Main Events

GERMAN IFO	US SPENDING	EU CPI	US PAYROLLS
Important indicator to monitor whether the latest spike in new Covid-19 cases impacted the sentiment of German corporations	US personal spending is expected to confirm the strength of the US consumers entering the holiday season	Eurozone inflation should reach its peak in November reading	Another strong month of hiring may put added pressure on FED to accelerate the pace of the tapering
24.11	24.11	30.11	03.12

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

TIGHT RIGHT

- **The reappointment of Mr. Powell as Fed Chairman should ensure continuity in the way the monetary policy is implemented**
- **The continuing surge in inflation is casting growing doubts about its supposedly transitory nature**
- **The strength in consumption and very loose financial conditions also suggest that more stringent monetary policy may have to be considered**

After a much longer than expected wait, the puzzle of who will hold the position of Fed chairman for the next four years is finally solved today. In the end, Mr. Powell has been reappointed to Fed's leadership role, ensuring consistency in the way the US central bank will manage the monetary policy amid the threats posed by the fallout of the pandemic and rising inflation.

Biden's pick was probably also driven by the desire to avoid a tough Senate confirmation battle, which could have happened should a more progressive candidate be nominated. Powell's confirmation will likely be ratified with ample majority by the Senate over the next few days.

In order to meet the demands of progressives as well, however, President Biden also elevated Mrs. Brainard to the post of Vice Chair, the second highest ranked role in Fed, replacing Mr. Richard Clarida. Mrs. Brainard was previously expected to be appointed as vice chair for the bank's supervision, a key role to shape financial regulation which will remain vacant for the time being.

Powell's confirmation comes at a tricky time for the Fed, which is between a rock and a hard place; on one hand, inflation continues to rise at even higher rates and affects an increasing number of goods and services, on the other hand, the fears of an economic slowdown following the waning of monetary and fiscal stimuli are mounting.

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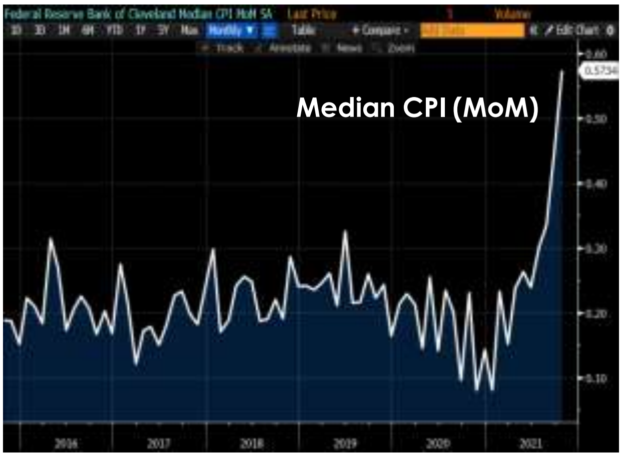


Source: Bloomberg

Source: Bloomberg

As shown in the graph above, the median CPI has grown to 0,57% month over month, that corresponds to an annualized rate of about 7%. The median is the "middle" of a sorted list of numbers or, put otherwise, the value separating the higher half from the lower half of a data sample. A median rate of inflation of 7% annualized means that half of the items in the CPI basket are experiencing price increases of 7% or higher.

One of the key arguments underpinning the narrative of the transitory inflation was that the inflation was confined to a limited number of items which were experiencing large increase in prices, for example airline tickets and used cars prices. When the CPI rate is 7% or higher for half of the items, it is no longer possible to talk about contained (in terms of number of goods affected) inflation.

If we look at the headline CPI number, it reached 6.2% in October. It is worth noting that the house inflation represents about one quarter of the headline CPI basket, but measured only indirectly. It is not the actual increase in home prices (as measured for example by the S&P CoreLogic Case-Shiller 20-City Composite, up 19.7% YoY) that is taken in consideration, but the so-called “owner equivalent rent” or “OER” which is the hypothetical amount homeowners could get for their house if they rented it out. The latest reading for the OER is only 3.1%, half of the rate of headline inflation and less than one sixth of the increase of the home values.

But if the overall CPI increases by 6.2% on average and one quarter of it increases only by 3.1%, it means that the remaining three quarters increase by 7,2% on average (6.2% = 3.1% x 25% + 7.2% x 75%). It is expected that the OER will continue to increase in the near future, further pushing up the CPI number.

Whether you look at the average or median rate of inflation, the evidence proposed seems to suggest that the notion of the transience of inflation is less and less defensible to the point that various economists began critizing the FED with respect to its ability to fulfill one of its two explicit mandates, namely price stability.

Mohamed El-Erian, chief economic adviser of Allianz SE, one of the most vocal critiques of Fed who has also drawn media attention when he called the current attitude of the Fed towards inflation as “one of the worst inflation call in decades”. And he was not alone. Bill Dudley, former New York Fed President suggested that the Fed should accelerate the taper; Lawrence Summers, former US Treasury secretary said that “the Fed should signal that the primary risk is overheating and accelerate tapering of its asset purchases” and that “given the house-price boom, mortgage-related purchases should stop immediately”; Jeffrey Lacker, former Richmond Fed President, said that the Fed “is on track to a major policy blunder” and “they need to pivot, recalibrate pretty rapidly. They need to accelerate the taper, get the rate increases started earlier next year, in the first half, and they’re going to need some good luck”

(continued)

Another goal of the Fed, besides price stability, is to foster full employment and stable growth. Many of the assumptions of an upcoming economic slowdown are based on rapidly shrinking savings, which are approaching the long-term trend after surpassing the normal levels thanks to the fiscal stimuli of the past two years.

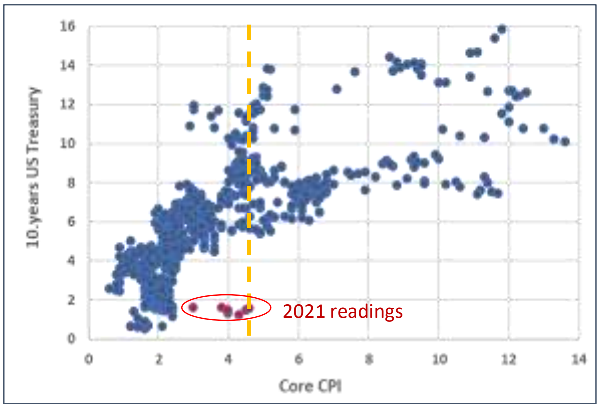
Source: Bloomberg

Source: Bloomberg

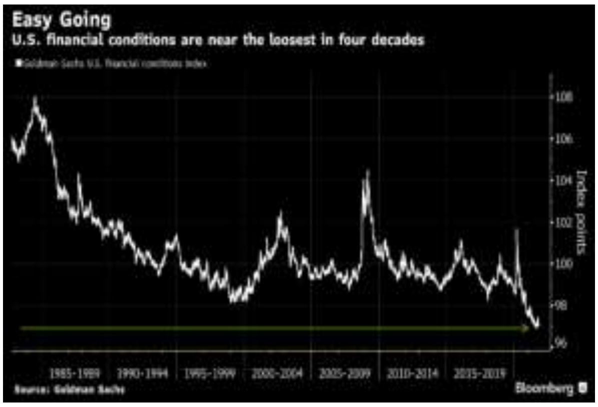
What is probably underestimated is the boost to consumptions due to the returns on investments made by retail traders on financial markets, funded by the unemployment subsidies. Many of the preferred investments of retailers have boomed in price, leading to large capital gains. These capital gains are not recorded as savings. Looking at savings solely could lead to a substantial underestimation of how much money is still available for future consumption. The graph above on the right clearly shows that retail sales have been growing at a much higher rate than pre-2020, despite the contraction in personal savings.

If financial markets continue to be strong, we can expect that the global economy to continue growing at a sustained pace helped by the capital gains fueled consumption. This is not the base assumption of major central banks. On one hand, this scenario could mean further gains in global stock markets. On the other hand, this could lead to economic overheating, which in turn will add to the inflationary pressures.

In light of all of the above, the current financial repression seems no longer justifiable. US 10 year Treasury rates remained flat around 1.5% in spite of an ever-growing core inflation, that currently stands at 4.6%. When core inflation was at this level, 10-year nominal rates were always at 5.5% or higher. Similarly, financial conditions are at the loosest level ever, notwithstanding the sustained growth and inflation.



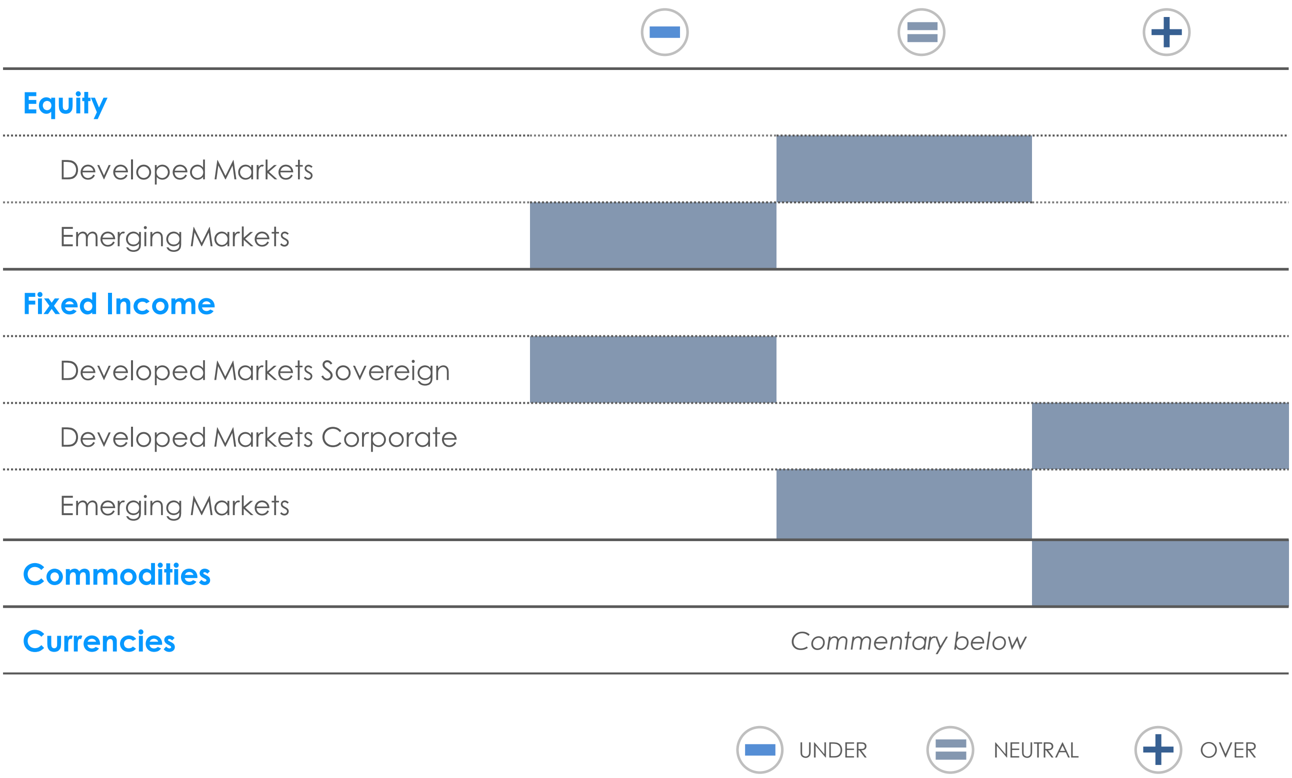
Source: Bloomberg, Azimut elaborations



Source: Bloomberg, Goldman Sachs

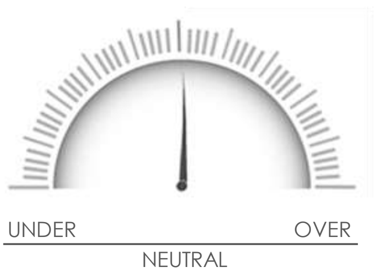
Recently, some members of the Fed have opened the door to a faster-than-anticipated tapering. Arguably, all these evidence and the risk of a hightened political pressure acting against soaring inflation are convincing the Fed to reconsider its pace of tightening.

Asset Allocation View



Equity

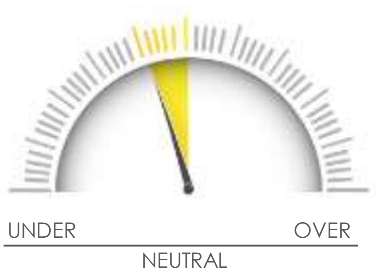
Developed Markets



We maintained our **Neutral** recommendation on Developed Markets Equities. Equities continue to benefit from the strength of consumer spending and deeply negative real interest rates, as argued in the prologue of this report. The upbeat guidance provided by corporations during the last reporting season are further supporting stocks. Furthermore, the valuations remain at historically high levels and the last wave of covid-19 in Europe may cast doubt on the prospect of economic growth, which was already expected to slow down in the near future. With respect to the regions, we continue to view the EU and US as equally attractive. In regards to sectors, we have a preference for financials, healthcare and technology.

US **Europe** **Japan**

Emerging Markets

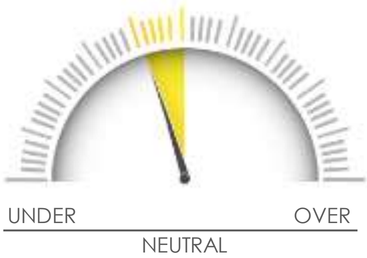


We maintained our **Slightly Underweight** recommendation on Emerging Markets Equities. Central banks in several emerging market countries are hiking rates to fight against the increase of inflation in their domestic markets and political uncertainty continues to weigh on some countries. Any increased pace of monetary tightening from western central banks could possibly lead to further weakness in the emerging markets, as they tend to underperform in times of more stringent monetary policies.

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

Fixed Income

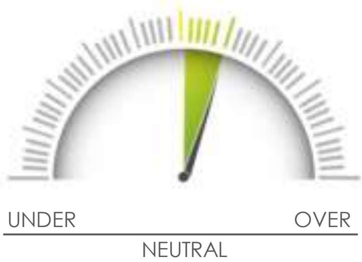
Developed Markets Sovereign



We maintained our **Slightly Underweight** recommendation on Developed Markets Sovereign Bonds. On one hand, continuing increases in inflation rates in developed countries are putting greater pressure on central banks to take action to prevent a further rise in the CPI, as argued in the prologue of this report. On the other hand, the prospects of a slower growth ahead and the new wave of covid-19 infections mostly in Europe could help limit the rise in risk-free rates in the short term. Among the developed market bonds, we continue to prefer the EU periphery.

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

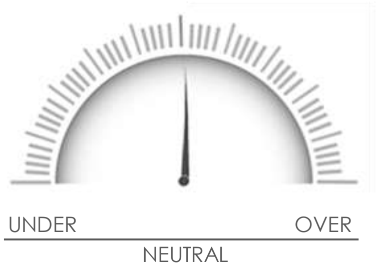
Developed Markets Corporate



We left our recommendation on Developed Markets Corporates unchanged at **Slightly Positive**. Solid balance sheets, low default rates and expectations for a continuation of the recovery/reopening of the economies all supportive of this view. Considering the increased volatility in rates, funds actively managing duration and credit risks could be an interesting investment solution. Within corporate bonds, we remain cautious on high yield bonds.

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

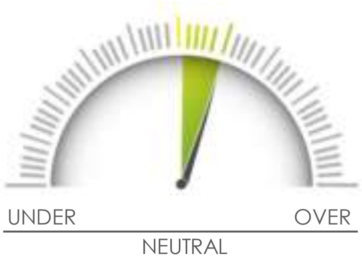
Emerging Markets



We kept our recommendation as **Neutral**. Emerging Markets corporate bond spreads continue to widen because of the lingering fear in Chinese real estate crisis. As a consequence, several bonds now trade at very wide spreads. Assuming a stressed scenario, we are therefore becoming more constructive on low-grade hard currency bonds. On the other hand, sovereign bonds were affected by the increase in central bank rates in some countries where inflation was reaching uncomfortably high levels. Generally speaking, the EM bonds continue to look attractive on a relative basis and they can still count on the ample liquidity and the hunt for yield.

Local Currency	Hard Currency IG	Hard Currency HY
=	=	=

Commodities



We maintained our **Slightly Positive** view on the commodities. After the strong price increases of the past months, a healthy consolidation may have just started in energy and industrial commodities. Also considering that the major central banks confirmed their dovish stance and real rates dropped further to negative levels and not to forget they lagged other commodities this year, the attractiveness of precious metals increased further.

Precious	Energy	Industrial	Agricultural
+	=	=	=

Currencies

On the US dollar, the Committee still maintains a neutral stance. The recent strength of the US dollar has been driven mostly by the unexpected jump in covid-19 infection in Europe, and by the expectation of a faster path of rate increases by the Fed, after the CPI data. At the current level, the room for further appreciation seems limited in the short term, hence the neutral recommendation.

The view on the Euro is also neutral. As reported above, the Euro has suffered against all major currencies recently mostly because of the new wave of infections, which could further postpone any normalization in the monetary policy by the ECB. The latest developments seem already reflected in the current level of cross rates.

On the Chinese Renminbi the view is slightly negative. The strength of the renminbi this year combined with weakness of other emerging market currencies is denting China's competitiveness compared to other EM, and this could prompt some actions from the Chinese government and/or PBOC.

The other Emerging Market currencies are expected to remain fairly stable thanks to the ongoing increase in central banks' policy rates, and assuming that US risk-free rates won't deviate materially from the current levels.

Euro	=	**USD**	=	**CNY**	–	**Other EM**	=