MARKET COMMENT – Q1 2018

The first steps into 2018 were full of hope and some would say, rather naive. Encouraged by longterm momentum, a subdued level of volatility and the US fiscal stimulus, some investors were of the thought that nothing could derail this long-term upward trend we've experienced over the last couple of years. After all, as economists and asset managers constantly repeated throughout 2017, we are in a "synchronised growth" environment and obviously, the stars have aligned to support the notion that we're getting the "best of all possible worlds". At the risk of sounding like Voltaire and despite my deepest wish to be living in a preestablished order, the reality is that some risks were bound to resurface and it was merely a question of when.

In January, neither the implementation of the new Markets in Financial Instruments Directive (MIFID II) in Europe nor another US government shutdown stopped the equity rally. The IMF raised their global economic forecast on the back of the new US fiscal policy while in their usual set of new year outlooks, large banks were all chanting about the bright future ahead for 2018. Nevertheless, the USD yield curb steadily increased, and volatility finally spiked at the end-of-the month due to concerns that interest rates will rise quicker than anticipated. Leveraged short volatility players then woke with a sudden start, only to be confronted with a surge after almost two years of slumber.

February saw the materialization of risk perceived through a correction of risky assets. Furthermore, the US investigation into Russian interference during the last elections made waves. In Europe, the UK government under Theresa May's leadership rejected the EU proposal on border issues concerning Northern Ireland. In the Middle East, Russia issued a warning to the US over its interventions in Syria. Nevertheless, the optimism that characterized last year eventually prevailed. The prospect of a temporary healthy correction became a reality as rates stabilized and markets rebounded for a while. The opening speech given by the new head of the FED, Jerome Powell challenged this optimism. Are valuations still too high? Warren Buffet seems to think so, as we learned that Berkshire Hathaway, his investment company, was holding on to billions of cash.

March saw an intensification of international tensions and this time round markets reacted more nervously than in previous years. First, President Trump announced and enforced a 25% tariff on steel and a 10% tariff on aluminium imports. Later in the month, he also imposed new measures designed to penalize China for trade practices that the Trump administration is critical of. In a surprising paradox, China suddenly looked like a free trade champion. While the tensions with North Korea were tempered as we learned that Kim Jong-un was in denuclearization discussions with Xi Jinpin of China. All the while, Western countries closed ranks against Russia. Multiple countries announced expulsions of Russian Diplomats as a sign of support to the UK following a murder attempt of a former Russian national on UK territory, as well as of his daughter. This didn't prevent Vladimir Putin's re-election with 77% of registered voters backing the incumbent. The tech industry went through a rough patch when the substantial data leak from Facebook to Cambridge Analytica became public knowledge. Beyond reminding everyone that private data held by FB is not and has never been safe, this prompted and highlighted authorities' willingness to increase their involvement when it comes to social media privacy policies (with possible tax implications etc…). Finally and as expected, the Fed raised its key interest rate by 0.25%.

In summary, the first quarter of 2018 was dominated by geopolitical headlines generated by Mister Trump's tweets, the trade war and Syria among others. There was a quick allocation of blame to these obvious triggers for being the cause of the subsequent riskier environment. The markets saw a return of volatility when bad news hit the headlines, but we believe the fundamental reason of this pattern is the retreat of the massive liquidity from the central banks. So let's take another look at the current policy positions of the main Central Banks. The fed is on its path to normalization and the ECB is in a tapering transitory phase that should end in September. Finally, while the BoJ abandoned a systematic asset purchase approach, it's holding a supportive stance with the goal of maintaining the near 0% 10-year interest rate. It is important to stress that the ECB and the BoJ were not only encouraged by the "synchronised growth" we mentioned initially, but also by the difficulty of continuing further easing. As explained above, everything may not be as bright as investors would have hoped at the very beginning of the year.

After years of central bank support, the question remains whether the global economy will be able to sustain itself without the liquidity injections. This is why we currently believe, as long as central bank polices are well communicated, markets may evolve sideways with boundaries aligned to the evolution of corporate earnings as valuations remains overall stretched.

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Performance of key global indices:

Markets	**Indices**	**Q1**
Equity World	*MSCI All Countries World Daily Total Return Net USD Index*	-0.96%
Equity Emerging Market	*MSCI Emerging Net Total Return USD Index*	1.42%
Global Fixed Income	*Barclays Global-Aggregate Total Return Index USD*	1.36%

Global Commodity	*S&P GSCGI Index Spot Index*	2.37%
Hedge Funds	*Hedge Fund Research HFRX Global Hedge Fund Index*	-1.02%
EUR/USD	*Euro Dollar*	2.66%