

Market Compass

April 2021

MARKET OUTLOOK

- Slow vaccination in Europe is a headwind, but a strong cyclical upswing and inflation spikes will still dominate markets into summer.
- The inflation spike will be transitory, but uncertainty has increased. Fiscal discipline is weaker, and central banks want to run the economy hot and exit the under-inflation regime.
- This implies upward pressure on bond yields eventually, but - for now - Central Banks want and have the means to contain the rise in yields. We then expect risky assets to show resilience (Value better than Growth).
- We keep an overweight in Equities and Credit, and a underweight in Govies. Yield curves are skewed towards further tapering. We cut our Emerging Markets equity overweight on the impact of China tapering, rising yields and slow vaccination.



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

- + UK to lift lockdown in several steps from mid-April
- + Strong rebound in Retail sales
- + Good progress on vaccination

EUROZONE

- + March PMIs signal expansion again
- + Exports partly cushions shutdown-effects
- Tighter lockdown measures due to 3rd wave
- Bumpy vaccine rollout

JAPAN

- + Japan's fresh Covid-19 cases receded
- + Disinflation to turn around due to oil prices
- + Economy to rebound from Q2 on

US

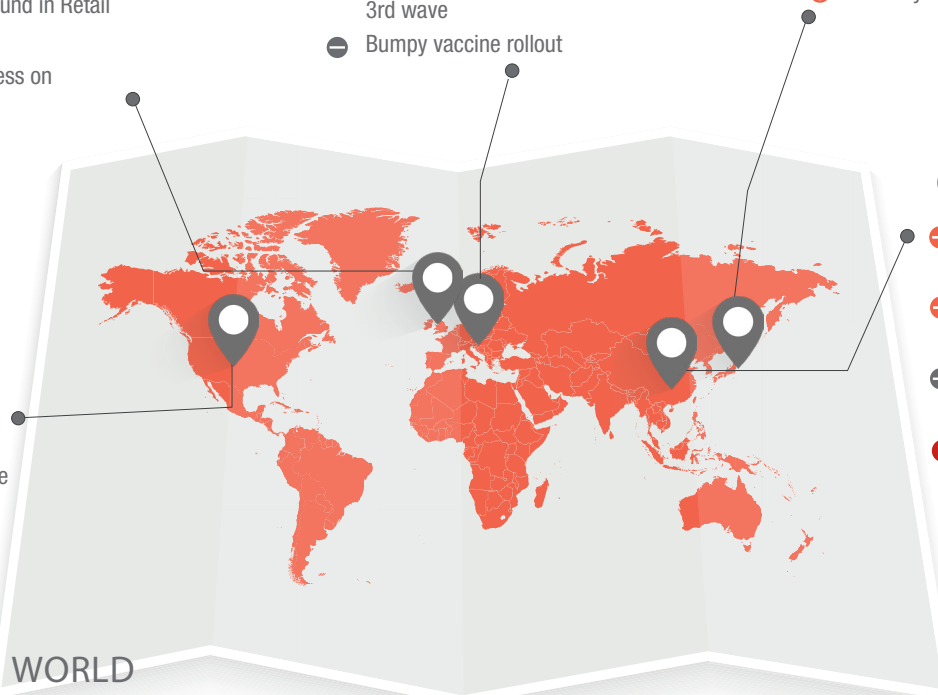
- + Strong Q1 and fiscal boost lead to 7.5% growth in 2021
- + Additional stimulus by year-end with infrastructure plan
- + Fed reaffirmed its dovish stance: no rate hikes before end 2023. Tapering not on the cards
- ! CPI inflation will temporarily reach 3% late in spring

CHINA

- + Recent Covid-19 outbreak looks under control
- + Government to confirm policy normalization
- Latest PMIs slowed slightly
- ! Money supply is normalized and first rate hike possible by year-end

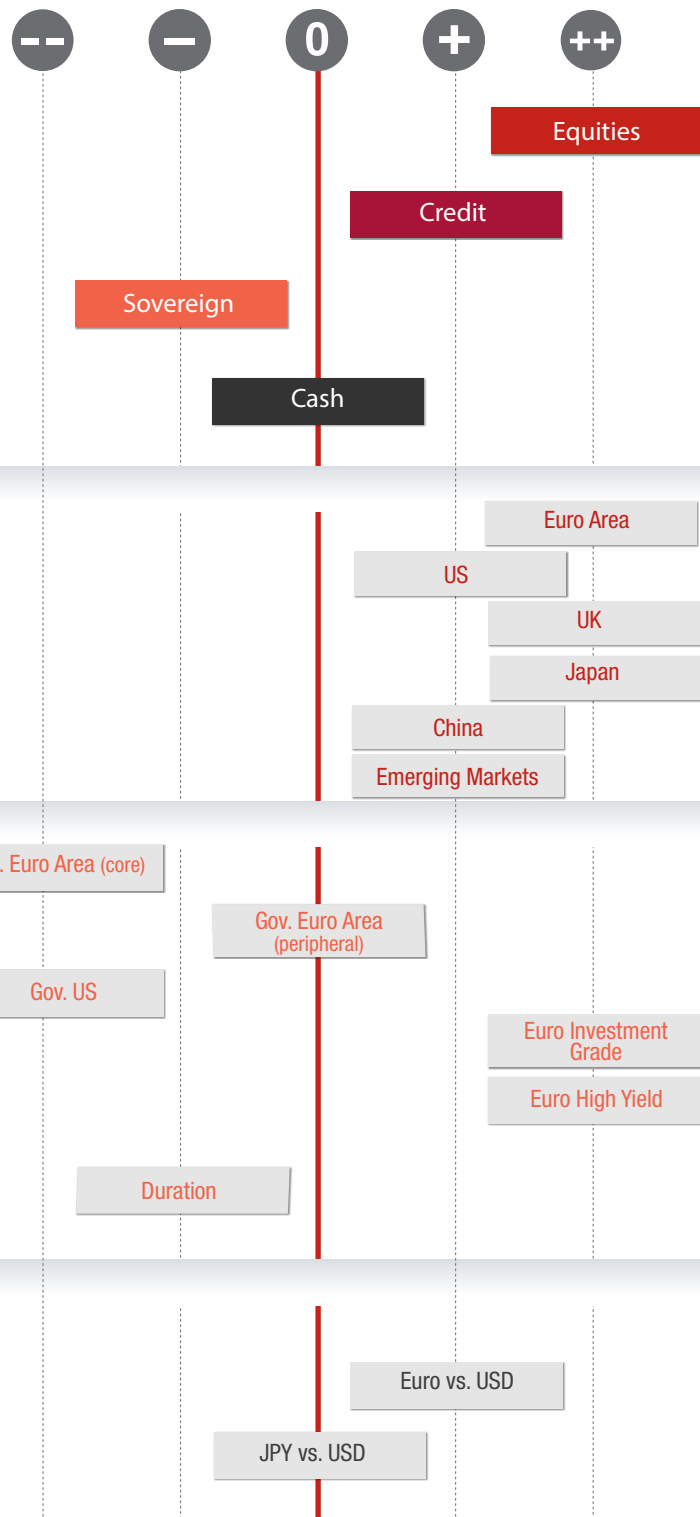
WORLD

- + OPEC+ ease production cuts betting on stronger demand for oil



DIRECTION OF TRAVEL

- Moderate overweight (OW) in Equities and High Yield (HY) Credit
- Maintain the OW in Euro Investment Grade (IG) Credit
- Maintain the underweight (UW) in Core bonds
- Emerging Markets: trim the OW in Equity and small UW Bonds



Equities

- Stocks can cope with an orderly rise in bond yields.
- The earnings rebound will offset decreasing PEs, producing positive total returns, thanks also to continuing policy support.
- We prefer EMU, Japan and to a lesser extent EMs.

Bonds

- Further increase in US yields likely to trigger a moderate rise in Euro Area (EA) yields.
- Increased ECB purchases and more friendly cash flow in Q2 to support EA non-core spreads.
- OW inflation linkers to protect against inflation risk.

Duration

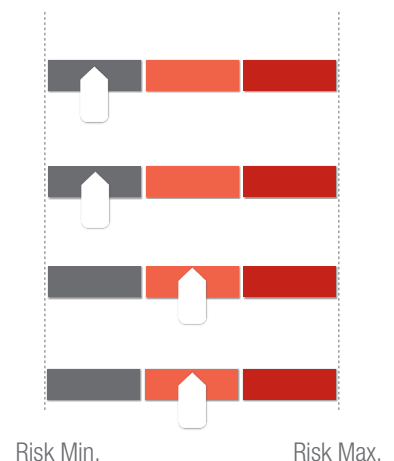
- Moderate short duration recommended.

Currencies

- Rising US yields, a strong US fiscal boost and a shakeout of speculative positions support the USD near term.
- However, we see USD weakness into the summer as the global economy reopens and the Fed keeps its dovish stance.
- A sustained EUR/USD rebound will require accelerated vaccination and the end of lockdowns as triggers.

TOPICS TO WATCH!

- US/China tensions on Taiwan escalate
- Slow vaccination in the EU delays the reopening of the economy
- Surprising strong rebound in inflation raise yields further
- Correction of crowded position in risk assets

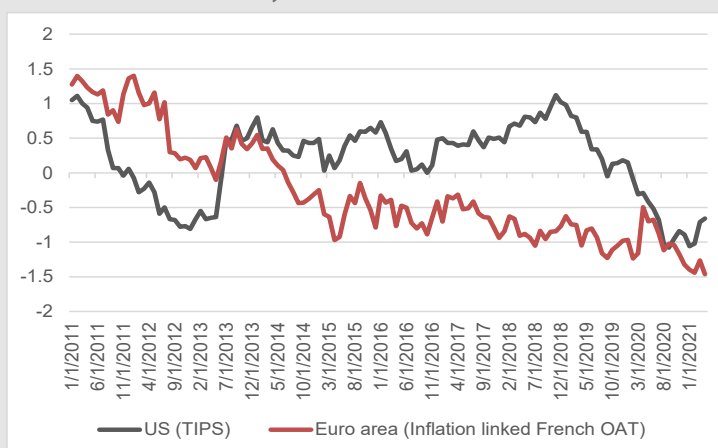


Interest rate only moderately up

The low growth regime prevailing after 2008, dubbed as secular stagnation has several explanations, including a drop in productivity and excess saving. Those forces are largely responsible for the decline in nominal yields, by pushing both real rates and inflation down. May the new, much more expansionary, fiscal stance, along with efforts by central banks to run the economy hot, defeat secular stagnation? A change of perception there has the potential to push long term real rates higher. By some measures, long-term real rates appear too low given the risks of a regime change. For now, central banks will do all they can to keep long-term real rates low, to protect financial conditions and the economic recovery. While we expect nominal bond yields to rise further in the coming months and quarters, we assume an orderly process. This should not be for now too disruptive for risky assets, but selected sectors (Tech) and styles (Growth) are more exposed.

Equity markets may survive a slow normalization of yields, especially given the expectation of fast-growing corporate earnings. This is particularly true in Europe, where we find the Equity Risk Premium (ERP) still high; bond yields can increase and the ERP fall without creating much damage on equities. Reassuringly, in late February as US long-term real yields crawled up, global credit markets weren't destabilized. The risk for Credit is that negative FI returns would cause fund outflows. Yet cyclical upswing will help spread to stay tight or tighten even further into the summer. The risk of rising yields is smaller in Europe than in the US, if only because the recovery is slower, the output gap will take much longer to close, and the ECB is obsessed with keeping yields low.

10 year real interest rates



Source: Datastream as at 6th of April 2021.

GLOSSARY

EQUITY RISK PREMIUM (ERP)

The term Equity Risk Premium refers to an excess return that investing in the stock market provides over a risk-free rate. This excess return compensates investors for taking on the relatively higher risk of equity investing. The size of the premium varies and depends on the level of risk in a particular portfolio.

OUTPUT GAP

It indicates the difference between the actual output of an economy and the level consistent with stable growth and inflation as a percentage of gross domestic product (GDP). A country's output gap may be either positive or negative. A negative output gap suggests that actual economic output is below the economy's full capacity for output while a positive output suggests the risks of a building up of inflationary pressures and higher interest rates.



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