

North America Strategy

July 2019



10 Signposts for 2019

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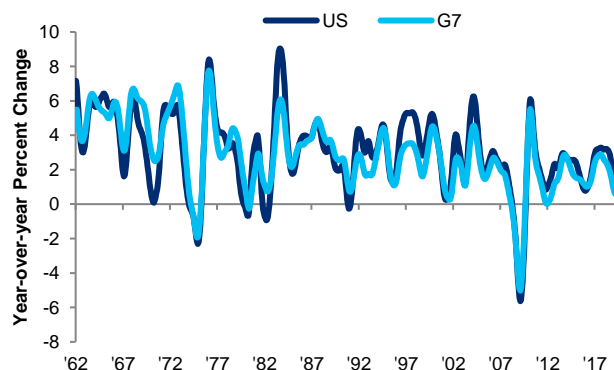
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The Fed looks poised to lower rates later this month, which could also give China more room to maneuver looser monetary policy, as trade talks resume. Our 10 Signposts for 2019 point to slow/moderate economic and profit growth ahead. An in-depth analysis of our first signpost follows and suggests a US recession is not imminent. After a strong first half of 2019, we expect more modest investment returns ahead.

1. **Leading Economic Indicators:** Point to moderating, but still positive global economic growth.
2. **Global PMI Surveys:** Show the global economy slowing and in need of stimulus.
3. **US Treasury Yield Curve:** Following years of flattening, it should steepen as the Fed eases.
4. **Corporate Bond Spreads:** Spreads are at tight levels.
5. **Financial Conditions:** Financial conditions are at levels that support slow/moderate growth.
6. **VIX Index:** With VIX in the low teens, hedging now could be a prudent way to safeguard assets.
7. **DM Equity Breadth:** 87% of developed market indices are trending higher.
8. **EM Equity Breadth:** 66% of emerging market indices are trending higher.
9. **Oil Prices:** Are in the middle of the range for this expansion and bull market.
10. **S&P 500 Forward 12-Month Earnings:** Are expected to reach new all-time highs in 2019-2020

Bonus: US leading economic indicators are not yet in the pattern formed prior to past recessions.

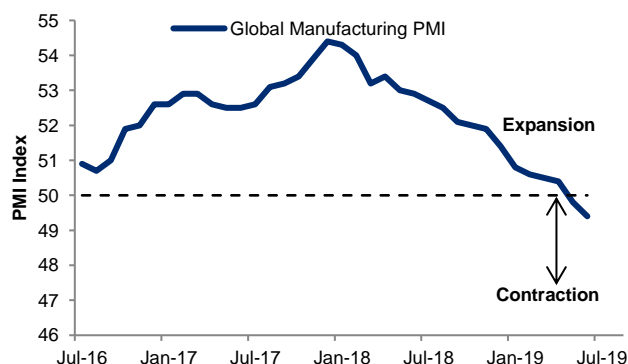
Figure 1: US and Global Leading Indicators (See Appendix)



Source: Bloomberg as of July 2019

Note: G7 nations include Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States

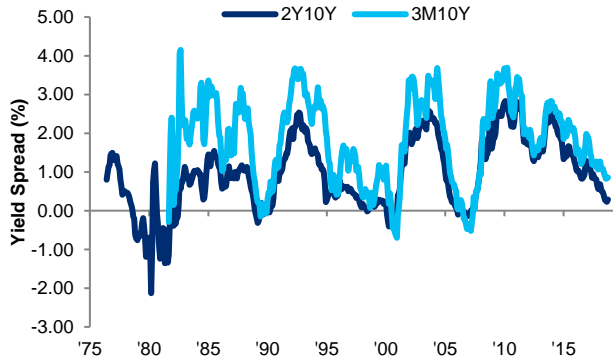
Figure 2: Global Manufacturing PMI



Source: Bloomberg as of July 2019

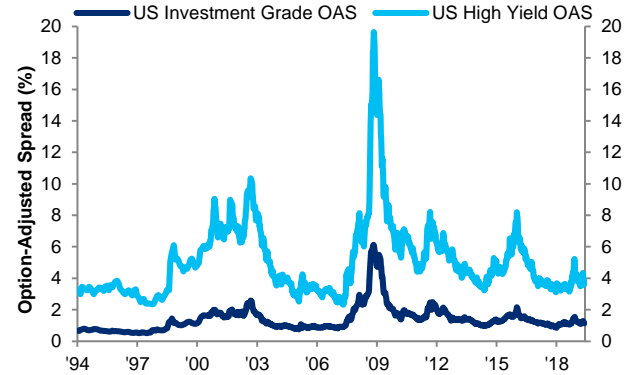
Note: A Purchasing Manager's Index (PMI) is an indicator of the economic health of the manufacturing sector and is based on five major indicators: new orders, inventory levels, production, supplier deliveries, and employment.

Figure 3: US Treasury Yield Curve Slope (2Y10Y and 3M10Y)



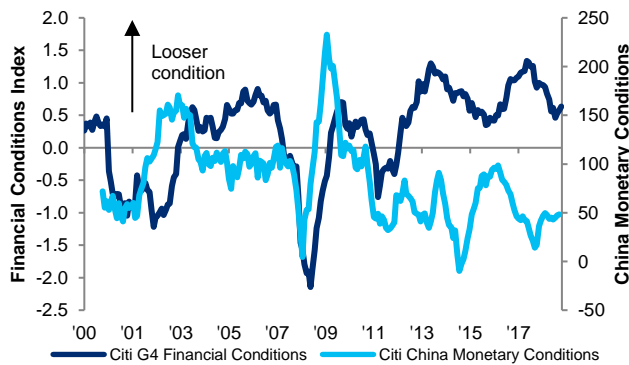
Source: Bloomberg as of July 2019.

Figure 4: Corporate Bond Spreads



Source: Bloomberg as of July 2019

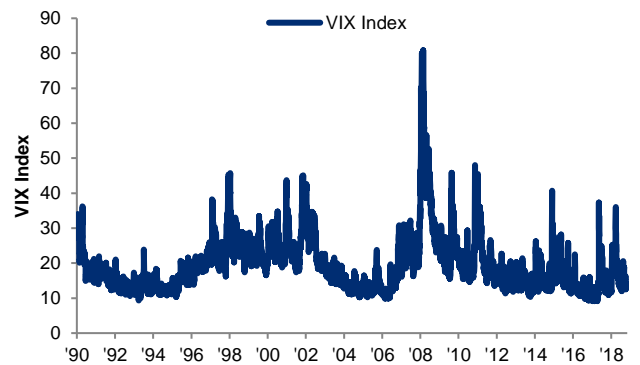
Figure 5: Financial Conditions Indices



Source: Bloomberg as of July 2019

Note: Citi Financial Conditions Indices use a number of variables including money market rates, debt and equity index prices, and other financial indicators to provide a summary of the "health" of financial markets. Financial conditions are the mechanism by which financial markets impact the real economy; in other words, a higher value for the FCI indicates that credit conditions and individual wealth are improving, which is supportive of economic growth.

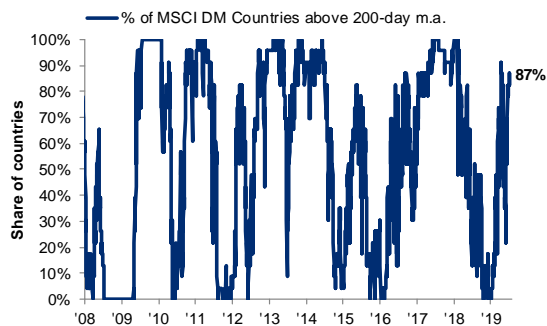
Figure 6: VIX Index



Source: Bloomberg as of July 2019

Note: The CBOE Volatility Index (VIX) is a measure of the stock market's expectation for future volatility implied by options on the S&P 500 index.

Figure 7: DM Equity Performance Breadth



Source: Factset as of July 2019

Historically, once at least 10% of EM countries are back above their 200-day moving averages, EM equity returns, on average, have topped 20%, 30% and 40% over the next 6, 12 and 18 months, respectively. DM returns have followed a similar pattern with average returns of 9%, 14% and 18% over like periods.

Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only. Past performance is no guarantee of future returns. Real results may vary.

Figure 8: EM Equity Performance Breadth

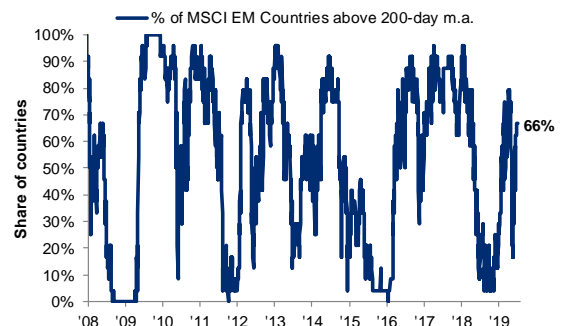
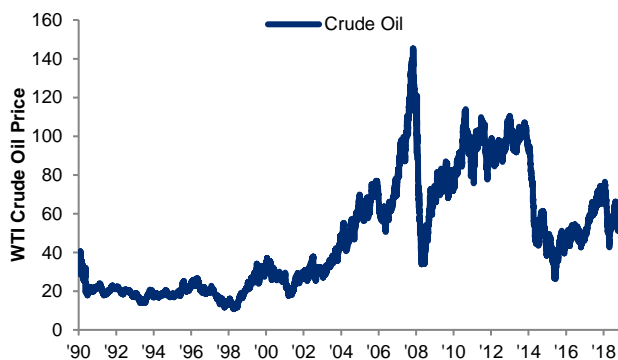
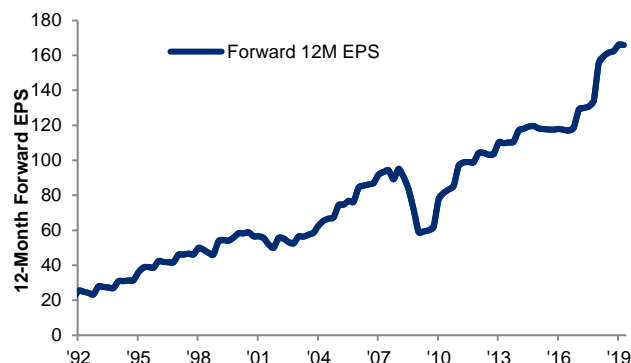


Figure 9: Crude Prices



Source: Bloomberg as of July 2019

Figure 10: S&P 500 12-Month Forward Earnings



Source: Bloomberg as of July 2019

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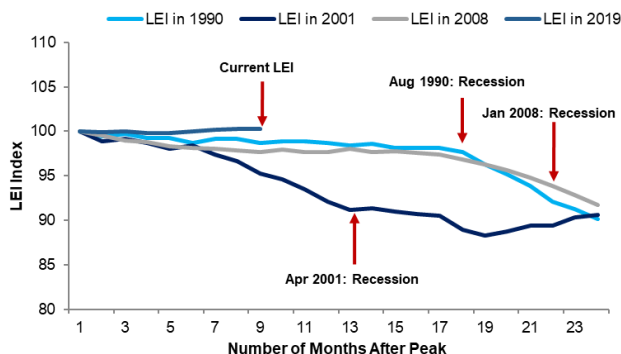
Bonus: A Three-Dimensional Analysis of US Leading Economic Indicators

We've been receiving lots of questions recently about when the "next recession" might begin. No one knows for sure but there are tools to help anticipate their likelihood or at least spot them early on. Currently, the NY Fed's Probability of Recession model assigns a 33% chance to one happening in the next 12 months while the CPB model odds are a bit higher ([Mid-Year Outlook 2019](#)). The St. Louis Fed's model gives a 1% chance to being in a recession now.

Another approach is pattern recognition. Here, we look at the US Leading Economic Indicator (LEI) series from three dimensions: level, time and breadth. The LEI has 10 components: average weekly hours worked, initial unemployment claims, new orders for consumer goods, new orders for non-defense capital goods, supplier delivery times, the yield curve, building permits, money supply, the stock market and consumer sentiment.

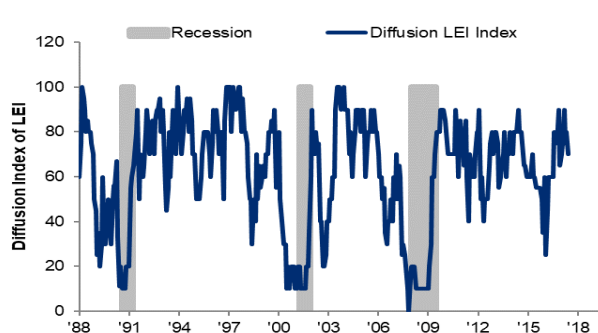
First, in the past three recessions the level of the US LEI was between 2.3% and 7.9% below its all-time high when an actual recession began (Figure 11). By comparison, today it is at an all-time high. Second, in the past three recessions, the LEI was below its all-time high for 12 to 22 months before the recession started, suggesting the possibility of the next recession being a year or more away. Third, less than 20% of the LEI's individual components had positive signals prior to the past three recession while 70% have positive signals currently (Figure 12). In other words, while trade and other risks abound, a recessionary pattern has yet to form.

Figure 11: US LEI Has Yet to Drop and Stay Below Peak Levels...



Source: Haver as of July 2019. Past performance is no guarantee of future returns. Real results may vary.

Figure 12: ...And Most of the Components Are Still Positive



Source: Haver as of July 2019

Global USD without Hedge Funds: Risk Level 3

Risk Level 3 is designed for investors with a blended objective who require a mix of assets and seek a balance between investments that offer income and those positioned for a potentially higher return on investment. Risk Level 3 may be appropriate for investors willing to subject their portfolio to additional risk for potential growth in addition to a level of income reflective of his/her stated risk tolerance.

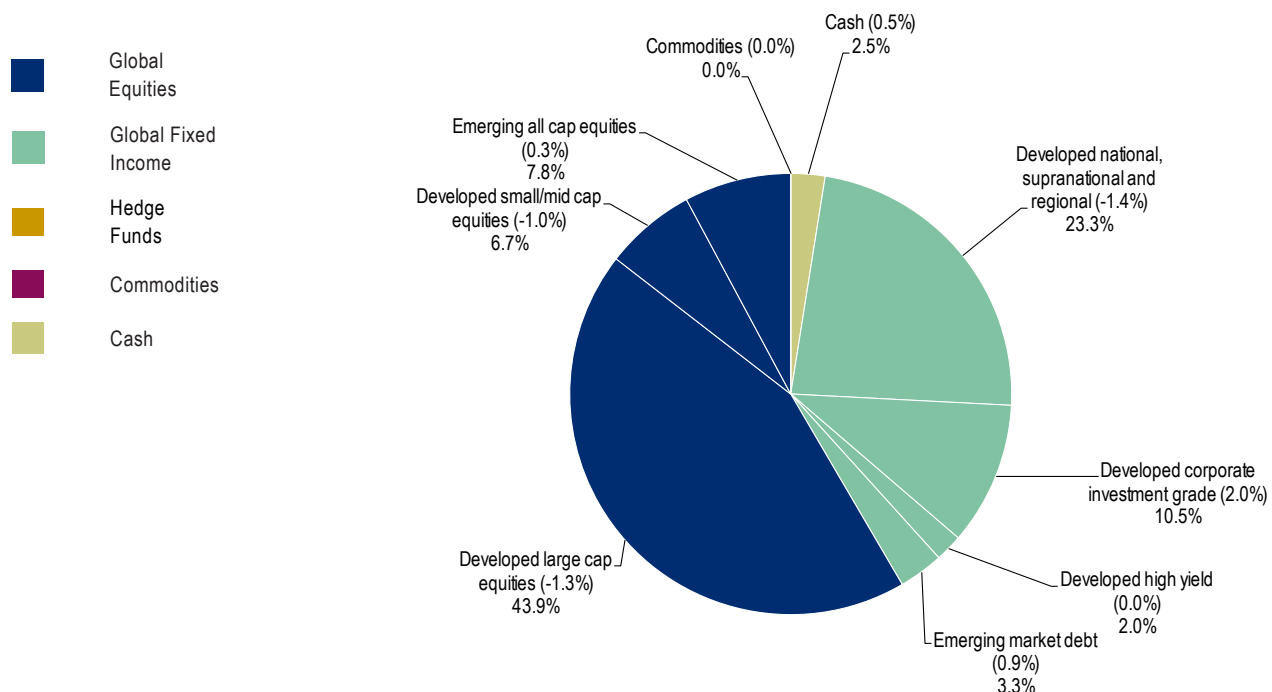
Classification	Strategic (%)	Tactical* (%)	Active (%)
Cash	2.0	2.5	0.5
Fixed Income	37.6	39.1	1.5
Developed Investment Grade	33.2	33.8	0.6
Developed National, Supranational and Regional	24.7	23.3	-1.4
Americas	9.7	14.3	4.6
EMEA	10.1	6.7	-3.4
UK	1.8	1.3	-0.5
Core Europe	4.8	3.2	-1.5
Peripheral Europe	3.8	2.0	-1.3
Others	0.3	0.2	-0.1
Asia	4.8	2.2	-2.6
Asia (ex Japan)	0.2	0.2	0.0
Japan	4.8	2.1	-2.7
Supranational	0.0	0.0	0.0
Developed Corporate Investment Grade	8.5	10.5	2.0
Americas	5.6	8.2	2.6
US	5.2	8.9	2.7
Canada	0.4	0.4	0.0
EMEA	2.8	2.2	-0.6
Europe (ex UK)	2.8	2.9	-0.4
UK	0.5	0.3	-0.2
Asia	0.0	0.0	0.0
Developed High Yield	2.0	2.0	0.0
Americas	1.6	1.6	0.0
EMEA	0.4	0.4	0.0
Emerging Market Debt	2.4	3.3	0.9
Americas	0.8	1.2	0.4
EMEA	1.3	1.0	-0.2
Asia	0.4	1.0	0.6
Hybrid Investments	0.0	0.0	0.0
Hedge Funds	0.0	0.0	0.0
Real Assets	0.0	0.0	0.0
Commodities	0.0	0.0	0.0
Private Equity	5.0	5.0	0.0
Real Estate	5.0	5.0	0.0

Classification	Strategic (%)	Tactical* (%)	Active (%)
Equities	60.4	58.4	-2.0
Developed Equities	52.9	50.6	-2.3
Developed Large Cap Equities	45.3	43.9	-1.3
Americas	30.1	29.0	-1.1
US All	28.4	27.4	-1.0
Canada	1.6	1.5	-0.1
EMEA	9.3	9.1	-0.2
UK	2.8	2.6	-0.1
Germany	1.3	1.4	0.1
France	1.5	1.5	-0.1
Switzerland	1.4	1.4	0.0
Benelux	0.6	0.6	0.0
Scandi	0.8	0.8	0.0
Spain	0.4	0.4	0.0
Italy	0.3	0.3	0.0
Others	0.1	0.1	0.0
Asia	5.9	5.8	-0.1
Australasia	1.1	1.1	-0.1
Far East ex Japan	0.8	0.9	0.2
Japan	4.0	3.8	-0.2
Developed Small/Mid Cap Equities	7.7	6.7	-1.0
Americas	4.4	3.8	-0.6
EMEA	2.1	1.8	-0.3
Europe (ex UK)	1.6	1.3	-0.3
UK	0.5	0.5	0.0
Asia	1.2	1.1	-0.1
Asia (ex Japan)	0.3	0.3	0.0
Japan	0.9	0.8	0.0
Emerging All Cap Equities	7.5	7.8	0.3
Americas	0.8	1.1	0.3
Brazil	0.5	0.7	0.2
Mexico	0.2	0.2	0.0
Other	0.1	0.2	0.1
EMEA	0.8	0.2	-0.6
Turkey	0.0	0.0	0.0
Russia and Eastern Europe	0.4	0.1	-0.3
South Africa	0.3	0.1	-0.3
Other	0.0	0.0	0.0
Asia	5.9	6.6	0.7
China	3.1	3.2	0.1
India	0.7	0.7	0.0
South Korea	0.8	1.0	0.2
Taiwan	0.7	0.8	0.2
Other Emerging Asia	0.6	0.9	0.3
Total	100.0	100.0	0.0

As of June 2019 GIC Meeting.

Active = the difference between tactical and strategic allocations. Minor differences may result due to rounding.

Global USD without Hedge Funds: Risk Level 3 - Tactical Allocations



Figures in brackets are active allocations. All allocations are subject to change at discretion of the GIC of the Citi Private Bank.

Core Positions

Global equities have an underweight position of -2.0%, global fixed income has an overweight of +1.5% with cash overweight at +0.5%.

Within fixed income, developed government debt has an underweight position of -1.4%, with US government debt at an overweight position. Developed corporate investment grade fixed income has an overweight position of +2.0% driven by overweight in US corporate investment grade fixed income.

Emerging market debt has an overweight position of +0.9% with both Asia and LatAm debt at overweight positions.

Within equities, developed large cap equities have an underweight position of -1.3% followed by developed small/mid cap equities at -1.0% while emerging market equities have an overweight of +0.3%.

As of June 2019 GIC Meeting.

Asset Allocation Definitions

Asset classes	Benchmarked against
Global equities	MSCI All Country World Index, which represents 48 developed and emerging equity markets. Index components are weighted by market capitalization.
Global bonds	Barclays Capital Multiverse (Hedged) Index, which contains the government -related portion of the Multiverse Index, and accounts for approximately 14% of the larger index.
Hedge funds	HFRX Global Hedge Fund Index, which is designed to be representative of the overall composition of the hedge fund universe. It comprises all eligible hedge fund strategies; including but not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, event driven, macro, merger arbitrage and relative value arbitrage. The strategies are asset-weighted based on the distribution of assets in the hedge fund industry.
Commodities	Dow Jones-UBS Commodity Index, which is composed of futures contracts on physical commodities traded on US exchanges, with the exception of aluminum, nickel and zinc, which trade on the London Metal Exchange (LME). The major commodity sectors are represented including energy, petroleum, precious metals, industrial metals, grains, livestock, softs, agriculture and ex-energy. The Thomson Reuters / Core Commodity Index is designed to provide timely and accurate representation of a long-only, broadly diversified investment in commodities through a transparent and disciplined calculation methodology.
Cash	Three-month LIBOR, which is the interest rates that banks charge each other in the international inter-bank market for three-month loans (usually denominated in Eurodollars).
Equities	
Developed market large cap	MSCI World Large Cap Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure the equity market performance of the large cap stocks in 23 developed markets. Large cap is defined as stocks representing roughly 70% of each market's capitalization.
US	Standard & Poor's 500 Index, which 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.
Europe ex UK	MSCI Europe ex UK Large Cap Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure large cap stock performance in each of Europe's developed markets, except for the UK
UK	MSCI UK Large Cap Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure large cap stock performance in the UK
Japan	MSCI Japan Large Cap Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure large cap stock performance in Japan.
Asia Pacific ex Japan	MSCI Asia Pacific ex Japan Large Cap Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure the performance of large cap stocks in Australia, Hong Kong, New Zealand and Singapore.
Developed market small and mid-cap (SMID)	MSCI World Small Cap Index, which is a capitalization-weighted index that measures small cap stock performance in 23 developed equity markets.
Emerging market	MSCI Emerging Markets Index, which is free-float adjusted and weighted by market capitalization. The index is designed to measure equity market performance of 22 emerging markets.
Bonds	
Developed sovereign	Citi World Government Bond Index (WGBI), which consists of the major global investment grade government bond markets and is composed of sovereign debt, denominated in the domestic currency. To join the WGBI, the market must satisfy size, credit and barriers-to-entry requirements. In order to ensure that the WGBI remains an investment grade benchmark, a minimum credit quality of BBB-/Baa3 by either S&P or Moody's is imposed. The index is rebalanced monthly.
Emerging sovereign	Citi Emerging Market Sovereign Bond Index (ESBI), which includes Brady bonds and US dollar -denominated emerging market sovereign debt issued in the global, Yankee and Eurodollar markets, excluding loans. It is composed of debt in Africa, Asia, Europe and Latin America. We classify an emerging market as a sovereign with a maximum foreign debt rating of BBB+/Baa1 by S&P or Moody's. Defaulted issues are excluded.
Supranationals	Citi World Broad Investment Grade Index (WBIG)—Government Related, which is a subsector of the WBIG. The index includes fixed rate investment grade agency, supranational and regional government debt, denominated in the domestic currency. The index is rebalanced monthly.
Corporate investment grade	Citi World Broad Investment Grade Index (WBIG)—Corporate, which is a subsector of the WBIG. The index includes fixed rate global investment grade corporate debt within the finance, industrial and utility sectors, denominated in the domestic currency. The index is rebalanced monthly.
Corporate high yield	Bloomberg Barclays Global High Yield Corporate Index. Provides a broad-based measure of the global high yield fixed income markets. It is also a component of the Multiverse Index and the Global Aggregate Index.
Securitized	Citi World Broad Investment Grade Index (WBIG)—Securitized, which is a subsector of the WBIG. The index includes global investment grade collateralized debt denominated in the domestic currency, including mortgage -backed securities, covered bonds (Pfandbriefe) and asset-backed securities. The index is rebalanced monthly.

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Bond rating equivalence

Alpha and/or numeric symbols used to give indications of relative credit quality. In the municipal market, these designations are published by the rating services. Internal ratings are also used by other market participants to indicate credit quality.

Bond credit quality ratings	Rating agencies		
Credit risk	Moody's ¹	Standard and Poor's ²	Fitch Ratings ²
Investment Grade			
Highest quality	Aaa	AAA	AAA
High quality (very strong)	Aa	AA	AA
Upper medium grade (Strong)	A	A	A
Medium grade	Baa	BBB	BBB
Not Investment Grade			
Lower medium grade (somewhat speculative)	Ba	BB	BB
Low grade (speculative)	B	B	B
Poor quality (may default)	Caa	CCC	CCC
Most speculative	Ca	CC	CC
No interest being paid or bankruptcy petition filed	C	D	C
In default	C	D	D

1 The ratings from Aa to Ca by Moody's may be modified by the addition of a 1, 2, or 3 to show relative standing within the category.

2 The ratings from AA to CC by Standard and Poor's and Fitch Ratings may be modified by the addition of a plus or a minus to show relative standing within the category.

Alternative investments referenced in this report are speculative and entail significant risks that can include losses due to leveraging or other speculative investment practices, lack of liquidity, volatility of returns, restrictions on transferring interests in the fund, potential lack of diversification, absence of information regarding valuations and pricing, complex tax structures and delays in tax reporting, less regulation and higher fees than mutual funds and advisor risk. Asset allocation does not assure a profit or protect against a loss in declining financial markets.

REITs are subject to special risk considerations similar to those associated with the direct ownership of real estate. Real estate valuations may be subject to factors such as changing general and local economic, financial, competitive, and environmental conditions. REITs may not be suitable for every investor. Dividend income from REITs will generally not be treated as qualified dividend income and therefore will not be eligible for reduced rates of taxation.

Mortgage-backed securities ("MBS"), which include collateralized mortgage obligations ("CMOs"), also referred to as real estate mortgage investment conduits ("REMICs"), may not be suitable for all investors. There is the possibility of early return of principal due to mortgage prepayments, which can reduce expected yield and result in reinvestment risk. Conversely, return of principal may be slower than initial prepayment speed assumptions, extending the average life of the security up to its listed maturity date (also referred to as extension risk).

Additionally, the underlying collateral supporting non-Agency MBS may default on principal and interest payments. In certain cases, this could cause the income stream of the security to decline and result in loss of principal. Further, an insufficient level of credit support may result in a downgrade of a mortgage bond's credit rating and lead to a higher probability of principal loss and increased price volatility. Investments in subordinated MBS involve greater credit risk of default than the senior classes of the same issue. Default risk may be pronounced in cases where the MBS security is secured by, or evidencing an interest in, a relatively small or less diverse pool of underlying mortgage loans.

MBS are also sensitive to interest rate changes which can negatively impact the market value of the security. During times of heightened volatility, MBS can experience greater levels of illiquidity and larger price movements. Price volatility may also occur from other factors including, but not limited to, prepayments, future prepayment expectations, credit concerns, underlying collateral performance and technical changes in the market.

The indexes 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. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results.

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.

Investing in smaller companies involves greater risks not associated with investing in more established companies, such as business risk, significant stock price fluctuations and illiquidity.

Factors affecting commodities generally, index components composed of futures contracts on nickel or copper, which are industrial metals, may be subject to a number of additional factors specific to industrial metals that might cause price volatility. These include changes in the level of industrial activity using industrial metals (including the availability of substitutes such as man-made or synthetic substitutes); disruptions in the supply chain, from mining to storage to smelting or refining; adjustments to inventory; variations in production costs, including storage, labor and energy costs; costs associated with regulatory compliance, including environmental regulations; and changes in industrial, government and consumer demand, both in individual consuming nations and internationally. Index components concentrated in futures contracts on agricultural products, including grains, may be subject to a number of additional factors specific to agricultural products that might cause price volatility. These include weather conditions, including floods, drought and freezing conditions; changes in government policies; planting decisions; and changes in demand for agricultural products, both with end users and as inputs into various industries.

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