# Monthly Letter

January 2018

Meilleurs Vœux
Season's Greetings

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## Economic environment

On the economic front, 2017 ended on a positive note, with GDP continuing to accelerate across much of the world as a result of the broadest cyclical upswing since the start of the decade. Indeed, one notable aspect of last year's upswing is its breadth: the acceleration of growth concerned almost three-quarters of the countries, and some of the major emerging countries – Argentina, Brazil and Russia – finally pulled out of recession. However, despite the undeniable improvement in the labor market that accompanied the enhanced economic situation, wage growth remained surprisingly soft in the vast majority of developed countries, which is partly explained by high levels of involuntary part-time unemployment and slow growth in productivity. In sum, the evidence of synchronized and non-inflationary global growth continues to prevail, but the context of extremely low volatility could eventually end abruptly due to a shock that many perceive to be forming in the bond market.

For now, the Markit index of business confidence continues to denote expansion of the global economy, and forward-looking indicators, such as new orders and backlogs of work, also point to the current upturn extending into the start of 2018. In fact, global confidence reached its highest level since March 2015, driven by the manufacturing sector, which has not been as upbeat in almost seven years.

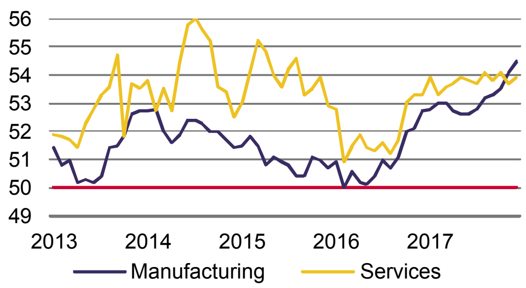
By region, it is in the Eurozone that business sentiment is the highest. The Markit manufacturing index reached 60.6 in December, its highest level since the survey was launched in 1997. For its part, the capacity utilization rate in the industrial sector is not only at a peak since 2008, but it is also well above its long-term average. Consequently, business investment could become an engine of growth. On the other hand, despite the good performance of the economy, inflationary pressures remain very limited. The December inflation rate edged down from 1.5% to 1.4%. More importantly, excluding food and energy, the inflation rate was only 0.9% for the fourth quarter as a whole, compared with 1.2% in the previous quarter. In this context, the ECB is likely to remain patient when it comes to normalizing its monetary policy, especially as the euro has recovered strength in recent weeks, particularly against the dollar. In addition, the end of 2017 was marked by a return of political risk. In Italy, the upcoming election on 4 March election is widely expected to produce a hung parliament, as the latest poll projected that Forza Italia and its right-wing allies the Northern League and Brothers of Italy might win 34% of the vote. The anti-establishment Five Star Movement, which has sworn off coalitions, is set to become the biggest single party at 26%, while the Democrats look likely to capture 25% of the vote.

### Performances in local currency

| | Price as of 12/29/17 | 1 month % change | 2017 % change |
|---|---|---|---|
| **Equity markets** | | | |
| CAC 40 | 5 313 | -1-1% | 9.3% |
| Eurostoxx 50 | 3 504 | -1.8% | 6.5% |
| S&P 500 | 2 674 | 1.0% | 19.4% |
| Nikkei 225 | 22 765 | 0.2% | 19.1% |
| **Currencies** | | | |
| 1 € = ...USD | 1.20 | 0.7% | 13.8% |
| 1 € = ...JPY | 135.01 | 1.5% | 9.4% |

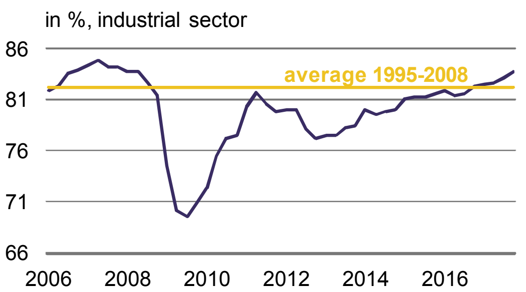
| | | Price as of 12/29/17 | 1 month bp | 2017 bp |
|---|---|---|---|---|
| **Government bonds** | | | | |
| 3 M | Euro zone | -0.78% | -5 | 12 |
| 3 M | United States | 1.38% | 12 | 88 |
| 10 Y | Euro zone | 0.43% | 6 | 22 |
| 10 Y | United States | 2.41% | 0 | -4 |

### World - Markit business confidence index




*Source Datastream, JP Morgan, Rothschild Asset Management*

### Eurozone – Capacity utilization rate

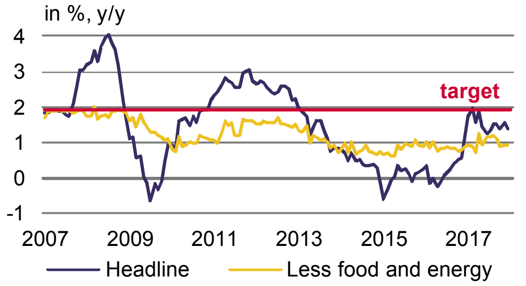



*Source Datastream, Rothschild Asset Management*

In the US, the yield curve continues to flatten and price-pressure developments are similar to those of most developed countries. Indeed, the unemployment rate ended the year 2017 at 4.1%, a low since December 2000, but wage growth remains modest, reaching 2.3% y/y for production workers – 17 years ago it was nearly twice as fast. Meanwhile, the pace of new jobs created fell from 2.3% y/y in early 2015 to 1.4% at the end of 2017. If this dynamic seems normal for a country whose labor market is practically at full employment, the fact remains that this slowdown could penalize the growth of household consumption, unless wage growth increases. Yet, the tax cuts voted by Congress and signed by President Trump could support – in the short term at least – households' income, especially those at the high end but whose marginal propensity to consume is low.

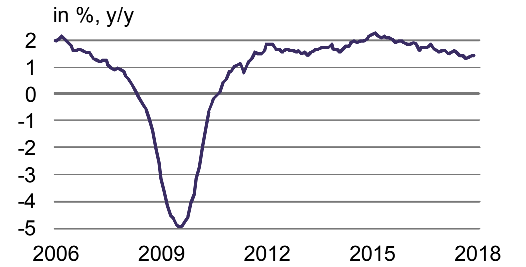
That said, businesses have been the big winner of the $1.5 trillion tax plan. Although some of the tax cuts can be turned into investment or higher wages for workers, the latest Fed minutes highlight that firms were cautious about expanding capital spending in response to the proposed tax changes or noted that the increase in cash flow that would result from corporate tax cuts was more likely to be used for mergers and acquisitions, debt reduction or stock buybacks. Thus, something that would support the stock market, but whose positive effects on economic growth could prove very modest.

### Eurozone – Inflation rate




*Source Datastream, Rothschild Asset Management*

### United States– Job creation




*Source Datastream, Rothschild Asset Management*