Weekly Update

C0 | EXTERNAL PUBLICATION


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All data taken from Bloomberg (11/10/2018).

Keep calm and carry on

The equity sell-off which began in the US last week has intensified in recent days and spread to other markets. The selling was triggered when strong US data – non-manufacturing ISM index at record highs and the lowest unemployment since 1969 – bred fears that rates would rise faster than expected. The S&P 500 shed 5.3% on Wednesday 10 and Thursday 11, leaving it down 6.9% from September 20's historic high. However, the overall decline has been more moderate so far than during the February correction while there has been little sign of a flight to safety in traditional safe havens such as Gold, US Treasuries or German Bunds.

The selling pressure may be related to investors locking in profits on equities in light of numerous headwinds for risky assets – the challenges created by rising bond yields, escalating trade wars, Brexit uncertainty or Italian budget concerns. Liquidity support to richly-valued assets is being removed gradually as central banks normalise policy – liquidity is tightening steadily as the Federal Reserve hikes rates and shrinks its balance sheet, while the European Central Bank will soon halt Quantitative Easing. In addition, inflationary pressure is building gradually, especially in the US and Germany where output gaps have narrowed, fuelling fears that central banks might need to hike more than anticipated.

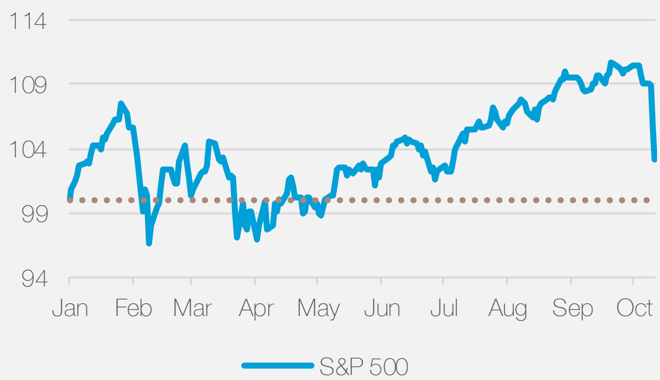
However, the fundamental backdrop is unchanged. Sustained global growth still justifies a moderate pro-risk stance and we do not expect that recent declines in equities will turn into a bear market. This being said, high valuations and tighter US monetary conditions are a recipe for temporary sell-offs. In addition, market jitters are likely as investors try to assess signals of easing momentum and worry about softer earnings growth.

The third-quarter (Q3) earnings season should reassure investors about US corporate sales and earnings – according to FactSet, the S&P 500 should report earnings growth above 20% for the third straight quarter. We do not expect any squeeze on US corporate margins before mid-2019, suggesting robust profitability. Banks will kick off Q3 reporting with JP Morgan, Citigroup, Wells Fargo on October 12.

Putting it all together. Our current allocation is unchanged, with a preference for US equities versus eurozone and Japanese equities. We prefer short-dated bonds, and high yielding credit. We remain defensive on long-dated bonds (US Treasuries and German Bund) as interest risks are tilted to the upside.

Trends remain on the upside despite the sell-off

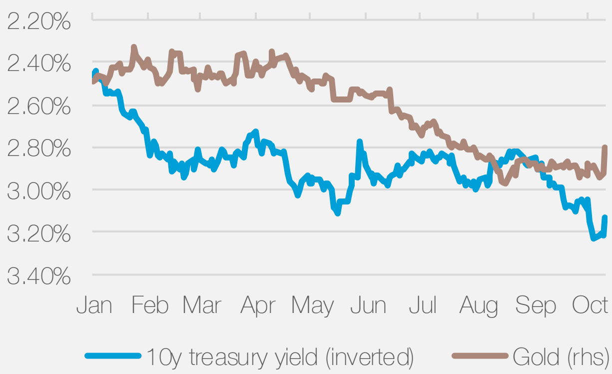
S&P 500 daily rate, in net returns



Sources: SGPB, Macrobond, 11/10/2018.

Little sign of a flight to safety in traditional safe havens

10-yr US Treasury yield and Gold trends (in $)



Sources: SGPB, Macrobond, Q2 2018.

Past performance should not be seen as a guarantee of future returns

This week and next

EUROZONE

- The fall in Sentix investor confidence in October was greater than expected, from 12 to 11.4. Uncertainties related to Italian fiscal policies and the German automotive industry probably took their toll.
- Industrial production growth rebounded from 0.3% YoY to 0.9% in August but is still well below early 2018 levels.
- Weak industrial output in Germany meant a third consecutive month of decline, at -0.3% MoM in August. In contrast, output in France has recovered over the past three months, up +0.3% in August.
- In Italy, consumer surveys improved with the Thomson Reuters sentiment index for October up from 45 to 45.6.

Next week's key events	Per.	Prev.	Cons.
17 Oct Headline inflation YoY	Sep	2.1%	2.1%
19 Oct Current account SA, €bn	Aug	21.3	--

UNITED KINGDOM

- GDP grew 0.7% in the three months to August, unchanged from the three months to July, boosted by a 0.8% rise in manufacturing.
- Industrial production was resilient, up 1.3% YoY from 1% in July. However, manufacturing output decelerated for the second consecutive month in August, down from 1.4% YoY to 1.3%.
- Domestic retail sales lost momentum for the fifth consecutive month according to BRC/KPMG, down -0.2% YoY.
- After three months of improvement, the trade deficit widened to -£11.2bn in August.

Next week's key events	Per.	Prev.	Cons.
16 Oct Unemployment rate	Aug	4.0%	4.0%
17 Oct Headline inflation YoY	Sep	2.7%	2.6%

UNITED STATES

- Headline inflation slowed from 2.7% YoY to 2.3% in September, but core prices rose 2.2% YoY, unchanged from August.
- The producer price index rose 2.6% YoY in September, slightly below expectations and the previous reading, both at 2.8%.
- The number of Americans filing for unemployment benefits surprised on the upside last week at 214k but still is close to early September's 49-year low.
- The NFIB's small business optimism index dropped slightly from August's historic high of 108.8 to 107.9 in September.

Next week's key events	Per.	Prev.	Cons.
15 Oct Retail sales (ex. autos) MoM	Sep	0.3%	0.3%
16 Oct Industrial production MoM	Oct	0.4%	0.3%

ASIA & EMERGING COUNTRIES

- Japan machinery orders expanded +12.6% YoY in August, slightly lower than the previous reading at 13.9%.
- Japanese bank lending has gained traction in recent months and printed at 2.3% YoY in September.
- Corporate goods prices (price companies charge each other for their goods and services) rose 3% YoY – encouragement for the Bank of Japan to reach its 2% inflation target.
- China's trade surplus was higher than expected at $31.7bn in September, as imports decelerated from +19.9% YoY to +14.3% and exports outperformed expectations, improving from +9.8% YoY to +14.5%.

Next week's key events	Per.	Prev.	Cons.
10 Oct Japan: Trade balance (¥bn)	Sep	-438.4	-50.0
19 Oct China: GDP YoY	Q3	6.7%	6.6%

Sources: Datastream, Bloomberg, 12 October 2018, Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, ECB = European Central Bank

Our 3-month targets for currencies and commodities

	Thursday close	3mth target
EUR/USD	1.15	1.15
GBP/USD	1.30	1.32
EUR/CHF	1.14	1.09
USD/JPY	114	110
Brent	$84.5	$80
Gold	$1199	$1220

Forecast figures are not a reliable indicator of future performance

Our 3-month targets are unchanged this week.

Question time

Past performance should not be seen as a guarantee of future returns.

Brazil General elections – Bolsonaro, close to a run-off

What were the general election results?

General elections were held on Sunday October 7 to elect Brazil's President and National Congress (2/3rd of the Senate and all 513 members of the Chamber of Deputies). Voters were also asked to vote for their State Governors and State Legislative Assemblies.

Among the 13 presidential candidates, Jair Bolsonaro, the far-right front-runner for the upstart Social Liberal Party (PSL) won 46% of the votes, beating all expectations. This is nearly 17% ahead of Fernando Haddad, the candidate of the leftist Workers' Party (PT), replacing former President Lula who was ruled ineligible in late August. The run-off between Bolsonaro and Haddad is on Sunday October 28.

Will Brazil see a regime shift?

The congressional election saw a swing to the right in both houses. The PSL won four Senate seats and 52 in the lower house (versus zero and 8 previously), making it the second-biggest party after the PT. More importantly, centre-right and right-wing parties won an estimated 63% of seats in the lower house, potentially implying strong support for Bolsonaro. However, Congress is highly fragmented (31 parties in the lower house, 20 in the Senate), hardly conducive to passing structural reforms.

Does the electorate still support any of the traditional parties?

Bolsonaro's clear lead in the first round has been boosted by anti-PT and anti-corruption sentiment. Brazil has just emerged from its worst ever recession and a corruption scandal that implicated most traditional parties – anti-establishment sentiment is running high. The results also reflect deep divisions in Brazilian society. Despite his controversial views and statements, Bolsonaro gained a majority in the two most populous states, Sao Paulo and Rio de Janeiro, while Haddad only won a majority in the northeast, a Lula stronghold.

How is Bolsonaro viewed by markets?

Investors perceive Bolsonaro as business and market friendly given his talk of free-market reforms. The Bovespa (+4.6%) and real (+1.6% vs. dollar) reacted positively to results on Monday 8, but then shed 2.8% on Wednesday 10 after promises of privatisation and pension reform were noticeably toned down.

In addition, Bolsonaro's highly-respected chief economic advisor is being investigated over accusations of fraud tied to the pension funds of state-run companies allegedly mismanaged by investment firms run by him.

What's next?

According to a Datafolha poll on Wednesday 10, voter intentions for the second round show 58% support for Bolsonaro versus 42% for Haddad (+/-2% margin of error, but with 14% still to decide). No television debates have been scheduled so far as Bolsonaro's doctors deem he has not recovered sufficiently after being stabbed last month by an opposition supporter.

But the game is not over yet. Haddad could try to move to the centre to woo support from other political parties to build an anti-Bolsonaro bloc. However, the PSL leader looks set to remain the front runner.

Market performance

Past performance should not be seen as a guarantee of future returns.

Interest rates

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-37 bp	0 bp	→	0 bp	-2 bp	0 bp
3mth Euribor (EUR)	-32 bp	0 bp	→	0 bp	1 bp	1 bp
3mth Libor (USD)	244 bp	3 bp	↑	10 bp	74 bp	108 bp
3mth Libor (GBP)	81 bp	1 bp	→	9 bp	29 bp	44 bp
10-year US Treasury bond	313 bp	-6 bp	↓	rke	72 bp	79 bp
10-year German bond	52 bp	-2 bp	↓	21 bp	9 bp	5 bp
10-year French bond	88 bp	0 bp	→	23 bp	9 bp	-1 bp
10-year UK bond	168 bp	1 bp	→	38 bp	49 bp	29 bp

Credit

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	0.0%	→	-0.4 %	-0.8 %	-0.3 %
BAML EURO Corp HY	-0.7%	↓	0.1 %	-0.6 %	-0.2 %
BAML GBP Corp IG	-0.5%	↓	-1.3 %	-2.9 %	-0.9 %
BAML US IG	0.2%	↑	-0.3 %	-2.8 %	-1.9 %
BAML US HY	-0.8%	↓	1.0 %	1.4 %	1.6 %
JPM Global EM Sov. Plus	-0.7%	↓	-1.5 %	-5.9 %	-5.0 %

Exchange rates

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1.16	0.7 %	↑	-0.7 %	-3.5 %	-2.2%
EUR/CHF	1.15	0.5 %	↑	-1.3 %	-2.0 %	-0.6%
GBP/USD	1.32	1.7 %	↑	0.2 %	-2.0 %	0.1%
USD/JPY	112	-1.5 %	↓	0.1 %	-0.4 %	-0.3%
USD/BRL	3.78	-2.4 %	↓	-2.5 %	14.2 %	19.2%
USD/CNY	6.89	0.3 %	↑	3.1 %	5.9 %	4.5%
USD/RUB	66.3	-1.1 %	↓	6.2 %	15.0 %	14.7%

Government bonds*

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	0.3 %	↑	-0.4 %	-1.3 %	-1.8 %
United Kingdom (3-7yr)	0.0 %	→	-0.6 %	-1.0 %	-0.5 %
Germany (3-7yr)	0.1 %	↑	-0.7 %	-0.1 %	-0.4 %
Japan (3-7yr)	0.1 %	→	-0.2 %	-0.2 %	-0.1 %

Equities*

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	489	-5.5 %	↓	-3.7 %	-2.6 %	1.6 %
Eurostoxx 50	3,209	-4.9 %	↓	-5.9 %	-5.4 %	-7.9 %
DAX	11,539	-5.8 %	↓	-7.1 %	-10.7 %	-11.0 %
CAC 40	5,106	-5.6 %	↓	-4.4 %	-1.0 %	-1.7 %
S&P 500	2,728	-5.9 %	↓	-1.2 %	3.6 %	8.8 %
FTSE 100	7,007	-5.4 %	↓	-6.6 %	-5.6 %	-3.0 %
SMI	8,639	-5.0 %	↓	-0.4 %	-4.7 %	-3.5 %
Topix	1,702	-5.5 %	↓	0.8 %	-4.5 %	2.5 %
IBOV Brazil	82,921	0.0 %	→	11.5 %	8.5 %	8.2 %
MICEX Russia *	2,366	-4.0 %	↓	1.3 %	12.2 %	12.6 %
MSCI EM	955	-5.5 %	↓	-9.7 %	-15.5 %	-12.2 %
SENSEX 30 India	34,001	-3.3 %	↓	-6.0 %	1.6 %	8.0 %
Hang Seng (H-K)	25,266	-5.0 %	↓	-10.0 %	-12.7 %	-7.8 %
Shanghaï Composite	2,583	-8.4 %	↓	-7.0 %	-21.9 %	-23.8 %

Commodities

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$81	-5.6 %	↓	5.7 %	21.6 %	43.7 %
Gold	$1,219	1.3 %	↑	-2.2 %	-6.5 %	-5.4 %
Silver	$14.6	-0.2 %	↓	-7.9 %	-14.2 %	-14.7 %

Source: DataStream, on 11/10/2018. 1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7 year returns. Figures are rounded.

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