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Weekly Market Flash
Stocks step back despite Biden's stimulus announcement

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Following the sharp gains during the first week of this year, markets have now entered what we view as a consolidation (or smooth correction) phase—with buy the rumor, sell the news, playing a key role. We are aware of the current expensive valuations and extreme positioning in equity markets, and as a result we welcome a sideways period. Positions can be cleared in such lateral market, while valuations should improve thanks to recovering corporate earnings in the coming months.

Highlights

▪ Newly elected US President Joe Biden announced an additional USD1.9 trillion of federal spending to tackle the pandemic and support the economy.

▪ Data revealed relevant stress in the US labor market, as initial jobless claims jumped to 965k last week, 176k above expected, while continuing claims came in 271k above expectations at 5.27 million. After a fall in employment in December, it's very likely that we'll see another decline in January. Retail sales were also weaker than expected.

▪ Newsflow on the vaccine distribution process and renewed lockdowns in Europe dampened sentiment this week—especially news that Pfizer will not be able to meet the deadlines for delivery of vaccines in Europe in the next four weeks, because its production plant will undergo changes to increase its production capacity.

▪ A late sell-off ahead of the long weekend in the US also left US indexes mixed for the week. Meanwhile, US banks kicked off the earnings season on Friday –JP Morgan and Citigroup posted positive earnings surprises, while Wells Fargo missed on revenue.

"If approved, Biden's package will bring US government stimulus spending since the start of the pandemic to more than USD5 trillion."

Markets & Macro | Biden: more stimulus, more tax

US stimulus to cross USD5 trillion.

Newly elected US President Joe Biden announced an additional USD1.9 trillion of federal spending to tackle the pandemic and support the economy. The announcement more or less confirms the rumors, with USD1.9 trillion in amount—but the famous USD2,000 checks are to be considered inclusive of those already sent. There is a plan to send an additional USD1,400 per capita.

Our view: Biden announced a new comprehensive plan to be unveiled in February, including spending on infrastructure and climate change solutions. But this will also include an increase in tax, which is a topic that had been on the back burner recently (in part because of the Georgia elections).

As a result, investors were taken by surprise. Among other measures announced were an increase in the corporate tax from 21% to 28%, and taxes for the rich and on capital gains. Undoubtedly, the Republicans will oppose a wall, and since raising taxes is not popular, some Democrats could have something to say about it as well. Since the majority in the Senate is made of one member, it will likely be a difficult approval process. Ultimately, taxes will go up, under Biden.

If approved, Biden's package will bring US government stimulus spending since the start of the pandemic to more than USD5 trillion. Such extreme measures will foster the coming consumption boom later in the year as lockdown restrictions become more relaxed. This will affect both the goods and services sector, and since the US has an high propensity to buy foreign-produced goods, the entire world should benefit. This assumption, along with a weak US dollar, is the basis for our exposure to Asia and emerging market equities in general.

"Nevertheless, the QE tapering discussion has now started and we expect to see more volatility in terms of Fed pricing—and also in terms of the long-end of the Treasury curve going forward."

Treasury volatility set to rise.

There seems to have been a concerted dovish push by Federal Reserve (Fed) speakers over the past week. In light of the vaccine roll-out and a better economic outlook for 2021, Fed members including Barkin and Kaplan opened the discussion of when the Fed should start to taper QE purchases. These interventions generated some confusion and sparked a dangerous rise in long-end yields, with the US 10-year yield climbing to 1.20% after breaking the 1% symbolic level. However, other Fed Members like Bullard argued that it is far too early with this discussion given we are still in a pandemic.

Our view: Nevertheless, the QE tapering discussion has now started and we expect to see more volatility in terms of Fed pricing—and also in terms of the long-end of the Treasury curve going forward.

Yet, we have little doubt that the shift from a smooth repricing in fixed income to a disorderly bear-steepening driven by reals played a crucial role in the change of communication since Tuesday this week. And it is even less of a coincidence considering that it took place ahead of the 10-year and 30-year supply (which saw very strong demand), and ahead of Biden's announcement and wider deficits.

Equities | Markets retreat, value and small caps outperform

Sentiment sours on disappointing data, lockdown extensions.

A late sell-off ahead of the long weekend in the US (Martin Luther King Day occurs on Monday) left US indexes mixed for the week. A disappointing December US retail sales figure added to the sell-off on Friday. Also, a stronger than expected industrial production figure was largely explained by a bounce in utility demand due to a colder December—which dampened sentiment regarding the beat. Meanwhile, US banks kicked off the earnings season on Friday. JP Morgan and Citigroup posted positive earnings surprises, while Wells Fargo missed on revenue.

"...Hong Kong listed shares were buoyed by a rebound in Chinese internet stocks following the decision by the US not to add Alibaba and Tencent to the US blacklist."

In Europe, stocks pulled back on political uncertainty in Italy and rising lockdown extensions. The China CSI 300 index also declined, while Hong Kong listed shares were buoyed by a rebound in Chinese internet stocks following the decision by the US not to add Alibaba and Tencent to the US blacklist.

Figure 1: Global Equity Market Performance

		Value	WTD % Chg	MTD % Chg	YTD % Chg
INDU Index	Dow Jones	30,814.26	-0.91%	0.73%	0.73%
SPX Index	S&P 500	3,768.25	-1.46%	0.38%	0.38%
CCMP Index	Nasdaq	12,998.50	-1.54%	0.87%	0.87%
SX5E Index	Euro Stoxx 50	3,599.55	-1.21%	1.43%	1.43%
UKX Index	FTSE 100	6,735.71	-1.98%	4.29%	4.29%
CAC Index	CAC 40	5,611.69	-1.67%	1.22%	1.22%
DAX Index	DAX	13,787.73	-1.86%	0.50%	0.50%
FTSEMIB Index	FTSE MIB	22,381.35	-1.81%	0.67%	0.67%
NKY Index	Nikkei 225	28,519.18	1.35%	3.92%	3.92%
HSI Index	Hang Seng	28,573.86	2.50%	4.93%	4.93%
SHSZ300 Index	CSI 300	5,458.08	-0.68%	4.74%	4.74%

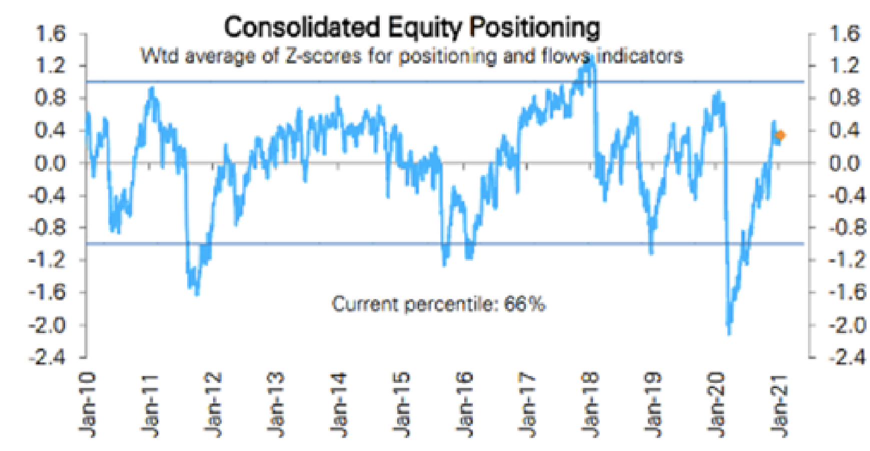
Source: Bloomberg, as at January 15, 2021. Performance figures in indices' local currencies.

> "...we view China's unexpected decision to drain liquidity for the first time since July as a signal to reduce our exposure to the asset class..."

Energy stocks led during the week but lost steam on Friday, together with other commodity stocks. Meanwhile, the value factor came under pressure on Friday following the announcement of President Biden's stimulus plan. Nonetheless, value stocks outperformed growth shares for the week, while small caps outperformed large caps for the second week this year.

Our view: The bullish sentiment has retreated according to the Goldman Sachs sentiment indicator, but the BAML Bull & Bear Indicator was unchanged. At the same time, consolidated equity positioning remains slightly above average, according to Deutsche Bank.

Figure 2: Equity Positioning



Source: Deutsche Bank.

This week, following the roughly 6% year-to-date rally on China A-shares (CSI 300 Index), we view China's unexpected decision to drain liquidity for the first time since July as a signal to reduce our exposure to the asset class—by taking profit on half of the position.

Fixed Income & Credit | Europcar CDS: To speculate or not?

> "Last year Europcar announced a restructuring of its capital structure—and last month, it finally defaulted."

French company defaults on bonds.

Last year Europcar, the struggling French car rental company, announced a restructuring of its capital structure—and last month, it finally defaulted. As a result, the price of the company's bonds collapsed.

Figure 3: Europcar CDS

Source: Bloomberg.

“The lesson is that CDS are not the devil’s instruments, and they work perfectly when used correctly. But, if you are speculating, keep in mind that markets do not always work as expected...”

Our view: In 2009 the process to settle credit default swaps (CDS) was standardized with the cash price set at auction. The problem with Europcar was that the bids exceeded the amount of available securities, driven by bondholders that had already entered a lock-up agreement, and by traders that had placed outsized bets on a lucrative swaps pay-out. The mismatch set an automatic recovery value of 100% on around USD100 million worth of swaps. The bondholders that hedged with CDS and delivered notes into the auction were fully compensated for their holdings. However, protection buyers who did not hold any of Europcar Mobility Group’s underlying debt were left with nothing, due to a shortage of bonds to settle contracts at the auction.

The lesson is that CDS are not the devil’s instruments, and they work perfectly when used correctly. But, if you are speculating, keep in mind that markets do not always work as expected—and this can result in an undesirable outcome.

Chart of the week

The US 10-year yield moved above 1% for the first time since March, breaking the post-COVID range. The sell-off in Treasuries came after the FOMC minutes, but as signalled by the Relative Strength Index, the move was exaggerated—and this week it corrected the sell-off.

Figure 4:

Source: Bloomberg.

Week Ahead | Key events to watch for

- **Biden's inauguration will be the dominating event** next week. In terms of data, we will see publications on the US housing market.
- **In the Eurozone, the focus will be on the European Central Bank.** However, after December’s big announcements, there is not much to be expected this time.
- **In terms of key earnings** next week, Bank of America, Goldman Sachs, Netflix, P&G, Intuitive Surgical and Intel are due to report.

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