Warsaw, January 2018

Happy New Year 2018 from stocks and commodities – Union Investment TFI market forecasts

The team managing Union Investment TFI funds has prepared forecasts for investors for the coming year. What is the year likely to bring?

- We may expect prices of stocks and some commodities to grow in 2018, but the increase will not be as spectacular as the year ago.
- There should be attractive rates of return on the stocks of companies listed on the Warsaw Stock Exchange, particularly in H1 2018. The companies from sWIG80 index are exhibiting higher potential. We suggest that in H2 2018 investment in stocks should be gradually decreased.
- In our opinion, the following might be the potential source of risk for investors: pick-up in inflation (likely in H2 2018), geopolitical risks, and the deteriorating real estate market in China, which might lead to a crisis in the banking sector.

Global markets

Goldilocks economy – synchronized growth of the global economy

Global economies will likely continue to grow in the coming year. According to the forecasts by the International Monetary Fund, global economies will reach a 3.6% growth rate by the end of this year, and a 3.7% growth rate in 2019. The highest growth rate is expected for developing economies such as India, Russia and Indonesia.

Bull markets will maintain good position

The now mature developing markets ("bull markets") have not reached their peak yet. Currently, stocks are still the most attractive asset class. The importance of commodities and corporate bonds is growing.

We believe that next year the risk of recession will continue to rise at a steady pace, particularly in the U.S. market. However, investors do not need to worry, as the expected risk levels will be unlikely to trigger actual recession.

Inflation will remain at its low level

Capital markets will likely continue to benefit from low inflation in 2018. Our forecasts show that in Q2 2018 inflation will pick up in the U.S., where it is expected to reach 1.5%.

Slow change in the monetary policy of the central banks

Quantitative easing will wind down ("taper"), but the monetary policy of the European Central Bank is still expansive in the outlook. The Bank will continue its

policy of assets' purchase from coupon bonds and reinvestment of funds from redeemed bonds, to name a few; this policy will be effective even after the closing of the QE program that is planned for September 2018. Such dovish communication should persuade investors to invest in more risky assets. The zero interest rate policy will probably last at least until 2019.

Following the December increase in the interest rate, the U.S. Federal Reserve has announced three more interest rate rises in 2018.

The monetary policy of the central banks is thus slowly changing its direction.

Further growth in the prices of stocks

Due to a favourable market situation, global stock markets will probably see further inflow of assets from the "Great Rotation" of bonds to stocks. We believe that, as part of the small rotation within stocks, the investors will shift their interest from the "growth" to "value" companies; this however will not apply to Poland, due to the adjustment of the stock prices in the SME sector. Investors should focus on stocks with high trading liquidity. European stocks should be a better alternative to the U.S. stocks. We also recommend stocks from emerging markets, including some of the BRICS and East Asian countries.

Commodities: crude oil and industrial metals will dominate

We forecast that the next year will see a moderate growth in the prices of black gold. We expect crude oil prices to stand at USD 70/Barrel.

Industrial metals may also deserve investors' attention. What makes the prices of these commodities grow are good PMI readings, global economic growth, growing demand of industry and weak dollar.

We believe that due to moderate inflation, gold – as of Q4 2018 – might constitute alternative investment.

Greatest risks in 2018

Investors should keep a close eye on China this coming year, as in keeping with the new direction, its economy will shift from cheap labour towards better quality and added value. This might temporarily slow down the GDP growth rate. Should this be the case, the market will be adjusted.

2018 hot topics will surely include cryptocurrencies, Brexit, elections in Italy and unpredictability of North Korea.

Focus on Poland

Minor slowdown in the GDP growth rate, higher inflation and interest rates' rise

This year's GDP readings are very good. The sensational reading on Q3 2017 should mean that Q4 should also be characterised by a similar growth rate. Therefore, we keep our forecast of 4.4%. However, in 2018, we expect that the economic growth rate will drop to 4%, which will, in our opinion, be the result of the absence of a

solution to the problem of the average income trap. Unfavourable structure of GDP, i.e. pro-inflation increase in consumption and absence of private investments, will also be disadvantageous. As for public investments, the situation will be relatively good due to the 2018 municipal elections.

Our forecasts show that inflation in Poland at the end of 2017 will stand at 2%. We have noticed a regular increase in salaries as well as problems with hiring employees, which is characteristic of a downward unemployment trend. However, this trend has slowed down significantly. In our opinion, next year's inflation will augment to 2.5%, which will encourage the Monetary Policy Council to bring the interest rates up in Q4 2018.

The Warsaw Stock Exchange will grow thanks to the SMEs

The coming year might turn out to be a good year for the Warsaw Stock Exchange. We forecast that the stocks of companies listed on WSE might rise up by approximately 10-12%. Small enterprises are the ones to keep an eye on. They have a big investment potential at relatively low valuation. In our opinion, investors' exposure in stocks should be higher, particularly in Q1 2018, while Q2 2018 should be the time of portfolio reductions. At the currently high prices, this will hedge investors against possible adjustments.

2018 investment targets of Union Investment TFI for selected asset classes

Funds	Investment targets for asset classes (net of fees)
Stocks	10–12%
Money market	2.5–3%
Debt instruments	3–3.5%
Mixed	5–7%
Absolute return	3–8%