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Weekly Market Flash

Will structural headwinds shift the investment landscape?

March 28, 2021

Markets were characterized by a battle between bulls and bears this week. While the performance of major equity indexes was stable to positive, and aggregate volatility measures declined accordingly, there are a number of tensions beneath the surface – including increased regulation on the tech sector and geopolitical tensions between the US and China. In addition, the "reopening trade" suffered a setback due to the chaos with vaccinations in Europe. In this environment, we tend to remain constructive on risky assets in the short term – but we also recognize the emergence of headwinds that could likely change the investment landscape in the longer term.

Highlights

- This week, tech stocks suffered, with Chinese names under severe pressure and in many cases, breaking their 200-day moving average.
- Economic data has also been strong, and not only in the US. The UK's strong PMIs should lead the show for Europe, and the second quarter could be the strongest of the year.
- The VIX index is declining. The ARKK ETF underperformance (-8.45% this year), as well as bitcoin's performance, are signs that market excesses are receding.
- After yet another turn by Turkey's President Erdogan, the bonds of Turkish debtors heavily corrected downward this week.

Markets & Macro | Will structural headwinds shift the investment landscape?

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Favorable environment remains in place for the short term.

While the performance of major equity indexes was indeed stable to positive, in our view, real action was very chaotic. Tech stocks suffered, with Chinese names under severe pressure and in many cases, breaking their 200-day moving average. Increased regulation in the tech sector and US-China tensions are certainly responsible for this move. In fact, the latest US-China meeting ended with more convergence on climate change, but relations remain tense. A series of cross-sanctions are being prepared, with the western block ready to launch targeted measures for the treatment of the Uighurs, while China is threatening retaliation including against the EU.

The "reopening trade" also suffered a setback in Europe driven by vaccine chaos, extended lockdowns and the possibility of temporary bans to vaccine exports out of Europe. If this move were to materialize, we believe it would have the effect of fueling tensions with non-EU countries, as well as reducing the appeal of the Eurozone as a place for productive investment.

Strength in the US dollar this week didn't help sentiment either, since a rising USD is often associated with a risk off tone and reduced liquidity in the system. Turkish assets were certainly the first victim of higher yields and the stronger USD.

Our view: In this environment, we remain constructive on risky assets in the short term, but we recognize the emergence of headwinds that could likely change the investment landscape in the longer term. In fact, many of the reasons for remaining long equities are either tactical or should exhaust in the coming weeks, once the positive impact on corporate earnings and economic data naturally fades as economies fully reopen a year after the first lockdowns were imposed.

At the same time, there are a number of tailwinds supporting the overall outlook. For instance, President Joe Biden's latest stimulus bill includes the famous USD1,400 checks that are being sent to US taxpayers. Retail investors are expected to pour a large chunk of their checks into the equity market – as mentioned last week, Deutsche Bank calculated a potential amount of up to USD170 billion over time. Biden also said he will reveal details of the new infrastructure package next week. The plan should be worth as much as USD3 trillion, partly financed by higher taxes on corporates and wealthy individuals, and should be spent on physical and cyber infrastructure.

"Economic data has also been strong recently, and not only in the US. The trend should continue in the coming weeks as economies reopen, even eventually in Europe."

In addition to this, the Federal Reserve (Fed) remains extremely dovish. Since the central bank changed its monetary policy objectives recently, it can focus on job recovery rather than to preemptively hike rates in anticipation of an inflation spike driven by higher growth. This is also true for other major central banks, especially the European Central Bank. As a consequence, financial conditions are extremely loose, and despite some recent recovery in the USD, they should remain loose.

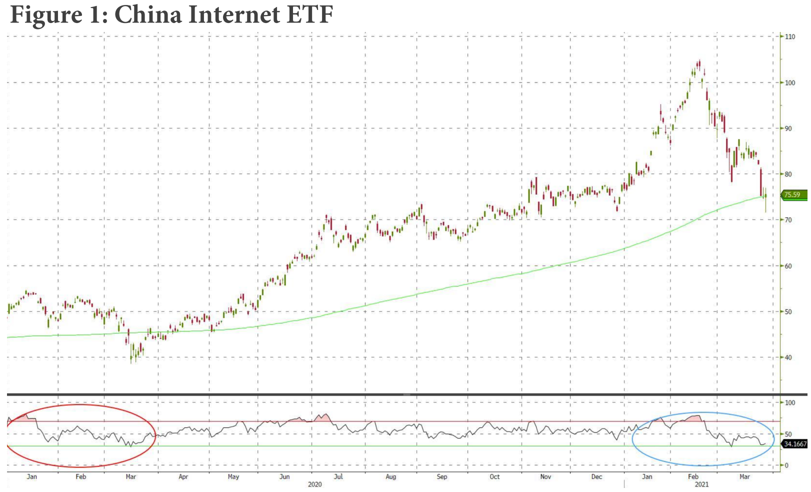
After a month packed with Treasury auctions, which burdened investors' ability to absorb the offer to some extent, no auctions are scheduled for the next two weeks. On the other hand, the Fed's Treasury purchases have increased lately, and the message to keep providing liquidity to the market was once again confirmed this week by the Fed's Chairman. The central bank also announced that restrictions regarding US banks' share repurchase programs and dividends will be removed for banks that comply with minimum capital requirements.

Economic data has also been strong recently, and not only in the US. The trend should continue in the coming weeks as economies reopen, even eventually in Europe. The UK's strong PMIs this week should lead the show for Europe, and the second quarter could see an enormous turnaround in sentiment and be the strongest of the year. The end-of-quarter rebalancing that we're currently witnessing should be a positive and start the second quarter on a stronger foot, with improved positioning.

Chart of the Week

Following the overextended rally which ended last February, the correction of the KWEB US (CSI China Internet ETF) stopped at the 200-day moving average. The RSI is showing a path similar to the period from January to March 2020.

Figure 1: China Internet ETF



Source: Bloomberg, as at March 26, 2021.

"...there is a decline in equity call volumes, at the same time that restaurant bookings pick up – in essence, we are seeing retail pull back and return to normal life."

Equities | Positive factors emerge, but uncertainties remain

Markets rise, but earnings and positioning likely to peak.

In addition to the positive factors mentioned above, technicals are likely to remain favorable in specific sectors – such as Chinese tech – post any major correction. The VIX index is also declining, suggesting commodity trading advisors would be buyers of equities. The ARKK ETF underperformance (-8.45% this year), as well as bitcoin's performance, are signs that market excesses are receding. Finally, there is a decline in equity call volumes, at the same time that restaurant bookings pick up – in essence, we are seeing retail pull back and return to normal life.

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Figure 2: Global Equity Market Performance

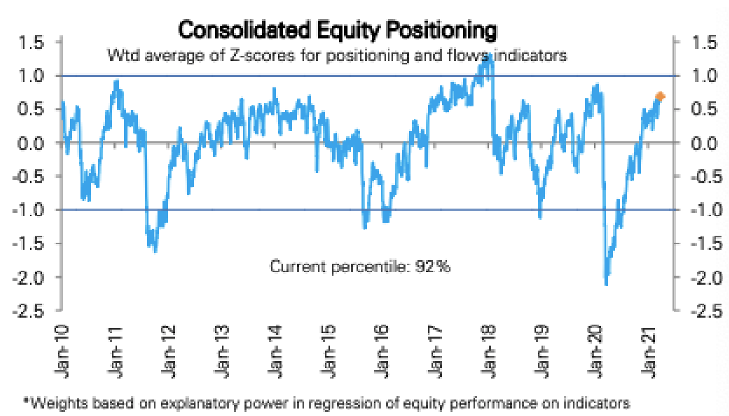
	Value	WTD % Chg	MTD % Chg	YTD % Chg
Dow Jones	33,072.88	1.36%	7.06%	8.58%
S&P 500	3,974.54	1.58%	4.40%	6.19%
Nasdaq	13,138.72	-0.57%	-0.35%	2.11%
Euro Stoxx 50	3,866.68	0.84%	6.48%	9.29%
FTSE 100	6,740.59	0.58%	4.58%	5.40%
CAC 40	5,988.81	-0.03%	5.14%	8.17%
DAX	14,748.94	0.88%	6.98%	7.51%
FTSE MIB	24,393.26	0.81%	6.77%	10.13%
Nikkei 225	29,176.70	-2.07%	0.73%	6.36%
Hang Seng	28,336.43	-2.25%	-1.90%	4.40%
CSI 300	5,037.99	0.62%	-5.60%	-3.32%

Source: Bloomberg, as at March 26, 2021. Performance figures in indices' local currencies.

Our view: Again, there are several headwinds that could shape the equity landscape going forward. For instance, earnings are likely to peak in the first half of 2021. And positioning, especially among discretionary investors, is also peaking.

There are also a number of uncertainties, including Big Tech regulation (although the silver lining is a value release in the case of breakup), and the path of inflation post the transitory period (poor demographics on one hand, MMT on other). In addition to this, the reopening of economies could divert part of the savings deployed in the stock market into consumption activities like travel and leisure. While this would be a pain in the short term, in the long term, we believe it would be better for market stability.

Figure 3: Equity Investor Positioning



Source: Deutsche Bank.

"After yet another turn by Turkey's President Erdogan, the bonds of Turkish debtors heavily corrected downward this week."

Fixed Income & Credit | Turkish risk appears skewed to the downside

Weaker TRY adversely impacts credit fundamentals.

After yet another turn by Turkey's President Erdogan, the bonds of Turkish debtors heavily corrected downward this week.

Figure 4: Turkey's Bond Prices

		Last week downside in %	Current	1 Year Min	1 Year Max	Downside in %	Upside in %
Sovereign	TURKEY 6 1/4 09/26/22	-3,2%	101,50	92,13	105,13	-9,2%	3,6%
	TURKEY 7 3/8 02/05/25	-6,8%	103,38	90,50	112,50	-12,5%	8,8%
Sen bank	GARAN 5 1/4 09/13/22	-2,5%	100,45	91,00	103,38	-9,4%	2,9%
	AKBNK 5 1/8 03/31/25	-6,2%	96,09	80,00	103,77	-16,7%	8,0%
Sub bank	GARAN 6 1/8 05/24/27	-9,1%	96,68	74,00	101,44	-23,5%	4,9%
	YKBNK 5 1/2 12/06/22	-3,1%	99,00	86,12	102,13	-13,0%	3,2%

“A weaker Turkish lira, directly or indirectly, adversely affects the credit fundamentals of Turkish assets.”

Our view: Comparing the current bond prices to the 1-year highs and lows suggests that risk appears to be skewed to the downside. In fact, the latest change in the Turkish central bank governor increases the uncertainty surrounding monetary policy and investors’ perception of an erosion of Turkey’s institutional strength. A weaker Turkish lira, directly or indirectly, adversely affects the credit fundamentals of Turkish assets. For banks, especially, a weaker TRY is likely to erode capitalization, put pressure on asset quality, dampen profitability, and increase liquidity risks.

Elsewhere on central banks, the Bank of Canada (BoC) said this week that it will unwind its crisis liquidity facilities and further reduce its purchases of Canadian government bonds. This was not totally unexpected, since the central bank had already recalibrated its purchases of government bonds last October. The BoC is wary of accumulating too large a share of outstanding securities, currently at 36% of the market compared with less than 13% before the pandemic. The Deputy Governor said that the BoC would be gradually dialling back the purchases of bonds down to where the purchases merely replace maturing securities. And on the subject of rate hikes, when the economy and inflation are on target, as outlined in the forward guidance, the Deputy Governor stated “we will need to start raising our policy rate”. This is only a deceleration, rather than putting on the brakes, but nevertheless still some relative tightening from a G7 central bank.

Week Ahead | Key events to watch for

Next week is a quiet calendar in Europe, with most markets closed on Friday for the Easter holiday.

- **In the US, key data releases include manufacturing and services ISM** surveys, and the March labor market report.

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