AZIMUT
DEFINING INVESTMENT DIRECTION

AZIMUT GLOBAL VIEW

03.02.20

Week 6

Main Events

US PRIMARY – 04.02
Voters started the process of choosing a Democratic presidential candidate with Iowa caucuses . Who will it be?

MARKIT PMI – 05.02
Some replies have been collected after the first outbreak of the coronavirus. How much will they be affected?

EU IP – 12.02
Will the December industrial production data confirm the rebound of the European economies?

US CPI – 13.02
A tame reading could allow the FED to keep its monetary policy unchanged for longer

Macro Commentary

The month of January ended with a sharp U-turn versus the first half of the month.

At the beginning of the year, everything seemed going for the better: the trade war and the Brexit saga was finally off the table, the macroeconomic data showed first signs of stabilization and improvement, and Central Banks pledged to remain accommodative for quite a long time. Even valuations, at the highest levels in almost two decades, were not perceived as an immediate threat. All in all, a perfect mix for the continuation of the risk-on environment, with no immediate threat in sight.

This scenario suddenly changed with the novel coronavirus outbreak in China. The disease, notwithstanding the impressive efforts set forth by the Chinese authorities to contain it, started to spread out from Wuhan (where originally emerged) to the mainland China and lately in several countries. Even if the mortality rate is quite low, the total number of deaths is already one third of the SARS death toll in three months.

In order to prevent a further expansion of the virus, with incubation period lasting up to 14 days with no symptoms, China enacted several travel bans, both internally and internationally, and ordered many public offices, schools, factories to remain closed up to several days or even weeks.

Many countries began closing their borders to Chinese passengers, and foreign corporations such as Apple, Starbucks, McDonalds, etc. announced temporary closurures of several stores in the mainland China.

These measures are much more drastic than those implemented during the SARS and could well cause a downward revision to the Chinese and global GDP growth. If history proves to be a guide, during SARS the Chinese GDP slowed temporarily from 12% to a 9% annual growth rate. As China is currently making up the biggest part of the global GDP growth, the fallout of this pandemic may have far reaching consequences in the financial markets.

Azimut Global Network

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

Macro Commentary (continued)

Suddenly valuations and overbought indicators started to matter again. Quite often markets do not experience a correction because of the internal factors, but they do wait for an external catalyst to pin the correction on.

Does this call for a drastic change to our asset allocation? The reply will mostly depend on how pervasive the contagion will be, but there are few things that could guide us through.

The first one is that due to these developments, Central Banks will keep their lax monetary policies for longer than expected. Some Central Banks could even further lower their benchmark rates. The Fed, for example, is now expected to cut at least one more time in 2020. Lower risk-free rates and/or more QE will be supportive for the equity prices.

A slowdown in global growth could well lead to a sustained correction in energy and industrial commodities. On one hand this could facilitate further easing by Central Banks, on the other hand, it will also contribute to depressed prices for cyclical sectors as well as the commodity-exporter emerging markets. Similarly, due to the tight trade relationship between China and the EU, a slowdown in China could delay or temporary halt the recovery of the Eurozone. In light of the above, tactically European and Emerging Markets equities have been downgraded from overweight to neutral.

Is all that negative? Of course not. Once the number of new cases are unraveled, then the market is expected to rally sharply. The rebound will probably be led by Emerging Markets and cyclical sectors, which at the bottom could enjoy from valuations at very compelling levels (thanks also to a reporting season that so far has been pretty good), ample liquidity and elevated risk premium (difference between expected return from equity and the risk-free rate).

Timing wise, this could happen also in a period when, typically, high dividend stocks tend to outperform the rest of the markets as pension funds are buying those stocks to cash in the dividends, and several cyclical stocks present elevated dividend yields.

As Emerging Markets, European equity markets and cyclical stocks are currently not the heavyweights of the main equity indices, being able to re-enter in those markets/sectors at the right moment could prove to be an extraordinary trade in a year, which started with quite high valuations and modest expected returns.

Timing will make all the difference.

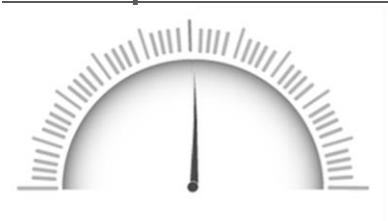
Asset Allocation View

	−	=	+
Equity			
Developed Markets		■	
Emerging Markets		downgrade	
Fixed Income			
Developed Markets Sovereign		upgrade	
Developed Markets Corporate		■	
Emerging Markets		downgrade	
Commodities		■	
Alternative strategies		upgrade	
Currencies		*Commentary below*	

− UNDER = NEUTRAL + OVER

Equity

Developed Markets



Developed Markets equities have been downgraded to neutral due to the outbreak of the Coronavirus, which could negatively affect the global GDP, with possible fallouts also on EPS. This could be a pretext for equities to correct in the short term from overbought stands. Traditionally, equity could also be used by bondholders to hedge the credit risk of their portfolios. On the other hand, macroeconomic data continues to improve gradually and central banks are still supportive, whilst reporting season was positive so far. European equities has been downgraded to neutral, in line with the US, due to the stronger trade relationship with China.

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

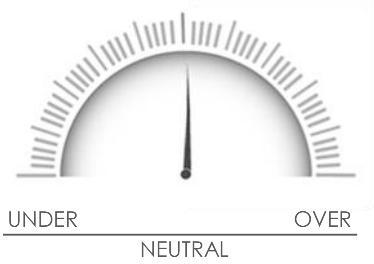
Emerging Markets

Emerging Markets equities have been downgraded to neutral due to the outbreak of the Coronavirus. Chinese economy will be hardly hit, as domestic and international travel restrictions together with several business halts will drag down Chinese GDP. In this environment, we have a preference for commodity-importing countries, as they will benefit from lower commodity prices. Once the number of new infections from coronavirus will start to decrease, emerging markets equities will be a strong buy as recent correction brought valuations back to very compelling levels.

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

Fixed Income

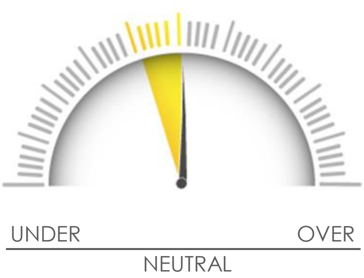
Developed Markets Sovereign



We tactically upgrade our view on the asset class to neutral, as DM sovereign may prove to be a good hedge until coronavirus infection start to recede. Strategic view remained negative, due to the historical low level reached by risk-free rates. Within sovereign, the preference is for US Treasuries as an hedging tool, and on Italian BTPs. The recent result of the local election in Italy, which clearly indicate that there is no risk a snap election in sight in the short/medium term, could drive the spread with German bund as low as 80 bps.

EU Core	−	**EU Periphery**	+	**US Treasury**	+	**Japanese JGB**	=

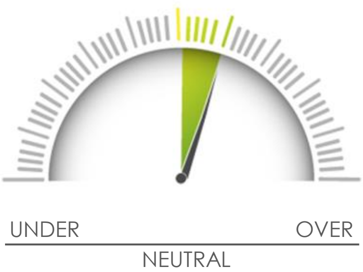
Developed Markets Corporate



We maintained a neutral view with an underweight tilt. The unchanged view is the result of two opposite forces: on the positive side there is no longer a preference for equities due to the outbreak of the coronavirus (corporate was in underweight mainly due to the preference for equities; therefore the general view on the asset class improved. On the negative side the higher uncertainties could lead to a more risk averse environment. The preferred region is still Europe, where ECB's QE will probably lead to a further compression in spreads, and within corporate bonds investment grade are preferred to high yield.

IG Europe	+	**IG US**	=	**HY Europe**	−	**HY US**	−

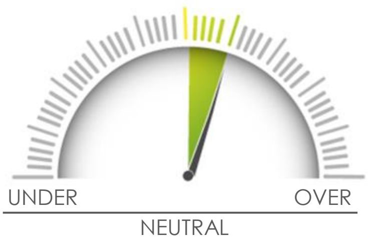
Emerging Markets



We downgraded the view on the asset class from positive to slightly positive, due to the coronavirus. The view is still positive as EM bonds trade at a relatively attractive levels, the current low/negative yield environment will support the hunt for yield, and DM central banks are still on the dovish side. Also, the fallout from the virus should moderately affect the asset class at this stage (bonds could benefit from the expectation of lower rates going forward). The only segment of EM bonds to avoid is the high yields.

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

Commodities



We have a neutral stance with a positive bias. We continue to prefer precious metals, not only because of the low yield environment, but also and more importantly as a hedge against geopolitical tensions and unexpected turbulence. We decreased to underweight the recommendation on energy and industrial commodities as the coronavirus could lead to a global slowdown.

Precious	+	**Energy**	−	**Industrial**	−

Alternative Strategies

We improved our view on liquid alternative strategies, as the low yield environment together with the increased risks related to the coronavirus makes low volatility strategies a good alternative to fixed income strategies. We continue to prefer mixed-assets or equity funds to medium- and high-volatility alternative strategies.

Low Volatility	Medium Volatility	High Volatility
+	−	−

Currencies

We have a neutral view on the Euro. On one hand the euro, being a currency with negative yield, could have been used as a funding currency, and during risk-off environment, funding currencies tend to outperform. On the other hand, EU will be one of the most vulnerable areas to a possible Chinese slowdown. Also the renewed tension with UK about the term of the trade pact could affect the Euro.

Corollary to this, we have a neutral view on the US dollar. US will be less impacted by a Chinese slowdown as the GDP mostly depends on the domestic consumption, and the US dollar tends to be considered as a safe haven in times of stress. On the negative side, the Fed has room to lower its benchmark rate more than other Central Banks, and a narrowing rate differential could drag down the greenback.

The view on Japanese Yen is neutral as well. It's the most used funding currency, and therefore could benefit from the increased risk aversion.

On the Emerging Markets Currencies, the view is tactically slightly negative. Even if some emerging currencies appear undervalued, the outbreak of the coronavirus will probably lead to outflows from the asset class.

Euro	USD	Yen	Emerging
=	=	=	−