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Inflation

Slower growth and dovish Central Banks are supportive of lower real yields

- We remain **constructive** on US duration as we expect the Federal Reserve to cut its reference rate in H2 2019
- **We see value** in Euro Area real rates as they still have to catch-up with the nominal rally
- We believe that **UK breakevens are overvalued** but we remain tactically positioned amidst political volatility

Rates and Inflation Team

| | Inflation & Monetary Policy | Inflation Linked Bonds Market |
|------------------|---|---|
| US | <p>The Federal reserve delivered a dovish forward guidance by lowering its rate expectations and signaling 2 rate cuts into 2020.</p> <p>Headline 1.8% (-0.1%) Core 2% (-0.1%)</p> | <p>Real yields rally supported performance. Breakeven performance was negative amidst risk off sentiment and fears of lower growth.</p> <p>5 yr Ry* 0.25% ▼ 10 yr Ry 0.33% ▼ 10 yr Be** 1.70% ▼</p> |
| Euro Area | <p>President Draghi surprised markets with a dovish tone in Sintra saying that the ECB was ready to extend its tools inferring a rate cut or a second round of QE were on the table.</p> <p>Headline 1.2% (=) Core 1.1% (0.3%)</p> | <p>Performance was positive driven by Italian linkers and followed by Spain particularly in longer maturities. Breakeven performance was positive only in Italy as the market remains skeptical that the ECB's announcement will be sufficient.</p> <p>5 yr Ry -1.31% ▼ 10 yr Ry -0.95% ▼ 10 yr Be 0.90% ▼</p> |
| UK | <p>The Bank of England softened its hawkish bias asserting that economic data have weakened compared to their forecasts.</p> <p>RPI 3% (=) Core CPI 1.7% (-0.1%)</p> | <p>Political uncertainty harmed UK linkers performance amidst ongoing elections in the Conservative Party to elect the next Prime Minister and the future direction of Brexit negotiations with the European Union.</p> <p>5 yr Ry -2.57% ▲ 10 yr Ry -2.48% = 10yr Be 3.28% ▼</p> |

What's happening?

***Ry** : Real Yield

****Be** : Breakeven

Portfolio positioning and performance

Key Strategies

Performance

Real Yields

We remain constructive in real duration in the US and Core Euro Area as we believe Central Banks will need to act preventively ahead of increasing signs of slowdown and lower inflation expectations

Breakevens

We hold a bearish view in UK breakevens that look to be 0.4% rich in a no hard brexit scenario. We have switched our long duration positions in the US from nominal bond futures into inflation linked bonds as we believe that the TIPS market still has some room to catch-up with the nominal Treasuries market.

- + Long Duration in the US and the Euro Area
- + Steepening position in the US



Slower growth and accommodative Central Banks are supportive of lower real yields

Outlook

United States

Inflation is expected to remain stable in the USA with core hovering around 2%. We expect long real yields positions to do well and the yield curve to steepen in the USA as the Federal Reserve moves to cut interest rates.

Euro Area

As the ECB is moving closer to being forced to act and to go further than liquidity injection, we see prospects for lower real yields.

United Kingdom

UK inflation breakevens are expensive from a valuation perspective. We have a long duration bias as the Bank of England has some room to shift to a more dovish stance.

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