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Global Outlook: Asset Allocation

Navigating markets in 2015: 8 core macro themes and a few consensus risks

November 2014

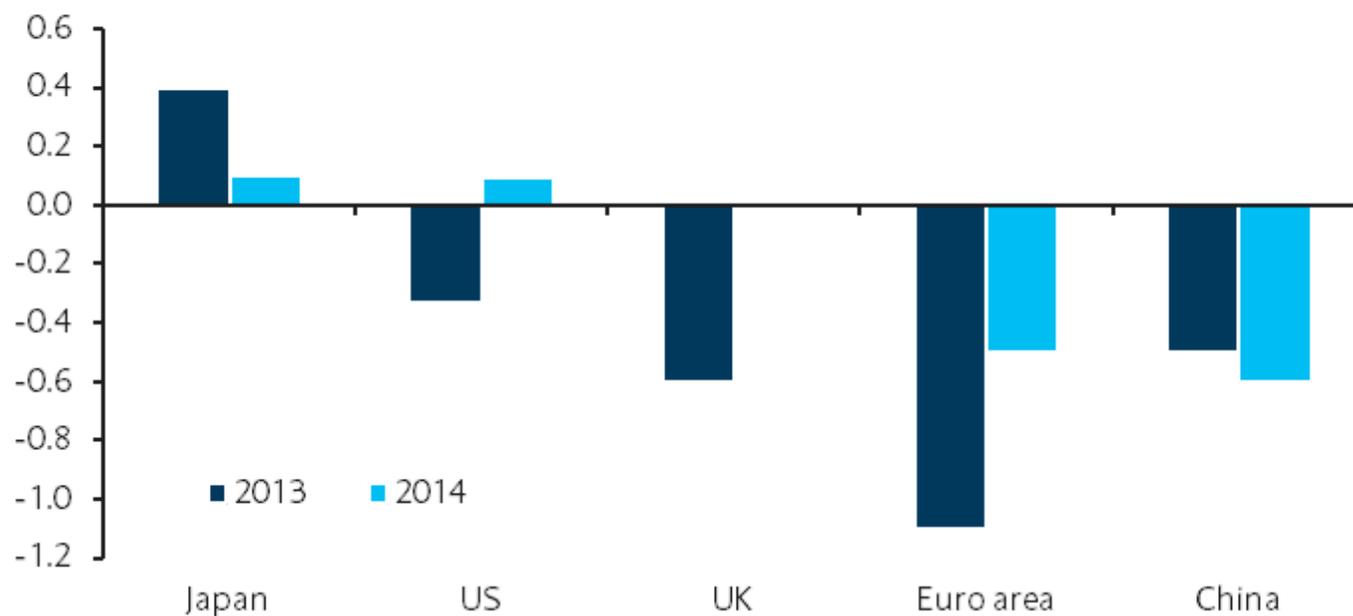
Theme 1: Underweight bonds, overweight equities should work this time around

Stick with balanced portfolio with modest equity OW

2014: deflation risks in Europe, more disinflation in China

Aggregate inflation surprises again lower in 2014

aggregate inflation surprise



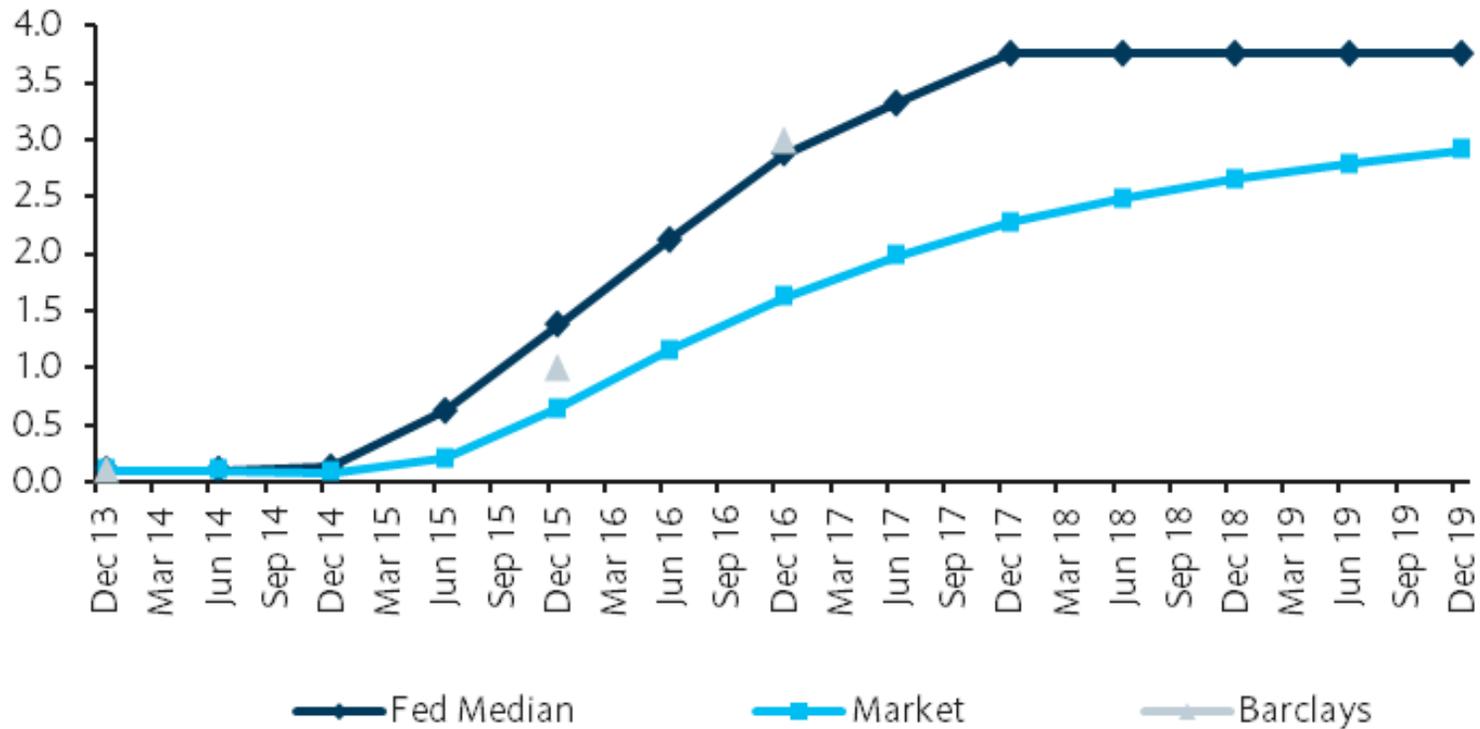
Source: Bloomberg, Barclays Research

Theme 2: The Fed will lift off in 2015

USD flatteners, lower portfolio returns and US equity UW

The market needs to price a faster pace of Fed tightening

Markets are still pricing rates well below the Fed's "dots"



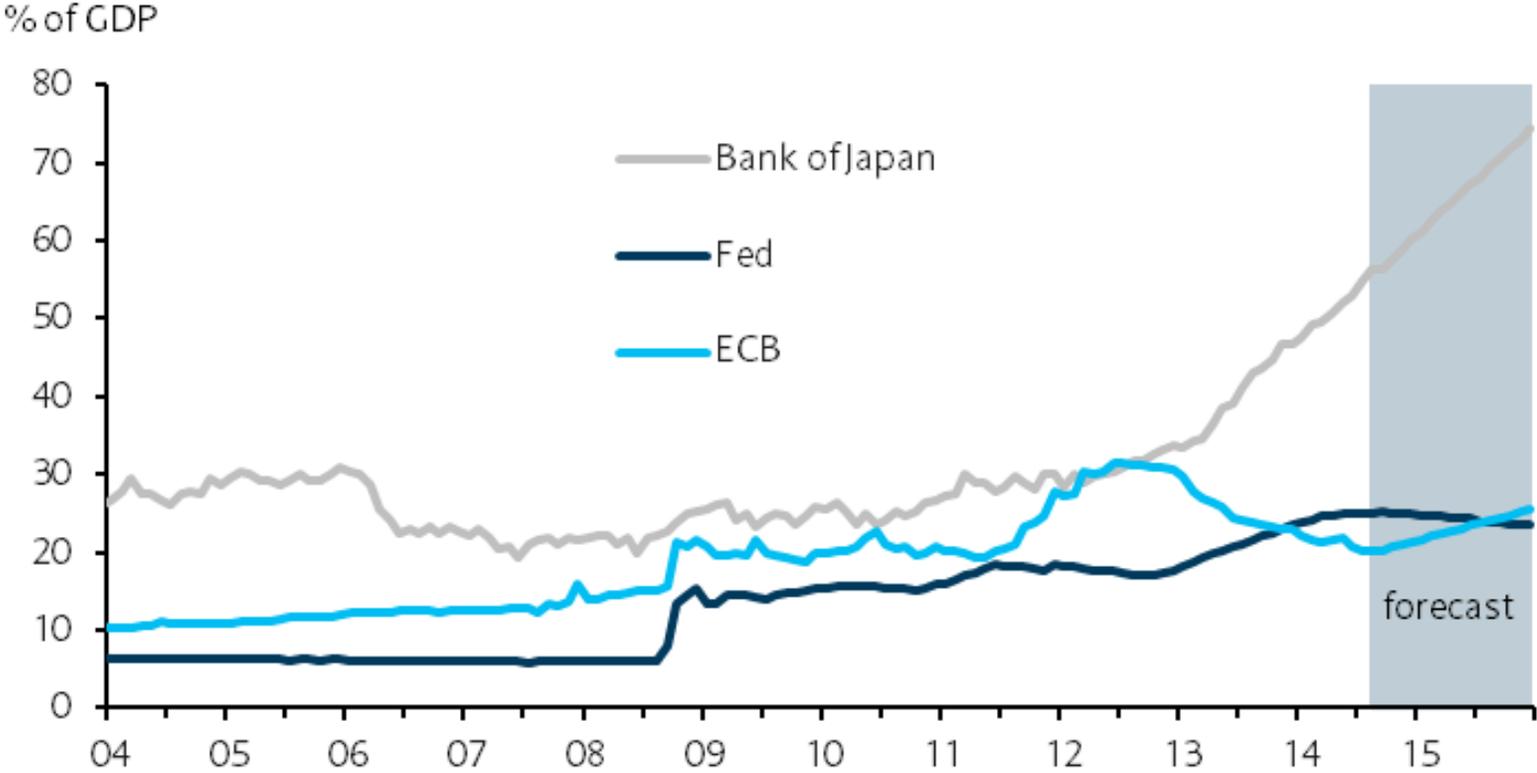
Source: Bloomberg, Barclays Research

Theme 3: Persistent US dollar strength

Long US dollar vs. majors, US rates divergence trades and OW non-US DM equities

Policy divergence will remain a key theme in 2015

Central bank balance sheets as a % of GDP



Source: Bloomberg, Barclays Research

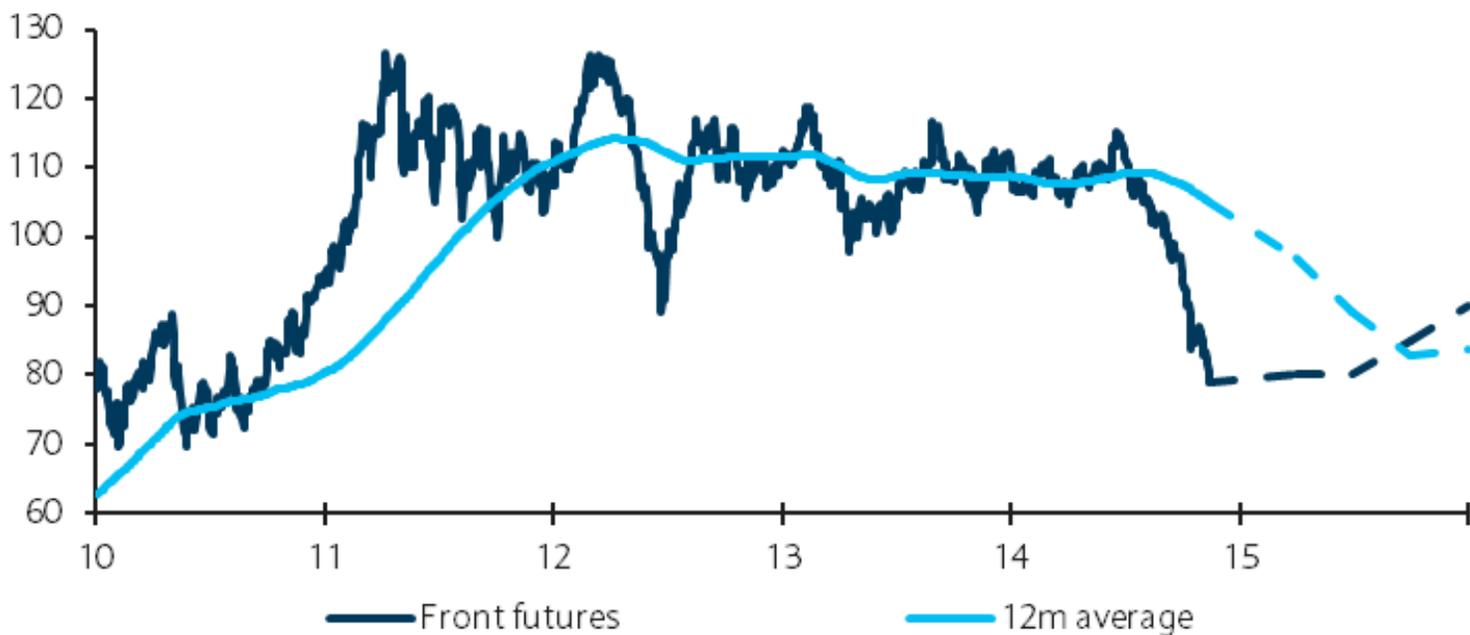
Theme 4: Lower oil prices: the negative implications are priced, the positive one less so

*Overweight consumer discretionary and Asia ex Japan;
underweight EM USD-based fixed income*

The oil price drop is substantial, and it should linger

Brent crude with Barclays' baseline forecast for 2015

Brent crude, \$ per barrel

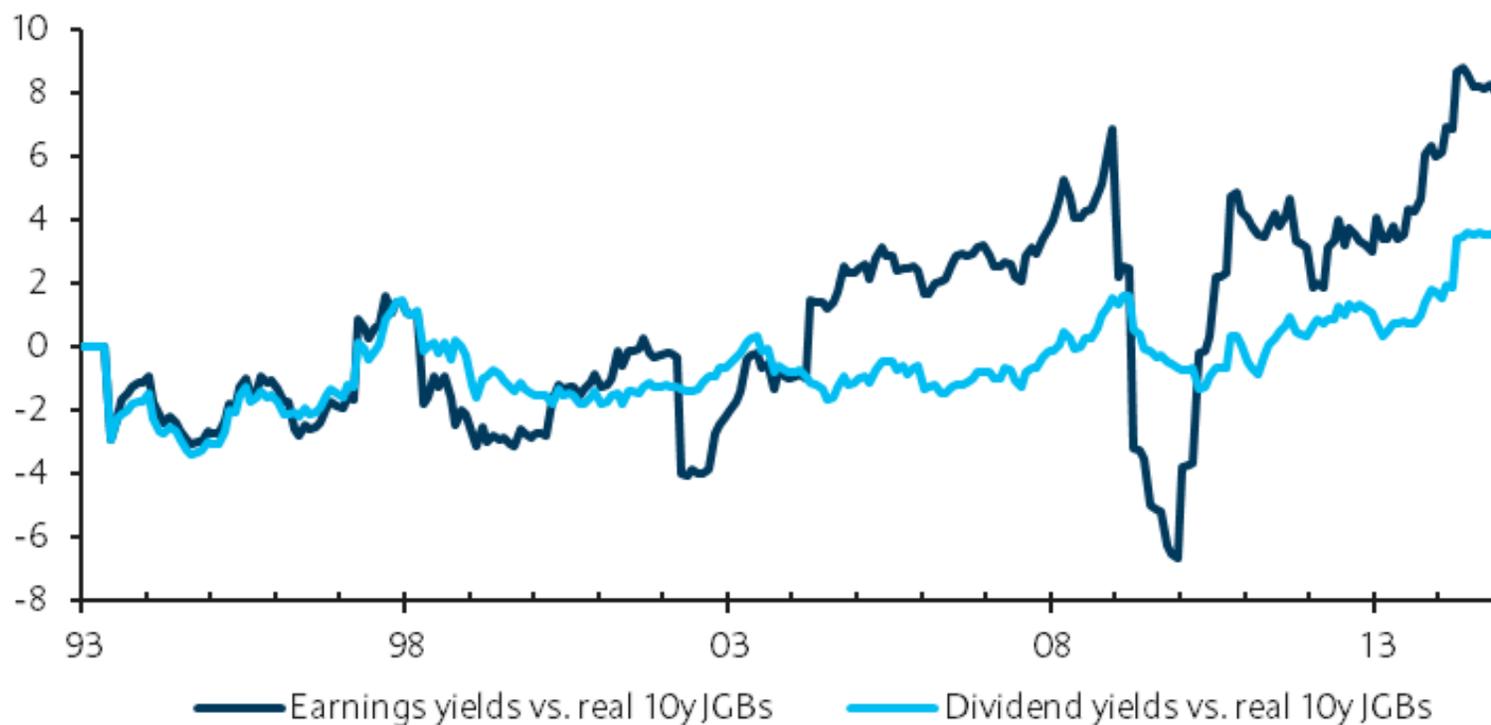


Theme 5: The Bank of Japan's bazooka

*Long equities (with large caps looking quite cheap), short the yen
and long JPY 10y breakevens*

Japanese equities: cheapest to JGB's for at least 20 years

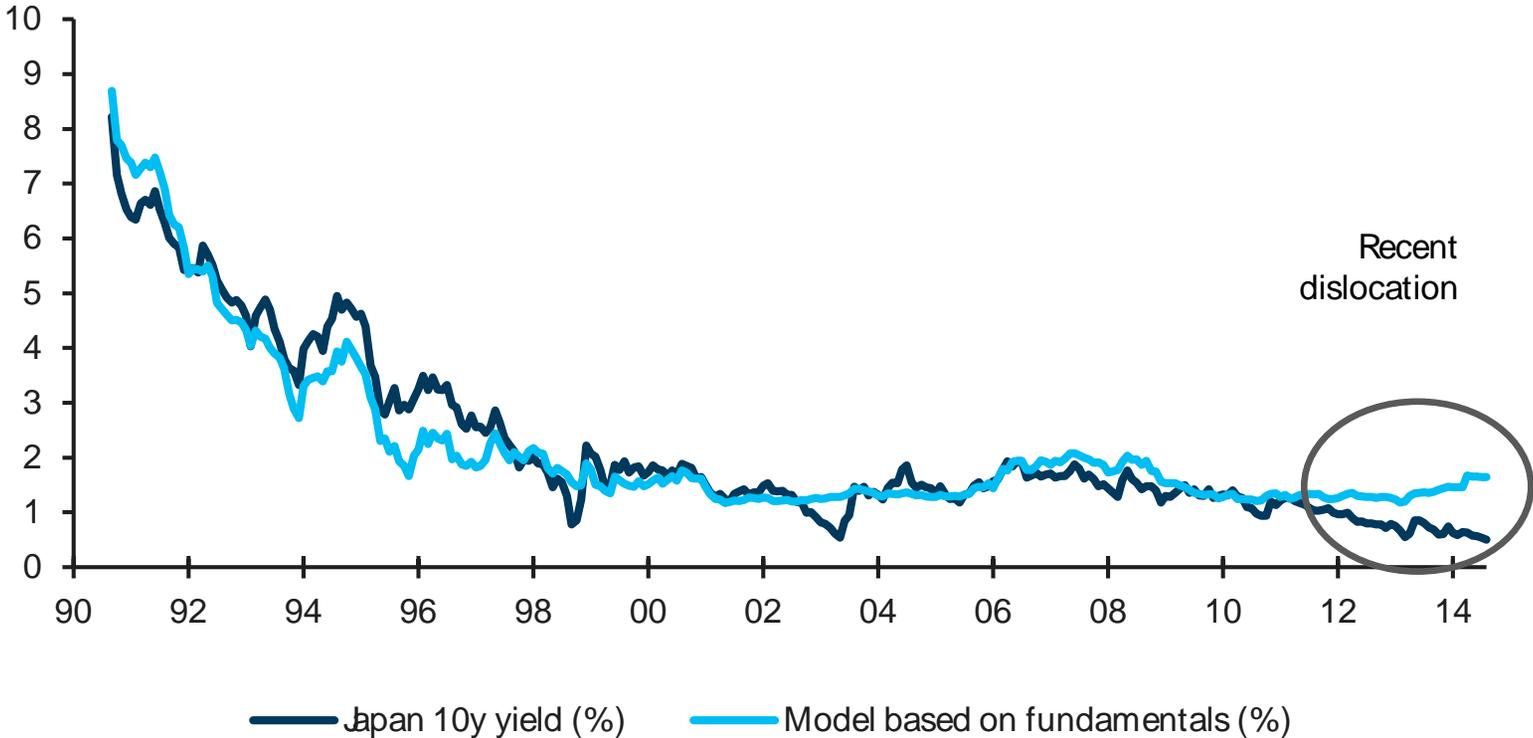
Real yield gap and dividend spread with JGBs



Source: Bloomberg, Barclays Research

Big negative asymmetry in 10y JGBs, but too early to sell

JGB 10y yields lower than its cyclical drivers predict



*10y JGB yields model based on JGB 2y yields, IP growth and core inflation (%/y).

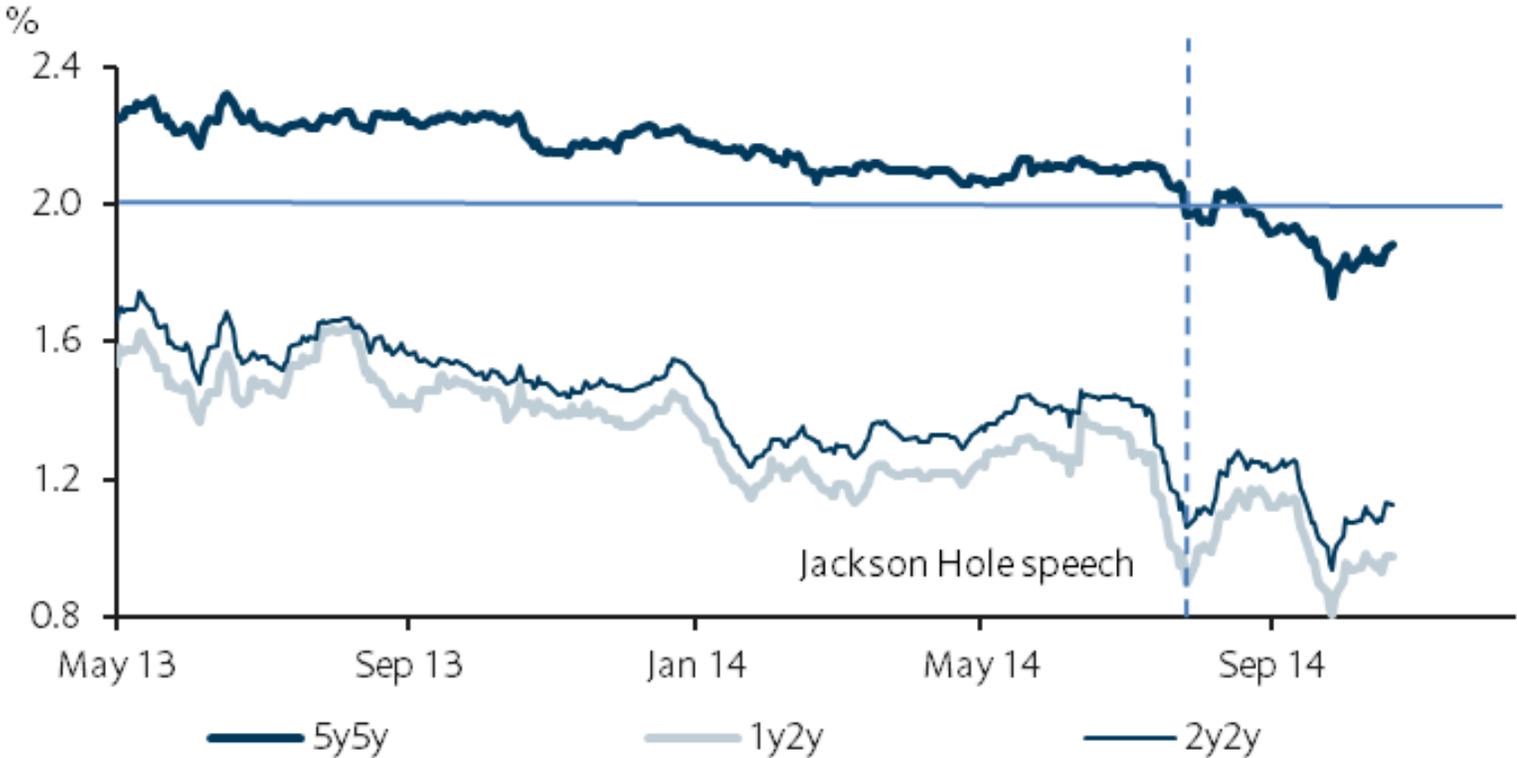
Source: Bloomberg, Barclays Research

Theme 6: Europe is priced for the Japan scenario, but the ECB can change that

Short euro, overweight bunds vs. Treasuries, overweight European equities

Inflation expectations are “de-anchoring”

EUR inflation swaps

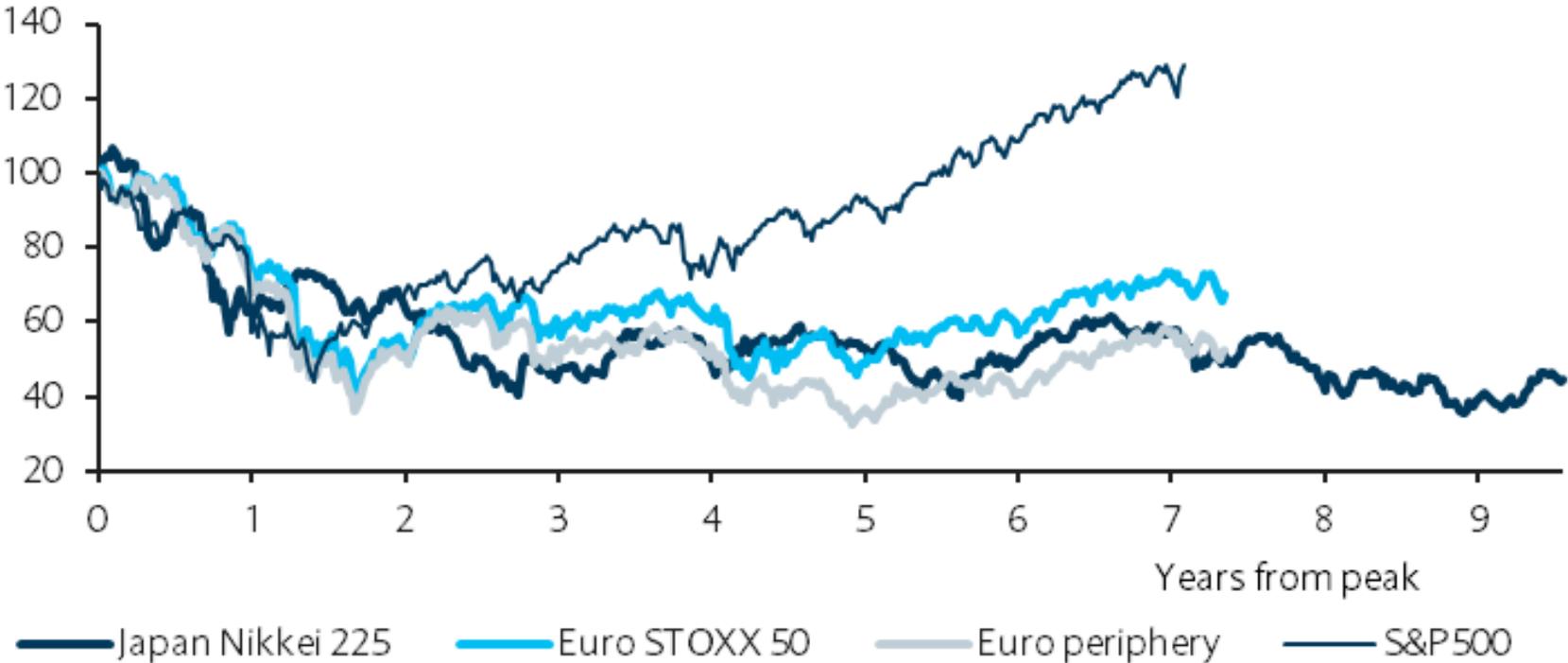


Source: Barclays Research

European equity markets look more like Japan than the US

Equity performance from pre-crisis peak

Japan: 12/1989=100; Eurozone: 07/2007; US 10/2007



Source: Barclays Research, Bloomberg

Theme 7: Broad negativity on global growth could be a good opportunity in 2015

Weak cyclically-link asset trend consistent with a weak cycle

Growth-linked assets price in quite a lot of bad news already

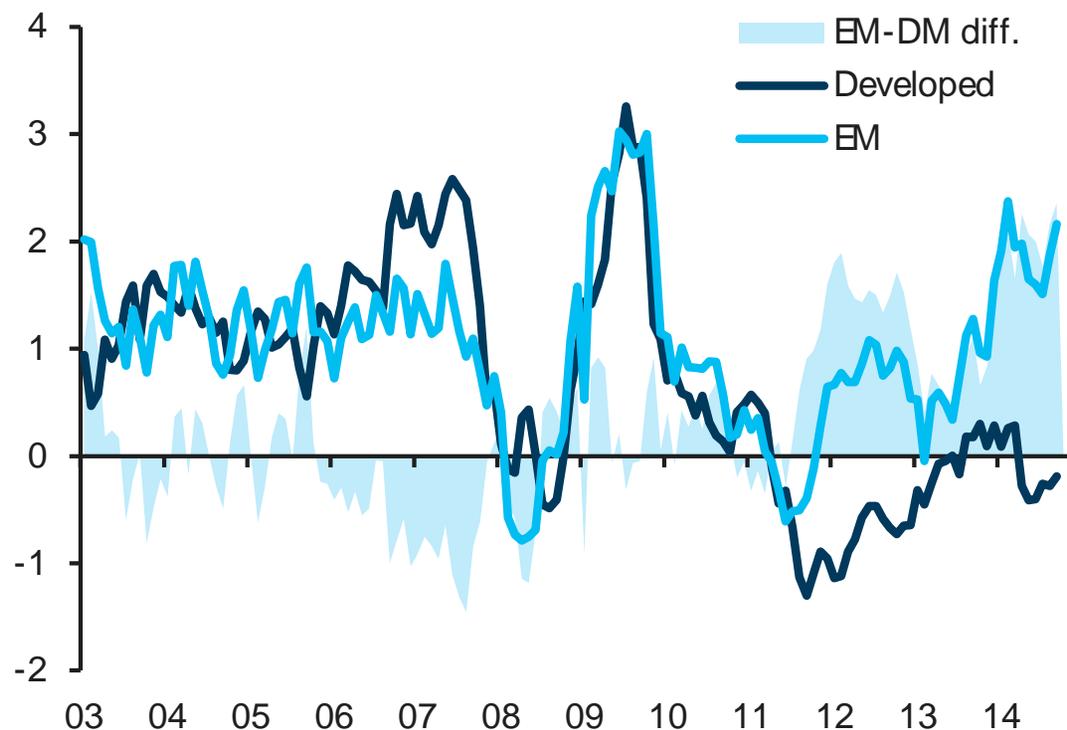


Source: Bloomberg, Barclays Research

Theme 8: Four headwinds for EM, but some opportunities as well

EM local debt: Real yields higher than DM but FX depreciation vs. USD to reduce returns

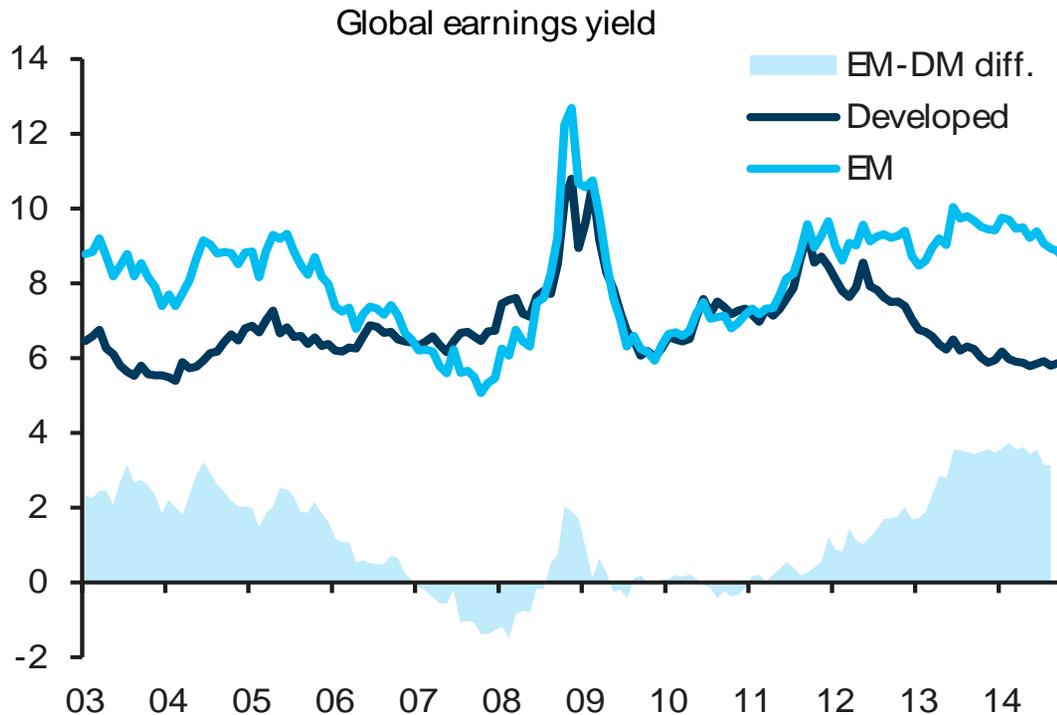
5y EM real rates are high versus DM real rates (%)



Source: Haver Analytics, Datastream, Bloomberg, Barclays Research

EM equity: earnings yields still attractive but not all is good

EM earnings yields (%) still attractive vs. DM despite recent fall



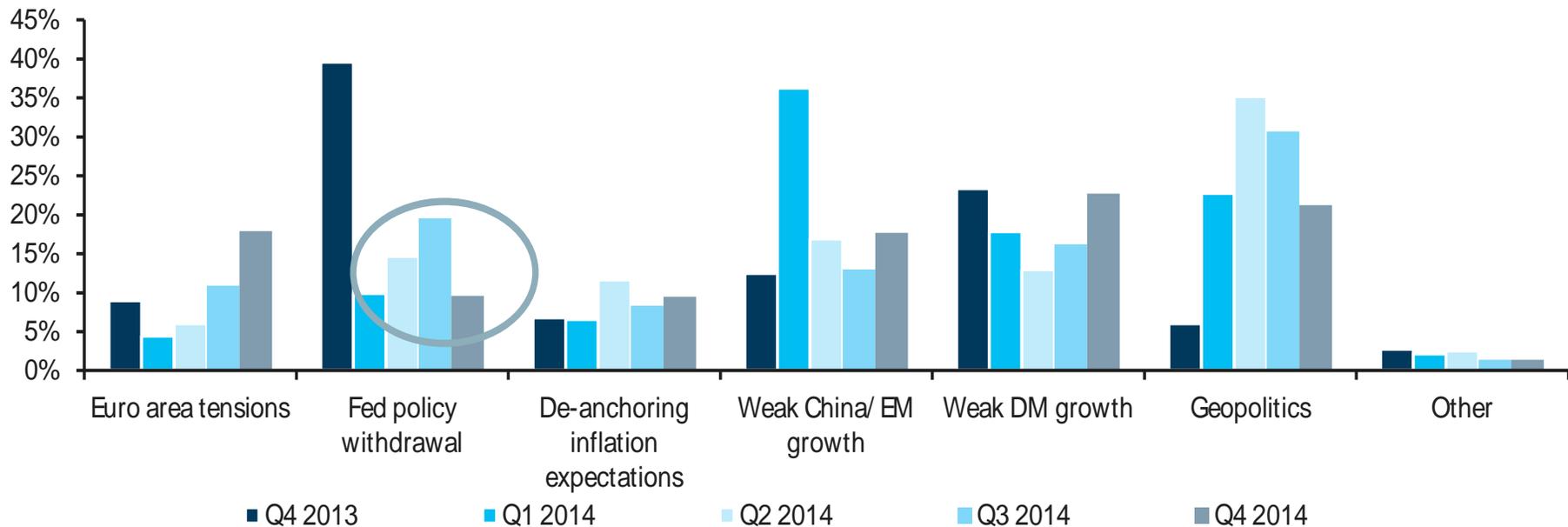
Favour beneficiaries of low oil prices and strong US growth: Kospi. Cautious on commodity producers

Source: Datastream, MSCI, Barclays Research

Theme 9:
What are the big consensus risks for 2015?

Little fear about Fed tightening

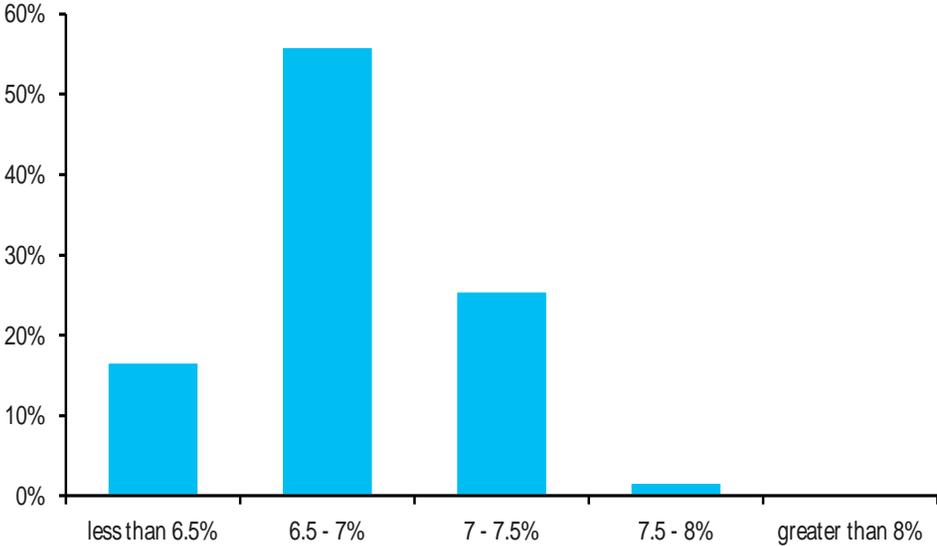
What is the most important risk to financial markets over the next 12 months?



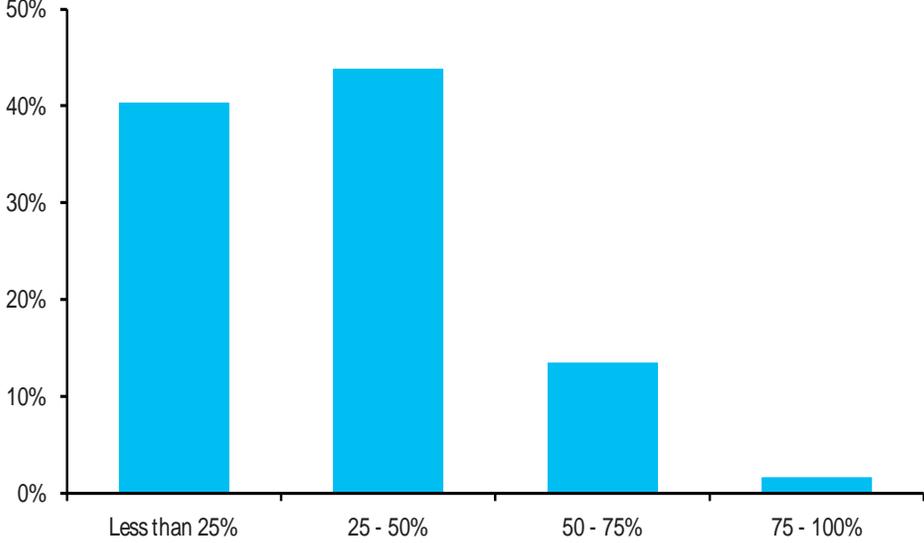
Source: Barclays Research

Increasing worries about China

What do you think China's growth rate will be in the next year?



What is the probability you place on a significant negative shock to China's economy over the next two years?



Source: Bloomberg, Barclays Research

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