

# Investment Digest

## Japan Loosens, U.S. Brightens, North Korea Frightens

Welcome to our monthly roundup of market and economic insights. The views in this publication are those of Citi Private Bank's Global Investment Committee and Citi Investment Research and Analysis. These views should not be considered a solicitation, advice or recommendation with respect to asset allocation or any particular investment. If you would like a copy of the research reports listed below, please contact your Citi Personal Wealth Management advisor.

April 10, 2013

**“The outlook for recovery in the global economy looks more sustainable than at any point since the crisis,”** reckons Alexander Godwin, Citi Private Bank's Global Head of Asset Allocation, in *Market Insights* (April 5, 2013). In particular, the U.S. outlook continues to brighten. “After a prolonged period of lackluster spending, corporations in the U.S. seem finally to have the confidence to take on more debt and investment in capital goods,” Godwin writes. “This, combined with rising housing prices and a steadily improving job market, will support growth going forward.” The picture is not as bright in Europe. “Economic data in Europe continues to be poor, with rising unemployment and weakening manufacturing,” Godwin notes. “The Italian election, and now the Cyprus bank bailout, has again demonstrated the fragility of the political and economic situation in Europe.”

**Recent gains in high-grade corporate bonds may not be sustainable,** Michael Brandes contends in *Bond Market Monthly* (April 9, 2012). “Although we still believe that the fundamental backdrop for credit issuers is relatively strong, balance sheet improvements have reversed,” he writes. “Indeed, leverage ratios have risen and issuers are increasingly taking advantage of the low rate environment to fund equity-friendly (i.e., share repurchases, dividends, et al) activities.” On the other hand, Brandes has a more-positive outlook for high-yield bonds. “High-yield corporate bonds continue to benefit from low government yields, low default rates and stimulative monetary policies conducive for risk assets,” he says. “The sector is still on pace to post high single-digit total returns this year.”

**Japan has made a “regime change” in monetary policy,** Kiichi Murashima observes in *Japan Macro Flash* (April 4, 2013). Prior to the Bank of Japan's April 4 announcement that it would more than double its purchases of Japanese government bonds, the bank was more concerned about fiscal discipline and market function. The new measures “represent a ‘different dimension’ in monetary easing,” he says. But one of the goals of the new policy, to raise Japan's inflation rate to 2%, could be hard to reach. “We think that reaching the 2% inflation goal within two years will be extremely challenging, regardless of the measures just announced,” he says. “In particular, the fiscal contraction slated for 2014, which we expect to equal around 2% of GDP, is likely in our view to make it harder to raise inflation and inflation expectations.”

**“North Korea has overtaken Iran as the year's biggest potential flashpoint,”** Tina Fordham contends in *Global Political Insights* (April 4, 2013). “The stakes have increased markedly since the last period of heightened tensions in 2010,” she writes, noting that “there's new leadership in China, a more muscular Japanese foreign policy, and a United States rapidly realigning security and trade relationships with its Asian partners, not to mention a new 20-something leader in Pyongyang.” While Fordham thinks developments on the Korean peninsula bear watching, she does not believe North Korean brinksmanship will hurt South Korean economic fundamentals. “Heightened North Korean tensions do not always have negative impacts on markets and have occasionally presented buying opportunities, but any shock that affects sentiment should not be ignored,” she cautions.

**March's disappointing jobs report “should give pause but it isn't very likely signaling a new direction,”** Robert DiClemente says in *U.S. Economics Weekly: Market and Policy Comments* (April 5, 2013). “In the absence of a significant shock or collapse in demand, it isn't credible, in our view, to argue that payroll growth has abruptly turned off.” For example, spending on consumption, housing and business investment continues to be relatively strong. While fiscal tightening resulting from the sequester may affect the second quarter, DiClemente says “the signs that fundamentals are improving and that meanwhile Fed policy is continuing to err on the side of aggressive accommodation, suggest that a second quarter dip in growth will give way to renewed strengthening later in the year.”

**Recent economic reports contain both signals and noise,** Steven Wieting argues in *Morning Comments* (April 8, 2013). Among the signals is the pace of consumer spending in January and February, which was stronger than the fourth quarter of 2012 and comes in the face of a 9% jump in gasoline prices and a \$133 billion annualized increase in payroll tax collections. At the same time, “it's not credible to think there has been or will be no impact at all from these negatives,” Wieting cautions. “On the noise front, eight months of relatively ‘well behaved’ payrolls data may have once again lulled markets into complacency with the jobs report. With a 135,000 jobs per month representing just a 0.1% monthly change in the employment level, persistent accuracy in payroll forecasts shouldn't be expected.”

The information set forth was obtained from sources believed to be reliable, but we do not guarantee its accuracy or completeness. Past performance is no guarantee of future results.

The Global Investment Committee is the office of the chief investment officer that provides research and analysis to Citi's various lines of business.

This material has been prepared for informational purposes only and is not an offer to buy or sell or a solicitation of any offer to buy or sell any security or other financial instrument or to participate in any trading strategy. This is not a deemed a research report. The views and opinions contained in this material are those of the author(s) and may differ materially from the views and opinions of others at Citi Personal Wealth Management.

There is no guarantee that these strategies or views will actually occur. These views do not necessarily represent the experience of other clients, nor do they indicate future performance or success. Investment results may vary.

The investment strategies presented are not appropriate for every investor. Individual clients should review with their advisors the terms and conditions and risks involved with specific products or services.

Investments are subject to market fluctuation, investment risk, and possible loss of principal. Investing in foreign markets entails greater risks than those normally associated with domestic markets, such as political, currency, economic and market risks.

There may be additional risk associated with international investing, including foreign, economic, political, monetary and/or legal factors, changing currency exchange rates, foreign taxes, and differences in financial and accounting standards. These risks may be magnified in emerging markets. International investing may not be for everyone.

Bonds are affected by a number of risks, including fluctuations in interest rates, credit risk and prepayment risk. In general, as prevailing interest rates rise, fixed income securities prices will fall. Bonds face credit risk if a decline in

an issuer's credit rating, or creditworthiness, causes a bond's price to decline.

Citi Private Bank is a business of Citigroup Inc. ("Citigroup"), which provides its clients access to a broad array of products and services available through bank and non-bank affiliates of Citigroup. Not all products and services are provided by all affiliates or are available at all locations. All credit products are subject to credit approval. Neither Citigroup nor any of its affiliates offers tax or legal advice. In the U.S., brokerage products and services are provided by Citigroup Global Markets Inc. ("CGMI"), Member SIPC. CGMI and Citibank, N.A. are affiliated companies under the common control of Citigroup. Outside the U.S., brokerage services will be provided by other Citigroup affiliates. Investment management services (including portfolio management) are available through CGMI, Citibank, N.A. and other affiliated advisory businesses.

Citi Personal Wealth Management is a business of Citigroup Inc., which offers investment products through Citigroup Global Markets Inc. ("CGMI"), member SIPC. CGMI and Citibank, N.A. are affiliated companies under the common control of Citigroup Inc. Citi and Citi with Arc Design are registered service marks of Citigroup Inc. or its affiliates.

© 2013 Citigroup Inc.