

Market Compass

January 2021



MARKET OUTLOOK

- After a weak Q1, vaccine rollout and - especially in the US - further fiscal stimulus will allow the economy to rebound strongly later in spring.
- Monetary policy will remain tilted to accommodation: central banks' bond purchases will continue until the activity is on a strong footing.
- Moreover, the reduction of political uncertainty in the UK and US warrants an increase in exposure to riskier assets.
- A deeper weakening of US dollar favours exposure to Emerging Markets (EMs); reflation expectations make cash and core Government Bonds unattractive.



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.

EUROZONE

- Worsening of pandemic situation...
- + ...But vaccine news improves outlook
- + ECB delivered broad policy package
- + Sentiment improved in December

JAPAN

- + More fiscal support expected
- + BoJ launched a monetary policy review
- Japan declares virus emergency for Tokyo area

UK

- + EU-UK agreed on a post-Brexit deal
- + Government to support businesses with GBP 4.6bn
- UK entered in 3rd Covid-19 lockdown as infections soar

US

- + Majority in the Congress allows Biden to scale up fiscal support...
- ...But, until vaccination progresses, consumption remains subdued
- + Political uncertainty to fall after the new administration is sworn in (Jan 20)
- + Fed keeps its accommodative stance

CHINA

- China's manufacturing PMIs eased...
- + ...But are still on a high level
- Less expansionary fiscal policy
- Deleveraging in real estate expected



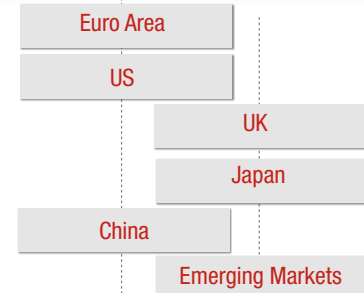
DIRECTION OF TRAVEL

- Maintain the OW to EMs, both bonds and equity
- Extend the overweight (OW) in equities and high yield (HY) credit
- Trim the OW in EUR investment grade (IG) credit
- Underweight (UW) in core bonds and, especially, in cash



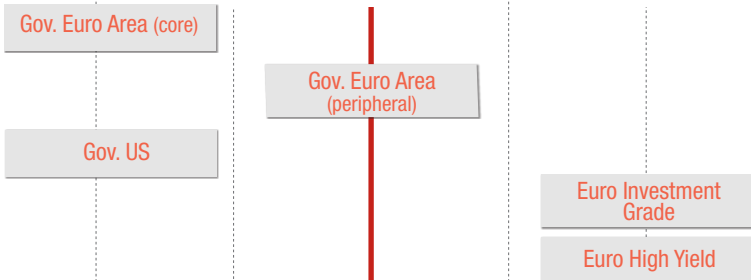
Equities

- Equities will benefit further from good news on the vaccine and continuing policy support
- We forecast good earnings growth ahead: 40% in 2021 and +14% in 2022 for the EA, with risks to the upside
- Value and Cyclical will continue to outperform. OW Japan, UK and EMs



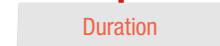
Bonds

- Limited upward potential for Euro Area (EA) core yields. Amid expansionary fiscal policy and better economic outlook, US yields to increase faster than EA
- Overperformance of EA non-core sovereign bonds likely to continue for the time being
- We maintain a positive view on credit due to the ECB support



Duration

- Neutral duration recommended



Currencies

- Easing political uncertainties, vaccination progress and constructive global risk sentiment will continue to weigh on USD in 2021
- EUR/USD with more upside, but after the euro's Q4 growth slowdown and the extended lockdowns, higher risk of temporary setbacks
- Favorable real yields in Japan will benefit the still cheap JPY



TOPICS TO WATCH!

- Setbacks on vaccine safety eventually reversing earlier good news on effectiveness
- Surprising strong rebound in inflation on reopening economies in spring/summer
- New wave(s) of Covid-19 infections on mutations requiring even broader/prolonged shutdowns
- Rough Tech regulatory tightening

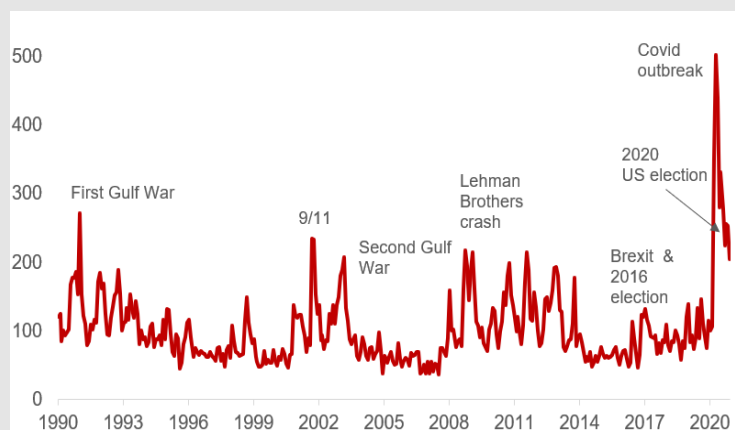


Fiscal policy and low uncertainty will lift US GDP growth

On January 20 Senator Joe Biden will officially become President of the United States. The win staged by Democrats in the two Georgia Senate race gave the President the smallest possible majority in the Senate (50-50, with vice President Harris voting to break the tie), but this will still have big implications for economic policy. Structural increases in expenditure and taxation would require the approval of 60 senators but a simple majority allows for less long-lasting (up to five years) measures. This should include enhanced and longer-lasting benefits for the over 10 million citizens who are still without a job following the pandemic. The bill should add up to \$800bn in fiscal support to the roughly \$900bn that Congress approved at the end of December. A further strengthening of welfare payments is likely later this year and will lift GDP growth to 5.5% this year. Part of the extra expenditure will be financed by the increase in taxes on corporations and wealthiest individuals, which could kick in later in the term. The thin majority in the Senate relies on centrist, more fiscally conservatives Senators, so we expect both the rise in benefits and the taxes to be relatively modest.

The impact on 2021 GDP will be large, lifting growth to above 4%. Financial markets were quick to take note of the new political landscape. The fall in political uncertainty following the news of the Georgia results lifted the S&P 500 despite the shocking news of the occupation of the Capitol by Trump supporters. At the same time, bond yields kept rising in the anticipation of a larger Government deficit.

US POLICY UNCERTAINTY INDEX
Based on text analysis of journal articles



Source: Chicago and Stanford Universities, end of December 2020

GLOSSARY

POLICY UNCERTAINTY INDEX (graph)

One of the most popular ways to measure the impact of political surprises on the economy and financial markets is the Policy uncertainty index developed by researchers at the universities of Stanford and Chicago. Each month the index is compiled by computing the ratio of articles discussing economic policy uncertainty to total articles published in the most important daily newspapers. The index is available for several countries and has normally an inverse correlation with future short term economic activity.



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