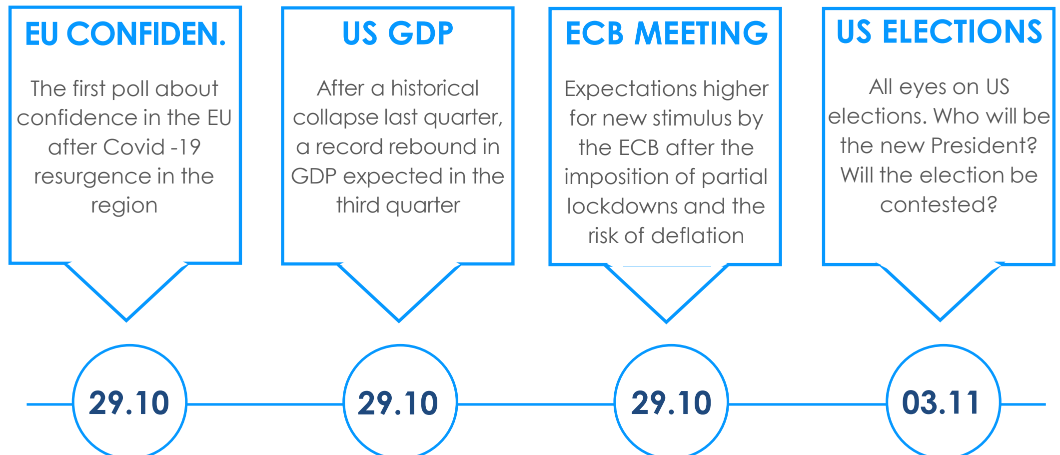
AZIMUT GLOBAL VIEW

26.10.20

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

SUN ABOVE THE CLOUDS?

It's widely known that the financial markets are more often than not in an upward trend. This happens because the primary goal of investing is trying to grow one's fortune over time, and human nature is such that people tend to focus only on positive expectations, disregarding the rest.

Over the past decades, the more and more frequent and increasingly powerful interventions by central banks and governments to support the markets and counter any tentative market correction have made investors increasingly complacent and risk-prone, as they feel that central banks and government will always be able to save the day.

This behavior has become more evident in the past few months when the dichotomy between the economy and financial markets has become quite extreme. Two of the main arguments put forward by the bulls were that a vaccine against the covid-19 would have been found and made widely available to the public by the year-end and a massive new stimulus package would have been approved before the US elections.

The reality is that a proven vaccine has neither been found nor approved, which means that there won't be enough time to be able to produce and distribute it to the general public within anticipated time frame. Instead, what is spiking again is the number of new covid-19 cases all over the world and in particular in Europe where governments are reintroducing some sort of masked lockdowns. This of course will take its toll on European GDP numbers, which are to be revised for the fourth quarter.

if Democrats and Republicans cannot compromise on a new stimulus bill, the country at the greatest risk of a rude awakening will be the United States. To understand why we need to turn our attention to the employment data. The unemployment rate is the most used metric to assess the status of the labor markets in the US. The first graph on the next page shows in white the number of unemployed people and in orange the unemployment rate.

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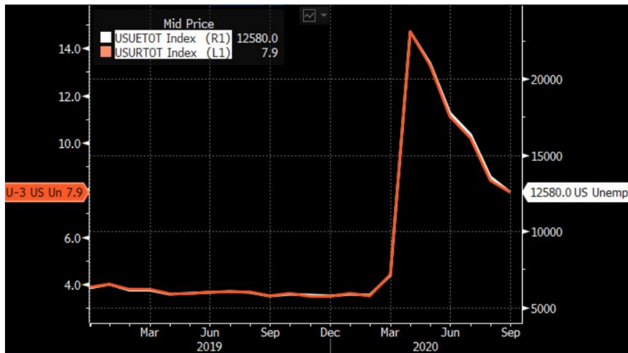
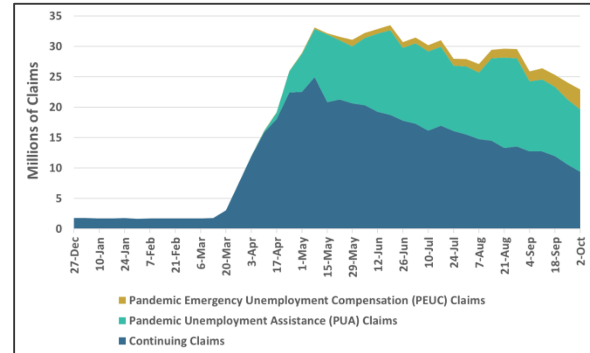


Source: Bloomberg



Source: Azimut Investments S.A., Bloomberg

As expected the two measures are highly correlated - the unemployment rate is calculated by dividing the total number of unemployed people by the total workforce, which is usually quite stable, and was about 158 million before the pandemic. According to the Bureau of Labor Statistic (BLS), the publisher of this data (non-farm payrolls), in September there was "only" about 12.6 million unemployed people in the US. The payrolls data collects information for the first half of the previous month, in this case August 2020.

This is in stark contrast to the data presented by the Department of Labor, that publish the data about the weekly unemployment claims. When someone loses his/her job, they are entitled to receive unemployment insurance benefit. The first claim is recorded as an "initial claim" and afterwards it is recorded as a "continuing claim". A person receives these continuing claims for a certain number of weeks (usually 26 weeks, but it varies by the State) following the job loss. The C.A.R.E.S. Act approved in March to fight the economic fallout of the pandemic, introduced two new programs called Pandemic Unemployment Assistance (PUA) and Pandemic Emergency Unemployment Compensation (PEUC). The former allows those who are not eligible for regular claims to receive unemployment claims anyway and the latter allows for an extension of up to 13 weeks of the regular claims.

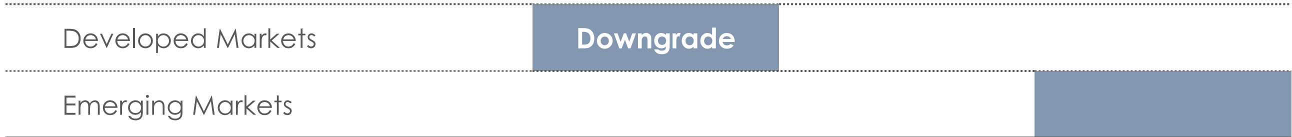
The sum of the unemployment claims cumulatively paid by those three programs reached a peak of nearly 35 million USD in March and recently decreased to less than 25 million USD. The latest available data for all programs is dated as October 2nd and is double the figure provided by the BLS in September and seen in mid-August. Probably people receiving PUA and PEUC benefits are for some reason not considered unemployed by the BLS, an underestimation of the true extent of the labor market slack.

The issue is that the C.A.R.E.S. Act states that PUA and PEUC programs, that are currently paying benefits to 13.5 million people, will both end on December 31st. It should also be considered that before year end portion of those still benefiting from regular unemployment claims will be rolled out of the program as they will have reached the maximum duration of 26 weeks. If the politicians do not approve another stimulus bill that extend (ideally retroactively) these programs, millions of people who lost their jobs will find themselves with no income starting from 2021. This risk materializing will lead to a decrease in aggregate consumptions on top of direct consequences for the economy and financial markets.

It would have been much easier to approve a bi-partisan legislation before the elections, as both parties may have claimed that the approval of the stimulus package was their merit. Once the election is over, it will be much more difficult to find common grounds and bridge the gaps between the priorities and ideological differences of the two parties. A contested election, an outcome that is not off the table, would further complicate the path to reaching an agreement.

Let's hope that a last minute agreement will be done before the elections, otherwise we should prepare ourselves for renewed volatility into the year end.

Asset Allocation View

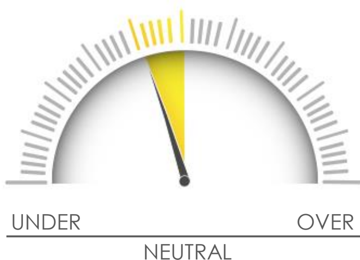


	Under (–)	Neutral (=)	Over (+)
Equity			
Developed Markets	Downgrade		
Emerging Markets			■
Fixed Income			
Developed Markets Sovereign	■		
Developed Markets Corporate		■	
Emerging Markets	■		
Commodities		■	
Alternative Strategies		■	
Currencies		*Commentary below*	

UNDER NEUTRAL OVER

Equity

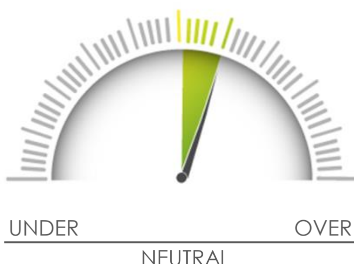
Developed Markets



We lower the recommendation on Developed Markets equity, reversing the upgrade assigned a month ago around the September lows. The markets have since then rebounded, but lately giving back some gains amid growing concerns about the resurgence of covid-19, the lack of progresses on fiscal stimulus in the US, and the uncertainties surrounding the outcome of the US elections. In spite of those developments, valuations remains stretched by historical standards, suggesting that a bit of caution warranted in the short term. We are downgrading Europe as the region is again the epicenter of new covid-19 cases, and local governments are starting to impose partial lockdowns.

US	Europe	Japan
=	–	–

Emerging Markets

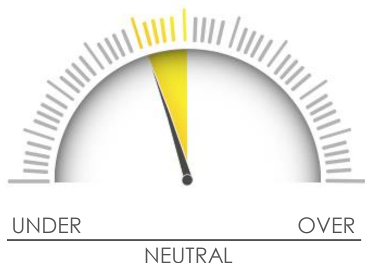


We keep our slightly positive recommendation on Emerging Markets with a strong long term preference for Asia ex-Japan, China in particular. The rationale for our positive stance on Chinese assets has been elaborated in last week's Global View commentary. The only downside risk in the short term is the unexpected reelection of Donald Trump. If that happens, then a correction in Chinese equity markets could unfold, but this should be considered as a very interesting buying opportunity. The view unchanged for the other regions. A weaker dollar, a continued consensus of the Committee, constitutes strength for the EM equities in general.

Asia ex-Japan	EEMEA	LATAM
+	=	=

Fixed Income

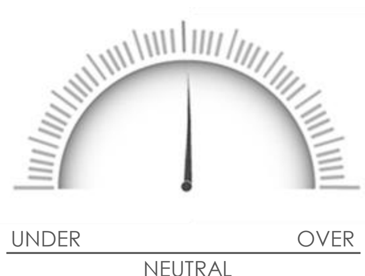
Developed Markets Sovereign



We kept our slightly underweight recommendation for Developed Markets sovereign bonds. We continue to prefer the US Treasury bonds as an hedge against market turbulence. US long term rates moved upward in the recent past on the back of the expectations of blue sweep in elections and the approval of a new round of fiscal stimulus. If those expectations are unmet, it's probable that longer dated US bonds could rally. Within Europe, we continue to maintain the preference for Italian bonds, also in light of the recent decision by S&P to upgrade the outlook for Italian sovereign bonds.

EU Core		EU Periphery		US Treasury		Japanese JGB	

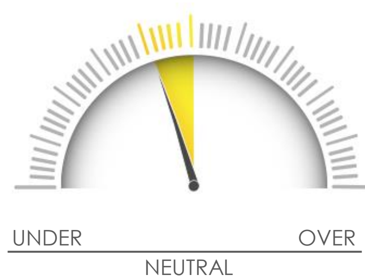
Developed Markets Corporate



We maintained our neutral recommendation on Developed Markets corporate bonds. The QEs implemented by all major central banks on their sovereign and corporate bonds are compressing both risk-free rates and spreads. Monetary policies will remain accommodative for an extended period of time supporting the corporate bonds prices amid the hunt for positive yield. In the corporate bond space our preference remains in the investment grade. The slowdown in the real economy is weakening the fundamentals of some corporates, especially in the high yield space, where we keep the negative stance.

IG Europe		IG US		HY Europe		HY US	

Emerging Markets



We keep our slightly underweight recommendation. Even if Emerging Markets bonds trade at richer yields than Developed Markets bonds, the EM Central Banks are not implementing QEs on their local bonds, and therefore EM bonds are more vulnerable than the corresponding DM bonds. We are keeping a positive stance only on Chinese debt, as the Renminbi is expected to continue to strengthen over time on the back of the increased inclusion in international portfolios.

Local Currency		Hard Currency IG		Hard Currency HY	

Commodities

We maintain our bullish view on the asset class. Among the commodities we mostly prefer gold because of the low yield environment, and as it could serve as a hedge against unexpected turbulence. In particular gold could strengthen in case of a blue sweep as more fiscal and monetary stimulus could be expected. Because of the possibility that the Euro will continue to be quite strong in the short term for the reasons explained in the currency section, for Euro-based investors precious metals could be a less attractive investment solution as any strength in the Euro might detract from the performance.

Precious		Energy		Industrial	

Alternative Strategies

We keep our slightly positive recommendation on liquid alternative strategies, because of the diminished expected returns on other asset classes. This implies that other asset classes now have greater downside risk and could be vulnerable to volatility as well. Therefore alternative/decorrelated strategies are more compelling on a relative basis.

Currencies

We maintained the positive view on the Euro in the short term, despite the expected spike in volatility driven by the current resurgence of the Covid-19 in EU, the Brexit and the US elections.
We kept our negative view on the US dollar due to the uncertainties of the Presidential elections, and whether it will be a contested election and Republicans will keep the Senate. This elements together with the sharp increase of covid-19 in Europe should lead to bout of volatility.
We maintain our slightly negative view on the Japanese yen as there are no positive catalysts in sight for the currency.
On Emerging Markets currencies, we maintain our cautious view with the exception of the Renminbi that is expected to remain relatively strong against other EM currencies.

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