

## What's going on and what about 2019?

Since October, equity markets have been in a tailspin. While until the end of September we were on buy on dips mode, all of a sudden everything changed to a sell on a rally mode. But what has really changed? What was the trigger that made these markets all of a sudden volatile and so unpredictable?

While we were on the “a correction might come but not a major sell-off” camp, our comments might be taken with a bit of salt. This crisis reminds pretty much the one we had in 2015, when China started to devalue his currency. At the time, the US equity markets sold off 10% on average, US high-yield corporate yields soared from 6.5% to over 10% and the 10-Year US Government bonds yields went from 2.5% to 1.5% in just six months.

This time around, the S&P500 has already declined 14% from its peak and the NASDAQ more than 18%. High-yield corporate yields on the other side went from 6% to 8% and the 10-Year US Government bonds yields from 3.25% to 2.8%. We like to look at high-yield bonds (and their relation to Government bonds) as they are among the best indicators of a possible credit-crunch or more bluntly stated a liquidity crisis.

As of today, the bond market, which historically has shown to be the most reliable, is not signaling as much stress as equities do. So where's the problem then?

Markets accept everything except one thing...changing rules and unpredictability! We believe that the key trigger for the sell-off in equities was the implementation of American tariffs on Chinese goods which occurred during the summer. The 2<sup>nd</sup> trigger (which definitely killed the bulls camp) was the continued rise of US interest rates and the overshoot of the 3% level in the 10-Year US Government bonds. All of a sudden, the markets did realize that with a faltering Chinese economy, a European continent showing renewed signs of weakness, the US would have been left alone in the global growth picture. And with the latest FED statement the markets capitulated by acknowledging that it was simply impossible for the US to keep up with growth in 2019.

We believe that the ongoing discussions on trade between the Chinese and the US are by far the most important catalyst for global growth. It is not in anyone interest to see such discussions faltering for too long or, even worse, to cease. Mr. Trump might still have some leverage with the Chinese but the longer discussions last the less the leverage he will have. If both parties are intelligent enough to reach an agreement, the markets in 2019 might look completely different from 2018 and we would for sure at next year's Christmas season remember how big the opportunity was to buy on the cheap side.

While it will take time to restore confidence in the market, with a Chinese economy which is in stimulus mode, a less risky European continent (Italy de-facto accepted European guidelines on budget) and the US which would not be the only engine of growth for global growth, the markets might completely reverse.

We believe that the FED is in waiting mode as it closely monitors the geopolitical landscape. In the case the US and Chinese come down to an agreement, everybody would applaud the FED for its latest decision as it would be obliged to closely monitor an economy which could overheat thanks to renewed

global growth. On the other side, if no agreement is reached between the Chinese and the US, it would have room to cut rates and enact monetary stimulus while Europe would have zero chance.

The conclusion in our view is rather straightforward: if investors believe that a trade agreement is reached between the Chinese and the US, they should buy equities and overweight Chinese ones (that is currently our strategy), buy US dollars as the US economy would likely be the strongest one in a global resynchronized growth with a FED continuing on its path of rate increases. On the opposite side, if investors believe that no trade agreement is reached, the best strategy might simply be being cash as there won't be any possible safe haven in the markets.

May this festive season bring the most joy to all of you and to the politicians around the world who are to decide the shape of the world of tomorrow.