Fixed Income Market Outlook

January 2018

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Raiffeisen
Capital Management

Take Aways from last years outlook as of January 12th, 2017

Raiffeisen Capital Management

- Most **fixed income asset classes are expensive** by historical standards. Performance expectations for 2017 suffer as a consequence of 2016s strong yield compression.
- Bond yields are expected to rise because of gradual normalization of monetary policies and a changing inflationary picture.
- Euro core-rates markets with negative yields up to 8 years (German Bunds) no place for traditional risk sensitive fixed income investors.
- Euro periphery government markets with higher YoY spreads, yet increasing political risks.
- Expect outperformance of Euro Corporates versus Euro Government markets.
- Expect Emerging markets to outperform developed market government bonds.
- Defensive portoflio position still waranted, balanced diversification between different performance drivers is key!
- Draw down risks between rates markets and spreadmarkets substantial. The latter offering better chances for positive returns.

Performance Fixed Income Markets in 2017

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Sector	Index	Total Return (LC; %) from Dec 31, 2016 to Dec 08, 2017	Excess Return from Dec 31, 2016 to Dec 08, 2017	Change in Govt OAS	Effective Yield (%) Dec 08, 2017	Effective Yield (%) Dec 31, 2016	Change in Effective Yield	Maccaulay Duration Dec 08, 2017	Composite Rating Dec 08, 2017
EMU Govt	ML German Government Index	-0,46	0,1	0	-0,08	-0,18	0,10	7,33	AAA
	ML German Treasury Bill Index	-0,70	0,0	-9	-0,83	-0,8	-0,03	0,26	AAA
	ML Euro Government Index	1,53	2,0	-15	0,42	0,44	-0,02	7,57	A1
	ML Spain Government Index	1,94	2,3	-16	0,85	0,87	-0,02	7,21	BBB1
	ML Italy Government Index	3,11	3,6	-30	0,93	1,14	-0,21	6,73	BBB2
	ML Euro Treasury Bill Index	-0,44	0,3	-3	-0,57	-0,59	0,02	0,40	A2
Euro IG Credit	ML Jumbo Pfandbrief Index	0,57	0,8	-14	0,04	-0,12	0,16	4,79	AAA
	ML Euro Corporate Index	3,07	3,4	-35	0,64	0,88	-0,24	5,34	A3
	ML Euro Single-A Corporate Index	2,39	2,8	-30	0,49	0,69	-0,20	5,27	A2
	ML Euro Single-BBB Corporate Index	4,04	4,4	-46	0,84	1,17	-0,33	5,34	BBB2
	ML Euro Non-Financial Index	2,69	3,0	-28	0,67	0,84	-0,17	5,75	A3
	ML Euro Non-Periphery Non-Financial Ind	2,66	3,0	-27	0,68	0,85	-0,17	5,80	A3
	ML Euro Periphery Non-Financial Index	2,96	3,3	-33	0,61	0,76	-0,15	5,39	BBB2
	ML Euro Financial Index	3,71	4,1	-46	0,59	0,96	-0,37	4,60	A3
	ML Euro Subordinated Financial Index	8,33	8,7	-95	1,29	2,1	-0,81	5,07	BBB1
Euro HYLD	ML Euro High Yield Index	6,67	7,1	-91	2,59	3,33	-0,74	4,53	BB3
	ML BB Euro High Yield Index	6,69	7,1	-72	1,96	2,52	-0,56	4,57	BB2
	ML Single-B Euro High Yield Index	5,30	5,7	-3	4,21	4,09	0,12	4,43	B2
	ML CCC & Lower Euro High Yield Index	13,51	13,97	-653	6,14	12,59	-6,45	4,35	CCC1
US Bonds	ML US Treasury Index	2,35	0,1	0	2,15	1,9	0,25	6,40	AAA
	ML US High Yield Index	7,22	5,81	-59	5,80	6,19	-0,39	4,96	B1
	ML US Corporate Index	5,98	3,4	-28	3,27	3,39	-0,12	7,37	A3
	ML US Corporates Yankee Index	6,20	4,1	-38	3,29	3,46	-0,17	6,25	A3
EM	ML Euro Emerging Markets Sovereign Plu	10,31	10,6	-97	2,07	2,89	-0,82	6,95	BB1
	ML EMEA Local Debt Market Index Plus	4,68	0,09	1	5,37	5,11	0,26	5,09	BBB2
	ML Local Debt Markets Index Plus	7,57	0,0	-1	5,58	5,97	-0,39	5,57	BBB2
	Average	4,30	3,8	-56	1,88	2,33	-0,44	5,28	

Source: ML, own calculations; Data as of December 8th, 2017

Euro Investmant Grade Markets (EMU0) Market Yield (-3y)

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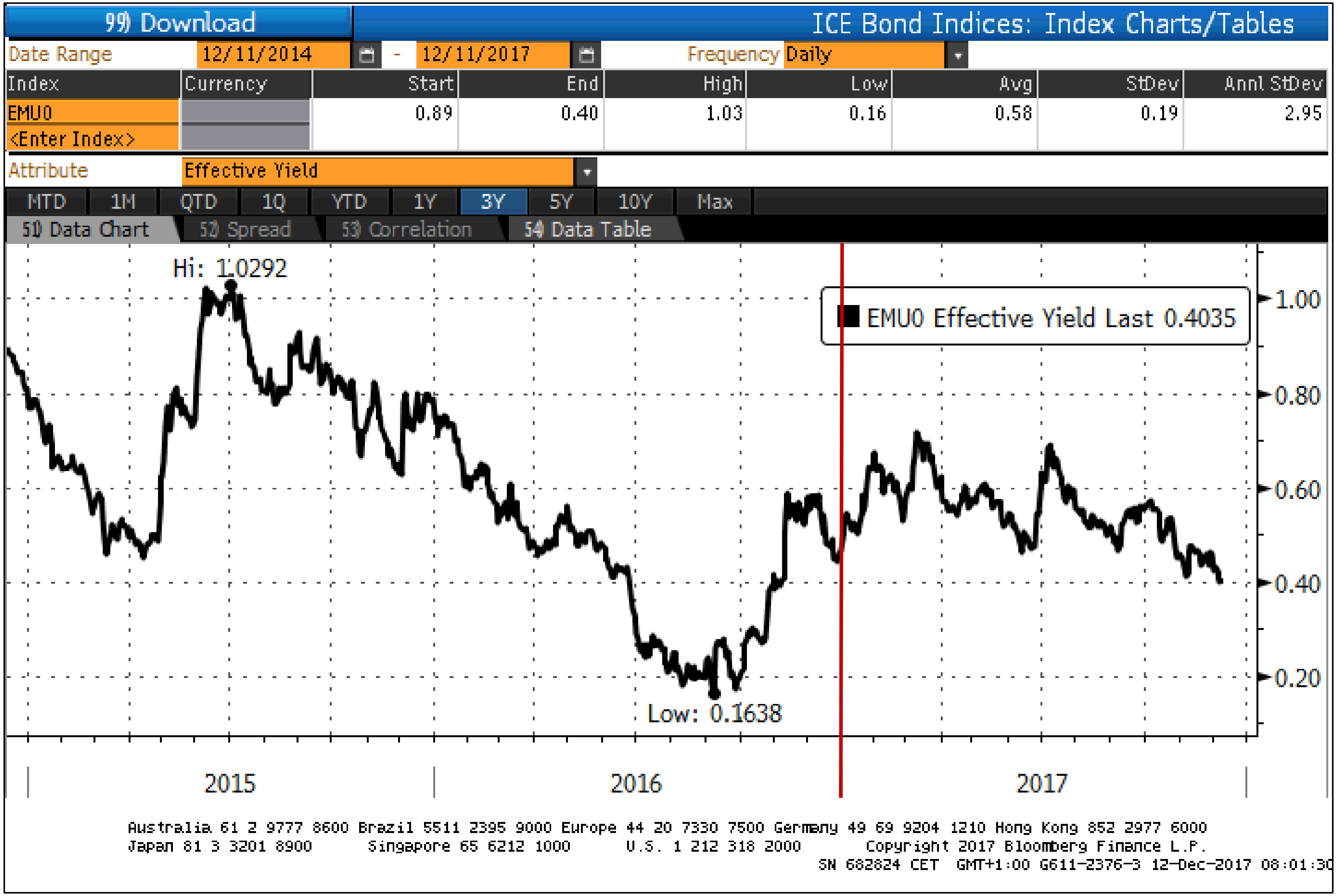
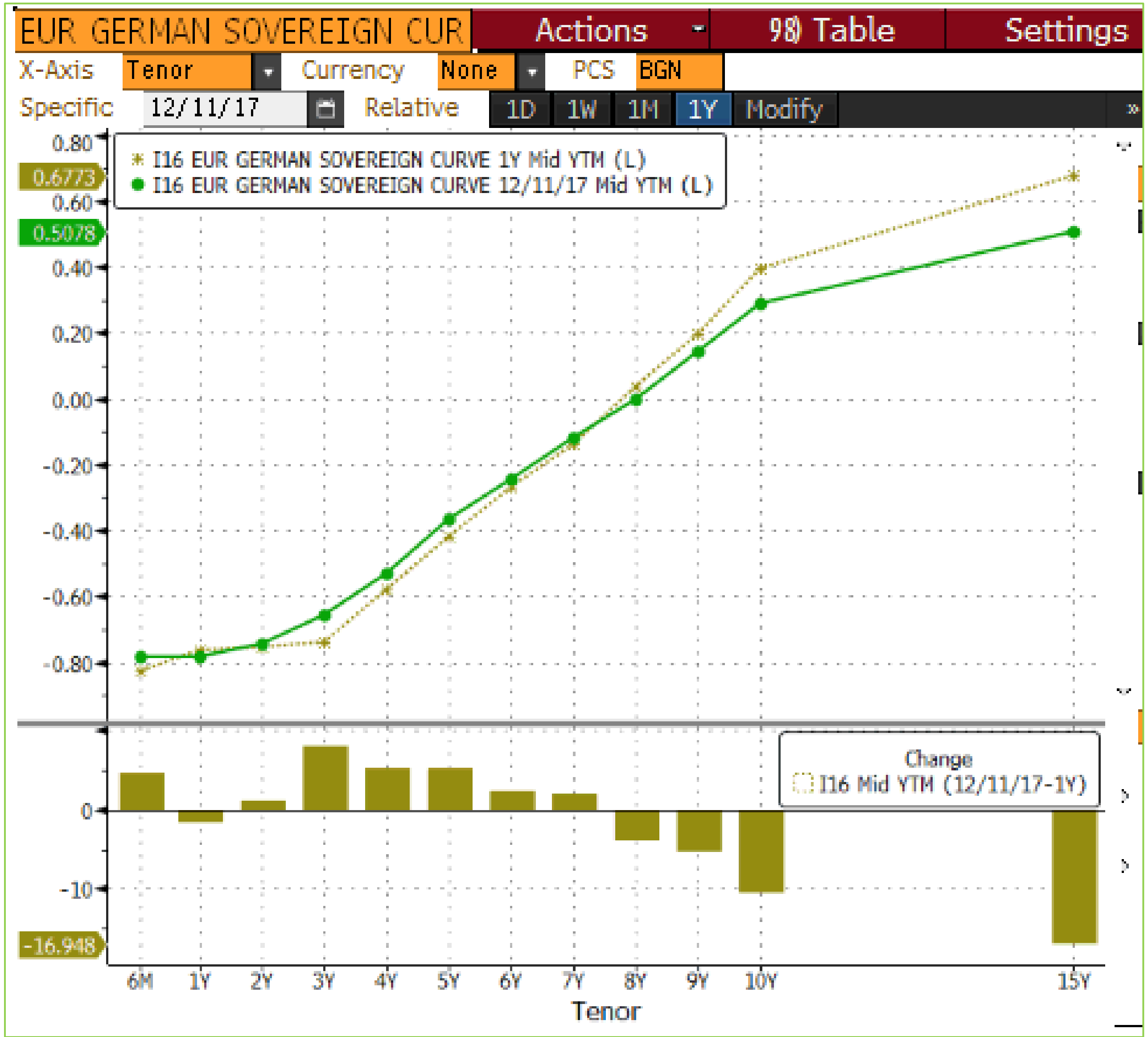


Source: Bloomberg, ICE_ML, Data as of December 11th,12,2017

What has happened to German Bund Yields? Yieldcurve Germany, -1y

Raiffeisen Capital Management



Quelle: Bloomberg, Daten per 12.12.2017

No big change in German bund yield versus last year. Despite much better growth and higher inflation expectations a slightly flatter curve?!

BE-Inflation Germany, 10y

Yield-Map-Euro Markets

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Yields (%)	1Y	2Y	3Y	4Y	5Y	6Y	7Y	8Y	9Y	10Y	15Y	20Y	30Y
Germany	-0.75	-0.74	-0.66	-0.53	-0.38	-0.25	-0.12	-0.01	0.14	0.29	0.51	0.81	1.12
France	-0.63	-0.60	-0.44	-0.30	-0.15	-0.04	0.13	0.29	0.47	0.62	0.87	1.19	1.59
Italy	-0.40	-0.38	-0.19	0.01	0.40	0.58	0.94	1.22	1.44	1.65	2.27	2.41	2.82
Spain	-0.40	-0.38	-0.04	-0.01	0.31	0.52	0.75	1.02	1.19	1.40	2.06	-	2.66
Netherlands	-0.77	-0.75	-0.65	-0.55	-0.42	-0.21	-0.07	0.10	0.23	0.38	-	-	1.12
Austria	-0.65	-0.63	-0.55	-0.49	-0.30	-0.15	0.01	0.17	0.34	0.44	0.93	-	1.38
Belgium	-0.65	-0.62	-0.58	-0.46	-0.31	-0.09	0.08	0.18	0.33	0.49	0.86	0.98	1.54
Portugal	-0.33	-0.30	-0.11	0.03	0.42	0.78	0.97	1.45	1.60	1.77	2.24	-	3.08
Ireland	-0.53	-0.60	-0.56	-0.27	-0.13	-0.07	0.09	0.28	0.68	0.49	0.94	-	1.62
Finland	-0.66	-0.70	-0.58	-0.50	-0.30	-0.09	-0.01	0.17	0.34	0.45	0.72	-	1.20
Financials AA+,AA,AA-	-0.34	-0.25	-0.12	0.03	0.19	-	0.51	0.67	0.81	0.94	-	-	-
Financials A+,A,A-	-0.27	-0.16	-0.02	0.14	0.30	-	0.62	0.77	0.91	1.04	-	-	-
Financials BBB+,BBB,BBB-	-0.18	-0.05	0.13	0.33	0.53	-	0.91	1.09	1.25	1.40	-	-	-
Non-Financials AA+,AA,AA-	-0.38	-0.30	-0.19	-0.06	0.09	-	0.40	0.55	0.69	0.82	-	-	-
Non-Financials A+,A,A-	-0.31	-0.21	-0.10	0.05	0.21	-	0.55	0.71	0.86	0.99	-	-	-
Non-Financials BBB+,BBB,BBB-	-0.22	-0.13	0.01	0.18	0.37	-	0.76	0.94	1.10	1.25	-	-	-
ITRX XOVER Implied	-	-	1.59	-	2.52	-	3.24	-	-	3.80	-	-	-
Covered AAA	-0.43	-0.37	-0.26	-0.12	0.03	-	0.33	0.48	0.62	0.74	-	-	-
Covered AA+,AA,AA-	-0.34	-0.28	-0.15	0.00	0.16	-	0.47	0.62	0.76	0.87	-	-	-

yield < 0.00

yield > 1.50

Quelle: Raiffeisen KAG, Bloomberg Finance L.P., 2017-12-11

Raiffeisen Capital Management - Rates&FX

Global Bonds Unhedged

Raiffeisen Capital Management

Yields (%) before FX Hedge	1Y	2Y	3Y	4Y	5Y	6Y	7Y	8Y	9Y	10Y	15Y	20Y	30Y	Cost of FX Hedge, 3M ann. (bp)
Germany	-0.75	-0.74	-0.66	-0.53	-0.38	-0.25	-0.12	-0.01	0.14	0.29	0.51	0.81	1.12	
Denmark	-	-0.51	-	-	-0.12	-	-	-	-	0.38	-	0.88	1.20	-0.08
Sweden	-	-0.84	-0.51	-0.34	-0.24	-	0.22	-	-	0.67	-	1.37	-	-0.06
Norway	-	0.50	0.65	0.85	1.04	-	1.20	-	-	1.48	-	-	-	1.43
Switzerland	-0.76	-0.87	-0.77	-0.66	-0.56	-0.50	-0.40	-0.33	-0.28	-0.18	0.13	0.23	0.34	-0.41
United Kingdom	0.42	0.47	0.51	0.57	0.73	0.88	0.94	1.03	-	1.22	1.55	1.78	1.80	1.20
USA	1.65	1.79	1.90	-	2.13	-	2.28	-	-	2.37	-	-	2.75	2.59
Canada	-	1.50	1.55	1.60	1.66	-	1.74	-	-	1.85	-	2.11	2.16	2.00
Australia	-	1.83	1.97	2.10	2.15	-	2.42	-	-	2.56	-	3.04	3.30	2.78
New Zealand	-	1.96	2.11	2.11	2.40	-	2.68	-	-	2.83	-	3.39	-	3.15
Japan	-0.17	-0.15	-0.13	-0.12	-0.11	-0.08	-0.06	-0.04	0.00	0.05	0.30	0.57	0.82	0.43

Spreads (bp) vs. Germany before FX Hedge	1Y	2Y	3Y	4Y	5Y	6Y	7Y	8Y	9Y	10Y	15Y	20Y	30Y
Denmark	-	24	-	-	26	-	-	-	-	9	-	7	8
Sweden	-	-10	15	20	13	-	35	-	-	39	-	56	-
Norway	-	124	131	138	141	-	132	-	-	119	-	-	-
Switzerland	0	-13	-11	-13	-19	-25	-27	-32	-42	-47	-38	-58	-78
United Kingdom	118	121	117	110	110	112	106	104	-	93	104	97	68
USA	240	253	256	-	251	-	240	-	-	208	-	-	163
Canada	-	224	220	213	204	-	187	-	-	156	-	131	104
Australia	-	257	263	263	252	-	254	-	-	227	-	223	218
New Zealand	-	270	277	264	278	-	280	-	-	254	-	258	-
Japan	58	59	53	42	26	17	6	-3	-14	-24	-21	-24	-30

yield < 0.00

yield > 1.50

Quelle: Raiffeisen KAG, Bloomberg Finance L.P., 2017-12-11

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Global Bonds Hedged

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Yields (%) after FX Hedge	1Y	2Y	3Y	4Y	5Y	6Y	7Y	8Y	9Y	10Y	15Y	20Y	30Y	Cost of FX Hedge, 3M ann. (bp)
Germany	-0.75	-0.74	-0.66	-0.53	-0.38	-0.25	-0.12	-0.01	0.14	0.29	0.51	0.81	1.12	
Denmark	-	-0.43	-	-	-0.04	-	-	-	-	0.46	-	0.96	1.28	-0.08
Sweden	-	-0.78	-0.45	-0.28	-0.19	-	0.28	-	-	0.73	-	1.42	-	-0.06
Norway	-	-0.93	-0.78	-0.58	-0.39	-	-0.23	-	-	0.05	-	-	-	1.43
Switzerland	-0.35	-0.47	-0.36	-0.25	-0.15	-0.09	0.01	0.08	0.13	0.23	0.53	0.63	0.75	-0.41
United Kingdom	-0.78	-0.73	-0.69	-0.64	-0.48	-0.33	-0.27	-0.17	-	0.02	0.35	0.58	0.60	1.20
USA	-0.94	-0.80	-0.69	-	-0.46	-	-0.31	-	-	-0.22	-	-	0.16	2.59
Canada	-	-0.50	-0.46	-0.40	-0.34	-	-0.26	-	-	-0.15	-	0.11	0.16	2.00
Australia	-	-0.95	-0.80	-0.68	-0.63	-	-0.36	-	-	-0.22	-	0.26	0.52	2.78
New Zealand	-	-1.19	-1.03	-1.04	-0.75	-	-0.47	-	-	-0.32	-	0.24	-	3.15
Japan	-0.60	-0.58	-0.56	-0.55	-0.54	-0.51	-0.49	-0.47	-0.43	-0.38	-0.14	0.14	0.39	0.43

Spreads (bp) vs. Germany after FX Hedge	1Y	2Y	3Y	4Y	5Y	6Y	7Y	8Y	9Y	10Y	15Y	20Y	30Y
Denmark	-	31	-	-	34	-	-	-	-	17	-	15	16
Sweden	-	-4	21	26	19	-	40	-	-	44	-	62	-
Norway	-	-19	-12	-5	-2	-	-11	-	-	-24	-	-	-
Switzerland	40	28	30	28	22	16	13	8	-1	-6	2	-17	-37
United Kingdom	-3	1	-4	-10	-10	-8	-14	-16	-	-27	-16	-23	-53
USA	-19	-6	-3	-	-8	-	-19	-	-	-51	-	-	-96
Canada	-	24	20	13	3	-	-14	-	-	-44	-	-70	-96
Australia	-	-21	-15	-14	-25	-	-24	-	-	-51	-	-55	-60
New Zealand	-	-45	-38	-51	-37	-	-35	-	-	-61	-	-57	-
Japan	15	16	10	-2	-17	-27	-37	-46	-57	-67	-65	-67	-73

yield < 0.00

yield > 1.50

Quelle: Raiffeisen KAG, Bloomberg Finance L.P., 2017-12-11

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Global Growth Environment (PMIs)
No signs of weakness

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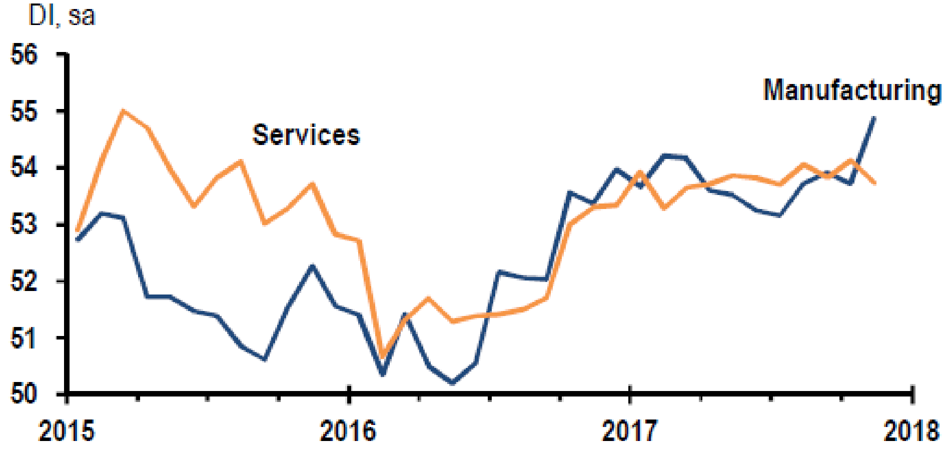
J.P. Morgan global PMI summary

		Jul	Aug	Sep	Oct	Nov
Output	Total	53.5	54.0	53.9	54.0	**54.0**
	Manufacturing	53.2	53.7	53.9	53.7	**54.9**
	Services	53.7	54.1	53.8	54.1	**53.7**
New orders	Total	54.3	54.6	54.4	54.1	**54.7**
	Manufacturing	53.7	54.2	53.8	54.2	**55.1**
	Services	54.5	54.8	54.6	54.1	**54.5**
Employment	Total	52.5	52.6	52.5	52.7	**52.7**
	Manufacturing	51.6	52.0	52.2	52.6	**52.8**
	Services	52.8	52.8	52.6	52.7	**52.7**

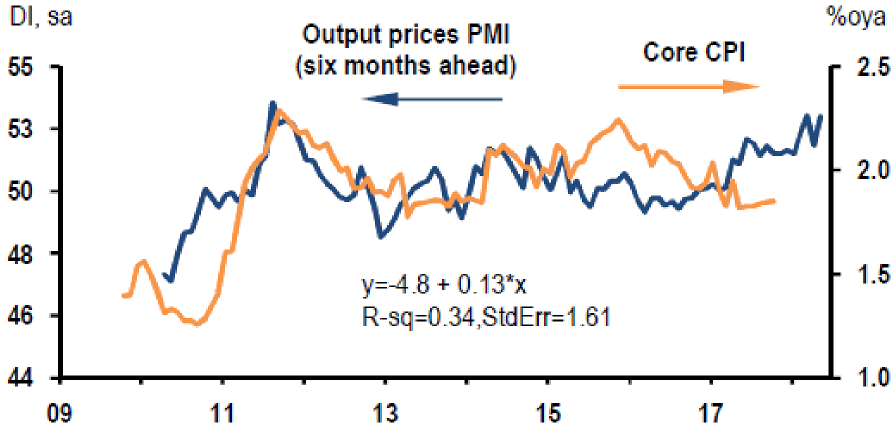
Source: J.P. Morgan, Markit

J.P. Morgan global PMI output indexes



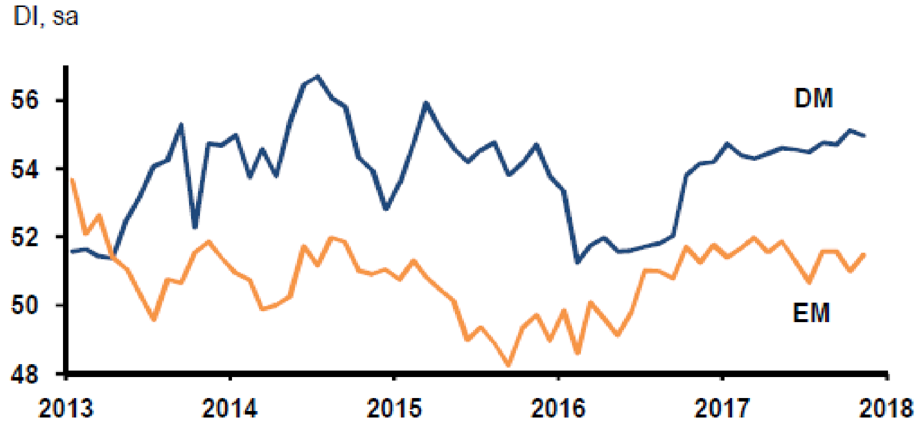
Source: J.P. Morgan

JPMorgan global all-industry output prices PMI and core CPI



Source: J.P. Morgan

J.P. Morgan global all-industry output PMI



Source: J.P. Morgan

Source, JPM; December 2017

Euro Government Bonds
New Issuance (Gross, Net) versus PSPP

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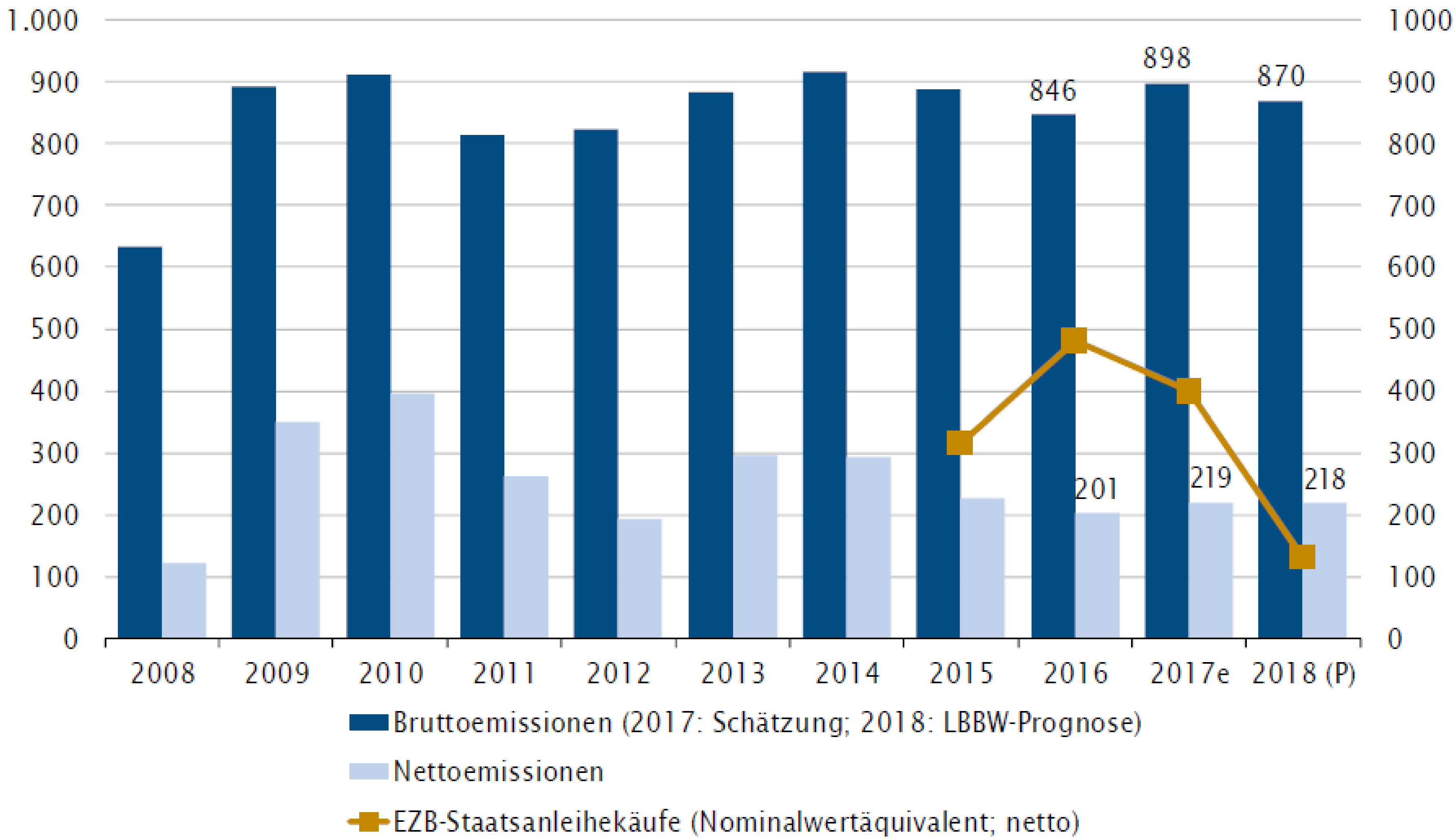

Source: LBBW, Kapitalmarktkompass, December 2017

Euro IG Corporates
Yield Compression

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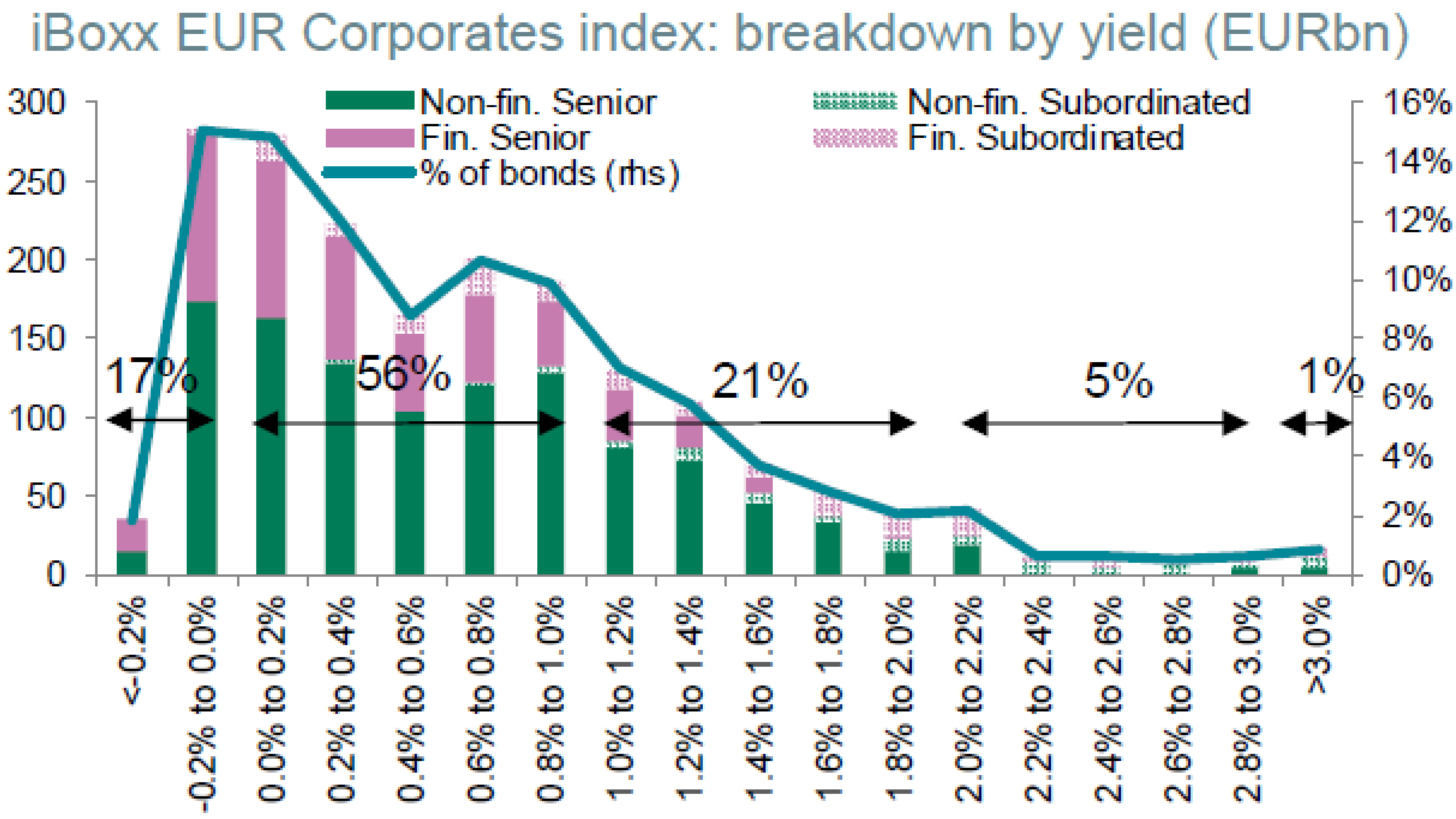

Quelle: Calyon 12/2017,

Euro-Corporates
How expensive is Credit?

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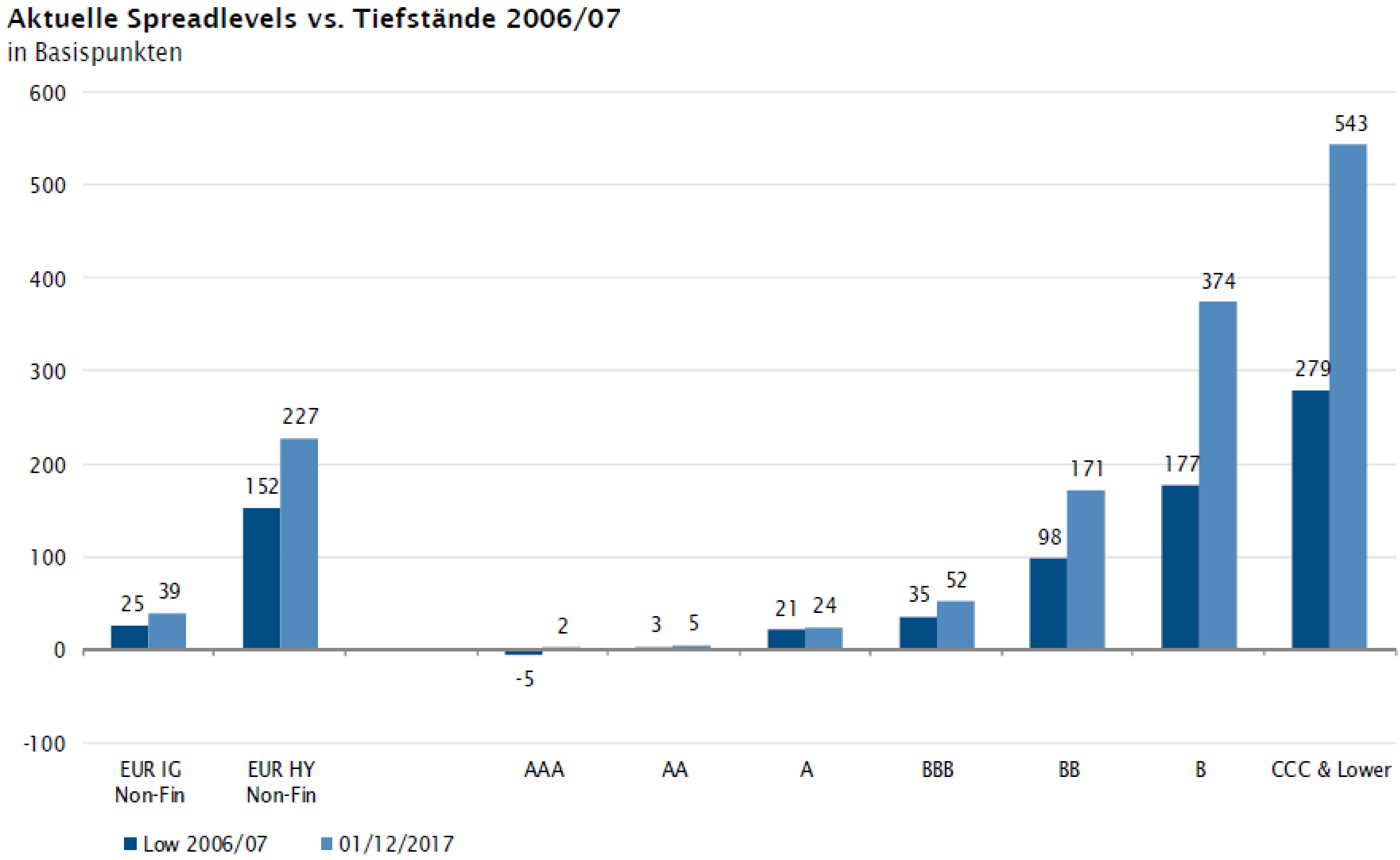

Source: LBBW, Kapitalmarktkompass, December 2017

Structural changes in Euro High Yield Also a Cause of lower Market Volatility

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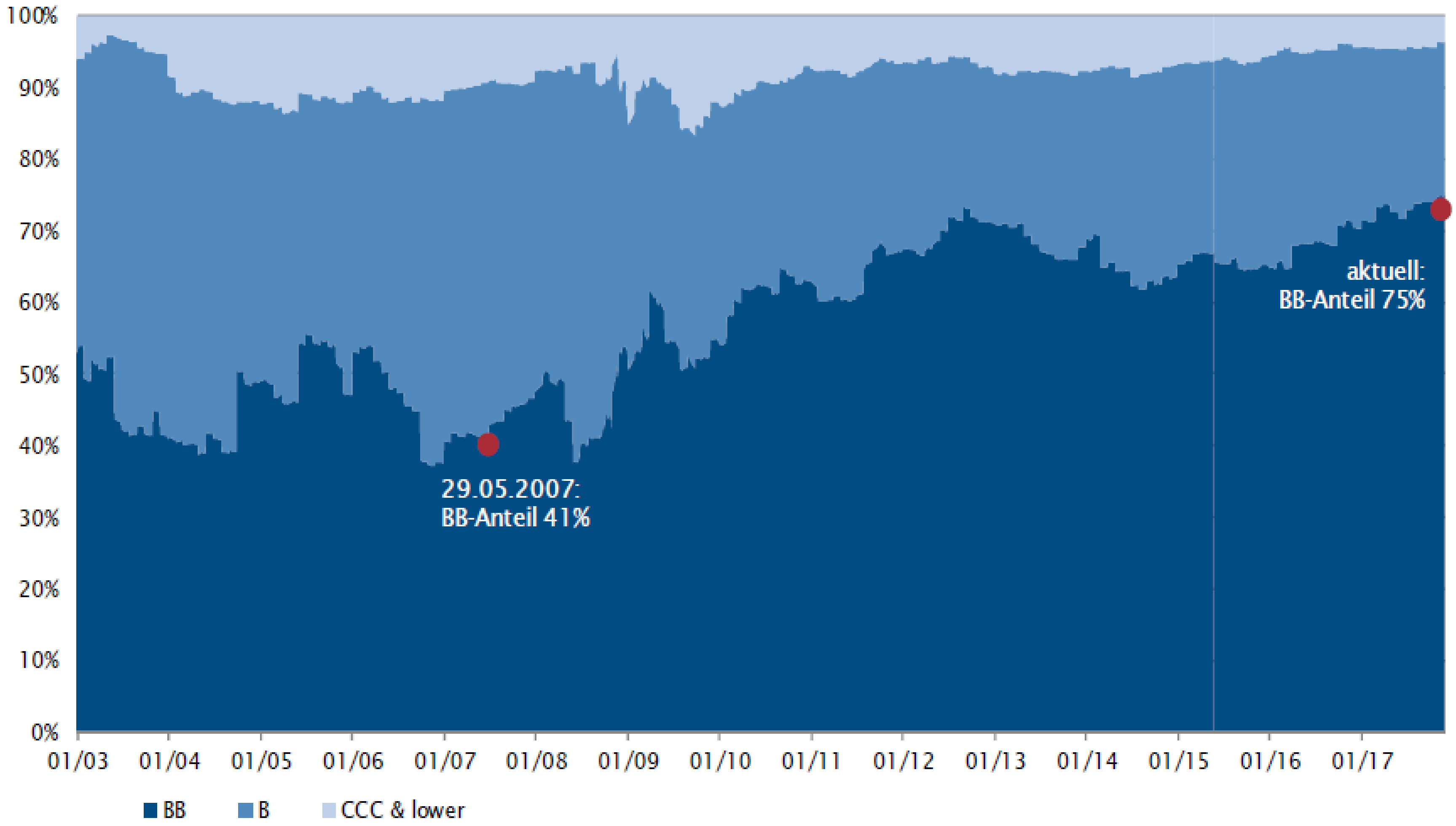
Anteil der einzelnen Rating-Klassen am EUR HY Non-Financials Index
in Prozent



Source: LBBW, Kapitalmarktkompass, December 2017

II) Central Bank View - FED

As expected, the Fed raised its policy target rate by 25bp, to between 1.25% and 1.50% at the December meeting.

Median inflation forecasts all unchanged except for 2017 headline PCE forecast, which rose to 1.7 percent from 1.6 percent.

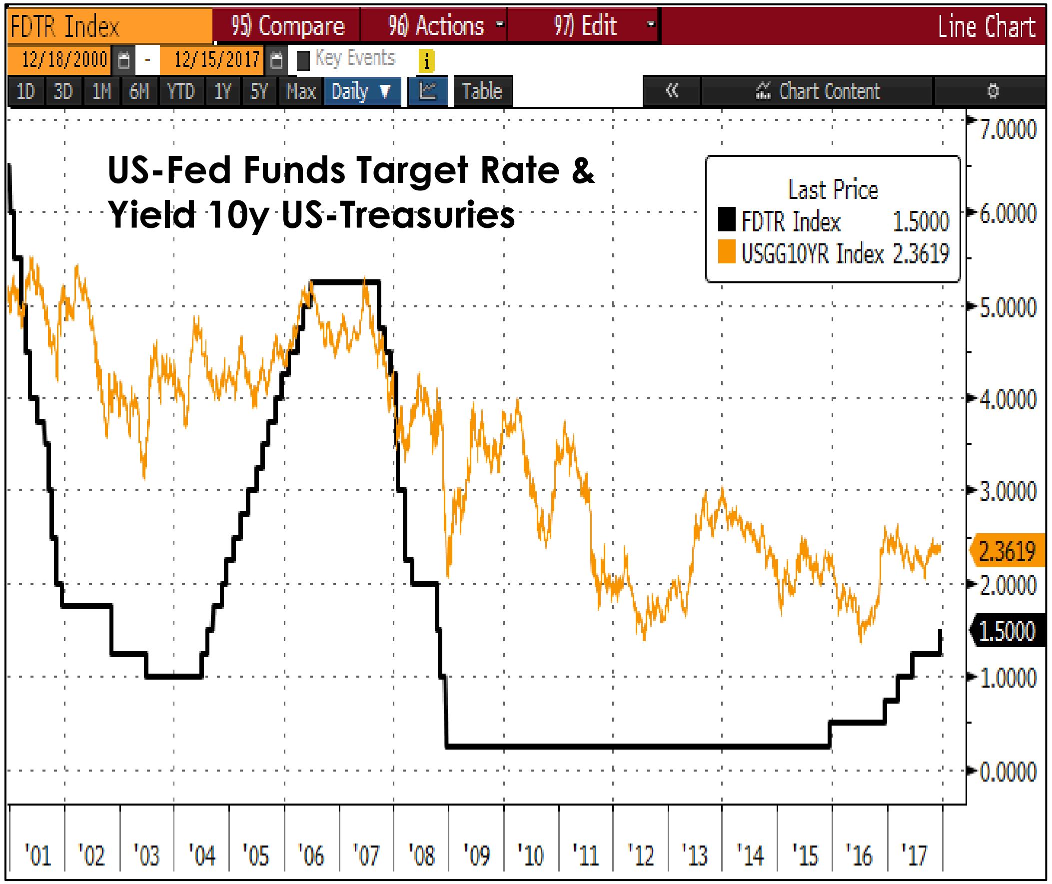
2018 growth expectation revised to 2.5% from 2.1%. 2019 median economic-growth forecast rose to 2.1 percent from 1,9 percent; 2020 projection moved to 2 percent from 1.8 percent

Median 2019 unemployment-rate projection fell to 3.9 percent from 4.1 percent; 2020 estimate declined to 4 percent from 4.2 percent.

Unchanged forward Guidance: Fed officials still expect to raise the policy target rate three times in 2018.

Median estimate for 2019 federal funds rate held at 2.7 percent; 2020 projection rose to 3.1 percent from 2.9 percent, while long-run rate remained at 2.8 percent.

Our take: Interest rate markets pricing in less than 2 hikes for 2018 seems a bit too complacent. Core scenario: Expect two further hikes 2018 with the possibility of a third one. Expect bearish flattening to continue with 10y-treasury yield of 2.7% in December 2018



FOMC Forecasts	2013	2014	2015	2016	2017	2018	2019
Real GDP (yoy%)	1.70	2.60	2.90	1.50	2.50	2.50	2.10
Core PCE (yoy%)	1.48	1.63	0.13	1.27	1.70	1.90	2.00
Unemployment (%)	7.37	6.17	5.26	4.85	4.10	3.90	3.90

Source: Bloomberg; Data as of December 14th, 2017

II) Central Bank View - ECB

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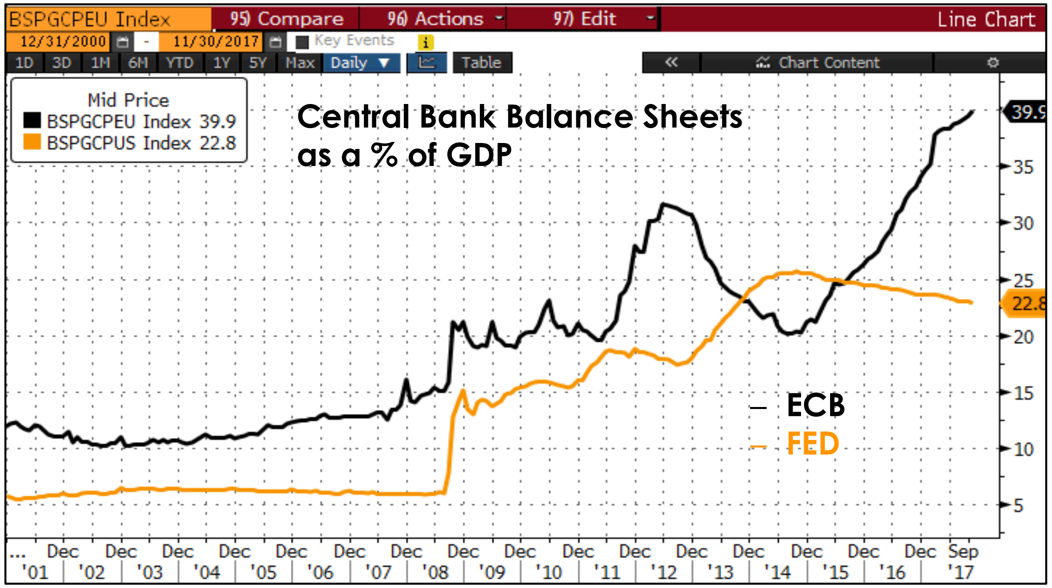
ECB-December Meeting: unchanged policy stance and forward guidance.

Significant revision of growth expectations for 2018.

Growth momentum declining after 2018, but above potential growth throughout the forecasting horizon.

Inflation forecast more or less unchanged – slowly moving towards the comfort level, but not reaching it.

No signs given, that ECB might speed up tapering process due to buyoant growth environment.



Our take: All in all, with the current economic projections it is getting more difficult for the ECB to to justify the extreme loose monetary policy in the long run (negative deposit rate). Still, the current forecasts give ECB enough flexibility in both directions – preparing markets for an adjustment of their stimulus or leaving it unchanged even longer than markets expect. Our main scenario remains the following:

- **Tapering starting in October 2018**
- **End of QE in December 2018**
- **First Rate hike (deposit rate) not before Q2/2019**

MACROECONOMIC PROJECTIONS FOR THE EUROZONE

Eurozone headline inflation	2017	2018	2019	2020
ECB (Dec projections)	1.5	1.4	1.5	1.7
ECB (Sep projections)	1.5	1.2	1.5	
Bloomberg consensus	1.5	1.5	1.6	
Berenberg	1.5	1.5	1.7	

Yoy change in %. Source: ECB, Bloomberg, Berenberg

Eurozone real GDP	2017	2018	2019	2020
ECB (Dec projections)	2.4	2.3	1.9	1.7
ECB (Sep projections)	2.2	1.8	1.7	
Bloomberg consensus	2.3	2.0	1.7	
Berenberg	2.4	2.4	2.1	

Yoy change in %. Source: ECB, Bloomberg, Berenberg

Source: Bloomberg; Data as of December 14th, 2017

Market Scenarios
GFI vs. Consensus

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	Reales Wachstum 2017	Reales Wachstum 2018	Inflation 2017	Inflation 2018	EUR/USD[1]	3m Euribor / US 3m TBill[2]	10J-Rendite[1]	Investment Grade - Credits[1] [4]
Euroland								
04. Dez. 2017[3]					1,18	-0,30	0,40	88
Consensus[5]	2,3%	2,1%	1,5%	1,4%	1,09-1,30	-0,20	0,30-1,50	109[6]
Raiffeisen KAG	2,4%	2,1%	1,5%	1,4%	1,15[7]	-0,25	0,70[7]	108
USA								
04. Dez. 2017[3]					1,18	1,30	2,40	
Consensus[5]	2,3%	2,5%	2,1%	2,1%	1,09-1,30	2,10	2,50-3,90	
Raiffeisen KAG	2,3%	2,7%	2,1%	2,2%	1,15[7]	1,90	2,70[7]	

[1] Zielwert in 12 Monaten
[2] 3m Euribor und US 3-Monats-Treasury Bill: Zielwert Dezember 2018
[3] Quelle: Bloomberg
[4] Basis: iboxx Non-Financial Corporate Index, wöchentliche Basis
[5] Quelle: „Consensus Economics“ 4.Dezember 2017
[6] Break-Even-Spread-Niveau Horizont 12 Monate
[7] Zielbandbreite: EUR/USD: 1.05-1,30; 10J-Rendite DE: -0,40-1,60 USA: 1,70-3,70

Rates Markets – Key assumptions for 2018 (I)

Raiffeisen Capital Management

Topic	Parameter	Main Scenario
EMU Economy (Updated: 12/2017) FM: mca, pga	Growth, Inflation, Central Bank activity	We expect the Eurozone economy to grow at a robust pace of about 0.5% per quarter which equates to 2.1% in 2018. The narrowing of the output gap should result in some upward pressure on core inflation, but labour market slack remains a drag on wage growth. The ECB will end its purchases of public debt in September and will shift to the deposit rate as transmission channel of monetary policy. We expect a first rate hike for 2019 mainly dependent on the evolution of core inflation.
USA Economy (Updated: 12/2017) FM: zic	Growth, Inflation, Central Bank activity	Economy continues to grow above trend powered by private consumption and increasingly private investment : 2.7% in 2018 vs. 2.3% 2017. Fiscal easing is supportive by ~ 0.3%. Headline inflation driven by oil price, core rate to recover 2018 as wage pressure rises slowly (unemployment rate falls to 50-year lows). Fed reduces balance sheet, hikes in December and twice in 2018. (with risks of three steps as FOMC composition gets more hawkish.)
Bund Curve (Updated: 12/2017) FM: mca, pga	Key levels, performance expectations Curve strategy	We expect somewhat higher yields over the course of 2018. Bond negative factors like the robust growth will be kept in check by the rather slow acceleration of inflation. Although the QE net buying will ebb away towards the end of the year, the stock of the ECB's holdings of government bonds will stay high. Negative carry in parts of the curve and higher yields in the core scenario support our expectations of negative returns for German bonds over the next 12 months.
TSY-Curve (Updated: 12/2017) FM:z ic	Key levels, performance expectation Curve strategy	2018 year end target 2.7% for 10yr. Performance by the end of 2018 from current yield levels flat in USD terms as long end yields rise only modestly and curve flattens. Rising budget deficit - overwhelmingly financed by additional supply at the short end (e.g. bills)- a risk of becoming an issue.

Rates Markets – Key assumptions for 2018 (II)

Raiffeisen Capital Management

Topic	Parameter	Main Scenario
EMU Government Markets (Updated: 12/2017) FM: boa	Country Spreads: Core vs Semi-Core vs Periphery	With big political decisions to come in Italy and Spain, spreads are doing remarkably well. As long as volatility will stay at low level, the market needs a political trigger to lead us towards wider spreads. In Spain we doubt that catalan separatists will get a convincing majority and expect that the dust will settle down. In Italy polls show a kind of hung parliament. As a consequence we would recommend a more defensive positioning there.
Linkers Markets (Updated: 12/2017) FM: mca	Performance & Valuation Linkers versus Nominal Yield Bonds Euro vs US-Linkers	Growth is strong and is slowly feeding through to wages as labour market slack diminishes at a decent pace. Despite recent increases, market pricing is still subdued as the inflation risk premium remains excessively negative. Dovish ECB rhetoric is likely to support BEIs until mid-year. Small long position vs nominals.
Agencies versus Government Bonds (Updated: 12/2017) FM: pga	Relative Value, Performance	Uncertainty about QE in '18 provides an incentive for Agency issuers to frontload supply in the first half of the year. Accordingly we will keep overall exposure rather low at the beginning of the year with the expectation to add bonds at somewhat wider levels starting in Q2. Focus will be on opportunities in the primary market.
Covered Bonds versus Government Bonds (Updated: 12/2017) FM: boa	Relative Value, Performance	Covered Bonds Govi-Spreads (iBoxx Covered all) at 44 Bps, seem to be reasonable priced as long as the support from the European Central Bank is in place. For the year to come net supply will be positive for the first time since years. But this will not change the technical picture for Covered Bonds dramatically. The stretched valuation of Covered Bonds and the complacency of many investors regarding pool quality and structure of program will be assigned as risk for the asset class. We like exposure in high quality names from Germany, Austria, Canada or Singapore.

Euro Credit Markets – Key assumptions for 2018

Raiffeisen Capital Management

Topic	Parameter	Main Scenario
Euro High Yield (Updated: 12/2017) FM: KTO, RGA	Performance, OAS	After this year's impressive performance the Euro HY Market has experienced some profit taking at year-end 2017. Hence, average yields (YTW 2,5%) currently trade around 60 Bp wide their all-time-lows. Average credit risk premia (300 Bp) look fair in historical perspective (Low 191 Bp, June 2007) and considering solid fundamentals. European Default Rates are expected to trend lower from currently 2,5 %, indicating default costs below 1%. However, based on our expectation of gradually rising Bund yields, we expect Spreads to trend marginally higher in 12 months. We expect to genereate absolut returns above 1%.
Euro Non Financial Corporates, IG (Updated: 12/2017) FM: NIG	Performance, OAS, Excess Returns vs Govt	Technicals are still strong with constant ECB buying and a healthy but manageable new issue pipeline. Slightly higher bund yields would help to bring in absolute yield buyers. Releveraging is still a topic to be watched, however, partly mitigated by improving earnings. Start of tapering will weigh on credits and we see wider spreads in 12 months. We still see few alternatives especially at the short end, but would be more careful with longer, illiquid and lower quality issues.
Financials vs Non Financials (Updated: 12/2017) FM: HIM	Relative Performance	Improving fundamentals (better capital ratios; steeper yield curves) Higher exposure to political risks and sovereign spreads versus non financials. Small premium of 0,10% of financials versus non-financials Strategy: focus on better quality issuers, national champions and liquid instruments. Attractive new issuance premia for new instruments (Tier 3). Attention on TLAC-capital. Senior preferred capital, which suffered in relative terms from hunt for yield, looks appealing.

Emerging Markets – Key assumptions for 2018

Raiffeisen Capital Management

Topic	Parameter	Main Scenario
Global Emerging Markets (Updated: 12/2017) FM: gws, mam, sro	Growth, Inflation, Central Bank activity	Economic growth is likely to accelerate slightly to 4% in 2018. Growth in China will continue to slow moderately to 6.4%, possibly surprising in H1. Monetary tightening will continue to be main topic, bond yields to increase further, CNY to appreciate to 6.40. Asia ex China: Growth to slow due to China, but export growth supporting. CEE continuation of relative positive growth momentum, easy monetary policy, Slowdown in Turkey, tighter monetary policy necessary, political risks prevailing. Russia supported by high oil price, easing of monetary policy. LATAM: Brazil continue to recover with Inflation low behind us and end of easing cycle reached. Political topics in focus Mexico as well. Other countries enjoy positive growth momentum, supported by commodity prices, pick-up in global trade.
EM Local Bond Markets (Updated: 12/2017) FM: gws, mam, sro	Currencies, Yields, Rating Trends -> Performance Expectation	GBI-EM Div Yield 6.16% below the post 2009 average (high: 7.35% / low 5.2%), tighter global monetary policy likely put some upward pressure, while some countries will be able to ease; FX with some room to appreciate expected -> 12m pwr: 5.0% (pos: +6.0% neg. 2.0%)
EM Hard Currency Markets (Updated: 12/2017) FM: gws, mam, sro	Yields, Spreads, Trends -> Performance Expectations	EMBI Glb. Div Spread 290 20Bp below post 2009 avg, (low: 240, high: 500), EMBI ytm 5.46% (low 4.3%, high 6.8%), downgrade migration pressure to moderate, default risks for commodity exporters reduced. Some upward pressure on spreads from US Fed policy. -> pwr: 3.6% (pos: 7.0%, neg. -1.3%, ex. hedging costs of ca. 2%)

Summary

2017… brought a few surprises for fixed income investors: stronger EMU-recovery than expected; ECB more expansive than expected; spread-markets even stronger than expected; Euro rates markets relatively strong; ECB's impact on markets was much stronger than market impact by macro developments and political events.

2018 - Our Expectations

What will be similar to 2017	What will be different to 2017
– Low market risk premia in general – Spread markets to outperform rates markets – EM-Government Bonds to outperform Credit – Euro-Yield-Map: negative yields to prevail in certain market segments – EMU-Govt: Outperformance of linkers versus Nominal Yield-Bonds – Hunt for yield will be key again – Low default rate environment to continue in credit markets – Euro High Yield with positive returns – Political risks will stay contained – Trump as a external risk factor	– ECB's market impact will be weaker – Expect market volatility to increase in general – Euro Core Government Bonds with negative returns – USD will appreciate versus the Euro – Higher Spread dispersion within Euro Government Bonds (+ Spain; - Italy) – Higher event risks in credit markets

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