BANQUE
ERIC STURDZA

MONTHLY NEWSLETTER

OCTOBER 2019

CONTENTS

1. MACRO EDITORIAL
DEAL OR NO DEAL: THAT IS THE QUESTION.

A fitting summary of this month's news that has been so dominated by 1– the possibility of the United States and China signing a "mini deal", and 2– the prospect of a deal finally being ratified for the United Kingdom's withdrawal from the European Union.

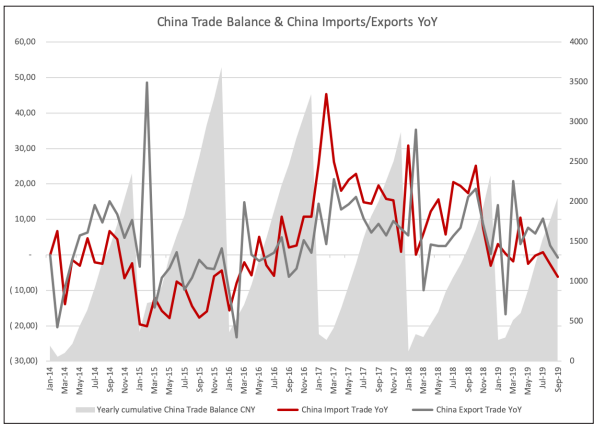
United States and China – dangerous liaisons

After this summer's deterioration in relations and numerous unexpected developments, the 13th round of negotiations between China and the United States led to a "phase one" draft agreement that the two nations could ratify in mid-November. The main concessions made by the United States would be to shelve the 25-30% increase in tariffs scheduled for 15 October and possibly to suspend the tariffs scheduled for mid-December on USD 160 billion worth of Chinese goods. On the Chinese side, the main breakthroughs would be an agreement to purchase USD 40-50 billion worth of US agricultural products and commitments to open up its financial services market. This deal could be accompanied by declarations of intent concerning the protection of intellectual property and China's undertaking not to use the devaluation of its currency as an economic weapon.

This turnaround can be explained by the sheer number of vested interests involved that have forced the two countries to find some form of resolution.

The crucial issues – access to and transfer of technology, the future of the tariffs already in place and Chinese subsidies to its own industry – would be dealt with later.

Graph 1: Chinese balance of trade and variation



Source : Bloomberg - Banque Eric Sturdza

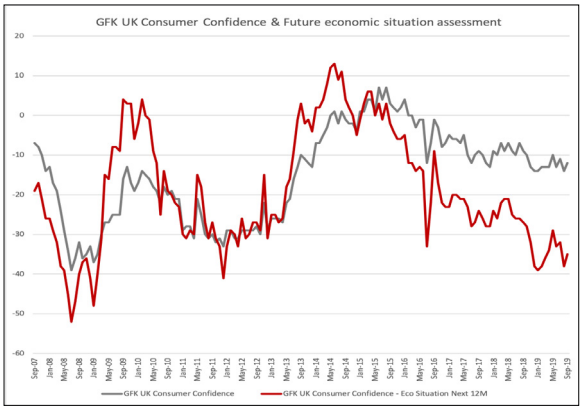
In China, the downturn in the growth of its manufacturing industry and global trade *(graph 1)* continues to be felt, while stimulus measures to promote domestic consumption have barely had any effect. The unrest in Hong Kong has also put the Chinese authorities in the spotlight. In the United States, after a long period of robustness, the American economy is also showing some signs of fatigue, particularly in the manufacturing sector. Last but not least, on a domestic level, Donald Trump is now facing the official launch of impeachment proceedings and the rising popularity of Elizabeth Warren, the left-wing Democratic candidate. Given his desire to be re-elected, these factors make the hope that a "mini deal" will materialise more plausible.

United Kingdom and European Union – a complicated divorce…

After much work and compromise, the British and European negotiators at the last minute also came to a second draft agreement on the United Kingdom's withdrawal from the European Union. In the agreement, which was endorsed by Boris Johnson's government and Jean-Claude Juncker's Commission at the European summit held from 17 to 18 October, the thorny issues of the Northern Irish border and the VAT system in Northern Ireland were addressed. By establishing the principle of the respect of European environmental and social standards, this agreement also lays the foundations for the future relationship between the European Union and the United Kingdom. While, to date, Boris Johnson's lack of a majority and the polarisation of the British parliament prevent both the agreement and the timetable for withdrawal from being passed, the risk of a no deal Brexit seems however to have diminished due to the existence of a new agreement that is acceptable to both parties, and to an extension granted by the European Union. The General Election scheduled for mid-December could help to unlock the political gridlock.

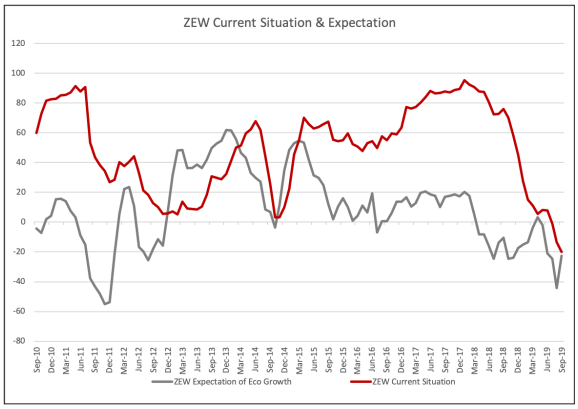
This uncertainty has had an impact on investment decisions and the confidence of British households. Hence, according to a survey in late September on their planned economic activity in the next 12 months *(graph 2)*, UK households revealed themselves to be more pessimistic than at any time in the last 8 years. This crisis of confidence can also be felt in Europe. We need only consider the case of Germany, the United Kingdom's main trading partner, where the morale of industrialists and the manufacturing PMI are at their lowest levels since 2008 *(graphs 3 and 4)*.

Graph 2: Consumer confidence – United Kingdom



Source : Bloomberg - Banque Eric Sturdza

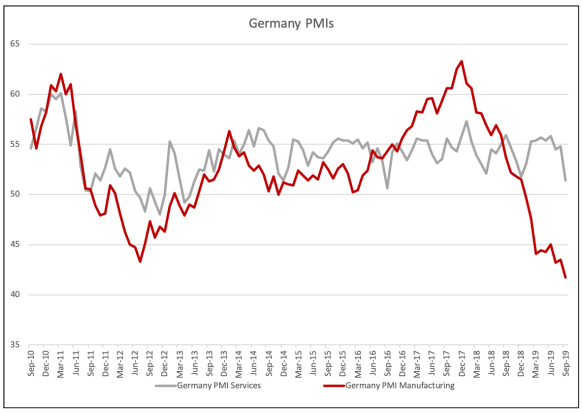
Graph 3: Germany – ZEW German expectations for economic growth



Source : Bloomberg - Banque Eric Sturdza

While we remain cautious concerning the final outcomes of the two agreements, the systemic risk linked to Brexit and the Sino-American trade war appears to be waning, as evidenced by the fall in long-term interest rates and of the US dollar. We will examine in further detail their implications for different asset classes in this letter. The introduction of quarterly publications will also be the opportunity to take stock of the equity markets.

Graph 4: Germany – Manufacturing & Services PMI



Source : Bloomberg - Banque Eric Sturdza

2. FIXED INCOME
SHORT BREAK OR START OF A CORRECTION?

The beginning of October saw a fall in rates following the publication of ISM manufacturing and service indexes that validated the fears of recession in the United States. The recovery in the value of US Treasury bonds was, however, quickly wiped out during the month following the encouraging news for the world economy concerning the Sino-American trade war and Brexit.

We may well wonder, therefore, if we are heading for the beginning of a bond bear market or whether this is just a short break. A partial answer to that question will come on the 30th October, the date of the next meeting of the US Federal Reserve (the FED). A 25bp cut has been decided, but we remain cautious as the «wait and see» approach could bring more volatility to bond and stock markets. In the meantime, the FED has had to manage the serious malfunctions of the money market by injecting huge sums of cash (USD 75 billion per day) while resuming its Asset Purchase Programme to the tune of USD 60 billion per month *(graph 5)*.

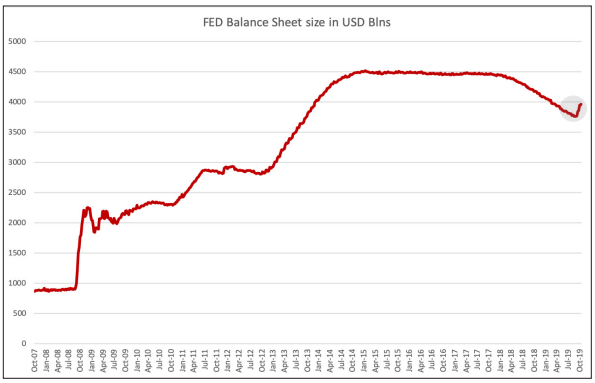
In Europe, inflation is still very low and the manufacturing recession has made Germany (and its automobile industry in particular) the sick man of Europe. The European Central Bank probably did all it could by reducing its deposit facility interest rate to -0.5% and by resuming its quantitative easing programme. Mario Draghi, as a kind of testament before handing over to Christine Lagarde, implored governments to pursue an aggressive common fiscal policy in order to get the economy of the old continent back on its feet. As a result, German interest rates rose in line with US rates, but the 10-year Bund still seems unlikely to return to positive territory any time soon without some miraculous agreement between the euro area governments to bite the bullet and abandon budgetary orthodoxy.

The FED has had to manage the serious malfunctions of the money market by injecting huge sums of cash.

In this context, any pursuit of a bond correction could be used to add some duration in preparation for another easing of long-term returns before the end of the year. The US Treasury's 10- and 30-year borrowing rates have risen to around 1.75% and 2.25% respectively. Our objective remains a return of the US 10-year rate to 1.40% in the next few months, but in the short term, a brief rise in the direction of 2% is possible. That eventuality would be an investment opportunity to be seized.

At this stage in the economic cycle, duration risk is always preferable to credit risk, which is too expensive, low in liquidity and too closely correlated to stock markets. When managing US Treasury borrowing rates, it is also necessary to pursue a strategy of blending nominal and real interest rates through inflation indexed TIPS.

Graph 5: FED results in USD billions



Source : Banque Eric Sturdza

3. EQUITIES
LESS MACRO, MORE MICRO NOW!

During the month of October, equity investors were confronted with the now familiar trifecta of market drivers: political volatility, disappointing macroeconomic statistics and suspense around corporate results.

Further ambiguous signals were sent from the Trump administration with regards to its negotiations with China, with an apparent shift of strategy towards a multi-step agreement, the first of which could progress in the coming weeks. Persistent unrest in Hong Kong, a slowing domestic economy and increasing political pressures on both sides are no doubt motivating all parties to deliver better visibility, yet investors remain on edge as false starts have been the norm rather than the exception. In the US, the run-up to the 2020 election is adding a dimension to the political volatility, especially as Mrs. Warren overtakes Mr. Biden firmly from the left, injecting uncertainty into healthcare and future corporate tax frameworks. In Europe, the situation around Brexit seems to be no easier under Mr. Johnson, as at time of writing the parliament has rebuked yet another tentative agreement with the EU.

Perhaps unsurprisingly given the political backdrop, the trend of softness in macroeconomic indicators carries on, forcing the IMF to reduce global GDP growth forecasts to 3% in 2019, the lowest level since 2008-2009. Softness in the industrial space is by now well taken into account, but ambiguous numbers from the services complex in the US and a lack of direction in Europe is noteworthy, and contributed to nervousness at the beginning of the month.

Although the sample is still limited, third quarter results have started rolling-in with encouraging results.

This backdrop has undoubtedly encouraged analysts to revise down their expectations of corporate results for the third quarter, which incidentally have started rolling-in with encouraging results. While on aggregate US earnings are not expected to grow from last years', the market will likely be heavily bifurcated, and most investors will be looking for macroeconomic clues from those CEOs exposed to large swaths of the global economy. Given the relative robustness in salaries, and the low unemployment rate, the US consumer could once again prove resilient and confirm this as a significant bright spot in the overall macro picture. Furthermore, let us not get overly lost in the averages: many companies in technology, health, consumer goods and services, sectors we are favouring in our allocations remain in exceptionally strong financial situations and are experiencing uniquely favourable financing terms given vast and cheap liquidity around the world.

In a nutshell, selectivity should remain key. Companies that continue to hire new talents, invest in long-term capabilities, acquire strategic assets and buy back their own stock should strengthen their competitive edge and financial attractiveness. The next weeks of earnings publications will provide valuable opportunities for investors to better understand the current macroeconomic undercurrents affecting global markets and position themselves accordingly.

Table 1: Summary of quarterly publications of S&P 500 companies

S&P500		Sale Surprise				Earnings Surprise			
		+	Inline	-	%	+	Inline	-	%
All Securities	**217 / 498**	**136**	**0**	**80**	**1,08%**	**172**	**1**	**43**	**3,72%**
Oil & Gas	8 / 28	4	0	4	3,03%	5	0	3	2,88%
Basic Materials	7 / 19	2	0	5	-1,50%	6	0	1	11,17%
Industrials	40 / 87	21	0	19	-0,04%	32	0	8	1,77%
Customer Goods	24 / 57	15	0	9	2,86%	20	0	4	7,41%
Health Care	21 / 52	17	0	4	1,68%	17	0	3	4,62%
Customer Services	25 / 67	13	0	12	0,54%	19	1	5	2,28%
Telecommunications	3 / 4	1	0	2	-0,63%	3	0	0	2,02%
Utilities	5 / 28	1	0	4	-6,00%	3	0	2	4,10
Financials	65 / 103	50	0	14	1,86%	51	0	14	3,29%
Technology	19 / 53	12	0	17	1,64%	16	0	3	4,62%

Source : Bloomberg, Banque Eric Sturdza, 28.10.2019

5. PERFORMANCE & INDICATORS

		Last Price		Dev.	Est P/E Ratio	1W %	1M %	YTD %	2018
N. Am	S&P 500 INDEX	3 039,42	10/28/2019	USD	18,46	1,46	2,73	23,22	(4,39)
	NASDAQ 100 STOCK INDX	8 110,67	10/28/2019	USD	22,19	3,00	5,63	29,22	0,04
	RUSSELL 2000 INDEX	1 571,93	10/28/2019	USD	29,21	1,37	3,45	17,86	(11,03)
	S&P/TSX COMPOSITE INDEX	16 387,53	10/28/2019	CAD	15,30	0,05	(1,65)	17,30	(8,88)
Europe	STXE 600 (EUR) Pr	397,31	10/28/2019	EUR	15,25	0,70	1,52	21,72	(10,27)
	Euro Stoxx 50 Pr	3 619,38	10/28/2019	EUR	15,16	0,40	2,10	24,69	(11,34)
	CAC 40 INDEX	5 728,26	10/28/2019	EUR	15,46	1,25	1,55	24,80	(8,14)
	DAX INDEX	12 925,40	10/28/2019	EUR	15,28	1,34	4,40	22,41	(18,26)
	FTSE MIB INDEX	22 683,02	10/28/2019	EUR	11,64	0,87	3,02	28,87	(13,65)
	SWISS MARKET INDEX	10 209,77	10/28/2019	CHF	17,31	1,92	1,71	25,16	(7,05)
	FTSE 100 INDEX	7 271,18	10/28/2019	GBP	13,23	0,83	(1,82)	12,35	(8,78)
Asia Pacific	TOPIX INDEX (TOKYO)	1 662,68	10/29/2019	JPY	13,70	2,09	3,64	13,78	(15,99)
	JPX Nikkei Index 400	14 874,20	10/29/2019	JPY	13,96	2,12	3,71	14,76	(15,70)
	MSCI AC ASIA PAC EX JAPN	520,55	10/28/2019	USD	14,77	0,87	3,78	12,30	(13,49)
	HANG SENG INDEX	26 786,76	10/29/2019	HKD	10,62	0,02	3,37	7,25	(10,55)
	HANG SENG CHINA ENT INDX	10 547,00	10/29/2019	HKD	8,34	0,19	3,93	8,11	(10,00)
	CSI 300 INDEX	3 910,23	10/29/2019	CNY	12,74	0,37	1,51	32,83	(23,64)
	KOSPI INDEX	2 092,69	10/29/2019	KRW	14,12	0,18	2,09	2,99	(15,39)
	TAIWAN TAIEX INDEX	11 333,87	10/29/2019	TWD	17,25	0,56	4,68	21,44	(4,95)
Emerging	MSCI EM	1 042,97	10/28/2019	USD	13,49	0,87	4,27	10,72	(14,28)
	Nifty 50	11 786,85	10/29/2019	INR	20,30	1,79	2,56	9,90	4,72
	JAKARTA COMPOSITE INDEX	6 281,14	10/29/2019	IDR	16,39	0,90	1,43	3,72	(0,28)
	MSCI EM LATIN AMERICA	2 833,35	10/28/2019	USD	14,87	2,51	5,78	13,52	(6,21)
	BRAZIL IBOVESPA INDEX	108 187,10	10/28/2019	BRL	14,87	0,75	2,96	23,10	15,03
	S&P/BMV IPC	43 765,48	10/28/2019	MXN	15,29	0,93	2,13	7,41	(13,81)
	S&P MERVAL TR ARS	33 177,16	10/28/2019	ARS	5,54	(0,26)	14,89	9,52	0,75
	MOSCOW EXCHANGE MICEX-RTS PJ	93,88	10/28/2019	RUB	10,00	0,96	(1,02)	26,24	(22,26)
	BIST 100 INDEX	99 838,30	10/28/2019	TRY	7,42	1,99	(5,05)	13,17	(17,61)
	FTSE/JSE AFRICA TOP40 IX	49 402,80	10/28/2019	ZAR	12,86	(0,42)	0,66	9,11	(8,18)

	Last Price		Dev	1Wk	1M	3M	YTD	1YR
Gold Spot $/Oz	1 487,26	10/28/2019	XAU	-0,03	1,00	4,24	15,97	20,97
Silver Spot $/Oz	17,71	10/28/2019	XAG	1,07	4,20	7,60	14,29	22,49
COPPER FUTURE Dec19	268,20	10/28/2019	USD	1,86	3,25	-1,60	1,36	(4,28)
WTI CRUDE FUTURE Dec19	55,01	10/28/2019	USD	0,97	-1,40	-3,44	13,70	(17,96)
BRENT CRUDE FUTR Dec19	60,91	10/28/2019	USD	2,03	-0,21	-2,99	10,46	(19,41)

Yield	2yr	5yr	10yr	Var 10yr YTD
USA	1,63	1,66	1,83	(0,85)
Germany	(0,64)	(0,59)	(0,35)	(0,59)
Switzerland	(0,20)	(0,69)	(0,52)	(0,27)
France	(0,60)	(0,40)	(0,05)	(0,76)
Italy	(0,17)	(0,17)	0,66	(1,72)

	YTW	M.D	Spread	1M%	YTD%
Pan-Euro Credit	0,63	6,19	0,92	(0,29)	7,43
Pan European High Yield	3,84	3,29	3,73	0,30	9,89
Corporate (USD)	2,95	7,82	1,06	(0,29)	12,81
U.S Corporate High Yield	5,43	3,16	3,54	0,57	12,05
EM USD Aggregate	4,99	6,25	3,15	0,24	11,05
EM Local Currency Govt	3,89	6,83	0,37	1,84	7,28

	Spot	1M%	YTD	1YR
Euro Spot	1,11	1,70	(3,34)	(2,54)
Japanese Yen Spot	108,91	(0,76)	0,72	3,18
Swiss Franc Spot	1,00	0,26	(1,31)	0,68
China Renminbi Spot	7,06	1,18	(2,64)	(1,45)
British Pound Spot	1,29	4,70	0,88	0,57

	Spot	1M%	YTD	1YR
Euro/CHF Spot	1,10	(1,40)	2,05	3,31
Euro/Yen Spot	120,72	(2,42)	4,23	5,86
Euro/Pound Spot	0,86	2,95	4,35	3,19
Euro/Renminbi Spot	7,83	(0,47)	0,46	1,29

Source : Bloomberg, 22.10.19

Contributors:
Marc Craquelin • Eric Vanraes • Pascal Perrone • David Haynal • Edouard Bouhyer