GENERALI INVESTMENTS

Market Compass

March 2021

MARKET OUTLOOK

- Despite stretched investors' positions and residual risks from Covid-19 mutations, the Spring rebound to support favourable financial conditions.
- Fears of soaring US inflation pose risks for fixed income.
- Equities should prove resilient, but the pick-up in real yields deserves to be watched, especially for the impact on highly valued risk assets.
- Overall, we maintain a moderate pro-risk tilt in our portfolios, with potential equity setbacks providing buying opportunities into a broader 'Spring reopening'.

Edited by

MACRO & MARKET RESEARCH TEAM

A team of 13 analysts based in Paris, Cologne, Trieste, Milan and Prague runs qualitative and quantitative analysis on macroeconomic and financial issues.

The team translates macro and quant views into investment ideas that feed into the investment process.

UK

- UK to lift lockdown in several steps
- Good progress on vaccination
- Retail sales hit more strongly than expected

EUROZONE

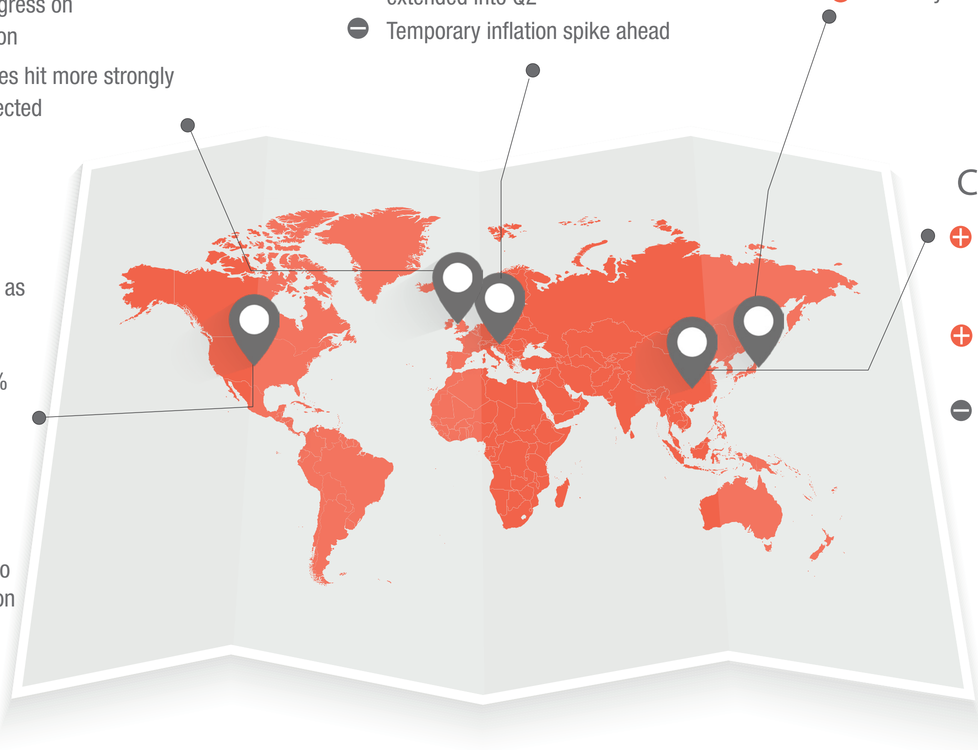
- Sentiment improved, global environment supportive
- Vaccination is gaining momentum
- Lockdown measures likely extended into Q2
- Temporary inflation spike ahead

JAPAN

- Japan's fresh Covid-19 cases receded
- Disinflation to turn around due to oil prices
- Economy to rebound from Q2 on

US

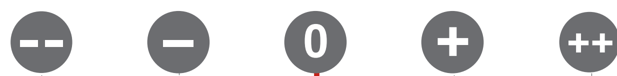
- Q1 stronger than expected as consumption picks up
- A US$1.6tn fiscal package will lift growth to nearly 7% this year
- Fed remains focused on slowly improving labour market: tapering is not imminent
- Pent up demand will lead to a temporary bout of inflation in Spring



CHINA

- Recent Covid-19 outbreaks appear under control
- NPC to confirm policy normalisation
- Latest PMIs slowed slightly

DIRECTION OF TRAVEL

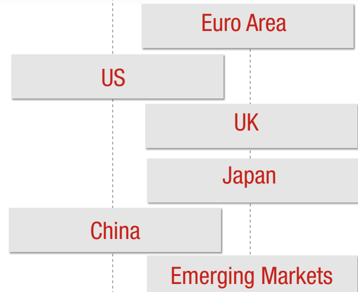


- Trim the still strong overweight (OW) in Equities and High Yield (HY) Credit
- Reduce the OW in Euro Investment Grade (IG) Credit
- Maintain the underweight (UW) in Core bonds
- OW in EMs (both bonds and especially equity) confirmed

Equities (++) · Credit (+) · Sovereign (-) · Cash (--)

Equities

- PEs are increasingly at risk but, differently from 2018, earnings have not reached their peak yet and are to improve
- Higher growth and yields in addition to policy support bode well for continuing sector rotation into Value (especially) and Cyclicals
- Lower equity OW. Favour Japan, UK and EMs and EMU vs US



Bonds

- Notwithstanding sell-off, there is further scope for higher EA and (particularly) US sovereign yields
- EA non-core spreads unlikely to widen given possible ECB interventions
- In corporates, tight spread are underpinned by fundamentals (incl. ECB support): we continue to prefer BBB within IG and BB in HY

Gov. Euro Area (core) · Gov. Euro Area (peripheral) · Gov. US · Euro Investment Grade · Euro High Yield

Duration

- Neutral duration recommended

Duration

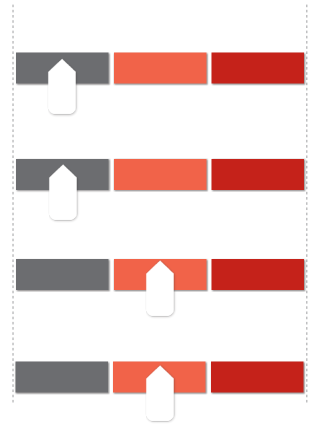
Currencies

- We stick to our view of another leg lower in the USD throughout 2021 amid a persistently supportive Fed and a global recovery from the pandemic
- Short term, however, higher US yields and an earlier US rebound (fiscal package, vaccination lead) make the USD outlook more balanced both against the yen and the euro

Euro vs. USD · JPY vs. USD

TOPICS TO WATCH!

- Setbacks on vaccine safety eventually reversing earlier good news on effectiveness
- Surprising strong rebound in inflation on reopening economies in spring/summer
- New wave(s) of Covid-19 infections on mutations requiring even broader/prolonged shutdowns
- Tightening in tech regulation and/or global taxation



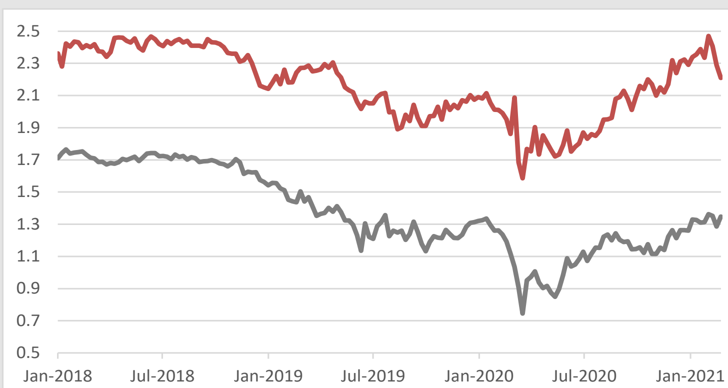
Risk Min. Risk Max.

SPECIAL FOCUS

Reflation: mostly healthy but with some risks

New infections and deaths have been falling sharply since January but lockdowns are still needed. Front-runners in vaccination (Israel, UK) are reporting promising results, allowing a quick reopening of the economy. EU is lagging behind, but accelerated production and improved logistics may allow for inoculating the most vulnerable people and front-line health care workers by May.

Meanwhile, inflation worries will take even more centre stage. The US administration will deliver another fiscal package, worth US$ 1.6tn in our estimations. This will greatly amplify the economic rebound and coincide with a sharp increase in annual inflation rates in spring (more in the US than in the EA), mainly due to statistical effects from last year's collapse in oil prices. The Fed will flag the temporary nature of the inflation spike, while employment is still almost 10m below pre-crisis levels. Yet markets may question the dovish Fed commitments, fuelling speculation about the tapering of its bond purchases. The orderly rise in yield that we expect will cap but not derail the overall friendly risk environment. Risks are rising, however. The whole investor community may not be prepared for a significant rise in yields, after a decades-long reduction.



Source: Datastream as at 1st of March, 2021.

For now, we retain a pro-risk bias. Pro-risk positioning among investors is high and valuations tight, but the recent rise in real yields (+40 bps in 10y TIPS) has been small compared to the 2013 taper tantrum (+150 bps). We are less concerned about a sell-off in EUR fixed income, as inflation remains very low. The new Italian government intends to complement Recovery Fund spending with structural reforms, keeping risk premia low. Credit spreads are tight but contained default rates and persistent ECB's support helps. We carefully watch EM exposure on headwinds from higher US yields.

GLOSSARY

PENT-UP DEMAND

Pent-up demand refers to a situation where demand for a service or product is unusually strong. Economists generally use the term to describe the general public's return to consumerism following a period of decreased spending. The idea is that consumers tend to hold off making purchases during a recession (or, as in the current situation, due to restrictions in mobility), building up a backlog of demand that is unleashed when signs of a recovery emerge.

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