Amundi
ASSET MANAGEMENT
Cross asset investment strategy
Research,Strategy and Analysis
WEEKLY

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Nov. 28 - Dec. 2, 2016

Highlights of the week

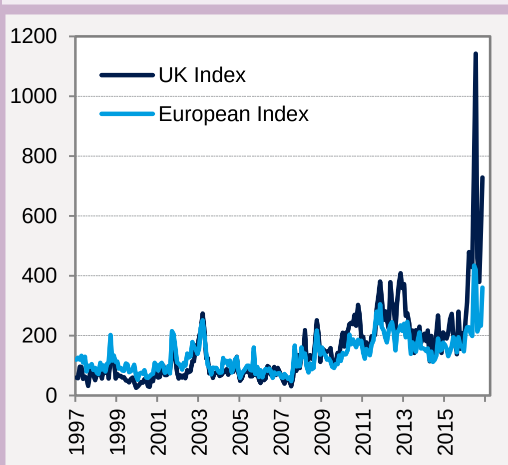
- **Markets :** Long bond yields in developed economies and **"**Commodity" currencies driven up by the OPEC agreement. Euro and dollar credit indices continued to trend in opposite directions. Not much movement among the major equity indices.
- **United States :** Two key appointments for the economy. Q3 y-o-y GDP growth was adjusted upward to +3.2%.
- **Eurozone :** Unemployment beneath the 10% threshold. Banking credit rebound continues.
- **Emerging:** China's November official manufacturing PMI much better than expected. Brazil's q-o-q GDP growth at -0.8% in Q3.

Key focus

Political uncertainty shuffles the deck and ruffles the markets

After the American elections and just before major elections in Europe (referendum in Italy on 4 December, general elections in France and Germany in 2017, then in Italy no later than spring 2018), uncertainty is the keyword (again). And that's not counting the negotiations between the United Kingdom and the EU over Brexit, which promise to be tense; no one knows where they will end up. **Economic policy uncertainty indices offer an instructive measure of the level of uncertainty[1].**

Political uncertainty indices



Source: Economic policy uncertainty website, Amundi Research

Surprisingly, this index has quite plainly fallen back in the United States since the election of Donald Trump[2] (the post-election peak was short-lived). It is probably related to the fact that President Trump and his team have softened the promises of Candidate Trump by setting aside the most controversial measures (building a wall with Mexico, immigration, and protectionism), seeming to focus on what gets the consensus, i.e. tax cuts. That's all it has taken to quash the uncertainty in America.

By contrast, uncertainty in Europe spiked in November. As expected, it remains highest in the UK, despite the publication of solid economic data in the third quarter. **Surprisingly, within the Eurozone, uncertainty climbed highest in France, and even reached an all-time high in November**. The French Republican primaries, and the US elections, have evidently played a role, and a growing number of observers (namely abroad) are taking seriously the possibility that Marine Le Pen will win the presidential elections. **On the flip side, the Italian media don't seem excessively concerned by the result of the referendum:** The uncertainty index scarcely budged in November, and is still far below what it was during the sovereign debt crisis, for instance.

Uncertainty indices are in no way predictive. They simply measure perceived reality at a given moment. However, they do help to take stock, after the fact, of the trends in certain financial variables: the rise in interest rates in the US, the 10Y spread between the US and Germany (which hasn't been this high since the late 1980s), the climbing dollar, the rising sovereign spread between France and Germany (50 bp), and the US equity market's outperformance over its European counterparts (despite being relatively expensive).

Everything is happening as if there were a positive "political risk premium" on Eurozone assets and a negative "political risk premium" on US assets. This configuration is probably not meant to last throughout 2017. Sooner or later, Donald Trump risks reviving his demons (protectionism, immigration). Meanwhile, in France and Germany, the dominant parties' candidates will probably win the elections next year. Nonetheless, it is much too early to be counting on that sort of development.

[1] These indices are compiled from a string of news articles containing certain expressions or keywords (economy/economic, uncertain/uncertainty, legislation, deficit, regulations, etc.). This measurement, which is still rough, retraces past uncertainty shocks that may predict recessions and are also closely correlated with volatility on the equity markets.
[2] There are daily indices in the United States and the United Kingdom. In the Eurozone, though, there are only monthly indices.

The week at a glance

> Other events

United States >

Two key appointments for the economy. The US President-elect has appointed Steven Mnuchin (formerly of Goldman Sachs) as Treasury Secretary. And Wilbur Ross (an expert in restructuring failed companies) has been tapped for Commerce Secretary.

Mnuchin, who supported Donald Trump's campaign (despite the candidate's diatribes against the financial establishment), has already said he would work to make sure the tax cuts promised by the President-elect are refocused on the middle classes rather than the wealthiest. He also confirmed that the corporate income tax rate would be sliced from 35% to 15%. Meanwhile, Ross will be steering industrial policy (more than trade negotiations).

> Economic indicators

Eurozone >

Unemployment beneath the 10% threshold. Banking credit rebound continues. The unemployment rate declined to 9.8% in October, compared to 10% in the previous month and 10.6% in October 2015. Country by country, the jobless rate in October 2016 was 4.1% in Germany, 9.7% in France, 11.6% in Italy, and 19.2% in Spain. Regarding **bank credit**, while volume growth in credit to households stayed at 1.8% yoy in October (unchanged from September), loans to nonfinancial corporations continued to rise, at +2.1% for the year (from +2% in September). In addition, the European Commission's **Economic Sentiment** Index rose slightly in November to 106.5 (compared to 107 expected and after 106.4 in October). Finally, **inflation** continued its rise (+0.6% over one year, compared to +0.5% in September for the general index; +0.8% over one year, compared to +0.7% in September for the core index).

Despite many political uncertainties, employment and credit – the cyclical drivers of the recovery – continue to provide their support. As for inflation, the general index will continue to rise until early spring, due to the base effects linked to oil prices. On the other hand, core inflation is still showing no sign of acceleration.

United States >

Continuing strength of the labour market. The US economy generated 178k new jobs in November (vs. 175k expected and with October nonfarm payrolls revised down to 142k vs 161k previously announced). The unemployment rate declined to 4.6% (it was expected to be unchanged at its October level of 4.9%), its lowest since 2007. Average workweek hours remained unchanged at 34.4. The participation rate declined slightly to 62.7% (vs. 62.8% in October). Average hourly earnings decelerated to +2.5% yoy (vs +2.8% yoy in October).

Growth in Q3 GDP was revised upward to +3.2%. This is a second estimate, the first one having been +2.9 Consumer spending rose 2.8%, non-residential +0.1%, and public spending +0.2%. Conversely, residential investi Foreign trade made a positive contribution (+0.9 pp), as did changes in inventory (+0.5 pp).

Increase in the ISM Manufacturing Index. It was 53.2 in November compared to 51.9 in October and 52.2 expec

US economic data has improved a lot in the second semester, even though the deceleration in wages in November is a small downside surprise. The Fed now has a clear horizon to raise rates at the December FOMC.

China >

China's November official manufacturing PMI came much better than expected at 51.7 (vs. consensus 51 and prior at 51.2), a strong pick up in the expansion territory. China's Caixin October manufacturing PMI, came slightly weaker than expected at 50.9 (vs. consensus 51 and prior at 51.2).

We have been calling for continuous manufacturing PMI stabilization within expansion territory for a few months already. The strong pickup in November official manufacturing PMI is broad based and mainly led by production (53.9 in November vs. 53.3 in October), new orders (53.2 in November vs. 52.8 in October), new export orders (50.3 in November vs. 49.2 in October), and most importantly input prices (68.3 in November vs. 62.6 in October), which gives us confidence in PPI further recovery, which is the foundation of our China bottoming and China stabilization call. We have extended our China stabilization call into end of 2017 given both bottom-up and top-down forces, and we think China stabilization is the key source of global economic stabilization in 2017.

Brazil >

GDP growth stood at -0.8% in Q3 compared to the previous quarter (after correcting for seasonal variations), **consistent with market expectations (compared to -0.4% in Q2). This drop in GDP of -2.9% year-on-year** is essentially due to a decline in private consumption and investment compared to the third quarter of 2015 (contributing -2.3% and -1.6% of it respectively).

In continuity with the trend seen since the year began, private consumption has contributed less to the reduction in GDP than in the previous quarter (year-on-year), and the trade balance has done less to buoy activity. In Q3, the growth carry over is now -3.2% year-on-year, compared with our forecast of -2.5% for 2016.

Financial markets

Fixed-income

Long bond yields in developed economies rose on the OPEC agreement on output cuts (with Brent up 13.6% on the week to $54). The 10-year US yield moved back over 2.40% for the first time in one year and a half. The inflation break-even point is moving upward. Euro zone sovereign spreads narrowed slightly. The 10-year spread between Italy and Germany narrowed by 21bp on the week, to 164bp.

The OPEC agreement pushed long bond yields and inflation expectations up a little further. Yields are likely to continue rising, particularly as the basis of comparison on inflation comes into play and in the run-up to possible Fed tightening on 14 December.

Foreign exchange

"Commodity" currencies were driven up by the OPEC agreement to lower output (with Brent rising 13.6% on the week, to $54). The week's best-performing currencies were the Colombian peso, the Norwegian krone, and the Canadian dollar. The two worst-performing ones were the Turkish lira and the Brazilian real. The USD/JPY parity is back to 114.

Short-term risks are downward on the EUR/USD exchange rate in the run-up to the Italian referendum, which could end up producing greater political uncertainty, the possible extension in the ECB's QE on 8 December, and possible Fed tightening on 14 December.

Credit

Euro and dollar credit indices continued to trend in opposite directions. Euro indices widened very slightly. Peripheral sovereign and corporate bonds, however, fared well, driven by expectations of coming ECB support. US credit indices continued to narrow, driven by solid economic figures and the oil price rally.

We expect the ECB to stick to the same level of accommodation in its monetary policy, given that inflation is still having a hard time gaining ground, and political risks have increased. Keep in mind that monetary policy actions are approaching their limits and that low interest rates are having an increasing negative impact on the European banking systems. We will be keeping a very close eye on the impact of the new measures on banking margins. We continue to overweight financials and BB rated issues within the IG universe. We still prefer dollar corporate bond markets to euro ones. Caution is the byword, however, on lower-rated US HY segments due to heavy debt in an environment of rising interest rates.

Equity

Not much movement among the major equity indices. Since the election of Donald Trump, the hierarchy of indices reveals better performance for Japan (+8%), which is beating even the historically high United States (+3%). Eurozone markets are stable (on average), followed by emerging markets (-1% on the MSCI EM index) over the period. The Italian market has lost -32% since its peak in August 2015, and -25% year-to-date. Thus, it seems that part of the risk related to the referendum is already being priced in.

While equities responded well to Trump's election, despite the rise in long-term rates, the rotation of styles that took place was quite clear: growth or quality stocks, which are rather expensive and sensitive to rate increases, underperformed value stocks by 3% on a global level. This movement will continue as long as long-term rates are on the rise.

Key upcoming events

Economic indicators

Eurozone : Services PMI should remain stable in November. **UK :** Industrial production is expected to grow in October.

Date	Country	Upcoming macroeconomic data	Consensus	Prior
5 December	Italy	Services PMI, November	51.3	51
	Eurozone	Services PMI, November	54.1	54.1
	US	Services PMI, November	54.9	54.7
	UK	Services PMI, November	54.3	54.5
7 December	UK	Industrial production. M/M. October	0.2%	-0.4%
9 December	China	CPI. YoY	2.2%	2.1%

Source : Bloomberg. Amundi Strategy

Auctions

Date	Country	Auctions of European sovereign debt [maturity, amount (if available)]
5 December	France	Short-term, € 3.6 Bn
6 December	ESM	Short-term, € 1.5 Bn
7 December	Spain	Short-term, amounts not available on Friday

Source: Bloomberg, Amundi Strategy

Key events

Date	Upcoming monetary policy committee meetings
8 December 2016	European Central Bank (ECB)
14 December 2016	Federal Reserve (Fed)
15 December 2016	Bank of England (BoE)
20 December 2016	Bank of Japan (BoJ)

Date	Upcoming political events
4 December 2016	Italy - Constitutional - Reform Referendum
4 December 2016	Austria - Second round of presidential election
22 January 2017	France - First round of Socialist primaries
29 January 2017	France - Second round Socialist primaries
15 March 2017	Netherlands - General elections
31 March 2017	UK - Deadline for triggering Article 50 to leave the EU
23 April 2017	France- First round of Presidential election
07 May 2017	France - Second round Presidential election
September 2017	Germany - General Election

Source: Amundi Strategy

Market snapshot

Equity markets	02/12/2016	Over 1 week	Over 1 month	Ytd
S&P 500	2191	-1.0%	4.4%	7.2%
Eurostoxx 50	2997	-1.7%	0.6%	-8.3%
CAC 40	4505	-1.0%	2.0%	-2.8%
Dax 30	10454	-2.3%	0.8%	-2.7%
Nikkei 225	18426	0.2%	7.5%	-3.2%
MSCI Emerging Markets (close -1D)	858	0.3%	-3.6%	8.1%
Commodities - Volatility	**02/12/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
Crude Oil (Brent, $/barrel)	54	13.6%	14.5%	43.9%
Gold ($/ounce)	1173	-0.9%	-9.6%	10.5%
VIX	14	1.9	-5.1	-3.9
FX markets	**02/12/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
EUR/USD	1.07	0.6%	-4.0%	-1.9%
USD/JPY	114	0.6%	10.2%	-5.5%
EUR/GBP	0.84	-0.9%	-6.6%	14.2%
EUR/CHF	1.08	0.1%	-0.5%	-1.1%
Fixed Income markets	**02/12/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
EONIA	-0.34	+1 bp	--	-22 bp
Euribor 3M	-0.31	-	-	-18 bp
Libor USD 3M	0.93	--	+6 bp	+32 bp
2Y yield (Germany)	-0.72	+2 bp	-9 bp	-38 bp
10Y yield (Germany)	0.33	+9 bp	+20 bp	-30 bp
2Y yield (US)	1.13	+1 bp	+31 bp	+8 bp
10Y yield (US)	2.42	+6 bp	+61 bp	+15 bp
Eurozone Sovereigns 10Y spreads vs Germany	**02/12/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
France	+45 bp	-10 bp	+13 bp	+9 bp
Austria	+24 bp	-7 bp	+5 bp	-3 bp
Netherlands	+15 bp	-4 bp	+3 bp	-2 bp
Finland	+16 bp	-6 bp	+1 bp	-13 bp
Belgium	+35 bp	-9 bp	+9 bp	+1 bp
Ireland	+57 bp	-11 bp	+7 bp	+5 bp
Portugal	+338 bp	+2 bp	+27 bp	+150 bp
Spain	+124 bp	-9 bp	+16 bp	+10 bp
Italy	+164 bp	-21 bp	+11 bp	+68 bp
Credit markets	**02/12/2016**	**Over 1 week**	**Over 1 month**	**Ytd**
Itraxx Main	+78 bp	-3 bp	+3 bp	+1 bp
Itraxx Crossover	+336 bp	-4 bp	-2 bp	+22 bp
Itraxx Financials Senior	+106 bp	-3 bp	+5 bp	+29 bp

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