

INVESTMENT OUTLOOK

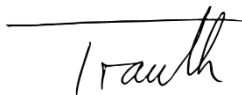
01.2018

20 January 2018

We hope you have started the year full of energy and with interesting new plans and ambitions. This is the time of the year when we usually review what happened in the previous year and plan for the year ahead. As usual, we would like to share with you our ten predictions for 2018.

In addition, we also take a critical look back at our last year's predictions, determining which ones we got right and which ones turned out to be wrong.

We look forward to another challenging year and hope you will stay with us throughout. We are very grateful for your loyalty, your feedback and your comments.

A handwritten signature in black ink, appearing to read 'Trauth', with a horizontal line above it.

Thomas Trauth

CEO – IMT Asset Management AG



LAST YEAR'S PREDICTIONS

In the following, we critically review our forecasts for last year. For the details, we refer to our Investment Outlook 01.2017.

1. Growth

Our GDP forecasts underestimated the strength of the recovery, especially in Europe. The US grew by 2.3% vs our forecast of 2.0%, the Eurozone by 2.4% vs 1.5%, Japan 1.8% vs 1.5% and China 6.8% vs 6.5%. Note that GDP growth for 2017 is based on the latest estimates since the actual 2017 figures are not yet available.

2. Inflation

In contrast, inflation surprised us on the downside. While, as expected, inflation picked up somewhat, it remained surprisingly low. US inflation was 2.2% and, thus remained below our forecast of 2.5%. Eurozone inflation was 1.5%, slightly below our forecast of 1.7%.

3. Central Banks

We expected the Fed to hike rates twice in 2017. The Fed decided, however, to hike three times instead.

As we rightly expected, the ECB kept rates unchanged and announced it would taper its bond purchases, while the Bank of Japan continued its QE program at full speed.

4. Rates

We rightly predicted a moderate rise in yields. The German 10-year government bond yield rose from

0.21% to 0.43%, while the US equivalent remained almost unchanged at about 2.4%.

5. Credits

As expected credits did well in 2017. Emerging market bonds in local currency delivered 15.2% and high-yield bonds almost 6%.

6. Equities

We were right to be positive on equities for 2017. Nevertheless, we were surprised how strongly markets performed. Instead of the expected single-digit returns, emerging markets performed 34%, the US S&P500 index 19.4%, the Japanese Nikkei225 index 19.1%, and the MSCI Eurozone index 10%. In local currency, the US and Japan clearly outperformed Europe. Taking the strong appreciation of the EUR into consideration, European equities outperformed the US and Japan.

7. Emerging markets

We were clearly too cautious on emerging markets. Emerging markets equities distinctly outperformed all other asset classes in our portfolio, and bonds also did very well, being the best performer among fixed-income assets.

8. Commodities

As expected prices for oil and industrial metals increased in 2017. The price for Brent oil rose by 17.7% and the price for a basket of industrial metals by 29.4%. Until mid-December gold traded close to the

upper band of our expected 1,000-1,200 range but started a year-end rally thereafter, which brought it to about USD 1,300 per oz at year-end.

9. Alternatives

Listed private equity did well in 2017. Our less directional absolute-return strategies delivered about the same return as investment grade bonds, which is disappointing. Nevertheless, we are happy to keep this asset class as a diversifier and as downside protection for our portfolios.

10. Currencies

We were wrong to predict a stronger USD. In fact, the USD weakened considerably and had its worst year in more than a decade. By contrast, the EUR appreciated versus most major currencies, most notably by 14% vis-à-vis the USD. We were right in anticipating a weaker JPY and GBP, at least vis-à-vis the EUR.

OUTLOOK 2018 – TEN PREDICTIONS

1. Growth

Global growth has clearly picked up. Furthermore, the upturn is more synchronized than usually observed. Monetary policy in most major economies remains accommodative (in the US) or very accommodative (Europe and Japan). Real GDP growth in the US is likely to be 2.2%; in the Eurozone it could be as high as 2.1%. In Japan we expect a GDP growth of 1.5%.

For China we expect growth of 6.5% but structural reforms could dampen it somewhat. Therefore, we see the risk for the Chinese growth outlook skewed to the downside.

2. Inflation

Despite stronger growth and improving labor market conditions, inflation stayed surprisingly low. For 2018 we expect a mild pick-up of inflation, in the US towards 2.5%, in the Eurozone towards 1.5%, and in Japan towards 1.0%. Due to a tightening labor market, a closing output gap, and an additional fiscal impulse from the tax reform, US inflation could very well deliver a surprise on the upside.

3. Central Banks

We expect the Fed to hike three to four times in 2018 but market expectations are still clearly lower than that. In mid-January the market prices indicate a 34% probability of three rate hikes and a 14% probability of four rate hikes by December 2018. A potential increase in inflation would support our view. However, we are also cognizant of the fact that the Trump administration would like to avoid a hawkish Fed, which

could derail the economic momentum. Since four out of seven positions on the Fed board come vacant in 2018 – if we include Janet Yellen's seat, when she retires later this year – President Trump has the means to influence Fed policy by his power to nominate new candidates.

The ECB will slowly reduce its asset purchase program, as already announced. Currently, market expectations for the first ECB rate hike stand at 15 months, i.e., March 2019. As the European economy is on a strong footing, we rather see the risk of the ECB turning more hawkish and speeding up the process of normalization. Mario Draghi's term as president of the ECB expires on 31 October 2019. Public discussion regarding his successor is already ongoing.

The Bank of Japan may lift its 10-year yield target somewhat in the second half of 2018.

4. Rates

Further Fed rate hikes in 2018 coupled with a potential pick-up of inflation are likely to drive US 10-year rates higher. We expect 10-year yields to rise towards 2.8% in 2018, and European yields to reach 0.9%. Since, in our view, especially US yields will be driven by rising inflation expectations, inflation-linked bonds are likely to outperform nominal bonds.

5. Credits

While US credit spreads have reached very tight, i.e., expensive levels, the yield-seeking market environment should continue to support credits. It is very unlikely that in 2018 the incidence of defaults would rise

meaningfully. However, as capital spending may finally start to rise, corporate leverage may increase somewhat. Therefore, we remain positive on US investment-grade and high-yield bonds. In Europe, however, spreads may move wider, since spread levels are lower than in the US and the supply/demand balance is likely to shift when the ECB continues to taper.

6. Equities

The robust and broad-based positive growth outlook should lead to solid earnings and good performance of equity markets in general. We favor European, Japanese and Emerging Markets equities. However, depending on how major currencies move in 2018, our regional preferences may change. Especially a stronger USD could provide headwind for emerging markets.

It is often feared that rising rates could trigger an equity market correction. However, equity markets have never corrected with US real money market rates below 2%. Currently, real rates are still negative. In addition, in the history of the last 30 years only one bond bear market was associated with negative equity market returns. This was in 1994 when US 10-year yields rose by 2%-points from 5.8% to 7.8% and the S&P500 fell 1.5%.

7. Emerging markets

In general, the growth outlook for emerging markets is even better than for developed markets. Rising commodities prices provide additional support for many of the commodity-producing emerging markets. Therefore, we stay constructive for emerging markets bonds and equities.

Nevertheless, there are a number of risks to observe. A rebound of the USD and a stronger rise of US yields could provide strong headwind for emerging markets. We will also keep a careful eye on how structural reforms and deleveraging in China might slow down Chinese growth and, in turn, growth in other emerging economies.

8. Commodities

We are moderately positive on oil prices as the OPEC's strategy of cutting production seems to work. However, we do not see Brent oil moving above USD/bl 80, since there is an ample supply, not least from US shale producers.

Regarding industrial metals we see some downside, after prices rallied by 29.4% in 2017 and since Chinese growth is likely to slow down. China has by far the greatest demand for industrial metals, greater than that of the rest of the world combined.

We continue to be skeptical about the outlook for gold prices, since economic growth is solid and real rates are bound to rise in 2018.

9. Alternatives

REITS had a bad year in 2017. There was reduced demand for low beta stocks and there were concerns that rising yields could negatively impact REITS. We would not be surprised to see a better market for REITS in 2018, since REITS should benefit from better growth, which drives up rents.

Absolute-return strategies and hedge funds should benefit from rising volatility and rising dispersion. We expect markets to pay more attention to fundamental developments as funding costs increase and valuations in general have become more demanding.

10. Currencies

Sentiment and momentum continue to support the EUR, despite short-term yields spreads reaching 2.7%-points. The EUR-USD yield spread is very likely to widen even further in 2018 since the Fed will continue to hike rates and the ECB is unlikely to hike before 2019. Also, speculative positioning has moved from a record long USD end of 2016 to a large short USD position. As a result, we expect the USD to rebound in the first half of 2018. As we will then come closer to first ECB rate hikes, the EUR will extend its gains. We expect the GBP to stay on the weak side, since the Brexit negotiations will prove to be very

tricky, and the UK will find it hard to finance its large current account deficit. On the other hand, the GBP looks very cheap by various measures and positive turns in the negotiations could lift it.

Normalization of monetary policy in Europe should help to further weaken the CHF, which still appears to be overvalued.

Major risks to watch in 2018

Overheating markets

Usually we look for downside risks in this section. However, for 2018 we see the possibility of overheating markets, which could boost equity and credit markets further and provide large double-digit returns. It is not unusual for markets to accelerate in the last part of the cycle and drive valuations beyond rational levels.

Further support for such a scenario comes from a pro-cyclical monetary and fiscal policy mix in the US. There is an argument that US monetary policy is currently too loose for the present phase of the cycle. In addition, and as mentioned above, the Trump administration could try to influence the Fed to keep rates low for even longer. Furthermore, the fiscal policy of large debt-funded US tax cuts will take effect when the US economy is already at or even beyond full capacity.

While this scenario would be very positive for investors in 2018, it would clearly increase the magnitude of a potential correction in the following years.

Italian elections

Italy's general elections will be held on 4 March. The Eurosceptic and anti-establishment Five Star Movement (M5S) leads the opinion polls with about 30% of the votes. The center-left Democratic Party (PD), which currently leads a broad coalition, has fallen sharply in the polls. It is very unlikely the elections will

lead to a clear mandate; instead another broad coalition or a hung parliament become increasingly likely. Either of the two outcomes make it very unlikely that we will see urgently needed economic reforms. Furthermore, since Eurosceptic forces are on the rise, this may spark uncertainties about the stability of the Eurozone as a whole.

China

On conclusion of the nineteenth National Party Congress on 25 October 2017, President Xi had further consolidated his power. He appears to be the most powerful Chinese leader since Deng Xiaoping. President Xi made clear where he sees his priorities. Among other things, he is committed to deleveraging the economy and to restructuring industry. This is likely to dampen growth in 2018. While leading indicators are still robust and suggest that Chinese growth will hold up, we at least see a certain downside risk. If the slow-down turns out to be more drastic, it has the potential to dampen growth especially in other emerging markets.

Strong deflation in combination with more hawkish central banks

Another risk might arise if the so-far surprisingly low inflation were to pick up rapidly. This is a risk in the US especially. If, for example, US wage growth were to accelerate significantly, US inflation could easily rise towards 3% or beyond. A rapid pick-up of inflation would certainly be alarming for the US Fed and could lead to more rapid rate hikes. Rapid rate hikes towards or beyond the neutral real rate, which is believed to be about 2%, would certainly spark recession fears and sharp corrections of equity markets.

Conclusions for asset allocators

In our base-case scenario, we expect risky assets to perform well in 2018. Central banks, especially the US Fed and the ECB will continue to normalize monetary policy, albeit at a measured pace. While the US Fed will move closer to a neutral policy stance, which could be reached towards the end of 2018, the ECB and the Bank of Japan will remain very accommodative. Better growth and earnings together with favorable monetary conditions, should continue to support risky assets, most notably equities and credit. Equity markets should do well, although we expect returns to fall short of the 2017 returns. Investment-grade and high-yield bonds look pricy to us, but may

still deliver positive returns. European bond markets, could, however, come under pressure when ECB tapering reduces demand for bonds.

We remain cautious regarding government bonds and expect yields to rise – most likely driven by rising inflation expectations.

We start the year with a portfolio tilt towards risky assets, albeit not very aggressively. We continue to underweight government bonds. We have slightly increased our exposure to less directional absolute return strategies and have reduced our cash and bond allocation.

ECONOMICS

In 2017, growth indicators improved across the board. Furthermore, global growth was remarkably synchronized. Job creation was strong in most countries. Tightening labor markets and rapidly closing output gaps, however, did not lead to a meaningful

pick-up of inflation nor of inflation expectations. We see no sign of slowing growth momentum. We expect that sooner or later inflation will pick up, which should move long-term rates higher eventually.

Fig. 1: PMIs

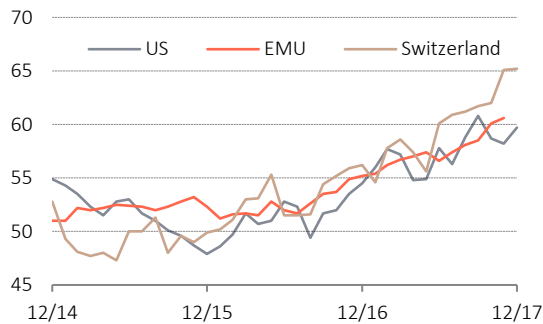


Fig. 2: PMIs

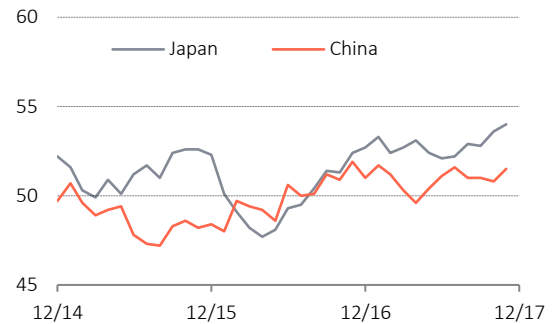


Fig 3: Consumer price inflation, in % YoY

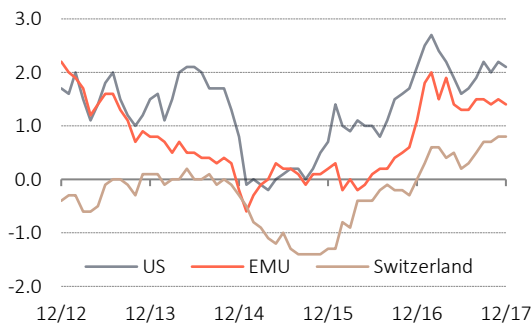


Fig. 4: Consumer price inflation, in % YoY

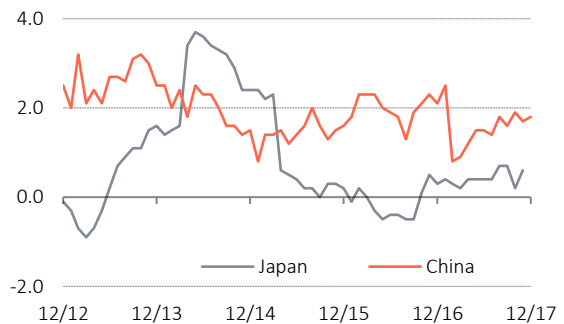


Fig 5: Unemployment rates, in %

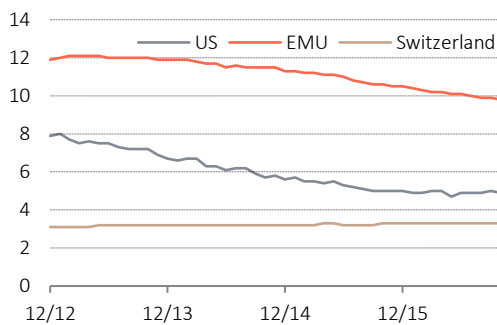
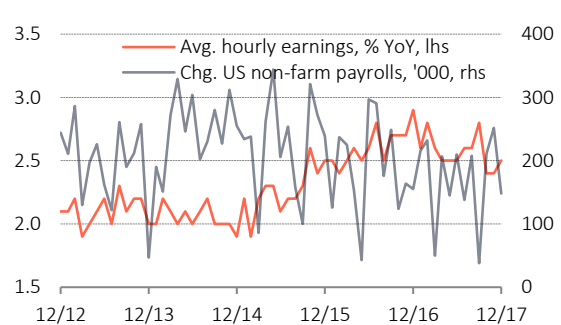


Fig 6: US labor market



FIXED INCOME

In 2017, especially US short-term rates increased noticeably, driven by Fed rate hikes. As a result, the yield spread between the US and Europe widened even further. The long-end of the yield curves and inflation

expectations remained remarkably stable, though. Credit spreads tightened further and especially emerging markets bonds performed very strongly in 2017.

Fig.7: 2Y government bond yields

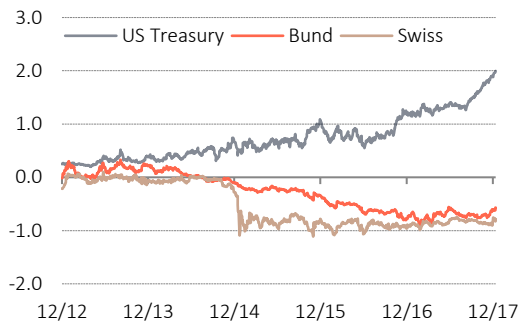


Fig. 8: 10Y government bond yields

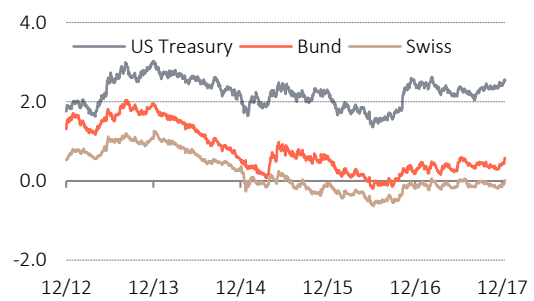


Fig 9: 10Y break-even inflation

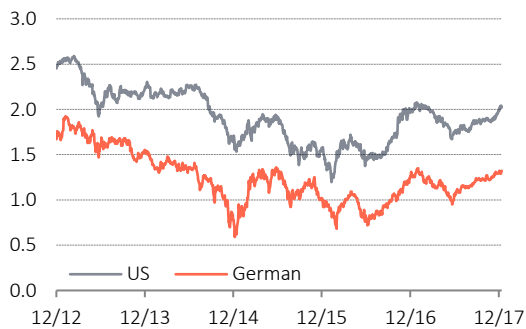


Fig. 10: Credit spreads, 5Y credit default swaps

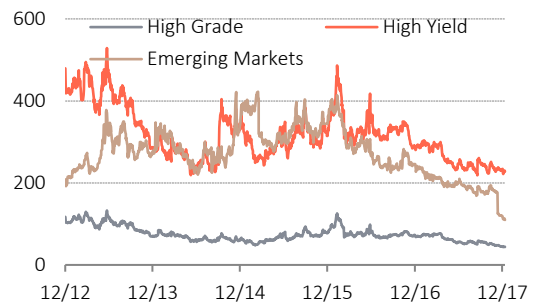


Fig 11: Money market spreads (3M-2Y)

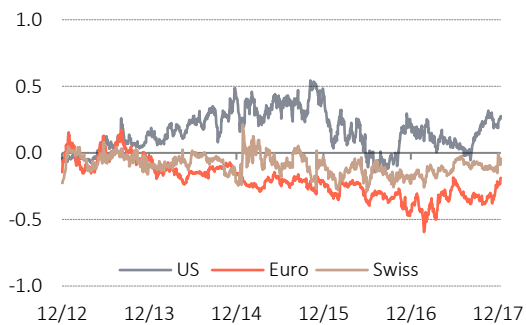
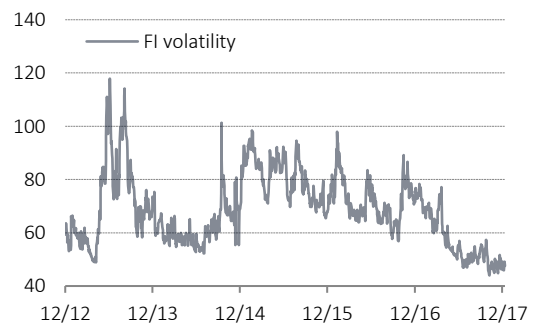


Fig 12: Merrill Lynch volatility index



EQUITIES

Equity markets rallied strongly in 2017. Emerging markets outperformed. The MSCI Emerging Markets index rose by 34%. The MSCI Developed Markets climbed by 20%. The S&P500 and the Nikkei225 outperformed among developed markets with 19%. The

best performing sectors are energy, technology and financials.

Fig. 13: MSCI equity indices – major regions

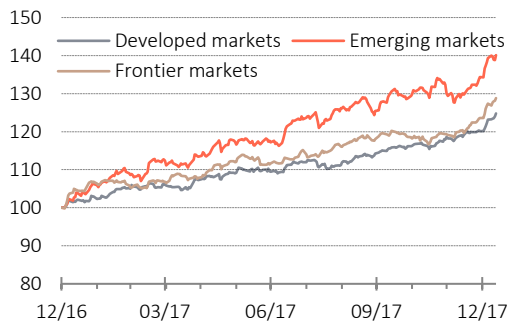


Fig.14: Equity indices – major developed markets

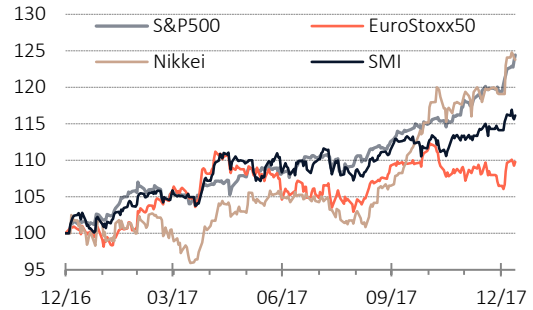


Fig 15: Equity indices – major emerging markets

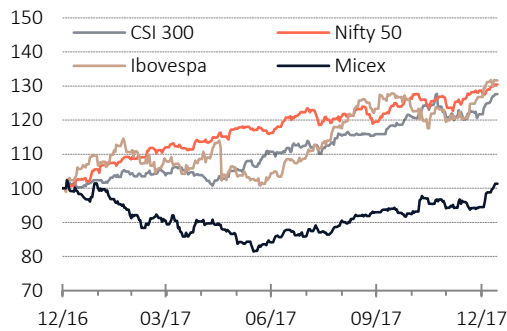


Fig. 16: Sector performance, MSCI Europe, 2017

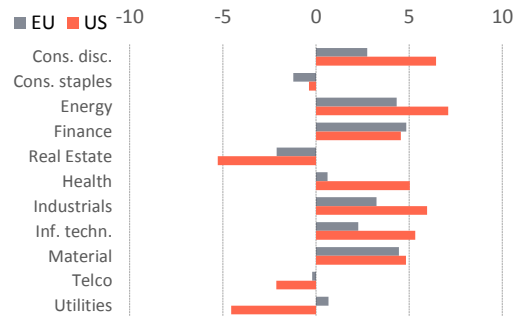


Fig 17: Price-earnings ratios

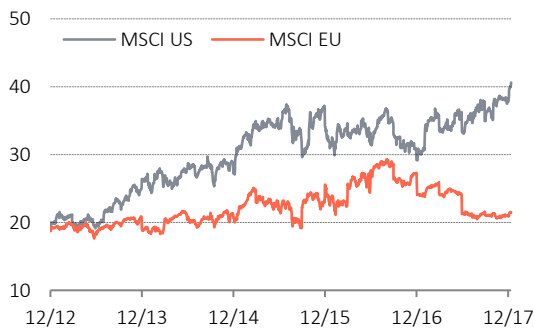
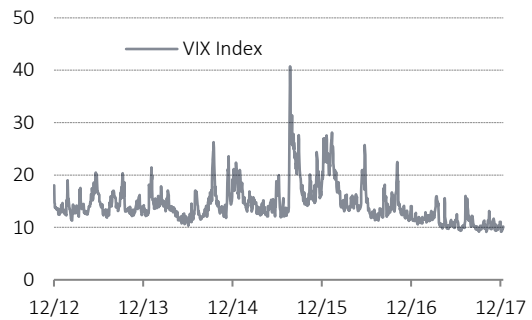


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

In 2017 better growth boosted prices for industrial metals – up by almost 30% - and oil. The price for Brent oil rose almost 18%. The gold price climbed 13.5% despite a benign risk environment, low inflation and rising interest rates. REITS underperformed

due to their sensitivity towards rising yields. Global listed private equity was up by 10%.

Fig. 19: Gold price, USD/oz



Fig.20: Oil price, USD/bl

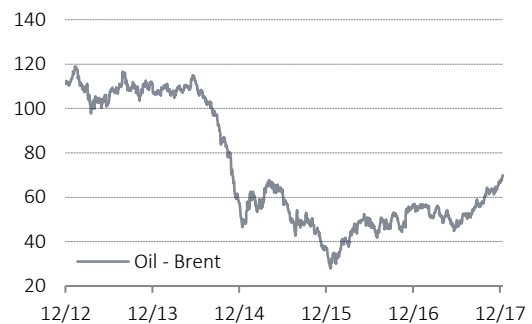


Fig 21: Bloomberg commodity indices

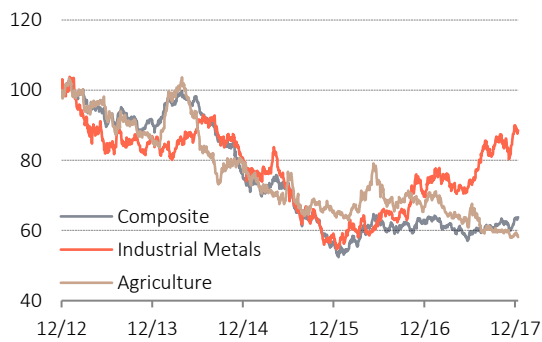


Fig. 22: HFRI hedge fund indices

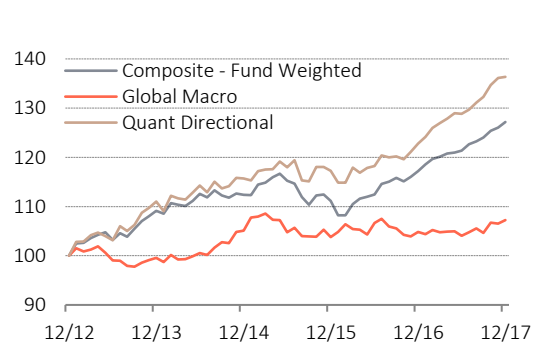
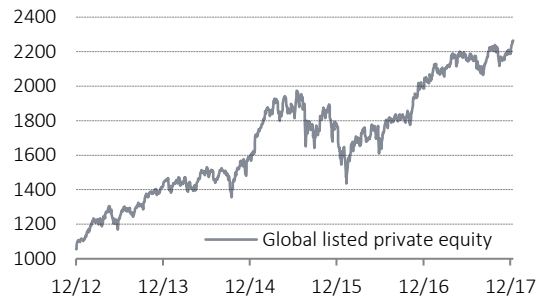


Fig 23: FTSE EPRA/NAREIT global index



Fig 24: LPX global listed private equity



CURRENCIES

The major theme in 2017 was the broad-based EUR strength / USD weakness. This occurred despite historic wide rates differentials in favor of the USD. The GBP was able to recover from the pronounced Brexit

sell-off in the second half of 2016. The CHF finally weakened more significantly vis-à-vis the EUR, but still continues to be overvalued in our view.

Fig. 25: EUR-USD exchange rate



Fig. 26: GBP-USD exchange rate

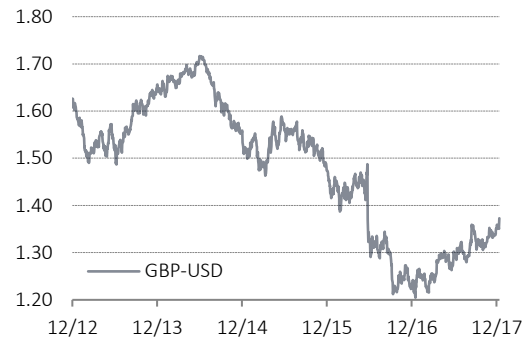


Fig. 27: USD-JPY exchange rate



Fig. 28: USD-CNY exchange rate



Fig. 29: EUR-CHF exchange rate

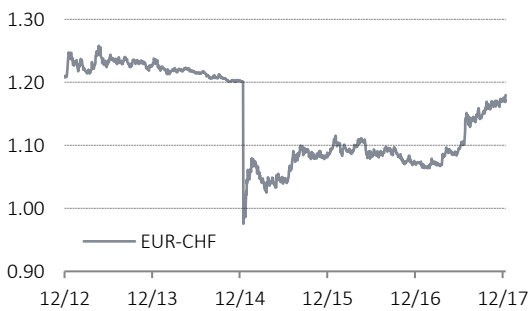
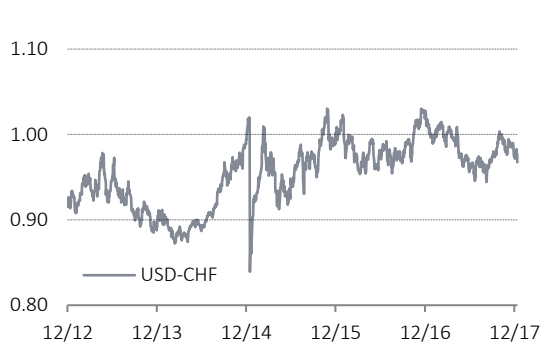


Fig. 30: USD-CHF exchange rate

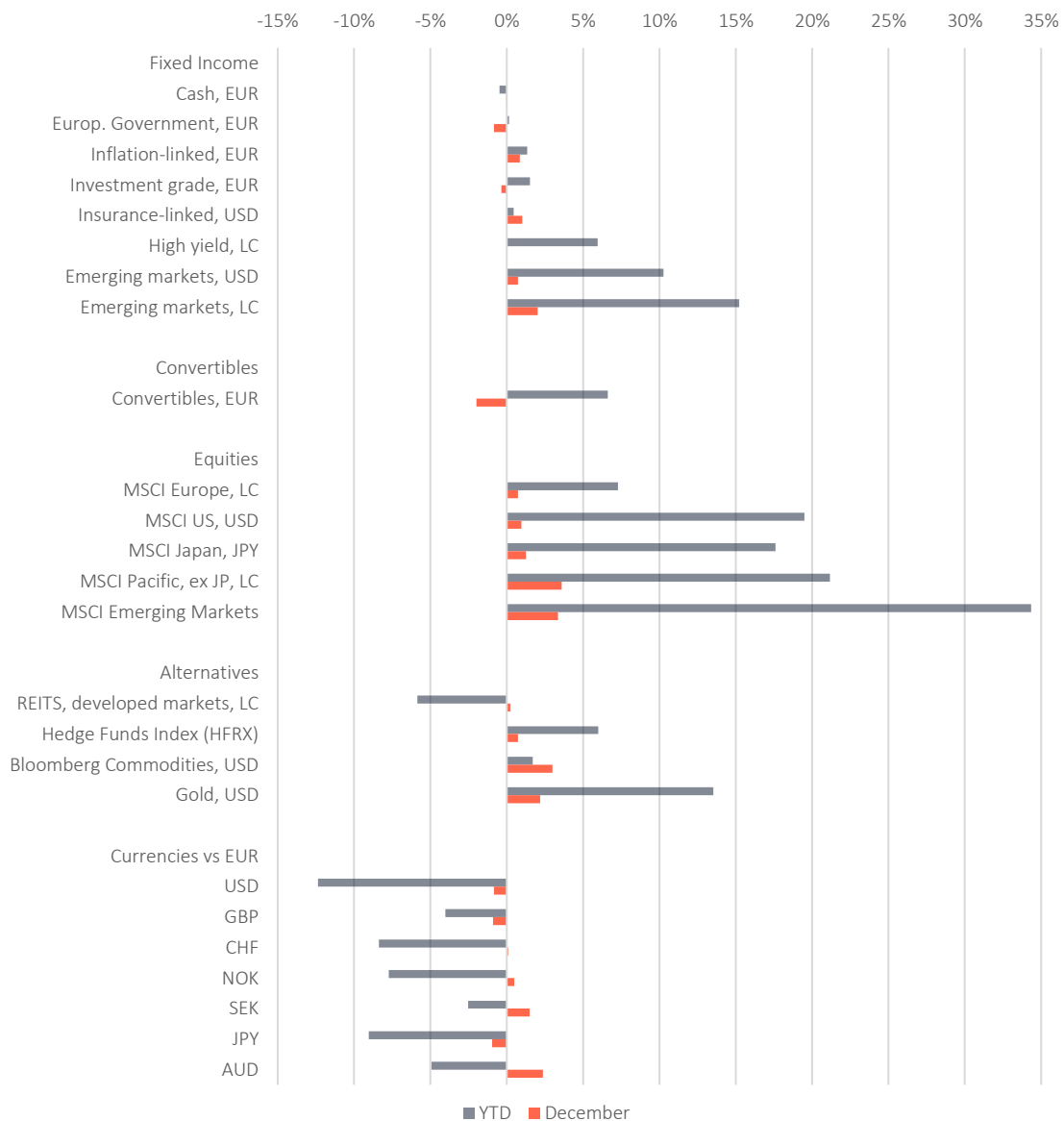


ASSET ALLOCATION

2017 was exceptionally good for multi-asset class investors. Risky assets rallied, while safe haven assets did not lose much. Interest-rate sensitive REITS were an exception and had a difficult year. Other than that, EUR strength was a major theme in 2017.

Most currencies devalued against the EUR, which had a negative currency effect in EUR portfolios. Since we reduced our foreign currency exposures in recent years, the negative impact was rather limited.

Fig. 31: Performance of major asset classes, based on our EUR portfolio strategy



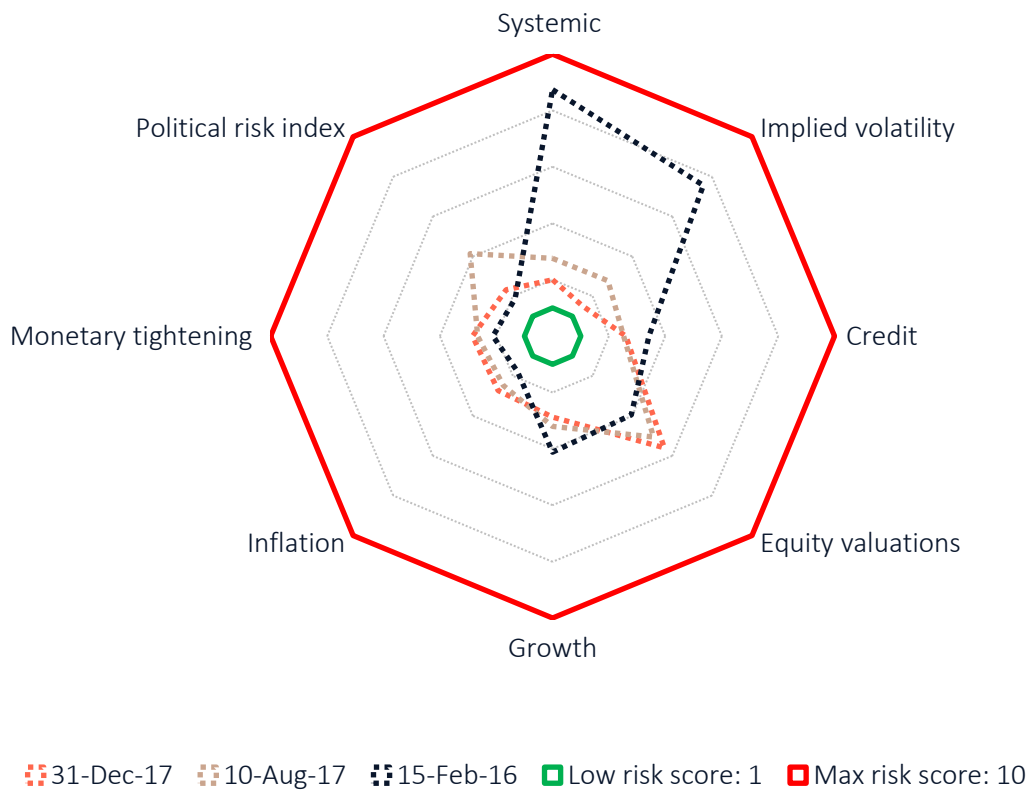
RISK MONITOR

Throughout the year neither of our risk indicators spiked significantly. We highlight below the increase of the political risk index in mid-August, when the rhetoric of political leaders regarding North Korea caused some concern. However, there

was no contagion effect on other financial market risk indicators. Throughout the year, our equity valuation risk indicator went up, and this remains one of our focus areas to monitor.

Fig. 32: IMT Risk Monitor

15 Feb 2016: China growth fears
10 Aug 2017: North Korea tensions



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