MARKET COMMENTARY – Q1 2019: Markets Liquidity Addiction – A relapse?

A couple of years ago, I had a fascinating discussion with an addiction specialist who had both academic research and field experience. This gave me a different view on the subject of markets' true addiction to central bank liquidity over the past decade. Indeed, it didn't only consider the relation with the addictive behavior, risky assets craving more liquidity injections, and the health and recovery of domestic economy, but highlighted the challenges to overcome it when the other economies weren't ready "to quit"[1]. I can't help but thinking of this metaphor when looking at what we went through during this year's first quarter. Risky asset prices went significantly higher, while most of the economic forecasts were on the downside and so much geopolitical risks remained at stake. The major central banks were back to a very supportive stance despite expected tightening trajectory and markets were boosted by central bankers' dovishness: A relapse.

Emphasizing the turmoil within the US government, **January** started with the world's leading power existing without an operational government in what became the longest US government shutdown in history. On the other side of the Atlantic, Prime minister Theresa May struggled with the UK divorce from the EU as her deals get rejected. Furthermore, the IMF communicated its macroeconomic forecast downward revision from 3.7% to 3.5% for 2019. Further, important business players such as Apple or Caterpillar warned about the impact of the Chinese economic slowdown. In this quite gloomy environment, the Chinese authorities reaffirmed their willingness to support the economy and the PBoC (People Bank of China) cut the RRR (Reserve Requirement Ratio) by 1%. The fed (US federal reserve) suddenly turned dovish, leaving market expectations for future hikes significantly weaker.

All settled down a little in **February**. The US government reached a budget agreement and showed encouraging signs of a potential trade agreement with China as the truce between the two countries was extended beyond March 1st. On top of this, a unified chorus of dovish central bankers reassured investors. The fed minutes publication confirmed a vast majority of participants in favor of a halt of the balance sheet reduction process. Benoît Coeuré from the ECB mentioned possible further liquidity injections less than two months after the end of the quantitative easing program while the Bank of England stated that any possible rate hikes are being delayed by the Brexit process.

1 « L'angle du traitement des addictions » Kenji Yamada, AGEFI August 2016

March brought back investor's attention to the weaker prospect of global growth. The OECD significantly reduced their forecast for 2019 and 2020, especially in Europe. The European Central Bank echoed the same view by downgrading eurozone growth to 1.1% from 1.7% and inflation to 1.2% from 1.6%. Consequently, the European institution communicated its decision to delay its interest rate hike until at least the end of the year, but also announced the project of a new TLTRO. The US fed continued to see a sustained expansion of the US economy and a strong labor market but kept its key interest rate between 2.25% to 2.5%. From early December's indication of two hikes in 2019 and one in 2020, we now have none for this year and one for 2020. The US yield curve inversion, the yield on the U.S. 10-year Treasury note dipped below the yield on the 3-month paper, also triggered some additional worries late in the month. The month of March was also the month of the Brexit, without an actual Brexit. Members of the UK parliament (MPs) rejected Prime Minister Theresa May's deal not once but twice and gained influence in the Brexit process. Despite an apparent willingness to avoid a no-deal situation, the UK failed to find a clear alternative to the rejected deal. As the deadline neared, The European Union agreed to extend the deadline by a little to April 12th in case no deal is ratified or to May 22nd if a deal is agreed to by then. Beside significant Brexit protests, over 5 Million signatures were gathered in a petition for a second referendum with the hope of staying in the EU.

Markets rode the liquidity wave provided by central banks again. Today, the question remains focused on the sustainability of this support. The significant government debt burden ensures questionable pressure on central banks to keep rates on the lower side, but this is unmistakably a dangerous game. Beyond the impressive rebound of the equity market for the quarter, we believe investors remain concerned about the growth prospect. As many of the large financial institutions were fast to remind after the US yield curve inversion, this doesn't necessary imply the end of the upward trend in the short-term and we could well be fine for 2019. The evolution of how well business is performing will be under high scrutiny. We remain open and ready for a more positive path as well as a more negative one, but for the time being remain well diversified and have a moderate level of directional exposure.

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Markets	Indices	Q1-2019
Equity World	*MSCI All Countries World Daily Total Return Net USD Index*	**12.2%**
Equity Emerging Market	*MSCI Emerging Net Total Return USD Index*	**9.9%**
Global Fixed Income	*Barclays Global-Aggregate Total Return Index USD*	**2.2%**
Global Commodity	*S&P GSCGI Index Spot Index*	**16.0%**
Hedge Funds	*Hedge Fund Research HFRX Global Hedge Fund Index*	**2.6%**
EUR/USD	*Euro Dollar*	**-2.2%**