

9 December 2019 /// n°41-2019

Fed: the illusionary pause

Key Points

- **S&P back at all-time high after choppy week**
- **US job growth surprises on the upside, 10-year yields at 1.85%**
- **Lagarde must rebuild consensus within governing council**
- **High yield outperforms**

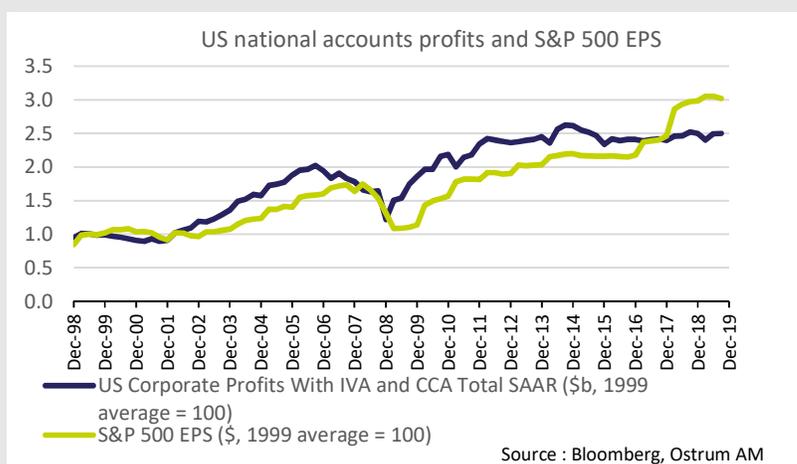
Equity markets experienced volatility last week as trade deal hopes and uneven data releases shift expectations. Gold moved slightly lower. Early on the S&P was down as much as 80 points before recouping losses to previous highs of 3145. Europe followed the same pattern although indices stayed at some distance from peak levels. Bank stocks led the market higher. M&A activity is accelerating.

Yields on 10-year notes hit 1.85% last week, the end of the recent trading range, after a surprisingly strong NFP print. Bund keep oscillating about -0,30%. Spread products are in good demand.

Portugal's bond spreads are narrowing, high yield spreads are also tighter. Bank Tier 1 securities echo performance from bank equity. The average spread on Euro IG corporate bonds is stable near 100bp over Bunds.

In currency markets, sterling prices in a Johnson victory at upcoming elections raising the odds of a ratification of the Brexit deal. In turn, South-American currencies (BRL, CLP) are stabilizing thanks to Central Bank intervention. Mexican peso also benefited from improved market sentiment.

Chart of the week



US national accounts produce a series of corporate profits adjusted for inventory valuation and capital consumption. It tends to move in synch with reported earnings of S&P 500 constituents.

Private-sector profitability has been stagnant for the past five years. Meanwhile, S&P 500 reported EPS have accelerated sharply.

The gap is not linked to the corporate tax relief from 2018. The relative effect of buybacks is the main explanation for the growing divergence in the two measures.



Contradictory activity signals

Reading economic indicators may be an art as economic data often seems incoherent. The large gap between the ADP private-sector employment estimate (+67k) and the BLS non-farm payroll data (+254k) is quite stunning. In turn, ISM services (53.9) paints a mixed picture of slowing activity in the context of rising employment and strong new orders. In Germany, industrial output continues to contract despite stabilization in surveys and better export data in October. Fiscal policy in Japan is also hard to apprehend. The Japanese government just announced \$120b worth of public investment spending barely a month after raising the sales tax. Investment is not the weak spot in the Japanese economy as the Asian nation will host the Olympics next summer.

Fed: the illusionary pause

In the US, labor market strength does reduce the risk of sharp deceleration in growth in the near term. The low level of layoffs indicate that skills are still in short supply. The unemployment rate is at a 50-year low (3.5%). Whilst private consumption can only slow from the heady pace of 2q/3q19, the improvement in the trade balance (\$46b deficit in October) and the pickup in housing investment suggest growth in the ballpark of 1.5%q in the fourth quarter. The current situation of the US economy is indeed that of a “glass more than half full” to paraphrase Jerome Powell. The Fed rapidly eased policy in the past few months although dual mandate objectives of stable inflation and maximum required no monetary accommodation. The Fed may use the argument of robust job growth to sell the ‘pause’ but the reality is that the Fed runs a very aggressive policy. Tensions in repo markets could be a source of disruption given the high sensitivity of the US economy and financial markets to credit conditions. The BIS estimates that banks and hedge funds played a big role in the tightening in repo funding conditions but bear in mind that the underlying economic issue may be crowding out effects from a ballooning federal deficit.

T-note yields proved to be volatile last week ranging from 1.70 to 1.85% ahead of this week’s FOMC. Consensus among final investors is bullish on balance whilst speculative accounts maintain their shorts. Annual inflation will accelerate to 2% in November due to a higher contribution from energy prices. Inflation-linked bonds and curve steepeners are attractive looking out to the first quarter. OPEC maintained its tight supply strategy but the motivations of Saudi Arabia may have changed as Aramco’s IPO is now done.

Equity markets swiftly erased the initial drop caused by Donald Trump pouring cold water on trade hopes by threatening to implement tariffs on December 15.

Similarly to past corrections in May, August and October, the two-day decline turned out to be an entry point. Equity positioning of asset managers and speculators are not extreme by any means and should not be an obstacle to higher stock prices. Mergers and acquisitions run high as elevated valuations foster security exchange deals. A return of the growth stock theme is also visible in last month’s trading.

Lagarde’s inaugural ECB council

In the euro area, Christine Lagarde will preside over her first ECB meeting this week. The President will have to recreate consensus within the Governing Council given the extent of the opposition to Mario Draghi’s latest stimulus package. A rate cut is off the table. It may also be too soon to redefine the ECB’s inflation target. The ECB may in turn provide funding to the green deal evoked by Commissioner Von Der Leyen by extending QE eligibility to green bonds. The resumption of APP net asset purchases in November signaled a relative shift towards corporate bonds away from public-sector bonds. That said, amounts of maturing public securities to be reinvested remain much larger.

In this context, Bunds traded around in line with Treasury bonds around the -0.30% threshold. Liquidity tensions around year-end would likely result in buying of safe securities leading to wider swap spreads. Italy (about 160bp) exhibited higher volatility than most sovereign bonds. Investors are back on Portugal bonds. Ireland was upgraded to AA- by S&P. The Irish government’s net cash position points to reduction in next year’s bond issuance.

In credit markets, the balance of flows has improved. Spreads on high credit quality private-sector bonds trade about 100bp against German Bund. Outperformance of Bank Tier 1 securities echoed strong gains in bank equity last week. High yield remains in high demand. Spreads on speculative-grade corporate bonds are now within 340bp vs. Bunds. Cds indices have magnified the bullish sentiment in high yield. The iTraxx XO index which represents BB-B credit trades tight at 220bp.

Currency market volatility increased last week as sterling made strong gains against the US Polls pointing to a conservative majority hint at Brexit deal ratification by the new Parliament. Some market participants still seek to hedge tail risks. Downunder, the sharp decline in the CLP against the US dollar was mitigated by Central Bank intervention. Zero carry against the US dollar appears to be favorable ground for disruptive price movements in an economy faced with slowdown and a current account deficit of 3pp of GDP.

Main Market Indicators

G4 Government Bonds	09-Dec-19	-1wk (bp)	-1m (bp)	Ytd (bp)
EUR Bunds 2y	-0.64 %	-2	-2	-3
EUR Bunds 10y	-0.31%	-3	-4	-55
EUR Bunds 2s10s	33 bp	0	-2	-52
USD Treasuries 2y	1.62 %	+2	-5	-87
USD Treasuries 10y	1.83 %	+1	-12	-86
USD Treasuries 2s10s	20 bp	-1	-6	+1
GBP Gilt 10y	0.76 %	+2	-3	-51
JPY JGB 10y	0 %	+4	+5	-1
€ Sovereign Spreads (10y)	09-Dec-19	-1wk (bp)	-1m (bp)	Ytd (bp)
France	32 bp	+1	+3	-15
Italy	158 bp	-5	+13	-92
Spain	76 bp	-1	+11	-41
Inflation Break-evens (10y)	09-Dec-19	-1wk (bp)	-1m (bp)	Ytd (bp)
EUR OATi	91 bp	+1	+4	-
USD TIPS	170 bp	+3	-3	-1
GBP Gilt Index-Linked	314 bp	+1	-1	-4
EUR Credit Indices	09-Dec-19	-1wk (bp)	-1m (bp)	Ytd (bp)
EUR Corporate Credit OAS	101 bp	-2	+3	-51
EUR Agencies OAS	46 bp	+0	+2	-14
EUR Securitized - Covered OAS	41 bp	+1	+1	-22
EUR Pan-European High Yield OAS	337 bp	-5	-31	-176
EUR/USD CDS Indices 5y	09-Dec-19	-1wk (bp)	-1m (bp)	Ytd (bp)
iTraxx IG	47 bp	-1	-1	-41
iTraxx Crossover	221 bp	-4	-10	-133
CDX IG	50 bp	-2	-2	-38
CDX High Yield	325 bp	-5	-1	-125
Emerging Markets	09-Dec-19	-1wk (bp)	-1m (bp)	Ytd (bp)
JPM EMBI Global Div. Spread	317 bp	-7	-2	-98
Currencies	09-Dec-19	-1wk (%)	-1m (%)	Ytd (%)
EUR/USD	\$1.106	-0.24	+0.2	-3.41
GBP/USD	\$1.316	+1.13	+2.31	+3.21
USD/JPY	¥108.61	-0.07	+0.38	+0.97
Commodity Futures	09-Dec-19	-1wk (\$)	-1m (\$)	Ytd (\$)
Crude Brent	\$64.3	\$3.4	\$2.7	\$9.0
Gold	\$1 459.7	-\$19.3	\$3.8	\$178.2
Equity Market Indices	09-Dec-19	-1wk (%)	-1m (%)	Ytd (%)
S&P 500	3 142	0.91	1.59	25.35
EuroStoxx 50	3 672	1.26	-0.74	22.35
CAC 40	5 837	0.87	-0.89	23.39
Nikkei 225	23 431	-0.42	0.17	17.07
Shanghai Composite	2 914	1.34	-1.68	16.86
VIX - Implied Volatility Index	15.08	1.14	24.94	-40.68

Source: Bloomberg, Ostrum Asset Management

Writing



AXEL BOTTE
STRATEGIST
axel.botte@ostrum.com

Legal information

This document is intended for professional clients in accordance with MIFID. It may not be used for any purpose other than that for which it was conceived and may not be copied, distributed or communicated to third parties, in part or in whole, without the prior written authorization of Ostrum Asset Management. None of the information contained in this document should be interpreted as having any contractual value. This document is produced purely for the purposes of providing indicative information. This document consists of a presentation created and prepared by Ostrum Asset Management based on sources it considers to be reliable. Ostrum Asset Management reserves the right to modify the information presented in this document at any time without notice, and in particular anything relating to the description of the investment process, which under no circumstances constitutes a commitment from Ostrum Asset Management.

Ostrum Asset Management will not be held responsible for any decision taken or not taken on the basis of the information contained in this document, nor in the use that a third party might make of the information.

Figures mentioned refer to previous years. Past performance does not guarantee future results. Any reference to a ranking, a rating or an award provides no guarantee for future performance and is not constant over time. Reference to a ranking and/or an award does not indicate the future performance of the UCITS/AIF or the fund manager.

Under Ostrum Asset Management's social responsibility policy, and in accordance with the treaties signed by the French government, the funds directly managed by Ostrum Asset Management do not invest in any company that manufactures, sells or stocks anti-personnel mines and cluster bombs.

This material has been provided for information purposes only to investment service providers or other Professional Clients, Qualified or Institutional Investors and, when required by local regulation, only at their written request. This material must not be used with Retail Investors.

In the E.U. (outside of the UK and France): Provided by Natixis Investment Managers S.A. or one of its branch offices listed below. Natixis Investment Managers S.A. is a Luxembourg management company that is authorized by the Commission de Surveillance du Secteur Financier and is incorporated under Luxembourg laws and registered under n. B 115843. Registered office of Natixis Investment Managers S.A.: 2, rue Jean Monnet, L-2180 Luxembourg, Grand Duchy of Luxembourg. Italy: Natixis Investment Managers S.A., Succursale Italiana (Bank of Italy Register of Italian Asset Management Companies no. 23458.3). Registered office: Via Larga, 2 - 20122, Milan, Italy. Germany: Natixis Investment Managers S.A., Zweigniederlassung Deutschland (Registration number: HRB 88541). Registered office: Im Trutz Frankfurt 55, Westend Carree, 7. Floor, Frankfurt am Main 60322, Germany. Netherlands: Natixis Investment Managers, Netherlands (Registration number 50774670). Registered office: Stadsplateau 7, 3521AZ Utrecht, the Netherlands. Sweden: Natixis Investment Managers, Nordics Filial (Registration number 516405-9601 - Swedish Companies Registration Office). Registered office: Kungsgatan 48 5tr, Stockholm 111 35, Sweden. Spain: Natixis Investment Managers, Sucursal en España, Serrano nº90, 8th Floor, 28006, Madrid, Spain.

In France: Provided by Natixis Investment Managers International – a portfolio management company authorized by the Autorité des Marchés Financiers (French Financial Markets Authority - AMF) under no. GP 90-009, and a public limited company (société anonyme) registered in the Paris Trade and Companies Register under no. 329 450 738. Registered office: 43 avenue Pierre Mendès France, 75013 Paris. In Switzerland: Provided for information purposes only by Natixis Investment Managers, Switzerland SARL, Rue du Vieux Collège 10, 1204 Geneva, Switzerland or its representative office in Zurich, Schweizergasse 6, 8001 Zurich.

In the U.K.: Provided by Natixis Investment Managers UK Limited which is authorised and regulated by the UK Financial Conduct Authority (register no. 190258). This material is intended to be communicated to and/or directed at persons (1) in the United Kingdom, and should not to be regarded as an offer to buy or sell, or the solicitation of any offer to buy or sell securities in any other jurisdiction than the United Kingdom; and (2) who are authorised under the Financial Services and Markets Act 2000 (FSMA 2000); or are high net worth businesses with called up share capital or net assets of at least £5 million or in the case of a trust assets of at least £10 million; or any other person to whom the material may otherwise lawfully be distributed in accordance with the FSMA 2000 (Financial Promotion) Order 2005 or the FSMA 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (the "Intended Recipients"). The fund, services or opinions referred to in this material are only available to the Intended Recipients and this material must not be relied nor acted upon by any other persons. Registered Office: Natixis Investment Managers UK Limited, One Carter Lane, London, EC4V 5ER.

In the DIFC: Provided in and from the DIFC financial district by Natixis Investment Managers Middle East (DIFC Branch) which is regulated by the DFSA. Related financial products or services are only available to persons who have sufficient financial experience and understanding to participate in financial markets within the DIFC, and qualify as Professional Clients or Market Counterparties as defined by the DFSA. No other person should act upon this material. Registered office: Office 603 - Level 6, Currency House Tower 2, PO Box 118257, DIFC, Dubai, United Arab Emirates.

In Japan: Provided by Natixis Investment Managers Japan Co., Ltd., Registration No.: Director-General of the Kanto Local Financial Bureau (kinsho) No. 425. Content of Business: The Company conducts discretionary asset management business and investment advisory and agency business as a Financial Instruments Business Operator. Registered address: 1-4-5, Roppongi, Minato-ku, Tokyo.

In Taiwan: Provided by Natixis Investment Managers Securities Investment Consulting (Taipei) Co., Ltd., a Securities Investment Consulting Enterprise regulated by the Financial Supervisory Commission of the R.O.C. Registered address: 34F., No. 68, Sec. 5, Zhongxiao East Road, Xinyi Dist., Taipei City 11065, Taiwan (R.O.C.), license number 2018 FSC SICE No. 024, Tel. +886 2 8789 2788.

In Singapore: Provided by Natixis Investment Managers Singapore (name registration no. 53102724D) to distributors and institutional investors for informational purposes only. Natixis Investment Managers Singapore is a division of Ostrum Asset Management Asia Limited (company registration no. 199801044D). Registered address of Natixis Investment Managers Singapore: 5 Shenton Way, #22-05 UIC Building, Singapore 068906.

In Hong Kong: Provided by Natixis Investment Managers Hong Kong Limited to institutional/ corporate professional investors only.

In Australia: Provided by Natixis Investment Managers Australia Pty Limited (ABN 60 088 786 289) (AFSL No. 246830) and is intended for the general information of financial advisers and wholesale clients only.

In New Zealand: This document is intended for the general information of New Zealand wholesale investors only and does not constitute financial advice. This is not a regulated offer for the purposes of the Financial Markets Conduct Act 2013 (FMCA) and is only available to New Zealand investors who have certified that they meet the requirements in the FMCA for wholesale investors. Natixis Investment Managers Australia Pty Limited is not a registered financial service provider in New Zealand.

In Latin America: Provided by Natixis Investment Managers S.A.

In Uruguay: Provided by Natixis Investment Managers Uruguay S.A., a duly registered investment advisor, authorised and supervised by the Central Bank of Uruguay. Office: San Lucar 1491, oficina 102B, Montevideo, Uruguay, CP 11500. The sale or offer of any units of a fund qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627.

In Colombia: Provided by Natixis Investment Managers S.A. Oficina de Representación (Colombia) to professional clients for informational purposes only as permitted under Decree 2555 of 2010. Any products, services or investments referred to herein are rendered exclusively outside of Colombia. This material does not constitute a public offering in Colombia and is addressed to less than 100 specifically identified investors.

In Mexico: Provided by Natixis IM Mexico, S. de R.L. de C.V., which is not a regulated financial entity or an investment manager in terms of the Mexican Securities Market Law (Ley del Mercado de Valores) and is not registered with the Comisión Nacional Bancaria y de Valores (CNBV) or any other Mexican authority. Any products, services or investments referred to herein that require authorization or license are rendered exclusively outside of Mexico. Natixis Investment Managers is an entity organized under the laws of France and is not authorized by or registered with the CNBV or any other Mexican authority to operate within Mexico as an investment manager in terms of the Mexican Securities Market Law (Ley del Mercado de Valores). Any use of the expression or reference contained herein to "Investment Managers" is made to Natixis Investment Managers and/or any of the investment management subsidiaries of Natixis Investment Managers, which are also not authorized by or registered with the CNBV or any other Mexican authority to operate within Mexico as investment managers.

The above referenced entities are business development units of Natixis Investment Managers, the holding company of a diverse line-up of specialised investment management and distribution entities worldwide. The investment management subsidiaries of Natixis Investment Managers conduct any regulated activities only in and from the jurisdictions in which they are licensed or authorized. Their services and the products they manage are not available to all investors in all jurisdictions. It is the responsibility of each investment service provider to ensure that the offering or sale of fund shares or third party investment services to its clients complies with the relevant national law.

The provision of this material and/or reference to specific securities, sectors, or markets within this material does not constitute investment advice, or a recommendation or an offer to buy or to sell any security, or an offer of any regulated financial activity. Investors should consider the investment objectives, risks and expenses of any investment carefully before investing. The analyses, opinions, and certain of the investment themes and processes referenced herein represent the views of the portfolio manager(s) as of the date indicated. These, as well as the portfolio holdings and characteristics shown, are subject to change. There can be no assurance that developments will transpire as may be forecasted in this material. Past performance information presented is not indicative of future performance.

Although Natixis Investment Managers believes the information provided in this material to be reliable, including that from third party sources, it does not guarantee the accuracy, adequacy, or completeness of such information. This material may not be distributed, published, or reproduced, in whole or in part.

All amounts shown are expressed in USD unless otherwise indicated.



www.ostrum.com

Ostrum Asset Management

Asset management company regulated by AMF under n° GP-18000014 – Limited company with a share capital of 27 772 359 euros

Trade register n°525 192 753 Paris – VAT: FR 93 525 192 753 – Registered Office: 43, avenue Pierre Mendès-France, 75013 Paris – www.ostrum.com

Tél. : 01 58 19 09 80