2pm PERSONALIZED PORTFOLIO MANAGEMENT

Quarterly market review

April 2019

Editorial

First quarter of 2019, exceptional for risky assets

After the fourth quarter of 2016, the recovery of risky assets in the first quarter of 2019 was quite remarkable. Thus, as we write these lines, the S&P500 has completely canceled its Q4 2018 loss of 14% by achieving the best quarter since the post-crisis recovery of 2009. The same for the Eurostoxx50 which has more than recovered the - 12% recorded at the end of last year. Similarly, in the emerging markets, the MSCI Emerging Markets erased its -7% drop in Q4 2018, almost + 10% over the last three months. At the same time, bonds performed well, with the Bloomberg Barclays Euro Government 1-10-year Index and the IBOXX Euro Liquid Corporates Index up 1.42% and 4.03% respectively. Gold also posted positive performances (+ 0.77% in USD) while a barrel of crude rose by 32.44% in the first quarter. Overall, risk appetite brought equities back to the highs of 2018 while volatility dropped to low points. This very rapid rise in global stock markets reinforces our philosophy of relative stability in our allocations. We observe this in the performance of competing multi-asset funds; the losers are those who ventured to cut the risk at the end of last year and thus accumulated a significant performance lag over the quarter, compared to those who remained invested or who, like us, have marginally strengthened their positions in the December trough. Market timing is decidedly an extremely random exercise ...

Several elements explain this vigorous rebound:

First, the attitude of central bankers around the world. Late last year, the US Federal Reserve had already altered its stance before announcing in January a pause in its cycle of hardening. At the FOMC meeting in March, the Fed confirmed its accommodative bias against a backdrop of a deteriorating economic outlook, first of all by downgrading its projection table, which now expects no rate hike in 2019 and just one in 2020; secondly by downgrading its growth and inflation outlook; and thirdly by announcing that it would reduce its balance sheet more moderately from May to stop completely in September. This political turnaround by the Fed, which is turning away from a systematic reduction of its balance sheet to stop it this year, was a crucial element for the markets that had suffered in 2018 from fears related to quantitative tightening. In the same spirit, the European Central Bank was more conciliatory in March, excluding any rate hike by the end of the year and announcing a new TLTRO (refinancing operation to support regional banks). Finally, in China, the PBoC has repeatedly lowered the amount of reserve requirements for banks and could further relax its policy on several other fronts.

Second, operators have bet on a favorable outcome to the trade dispute between the United States and China, the two parties having lately issued rather encouraging signals.

Lastly, the Q4 2018 quarterly results published at the beginning of the year by listed companies were generally good on both sides of the Atlantic. For example, nearly 75% of US companies have released results above consensus.

These three elements have favored the persistence of a deliberately "risk-on" attitude among operators who suddenly have integrated, with great complacency, the incredible British BREXIT circus or the deterioration of macroeconomic figures that raise fears that the global economy is now on a downward slope.

At the end of last year, we adopted a rather positive tactical positioning regarding risky assets, taking advantage of the December anomaly to marginally complete some of our positions. Today, it seems wise to show more neutrality, or even more caution because:

A) The slowdown in global growth has been proven, particularly in Europe which could moreover be affected by exogenous political factors in the event of a United Kingdom exit without agreement from the EU, results clearly in favor of the populist parties in the European elections or in the event of a worsening Italian political and economic situation.

	FY 2018	Q1 2019	Close 29/03/19
DOW JONES	-5.63%	11.15%	25 928.68
S&P 500	-6.24%	13.07%	2 834.40
FTSE 100	-12.48%	8.19%	7 279.19
EUROST.50	-14.34%	11.67%	3 351.71
CAC 40	-10.95%	13.10%	5 350.53
FTSE MIB	-16.15%	16.17%	21 286.13
MSCI EM	-16.64%	9.56%	1 058.13
CRUDE OIL	-24.84%	32.44%	60.14
GOLD	-1.58%	0.77%	1 292.30
EUR/USD			1.1218
EUR/CHF			1.1163
EUR/GBP			0.8606
EURIBOR 1M			-0.367%

B) Markets are likely to have integrated the more accommodating positioning of central banks into the stock market, with, in the case of Europe, an additional pitfall: at the current level of both short and long rates, i.e. close to 0, the margins for maneuver for the ECB are now limited compared to the situation in US or Chinese central banks. Not to mention that the upcoming departure of Mario Draghi, whose action proved brilliant in many ways, is a major uncertainty.

C) Furthermore, operators have more than anticipated a favorable outcome for Sino-US trade negotiations. Once the agreement is made public in the coming weeks, a classic "sell the news" reaction could be implemented.

D) Market growth since the beginning of the year did not occur in high volumes.

In any case, the publication period of the results of companies that will begin in the next few days should be very enlightening. We will be able to analyze how the economic slowdown has affected companies' turnover or not and measure their ability to maintain stable results. We will be particularly attentive to the margins of US companies, some of which could be penalized by rising labor costs and energy costs. Emerging markets could hold good surprises, both in equity and debt.

Faced with this potentially more uncertain environment in the coming months, we continue to believe that it is essential to build robust portfolios, always more discerning in the choice of our investors / instruments, and through effective diversification. On these levels, we particularly like funds that recurrently manage to present asymmetrical behavior, positively capturing the gains, but protecting assets in the event of a decline. We also prefer investors who give us access to some decorrelating assets that we do not own or have a direct interest in: US bonds, real estate, private equity, infrastructures, loans... We maintain our mix of flexible bond funds and our range of high quality multi-assets funds, mixing styles and management methodologies as efficiently as possible. We continue to hold some real gold in the bottom of our wallet for protection and insurance.

Christophe Carrafang

The Big Picture

The new deal with bonds

The Fed was the first from 2015 to start a reduction program as part of its policy called "quantitative easing". The ECB is about to enter a stabilization phase just like Japan. Since the beginning of the year, it seems that the Chinese Central Bank (PBoC) has followed suit. If it continues its momentum, a trend deemed credible by several observers, it could trigger the gradual decline of the global liquidity. This risks calling into question several balances that financial markets have become accustomed to, in particular, low volatility and lower and lower yields.

As a result, investors will have to be selective because an environment of less liquidity from central banks generally leads to greater volatility. Such a context tends to benefit companies with strong balance sheets that are committed to preserving a sustainable capital structure.

To which investment categories do we turn? The high-yielding compartment has had a good run. In the United States, the high-yield bond index since the beginning of the year has soared more than 7%, and now gives the impression of falling on a resistance threshold at the level of US government bonds, at around 350 basis points. The same is true for Europe, where the high-yield credit market grew by almost 6% in the first quarter. Emerging bond markets after the debacle last year also rebounded spectacularly (+ 5.4%).

This will not prevent central banks from remaining masters of the game and deftly practicing the art of opposition as we saw at the last Fed meeting of the Monetary Policy Committee on March 20.

Last fall, many saw US 10-year bond yields rise steadily to 3.50% or even 4%. These forecasts were based on the anticipation of several rounds of tricks from the Fed, made necessary by the strength of growth and unemployment at its lowest rate in history (see below the 10Y US Treasury Bond Yield chart).

Jerome Powell, the governor of the Fed, surprised us by announcing a pause in the process of adjusting its intervention rate. This means that, more than ever, diversification is necessary and the choice of instruments (issues and funds) becomes a determining factor.

Geoffroy de Villaines

Macro-economy

MANUFACTURING ACTIVITY

- Rebound of Chinese manufacturing activity at the end of the quarter. Indicators have been reverted to growth levels (average 50.6). The fiscal stimulus of 1.5% of GDP begins to take effect.
- Rebound observed also in the United Kingdom (55.1) and the US (55.3).
- Manufacturing weakness in the Euro Zone continues, showing a particularly severe decline in Germany and Italy.
- We are no doubt witnessing the end of the second manufacturing recession since the great crisis of 2008 (see Special Topic).

SERVICES ACTIVITY

- Overall, the level of service activity is correct, it offsets the weakness of the productive sector.
- Declining interest rates, a rather favorable employment situation and fiscal and budgetary incentives favor the purchasing power of households.
- Saving rates are rising everywhere, suggesting that consumption will remain well oriented.
- PMI / ISM services indexes remain strong, close to 55 in China, bouncing back in the Euro Zone at the end of the quarter. In the US, the indicator falls in March, but remains one of the best indicators of developed countries.

INFLATION

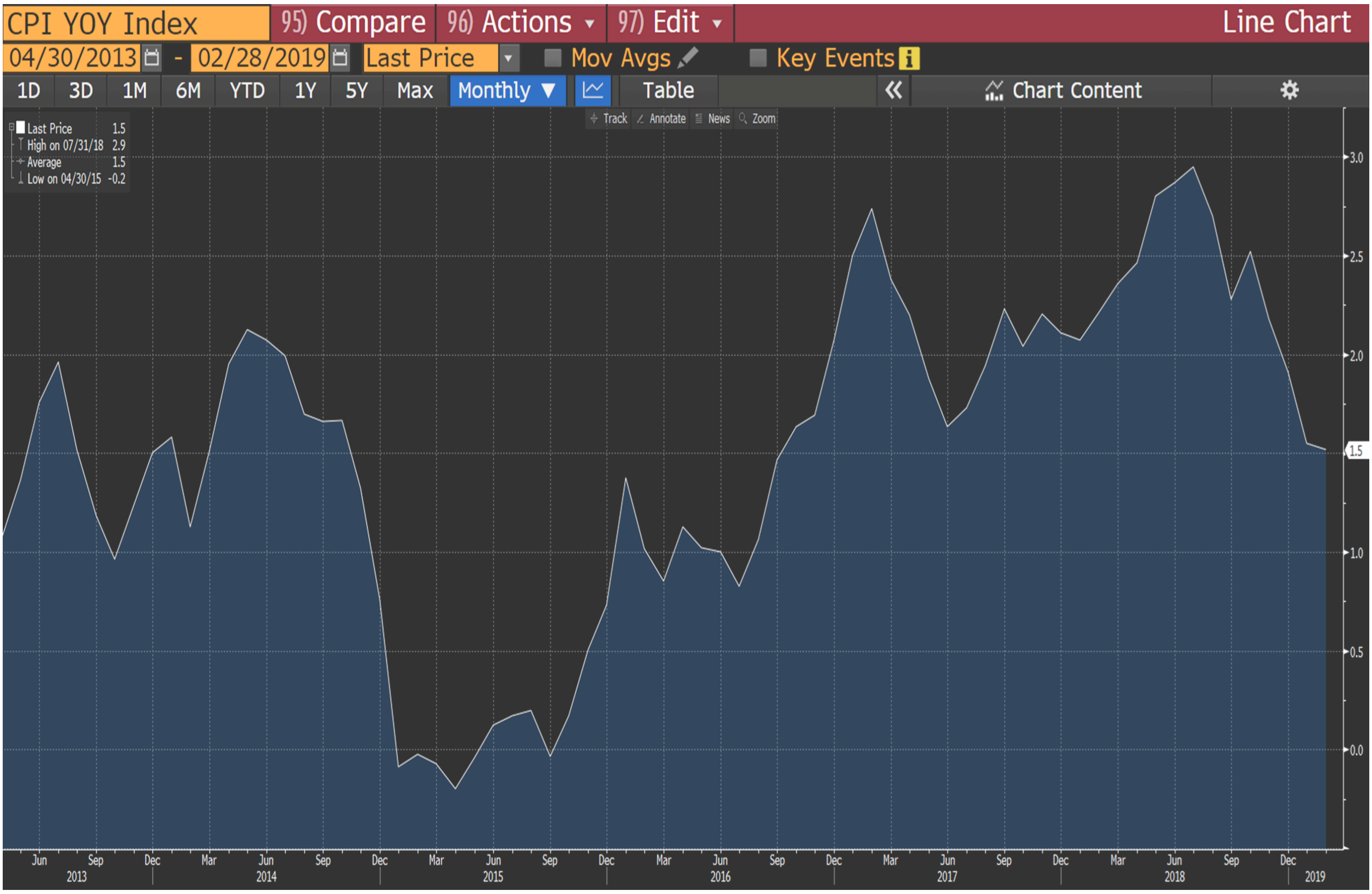
- The measured growth environment is accompanied by low inflation rates.
- In the Euro Zone, prices rose at an annualized rate of only + 1.4% at the end of March against a peak of + 2.2% in October 2018. Excluding cyclical components, the increase was only + 0.8%.
- In the US, we see the same trend with a core rate of + 2.1% against + 2.2% at the end of last year.
- The change in tone of the ECB and the US Federal Reserve triggered a general decline in interest rates.

GROWTH

- Overall growth prospects have been revised downwards for the 2019/2020 period.
- According to the average forecast, US growth should be + 2.4% in 2019, and that of the Euro Zone to + 1.2%.
- Global growth is forecast at + 3.4% in 2019 and + 3.3% for 2020.

Damien Liegeois

US Consumer Price Index since 2013



Special Topic

Will the current cycle last as long as envisioned?

One wonders about the length of the current cycle that has lasted since the end of the 2008 crisis, notably a lack of recession in the US. What we often forget is that this cycle is atypical for several reasons: Historically, the recovery was one of the weakest modern recessions, which is explained by the violence and the nature of the events of 2008. Similarly, price growth remains relatively low, particularly because of the 'uberisation' / digitization of the economy, which pushed prices down, compressed wage increases and thus avoided recessionary inflationary shocks. Another decisive factor is the mastered and structural slowdown in the Chinese economy, which is gradually transforming itself from an emerging to a developed economy.

These elements allow interest rates to remain below historical averages which supports the activity but raises fears for some of a new debt crisis.

If at the global level and the major economies a recession is unlikely in the medium term, it is also because we have experienced, in recent years, two changes in the manufacturing cycle punctuated by productive recessions. These economic developments were accompanied in 2015 and 2018 by recessionary market conditions: significant drop in stock market indexes, bankruptcy of companies, decline in high yield bonds, decline in the banking sector, and rally in protection assets (Gold, US debt, German debt ...).

Firstly, a commodities cycle triggered by an OPEC decision late in 2014, and a slowdown in the Chinese economy, led to a vertiginous drop in oil from $ 110 to $ 26 (see chart below). This collapse caused a recession of the entire oil industry (with many bankruptcies), a recession in Brazil, Russia, Indonesia and undermined some monarchies in the Persian Gulf.

The second manufacturing recession we are currently experiencing, with again a Chinese slowdown accompanied by the US Sino trade tensions, a reversal of the semiconductor cycle and an automotive sector caught between drastic regulation and custom pricing fears, all crowned by political crises in Italy and the UK. The recession was narrowly avoided in Germany, but not in Italy. The semiconductor sector has been affected in the same way as the producing countries (Taiwan, Korea) as well as the entire automotive sector, which is valued on highly discounted multiples.

This cycle is certainly long, and among the longest in history, but it has been slowed down already twice by manufacturing cycles that have allowed adjustments, and thereby restored fuel to the main cycle; a first time in 2016 and a second time in 2019?

Damien Liegeois

Crude Oil prices since 2008