December 4th, 2020

View

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Macroeconomic scenario

We have not significantly changed our growth forecasts for 2021 since the negative effects deriving from the “second wave” of the spread of the virus and the consequent adoption of new restrictive measures by the authorities (particularly in Europe) have been offset by positive developments on the vaccine front in recent weeks. The economic weakening in the Euro Area further bolstered the expectation of an expansionary move by the ECB at its next meeting on 10 December. In the US, the outcome of the elections considerably lowered expectations of a broad fiscal expansion programme by the Biden administration over the next few years.

Equity Markets

November saw the resolution of two sources of uncertainty that had weighed on the performance of the financial markets in the previous month: the victory of the Democratic candidate for the US presidency and overcoming "Phase 3" for several vaccines against the Sars-Covid-2 virus.

Above all, the second piece of news led to a strong sector rotation favouring more cyclical sectors of the equity universe, particularly rewarding traditional energy and financial stocks and, in terms of style, Value and Small Cap factors.

This scenario implies a broadened market leadership which favours Europe and the emerging markets, characterised by lower valuations and an investor positioning that remains low.

For this reason, **we are raising our view of the European and emerging market equities to positive and diversifying our equity overweight in favour of these markets, in addition to the US**.

Bond Markets

The end of the uncertainty surrounding the US elections and the positive news about vaccines are helping reduce risk elements.

Even in a context where the support of the main monetary policy authorities continues, these developments favour a greater focus on the recovery phase for next year.

Overall, we are adopting a more pro-cyclical stance by changing the exposure to the US treasury from neutral to slightly underweight and balancing the exposure to the emerging local currency segment from an initial underweight allocation.

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Macroeconomic scenario

US: Extensive fiscal stimulus now unlikely

Despite the considerable increase in the spread of the epidemic in recent weeks and the failure to approve an additional fiscal stimulus package, **economic activity continued to recover in the current quarter, albeit with clear signs of deceleration**.

Our scenario continues to envisage that Congress will approve an impressive (close to a trillion USD) Covid emergency fiscal package in the coming weeks.

On the other hand, **the election outcome makes it unlikely that much of president-elect Biden's economic agenda will be implemented** (and in particular, an extensive fiscal stimulus programme financed by an increased business and high-income taxation). It actually seems unlikely that the Democrats will be able to assert themselves in both run-offs in Georgia (next 5 January) in order to control the Senate, albeit marginally so.

Euro Area: Prudence and hope

The "second wave" of the epidemic in the autumn forced governments to arrange new lockdowns from the end of October, which, although less stringent than those in the spring, still have a negative impact on the service sector.

Although **the measures worked** in reducing the spread of the epidemic, **the authorities remain cautious** and restrictions on mobility will continue in December. GDP is expected to drop by -9% per annum in the fourth quarter and growth is expected to remain very sluggish even at the beginning of 2021.

However, the first anti-Covid vaccines will encourage a recovery from next spring, assuming that the vaccination campaign is launched in early 2021. Inflation will close 2020 in negative territory (-0.2%) and **in December the ECB will approve a new expansionary package** to support the economy and help the fiscal effort of governments while awaiting the recovery due to the vaccines.

China: Recovery is consolidating

Success in containing the spread of the pandemic is allowing the Chinese economy to continue and consolidate the recovery phase.

This was further confirmed by October data, with industrial production benefiting from the surprisingly strong export performance, while investments are backed by the real estate sector and measures to support the infrastructure segment.

Instead, the gradual and later recovery in consumption is a sign that consumers are gradually regaining confidence thanks to the improvement in employment.

Therefore, GDP growth in the fourth quarter should accelerate further, while Biden's the election as US President reduces the risks of new commercial tensions.

Equity Markets

Good news regarding vaccines

The distribution of data on phase 3 of the Sars-Covid-2 vaccine trial by a number of pharmaceutical companies (and Pfizer in particular, which was the first to publish data on 9 November), has thinned out some of the doubts in the equity markets about the difficult management of the pandemic, allowing investors to be more certain about the availability of a cure in the short term.
All of this was reflected in a sudden sector and style rotation that rewarded the most cyclical components at the expense of the themes widely followed throughout 2020, such as technology, large capitalisations and Momentum and Quality styles.
Rotation also spread at geographical level with areas more exposed to international trade and commodity exports, specifically the Euro Area and emerging markets in their most cyclical components such as Latin America, which recovered positions compared to the US.
This recovery was confirmed by the strengthening of both the euro and emerging currencies against the dollar. For this reason, **we are raising our view of the European and emerging market equities to positive** and diversifying our equity overweight in favour of these markets, in addition to the US.

Specifically:

- despite less attractive valuations, **US equities**, and, in particular, the technology sector, are still characterised by higher and less volatile profit growth compared to other geographical areas and, for this reason, constitute the most defensive and high-quality option.

The overall positioning is at average levels and the election result reduces the likelihood of a fiscal stimulus financed by tax hikes.
Therefore we are maintaining an overweight position;

- **we are raising our view to positive on Europe** because the progress made on the vaccines mitigates the uncertainty related to the duration of the macroeconomic slowdown in Europe after the introduction of measures to contain the epidemic.
This factor also supports a broader market leadership and favours more cyclical components with more attractive valuations and a lighter position;

- concerning **Japan,** the potential rebound of global economic activity and attractive valuations are favourable.
Nevertheless, the defensive nature of the currency and the slow recovery of profits (still subject to slight downward revisions) dampen investor interest.
We continue to hold a neutral view on this area;

- **emerging countries** benefit from a better combination of the global macroeconomic scenario and US politics going forward.
We expect less political uncertainty under the Biden administration, on top of a reduced ambiguity in terms of trade and reduced reliance on tariffs. This results in a downsizing of the risk premium on local currencies and assets.
Moreover, valuations are lower than in other geographical areas and investors' positioning is not significant.
We increased our exposure to slightly overweight for emerging countries.

Bond Markets

Less political uncertainty in the US and the forthcoming vaccines strengthen the focus on the cyclical recovery

The reduction in short-term uncertainties and positive news on the effectiveness of vaccines support the trend towards market spread components, despite recent further compressions, in a context that continues to see central banks keeping rates suppressed for a long time to come.

Government bonds

In the Euro Area, German rates are affected by the ECB's highly accommodative monetary policy and expectations of a further expansion as early as December.

We expect the gradual return to normal for mobility and business activities may exert a moderate upward pressure.

Therefore, we confirm the underweight in the core markets.

We maintain a more positive view on peripheral debt; spreads on peripheral securities are supported by the ECB's protection, which is expected to expand the emergency plan in December.

This will allow next year's net offer to be covered on this segment, pending the approval of the Recovery Fund (we remain confident that differences among member states will be settled).

Spread products

Improved economic prospects and favourable liquidity conditions, together with the central banks' protection, continue to support the **corporate IG sector over which we confirm our preference** even though, at current levels, the spread compression margins (and underlying rates) have clearly narrowed.

In the US, the long-awaited appointment of J. Yellen as Secretary of the Treasury by the Biden administration shows a strengthening of coordination between the Fed and the Treasury in the future and this represents a positive development for the market.

We maintain our exposure to the financial sector bonds, even if they are not directly within the scope of the central banks' purchasing efforts. The fundamentals are more solid than in the previous crisis and the spectre of a relapse into recession has been driven away.

The expected developments of the macroeconomic and healthcare scenarios mitigate the default risks **for HY securities**, while central banks are contributing to reduce risk premiums. Nevertheless, **we continue to prefer to assume the cyclical risk and the possible rotation in market leadership through the equity market, due to valuations and liquidity.**

We maintain an overall neutral position on emerging market bonds, and **we are bringing our relative allocation between hard currency and local currency bonds to neutral** (starting from a position where the hard currency component was initially preferred).

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