
FINALIZED NOVEMBER 20TH, 2018

- The corporate earnings growth may be peaking
- Debt accumulation takes a break
- Commodities send up a red flag
- Oil is sending a distressing signal
- A lot of the U.S. debt issuance looks like financial engineering
- Palladium is soaring as consumers choose gasoline vehicles over diesel

Dear investor,

- There is still some trading day left in 2018, but already **this year is the worst for global equity markets since 2011** (-6.6%), with the MSCI All Country World index losing about 1% in euro.
- Markets are ignoring what is likely to be the biggest year for U.S. profit growth this decade and turning their focus to the first **signs of an impact in the corporate outlook from the raging trade war, a slower global activity and higher interest rates.**
- In a typical late cycle, characteristics that distinguish **resilient equity portfolios include defensive and value-style investing.**

*Thierry Masset, Chief Investment Officer ING Belgium*

## EQUITIES

### The corporate earnings growth may be peaking

**As robust corporate profit growth, that has supported elevated equity prices, may have reached a peak, defensive and value stocks, companies with big capitalization or stronger balance sheet, stocks with high and stable gross margins, and stocks with high dividends are leading the way. Higher bond yields and less strong corporate earnings is a tough combination. Over the last 70 years, rising rates and diminishing profit growth are the only macro backdrop that has generated a negative quarterly return in the S&P 500 index.**

The protectionist rhetoric is a shock of uncertainty that has begun to spread to companies which may be experiencing a peak earnings growth. Even though U.S. earnings are coming in fairly strong – the bottom lines of corporations in the S&P 500 are expected to rise 23.5% this year –, we are seeing this phenomenon where stocks get punished. That is because interest rates are up and earnings growth – the fuel for the longest bull market on record – is poised to shrink as more companies, even in the U.S., are speaking up about the trade conflict's impact on their business. Analysts are now expecting 2019 U.S. earnings growth to slow to 10%, virtually the same growth they were predicting back in June 2017, six months before the passage of the tax cut. So the question now is, what exactly is an appropriate price to pay for stocks amid a higher interest rate environment and a lower U.S. earnings growth? One thing is for sure: the forward price-to-earnings earnings ratio for the S&P 500, which at 16.8 times is above the average of 15.7 times over the past decade, is probably still a bit rich. Should the market return to the mean, it would imply a 7% decline, all else equal.

## BONDS

### Debt accumulation takes a break


**While the efforts by the world's biggest central banks to unwind their quantitative easing measures have not so much disrupted the bond market since 2005, the growth in money supply, a gauge of economic activity, is continuing to drop around the world. That slowdown may finally be having an impact on the outlook for Fed rate hikes by preventing the central bank from becoming too hawkish.**

The Institute of International Finance said that worldwide debt fell by $1.5 trillion in the second quarter to $247 trillion. It is not much, but the global debt market has shrunk for the first time since 2016! Even so, nobody is going to say that the fixed-income market has reached some turning point after years of rapid accumulation amid the easy money policies employed by top central banks after the financial crisis. That decline hardly offsets the $29 trillion that has been added since the end of 2016 alone! But, with the Federal Reserve shrinking its balance sheet and other central banks looking to follow suit, bond investors are for the first time in a long time talking about whether there is enough demand to soak up all the debt that is floating around the world. That is one reason why bond yields globally have risen to 2.25%, the highest since 2013, as measured by the global investment grade debt (sovereign and corporate) index of Bloomberg and Barclays. That benchmark has lost 3.1% in 2018, already making this the worst year since it dropped 4.5% in 2005.

## OTHER ASSET CLASSES

### Commodities send up a red flag


**Is the decline in commodities prices the symptom of slower global GDP growth? The risk seems real that commodities consumption growth will fall as high gasoline levies, geopolitical tensions and trade tariffs stall the economic momentum. The message of a weakening demand on the oil and industrial metals front, also illustrated by a recent grassroots movement branded "Yellow Vests", is reinforced by a stronger greenback.**

Weaker commodity prices (after having reached a 3.5-year high earlier in October, they finally erased nearly all their yearly gains) are a result of two related factors. Economies other than the U.S. have lost the vibrancy they exhibited in 2017. The shift is being led by China, where the economy's weakest performance since 2009 is set to worsen unless a peace can be struck in the trade war with the U.S. The Euro-Area too is also losing momentum. The question is whether the U.S. can resist the downdraft, providing ballast for the rest of the world and for industrial demand. Lower commodity prices are also a response to the dollar's relentless march upward (the dollar index gained as much as 8% since mid-April) as the Federal Reserve increased interest rates eight times since December 2015. By contrast, the European Central Bank has maintained crisis-level, low interest rates. The Bank of Japan not only has a short-term interest rate target of -0.1%, but is also continuing asset purchases, boosting its balance sheet assets to more than 100% of gross domestic product. In pushing down prices, commodity traders realize that such a divergence of monetary policies across the industrialized countries is likely to continue and further dollar strength during the coming year would add pressure on oil and industrial metal prices.

## IN THE NEWS

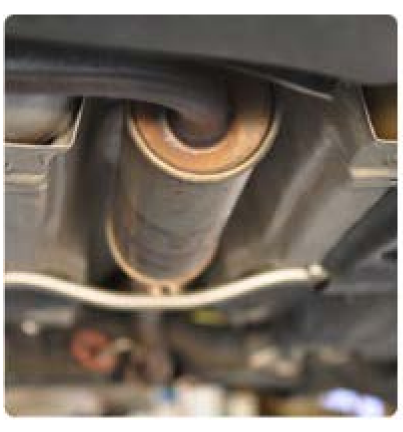
### Oil is sending a distressing signal


After reaching a 4-year high in early October, the price of crude has collapsed by more than 25%. This move is about more than just the ups and down of global supplies and whether OPEC and other producers can adjust. More importantly, it seems to speak to waning demand, caused by rising trade tensions, higher interest rates and instability in Emerging Markets.

### A lot of the U.S. debt issuance looks like financial engineering


Despite strong incentives in the Republican tax plan for American executives to expand, invest and ultimately boost the U.S. economy's growth potential, a lot of the debt companies are issuing appears to be motivated by something else...

### Palladium is soaring as consumers choose gasoline vehicles over diesel




In a year that has seen losses for most other commodities, the rally in palladium, a precious metal widely used in the automotive industry, has been exceptional. It is the one major metal that is at an all-time high (above $1,110 an ounce) and prices have almost doubled in the past two years.

If you have any questions or wish to discuss this further, please contact your private banker.

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