity slowing but not upending the European economic recovery.

- For now, China remains lower down our global list of concerns. Concerns regarding the pace of capital outflows have resurfaced. However, we remain of the view that further outflows or currency depreciation wouldn't pose a huge risk to the financial system, given how little China relies on external financing.

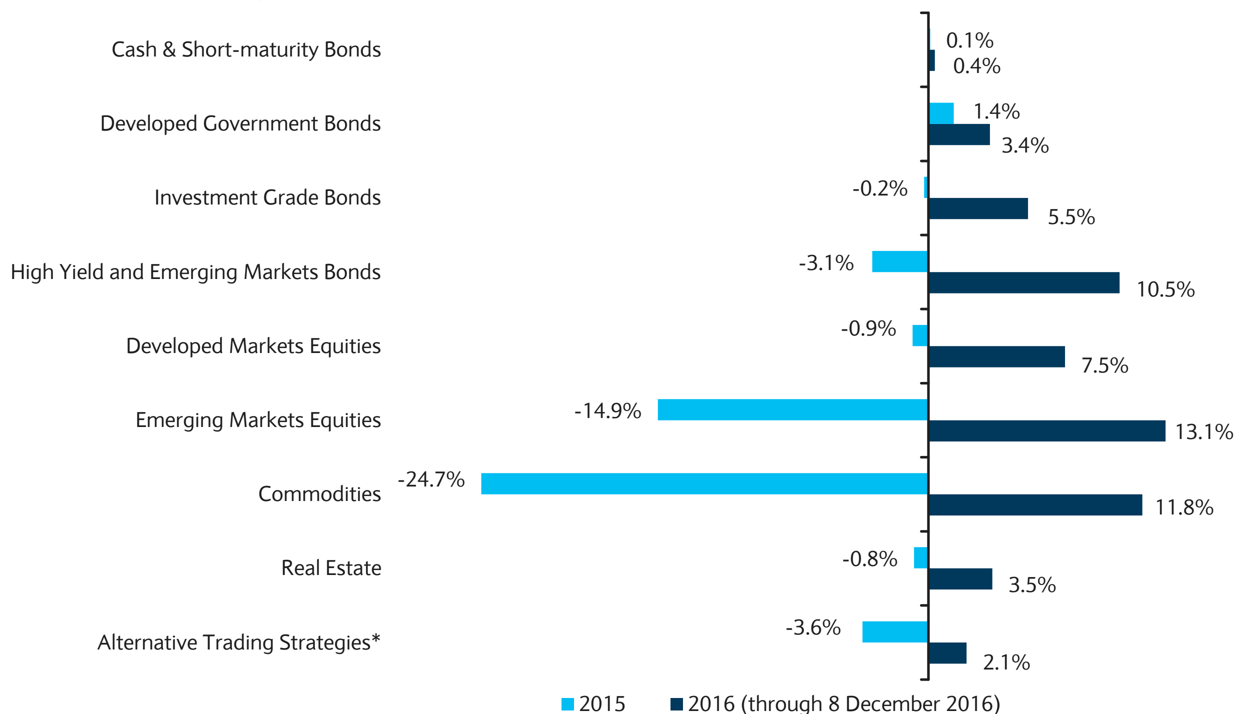
- More broadly, we believe the world economy will continue to grow at above stall speed and see the cycle end as a relatively distant prospect. The political backdrop is set to remain noisy as we go into 2017, but investors will be best served by tuning much of this out and focusing on the above described fundamentals in our view.

Investment conclusions

1. Strategically: corporate securities preferred to government, and stocks to bonds
   – There remain unfulfilled economic opportunities to exploit for the corporate sector in our view. Bonds look expensive, with positive real returns likely hard to achieve even if inflationary pressures remain benign.

2. Tactically: we remain overweight developed equities
   – Continuing economic growth, as well as the reduced influence of commodity earnings may see quoted sector earnings surprise market expectations positively next year. Equity market valuations continue to look unremarkable.

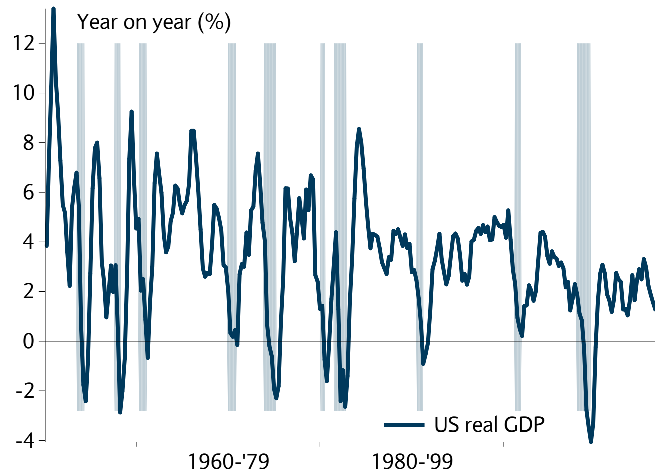
Total returns across key asset classes



*As of 7th December; Source: FactSet, Barclays. List of indices used: Cash & Short-Maturity Bonds: Barclays US T-Bills (USD); Developed Government Bonds: Barclays Global Treasury (USD Hgd); Investment Grade Bonds: Barclays Global Aggregate - Corporates (USD Hgd); High Yield & Emerging Market Bonds: 40% Barclays Global HY (USD Hgd), 30% Barclays EM Hard Currency Aggregate (USD Hgd), 30% Barclays EM Local Currency Government (USD); Developed Market Equities: MSCI World Net TR (USD); Emerging Market Equities: MSCI EM Net TR (USD); Commodities: Bloomberg Commodity TR (USD); Real Estate: FTSE EPRA/NAREIT Net TR (USD); ATS: HFRX Global Hedge Fund (USD).

Selected risks to our views

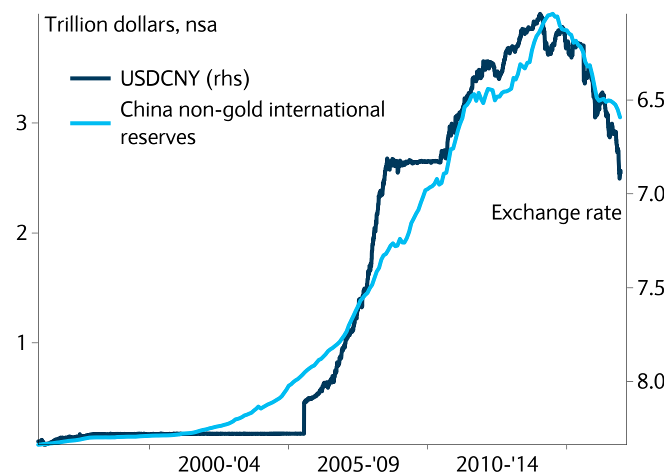
US recession?



Source: Datastream, Barclays

- A recession in the US poses the greatest risk to our investment outlook.
- The current US economic expansion is now in its eighth year, a year longer than the average post-War cycle. This has led many to call, somewhat mechanically, for an imminent recession.
- However, such claims are based on misguided notions about the fundamental drivers of the business cycle. Business cycles usually end because of some exogenous shock that causes firms and individuals to alter their planned expenditures and expectations of future incomes. They do not die of old age.
- So far, lead indicators for the US economy still indicate decent growth prospects for the US economy. In particular, trend readings in the ISM Manufacturing and Non-manufacturing indices are still hovering close to their expansion thresholds.

China currency crisis?



Source: Datastream, Barclays

- Chinese capital outflows have begun to reaccelerate, with outflows reaching a near-record $200 billion in Q3. This has once again sparked worries of a yuan devaluation by the PBoC.
- In response, the Chinese authorities have tightened outflows through administrative means, including on outbound FDI, gold imports, and cross-border yuan payments. Our base outlook is for the Chinese to continue relying on capital controls in order to regulate the outflows, while steadily moving to a freer float for the yuan.
- Regardless of whether outflows accelerate, we do not think a Chinese version of the 1997 Asian Financial Crisis is likely, considering how little the domestic economy relies on external financing relative to its EM counterparts. However, this is something we continue to monitor closely.

A messy end of the bond bull market?

Source: Datastream, Barclays

- The multi decade long bond bull market remains more or less in place, driven by a cocktail of economic pessimism, low inflation and central bank easing. However, this poses significant downside risks to global capital markets should this bull market unwind chaotically.
- Government bond yields have indeed moved sharply higher since the summer, amidst recovering inflation expectations and fears of an inflationary policy agenda under President-elect Trump.
- However, for the moment, central bank ownership and historic precedent suggest to us that the bond market will remain more or less orderly, even with the return of more inflation. However, this is certainly a risk worth keeping an eye on.

Asset class summary

We maintain a Strategic Asset Allocation for five risk profiles, based on our outlook for each asset class. Our Tactical Allocation Committee (TAC), made up of our senior investment strategists and portfolio managers, regularly assesses the need for tactical adjustments to those allocations, based on our shorter-term (three to six month) outlook. Here, we share our latest thinking on our key tactical tilts.

Developed Market Equities: Overweight (changed 22 July 2016)

Our favoured developed equity regions remain for the moment the US and Europe ex-UK

The prospects for global growth and inflation seem less materially underestimated than they were earlier in the year. However, we still see expectations having further to travel before they meet the underlying reality as we see it, something that should continue to help stocks to outperform bonds in coming quarters in our view. It is these prospects that are likely to continue to be most influential with regards to the performance of capital markets, rather than the ever-murky political backdrop. The prospects for US consumption remain well founded on a robust jobs backdrop, characterised by more visibly rising wages, which in turn is helping appetite for credit to continue to recover. The negative hit from oil prices on associated corporate earnings is fading as is the headwind to profits from the previous ascent of the US dollar. US operating earnings growth have now made it back into positive year-on-year territory for the Q3 earnings season, confounding those who believed the decline in profitability was terminal for this cycle.

Within the developed world, our preferred markets remain the US, Europe ex-UK, and UK in roughly that order. For the US, we are not relying on further gains coming from multiple expansion, but from continuing earnings and dividend growth. For our overweight position in Continental European equities, much depends on the performance of the embattled banking sector where we expect a more helpful yield curve to continue to alleviate some of the more apocalyptic concerns. Our more positive outlook for oil prices is part of the reason that we have turned more positive on large cap UK equities. Perversely, they may also be a way for investors to insulate themselves from Brexit risks, with weaker sterling a positive for the large cap space, albeit predominantly a superficial one.

Emerging Market Equities: Overweight (increased 23 November 2016)

We moved our recommended tactical position in Emerging Market Equities up to Overweight from Neutral in November. The Emerging Markets business cycle is bottoming, as evidenced by business confidence surveys and trade data. The latter has clearly collapsed and recovered in value terms due to commodity price swings, but the latest round of business confidence surveys have seen a sizeable rebound. US consumption also looks healthy, with wages now more visibly picking up and credit provision following suit. This suggests to us that the fundamental macroeconomic backdrop has turned more positive for Emerging Market corporate profitability.

Within Emerging Market Equities, Asia remains our preferred region, with Korea, Taiwan and China (offshore) our highest conviction country bets on a strategic basis. With the regions' earnings sensitive to the trade cycle, what President Trump decides to implement in regards to trade policy is important. Here, we take some solace from the mellower perspective offered by the newly nominated Treasury and Commerce Secretaries on some of the President-elect's more controversial campaign trail pledges. We suspect that economic self-interest will ultimately triumph over some of the president-elect's more populist trade threats.

Cash & Short-Maturity Bonds: Underweight (decreased 23 November 2016)

While cash continues to play a pivotal portfolio insulation role, the rising appeal from Emerging Market Equities have led the Tactical Allocation Committee to deploy our cash holdings into the former, bringing our position in Cash & Short-Maturity Bonds from neutral to underweight.

Some returning inflation is central to our current tactical posture

Developed Government Bonds: Underweight (decreased 13 October 2016)

Nominal yields offered by large chunks of the government bond universe are still negligible, even after the fairly dramatic sell off seen since the summer. Investors will likely have to work hard to make real returns from these levels over the next several years. Our view remains that such valuations underestimate the underlying inflationary pressures within the US economy in particular, something that incoming inflation data pay some testament to. The threat of a more fiscally expansive US administration has accelerated the yield retracement. For us, the level of (returns insensitive) central bank ownership probably suggests that the bond market will remain more or less orderly and may lag a pick-up in inflation. Nonetheless, our continuing small strategic and tactical allocation to the area suggests that higher real returns lie elsewhere.

Investment Grade Bonds: Underweight

The spread of investment grade credit over government bond yields has held more or less firm amidst the above mentioned correction; however this has still left investors nursing some short term bruises particularly within the utilities space. Nominal yields in high quality corporate credit remain low in absolute terms and may make the job of those trying to make positive real returns difficult.

High Yield & Emerging Market Bonds: Overweight (increased 13 October)

Earlier in the summer we moved from a tactical underweight to overweight position in High Yield and Emerging Market Bonds by adding to Global High Yield. This was funded by moving from a tactical overweight to neutral position in Cash & Short-Maturity Bonds. Given our more sanguine take on the various risks to global growth and inflation, yields on junk credit look attractive on a risk-reward basis. We have more recently neutralised our earlier underweight position in Local Currency Emerging Market Bonds, again using Cash & Short Maturity bonds.

Commodities: Neutral (Increased 13 May 2016)

We closed our long-held underweight in the commodity complex in May. US monetary normalisation will likely provide a headwind, but the stabilisation in Chinese growth looks sufficient to offset this for the moment. Although the prospects for greater US infrastructure spending have increased a little in the wake of the US elections, we would still take some of the more grandiose claims with a pinch of salt, just as we would tread carefully around the recent related spike in industrial metals prices.

Investors are likely best served by tilting their commodity exposure towards oil and away from gold where possible, with the latter still particularly vulnerable to further US interest rate rises. We see oil prices continuing to drift higher over the coming 12 – 18 months as the market's worst fears on China fail to materialise and a smaller than suspected surplus is worked through.

Real Estate: Neutral

Recent volatility has served as a timely reminder of the importance of maintaining a diversified portfolio with the ability to weather a number of market environments, and we continue to encourage clients to ensure that they are fully allocated to Real Estate.

Alternative Trading Strategies: Underweight (decreased 13 May)

We shifted our previous tactical underweight in Commodities to Alternative Trading Strategies (ATS). This is primarily a function of the difference in volatilities for the two asset classes. There is less risk being underweight the lower volatility ATS in the current market environment in our opinion. Alongside this, regulation and lower leverage leave this diversifying asset class without much tactical appeal at the moment.

Equities

MSCI indices	Yield	Total Return Performance 1 Week	YTD	5Yr Ann.	Global Market Capitalisation (%)	EPS growth (%) 2016	2017	P/E ratio (x) 2016	2017	LTM[1]	10 Year Ave. LTM[1]
Developed markets	2.5	2.6	7.5	10.6	89.4	0.7	12.5	17.9	15.9	17.9	15.1
US	2.1	2.6	11.2	14.4	53.9	1.5	11.8	19.1	17.1	19.1	15.9
Europe ex UK	3.4	3.9	-2.9	6.9	14.2	-0.7	11.7	15.8	14.1	15.8	13.7
UK	4.1	2.1	-1.5	3.9	5.9	-4.7	19.5	16.7	14.0	16.6	12.6
Japan	2.1	2.3	4.3	8.2	8.0	11.1	9.2	15.6	14.3	16.0	n/m
Asia ex Japan	2.5	1.3	9.1	4.8	9.1	1.6	12.7	14.0	12.4	14.0	13.8
Emerging markets	2.6	2.4	13.1	1.0	10.6	7.6	12.9	13.3	11.8	13.4	12.6

[1] LTM = Last Twelve Months, i.e. trailing. Source: FactSet, Datastream, Barclays

Developed markets – sectors

MSCI indices	Yield	Total Return Performance 1 Week	YTD	5Yr Ann.	Global Market Capitalisation (%)	EPS growth (%) 2016	2017	P/E ratio (x) 2016	2017	LTM[1]	10 Year Ave. LTM[1]
Developed markets	2.5	2.6	7.5	10.6	89.4	0.7	12.5	17.9	15.9	17.9	15.1
Energy	3.5	1.6	25.4	0.9	6.4	-53.8	159.0	61.7	23.8	62.5	49.6
Materials	2.1	3.8	25.8	2.6	4.6	-5.3	24.4	20.5	16.5	20.2	17.9
Industrials	2.3	1.5	14.2	11.8	10.1	9.1	8.4	18.4	16.9	18.9	17.1
Cons. Discretionary	2.0	2.9	4.7	14.8	11.2	8.8	11.3	17.8	16.0	18.0	20.7
Consumer Staples	2.8	1.7	-0.6	9.8	8.5	4.2	9.5	20.5	18.7	20.4	18.4
Health Care	2.1	-0.3	-9.3	13.7	10.5	6.8	7.8	16.0	14.8	15.7	19.0
Financials	3.0	4.6	14.6	13.4	16.4	-3.7	9.3	13.6	12.4	13.8	n/m
IT	1.6	3.6	11.5	14.3	13.1	3.4	12.1	18.9	16.8	18.6	20.2
Telecom. Services	4.4	3.4	2.9	8.0	2.9	11.1	3.0	14.2	13.8	14.8	15.6
Utilities	4.0	2.6	3.2	5.4	2.8	-1.5	1.5	15.6	15.3	15.7	16.8

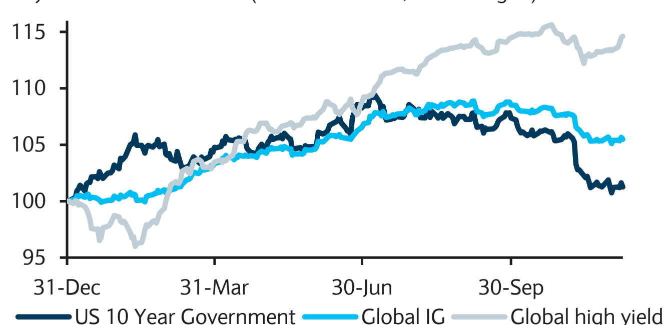
[1] LTM = Last Twelve Months, i.e. trailing. Source: FactSet, Datastream, Barclays

Fixed income

Index	Yield	Total Return Performance 1 Week	YTD	5Yr Ann.
Global inv. Grade	2.7	0.4	5.5	4.8
Financials	2.5	0.3	3.9	5.6
Industrials	2.9	0.4	6.5	4.0
Utilities	2.8	0.5	6.3	5.1
High yield global	6.0	1.1	14.6	8.4
US	6.2	1.1	16.3	7.4
Europe	4.4	0.8	9.2	11.0
US 10Y	2.4	0.5	1.3	2.0
Euro 10Y	0.3	-0.1	4.2	5.5
UK 10Y	1.4	1.0	7.9	4.4

Performance represents local currency/USD hedged returns.

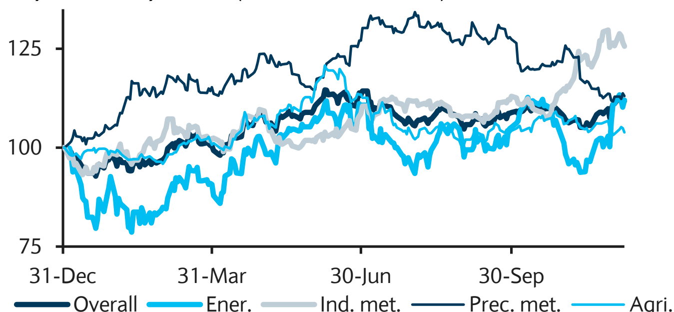
Key Fixed Income Indices (31-Dec-15=100, USD Hedged)



Commodities

DJ-UBS	Price Level	Total Return Performance 1 Week	YTD	5Yr Ann.
Energy		0.9	12.0	-17.5
Brent crude	51.84 $/bbl	0.0	20.4	-17.0
Industrial metals		-0.7	25.6	-6.2
Copper	5,781 $/tonne	-0.6	21.3	-6.6
Precious metals		1.2	13.0	-9.0
Gold	1170.5 $/oz	0.3	9.6	-7.8
Agriculture		0.7	3.9	-5.8
Corn	3.34 $/bushel	3.2	-9.4	-10.7
Commodities		0.8	11.8	-9.3

Key Commodity Indices (31-Dec-15=100, USD)



Source for all figures on this page: FactSet, Datastream, Barclays.
All data as of close of business (COB) 8th December and in USD unless stated otherwise – see following page for more performance figures.

Performance

Equities

	Total Return Performance														
	QTD	YTD	1 Year	2 Yr Ann.	3 Yr Ann.	5 Yr Ann.	12m to 08.12.15	12m to 08.12.14	12m to 08.12.13	12m to 08.12.12	2015	2014	2013	2012	2011
Developed markets	1.9	7.5	7.1	2.8	4.9	10.6	-1.4	9.2	24.7	15.1	-0.9	4.9	26.7	15.8	-5.5
US	3.7	11.2	10.3	5.9	9.0	14.4	1.6	15.6	29.3	16.8	0.7	12.7	31.8	15.3	1.4
Europe ex UK	-2.5	-2.9	-3.0	-3.7	-2.0	6.9	-4.4	1.7	25.4	18.2	-0.6	-6.5	27.6	21.3	-15.3
UK	-2.3	-1.5	-1.4	-5.4	-3.5	3.9	-9.2	0.5	17.0	15.1	-7.6	-5.4	20.7	15.3	-2.6
Japan	1.7	4.3	5.2	5.7	4.2	8.2	6.2	1.2	28.5	2.2	9.6	-4.0	27.2	8.2	-14.3
Asia ex Japan	-3.1	9.1	9.8	-0.9	1.3	4.8	-10.6	5.8	5.2	16.0	-9.2	4.8	3.1	22.4	-17.3
Emerging markets	-2.5	13.1	13.2	-2.9	-2.0	1.0	-16.6	-0.2	0.3	10.9	-14.9	-2.2	-2.6	18.2	-18.4

Developed markets – sectors

	Total Return Performance														
	QTD	YTD	1 Year	2 Yr Ann.	3 Yr Ann.	5 Yr Ann.	12m to 08.12.15	12m to 08.12.14	12m to 08.12.13	12m to 08.12.12	2015	2014	2013	2012	2011
Developed markets	1.9	7.5	7.1	2.8	4.9	10.6	-1.4	9.2	24.7	15.1	-0.9	4.9	26.7	15.8	-5.5
Energy	6.4	25.4	25.0	-0.4	-4.0	0.9	-20.6	-10.9	15.0	2.9	-22.8	-11.6	18.1	1.9	0.2
Materials	5.7	25.8	26.3	2.5	1.7	2.6	-16.9	0.2	3.8	3.9	-15.3	-5.1	3.4	11.3	-19.8
Industrials	3.3	14.2	14.0	5.6	5.5	11.8	-2.3	5.3	29.1	15.3	-2.1	0.4	32.1	16.0	-8.2
Cons. Discretionary	3.5	4.7	3.1	5.3	5.9	14.8	7.5	7.1	38.1	21.4	5.5	3.9	39.2	24.3	-4.7
Consumer Staples	-7.7	-0.6	-0.3	2.4	4.7	9.8	5.2	9.5	17.7	17.9	6.4	7.3	21.3	13.4	8.6
Health Care	-7.9	-9.3	-8.0	-3.4	5.0	13.7	1.4	24.3	33.4	23.0	6.6	18.1	36.3	17.5	9.5
Financials	16.7	14.6	14.1	4.4	5.7	13.4	-4.5	8.3	27.0	25.2	-3.4	3.2	27.3	29.4	-18.5
IT	0.2	11.5	8.4	8.0	12.1	14.3	7.6	20.8	25.8	10.0	4.8	16.1	28.7	13.3	-2.5
Telecom. Services	-4.1	2.9	3.9	1.0	2.3	8.0	-1.8	5.0	26.7	8.5	2.5	-1.9	31.2	6.4	0.8
Utilities	-5.7	3.2	5.8	-1.9	4.0	5.4	-8.9	16.7	12.8	2.8	-6.6	15.3	12.6	1.8	-3.3

Fixed income & Cash

	Total Return Performance														
	QTD	YTD	1 Year	2 Yr Ann.	3 Yr Ann.	5 Yr Ann.	12m to 08.12.15	12m to 08.12.14	12m to 08.12.13	12m to 08.12.12	2015	2014	2013	2012	2011
Cash & short-mat. Bonds	0.0	0.4	0.4	0.2	0.2	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Developed gov. Bonds	-3.0	3.4	3.3	2.9	4.2	3.7	2.4	6.9	0.2	5.6	1.4	8.1	0.1	4.5	5.5
Investment grade	-2.8	5.5	4.9	2.8	4.3	4.8	0.8	7.4	-0.1	11.5	-0.2	7.6	0.1	10.9	4.8
Financials	-1.8	3.9	3.7	2.8	4.0	5.6	2.0	6.5	2.1	14.4	1.4	6.7	2.0	14.4	1.6
Industrials	-3.3	6.5	5.7	2.7	4.3	4.0	-0.2	7.6	-1.7	9.2	-1.4	7.8	-1.4	8.2	8.0
Utilities	-4.0	6.3	5.7	3.4	5.6	5.1	1.1	10.2	-1.1	10.2	-0.6	11.3	-0.8	9.2	6.1
High yield global	0.1	14.6	13.2	6.3	5.5	8.4	-0.1	4.0	6.6	19.2	-0.7	2.6	6.5	19.2	3.6
US	1.0	16.3	14.8	5.3	4.6	7.4	-3.5	3.2	7.6	16.3	-4.5	2.5	7.4	15.8	5.0
Europe	1.1	9.2	7.8	5.4	5.9	11.0	3.0	7.0	11.4	27.5	2.0	5.8	10.5	28.8	-2.5
HY&EM Bonds	-3.0	10.5	9.6	3.1	3.2	5.2	-3.0	3.2	0.7	16.4	-3.1	2.0	0.2	17.6	3.4
US 10Y	-5.7	1.3	1.0	1.6	4.0	2.0	2.3	8.8	-7.7	6.4	1.0	10.9	-7.6	4.3	16.9
Euro 10Y	-4.2	4.2	3.6	3.0	6.5	5.5	2.5	13.9	-1.8	9.9	0.2	16.7	-2.6	7.6	13.9
UK 10Y	-5.2	7.9	6.7	5.3	7.6	4.4	3.9	12.2	-5.7	5.9	0.8	15.6	-6.1	3.8	18.4

Performance represents local currency/USD hedged returns.

Commodities & other diversifying asset classes

	Total Return Performance														
	QTD	YTD	1 Year	2 Yr Ann.	3 Yr Ann.	5 Yr Ann.	12m to 08.12.15	12m to 08.12.14	12m to 08.12.13	12m to 08.12.12	2015	2014	2013	2012	2011
Energy	6.5	12.0	9.8	-24.0	-25.1	-17.5	-47.3	-27.3	4.6	-13.1	-38.9	-39.3	5.2	-9.4	-16.0
Brent crude	3.3	20.4	10.1	-24.7	-30.1	-17.0	-48.5	-39.6	12.2	2.5	-45.6	-47.6	7.2	7.6	16.8
Industrial metals	11.2	25.6	29.8	-6.3	-4.0	-6.2	-32.3	0.9	-16.8	-1.5	-26.9	-6.9	-13.6	0.7	-24.2
Copper	18.4	21.3	26.1	-5.7	-7.5	-6.6	-29.5	-10.9	-13.0	3.4	-25.1	-16.6	-8.8	5.0	-24.4
Precious metals	-11.3	13.0	11.2	-0.8	-2.9	-9.0	-11.5	-6.9	-31.9	-0.1	-11.5	-6.7	-30.8	6.3	4.6
Gold	-11.2	9.6	8.1	-1.6	-2.1	-7.8	-10.4	-3.0	-28.3	-1.3	-10.9	-1.7	-28.7	6.1	9.6
Agriculture	-0.4	3.9	1.8	-7.2	-7.9	-5.8	-15.5	-9.2	-16.9	14.3	-15.6	-9.2	-14.3	4.0	-14.4
Corn	2.5	-9.4	-13.0	-13.7	-14.9	-10.7	-14.5	-17.2	-32.1	35.3	-19.2	-13.3	-30.3	19.0	1.1
Commodities	2.7	11.8	11.0	-10.9	-11.2	-9.3	-28.4	-11.7	-11.3	-1.3	-24.7	-17.0	-9.5	-1.1	-13.3
Real Estate	-6.1	3.5	4.8	1.7	6.0	9.7	-1.3	15.3	5.2	26.3	-0.8	15.0	3.7	27.7	-6.5
ATS	0.8	2.1	1.6	-0.7	-0.4	1.5	-3.0	0.2	6.4	2.8	-3.6	-0.6	6.7	3.5	-8.9

Source for all figures on this page: FactSet, Datastream, Barclays.

All data as of close of business (COB) 8th December and in USD unless stated otherwise.

Barclays key macroeconomic projections

Figure 1: Real GDP and consumer prices (% y-o-y)

	Real GDP			Consumer prices		
	2016F	2017F	2018F	2016F	2017F	2018F
Global	3.1	3.5	3.8	1.7	2.3	2.5
Advanced	1.6	1.7	2.0	0.7	1.8	2.1
Emerging	4.3	4.9	5.1	3.2	3.0	3.1
United States	1.6	2.2	2.5	1.2	2.4	2.8
Euro area	1.6	1.2	1.6	0.2	1.2	1.4
Japan	0.8	1.3	0.7	-0.3	0.6	1.1
United Kingdom	2.0	0.5	1.5	0.6	2.4	2.1
China	6.7	6.3	6.1	2.0	2.2	2.3
Brazil	-3.5	0.5	1.8	8.8	5.5	5.3
India	7.6	7.9	8.0	5.1	4.8	5.3
Russia	-0.5	1.1	1.9	7.1	4.7	4.1

Source: Barclays Research, *Global Economics Weekly, 2 December 2016*

Note: Arrows appear next to numbers if current forecasts differ from previous week by 0.2pp or more. Weights used for real GDP are based on IMF PPP-based GDP (5yr centred moving averages). Weights used for consumer prices are based on IMF nominal GDP (5yr centred moving averages). Aggregates for CPI exclude Argentina and Venezuela. There can be no guarantees that these projections will be achieved.

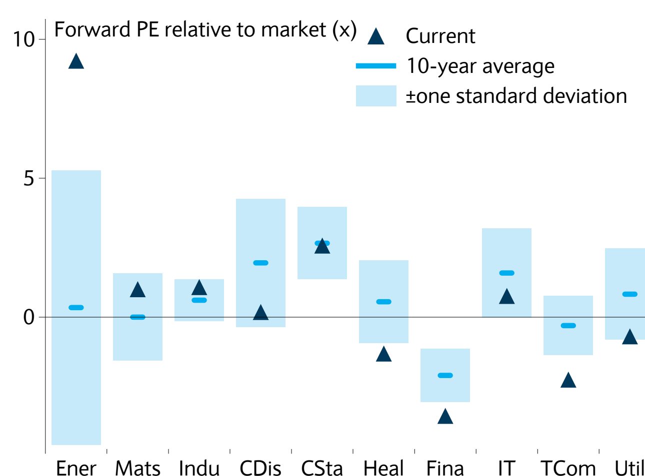
Wealth and Investment Management equity sector recommendations

Figure 1: Global sector strategy (% relative to GICS) – a zero indicates a neutral or GICS benchmark position

	US	Eu x UK	UK
Energy	1.5	1.5	1.5
Materials	0	0	0
Industrials	1.5	1.5	1.5
Consumer Discretionary	0	0	0
Consumer Staples	-3.0	-3.0	-3.0
Health Care	-1.5	1.5	1.5
Financials	1.5	1.5	1.5
Information Technology	1.5	0	0
Real Estate	0	0	0
Telecommunication Services	0	-1.5	-1.5
Utilities	-1.5	-1.5	-1.5

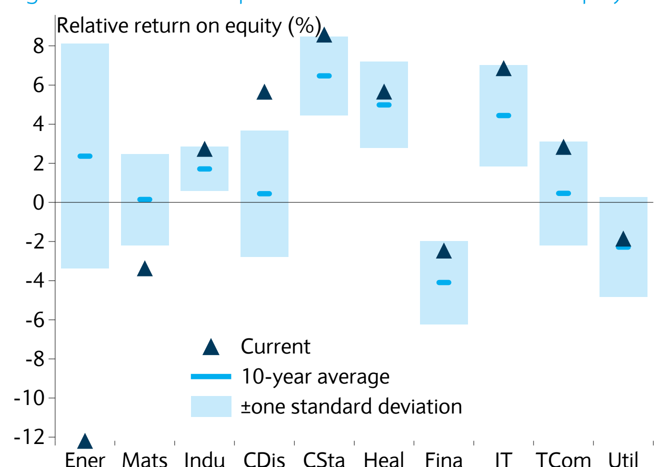
Source: Barclays

Figure 2: MSCI developed markets – sector forward PE ratios



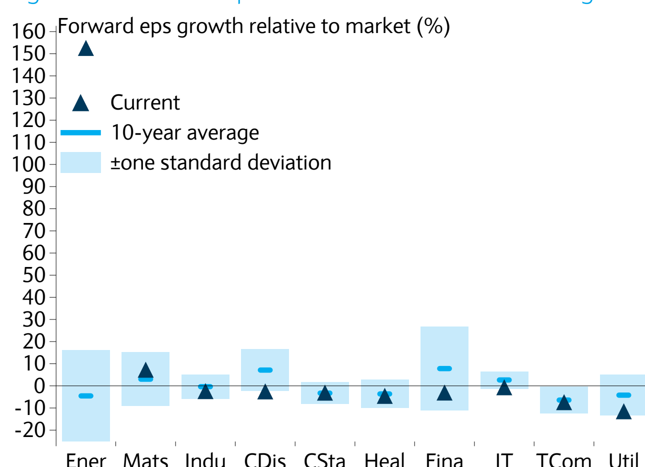
Source: MSCI, FactSet, Barclays

Figure 3: MSCI developed markets - sector return on equity



Source: MSCI, FactSet, Barclays

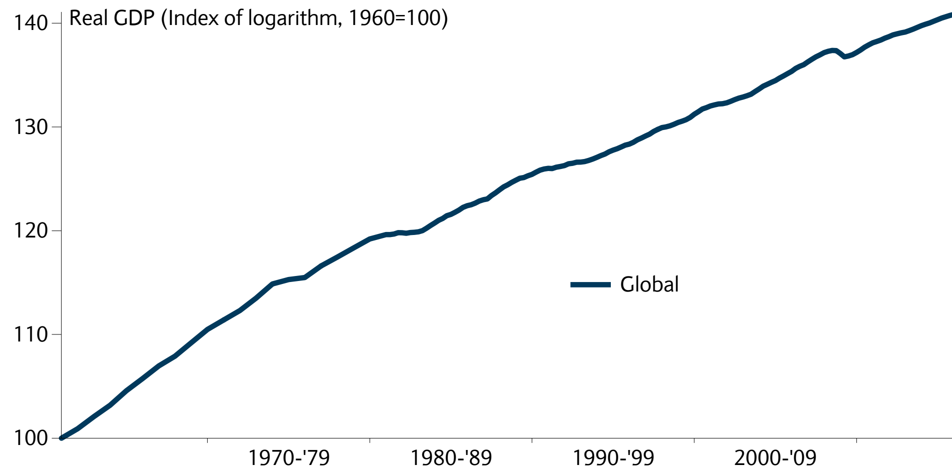
Figure 4: MSCI developed markets - sector forward EPS growth



Source: IBES, Datastream, Barclays

The case for investing

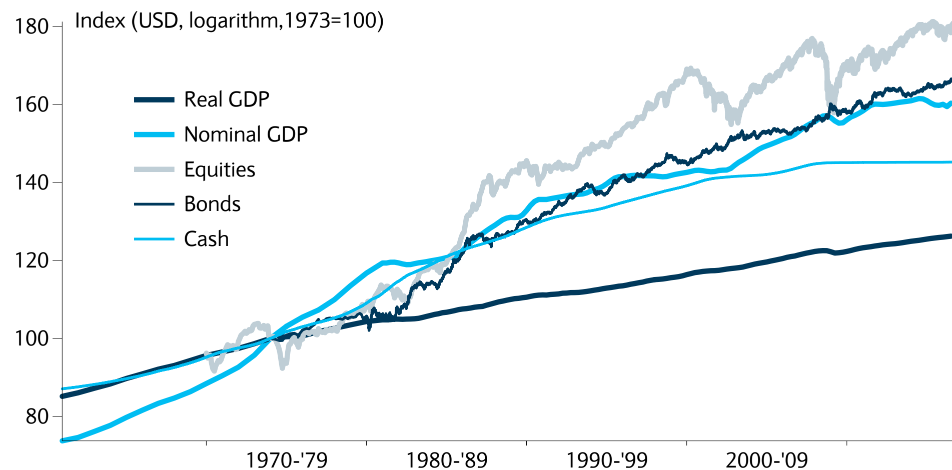
Global real GDP



Source: Datastream, Barclays

- Growth is the norm, not the exception.
- Most years, world output grows because of the simple interaction of new technology and the learning curve.
- The inference is that you have to find good reasons for betting against that trend and not with it, as has been the prevailing wisdom in the aftermath of the great financial crisis.

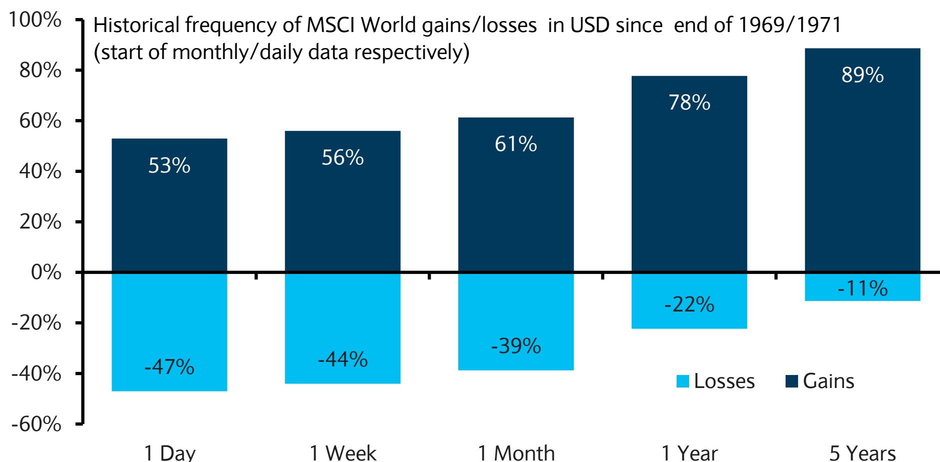
Growth of global GDP and asset classes



Source: Datastream, Barclays

- The future is of course unknowable. However, in addition to being able to suggest that it is more likely that the world will grow than not, we can also point to historic performance of the major asset classes relative to cash and both nominal and real GDP as an argument for both diversification and being invested in the first place.
- As our colleagues in Behavioural Finance are regularly at pains to point out, it is not so much about timing the market but time in the market.

Historical frequency of equity market gains/losses

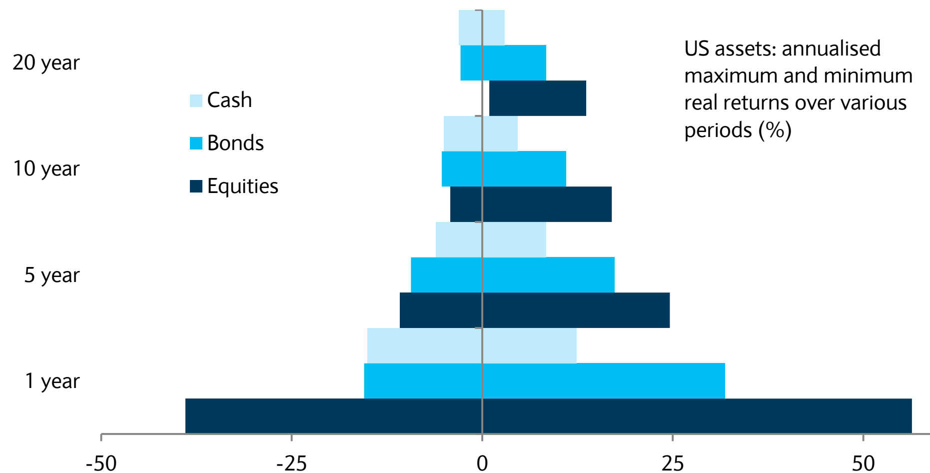


Source: Datastream, Barclays

- Historically, equity market returns have been positive a lot more than 50% of the time over the long term.
- Although equity markets are not the only source of investor returns, it is stocks that are going to provide the bulk of the long-term returns to investment portfolios.
- This ultimately means that an investor looking to grow assets above inflation will likely have to accept an investment portfolio that will be reasonably correlated to equity markets over time.

The case for investing

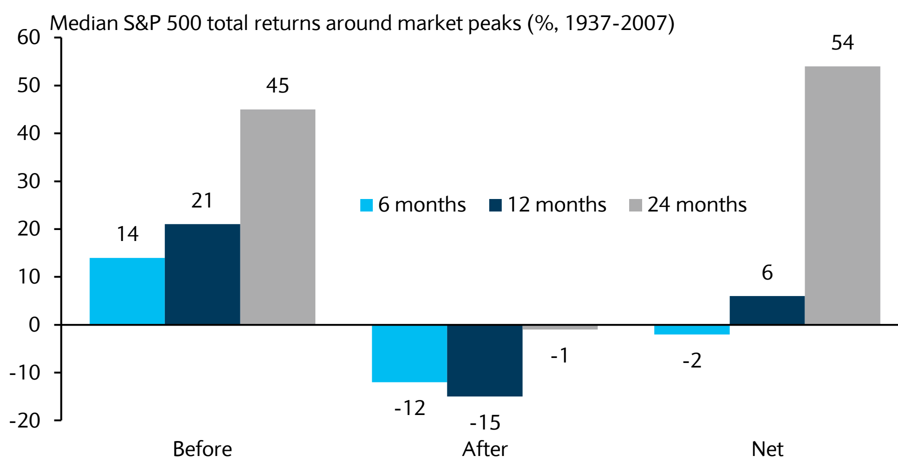
Minimum/maximum real return of US assets



Source: Datastream, Barclays

- Those able to buy and hold for longer periods may have a different perspective on the risks inherent in the major asset classes anyway.
- Deeper real annualised losses have come from bonds and cash when the holding period is extended to 10 years or more.
- The profile of real returns and losses is significantly more attractive for stocks over 10 and 20 year holding periods.

Median equity returns around market peaks



Source: BAML, Barclays

- Avoiding bear markets is an industry obsession. Understandably so – the work of Nobel laureate Daniel Kahneman and his colleague Amos Tversky tells us that 'losses loom larger than gains' for the average investor.
- However, the fact that most bear markets are preceded by a rush of blood that tends to outweigh the bloodletting that inevitably follows should temper how carefully we listen to the more persistent doomsayers.
- Being too early to call the end of the cycle tends to be more costly than missing the bear market altogether.

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