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Weekly Market Flash

New year, renewed focus on growth and job support

January 10, 2021

Global equity markets started the new year on a very strong note—with all countries and sectors posting significant gains this week—while the events at Capitol Hill represent the end of an unconventional and uncertain phase (Trump's tenure in the past 12 months). Our constructive view on risky assets, recently outlined in our 2021 Outlook, remains fully justified so far.

Highlights

▪ Economic data was strong across the globe, excluding the US labor market report, which remains a lagging indicator. ISM manufacturing and non-manufacturing were particularly strong in the US.

▪ The wind of reflation has been very strong, with rates rising due to increased inflation expectations. Commodities and Bitcoin have become the early stars of 2021. Surprisingly, EM currencies, precious metals and short USD trades didn't follow this trend, despite a very promising price action in the first few days.

▪ Following the Democrats' victory in the Georgia run-off election, major indexes started to price in major federal spending. Inflation beneficiaries, such as energy and commodity stocks, led gains. Saudi Arabia's surprise decision to unilaterally cut oil production further supported energy prices.

▪ The confusion around Fed communication on tapering Treasury purchases, along with diminished uncertainties, contributed to some repricing in fixed income and gold—and we believe that gold has also been penalized by the unstoppable performance of Bitcoin.

▪ Our constructive view on risky assets is fully justified so far, and we remain invested since the trend appears strong, despite the many risks we have analyzed.

"If there is any underappreciated risk in markets at the moment, it is that too much stimulus has been injected into western economies, with no end in sight."

Markets & Macro | 2021: A focus on growth and job support

US policymaking will be the key short-term market mover.

This week's events at Capitol Hill represent the end of an unconventional and uncertain phase (Trump's tenure in the past 12 months), while the propensity of physically threatened Congress members to ease when needed should increase.

Our view: If there is any underappreciated risk in markets at the moment, it is that too much stimulus has been injected into western economies, with no end in sight.

With the Democrats winning the Georgia run-off election, they will have a 4-year majority in the two chambers ahead of them. Of course, a 1-vote majority (that of Vice President Kamala Harris) in the Senate does not allow them to do great things—as there is the filibustering method in the Senate, with 60 votes needed to get around it. Reconciliation, through which Congress can pass tax legislation with a simple majority in the Senate and circumvent filibustering, can only be used once a year. In addition to this, with 50-50, all it takes is one absence or dissent among the Democrats to block any vote. Joe Biden will have the scope to push ahead with a broad package of policies aimed at boosting jobs, investment and green energy.

This week, soon-to-be Senate leader Chuck Schumer also noted that the $2,000 stimulus checks are "one of the first things we want to do". Given that we will likely struggle until spring with the virus, we believe US policymaking is the main area to follow to gauge for the short-term direction of markets.

On the other side, investors are not worrying about promised tax hikes for corporates and high-income households, or the prospect of tighter regulations on key sectors such as big tech, healthcare and financial services. Instead, 2021 will see a focus on growth and regaining all the lost jobs.

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Equities | Fundamentals don't fully justify asset prices

FTSE 100 leads with 6.4% weekly gain.

Following the Democrats' victory in the Georgia run-off election, major indexes started to price in major federal spending. Inflation beneficiaries, such as energy and commodity stocks, led gains. Saudi Arabia's surprise decision to unilaterally cut oil production further supported energy prices, while financial stocks received some support from rising Treasury yields.

On the other hand, technology stocks were held back by the rise in interest rates and the risk of new regulation, while Chinese internet stocks performed poorly following news of the US potentially adding Tencent and Alibaba to the list of Chinese companies to be delisted by the NYSE.

Value-rich European indexes outperformed US indexes, led by energy and banking stocks. The FTSE 100 index stood out, with a 6.40% rally.

Figure 1: Global Equity Market Performance

		Value	WTD % Chg	MTD % Chg	YTD % Chg
INDU Index	Dow Jones	31,097.97	1.66%	1.66%	1.66%
SPX Index	S&P 500	3,824.68	1.87%	1.87%	1.87%
CCMP Index	Nasdaq	13,201.98	2.45%	2.45%	2.45%
SX5E Index	Euro Stoxx 50	3,645.05	2.67%	2.67%	2.67%
UKX Index	FTSE 100	6,873.26	6.40%	6.40%	6.40%
CAC Index	CAC 40	5,706.88	2.93%	2.93%	2.93%
DAX Index	DAX	14,049.53	2.41%	2.41%	2.41%
FTSEMIB Index	FTSE MIB	22,793.94	2.52%	2.52%	2.52%
NKY Index	Nikkei 225	28,139.03	2.53%	2.53%	2.53%
HSI Index	Hang Seng	27,878.22	2.38%	2.38%	2.38%
SHSZ300 Index	CSI 300	5,495.43	5.45%	5.45%	5.45%

Source: Bloomberg, as at January 8, 2021. Performance figures in indices' local currencies.

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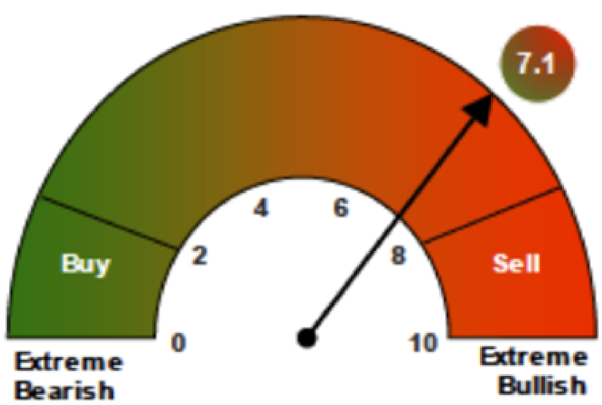
The closely followed BAML Bull & Bear Indicator also jumped from 6.7 on December 17 to 7.1, approaching the "sell" signal (which is above 8).

Figure 2: BAML Bull & Bear Indicator



Source: BofA Global Investment Strategy.

Our view: The week's price action revealed several pockets of asset price exuberance that would be challenging to support on a fundamental basis. It remains to be seen if and how this speculative behavior spreads to other areas of the market.

Then NCP Model Portfolio benefited from our decision to increase the weight of the value component (financials, energy and materials) at the expense of growth stocks (mainly technology).

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FX & Commodities | USD recovers, but we maintain bearish stance

Economic data and looming stimulus support our long-term view.

The US dollar surprisingly recovered after the Democrats took control of the Senate.

Our view: The move is counterintuitive, and we think it is due to heavy (short) positioning and "sell the fact" price action. In our opinion, the declining USD trend is solid and this week's events support the bearish case.

For example, this week, the trade deficit as of November was the highest in over a decade, and one of the highest on record, due to strong imports notably outpacing exports. Economic data was strong even prior to the results of the Senate run-offs, and now another large-scale round of fiscal support is looming. We believe it is the perfect scenario for starting a self-sustaining recovery from the pandemic—or a perfect storm for the USD, deficits, and inflation.

This notwithstanding, we will probably have to wait for the next phase of USD weakness and a sustained recovery in precious metals. The real Federal Reserve's (Fed) dovishness will come when the economy has recovered. In normal circumstances, the Fed would typically start to normalize rates, but instead with their new Flexible Average Inflation Target, they will be staying on hold for potentially years to come.

Chart of the week

This week we focus on the weekly bars chart of the Dollar Index, showing the long term view. If we look at the bottom of the channel, the USD has room to depreciate in the long run.

A negative MACD is another signal of weakness for the extended period.

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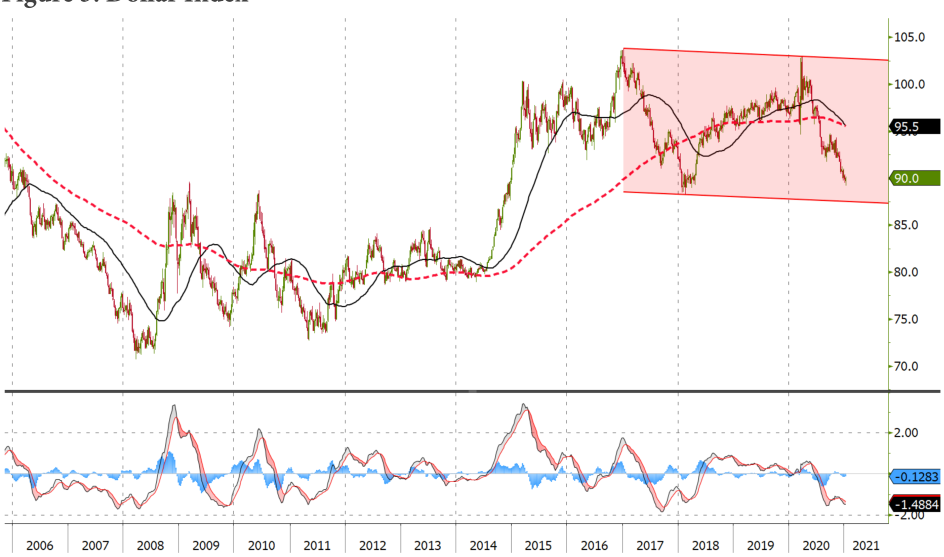
Figure 3: Dollar Index



Source: Bloomberg.

Fixed Income & Credit | Expectations drive up 10-year UST yields

“We believe any movement in the 10-year UST above 1.30%-1.50% should be monitored very carefully, at which point the long-term bond rally will be under discussion.”

Will large investors view this as a buying opportunity?

The change in sentiment—following the Democrats’ victory—has impacted the US fixed income market. Since the beginning of the year, yields on 10-year Treasuries have risen from 0.91% to 1.07%.

Our view: Strangely enough, given the creeping up of the disinflationary trend, a large part of the increase in rates came from rising inflation expectations. US 10-year breakevens rose almost 10 basis points to 2.09%, levels not seen since 2018—when breakevens were in a range of 2%-2.20% (pretty steadily above the Fed’s inflation target).

We believe any movement in the 10-year UST above 1.30%-1.50% should be monitored very carefully, at which point the long-term bond rally will be under discussion. However, we shouldn’t forget we still live in a world of financial repression ruled by central banks, where some big players like insurance and pension funds, which are starving for yield, do not have many choices other than bonds. We will watch carefully to see if at 1.25%-1.50% these players step in, viewing this level as a buy opportunity.

Week Ahead | Key events to watch for

The week ahead will see the pandemic remain the key focus as attention turns toward the vaccination programs in various countries, and how quickly distribution is taking place.

- **Data wise, in the US, CPI and retail sales** for December will be published. Earnings releases will also begin.

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