AZIMUT
DEFINING INVESTMENT DIRECTION

AZIMUT GLOBAL VIEW

07.06.21

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

US INFLATION — 10.06
Another upside surprise in US inflation may roil the markets

ECB MEETING — 10.06
The ECB is expected to maintain its monetary policy unchanged

UMCSENT — 11.06
The inflation expectations sub-index of the University of Michigan Sentiment survey will be closely watched

FED MEETING — 16.06
Will the Fed start thinking about thinking about tapering?

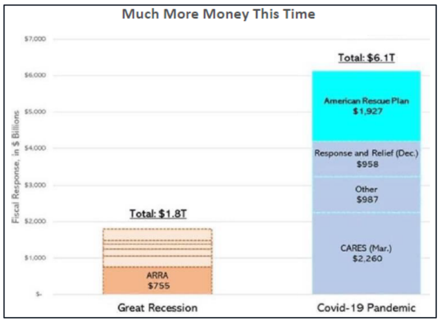
WANING STIMULUS

- **The fiscal stimulus has been massive over the past year, but it is starting to wane with the imminent expiry of the extraordinary jobless claim program**
- **Recent GDP and fiscal spending growth rates are unsustainable, and will moderate in the coming years**
- **Equity markets still seem very optimistic about the strength of the economy**

For more than a year now, consumers and businesses have benefited from unprecedented fiscal support, to the point that, as elaborated in previous publications, there has been an unusual event, namely an increase in disposable income during a recession.

To better understand the extent and effectiveness of these fiscal measures, let's start by clarifying the actual effect of last year's lockdown on GDP. Normally, US GDP is always calculated by annualizing the quarterly figure. Therefore, the number -31% (annualized) recorded in the second quarter of last year actually corresponds to a decrease of -9% (in absolute terms) of the GDP of that quarter. This collapse was recovered in the following three quarters (+ 7.5%, + 1.1% and + 1.6%).

Source: Bloomberg



Source: DoubleLine

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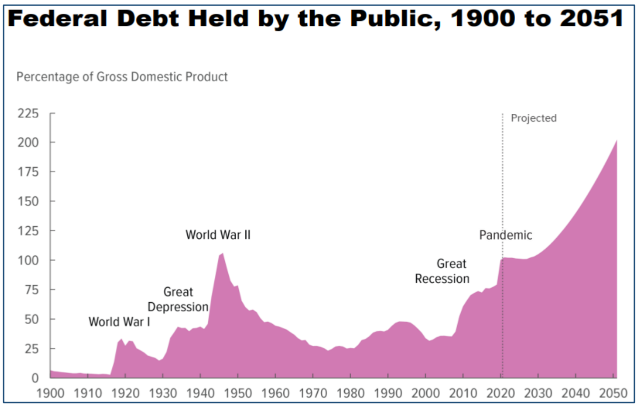
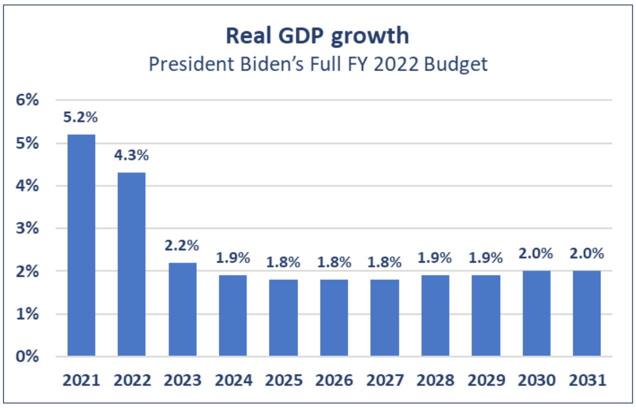
Against this decrease of about 10 percentage points of GDP, the Trump and Biden administrations have approved stimulus plans that cumulatively amount to about 6.1 trillion dollars. Considering that US GDP is approximately $ 21.4 trillion, this spending equals to 28.5% of GDP, three times as much the Covid-19 induced contraction.

Looking forward, last week Biden presented a $6 trillion budget for the next 10 years, which includes about $5 trillion in new spending and tax breaks, reflecting the previously proposed American Jobs Plan, American Families Plan, and non-defense discretionary spending increases (source: www.crfb.org). According to the projections, in the ten years time the costs of those spending will be reduced to only 900 billion, thanks to the additional tax revenues generated by these programs.



Source: Committee for a Responsible Federal Budget, May 20, 2021



Source: Committee for a Responsible Federal Budget, May 28, 2021

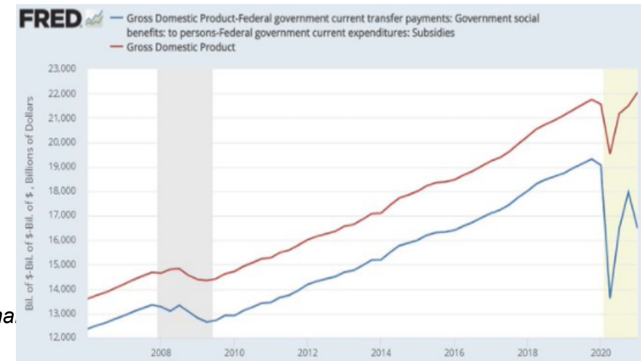
The figures above show that the already approved fiscal plans ($6.1 trillion) have brought the debt/GDP ratio to the post-war record levels. Probably optimistically, the debt-to-GDP ratio is not expected to rise for the entire period until Biden's term ends, despite the $6 trillion budget mentioned earlier. The projected debt/GDP ratio will begin to rise again quickly afterwards, reaching over 200% in 2050. This is hardly a sustainable path.

Additionally, GDP growth is expected to fall back to quite sluggish levels (about 2%) as soon as 2023. Unfortunately, an important part of the pre-approved tax plans included non-productive expenses, such as tax aids to states with unsustainable deficits, or counterproductive measures like unemployment subsidies that are too high that they discourage job search. These measures clearly won't pay for themselves.

Considering that the future fiscal spending plans will be implemented more gradually than in the past year and that there will be fewer direct transfers to citizens and businesses, attention must be paid to the potential negative impact on GDP resulting from the waning of previously approved stimuli.

The graph on the right compares total GDP (red), with GDP excluding public transfers (blue).

The large gap between the two historical series shows the potential downside risk that could materialize in the next quarters. It is absolutely reasonable to expect a consumption boom due to the reopening and spending of accumulated savings. But if such consumption fails to fill the gap resulting from lower public spending, then the total GDP will be negatively affected.



From: FRED, John P. Hussma

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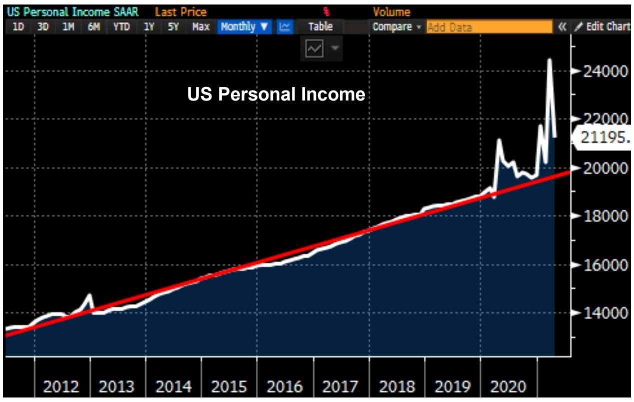
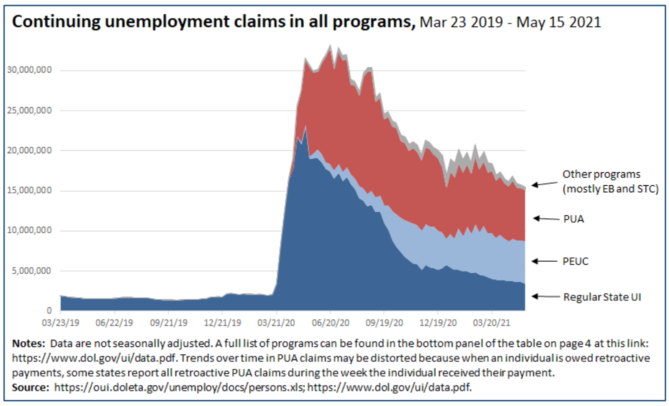
Extrapolating the recent strength of consumption to a far too distant future could therefore be risky. Disposable income has grown well above the pre-pandemic growth trend (red line in the graph below) owing to the fiscal handouts.

Much of the aid to individuals has been granted either via the unemployment benefits or through "one-off" payments made in various tranches following the approval of the fiscal measures (the three rounds in April and December last year, plus the March of this year).



Source: Bloomberg



Source: www.trendsmap.com

As mentioned earlier, new one time payments are unlikely to be approved in the future. As for unemployment benefits, they are currently paid to 15 million recipients. Among the different compensation schemes, Pandemic Unemployment Assistance (PUA) and Pandemic Emergency Unemployment Compensation (PEUC), both expiring in September, still cumulatively pay 11.5 million claims to individuals. Thereafter, only the "regular state" unemployment insurance program and other minor programs will remain in effect. The vast majority of Republican states have announced that they will terminate the extraordinary programs early, over a period spanning from next week to mid-July. This will negatively affect both the disposable income and future spending.

As we expounded upon about a month ago, the reporting season of the 1Q of 2021 was one of the best ever, with exceptional beats over consensus. Market participants have continued to increase their earnings expectations since then and now the 2023 consensus EPS for the S&P500 stands at $232. Compared to the 2019 pre-pandemic EPS of $160, this represents an increase of 45%, corresponding to an annual growth rate of about 10% (or 40% above the realized long-run EPS average growth rate of 7% annualized).

Ostensibly, what is happening right now is that the market is extrapolating for the indefinite future the exceptional GDP and EPS growth rates that we experienced recently thanks to the fiscal stimulus. This shouldn't be taken for granted, considering that not only governments but also central banks may start to reduce their monetary stimulus in the coming quarters. Elevated expectations coupled with rich valuations and less favorable monetary and fiscal conditions suggest that a cautious approach should be appropriate over the mid-term.

Asset Allocation View

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

− UNDER = NEUTRAL + OVER

Equity

Developed Markets

UNDER OVER
NEUTRAL

We kept our neutral recommendation on Developed Markets equities. On one hand, high valuations, threat of higher inflation/risk-free rates, and the risk amid waning fiscal stimulus in the rest of the year suggest some caution. On the other hand, still dovish centrals banks coupled with the gradual normalization expectations helped by accelerating vaccination rollout may sustain equity prices. In the short term, US inflation data and the meetings of the ECB and the Fed could change this outlook. In terms of styles, we have a preference for the value, while in terms of geography we continue to prefer Europe and Italy in particular, as they are more "value" than US and also trade at lower multiples.

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

Emerging Markets

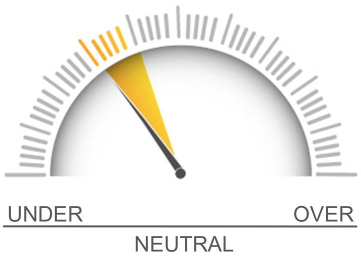
UNDER OVER
NEUTRAL

We increased our recommendation on Emerging Markets Equities to neutral. The threats of higher inflation and tapering in the second half of the year will less likely to weigh on investor sentiment towards emerging markets assets, unless this week's CPI comes out materially worse and/or a Fed reveals a more hawkish tone next week. Within EM space, we are keeping our cautious view on Asia ex-Japan, not only because Asia is the biggest importer of commodities, but also due to the new outburst of Covid-19 infections in some countries. In the current environment, our preference continues to be tilted towards commodity exporters regions like Emerging Europe (Russia and MENA) and Latin America.

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

Fixed Income

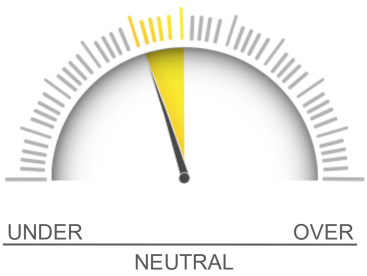
Developed Markets Sovereign



We maintained our overall underweight recommendation on Developed Markets sovereign bonds. The US CPI data scheduled for this Thursday is expected to be quite higher than in April and this could put pressure on rates. Considering the recent underperformance of Italian BTPs, we reaffirm our (relative) positive view on European Periphery bonds, in expectation of a narrowing of the Bund-BTP spread. Additionally, should the 10-year Bund reach zero before the ECB, we could also tactically upgrade our recommendation on EU core bonds.

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

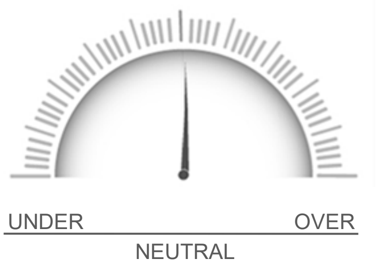
Developed Markets Corporate



We kept our negative recommendation on Developed Markets Corporates. There is no expectation of further compression in corporate investment grade spreads. Since the performance of investment grade bonds will be sensitive to the evolution of risk-free rates, we should avoid these bonds mainly because they are likely to deliver negative returns. In the crossover/high yield segments, there is still room for some spread compression, but the bulk of the tightening has already happened, and a more cautious approach should be warranted. Considering the above, for those looking to lock in higher yields over a longer time horizon, private debt strategies are a suitable solutions also offering an attractive risk profile.

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

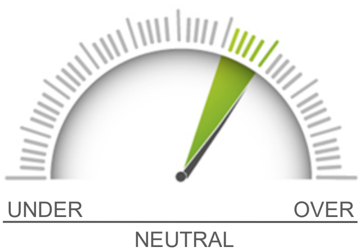
Emerging Markets



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 prevent central banks from increasing rates to defend the currencies and/or restrain inflation pressures. For Emerging Hard Currency, we have a preference for low duration strategies.

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

Commodities



We maintain our positive view on the asset class, as we think commodities may have started another bullish super cycle. The bull case on precious metals is still supported by the ample liquidity and the surge in fiscal deficits, even if an increase in long term rates is increasingly plausible. As for agricultural, industrial and energy commodities, a combination of years of underinvestment, surging demand and shipping bottlenecks are all driving commodity prices to new highs.

Precious	+	**Energy**	+	**Industrial**	=	**Agricultural**	+

Currencies

We maintain our neutral view on Euro, USD, Yen and Emerging Markets 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, unless Fed and ECB's communications and/or US inflation data materially differ from market expectations.

Euro	US D	Yen	Emerging
=	=	=	=