Weekly Update

Co | EXTERNAL PUBLICATION

Ringing in the New Year

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All data taken from Bloomberg, Datastream, Macrobond (03/01/2019).

2018 will be remembered as one of the poorest years in financial markets. Not so much in terms of percentage declines – the MSCI World index shed 4.2% on a net total return basis in EUR, painful but much less so than 2002's -32.1% or 2008's -38.0% – but rather because so many markets lost ground at the same time. According to Société Générale Corporate and Investment Banking data, every single equity market declined last year in USD terms, as did every global sector apart from Healthcare. And although 10-year sovereign bonds did register positive returns on Q4 safe-haven flows, corporate bond markets lost ground across the board. What will the bells ring in for 2019?

The reasons behind the 2018 weakness are well known. Escalating protectionist rhetoric from the White House has raised fears that globalisation might go into reverse. Central banks have changed tack – after years of synchronised easing, asset purchases are slowing or going into reverse as gradual policy normalisation continues. Political worries are manifold – protests in France, budget slippage in Italy, the fog surrounding Brexit, the end of Republican dominance of US Congress, and so on. And investors have begun to fear that a recession might be at hand.

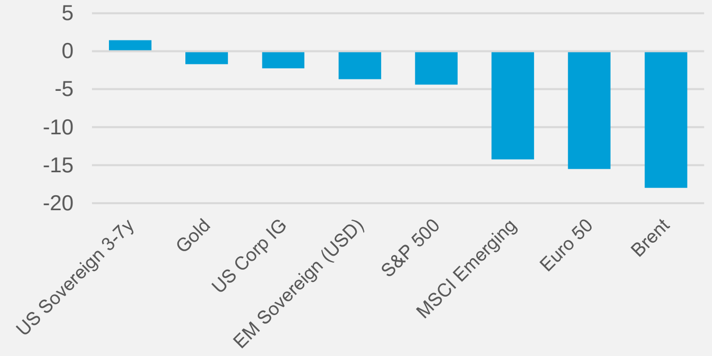
Looking at each in more detail, we should highlight that Washington and Beijing have provided some crumbs of trade comfort in recent weeks – delegations are now set to meet in China on January 7-8. Regarding central banks, the Federal Reserve has recently indicated that rates were now close to neutral – after four hikes in 2018, we only expect two this year. And with underlying inflation currently at 1.9% year-on-year and key rates at 2.25-2.50%, monetary policy is hardly restrictive.

Political events remain highly uncertain of course, but even here there are more encouraging signs. The Macron government has announced massive fiscal stimulus to address some "gilets jaunes" concerns. The Italian parliament has now approved a lower deficit than initially sought by the coalition. With time ticking away, Theresa May's Withdrawal Agreement remains the only Brexit deal on the table. And the split in Congress between the Republican Senate and Democrat House spells legislative gridlock – paradoxically, this means good visibility for investors.

As regards the US economy, the picture is much better balanced than recent headlines suggest. Although December ISM manufacturing confidence fell sharply, at 54.1 it remains consistent with continued expansion. And although US housing was weak last year, the average level of consumer confidence in 2018 was the highest since 2001, bolstered by the lowest level of unemployment since 1969. Indeed, our proprietary model puts 12-month recession probability at only 28%.

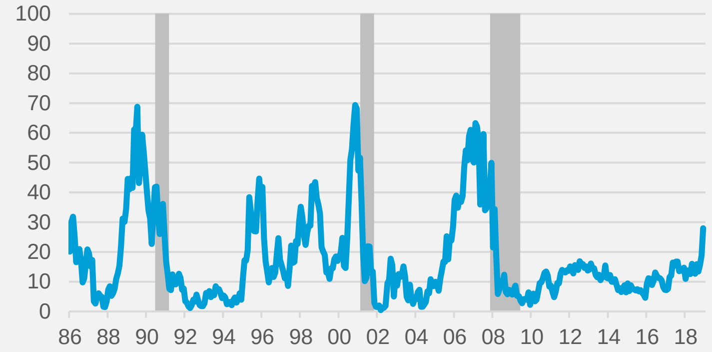
Putting it all together. We continue to expect global economic expansion in 2019, albeit at a slower pace than last year. Corporate earnings-per-share growth this year is expected at 7.2% for the MSCI World. Trailing EPS multiple fell sharply in 2018 – from 20.5x to 16.1x, 20% below its 20-year average – making valuation rather more attractive than twelve months ago. In all, we still prefer equities to bonds for 2019.

Main asset classes performance in 2018
Expressed in US$ (%)



Sources: SGPB, Datastream, data as of 31/12/2018

US Recession Probabilities
Model puts 12-month recession probability at 28%



Sources: SGPB, Macrobond, data as of 31/12/2018

This week and next

EUROZONE

- Eurozone final manufacturing PMI fell for the fifth consecutive month, printing at 51.4, versus 51.8 in November, still above the 50-threshold level distinguishing expansion from contraction.
- Eurozone consumer prices were up 1.6% YoY in December, down from the previous month's 1.9%, or the slowest since April.
- Eurozone producer prices declined 0.3% MoM in November, from +0.8% in the previous month, partly due to the impact of the "gilets jaunes" demonstrations in France.

Next week's key events		*Per.*	*Prev.*	*Cons.*
7 Jan	Retail Sales MoM	Nov	0.3%	0.1%
8 Jan	Economic Sentiment:	Dec	109.5	108.5

UNITED KINGDOM

- Manufacturing PMI unexpectedly hit a 6-month high at 54.2 in December, from 53.6 a month earlier, on the back of new order inflows amid pre-Brexit stockpiling. Construction PMI fell to 52.8 from 53.4 in November.
- Nationwide house prices took a pre-Brexit hit in December, declining by 0.7% MoM, the biggest monthly fall since July 2012. Simultaneously, the drop in home-loan approvals in November to 63,728 was sharper than expected at the lowest since April.

Next week's key events		*Per.*	*Prev.*	*Cons.*
11 Jan	GDP Estimate YoY	Nov	1.5%	1.3%
11 Jan	Manufacturing output YoY	Nov	-1.0%	-0.6%

UNITED STATES

- ISM Manufacturing PMI fell unexpectedly to 54.1 in December, from a previous reading of 59.3.
- Initial jobless claims for the week ended December 29 were higher than expected up 10,000 to 231,000.
- Total vehicle sales rose slightly to 17.5 million units in December, from 17.4 million in November.

Next week's key events		*Per.*	*Prev.*	*Cons.*
7 Jan	Factory Orders MoM	Nov	-2.1%	0.3%
11 Jan	Inflation rate YoY	Dec	2.2%	1.9%

ASIA & EMERGING COUNTRIES

- The decrease in the China Caixin Manufacturing PMI was higher than expected at 49.7 in December, versus 50.2 in November, its first contraction since May 2017. However, Caixin Services confidence hit the highest level since January.
- Indonesia's inflation rate came in at 3.1% YoY in December, lower than November's 3.2% but higher than expected, with food prices boosting the headline figure.

Next week's key events		*Per.*	*Prev.*	*Cons.*
10 Jan	China: Inflation rate YoY	Dec	2.2%	2.1%
10 Jan	China: outstanding loan growth	Dec	13.1%	13.2%

Sources: Datastream, Bloomberg, 3 January 2019, 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	1.12
GBP/USD	1.26	1.28
EUR/CHF	1.12	1.12
USD/JPY	108	112
Brent	$54.9	$65
Gold	$1289/oz	$1220/oz

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

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

Question time

No Q&A this week.

Market performance

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

Interest rates

	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-37 bp	-3 bp	↓	0 bp	-1 bp	-1 bp
3mth Euribor (EUR)	-31 bp	0 bp	➡	1 bp	0 bp	2 bp
3mth Libor (USD)	280 bp	-1 bp	➡	39 bp	-1 bp	110 bp
3mth Libor (GBP)	91 bp	1 bp	➡	11 bp	0 bp	39 bp
10-year US Treasury bond	255 bp	-19 bp	↓	-61 bp	-14 bp	11 bp
10-year German bond	15 bp	-8 bp	↓	-33 bp	-10 bp	-29 bp
10-year French bond	65 bp	-5 bp	↓	-18 bp	-7 bp	-16 bp
10-year UK bond	120 bp	-11 bp	↓	-38 bp	-7 bp	-2 bp

Credit

	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	0.1%	➡	-0.5 %	0.1 %	-1.1 %
BAML EURO Corp HY	-0.4%	↓	-4.2 %	-0.5 %	-4.4 %
BAML GBP Corp IG	0.7%	↑	0.3 %	0.7 %	-1.7 %
BAML US IG	0.8%	↑	1.1 %	0.7 %	-1.3 %
BAML US HY	0.7%	↑	-4.7 %	0.2 %	-2.5 %
BAML Global EM Sov. External Plus	0.5%	↑	-0.5 %	0.4 %	-4.9 %

Exchange rates

	Last	1wk		3mth	YTD	12mth
EUR/USD	1.14	-0.3 %	↓	-0.7 %	-0.7 %	-5.2%
EUR/CHF	1.12	-0.4 %	↓	-1.3 %	-0.2 %	-4.2%
GBP/USD	1.26	-0.1 %	➡	-2.4 %	-1.0 %	-6.5%
USD/JPY	108	-3.0 %	↓	-6.0 %	-1.7 %	-4.3%
USD/BRL	3.76	-3.0 %	↓	-3.7 %	-3.2 %	16.0%
USD/CNY	6.87	0.1 %	➡	0.0 %	-0.1 %	5.7%
USD/RUB	68.7	-1.1 %	↓	4.3 %	-1.4 %	20.3%

Government bonds*

	1wk		3mth	YTD	12mth
United States (3-7yr)	1.0 %	↑	3.7 %	0.7 %	2.3 %
United Kingdom (3-7yr)	0.4 %	↑	1.7 %	0.4 %	1.2 %
Germany (3-7yr)	0.2 %	↑	1.1 %	0.3 %	1.2 %
Japan (3-7yr)	0.1 %	➡	0.4 %	0.0 %	0.2 %

Equities*

	Last	1wk		3mth	YTD	12mth
MSCI AC World	448	-0.4 %	↓	-13.9 %	-1.6 %	-11.5 %
Eurostoxx 50	2,955	0.6 %	↑	-12.9 %	-1.6 %	-12.8 %
DAX	10,417	0.3 %	↑	-15.2 %	-1.4 %	-19.7 %
CAC 40	4,611	0.3 %	↑	-15.7 %	-2.5 %	-10.6 %
S&P 500	2,448	-1.6 %	↓	-15.9 %	-2.3 %	-8.0 %
FTSE 100	6,693	1.7 %	↑	-10.1 %	-0.5 %	-9.0 %
SMI	8,466	3.3 %	↑	-7.7 %	0.4 %	-7.6 %
Topix	1,494	-0.5 %	↓	-16.9 %	0.0 %	-16.0 %
IBOV Brazil	90,986	6.5 %	↑	9.3 %	3.5 %	16.7 %
MICEX Russia *	2,376	2.1 %	↑	-4.7 %	0.7 %	10.3 %
MSCI EM	950	-0.3 %	↓	-7.8 %	-1.7 %	-17.5 %
SENSEX 30 India	35,514	-0.8 %	↓	-1.0 %	-1.5 %	6.4 %
Hang Seng (H-K)	25,064	-1.6 %	↓	-7.2 %	-3.0 %	-15.1 %
Shanghaï Composite	2,464	-0.8 %	↓	-12.7 %	-1.2 %	-26.9 %

Commodities

	Last	1wk		3mth	YTD	12mth
Brent	$54.9	3.3 %	↑	-35.6 %	3.3 %	-18.7 %
Gold	$1,289	1.1 %	↑	7.3 %	0.6 %	-2.1 %
Silver	$15.7	2.9 %	↑	6.6 %	1.1 %	-8.7 %

Source: DataStream, on 03/01/2019. 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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