RESEARCH WEEKLY
END OF THE BEGINNING? OR BEGINNING OF THE END?

**CONTENT**

**Stories of the week**
- Brexit: The UK’s giant leap into the unknown
- Brexit: Outcome for “safe haven” currencies and Switzerland
- Bonds: Inflation expectations to keep long-term bond yields down
- Brexit: Impact on UK and European banks
- Commodities: Limited impact of Brexit
- Brexit: Impact on UK equity universe
- Quality: even more important now
- Emerging markets – upgrade from neutral to overweight

**Ideas of the week**
- Stock of the week: DSM (Buy)
- Technical idea: US equities (Buy)

**Number of the week**
10%  
Around 33,000 Icelanders or 10% of the entire Iceland nation will be in France this evening to cheer their national football team against England.

**Finance Talk**

**NEXT GENERATION**

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**EDITORIAL**

- The British verdict is here, and so is uncertainty around its impacts. Hence investors require higher risk premia now.
- In brief: The British pound will devalue further in the months ahead. Investors hold quality growth stocks against uncertainty. We upgrade emerging market stocks globally.

The end of the European Union? Or even the end of globalisation? Or just the end of the UK after Scotland and Northern Ireland leave? As usual, the market pundits are digging deep into their boxes to make last week’s referendum the biggest thing in recent history. On a more sober note, the market move on Friday was historical indeed – destroying wealth of USD2trn in global stocks alone. That is almost 3% of world gross domestic product wiped out in a day. Just because 1% of global population want a new deal with their neighbours.

So the end of the UK, the European Union or the world as we know it? The answer is we do not know. We are not in the business of predicting reversals of well-established regimes, some lasting more than 50 years, others more than 500 years each. But what we do know is that uncertainty around those questions will not go away anytime soon. And one law in finance is the more uncertainty there is, the more potential return (i.e. risk premia) investors will require.

Hence the key takeaway for investors is that risky financial assets will remain cheap after the change in prospects. So bargains will remain bargains for the foreseeable future. The other high conviction we have is that the British pound will devalue markedly in the next few months as an economy running large trade deficits and in deep need of capital inflows will see a major lack of foreign direct investment, given the uncertainties ahead. Something has to give: the sterling.

In more concrete financial terms, we made a few changes to our forecasts, downgrading the British pound to parity versus the euro and to 1.12 to the US dollar. We see stagflation for the United Kingdom (UK) in 2016/17. So keep the hedges on. More specifically, we made a few changes to our forecasts. We downgraded the bond rating of some UK banks as well. From a global perspective, we think it is time to upgrade emerging markets given fundamentals and their relative insulation to European issues. And we upgrade quality growth stocks as an investment style. In fixed income, we stick to emerging market debt.

Christian Gattiker, CFA, CAIA

**KEY DATES**

28 and 29 June  
Post-Brexit EU summit

The UK will likely not give the formal notification for its exit yet. PM Cameron will explain the UK’s position over dinner, then leave the remaining 27 heads of state and government for unofficial talks on how to deal with the UK’s exit.

29/30 June and 1 July  
Japan: Tankan and other key data

The Tankan survey could show a mild weakening of corporate sentiment for Q2, with a stabilisation ahead in Q3. Investment intentions will likely remain restrained in the current risky environment. Inflation is due to tick down further.

29 June  
US PCE-deflator

The Federal Reserve’s (Fed) most important inflation gauge has likely remained stuck on a rather low level in May, another argument not to expect any US rate hikes in the near future.

30 June  
Swiss KOF Barometer

The Economic Barometer should have remained stable at a relatively high level in June and continue to signal resilient growth ahead.

30 June  
Eurozone June inflation

Headline inflation is set to tick up due to the fading of last year’s fall in energy prices. The core should remain stable at 0.8% y/y.

1 July  
June manufacturing PMIs

The purchasing managers’ indices (PMIs) are expected to signal that manufacturing conditions have remained rather stable worldwide compared to last month.
MARKETS AT A GLANCE

Asset allocation (latest changes)

Bonds (confirmed)  Equities (increased)

Money market (reduced)  Alternatives (confirmed)

Profile 'Balanced', in %

Currencies

<table>
<thead>
<tr>
<th>Currency</th>
<th>Views (3 months)</th>
<th>Bonds</th>
<th>Equities</th>
<th>Commodities</th>
</tr>
</thead>
<tbody>
<tr>
<td>US dollar</td>
<td>neutral</td>
<td>High grade (USD) neutral</td>
<td>United States bearish</td>
<td>Crude oil neutral</td>
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<tr>
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<td>neutral</td>
<td>Low grade (USD) bullish</td>
<td>Eurozone neutral</td>
<td>Cyclical metals bearish</td>
</tr>
<tr>
<td>Swiss franc</td>
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<td>Switzerland neutral</td>
<td>Gold neutral</td>
</tr>
<tr>
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<td>Inflation protected neutral</td>
<td>Japan neutral</td>
<td>Agriculture neutral</td>
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<tr>
<td>Yen</td>
<td>neutral</td>
<td>EM hard currency bullish</td>
<td>Emerging markets Asia bullish</td>
<td></td>
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<td>Renminbi</td>
<td>neutral</td>
<td>EM local currency bullish</td>
<td>EM Latam &amp; EMEA neutral</td>
<td></td>
</tr>
</tbody>
</table>

Forecasts (spot, technical view/arrow* and 3-month forecast)

- Exercises: Bloomberg Finance L.P., Julius Baer (*/-: upward/downward revision in the past two weeks, *in basis points, ** returns depict investment yield)
- 1: Technical Analysis may be inconsistent with and reach different conclusions to fundamental analysis. # = negative, # = neutral, $ = positive.
MATTERS OF DEBATE

Risk positioning*  
Risk-off (cautious)  
Risk-on (constructive)  
Market sentiment pressure points

Economic outlook

Brazil  
China  
Switzerland  
United Kingdom  
Germany  
Eurozone  
United States  
World

Source: Julius Baer

- Industrial activity continues to bottom out in most developed markets, ending a period of recessionary activity.
- Some weak economic activity, however, prevails among emerging markets and commodity producers.
- Growth in the US was disappointingly weak in the first quarter of 2016, with dollar strength acting as a major headwind. Data provides little motivation for a near Federal Reserve rate hike.
- In contrast, eurozone economies surprised with strong growth in the first quarter of 2016, reducing the necessity for additional European Central Bank monetary policy easing.
- China’s intensified fiscal measures are showing some first ‘green shoots’. The ‘soft landing’ scenario remains warranted.
- After a difficult 2015, Switzerland is shrugging off continued franc strength – a recession remains off the table.
- After the ‘yes’ to the Brexit-referendum, headwinds from uncertainty will likely choke off growth in the second half of 2016.
- A normalisation of headline inflation rates is expected in the course of 2016, given no further collapse in oil prices.
- However, overcapacities and weak commodity prices keep inflation pressure muted on a global scale.
- Accommodative monetary policies continue to prevail and rate-hike expectations will remain scaled back in the time being.

David A. Meier

Forecasts (year-on-year, %)  

<table>
<thead>
<tr>
<th></th>
<th>Real growth</th>
<th>Inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>3.1</td>
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<tr>
<td>United States</td>
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<tr>
<td>Eurozone</td>
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</tr>
<tr>
<td>Germany</td>
<td>1.7</td>
<td>1.8</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2.3</td>
<td>1.4</td>
</tr>
<tr>
<td>Switzerland</td>
<td>0.9</td>
<td>1.1</td>
</tr>
<tr>
<td>Japan</td>
<td>0.6</td>
<td>0.7</td>
</tr>
<tr>
<td>China</td>
<td>6.9</td>
<td>6.4</td>
</tr>
<tr>
<td>Brazil</td>
<td>-3.8</td>
<td>-3.5</td>
</tr>
</tbody>
</table>

* The risk positioning illustrates our general stance towards risk assets such as equities and corporate bonds within an investment portfolio based on our assessment of the economic outlook and market sentiment.

Brexit: Risks after the accepted referendum

Following the surprising 51.9% yes vote to the UK’s June 23 referendum on independence from the European Union, more is uncertain than certain now. Beyond the first wave of market reaction, the vote has set the stage for a prolonged period of political risks, which could last for months or years to come. In the UK, Prime Minister Cameron’s retirement, succession and breaking test in the Tories’ majority government have to be dealt with, while a pro-EU fraction in the government threatens to block the separation process. For the European Union, upwind to independence movements in various member countries is feared. All this before long-lasting separation negotiations can take place. This uncertainty could cause market volatility to remain elevated and sensitive to Brexit-related news-flow for some time to come.

David A. Meier

Central bank exit strategies

The US central bank (Fed) has softened its determination for rate hikes following a weak labour market report and risks surrounding the UK’s EU referendum. However, the Fed will try to guide market expectations towards additional rate hikes this year once the risk backdrop improves as the US growth backdrop is improving. Other major central banks, however, have little choice than to keep an accommodative stance for longer. Even the Bank of England – long treated as an early mover – has no reason to end its near-zero interest rate policy. The European Central Bank and the Bank of Japan are doing the best they can to even add stimuli. Negative interest rates in the eurozone, Japan and Switzerland suggest that any exit from loose monetary policy is moving farther away.

David Kohl

Chinese growth and reforms

Reforms and a more moderate increase of debt have led to a slowdown in economic growth, most visible in the weakness in the property and manufacturing sectors. While China reached its growth target of almost 7% in 2015, the envisioned 6.5% yearly growth over the next five years looks very ambitious and increase the risk for a debt crisis. Reaching 6.5%-7% growth this year will require constant fiscal and monetary support as headwinds remain strong. Structural reform momentum will remain similar in H2 2016, with gradual progress particularly in the areas of financial liberalisation and the internationalisation of the renminbi, financial regulation and consolidation of state-owned enterprises.

Susan Joho

Middle East and diminishing petrodollar flows

While 2015 was the year of consumers enjoying lower commodity prices, 2016 might become the year when producer pain reaches a critical boiling point in certain segments. Especially the Middle East seems ill-prepared to adjust for a new normal of low oil prices for longer. The governments’ responses to the running dry of petrodollars are so far only homeopathic economic reforms insufficient to rein in on the ballooning budget deficits. Financial markets should not only eye the despair of the American shale industry but the Middle East’s growing struggles to maintain social welfare for a growing young population.

Norbert Rücker
STORIES OF THE WEEK

Brexit: The UK’s giant leap into the unknown

- Political risks, which are set to last for months if not years to come, will keep volatility elevated.
- The pound will continue to weaken, while growth will receive a blow from the second half of 2016 onwards.

The aftermath of the United Kingdom’s surprising 51.9% ‘yes’ vote to the referendum on independence from the European Union has only just begun. While the initial shockwave of the outcome has rampaged across markets on Friday and continues to roll somewhat more mildly today, we must admit that the financial industry was clearly focusing too strongly on bookmakers’ odds and got caught wrong-footed. Beyond the turmoil, we dare to take a look at what stands ahead for the United Kingdom, with a grain of salt given the high level of uncertainties which currently exist.

As the market shock will eventually ebb away, the UK will have to overcome a prolonged period of political uncertainty and risks, which could last months if not years to come. Prime Minister Cameron’s retirement and succession, indicated to take place over the next three months, and a breaking test in the Tories’ majority government have to be overcome. While the vote has clearly divided the public, the pro-EU fraction in the parliament threatens to block the separation process going forward. Furthermore, break-up risks of the UK as such are rising with Scotland and Northern Ireland’s large dissent with the outcome eventually resulting in their own independence pledges. These political risks, which will still lie ahead of the following tough and complex negotiations with the EU, will keep volatility elevated and markets sensitive to Brexit-related news flow for some time to come.

For the pound sterling, we believe that weakness will extend gradually beyond the first shock reaction, as the fundamental data will continuously turn pound-negative. In this context, an expected breakdown of foreign direct investments will expose the UK’s large current account deficit to the attention of FX markets. Furthermore, Bank of England rate hikes next year have been mined not to give in, such a policy stance in the case of the Swiss National Bank (SNB) could backfire and make the SNB’s task even more difficult.

Brexit: Outcome for “safe haven” currencies and Switzerland

- Of the three “safe haven” currencies US dollar (USD), Japanese yen (JPY) and Swiss franc (CHF), we prefer the USD.
- Brexit puts not only the Swiss National Bank (SNB) but also Switzerland’s government under a squeeze, with all bilateral trade agreements between Switzerland and the EU at risk.

Last Friday, the surprising Brexit vote triggered, as expected, hefty moves away from the British pound and let “safe haven” currencies like the USD, JPY and CHF surge. Now the dust is settling, what does this mean for our outlook of these currencies? Of these three “safe haven” currencies, we prefer the USD in the quarters ahead, even though the JPY showed in relative terms the largest strength last Friday, when the Brexit shock occurred. With the British pound, the euro also came under pressure. We believe this will last against the US dollar: Therefore, we reduce our 3-month EUR/USD forecast to 1.10 from 1.15 and 12-month horizon to 1.12 from 1.15. The US dollar is well positioned to profit also against the Japanese yen in the coming months, but not as pronounced as previously forecasted. Therefore, we lower our USD/JPY forecast to 106 from 109 and leave our forecast unchanged at 110 for a 12-month horizon. Weak cyclical momentum and the recent yen surge will likely push the Bank of Japan into further action going forward. The Swiss franc, on the other hand, was kept so far relatively steady to the euro, its most relevant reference currency, through hefty intervention by the SNB. Should this not suffice, we could therefore imagine the SNB to lower its negative target rate of -0.75% further in the direction of -1.25%. With this in mind, we reduce our 3-month EUR/CHF forecast to 1.09 from 1.10 and leave our 12-month forecast unchanged at 1.10. Apart from keeping the SNB under pressure, Brexit is putting Switzerland’s government under a squeeze too. The renegotiation of free mobility of EU citizens in Switzerland is set to find a deaf ear in Brussels and to miss domestic deadlines. Any unilateral implementation of the constitutional mandate to cap this EU mobility will put all bilateral trade agreements between Switzerland and the EU at risk. While the SNB is determined not to give in, such a policy stance in the case of the Swiss government could backfire and make the SNB’s task even more difficult.

Janwillem Acket

Brexit keeps the SNB on a high currency intervention pace

In terms of economic forecasts, uncertainty will freeze investments and hiring, resulting in a wipe-out of economic growth in the second half of 2016. As the first two quarters of 2016 are already home and dry, the drag is fully visible only in the 2017 forecast with 0.7% average growth, down from a previous 1.7%. For inflation, collapsing growth will contain the currencies’ inflationary effect and we expect the consumer price index to rise not faster than 1.7% next year – enough room for the Bank of England to manoeuvre without risking inflation to overshoot.

David A. Meier

Source: Datastream, SNB, Julius Baer
Bonds: Inflation expectations to keep long-term bond yields down

- Market-based inflation expectations continue to trend lower.
- G7 central banks forced to maintain high level of accommodation, inducing more search for yield.

Much has been written about the implications of the “Brexit” vote for the British currency and the challenges facing the Bank of England (BoE). There is one element, however, the other G7 central banks will regard the BoE with envy: inflation expectations are staying stable in the UK. In fact, market-based inflation expectations, i.e. the future inflation rates implied by the forward market or the market for inflation-linked securities, the European Central Bank and the Federal Reserve alike must become utmost concerned. Despite all monetary stimuli, these inflation expectations are still falling to new lows, as our chart below illustrates.

Market-based inflation expectations are spiralling lower in the US and the eurozone, keeping long-bond yields down

The message of the market to central banks in Frankfurt and Washington is rather simple: you must do more. Bringing down the jobless rate to 4.7% has neither caused wages to accelerate, nor has buying large quantities of government bonds and corporate bonds lifted eurozone growth prospects.

It is hard to see how the central banks can revive inflation expectations anytime soon, in particular after the Brexit vote has been rocking investor confidence. What is rather obvious at this juncture is that central banks are mired in a pro-growth stance for a long time to come, keeping policy rates and long-bond yields stuck at record-low levels.

With long-bond yields already at record lows or even negative, there is not much income to be generated with high-quality bonds. Given the determination of central banks to keep rates low for longer, the search for yield will ultimately induce more shifts into higher-yielding segments of the bond market. We thus maintain our call for USD high-yield bonds and emerging market debt in both hard and local currency.

Markus Allenspach

Market based inflation expectations collapse in eurozone and US

Brexit: Impact on UK and European banks

- The Brexit vote has put short-term uncertainties on the economic growth prospects of the UK which will affect UK banks.
- European banks will be mainly hit via a lower net interest margin as a result of probably lower rates for longer.

The Brexit vote has put short-term uncertainties on the economic growth prospects of the UK. Over the near term, we believe weakening currency, rising unemployment and slowing economic growth could result in asset quality deterioration. In addition, higher funding costs, loan growth and weak real-estate sector could weaken UK banks.

The UK public decision to leave the European Union did not catch the UK banks off guard. The macroeconomic effects of this decision for the UK were already tested in the last stress test in the adverse scenario and missing capital was raised in the meantime.

Nevertheless after the vote, we changed our view on Lloyds Banking Group and Barclays from Buy / Opportunistic to Hold Opportunistic. Reason for the downgrade was the big exposure to the UK market which for Lloyds reaches almost 100% of their revenues for FY 2015. Royal Bank of Scotland Group (RBS) was already Hold / Opportunistic rated, while we leave the rating for HSBC unchanged at Buy / Opportunistic due to good diversified earnings base of the bank. HSBC had an exposure of only 26% of earnings for FY 2015.

Brexit will have certain implications for European banks because of their high correlation to the interest rate level. If we assume low rates for longer, European banks will be hit by pressurised net interest rate margins.

For European banks in general, Brexit will have certain implications because of their high correlation to the interest rate level. If we assume low rates for longer, European banks will be hit by pressurised net interest rate margins. Most hit will be the peripheral banks, notably the ones in Italy. Another area to track is the legal uncertainty following the Brexit for banks. On the one hand, 5,000 UK firms are allowed via passporting to provide financial services to EU member states. Consequently this passport will be lost as a consequence of the Brexit. On the other hand, we have a significant amount of banks such as big US or other European investment banks performing their operations out of London. As a result of the Brexit, these banks will rethink their strategy.

Christian Dubs

Corporate rating summary

HSBC (Buy/Oppportunistic)
Barclays (Hold/Oppportunistic)
RBS (Hold/Oppportunistic)
Lloyds Banking Group (Hold/Oppportunistic)

Source: Bloomberg Finance L.P., Julius Baer
US: Fed-calculated 5-year break-even inflation rate 5-year forward, eurozone and UK: 5-year inflation swap rate 5-year forward
Commodities: Limited impact of Brexit

- The impact of a Brexit on commodities should be limited to a strengthening US dollar and deteriorating market sentiment.
- Unless wider economic and financial market consequences materialise from the Brexit, high gold prices are unlikely to last.

The Brexit vote shook financial markets on Friday, but commodities as an asset class did not move much. Commodity indices fell between 2% and 3% on the back of a stronger US dollar. Within the asset class, losses in crude oil and industrial metals were offset by gains in precious metals. That said, the impact of a Brexit on commodity markets should be generally limited. It should primarily be related to a strengthening US dollar and deteriorating market sentiment rather than fundamentals. A case in point is crude oil, which lost around 5% on Friday despite the fact that a Brexit would hardly shift supply and demand balances. As we have been arguing before, the recent rally in crude oil was driven by improving market sentiment rather than improving fundamentals. The market remains well supplied as Middle Eastern exports are growing while US shale is coming back to life. Despite Friday’s correction, we see more downside than upside for oil and reiterate our cautious view.

High gold prices are unlikely to last.

The only market where we do see a fundamental impact is of course gold. Brexit-related uncertainties should remain a supportive element going forward. Gold should continue trading with market sentiment, i.e. benefit from rising risk aversion and suffering from falling risk aversion. In the short term, prices could rise towards USD 1,400 per ounce, which has been our bullish scenario for some time. Unless wider economic and financial market consequences materialise, e.g. renewed fears of a eurozone breakup, we maintain the view that high prices are unlikely to last. History has shown that political events usually do not have a lasting impact on gold but cause short-term deviations from longer-term trends. Due to the prevailing uncertainties, we lifted our gold price targets to USD 1,300 and USD 1,200 per ounce on a three and twelve-month horizon.

Carsten Menke, CFA

Commodity performance (24 June 2016)

<table>
<thead>
<tr>
<th>Commodity</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
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<td>Crude oil</td>
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<tr>
<td>Palladium</td>
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<td>Iron ore</td>
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<tr>
<td>Soybeans</td>
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<td>Copper</td>
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<td>Aluminium</td>
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<td>Corn</td>
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<tr>
<td>Steel</td>
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<td>Natural gas (UK)</td>
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<tr>
<td>Gold</td>
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Brexit: Impact on UK equity universe

- The decision to leave the EU may heavily impact the growth perspective of the UK but the impact on most stocks we cover should be limited.
- We expect the strongest negative impact to be felt by consumer discretionary names and financials, primarily banks but also REITs and homebuilders.
- On the other hand, we see no major negative impact for most UK consumer staples, utilities and pharma equities we cover, some should even benefit from currency tailwinds.

UK equities sold off heavily following the decision of the British voters to leave the European Union. While we believe that the share price declines may be justified for some heavily exposed equities, we also see some buying opportunities, particularly in the consumer staples, healthcare and utilities space in the UK. In light of the expected sterling weakness, we would recommend to hedge the currency weakness.

We would like to stress that the large international FTSE 100 stocks we cover should in general be clearly less impacted than the overall domestic UK economy. The most impacted sectors are in our view cyclical consumer stocks and financials, mainly banks but also real estate investment trusts (REITs) and homebuilders since those stocks tend to be overexposed to the domestic economy and consumer sentiment.

On the other hand, we see no major negative impact for most consumer staples, pharma and healthcare stocks we cover as they tend to be geographically well diversified. Additionally, many consumer staples stocks should benefit from a positive currency translation impact.

We also see the negative impact on UK utilities as limited, given the high percentage of regulated and domestic business the companies are operating in.

For mining and energy companies under our coverage, the direct impact is limited. Their operations are global, their products are priced in USD and the bulk of the costs occur at the level of operations which are spread across the globe.

For detailed stock specific information, please refer to our Brexit bottom up note published last Friday on the Intranet where we give detailed information for all UK stocks we cover.

Patrik Lang, CFA

Source: Bloomberg Finance L.P., Julius Baer
Quality: even more important now

- Brexit showed that against the backdrop of the looming uncertainty in financial markets, quality remains an important aspect.
- We are overweight quality and due to the correlation also overweight growth.

Following last Friday’s UK referendum, the uncertainty in financial markets has risen and investors require higher risk premia. Some sell-side brokers have hence immediately adjusted some of the price targets and ratings, partly due to recession fears (which is not our view). We will examine our various near-term stances and come up with adjustments, if needed. One of the currently important aspects is the preference of quality stocks against the backdrop of a number of uncertainties looming out there. As can be seen in the chart below, quality stocks outperform the overall market in times of rising economic policy uncertainty. As the UK situation suggests, the time has not come yet to reverse this trend. As a consequence, we are overweight quality in the US and now also in Europe.

Backtesting shows that quality is moving largely in line with the growth style. Consequently, preferring one investment style also means being overweight the other one. We are aware that the valuation of growth vs. value is demanding, but would argue that the aspect of quality in the current environment is more important. Decomposing quality shows that it can be mainly found in sectors such as consumer staples, IT or healthcare while financials, telecom and utilities are representing the low-quality segment. From a regional perspective, UK (despite Brexit) and Switzerland are biased towards quality, European peripheral markets and France are not. Please find below a selection of quality companies which belong to the most preferred quality stocks of our equity analysts.

Christoph Riniker, CEFA

Emerging markets – upgrade from neutral to overweight

- We upgrade emerging markets (EM) from neutral to overweight due to various country rating changes. We expect the MSCI EM to outperform the MSCI AC World over the next six months.
- Country rating changes are: Poland, Turkey, Indonesia and Chile upgrade to overweight. Brazil upgrade to neutral and Colombia downgrade to neutral.

With the United Kingdom voting to leave the European Union we have decided to make several changes within emerging markets. First, we upgrade EM from neutral to overweight due to various rating changes on country level. Our top down investment rational is that the US Fed will stay put, more funds will flow from Europe to emerging markets and the earnings recovery will continue while valuations are attractive. We expect the MSCI Emerging Markets index to outperform the MSCI AC World index over the next six months.

A window has opened for the MSCI Emerging Markets to outperform the MSCI AC World index over the next six months.

In the EMEA region (Eastern Europe, Middle East & Africa) we initiate two contrarian trades and upgrade Turkey and Poland from underweight to overweight. The MSCI Poland has overshot on the downside, the financial sector (48% of the index) has de-rated and the market offers a dividend yield of 3.5%. Since our overweight rating the MSCI Poland has dropped -18%. The MSCI Turkey offers an attractive equity risk premium and hence, downside cushion. The market’s financial sector has also de-rated and is currently trading at a price/book ratio of 0.9 times.

In Latin America we upgrade Brazil from underweight to neutral, Chile from neutral to overweight and downgrade Colombia1 from overweight to neutral. Brazil warrants an upgrade because the market has been remarkably resilient despite various incidents such as the bankruptcy of a large telecom operator, the state of Rio and others financial difficulties and the recent Brexit vote. Under normal circumstances the equity market and currency would have sold-off. Since our underweight rating on Brazil the market dropped by -38%. In Colombia we take profits after the market went up +50%. In Chile the equity risk premium (ERP) has reached a new high and, historically, a high ERP has been a good entry point.

In emerging Asia we upgrade Indonesia from neutral to overweight. With the Brexit, the US Fed is likely to stay put for longer benefiting countries with large current account deficits such as Indonesia. In addition, the inflation rate has dropped leaving room for the central bank to cut interest rates. Lower interest rates are equity market positive. Last but not least, we find evidence for positive operating leverage and that 12-month trailing earnings have rebounded.

Research Focus publications with more details on the various rating changes will follow through.

Heinz Rüttimann, CAIA

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1. Julius Baer makes no offering in local markets.
**INVESTMENT IDEAS**

<table>
<thead>
<tr>
<th><strong>short term</strong></th>
<th><strong>medium term</strong></th>
<th><strong>long term</strong></th>
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<tbody>
<tr>
<td><strong>Trading ideas</strong></td>
<td><strong>Key ideas</strong></td>
<td><strong>Thematic ideas</strong></td>
</tr>
<tr>
<td>Stock of the week: DSM (Buy)</td>
<td>Equities: Quality (p. 7) – Associated British Foods (Buy), Compass Group (Buy), Nestlé (Buy), Roche (Buy), SAP (Buy)</td>
<td>Shifting Lifestyles: Genomics 2.0 (Buy)</td>
</tr>
<tr>
<td>Technical idea: US equities (Buy)</td>
<td>Equities: Emerging Asia (Buy), MSCI Emerging Markets index (Buy) (p. 7)</td>
<td>Digital Disruption: Automation &amp; robotics (Buy)</td>
</tr>
<tr>
<td></td>
<td>Equities: Affordable luxury equities (Buy)</td>
<td>Shifting Lifestyles: Digital Health (Buy)</td>
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<td>Bond issues: Lloyds Banking Group &amp; Barclays (downgrade from Buy to Hold/Opportunistic) (p. 5)</td>
<td>Digital Disruption: Cybersecurity (Buy)</td>
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<tr>
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<td>Bond issues: Emirates NBD (Buy), Sberbank (Hold), Unicredit (Hold)</td>
<td>Digital Disruption: 3D Printing (Sell)</td>
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<tr>
<td></td>
<td>Currencies: Hedge GBP exposure</td>
<td>Shifting Lifestyles: Health &amp; Wellness (Buy)</td>
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<tr>
<td></td>
<td>Bonds: Emerging market local currency (Buy)</td>
<td>Digital Disruption: Mobile payments (Buy)</td>
</tr>
<tr>
<td></td>
<td>Bonds: US high yield (Buy)</td>
<td>Digital Disruption: Wearable technology (Buy)</td>
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</tbody>
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**Stock of the week**

**DSM**

DSM (Buy, Price/Target: EUR51.74/60) is a global leader in human and animal nutrition, segments of the chemicals industry that we find structurally attractive, particularly nutritional supplements given its exposure to ageing demographics and increased health awareness. DSM also has a performance materials division, where the company has been able to divest commoditised assets and focus on higher value-add products. In the last several years DSM’s nutrition division, in particular Vitamin E, suffered from fierce Chinese competition. However, prices have troughed and Chinese producers have been partly squeezed out of the market again, hence this headwind has now largely passed and we have upgraded the stock to Buy. The shares trade on 9x 2017E EV/EBITDA. Taking a weighted average of multiples paid for specialty chemicals and consumer chemicals gives us a fair valuation multiple of 10x.

*Philipp Lienhardt, CFA*

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**Technical idea**

**US equities continue to climb the wall of worry**

S&P 500 saw a 3.5% drop on Friday and investors now can ask whether the uptrend in the S&P 500 is over. From a technical point of view, the setback on Friday was a selling climax, where most stocks declined. Nevertheless, the S&P 500 was able to hold its key support levels at 1,980/40. Thus, as the S&P 500 continues to outperform the rest of the world and trades above its 200-day moving average, we expect US equities to resume climbing the wall of worry.

*Mensur Pocinci, MFTA*

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**S&P 500 Index – weekly line chart**

*Technical Analysis may be inconsistent with and reach different conclusions to fundamental analysis.*
Strategic equity calls

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<th>Sector</th>
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Changes as per 27 June 2016
Additions: None
Deletions: None

Equities Idea initiation: April 2016

Affordable luxury equities
The exponentially growing middle class combined with falling fuel prices, globalisation and technological changes will ultimately change consumption behaviour. The rising middle class will have more disposable income and start trading up, hence requiring more and more branded products, and we will witness the rise of the premium consumer. Companies that have an established, appealing image which portrays quality should profit from these trends. Prime examples of such companies would be Starbucks, Estée Lauder, Comcast, Constellation Brands, H&M, Adidas, L’Oreal, Heineken, Pernod Ricard, Reckitt-Benckiser, British American Tobacco, and Lindt & Sprüngli. In our view, going forward this affordable luxury sector will generate above-average growth, which in times of growth scarcity should be a valuable feature for investors.

Bence Boldvai; Patrik Lang, CFA

Corporate rating summary
Adidas (Buy, Price/Target: EUR120.7/127)
British American Tobacco (Buy, Price/Target: GBp4’447.00/4’600)
Constellation Brands (Buy, Price/Target: USD152.53/180)
Comcast (Buy, Price/Target: USD61.65/70)
Estée Lauder (Buy, Price/Target: USD97.75/96)
Heineken (Buy, Price/Target: EUR80.01/91)
H&M (Buy, Price/Target: SEK240/310)
Lindt & Sprüngli (Buy, Price/Target: CHF5’695/6’500)
L’Oreal (Buy, Price/Target: EUR164.80/195)
Pernod Ricard (Buy, Price/Target: EUR95.69/110)
Reckitt-Benckiser (Buy, Price/Target: GBp7’016/7’000)
Starbucks (Buy, Price/Target: USD54.68/65)

Fixed Income

Fixed Income – latest bonds of covered issuers
Last week’s corporate bond market of new issuances showed activity mainly in the financial space within our actively covered universe. UniCredit, an Italy-based bank operating over 7,300 branches in ca. 20 countries and also providing a full range of investment banking and asset management services, raised EUR 520m last week. Emirates NBD, Buy-rated because of its leading market share in the UAE resulting in solid earnings and profitability, accumulated a relatively small tranche of new debts amounting to USD100m. Furthermore, the largest bank in Russia, Sberbank, announced an issue of RUB11.5bn (ca. USD 180m).

Dario Messi

Corporate rating summary
Emirates NBD (Buy/Opportunistic)
Sberbank (Hold/Opportunistic)
UniCredit (Hold/Opportunistic)
**Equity Strategy**

**Idea initiation: June 2016**

**Emerging markets – an investment window has opened**

With the United Kingdom voting to leave the European Union we have made several changes within emerging markets (EM). First, we upgrade EM from neutral to overweight due to various rating changes on country level. Our top down investment rational is that first, the US Fed will stay put for longer benefitting countries with a large current account deficit. Second, more funds will flow from Europe to emerging markets and third, the earnings recovery in emerging markets will continue while valuations are attractive. We expect the MSCI Emerging Markets index and in particular emerging Asia to outperform the MSCI AC World index over the next six months.

Heinz Rüttimann, CAIA

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**Currencies**

**Idea initiation: March 2016**

**GBP: Maintain pound exposure hedged after Brexit**

After the surprising acceptance of the UK’s Brexit referendum, first shock reactions have caused record-high pound losses, rewarding investors which had hedged pound exposure. After the referendum, we expect the pound sterling to continue to suffer gradually beyond the initial reactions. While political uncertainties will keep volatility elevated, fundamentals will clearly turn pound negative ahead. Crumbling foreign direct investments will shift the markets focus on the UK’s twin deficit, in particular the huge current account deficit. We revised our GBP forecast to EUR/GBP 0.92 for the 3-months horizon and would not be surprised to see parity within the 12-months horizon. Obviously, as further pound losses remain our baseline scenario, we recommend keeping pound exposure hedged.

David A. Meier

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**Fixed Income**

**Idea initiation: June 2016**

**Emerging market local-currency bonds**

We hold a positive view on emerging market bonds, both in local and hard currency, in line with our shift of focus towards riskier parts of the asset class and our preference for credit rather than rate risk in the fixed-income space. Fundamentally, we are seeing concrete improvements at the macro and corporate levels, with data this year showing some improvements in current accounts, growth expectations and slightly stronger credit metrics, particularly in terms of corporate leverage. Going forward, we see no reason to change our optimistic view on emerging markets as: 1) we believe there is still potential for positive surprises at the macro level; 2) companies have recently improved their liquidity and should continue to deleverage in upcoming quarters, 3) low interest rate policies in the developed world increase the attractiveness of yields in the emerging world, and 4) these regions have a generally low direct exposure to the UK, leaving them relatively well-sheltered from the political uncertainty in Europe. In that context, emerging market bonds should continue to behave in a stable manner while providing substantially higher yields compared to similar issuers in the developed world.

Alejandro Hardziej

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**Fixed Income**

**Idea initiation: June 2016**

**US high-yield bonds: Rally due to abating risk perception**

The US high-yield market with its strong bias towards commodity-related issuers has rebounded strongly since mid-February, albeit from exceptionally low levels. Fears over the growth slowdown in China and its negative impact on commodity prices have abated and led to strong short covering of traders’ positions. Also, reassuring data in regard to the overall economic environment in the US have helped the segment to perform well over the past weeks and primary issuance to pick up from the lows of the past months. The segment has been quite resilient and the result of the Brexit referendum has led to only limited spread widening, keeping investors well compensated for a potential surge of defaults. Although leverage is high, we believe that it is manageable given our expectations for acceleration of nominal growth and higher revenues in the segment.

Eirini Tsekeridou

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Genomics 2.0: Understanding the source of life
We believe we are at the start of a potential paradigm shift for healthcare innovation in terms of diagnostics, drug discovery, and precision medicine. Genome sequencing technologies are leading this change, which are becoming much more rapid and affordable. In this transition phase, we have identified several structural growth areas where genomics will have a large impact such as oncology, rare diseases, reproductive health and consumer genomics. However, many barriers need to be overcome: the Big Data challenge, regulation, and the reimbursement framework. Early in this race, we favour key genomics technology players and early adopters.
Alberto Perucchini, Fabiano Vallesi

Corporate rating summary
Illumina (Buy, Price/Target: USD 138.91/170)
QIAGEN (Buy, Price/Target: USD 21.01/27)

Digital Disruption: Cybersecurity
Cybersecurity is one of the top global risks today, as our daily life is increasingly more connected and digitised. Unsurprisingly governments and corporations recognise the growing importance of data protection, as data breaches and cyberattacks are surging. We expect cybersecurity to continue to experience above-average growth on the back of factors such as: cloud penetration, increased connectivity (Internet of Things, smart cars etc.), regulation and growing complexity and impact of cyberattacks. We recommend a diversified approach to the theme.
Fabiano Vallesi

Corporate rating summary
Akamai Technologies (Buy, Price/Target: USD 53.55 / 67)
Check Point Software (Hold, Price/Target: USD 78.17 / 82)

Digital Disruption: Automation & robotics
Advances in robotics technology are supporting increased automation outside the automotive industry, with robots becoming increasingly affordable, flexible, smart and interconnected. In addition, rising labour costs and quality requirements in emerging economies are driving a transition to automation systems over raw manpower, with China emerging as the market to watch for industrial robots. To gain exposure to this trend, we favour the large, global incumbent players in the automation space (to the detriment of local upstarts) as well as niche leaders in automation software and robo-surgery.
Alberto Perucchini, Fabiano Vallesi

Corporate rating summary
Intuitive Surgical (Buy, Price/Target: USD 644.82 / 690)
Hitachi (Buy, Price/Target: JPY 419.20 / 610)

Shifting Lifestyles: Digital Health
Throughout the world, a significant and growing portion of GDP is spent on healthcare. Some of many drivers of this relentless growth in spending come from the mounting occurrence of chronic diseases and shift to ageing demographic triggering increased demand for healthcare. Digital health, though still in early stages of development, has the potential to wedge itself into a static system that has been averse to change potentially improving the quality of medical care while reducing costs. We see tangible growth potential in the fields of healthcare IT, remote patient monitoring, telehealth and genomics applications.
Fabiano Vallesi

Corporate rating summary
Cognizant Technology Solutions (Buy, Price/Target: USD 58.01 / 71)
Medtronic (Buy, Price/Target: USD 83.26 / 89)

Digital Disruption: Mobile payments
We believe the increased penetration of payment-enabled mobile devices such as smartphones and wearables along with a technology-savvy generation will be the basis for a mobile payments boom in the coming years. Due to technological developments, the payment industry has become a competitive space where non-financials are increasingly challenging incumbents. We recommend focusing on payment networks as well as leading technology enablers such as near-field communication chip suppliers, point-of-sale terminal manufacturers and selected security and data solution providers which will benefit from the growth.
Fabiano Vallesi

Corporate rating summary
Worldpay Group (Buy, Price/Target: GBp 267.20 / 310)
NXP Semiconductors (Buy, Price/Target: USD 80.07 / 98)
Digital Disruption: Wearable technology

The wearable technology trend is here to stay and we see it as longer-term accretive drivers for silicon consumption, but only when applications support their utility. We note the new hype around virtual and augmented reality but actually see little incremental upside for this segment to support wearables this year – rather from next year onwards. Smart watches and fitness trackers remain the main drivers for the time being. We expect to see a continued rise of connectivity and sensors content in everyday objects, which will benefit leading-edge semiconductors in the long term, as well as device platform operators.

Fabiano Vallesi

Corporate rating summary
Broadcom (Buy, Price/Target: USD 148.72 / 172)
Sony (Buy, Price/Target: JPY 2'782.00/ 3'500)

Digital Disruption: 3D printing (Sell)

3D printing technology has made big steps forward over the last years from facilitating prototype building to enabling direct manufacturing of parts. However, expectations for rapid and sustained growth coming from the increased penetration of 3D printing in manufacturing have not matched reality since 2014. A recent sign of growth stabilisation has led to a rebound in performance. Nevertheless, we do not recommend entering the 3D printing theme, but rather prefer to wait for growth to recover before reconsidering investments. In addition, there are signs of growing risks, especially in terms of the still immature technology and rising competition in the prototyping business. We favour the 3D printing software segment over hardware and materials.

Fabiano Vallesi

Corporate rating summary
3D Systems (Hold, Price/Target: USD 12.95 / 12.9)
HP Inc. (Hold, Price/Target: USD 12.26 / 14.0)
IMPORTANT LEGAL INFORMATION

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IMPRINT

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APPENDIX

Analyst certification
The analysts hereby certify that views about the companies discussed in this report accurately reflect their personal view about the companies and securities. They further certify that no part of their compensation was, is, or will be directly or indirectly linked to the specific recommendations or views in this report.

Please refer to the following link for more information on the research methodology used by Julius Baer analysts: www.juliusbaer.com/research-methodology

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Price information
Unless otherwise stated, the price information reflects the closing price of the previous trading day.

Disclosure
No specific disclosures

Equity research

Frequently used abbreviations

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<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>CAGR</td>
<td>Compound annual growth rate</td>
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<tr>
<td>DCF</td>
<td>Discounted cash flow</td>
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<td>EPS</td>
<td>Earnings per share</td>
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<td>Enterprise value</td>
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<td>P/E</td>
<td>Price-to-earnings ratio</td>
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<td>PEG</td>
<td>P/E divided by year-on-year EPS growth</td>
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EBITDA: Earnings before interest, taxes, depreciation and amortisation
ROE: Return on equity
**Consensus rating** indicates the analysts’ opinions on the security. It shows the number of analysts covering the security and the breakdown between Buy, Hold and Sell ratings.

**Consensus target** is the average price to which analysts expect the security to rise.

### Equity rating allocation as of 27/06/2016

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To view a quarterly history of the proportion of equity ratings published, please refer to the following link: [www.juliusbaer.com/research-rating-history](http://www.juliusbaer.com/research-rating-history)

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### Equity rating history as of 27/06/2016

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<tr>
<td>H&amp;M</td>
<td>Buy</td>
<td>Since 27/09/2013</td>
</tr>
</tbody>
</table>
Heineken  Buy (initiation of coverage)  Since 21/11/2014
Helvetia  Buy (initiation of coverage)  Since 26/09/2007
Hitachi  Buy (initiation of coverage)  Since 17/12/2014
Home Depot  Buy  Since 25/02/2010
Honeywell  Buy  Since 20/10/2014
HP Inc.  Hold  Since 27/11/2013
Illumina  Buy (initiation of coverage)  Since 01/04/2015
Intuitive Surgical  Buy  Since 01/05/2015
Kerry Group  Buy (initiation of coverage)  Since 15/12/2015
Kruger  Buy (initiation of coverage)  Since 07/12/2015
Lindt & Sprüngli  Buy  Since 20/01/2015
L’Oréal  Buy  Since 15/02/2012
Mastercard  Buy (initiation of coverage)  Since 04/05/2011
Medtronic  Buy  Since 08/09/2014
Munich Re  Buy  Since 19/11/2013
Nestlé  Buy  Since 20/08/2015
Nestlé  Hold  Since 18/04/2013
NXP Semiconductors  Buy (initiation of coverage)  Since 15/12/2014
Orange  Buy  Since 29/04/2015
PepsiCo  Buy (initiation of coverage)  Since 09/12/2014
Pernod Ricard  Buy  Since 28/04/2015
Pfizer  Buy  Since 18/09/2008
Ping An Insurance-H  Buy  Since 07/09/2015
PPG Industries  Hold  Since 03/10/2015
QIAGEN  Buy (initiation of coverage)  Since 28/04/2015
Reckitt Benckiser  Buy (initiation of coverage)  Since 09/03/2016
Roche  Buy  Since 15/02/2011
Royal Dutch Shell  Buy (initiation of coverage)  Since 05/02/2013
Sanofi  Buy  Since 05/11/2015
SAP  Buy  Since 06/03/2015
Schneider Electric  Buy  Since 06/01/2006
Schneider Electric  Buy  Since 30/10/2015
Shanghai Fosun Pharmaceuticals-H  Buy (initiation of coverage)  Since 27/03/2014
Sherwin-Williams Company  Buy  Since 17/07/2015
Simon Property  Buy (initiation of coverage)  Since 08/10/2012
Smurfit Kappa  Buy (initiation of coverage)  Since 24/12/2015
Societe Generale  Buy  Since 19/12/2012
Sony Corporation  Buy (initiation of coverage)  Since 17/12/2014
Starbucks  Buy  Since 06/11/2012
SUEZ  Buy (initiation of coverage)  Since 19/12/2014
Tencent Holdings  Buy  Since 27/09/2013
Toray Industries  Buy (initiation of coverage)  Since 22/01/2016
UBS  Buy  Since 05/02/2015
Under Armour  Buy (initiation of coverage)  Since 06/05/2016
Unibail-Rodamco  Buy (initiation of coverage)  Since 28/06/2010
United Technologies  Buy  Since 23/09/2009
Visa  Buy (initiation of coverage)  Since 18/03/2016
Wells Fargo  Buy  Since 27/10/2010
Worldpay Group  Buy (initiation of coverage)  Since 30/05/2016
Zimmer Biomet  Buy  Since 29/01/2016

Rating system for global equity research (stock rating)
Buy  Expected to outperform the regional industry group by at least 5% in the coming 9-12 months, unless otherwise stated.
Hold  Expected to perform in line (±5%) with the regional industry group in the coming 9-12 months, unless otherwise stated.
Reduce  Expected to underperform the regional industry group by at least 5% in the coming 9-12 months, unless otherwise stated.
The risk rating (High/Medium/Low) is a measure of a stock’s expected volatility and risk of losses in case of negative news flow. This non-quantitative rating is based on criteria such as historical volatility, industry, earnings risk, valuation and balance sheet strength.

**MSCI ESG Rating**

MSCI ESG Research provides in-depth research, ratings and analyses to support companies’ and government’s efforts in terms of environmental, social and corporate governance (ESG). **MSCI ESG Research Intangible Value Assessment (IVA) Rating** (MSCI ESG Rating) provides ratings of companies’ investment risk and opportunities which are not generally detected by traditional research methods. There are three steps to the method: 1) identification of key issues for each sector 2) evaluation of risks and how they are handled within the company 3) drawing up ratings to qualify the ESG risks not identified. The MSCI ESG Rating is expressed on a seven-point scale and they range from CCC (worst) to AAA (best).

**Strategy research**

Countries, sectors and investment styles are rated “overweight”, “neutral” or “underweight”. These ratings are based on our expectations for relative performance versus regional and global benchmark indices.

- **Overweight**: Expected to outperform regional or global benchmark indices in the coming 9-12 months, unless otherwise stated.
- **Neutral**: Expected to perform in line with regional or global benchmark indices in the coming 9-12 months, unless otherwise stated.
- **Underweight**: Expected to underperform regional or global benchmark indices in the coming 9-12 months, unless otherwise stated.

Equity investments are divided into three different risk segments. Risk here is defined as the historical five-year volatility based on monthly returns in CHF. Based on the data of all segments considered (developed markets, emerging markets, global sectors, investment styles) the following distinction is made:

- **Conservative**: Investments whose historical volatility is in the bottom quartile of the universe described above.
- **Medium**: Investments whose historical volatility is in the middle two quartiles of the universe described above.
- **Opportunistic**: Investments whose historical volatility is in the top quartile of the universe described above.

**Fixed income research**

**Frequently used abbreviations**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>FCF</td>
<td>Free cash flow</td>
</tr>
<tr>
<td>CFI</td>
<td>Cash flow from investing</td>
</tr>
<tr>
<td>CFO</td>
<td>Cash flow from operation</td>
</tr>
<tr>
<td>FFO</td>
<td>Funds from operation</td>
</tr>
<tr>
<td>EBIT</td>
<td>Earnings before interest and taxes</td>
</tr>
<tr>
<td>EBITDA</td>
<td>Earnings before interest, taxes, depreciation and amortisation</td>
</tr>
<tr>
<td>CFF</td>
<td>Cash flow from financing</td>
</tr>
<tr>
<td>RCF</td>
<td>Retained cash flow</td>
</tr>
<tr>
<td>EM</td>
<td>Emerging Markets</td>
</tr>
</tbody>
</table>

**Proportion of issuer ratings published during the last quarter (ending 31/03/2016)**

- **Buy**: 59.5%
- **Hold**: 39.2%
- **Sell**: 1.3%

To view a quarterly history of the proportion of issuer ratings published, please refer to the following link: [www.juliusbaer.com/research-ratings-history](http://www.juliusbaer.com/research-ratings-history)

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**Issuer rating history as of 27/06/2016**

<table>
<thead>
<tr>
<th>Issuer</th>
<th>Rating</th>
<th>History</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barclays</td>
<td>Buy (initiation of coverage)</td>
<td>Since 07/04/2015</td>
</tr>
<tr>
<td>Emirates NBD</td>
<td>Buy (initiation of coverage)</td>
<td>Since 19/09/2012</td>
</tr>
<tr>
<td>HSBC</td>
<td>Buy (initiation of coverage)</td>
<td>Since 15/07/2009</td>
</tr>
<tr>
<td>Lloyds Banking Group</td>
<td>Buy (initiation of coverage)</td>
<td>Since 21/04/2015</td>
</tr>
<tr>
<td>Royal Bank of Scotland Group</td>
<td>Hold (initiation of coverage)</td>
<td>Since 15/04/2015</td>
</tr>
<tr>
<td>Sberbank</td>
<td>Hold</td>
<td>Since 29/07/2014</td>
</tr>
<tr>
<td>Unicredit</td>
<td>Hold</td>
<td>Since 10/11/2011</td>
</tr>
</tbody>
</table>

**Rating system for fixed income research**

- **Buy**: Within its risk category, the issuer is highly recommended due to its financial and business condition (strong balance sheet, income statement, cash flow and good position in the industry). Debt instruments of the issuer are regarded as an attractive investment from a risk/return perspective.
- **Hold**: Maintain position based on stable credit fundamentals and/or average expected return characteristics within peer group.
- **Sell**: The rating is changed to Sell, depending on a significant deterioration in the fundamental data of the issuer in relation to the industry peers. The investment is no longer justified from a risk/return perspective for the relevant category.

**Fixed income market segment ratings**

- **Attractive**: Segments that are expected to yield a return that is above the ten-year historical average.
- **Neutral**: Segments that are expected to yield a return that is in line with the ten-year historical average.
- **Unattractive**: Segments that are expected to yield a return that is below the ten-year historical average.

**Risk categories for fixed income research**
Conservative
Supranational issuers, top-rated sovereign issuers and bodies that are directly and fully guaranteed by these institutions. These issuers are most likely to preserve their top rating throughout the business cycle.

Quality
Sovereigns and corporate issuers that are very likely to service and repay debt within a five-year credit scenario. They are likely to preserve their investment-grade rating throughout a normal business cycle.

Opportunistic
Issuers that are quite likely to service and repay debt within the five-year credit scenario. Such issuers have an attractive risk/return profile in the current credit scenario but are subject to rating downgrade risk and, thus, might be exchanged periodically.

Speculative
Sub-investment-grade issuers in Europe and the USA as well as local issuers in emerging markets. Issuers are likely to service and repay debt in the current credit scenario. Investors must note that these issuers are subject to a higher downgrade and default frequency and that an active management of these positions is crucial.

Credit rating definition
Credit ratings used in our publications follow the definitions and systematic of Moody’s (www.moodys.com).

<table>
<thead>
<tr>
<th>Moody’s</th>
<th>Standard &amp; Poor’s</th>
<th>Fitch/IBCA</th>
<th>Credit rating definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aaa</td>
<td>AAA</td>
<td>AAA</td>
<td>Obligations rated Aaa are judged to be of the highest quality, with minimal credit risk.</td>
</tr>
<tr>
<td>Aa1</td>
<td>AA+</td>
<td>AA+</td>
<td>Obligations rated Aa are judged to be of high quality and are subject to very low credit risk.</td>
</tr>
<tr>
<td>Aa2</td>
<td>AA</td>
<td>AA</td>
<td>Obligations rated Aa are judged to be of high quality and are subject to low credit risk.</td>
</tr>
<tr>
<td>Aa3</td>
<td>A-</td>
<td>A-</td>
<td>Obligations rated A are considered upper-medium grade and are subject to low credit risk.</td>
</tr>
<tr>
<td>Baa1</td>
<td>BBB+</td>
<td>BBB+</td>
<td>Obligations rated Baa are subject to moderate credit risk. They are considered medium-grade and as such may possess certain speculative characteristics.</td>
</tr>
<tr>
<td>Baa2</td>
<td>BBB</td>
<td>BBB</td>
<td>Obligations rated Baa are subject to moderate credit risk. They are considered medium-grade and as such may possess certain speculative characteristics.</td>
</tr>
<tr>
<td>Baa3</td>
<td>BBB-</td>
<td>BBB-</td>
<td>Obligations rated B are subject to speculative elements and are subject to substantial credit risk.</td>
</tr>
<tr>
<td>Ba1</td>
<td>BB+</td>
<td>BB+</td>
<td>Obligations rated B are judged to have speculative elements and are subject to high credit risk.</td>
</tr>
<tr>
<td>Ba2</td>
<td>BB</td>
<td>BB</td>
<td>Obligations rated B are judged to have speculative elements and are subject to high credit risk.</td>
</tr>
<tr>
<td>Ba3</td>
<td>BB-</td>
<td>BB-</td>
<td>Obligations rated B are judged to have speculative elements and are subject to high credit risk.</td>
</tr>
<tr>
<td>B1</td>
<td>B+</td>
<td>B+</td>
<td>Obligations rated B are considered speculative and are subject to high credit risk.</td>
</tr>
<tr>
<td>B2</td>
<td>B</td>
<td>B</td>
<td>Obligations rated B are considered speculative and are subject to high credit risk.</td>
</tr>
<tr>
<td>B3</td>
<td>B-</td>
<td>B-</td>
<td>Obligations rated B are considered speculative and are subject to high credit risk.</td>
</tr>
<tr>
<td>Caa1</td>
<td>CCC+</td>
<td>CCC+</td>
<td>Obligations rated Caa are judged to be of poor standing and are subject to very high credit risk.</td>
</tr>
<tr>
<td>Caa2</td>
<td>CCC</td>
<td>CCC</td>
<td>Obligations rated Caa are judged to be of poor standing and are subject to very high credit risk.</td>
</tr>
<tr>
<td>Caa3</td>
<td>CCC-</td>
<td>CCC-</td>
<td>Obligations rated Caa are judged to be of poor standing and are subject to very high credit risk.</td>
</tr>
<tr>
<td>Ca</td>
<td>CC+</td>
<td>CC+</td>
<td>Obligations rated Ca are highly speculative and are likely in, or very near, default, with some prospect of recovery of principal and interest.</td>
</tr>
<tr>
<td>C</td>
<td>D</td>
<td>D</td>
<td>Obligations rated C are the lowest rated class of bonds and are typically in default, with little prospect for recovery of principal or interest.</td>
</tr>
</tbody>
</table>

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The information and opinions expressed were produced by Julius Baer Technical Analysis as of date of writing and are subject to change without notice. Julius Baer conducts primary technical analysis aimed at creating value through investment recommendations. Technical Analysis uses historic market prices in order to assess market conditions. The historic data is analysed by chart reading i.e. by following chart patterns and interpreting indicators calculated from historic price movements. Technical Analysis may be inconsistent with and reach different conclusions to fundamental analysis. It may vary at any time due to the different tools used to assess market conditions and recommendations. Besides individual investment recommendations, Technical Analysis also publishes technical indicator readings, which are mechanically calculated and only provide additional information to large sets of data, and are not intended as investment recommendations. These tables show current trends on an absolute price or relative basis using up, flat and downward pointing arrows. At the same time, support and resistance levels might be displayed which are calculated using Bollinger Bands.

Frequently used abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>MAV</td>
<td>Moving average</td>
</tr>
<tr>
<td>Bollinger-band</td>
<td>The middle Bollinger band is a 20 day simple moving average, the higher and lower bands are calculated as a 20-day simple moving average plus or minus two standard deviations on a 20-day period.</td>
</tr>
<tr>
<td>Momentum</td>
<td>Momentum is derived from different rate of change calculations based on the underlying instrument.</td>
</tr>
<tr>
<td>RSI</td>
<td>Relative strength index is a leading momentum indicator of prices, showing the strength of a stock by monitoring changes in closing prices in a 9-day period.</td>
</tr>
</tbody>
</table>

Rating system for global technical analysis (absolute)

<table>
<thead>
<tr>
<th>Rating</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy</td>
<td>Expected to advance by at least 10% in the coming 3-12 months, unless otherwise stated.</td>
</tr>
<tr>
<td>Hold</td>
<td>Expected to perform in line (±15%) in the coming 3-12 months, unless otherwise stated.</td>
</tr>
<tr>
<td>Reduce</td>
<td>Expected to decline by at least 10% in the coming 3-12 months, unless otherwise stated.</td>
</tr>
</tbody>
</table>
Rating system for global technical analysis (relative)

<table>
<thead>
<tr>
<th>Rating</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overweight</td>
<td>Expected to outperform its benchmark by at least 5% in the coming 3-12 months, unless otherwise stated.</td>
</tr>
<tr>
<td>Neutral</td>
<td>Expected to perform in line (±5%) against its benchmark in the coming 3-12 months, unless otherwise stated.</td>
</tr>
<tr>
<td>Underweight</td>
<td>Expected to underperform its benchmark by at least 5% in the coming 3-12 months, unless otherwise stated.</td>
</tr>
</tbody>
</table>

For the history of Technical Analysis equity recommendations over the previous 12 months please view the document at: http://www.juliusbaer.com/tech-analysis-recom-history

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RESEARCH WEEKLY | 27 JUNE 2016 18/20
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