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- Markets struggle on geopolitics
- The bond market holds its nerve
- U.S.-Russia tensions boost industrial metals
- How do you price a trade war?
- The Swiss franc is back to the 1.20 mark
- Central and Eastern Europe bonds "safer" than Russian and Turkish ones

Dear investor,

- **The current phase of tit-for-tat tariffs by China and the U.S. is probably not the prelude to a full trade war but** part of a negotiating process toward trade that is fairer and more free. While **it may take some time before they agree on terms that will allow both sides to declare victory**, one can be hopeful that ultimately a grand bargain can be reached.

- **The result is a stock market that has grown increasingly reactive** to trade tensions, Donald Trump's tweets, and more uncertain geopolitics after the U.S.-led missile strike in Syria. **World stocks posted 17 daily moves of at least +1% or -1% this year, double the previous year's level**.

- But as we saw in early February, it is an escalation of fixed income volatility which will be a dangerous development for equity markets at this point in the cycle. **Fortunately, both bond and currency markets have been remarkably calm about the whole trade tension spat**. As such, the reduction in global equity prices represents a legitimate cheapening of the asset class.

Thierry Masset, Chief Investment Officer ING Belgium

EQUITIES

Markets struggle on geopolitics

Stocks seem highly sensitive to trade-policy rhetoric, but unless policy begins to dismantle economic and earnings trends, stocks' recent weakness may prove to have unlocked a decent amount of value for investors.

It is notable that the volume of news stories mentioning Donald Trump and a potential trade war has risen over the past few months and fuelled a higher volatility in the stock markets, which have lopped off about 6 billion in value since end January. But, of course, the market is being tested by more than just the U.S. president's tweets. The Federal Reserve remains steadfast in its push to tighten monetary policy (but may be forced, in case of a trade war, to decide between battling weaker economic growth or rising prices), and uncertainty remains over the level of geopolitical risk in the Middle East following the American-led missile strike in Syria or U.S. sanctions on Russia. But as we saw in early February, it is an escalation of fixed income volatility which will be a dangerous development for equity markets at this point in the cycle. Fortunately, both bond and currency markets have been remarkably calm about the whole trade spat. As such, the reduction in global equity prices represents a legitimate cheapening of the asset class. Twelve-month earnings projections for the MSCI World index are hovering around the highest level since 2008 and let hope a strong earnings growth this year (+13%), while valuations, in terms of forward price/earnings, have retreated 8.5% from a January peak.

BONDS

The bond market holds its nerve


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If the long-predicted bear market in bonds has arrived, traders don't seem to be too concerned. The anticipated volatility in U.S. sovereign bonds is now closer to its record low than it is to its high of early February. This decline may suggest traders doubt the Federal Reserve will follow through its plan to raise interest rates at least two more times this year.

The recent surge in stock volatility has captivated the financial community. Throughout the swings, however, bonds have remained unusually calm. The two markets are so disconnected that when the volatility of the S&P 500 jumped amid concern China would sell its hoard of more than $1.1 trillion in U.S. Treasuries in retaliation for the Donald Trump administration's proposed tariffs on $150 billion in Chinese imports, U.S. sovereign bonds (Treasuries) barely budged. Their volatility has dropped to a quasi-all-time low this year. It is fair to point out that in a period of record-low interest rates, one would expect smaller trading ranges in yields. But the bond market is particularly sanguine right now as the U.S. 10-year yield has been stuck in a 20-basis point range since the beginning of February. Fixed-income investors are refusing to push U.S. 10-year yields above the closely watched 3% threshold without evidence that inflation is starting to take off and bring with it a faster pace of Federal Reserve (Fed) interest rate increases, especially with signs the U.S. economy may be slowing. According to the Atlanta Fed, the U.S. economy is likely expanding at rate that is just below 2%.

OTHER ASSET CLASSES

U.S.-Russia tensions boost industrial metals


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With concerns about supply disruptions, low cross-asset correlations and inflationary risks, the strategic case for owning commodities is still valid. Especially when we know that the steady expansion in Chinese activity shows the economy shaking off threats from deleveraging and protectionism.

Global markets for equities have been whipsawed by the uncertainty over what President Donald Trump's next geopolitical move would be, and last month came the turn of industrial metals. They have been rocked by the U.S. clampdown against Russia's Rusal, the largest aluminum producer outside China, which set off a scramble for alternative supplies and stirred concern further U.S. action may embroil other raw materials such as nickel or palladium. Aluminum has reached its highest level since 2011 ($2,550 a ton on the London Metal Exchange) and recorded a strong rally (+29%, in euro, since the day before sanctions were announced). Nickel, the best performing industrial metal this year, pushed year-to-date gains to 18% and palladium posted last month its longest winning streak since August (+15%). Oil has not been left behind (+11.5% in 2018) as oil glut vanishes and Iran's oil exports (about 2.1 million barrels a day of crude) are at risk of potential U.S. sanctions. Trump is due to decide by May 12 whether to extend waivers that were put in place as part of the Iran nuclear deal. As a result, commodity prices have rebounded 10% (in euro) since their recent low. Supported also by the fact that China's economic expansion held up (Chinese gross domestic product grew 6.8% in the first quarter from a year earlier), they have reached their highest level since 2015!

IN THE NEWS

How do you price a trade war?


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The base case scenario remains more trade skirmish than trade war (the impact of measures announced so far is close to zero), but the risks are growing and investors are trying to know what will happen to global growth if there is a trade war.

The Swiss franc is back to the 1.20 mark


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While the 1.20 CHF level (for 1 euro) is largely symbolic, the franc's weakening provides a potential milestone for Swiss National Bank President Thomas Jordan and his colleagues, which may allow them to start imagining how to take interest rates back into positive territory after a decade on the front lines of unconventional monetary policy.

Central and Eastern Europe bonds “safer” than Russian and Turkish ones


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Eastern Europe, home to a new class of illiberal leaders within the European Union, is becoming a favorite for Emerging Market bond investors as trade threats, sanctions and geopolitical risks spur a retreat from high-yielding debt in Russia and Turkey.

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