Market comment
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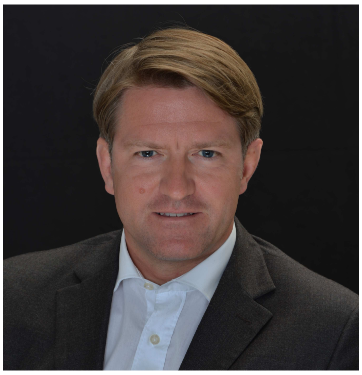

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"A decelerating global economy and markets that are waiting for the major monetary policy decisions"

The third quarter earnings releases proved to be mixed and uneven. So the microeconomy has finally caught up with the macroeconomy. While companies' international activity is disappointing, European domestic activities show good results in a monetary environment flooded with cash.

The third-quarter earnings reflect the deceleration in the global economy. In addition, the results are blurred by the turmoil caused by exchange-rate fluctuations.

When there is a change in a macroeconomic trend, whether on the upside or the downside, the microeconomy always ultimately catches up with the macroeconomy, with a time lag. This feeling of a widespread slowdown is now noticeable in the rather disappointing third quarter earnings releases (one of the worst since 2008). Even though satisfactory result were noteworthy in a few domestic activities (telecoms, for example), we should no longer expect any upward earnings revision for this year or next year. For some sectors such as commodities (oil, steel, etc.), 2016 will be worse than 2015.

Chinese demand is affecting large international groups (commodity producers, car manufacturers and large consumer goods groups). Furthermore, companies as a whole are being impacted by unfavourable currency effects because emerging currencies remain under pressure. While Europe is benefiting from the effect of the exchange rate against the dollar, it is, conversely, suffering from the negative effects of the fall in emerging currencies against the euro (e.g. the Brazilian real).

So the junction between the macroeconomy and the microeconomy has been reached. The question for investors is now whether the pace of the slowdown will gather speed or not. It is possible that the trough of Chinese GDP was reached during the third quarter. The question of the Chinese slowdown and the vigour of the US economy is crucial as the euro zone is not immune against external shocks. Many investors have doubts about the solidity and the sustainability of the European recovery, especially because industrial investment figures are still poor.

Even so, European companies - and particularly those in southern Europe (including France) - still expect double-digit earnings growth for 2015 and 2016. This is not abnormal since it is these countries (France, Italy, Spain) that show the best momentum in in terms of economic velocity - even though growth remains weaker than in a typical recovery. Germany, the exporting power by definition, is being affected by the sluggishness of Chinese demand and to a lesser extent by the Volkswagen affair. Even though there are disparities within the eurozone, its recovery does not seem to be endangered by the global environment for the time being, despite last summer's fears about China.

While the global economy is slowing down and some companies are faced with downward revisions of their earnings, all markets have put their hope in the pro-activeness of central banks, especially in Europe.

The European economy's growth rate (+1.5%e in 2015) is not sufficient to completely reassure the financial community. The stimulation of domestic demand through the ECB's accommodating monetary policy deserves to be continued, which Mario Draghi has hinted for the next Governing Council meeting on 3 December.

Equity markets immediately identified this support factor: the prospect, already more or less announced, of further quantitative easing (increase, extension, new measures, etc.) triggered a rapid rise in European equity markets. This likely announcement would probably make it possible to absorb a monetary policy tightening decision in the United States: the first increase in US interest rates could in fact be decided on 4 December.

Investors must now base their reasoning on a less favourable macro- and microeconomic phase and an increasingly obvious monetary divergence: they must first psychologically accept the US monetary normalisation which seems inevitable and sound, given the US economy's performance (e.g. the latest unemployment figures).

Furthermore in Europe, they now know that they have the ECB's umbrella. The central bank is clearly determined to revitalise the European economic cycle, which is weaker than the US cycle. It is not surprising that monetary policies diverge when the two economies are at such different stages of the cycle. This is not a total desynchronisation, but a cyclical divergence.

It is still too early to draw conclusions on the trajectory of financial markets in 2016. At the very least, next year will probably be marked by a more pronounced divergence of monetary policies and a preference for the euro zone because of the inflow of cash.

How will the markets factor in these divergences in terms of economic cycle and monetary policy? Will China continue to disrupt global markets? As for the first question, investors seem to have understood that the monetary policies should and could be different. As long as there are monetary areas with accommodating monetary policies and which are large enough to invest in, investors will have a choice where to invest their cash. So US investors, the dominant actors in the financial markets, will in all likelihood favour the euro zone which is being boosted by the trio of positive factors (low oil price, weak euro and low funding cost).

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It is nevertheless quite difficult to predict the trajectory of global growth in 2016 and therefore equity market performance in certain markets. As we have seen in 2015, the episode of the devaluation of the Chinese renminbi during the summer led to a reduction in growth forecasts by the major international institutions.

There will be a historical decoupling of US and European bond markets, probably with opposite and simultaneous measures. That has never happened before. We have to keep in mind that European and US bond markets are closely linked (re. the recent pressure on long-term interest rates), and no one can really predict how the European yield curve will react in relation to the US curve. This will probably also be a key issue in 2016.

The ECB will do everything in its power to prevent the situation from getting out of hand in the bond market, and especially in terms of financing costs for European economies. It is also reasonable to believe that Europe could still be the best investment area in the future. Even so, the institutional and political risk in Europe still persists, even though it is somewhat lower. As good example of this is the British referendum on whether or not it should remain an EU member and the recent tensions within the Portuguese government.

However, we should make no mistake about monetary policies: the main consequence of quantitative easing programmes is a deprecation of the currency of the monetary area in question, but not an in-depth reform of the economic systems. A central bank can prevent certain risks (in particular the most dangerous of them: systemic risk) but it is final demand that must take the slack and generate a virtuous cycle of value creation among companies: margin growth, improvement in the return on capital employed, earnings growth and industrial investment. Economic agents cannot live under monetary perfusion forever. Nevertheless, optimism will in all likelihood continue to reign until the end of the year. The issues addressed by the markets are not unknown, but what is new is that they have to - as always - project themselves into a monetary world they are unfamiliar with.
Text completed on 10 November 2015 by Igor de Maack, Management spokesperson.

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