2pm PERSONALIZED PORTFOLIO MANAGEMENT

Quarterly marketreview

October 2017

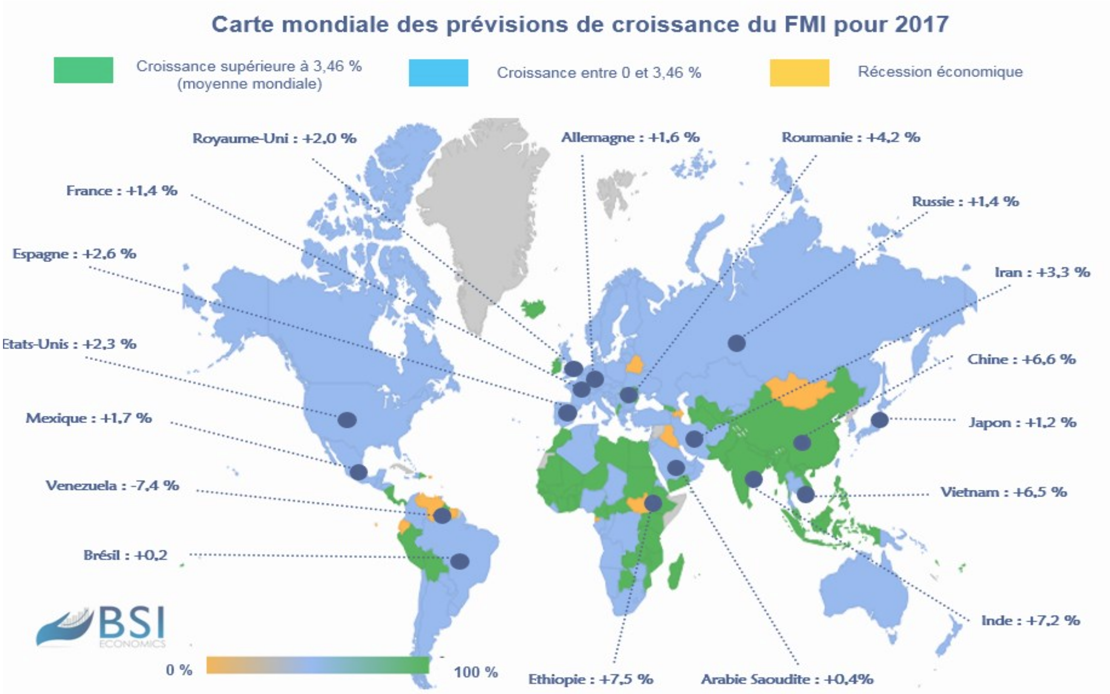
Editorial

Since the beginning of autumn, the macroeconomic environment has remained buoyant with an acceleration in global growth. The same cannot be said, however, for the global political and geopolitical environment, as the president of the United States continues have trouble passing his reforms and tensions between the United States and North Korea escalate. In the Eurozone, economic activity is improving. GDP's +0.6% growth this second quarter marks a third consecutive quarter with growth above 0.5%. This recovery is shared by all economic sectors and countries in the Eurozone. Germany remains a principal driving force, with growth pursuing a dynamic momentum and a GDP nearing +0.6% in the second quarter. Improvement (finally!) is seen in France, as economic activity has progressed to +0.5%. In Spain, despite stirrings from Catalonia's independentists which have cast a shadow on Spain's outlook, growth has confirmed its dynamism with a GDP of +0.9%. In Italy, growth has strengthened with a GDP near +0.4%. In light of these encouraging economic results and leading indicators, the IMF has revised its 2017 growth forecast and anticipates henceforth growths of 1.85% in Germany, 1.5% in France, 3.1% in Spain, and 1.3% in Italy, on top of a political risk which has otherwise been reduced since the election of Mr. Macron. While the French President has set the rhythm for working towards a strengthening of the Eurozone, last week's German elections came with an unexpected obstacle as the German chancellor learned that she will have to deal with a new coalition at parliament where the extreme right sits in third position. Moreover, political risk subsists in Italy in anticipation of potential elections to take place before March 2018. These elections could also temper the optimistic outlook set by the IMF. In the UK, growth appears modest, no doubt a consequence of BREXIT, with a GDP above +0.3% in the second quarter after a GDP of +0.2% in the first quarter. Meanwhile, industrial and construction sectors were affected by the pound's fall, which raises import prices, and lobbyists urged Theresa May's government to clarify the terms of BREXIT as soon as possible. The United States economy has remained sound. The GDP has sprung to +3%, annualized in the second quarter, from +1.2% in the first quarter. The labor market has nearly reached full employment, with the unemployment rate anchored under 5% since over one year. However, keep in mind that this momentum could slow down due to difficulties Trump faces on the internal political scene and a budget less expansionary than expected. Additionally, the US president may have difficulties implementing his ambitious tax reform after failing to repeal Obamacare. Meanwhile, certain members of the Republican Party consider this tax reform not balanced enough by economic measures. On top of that, the rising tension between the United States and North Korea, which has the global community worried, is further troubling the image of the US President.

In Jackson Hole, central bankers are remaining vague concerning their monetary policies, but it appears more and more clear that the FED and the ECB will initiate a new stage of normalization. In the US, the Federal Reserve should soon start to reduce the size of their balance sheets. In fact, the FED announced in June that it will gradually stop reinvesting in matured bonds. In contrast, we are left in suspense for the moment concerning the third rate hike expected this year…Will it be carried out in December? Seen in 2018? Bringing more uncertainty, Ms. Yellen's mandate at the head of the FED will come to an end in February, and it seems that it couldn't be renewed. Ms. Yellen has held positions often opposing Trump's administration, which aims for massive deregulation in the financial sector. In the Eurozone, Mr. Draghi carried an unmistakably optimistic tone before the summer, highlighting the 'broadening and reinforcement of economic recovery,' and the fact that 'deflationary forces have replaced reflationary ones.' Moreover, he gave hints that the BCE plans to modify their quantitative easing program. Mr. Draghi's interventions and the reunion of the ECB at the beginning of September confirmed that the ECB does not have the intention to publicize its agenda yet. In fact, the ECB may announce essential decisions concerning the future of their asset purchase program at the end of October. In the context of rising tensions between the US and North Korea, government debts provided a safe haven this summer. The 10 year French OAT yield dropped -20 bp between mid-July and the beginning of September, whereas the 10 year US yield dropped by -30 bp, returning to the low point of the year at 2.10%. The uncertainty around the FED's roadmap, doubts around Mr. Trump's capacity to implement his reforms, and the appreciation of the euro against the dollar have amplified the US bond rally. Since a few days, however, US long term rates have been on the rise again.

	Q3 2017	YTD	Close 29/09/17
DOW JONES	4.94%	13.37%	22 405.09
S&P 500	3.96%	12.53%	2 519.36
FTSE 100	0.82%	3.22%	7 372.76
EUROST.50	4.44%	9.25%	3 594.85
CAC 40	4.08%	9.61%	5 329.81
FTSE MIB	10.26%	18.00%	22 696.32
MSCI EM	7.02%	25.45%	1 081.72
CRUDE OIL	12.23%	-3.82%	51.67
GOLD	3.11%	11.10%	1 280.15
EUR/USD			1.1814
EUR/CHF			1.1439
EUR/GBP			0.8820
EURIBOR 1M			-0.372%

Within this positive global framework, we have seen equity markets take different paths during the summer period. US indices have globally been robust even with political and geopolitical events, while European equities experienced a significant setback up until August, most notably due to the strength of the euro, which our "Special Topic" is dedicated to. Meanwhile, US equities broke record highs. As recalled by certain specialists, the dollar's 10% depreciation against main global currencies drove an average appreciation of 5% of profit among US businesses. In fact, publications of US companies in the second quarter provided very good reports. We remain cautious, however, as the US market could lack catalyzers in the short term. Though economic indicators have been particularly well orientated for the past few months, the US economy has not really accelerated. The “Trump trade” is at a stop and companies which should theoretically benefit the most from the new administration’s program have returned to normal trading ranges. Consistent progress of the promised reforms is needed in order for the market to maintain these levels. Discussions within the Republican Party on tax reform will be monitored closely after Mr. Trump's failed attempt to repeal Obamacare and agreement with democrats concerning the debt ceiling. Furthermore, the valuation of US equities stands quite high, with a P/E multiple at 19x earnings in 2017. In Europe, despite good earnings, European equities lost traction during the summer due to capital outflows and the Euro's incredible rally against the dollar which has undoubtedly mislead more than one investor. The YTD gain is now back to 6%. While US equities may experience a slowdown and see some profit taking, we anticipate Eurozone equities to rebound over a three month horizon, linked to a stabilization of the euro-dollar. Euro zone equities are benefiting from a solid cyclical economic environment and valuations have remained reasonable at 15x earnings for 2017. The mergers and acquisitions market remains dynamic, which is a good indicator of manager confidence. Moreover, the potential for improvement in corporate profit margins is much higher in Europe than in the US. The reflation theme, which had run out of steam during the summer, should strengthen again due to a focus on good economic fundamentals.



Emerging markets have outperformed developed markets in 2017, with a return of nearly +30% since the beginning of the year. This rise was fueled by a robust economic environment, the maintenance of the Fed's accommodative monetary policy, the stabilization of oil prices, and the rebound of other commodities and emerging market currencies. Due to a lack of progress concerning President Trump’s protectionist measures, emerging economies continue to benefit from free trade at the global level.

In China, growth has been better than anticipated due to a stronger level of activity. The central bank began to prudently tighten its monetary policy and real estate policy has become more restrictive in cities where the housing market is overheated. In India, growth was hit by delayed, and bigger than expected, consequences of demonetization (with the withdrawal of 500 and 100 notes at the end of 2016). Good leading indicators, however, signal a resumption of activity. In the medium term, the introduction of VAT throughout India in July should contribute to growth, transforming India into a kind of single market, and will reduce administrative procedures. The IMF forecasts growths of 7.2% in 2017 and 7.7% in 2018. Russia has returned to growth since the end of 2016 after two years of recession. However, growth potential remains low at 1%, possibly 1.5%, structural constraints remain strong, and no large scale reform has been planned ahead of the presidential elections. The IMF predicts a growth rate of 1.4% in 2017 and 2018. In Brazil, things are looking up. Brazil has ended its recession and the IMF is pleased to underline the ambitious reforms planned by the government. We remain cautious, however, as President Temer is caught up in the Petrobras scandal, which could weigh down the economy on the short term. According to the IMF, the country is expected to record modest growth in 2017 (+ 0.3% according to the IMF) and lowered their growth expectation for 2018, (1.3% vs + 1.7% in the previous estimate).

For the quarter to come, we remain cautious towards the bond market, avoiding government bonds as well as investment grade corporate bonds, which are still extremely expensive. We favor short and midterm corporate euro high yield bonds and, particularly, flexible bond allocation funds (EDR Bond Allocation, Nordea Flexible Fixed Income and Legg Mason Macro Opportunity Bond Fund) as well as our emerging market bond funds. Equity markets, especially European markets after a difficult summer in 2017, appear to have more potential than fixed income markets. Absolute return funds have confirmed their progress and their capacity to generate a good performance in a manner reasonably uncorrelated with indices. We are also maintaining a significant allocation on flexible multi-asset funds, striving to maintain a balance between the most cautious (Ruffer Total Return, Nordea Stable Return, BNY Mellon Real Return) and the most optimistic (M&G Dynamic Allocation, Sycomore Allocation Patrimoine...). October is expected to allow investors to get clarity on both monetary policies and the geopolitical scene, and hopefully see a diplomatic path established between the US and North Korea.

Macroeconomics

United States:

- After a disappointing first semester, and despite devastating natural disasters, the summer ended with a perseverant acceleration of US growth.
- All leading indicators are flashing green. The ISM manufacturing index reached a 13-year high at 60.8 at the end of September and the index of services rebounded to reach a peak of 59.8.
- Consumer confidence stabilizes at high levels.
- For the moment, this growth is not provoking a significant increase in inflation. It is, nevertheless, at + 1.9%, (+ 1.7% excluding more cyclical elements), very close to the Federal Reserve's target.

Europe:

- In the Eurozone, favorable momentum continues to persist in the third trimester.
- At a level of 58.1, the manufacturing activity index reflects vigorous growth undisturbed, for the moment, by the rebound of the euro.
- Core inflation is struggling to rise above + 1.2% and the overall index above + 1.5%. Inflation, though, is a lagging indicator: its evolution is out of sync with economic activity and it should continue to increase from now until the end of the year.
- This positive situation will undoubtedly drive Mr. Draghi to delve into the specifics of his agenda in the coming weeks concerning the exit of his ultra-accommodative monetary program.

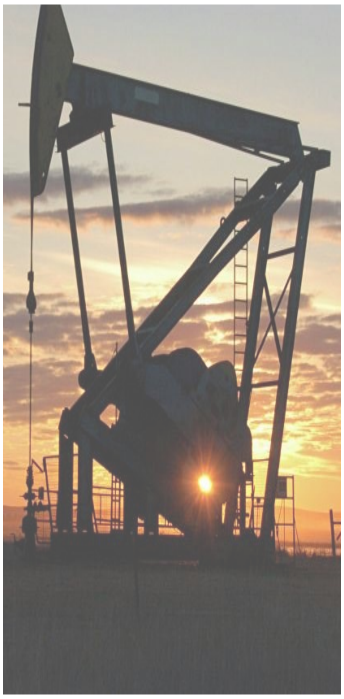
China:

- After a solid performance during first half of the year, which surprised a good number of analysts, growth slowly weakened during the summer.
- Local and national authorities have made economic stability a priority during this period of political renewal.
- At the national level, credit supply is being piloted by pressures put on the banking system (interest rates and the reserve requirement ratio). At the local level, pressure is being directed towards the real estate market.
- As a result of rising debt levels, the S & P and Moody's lowered their Chinese sovereign ratings in September.

Broad View

Black Gold: The unexpected movements

It was a moment when a large number of observers no longer believed that black gold would emerge from its summer lethargy. The price of oil retrieved their spring highs with a WTI at $50 and even above in the case of Brent at $58. This positive dynamic is justified by a change of sentiment following a visible amelioration of a few fundamentals:



Production in the United States: measured by the number of rigs actively drilling, it confirms a downward trend that began in early August.

Climatic disruptions: Hurricanes that swept the Gulf of Mexico and Florida have put a weight on total US stocks (oil and gas) as they continue to decline. (Production in the United States has also normalized).

Geopolitical factors: Tensions in Iraqi Kurdistan have helped support the price of crude oil. In fact, Mr. Barzani's, President of the Autonomous Region of Iraqi Kurdistan, decision to organize a self -determination referendum, in spite of opposition from Bagdad and other neighboring countries (Turkey and Iran), had an impact on market sentiment. The «yes» triumphed, but Kurdistan seems to be largely isolated. Iraq called a boycott on Kurdish oil and President Erdogan threatened to stop exports via Turkey, a key trade hub for exporting to Europe. Some 550-600.000 barrels of Iraqi Kurdistan oil, produced per day, are exported via a pipeline linked to the Turkish Mediterranean port of Ceyhan. President Erdogan's threat is considered extremely serious by the market.

The warming relations between oil-producing countries: The reunion of OPEC and/non OPEC countries held on the 23 of September was quite constructive. The cartel remains optimistic vis-a-vis the rebalancing of the market and reiterated that « all options remain open » in order to assure a stabilization of supply and demand and for « the benefit of all». The positive agreement between Russia and Saudi Arabia has been reinforced by the recent meeting in Moscow between King Salman and Vladimir Poutine. The Russian leader specified that the decision regarding the extension of production cuts beyond March 2018 will take place next January. The United Emirates, known as the bad student in terms of respecting quotas, announced 100% accordance with last November's agreement. The next meeting, to be held in late November in Vienna, should consolidate this consensus.

With an ameliorating technical configuration, optimists can dream of a return of barrel prices at 55$, even 60$, in the next months, a scenario which seemed still, since recently, very improbable.

Special Topic

€/$: a turning point ?

The market's alleviation following the results of the French presidential election was the factor that triggered the spectacular strengthening of the euro in recent months. This could be the starting point of a long term trend reversal. Technically, based on history, the euro's significant trends (and previously the German mark), which govern the evolution of the euro against the dollar, last on average 6 to 9 years. It has now been 9 years since the euro depreciated, from 1.6038 in 2008 to its lowest at the beginning of the year at 1.0341. Though there have been favorable periods for the single currency, the underlying trends have made themselves clear.

Technically speaking again, the turnaround we are currently observing resembles, in all respects, the reversal of 2000/2002 which followed a long period of the dollar appreciating. I.e. a testing point for the Euro's low followed by a sharp rise (cf graph).

Beyond technical analysis, the political risk feared in Europe for 2017 ultimately did not materialize. It instead crossed the Atlantic. Brexit and the rise of populism triggered a political will to change a Europe that is not pragmatic enough, not convergent enough, and far from its people. Meanwhile, the inability of President Trump to pass his promised reforms has made investors nervous. This nervousness has been expressed more on the forex market than on the stock market. The rapid appreciation of the euro from 1,0341 to 1,2092 is not only related to political factors. To this, we must add the unexpected robust economic improvement in the Eurozone which has induced a GDP growth rhythm above 2% in the first semester, a rate that had not been seen in a long time. The second half of the year should be of the same quality, which will push the ECB to prematurely announce details regarding an exit plan from their ultra-accommodating policy.

As Europe gradually filled its cyclical lag with the US, forex markets had to adjust. Moreover, the middle/end of the US economy's business cycle often corresponds to periods of dollar underperformance, which generally allows companies to more readily absorb the Federal Reserve's rate hikes.

In the short term and by the end of the year, this increase could very well be reversed and a few factors could support the greenback. Firstly, in the US, and in order to be in good condition before midterm elections, Republicans should temporarily bury the hatchet with Donald Trump and pass a tax reform. Beyond the good news that would come with this agreement, the dollar could also be sustained by tax incentives that facilitate the repatriation of profits accumulated in foreign currencies. We are talking about 1 to 3 trillion dollars' worth of potentially affected assets. In Europe, political tensions around the Catalan referendum have put negative strains on the Euro, strains whose actual implications have not yet been fully measured, especially considering that the Italian elections could rekindle political risk in the Eurozone.

Beyond these short-term factors that could push the euro back below 1.15, it appears that we may modify our typical reflexes on the forex market and consider the next phases of the dollar's appreciation as opportunities to sell. There is a lot of uncertainty and the forex market is known to be one of the most unpredictable, but little by little, key elements falling into place are signaling us to become more cautious towards the greenback. We can bet that doomsayers in the Eurozone will, without a doubt, disagree with this analysis.

EUR/USD over the last 40 years