Amundi
ASSET MANAGEMENT

Cross asset investment strategy

Research,Strategy and Analysis

WEEKLY

Letter finalised at 3pm Paris time **November 23 - 27, 2015**

Highlights of the week

- **United States:** Q3 economic growth figures revised upward at an annualised pace of 2.1%.
- **Eurozone:** More and more favorable signs (PMI Composite, Economic Sentiment, private sector bank lending). A Portuguese government formed with the support of the far left.
- **Markets:** Sovereign bond market expectations for more Eurozone QE have been mounting. Stabilization of EUR/USD parity and credit spreads. Same for equity markets, waiting for the Fed's move.

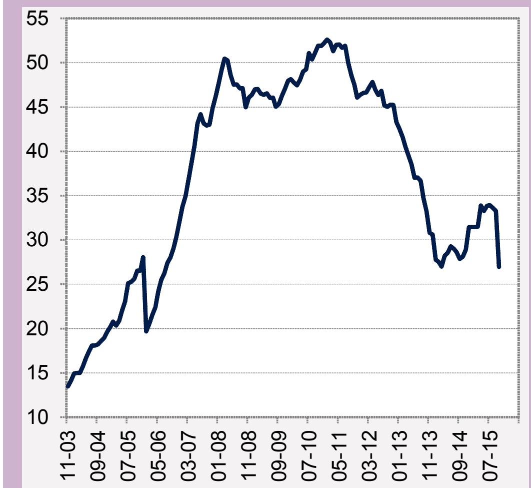
Key focus

The Argentinian presidential elections: the times, are they a-changin'?

On Sunday, 22 November 2015, the centre-right opposition candidate, Mauricio Macri, was elected president of Argentina with 51.4% of the vote during the second round of voting, winning out against his centre-left rival, Peronist Daniel Scioli, who was endorsed by outgoing president Cristina Fernandez. The new president, who until then served as mayor of the capital Buenos Aires, will take office on 10 December for a four-year term. During a press conference following his victory, Mauricio Macri said: **"This is the beginning of a new era that has to carry us toward the opportunities we need to grow and progress."**

From a political standpoint, even though the reform programme has not yet been established, the newly-elected **president has condemned corruption in political circles, the opacity of government and the central bank's lack of independence.** Regarding this last point, Mauricio Macri went directly after the president of the central bank, Alejandro Vanoli, by letting Vanoli know that he wanted him to resign so the new government can appoint a team they can fully trust. He also aims to **end the stalemate between Argentina and its creditors,** especially the "vulture funds", which twice rejected (in 2005 and 2010) sovereign debt restructuring plans. **As for foreign politics,** he intends to reposition the country in its natural diplomatic space: **prioritising Brazil, its leading trade partner, Europe and the United States over Mercosur,** from which he has demanded the temporary expulsion of Venezuela due to the persecution of President Nicolas Maduro's political opponents.

Foreign exchange reserves ($bn)



Source: Datastream, Amundi Research

With regard to the economy, Argentina has posted a **significant budget deficit** (2.4% of GDP in 2014 and an estimated 4% of GDP in 2015), which Cristina Fernandez financed by printing money, pushing up **continued high inflation** (an average of approximately 16% YoY in 2015). **Foreign currency reserves are at their lowest in more than nine years** (see chart) and the country is experiencing difficulties to finance itself on bond markets because **it defaulted on its debt last year.** Mauricio Macri has promised broad economic and financial reforms, starting with **lifting capital controls** imposed by his predecessor, which according to him **"was a mistake".** He also wants to roll back some taxes that are weighing down the country's agricultural exports (corn, wheat, soybeans). Furthermore, **the election of business-friendly Mauricio Macri has been well-received by the markets.** Indeed, between the first round of the presidential election on 25 October and the second round one month later, **the bellwether index for Argentinian equity**, the Merval index, **rose by more than 25%.**

At the moment, **Mauricio Macri does not have control over the Chamber of Deputies or the Senate.** He will therefore have to put together a broad coalition to carry out all the necessary reforms in Argentina. However, he has warned that "we cannot solve all the problems that this government is leaving behind on the first day". There is still room for hope.

The week at a glance

> Other events

Portugal > **A government formed with the support of the far left.** After a month-and-a-half stalemate, the Portuguese president asked the head of the Socialist party (moderate left), Mr Antonio Costa, to form a minority government with parliamentary support from far left parties. The president had previously made the Socialists promise formally to comply with Portugal's commitments to European institutions, particularly as regards fiscal discipline, and to maintain financial stability.

While this is the start of a resolution to the political stalemate, the government will remain on shaky footing, as it will need support from the far left, which rejects the austerity policies and reforms requested by the European institutions. There is considerable risk of a new local political crisis, but we would rule out the possibility of a major, Greek-style confrontation with the rest of the eurozone, as the Portuguese far left will not be participating directly in the government.

> Economic indicators

United States > **Q3 economic growth figures revised upward. A mixed start to Q4.** According to a second estimate, GDP rose at an annualised pace of 2.1% in Q3 (vs. +1.5% previously reported). Most of the revision was due to a greater contribution from inventory buildup and investment. Personal consumption expenditure, in contrast, rose a little less than previously reported (+3.0% vs. +3.2), while the contribution of exports, initially reported as zero, was ultimately slightly negative (-0.2 percentage points). As for early Q4, personal consumption disappointed in October (+0.1% vs. +0.3% forecast), while durable goods orders, ex-aviation and ex-defence (used to forecast business investment) were surprisingly strong at +1.3% vs. +0.2% forecast.

The US recovery is still robust and has been driven until recently by consumption, while industry has had a harder time. We forecast a slight deceleration in 2016, as it will be hard to keep growth in consumption as strong as in 2015 (where it has been supported by both the sharp drop in fuel prices and strong job creations).

Eurozone > **More and more favorable signs.** The flash **PMI Composite** rose to 54.4 in November (vs. 53.9 in October and 54 forecast), a more than four-year high. Its Industry and Service components both rose and beat forecasts. The flash German PMI Composite was up sharply, driven by both services and industry, but its French counterpart declined (due to services, while industry was up slightly). Meanwhile, the European Commission's **Economic Sentiment** indicator improved to 106.1 (vs. 105.9 forecast and a revised October figure of 106.1), a high since May 2011. Likewise, **private sector bank lending** expanded by 0.8%, year-on-year, in October (+1.2% in lending to households and +0.6% in lending to companies, based on figures adjusted for securitisation and sales). In Germany, the IFO index also rose, to 109 (vs. 108.2 in October and 108.2 forecast), and the Q3 increase in **German GDP** was confirmed at 0.3%, with a solid positive contribution from consumption and public-sector spending and a negative contribution from investment and international trade. The Q3 increase in **Spanish GDP** was also confirmed at +0.8%, with a positive contribution from consumption, public spending, and investment, but a negative contribution from international trade.

The improvement in economic indicators (PMI, Economic Sentiment and IFO, in addition to the rebound in lending) points clearly to a further recovery and possibly to growth above our 2016 forecast (+1.5% for the euro zone). However, we would rather remain cautious, given the extent of external risks. The decline in the French PMI Composite in November is probably due in part to the Paris terrorist attacks.

> Monetary policy

Brazil > **Status quo on monetary policy in Brazil.** As expected, the BCB left its rates unchanged despite double-digit inflation.

The BCB's decision was no surprise as such. However, the fact that it was not a unanimous decision was unexpected. Two COPOM members actually spoke out in favour of a 50bp hike. This is even more surprising given that the BCB communiqué was reworded from the previous version, with no further mention of a "convergence in inflation" towards the target. Inflation risks are indeed increasing, but given the current key rate level (14.25%) and the magnitude of the current recession (greater than 3%), a further tightening in monetary policy seems unappropriated to our point of view, unless the objective is to ease fears of slippage in inflation.

Turkey > **The CBRT kept its main rates unchanged** at 7.5% for the repo, 10.75% for the lending rate, and 7.25% for the borrowing rate.

With inflation at 7.8%, well above the official 5% target, the CBRT is being relatively accommodating. We don't see how it can keep its rates on hold for an extended period of time, given that pass-through effects from the currency depreciation are additional upside inflation risks.

Financial markets

Fixed-income

Ahead of the ECB meeting next week, market expectations for more QE have been mounting. Over the last few days, yields have continued to fall and, as we are writing, the average yield of the eurozone government bonds universe's three- to five-year segment (therefore including both core and peripheral sovereign bonds) fell for the first time ever into negative territory. The two-year Bund is now trading below -40 b.p. yield to maturity, while the five-year Bund yield to maturity fell close to -20 b.p.: both fell by -15/-20 b.p. from levels recorded before the last ECB meeting.

Peripheral sovereign bonds have rapidly "joined the club" of negative yields over recent weeks following October's ECB meeting. As we are writing, around 16% of overall peripheral sovereign debt is now in negative yield territory, while this percentage was close to zero just five weeks ago, on 21 October. The dramatic fall of short- to medium-term core and peripheral yields confirms that markets are implying quite a strong combination of measures by the ECB on rates and its purchase programme.

Foreign exchange

The EUR/USD has been more stable in recent days, after the big move of the previous week. This was also in line with the recent trend in oil prices which tended to stabilise over the week.

December may be the month of actual implementation of monetary policy divergence between the two sides of the Atlantic. The ECB is expected to increase the pace of QE next week, while the probability of a Fed hike later in the month, implied in futures on fed funds, has increased to even higher levels and stands precisely at 74%. The USD/EUR has already discounted most of this news but further, though more limited space for a stronger USD vs EUR is still there.

Credit

Spreads stabilised and even narrowed on cash markets. The US HY market got a boost from the slight rise in Brent. Primary markets should remain busy until the traditional yearend break.

Most US and European companies have already reported their earnings. In the US, the gap widened between oil-related and consumption sectors. The energy and basic materials sectors were big disappointments: company balance sheets were weakened further by sharp drops in revenues and earnings, sustained expansion in debt, and a worsening in coverage ratios and financial leverage. In contrast, the financial leverage of consumer companies actually improved slightly, driven by earnings growth. US companies' debt nonetheless remains at cycle-peak levels, in contrast to their European peers. Financial leverage of euro issuers on the whole declined in Q3, after worsening slightly in the first half.

Equity

Waiting for the Fed. After its undeniable rebound last week (+3% from 13 to 20 November), the MSCI World AC made very little progress this week (+0.2%). This wait-and-see approach is primarily because the New York stock exchange (0.0%), which was closed for Thanksgiving on Thursday and part of Friday, is waiting for the Fed meeting on 15 and 16 December. In all likelihood, that is when the Fed will announce its first interest-rate hike since June 2004. As for Europe, its recovery continued (+1% after 3.1% the previous week): the markets are still boosted by the expectation of further easing on the part of the ECB on 3 December. With regard to business sectors, mining stocks stood out (+2.5%) following various rumours from China regarding the authorities' determination to prop up the sector.

Even though it has long been expected, the dichotomy between monetary policies on both sides of the Atlantic is strengthening our preference for Eurozone equity. Despite the restrained nature of the recovery, a competitive euro, the price of oil and low interest rates are likely to boost corporate earnings in Europe. In terms of business sectors, basic materials is one of the worst-performing sectors for the last three years (-40% since July 2012). In such a context, the slightest rumour can cause a reaction. However, aside from symbolic measures (investigations into possible malfeasance, etc.), the real imbalances will not be corrected until overcapacity has been reduced. This will be a long process.

Key upcoming events

Economic indicators

United States : The job report for November should be good, as the manufacturing ISM. **Eurozone :** The November inflation is expected to increase slightly. **Emerging Asia:** The Indian Q3 real GDP growth is expected at +7.3% YoY. The Chinese manufacturing PMI should still be in the contracting zone in November. **Brazil:** The Q3 real GDP growth is expected at -1.2% QoQ.

Date	Country	Upcoming macroeconomic data	Consensus	Prior
30 november	India	GDP, YoY, Q3	7.3%	7.0%
1 December	China	Manufacturing PMI, November	49.9	49.8
	China	Services PMI, November		53.1
24 November	UK	Manufacturing PMI, November	53.8	55.5
	Eurozone	Unemployment rate, October	10.8%	10.8%
	Brazil	GDP, QoQ, Q3	-1.2%	-1.9%
	US	Manufacturing ISM, November	50.5	50.1
2 December	Eurozone	CPI, YoY, November	0.2%	0.1%
3 December	Eurozone	Michigan consumer sentiment, November	0.2%	-0.1%
	US	Non manufacturing ISM, November	58.0	59.1
4 December	US	Change in nonfarm payrolls, November	200 K	271 K

Source: Bloomberg, Amundi Strategy

Auctions

Date	Country	Auctions of European sovereign debt [maturity, amount (if available)]
30 November	France	Short-term, € 7.5 Bn
1 December	ESM	Short-term, € 1.5 Bn
3 December	Spain	Long-term, amounts not available on Friday
	France	Long-term, amounts not available on Friday

Source: Bloomberg, Amundi Strategy

Key events

Worth watching: the ECB's monetary policy committee. Further easing measures could be pronounced (new reduction in deposit rate, extension of QE in terms of both time and amounts).

Date	Upcoming monetary policy committee meetings
3 December	European Central Bank (ECB)
10 December	Bank of England (BoE)
16 December	Federal Reserve (Fed)
17 December	Bank of Japan (BoJ)
27 January	Federal Reserve (Fed)

Date	Upcoming political events
December 2015	General election in Spain
May 2016	G8 Shima (Japan) summit
November 2016	Presidential elections in the United States

Source: Amundi Strategy

Market snapshot

Equity markets	27/11/2015	Over 1 week	Over 1 month	Ytd
S&P 500	2089	0.0%	1.1%	1.5%
Eurostoxx 50	3497	1.3%	3.4%	11.1%
CAC 40	4943	0.7%	2.0%	15.7%
Dax 30	11287	1.5%	5.6%	15.1%
Nikkei 225	19884	0.0%	5.9%	13.9%
MSCI Emerging Markets (close -1D)	838	-0.6%	-2.9%	-12.4%
Commodities - Volatility	**27/11/2015**	**Over 1 week**	**Over 1 month**	**Ytd**
Crude Oil (Brent, $/barrel)	44	3.4%	-3.1%	-21.7%
Gold ($/ounce)	1055	-2.2%	-9.6%	-10.8%
VIX	15	-0.3	-0.2	-4.0
FX markets	**27/11/2015**	**Over 1 week**	**Over 1 month**	**Ytd**
EUR/USD	1.06	-0.7%	-4.4%	-12.7%
USD/JPY	123	-0.1%	1.9%	2.5%
EUR/GBP	0.70	0.2%	-2.7%	-9.5%
EUR/CHF	1.09	0.5%	0.0%	-9.4%
Fixed Income markets	**27/11/2015**	**Over 1 week**	**Over 1 month**	**Ytd**
EONIA	-0.14	-1 bp	--	-28 bp
Euribor 3M	-0.11	-2 bp	-5 bp	-19 bp
Libor USD 3M	0.41	+2 bp	+8 bp	+15 bp
2Y yield (Germany)	-0.42	-3 bp	-8 bp	-32 bp
10Y yield (Germany)	0.45	-3 bp	+1 bp	-9 bp
2Y yield (US)	0.92	+1 bp	+30 bp	+26 bp
10Y yield (US)	2.21	-5 bp	+18 bp	+4 bp
Eurozone Sovereigns 10Y spreads vs Germany	**27/11/2015**	**Over 1 week**	**Over 1 month**	**Ytd**
France	+32 bp	-2 bp	-4 bp	+3 bp
Austria	+25 bp	-1 bp	-2 bp	+15 bp
Netherlands	+16 bp	-1 bp	-1 bp	+1 bp
Finland	+25 bp	-1 bp	-2 bp	+13 bp
Belgium	+30 bp	--	-	+1 bp
Ireland	+49 bp	-4 bp	-11 bp	-22 bp
Portugal	+184 bp	-16 bp	-18 bp	-30 bp
Spain	+107 bp	-9 bp	-7 bp	-
Italy	+95 bp	-7 bp	-5 bp	-40 bp
Credit markets	**27/11/2015**	**Over 1 week**	**Over 1 month**	**Ytd**
Itraxx Main	+70 bp	-1 bp	-2 bp	+7 bp
Itraxx Crossover	+293 bp	--	-8 bp	-52 bp
Itraxx Financials Senior	+68 bp	-2 bp	-1 bp	+1 bp

Source: Bloomberg, Amundi Strategy *3:00 pm Paris time*