AZIMUT
DEFINING INVESTMENT DIRECTION

AZIMUT GLOBAL VIEW

27.04.20

Main Events

EU CPI – 29.04
After the oil crash and more than one month of lockdown, how concrete is the risk of falling back in deflationary area for the EU?

Q1 US GDP – 29.04
The advance reading of the US GDP will be the first assessment of the impact of the coronavirus on the US economy

FED MEETING – 29.04
No new measures are expected, but the Q&A will be very important to gauge the future path of the US monetary policy

EU GDP, ECB – 30.04
On the same day, the first reading of the EU GDP and the ECB meeting.

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

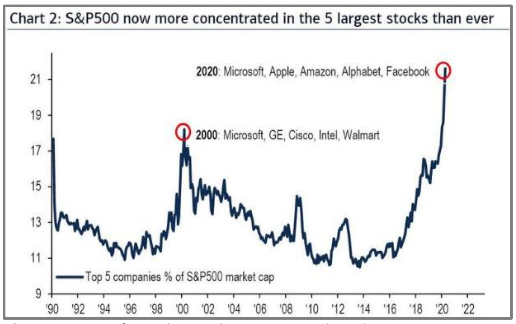
WAITING FOR GODOT

After a wild ride in the first part of the year, and a lot of speculation about what impact the Covid-19 will have on EPS, the ongoing reporting season will hopefully shade some light, even if only the last few weeks of the quarter was really affected by the lockdown.

At least for the US, the evidence is that companies fared quite well in the first quarter with 65% of them able to beat consensus (see graph below on the left, RHS). Looking forward, unfortunately the percentage of the companies providing positive guidance is just 15%, whilst 85% (LHS) of them are either issuing a negative guidance or withdrawing it. It has to be stressed that withdrawing the guidance does not necessarily mean bad things are going to happen, just that there are too many uncertainties to make accurate predictions.

This week will be particularly important as many of the heavyweights in the S&P500 will report their earnings. It is worth noting that due to the polarization in the economy, growth (tech) companies largely outperforming cyclicals over the past few years. This trend has been reinforced by the Covid, with many tech giants that benefited from the lockdown. This phenomenon led the 5 largest stocks, all tech-related (Microsoft, Apple, Amazon, Alphabet and Facebook), to reach a cumulative weight of about 22% of the S&P500, well above the previous peak in 2000, as shown in the graph below on the right.

Source: J.P. Morgan, Zerohedge



Source: BofA, Bloomberg, Zerohedge

(continued)

This means that the S&P is more and more linked to the performance of a handful of stocks. Even if those companies have very strong business model and above average profitability, they are also quite overbought and trade at higher multiples than the market average, therefore the hidden risk is that a reversal of fortune, even on a temporary basis, could make the entire market correct quite significantly.

That's why this week will be of utmost importance. If the results of those tech giants will be in line with, or top, market expectations, the rally could have room to continue. In case of a miss, then market could find an excuse to start a psychological correction after a relief rally which, by many standards, has been very powerful.

Another asset class, another very uncommon type of "concentration" risk. As global economies are shutdown, the oversupply of oil is concentrated into the storage facilities, which are rapidly filled up, with very limited spare capacity left. This is the reason why last week crude oil prices for the West Texas Intermediate (WTI, the US standard for oil), dipped deeply into negative territory, reaching -40$/barrel.

The reason why this happened is that commodities futures are very different from the futures on other financial securities. At the expiry of the contract, futures on financial securities are settled in cash, without any other further obligations. In case of a commodity futures, the buyer is obliged to take physical delivery of the underlying commodity, in the case of the WTI, 1000 barrels/contract. That's why positions in commodity futures are generally closed in advance of the expiry, only companies operating in those sectors usually take delivery.

What happened in the WTI last week is the combination of three factors: 1) crude oil storage was already quite filled before the crisis 2) the Covid caused a sharp reduction in worldwide oil consumption, which many estimated in the range of 30 million barrel per day 3) Notwithstanding this, the OPEC cartel broke in early March and oil production was increased as a response (the new agreement struck on April will go into effect only from May, 1st, and will cut overproduction by only 10 mln/bbl/day, a level not able to balance the oil market anyway).

The oversupply vs. consumption led to a rapid exhaustion of available onshore storage capacity, to the point that even vessels are rented as floating storage for crude oil, with no booked delivery destination.

As the expiry of the front-month contract for May delivery approached, the players who had long positions but was not willing to take physical delivery, were not able to find anyone to resell the positions, as it was more and more difficult and costly to find available storage. The price of the front-month contract started to fall sharply, breaking zero and then falling up to -40$/bbl. That means that the seller had to pay the buyer. In a very crazy day, what had always been an asset, suddenly became a liability.

Some ETFs/ETCs/ETNs were caught into this dive, and in some jurisdictions the owner of these products now owe funds to the bank/brokers where they have their accounts, which means they lost more money than they invested. This is a shocker, as normally with ETFs the risk of loss is limited to the amount invested.

The largest ETF on WTI escaped this fate, as by its own regulations it rolls the positions from the front- month to the next one, one week in advance of the expiry. Now the question is: what will happen at the next expiry in 20 days? The oversupply will not be reversed and the storage capacity left will be minimal or inexistent. If market players and/or speculators will front-run the roll of the ETFs, another dive, maybe even deeper, could be in the cards.

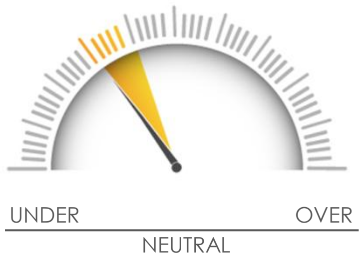
Asset Allocation View

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

− UNDER = NEUTRAL + OVER

Equity

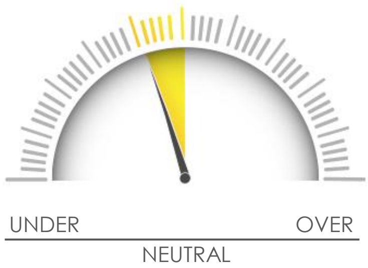
Developed Markets



We maintain our underweight recommendation, as the dichotomy between real economy and financial markets is becoming more and more evident. The committee sees the current level as near the upper bound of a trading range, where markets could be trapped for some time, unless the ongoing reporting season will provide clear indications in one direction or the other. Even if it's the market with the highest multiples, the preference remains for the US markets, as it's the country where the biggest monetary and fiscal stimulus have been implemented. In the committee there is also a preference for the growth style, in spite of some disagreements.

US	=	**Europe**	−	**Japan**	−

Emerging Markets

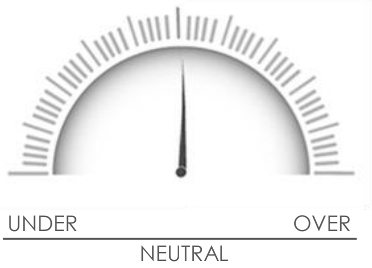


We keep emerging markets in a slightly underweight position after the recent rebound. We maintain a moderate preference for emerging markets as their multiples are well below of those main developed markets. In terms of the geographical area, we maintain the positive view on emerging Asia, as it is the first region that is reopening from the coronavirus, and it's the biggest importer of commodities, whose prices have dropped dramatically. For the very same reason we are keeping the underweight recommendation for Emerging Europe and Latin America, as those regions are mostly commodity exporters and therefore severely impacted in the current environment.

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

Fixed Income

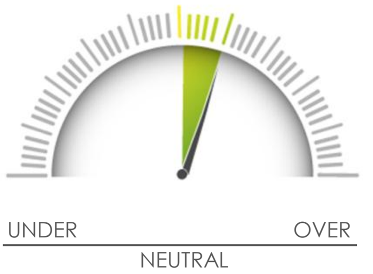
Developed Markets Sovereign



We maintain a neutral view as the ongoing QEs by all the major central banks should keep rates close the current levels, notwithstanding the expected explosion of debt/GDP ratio due to the fiscal measures just approved by many governments. Among sovereign bonds, US treasuries is the only asset class we have a positive stance on, as they could benefit from the safe haven status for investors during phases of risk aversion. We change our recommendation for the EU peripheral bonds to neutral as S&P rating agency did not lowered the credit rating for Italy, therefore there's room for at least a short term rebound.

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

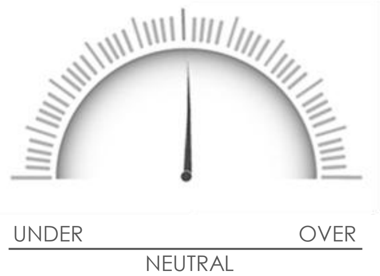
Developed Markets Corporate



We increased our stance to slight overweight. Even if the spreads continued to compress over the last two weeks, the QEs by central banks will last for a long time favoring a further reduction in spreads. On top of that, many banks are not able to pay dividends as indicated by some central banks, and it's reasonable to expect the same from companies in the oil and material sector. Also buybacks will be much lower than in the past. This loss in dividend stream and buybacks will lead to an increase the demand of corporate bonds for their coupons. The preference remains for IG bond, but we increased to neutral the view on US HY due to the intervention by the Fed.

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

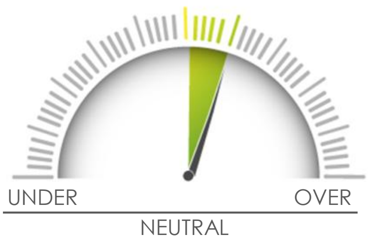
Emerging Markets



We keep the neutral stance. The asset class suffered the biggest outflows ever in the first quarter of 2020, and spreads are at attractive levels compared to the historical averages. The liquidity injected by many central banks of developed markets, and the low yield environment should gradually lead to a renewed hunt for yield. The only cautious note is that central banks of emerging markets are not engaging in QEs in order to protect the price and liquidity of their own bonds, and therefore the segment is more vulnerable to short term volatility.

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. As widely discussed in the general commentary, the oversupply of oil could continue to keep crude prices at depressed levels. We keep the underweight recommendation also on industrial commodities.

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

Alternative Strategies

We slightly reduced our underweight recommendation on liquid alternative strategies, as the expected normalization in volatility over the next weeks could allow for a recovery of some strategies.

Low Volatility		Medium Volatility		High Volatility	
	=		=		−

Currencies

We have a neutral view on the Euro. The region seems slower than other to reopen its economies, and the fiscal and monetary responses so far have been more limited than in other countries. On one hand this means European assets will look less attractive than others, but on the other hand this also implies that the supply of euros will increase less than that of other currencies.
We have a neutral view on the US dollar as well, but with a positive tilt due to the fact that the US will continue to be considered as a safe haven.
The view on Japanese Yen remains 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.
On the Emerging Markets Currencies, the view is neutral. Some emerging currencies appear undervalued and the mounting negative yielding assets are supportive for the asset class, but the expectation for a global recession due to the coronavirus is reducing emerging currencies appeal.

Euro		USD		Yen		Emerging	
	=		=		−		=