Weekly Update

C0 | EXTERNAL PUBLICATION

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All data taken from Bloomberg (22/11/2018).

Tech it easy

For several years now, Information Technology (Tech) has been the single largest sector of the US stock market, representing 26.5% of the S&P500 index at end August 2018, before a series of changes in sector definitions. It has also been the single largest contributor to performance since end-March 2009, rising 499% versus 344% for the S&P500 (on a net total return basis). So, the recent tumble has been a rude awakening for many investors. What caused it, and what is the outlook for tech?

As highlighted in our Weekly Update back on April 6, pressure on the sector has risen over the past twelve months from a number of sources. Data protection has become an area of acute concern as revelations about potential abuses have emerged (for example, the Cambridge Analytica/Facebook scandal), as illustrated by the European Union's General Data Protection Regulation which took effect in late May. More recently, Apple chief executive Tim Cook declared in an interview that new regulations were "inevitable".

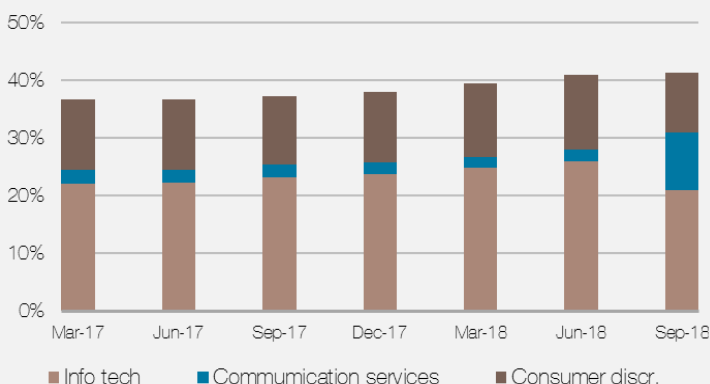
The increased scrutiny has come with increased financial penalties. This year alone, the European Commission has fined Qualcomm ($1.2bn), Google ($5bn) and in September Apple completed payment of $16bn in disputed taxes to Ireland. Moreover, moves are afoot to change the basis under which technology and online businesses are taxed. In his recent budget, UK chancellor Philip Hammond announced that large internet companies would be taxed 2% on their UK revenues from April 2020. A move which is a forerunner to the EU plan to levy a 3% tax on the sector's turnover.

In addition, signs have emerged of a slowdown in tech demand. For example, the revenue growth rate for the global semi-conductor industry has slowed from 21.6% year-on year in 2017 to 12.4% this year with forecasts of 4.4% in 2019. When announcing its Q3 results, chipmaker Nvidia revealed that the collapse in crypto-currency mining had hit demand for its products. And Apple's decision to halt reporting iPhone sales raised fears that its key product was on the wane.

Analysis of the Tech sector has been muddied by sector reclassification, with internet retailers moving to Consumer Discretionary and Social Media stocks to Communication Services. As a result, Information Technology has shrunk from 26.5% of the index to 19.8%, triggering some ETF selling which has added to the downward pressure.

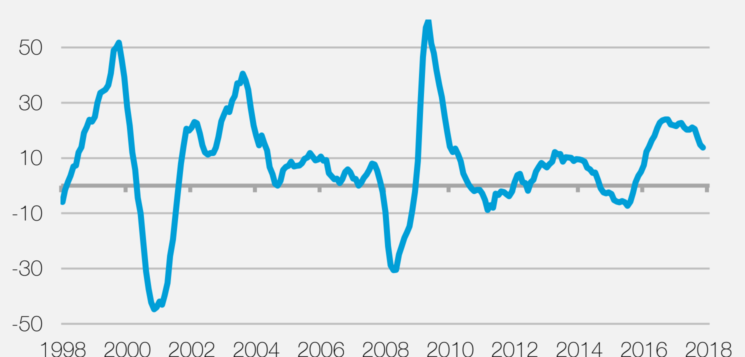
Bottom line. According to Credit Suisse data, analysts expect that Tech earnings will increase 8.3% in 2019 under the new sector classifications, slightly below the S&P500's 9.1%. However, the price to forward earnings multiple has shrunk to 16.3, only a modest premium to the index's 15.5. Tech's glory days may be fading, prices may have corrected but valuations are no longer demanding.

The share of the IT sector has shrunk after the recent reclassification
S&P 500 sectors breakdown



Sources: SGPB, Bloomberg, data as of 22/11/2018

Earnings growth closely linked to the world's semiconductor cycle
World Semiconductor sales, 3M mav, YoY%



Sources: SGPB, Bloomberg, data as of 21/11/2018

This week and next

EUROZONE

- Consumer confidence has slipped to its lowest since May 2017, sliding from -2.7 to -3.9 in November, though the index remained high when compared to the past 10-year range.
- Manufacturing confidence extended its downtrend sliding to 51.5 in November. Service sector confidence also printed lower at 53.1, sending the composite reading well below expectations to 52.4, a 47-month low.
- In Germany, October producer prices rose from 3.2% YoY to 3.3%, the highest in almost seven years. Prices of petroleum products, up 19.2%, lifted the overall index.

Next week's key events		*Per.*	*Prev.*	*Cons.*
30 Nov	Core inflation YoY	Nov	1.1%	1.1%
30 Nov	Unemployment rate	Oct	8.1%	--

UNITED KINGDOM

- November CBI industrial trend orders were up from -6 (two-year low) to +10, a significant bounce!
- The RightMove asking price for properties for sale fell 0.2% YoY in November, the first dip since 2011.
- Public sector net borrowing (excl. state-owned banks) was £8.8bn, in October, £1.6bn higher than a year ago and the worst October posting for public finances in three years. However, year-to-date borrowings are the lowest in 13 years at £26.7bn.

Next week's key events		*Per.*	*Prev.*	*Cons.*
29 Nov	BoE consumer credit (£bn)	Oct	0.79	--
30 Nov	GfK consumer confidence	Nov	1.6%	--

UNITED STATES

- Last week, initial jobless claims reached 224k, up 8,000 in a week and a four-month high.
- October new orders for durable goods decreased 4.4% MoM, the third fall in the last four months. However, after excluding volatile transportation equipment, new orders were up 0.1% vs -0.6%.
- University of Michigan consumer sentiment was underwhelming in November, still high in absolute terms but down from 98.6 to 97.5.
- Existing-home sales rebounded 1.4% in October to 5.22 million after six straight months of deceleration.

Next week's key events		*Per.*	*Prev.*	*Cons.*
28 Nov	GDP YoY (2nd release)	Q3	4.2%	3.6%
29 Nov	Consumption MoM	Oct	0.4%	0.4%

ASIA & EMERGING COUNTRIES

- Japanese exports rose 8.2% YoY in October while imports surged 19.9% YoY.
- Japanese headline inflation rose from 1.2% to 1.4% YoY in October, its highest level since February while core inflation was unchanged compared to the previous month at 0.4%.
- Chinese broad M2-money supply growth was only up 8.0% in October, the lowest on record, suggesting that China is still deleveraging.

Next week's key events		*Per.*	*Prev.*	*Cons.*
26 Nov	Japan: Manufacturing PMI (P)	Nov	52.9	--
30 Nov	Japan: Unemployment rate	Oct	2.3%	2.3%

Sources: Datastream, Bloomberg, 23 November 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	1.14	1.15
GBP/USD	1.29	1.32
EUR/CHF	1.14	1.15
USD/JPY	113	110
Brent	$62.9	$75
Gold	$1228	$1220

No changes made to our 3-month target this week.

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

CHINA: WILL CHINA REDUCE ITS DEPENDENCE ON USD IN ITS FX RESERVES?

In this week's Q&A, we look at the financial dependence of Asian emerging countries.

More specifically, we look at the share of the US dollar in China's foreign-exchange reserves, and discuss whether this share is now lower than in prior years. And we also ask whether China could become less dependent on the dollar in coming years by shifting its reserves towards Asian currencies.

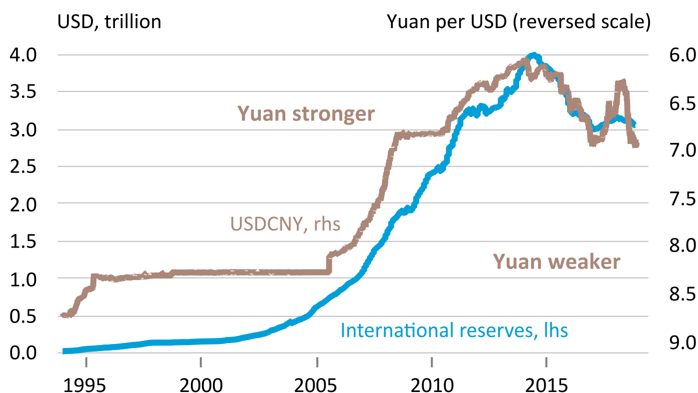
China has never disclosed information regarding the detailed breakdown of its foreign exchange reserves in terms of currencies and assets. Like many others, China prefers to avoid divulging its currency trading to the markets.

Chinese currencies reserves rose sharply until 2014 due mainly to accumulated current account surpluses, and to a lesser extent, to foreign direct and portfolio investments. Since then, capital outflows have tended to be the norm while current account surpluses have shrunk noticeably due to a shift towards domestic demand – reserves are down from their highs and have stabilised at around $3000 billion.

It is generally estimated that the lion's share of Chinese official reserves (two-thirds) is in American treasury bonds as well as other fixed income assets denominated in dollars (MBS, investment-grade corporate bonds, etc.).

Capital outflows and smaller surpluses have eaten into reserves

China international foreign exchange reserves and USDCNY



Sources: SGPB, Macrobond, State Administration of Foreign Exchange, 22/11/2018

Given the size of the reserves, any shift in allocation is slow. For large investors like China, there are few alternatives to the dollar. US Treasuries offer the only market with the necessary depth and liquidity.

Moreover, the Chinese authorities' desire to control the value of the yuan means that they need to maintain high foreign-exchange reserves.

It is worth noting that since 2015, China has been driving the value of its currency not only against the dollar but also against a basket of currencies reflecting the country's trade flows – the weight of currencies depends on the size of the bilateral trade relationship.

However, the need to accumulate foreign exchange reserves will diminish as China allows the yuan to fluctuate more freely. The world's major countries – US, the eurozone, UK and Japan – all allow their currencies to float freely and need little in the way of foreign reserves in relation to their Gross Domestic Product (GDP).

Asian countries with the closest trade links with China have the biggest incentive to hold the yuan currency reserves. The recent opening of the Chinese domestic bond market to foreign investors emphasised a genuine need for foreign capital while allowing foreign central banks, both Asian and non-Asian, to build up their yuan holdings – this all serves to encourage international yuan trading. It is worth noting that from April 2019, Chinese domestic bonds will be included in global bond indices. This will further contribute to boost yuan holdings around the globe.

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

SOCIETE GENERALE
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Market performance

Interest rates

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-36 bp	1 bp	→	0 bp	-2 bp	0 bp
3mth Euribor (EUR)	-32 bp	0 bp	→	0 bp	1 bp	1 bp
3mth Libor (USD)	269 bp	5 bp	↑	38 bp	99 bp	123 bp
3mth Libor (GBP)	89 bp	1 bp	→	9 bp	37 bp	37 bp
10-year US Treasury bond	306 bp	-6 bp	↓	rke	65 bp	74 bp
10-year German bond	37 bp	1 bp	→	2 bp	-6 bp	2 bp
10-year French bond	75 bp	0 bp	→	5 bp	-4 bp	8 bp
10-year UK bond	143 bp	6 bp	↑	16 bp	24 bp	15 bp

Credit

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	-0.5%	↓	-1.3 %	-1.4 %	-1.7 %
BAML EURO Corp HY	-0.9%	↓	-2.9 %	-2.9 %	-2.9 %
BAML GBP Corp IG	-0.9%	↓	-2.3 %	-3.1 %	-1.8 %
BAML US IG	0.1%	→	-2.0 %	-3.6 %	-3.1 %
BAML US HY	-0.3%	↓	-2.1 %	-0.3 %	0.1 %
JPM Global EM Sov. Plus	-0.4%	↓	-1.7 %	-6.9 %	-5.8 %

Exchange rates

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1.14	0.7 %	↑	-1.6 %	-5.0 %	-3.5%
EUR/CHF	1.14	-0.5 %	↓	-0.4 %	-3.0 %	-2.2%
GBP/USD	1.29	0.8 %	↑	-0.3 %	-4.6 %	-3.4%
USD/JPY	113	-0.6 %	↓	2.2 %	0.3 %	1.6%
USD/BRL	3.80	0.5 %	↑	-5.9 %	14.9 %	18.0%
USD/CNY	6.93	-0.1 %	↓	1.3 %	6.5 %	4.9%
USD/RUB	65.6	-0.4 %	↓	-3.5 %	13.8 %	12.4%

Government bonds*

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	0.3 %	↑	-0.1 %	-0.6 %	-0.9 %
United Kingdom (3-7yr)	-0.2 %	↓	0.4 %	0.3 %	0.5 %
Germany (3-7yr)	-0.1 %	↓	-0.1 %	0.6 %	0.0 %
Japan (3-7yr)	0.1 %	→	0.1 %	0.0 %	-0.2 %

Equities*

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	478	-1.9 %	↓	-7.4 %	-4.8 %	-2.4 %
Eurostoxx 50	3,127	-2.0 %	↓	-8.4 %	-7.8 %	-9.1 %
DAX	11,138	-1.9 %	↓	-10.1 %	-13.8 %	-14.4 %
CAC 40	4,938	-1.9 %	↓	-8.7 %	-4.2 %	-4.8 %
S&P 500	2,650	-2.9 %	↓	-7.0 %	0.8 %	4.0 %
FTSE 100	6,960	-1.0 %	↓	-7.3 %	-5.7 %	-2.1 %
SMI	8,781	-1.0 %	↓	-2.9 %	-3.2 %	-2.2 %
Topix	1,629	-0.6 %	↓	-3.3 %	-8.6 %	-6.4 %
IBOV Brazil	87,477	1.8 %	↑	13.8 %	14.5 %	17.4 %
MICEX Russia *	2,370	-0.5 %	↓	3.2 %	12.3 %	9.7 %
MSCI EM	976	-0.5 %	↓	-6.7 %	-13.6 %	-13.2 %
SENSEX 30 India	34,981	-0.8 %	↓	-8.4 %	4.7 %	5.5 %
Hang Seng (H-K)	26,019	-0.3 %	↓	-6.1 %	-10.0 %	-10.2 %
Shanghaï Composite	2,645	-0.9 %	↓	-2.5 %	-20.0 %	-22.9 %

Commodities

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$63	-6.4 %	↓	-15.4 %	-5.6 %	-0.3 %
Gold	$1,228	1.2 %	↑	2.7 %	-5.8 %	-4.8 %
Silver	$14.5	1.7 %	↑	-1.7 %	-14.6 %	-15.3 %

Source: DataStream, on 22/11/2018. 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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