

# Market Compass

November 2020

## MARKET OUTLOOK

- After a strong Q3 rebound on reopening businesses and pent-up demand, the pace of the recovery will slow - especially in services.
- The Fed's strategic turn towards average inflation targeting (AIT) and asymmetric employment target induces a long-term dovish bias in monetary policy, with rates to remain close to zero for years. The ECB is likely to take a similar approach.
- Despite looming political uncertainty, the upcoming policy action (ECB, US fiscal) and continued economic recovery may favour cyclical assets, while central banks will keep rates range stable.
- Our largest overweight remains in Credit, where we recommend to go down the rating scale but not too much (BB). The US dollar has temporarily stabilized, but the trend is bearish.



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.

### UK

- New lockdown measures in place...
- ...will push growth into negative territory in Q4
- BoE expected to increase QE
- ❗ Brexit negotiations in a decisive phase

### EUROZONE

- PMIs signal a weak start into Q4
- Resurgence of lockdown measures
- ➕ ECB has signalled policy action for December
- ➕ Recovery Fund, some fiscal measures extended

### JAPAN

- Japan's recovery likely lacks vigour
- ➕ More fiscal stimulus expected in December
- Deflation to gain pace

### US

- Lack of a Dem majority in Congress will significantly limit the fiscal stimulus
- Q3 GDP pick up in line with expectations, but signals of a slowdown in Q4
- ❗ Concerns about a delayed and contested election outcome
- ➕ No rate hikes before H1 2025. Fed ready to prop up QE

### CHINA

- ➕ China has only a few fresh Covid-19 cases
- ➕ Strong recovery in domestic demand
- Exports could suffer from European lockdowns
- PBoC in *wait-and-see* mode



## DIRECTION OF TRAVEL

- Prudent overweight (OW) in Equities and High Yield (HY) Credit
- Keep a sizeable OW in EUR Investment Grade (IG) Credit.
- Underweight (UW) in Core bonds and Cash
- Risk of further steepening bias at the long end of the yield curve (10y+).
- Keep the underweight in cash.



Sovereign

Equities

Credit

Cash

### Equities

- Short term, Euro Area equities should remain under pressure due to uncertainty on the US elections and weaker economic momentum (Covid-induced)
- Still, recovery is set to continue due to further supportive fiscal and monetary measures
- We recommend a tilt on value and cyclical, while having OW in Emerging Markets (EMs) and Japan

Euro Area

US

UK

Japan

China

Emerging Markets

### Bonds

- Driven mainly by lower Euro Area yields, transatlantic yield spread widened.
- Short-term, concerns US politics to keep yields in check
- Euro Area non-core sovereign spreads narrowed, but with limited scope for further tightening
- We maintain a positive view on Credit due to ECB support

Gov. Euro Area (core)

Gov. Euro Area (peripheral)

Gov. US

Euro Investment Grade

Euro High Yield

### Duration

- Neutral duration recommended

Duration

### Currencies

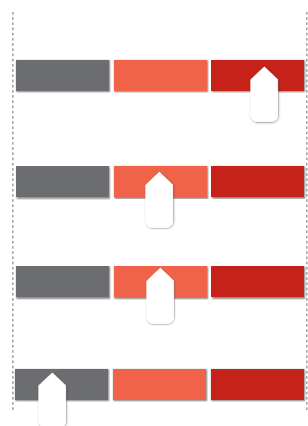
- Questions about the funding of the US external deficits weight on the mid-term prospects of the USD
- The risk of a contested US election outcome and rising Covid-19 cases in Europe is keeping a lid on the EUR/USD in the near term, while the JPY may benefit mildly

Euro vs. USD

JPY vs. USD

## TOPICS TO WATCH!

- No-deal Brexit
- Political gridlock in the US prevents policy action
- Financial markets reprice sharply down growth expectations
- Delayed vaccine availability will force to longer laster lockdown



Risk Min.

Risk Max.

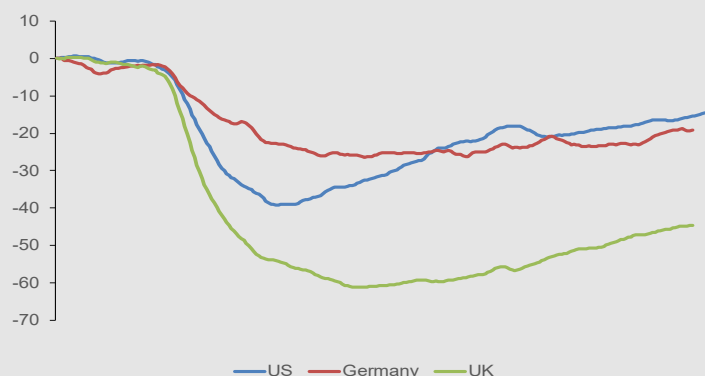
### A glimpse to the first financial impact of the US election

The risk of a contested outcome of the US election is materializing, and this will have a short term impact on financial markets. Looking at what happened in the 2000 presidential election, when it took five weeks to recount the votes, a prolonged standoff and a better legal battle would lead to high market volatility, weighting on equities, whereas Treasuries and the Dollar would benefit from their “safe-haven” status. Longer-term, the biggest implication for financial markets so far is the fact that Democrats, without a majority in the Senate, will not be able to implement the large (US\$ 2tn or 10% of GDP) fiscal package they planned. However, and especially in light of a possible worsening of the economic outlook, a much smaller package (around US\$ 1tn) may still pass. A scaled-down fiscal package and the possible hit of COVID to growth will support the case of stable or lower yields.

Beyond the turn of the year, however, fundamental factors (vaccine, growth, supply) are likely to drive yields higher. Lower bond yields are a plus for equities, in part offsetting the negative impact from lower growth.

No Democratic majority in the Senate also means no tightening in energy, IT and financial regulation, a possible other plus for equity. On the dollar, the prospect of another fiscal US stimulus (if a smaller one) and progress on a Covid-19 vaccine may still help to underpin risk sentiment while weighting on the currency. Given the questions about the funding of the US' external deficits, we remain structurally bearish on the dollar.

### New job postings show a slow and uneven labour market recovery % diff. from Feb, 1- 7-days average



Source: Federal Reserve Bank of St. Louis as of end of October 2020

## GLOSSARY

### INFLATION TARGETING AND AVERAGE INFLATION TARGETING (AIT)

Inflation targeting is a central bank strategy of specifying an inflation rate as a goal and adjusting monetary policy to achieve that rate. Inflation targeting primarily focuses on maintaining price stability, but is also believed by its proponents to support economic growth and stability. In the average inflation targeting, instead of aiming to return inflation over the medium term to the target rate of 2 per cent, the central bank would aim to return the average of inflation over some period to the target rate. As a consequence, it will tolerate - without rising rates - a prolonged period of inflation above target to compensate for past shortfalls.



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