MONTHLY STRATEGY REPORT
JULY 2018

SUMMER SOLSTICE

BancaMarch

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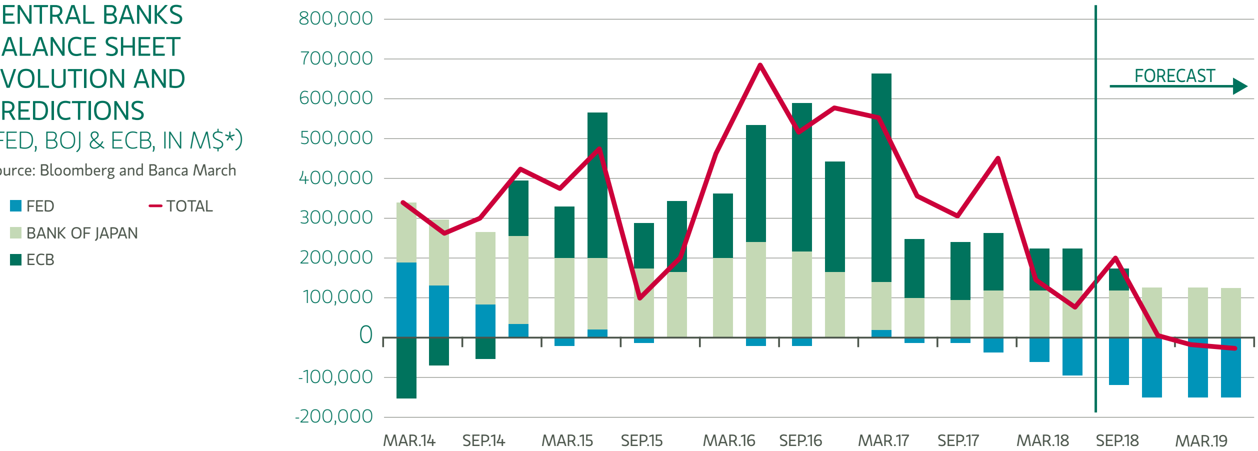
A few days ago, we crossed the summer solstice, the time of year when the sun is at its highest. In the Southern Hemisphere more than 500 years ago, the Incas celebrated the Wawa Inti Raymi, a ritual in honour of the sun, this time of year. This celebration was started by Inca Pachacutec to legitimise the control the empire had over its subjects. This ceremony symbolised the re-birth of the Sun god, starting a new annual cycle, "the Inca circular time." For the Incas, the notion of time was different from ours. It wasn't linear with a start and finish, but rather a "spiral" process whose phases were repeated in large, recurring cycles. This idea was linked to the agricultural cycle (preparing the land, seeding, and harvesting). For them, the past was not separated from the future or the present; instead, it was part of the same cycle that allowed continuous regeneration.

While the sun shines highest in the Northern Hemisphere, and the global economy recovers, the central banks have recently announced they will continue their stimulus withdrawal. The Federal Reserve has sped up, raising interest rates 0.25%, and it hopes to raise rates two more times by the end of the year to around 2.25-2.50. For its part, the ECB has chosen to reduce its bond buying programme by half (15 Billion Eur/month) starting in September. Most importantly, it has stated that it will end the bond buying programme in December. This decision implies that by the next winter solstice in the Norther Hemisphere, the main central banks will have stopped being net contributors of net cash flow into the system.

CENTRAL BANKS BALANCE SHEET EVOLUTION AND PREDICTIONS

(FED, BOJ & ECB, IN M$*)

Source: Bloomberg and Banca March



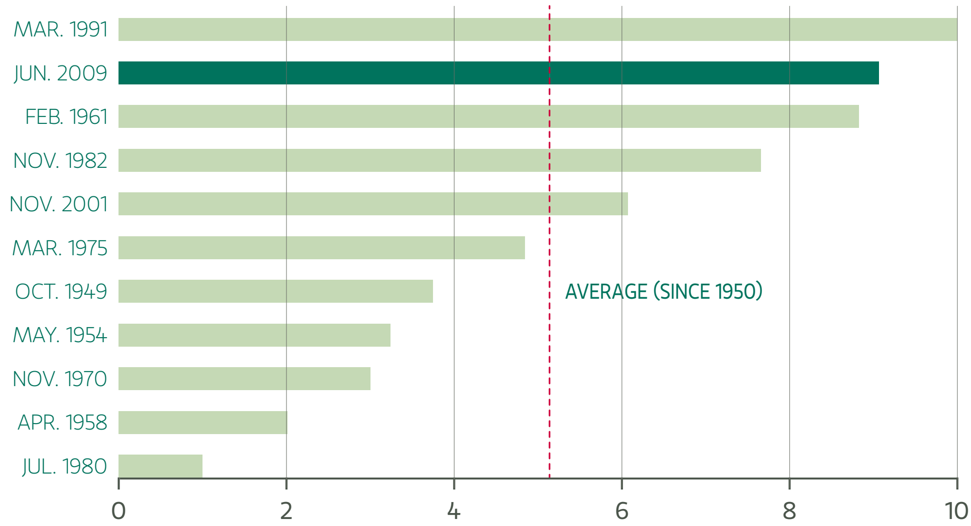
* Assuming: BoJ extends the frequency of its balance sheet increase and the FED increases its pace of balance sheet reduction to $50 billion.

After 11 years of unprecedented monetary stimulus, having quadrupled its balance sheets such that organisations like the ECB have pumped in around 2.5 trillion Euros, we are going to face a significant change. Without a doubt, the current economic cycle is not only a spiral, and one that has very little to do with the Inca concept of time cycles, but the monetary medicine that got us out of the 2008 crisis has no comparison in history, especially regarding the magnitude of cash flow that the central banks have put into the system.

These organisms, who understand the situation and the side effects perfectly, have, for a long time, been telegraphing and postponing the withdrawal. The monetary "doping" and extremely low interest rates have favoured economic recovery in the US for over nine years, and with growth above 2%, we are in the second longest economic cycle in history.

US ECONOMIC CYCLE LENGTH

Source: Bloomberg and Banca March



With such a mature cycle in the US, the main destabilizing factor to keep an eye on, outside of Trump's threats of trade war, or the Italian political crisis, will be the steps toward monetary normalisation and the maturation of the US cycle.

The good news is that, although some indicators have started to deteriorate, there are many factors that still make us optimistic.

On the negative side is the trend of Consumer confidence expectations and the deterioration of the credit spreads over the last six months. On the bright side, the Business confidence trend clearly stands out, particularly in the US, where it is near February levels, when it was the highest it has ever been during this cycle. Additionally, the trend of the different yield curves, even though they are flattening, still offer a safety margin, and their inversion would not necessarily mean a recession will start within the next 12 months.

EVOLUTION RECESSION RISK

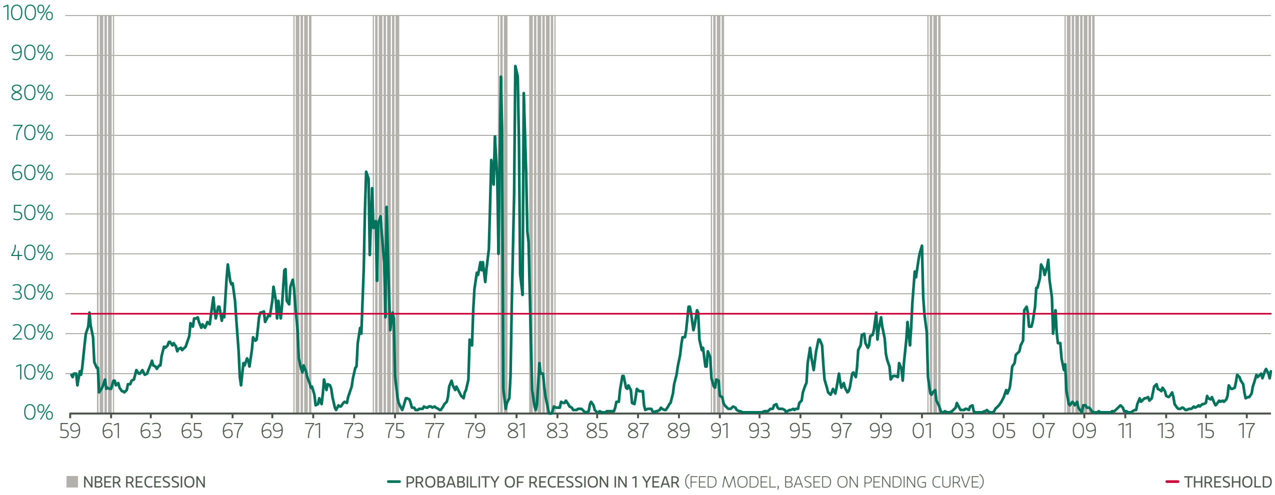
Source: Banca March

INDICATOR	DESCRIPTION	VALUE
WORSENING OF CREDIT DIFFERENTIALS		0.33
PENDING CURVE EVOLUTION		0.937
STOCK MARKET EVOLUTION	LOSS OF PERFORMANCE LEVELS FROM 6 MONTHS AGO	75.63
BUSINESS CONFIDENCE	MANUFACTURING ISM > 50	60.2
CONSUMER CONFIDENCE	FALL < 12-MONTH AVERAGE	
WORSENING OF CONSUMER CONFIDENCE	EXPECTATIONS VS PRESENT SITUATION	-57.90
FALL FROM HIGH LEVELS OF PLANTS' USED CAPACITY		77.86
SLOWDOWN OF EMPLOYMENT RATE GROWTH		0.82
NEGATIVE REAL INTEREST RATES		-0.46
PENDING AUSTRALIAN CURVE	10 YEARS VS 2 YEARS	0.599
PERFORMANCE OF CHINESE ECONOMY		51.5

This is why models like the one the FED uses still point toward a reduced likelihood of recession.

PROBABILITY OF RECESSION. FEDERAL RESERVE

Source: Bloomberg, FED and Banca March



However, what we are convinced of is that, even if the central banks put all their effort into ensuring the stimulus is withdrawn very soon, it will be very difficult to replicate the low volatility environment we have enjoyed in the past. From now on, it will be much more painful to obtain the extra returns that risk assets like equities provide. While the cycle stretches on and our indicators still show that the current expansion should last at least another 12 to 18 months, inflation rates are already starting to reflect the increased price of oil. Just like the Incas, I would like to think that this cycle will be a spiral and that it is time to harvest the fruits. The problem is that after 11 years of intervention, the ammunition used by the central banks is starting to be pulled back and this time the idea of a cycle is more linear than ever.

In this last part of the cycle, the stock markets should continue to do well. The secret is getting out six months before the party ends. For now, put up with the volatility.

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