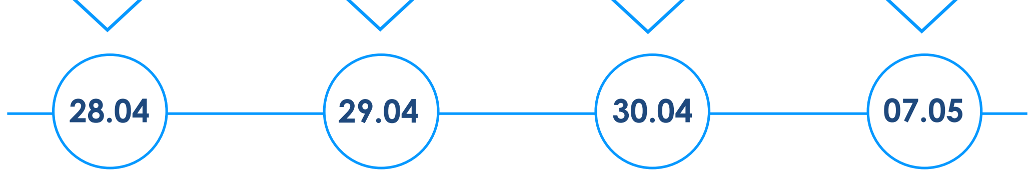
Main Events

FED FOMC
The Fed is expected to stick to its previous commitment of maintaining the current monetary policy for an extended period of time

US GDP
Real US GDP may have expanded by 6.8% in Q1 in spite of not yet being fully powered up by the stimulus package of March

EU GDP
Euro Area GDP is expected to contract by 0.8% QoQ (-3.2% annualized) due to the lockdowns imposed in most of the EU countries

US PAYROLLS
Another month of strong hiring may lead to renewed pressures on long term rates



Azimut Global Network

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- Singapore
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SELL IN MAY AND GO AWAY?

- **As evidenced by macroeconomic indicators, the sentiment is very positive**
- **Market sentiment and the stimulus have driven equity markets to relatively high valuation levels, especially in the US**
- **Nonetheless, reducing exposure in risky assets could be premature**

A little over a year ago, financial markets bottomed out as the world was just beginning its long journey through the pandemic. At that time, everything seemed terrible. Yet, since then, the equity and credit markets have been able to anticipate what would happen with astonishing accuracy, delivering one of the most spectacular performances ever, and demonstrating once again how human emotions can be misleading.

Today the future looks bright. There are several reasons to be optimistic. Vaccine distribution is proceeding apace and the vaccines themselves are proving effective against all variants. Monetary and fiscal stimuli of unprecedented magnitude are laying the foundations for achieving global economic growth not seen for decades.

In terms of cyclicality, we are entering a period that is regarded as the worst time in the year for equity investments. After such an extended bull market, it makes sense to ask whether this old adage can once again be proven correct.

Over the past 5 months, inflows to equity funds exceeded those of the last 12 years combined. It should be emphasized that it is still a very small share compared to the liquidity injected into the financial system in recent years and a fraction of the flows in bond instruments. But nonetheless it is a very strong inflow.

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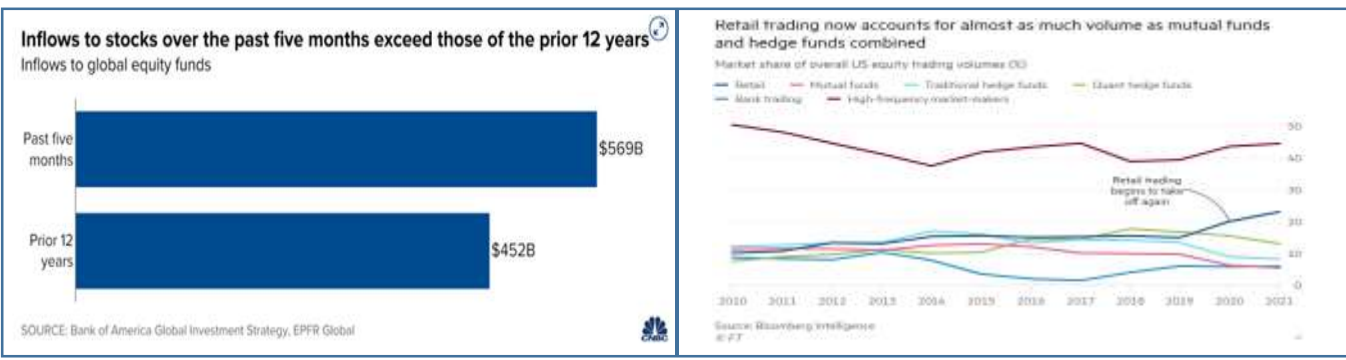


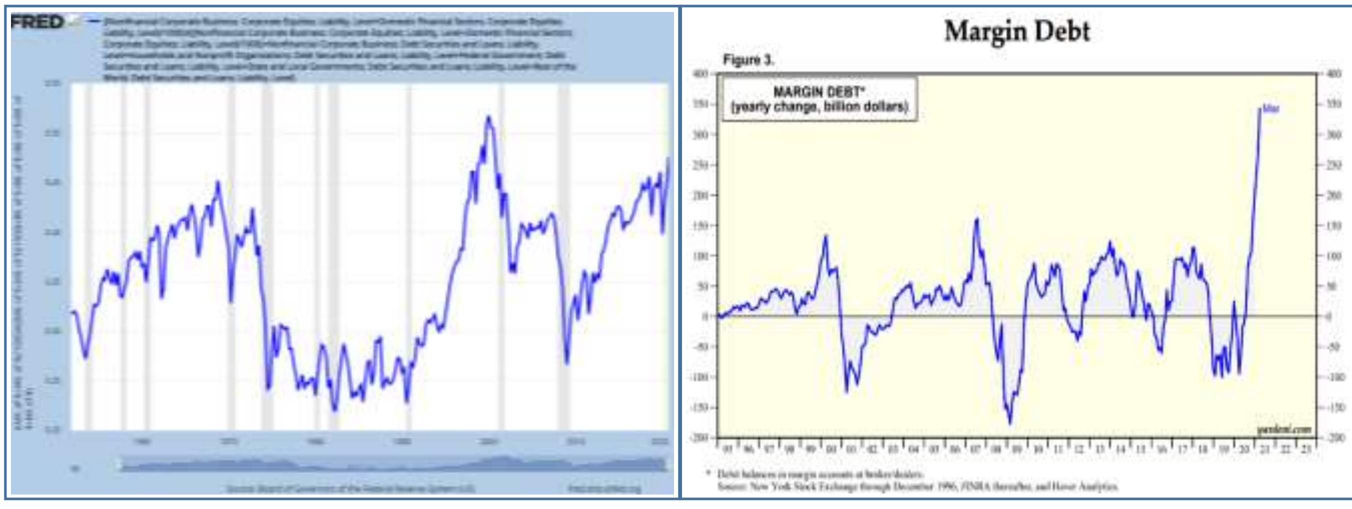
Souce: CNBC, BofA Global Investment Strategy, EPFR Global

Source: Financial Times, Bloomberg intelligence

Part of these inflows, especially in the United States, is derived from stimulus payments to individuals. We have already discussed several times the impact of extraordinary amount of stimuli and therefore we will not dwell on it again. The consequence was that many people for whom subsidies were not essential to cover current expenses, have begun speculative trading in the stock markets. Over the last year, this trend has escalated to the point that retail trading volume surpassed the combined trading volume of mutual and hedge funds.

The average equity allocation for the US investor (https://fred.stlouisfed.org/graph/?g=qis) is consequently returning to nearly all-time highs reached in 2000. The figure still refers to the third quarter of 2020 due to the time it takes to aggregate all the data. Considering what happened at the beginning of the year (Gamestop and similar stocks) and the stimulus payments made following the $ 1.9 trillion fiscal bill, it is reasonable to assume that today this figure is significantly higher, making the further appreciation of margins much more limited.

Additionally, last year's bull market was supported by an unprecedented use of leverage, by both retail and institutional investors. The "margin debt", i.e. the collateral for derivative/leveraged positions, has reached a record high level annually. As can be seen from the historical series below, in general strong increases in margin debt also coincided with the main market peaks. Also, as recent financial scandals have shown, excessive use of leverage does not come without risk.



Source: Federal Reserve Economic Data (FRED), St. Louis Fed

Source: Yardeni Research

Sentiment is very positive not only among investors, but also among entrepreneurs. The ISM Manufacturing PMI also reached 64.7 in March, the strongest readings ever.

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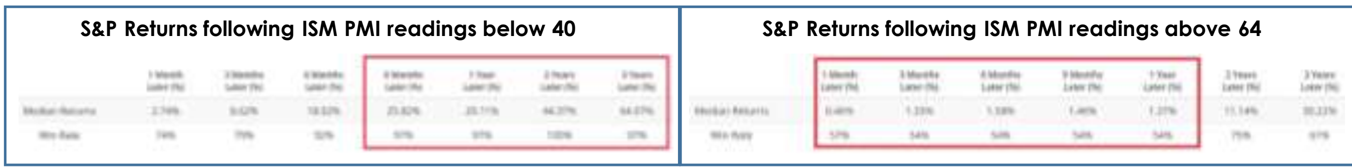


S&P Returns following ISM PMI readings below 40 | **S&P Returns following ISM PMI readings above 64**

Source: SentimenTrader, Sundial Capital Research | *Source: SentimenTrader, Sundial Capital Research*

As the above data from SentimenTrader shows, the best time to invest is when business sentiment is very bearish: when ISM readings are below 40, the median return achieved by the S&P 500 in subsequent years is always very high, and the percentage of success close to or equal to 100%. Conversely, when ISM sentiment is very bullish, then the median return of the S&P500 over the next 12 months is barely positive. High ISM readings are therefore not to be interpreted as bearish, but certainly when business confidence reaches such high levels, the markets tend to discount much of the positive news thus leaving limited upside.

All the elements discussed so far have unquestionably contributed to supporting and justifying the rise in the stock market prices. And it must certainly be considered that in the short term the markets will continue to enjoy extraordinarily good macro data and corporate results, considering that the effects of monetary and fiscal stimuli will be felt for a few more quarters.

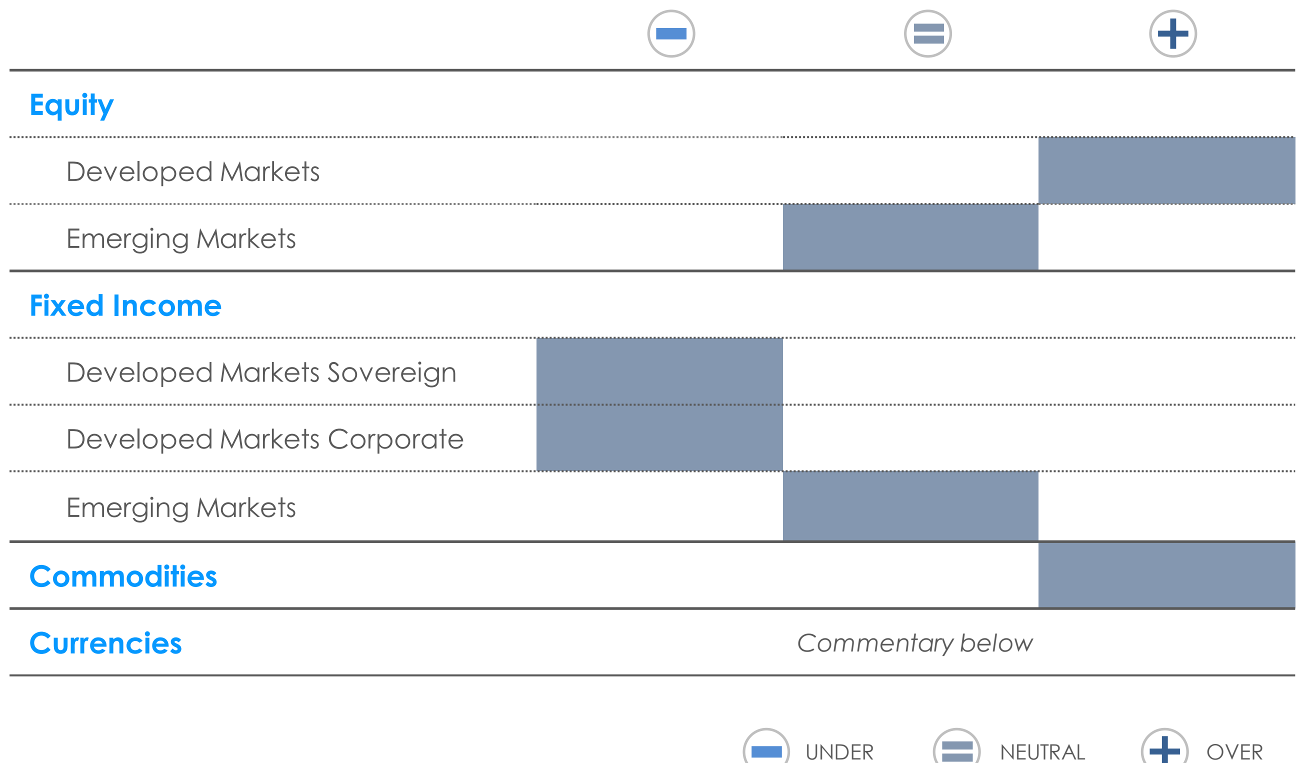
The GDP and EPS growth rates we are currently experiencing, however, are not sustainable in the medium / long term, as they are in part the consequence of extraordinary stimulus that are one-off and not permanent. One of the most used indices to gauge how over- or undervalued the market is the Cyclically Adjusted Price Earning (CAPE) or Shiller PE. The CAPE is based on average inflation-adjusted earnings from the previous 10 years. The idea behind the index is that over a 10-year horizon, both recessions and negative sentiment phases and economic expansion phases with positive sentiment are included. Using the average earnings of the last 10 years allows us to objectively estimate how expensive the market is compared to a long-term sustainable earnings growth trend. At 37.6, the CAPE is at levels only reached during the late 1990s bull market.

Source: https://www.multpl.com/shiller-pe | Source: Bloomberg

Should we be alarmed and rush to reduce equity exposure in the portfolios? No and the answer lies in two main reasons.

The first one is that macroeconomic data and corporate results will continue to be very good for some time, supported by the stimuli and the reopening of the economies. This will continue to favor risky assets. Considering the ample liquidity and interest rates at close to zero levels around the world, there is still no alternative to equity. Only when governments and/or central banks start hinting the need to scale back stimuli, it will be the time to reduce risk. The second reason is that the excesses discussed in the first part of this narrative are largely concentrated in the US and/or in some specific growth stocks. Equities in the rest of the world are trading at a deep discount to the United States. Using the Price-to-Book (graph above), the discount is 60%. Using the forward Price-Earnings the discount is 30%. Selection will be the key for prudent asset allocation.

Asset Allocation View



	− (Under)	= (Neutral)	+ (Over)
Equity			
Developed Markets			■
Emerging Markets		■	
Fixed Income			
Developed Markets Sovereign	■		
Developed Markets Corporate	■		
Emerging Markets		■	
Commodities			■
Currencies		*Commentary below*	

− UNDER = NEUTRAL + OVER

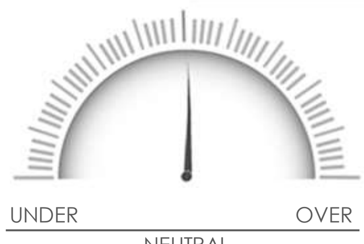
Equity

Developed Markets

We maintained our recommendation on Developed Market equities as slightly positive. The recommendation is conditioned upon the rates not moving past their recent highs. If rates continue their upward move, then the risk of a retracement becomes material. If rates remain under control, then it could be expected that markets will not correct until when governments and/or central banks begin to talk about scaling back stimulus. In terms of geographical allocation, we continue to prefer Europe, which is much more "value" than US, and trade at multiples lower than the historical averages for MSCI World.

US	=	Europe	+	Japan	=

Emerging Markets



We maintained the neutral stance for Emerging Markets Equities. Traditionally, Emerging Markets returns tend to be negatively correlated with US rates. Additionally, some Emerging Countries are experiencing a new wave of COVID-19 cases, dampening the expectation for GDP and EPS growth. Therefore, even if in the long term Emerging Markets continue to grow faster than Developed Markets, we prefer to maintain a more cautious approach in the short term.

Asia ex-Japan	=	EEMEA	=	LATAM	=

Fixed Income

Developed Markets Sovereign

We maintained our overall underweight recommendation on Developed Markets sovereign bonds. US rates have marginally corrected notwithstanding the strong CPI print, but we consider this as a short term retracement that does not change our view of higher rates in the coming months. In Europe, where long-term interest rates rose less than in other parts of the world in February, they continued to rise steadily and are now at their highest level since the start of the pandemic.

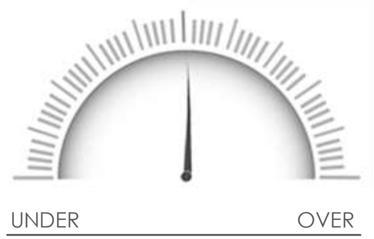
EU Core	=	EU Periphery	=	US Treasury	=	Japanese JGB	=

Developed Markets Corporate

We kept our negative recommendation on Developed Markets Corporates. Thanks to the combined effect of fiscal stimulus and the continued support from the central banks, we maintain our view that further spread compressions could be possible in the segment between investment grade and high yield, in particular in subordinated bonds. To the contrary, we do not find particular value in the high grade corporates.

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

Emerging Markets



We kept our recommendation as neutral. In addition to the risk of further increases in US risk-free rates, some emerging markets are experiencing a new wave of COVID-19 cases. This could derail or delay the expectations of a sustained GDP growth and leave central banks unable to increase rates to defend the currencies and/or restrain inflation pressures.

Local Currency	=	Hard Currency IG	=	Hard Currency HY	=

Commodities

We maintain our bullish view on the asset class. After our recent call to tactically favor precious metals within commodities and the rebound over the month of April, we are moderately more cautious over the next few weeks. The bull case on precious metals is still supported by the ample liquidity and the surge in fiscal deficits, but an increase in long term rates is increasingly plausible, thus creating a headwind for precious metals.

Precious	+	Energy	+	Industrial	=

Currencies

We maintain our neutral view on Euro, USD and Yen, in line with the recommendation for all other currencies. The view of the asset allocation committee is that in the short term, all major currencies will remain rangebound within their recent trading range.

On Emerging Markets currencies, we maintained our neutral view. In case of further increase in US rates, emerging market currencies may have room to weaken.

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