INVESTMENT STRATEGY

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Global manufacturing bottoming
Mostly soft signals + German orders; U-shaped process likely (late phase)
China activity: modest bounce in store

- Real activity still soft (IP, Capex, Corp profits, Consumption)
- Manufacturing & exports surveys picking
- Stimulus & possible tariffs roll back => GDP ▲ 0.2 ppt
  - Calibrated monetary stimulus (except property sector)
- Tax cuts
- Infrastructure boost
- A Sept tariff roll back would boost GDP by 0.1 ppt

![Share of global manufacturing value-added (2017, World bank)](image)

- China 27.0%
- US 16.5%
- Germany 5.9%
- Macrobond, Lyxor AM
Global monetary accommodation ...

Overnight Rates Forward Curves net of current OIS (%)

EONIA (EUR)
TONAR (JPY)
SONIA (GBP)
Fed Funds (USD)

Policy rates
- Russia 1W
- Brazil SELIC
- India Repo
- Indonesia BI 7d
- US Fed Funds
- South Korea Base Rate
- Australia
- Turkey O/N

Nb of months

Macrobond, Lyxor AM
... and the related negative yielding debt

- 20% to 30% of bonds outstanding (market value)
- <0 sovereign curve: GE, NL, FR & JP up to 10Y

<table>
<thead>
<tr>
<th>Total Debt Securities amount outstanding at face value (BIS)</th>
<th>USD</th>
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<tr>
<td>Global</td>
<td>84.6 trillion</td>
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<td>United States</td>
<td>42 trillion</td>
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<td>Euro Area</td>
<td>19.5 trillion</td>
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<td>EM (incl. China)</td>
<td>18.1 trillion</td>
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<td>Japan</td>
<td>12.4 trillion</td>
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<tr>
<td>United Kingdom</td>
<td>5.88 trillion</td>
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<td>Canada,</td>
<td>3.24 trillion</td>
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<td>Australia</td>
<td>1.93 trillion</td>
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<td>Sweden</td>
<td>677 billion</td>
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<td>Hong Kong</td>
<td>502 billion</td>
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Yield Curve as of 27/11/2019

Macrobond, Lyxor AM
…would keep US & Global growth afloat
… and Financial Conditions supportive

Lyxor Stress Indicator

Based on Equity vol, FX vol, spreads (HY, EM, Libor-OIS)

- 15 Sept 2008 Lehman fallout
- July 2007 Bear Stearns HF collapse
- 3 August 2011 S&P lowers US rating
- Sept 2011-March 2012 Greek crisis
- € Debt Crisis
- 26 July 2012 Draghi "Whatever it takes"
- 11 Aug 2015 CNY devaluation
- 2H 2014 Oil rout
- 24/09/2018 US implements 10% tariffs on $200bn Chinese goods
- February 2016 Recession scare
- Dec-2018 Start of US-China Trade Truce & Talks

Macrobond, Lyxor AM
Pivotal factor: US-China trade truce or light deal, at best

- So far
  - USMCA stalled in Congress
  - US tariffs $550bn Chinese goods
  - China tariffs $185bn US goods
  - US tariffs on $7.5bn EU goods
  - Waiting for Trump’s decision on auto imports restrictions

- $40 to $50bn agricultural purchases, a required condition for tariffs roll-back, but far above typical demand

- Protectionism’s boomerang effect on Trump’s reelection prospects driving a less aggressive stance

Macrobond, Lyxor AM
EMU vs US
A reprieve in 2020
EMU’s underperformance …

EuroStoxx relative performance to S&P 500
(100 = 1 Jan 1988)

Macrobond, Lyxor AM
… deeply rooted in fundamentals but not only. 2020 could offer some respite
US
US Moderation likely to last
2020 GDP [+1.5%-2%] vs. +1.8% BBG and +2% Fed

ISM Composite (pushed forward 2M), rhs
US real GDP growth, lhs

Macrobond, Lyxor AM
US wage inflation: little upside

- Labor market dynamics peaking (workweek, overtime, breadth …)
- Small firms signal difficulty to hire & rising labor costs
- Wage inflation to stay in a [3%, 3.5%] range
US CPI inflation likely to firm up in N3M (tactical buy)
Core inflation skewed towards the downside

US core CPI Inflation
2.3% in Oct-19

Model (ULC, nGDP, DXY)
2.0% in Dec-20

10Y Breakeven Inflation
1.5% in Oct-19

WTI @ $70
2.4% in Oct-20

WTI @ $60
2.1% in Oct-20

WTI @ $50
1.7% in Oct-20

Macrobond, Lyxor AM
Fed (un)easy stance
DOTS: no change in 2020; Implied: 1 cut; View: status quo with easing bias
US Treasuries: O/W Short duration $2Y@1.5\% \iff E(r)\approx +1.6\%$

Tepid recovery in term premium; $10Y@2\% \iff E(r)\approx -0.5\%$
S&P 500 Sales growth slowdown

- Update of our forecasts with nominal growth @3.5%, DXY @97 and WTI @55
- S&P 500 sales per share growth decelerating to low single digit in 2019 & 2020 at around 3%
- In line with BBG bottom-up consensus

**Macrobond, Lyxor AM**
S&P 500 margin erosion to continue in 2020
-0.5 ppt combined with 3% sales growth => Stalling EPS

Macrobond, Lyxor AM
US Equity: Neutral with a defensive bias

- **EPS 2019:** consensus ▼to 1%
- **EPS 2020** likely flat vs. consensus > +9%
- **PE expansion** quite advanced
- **Valuation vulnerable to potential policy risk premium**
- **Equity concentration risk** (top 9 stocks = 25% mkt cap)
- **Target SPX yearend:** 3130

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**MSCI US Total Return Breakdown Estimate (3M rolling %)**

- Oper Margin
- Sales Growth
- Div Yield
- PE expansion
- Buyback & Other
- Total Return

- Macrobond, Lyxor AM
EMU growth: towards a mild upswing

- ECB accommodation
- Fiscal stimulus ≈ 0.5% GDP in 2019 and ≈ 0.2% in 2020 (OECD)
- Fading WLTP-related headwinds for the auto sector & positive base effects
- Less intra-zone dispersion: growth to pick-up in Germany & Italy vs Spain’s slowdown
EMU growth: towards a mild cyclical upswing (2)

GDP growth forecasts for 2019 (BBG consensus, %)

Germany (Y/Y %)

Motor Vehicles new orders (ma 4M)
Motor vehicles production (ma 4M)

Macrobond, Lyxor AM
EMU muted inflation prospects
Core inflation @1%+ despite wage acceleration
Reviving inflation expectations (+15 bps)
ECB seemed powerless, a mild cyclical upswing might not be
U/W German Bunds
Target 10YY: -0.05% ⇔ \( E(r) ≈ -3.5\% \)
EMU Corporate margins stable with upside risk (operating leverage) 2020 EPS growth zero to mid single-digit (vs consensus ≈ 10%)
A reprieve in 2020
Relative Valuation: catch-up amid growth uptick

EuroSTOXX vs S&P 500
12MF PE ratio spread

Macrobond, Lyxor AM
Flows as an amplifier

ETF flows to European Equity (YTD sum as of 25-Nov)

EU investors (€B)
US investors ($B)
[18 largest funds]

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Brexit: closing in, finally

- Oct 17, BoJo struck a deal
- Snap elections Dec 12
  Tories to get a majority (320 seats according to polls)
- Hard Brexit risks contained
- New Brexit deadline Jan 31
- End 2020: end of transition

Macrobond, Lyxor AM
US Elections: not a done deal

- Democrats leading polls so far
- Bloomberg’s candidacy likely to benefit Warren
- Feb 3: Iowa caucuses
  June: last Democrat primaries
  Sept 29 to Oct 22: 3 presidential debates
- Impeachment favors further legislative inertia
- Not much levers left for Trump

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**US Polls Democrat Nomination (RealClearPolitics)**

- Biden 29.8%
- Warren 18.5%
- Sanders 19.3%
- Buttigieg 7.8%
- Harris 4.0%
- O’Rourke 1.5%
- Yang 2.8%
- Booker 1.3%
- Klobuchar 1.5%
- Castro 1.0%
- Gabbard 2.0%

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US Elections: the Warren risk
Most reforms would need a fully Democrat Congress to be passed

- Maximize stakeholder not shareholder value: shift the distribution of value added towards workers & consumers
- Corporate tax revenues X 2
- More tax & regulation (Antitrust, Environment…)
- Targeted: Tech/Fin/Energy
- Patriotism vs Protectionism
- Tax on net worth: 2% above $50M & 3% above $1bn
- ▼business confidence
- ▼corporate profits ▼equity
EMU’s underperformance likely to level off / reverse in 2020 as economic policy uncertainty crosses the Atlantic.
EMU Equity Beta to US Equity is diminishing

EMU Equity Beta to US Equity (SXXE vs SPX, weekly returns, 26W)

Macrobond, Lyxor AM
Japan
Japan no-growth backdrop to ease in H2
Consensus BBG +0.9% in 2019, +0.3% in 2020

- Activity & labor market peaked
- Consumption negative payback likely in Q4 post-Oct. tax hike
- Capex impaired by trade war impact on business sentiment
- Fiscal package in H2 (0.3%GDP, public spending, infrastructure)
- Upside risk from trade deal: export, Mfg & Tech bounce

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JP subdued inflation

- Growth at potential
- Wage downward reversal
- Inflation likely to remain well below BoJ target
- BoJ continued trimming its inflation forecasts
  - 0.7% in FY19 [0.5% x tax hike]
  - 1.1% in FY20 [1.0% x tax hike]

Japan Core Inflation excl. Tax effects, lhs

Japan Output Gap (IMF) pushed forward 12M, rhs

- Macrobond, Lyxor AM
BoJ status quo likely to last

- Natural QEE tapering amid scarcer pool of JGBs (JGB purchases running at 1/2 target)
- BoJ >43% JGB market
- Change in policy unlikely
  - Japan growth slowing but not below potential
- JPY ▲ ↔ tighter financial conditions

Outlook for LT Rates - Newly Issued 10YY (%, BoJ Bond Market Survey)
USDJPY risks skewed to the downside
Growth bounce, rate differential & yen carry trade
Japan Equity: from tactical buy to O/W
Sensitivity to trade; Operating leverage; Fair valuation

JP Topix (source Bloomberg)

Oper Margin, rhs

Gross Margin, lhs

US-China Trade war

TPX Fwd PE FY+1

Topix 100 Index (% qoq)

Model (SPX, USDJPY)

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EM & Commodities
Remain O/W EM Debt (HC)
But more limited upside than in 2019

- Fundamentals supportive
- EM inflation curbed @3%
- Low default & CDS spread
- Dovish Fed, ECB, BoJ
- EMI CBs leaning on easing side
- Chase for yield to foster inflows (alternative carry to DM)
- Better technicals following decelerating EM debt flows
- Large issuance
- Risks: Trade deal & DM bond sell off

EM Sovereign Bonds Total Return

Local currency denominated (Unhedged USD, GBI-EM Global Div.)
USD denominated (EMBI Global Div.)

Macrobond, Lyxor AM
EM FX upgraded to O/W

- EM FX trailed the EM asset recovery due to
  - USD strength
  - ARG, TUR, STH AFR
- EM carry: appealing alternative to DM bonds
- USD trends neutral with a shift of risk towards the US
- Conditions in place for another leg of rally in EM FX from trade and EM growth improvements
Overall EM Equity at Neutral

- View aligned with DM
- Sensitivity to trade
- Monetary & fiscal policies in neutral/easing mode (China, India, Russia, Brazil, Indonesia, Korea …)
- Cyclical upside less priced in in EM than in DM
- Current idiosyncratic risks to remain local (x HK unrest)
EM Equity: Expect more dispersion

A growth bounce not powerful enough to lift all boats. Discrimination function of:

- Sensitivity to Trade & Tech wars (Tech: TWN, KOR, Indus: THAI, VN, Agric: BZ, Re-export: MX). Supply chain relocations would not be reversed without a ever elusive full trade agreement
- Sensitivity to global liquidity (ARG, STHAF, TUR, INDO)
## EM Equity – Country positioning (1/2)

### China: Upgrade to Neutral
- Chinese stabilization delayed by Sept tariffs but calibrated stimulus and a possible roll back in tariff to result in a modest bounce
- Room for sales, margin and multiple growth, but trade tension will eventually resume (H2?)
- Buy call locked in strategic Neutral

### Taiwan: Remain Neutral
- Eco pulse gradually turning with benefits from supply chain substitution (tech export to US)
- Fiscal push being stepped up
- LT diplomatic risk premium as US & China raise stakes
- Valuation and rich trade war respite pricing keep us neutral (vs OW)

### South Korea: Upgrade to Neutral
- Early sign of recovery, with pulse highly dependent on China and tech demand stabilization (semi bottom)
- LT benefit from tech supply chain revamping and more needed fiscal and monetary push
- But adverse trade backdrop w/ Japan sanctions and abating trade and tech war pressure richly priced

### India: Remain Neutral
- Marked economic slowdown to lead to fiscal package and rate cuts (with more elusive reforms potential) keeps us neutral
- Trade agreement with the US and a cyclical Asian rebound would eventually contribute to a bottom
- Isolation from the trade war, neutral valuation and tactical backdrop
**EM Equity – Country positioning (2/2)**

**Mexico: Upgrade to Neutral (pos watch)**
- Weak eco pulse but early sign of bottom
- Reasonable policies result in limited fiscal slippage and inflation, with upside from greater crude output
- Upside risk from possible USMCA ratification and abating US pressure
- Early stage of rally and cheap valuation

**Brazil: Remain O/W**
- Accelerating eco pulse, driven by capex and consumption and green light from reforms
- Less sensitivity to the trade war offers diversification
- Fiscal not monetary expansion
- Fair valuation but tactical pulse not overly stretched yet

**Russia: remain O/W (but monitoring a rally becoming stretched)**
- Firming fiscal & monetary expansion to boost domestic demand
- Fundamental resilience (low public debt, positive C/A, strong FX reserves) and firming trade ties with non-Western partners
- Less pressure from sanctions as US and other Western countries shifted their focus away from Russia. Isolation from the trade war offers diversification
- High carry, but risk from rich valuation and a stretched rally + oil prices volatility
Neutral+ Gold for its safe haven feature
Brent oil target $60-65

- Modest demand upside (+1Mbd?) hinges on trade deal
- Rising non-OPEC output balanced by OPEC+
- No sign of détente with Iran (which would collapse prices). Higher odds of other shocks
- Status quo regarding Libya and Venezuela risk
- Technical, Sentiment, Position look appealing
- $ becoming neutral for $ assets
- Saudi Aramco’s IPO turning regional (viewed as too expensive by US/EU investors)
Agenda

- Nov ? Trump’s decision on restrictions on US imports of autos (EU / Japan)
- Dec 1st: Charles Michel, president of EU Council (following Donald Tusk)
- Dec 1st: Ursula Von der Leyen, president of EU Commission (following JC Juncker)
- Dec 5: OPEC meeting
- Dec 11: FOMC meeting (with forecasts)
- Dec 12: ECB monetary policy meeting (with projections)
- Dec 12: UK elections to the House of Commons
- Jan 23: ECB monetary policy meeting
- Jan 29: FOMC meeting
- Jan 30: BoE MPC meeting (with report)
- Jan 31st: BoE Carney mandate ends but …
- Jan 31st: New (and last?) Brexit deadline
- Feb 3rd: Iowa Caucuses
- Mar 12: ECB monetary policy meeting (with projections)
- Mar 18: FOMC meeting (with forecasts)
- Mar 26: BoE MPC meeting (with report)
- Nov 3: US presidential Elections
## MARKET VIEWS

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<th>Equities</th>
<th>UW</th>
<th>N</th>
<th>OW</th>
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<tbody>
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<td>U.S. Utilities</td>
<td>U.S. Equities</td>
<td>U.S. Staples / Discretionary</td>
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<td>EMU Staples</td>
<td>U.S. Growth vs Value</td>
<td>EMU Discretionary</td>
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<td>EMU Equities</td>
<td>EMU Industrials</td>
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<td>EMU Large vs Small</td>
<td>Japan Equities</td>
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<td>UK Equities</td>
<td>Brazil Equities</td>
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<td>EM Equities</td>
<td>Russia Equities</td>
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<td>Taiwan Equities</td>
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<td>India Equities</td>
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<td>Mexico Equities</td>
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<th>Fixed Income</th>
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<tr>
<td>10Y Bund</td>
<td>10Y UST</td>
<td>2Y UST</td>
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<td>Spanish SPGB vs Bund</td>
<td>10Y Gilt</td>
<td>U.S. Breakeven (tactical)</td>
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<td>EU Credit IG</td>
<td>U.S. Credit HY</td>
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<td>Italian BTP vs Bund</td>
<td>EM Debt HC</td>
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<td>Brent</td>
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<td>Special Situations</td>
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<td>Copper</td>
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<th>Hedge Funds</th>
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<tr>
<td>L/S Equity Market Neutral</td>
<td>L/S Equity Directional</td>
<td>Special Situations</td>
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Lyxor AM
EURUSD in a trading range
USD long positions stretched. Reduced EUR shorts
US consumption: solid fundamentals but shaky confidence

US real Personal Consumption
Model (Labor income, Confidence)

US Consumer Confidence (Michigan survey)
Buying Conditions for Large Durables

US Personal Saving Rate NET
2019 Q3 @7.9%

France Household Saving Rate NET
(of FCC from Households & NPISH)
2019 Q2 @8.7%

US Household Saving Rate + FOR

US Personal Saving Rate, lhs

US Financial Obligations Ratios (FOR), rhs
FOR = debt payments + auto lease payments +
rental payments + homeowners’ insurance + property tax
US capex would benefit from diminishing trade tensions, favoring sustained productivity gains
**US Treasuries – O/W Short duration**

Target 10YY: 2% (RR 1.0% BE 1.6% TP -0.6%)

- Tepid recovery in term premium amid diminishing recession risks
- Tariffs ↔ deflationary threat
- Neutral 10Y UST
  Target 3M = 1.85% $E(r) \approx -0.5$
  Target 12M = 2% $E(r) \approx -0.5$
- Overweight 2Y UST
  Target 3M = 1.65% $E(r) \approx +0.3$
  Target 12M = 1.5% $E(r) \approx +1.6$

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Macrobond, Lyxor AM
Neutralizing US Quality that performs best during a soft-patch O/W US Staples / Discretionary on earnings & valuation grounds
**Neutral US Financials:** flatter yield curve, cyclicality, full valuation

**Neutral US Growth/Value:** valuation & sensitivity to a mild recovery

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**Graphs:**

- S&P 500 Banks P/B
- Performance relative to S&P 1000 (100 = 3M ago)

- Macrobond, Lyxor AM
Neutral Healthcare: attractive valuation but policy risk
U/W Utilities: valuation overstretched
O/W US High Yield for the ST
Moderate spread widening in H2 as default rate rises; Energy is key
US High Yield: challenging fundamentals longer term
EMU fiscal stimulus to support the expansion

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<th>Fiscal stimulus (% GDP, OECD)</th>
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<td>(Chge in cyc.adj. primary deficit)</td>
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<tr>
<td>-1.5      -1.0      -0.5     0.0    0.5    1.0    1.5</td>
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<td>Eurozone</td>
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2019 [ ]  2020 [ ]

Macrobond, Lyxor AM
Closing the tactical buy on Italian spread; U/W Spain spread

- Neutral BTP vs Bund
  - Spread already compressed
  - Unstable politics & weak growth
  - Budget execution slippage likely controlled but …
  - S&P kept BBB with <0 outlook
  - Moody’s: Baa3 with = outlook

- U/W SPGB vs Bund
  - Political vacuum & ▲ polarization (left: separatists, right: Vox)
  - Spreads tight & economy to decelerate
  - 2020 budget overoptimistic on growth, slippage likely
Europe Credit: Prefer HY (O/W) to IG (N)
Persistent crave for yield

- HY spreads flattish (c. 420bps) with some room to compress
- HY carry attractive in € (c. 4%)
- Low but rising default risk (Moody’s 3.7% in Sep.)
- ECB IG purchases to support HY
- Low maturity wall for € HY bonds (€ 10bn)
Neutral EMU Banks
Hampered by negative rates (-) ; Some steepening of yield curves (+)
**O/W EMU Cyclicals vs Defensives**

- **Consumer Discretionary (O/W)**
  - 2020 EPS growth expected at double digits despite downward revisions
  - Constructive view on EMU consumer confidence (wage growth)
  - Moderate cyclical features (beta 1)
  - But rich valuation relative to history

- **Consumer staples (U/W)**
  - Rich valuation relative to other sectors
  - Little revision to 12MF EPS estimates

- **Industrials (O/W) vs Materials (N)**
  - Lower beta but similar valuation
  - Materials’ earnings momentum very sensitive to trade

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Eurozone MSCI 12MF PE ratio

- Last 8Y Average
- Low, High, 10th Percentile, 90th Percentile

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*Macrobond, Lyxor AM*
Neutral EMU Large vs. Small
Mild cyclical upswing potential have us less defensive on small caps
Neutral UK Equities
DY >4%; fair valuation; EPS flattish in 2019
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