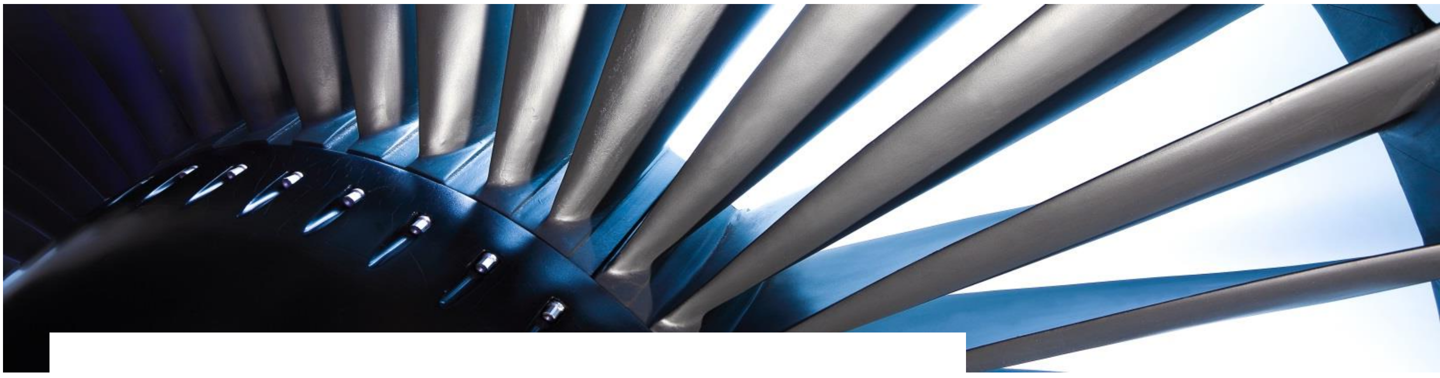


27 FEBRUARY 2017

All Eyes on Trump's Address to Congress

By Florence Tan, Tae Hyon Ahn, Celestee Tan

President Trump will address a joint session of Congress on 28 February. Newly inaugurated presidents often deliver this type of speech instead of a formal State of Union address, giving them a full year to fully assess the state of the country.

Read more on page 2 >

Market Performance

Global equities continued their recent rally with the MSCI World Index up 0.22%. In the US, the Dow Jones Industrial Average increased 0.96%, the S&P 500 Index advanced 0.69%, and the Nasdaq Composite ticked 0.12% higher.

European equities, as measured by the Stoxx Europe 600 Index lost 0.06% on earnings and political uncertainty while Japanese stocks gained amid weaker Yen (Nikkei 225: 0.25% and Topix: 0.36%).

Emerging Market equities continued its recent outperformance. The MSCI EM index rose 0.48% led MSCI Asia ex Japan (0.78%). In contrast, MSCI Latin America and MSCI Emerging Europe dropped 0.25% and 1.35% respectively. Within Asia, the Shanghai Composite index was the biggest outperformer, climbing 1.60% on the week, to end at 3253.43.

IN THIS ISSUE

All Eyes on Trump's Address to Congress(Continued)

- Investors are particularly focused on any comments relating to the Border Tax Adjustment (BTA), where US firms will pay a 20% tax on all imported inputs and be exempt from paying taxes on export revenue. Citi analysts believe that inclusion of a BTA is increasingly unlikely given lack of support from President Trump and intense lobbying from the importing sectors. Without the offsetting revenues from a border adjustment tax, the actual reduction in the 35% US corporate tax rate may only be to 25%, instead of the earlier proposed 15% to 25%. This will imply a smaller lift to company earnings.

Policy	US$	Equities	Corporate Bonds	Rates
Repatriation	Positive	Positive via increased buybacks and dividends	Positive if funds are used to repay Investment Grade (IG) debt issues	Marginally lower yields as strong dollar tempers inflation. Also positive impact as IG debt gets repaid.
Interest Deductibility	Positive if it creates increased bond issuance overseas and repayment in the US	Negative if buybacks, dividends, private equity and leveraged buyouts discouraged	Positive for US Investment Grade if debt is repaid. Less helpful for High Yields where interest coverage is lower.	Marginally lower yields as IG debt gets repaid.
Border Tax Adjustment	Positive if Fed responds to higher inflation from higher import prices	Country/sector winners and losers will emerge	Country/sector winners and losers will emerge	Higher yields if US inflation rises or Fed tightens.
Fiscal easing/ Tighter monetary policy	Positive	Probably positive but valuations are much higher than in 1980s	Probably positive	Negative
Negative Trade Policy	Likely negative	Negative	Negative	Higher yields if inflation rises. Lower yields if risk assets fall sharply.
Deregulation	Positive via capital inflows	Positive via stronger real growth and lower inflation.	Positive via stronger real growth and lower inflation.	Higher real yields, lower inflation breakeven levels.

Source: Citi Research as of 27 February 2017.

- With the potential policies appearing mostly positive for equity markets, it is not surprising that they have rallied after the US election. Following the re-rating which has taken place, any policy disappointment may be negative for equity markets. On the other hand, earnings growth will be needed to drive markets higher from here.

- Citi analysts remain overweight on US Investment Grade corporate and US High Yield bonds. Tax cuts, elimination of interest deductibility and full expensing of capital expenditure may benefit US Investment Grade corporates more than US High Yields.

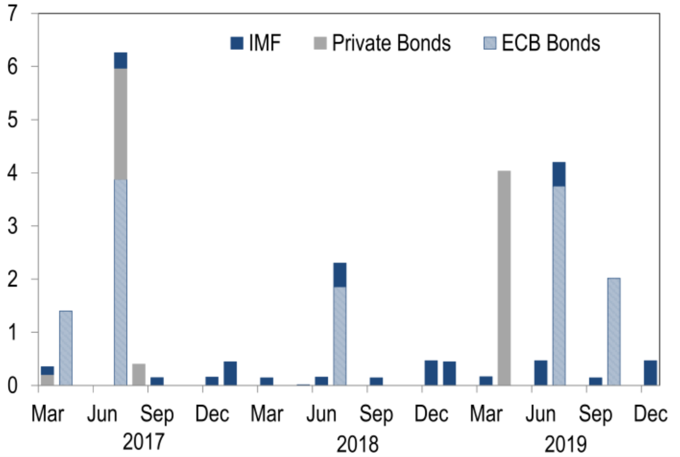
Greece – A Little Step Forward

The Eurogroup meeting on 20 February found "enough common ground" for Greece and its lenders to agree "to work on an additional package of structural reforms".

- These will entail *"a change in the policy mix, moving away from austerity and putting more emphasis on deep reforms, which has also been a key element for the IMF".* Reforms will involve the *"tax system, the pensions system, also labour market regulation"*. However, the Eurogroup head Dijsselbloem stressed *"there is no political agreement at this point"* as *"a lot of work still needs to be done",* and he tamed expectations on the next bailout steps, stating that *"Greece does not need any new bailout money in March, April or May"*.

"Deal shows the willingness by European policymakers to avoid the current Greek impasse."

Greece: Government Debt Redemption Profile (EUR bn), 2016-2019



Source: Citi Research as of 8 February 2017.

Three key takeways from the Eurogroup meeting:

- (i) The IMF remains onboard for now (as per Germany's request), with the assumption that a new package of structural reforms may improve debt sustainability.

- (ii) The other most divisive issue of how high and for how long Greece's primary fiscal surplus can be sustained has been pushed off the table for now. The focus shifts onto less politically toxic structural reforms and no new fresh austerity is deemed necessary right now (as per Athens' request). The working assumption remains the primary surplus will reach 3.5% of GDP next year (the IMF had suggested 1.5% as a realistic target) and that it will be maintained for a still-undefined, but "realistic", number of years.

- (iii) Given the lack of imminent liquidity needs in Greece and given that it will take a few months for the new package of reforms to be agreed, Citi analysts do not expect political agreement on the next loan disbursement before June.

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