

STRATEGY WEEKLY

Document intended for professional clients

24 June 2019 /// n°21-2019

Fed: losing patience

Key Points

- Fed statement hinting at rate cut in near future
- Market equilibrium crucially depends on cut being delivered
- Treasuries: steepening and wider inflation breakevens to come
- Lower dollar benefits risk assets

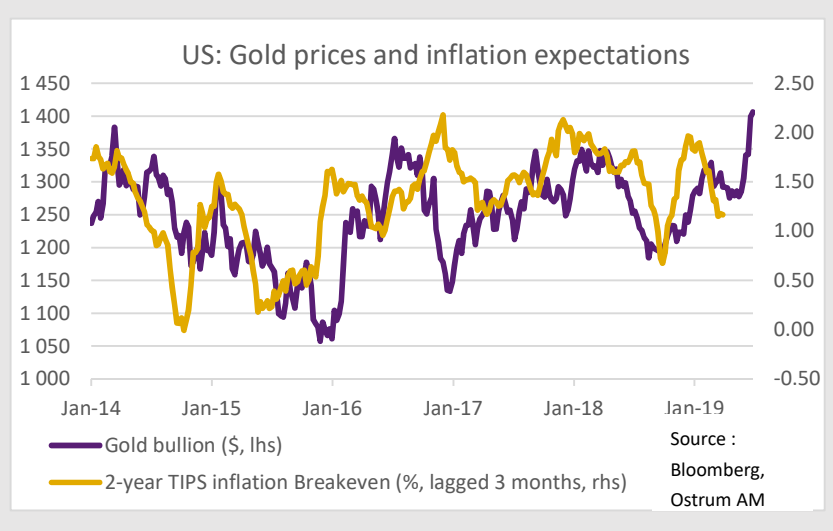
The Fed's statement only confirmed market expectations. Easing is coming, which keeps the yield curve steep (+6bp last week on 2s10s). The outlook for lower rates is a boon for risky assets. The S&P 500 gauge and European markets both gained 2% last week whilst Shanghai went up 4%.

Crypto currencies had a great run. So did gold as prices rose 5% helping breakeven inflation rates higher. Gulf tensions have also resulted in higher oil prices.

In Europe, Mario Draghi's speech sparked a sharp market reaction pushing 10-year Bund yields below -0.30%. Most sovereign spreads declined. Credit benefitted from reach-for-yield flows following tightening in synthetic credit spreads.

The dollar was weaker against both developed market currencies and emerging currencies. For example, the euro-dollar exchange rate is now quite close to the \$1.14 mark.

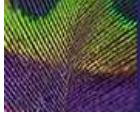
Chart of the week



According to FOMC participants, more accommodative policy is required in response to lower inflation expectations.

The dollar decline due to lower rate expectations ignited a rise in gold prices, which generally signals fear of purchasing power loss.

If historical correlation holds, breakeven inflation rates should creep higher towards levels consistent with the Fed's target.



Fed: losing patience

The Fed described growth as moderate. Activity is underpinned by strong consumer spending although business fixed investment appear less robust. Available data suggest growth of around 2% at annualized rate in the second quarter. Inflation is below target and the market-based measures of inflation expectations have turned down in the last few weeks. The currently benign economic situation justifies no US monetary adjustment.

Yet changes in the wording of central bank communiqués usually have consequences. The Fed depicts a situation of increased uncertainty. Renewed tensions between China and the United States and the Iranian situation foster a deleterious international backdrop ahead of the G20 in Japan. The word 'patience' was indeed removed from the statement, which has fanned expectations of a July cut. The Fed has a window to lower interest rates before inflation rises again towards the end of the year. A one-and-done scenario of a 50bp cut in July appears most likely. However, the FOMC is divided into two camps: eight policymakers are in favour of status quo; seven prefer to lower rates by 50bp in total this year. Richard Clarida and other recently-appointed governors (Randy Quarles, Michelle Bowman) might have been able to convince Jerome Powell to change the course of interest rates in a matter of just six months. For operational reasons, a rate cut would be in line with the previously announced end of quantitative tightening next September.

The rally is conditional to Fed action

The rate cut expected by market participants is crucial to maintain current financial market equilibrium. The Fed put itself in a situation where status quo on rates may spark resumption of selling. The rhetorical change validated the S&P rise to new highs. High beta technology stocks and industrials outperformed whilst the energy sector was boosted by higher oil prices. Financials did less well in part due to the fall in rates. US small caps continue to underperform their large-cap counterparts. The equity positioning of asset allocators is however not excessive but continued equity fund outflows do raise the question of the sustainability of the rally.

In US bond markets, bullish consensus may hint at the risk of correction but leveraged players appear to hold on to sizeable short positions, which in turn could spell buybacks. A neutral stance is warranted on duration in US Treasuries. The yield curve is steepening, as promised easing keeps 2-year yields lower than 10-year yields (2.03%) The 5s30s spread is most attractive

to gain steepening exposure. The spread widened from 25bp in late September to 77bp currently. The steepening trend may continue as inflation expectations creep higher. In parallel, current 30-year bond valuations could be under more scrutiny if the Fed does reassess the duration profile of its portfolio over the coming year.

US inflation-linked bonds are also well positioned to benefit from the dollar decline. Short-term inflation breakeven rates are at extremely low levels considering inertia in price gauges. Core CPI inflation is indeed steady about 2%y. US credit and emerging market bonds also enjoy lower US rates and dollar depreciation. Leaving Turkey aside, volatility in investable emerging bonds is quite limited. Carry trades are hence fostered. Peru's tender offer on its USD debt is another favourable signal for the asset class.

ECB: 'Whatever...'

In the euro area, Mario Draghi appears willing to tie his successor's hands by waiving the risk of further cuts and possible resumption of net asset purchases. The interest rate scheme of TLTRO-III depends on deposit rates. The ECB likely judged that signalling the possibility of cuts could contribute to raise loan take-up at the September loan deal. One can, easily imagine that the ECB stands ready to expand net asset purchases to include unsecured bank bonds. The reduction in TLTRO-III maturity to just 2 years aims at incentivizing banks to increase market borrowing.

Sovereign bond yields have made now all-time lows. German Bunds are trading under the -0.30% mark in a bond market fled by institutional investors. Reach-for-yield keeps yield curves flat. OAT yields now oscillate about 0% on 10-year maturities, which discourages even Japanese investors. Iberian Bonos continue to attract large demand. In this context, positive-yielding BTP could appear as an anomaly if only the fiscal backdrop was not as dire. The EU may launch an excessive deficit procedure against Italy in early July.

European corporate bonds represent the alternative to ever lower sovereign bond yields all the more so even long-term sovereign bond spreads have now shrunk considerably. Credit fund inflows have resumed and pushed spreads tighter. The average spread on European investment grade corporate bonds stands at 112bp against German government debt. Market yields indeed tightened fully 10bp last week. High yield recorded even more significant spread tightening with a 50bp decline. The yield gap between high yield corporate bonds and German Bunds is now just 333bp.

Main Market Indicators

G4 Government Bonds	24-Jun-19	-1w k (bp)	-1m (bp)	Ytd (bp)
EUR Bunds 2y	-0.74 %	-5	-11	-13
EUR Bunds 10y	-0.31%	-6	-19	-55
EUR Bunds 2s10s	44 bp	-1	-8	-42
USD Treasuries 2y	1.73 %	-14	-44	-76
USD Treasuries 10y	2.02 %	-7	-30	-66
USD Treasuries 2s10s	29 bp	+7	+14	+9
GBP Gilt 10y	0.82 %	-3	-14	-46
JPY JGB 10y	-0.15 %	-3	-8	-16
€ Sovereign Spreads (10y)	24-Jun-19	-1w k (bp)	-1m (bp)	Ytd (bp)
France	33 bp	-2	-7	-14
Italy	246 bp	-8	-21	-4
Spain	72 bp	-5	-23	-46
Inflation Break-evens (10y)	24-Jun-19	-1w k (bp)	-1m (bp)	Ytd (bp)
EUR OATi	80 bp	+14	-8	#VALEUR!
USD TIPS	171 bp	+9	-6	0
GBP Gilt Index-Linked	334 bp	-4	+1	+16
EUR Credit Indices	24-Jun-19	-1w k (bp)	-1m (bp)	Ytd (bp)
EUR Corporate Credit OAS	112 bp	-10	-7	-40
EUR Agencies OAS	51 bp	-2	-3	-9
EUR Securitized - Covered OAS	49 bp	+1	+0	-14
EUR Pan-European High Yield OAS	333 bp	-50	-53	-180
EUR/USD CDS Indices 5y	24-Jun-19	-1w k (bp)	-1m (bp)	Ytd (bp)
iTraxx IG	54 bp	-7	-14	-34
iTraxx Crossover	257 bp	-18	-38	-97
CDX IG	56 bp	-5	-9	-32
CDX High Yield	325 bp	-31	-40	-126
Emerging Markets	24-Jun-19	-1w k (bp)	-1m (bp)	Ytd (bp)
JPM EMBI Global Div. Spread	342 bp	-19	-11	-73
Currencies	24-Jun-19	-1w k (%)	-1m (%)	Ytd (%)
EUR/USD	\$1.139	+1.46	+1.67	-0.54
GBP/USD	\$1.273	+1.38	+0.13	-0.12
USD/JPY	¥107.37	+1.12	+1.81	+2.13
Commodity Futures	24-Jun-19	-1w k (\$)	-1m (\$)	Ytd (\$)
Crude Brent	\$64.3	\$3.4	-\$3.2	\$9.4
Gold	\$1 414.9	\$75.1	\$129.9	\$133.3
Equity Market Indices	24-Jun-19	-1w k (%)	-1m (%)	Ytd (%)
S&P 500	2 952	2.17	4.47	17.77
EuroStoxx 50	3 456	2.14	3.13	15.13
CAC 40	5 522	2.43	3.86	16.72
Nikkei 225	21 286	0.77	0.80	6.35
Shanghai Composite	3 008	4.17	5.44	20.62
VIX - Implied Volatility Index	15.37	0.13	-3.03	-39.54

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 Carree, 7. Floor, Frankfurt am Main 60322, Germany. Netherlands: Natixis Investment Managers, Nederlands (Registration number 50774670). Registered office: Stadsplateau 7, 3521AZ Utrecht, the Netherlands. Sweden: Natixis Investment Managers, Nordics Filial (Registration number: 616405-9601 - 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 Zurich.

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

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

Tél. : 01 58 19 09 80