

Letter from the President and the Fund Managers July 2015

With the exception of commodities and investments assimilated to them, all the main categories of assets produced positive returns in the first quarter of 2015. The principal explanation underlying this is the fact that, on 22 January, the European Central Bank (ECB) announced that it was going to proceed to buy massive quantities of government bonds in the euro zone and that this action was to continue at least until September 2016. The foremost objective of this programme is to boost economic growth and to stem the risk of deflation. The most perceptible consequence of this extraordinary measure, often dubbed “quantitative easing” or QE, has been the marked depreciation of the euro (-11.2% relative to the US dollar in the first quarter). Other monetary authorities have also made adaptations to their policies. On 15 January, the Swiss National Bank (SNB) abandoned the minimum peg for the euro against the Swiss franc after having upheld an exchange rate of CHF 1.20 to the euro for three-and-a-half years. In addition to that, the SNB and the Danish Central Bank introduced negative rates of interest on deposits. The Swedish authority too announced a QE programme. On the other side of the Atlantic there is a somewhat contrasting picture. Over there, a more restrictive monetary policy is emerging, given that the American Federal Reserve (Fed) has signalled that it is envisaging increasing its interest rates, albeit cautiously.

The second quarter of the year was marked by two major events with differing consequences. Firstly, there was a notable improvement in the growth and inflation prospects for the developed countries and, secondly, there was the aggravation of the Greek debt crisis. Globally, however, it was the bad news that predominated in the eyes of the investors.

Currencies

An improvement in the American economic data and, if it happens, the first increase in interest rates in nine years, ought to reinvigorate the US dollar relative to the euro and the Swiss franc during the second half of the year. An economic recovery in Japan ought also to give support to the yen, but only relative to the euro and the Swiss franc for the time being.

Short-term rates (three-month outlook)

We take the view that the American Federal Reserve is likely to increase its key interest rates in two stages, in September and then again in December. There is, on the other hand, no upturn in sight in the euro zone, in Japan or in Switzerland. The economy there is still too fragile and the inflation rates too low.

Return on ten-year government bonds (three-month outlook)

The returns on German government bonds have gained 80 base points since April in reaction to a minor resurgence in the cyclical prospects and the forecasts for inflation in the euro zone to rise. Our own projections are higher than the consensus ones for Germany and identical to them for the other countries.

Inflation in 2015

Within the euro zone, our current reckoning is no longer that the cost of living will remain at the same level but that it will go up by 0.6%. It has to be said that the underlying inflation has progressed since January and that the fall in the price of energy has slowed down somewhat. Our belief is that this tendency is going to remain with us until the end of the year. Our forecasts from now on are higher than those of other analysts for both the USA and the euro zone.

Outlook

Considering that the cyclical signals are globally encouraging in the majority of developed countries, we are sticking to our forecasts of economic growth through until the end of the year. We have increased to 80%, compared with 50% beforehand, the probability that our principal scenario of “continuation of the recovery despite adverse winds” is what will come about. We feel that the USA ought to pull out of the first quarter’s period of sluggish growth. The services sector, in particular, ought to experience a positive trend, whereas manufacturing industry has not yet started to grow. In Europe we are still banking on an economic recovery. The weakness of the euro is a competitive advantage for many European businesses, because it is bringing down the cost of exports to countries outside of the euro zone. The strong injections of liquidity by the ECB constitute another supporting factor, making it more attractive for banks to grant loans and for businesses to apply for them. Turning to the Japanese economy, we have now become more confident than we were and are expecting an annual growth rate of 0.9%. By contrast, there is little comfort in the situation faced by the emerging countries, which are struggling to find new growth models against a background of low commodity prices. While the efforts being deployed in India, Mexico and China to see through reforms seem encouraging, Russia and Brazil are unlikely to experience a sustainable cyclical upturn.

The question of Greece’s future is likely to continue to exercise the minds of all the market players. Whether or not a (political) solution in one form or another is brought about to the crisis of Greek public debt, strong fluctuations in exchange rates cannot be ruled out. The least that can be said is that the contagious risk for the other peripheral countries in the euro zone appears to a large extent to have been eliminated, given their more stable political situation and the slight cyclical improvement.