Monthly Newsletter
Savings and Investments
Focus on Q3 earnings season

October 2017

Market overview

As we now entered the last quarter of this year, we can say that third quarter has been good for global equity markets, with the economic data continuing to point to a healthy global economy. The focus on geopolitical risks has receded and investors has started to focus on macroeconomic data and earnings. As we are entering Q3 earnings season, we predict that it will surprise on the upside and give tactical support to equities. Against this positive economic backdrop, central banks continues to indicate that they want to gradually reduce the level of monetary policy stimulus. So far it does not bring negative impact on equities. Overall, from tactical perspective our level of risk tolerance remains high.

Stock markets*	Major events and expectations
USA (S&P 500 index, USD): **+1,9%** in September **+12,5%** YTD **+74,9%** in 5 years **Europe** (MSCI EURO, EUR): **+4,5%** in September **+10,1%** YTD **+55,4%** in 5 years **Eastern Europe** (MSCI EM Eastern Europe, USD): **+1,3%** in September **+8,3%** YTD **-20,2%** in 5 years **Asia** (MSCI EM Asia, USD): **-0,2%** in September **+29,6%** YTD **+28,4%** in 5 years **Latin America** (MSCI EM Latin America, USD): **+1,5%** in September **+24,6%** YTD **-20,6%** in 5 years	As the focus on geopolitical risks has receded and investors has started to focus on macroeconomic data and earnings **US equities recorded new record highs in September**. US equity market gains, with low volatility, are being driven by the fact that investors are seeing decent earnings growth come through from corporates with little sign of any near-term recession risk. **In Q2 US economy grew at strongest pace in two years, unemployment rate is at 15 years low, consumer confidence remains high and business investment intentions are rising**. There is also **renewed talk of Trump's tax reform** which gives positive impact on equities but we don't expect the impact to be as large as we saw following the Trump presidential victory. Against this positive economic backdrop, **central banks** continues to indicate that they want to gradually reduce the level of monetary policy stimulus. **The US Federal Reserve (the Fed)** announced that it will start **balance sheet reduction process, which is contrary to quantitative easing (QE)**. The Fed also continues to signal about another **interest rate rise in December**. Meanwhile, the possibility that the **European Central Bank (ECB) could reduce its stimulus measures** (its own QE programme) also continues to be a focus for the market. In September, ECB President M. Draghi said that the central bank is discussing various scenarios to do with the QE programme. Details are expected to be released in this month. **In Europe, growth has continued to improve**. **GDP** growth was confirmed at 0.6% in Q2, up from 0.5% in the Q1. **Unemployment** in the euro zone remained at 9.1%, the lowest rate since February 2009. **Economic sentiment indicator** (calculated by the European Commission's) rose to its highest level in 10 years. This is providing a **positive backdrop for stronger corporate profit growth as consumption is increasing**. In response to the improved growth picture and lower deflation risks, ECB has led markets to expect tighter monetary policy. Also **tension in Europe** increased a bit after **Catalonia's referendum** and its will for independency from Spain, but so far there has been little impact on financial markets. **Emerging markets (EM) equities recorded a robust return** in Q3 with a backdrop of steady global growth and modest inflation proving supportive. The weaker USD, continued momentum in the Chinese economy and a pickup in commodity prices were all positive for EM equities. Overall, **global growth will continue to strengthen going into 2018**. We are presently seeing a very strong acceleration in leading indicators which we expect will translate itself into stronger GDP growth over the coming quarters. Of course as this economic expansion matures and monetary policy tightens, the risk of recession naturally rises but for now we see no signs that have historically warned that a global recession is around the corner.

* More information regarding indexes' performance can be found at the end of the document

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Impact on investments of different risk categories

Product group	Impact during the last month and expectations looking forward
Low risk (conservative)	After government bonds yields increase in August (due to political risk related to North Korea and natural disaster in US), in September government bond yields were tend to increase as markets started to take central bank tightening communications more seriously. In the longer run we see the trend of rising yields triggered by more favourable economic growth outlook, less accommodative monetary policy by Fed, ECB tapering. Expectations to gradually rising core government bond yields will continue to drive investors into less rate sensitive asset classes such as High Yield bonds.
Medium risk (balanced)	In September our balanced risk portfolios provided solidly positive returns. We increased total risk exposure in our portfolios during the summer and in September by decreasing the proportion of fixed income investments and increasing the weight of global equities. When it comes to medium risk instruments in bond market – high yield bonds (HY), we estimate that the risk reward profile of HY has deteriorated to such a level that we think it is prudent to enter an underweight despite our expectation that growth will remain strong in 2018
High risk (aggressive)	Our risk tolerance increased once again. The focus on geopolitical risks has receded and investors has started to focus on macroeconomic data, which is good, and on earnings. We expect that Q3 earnings season will surprise on the upside and give tactical support to equities. We also expect to see a repricing of the likelihood of tax reform in the US which should give tactical support to equities, although we don't expect the impact of a repricing to be as large as the one we saw following the Trump presidential victory. However, we stress that the increase of risk tolerance is tactical and aimed primarily at gaining a larger exposure to equities over the coming earnings season. Regionally, we still see better conditions for Asia / EM and Europe compared to the US.

Glossary

Terms used	Explanation
Consumer spending/consumption	The amount of money spent by households in an economy. The spending includes durables, such as washing machines, and nondurables, such as food. It is also known as consumption.
Deflation	A general decline in prices of goods and services. Deflation can be caused by a reduction in the supply of money, also by a decrease in government or personal spending. The opposite of inflation, deflation has the side effect of increased unemployment since there is a lower level of demand in the economy, which can lead to an economic depression. Central banks attempt to stop severe deflation, along with severe inflation, in an attempt to keep the excessive drop in prices to a minimum.
Fiscal policy	Fiscal policy relates to government spending and tax collection. Fiscal policy refers to the use of the government budget to influence economic activity. For example, when economic growth is slowing down, the government can step in and increase its spending to stimulate demand and economic growth. Or it can lower taxes to increase disposable income for people and businesses.
Gross Domestic Product (GDP)	The monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.
Investment grade bonds, high yield bonds	Investment grade bonds – bonds (sovereign or corporate) with credit ratings that indicate a relatively low risk of default. High yield bonds – bonds (sovereign or corporate) with credit ratings that indicate a relatively higher risk of default than investment grade bonds. Because of the higher risk of default, these bonds pay a higher yield than investment grade bonds. Two main credit rating agencies Standard & Poor's (S&P) and Moody's, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. S&P designations of 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality, and are commonly referred to as high yield or "junk bonds".
Leading indicator	A measurable economic factor that changes before the economy starts to follow a particular pattern or trend. Leading indicators are used to predict changes in the economy, but are not always accurate. Few examples of leading indicators include stock market performance, manufacturing activity, inventory levels.
Monetary policy	Monetary policy is the process by which the monetary authority (usually the central bank) of a country controls the supply of money (the size and rate of growth of the money supply), for the purpose of promoting economic growth and stability. For example, if the money supply grows too fast, the rate of inflation will increase and the economy will "overheat". If the growth of the money supply is slowed too much, then economic growth may also slow. The main tools to control money supply include open market operations (buying or selling assets), changing interest rates and changing reserve requirements for commercial banks.
Tapering	Tapering is the gradual winding down of central bank activities used to improve the conditions for economic growth. Activities can include changes to conventional central bank activities, such as adjusting interest rates or reserve requirements, or more unconventional ones, such as quantitative easing (QE). As a financial term, tapering is best known in the context of the Federal Reserve's quantitative easing program.
Yield	The income return on an investment. This refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

Stock market indexes performance information covering the immediately preceding 5 years till 30 September, 2017

Region	Index	Currency	Performance						
			2012	2013	2014	2015	2016	12 months	2017 YTD
USA	S&P 500	USD	13,4%	29,6%	11,4%	-0,7%	9,5%	16,2%	12,5%
Europe	MSCI EURO	EUR	15,6%	19,6%	2,3%	6,1%	1,7%	19,4%	10,1%
Eastern Europe	MSCI EM Eastern Europe	USD	13,2%	-2,9%	-40,0%	-8,1%	33,0%	23,0%	8,3%
Asia	MSCI EM Asia	USD	18,1%	-0,2%	2,5%	-11,8%	3,8%	21,3%	29,6%
Latin America	MSCI EM Latin America	USD	5,4%	-15,7%	-14,8%	-32,9%	27,9%	22,5%	24,6%