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# MULTI-ASSET ANNUAL

Insight broad opportunities strategy (USD)

## Outlook for 2019

### SUMMARY

**After a very difficult investment environment in 2018 the near-term outlook remains challenging, at least until some key event risks are in the rear-view mirror or a greater degree of economic clarity is forthcoming. Indeed, one of the key questions is whether the economic data will follow where the markets are guiding them or whether markets have overshot the likely economic reality. For now our appetite for running significant directional exposure is limited but pockets of volatility present opportunities for alternative strategies that can benefit from elevated levels of stress.**

### MARKET AND ECONOMIC OUTLOOK

#### BACKGROUND

It was not a great surprise that the market environment in 2018 became more difficult than in previous years, but the extent to which it did so was. Chart 1 shows the percentage of assets that posted negative returns. Of the 70 assets observed (including developed and emerging equity and bond markets, credit and commodities), 90% of them posted negative returns last year – by far the worst outturn in the post-war era.

The year was also characterized by a number of volatility challenges. There was the VIX shock in early February, the sharp sell-off in Italian government bonds in May and emerging market stresses over the summer, alongside the equity and credit market downdrafts in Q4 2018 with US-China trade tensions, the Italy-EC budget stand-off and of course Brexit adding to the uncertainty.

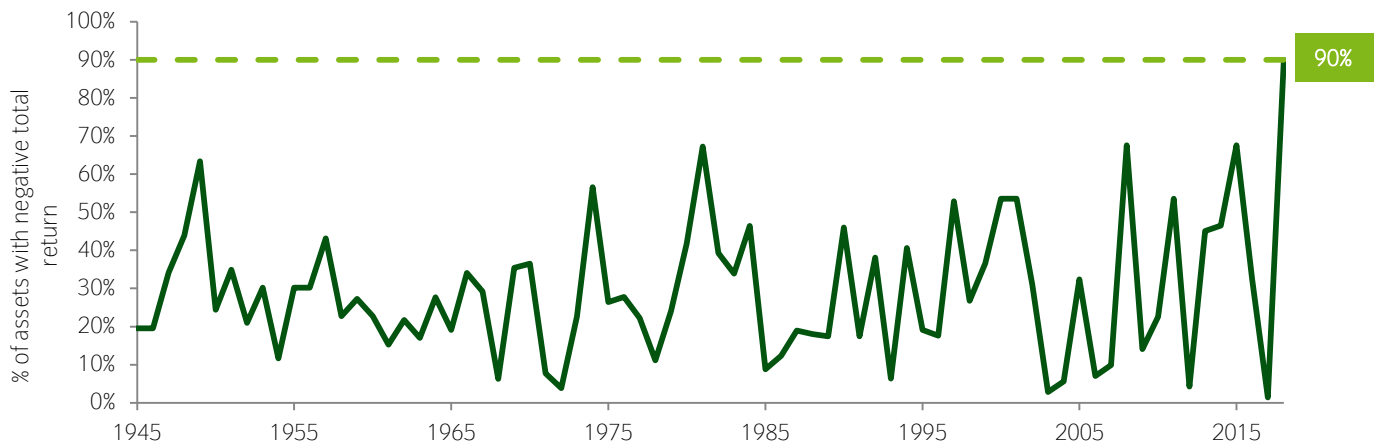
Whether some of these ‘independent’ shocks are reflective of broader pressures caused, for example, by a tightening in global financial conditions is unclear, but after an extraordinarily long period of easy policy the tightening financial conditions seen over the last year may have provoked a sharper market reaction than macro forces alone would have suggested.

Looking forward, global growth is projected to slow from 3.7% in 2018 to 3.5% in 2019-20, according to the OECD, with stronger activity in emerging economies offsetting a further moderation in developed economies and China. Wage pressures are on the rise although the pass through into higher inflation is likely to be only modest. Nonetheless, the combination of moderating activity and higher inflation has not historically been associated with strong asset-price returns and, from our current viewpoint, the risks to the growth outlook seem skewed to the downside. The key question, from an asset-allocation perspective, is whether the fall in asset prices seen in 2018 adequately reflects those risks.

#### LOOKING BACK – TO LOOK FORWARD

As ever, when market behavior seems extreme it is useful to review events through the lens of history. Of the many asset classes that posted negative returns in 2018 some have been in bear-market territory while others are close. Since 1929 there have been 14 equity bear markets (defined as a drop in equities in excess of 20% – using the S&P 500 Index as a global proxy, Chart 2) and all but one (in 1987) have been associated with a recession (two negative quarters of GDP growth). Long-term market history, while fascinating, needs to be viewed in context given that some of the more extreme cases are associated with momentous events such

Chart 1: Breadth of asset class weakness in 2018 – a post-World War II record



Source: Bloomberg, Deutsche Bank and Insight Investment as of January 1, 2019.

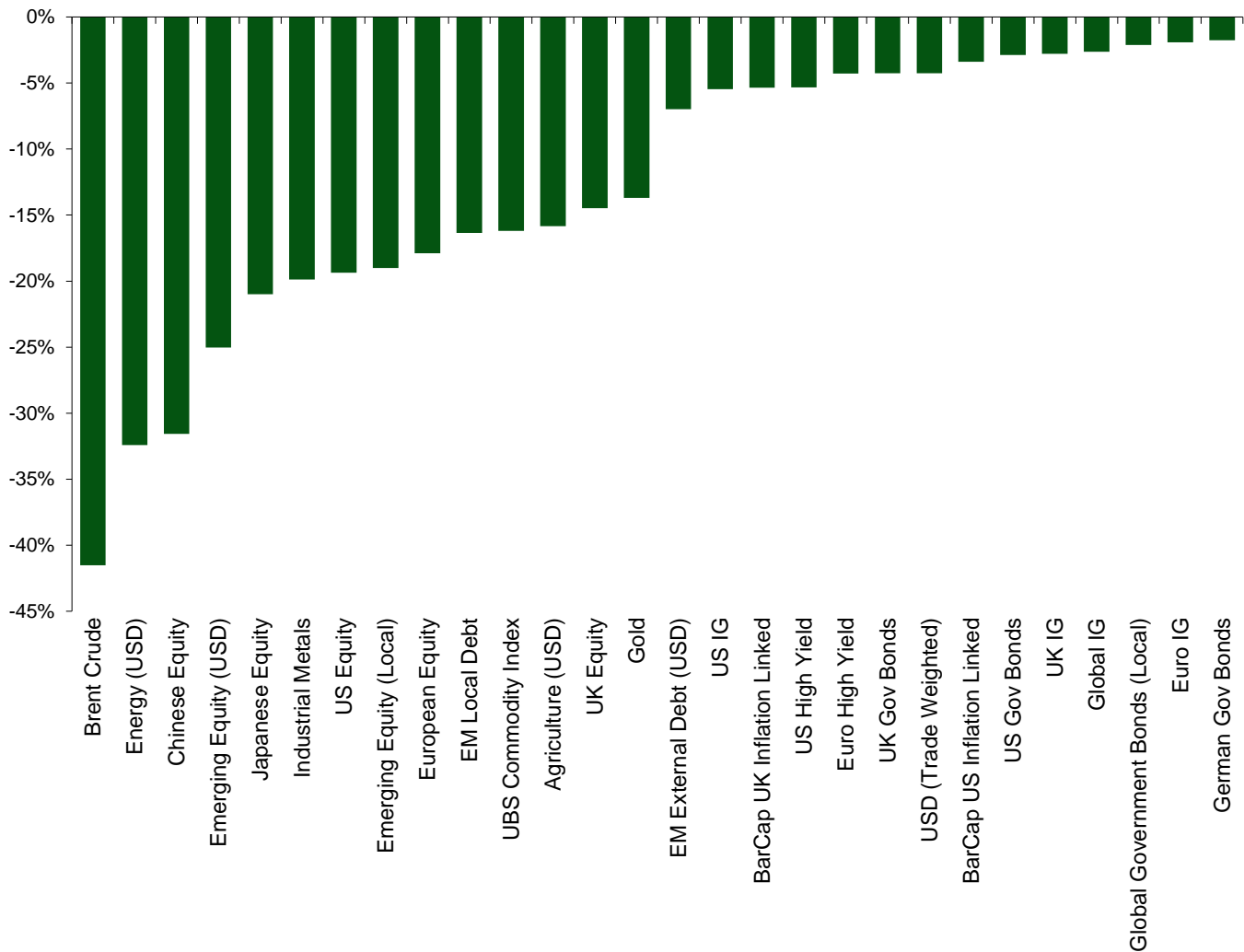
## MARKET AND ECONOMIC OUTLOOK

Chart 2: Bear markets in the S&P 500 Index (1929-2018)

Year	Decline	Length decline (months)	Recover to peak (months)	Ratio recover to decline	Vol During
1929-32	-86%	32	268	8.2	40%
1932-33	-41%	6	3	0.5	52%
1933-35	-34%	20	7	0.4	32%
1937-42	-60%	62	45	0.7	26%
1946-49	-30%	37	12	0.3	17%
1956-57	-22%	15	11	0.8	12%
1961-62	-28%	6	14	2.2	18%
1966-66	-22%	8	7	0.9	12%
1968-70	-36%	18	21	1.2	12%
1973-74	-48%	21	69	3.4	18%
1980-82	-27%	20	3	0.1	14%
1987-87	-34%	3	20	5.9	57%
2000-02	-49%	31	56	1.8	23%
2007-09	-57%	17	49	2.9	38%

Source: Bloomberg and Insight Investment as of January 1, 2019.

Chart 3: Asset class drawdowns in 2018 (peak-to-trough movements over the course of the year)



Source: Bloomberg and Insight Investment, as of January 1, 2019. Returns displayed in local currency unless otherwise stated.

## ECONOMIC AND MARKET OUTLOOK

As global conflict (after World War II) or collapse of the world financial order (the demise of Bretton Woods in the early 1970s).

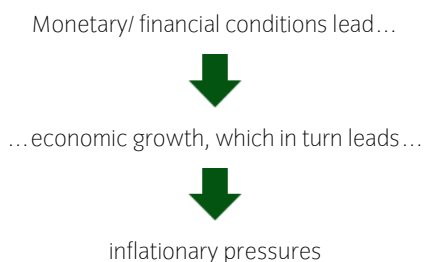
In the more recent past (since the early 1990s) recessions have coincided with bear markets. The causality of such events is, however, key. Financial excesses in the late 1990s and in 2007/8 led to extended asset-price adjustments (inflated stock valuations for the former and elevated real-estate values that lay at the heart of the sub-prime crisis for the latter). These were the precursors of financial crises that ultimately led to recessions. Given this experience, a narrow focus on 'recession forecasting' is of limited value from an asset-allocation perspective as asset prices have led economies in recent decades. Even more so given that official bodies such as the National Bureau of Economic Research declare recessions after the fact – anywhere from 6-18 months after a recession is deemed to have started.

The link between valuations and risk-asset declines is more complex. Our analysis flags that valuations matter most at extremes and away from those rare events they offer less guidance in terms of forward returns. This is particularly true of risky assets like equity. Expensive valuations increase the risk of larger drawdowns simply because there is less of a valuation cushion to absorb unanticipated shocks, but valuation in itself is a poor timing tool. The extent and duration of bear markets vary according to their origin. The worst have been associated with seismic events (e.g. the great depression, the collapse of Bretton Woods or more recently the great recession) and we would not expect to see such falls in the absence of a global crisis of similar magnitude.

To put current moves into context, the MSCI All-World Index broke into bear market territory in late December – ending the year 17% below its January peak while the S&P 500 Index dipped to a peak-to-trough decline of -19.8% (see Chart 3) before rebounding into year-end.

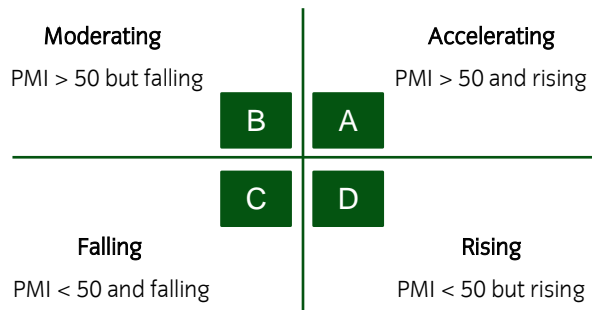
### OUR ASSET-ALLOCATION FRAMEWORK

From here, one of the key questions is whether the economics will follow where the markets are guiding them or whether markets have overshot the likely economic reality. Regular readers will be familiar with our macro framework. In stylized form:



We look at a raft of indicators when assessing monetary conditions. Among our favorites are our financial conditions indices, which aim to capture changes, be they driven by conventional factors (short-term interest rates) or other less conventional factors that affect perceptions of the broader cost of capital. These have been tightening since early 2018 (for example see Chart 4) and this provided us with an early warning sign of an impending moderation. Again, when assessing growth dynamics, we look at a wide range of indicators, some forward looking and some coincident.

One of the best sets of timely indicators are purchasing managers indices (PMIs) which reflect the health of the manufacturing and service sectors. We track around 38 monthly country and regional releases. Interpreting PMIs is relatively simple. Any data point can be in one of four regimes:

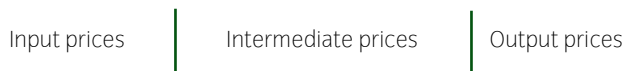


Using this framework we have looked at asset-price returns across these different regimes since the early 1970s (see Chart 8) and this serves as a guide in our asset-allocation framework.

Unsurprisingly, the sweet spot for risk assets tends to be an accelerating regime and our assessment was that this was the dominant phase during H2 2016 and 2017. This is why our asset allocation was skewed towards directional (equity) exposures during that time. Our contention at the start of 2018 was that economic activity would shift to a moderating regime over the year, and in that environment risk-asset returns would be generally lower than in an accelerating regime. We also expected the variability of returns to be higher. Accordingly, we began scaling back our directional exposures early in 2018.

Over the course of last year, the shift in the bulk of our 38 PMI data points has been clearly into the moderation zone (B – see Charts 5, 6 and 7). However, to put these moves into context, global growth actually came in only slightly below consensus forecasts made at the start of the year, and asset-price returns have been materially below the returns guided by this historic analysis (See Chart 9). Indeed, returns are closer to some of those witnessed in falling PMI regimes.

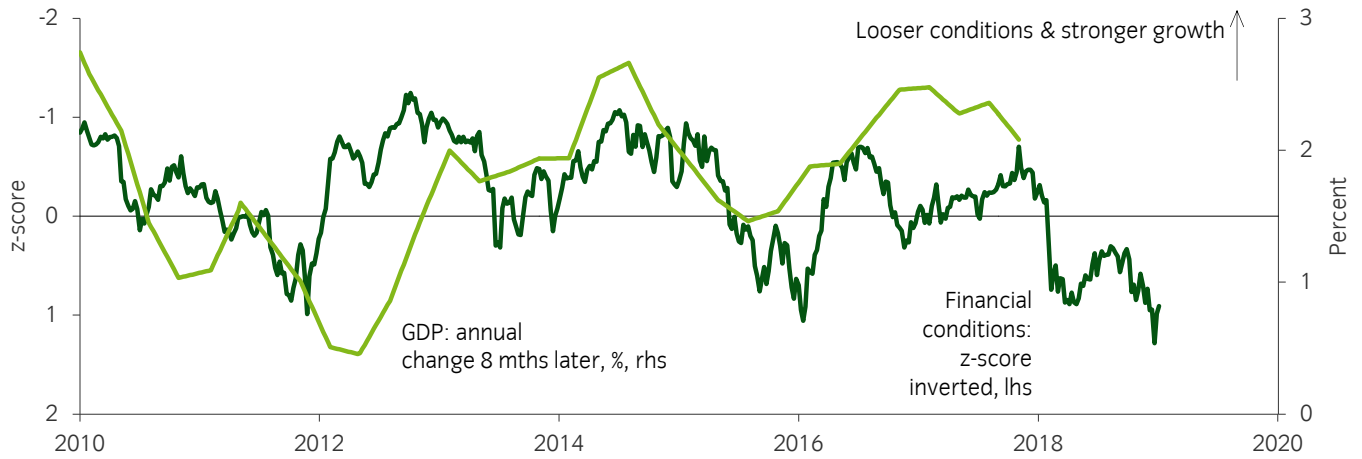
Our understanding of inflation dynamics again relies on a wide range of indicators and analysis. Some are long term, assessing factors such as prices and employment. Other indicators are more short term, tracking inflation pressures along the price chain, as illustrated below:



Using this framework, we can see that wage and price pressures should move higher in most developed economies, but only modestly. In the near term the most obvious risk to this relatively benign environment is via a trade war and tariffs. The first-round implications of a major trade war would be higher prices which would impact consumption. How these dynamics play out has a number of implications and we discuss their impact on corporate profit margins on page 8.

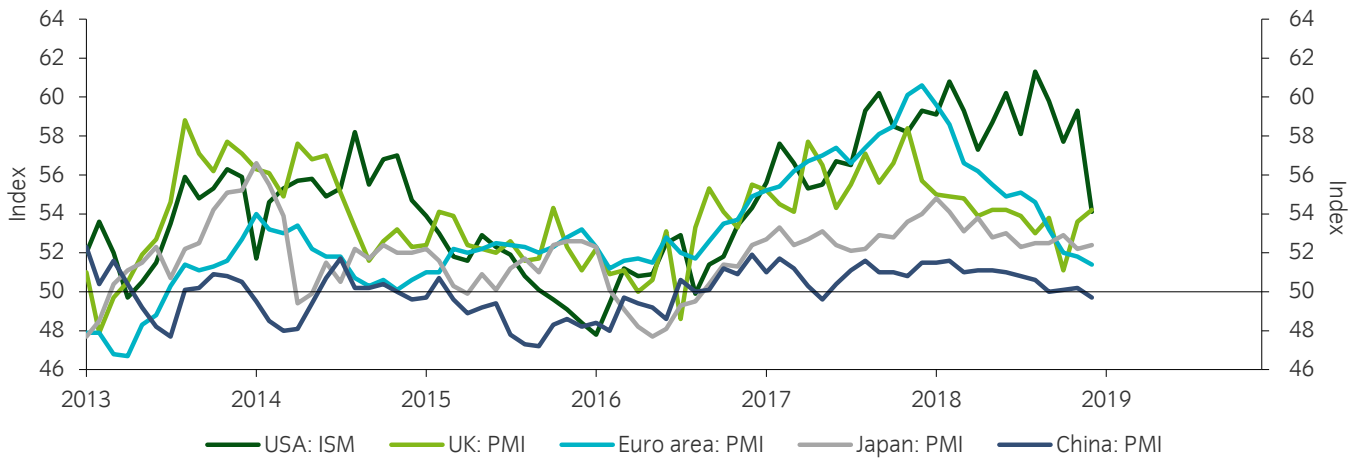
ECONOMIC AND MARKET OUTLOOK

Chart 4: Insight Global Financial Conditions Indicator



Source: Thomson Reuters and Insight Investment as of January 1, 2019.

Chart 5: Global growth indicators – manufacturing PMIs in moderation zone



Source: Thomson Reuters and Insight Investment as of January 1, 2019.

Chart 6: Global manufacturing PMIs in 2017

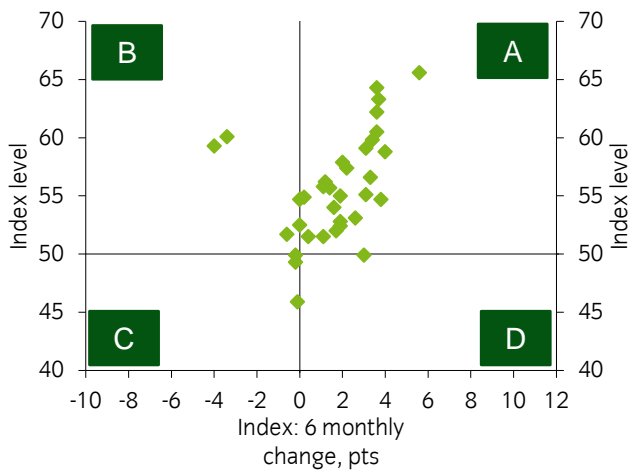
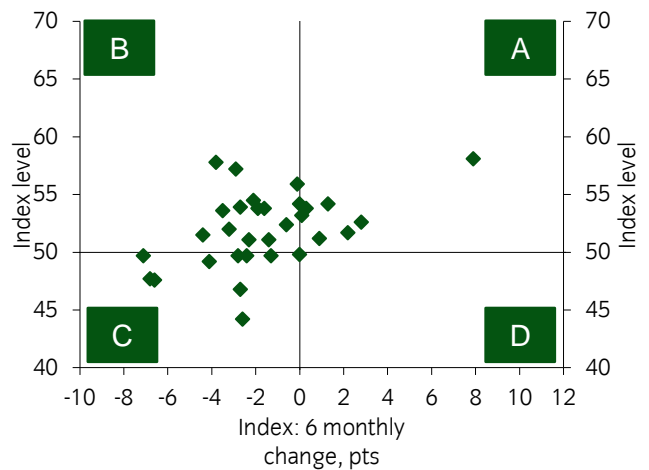


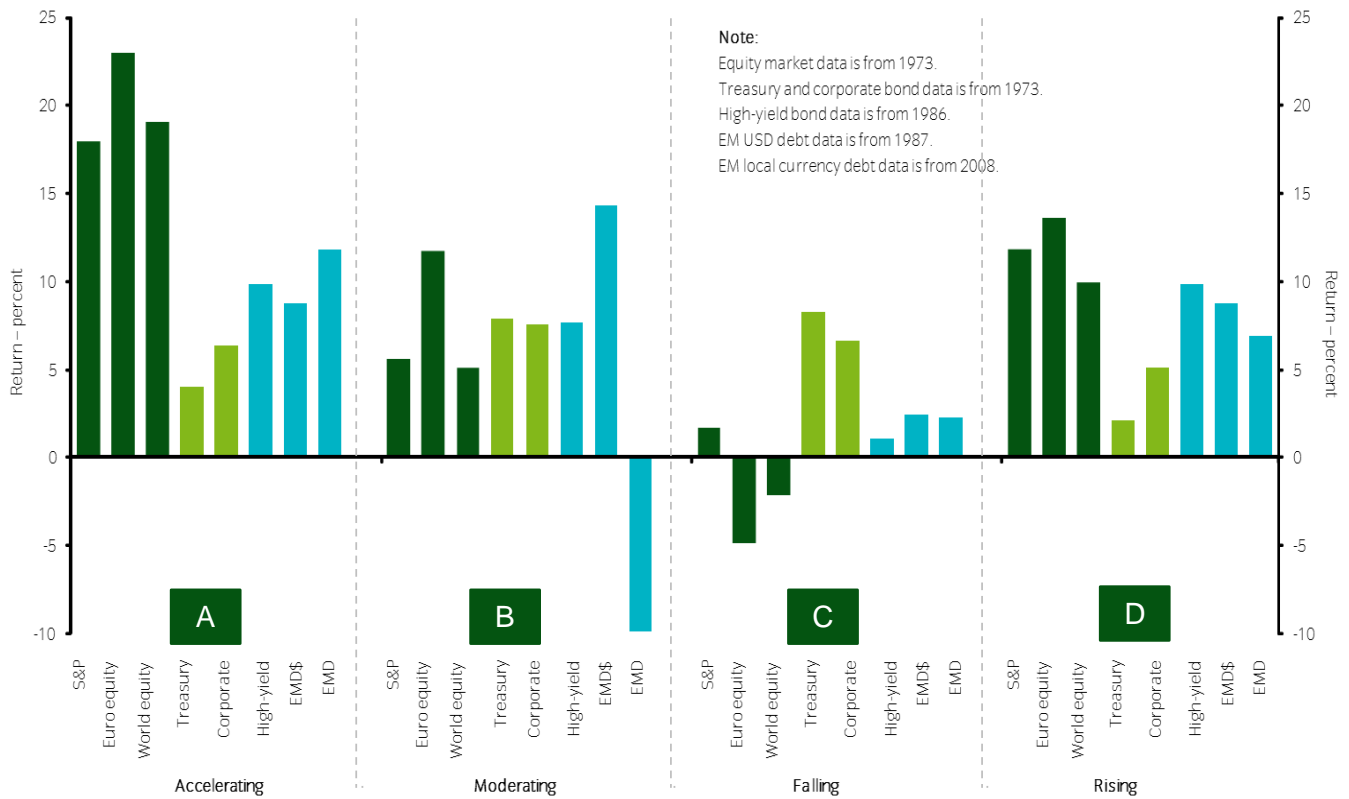
Chart 7: Global manufacturing PMIs in 2018



Source: BIS and Insight Investment as of January 1, 2019. Each dot represents a different country.

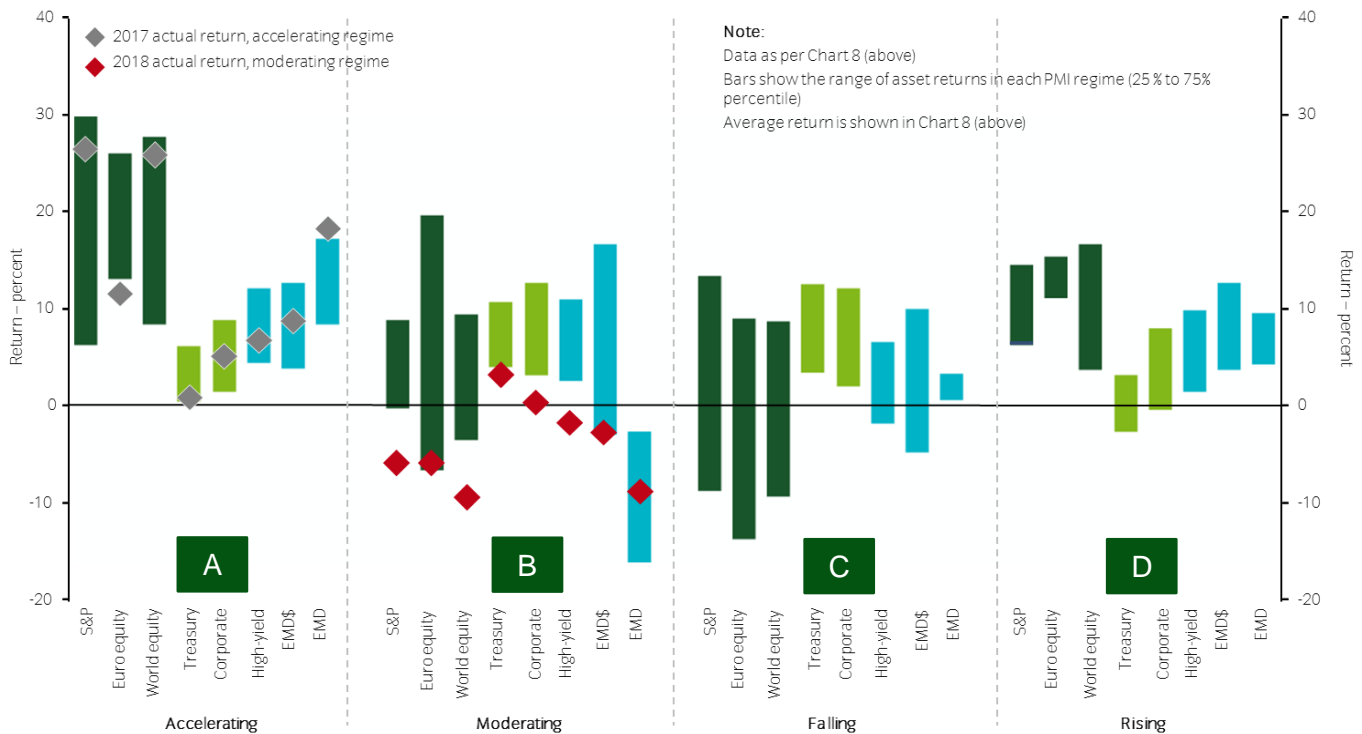
# ECONOMIC AND MARKET OUTLOOK

Chart 8: PMI (ISM) growth regimes and asset-class returns



Source: Thomson Reuters and Insight Investment as of January 1, 2019.

Chart 9: PMI (ISM) growth regimes and asset-class returns – deviations from average



Source: BIS and Insight Investment as of January 1, 2019.

## ECONOMIC AND MARKET OUTLOOK

So when we look at the world through this framework how does the outlook for 2019 stack up and how do we overlay the geopolitical risks that seem to have weighed heavily on markets in 2018?

### FINANCIAL CONDITIONS

As discussed in our overview, part of the story of 2018 has been a tightening in financial conditions. This is normal in the later stages of an extended economic cycle. Financial conditions have been very accommodative for an extraordinarily long time after the global financial crisis, and it may well be that the impact of the tightening seen over the last year has provoked a sharper reaction than in previous cycles. This suggests that policymakers should be cautious in their attempts to normalize monetary policy further.

To various degrees central banks have shifted from quantitative easing to quantitative tightening, but the impact of changes in central bank balance sheets should transmit via term premiums or real rates. Moves in these have been relatively modest which suggests this impact has been somewhat minor.

Of course, in the US, official short-term interest rates have risen to 2.50% from their low back in 2015. The move in US rates has been far greater (closer to 5.75% of tightening) if you view the starting point as the 'shadow' federal funds rate which bottomed at around -3% in 2014 according to the Atlanta Federal Reserve (Fed) calculations.

After hiking the federal funds rate to 2.5% in December, it is now at the bottom of the central bank's estimate of neutral (the Fed's range of estimates for neutral is currently 2.5% to 3.5%, see Chart 10) and expectations for next year are now much more data-dependent. The flattening in the US yield curve may not automatically mean a recession is imminent but inversion of the curve (see Chart 11) will not be ignored either.

Policy settings elsewhere in the G7 look set to remain stable and perhaps the biggest question is whether we are getting to the point that the bulk of the tightening in financial conditions is behind us as we look into 2019.

The European Central Bank (ECB) ceased asset purchases at the end of 2018, and it seems likely that policy will be maintained at this current stance through much of 2019. Expectations of a rate hike in September 2019 are likely to be put back into 2020 given the fragility of the euro area to downside risks. Similarly, we see little in the way of policy adjustment from the Bank of Japan.

The outlook for the UK remains particularly uncertain given the Brexit negotiations. Without parliamentary ratification before March 2019 a disorderly Brexit is a genuine risk, but as things stand, the range of scenarios (including a second referendum on EU membership) remains uncomfortably large. In a no-deal outcome, growth would slow sharply and very different policy settings are likely to be required depending on the outcome.

Economic activity in China was already moderating with both credit growth and infrastructure spending declining. In 2018 trade tensions had an impact, knocking PMIs close to the expansion/contraction threshold at the 50 level. Export growth has slowed sharply. In response, the authorities have recently been easing policy and the scope remains to expand fiscal policy, though this would lead to a delay in deleveraging of state-owned enterprises with the accompanying heightened risk of financial fragility. In the short term, however, the easing in policy already enacted and the prospect of further stimulus will be important offsets to the potential trade war impact.

### GROWTH

As noted earlier, overall economic activity held up pretty well in 2018 with G20 GDP growth holding steady at 3.8%. This, however, masks notable differences with strong US growth masking decelerations in the euro area and Japan. Similarly, emerging market growth varied with softness in China partially off-set by growth in the likes of India and Brazil. Of late, however, the forces of deceleration appear to be broadening (see Chart 12).

Amid rising trade tensions, global trade volume growth (goods plus services) has slowed. Policy reaction to higher tariffs depends on whether they are seen as a one-off shock to the price level or if there are second-round effects (on inflation expectations and wages, for example). The wider the imposition of tariffs, the more likely second-round effects are. In the short term, a large part of the burden of tariffs may fall on the US consumer in the form of higher prices.

The People's Bank of China (PBOC) has said it will not use the exchange rate to cope with trade tensions but the perception that it might do so could see other countries use currency depreciation to maintain trade competitiveness. Sensitivities here will remain high as last year saw sizeable currency depreciations against the US dollar in many emerging markets, specifically those with large and expanding external imbalances. Should the US tightening cycle be entering a more gradual phase, the US dollar should face less upward pressure and this would in turn provide an element of support for emerging markets.

### INFLATION

Conventional estimates of economic slack (output gaps and unemployment) suggest that spare capacity is now limited in the major economies so it is reasonable to assume some pick-up in wages and prices. However, inflation expectations appear well anchored and despite the longevity of the expansion cycle, pricing pressures have been subdued – in part because of technological and competitive pressures.

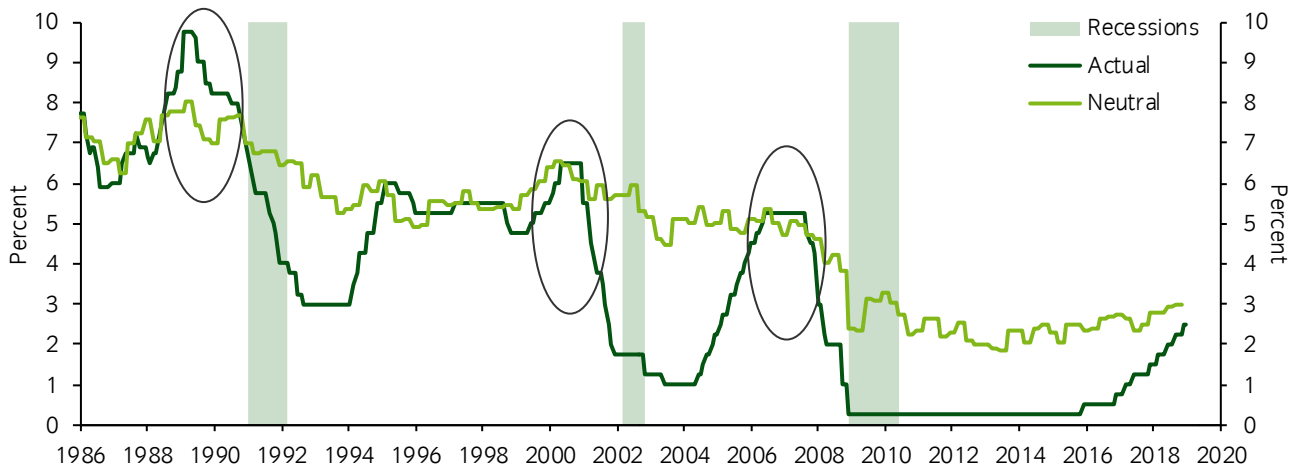
The flatness in Phillips curves has been a subject we have written about in the past, but at some point tight labor markets should lift compensation and that should filter through to prices. That said, participation remains below pre-global financial crisis levels in the US and there is scope for hours worked to rise in other developed economies (such as Europe). Overall, it seems that wage and price pressures should move higher in most developed economies but only modestly, trade wars notwithstanding.

Beyond financial conditions, the other transmission mechanism or channel by which expansion phases come to an end normally revolves around an erosion of corporate profit margins – this prompts businesses to pare back hiring and investment spending plans with obvious self-reinforcing second round effects.

An alternative narrative behind such defensive corporate behavior is a reassessment of the rising costs of business relative to potential return. Clearly, rising unit labor costs are an important factor here. In the US we have seen rising wage costs, but so far, productivity gains ensured those wage gains have been non-inflationary.

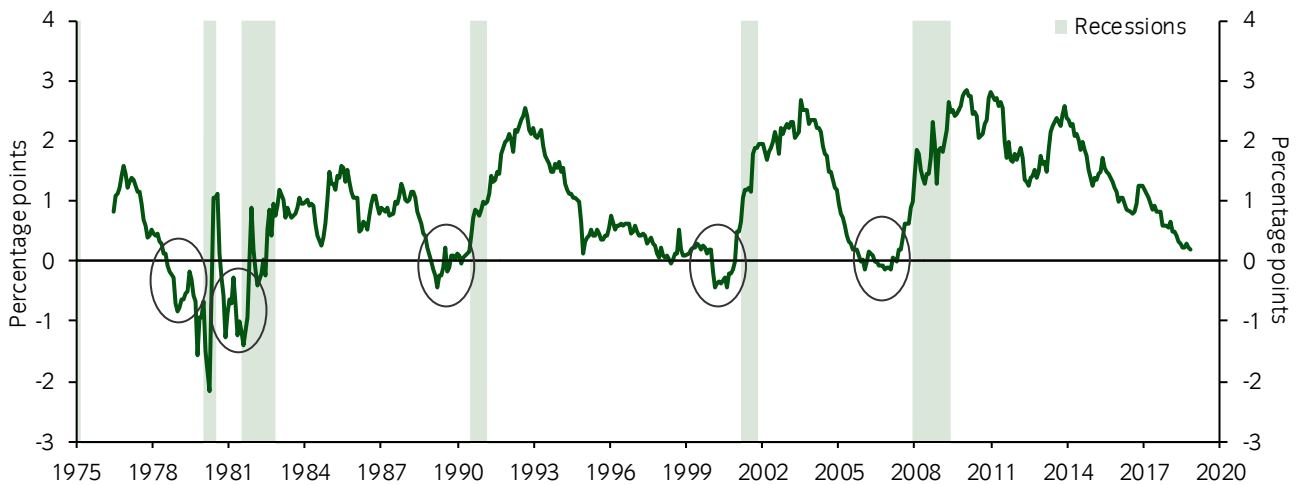
## ECONOMIC AND MARKET OUTLOOK

Chart 10: Actual versus the neutral nominal federal funds rate



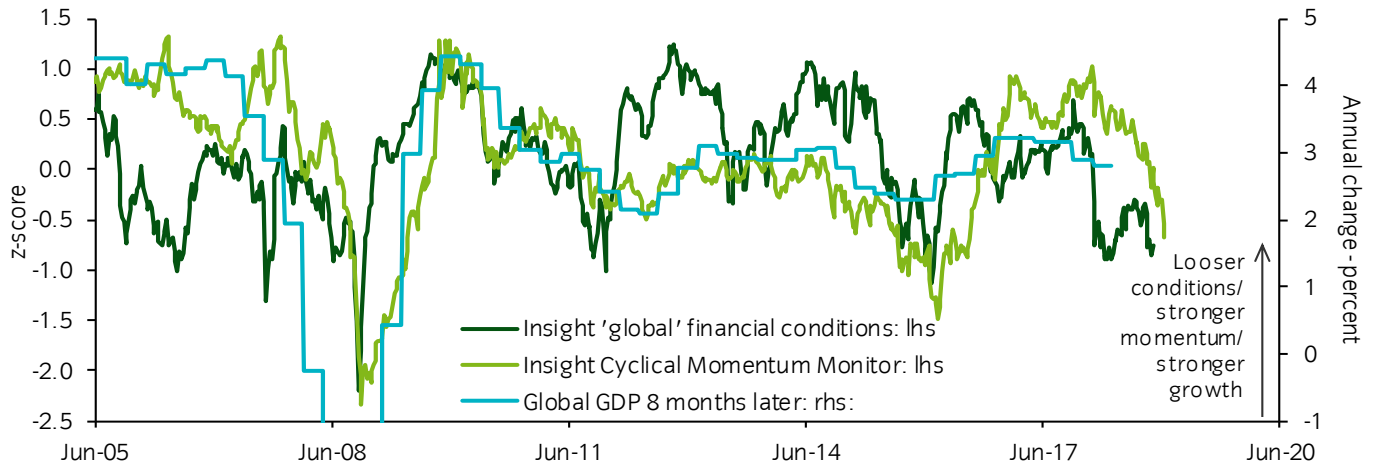
Source: Bloomberg, Thomson Reuters and Insight Investment as of January 1, 2019.

Chart 11: US slope of the yield curve – 30-year yield minus 2-year yield



Source: Federal Reserve and Insight Investment as of January 1, 2019.

Chart 12: Global GDP versus Insight financial conditions and cyclical momentum measures



Source: Bloomberg and Insight Investment as of January 1, 2019.

## ECONOMIC AND MARKET OUTLOOK

We analyzed a range of scenarios about the likely path of US corporate profit margins. While the medium-term trend should be for some contraction, the timing of this seems far from imminent in all but fairly extreme trade-war induced scenarios (see Chart 15). We assessed a range of scenarios with various degrees of adjustment both to demand (shocked downward) and costs (shocked upward) to deviate from a 'base case' of solid but moderating activity in which pricing pressure peaks somewhere in the middle of 2019. To engineer a quick contraction in margins by the summer of 2019 we need some fairly aggressive demand and price shocks.

This is of course possible if the dispute between the US and China based on trade intensifies, and if the individualist policy agendas in Europe continue unabated, as these forces would undoubtedly negatively impact the economic environment. One would expect policy reaction functions to adapt to avoid such worst-case outcomes but this is where markets, economics and politics come together.

### GEOPOLITICS IN FOCUS

In the past, the normal policy prescription for intensified downside risks would be some global form of coordinated action. However, in many countries there is less scope to use macroeconomic policy to stimulate growth than in previous downturns. Moreover, any coordinated approach is threatened by a political environment that has lurched towards protectionism and single country agendas and away from the post-Bretton Woods world order of integration and free trade.

In the US, the medium-term implications of a split Congress until 2020 are that there is little chance of economically positive legislation, whether in the form of tax reform or infrastructure spending. Areas where President Trump can act without interference (such as trade) look set to remain his focal point while he prepares the groundwork to blame the influence of congressional Democrats should the economy show signs of deterioration. Indeed, in the short term, disruptions caused by a government shutdown coming into year-end do not bode well for a stable policy platform.

The European outlook for 2019 also looks to be challenging. In the short term, ongoing Brexit uncertainties will be a key concern, and while a no-deal out-turn would no doubt be most painful for the UK, there would be ramifications on the continent. Also, populist unrest in France is prompting President Macron to open the fiscal taps (in the form of accelerated spending plans). This is likely to result in an overshoot of France's 2.8% fiscal deficit target for 2019. Of course any hints of fiscal slippage complicate the Italian budget stand-off between the Italian government and the European Commission.

With European parliamentary elections in May 2019, the tussle between a more populist approach to policy versus the current orthodoxy will come into even sharper focus. A shift in the balance of power would affect key EU policy agendas such as trade, budgetary matters and the appointment of senior personnel. The results may also have repercussions for national politics impacting the prospects for eurozone reform.

On top of this we have Chancellor Merkel withdrawing from the political scene and the possibility of elections in Germany, Spain and Italy along with a change in stewardship at the ECB in the form of President Draghi's successor.

Despite a rollercoaster of political developments most forecasters believe the most likely Brexit scenario is that the UK comes to some form of withdrawal agreement which extends negotiations beyond March 29, even if that agreement is effectively a fudge. However, a no-deal outcome is certainly possible and both the political and economic ramifications carry a huge amount of uncertainty.

### MARKET OUTLOOK

In the near term, our appetite for running significant broad directional exposures is limited. Our view remains that the environment will be challenging in the early part of 2019 at least until some of the key event risks highlighted above are in the rear-view mirror or when a greater degree of economic clarity is forthcoming. In the meantime, pockets of volatility present opportunities for alternative strategies that either offer a high degree of asymmetry in their pay-off profiles, or wide buffers to protect us should further weakness persist. We are alert to opportunities across asset classes where the wider ranges of which we can avail ourselves via total return strategies sit well in what we see as late-cycle market dynamics.

### RISK ASSETS

Central bank reaction functions include a feedback loop with asset markets (but only when those asset-price moves themselves bring with them material economic risks). After the precipitous falls in risk assets seen in Q4 2018, we may be moving closer to the point when they start to impact policy thinking. Moreover, some of the decline in risk assets reflects fears, most obviously surrounding trade wars or supply gluts in the case of commodity or commodity-linked assets, which may prove wide of the mark.

Identifying areas of excess pessimism in a bearish environment is by definition a challenge. One obvious area of focus is the vulnerability of China. Indeed, activity has been softening for much of 2018 with trade fears aggravating negative sentiment. The policy response has been aggressive stimulus (with the prospect of more to come). Clearly, confidence in an improvement would be aided by positive information relating to US-China relations but even absent that, market sentiment may be getting overly bearish as the lagged impact of last year's easing should start to have some impact around Q2 2019.

Tightening in US dollar liquidity has also been a material headwind for emerging markets over the last year, exposing countries with macroeconomic imbalances. The broad-based sell-off in emerging market assets suggests pockets of value exist. But at the very least, some stabilization in the US dollar and rates would be helpful in improving risk appetite.

For developed markets, valuations may suggest when to engage. Credit spreads are back at the levels of end-2016, and should underlying commodity markets stabilize, valuations in credit-related areas may become interesting. In equity land, a year ago it was fair to argue that, on some metrics, valuations were the wrong side of fair value. But in 2018 the de-rating in stock market valuations has been material given strong earnings-per-share (EPS) gains and falling stock prices. As an example, the MSCI World Index has de-rated by 23% over the last 12 months, even in Europe, where earnings have lagged, we have seen a de-rating in the high teens. Charts 16, 17 and 18 provide some context around these points.



## ECONOMIC AND MARKET OUTLOOK

EPS growth expectations for 2019 are more modest than in 2018 (8% for the MSCI World Index) and in some areas (such as Europe) they still appear too high – but forecasts have been coming down sharply in the last few months. We may not yet be at the point where valuations alone provide a compelling reason to look through near-term uncertainty, but there are some niche areas – for example, in emerging markets and European dividends, where value-based opportunities have opened up.

### DEFENSIVE ASSETS

The role that government bonds play in a multi-asset strategy depends on their likely relationship with the other return-seeking assets we hold. Broadly speaking, if our biggest concern is a lack of growth, we would expect government bonds to help us out in risk-off environments. Consequently, we view them as important diversifying assets even if our forecasts are for modestly higher yields. We are some way from the levels where we see bonds as a valuation threat to equities although, as ever, the rate of change matters – so a violent move upwards can cause dislocations. Such moves should however be contained so long as inflationary expectations remain anchored. Cash, volatility and real assets are alternative diversifiers should inflationary risks build.

### REAL ASSETS

Real assets in the form of infrastructure and securitized credit have attractive attributes from a diversification standpoint. Others such as commodities are highly cyclical. A combination of excess supply concerns and fears about global growth don't provide a compelling backdrop for commodities although, after a near 40% fall in oil last quarter, the risks are not all one way.

Our largest real-asset exposure remains in infrastructure, which we believe provides long-term predictable revenues with some inflation linkages. Strategy holdings include exposures to operational projects with availability-based revenues with public-sector counterparties (e.g. relating to education and healthcare sectors). Holdings also include exposures to assets considered as delivering essential services (e.g. railway stock, regulated utilities), renewable energy assets with high levels of contractual subsidy, demand-based assets with lower levels of economic sensitivity and aircraft leases. We expect continued diversification within strategy companies from availability-based projects towards selective investments in infrastructure assets with low sensitivity to economic growth as valuations and the opportunity set remains tight. Our renewable energy exposures are well-positioned to capture emerging opportunities – for example, in battery storage and energy generation from waste, in addition to on and off-shore wind resources and solar power.

The outlook for securitized credit is more balanced. Increased supply in 2018 helped correct supply/demand imbalances and reduced the technical support for the asset class. Reducing ECB policy support poses further headwinds for the asset class. Asset-class fundamentals remain supportive with strong covenants, healthy loan-to-value ratios and wider spreads. Securitized credit still offers good relative value within the credit universe, when comparing spread levels to similarly-rated corporate bonds.

### CURRENCY

Relative economic strength, higher US interest rates and trade tensions all helped to drive the US dollar higher last year. Emerging market currencies in particular struggled against that background, with country-specific risks providing an additional layer of stress.

Fears that the Chinese might use currency depreciation as a weapon in the trade dispute remain in the background and while the Chinese currency did slide sharply from mid-June to August, it has subsequently been relatively stable, in line with the PBOC's stated desire for a more stable renminbi, despite trade tensions. Relative stability here alongside a weaker or stable US dollar may provide an opportunity to buy emerging market currencies where valuations look attractive. However, overall, we don't see the obvious catalysts (in terms of relative growth or interest-rate differentials) to drive high-conviction currency views. Rather we see the near-term environment as being more conducive to more range-trading strategies where the mean-reverting nature of currency pairs can be a diversifier to more traditional assets.

### VOLATILITY

While equity volatility was compressed in 2017, worries about the extent of US interest rate increases led to an increase in equity, rates and currency volatility in January 2018. The subsequent jump in VIX futures, caused by the imbalance of large short VIX exchange-traded products, resulted in a spike in equity volatility in early February 2018. During Q2 and Q3 volatility normalized but to levels above those in 2017. This makes sense as rising interest rates tend to lead asset-class volatility (see Chart 20). Trade-war worries added another source of uncertainty, although the VIX did briefly dip below 11 in August.

During Q4, cross-asset volatility for all asset classes became much more elevated as assets that had previously been relatively resistant to stress (for example, oil) broke lower. Oil volatility, which had previously been in a 20%-30% range, spiked above 60%. The VIX rose above 35 having been below 15 for most of Q3. Rates and gold volatility similarly rose back towards the top of their recent ranges.

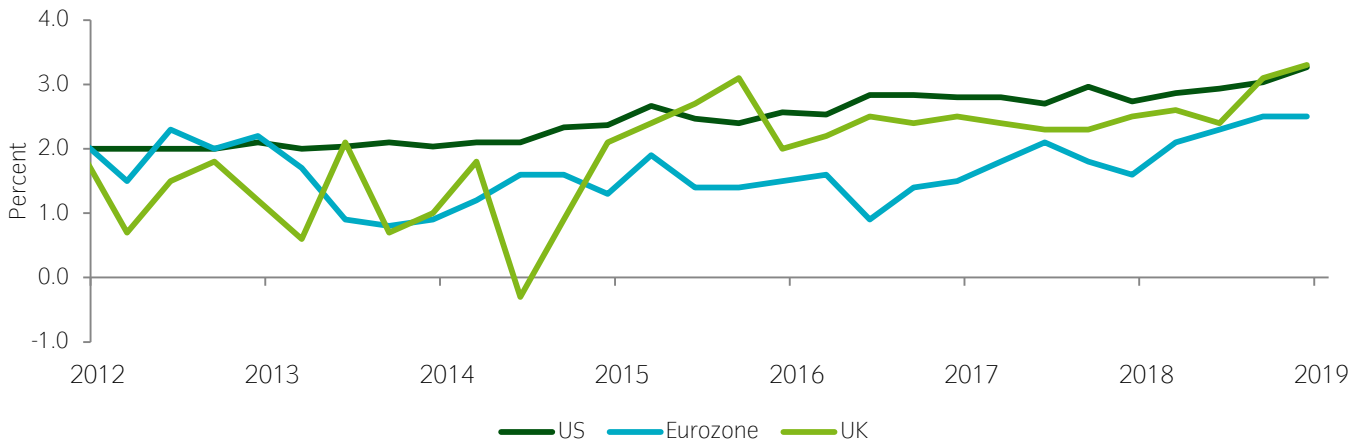
While correlation has remained relatively low throughout 2018, recently there has been an increase in S&P 500 Index implied correlation from 33% in early October to over 50% in December (see Chart 21). This increase in correlation is usually a late-cycle signal and volatility should remain high at least in the short term. From a volatility cycle standpoint this suggests that we should be able to avail ourselves of a broad range of strategies by using option pricing to provide asymmetric opportunities. We are closely monitoring levels of volatility across all asset classes to identify stressed market environments.

Overall, our reading of the current investment environment leads us to have modest levels of directional exposure. A material shift towards running more directionality would require a return to a more benign economic environment which, in turn, would require some key sources of stress outlined above to dissipate. This seems unlikely, at least in Q1 2019, but as the year progresses and key event risks move into the rear-view mirror, such an environment may well present itself.

Risk-asset valuations are no longer as lofty as they were a year ago but divergent growth and idiosyncratic risks bring periods of elevated volatility. To the extent this can be translated into wider ranges in which we can generate returns via our total return strategies, this is an environment where our wide opportunity set should be helpful to us. However, we are mindful that volatility has moved higher for good reasons and accordingly we need to use our appetite for taking risk wisely.

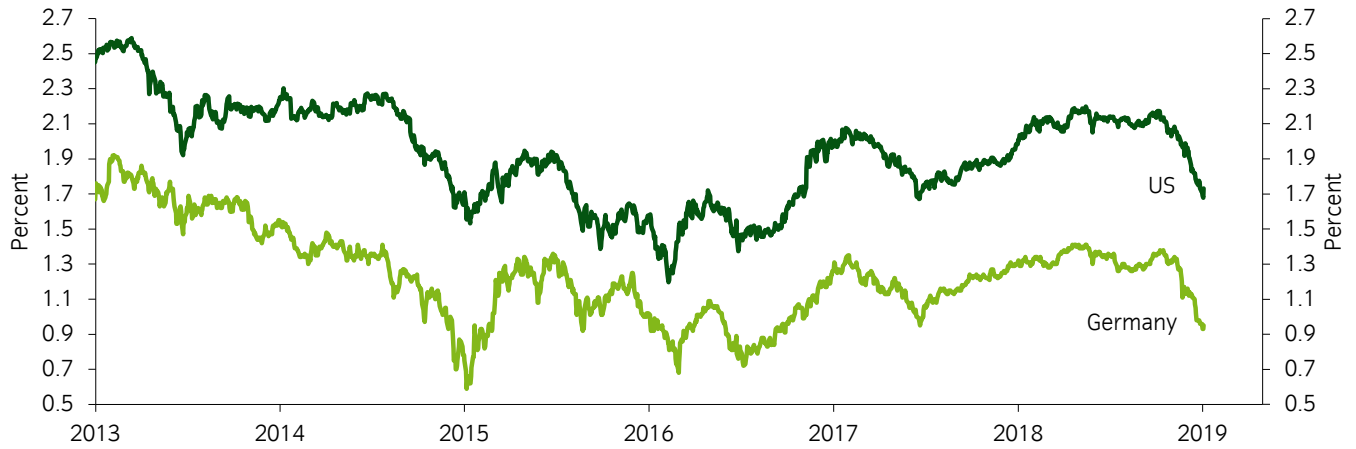
ECONOMIC AND MARKET OUTLOOK

Chart 13: Global wage growth



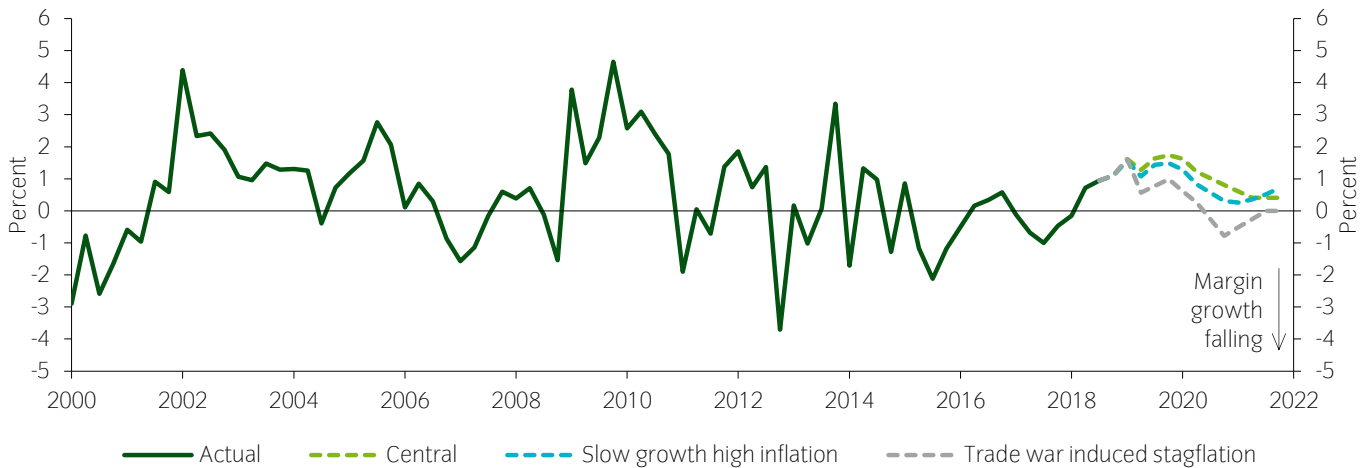
Source: Bloomberg, Thomson Reuters and Insight Investment, as of January 1, 2019.

Chart 14: US and Germany 10-year breakeven rates



Source: Bloomberg, Thomson Reuters and Insight Investment, as of January 1, 2019.

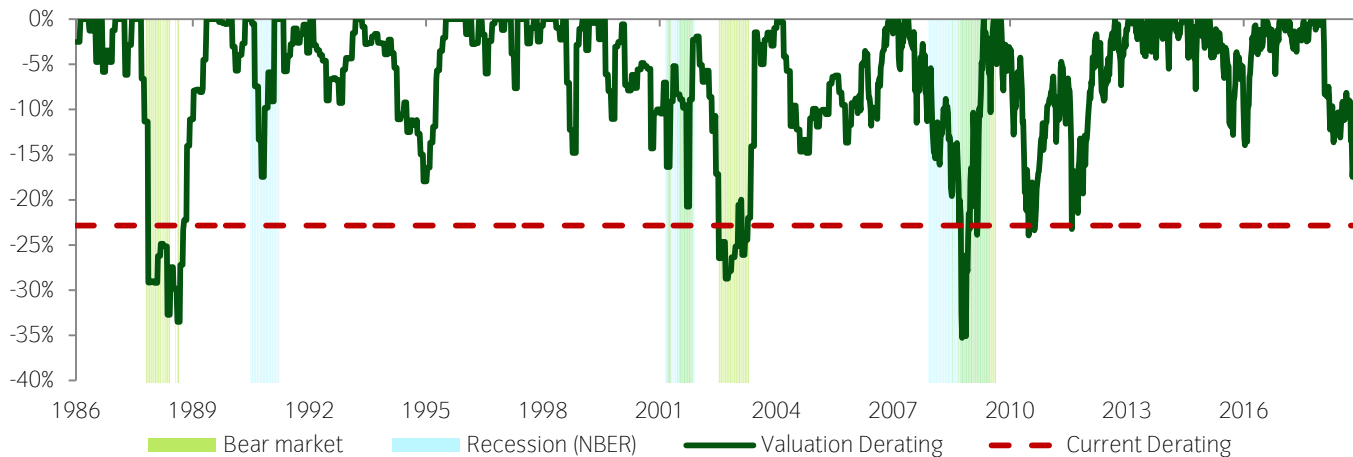
Chart 15: US corporate profit margin scenarios



Source: Bloomberg, Thomson Reuters and Insight Investment, as of January 1, 2019.

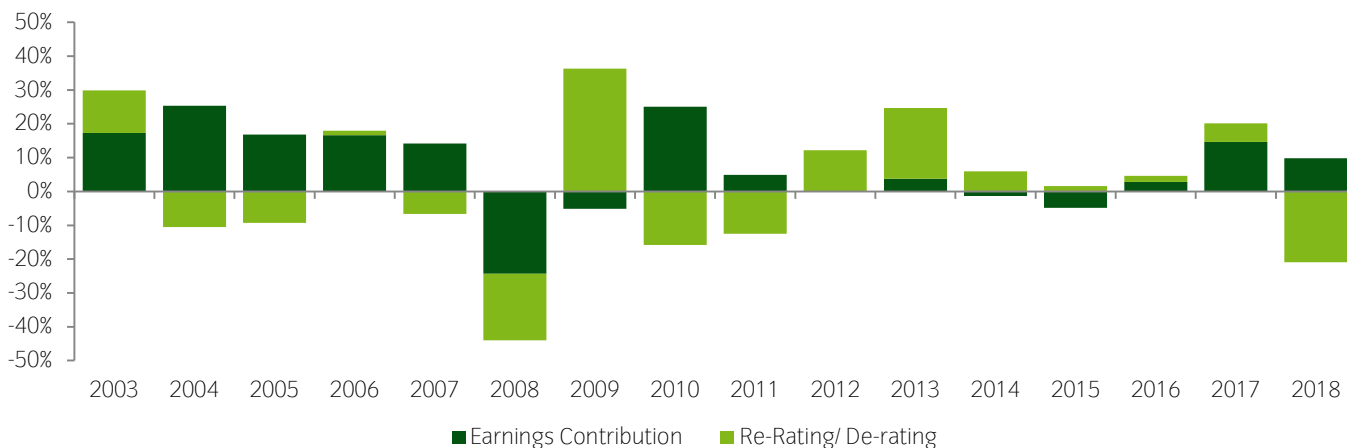
ECONOMIC AND MARKET OUTLOOK

Chart 16: US equity de-rating in 2018 compared to previous bear markets and recessions



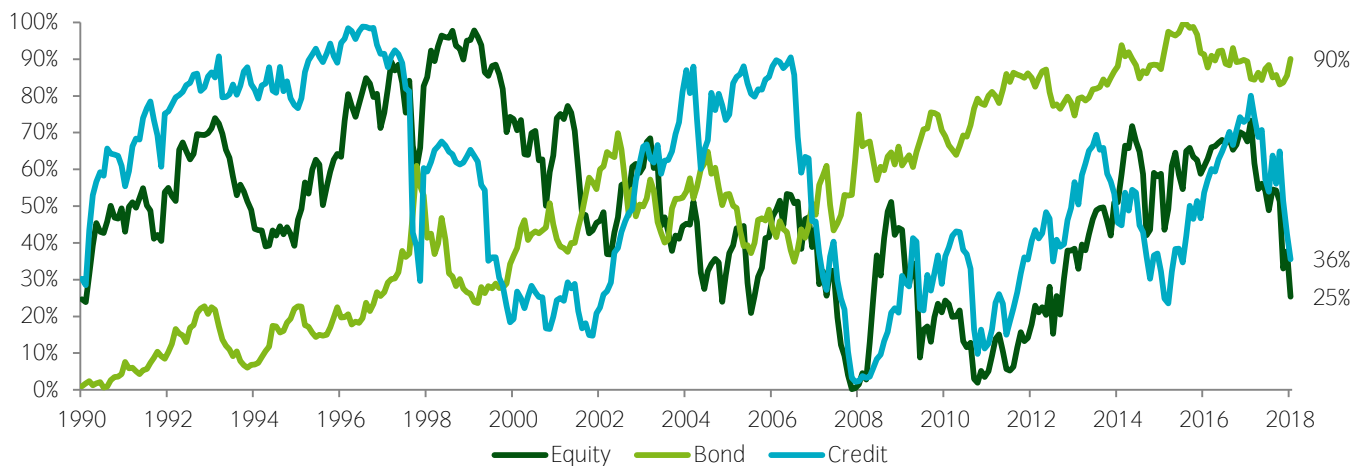
Source: Bloomberg, Thomson Reuters and Insight Investment as of January 1, 2019.

Chart 17: Global equity valuations – earnings growth versus re-rating/de-rating



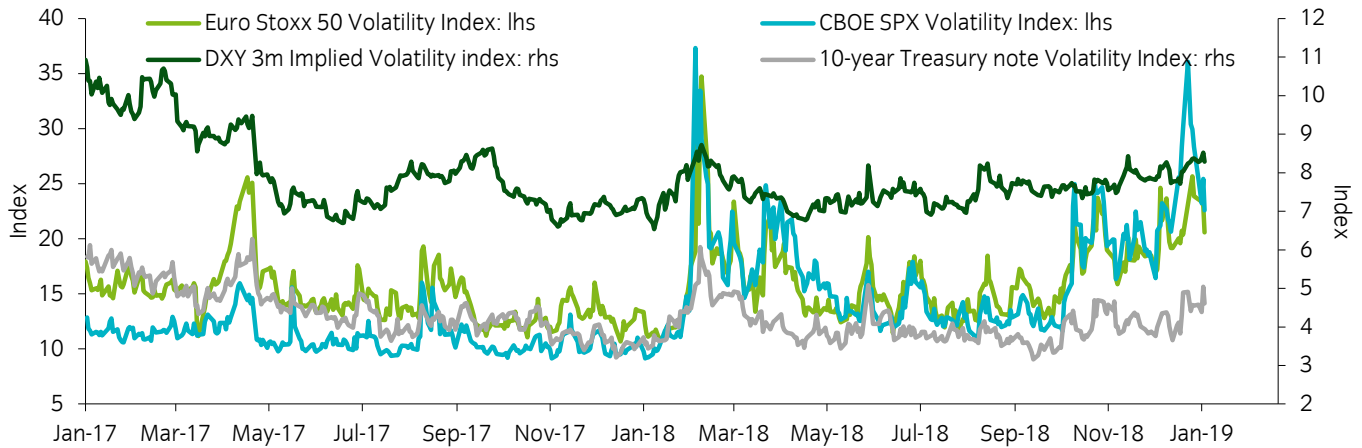
Source: Bloomberg, Thomson Reuters and Insight Investment as of January 1, 2019.

Chart 18: Global cross-asset valuations



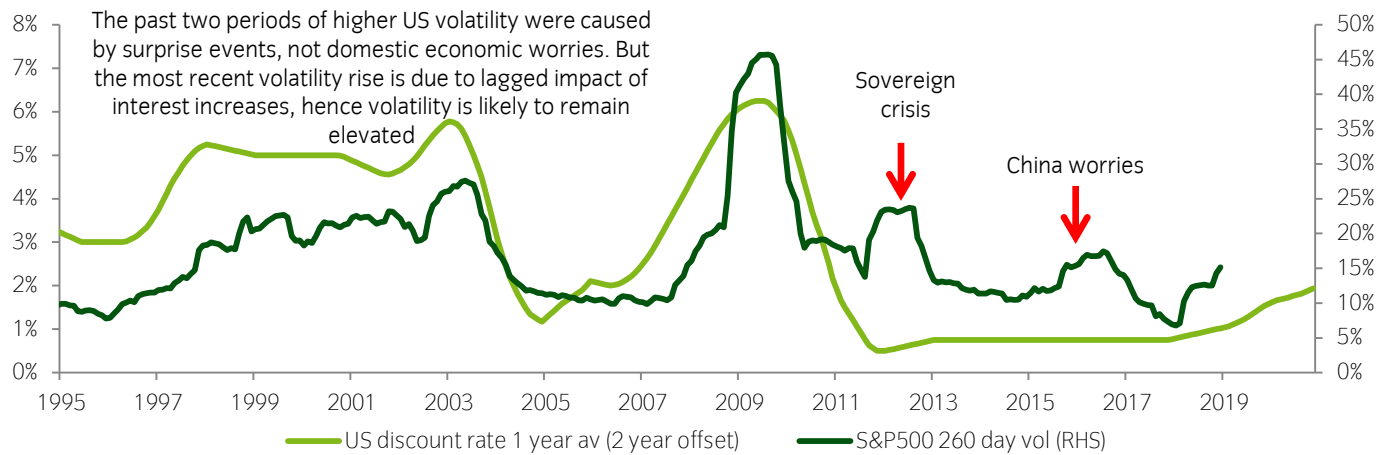
Source: Bloomberg and Insight Investment as of January 1, 2019.

Chart 19: Cross-asset volatility



Source: Bloomberg and Insight Investment as of January 1, 2019.

Chart 20: Real rates and volatility



Source: Bloomberg and Insight Investment as of January 1, 2019.

Chart 21: S&P 500 Index 1-year implied correlations



Source: Bloomberg and Insight Investment as of January 1, 2019.

## FINANCIAL MARKET OVERVIEW IN NUMBERS

		2012	2013	2014	2015	2016	2017	2018
<b>Equities</b>								
MSCI – World	ann. chge, %	+13.2	+24.1	+2.9	-2.7	+5.3	+20.1	-10.4
MSCI – North America	ann. chge, %	+12.9	+27.6	+10.3	-2.4	+9.8	+19.2	-7.1
MSCI – Latin America	ann. chge, %	+5.4	-15.7	-14.8	-32.9	+27.9	+20.8	-9.3
MSCI – Europe	ann. chge, %	+13.4	+16.4	+4.1	+5.5	-0.5	+7.3	-13.1
MSCI – Asia	ann. chge, %	+13.6	+9.3	-2.5	-4.3	+2.3	+28.7	-15.6
S&P 500	ann. chge, %	+13.4	+29.6	+11.4	-0.7	+9.5	+19.4	-6.2
Eurostoxx 50	ann. chge, %	+13.8	+17.9	+1.2	+3.8	+0.7	+6.5	-14.3
FTSE 100	ann. chge, %	+5.8	+14.4	-2.7	-4.9	+14.4	+7.6	-12.5
Nikkei 225	ann. chge, %	+22.9	+56.7	+7.1	+9.1	+0.4	+19.1	-12.1
ASX 200	ann. chge, %	+14.6	+15.1	+1.1	-2.1	+7.0	+7.0	-6.9
KOSPI	ann. chge, %	+9.4	+0.7	-4.8	+2.4	+3.3	+21.8	-17.3
Bovespa	ann. chge, %	+7.4	-15.5	-2.9	-13.3	+38.9	+26.9	+15.0
Hang Seng	ann. chge, %	+22.9	+2.9	+1.3	-7.2	+0.4	+36.0	-13.6
Shenzhen Composite	ann. chge, %	+1.7	+20.0	+33.8	+63.2	-14.7	-3.5	-33.2
Sensex	ann. chge, %	+25.7	+9.0	+29.9	-5.0	+1.9	+27.9	+5.9
<b>Bonds</b>								
US 2-year yield	ann. chge, bp	+1	+13	+28	+38	+14	+69	+60
DE 2-year yield	ann. chge, bp	-16	+23	-31	-25	-42	+14	+2
UK 2-year yield	ann. chge, bp	-0	+24	-12	+21	-57	+35	+31
JP 2-year yield	ann. chge, bp	-4	-0	-12	+1	-17	+5	-1
AU 2-year yield	ann. chge, bp	-64	+1	-48	-15	-19	+14	-7
KR 2-year yield	ann. chge, bp	-56	-3	-70	-44	-1	+45	-25
US 10-year yield	ann. chge, bp	-12	+127	-86	+10	+17	-4	+28
DE 10-year yield	ann. chge, bp	-51	+61	-139	+9	-42	+22	-19
UK 10-year yield	ann. chge, bp	-15	+119	-127	+20	-72	-5	+9
JP 10-year yield	ann. chge, bp	-20	-5	-41	-6	-22	+0	-5
AU 10-year yield	ann. chge, bp	-40	+96	-150	+14	-12	-14	-31
KR 10-year yield	ann. chge, bp	-63	+43	-98	-52	+1	+38	-51
US 10yr-2yr yield	ann. chge, bp	-13	+114	-114	-29	+3	-73	-33
DE 10yr-2yr yield	ann. chge, bp	-35	+39	-108	+34	+0	+8	-20
UK 10yr-2yr yield	ann. chge, bp	-15	+95	-115	-0	-15	-40	-23
JP 10yr-2yr yield	ann. chge, bp	-16	-5	-30	-8	-5	-5	-4
<b>Forex</b>								
Trade-weighted index – USD	ann. chge, %	+0.2	+3.9	+11.6	+10.6	+1.4	-8.4	+4.4
Trade-weighted index – Euro	ann. chge, %	+1.5	+6.2	-6.0	-7.9	+2.8	+8.7	-2.4
Trade-weighted index – GBP	ann. chge, %	+3.6	-0.0	+4.0	+1.7	-14.4	-0.1	-2.6
Trade-weighted index – JPY	ann. chge, %	-12.3	-18.3	-6.5	+5.5	+5.2	-2.6	+5.7
Trade-weighted index – AUD	ann. chge, %	+4.1	-9.5	-0.5	-6.6	+0.5	+2.5	-8.5
EURUSD	ann. chge, %	+1.8	+4.5	-12.2	-10.2	-2.9	+14.0	-4.7
GBPUSD	ann. chge, %	+4.7	+2.0	-5.9	-5.4	-16.2	+9.6	-5.8
USDJPY	ann. chge, %	+12.5	+21.5	+13.9	+0.3	-3.0	-3.5	-2.6
USDAUD	ann. chge, %	+1.2	-14.0	-8.5	-10.7	-1.0	+8.2	-9.8
USDKRW	ann. chge, %	-7.6	-1.4	+3.9	+7.7	+2.6	-11.5	+4.1
USDCNY	ann. chge, %	-1.0	-2.8	+2.5	+4.6	+6.9	-6.3	+5.7

## FINANCIAL MARKET OVERVIEW IN NUMBERS

		2012	2013	2014	2015	2016	2017	2018
<b>Commodities</b>								
GSCI	ann. chge, %	+0.3	-2.2	-33.9	-25.5	+27.8	+11.1	-15.4
GSCI – Industrial metals	ann. chge, %	+3.8	-9.3	-5.9	-23.1	+18.9	+31.0	-19.0
GSCI – Precious metals	ann. chge, %	+7.1	-29.3	-3.8	-10.6	+9.4	+12.9	-2.9
GSCI – Energy	ann. chge, %	-1.6	+4.0	-45.3	-31.5	+47.9	+12.3	-20.9
GSCI – Agriculture	ann. chge, %	+3.9	-22.1	-8.3	-12.1	+2.6	-3.0	+0.6
Oil	ann. chge, %	+3.5	-0.3	-48.3	-35.0	+52.4	+17.7	-19.5

Source: Bloomberg and Insight Investment as of January 1, 2019.

## MACRO OVERVIEW IN NUMBERS

	2015	2016	2017	2018 Estimate	2019 Market forecast	2019 Insight forecast
<b>United States</b>						
GDP	2.9	1.5	2.6	3.1	2.3	2.0
Inflation	0.1	1.3	2.1	2.3	2.3	2.3
<b>Eurozone</b>						
GDP	2.3	1.8	2.3	1.6	1.7	1.2
Inflation	0.0	0.3	1.5	2.0	1.6	1.5
<b>United Kingdom</b>						
GDP	2.3	1.8	1.8	1.2	1.5	1.3
Inflation	0.0	0.7	2.7	2.0	2.2	2.1
<b>Japan</b>						
GDP	1.4	0.9	1.5	1.0	0.3	1.0
Inflation	0.8	-0.1	0.4	0.8	1.6	1.2
<b>China</b>						
GDP	6.9	6.7	6.9	5.8	6.3	6.3
Inflation	1.4	2.0	1.8	2.3	2.2	2.3

Source: Bloomberg, Thomson Reuters and Insight Investment as of January 1, 2019.

## THE INVESTMENT TEAM

Insight's broad opportunities strategy is managed by a team of 10 dedicated portfolio managers. They sit within Insight's investment division which comprises over 200 front-line investment professionals<sup>1</sup>. The team is able to harness investment ideas from all the specialist investment units within the firm ensuring that the strategy benefits from a rich source of investment ideas. The team is specialized in asset allocation, macroeconomic analysis and portfolio construction and has developed a clear and transparent investment process that allows ideas to be channeled into a robust portfolio specifically designed to meet its objectives.

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<sup>1</sup> Includes employees of Insight North America LLC (INA) and its affiliates, which provide asset management services as part of Insight, the corporate brand for certain companies operated by Insight Investment Management Limited (IIML).

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3-month USD Libid: Libid (the London Interbank Bid Rate) is the average interest rate at which major London banks borrow eurocurrency deposits from other banks. Libid is calculated through a survey of London banks to determine the interest rate at which they are willing to borrow large eurocurrency deposits. 3-month USD Libid is calculated as a monthly return based on the average month’s daily 3-month USD Libid annualized rates. The average is deannualized and then compounded on a daily basis for the month.