

16 July 2018 /// n°14-2018

## Markets hoping for a trade war truce?

### Key Points

- **US inflation highest since 2012 (2.9%y)**
- **Risk asset rally continues (equities, credit, emerging)**
- **S&P buoyed by strong 2q18 earnings releases**
- **Bund and Treasuries go sideways**
- **Italy's spreads easing after reassuring bond auctions**

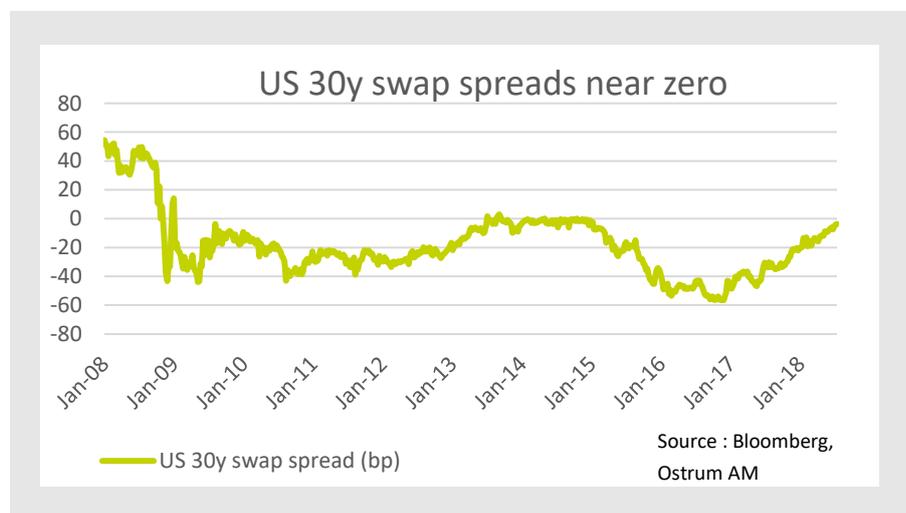
Despite the ongoing trade war climate, financial markets remain upbeat. Equity prices are up (+1.5% on the S&P 500 benchmark), spreads tighten globally, whilst risk-free rates in both the US and Germany barely move. Equity volatility has fallen again. Curve flattening is evidence of strong demand for rate duration despite allocation flows into risky assets.

Successful bond auctions in Italy trigger some easing in short-dated spreads. Credit spreads in the euro area (116bp against Bunds) have come in despite investor caution about the asset class. Financials

keep trailing the overall credit market. ITraxx crossover has tightened by 31bp month-to-date. High yields spreads have eased in parallel. Breakeven inflation rates have decreased slightly on the back of lower oil prices.

In foreign exchange markets, the Japanese yen weakened to 112 against the dollar allowing for a sharp bounce in the Nikkei. The euro hovers about \$1.17 while the Mexican peso continued to rise. Peso bounce also helped to reduce external debt spreads.

### Chart of the week



There is considerable demand for US duration from defined benefit pension funds.

Rising (scheme guarantee) premiums force pension funds to reduce their duration gap and cut their deficits at a time when equities are near all-time highs and yields have risen from 2016 lows.

Curve flattening and shrinking swap spreads result from asset allocation shifts from US pension funds.

## Macro worries vs. micro trends

The protectionist wave relentlessly fanned by Donald Trump represents the largest risk over the global economic cycle. That's said, new US tariff threat impacting \$200b worth of Chinese products has yet to spell retaliation from China, which now appears less willing to add fuel to the fire.

The truce did benefit risk assets. Equity markets in the US hence refocused on fundamentals as the earnings season starts. Out of 28 releases, just two failed to beat consensus estimates. Sales growth was 8.3%y in the second quarter and net corporate income is increasing to the tune of 20% from a year ago. Dollar strength and restrictive trade policy have had little impact to date on corporate activity and performance. Technology and industry have recorded the highest earnings growth.

Investor positioning does not look excessive, and enabled a rebound in the S&P index above the 2800 mark. CFTC data on future and option holdings reveal that speculative accounts remain net sellers of US equities. Furthermore, fiscal easing triggered many announcements of share buyback programs in the US. Corporates are net buyers of equities to the tune of hundreds of billion dollars a year, either for acquisition purposes or returning cash to shareholders. The latest buyback announcements pertain to the financial sector. Earnings per share tend to rise as the capital base is depleted through share buybacks. Indeed, at the macroeconomic level, leverage has been on a constant rising trend since 2012 in the non-financial sector. Despite some easing of late, investment grade spreads are still 25bp wider than at the start of the year.

Consumer credit rose \$24.5b in May, a very high monthly increase historically. Household credit remains dynamic even as defaults on credit cards and auto loans increase. Monetary policy is accommodative ignoring accelerating inflation on a dubious argument of "symmetry around the 2% target". CPI inflation is at its highest level (2.9%y) since 2012. Fed policy predictability is a key reason for continued curve flattening. The 2s10s spread is trading about a mere 25bp and 10s30s hovers near 10bp. Besides monetary policy, it appears that bond stripping activity on long-term Treasuries is driven by strong duration demand from US pension funds. In this context, regained appetite for risk assets (equities, credit) should not trigger a sharp yield increase. The gap to fair value (which we see at 3.02% on 10-year notes) is unlikely to be close in the very near term. Duration neutrality is hence warranted around a flattening on view expressed on 2s10s spreads.

In the euro area, surveys have ceased to deteriorate in May-June. Inflation ticked higher in most countries. The hiccup in the economic slowdown may not be indicative of an imminent rise in bond yields, as the ECB retains plenty of flexibility with its reinvestment policy. Bund Feb28 broke below its 0.30% floor last week, which entails a bullish technical signal. Yield curve flattening in the German bond market is worth considering as it represents a positive carry opportunity.

About spreads, easing continues with a pickup in risk appetite. Bond auctions in Italy attracted sound demand including on 20-year BTP yielding 3.26%. The spread on 10-year BTPs is now close to 220bp. It is of the utmost importance that Italy retains adequate market access ahead of rating decisions by Fitch and Moody's in a few weeks' time. Spain tightened towards 90bp against Bunds after Fitch maintained it's a rating. It is hence recommended to hold on to Spain overexposures (91bp on 10-year bonds) and Portugal (139bp). The government crisis in the UK has had surprisingly little impact on Gilts considering what is at stakes. British bonds trade under 1.30%.

Euro area credit markets benefit from rising risk appetite. The trend in iTraxx crossover (291bp) reversed sparking a sharp 30bp spread tightening month to date. Technical signals have turned indicating tightening from July 4<sup>th</sup>. Whilst corporate bonds are less responsive than indices, spreads(116bp) have also come in (-5bp last year). Flows suggest that asset allocators remain unwilling to add to euro IG credit holdings. Financials keep underperforming the broader market although high beta subordinated debt securities fared well. High yield spreads trade at 365bp compared with more than 400bp earlier this month.

## Emerging debt tightening

The improvement in high yields resonates in emerging markets. The broad dollar uptrend against emerging market currencies is moderating, despite lingering downside risks in both Argentina and Turkey. The benchmark spread gauge is now 341bp over US treasuries (-12bp last week). Peso appreciation reduces the risk on BBB+ Mexican credit so that spreads on USD-denominated bonds is now 138bp. However, on IIF data, investors appear to have pulled \$14b worth of both bond and equity holdings from emerging markets in May and June. Fund inflows have seemingly stabilized last week after a difficult three-month period.

## Main Market Indicators

<b>G4 Government Bonds</b>	<b>16-Jul-18</b>	<b>-1w k (bp)</b>	<b>-1m (bp)</b>	<b>Ytd (bp)</b>
EUR Bunds 2y	-0.63 %	+2	-1	0
EUR Bunds 10y	0.36%	+6	-4	-7
<b>EUR Bunds 2s10s</b>	<b>99 bp</b>	<b>+4</b>	<b>-3</b>	<b>-7</b>
USD Treasuries 2y	2.6 %	+4	+6	+72
USD Treasuries 10y	2.86 %	+0	-6	+45
<b>USD Treasuries 2s10s</b>	<b>26 bp</b>	<b>-4</b>	<b>-12</b>	<b>-27</b>
GBP Gilt 10y	1.29 %	+4	-4	+10
JPY JGB 10y	0.04 %	+0	+0	-1
<b>€ Sovereign Spreads (10y)</b>	<b>16-Jul-18</b>	<b>-1w k (bp)</b>	<b>-1m (bp)</b>	<b>Ytd (bp)</b>
France	28 bp	-6	-5	-7
Italy	222 bp	-14	+2	+63
Spain	92 bp	-7	+3	-22
<b>Inflation Break-evens (10y)</b>	<b>16-Jul-18</b>	<b>-1w k (bp)</b>	<b>-1m (bp)</b>	<b>Ytd (bp)</b>
EUR OATi	146 bp	-3	-1	+3
USD TIPS	211 bp	-3	-2	+13
GBP Gilt Index-Linked	304 bp	+1	-2	-2
<b>EUR Credit Indices</b>	<b>16-Jul-18</b>	<b>-1w k (bp)</b>	<b>-1m (bp)</b>	<b>Ytd (bp)</b>
EUR Corporate Credit OAS	116 bp	-5	+3	+30
EUR Agencies OAS	50 bp	-1	+2	+12
EUR Securitized - Covered OAS	54 bp	0	+3	+15
EUR Pan-European High Yield OAS	365 bp	-23	+12	+71
<b>EUR/USD CDS Indices 5y</b>	<b>16-Jul-18</b>	<b>-1w k (bp)</b>	<b>-1m (bp)</b>	<b>Ytd (bp)</b>
iTraxx IG	64 bp	-4	-4	+19
iTraxx Crossover	291 bp	-12	-6	+59
CDX IG	62 bp	-1	+1	+13
CDX High Yield	335 bp	-3	+2	+28
<b>Emerging Markets</b>	<b>16-Jul-18</b>	<b>-1w k (bp)</b>	<b>-1m (bp)</b>	<b>Ytd (bp)</b>
JPM EMBI Global Div. Spread	341 bp	-12	-11	+56
<b>Currencies</b>	<b>16-Jul-18</b>	<b>-1w k (%)</b>	<b>-1m (%)</b>	<b>Ytd (%)</b>
EUR/USD	\$1.171	-0.33	+0.89	-2.47
GBP/USD	\$1.326	+0.35	+0.15	-1.86
USD/JPY	¥112.38	-1.39	-1.71	+0.28
<b>Commodity Futures</b>	<b>16-Jul-18</b>	<b>-1w k (\$)</b>	<b>-1m (\$)</b>	<b>Ytd (\$)</b>
Crude Brent	\$73.3	-\$4.8	\$0.2	\$8.5
Gold	\$1 240.8	-\$18.3	-\$37.8	-\$62.0
<b>Equity Market Indices</b>	<b>16-Jul-18</b>	<b>-1w k (%)</b>	<b>-1m (%)</b>	<b>Ytd (%)</b>
S&P 500	2 801	0.62	0.78	4.78
EuroStoxx 50	3 453	-0.21	-1.48	-1.45
CAC 40	5 417	0.34	-1.55	1.96
Nikkei 225	22 597	3.71	-1.11	-0.74
Shanghai Composite	2 814	-0.04	-6.88	-14.91
VIX - Implied Volatility Index	12.27	-3.31	2.42	11.14

Source: Bloomberg, Ostrum Asset Management

## Writing



**AXEL BOTTE**  
**STRATEGIST**  
 axel.botte@ostrum.com

## Legal information

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): 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. **France:** Natixis Investment Managers Distribution (n.509 471 173 RCS Paris). Registered office: 43 avenue Pierre Mendès France, 75013 Paris. **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 Carrée, 7. Floor, Frankfurt am Main 60322, Germany. **Netherlands:** Natixis Investment Managers, Netherlands (Registration number 50774670). Registered office: World Trade Center Amsterdam, Strawinskylaan 1259, D-Tower, Floor 12, 1077 XX Amsterdam, 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 n°90, 6th Floor, 28006, Madrid, Spain.

In Switzerland: Provided for information purposes only by Natixis Investment Managers, Switzerland Sàrl, Rue du Vieux Collège 10, 1204 Geneva, Switzerland or its representative office in Zurich, Schweizergasse 6, 8001 Zürich.

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 as defined by the DFSA. 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: 16F-1, No. 76, Section 2, Tun Hwa South Road, Taipei, Taiwan, Da-An District, 106 (Ruentex Financial Building I), R.O.C., license number 2017 FSC SICE No. 018, Tel. +886 2 2784 5777.

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: 10 Collyer Quay, #14-07/08 Ocean Financial Centre, Singapore 049315.

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](http://www.ostrum.com)

Ostrum Asset Management  
 Registered Office: 43, avenue Pierre Mendès-France – 75013 Paris – Tel. +33 1 78 40 80 00  
 Limited Liability Company, Share Capital €50,434,604.76  
 Regulated by AMF under n°GP 90-009  
 Company Trade Registration (RCS) Number 329 450 738 Paris