"The heavy sell-off at the end of 2018 was followed up by a rebound last month. Whilst on the one hand, markets are being negatively impacted by economic and political challenges, on the other they are being supported by the central banks, by investors holding funds ready to invest and by the reduced pricing levels. So maintaining a neutral stance would appear a sensible course of action."

Michael Herzum, Head of Macro & Strategy and UIC Manager

February 2019: Market news and expert views

We work for your investment

The markets at a glance

We do not yet see the strong upward movement in the prices of higher-risk assets over recent weeks as an indication of a significant shift in macroeconomic conditions. The economic cycle is still at a late stage, the political situation is fragile and the fundamental business-side pressures on companies are increasing. Rather, the recovery since the start of this year is believed to be linked to the heavy sell-off in the final weeks of 2018 and can be interpreted, to an extent, as a rebound. What is new, however, is the more moderate tone of the central banks. A number of statements (in particular from the Fed) have recently indicated greater acknowledgement of the weakening economy and a willingness to take supporting measures and/or forego tightening if necessary. As a result, the Fed has called a kind of 'soft put' that should provide support for the capital markets in the coming weeks. The central banks will take greater account of prevailing economic indicators in their decision-making. But at the same time, this mechanism ('weak economy prompts monetary policy stimulus') works in the opposite direction and thus limits upside potential. After all, the central banks are likely to return to their original course (of tightening) if the economic picture improves significantly. We therefore confirmed our current risk positioning (RoRo meter at level 3). Political uncertainties such as the simmering trade dispute and the unresolved issue of Brexit point in favour of a neutral stance, as both positive and negative developments are possible in terms of market impact. As a result, we are focusing mainly on positions in which the picture with regard to economic or monetary policy is sufficiently clear.

Other important news

Economy: As the above suggests, we do not expect the global economy (or major regions such as the US, Europe or China) to slip into recession. But economic activity has tapered sharply of late. There are many different reasons for this, ranging from industry-specific issues (especially in the automotive sector) to weather effects and the weakness of global trade. Germany's poor industrial output in the fourth quarter of 2018 was a visible sign of this stagnation. At macroeconomic level, however, this weakness is not so pronounced that it will drag individual economies into recession. After all, robust labour markets (not only in the US, but also in Germany) and high wage settlements are leading to a rise in real incomes and thereby stabilising consumer spending. Taking all this into consideration, our Chief Economist David Milleker lowered the 2019 growth forecasts for the eurozone to 1.1 per cent (previously: 1.7 per cent) and to 0.8 per cent for Germany (previously: 1.5 per cent). Of course, this is assuming that the United Kingdom does not leave the EU without a deal in place. The US growth forecast is now 2.4 per cent (previously: 2.5 per cent), compared with 2.8 per cent in 2018. The forecast has thus been lowered to a much lesser degree than on this side of the Atlantic. This is because the US economy has a far stronger domestic focus and is more immune to deteriorating conditions elsewhere, although it cannot escape entirely unscathed.

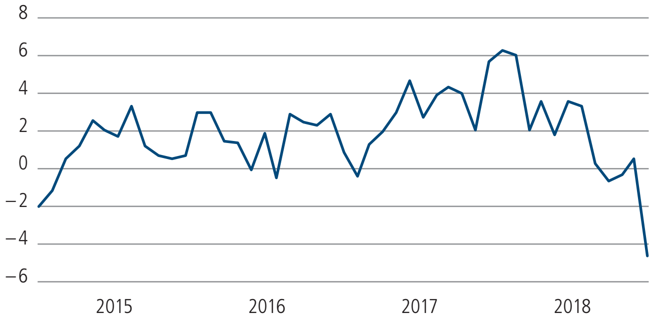
Monetary policy: In December, the US Federal Reserve (Fed) raised key interest rates for the fourth time in 2018. This much is already clear: the Fed will not continue at this pace. Fed Chair Jerome Powell has already stated publicly that interest rates would be raised at a much slower rate in 2019 than had previously been expected. We therefore do not expect key interest rates to be raised in March, especially given the current economic weakness. Over the year as a whole, the Fed is likely to put up interest rates twice at most. We also predict a more cautious approach from the European Central Bank (ECB). An initial deposit-rate hike is unlikely until late 2019, while an increase in the base rate itself is not expected until 2020.

Equities: Following their significant correction in December, the equity markets have been staging a recovery since the start of the year, primarily due to the Fed's more moderate tone (soft put). With the economy in a late-cycle phase, analysts have lowered their profit estimates for the first half of 2019. Medium-term expectations are still too high and will probably be adjusted as the year goes on. The upside potential of this asset class is therefore limited, especially as an improvement in the economic data going forward would likely prompt the Fed to reconsider its more cautious stance. We therefore expect equities to remain relatively static in the coming months.

Commodities: The curbing of production by OPEC and Russia and the diminishing level of drilling activity in the US due to lower prices are starting to take effect, and oil prices have rallied sharply since the start of the year. The fundamental environment remains positive. If supply decreases slightly and demand increases over the course of the year, the market should regain its equilibrium and, in the second half of the year, we should see a modest fall in inventories again.

German industry continues to weaken

Year-on-year change (%)



Source: Bloomberg, as at 22 January 2019.

The markets at a glance

Our current risk assessment

- Moderate tone from the major central banks triggered a rebound following the heavy sell-off in December.
- Economic data remains weak, but is likely to stabilise as the year goes on.
- We are not expecting a recession in Europe, provided there is no hard Brexit.
- Analysts have now lowered their profit estimates for the first half of 2019 to a more realistic level.
- Political risks, such as the trade dispute, remain.
- Our general risk assessment (RoRo meter) remains at level 3 (neutral).

RoRo meter

Source: Union Investment, as at 22 January 2019. Last changed (from 4 to 3) on 20 November 2018.

Note: The investment strategy is established by first closely analysing the market environment. The result is reflected in a risk rating. For this, the Union Investment Committee (UIC) expresses a risk-on/risk-off decision at one of five levels (1, 2, 3, 4 or 5). It is to be interpreted as follows: a '5' indicates a strong appetite for risk while a '1' indicates a general withdrawal from risk assets.

Our view of the asset classes

- **Fixed income:** The Fed's moderate tone is currently supporting higher-risk asset classes.
- **Equities:** Following the recent price gains, we are taking profits on equities from the emerging markets and adopting a slightly more defensive stance. We expect a sideways trend.
- **Currencies:** We are reopening the hedging position in Japanese yen at the expense of the US dollar.
- **Commodities:** Because of the good fundamentals, we currently favour energy commodities and industrial metals. Demand for gold is likely to fall as investors become less risk averse.
- The situation in the money markets remains unchanged. Interest rates are still close to zero, which means that holding **cash** is not a good idea.
- We take a neutral view of **absolute return strategies**.
- The outlook for **real estate** has improved in Germany but deteriorated in the US.

The → = ← signs indicate the change compared with the UIC's previous decision.

Not favoured **Strongly favoured**
Neutral

Appeal of different asset classes

Fixed income		←
Core European government bonds		=
Covered bonds		→
Eurozone periphery government bonds		=
Corporate bonds (euro-denominated, investment-grade)		=
Corporate bonds (euro-denominated, high-yield)		=
Emerging-market government bonds		←
Equities		=
Industrialised countries		=
Emerging markets		=
Commodities		=
Currencies		
US dollar		=
Pound sterling		=
Japanese yen		=
Emerging-market currencies		=
Absolute return		=
Cash		→

Source: Union Investment, as at 8 February 2019.

Note: The table above shows a **relative view of a multi-asset portfolio (excluding real estate).** If an asset class is more strongly favoured, a lower level of investment in another asset class is required in return. The latter would then be classified as less favoured – or vice versa. Real estate is excluded from this analysis..

Real estate		
Germany		→
Europe (ex Germany)		=
US		←
Asia-Pacific		=

Source: Union Investment, as at 31 December 2018. Assessment is valid up to 30 April 2019.

Note: The table above shows a **relative view of the office real-estate markets** in light of current market prospects. Owing to data availability, it is only updated quarterly.

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Forecasts

These forecasts represent Union Investment's assessment at the current time and may be changed without notice. Where a forecast has been significantly revised in comparison with the previous report, we will explain this in the relevant section. Routine adjustments that arise from a change in the forecasting horizon are not usually explained.

GDP	Germany	UK	Eurozone	US	Japan	China
2018	1.5%	1.4%	1.8%	2.8%	0.7%	6.6%
2019	0.8%	1.6%	1.1%	2.4%	1.5%	6.3%
2020	1.3%	1.4%	1.4%	1.7%	0.0%	6.2%

Inflation	Germany	UK	Eurozone	US	Japan	China
2018	1.9%	2.4%	1.7%	2.4%	1.0%	2.1%
2019	1.7%	2.2%	1.8%	2.0%	1.0%	2.0%
2020	2.3%	2.0%	2.0%	2.5%	1.9%	2.3%

10-year yields	Germany	US
Current status*	0.2%	2.6%
In 3 months	0.5%	2.9%
In 12 months	0.6%	2.8%

Benchmark rates	Eurozone	US
Current status*	0.00%	2.25–2.50%
In 3 months	0.00%	2.25–2.50%
In 12 months	0.00%	2.50–2.75%

Equities	DAX 30	EURO STOXX 50	S&P 500	Nikkei 225
Current status*	11,275	3,190	2,720	20,850
In 3 months	11,100	3,150	2,650	21,000
In 12 months	11,100	3,150	2,650	21,000

Commodities	Gold	Oil (Brent)	MS RADAR ex Ag.
Current status*	1,310	63	152
In 3 months	1,300	68	155
In 12 months	1,350	70	160

Currencies	Euro/ US dollar	Euro/ pound sterling	Euro/ Japanese yen	Euro/ Swiss franc
Current status*	1.14	0.88	126	1.14
In 3 months	1.16	0.88	125	1.16
In 12 months	1.18	0.90	134	1.20

Real-estate yields**	Germany	Europe (ex Germany)	US	Asia-Pacific
30 December 2018	3.1%	3.8%	4.7%	4.2%
30 December 2019	3.0%	3.7%	4.9%	4.2%

* As at 31 January 2018.

** Data is updated every quarter. The following cities have been aggregated on the basis of regional indices: **Germany**: Berlin, Düsseldorf, Frankfurt, Hamburg, Munich. **Europe:** Amsterdam, Brussels, Helsinki, Lisbon, London, Luxembourg, Madrid, Milan, Paris, Prague, Stockholm, Warsaw. **US:** Atlanta, Boston, Chicago, Dallas, Houston, Los Angeles, New York, Miami, San Francisco, Seattle, Washington. **Asia-Pacific:** Tokyo, Kuala Lumpur, Singapore, Seoul, Sydney.

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READ THE PROSPECTUS BEFORE INVESTING

Unless otherwise stated, all information, descriptions and explanations are dated **8 February 2018**.

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