

7 October 2019 /// n°33-2019

## Fed: heading for an October cut?

### Key Points

- **Deterioration in activity surveys**
- **Fed under pressure to cut in October**
- **Equity markets plummet before stabilisation late last week**
- **Significant widening in European high yield spreads**

The downturn in economic surveys (ISM, PMI) sparked a sharp pullback in equity markets over two sessions before tentative signs of stabilization emerged on Friday. The S&P 500 resisted but industrial sectors took a beating. European indices lost fully 3% last week.

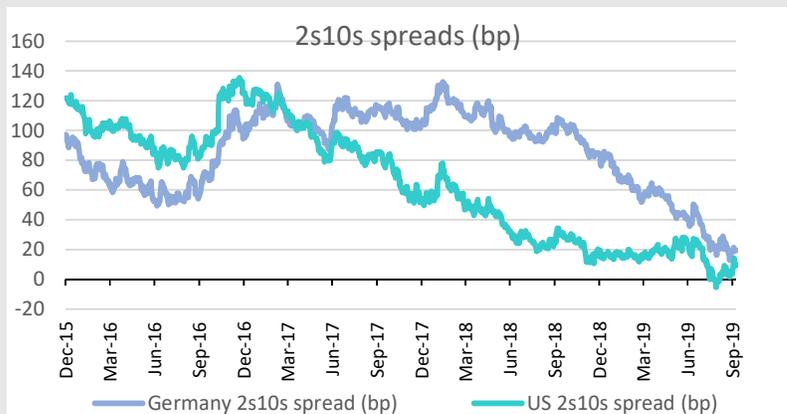
The increase in volatility contributed to yield curve steepening in the US, as markets price in a higher probability of a rate cut this month. T-note yields stand above 1.50% which keeps real yields near zero percent. In the euro area, Bunds yields remain stuck at -0.60% whilst sovereign spreads barely budge.

Gilt yields follow global markets despite ongoing Brexit cacophony.

Investment grade credit is mostly stable in the euro area (spreads up 1bp from a week ago) which is in stark contrast with the widening in high yield (+37bp). Heavy market trading and specific risks have weighed on spreads. Asset swap spreads on BB European names have increased by 15bp to 239bp.

Equity volatility buoyed both the yen (under the 107 threshold against the dollar) and gold. In turn, Brazil's real recovered last week with a 2.5% gain.

### Chart of the week

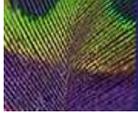


Source : Bloomberg, Ostrum AM

Term premiums have been low across bond markets. The 2s10s spread is currently 19bp in the euro area and near 10bp in the US.

Successive QE programs have pushed long-term yields lower. The announced resumption of QE in the euro area is one of the reasons for recent curve flattening.

In the US, the Fed seems more willing to cut rates, which could result in curve steepening in the months ahead.



## Surveys point to downturn

US activity surveys and, actually most global indicators, continue to point to weaker growth ahead. ISM manufacturing stood at 47.8 in September due to widespread weakness in its new orders (especially export orders), output and employment components. The service survey (52.6) also suggested moderation in growth in the months to come. The US economy will nevertheless record GDP growth in line with potential in the three months to September. GDP likely expanded at a 2% annualized clip in the third quarter. Household consumption remains the main demand driver. Corporate investment expenditure, except for R&D, appears lacklustre. Conversely, residential construction is showing signs of life in response to lower interest rates and low levels of home inventories. Employment continues to increase at a pace close to population growth, indeed +156k on average in 3q19. Unemployment rate reached 3.5% in September which could overstate US labour market strength given the dubious 390k net job increase in the household survey. In any case, the US economy is operating slightly above potential and a slowdown seems inevitable. Car sales above the 17mn mark at annual rate in September still suggest credit conditions remain very accommodative for the consumer. The willingness to prolong the cycle at any cost carries risks to financial stability, which the Fed chooses to ignore. Jerome Powell's latest speech is yet another sign that the Fed is under market pressure. The minutes of the September FOMC should shed light on monetary policy prospects in the months ahead. The Fed will have to tackle repo market tensions and likely deliver rate cuts priced in bond and equity prices or face a financial market correction. Bad news were treated as such last week before easing expectations stabilised markets. And the Fed does very little to restore the exogenous nature of monetary policymaking.

## Fed heading for an October cut?

Bond markets logically reassessed the likelihood of a Fed Funds rate cut later this month. This has swiftly translated into a steeper yield curve whilst reinforcing the bullish bond consensus. Leveraged funds have also bought back short Treasury positions. The 2s10s spread increased by 9bp last week. Swap spreads widened as Fed maintained its grip on repo markets. These elements lead us to maintain a constructive stance on US Treasuries, in particular at the short end of the curve. A new permanent repo facility would only enhance demand for short-term Treasury paper.

In the euro area, economic surveys and stable inflation about 1% argue for low bond yields. The account of the

September ECB meeting should unveil disagreements within the governing council ahead of new asset purchases in November. The program would require increases in holding limits which are opposed by many policymakers including Germany. Bund yields hit a floor at -0.60%. The 2s10s spread has little room to decline further. The trend for narrower swap spreads appears to be waning. France is trading about 30bp over 10-year Bunds, in line with German agencies. Peripheral spreads barely budged with Italian BTPs hovering about 140bp. Iberian bonds trade just over 70bp. Italy will make a comeback in USD bond markets with a multi-tranche deal. The Italian Treasury aims at expanding its international investor base again, which has declined to a mere 30% of total debt outstanding. Portugal was upgraded to BBBH by DBRS, which only reinforces our bullish stance. The socialist-led minority government will likely stay in power after last weekend's elections.

## Sharp widening in European high yield

Credit markets show slight underperformance. Investment grade spreads continue to adjust (+1bp last week) before the start of an uncertain earnings season. High yield turned out to be much more volatile. The average spread over Bunds increased by 37bp over five market sessions to over 400bp. Synthetic high yield market indices (e.g. iTraxx XO) widened by 20bp to 254bp. The main question at this juncture appears to be whether spreads represent a large enough risk premium in case of a cyclical downturn. Besides identified specific credit stories, the market appears now less supported by institutional money flows. In turn, equity volatility may have spurred outflows from the high yield asset class.

European equity indices plummeted on Wednesday-Thursday in response to incoming US data. The weekly drop in markets reached 3%. Sectoral trends are similar to that of credit markets. Cyclical industrials have lost ground. Energy stocks lost 5% in the wake of the continued pullback in crude prices. European banks and the materials sector took a pronounced nosedive. Telecommunications and real estate companies resisted in part due to lower interest rates. Final investor flows remain quite scarce in European equity markets. The earnings season will likely be lacklustre, which does limit potential upside.

Lastly, new expectations of Fed rate cuts later this month have contributed to stem upward pressure on the US dollar. The euro, is trading closer to \$1.10 but, in G10 FX space, the Japanese yen is the main outperformer vs. the greenback.

## Main Market Indicators

<b>G4 Government Bonds</b>	<b>07-Oct-19</b>	<b>-1w k (bp)</b>	<b>-1m (bp)</b>	<b>Ytd (bp)</b>
EUR Bunds 2y	-0.77 %	-1	+10	-16
EUR Bunds 10y	-0.58%	0	+6	-82
<b>EUR Bunds 2s10s</b>	<b>20 bp</b>	<b>+0</b>	<b>-3</b>	<b>-65</b>
USD Treasuries 2y	1.45 %	-17	-9	-104
USD Treasuries 10y	1.54 %	-12	-2	-114
<b>USD Treasuries 2s10s</b>	<b>9 bp</b>	<b>+5</b>	<b>+7</b>	<b>-10</b>
GBP Gilt 10y	0.45 %	-4	-6	-83
JPY JGB 10y	-0.22 %	-1	+2	-23
<b>€ Sovereign Spreads (10y)</b>	<b>07-Oct-19</b>	<b>-1w k (bp)</b>	<b>-1m (bp)</b>	<b>Ytd (bp)</b>
France	30 bp	+0	+0	-17
Italy	143 bp	+3	-9	-107
Spain	71 bp	0	-10	-46
<b>Inflation Break-evens (10y)</b>	<b>07-Oct-19</b>	<b>-1w k (bp)</b>	<b>-1m (bp)</b>	<b>Ytd (bp)</b>
EUR OATi	66 bp	-3	-7	-
USD TIPS	151 bp	-1	-4	-20
GBP Gilt Index-Linked	339 bp	-2	0	+22
<b>EUR Credit Indices</b>	<b>07-Oct-19</b>	<b>-1w k (bp)</b>	<b>-1m (bp)</b>	<b>Ytd (bp)</b>
EUR Corporate Credit OAS	113 bp	+1	+2	-39
EUR Agencies OAS	49 bp	+1	-1	-11
EUR Securitized - Covered OAS	43 bp	0	-3	-20
EUR Pan-European High Yield OAS	404 bp	+37	+43	-109
<b>EUR/USD CDS Indices 5y</b>	<b>07-Oct-19</b>	<b>-1w k (bp)</b>	<b>-1m (bp)</b>	<b>Ytd (bp)</b>
iTraxx IG	58 bp	+3	+10	-30
iTraxx Crossover	252 bp	+21	+13	-101
CDX IG	61 bp	+0	+9	-27
CDX High Yield	359 bp	+8	+32	-91
<b>Emerging Markets</b>	<b>07-Oct-19</b>	<b>-1w k (bp)</b>	<b>-1m (bp)</b>	<b>Ytd (bp)</b>
JPM EMBI Global Div. Spread	350 bp	+1	+4	-65
<b>Currencies</b>	<b>07-Oct-19</b>	<b>-1w k (%)</b>	<b>-1m (%)</b>	<b>Ytd (%)</b>
EUR/USD	\$1.098	+0.4	-0.71	-4.1
GBP/USD	\$1.232	-0.02	-0.26	-3.37
USD/JPY	¥107.14	+0.51	-0.08	+2.35
<b>Commodity Futures</b>	<b>07-Oct-19</b>	<b>-1w k (\$)</b>	<b>-1m (\$)</b>	<b>Ytd (\$)</b>
Crude Brent	\$59.1	-\$0.1	-\$1.4	\$4.0
Gold	\$1 499.5	\$16.1	-\$3.9	\$217.9
<b>Equity Market Indices</b>	<b>07-Oct-19</b>	<b>-1w k (%)</b>	<b>-1m (%)</b>	<b>Ytd (%)</b>
S&P 500	2 952	-0.83	-0.90	17.76
EuroStoxx 50	3 471	-2.75	-0.69	15.65
CAC 40	5 522	-2.75	-1.47	16.72
Nikkei 225	21 375	-1.75	0.83	6.80
Shanghai Composite	2 905	-2.41	0.66	16.49
VIX - Implied Volatility Index	17.12	5.42	14.13	-32.65

Source: Bloomberg, Ostrum Asset Management

## Writing



**AXEL BOTTE**  
STRATEGIST  
axel.botte@ostrum.com

## Legal information

This document is intended for professional clients in accordance with MIFID. It may not be used for any purpose other than that for which it was conceived and may not be copied, distributed or communicated to third parties, in part or in whole, without the prior written authorization of Ostrum Asset Management.

None of the information contained in this document should be interpreted as having any contractual value. This document is produced purely for the purposes of providing indicative information. This document consists of a presentation created and prepared by Ostrum Asset Management based on sources it considers to be reliable. Ostrum Asset Management reserves the right to modify the information presented in this document at any time without notice, and in particular anything relating to the description of the investment process, which under no circumstances constitutes a commitment from Ostrum Asset Management.

Ostrum Asset Management will not be held responsible for any decision taken or not taken on the basis of the information contained in this document, nor in the use that a third party might make of the information.

Figures mentioned refer to previous years. Past performance does not guarantee future results. Any reference to a ranking, a rating or an award provides no guarantee for future performance and is not constant over time. Reference to a ranking and/or an award does not indicate the future performance of the UCITS/AIF or the fund manager.

Under Ostrum Asset Management's social responsibility policy, and in accordance with the treaties signed by the French government, the funds directly managed by Ostrum Asset Management do not invest in any company that manufactures, sells or stocks anti-personnel mines and cluster bombs.

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 and France): 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. 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, Netherlands (Registration number 50774670). Registered office: Stadsplateau 7, 3521AZ Utrecht, the Netherlands. Sweden: Natixis Investment Managers, Nordics Filial (Registration number: 516405-9501 - Swedish Companies Registration Office). Registered office: Kungsgatan 48 5tr, Stockholm 111 35, Sweden. Spain: Natixis Investment Managers, Sucursal en España, Serrano nº90, 8th Floor, 28006, Madrid, Spain.

In France: Provided by Natixis Investment Managers International – a portfolio management company authorized by the Autorité des Marchés Financiers (French Financial Markets Authority - AMF) under no. GP 90-009, and a public limited company (société anonyme) registered in the Paris Trade and Companies Register under no. 329 450 738. Registered office: 43 avenue Pierre Mendès France, 75013 Paris. In Switzerland: Provided for information purposes only by Natixis Investment Managers, Switzerland SArl, 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 or Market Counterparties as defined by the DFSA. No other person should act upon this material. 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: 34F., No. 68, Sec. 5, Zhongxiao East Road, Xinyi Dist., Taipei City 11065, Taiwan (R.O.C.), license number 2018 FSC SICE No. 024, Tel. +886 2 8789 2788.

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: 5 Shenton Way, #22-05 UIC Building, Singapore 068806.

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](http://www.ostrum.com)

Ostrum Asset Management

Asset management company regulated by AMF under n° GP-18000014 – Limited company with a share capital of 27 772 359 euros

Trade register n°525 192 753 Paris – VAT: FR 93 525 192 753 – Registered Office: 43, avenue Pierre Mendès-France, 75013 Paris – [www.ostrum.com](http://www.ostrum.com)

Tél. : 01 58 19 09 80