In Focus: Markets as we see them

Bond massacre?

06 January 2017

For EMEA and Asia distribution only

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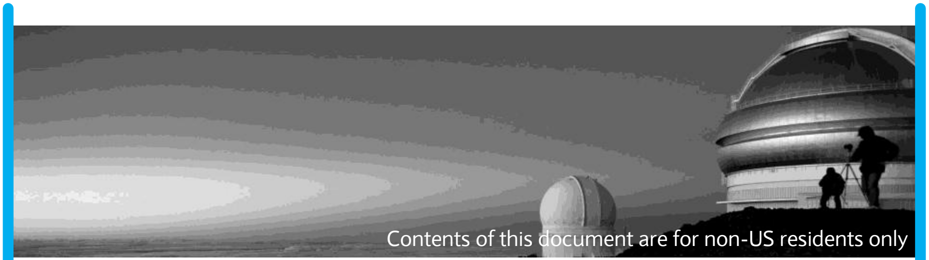


"If it bleeds, we can kill it" (Dutch, Predator)

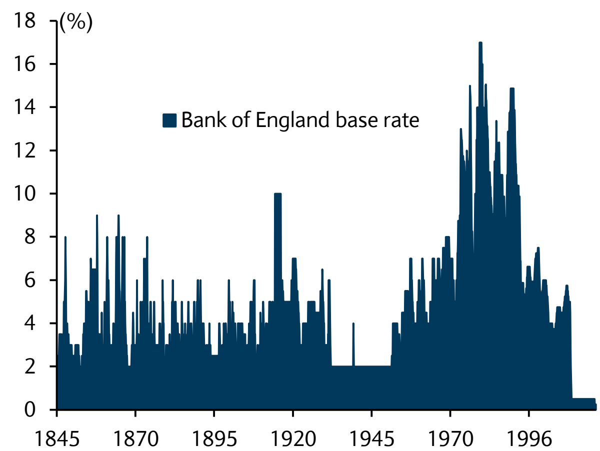
Limping bull

The dramatic rise in bond yields in the second half of 2016 has once again roused those wondering whether the end of one of the longest and strongest bond 'bull markets' seen since the late 13th century is upon us. In over 8 centuries of history, only two previous episodes – the rally at the height of Venetian commercial dominance in the 15th century, and the century following the Peace of Cateau-Cambrésis in 1559 – recorded longer continued risk free rate compressions. Meanwhile, in terms of scale, only the rallies following the War of the Spanish Succession, and the election of Charles V as Holy Roman Emperor can trump the bond run spurred by Paul Volcker's 'war on inflation' (Figure 1)[1]. This week we examine some of the factors influencing the bond market at the beginning of the New Year.

Inappropriate bond yields

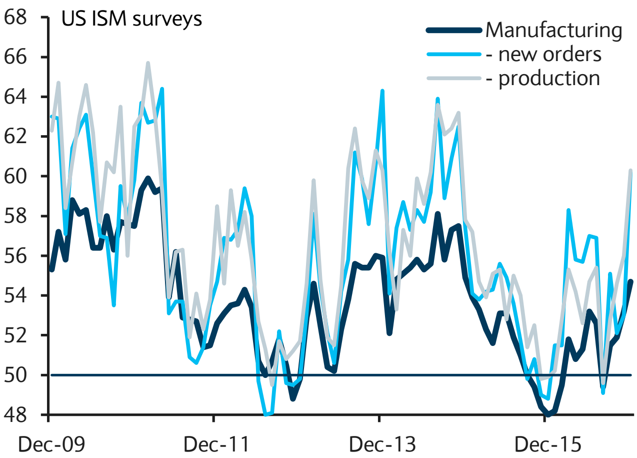
The level of developed world bond yields certainly remains inappropriate, increasingly so, in the context of a world economy where the prospects for growth and inflation continue to firm. Surging business and consumer confidence in the US (Figures 2 to 4) is coinciding with a brightening economic picture almost everywhere else in the world (Figures 5 to 7). Headline inflation even seems to be rebounding from its oil price crush in Europe (Figure 8), while US wages are now on a less questionable

Figure 1: Long-term BoE base rate



Source: Bank of England, Barclays

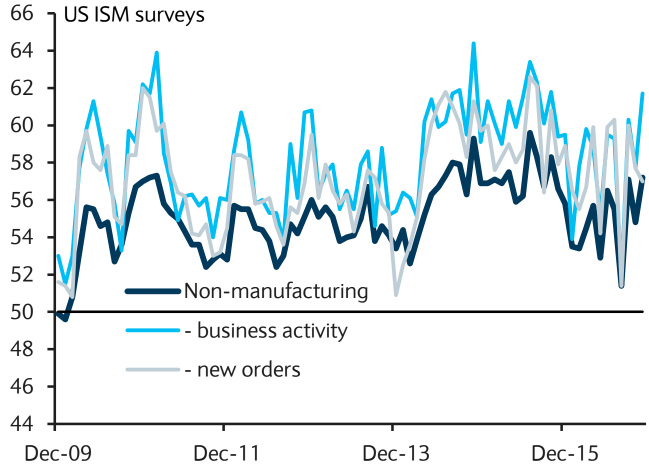
Figure 2: US ISM Manufacturing Index



Source: Datastream, Barclays

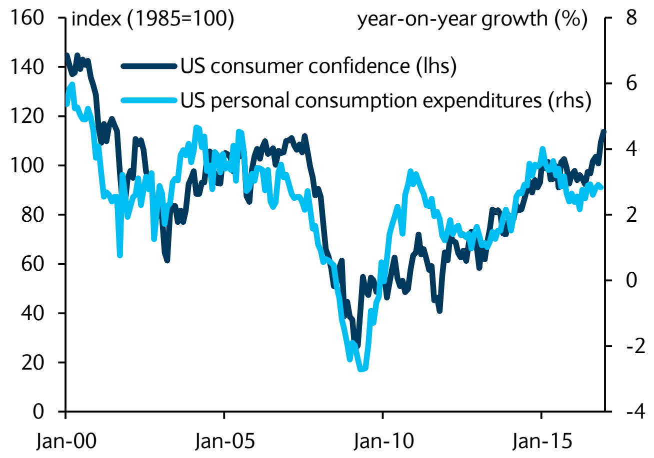
[1] *Venetians, Volcker and Value-at-Risk: 8 centuries of bond market reversals – Bank Underground, 4th Jan 2017*

Figure 3: US ISM Non-manufacturing Index



Source: Datastream, Barclays

Figure 4: US consumer confidence and consumption



Source: Datastream, Barclays

Global trade is unquestionably suffering from an image problem at the moment

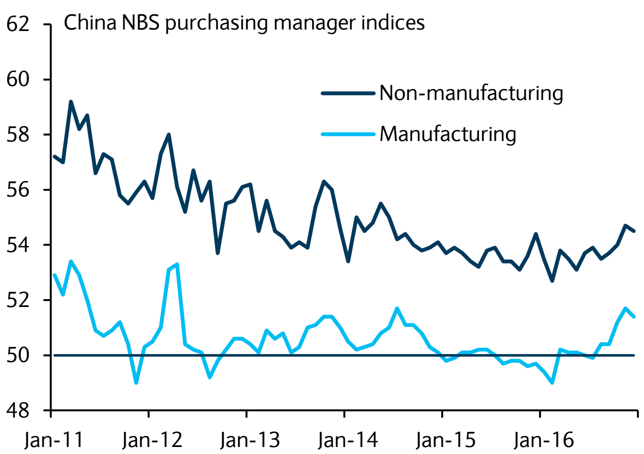
upward trajectory (Figure 9). All this points to a world with good and improving growth prospects, something that analysts are already factoring into their earnings expectations (Figure 10).

Of course, safe haven enthusiasts will note the herd of political elephants about to stampede into the room, from President-elect Trump's impending inauguration to the various electoral minefields in Europe's path this year. For the moment, we prefer to focus on that improving economic backdrop as the primary driver of investments. As we noted in *Compass Q1 2017*, we expect the political backdrop to remain noisy, but not the dominant factor in our investment thinking for the most part.

Trade war...

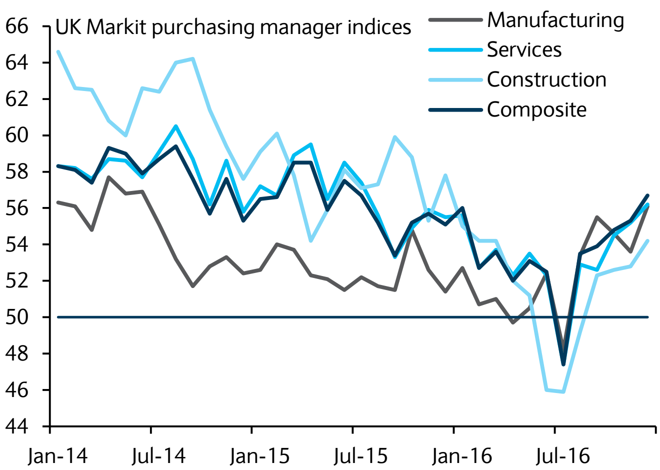
As we've noted before, a potential exception here concerns the President's ability, and apparent inclination, to act unilaterally on trade. Global trade is unquestionably suffering from an image problem at the moment. The significant but indirect benefits can be hard to perceive directly – consumers may simply not realise the extent to which they sell to and buy from overseas. On the flip side, its costs are concentrated and arguably far more observable – cheap imports have hit American manufacturers, particularly in the Midwestern rustbelt and the South. This, alongside the inexorable march of technology, has decimated American (and other developed world) manufacturing jobs in the last decade in particular[2]. The prescription from the President-elect's trade team, as described in an alarmingly economically illiterate

Figure 5: China PMIs



Source: Datastream, Barclays

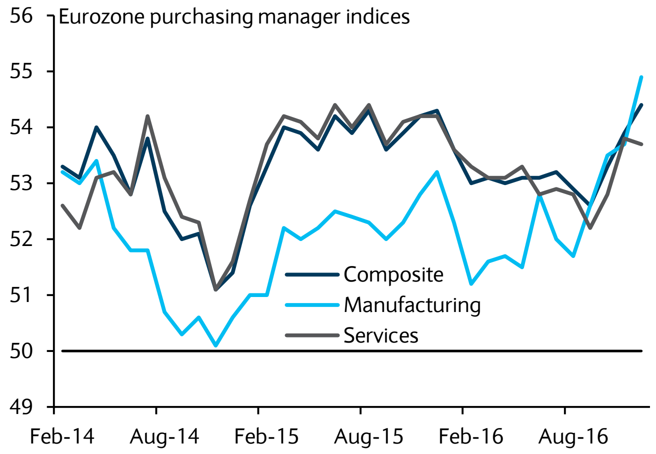
Figure 6: UK PMIs



Source: Datastream, Barclays

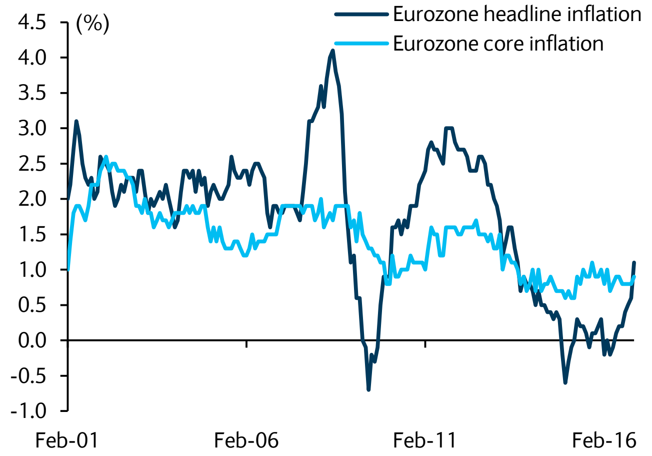
[2] *Trade, at what price? – The Economist, 2nd Apr 2016*

Figure 7: Eurozone PMIs



Source: Datastream, Barclays

Figure 8: Eurozone inflation



Source: Datastream, Barclays

policy proposal[3], is to refocus on the trade deficit – the perceived source of many of the economy's ills. "When net exports are negative," Ross and Navarro write, "that is, when a country runs a trade deficit by importing more than it exports, this subtracts from growth."

Simply reducing imports does not automatically boost the economy

In its simplest form, a country's GDP is the sum of four parts:

GDP = C + I + G + NX, where

C: Consumption

I: Investment

G: Government spending

NX: Net exports

It follows then that by reducing imports, net exports will rise, thus leading to a corresponding rise in GDP based on the accounting equation above. This will in turn boost tax revenues and fund domestic spending programmes – why didn't anyone think of this before?

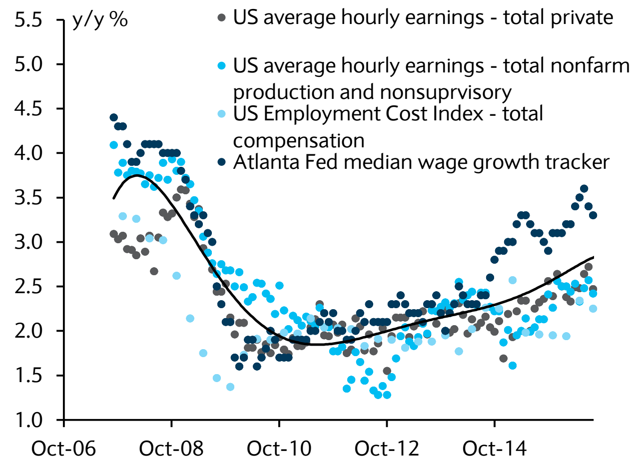
Unfortunately, Ross and Navarro's analysis is founded on a surprisingly elementary misunderstanding of GDP accounting – the equation above is merely an accounting identity, not a causal theory of how an economy operates.

To further explain, simply reducing imports does not automatically boost the economy. This is because much depends on what those imports are and how much it would cost the domestic consumers to replace them with domestically produced goods. For example, if the new US administration made it illegal to import oil, that would instantaneously wipe $180bn off the trade deficit and theoretically boost GDP by a similar amount[4]. However, American businesses and consumers would suffer from having to consume significantly more expensive oil related products, leading to lower real incomes and a fall in consumption (C).

Until we know the relative sizes of these counteracting effects, it's hard to believe that curtailing imports would actually lead to higher incomes as suggested in the proposal. To fully understand the impact of trade changes on the economy, we need to know how trade

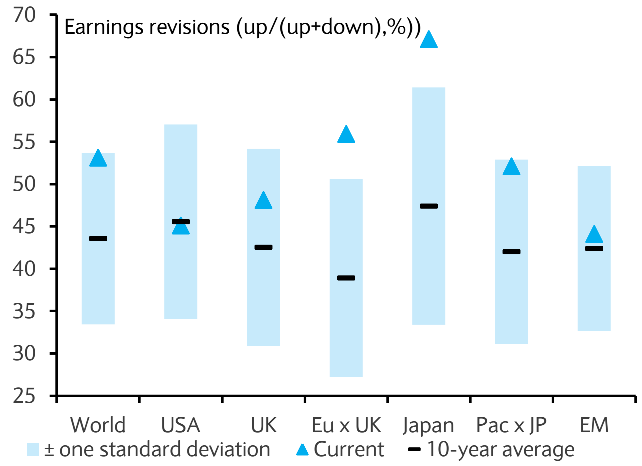
[3] *Scoring the Trump Economic Plan: Trade, Regulatory, & Energy Policy Impacts – Navarro, Ross, 29th Sept 2016*
[4] *Donald Trump's trade team has based their analysis on a remarkably silly mistake – Vox, 21st Dec 2016*

Figure 9: US wage growth



Source: Datastream, Barclays

Figure 10: Earnings revision ratios



Source: Factset, Barclays

interacts with domestic production – the other three components – rather than just relying on simple accounting relationships.

Investment conclusion

Keep an open mind and focus on the fundamentals remains our best advice. The New Year is always cluttered with strident predictions from an array of talking heads and subject matter experts. Much of this is simply part of the perpetual battle for precious marketing air, given added impetus by our desire to hear fresh views and themes to complement our temporary new diet or smoking/gym regime.

Keep an open mind and focus on the fundamentals

For our part, we do not currently envisage developed world inflation running out of control, but can certainly imagine above target inflation in the US and UK in coming quarters. US fiscal plans are certainly going to be important to watch carefully, as is the progression of US wages. However, arguments based on a reversal of globalisation and the resulting effects on interest rates likely fall too far into the speculative category to be of much practical investment use.

Investors will need to continue to tread carefully and lightly in the higher quality areas of the bond market, being sure to keep duration low. For our part, we remain tactically underweight high quality government and corporate debt and our recommended medium risk portfolio holds a very low strategic weight to the former in any case. With the cycle having further to run and default rates likely remaining low, we still see merit in investors taking selected credit risk, a likely necessity for those looking for acceptable real returns from the fixed income complex in coming quarters.

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Market calls – summary

Macro economy summary

- Prospects for the world economy seem a bit brighter compared to last year, as evidenced by the pickup in business confidence surveys across the major economies. 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.

- Upcoming elections in core Eurozone countries remain high on the list of worries for investors as we move into 2017. However, investors would do well to remember the link between corporate profits and political risk is tenuous, and the presence of significant political barriers against further referenda in the core European countries should provide some comfort.

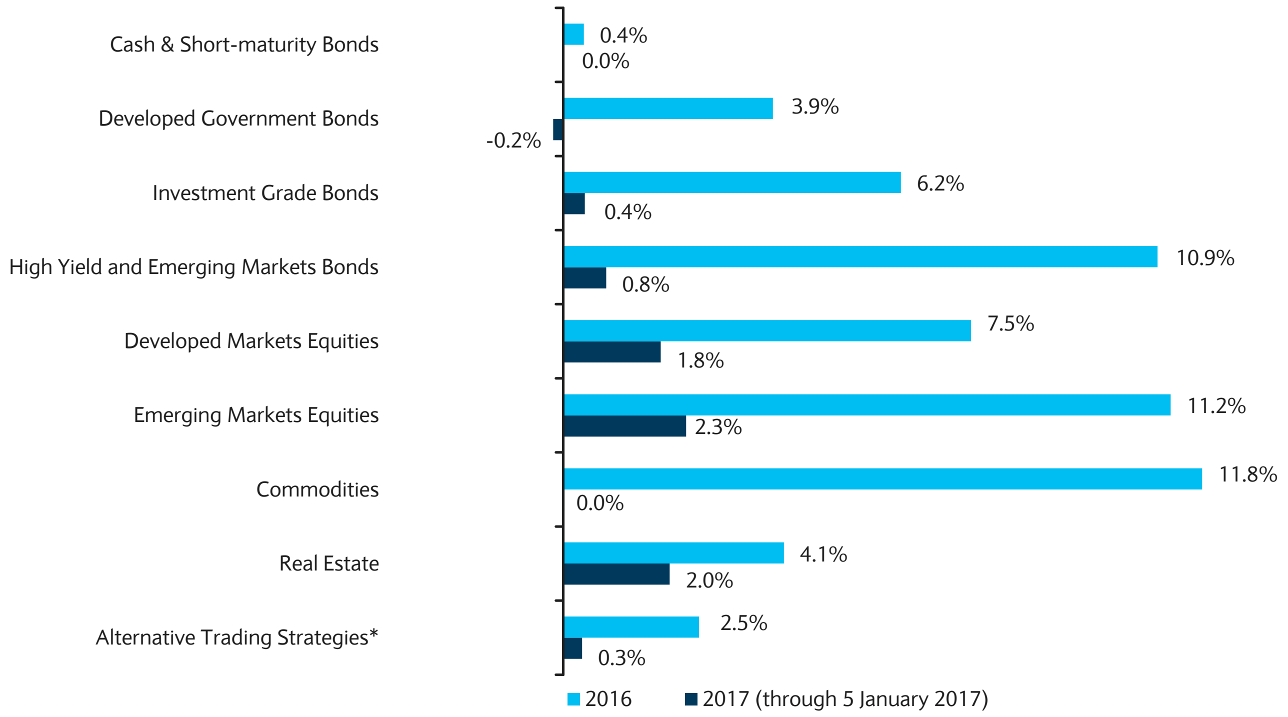
Investment conclusions

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 equities
   - Continuing economic growth and unremarkable valuations should continue to combine to generate attractive returns for equity investors.

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

- More broadly, we believe the world economy will continue to grow 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.

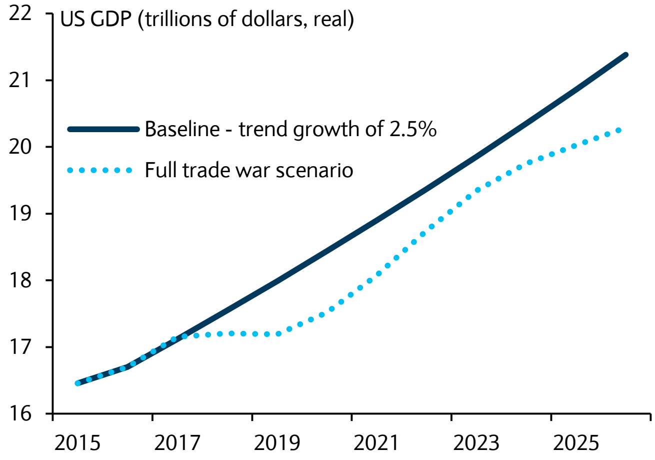
Total returns across key asset classes



*As of 4th January; 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

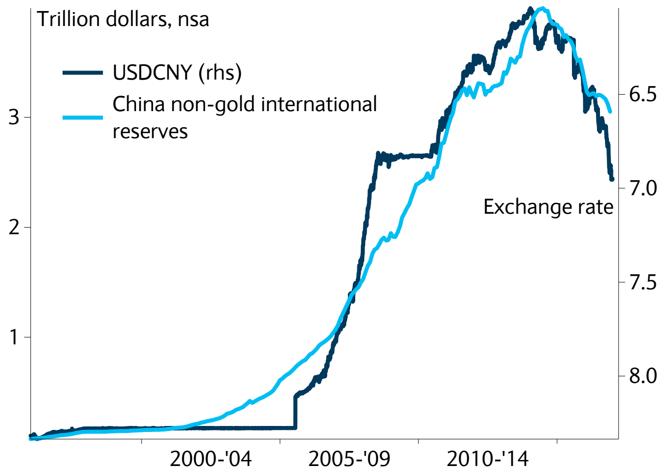
US trade war?



Source: Peterson Institute of International Economics, Barclays

- The election of Donald Trump to the presidency has sparked worries about a potential trade war between the US and it's major trading partners, given the new administration's protectionist posturing.
- If President Trump were to unilaterally enact tariffs on major trade partners, this would surely be followed by retaliatory measures, risking a full blown trade war. Based on the Peterson Institute of International Economics' (PIIE) analysis, such a scenario would send the US economy into recession and cost millions of Americans their jobs.
- With less in the way of congressional impediments here, to a certain extent, we are left relying on economic self interest to drive a wedge between soap box tirades and implementable policy.

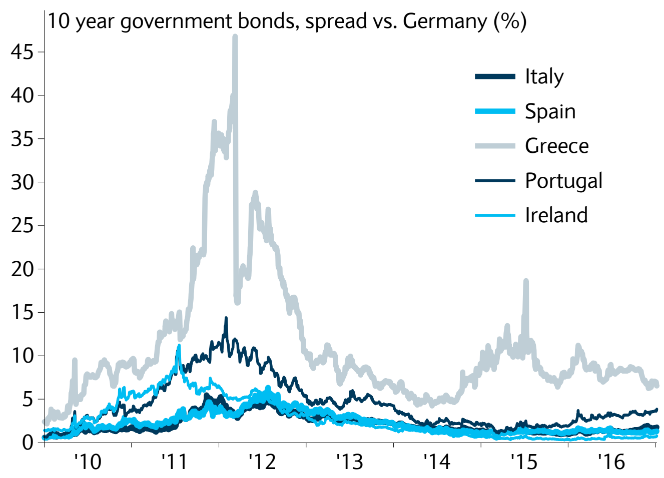
China currency crisis?



Source: Datastream, Barclays

- Chinese capital outflows have begun to reaccelerate, with outflows reaching a near-record $200 billion in Q3 2016. 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.

Euro Crisis 2.0?



Source: Datastream, Barclays

- With lacklustre profit margins, anaemic core inflation and a fragile banking system, European markets are vulnerable to a range of political risks in the coming months that could derail investor sentiment.
- Dutch elections in March, French elections in May and German elections around August – October may introduce greater political uncertainty to a region still recovering from the Euro Crisis.
- That being said, even if the National Front were to win in France, a potential referendum on EU membership would require a Parliamentary vote, which will remain a significant hurdle. In the Netherlands, an EU referendum would need a change in the constitution, which requires a two-thirds majority in parliament. In Germany, polls still highlight that it is very unlikely that anti-EU forces will wield much direct political influence. Given these political buffers, we think that European assets remain attractive to us on a risk-reward basis.

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 last 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, earnings, not elections, should be the key driver of equities in 2017. The ongoing pick up in global inflation should lead to better pricing power and higher profit margins for European corporates. 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 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 last 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 2016)

Last 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 last 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	Total Return Performance YTD	Total Return Performance 5Yr Ann.	Global Market Capitalisation (%)	EPS growth (%) 2017	EPS growth (%) 2018	P/E ratio (x) 2017	P/E ratio (x) 2018	P/E ratio (x) LTM[1]	P/E ratio (x) 10 Year Ave. LTM[1]
Developed markets	2.5	1.7	1.8	10.5	89.5	12.8	10.9	16.4	14.8	18.5	15.1
US	2.1	1.0	1.4	13.7	53.6	12.1	12.0	17.5	15.6	19.5	15.9
Europe ex UK	3.2	2.5	1.8	7.9	14.5	11.2	10.6	15.1	13.6	16.7	13.7
UK	4.0	2.7	1.3	4.1	5.9	21.2	9.6	14.3	13.1	17.2	12.7
Japan	2.0	3.3	3.4	8.7	8.0	10.8	8.9	15.1	13.8	16.7	n/m
Asia ex Japan	2.5	3.3	2.5	5.0	8.9	13.0	10.7	12.1	10.9	13.7	13.8
Emerging markets	2.6	2.7	2.3	1.4	10.5	14.1	11.7	11.6	10.3	13.2	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	Total Return Performance YTD	Total Return Performance 5Yr Ann.	Global Market Capitalisation (%)	EPS growth (%) 2017	EPS growth (%) 2018	P/E ratio (x) 2017	P/E ratio (x) 2018	P/E ratio (x) LTM[1]	P/E ratio (x) 10 Year Ave. LTM[1]
Developed markets	2.5	1.7	1.8	10.5	89.5	12.8	10.9	16.4	14.8	18.5	15.1
Energy	3.3	1.1	1.1	0.7	6.5	159.8	35.5	24.9	18.4	66.2	15.5
Materials	2.0	2.0	2.2	2.4	4.5	28.1	3.9	16.0	15.4	19.8	15.4
Industrials	2.3	1.4	1.5	11.2	10.0	8.4	10.7	17.3	15.6	19.1	15.8
Cons. Discretionary	1.9	1.5	1.9	14.4	11.0	11.5	11.9	16.4	14.7	18.2	18.3
Consumer Staples	2.7	0.8	0.8	10.0	8.6	9.3	8.5	19.4	17.8	21.0	17.7
Health Care	2.1	2.7	2.7	13.9	10.9	7.8	9.9	15.1	13.8	16.3	15.3
Financials	2.9	2.5	2.2	13.2	16.2	9.4	9.2	13.0	11.9	14.2	13.7
IT	1.6	0.8	1.6	14.5	13.1	12.7	11.5	17.2	15.4	19.0	17.3
Telecom. Services	4.1	2.6	2.7	9.0	3.0	3.2	8.8	14.8	13.6	15.5	14.0
Utilities	3.9	0.3	0.4	5.9	2.8	2.3	6.8	15.9	14.9	16.1	15.4

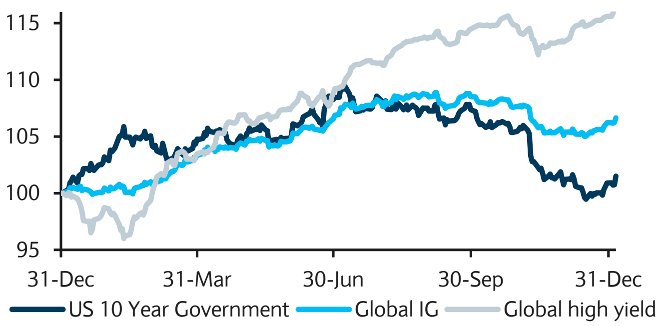
[1] LTM = Last Twelve Months, i.e. trailing. Source: FactSet, Datastream, Barclays

Fixed income

Index	Yield	Total Return Performance 1 Week	Total Return Performance YTD	Total Return Performance 5Yr Ann.
Global inv. Grade	2.7	0.6	0.4	4.9
Financials	2.5	0.4	0.3	5.7
Industrials	2.8	0.7	0.5	4.2
Utilities	2.8	0.6	0.4	5.3
High yield global	5.6	0.9	0.8	8.4
US	5.9	0.9	0.9	7.4
Europe	4.0	0.6	0.5	11.0
US 10Y	2.4	0.9	0.6	2.1
Euro 10Y	0.2	-0.8	-0.5	5.3
UK 10Y	1.3	-0.7	-0.7	4.4

Performance represents local currency/USD hedged returns.

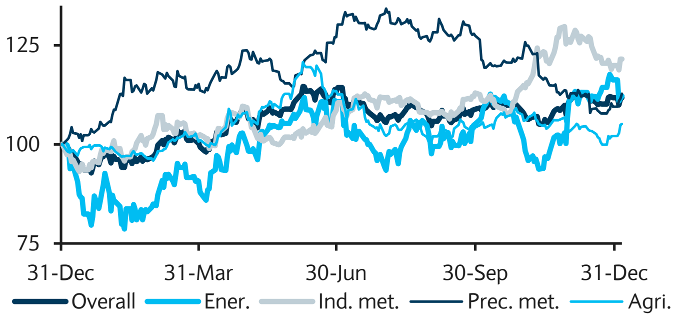
Key Fixed Income Indices (31-Dec-15=100, USD Hedged)



Commodities

DJ-UBS	Price Level	Total Return Performance 1 Week	Total Return Performance YTD	Total Return Performance 5Yr Ann.
Energy		-4.0	-3.5	-17.3
Brent crude	54.89 $/bbl	0.1	0.1	-17.0
Industrial metals		2.1	1.3	-6.4
Copper	5,561 $/tonne	2.0	1.3	-6.8
Precious metals		2.2	3.0	-8.0
Gold	1183.6 $/oz	2.0	2.6	-6.7
Agriculture		3.1	3.0	-6.2
Corn	3.46 $/bushel	3.3	2.6	-11.6
Commodities		-0.1	0.0	-9.2

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) 5th January 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 05.01.16	12m to 05.01.15	12m to 05.01.14	12m to 05.01.13	2016	2015	2014	2013	2012
Developed markets	1.8	1.8	11.6	5.3	4.7	10.5	-0.6	3.5	22.6	17.1	7.5	-0.9	4.9	26.7	15.8
US	1.4	1.4	14.0	7.4	8.8	13.7	1.2	11.7	26.9	16.4	10.9	0.7	12.7	31.8	15.3
Europe ex UK	1.8	1.8	5.0	2.2	-1.5	7.9	-0.6	-8.4	23.3	24.4	-0.6	-0.6	-6.5	27.6	21.3
UK	1.3	1.3	3.6	-1.0	-3.6	4.1	-5.4	-8.7	17.2	16.8	-0.1	-7.6	-5.4	20.7	15.3
Japan	3.4	3.4	7.9	7.9	3.4	8.7	7.8	-4.9	25.9	9.1	2.4	9.6	-4.0	27.2	8.2
Asia ex Japan	2.5	2.5	11.7	-0.7	1.8	5.0	-11.7	6.9	-1.5	22.9	5.4	-9.2	4.8	3.1	22.4
Emerging markets	2.3	2.3	17.5	-0.8	-1.1	1.4	-16.3	-1.5	-6.9	18.7	11.2	-14.9	-2.2	-2.6	18.2

Developed markets – sectors

	Total Return Performance														
	QTD	YTD	1 Year	2 Yr Ann.	3 Yr Ann.	5 Yr Ann.	12m to 05.01.16	12m to 05.01.15	12m to 05.01.14	12m to 05.01.13	2016	2015	2014	2013	2012
Developed markets	1.8	1.8	11.6	5.3	4.7	10.5	-0.6	3.5	22.6	17.1	7.5	-0.9	4.9	26.7	15.8
Energy	1.1	1.1	28.6	1.7	-3.9	0.7	-19.5	-14.3	13.1	3.0	26.6	-22.8	-11.6	18.1	1.9
Materials	2.2	2.2	28.4	4.5	0.5	2.4	-15.0	-7.1	0.8	10.0	22.5	-15.3	-5.1	3.4	11.3
Industrials	1.5	1.5	16.8	7.2	4.4	11.2	-1.6	-1.1	27.7	17.0	12.9	-2.1	0.4	32.1	16.0
Cons. Discretionary	1.9	1.9	8.0	6.7	5.1	14.4	5.5	1.8	34.9	25.1	3.1	5.5	3.9	39.2	24.3
Consumer Staples	0.8	0.8	4.1	5.5	5.8	10.0	7.0	6.3	17.7	15.8	1.6	6.4	7.3	21.3	13.4
Health Care	2.7	2.7	-2.7	1.3	6.6	13.9	5.5	18.0	32.9	19.1	-6.8	6.6	18.1	36.3	17.5
Financials	2.2	2.2	17.7	6.6	4.8	13.2	-3.5	1.4	23.0	31.4	12.5	-3.4	3.2	27.3	29.4
IT	1.6	1.6	15.6	9.9	11.7	14.5	4.5	15.5	24.6	13.0	11.5	4.8	16.1	28.7	13.3
Telecom. Services	2.7	2.7	9.8	6.6	3.4	9.0	3.6	-2.9	27.0	9.9	5.7	2.5	-1.9	31.2	6.4
Utilities	0.4	0.4	7.1	0.7	5.2	5.9	-5.4	14.7	8.8	5.3	6.0	-6.6	15.3	12.6	1.8

Fixed income & Cash

	Total Return Performance														
	QTD	YTD	1 Year	2 Yr Ann.	3 Yr Ann.	5 Yr Ann.	12m to 05.01.16	12m to 05.01.15	12m to 05.01.14	12m to 05.01.13	2016	2015	2014	2013	2012
Cash & short-mat. Bonds	0.0	0.0	0.4	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.4	0.1	0.1	0.1	0.1
Developed gov. Bonds	-0.2	-0.2	3.4	2.3	4.3	3.6	1.3	8.4	0.8	4.3	3.9	1.4	8.1	0.1	4.5
Investment grade	0.4	0.4	6.5	2.9	4.6	4.9	-0.6	8.0	0.7	10.5	6.2	-0.2	7.6	0.1	10.9
Financials	0.3	0.3	4.6	2.9	4.2	5.7	1.1	7.0	2.3	14.1	4.5	1.4	6.7	2.0	14.4
Industrials	0.5	0.5	7.7	2.8	4.6	4.2	-1.8	8.2	-0.6	7.8	7.3	-1.4	7.8	-1.4	8.2
Utilities	0.4	0.4	7.4	3.0	5.9	5.3	-1.2	11.9	0.2	8.7	7.3	-0.6	11.3	-0.8	9.2
High yield global	0.8	0.8	16.5	7.7	5.8	8.4	-0.4	2.1	5.7	19.5	15.6	-0.7	2.6	6.5	19.2
US	0.9	0.9	18.1	6.4	4.9	7.4	-4.2	2.0	6.9	15.8	17.1	-4.5	2.5	7.4	15.8
Europe	0.5	0.5	11.2	6.5	6.2	11.0	1.9	5.7	9.7	28.5	10.6	2.0	5.8	10.5	28.8
HY&EM Bonds	0.8	0.8	12.0	4.4	3.4	5.4	-2.8	1.6	-0.4	17.8	10.9	-3.1	2.0	0.2	17.6
US 10Y	0.6	0.6	1.2	0.6	4.3	2.1	0.1	12.1	-6.1	3.8	0.9	1.0	10.9	-7.6	4.3
Euro 10Y	-0.5	-0.5	4.5	2.6	7.2	5.3	0.8	17.0	-0.6	5.8	5.9	0.2	16.7	-2.6	7.6
UK 10Y	-0.7	-0.7	7.7	4.1	8.1	4.4	0.7	16.4	-3.5	1.8	9.3	0.8	15.6	-6.1	3.8

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 05.01.16	12m to 05.01.15	12m to 05.01.14	12m to 05.01.13	2016	2015	2014	2013	2012
Energy	-3.5	-3.5	13.9	-15.4	-24.9	-17.3	-37.1	-40.8	3.6	-11.9	16.3	-38.9	-39.3	5.2	-9.4
Brent crude	0.1	0.1	28.2	-14.3	-28.1	-17.0	-42.7	-49.4	3.2	2.6	25.4	-45.6	-47.6	7.2	7.6
Industrial metals	1.3	1.3	24.5	-5.1	-5.7	-6.4	-27.7	-7.0	-14.8	0.8	19.9	-26.9	-6.9	-13.6	0.7
Copper	1.3	1.3	19.4	-5.3	-9.5	-6.8	-24.9	-17.3	-10.9	6.5	15.7	-25.1	-16.6	-8.8	5.0
Precious metals	3.0	3.0	11.0	-1.1	-3.4	-8.0	-12.0	-7.7	-27.4	1.0	9.5	-11.5	-6.7	-30.8	6.3
Gold	2.6	2.6	8.7	-1.6	-2.1	-6.7	-10.8	-3.0	-25.3	0.9	7.7	-10.9	-1.7	-28.7	6.1
Agriculture	3.0	3.0	7.3	-6.3	-6.7	-6.2	-18.2	-7.6	-12.8	2.4	2.1	-15.6	-9.2	-14.3	4.0
Corn	2.6	2.6	-5.9	-14.5	-13.5	-11.6	-22.3	-11.6	-28.2	16.5	-9.8	-19.2	-13.3	-30.3	19.0
Commodities	0.0	0.0	13.1	-8.0	-11.1	-9.2	-25.2	-16.8	-9.3	-3.1	11.8	-24.7	-17.0	-9.5	-1.1
Real Estate	2.0	2.0	6.5	2.2	6.6	9.8	-2.0	16.0	2.3	28.8	4.1	-0.8	15.0	3.7	27.7
ATS	0.3	0.3	3.4	-0.2	-0.4	1.6	-3.7	-0.7	5.8	3.5	2.5	-3.6	-0.6	6.7	3.5

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

All data as of close of business (COB) 5th January 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	1.9	2.0
Emerging	4.3	4.9		5.1	3.2	3.0	3.1
United States	1.6	2.2		2.5	1.3	2.5 ↓	2.6
Euro area	1.6	1.2		1.6	0.2	1.2	1.4
Japan	1.0	1.2		0.6	-0.3	0.6	1.1
United Kingdom	2.0	1.0	↑	1.5	0.6	2.5	2.1
China	6.7	6.3		6.1	2.0	2.2	2.3
Brazil	-3.6	0.5		1.8	8.8	5.2	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, 16 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.

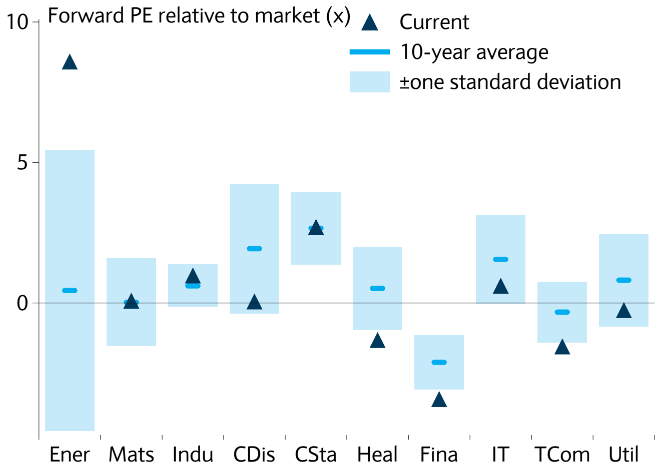
Wealth and Investment Management equity sector recommendations

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

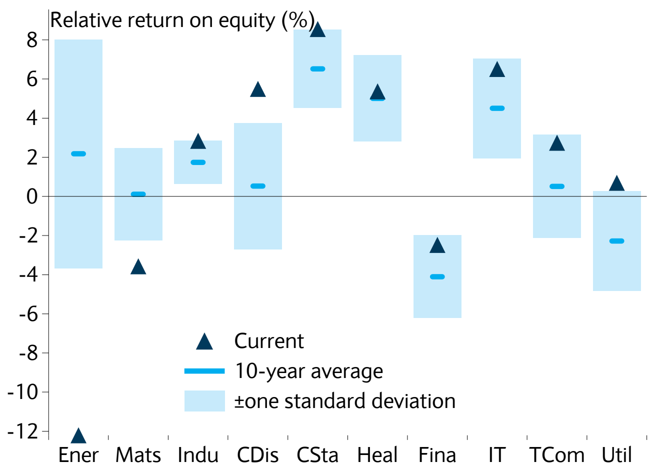
Source: Barclays

Figure 2: MSCI developed markets – sector forward PE ratios



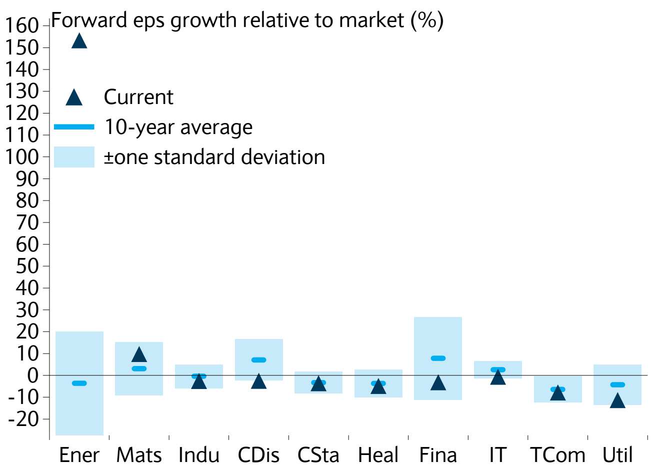
Source: MSCI, FactSet, Barclays

Figure 3: MSCI developed markets - sector return on equity



Source: MSCI, FactSet, Barclays

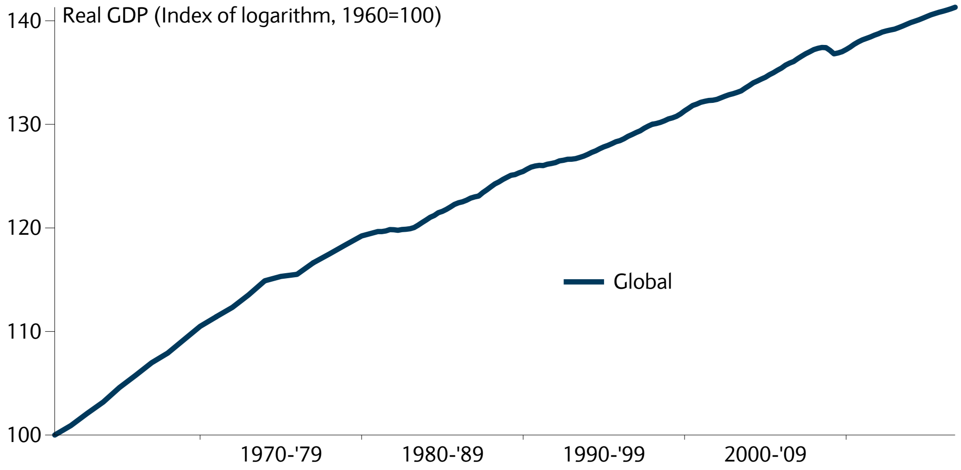
Figure 4: MSCI developed markets - sector forward EPS growth



Source: IBES, Datastream, Barclays

The case for investing

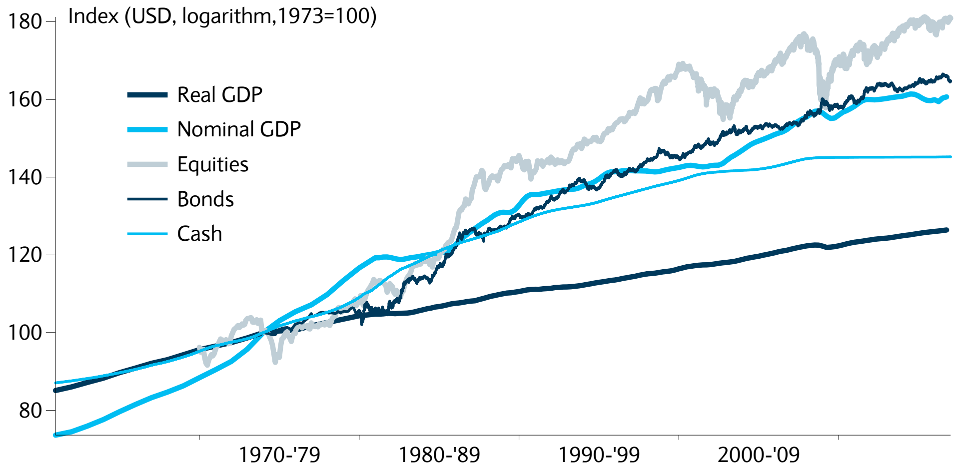
Global real GDP



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.

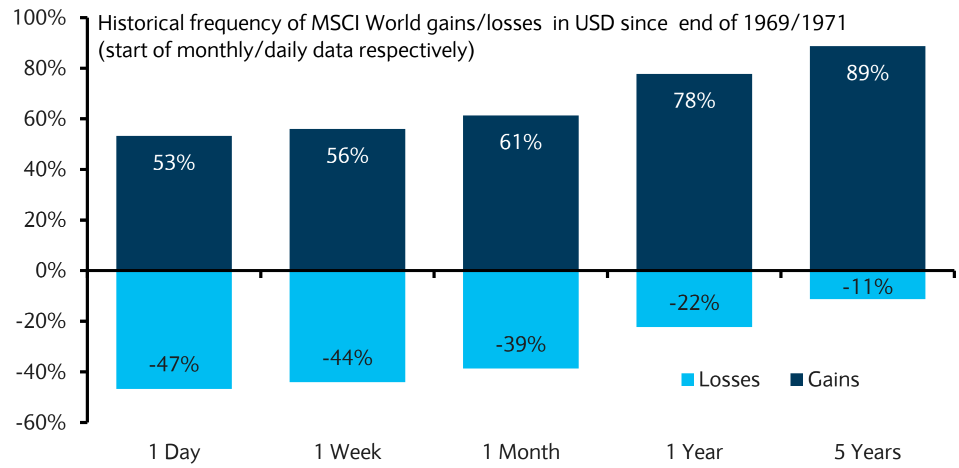
Growth of global GDP and asset classes



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

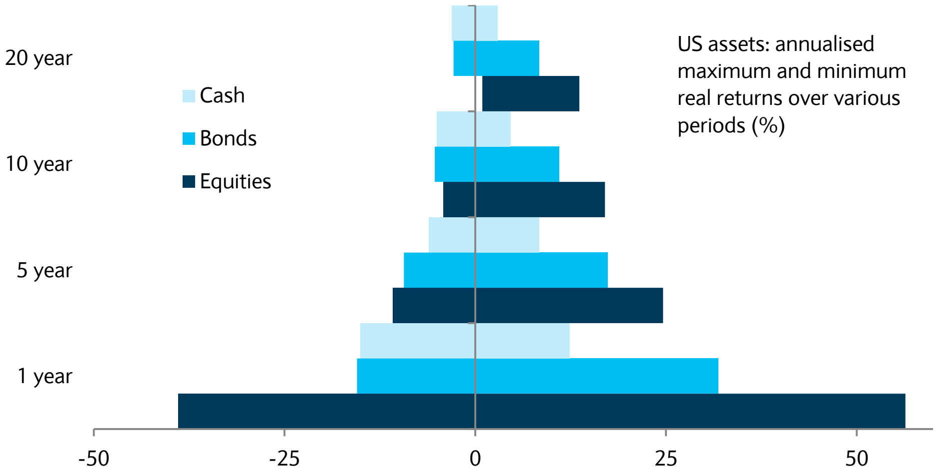


Source: Datastream, Barclays

- 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

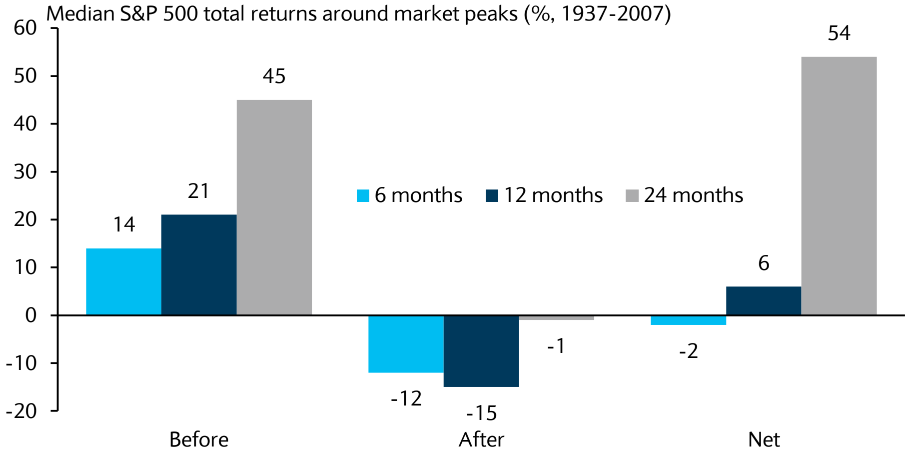
Minimum/maximum real return of US assets



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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Barclays Bank PLC is registered in England and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Registered No. 1026167. Registered Office: 1 Churchill Place, London E14 5HP. Barclays Bank PLC in the Qatar Financial Centre (Registered No. 00018) is authorised by the Qatar Financial Centre Regulatory Authority. Barclays Bank PLC QFC Branch may only undertake the regulated activities that fall within the scope of its existing QFCRA authorisation. Principal place of business in Qatar: Qatar Financial Centre, Office 1002, 10th Floor, QFC Tower, Diplomatic Area, West Bay, PO Box 15891, Doha, Qatar. This information has been distributed by Barclays Bank PLC. Related financial products or services are only available to Business Customers as defined by the QFCRA. **Singapore and Hong Kong** – Barclays offers wealth and investment management products and services to its clients through Barclays Bank PLC and its subsidiaries. Barclays Bank PLC is registered and incorporated in England and authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Its members have limited liability. Registered No. 1026167. Registered Office: 1 Churchill Place, London E14 5HP. Barclays Bank PLC Singapore Branch is a licensed bank in Singapore and is regulated by the Monetary Authority of Singapore. Registered Address:10 Marina Boulevard, #24-01 Marina Bay Financial Centre Tower 2, Singapore 018983. Barclays Bank PLC Hong Kong Branch is registered with the Hong Kong Securities and Futures Commission (CE No. AAJ160) and is authorised and regulated by the Hong Kong Monetary Authority. Main business address in Hong Kong: 41/F Cheung Kong Center, 2 Queen's Road Central, Hong Kong. **Switzerland** – Barclays Bank (Suisse) SA is a Bank registered in Switzerland and regulated and supervised by FINMA. Registered No. CH-660.0.118.986-6. Registered Office: Chemin de Grange-Canal 18-20, P.O. Box 3941, 1211 Geneva 3, Switzerland. Registered branch: Beethovenstrasse 19, P.O. Box, 8027 Zurich. Registered VAT No. CHE-106.002.386. Barclays Bank (Suisse) SA is a subsidiary of Barclays Bank PLC registered in England, authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. It is registered under No. 1026167 and its registered office is 1 Churchill Place, London E14 5HP. **United Arab Emirates (Dubai)** – Barclays offers wealth and investment management products and services to its clients through Barclays Bank PLC and its subsidiary companies. Barclays Bank PLC is registered in England and authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Registered No. 1026167. Registered Office: 1 Churchill Place, London E14 5HP. Barclays Bank PLC (DIFC Branch) (Registered No. 0060) is regulated by the Dubai Financial Services Authority. Barclays Bank PLC (DIFC Branch) may only undertake the financial services activities that fall within the scope of its existing DFSA licence. Related financial products or services are only available to Professional Clients as defined by the DFSA. Principal place of business in the DIFC: Dubai International Financial Centre, The Gate Village Building No. 10, Level 6, PO Box 506674, Dubai, U.A.E.