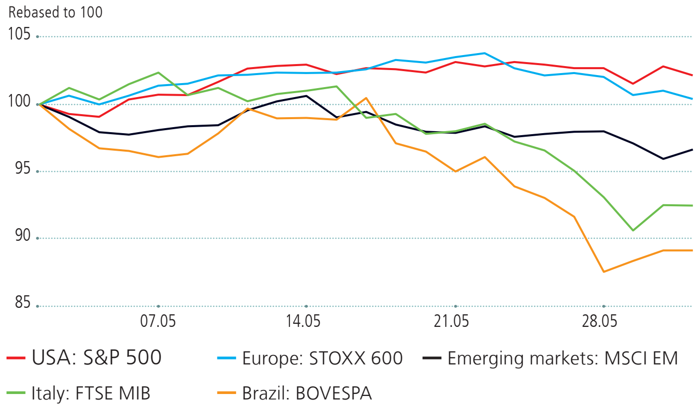
Economic overview

June 2018

The political crises in May had a strong impact on the markets and led to a shake-up in financial asset prices. The overall average increase in equities hides strong sectoral and regional disparities. The prices of Italian and Brazilian equities fell in particular as a result of the unrest that shook the governments of these countries. However, U.S. and European averages continued to advance, and growth stocks were favoured over companies with lower valuation ratios. Smaller companies were in demand as a further indicator of the strength of the economy. The cyclical sectors also outperformed the more defensive sectors. In particular, technology companies shone brightly on both sides of the Atlantic. In the United States, industrial and material stocks also provided good returns, while banking stocks in Europe suffered from the sharp easing of bond yields in core countries and the Italian political crisis.

Italian borrowing rates came under severe pressure as politicians were questioned about the country's debt. However, the formation of a new government eased pressure and the 10-year benchmark rate remains well below 3%. Overall, the credit market also suffered from sudden tension among investors. But the losses incurred were contained by the corporate high-yield segment. While currency movements also mirrored these political tensions, the euro's decline was limited, whereas the most vulnerable emerging currencies fell sharply against the dollar.

Equity market indices: USA, Europe, Italy, Brazil

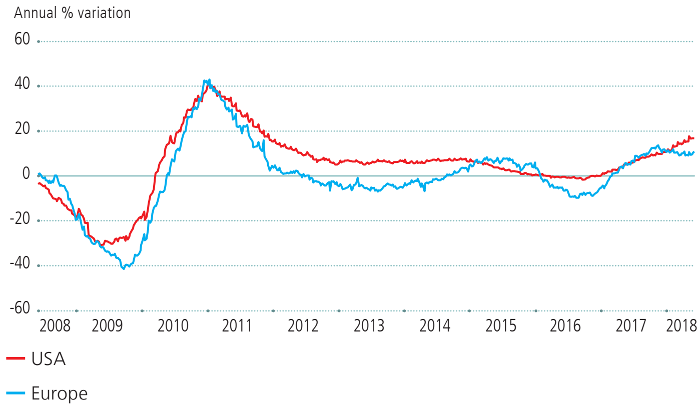


Source : Thomson Reuters Datastream

While political developments affected financial markets during the month of May, company earnings announcements for the first quarter confirmed the health of companies on both sides of the Atlantic. In the United States, double-digit profit growth was published for most business sectors. Supporting the strong performance reported recently, cyclical sectors generated the highest profits. Behind the energy sector, whose figures were boosted by the increase in the price of oil over a year, technology stocks have asserted themselves with a growth of over 30%. According to market expectations, the increase in profits in the United States should exceed 20% in 2018, an estimate that would still be close to 15% without the boosting effect associated with the tax reform.

In Europe, sales growth was much more modest. However, growth in profits demonstrated the ability of business leaders to generate added value despite the appreciation of the euro. Driven by the digital revolution, semiconductor companies have shown strong earnings growth. The luxury sector also benefited from a significant increase in profits. Earnings growth was modest in 2017 but is expected to rise to a higher level this year, close to 8%. While the market's most promising expectations are in technology, finance and especially energy also stand out. Overall, the trend will depend on the evolution of the euro, but also on interest rates and oil prices for the sectors concerned. The growing trade tensions is another exogenous factor to be closely monitored, particularly if it were to have an impact on the highly sensitive automotive sector in Europe.

Corporate profits in Europe and USA



Source : Thomson Reuters Datastream

The figures reported by companies put into perspective the market volatility generated by political events that had no impact on fundamentals. This solidity combined with that of the economic situation calls for the maintenance of an asset allocation favouring the added value generated by companies. The strategic orientation of portfolios that prefer equities to government borrowing is in line with this perspective.

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