AXA Investment Managers

2018: A Year Of No Returns

Monthly Investment Strategy

Research & Investment Strategy

December 2018

2018: A Year Of No Returns

From end-QE to end-cycle

2018, a frustrating year for investors…

- While 2017 was an enjoyable synchronisation of positive growth momentum and strong performance of risky assets, 2018 will hardly be missed. Equity returns are closing the year poorly across the board, and the de-rating of equities can be attributed to a mix of higher risk-free rates and poor investor sentiment.
- In particular, on top of lacklustre growth, euro area equities disappointed in the wake of political risk. Emerging market equities, meanwhile, suffered from both tighter financing conditions and concerns around trade protectionism.
- Credit inevitably succumbed to equity contagion, especially in the last quarter of 2018. The pain has been particularly acute for high yield, upending the reflation trade that saw high yield outperforming investment grade for much of 2018.

…And a challenging 2019 ahead, especially as our risk scenarios are already unfolding

- We believe that the rise in cross-asset correlation and in market volatility in 2018 is related to the end of the global expansion of central banks' balance sheet and the reversal of the liquidity tide. 2019 and possibly beyond could prove just as challenging with low returns and high cross-asset correlations.
- 2019 may prove all the more challenging if the two risk scenarios we outlined in our 2019 Outlook and which have already begun to unfold in December gain further traction: the US Federal Reserve (Fed) losing confidence and the Eurozone economy exiting the cyclical expansion first even though it entered the cyclical upswing last.

Asset allocation: shifting down a gear

- The QE tide is reversing, putting downward pressure on asset prices and upward pressure on correlations
- We maintain a modest risk appetite, partly shifting from US to emerging market equities
- We underweight investment grade credit, expect Bund yields to remain range-bound in 2019 and see value in Treasuries above 3.25%

Central scenario

Summary – Key messages

Monetary policy

2 final Fed hikes in 2019. ECB's rates stable until Sep 2019 and hike in March-20

Inflation

Accelerating wages should eventually put upward pressures on core inflation but slowly and unevenly

Fiscal policy

US fiscal impulse fading, several EMU members stimulating

Growth

Slowing in the US, the EMU and China. Stable in Japan and non-China EMs

Our central scenario:

From end-QE to end-cycle

A resilient macro backdrop allows central banks to exit carefully. Markets appear more range-bound and volatile. We are taking a less positive view on risk assets

Emerging Markets

EM should prove resilient although with regional divergences

Rates

Bund to remain range-bound. We see value in Treasuries above 3.25%

FX

Neutral on the US dollar Positive bias on EURUSD over the medium term

Credit

Credit spreads should remain under pressure. Downgrade risks are mounting

Equities

Softer top line growth and pressures on profit margins are a key concern, whilst valuations are no longer a headwind

Alternative scenarios

Summary – Key messages

EMU Last In First Out – ECB Stalemate *(probability 30%)*

What goes differently?

- An adverse shock hits the Eurozone: disruptive Brexit, escalation over Italy's risk, China's demand slows more than anticipated…
- Having lagged in the economic cycle, the EMU ends up leading in the slowdown

What it means

- The ECB does not normalise rates which remain at their current levels throughout 2019 and 2020
- Growth/inflation expectations tank

Market implications

- Risk appetite deteriorates
- Safe-haven rates rally and peripheral spreads widen with contagion from Italy, euro depreciating
- US equities over performing. EM debt may hold up

Fed hawk down *(probability 15%)*

What goes differently?

- As seen in 1966 and 1995, the Fed averts/postpones the end-cycle by pre-emptively easing
- The US economy manages a soft landing in 2020 with stable unemployment

What it means

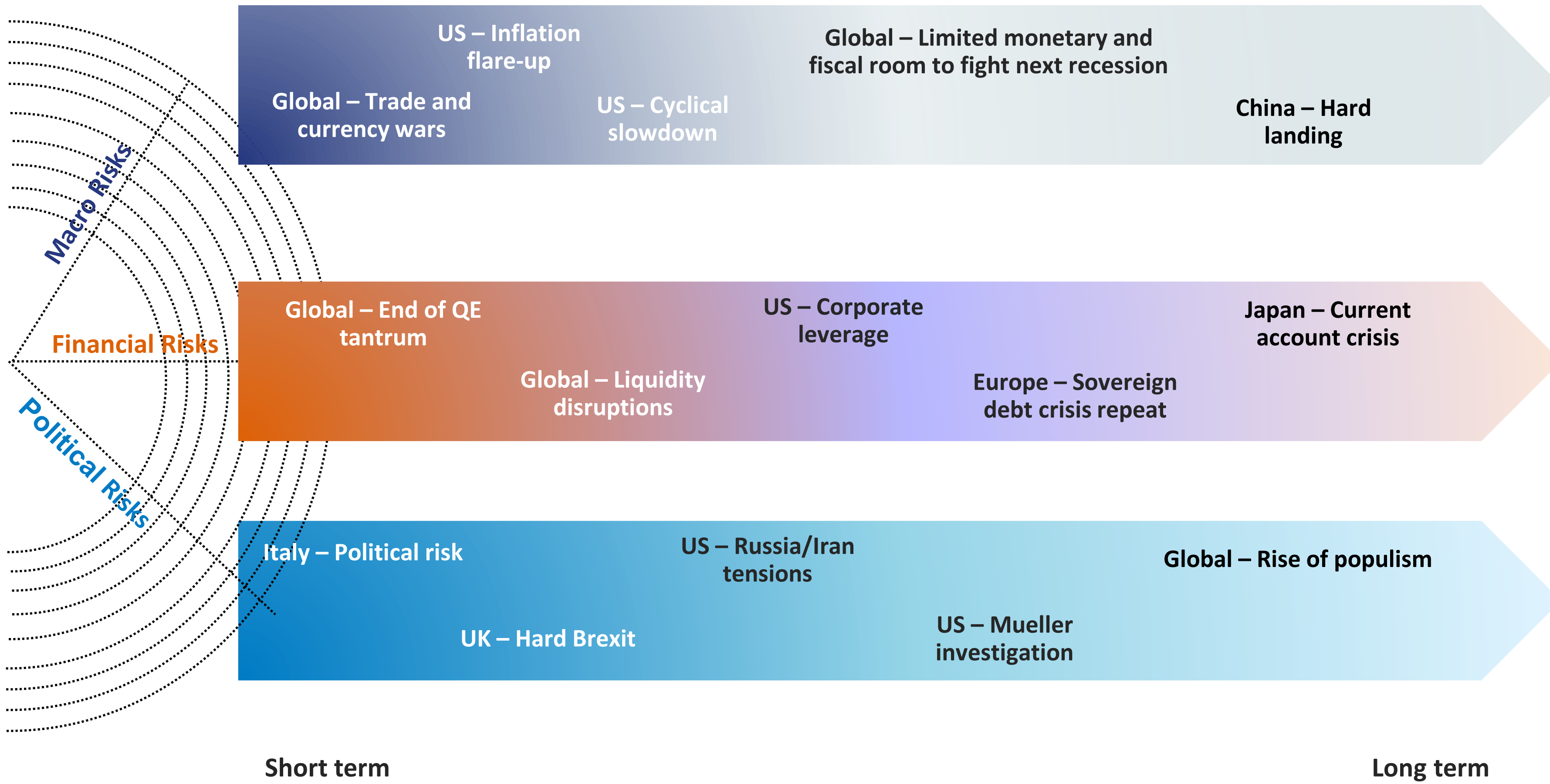
- The Fed's easing starts as early as end-2019
- US growth and inflation surprise on the upside in a super extended economic cycle

Market implications

- UST yield curve re-steepening on break-evens and term premium, US$ depreciating.
- Bull US equities, possibly in a reflation trade reloaded. Risk-on with EM equities over performing

RIS.k Radar

Summary – Key messages



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Theme of the Month

Macro forecast performance shed little light on market underperformance

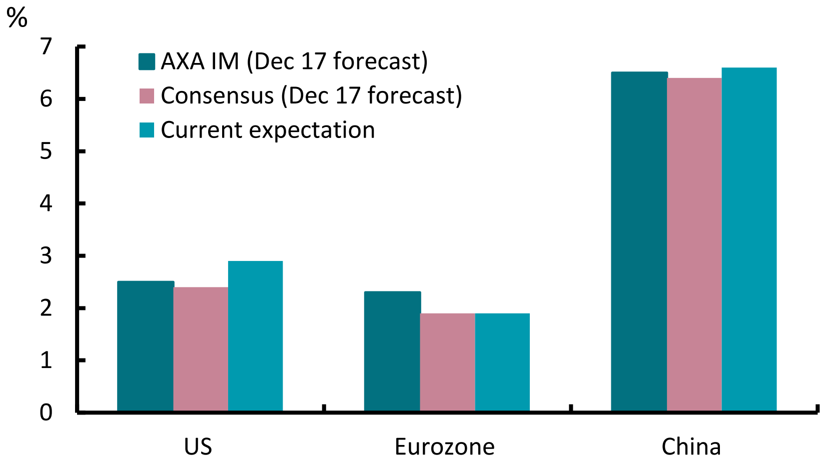
Theme of the month – A year of no returns

Growth outlook more difficult outside the US.

- We compare our 2018 forecasts at the end of last year to their current likely outturns. Global performance was more mixed than expected.
- We forecast US growth at 2.5%, modestly ahead of consensus. However, additional fiscal stimulus enacted in early 2018, meant it took until February for us to correctly anticipate the 2.9% currently expected.
- China GDP growth was also forecast ahead of consensus and appears closer to the current expectation of 6.6%. However, the headline GDP measure perhaps fails to convey the underlying weakening of activity in China this year.
- Our Euro area growth forecast was also ahead of consensus at 2.3%. However, weak net trade and subsequent auto-sector weakness leaves output more likely at 1.9% this year, in line with the consensus forecast in 2017.

Q4 GDP growth remains on track for solid close

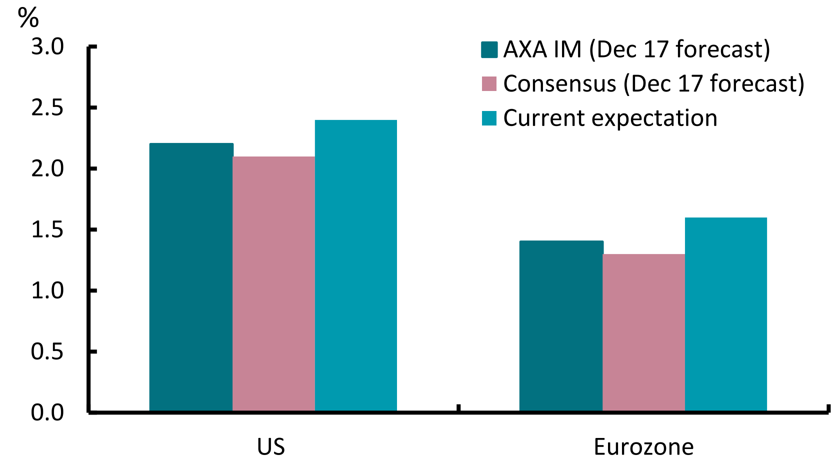
2018 GDP forecast performance



Source: BEA, FRBA, ISM, AXA IM Research, Dec 18

Financial conditions tighten across range of metrics

2018 CPI forecast performance



Source: BLS, AXA IM R&IS calculations

Monetary Policy Divergence - A major driver of rate expectations & yield curve dynamics

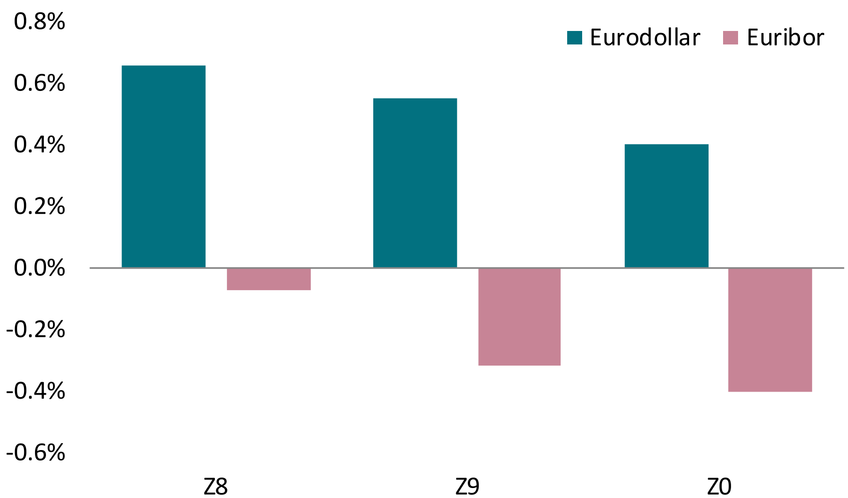
Theme of the month – A year of no returns

2018 has again been a year of divergent monetary policy

- The Fed has delivered on its promised path, while the ECB is enhancing its forward guidance;
- In both cases, markets have repriced heavily compared to implied levels at the start of the year.
- This divergence has also affected the shape of the USD and EUR curves, thus sending a signal to the markets that the decade-long US business cycle might be close to a turning point

Repricing of divergent monetary policy in the US and Euro area

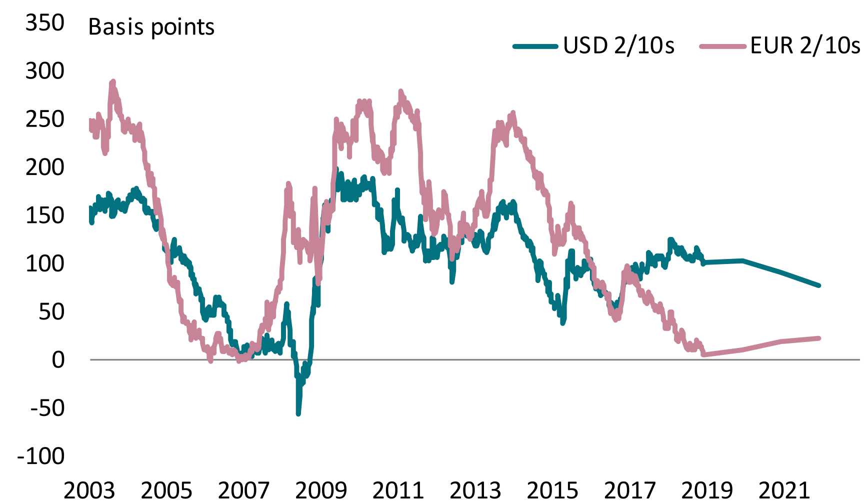
STIR: Changes year to date



Source: Bloomberg and AXA IM R&IS calculations

US yield curve flattening signalling a turning point in the cycle

Yield Curve: EUR vs USD



Source: Bloomberg and AXA IM R&IS calculations

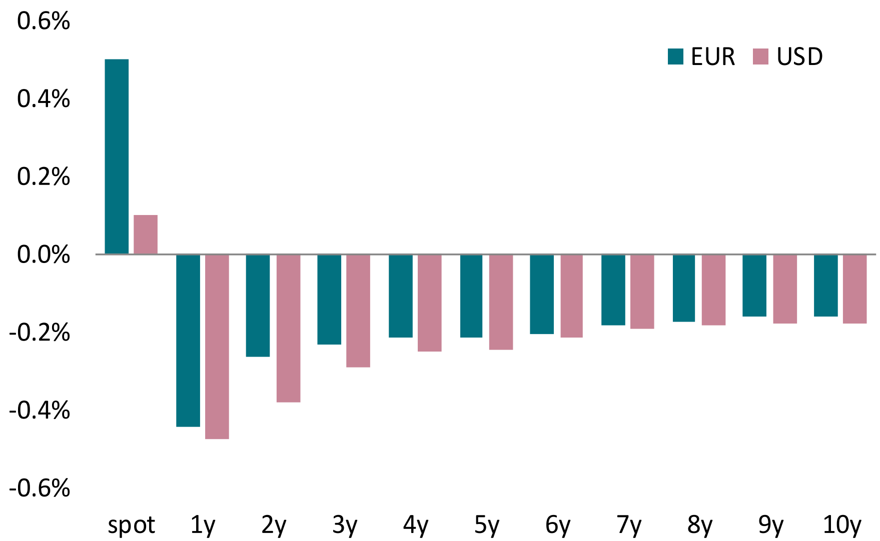
Increased Geopolitical Risk

Theme of the month – A year of no returns

The rise of populism in an environment of global economic slowdown

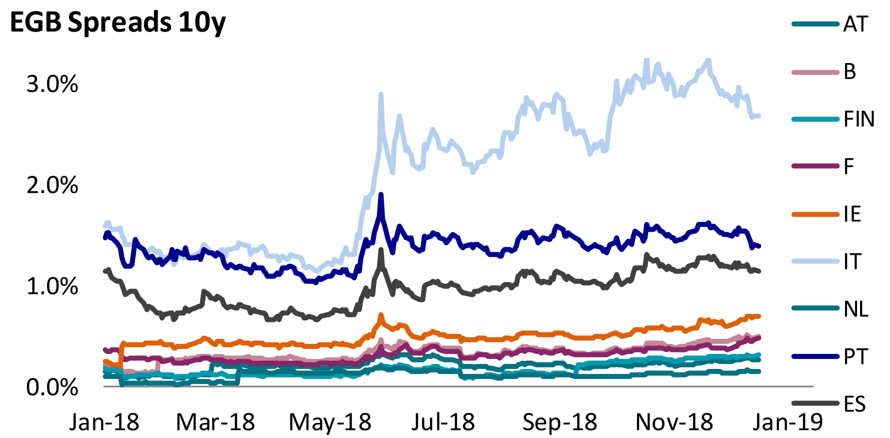
- Concerns about a global economic slowdown have also hit **inflation expectations** both in USD and EUR.
- Furthermore, a **political clash** between the EC and Italy has pushed BTP spreads to levels not seen since 2013, thus adding to overall uncertainty.
- The move in BTPs has affected also other EMU spreads as well as financials' valuation. More generally, **financial conditions** in the EZ have probably tightened in 2018.

Concerns about an economic slowdown hit inflation expectations



Source: Bloomberg and AXA IM R&IS calculations

BTP spreads move to levels not seen since 2013



		AT	BE	FIN	FR	DE	GR	IE	IT	NL	PT	ES
10y	**Yield**	0.52	0.76	0.57	0.73	0.26	4.35	0.96	2.95	0.41	1.64	1.40
	Change vs Q1	-0.19	-0.01	-0.04	0.01	-0.24	0.03	0.05	1.17	-0.22	0.05	0.24
	Spread	0.26	0.50	0.31	0.47	0.00	4.09	0.70	2.69	0.16	1.39	1.14
	Change vs Q1	0.05	0.23	0.20	0.25	0.00	0.27	0.29	1.40	0.02	0.29	0.47

Source: Bloomberg and AXA IM R&IS calculations

Credit markets in the red year to date amid broad based cross asset shakeout

Theme of the month – A year of no returns

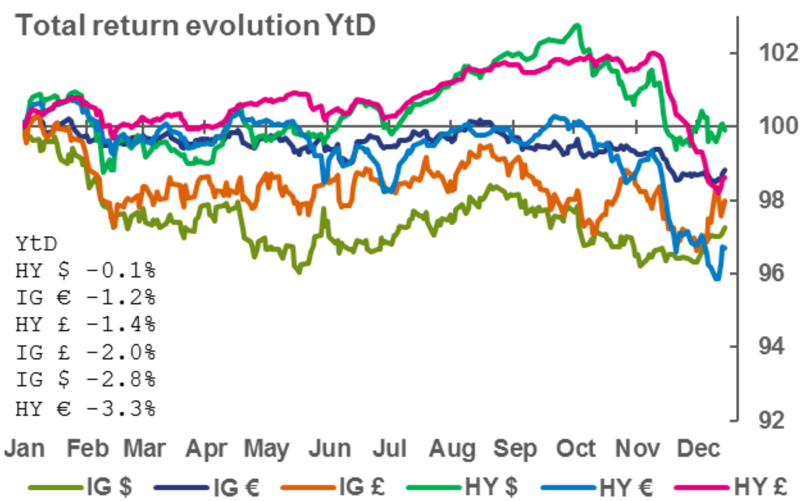
Credit inevitably succumbed to equity contagion in November

- November proved even harsher than October for risky assets, pushing credit returns deeper into negative territory.
- The pain has been particularly acute for high yield, upending the reflation trade that saw high yield outperforming investment grade for much of 2018.
- Credit is now flat or behind government bond returns but is holding up better compared to equity.

The rise in spreads since the year's lows is nothing short of dramatic

- The repricing has been such that in some markets like euro credit, spreads have almost doubled since the Feb lows.
- The silver lining is that valuations have improved materially; our macro spread model shows that valuations have reverted to neutral for the first time in two years.
- Default expectations have only increased modestly as lending conditions remain ok and distress ratio has not risen a lot.

All credit in the red year to date after November's drawdown



Source: ICE, Bloomberg and AXA IM R&IS calculations

Govies prevail year to date while but credit outperforms equity

$	HY -0.1%	UST -0.1%	IG -2.8%	Eqty -2.8%
€	Bund 2.3%	IG -1.2%	HY -3.3%	Eqty -12.1%
£	Gilt 1.1%	HY -1.4%	IG -2.0%	Eqty -11.6%

Source: ICE, Bloomberg and AXA IM R&IS calculations

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Risk off in equity markets despite robust earnings growth

Theme of the month – A year of no returns

Frustrating year for equity investors with most major segments in the red

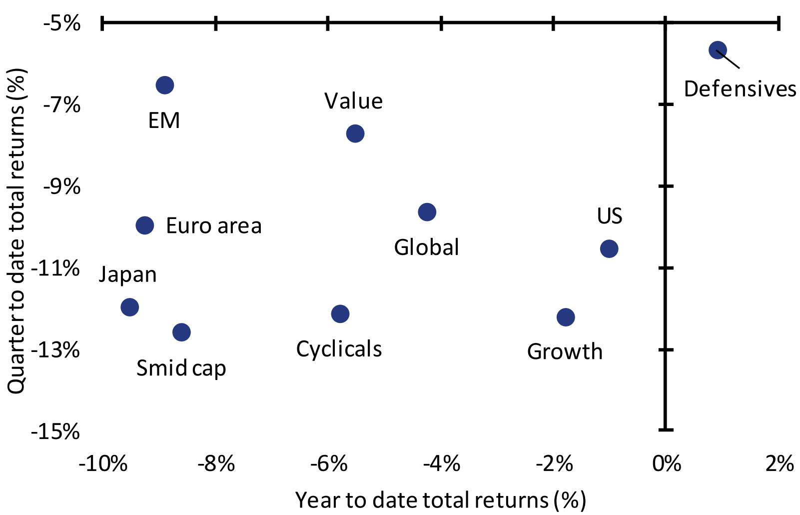
- Year to date, equity returns are poor across the board with the US outperforming and defensives marginally posting positive returns. EM suffered from tighter financing conditions and concerns around trade protectionism. Euro area equities also disappointed in the wake of lacklustre growth and ample political risk. On the style front, defensives outperformed cyclicals and growth beat value although losing most of the gains from earlier this year.

Despite robust earnings growth, equities de-rating heavily driven by a deterioration in sentiment

- Breaking down global equities' total returns of -6.7% year to date, earnings growth delivered close to 19.4%, dividends contributed around 2.4% while valuation multiples contracted sharply by 23.7%. The de-rating in multiples can be attributed to a mix of higher risk free rates and equity risk premiums driven by poor investor sentiment.

Disappointing equity market performance in 2018

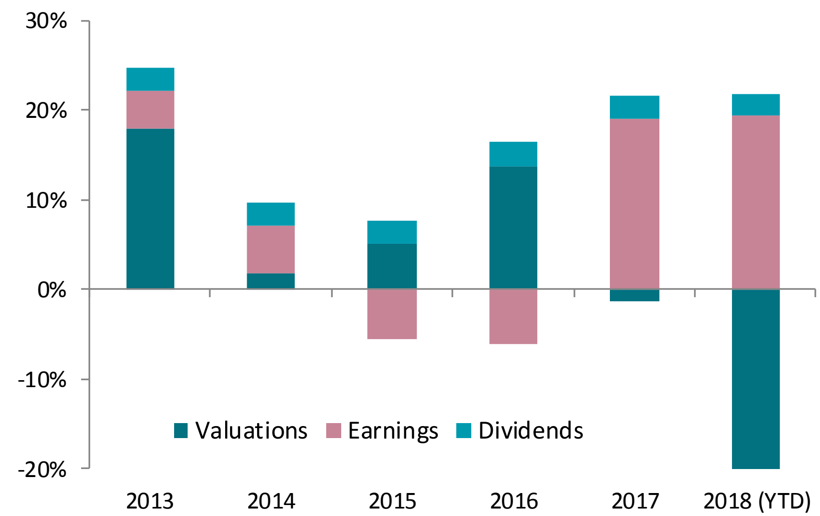
Equity total returns (local FX): regions and styles



Source: Data stream, MSCI and AXA IM R&IS calculations

Robust earnings growth; heavy de-rating in valuation multiples

Global equities: total return decomposition



Source: Data stream, MSCI and AXA IM R&IS calculations

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Macro outlook

Current activity solid, but tighter financial conditions threaten future

Macro outlook – US

Momentum continues to support our 2.8% (saar) forecast for Q4.

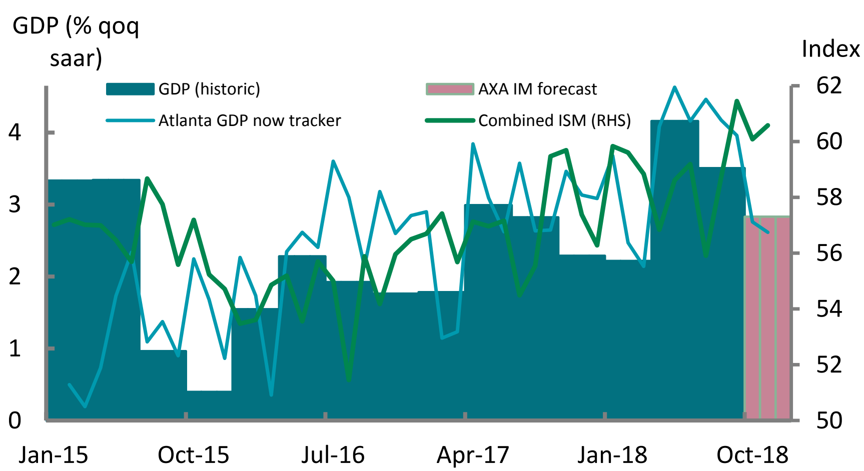
- Hard and soft data in the US remains solid. Most survey evidence remains around elevated levels, with only a few showing some signs of retreating (Empire State, NFIB). The labour market remains tight (jobless claims, JOLTS). And activity indicators are solid (industrial output and retail sales). We continue to forecast Q4 GDP at 2.8% annualised (Atlanta Fed now tracker 3.0%, New York 2.4%). This would see 2018 record 2.9% growth – a 12-year high.

Financial conditions tighten as markets brace for 'slowdown'

- Financial conditions have tightened across a broad range of indices. However, only the Bloomberg metric suggests financial conditions are tighter than in 2015, when the Fed started tightening policy.

Q4 GDP growth remains on track for solid close

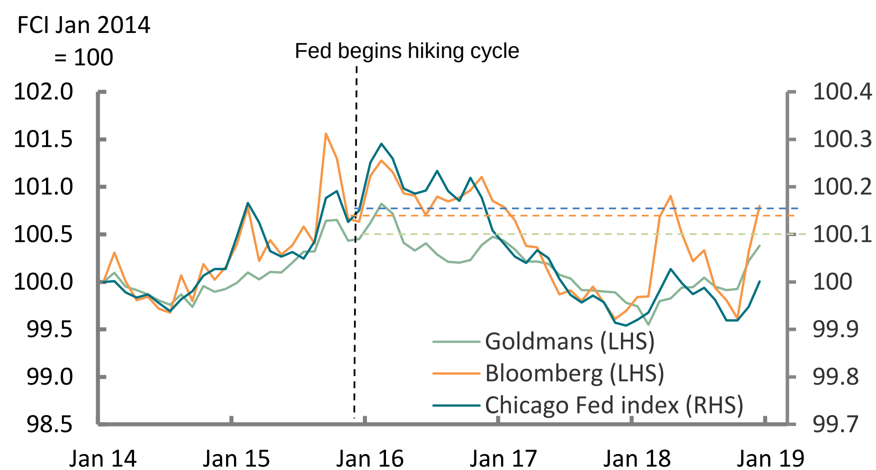
GDP growth and short term outlook



Source: BEA, FRBA, ISM, AXA IM Research, Dec 18

Financial conditions tighten across range of metrics

Financial conditions indices



Source: FRBC, Bloomberg, Goldman Sachs, AXA IM R&IS calculations

Outlook flirts with recession

Macro outlook – US

Yield curve close to recession signal

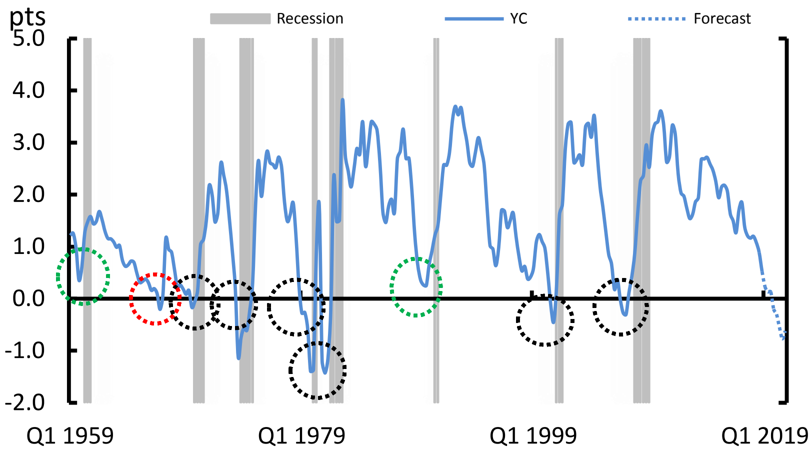
- Since the start of November the yield curve has flattened materially. This has reduced the yield curve slope to its lowest level since 2008. This reliable recession indicator is close to suggesting a US recession in early 2020 – one year earlier than our base forecast.

Fed reaction to govern outlook

- The Fed raised the FFR to 2.25-2.50% in December. It shifted guidance to "some" further gradual tightening and lowered its expected rate outlook (dots). With the economy expected to be in excess demand, the Fed is likely to need to tighten rates further. Yet its reaction will be governed by overall financial conditions. We shift our forecast to two hikes in 2019, but remove our outlook for easier policy in 2020. However, additional tightening in financial conditions could lower this outlook further.

Recession indicator close to signalling downturn

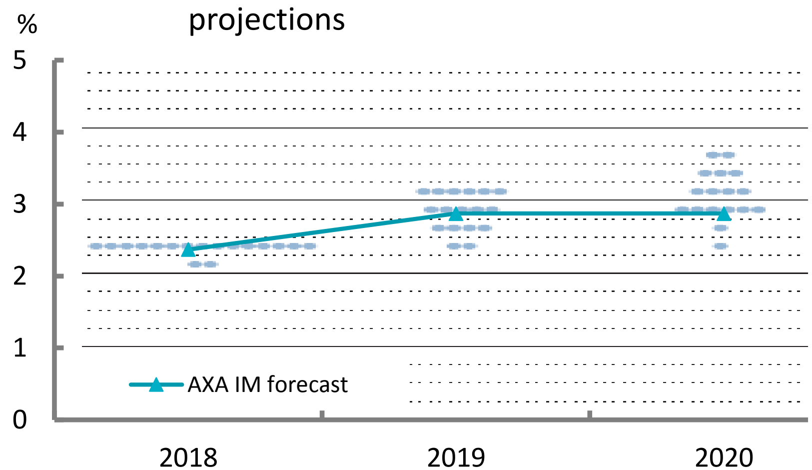
YC Slope and Recession



Source: BEA, FRED, AXA IM R&IS calculations

Fed lowers dots forecasts

FOMC dot forecasts and Taylor Rule projections



Source: FRB, AXA IM R&IS calculations

A soft end to 2018

Macro outlook – Eurozone

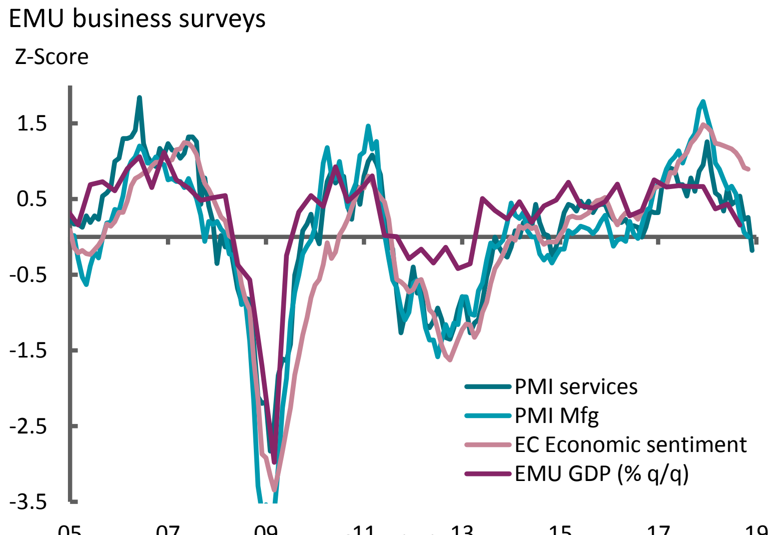
Depressed sentiment and subdued inflation: 2018 ending on a soft tone

- Economic activity indicators suggest only a mild rebound in Q4, after the weak 0.2% q/q Q3 GDP growth. EC surveys barely stabilised, while December Flash PMIs fell to a 49-month low, as French services PMIs plunged on street protests. Hard data show some modest improvement, with car registrations only gradually normalising and IP slightly up, altogether consistent with our Q4 GDP forecast of 0.3%q/q. On the prices front, headline inflation loses steam to 1.9% y/y on weaker energy prices and core inched down to 1.0% y/y on volatile components.

ECB: End of QE in the backdrop of continuing confidence but increasing caution

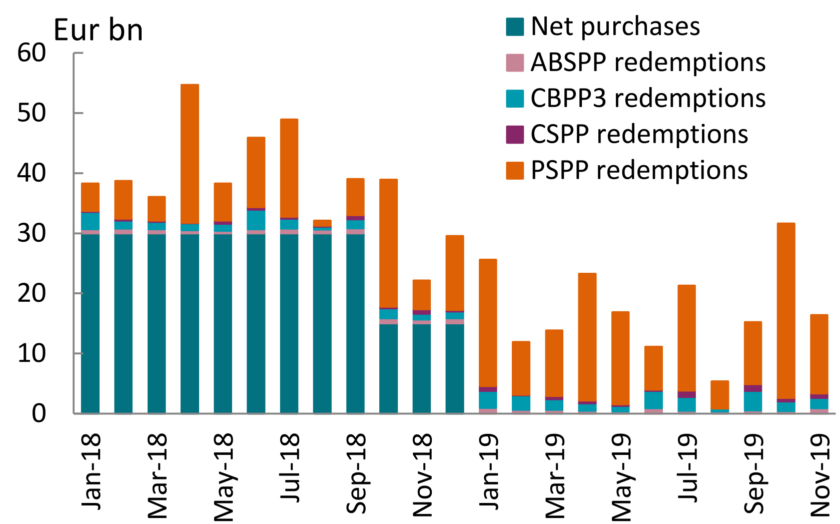
- The ECB revised down both its 2019 growth and inflation forecasts to 1.7% and 1.6%, respectively. It mentioned that the balance of risks is moving to the downside, consistent with our view that the ECB might have to revise its outlook further down in March 19. At that meeting we expect the ECB to announce another TLTRO to alleviate funding pressure for banks. With the end of QE, the focus is shifting to reinvestments: they will operate under the market neutrality principle via smooth and flexible implementation (over longer horizon: 12m vs. 3m, previously).

Business surveys stabilising at best



Source: Datastream, AXA IM R&IS calculations

With the end of QE, focus shifting to reinvestments



Source: ECB, AXA IM R&IS calculations

Politics never sleep

Macro outlook – Eurozone

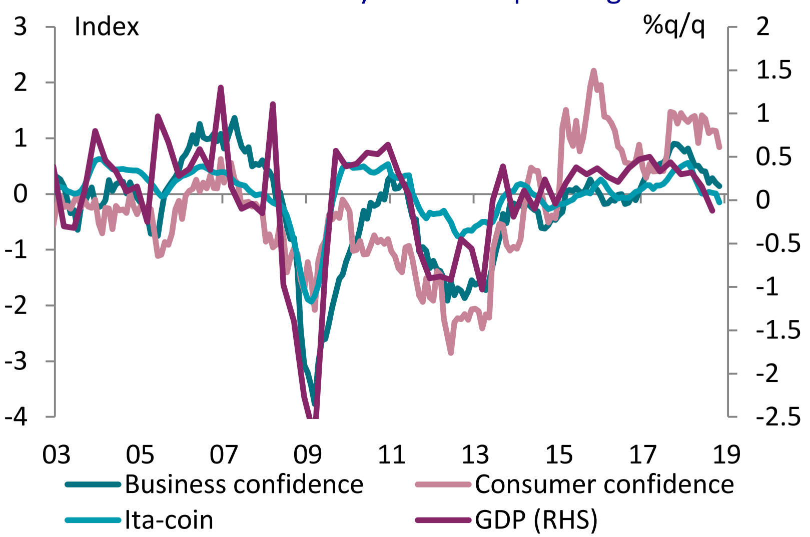
Unexpected deal on Italian 2019 Budget, with France fiscal issues likely playing a critical role

- Following the EC recommendation to open an EDP and weaker growth (Q3 GDP revised down to -0.1% q/q), the Italian government softened its tone and agreed to revise down its 2019 deficit target to 2.04% of GDP from 2.4% previously. It unexpectedly reached an agreement with the EC by 1) postponing the implementation of pension and universal income reforms (savings of c. EUR4.0bn), 2) reduce tax expenditures/cut current spending by c. EUR2.0bn, and 3) increase privatization efforts by EUR2.0bn to EUR20bn. It also revised down its 2019 growth forecast from 1.5% to c.1.0%, altogether implying a flat structural deficit and allowing Italy to escape an EDP for now.

France 2019 deficit to hit the 3% threshold, as the government opted for tax cuts to address “Yellow vest” social unrest

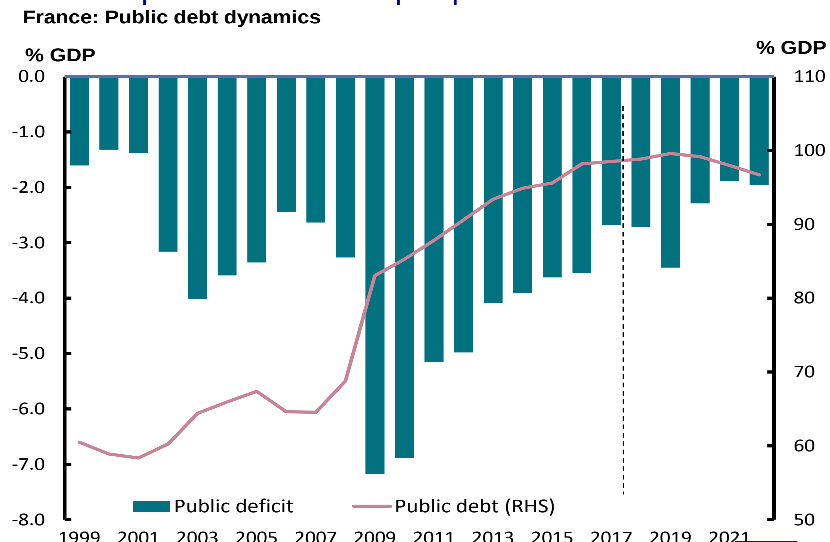
- These fiscal measures include the extension of tax credits, which will provide a monthly boost of €100 for those on minimum wage, the de-taxation of overtime and the cancellation of the 1.7% tax hike for pensioners living on below €2,000 a month. We estimate these measures (and cancellation of the fuel tax) will push the 2019 fiscal deficit to 3.4%– up from 2.8% in the budget and 2.6% in 2018. The 2020 deficit should move back below the 3% bar (as 2019 deficit was also boosted by a one- off of 0.9pp of GDP) and providing the reform agenda is maintained, we do not expect the EC to recommend the opening of an EDP next Spring.

Italian economic activity indicators pointing to recession



Source: Datastream, AXA IM R&IS calculations

France’s public debt decline postponed further



Source: Datastream, AXA IM R&IS calculations

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Brexit outlook clouded by politics

Macro outlook – UK

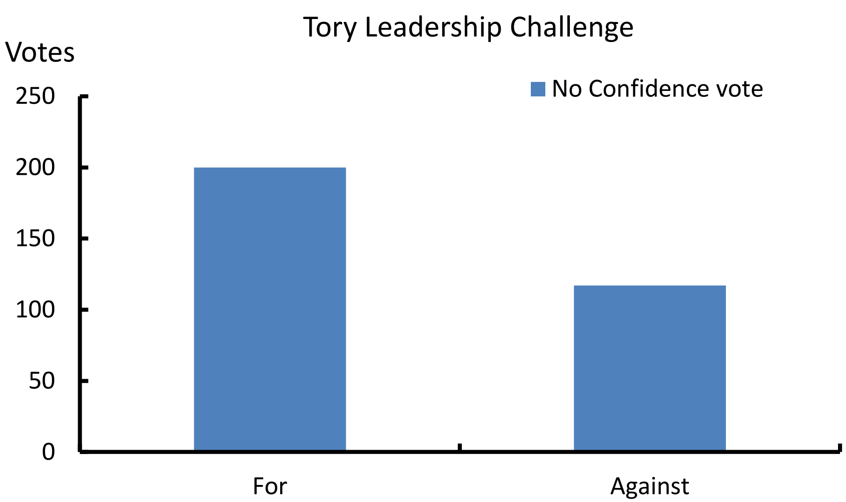
Political fragility impedes Brexit progress

- Despite having reached a negotiated Withdrawal Agreement, PM May has refused to table this before Parliament for fear of a hefty defeat (>110 loss). PM May faced and survived a challenge from within her own party. She awaits a challenge to her government from the opposition party. Meanwhile she attempts to garner more political support from EU members, in the form of reassurances – the EU has made clear re-negotiation is off the table.

ECJ decision increases chances of prolonged withdrawal process

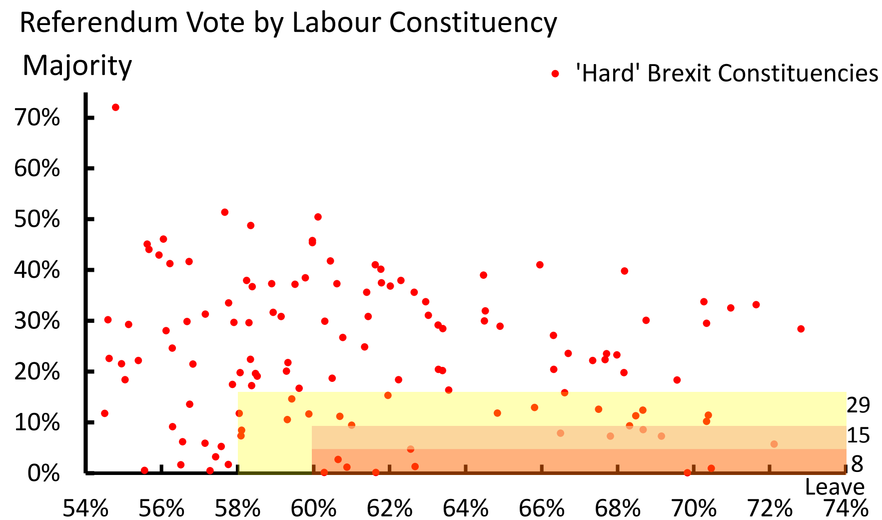
- We expect the government to survive a vote of no confidence from Labour. After this, PM May's deal may receive more backing from Labour supporters – 129 of which come from constituencies voting >55% to leave the EU. This will help pass her bill. However, the European Court of Justice (ECJ) decision that the UK can unilaterally revoke Article 50 reduces the probability of hard Brexit – as MPs could 'stop the clock' and reassess the best strategy.

No clear opinion on next steps for Brexit



Source: BBC, AXA IM R&IS calculations

GDP lifted over summer, but weakest growth since xx



Source: National Statistics, AXA IM R&IS calculations

Unchecked economy threatens overheating

Macro outlook – UK

Short-term economic outlook depends on Brexit path

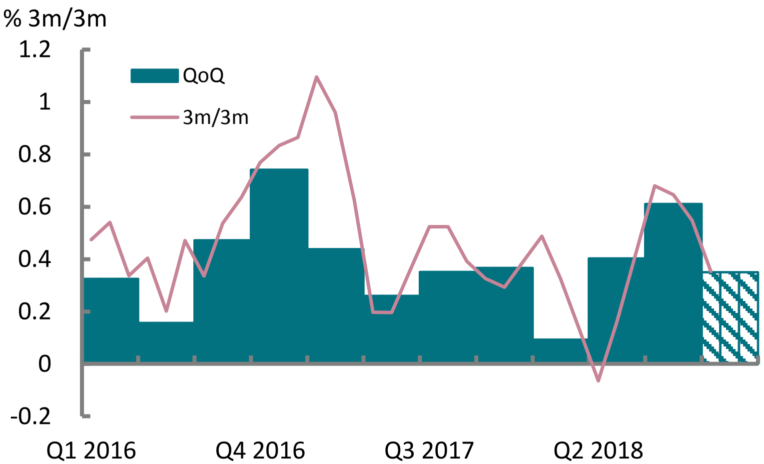
- The Bank of England (BoE) estimated a 2-8% of GDP economic cost of Brexit without transition. We consider the chances of this fading. We estimate GDP growth of 1.8% in 2019 and 2020, if the UK accepts the Withdrawal Agreement. A delayed Brexit should see growth of 1.5% in 2019 and 2020, faster than 1.3% expected in 2018.

BoE increasingly wary of tight labour market.

- The BoE considers the tightness of the labour market (unemployment around 43-year lows and rising wage growth) as a key guide to medium-term inflation pressures. We believe the BoE will not tighten monetary policy amidst Brexit uncertainty and will hence leave policy unchanged in February. If the UK avoids a hard separation in March, the BoE should hike in May (outside chance of an earlier March). The pace of subsequent tightening will depend on which Brexit option is followed. We forecast two hikes in 2019.

Tight labour market points to rising domestic inflation

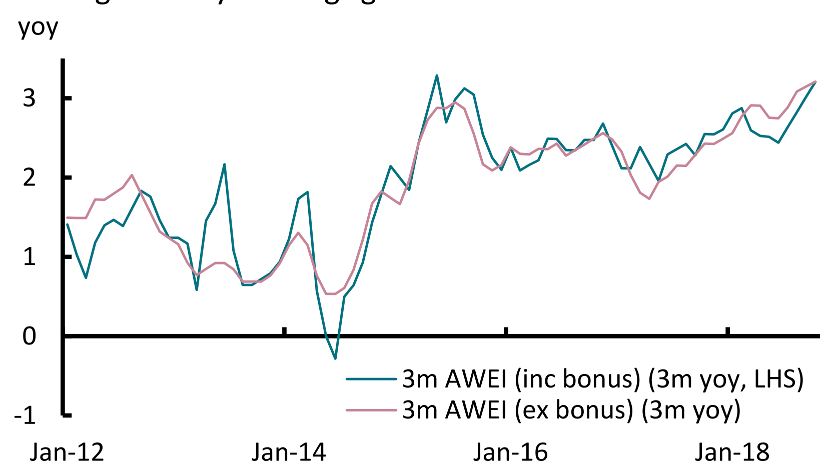
GDP growth



Source: IMF, AXA IM R&IS calculations

UK to resynchronise with the global outlook from 2020

Average weekly earnings growth



Source: National Statistics, Dec 18

Japan – Volatility of the Japanese GDP is still here, it shouldn't change in 2019

Macro outlook – Japan

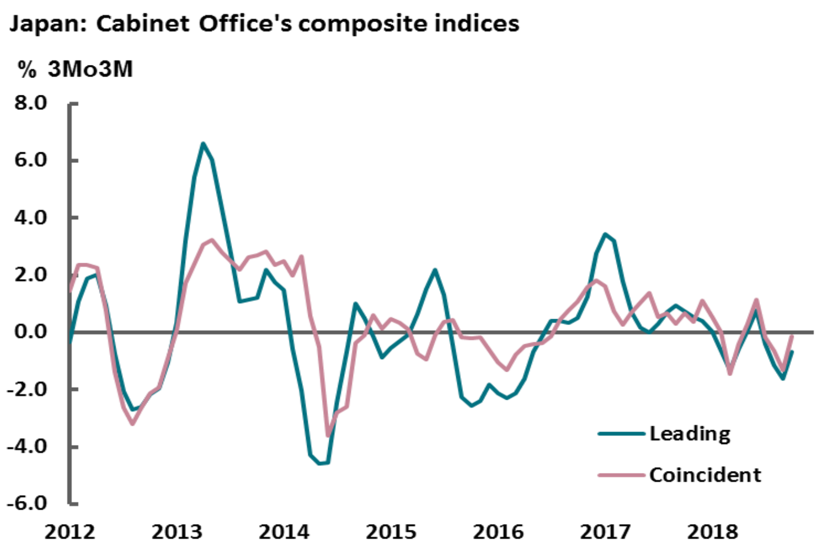
Japanese GDP growth to reach 0.7% in 2018.

- Q3 GDP second estimate has declined sharply (-2.5%qoq a.r instead of -1.2% published earlier), mainly due to a downward revision to capex and higher damages from the natural disaster. We expect a large jump in Q4 to 2%qoq a.r. thanks to domestic consumption and investment rebound. The recent wage acceleration is encouraging but core prices are only mildly accelerating (+0.4% in October), even with unemployment rate at its lower level since 24 years.
- The main risk for 2019 remains the external factors with a potential slowing world demand.

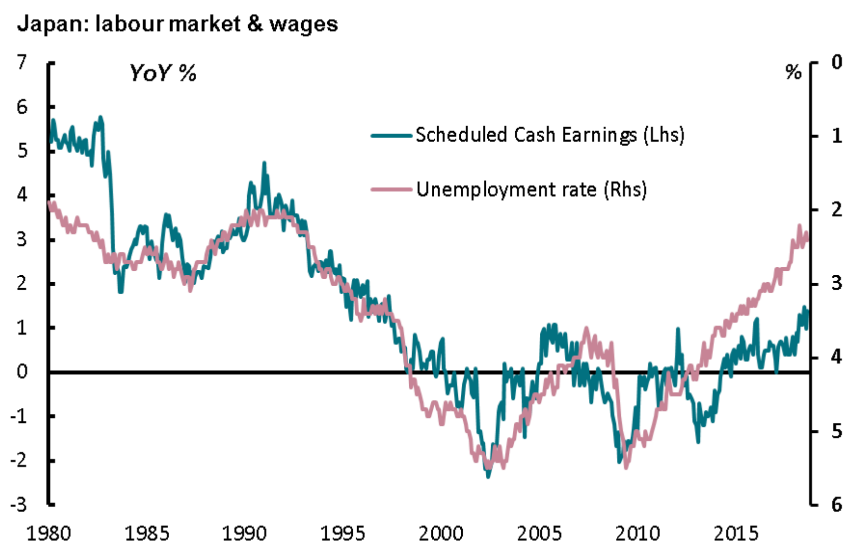
No change in BoJ monetary stance.

- At the July meeting, the BoJ introduced forward guidance that puts a lid on interest rate normalization until at least the effects of the consumption tax hike scheduled for October 2019 have run their course. There were no modifications since. The BoJ is maintaining the gradual reducing of its annual JGB purchases to around ¥40tn per year.

Both indicators have bounced back



Labour market and wages



Source: Statistics Japan, NHK and AXA IM Research

Economic slowdown continues

Macro outlook – China

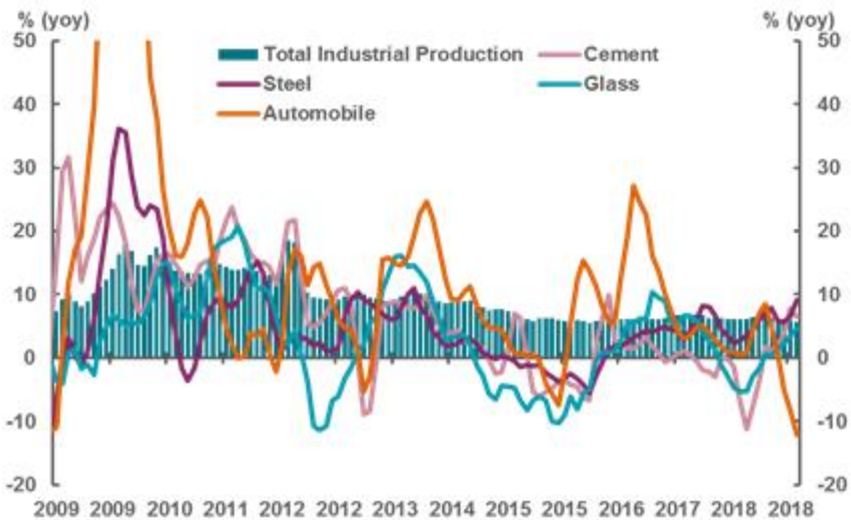
November data suggests slowdown continues to take place

- Despite trade tension has eased somewhat, November activities data indicate continued slowdown is taking place. Both Industrial production and retail sales disappointed market expectations, dragged by weak auto sector

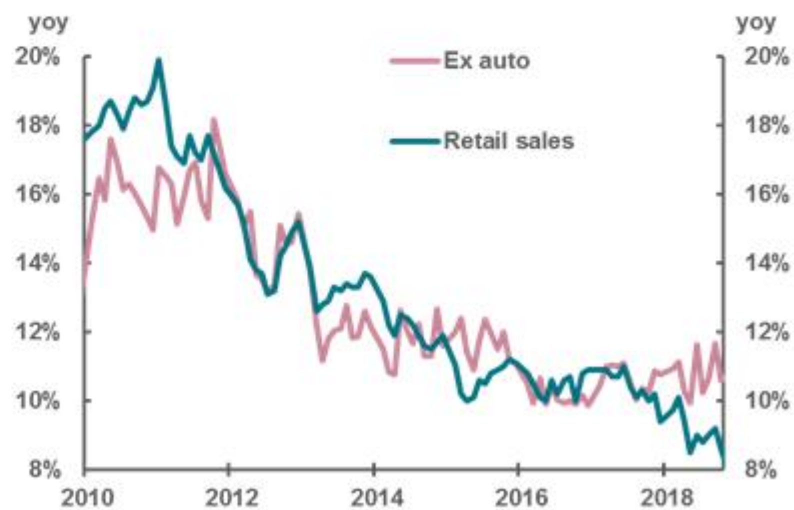
We maintain our 2019 growth forecast at 6.1%

- Going forward, regardless of the expected tax cuts, consumption is likely to moderate further on the back of cooling housing market and slower wage growth. The Central Economic Work Conference (18 – 20 December) will set the national agenda for 2019. We expect authorities to step up macro policy supports, via fiscal policy and tax cuts to deliver stability in 2019.

Industrial production weakens on sluggish auto sector



Ex-auto retail sales still holds up relatively well



Source: CEIC and AXA IM Research

Economic slowdown continues

Macro outlook – China

Fixed asset investment remains a bright side

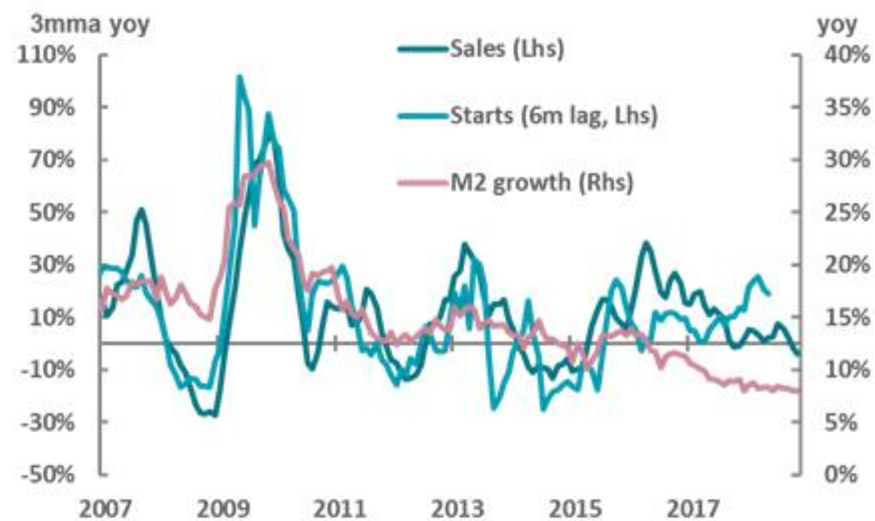
- FAI on the other hand stayed relatively robust, thanks to the strong manufacturing investment. Infrastructure investment also remained steady following extensive government support since mid-year, and will serve as a key growth driver throughout 2019.

Property market expected to cool soon

- Although housing starts and real estate investment have recently picked up, we expect to see overall cooling in the property market next year.

Strong manufacturing investment continues to support FAI

Housing starts remains robust despite weak house sales



Source: CEIC and AXA IM Research

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Growth slowing but still resilient

Macro outlook – Emerging Markets

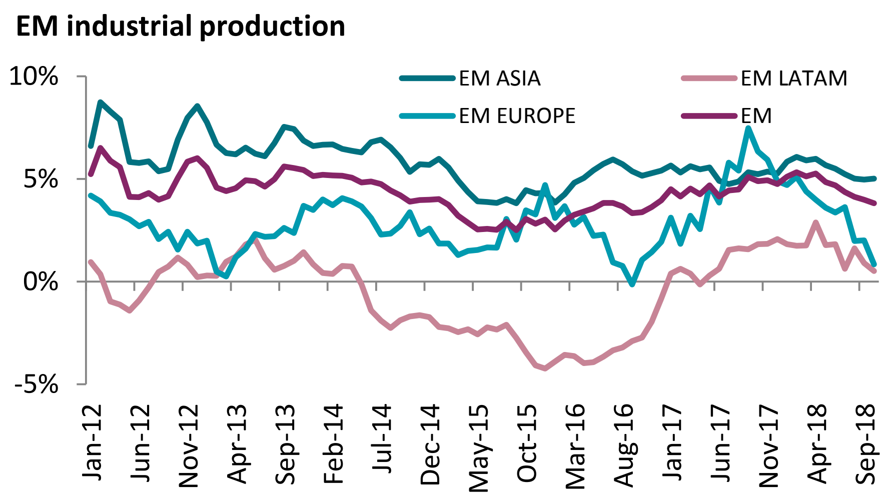
EM growth picture remains overall resilient, albeit with already strong regional divergences and more to come

- Trade war, currency shocks, tighter global financing conditions have sewn the seeds of economic weakness as of early 2018. Industrial production and export momentum faded into H2 2018.
- Asian economies remained particularly resilient, but should weaken into 2019 on trade war effects. Latin American countries growth is likely to trough and accelerate into 2019 driven most notably by Brazil. Within Emerging Europe, Turkey is facing massive economic adjustment; Central European countries should weaken as EZ slows down.

PMI surveys improvement in November driven by strong readings in big EM economies

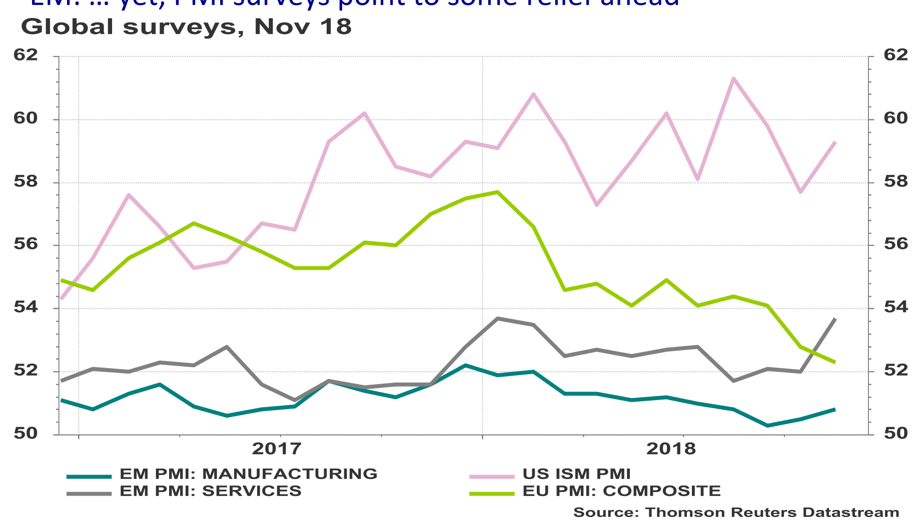
- Interestingly, PMI surveys pointed to an improved economic momentum in November in big EM countries such as Russia, India, Brazil or South Africa. A more muted reaction was registered in China and Mexico where surveys point to unchanged lackluster momentum. Deterioration has been reported in Chile and Hungary.

EM: industrial production momentum fading…



Source: Datastream, AXA IM R&IS calculations

EM: … yet, PMI surveys point to some relief ahead



Source: Datastream

Tighter monetary policy stances, but less tightening ahead

Macro outlook – Emerging Markets

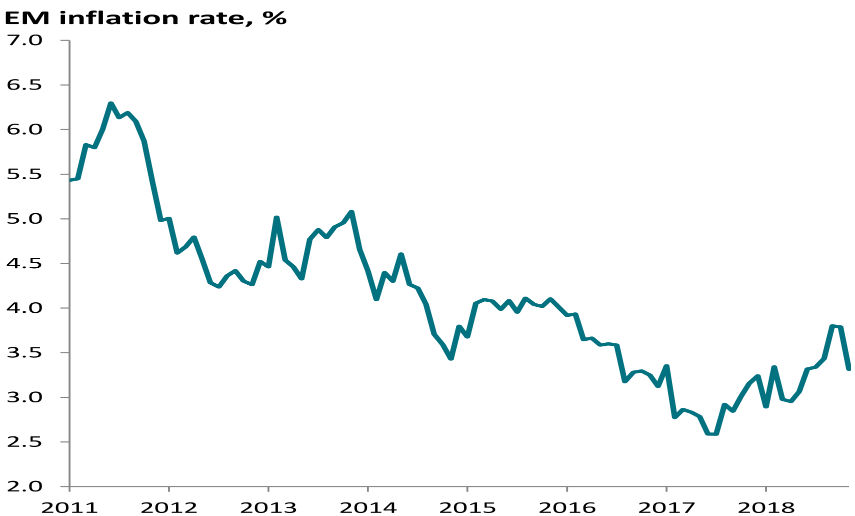
Inflation pressures to recede in 2019 and to require less monetary policy tightening ahead…

- Pressure on inflation from past FX weakness and oil price strength will fade and growth moderation should require less monetary tightening next year. November prints show Inflation rate s already weaker across the board, in some cases even below the low band of the target rate.

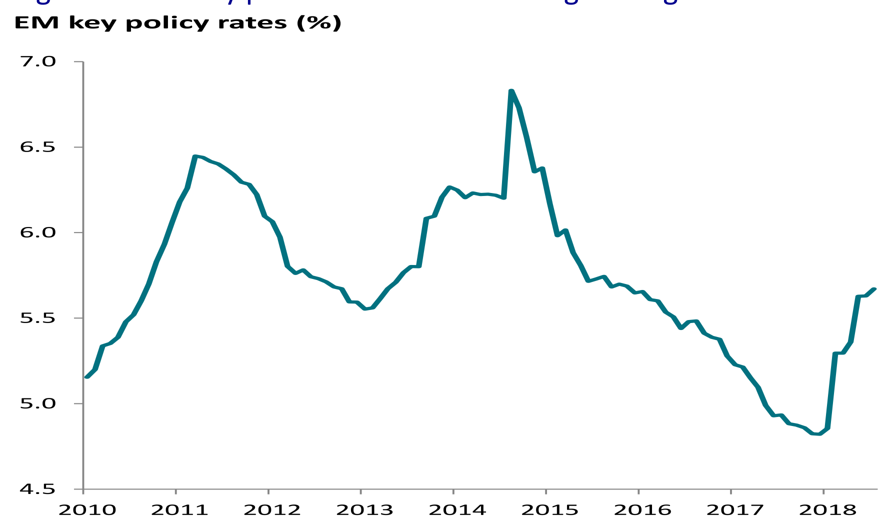
… though some central banks will have to stay ahead of the curve

- Some central banks may still need to do more in order to keep inflation expectations credibly anchored; in troubled economies such as Turkey or Argentina, but also in places like India and Indonesia.
- More recently, central banks in South Africa and Russia chose to pre-emptively raise interest rates against market expectations of status quo.

EM inflation pressures already fading?



Tighter monetary policies but how much tightening ahead?



Source: Datastream, AXA IM R&IS calculations: EM proxy indices for 20 EM countries GDP PPP-weighted

AXA Investment Managers

Investment Strategy

Diversification becomes more difficult in the Quantitative Tightening era

Investment Strategy – Cross-asset allocation

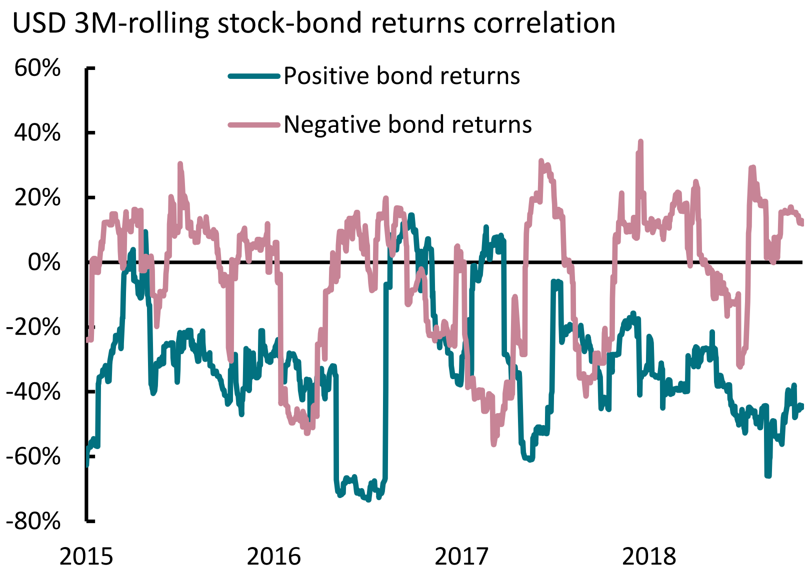
The recent risk-off episode illustrated the poor diversification benefit of government bonds

- As equities dropped and credit spreads widened, government bonds failed to gain significantly

With the QE tide reversing, all asset prices experience downward price pressure

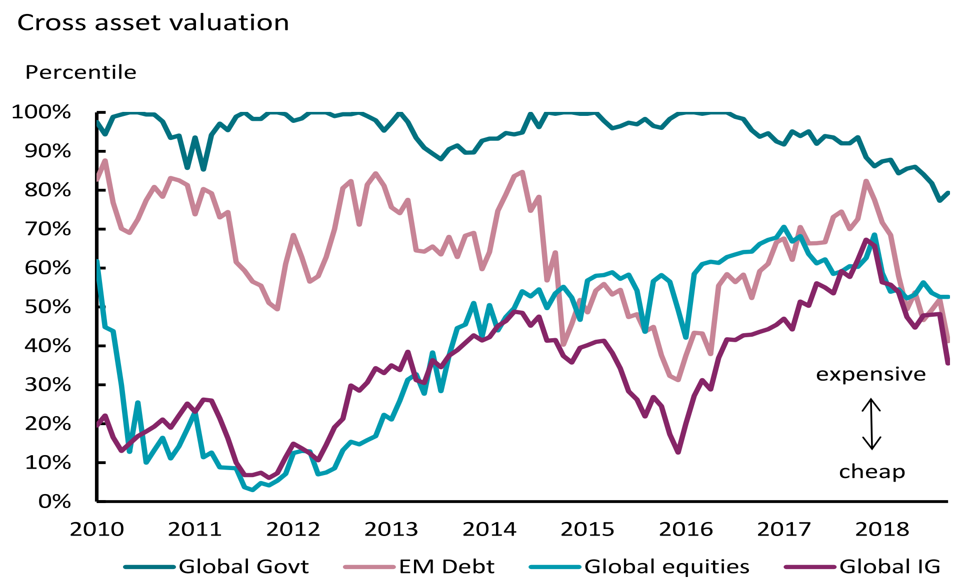
- Alternative downside hedges will be important in 2019: currencies and volatility should be considered

Stock-bond correlation getting more tricky



Source: Bloomberg, AXA IM R&IS calculations

Downward pressure on valuation across the board



Source: MSCI, BAML, JPMorgan, AXA IM R&IS calculations

AXA Investment Managers

Allocation recommendation

Investment Strategy – Cross-asset allocation

Asset Allocation

Key asset classes

- Equities
- Bonds
- Commodities
- Cash

Equities

Developed

- Euro area
- UK
- Switzerland
- US
- Japan

Emerging & diversification

- Emerging Markets ▲

Fixed Income

Govies

- Euro core
- Euro periph
- UK
- US

Inflation

- US
- Euro

Credit

- Euro IG
- US IG
- Euro HY
- US HY

EM Debt

- Short duration

Legends Negative | Neutral | Positive

Last change ▲ Upgrade | ▼ Downgrade

Source: AXA IM – As of 19 December 2018

AXA Investment Managers

Global: Diverging Real Yields

Investment Strategy – Rates

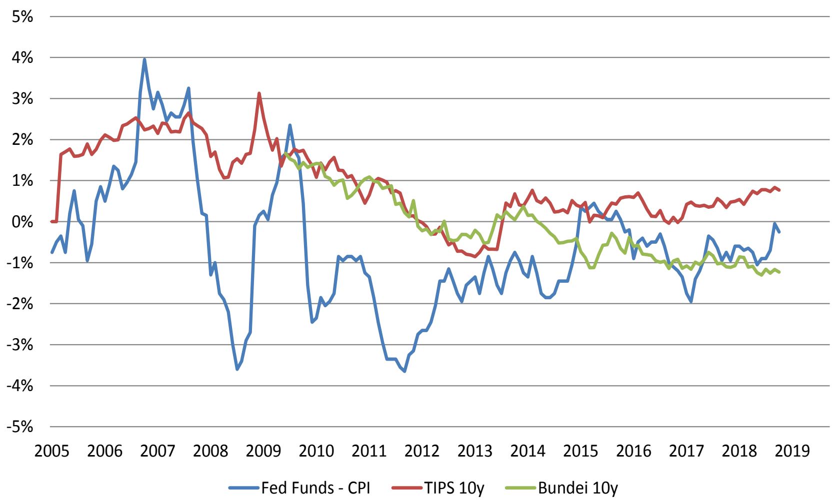
Real yields to drive asset allocation decisions

- US real yields have increased in steps since 2016 (0%) and are now trading north of 1%, in contrast to German real yields hovering near all time lows
- At global portfolio level, this is likely to be a driver of allocation decisions in 2019. In particular, liquidity management might be tilted towards US Treasuries, affecting the foreign exchange as well as short-term credit spreads

Bund yields to remain range-bound

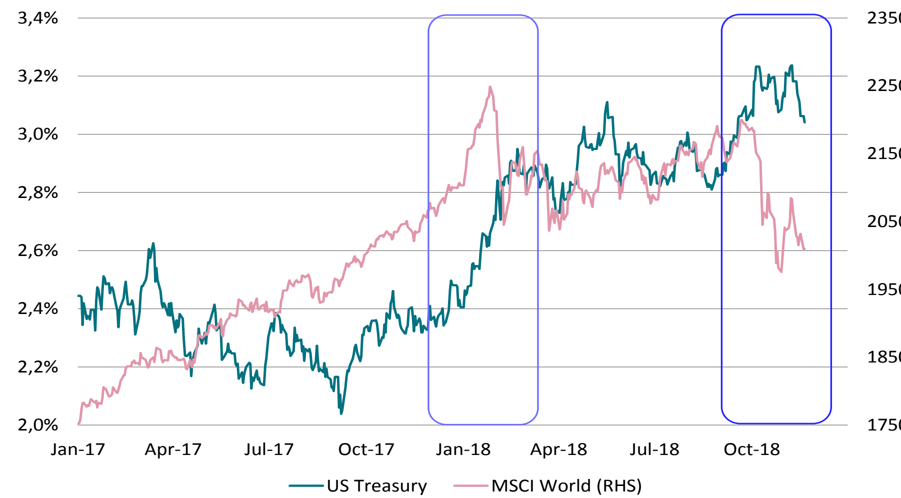
- We expect Bund yields to remain range-bound in 2019 as a result of weaker investor sentiment, prudent ECB policy and a strong technical backdrop. We see a range of 0.2-0.7% as persisting through the year
- We see value in Treasuries above 3.25%, however, as a good diversifier in case of a more pronounced slowdown

Divergence in real yields, implications for investment flows



Source: Bloomberg and AXA IM R&IS calculations

Treasuries hedged 2018 risk episodes only partially, though



Source: Bloomberg, MSCI and AXA IM R&IS calculations

Glass half full – credit spreads attractive rather than flashing recession

Investment Strategy – Credit

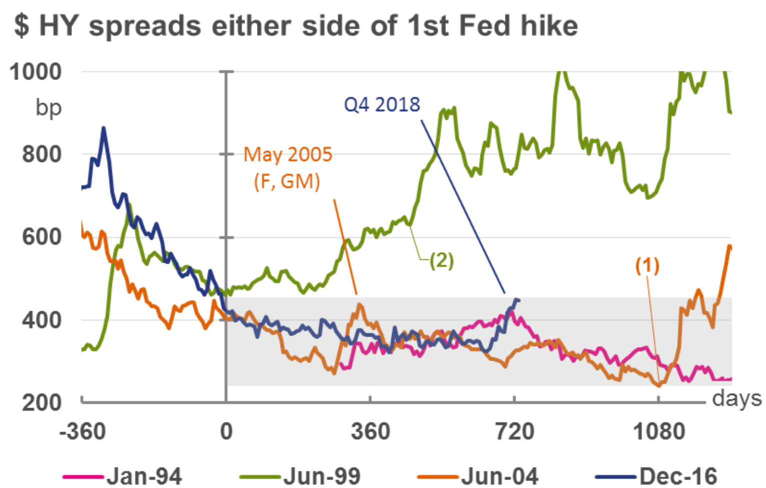
Spreads are approaching levels last seen in early 2016

- Spreads are currently wider than at the end of 2016 which was followed by a constructive year for credit in 2017.
- So the more spreads widen into year end, the weaker our bearish conviction becomes for spreads in 2019.
- An attractive entry point for credit investments must be close unless recession risk is around the corner.

Glass half full – credit spreads attractive rather than flashing recession

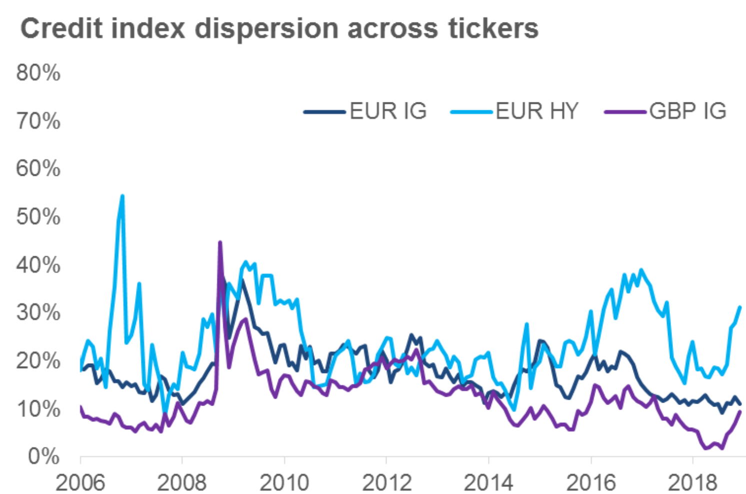
- US HY spreads have broken decisively out of the low and narrow range they held for two years but they remain within the historic norms of previous hiking cycles.
- But caution is warranted as markets are set to trade in a volatile fashion amid reduced liquidity into yearend and amid a plethora of risks during the first quarter of 2019.
- Rising idiosyncratic risk is another reason to be cautious; strong credit selection and avoiding 'landmine' is key to safeguarding portfolio returns.

US HY still within a normal hiking cycle spread range



Source: ICE, Bloomberg and AXA IM R&IS calculations

Increasing spread dispersion reflects rising idiosyncratic risk



Source: ICE, Bloomberg and AXA IM R&IS calculations

AXA Investment Managers

Global equity valuation multiples touch lowest levels since 2013

Investment Strategy – Equities

Softer top line growth and pressures on profit margins are a key concern

- Decelerating economic globally should dampen top line growth while pressures on profit margins are a key concern, induced by the rise in unit labour costs and fading effect of the tax stimulus in the United States.

Valuations multiples are not a major headwind at this juncture

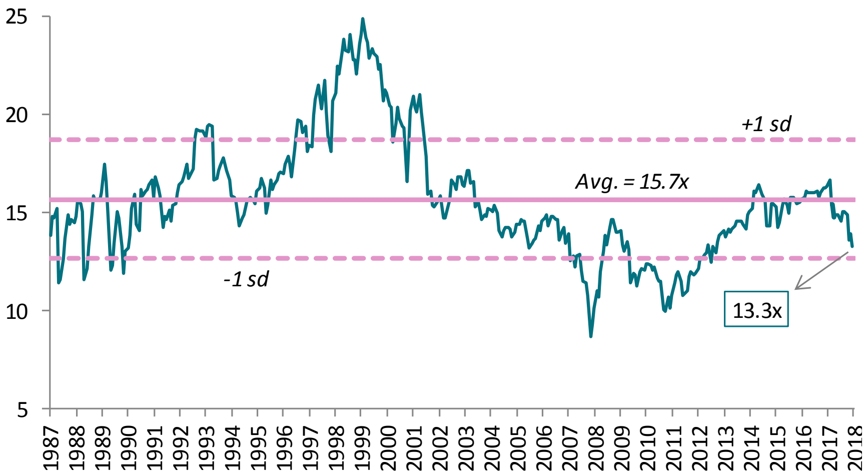
- Reduced excess liquidity and rising US short term rates due to the ongoing monetary tightening, and possibly higher equity risk premiums driven by higher volatility and weaker sentiment suggest limited scope for re-rating.

Continuing to prefer the US over euro zone; getting more constructive on emerging markets

- Continuing to prefer the US over euro zone. Political risks in Europe continue to weigh on the equity markets while the banking sector remains under pressure as the yield curve fails to steepen along with muted economic momentum.

Global equity valuations in comfortable territory

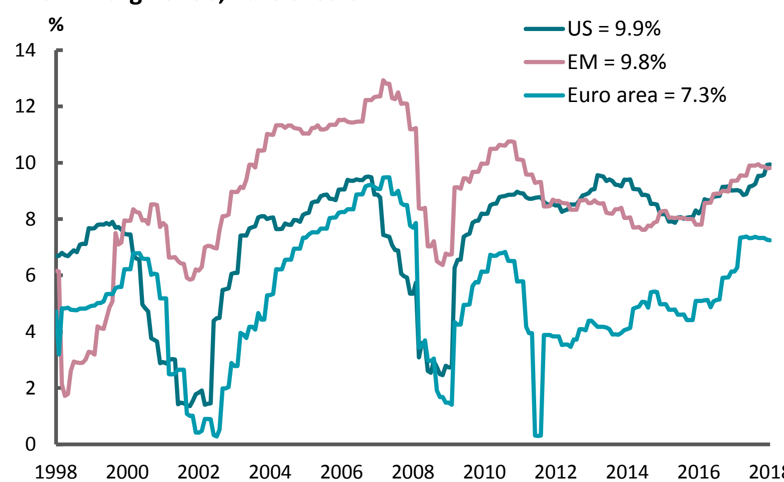
MSCI AC World: Forward price to earnings



Source: Bloomberg and AXA IM R&IS calculations

Peak margins are a key concern for 2019

Profit margins: US, Euro area & EM



Source: Data stream, IBES and AXA IM R&IS calculations

The US dollar looking for a direction

Investment Strategy – Foreign Exchange

The US dollar appreciated 5% against the G10 in 2018, the best performer

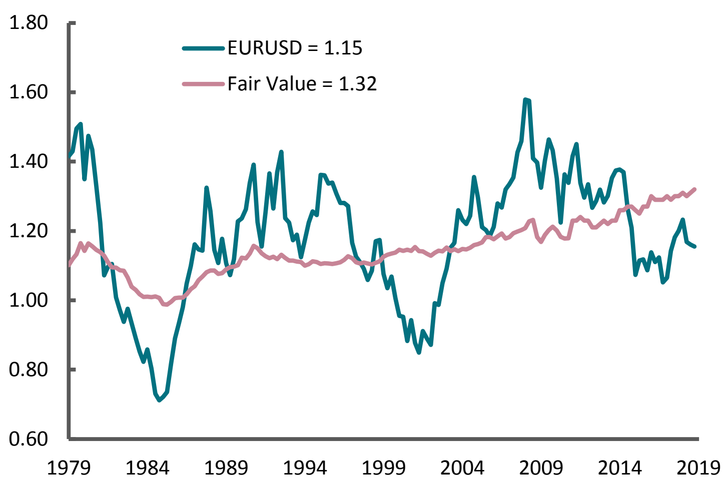
- The US dollar is now among the most expensive currencies in real effective exchange rate terms
- Against the euro, our estimated fair value is just above 1.30, more than 10% above the current level

A very positive interest rate differential to the rest of the G10 makes a large USD decline unlikely, at least in the first half of 2019

- We hold no strong conviction on the EUR/USD cross in the near term, but a bullish view in the medium term

EUR still cheap to the US dollar

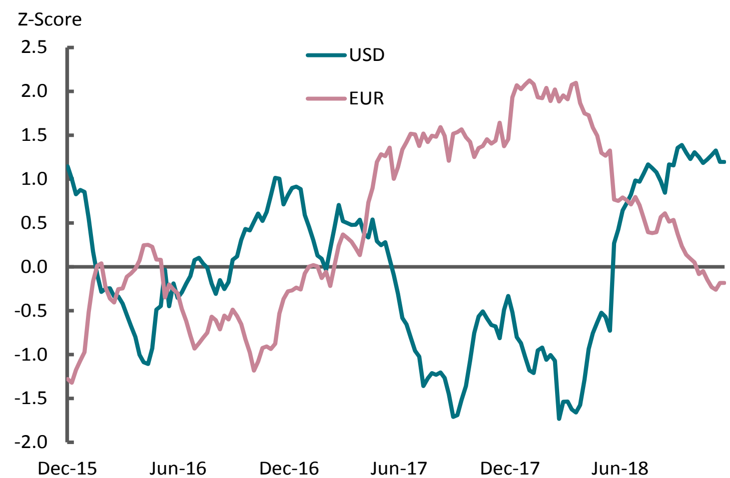
EUR/USD valuation



Source: Goldman Sachs, AXA IM R&IS calculations

Sentiment significantly long US dollar vs euro

Non-commercial positioning, EUR & USD



Source: CFTC, AXA IM R&IS calculations

Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2018	2019*		2020*	
		AXA IM	*Consensus*	AXA IM	*Consensus*
World	**3.8**	**3.6**		**3.5**	
Advanced economies	**2.4**	**2.0**		**1.5**	
US	**2.9**	**2.3**	*2.6*	**1.4**	*19*
Euro area	**1.9**	**1.4**	*17*	**1.2**	*15*
Germany	**1.5**	**1.4**	*17*	**1.2**	*15*
France	**1.6**	**1.4**	*17*	**1.3**	*16*
Italy	**1.0**	**0.6**	*10*	**0.5**	*0.9*
Spain	**2.5**	**2.2**	*2.3*	**1.7**	*19*
Japan	**0.7**	**0.9**	*11*	**0.5**	*0.6*
UK	**1.3**	**1.6**	*15*	**1.7**	*16*
Switzerland	**3.0**	**1.7**	*17*	**1.5**	*17*
Emerging economies	**4.7**	**4.6**		**4.7**	
Asia	**6.3**	**6.1**		**6.1**	
China	**6.6**	**6.1**	*6.2*	**6.1**	*6.0*
South Korea	**2.8**	**2.6**	*2.6*	**2.5**	*2.5*
Rest of EM Asia	**6.1**	**6.1**		**6.1**	
LatAm	**1.2**	**2.1**		**2.2**	
Brazil	**1.5**	**2.5**	*2.3*	**2.5**	*2.6*
Mexico	**2.2**	**2.2**	*2.1*	**2.0**	*2.4*
EM Europe	**3.2**	**2.2**		**2.6**	
Russia	**1.9**	**1.8**	*15*	**1.8**	*17*
Poland	**5.2**	**3.5**	*3.6*	**3.0**	*3.1*
Turkey	**3.5**	**0.5**	*0.8*	**2.5**	*3.0*
Other EMs	**2.9**	**3.2**		**3.4**	

Source: Consensus Economics, IMF and AXA IM R&IS calculations – As of 19 December 2018

AXA Investment Managers

Expectations on inflation and central banks

Forecasts

Inflation Forecasts

CPI Inflation (%)	2018	2019*		2020*	
		AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	**2.0**	**1.7**		**2.0**	
US	2.4	2.1	*2.3*	2.9	*2.2*
Euro area	1.8	1.5	*17*	1.4	*17*
Japan	1.0	0.7	*19*	0.5	*17*
UK	2.5	2.0	*17*	2.2	*15*
Switzerland	1.0	0.7	*14*	1.0	*13*
Other DMs	1.8	1.9		2.0	

Source: Bloomberg, IMF and AXA IM R&IS calculations – As of 19 December 2018

Central banks' policy: meeting dates and expected changes

Central bank policy
Meeting dates and expected changes (Rates in bp / QE in bn)

		Current	Q1 - 19	Q2 - 19	Q3 - 19	Q4 - 19
United States - Fed	Dates	2.25-2.50	29-30 Jan 19-20 Mar	30-1 Apr/May 18-19 Jun	30-31 July 17-18 Sep	29-30 Oct 10-11 Dec
	Rates		unch (2.25-2.50)	+0.25 (2.50-2.75)	unch (2.50-2.75)	+0.25 (2.75-3.00)
Euro area - ECB	Dates	-0.40	24 Jan 7 Mar	10 Apr 6 Jun	25 July 12 Sep	24 Oct 12 Dec
	Rates		unch (-0.40)	unch (-0.40)	+0.15 (-0.25)	unch (-0.25)
Japan - BoJ	Dates	-0.1/¥42tn	22-23 Jan 14-15 Mar	24-25 Apr 19-20 Jun	29-30 Jul 18-19 Sep	30-31 Oct 18-19 Dec
	Rates / QE		net QQE ¥40tn	unch/taper	unch/taper	net QQE ¥30tn
UK - BoE	Dates	0.75	7 Feb 21 Mar	2 May 20 Jun	1 Aug 19 Sep	7 Nov 19 Dec
	Rates		unch (0.75%)	+0.25% (1.00%)	unch (1.00%)	+0.25% (1.25%)

Source: Datastream, AXA IM R&IS calculations - As of 19 December 2018

Investment Managers

Calendar of 2019 event

2019	Date	Event
January	1 Jan	US 25% Tariffs on $200bn of Chinese imports
	23 Jan	BoJ Meeting
	24 Jan	ECB meeting
	22-25 Jan	World Economic Forum
	30 Jan	FOMC meeting
February	7 Feb	BoE meeting
	17 Feb	Section 232 investigation into Autos deadline
	February	Thailand General Election
March	1 Mar	US Debt Ceiling Lifted
	7 Mar	ECB Meeting
	15 Mar	BoJ Meeting
	19 Mar	FOMC meeting
	21 Mar	BoE Meeting
	29 Mar	Brexit Day
	31 Mar	Ukrainian Presidential Elections
	March	China National Congress
April	10 Apr	ECB Meeting
	12-14 Apr	IMF/World Bank meetings
	17 Apr	Indonesia General Election
	25 Apr	BoJ Meeting
	April/May	Indian General Election
May	1 May	FOMC Meeting
	2 May	BoE Meeting
	26 May	EU & Belgium Elections
June	6 Jun	ECB Meeting
	19 Jun	FOMC Meeting
	20 Jun	BoJ & BoE Meeting
July	25 Jul	ECB Meeting
	30 Jul	BoJ Meeting
	31 Jul	FOMC Meeting
August	1 Aug	BoE Meeting
	August	US Debt Ceiling lift expected to bite
September	12 Sep	ECB Meeting
	13 Sep	End of US Fiscal year
	18 Sep	FOMC Meeting
	19 Sep	BoJ & BoE Meeting
October	20 Oct	Swiss Federal Election
	21 Oct	Canadian Federal Election
	24 Oct	ECB Meeting
	27 Oct	Argentine General Election
	30 Oct	FOMC Meeting
	31 Oct	BoJ Meeting
November	7 Nov	BoE Meeting
December	11 Dec	FOMC Meeting
	12 Dec	ECB Meeting
	19 Dec	BoJ & BoE Meeting

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