Market comment
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By Igor de Maack
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"The latest stance from central banks along with initial signs of renewed inflation could fast-track a shift in the bond scenario".

Central banks are realizing that the asset purchase programs are having only a marginal impact and they are concerned about the aftermath of the zero interest rate policy. After the Fed and the BoJ, it's the ECB's turn to start sowing the seeds of doubt on the market on the effectiveness of continuing with asset purchase programs. With the probability of a US rate hike lying ahead in December, on a subliminal level investors are beginning to expect a much more negative bond scenario. Admittedly, it is not yet a given that a hike in short-term rates would trigger a rise in long-term rates, but investors could be tempted to put these negative rate financial instruments back in their rightful place and back to their rightful price. Against this backdrop, long-term bonds should be excluded from portfolios. It is still too early to raise concern among investors at this stage, but bond haven could become bond hell. Equities are one of the few asset classes that can still provide real positive yield, so they could therefore benefit from arbitrage moves. However, we are far from this situation at this stage, as European equities have seen their thirty-fourth consecutive week of outflows. Brexit had little impact on equity market performances in the end, but it set off a wave of political dissatisfaction. The forthcoming US elections and the Italian referendum are sound reasons to avoid taking risks.

The macroeconomic climate saw a slight improvement on the back of stabilization for emerging markets and the beginnings of a recovery in global industry. According to estimates from various bodies, the global economy is stabilizing with growth of around 2.8%-3% for 2016-2017. Macroeconomic risks were broadly overestimated at the start of the year against a backdrop of worsening military conflict in Syria. Meanwhile, the expected collapse in an oil-producing emerging country did not happen; the slow death of the Eurozone economy has not yet materialized; the USA has not reached the end of the current economic cycle and China has been "landing" for three years now.

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In September, the manufacturing PMI recovered across most industrialized countries. After hitting a low of 50, the global manufacturing PMI is now close to 52, primarily as a result of the end of the reduction process of the industrial overcapacities. Service businesses are majority contributors to GDP in developed and/or highly digitalized economies, but industry still drains a hefty proportion of capital and investment, for example in the oil sector. This improvement in the industrial component could therefore bolster the world growth outlook.

Commodities are coming out the other side after a rough patch and rising prices could help fuel inflationary pressure. The surprise decision by OPEC to reduce oil output following the meeting in Algiers may mark the end of oil's downtrend. This would automatically trigger a rebound across all commodities, which would have a positive knock-on effect on price indices. Since the two major financial crises of 2008 and 2011, issues of permanent global deflation and the inexorable decline of the European economic area have been the subject of much conversation. Inflationary statistics are still low in the Eurozone, hitting 0.4% for September, but this is their highest level since July 2014. The first signs of wage pressure are visible in the USA and the Fed is increasingly referring to the possibility of reaching an inflation target of 2%. With the recovery in oil prices, oil-producing countries such as Russia, Brazil and Saudi Arabia are set to regain some budget headroom. The oil majors drastically cut back their investment programs and will now have to resume them in order to offset the depletion of their reserves. This virtuous inflationary spiral will of course take several years and will require an absence of any major economic crisis in the meantime. But just as no-one in the 1980s could imagine 0% inflation 30 years later, a lot of investors in 2016 think that inflation is unlikely to reappear …

Text completed on October 12, 2016 by Igor de Maack, fund manager and spokesperson for DNCA fund management team.

About DNCA:

DNCA is a French asset management company set up in 2000 by wealth-management specialists acting on behalf of private and institutional investors. With a defensive slant, the company seeks to optimize the risk/return ratio on its portfolios. With a team of more than 104 staff, DNCA has developed expertise in European and international equities (long only and absolute return), diversified fund management, convertible bonds and Eurozone bonds. The quality of the company's investment management, which regularly wins awards from the financial press, has enabled the company to enjoy swift growth over the past fifteen years. AUM currently stand at €18.9bn (as at 09/30/2016).

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