# Market review June 2019


In anticipation of an imminent conclusion of trade agreements between China and the United States, markets rebounded strongly in June. An escalation of the conflict was avoided at the last G-20 summit in Osaka, but no concrete decision was taken. We find ourselves in a situation similar to that of the December 2018 G-20, where trade sanctions were frozen with a view to an upcoming agreement. We are seeing a slowdown in global trade related to economic uncertainties. In the current uncertain environment, few companies risk engaging in costly investment programs as global economic rules are about to be significantly redefined.

Whereas equity markets are progressing at a fast pace since the beginning of the year, bond markets are reflecting this slowdown. Interest rates are on a slippery slope and reach negative levels never seen before (10-year rates are at -0.36%, 0% and -0.2% in Germany, France and the Netherlands respectively). Central bankers have already announced future rate cuts and massive monetary support. But will that be enough for the next recession?

## Market trends at end of June 2019

| | Equities in Local Currencies | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **End of June** | **MSCI World** | **S&P 500** | **EuroStoxx** | **CAC** | **Spain** | **Switzerland** | **UK** | **Hong Kong** |
| **Perf 1 Month** | 6.46% | 6.89% | 5.89% | 6.36% | 2.16% | 3.93% | 3.69% | 6.10% |
| **Perf 3 Month** | 3.35% | 3.79% | 3.64% | 3.52% | -0.45% | 4.44% | 2.01% | -1.75% |
| **Perf YTD** | 15.63% | 17.35% | 15.73% | 17.09% | 7.72% | 17.43% | 10.37% | 10.43% |

| | Commodities | | | | Currencies vs EUR | | | |
|---|---|---|---|---|---|---|---|---|
| **End of June** | **WTI Oil** | **Brent Oil** | **Gold** | **Copper** | **USD** | **JPY** | **GBP** | **CHF** |
| **Perf 1 Month** | 9.29% | 3.19% | 7.97% | 2.80% | -1.80% | -1.39% | -1.26% | 0.67% |
| **Perf 3 Month** | -2.78% | -2.69% | 9.07% | -7.55% | -1.36% | -1.36% | -3.91% | -0.53% |
| **Perf YTD** | 28.76% | 23.70% | 9.90% | 0.47% | 0.66% | 2.41% | 0.31% | 1.37% |

| | Bloomberg Indices Bonds Total returns | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **End of June** | **Global Aggregate** | **US Aggregate** | **Euro Aggregate** | **US 10 Year Treasury** | **German 10 Year Bund** | **Global Credit** | **Global High Yield** | **Emerging Sovereign $** |
| **Perf 1 Month** | 2.22% | 1.26% | 1.89% | 1.36% | 2.72% | 2.63% | 3.18% | 2.71% |
| **Perf 3 Month** | 3.29% | 3.08% | 2.83% | 3.97% | 4.99% | 3.79% | 2.97% | 3.75% |
| **Perf YTD** | 5.57% | 6.11% | 5.41% | 6.96% | 10.68% | 7.75% | 9.49% | 9.39% |

Source : Bloomberg 28/06/19.



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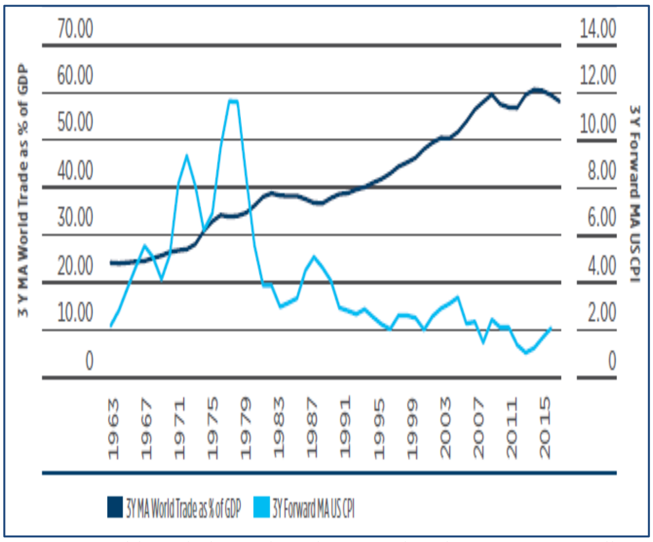
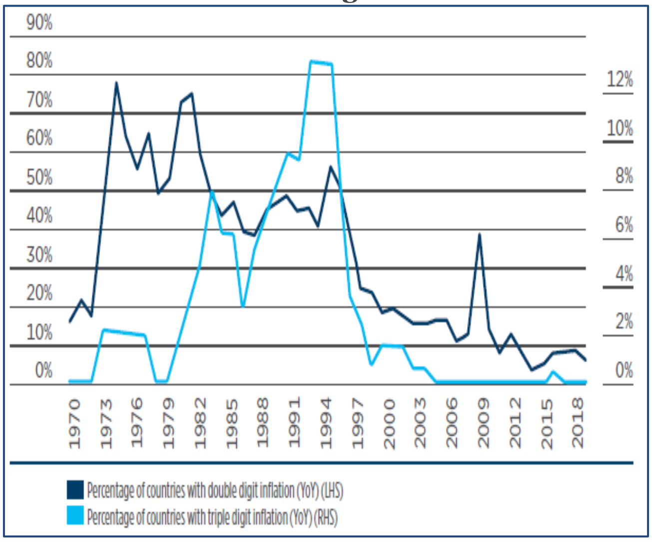
We are experiencing a deep economic paradigm shift. If we regularly mention technological transformations, demographic evolution and climate change as major upheavals, we are also experiencing the end of a monetary era. It is difficult to put a specific date on the turning point of economic cycles. But central banks have really entered a new regime.

The use of debt and budget deficits as a means of economic recovery has been the main tool of political leaders of most countries since the 1970s, with the immediate consequence of rising inflation. This period has had a lasting impact on the monetary authorities.
Paul Volker's arrival at the head of the US central bank at the end of the 1970s and his policy of raising rates was a milestone in the fight against inflation. But this also coincided with the expansion of world trade, the globalization of exchanges and the lowering of customs barriers.

**Global trade to GDP and US CPI**




**The death of high inflation**




Source : World Bank data, Bloomberg, National Sources, Amundi.

How far this world seems today! The 2008 financial crisis marked a major turning point. With the lessons learned from the 1929 crises, central bankers lowered interest rates, injected liquidity into markets and governments allowed deficits to grow in order to save the global economy. We have certainly avoided the worst. But the side effects of these measures begin to be felt and will certainly cause the next crisis. These stimulus, which should have remained temporary, have become almost permanent. Artificially low interest rates have fuelled a dramatic increase in government and corporate debt. Any increase in rates would become fatal. This increase has no longer been relevant for the past few months (whereas at the end of 2018 the American central bank was still talking about an increase for 2020!).

Disparities in wealth and income have reached extreme levels, comparable to those of the last century. Such a situation was followed by vast political and economic upheavals. There is an underlying trend towards the reappropriation of national destiny. The globalization of trade and the reduction in tariffs have contributed significantly to global economic growth since the 1980s. But the social cost has been significant (relocations, downward mobility...) which is reflected in the current frustrations and protest votes. The trade war between the United States and China certainly marks the end of this globalization cycle (the volume of world trade is stagnating).

The overall trend is no longer towards higher rates. The decline has begun, and central banks will start injecting liquidity. A new instrument will be added to this list: budget deficit. Since the early 1980s, Western countries have been living above their means.



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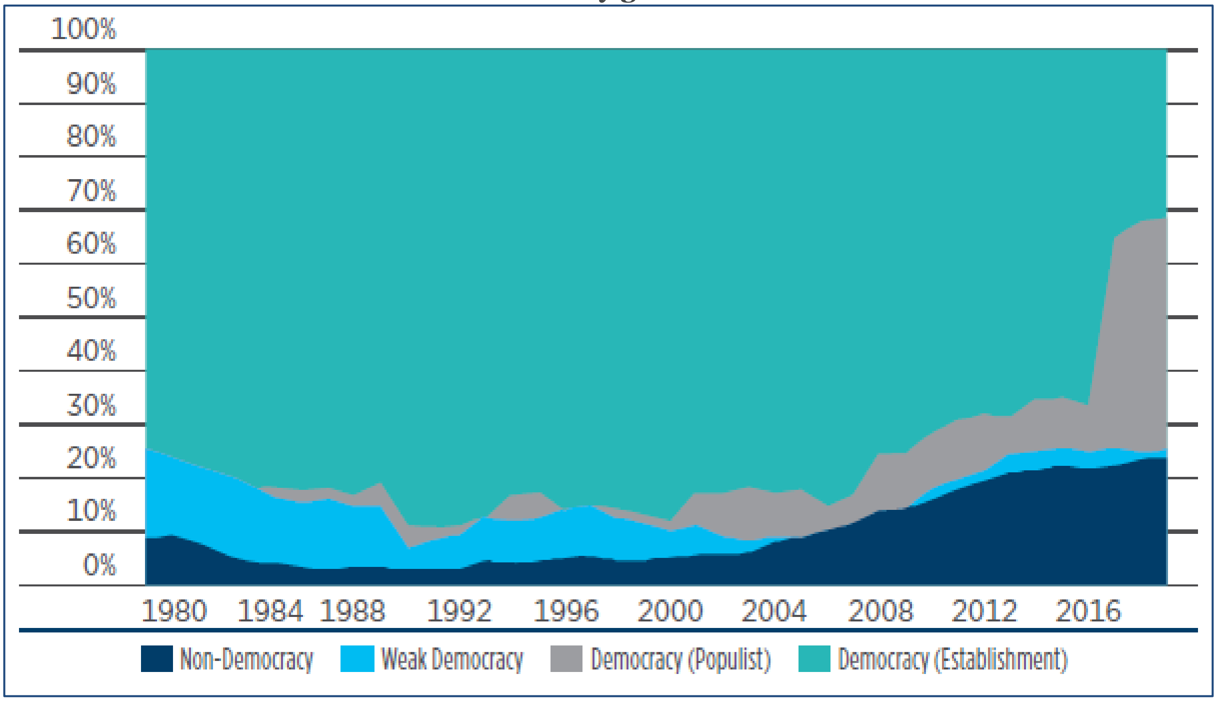
Few manage to balance their annual budget. If this economic stimulus was initially intended to remain temporary following oil shocks, and could be tolerated given the low debt levels at the time, it has now become permanent and the current level of government debt reduces the room for manoeuvre. This budget deficit will certainly increase by an even larger amount in the coming years.

The reason? Political power taking back control of central banks (and therefore of banknote printing). Budget deficits will be financed by an increase in debt, which will itself be purchased by central banks (US Federal Reserve, ECB, Bank of Japan, Bank of England, etc.). The graph below is quite eloquent in this sense, and perfectly illustrates the change in political context. The appointment of Mrs. Lagarde as head of the ECB thus appears to be the latest illustration of central bankers newly subordinated to political leaders (... if we still had some doubts about their independence).

President Trump's exhortations to Mr Powell to lower interest rates follow the same logic. In the 1960s, Lindon B Johnson had already urged the Federal Reserve chairman of that time to lower interest rates in order to have a more accommodating monetary policy.

**G-20 GDP by governance**




Source: Bloomberg Economics, Freedom House, International Monetary Fund.

A year ago, the world's central bankers were moving towards normalizing their monetary policies. Since then, threats of trade wars have reduced growth hopes and we are witnessing a downward revision of corporate profits. This certainly explains the change of mind of these same bankers, who for the past few months have announced upcoming rate cuts and new monetary easing programs.



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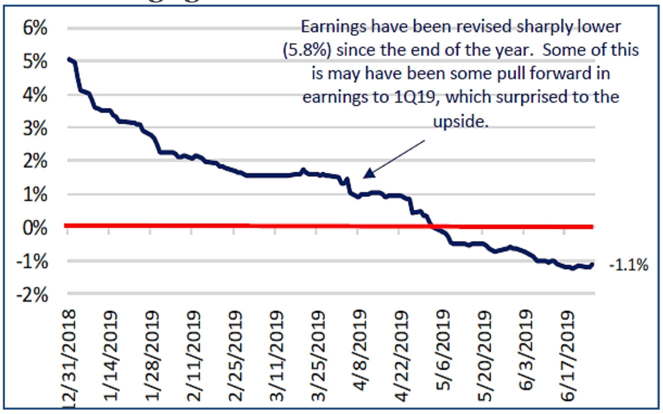
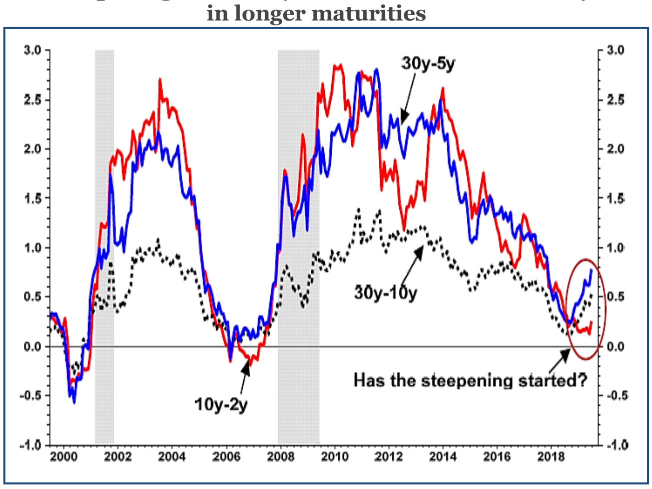
**Earnings growth estimate revision trend**



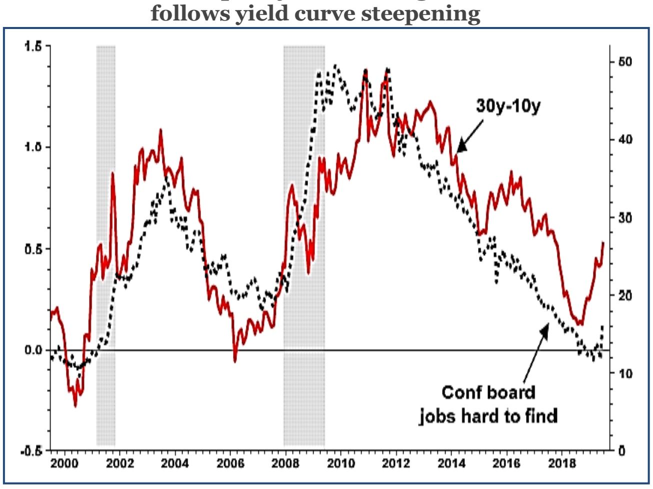

Source Raymond James Equity Strategy

We are not yet in recession, but many indicators suggest that we are getting closer to it in the United States. The yield curve inversion and its steepening are the warning signs of a slowdown. A loosening labour market would confirm our apprehensions.

**Steepening of the US yield curve is well underway in longer maturities**




**Jump in "jobs hard to get" follows yield curve steepening**




Source : Datastream, SG

Will central bankers come to the rescue of investors once again? Of course, but let us doubt the effectiveness of such support.

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The politicization of central banks could permanently damage the credibility of monetary policies. Remember Mr Draghi's "Whatever it takes" to save the euro. These simple words were enough to overcome the most reluctant.

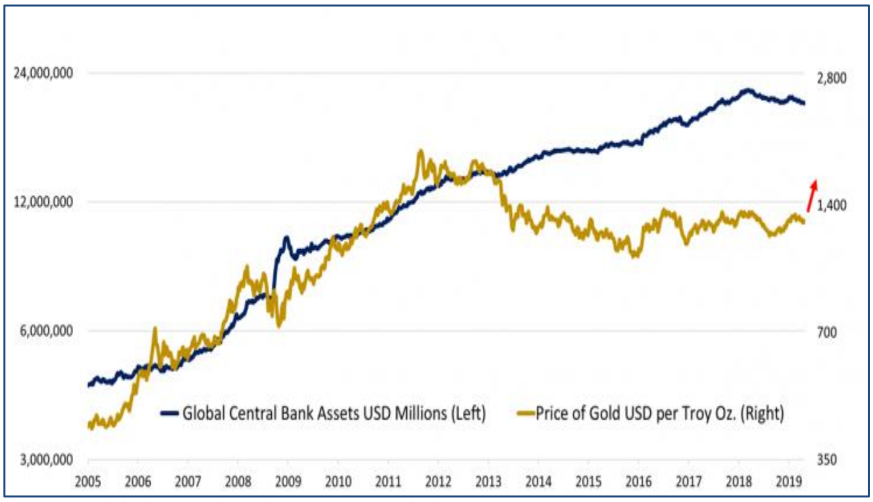
The fourth quarter of 2018 seems to have been a turning point. The economic slowdown caused fears of the worst and investors sought to protect their assets. Gold has always been considered a safe haven. Certainly unproductive, but a safe haven because it is nobody's debt and it is part of the central banks' monetary reserves. In a context of negative interest rates (there are more than USD 14 000 billions of government bonds with negative yields!), the opportunity cost of gold (gold does not pay interest or dividend) is no longer an argument. Its decline since the 2011 peaks seems to have come to an end.

**Real yields vs. Gold**


Source : Bloomberg, Crescat Capital LLC.

Gold is produced in measurable and finite quantities. Central banks can inject more liquidity (and print more paper!), but they cannot print gold! It is therefore a real asset that should not depreciate unlike paper assets.

**Global Central Bank Assets vs. Gold**




Source : Global Central Banks, Crescat Capital LLC.

The monetary experiments of central bankers since 2008 seem never to end. Current social tensions are certainly collateral effects. However, it is difficult to define the economic changes that await us, as monetary adjustments have muddied the waters. However, if we evaluate the various possible economic configurations (put in the case of deep deflation), gold seems to be a predestined asset for uncertain situations. Its resurrection since the end of 2018 therefore seems to follow this logic.



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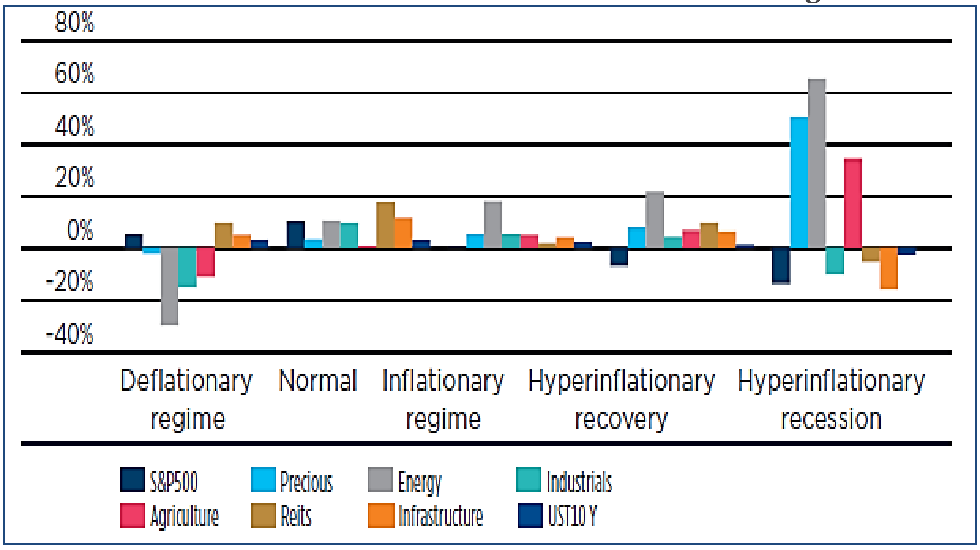
**Financial assets real returns in different inflation regimes**




Source: Amundi Research, S&P 500, global financial data, Bloomberg, GSCI Precious Metals Total Return Index, GSCI Energy Total Return Index, GSCI Industrial Metals Total Return Index, GSCI Agriculture Total Return Index

The launch of cryptocurrencies after the 2008 crisis corresponded to the same logic of independence from monetary authorities. The evolution of these technologies is promising, but no central bank has any in reserve, unlike gold, "this barbaric relic"! Things may change in the coming decades, but not in our near term horizon.





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