Info Flash from the Chairman and Fund Managers
July 2017

Return to growth despite higher interest rates and uncertainties surrounding the EU

The economic recovery, which began half way through 2016, has continued in the first half of the current year. The advanced indicators of future trends in the various sectors hit record levels not only in the United States but throughout the entire world. Furthermore, equity markets grew by 10% worldwide between January and June.
Following the acceleration in the economic cycle, the American Federal Reserve (Fed) increased its key interest rates in March and June, but the terms in which its chair, Janet Yellen, has chosen to present those actions hint at a need to be wary as regards longer-term trends. Despite contemplating a scenario like this, the long rates have fallen in the United States, given the expectation that inflation will come down. The rate at which Janet Yellen intends to tighten the interest-rate screw again also depends on the economic policy pursued by the new American administration.

The political uncertainties in the euro zone have remained a topical issue throughout the six months. The United Kingdom has put in the official notification of its intention to withdraw from the European Union, while Theresa May's government has been weakened by losing its absolute majority in parliament as a result of the early general election of 8 June. As far as the French presidential election was concerned, several observers were afraid that Marine Le Pen, leader of the extreme right, which is hostile to the European Union, would win the day. In the end, the markets heaved a sigh of relief after the first round of elections on 23 April and all the more so after the very clear victory of the pro-European candidate, Emmanuel Macron, in the second round on 7 May. Those uncertainties have been reflected in noticeable premiums on the returns on bonds issued in the peripheral countries in the south of Europe, which are considered to be the weakest links in the euro zone.

Equities:

As the equity markets have progressed significantly, nearly all the regional and sectoral indices have been positive (+8.6% in local currency in the first quarter and +2% in the second quarter). It is only equities in the energy sector that have not followed this trend. They have suffered from the weakness of oil prices and the decision by numerous investors to cash in the profits that they had been accumulating since last year.
Analysing the regions, equities in the emerging countries recorded the most felicitous trend, and Asian equities, in particular, have grown strongly in the course of the past month, with that growth being led by securities in advanced technologies and consumer goods.

Bonds:

There have been no very spectacular occurrences on the bond markets of the developed countries. In the wake of Donald Trump's election, the investors have set their sights on *reflation trade* – in other words a new phase marked by higher price increases and a growth in bond returns, which has not yet happened in reality. That has been the case especially in the United States, but also in Germany. German ten-year government bonds have remained extremely expensive for a meagre return (0.3%). Returns on Swiss government bonds have even stayed in the negative zone.
In both Europe and the United States, the context has been favourable for company bonds – and that even for debtors with the poorest solvency.

Emerging country bonds, whose returns had slumped in global terms, moved back into favour with the investors. This return to grace is explained especially by the vigorous growth signals coming from the emerging economies and by the Fed's cautiousness.

Currencies:
Currencies are more or less a reflection of political and economic events. Emmanuel Macron's victory was thus a shot in the arm for the euro. At the other end of the scale, the Japanese yen must be included among the losers, having had the function of a safe haven thrust on it. The American dollar suffered from the disappointing results of the American real-estate market and the delay in applying Donald Trump's electoral programme to favour business. Despite the fall in commodity prices, the emerging countries' currencies generally transpired to be robust.

Commodities:
Having undergone a stagnant trend at the beginning of the half year, the Brent price receded by more than USD 5 to arrive at a level slightly higher than USD 50 per barrel. This movement is explained by the higher-than-expected level of stocks in the United States and by the uncertainty as to whether the promises made in November by the Organisation of Petroleum Exporting Countries (OPEC) to reduce output would be respected or not.
The turbulences that shook crude oil also had the effect of contaminating other commodities.
Towards the end of the period under review, the price of gold stood at USD 1268 or roughly USD 100 higher than at the end of last year.

The immediate future:
In the period since the Brexit referendum, the situation has fortunately finally calmed down in Europe. Moreover, the anti-European populist wave has been contained. In the light of a global recovery occurring at the same time as weak inflationary pressure, it would almost be tempting to think that the world economy was playing along to a "Goldilocks scenario". This is an environment that is likely to persist until the end of the year, while the financial markets ought to be sufficiently underpinned by robust company profits and the adaptability of monetary policy.

However, as always, there are risks. An unexpected slowing down in the economic cycle might weigh heavily on company profits at time when equity valuations are at a historically high level. Such a trend could be triggered by the Chinese government steering in the wrong direction or by a renewed build-up of tension on the Korean peninsula. In addition, if the price of oil were to collapse to below USD 40, that might have an upsetting impact on the prospects for the issuers of bonds in the energy sector, which might, in turn, have negative repercussions on all the bond markets. These three scenarios are, however, highly unlikely before the end of the year.