HOUSE VIEW

HINDUJA BANK SWITZERLAND

GICS reclassification

ESG: a multiplicity of approaches

Record low rupee put Modi under pressure

Trade war weakens the yen

Greece: still struggling

October 2018

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Dear Reader,

The proliferation of funds with responsible investing strategies has spurred a multiplicity of approaches, from a tick-box mentality to a more nuanced scrutiny of each investment opportunity. As the popularity of impact measurement grows, companies face growing demands from investment houses and fund managers to publish information, fuelling debate about how to standardise these measurements into a formal classification system.

In India, weak currency and stock markets put further pressure on Prime Minister Narendra Modi's government, which has promised a range of measures to halt the rapid depreciation of the rupee. As a matter of fact, Mr Modi argued, while in opposition, that the strength of the rupee reflected the strength of its leadership.

One reason why most other major currencies have recovered some ground against the US dollar since mid-August could be that US has refocussed its protectionism on China. The yen, however, has not participated in this relief rally because Japan has relatively close ties to China.

Greece's economy is struggling along, with no signs of a badly needed upswing. Nevertheless, manufacturing and retail trade posted significant improvements compared to the previous year.

Sincerely,

Michel Menoud
Chief Investment Officer

Key Themes

ESG: a multiplicity of approaches

As the market for environmental and social investing grows, investors are reassessing the non-financial effects of the companies they back, a process set to make more green assets available.

The proliferation of funds with responsible investing strategies has spurred a multiplicity of approaches, from a tick-box mentality to a more nuanced scrutiny of each investment opportunity.

Traditional ESG measuring has been about how much less bad you are, what is being asked now is what good you are doing.

Investors generally insist their impact methodologies do not justify backing a financially weaker company. Instead, they are a way of choosing between potential investments that have already met purely financial criteria. The impact rating becomes integrated into the overall investment decision.

As the popularity of impact measurement grows, companies face growing demands from investment houses and fund managers to publish information, fuelling debate about how to standardise these measurements into a formal classification system.

Record low rupee put Modi under pressure

Weak currency and stock markets put further pressure on Prime Minister Narendra Modi's government, which has promised a range of measures to halt the rapid depreciation of the rupee.

The government has announced a series of import restrictions, which should help sustain the country's currency and close the widening current account deficit. However, the move is likely to exacerbate tensions with some of India's closest allies, which have expressed concern over some of the country's protectionist trade policies.

The rupee has fallen sharply this year, losing about 12% against the dollar, in part because of economic problems in countries such as Turkey and Argentina, but also because sluggish exports and high imports have driven up the country's current account deficit. India has announced this month that the deficit had widened to USD15.8bn, or 2.4% of gross domestic product, during the April to June quarter.

This has caused problems for Mr Modi, who argued while in opposition that the strength of the rupee reflected the strength of its leadership. The currency's decline has come alongside a rise in the oil price, both of which have led to higher fuel costs for consumers.

Corporate groups are lobbying to be excluded from the list of sectors about to be hit by import curbs.

Trade war weakens the yen

One reason why most other major currencies have recovered some ground against the US dollar since mid-August could be that US has refocussed its protectionism on China. The yen, however, has not participated in this relief rally because Japan has relatively close ties to China. Admittedly, the renminbi has stabilised.

There is a high probability that China will remain the primary focus of US protectionism and that China's economy will continue to cool until policy stimulus there starts to stabilise growth next year. If so, the yen could struggle some more against the currencies of other major developed economies outside the US, unless Trump turns up the heat on them again or else turns it down on Japan. Yet even if developments in the global trade war remain unfavourable for Japan, analysts think that the yen will recover against the US dollar itself.

This is tied to the view that the greenback could weaken as the Fed stops its rate hikes. While investors have slowly come round to the view that the policy rate in the US will peak at 2.75-3.00%, they are assuming that the peak will not be reached until the end of 2019. Other analysts think that it will be hit in the middle of the year, as economic growth starts to slow below its potential.

Some argue that the yen must fall further regardless of the prospects for monetary policy, as it is the only way for Japan to inflate away its huge public debt. However, the yen is already near a multi-decade low after accounting for inflation at home and abroad.

Greece: still struggling

Greece's economy is struggling along, with no signs of a badly needed upswing. Nevertheless, manufacturing and retail trade posted significant improvements compared to the previous year.

The current account balance did not fare so well however. During the first half of the year, the deficit increased to EUR 3.6bn, marking an increase of around 25% compared to H1 2017.

Following the official end of the "bailout regime" the country will remain under an enhanced "surveillance programme" by the EU and IMF until at least 2022.

Reports on fiscal policy and reform efforts will be prepared on a quarterly basis, and the approval of further aid will be linked to these. In parallel with this, the Greek banking system must work to reduce its stock of non-performing loans.

The equity index in Athens slipped significantly in August, losing around 4%.

Economic overview

The Global economy remains above trend, although recent data suggest a softening in Europe. President Mario Draghi is expecting a "relatively vigorous" pickup in inflation. However, the ECB has been always clear regarding its forward guidance, stating no interest rate hike before September 2019.

Switzerland

Consumer sentiment in Switzerland has almost dropped back to its long-term average, as showed by the State Secretariat for Economic Affairs survey, which is conducted on a quarterly basis. Consumers anticipate positive developments in the economy and labour market, but with a somewhat reduced momentum, as uncertainty about the potential effects of trade tensions are unclear. On the other hand, the Federal Council announced it forecasted Switzerland to end 2018 with a budget surplus of CHF 2.8bln instead of the 300mln initially budgeted, the explanation being the solid state of the economy.

SNB's alternate governing board member Thomas Moser said it could take a very long time for the Central Bank to reduce the size of its balance sheet, which reached 120% of the size of the economy, a larger ratio than the ECB or BoJ. "The size of the balance sheet is not a goal or objective of the SNB, its expansion is the result of our policy" he said. The strategy differs from other major Central Banks, such as the Fed or the ECB, who are in the process of reducing the size of their balance sheets.

Eurozone

Trade tensions, receding consumer and manufacturer confidence as well as the Turkey crisis and the contagion risks it poses, weighted heavily on European financial markets in August. These factors also dampened hopes of solid economic growth for the remainder of the year. Italy-EU relations remained tense as the nation populist administration is preparing to unveil its budget next month, which investors fear it will break the EU deficit rules, as the government said they are ready to increase the imbalance if it boosts their economy.

Mario Draghi unrenewable mandate will come to an end in October 2019. Jens Weidman, the actual Bundesbank president and a stimulus hawk was seen as the favourite candidate likely to get the job with the help and support of Angela Merkel, in a move to assert Germany's clout over European institutions. According to Handelsblatt, Mrs Merkel is now focused on securing the European Commission presidency, as the position is going to be vacant next year and where Germany would gain more political leverage than at the ECB.

USA

Trade talks between the US and China were again making headlines last month, bringing the total amount on which tariffs are levied to a combined USD 100bln, it however had little effect on the US economic performance which showed solid numbers for growth, employment and inflation. Probably buoyed by soaring stock indices, the consumer confidence index published by the conference board reached a record level not seen for almost two decades. US Q2 GDP grew 4.2%, its best performance in four years.

The Federal Reserve raised short-term interest rate for the third time this year and signalled it would forge ahead with plans to tighten policy even as central bankers face White House pressure to keep down borrowing costs. The Fed assessed strong labour market conditions as well as strong household spending growth. The statement did not contain any elements that showed the committee members were worried about Mr Trump's protectionist trade policies, or that could lead to a slower growth rate in the economy.

Asia - China

China's latest economic data reflect deceleration in growth. At the same time, inflation has picked up. The latter, however, should only be a temporary phenomenon and will not likely have any major effect on the policies of the government and the central bank. By contrast, these policies will depend strongly on the future course of the trade conflict with the USA. So far, the real impacts of the conflict on the Chinese economy have been very limited, in particular as the punitive tariffs, which have been imposed are extremely modest in terms of their volume. Nonetheless, there is quite clearly a sense of uncertainty among investors, companies, and in the Chinese leadership. At almost every opportunity, Beijing has made it clear that it is not interested in waging a trade war and that it will pursue solutions through negotiations, but that at the same time it will not be blackmailed. By contrast, the Trump Administration is sending very mixed signals, with frequent, abrupt changes in direction and sometimes contradictory announcements. In the meantime, there is a possibility that tariffs of 25% will be levied on essentially all Chinese imports to the USA.

Economic overview

India

India's economy grew at an annual rate of 8.2% in the past quarter (April to June), marking a tangible acceleration in light of the rising oil price and weakening rupee. Growth was supported by consumption and industrial production in particular. At the same time, additional government spending in the run-up to the general elections in spring 2019 also played a major role.

This level of spending will not be sustainable, since it appears that one half of the budget deficit slated for the year as a whole has already been reached in the first two months of the current fiscal year. As the world's third largest importer of crude oil, India will also likely be impacted by the increase in the oil price. So far, some very lucrative deals have been concluded with Iran. There are, however, questions as to whether these can be maintained, in light of US pressure on all countries to quit doing any business with Iran. The depreciation of the rupee versus the US dollar (more than 3% since August and around 10% since the beginning of the year) makes oil imports even more expensive.

In the meantime, the statistics office has released the newly calculated growth figures for the past ten years. The current government under Prime Minister Modi changed the basis for calculation back in 2015. As a result, growth for 2015 was revised up from 5% to 6.9%. Back then, many observers though that the government was mainly trying to window-dress the growth figures.

The government immediately explained that the new calculations were merely "experimental" and by no means final. It will probably be very interesting to see what the "final" figures look like and when they will be released. Bucking the trend in the emerging markets, the Indian equity market produced very robust performance, gaining almost three per cent in August.

Iran

Iran is located in the Tethyan–Eurasian Metallogenic Belt and has considerable mineral reserves, with 68 types of mineral commodities. Holding 7% of global mining reserves, the country is seeking to shift from its reliance on crude oil to revenues from value added manufacturing industries such as the mining sector.

The Tehran Stock Exchange (TSE) continued its positive momentum in August, with its second best performing month in 2018 in local currency terms, as the overall index rose by 13.5%.

It is important to note, that the TSE has gained 40% in local currency terms YTD but has fallen by 22.3% in EUR YTD, which demonstrates that the market has not yet compensated for the additional ~40-50% drop in the IRR versus the EUR.

The newly elected Governor of the Central Bank of Iran introduced a new policy package, which has led to a multi-tiered exchange regime in which there are essentially three "official" rates:

- A preferential dollar rate of 42,000 for the importation of essential goods and medicine;
- A secondary market rate, where exporters sell their hard currency holdings to importers through foreign exchange bureaus;
- A daily Central Bank market rate (applicable to the Fund) which is, as of the date of the end of September, 90,927 IRR to the EUR.

Given the outperformance of the equity market after the last severe devaluation in 2012-13, at these currency levels, there is a high probability that a large part of the market is undervalued and one could expect the market to re-adjust.

Asset class overview

Equities

We remain supportive for equities, as trade tensions eased and the release of lower than expected CPI inflation in the US do not call for aggressive monetary tightening. Companies worldwide are still reporting strong profits, and valuations are more attractive especially in the Eurozone.

⬆ Buy ⇔ Hold ⬇ Sell

Switzerland ⬆

The robust global economy should continue to boost Swiss exports, while many companies have reduced their operating costs since the franc's sharp appreciation in 2015. Globally the industrial sector has regained competitiveness, as reflected by the purchasing managers' index, close to a post-2011 high. We keep on being positive for the Swiss stock market.

Recommended global equities to buy - Switzerland

Stock	Currency	Price	Target Price
Adecco	CHF	52	62
AMS	CHF	57	100
Autoneum	CHF	197	300
Novartis	CHF	85.6	90
Roche	CHF	242	260
UBS	CHF	15.2	18.5

UK ⇔

Speculation about the probability of the UK cashing out of Europe without a deal were at the forefront of investors' concerns again last month. Theresa May played down the risks claiming that a no deal-Brexit "would not be the end of the world" while others, such as Philipp Hammond, warned a disorderly walk out could cost as much as GBP 80bln. On the economic data front, higher fuel prices, an indirect effect of the falling pound, pushed up the rate of inflation for the first time this year. Household disposable income was further squeezed by falling wage growth, a trend that has been lasting for several months despite the record low unemployment.

Recommended global equities to buy - UK

Stock	Currency	Price	Target Price
Shire	GBP	46.1	52
SSE	GBP	11.5	14.5

USA ⇔

Corporate profit repatriation and tightening dollar liquidity have been driving money back to the US. Coupled with strong corporate earnings, and an excellent economic backdrop, the US stock market has strongly outperformed its peers, year to date. It is difficult to predict whether the impact of tax reforms will continue to be supportive, but one can observe that the country is still looking strong. The labour market is tight but inflation risks are relatively limited for the time being. What could be expected is some moves into more defensive sectors such as utilities and telecoms and a shift in favour of the Eurozone market.

Recommended global equities to buy - USA

Stock	Currency	Price	Target Price
Applied Mat.	USD	38.9	60
Comcast	USD	35.7	46
Delta	USD	54.7	61
Halliburton	USD	41.7	53
Pioneer Nat Res	USD	178	210
Stanley Black & Decker	USD	147	170
Synchrony Financial	USD	31.3	40

Japan ⬆

Japanese GDP quarterly growth was revised up to 3% in annualised terms in 2018 Q2, as the business investment expansion was significantly upgraded, to 3.1% QoQ. Japanese economic expansion will probably continue in the coming quarters. However, GDP growth may slow in 2018 Q3, due to adverse weather conditions and natural disasters.

Recommended global equities to buy - Japan

Stock	Currency	Price	Target Price
Hitachi	JPY	3780	4800
Nintendo	JPY	41330	50000

Asset class overview

Equities

Eurozone

Economic growth in the euro area keeps on growing, but at a slower pace. Thanks to its accommodative monetary policy, consumption has been steady, and unemployment rate is at an eight years low, while wages are rising. For now, no rate rise should happen before September 2019, according to the ECB. As a result, the interest rate differential with the US could amount to roughly 3% and any weakness of the euro should be supportive for exporters, and be an engine growth for companies.

Of course, the spectrum of an escalation of trade war is still a risk to this positive scenario. Volatility has risen already and carmakers manufacturers are suffering from an anticipated disruption of their supply chains.

As far as the Brexit impact is concerned, there is little clarity on the state of play in negotiations and it remains difficult to predict the outcome, with only months to go. However, even a ‘soft’ Brexit will probably be negative for UK growth. A no-deal Brexit would cause significant headwinds for the whole of Europe as well as more localised impacts. For example, the UK is Spain’s fourth largest trading partner and any UK slowdown would hurt many exporters there.

We remain positive for Euro equities.

Recommended global equities to buy - Eurozone

Stock	Country	Currency	Price	Target Price
Erste Group	AT	EUR	35.9	40
Anheuser-Busch	BE	EUR	74.9	110
Fresenius	DE	EUR	69.2	80
Heidelberg cement	DE	EUR	67.3	90
Siemens	DE	EUR	107.4	130
Axa	FR	EUR	23.2	25
Orange	FR	EUR	13.7	16.5
InDiTex	SP	EUR	25.8	33
Melia Hotels	SP	EUR	9.6	13.5

Emerging Markets

The modest recovery that started in July only lasted for a brief time on the financial markets in most of the emerging countries.

For most of the emerging markets, the recovery in July proved to be quite short-lived. The MSCI EM index lost almost 3% in August, versus an increase of about 1% for the developed markets (both calculated in USD). That said, the gains in the developed markets were once again almost exclusively due to developments in the USA. Within the EM universe, however, investors are drawing much finer distinctions. For example, equity indices in Poland, India, Hungary, and in Russia saw increases, in contrast to the general trend. Again, pressure on the emerging markets mainly manifested itself through currency channels, especially in the countries with the most vulnerable economies (Argentina, Turkey, Brazil, Indonesia). The rouble also came under pressure in the wake of political and economic attacks on Russia by Washington and London.

Even though some of the movements in exchange rates have been intense, so far there are no signs of panic among international investors. While foreign capital continues to exit the EM financial markets, the scope of this remains moderate and the pace of withdrawals has tapered off significantly compared to May/June. We remain positive on the region for long-term investors.

Recommended global equities to buy – Emerging Markets

Stock	Country	Currency	Price	Target Price
AAC Technologies	HK	HKD	79	110
China Mobile	HK	HKD	76	90
Tencent	HK	HKD	316	390
BSE	IN	INR	676	1050
Singapore Telecom.	SG	SGD	3.2	4

Asset class overview

Fixed income

With the spread between 10-year and 2-year US Government Bond yields to 30 basis points, close to their lowest level since July 2007, more investors are worried about the US economy's medium term prospects, as historically an inverted yield curve has signalled recession down the road.

GB Government Bonds ⬇

The Bank of England voted unanimously to raise Bank Rate by 0.25% to 0.75% from the level it set in March 2009 in order to face the financial crisis. The Bank's decision was motivated by a very low unemployment level, which could induce inflationary wage pressures. However, as fears about the economic impact of Britain leaving the EU without a deal are growing, Mark Carney said the Committee is prepared to adjust the path of rates if and when necessary.

Eurozone Government Bonds ⇔

The European Central Bank remained on hold, not changing the policy rate and leaving forward guidance unchanged. President Draghi emphasised that, in the Governing Council's view, the Euro Area's economy is on track and will deliver strong GDP growth figures, while inflation may gradually converge to the ECB's target. Compared to the previous meeting, the Governing Council tweaked the language related to the termination of the asset purchase programme by including data dependency to actually end monthly net purchases in December.

US Government Bonds ⬇

US Government Bonds performed well in August. 10yr Treasury yields have been trading within a 21 basis points range this quarter, ignoring the good news coming from the equity market, as well as uncertainty induced by the trade war. Given the still positive economic backdrop, the Fed should be able to hike once more in December, which is already priced in by the market.

Emerging Market Bonds ⇔

Analysts believe that markets have been right to re-price emerging market risk against key factors such as increased geopolitical concerns and international trade tensions. However, the global economic growth outlook remains stable, albeit more moderate from high levels and somewhat less synchronised. This environment should still help fiscal improvements and deleveraging in many emerging economies. One should also consider that emerging market corporate fundamentals continue to be resilient or improving, with default rates among emerging market corporate bond issuers remaining low.

Recommendations

In the current rising rate environment, we tend to avoid typical buy-and-hold strategies. Short-term corporate bonds in USD start looking attractive again. In the quest for yield, subordinated debt of selected issuers and preferred shares of financial companies offer an attractive yield.

Investors highly exposed on the stock market and who would like to reduce this sensitivity may want to consider convertible bonds as well. Convertible bonds limit the downside risk, while allow the investors to participate in the upside potential.

Outlook of bonds

Sector	Currency	Outlook (1 month)	Expected % change* (1 month)	Outlook (3+ months)	Expected % change (3+ months)
Bonds CHF (Corporate & Gvt. Bonds)	CHF	⇔	within +/-0.10%	⇔	within +/-0.10%
Bonds EUR (Corporate & Gvt. Bonds)	EUR	⇔	within +/-0.15%	⬆	within +/-0.25%
Bonds GBP (Corporate & Gvt. Bonds)	GBP	⇔	within +/-0.25%	⬇	within +/-0.50%
Bonds USD (Corporate & Gvt. Bonds)	USD	⬆	within +/-0.25%	⬇	within +/-0.50%
Global EM (Sovereign Bonds)	USD	⇔	within +/-0.50%	⬆	within +/-1.00%
Global HY Bonds (High Yield Bonds)	USD	⇔	within +/-0.50 %	⬆	within +/-1.00%

Asset class overview

Currencies

Trade War concerns are still the main driver for currency market over the near term. Other concerns for markets include political uncertainty in Turkey and Middle-East.

CHF⬇

Since we do not expect that the crisis in Turkey and Argentina will lead to major contagion risks for other emerging markets and we do not expect a general crisis in the emerging markets, the Swiss franc is unlikely to appreciate significantly further in the coming weeks and will tend to weaken somewhat once the situation calms down.

EUR⬇

When the euro traded at stronger levels after markets heard the words “vigorous pick-up” in connection with inflation in the Eurozone from ECB President Mario Draghi, investors expected a halt in accommodative monetary policy. Unfortunately, Draghi was not referring to the current inflation trend but only the assumptions on which the ECB’s longer-term forecasts are based. According to the ECB expert one could therefore even interpret his comments in a dovish manner, i.e. that the central bankers are forecasting a much stronger rise in inflation than we are currently witnessing so that their inflation outlook is becoming increasingly uncertain.

GBP⬆

The pound rose against its G-10 counterparts after UK Prime Minister Theresa May ruled out early elections, while havens eased amid rising oil prices and higher yields as traders shrugged off belligerent US rhetoric on trade.

USD ⬆

The greenback is gaining ground on a risk-off atmosphere emerging from Emerging Market. Argentina is the centre of the attention. The troubles in Emerging Markets push the US Dollar higher on a risk-off atmosphere. China remains the No. 1 Emerging Market and the world’s second-largest economy.

The US is set to impose whopping tariffs worth USD 200bn of Chinese goods as early as September. The move would serve as a severe escalation in the trade wars. US President Donald Trump cut off a planned media outing on Monday to make phone calls related to trade.

JPY ⬇

Weak inflation points to continued low interest rates. The fact that the inflation trend in Japan has weakened in recent months evidently confirmed this assumption. In June, the core rate based on consumer prices was only 0.2%. At its July meeting the central bank lowered its inflation forecasts again on the back of the weak price trend. As the BOJ wants to maintain its expansionary approach until inflation has even exceeded its 2% target temporarily, enabling it to anchor inflation expectation at a higher level. It is admittedly difficult to predict the timing of the upward movement in USD/JPY and EUR/JPY.

INR ⬄

GDP grew 8.2% in Q2. That beats the 7.6% median estimate. Indian economy has continued recovery sharply from demonetisation-GST slump last year and a strong growth augurs well for the rupee assets. However, turmoil in Emerging Market as well as high oil prices are bigger factors that can continue to drive the rupee away from domestic positive factors.

Anticipated trend of major currencies

Sector	Spot	Outlook (1 month)	Outlook (1 month)	Outlook (3+ months)	Outlook (3+ months)
EUR/CHF	1.14	⬆	1.15	⬆	1.16
EUR/JPY	132.60	⬆	134.15	⬆	135.65
EUR/USD	1.17	⬆	1.18	⬆	1.18
GBP/CHF	1.27	⬆	1.28	⬆	1.29
USD/CHF	0.97	⬆	0.98	⬆	0.98
USD/JPY	113.00	⬆	113.70	⬆	114.50
USD/INR	72.60	⬆	73.30	⬆	74.30

Asset class overview

Commodities

Precious metals prices are still struggling. Net commitments of Gold Futures Traders show large speculators (hedge funds and money managers) are slightly short for September. The gold market is currently politically driven (trade dispute) and traders do not want to be overly exposed in such an environment.

Oil ⇔

The crude oil market continues to firm from a fundamental and technical perspective and some of the recent price gyrations are simply a prelude to a market which is still looking to go higher for prices. Although we have had some very brief attempts above USD70 per barrel for WTI and touching just over USD80 per barrel for Brent, expect these price levels to be reached shortly and then hold as support the deeper the market gets into September and October. With inventories still holding at lower levels and global demand ready to firm up into the fall, oil price direction should be gradually higher.

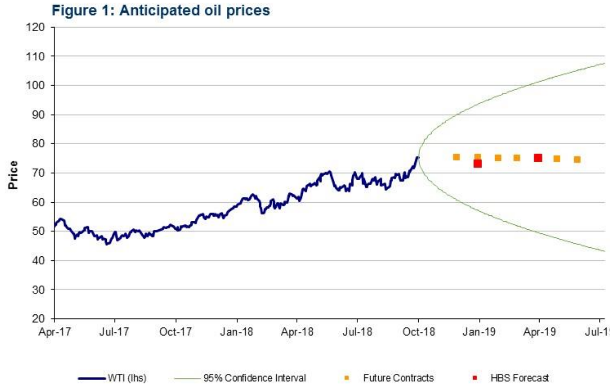
The latest update from the International Energy Agency (IEA) last week (data to July 2018) indicates that OECD inventories continue to drift a little further below the five-year average. What looks interesting is that a growing portion of the modest deficit is in other OECD countries rather than in the United States.

The latest IEA assessment for Iran's production (to August) shows only a slight decline, but that production number is likely to move sharply lower by the end of the year as buyers of Iranian crude become fewer, and the country's ability to store barrels offshore is quickly exhausted given the limited size of its own tanker fleet.

The extent of the loss of Iranian barrels will ultimately determine the upside for prices and how quickly (or not) other suppliers can respond, such as Russia and Saudi Arabia. For the most part, analysts think these two suppliers will see only moderate supply increases over the next six to nine months.

Figure 1 shows the recent evolution of the price of oil.

Figure 1: Anticipated oil prices



Gold ⇔

Gold prices extended lower in August to set a low at USD1,160.30/oz per oz. Up until recently, the downtrend had been relentless since April's high at USD1,365.25/oz failed to overcome the January high at USD1,366.15/oz, which formed a double top. Interest in Gold in most areas of demand has been weak, even investment interest – this despite numerous escalations in the geopolitical arena, including US trade disputes, some jittery emerging markets and the prospects of deeper US sanctions against Iran, all of which could trigger financial crises.

The geopolitical situation probably should warrant a pick-up in interest in Gold, but there has been a massive amount of selling from the funds trading Comex. Short positions climbed to a high of 222,210 contracts on 21st August from a recent low of 72,512 contracts in mid-June, while the gross long position has fallen to 207,370 contracts from 220,620 contracts in late-July and a peak of 305,812 contracts in January.

Despite the wave of bearishness affecting the funds trading Gold, ETF investors are only seeing a gradual reduction in holdings. The ETFs saw holdings fall 43 tonnes to 2,045 tonnes in August. Peak holdings this year were 2,200 tonnes.

The rising US interest rate environment and US President Donald Trump's 'America First' policy are both factors behind the strength of the dollar. US equity markets are benefitting from the strong US economy too, all of which continues to keep the opportunity cost of holding Gold high. As long as this situation persists, interest in gold will remain weak.

Opportunities

On 15 November 2017, MSCI and S&P Dow Jones announced revisions to the Global Industry Classification Standard ("GICS"). GICS is an industry taxonomy that is used to classify the company into one of the 11 sectors, 24 industry groups, 68 industries, and 157 sub-industries. The changes were implemented as of the close of 28 September 2018. We review here the impact of the changes on the equity products.

Background and changes

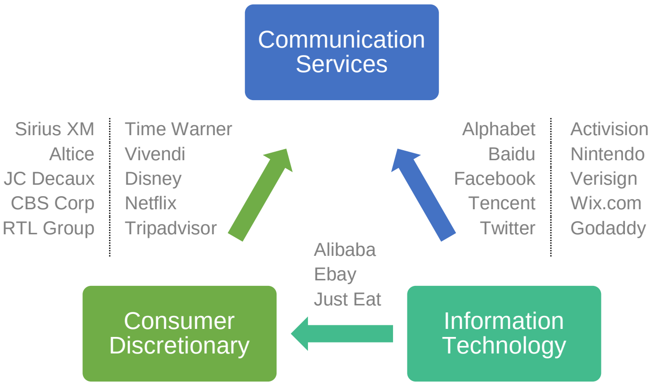
The GICS structure was revised to reflect the evolution in the mode in which people communicate and access entertainment content and other information. Here are the main changes:

- The sector *Telecommunication Services* was broadened and renamed as *Communication Services*;
- The industry group *Media* moved from *Consumer Discretionary* to *Communication Services*;
- Internet services companies moved from *Information Technology* to *Communication Services*;
- E-Commerce companies moved from *Information Technology* to *Consumer Discretionary*.

Impact

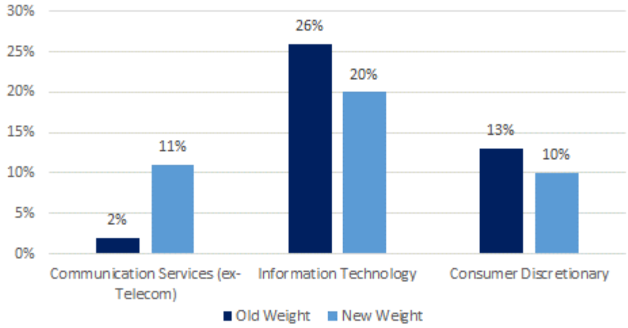
While GICS often modifies the industry or the sub-industry to which a company belong to according to the evolution of the revenues (e.g. after a change in business activity), the September 2018 reclassification is one of the most important ever faced by investors, as it impacts about 200 companies.

Giants like Alphabet, Facebook, Disney, or Alibaba will move from one sector to another. These changes will impact hundreds of indices which will in turn impact thousands of products based on these indices.



The *Telecommunication Services* sector was traditionally considered as defensive, like *Consumer Staples*. This will no longer be true, as a lot of IT cyclical companies joined the new *Communication Services* sector. Telecom companies used to be not very relevant for the S&P, weighting only about 2%. Now, more than 11% of the main index is represented by this sector. The weight of *Information Technology* stocks is revised down, as shown in Figure 2.

Figure 2: S&P 500 sector weight



While the impact is important in the United States, it is even larger in Emerging Markets. For the MSCI Emerging Market Index, the *Information Technology* sector moved from a weight of 28% to 15%.

Passive investing

Sector ETFs, such as iShares S&P 500 Information Technology Sector UCITS ETF, Lyxor MSCI World Information Technology UCITS ETF, or Invesco Consumer Discretionary S&P US Select Sector UCITS ETF, will of course be rebalanced to reflect the sector changes.

Investors will need to pay attention to the sector they want to be exposed to. If they are willing to be invested in companies such as Alphabet or Facebook, then they will need to get an exposure to the new Communication Services index. SPDR has already launched a US-based ETF for this sector that has already accrued more than USD 1 billion in assets under management. We expect to see products in the UCITS format soon.

The existing products have to be rebalanced to match the new GICS classification. S&P Dow Jones rebalanced its indices on 24 September 2018, as per its usual quarterly rebalancing. MSCI reviews its indices on a semimanual basis, and the next review is scheduled for the end of November 2018.

Finally, investors should remember that ETFs do not necessarily uses the GICS classification. In the future, we could see divergence in performance between two products on the same sector, one following the GICS classification and the other one following another set of norms. The selection of passive products must be done carefully.

Past performance does not guarantee future results. For illustration only. Data for the graph as of 02/07/2018. Sources: HBS, MSCI, Blackrock, ETF.com. Prospectus, annual reports, KIIDs, and factsheets of the proposed ETFs can be obtained from your relationship manager. Before entering into any transaction, you should consult your relationship manager to make sure that you understand the underlying risks.

Summary on future trends

As of 03 October 2018

↑ Overweight ⇔ Neutral ↓ Underweight

Asset class	Outlook	Benchmark	Value	1-Year Evolution	m/m perf[1] in %	Ytd Perf.
Equities						
USA	⇔	S&P 500	2'923		0.9%	10.9%
Eurozone	↑	Euro Stoxx 50	3'402		0.3%	0.1%
UK	⇔	FTSE 100	7'494		-0.1%	0.7%
Japan	↑	Nikkei 225	24'111		6.8%	7.6%
Switzerland	↑	SMI	9'140		1.6%	0.8%
Emerging Markets	⇔	MSCI EM	1'033		-1.1%	-8.8%
Bonds						
US Government bonds	↓	10-year yield	3.07%		-0.5%	-0.7%
US corporate bonds	↑	Spread (vs 10yr US Gvt)	112 bps	-	-0.2%	-3.2%
US high yield bonds	⇔	Spread (vs 10yr US Gvt)	310 bps	-	0.6%	2.8%
EM sovereign	⇔	Spread (vs 10yr US Gvt)	366 bps	-	2.0%	-3.6%
Swiss Government bonds	↓	10-year yield	0.02%		-1.1%	-2.1%
Germany Government bonds	↓	10-year yield	0.45%		-0.8%	1.1%
Alternative investments						
Commodities	⇔	Dow Jones Commodity	640		4.4%	2.3%
Listed Real Estate	↑	FTSE EPRA/NAREIT Developed	4'495		-2.9%	-1.2%
Currencies						
USD	⇔	-	N/A	-	N/A	N/A
EUR	↑	EUR/USD	1.16		-0.4%	-3.6%
CHF	⇔	USD/CHF	0.98		-1.6%	-1.1%
GBP	⇔	GBP/USD	1.30		1.0%	-3.8%
JPY	⇔	USD/JPY	113.78		-2.4%	-1.0%
INR	⇔	USD/INR	73.07		-2.6%	-12.6%

[1]Month-over-month performance

Sources: HBS, Bloomberg, Financial Times, Jefferies, Exane, Bridport, Capital Economics, Raiffeisen.

Asset allocation

Preferred investment views

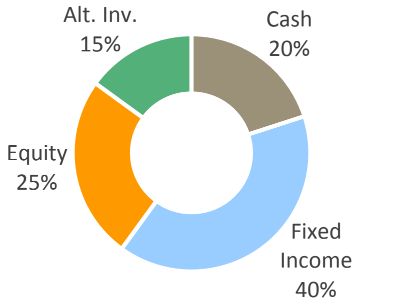
Asset Class	Most preferred	Least preferred
Equities	Japan (with FX hedged) Eurozone	-
Bonds	Floating-rate notes in USD Short-term corporate bonds in USD Convertible bonds	Government bonds Long duration bonds
Foreign Exchange	EUR	
Alternative investments	Equity market neutral Structured products (selling volatility)	-
Cash	-	-

Asset allocation

Recommended asset allocation

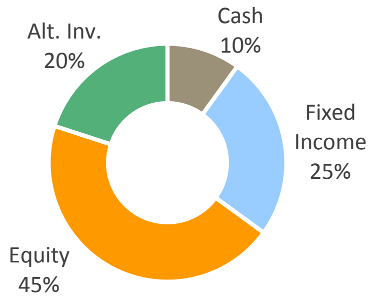
The Conservative Investor

Asset Class	Range of SAA[1]	TAA[2] Portfolio	Change (from prev. allocation)
Cash	0% - 50%	20%	0%
Fixed Income	20% - 80%	40%	0%
Equity	0% - 30%	25%	0%
Alternative Investments	0% - 20%	15%	0%
Total	100%	100%	0%



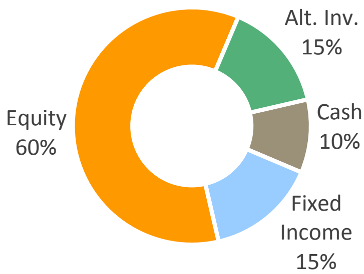
The Balanced Investor

Asset Class	Range of SAA[1]	TAA[2] Portfolio	Change (from prev. allocation)
Cash	0% - 30%	10%	+5%
Fixed Income	10% - 70%	25%	0%
Equity	20% - 60%	45%	-5%
Alternative Investments	0% - 30%	20%	0%
Total	100%	100%	0%



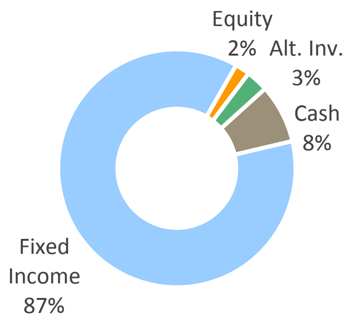
The Dynamic Investor

Asset Class	Range of SAA[1]	TAA[2] Portfolio	Change (from prev. allocation)
Cash	0% - 20%	10%	+5%
Fixed Income	0% - 60%	15%	0%
Equity	50% - 90%	60%	-5%
Alternative Investments	0% - 40%	15%	0%
Total	100%	100%	0%



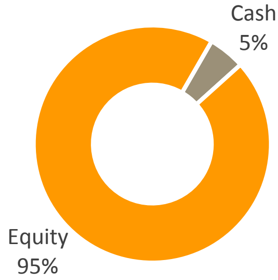
The Strategic High Yield Bonds Investor

Asset Class	Range of SAA[1]	TAA[2] Portfolio	Change (from prev. allocation)
Cash	0% - 20%	8%	0%
Fixed Income	20% - 100%	87%	0%
Equity	0% - 20%	2%	0%
Alternative Investments	0% - 30%	3%	0%
Total	100%	100%	0%



The Strategic Equity Investor

Asset Class	Range of SAA[1]	TAA[2] Portfolio	Change (from prev. allocation)
Cash	0% - 20%	5%	0%
Fixed Income	0% - 20%	0%	0%
Equity	70% -100%	95%	0%
Alternative Investments	0% - 20%	0%	0%
Total	100%	100%	0%



[1] SAA – Strategic Asset Allocation, [2] TAA – Tactical Asset Allocation

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