AZIMUT
DEFINING INVESTMENT DIRECTION

AZIMUT GLOBAL VIEW

15.
03.
21

Main Events

Azimut Global Network

- Milan
- Abu Dhabi
- Cairo
- Dubai
- Dublin
- Hong Kong
- Istanbul
- Lugano
- Luxembourg
- Mexico City
- Miami
- Monaco
- New York
- Santiago
- São Paulo
- Shanghai
- Singapore
- Sydney
- Taipei

FOMC MEETING — 17.03
After the significant increase in rates of last month, the market is expecting some light from the Fed on the rate trajectory

BOE MEETING — 18.03
Due to the speed of domestic vaccination, the Bank of England may be the first central bank to normalize its monetary policy post COVID-19

US CURR ACC. — 23.03
The US is running a record twin deficit (fiscal and current), that needs to be financed by the rest of the world, putting pressure on USD and US rates

MARKIT PMI — 24.03
Markit PMI may highlight the growing disparity in recovery rates worldwide, depending on the speed of vaccination and fiscal stimulus

THE PRISONER'S DILEMMA

Following up on last week's Global View report about $1.9 trillion stimulus bill signed into law by President Biden last week, we thought it would be appropriate at this time to discuss the conundrum the Fed is facing ahead of this week's most anticipated meeting.

Immediately after the approval, the Biden administration reiterated its intention to begin working on a new stimulus plan, focusing on infrastructure. Details have not been disclosed, but there are rumors of a new stimulus plan worth an additional $2 trillion, on top of the $6.1 trillion already spent in the last year to fight the covid-19-induced recession. For comparison (graph on the next page), the fiscal response to the 2008 Great Financial Crisis was "only" $1.8 trillion. We are therefore talking about measures that are three or four times the record ones approved just over a decade ago.

Prompted by the approval of the $1.9 trillion fiscal plan, investment houses have revised upward their US GDP growth estimates for 2021, which is expected to grow by 7% (in real terms). If we add the estimated inflation rate of about 3%, we end up with a nominal GDP growth rate of roughly 10%, making the US the fastest growing economy among the major countries.

If the fiscal plan will be the driving force for a sustained real growth, the vaccine rollout will be at the heart of the labor market recovery. Considering the pace of vaccination in the United States, it is likely that lockdowns can be lifted in late spring, thus allowing for a full reopening of economies and the resumption of normal life.

Considering that the official unemployment rate has already dropped to 6.2%, and that a large part of the remaining jobs losses are in the sectors most impacted by the lockdowns (graph on the next page), a return to normality should make it possible to recover a large part of these unemployed. It is not unlikely, therefore, that in a relatively short period of time the US economy will find itself not too far from achieving a full employment.

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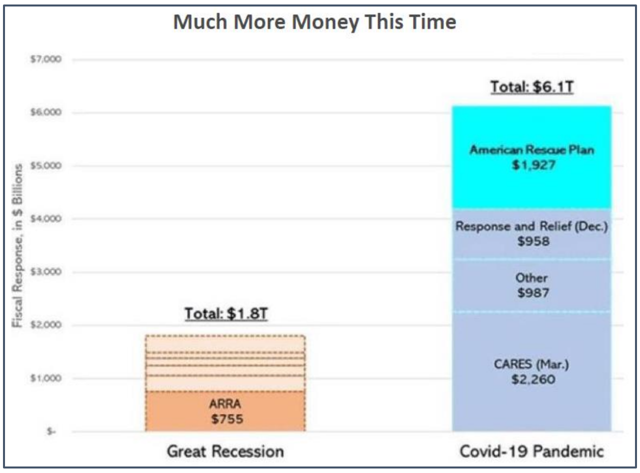
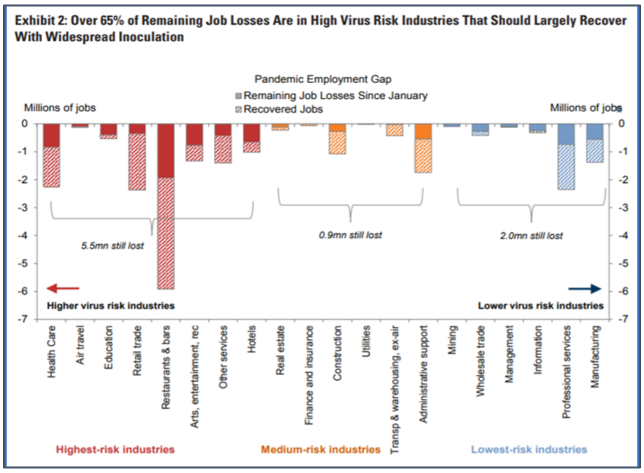
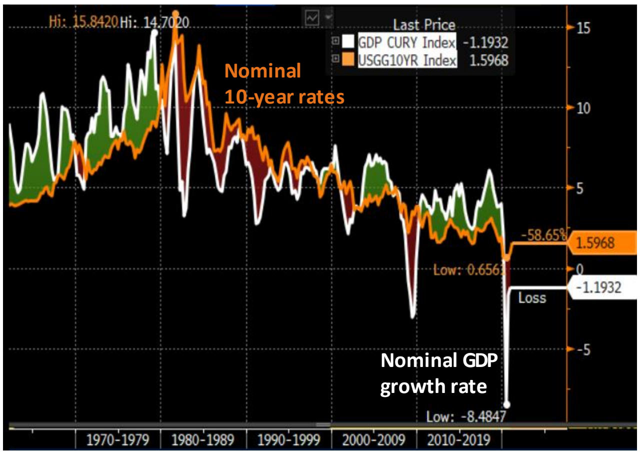


Source: Doubleline

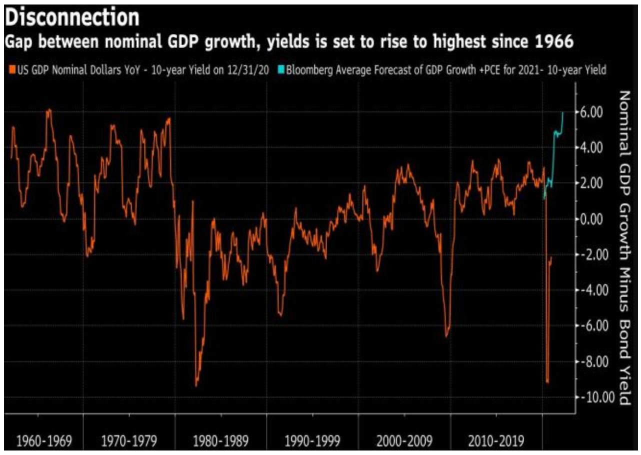


Source: US BLS, Goldman Sachs Global Investment Research

Over the past decades, nominal GDP growth rate and nominal ten-year interest rates were somewhat correlated (albeit with large fluctuations), as seen in the lower left graph. The lower right graph shows the same concept, but instead of the two series, it only shows the differential between the two (nominal GDP growth rate minus the US 10 Year rates). The series in orange shows the actual differential to date; the blue line shows the projection of this differential at the end of the year based on the market consensus. If the prediction holds true, the year end differential will be at its highest level since 1966.



Source: Bloomberg



Source: Bloomberg

The Fed, scheduled to meet this week, is therefore between a rock and a hard place: a nominal GDP growth rate of 10% and a rapid return to full employment are at odds not only with zero-interest rate monetary policy and the ongoing QE, but also with the Fed's other mandate, price stability.

Furthermore, the Fed must also take into account the effects of fiscal and monetary policies on the assets prices in general, particularly in equities. If history is any guide, the payment of $1,400 stimulus checks per person (for household incomes below $ 150k) will lead to a new flare-up in the stock markets as happened after March and December 2020. Maintaining a particularly dovish monetary policy with markets where valuations at or close to all-time highs, overly-bullish sentiment (graph on the next page) and incoming stimulus checks risk are all creating a future market instability.

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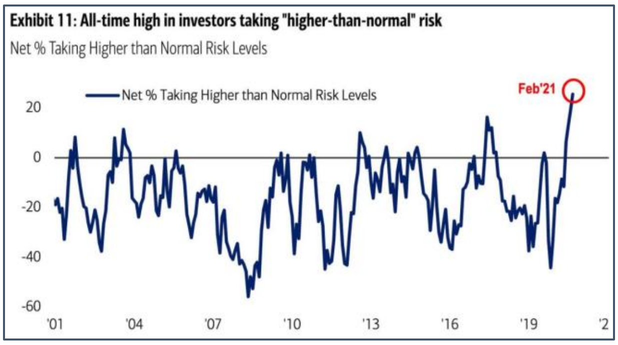
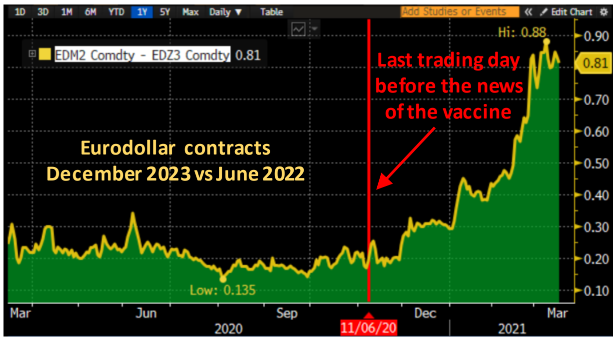


Source: Bank of America, Global Fund Manager Survey



Source: Bloomberg

The market is telling the Fed that they may be behind the curve: while the "Fed Dots" (Fed governors' expectations of where rates will be in the medium term) shows that the Fed will not raise rates before 2024, the implicit yields in the Eurodollar futures show that the market expects an increase in rates of about 80 basis points (slightly more than three rate hikes) between June 2022 and December 2023. The market expectation of higher rates has been gathering momentum, as the expectation of economies reopenings and the creation of herd immunity become rapid and concrete.

The Fed must walk a fine line between dovishness and hawkishness in order not to upset the markets. If they seem too relaxed about the inflation and the risk of overheating of the economy, they could cause long-term rates to rise further, which in turn may cause risky assets to correct. If they hint at a less accommodative monetary policy sooner than expected, they risk causing a correction in risky assets as well.

The only possible solution for keeping the markets calm seems to be the sticking to the rationale that everything is going welll, the situation is under control and that the unwinding of the accommodative monetary policies will occur in a controlled and non-traumatic way. If Powell is convincing, then the market will continue to drive interest rates higher gradually. Once the market has priced in the start of a rate hikes cycle, then and only then can the Fed actually start raising rates without running into the risk of creating market disruption.

The Fed's upcoming press conference could be one of the most important in recent years. It will be interesting to see how Fed officials finetune their messages to manage investor expectations.

Asset Allocation View

	−	=	+
Equity			
Developed Markets			
Emerging Markets		Downgrade	
Fixed Income			
Developed Markets Sovereign			
Developed Markets Corporate			
Emerging Markets			
Commodities			
Currencies		*Commentary below*	

− UNDER   = NEUTRAL   + OVER

Equity

Developed Markets

We maintained our positive recommendation on Developed Markets Equities. The 1.9 trillion USD fiscal stimulus that got recently approved in the US should support the equity markets, as happened with previous packages. The area that will benefit the most is the US, where vaccinations continue at a rapid pace. In Europe, on the other hand, the lack of similar fiscal measures and the slower vaccine rollout could dampen enthusiasm. As a result, we have removed the preference for Europe over the United States. In the medium term, once the euphoria for the fiscal stimulus fades away, a more cautious approach on the asset class should be taken in consideration of valuations that continue to be elevated.

US	=	**Europe**	=	**Japan**	=

Emerging Markets

We reduced the recommendation on Emerging Markets Equities to neutral, as the fiscal stimulus in the US may put additional pressure on risk-free rates, particularly in the US. Traditionally, Emerging Market returns tend to be negatively correlated with US rates. Furthermore, over the past year the weight of growth stocks in Emerging Markets indices has increased materially, and those stocks are most affected by an increase in risk-free rates. Therefore, even if in the long term Emerging Markets should continue to grow faster than Developed Markets, we prefer to maintain a more cautious approach in the short term. We also removed our preference for Asia due to its higher exposure to growth stocks then EEMEA and Latin America.

Asia ex-Japan	=	**EEMEA**	=	**LATAM**	=

Fixed Income

Developed Markets Sovereign

NEUTRAL

We keep our slight underweight recommendation on Developed Markets sovereign bonds. Although a phase of consolidation in interest rates is possible after the violent upward movement of the last month, the fiscal stimulus just approved in the United States could lead to a further increase in US rates. In Europe, the increase in PEPP purchases announced by the ECB last week, together with a very slow vaccination, could lead to a stabilization of rates around this level in the short term. Therefore, within an underweight recommendation on the asset class overall, we have a relative preference for Europe and Japan.

EU Core	=	**EU Periphery**	=	**US Treasury**	–	**Japanese JGB**	=

Developed Markets Corporate

UNDER OVER
NEUTRAL

We kept our negative recommendation on Developed Markets corporates. The recent move in risk-free rates has not been extended enough to make investment grade bonds attractive again and the high yield spreads remained broadly unchanged. We stick to our view that further spread compressions could be possible in the segment between investment grade and high yield, in particular in subordinated bonds.

IG Europe	–	**IG US**	–	**HY Europe**	=	**HY US**	=

Emerging Markets

UNDER OVER
NEUTRAL

We lowered our recommendation on the asset class because Emerging markets bonds are usually negatively affected by increase in risk-free rates, and in particular on the US curve. The move in US rates may not be over due to the approval of the $1.9 trillion stimulus last week. In case of an extension of the US risk-free upward move, Local Currency debt may suffer because of a weakening of EM currencies, and Hard Currency debt because of the very long duration of the strategy. Therefore, a more cautious approach to Emerging Market bonds should be warranted. Among EM bonds, we still prefer Local Currency debt, and in particular Chinese Renminbi (RMB).

Local Currency	+	**Hard Currency IG**	=	**Hard Currency HY**	=

Commodities

UNDER OVER
NEUTRAL

We maintain our bullish view on the asset class. In the short term precious metals could face headwinds due to the increase in risk-free rates, but the ample liquidity, the surge in fiscal deficits and the expectation for higher inflation later in the year should continue to underpin precious metals. We maintain our positive stance also on energy commodities.

Precious	+	**Energy**	+	**Industrial**	=

Currencies

We maintain our neutral view on the euro mainly because on one hand the expectation for a stronger economic growth should sustain the demand for cyclical/value stocks that are more represented in EU vs. the US, and on the other the slower vaccine rollout may temper the expectation of the Eurozone recovery.
We upgraded the view on the US Dollar to neutral. While the US dollar may weaken over the long term because of the unsustainable pace of fiscal deficit expansion over the past year, in the short term the widening gap between US rates and those of the rest of the world should be supportive for the greenback.
We kept the neutral view on the Japanese Yen as the country may attract foreign investments if the interest on value stocks, which are well represented in the main equity indices, continues in the near future.
On Emerging Markets currencies, we lowered our stance to neutral because of the possibility that further increase in US risk-free rates will put downward pressure on Emerging Market currencies.

Euro	=	**USD**	=	**Yen**	=	**Emerging**	=