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FRÈRES GESTION

SEPT 2015

ECONOMIC AND FINANCIAL OUTOOK

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Report completed on September 29th, 2015

The global economic context should remain favourable for risky assets but several distinctions should be made

Markets have been experiencing high volatility for several weeks now, with investor concerns fuelled by question marks over global growth, especially in China, and by US monetary policy. In our opinion, this period of uncertainty can be explained by shifts in the global economy that require markets to adjust. Against a backdrop characterised by falls in oil and other commodity prices, global growth is expected to gradually gather pace again after a lacklustre first half-year. The upswing will chiefly benefit the developed countries and commodity-consuming emerging countries. Interest rates should gradually rise under the influence of the Fed's expected rate hike but without adversely affecting equity markets. The Eurozone's positive economic backdrop should continue to underpin the performance of the region's equities.

Continued growth rotation towards developed countries

World: global growth should gradually gather pace

Despite the usual setbacks, global growth has actually remained fairly stable at around 3.5% over the last three years, its average level since 1980. However, this stability masks diverging regional trends, as growth accelerates in the developed world and slows in emerging countries. Although the fall in oil prices is excellent news for the global economy, the economic impact has been less significant than predictions by international organisations seemed to suggest. Nonetheless, the prolonged period of low oil prices arising from abundant supply and energy-efficient growth should pay off eventually.

United-States: sustained growth

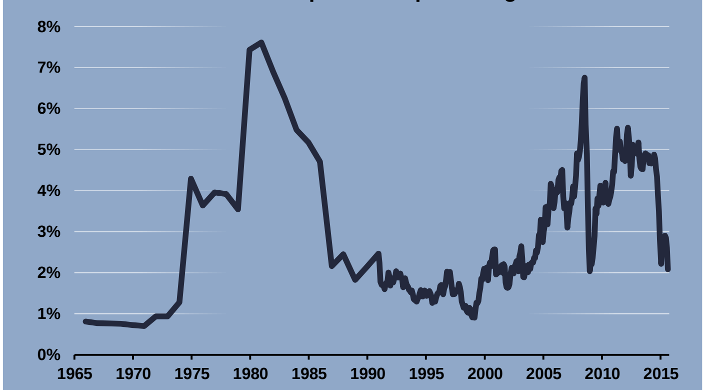
US growth dipped at the beginning of the year before significantly recovering in the second quarter. Business confidence indicators are in line with ongoing dynamic growth in the quarters ahead, although stockpiling represents a short-term risk. The recovery in construction will underpin activity and investment should pick up after the correction arising from lower oil prices. The resulting improved purchasing power coupled with a healthy labour market should see consumption gaining pace.

Eurozone: a recovery set to continue

The Eurozone's recovery will continue and business confidence indicators are consistent with slightly faster growth in the region of 2%. This figure lends itself to an ongoing decline in unemployment rates which will buoy household consumption further, and improved credit conditions should lead to investment gradually prevailing. Trade surplus reached record levels despite weak exports in several emerging markets. Political risk in Greece has eased but an eye should be kept on the Spanish legislative elections in December.

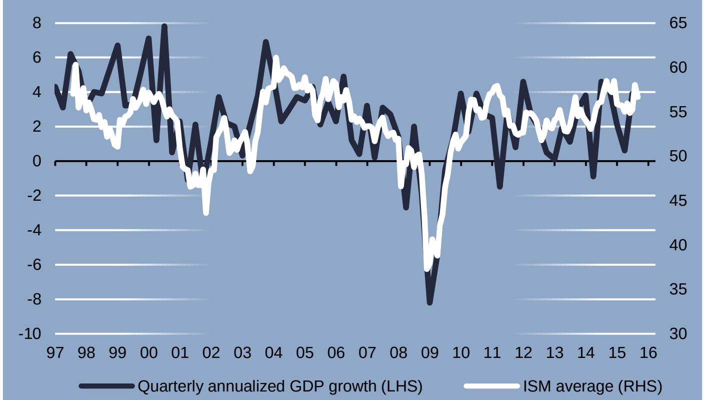
Key statistics

World oil consumption as a percentage of GDP



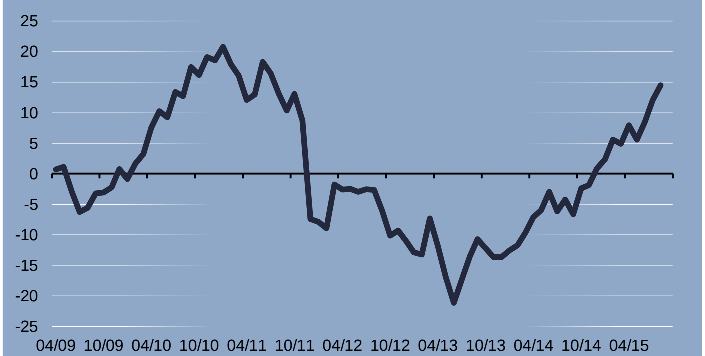
Source: Factset, as of September 28th, 2015

United States: GDP growth and ISM indices



Source: Factset, as of September 28th, 2015

Euro zone: net loans to the private sector
(adjusted for sales and securitisation, bn EUR, 3 months average)



Source: ECB, as of September 28th, 2015

Japan: the economic slowdown is likely to be transitory

After an excellent first quarter, the Japanese economy is going through a bad patch. Household consumption is throttled given the absence of wage growth despite an ever-tightening labour market. To a large extent, the consequences of Shinzo Abe's policy can be found in Japan's ongoing corporate earnings surge. Business confidence indices point to high resilience, indicating that the economic slowdown is likely to be short-lived.

China: a controlled structural slowdown

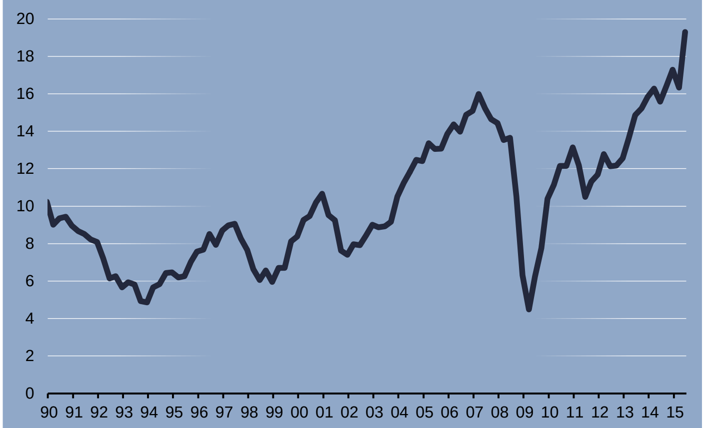
Chinese growth recovered in the second quarter but economic indicators published since then have been disappointing overall, particularly in the industrial sector. Leaving short-term factors aside, China has reached a stage in its development from which growth trends will be slower. Even so, a soft landing is possible. A growth transition in favour of the services sector is well underway and the authorities have ample leeway for supporting momentum. Meanwhile, the fall in the yuan (-3% in three days, 10-12 August) seems to be a case of internationalising the currency rather than slowing down the economy, given that the depreciation was too slight to significantly affect exports.

Emerging markets: a difficult situation for several net exporters

The uneven growth scenario is liable to continue in emerging markets with net importers, such as India, benefiting from lower prices and net exporters, such as recessionary Russia and Brazil, bearing the brunt. The fresh decline in oil prices is likely to postpone a Russian recovery whilst the Brazilian economy shall remain affected by the weak business climate, budgetary austerity, monetary tightening and a dismal political environment. The Fed's imminent rate hike may weigh on capital flows. Although current accounts deficits are lower than in the past, they remain significant in certain countries such as Turkey, where political risk has grown.

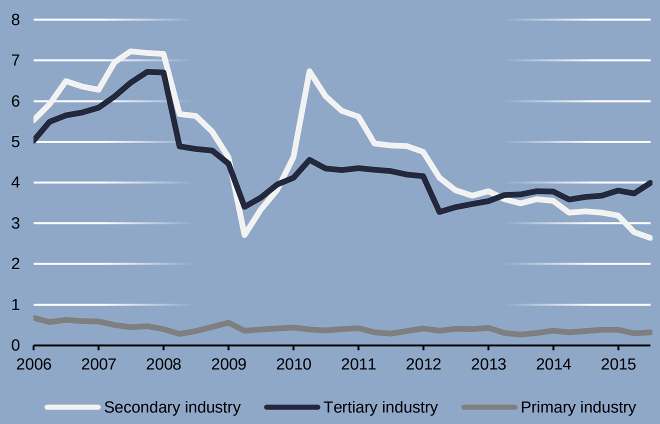
Key statistics

Japan: corporate profits
(tn JPY)



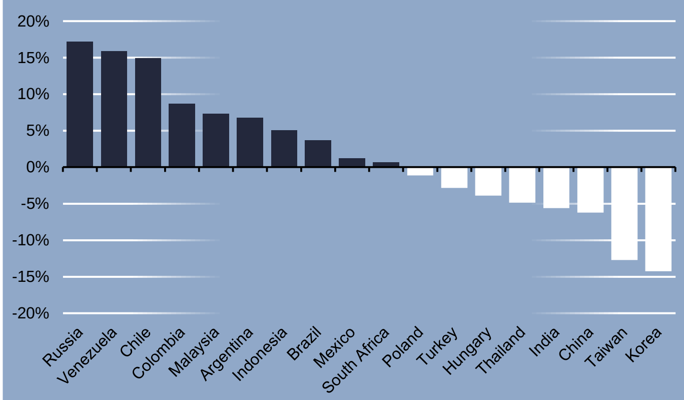
Source: Factset, as of September 28th, 2015

China: contributions to annual GDP growth



Source: Bloomberg, as of September 28th, 2015

Emerging countries: net exports of commodities
(% of GDP)



Source: UNCTAD, 2013

What can we expect from the Fed and the ECB?

The Fed inclined to raise rates shortly

Despite an ever tighter labour market, the Fed took the decision not to raise rates in September. The aim, it seems, is to avoid premature monetary tightening in a volatile market environment. The risk, however, is having to increase rates at a faster pace should inflation gain momentum, which would undoubtedly affect long-term yields significantly. Although inflation currently remains low, economic upswings and rapidly declining unemployment rates lend themselves to marked accelerations in wages and therefore inflation. For these reasons, and to dissipate market uncertainty, the Fed is liable to raise rates before the end of the year.

The ECB could extend its asset purchase programme

The ECB's quantitative easing has already partially paid-off: credit conditions in peripheral countries are progressively converging with those of the core and credit flows have increased significantly. Even so, the Fed's postponed rate hike, low levels of inflation and the strengthening of the euro in recent weeks could lead to the ECB adjusting or extending its asset purchase programme.

A positive environment for Eurozone equities

A gradual rates increase in view

The long end of the yield curve remains very low and exposed to changing monetary policy expectations from the Fed who will probably initiate a steeper rate increase than currently expected by the market from 2016 onwards. The rise in US long-term rates should push the Eurozone equivalents up, despite monetary policy divergences akin to 1994. We believe that rising rates can be offset by credit spreads on high-yield bonds and subordinated financial debt as they still offer potential for narrowing.

A positive environment for Eurozone equities

A fresh acceleration in global growth and abundant liquidity should underpin equity markets that offer attractive additional returns compared to other asset classes. The rate hike is not a risk for the US equity market which has typically risen in previous Federal Reserve rate-raising cycles. However, already strong profit margins in the US dampen upside potential. A positive Eurozone backdrop should continue to underpin the performance of the region's equities. The euro is likely to pursue its modest depreciation against the dollar and operating leverage should ensure good profit growth levels. The Japanese market was hit by the rise in the yen but is still enjoying favourable earnings momentum. Emerging markets require caution against a backdrop of falling commodity prices and rising US rates.

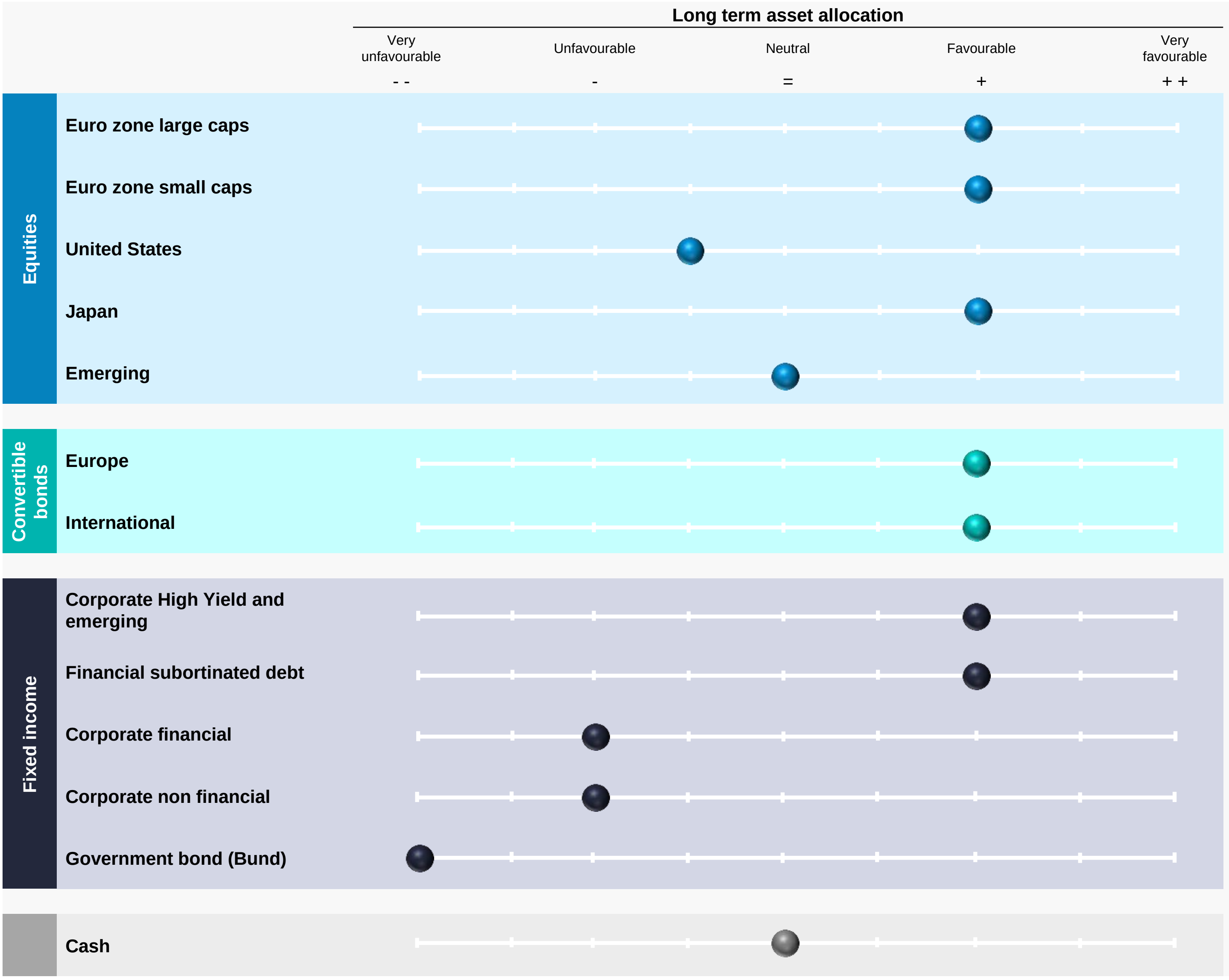
The opinion expressed above is dated as of September 2015 and is liable to change.

Macroeconomic and political agenda

In the weeks ahead, markets will keenly follow possible announcements by the main central banks, particularly during the Fed's and the ECB's next meetings in October and December. An eye should also be kept on the factors prone to having a decisive impact: developments in the US labour market, Eurozone inflation and data on Chinese activity.

Political risk could also be back in the spotlight. The vote on the US budget, the Spanish and Turkish elections and the political situation in Brazil deserve particular attention.

Our view on the main asset classes



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