



1 MONTH IN 10 SNAPSHOTS

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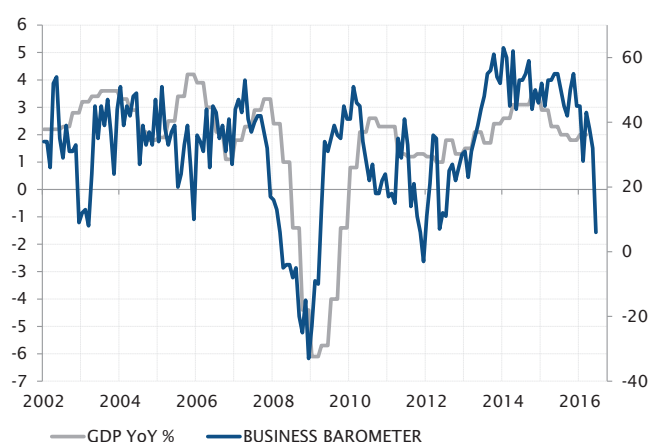
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1. United Kingdom - Out

- The UK referendum on its EU membership has delivered its verdict and the British people has opted to exit. Although it is not a complete surprise given the polls' evolution in the preceding weeks, this outcome was mostly dismissed in the financial and business community and has sent shockwaves causing repercussions that are actually difficult to assess.
- If the political chaos that ensued in the UK was unexpected, the immediate reaction of financial markets has closely met the projections associated with such a vote. From the early indicators that were available, it also appears that the immediate reaction in the real economy sticks to what was predicted by the vast majority of forecasters: a severe blow to business and consumer confidence. The Lloyds business barometer demonstrated a collapse in sentiment to levels reached, in the recent past, only in the 2008/09 recession and at the peak of the European sovereign crisis. The Gfk consumer confidence index experienced its largest decline twenty years.
- Those early indicators suggest that warnings of a sharp immediate blow to economic activity following an "Out" vote were not exaggerated. GDP growth is likely to slow down abruptly in the second half of 2016 and might even turn negative.

The Brexit shock on confidence will weigh on growth

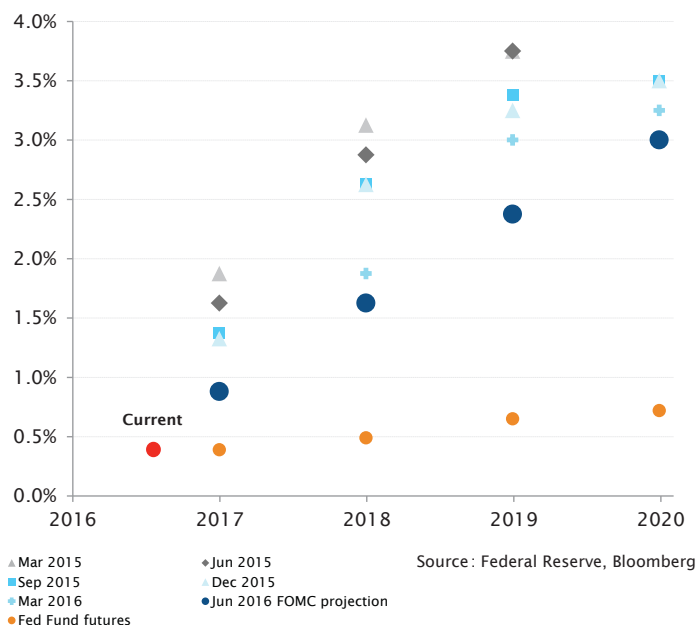


Source: Lloyds, Bloomberg

2. United States - The Fed once again revises its projections

- Following its June meeting, the Fed delivered a cautious message. Not only did the central bank revise a tad lower its GDP growth forecast, but several members downgraded their expectations for interest rate hikes.
- Such downward revisions should not have been a surprise when looking at the historical pattern of Fed projections. Indeed, GDP growth forecast have repeatedly been too optimistic, not only from the Fed but from the vast majority of forecasters. More strikingly so, the projections of Fed members regarding the Fed Fund rate evolution have constantly been much higher than markets' expectations...and have constantly been revised downward!
- As it stands, if the median expectation within the Fed's committee is still for two 25bp rate hikes before year end, many members are now expecting only one such hike in 2016. Projections for rate hikes in 2017 and 2018 have also been revised lower but remain clearly positive, at +75bp for each year. In the meantime, market expectations are for no hike this year and next, and one single hike by end-2018... If history is any indication, market expectations shall be seen as a more reliable indicator and the Fed will continue to struggle to normalize its monetary policy.

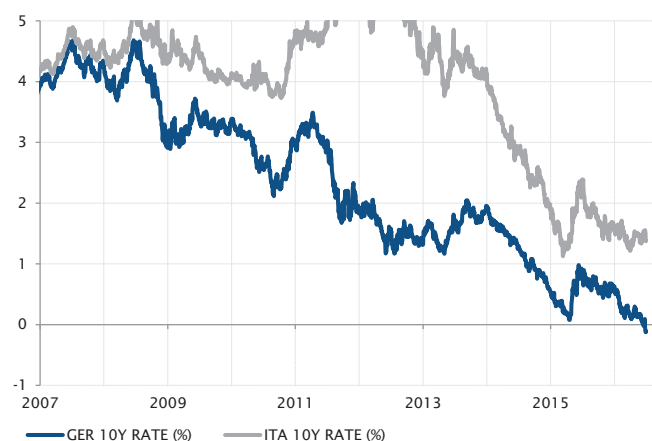
The Fed keep revising lower its rate projections



3. Euro area - Bund yields turn negative amid rising political risk

- In June, following a long flirtation with the zero bund, the German 10-year government rate has joined its Swiss and Japanese counterparts into negative territory. A cocktail of global risk aversion, downward pressures on US rates and rising ECB asset purchases have contributed to overcome this psychological floor.
- The movement has been further fueled by the UK referendum that has suddenly increased political risk in the euro area. With elections to be held in all major European economies in the next 15 months, the risk of a referendum-driven Eurozone breakup came back in the forefront and amplified the flight-to-safety movement: German rates dropped further into negative territory while peripheral country rates rose, widening sovereign spreads already on a gradual upward trend since the beginning of 2016.
- However, this movement has been contained so far thanks to the support of the ECB. The central bank is purchasing EUR 80bn of bonds per month, most of it government bonds. This has acted like a cap on Spanish, Portuguese or Italian government rates until now despite, for the later, growing concerns around the stability of its banking sector. However, heightened political risk in the Eurozone may keep sovereign spreads volatile in the months ahead.

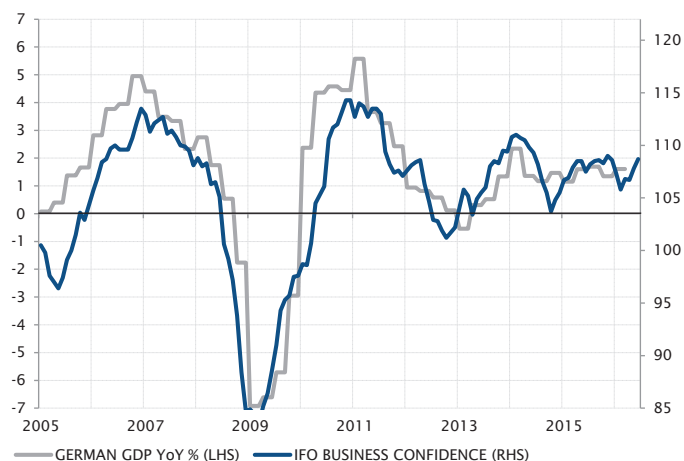
Peripheral spreads widen amid rising political risk



4. Germany - At cruising speed

- While most of the European continent still doesn't feel like out of the woods, plagued with high unemployment, the German economy is in a league of its own. Not only is it growing, since 2014, steadily and slightly above its potential, at 1.5% per year. It is also experiencing a historically low unemployment rate, the lowest among European countries.
- After having experienced a brief and mild softpatch in the first months of the year, most indicators have turned green again and suggest that Europe's powerhouse is still on a solid growth track. In particular, leading manufacturing indices have strongly rebounded, to their highest level in two years, pointing to a summer rebound in industrial production. The Ifo broad business confidence index has followed a similar trend, back toward its 2015 high.
- Of course, Germany cannot be entirely insulated from the neighbouring turmoils: the UK's Brexit and the Italian banking stress may affect Germany through weaker demand for its exports and a negative impact on business sentiment. But the strength of the domestic situation, coupled with an ECB policy that is clearly overly accommodative for Germany, are likely to ensure that the economy doesn't deviate significantly from its cruising speed of 1.5%.

Cruising at 1.5% GDP growth rate

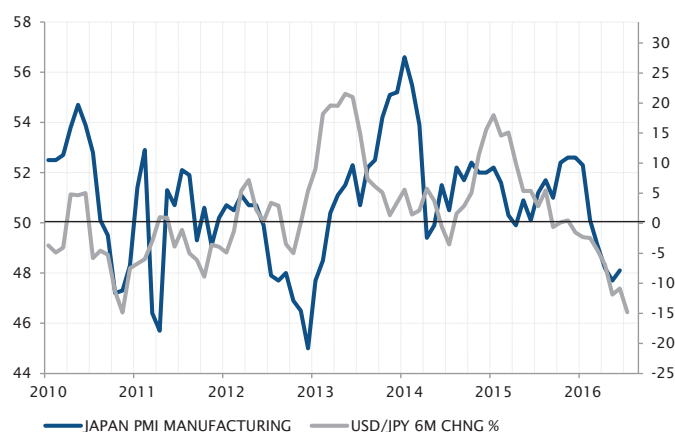


Source: Datastream

5. Japan - The problem with the yen

- Japan is expected to post, in 2016, the weakest GDP growth rate of the developed world. Inflation has dropped back into negative territory. Three years following the launch of Abenomics, the initial optimism has turned into a mild hungover. The attempt to extract the economy from the deflationary trap has been undermined by the drift of the global economy toward the very same trap.
- The ECB has followed the BoJ's path toward large asset purchases. The Fed has not managed to raise meaningfully its short term rate. As a result, European and US monetary policies have not diverged as expected from the Japanese one, undermining efforts to weaken the yen. The attempt to prevent the JPY reversal early this year by implementing negative rates has even been cruelly ineffective: the yen is up 15% against the USD since then.
- Given the lack of domestic dynamism, this strength of the yen is unsurprisingly negatively impacting economic growth through external trade. Yen fluctuations have been good leading indicators of the Japanese business cycle over the past five years. To spur activity, Japanese authorities must find a way to put a halt to the ongoing yen appreciation, and even ideally to reverse it.

Yen movements lead the business cycle and currently point south

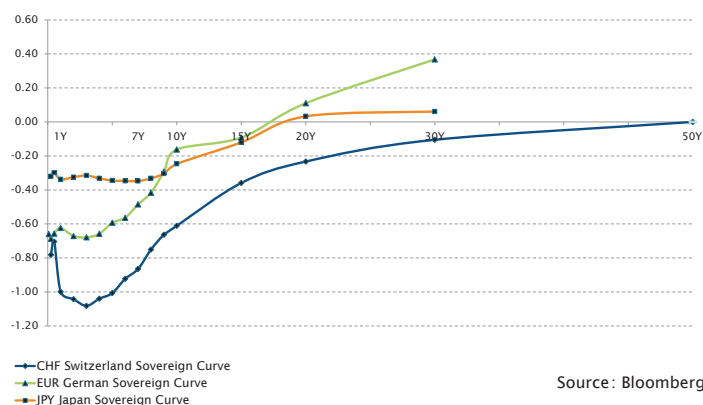


Source: Datastream

6. Fixed income - A world of negative interest rates

- In this new era of financial repression, interest rates are edging lower and lower with Central Banks becoming more and more accommodative (less true for the US Federal Reserve) to stimulate economic growth and to prevent their economy from falling into deflation.
- Switzerland (CHF), Germany (EUR) and Japan (JPY) government bonds until 10y maturity are returning negative yield to investors. This indicates that investors are so desperate to hold "safe haven" assets that they are willing to pay governments to lend them some money.
- During the month, Bloomberg news agency reported that about 40% of bonds in its Eurozone Sovereign Bond Index have yields below 0%.
- In relative terms, some value can still be found, for example with US 10y Treasury and Australian 10y government bond yielding at the end of June respectively 1.47% and 1.98% against (same maturity) -0.58% for Switzerland, -0.22% for Japan and -0.13% for Germany. Moreover, for the first time, the entire Swiss curve (until 48 years maturity) is now trading with yields in red numbers.
- In conclusion, one of the biggest worries for fixed income investors is to try to time the market: to assess how low interest rates could go and how fast also they could revert.

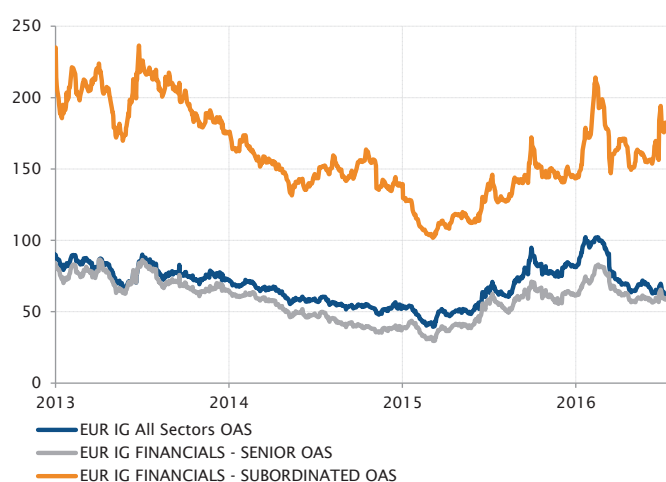
Switzerland (CHF), Germany (EUR) and Japan (JPY) Sovereign Yield curves



7. Fixed Income - Value in European subordinated financials

- The European financial sector has experienced a tough start to the year. In an environment of subdued global growth and rising risk aversion, bonds issued by European financials, especially subordinated, clearly underperformed the rest of the credit market and the combination of the Brexit vote and renewed concerns around Italian banks has triggered an additional widening in spreads. In the meantime, spreads for industrials and utilities have tightened considerably, supported by the prospect of ECB purchases.
- As a result, in an environment of very low government bond rates, financials are today the only segment of the European bond market, along with the HY space, where investors can find some yield. Their higher level of spreads certainly reflects the tough environment that European banks face: negative interest rates, profitability hampered by regulation, legacy NPL issues in Italy, subdued economic growth... However, the strong regulatory push for cleaner and stronger balance sheets in the build-up of the European banking union has left the vast majority of banks in much better situations than a few years ago. Unless a EU breakup scenario materialises, financials and especially subordinated debt offer value for yield-starved bond investors, provided one adopts a selective and diversified approach.

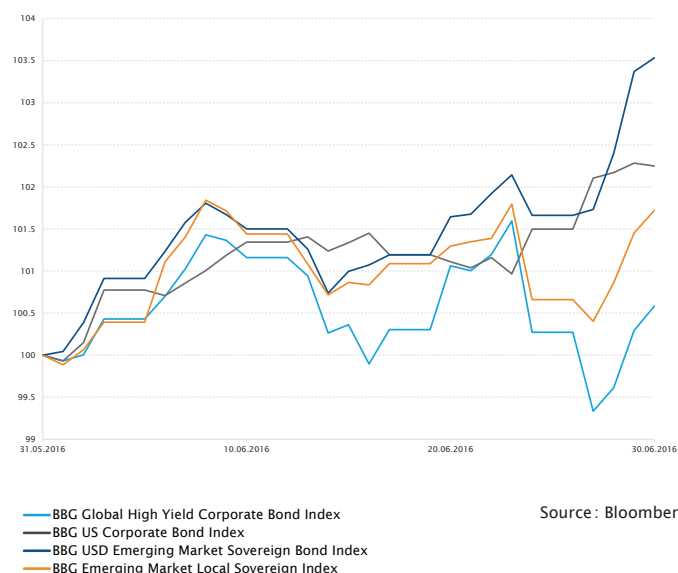
Searching for spreads? Take a look at European subordinated financials



8. Fixed income - Outperformance of Emerging Market Debt

- In June, emerging market debt in hard and local currency posted positive performances (respectively +3.5% and +1.7%) despite the high volatility in the run up to the Brexit referendum. Technicals and sentiment remain supportive for the asset class and the Brexit vote was generally positive for EM as central banks are likely to remain accommodative for longer.
- The latest dovishness from Central Banks around the world but more particularly in the US, with the Fed probably postponing its next rate hike, contributed positively to the emerging markets bloc. Moreover, the stabilisation of the oil price between USD 40 and USD 50 was also welcomed by a lot of emerging economies.
- Another threat for emerging markets debt was the Chinese slowdown that now seems to have slightly faded and already priced in by markets while at the same time, USD weakness is giving some fresh air to many emerging economies. Nevertheless, elections and uncertainty in a lot of countries could be a source of volatility.
- Since the taper tantrum in 2013, this asset class was heavily underweighted in portfolios but is becoming again more and more interesting in this environment of hunt for yield and negative interest rates in Europe and Japan, because nominal and real EM yields remain elevated.

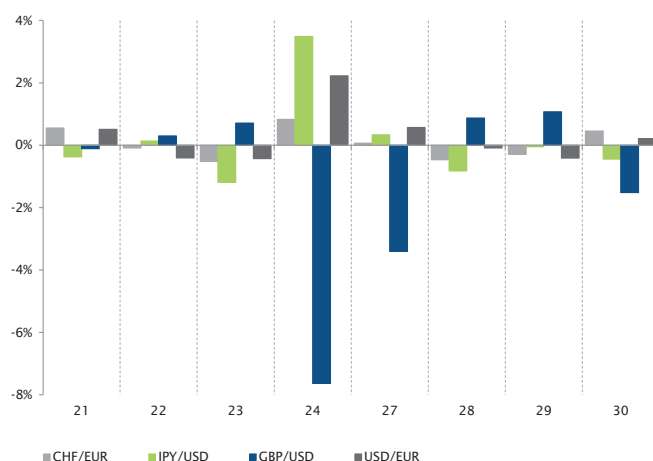
Emerging Market USD and Local Sovereign Bond vs. High Yield and US Corporate Bond indices



9. Foreign exchange - Strong FX market reaction after Brexit

- The result of the UK referendum prompted a significant forex market reaction as the market was not prepared for this outcome. The week before the voting day, general sentiment was that the "remain" would dominate and the GBP as well as risky assets were quite strong. The leave vote took the world and markets by surprise and led to a plunge of the sterling to its lowest level in the last three decades.
- As usual in a classic risk aversion move, the dollar and the yen played their traditional role of safe haven assets. The yen was clearly the winner as it surged against every major currency. Its sharp appreciation led the Japanese government to hold an emergency meeting to elaborate a strategy in order to limit its strengthening. While Japan needs a weaker yen to boost its economy, the political uncertainty arising from the UK decision to leave EU may continue to make the yen attractive.
- The appreciation of the Swiss franc, which is also usually favored during market turmoil, has been limited by interventions of the SNB. The Central Bank decided to take immediate actions in order to counteract undesired strengthening, particularly against the euro.

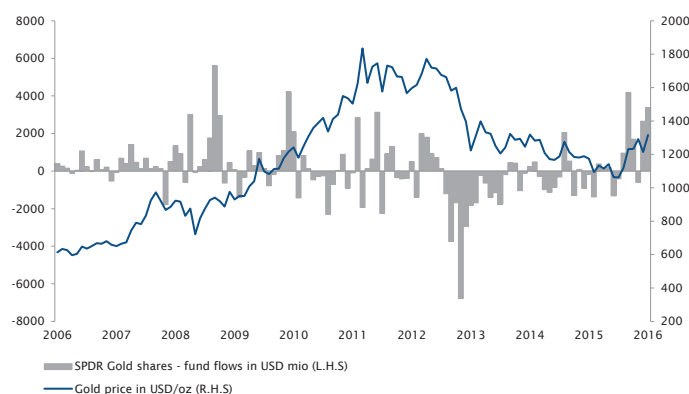
June daily performance of currency pairs



10. Precious metals - Gold supported by global uncertainty and flows

- The decision of UK voters to leave the EU boosted demand for safe haven assets such as gold. The precious metal rallied to \$1'300 an ounce as a consequence of the result of the referendum. Even if markets are experiencing signs of revived investor appetite for risky assets, the uncertainty around repercussions of Brexit may continue to fuel the flight-to-safety sentiment.
- Before the vote, Central Bankers signaled that a UK exit from the EU could be disruptive to global economy. Brexit has thus increased chances to see additional easing measures from the world's major Central Banks as it is a potential source of new headwinds for economies, the US included. With a more volatile geopolitical environment, speculations that the Federal Reserve will keep US interest rates low has and might continue to support gold prices.
- In this kind of macro landscape, investors tend to stay hedged with gold. Rising chatter that the Fed may dip into another round of quantitative easing might also increase demand for the precious yellow metal. Major and well known hedge funds have said publicly that they recently increased exposure to gold, mainly as a currency hedge.

Weekly inflows into SPDR gold shares have intensified this year



Source: Bloomberg