Welcome to an amazing year 2017

Are we credit bull or bear in 2017 ?

When one takes a look at the data pricing in the bond markets post Trump election it is easy to abandon the ship and try to escape from the worst that might happen….if it is to happen!! In fact, we are all back again staring at (catching up with) the Fed and trying to find our way around and predict what could be next. The year 2017 will be harder tougher than the past 8 years.

Liquidity paradigm, leverage ratio, political events, market structures and flows, regulatory changes, foreign exchange dynamics with taxation effects, cost of hedging and carry, convexity plays, etc. there will be ways to outpace the pessimists in the search for yield in the fixed income sphere.

We will not deny that when we observe the current landscape and endeavor to look beyond the US new reality , we have witnessed surging oil prices (WTI crude at 54 versus below 30 USD per barrel February last) with a steep climbing of bond yields of most developed countries (2 year US Treasury at1.14%, 10 year US at 2.50%, continental Europe gaining 8-9 bps). US markets work by anticipation and the best years are usually shining bright when Republicans are at the helm. So, our advice will be to remain patient and persistent in the year to come. Of course, investors are anxious when seizing the steam-rolling US public deficit, projected to be growing even more during the next US presidency: you don't generate 3 to 4% growth with peanuts. Over the last few weeks, bond investors have seen upside down and volatility exacerbated with one of the worst performing months in the asset class since 1994 (for those remembering it).

What can we say about Credit today, knowing that there were actually several ball park notes written in advance for credit?

Growth prospects are finally in the cards all over the world BUT certainly not yet in Europe and not to a point where disruptions are creeping up all over and frightening economic policy makers, ECB included as "uncertainty prevails everywhere" dixit Mr. Draghi . Germany, one of the main remaining economic engines will grow by 1.8% in 2017, building on a stronger consumer spending outlook. Followers such as Italy, France and Spain are lagging behind with more political troubles ahead (Germany might also have to navigate uneasy waters). Spread widening intra Europe will be prevalent but there won't be enough "negative juice" for the Bears to gain over Bulls in Europe with a tamed ECB. Investors would be wiser at selecting actively managed strategies mastered by experienced PMs : **whether IG or Credit including Hybrids, there will be volatility associated with plenty of windows for investors to properly program investments during the year. Especially In case of limited sell-off in Europe despite US interest rate policy changes, , indeed. In this type of**

markets with disciplined growth and controlled inflation projections, Euro fixed income remains an important building block in a true diversified global portfolio profiling with a pre-defined low duration tag.

Fiscal policies are emerging as to finally synchronize themselves or taking the lead over the post 2008 financial crisis monetary policy still in place. We have been quietly safeguarded by Central banks and market participants rejuvenating at banks capable of recapitalizing nicely . Today, whether in Europe or Us, the new leaders advocates of public spending are running ahead of the 2017 game. The sustainability of US economic policy with the new team moving in, is at stake.
How can we repeat the previous successful teaming relationship between FED/Government/Houses? In essence, how to continue creating jobs more wealth, without too much short termism and gearing of public finance (Mr. S. Mnuchin, Trump US Treasury secretary, will definitely be in favor of that card). A damaging strong US dollar could dampen their ambitions (jobs “made in Us” and export driven economy).

Summarizing:

Bearing in mind a possible deviation from the current projected FED scenario (i.e. two Fed funds adjustments in 2017), the US bond market remains positive while negative interest rates will continue their roadshow in Europe and Japan. The name of the game will be experts controlling volatility of returns, able to change pace, reduce or freeze global portfolio positions as political choices unfold then spotting new economic dynamics while surfing credit rerating based on appreciations of where we stand on the current global cycle.

Welcome to an amazing year 2017!!

Philippe Batchevitch

Deputy CEO /Alpha fixed Income at Amundi

Writing at the end of 12/12/2016