Investment Challenges and Opportunities in a Low Interest Rate Environment

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CONTEXT

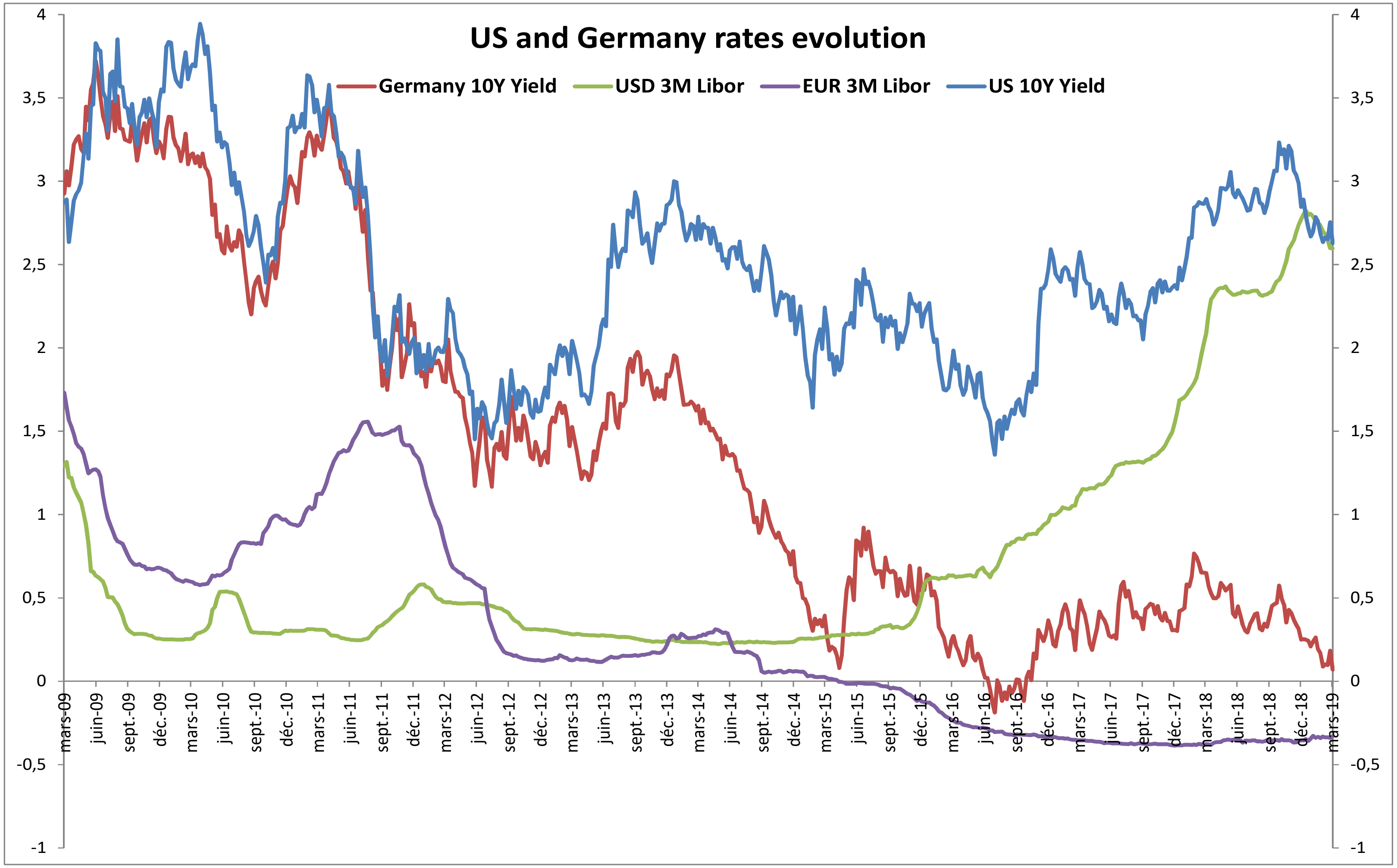
- Central Banks have been **seeking asset prices reflation**

  In Continental Europe: combination of **negative short term rates** and **bonds purchases**

  Very low rates have **provided time** but strongly **upset** traditional **compasses**

1. Impact on rates relative valuations
2. Impact on equities sectors relative valuation
3. Cross asset portfolio diversification much more challenging

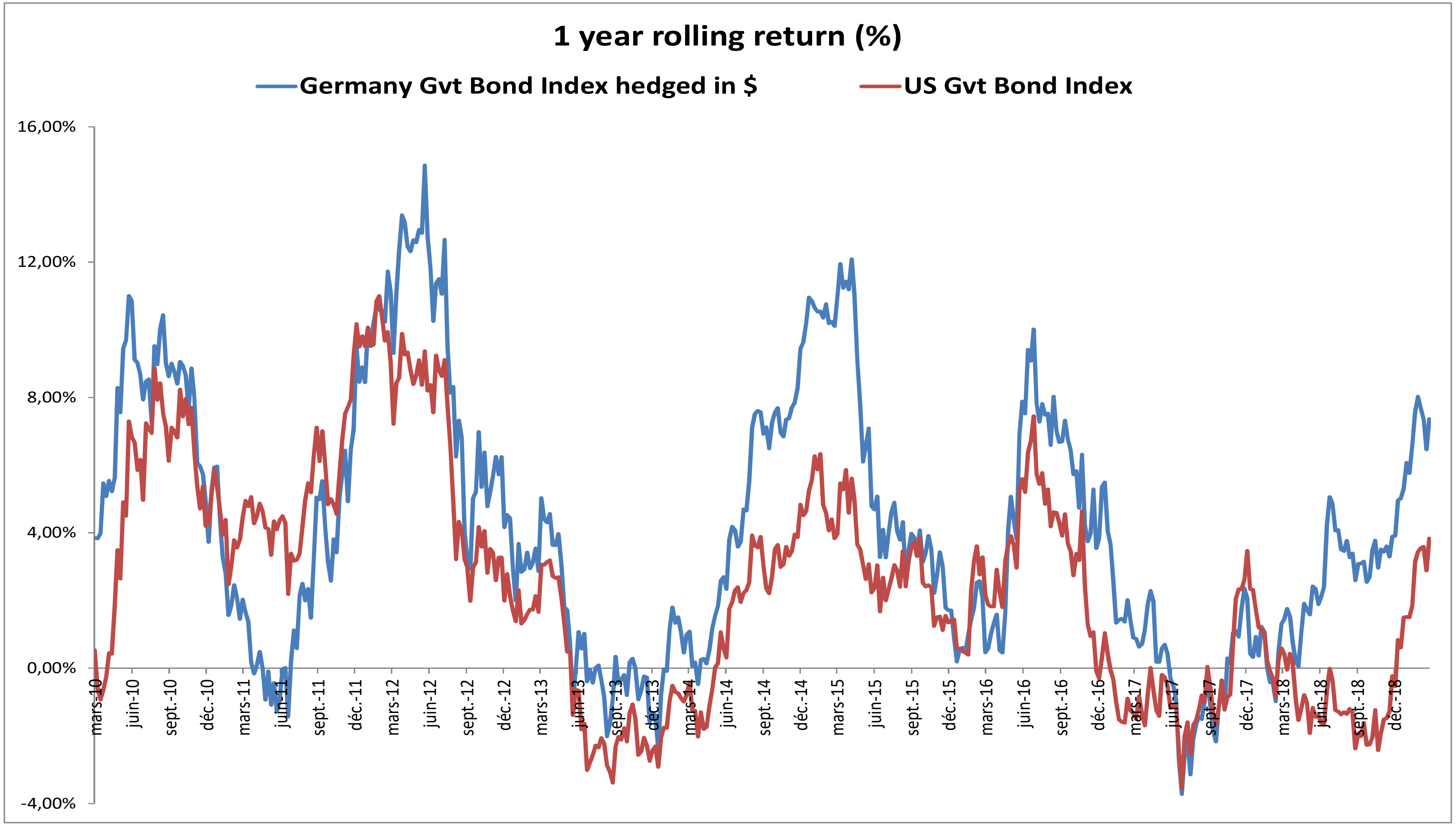
LOW RATES FOR 10 YEARS….



► **… but FED and ECB monetary policy cycles are not synchronized**

Source: Bloomberg. Data at 09/03/2019

NEW OPPORTUNITIES IN RATES RELATIVE VALUE POSITIONS

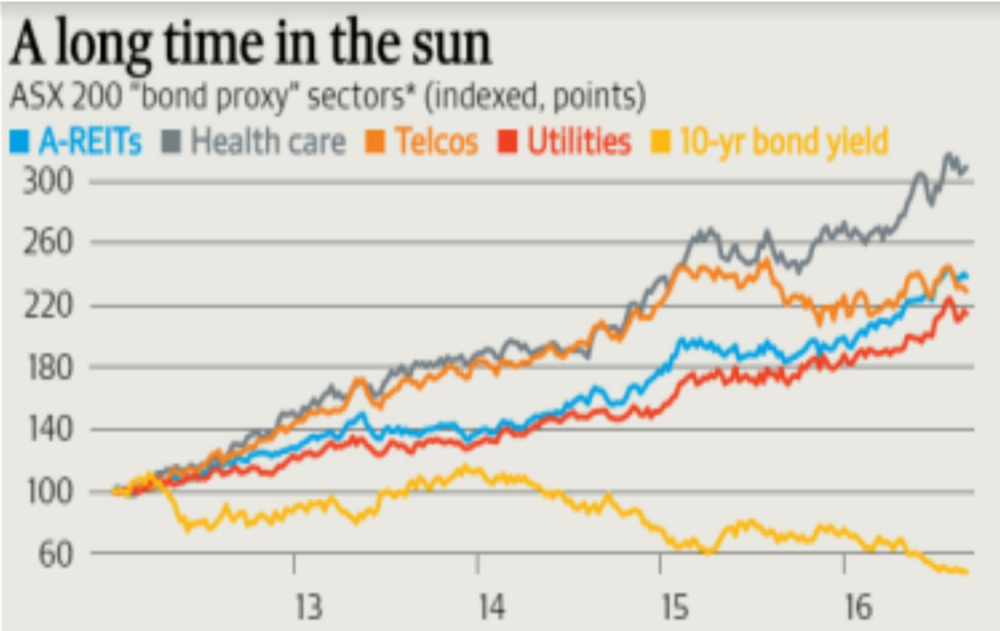


► **But much more for USD based investors…**

Source: Bloomberg, JP. Morgan. Data at 09/03/2019

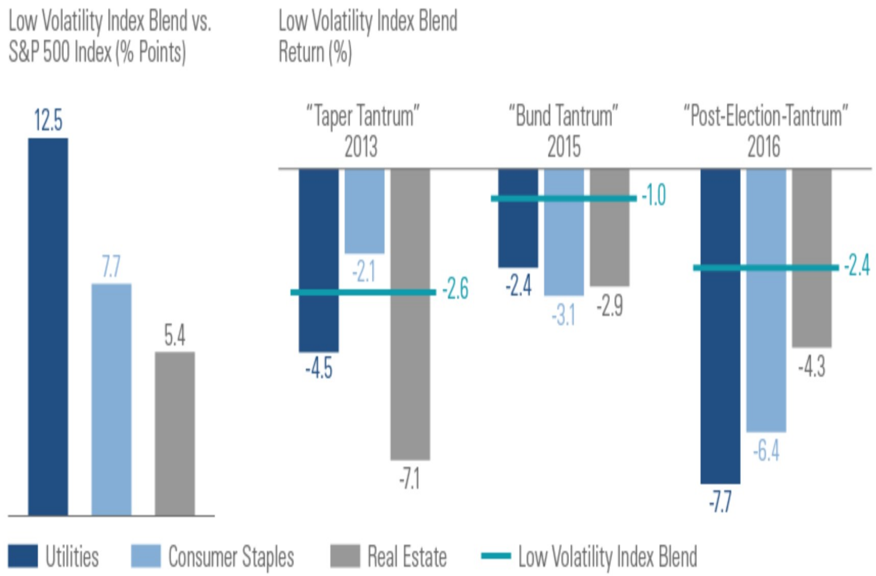
EQUITY SECTORS BOND PROXIES GETTING MORE RISKY

LOW RATES HAVE PUSHED DEFENSIVE SECTORS VALUATIONS



Source: Fairfax media, Bloomberg

HIDDEN DRIVERS OF RISK AND RETURN

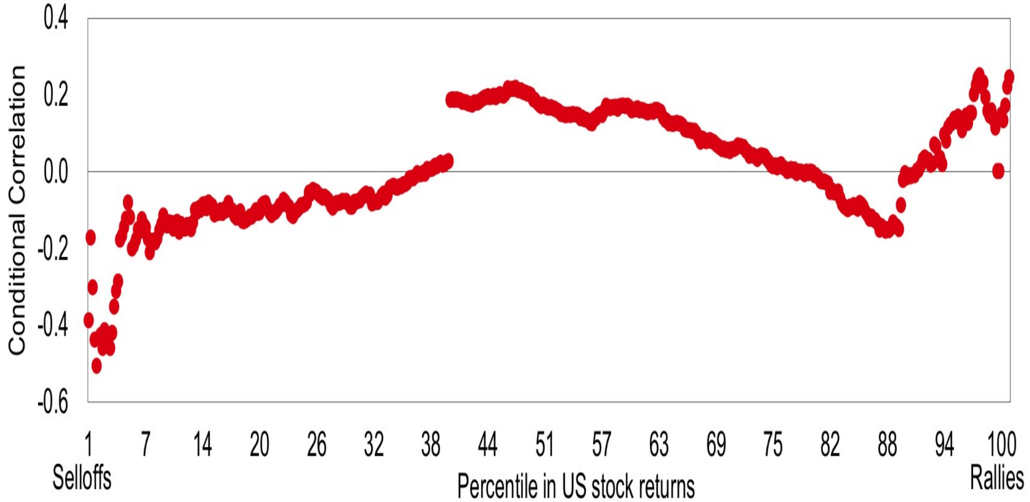


Source: Bloomberg, Morningstar, GSAM

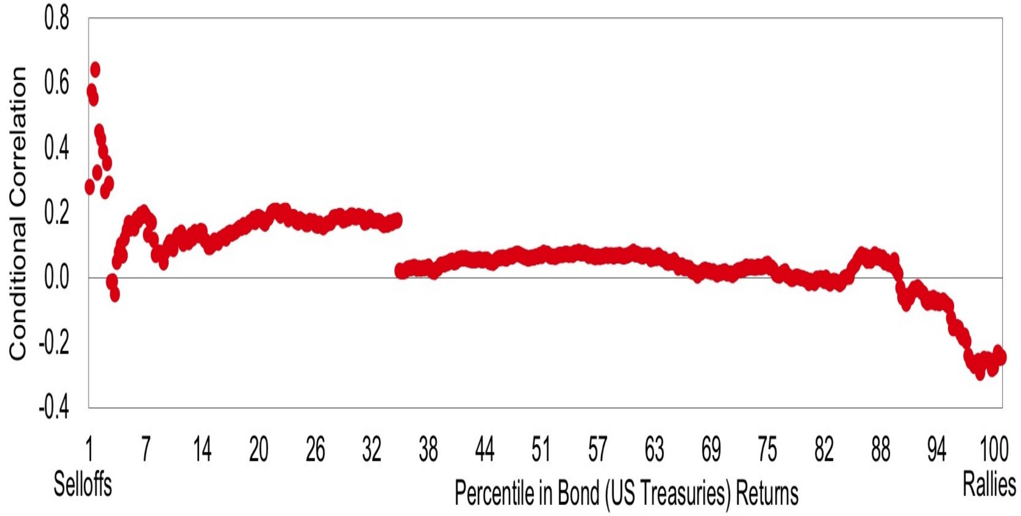
► **Downside risks on equities getting more tricky**

ASSYMETRY IN BOND-EQUITY CORRELATION

US Stocks vs Treasuries correlation conditional on stock returns (1976-2018)



US Stocks vs Treasuries correlation conditional on bond returns (1976-2018)



Source: Bloomberg, HSBC

► **Bond-equity correlation is volatile and positive correlation much more likely in bonds selloffs**

A NEW PHENOMENON : LOST IN DIVERSIFICATION

	Global Equities	Europe Equities	Japon Equities	Emerging Equities	US Treasuries	Euro Aggregate Corpo	EMBI
2018	-0,13	-4,96	-5,52	-9,66	-2,19	-0,73	-5,34
2017	18,48	13,06	19,75	30,55	2,31	2,41	9,32
2016	9,00	7,23	-0,74	9,69	1,04	4,73	10,19
2015	2,08	4,91	9,93	-5,76	0,84	-0,56	1,23
2014	9,81	4,66	9,48	5,17	5,05	8,40	5,53
2013	28,87	21,55	54,58	3,44	-2,75	2,37	-6,58
2012	15,71	15,61	21,57	16,99	1,99	13,59	18,54
2011	-5,49	-9,34	-18,73	-12,74	9,81	1,49	8,46
2010	10,01	6,83	0,57	14,10	5,87	4,75	12,04
2009	25,73	27,70	9,12	62,29	-3,57	15,71	28,17

- **Asset classes generally rose up to 2017** (apart from in 2011)
- **Equity market losses were cushioned in 2011** thanks to AAA-rated government debt duration (and US Treasuries in particular)
- In 2018, **major assets classes saw correlated negative returns** as euro-denominated money market returns remained in negative territory

CONCLUSION : MORE CHALLENGES THAN OPPORTUNITIES

- Easier debt rollover **supporting credit,** cheap debt cost **helping innovation**

BUT

- **No more positive** yielding **risk-free** asset for many investors , even for US in real terms
- **Historical data** on risk premia, sectors behaviors **less useful**
- **Robust portfolio construction much more difficult** with lower returns, higher drawdown risks and rising correlations