AZIMUT
DEFINING INVESTMENT DIRECTION

AZIMUT GLOBAL VIEW

02.03.20

Week 10

Main Events

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

BEIGE BOOK — 04.03
How does the Fed view the US economy when the coronavirus poses a new risk to global growth

US PAYROLLS — 06.03
A strong labour market will help US remain insulated against external slowdown.

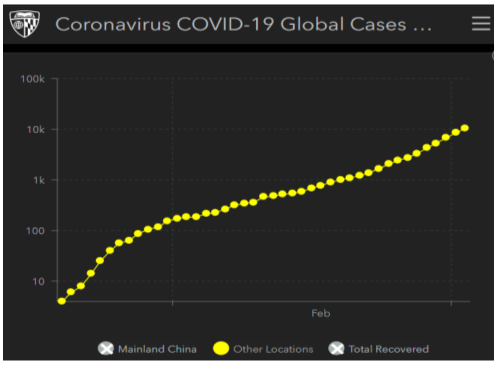
ECB — 12.03
Will Mrs. Lagard signal more easing ahead to sustain the European economy?

CHINA — 16.03
Will Industrial production and retail sales confirm the poor PMI numbers?

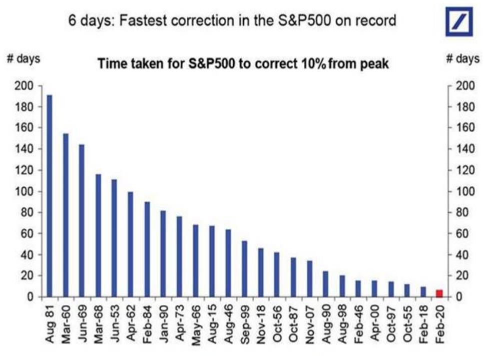
Macro Commentary

The goldilocks blessing of all asset classes since last summer eventually came to an abrupt halt. Outbreaks in Italy and Iran, outside of China, followed by very few cases reported in the US dramatically shifted the investor sentiment.

Nothing material changed in the expansion pattern of the coronavirus, as demonstrated by the chart below (LHS), which clearly shows that the growth rate of the contagion has been constant (scale is logarithmic). But financial markets, after ignoring the virus until mid-February, began to literally collapse on those news. It took just 6 days for the S&P 500 to plunge into a correction on coronavirus concerns – a decline of 10% from a recent high. It is the shortest time on records (below, RHS).



Source: Johns Hopkins CSSE

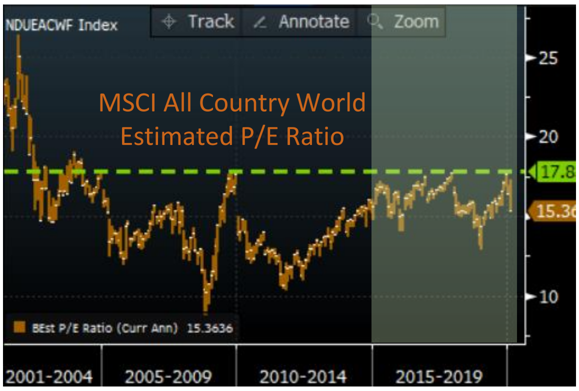


Source: Deutsche Bank Research

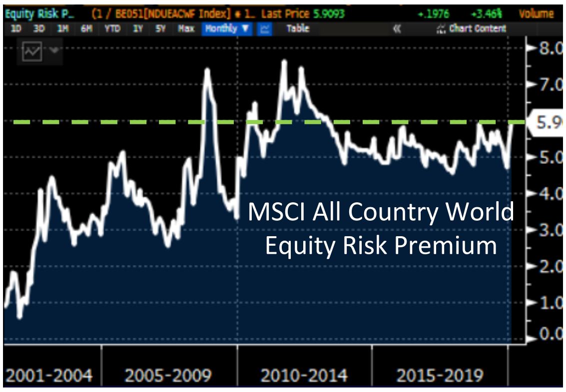
In times of high volatility, when typically emotions are the worst enemy of any investment decisions, we need to focus on numbers in order to avoid mistakes.

Looking at the fundamentals, markets were vulnerable to a correction not only because of the short term overbought condition, but also because multiples were close to the highest level in two decades. In the next page, the picture on the left shows the P/E ratio of the MSCI All Country World index. After this rapid correction, valuations came back to the lower part of the range since 2015 (the start of the zero/negative interest rate policies)

Macro Commentary (continued)



Source: Bloomberg



Source: Bloomberg

As a consequence of the stock markets correction, which also sparked a buying frenzy on the sovereign bonds, equity risk premium rose to levels associated with strong subsequent returns (graph above, RHS).

After the last dismal week on financial markets, Central Banks are expected to provide additional liquidity and/or stimulus. Also governments could consider further aggressive fiscal stimulus in order to mitigate against the virus-induced slowdown. All these measures are expected to be supportive of risky assets, in particular for equities.

Is it all good then? Is it finally time to build up of equities aggresively? Perhaps the current situation should be taken with a healthy pinch of salt. Put aside what Central Banks and/or governments will do, coronavirus continues to ignite more fear as cases spike. In many Emerging and Developed countries, travels, events and conferences are cancelled or restricted; schools, nurseries, public offices are or have been closed for some time; companies are telling staff to work from home. The greater the extent of the contagion, the bigger the reverberations on the economy would be. It is therefore reasonable to expect that earnings forecasts will be revised downward. If that happens, then the valuations will start climbing that may make the markets vulnerable again to further downside.
Therefore, after this huge and sharp downwards move, we expect at least a short term rebound, but in the long run a more cautious approach is certainly warranted.

Should we then park our money into corporate debt? Probably one of the most protected segment will be the European Corporate Investment Grade Bonds, as the ECB will continue its QE putting a floor in the prices of those bonds, but expected returns will be barely positive. In the High Yield space, the risk of a more pronounced slowdown will probably expose those bonds to a significant downside, therefore better to avoid this credit segment. Only in Emerging Markets bonds there is some value, as the asset class suffered from huge outflows last year due the trade war, and this year as the virus hit first the Emerging Market countries.

Finally, some food for thought about Sovereign Bonds. The long end of the curve already reached the lowest level ever. There is no rational need for Central Banks to engage in QEs to further compress the long term rates. Markets are facing now a confidence and liquidity issue, which should be addressed by providing extra (or unlimited) funding to commercial banks, by injecting fresh cash into the Repo market or via open markets operations, and/or by lowering policy rates. But the hidden risk is that this time the crisis is not indigenous to the financial markets. It is linked to (ir)rational fear by ordinary people, and monetary stimulus could not change these behaviors. Also, if the shut down of factories and lower global trade will lead to disruptions in the supply chains, then we can witness a comeback of inflation, which could negatively affect the long term bonds. Maybe central banks will no longer seem almighty, and long term Treasuries may no longer be a safe-heaven.

2020 is already shaping up to be a very interesting year.

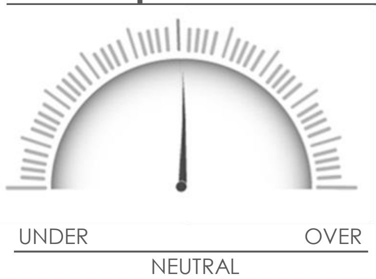
Asset Allocation View

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

− UNDER = NEUTRAL + OVER

Equity

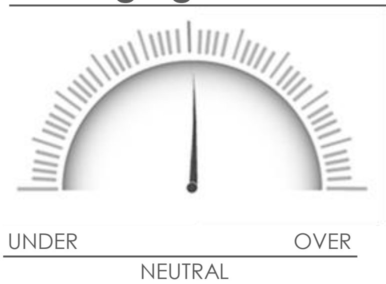
Developed Markets



We maintain the neutral stance. On one side, lower multiples and equity prices could stoke a more aggressive tone, and some portfolio managers increased their equity exposure during the last two days of February. On the other hand, the constant media coverage of the coronavirus could lead to a more pronounced slowdown in economic activity, which could more severely affect global growth, and in turn the EPS. A short term bounce is possible due to the oversold condition, but there is a risk of further downside in the medium term. US is the preferred region.

US	+	**Europe**	=	**Japan**	−

Emerging Markets

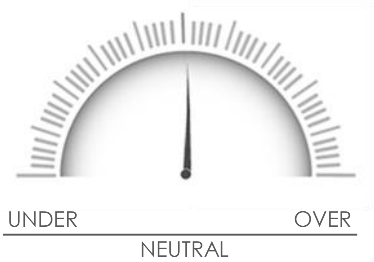


We maintain the neutral stance. If emerging markets are the most affected region by the coronavirus, not only because it is where the virus initially emerged, but also due to their greater dependence on global growth, they are also the markets with the lowest valuation amongst equity indices. We are turning positive on Asia, as the contagion seems to recede there (except South Korea). Also, Asia is a strong net importer of commodities, that experienced a massive price drop. Conversely, we are turning bearish on Emerging Europe and Latin America, as those regions are much more dependent on commodities.

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

Fixed Income

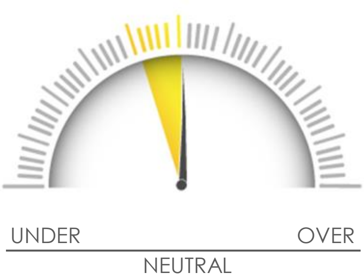
Developed Markets Sovereign



We maintain a neutral stance as expectations for CB interventions could still lead to further upside for sovereign bonds. The advice is to start taking profit on long term bonds, selling on the news of CB activity. The view on Italian BTPs revised to neutral (with further downgrade possible) because of the coronavirus in Italy, as this will weigh on the fiscal budget, decline in tourist arrivals in the spring/summer and lower economic activity in general. We are turning negative also on Japanese sovereign due to domestic slowdown.

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

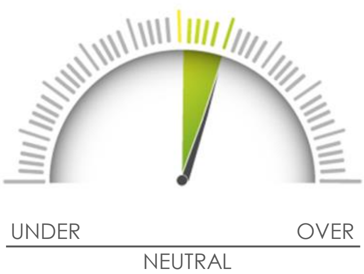
Developed Markets Corporate



We keep the neutral view with an underweight tilt. European corporate bonds remain compelling amid the ECB QE support. Within European corporates, the preference is towards subordinated bonds, mostly from Italian issuers because they were hardly sold on the virus news. The view on the high yield further downgraded, as the segment is more vulnerable to a pronounced slowdown and expectedly suffered huge outflows in the past week. High yields are also more affected by lower oil prices, as many energy companies are rated sub-investment grade.

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

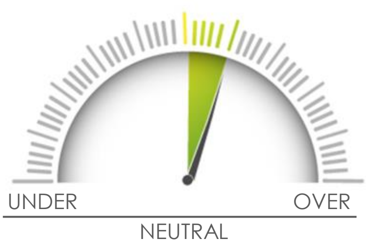
Emerging Markets



We keep the slightly positive view on the asset class. The recent drop in risk-free rates globally will further sustain the yield chasing. Expectations of further interventions by developed markets central banks are supportive for the asset class, which always benefited from looser monetary policies.

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

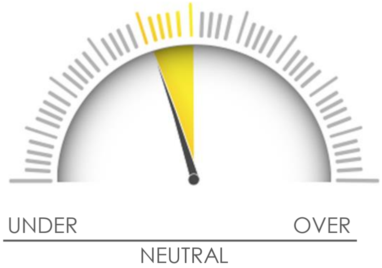
Commodities



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 slightly negative view on the Euro. The outbreak of the coronavirus in Italy is affecting the domestic economy and could lead to further spread in the whole EU. On top of that, the close tight with the Chinese economy, the renewed tensions with the UK about the trade deal and the threat by Erdogan to flood the EU with migrants are all negative for the Euro.
We upgraded again the view on the US dollar to slightly positive. The US dollar didn't suffer as much as expected during last week's correction, as usually "funding currencies" (notably Yen but also the Euro) tend to strengthen. Also the narrowing two years spread didn't affect the greenback. The deleveraging and the more risk-averse attitude by market participants are supporting the demand for "safe haven" assets, and US Treasuries are amongst them. Supporting the US dollar is also the tension on the repo markets.
The view on Japanese Yen has been downgraded to strongly negative. The only appeal of the Yen was its strength during phases of rising risk aversion. During the recent sharp correction, Japanese Yen did not outperform other currencies, losing its main function in a portfolio. Domestic economy was also facing a pronounced slowdown, even before the coronavirus outbreak. All-in-all, better to avoid.
On the Emerging Markets Currencies, the view is neutral with a positive bias. Some emerging currencies appear undervalued, and the mounting negative yielding assets are supportive for the asset class.

Euro	USD	Yen	Emerging
−	+	−	=