BANQUE
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1. MACRO VIEW
THE TRADE WAR WILL NOT BE HAPPENING…

That is the mantra that investors seem to be repeating over and over this month. Indeed, the markets appear to have been buoyed by the prospect of finally seeing an agreement between the United States and China over the trade war.

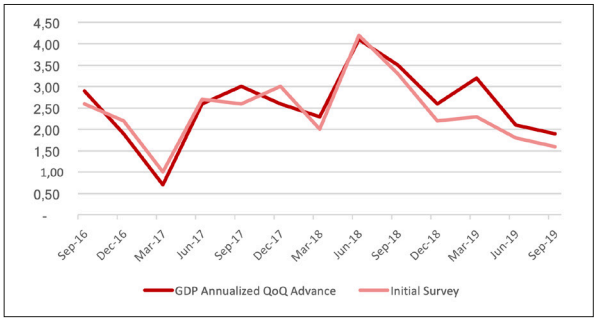
Although both sides appear to want an agreement this time, as demonstrated by the encouraging comments on the subject from both the American and Chinese sides, it must be noted that 1- no date has been set to sign the initial agreement, 2- the contents of this first phase remain vague, 3- there is still some disagreement concerning the suspension or partial or total removal of tariffs, 4- finally, the adoption by the US Congress of the Hong Kong Human Rights and Democracy Act could complicate matters. At the moment, the markets prefer to see the glass half full rather than half empty, which calls for a degree of vigilance.

In the end, in 2019, the global economy slowed significantly BUT avoided recession.

In November, it was with a sense of relief that Germany discovered its third-quarter growth numbers. Thanks to a very modest 0.1%, the country was able to avoid being declared officially in recession: good news, of course, but maybe not that good. By narrowly avoiding recession, some of the pressure on the German government to launch a fiscal stimulus package was lifted.

Let's not forget, at the same time last year, financial media were all talking about recession. And remember how nervous the markets were then: flat interest rate curves, a corresponding decline in growth in most big economies, trade war: the great fear of recession in the autumn of 2018 intensified in December, leading markets to finish 2018 in a general slump. The example of Germany reminds us that concern at the end of 2018 was not completely unfounded. However, given the performances of stock markets this year, it is tempting to say with a wry smile that last year's fears were exaggerated.

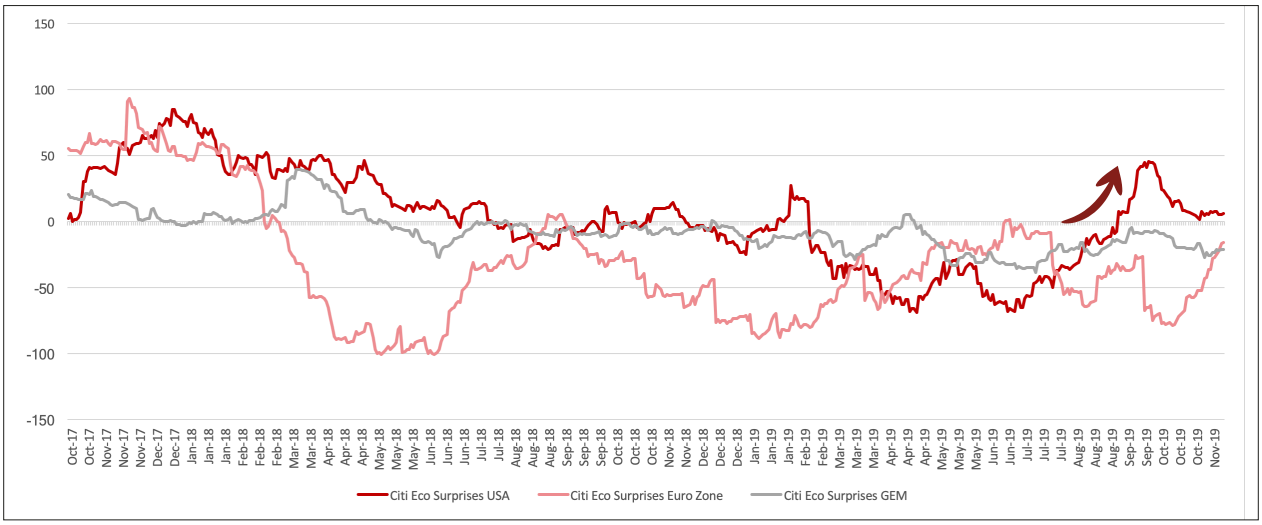
Graph 1 : United States, quarterly GDP, 1st publication v. initial estimation



Source : Bloomberg, BEA, Banque Eric Sturdza

In the end, in 2019, the global economy slowed down considerably BUT avoided recession. This modest BUT resulted in a sharp rise in the stock markets. It is a simplistic view, but it reminds us that what counts for the markets is not an absolute figure but rather the difference between expectations and reality. From that point of view, the discrepancy between US GDP advance figures and the consensus of economists *(graph 1)* is striking, as is the recent recovery from economic surprises *(graph 2)*.

Graph 2 : Citigroup Economic Surprise Indices



Source : Bloomberg, Citi, Banque Eric Sturdza

It is true that, once again, central banks will have helped a lot. They are all now in an accommodating mood: those who already were (the ECB) and those who had been, but no longer were (the Fed). After a period of slight contraction, the global money supply is again in expansion: the strong performance of stock market indices is also due to underlying monetary "doping".

As far as the stock market is concerned, 2019 is the exact opposite of 2018: all asset categories are on the rise, whether "risk-on" categories, like shares, or "risk-off", like gold or government bonds. "Risk-on" has also appeared more recently through a return to favour of cyclical and value stocks. Despite this, the fall of WeWork is a reminder that the abundant liquidity created by central banks can lead to overvaluation, especially of asset categories that by nature are of low liquidity or illiquid. As a reminder, this "unicorn" saw its valuation plummet straight from 45 to 8 billion and its stock market flotation postponed indefinitely.

**Unicorn: a privately held start-up valued at more than USD 1b through all financing rounds.*

We remain cautiously optimistic about the progress of the macroeconomic situation in the coming months. Nevertheless, it will be necessary to take into account the fact that the positioning of stakeholders is considerably more aggressive than a few months ago. The VIX is very low, buying consensus more pronounced… a less favourable technical situation.

2. INTEREST RATE MARKETS
STOCK MARKET EUPHORIA GIVES LONG-TERM RATES A BEATING

November was marked by the sharp fall in systemic risk, resulting in a sudden stock market increase and a beating for the interest rate markets. Indeed, the Americans and the Chinese should be signing the first part of their trade agreement in the coming weeks and Brexit has been postponed until 31 January with the chance of an acceptable deal being agreed.

As expected, Jerome Powell called a time-out after the Fed's decision to cut its rates on 30 October. Thus, the current level of the federal funds rate (1.50-1.75%) may not change until April 2020, but we are much less confident about this. When a central bank announces the end of a series of cuts in interest rates and long-term rates automatically fall by nearly 20 points, the message is crystal clear! The situation is still confused on the US money market. According to Jerome Powell, everything is under control and the Fed has mobilised the necessary resources to restore calm, but the Fed's daily contributions to the interbank lending market have risen from USD 75 billion to USD 120 billion and a QE in all but name has been implemented for an amount of USD 60 billion per month in purchases of Treasury bonds. The US 10-year bond has thus returned to around 1.80%, but interest rates are no longer responding much to Wall Street's record levels. There is also fear of an escalation of violence in Hong Kong and the markets are becoming increasingly tired of waiting for a concrete trade agreement between Beijing and Washington.

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In Europe, Mario Draghi bid his farewell. We will forever be indebted to him for his "whatever it takes" policy, which saved the euro, and his determination to limit the size of spreads for the peripheral countries, which saved them from an even more painful crisis. We must wish Christine Lagarde the best of luck, and hope that, unlike her illustrious predecessor, she will be able to convince the European governments to help her with a stimulus package that is both necessary and beneficial. The deterioration of the German economy is undoubtedly, from this point of view, rather good news for the ECB because it will perhaps force the Germans to abandon a budgetary orthodoxy that is suffocating their economy as well as that of the entire euro area.

We cannot rule out an end-of-year rally in bonds, which, moreover, would not be incompatible with a good performance for the stock markets. After all, both markets ended 2018 in the red, and they could well finish 2019 in the black. Barring a major unforeseen event, the last event of great importance for the interest rate markets will be the FOMC meeting on 11 December.

3. STOCK MARKETS
A MARKET ON THE RISE HELPED BY CYCLICAL AND DISCOUNTED STOCKS

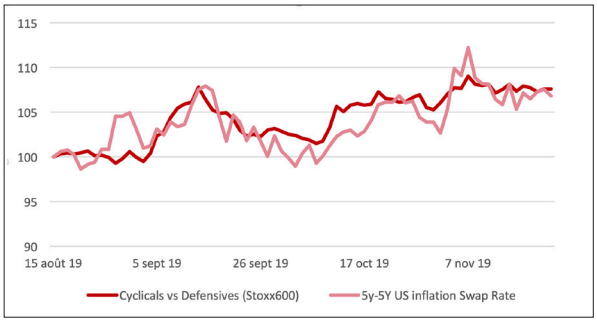
Following the trend since August, November turned out to be positive for the developed global stock markets. Although tension remains high in Hong Kong, political risk premiums seem to be generally falling, with the possible detente between the US and China as the leading light.

Some reassuring economic figures in the US and an improvement in the direction, albeit still negative, of the manufacturing sector in Germany are continuing to provide investors with more peace of mind concerning the economic cycle. Recent statements from the Fed also demonstrate a greater tranquillity on the part of its members. Even in a stock market dominated by concerns about liquidity and interest rates, this news is welcomed, helps the acquisition of assets and encourages managers to increase their allocations to more cyclical or value stocks, as shown by the changes in their stock portfolios in recent months.

Rotation towards value stocks, far from weakening, seems to be enduring.

Indeed, the rotation towards value stocks, far from weakening seems to be enduring, which seems logical given the huge discrepancies in valuation between growth stock and value stock at the August high. This return to favour of cyclical stocks is accompanied by the slightly less bad outlook of investors regarding the economic cycle and their inflation forecasts *(graph 3)*. It is also interesting to note that, at this stage, this rotation is more the result of a recovery of value and cyclical stocks than investors moving away from quality and growth stocks.

Graph 3 : Cyclical/defensive stocks v. inflation forecasts



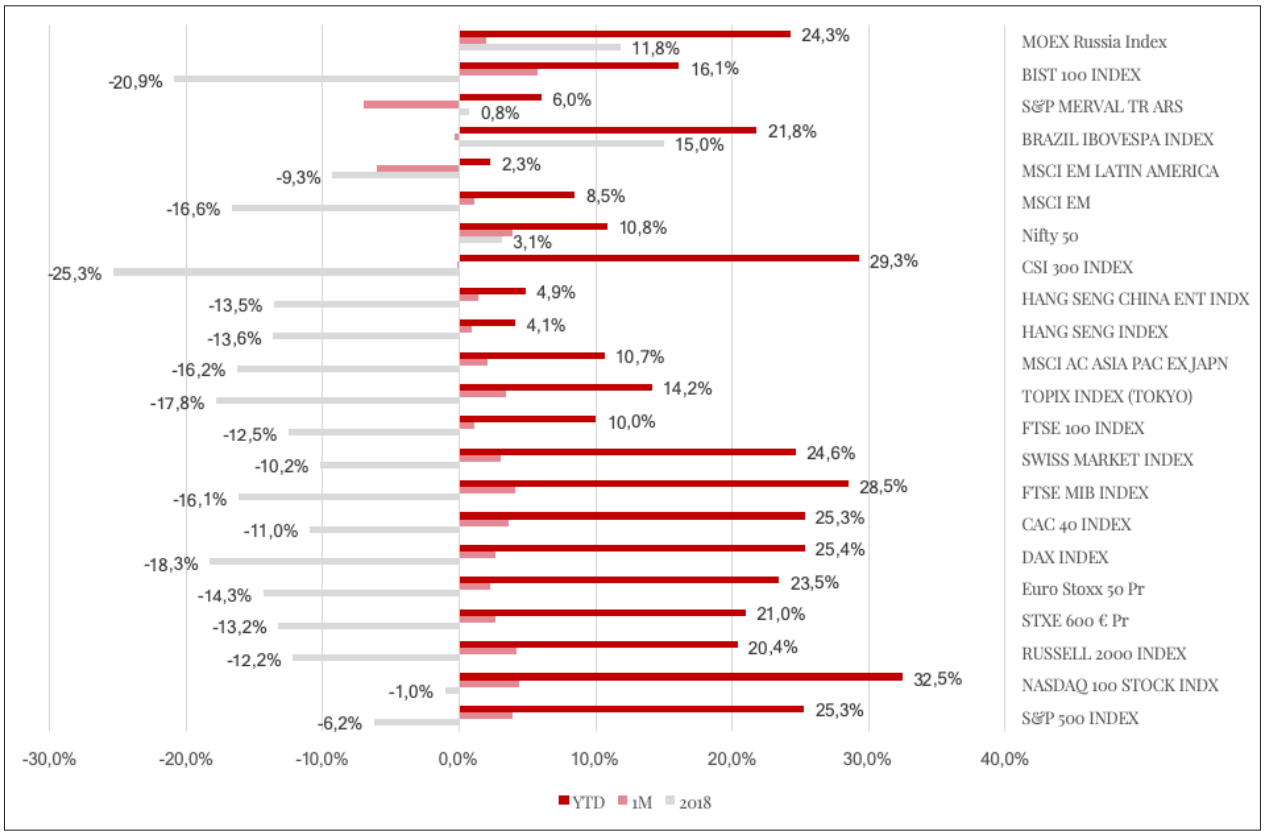
Source : Bloomberg, DJ Stoxx, Banque Eric Sturdza

Closely linked to the short-/medium- term economic outlook, this trend has also been confirmed during the period of publication of results, which is now coming to an end, and which can be described as relatively satisfying, with a degree of positive surprises well above the average in the US, and good numbers in Europe also. Remember, however, that despite the fact that this performance largely surpassed initial expectations, in the US the final result remains an earnings growth rate close to 0% and barely higher in Europe. Furthermore, lowered expectations continue, particularly in Europe, where estimates have not undergone a net upward revaluation (number of increases - number of decreases/number of total estimates) since summer 2018.

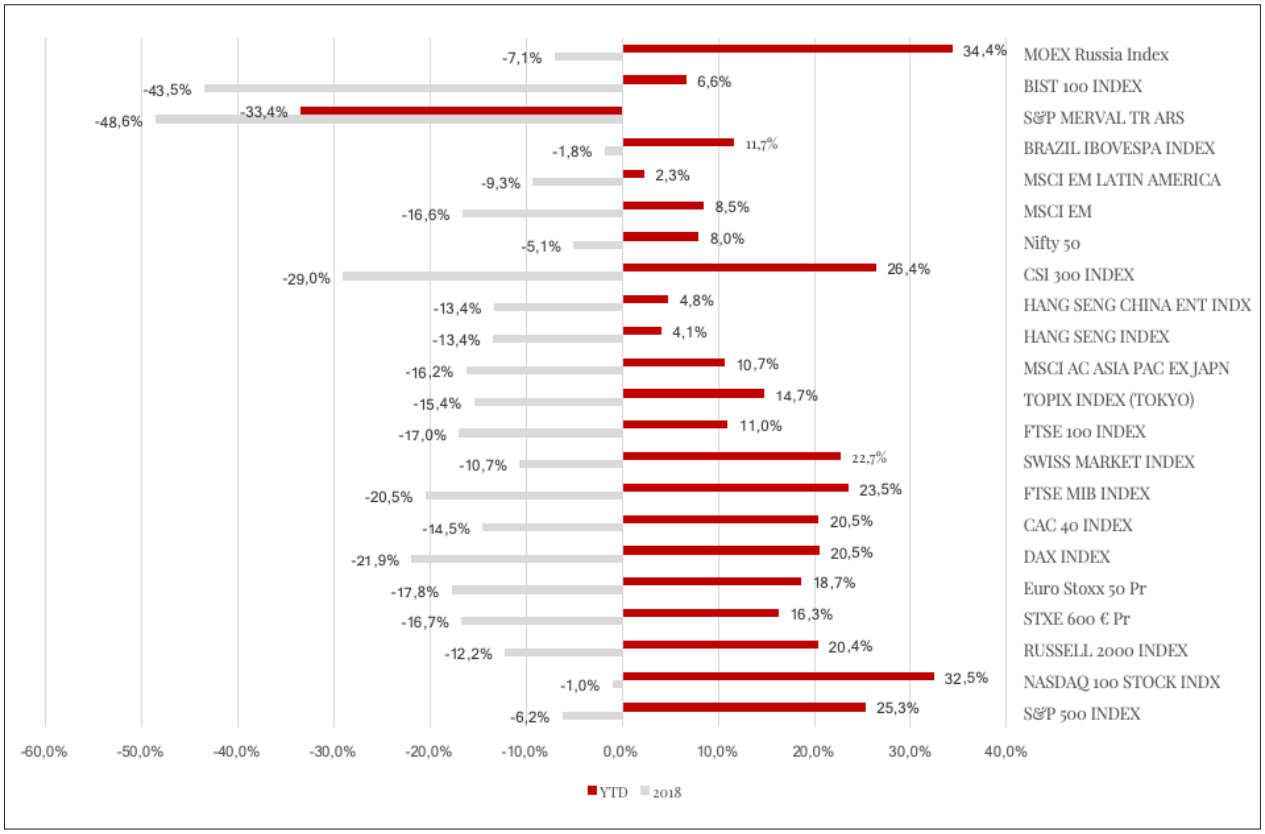
At the dawn of the new year, the essential question for investors will be to understand the potential for earnings growth for businesses in an uncertain macroeconomic context and to estimate how far the inertia created by commercial tensions on global GDP will take us. But in the longer term, remember that political risks and macroeconomic uncertainties are the rule, rather than the exception, and that compared to other asset classes, equities remain attractive.

5. PERFORMANCE & INDICATORS

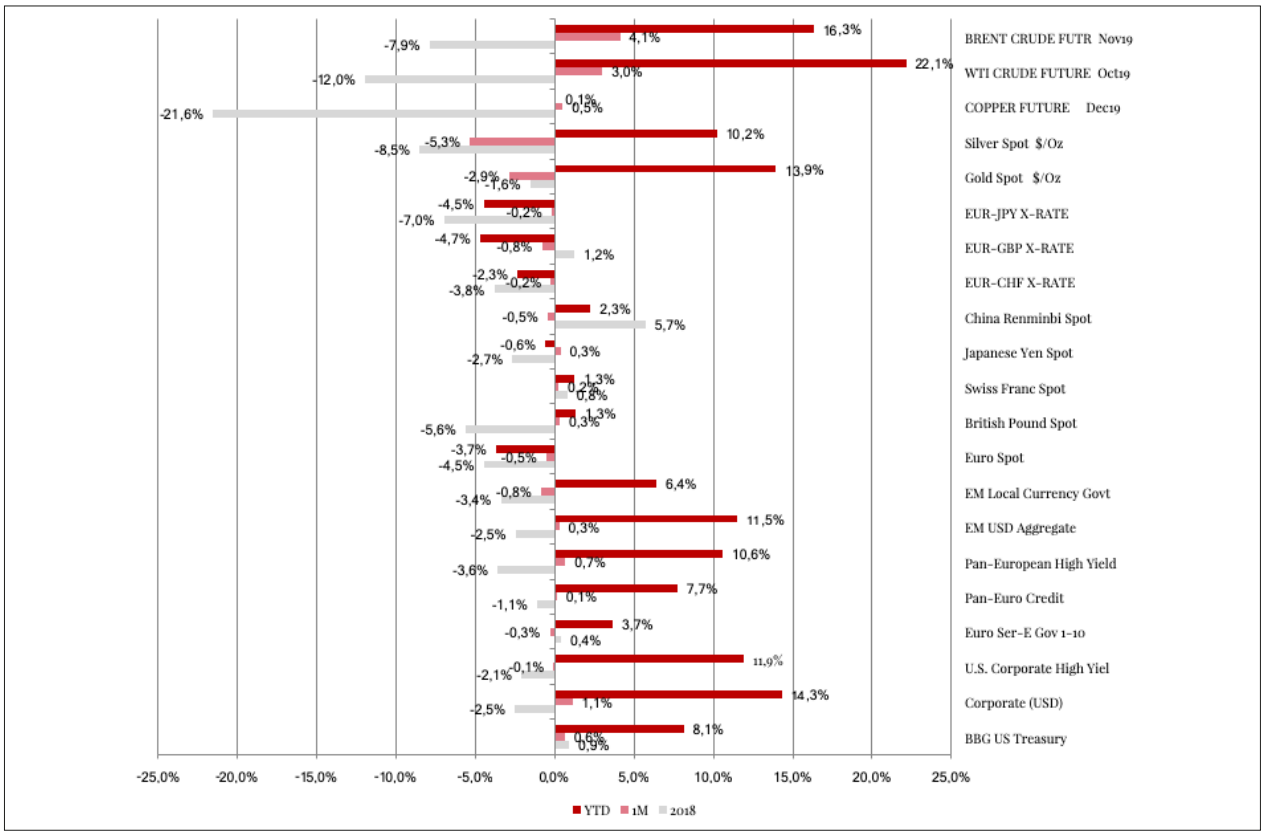
Equity performances in local currencies



Equity performances in USD



Fixed income, currency and commodity performances



Source : Bloomberg, 27.11.19

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