MONTHLY STRATEGY REPORT
OCTOBER 2018

JEROME AND THE WORLD'S LARGEST MOBILE

BancaMarch

JEROME AND THE WORLD'S LARGEST MOBILE

Last week, the Federal Reserve continued its slow and steady process of monetary normalisation. After having increased its balance sheet by $4.5 billion to weather the subprime crisis and nearly three years after implementing the first interest rate hike, the Fed announced another turn of the screw: the eighth increase in this economic cycle. Perhaps more tellingly, it removed the phrase "monetary policy will remain accommodative" from its official statement. This decision suggests that, for the Federal Reserve, the economy is already evolving as planned. Going forward, Jerome Powell and the members of the Federal Open Market Committee will shift to a monetary policy phase that is based more on macroeconomic data and less on the forward guidance used until now to determine each of the monetary normalisation processes. The change in rhetoric is confirmation that, from now on, the decision to raise interest rates will be based on the evolution of future data, depending on how the wind blows.

This new phase of the US monetary policy could be likened to the movement of a mobile sculpture: yes, one of those contraptions typically suspended from the ceiling that appears to defy the force of gravity and move according to air currents, reflecting the changing effects of light as they drift. This allegory was originally used 42 years ago in the construction of the new Federal Reserve Bank of Philadelphia, when Alexander Calder, the originator of kinetic sculpture, was commissioned to create a major work for the lobby of the main building.

Process of installing White Cascade. Alexander Calder. May 1976.

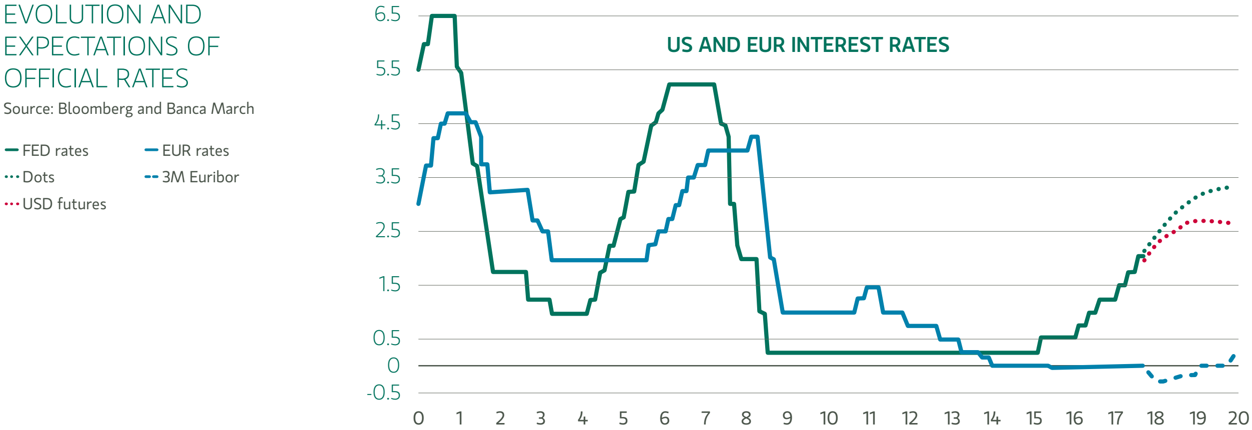
Current view of the lobby at the Federal Reserve Bank of Philadelphia.

At his first exhibition in Paris in the early 1930s, Calder, a great friend of Miró, Mondrian and Duchamp, revolutionised the conventional concept of sculpture, freeing it of mass and incorporating movement as an additional element in his work. Underlying this artistic concept and the new dimension that moving sculptures provide is the idea of the impossible equilibrium that so closely resembles the decisions that the Federal Reserve will have to make in the coming months to avoid excessively overheating the economy.

At the moment, the path seems clear. As the graph below illustrates, despite the contrary belief of the market (red dots), there will be an additional interest rate hike in December of this year, to the 2.25%-2.50% range, and another three in 2019. Depending on the data, it is even possible that in 2020 rates will reach the 3.25%-3.50% range, exceeding the forecast of long-term neutral rates that stands at 3%.

1. EVOLUTION AND EXPECTATIONS OF OFFICIAL RATES

Source: Bloomberg and Banca March



Going forward, Powell's job will enter a new, crucial phase where his decisions will be monitored more than ever. He will have to be able to balance the three main objectives of the central bank (maximum employment, price stability, and moderate long-term interest rates) with the responsibility of maintaining stability and containing the risks that may arise in the financial system. Although not its main objective, he will have to govern by managing the imbalance that exists between the domestic economy—which according to the latest figures has reached maximum growth, with an annualised rate of 4.2% and unemployment at an 18-year low—with a much more turbulent international climate, where Europe is nearly four years behind in the monetary normalisation process and emerging economies are slowing under pressure from Trump's trade renegotiations.

"White Cascade," which is the title of the mobile that hangs in the Federal Reserve Bank of Philadelphia, is arguably not the best work of Calder's prolific career, but at a height of more than 30 metres and a weight of 10 tonnes, it is the biggest mobile sculpture in the world. Its grandeur and size aim to demonstrate, in artistic terms, the importance of the FED among the world's main central banks. We hope Jerome Powell takes this into account, because macroeconomic trends—and, by extension, the mobile—will move more than ever.

Joan Bonet Majó
Director of Market Strategies

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TEN YEARS AFTER THE START OF THE GREAT RECESSION, THE GLOBAL ECONOMY IS EXPANDING

BancaMarch

WHAT HAPPENED IN MARKETS?

Concerns about budgetary stability in Italy, tensions associated with Brexit, and the latest trade war developments were the highlights in September.

In Italy, the new government's budget plans, if implemented, will increase the public deficit to 2.4% of GDP, a figure well above the previous administration's target and in contention with Brussels, which wants to see credible accounts consistent with EU guidelines. There is also uncertainty surrounding the United Kingdom and its exit from the EU, with no progress being made toward a negotiated Brexit.

There were ups and downs in the trade war. On the downside, Trump raised tariffs on $200 billion in Chinese imports. China's response was two-fold: it announced its withdrawal from negotiations, at least until after the mid-term elections in the US, and it set tariffs on US goods valued at $60 billion. On the upside, Canada and the United States announced a new trilateral trade agreement with Mexico that will replace NAFTA.

The Fed acted as expected, raising interest rates to the 2-2.25% range and removing the term "accommodative" from its latest press release, a sign that the institution is approaching a neutral position on interest rates. Surveys of the Board of Governors suggest one more hike in December and another three next year. With regard to inflation, Powell sees no significant pressure, although in its statement the Fed confirmed that it is nearing its medium-term target of 2%.

On a macro level, economic dynamism persisted in the US, with robust job creation and consumer confidence data at an 18-year high. In Europe, the indicators suggest lesser dynamism, compatible with the economic expansion. In the case of Spain, the economy grew at a rate of 2.5% y-o-y, the lowest since 2014, and the Bank of Spain cut GDP forecasts for the next three years, although job creation will remain healthy. In China, inflation rebounded and confidence indicators were mixed.

Equities were mixed in September. The US saw slight gains in the S&P (+0.4%) after an outstanding previous month, while the Nasdaq shed 0.8% in September on the declines of companies like Tesla and Facebook. It was a positive month for the Japanese stock market: a weak yen prompted the Nikkei to gain 5.5% in September, to levels unseen since 1991.

In Europe, advances on the majority of stock exchanges failed to offset August's sharp declines, with Britain's Footsie up +1% and Italy's MIB up +2.2%. There was minimal movement on the Eurostoxx50 (+0.1%) and IBEX (-0.1%).

In emerging markets, the MSCI Emerging Markets Index suffered further losses (-0.7%), with declines in China (-1.9%) and advances in Brazil (+6.8%), which has yet to recover from the -12% dip in August due to concerns about the impending elections.

It was a mixed month for bonds, with weak trends in European sovereign and corporate debt, in contrast to more favourable trends in the United States and the positive month for emerging fixed income.

There was little movement on the currency market. The euro-dollar crossover remained virtually unchanged, closing the month at 1.16 EUR/USD. The pound sterling, meanwhile, made gains—to 0.89 GBP/EUR—in anticipation of progress in the Brexit negotiations. The yen declined against the euro to close the month at 131.90 EUR/JPY.

On the commodities market, Brent remained bullish in September, up +6.8% to $82.70/barrel, nearing a 4-year high. OPEC's refusal to increase production despite the impending entry into force of sanctions on Iranian exports justifies the rise in part. The price of gold, meanwhile, reflected easing trade tensions, slipping below its benchmark value of $1,200/ounce after shedding 0.7%.

HOW TO POSITION OURSELVES IN THE CURRENT ENVIRONMENT

Awaiting greater visibility

STRATEGIC POSITION

TYPE OF ASSET	-2	-1	NEUTRAL	+1	+2
LIQUIDITY			■		
BONDS	■				
EQUITIES			■		
ALTERNATIVE ASSETS				■	

BONDS	-2	-1	NEUTRAL	+1	+2
SOVEREIGN DEBT	■				
High Quality (AAA)	■				
Peripherical assets			■		
CORPORATE BONDS			■		
Investment Grade		■			
High Yield			■		
EMERGING DEBT				■	
CONVERTIBLE BONDS			■		

EQUITIES	-2	-1	NEUTRAL	+1	+2
EUROPE				■	
UNITED STATES			■		
EMERGING MARKETS				■	
JAPAN			■		

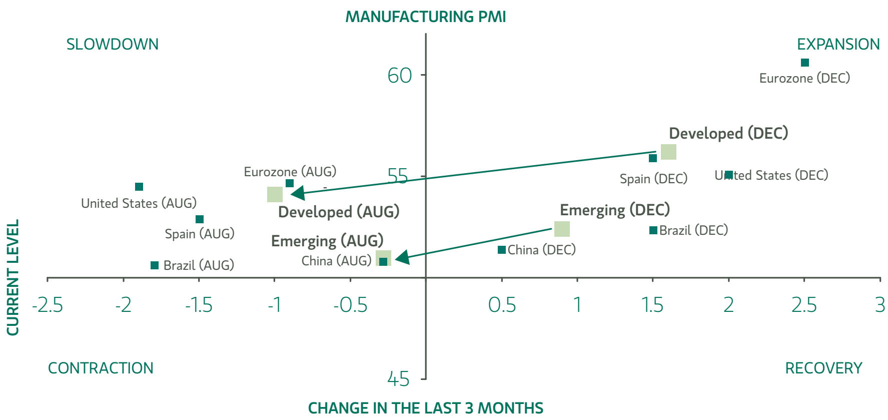
Ten years after the start of the Great Recession, the global economy is expanding.

Last month marked the 10-year anniversary of the Great Recession. In September 2008, the collapse of Lehman Brothers helped trigger the financial crisis that dragged the global economy into one of the worst recessions in history. However, 10 years after the onset of the crisis, the global economy is expanding, growing at a rate above the historical average and buoyed by the stimulus measures implemented by governments and Central Banks.

As illustrated in graph 1, leading indicators suggest that the main economies will continue to expand in the coming months, although the expected growth rate will be lower than that of the first half of the year.

1. BUSINESS CONFIDENCE AND THE ECONOMIC CYCLE

Source: Bloomberg and Banca March



However, the strongest point of growth is behind us…

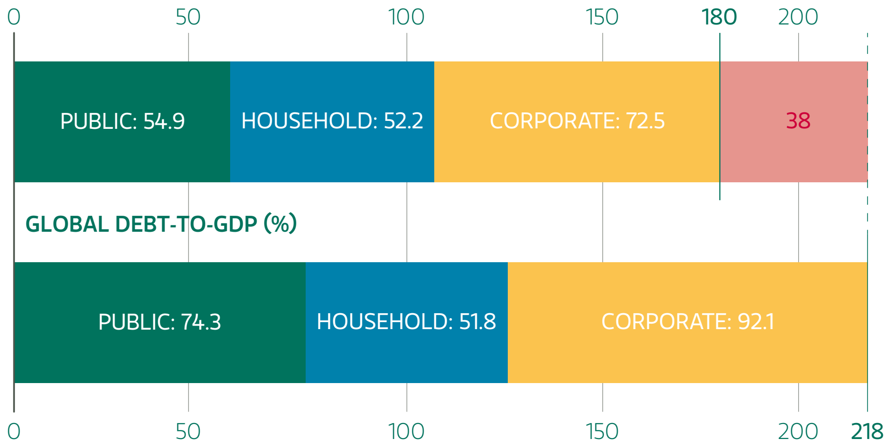
Our outlook is one in which the global economy grows at a rate of 3.8% this year, but more important is the fact that a new macroeconomic cycle is on the horizon. Predictably, the second quarter of the year marked the strongest point of global growth, and in the next 6-12 months we expect to see a global economy in expansion, though with some signs of easing and an increase in the dispersion of activity in the main economies.

…and important imbalances remain, such as excessive global indebtedness.

It is worth noting that the current economic cycle is already the second longest in the history of the world's number one economy, the United States, where GDP growth has persisted for the last 10 consecutive years. However, one of the causes of the previous economic crisis—excessive debt—has not been resolved. In fact, globally, total debt has increased in the last decade to 218% of GDP compared to 180% at the end of 2007.

2. EVOLUTION OF GLOBAL DEBT

Source: Bis and Banca March



The context will continue to be characterised by a growing dispersion in asset yields…

Turning now to the current situation and the recommended positioning, it should be noted that this year we are witnessing greater dispersion in asset yields, a factor that will persist in the coming quarters, requiring us to be more selective in our investments.

…with three main short-term risks: trade war, emerging economies, and political negotiations in Europe.

There are three primary concerns that we believe will continue to affect short-term market performance and subsequently increase market volatility and make it more difficult to capture the excess return offered by equities. We refer to i) trade tensions with the United States, ii) the deterioration of financing conditions in certain emerging economies, with the inherent risk of contagion to other economies with better fundamentals, and finally, iii) negotiations in Europe regarding Brexit and especially the budgets of the new Italian executive.

Although the central scenario is one in which an agreement is reached…

With regard to trade tensions, we remain in a context characterised by advances and setbacks in negotiations between the Trump administration and the US's other trading partners. On the one hand, a new free trade agreement with Mexico and Canada was finalised, the outcome of which will not yield any special advantage for the US beyond those in the previous NAFTA agreement. On the other hand, China is an issue after both countries raised the tariffs that will apply to their merchandise transactions.

…heightened tensions persist between the US and China.

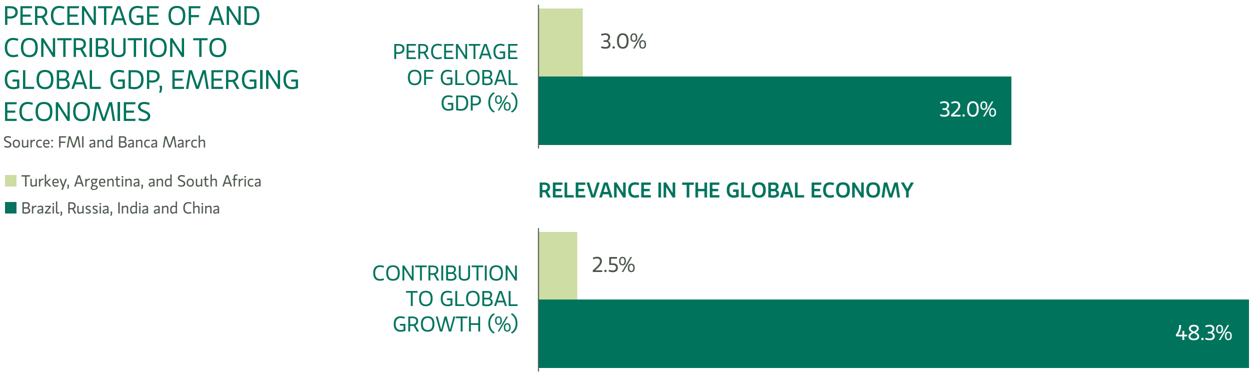
Despite the difficult negotiations, a final settlement must be reached since all other options would be detrimental to both China and the US. Tougher trade barriers would reduce productivity and boost inflation. However, no agreements are expected until after the US mid-term elections on 6 November.

The financing difficulties of Turkey, Argentina and South Africa should not spread to other emerging economies.

On the topic of emerging economies, we believe that the problems of Turkey, Argentina and South Africa will not spread to other emerging markets, where assets have begun to reflect an overly adverse scenario. Although these three economies present macroeconomic imbalances that make them more vulnerable to the deterioration of international financing conditions (high foreign debt and current account deficit), this situation cannot be extrapolated to all emerging economies. Moreover, it should be noted that the combined contribution of these three countries to global growth is not significant, a fact that should minimise the risk of contagion to the major emerging economies.

3. PERCENTAGE OF AND CONTRIBUTION TO GLOBAL GDP, EMERGING ECONOMIES

Source: FMI and Banca March



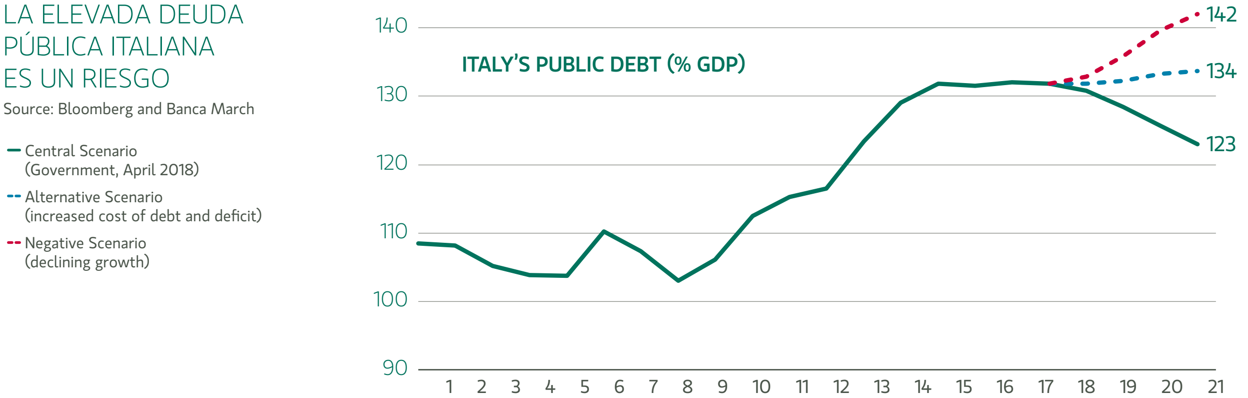
Concerns about public debt re-emerge in Italy…

In Europe, uncertainty in Italy is on the rise again following the initial news about the new executive's budgets, which reportedly will increase the public deficit to around 2.4% of GDP, rather than the 1.6% previously agreed to with the European Commission for 2019.

If this increase in the imbalance of the public accounts is approved (together with the rising cost of financing), the anticipated scenario of reducing Italy's soaring public debt will be substantially altered (see graph 4). The primary risk would entail a decline in economic growth due to the waning confidence of economic agents, which—in our scenario—would raise public debt to levels above 140% of GDP in the coming years.

4. LA ELEVADA DEUDA PÚBLICA ITALIANA ES UN RIESGO

Source: Bloomberg and Banca March



…and the new budgets must be negotiated with the CE before year-end.

In the coming months, we will continue to monitor the budget approval process. The Italian government must submit its final proposal before 15 October and, for its part, the European Commission will review the budgets and issue its recommendations by 30 November. Also in October, two credit rating agencies will present their review of Italy's rating, which risks a downgrade due to increased concerns about debt sustainability.

Despite a positive economic scenario, we remain cautious.

In conclusion, although we are still in an expansive economic cycle where corporate profits continue to grow substantially, the aforementioned latent risks are cause for greater caution.

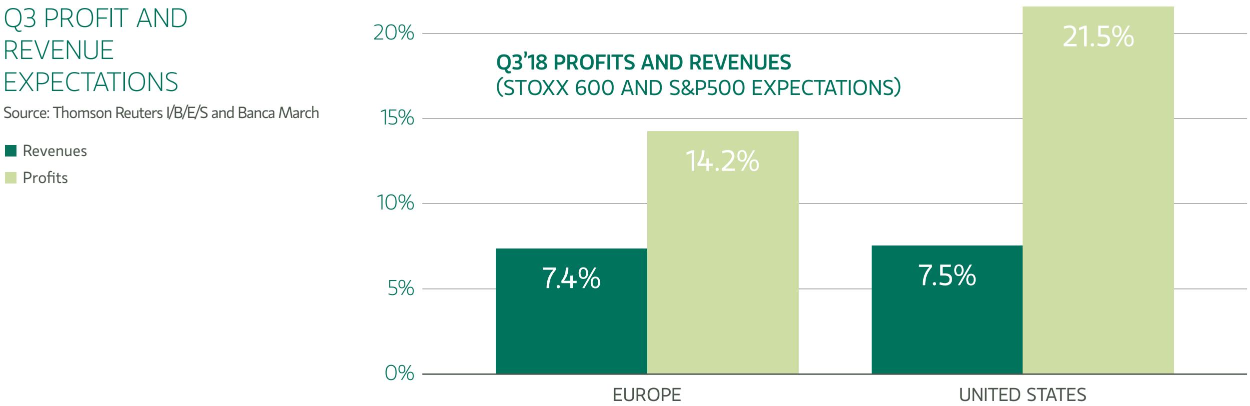
Since July, we have recommended reducing equity exposure from overweighted to neutral while awaiting better purchase opportunities, and for the moment, we maintain this position. We prefer to wait for more visibility on trade tensions and Italy's budgets, as well as for more attractive global stock valuations before increasing positions.

The corporate earnings season will help dispel doubts.

In this respect, it will also be essential that the Q3 earnings season, which begins this month, meets expectations. In the United States, profit growth is expected to climb +21.5% y-o-y, but we also have encouraging data in Europe, where an increase of +14.2% is anticipated for Stoxx600 companies, an improvement from the first half of the year, which was burdened by the appreciation of the euro, exposure to emerging markets, and weak financial sector results.

5. Q3 PROFIT AND REVENUE EXPECTATIONS

Source: Thomson Reuters I/B/E/S and Banca March



Investment-grade debt is unattractive…

With regard to the bond market, we continue to recommend avoiding investment-grade sovereign debt, and credit, for its part, increasingly shows lower potential. Higher inflation and a less expansionary monetary policy are negative factors that will ultimately drive up long-term interest rates. In Germany, the required 10-year yield is expected to reach 0.9% and 3.2% for the US benchmark. Therefore, we maintain a preference for short durations and contain credit exposure by being very selective about issuers in the portfolio given that, presumably, default rates will be at a minimum in the coming months and current spreads will not cover a potential uptick in defaults.

…but the punishment of emerging debt is excessive.

On the other hand, we recommend capitalising on this year's poor performance of emerging debt in safe-haven currency and increasing exposure. In our opinion, the current level of required risk premiums for these countries already incorporates negative scenarios to a large extent.

The dollar is not expected to appreciate beyond 1.15 EUR/USD.

On the currency market, the euro-dollar crossover returned to around 1.15 EUR/USD, which seems adequate to reduce exposure to the dollar, given that in our forecast the exchange should be nearer to 1.20 EUR/USD. We therefore advise hedging exposure to the US currency. We believe that the factors leading the euro to depreciate against the dollar to 1.15 EUR/USD are temporary (political fears about Italy's exit from the euro are overblown) and the dollar is not expected to appreciate in a sustained way beyond that level.

The pound will remain under pressure in the short term.

As for the euro-pound crossover, it will continue to trade in the range of 0.85-0.90 EUR/GBP. Although the market has already taken into account part of the negative scenario and the crossover is in the higher part of the expected range, a lack of visibility about an exit agreement could trigger further depreciations in the pound in the short term. Therefore, we recommend hedging exposure to the British currency although at current levels it is undervalued against the euro.

Joan Bonet Majó
Pedro Sastre
Paulo Gonçalves
Banca March Market Strategies Team.

EURIBOR

	LAST	1 MONTH	YTD	1 YEAR
1 MONTH	-0.37	-0.37	-0.37	-0.37
3 MONTHS	-0.32	-0.32	-0.33	-0.33
6 MONTHS	-0.27	-0.27	-0.27	-0.27
12 MONTHS	-0.16	-0.17	-0.19	-0.17

CURRENCIES

	LAST	1 MONTH	YTD	1 YEAR
EUR/USD	1.1604	1.160	1.201	1.175
EUR/GBP	0.890	0.896	0.888	0.877
EUR/CHF	1.140	1.124	1.170	1.143
EUR/JPY	131.9	128.8	135.3	132.4

GOVERNMENT BONDS

		LAST	1 MONTH	YTD	1 YEAR
USA	2 YEARS	1.1604	1.160	1.201	1.175
	5 YEARS	0.890	0.896	0.888	0.877
	10 YEARS	1.140	1.124	1.170	1.143
	30 YEARS	131.9	128.8	135.3	132.4
GERMANY	2 YEARS	1.1604	1.160	1.201	1.175
	5 YEARS	0.890	0.896	0.888	0.877
	10 YEARS	1.140	1.124	1.170	1.143
	30 YEARS	131.9	128.8	135.3	132.4
SPAIN	2 YEARS	1.1604	1.160	1.201	1.175
	5 YEARS	0.890	0.896	0.888	0.877
	10 YEARS	1.140	1.124	1.170	1.143
	30 YEARS	131.9	128.8	135.3	132.4
UK	2 YEARS	1.1604	1.160	1.201	1.175
	5 YEARS	0.890	0.896	0.888	0.877
	10 YEARS	1.140	1.124	1.170	1.143
	30 YEARS	131.9	128.8	135.3	132.4

CORPORATE BONDS (1 YEAR SPREAD)

	LAST	1 MONTH	YTD	1 YEAR
AA	-0.22	-0.23	-0.26	-0.30
A	-0.17	-0.18	-0.21	-0.23
BBB	-0.04	-0.05	-0.12	-0.13

COMMODITIES

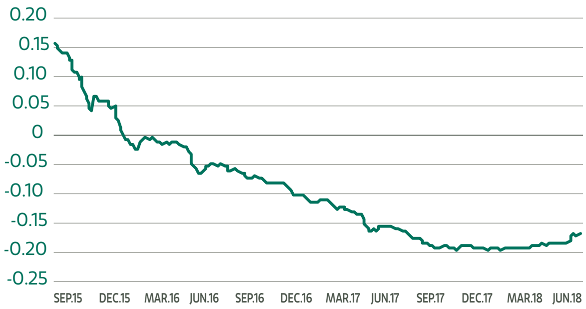
	LAST	1 MONTH	YTD	1 YEAR
BRENT	82.72	77.42	66.87	57.90
GOLD	1192.5	1201.4	1303.1	1282.8

EQUITY INDICES

	LAST	1 MONTH	YTD	1 YEAR
MSCI WORLD*	524.25	0.26%	2.19%	32.14%
SP500	2913.98	0.43%	8.99%	47.75%
EUROSTOXX50	3399.2	0.19%	-2.99%	3.96%
TOPIXX	1817.25	4.72%	-0.02%	18.23%
IBEX35	9389.2	-0.11%	-6.52%	-8.48%
FOOTSIE100	7510.2	1.05%	-2.31%	20.20%
MSCI BRAZIL	1729.49	6.82%	-14.50%	40.33%
MSCI CHINA	79.76	-1.97%	-10.73%	36.18%
MSCI EMERGING	1047.91	-0.76%	-9.54%	27.99%

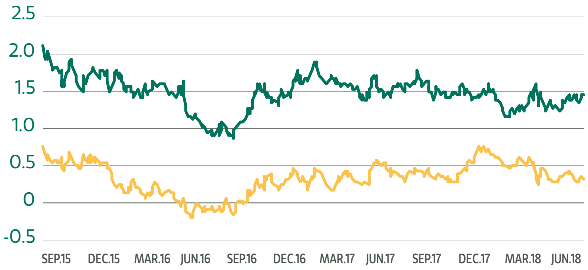
* All Countries

EURIBOR 12 MONTHS (3 YEARS)

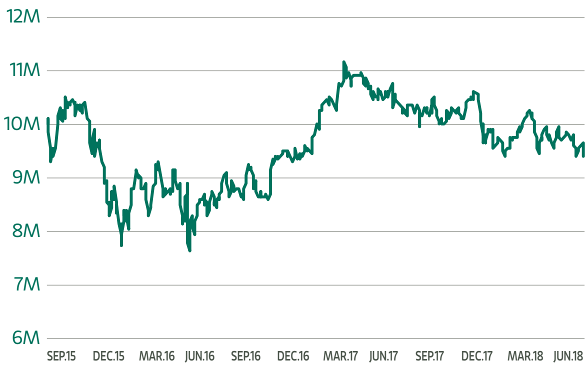


EUR/USD (3 YEARS)

TEN YEAR GOVERNMENT YIELDS (SPAIN VS GERM.)



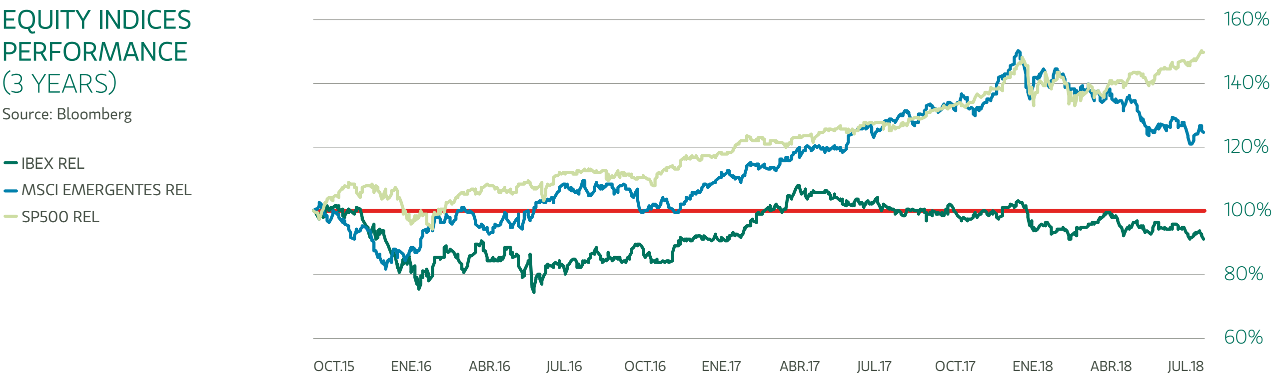
IBEX (3 YEARS)



Source: Bloomberg

EQUITY INDICES PERFORMANCE (3 YEARS)

Source: Bloomberg



DATE AS OF 30TH SEPTEMBER 2018

	RETURN				DURATION		PORTFOLIO DISTRIBUTION					CURRENCY EXP.	
	WEEK	MONTH	YTD	YEAR	ACTUAL	1 MONTH AGO	LIQUIDITY	DEPOSITS	FI	EQUITY	ALT. INV.	TOTAL	USD
MARCH MONETARIO F.I.	-0.02%	0.00%	-0.35%	-0.40%	0.277	0.319	41.14%	19.74%	39.24%	0.00%	0.00%	0.00%	0.00%
MARCH RENTA FIJA CORTO PLAZO F.I.	-0.04%	0.10%	-1.27%	-1.21%	0.449	0.462	2.30%	5.95%	92.09%	0.00%	0.00%	0.00%	0.00%
MARCH PREMIER R.F. C.P. F.I.	-0.03%	0.10%	-1.03%	-0.94%	0.477	0.464	5.61%	5.80%	88.76%	0.00%	0.00%	0.00%	0.00%
MARCH PATRIMONIO C.P. F.I.	-0.04%	0.08%	-0.93%	-0.85%	0.818	0.839	2.99%	2.17%	95.02%	0.00%	0.00%	0.00%	0.00%
FONMARCH F.I.	-0.15%	0.00%	-1.08%	-0.93%	2.423	2.344	3.39%	0.00%	96.36%	0.00%	0.00%	0.01%	0.00%
MARCH EUROPA F.I.	-0.88%	0.00%	-0.19%	-3.36%	0.005	0.004	0.47%	0.00%	0.00%	98.42%	0.00%	34.30%	4.95%
MARCH INTL - VALORES IBERIAN EQUITY	-0.49%	-1.06%	0.08%	2.88%	0.003	0.003	3.05%	0.00%	0.00%	96.95%	0.00%	0.00%	0.00%
MARCH GLOBAL F.I.	-0.14%	-0.85%	-0.13%	1.92%	0.008	0.008	3.60%	0.00%	0.00%	95.91%	0.00%	61.64%	16.03%
MARCH INTL - MARCH VINICATENA	0.49%	0.86%	-1.39%	3.42%	0.003	0.003	17.09%	0.00%	0.00%	82.91%	0.00%	51.36%	18.59%
MARCH INTL - THE FAMILY BUSINESSES FUND	-0.77%	-1.40%	-4.25%	0.00%	0.003	0.003	14.43%	0.00%	0.00%	85.57%	0.00%	41.80%	19.09%
MARCH NEW EMERGING WORLD F.I.	-1.03%	-2.81%	-11.43%	-6.85%	0.000	0.005	16.54%	0.00%	0.00%	100.32%	0.00%	43.83%	-29.92%
MARCH INTL - TORRENOVA LUX	-0.35%	0.08%	-1.70%	-2.02%	1.0	1.0	2.89%	0.00%	73.31%	23.80%	0.00%	10.64%	6.07%
TORRENOVA DE INVERS. S.I.C.A.V. S.A.	-0.34%	0.09%	-1.19%	-1.32%	0.989	0.974	6.17%	0.00%	69.95%	23.77%	0.00%	19.25%	12.23%
CARTERA BELLVER S.I.C.A.V., S.A.	-0.64%	0.37%	-0.42%	0.76%	1.050	1.029	3.72%	0.00%	42.11%	53.85%	0.00%	59.94%	36.57%
LLUC VALORES S.I.C.A.V., S.A.	-0.80%	-0.03%	1.01%	4.14%	0.007	0.007	12.73%	0.00%	0.00%	86.83%	0.00%	104.44%	68.16%
MARCH PATRIMONIO DEFENSIVO FI	0.11%	0.08%	-1.73%	-1.73%	0.000	0.008	1.54%	0.00%	80.01%	12.43%	5.88%	0.43%	0.42%
MARCH CARTERA CONSERVADORA FI	0.05%	-0.09%	-1.29%	-0.86%	0.000	0.008	2.76%	0.00%	61.44%	29.59%	6.58%	0.38%	0.38%
MARCH CARTERA MODERADA FI	-0.04%	-0.28%	-0.61%	0.34%	0.000	0.008	4.50%	0.00%	42.66%	48.96%	4.13%	0.38%	0.38%
MARCH CARTERA DECIDIDA FI	-0.14%	-0.51%	-0.69%	1.13%	0.000	0.008	3.78%	0.00%	16.31%	75.20%	5.27%	2.55%	-2.54%
PLAN PENSION CRECIENTE, F.P.	-0.09%	0.02%	-1.26%	-1.23%	1.626	1.673	2.95%	2.16%	94.87%	0.00%	0.00%	0.00%	0.00%
MARCH PENSIONES 80/20, F.P.	-0.07%	-0.11%	-1.08%	-0.41%	2.572	2.607	0.63%	0.00%	74.47%	24.17%	0.00%	15.06%	4.65%
MARCH PENSIONES 50/50, F.P.	-0.01%	-0.24%	-0.39%	1.02%	2.271	2.199	5.03%	0.00%	47.35%	46.74%	0.00%	29.40%	8.65%
MARCH ACCIONES, F.P.	0.10%	-0.44%	0.71%	3.73%	0.008	0.008	4.69%	0.00%	0.00%	94.61%	0.00%	59.30%	17.54%
MARCH AHORRO, F.P.	-0.04%	-0.11%	-0.26%	1.34%	2.639	2.688	2.30%	0.00%	64.65%	32.47%	0.00%	20.40%	6.31%
PLAN OPTIMO, F.P.	-0.12%	-0.15%	-0.51%	1.06%	2.308	2.376	12.95%	0.00%	56.56%	28.84%	0.00%	18.17%	5.43%
MARCH MODERADO EPSV	-0.10%	-0.10%	-0.44%	0.19%	2.299	2.363	6.00%	0.00%	65.96%	30.49%	0.00%	17.61%	4.86%
MARCH ACCIONES EPSV	0.11%	-0.47%	1.15%	3.97%	0.008	0.007	7.58%	0.00%	0.00%	91.75%	0.00%	58.43%	16.70%

IMPORTANT REMARK:

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