View

Fideuram Asset Management

Macroeconomic Scenario

Over the summer there was an unexpected deceleration in global growth due to the slowdown in the US and China, caused both by the spread of the Delta variant and by supply-side constraints.

Our scenario envisages growth acceleration in both areas in the final quarter of the year (and a relative slowdown in the Eurozone, where growth has been very high since spring), but real estate adjustment is a risk factor for China.

Moreover, bottlenecks in production and distribution chains risk prolonging the ongoing rise in inflation. It also seems likely that the Fed will start tapering by the end of the year.

Equity Markets

Equity markets have recently shown a significant increase in volatility following the emergence of some elements of uncertainty. Investors are particularly concerned about the Evergrande saga, one of China's largest real estate companies suffering from liquidity problems and at risk of failing to meet payment deadlines on its bond issues. The concern is that its eventual failure could create a domino effect in the financial sector whose ramifications would be difficult to predict.

Another area of concern is the supply-side constraints that are causing price increases in both raw materials and essential components for certain production chains such as semiconductors.

The still-positive macro scenario is helping to partially calm the market sentiment with sustained earnings growth rates and progressive upward revisions.

We are therefore still bullish on equities and **we are maintaining our positive view on Japan, Europe and the emerging markets and our neutral view on the US**.

Bond Markets

Our view of the bond market has not changed compared to the summer months, when we had indicated a reduction in the size of the overweight on the Chinese bond as a precaution against a possible increase in exchange rate volatility following the regulatory initiatives of some economic sectors and some difficult situations on the corporate credit front (Evergrande).

We maintain a duration underweight, concentrated in the government component, and a substantial neutrality in credit risk. In fact, government rates remain below what would be suggested by macro fundamentals both in the US and in Europe. We confirm our preference for inflation-indexed securities and issues from peripheral European countries, albeit to a lesser extent than in previous months after the outpeformance that has already taken place. While we are aware of the risks associated with possible new waves of the virus, we believe that the overall scenario is still favourable for risky assets with the support of cyclical growth and a monetary policy that adjusts only gradually and with a limited potential increase in medium/long-term rates. We therefore maintain a neutral exposure to IG credit from a carry perspective while favouring exposure in financial sector bonds, especially in the more subordinated segments.

FIDEURAM INTESA SANPAOLO PRIVATE BANKING Asset Management

Macroeconomic scenario

US: Unexpected slowdown in growth

Over the summer there was **a marked and unexpected deceleration in growth rates** (and in particular in private consumption) caused both by the spread of the Delta variant and by supply constraints (very evident for example in the collapse in car sales in recent months).

Employment growth was also weaker than expected in August. We have therefore revised the GDP growth of the third quarter downwards (now at 4.5% p.a.), but **we expect consumption (and GDP growth more generally) to accelerate** again in the final quarter of the year.

Core inflation slowed in August but may still remain high in the short term due to renewed supply-side constraints. It is therefore not surprising that **the Fed shifted towards a reduction in security purchases before the end of the year**.

Euro Area: Summer surprises

The recovery surprised by starting as early as the second quarter, with GDP growing at 9.2% q/q annually thanks to reopenings in the sectors most affected by the pandemic. Growth likely remained strong in the third quarter: **the spread of the Delta variant during the summer was lower than feared** (also in view of the experience in other countries), while the vaccination campaign continues successfully.

Concerns relate to **production difficulties due to bottlenecks** in global supply chains, which also have a negative impact on producer prices. **Inflation surprised by rising in August (3.0%)** and is expected to hit just over 4% in December due to increases in energy and food prices. Higher inflation complicates the communication of monetary policy, but we expect the ECB to continue to view the shock as transitory. For the time being, the ECB has decided to **moderately reduce purchases of the PEPP programme** in the fourth quarter.

China: Regulations and the Delta variant slow growth

Economic activity slowed sharply in August: consumption was affected by the restrictive measures adopted following the increase in contagions resulting from the Delta variant, and investments were slowed by regulation in the real estate market and by local government debt controls.

We therefore expect a third quarter with GDP growth slowing sharply (0.8% annually), with a recovery in the fourth quarter thanks to the removal of containment measures and greater support from fiscal policy.

The PBoC continues to monitor the level of liquidity in the system and **had to provide short-term liquidity to reassure the markets with respect to the risk associated with the Evergrande crisis**, which presents a further element of uncertainty for the economic scenario.

Equity Markets

More uncertainty

After an August marked by concerns related to the resurgence of the pandemic with the spread of the Delta variant that has lowered activity levels and consumer confidence, the market refocused its attention on inflation which, in its input components, shows no signs of decreasing and, linked to it, on the poor availability of some technological components such as semiconductors, necessary for many production chains, in particular the automotive sector.

Furthermore, Chinese authorities' crackdown on large technology capitalisations and the residential sector continues to be a cause for concern, in the latter case in an attempt to stem potential speculative bubbles deriving from an excessive ease of access to credit. In this sense the markets are carefully observing the developments of Evergrande, which is facing serious liquidity problems and risks not being able to pay coupons due on its bonds.

In any case we did not modify the approach to the equity component of the portfolios, which include a modest overall overweight and a preference for markets outside the US.

The overweight is explained by relative valuations that are still attractive compared to bonds and profit growth that we believe still has room for improvement compared to market expectations.

Conversely, we are more positive about Japan after the resignation of Minister Suga and the drop of the contagion curve.

To sum up, we confirm our fairly positive view on European, Japanese and emerging equities and our neutral view on US equities.

Specifically:

- **in the US** we maintain a neutral view on US equities and the technology sector where valuations are higher and more sensitive to changes in interest rates, which we think are lower than suggested by macro developments. Corporate fundamentals are solid and the rate of profit growth will remain high in the coming quarters, even if we have already passed peak growth and we expect that US profits can grow more in the second half of the year. In support of these assessments we also note the strong expansion in corporate margins that is returning to the peaks of the 1990s;

- **we maintain a fairly positive assessment of Europe** for the support provided by the acceleration of corporate profitability and valuations lower than those of the US and less sensitive to changes in interest rates. We are also close to a peak in earnings growth in Europe, but as for the US we see room for an upward revision of estimates;

- as for the **Japanese market we maintain our positive opinion.** We have increased the overweight after the resignation of the prime minister thinking that discontinuity can lead to a more expansive economic policy. This is accompanied by a positive assessment of the sensitivity of the economy and the market to the overall cyclical improvement, to lower valuations compared to other geographical areas and to the improvement in company profitability in the second part of the year;

- **we confirm the overweight position in emerging markets.** The cyclical and policy evolution appears favourable to emerging markets after many countries have already raised interest rates to contain inflation, and China is on the sidelines moving in the direction of greater easing of economic policy. The uncertainty concerns the regulatory impact of some sectors in China but the assessments have already baked in a good deal of risk premium. In order to achieve lasting outperformance, corporate profitability must be accelerated compared to developed countries.

Bond Markets

Waiting for tapering

After the marginal adjustment in the PEPP made by the ECB at the beginning of the month, details of the tapering in the US are now expected to be announced, although the Fed has already largely anticipated the move.

At its September meeting, the Central Bank acknowledged that inflation is "high, reflecting largely transitional factors", adding that if the economy proceeds as expected, "a reduction in the level of purchases may soon be warranted".

The approaching maturity of the debt ceiling could represent an element of volatility in the market while uncertainty remains about possible delays in supply chains in some sectors and the consequent effects on production and price dynamics.

Government bonds

US Treasuries continue to trade at lower yield levels than suggested by the economic fundamentals that typically explain their performance, even if the space for growth now appears more limited than a few months ago. We believe that upward pressures on US government bond yields can prevail, albeit moderated by the context of global rates and a reduced likelihood associated with tail scenarios of rising growth and inflation.

Even in Europe, where we await the December meeting of the ECB when the method of transition from the flexible PEPP emergency programme to the ordinary system will be clarified, we maintain an underweight of duration. In fact, we expect a progressive increased relevance of macroeconomic and political variables both on core and peripheral rates (for the latter for the impact on creditworthiness) following the gradual removal of central bank support. We confirm our preference for peripheral bonds over core bonds despite their lower relative attractiveness than in the past.

Spread products

Spreads in the corporate segment are at compressed levels, but the combination of economic policy and the economic situation limits the space for expansion as it fosters an improvement in credit quality. We confirm our preference for credit over the government component, but mainly with regard to exposures that are less vulnerable to underlying rates (such as financial bonds especially in the most subordinate classes) since these are expected to be the main driver of performance in the asset class in the coming months.

We maintain a neutral approach on HY credit only with a portfolio carry logic: market liquidity conditions remain good, earnings growth is reducing the leverage effect on balance sheets and macro conditions support a credit upgrade process, but much of the good news already appears to be built into current spread levels.

In emerging markets we are maintaining an overall overweight exposure for cyclical and valuation reasons, but with a preference for the local currency component, with greater emphasis on the Chinese bond market where we have however reduced our overexposure in the summer months for the reasons outlined above.

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