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

CHINA CPI
China, with only 1.5% inflation YTD, "exported" disinflation to the rest of the world. Expectations, however, point to rising inflation in China as well

09.12

US CPI
Headline inflation is expected to climb to 6.8%, while Core inflation to 4.9%. In both cases it will represent a three-decade high

10.12

FOMC MEETING
The Federal Reserve meeting is expected to accelerate the tapering as anticipated by Powell last week

15.12

ECB MEETING
The ECB is between a rock (inflation) and a hard place (increased Covid-19 infections). What changes, if any, will be announced to the monetary policy?

16.12

THREATS OR OPPORTUNITIES?

- **Financial markets have recently been shaken by a new Covid-19 variant, the Powell's turnaround on inflation and a weak non-farm payroll number**
- **The market reaction has probably been exaggerated**
- **The volatility caused by these events has created some opportunities to accumulate assets at more attractive levels**

Over the past two weeks, financial markets have been shaken by three unexpected events that have altered the expectations of market participants and have led to a significant increase in volatility.

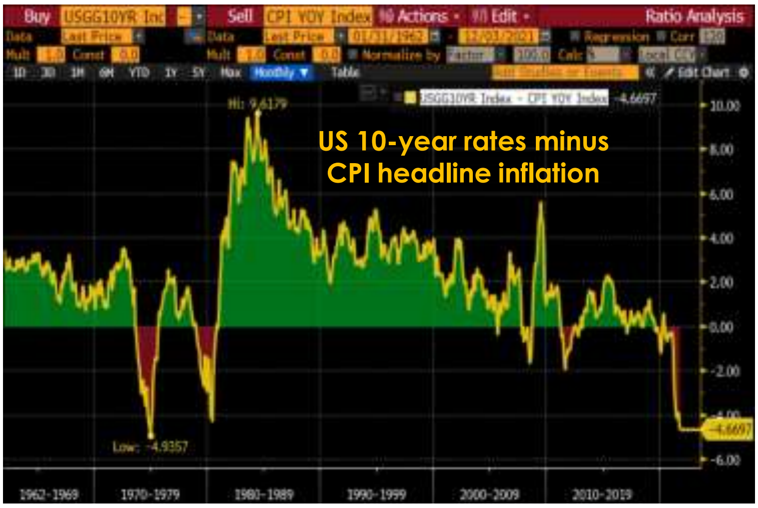
The first of these events was the spread of the Omicron variant. First discovered in South Africa and announced on November 26, the variant was immediately declared to be of concern by WHO due to a large number of mutations. Since the variant has just been discovered, though, there was no solid and reliable scientific basis to evaluate its actual dangerousness, understand its transmissibility, rate of mortality, nor it's the ability to evade the immunization from vaccines.

Financial markets reacted to the news, probably emotionally, as if the new variant could cause a new general lockdown in the style of March 2020. Europe, Japan and the Cyclicals corrected violently with declines around 7%, while Growth stocks and the Nasdaq remained largely unscathed on the expectation of a new tailwind for "stay-at-home" stocks.

As for the bond market, interest rates, especially long-term, have fallen considerably and reached levels close to (in Europe) or not very far from (in the United States) post lockdown levels. All this occured despite the evidence that previous worrisome variants (such as the delta) were not able to dent economic growth, or that Covid-19 has contributed to the current acceleration in inflation due to the disruption in the production of goods and bottlenecks in shipping.

(continued)

Source: Euronews, European Center for Disease Prevention and Control



Source: Bloomberg

What we know so far from the European Centre for Disease Prevention and Control (source: https://www.ecdc.europa.eu/en/news-events/epidemiological-update-omicron-variant-concern-voc-data-6-december-2021) is that on December 6, ten days after the announcement of the new variant, 212 confirmed Omicron cases have been identified in the entire European Union, while countries and territories outside of the EU/EEA have reported 693 confirmed cases, bringing the world total to 905 cases reported by 47 countries.

Omicron's pace of spread, at least in developed countries with a higher vaccination rate than in South Africa, appears to be not as rapid as the delta variant. But most importantly, as reported by the aforementioned report "all cases for which there is available information on severity were either asymptomatic or mild. No deaths have been reported among these cases so far". This seems very much in line with the first indications given by the doctors in South Africa who first detected the variant, who said that the symptoms were milder than in other variants. While these comforting evidence have yet to be confirmed, there is room for thinking that the initial panic about this variant may have been overestimated.

The second factor that troubled the markets was Powell's turnaround on inflation. During the periodic congressional hearing, Powell admitted that it is probably time for the central bank to stop using the word "transitory". Additionally, he said that "at this point the economy is very strong and inflationary pressures are high and it is therefore appropriate in my view to consider wrapping up the taper of our asset purchases ... perhaps a few months sooner". But there is more. Powell previously said that before the Fed could think of a rate hike, inflation first had to pass more stringent tests, including steadily settling at over 2% over the medium term. In the recent hearing, Powell also said that, based on recent data, "the Fed's test for inflation has been met".

So, all of a sudden, inflation has gone from not being a problem as it was transitory to being an issue as it is not-so-transitory, the pace of tapering needs to be increased, and perhaps rate hikes could start sooner than expected. This is a major hawkish twist by the Fed, but it wasn't that hard to predict that it would happen sooner or later, as the arguments supporting the view that inflation was not an issue were less and less credible, as we have also discussed in the November 23 dated report.

As the Fed has finally admitted that inflation has become a problem, one should have expected an increase in market rates to mitigate the expected loss in purchasing power of the bond's principal. But only the short-term interest rates have gone up. The long-term ones, to the contrary, fell further, widening the gap between the 10 year rates and inflation (graph above on the right), to the point that today we are at levels similar to those reached during the 70s and 80s., which were followed by runaway inflation.

(continued)

The last market mover to have an impact on the market was the US payrolls data, which was generally viewed as weak mostly because the increase in non-farm payrolls was well below expectations (210k vs 550k exp.). First of all, it should be noted that this has already happened twice this year, in April and August, and it was never a sign that the labor market was halting its recovery. Secondly, after the huge distortions in season patterns caused by the lockdown as well as the extraordinary unemployment benefits, the seasonal adjustment factors may have distorted the reality.

If we look at the big picture, the report is very strong. The unemployment rate has fallen back from 4.6% to 4.2%, not too far from the minimum touched on just before the pandemic. The underemployment rate fell by 0.5% in just one single month, while the participation rate inched up by 0.2%.

Source: Bloomberg

Source: Bloomberg

Additionally, it is worth noting the number of "quitters" i.e. those who voluntarily resign from their current jobs - typically the people who quit as they have a better opportunity elsewhere. We have now reached the highest level ever since the series was created 20 years ago. This strong reading means that there is plenty of opportunities, and that wage inflation may be more robust than estimated as normally people leave for better-paying jobs.

All in all, the data from the last couple of weeks was mixed, but considering how deep the retracement has been at least in some markets/sectors plus the negative interpretation of some of the news mean that were actually not that bad, and the recent bout of volatility may have created some interesting entry points.

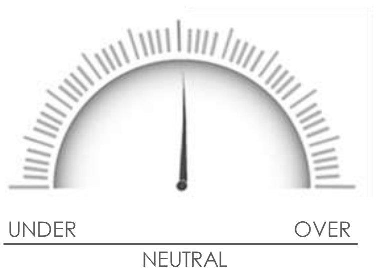
Asset Allocation View

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

− UNDER = NEUTRAL + OVER

Equity

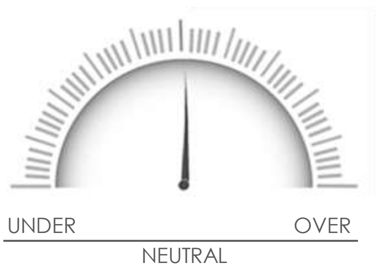
Developed Markets



We maintained our **Neutral** recommendation on Developed Markets Equities. Over the past two weeks, the new Omicron variant, Powell's turnaround on the transience of inflation and the weak US job report, took equity markets by surprise as they were all unexpected (elaborated in the prologue of this report). The resulting correction is perceived as large enough to assume that these new factors are now priced-in. Although, the view on equity markets is neutral in aggregate, recent movements have caused a widening of the valuation gap between countries and sectors. As a result, we are now turning more bullish on European and Japanese equities, and on sectors and companies that were hit the hardest in the past few days.

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

Emerging Markets

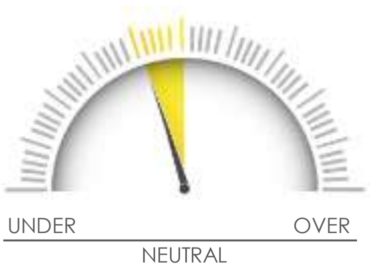


We upgraded our recommendation on Emerging Markets Equities to **Neutral**. We are approaching the end of the year, a time when market participants tend to reduce or liquidate holdings in the worst performing assets YTD. This process, called window dressing, normally exacerbates the losses for the losing stocks of the year. This part of the year, therefore, offers an attractive entry point for accumulating assets with compelling valuations. After the huge underperformance during 2021, emerging markets are now trading at a significant discount to developed markets, and may represent one of the most interesting opportunities in 2022. Among EM space, we specifically prefer Asian region and China.

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

Fixed Income

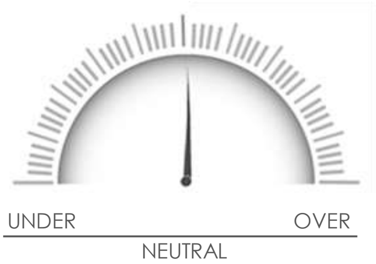
Developed Markets Sovereign



We maintained our **Slightly Underweight** recommendation on Developed Markets Sovereign Bonds. We continue to expect higher sovereign bond yields over the medium term, as a result of a no-longer transitory inflation, economic growth that remains robust and faster than expected withdrawal of monetary stimulus from major central banks. In the short term, however, fears related to the outbreak of the Omicron variant and market concerns about a monetary policy mistake by central banks may still put a cap on the rates. Within sovereign bonds, we continue to prefer EU Periphery.

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

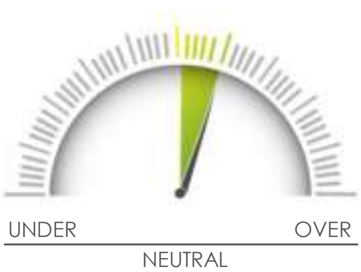
Developed Markets Corporate



We reduced our recommendation on Developed Markets Corporates To **Neutral**. Powell's announcement of the possibility of a faster-than-expected tapering together with the growing concern about the new Covid-19 outbreak may increase the possibility of the widening of corporate spreads, although not dramatically. As spreads are at very low levels, both in investment grade and high yields, a worsening of the overall liquidity suggests that a more cautious approach to the asset class is needed.

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

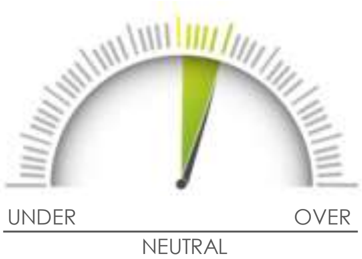
Emerging Markets



We increased our recommendation to **Sligthly Overweight**. Similarly to what has been said for Emerging Market Equities, the last part of the year may prove a good entry point to accumulate Emerging Market bonds, taking advantage of the window dressing. Over the year, the asset class has been underperforming Developed Market bonds and trading at decent spreads overall. We are turning more bullish on Asian bonds, including High Yield. After the crackdown of the Chinese government and the Evergrande crisis, spreads on Asian bonds are near the highest level of the past decades.

Local Currency	Hard Currency IG	Hard Currency HY
=	=	=

Commodities



We maintained our **Slightly Positive** view on the Commodities. We continue to prefer precious metals, considering that the real rates are still deeply in negative territory and lagged other commodities this year. Additionally, precious metals are one of the few asset classes that may serve as a hedge in case of a market turbulence. We have maintained a more cautious view on other commodities due to worries related to the spread of the Omicron variant may weigh on the perspective of energy and industrial metals.

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 tapering by the Fed, as confirmed by Powell last week. 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, like the reserve requirement ratio reduction just announced.

The other Emerging Market currencies are expected to have room for a rebound after the correction caused by the new wave of covid-19 infection and the possibility of a faster tapering by the Fed.

Euro	=	USD	=	CNY	−	Other EM	+