Private Bank

Europe Strategy

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Europe recovering, fiscal transfers expected soon

- **Europe and UK face challenging unlocking phases.** We expect some virus resurgences, but no new widespread and prolonged lockdowns.

- **Government financial support programs have further to go.** Implementation – ensuring that the most needy individuals and companies receive timely and sufficient support – has differed by country. A pan-European fiscal approach is moving closer, which would be very positive.

- **Central banks have supported bond market stability and bank payment systems, as well as providing cheap lending.** We expect both the European Central Bank (ECB) and the Bank of England (BoE) to expand their asset purchase programmes in size and breadth.

- **GDP recoveries are underway, but activity levels are still far below normal levels, with risks that recovery paces could slow.** We expect corporate earnings will fall by over 40% this year, before rebounding a similar amount next year.

- **Equities are expected to recover in relative terms, as the growth differential with the US narrows, and as European policymaking gets more aggressive.** We expect 'COVID-cyclical' areas to lead. Value is preferred over growth. Balance sheet strength is vital and a key differentiator for selection in the months ahead.

- **As the UK enters the last six months of the Brexit transition period, we increasingly expect a basic trade deal between the EU and the UK to be agreed in the autumn.**

- **The virus's impact reinforces some of our recommendations from the start of the year**. These include staying invested, diversifying sensibly, and embracing higher volatility. Our long-term Unstoppable Trends like fintech and cybersecurity still offer attractive equity potential.

Contents

Unlocking and virus progression

As unlocking proceeds, governments face a delicate balancing act between containing the virus, not overwhelming healthcare systems, maintaining social stability, and preserving economic capacity.

For this reason, there is a growing likelihood that we see phased and partial lockdowns in the months ahead, once the current lockdown periods end. We expect the virus to run its course, with periodic regional resurgences. We don't expect a commercialized vaccine before the middle of next year at the earliest.

We raise Europe equity to neutral

At the start of this year, Europe was finally beginning to see some positive growth impact from the extensive ECB actions over the previous eight years. However, the upturn was fragile and without strong momentum. The timing of COVID-19 was thus particularly unfortunate for Europe. The early epicentre of the virus was Europe's most economically fragile country Italy, highlighting the challenges to come. The breakdown of European economic output, with a heavy weighting in areas immediately and severely hit by crisis – notably travel and tourism, **figure 1** – has resulted in the worst quarterly growth on record in the current second quarter, and a downgrade in our growth forecast for this year to -8%.

Initial European government policies were aimed at maintaining corporate productive capacity and individuals' ability to spend when the pandemic eventually eased. While being the largest on record in absolute terms and the biggest on record as percentages of GDP, the amounts were inadequate as they were less than the full fiscal absorption needed. They also differed by country in terms of their breakdowns, implementation, and particularly with the sizes needed. Early in the pandemic, it was clear that significant solidarity was needed with respect to financial support for the peripheral Eurozone countries **– figure 2.**

Figure 1: Inbound & outbound tourism expenditures (% GDP in 2019)

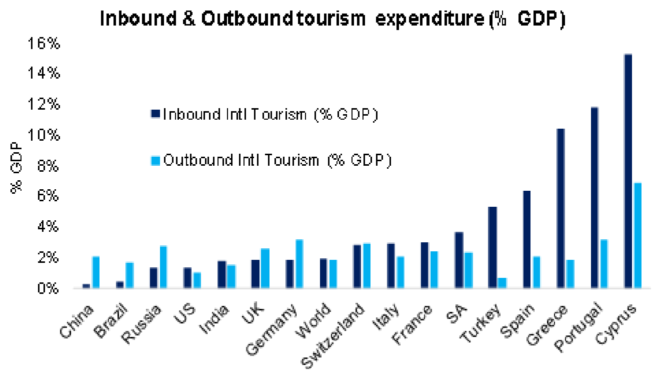
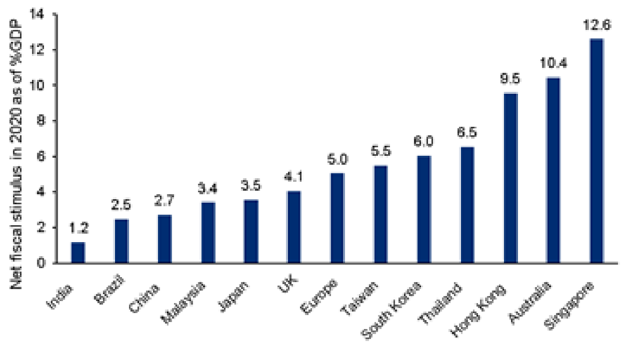


Figure 2: Fiscal stimulus as % GDP



Source: Bloomberg, World Bank as of June 17th 2020

The initial ECB response, with the announcement of its €750 billion Pandemic Emergency Purchase Programme (PEPP), was primarily aimed at helping to keep bond yields low to help finance the fiscal expansions. The ECB also breached their capital keys to enable greater support for the periphery bond markets. But the German Constitutional Court (GCC) decision a few weeks ago raised uncertainty about the legality of the PEPP and also previous ECB quantitative easing programs.

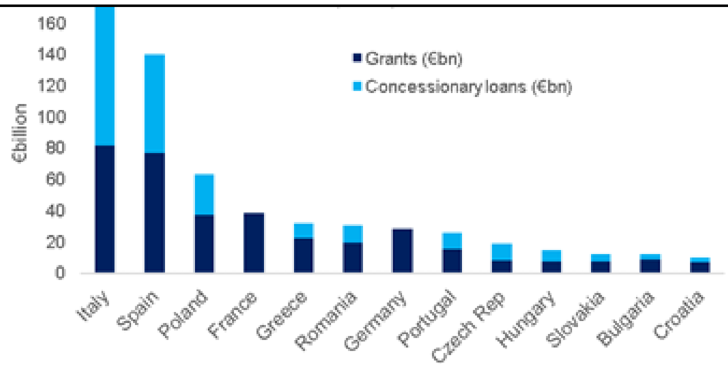
While these policy responses were an important reason for European markets to suffer badly in the early stages of the pandemic, the underperformance during the recent global market recovery has been due to an additional reason – the global recovery has been led by 'COVID-defensive' sectors such as technology. European markets only have modest weightings in ‘COVID-defensives’, particularly in comparison with the US.

We have recently had compelling reasons to double our European 2021 GDP growth forecast to +3.0%. This gives us high confidence that European equities can start to participate more fully in the new economic cycle’s global equity upturn, led by ‘COVID-cyclicals’. There are now fewer reasons for European markets to continue to underperform in relative terms. In absolute terms, the return outlook should be positive, as the global market outlook improvement has justified our move to overweighting global equities.

There are three reasons for our growth upgrade, which is at the heart of our increased European equity addition and move to a neutral weighting:

Firstly – and most critically – we believe that the recently-proposed EU 27 pan-European response will eventually be agreed as part of the next seven-year EU budget **– figure 3**. Its importance cannot be underestimated. The proposed size of €750 billion starts in 2021 and would add fiscal stimulus of about 1.4% of GDP for the next few years starting in 2021. The proposal includes €440 billion in the form of grants with minimal conditions, focused on the periphery countries. The concept of fiscal transfers was originally proposed by Germany and France, and as a consequence, both would be bigger net contributors to the EU budget than they have been. The proposal includes revenue-generating proposals in growth areas like digital technology and green energy. EU solidarity around the proposal also gives hope that it could be the start of further structural reform progress in the longer term.

Figure 3: EU 27 Recovery Fund proposal



Source: EU as of June 17th 2020

Secondly, both Germany and France have made further substantial domestic fiscal expansions, each of around €130 billion. This is in addition to their €156 billion and €90 billion respective previous commitments. In Germany’s case, this is being funded with €150 billion of new borrowing, which moves them away from their historic aversion to debt and ‘schwarze Null’ rule. In France, President Macron is taking this fiscal expansion step further in a socialist direction even as he is slipping in recent polling, indicating his recognition of the game-changing impact of COVID-19.

Thirdly, the ECB added €600 billion to its PEPP, increasing its total size to €1.35 trillion. It also reiterated its intention to do more if necessary. In addition to the clear benefit this will have on helping to suppress peripheral nations’ bond yields, with this move the ECB also allayed concerns relating to the GCC, and reconfirmed the primacy of the European Court of Justice (ECJ) over the GCC. ECB head Ms Lagarde stressed the importance of the latest ECB move being ‘proportional’ to aims and expected outcomes, the critical requirement from the GCC.

These policy moves in combination are likely to have a substantial positive impact on the economic data, which is only now starting to pick up off the April lows, with above-consensus data rises from very depressed levels **– figure 4**. The positive growth surprises will change investor perceptions of Europe. However, given the deep skepticism towards European policymaking going back several years, this investor perception change will only take place gradually. Markets will thus only discount this slowly, giving the opportunity to add despite the Eurostoxx index's 35% rally from its March lows. Note that the Eurostoxx is still down 15% from its February 2020 high, and is down 8% year-to-date compared with the S&P index down 4% year-to-date.

Figure 4: Citi Economics Surprise Index - Europe

Source: Bloomberg as of June 17th 2020. Citi Economic Surprise Indices are objective and quantitative measures of economic news. They are defined as weighted historical standard deviations of data surprises (actual releases vs Bloomberg survey median).

Economic recoveries underway, but activity levels far below normal

While the economic recoveries are firmly underway, the pace of the growth upturn is expected to ease in the coming months. Specifically, the economy could still be held back by three factors:

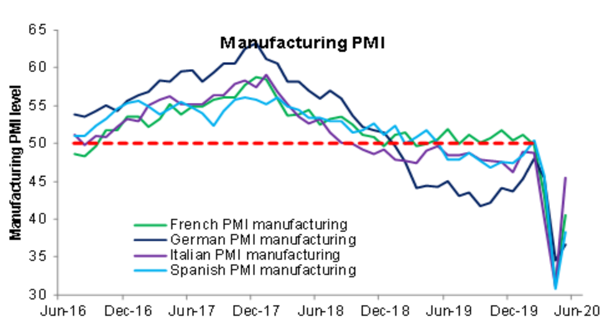
1. **Ongoing social distancing** in some sectors like travel, restaurants, live entertainment, and retail;

2. **Further challenges in rebuilding supply chains** for manufacturers;

3. **A recovery in corporate and consumer confidence that takes some time.**

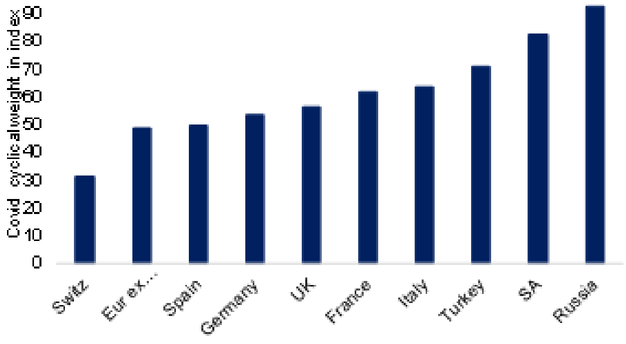
Even as the pace of the pickups eases for the above reasons, European markets will be led by cyclical sectors of the larger manufacturing-dominated countries like Germany - **figure 5**. That nation's export sectors will benefit from firmer global growth. Across Europe, we anticipate that the 'COVID-cyclical' areas that will rebound most will be broader than industrials, and include consumer cyclicals, energy, and financials. These sectors are above 50% in almost all European markets – **figure 6**. **Some of those areas, notably financials, are cheap in valuation terms and should benefit from a broader investor interest in value stocks.** See further details on pages 7 and 8.

Figure 5. Manufacturing PMI level



Source: Bloomberg as of July 1st 2020.

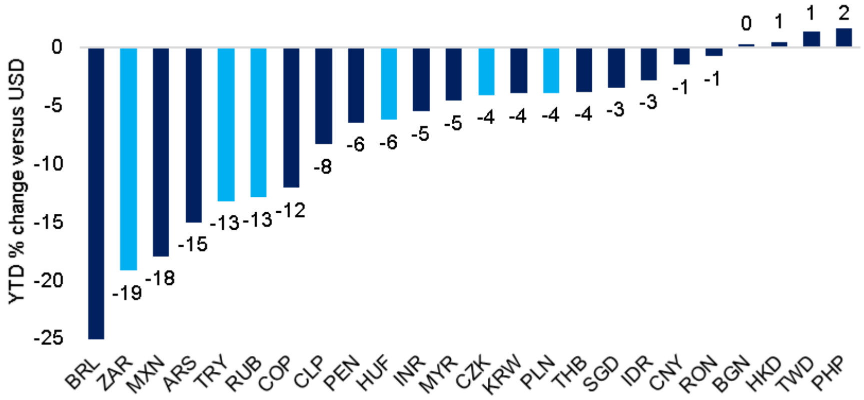
Figure 6. 'COVID-cyclical' country weightings



Source: Bloomberg as of July 1st 2020. "Covid Cyclicals: Financials, industrials, materials, real estate, consumer discretionary. "Covid Defensives": IT, healthcare, communication services, consumer staples, utilities.

We have reduced our underweight positions in the large emerging countries of Europe – Turkey, Russia, South Africa. They are not yet seeing confirmed peaks in virus infections. On the positive side, though, their valuations are reasonable, they benefit from firmer commodity prices, as well as from increasing global risk appetite and a weaker US dollar. In particular, Russia is helped by a higher oil price, South Africa by a firmer rand, and Turkey by a pickup in its manufacturing sector. CEEMEA equities have rallied over 40% since the March lows, yet still trade over 24% down year-to-date **– figure 7.**

Figure 7: CEEMEA YTD currency performance (%)



Source: Bloomberg as of July 1st 2020. Past performance is no guarantee of future returns. Real results may vary.

Europe - asset class views

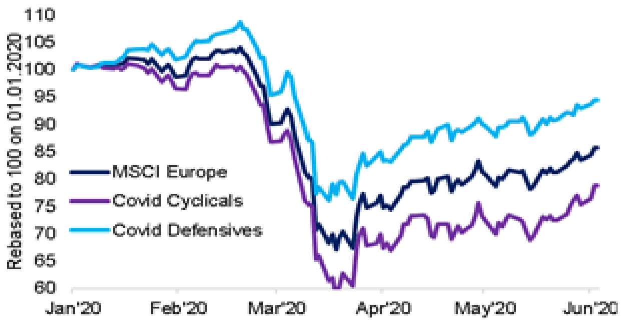
Equities

As we highlighted in April, (COVID-19 highlighting European winners and losers), we have favoured more resilient and defensive areas within the market, including **healthcare, IT, communication services, and consumer staples.** These areas have outperformed, with the smallest earnings downgrades on a relative basis.

However, as we've shown in both the Mid-Year Outlook and in the May Quadrant, a growing performance divergence has emerged between European 'COVID cyclicals' and 'COVID-defensives', with 'COVID-cyclicals' outperforming by 16% year-to-date – **figure 8**. While we continue to maintain portfolio quality and favour our long-term 'COVID-defensive' winners like IT and healthcare, more tactical outperformance is likely to come from industries and sectors which have been oversold. Strong returns in our favoured sectors thus far only detracts from further forward looking returns. Our Global Investment Committee (GIC) has already begun increasing exposure to more cyclical areas of the market.

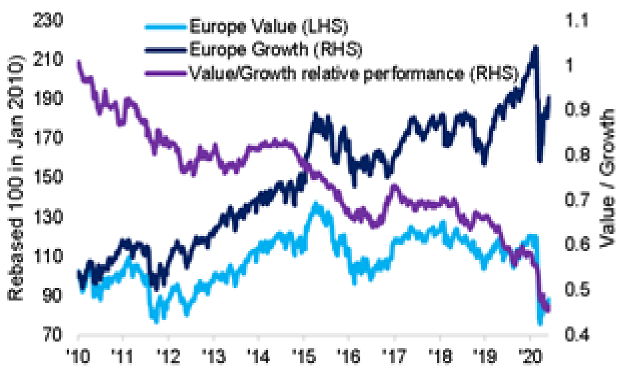
This creates tactical opportunities in oversold industries, and in companies which have underperformed despite their resilient balance sheets. It also creates opportunities in certain value areas, with value stocks outperforming growth by 5% since mid-May, following a decade of underperformance – **figure 9.**

Figure 8: European 'COVID-cyclicals' have lagged



Source: Bloomberg as of June 17th 2020. "Covid Cyclicals: Financials, industrials, materials, real estate, consumer discretionary. "Covid Defensives": IT, healthcare, communication services, consumer staples, utilities. 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 9: Long-term value underperformance vs growth



Source: Bloomberg as of June 17th 2020

In addition to being oversold, the 'Covid Cyclical' sectors have solid fundamental and valuation support:

Financials are down 30% YTD driven by (1) dividend suspensions (which could get extended into 2021), (2) rising likely loan defaults, and (3) elevated periphery exposure – Italy and Spain account for 48% of the index. The sell-off has driven banks to their cheapest average P/B valuation at 0.35x in history. We expect financials will benefit from a value rebound, while the proposed EU recovery fund and ECB measures will help also alleviate tail-risk periphery pressures.

Industrials: As manufacturing activity resumes and factories re-open, industrials are set to benefit. Manufacturing PMI data for May rose to 39.4 (v 33.4 in April) as lockdown measures begin to ease. Europe generates 15% of its GDP from manufacturing, with Germany and Switzerland having weightings closer to 20%. Industrials in these areas could see some near term outperformance, despite having a price-to-earnings ratio higher than Europe more broadly.

Consumer Discretionary: The sector has seen large downward revisions so far year-to-date. While many areas of the discretionary space are likely to continue facing pressure, such as airlines and autos, pockets of opportunity have emerged in oversold, resilient companies with strong balance sheets, which could benefit as economies re-open and demand returns.

Energy: As energy consumption picks up and OPEC+ production cuts since 1st May feed through, oil prices have rebounded 30% from the lows over the last month. Citi Equity Research expects Brent to average $39/barrel in Q3 and $48/barrel in Q4. While the more resilient oil majors could continue their short-term rebounds, we continue to maintain our preference for companies within the clean energy space on a longer term basis. Our renewable energy basket (A Cleaner Way to Play European Equities) has outperformed broader Europe by over 20% since the beginning of 2020 and by over 60% since early 2017.

European small and medium-sized companies (SMID) are expected to outperform. Historically SMID has outperformed in the early stages of a cyclical upturn and also shown strong performance after sizeable market consolidations **- figure 10.**

Figure 10: SMID performance 12m period after previous market bottoms

	Forward 12M Performance	
Prior Bottoms	Large	SMID
12/03/2003	45%	61%
09/03/2009	62%	79%
23/11/2011	22%	30%
12/02/2016	19%	24%
27/12/2018	26%	35%
Average	**35%**	**46%**
Performance since recent bottom		
23/03/2020	*25%*	*34%*

Source: Bloomberg as of June 17th 2020. 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. Index returns do not include any expenses, fees or sales charges, which would lower performance. For illustrative purposes only. Past performance is no guarantee of future results. Real results may vary. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events.

Fixed Income

Within the corporate bond space,we still favour the higher quality investment grade (IG) issuers which have strong credit metrics and do not face credit rating downgrade risks.

In addition, selective opportunities also exist in the high yield (HY) sub-sector. Since the March lows, European HY has rallied 18% compared to the 6.5% rally in IG. Defaults in Euro HY have stayed muted versus the US, although this can also be attributed to lower overall levels of leverage and a smaller energy sector weighting. The month of May saw zero defaults in Europe, placing the trailing 12-month default rate at 1.1%. For comparison, the US saw 10 defaults in May and a default rate of 4.1%.

While the S&P rating agency have forecasted Euro HY defaults to reach over 8% this year, we believe there is a strong possibility that defaults will not rise this high. Yields in Euro HY also look attractive at 5.7%, compared to IG which offers yields of 0.9%.

United Kingdom

As Brexit enters the last six months of the transition period, trade negotiations intensify

Having left the European Union on 31st January 2020, the UK is next due to leave its one-year transition period on 31st December 2020. During the transition, the UK's trading relationship, financial contributions, and legal obligations are the same as they were during its formal membership. The UK's Prime Minister Johnson has chosen not to seek an extension.

With just over six months to go – and with the attention of both sides having focused on the COVID-19 pandemic over recent months – there is a risk that the UK will finish the transition without achieving the period's principal objective of striking an EU trade deal. **However, our base case is that this risk is falling and a trade deal is increasingly likely.**

PM Johnson's end of July deadline for an outline deal is probably too aggressive. However, an outline by October should give the respective governments sufficient time to ratify the deal in their parliaments. Given the short time period, we are not expecting an elaborate deal, and in economic terms the deal might not be hugely more advantageous than leaving without a deal under WTO terms. The key benefit of a basic trade deal would be political, in that it would maintain a strong relationship and dialogue for a future broader agreement or series of sub-agreements.

These are the main points of contention, with limited signs of agreement on any of them yet:

1. **Sovereignty.** The UK's negotiating stance on this is that the UK is a sovereign country and is thus entitled to the same type of EU agreement as other sovereign countries like Canada.

2. **EU market access.** The EU wants a "level playing field" on labour, environment, state aid, and competition rules, in exchange for UK market access to the single market.

3. **Governance.** The EU would like a single agreement covering everything, overseen by the European Court of Justice (ECJ) which can also impose sanctions if necessary. The UK says that this would bind it to the EU's legal order and thereby violate UK sovereignty. The UK seeks a comprehensive free trade agreement, plus separate individual agreements covering such areas as aviation, energy, social security, nuclear cooperation, law enforcement, fishing rights, and asylum seekers.

4. **Irish border.** The Northern Ireland protocol was agreed alongside the exit deal signed last year. It stipulates that Northern Ireland remains part of the UK customs territory. As such, it can participate in any trade deals that the UK strikes with other countries. Simultaneously, however, Northern Ireland is covered by the EU customs code, thus ensuring no hard border with the Republic of Ireland. The EU is insisting on customs checks on goods entering Northern Ireland from the British mainland, to ensure that the correct tariffs are paid before the goods are moved into the single market via the Republic of

Ireland. The detailed logistical arrangements of these customs checks are not yet agreed.

5. **Fishing rights.** The issue is what rights EU fishermen will have to the UK's Exclusive Economic Zone after Brexit, which could stretch as far as 200 nautical miles from the UK coastline. There are around 75 species of fish in the zone, including staples of the European diet like sole, mackerel, and herring. The UK is also incentivised to reach a fishing rights agreement, as it runs a trade surplus with the EU in fish. The UK also depends on the European single market for sales of some of its most lucrative species like scallops and langoustines. The EU would like to "uphold" its existing fishing rights on a perpetual basis, while the UK wants to break free from the EU's Common Fisheries Policy and instead establish quotas based on "zonal attachment" (where the fish are) with an annual review. The political declaration agreed last year alongside the exit agreement specified that fishing rights would be agreed by the end of June 2020. Any fishing agreement would also need to address the issue of fish sustainability.

6. **UK financial services.** The sector contributes 12% of UK output and generates more tax revenue than any other sector. The UK accepts that "passporting" – full access for its financial services firms to all European single market nations – is unlikely. However, the UK is aiming instead for "mutual recognition" of closely aligned regulatory standards. But "mutual recognition" is more than the EU offers any other third country. So, the EU is instead seeking "equivalence". This is where the two sides would each set their own standards and regulations, while recognising each other's regulations as effectively the same. The major drawback of "equivalence" from the UK standpoint is that it could be withdrawn by Brussels at very short notice.

The pressure on both sides to compromise and to show flexibility is greater than it was during the three-year exit negotiations. This is because the pandemic-weakened EU economic environment has weakened both sides, and put both under enormous pressure to find ways to revive growth sustainably.

Should no extension be agreed this month, the UK would leave the transition period and trade with the EU on World Trade Organisation (WTO) terms. Preparation time for this scenario would be very limited, resulting in significant administrative challenges. After the transition period, the EU will classify the UK as a "third country", meaning that it is no longer an EU member and no longer benefits from its current trade access to EU countries and the outside world. The current average WTO tariff is 4.8%. However, the UK government has previously stated that it would introduce temporary measures to remove tariffs on 60% of goods so as to reduce the business disruption due to Brexit. Nonetheless, given that WTO members are required to treat countries with which they do not have a trade deal with in the same way, any UK tariff reductions or eliminations for a particular country would require it to grant the same to all other WTO member states.

On balance we feel the swing factor in getting a basic deal done could be the increasing involvement of senior figures in addition to the trade negotiators from both sides in recent discussions. For example, PM Johnson has recently met the European Commission President Ursula von der Leyen to discuss Brexit. From 1st July, Germany assumes the six-month presidency of the EU Council, and its probable that Angel Merkel will prioritize helping to achieve a cordial exit including a trade deal.

UK – Asset Class Views

UK Equities - long-term positive, will move with the virus unlocking progress

UK equities remain down 14% so far in 2020 (as of 30th June), underperforming broader Europe and the US. With close to 70% of overseas revenue exposure, UK equities have been hit hard by a combination of the global slowdown, its delayed virus containment strategy, and the fact that 70% of output is derived from the stressed services sector. With earnings and dividend uncertainty, the FTSE 100 currently offers a dividend yield of 4.4% and trades on a high teens multiple of prospective earnings. There are selective opportunities in cyclical areas like energy and financials, as well as in mid-caps as the economy starts to rebound. UK equities could also benefit from a value rebound more broadly.

Sterling - short-term pressures moving with economic news, giving long-term buying opportunity driven by positive Brexit developments

Since March lows, Sterling has rallied from $1.15 to $1.27, before retracing back to $1.24. Economic pressures will hold back an immediate recovery. Medium-term, having now discounted that the UK won't be seeking a transition extension beyond the end of this year, focus will turn to the trade discussions. Our view is that a basic deal with the EU is increasingly likely, which would support Sterling. Sterling is also attractive in valuation terms.

Gilts - short term positive, will move with BoE bond buying programe

In the last two months, Gilt 10-year yields have fallen from 0.8% to under 0.2%. While increased gilt issuance is necessary to fund the rising fiscal expansion in the face of COVID-19's economic fallout, and with the early signs of a cyclical pickup, continued BoE buying is going to be necessary to maintain the current low level of yields. The BoE have already increased its asset purchase programme by £100bn in the last month.

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	Bloomberg 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.
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. FTSE 100 Index: Capitalisation weighted index of the 100 most highly capitalised companies traded on the London Stock Exchange FTSE 250 Index: Capitalisation weighted index of the 250 most highly capitalised companies outside of the FTSE 100 traded on the London Stock Exchange
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.

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Changes in Regulatory or Tax Treatment of Energy Related MLPs. If the IRS changes the current tax treatment of the master limited partnerships included in the Basket of Energy Related MLPs thereby subjecting them to higher rates of taxation, or if other regulatory authorities enact regulations which negatively affect the ability of the master limited partnerships to generate income or distribute dividends to holders of common units, the return on the Notes, if any, could be dramatically reduced. Investment in a basket of Energy Related MLPs may expose the investor to concentration risk due to industry, geographical, political, and regulatory concentration.

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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.

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