Ostrum ASSET MANAGEMENT

FUNDING YOUR TOMORROW

STRATEGY WEEKLY

Document intended for professional clients

21 January 2019 /// n°3-2019

Markets rise despite political obstacles

Key Points

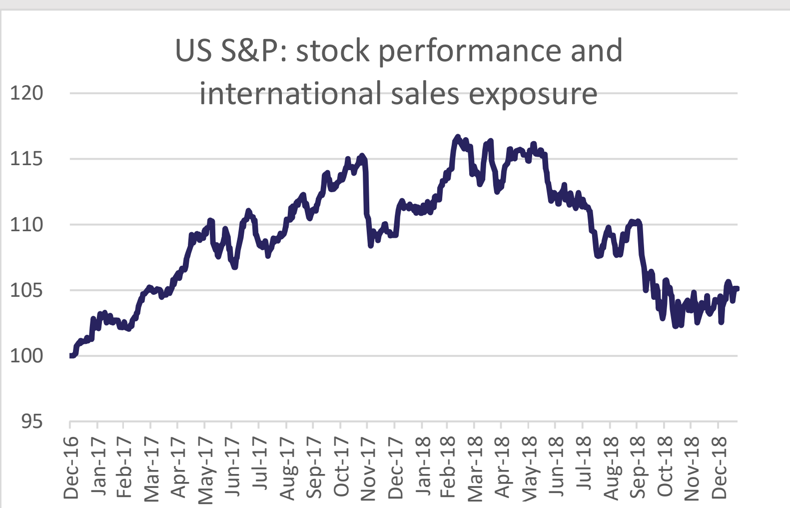
- **Brexit, shutdown: no end in sight**
- **Broad strength across risky asset markets**
- **US 10-year yields near 2.80%**
- **Appetite for European credit returns**
- **Emerging debt spreads down 50bp since January 3rd**

Risky asset markets continued rallying last week. Equity markets remain underpinned by expectations of an agreement between China and the US, or even a suspension of tariffs. Asian markets also showed strength. Shanghai is up 4% year-to-date. The S&P 500 gauge gains 6.5% so far this year thanks to earnings momentum across all sectors but select large banking institutions.

In the euro area, asset allocators are increasing credit exposures. High yield spreads declined by as much as 40bp year-to-date. Sovereign spreads were generally tighter. In parallel, external emerging debt is trading near 370bp vs. US Treasuries after a peak above 420bp on January 3rd. The likely paus in the Fed rate cycle underpins the asset class.

The dollar firmed up thanks in keeping with rising bond yields. Yields in the 2-5y maturity bracket are again above 2.60%. The euro lost 1% against the dollar last week. The ECB may stress economic slowdown at its upcoming meeting on Thursday.

Chart of the week



Source : Bloomberg, Ostrum AM

International tensions have weighed on stock performances last year.

This chart reflects relative stock market performances between US firms as a function of their international sales exposure. An increase indicates outperformance from companies with high foreign revenue exposure.

After several months of protectionist tensions between April and September 2018, the trend has started to reverse in early 4q 2018 and seems to gather pace in 2019.

China GDP at 6.4%y

China's national bureau of statistics estimates GDP growth at 6.4%y in the fourth quarter. In 2018, average growth was 6.6%y.

Yet several indicators suggest the economy took a turn for the worse in the last months of 2018. Fiscal revenue decreased from 4%y to minus 2%y in November. Tax cuts worth 0.5pp of GDP do explain part of the shortfall but the decline appears quite steep. Durable goods' consumption including automobiles has moderated. Productive investment spending (equipment) is anywhere between 0 and 3%y. Foreign direct investment plunged in the three months to December (-15.8%y 3mma). Foreign trade contracted in December after dubious strength in October-November.

Furthermore, default rates quadrupled in 2018 to CNY 120b compared with 2017. The fight against shadow banking favours funding through corporate bond issuance. However, as recent credit events suggest, financial reporting in China may not be at international standards just yet. Other signs of funding stress relate to PBoC intervention. Monetary policy was eased considerably. Repo cash injection increased contributing to a significant decline in rates in Chinese interbank markets. Policy easing is also a weapon in the current trade talks with the US.

Shutdown continues

The US government shutdown entered its fifth week. Shutdown impact on activity may only worsen from here. The lack of precautionary savings in the US will likely lead to rising defaults notably on credit card and autos. Household confidence that had weathered volatility in the stock market is now off its highs. In manufacturing, Fed surveys moved in opposite directions as the Empire index fell whilst the PhilFed gauge rose on higher new orders. Homebuilders consolidated after last month's sharp decline. The Fed's Beige book just confirmed tensions in labour markets and uncertainty linked to current trade feud with China.

Economic slowdown in the euro area is talking hold. Industrial output contracted 3.3%y in November. Inflation slowed to 1.6%y in December with the core rate stuck at 1%y. Mario Draghi may underscore the weakness in activity and inflation inertia and indeed pre-announce a new round of TLTROs in the near future. In the UK, looming Brexit is weighing on housing and credit demand from both households and the non-financial corporate sector. Indeed, the risk of a sharp disruption in activity is elevated, all the more so that Theresa May's plan B remains unclear.

Sharp bounce in equities

The US stock market (S&P 500) is up about 6.5%. Hopes for a trade deal definitely benefits stocks with a large international sales exposure over the past few trading sessions. Furthermore, the S&P index crossing its 50-day moving average entails a bullish signal for a number of CTA accounts, which may add to their exposure. The drop in volatility will spark further reallocation from risk-parity funds. Despite some misses (mostly in investment banking), quarterly EPS growth topped 15% after roughly a third of the S&P index released 4q18 earnings. Sales grew 7% in aggregate. Technology, industrials and health care recorded strongest sales numbers. The upbeat sentiment translates into flows including across European markets. Us fund managers still remain cautious regarding Europe even as valuations have cheapened towards about 11x 2019 earnings.

As stocks rise, Treasury note yields creep higher. The yield on 10-year note rose towards 2.80% although the shutdown, a pause in the Fed cycle and the looming debt ceiling debate maintain a cap on yields. We recommend holding a neutral stance in US Treasuries. A steeper 10s30s spread is still in the cards despite a recent pullback. In Bund space, valuations (fair value is 0.51% on our estimates) should lead to higher yields but the ongoing slowdown and a likely dovish ECB stance keep a lid on safe bond yields. This situation underpins sovereign spreads. Success at the Italian syndicated deal with more than €40b orders for the new 15-year benchmark bond continues to suppress spreads. Spain may follow suit with a 10-year bond transaction. Issue size may fetch €9b. Spain's Bonos trade near 110bp.

Investor appetite for European investment grade credit returns after several months of outflows. New issue yield premiums remain elevated but stronger credit demand should ultimately help yield premiums lower. Average market spreads (153bp) fell by some 7bp last week and spreads on financials eased even faster (-10bp). High yield was markedly tighter (-24bp) to 472bp over German risk-free bonds. Our quantitative signals point to further spread tightening in CDS index markets. The iTraxx crossover spread is now 324bp whilst the spread was trading as high as 366bp on January 3rd.

The risk-on environment benefits most risky assets and the pick-up in crude oil prices provide considerable support to emerging markets. The spread on emerging market debt (in US dollars) tightened by more than 50bp since early January highs. Uncertainty remains elevated but stability in US interest rates for some time fosters carry plays including allocation into high-quality emerging market bonds.

Main Market Indicators

G4 Government Bonds	21-Jan-19	-1wk (bp)	-1m (bp)	Ytd (bp)
EUR Bunds 2y	-0.58 %	+1	+2	+3
EUR Bunds 10y	0.26%	+2	+1	+1
EUR Bunds 2s10s	84 bp	+1	-1	-1
USD Treasuries 2y	2.61 %	+8	-3	+13
USD Treasuries 10y	2.78 %	+8	-1	+10
USD Treasuries 2s10s	17 bp	+0	+2	-3
GBP Gilt 10y	1.32 %	+3	+0	+5
JPY JGB 10y	0.01 %	-1	-4	+1
€ Sovereign Spreads (10y)	**21-Jan-19**	**-1wk (bp)**	**-1m (bp)**	**Ytd (bp)**
France	40 bp	-1	-5	-7
Italy	250 bp	-11	-8	+0
Spain	111 bp	-8	-4	-6
Inflation Break-evens (10y)	**21-Jan-19**	**-1wk (bp)**	**-1m (bp)**	**Ytd (bp)**
EUR OATi	103 bp	-3	+0	+3
USD TIPS	182 bp	+2	+6	+11
GBP Gilt Index-Linked	316 bp	-11	-5	-1
EUR Credit Indices	**21-Jan-19**	**-1wk (bp)**	**-1m (bp)**	**Ytd (bp)**
EUR Corporate Credit OAS	153 bp	-7	+2	+1
EUR Agencies OAS	64 bp	-2	+2	+4
EUR Securitized - Covered OAS	69 bp	-1	+3	+6
EUR Pan-European High Yield OAS	472 bp	-24	-29	-41
EUR/USD CDS Indices 5y	**21-Jan-19**	**-1wk (bp)**	**-1m (bp)**	**Ytd (bp)**
iTraxx IG	76 bp	-6	-13	-13
iTraxx Crossover	319 bp	-23	-35	-35
CDX IG	72 bp	-6	-18	-15
CDX High Yield	383 bp	-25	-88	-67
Emerging Markets	**21-Jan-19**	**-1wk (bp)**	**-1m (bp)**	**Ytd (bp)**
JPM EMBI Global Div. Spread	370 bp	-20	-25	-45
Currencies	**21-Jan-19**	**-1wk (%)**	**-1m (%)**	**Ytd (%)**
EUR/USD	$1.137	-0.21	-0.39	-0.75
GBP/USD	$1.289	+1.22	+1.33	+1.1
USD/JPY	¥109.64	-0.93	+0.67	+0.02
Commodity Futures	**21-Jan-19**	**-1wk ($)**	**-1m ($)**	**Ytd ($)**
Crude Brent	$62.6	$3.6	$8.5	$8.8
Gold	$1 280.2	-$7.9	$11.8	-$1.4
Equity Market Indices	**21-Jan-19**	**-1wk (%)**	**-1m (%)**	**Ytd (%)**
S&P 500	2 671	2.87	10.51	6.54
EuroStoxx 50	3 125	2.29	4.15	4.12
CAC 40	4 868	2.21	3.69	2.90
Nikkei 225	20 719	1.77	2.74	3.52
Shanghai Composite	2 611	2.95	3.75	4.68
VIX - Implied Volatility Index	17.80	-2.14	-40.88	-29.98

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, Nederlands (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

Ostrum Asset Management
43, avenue Pierre Mendès-France – CS 41432 – 75648 Paris cedex 13 France – Tél. : +33 1 78 40 80 00
Limited company with a share capital of 27 772 359 euros – Trade register n°525 192 753 RCS Paris – VAT : FR 93 525 192 753
Register office : 43, avenue Pierre Mendès-France – 75013 Paris – www.ostrum.com

Ostrum ASSET MANAGEMENT

An affiliate of: NATIXIS INVESTMENT MANAGERS