AZIMUT
DEFINING INVESTMENT DIRECTION

# AZIMUT GLOBAL VIEW

13.09.21

## Main Events

**Azimut Global Network**

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

**CHINESE DATA** — 15.09
Retail sales, industrial production and fixed assets investments are all due today. Will they show a larger slowdown than the one already priced-in?

**US RETAIL SALES** — 16.09
Did US consumers already begin to reduce their spending in August, given the upcoming expiry of the extraordinary unemployment benefits?

**FOMC MEETING** — 22.09
Will the Fed finally announce the details of the tapering? How will the markets react?

**GERMAN IFO** — 25.09
Another drop after two consecutive declines would be a worrying sign that the recovery is faltering in Germany ahead of the general elections

# LONG LIVE THE SPREAD

- **Good balance sheets and credit quality together with profitable and sound businesses explain the current level of spreads, which are priced for perfection**
- **Global defaults rates are at much lower levels compared to the past**
- **We are probably close to the peak of total liquidity: a gradual reduction, together with sustained GDP growth and inflation, overtime should translate into higher nominal yields**

Liquidity is the one single world to explain what is going on in the markets. Too much liquidity enriching valuations of every asset class is the one thing all could think about. Lot of criticism is circulating around this "abundance of liquidity" – they call it "bubble" – but one subject will surely never complain about it: the corporate space.

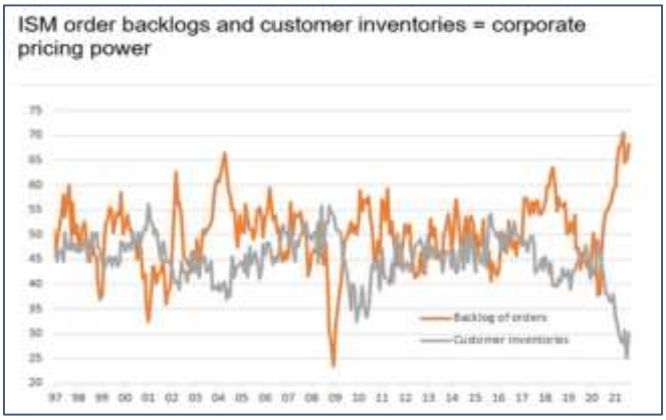
Credit issuers have been enjoying years of easy financial conditions, which through credit availability, decreasing yields and spreads helped them manage their indebtedness and streamline their balance sheets. At the same time, given the persistent uncertainty driven by the sequence of crisis in the aftermath of the global financial one, they have continuously underinvested, further increasing their liquidity pile.

This is going to change; there is a new capex cycle in front of us linked to both the need to compete in an ever-changing world and also the need to be as ESG-friendly as possible. But at the end of the day, no one should care much about this deployment of liquidity.

The balance sheets have been extremely healthy, and as if it weren't enough, corporates are now experiencing one of the most attractive macro situations ever, especially in old economy sectors tied to manufacturing: an increasing surge in orders when inventories are running low. This calls for an increase in pricing power and profits, which will be deployed to further expand operations.

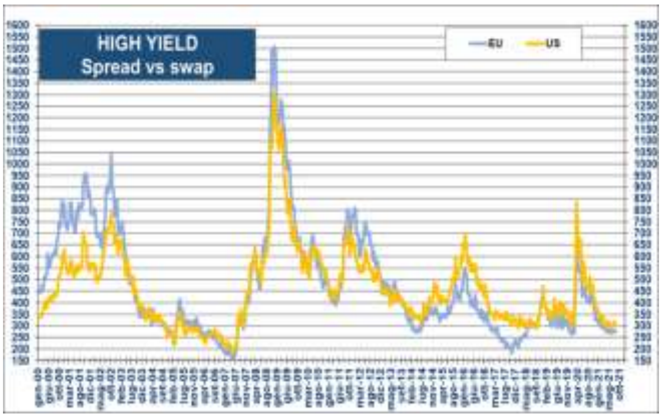
# (continued)


*Source: Datastream, Barclays Research*

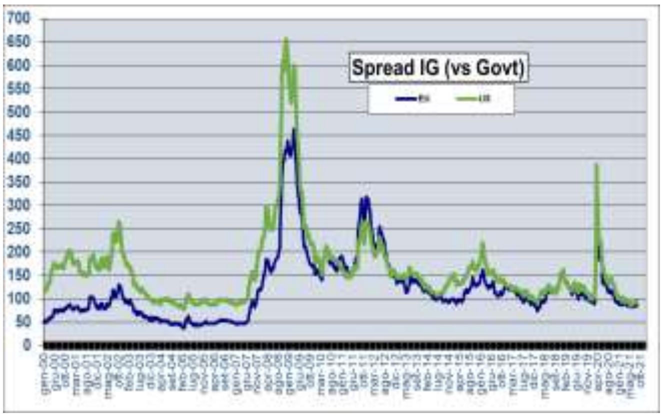



*Source: Macrobond, ING*

Good balance sheets and credit quality, together with profitable and sound businesses make it easy to explain the current status of credit spreads, which are priced for perfection, even in the High Yield space. This perfection has attracted a lot of buyers in the last few years, the so-called "tourists" in the credit space; those investors who were previously engaged in other asset classes looking for value/yield/returns in corporate bonds.

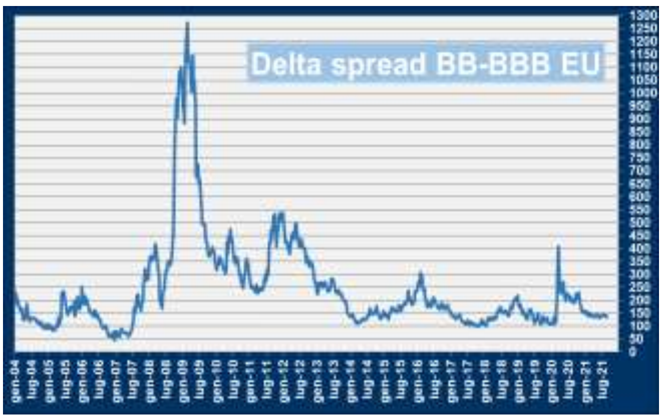



*Source: Bloomberg, ICE BofA, Azimut elaborations*

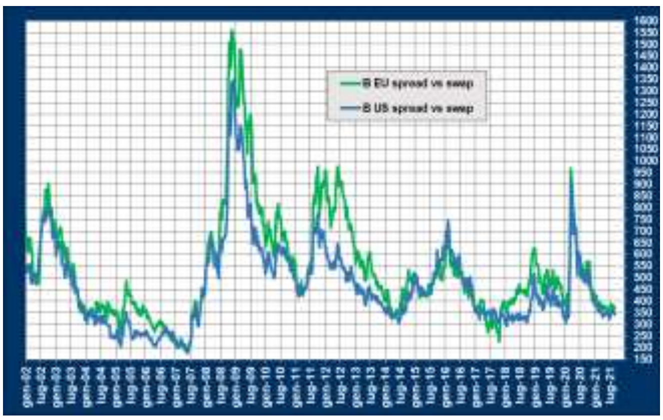



*Source: Bloomberg, ICE BofA, Azimut elaborations*

The proof of this comfort in buying credit is also evident when looking at the premium required to go lower in quality, from the BBB rating to the BB. Clearly, the High Yield space has become more mainstream with very little concern placed over going down in credit quality. The pure HY space for specialists, such as the B rating category, remains an environment definitely demanding in terms of valuations, but still with a decent margin compared to the levels seen before the global financial crisis.



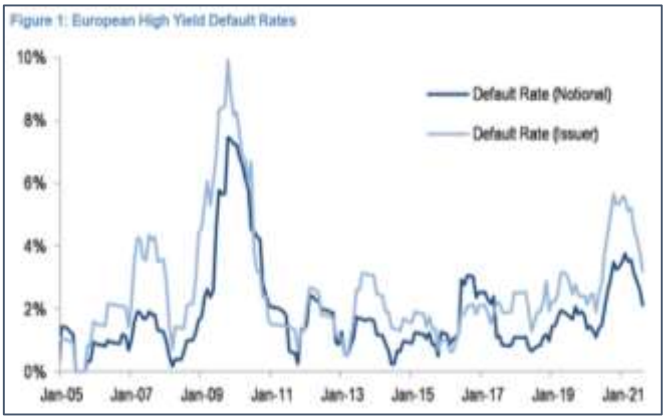

*Source: Bloomberg, ICE BofA, Azimut elaborations*



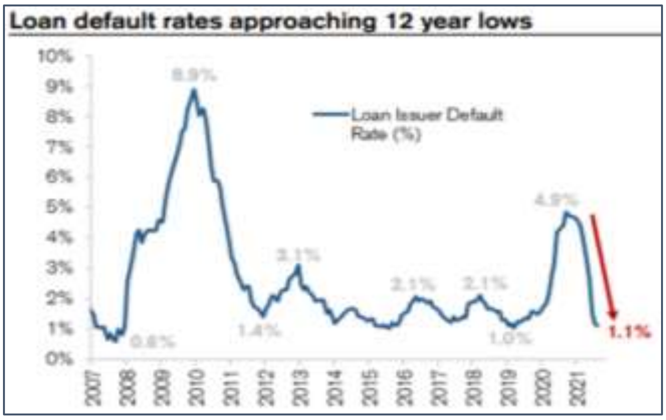

*Source: Bloomberg, ICE BofA, Azimut elaborations*

# (continued)

Even looking at the behavior of default rates in the last 12 months, in the context of the worst recession experienced in recent history, the ability of issuers to manage the crisis is astonishing. Liquidity, once again, has been the key to keep global defaults at much lower levels compared to the past.

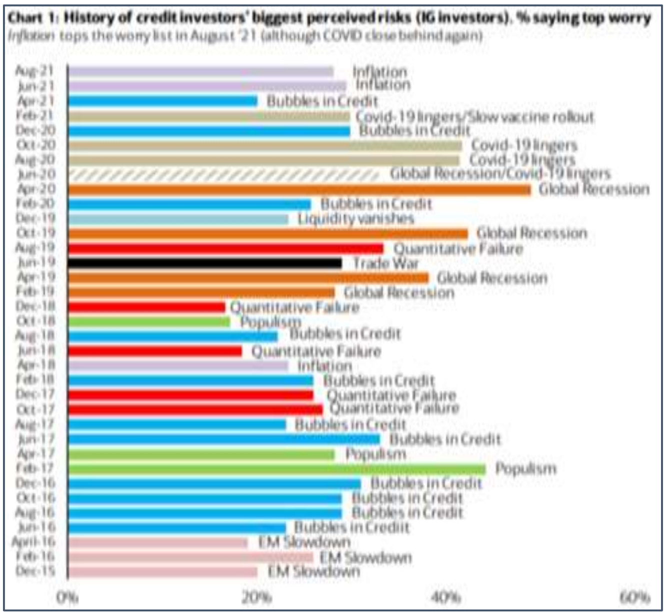



Source: J.P. Morgan




Source: Credit Suisse

What can change this idyllic situation? Probably the same asset class that has brought us to the current levels of extreme low yields: government bonds. Inflation is the major threat to markets, as per recent surveys, and the confirmation that it is temporary, as indicated by central banks, but will always be around their targets – as seems to be the case – would be the factor moving yield curves higher going forward.

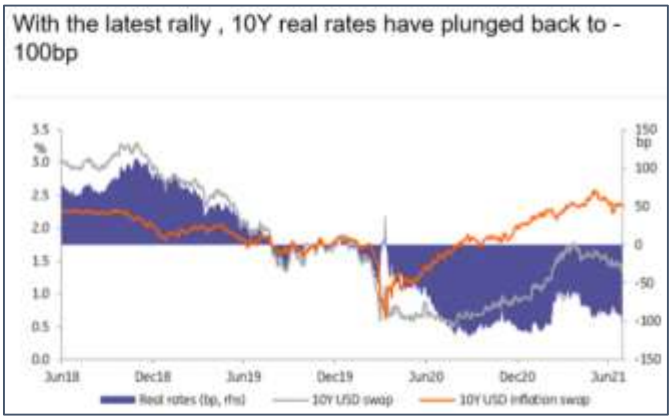



Source: BofA Global Research, IG investors only, % of investors

We are probably close to the peak of total liquidity in the markets: central banks will start pouring less and in a few years will start draining it, issuers are starting using it, and with the full deployment of vaccines and the hopeful end of the pandemic, the economies will completely reopen letting consumers start spending their savings.

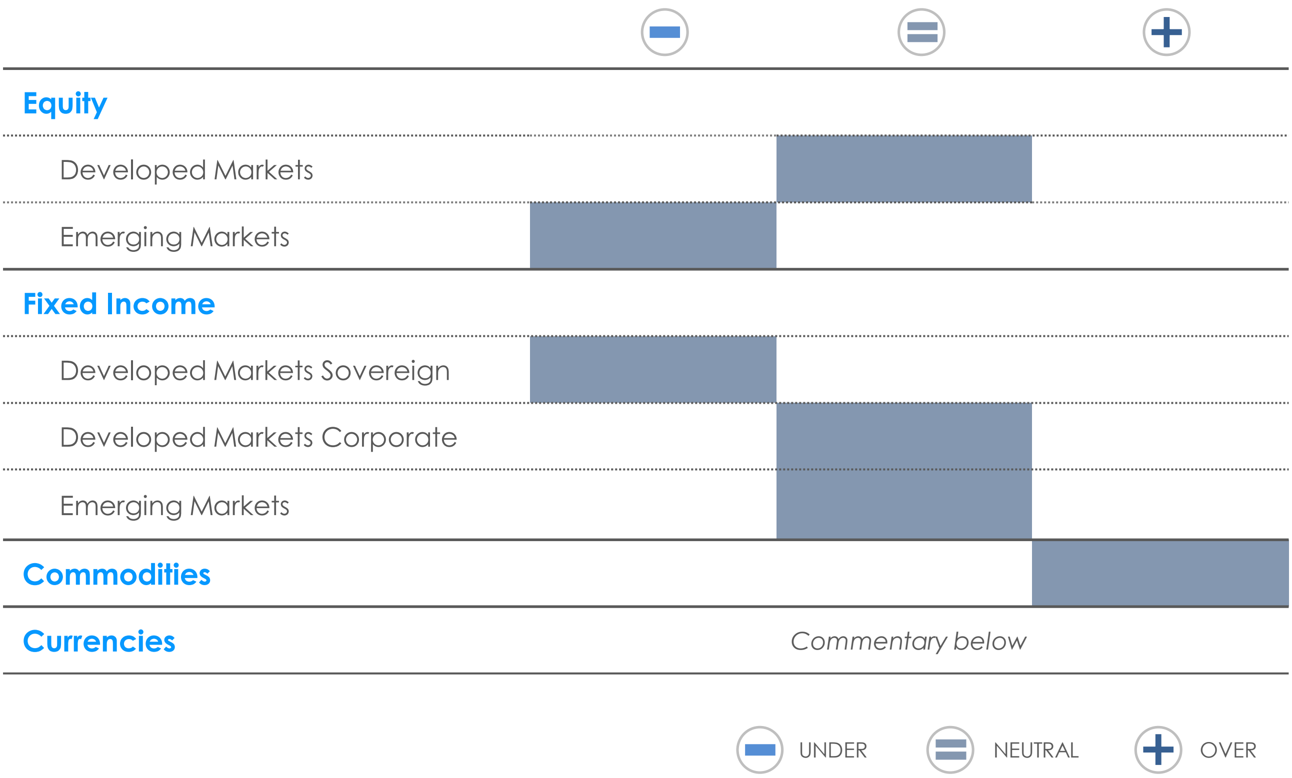
This means the growth forces, together with inflation, will be at full speed. Overtime this should translate into higher nominal yields as well. When the normal macro dynamics start functioning again, without distortions from QEs or excess liquidity, they will probably not require such negative real yields anymore.


Source: Bloomberg, ICE BofA, Azimut elaborations



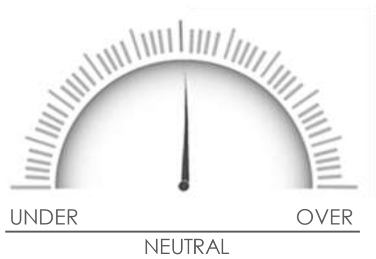

Source: Refinitiv, ING

# Asset Allocation View




# Equity

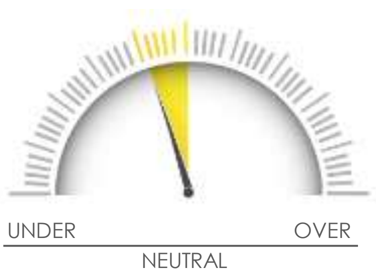
## Developed Markets




We kept our **Neutral** recommendation on Developed Markets Equities. On one hand, valuations continue to be elevated from an historical point of view, the main indices are in overbought territory, and the expiry of the extraordinary unemployment benefits in the US last week may weigh on the future consumption. On the other hand, liquidity is abundant and the major central banks do not appear to be in a hurry to reduce the monetary support to the economy and financial markets. Within equities, there is no clear preference for any particular style, while there is a clear preference for European stocks.

| | | | | | |
|---|---|---|---|---|---|
| **US** | = | **Europe** | + | **Japan** | = |

## Emerging Markets

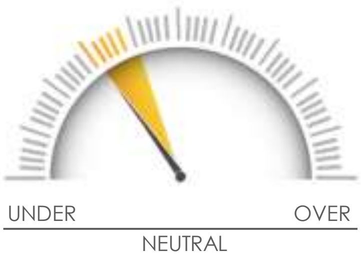



We maintained our recommendation on Emerging Markets Equities as **Slightly Underweight**. Even if the discount versus Developed Markets is substantial, recent developments in some of the major countries suggest that investors may continue to cautiously stay away from Emerging Countries for some time. In China the government is continuing to intervene in the market, either targeting new companies (this week they announced the intention to break up Ant Group's Alipay) or not preventing large corporations to default (Evergrande). In Brazil, there was an unexpected escalation of the political tensions in view of the general election of 2022.

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

# Fixed Income

## Developed Markets Sovereign




We maintained our overall **Underweight** recommendation on Developed Markets Sovereign Bonds. Over the medium term, we still expect to see higher rates due the tapering by the Fed (which could be announced as early as the next FOMC meeting), a not-so-transitory inflation and more contained fallouts from the delta variant. Within sovereign bonds, we currently have no particular preferences in terms of the regions/curves. After the last ECB meeting where no tapering of the PEPP purchases has been announced, European rates may remain stable at the current levels for some time.

| EU Core | = | EU Periphery | = | US Treasury | = | Japanese JGB | = |
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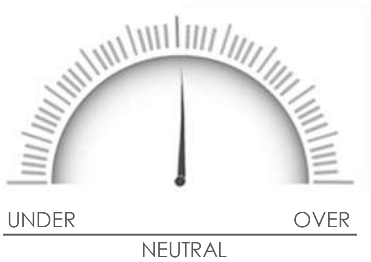
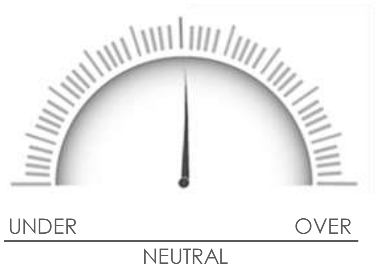
## Developed Markets Corporate




We maintained our **Neutral** recommendation on Developed Markets Corporates. As argued in the prologue of this report, credit spreads are quite compressed from an historical point of view, but ample liquidity, solid balance sheets, low default rates and expectations for a continuation of the recovery/reopening of the economies should prevent spreads for widening in the foreseeable future. As the normalization in risk-free rates is expected to happen in the coming months, we continue to prefer bonds on the short-end of the curve with acceptable ratings, or normal/long duration bond with some duration hedges. Among funds, we continue to recommend those with flexible mandates.

| IG Europe | = | IG US | = | HY Europe | = | HY US | = |
|---|---|---|---|---|---|---|---|

## Emerging Markets




We kept our recommendation as **Neutral**. Emerging Markets Bonds spreads have compressed less than the developed market bonds with similar risk. Considering the reduction in the long end of the US rates, the ample liquidity, the hunt for yield and the fact that the Fed will wait some time before rising rates, Emerging Market bonds could still be attractive even considering the possibility of a slower reopening due to the delta variant. For the EM Hard Currencies, we have a preference for low duration strategies.

| Local Currency | = | Hard Currency IG | = | Hard Currency HY | = |
|---|---|---|---|---|---|

# Commodities


We maintained our **Positive** view on the asset class. We continue to be positive in particular on precious metals as they should benefit from lower risk-free rates and rising inflation, and also as they could serve as an hedge in case of increased risk aversion. Additionally, we have turned more bullish on energy and industrial metals due to the strength of the demand, supply constraints and shipping bottlenecks.

| Precious | + | Energy | + | Industrial | + | Agricultural | = |
|---|---|---|---|---|---|---|---|

# Currencies

On the US dollar, the Committee still maintains a neutral stance. In the short term, we expect the US Dollar to remain rangebound after Powell did not surprise the markets in Jackson Hole. In the medium term, huge fiscal deficits and increasingly negative real rates suggest a weaker Dollar is possible.

The view on the Euro is also neutral in the short term due to the spread of the delta variant. In the medium term, a more favorable real rate differential against the USD and the positive impacts on GDP of the Recovery Fund-related fiscal spending may lead to a stronger Euro.

The Yen is no longer serving as an hedge during times of risk aversion, as it has been trading around 107 +/-5 USD for about three years.

Emerging Market currencies are also expected to remain fairly stable, as the risk of a slower global growth is offset by low US risk-free rates and a still dovish Fed.

| Euro | = | USD | = | Yen | = | Emerging | = |
|---|---|---|---|---|---|---|---|