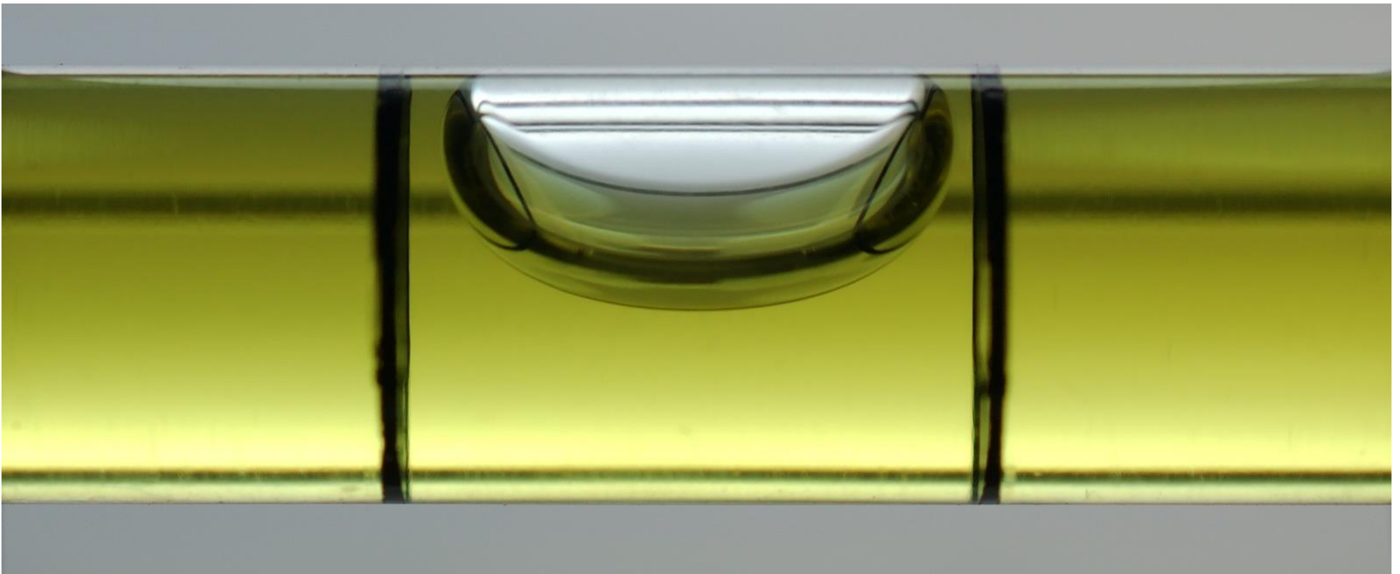
Quarterly House Views

A Study in Contrasts



Our economic scenario

Despite numerous headwinds, the global economy looks to be recovering from first-half softness and 2018 is set to register stronger growth than last year. The two major risks at present are 1/ Italy sparking a full-blown eurozone crisis and 2/ tariff tit-for-tat degenerating into a trade war. Both warrant close attention but at this stage neither looks inevitable. However, the combination of rising Fed Funds and a stronger dollar has proved challenging for weaker emerging economies, such as Argentina or Turkey.

Strong US growth and a tight labour market are putting upward pressure on wages, helping push inflation close to target excluding volatile items. Price pressures are more muted in the eurozone, but still building nonetheless. And Japan continues to dash hopes of a sustained return to stronger inflation. In emerging economies, the contrast is sharp between Asia where price rises tend to be in low single digits and the fragile few where currency devaluation has sparked even faster rises in inflation.

The US Federal Reserve (Fed) has set a course of further hikes (we expect two more this year) and gradual unwinding of its security holdings. The European Central Bank (ECB) will continue to grow its portfolio until year-end and has recently guided investors not to expect a first hike until next summer. The Bank of England has held off from mooted rate increases while the Bank of Japan continues to target zero yield on long-dated bonds. Trade tensions have recently encouraged the People's Bank of China to ease reserve requirements, to add liquidity to the system.

Robust growth and rising geopolitical concerns are opposing forces. The former acts as a floor for asset prices and the latter as a ceiling. In this context, we continue to recommend broad diversification across asset classes, with a bias towards developed world equities, in particular in the US. Rising US rates and negative core yields in euros make this a challenging environment for fixed coupon bonds and we continue to prefer corporate to sovereign issuers.

How does this impact asset classes? Find out inside.

In accordance with the applicable regulation, we inform
the reader that this material is qualified as a marketing document.
CA169/JULY/2018

SOCIETE GENERALE
Private Banking

BUILDING TEAM SPIRIT
TOGETHER

The global environment is characterized by opposing forces. On one hand, trade tensions, the new populist government in Italy, currency crises in Turkey or Argentina all add up to a worrying backdrop for investors. On the other, business confidence remains high, monetary policy supportive and this year's global GDP growth should outpace 2017. In this context, we expect that neither of the opposing forces will dominate, meaning choppy markets ahead.

Tug-of-trade-war

Many commentators often observe that President Trump is unpredictable in his words and actions. While it is undeniable that his style of communication and government is radically different from his predecessors and peers, he does hold strong, unshakeable beliefs. One is that bilateral relations are preferable to multilateral organizations. Another is that a trade deficit is proof that foreign companies have won out to the detriment of US workers, a problem which is best addressed by tariffs.

Throughout his career, even before entering politics, Donald Trump has been a vocal opponent of free trade. Since winning the presidency, he has set about putting his beliefs into action, with little distinction between traditional US allies and adversaries. And his approach is proving popular with his electoral base – according to fivethirtyeight.com, his approval rating has risen from 37.9% at the turn of the year to 42.2% today. With mid-term elections looming on November 6, we would expect trade to remain a key focus point for politics and markets

This is not to say that there are not legitimate concerns on trade. China's respect of international intellectual property rights leaves much to be desired. And the EU's 10% tariff on car imports from the US looks like an indefensible anachronism. But in bypassing the World Trade Organization's multilateral forum in favour of unilateral action, the US has encouraged tit-for-tat responses from partners and foes alike. The risk here is that higher prices and less trade could lead to slower growth and lower profits. This outcome is not our core scenario – we expect that deals will be struck ahead of the mid-terms. However, continuing trade tensions will keep worries and volatility high in the interim.

Supportive Macro Backdrop

The past six months have proved challenging for risk assets. The first quarter saw a dip in growth in the United States (perhaps due to imperfect seasonal adjustments), the euro zone hit a soft patch and media headlines have been dominated by geopolitical and trade tensions. Is the global economy sliding into recession?

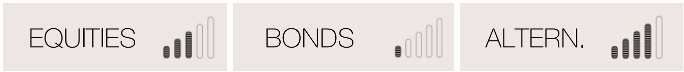
In order to identify turning points in the cycle, economists tend to use a number of forward-looking tools, either by constructing a composite leading index or by studying corporate confidence. In our VaMoS™ investment framework for example, we use the Conference Board's US Leading Economic Index. This blends a number of components such as new orders, consumer expectations or building permits in order to estimate future trends in growth. The most recent reading – for May 2018 – remains very close to recent cycle highs and suggests continued robust growth.

In addition, monthly surveys of corporate confidence provide good real-time data on trends in the economy, well ahead of the computation and publication of Gross Domestic Product figures. For example, the Purchasing Manager Index calculated by IHS Markit is widely used to gauge periods of expansion and contraction in activity, with the dividing line between the two set at 50 points. It is therefore encouraging that the most recent preliminary composite figures for the euro zone jumped from 54.1 to 54.8 in June, still well in expansion territory, and suggesting that the first quarter soft patch is not a harbinger of a downturn in activity.

Bottom line

Although the macro environment remains solid, there are sufficient geopolitical headwinds at present for us to continue to recommend a neutral stance. The higher volatility environment we expect will no doubt generate some attractive opportunities to reweight portfolios in due course.

Our views summarized



Here, we present our VaMoS investment approach, combining economic, valuation, momentum and sentiment signals that help us fine-tune our views on asset classes for the coming period. The signals below reflect the latest conclusions of our Global Investment Committee. Here's how to read them:

EQUITIES		VA			MO		S	
		Valuation	Fundam.	Macro.	Momentum	Technicals	Sentiment	Risk
United States								
Eurozone								
UK								
Switzerland								
Japan								
Emerging								

BONDS – EUR	Global	VA	MO	S
Sovereign				
Inflation-linked				
Inv. Grade				
HY				
Duration*	Short			

BONDS – USD	Global	VA	MO	S
Sovereign				
Inflation-linked				
Inv. Grade				
HY				
Duration*	Short			

BONDS – GBP	Global	VA	MO	S
Sovereign				
Inflation-linked				
Inv. Grade				
HY				
Duration*	Short			

CURRENCIES	
EUR/USD	
GBP/USD	
USD/JPY	
EUR/CHF	
Emerging vs USD	

ALTERNATIVES	
Hedge funds	
Gold	
Oil	

Source: SG Private Banking, 29/06/2018, * Duration: short = 3 to 5 years, medium = 5 to 7 years, long = 7 to 10 years. HY = High Yield bonds (higher return but greater risks), Inv. Grade = Investment Grade bonds (higher quality but lower return)

In other words

EQUITIES*	*United States*	*We upgrade our view as corporate profits are revised up on solid US growth. Apart from positive tax effects, high EPS growth reflects strong top-line revenues and high margins. In a context of rising rates, we prefer Financials and low-leverage sectors, such as Technology and Healthcare.*
	Europe	*Corporate earnings will be bolstered by firmer global economic expansion in the second half although trade fears will penalise export-driven markets. Softer growth and political concerns (Brexit, Italy) will unnerve investors.*
	Eurozone	*We stay neutral on eurozone equities as domestic political risks and trade tensions are likely to overshadow stronger fundamentals. Sector-wise, we maintain a cyclical tilt and reduce Banks to neutral.*
	UK	*We upgrade to neutral as earnings-per-share are recovering on the back of higher oil prices and recent sterling weakness. However, key challenges loom: the economic slowdown and lack of visibility on Brexit talks.*
	Switzerland	*High valuations and slower profit growth should weigh on the Swiss market. However, we stay neutral as its bias towards high-quality defensive stocks may prove useful should risk aversion return.*
	Japan	*Protectionism is a threat to this export-driven market, earnings have been revised down and reflation seems delayed once again. We remain neutral despite attractive valuations, solid cash generation, structural economic reforms and better distribution of profits to shareholders.*
	Emerging	*Caution is advised as emerging equities are weakened by rising US rates, a strong dollar and trade tensions.*
BONDS*	*Sovereigns*	*US yields may rise further, suggesting a defensive stance. Recent ECB comments have provided more visibility although political risks may again shake eurozone peripheral sovereign bond markets, calling for prudence.*
	*Duration**	*We still favour short maturities as yield curves may steepen or shift upwards.*
	Inflation-linked	*Inflation-linked bonds offer protection to bond investors.*
	Investment Grade	*Wider spreads offer better entry points in the eurozone. We upgrade to Neutral.*
	High Yield	*Eurozone high yield remains attractive from a carry perspective but high debt ratios in the US suggest a more defensive approach.*
	Emerging debt (in € and $)	*Rising US rates are draining liquidity out of emerging debt. Hence our downgrade.*
CURRENCIES	*EUR/USD*	*The euro could stay range-bound near term but then break out to the upside.*
	GBP/USD	*With economic resilience on one hand and Brexit concerns on the other, Sterling is likely to remain in check.*
	EUR/GBP	*Both currencies are cyclical and have weakened versus the dollar. However, the euro should emerge the stronger.*
	USD/JPY	*The outlook is stable but risk will be a higher yen should risk aversion return.*
	EUR/CHF	*We foresee a weaker Swiss franc but much will depend on sentiment vis-a-vis the eurozone.*
	Emerging	*Emerging currencies are struggling but countries with weak fundamentals are set to feel the brunt of the pain.*
ALTERNAT.	*Hedge funds*	*Record high deal volumes and higher spreads are potent supports for Merger Arbitrage while high corporate confidence has fostered increasing numbers of Special Situations.*
	Gold	*Rising US rates should see gold prices slide further.*
	Oil	*Relaxation of OPEC quotas and stronger US shale production should drive oil prices lower.*

Source: SG Private Banking, 29/06/2018, * Duration: short = 3 to 5 years, medium = 5 to 7 years, long = 7 to 10 years. HY = High Yield bonds (higher return but greater risks), Inv. Grade = Investment Grade bonds (higher quality but lower return)

Central banks

Monetary policy normalization – temporary divergence

Many developed market economies are at or near full capacity and price pressure is building in the US and UK, with inflation around 2% ex volatile items. While this will encourage the US Federal Reserve (Fed) to hike rates again, there are too many uncertainties in the UK for the Bank of England to follow suit. In the eurozone, we would not expect the European Central Bank (ECB) to hike rates before September 2019.

Fed shifts gears

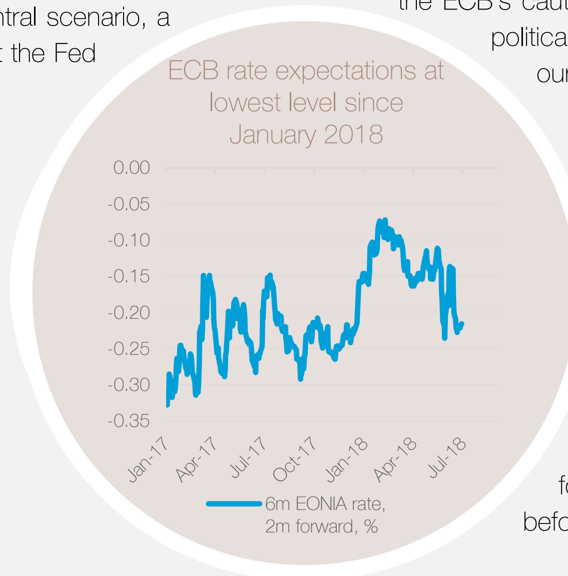
"Faster growth will lead to tighter Fed stance"

- US Federal Reserve (Fed) – hiking again. The Fed's monetary policy committee (FOMC) has signalled four rate hikes in 2018 and three in 2019.
- The tax reform is giving the economy a boost and GDP growth could rise to 3% this year. The unemployment rate is at a 50-year low and hiring shows no signs of abating with more than 210,000 jobs created each month so far this year. Trade tariffs are also having an impact, with producer price indices for iron and steel up 13% year-to-date. Although this is not our central scenario, a stark rise in inflation could prompt the Fed to accelerate the pace of hikes.

ECB and BoE on hold

"ECB turns more dovish than expected"

- European Central Bank (ECB) – Very slow motion. Price pressure is growing in the eurozone. However, this is mainly because of oil and the ECB does not expect inflation ex volatile items to hit the 2% target before 2020. In June, the ECB announced it would cut its monthly asset purchases to €15bn in Q4 before ending the scheme in December 2018. More surprisingly, the central bank pledged not to hike rates before summer 2019. This statement was viewed as quite prudent but the ECB's caution is justified by trade tensions, political uncertainty and softer growth in our view.
- Bank of England (BoE) – little visibility. After signalling a likely move in May, the BoE stayed pat. Inflation is running above target (+2.4% YoY in May) but slower growth could ease price pressures. Markets still assign a 73% probability to a rate hike this year but this is no done deal. The BoE could wait for greater visibility about Brexit before taking action.



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Government bonds

Brace for higher yields

Rising short rates and growing price pressure will gradually drive long-term yields higher. The upside will be greater in the US and core eurozone than in the UK. However, the ECB's recent cautiousness will delay the move in the eurozone.

For the coming quarter, we remain defensive on US Treasury bonds, while we still favour inflation-linked and floating-rate bonds. We cut our exposure to emerging sovereign debt as the economic context is worsening.

Move on up

Bond yields will rise further – but upside will vary from a country to another

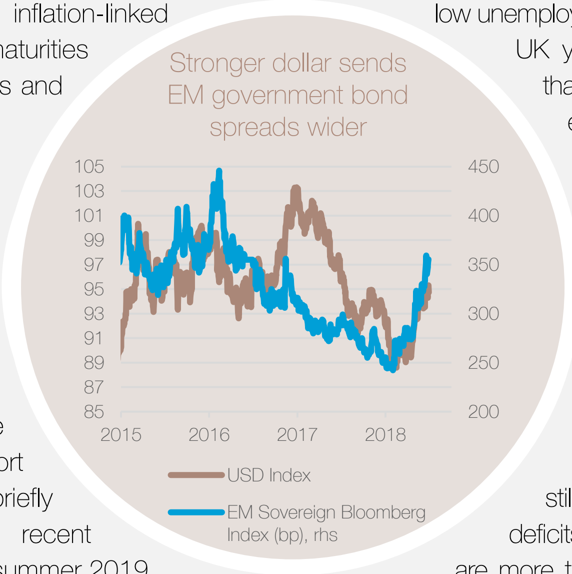
- US government bonds. Price pressure and two rate hikes this year have pushed 10-year US Treasury yields to 3.10%. Although they are now back in a 2.75-3.10% range, risks are still tilted to the upside. We target 3.25% by year-end as bond yields will be supported by higher inflation and rising term premia (the extra return demanded by bondholders to prefer long maturities to shorter ones). A tighter labour market is set to lift inflation through wages. We still favour inflation-linked bonds and would focus on short maturities to hedge against inflation surprises and rising yields.
- Eurozone government bonds. After a high at 0.75% earlier this year, the 10-year German Bund yield is back at 0.35% following disappointing growth data and a political crisis in Italy. However, the fall in yields has been limited by strong growth and a more robust eurozone framework. In short term, the yield curve could flatten briefly in response to the ECB's recent commitment to stay on hold until summer 2019 and fears that the Italian crisis is not over yet. In the longer run, however, we still expect long-term yields to rise, supported by the end to ECB asset purchases, a pick-up in inflation and a correction of the current overvaluation.

Emerging debt – stay cautious

Performance will be driven by carry not spread compression

- UK government bonds. The 10-year yield has been stuck in a tight 35bp range since the beginning of year (1.20-1.55%). With inflation now receding, the Bank of England could postpone its next rate hike. As Brexit talks founder and with Mark Carney due to be replaced next year, UK monetary policy could remain ultra-accommodative a little longer. This could open the door to stronger growth once wages start increasing again on the back of historically-low unemployment. In the near term however, UK yields seem to offer less upside than in the US or even core eurozone.
- Since the beginning of the year, emerging debt spreads have widened due to growing geopolitical instability, and political tensions in Turkey. The Bloomberg Barclays EM Sovereign Spread Index now trades at 353bp, still well below its 2016 high of 450bp. Countries still showing large current account deficits, such as Argentina and Turkey, are more the exception than the rule – we expect real GDP in emerging markets (EM) to grow 5% this year after 4.8% in 2017, driven by those economies with tighter deficits, solid growth and useful reforms.. EM yields are rather attractive. However, as long as US rates ratchet upwards, trade concerns swirl and outflows continue, emerging markets' love and hate relationship with the strengthening dollar will look rocky. We have decided to trim our exposure to EM sovereign bonds.

Stronger dollar sends EM government bond spreads wider



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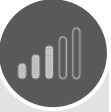
Credit



Selectivity is key

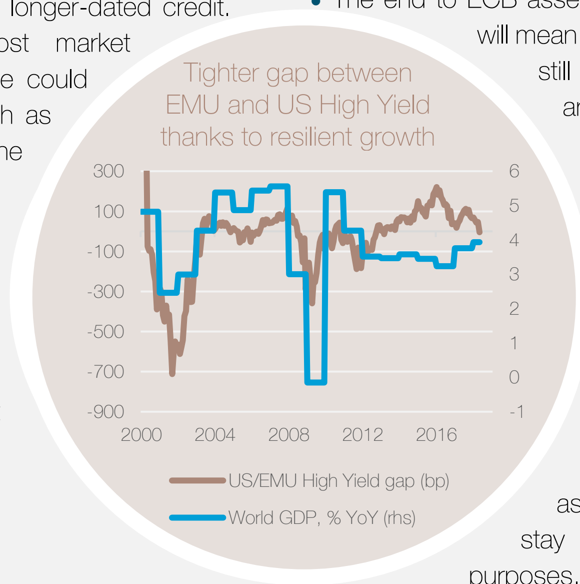
Credit markets have disappointed so far this year, with benchmark yields rising in the US and spreads widening in the eurozone. However, this challenging context should not prevent investors from finding opportunities, provided they are selective.

In the US, we still prefer Investment Grade (IG) to High Yield bonds (HY). In the eurozone, we upgrade IG to neutral but stay overweight on HY. Financial debt and corporate hybrid bonds still offer attractive entry points. In the UK, slower growth could weigh on credit.

United States

We still prefer IG bonds to HY and banks to non-financial corporate debt

- United States. Spread-wise, investment grade (IG) bonds have remained range-bound in H1 while High Yield (HY) have moved away from their January lows following heavy issuance and some repricing of credit risks.
- Despite a broadly supportive environment marked by stronger corporate earnings and improved valuations, credit spreads may widen further.
- Higher US rates could weigh on longer-dated credit. M&A-related supply may boost market issuance while poor performance could drive major investor groups (such as retail) away from the market. As the Fed's monetary policy turns less accommodative, the most leveraged issuers are set to experience higher net financing costs.
- Against this backdrop, we still prefer IG to HY, where we expect more spread widening.



Eurozone & UK

We upgrade eurozone IG bonds

- Eurozone. Softer growth and political tensions in Italy have widened spreads. Fear of a full-blown trade war has also weighed on valuations and spreads on industrial credit instruments are up 270 basis points from their 2017 lows. On both buckets – IG and HY – the spread compression recorded in 2017 has now been fully unwound.
- The end to ECB asset purchases in December 2018 will mean less support for credit. There are still positives, such as low leverage and the economic backdrop. But the market will also face negative technicals – debt issuance is still quite active, leading to growing imbalance between supply and demand. Subordinated financial debt and corporate hybrid bonds remain our preferred segments. We upgrade eurozone IG to neutral as valuations have improved and stay overweight on HY for carry purposes.
- UK. After tightening throughout 2017, spreads have widened markedly since January. Brexit uncertainty remains the biggest risk with slower growth already weighing on corporate fundamentals. Large issuers have seen their earnings deteriorate, which has translated into slightly higher leverage ratios. We reiterate our neutral stance on the asset class.

Sources: SGPB, Bloomberg, 01/05/2018. Past performance should not be seen as an indication of future performance. Investments may be subject to market fluctuations, and the price and value of investments and the income derived from them can go down as well as up. Your capital may be at risk and you may not get back the amount you invest.

Equities

Choppy waters on trade dispute

- Growing trade concerns, higher oil prices, US rate hikes and curve flattening are likely to keep volatility high, meaning choppy trading for equity markets in coming months.
- Protectionism is a negative for export-driven markets while Emerging markets are also penalised by a stronger dollar and Fed tightening.
- Fundamentals remain supportive with firmer global economic in the second half and strong corporate profit growth, while valuations are cheaper since the beginning of the year.

Still neutral on eurozone equities

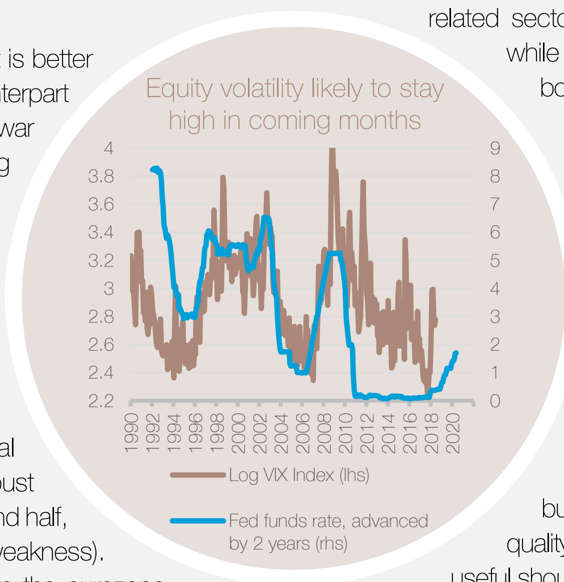
Domestic political risks and trade tensions to overshadow better fundamentals

- Eurozone – neutral. After a strong 2017, earnings-per-share (EPS) growth may weaken this year as was already the case in H1. Despite support from easy financing, firmer economic activity in the second half and a weak euro, heavy exposure to global trade will leave companies vulnerable to rising US protectionism while domestic political risk may linger in coming months. Moreover, the ECB's decision to delay its first rate hikes is negative for Financials, the biggest sector weight. Finally, valuations are not particularly attractive relative to other regions.
- Country-wise, we favour France – it is better diversified than its German counterpart (heavily exposed to trade war concerns), while the unwavering reform agenda should deliver long-term productivity gains.
- Sector-wise, we favour Energy (which will benefit from high oil prices and improved corporate fundamentals), Materials and Construction (supported by robust housing investment and higher real estate prices) and Industrials (robust global growth improving in the second half, ongoing capex cycle, recent euro weakness). Despite solid household demand in the eurozone, we have chosen to go tactically neutral on Consumer Discretionary (given growing concerns about US auto tariffs) and on Technology (expensive valuations).
- We also reduce our view on EMU banks to neutral. The first ECB rate hike has been postponed to September 2019 at the earliest which means it will be difficult for banks to improve significantly their net interest margins and revenues with low rates for long.

Japan struggling to revive inflation

Protectionism threatens export-driven markets

- European banks face structural challenges in coming years: consolidation, tight regulation, disruptive competition and stronger investment in IT. We continue to avoid expensive defensive sectors with low earnings growth prospects, particularly Consumer Staples.
- UK – back to neutral. The British market faces key challenges ahead: the economy is slowing and firms lack visibility on the outcome of Brexit negotiations. However, UK stocks surged 9.1% in Q2 mostly thanks to energy-related sectors (25% of the FTSE 100 index) while sterling weakness over the quarter boosted the performance of multinationals generating most of their revenues abroad. As a result, EPS have been revised up over the past months – good news for the market. Given these short-term supports, we upgrade our stance to neutral.
- Switzerland – neutral. We are neutral because of high valuations and slower profit growth but the market's bias towards high-quality defensive stocks could prove useful should risk aversion return.
- Japan – neutral. Japan is a cyclical market and sensitive to global trade. Its manufacturers are particularly exposed to a trade war. Also, softer global manufacturing activity in H1 has prompted analysts to cut growth forecasts, with real GDP expected to return below potential in 2020. In this context, earnings expectations have been slashed. Finally, Japan is still struggling to revive inflation which remains well below the 2% target. Hence our neutral stance despite attractive valuations, solid cash generation, structural reforms and better shareholder returns.



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Other equity markets

US upgraded to slightly overweight

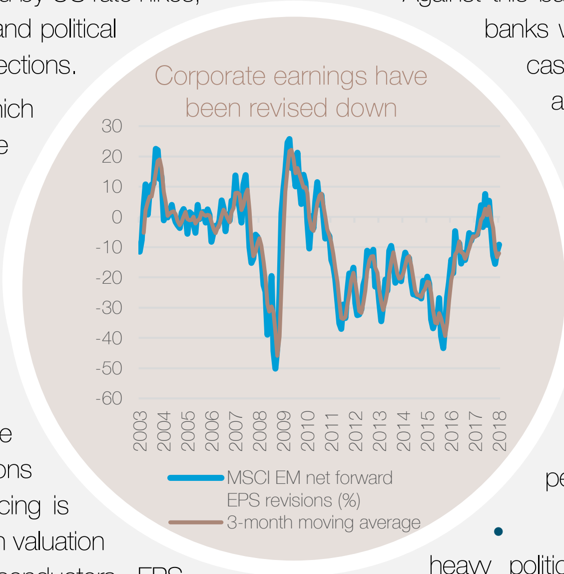
US equities should rise further supported by strong profit growth

- US – tactical overweight. The one-off tax boost is now discounted in IBES earnings-per-share forecasts and strong revenues and high margins will be required to continue high EPS growth. Top-line sales should continue to grow thanks to economic expansion and limited upside for the dollar (see page 12). Although wage pressures will threaten profit margins in coming quarters, we believe that the recovery in capital expenditure should boost productivity and hence mitigate the negative impact of rising wages. US equity prices should rise further in coming months supported by strong profit growth. However, upside is unlikely to be substantial as we expect expensive valuations to be pressured by US rate hikes, a flatter yield curve, trade tensions and political uncertainty ahead of US mid-term elections.
- Sector-wise, we favour Energy (which benefits from improved corporate fundamentals and high oil prices), Financials (the flattening of the yield curve is a headwind but solid US economic growth, rising interest rates, looser regulation and loan growth should support bank profits). We upgrade Healthcare (this defensive sector has low leverage and high EPS growth expectations while political pressure on drug pricing is fading) and Technology (despite high valuation and a cyclical slowdown in semiconductors, EPS growth is strong thanks to structural tailwinds, high pricing power and margins). We would avoid Consumer Discretionary which is concentrated on a few stocks (idiosyncratic risk) and where valuations are excessive (e-retailing). We keep a negative stance on defensive interest-rate sensitive sectors such as Telecoms, Utilities, Consumer Staples. The latter has weak pricing power given high competition from online/internet retail giants prevents them from passing rising input costs to consumers.

Cautious on emerging equities

Emerging equities are undermined by rising US rates, a strong dollar and trade tensions

- Emerging markets – favour selectivity. The MSCI Emerging markets (EM) index lost 10% in USD terms in the second quarter. This sharp underperformance versus developed markets comes from a stronger dollar, rising US rates and growing protectionism. These factors will continue to weigh on emerging economies in coming months, especially those most dependent on external funding (e.g. Turkey, Argentina). However, recent years have seen significant improvement in current account balances and in national debt in many EM countries. The emerging world should thus be more resilient to rising global rates than in the past. Against this background, emerging market central banks will stay on alert and might in some cases take pre-emptive measures (such as rate hikes) to avoid sudden outflows and a surge in inflation.
- Corporate profits growth slowed in H1 as softer global trade weighed on manufacturing activity. Despite some weakness, EPS will continue to grow at double-digit pace this year and EM equity valuation is attractive, two factors that mitigate the current pessimism somewhat.
- In this context, selectivity is key. A heavy political agenda in Latin America and Eastern Europe and growing tensions in the Middle East will encourage investors to stay cautious. In Asia, the Indian economy is more domestic-oriented while Korea and Taiwan are vulnerable to weaker global trade and growing US protectionism, given their importance in global supply chains, especially electronic products. The US-China trade disputes should remain tense in coming months but Chinese offshore equities (as measured by the MSCI China index) are likely to do better than their Asian peers.



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Corporate America: Prefer low-leverage companies

In a nutshell

- Rate hikes will have less impact on low-leverage companies, helping them outperform.

Ten years after the global financial crisis, US corporate leverage is back at historical highs. After a short period of deleveraging, US non-financial businesses started rebuilding debt from 2011 as the US Federal Reserve's very accommodative monetary policy drove borrowing costs to extremely low levels.

Going deep in debt has helped US companies grow faster, improve their return-on-equity and distribute more to shareholders through higher dividends and share buybacks. According to data from the Bank for International Settlements (BIS), non-financial corporations' debt level – measured by the net debt/GDP ratio – reached 73.5% in Q4 2017, even higher than the previous peak recorded in Q1 2008 at 72.5%.

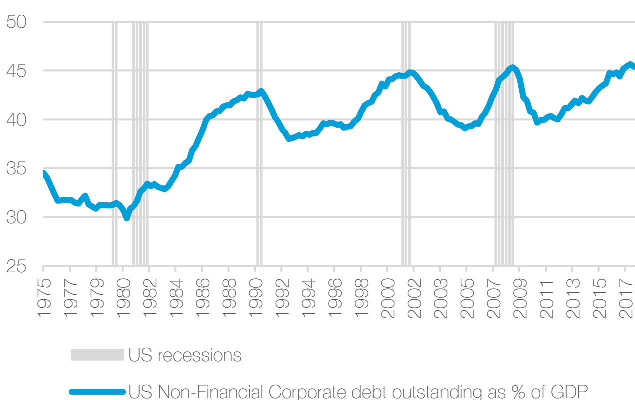
The tax boost, ongoing earnings recovery and cash flow generation should help companies find enough funds to pay part of their debts. However, while a high debt level is manageable when borrowing costs are low, it also makes companies vulnerable when interest rates start rising. Financial conditions have toughened considerably in the US, as the US Federal Reserve has continued to hike rates. Higher US Treasury yields, a strong dollar and wider credit spreads only made things worse. We expect this trend to persist in coming months as monetary tightening continues in the US – we forecast two more rate hikes this year and three next year. We also believe the 10-year Treasury yield will reach 3.40% by late 2018 (see pages 6-7 for more).

Low-leverage companies are better placed to weather tighter financial conditions. Higher rates and wider credit spreads should increase interest costs and thus worsen the interest coverage ratio (ratio of interest expenses to earnings before interest and tax) on bonds and loans. Higher corporate interest expenses result from new debt issued at higher rates and from higher rates on existing floating-rate debt. Sensitivity to rate hikes varies from sector to sector. Those with high leverage ratios, high exposure to interest rate changes or high exposure to floating rates (e.g. real estate) are more vulnerable to rising rates.

Bottom line. Low-leverage US companies will withstand monetary tightening better than high-leverage ones, helping them outperform. Sector-wise, we prefer Technology and Healthcare (both cash rich) to Telecoms, Utilities and Real Estate.

US corporate leverage at record high

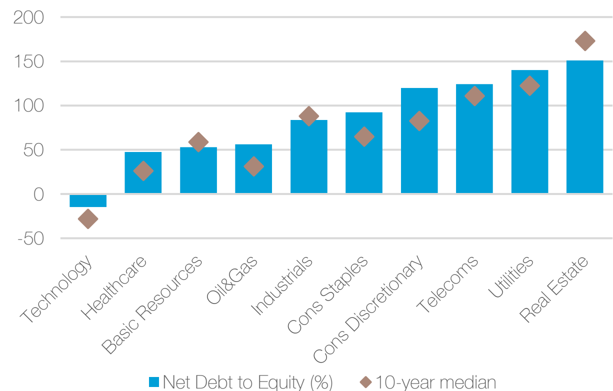
US non-financial corporate debt (outstanding as % of GDP)



Source: SGPB, Datastream, at end Q1 2018

Real estate is most in debt

US sectors' leverage ratios (%)



Source: SGPB, Datastream, 30/06/2018

Main currencies

Dollar – firmer for now

- Stronger US growth and Fed rate hikes are supporting the dollar.
- No catalyst for a euro bounce yet. However, we remain constructive in the longer term.
- Brexit outlook remains highly uncertain, putting a lid on the pound.
- Yen to trade range-bound but risks are tilted to the upside.

Dollar upside seems limited

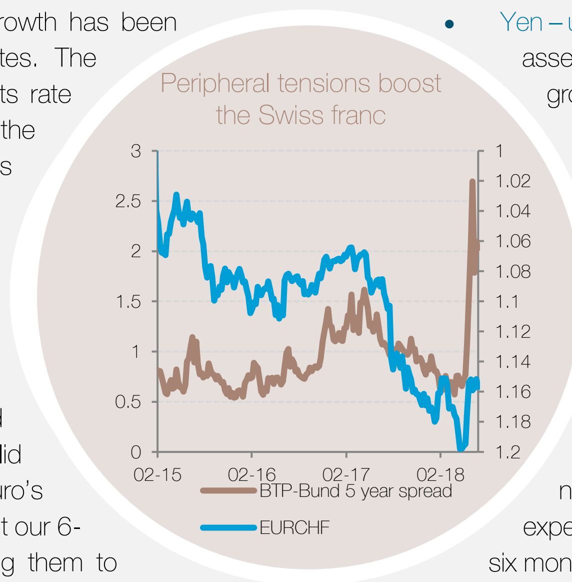
We believe the euro has reached a floor.

- Dollar – modestly higher. Stronger US growth and Fed rate hikes are benefiting the dollar. Trade tensions will provide additional support as export-driven currencies feel the pain. Emerging currencies have shed ground versus the dollar and the downward spiral may well continue. Although the greenback could gain further ground, we see limited upside as the dollar is already expensive.
- Euro – moving sideways. Several factors have weakened the single currency. Eurozone growth has been weaker than in the United States. The Federal Reserve has upgraded its rate projections for 2018 while the European Central Bank has committed to stay on hold until summer 2019. Also, Italian concerns and slow reforms in the eurozone have weighed on investor sentiment. However, we believe that 1.15 will act as a strong support for the euro and remain mildly bullish given the solid growth path and the euro's undervaluation. We have again cut our 6- and 12-month forecasts, bringing them to 1.20 and 1.25 respectively.
- Sterling – levelling off. Sterling has been sliding as a result of trade tensions and lingering Brexit uncertainty. As we do not expect improvement on either front in the short run, sterling should remain under pressure. However, the currency's slight undervaluation and a possible rate hike before year-end should provide some support. We target 1.35 in both six and twelve months.

Good news for safe-haven currencies

The Swiss franc and Japanese yen will benefit from risk aversion.

- Swiss franc – underlying strength. Shrinking liquidity, waning risk appetite and trade conflicts have helped the franc regain ground versus the euro. In the short run, we expect some range trading but still forecast some modest weakening. The currency is clearly overvalued and the central bank is keen to let the currency depreciate. All in all, we see EUR/CHF rising to 1.18 in 6 months and 1.22 in a year.
- Yen – upside risks. Like other safe-haven assets, the yen has benefited from growing risk aversion. Japanese monetary policy remains ultra-loose with the 2% inflation target still far away. When volatility picks up, domestic investors tend to repatriate assets or hedge their overseas exposure. This means that risks are tilted to a stronger yen. Unsurprisingly, the yen and Swiss franc have been trading in narrow ranges. At present, we expect the yen to trade around 110 in six months and 105 in a year.



Sources: SGPB, Bloomberg, 29/06/2018. Past performance should not be seen as an indication of future performance. Investments may be subject to market fluctuations, and the price and value of investments and the income derived from them can go down as well as up. Your capital may be at risk and you may not get back the amount you invest.

Emerging currencies

Weakest emerging currencies take the plunge

- Adverse factors are dragging emerging currencies down.
- Trade tensions are hitting export-driven currencies.
- Higher US rates are driving dollar investors away from emerging markets as the yield gap narrows.
- Yuan weakness should be contained

Downside risks remain

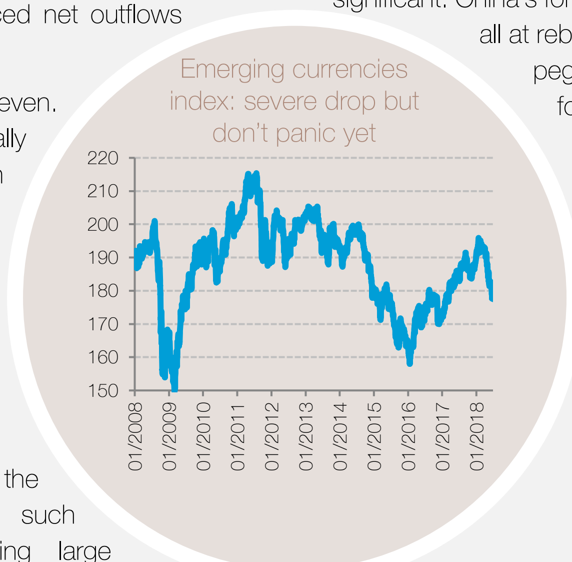
Emerging currencies with the largest deficits are most at risk

- Emerging currencies – pockets of weakness. Trade tensions have sent emerging currencies down 9% since early April (JP Morgan index), a record since 2015. There is more to this than just trade war concerns. Higher US rates on both short and long maturities have become appealing alternatives for retail and institutional investors.
- Spreads on emerging debt denominated in hard currencies have climbed and mutual funds invested in emerging assets have experienced net outflows these last few months.
- However, losses have been uneven. The weakest countries economically and/or politically have been hardest hit with the Argentinean peso down 25% in Q2 versus 13% for the Brazilian real and South African rand. Emerging Asia currencies have proved much more resilient, losing only 2% to 6% over the same period.
- Fundamentals appear to be the biggest factors behind such discrepancies. Countries running large current account deficits are more dependent on foreign capital and hence more vulnerable to sudden withdrawals.
- We expect downward pressure to persist but do not foresee a broad-based market rout as long as US rates do not skyrocket and global growth remains strong.

Yuan still alive and kicking

We may see further weakness but nothing meaningful

- Yuan – down but not out. The renminbi has not been spared from the general EM sell-off in Q2, losing a little more than 5% verus the US dollar. Moreover, the yuan could weaken a bit further as domestic investors accelerate their diversification away from Chinese assets. However, the downside now seems limited. Although depreciation could be used as a weapon in the trade war versus the US, it is unlikely to be the most significant. China's foreign exchange policy aims above all at rebalancing growth and the crawling peg has become the key instrument for forex flexibility. Other policy measures such as cutting the reserve requirement ratio look more designed to mitigate the impact of tariffs. We may see further weakness but nothing meaningful.



Sources: SGPB, Bloomberg, 02/07/2018. Past performance should not be seen as an indication of future performance. Investments may be subject to market fluctuations, and the price and value of investments and the income derived from them can go down as well as up. Your capital may be at risk and you may not get back the amount you invest.

Commodities

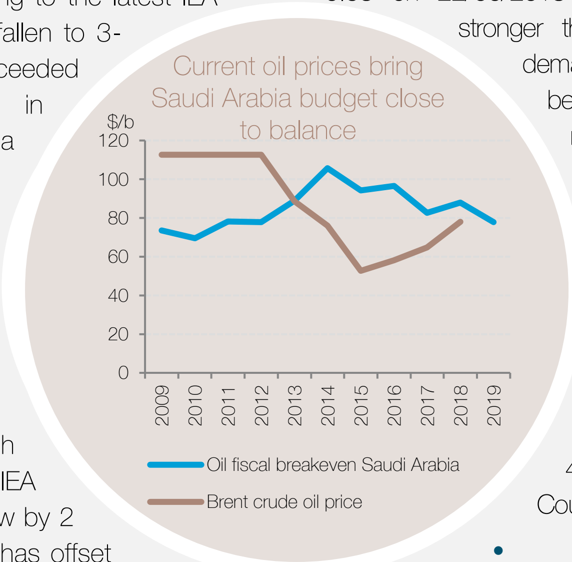
Strong US output and OPEC increases to rebalance the oil market

- The recent OPEC summit with its allies showed willingness to boost supply which should help cap upside in prices
- Dollar strength and rising US rates have pushed bullion lower. However, we continue to value gold's diversification benefits in terms of portfolio construction

Oil

OPEC increases production to meet strong demand

- Oil prices briefly touched the $80 mark in May – a first since November 2014 – before correcting lower ahead of the OPEC summit. Demand has been strong so far this year with cold winter conditions. The International Energy Agency (IEA) forecasts global demand growth at 1.4 million barrels/day (mb/d) this year and next.
- The 1.8 mb/d production cut announced by OPEC and its allies in late 2016 has contributed to tightening the market and lifting prices. According to the latest IEA data, OECD crude stocks have fallen to 3-year lows as OPEC curbs have exceeded targets, given the collapse in Venezuela. At their June 22 Vienna meeting, OPEC members decided to raise production by 0.8 mb/d in order to converge with original quotas.
- Global oil supply crept up in May with non-OPEC output (in particular, the US) offsetting weakness in OPEC members such as Venezuela and Nigeria. The IEA expects non-OPEC supply to grow by 2 mb/d this year. US shale supply has offset OPEC cuts with a 1.8 mb/d rise in the last 18 months. According to the Energy Information Administration (EIA), production reached 10.7 mb/d in May and is estimated to top 10.8 mb/d on average this year and 11.8 mb/d next, making the US the largest world producer.
- Despite a market share reshuffle between producers, supply is likely to increase to meet strong demand in the next quarters. We now expect prices to hover around $75 in coming months before returning to $70 within a year.



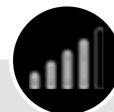
Gold

Gold likely to struggle as rates rise

- Despite some support (trade war with China, global tensions, market volatility), gold prices broke below their $1,300-$1,360 range in mid-May and the $1,300 mark now looks like a ceiling.
- The non-yielding asset lost its shine because of stronger Fed rate hike forecasts, higher real rates and solid growth. Another source of pressure was the dollar's bounce since mid-April given its record negative correlation with gold (-0.53 on 22/06/2018 according to Bloomberg). The stronger the greenback, the weaker the demand as dollar-denominated gold becomes less affordable in non-USD regions. The dollar remains key for gold in the short run.
- Gold ETFs saw more inflows in Europe than North America this year following a reversal in May. Despite gold's poor performance so far this year, global holdings of gold-backed ETFs were up $4.9bn or 4.7% at end-May (World Gold Council data).
- The World Gold Council sees modest production growth this year. In Q1, global supply was up 3% YoY, while demand hit a decade low (-7% YoY) as weaker investment in bars and ETFs was only partly offset by central bank purchases (+42% YoY). Jewellery was flat while technology demand grew further.
- Gold remains a good diversifier, helping mitigate drawdowns and reduce portfolio volatility. Recent price pressure may offer an attractive entry point. Given gold's resilience and its safe-haven status, we see the ounce at $1,250 in 6 months and $1,225 in a year.

Sources: SGPB, Datastream, 29/06/2018. Past performance should not be seen as an indication of future performance. Investments may be subject to market fluctuations, and the price and value of investments and the income derived from them can go down as well as up. Your capital may be at risk and you may not get back the amount you invest.

Hedge funds



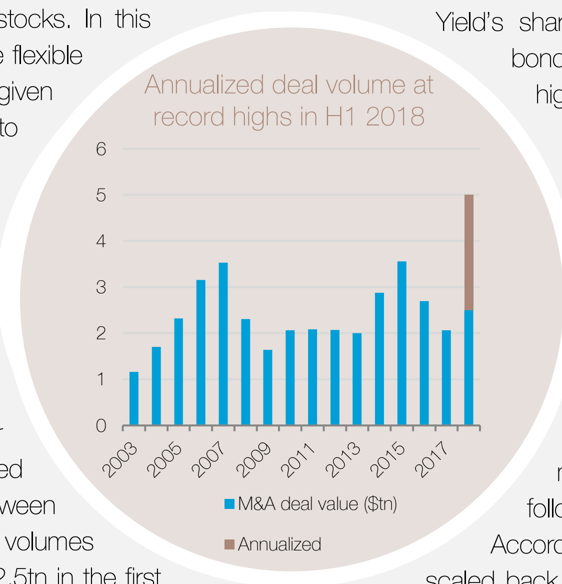
A Time for Diversification

- Choppy equity markets lead us to prefer deep value Long/Short managers and Variable Bias funds. Still Neutral overall.
- High levels of corporate confidence fuelled by US tax cuts have boosted M&A activity and corporate restructuring plans. Overweight Event Driven.
- Opportunities in Credit Arbitrage and Distressed Debt remain thin on the ground. Keep an Underweight stance.
- Range-bound markets are a challenge for CTAs, and position clustering reduces diversification benefits in Global Macro. Underweight.

Dynamic drivers in Event-Driven strategies

Variable Bias funds can adjust exposure to changing market dynamics

- Long/Short Equity. June saw a reversal in equity markets as trade concerns took hold, with defensive laggard sectors such as Utilities and Staples recovering some lost ground. Such switches in market focus can be challenging for many Long/Short Equity managers and we continue to favour those with a deep value approach to stock-picking. In Europe, the macro backdrop is less supportive than in the US but there is a greater diversity of portfolio themes which has boosted dispersion between stocks. In this context, we continue to prefer more flexible funds in the Variable Bias segment given their ability to adjust exposure to changing market dynamics.
- Event Driven. Trade concerns have impacted Merger Arbitrage, as investors gauge risks relating to China-linked deals, and deal spreads have widened to over 9%, boosting return potential. In addition, the recent green light for AT&T's bid for Time Warner has revived appetite for such "vertical" deals between producers and distributors. M&A volumes have surged to a historic high at $2.5tn in the first half, up 65% over the same period last year. In Special Situations, many new activist campaigns have been launched in the US and Japan, with a focus on small and mid-sized companies in Consumer Discretionary and Technology.



Range-bound markets are tough for CTAs

Distressed Debt investors will have to wait before new opportunities emerge

- Credit/Distressed Debt. As risk factors have come to the fore, yield spreads between sovereign and corporate bonds have begun to widen from historically tight levels. However, the opportunity set for Credit Arbitrage managers has yet to broaden sufficiently in our view. Regarding Distressed Debt funds, default rates remain extremely low at just 3% in High Yield according to Moody's. However, the rating agency highlights that High Yield's share in the non-financial corporate bond universe has reached an all-time high – this suggests that investors will have to wait for the next economic downturn before the next wave of opportunities emerge in this segment.
- Global Macro/CTAs. The current environment of supportive macro fundamentals and heightened geopolitical risks translates into range-bound markets, a challenge for trend-following funds like CTAs. Accordingly, many managers have scaled back their positions, meaning reduced risk but also limited return potential. In Global Macro, the gradual normalization of monetary policy has been well priced in by investors and hence has yet to create major dislocations for managers to play. As a result, managers have reduced their exposure to markets and returns have been less volatile. However, they have concentrated portfolios in similar trades, suggesting that their returns will now show higher correlation than before.

Sources: SGPB, Datastream, Thomson Reuters, 29/06/2018. Past performance should not be seen as an indication of future performance. Investments may be subject to market fluctuations, and the price and value of investments and the income derived from them can go down as well as up. Your capital may be at risk and you may not get back the amount you invest.

Tactical and strategic themes: open strategies

Inception date	Conviction	Strategy description	Time horizon
27/11/2014	Blue gold (Water)	Many regions of the world face large water supply disruptions. Water remains underpriced.	Strategic
24/09/2015	Inflation linkers: Useful TIPS	Market prices for forward inflation levels in the US are well below our expectations.	Strategic
15/06/2016	How demographic changes shape future spending	Population growth and ageing generate investment opportunities in several sectors.	Strategic
15/06/2016	Climate change – The global shift towards energy efficiency	The world's transition to an energy-efficient and low-carbon economy will create long-term investment opportunities in a wide range of sectors.	Strategic
01/12/2016	Senior loans: diversifying credit	Senior loans are a useful tool to diversify credit exposure, reduce interest rate risks, and benefit from attractive yields.	Tactical
31/03/2017	Floating rate notes – Float on	With their lower interest rate risk, floating-rate notes are a good way to capture a rising trend in rates and a useful diversification instrument for portfolios.	Tactical
31/03/2017	Safety first	Security and safety needs are set to grow in coming years offering a broad range of business opportunities.	Strategic
06/07/2017	Millennials: Redefining the rules	Companies able to anticipate and/or adapt quickly to new consumer trends will be the main beneficiaries of millennials' growing spending power.	Strategic
06/10/2017	Convertible Bonds – Yin and Yang	Convertibles combine the attributes of different asset classes in one security. As long as their credit quality is not impaired, they can offer unlimited upside with downside protection.	Strategic
06/10/2017	Benefiting from stronger capital spending	The global upturn in business capital spending should further improve earnings in Industrials and IT. Valuations are already elevated but there is room for more gains.	Tactical
08/12/2017	Insurance-Linked Securities – Marching to a Different Drum	ILS represent a source of uncorrelated returns for bond portfolios. The recent drawdowns linked to US hurricanes create a new opportunity in this segment.	Strategic
08/12/2017	Fed rate hikes to benefit US Financials	US Financials will be supported by Fed rate hikes but also softer regulations, strong balance sheets and improved earnings growth. In addition, their relative valuation is also appealing.	Tactical
08/12/2017	Education: The Most Powerful Weapon	Achieving the UN goal of universal primary and secondary education by 2030 and adapting workers' skills to 21th century needs will create interesting investment opportunities.	Strategic
29/03/2018	Inflation – Playing catch-up	Despite stronger growth, inflation remains tame. However, price data could surprise on the upside, especially in the US. Getting exposed to inflation breakevens would help reduce the risk of taking a hit when yields grind higher.	Tactical
29/03/2018	Artificial Intelligence: from fiction to reality	China may well become the largest digital economy and overtake the United States this year. Worldwide spending on cognitive and AI is expected to rise from $12bn in 2017 to $57.6bn in 2021. Outside technology, AI growth is more contained but good progress has been made in nearly every sector	Strategic
29/06/2018	Corporate America: Prefer low-leverage companies	Rate hikes will have less impact on low-leverage companies, helping them outperform.	Tactic

Sources: Societe Generale Private Banking, Datastream. Data as at 29/06/2018

* Strategic: 1-3 years. Tactical: 3-12 months

Denotes a change from our previous quarterly

Closing strategies

Inception date	Conviction	Closing rationale	Type
15/06/2016	Time for emerging challengers to conquer the world	▪ The current context of rising US rates, dollar strength and trade tensions means emerging market equities may continue to struggle	Strategic
29/09/2016	Adding hybrids to a yield-starved menu	▪ Time to take profits on this tactical idea, as rising spreads are likely to create headwinds	Tactical
06/10/2017	Hunting for recovery trades	▪ The current context of rising US rates, dollar strength and trade tensions means emerging market currencies may continue to struggle	Tactical
29/03/2018	Yen – tide is turning	▪ Within inflation still negligible, the Bank of Japan looks unlikely to abandon its accommodative policy settings.	Tactical

Sources: Societe Generale Private Banking, Datastream (data as at 29/06/2018).

Global economic forecasts

Growth and inflation

YoY changes in %	Real gross domestic product growth*					Consumer price indices*				
	2016	2017f	2018f	2019f	2020f	2016	2017f	2018f	2019f	2020f
World (Mkt FX weights)	2.7	3.3	3.4	3.0	2.6	2.0	2.6	2.8	2.6	2.6
World (PPP** weights)	3.4	3.8	3.9	3.7	3.4	2.8	3.2	3.6	3.3	3.1
Developed countries (PPP)	1.7	2.4	2.3	1.7	1.0	0.8	1.7	2.0	1.7	1.9
Emerging countries (PPP)	4.6	4.8	5.0	5.0	5.0	4.2	4.3	4.7	4.3	3.9
Developed countries										
US	1.5	2.3	2.6	1.4	0.5	1.3	2.1	2.5	2.0	2.3
Eurozone	1.8	2.5	2.4	1.9	0.7	0.2	1.5	1.6	1.3	1.3
Germany	1.9	2.5	2.2	1.9	0.8	0.4	1.7	1.8	1.5	1.4
France	1.1	2.0	2.2	2.1	0.8	0.3	1.2	2.1	1.0	1.2
Italy	1.0	1.6	1.6	1.2	0.3	0.0	1.4	1.3	0.9	1.0
Spain	3.3	3.1	2.6	1.8	0.8	-0.3	2.0	1.3	0.9	1.2
UK	1.9	1.8	1.1	0.8	0.9	0.7	2.7	2.4	1.6	1.5
Japan	1.0	1.7	1.2	1.4	0.8	-0.1	0.5	0.8	1.5	2.7
Switzerland	1.4	1.1	2.3	2.0	1.0	-0.4	0.5	1.0	1.2	0.9
Australia	2.6	2.3	3.2	3.0	2.2	1.3	1.9	2.2	2.3	2.1
Emerging countries										
China	6.7	6.9	6.6	6.1	5.7	2.0	1.5	2.2	2.2	1.7
South Korea	2.9	3.1	2.8	2.5	2.3	1.0	1.9	1.7	1.7	1.7
Taiwan	1.4	2.9	2.8	2.2	0.4	1.4	0.6	1.5	0.9	0.9
India***	7.1	6.7	7.3	7.4	7.7	4.9	4.5	3.6	5.0	4.4
Indonesia	5.0	5.1	5.2	5.5	5.7	3.5	3.8	3.7	3.9	4.0
Brazil	-3.5	1.0	1.9	2.3	1.7	8.7	3.4	3.2	4.3	4.1
Mexico	2.6	2.3	2.3	1.8	1.3	2.8	6.0	4.2	3.6	3.6
Chile	1.3	1.5	3.7	2.9	1.9	3.8	2.2	2.4	2.8	3.1
Russia	-0.2	1.5	1.6	1.7	1.3	6.6	3.5	3.1	3.9	3.9
Poland	3.0	4.6	4.2	3.4	3.0	-0.6	2.0	1.8	2.8	2.5
Czech Republic	2.5	4.6	3.8	2.7	1.6	0.5	2.4	2.3	2.9	2.8

* (f: forecast) ** PPP: Purchasing Power Parity *** In India, the numbers are averaged over the Fiscal Year, ending in March.

Sources: SG Cross Asset Research / Economics, IMF, 30 May 2018

Forecast figures are not a reliable indicator of future performance

Market performance

Developed market equities		Performance - total return (in local currency)							
Index	Current level	1m	3m	YTD	12m	2Y	3Y	4Y	5Y
S&P500	2718	1.2%	3.4%	2.7%	14.6%	36.7%	40.6%	50.6%	87.7%
DJ Euro Stoxx 50	3396	-0.5%	3.6%	-0.3%	1.3%	28.5%	9.0%	21.2%	55.9%
FTSE100	7637	0.5%	9.6%	1.7%	8.2%	30.0%	30.0%	32.0%	48.6%
Topix	1731	-1.6%	1.8%	-3.7%	8.9%	44.8%	13.5%	50.0%	69.1%
MSCI AC World ($)	505	-0.1%	0.8%	-0.1%	11.1%	34.5%	28.8%	30.5%	61.0%

Developed market bonds		Performance - total return (in local currency)							
Index	Current level	1m	3m	YTD	12m	2Y	3Y	4Y	5Y
Citigroup US Sovereign 3-7y		-0.4%	0.0%	-1.0%	-1.1%	-2.7%	2.2%	4.6%	6.6%
Citigroup Germany Sovereign 3-7y		-0.3%	0.8%	0.8%	0.9%	-0.7%	2.5%	4.1%	7.5%
Citigroup UK Sovereign 3-7y		-0.2%	0.6%	-0.3%	-0.2%	-0.4%	5.9%	10.8%	11.0%
Citigroup Japan Sovereign 3-7y		0.0%	0.0%	0.0%	0.2%	-1.1%	0.9%	1.5%	2.7%
	Yield to maturity								
BAML Corp Euro IG	1.06%	-0.2%	-0.2%	-0.6%	1.2%	2.4%	7.7%	9.6%	17.6%
BAML Corp Euro HY	3.84%	-0.2%	-1.2%	-1.7%	0.8%	10.6%	13.3%	15.4%	31.1%
BAML Corp US IG	4.06%	-0.9%	-0.9%	-3.1%	-0.7%	1.6%	9.1%	10.2%	19.0%
BAML Corp US HY	6.57%	0.5%	1.0%	0.1%	2.5%	15.6%	17.6%	16.9%	30.8%
BAML Corp UK IG	2.83%	-0.2%	-0.4%	-1.8%	0.5%	7.7%	17.4%	24.6%	34.7%

Emerging market equities		Performance - total return (in USD)							
Index	Current level	1m	3m	YTD	12m	2Y	3Y	4Y	5Y
MSCI EM	1070	-4.5%	-7.7%	-6.4%	8.3%	36.9%	20.7%	13.9%	30.0%
MSCI EM Asia	552	-5.1%	-5.6%	-4.8%	10.0%	43.9%	26.5%	30.2%	51.2%
MSCI EMEA	259	-2.8%	-10.0%	-10.8%	5.8%	22.0%	5.9%	-10.5%	1.2%
MSCI Latam	2477	-3.0%	-17.7%	-11.0%	0.7%	17.5%	8.1%	-17.7%	-10.0%

Emerging market bonds		Performance - total return (in USD)							
Index	Yield to maturity	1m	3m	YTD	12m	2Y	3Y	4Y	5Y
BAML EM Sovereign	5.63%	-1.8%	-4.7%	-6.1%	-2.0%	3.7%	13.5%	10.8%	24.6%
Asia	4.77%	-1.5%	-2.7%	-5.0%	-1.4%	3.0%	13.5%	19.5%	30.0%
EMEA	5.80%	-1.9%	-4.8%	-5.5%	-1.2%	4.7%	13.1%	11.2%	24.4%
Latam	5.82%	-1.9%	-5.5%	-7.2%	-3.1%	2.9%	14.1%	6.7%	22.5%
BAML EM Corp	5.20%	-0.6%	-2.0%	-2.8%	0.1%	2.8%	9.5%	12.7%	22.7%
Asia	4.76%	-0.8%	-1.2%	-2.3%	-0.3%	5.0%	14.3%	11.3%	21.9%
EMEA	5.09%	0.0%	-2.1%	-2.3%	0.2%	11.8%	13.7%	9.0%	22.1%
Latam	5.98%	-0.7%	-3.1%	-3.9%	0.5%	3.6%	8.7%	7.4%	17.5%

Source: Societe Generale Private Banking, Bloomberg, Datastream (data as of 29/06/2018), YTD = year-to-date

BAML: Bank of America Merrill Lynch
Corp: Corporate
IG: Investment Grade
HY: High Yield

EM: Emerging Market
EMEA: Europe, Middle East, Africa
LatAm: Latin America

Market performance and forecasts

		Forecasts		Performance					
Currencies	Current	6 months	12 months	YTD	12m	2Y	3Y	4Y	5Y
EUR/USD	1.17	1.20	1.25	-2.7%	2.1%	5.0%	4.0%	-14.4%	-10.2%
USD/JPY	111	110	105	-1.8%	-1.3%	7.6%	-9.7%	9.2%	11.6%
EUR/CHF	1.16	1.18	1.22	-1.1%	5.9%	6.2%	11.4%	-4.8%	-5.8%
GBP/USD	1.32	1.35	1.35	-2.2%	1.6%	-1.6%	-16.1%	-22.5%	-13.2%
EUR/GBP	0.88	0.89	0.93	-0.5%	0.6%	6.8%	23.9%	10.4%	3.4%

		Forecasts		Performance (in local currency)					
10-year yields	Current	6 months	12 months	YTD (bp)	12m	2Y	3Y	4Y	5Y
USA	2.9%	3.25%	3.4%	45	59	138	53	33	38
GER	0.3%	0.6%	0.8%	-12	-15	44	-49	-96	-142
UK	1.3%	1.5%	1.7%	11	15	26	-75	-131	-111

		Forecasts		Performance (in USD)					
Commodities	Current	6 months	12 months	YTD	12m	2Y	3Y	4Y	5Y
Gold in USD	1251	1250	1225	-4.0%	0.6%	-5.5%	6.1%	-5.2%	2.9%
Oil (Brent) in USD	79.4	75	70	19.3%	66.4%	58.9%	31.9%	-30.0%	-22.6%

		Forecasts		Performance - Total return (in local currency)					
Equities	Current	6 months	12 months	YTD	12m	2Y	3Y	4Y	5Y
S&P 500	2718	2850	2920	2.7%	14.6%	36.7%	40.6%	50.6%	87.7%
Euro Stoxx 50	3396	3470	3520	-0.3%	1.3%	28.5%	9.0%	21.2%	55.9%
FTSE 100	7637	7800	7760	1.7%	8.2%	30.0%	30.0%	32.0%	48.6%
Topix	1731	1770	1820	-3.7%	8.9%	44.8%	13.5%	50.0%	69.1%

Source: Societe Generale Private Banking, Bloomberg, Datastream (data as of 29/06/2018), bp = basis points

BAML: Bank of America Merrill Lynch
Corp: Corporate
IG: Investment Grade
HY: High Yield
EM: Emerging Market
EMEA: Europe, Middle East, Africa
LatAm: Latin America

Forecast figures are not a reliable indicator of future performance

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