AZIMUT GLOBAL VIEW

15.02.21

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

17.02 – US RETAIL SALES
After three negative readings, US retail sales are expected to rebound thanks to government checks paid in December

19.02 – MARKIT EU
Expectations for another reading below 50, due to lockdowns and slow vaccine rollout

25.02 – ITA SENTIMENT
Three different measures of confidence for Italy will be published. How big will be the Draghi effect?

26.02 – US PERS. INC.
Thanks to the December stimulus bill, the US personal income is expected to rise by about 10%

Almighty Central Bankers

One thing we can be certain of is that the early part of this millennium will be remembered in the history books as the years of central bankers. Thanks to their bold decisions over the past decade, they were the policymakers that effectively steered global economies through the various crisis of the past two decades and have achieved the greatest results.

The results have been so well received that, shortly after they served their terms, they are called upon to fill other public roles of utmost importance. That has been the case for Janet Yellen, the ex-Federal Reserve chairwoman and also Mario Draghi, the ex-ECB president.

Mario Draghi has recently been appointed the President of the Italian government and because of his charismatic leadership and reputation, he has managed to bring together a very heterogeneous cabinet. Owing to his authority and experience with the European institutions, Draghi is certainly the most suitable political personality to successfully carry Italy into the post-covid era and ensure that the country will be able to obtain and use the resources made available by the Recovery Fund in the best possible way.

Since he was appointed to form a government by the Italian Head of State, the Bund-BTP spreads has tightened substantially, and the Italian stock market has outperformed the other equity indices. Considering that Italy has often been perceived as one of Europe's weaker links, Draghi's appointment could lead to a re-rating of Europe as a whole.

In the United States, it was Janet Yellen and the Treasury Department under her helm that was the center of attention, openly endorsing Biden's proposed stimulus plan. Yellen has said that Biden’s $1.9 trillion fiscal measure is absolutely needed for the US economy to return to full employment as early as 2022. In the case of more limited spending, however, the recovery would be much slower, as happened following the great financial crisis.

(continued)

But the most important news of the last two weeks, that have gone largely unnoticed, came from a press release dated February 1, 2021 (source: https://home.treasury.gov/news/press-releases/jy0011) of the US Treasury Department, headed by Yellen, where it is reported that:

1) During the January - March 2021 quarter, Treasury expects to borrow $274 billion in privately-held net marketable debt, assuming an end-of-March cash balance of $800 billion. The borrowing estimate is $853 billion lower than announced in November 2020.

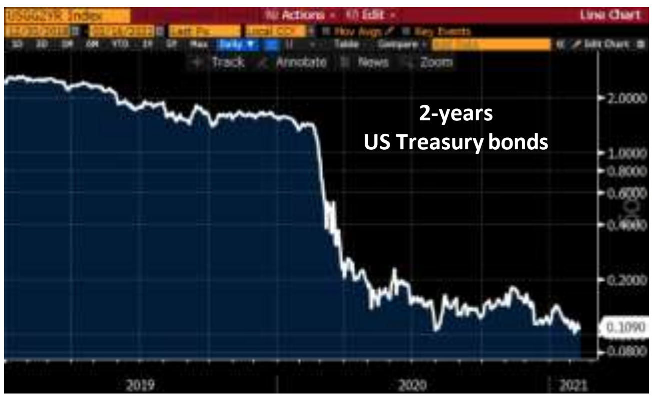
2) During the April - June 2021 quarter, Treasury expects to borrow $95 billion in privately-held net marketable debt, assuming an end-of-June cash balance of $500 billion.

The first thing to take into consideration is that for the current quarter the US Treasury Department will issue 853 billion less debt than previously forecasted ($274 billion vs $1.127 trillion projected last November), and that during the second quarter it will only issue $95 billion of new debt. These numbers are sharply lower than consensus estimates and could ease a lot of pressure on market rates for at least the first half of the year.

This begs the question of how it is possible for the US Treasury Department to issue such a limited amount of debt considering the ballooning Federal deficit. It all depends on the Treasury General Account (hereinafter "TGA"), which is the general checking account that the Department of the Treasury uses and from which the U.S. government makes all of its official payments. Usually, the US Treasury replenishes the TGA by selling short-dated bonds and bills to the banking system. When the TGA balance rises, the US Treasury drains reserves (liquidity) from the banking system; when money is spent and/or the maturing bonds and bills are not rolled over, the TGA balance contracts and the US Treasury provides liquidity (via the reimbursing of the bonds/bills) to the banking system that results in increased cash balance.

The TGA balance increased well above its historical standard during last year crisis, when the US Treasury issued unprecedented amount of debt to fund massive pandemic relief programs. As some of these programs were not fully used, the TGA balance increased to a high of $1.817 trillion, while the latest available figure, dated February 10, is still $1.609 trillion. According to the US Treasury Department projections (point 1 above), the TGA balance should stand at about $800 billion by the end of March, and at about $500 billion by the end of June. If this proves true, the US Treasury will inject approximatively $800 billion of cash into the financial system over the next 6 weeks (just over $500 billion per month), which corresponds to four times the Federal Reserve's QE. In the next quarter, the TGA is expected to decline by another $100 billion per month. However, there is still one consideration to be made. Under the US law, when the debt ceiling suspension expires on August 1st, 2021, the TGA must be at levels not higher than when the debt ceiling suspension was enacted on August 1st, 2019, which was of $118 billion. It is quite reasonable to expect that Democrats, having the majority in both chambers, will be able to rise the US debt ceiling without problems. But, if this is not the case, the TGA has to further drop by $400 billion in July.

Source: Bloomberg



Source: Bloomberg

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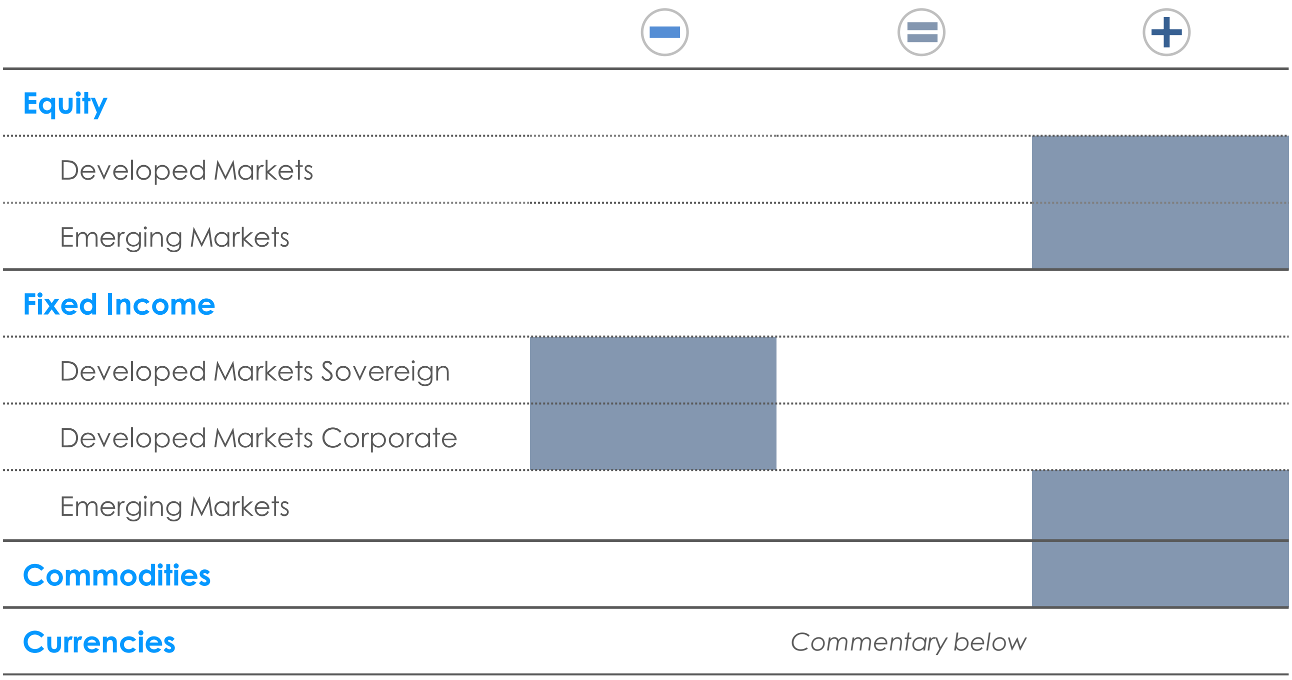
It is reasonable to expect that this liquidity wall, coupled with the lesser issuance of short dated Treasuries will contribute to put downward pressures on short term rates, which reached a new all-time low just after the press release.

The real question is if and how much this liquidity will impact the financial markets since changes in TGA levels mostly affect short dated bills, banking reserve and money market rates. Considering the huge amount of liquidity already injected in the financial system and the extremely bullish sentiment, it is possible that at least part of this additional liquidity might likely result in additional purchases of risky assets (equity and credit) over the next few weeks.

Beginning in summer, when the TGA balance will have returned to normal levels and the US Treasury will again have to resort to the markets in order to finance the fiscal deficit, rates could again come under severe upward pressure, also in consideration of an economy that, by that date, it should be growing substantially thanks to the achievement of herd immunity.

Asset Allocation View



− UNDER = NEUTRAL + OVER

Equity

Developed Markets

We further increased by one notch our positive recommendation on Developed Markets Equities. The reasons behind the move are a very strong reporting season and the expectation of additional liquidity to be injected into the financial markets because of the decrease in the US Treasury General Account balance (*please see the main commentary in the prologue*).
In terms of the regions, we are upgrading Europe thanks to the positive sentiment boosted by the appointment of Mario Draghi as next President of the Italian government.

US	−	**Europe**	+	**Japan**	+

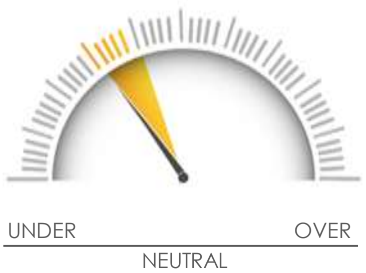
Emerging Markets

We also increased our positive recommendation on Emerging Markets Equities for the same rationale explained above. As Emerging Markets have typically higher beta than the Developed Markets, they should continue to outperform in the short to medium term. In terms of the regions, we continue to prefer Asia versus other Emerging Market regions, notwithstanding the YTD underperformance of the latter vs. the former.

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

Fixed Income

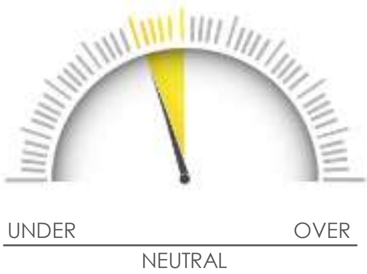
Developed Markets Sovereign



We kept our underweight recommendation for Developed Markets sovereign bonds. The expected decrease in the US Treasury General Account balance over the next few weeks (*please see the main commentary in the prologue*) should impact mostly the short-end of the curves, leaving the long-end vulnerable to further corrections in expectation for higher inflation rates in the second half of 2021. In consideration of the appointment of Mario Draghi as the next President of the Italian government, we have upgraded the recommendation for European Periphery to neutral.

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

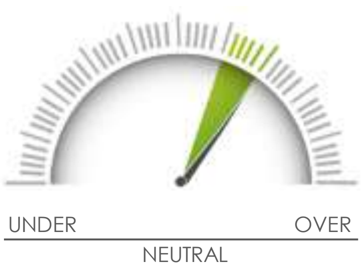
Developed Markets Corporate



We kept our negative recommendation on Developed Markets corporates. There is no value left in most of the investment grade component, where extremely low yields to maturities and long duration make the risk return profile of those bond very unattractive. In consideration of the additional liquidity coming into financial markets and the positive reaction to the appointment of Draghi, we expect 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



We kept our bullish recommendation on the asset class. EM bonds should benefit from the expectation of a vaccine-driven strong global economic recovery. Moreover, the environment of USD18 trillion of negative yielding debt should bode well for EM bonds, especially considering the chase for higher yields. It is projected that EM bonds could benefit both from a spread compression and a recovery in the value of their currencies. Amongst local currency bonds, our preference is towards Chinese Renminbi denominated ones. Only a worldwide spike in inflation and the long term rates could partially change this outlook, as historically rising rates in developed markets have been associated with weakening EM currencies.

Local Currency	Hard Currency IG	Hard Currency HY
+	+	+

Commodities

We maintain our bullish view on the asset class. Precious metals could be sustained by the ample liquidity and could serve as a hedge against the debasement of most currencies after the massive monetary interventions of this year. Energy and industrial metals should benefit not only from the expectation of a quick and prompt recovery as soon as the vaccines are distributed, but also because of the very low inventories.

Precious	Energy	Industrial
+	+	+

Currencies

We maintain our neutral view on the euro, as the positive mood ingenerated by the appointment of Mario Draghi are counterbalanced by a slower than expected rollout of the vaccine.
We lowered our stance on the US Dollar, because of the expectation for lower short term yields in the US curve as argued in the general commentary of this report, and of the huge liquidity injection from the US Treasury Department.
We kept the neutral view on the Japanese Yen as the country may attract foreign investments if the focus on value stocks, which are well represented in the main equity indices, continues in the near future.
On Emerging Markets currencies, we maintain our positive view considering that the ample liquidity and bullish sentiment will continue to sustain the long term positive perspectives for the asset class.

Euro	=	USD	−	Yen	=	Emerging	+