Quarterly market review

July 2019

Editorial

	Q2 2019	YTD	Close 28/06/19
DOW JONES	2.59%	14.03%	26 599.96
S&P 500	3.79%	17.35%	2 941.76
FTSE 100	2.01%	10.37%	7 425.63
EUROST.50	3.64%	15.73%	3 473.69
CAC 40	3.52%	17.09%	5 538.97
FTSE MIB	-0.24%	15.88%	21 234.79
MSCI EM	-0.31%	9.22%	1 054.86
CRUDE OIL	-2.78%	28.76%	58.47
GOLD	9.07%	9.90%	1 409.45
EUR/USD			1.1373
EUR/CHF			1.1104
EUR/GBP			0.8958
EURIBOR 1M			-0.388%

More than ever, this second quarter of 2019 has been under the double influence of the central bankers and the Twitter account of the American president. His double tweet of May 5 announcing a new salvo of customs taxes on Chinese imports will indeed ignite the fuse, putting a stop to the stock market rally that had developed for 4 months.

Everything was going for the better. The reporting period for US companies for the first quarter had generally started well. And even when he had hinted at the Fed's last meeting that a rate cut was not on the agenda, the president of the US Central Bank had barely begun investor optimism. The Chinese stock market has been close to 30% since the beginning of the year, and the S&P 500 was close to its historic high, with a rise of 25% since the December 24th low. The recovery was even more enduring since an agreement between Beijing and Washington on the trade war seemed imminent. Unfortunately, the two tweets published Sunday 5th May by D. Trump disturbed this tranquility. The tenant of the White House has indeed announced that the rate of 10% on 200 billion Chinese goods would quickly be increased to 25%. With this threat, if the negotiations were to skate, tax at 25% would yield about 325 billion in additional imports.

The markets' reaction was not surprising, with the S & P 500 index falling by nearly 7% in the four weeks that followed. Same-level decline on European stock markets, with a more pronounced decline in sectors more directly related to China, such as luxury goods or the automobile sector, whereas Hong Kong posted a 10% decline. This brutal reaction from investors is not surprising because the markets were a little sleepy on the risk of escalation in trade tensions, being surprised by the already proven tactics of D. Trump with muscular threats and maximum pressure before refining and reaching his goals. The strategy is certainly risky because the Chinese are by nature reluctant to negotiate with such shotgun schemes, but this strategy is probably based on the observation that the two superpowers have invested too much political capital to let the conflict get too steamy. Especially, since the economic consequences would not be neutral. In fact, more than 90% of already taxed goods were intermediate goods. These taxes therefore had little direct effect on the prices paid by consumers. But with the escalation to 25% on an additional 325 billion, it is the entire economy that could be penalized; experts believe that a tough trade war could lose almost a point in global growth.

It is undoubtedly the consideration of this reality that led to the new truce concluded between China and the United States on the sidelines of the last G20 in Osaka last week. It is true that, in the context of a generalized slowdown in profits, the fall in business investment observed in recent months could lead to a pause or even a decrease in hiring, negatively impacting consumer spending and thereby forcing the risk of recession. Far too dangerous at the dawn of 2020 is the election campaign year for Donald Trump's re-election. Washington has therefore waived the imposition of additional tariffs on Chinese imports, and negotiations for an agreement are expected to resume after several weeks of relatively cool relations between Beijing and the White House. The operators have not shunned their pleasure, enthusiastically propelling the S & P 500 index beyond the historical high of 2955 points. Same dynamic in Europe with the breaking of 3500 points on the Eurostoxx50 index, which, like the US index, had been rising again since the beginning of June, thanks to the very accommodating positioning of large central banks.

The Fed and ECB, with well-calibrated speeches, have indeed contributed greatly to the good performance of equity markets since the beginning of the year, except for the difficult month of May that we have just mentioned. Some might add that the 180-degree turn of the central bankers was also the real surprise element of the first half. The speed and strength with which the monetary authorities moved from a strict policy in late 2018 to a stimulus strategy is unheard of. For the US central bank, the difference compared to the expected key interest rate reaches at least 1.5 percentage points: from 3 to 4 rate increases planned for the end of 2018, operators have now started to anticipate 2 to 3 rate cuts. The reasons for this turnaround are equally remarkable. It is not so much a reaction to a change in economic reality as the US economy has evolved more or less as expected in the first quarter. The Fed seems especially for the moment, which is rather rare, to react to the nervousness observed on the financial markets and to the huge decrease of the estimates of inflation by the operators. In the euro zone too, inflation expectations have fallen back to unprecedented levels. In concrete terms, the markets no longer seem to believe that central banks will maintain their inflation target of plus or minus 2% in the short term. To counter this perception, the Fed and the ECB have multiplied the dovish, i.e. accommodating speeches, with new stimuli on the horizon across the range of instruments available. On a strictly economic level, some economists even publicly ask if

such rate cuts would be useful to the United States while Trump uses all his weight to see them materialize.

It is in this context that much less hawkish (i.e. combative against inflation, ed) long-term bond yields fell in proportions that no one suspected at the beginning of the year. Thus, the 10-year US fell from 2.685 to 2.006% as of June 28, while the yield of the German Bund at 10 years was declining from 0.24 to -0.33%! It therefore becomes complicated for the EUR core investor to find decent returns on the bond market, even by substantially degrading the quality of issuers. This also largely explains the rally observed on the equity markets: Many investors, not necessarily very invested at the beginning of the year after the purge of 2018 and disconcerted by the negative monetary returns and the low yields of fixed-rate papers, are therefore forced to re-enter the world stock exchanges, thus fueling the rise in prices. Another factor that is more mathematical, but just as relevant, valuations rise mechanically with falling interest rates. What is a stock market price, if not the discounting of future flows of a company? Well, when the discount rate drops to the denominator, the enterprise value goes up. Unstoppable. Finally, numerous mergers / acquisitions (United Technologies-Raytheon, Gemini-Altran Cap, Abbvie-Allergan ...) as well as share buyback programs have supported the rating. At the end of April, the amount invested since the beginning of the year by American companies in their own shares was estimated at $300 billion. In Europe, share buybacks are at their highest level in ten years. With such low rates, it is tempting for many European companies to go into debt to buy back their own shares ...

The question therefore arises: Can this rally continue over the next few months? Difficult to answer this question as the different market segments seem to integrate different things. Recent movements in US and European yield curves suggest that bond specialists anticipate an escalation of the trade war, macroeconomic data becoming more subdued and expectations of ever lower inflation. At the time of writing, the 10Y US has just gone back below the 2% mark ... On the contrary, it is clear that those who are still interested in equity markets today see the glass as half full and tend to focus on the very accommodating policies of central banks (with both short and long rates that will remain permanently low), the power of the Chinese stimulus, and the expectation of an upcoming agreement between Washington and Beijing on the eve of an election year in America.

We would rather tend to be in the second camp, finding that equity markets today harbor more opportunities than the bond markets which are frankly expensive. However, two geopolitical unknowns will lead us to remain extremely vigilant in the coming months. First, the rising tensions in the Strait of Hormuz in a context of escalation between Iran and the United States against the backdrop of the American desire to renegotiate the Iran nuclear deal. And secondly, the unknown Brexit (see our Big Picture below) which could, in case of exit without agreement of the United Kingdom under the aegis of the whimsical B. Johnson, cost Europe some growth points. Diversification will therefore remain crucial, especially in emerging countries that benefit from valuations that are still attractive in relative terms, particularly Asia and China, which cannot be ignored today in a global portfolio.

C. Carrafang

The Big Picture

BREXIT OR NOT BREXIT, TREACHEROUS OR CANDID ALBION?

Probably for the first time in its history, the Kingdom of Her Most Gracious Majesty presents a wavering image that provokes the astonishment or ire of the international community. After having voted in favor of leaving the European Union exactly three years ago, the United Kingdom seems to be in such a stalemate that we are currently wondering whether there will be Brexit (hard or soft). or not Brexit? We already know that the candidate who will succeed Theresa May at 10 Downing Street will be from the pro-Brexit camp. One of the paradoxes of the political situation was the moderate "Pro Remain" personality in charge of implementing the exit of the U.E. The alternative now is between former London mayor Boris Johnson, an eccentric figure in British politics, and Jeremie Hunt, current Secretary of State for Foreign Affairs, a moderately conservative party figure.

The favorite is Boris Johnson who does not hide his desire to meet the deadline set in agreement with the U.E October 31, 2019 ... with or without a deal! An agreement that will not be renegotiated as confirmed by the new European Commissioner, Ursula von der Leyden. Will he manage to override the will of deputies in the Commons, who are mostly hostile to an exit without agreement under the leadership of the flamboyant speaker John Bercow? Nothing is less sure. A showdown could then occur, with MPs able to use two weapons: one to make the exit impossible without an agreement, the other to bring down the government. In both cases, the race against time will be tight because in the current climate, few are the parliamentarians wishing to soon represent themselves before their constituents. The name of the lucky winner will be known in the week of July 22, but the suspense will remain intact for some time before reaching the chop date.

The task of the future Prime Minister will be immense because beyond the European question, the challenge arises to restore confidence to economic agents, uncertainty being the worst enemy of companies and financial markets. IHS Markit announced that the economy had contracted slightly in the second quarter for the first time since 2012 as well as the index of positive economic surprises.

This context explains the underperformance of British financial assets since the 2016 referendum, with the exception of bonds protected by their safe haven status. Bond yields eased to the same extent as other major markets. But it was currency that the sanction affected heavily, resulting in a depreciation of the pound sterling more than 15% against the dollar and the euro and also compared to its theoretical parity of purchasing power. For the next few months, which will undoubtedly be more volatile, the forecast differences are considerable. Facing the dollar, forecasts for extreme scenarios range from 1.15 to 1.45 against 1.26 today. There may be something for the most daring investors to do and make a "Never Ending Story" a Happy End.

G. de Villlaines

Macro-economy

CHAMPIONS OF EXPORT FACE DIFFICULTY...

- Germany, Japan, China, Korea, Taiwan: Manufacturing indexes are at their lowest, and still indicate that a manufacturing recession is in progress.
- This mainly reflects the difficulties in the automotive sector (regulations, energy mix,) and semiconductors (cyclical correction).
- US-Sino tensions are also holding back investment intentions of business leaders.

BUT THERE ARE REASONS TO HOPE:

- Since the G20 Meeting, there has been a lull in China-US tensions.
- Some leading indicators such as the Baltic Dry Index, the price index for the transport of industrial raw materials, have been growing for several months (see graph below).
- The effects of the Chinese stimulus package should be felt in the second half of the year.
- Similarly, in the US, Democratic and Republican lawmakers are negotiating a plan for the renewal and repair of infrastructure across the country… we are talking about $1,500 to $2,000 billion.

FRANCE: A MORE DOMESTIC ECONOMY THAT IS RIDING THE TIDE OF THE PRESENT ENVIRONMENT.

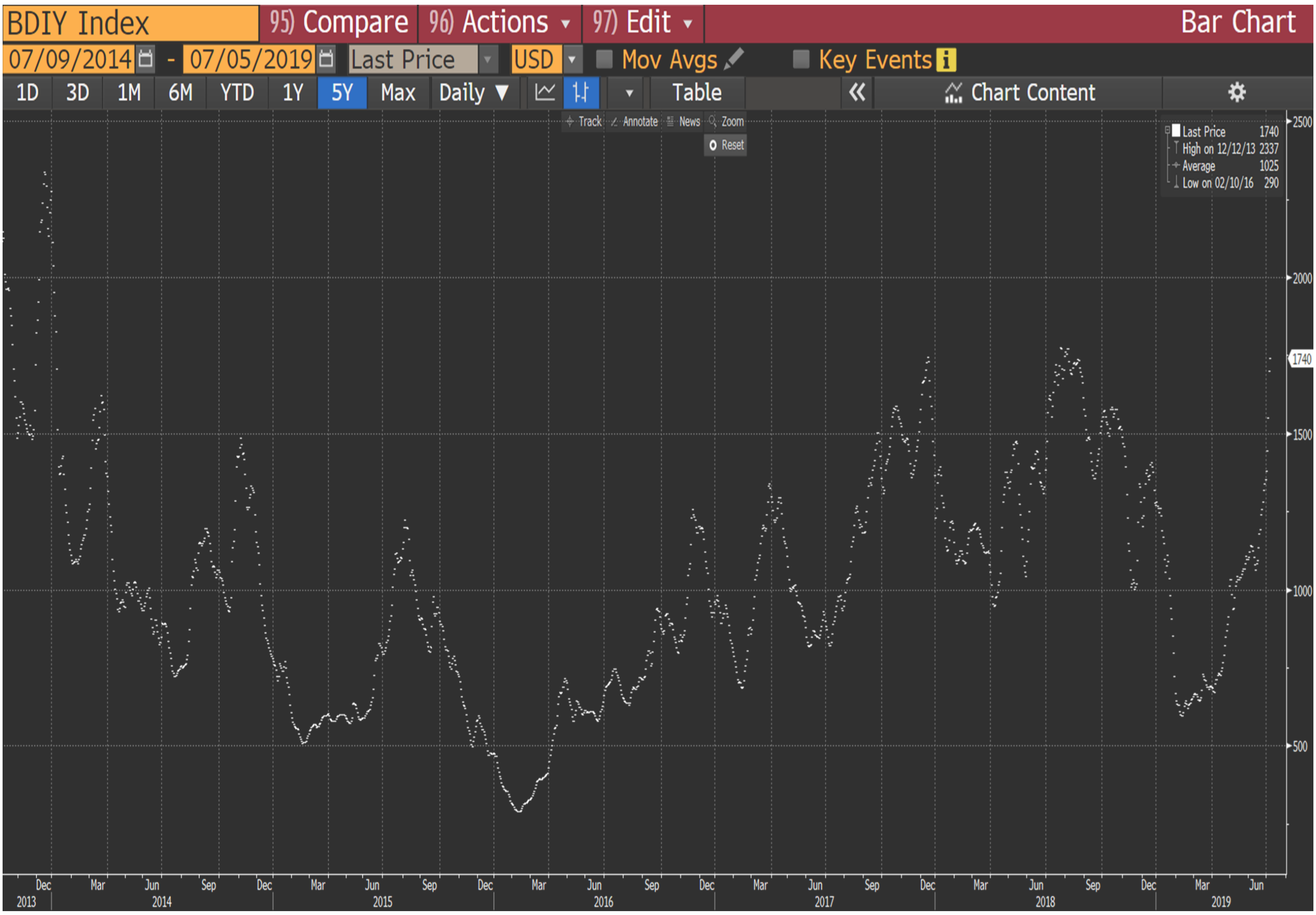
- As a result of government action, consumer confidence has rebounded strongly since the beginning of the year.
- Consumption is again well oriented.
- The French growth rate, +1.3%, is thus much better than Germany's +0.8% rate.

USA: WHAT HAPPENED TO FEARS OF RECESSION?

- Economic figures are a bit disappointing, but the base effects are significant after a year at almost 3% growth.
- Expectations for GDP growth are still excellent at +2.5%.
- The services index is down, but relatively high at 55.1.
- Job creation remains strong, the month of June being good with 224K job creations against 72K in the previous month.

D. Liegeois

Baltic Dry Index since 2014



Special Topic

Libra or the revival of crypto currencies?

They had almost died out, finished, and suddenly they revived. The most famous of these, Bitcoin, which lost more than 80% since its highs of 2007, rebounded nearly 300% in a few months before falling back to nearly 25% in 24 hours in June.

The increase was fueled by massive redemptions of short selling positions, but not only. It was also supported by the announcement by Facebook and twenty other companies to create a crypto currency: the LIBRA. With 2.7 billion customers and 90m companies on its platforms, Facebook wants to create its own currency (instrument of exchange?), available to all, especially for those who do not have access to a bank account. The use of Blockchain technology will ensure the speed and security of online transactions (see operating diagram below).

Until now, the value of a crypto currency was determined solely by supply and demand, with supply bottlenecks in the uptrend phases and vice versa on demand in downturns. Whoever enters at a certain price gives value to the one who leaves. Such a parallel with a pyramid organization (Ponzi scheme) is quite obvious. The operation of the Libra will be different, since with each monetary creation, the Libra Association undertakes to buy the equivalent in sovereign securities in developed currencies: USD, GBP, CHF, EUR, and its value will vary according to a fixed currency basket. This mode of operation will be similar in operation to the IMF's special drawing rights, but accessible to all.

Is the Libra the new crypto currency? Yes. New bitcoin? No. By its operation, it will be infinitely less volatile and should not be the subject of crazy speculation. It could even be a simple e-transaction tool. No one has a clue; even Facebook does not know (yet) and will proceed step by step.

The Libra Association will thus have some of the same prerogatives as a Central Bank: the capacity to create money and the ability to hold sovereign securities (interest). If its adoption is a success, there is no fear that the use of this medium of exchange may limit in the long run, the impact of conventional monetary policies, or even that it may, in some emerging countries, encourage the flight of capital and precipitate the fall of a currency.

The future will tell if consumers will favor this method of payment, but the presence of online payment masters: Mastercard, PayPal and Visa, is a sign that this project makes sense and that it will go far. In any case, this announcement has made the central bankers react, reluctant to allow a new sister to come on the scene without any state commitment. In this context, and it was time, the response is organized. The Central Banks reacted by announcing the creation within the G7 of a task force on anti-money laundering requirements and the client's knowledge of these new currencies. Which might bring them back into the ranks?

D. Liegeois