2pm PERSONALIZED PORTFOLIO MANAGEMENT

Quarterly market review

October 2019

Editorial

Equity markets have been volatile this summer, as is often the case at this time of the year, with a major hinge around August 15. Thus, the Eurostoxx50 was deviating more than 7% between the high point of July 4 and the low point of August 15, marked by the rise of geopolitical risks and the slowdown in macroeconomic data, especially in the manufacturing sector, to finally rebound quite strenuously by nearly 9% until the end of September. Same evolution in "V" in the United States, however on a smaller scale (-4%, + 5%). Before trying to identify some prospects for this end of the year and the beginning of 2020, it is useful to review the events of the summer in order to understand the reasons for this increased volatility, after a deliberate "risk-on" start of the year.

The historical observation of the US economic statistics shows us that the degradation really began in the spring of 2018, but it is quite obvious that the commercial tensions between the United States and China, because of the rise of the uncertainty, have without a doubt magnified the slowdown in business investment, dragging the manufacturing sector into a recession. However, the good news is that the monetary authorities did not procrastinate to take the necessary action. At his July press conference, Mario Draghi pointed out that European inflation has been below acceptable levels for too long, paving the way for monetary easing in September, details of which can be found in our Special Topic on Central Banks on page 4. Similarly, the US Federal Reserve lowered its key interest rate by a quarter of a point by the end of July, highlighting the absence of inflationary pressures, the impacts of the trade war, and global growth under pressure. From a terminological point of view, Jerome Powell, the president of the FED, described this gesture as "a mid-cycle adjustment" and not the beginning of a prolonged

cycle of falling interest rates, attracting the wrath of Donald Trump waiting for action and a more accommodating speech. This has not stopped long rates from relaxing dramatically on both sides of the Atlantic. Thus, the 10-year yield of the US Treasury Bond passed from 2.00% at the end of June to 1.66% at the end of September, after bottoming out at 1.46% on September 3rd. Who would have imagined this in December 2018 when the US 10Y yielded 3.20%? Similarly, the 10-year yield of the German Bund was down 0.24% at the beginning of the year, and -0.57% at end September, after hitting a low -0.71% on 28/08! It is therefore understandable why performance differentials are so important this year between investors still having a good bond pocket (a fortiori longer) and those who a few months ago, drastically lowered the duration in their portfolios.

The political situation in Europe has also played a role with a bag of surprises this summer, fueling the persistence of some volatility in the market. Starting with the Italian situation where Matteo Salvini undeniably appears as the big loser of the political soap opera of the Italy’s summer. And yet it was he, himself, who penned the first page by deciding last August 9 to end the government experience between his party, the League (far right), and the 5 Stars Movement (M5S, antisystem). Pressed by the calendar, annoyed by the blockages imposed by the M5S and especially galvanized by excellent polls showing his party in the lead, the Minister of the Interior took a daring bet: he called for the organization of early elections. Salvini's mistake was to underestimate the former president of the Italian Council. As a reminder, Matteo Renzi was the one who killed the talks between the M5S and his Democratic Party in 2018. It was this torpedoing in rule that led to the M5S-Lega alliance as the only possible majority. But things have changed since then. Renzi has certainly lost the party secretariat, but he is preparing a new electoral option comparable to En Marche, which is not yet ready to go into orbit. Therefore, he did not want a return to the ballot box in the short term. This is one of the basic reasons why Renzi made a gamble by opening the door to the M5S to form a new government. The leader of the League did not expect this turnaround, thinking that a majority between PD and M5S would be impossible. That is why, in the week of August 12-19, he made a series of mistakes that cost him dearly afterwards. He first called for censoring Giuseppe Conte's government in order to bring it down and provoke a return to the polls. Then, in front of the advance of the M5S-PD talks, he took a step back and proposed to Di Maio to pick up the pieces while he had just triggered a political psychodrama in the heart of the summer. Subsequently, he reshuffled and demanded a return to the polls, before again calling his ally to return to the table to reform the government he had just torpedoed. These procrastinations gave an image of irresponsibility and inconsistency on the part of the one who had, so far, dominated the

	Q3 2019	YTD	Close 30/09/19
DOW JONES	1.19%	15.39%	26 916.83
S&P 500	1.19%	18.74%	2 976.74
FTSE 100	-0.23%	10.11%	7 408.21
EUROST.50	2.76%	18.93%	3 569.45
CAC 40	2.51%	20.02%	5 677.79
FTSE MIB	4.11%	20.65%	22 107.70
MSCI EM	-5.11%	3.65%	1 001.00
CRUDE OIL	-7.53%	19.07%	54.07
GOLD	4.47%	14.81%	1 472.39
EUR/USD			1.0899
EUR/CHF			1.0875
EUR/GBP			0.88686
EURIBOR 1M			-0.457%

situation. Salvini has lost part of his aura and the myth of his infallibility has been damaged. He pays clearly in the polls where there is a significant decline in the League and a rise of the M5S and the PD. In the Conte 2 government, he was replaced by a technician little known to the general public, Luciana Lamorghese, who has been frequently positioned in the past in favor of the integration of migrants. Thus, a change in the Interior and an attitude now much more cooperative vis-à-vis Europe, as evidenced by the tremendous easing observed on the Italian bond, which contributed in part to the strong rebound of European markets from mid-August.

The second European soap opera of the summer, truly a saga: BREXIT. Call to mind that to avoid a brutal divorce between the United Kingdom and the EU, the European and British parliaments must validate an exit agreement and a political declaration that will frame their future negotiations. The United Kingdom would then enter a transition period until 31 December 2020. A period of time that would allow agreements to be reached on future relations. On the other hand, if no withdrawal agreement is endorsed ("no deal" scenario), the UK will be considered a third country from the first day of Brexit. This fateful date was set for March 29, 2019 at midnight, before being postponed until April 12, and finally October 31. If the withdrawal agreement is still not validated by the House of Commons on that date, the British could end up without an agreement, cancel the Brexit or request a new postponement. All scenarios are still open. Having failed to implement the Brexit, Theresa May resigned from the post of Prime Minister on June 7. She has been replaced by Boris Johnson since July 24, who was elected by the Conservatives. After failing twice to call early elections before the suspension of the Parliament he had decided until October 14, Johnson finally proposed on October 1 a new agreement to the EU in which he proposes an alternative to " backstop ". Northern Ireland would be maintained in the common market for a renewable four-year period and would continue to follow EU regulations, while regulatory controls would take place between the province and the rest of the Kingdom in the Irish Sea. However, it would come out of the customs zone with the rest of the United Kingdom, which would also entail the return of customs controls to the Island of Ireland. This proposal was timidly welcomed by the Europeans. France, Germany and Ireland, on the other hand, deplore such an unacceptable offer. While Jean-Claude Juncker and Michel Barnier have welcomed positive progress; they expect more guarantees on the protection of the single market in Ireland in particular. Parliament spokesman for Brexit, Guy Verhofstadt, also regretted the lack of guarantees. While there are still many doubts, all agree to continue negotiations on the basis of this proposal. Boris Johnson has indeed indicated his intention to put an end to the negotiations if this plan was rejected, posing the threat of an exit without agreement at the end of the month.

So much for this busy summer. What can we hope for the next few months? The sharp decline in markets in the first days of October seems to indicate that traders are afraid of a recession as trade tensions depress the manufacturing sector and that the slight reversal of the curve of US rates in its short portion urges to act prudently. That said, at 2PM, we strive to keep a cool head, because the combination of very accommodating central banks with a possible upcoming truce in the trade war, and why not the prospect of fiscal stimulus in China and Germany (more and more talk on this subject), could suddenly clear up the horizon, although well obstructed at the moment. In the United States, the weakness of recent statistics in the manufacturing sector urge for a quick trade agreement with the Chinese. Moreover as we enter an election year in the US, and Donald Trump, although impeded by cumbersome impeachment procedures for him at this time, will be keen to do everything to avoid a recession before the elections. Also in China, the deterioration in employment figures and the fear of social instability could push the authorities to de-escalate trade and set up a stimulus on the domestic front. If these two conditions are met - trade agreement and stimulus in China and perhaps Germany - then a global economic recovery in 2020 is far from a far-fetched assumption.

In terms of classes of assets, stocks could therefore still have potential. Valuations are far from excessive, especially in Europe, most emerging markets, and Japan. Dividends pay more than bond yields. And, especially, the flows will continue to exist. Truly, where else to invest than in equity markets for the long-term investor, when the government bond yields remain desperately low, or negative as in Europe?

Conversely, bonds are probably the riskiest asset class to date, especially after the dramatic easing of 10-year yields since the beginning of the year. Credit spreads are also very small, and in many cases (apart from perhaps European bank subordinates and the emerging bond), we are not really paid for the bond risk we are taking.

With $17 trillion of negative debt, gold has regained its reputation and its status as a safe haven. And despite the recent upsurge, it still seems useful as an insurance and hedge against systemic risk and the inflationary risk of holding a bit of golden metal in portfolios.

We also maintain exposure to our mix of liquid absolute return funds, as well as our multi-asset class funds, with a particular focus on diversification of management styles, after the first nine months of 2019 which will have shown very large performance gaps between investors, related to the content of their respective bond pockets (holding of government bonds or not? long duration or short?) and how they cut, or not, the risk action at the end of year 2018.

Christophe Carrafang

The Big Picture

Gold – Solid as ever

In recent years, gold had become a neglected asset. After its peak in September 2011 to more than USD 1900/oz at the height of the sovereign debt crisis in the euro area, it suffered a violent relapse to USD 1050 end 2015 before being shunned by investors until last spring. Since May, it has seen a spectacular improvement from USD 1280 to USD 1550 at the beginning of September, an increase of more than 20% in 4 months.

Several factors can explain this ascension:

The flight of the precious metal comes as the gold market stalled at the beginning of the year, when investors were confident about the future and the global trading environment seemed to be easing after rising economic tensions between China and the United States.

But that was without considering the unpredictable American president and the return of tensions between Washington and Beijing. In general, we know that gold is part of the safe haven and that in all respects the international context seems more than ever uncertain and dangerous: impeachment procedure against the American President; drone attack presumably orchestrated by Iran against the main oil installations of Saudi Arabia. To this must be added the endless saga of Brexit and recently North Korea, which benefits from the weakening of the US President entangled in the famous Ukrainian case, to renew ballistic missile launch tests.

Another important factor is interest rates: Gold being an asset with no return, it suffers structurally from the competition of risk-free investments. But we are living in an exceptional period where a large number of developed countries offer low interest rates, mainly in the Anglo-Saxon world, and even negative in the Euro Zone. As a result, holding the fine metal is much less expensive in terms of opportunity cost. This ultra-lax monetary policy is likely to revive inflation at a certain moment as wage tensions in several developed economies begin to emerge. This has been the case since the summer of 2018 in the United States, but this is also the case in Europe and even surprisingly in the United Kingdom on the eve of the expiration of the Brexit deadline.

Diversification of central bank reserves. China, like many other countries such as Russia, for example, also use it as a political weapon in their bilateral relations with the United States. A way for them to try to counter the strength of the greenback.

Finally, the traditional demand of the two major consumer countries, China and India. In this instance, its level of control is very sensitive to the fluctuations of its currency. Thus, the very beginning of the recovery of gold also coincided with the low point reached by the Indian currency against the dollar in October 2018. In such an environment and despite its recent rise, for any investor looking for diversification, it seems quite reasonable to hold on to gold.

Geoffroy de Villaines

Macro-economy

MANUFACTURING ACTIVITY

- The long-awaited improvement is slow in coming.
- The US indicator falls below the psychological threshold of 50 for September (47.8), while a slight improvement was expected.
- For the Euro Zone and the United Kingdom, it stabilizes at fairly low levels of 45.7 and 48.3, respectively.
- Activity in China continues its rebound initiated in July (51.4 for the private indicator Caixin).

SERVICES ACTIVITY

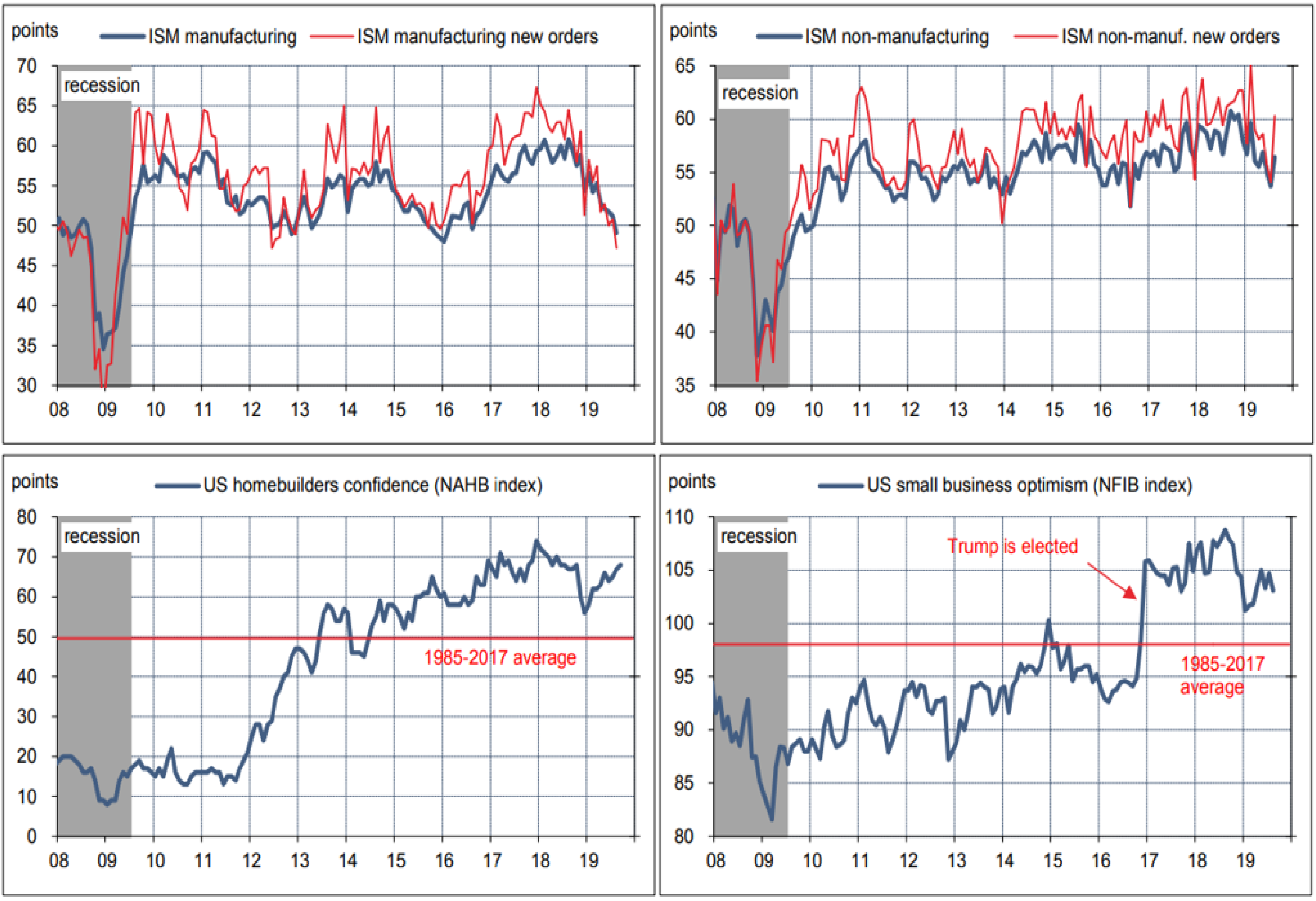
- In the United States, the slowdown in growth continues and weighs on the service activity whose indicator drops to 52.6.
- The improvement in the service activity in the Euro Zone, observed since the beginning of the year, suffered a halt (temporary?) in September with a disappointing indicator.
- In China, it remains well oriented with a good consumer performance.

INFLATION

- Core inflation in Europe remains relatively stable around 1%. With the fall in the price of commodities and despite a weak currency, the global inflation indicator (with energy and raw materials) fell to 0.9% against 2% a year ago.
- In the U.S., the "core" indicator rose in the quarter from + 0.4% to 2.4%, due to the rise in wage costs, while the overall indicator remained stable at 1.7%.
- In many emerging countries, inflation is declining, allowing monetary authorities to implement easing policies: China, Brazil, Turkey, Russia, South Africa, India...

Damien Liegeois

US Business Sentiment



Special Topic

The Federal Reserve and the European Central Bank in support of activity

The global manufacturing activity recession has led central banks to stop monetary tightening and lead a new phase of easing. The current environment seems similar to that of the manufacturing crisis of 2014-2015, related to the event of the sharp fall of oil.

The Federal Reserve was the first to act in July with a rate cut from 2.5% to 2.25% and again mid-September from 2.25% to 2%. Mr. Powell said the 0.5% drop is part of a mid-cycle easing rather than the beginning of a long run of decline. Certainly, the rest of activity, especially that of services and consumption, remains relatively well oriented. Market watchers want more, since at the end of September, 60% of them project a further decline at the next meeting on October 30, and a very large majority of them (80%) in mid-December. Two new declines are expected by the end of the year. The pressure is also strong from the White House where Donald Trump continues to vilify Jerome Powell of his reluctance, he who wants interest rates and a much lower dollar.

It is thus difficult to say where it will end exactly since the probability of occurrence will vary daily in accordance with the quality of economic figures.

In September, the European Central Bank acted in turn to revive the activity of the Euro Zone. Mario Draghi first announced a drop of -0.50% in the deposit rate and a return of asset purchases for 20 billion euros per month from November, with no deadline this time. Finally, in an attempt to soften the cost of negative interest rates for the banking sector, the new TLTROs (loans to the banking sector) will be less costly for the sector.

These measures are not the "money Bazooka" that some had hoped for, but they are already important and have caused a sharp decline in rates, including the so-called peripheral countries. These rate movements will save the Eurozone countries tens of billions of euros of interest on their debt. In return, the ECB urges governments to encourage them to pursue in parallel vigorous fiscal policies. Indeed, after years of austerity, the structural budget balance excluding interest charges is positive which, together with lower interest charges, provides a favorable environment for expansionary fiscal policies. Some countries, such as France and Italy, applaud; others like Germany or the Netherlands are not applauding at all.

The European monetary authorities could have done more, but Mario Draghi undoubtedly wanted to leave room for maneuver to Christine Lagarde, his successor (on November 1), who in her speech in parliament confirmed the continuation of an expansionary monetary policy for the coming quarters.

Damien Liegeois

FED & ECB key rates