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Natixis Asset Management's 2017 outlook: in the current market context characterized by political uncertainties and increased volatility, diversification and a selective approach will be key in seeking out yield

2016 was eventful and full of surprises, from the Brexit vote to Donald Trump's election, and 2017 looks set to be equally unpredictable, with some major political events coming up and a likely divergence in monetary policies. According to Natixis Asset Management's experts, investors who are seeking out yield will need to adopt an increasingly selective approach in view of the number of risks we are currently seeing on the financial markets.

Shift in worldwide macroeconomic balance

According to Natixis Asset Management's Chief Economist Philippe Waechter, we are set to see a change in the economic system in 2017 as a result of an in-depth shift in the balance of economic policies in the US. *"As is the case for other developed countries, monetary policy has so far underpinned private domestic demand",* he states. *"This explains why central banks kept their interest rates very low. But the tax cuts pledged by Donald Trump will buoy US domestic demand and give the Fed back some leeway, enabling it to raise its key rate and reclaim some flexibility as it manages monetary policy."*

Across other developed countries, the framework remains unchanged: the central bank's policy is still the key decisive factor in driving growth momentum. In this respect, at its December meeting the ECB clearly announced that it would keep its key rate low, even after the end of its Quantitative Easing program.

"This new order for US economic policy is set to trigger a divergence in monetary policies and hence push up US interest rates" adds Philippe Waechter. *"We are not expecting any strong moves to underpin economies in other developed markets, so this will lead to an increase in the dollar over the long term."*

Inflation is set to remain limited, well under the ECB target in the Eurozone and close to this target in the US. Meanwhile, energy will no longer make a negative contribution to inflation, but against a backdrop of modest growth worldwide, Philippe Waechter does not see a strong or lasting rise in oil prices.

Bond markets faced with rising interest rates

2016 was characterized by renewed volatility due to political risk. Concerns on the cycle in China at the start of the year, question marks over OPEC's strategy after plummeting oil prices, along with various protest votes (Brexit, Trump, Italian referendum) turned out to be decisive for the financial markets. The Fed's caution and the ECB's active approach buoyed bond performances. The low interest rate context continued, particularly as the ECB extended its asset purchase program to credit in particular. However, the trend

towards yield curve flattening gave way to a sharp steepening movement in the second half of the year.

According to Ibrahima Kobar, Co-CIO and Head of Fixed Income, uncertainties and political risk will still be ever-present in 2017. *“Europe will remain at the very heart of concerns due to Brexit and elections in France”,* he explains. *“Divergence of monetary policies may also trigger pressure on the bond markets. Lastly, OPEC members’ resolve will be tested when faced with the expected rebound in US output. The steep yield curve will safeguard investors on the fixed income markets, but we should expect greater volatility in 2017. Diversification will be key.”*

However, against this backdrop, Natixis Asset Management expects neutral to positive performances across the various bond indices. *“On the credit market, we prefer products where duration to interest rates is virtually zero, such as ABS or loans, followed by shorter duration products, High Yield as a whole as these bonds are negatively correlated with interest rates, and lastly, convertible bonds”,* concludes Ibrahima Kobar.

European equities: a year of two halves

On the equity markets, against a backdrop of ongoing very sluggish growth and weak inflation, Donald Trump’s election quickened expectations of price increases and broke with the trend towards fiscal consolidation. *“The configuration in Europe is different, but equities have followed trends on the US stockmarket, stepping up the sector rotation that kicked off mid-2016”,* states Yves Maillot, Head of European Equities. *“Cyclical and banking stocks have swiftly corrected part of their discount, to the detriment of defensives.”* The key question remains the sustainability of this trend. According to Yves Maillot, the US recovery looks logical, but transposing it to Europe is not a given. *“We therefore think it is appropriate to follow the shift towards banking stocks in the short term, but we must consider revisiting defensive stocks in the second half of 2017 as the recovery in growth will be more limited in Europe. We are also keeping an eye on oil stocks due to the combination of more stable oil prices, a drop in oil exploration spending and the increase in free cashflow. Lastly, small caps’ increasing profit growth advantage over large caps continues to make this segment attractive”,* concludes Yves Maillot.

Asset allocation: emergence of new correlations between asset classes

According to Franck Nicolas, Head of Investment & Clients Solutions, we could see a number of shifts in the usual correlations between the various assets in 2017.

All eyes will be on changes in US economic policy. Tax cuts are set to swiftly prompt renewed confidence in both consumer spending and corporate investment, yet the fiscal stimulus from infrastructure will take much longer and looks less certain. *“This change in direction comes at a time when risky assets are carrying demanding valuations due to several years of accommodative monetary policy, and this could trigger long-lasting disaffection in the shape of several months of stockmarket stagnation”,* explains Franck Nicolas. Similarly, political and economic risks in the Eurozone, such as the severe disparity of emerging regions, make a highly selective approach to asset allocation absolutely vital.

“More than ever, the secular trend towards a widespread rise for financial assets seems interrupted, so a more discerning stance will be required to seek out yield”, adds Franck Nicolas. *“We are fairly positive on US equities at this stage, although they are somewhat pricey. In the second part of the year, we will likely take profits, and if the yield curves steepen, we will bolster our allocation on US bonds. Meanwhile in Europe, we underweight both equities and fixed income. Lastly, on emerging markets, selection will be the watchword: fundamentals are admittedly stabilizing, but the rising dollar could hamper growth in some regions”,* concludes Franck Nicolas.

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Natixis Asset Management ranks among the leading European asset managers¹ with more than €355 billion in assets under management and 744 employees².

Natixis Asset Management offers its clients (institutional investors, companies, private banks, retail banks and other distribution networks) tailored, innovative and efficient solutions organised into five investment divisions: Fixed income, European equities, Investment and client solutions, Volatility and structured developed by Seeyond, Emerging equities developed by Emerise.

Natixis Asset Management owns also three subsidiaries asset managers: Mirova, Dorval Asset Management and H2O Asset Management.

Natixis Asset Management's offer is distributed through the global distribution platform of Natixis Global Asset Management and Groupe BPCE's two retail networks, Banque Populaire and Caisse d'Epargne.

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(1) Source: Natixis Asset Management – 30/09/2016.

(2) Source: IPE Top 400 Asset Managers 2016 ranked Natixis Asset Management as the 49th largest asset manager based on global assets under management, and by the country of the main headquarters and/or main European domicile, as of 31 December 2015.

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Natixis is the international corporate, investment, insurance and financial services arm of Groupe BPCE, the 2nd-largest banking group in France with 35 million clients spread over two retail banking networks, Banque Populaire and Caisse d'Epargne.

With more than 16,000 employees, Natixis has a number of areas of expertise that are organized into three main business lines: Corporate & Investment Banking, Investment Solutions & Insurance, and Specialized Financial Services.

A global player, Natixis has its own client base of companies, financial institutions and institutional investors as well as the client base of individuals, professionals and small and medium-size businesses of Groupe BPCE's banking networks.

Listed on the Paris stock exchange, it has a solid financial base with a CET1 capital under Basel 3(1) of €12.7 billion, a Basel 3 CET1 Ratio (1) of 11.2 % and quality long-term ratings (Standard & Poor's: A / Moody's: A2 / Fitch Ratings: A).

(1) Based on CRR-CRD4 rules as reported on June 26, 2013, including the Danish compromise - without phase-in except for DTAs on tax-loss carryforwards and pro forma of additional phase-in of DTAs following ECB regulation 2016/445.

Figures as at September 30, 2016

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