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%
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.

**Monetary policy**
- ECB’s rates stable until Sep 2019 and hike in March-20.

**Fiscal policy**
- US fiscal impulse fading, several EMU members stimulating.

**Inflation**
- Accelerating wages should eventually put upward pressures on core inflation but slowly and unevenly.

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

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

**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.

**Emerging Markets**
- EM should prove resilient although with regional divergences.

**FX**
- Neutral on the US dollar Positive bias on EURUSD over the medium term.
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
RIS.k Radar

Summary – Key messages

**Short term**

- US – Inflation flare-up
- Global – Trade and currency wars
- Global – End of QE tantrum
- Italy – Political risk
- UK – Hard Brexit

**Long term**

- Global – Limited monetary and fiscal room to fight next recession
- US – Cyclical slowdown
- US – Corporate leverage
- Japan – Current account crisis
- Global – Rise of populism

**Financial Risks**

- Global – Liquidity disruptions
- Europe – Sovereign debt crisis repeat

**Political Risks**

- China – Hard landing
- US – Mueller investigation
- US – Russia/Iran tensions
- US – Mueller investigation

**Macro Risks**

- Global – End of QE tantrum
- Global – Liquidity disruptions
- Global – Rise of populism

**Global – Limited monetary and fiscal room to fight next recession**

- China – Hard landing
- Global – Rise of populism

**Global – Limited monetary and fiscal room to fight next recession**

- China – Hard landing
- Global – Rise of populism
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.

Source: IMF, AXA IM R&IS calculations

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.
**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**

**Material slowdown in growth expected**

**US contributions to growth**

Source: BEA, FRED, 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

![First and second round impact of trade war on Chinese GDP](image1)

![Trade war accelerates the turn of China’s current account](image2)

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**

China’s fiscal revenue, expenditure and imbalance

- Source: CEIC, AXA IM R&IS calculations

**Monetary easing is restrained by deleveraging**

China’s M2, bank loan and total social financing growth

- Source: CEIC, AXA IM R&IS calculations
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

China faces the same pressure that precedes reforms in the past

Source: Penn World, AXA IM R&IS calculations
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.
**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.
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.

**Graphs:**

**Italian public debt ratio on a slightly rising trend**

- Government forecast
- AXA IM baseline
- AXA IM assuming stronger fiscal multiplier

**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

GDP lifted over summer, but weakest growth since xx

GDP growth and outlook

Source: YouGov, AXA IM R&IS calculations

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).
Beyond quarterly volatility, GDP should expand at a stable 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**

**Q-o-q real consumption growth (%)**

Source: Japan Statistics, AXA IM R&IS calculations

**Corporate investment to GDP peaking soon**

**Corporate investment to GDP (%)**

Source: AXA IM R&IS calculations
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

Further QQE tapering in 2019

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

2019 EM growth to remain relatively resilient

Source: Datastream, AXA IM R&IS calculations

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

<table>
<thead>
<tr>
<th>Region/Country</th>
<th>Real GDP growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Emerging economies</strong></td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>4.7 6.9 6.5 6.1</td>
</tr>
<tr>
<td>Asia ex-China</td>
<td>5.8 6.1 6.1 6.1</td>
</tr>
<tr>
<td>South Korea</td>
<td>3.1 2.8 2.6 2.5</td>
</tr>
<tr>
<td>India</td>
<td>6.7 7.3 7.4 7.5</td>
</tr>
<tr>
<td>Latin America</td>
<td>1.3 1.2 2.1 2.2</td>
</tr>
<tr>
<td>Brazil</td>
<td>1.0 1.5 2.5</td>
</tr>
<tr>
<td>Mexico</td>
<td>2.0 2.2 2.2</td>
</tr>
<tr>
<td><strong>Emerging Europe</strong></td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td>1.5 1.9 1.8</td>
</tr>
<tr>
<td>Poland</td>
<td>4.7 5.2 3.5</td>
</tr>
<tr>
<td><strong>Other EMs</strong></td>
<td>2.6 2.9 3.2 3.4</td>
</tr>
</tbody>
</table>

Source: Datastream, AXA IM R&IS calculations

... intra-regional divergence as well
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 dysfunctioning 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

Turkey heading into recession

Source: Datastream, AXA IM R&IS calculations
2019 Investment Strategy
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**

**Downward pressure on valuation across the board**

**Cross asset valuation**

Source: MSCI, Barclays, BAML, 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

Treasuries hedged 2018 risk episodes only partially, though

Source: Bloomberg and AXA IM R&IS calculations

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

<table>
<thead>
<tr>
<th>Country</th>
<th>LTRO</th>
<th>%</th>
<th>PSPP</th>
<th>%</th>
<th>Lending to non-MFI</th>
<th>%</th>
<th>Banks’ govt bond holdings</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>20</td>
<td>3%</td>
<td>58</td>
<td>3%</td>
<td>328</td>
<td>3%</td>
<td>26</td>
<td>3%</td>
</tr>
<tr>
<td>Belgium</td>
<td>23</td>
<td>3%</td>
<td>73</td>
<td>3%</td>
<td>358</td>
<td>3%</td>
<td>33</td>
<td>3%</td>
</tr>
<tr>
<td>Finland</td>
<td>9</td>
<td>1%</td>
<td>33</td>
<td>2%</td>
<td>219</td>
<td>2%</td>
<td>3</td>
<td>0%</td>
</tr>
<tr>
<td>France</td>
<td>114</td>
<td>16%</td>
<td>416</td>
<td>19%</td>
<td>2.441</td>
<td>23%</td>
<td>144</td>
<td>14%</td>
</tr>
<tr>
<td>Germany</td>
<td>93</td>
<td>13%</td>
<td>513</td>
<td>24%</td>
<td>2.708</td>
<td>26%</td>
<td>177</td>
<td>17%</td>
</tr>
<tr>
<td>Ireland</td>
<td>3</td>
<td>0%</td>
<td>30</td>
<td>1%</td>
<td>150</td>
<td>1%</td>
<td>18</td>
<td>2%</td>
</tr>
<tr>
<td>Italy</td>
<td>239</td>
<td>33%</td>
<td>362</td>
<td>17%</td>
<td>1.540</td>
<td>15%</td>
<td>179</td>
<td>36%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>6</td>
<td>1%</td>
<td>114</td>
<td>5%</td>
<td>943</td>
<td>9%</td>
<td>27</td>
<td>3%</td>
</tr>
<tr>
<td>Portugal</td>
<td>19</td>
<td>3%</td>
<td>36</td>
<td>2%</td>
<td>196</td>
<td>2%</td>
<td>35</td>
<td>3%</td>
</tr>
<tr>
<td>Spain</td>
<td>168</td>
<td>23%</td>
<td>257</td>
<td>12%</td>
<td>1.184</td>
<td>11%</td>
<td>198</td>
<td>19%</td>
</tr>
<tr>
<td>Eurosystem</td>
<td>728</td>
<td>100%</td>
<td>2.148</td>
<td>100%</td>
<td>10.500</td>
<td>100%</td>
<td>1.041</td>
<td>100%</td>
</tr>
</tbody>
</table>

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
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 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

![Year-end spread levels in big four credit markets](image)

Source: Bloomberg and AXA IM R&IS calculations

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

![Graph showing share of BBB rated credits](image)

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

Global equity valuations in comfortable territory

MSCI AC World: Forward price to earnings

Source: Bloomberg and AXA IM R&IS calculations

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

![Graph showing EUR/USD valuation with a line for Fair Value = 1.32 and EURUSD = 1.15. Source: Goldman Sachs, AXA IM R&IS calculations.](image)

**Too much carry for the US dollar to weaken substantially**

USD relative carry to average G10 currencies

![Graph showing USD relative carry to average G10 currencies. Source: Bloomberg, AXA IM R&IS calculations.](image)
## Macro forecast summary

**Forecasts**

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

Source: Consensus Economics, IMF and AXA IM R&IS calculations – As of 05 December 2018
### Expectations on inflation and central banks

#### Forecasts

#### Inflation forecasts

<table>
<thead>
<tr>
<th></th>
<th>CPI Inflation (%)</th>
<th>2018*</th>
<th>2019*</th>
<th>2020*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Advanced economies</strong></td>
<td></td>
<td>AXA IM</td>
<td>Consensus</td>
<td>AXA IM</td>
</tr>
<tr>
<td>US</td>
<td>2.0</td>
<td>1.9</td>
<td>2.1</td>
<td></td>
</tr>
<tr>
<td>Euro area</td>
<td>1.8</td>
<td>1.5</td>
<td>1.4</td>
<td>1.7</td>
</tr>
<tr>
<td>Japan</td>
<td>1.0</td>
<td>0.7</td>
<td>1.9</td>
<td>0.5</td>
</tr>
<tr>
<td>UK</td>
<td>2.5</td>
<td>2.0</td>
<td>1.7</td>
<td>2.3</td>
</tr>
<tr>
<td>Switzerland</td>
<td>1.0</td>
<td>0.7</td>
<td>1.4</td>
<td>1.0</td>
</tr>
<tr>
<td>Other DMs</td>
<td>1.8</td>
<td>1.9</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Consensus Economics, IMF and AXA IM R&IS calculations – As of 5 December 2018

#### Central banks’ policy: meeting dates and expected changes

**Central bank policy**

**Meeting dates and expected changes (Rates in bp / QE in bn)**

<table>
<thead>
<tr>
<th></th>
<th>Current</th>
<th>End-18</th>
<th>Q1 - 19</th>
<th>Q2 - 19</th>
<th>Q3 - 19</th>
<th>Q4 - 19</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>United States - Fed</strong></td>
<td>2.00 - 2.25</td>
<td>18-19 Dec</td>
<td>29-30 Jan</td>
<td>30-1 Apr/May</td>
<td>30-31 July</td>
<td>29-30 Oct</td>
</tr>
<tr>
<td>Dates</td>
<td></td>
<td></td>
<td>2018</td>
<td>2019</td>
<td>2020</td>
<td>2021</td>
</tr>
<tr>
<td>Rates</td>
<td>+0.25 (2.25-50)</td>
<td>19-20 Mar</td>
<td>18-19 Jun</td>
<td>17-18 Sep</td>
<td>10-11 Dec</td>
<td></td>
</tr>
<tr>
<td><strong>Euro area - ECB</strong></td>
<td>-0.40</td>
<td>13 Dec</td>
<td>24 Jan</td>
<td>10 Apr</td>
<td>25 July</td>
<td>24 Oct</td>
</tr>
<tr>
<td>Dates</td>
<td></td>
<td></td>
<td>2018</td>
<td>2019</td>
<td>2020</td>
<td>2021</td>
</tr>
<tr>
<td>Rates</td>
<td>unch (-0.40)</td>
<td>7 Mar</td>
<td>6 Jun</td>
<td>12 Sep</td>
<td>12 Dec</td>
<td></td>
</tr>
<tr>
<td><strong>Japan - BoJ</strong></td>
<td>-0.1/¥42tn</td>
<td>19-20 Dec</td>
<td>22-23 Jan</td>
<td>24-25 Apr</td>
<td>29-30 Jul</td>
<td>30-31 Oct</td>
</tr>
<tr>
<td>Dates / QE</td>
<td></td>
<td></td>
<td>2018</td>
<td>2019</td>
<td>2020</td>
<td>2021</td>
</tr>
<tr>
<td>Rates / QE</td>
<td>unch/taper</td>
<td>14-15 Mar</td>
<td>19-20 Jun</td>
<td>18-19 Sep</td>
<td>18-19 Dec</td>
<td></td>
</tr>
<tr>
<td><strong>UK - BoE</strong></td>
<td>0.75</td>
<td>20 Dec</td>
<td>7 Feb</td>
<td>2 May</td>
<td>1 Aug</td>
<td>7 Nov</td>
</tr>
<tr>
<td>Dates</td>
<td></td>
<td></td>
<td>2018</td>
<td>2019</td>
<td>2020</td>
<td>2021</td>
</tr>
<tr>
<td>Rates</td>
<td>unch (0.75%)</td>
<td>21 Mar</td>
<td>20 Jun</td>
<td>19 Sep</td>
<td>19 Dec</td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Datastream, AXA IM R&IS calculations - As of 23 November 2018
## Calendar of 2019 event

<table>
<thead>
<tr>
<th>2019</th>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>1 Jan</td>
<td>US 25% Tariffs on $200bn of Chinese imports</td>
</tr>
<tr>
<td></td>
<td>23 Jan</td>
<td>BoJ Meeting</td>
</tr>
<tr>
<td></td>
<td>24 Jan</td>
<td>ECB Meeting</td>
</tr>
<tr>
<td></td>
<td>22-25 Jan</td>
<td>World Economic Forum</td>
</tr>
<tr>
<td></td>
<td>30 Jan</td>
<td>FOMC meeting</td>
</tr>
<tr>
<td>February</td>
<td>7 Feb</td>
<td>BoE meeting</td>
</tr>
<tr>
<td></td>
<td>17 Feb</td>
<td>Section 232 investigation into Autos deadline</td>
</tr>
<tr>
<td></td>
<td>February</td>
<td>Thailand General Election</td>
</tr>
<tr>
<td>March</td>
<td>1 Mar</td>
<td>US Debt Ceiling Lifted</td>
</tr>
<tr>
<td></td>
<td>7 Mar</td>
<td>ECB Meeting</td>
</tr>
<tr>
<td></td>
<td>15 Mar</td>
<td>BoJ Meeting</td>
</tr>
<tr>
<td></td>
<td>19 Mar</td>
<td>FOMC meeting</td>
</tr>
<tr>
<td></td>
<td>21 Mar</td>
<td>BoE Meeting</td>
</tr>
<tr>
<td></td>
<td>29 Mar</td>
<td>Brexit Day</td>
</tr>
<tr>
<td></td>
<td>31 Mar</td>
<td>Ukrainian Presidential Elections</td>
</tr>
<tr>
<td>March</td>
<td>10 Apr</td>
<td>ECB Meeting</td>
</tr>
<tr>
<td></td>
<td>12-14 Apr</td>
<td>IMF/World Bank meetings</td>
</tr>
<tr>
<td></td>
<td>17 Apr</td>
<td>Indonesia General Election</td>
</tr>
<tr>
<td></td>
<td>25 Apr</td>
<td>BoJ Meeting</td>
</tr>
<tr>
<td>April</td>
<td>April/May</td>
<td>Indian General Election</td>
</tr>
<tr>
<td></td>
<td>1 May</td>
<td>FOMC Meeting</td>
</tr>
<tr>
<td></td>
<td>2 May</td>
<td>BoE Meeting</td>
</tr>
<tr>
<td>June</td>
<td>26 May</td>
<td>EU &amp; Belgium Elections</td>
</tr>
<tr>
<td></td>
<td>6 Jun</td>
<td>ECB Meeting</td>
</tr>
<tr>
<td></td>
<td>19 Jun</td>
<td>FOMC Meeting</td>
</tr>
<tr>
<td></td>
<td>20 Jun</td>
<td>BoJ &amp; BoE Meeting</td>
</tr>
<tr>
<td>July</td>
<td>25 Jul</td>
<td>ECB Meeting</td>
</tr>
<tr>
<td></td>
<td>30 Jul</td>
<td>BoJ Meeting</td>
</tr>
<tr>
<td></td>
<td>31 Jul</td>
<td>FOMC Meeting</td>
</tr>
<tr>
<td>August</td>
<td>1 Aug</td>
<td>BoE Meeting</td>
</tr>
<tr>
<td></td>
<td>August</td>
<td>US Debt Ceiling lift expected to bite</td>
</tr>
<tr>
<td>September</td>
<td>12 Sep</td>
<td>ECB Meeting</td>
</tr>
<tr>
<td></td>
<td>13 Sep</td>
<td>End of US Fiscal year</td>
</tr>
<tr>
<td></td>
<td>18 Sep</td>
<td>FOMC Meeting</td>
</tr>
<tr>
<td></td>
<td>19 Sep</td>
<td>BoJ &amp; BoE Meeting</td>
</tr>
<tr>
<td>October</td>
<td>20 Oct</td>
<td>Swiss Federal Election</td>
</tr>
<tr>
<td></td>
<td>21 Oct</td>
<td>Canadian Federal Election</td>
</tr>
<tr>
<td></td>
<td>24 Oct</td>
<td>ECB Meeting</td>
</tr>
<tr>
<td></td>
<td>27 Oct</td>
<td>Argentine General Election</td>
</tr>
<tr>
<td></td>
<td>30 Oct</td>
<td>FOMC Meeting</td>
</tr>
<tr>
<td></td>
<td>31 Oct</td>
<td>BoJ Meeting</td>
</tr>
<tr>
<td>November</td>
<td>7 Nov</td>
<td>BoE Meeting</td>
</tr>
<tr>
<td></td>
<td>11 Dec</td>
<td>FOMC Meeting</td>
</tr>
<tr>
<td>December</td>
<td>12 Dec</td>
<td>ECB Meeting</td>
</tr>
<tr>
<td></td>
<td>19 Dec</td>
<td>BoJ &amp; BoE Meeting</td>
</tr>
</tbody>
</table>
Rising Brexit drama, intensifying trade negotiations and buoyant third quarter earnings
19 November 2018

Unstable hedges and monetary policy gaps
14 November 2018

Italy’s budget deadline, Chinese manufacturing surprise and calm from the US Fed
12 November 2018

The hurt of red October
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