AZIMUT
DEFINING INVESTMENT DIRECTION

AZIMUT GLOBAL VIEW

27.10.21

Main Events

ECB
The ECB is the one expected to maintain a more accommodative stance than the other major central banks
28.10

US GDP
The third quarter GDP is expected to slow down to 2.7%, with personal consumptions barely positive (+0.8%) and deflator down to 5.3%
28.10

FED
Powell is expected to announce the start date of the tapering. No change in the long term guidance, nor in the transience of inflation is expected
03.11

BoE
Will the BoE effectively deliver its first policy rate increase in response to rising inflation?
04.11

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

GREEN AMBITIONS AND OPPORTUNITIES

- **UN COP26 is expected set more ambitious targets for world governments to achieve the goal of Net Zero Emission by 2050**
- **The energy transition, core to the Net Zero Emission goal, requires enormous investments, which will translate into financial opportunities**
- **ESG-integrated funds continue to gather assets at a growing pace. Valuations of ESG leaders are slightly above the average, but this is justified by the continued flow of investments**

Starting from October 31st all eyes will be on Glasgow for **the 26th United Nation's** conference on climate change, the **Conference of the Parties or "COP26"**, which is expected to deliver the new landmark agreement among world governments to tackle the climate change risks. **This follows 2015 Paris Agreement** in which leaders from 195 countries first reached an agreement to limit global warming to well below 2°, preferably to 1.5° Celsius, compared to pre-industrial levels, and to achieve a carbon neutral world by 2050.

The upcoming UN Climate Change conference in November **has four formal objectives** (source: https://ukcop26.org/cop26-goals/):

- Secure global net zero emission by mid-century and keep 1.5° within reach, accelerating the phase-out of coal, advancing the switch to electric vehicles and encouraging investment in renewables
- Adapt to protect communities and natural habitats, protecting and restoring ecosystems
- Raise at least $100bn in climate finance per year, unleashing the trillions in private and public sector finance required to secure global net zero
- Work together to determine exactly how Paris Agreement targets will be implemented, accelerating collaboration between governments, business and civil society.

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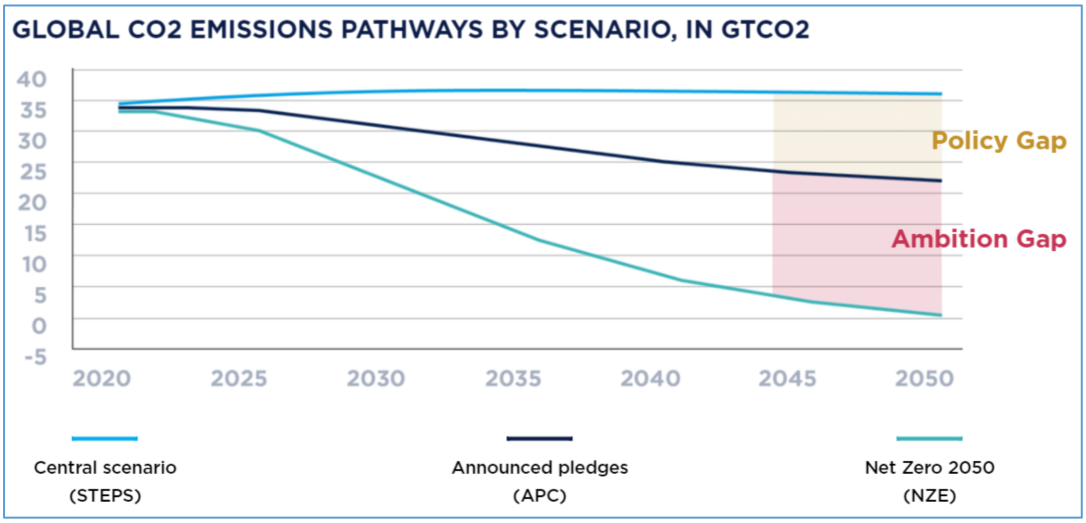
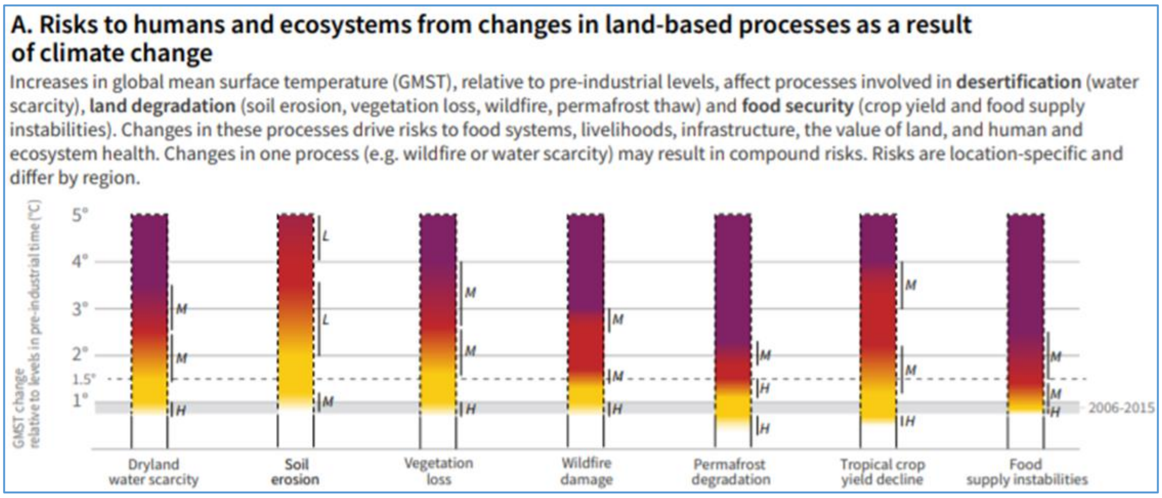
Nationally determined contributions (NDCs) are the heart of the Paris agreement (source: https://unfccc.int/process-and-meetings/the-paris-agreement/nationally-determined-contributions-ndcs/nationally-determined-contributions-ndcs). They **capture voluntary efforts by each country to reduce national emissions** and adapt to the impacts of climate change. While commitments vary, they tend to fall in the 35–40% range of reduction of GHG emissions relative to 2005, by 2050. Sadly, many countries are not on track to achieving their targets, with existing NDCs estimated to be aligned with a dangerous trajectory of around 3°.

As shown in the graph below, although several governments worldwide have already committed to the net-zero objective, the gap between the stated pledges and those required by Net Zero is still substantial.



Source: International Energy Agency (IEA), Amundi

As illustrated by the Intergovernmental Panel on Climate Change (IPCC) Special Report on Climate Change and Land (https://www.ipcc.ch/site/assets/uploads/sites/4/2020/02/SPM_Updated-Jan20.pdf), **limiting the temperature rise to 1.5° above pre-industrial averages would allow to minimize land degradation and to ensure food security** with high confidence ("H", in the chart below). Should global temperatures rise above that threshold, there would be a much lower confidence ("L") on the ability to preserve soil and secure adequate food supply.



Source: Intergovernmental Panel on Climate Change (IPCC)

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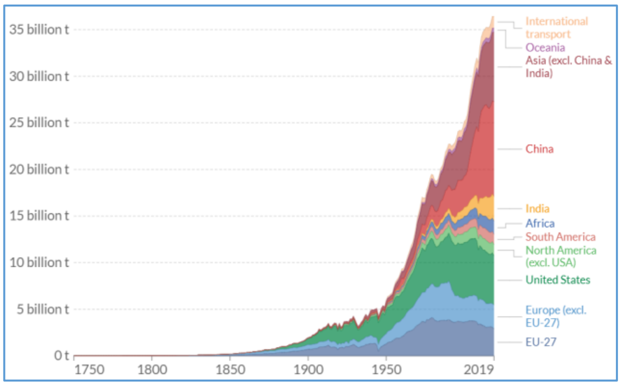
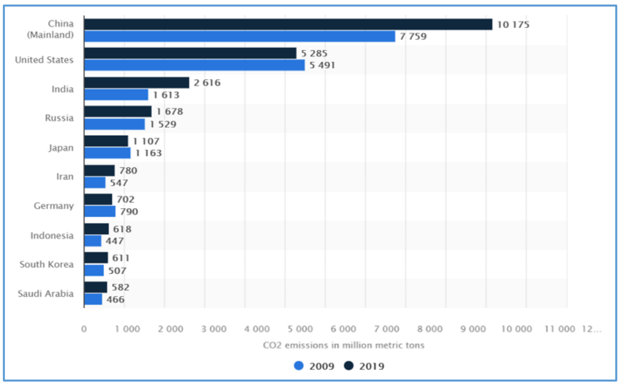
In terms of countries, **the biggest emitters of carbon dioxide (CO2)** in the world are, as shown below, **China and USA**. Efforts to contain emissions in the USA have been achieved during last ten years, while China's emission has increased significantly mainly driven by its "developing nation" status. Plans to reduce emissions have been announced by President Xi Jinping, trying to achieve carbon neutrality by 2060. The Chinese CO2 emissions would peak before 2030, and China would no longer finance coal-fired power projects abroad. The country, however, is still far from achieving its domestic pledges.



Source: *Global Carbon Budget, Global Carbon Project (2020)*

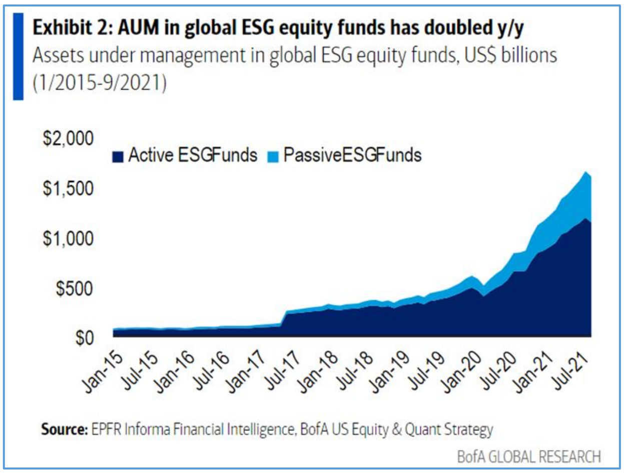


Source: *Statista.com*

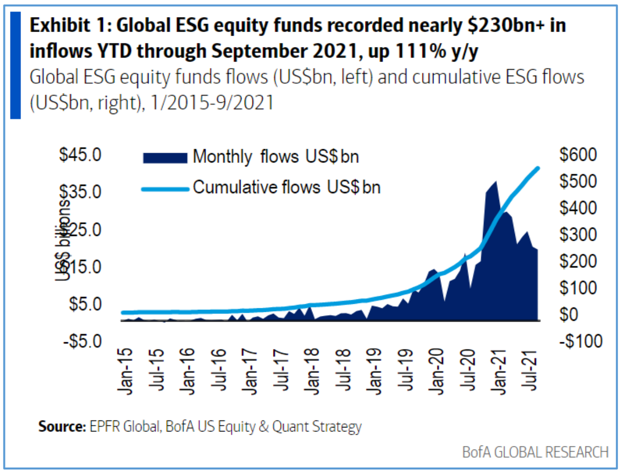
How to reach net zero? As fossil fuel combustion is by far the biggest source (about three quarters) of GHG emission, an **energy transition towards greener and renewable source of energy** is essential to achieve the net zero goals. This transition **will require enormous investments**. Estimates on this subject vary significantly, spacing from the "trillions" referred to by COP26 goals to "**$150tn over 30 years**" as estimated by Bank of America Global Research in its report ""Transwarming" World: Net Zero Primer". Also according to this BofA report, "boosting funding sources to $5tn a year is equivalent to the entire US tax base, or 3x the COVID-19 stimulus this decade".

The COP26 agreement and outcome would therefore not only help progressing towards a more sustainable world, but due to the enormous amount of investments that it requires, it will also impact future market trends and potentially reshaping the perspective for many companies and sectors.

Irrespective of the effective commitments reached by the COP26, **investors have already fully embraced** this push for a more sustainable world. **Funds integrating ESG** into their investment processes benefited from massive inflows recently. According to data from EPFR, at the end of last quarter the total assets managed by such funds have **reached to $1.6 trillion, while YTD inflows are exceeding $230 billion**, more than double the amount of last year.



Source: *EPFR, BofA Global Research*



Source: *EPFR, BofA Global Research*

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The massive flow of funds into ESG equity funds has resulted in **a small valuation premium for companies with superior ESG characteristics.** We thus compare two similar equity indices. They are both global, developed,and diversified on a sector basis with a large-cap tilt.

The MSCI World in the traditional benchmark for global developed companies. The MSCI World ESG Leaders is the global equity developed index that provides exposure to companies with high ESG metrics relative to their sector peers. While the MSCI World is comprised of 1561 companies, the MSCI World ESG Leaders is comprised of 725 companies. Country and sector weights are nearly identical.

As we can see below, since 2021 a valuation premium has built up. **The MSCI World ESG Leader is trading at 7% premium on a forward 12M P/E basis**, partly justified by higher visibility and less foreseen risks embedded in ESG leaders' companies, partly justified by positive and continues flows of investments.

Source: Bloomberg

Asset Allocation View

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

− UNDER = NEUTRAL + OVER

Equity

Developed Markets

We kept our **Slightly Underweight** recommendation on Developed Markets Equities. The major central banks will hold their meetings over the next ten days, but no surprises or change in the long term guidance are expected. The end of fiscal and monetary stimuli, the spike in the energy and commodities prices, and valuation near historical highs suggest that a cautious approach is warranted in the short term, even if macro and micro data continue to be supportive. In terms of regions, we do no longer have preferences, as the surge in energy prices could affect Europe more than the US. In terms of sectors, those that benefit from higher commodity prices (energy and material) or interest rates (banks) could outperform, as well as those sectors (like technology) whose costs are not, or only marginally, affected by higher input prices.

US	=	**Europe**	=	**Japan**	=

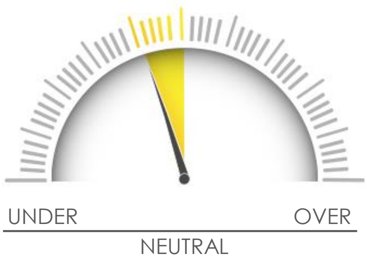
Emerging Markets

We maintained our **Slightly Underweight** recommendation on Emerging Markets Equities. After the strong underperformance (-40%) against the S&P500 since February, the selling pressure on China seems to abate gradually in line with the diminished interventions of the Chinese Government. To the contrary, other Emerging Markets like Brazil and Turkey have experienced higher volatility due to increased domestic political uncertainties. Considering that the major central banks of developed markets are expected to formalize the widely anticipated reduction of their monetary stimuli, caution is still warranted as this is usually associated with weak emerging markets performances.

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

Fixed Income

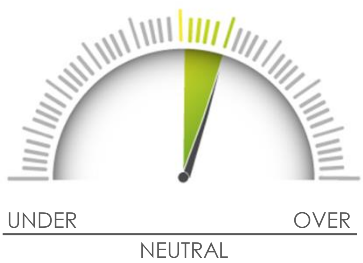
Developed Markets Sovereign



We maintained our **Slightly Underweight** recommendation on Developed Markets Sovereign Bonds. The Fed, the ECB and the BoE will all meet over the next tend days. All have clearly sent to the market precise indication about the decision that will be taken in these meetings, therefore rates should not move significantly unless there are changes in the forward guidance, which is not expected either. On inflation, both the Fed and the ECB are expected to maintain their view that this spike is transitory. In terms of curve, after the recent weakness we have turned more bullish on Italian BTPs.

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

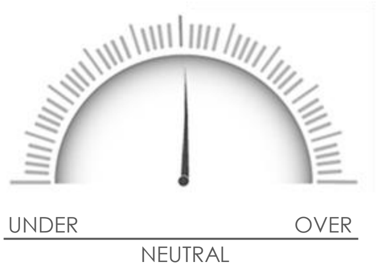
Developed Markets Corporate



We left our recommendation on Developed Markets Corporates unchanged to **Slightly Positive**. A less accommodative monetary policy by the major central banks may trigger a correction in risky assets and increase the attractiveness of less volatile assets. Solid balance sheets, low default rates and expectations for a continuation of the recovery/reopening of the economies should prevent spreads from widening significantly, even in a moderate risk-off scenario. Therefore, funds actively managing duration and credit risks could prove to be an interesting investment solution. Within corporate bonds, we are still cautious on high yield bonds.

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

Emerging Markets



We kept our recommendation as **Neutral**. Emerging Markets bond spreads widened in response to the Evergrande crisis, with low grade corporate bonds suffering the most. Some of the hardest hit bonds now trade at a very wide spread, even assuming a stressed scenario. Some portfolio managers profited of the weakness to build limited positions in their portfolios. More in general, EM bonds continue to look attractive on a relative basis, and they can still count on the ample liquidity and the hunt for yield. Assuming no surprise from the Fed, EBC and BoE, the view on the asset class is therefore balanced.

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

Commodities

We maintained our **Positive** view on the asset class. We continue to be positive precious metals specifically as they should benefit from very low real rates and rising inflation, and also they could serve as an hedge in case of increased risk aversion. Additionally, we maintain our bullish stance 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. The announcement of the tapering may be balanced by worries about the debt ceiling and the potential approval of the infrastructure bill.

The view on the Euro is also neutral. The reduced risks related to the spread of the delta variant is balanced by a more favorable real rate differential against the USD and by the spike of the energy prices.

On the Chinese Renminbi the view is slightly negative. The increased risk aversion on the Chinese assets due to the ongoing financial crackdown may continue to keep investors away. Additionally, the central bank may turn more dovish and inject liquidity in the system in order to avoid a slowdown.

The other Emerging Market currencies are expected to remain fairly stable, assuming that US risk-free rates won't increase materially above the current levels. Some central banks are either starting or continuing to raise rates, which could help support their currencies, or slowing down their depreciation.

Euro	=	**USD**	=	**CNY**	−	**Other EM**	=