

Market Compass

November 2021



MARKETOUTLOOK

- The global recovery is set to continue, supporting corporate earnings and risk sentiment.
- Yet mounting uncertainties over the energy crunch and central banks' response to a stickier inflation are making us more prudent.
- Despite incoming tapering and higher expected inflation, plunging real yields are a support for risk assets.
- We scale back our overweight in Equities and HY Credit, in favour IG Credit and Cash - both already OW. We keep a prudent short duration stance, anticipating only a gradual further rise in yields.

Edited by
**MACRO & MARKET
RESEARCH TEAM**



A team of 13 analysts based in Paris, Cologne, Trieste, Milan and Prague runs qualitative and quantitative analysis on macroeconomic and financial issues.

The team translates macro and quant views into investment ideas that feed into the investment process.

US

- + Fed to start tapering. No rate hikes before mid-Q4 2022
- + The discussion on the fiscal package is slowly proceeding. The size of the measures was severely cut
- ! Bottlenecks in some sectors are tentatively easing but inflation will remain above 4% until Q2 2022

UK

- PMI surprised on the upside
- CPI inflation expected to rise until spring
- ! BoE likely to raise rates soon on inflation concerns
- ! A new spike in covid cases may lead to the position of new lockdowns

EUROZONE

- + Indicators show that growth remains intact
- + ECB strongly signals no rate hike in the near term
- + NGEU funds will start flowing into the economy soon
- Base effects, commodities and supply chain disruptions are pushing inflation to record highs

CHINA

- + Power outages are more under control
- China's GDP growth eased to 4.9% yoy in Q3
- Another (limited) Covid-19 outbreak to weigh on consumption
- Evergrande and the real estate sector remain a worry

EMERGING MARKETS

- EM activity in Q4 will improve marginally as vaccination accelerates
- Inflationary pressures keep mounting leading to further monetary tightening
- ! Pressure on EM assets eased temporarily but volatility remains high with expected rising US yields

- + Positive
- Negative
- ! Topics to watch

DIRECTION OF TRAVEL

- Trim further the equity and Euro Area High Yield overweight (OW)
- Increase the OW on euro area Inv. Grade bonds
- Maintain the core bonds underweight (UW) due to inflation risk and incoming tapering
- Reduce the OW on hard currency EM debt
- Increase OW cash to protect from inflation

Equities

- The good reporting season is triggering positive equity returns also thanks to lower volatility and still subdued real rates.
- We maintain lower-than-consensus earnings forecasts due to higher input costs, peaking margins, lower policy support.
- We expect around +5% in global TR over 12-months. We continue to prefer Euro Area vs the US.

Bonds

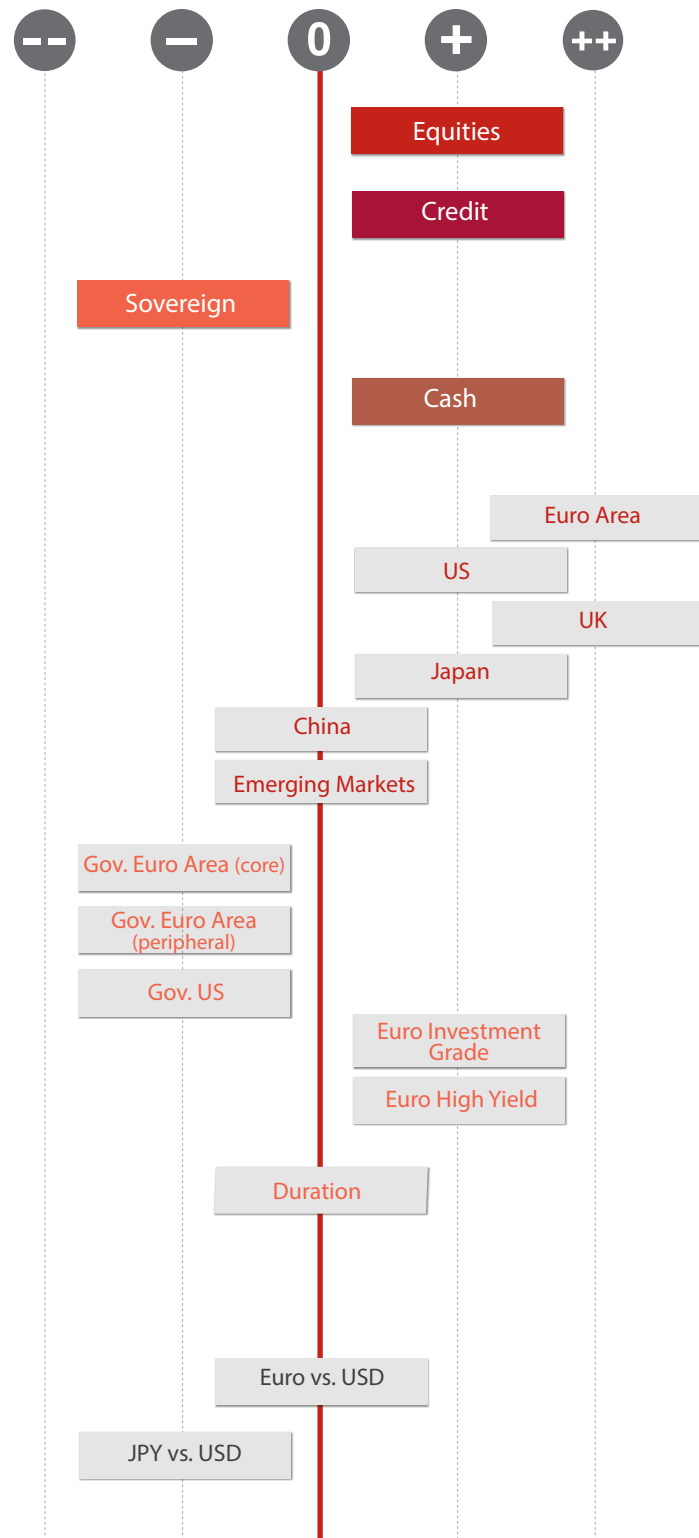
- Recent bear flattening of government bond yield curves appears overdone. Above trend growth and inflation concerns trigger another leg higher in long-dated yields.
- EA non-core sovereign bond spreads to trend sideways supported by ECB bond purchases and solid growth data.

Duration

- Moderately (almost neutral) short duration recommended.

Currencies

- After undershooting over the summer, the EUR/USD is likely to extend its recent stabilization. Yet monetary policy divergence in the US and euro area tilt the outlook to a lower EUR/USD into 2022.
- USD/JPY may follow US yields further to the upside in the short term.



TOPICS TO WATCH!

- Inflation spike raises concerns on central banks tightening and a faster yield rise
- Rough Tech regulatory tightening
- Evergrande default triggers wider contagion on global credit markets and the Chinese economy
- Mutations challenging vaccine effectiveness, new shutdowns

Probability:	Impact:

Probability: High Low

Impact: High Low

SPECIAL FOCUS

Risk sentiment has still legs, but uncertainty increases

Markets have overcome stagflation worries in October. Global equities have unwound the September drawdown, defying soaring inflation expectations and benefiting the trimmed pro-risk tilt in our portfolios. Risk sentiment still has legs going forward. Firstly vaccination progress will prevent harsh lockdowns and this will allow consumers to gradually spend a large part of their huge excess savings. Corporate earnings have been stellar; growth will slow but stay largely positive. And while nominal yields have risen, higher inflation expectations depressed real yields even deeper below zero, supporting valuations.

Yet, we turn more prudent as the inflation spike looks less transitory and uncertainties over monetary policy rise. First, multiple supply shocks (energy, chips, containers, labour) are proving more persistent. In particular, the energy transition may – ironically – keep oil and gas prices high for long. Already harmed by years of underinvestment, the energy supply is struggling to meet the recovery demand.

Central banks are ill-equipped to tackle supply-side problems. Any pre-emptive action to dampen inflation may adversely hurt growth expectations and risk assets, which will mechanically cap any rise in long-term yields. The recent flattening of the yield 5-30y curves signals increasing growth concerns, though strong earnings have kept equities alive and well so far. Among other risks, we also carefully watch the seasonal increase in Covid cases and the US debt ceiling dispute, whose deadline has been kicked towards early December.

Overall, we maintain but mildly scale down our overweight in the riskiest segments (Equities, High Yield) and EM bonds to the benefit of IG Credit and Cash. We maintain a prudent stance on duration as more persistent price pressures and the removal of monetary policy will sustain upside pressure on yields. Yet the increase in longer-dated bonds yields will be capped by excess leverage and the dependence of global asset valuation on low long-term real yields.

Oil prices and inflation expectations*



Source: Refinitiv as of 29/10/2021 *5y-5y inflation linked swap rate

GLOSSARY

NEXT GENERATION EU (NGEU) FUND

The Next Generation EU (NGEU) fund is a European Union recovery package to support member states hit by the COVID-19 pandemic. Agreed by the European Council on 21 July 2020, the fund is worth €750 billion. The NGEU fund will operate from 2021–2023, and will be tied to the regular 2021–2027 budget of the EU's (MFF).



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