OUTLOOK 2024

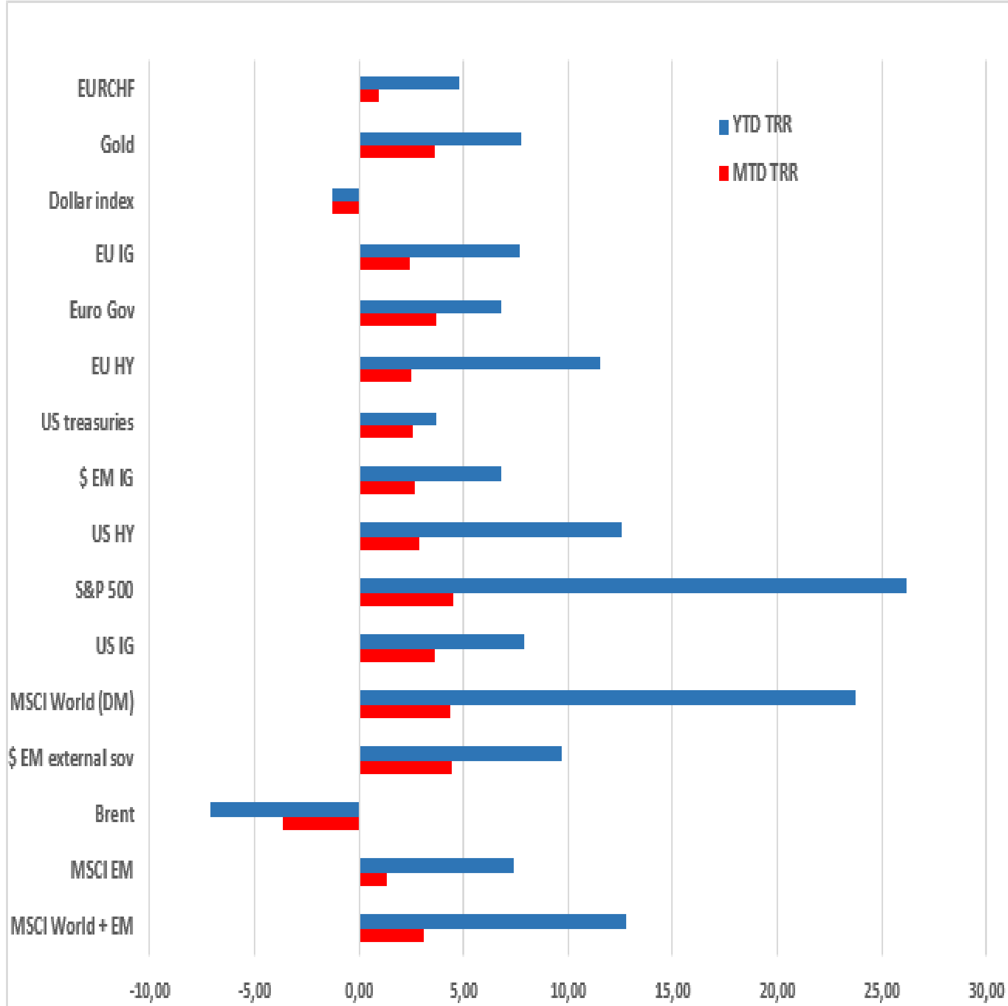
December 2023

BANQUE CRAMER

Where do we stand?

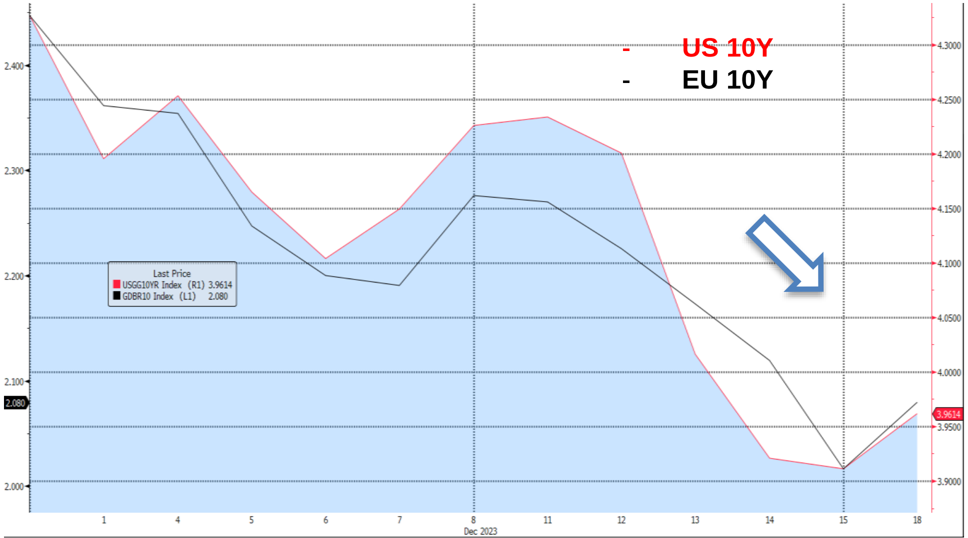
Asset Class Performance

- **FED, ECB, BoE, SNB kept rates on hold but the FED's dovish pivot has catalysed a notable drop in yields, taking them back to May level**: the US 10-year broke the 4% threshold to reach 3,90%. The front part of the curve mirrored the decline, keeping the spread between the 2-year and the 10-year tenors around -50bps
- **Powell "pivot" triggered panic bids in stock** with S&P 500, Nasdaq Composite, and Dow Jones recorded their 7th consecutive week of gains
- **Credit enjoyed the rally on core sovereign bonds and the tightening in spreads**, especially the high beta spectrum
- **US dollar slightly weakened while the EURCHF reached 0,94036,** the strongest level since the currency cap was removed
- **Oil hit new lows** on oversupply concerns and softening demand and gas prices have fallen to the cheapest level of the year



Bloomberg

Strong Rally on Core Sovereign Yields



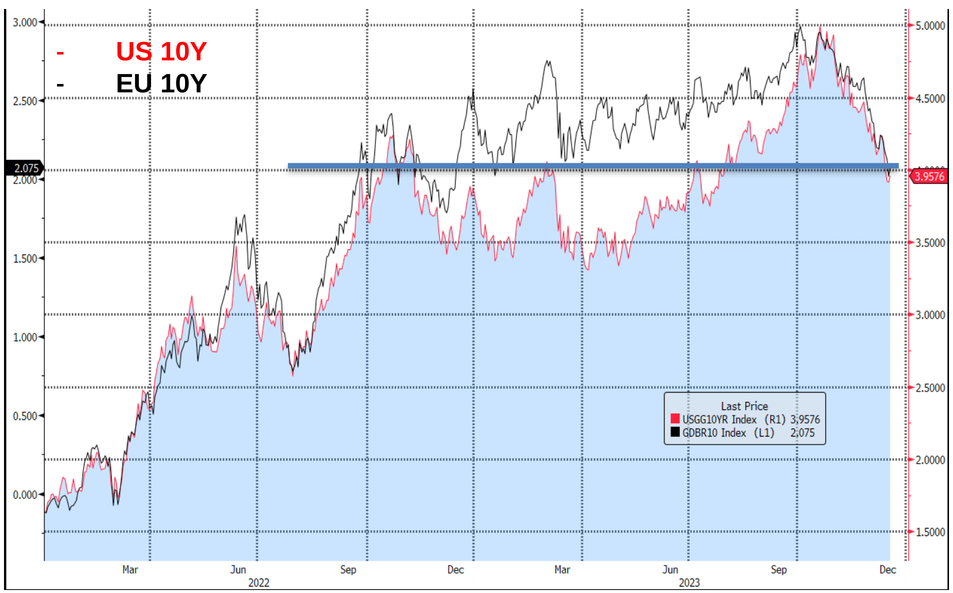
Source: Bloomberg

- Powell «pivot» triggered panic bids in bonds, with the 4% threshold broken on the US 10Y

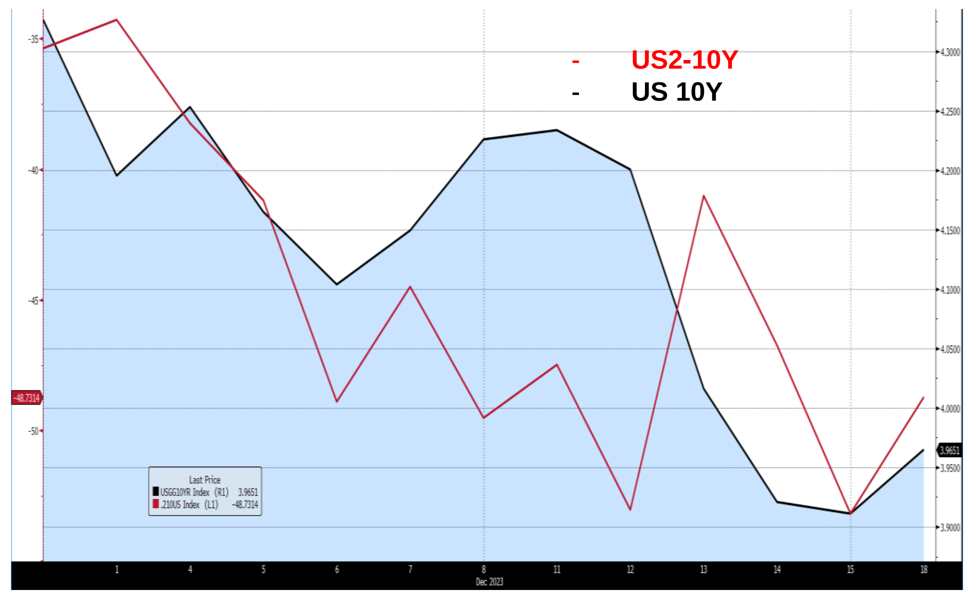
- The upward movement of 2023 has almost been wiped out in the US (The US 10-year closed 2022 at 3.74%) while the German 10-year is already below the 2022 closing price at 2.44%, making Euro government bonds outperforming US Treasuries

- -A strong rally has been observed on Peripherals, with the Italy 10-year bonds trading at 3,20%

- Flattening of the US curve along with the US Treasuries' rally: well-anchored in negative territory at approx. -50bps



Source: Bloomberg



Source: Bloomberg

Strong Tightening of Credit Spreads

EUR IG (white) versus USD IG (Orange)

Source: Bloomberg

EUR HY (white) versus USD HY (Orange)

Source: Bloomberg

As of 15/12/23	Current Spread	Δ Spreads MTD	Average over 5Y	2021 lows	Spd vs 2021
EUR IG	136	-9	132	83	53
USD IG	104	-7	129	86	18
EUR HY	395	-37	425	285	110
USD HY	351	-33	432	301	50

Source: ICE indices

-Strong tightening, especially in the HY spectrum

-IG is not ending the year at very attractive levels when considering current spread versus the 5-year average, but will remain supported by quality buying

-HY is trading far below the 5-year average, especially in the US.
Risks remain and current level do not reflect for the downside risks to our scenario. Default rates are already higher than the long-term average (>3% in EU and >5% in the US)

Strong Rally in Credit Yields

EUR IG (white) versus USD IG (Orange) Source: Bloomberg

EUR HY (white) versus USD HY (Orange) Source: Bloomberg

As of 15/12/23	Current Yield	Δ Yields	Average over 5Y	2021 lows	Spd vs 2021
EUR IG	3,61	-45	1,68	0,12	349
USD IG	5,21	-47	3,58	1,78	343
EUR HY	6,40	-66	4,67	2,3	410
USD HY	7,86	-64	6,53	3,78	408

Source: ICE indices

-Strong rally in yields, while being still far from both 2021 lows and 5-year average

-With interest rates likely plateauning and some uncertainties regarding defaults in the HY space, it makes sense to favor IG

-Extending duration does not make sense from a spread perspective as curve are very flat, if not inverted, but could make sense if we think central bank will decrease rates

-With the current rally in yields, favor 5-7Y bucket, and hybrid corporate bonds issued by IG issuers (largely compensate for extension risk and coupon risk, and interesting versus BBs)

Central Banks' Kept rates on hold

- Central bank meeting have showcased divergent monetary policy paths.
- The FED has leaned towards a dovish stance, suggesting 75pbs of cut in 2024, prompting market participants to expect five rate cuts next year with the first one early in 2024 (March meeting: 76,1% probability).
- In contrast, the ECB and the BoE took a more cautious stance. The ECB held rates steady, focusing on reducing the PEPP portfolio, while the BoE stressed the need for a longer period of restrictive policy.
- Elsewhere, the Norges Bank raised rates by 25bps and the SNB kept rate on hold but shift its policy focus: "monetary conditions are adequate and we do not have to hint any change of monetary policy in the future" said SND Pst Thomas Jordan

FED

Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate
01/31/2024	-0.083	-8.3%	-0.021	5.307
03/20/2024	-0.761	-67.8%	-0.190	5.138
05/01/2024	-1.635	-87.5%	-0.409	4.919
06/12/2024	-2.553	-91.8%	-0.638	4.690
07/31/2024	-3.368	-81.5%	-0.842	4.486
09/18/2024	-4.213	-84.6%	-1.053	4.275
11/07/2024	-5.015	-80.2%	-1.254	4.074

ECB

Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate
01/25/2024	-0.074	-7.4%	-0.019	3.881
03/07/2024	-0.469	-39.5%	-0.117	3.782
04/11/2024	-1.350	-88.1%	-0.337	3.562
06/06/2024	-2.629	-127.9%	-0.657	3.242
07/18/2024	-3.772	-114.4%	-0.943	2.956
09/12/2024	-4.640	-86.8%	-1.160	2.739
10/17/2024	-5.438	-79.8%	-1.359	2.540

SNB

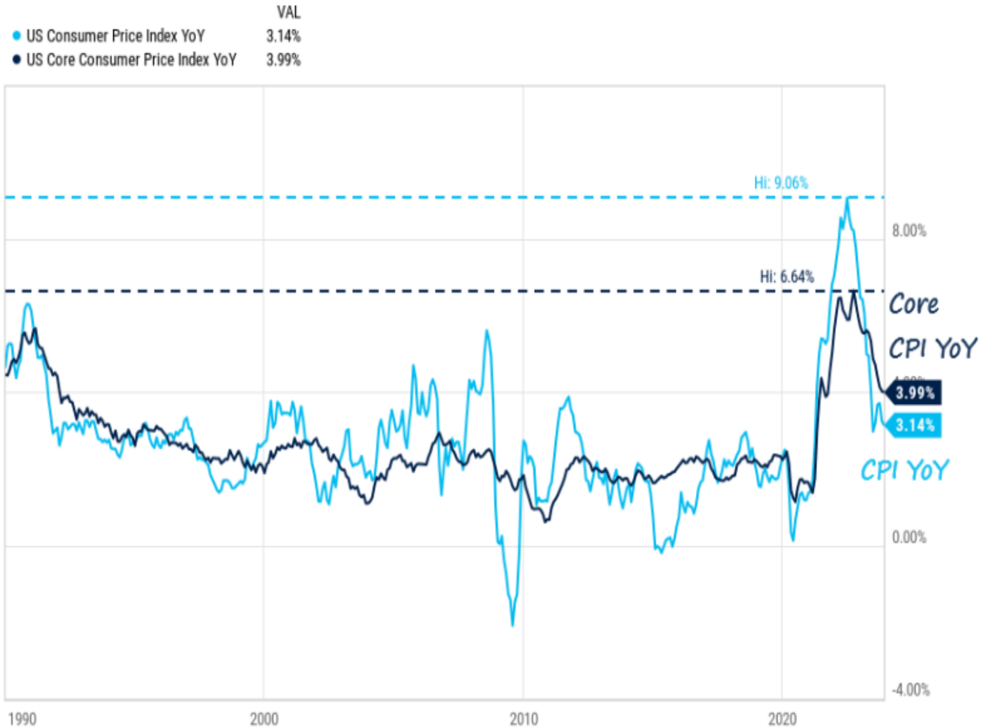
Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate
03/21/2024	-0.662	-66.2%	-0.165	1.514
06/20/2024	-1.514	-85.2%	-0.379	1.301
09/26/2024	-2.257	-74.3%	-0.564	1.115

BOE

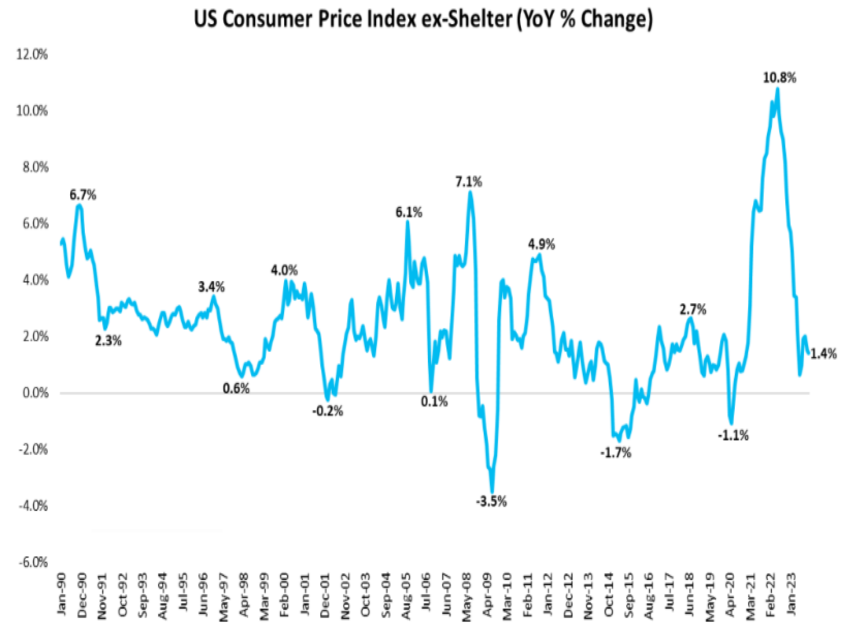
Meeting	#Hikes/Cuts	%Hike/Cut	Imp. Rate Δ	Implied Rate
02/01/2024	+0.029	+2.9%	+0.007	5.194
03/21/2024	-0.293	-32.3%	-0.073	5.113
05/09/2024	-0.917	-62.3%	-0.229	4.958
06/20/2024	-1.576	-65.9%	-0.394	4.793
08/01/2024	-2.382	-80.6%	-0.595	4.591
09/19/2024	-3.157	-77.6%	-0.789	4.397
11/07/2024	-3.938	-78.1%	-0.985	4.202

Source: Bloomberg

Is the US inflation fight over?



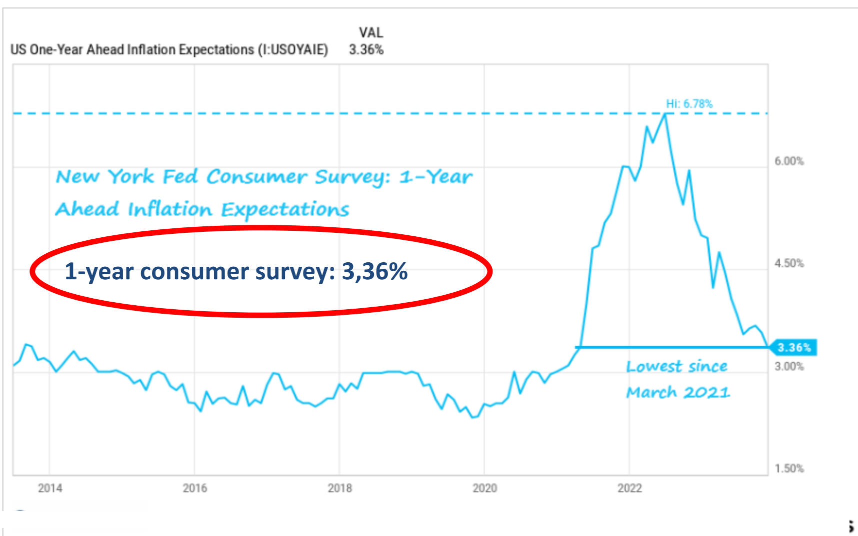
Source: Charlie Bilello

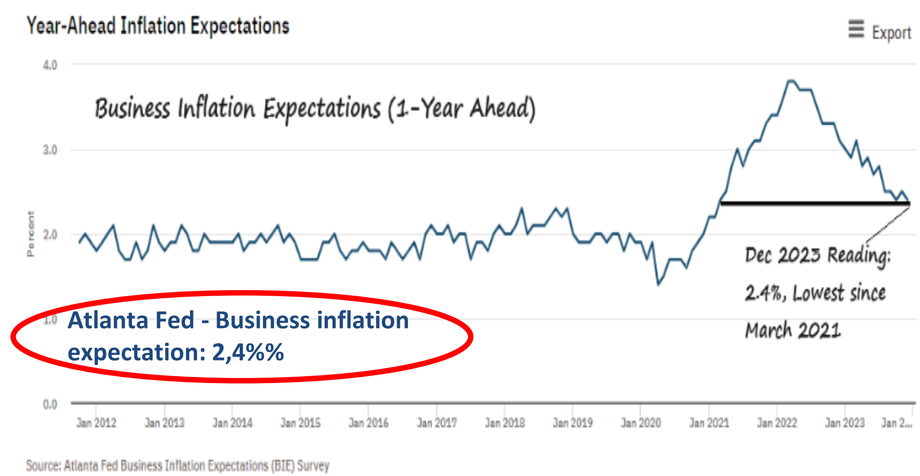


Source: Charlie Bilello

- **That is the big question for investors and the markets seem to believe that the answer is YES**
- **Overall, US CPI moved down to 3,1% YoY in November from 3,2% in October, the lowest reading since June. Core CPI moved down to 4% YoY, the lowest from September 2021**
- **Shelter, the largest component of the index (>33%), has been the primary reason why inflation has been so elevated in recent months. Excluding this variable, US consumer price rose just 1,4% over the last year, the 6th consecutive month below 2%**

More evidence of cooling US inflation

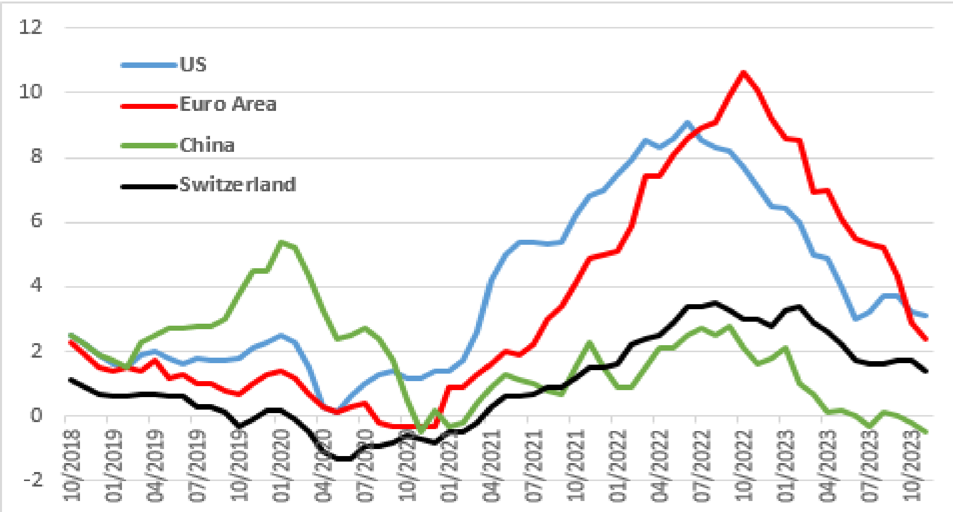




Source: Charlie Bilello

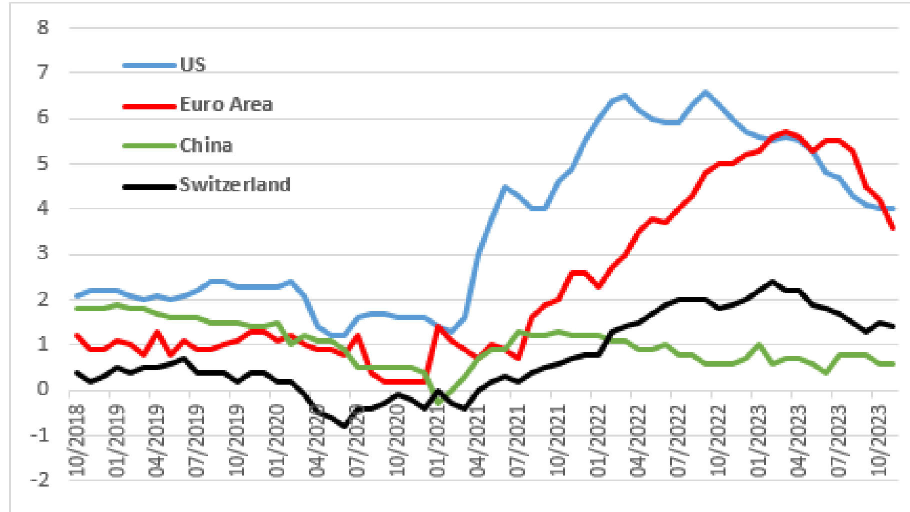
Global inflation is cooling

Headline



Source: Bloomberg

Core



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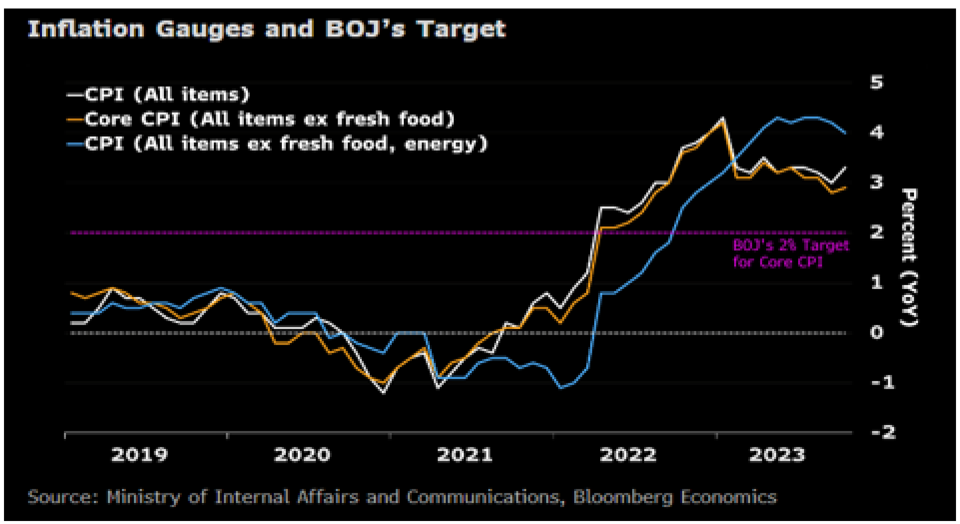

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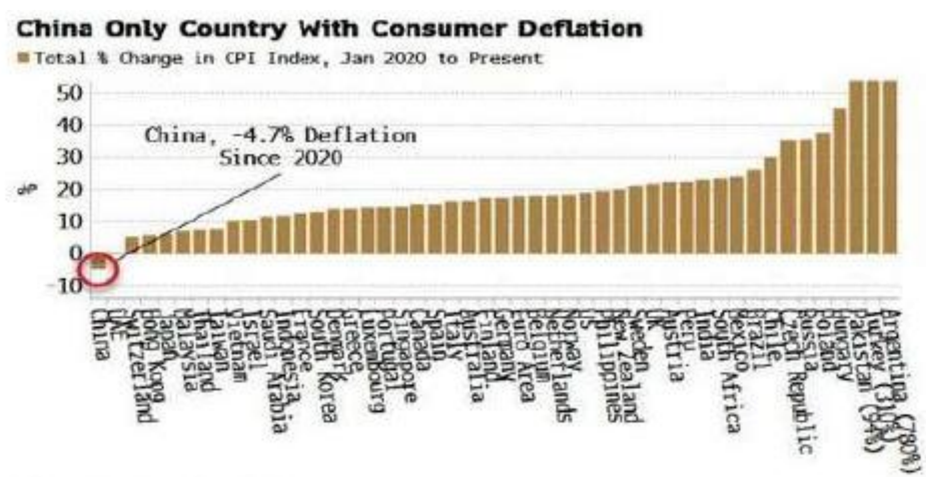
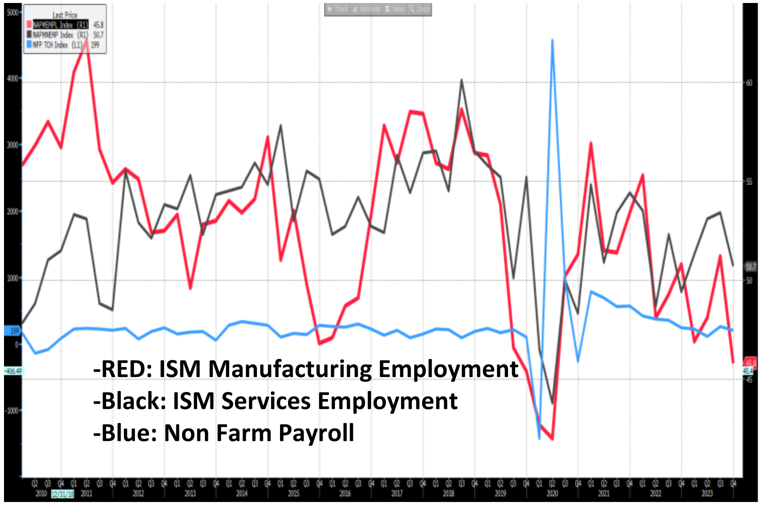


Source: Zero Hedge

A loosening US labour market

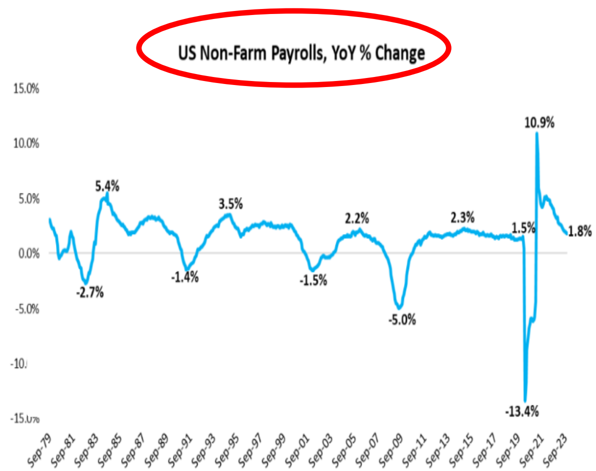


Source: Bloomberg

-The US unemployment rate has been below 4% for 22 straight month, the longest serie since late 1960s, with the last print at 3,7% from 3,9% in October; 33% of the jobs created this year have been in the healthcare sector

-Despite the US economy continuing to create jobs, some factors are pointing to a loosening in the US labor markets:1/ the US job openings fell to 8,7 millions, the fewest since March 2021, the increase in NFP was the lowest YoY growth rate since March 2021 and the average hourly earnings increased at the slowest YoY growth rate since May 2021

-The recent deterioration in US employment data is compatible with a FED pivot but not yet with a rate cut



Source: Charlie Bilello

Do not Forget the P. Horvath chart – Winter is Coming in the US

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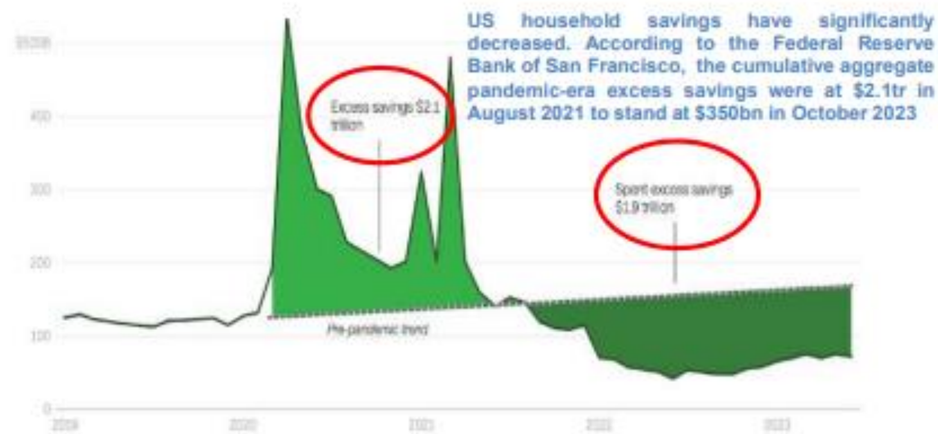
As more and more economists talk about a pending «soft landing», the US economy is facing real challenges:

1) **Credit card debt** topping $1 trillion at 20%+ interest rates
2) **Auto delinquencies** surpassing 2008/2009 levels
3) Resumption of payments on over $1.6 trillion in **student loans**
4) **Energy, food, and shelter prices and inflation remain stubbornly high** despite the FEDs attempts to reign it in
5) **Emerging banking stress** among US regional and super regional banks such a Schwab
6) **Upcoming refinancing wall of commercial real estate** with office vacancies at multi-decade highs
7) **Corporate bankruptcies** so far this year have already matched/surpassed 2020 and GFC levels
8) **Exploding net interest on the US government debt service**. Last year, the US Government paid $130bn in interest. This year, it is roughly $900bn. The number will grow to as much $1.8tr



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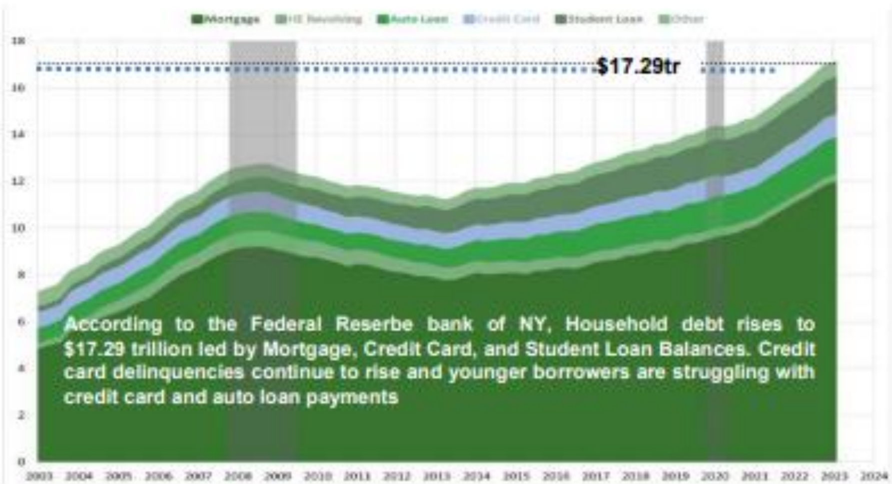
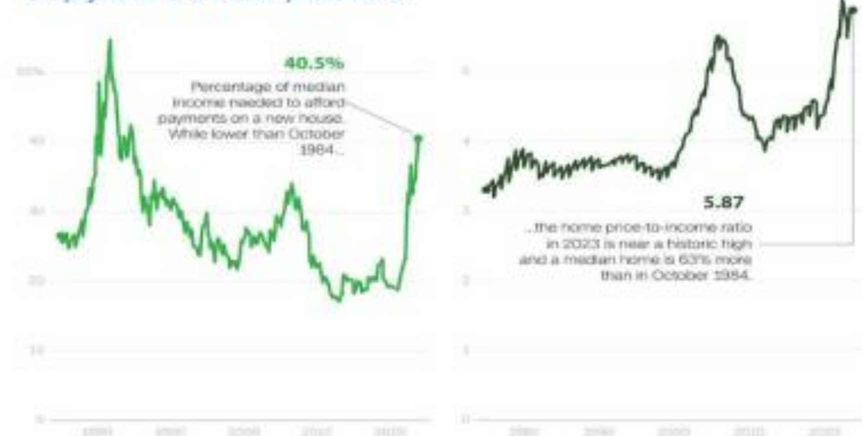
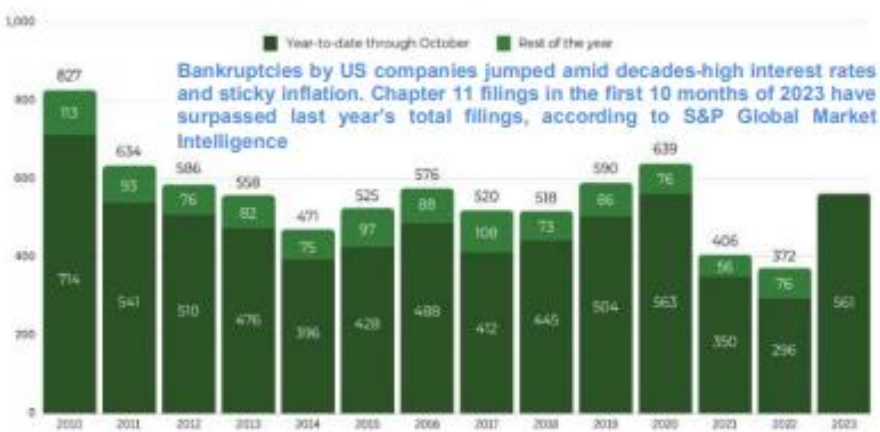
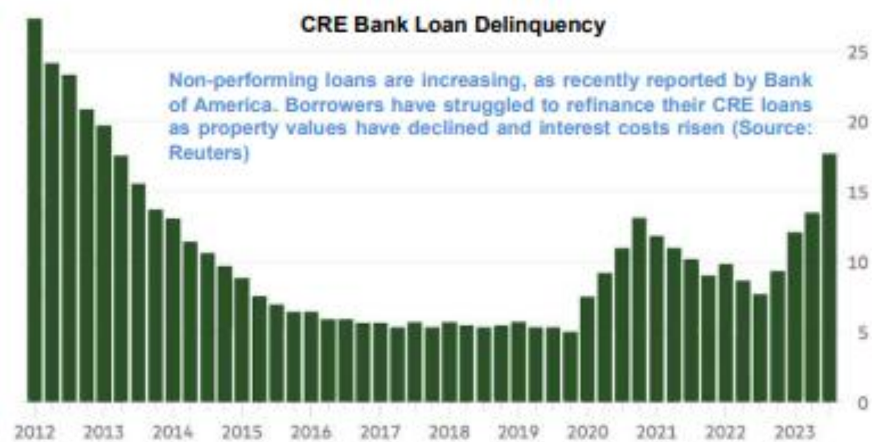


«This is the least affordable housing market since 1984. It is getting worse» (Source: CNN). According to Intercontinental Exchange, housing costs are the highest in 40 years and they take nearly 41% of the median household's monthly income to afford the payments on a median-priced home





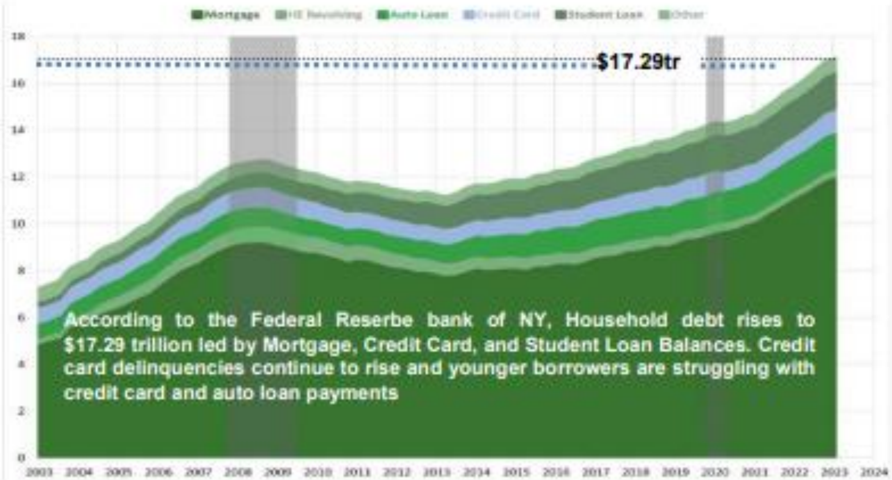
Includes S&P Global Market Intelligence-covered US companies that announced a bankruptcy between Jan. 1, 2010, and Oct. 31, 2023.



Source: Charlie Bilello

Do not Forget the P. Horvath chart – Winter is Coming in the US

BANQUE CRAMER



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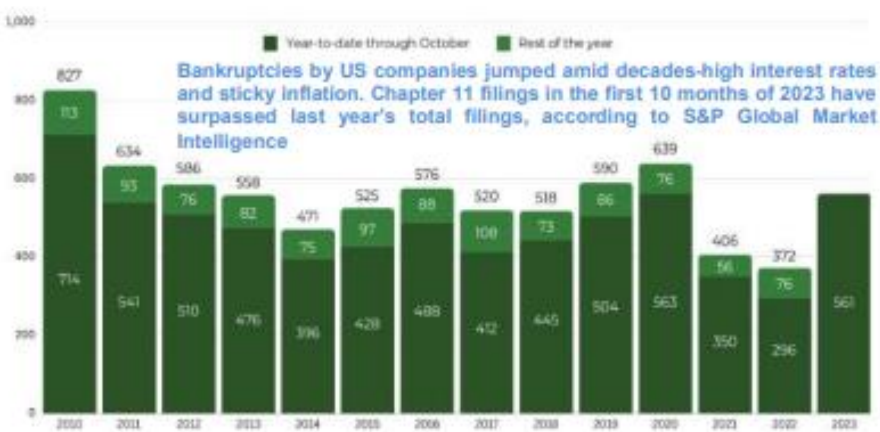

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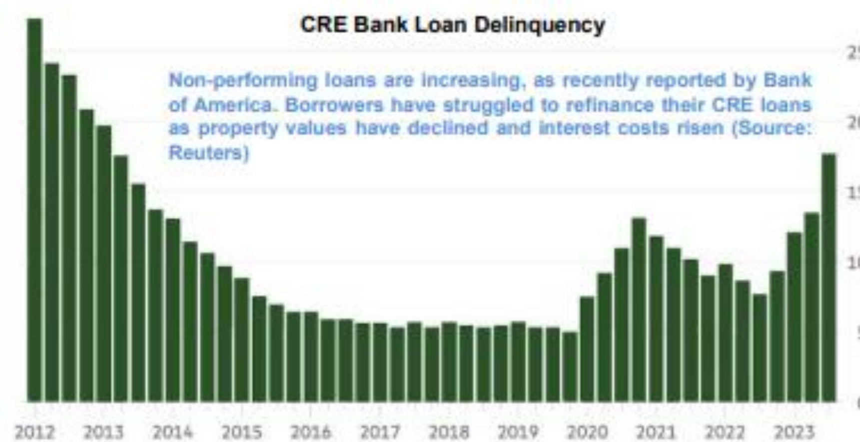

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Do not Forget the P. Horvath chart – Winter is Coming in the US

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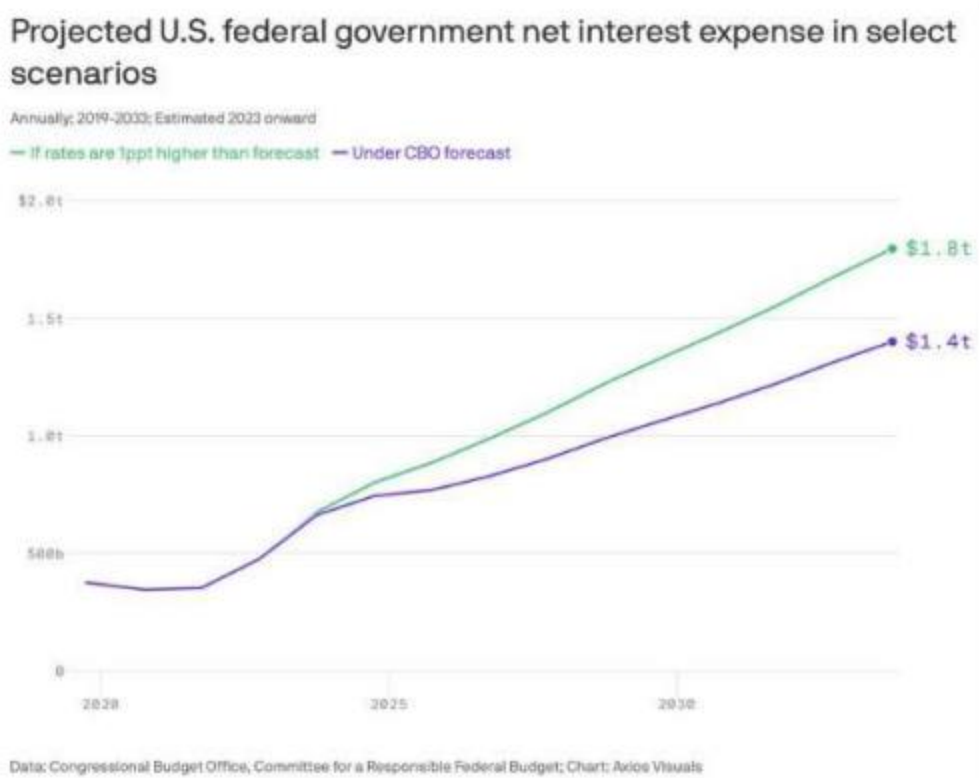


February 2023

The Budget and Economic Outlook: 2023 to 2033

Congressional Budget Office

Source: Charlie Bilello

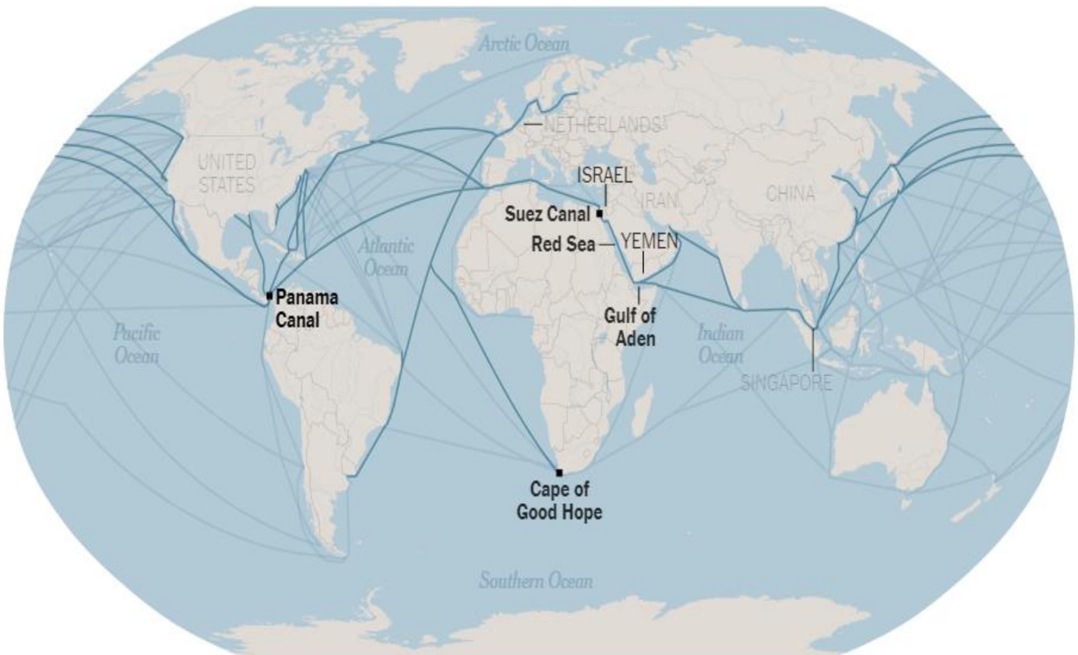
Shipping Road

BANQUE CRAMER

Panama Canal has gotten so dry and backed up after brutal drought that shippers are paying up to $4m to jump the queue

Panama Canal fallout

FREIGHTWAVES: The Panama Canal crisis is getting worse. We've just seen two of the three global alliances abruptly shift their Asia-East Coast services from the Panama Canal to the Suez Canal. How does this impact U.S. importers in terms of transit time and cost?



Source: C.I.A. • By Scott Reinhard

Red Sea Attacks Pose Another Threat to Global Economy

A new Suez crisis threatens the world economy

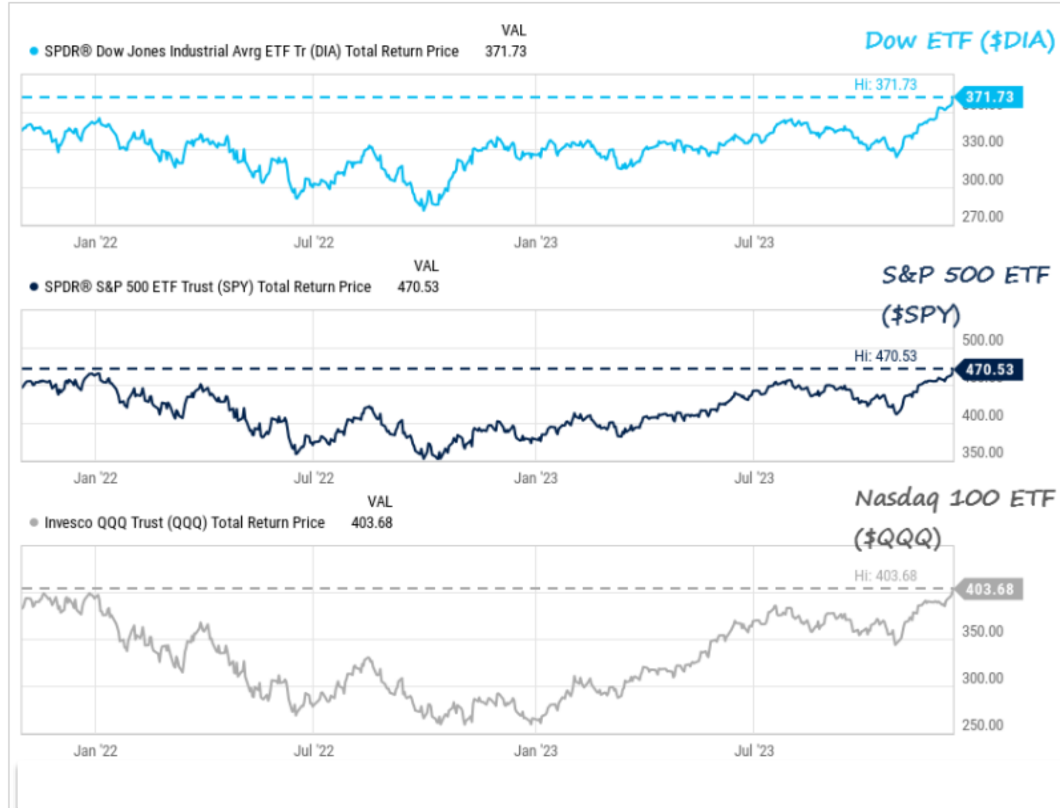
OVER A THOUSAND MILES from Gaza, a naval crisis is unfolding that could transform the war between Israel and Hamas into a global affair with implications for the world economy. Since December 15th four of the world's five largest container-shipping companies, CMA CGM, Hapag-Lloyd, Maersk and MSC, have paused or suspended their services in the Red Sea, the route through which traffic from the Suez Canal must pass, as Iran-backed Houthi militants, armed with sophisticated weapons, escalate their attacks on global shipping flows. As

Suez Canal or Cape of Good Hope?

FREIGHTWAVES: Regarding security issues for Suez transits, there have been attacks by Yemen's Houthi militia targeting Israel-linked ships at the Bab-el-Mandeb Strait — and we've already seen spillover to non-Israeli ships, with an OOCL container vessel mistakenly attacked on Sunday.

Some container ships are already taking the long way around Africa's Cape of Good Hope. It's very easy to see how this could escalate and become a much more serious threat to shipping, which would force a lot more container vessels around the Cape. How might this escalation scenario play out for container shipping? This would affect not just trans-Pacific services rerouted from Panama through the Suez, but also the entire Asia-Europe trade.

Valuation - Equity



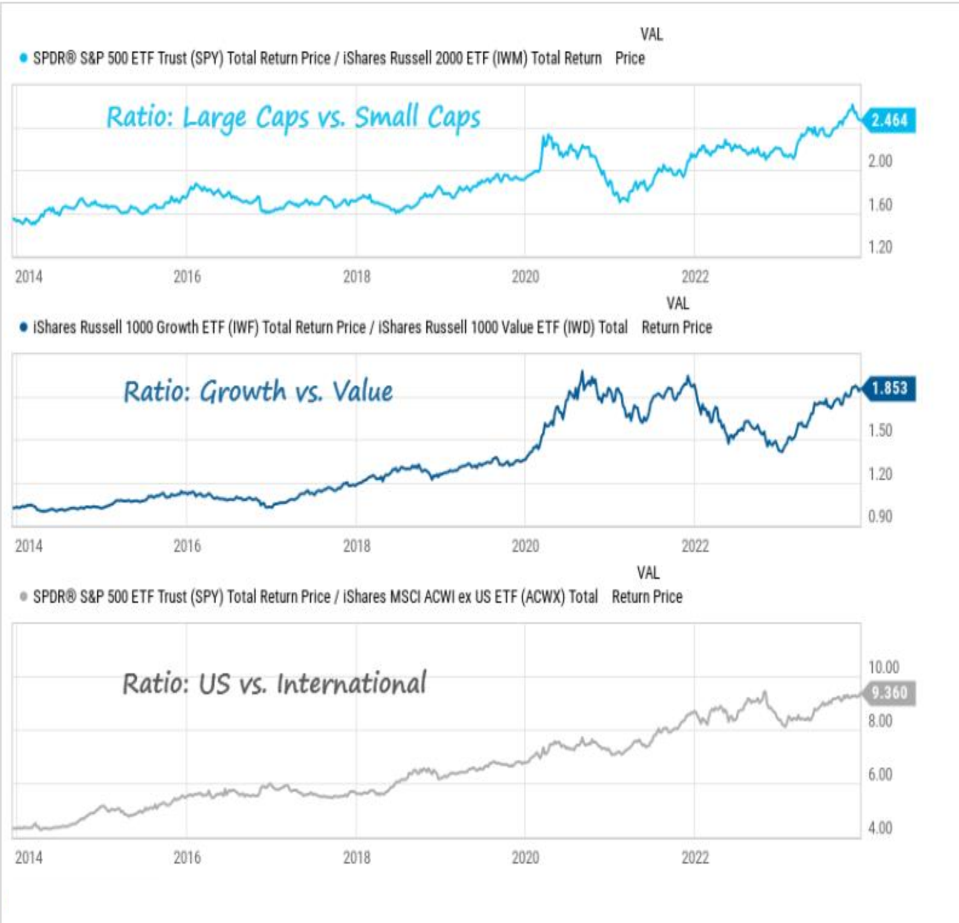
Source: Charlie Bilello

- **New all-time highs in US equities**

- The S&P 500 Total Return index is back at an all time high for the first time since early 2022

- The ETFs on Dow Jones, S&P 500 and Nasdaq 100 are at new total return highs (last time that happened was November 2021)

Valuation - Equity



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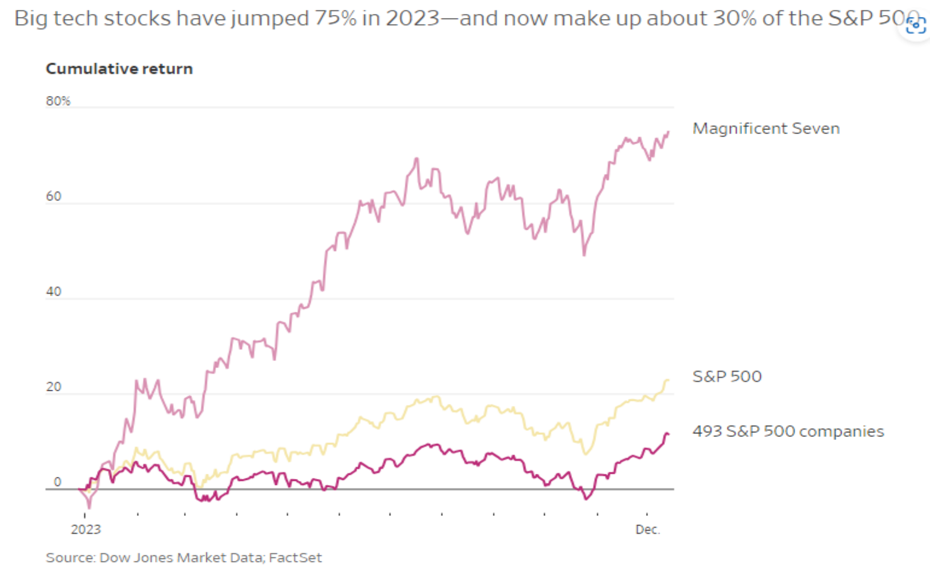

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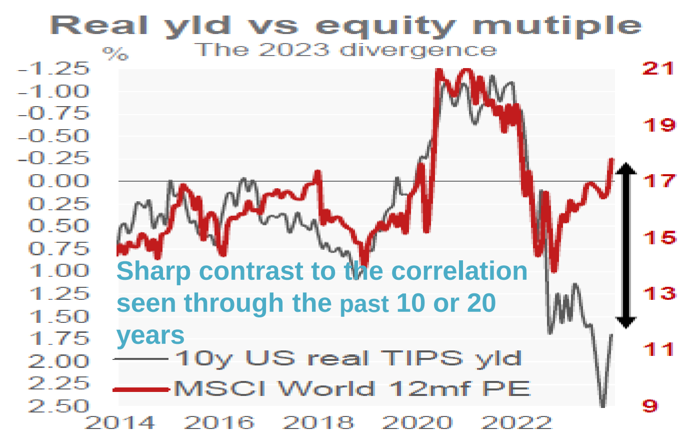


Source: Generalli

-The outperformance of the Magnificent Seven has played an important role when looking at relative valuations

-They represent about 30% of the S&P 500, with a return of +75% in 2023 vs +12% for the remaining 493 companies in the index

- What about a reversion to the mean?

Valuation - Equity

Source: Bloomberg

- **Underperformance of the MSCI Emerging vs MSCI Developped**
- **The asset class could remain affected short-term by global macro uncertainties but window of opportunity is starting to open**

Valuation – Correlation Equity - Bonds

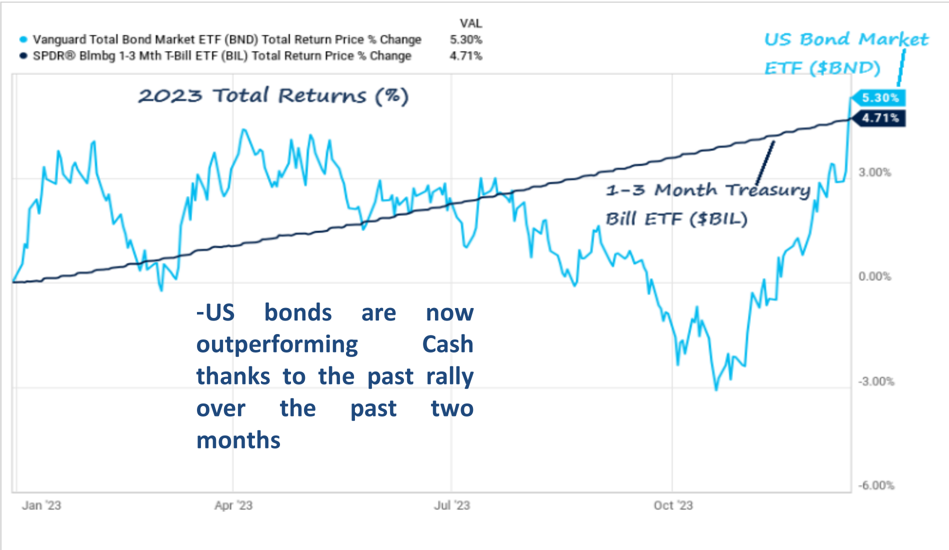
BANQUE CRAMER

Source: Bloomberg

-The dominance of the monetary policy has supported the positive correlation between stocks and bonds, as it has been the case in 2022

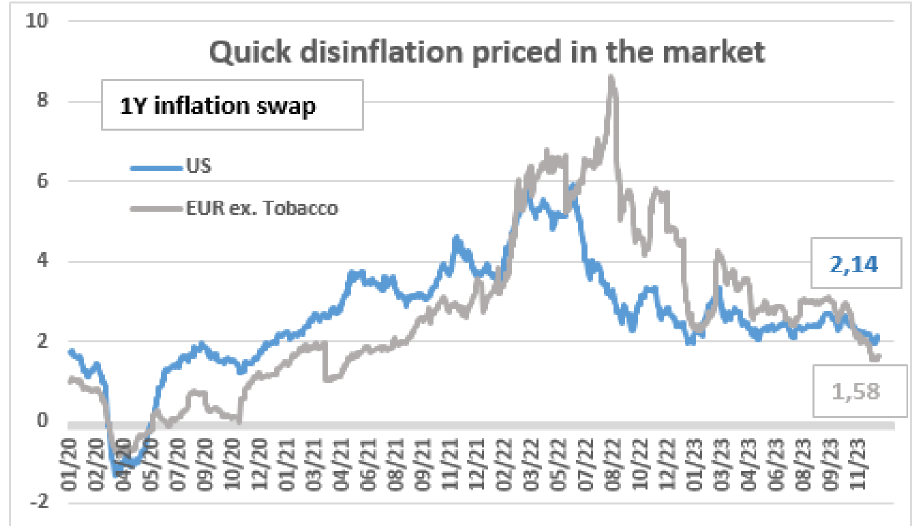
- With cyclical forces back on the forefront, the correlation should tend to be lower or negative

Valuation – Fixed Income



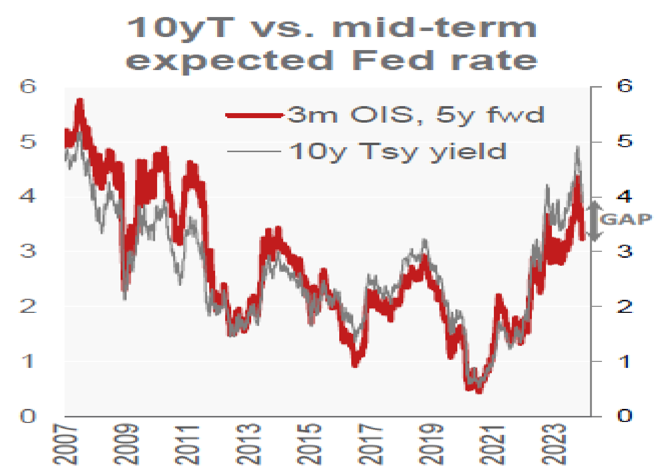
-US bonds are now outperforming Cash thanks to the past rally over the past two months

Source: Charlie Bilello



Source: Bloomberg

Based on 1Y inflation swap, a lot is already priced in EUR

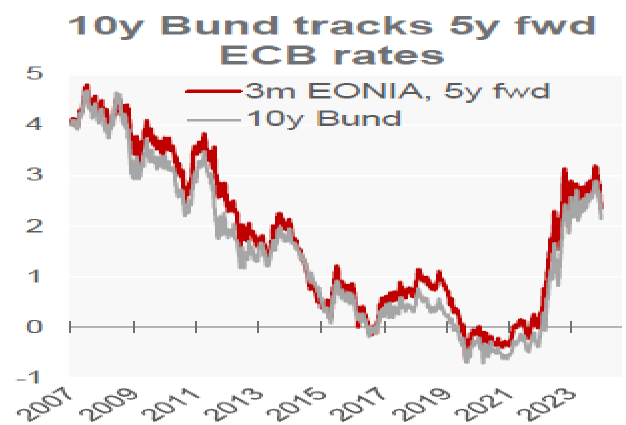


Source: Generalli

-US10Y (3,90%) tends to move in sync with medium term rate expectations as priced by the 3m OIS, 5y forward (3,47%)

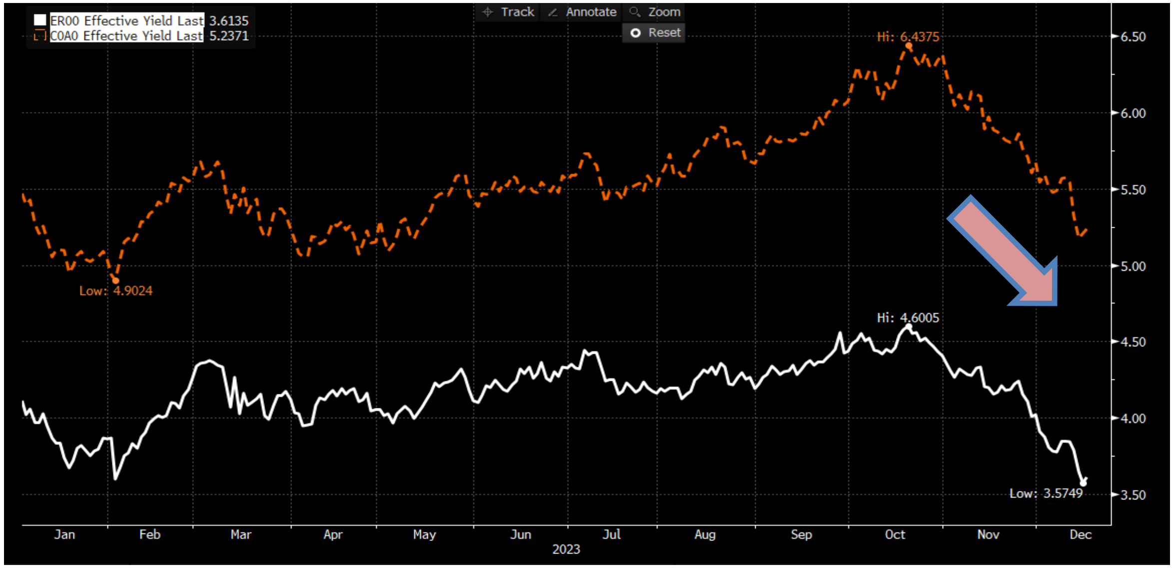
-The German 10Y (2,02%) tends to follow the 3 month Eonia, 5y forward (2,23%)

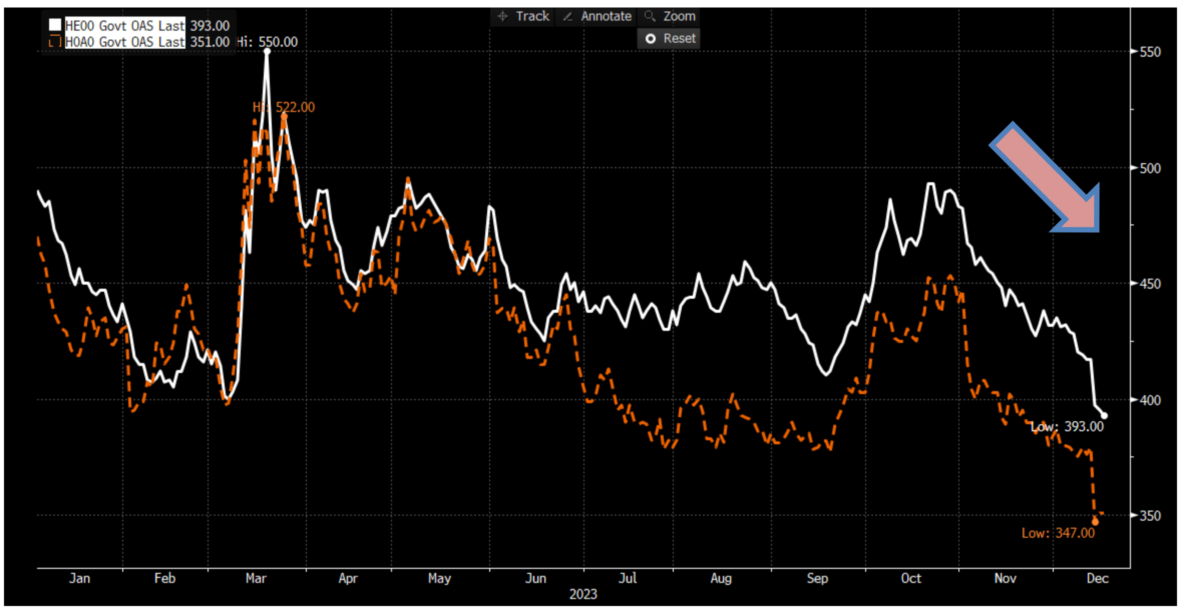
-Based on this corelation, the US Treasuries yields have more downside than German Bunds



Source: Generalli

Valuation – Investment Grade





- **Core sovereign have not been the only yields that have been falling**

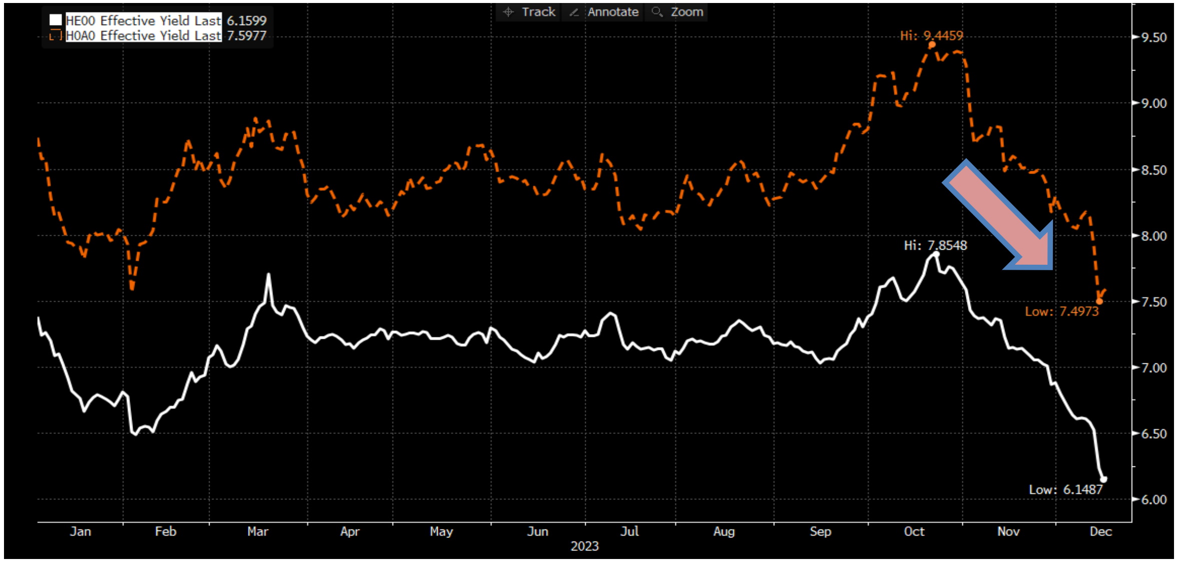
- **From the peak in October, Euro and US Investment Grade bonds effective yields have seen a decline of 99bps and 120bps respectively to currently trade at 3,61% and 5,24% (348bps and 346bps from the 2021 lows)**

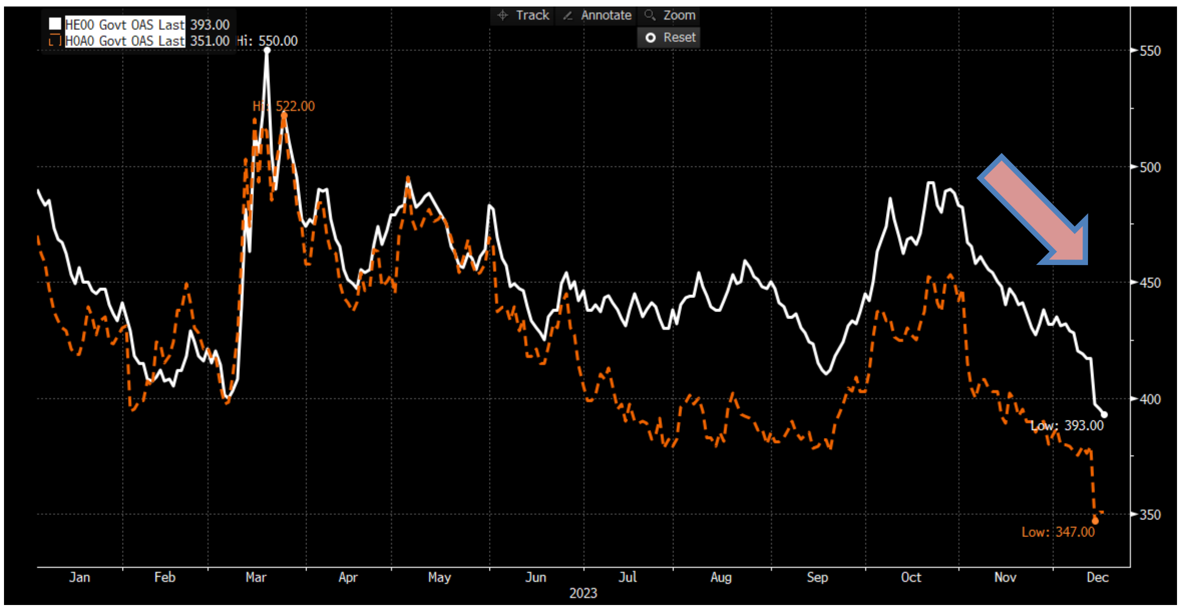
- **Euro and US High Yield bonds spreads have seen a decline of 24bps and 26bps respectively, to currently trade at 136bps and 105bps (53bps and 19bps from the 2021 lows)**

- **Both are at their tightest levels since early 2022**

Source: ICE index, Bloomberg

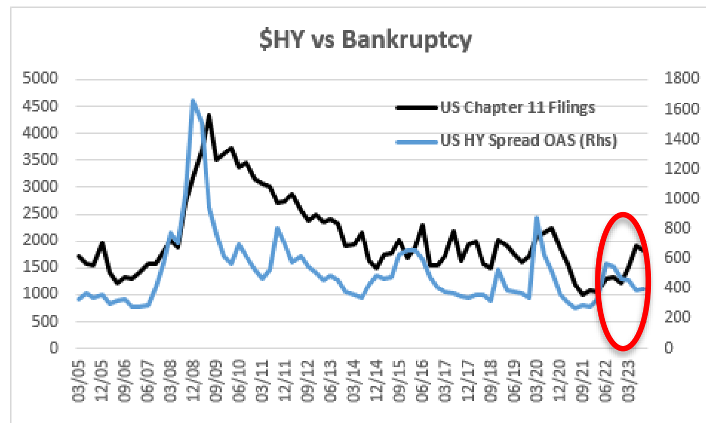
Valuation – High Yield





Source: ICE index, Bloomberg

- **Core sovereign have not been the only yields that have been falling**
- **From the peak in October, Euro and US High Yield bonds effective yields have seen a decline of 164bps and 179bps respectively to currently trade at 6,16% and 7,60% (392bps and 368bps from the 2021 lows)**
- **Euro and US High Yield bonds spreads have seen a decline of 88bps and 80bps respectively, to currently trade at 393bps and 351bps (108bps and 50bps from the 2021 lows)**
- **Both are at their tightest levels since early 2022**



Source: Bloomberg

Sentiment – From Fearful to Greedy

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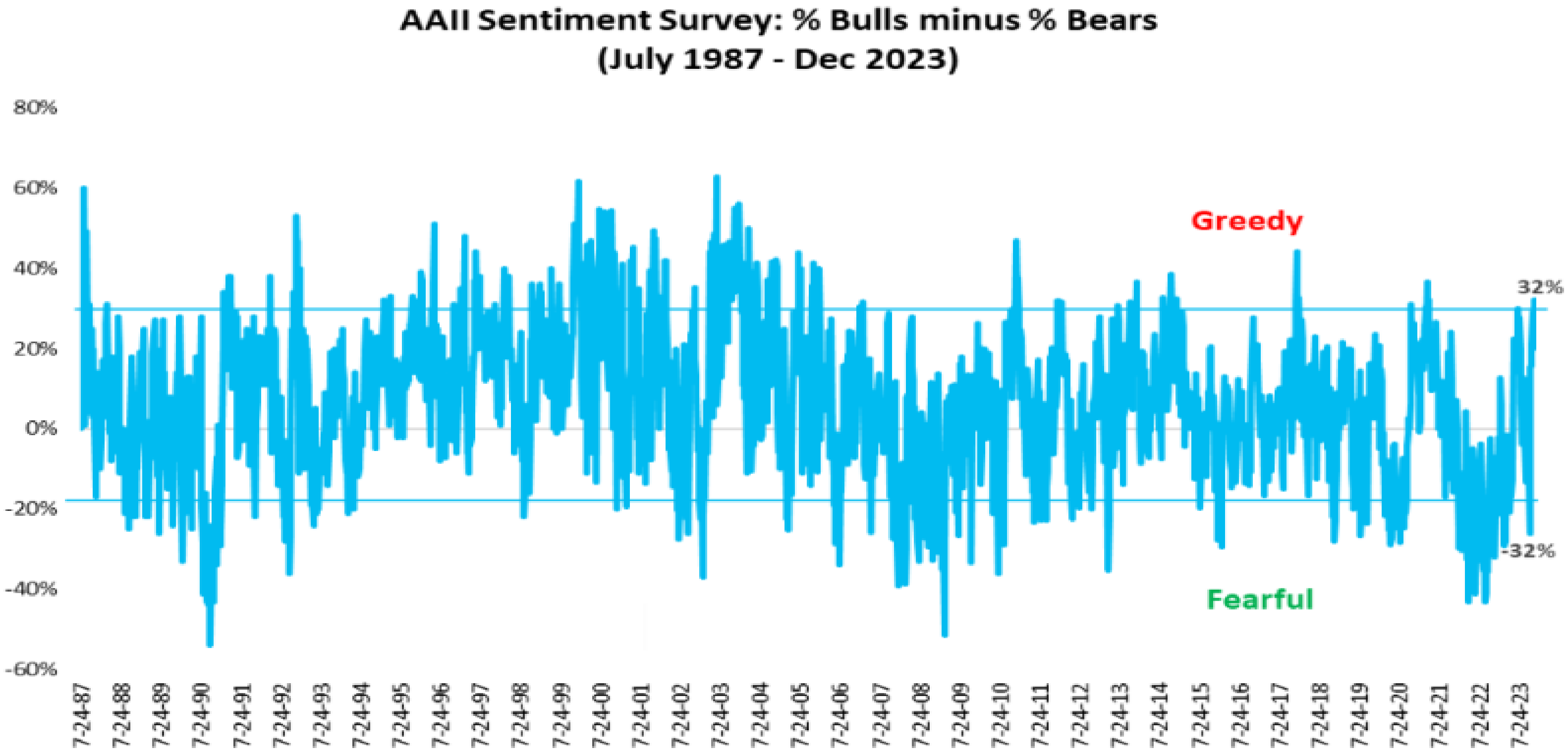


Source: AAII, Bloomberg

- In December 2022, Bears outnumbered Bulls by 32%. In December 2023, Bulls outnumber Bears by 32%
- The S&P 500 is over 24% higher and the Nasdaq 100 is over 53% higher
- The S&P 500 is now approx. 9% higher in price than where it was when the FED starting hiking rates in March 2022, 16th (525bps)
- Best sectors: Tech, Communications, Consumer Discretionary – those sectors were the losers in 2022
- Worst sectors: Energy, Consumer Staples and Utilities – those sectors were the main performance contributors in 2022

OUTLOOK 2024

What a year!

- **2022 was considered as an “annus horribilis”**, ending in a bloodshed for investors. Both equity and bond markets delivered double-digit negative total returns. **2023 has been marked by expectations of a recession in the developed countries and positive consequences from the reopening of China:** both turned out to be wrong bets

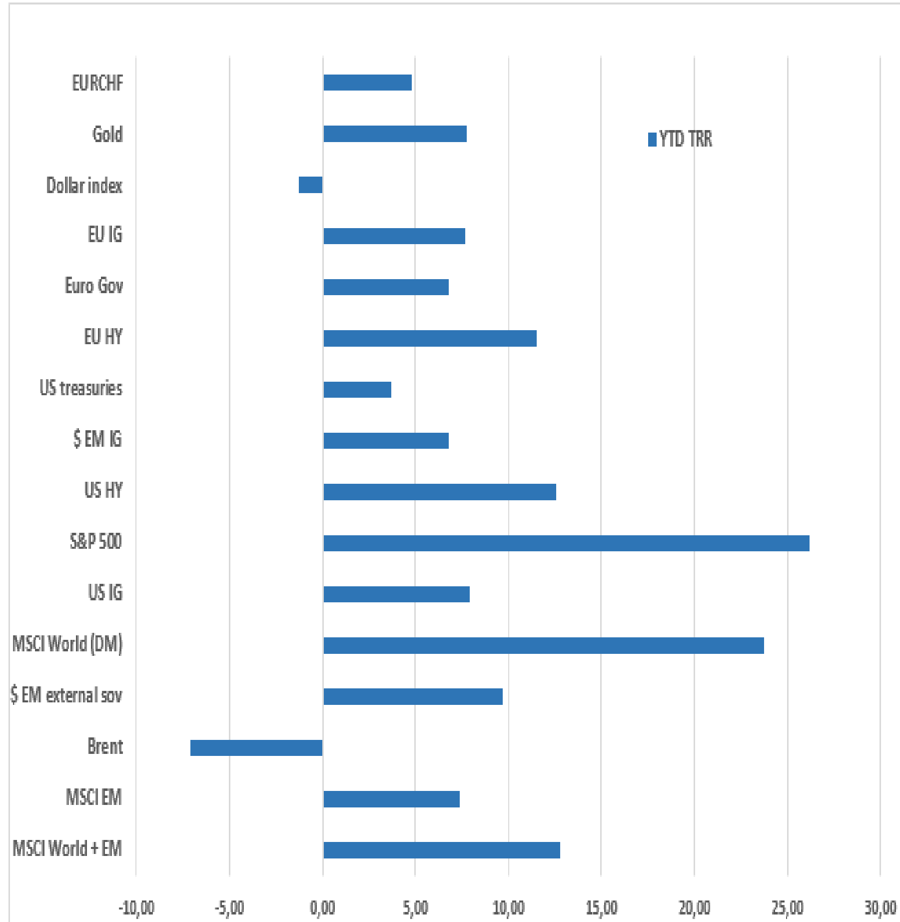
- **Investors have once again encountered numerous challenges**: aggressive interest rate hikes in Western countries, a substantial bond sell-off, a banking crisis in the USA in March, the collapse of Credit Suisse, a decline in Chinese domestic demand, a new conflict in the Middle East as the situation in Ukraine persists, escalating geopolitical tensions between China and the US, the ongoing energy transition, and the AI revolution... the list appears endless

- **The global economy has shown surprising resilience despite the impact of severe monetary tightening**, which would typically lead to much weaker economic activity and an increase in joblessness during normal times. Notable divergences across regions have been observed: while the US economy has proven remarkably resilient, thanks in part to the IRA, despite the Federal Reserve's aggressive measures, Europe and China have faced an increasingly challenging environment, marked by slowing demand and geopolitical tensions. Switzerland has remained a beacon of stability, experiencing a moderate deceleration in activity and largely contained inflation

- **The year is expected to conclude with commendable results**, particularly for risky assets. In the years ahead, investors will likely reflect on November 2023 as one of the strongest months in the history of financial markets. Where does the consensus stand? The initial half of December is still underpinned by a narrative that centers around confidence in the Goldilocks scenario: accelerated global disinflation, resilient growth, and swift policy rate cuts in developed countries

- **As we approach the dawn of 2024**, market participants find themselves in an optimistic mood. Major central banks are signaling that victory over inflation is on the horizon, maintaining rates during the mid-December meetings. What's more, 'Santa Claus,' as Jerome Powell, is back! Rate cuts are now being considered by the same figure who, earlier this month, expressed reluctance to declare victory. The FED press conference from the mid-December meeting is likely to be remembered as one of the most significant macro events of this decade. Risk appetite remains robust, with equity markets skyrocketing and sovereign bond yields drifting lower.

Global Assets Return (Year-to-Date)



Source: Bloomberg

What to expect in 2024?

- No one knows what the future holds with any degree of certainty. What is certain, however, **is that in 2024, investors will have to balance several headwinds:**
  1. The impact of severe monetary tightening will induce a **slowing global growth with notable divergence across regions**,
  2. **Ongoing declines in inflation, while still remaining above central banks' targets**, are notable. Most of the inflationary impacts linked to the Covid-19 pandemic, particularly tensions on global supply chains, have largely normalized. Raw materials' inflation is easing, and even in areas where it is more persistent, such as services inflation (housing costs and wage growth), leading indicators are pointing to a potential easing
  3. **Persistent geopolitical risks continue** as regional flashpoints multiply, with no sign of resolution in Ukraine,
  4. **The largest election year in history** is on the horizon, with 40% of both the world's population and GDP scheduled to go to the polls. There is a possibility of a populist wave impacting the developed world,
  5. **Limited fiscal headroom** is likely to make it difficult for any party to deliver further tax cuts or major spending programs,
  6. **High government issuances raise concerns about an increasing interest burden,**
  7. **Extended quantitative tightening** (QT) is accompanied by shrinking central bank balance sheets
- **Is the long-awaited great pivot about to arrive?** Inflation has declined but remains high enough for central banks to pivot tomorrow rather than today. It's essential to note that the FED's dovish communication occurred against the backdrop of a core CPI still at 4%, with government spending exceeding 20% of GDP and rising deglobalization forces.

Assuming that the FED will regain considerable room for maneuver to cut rates in 2024, as illustrated by the changes its members have made to their forecasts, is one thing. **However, committing to further Fed Funds cuts today**, after the fall in long-term rates we have seen since the end of October, is quite another.

The Fed might have been tempted to delay the fall in interest rate expectations until it could at least assess the impact on the US economy. But that was not to be…

- **2024 should, therefore, be a landing year**, albeit at different speeds depending on the regions, and with it, ultimately, **a pivotal year for central banks**, albeit also at different speeds. The US economy is expected to finally slow down during the first half of 2024. Central banks may also fear that the sharp easing of financial conditions largely expected by the markets will make the 'last inflation mile' more difficult and will not rush to cut rates during Q1

- Will the European Union lead the recovery after being the first to experience a contraction? Two years ago, we were talking about transitory inflation. Should we now be discussing transitory disinflation? **There are still many unanswered questions, but one thing is certain: volatility is back**, with the economic cycle likely to be shorter than before, which could imply a drastic pivot in monetary policies.

- **Central banks will have to be pragmatic and nimble, just as investors should be, taking advantage of volatility instead of being victims of it**

- **Our base scenario involves a soft landing, with continued disinflation and a central bank pivot in the second half of the year**, as inflation returns to levels compatible with central bank mandates

- **<u>Risks to our scenario</u>:**

- ➢ **A hard landing scenario envisions a global recession and deflation**, necessitating explicitly accommodative monetary policy, not simply a pivot, in a context of rising unemployment far beyond central banks' expectations
- ➢ **No landing scenario foresees firm growth persisting alongside inflationary pressures**, leading to a hawkish turn in the monetary policy stance, especially in the US.

Key views and investment implications for 2024?

- **Lower rates combined with credit spread carry will be significant performance drivers**

- Government bonds: We anticipate lower yields in 2024 as inflation continues to recede and central banks deliver on rate cuts. However, investors have largely front-run the rally in yields, and our positive view on bonds is more measured ahead of 2024, with the expectation that central banks may not deliver what the markets anticipate. We favor US treasuries over Bunds

- Credit: With credit spreads having compressed in the last quarter of 2023, following a rally in both yields and equities, a cautious and selective approach based on fundamentals must prevail early in the year. Consequently, we favor Investment Grade Credit entering 2024. While USD Investment Grade spreads are close to their 5-year low, EUR Investment Grade appears less stretched.

- **Risky asset will take advantage of rate cuts' expectations**

- High Yield: The very low issuance in 2023 has been a major support for the strong performance of High Yield. Moreover, spreads have proven highly resilient to the deteriorations seen in fundamentals and are tight based on historical standards. With significant refinancing needs in 2024 and 2025 for the asset class, supply pressures will rise throughout 2024 as issuers often act early to roll their debt. Despite a soft performance early on, we believe that 2024 will be a positive year for High Yield credit. We favor capital structure over High Yield exposure entering 2024

- Hard currency Emerging Debt: Compared to USD-denominated BB-rated High Yield, Emerging Debt is less tight than High Yield spreads on a historical basis, with quite similar yield and lower volatility.

- Equities: The strong rally seen since the end of October puts us in a complicated situation at the dawn of 2024. Global equity risk premia have dropped significantly, making equities less attractive in terms of risk-reward. We favor a defensive stance entering 2024, supporting defensive and dividend stocks, and deploying towards more alpha exposures throughout 2024

- **US Dollar will weaken and Japanese Yen recover**

- Local currency Emerging Markets: In 2023, EM foreign currencies depreciated against the US Dollar. In 2024, we expect local currency debt and equity markets to take advantage of US Dollar weakness, but selectivity is key given the disparate and diversified nature of these markets

- Yen: the currency has bottomed. Lower US yields and a normalisation to come from the BoJ's monetary policy will provide support to the Japanese currency
- Gold: The precious metal reached a historical record at $2135 but failed to establish itself above the $2100 mark. Short-term moves will be driven by the expected trajectory of US rates and a softer US Dollar. Gold prices are expected to stall in 2024 due to renewed appetite for risky assets

- **Risks to our scenario:**

❑ **Hard-landing / deflation / explicitly accommodative stance**

- With earnings prospects declining, equities will be hit the hardest
- Government bonds will play their safe-haven role
- Credit spread, especially on high beta, will widen but carry would compensate. Focus on short maturities

❑ **Firm growth / inflation / explicitly restrictive stance**

- Earnings growth would benefit from persistently high inflation, with global equities posting positive returns, along with quality High Yield thanks to carry (Focus on short maturities)
- Government bonds will struggle to outperform cash and money market yields

2024 - A Bumby Path

	Start 2024	End 2024
❑ Asset Allocation	Start the year with a conservative allocation	Gradually add to Equities and rotate from Government bonds to Credit
❑ Fixed Income	Gradually add duration and focus on USD quality Credit, Emerging Hard Currency, short-term Euro High Yield and Capital structure	Gradually add to High Yield and Emerging local debt after the FED starts cutting rates
❑ Equities	Stay defensive with a focus on dividends and quality.	Turn toward more cyclical market when Feds starts cutting rates. Rotate into Europe, Emerging market winners (from near-shoring stories, energy transition and technological advances) and Small caps

❑ **Thematics**

Re-shoring, Energy transition and sustainable infrastructure, water, building, demography and ageing population, Artificial Intelligence

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Banque Cramer & Cie SA
Avenue de Miremont 22
1206 Genève
T +41 58 218 60 00

Genève | Lugano | Zürich
info@banquecramer.ch
www.banquecramer.ch