ANALYSIS & STRATEGY

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PROTECTIONISM

Fears of protectionism are back on top of the agenda since late February, following decisions made by the US President. First President Trump announced taxes on aluminium and steel (10% and 25% respectively). Then he singled out China, imposing a 25% tax on $60 billion in Chinese imports.

The impact on the markets has been significant: equities and fixed-income products have declined considerably, while credit spreads have widened. Volatility should remain high in the short term as the markets await details on the products targeted and retaliation measures by China.

Do these new developments pose a challenge to the optimistic scenario of global growth? Are we witnessing the start of a trade war, or is it merely political posturing in preparation of the US midterm elections?

- The measures adopted for aluminium and steel will not have significant impacts on growth, as the combined imports of these two commodities account for only 0.5% of US GDP. Only the automotive and construction sectors will potentially see an impact.
- Similarly, the taxes imposed on Chinese goods are unlikely to compromise recent trends in either US or Chinese growth. A 25% tax on $60 billion in imports represents $15 billion in tax revenue. With total Chinese exports to the US of around $450 billion, this tax amounts to 3% of the total. Various studies estimate a roughly 1% impact on the profits of US companies.
- China did not initially react to the earliest announcements, but it ultimately decided to retaliate using equivalent measures.
- Could Trump go even further? He'd likely meet opposition from lobby groups and Congress, who are generally more favourable to free trade. But even if an open trade war with China seems an irrational move, this scenario cannot be fully ruled out.

Surprisingly, inflation anticipations did not benefit from the news. The market seems more concerned about a possible recession than a period of stagflation—the natural consequence of trade wars.

At this stage, we believe the impact on global growth will be moderate. The recent disappointments over economic data are also unlikely to compromise our scenario, as these figures are still broadly compatible with global growth of around 4%.

Thus, for the medium term, we are maintaining a positive outlook on the equity markets, which are currently quite inexpensive compared to other asset classes. We are also maintaining a slight upward bias on interest rates and inflation breakevens.

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ATTRACTIVE PREMIUMS **AND** REAL RATES **IN THE** EMERGING MARKETS

Genuine return potential on emerging local debt

After three years of adjustment (2013 to March 2016), the emerging economies are back on track in terms of economic activity, account balances (both domestic and external) and the accumulation of reserves.

The macro outlook for 2018 is positive, with growth expected to be higher than 2017 across all of the emerging countries (5% in 2018 after 4.8% in 2017, according to JPMorgan). The rebound from 2017 appears to be strongest in Latin America (2.8% growth projected in 2018, vs. 1.7% in 2017). Inflation is under control across all of the emerging markets (3.3% average EM inflation in 2017; 2.9% in Brazil, 2.5% in Russia). Finally, public debt levels remain very low compared to the developed countries.

Our macro scenario for this asset class is positive.

Despite highly promising prospects for emerging fixed income, the uncertain future of trade agreements like NAFTA, fears of a trade war due to protectionist measures and threats by the United States and anticipations of faster policy normalisation by the Fed have all put a damper on the initial outlooks in recent weeks.

We now believe that the markets have priced in these concerns, and that they are unlikely to fundamentally alter our baseline scenario.

Our investment strategies focus on debt in strong currencies (EUR and USD) as well as local fixed income with or without foreign exchange risk, as the case may be.

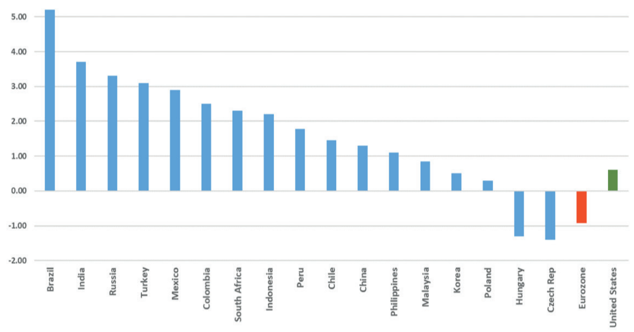
The risk premium[(1)] amounts to **53%** of emerging market returns

The risk premium on USD foreign debt currently stands at around 3% according to the JPMorgan Global Diversified Index. The historical average (2004-today) amounts to 3.25%, with the lowest point (1.67%) reached in June 2007. This risk premium is currently equivalent to 53% of the return on this asset class. In an environment of low core interest rates, bonds in strong foreign currencies offer additional yield on country risk, with solid fundamentals.

Local sovereign debt is even more attractive, representing a rapidly growing market across all the emerging countries. In real terms[2], local yields are mostly positive, ranging from 1% to 5%. The yield curves are often steep, offering more opportunities on the intermediate and long portions. These strategies may be hedged for foreign exchange risk; in this case, they would benefit exclusively from modified duration risk. Otherwise, they could be supported by foreign exchange risk and would also benefit from a highly attractive nominal carry.

Emerging market currencies were the adjustment variables for the emerging economies over the 2013-2016 period. Many of them are currently undervalued in terms of real effective exchange rates. As a result, they represent genuine return potential in view of these countries' satisfactory economic performance.

Five-year real rates



(Source: Bloomberg, LFAM)

(1) Emerging bonds in strong currencies

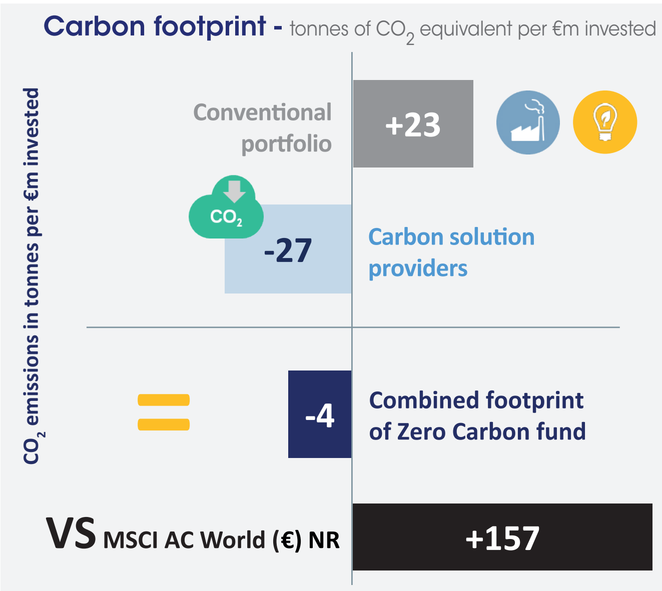
(2) Difference between 5-year nominal rates and anticipated 12-month inflation

TOWARD A **LOW-CARBON ECONOMY**

It is our view that climate change has become a key factor in our economic and social development, and that it will most probably remain that way for a long time.

Urgent action is needed. We face catastrophic consequences due to climate change, and immediate measures are needed to adapt to this new reality.

In 2014, the International Energy Agency (IEA) estimated that USD 53 trillion would need to be invested by 2035 in order to meet the COP 21 targets and potentially avoid the worst consequences of global warming. This amount of money cannot conceivably be mobilised without the participation of ordinary investors. **The role of finance in the fight against climate disruption is to guide investments toward companies that contribute to reducing carbon emissions in order to limit warming to under two degrees, as established at COP 21.** However, current trends on the equity indexes point to a warming of at least four degrees.



To prevent the worst, we need not only to slow down CO_2 emissions but also to reduce emissions by 60% from current levels by 2050.

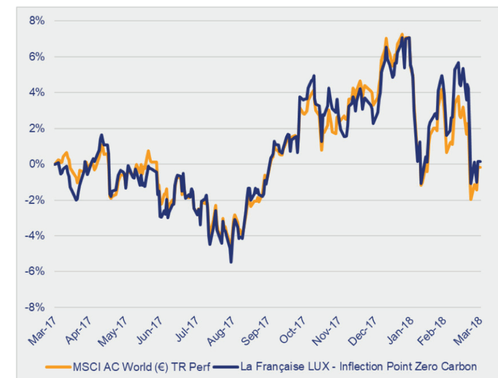
We believe that this objective is perfectly compatible with our fiduciary obligations as asset managers: namely, to protect savings entrusted to us and to limit the costs associated with risks linked to climate change.

This is especially true considering that our strategic analysis of companies based on **innovation** and the ability to **adapt** and **respond** has unveiled surprising opportunities for value generation in areas like electrification, the optimisation of resource allocation and clean technology.

These were the factors behind our launch of the Zero Carbon global fund three years ago. This thematic fund maintains a neutral carbon footprint and invests in companies that create value through the energy transition. The core of our investment strategy is to focus on companies that provide energy solutions that generate additional growth thanks to their technologies, making it possible to transition toward a low carbon economy. Key themes in this regard include digitalisation, automation and renewable energies. The fund also invests in companies that have gained competitive advantages in terms of cost and productivity by reducing their carbon footprint.

The "impact" component of this fund relates to the stated goal of reducing carbon emissions from investments and the possibility of measuring the results. Our aim is to combine strong environmental performance with strong financial performance and thereby demonstrate that using investments as a tool in the fight against climate disruption can also deliver strong financial results.

Zero Carbon fund performance (YoY)



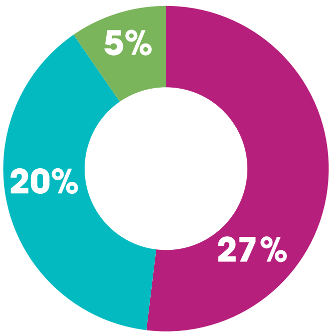
(Source: La Française)

CONCERNS ABOUT PROTECTIONISM AND WEB GIANTS **IN THE SPOTLIGHT**

The resurgence of protectionist measures by the United States, particularly those aimed toward China, was the main concern of investors in March. There was also an impact from the stream of bad news about technology stocks. As a result, the Nasdaq had one of its worst weeks in the last 20 years, falling 6.53% in USD. The Cambridge Analytica scandal in particular caused a major dip for Facebook, dragging down Google, Twitter and Internet stocks in general. The European Union has published a proposal to impose additional taxes on Internet companies while President Trump plans to put tax pressure on Amazon. The S&P ultimately fell 2.7% while the Euro Stoxx 50 shed 2.2% and the Nikkei was down 4.12%.

In macroeconomic publications, figures for business sentiment and economic activity released during the first quarter of 2018 were mixed in the United States and below expectations in the Eurozone. As anticipated, the Federal Reserve, under the chairmanship of Jerome Powell, raised its key rate by one quarter of a percentage point to 1.75%. Meanwhile, the ECB opted to keep its accommodative monetary policy in place. On the government bond market, nominal yields eased all across the board, primarily via the decline in real rates. As a result, the credit market was negatively impacted, with subordinated debt and corporate hybrids taking the biggest hit.

We retain our positive interpretation of the fundamentals and we are approaching the US earnings season with a positive outlook. We are keeping our equity exposure near 50% with the same major regional allocations. As for fixed income, the US curve still offers attractive potential for balancing the portfolio. We are maintaining our diversification in international inflation-indexed bonds and a cautious stance on credit while reducing our exposure to emerging and hybrid debt.



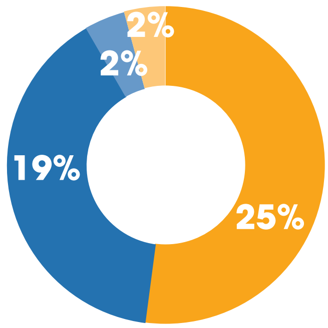
EQUITY EXPOSURE: **52%**

UNITED STATES
We are slightly increasing our exposure to US equities in anticipation of the earnings season.

EUROPE
We are maintaining our position.

JAPAN
We have strengthened our position in Japanese equities on tactical grounds.

EMERGING MARKETS
We are closing out our emerging equity component.



FIXED INCOME EXPOSURE: **48%**

DEVELOPED GOVERNMENT BONDS
We have reduced this component, which remains concentrated in exposure to US Treasuries.

INFLATION-LINKED BONDS
We have substantially increased our play on inflation-linked bonds, especially the US variety.

FINANCIAL/SUBORDINATED DEBT
We are scaling back our investment on tactical grounds as we await an opportunity to return to this asset class.

EMERGING MARKET DEBT
We are also reducing our position in this theme.

HIGH YIELD CREDIT
We are continuing to avoid this asset class for valuation reasons.

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