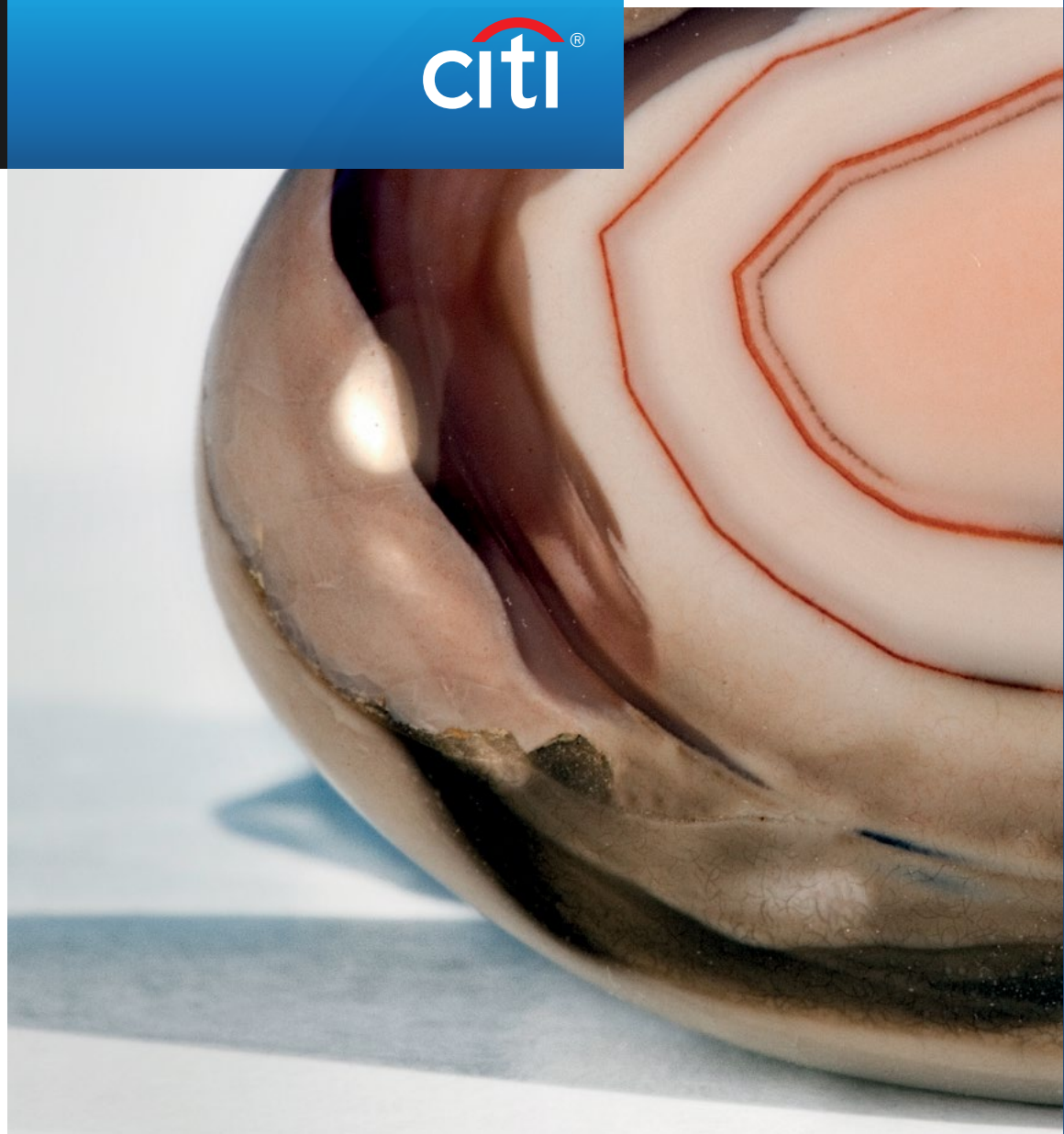


Private Bank



Growth, uninterrupted

Mid-year review and outlook 2017



Growth, uninterrupted

Steven Wieting, Global Chief Investment Strategist

With policy and political shocks failing to materialize, world markets have continued to advance. While there will be challenges, we see a more durable global growth outlook.

Is it just a run of good luck that the world economy and financial markets have shrugged off recurring political fears and diverging monetary policy? We doubt it. Since the release of our [Outlook 2017](#) report in January, the Citi Private Bank Global Investment Committee (GIC) has noted increasing evidence that the world economy will prove more resilient than previously anticipated. For the first time since the early stages of the present

economic recovery, Citi Research has not revised its annual global growth forecasts downwards. Against this backdrop, the GIC has raised allocations to global equities, decreased allocations to certain fixed income assets, and upgraded emerging markets (EMs) across both asset classes – **figure 1**. We would consider adding to these positions on market weakness, bouts of which tend to be common but short-lived during the summer months.

Figure 1. Changes to our tactical asset allocation in 2017 to date



Increased **global equities** weighting to neutral from 1.0% underweight

- + Increased EM equities to overweight (all regions, country specific)



Decreased **global fixed income** weighting from 1.0% underweight to 1.5% underweight

- + Increased EM local currency bonds to larger overweight (all regions, country specific)
- Decreased Euro corporate investment grade debt to underweight
- Decreased Euro high yield debt to smaller overweight
- Decreased US high yield debt to smaller overweight
- Decreased US inflation-linked Treasuries to neutral



Decreased **cash** weighting from 1.5% overweight to 1.0%

Source: Citi Private Bank, as of 15 May 2017

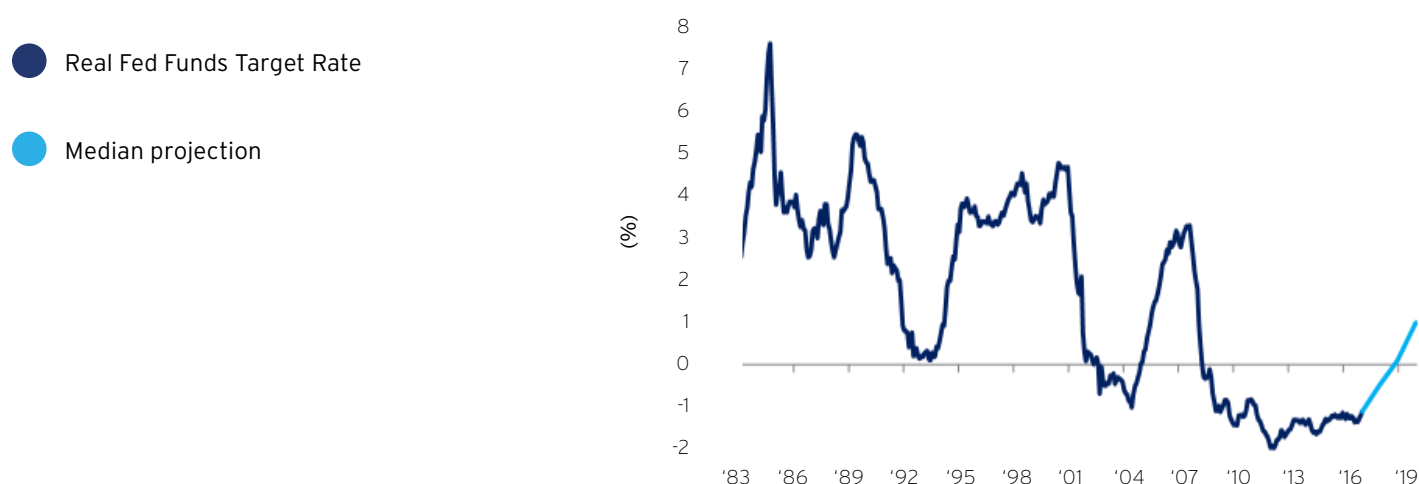
The US Federal Reserve has raised policy interest rates twice since December and three times since late 2015. It hints at plans to shrink its bond portfolio in what some are sure to call “Quantitative Tightening.” And yet, the US dollar has weakened this year. We suspect this is largely as a result of the trade-weighted dollar having risen 33% since mid-2011. It also reflects the purposely mild rate-hiking path predicted by the Fed in comparison to past cycles – **figure 2**.

As we discuss in our new theme – see [Emerging opportunities](#) – we expect to increase further our allocations to non-US dollar investments over time, while remaining mindful of overall asset class risk so late into an economic recovery. For most of the past four years, the GIC has recommended a tactical asset allocation for global investors skewed towards US dollar denominated holdings. During much of that period, we were underweight EMs as a strengthening dollar increased external debt burdens for most EM borrowers. Broad EM asset classes underperformed for most of that time.

By late 2014, the natural resources boom in US oilfields had undermined global energy producers, culminating in the oil-price crash that bottomed out in early 2016. Despite occasional setbacks, that price crash laid the foundations for solid EM asset performance from that point, which we believe can continue, especially given current valuations. Across EM regions, equities are now valued somewhat below their own long-term average and at a 45% discount to US equities by one key measure – figure 3 in [Emerging opportunities](#). Local currency government bonds in emerging markets on average yield six times more than Eurozone corporates of all credit ratings. Evidence is building that most EM country balance sheets are sufficiently robust to endure a mild US monetary tightening cycle better than they could have just a few years ago.

While we don’t recommend highly concentrated home-currency portfolios – especially for investors in small countries – we see opportunities from investing and diversifying more broadly than US dollar denominated assets.

Figure 2. Inflation-adjusted US Fed Funds Target Rate and Fed projections



Source: Haver Analytics and Federal Reserve as of 31 May 2017. Note: Median projections are those of Federal Open Market Committee members. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events.

European populism abates

In 2017 to date, the threat to the Eurozone that we discussed in [The populist challenge and portfolios](#) has receded somewhat, including the defeat of a prominent Eurosceptic in March's Dutch general election. In France, Emmanuel Macron's presidential election victory in May denied his nationalist rival Marine Le Pen the chance to push for their country's departure from the Euro and the restoration of the franc. However, risks on the continent remain. Brexit negotiations will still result in frictions which will impact both the UK and the European Union, even though the vote to leave the EU has had far less effect so far than was initially feared.

We would caution against complacency, however. The widening economic divide between the Eurozone's more prosperous northern countries and its struggling south leaves a significant risk to the monetary union over time. Still, political risks have not overwhelmed the strengthening economic recovery in the region as a whole. This allows us to consider equities from a widening range of countries and regions looking forward - **figure 3**. But despite our shift away from dollar denominated assets, we should not ignore the US. Corporate profits grew at a near 15% year-on-year pace in the first quarter, suggesting very solid full-year earnings progress in 2017.

US policy impact

In terms of trade and fiscal policy, we remain more confident than financial markets that the US Republican-led government will achieve some of its main goals. Overall, however, the US is looking both less disruptive and less exceptional within a world economy that is finding its legs.

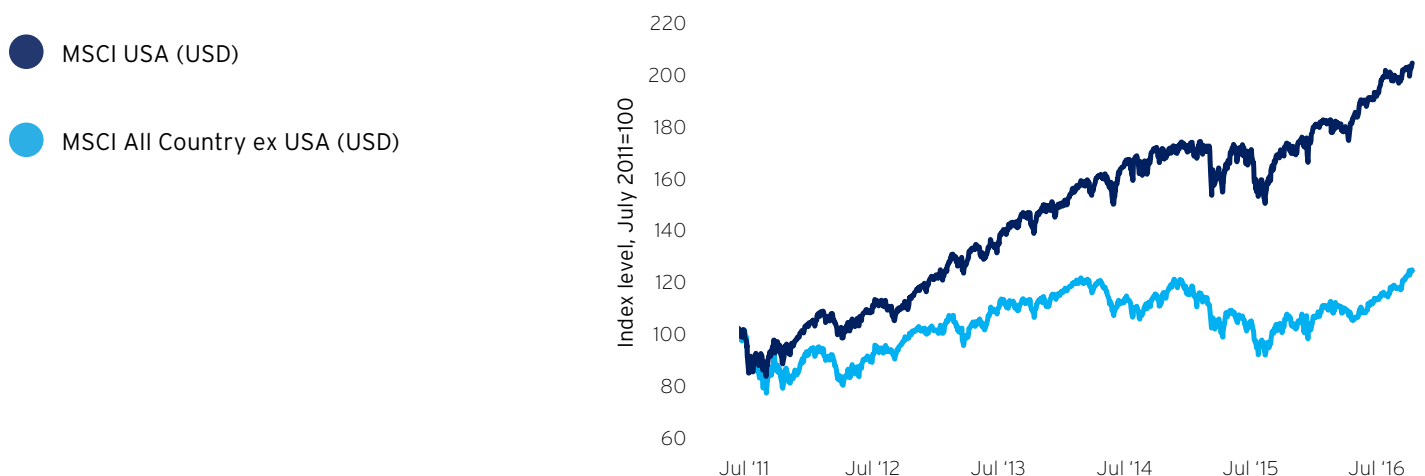
Promises of large tax cuts have not been made outside the US, yet growth indicators abroad have accelerated.

Global markets could yet recoil over certain US policies. President Trump has imposed tariffs on Canadian lumber after a long-running dispute. His administration's aims around the North American Free Trade Agreement are still not fully known. However, his apparent willingness to negotiate across multiple areas of interest with China hints at reduced risk of severe trade disputes, a key early fear surrounding his incoming administration.

Meanwhile, amid legitimate concerns of domestic economic dislocation, the Trump administration has come out against the House Republican "Border Adjustment Tax" plan, at least in its current form. The plan would impose import tariffs and painfully disallow the deduction of imported goods as a business cost. We believe this complex plan is quite unlikely to be used to fund domestic tax cuts without substantial revision. With or without this mechanism, Congressional debate suggests the size of prospective US tax cuts - and thus of the rise in US borrowing requirements or offsetting taxes - will be less substantial than first believed.

We would urge investors not to extrapolate failures and setbacks of the US Congress too far. Many failed votes or attempts will change nothing. A tax bill that reshapes the US growth outlook for 2018 and moves financial markets needs to find sufficient votes to pass just once. As we write, it is still not possible to fully understand the goals and policy approach the new US administration will follow to achieve its election campaign promises. Confidence in what it can achieve - or disrupt - has waned for now. But we think there is a good chance that such confidence could return again and seek to position ourselves accordingly.

Figure 3: International equities' catch-up potential



Source: Bloomberg, as of 15 May 2017. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Past performance is no guarantee of future results, and future results may not meet our expectations due to a variety of economic, market and other factors.



Review and update of themes

Position for higher rates

We think it quite plausible that the Federal Reserve will carry out its projected two further 0.25% rate-hikes in 2017, although it might possibly delay one or the other move. Against this backdrop, we continue to find US fixed income appealing relative to that of other developed markets. As has been the case in every previous tightening cycle bar none, the US Treasury yield curve has flattened, with short rates moving up relative to long-term rates. This has helped US bonds and credit outperform other developed market bonds year to date. It has also helped emerging market fixed income to outperform, as US rates have not risen to levels that would draw funds away.

We see US bond yields rising from present levels late in the year, and have somewhat reduced our overweight in high yield bonds as credit spreads have tightened. That said, we have not pared back our overweight in US high yield loans, which benefit from adjustments up in LIBOR and from significantly lower asset price volatility than high yield bonds. Yields are now near 5.3%, very close to those of high yield bonds, even though loans rank higher in capital structure. Their floating rate structure reduces effective duration and provides a way to benefit from the Fed's rate hikes.

Allocating to infrastructure The liquidity tradeoff

We continue to see increased infrastructure investment from public and private sources as a means of improving global growth potential. Such investment is favored by most policymakers in a world dogged by under-investment, with the sole exception of China, where over-investment has been the problem. As we warned in [Allocating to infrastructure](#), however, markets were running ahead of political reality in some cases. Particularly in the US, the notion that the Trump administration would quickly receive congressional approval to spend \$1 trillion or more on infrastructure seemed to us the least probable component of fiscal easing. No funds have been allocated to building a border wall with Mexico in a bi-partisan deal to fund the US government until fiscal year-end. With confidence in the likelihood of US legislative action waning, US infrastructure equities have underperformed broader domestic equities slightly after surging in late 2016. Nonetheless, global infrastructure equities have outperformed global equities both this year and over the past fifteen years, reflecting persistent under-investment. We still see opportunities across the risk spectrum. This also includes private equity and real estate investments dedicated to changing retail industry logistics, as we set out in [The liquidity trade-off](#). The ongoing global growth and low interest rates that we expect also remain supportive for real estate assets.

Transforming commerce: the robotics revolution

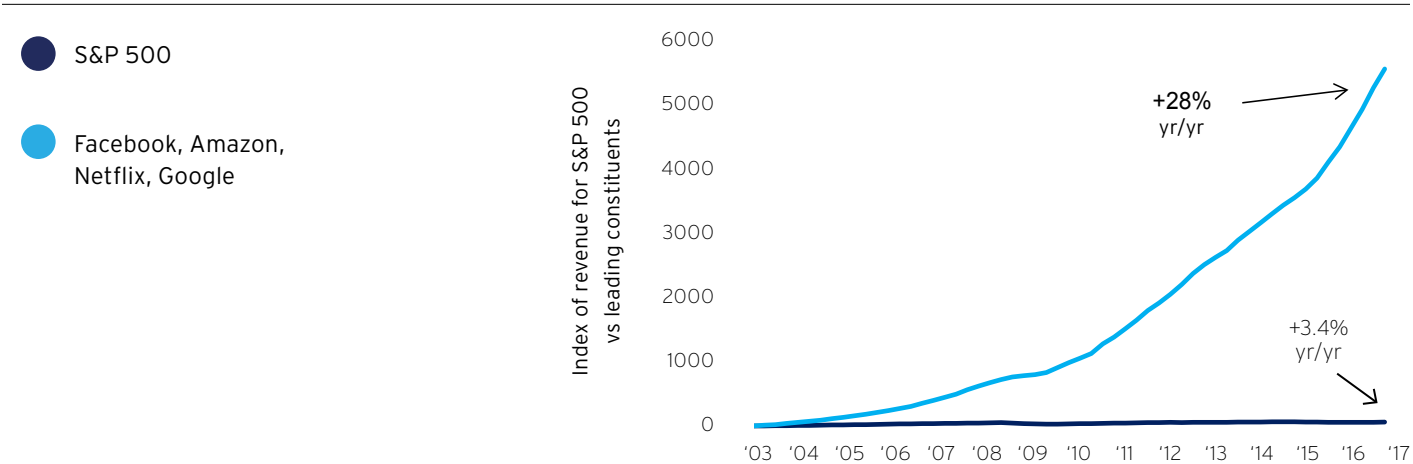
Technological progress - such as e-commerce and robotics - is relentlessly challenging many traditional industry models and creating fresh opportunities for businesses and investors alike. We advocate seeking to invest in the likeliest persistent winners of these processes, rather than also holding persistent losers via a passive investment strategy. To date, high returns in the technology industry have tended to be heavily concentrated among a handful of stocks while many other technology firms have persistently underperformed the markets - **figures 4 and 5**.

The creeping obsolescence of much of traditional retailing has ramifications across many asset classes, including retail real estate assets as well as the more obvious equities.

We saw global retail equities as the most expensive equity sector in the world given the competitive threat from e-commerce. Since we published [Transforming commerce: the robotics revolution](#), this theme has gained even greater recognition among investors, with various leading robotics equities recording 25% gains - roughly double the year-to-date return of global equities - **figure 6**.

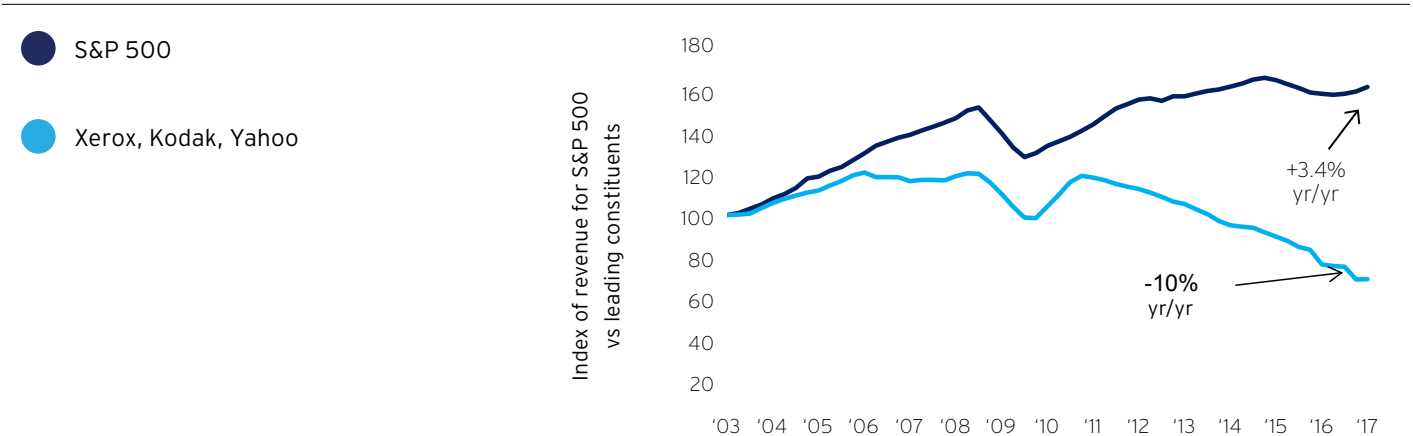
As we argued, there is far more to this than simply investing in robotics producers. We were surprised by the number of clients who told us of their fears that technology would create mass unemployment. History suggests to us that humans will still have incentives to work in the future and produce alongside ever-more productive machines.

Figure 4. Concentrated outperformance in tech



Source: Bloomberg, as of 5 May 2017. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Past performance is no guarantee of future results, and future results may not meet our expectations due to a variety of economic, market and other factors. FOR ILLUSTRATIVE PURPOSES ONLY. This should not be construed as an offer of, or recommendation of companies discussed.

Figure 5. Persistent tech underperformers



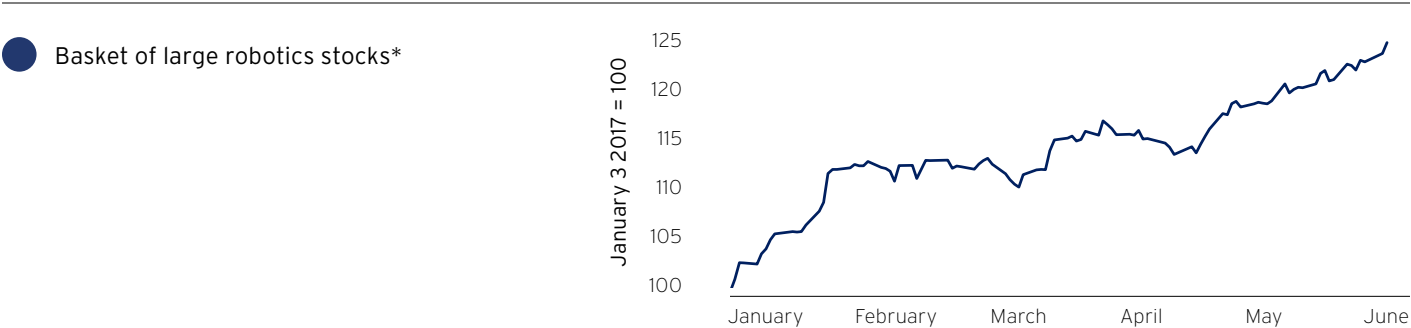
Source: Bloomberg, as of 5 May 2017. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Past performance is no guarantee of future results, and future results may not meet our expectations due to a variety of economic, market and other factors. FOR ILLUSTRATIVE PURPOSES ONLY. This should not be construed as an offer of, or recommendation of companies discussed.

Performance review

Valuation is our principal guide to long-term returns in every asset class. However, there are often sound fundamental justifications for how seemingly cheap or expensive assets reached that point. High yielding equities often signal future dividend cuts. A high price/earnings multiple often precedes rapid future earnings growth. Therefore, the Global Investment Committee does not rely on valuation alone to decide tactical allocations.

That said, the extremes in valuation we identified across global markets in our full year publication has done a reasonably good job in 2017 to date in predicting positive or negative outcomes. We will be keen to see if that persists - **figure 7**. Meanwhile, we continue to believe that the global investment themes we have identified will help to select outperformers and underperformers on a multi-year basis.

Figure 6. The rise of the robot stocks



We first discussed e-commerce as a “creative destruction” force in Outlook 2015. Despite positive overall market performance this year, the MSCI index of Global Department Store Retailers fell to its lowest level since 2010. We see e-commerce as the better business model and saw too great an aggregate market capitalization for both retail and e-tail together in Outlook 2017. An earlier-stage trend was identified in the robotics revolution, with automation powering above-

market equity performance this year. Infrastructure equities have outperformed in 2017 despite setbacks in the US market driven by politics.

Our favored bond market segments were those that we expected to perform well despite rising short-term rates from the Fed, and they have significantly outperformed global fixed income benchmarks this year - **figure 8**.

Figure 8. Global income performance 2017 year-to-date

High yield bonds	4.1%
High yield bank loans	1.8%
US preferreds (fixed-to-float)	8.3%
Emerging market debt (USD)	5.5%
LatAm debt (USD)	6.7%
Brazilian corporates (USD)	7.1%
Argentinian quasi-sovereigns (USD)	11.0%
Local short-term Brazil sovereigns	+6.7% (local return), +10.9% (unhedged in USD)
US TIPS (vs. US Treasury debt)	1.4%

Source: Bloomberg, Citi Research, Haver Analytics as of 30 May 2017. Past performance is no guarantee of future results, and future results may not meet our expectations due to a variety of economic, market and other factors.

There may be additional risk associated with international investing, including foreign, economic, political, monetary and/or legal factors, changing currency exchange rates, foreign taxes, and differences in financial and accounting standards. These risks may be magnified in emerging markets. International investing may not be for everyone.

Bonds are affected by a number of risks, including fluctuations in interest rates, credit risk and prepayment risk. In general, as prevailing interest rates rise, fixed income securities prices will fall. Bonds face credit risk if a decline in an issuer's credit rating, or creditworthiness, causes a bond's price to decline. High yield bonds are subject to additional risks such as increased risk of default and greater volatility because of the lower credit quality of the issues. Finally, bonds can be subject to prepayment risk. When interest rates fall, an issuer may choose to borrow money at a lower interest rate, while paying off its previously issued bonds. As a consequence, underlying bonds will lose the interest payments from the investment and will be forced to reinvest in a market where prevailing interest rates are lower than when the initial investment was made.

Concentrated exposure to any one industry, sector, asset class, country, issuer or position limits diversification and increases risk. To reduce this risk, portfolio holdings are diversified across multiple industries and companies.



Emerging opportunities

Steven Wieting, Global Chief Investment Strategist

Jorge Amato, Latin America Investment Strategist

Ken Peng, Asia Pacific Investment Strategist

With a possible peak in sight for the US dollar, we believe emerging markets may offer potential for investors both near- and longer-term.

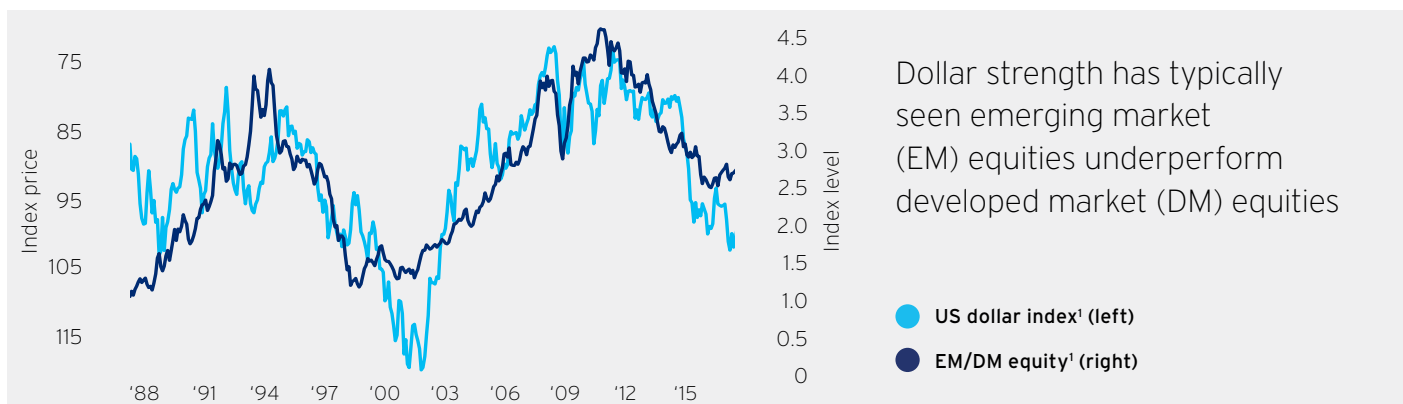
Since 2011, many emerging market (EM) assets have underperformed those from developed markets, while the US dollar has strengthened significantly. The first of these two trends has already begun to reverse and we believe that the second may do so in the not-too-distant future.

A major shift may be underway in global financial markets. Since 2011, many emerging market (EM) assets have underperformed those from developed markets, while the US dollar has strengthened significantly. The first of these two trends has already begun to reverse and we believe that the second may do so in the not-too-distant future. If we are correct, it will present investors with opportunities but also risks.

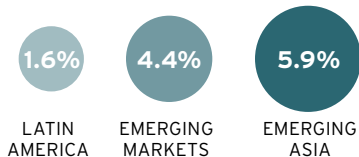
The fortunes of EMs and those of the US dollar have been closely linked over time. A rising US dollar has typically been associated with capital outflows from emerging economies. The rising dollar can put downward pressure on commodities prices, creating a vicious circle of lower growth and further currency weakness. This was particularly the case as US oil production boomed in the past six years. A rising dollar - and the higher US interest rates that it often accompanies - increase EM external borrowing costs. EM returns across asset classes have therefore generally struggled in such periods.

Lately, however, many EMs have shown economic resilience despite the challenges emanating from the strength of the US dollar and interest-rate rises from the Federal Reserve. The MSCI Emerging Markets Index - which measures the performance of equities in 23 emerging economies such as China, India, and Brazil - has gone up by one-third since February 2016. For much of that time, the US Dollar Index - which tracks the currency's performance against a basket of other major currencies - has also strengthened, gaining almost 10% in the last eight months of 2016.

EMERGING OPPORTUNITIES



GDP growth forecasts 2017⁴:

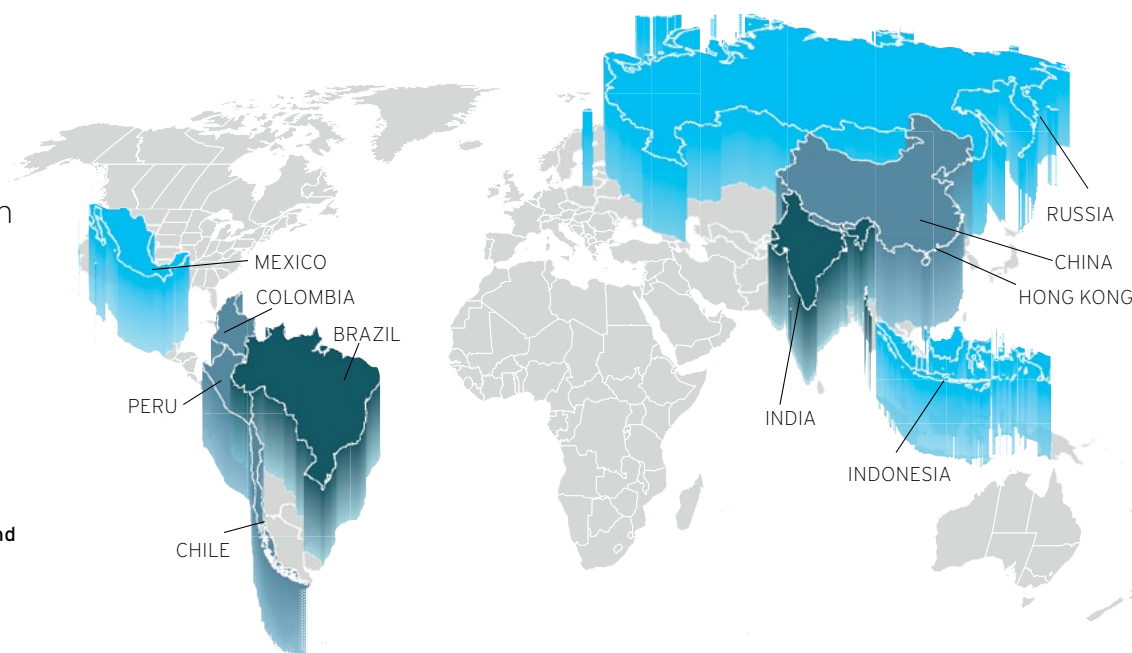


Forecast annualized returns over next 10 years⁵:



With GDP growth improving, we see potential opportunities in:

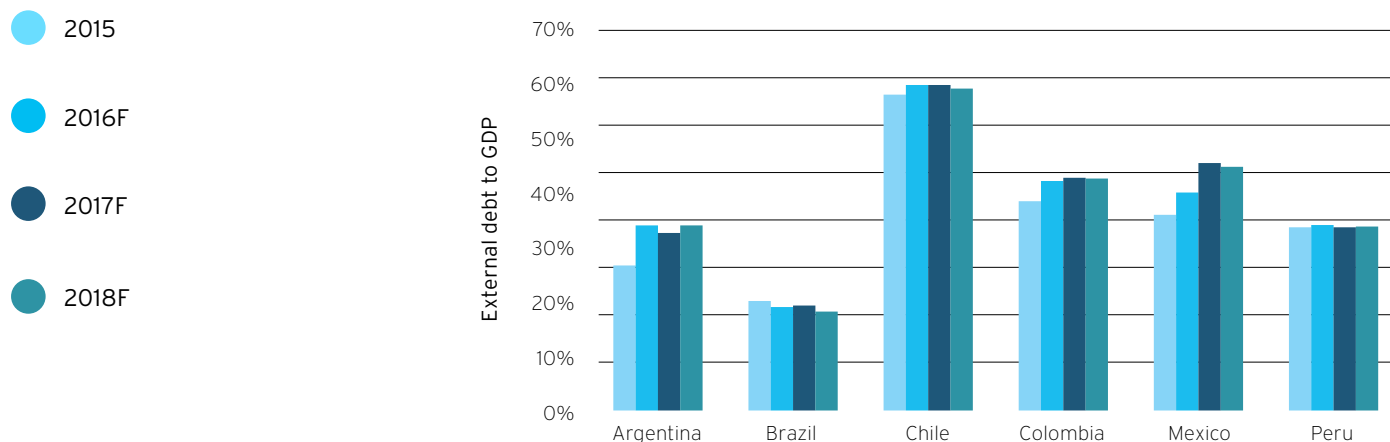
- Fixed income
- Equities
- Both equities and fixed income



Sources: 1 Bloomberg, 1&2 Haver, 3&5 Citi Private Bank, 4 Citi Research; as of 14 May 2017. See Glossary for definitions.

Indices are unmanaged. An investor cannot invest directly in an index. Opinions expressed herein are not intended to be a forecast of future events, a guarantee of future results for investment advice, and are subject to change based on market and other conditions. There may be additional risk associated with international investing, including foreign, economic, political, monetary and/or legal factors, changing currency exchange rates, foreign taxes, and differences in financial and accounting standards. These risks may be magnified in emerging markets. International investing may not be for everyone. Each investor should carefully view the risks associated with the investment and make a determination based upon the investor's own particular circumstances, that the investment is consistent with the investor's objectives.

Figure 1. Latin American external indebtedness



Source: Citi Research, as of 15 March 2017.

All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events.

The dollar's destiny

Likely US policies are one of the reasons why we should expect further strength in the dollar before it reaches its cycle-peak. The Trump administration looks set to pass a package of significant corporate and personal tax cuts. This could raise business investment and personal consumption in the US, boosting economic growth and potentially strengthening the dollar. One particularly likely measure is a large reduction in the tax-rate for corporate profits currently held overseas. Such a measure would probably attract a considerable amount of capital back into US, driving up demand for the US dollar.

In response to these prospective measures, further US monetary tightening could follow. The US Federal Reserve has already raised interest rates three times and we expect it to hike two more times in 2017. At the same time, various central banks elsewhere – especially in Europe and Japan – still have negative interest rates and asset purchasing programs.

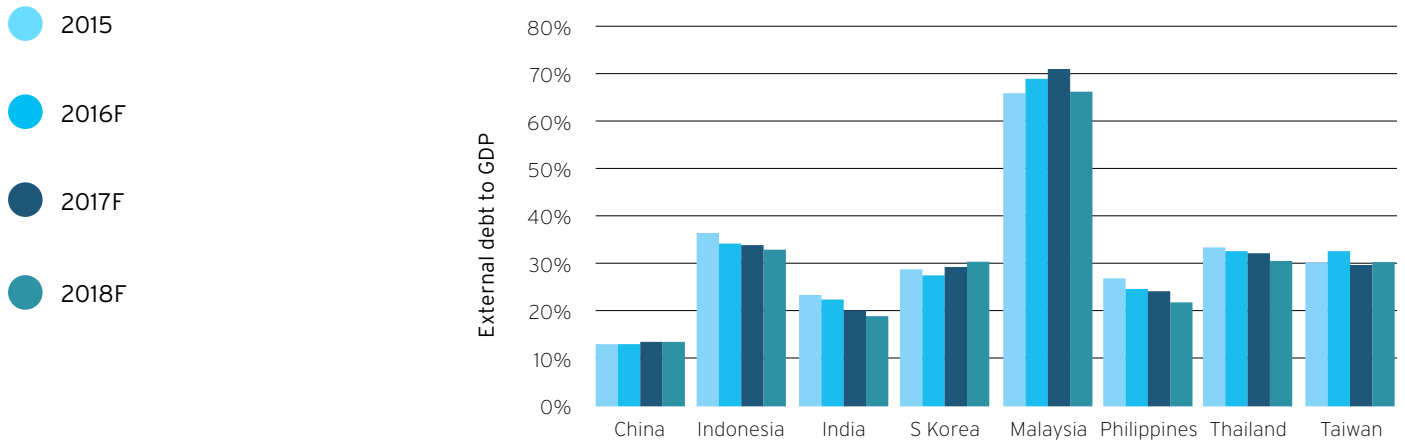
Our outlook for higher US interest rates are another reason why we should expect further US dollar strengthening before it reaches its final peak in this cycle. However, the US dollar's 33% nominal appreciation against the currencies of its main trading partners since mid-2011 has elevated it to levels that could threaten US competitiveness. The current US dollar's valuation alone makes it likely that the expected one-time tax cuts will mark the finale of the currency's bull market. If the US Congress is unable to take these actions, the dollar's peak may have already occurred. The downward pressure upon the US dollar in early 2017 – when confidence in a large US fiscal package waned – seems a telltale sign.

Emerging endurance

While EMs have traditionally suffered from higher US rates and a stronger dollar, they may not face as great a challenge this time around. We believe that the current US rate-hiking cycle is likely to be less aggressive than usual. Taking the Federal Reserve's own forecasts, the Federal Funds Rate adjusted for inflation would rise by 2.25%, compared to an average of 4.25% in past cycles.

EMs are also generally in better shape to withstand rises in the dollar and US rates. In the past, large current account deficits have been a key source of weakness for EMs. In emerging Asia today, though, current accounts are in surplus, except for India and Indonesia, whose deficits have nevertheless fallen. And while Latin America is running current account deficits, they are low and manageable, averaging 2.5% of GDP for 2017 and 2018. As a result, emerging economies are less reliant on foreign funding, and so less exposed to a sudden outflow of funding.

Figure 2. Asian external indebtedness



Source: Citi Research, as of 30 Apr 2017.

All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events.

The external indebtedness of many EMs is also healthier than previously. Rising US interest rates and a stronger dollar make meeting payments on external debt more expensive, frequently causing defaults in the past. But in Latin America now, for example, external public and private debt averages around 40% of GDP - **figure 1**. This is substantially lower than the equivalent figure for developed markets. Most EM Asia countries, except Malaysia have external debt averages around 30% of GDP - **figure 2**.

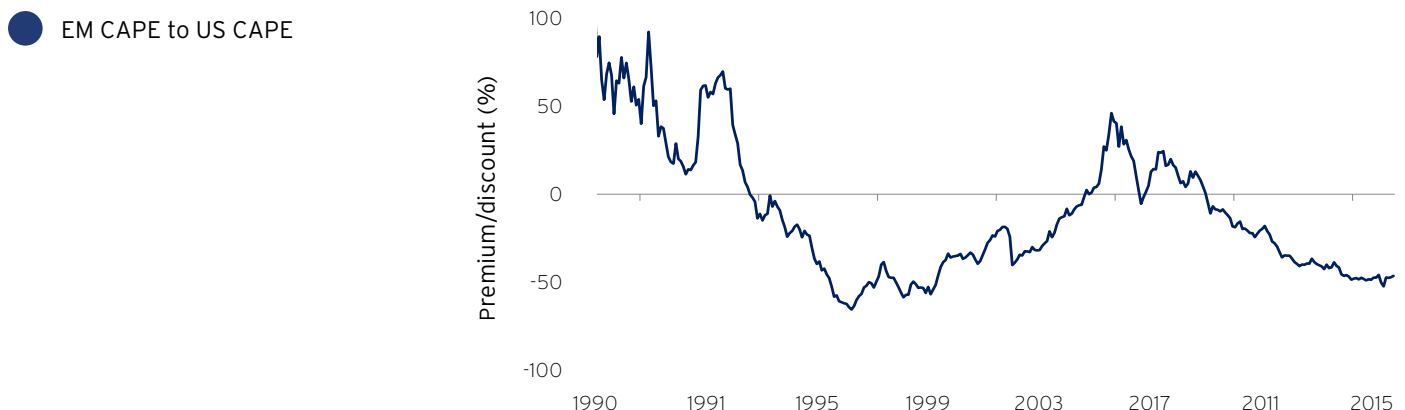
The outlook for EM growth also seems robust. For EMs as a whole, Citi economists forecast GDP growth to accelerate from 3.9% to 4.4% this year. The fastest growth is seen coming from emerging Asia, with 5.9% forecast for both 2017 and 2018. Aided by economic reforms,

Latin America is experiencing a cyclical upturn, having suffered contraction last year. Citi Research forecasts regional growth of 1.6% in 2017 and 2.9% in 2018, with the possibility of a positive surprise for the region.

Attractive valuations

As well as solid fundamentals, EM asset prices remain attractively valued. Unusually, this is largely true across EM regions, even after the strong rally since last year's lows. EM equities trade at a 45% discount to US equities based on their 10-year cyclically-adjusted price-earnings ratio (CAPE) - **figure 3**. This is not that far above their record discount against US equities, which was reached during the late 1990s technology boom.

Figure 3. EM equities' relative cheapness



Source: Factset and Citi Private Bank as of 17 March 2017. Indices are unmanaged. An investor cannot invest directly into an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Past performance is not guarantee of future results, and future results may not meet our expectations due to a variety of economic, market and other factor.

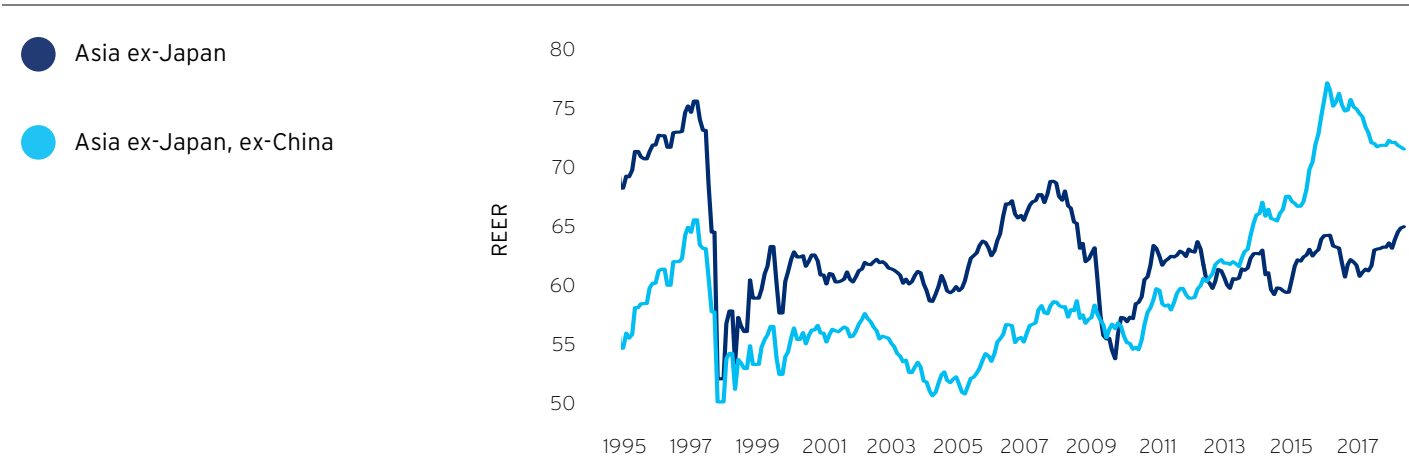
EM equities' low valuations could give way to strong long-term returns. As of December 2016, Citi Private Bank's own strategic asset allocation estimates that EM equities will return an annualized 10.8% over the coming decade. By contrast, developed equities are forecast to return 6.3%.

After a long period of depreciation, EM currencies look cheap. Real effective exchange rates across EMs - which measure a currency's inflation-adjusted value against a basket of other currencies - are still generally well below their long-term averages, despite something of a recovery in the last year - **figures 4 and 5**. Historically, low currency valuations have been followed by strong asset price returns.

In Latin America, for example, regional equities have returned an average of 57% and 99% in the one- and two-year periods after a trough in the real exchange rate.

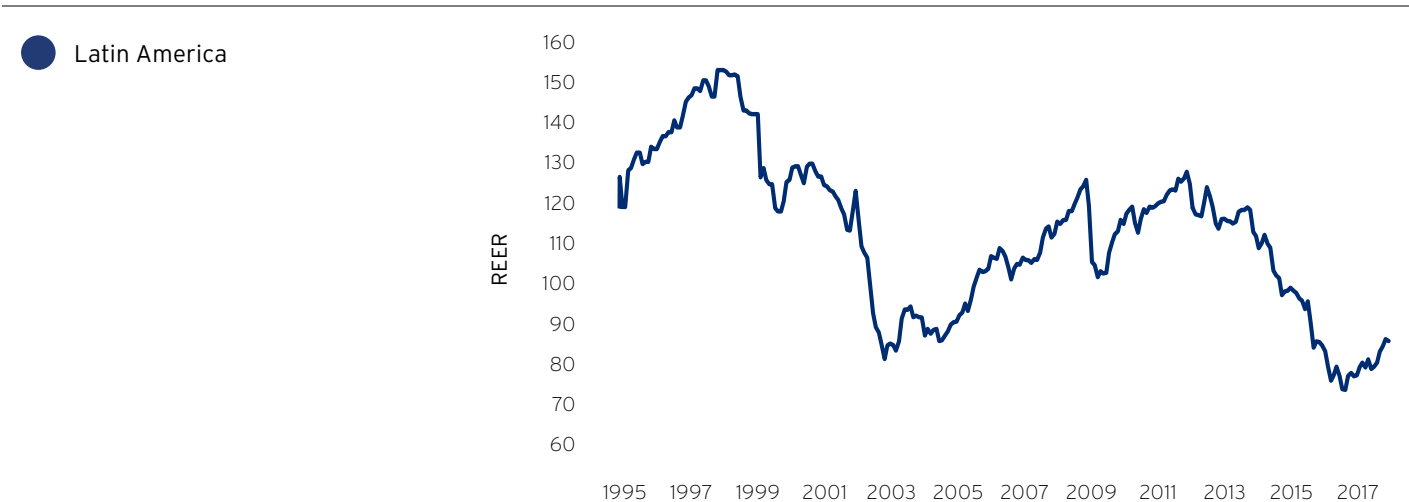
As valuations in fixed income assets across developed markets have risen, the lure of higher yielding EM has grown. Local currency EM debt looks particularly attractive to us, given an average yield-to-maturity of 6.9%, as well as currency stability, high real interest rates, and falling inflation. By contrast, US dollar denominated EM debt no longer offers quite such appealing valuations, although average yields are still some five times higher than the 0.9% average of G7 sovereign fixed income yields.

Figure 4. Asian real effective exchange rates (REER)



Source: Bloomberg, as of 30 May 2017. Past performance is no guarantee of future results, and future results may not meet our expectations due to a variety of economic, market and other factors.

Figure 5. Latin American real effective exchange rates (REER)



Source: Bloomberg, Citi Private Bank as of 30 May 2017. Past performance is no guarantee of future results, and future results may not meet our expectations due to a variety of economic, market and other factors. Real effective exchange rates measure a currency's inflation-adjusted value against a basket of other currencies.

Risks remain

Despite our positive outlook for emerging markets overall, we do acknowledge possible challenges to our constructive view. Chinese debt is often seen as the greatest risk in EMs – and indeed for markets globally. But while the country's non-financial debt stands at 256% of GDP, this is below the average for developed markets of 275%. These developed markets have much higher government and household indebtedness, whereas China's high debt is concentrated among largely state-owned corporates. We would stress that high debt levels are a direct result of China's high savings rate, which has incentivized eager domestic investors to borrow. Corporate leverage has also recently begun to fall.

As noted, China has both a high stock of assets and high level of debt. Many analysts fail to take both parts into account. The risk is that China allows significant defaults by the weakest borrowers despite having the resources to make lenders whole. For numerous reasons, we greatly doubt that China will choose such a highly disruptive path for its debt markets.

A sharp economic slowdown in China would present another risk to our outlook. Because the Chinese economy is such a heavy consumer of commodities, a significant deceleration in its growth would impact commodity prices and therefore growth in commodity-producing emerging markets. However, recent China trends give cause for optimism. Real borrowing costs have fallen, which is helpful for growth. Industrial price deflation has given way to inflation, which is helpful for corporate profits. As such, we believe that China can maintain GDP growth at its 6.5% target level this year.

External shocks could also undermine our case for emerging markets. Increased protectionism by the US could be especially damaging to its largest EM trading partners, such as Mexico and China. However, concerns over a possible trade war have eased lately, with the US stressing its goal of increasing exports over restricting imports. Another risk is that of an escalation of geopolitical tensions, perhaps involving North Korea. Such escalations are hard to anticipate, however, making them a wildcard for investors.

Favored markets

Reflecting our bullish outlook for EMs as a whole, the Citi Private Bank Global Investment Committee is overweight both EM equities and fixed income. We have raised our allocations to these asset classes by reducing our weightings in US dollar denominated assets, including US high yield fixed income and US Treasury Inflation Protected Securities (TIPS).

With inflation broadly trending lower across EMs, many central banks in these regions may be able to continue cutting interest rates. Easier financial and credit conditions combined with higher consumption may feed through into higher corporate profitability and improved credit quality. In turn, this could cause asset prices to rise, which may attract more capital inflows. We believe this virtuous cycle is likely to remain in place, supporting EM asset prices.

While we are overweight EM equities overall, there are certain markets within this asset class that we favor. In Asia, we are attracted to Chinese and Hong Kong equities, which may benefit from higher earnings growth driven by a cyclical recovery. Concerns over excessive indebtedness and overblown real estate speculation will likely ease, meanwhile. Although not cheap, Indian equities could see outperformance thanks to improved business investment growth, helped by stronger credit growth and a friendlier business environment. Indonesia, meanwhile, looks well placed to boost economic growth by expanding credit.

After five years of declines, Citi Research believes that Latin America may experience the strongest earnings growth worldwide – of 18% – in 2017. Against a more stable regional political backdrop, we favor the markets of Brazil, Chile, Colombia, and Peru. We would also add to Mexico opportunistically during corrections. Among sectors, we like regional financials and energy. The former could do

well thanks to EM banking equities' close correlation with improving GDP and investment. The latter could receive a boost from global deflation and reduced crude oil inventories. We are also attracted to materials and cyclicals.

For appropriately-sized holdings of EM fixed income, we prefer local over US dollar denominated markets where real exchange rates are undervalued, inflation is falling, and central bank policy is less disruptive. In Latin America, Brazil and Mexico are our two favored local markets. The Mexican peso is considered one of the cheapest EM currencies of all. And with 10-year sovereign yields above 7%, Mexico is the world's highest-yielding A-rated sovereign.

In Asia, India and Indonesia are our preferred local debt markets. Ten-year yields in both countries are near 7%, while the fundamental outlook for their currencies is conducive to stability. In May, ratings agency S&P upgraded Indonesia to investment grade status, which could potentially attract additional inflows from investors with investment-grade only mandates.

Despite ongoing geopolitical risks, Russian local markets look attractive for suitable investors. With short-term yields just below 10%, the economy has benefited from the oil-price recovery. Rate-cuts are becoming likelier, and a relatively closed economy has created less dependence on external financing. International sanctions will continue to deter investment, meanwhile. But if lifted in future, this would potentially provide a positive catalyst.

Looking ahead, we expect to continue the process of lightening our exposure to US dollar denominated assets. At the same time, we will look to keep gradually increasing our exposure to EM and other international assets.

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International investing entails greater risk, as well as greater potential rewards compared to US investing. These risks include political and economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in countries with emerging markets, since these countries may have relatively unstable governments and less established markets and economics.

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Glossary

Asset class definitions

Cash is represented by US 3-month Government Bond TR, measuring the US dollar-denominated active 3-month, fixed-rate, nominal debt issues by the US Treasury.

Global Developed Market Corporate Fixed Income is composed of Bloomberg Barclays indices capturing investment debt from seven different local currency markets. The composite includes investment grade rated corporate bonds from the developed-market issuers.

Global Developed Market Equity is composed of MSCI indices capturing large-, mid- and small-cap representation across 23 individual developed-market countries, as weighted by the market capitalization of these countries. The composite covers approximately 95% of the free float-adjusted market capitalization in each country.

Global Developed Investment Grade Fixed Income is composed of Bloomberg Barclays indices capturing investment-grade debt from twenty different local currency markets. The composite includes fixed-rate treasury, government-related, and investment grade rated corporate and securitized bonds from the developed-market issuers. Local market indices for US, UK and Japan are used for supplemental historical data.

Global Emerging Market Equity is composed of MSCI indices capturing large and mid-cap representation across 20 individual emerging-market countries. The composite covers approximately 85% of the free float-adjusted market capitalization in each country. For the purposes of supplemental long-term historical data, local-market country indices are used, wherever applicable.

Global Emerging Fixed Income is composed of Bloomberg Barclays indices measuring performance of fixed-rate local currency emerging markets government debt for 19 different markets across Latin America, EMEA and Asia regions. iBoxx ABF China Govt. Bond, the Markit iBoxx ABF Index comprising local currency debt from China, is used for supplemental historical data.

Global Equity is represented by the MSCI ACWI Index, capturing all sources of equity returns in 23 developed and 23 emerging markets.

Global Fixed Income is represented by the Bloomberg Barclays Multiverse Index, with returns hedged into US dollars.

Global High Yield Fixed Income is composed of Bloomberg Barclays indices measuring the non-investment grade, fixed-rate corporate bonds denominated in US dollars, British pounds and Euros. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below, excluding emerging market debt. Ibbotson High Yield Index, a broad high yield index including bonds across the maturity spectrum, within the BB-B rated credit quality spectrum, included in the below-investment-grade universe, is used for supplemental historical data.

Private Equity characteristics are driven by those for Developed Market Small Cap Equities, adjusted for illiquidity, sector concentration, and greater leverage.

Real Estate contains index contains all Equity REITs (US REITs and publicly-traded real estate companies) not designated as Timber REITs or Infrastructure REITs: NAREIT US REIT Index, NAREIT Canada REIT Index, NAREIT UK REIT Index, NAREIT Switzerland REIT Index, NAREIT Euro-zone REIT Index, NAREIT Japan REIT Index, NAREIT Hong Kong REIT Index, NAREIT Singapore REIT Index, NAREIT Australia REIT Index

Index definitions

The Barclays world bond market index is a market-weighted index of global government, government-related agencies, corporate and securitized fixed-income investments.

The Bloomberg-JPMorgan Asia Currency Index (ADXY) is a US dollar tradable index of emerging Asian currencies, which serves as a benchmark for monitoring Asia's currency markets on an aggregate basis. It is a spot index of emerging Asia's most actively traded currency pairs valued against the US dollar.

The Bloomberg Barclays Pan-European High Yield Index measures the market of non-investment grade, fixed-rate corporate bonds denominated in the following currencies: Euro, British pounds, Danish krone, Norwegian krone, Swedish krona, and Swiss franc. Inclusion is based on the currency of issue, and not the domicile of the issuer.

The Bloomberg Barclays US Corporate High Yield Total Return Index Value Unhedged USD is a Citi's Emerging Markets US Dollar Government Bond Index (EMUSDGBI) includes US Dollar-denominated emerging market sovereign debt issued in the global, Yankee, and Eurodollar markets. The index comprises debt of more than 50 countries from Latin America, Eastern Europe, Middle East, Africa, and Asia and offers geographical diversification without exposure to local currency fluctuations. The index provides exposure to a broad array of countries and sub-indices are available in any combination of country, maturity, and rating.

Citi's US High-Yield Market Index is a US dollar-denominated index which measures the performance of high-yield debt issued by corporations domiciled in the US or Canada. Recognized as a broad measure of the North American high-yield market amongst all Citi's fixed income indices, it includes cash-pay and deferred-interest securities. All the bonds are publically placed, have a fixed coupon, and are non-convertible.

Citi US Broad Investment Grade Index (USBIG)–Corporate, is a subsector of the USBIG. The index includes fixed rate US Dollar-denominated investment grade corporate debt within the finance, industrial and utility sectors. This index includes US and non-US corporate securities (excludes US government-guaranteed and non-US sovereign and provincial securities).

Commodity Index is the S&P Goldman Sachs Commodity Index (S&P GSCI), a composite index of commodity sector returns representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities.

Emerging market currencies are represented by the OITP (Other important trading partners) index is a weighted average of the foreign exchange values of the US dollar against a subset of currencies in the broad index that do not circulate widely outside the country of issue. The weights are derived by rescaling the currencies' respective weights in the broad index so that they sum to 1 in each sub-index.

European equities are represented by the MSCI Europe index, which captures large- and mid-cap representation across 15 Developed Markets (DM) countries in Europe. It covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe.

Gold is represented by the commodity futures price for gold.

The High Yield Energy Bond Price index measures the price performance of US bonds with ratings below investment grade comprising energy and natural resources industries.

Japan equities are represented by the MSCI Japan index, which is designed to measure the performance of the large- and mid-cap segments of the Japanese market. It covers approximately 85% of the free float-adjusted market capitalization in Japan.

LIBOR is a benchmark interest rate that some of the world's leading banks charge each other for short-term loans. It stands for London Interbank Offered Rate and serves as the first step to calculating interest rates on various loans throughout the world.

The MSCI All Country World Index represents 48 developed and emerging equity markets. Index components are weighted by market capitalization.

The MSCI Asia ex-Japan index has large and mid-cap representation across 2 of 3 Developed Markets countries and 8 Emerging Markets countries in Asia. It captures approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI Emerging Markets Index represents the performance of large- and mid-equities from 23 emerging countries, covering approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI Emerging Markets (EM) Latin America Index captures large and mid cap representation across 5 Emerging Markets (EM) countries* in Latin America. With 121 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI Global Department Store index includes owners and operators of department stores and stores offering diversified general merchandise.

The MSCI USA Index is designed to measure the performance of the large and mid cap segments of the US market, covering approximately 85% of the free float-adjusted market capitalization in the US.

The MSCI World Index represents the performance of more than 1,600 large- and mid-cap stocks across 23 developed markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI World ex-USA Index represents the performance of large- and mid-cap representation across 22 of 23 developed markets countries excluding the United States. With 1,005 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

Oil is represented by the West Texas Intermediate Crude Oil price.

The Standard & Poor's (S&P) 500 Index is a capitalization-weighted index that includes a representative sample of 500 leading companies in leading industries of the US economy. Although the S&P 500 focuses on the large cap segment of the market, with over 80% coverage of US equities, it is also an ideal proxy for the total market.

The S&P Global Infrastructure Index is designed to track 75 companies from around the world chosen to represent the listed infrastructure industry while maintaining liquidity and tradeability. To create diversified exposure, the index includes three distinct infrastructure clusters: energy, transportation, and utilities.

The S&P Global Department Store Index represents retail distributors of discretionary consumer merchandise primarily through physical store locations

US Investment Grade Corporate Debt Total Return Index is an index made up of investment-grade debt issued by US companies, measured on a total return basis.

Other terminology

Adaptive Valuations Strategies is Citi Private Bank's own strategic asset allocation methodology. It determines the suitable long-term mix of assets for each client's investment portfolio.

Correlation is a statistical measure of how two assets or asset classes move in relation to one another. Correlation is measured on a scale of 1 to -1. A correlation of 1 implies perfect positive correlation, meaning that two assets or asset classes move in the same direction all of the time. A correlation of -1 implies perfect negative correlation, such that two assets or asset classes move in the opposite direction to each other all the time. A correlation of 0 implies zero correlation, such that there is no relationship between the movements in the two over time.

The cyclically adjusted price-to-earnings ratio (CAPE) is a valuation measure defined as price divided by the average of ten years of earnings (moving average), adjusted for inflation. As such, it is principally used to assess likely future returns from equities over timescales of 10 to 20 years, with higher than average CAPE values implying lower than average long-term annual average returns. It is not intended as an indicator of impending market crashes, although high CAPE values have been associated with such events.

Strategic asset allocation is the process of creating a long-term investment plan by assembling an appropriate mix of equities, fixed income, cash and other investments. It can potentially

enhance portfolio returns and help manage risk.

Strategic Return Estimates are Citi Private Bank's forecast of returns for specific asset classes over a 10-year time horizon. The forecast for each specific asset class is made using a proprietary methodology that is appropriate for that asset class. Equity asset classes are forecast using a proprietary methodology based on the calculation of valuation levels with the assumption these valuation levels revert to their long-term trends over time. Fixed Income asset classes are forecast using a proprietary methodology based on current yield levels. Other asset classes have other specific forecasting methodologies. Please note that hedge funds, private equity, real estate, structured products and managed futures are generally illiquid investments and are subject to restrictions on transferability and resale. Each SRE is gross of actual client fees and expenses. Components of the methodology used to create the SREs include the rate of return for various asset classes based on indices. Termination and replacement of investments may subject investors to new or different charges. Past performance is not indicative of future results. Future rates of return cannot be predicted with certainty. Investments that pay higher rates of return are often subject to higher risk and greater potential loss in an extreme scenario. The actual rate of return on investments can vary widely over time, especially for long-term investments. This includes the potential loss of principal on your investment. It is not possible to invest directly in an index.

Tactical asset allocation looks to adjust the strategic asset allocation of a client's investment portfolio to incorporate shorter-term market insights.

Yield-to-Maturity (YTM) is the total return received on a bond or index of bonds when held to maturity. The total return includes both the payment of coupons and the return of the principal at maturity.

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