Global Investment Strategy

JUNE 2017

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HEAD OF INVESTMENT

Mitsubishi UFJ Asset Management (UK) Ltd. (Registered in England No 1842259)
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Investment Summary

2017 started strongly; business confidence is firm but data from the USA is confused.

Economic activity outside of the US has continued to firm in the second quarter of 2017.

Globally labour markets remain tight, but wage growth has yet to accelerate.

Corporate profit expectations are positive and are leading to improved capital investment.

While we are seeing the end of monetary easing, increased fiscal spending has yet to be seen.

Inflationary pressures continue to firm outside of headline numbers.

Service sector prices are firm, commodity prices have been rising.

Inflation expectations have normalised in US, and also elsewhere.

Bond markets have moved back to lows despite expecting higher US interest rates.

The Fed are now forecast to raise rates again at the June meeting.

The market is unsure about further rate hikes, but we think the Fed will do more.

Other Central banks are gradually moving towards tightening monetary policy.

Equity markets may finally get profit growth.

Earnings revisions have moved into positive territory.

Valuations are not cheap, so equities can only return in line with earnings at best.

Despite US seeing higher economic growth, Japan and Europe are seeing better earnings growth.

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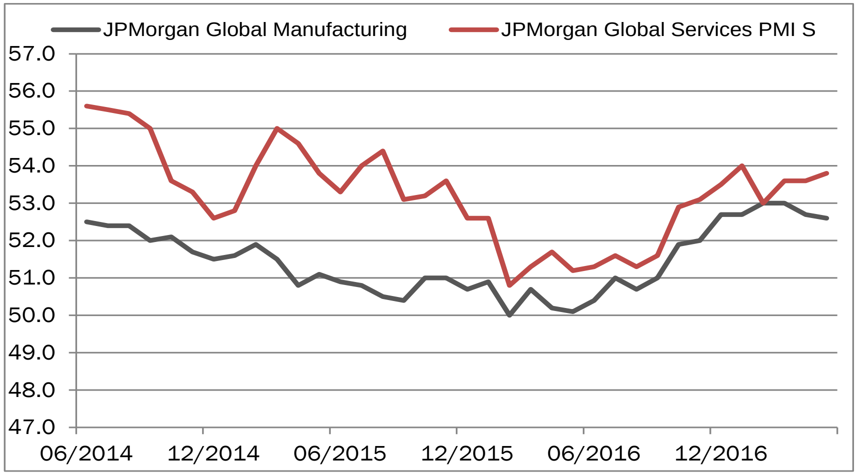
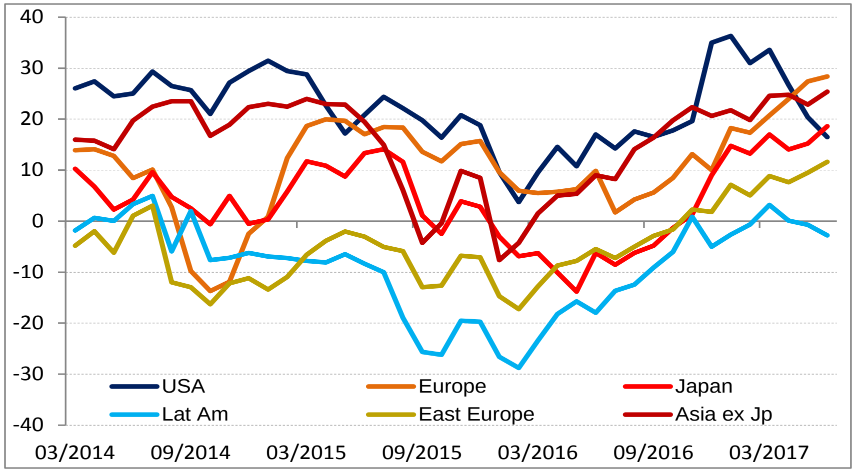
Growth and Inflation

Source: JP Morgan, Sentix, OECD, Bloomberg,

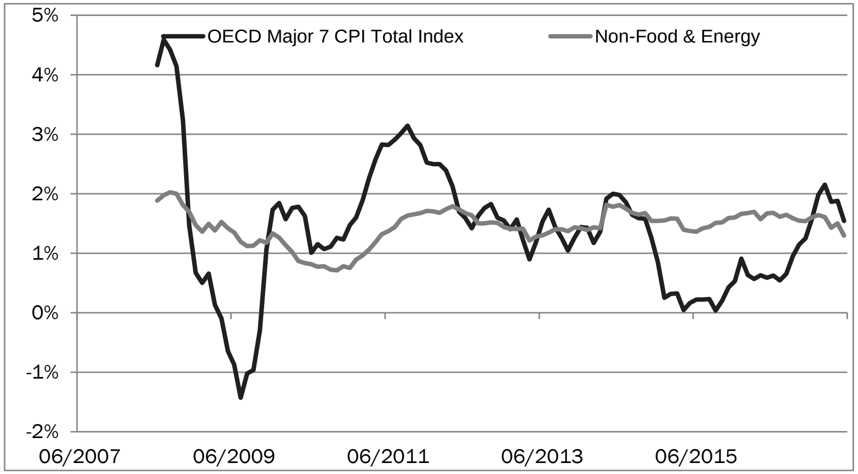
JP Morgan Global PMIs



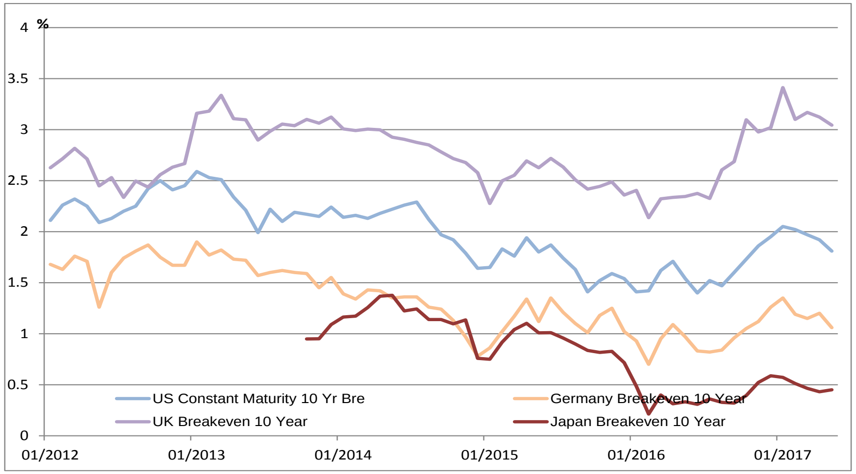
SENTIX Business Expectations Survey



OECD G7 Inflation



Implied Inflation from Index Linked Bonds



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Main Risks

All economies have to contribute to growth – US cannot go it alone.

US $ strength – holds back US profits, causes Emerging economy pain.

Europe is growing, but has to resolve BREXIT and there are several important elections.

Abe unable to extend time in power, economic experiment drifts and inflation never arrives.

China credit crunch, deflation.

Lack of policy options if growth deteriorates.

Growth is stronger and central banks get behind the markets.

Too much emphasis on Europe's structural issues – cyclical rebound.

Japan gets growth and inflation.

Global rebalancing reduces risk, capital spending / infrastructure boom.

Inflation targets become more ambiguous

Central Banks allow inflation to rise, citing target is over the long cycle.

Problems have not gone away.

Debt reduction still has a long way to go, while structural reform remains difficult.

Political risk is high and everywhere.

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Fixed Income

Fixed Income Strategy (1)

DURATION

Yield curves have flattened again as US ten year yields fall to 2017 lows.

The consensus has moved back to its view that interest rates must remain low for ever.

US long dated yields predicted to peak at 3.5%, or ~1% real rates.

While German and Japanese long rate expectations have risen they are still below target inflation.

SPREAD PRODUCT

Spread product position has been upgraded in quality.

We are still overweight spread product as economic activity is firm and default rates are low.

But we expect corporate managements with cash to increase M&A and capex.

We still want to pick up carry where we can, but only if spreads warrant.

High quality Covered Bonds are a good fit for our strategy and offer relative value.

Financials are still attractive.

Regulatory pressure on financials to deleverage remains in place.

Subordinated securities to outperform Senior debt.

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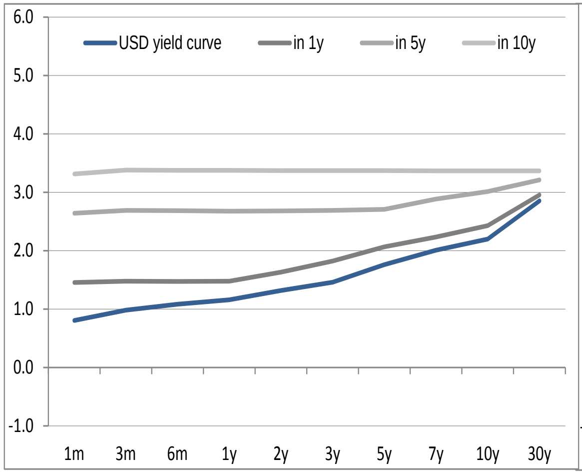
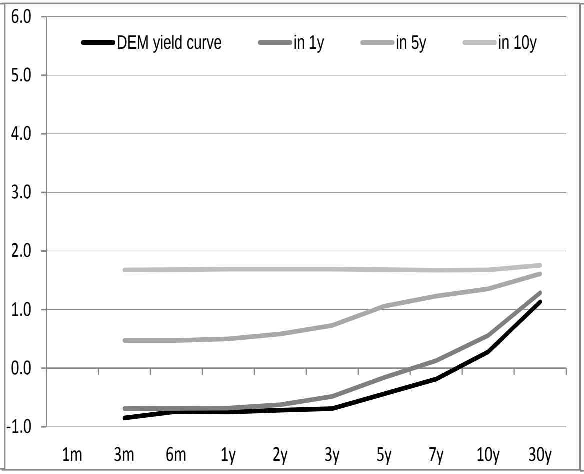
Forward Yield Curves

Source: Bloomberg,

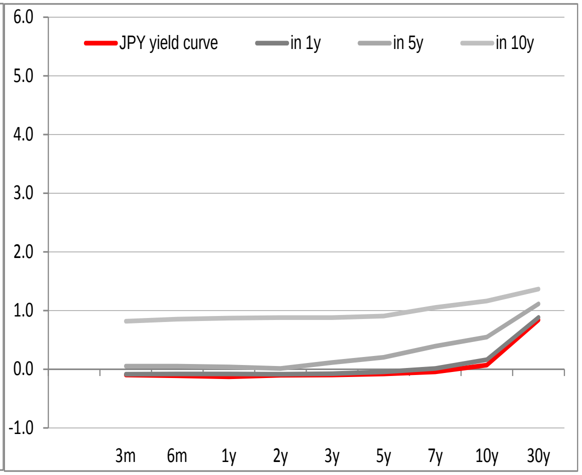
USA



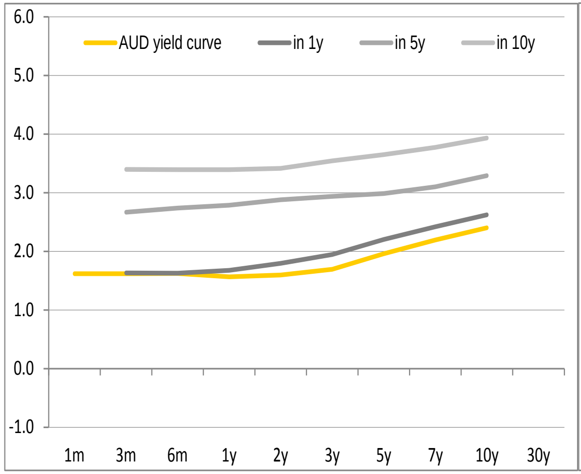
GERMANY



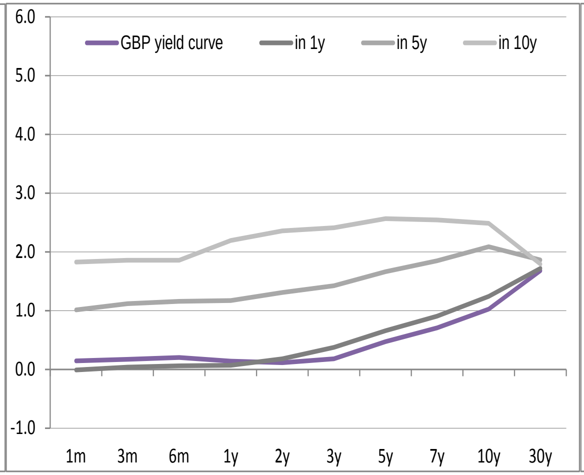
JAPAN



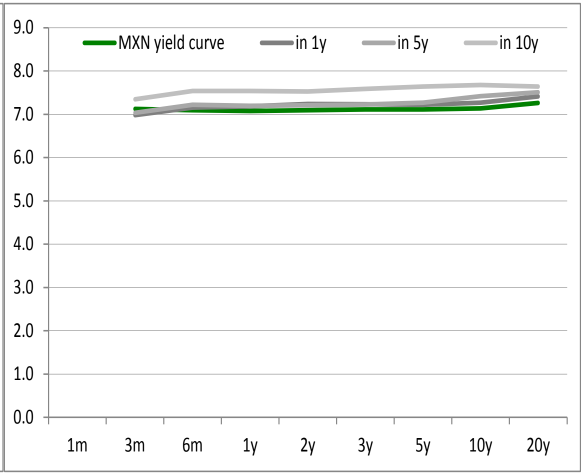
AUSTRALIA



UK



MEXICO



Fixed Income Strategy (2)

COUNTRY ALLOCATION

We prefer markets where future yields already discount growth.

We continue to favour higher yielding countries: USA, Australia, Mexico.

US fundamentals remain strong, rates are starting to discount this.

Australian yield curve is still flat and at relatively high levels; economy is mixed.

Mexico’s yields are pricing in some of the worst of Trump’s possible policies.

It is not the same for Europe or Japan.

The short end offers negative yields and curves have steepened but nowhere as much as in the US.

Japan has no attractions offering negative real yields along the curve and zero nominal at 10 years.

German 10 year yields are no longer negative.

We have limited currency positions.

The firm USD story makes sense but is well known and to some degree already in the market.

However for choice we are long USD with positions also in SEK, PLN, AUD and MXN.

And are mainly short in KRW, EUR and JPY.

Equity

Equity Strategy (1)

GLOBAL

The profit cycle has turned up rising 10% over the past 6 months

Most markets acknowledge this as equities have moved up as much if not more.

Better growth and low bond yields should be supportive of share prices.

Valuations are mixed and currently are not in focus

US equities continue to look stretched on most valuation measures.

European equities also have high P/Es but strong earnings growth is expected to alleviate this.

Japan looks best value at present, but the Yen is still a big influence.

Global Emerging Markets have bounced off low levels and offer value

Stabilising currencies and share prices suggest a bottom has been formed.

The problem is a rising US Dollar and rising US interest rates and the threat of protectionism.

We remain buyers and not sellers.

Profit momentum favours Japan and Europe.

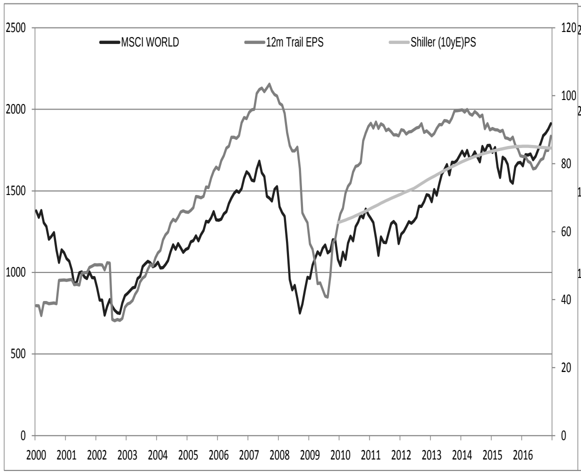
European profits are at lows since the pre-crisis peak yet Europe is growing.

Japan’s profits are at all time highs with scope for structural improvement.

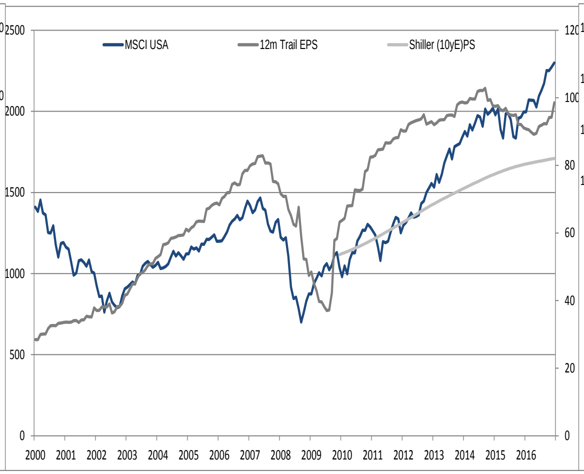
MSCI Equity Indices and Earnings (right hand axis)

Source: MSCI, Bloomberg,

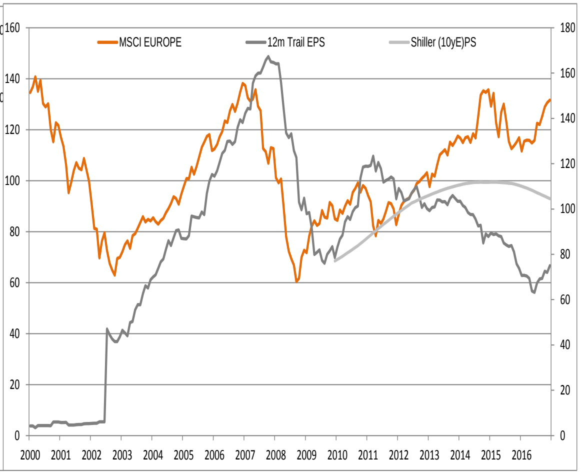
WORLD



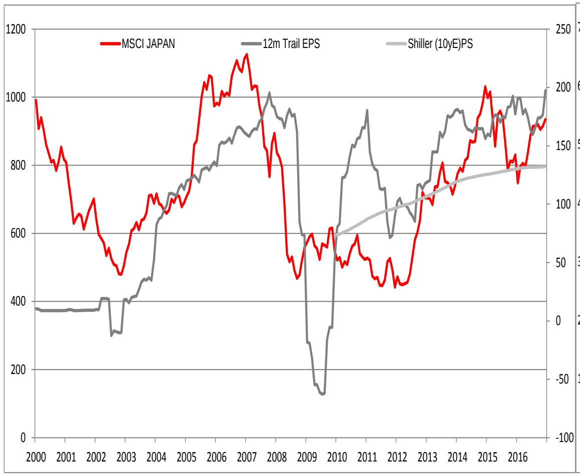
USA



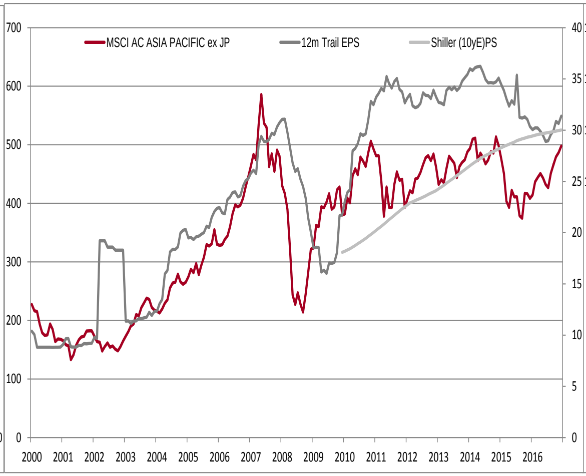
EUROPE



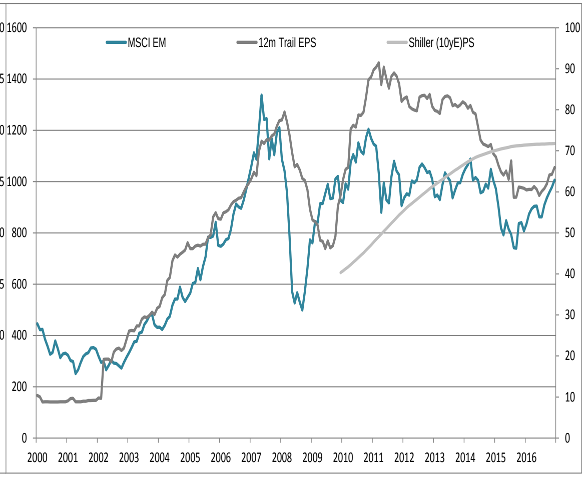
JAPAN



ASIA ex JAPAN



GLOBAL EMERGING



Equity Strategy (2)

EUROPE

Historically profits in Europe and US are closely correlated.

Euro-zone profits are recovering while UK and Swiss are weak

There is huge scope for a positive profit surprise after 5 years of no growth

The European economy is doing better than expected and this is not priced in.

JAPAN

Improving corporate governance means higher profitability

Japan's underlying profit momentum is less reliant on the performance of the Yen currency.

Increasing evidence that corporate management is changing.

Switch from bonds to equity only just starting.

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EMERGING MARKETS

Markets have bounced back from lows, but we see growth and remain buyers .

China**,** Brazil, Turkey, Russia are all looking to turn around.

Valuations are at fair value, but earnings are 30% below recent highs.

Currently 13.6x P/trend E, with earnings at 5 year lows.

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