MARKET COMMENTARY – Q3 2019: The revenge of geopolitics

For many years geopolitical events have been the synonym of short-term volatility and buying opportunities as they tended to have only temporary impact on markets. The Arab spring in 2010, the earthquake and tsunami in Japan causing the Fuskushima nuclear crisis in 2011, the Russian military intervention in Ukraine in 2014 or the North Korean rogue nuclear program in 2017-2018 to name but a few, all had relatively short-lived impact on financial markets. The reason systematically raised is that in the medium to long term, equity markets are driven more by earnings and economic growth than by political events. Nevertheless, the growing importance and alignment of headlines regarding concerns such as the trade war and Brexit and their lasting influence on markets, has definitely changed this perspective.

During the course of the third quarter, the main focus indeed remained on the trade war. This return to protectionism, which we first mentioned in our first quarter commentary of 2017, did truly change the dynamic of international relationships. During the summer, despite a short break reached during the G20, China and the US continued their tariff escalation. In August, Donald Trump announced an additional 15% charge on three hundred billion worth of Chinese goods to be imposed during the last quarter of the year. China then retaliated with tariffs on seventy-five billion worth of US goods and made State Owned Enterprises (SOEs) stop importing US crops. Europe was also getting ready for an impending confrontation with the Trump administration on the same subject, on the back of a long-standing dispute over governmental support to Airbus. In Asia, the trend continued with Japan and South Korea, where political issues also created mutual threats on the commercial trade side. The resulting deterioration of business confidence being at stake, growing scrutiny on the evolution of new orders, inventory, production levels and employment data to assess the related economic slowdown occupied the mind of market participants.

Unfortunately, but unsurprisingly, the trade war was not the only geopolitical concern. The divorce between the UK and the European Union continues occupy daily headlines despite very little progress during the period. The quarter was notably marked by the appointment of Boris Johnson as prime minister in July, succeeding Theresa May. His successive political failures, one of the most important ones being the supreme court ruling illegal his suspension of the UK parliament, reduced the hope reaching a deal in time for the deadline of October 31st. Beyond these two major worries for market, the tensions in the middle east, the persistent protests in Hong Kong and the Argentinian crisis punctuated the volatile evolution of financial markets.

As a counterbalance, central banks were particularly supportive during the whole quarter. In July, for the first time since 2008, the Federal Reserve cut its key rate by a quarter percent while most other central banks communicated their willingness to also support the economy against an expected slowdown caused mainly by the international commercial tensions mentioned above. Despite Fed Chairman Jerome Powell's expectations that only a temporary adjustment was required given the strength of the US economy, the US central bank again reduced their key rate by another quarter percent in September and intervened in the repo market following a troubling cash shortage, despite outstanding premiums offered. In September, the European central bank, led by Mario Draghi in the final couple of months of his mandate, also announced a cut in the deposit rate along a new stimulus package including the reviving of their bond purchasing program stopped less than a year ago, which, in hindsight, looks like a delusional hope of interest rate market normalization. Finally, the Chinese central bank was also quite active in managing a weakening Yuan during the tariff war escalation in August and also provided additional support to its domestic market by reducing its cash reserve requirement ratio for banks, providing additional cash to their financial system.

Between central banks' support and geopolitical tensions, which can worsen or improve quite rapidly, the environment proved to be quite tricky but confirmed our careful outlook resulting in a highlight on diversification and safe havens such as gold. We believe also that absolute return strategies should benefit from an environment with a higher volatility regime and set of opportunities created by several years of massive passive investment. We will be keenly monitoring business sentiment indicators for further potentially defensive views. That said, experience tells us not to underestimate central banks' support to the economy as well as how quick a resolution of some geopolitical challenges could impact sentiment. The UK and the EU finally reaching a deal for instance would definitively provide a significant improvement. Constant vigilance is warranted as well as careful planning of required and related adjustments.

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Markets	**Indices**	**Q3-2019**	**YTD**
Equity World	*MSCI All Countries World Daily Total Return Net USD Index*	**0.0%**	**16.2%**
Equity Emerging Market	*MSCI Emerging Net Total Return USD Index*	**-4.2%**	**5.9%**
Global Fixed Income	*Barclays Global-Aggregate Total Return Index USD*	**0.7%**	**6.3%**
Global Commodity	*S&P GSCGI Index Spot Index*	**-5.1%**	**7.8%**
Hedge Funds	*Hedge Fund Research HFRX Global Hedge Fund Index*	**1.6%**	**5.9%**
EUR/USD	*Euro Dollar*	**-4.2%**	**-5.0%**