The entire Hugau Gestion team wishes you all the best in this New Year

Next publication on 4th of February 2019

Hugau Gestion - 2018 in review

2018 A tricky year which ended with a market rout

The year kicked off with world leaders in Davos expressing satisfaction that growth was back, but sentiment quickly cooled on financial markets. At the beginning of February, worries surfaced that the Fed might tighten as a response to rising wages, and then in March the US slapped customs tariffs of 25% on steel imports and 10% on aluminium. As a result, emerging markets /currencies and commodities tumbled over the first half. Copper was down 10% by June 30 as the US dollar strengthened, Fed Funds rose and the Trump administration turned its back on the multilateralism that had driven a boom in emerging economies since the end of colonisation and the collapse of communism. European markets also fell in the first half with the STOXX 600 losing 2.4%. Europe is the world's second largest exporter after China and would stand to lose a lot if globalisation were to be called into question. The US, in contrast, proved relatively resilient in the first half of 2018, helped by the Trump administration's fiscal and budgetary stimulus introduced on January 1st. The cut in corporation tax rate from 35% to 21% was particularly effective in boosting company earnings. The Dow Jones ended the first half only 1.8% lower while the S&P500 advanced 1.7% and the Nasdaq even jumped 11.8% on strong GAFA performance.
But the summer ushered in a more complicated period for markets.

- Europe witnessed:

- a budgetary tussle between Italy and Brussels after the Conte coalition of the Northern League and the 5-star movement opted for fiscal slippage in 2019,
- increasingly hazy Brexit arrangements, a threat for Theresa May,
- Angela Merkel standing down as CDU secretary general and then in December the yellow jacket protests in France.

- And a number of international obstacles appeared:

- mounting trade tensions between the US and China,
- the Fed's acceleration of rate hikes (one in March and three between end June and December 31) and the Republican Party's loss of its majority in the House of Representatives in the November 6 mid-term elections,
- the ECB announcement that it would stop QE on December 31 2018.

All these developments led to **volatility surging across assets, whether oil, equities or corporate bonds.** And the situation climaxed in December with a mini-crash on Wall Street that sent the Dow Jones 8.7% lower while the Nasdaq plummeted by 9.5%. Meanwhile in France, yellow jacket unrest turned violent and the CAC 40 ended the month 5.5% lower. Investors are now worried that a recession is looming. On the back of slowing Chinese and European growth due to less robust global trade and decelerating US growth triggered by the Fed's monetary tightening, they have created a quasi-recessionary scenario for 2019, one which justifies soaring risk premiums on financial markets.
As a result, almost all markets fell in 2018 (see table below).

Market indices, changes as of December 31 2018

	France	Germany	Europe	UK	US	Japan	China	Brazil
Change	CAC40	DAX30	Stoxx600	FTSE100	Dow Jones 30	Nikkei225	Shanghai Comp.	Bovespa
Q4 2018	-13.89%	-13,78%	-11,88%	-10.41%	-11.83%	-17.02%	-11.61%	10.77%
2018	-10.95%	-18,26%	-13,24%	-12.48%	-5.63%	-12.08%	-24.59%	15.03%

Source: Hugau Gestion calculations

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Commodity prices plunged. Brent crude hit $85 on October 3 2018 but had fallen to $53.8 by December 31, a drop of 19% over the full year. The correction was due to a production surplus in the US, Russia and OPEC countries as demand estimates were revised lower.
Currency trading in 2018 was dominated by the rising US dollar, the big winner from higher Fed Fund rates. The greenback gained ground against emerging country currencies, rising 17% against the Brazilian real and 21% against the rouble. The euro ended the year 4.5% lower against the dollar and Brexit worries took sterling 5.6% lower against the dollar. Only the yen, Asia's safe haven currency, managed to hold up, ending the year 2.7% higher against the dollar.
Corporate debt ended in negative territory, dragged down by massive new issuance and wider credit spreads. Only eurozone sovereign debt mustered positive returns thanks to its safe haven status. The BOAMLEURO 7/10 index gained 1.41%. With EONIA yielding minus 0.37%, cash produced negative returns but, compared to declines in other assets, still managed to be one of the year's best investments!
And yet, closer inspection suggests corporate earnings growth is still robust and the economic cycle is holding up well even if it has slowed. The **US** grew by 3% in 2018 and the Fed sees +2.3% for 2019 thanks to a vigorous jobs market. Unemployment is running at 3.7%, the lowest reading since the second world war, and bolstering household disposable income. The recent retreat in oil prices should reinforce this trend in 2019, especially as consumer lending growth is still strong at around 5% a year. More support is expected to come from spending on infrastructure and defence which has already taken the 2019 Federal deficit to around 5% of GDP.
China and India grew at 6.5% and 7.2% a year respectively. Even if China's growth slows to 6.2% in 2019, this is still a long way from the recession that markets are currently worrying about. Brazil's GDP was up 1.7% in 2018 and should gradually recover as Jair Bolsonaro rolls out his neoliberal economic programme. But the emerging universe, OPEC countries and Russia, which grew by 1.7% in 2018, should be hit by lower crude prices.
After an exceptional 2017, the growth trend in the eurozone had already started to move back to around 1,5% in 2018. It was roughly the same story in France but with the added setback of second quarter transport sector strikes and the yellow jacket disruptions in December. INSEE estimates these events will shave 0.3 points off GDP, taking it down from 2.3% in 2017 to 1.5% in 2018. Without the support of global trade momentum, eurozone growth can now only rely on internal demand but healthy employment levels should underpin demand. As of the third quarter of 2018, eurozone employment was running at a record 158.3 million, or more than the 149.89m in the US (November 2018). High employment levels are good for wages and a boost for household consumption. At the same time, job scarcity and supply-side constraints have encouraged companies to invest. The ECB forecasts GDP growth of 1.7% in the eurozone in 2019. The bank's confidence that wages would rise was behind its decision to stop QE at the end of 2018 while leaving its balance sheet and benchmark rates unchanged. The REPO rate is still 0% and the bank deposit rate remains at minus 0.4%. Capitalised EONIA returned -0.37% on average in 2018.

To sum up, 2018 saw a sharp drop in valuations as equities lost between 10-20% but earnings remained upbeat. Markets moved down a step to adapt to a less accommodating monetary environment, a moderately restrictive move in the US and a return to neutral in Europe. Let's hope that this new balance proves stable. Meanwhile, Donald Trump's *America First* policy, part and parcel of a rejection of multilateralism and its institutions (i.e. the world order set up after 1945 to maintain peace), has ended up fuelling uncertainty. Populist movements have been strengthened across the globe, creating a sense of insecurity which is hardly conducive to risk-taking.

NAV OF THE FUNDS

NAV DATE	UCITS	NAV	% 1 Week	%1 Month	%3 Months	%YTD	%1 Year	%2 Years	%3 Years	%5 Years
			Cumulated Performances							
31/12/2018	HUGAU MONETERME I	120 806,33	-0,000	-0,012	-0,048	**-0,213**	**- 0,21**	**- 0,10**	**0,28**	**1,58**
31/12/2018	HUGAU OBLI 1-3 I	1 361,83	-0,05	-0,34	-1,48	**-2,79**	**- 2,79**	**- 0,54**	**1,58**	**5,12**

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