Confidence must be earned

Amundi ASSET MANAGEMENT

Monthly Market Review

Our investment perspectives for the month

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Everything went right

2017 will be remembered as an exceptional year for the markets. Government and corporate bonds delivered positive returns, while equities reached new highs.

The markets benefited from the fact that certain risk scenarios, such as protectionism by the US administration or an error in monetary policy, did not materialise.

2017 was also a particularly calm year: market volatility was historically low and the US stock markets recorded no negative monthly performance despite major geopolitical events, such as the North Korean crisis.

There are several factors that may explain this exceptionally positive environment: a solid and synchronised recovery in global economic growth without inflationary pressure, an improvement in the political environment in the Eurozone, policies to stimulate growth such as the US tax reform adopted in December and economic reforms in China.

In addition to this positive macroeconomic environment, markets benefited in particular from very advantageous financial conditions. Central banks maintained accommodative monetary policies, the dollar depreciated, and US long-term interest rates remained at very low levels despite the Fed's three, key interest rate hikes during the year.

Moreover, speculation around liquidity shifted to an entirely new asset class, cryptocurrencies. While the spike in price of Bitcoin and other cryptocurrencies suggests a bubble could be on the cards, it confirms above all the appeal of blockchain technology, which has brought about a new form of transaction liquidity that, for now, is not subject to intermediation by the central banks.

Market gains in 2017 were also concentrated around a small number of stocks, notably in the technology sector. This sometimes materialised in the most unexpected areas, such as artificial intelligence, robotics and the internet of things. Its impact is set to grow as the sector's potential to transform our daily lives and our modes of consumption increases. Amazon's acquisition of Whole Foods in 2017 is a particularly interesting example of the way in which the food retail sector is evolving.

Will 2018 be different? After a historically calm year in 2017, volatility could return if liquidity conditions tighten. There is no denying that the products and services of technology groups are set to play an increasingly bigger role in our everyday lives. Our growing dependency on new technologies and hyperconnectivity is as strong as the markets' addiction to liquidity. It will therefore probably be central banks' monetary policies that will have the biggest influence on the markets.

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Macroeconomy & Markets

Global economic conditions are benign thanks to a highly accommodative monetary and financial environment. Meanwhile trade multipliers have magnified the re-synchronisation of the global cycle, the recovery in global investments and corporate profits. The weak relationship between growth and inflation marks this cycle as unique.

Going into 2018, we expect:

- A mature cycle in the **US** but no recession in sight. The cycle is ageing (so far lasting almost nine years) but an extension in 2018-2019 is likely thanks to fiscal policy, low inflation and still accommodative monetary and financial conditions.
- The **Eurozone**'s late-recovery is now broadening to all countries and GDP components. Thanks to accommodative monetary and credit conditions, growth is expected to remain above potential for several consecutive years, even though some local-risks remain. Hence, our belief in the "Renaissance" of Europe.
- **Japan**'s economy is not particularly strong by historical standards but this cycle has proved more robust than expected, driven both by domestic demand and global trade.
- **China**'s economy appears more resilient than previously believed and the (widely expected) coming slowdown is likely to be moderate.
- Most **emerging economies** are enjoying strong growth momentum, with solid domestic demand and are less vulnerable than before the Great Financial Crisis.

	17/01/2018	Over the month	Since 30/12/2017
Equity Markets			
CAC 40	5514	3.1%	3.8%
S&P 500	2776	3.8%	3.8%
EuroStoxx 50	3622	1.7%	3.4%
MIB	23495	6.3%	7.5%
DAX 30	13246	1.1%	2.5%
Nikkei 225	23868	5.8%	4.8%
MSCI Emerging Markets	1218	8.9%	5.1%
Commodities - Volatility			
Crude Oil (Brent)	69.2	9.4%	3.4%
Gold ($/ounce)	1338	6.6%	2.7%
VIX	11.7	2.2	0.6
Currencies			
EUR/USD	1.223	4.1%	1.9%
USD/JPY	110.8	-1.6%	-1.7%
EUR/GBP	0.89	0.7%	0.0%
EUR/CHF	1.18	1.1%	0.6%
Money Rates & Government Bond Yields			
Euribor 3M	-0.329	-	-
Libor USD 3M	1.73	+12 bp	+4 bp
2 years Yield (Germany)	-0.57	+14 bp	+5 bp
10 years Yield (Germany)	0.56	+26 bp	+13 bp
2 years Yield (US)	2.03	+20 bp	+15 bp
10 years Yield (US)	2.56	+20 bp	+15 bp

For European and US equity markets and MSCI indices: the values are the closing prices of the day before. For Asian equity indices: closing price of the indicated date. For FX rates, bond yields, gold: values of the indicated date, around 9am (Paris time). Sources: Bloomberg, Amundi Strategy.

Equity markets

After +1.1% in November, the MSCI World AC index (excluding dividends) continued its rise in December with +1.2%, and was therefore up 17.5% over the year as a whole. However, performances in December were somewhat uneven from one market to another. While the London FTSE (+4.9%) and the Emerging Markets (+3.4% for the MSCI EM in $) shone, Wall Street (+0.4% for the Nasdaq, +1.0% for the S&P, +1.8% for the Dow Jones) and Tokyo (+0.2% for the Nikkei) were more lacklustre. The UK market welcomed the end of the first set of Brexit negotiations, while the Emerging Markets benefited from the sharp rise in oil prices and commodities. The Eurozone on the other hand saw widespread profit taking, with -0.8% for the Dax in Frankfurt, -1.1% for the CAC 40, -1.6% for the IBEX in Madrid and 1.8% for the Eurostoxx 50, while the MIB in Milan was down as much as -2.3%. Despite growing signs of recovery in the Eurozone, its stock market performance was linked to the continued rise in the euro (+0.7% against the $ in December after +2.4% in November) and the resurgence of political issues (Catalonia, Italy, Germany).

Past performance and market behaviors do not prejudge future performance and behaviors.

Interest rate markets

Developed country long rates increased at least temporarily in December, mainly due to the announced adoption by US Congress of sweeping tax reforms. Over the month as a whole however, movements were very limited. The US 10-year rate finished December at about 2.40%, roughly the same level as the end of November. The German and French 10-year rates rose respectively from slightly under to just above 0.40% and from around 0.70% to around 0.80%. After narrowing for several months, the interest rate gap between Italy and Germany widened over the month following the announcement of Italian legislative elections in early March: the Italian 10-year rate rose from around 1.75% to around 2%.

Foreign exchange markets

The main currencies saw little in the way of large-scale movements during December. The EUR/USD parity rose marginally from 1.19 to 1.20, while the USD/JPY parity remained virtually unchanged at around 112.

The positive trend should continue

2017 was a quiet year on the markets, with strong performances and historically low volatility. 2018 may not be so linear.

Indeed, a number of factors could argue in favour of stopping the interest rates decline that we have been experiencing for more than 30 years or even a possible, albeit moderate, increase in interest rates. Indeed, the overall macro-economic environment remains robust and underpinned by pro-growth policies such as fiscal reform or future infrastructure spending in the United States; in a context of full employment, we could see a (although still timid) rise in inflation.

OUR ANALYSIS

Asset classes

Although the economic environment remains robust and the current phase of the business cycle makes it possible to remain constructive, the year should be approached with a moderate exposition to risk. In this context, we maintain a clear preference for equities over bonds. Our neutral equity position does not call into question a positive bias in certain areas such as Europe and emerging markets. The rise in interest rates in 2018 is expected to be moderate in both the U.S. and the Eurozone, but is nonetheless present. For this reason, we always prefer inflation-linked bonds and emerging debt in a carry perspective.

Negative		Neutral		Positive	
		Equities			
	Bonds				
			Cash		

Equities

We remain constructive on equities, particularly in the Eurozone and emerging markets, respectively for expected earnings growth and attractive valuations relative to the others. Nevertheless, we believe that a tactically cautious approach is appropriate. We remain neutral on the U. S. due to current, expensive valuations, with indices still at historic highs.

Negative		Neutral		Positive	
			Euro Zone		
		United States			
			Emerging		
		Japan			
		World			

Bonds

2018 could be a more volatile year on the bond side. Indeed, even if a very gradual monetary policies normalization is expected by the market, any sensation of overheating or any surprise on inflation could cause interest rates go north. In this context, we remain cautious about duration and prefer floating-rate bonds and inflation-linked bonds. We always favour quality credit to government securities because of a more attractive risk/return ratio.

Negative		Neutral		Positive	
	Euro Zone - Core				
	Euro Zone - Peripherals				
	United States				
			Euro Inflation		
			US Inflation		

Currencies vs EUR

The U.S. dollar remains a useful hedge in case of market crisis.

Negative		Neutral		Positive	
			USD		

Spreads

Quality and liquidity remain key in the credit market. The acceleration of economic growth continues to reinforce our bias towards the asset class. We still consider that financial subordinated debt is attractive, as is emerging debt, which should perform well in the case of a gradual and orderly rise in interest rates.

Negative		Neutral		Positive	
		Investment Grade EUR			
		Investment Grade US			
			Subordinated Financials		
	High Yield EUR				
	High Yield US				
			Emerging Local Cur.		
			Emerging Hard Cur.		

Styles, Factors

We are always positive about value and quality factors as well as cyclical styles. Continued positive global macro-economic dynamics continue to support rotation towards cyclical sectors/industries.

Negative		Neutral		Positive	
			Value		
		Growth			
			Quality		
		High Dividend			
		Small Cap			
			Cyclical		
		Defensive			

Diversification

Volatility remains historically low. Gold has strongly performed over the past year. We keep a positive view on the latter in a diversification purpose.

Negative		Neutral		Positive	
		Volatility			
			Gold & related		

*Diversification does not guarantee a profit or protect against a loss.

Glossary

Deleveraging
The process or practice of reducing the level of one's debt by rapidly selling one's assets.

Investment Grade
Bonds that are Investment Grade are deemed low risk by the rating agencies. AAA is the highest rating that an issuer can receive.

MSCI Emerging Markets
Stock index representing about 820 companies listed in the equity markets of 21 emerging countries (South Africa, Brazil, Chile, Colombia, Korea, Egypt, Hungary, Indonesia, Malaysia, Morocco, Mexico, Peru, Philippines, Poland, Czech Republic, Russia, Taiwan, Thailand and Turkey).

S&P 500 (Standard and Poor's Composite Index of 500 Stocks)
Index representing the 500 largest stocks on the US market.