Main Events

Azimut Global Network

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

RETAIL SALES EU
Will EU consumers continue to spend as strongly as the US consumers?
05.08

US PAYROLLS
Expectations are for another month of jobs creation, even if weekly jobless claims continue to grow at 1.5 mln per week. Will this be confirmed?
07.08

EU 2Q GDP
First reading on Euro Area GDP for the second quarter 2020
14.08

WORLDWIDE PMI
Markit PMI will be published for all major economies. How resilient the post-reopening recovery will be?
21.08

SO FAR SO GOOD…

Never has been a reporting season anxiously awaited by the market participants, who were expecting companies to shed some light on what to expect for the next few quarters.

Last quarter, nearly 4 in every 5 companies withdrew their guidance for Q2 2020 due to a lack of visibility on future sales and earnings. In an unprecedented situation with lockdowns still in place for at least one third of the quarter, forecasting models were not helpful either, forcing equity analysts to guesstimate the companies' results. Because the earnings expectations for cyclical stocks -the hardest hit by the lockdown- have been lowered so dramatically, the earnings beat was quite easy to achieve, on the other hand for the companies providing online services and/or tech infrastructure strong results were needed to sustain the very high expectations and multiples.

With almost 2/3 of the earnings season over, the results were well above the consensus, irrespective of the sector of activity.

The US stocks delivered the most positive results with 84% of companies beating market expectations. It is the highest ever percentage of earnings beat since 2008. The average earning surprise was 21.8% above market consensus, also a record. This data should be read in conjunction with the fact that Q2 expectations have been dramatically lowered as discussed above: QoQ EPS change is -35.7%, the second largest drop on record after Q4 2008.

The healthcare and Information Technology were the best performing sectors in terms of earnings and sales, whilst energy and real estate were the worst. On the spot were also the S&P500 heavyweights, all technology stocks; the top 5 companies making up the highest weighting in the S&P Index first time ever. Microsoft, Apple, Amazon, Facebook and Google all reported earnings well above market expectations. Notwithstanding this, their share price didn't react as positively as the numbers would have suggested (with the notable exception of Apple).

(continued)

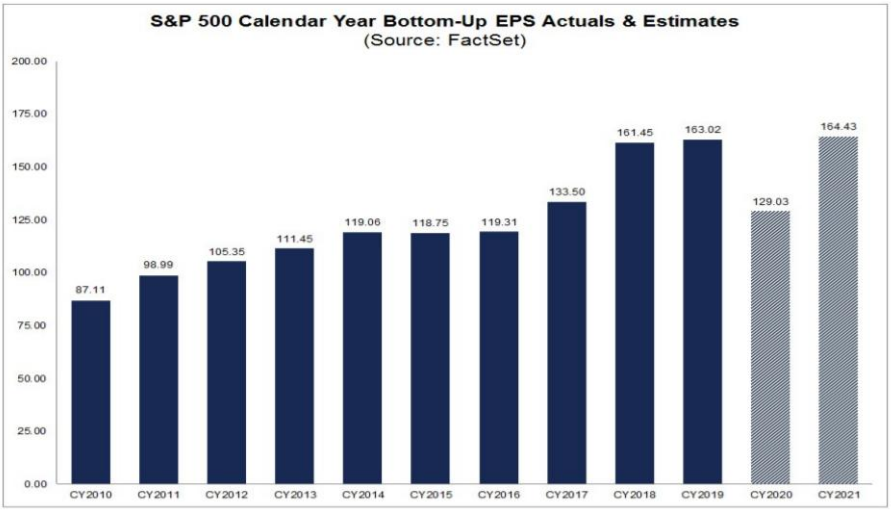
Elsewhere in the world, the reporting season was still positive, but results lagged behind the US. In terms of EPS, just 56% of the companies listed on the Eurostoxx 50 and the Topix index was able to beat the consensus (vs 84% for the US). On the positive side, the decline in YoY EPS was -26% and -16% respectively, against -34% for the US.

In terms of sales, 61% of Euro-Area companies beat consensus, vs 54% for Topix and 67% for the S&P500. The YoY decline in sales volumes, though, was much more pronounced in EU (-28%) and Japan (-20%) than in the US (-10%). This is partially explained by the fact that non-US indices have larger exposure to cyclical sectors, which were hardest hit by the lockdown.

Thus far, the results seem good enough to avoid a short term market correction, thanks also to the bullish market sentiment.

But if the expectations for this past quarter was in general very low, those for the near future would be quite bullish. According to Factset (see graph below), expected EPS for the full year 2021 will reach new record highs, even if just slightly above 2019 EPS (the record-high year in terms of EPS for the US market).

Bottom-up EPS Estimates: Current & Historical



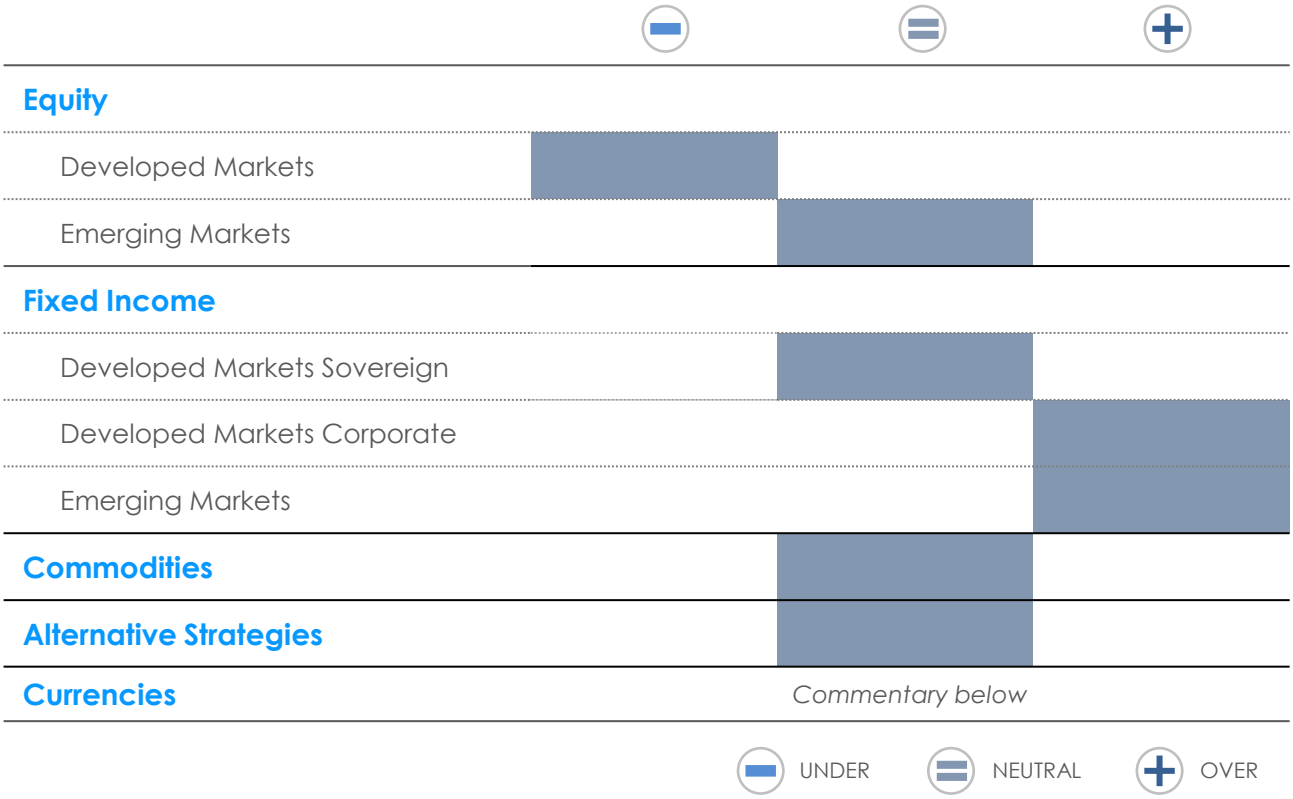
Source; Factset

Never before EPS has been able to recover to pre-recession peak in less than 3 years. But it is also true that governments and central banks never before reacted in such a powerful way to an economic slowdown.

Consumer spending will be the key to assessing whether this V-shaped recovery is possible or not. Weekly jobless claims in US continue to remain close to 1.4 million per week. To put this in perspective, the weekly claims in pre-covid period were less than 700k per week, whilst the level needed to prevent the unemployment rate from increasing further was around 250k/300k per week. In this respect, it should be noted that the enhanced unemployment benefit in US expired on July, and so far the Congress has not been able to reach an agreement for an extension, risking future spending.

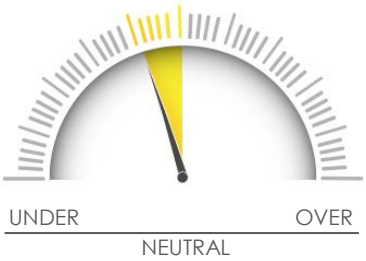
Finally, it should also be considered that if Joe Biden is elected as the next US president (polls show Biden with a solid lead over Trump), he will probably increase the tax rate on corporations at least to the pre-Trump level, and this would lower the overall EPS by 20$. This is currently completely downplayed by the markets, but sooner or later this might constitute another headwind.
So far so good, but better to remain vigilant.

Asset Allocation View



Equity

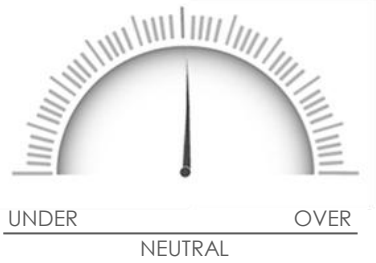
Developed Markets



We kept our slightly underweight recommendation unchanged. During the past two weeks equity markets remained rangebound in USD terms, and corrected slightly in euro terms mostly because of the weakness in US dollar. The earning season so far has been quite strong, but markets were unable to continue their advance as the rally since the March low brought valuation to stretched levels. Europe continues to be the favorite region but some portfolio managers decreased their exposure after the European Recovery fund was formally approved, also considering that the strength of the Euro, if protracted, could undermine the competitiveness of EU exports.

US	Europe	Japan
−	+	−

Emerging Markets

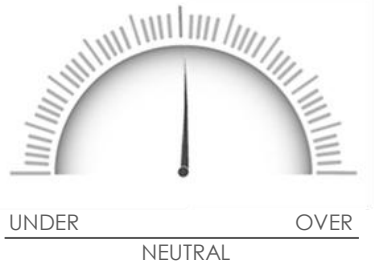


We kept our recommendation on Emerging Markets to Neutral, with a strong preference for the Asia ex-Japan region, and China in particular. The main catalyst is the recent spike in polls by Joe Biden. If elected, he is expected to halt and possibly even reverse the policy of Trump vs China. This could lead to a sharp rerating of Chinese stocks, that have been sharply sold off over the past few years. Valuations of Chinese stocks are currently about half the US markets, and technology companies trade at much more reasonable multiples. Unchanged the view on the other regions. The weaker dollar constitute a further element of strength for emerging markets equities.

Asia ex-Japan	EEMEA	LATAM
+	=	=

Fixed Income

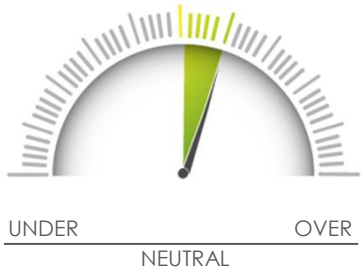
Developed Markets Sovereign



No change in the neutral view on sovereign bonds of developed markets. The Fed is apparently applying a yield curve control, even if not officially declared, as long term rates remain within a very narrow range for several weeks now. In general, we reiterate the view that the ongoing QEs by all the major central banks should keep rates close to the current levels for all markets. There is little value to be found now, but this does not imply that there is downside risk either, at least in the short term. Considering that European Recovery fund has been formally approved, the spread of peripheral bonds could continue to narrow.

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

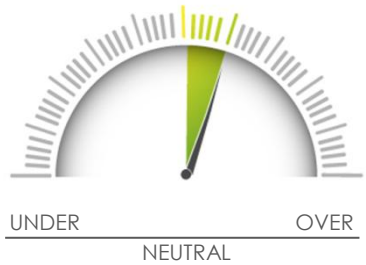
Developed Markets Corporate



We keep our overweight stance. Unfortunately as in many other asset classes, the levels reached by the spreads are not particularly attractive anymore. Notwithstanding this, because of the various QEs, investment grade corporates are as protected as sovereign bonds, but offer a slightly higher yield. In the Fixed Income space, investment grade bonds appear to be the best place in terms of risk/reward. We reinforced our underweight stance on EU and US high yields as their spreads contracted too much, also considering the expected increase in the default rate.

IG Europe	IG US	HY Europe	HY US
+	+	−	−

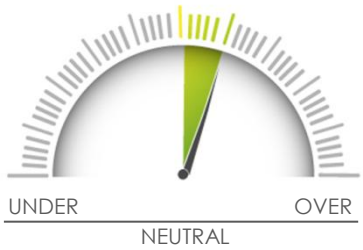
Emerging Markets



We maintained the recommendation on EM bonds to slightly overweight as these bonds did not enjoy the same fast recovery of other segments of the credit markets. They were left behind because EM central banks are not doing QE on their bonds, therefore investors have been more cautious in buying those. Considering the low levels of the risk-free rates, the compression of the spreads in developed market corporates and the rebound of commodities, there is room now for a catch up of emerging bonds. Among them, we have a strong preference for local currency bonds.

Local Currency	Hard Currency IG	Hard Currency HY
+	=	−

Commodities



We have a neutral stance with a positive bias. We continue to prefer precious metals because of the low yield environment, and as a hedge against unexpected turbulence. 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 will dent on performances.

Precious	Energy	Industrial
+	=	=

Alternative Strategies

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

Low Volatility	+	Medium Volatility	=	High Volatility	−

Currencies

We reinforced the positive view on the euro, as market sentiment is still positive on the EU, whilst the US is facing several issue (see below).
We kept our negative view on the US dollar for several reasons, among which, inter alia: 1) The spike in new covid-19 cases and deaths after the reopening 2) Increasingly loose (even reckless) fiscal policy, with another fiscal stimulus expected (Republicans are proposing 1 trillion, whilst Democrats are looking for 3.5 trillion), and 3) the probable victory of Joe Biden as the next US president (according to the polls), who is expected to implement policies which could be less market-friendly than those of Trump.
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 have a constructive view as most of them appear to be undervalued and the yields offered by those currencies are more and more attractive as YTM continues to fall in developed markets.

Euro	+	USD	−	Yen	−	Emerging	+