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CONTINUED ECONOMIC AND EQUITY REFLATION DESPITE LESS DOVISH CENTRAL BANKS

Global Investment Committee's Outlook

Global Growth Should Match the Positive Consensus

In our December forecasts, we were likely too optimistic about global economic prospects in CY17, but their underlying trend remains very firm and equity markets have been even stronger than our aggressive targets. As for the future, despite all the troubles on the world scene, the Global Investment Committee estimates that for the next four quarters, the G-3 and Chinese economies will match the positive consensus outlook and that central banks will only be mildly more hawkish, while equity markets will continue their upward path, although in much more moderate fashion.

The primary impetus for US equities has been that Trump's tax cuts' effect on corporate earnings are being priced in, but this fact is also now boosting confidence macro-economically, among both corporates and consumers. This is true not only in the US but, either directly or indirectly, in much of the developed world. Moreover, this is accompanied by monetary policy that is extremely loose in all major countries, and although we believe such will become a bit more hawkish as per consensus. Obviously, there remain concerns about the quality, quantity and timing of the implementation of Trump's economic plans, but we believed that most of his plans will eventuate in the second half of 2017 or soon thereafter. As for geopolitical issues, we believe, as have markets so far, that such will be handled without crisis due to the strong economic incentives of all major players.

As for the major economies, US GDP, at a 2.1% Half on Half Seasonally Adjusted Annualized Rate (HoH SAAR) in the 2Q-3Q17, should match consensus expectations, with a similar rate in the following two quarters, which, although not booming, is quite firm. Growth should come from increased personal consumption, fixed asset investment, government spending and inventories, while net trade will likely be negative.

Meanwhile, Japan's and the Eurozone's GDP will likely grow at 1.2% and 1.7%, respectively on a HoH SAAR basis in both periods, equaling consensus. These results should re-assure risk markets and corporate profit estimates should continue to show strong growth for CY17. Personal consumption and capex should lead economic growth forward in each region, with trade being slightly positive for Japan, while slightly negative for Europe. BREXIT fears will be crystalized in the coming quarters, although the real effect should be delayed to well into 2018. Japan will also continue to benefit from the large fiscal stimulus enacted last year. Lastly, China's official GDP should be 6.5% HoH SAAR in both periods, which is similar to consensus forecasts. Here too, personal consumption will likely lead the way, while fiscal stimulus will continue to provide some (but fading) support, including to private capex.

Central Banks: Mild Moves towards Normalization

In December, we were quite a bit more hawkish than the market on G-3 central banks, and as we thought, the Fed hiked in March and it looks likely to continue hiking twice more (vs. consensus of only one or two 2017 hikes at the time), but the ECB and BOJ will not likely be as hawkish as we thought given global growth is not reflating as fast as we estimated then. The ECB did eliminate a program (TLTRO), as we expected, and both it and the BOJ are more confident about their economies, but the odds of any major change in the 2QCY17 is unlikely.

In the 2H, though, we see the ECB tapering/redefining the CSPP (corporate bond purchasing) and raising the interest rate floor for QE purchases and hinting in the 3Q of QE tapering or an interest rate hike in early 2018. The BOJ will likely taper ETF purchases in the 2H as the equity market no longer needs its support. We forecast a Fed hike in the 3Q and 4Q with a MBS reduction plan announced in the 4Q (which is increasingly becoming consensus). As for inflation, we expect the US Core CPI to be at 2.4% YoY in September, and as we expect the Brent oil price to be $56 then, we expect the headline CPI to be 2.5% YoY which is a bit lower than current levels due to a higher oil price base-effect.

Rising USD and G-3 Bond Yields Except JGBs

Given our scenario, we expect G-3 bond yields to continue rising moderately and gradually throughout 2017. For US 10Y Treasuries, our target for September- end is 2.7%, while those for 10Y JGBs and German Bunds are 0.1% and 0.6%, respectively. These are not major changes from current levels, and we expect only moderate further increases by March 2018, as well, at 3.0%, 0.1% and 0.9%, respectively. For Australia, we expect 3.0% in September and 3.3% six months after that. This implies (coupled with our forex targets) that including coupon income, the Citigroup WGBI (index of global bonds) should produce a -1.9% unannualized return from a base date of March 28th through September in USD terms, and -4.0% return for the four quarters ahead. Thus, we continue to **maintain an underweight stance (although less than before) on global bonds for USD-based investors.** The WGBI index should rise 1.0% through September in Yen terms. As for JGBs, we target the 10Y to have a -0.2% total unannualized return in Yen terms through then, so within bonds, we clearly prefer overseas bonds for Yen-based investors.

Our scenario in December implied a stronger USD, but the opposite has occurred so far, likely due to lower confidence in US reflation as well as the market's dovish perception of the Fed's March meeting (which we believe is an exaggerated response).

Because Fed policy will tighten faster than BOJ policy, we expect the Yen to weaken to 116:USD at end-September. As for the EUR, the somewhat hawkish announcements that we expect from the ECB will clearly cause volatility in the market, but we expect it to end at 1.05 vs. the USD at end-September. We expect 120 and 1.04 for each, respectively, four quarters from now. We expect the AUD to be 0.75 and 0.73, for each period respectively, vs. the USD, thanks to rising commodity prices and higher local interest rates.

As for commodities, they have been quite volatile and driven by non-market events, especially the compliance and durability of the OPEC-Russia agreement, but the result has not been as good as we anticipated, although we did not expect a significant increase, due to stronger US oil production and lower global economic reflation. How fast commodity supply will rise in the next six months is an important question, but very difficult to answer, particularly for oil due to political factors. However, due to continued global economic growth, we expect some moderate price increases, with our Brent forecast at $56 in September and $60 in March 2018 as we expect OPEC-Russia production pact to hold together reasonably well and be extended into the 2H17, greatly due to the Saudi desire for high profits for its ARAMCO oil production company and its fiscal coffers, which remain under great strain.

Overweight Global Equities

Despite the somewhat disappointing macro results since our December meeting, all of our equity targets (except for TOPIX due to the stronger Yen) for March were exceeded by the time of our mid-March meeting. Despite all the political wrangling, we think a good portion of Trump's agenda will be enacted in the 2H17 or soon thereafter, including moderately-sized corporate tax cuts and infrastructure spending. It will be important for markets whether this is financed with short term deficits or be offset by income. Our base case is that a Border Adjustment Tax will not occur, but the "repatriation tax holiday" will generate more than expected income with the balance being deficit-financed. Expectation of Trump's success is greatly built into US equity prices, so they will likely have high volatility during all the wrangling and as the results disappoint some investors, but in the end, the animal spirits that have been released should keep the profit outlook strong. Other major global equity markets (see below) should also perform reasonably well, so aggregating our national forecasts from our base date of March 17th, we forecast that the MSCI World Total Return Index will increase 5.4% (unannualized) through September in USD terms (8.5% in Yen terms) and 9.3% by March 2018 (16.4% in Yen terms). **Clearly, this suggests a continued overweight stance on global equities for USD-based investors (and Yen-based investors, as well).**

Aren't US equities too expensive? The answer is definitely "Yes" if Trump's agenda is not passed, but we think significant portions will be enacted and that the global economic reflation cycle will be hard to stop. Interest rates will rise, pressuring valuations a bit, but, crucially, we do not expect them to rise too rapidly and Fed policy will remain quite accommodative. US deregulation and accelerated share buybacks are further icing on the cake, and although there are moderate profit headwinds from a mildly stronger USD, CY17 and CY18 earnings should be quite strong. Currently, because the tax cuts are not legislated, analysts are not adjusting their EPS forecasts, but this **is likely a major anomaly that makes the market much less expensive than it appears.** Indeed, we estimate that the market is trading on about 16.5 times CY18 EPS (and even less if buybacks due to the repatriation "holiday" are greater than expected). In sum, these factors should send the SPX to 2502 (6.3% total unannualized return from our base date) at end-September and 2581 in March 2018 (10.6% total return), **which is higher than its peers and, thus, justifies an overweight stance.**

European equity prices should perform quite well in local terms, with Euro Stoxx rising to 390 and the FTSE to 7620 at end-September (410 and 7700 at year-end). This translates to 3.6% and 7.5% unannualized European returns in USD terms for those periods. Fears of a banking crisis have greatly diminished (although the threat remains) and global growth should cause consensus profit estimates to rise. BREXIT rhetoric will likely become harsher, and, thus, we expect UK equities to underperform the rest of the region, but the market will likely ignore the threats of a major disruption of European trade. Valuations in Europe are a bit high, but because of the improving intermediate-term profit outlook, we think they can be sustained despite a less dovish ECB stance. We still don't see any European election leading to significant problems. Thus, equity prices can come close to rising along with earnings. In sum, **we are positive, but will continue an underweight stance on the region.**

Japanese equities have performed modestly in local currency terms, but very well in USD terms. We expect TOPIX at end-September to rise to 1659, with 1728 in March 2018 for a total return of 3.9% and 5.5% in USD terms respectively (7.0% and 12.3% in Yen terms). These are, of course, significant gains, allowing the BOJ to reduce its ETF purchases in the 2H, as such were always meant only as a backstop for risk sentiment, and it can accrue the unused purchases for later date, if needed. This view is a departure from market consensus, but it seems logical, will not affect bond yields (nor equity prices for very long), and likely will prove popular internationally (and likely to many domestic traditionalists, as well), in our view, due to the program's heavily unorthodox nature.

As for the fundamental drivers, we expect continued corporate governance improvement (including profit orientation and improved returns to shareholders) to be a prime positive factor, but macro factors are likely to play a much stronger positive factor too. Japan's economy will likely grow well above its trend, driven by improved consumer and corporate sentiment, as well as likely improvements in net trade, as the global economy, especially in China, continues to grow. Such, combined with a weaker Yen, should be a strong positive driver for corporate profits, while valuations are very reasonable, so the outlook is fairly bright, in our view; however, given that the US's USD-termed equity returns are higher, **we shift to slightly underweight stance from neutral.**

As for the Developed Pacific-ex Japan region, we expect Hong Kong and Australian equities to perform well, and as currencies will be stable, in our view, this leads to a strong 5.1% USD unannualized return in USD terms through September and 8.1% at year-end, even after the out-sized recent returns so far this year. This is greatly due to China's continued economic rise and capital outflows to HK (where we do not expect too much disturbance from the upcoming Chief Executive election), and especially for Australia, China's continuing demand for commodities. Thus, we **will maintain large overweight stance on the region.**

Investment Strategy Concluding View

There is no doubt, however, that the Trump agenda carries many uncertainties and that geopolitical tail risks remain quite large, but even after the very positive 1Q experience, the Global Investment Committee remains upbeat because the net impulses for global economic growth and corporate profits have clearly improved. Similar to our last meeting, this justifies **an overweight stance on global equities, particularly for the US and Pacific ex Japan.** Meanwhile, global bond yields should rise somewhat further, so we **maintain an underweight stance on global bonds, with an overweight stance USD cash** for USD-based clients. For Yen-based clients, however, cash looks less attractive than global bonds, and slightly more so vs. 10-year JGBs.

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