MARKET COMMENTARY – Q3 2018

Is the global bull market in its final throes? It certainly was tested by various factors in the last quarter, all of which shone a light on the challenges ahead. What are these challenges and what to think about them?

In Europe, the deadline for Brexit of next March is putting pressure on both sides to reach a reasonable deal in time. Far from merely a two-sided game, the UK government itself can't show a unanimous front in the negotiations. In July, several British ministers resigned in order to voice their disagreement with the terms of the discussions. Given the turmoil within the British government, in August Theresa May raised the possibility a "no-deal Brexit" scenario. She urged her own government to consider what is at stake and stressed the importance of persevering through the negotiations. Nevertheless and despite a lot of effort, the ongoing questions around the Northern Ireland border issue remained at an impasse at the end of the quarter.

Could failure in the negotiations result in a disastrous departure of the UK without any agreement? Brexit revolves around three core issues: the fate of UK citizens living in the EU and EU citizens living in the UK, how much the UK owes the EU and lastly, the Ireland border. The first two have been addressed and provisionally agreed, the remaining issue being in limbo.

In a way, important aspects already have been covered and it is therefore hard to imagine that the outstanding Ireland issue would jeopardize the rest. Furthermore, in an obvious paradox, in order for Brexit to not be a catalyst for other EU departures, the process can't appear to be easy, but rather it should demonstrate the risks involved, the strength of the Union and the intense challenges that leaving presents. For UK citizens, the level of satisfaction with the deal is also directly impacted by perceived process. Today we are monitoring it closely, but currently are of the belief that a resolution (probably imperfect and indefinite) will be found.

The main geopolitical challenge remains the trade war between the US and China which escalated further. During every single month of the last quarter, President Trump slapped additional tariffs to the total value of $250billion worth on Chinese goods, with quasi automatic retaliation from China. No indication of a potential agreement was to be found and plans of tarrif increases have already been communicated.

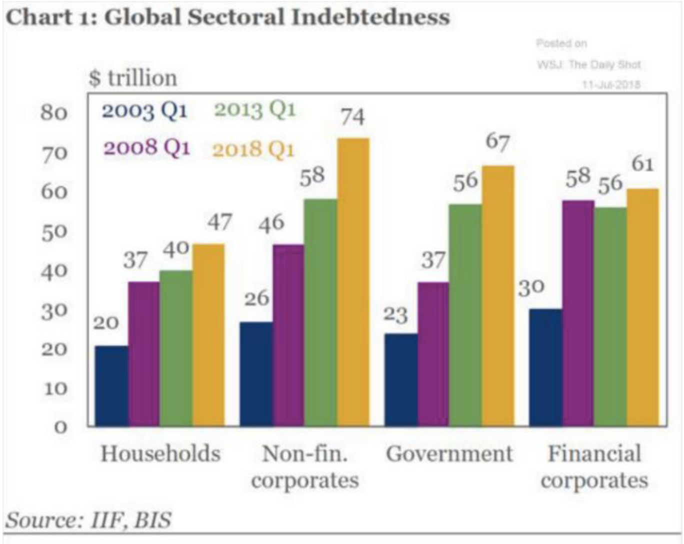
As mentioned previously, our concerns were especially focused on the deterioration of diplomatic ties as a return of protectionism was expected since the 2016 US election. But the speed, aggressivity and the method employed to implement this politic were globally underestimated. This being said, today most of the tariffs applied on Chinese goods can be seen as more or less neutralized by the depreciation of the Yuan. We also have to acknowledge the completion of the USMCA (new version of the Nafta), proof that a solution can indeed be found despite a rocky start. But investor confidence has been shaken as we already see volatility in the Chinese equity market and this could be one of the main ingredients in ending global positive trends.

Beyond the political realm, the most fundamental factor impacting the markets remains the US Central Bank tightening its policies. For a third time in 2018, the fed raised its key rate by a quarter of a percent and Jerome Powell communicated the high likelihood of a fourth hike in the last quarter of the year. President Trump repeatedly stated his disagreement with the pace of the tightening. But given the growth, inflation and labor markets of the US economy, it would be hard to understand why they shouldn't indeed raise the rates. The resulting strength of the US dollar had unfortunately dramatic impacts on EMs. Turkey and Argentina in particular have been impacted, raising worries of a global EM meltdown caused by their important USD denominated debt reliance.

Could the strength of the US Dollar trigger a global Emerging Market crisis? A reassuring argument when we have a closer look is to see a significant increase of the EM government debt being issue in local currency. "*We have been shifting from a world in which emerging economies were borrowing in dollars to a world in which they're borrowing in their own local currencies as well as in dollars. This has helped stabilize emerging economies, and their debt. As countries issue more bonds in their domestic currencies to support growth, they become less sensitive to the currency mismatch risk that comes with borrowing in dollars*."1[1]. But less sensitive doesn't mean complete immunity and it is hard to forget past crisis where EM debt was involved.

The ghost of the 2008 global debt crisis haunts us as well when we think about the risk related to higher interest rates. Where do we stand as we enter the last quarter of the year in terms of debt level, should it be something to worry about today? Let us again be blunt here, the level of global debt is far worse. As you can see in the chart below, the level of debt at the beginning of this year is higher than it was 10 years ago at the beginning of the crisis. But again, the situation is quite different. First of all, the service of the debt is significantly lower and more importantly the leverage used, while more difficult to assess, seems nowhere near where it was then. The reality remains that higher interest rates will challenge valuation (tech valuations?), financial strength of businesses and is then a key component to monitor.

[1] Laurent Develay, Head of Emerging Markets Local Debt at Blackrock



In summary, the third quarter was all about the development of the trade war, the future of Europe through Brexit negotiations uncertainty, emerging markets confronted with a stronger dollar and worries of higher interest rates challenging the current bull market. We believe the current environment warrants cautious exposure and a solid level of diversification rather than directional bets.

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Markets	**Indices**	**Q3-2018**	**YTD**
Equity World	*MSCI All Countries World Daily Total Return Net USD Index*	**4.3%**	**3.8%**
Equity Emerging Market	*MSCI Emerging Net Total Return USD Index*	**-1.1%**	**-7.7%**
Global Fixed Income	*Barclays Global-Aggregate Total Return Index USD*	**-0.9%**	**-2.4%**
Global Commodity	*S&P GSCGI Index Spot Index*	**-0.2%**	**9.9%**
Hedge Funds	*Hedge Fund Research HFRX Global Hedge Fund Index*	**-0.4%**	**-1.2%**
EUR/USD	*Euro Dollar*	**-0.7%**	**-3.3%**