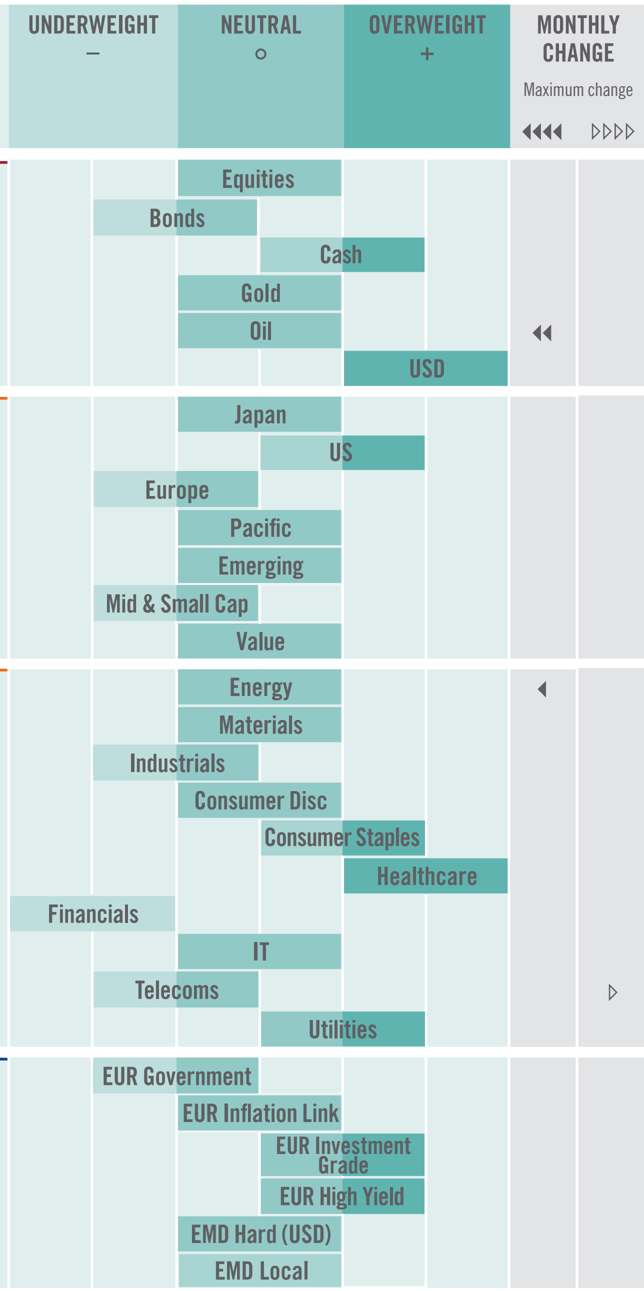
PICTET 1805



GLOBAL ASSET CLASSES
We maintain a neutral stance on equities and an underweight in bonds as strong liquidity support offsets slowing macro-economic momentum.

EQUITY REGIONS AND STYLES
The US offers the best earnings visibility and is our main overweight. Europe remains hostage to tail risks.

EQUITY SECTORS
We increase our defensive tilt by cutting our exposure to energy and reducing our underweight in Telecoms. Financials and industrials are our least-liked sectors.

FIXED INCOME
Investment-grade and high-yield bonds are still our favoured asset classes within fixed income.

Market resilience masks economic risks

Pictet Asset Management Strategy Unit

Monthly euro investor outlook on a 3 month view

Barometer

May 2013

Monthly outlook

Pictet Asset Management
Strategy Unit

Issued 29 April 2013

Global market overview

Japan moves spur equity rally

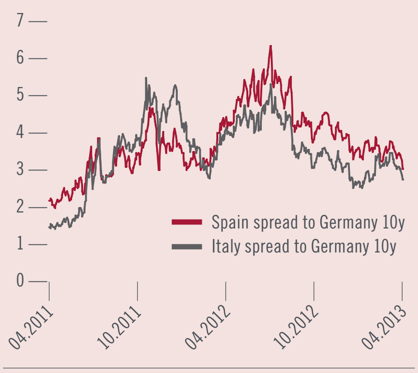
Equities gained as signs of a deterioration in US business conditions were eclipsed by an enthusiastic response to Japan's bold move to boost the country's economy and end deflation.

Under its new governor Haruhiko Kuroda, the Bank of Japan committed itself to the world's largest monetary stimulus effort, a package of measures that will double the monetary base in a bid to lift inflation to 2 per cent by 2015. The plan will expand the BoJ's balance sheet to a size equivalent to 56 per cent of the country's GDP, making it more ambitious in both size and scope than the US Federal Reserve's quantitative easing programme. Investors welcomed the news – Japanese shares were the top performers in global markets in both local currency and US dollar terms while the yen continued its descent.

Elsewhere, US stocks lagged global indices as disappointing economic data – in the shape of worse-than-expected retail sales and employment figures – acted as a drag on the market. The gap in the year-to-date performance between developed and emerging market stocks widened further, meanwhile, as developing equities declined after Chinese economic growth slowed and Brazil unexpectedly raised rates in response to an increase in inflation. A sharp drop in commodities prices – led by gold, which sold off sharply - also weighed on emerging market stocks. Separately, in a continuation of a trend that has been in evidence over the past several months, defensive stocks outperformed their cyclical counterparts. Health care, consumer staples and telecom stocks were the standout performers while energy, materials and information technology lagged. In our view, this development suggests a market decline is in prospect if economic growth does not accelerate.

In fixed income, both government bonds and credit markets ended higher. Investors reacted positively to the latest political developments in Italy, where a new government supported by the two major parties was formed. While this is positive, it remained unclear whether the new administration can deliver on a programme of reform. The yield on Italian two-year government bonds hit a two-year low while the spread between Italian and German benchmark yields tightened, as did those for Spanish government bonds (see chart). In currency markets, the Japanese yen weakened by some 5 per cent against the US dollar.

YIELD SPREADS ON PERIPHERAL DEBT FALL DESPITE HEIGHTENED POLITICAL AND ECONOMIC RISKS



Source: Bloomberg

Asset allocation

Neutral equity, underweight government bonds

We stick to our neutral stance on equities as strong liquidity conditions are offset by a deterioration in economic activity. We remain underweight government bonds, meanwhile, as a recent rally has taken yields to levels to near record lows in both Europe and Japan; we keep our long US dollar position partly on valuation grounds.

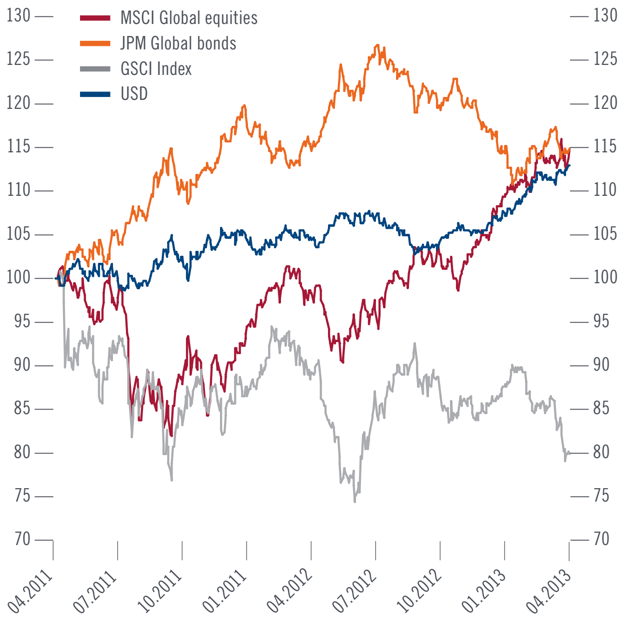
The improvement we have seen in our **business cycle** indicators since the end of last year has begun to wane and we expect the second quarter to witness a deceleration in global growth. This is because a recent slowdown in the US, which we believe has been caused by fiscal tightening, has the potential to spread to other regions. Europe remains mired in recession as evidenced by the latest business confidence readings; data in China has also been very mixed recently, with first-quarter GDP growth slowing to a disappointing 7.7 per cent, year-on-year. Although the slowdown should prove to be temporary, a deterioration in the economic surprises index – which now shows economic data undershooting expectations in aggregate (see chart on page 6) - is a gauge that needs to be monitored, chiefly because it has a good track record of predicting future market moves.

Such negative readings on the economy seem to have passed investors by. This may reflect a belief that the slowdown will not last or that it might trigger another round of quantitative easing from central banks. A number

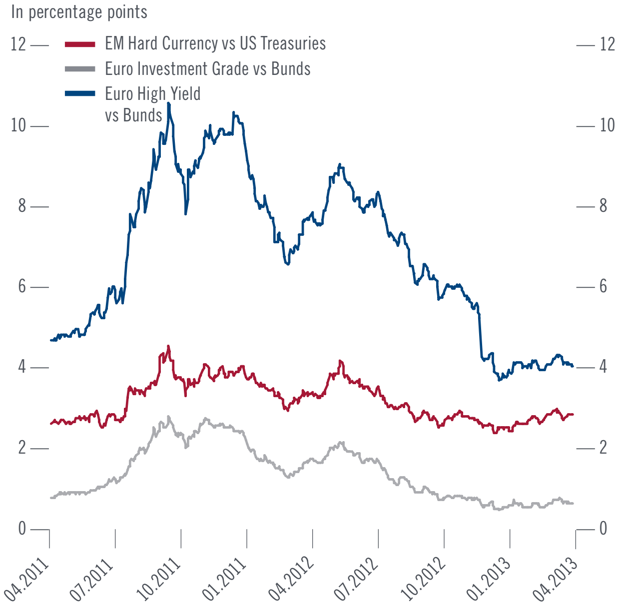
Source: Pictet Asset Management, Thomson Reuters Datastream / JPM and BoA Merrill Lynch

MAJOR ASSET CLASSES

PERFORMANCE: ASSET CLASSES

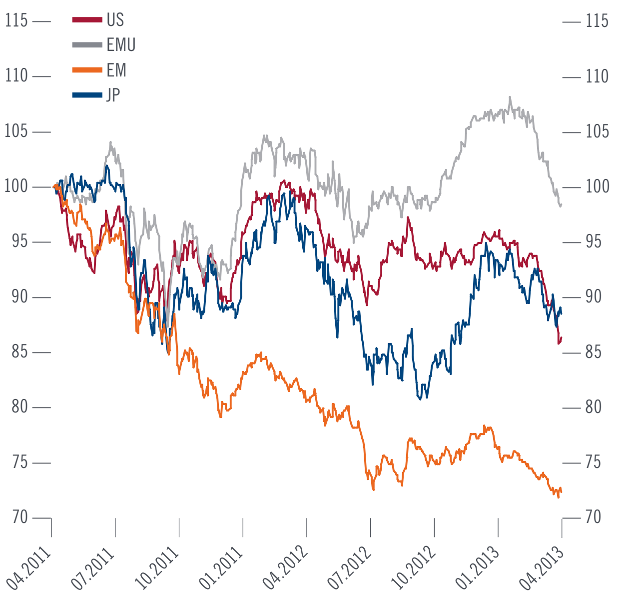


BONDS: ASSET CLASS SPREADS

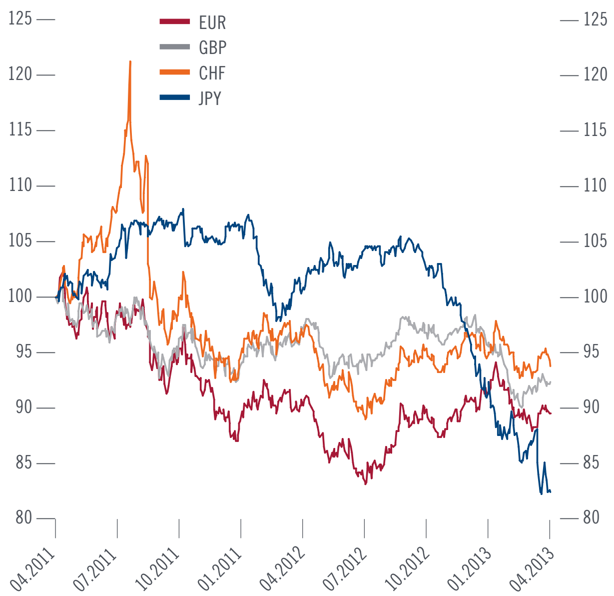


EQUITY SECTOR ROTATION AND CURRENCY PERFORMANCE

GLOBAL EQUITY SECTOR ROTATION:
PERFORMANCE OF CYCLICAL VS DEFENSIVE STOCKS

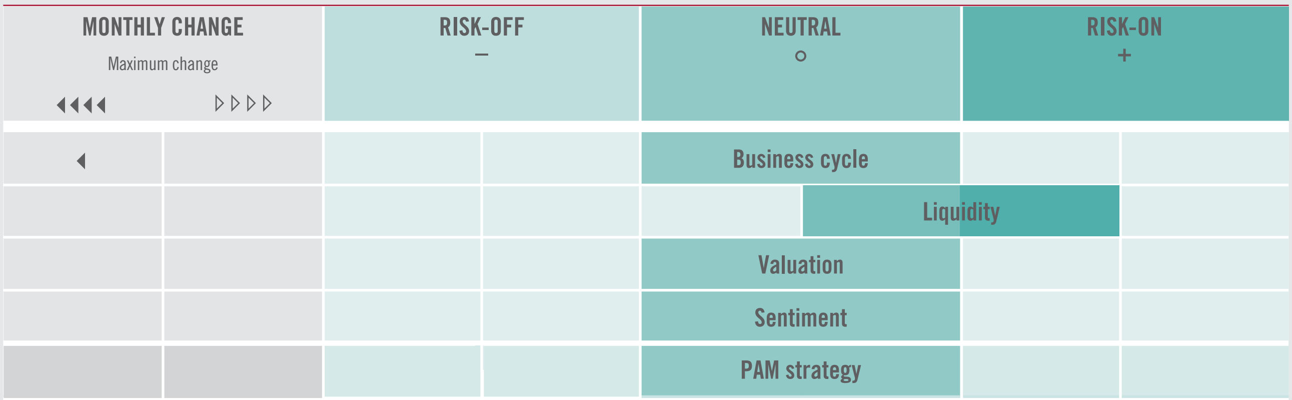


PERFORMANCE: CURRENCIES VS USD



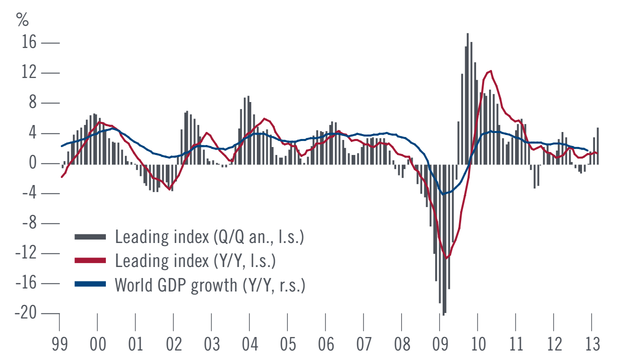
Source: Pictet Asset Management, Thomson Reuters Datastream

RISK BIAS INDICATORS

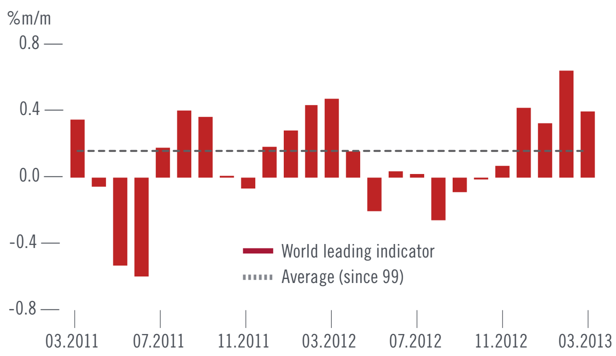


BUSINESS CYCLE: WORLD ECONOMIC ACTIVITY SLOWING

WORLD LEADING ACTIVITY INDEX & REAL GDP GROWTH

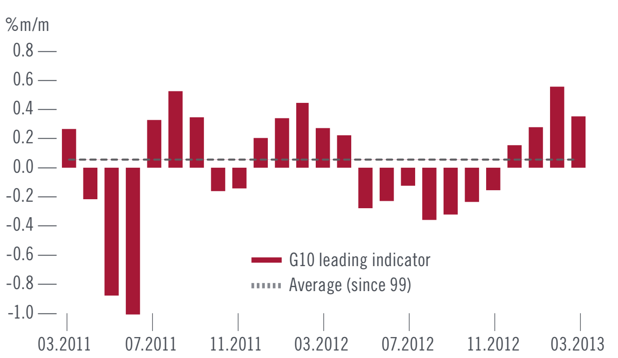


WORLD LEADING ACTIVITY SEQUENTIAL GROWTH (M/M)

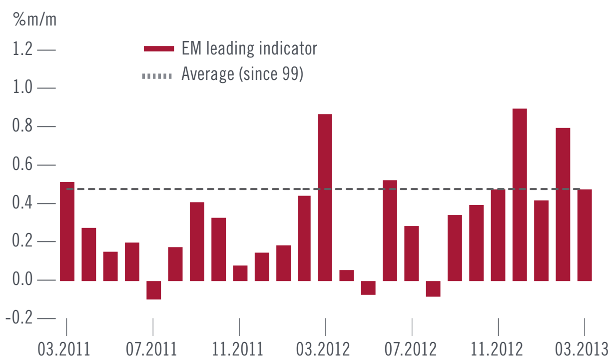


ECONOMIC MOMENTUM DECELERATES IN G10 AND EMERGING ECONOMIES

G10 LEADING INDICATOR M/M GROWTH



EM LEADING INDICATOR M/M GROWTH



Source: Pictet Asset Management, Thomson Reuters Datastream

VALUATION: EQUITY MARKETS AND SECTORS

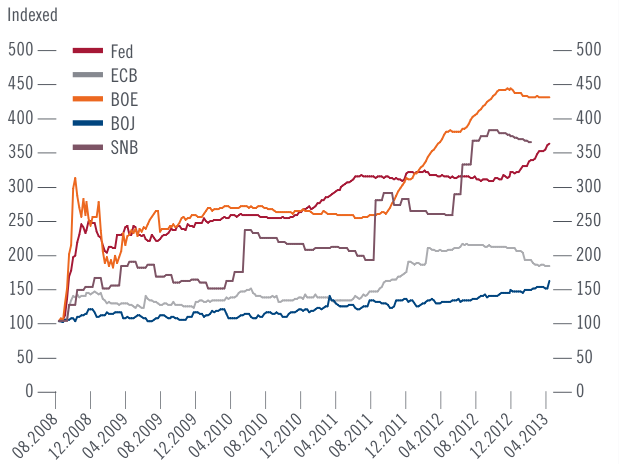
COUNTRIES AND SECTORS

MSCI REGIONS	EPS GROWTH 2013	EPS GROWTH 2014	SALES GROWTH 2013	SALES GROWTH 2014	PE 2013	PE 12M	PB 2013E	P/SALES 2013E	DY 2013E
US	7%	11%	3%	5%	14.1	13.5	2.1	1.4	2.2%
Europe	6%	12%	1%	4%	12.0	11.5	1.5	0.9	3.9%
EMU	8%	14%	1%	4%	11.8	11.2	1.2	0.7	3.9%
Switzerland	8%	11%	5%	5%	14.8	14.3	2.3	1.9	3.3%
UK	5%	10%	1%	4%	11.5	11.1	1.6	1.0	4.0%
Japan	50%	13%	5%	3%	15.4	15.2	1.4	0.6	1.9%
EM	16%	11%	10%	7%	10.4	10.0	1.4	0.7	3.0%
NJA	18%	12%	11%	8%	11.4	11.0	1.5	0.7	2.7%
Global	10%	12%	4%	5%	13.3	12.7	1.7	1.1	2.8%

MSCI GLOBAL SECTORS	EPS GROWTH 2013	EPS GROWTH 2014	SALES GROWTH 2013	SALES GROWTH 2014	PE 2013	PE 12M	PB 2013E	P/SALES 2013E	DY 2013E
Energy	4%	8%	-1%	3%	10.0	9.8	1.2	0.6	3.4%
Materials	15%	17%	5%	6%	12.0	11.2	1.4	0.9	2.9%
Industrials	11%	13%	6%	5%	14.0	13.4	2.0	0.7	2.6%
Consumer Discretionary	16%	15%	6%	6%	15.0	14.3	2.3	0.9	1.9%
Consumer Staples	9%	10%	6%	5%	17.8	17.1	3.4	1.1	2.8%
Health care	1%	9%	4%	5%	15.6	15.1	3.0	1.7	2.3%
Financials	14%	11%	4%	5%	11.7	11.3	1.1	1.5	3.2%
IT	12%	13%	7%	7%	13.3	12.5	2.5	1.5	1.7%
Telecoms	6%	9%	2%	3%	13.4	13.1	1.9	1.2	4.8%
Utilities	11%	12%	1%	3%	15.1	14.8	1.3	0.8	4.2%

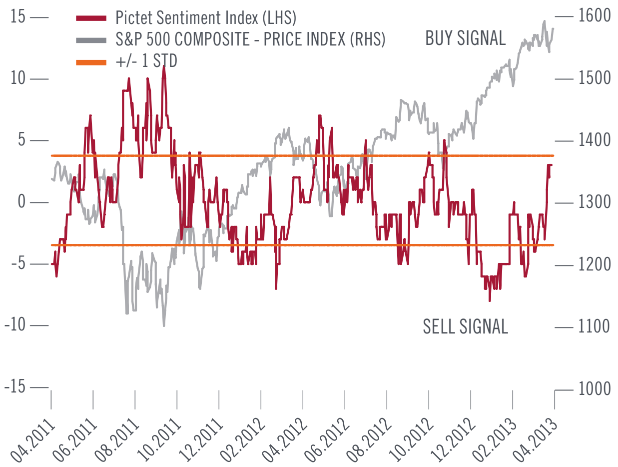
LIQUIDITY: STILL BOOSTED BY EASY MONETARY POLICY

SIZE OF CENTRAL BANKS' BALANCE SHEETS



SENTIMENT READING IN NEUTRAL TERRITORY

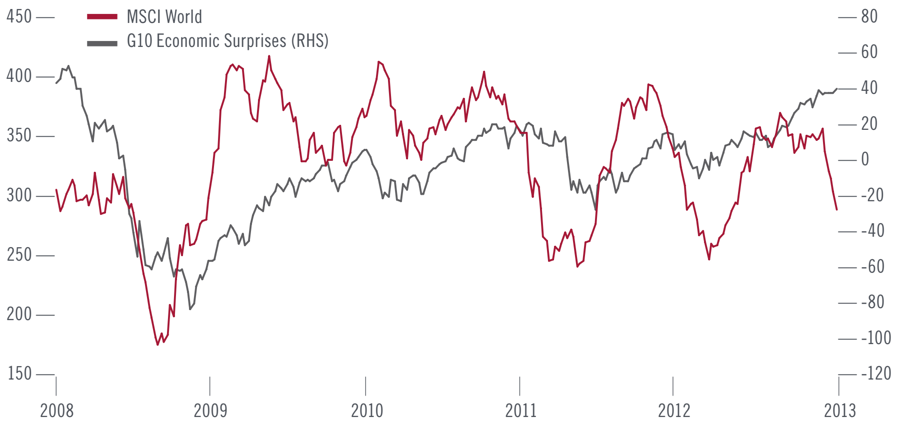
PICTET SENTIMENT CYCLE INDEX



of indicators we follow signal that a market correction is due. The fact that stock markets are gaining while other gauges of economic conditions such as commodities (see chart) are exhibiting weakness is one such warning sign.

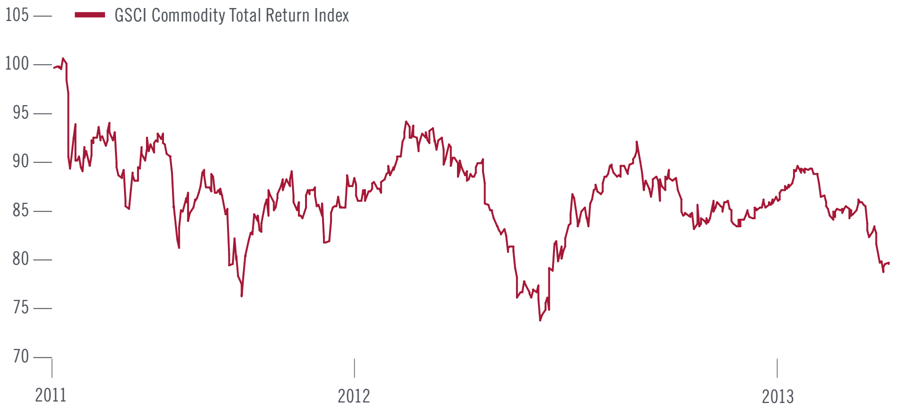
Clearly, part of the market's resilience can be attributed to supportive **liquidity** conditions. Monetary stimulus provided by central banks and the decision from the BoJ to significantly ramp up the amount of asset purchases until its 2 per cent inflation target is met constitute a positive for risk assets. Major central banks should maintain their very accommodative monetary policies for the rest of the year. In China, meanwhile, money supply and lending growth have been accelerating while the real estate market remains buoyant. But even in the area of liquidity, there are warning signs. We are concerned that the growth in both bank lending and the monetary base is decelerating in the US; also worrying is the fact that the availability of credit to small companies remain severely limited in Europe.

ECONOMIC SURPRISES INDEX SHOWS DATA UNDERSHOOTING EXPECTATIONS



Source: Thomson Reuters Datastream, Pictet Asset Management

COMMODITY PRICES FALL, SIGNALLING DETERIORATING ECONOMIC CONDITIONS



Source: Thomson Reuters Datastream

When it comes to **valuations**, it is striking to note that not one asset class appears cheap on an absolute basis in our analysis. Equities trade either close to or at record highs, bond yields have fallen to record lows and yield spreads on investment and speculative-grade debt have compressed even further. With equities trading at a multiple of some 12.7 times 12-month forward earnings, they do not appear especially cheap considering profit margins are already at record levels. Our view on valuations is reinforced by US corporate profit trends – although the majority of companies that have reported earnings have beaten analyst expectations, their guidance for the rest of the year has been disappointing.

Our **sentiment** indicators remain in neutral territory. Investor sentiment, as captured by surveys and investment flows into equity funds, has deteriorated slightly. However, other signals we monitor continue to paint a picture of an overly-bullish market: hedge funds appear to be very overweight equities; implied volatility, or the cost of insuring against a market decline, remains low and all our measures of market breadth indicate that the rally is less broad-based than usual, a sign that the market is vulnerable to a correction.

Equity region and sector allocation

A preference for defensive markets and sectors

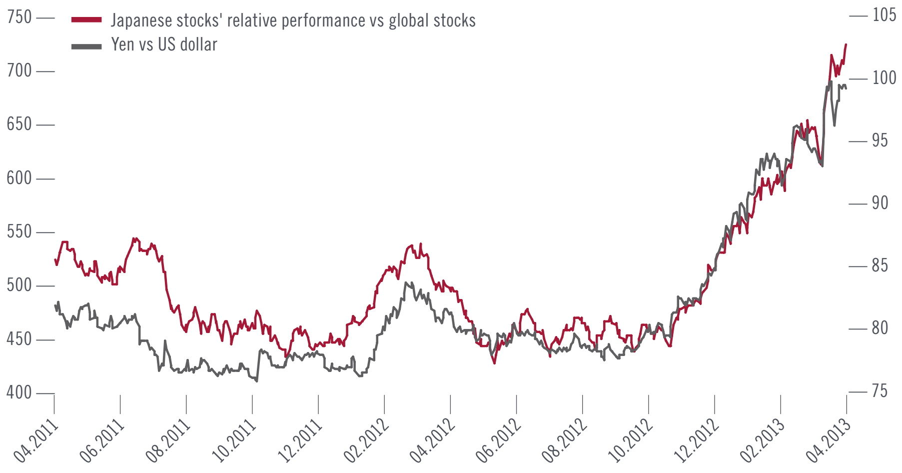
Our overweight US, underweight Europe allocation remains in place. The US market is supported by what we consider to be the appropriate mix of fiscal tightening and monetary stimulus while Europe has, to date, placed too much emphasis on public spending cuts and not enough on boosting the flow of credit. The widely-expected ECB rate cut in May might not be much help, as it is the availability of credit, rather than its cost, that is the region's biggest problem. What is more, with the euro trading at 1.30 vs. the US dollar, corporations are also having to contend with adverse currency effects.

By contrast, at a time of weak global growth and deteriorating profit forecasts, the US commands a premium as it is the market with the best earnings visibility, even though at a valuation of 13.5 times 12-month earnings or a price to book ratio of 2.1, it is not especially cheap.

Following a strong rally, Japanese equities should perform in line with global markets over the next few months. The yen is now the cheapest major developed currency according to our models. Given the strong inverse correlation between the yen and Japanese equities, this also suggests limited upside for the country's stock market.

Meanwhile, after their recent underperformance, emerging markets are beginning to look increasingly attractive. They currently trade on a multiple of around 10 times 12-month forward earnings - a 21 per cent discount to global equities; and should global growth accelerate, we would consider increasing our exposure.

YEN WEAKNESS AND JAPANESE STOCKS HIGHLY CORRELATED



Source: Thomson Reuters Datastream, Pictet Asset Management

On sectors, we increase our defensive tilt slightly to reflect the risk of a slowdown in economic growth. Healthcare and consumer staples remain our biggest overweights. We have reduced our exposure in energy to neutral to reflect a downgrade of our outlook for the oil price.

Additionally, we have reduced our underweight in telecoms. The sector exhibits improving earnings momentum; it also has the highest dividend yield of any global sector at 4.8 per cent. Of note, cyclicals in aggregate do not appear cheap compared to defensive sectors – only a significant improvement in economic conditions would push cyclical stocks significantly higher from their current levels.

We maintain our underweight in financials and industrials. Meanwhile, the recent underperformance of technology stocks has left the sector as one of the cheapest on our scorecard; it could warrant an upgrade should economic conditions improve.

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Fixed Income

The value remains in credit

Corporate investment-grade and high-yield bonds remain our favoured asset classes within fixed income. Even though yields on such securities are low by historical standards, the yield pick-up they offer over benchmark bonds remains well within its historical range; it also sits some distance above all-time lows. What is more, current valuations imply a bond default scenario that is far worse than the historic norm.

For investment-grade corporate bonds, the market appears quite pessimistic – the implied default rate is higher than the levels seen during the asset class's worst five-year period

Current valuations for European high-yield bonds, meanwhile, imply a cumulative five-year default rate that is almost 50 per cent higher than the realised average. For high-yield in particular, there are a number of reasons why default rates can be expected to remain in the single digits.

With central banks having re-opened the credit markets through quantitative easing, speculative-grade borrowers have been quick to take advantage. Companies have refinanced existing debt at lower interest rates, and have extended the duration of those liabilities. According to data from rating agency Fitch, around 45 per cent of the European high-yield bonds originally due to be redeemed in 2013-2015 - some EUR70 billion - has been refinanced at longer maturities.

As we expect low growth and low interest rates to persist for the foreseeable future, we believe the search for yield will lead to an outperformance of credit relative to government bonds.

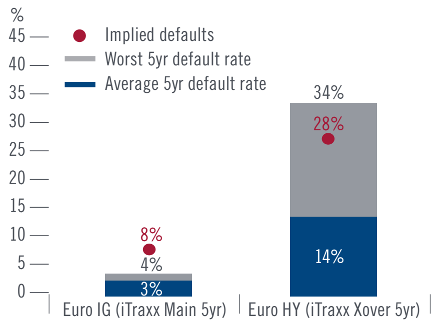
Meanwhile, after the sharp decline in European government bond yields that has occurred over the past month, we see very little value in Italian and French debt yet retain an overweight in safer markets such as Germany. We remain neutral on emerging market bonds on valuation grounds.

On currencies, we retain our bearish view on the Japanese yen, the euro and the UK pound and we also see limited upside in emerging market currencies in the short term.

Olivier Ginguené, *Chairman*
Pictet Asset Management Strategy Unit

Luca Paolini, *Chief strategist*
Pictet Asset Management

CREDIT OFFERS GOOD COMPENSATION AGAINST DEFAULT RISK



Note: Implied defaults calculated using 35% recovery. Historical defaults calculated using current index ratings. Source: Morgan Stanley Research, Bloomberg, Moody's

ABOUT THE PSU

The Pictet Asset Management Strategy Unit (PSU) is the investment group responsible for providing asset allocation guidance across stocks, bonds, cash and commodities.

Each month, the PSU sets a broad policy stance based on its analysis of:

- **business cycle:** proprietary leading indicators, inflation
- **liquidity:** monetary policy, credit/money variables
- **valuation:** equity risk premium, yield gap, multiples vs. history
- **sentiment:** Pictet sentiment index (investors' surveys, tactical indicators)

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