Market Developments
Key Themes driving markets this quarter

- Brexit - How to position for the impact? (so far mostly GBP and gilts)
- Real yields driving FX instead of nominal – Monetary policy operating at limit
  - Bank of Japan making this most explicit?
- Fed – Hiking in 2016? Implications for EM and capital flows
- Politics – Increasingly important for markets (eg MXN and Trump, European elections)
Market Developments

FX since 20-Jun – Broadly stable, sterling weaker on Brexit

Source: JP Morgan, Bloomberg
Market Developments
Equities since 20-Jun – Post Brexit rebound extends

Equity Valuations (20th June = 100)

Source: Bloomberg
Bond Market Key Developments

Global yields lower

10y yields

Source: Bloomberg
Bond Market Key Developments

Eurozone peripheral spreads

10 year spread vs Bunds

Source: Bloomberg
Eurozone swap rates
Per cent YoY

Source: Bloomberg
Eurozone Inflation Outlook

Per cent yoy

Source: Eurostat, Bloomberg.
Decomposing yields

France 10y real rate using nominal yields and inflation swaps

Volatility
Implied Volatility across asset classes

Source: Bloomberg, CBOE, Deutsche Bank
Growth slowing into Q3 2016

Real GDP growth; per cent yoy

Source: Bloomberg, National statistics offices
ECB PSPP
Change in supply of public debt (% of outstanding) by Mar 17

Net Supply of EA bonds; Mar 15 – Mar 17 (% outstanding)

Source: Bloomberg.
ECB CSPP
Yields still grinding lower; ECB driving issuance

BoA ML Eurozone Corporate Investment Grade YTM (per cent)

Source: Bank of America Merril Lynch.
OUTLOOK
Key Issues

- **Monetary Policy exhausted?**
  - Will EUR move stronger if the market senses lethargy from fiscal side?
  - Impact of low rates unclear

- **Impact of Brexit, what is it?**
  - Trade agreements needed sorting. British imports vital for Eurozone growth
  - Real investor sentiment dampened across Europe and not just UK?

- **Politics the key factor looking ahead**
  - Italy, France, Germany elections; Euro scepticism rife and growing

- **Structural questions surrounding Eurozone setup unresolved**
  - Strong core with fiscal unity or widening core – periphery disparity?
Impact of low rates

- Pension systems under stress. Companies diverting profits to fund deficits instead of investment?
- Banks - credit creation under jeopardy as margins squeezed?
- Absence of animal spirits means lower rates encourage more saving?
- Frothy asset markets setting the stage for the next bubble?

Source: Bloomberg
Fiscal trajectory finally aligned with ECB
Cyclically adjusted primary balance

Source: Eurostat
Credit more abundant and cheaper
Growth firm, interest rates declining

Eurozone credit growth (M3)

Interest rate on outstanding loans falling

Source: ECB.
PMI surveys however mixed

Eurozone Manufacturing, Services and Construction PMI

Source: Markit
Unemployment
Declining, but structural questions persist

Source: Eurostat.
Discussion Points

- Likelihood of additional fractures in the European project – economic and political
- Is unconventional policy the new convention? What next?
- Willingness and ability for fiscal authorities to act
- Impact of low yields. Would higher rates help?
- A de-globalizing world, implications for markets.

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