Outlook 2019
Waving goodbye to peak global growth

Monthly Investment Strategy

Research & Investment Strategy

November 2018

2019 Outlook

From end-QE to end-cycle

2018 A year of peak growth

- 2018 looks on course to deliver the fastest global expansion in 7- years. US GDP growth reached a 12-year high, China looks set to beat its target growth rate at 6.6%, emerging markets expanded in line with last year's rate and although Eurozone growth slowed, at 1.9% it remains above potential
- Global central banks tightened monetary policy: the Fed in each quarter; the BoE and several EM banks also hiked. The BoJ reduced QQE across the year and the ECB signaled an end to QE by year-end. Of major central banks, only the PBoC engaged in targeted easing in the face of domestic slowdown and tariff threats

2019 the start of a slowdown

- US growth is forecast to slow in 2019 to 2.3% from 2.9%, with the Fed's hiking cycle likely to close in that year. More material slowdown looks likely in 2020, when we forecast GDP growth of 1.4% and the Fed to cut rates
- Slower external growth will continue to weigh on Eurozone activity, but slower business investment will contribute to an expected slowdown to 1.4% in 2019 and 1.2% in 2020, limiting ECB hikes
- China's GDP growth also looks set to slow to 6.1% in 2019 and 2020 reflecting the macroeconomic impact of US tariffs. This is likely to be somewhat mitigated by further policy easing (bias towards fiscal, rather than monetary)

Asset allocation: shifting down a gear

- The QE tide is reversing, putting downward pressure on asset prices and upward pressure on correlations
- We have a less positive view on risk assets and look to downgrade equities back to neutral over the course of 2019
- We expect Bund yields to remain range-bound in 2019 and see value in Treasuries above 3.25%

Central scenario

Summary – Key messages

Monetary policy

1 final Fed hikes in 2018, 3 in 2019. ECB's rates stable until Sep 2019 and hike in March-20

Inflation

Accelerating wages should eventually put upward pressures on core inflation but slowly and unevenly

Fiscal policy

US fiscal impulse fading, several EMU members stimulating

Growth

Slowing in the US, the EMU and China. Stable in Japan and non-China EMs

Our central scenario:

From end-QE to end-cycle

A resilient macro backdrop allows central banks to exit carefully. Markets appear more range-bound and volatile. We are taking a less positive view on risk assets

Emerging Markets

EM should prove resilient although with regional divergences

Rates

Bund to remain range-bound. We see value in Treasuries above 3.25%

FX

Neutral on the US dollar Positive bias on EURUSD over the medium term

Credit

Credit spreads should remain under pressure. Downgrade risks are mounting

Equities

Softer top line growth and pressures on profit margins are a key concern, whilst valuations are no longer a headwind

Alternative scenarios

Summary – Key messages

EMU Last In First Out – ECB Stalemate *(probability 30%)*

What goes differently?

- An adverse shock hits the Eurozone: disruptive Brexit, escalation over Italy's risk, China's demand slows more than anticipated…
- Having lagged in the economic cycle, the EMU ends up leading in the slowdown

What it means

- The ECB does not normalise rates which remain at their current levels throughout 2019 and 2020
- Growth/inflation expectations tank

Market implications

- Risk appetite deteriorates
- Safe-haven rates rally and peripheral spreads widen with contagion from Italy, euro depreciating
- US equities over performing. EM debt may hold up

Fed hawk down *(probability 15%)*

What goes differently?

- As seen in 1966 and 1995, the Fed averts/postpones the end-cycle by pre-emptively easing
- The US economy manages a soft landing in 2020 with stable unemployment

What it means

- The Fed's easing starts as early as end-2019
- US growth and inflation surprise on the upside in a super extended economic cycle

Market implications

- UST yield curve re-steepening on break-evens and term premium, US$ depreciating.
- Bull US equities, possibly in a reflation trade reloaded. Risk-on with EM equities over performing

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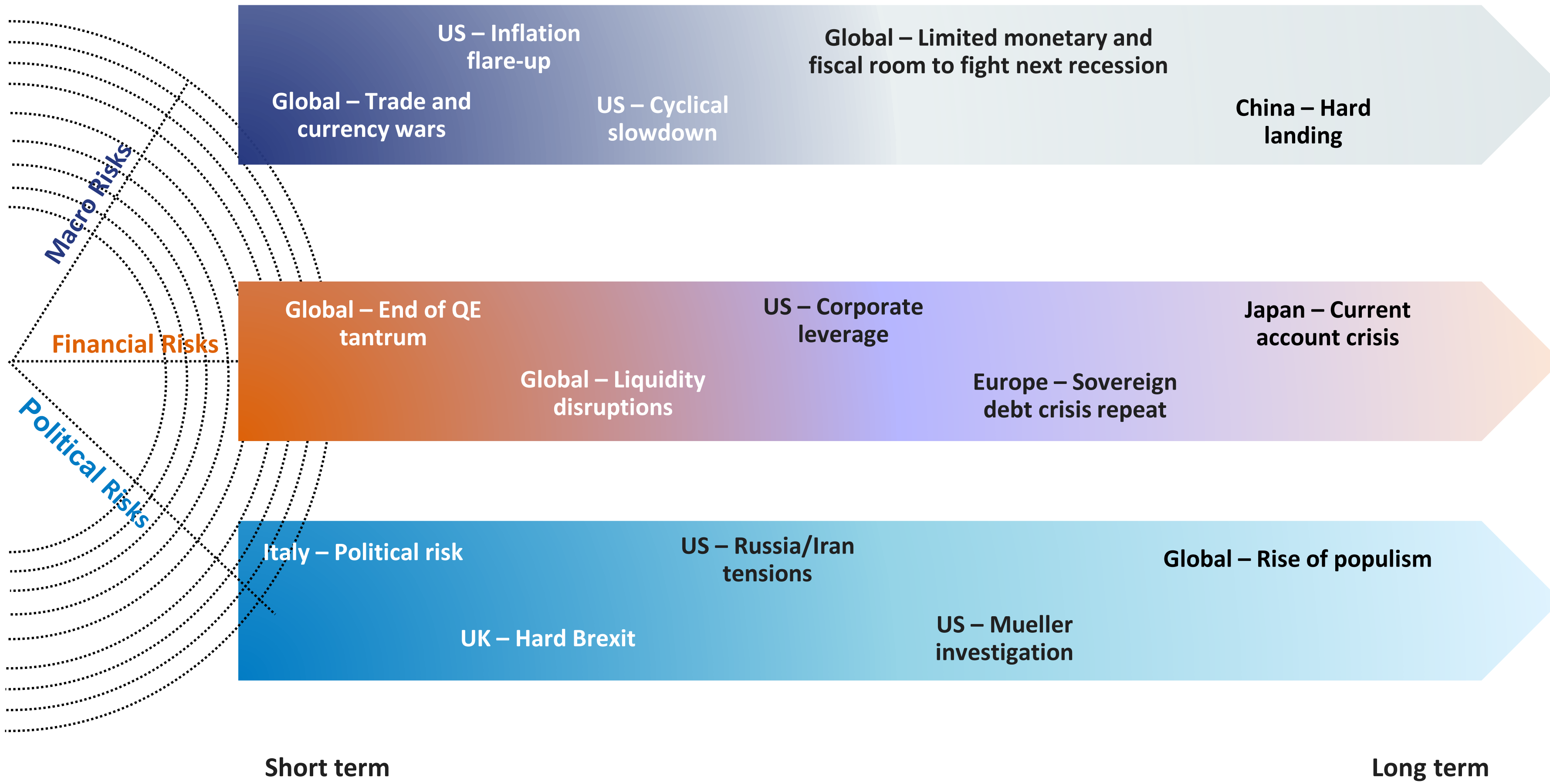
RIS.k Radar

Summary – Key messages



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2019-2020 Macro outlook

US – Headwinds to growth begin to build

Macro outlook

The fiscal boost that underpinned 2018 growth to fade

- The fiscal loosening associated with Tax Reform and the Bipartisan Budget Act (2018) will fade over the coming years, from +0.6ppt GDP in 2018, to +0.25ppt in 2019 and a modest contraction expected for 2020. Its fading will lessen the boost to activity from the current year's expected 2.9%.

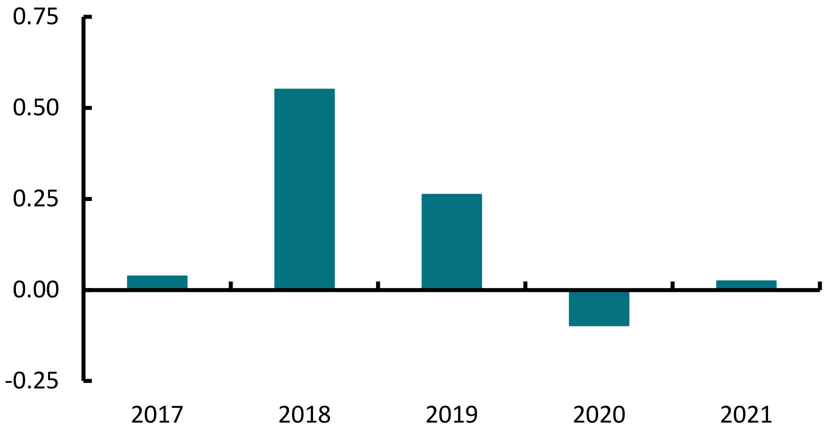
Restrictive trade policy to weigh on growth

- The outlook for trade policy is uncertain and upcoming negotiations between Presidents Trump and Xi may ease escalation tensions. We envisage a further increase in tariffs to 25% in January 2019. This would likely slow growth by 0.1ppt in 2019 and 2020 (with a modest lift to inflation). Further escalation would additionally weigh on growth.

Fiscal fade to see GDP growth slow

Estimated fiscal impact

GDP ppt

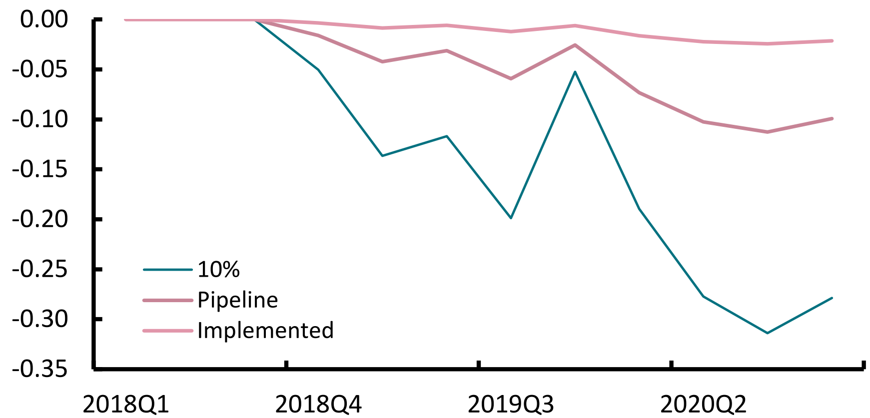


Source: IMF, AXA IM R&IS calculations

Restrictive trade policies to dampen growth outlook further

GDP Forecast

ppt



Source: FRB, AXA IM R&IS calculations

US – growth slowdown to threaten tipping point

Macro outlook

Financial conditions to tighten

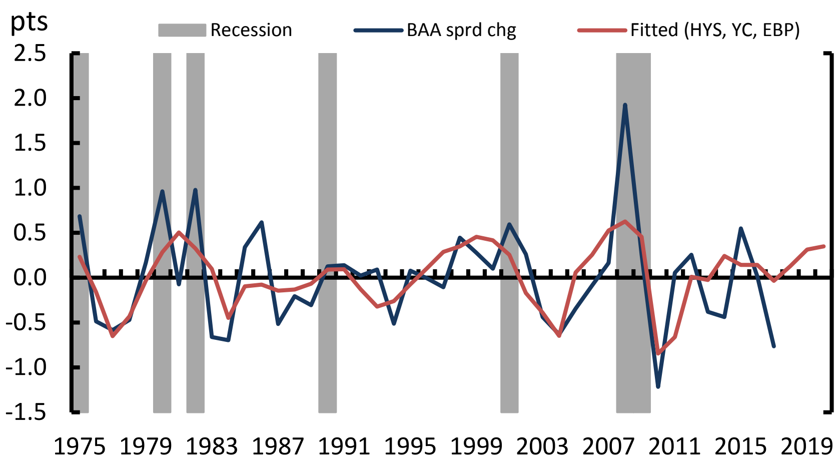
- Federal Reserve monetary policy tightening has started to contribute to a broad tightening in financial conditions. While these will become less supportive of growth, we anticipate additional tightening in credit markets to reduce growth by around 0.7ppt in 2019 and 2020.

Few examples of soft landings, economic tipping points more common

- Initiating a deceleration, we ask how far it will go. Modest initial impulses often gather momentum for a more material deceleration, something evident in labour market adjustments. Moreover, examples of 'soft landings' are few and far between in recent economic history – we consider examples in the mid-1960s and 1990s. Monetary policy was left loose in both instances, the first considered in error, the second facilitated by productivity gains.

Tightening in financial conditions to reduce growth further

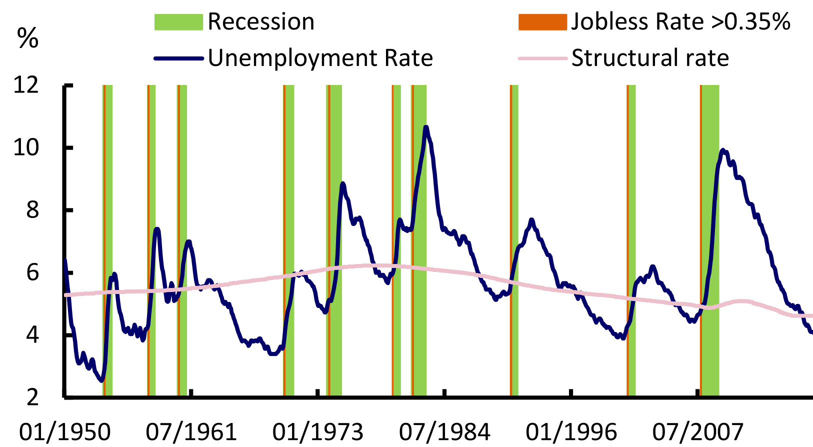
Change in Credit Spreads (Actual & Forecasts)



Source: FRED, FRB NY, AXA IM R&IS calculations

Modest gains in unemployment have ended in recession

Changes in unemployment



Source: BLS, AXA IM R&IS calculations

US – material deceleration, but to avoid contraction

Macro outlook

Yield curve to point to recession, but likely after 2020

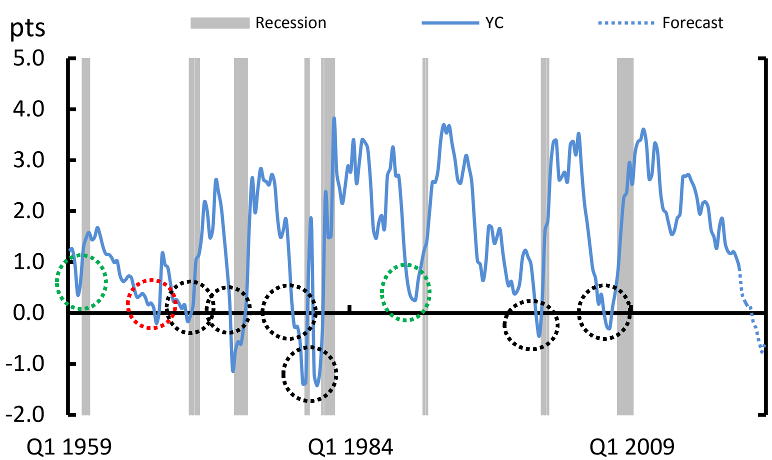
- The yield curve has signaled previous recessions. We forecast the Fed raising rates once more this year (Dec) and three times in 2019 (to 3.00-3.25%). We expect the yield curve to invert end-2019, something that would point to a recession only in early 2021 if previous lags were followed. We expect the Fed to begin to ease policy in H2 2020.

US economy to slow more than expected, but avoid recession in 2019 and 2020

- Combining forces looks set to result in a material deceleration of economic activity over the coming few years. We forecast growth of 2.3% in 2019 (consensus 2.5%) and 1.4% in 2020 (1.9%). This assumes the Us avoids contraction in the coming years, but that markets should anticipate faster deceleration from towards the end of next year.

Flatter curve to signal downturn beyond 2020

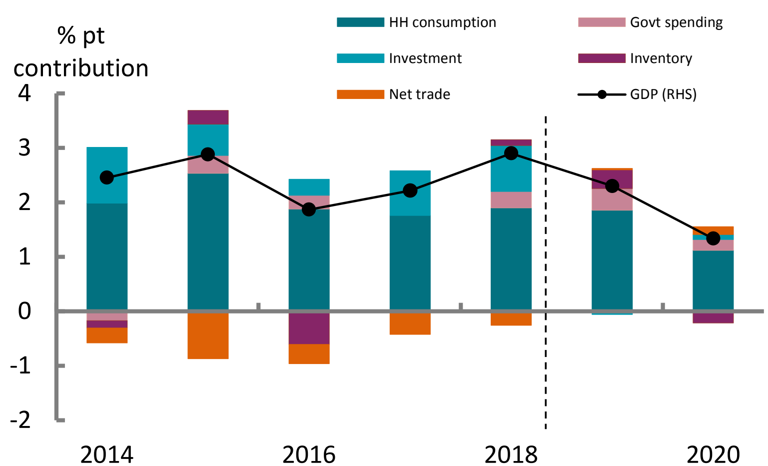
YC Slope and Recession



Source: BEA, FRED, AXA IM R&IS calculations

Material slowdown in growth expected

US contributions to growth



Source: BEA, AXA IM R&IS calculations

China – Sino-US trade war turns from a market shock to a growth shock

Macro Outlook

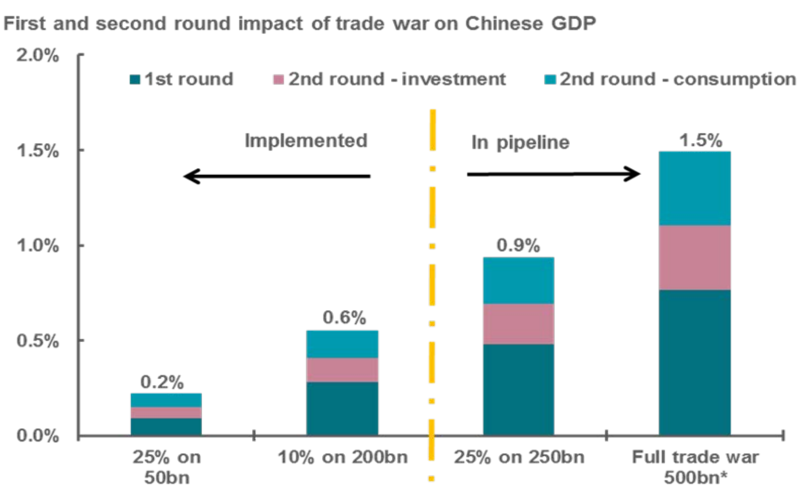
Real economic impact of the trade war starts to bite

- Our base-line case of a 25% tariff on $250bn Chinese goods will lower China's GDP growth by 0.9ppt. If the upcoming Xi-Trump meeting leads to a "cease fire", investors will breath a sigh of relief, leading to a rally in markets and less pressure on growth. But if the conflict escalates further, an all-out trade war could shave up to 1.5ppt off Chinese growth in 2019.

Trade war to accelerate the turning of China's current account

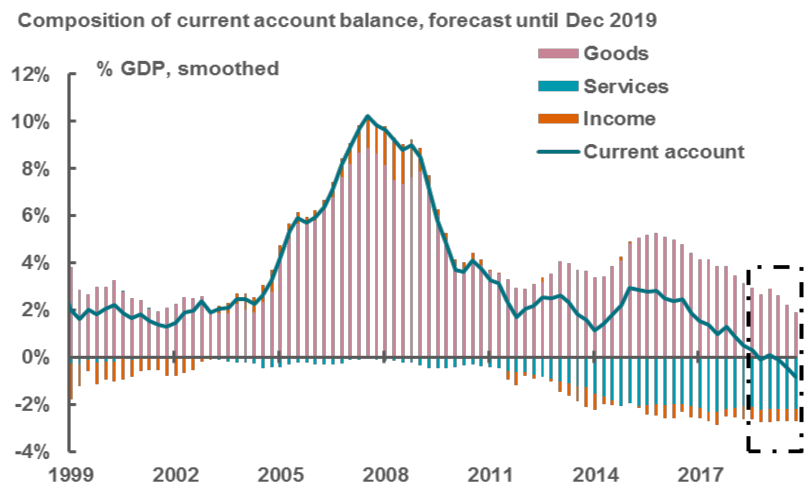
- China will record its first annual current account (CA) deficit since 1994. While the trade war will accelerate the timing, the overall evolution of the CA is driven by China's domestic factors, including the rebalancing towards consumption-driven growth. This structural shift will have important implications for China and the world.

Trade war starts to bite in 2019



Source: CEIC, AXA IM R&IS calculations

Trade war accelerates the turn of China's current account



Source: CEIC, AXA IM R&IS calculations

China – Beijing steers policy to strike a balance between growth and sustainability

Macro Outlook

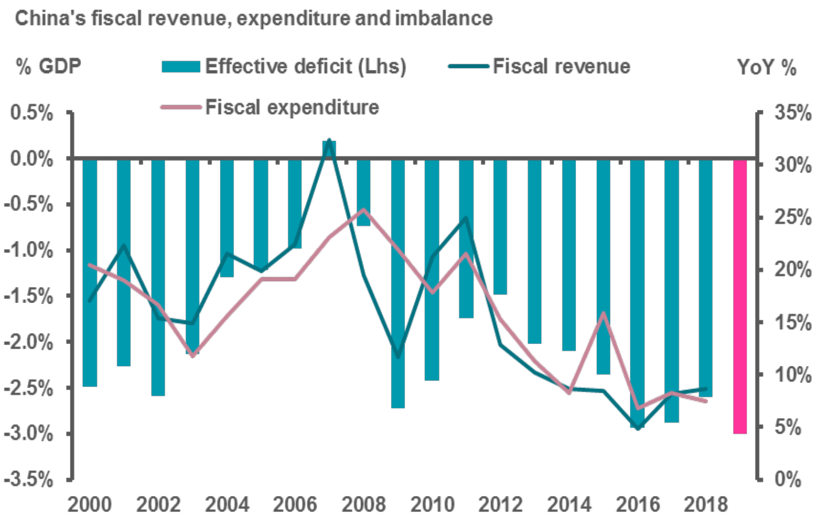
Changing macro conditions force Beijing to adjust policies

- Macro policy has now shifted to pro-growth as economic headwinds stiffen. But the desire to avoid a complete reversal on deleveraging means that Beijing will try to strike a better balance between short-term growth preservation and long-term structural reforms.

Current stimulus differs from the past, with pros and cons

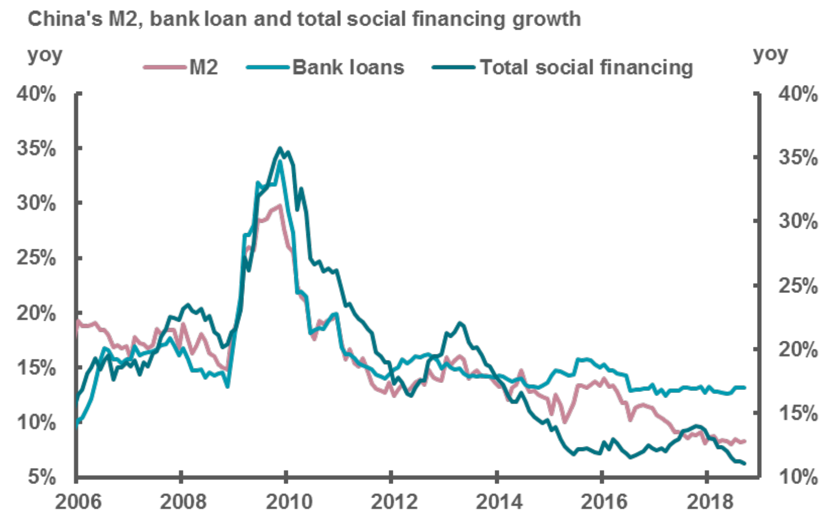
- Beijing will rely less on monetary easing, but more on fiscal tools. The latter will allow it to provide more targeted supports for households and private-sector businesses, which are less indebted and more productive than their SOE counterparts. This is a slow route for short-term recovery but a more sustainable path to healthy long-term growth.

Fiscal easing to step up, focusing on tax cuts



Source: CEIC, AXA IM R&IS calculations

Monetary easing is restrained by deleveraging



Source: CEIC, AXA IM R&IS calculations

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China – Growing macro challenges pressure Beijing to accelerate reforms

Macro Outlook

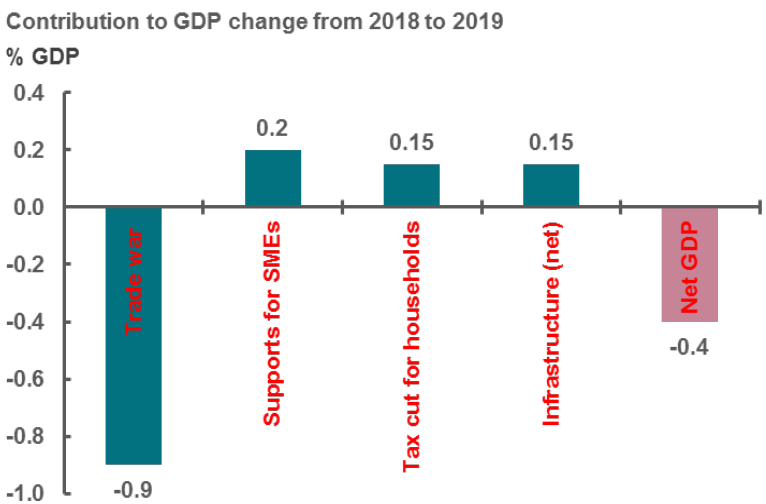
A cautious stimulus package not enough to offset the trade impact

- A more "balanced and sustainable" stimulus package will come at a cost of a less vigorous rebound in short-term growth. Hence, the policy easing – even with more to come – will not be enough to fully offset the impact from the trade war. We expect annual growth to moderate further to 6.1% in 2019 and 2020, with waning inflation to 2%.

Rising external pressure forces China to accelerate reforms

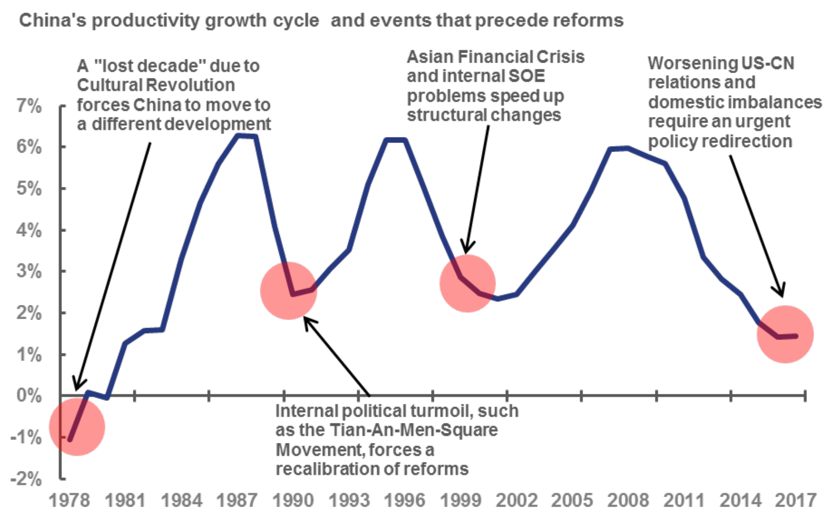
- Beijing will speed up the liberalization of China's capital account and RMB exchange rate in light of the shrinking of current account surplus. The focus on private-sector businesses could also lead to a reallocation of resources from the state to private sector that ultimately improves economic efficiency the way a successful SOE reform does.

Policy easing not enough to offset the trade shock



Source: AXA IM R&IS calculations

China faces the same pressure that precedes reforms in the past



Source: Penn World, AXA IM R&IS calculations

Investment Managers

Eurozone – It's getting cloudy…

Macro Outlook

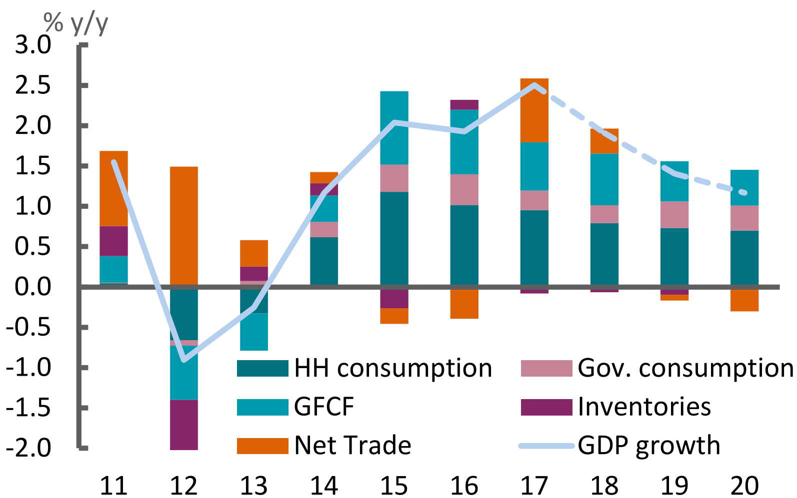
After a disappointing 2018, further slowdown to come in 2019…

- Eurozone economic activity has been disappointing for most of 2018 (1.9%) as some temporary factors distorted growth. We expect growth to slow further to 1.4% in 2019 and 1.2% in 2020, as private consumption decelerates on the back of lower job creation and investment moderates in the wake of high uncertainty and lack of global traction.

…Mainly as a result of weaker external backdrop

- Net trade will be the main drag on growth as we foresee a significant deceleration in key trade partners. In addition, elevated uncertainty amid recurrent tariffs threats, may also take a toll on exports. Finally, despite the EUR/USD depreciation in the past few months, the euro's real effective exchange rate (the trade-weighted measure adjusted for export prices) has stabilised after rising substantially in late 2017, which is not helping competitiveness.

Domestic demand still the main growth engine



Source: Datastream, AXA IM R&IS calculations

Lack of competitiveness and weaker external demand weighing on growth

Source: Datastream, AXA IM R&IS calculations

Eurozone – …The ECB won't take back the umbrella

Macro Outlook

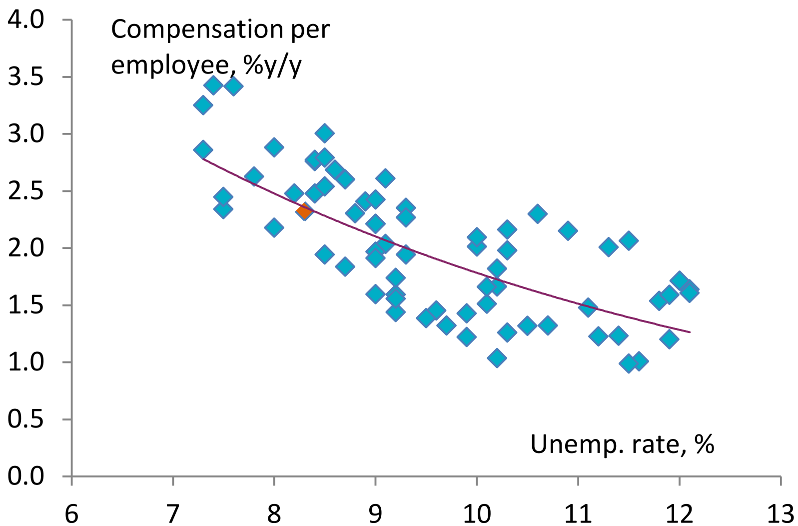
Slowly waking up Phillips

- Headline inflation has been on a rising trend in 2018, as a result of higher energy prices. But core inflation has remained subdued and we expect only a gradual pick up in 2019 (1.2%) and 2020 (1.5%), as solid wage growth transmitted to rising unit labour costs means that firms profit margins are squeezed, leading to price pressures.

Monetary policy normalization to be very gradual, with the ECB likely operating on liquidity dynamics

- We believe the gradual pick-up in core inflation would nonetheless be enough for the ECB to bring the deposit rate to 0% by spring 2020 - arguing that the negative effects of negative interest rate policy are progressively offsetting its benefits. Although we remain sceptical about an "operation twist" we expect targeted longer- term refinancing operations in the first half of next year, to avoid a large jump in banking sector's financing costs

Phillips' curve slowing waking up



Source: Datastream, AXA IM R&IS calculations

T-LTRO in H1 19 could alleviate funding difficulties for Italian banks

Liquidity Analysis - Eurozone Banks (EUR bn)

Country	LTRO	PSPP	Lending to non-MFI	Domestic govt bonds
Austria	20	58	328	26
Belgium	23	73	358	33
Finland	9	33	219	3
France	114	416	2,441	144
Germany	93	513	2,708	177
Ireland	3	30	150	18
Italy	239	362	1,540	379
Netherlands	6	114	943	27
Portugal	19	36	196	35
Spain	168	257	1,184	198
Eurosystem	728	2,148	10,500	1,041

Source: ECB, AXA IM R&IS calculations

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Eurozone – Italy: The elephant in the room

Macro Outlook

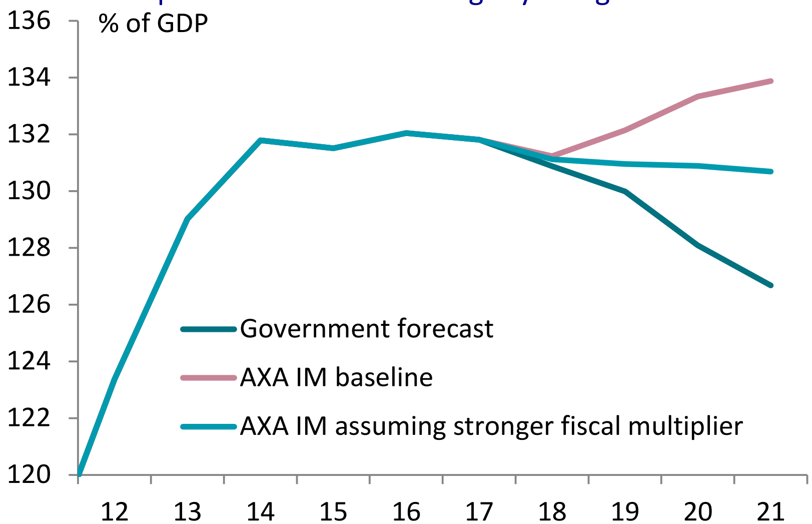
Risks are skewed to the downside

- Our baseline scenario assumes that no tariffs will be imposed on the EU's car sector. In addition, we assume Brexit ratification by March 2019, with status-quo maintained at least until the end of the transition phase by end-2020. However should these assumptions prove wrong, trade disruption would severely undermine growth, while related uncertainties would have a negative effect on aggregate demand.

Italy casts the darkest cloud to our outlook, given potential risk for financial contagion

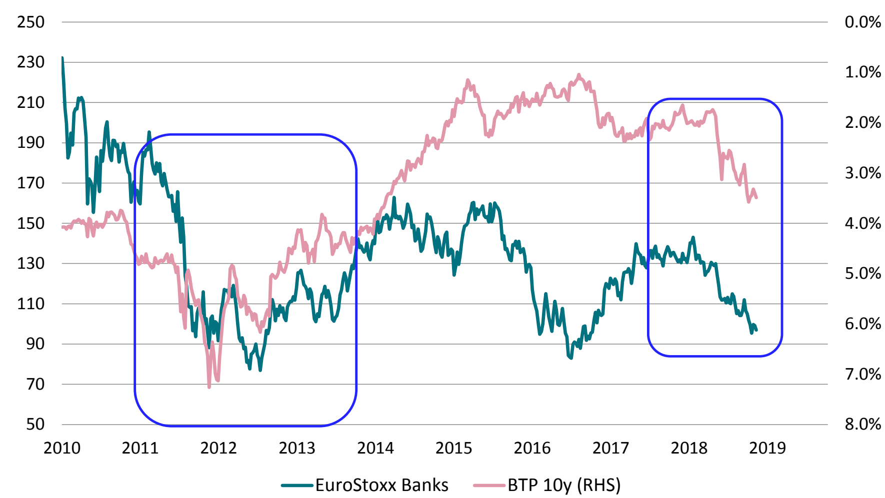
- Market pressure is needed for a change in the current coalition or snap elections that could lead to less expansionary fiscal policies. Financial spillovers to other peripheries, with a revival of the sovereign-bank loop could damage growth via tighter financial conditions and a confidence shock, changing the ECB plans.

Italian public debt ratio on a slightly rising trend



Source: Datastream, AXA IM R&IS calculations

Bank sovereign nexus: a key risk to our outlook



Source: Datastream, AXA IM R&IS calculations

UK – Brexit governs the outlook

Macro outlook

Brexit politics to dominate key economic decision

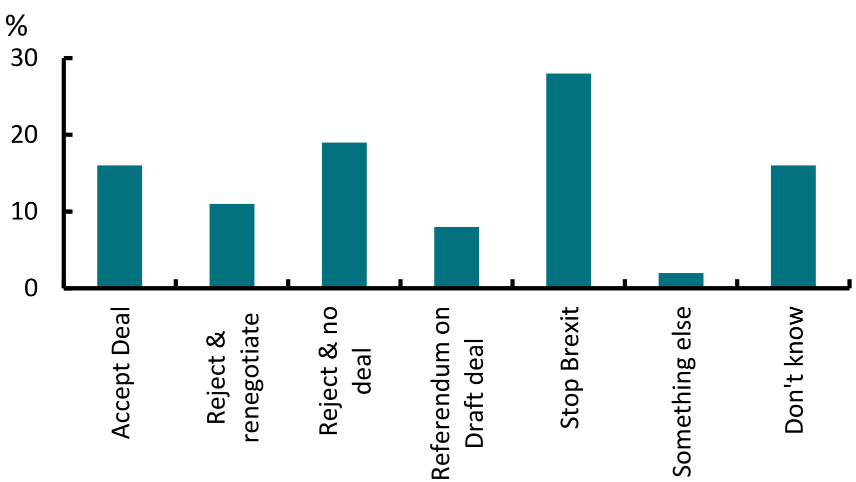
- The UK and EU concluded a Withdrawal Agreement (Brexit deal) and Political Protocol (future relationship). The UK political backdrop is fractious. The next few weeks could deliver failure to pass the agreement through Parliament, leading to a leadership challenge, General Election, second referendum or all of the above.

Brexit transition set to deliver boost to growth

- The Brexit Withdrawal Agreement would deliver a minimum 21 months of transition. Reduced uncertainty would boost income, rising sterling would boost consumer spending (boosting real incomes) and looser fiscal policy is set to follow. In combination this should lift activity to 1.8% in 2019 and 2020, from an expected 9-year low in 2018. That said, an abrupt "no deal" exit would deliver an unprecedented supply-side shock, likely to result in recession.

No clear opinion on next steps for Brexit

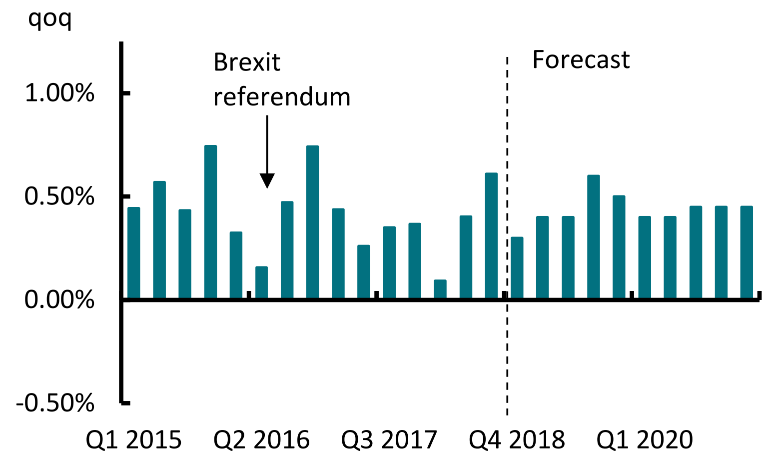
Public opinion of next steps for Brexit



Source: YouGov, AXA IM R&IS calculations

GDP lifted over summer, but weakest growth since xx

GDP growth and outlook



Source: National Statistics, AXA IM R&IS calculations

UK – growth would drive higher rates

Macro outlook

Longer-term resynchronization with global economy

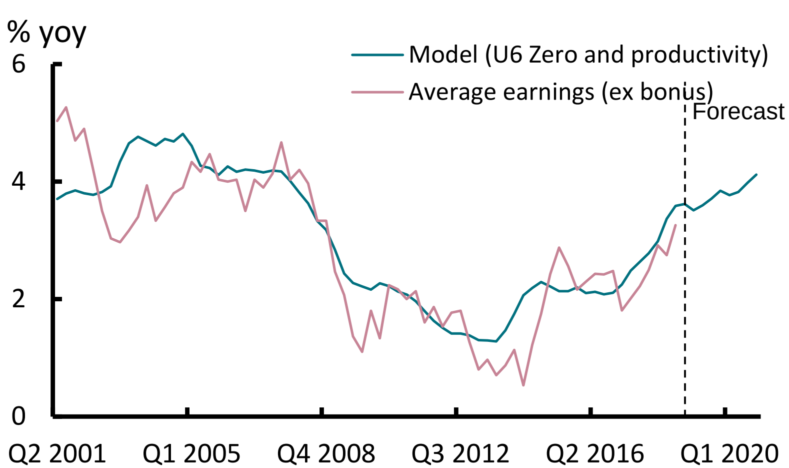
- Pent–up investment demand and a sterling-related boost to consumer spending should lift economic growth in 2019 and 2020, despite expected deceleration global activity. Yet as this catch-up fades, UK growth will again reflect broader global trends. Moreover, a Brexit slowdown now would exacerbate any global deceleration.

Economy on cusp of expanding beyond potential

- Despite weak growth in 2018, unemployment remains around 43-year lows. The tightness of the labour market is delivering wage inflation, which in the context of subdued productivity is forcing unit labour costs, and hence domestically generated inflation higher. The BoE is clearly focused on this development and as Brexit uncertainty clears looks set to raise rates at a faster tempo (we forecast four hikes across 2019 and 2020 to 1.75% by end-20).

Tight labour market points to rising domestic inflation

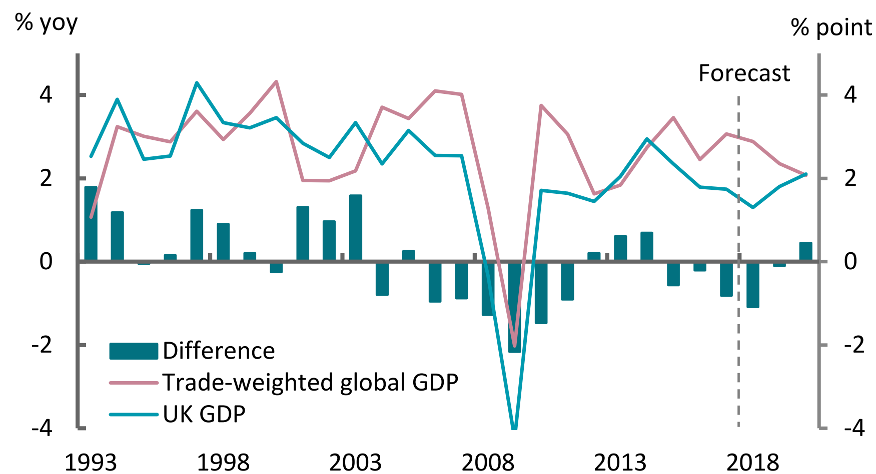
Average earnings and simple model



Source: IMF, AXA IM R&IS calculations

UK to resynchronise with the global outlook from 2020

UK and trade-weighted global GDP growth



Source: National Statistics, AXA IM R&IS calculations

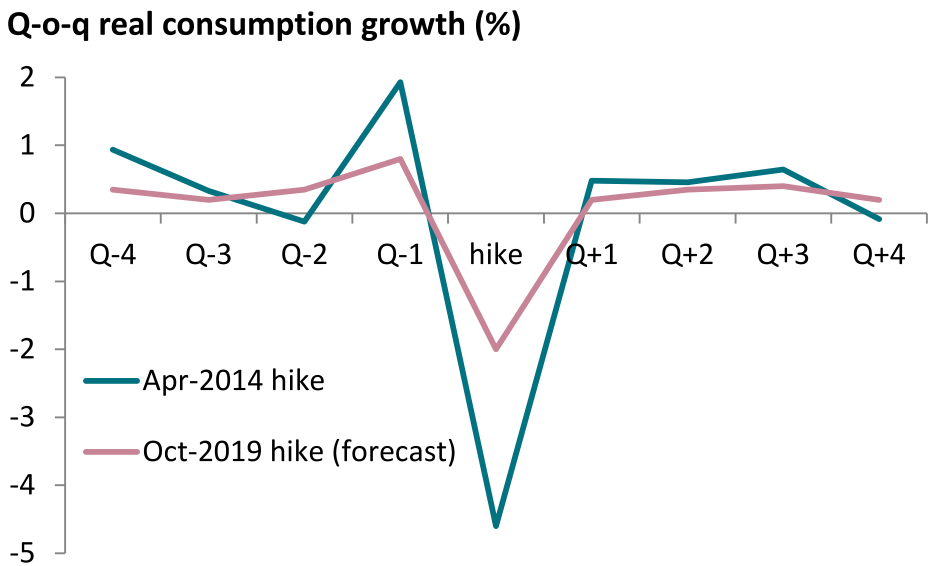
Japan – volatile and modest growth in 2019, slowdown in 2020

Macro Outlook

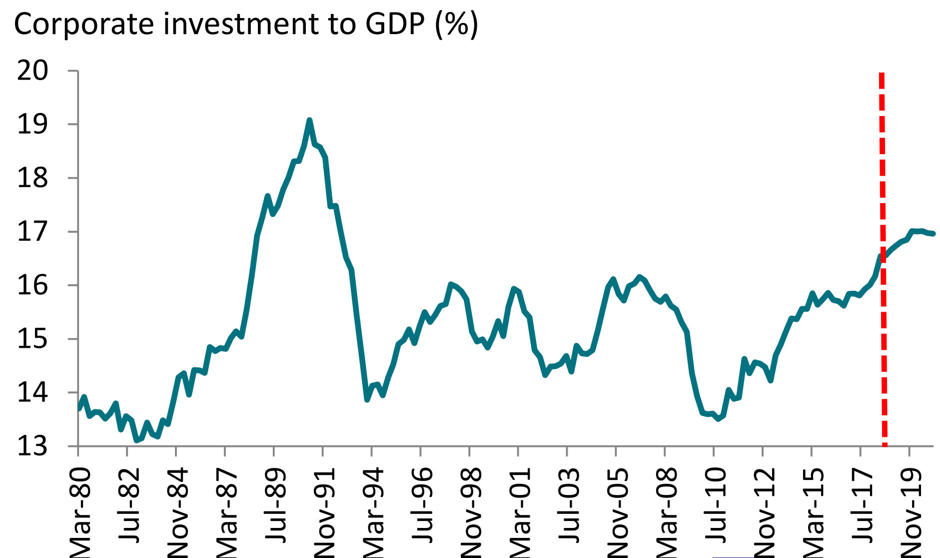
Beyond quarterly volatility, GDP should expand at a stabile 0.9% in 2019 with a significant slowdown in 2020

- After extreme natural events in 2018 (negatively affecting the first and third quarters), the Oct-2019 consumption tax hike should keep growth volatile (front-loaded purchases in 2019Q2-Q3 and a sharp fall thereafter)
- Altogether, domestic-led growth should stabilise in 2019 (+0.9% as in 2018) with households' real income benefitting from sustained job creations, nominal wages accelerating and a modest pick-up in inflation. Slowdown expected in 2020 (+0.5%) with fading corporate and public spending (investment ratio at peak, 2020 Olympic Games) and the negative income effect from the consumption tax hike
- The main headwind and risk comes from the external side with slowing world demand

2019 consumption tax hike milder than 2014 precedent



Corporate investment to GDP peaking soon



Source: Japan Statistics, AXA IM R&IS calculations

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Japan – BoJ tentatively normalising rates after tapering asset purchases

Macro Outlook

Core inflation barely rising on entrenched, low expectations

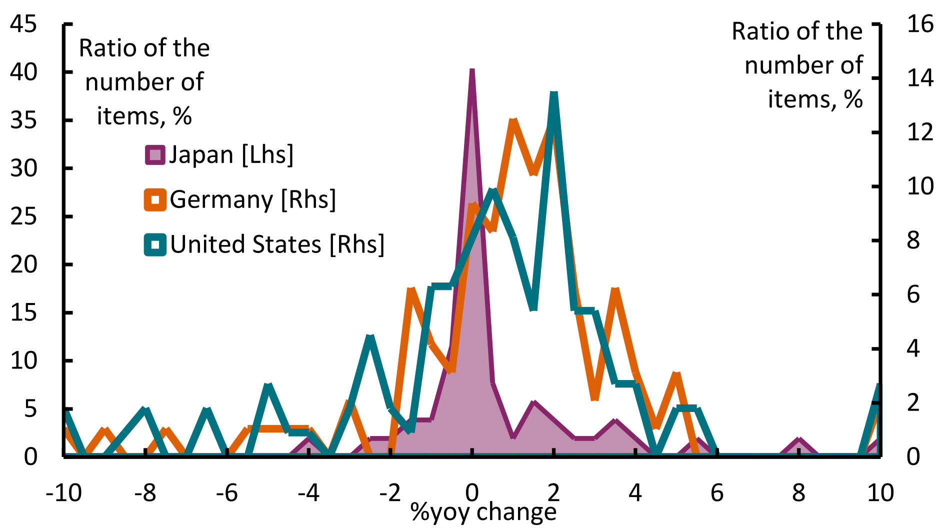
- Despite the BoJ's action, a record-tight labour market (unemployment rate at a 24-year low) and surveys pointing to labour and capital shortages, "new" core inflation has failed to increase much (+0.4% y-o-y in Sep-18).
- With entrenched, low inflation expectations – a result of an ageing society and adjustment to a low observed inflation for years – we expect this feature to prevail and forecast "new" core inflation at +0.5% in 2019 and 2020

The BoJ sticking to Yield Curve Control, further tapering its QQE and modestly normalising interest rates

- The gradual reduction of net asset purchases (¥32tn in 2019 *vs.* ¥80tn in 2016) should remain in line with the July widening of the interval around the 0.0% 10Y JGB yield target (to ±0.2%). The next step should see the end of negative interest rates, probably by mid-2019

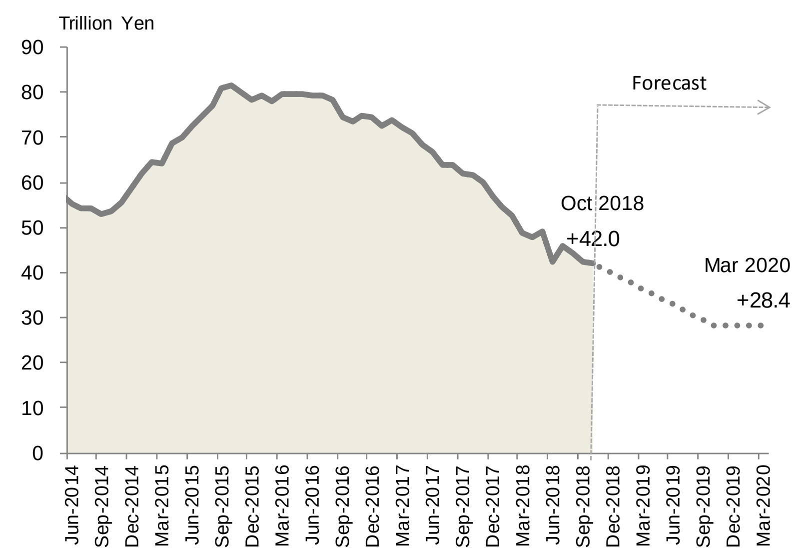
Most of the consumption basket has stable prices

Inflation distribution in main developed countries



Source: US BLS, Eurostat, Japan Statistics, AXA IM R&IS calculations

Further QQE tapering in 2019



Source: BoJ, AXA IM R&IS calculations

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Emerging Markets – Resilient economic growth in 2019…

Macro outlook

EM growth to prove its resilience, but to remain below potential into 2019 as well

- Trade war, currency shocks, tighter global financing conditions (albeit still loose on historical comparison basis) have sewn the seeds of economic weakness as of early 2018. Growth should nevertheless remain relatively resilient into 2019 as several big EM economies see improve economic outlooks (ie India, Brazil).

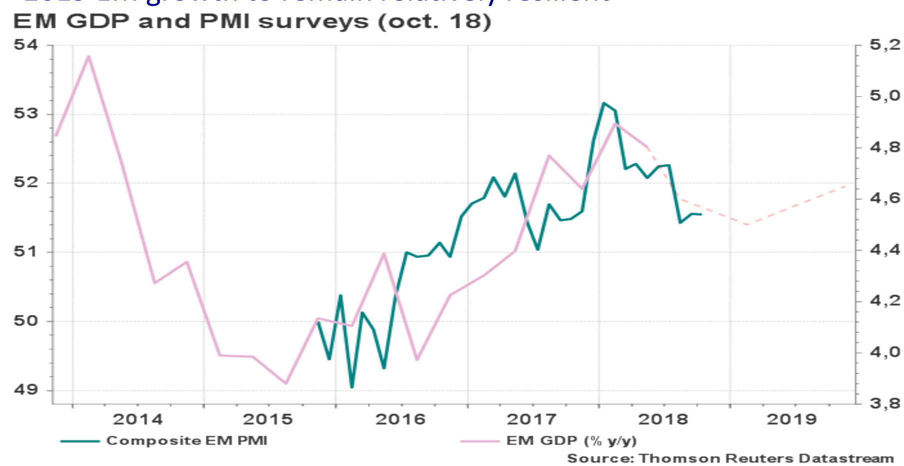
Growth levers changing: from trade support in 2018 to domestic demand resilience in 2019

- Temporary trade disruptions and diversions from one country to another related to the upcoming introduction of US import tariffs will bear transition costs worldwide and we see EM as a whole no longer benefitting from the strong export growth engine in 2019.
- Healthy households balance sheets, generally robust labour markets and pent up demand in some big EM countries are likely to support household consumption into 2019.

EM GDP more resilient in 2018 than financial markets

Source: Datastream, AXA IM R&IS calculations

2019 EM growth to remain relatively resilient



Source: Datastream, AXA IM R&IS calculations

Emerging Markets – Strong regional divergences

Macro outlook

Regional divergence: Latam and MENA acceleration versus EM Asia and Europe slowdown

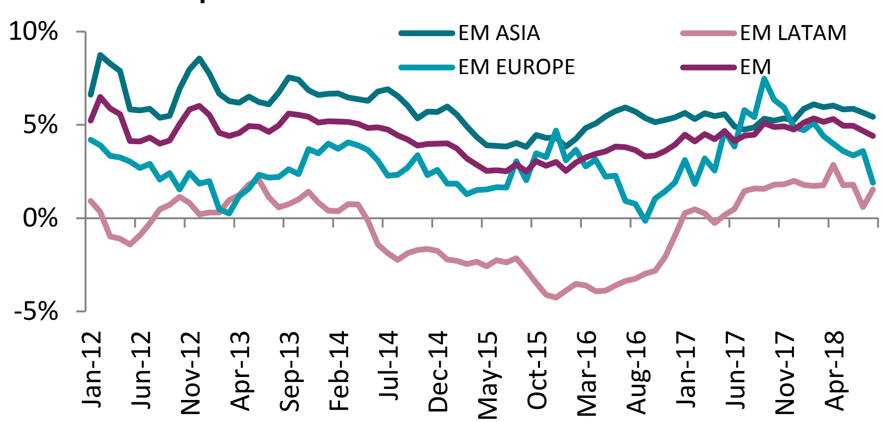
- Pent up demand in Brazil or India will help growth gaining traction, while global economic slowdown will affect most Asian and European developing economies. Recession in Turkey and Argentina should alleviate some of the imbalances, but further policy action is needed in order to tackle structural issues and credibly anchor expectations. Middle East economies (bar Iran which will see negative economic growth given US sanctions) should enjoy a favourable growth environment on the back of still strong oil price.

Several important elections will take place in 2019

- In India, political outcome is particularly important for policy direction going forward. Philippines midterms should offer a measure of the public support for president Duerte. Given the difficult economic backdrop in Turkey and Argentina, both in recession, upcoming elections may prove more difficult for the incumbent leaders.

Regional divergence within EM continents…

EM industrial production



Source: Datastream, AXA IM R&IS calculations

… intra-regional divergence as well

Real GDP growth (%)				
Region/Country	2017	2018	2019	2020
Emerging economies	**4.7**	**4.6**	**4.6**	**4.7**
China	**6.9**	**6.5**	**6.1**	**6.1**
Asia ex-China	**5.8**	**6.1**	**6.1**	**6.1**
South Korea	3.1	2.8	2.6	2.5
India	6.7	7.3	7.4	7.5
Latin America	**1.3**	**1.2**	**2.1**	**2.2**
Brazil	1.0	1.5	2.5	2.5
Mexico	2.0	2.2	2.2	2.0
Emerging Europe	**3.9**	**3.0**	**2.2**	**2.5**
Russia	1.5	1.9	1.8	1.8
Poland	4.7	5.2	3.5	3.0
Turkey	7.4	3.5	0.5	2.5
Other EMs	**2.6**	**2.9**	**3.2**	**3.4**

Source: Datastream, AXA IM R&IS calculations

Emerging Markets – Risks remain and could challenge policy makers' astuteness

Macro outlook

Inflation pressures should recede in 2019 and require less monetary policy tightening

- Pressure on inflation from past FX weakness and oil price strength will fade and growth moderation should require less monetary tightening next year, though some central banks may still need to do more in order to keep inflation expectations credibly anchored (Turkey, Argentina, India, Indonesia).
- Exchange rate flexibility helped absorb recent external shocks but it will affect private and public balance sheets. Central banks' interventions in the currency markets should remain limited, albeit focused on addressing market dis-functioning at stress moments, while keeping adequate reserves buffers.

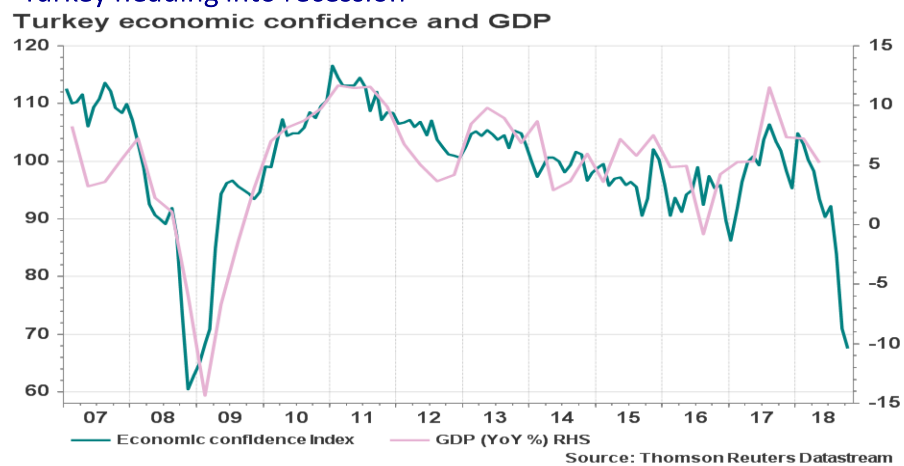
Turkey/Argentina in recession, Brazil's new President Bolsonaro needs to push through important structural reform agenda

- Fiscal policy should be overall looser into 2019, with some notable exceptions such as Argentina (under IMF agreement), Brazil (in need of structural reforms), Turkey (after excessive boost).

Brazil growth accelerating after years of lethargy

Source: Datastream, AXA IM R&IS calculations

Turkey heading into recession



Source: Datastream, AXA IM R&IS calculations

2019 Investment Strategy

AXA Investment Managers

Diversification becomes more difficult in the Quantitative Tightening era

Investment Strategy – Cross-asset allocation

The recent risk-off episode illustrated the poor diversification benefit of government bonds

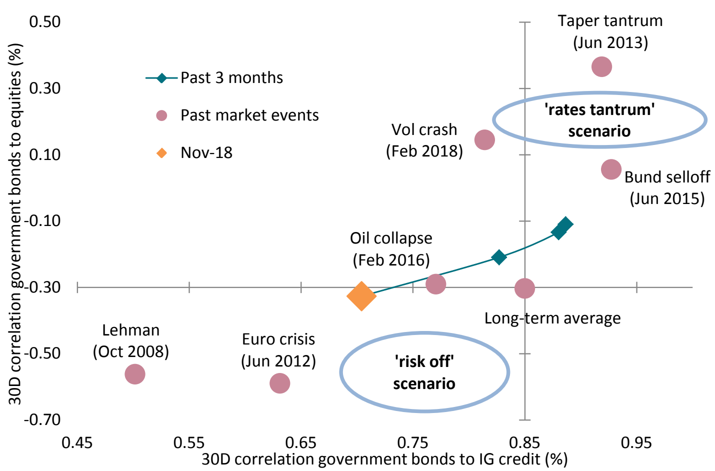
- As equities dropped and credit spreads widened, government bonds failed to gain significantly

With the QE tide reversing, all asset prices experience downward price pressure

- Alternative downside hedges will be important in 2019: currencies and volatility should be considered

Correlations moving towards risk-off

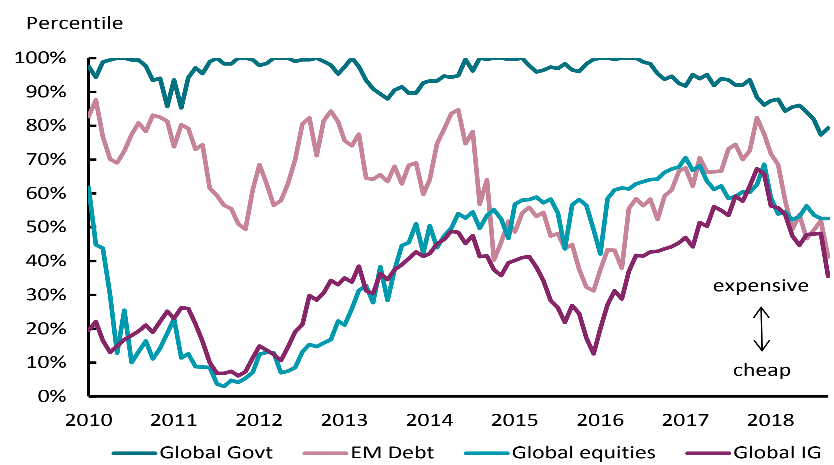
Cross-asset correlation diagram



Source: MSCI, Barclays, BAML, AXA IM R&IS calculations

Downward pressure on valuation across the board

Cross asset valuation



Source: MSCI, BAML, JPMorgan, AXA IM R&IS calculations

Global: Diverging Real Yields

Investment Strategy – Rates

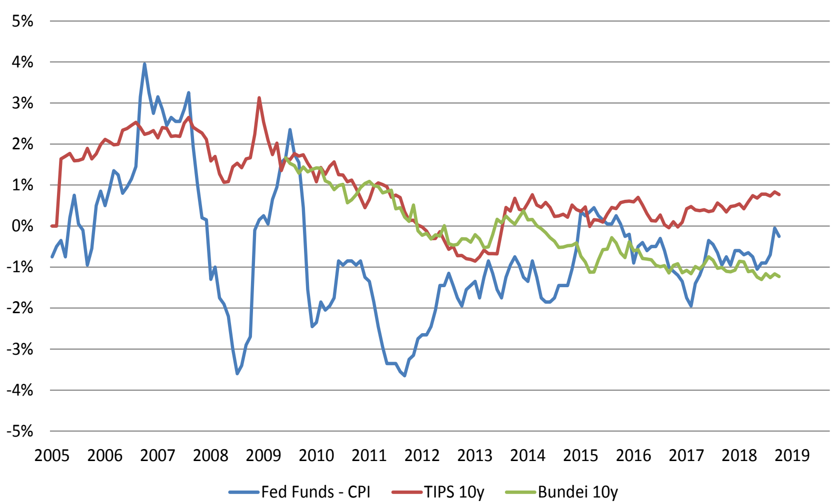
Real yields to drive asset allocation decisions

- US real yields have increased in steps since 2016 (0%) and are now trading north of 1%, in contrast to German real yields hovering near all time lows
- At global portfolio level, this is likely to be a driver of allocation decisions in 2019. In particular, liquidity management might be tilted towards US Treasuries, affecting the foreign exchange as well as short-term credit spreads

Bund yields to remain range-bound

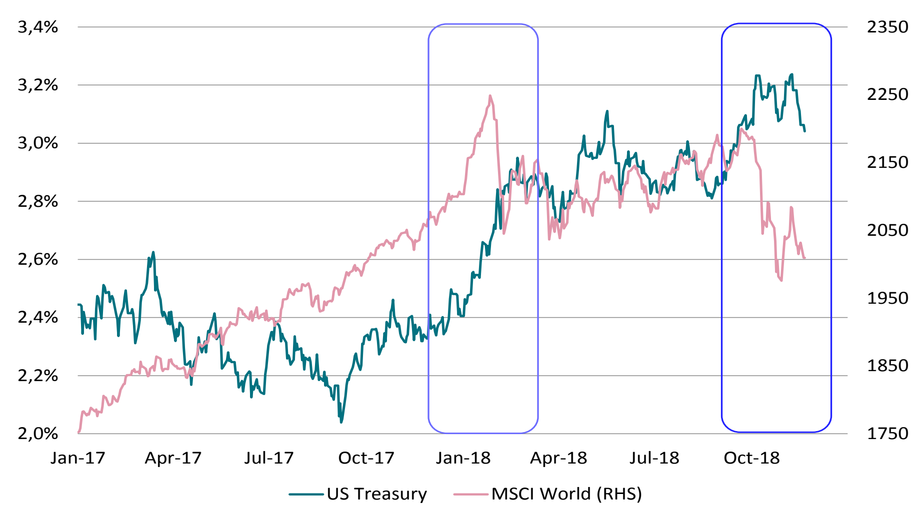
- We expect Bund yields to remain range-bound in 2019 as a result of weaker investor sentiment, prudent ECB policy and a strong technical backdrop. We see a range of 0.2-0.7% as persisting through the year
- We see value in Treasuries above 3.25%, however, as a good diversifier in case of a more pronounced slowdown

Divergence in real yields, implications for investment flows



Source: Bloomberg and AXA IM R&IS calculations

Treasuries hedged 2018 risk episodes only partially, though



Source: Bloomberg, MSCI and AXA IM R&IS calculations

Europe: Risk Sentiment and Regulated Investors in 2019

Investment Strategy – Rates

Sovereign-Banks Nexus – Little has been done to prevent this vicious feedback loop

- The correlation between banks' valuations and peripheral spreads peeped back on investors' radar screens in 2018.
- Italian banks are still exposed to EUR 380bn of domestic government bonds, while utilising 33% of ECB's LTROs
- Also, other member states' banks hold substantial sovereign risk in excess of their regulatory liquidity needs

Negative convexity portfolios and risky assets

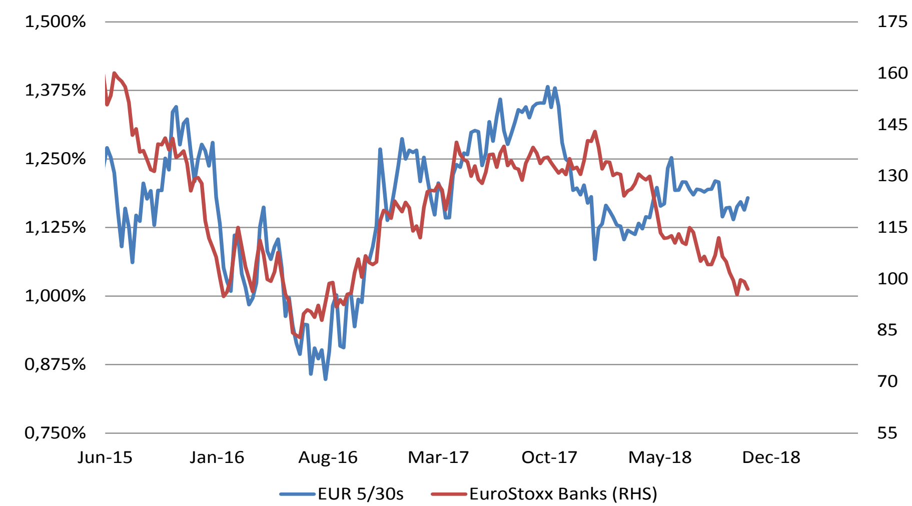
- The theme of asset/liability management of pension fund portfolios is likely to re-emerge in 2019, due to weak European equities in an environment of very low interest rates.
- Expect the long-end of the curve to perform well in a prolonged risk-off / economic slowdown scenario.

European banks are the main risk transmission mechanism

Country	LTRO	%	PSPP	%	Lending to non-MFI	%	Banks' govt bond holdings	%
Austria	20	3%	58	3%	328	3%	26	3%
Belgium	23	3%	73	3%	358	3%	33	3%
Finland	9	1%	33	2%	219	2%	3	0%
France	114	16%	416	19%	2.441	23%	144	14%
Germany	93	13%	513	24%	2.708	26%	177	17%
Ireland	3	0%	30	1%	150	1%	18	2%
Italy	239	33%	362	17%	1.540	15%	379	36%
Netherlands	6	1%	114	5%	943	9%	27	3%
Portugal	19	3%	36	2%	196	2%	35	3%
Spain	168	23%	257	12%	1.184	11%	198	19%
Eurosystem	**728**	100%	**2.148**	100%	**10.500**	100%	**1.041**	100%

Source: Bloomberg, ECB and AXA IM R&IS calculations

Risky assets and their implication for the shape of the EUR curve



Source: Bloomberg and AXA IM R&IS calculations

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Spreads vulnerable due to macro but overvaluations have narrowed

Investment Strategy – Credit

Credit spreads are likely to remain under pressure in 2019

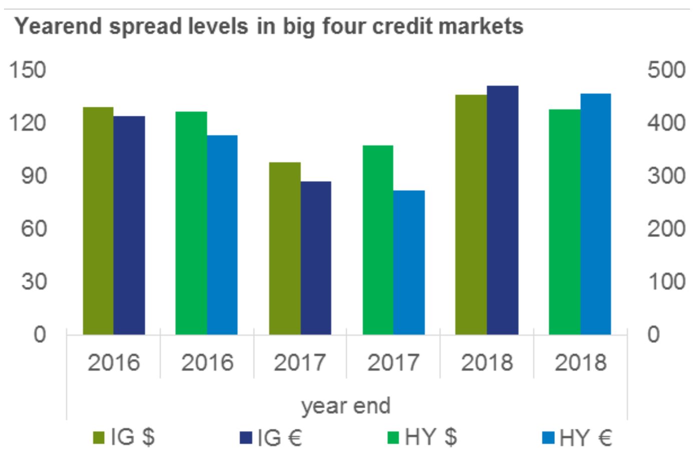
- Macro and technical are headwinds but valuations have improved following the material widening over the past twelve months.
- A record high level of BBB-rated credits is the Achilles heel of credit markets in this cycle. This is issue is particularly acute in the US where jumbo acquisitions have left some IG corporates over-levered and very dependent on strong profits in order to avoid falling into HY over the next 2-3 years.

Euro credit faces higher economic and political uncertainty

- Better credit fundamentals and past underperformance due to the Italian budget saga may lead to outperformance in 2019, especially in a scenario where the ECB extends its monetary policy support.

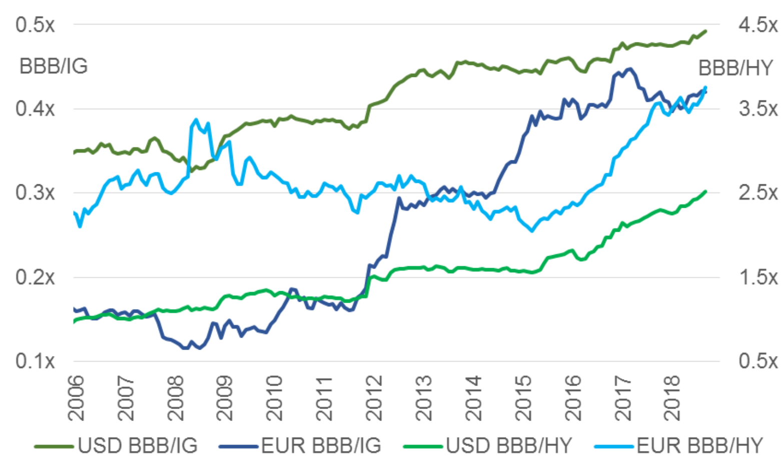
HY should continue to outperform IG as interest rates continue to rise, bar a protracted risk-off episode

Spreads set to end 2018 at wider levels than in 2016



Source: Bloomberg and AXA IM R&IS calculations

Share of BBB rated credits at a record in USD and EUR markets



Source: Data stream, IBES and AXA IM R&IS calculations

Turning neutral on equities moving into 2019

Investment Strategy – Equities

Softer top line growth and pressures on profit margins are a key concern

- Decelerating economic globally should dampen top line growth while pressures on profit margins are a key concern, induced by the rise in unit labour costs and fading effect of the tax stimulus in the United States.

Valuations multiples are not a major headwind at this juncture but we see limited scope for re-rating

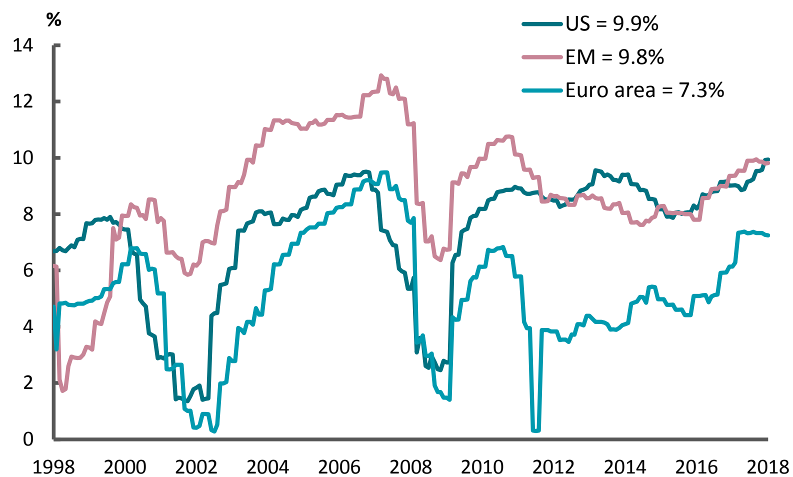
- Reduced excess liquidity and rising US short term rates due to the ongoing monetary tightening, and possibly higher equity risk premiums driven by higher volatility and weaker sentiment suggest limited scope for re-rating.

We are looking to neutralise our positioning in global equities over the course of 2019

- Continuing to prefer the US over euro zone. Political risks in Europe continue to weigh on the equity markets while the banking sector remains under pressure as the yield curve fails to steepen along with muted economic momentum.

Peak margins are a key concern for 2019

Profit margins: US, Euro area & EM



Source: Bloomberg and AXA IM R&IS calculations

Global equity valuations in comfortable territory

MSCI AC World: Forward price to earnings

Source: Data stream, IBES and AXA IM R&IS calculations

The US dollar looking for a direction

Investment Strategy – Foreign Exchange

The US dollar appreciated 5% against the G10 in 2018, the best performer

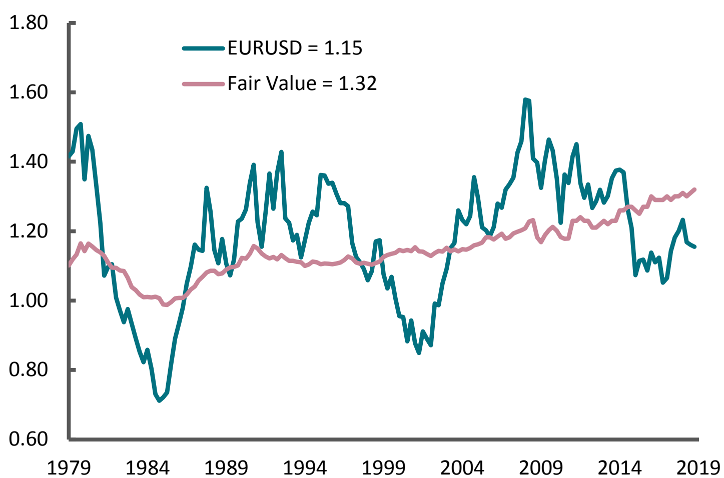
- The US dollar is now among the most expensive currencies in real effective exchange rate terms
- Against the euro, our estimated fair value is just above 1.30, more than 10% above the current level

A very positive interest rate differential to the rest of the G10 makes a large USD decline unlikely, at least in the first half of 2019

- We hold no strong conviction on the EUR/USD cross in the near term, but a bullish view in the medium term

EUR still cheap to the US dollar

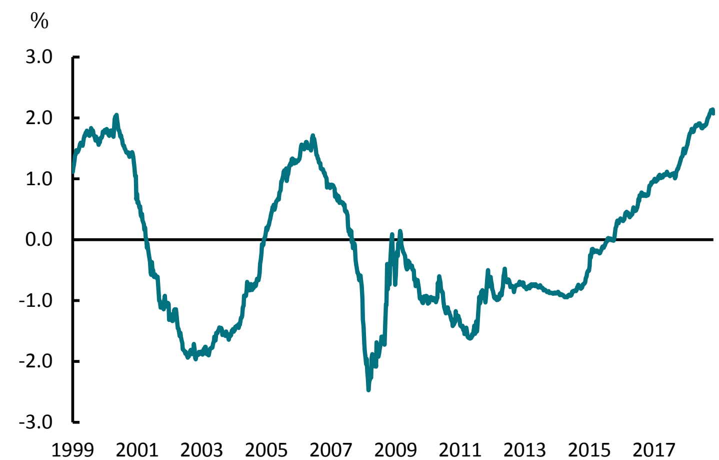
EUR/USD valuation



Source: Goldman Sachs, AXA IM R&IS calculations

Too much carry for the US dollar to weaken substantially

USD relative carry to average G10 currencies



Source: Bloomberg, AXA IM R&IS calculations

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Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2018*	2019*		2020*	
		AXA IM	*Consensus*	AXA IM	*Consensus*
World	**3.8**	**3.6**		**3.5**	
Advanced economies	**2.4**	**2.0**		**1.5**	
US	**2.9**	**2.3**	*2.6*	**1.4**	*1.9*
Euro area	**1.9**	**1.4**	*1.7*	**1.2**	*1.5*
Germany	**1.5**	**1.4**	*1.7*	**1.2**	*1.5*
France	**1.6**	**1.4**	*1.7*	**1.3**	*1.6*
Italy	**1.0**	**0.6**	*1.0*	**0.5**	*0.9*
Spain	**2.5**	**2.2**	*2.3*	**1.7**	*1.9*
Japan	**0.9**	**0.9**	*1.1*	**0.5**	*0.6*
UK	**1.3**	**1.8**	*1.5*	**2.0**	*1.6*
Switzerland	**3.0**	**1.7**	*1.7*	**1.5**	*1.7*
Emerging economies	**4.7**	**4.6**		**4.7**	
Asia	**6.3**	**6.1**		**6.1**	
China	**6.6**	**6.1**	*6.2*	**6.1**	*6.0*
South Korea	**2.8**	**2.6**	*2.6*	**2.5**	*2.5*
Rest of EM Asia	**6.1**	**6.1**		**6.1**	
LatAm	**1.2**	**2.1**		**2.2**	
Brazil	**1.5**	**2.5**	*2.3*	**2.5**	*2.6*
Mexico	**2.2**	**2.2**	*2.1*	**2.0**	*2.4*
EM Europe	**3.2**	**2.2**		**2.6**	
Russia	**1.9**	**1.8**	*1.5*	**1.8**	*1.7*
Poland	**5.2**	**3.5**	*3.6*	**3.0**	*3.1*
Turkey	**3.5**	**0.5**	*0.8*	**2.5**	*3.0*
Other EMs	**2.9**	**3.2**		**3.4**	

Source: Consensus Economics, IMF and AXA IM R&IS calculations – As of 04 December 2018

Expectations on inflation and central banks

Forecasts

Inflation forecasts

CPI Inflation (%)	2018*	2019*		2020*	
		AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	**2.0**	**1.9**		**2.1**	
US	2.0	1.9	*2.3*	2.1	*2.2*
Euro area	1.8	1.7	*1.7*	1.4	*1.7*
Japan	1.0	0.7	*1.9*	0.5	*1.7*
UK	2.5	2.0	*1.7*	2.3	*1.5*
Switzerland	1.0	0.7	*1.4*	1.0	*1.3*
Other DMs	1.8	1.9		2.0	

Source: Bloomberg, IMF and AXA IM R&IS calculations – As of 04 December 2018

Central banks' policy: meeting dates and expected changes

Central bank policy
Meeting dates and expected changes (Rates in bp / QE in bn)

		Current	End-18	Q1 - 19	Q2 - 19	Q3 - 19	Q4 - 19
United States - Fed	Dates	2.00 - 2.25	18-19 Dec	29-30 Jan 19-20 Mar	30-1 Apr/May 18-19 Jun	30-31 July 17-18 Sep	29-30 Oct 10-11 Dec
	Rates		+0.25 (2.25-50)	+0.25 (2.5-75)	+0.25 (2.75-3.00)	unch (2.75-3.00)	+0.25 (3.00-25)
Euro area - ECB	Dates	-0.40	13 Dec	24 Jan 7 Mar	10 Apr 6 Jun	25 July 12 Sep	24 Oct 12 Dec
	Rates		unch (-0.40)	unch (-0.40)	unch (-0.40)	+0.15 (-0.25)	unch (-0.25)
Japan - BoJ	Dates	-0.1/¥42tn	19-20 Dec	22-23 Jan 14-15 Mar	24-25 Apr 19-20 Jun	29-30 Jul 18-19 Sep	30-31 Oct 18-19 Dec
	Rates / QE		unch/taper	net QQE ¥40tn	unch/taper	unch/taper	net QQE ¥30tn
UK - BoE	Dates	0.75	20 Dec	7 Feb 21 Mar	2 May 20 Jun	1 Aug 19 Sep	7 Nov 19 Dec
	Rates		unch (0.75%)	unch (0.75%)	+0.25% (1.00%)	unch (1.00%)	+0.25% (1.25%)

Source: Datastream, AXA IM R&IS calculations - As of 23 November 2018

Calendar of 2019 event

2019	Date	Event
January	1 Jan	US 25% Tariffs on $200bn of Chinese imports
	23 Jan	BoJ Meeting
	24 Jan	ECB meeting
	22-25 Jan	World Economic Forum
	30 Jan	FOMC meeting
February	7 Feb	BoE meeting
	17 Feb	Section 232 investigation into Autos deadline
	February	Thailand General Election
March	1 Mar	US Debt Ceiling Lifted
	7 Mar	ECB Meeting
	15 Mar	BoJ Meeting
	19 Mar	FOMC meeting
	21 Mar	BoE Meeting
	29 Mar	Brexit Day
	31 Mar	Ukrainian Presidential Elections
	March	China National Congress
April	10 Apr	ECB Meeting
	12-14 Apr	IMF/World Bank meetings
	17 Apr	Indonesia General Election
	25 Apr	BoJ Meeting
	April/May	Indian General Election
May	1 May	FOMC Meeting
	2 May	BoE Meeting
	26 May	EU & Belgium Elections
June	6 Jun	ECB Meeting
	19 Jun	FOMC Meeting
	20 Jun	BoJ & BoE Meeting
July	25 Jul	ECB Meeting
	30 Jul	BoJ Meeting
	31 Jul	FOMC Meeting
August	1 Aug	BoE Meeting
	August	US Debt Ceiling lift expected to bite
September	12 Sep	ECB Meeting
	13 Sep	End of US Fiscal year
	18 Sep	FOMC Meeting
	19 Sep	BoJ & BoE Meeting
October	20 Oct	Swiss Federal Election
	21 Oct	Canadian Federal Election
	24 Oct	ECB Meeting
	27 Oct	Argentine General Election
	30 Oct	FOMC Meeting
	31 Oct	BoJ Meeting
November	7 Nov	BoE Meeting
December	11 Dec	FOMC Meeting
	12 Dec	ECB Meeting
	19 Dec	BoJ & BoE Meeting

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19 November 2018

Unstable hedges and monetary policy gaps

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08 November 2018

Sustained divergence: US growing alone

05 November 2018

US midterm elections set to dominant market proceedings

05 November 2018

S&P 500 sell-off overshoots fundamentals

02 November 2018

Volatile markets, election results and a busy economic calendar

29 October 2018

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