Global

Periodical

DB Today - Global/Macro

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Tuesday, 29th November 2016

MACRO HIGHLIGHTS

Global Strategy - The House View - Marcos Arana
Trump's win may have opened a new chapter for the US. The shift toward a more balanced mix of easy monetary and fiscal policy and looser regulation is expected to jumpstart the economy, ending years of low growth and inflation. Faster US growth would also have positive spillovers to the rest of the world. Details on page 07

Credit Strategy - Early Morning Reid - Jim Reid
While we're in outlook mode and while we wait for the OPEC meeting tomorrow, payrolls on Friday and the Austrian elections and Italian referendum on Sunday, we thought we'd start today by highlighting our Chinese economists' 2017 outlook published yesterday. They believe the Chinese government faces a policy dilemma in 2017 but think they will achieve the 6.5% growth target with strong fiscal easing. But this requires further credit expansion, which would exacerbate the risk of a property bubble and intensify capital outflows. They expect FX reserves to fall to US$ 2.8trn in 2017 and 2.4trn in 2018, and USDCNY to depreciate to 7.4 by end-2017 and 8.1 by end-2018 (6.9% and 17.1% from the current level of 6.92). They see macro risks rising beyond 2017, with a 50% chance that growth will drop below 6% for a full year sometime between 2018 and 2020. Debt to GDP is set to go up. The property bubble will impose more macro risks, the US rate hikes will further constrain the policy room for PBoC, and the excessive liquidity onshore will likely drive inflation up eventually. Details on page 08

European Equity Strategy - Weekly Fund Flows - Andreas Bruckner
Over the course of last week, DM investors remained energized by heightened expectations of a regime change from monetary to fiscal policy. DM bond funds lost $3bn of assets, which is somewhat lighter than the previous week's $8bn of outflows, but keeps DM bond fund redemptions on the fastest pace since the 2013 taper tantrum. Meanwhile DM equities garnered $7bn, which showed more constraint than the record-setting $33bn of the week prior, but still accentuated the rotation from bond funds to equity funds that has characterised investor flows since Donald Trump's election victory on Nov 8. To put this in perspective, DM bond funds have seen $750bn more inflows than DM equity peers since 2007 ($1tn versus $250bn). Looking at the year-onyear changes of this 'over-allocation' since 2004, it seems to be primarily driven by the yearly changes in the US 10-year Treasury yield. Details on page 09

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GLOBAL MARKET WRAP

INDEX	Close	1D %Chg	YTD %Chg
S&P 500	2201.72	-0.53	7.72
NASDAQ	5368.81	-0.56	7.22
DOW	19097.90	-0.28	9.60
DJ STOXX 50	3018.17	0.05	-7.63
FTSE 100 INDEX	6777.76	-0.32	8.58
HANG SENG INDEX	22737.07	-0.41	3.75
MSCI Asia ex Japan	525.16	0.63	5.05
BRAZIL BOVESPA	62855.50	2.11	45.00
RTS-2 INDEX	1183.27	-0.10	86.98

COMMODITY PRICES

COMMODITIES	Close	1D %Chg	YTD %Chg
West Texas	47.08	5.18	27.11
Brent	47.47	-0.25	32.78
CRB	187.76	1.10	6.60
Copper	262.20	-1.30	22.81
Gold (Spot)	1190.60	-0.29	12.17
Alum. (LME)	1747.00	-0.57	15.93
Baltic Dry	1184.00	0.25	147.70

FOREIGN EXCHANGE PRICES

FOREX (vs US$)	Close	1D %Chg	YTD %Chg
HK$	7.76	0.01	-0.07
EUR	1.06	-0.04	-2.31
JPY	112.38	-0.39	6.98
GBP	1.24	-0.02	-15.76

DERIVATIVES

	Current Value	%-ile Rank
SPX 3M Mat ATM-Strike Imp Vol	12.49	13.15
SPX 3M Mat 90%-110% IV Skew	8.39	1.59
SPX 3M Mat Realized Vol	10.97	23.85

Source: Bloomberg Finance Lp,

CREDIT

Credit	Close	1D %Chg	YTD %Chg
CDX.NA.IG	73.85	0.11	-16.32
ITRX.Europe	81.56	0.51	5.85
CDX.NA.HY	104.60	0.09	3.32
ITRAX.XOVER	340.76	-0.12	8.38

Source: Bloomberg Finance LP

MACRO HIGHLIGHTS

FX Strategy - FX Daily - Mallika Sachdeva

After a sharp one-way rally since the US election, we have seen the first real dip in USD/JPY this week. We examine five forces to track for the yen: 1. Relative real yield spreads. The golden relationship for USD/JPY has been with US-Japan real yields. Chart 1 illustrates the extremely tight co-movement of spot with 10Y nominal-breakeven spreads. For context, another 30bps move in this real yield spread would be consistent with USD/JPY north of 120. After a sharp run-up in US yields though, further upside will likely require Trump's fiscal plans to take shape, and the market to price a more aggressive 2017 Fed path. There could eventually be more contribution from Japanese real yield compression, if inflation expectations in Japan finally perk up – the labor market is tight, and Abe is putting emphasis on wage negotiations next spring. Details on page 10

Asia Strategy - Asia Economics Special - Taimur Baig

We update the indicators of macro and structural vulnerabilities in 26 EM economies. This exercise assesses the susceptibility of emerging market countries to economic crises or a period of painful adjustment should external conditions worsen. Details on page 11

Japan Strategy - JAPAN FI Flash memo - Makoto Yamashita

Four months have now passed since the BOJ hiked its equity ETF
purchases to JPY6 trillion a year on July 29. It would appear that the probability of purchases has increased by comparison with QQE1 and QQE2, with operations having been conducted on 100% of the occasions when the TOPIX index has fallen by at least 0.5% from the previous day's close by the end of the morning session. We also note that the index has been more likely to rise during the afternoon session on days when such operations are conducted on averaged basis. It might therefore be worth considering a "BOJ trade" that entails buying ETFs at the end of morning sessions where the TOPIX index has fallen by at least 0.5% and then selling at the close of the afternoon session. Details on page 12

US Economics - US Daily Economic Notes - Joseph LaVorgna

As we discussed last week, many economic data series are backward looking since they have not yet captured the expected shift in fiscal policy, which should be substantially stimulative for real GDP growth. In this regard, this morning's consumer confidence report for November, as well as the Chicago PMI and manufacturing ISM surveys (released Wednesday and Thursday, respectively) take on elevated significance. To be sure, these data will likely capture only some of the consumer and business reactions to the outcome of the US Elections. Thus, we expect the Chicago PMI (52.0 vs. 50.6) and the manufacturing ISM (52.0 vs. 51.9) series to improve only slightly. However, the trends in these forward-looking indicators will be increasingly important to monitor as more details of the incoming Congress' spending and tax priorities are unveiled. Details on page 13

KEY COMPANY RESEARCH

JAPAN
Bridgestone (5108.T),JPY4349 Hold Price Target JPY4400

Kurt Sanger: **Buy to Hold, tgt JPY3850 to JPY4400.** We have adjusted our earnings assumptions at Bridgestone for a weaker yen and higher raw material prices. While large market themes, we actually do not view either as large net drivers of earnings in FY17, with positive forex being offset somewhat by some negative material price impact. Our net change to our earnings outlook is only 3.5%. Applying 11x PER and 5x EV/EBITDA to FY18 earnings we get a TP of ¥4,400. With only 1% upside to our revised target price we are revising down our ratings from BUY to HOLD. **Details on page 14**

EUROPE
Italy Special Report

Marco Stringa: After Brexit and Trump's victory, the next key political event is Italy's 4 December referendum on the Senate reform. On 11 November we have published our in-depth analysis of this topic. In this article we consider the main downside and upside risks to monitor in the short and medium term. **Details on page 15**

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KEY COMPANY RESEARCH

Economics Special Report: China outlook 2017
Zhiwei Zhang: The Chinese government faces a policy dilemma in 2017. We believe they will achieve the 6.5% growth target with strong fiscal easing. But this requires further credit expansion, which would exacerbate the risk of property bubble and intensify capital outflows. We expect FX reserves to fall to US$ 2.8trn in 2017 and 2.4trn in 2018, and USDCNY will depreciate to 7.4 by end-2017 and 8.1 by end-2018 (6.9% and 17.1% from the current level of 6.92). We see macro risks rising beyond 2017, with 50% chance that growth will drop below 6% for a full year sometime between 2018 and 2020. **Details on page 16**

Economics Special Report: The risk of de-globalization
Zhiwei Zhang: We do not take an outbreak of a US-China trade war as our baseline case. But the Brexit vote and the US election clearly show how the conventional wisdom in economics may backfire these days. We need to think of the previously unthinkable as risk scenarios, and want to make three points in this report. **Details on page 17**

TODAY'S HEADLINES

Markets: ITA equities weigh on European equities in particular, bonds modestly firmer.

USA: **Dallas fed manufacturing activity index** up 11.7pts to 10.2 in November, above mkt.

EMU: **ECB's Draghi** says a less open UK economy would weigh first and foremost on the UK.

EMU: **M3** up 4.4%yoy in October, below mkt.

ITA: **Consumer confidence index** down 0.1pts to 107.9 in October, above mkt.

ITA: **Economic sentiment index** down 1.0pts to 100.4 in November.

THE DAY AHEAD.

USA: **Fed's Powell, Dudley** speak, **GDP** (Q3 S), **Consumer confidence index** (Nov), **S&P CoreLogic CS HPI index** (Sep); CAN: **BoC's Poloz** speaks, **Current account balance** (Q3); EMU: **Economic sentiment** (Nov); UK: **Mortgage approvals** (Oct), **M4** (Oct); DEU: **HICP** (Nov P), **Import prices** (Oct); FRA: **GDP** (Q3P), **Consumer spending** (Oct); ESP: **HICP** (Nov P); SWE: **GDP** (Q3); JPN: **Jobless rate** (Oct), **Retail trade** (Oct), **Real household consumption** (Oct)

Source: Extract from DB Daily published on29 November 2016

Forecast G7 Quarterly GDP growth

% qoq saar/annual: % yoy	Q1 15	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16F	Q4 16F	2015	2016 F	2017 F
US	2.0	2.6	2.0	0.9	0.8	1.4	2.9	1.0	2.6	1.5	2.3
Japan	5.0	-1.3	1.6	-1.6	2.1	0.7	2.2	0.2	0.6	0.7	1.0
Euroland	3.2	1.5	1.4	1.8	2.1	1.2	1.4	1.4	1.9	1.6	1.1
Germany	0.7	2.1	1.0	1.4	2.9	1.7	0.8	1.8	1.7	1.9	1.0
France	2.4	0.1	1.5	1.4	2.6	-0.3	0.9	1.7	1.2	1.3	1.3
Italy	1.2	1.0	0.4	0.8	1.5	0.1	1.3	0.5	0.7	0.9	0.6
UK	1.0	2.0	1.2	2.7	1.7	2.7	2.0	0.8	2.2	1.9	0.9
Canada	-1.0	-0.5	2.2	0.5	2.5	-1.6	3.2	1.8	1.1	1.2	1.9
G7	2.0	1.5	1.6	0.8	1.5	1.1	2.3	1.0	1.9	1.4	1.7

a) Euroland forecasts as at the last forecast round on 30/09/2016. Bold figures signal upward revisions, bold, underlined figures signal downward revisions. (b)GDP figures refer to working day adjusted data, except Germany and Italy. Adjusted for calendar days, Italy 2015 GDP was 0.6% yoy. (c) HICP figures for euro-zone countries and the UK (d) Current account figures for Euro area countries include intra regional transactions. e) The world aggregate has been calculated based on the IMF weights released in April 2016.
Sources: National authorities, Deutsche Bank Research
Data updated from Global Economics Perspective note published on 21 November 2016

Commodities: Energy Commodities & Precious Metals Price Forecasts

USD	Q4 15	2015	Q1 16	Q2 16	Q3 16	Q4 16	2016	Q1 17	Q2 17	Q3 17	Q4 17	2017	2018	2019
WTI (bbl)	42.2	48.8	33.6	45.6	45.8	48.0	43.3	51.0	51.0	55.0	55.0	53.0	65.0	65.0
Brent (bbl)	44.7	53.7	35.2	47	47.8	50	45.0	53	53	57	57	55	70	70
US Natural Gas (mmBtu)	2.11	2.61	1.96	2.14	2.77	2.88	2.44	3.25	3.10	3.00	3.15	3.13	3.01	3.01
Gold	1104	1161	1184	1259	1330	1320	1273	1280	1310	1340	1380	1328	1350	1340
Silver	14.8	15.7	14.9	16.8	19.5	18.7	17.5	19.2	18.8	18.0	19.0	18.8	19.5	18.5
Aluminium														
USc/lb	67.8	75.5	68.7	71.3	73.0	70.8	71.0	72.1	69.9	70.3	71.2	70.9	74.9	77.5
USD/t	1494	1664	1515	1572	1610	1560	1564	1590	1540	1550	1570	1563	1650	1708
Copper														
USc/lb	221.9	250.1	212.3	214.9	215.5	208.7	212.8	199.6	195.1	208.7	217.8	205.3	235.9	252.8
USD/t	4890	5512	4678	4736	4750	4600	4691	4400	4300	4600	4800	4525	5200	5572

Source: Deutsche Bank, Figures are period averages
Data updated from Commodities Digest note published on 13 October 2016

CENTRAL BANK POLICY (%)

	Current	Q4-16F	Q4-17F	Q4-18F
US	0.38	0.63	1.13	2.13
Eurozone	0.00	0.00	0.00	0.00
Japan	-0.10	-0.10	-0.10	-0.10
UK	0.25	0.25	0.25	0.25
China	1.50	1.50	1.50	1.50

Source: The House View published on 29 November 2016

FORECAST
FOREIGN EXCHANGE RATES

	Vs US Dollar				vs. Euro			
Countries	Current	Dec 16	Jun 17	Dec 17	Current	Dec 16	Jun 17	Dec 17
United States	-	-	-	-	1.06	1.05	1.00	0.95
Japan	112.27	109	114	115	118.81	114	114	109
Euroland	0.94	0.95	1.00	1.05		-	-	-
United Kingdom	0.81	0.86	0.89	0.95	0.85	0.90	0.89	0.90
Switzerland	1.01	1.05	1.04	1.05	1.07	1.10	1.04	1.00
Canada	1.34	1.35	1.38	1.40	1.42	1.42	1.38	1.33
China	6.90	6.80	7.10	7.40	7.31	7.14	7.10	7.03
India	68.73	70	71	73	72.73	74	71	69

** Sources: Deutsche Bank, Bloomberg, Datastream.*
Data last updated form 'Macro Forecasts' report published on 29 November 2016
Current rates taken from Bloomberg Finance Lp

GOVERNMENT RATES

	Current	Q4-16F	Q4-17F	Q4-18F
US 10Y yield	2.32	1.75	2.00	2.00
EUR 10Y yield	-0.05	0.00	0.15	0.25

Source: The House View published on 18 October 2016
**Current Rates taken from Bloomberg Finance Lp*

INDEX FORECASTS

	Current*	2016
DJ Stoxx 600	339.83	325
FTSE 100	6799.47	NA
Dax 600	10582.67	NA
MSCI AC World	413.64	NA
S&P 500	2201.72	2150

Source: : The Equity View published on 07 October 2016
**Current Rates taken from Bloomberg Finance LP*

CORPORATE ACCESS
UPCOMING CONFERENCES/TRIPS/EVENTS

Date	Conferences
November 30, 2016	Mortgage REIT One-on-One Day @ New york
December 1, 2016	dbAccess Pharmaceutical and Healthcare Corporate Day@ London
December 1, 2016	Homebuilding & Building Products Strategic Value Creation Conference @ New York

Source: Deutsche Bank For more details log on to www.conferences.db.com

The House View

The House View, 29 November 2016 Switching into a higher gear

Trump's win may have opened a new chapter for the US. The shift toward a more balanced mix of easy monetary and fiscal policy and looser regulation is expected to jumpstart the economy, ending years of low growth and inflation. Faster US growth would also have positive spillovers to the rest of the world.

Risks remain that some of these growth-friendly policies are not implemented or have unexpected effects. But the biggest threat to growth is a possible protectionist turn, which would further depress already anaemic global trade.

Any political spillover in Europe would also be negative. The first risk event is Italy's Senate referendum on 4-December. Polls suggest the vote will fail, and if it does, PM Renzi will likely resign. The sell-off in Italian assets indicates that this outcome is being priced, but as long as immediate elections and a eurosceptic government are possible, market stress can build further. Elections in the Netherlands, France and Germany next year will ensure that political risk remains a source of volatility.

In the coming weeks we will see the last ECB and Fed decisions of 2016. In Europe, taper talk is premature, and we expect a six month extension of QE. In the US, a rate hike in December is all but a done deal.

Markets have so far focused on the positives of Trump's policies, with the dollar strengthening, rates selling off and equities rising, reaching all-time highs in the US. Several of these trends should continue in the coming months: the rates sell-off has some further room to run and the dollar should strengthen further, with the euro reaching parity next year and further weakness expected in sterling and yen.

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Early Morning Reid Macro Strategy

A reminder that our 2017 credit outlook was published last week. For those who missed it it's called "Volatility Ahead" with a front cover that sums up our view somewhat. See the following link for the full report http://pull.db-gmresearch.com/p/33335-6B13/204020606/DB_SpecialReport_2016-11-22_0900b8c08c05b934.pdf.

While we're in outlook mode and while we wait for the OPEC meeting tomorrow, payrolls on Friday and the Austrian elections and Italian referendum on Sunday, we thought we'd start today by highlighting our Chinese economists' 2017 outlook published yesterday. They believe the Chinese government faces a policy dilemma in 2017 but think they will achieve the 6.5% growth target with strong fiscal easing. But this requires further credit expansion, which would exacerbate the risk of a property bubble and intensify capital outflows. They expect FX reserves to fall to US$ 2.8trn in 2017 and 2.4trn in 2018, and USDCNY to depreciate to 7.4 by end-2017 and 8.1 by end-2018 (6.9% and 17.1% from the current level of 6.92). They see macro risks rising beyond 2017, with a 50% chance that growth will drop below 6% for a full year sometime between 2018 and 2020. Debt to GDP is set to go up. The property bubble will impose more macro risks, the US rate hikes will further constrain the policy room for PBoC, and the excessive liquidity onshore will likely drive inflation up eventually. See the following link for more info. http://pull.db-gmresearch.com/p/13828-AEC4/225361463/DB_SpecialReport_2016-11-28_0900b8c08c165365.pdf.

Also from DB, the latest The House View titled "Switching into a higher gear" was published overnight. The team notes that Trump's win has opened the door for a large fiscal stimulus that is expected to jumpstart the US economy. However, risks remain that a protectionist turn could weigh on global growth. Political spillover in Europe is also a concern. Italy's Senate referendum on 4-December is likely to fail; elections in the Netherlands, France and Germany next year also bear watching. Markets have so far focused on the positives of Trump's policies, with the dollar rallying, rates selling off and equities rising. Several of these trends should continue, with the euro reaching parity next year. Meanwhile, the ECB is likely to extend QE by six months, and the Fed will most probably hike in December. See the following link for more details. http://pull.db-gmresearch.com/p/12182-023B/228379890/DB_TheHouseView_2016-11-29.pdf

Moving back to the current, Sunday's referendum in Italy is coming into full view now and even though a rejection is probably the most likely scenario, what happens after that is still open to much debate. Indeed DB's Marco Stringa published an updated report yesterday looking at the risks after and beyond Italy's referendum. He notes that given the recent underperformance in Italian assets, the impact of a rejection may already have partially been reflected in valuations. But when looking at implied moves from options, the equity market seems to be mostly pricing in limited probability of extreme scenarios. An apparent lack of concern over contagion risks is even more apparent in broader European indices. The report goes through Marco's various downside and upside scenarios for which his central case still remains a muddle-through government with limited scope and duration. In this case he expects an early election from June 2017. A link to Marco's latest report is attached here. http://pull.db-gmresearch.com/p/1628-E6D6/224462027/DB_SpecialReport_2016-11-28_0900b8c08c1c5fcf.pdf

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Weekly Fund Flows Bond-to-equity rotation: scaling the potential

Last week's (Wed-Wed) review of funds' in/outflows as % of funds' AuM

Over the course of last week, DM investors remained energized by heightened expectations of a regime change from monetary to fiscal policy. DM bond funds lost $3bn of assets, which is somewhat lighter than the previous week's $8bn of outflows, but keeps DM bond fund redemptions on the fastest pace since the 2013 taper tantrum. Meanwhile DM equities garnered $7bn, which showed more constraint than the record-setting $33bn of the week prior, but still accentuated the rotation from bond funds to equity funds that has characterised investor flows since Donald Trump's election victory on Nov 8. To put this in perspective, DM bond funds have seen $750bn more inflows than DM equity peers since 2007 ($1tn versus $250bn). Looking at the year-on-year changes of this 'over-allocation' since 2004, it seems to be primarily driven by the yearly changes in the US 10-year Treasury yield (see top right chart). So where do we go from here?

In the recovery of 2009, bond yields rose by 150 basis points over 12 months but investors' relative preference for bonds remained unaffected. But the historic flow/yield relationship also suggests that, if all goes well on the prospect of stepped-up US growth and inflation, the great unwind might just have started, and a US 10-year bond yield at 2.5% in Q2 next year (as expected by our fixed income strategists) would be supportive of $250bn to revert back from DM bonds into DM equities until May next year. While this accounts for only 1% of the US total market capitalization, it still means that DM equity funds could see just as much inflows over the following six months as they have over the past three and a half years together. In such a scenario, US equity mandates would likely draw the most attention, and last week, US mutual funds saw their first inflows since Jul'15 (see bottom right chart).

Bonds (--) versus equities (+) and MM (+): Total equity funds (+0.1%, MFs: -0.0%, ETFs: +0.2%) gained inflows for the third week running as ETF inflows outweighed marginal MF redemptions. On the other hand, total bond funds (-0.2%) continued their selloff with broad-based losses across the board, whereas MM funds gained inflows (+0.4%).

DM equity funds (+) with US (+), Europe (~) and Japan (-): DM funds (+0.1%, MFs: +0.0%, ETFs: +0.3%) gained inflows for the third consecutive week as MF inflows rose to their highest level since March. This was mainly driven by US equity mandates (+0.1%, MFs: +0.0%, ETFs: +0.3%); however, Europe also saw marginal inflows (+0.0%, MFs: +0.0%, ETFs: -0.1%) thanks to the domestic support of 10-month high Euro-denominated flows (+0.1%). Japanese peers however continued to suffer (-0.4%, MFs: -0.4%, ETFs: -0.4%).

EM equity funds (-) with EMEA (+) but Asia x-J & LatAm (-): EM equity funds (-0.2%, MFs: -0.3%, ETFs: -0.1%) extended their negative run into their fourth week with the diversified GEM categories bearing the major brunt (-0.3%, MFs: -0.4%, ETFs: -0.3%) of strong dollar and free trade concerns. Regionally, rising oil prices helped EMEA equity funds to see highest inflows since Feb'15 (+0.5%, MFs: +0.3%, ETFs: +0.9%), but outflows prevailed in LatAm (-0.8%, MFs: -0.7%, ETFs: -0.9%) and Asia ex-Japan (-0.1%, MFs: -0.3%, ETFs: +0.1%).

Bond funds (--) with sell-off across the board: Total bond funds (-0.2%) experienced outflows yet again with broad-based losses across sovereigns (-0.5%), IG (-0.1%) and HY (-0.1%) Regionally, EM bond funds (-0.9%) as well as DM peers (-0.2%) continued to see sizeable outflows European bonds in particular (-0.5%) came in at the lowest level since Jun'15.

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FX Daily — Five forces for the yen

After a sharp one-way rally since the US election, we have seen the first real dip in USD/JPY this week. We examine five forces to track for the yen:

1. Relative real yield spreads. The golden relationship for USD/JPY has been with US-Japan real yields. For context, another 30bps move in this spread would be consistent with USD/JPY north of 120. After a sharp run-up in US yields though, further upside will likely require Trump's fiscal plans to take shape, and the market to price a more aggressive 2017 Fed path. There could eventually be more contribution from Japanese real yield compression, if inflation expectations in Japan finally perk up -- the labor market is tight, and Abe is putting emphasis on wage negotiations next spring.

2. Japanese buying of Treasuries. According to weekly data, the Japanese sold overseas debt after the US election, but with 10Y USTs now offering a 50bps pick-up on a hedged basis, we would watch whether these flows resume. To the extent that Japanese buyers provide support for Treasuries, and help cap US yields, they could ironically even work against USD/JPY upside!

3. Hedging behavior of domestic players. Will Japanese asset managers and corporates fade USD/JPY strength by adding to hedges? The latest data from major life insurer balance sheets show the largest jump in hedges between Mar-Sept 2016 since the GFC. Net short USD forward and put positions made up 64.8% of total assets by Sept, with hedge ratios the highest since late-2010 when USD/JPY was trading in the 80s. This could mean lifers are now slower in adding to hedges, despite the "better levels" and may even be under pressure to unwind hedges put on at lower spot levels. Hedging activity by nature tends to be more trend-following rather than opportunistic in nature.

4. Risk and volatility. Positive risk appetite and an easing in developed equity vol have been supportive for USD/JPY. While JPY weakness is typically seen as driving Nikkei via better corporate earnings, there is likely also some positive feedback from addition of long USD/JPY hedges on foreign holdings as stocks rally. The resilience of risk is thus important, and prone to upset should the Italian Referendum this weekend produce a market-unfriendly outcome. A 1 point rise in European equity vol is associated with 0.2% strength in the JPY based on a one year regression of daily changes. If EUR Stoxx vol returned to June highs, this could be consistent with a move in USD/JPY to 108.

5. Valuations. The JPY is already the cheapest currency in the world on an average of our models, which could be a hurdle for significant further weakness. However, it is still about 3.5% from undervaluation extremes reached in 2015, which is roughly consistent with our 115 forecast.

The rapid post-election run in spot, pause in US yields, and potential political risks argue for some near-term caution with USD/JPY longs. Our FX gamma report also shows spot slightly slippy to the downside now. We would wait for dips to add to USD/JPY longs. Alternatively, a 2M 110 call with a knock-in at 108 costs 0.43% (indicative), less than half the cost of a 2M 114 call.

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Asia Economics Special EM Vulnerability Monitor: Headwind from the US

- We update the indicators of macro and structural vulnerabilities in 26 EM economies. This exercise assesses the susceptibility of emerging market countries to economic crises or a period of painful adjustment should external conditions worsen.
- EM has been under pressure since the US election results in early-November. FX selloff, yield curve steepening, sharp capital outflow, political noise, trade-related uncertainty, and lackluster growth in most of the economies under our coverage have caused considerable economic uncertainty and policy dilemmas. Capital flow volatility and political noise could well rise in the coming months and quarters.
- The immediate risk is that relentless capital outflows could weaken currencies and make debt expensive enough to warrant sharp demand adjustment in some EM economies. Those ranked as highly vulnerable in our analysis are clearly under scrutiny at this juncture.
- There have been some notable changes in the top cohort of high risk economies in the vulnerability exercise. Latin America still dominates, with Venezuela, Brazil, Argentina, and Colombia ranking among the most vulnerable economies. But Colombia's vulnerability has eased markedly. On the other hand, South Africa's ranking has worsened materially. Generally, these economies are still struggling to get out of a pernicious nexus of weak growth, high inflation, poor fiscal position and high debt.
- China remains in the high-risk category in this iteration. Weighed down by a sharp decline in growth momentum, an overvalued currency, and a heavily-leveraged corporate sector, China continues to struggle in taking steps to correct financial imbalances without undermining the growth dynamic. Rapid credit growth and frothy equity and property markets add to its vulnerability.
- Turkey has retained its high vulnerability score, despite slowing credit growth. A combination of domestic and external shocks has lead to substantial slowdown in growth momentum, while inflation has remained elevated.
- We find India, Malaysia, Chile, Hong Kong and Singapore in the medium risk group, although the Asian economies in this cohort have seen a general worsening of their rankings. If friction in global trade rises in the coming year, as feared, Asia will clearly be on the receiving end more than any other region, given its dependence on trade and commerce.
- At the favorable end of the risk spectrum, Russia and South Korea edge in, although the latter's outlook is likely to be affected by the ongoing political turbulence. Mexico has been under tremendous market pressure lately, but its vulnerability scores are broadly neutral. Hungary, Peru, Poland, Romania, and Thailand comprise the top-5 of the low risk cohort.
- While not captured in our metrics, the political dimension is critical to consider as well. Political noise in Brazil, Malaysia, South Korea, South Africa, and Turkey are particularly relevant in this context.

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JAPAN FI Flash memo Is a "BOJ trade" also possible in the stock market?

- Four months have now passed since the BOJ hiked its equity ETF purchases to JPY6 trillion a year on July 29. It would appear that the probability of purchases has increased by comparison with QQE1 and QQE2, with operations having been conducted on 100% of the occasions when the TOPIX index has fallen by at least 0.5% from the previous day's close by the end of the morning session. We also note that the index has been more likely to rise during the afternoon session on days when such operations are conducted on averaged basis. It might therefore be worth considering a "BOJ trade" that entails buying ETFs at the end of morning sessions where the TOPIX index has fallen by at least 0.5% and then selling at the close of the afternoon session.
- Domestic stock prices had been quite closely correlated with foreigners' net purchases of Japanese equities from September 2012 onwards, but August–September of this year saw stock prices hold firm despite a net selloff by foreigners, suggesting that the BOJ's ETF purchases were indeed successful in shoring up the market. Foreigners' cumulative net purchases of Japanese equities peaked at around JPY21 trillion in May 2015(from Sep 2012), while the BOJ's cumulative net purchases of equity ETFs will be slightly above that level by end-2018 at the current pace of buying. With banks and life insurers having already reduced their ownership shares quite significantly and foreigners seemingly the only sizable sellers, we see ample potential for the BOJ's ETF purchases to lend further support to domestic equities.

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US Daily Economic Notes Consumer attitudes can be telling

Commentary for Today: As we discussed last week, many economic data series are backward looking since they have not yet captured the expected shift in fiscal policy, which should be substantially stimulative for real GDP growth. In this regard, this morning's consumer confidence report for November, as well as the Chicago PMI and manufacturing ISM surveys (released Wednesday and Thursday, respectively) take on elevated significance. To be sure, these data will likely capture only some of the consumer and business reactions to the outcome of the US Elections. Thus, we expect the Chicago PMI (52.0 vs. 50.6) and the manufacturing ISM (52.0 vs. 51.9) series to improve only slightly. However, the trends in these forward-looking indicators will be increasingly important to monitor as more details of the incoming Congress' spending and tax priorities are unveiled.

Now that bond market participants have fully priced a 25 basis-point (bp) rate hike at the December 14 FOMC meeting, attention is turning to prospects for monetary policy next year. Since the details of the incoming administration's fiscal priorities are still unknown, it is too soon for the Fed to materially rethink its stated strategy of "gradual" rate increases. Thus, at this point, we expect the Fed to continue to project just two more rate hikes in 2017 when the Committee releases its latest Summary of Economic Projections (SEP) at the December meeting. In the absence of concrete information on the fiscal outlook, developments in the labor market and inflation will be the key factors with respect to the Fed's intermediate-term expectations for monetary policy.

For the Fed to become more hawkish, the labor market would need to outperform the Committee's current SEP forecasts. Recall that the current median FOMC estimate of the unemployment rate for yearend 2017 is 4.6%. If our forecast of a 150k gain in nonfarm payrolls in November is close to the mark, the unemployment rate should remain unchanged at 4.9%. This morning's consumer sentiment data may provide some clues in this regard as consumer attitudes can be a decent indicator of the underlying health of the labor market. As the chart below illustrates, the difference between the percentage of respondents in the consumer confidence survey who view jobs as "plentiful" and the percentage of those who view jobs as "hard to get" is highly correlated with the U-3 unemployment rate. In the current business cycle, the jobs-plentiful / jobs hard-to-get differential peaked at 5.3 percentage points in September, as 27.6% of respondents saw jobs as plentiful while 22.3% viewed jobs as hard to get. This differential slipped modestly in October to 2.2 and has yet to reach its previous-cycle peak of 11.4 (March 2007). In turn, there is likely some scope for further improvement. Greater consumer optimism with respect to job prospects could signal a more rapid improvement in the labor market than monetary policymakers currently expect.

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Bridgestone

Hold

Reuters: 5108.T Exchange: TYO Ticker: 5108

Buy to Hold, tgt JPY3,850 to JPY4,400

Price (¥)	4,349
Price target - 12mth (¥)	4,400
52-week range (¥)	4,420 - 3,140
Market cap (¥bn)	3,406
Shares outstanding (m)	783
Foreign shareholding ratio (%)	31.6
TOPIX	1,470

FYE 12/31	2015A	2016E	2017E
Sales (¥bn)	3,790.3	3,331.6	3,597.2
OP (¥bn)	517.2	454.5	476.4
RP (¥bn)	507.3	442.0	479.4
NP (¥bn)	284.3	260.9	306.4
EPS (¥)	363	333	391
P/E (x)	12.5	13.1	11.1

Adjusting earnings for materials and forex

We have adjusted our earnings assumptions at Bridgestone for a weaker yen and higher raw material prices. While large market themes, we actually do not view either as large net drivers of earnings in FY17, with positive forex being offset somewhat by some negative material price impact. Our net change to our earnings outlook is only 3.5%. Applying 11x PER and 5x EV/EBITDA to FY18 earnings we get a TP of ¥4,400. With only 1% upside to our revised target price we are revising down our ratings from BUY to HOLD.

We are not overly concerned on materials, nor are we excited on forex

In this note we apply new ¥/US$ and material prices assumptions given recent moves. For forex, Bridgestone has relatively low sensitivity to the ¥/US$ (0.7% change to OP for each one-yen change) when compared to our Auto OEM coverage (1.5-2.5%). Our new assumption of ¥112.5/US$ (from ¥100/US$) implies modest forex upside YoY in FY17 (¥13bn) against a FY16e average of ¥108.5/US$. Material prices are a much more uncertain variable on a standalone level. Natural rubber and synthetic rubber have spiked of late and we have tried to capture this assuming a 34% increase in natural rubber and a 22% increase in synthetic rubber prices. That is not the key assumption for 2017, however. The key assumption is the rate of pass-through. There we are confident the industry will maintain a high level of discipline. We assume 90% in FY17 given a time lag to raise prices, followed by 110% in FY18. In that sense we have assumed a net headwind of ¥13bn from materials in FY17. At least for FY17 we believe this assumption may have downside risk unless pricing in N.America commercial vehicles tires can stabilize.

Operating performance mixed, while management actions positive.

Bridgestone is finishing up a mixed year of performance. The shares have outperformed TOPIX by 9% CYTD and are up 27% over the last 3-mths despite fundamentals (ie. lack of growth) having disappointed initial assumptions. We think share price performance has been helped by positive management decisions. It first backed out of a deal for Pep Boys when it became too rich. It next guided for a 35% payout in FY16 and then kept that ¥140 promise flat even when it revised down at the half pushing the implied payout to 43%. Operationally, however, the company continues to struggle to find consistent growth with production likely to finish down about 1%. Performance was hurt by weak N.American commercial tire operation and pricing in low-end tires. High-end tire sales are relatively stable, but are not showing signs of market share growth. Overall, while input price volatility raises some questions on the level of pass-through, we see sector replacement tire mix trends and modest improvement in the ultra-large mining tire business as supportive of earnings growth (OP ¥476bn, +4.8% YoY).

Valuation/Risks – Raising target price to ¥4,400 (from ¥3,850)

Our TP is set at FY18 11x PER and 5x EV/EBITDA (up from 10.5x and 4.5x FY17). We have bumped up our valuation metric somewhat on positive shareholder moves this year and for reference this is in-line with DB target multiples at rival Michelin. Overall, sector dynamics are supportive of strong margins we continue to believe, while FCF should remain strong on limited capex needs. As it relates to the dividend, as BS is outside of its projected boundaries (20-40% payout) we do not expect further action in FY17, nor do we expect to see consideration of share buybacks as projected ROE is in-line the company target 12%. Risk to the upside include strong growth in N.America. Risks to the downside include more limited ability to pass on higher material prices.

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Italy Special Report — Risks after and beyond Italy's referendum

- After Brexit and Trump's victory, the next key political event is Italy's 4 December referendum on the Senate reform. On 11 November we have published our in-depth analysis of this topic. In this article we consider the main downside and upside risks to monitor in the short and medium term.
- Italy's government bond and equity markets have underperformed recently. Hence, the impact of a "No" outcome may already have partially been reflected in asset valuations. Still, when looking at implied moves from options, the equity market seems to be mostly pricing in limited probability of extreme scenarios. An apparent lack of concern over contagion risk is even more apparent in broader European indices such as E-STOXX 50.
- *Short-term downside risk: in our opinion the key factor to monitor is the banking sector.* In the case of a "No" victory we continue to believe that PM Renzi will resign. If we are correct markets will have to deal with a "No" and the risk of a government vacuum. Markets could react negatively, with the risk of particular stress on the Italian banking sector. If a solution is not found swiftly stress could quickly mount above July 2016 levels.
- *Medium-term downside risk: under a prolonged muddle-through scenario there is a risk of market complacency as investors dismiss it as Italy's status quo.* We see a non-trivial risk that a new, prolonged period of ineffectual governments leads to systemic instability in the medium term. A muddle-thorough scenario means a very low likelihood of significant reforms; in our view Italy's economy will continue to perform poorly in both absolute and relative terms. We do not see this as a sustainable equilibrium. Hence, over the medium-term there will have to be a convergence to either a pro-reform government or a euro-sceptic government. Our concern is that the longer Italy is stuck in a muddle-through strategy, the higher the support for euro sceptic parties will likely grow. In current polls, Italy's three euro-sceptic parties already capture a cumulative 44% of potential votes.
- *There could be room for a material rebound in Italian assets, driven by banks' equity prices, in the case of a "Yes" victory*. (i) In our opinion market expectations are tilting towards a "No" outcome. (ii) The proportion of undecided voters was still very large when the latest opinion polls were conducted before a two-weak black-out period ahead of 4 December. (iii) Italy's equity market has significantly underperformed in 2016. The underperformance the banking sector has recently accelerated.
- *Medium-term upside risk: an unlikely systemic solution.* We expect no immediate proactive systemic solution for the banking sector even if the Senate reform is approved. We could be too pessimistic. A systemic solution to the banking sector could be a chance of turning the current growth-banks-politics vicious circle into a virtuous one and revitalize the reform process. In the case a proactive systemic solution is implemented we would significantly revise upwards our GDP forecasts.
- The last section analyses option markets and potential hedging strategies for investors looking for either (a) downside hedges in case of market contagion concerns, or (b) upside surprise hedges, in case they are already bearishly positioned into the referendum, but want to hedge against a "Yes" result.

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Economics Special Report China outlook 2017: property bubble, RMB, and growth forecasts

The Chinese government faces a policy dilemma in 2017. We believe they will achieve the 6.5% growth target with strong fiscal easing. But this requires further credit expansion, which would exacerbate the risk of property bubble and intensify capital outflows. We expect FX reserves to fall to US$ 2.8trn in 2017 and 2.4trn in 2018, and USDCNY will depreciate to 7.4 by end-2017 and 8.1 by end-2018 (6.9% and 17.1% from the current level of 6.92). We see macro risks rising beyond 2017, with 50% chance that growth will drop below 6% for a full year sometime between 2018 and 2020.

The property bubble

We believe this is the most important macro issue in China (see our report *China's property bubble* issued on Sept 28). Land sales accounted for 36% of local government revenue so far this year, and mortgage loans accounted for 43% of new RMB loans (63% in July to Oct). Policies tightened in this sector, property and land sales dropped in Oct, but land auction premium remained high in some cities. This shows some developers continue to expect sharp property price inflation to come.

In the next few months we believe the government will put further pressure on developers by tightening broad credit growth. Property sales and investment growth will likely slow further in 2017Q1. Local government land revenue may weaken by 2017Q2. We expect the monetary policy stance to shift towards easing in 2017Q2, to avoid further slowdown in the property sector and fiscal revenue.

17% RMB devaluation by 2018

RMB depreciated by 6.4% against USD so far in 2016, while the DXY index for the US dollar appreciated by 2.8%. Taking DB forecasts for other currencies, our forecast implies 2.1% and 12.1% depreciation against the PBoC basket in 2017 and 2018, respectively. The depreciation against our proprietary RMB basket would be 1.4% in 2017 and 7.5% in 2018.

We expect the pace of RMB depreciation to pick up in 2018. This is because we expect FX reserves to fall below US$ 3trn by 2017Q1 and US$2.5trn by 2018Q3. We believe the rise of capital outflows in Q3 this year is the beginning of a structural trend. It reflects a change of expectation among onshore investors and corporates on RMB outlook, partly due to their concerns on the property bubble. The rate hikes in the US will likely exacerbate the outflow pressure

Stable growth in 2017, higher risks beyond

We expect China's economy to grow 6.5% in 2017 and 6.0% in 2018.Fiscal policy will likely be loosened in 2017 as quasi fiscal spending pushes up growth of infrastructure investment. On monetary front, the PBoC may keep the benchmark interest rates stable, but loosen credit supply in 2017Q2 to mitigate the slowdown in property sector. CPI inflation will likely pick up to 2.5% in 2017 from 2.1% in October 2016.

Risks to our growth and inflation outlook in 2017 are tilted to the upside, while risks to our rate and RMB forecasts are balanced. We see macro risks to rise beyond 2017. The debt to GDP ratio is set to go up. The property bubble will impose more macro risks, the US rate hikes will further constrain the policy room for PBoC, and the excessive liquidity onshore will likely drive inflation up eventually.

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Economics Special Report The risk of de-globalization: a US-China trade war?

We do not take an outbreak of a US-China trade war as our baseline case. But the Brexit vote and the US election clearly show how the conventional wisdom in economics may backfire these days. We need to think of the previously unthinkable as risk scenarios, and want to make three points in this report.

China only accounts for 16% of the US trade deficit

The headline trade data suggest China accounts for 50 percent of the US trade deficit in 2015. That is misleading. Around 37 percent of China's exports to the US consisted of imported parts from other countries. After making proper adjustment for global supply chains, we find that, on a value-added basis, only 16 percent of US trade deficits in 2015 came from China, slightly higher than 13 percent from Japan and 11 percent from Germany. We note a trade war against China would be a war against all participants of the global supply chain, including some US companies.

Scenario: Winners and losers in a US-China trade war

What industries would the US target in a trade war? Assume that the US takes serious actions to (i) reduce trade deficit, (ii) boost domestic growth; and/or (iii) "bring jobs back to the US". We find industries that stand out are (Figure C2):

- Electronics, including computer and phones;
- Electric equipments;
- Textile and apparel;
- Furniture; and
- Automobile.

This shows the difficulty to target China in a trade war: higher tariff on furniture, textile and apparel will likely drive the deficit to other developing countries; China doesn't export that many cars; electric and electronic products are often made by multinational companies using imported parts.

<u>Winners and losers by country</u> We track the data on global supply chain and US imports, which allows us to estimate the potential impact on other countries. If the US imports from China are down by 10% and the vacuum is filled by other exporters to the US, we find countries that benefit most would be: Mexico (overall exports up 3%), Vietnam (1.7%); Canada (1.3%); Pakistan (1.1%), and the Philippines (0.9 percent).

<u>China's potential retaliation</u> Should the US wage a targeted trade war—focusing on certain industries, China's retaliation would probably be selective as well. The most likely target sectors we identify include: aircraft, seeds and fruits, pulp, and some other agricultural products.

An alternative and more sensible scenario

The rhetoric of a trade war might well be a threat that intends to bring China to the negotiation table. The two countries could find other ways to reduce the bilateral trade imbalance, including for instance, China importing more goods from the US, or China removing restrictions and expanding services trade with the US, where the US has been running surplus. Under such a scenario, the biggest winners could be the aircraft industry, high tech firms and service sectors in the US.

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Appendix 1

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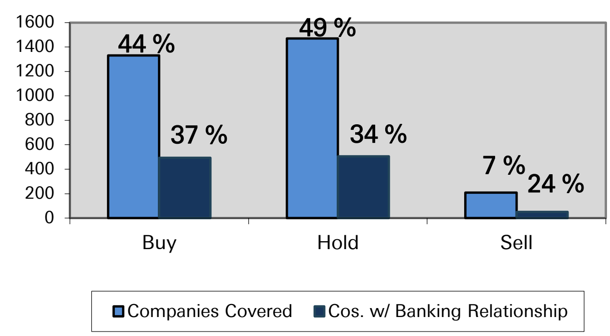

Global Universe

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