Monthly Market Review

FINALIZED FEBRUARY 26TH, 2018

Dear investor,

- The recent market setback represents a buying opportunity as **the fears about rising inflation and wage growth crimping corporate profits are way overblown**. It is the outlook for both production and sales volumes rather than higher wages that determine the impact on profitability.
- Investors should consider selling when production and revenue growth begin to disappoint. But we don't expect weaker growth any time soon, as **monetary policy tightening remains far from restrictive**.
- We remain bullish on stocks, as the asset class provides a **natural hedge against inflation** by producing earnings and sales growth.
- … even if **fear of trade war** injected a degree of risk to the favorable outlook.

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Thierry Masset, Chief Investment Officer ING Belgium

EQUITIES

Earnings boom means equity optimism makes senses

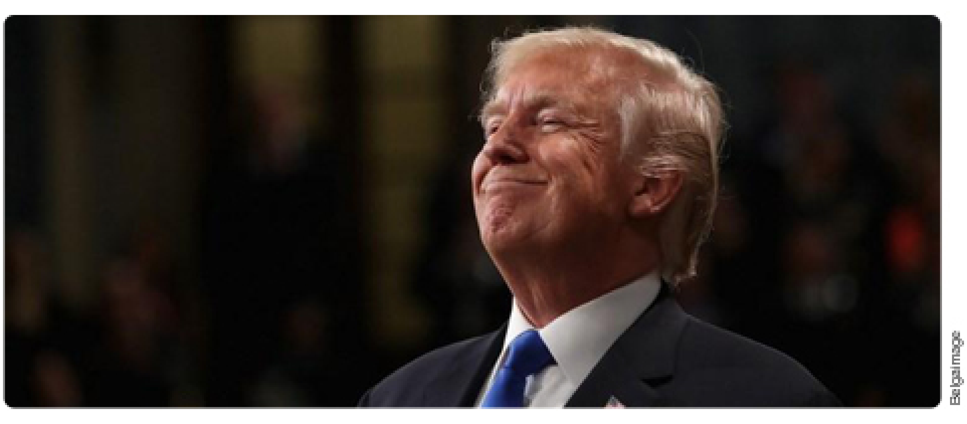
We remain bullish on stocks, as the asset class provides a natural hedge against inflation by producing earnings and sales growth. Historically, equities tend to offer their best returns with inflation in the 1% to 3% range, which also happens to be what is forecasted now.

While Donald Trump's protectionism could undermine the pro-growth tilt of its fiscal policy, the underlying strength of the global economy is still healthy. Just few weeks ago, the International Monetary Fund raised its forecast for global economic growth this year to 3.9%, up 0.2% from its projection in October. That would be the fastest rate since 2011, when the world was bouncing back from the financial crisis! It is synchronized, too, with growth picking up last year in 120 of the countries it monitors, which together account for three-quarters of world output. Such an environment means firms should be more confident about passing on cost burdens to customers. More demand leaves many industries running into supply limits, handing them another reason to raise prices. Furthermore corporate earnings are hopping. Through February 23, 450 of the S&P 500 companies had reported results for the fourth quarter of 2017 and 80% beat expectations. Should this level hold, it will be the highest of the post-crisis period! There is more: Year-over-year operating earnings growth now exceeds 15% and analysts have increased their forecasts for full-year 2018 earnings to 20%, an outsized gain that can be attributed in part to the deep corporate tax cut but also to strong global growth. Read More

- **Emerging Markets are turning into havens for investors.**
- **European Small Caps fare better than bigger peers in rout.**

BONDS

Bond investors can't catch a break



It is more difficult for investors to rely on a diversified stock-bond portfolio to provide protection in times of market volatility as, in a reflationary environment, the correlation between stocks and bonds is likely to go up, reducing the diversification benefits for investors holding both assets.

At its current level of about 2.9%, the 10-year Treasury yield remains well below the 4.45% average that prevailed in the decade beginning in 2000, or the 6.66% that was the norm in the 10 years prior to that. It is, however, above the 2.37% average since the start of 2010 and may well have further to climb as the most extensive rewrite of the U.S. tax code in more than 30 years would create a rising debt issuance to finance growing budget deficits. U.S. Senate leaders agreed on a two-year budget agreement which would provide almost $300 billion in additional spending. That is the last thing bond investors wanted to hear. After all, they are already being asked to put up more cash to finance the U.S. government, which is forecast to at least double its debt sales this year to more than $1 trillion – the most since 2010 – to make up for the lost revenue from the tax cuts. In the current reflationary environment, with pro-cyclical fiscal stimulus, it is more difficult to see bonds providing a consistent diversification benefit. Over the past 25 years, the main periods in which correlation between bonds and stocks turned positive (their prices moved together in the same direction) were around Federal Reserve tightening cycles. Read More

- **Disappearing defaults mark a new era for Emerging Market bonds.**
- **The number of defaults by heavily indebted corporates could rise significantly.**

OTHER ASSET CLASSES

Commodities like a weaker dollar and faster inflation

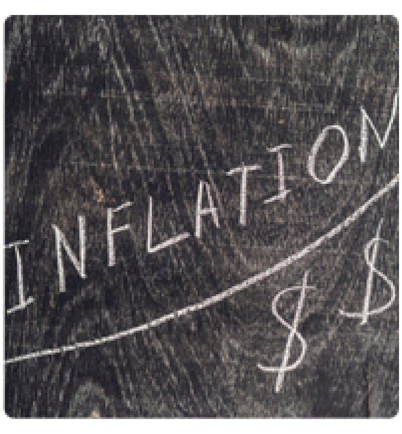
Commodities are largely priced and traded in dollars, so a weaker greenback tends to translate into stronger demand and higher prices. Rising commodity prices are also feeding through to expectations for quickening inflation. Strong aggregate demand and price inflation are precisely the time when commodities perform the best !

Commodities have escaped the worst of the global rout in equities as losses in raw materials are capped by speculation that the bullish outlook for demand remains intact. The Commodity index of Goldman Sachs and Standard & Poor's, which measures returns on 24 basic resources from crude to copper, has dropped 5% (in euro) since its recent top, but it could be a lot worse without the global synchronized economic recovery. A weaker dollar (-4.6% since mid-December 2017 versus the ten main currencies), U.S. corporate tax cuts, and an improving global economic growth are likely to sustain rising demand of basic resources and increase commodities deficit! Although their current winning run (+10% since end August 2017) tops the previous record which was set in 2005, commodities remain well down on highs in 2008! Therefore, they have room for further appreciation… Read More

- **The U.S. continues to be the biggest adversary to the OPEC's efforts to alleviate a global oversupply.**
- **There is a huge difference of return between European and U.S. gold investors.**

IN THE NEWS

Inflation fears infect world financial markets



Investors have finally detected the whiff of inflation as stocks and bonds slide worldwide amid concern that prices are set to accelerate after their post-crisis lull. Though inflation still looks under control in most major economies, pressure is building and there are legitimate reasons to say its return is much nearer than for some time. That being said, equities tend to produce their best returns with inflation in the 1% to 3% range, which is what is forecasted now.

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Yield hunters have more to gain in Europe than in the U.S.

With rich corporate dividends, still ultra-low interest rates by the European Central Bank and little prospect of a hike on the horizon, Europe offers investors payout yields close to 3% above those on the German 10-year benchmark bonds, a nice cushion in market selloffs.

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Why U.S. Small Caps aren't reaping the biggest rewards of the Tax Reform?

Two reasons why they aren't cashing in on lower domestic taxes. First, the London interbank offered rate (commonly known as Libor) is going up. And second, the dollar is been going down. In this context, Small-Caps companies outside the U.S. should be able to increase their rebound relative to U.S peers.

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