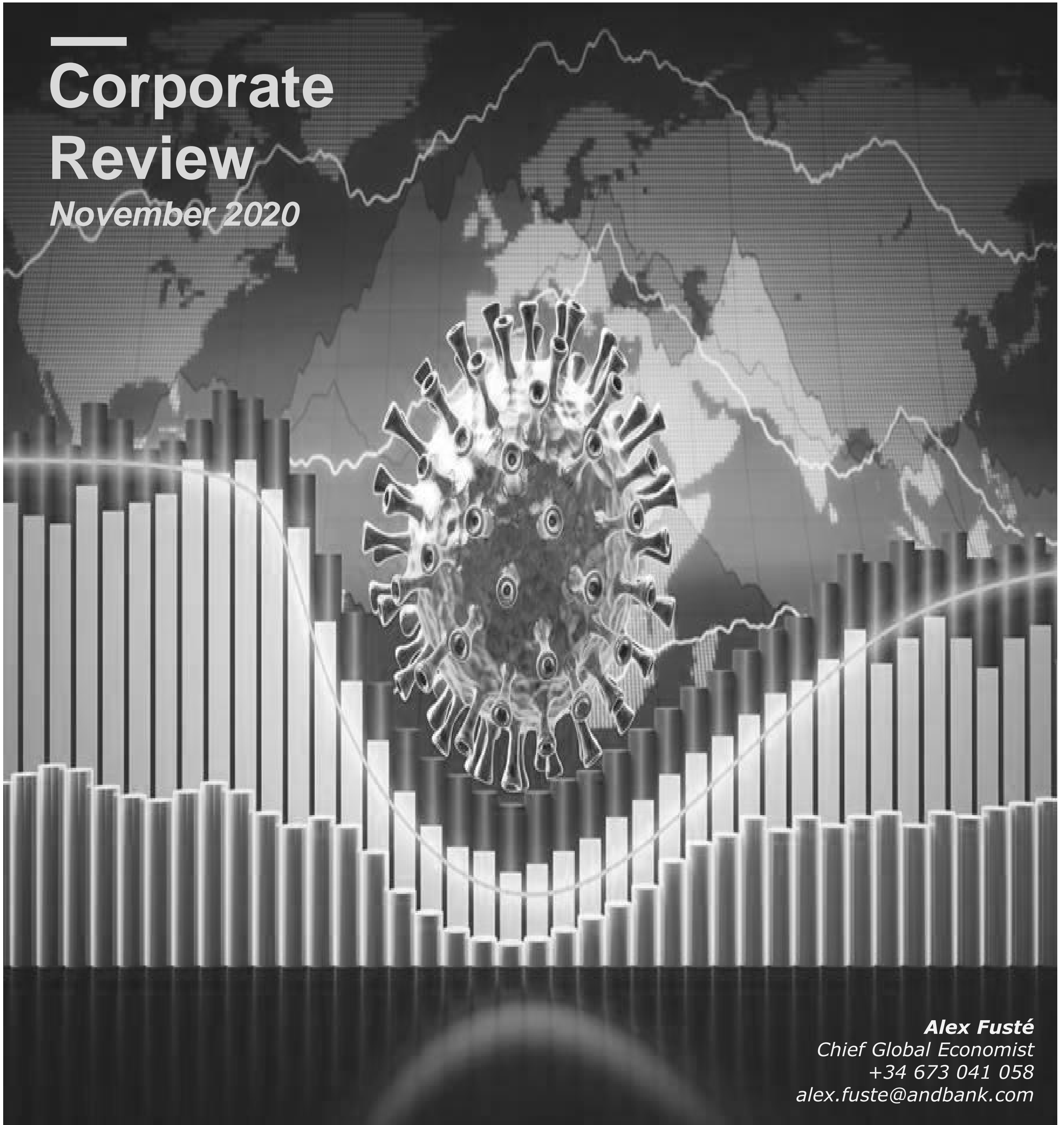
GLOBAL OUTLOOK

ECONOMY & FINANCIAL MARKETS

ANDBANK
Private Bankers

Andbank Monthly Corporate Review

Andbank Monthly Corporate Review – November 2020



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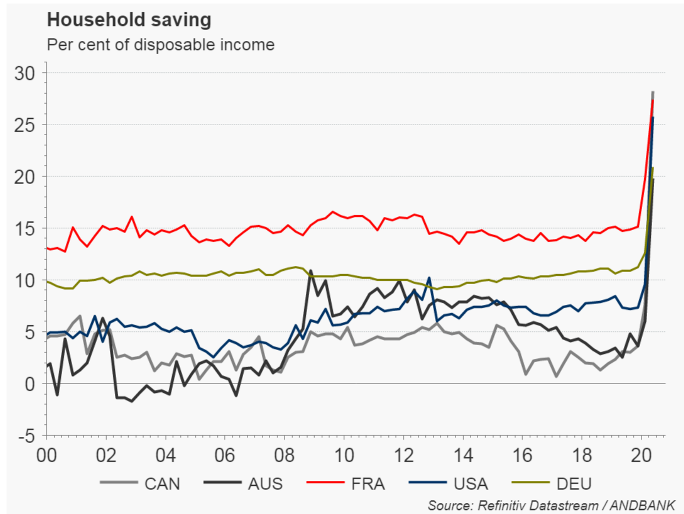
EXECUTIVE SUMMARY

CHART OF THE MONTH



EQUITIES

Index	INDEX CURRENT PRICE	Current Fair Value (EPS 12 month fw)	2020 E[Perf] to Fair Value	Recomm	2020 Exit Point
USA S&P 500	3.270	3.364	2,9%	MW	4.037
Europe - Stoxx Europe 600	342	348	1,5%	MW	417
Euro Zone - Euro Stoxx	333	357	7,2%	MW/OW	429
Spain IBEX 35	6.452	6.831	5,9%	MW	8.197
Mexico IPC GRAL	36.988	37.670	1,8%	MW	45.203
Brazil BOVESPA	93.952	102.254	8,8%	OW	122.704
Japan NIKKEI 225	23.295	21.101	-9,4%	UW	25.321
China SSE Comp.	3.225	3.064	-5,0%	UW	3.677
China Shenzhen Comp	2.223	1.955	-12,1%	UW	2.345
India SENSEX	39.533	37.266	-5,7%	MW	44.719
Vietnam VN Index	933	905	-3,1%	MW	1.085
MSCI EM ASIA	621	598	-3,6%	MW	718

FIXED INCOME GOVIES CORE & CORPORATE CREDIT (DM)

Asset Class	Indices	Current Price	Fair Value	Expected Performance to Fair Value (Next 12 months)
Fixed Income Core countries	US Treasury 10 year Govie	0,86	1,00	-0,3%
	UK 10 year Gilt	0,26	0,80	-4,1%
	German 10 year BUND	-0,64	-0,40	-2,5%
	Japanese 10 year Govie	0,04	0,00	0,3%
Fixed Income Peripheral	Spain - 10yr Gov bond	0,13	0,40	-2,0%
	Italy - 10yr Gov bond	0,73	0,90	-0,6%
	Portugal - 10yr Gov bond	0,09	0,40	-2,4%
	Ireland - 10yr Gov bond	-0,28	0,00	-2,5%
	Greece - 10yr Gov bond	0,88	1,40	-3,3%
Fixed Income Credit	Credit EUR IG-Itraxx Europe	65,31	70	0,0%
	Credit EUR HY-Itraxx Xover	382,21	350	4,3%
	Credit USD IG - CDX IG	65,15	78	0,5%
	Credit USD HY - CDX HY	418,35	440	3,7%

FIXED INCOME EMERGING MARKETS

Asset Class	Indices	Current Price	Fair Value	Expected Performance to Fair Value (Next 12 months)
Fixed Income EM Europe (Loc)	Turkey - 10yr Gov bond (local)	14,06	13,25	20,5%
	Russia - 10yr Gov bond (local)	6,18	5,25	13,6%
Fixed Income Asia (Local curncy)	Indonesia - 10yr Gov bond (local)	6,57	5,60	14,3%
	India - 10yr Gov bond (local)	5,89	6,80	-1,4%
	Philippines - 10yr Gov bond (local)	3,05	3,00	3,4%
	China - 10yr Gov bond (local)	3,17	3,00	4,5%
	Malaysia - 10yr Gov bond (local)	2,62	1,60	10,7%
	Thailand - 10yr Gov bond (local)	1,32	0,60	7,0%
	Singapore - 10yr Gov bond (local)	0,78	0,40	3,9%
	Rep. Korea - 10yr G. bond (local)	1,50	1,40	2,3%
	Taiwan - 10yr Gov bond (local)	0,29	0,25	0,6%
Fixed Income Latam	Mexico - 10yr Govie (Loc)	6,01	6,00	6,1%
	Mexico - 10yr Govie (USD)	3,18	3,50	0,6%
	Brazil - 10yr Govie (Loc)	7,58	7,50	8,2%
	Brazil - 10yr Govie (USD)	4,02	4,00	4,2%

COMMODITIES & FX

Asset Class	Indices	Current Price	Fair Value	Expected Performance to Fair Value (Next 12 months)
Commodities	Oil (WTI)	34,1	45,00	31,9%
	GOLD	1.883,3	1.600	-15,0%
Fx	EURUSD (price of 1 EUR)	1,163	1,15	-1,2%
	GBPUSD (price of 1 GBP)	1,29	1,32	2,3%
	EURGBP (price of 1 EUR)	0,90	0,87	-3,3%
	USDCHF (price of 1 USD)	0,92	0,97	5,7%
	EURCHF (price of 1 EUR)	1,07	1,12	4,5%
	USDJPY (price of 1 USD)	104,79	107,00	2,1%
	EURJPY (price of 1 EUR)	121,92	123,05	0,9%
	USDMXN (price of 1 USD)	21,30	22,00	3,3%
	EURMXN (price of 1 EUR)	24,77	25,30	2,1%
	USDBRL (price of 1 USD)	5,74	5,50	-4,3%
	EURBRL (price of 1 EUR)	6,68	6,33	-5,3%
	USDARS (price of 1 USD)	78,32	95,0	21,3%
	USDINR (price of 1 USD)	74,43	74,00	-0,6%
	CNY (price of 1 USD)	6,69	6,75	0,8%

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MACRO ECONOMY

USA

A democratic election hat trick would likely lead to higher yields

Economic recovery continues but is cooling

Retail sales growth picked up again in September, increasing 1.9% and with a broad base. Consumer spending has also been increasing in recent months while disposable incomes have been declining and the recent rapid rate of spending growth therefore seems unsustainable. The stimulus payments distributed as part of the CARES Act are likely now a distant memory for many households and the generosity of unemployment benefits was reduced over the summer. Unemployment insurance payments will also drop further at the start of next year unless policymakers agree to extend benefits or put some other programs in place.

Fiscal boost

Next year, fiscal policy will depend more on the outcome of the Senate elections than the presidential election. Fiscal policy differences between Republicans and Democrats in the Senate are significant. Recent negotiations over a COVID-19 relief package demonstrate this clearly, as the Trump Administration's $1.8 trillion offer and Speaker Pelosi's $2.4 trillion request are much closer to each other than either is to the $500bn Republican Senate proposal. If Biden wins the White House but Republicans hold their majority in the Senate we would expect a Biden Administration and a Democratic House to agree on a large fiscal relief package but we would anticipate that Senate Republicans would try to limit fiscal legislation to around the $500 billion. We would expect the rest of the Biden agenda to face similar resistance. It is unlikely that most Republican senators would support an infrastructure package even half as large as the $2 trillion over four years that Biden has proposed. We also think that Republicans would likely block any attempt to roll back the 2017 tax law. We expect a Senate Republican majority would be more likely to overcome an aversion to spending in support of President Trump's proposals. It is unclear what a second-term Trump Administration would set as a legislative priority but infrastructure is one candidate.

Instead, a democratic election hat trick would probably lead to frontloaded fiscal stimulus and a better near-term growth outlook, and contribute to higher yields. The CRFB estimates Trump's plan would increase debt by $4.95tn over the next decade, while Biden's platform would add $5.6tn.

Fixed Income Market

Treasury yields have been spurred higher and the curve steeper as market participants are focused more on the post-election prospects for large-scale stimulus. Looking forward, with front-end yields likely to remain well anchored by the Fed's forward guidance, yield/curve directionality should remain firmly positive and continue to steepen. We are therefore keeping our target for the 10 year bond at 1.0%.

HG credit spreads have rebounded from September levels. Supply has slowed in October ($31bn MTD) as companies are reluctant to issue right before the election. Demand for HG bonds has picked up as over 75% of developed market sovereign debt is trading at negative real yields. The universe of nominally negative yielding debt has grown by 50% since March and is currently at $14tn. This is a powerful force pushing investors out of sovereign debt globally and into spreads (and equities) as central banks likely intended.

HY corporate yields touched a nine-month low despite the uncertainty around the stimulus bill and increased attention to COVID rates. Primary market activity has decreased as well – only 29 new high yield bonds have been priced in October MTD, compared to 77 new bonds priced in September totaling $50.9bn. Default volume has been slowing during the past month, with only about $2.9bn of high yield defaults in September, and $1.6bn in August. This compares with nearly $19bn in March, $37bn in April and $27bn in June. The par-weighted high-yield default rate is currently 5.80%. Recent defaults include Pacific Drilling (1.1bn) and Oasis Petroleum (1.6bn).

Equity Market

In equities, the S&P500 recovered +2% in October (after -3.92% in September), while the Nasdaq rose +2.81%, approaching historical highs again. Results reporting has started, but only 10% of the index has been released so far. The electoral result, in addition to earnings, will be a key factor in assessing the fair level of the S&P500 vis-à-vis the tax increase that a Democratic victory may imply. We forecast an EPS for the next 12 months of 158, with a 20x PE ratio, resulting in a fair value for the S&P of 3,165 and an exit point at 3,800.

Financial market assessment

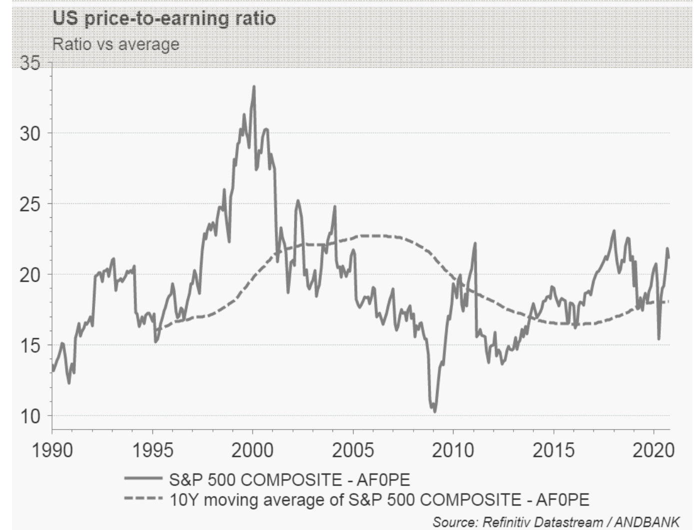
Equities – S&P: MARKETWEIGHT

Bonds – Govies: UNDERWEIGHT (10Y UST Entry point 1.0%)

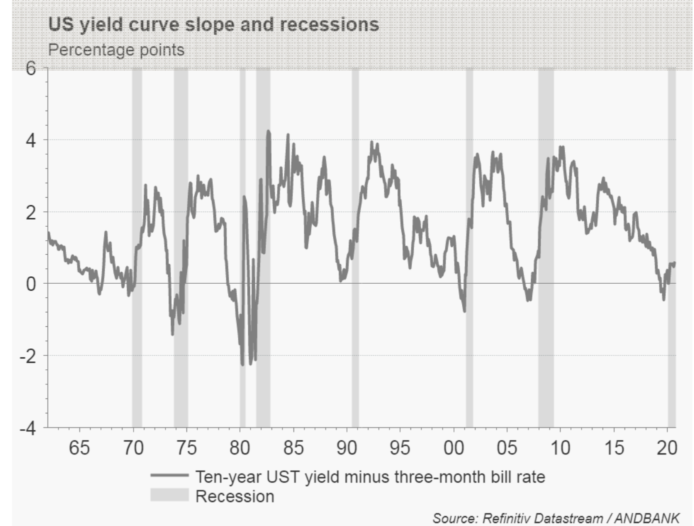
CDX IG: MARKETWEIGHT (Target Spread 70)

CDX HY: MARKETWEIGHT-OVERWEIGHT (Target Spread 350-400)

Forex – DXY index: MARKETWEIGHT



Source: Refinitiv Datastream / ANDBANK



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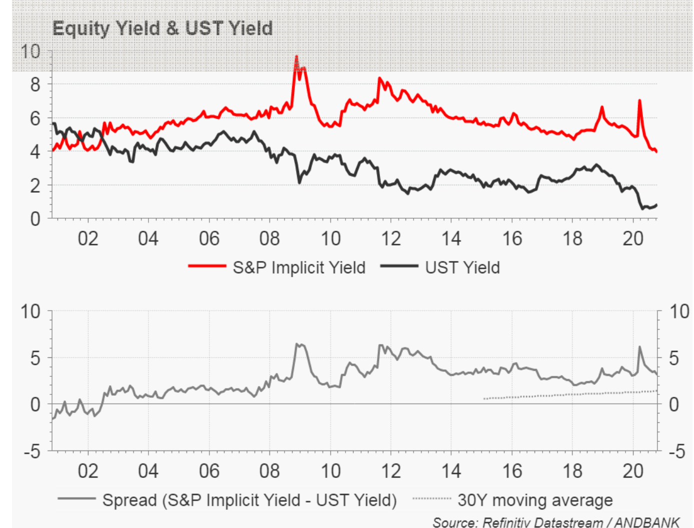

Source: Refinitiv Datastream / ANDBANK

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MACRO ECONOMY

EUROPE

New mobility restrictions. Full lockdown is not on the agenda (for now)

European economy: losing momentum?

The recovery seems to be losing momentum, according to the service PMIs (turning down) and the words of some ECB members (dovish) as the coronavirus spreads again. Consumer data (retail sales) and manufacturing surveys also paint a gloomy picture. Could a new slowdown push Europe into a second recession? Some arguments for a "No" response include: 1) The US experience during its second wave last summer (widespread resilience); 2) The fact that the slowdown is mainly affecting specific hard-hit sectors (travel agencies, airlines…), which have been in the doldrums since March. They should therefore experience a smaller aggregate effect from here on; 3) Limited confinement measures have so far been the initial and basic response (schools and shops remain open, no intention of closing borders…); 4) "Learning experience" with workers, consumers, citizens adapting to lockdown measures. In Merkel´s words: "Economically, we (Germany) can't afford a second wave with the same consequences as we had in the spring". And a few reasons for a "Yes" response: 1) Europe is not the US (politically, socially…speaking); 2) Some countries/regions such as Ireland and Wales have just announced much stricter lockdown measures, more to follow? Policy response in constant flux.

ECB ready for more stimulus?

The stance in the ECB's rhetoric has clearly become more dovish and though a larger stimulus was not discussed in September it could be on the table at the ECB's October meeting. The consensus still expects an increase in the PEPP envelope (+€300-350bn), for the end of 2020-beginning of 2021. Inflation expectations remain sluggish and could justify a more accommodative monetary policy, but there is some skepticism surrounding the effect of further ECB measures. The central bank has proven effective when it comes to liquidity/confidence crises, but not so effective (compared to many other central banks) when trying to accelerate inflation.

Brexit at the European summit: "Let's kick the can down the road (again)"

Without more progress at the October summit, more time will be needed. Despite Boris Johnson's ultimatum and "threatening" tone, he lacks public support and the latest moves by the United Kingdom point to ongoing negotiations. The UK would be prepared to modify the Internal Market Bill as part of a deal. Though "accidents do happen", and a no-deal outcome cannot be totally discarded, a "bare-bones" agreement limited to certain sectors could ultimately be this year's outcome.

Bond markets: Govies & Corporates

Govies: Over the last two months bund and treasury yields have decoupled. Why? 1) Firmer inflation expectations in the US. 2) A more likely stimulus from the ECB vs the Fed (which remains in a "status quo" mode). 3) In Europe, net supply is expected to be absorbed by the ECB in 2020 and 2021, while the Fed could be buying around 25% of the estimated 2021 Treasury supply. 4) Blue wave scenarios are starting to be priced in. We see tailwinds for European govies largely in place until 2022 and we are sticking to our targets.

Corporates: Market highly supported by the explicit support of the ECB. A recent innovation has seen this support extended to the "green" segment by accepting bonds linked to sustainability as collateral. Start of social bond issuance under the SURE program, with demanding yields. The rate of inflows in both investment grade and high yield categories has slowed considerably, with both inflows and outflows slowing. By country, English names have performed particularly poorly, especially in the financial sector, while by sector, the best performing banks have been in peripheral countries, specifically Italy and Spain. Deposits with the ECB have outstripped withdrawals (TLTROs) by German and French banks, with their consequent penalties. In the European high yield category, the recent crisis has had a considerable impact on some risk metrics, such as the increase in leverage (1.8x in 2019 to 5.6x in H120) and the reduction in interest coverage (1.4x in 2019 to 3.7x in H120). Default rates in Europe are currently around 4%. The most affected sectors are oil & gas, consumer goods, retail/restaurants and transport. For example, the recent additional downgrade of IAG in the airline sector to BB (with negative outlook) by Fitch.

Financial market assessment

Equities – Stoxx Europe: MARKETWEIGHT.

Equities – Euro Stoxx: MARKETWEIGHT-OVERWEIGHT

Bonds – Core governments: UNDERWEIGHT (Bund target –0.40%)

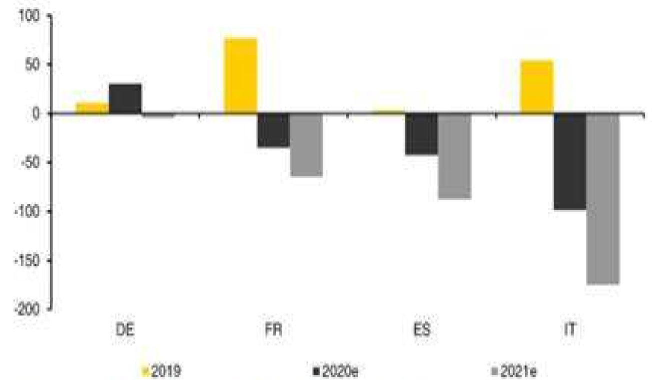
Peripheral – MW: IT (0.9%). UW: SP (0.4%), PO (0.4%), IE (0%), GR (1.4%).

Credit – Itraxx Europe (IG): MARKETWEIGHT (Target Spread 70)

Credit – Itraxx Europe (HY): MW-OW (Target Spread 350)

This crowding out is different!

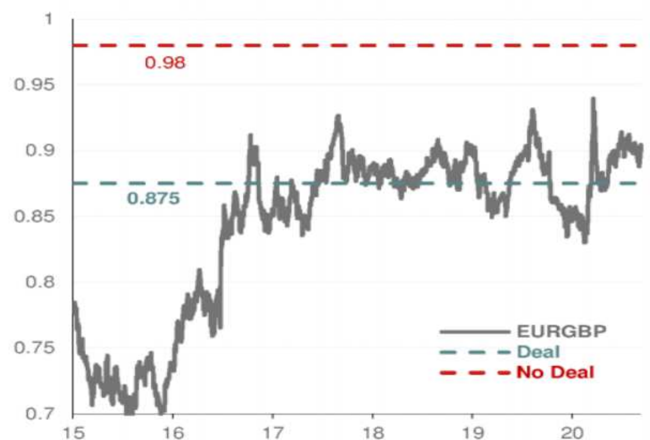
Net bond supply estimates after accounting for ECB purchases and EU grants and loans, in €bn



Source: EU, ECB, Bloomberg, Commerzbank Research

Fig. 9: EUR/GBP Brexit scenarios

Brexit could push EUR/GBP to levels we're rarely seen before



Euro STOXX banks Index

Source: Refinitiv Datastream / ANDBANK

CHINA

Chinese economy to expand 2% in 2020. Chinese companies have trouble raising capital in foreign markets

Macro. Some Key figures for Q2. Expectations for Q3

Q3 GDP +4.9% YoY (vs consensus +5.2% and +3.2% in prior quarter). September industrial production +6.9% YoY (vs consensus +5.8% and +5.6% in prior month). Fixed asset investment (YTD) +0.8% (vs consensus +0.9% YoY and 0.3% in prior month). Retail sales +3.3% YoY (vs consensus +1.8% and +0.5% in prior month). September CPI +1.7% YoY vs consensus +1.8% and +2.4% in prior month

Central Bank

Reuters cited PBOC Governor Yi Gang in an online G30 seminar, stating that China will see its economy expand about 2% this year as it has got the coronavirus pandemic under control, signaling confidence about the prospects of a domestic demand-driven recovery. Yi also said the yuan had appreciated against the US dollar "significantly" in the past three months reflecting interest-rate spreads between the two countries - a development he said should be left to market forces.

Policy – China-baiting by US politicians continue

Ant Group's US$200 billion (£168 billion) flotation would normally have been a candidate for either the NYSE or NASDAQ, but will instead take place on the Hong Kong Stock Exchange (as well as Shanghai). This comes after the US State Department submitted a proposal to add China's Ant Group to a trade blacklist before the financial technology firm was slated to go public. Trump's administration is seeking to send a message to deter US investors from taking part in the initial public offering for Ant Group. That is why China's Securities Regulatory Commission (CSRC), greenlit Ant Group to seek a listing with Hong Kong Exchanges and Clearing, paving the way for what could the world's biggest IPO. Ant Group, which has already won approval from the Shanghai exchange for its onshore listing, could raise ~$35bn in a dual listing at a valuation of at least $280B. To clarify, Ant Group is an online payments powerhouse that grew out of Alibaba (China's answer to Amazon) and is ultimately controlled by Alibaba co-founder Jack Ma. The fact that it is not listing in the US looks very likely to be the latest instalment in the very real and potentially dangerous political spat taking place between China and the US. The US has the proposed "Holding Foreign Companies Accountable Act", designed to enforce compliance with certain company rules, including complying with US audits and disclosing foreign government ownership or control.

Evergrande tumbles after share placement misses target. China's Evergrande slumped in Hong Kong trading after raising far less than anticipated from a top-up share placement ($555m) in Evergrande's first foray into the capital markets since a liquidity scare last month. The target was to raise as much as $1.09bn.

Sanctions on banks: The US State Department warned international financial institutions doing business with individuals deemed responsible for China's crackdown in Hong Kong that they could soon face tough sanctions. The State Department named 10 people, including Hong Kong's chief executive Carrie Lam, all of whom have already been sanctioned, and also said that it would identify financial institutions that conduct significant transactions with those 10 people within 60 days.

China has passed a law (effective 1 Dec) restricting exports of controlled items that would restrict sensitive exports vital to national security, expanding its toolkit of policy options as competition grows with the US. This means the government is acting against countries that abuse export controls in a way that harm's China's interests. Xinhua did not name any target countries, but last month the US angered Beijing with curbs on exports to SMIC, and it has taken various steps against Huawei and other companies.

China's first direct bond sale in the US

China's first direct bond sale in the US received bumper demand, spurring expectations that more high-graded Chinese borrowers will follow in spite of President Donald Trump's decoupling threats. The sale raised $6bn and garnered almost $30bn in bids, helping the Chinese Ministry of Finance sell the debt at a lower cost compared to an offering last year. US-based investors will get almost one-fifth of the bond offering.

COVID (knowing more about the virus)

A China CDC report states that contact with frozen food packaging contaminated by live coronavirus could cause infection. The CDC detected and isolated living coronavirus on the outer packaging of frozen cod during efforts to trace the virus in an outbreak reported last week in Qingdao city. The finding is a world first and suggests that the virus could be conveyed over long distances via frozen goods.

Financial market outlook

Equities – SHANGHAI Idx: UNDERWEIGHT

Equities – SHENZHEN Idx: UNDERWEIGHT

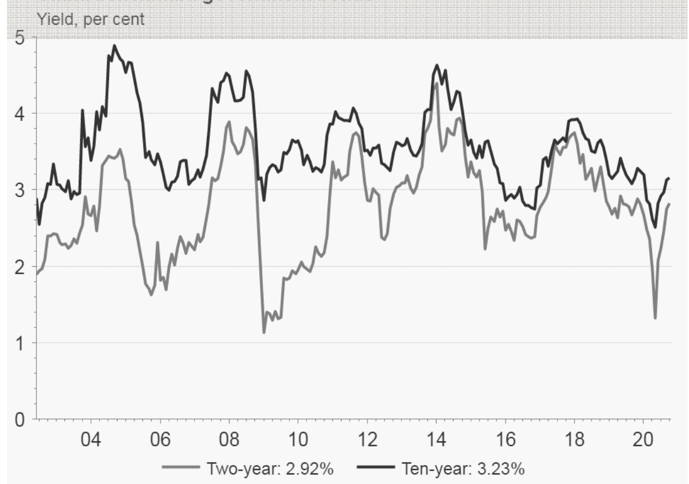
Bonds – Govies: MARKETWEIGHT (10Y Yield target 3.00%)

Forex – CNY/USD: MW (Target 6.75)

China Broad, price/earnings, Datastream index

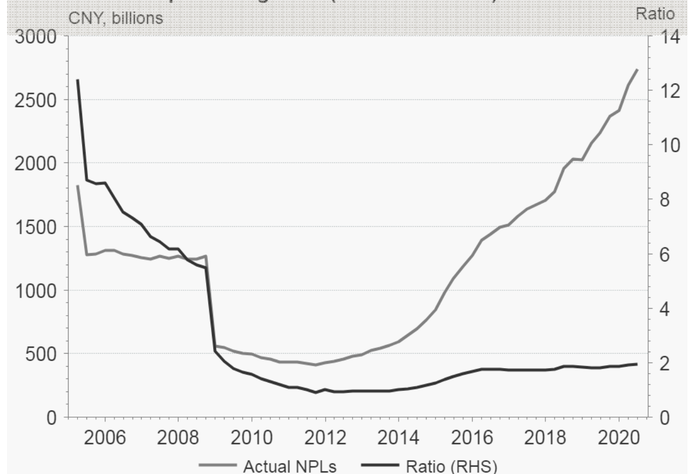
Source: Refinitiv Datastream / ANDBANK

China benchmark government bonds



Source: Refinitiv Datastream / ANDBANK

China non-performing loans (official estimates)



Source: Refinitiv Datastream / ANDBANK

JAPAN

Japan expands 'China exit' subsidies for moves to Southeast Asia

Geopolitics

Japan will significantly ramp up a program encouraging businesses to build production sites in Southeast Asia to diversify supply chains that are too dependent on China. The government will cover up to half the cost of such investments within the Association of Southeast Asian Nations for large companies and as much as two-thirds for smaller businesses.

Macro & External Trade. Recovery slows down. Third supplementary budget?

The Tankan manufacturers' sentiment index rose to -26 in October from -29 the previous month. While this is the fourth straight improvement, the index has been in negative territory for 15 consecutive months. The service sector index climbed to -16 from -18 in September. August final industrial production was +1.0% MoM vs +8.7% in prior month. September bank lending +6.4% YoY vs +6.7% in prior month. August core machinery orders +0.2% MoM vs consensus (1.0%) and +6.3% in prior month. Exports (4.9%) YoY vs consensus (2.6%) and (14.8%) in prior month. Imports (17.2%) YoY vs consensus (21.5%) and (20.8%) in prior month. September CGPI (0.8%) YoY vs consensus (0.5%) and revised (0.6%) in prior month.

Japan is considering an additional economic stimulus package to boost consumption dampened by the coronavirus pandemic. Prime Minister Suga is expected to have specifics drawn up as early as next month, with a draft FY20 third supplementary budget to be compiled by the end of the year to be submitted to the next ordinary Diet session in January, coinciding with the FY21 main budget discussions.

BoJ: Global central banks stick to gloomy tone

Central bank chiefs at the G30 online seminar are under no illusion that they are through the fallout from the coronavirus, issuing fresh warnings about new government restrictions, struggling recoveries and threats to jobs. G3 regions concurred saying outlook risk remains on the downside, signaling that support is going to be needed for some time, with BoJ Governor Kuroda even warning that Japan is at risk of a recession if things turn sour. September M2 money supply +9.0% YoY vs consensus +9.0% and +8.6% in prior month.

The BoJ's escalating presence in almost every corner of the nation's financial markets threatens to further distort activity and complicate any future pulling back from stimulus. Bloomberg estimated total assets have reached 137% of GDP. In dollar terms, the total is just 8% smaller than the Fed's even though the US economy is four times bigger than Japan's. This underscores longstanding concerns about the difficulties of an eventual exit without causing market instability.

Japanese investors continue with global carry trade (week ended 10 Oct)

Net buyers of ¥312.5B in foreign equities. Net buyers of ¥1,946.5B in foreign long-term debt.

TSE blames bad system setting for outage

The TSE report submitted to the FSA explains that the system-wide shutdown that halted a full day of trading earlier this month was caused by just one bad setting preventing auto-backup equipment from kicking in when a critical device failed. The reason why trading did not resume that day lay in confusion and how brokerages handle orders already submitted by customers in the event of a system reset. Some companies indicated that restarting would be difficult.

Corporates

Uniqlo and Muji are expecting record profits for the year ahead, bucking a downturn in the global retail industry with a pandemic-driven boom in online sales across Asia. Fast Retailing (~9983.JP~) and Ryohin Keikaku (~7453.JP~), the owners of the two brands, have been hit hard by the global shutdown in stores. But the two groups are also recovering faster than global peers from the coronavirus crisis as stay-at-home consumers in Asia have turned to their affordable everyday casual clothes.

ANA eyes 5% monthly wage cut as part of cost-cutting amid pandemic. Kyodo reported that ANA (9202.JP) is seeking to cut monthly wages and other remuneration by 5% from January at the latest, as part of sweeping cost-cutting measures to cope with the coronavirus pandemic that has depressed demand for air travel. With about 15,000 employees, the airline will also start offering early retirement from the end of March next year by increasing severance pay from 14 Oct

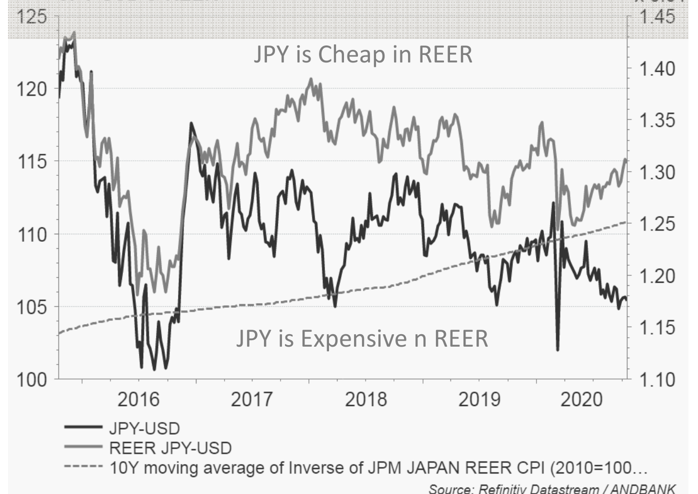
Financial market outlook

Equities – N225: UNDERWEIGHT

Bonds – Govies: MARKETWEIGHT (Target yield 0.00%)

Forex – USD-JPY: MARKETWEIGHT-UW (Mid-term target 107)

Source: Refinitiv Datastream / ANDBANK



Source: Refinitiv Datastream / ANDBANK

Source: Refinitiv Datastream / ANDBANK

INDIA

Important and courageous reforms to modernize agriculture & manufacturing to attract external private investment

Agricultural Reform

India's short-term economic outlook remains dire, with GDP set to contract by more than -10% this fiscal year (+11% estimated in 2021), but policymakers are pushing through long-awaited reforms to open up agricultural and labor markets, with new measures that should raise productivity and boost private investment over the longer term. The largest proposed reforms are in agriculture, where the state maintains strict control over trade and marketing. Currently, farmers are restricted from selling their produce to licensed merchants in local state markets, known as *mandis*. This is supposed to protect them from exploitation, but traders use their monopoly power to set prices, often working in collusion with local politicians. The result? The system locks out private investors and discourages interstate commerce, keeping the agricultural supply chain weak and fragmented. Analysts at Gavekal put this in numbers, estimating that the current system translates into a third of the crop lost. The government rammed three bills through parliament in an attempt to solve these problems. Farmers will be allowed to sell their produce to anybody, anywhere. They will be able to bypass local *mandis* and enter deals with large buyers, such as retailers and exporters. In addition, the production, supply and distribution of certain "essential commodities"—cereals, pulses, oilseed, edible oils, potatoes and onions—will be deregulated, doing away with state-imposed stock limits. In theory, the reform package should boost competition among buyers, create a national market in farm produce, and help to modernize agriculture by attracting greater private investment. Prime Minister Narendra Modi called it a "watershed moment" that would benefit hundreds of millions of farmers, allowing them to capture their fair share of agricultural profits. Similar reforms have been debated for a decade, but they never went well because they were not targeted by a proper vote. The main complaint of the opposition is that the bills constitute an assault on state powers. In the federal system of India, agriculture is largely a matter for state governments. The governments of large agricultural producers such as the northern states of Punjab and Haryana fear losing *mandi* taxes, an important source of income. However, from now on, the new core laws will prevail over state laws. The Indian president has already given his consent, which means they are ready to be implemented. Modi has promised that both MSPs (minimum support prices when market price falls) will remain. What to expect? Critics worry they will create an unregulated market even more exploitative than the current system, concentrating buying power in the hands of unscrupulous corporates at the expense of illiterate farmers. But the logic behind the reforms is sound: opening up markets does have the potential to raise both rural incomes and agricultural output. This is vital to reduce endemic rural poverty. These reforms were already implemented in some of the poorest states in 2006 (a sign that the current system was inefficient). The state of Bihar, Madhya Pradesh, Uttar Pradesh, Gujarat and Karnataka amended their state Mandi laws to allow farmers to sell their products directly to consumers. The growth trend in agriculture has been less than half that of industry and services, and rural incomes are so low that a farmer is said to commit suicide every 42 minutes.

Labor Reform

More than 40% of India's workforce is engaged in farming, the highest share in any large emerging market. This is around 15 percentage points higher than one would expect at India's stage of development, meaning that tens of millions of India's rural workers would be far more productively employed in industry or services. Unleashing this potential would add several percentage points onto long-term growth. Yet India has failed to create enough labor-intensive jobs to absorb its vast surplus of workers, held back by rigid labor regulations that discourage companies from growing large enough to capture economies of scale (more than 80% of Indian factories employ fewer than 100 staff, making them much smaller on average than competitors in China or Vietnam). It is up to the central government to set a basic threshold across the country, and it is finally acting. Three labor reform bills were passed last month, adding to an as yet unimplemented bill passed in 2019. The government expects to implement them as a single package by December. Of most consequence is the Industrial Relations Code, which allows firms with up to 300 workers to close down or lay off staff without government permission, up from the current 100. The greater flexibility to fire workers in effect gives companies the green light to hire more. Studies show that output per worker shoots up, on average, at a headcount of 200. So the new law should raise productivity in addition to boosting factory sizes.

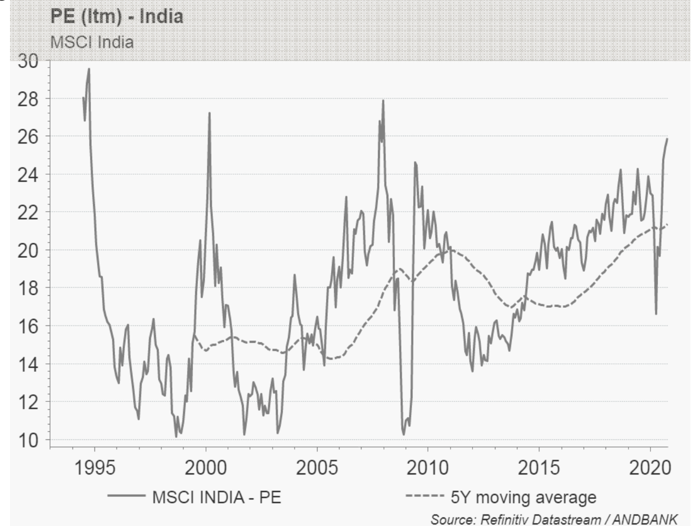
Financial market outlook

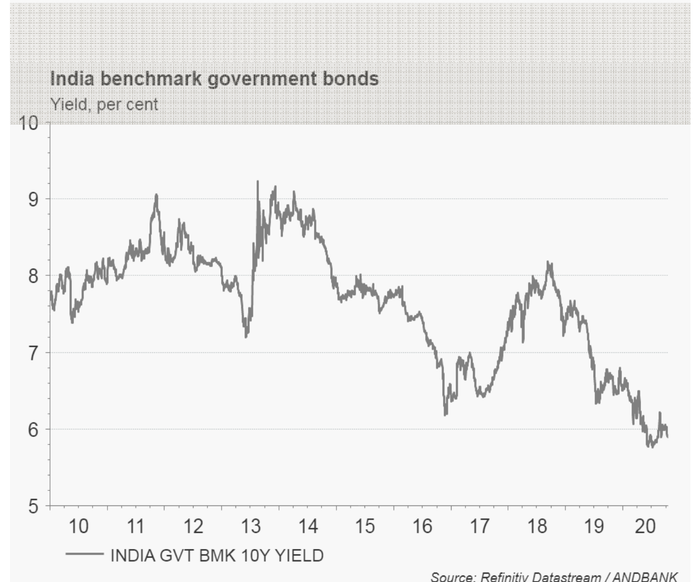
Equities – SENSEX: MARKETWEIGHT-OVERWEIGHT

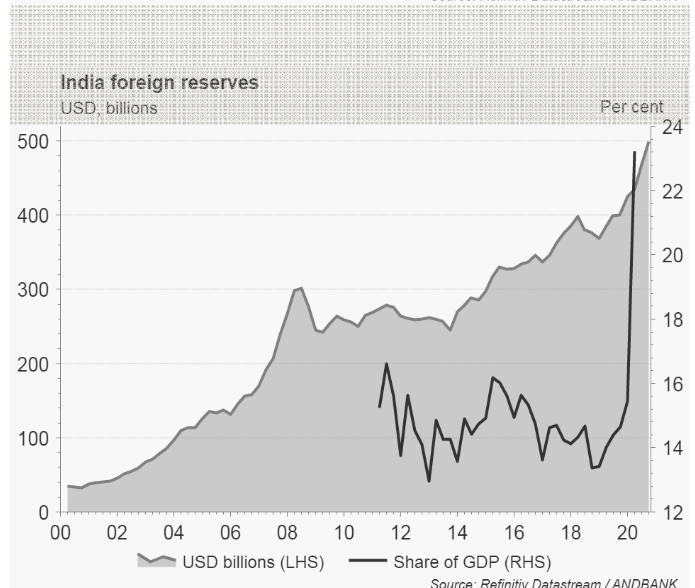
Bonds – Govies: UNDERWEIGHT (Target yield 6.8%)

Bonds – Corporates: MW-UNDERWEIGHT

Forex – INR/USD: MARKETWEIGHT (Target 74)







ISRAEL

The no-budget limbo and the steep rise in the deficit likely to lead to rating review

Israel's Macro

Israel's 2Q GDP declined by 28.8% YoY due to Covid-19 and the high infection level that led to a second lockdown. The decline in GDP came from almost all sections, except for public spending, which rose by 26%. Israel's CBS published an unemployment rate in September of 12.4% as the second lockdown forced businesses to close their doors for the second time this year. As for the financial system, the NPL ratio remains at a low 1.4%.

Bond Market

The Israeli government still hasn't passed a new budget for 2020-2021 and instead decided to delay the vote for a few months. This no-budget limbo along with the steep rise in the budget deficit and the rising debt-to-GDP ratio, is likely to cause a downgrade in the country's credit rating, although the aid from the Israeli government to its economy compared to its GDP, is one of lowest in the developed world.

As for the Central Bank, we believe the Israeli central bank will aggressively step-up its liquidity injection to the financial sector and its aid to the government and the corporate credit market.

After the sharp increase in the number of Covid-19 infections, the government was forced to impose a second nationwide lockdown, but in recent days the infections have begun to subside and the Israeli economy is now starting to open-up again.

The credit spread in the CPI linked TelBond60 index fell to 1.50% compared with 1.52% in mid-September. The asset class has remained well supported, but still has a way to go when we consider that it is still above pre-pandemic levels of 1.2%-1.25%. As for the credit spread in the non-CPI linked TelBond Shikli50, this fell to 1.34% compared to 1.4% in mid-September, much in line with pre-Covid19 spread levels of 1.3%-1.35%.

Equity Market view: Neutral

The Israeli stock market performed strongly last month despite the second lockdown that was imposed at the end of September. The Tel Aviv 35 gained 3.7% and the Tel Aviv 90 recorded an impressive return of 4.45%. The rise in the stock indices was led by the financial sector, where the major banks rose by nearly 6% and insurance companies had an impressive run of over 10%. It should be noted that the financial sector is still trading at relative attractive valuations, while the banks currently trade at a book value to market cap ratio of 0.7. The main insurance companies are trading at a P/BV ratio of 0.6. If past performance is any guide, these valuations are still very attractive.

It's worth noting that despite its strong performance during recent weeks, the financial sector is still down by approximately 30% from the beginning of the year.

Local technology firms continued their phenomenal run with a return of nearly 8%, extending their outstanding outperformance of the broad market from the beginning of the year to over 40%.

In general terms, and despite its recent strong performance, the Israeli stock market is still lagging the major world indices due to poor handling of the pandemic by the authorities and political turmoil.

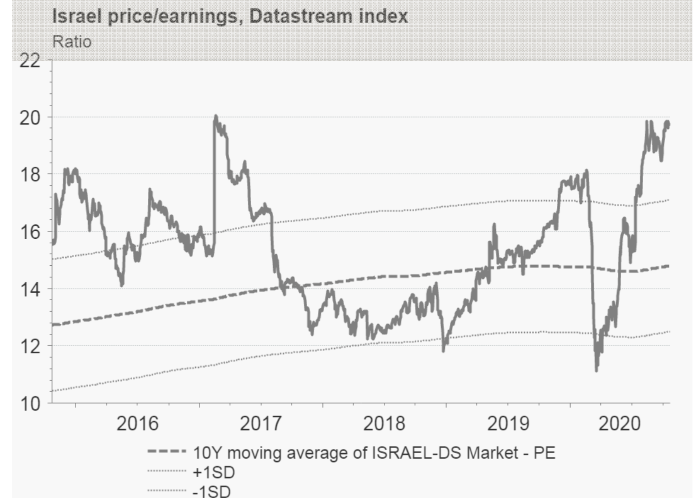
The recent sharp decline in the number of infections should provide a boost to the market, while the high likelihood of another election (the 4th in the last two years) increases the need for caution in with this market, causing investors to hedge the instability due to the political risk currently in this market.

Financial market outlook

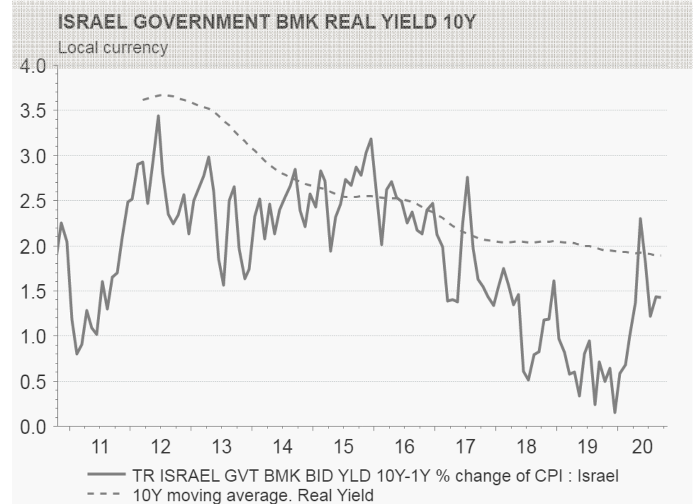
Equities – TLV35 Index: MARKETWEIGHT (Slightly expensive)

Bonds – 10Y Gov: MARKETWEIGHT-OW (Positive real yield)

FX – ISL vs USD: UNDERWEIGHT (Expensive in REER)



Source: Refinitiv Datastream / ANDBANK



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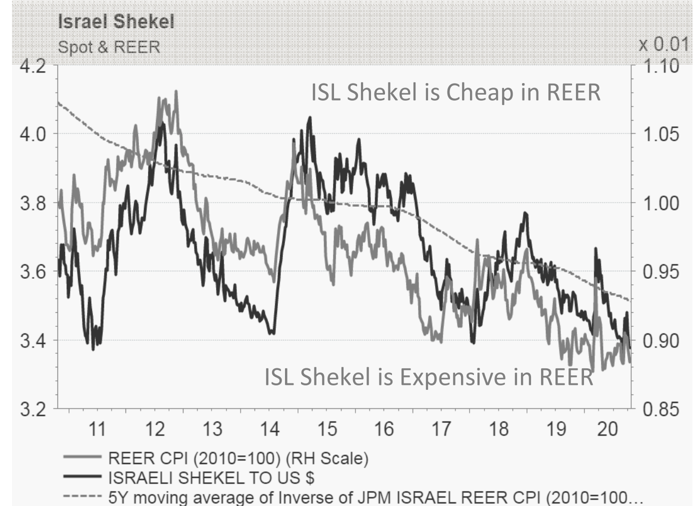


Source: Refinitiv Datastream / ANDBANK

BRAZIL

Brighter economic outlook in Central Bank's Focus survey, with an average forecast of a 4.8% fall in 2020 GDP

Politics & Reforms

To try to regain prominence, the Ministry of Economy issued a proposal for administrative reform and announced studies on the privatization of the Post Office. However, no results will be seen in the short term as the reform does not apply to existing officials and has been questioned directly and indirectly by other authorities, as well as the military, which could lead to a limited scope for the reform.

The fiscal agenda continued to stall due to the electoral campaign in the municipalities. However, statements by the president of the Federal Chamber of Deputies, Dep. Rodrigo Maia, in support of continuing the spending ceiling and the adoption of measures to reduce expenditure had a positive impact on stock prices and the Real.

Economics

The economic indicators released in October show a rapid return of growth in economic activity, highlighting the strong rise in the industrial entrepreneur confidence index in October and federal revenues, which exceeded analysts' estimates recording a volume of R$120 billion in September.

September's external accounts data showed the continuity of the current account surplus, which offsets the weak flow in foreign investment this year.

The Central Bank's survey (FOCUS) showed how the economic outlook brightened, with an average forecast for a 4.8% fall in 2020 GDP, the least pessimistic since May and close to the government's forecast of a 4.7% contraction. Last week a senior ministry official said that the forecast will be revised in early November and Economy Minister Paulo Guedes said he now expects the GDP decline this year to be around 4%. Although this would still represent the steepest annual downturn on record, it is a notable improvement from the consensus for a fall closer to 7% earlier this year during the depths of the anti-coronavirus social isolation and lockdown measures.

The expectation of a strong economic recovery in Q3 boosted investor optimism regarding the corporate results that will begin to be released soon.

Central Bank, Monetary Policy & Inflation

Inflation, measured by the IPCA-15, registered 0.94% in October, above the market projection, although in general terms we can conclude that inflation remains under control. Brazil's 2020 inflation outlook rose to 3% according to a central bank survey on Monday. This is the eleventh week in a row it has risen as a recent spike in food prices continues to intensify short-term inflation pressures, although the estimate remains well below the bank's official 2020 goal of 4%.

The central bank is widely expected to keep the Selic rate on hold at a record low of 2.00% at its October meeting, but the survey also showed that this trend in prices could force the central bank to tighten policy more than previously expected. Economists now see the bank's benchmark Selic rate ending 2021 at 2.75%, up from 2.50% early this month, as the FOCUS survey showed the average 2021 inflation outlook ticking up to 3.1% from 3%, again still below the bank's 3.75% target.

Fixed Income Market

The National Treasury managed to sell just under R$40 billion in Federal Government Bonds with lower premiums than those in previous auctions. This time the Treasury distributed its funding across various types of paper, which eased the pressure on the interest curve, mainly in its longer maturities.

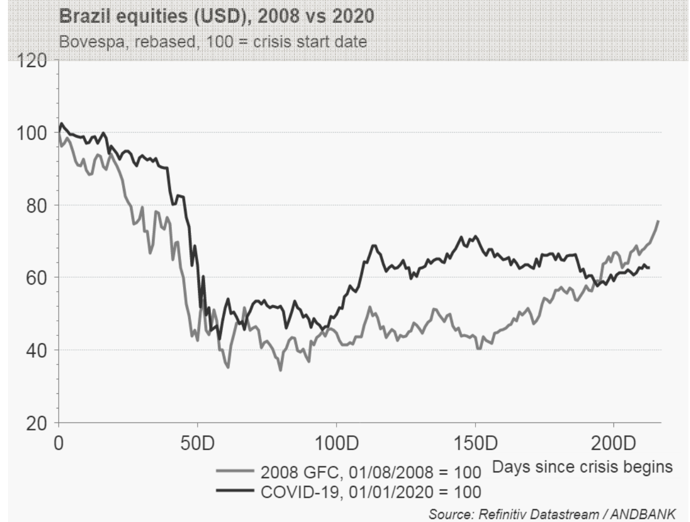
Financial market outlook

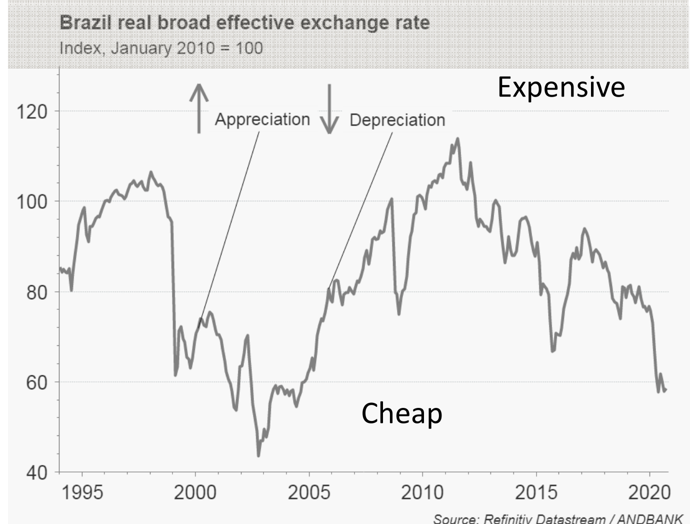
Equities – iBovespa: MW-OVERWEIGHT

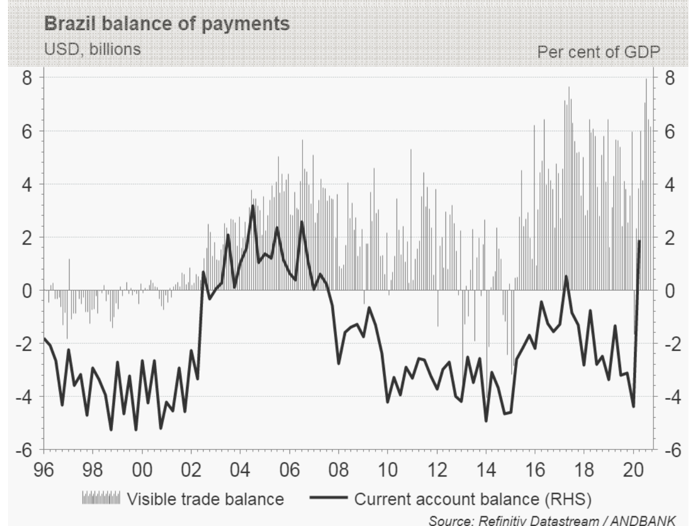
Bonds – Govies Local: MARKETWEIGHT (Target yield 7.5%. Spread 650)

Bonds – Govies USD: OVERWEIGHT (Target yield 4%. Spread 300)

FX – BRL/USD: MARKETWEIGHT (Mid-term target 5.50)







MEXICO

Obrador continues to lose popular support. Still unclear fiscal outcome but most Mexican assets are fairly valued.

Economy, inflation and FX.

Industrial output remains depressed at -9% YoY, though improved from last month's reading (-11.3%) meaning a moderate expansion of +3.3% MoM, which represents a sharp slowdown versus last month's expansion of +6.9% MoM. High frequency data suggest that activity remains in contraction right now, with the Markit Manufacturing PMI Index at a very low level of 42.1. The employment index has recovered very little ground and remains at 2017 levels (with a reading of 112), while retail sales don't look good either. The year-on-year reading shows growth of -12.5% YoY, while the monthly reading has gone from +8% to a mediocre +5.5% MoM. The fall in tax revenues at the end of August has slowed compared to May and June. Non-oil revenues have increased, but this was (again) due to the use of non-recurring resources such as funds and trusts (*fideicomisos*) aimed at mitigating the decline in recurring fiscal receipts negatively affected by lower growth dynamics. Meanwhile, public spending has continued to grow, although a serious deterioration in the public accounts has yet to emerge, as the use of non-recurrent resources as funds intended for countercyclical spending has served to mitigate the imbalance between income and expenses. The debt / GDP level has reached 54%, although the expectation that it will continue to increase has diminished as estimates of a double-digit decline in economic activity for the year have eased. Inflation in August ran at an annual rate of 4.01%, slightly above the upper range of Banxico's long-term target; a price change that is considerably higher than in the US, which could put pressure on the Mexican peso.

Monetary environment. We could have reached the end of the easing cycle. The monetary environment can no longer offer more support.

Banxico cut its interest rate by an additional 25bp leaving rates at 4.25%. The decision was unanimous, but the committee showed greater concern about the recent behavior of inflation, suggesting we could be nearing the end of the easing cycle. The fact that August inflation came in at an annual rate of 4.05%, above the upper range of Banxico's long-term target, contributes to this hypothesis. The median level from local surveys points to a rate in the 4.00%-4.25% area (current level) at the end of 2020, while forecasts are for rates to remain unchanged in 2021.

Politics

The 2021 budget was submitted and the primary balance is forecast to be zero. Nevertheless, a deterioration in public finances could occur if the growth estimates that determine public revenues were indeed too optimistic (as it seems) and therefore fall short of the estimate. The former secretary of public security was arrested for ties to drug trafficking. Obrador continues to lose popular support and in the most recent polls his acceptance rate fell to nearly 50%. His non-existent handling of the pandemic and the question over public security are the main reasons for the general loss of confidence in the president. In the recent state elections held on the weekend of October 18, the PRI party managed to establish itself as the main political force in two states, taking President López Obrador's party by surprise. Meanwhile, the Odebrecht case still has the potential to shake the foundations of Mexican politics due to the serious accusations made by the former director of Pemex (Emilio Lozoya) that promise to set off a political earthquake. The risk is that AMLO will take the results of its popular enquiries as a source of legitimacy to carry out his plans to put his political enemies in the dock, potentially causing political tremors of great magnitude.

Mexican Bonds & FX

Uncertainty in the business sector remains, although some optimism was noticeable following the presentation of an infrastructure plan, although the impact would be limited. A slow recovery is still expected, fully linked to the level of global liquidity that supports economies such as North America. One of the greatest risks is the possibility of an imbalance in public finances that could put pressure on financial variables or the actions of rating agencies. Target 35,000-41,000.

Mexican Bonds & FX

Local bonds: Marketweight. Our target spread for the local bond remains in the 500 bp area (slightly above its 10-year average of 425 bp) meaning that yields in local bonds should trade near the 6.0% level (currently at 5.86%). US dollar-denominated bonds: MW-UW. For the USD-denominated Mexican bond, we set a target spread vs the UST bond in the 250bp area, suggesting a target yield of 3.5% for this bond (currently at 3.11%).

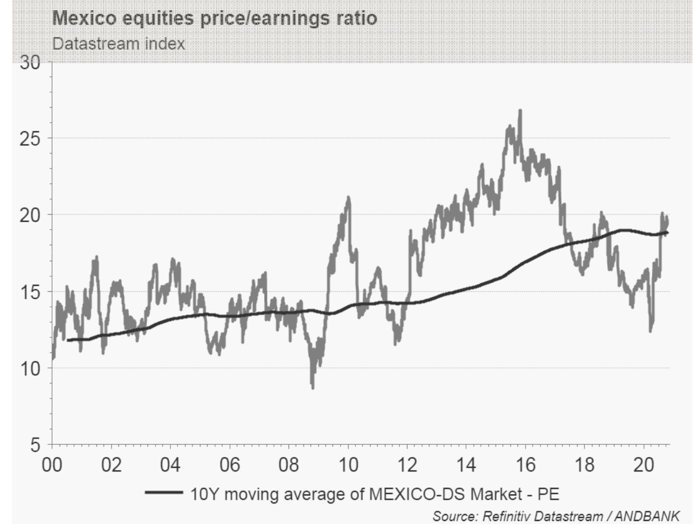
Financial market outlook

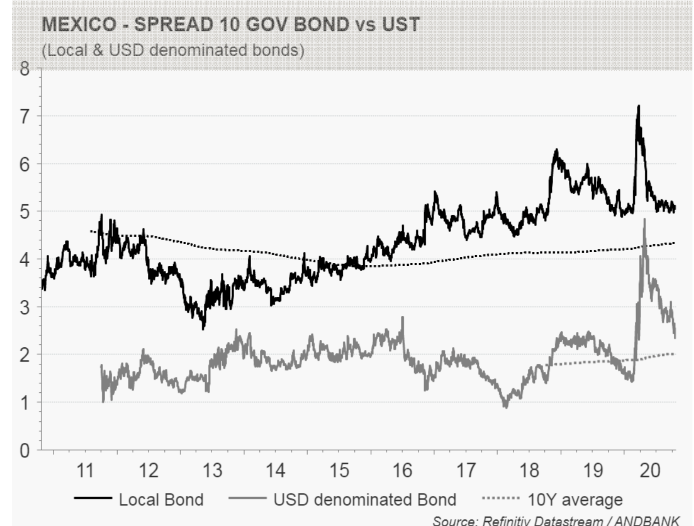
Equities – Mex IPC: OVERWEIGHT

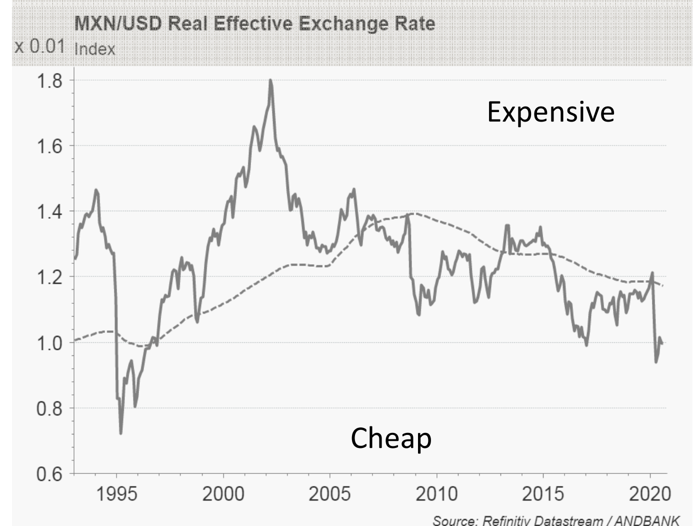
Bonds – Govies Local: MARKETWEIGHT (Target yield 6%. Spread 500bp)

Bonds – Govies USD: MARKETWEIGHT -UW (Target yield 3.5%. Spread 250bp)

FX – MXN/USD: UNDERWEIGHT (Mid-term target 22)







ARGENTINA

Post debt deal, reality prevails over expectations.

Fixed income market continues to struggle

Despite the successful debt restructure, Argentinian bonds have dropped more than 20% since closing the deal. The government has taken some measures in the right direction (reducing export taxes, price incentive plan to promote gas production…) but insufficient to generate a change in expectations and investor confidence at the moment due to the lack of a comprehensive macroeconomic plan and an erratic policy approach that has exacerbated the uncertainty weighing on the economy.

The new package with the IMF could be an opportunity to build a credible program to anchor expectations. The problem seems to be the political willingness to tackle growing imbalances, especially the fiscal deficit and the monetary expansion to finance it (estimated at 6% GDP YTD).

Peso is melting as there is no USD in the country.

As at all times of uncertainty experienced in the country's recent history, Argentines seek to buy all the dollars their budget allows (flipside of the depressed peso demand). Consequently, the gap between the official and the Blue Chip Swap rate went from 70% to 120% in last month.

Despite increasingly strict capital controls (limiting retail demand, corporate access to repay USD debt and controls on imports) and the current account surplus, reserves keep going down. Savers' mistrust is also on the rise and is reflected in a 11.5% fall in private sector USD deposits in recent weeks.

The economy

Argentina's GDP fell by 19.1% YoY in 2Q20 and by 16.2% QoQ SA in the same period. In July, the economic activity Index fell 13.2% YoY and posted weak +1.1% MoM growth (a significant deceleration vs the +7.5% seen in June). The IMF downgraded its forecast and now expects GDP to fall 11.8% YoY in 2020 (9.9% YoY previously), projecting a 4.9% recovery in 2021.

Mendoza: First provincial restructuring

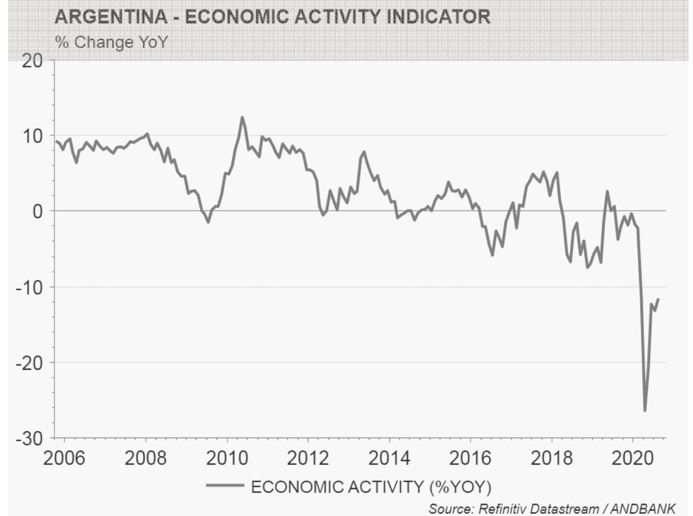
Mendoza announced that it reached an agreement with bondholders (95.3% support) and consequently the province is the first to complete its debt restructuring (590 MM USD of its 2024 note) with a NPV of 81 USD (@10% exit yield). The province of Buenos Aires extended its debt swap offer until November 6 with no changes from its original offer. Neuquén improved its offer for secured bondholders (improving coupons and cash consent) with no modifications for the unsecured bonds (2025).

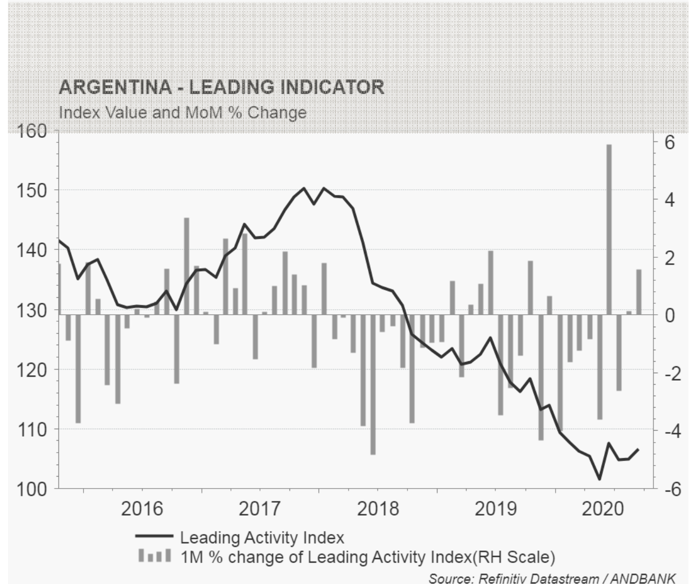
Inflation remains unchanged but could accelerate again

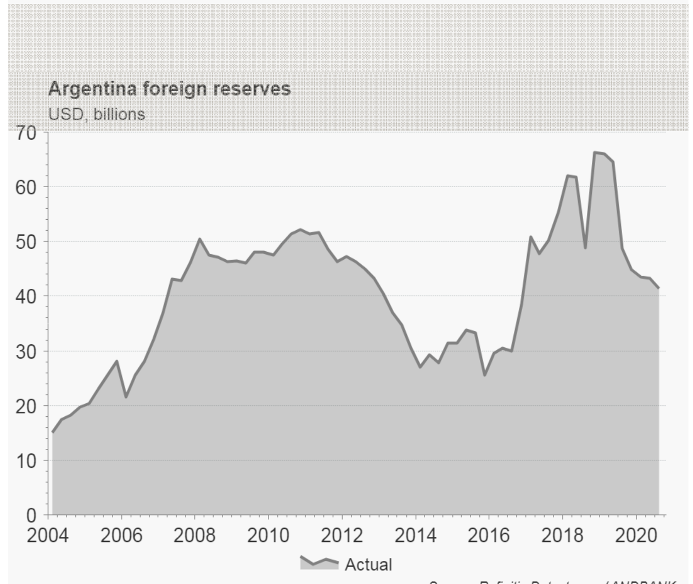
CPI came in at 2.8% MoM in September, similar to the previous month (2.7%), although below the BCRA's expectations survey (3% MoM). On an annual basis, headline inflation slowed to 36.6% YoY, maintaining its downward trend. Core inflation decelerated to 2.3% MoM from 3% MoM in August, but seasonal prices jumped 7.9% MoM and regulated prices accelerated to 1.9% MoM. Educational services and communications explained the lower inflation, as most of these prices are regulated (and were previously frozen). Nevertheless, regulated prices are up 7% YoY YTD while core prices increased 21%, a signal of repressed inflation.

Financial market outlook

Bonds – 10YGov USD: NEUTRAL
FX – USD-ARS: NEGATIVE (2020 year-end target 95)







EQUITIES

GLOBAL EQUITY INDICES

Fundamental assessment

Index	Projected EPS Andbank 2020	Projected EPS Andbank 2021	Projected EPS Andbank Fw 12m	Projected EPS Growth Andbank 2020	Projected EPS Growth Andbank 2021	Projected PE EPS nxt 12m	INDEX CURRENT PRICE	Current Fair Value (EPS 12 month fw)	2020 E[Perf] to Fair Value	Recomm	2020 Exit Point
USA S&P 500	139	174	168	-15,5%	25,00%	20,00	3.270	3.364	2,9%	MW	4.037
Europe - Stoxx Europe 600	16,9	21	20	-35,0%	25,00%	17,00	342	348	1,5%	MW	417
Euro Zone - Euro Stoxx	17,1	22	21	-32,0%	27,00%	17,00	333	357	7,2%	MW/OW	429
Spain IBEX 35	310,0	449	427	-56,4%	45,00%	16,00	6.452	6.831	5,9%	MW	8.197
Mexico IPC GRAL	2.264	2.717	2.643	-20,0%	20,00%	14,25	36.988	37.670	1,8%	MW	45.203
Brazil BOVESPA	5.838	7.006	6.817	-20,0%	20,00%	15,00	93.952	102.254	8,8%	OW	122.704
Japan NIKKEI 225	1.063	1.276	1.241	-20,0%	20,00%	17,00	23.295	21.101	-9,4%	UW	25.321
China SSE Comp.	226	249	245	-10,0%	10,00%	12,50	3.225	3.064	-5,0%	UW	3.677
China Shenzhen Comp	75,1	83	81	-10,0%	10,00%	24,00	2.223	1.955	-12,1%	UW	2.345
India SENSEX	1.576	1.813	1.775	-15,0%	15,00%	21,00	39.533	37.266	-5,7%	MW	44.719
Vietnam VN Index	53,6	62	60	-10,0%	15,00%	15,00	933	905	-3,1%	MW	1.085
MSCI EM ASIA	35,4	41	40	-10,0%	15,00%	15,00	621	598	-3,6%	MW	718

POSITIONING, FLOW & SENTIMENT ANALYSIS

Risk Outlook: Neutral // Positioning: Neutral

Andbank's Assessment: +0.0 (in a –7/+7 range)

Aggregate (MW bias): The aggregate assessment arising from our analysis of asset managers' positioning, flows from speculators and sentiment surveys suggests that positioning in risk markets and assets should be neutral.

Market Positioning (UW bias): Asset allocation in equity remains high in global portfolios (negative implications) and the last readings in the put-call ratio indicate that investors are not hedging their portfolios; on the contrary, they are eventually getting more exposure. Meanwhile, the volatility skew remains in positive territory, although it has receded recently (to 129 from 144), suggesting that fear of a big downside movement has also declined.

Flow Analysis (OW bias): Net inflows in the US equity indices suggest that positive momentum in equities remains in place. However, we noticed very small positive flows in EM markets, while the rest of the developed world remains far behind the US market. The global focus is on US equities and more specifically is targeting small caps.

Surveys & Sentiment Analysis (MW bias): Investor sentiment is still bearish and our contrarian reading therefore suggests a neutral to positive stance.

TECHNICAL ANALYSIS

Trending Scenario. Supports & Resistances

	Name	Ticker Reuters	View 1 month	Principal Support 2020	Principal Resistance 2020	Support 1 month	Resistance 1 month	Target (TA) 2020	@	Return to Target (TA)
INDICES	Euro Stoxx Index	.STOXXE	Lateral bearish	252,89	443,29	335,39	375,63	443,00	361,94	22,40%
	Euro Stoxx 600	.STOXX	Lateral bearish	268,57	433,90	344,91	380,26	441,75	367,48	20,21%
	Ibex	.IBEX	Lateral bearish	5.814,50	10.100,00	6.421,00	7.321,90	8.375,60	6.849,70	22,28%
	S&P	.SPX	Lateral bullish	2.191,86	3.393,52	3.209,45	3.588,11	3.393,52	3.483,81	-2,59%
	Japón	.N225E	Lateral bullish	16.358,19	24.448,00	22.594,79	24.116,00	24.116,00	23.671,13	1,88%
	China	.SZSC	Lateral	1.691,00	2.333,36	2.122,00	2.333,36	2.441,38	2.249,53	8,53%
	India	.BSESN	Lateral	24.833,00	42.273,00	36.495,00	42.273,87	42.273,87	39.982,98	5,73%
	Brasil	.BVSP	Lateral bearish	57.600,00	119.593,00	90.147,92	105.703,62	119.593,10	98.309,12	21,65%
	México	.MXX	Lateral	30.000,00	45.955,00	35.277,54	40.030,95	41.388,00	37.876,49	9,27%
OTROS	Oil West Texas	WTCLc1	Lateral	10,37	51,00	36,15	43,57	50,00	40,71	22,82%
	Gold	XAU=	Lateral	1.659,00	2.072,49	1.848,81	1.991,91	2.230,00	1.898,97	17,43%
	Treasury 10Y USA	US10YT=RR	Lateral	0,1289%	1,3210%	0,6460%	0,9590%	0,8658%	0,7481%	15,73%

Bullish -> +3.5%; Lateral bullish -> (+1.5%, +3.5%); Lateral -> (−1.5%, +1.5%); Lateral bearish -> (−3.5%, −1.5%); Bearish <−3.5%

ENERGY – OIL

NEW!! Fundamental view (WTI): Target range USD40-50bbl (from previous 35-45)

Buy < USD40; Sell >50

Short-term drivers

(Price Positive) – Two big oil donations to Democrats : CVX and XOM, the two largest US energy firms, have increased their campaign donations to Democratic candidates, in contrast to the ~85% of all oil and gas donations that have flowed to Republicans this election cycle. This has come as Democratic presidential candidate Joe Biden --who has called for a renewable energy transformation and an end to new fracking permits on federal land-- has been surging in the polls. Biden had pledged not to accept donations over $200 from the fossil-fuel industry, but has taken nearly $900K from individuals and PACs linked to oil and gas. This information leads me to think that a Democratic victory could represent a severe setback for unconventional energy activity, and a considerable reduction in global supply, which would push crude prices considerably higher.

(Price Positive) – OPEC joint ministerial meeting committee acknowledges a slowdown in oil market recovery, and delays the easing of output restrictions: Saudi energy minister Prince Abdulaziz bin Salman said the group will do what is necessary in the interests of all, while Russia's Novak said the oil market has seen a material slowing of demand recovery as many countries re-impose lockdowns to contain COVID-19. Novak also highlighted many uncertainties around the path to return to pre-pandemic levels. Analysts expect the group to postpone the planned production increase in early 2021 by a few months, citing Novak's comments on demand trends as well as elevated global stockpiles. Officials, including OPEC Secretary General Barkindo, have recently said the demand outlook is still looking anemic, while the group still expects a persistent supply overhang to continue into 2021 in the event of a prolonged and severe COVID-19 second wave. However, global oil demand recovery to 94% of pre-pandemic levels and stronger consumption trends in China and India could also play a part in the December decision.

(Price Positive) – Russian oil majors signal lower drilling in 2021: Bloomberg reports that Russia's crude producers are looking to reduce drilling volumes in 2021 as the pandemic continues to threaten demand and price recoveries. The article quotes analyst projections that oilfield spending in Russia and the former Soviet Union may drop by 31% in 2020, making the region the third hardest-hit by the virus, behind North America and Africa. It adds that oil producers have signaled some confidence that they can ramp up production quickly after the end of the year in accordance with the OPEC+ agreement, but lower drilling may delay capacity growth on projects that Russia sees as the drivers of future output growth.

(Price Positive) – China's next five-year plan to call for increases to crude reserve: China's next five-year plan beginning in 2021 will call for increases to its state reserves of crude in an effort to withstand supply disruptions following deteriorating relations with the US and its allies. The plan is expected to be rolled out in October. The country has already begun to prepare and build some of the storage capacity needed to boost reserves. In April the government set a reserve target of 90 days of net imports, but could eventually be expanded to 180 days when commercial reserves are included.

(Price Positive) – CTFC votes to institute position limits: The WSJ reports that the US Commodities Futures Trading Commission (CTFC) voted 3-2 to institute position limits on 16 agricultural, metal and energy commodities, with the goal of preventing speculators from causing price swings that don't reflect underlying supply and demand. The limits were authorized by the Dodd-Frank Act but have proved to be thorny to implement, with four previous attempts having failed amid industry opposition or court challenges. This decision could avoid episodes like the one seen in June.

(Price Negative) – Libyan output moves toward 500K bpd: In the wake of a truce in Libya's civil war, the country's oil production has risen to almost 500K bpd, with a large contribution from ramping production at the large Sharara oilfield (which can top out at ~300K bpd). The article notes Libya's exports averaged 385K bpd for the first two weeks of the month, against 213K bpd for all of September. It adds, however, that many of these shipments have thus far been from storage tanks at the country's port facilities rather than freshly pumped crude.

Long-term drivers

(Price Negative) **–** Alternative energies picking up the baton: Conventional producers must bear in mind that the value of their reserves is dictated by the amount of time they can pump before alternative energies render oil obsolete. In order to push back this deadline as far as possible, it is in producers' interest to keep oil prices low for as long as possible (keeping the opportunity cost of alternative energy sources as high as possible).

(Price Negative) **–** Growing environmental problems will gradually tighten legislation over production levels. The value of producers' reserves depends on the amount of time they can pump at current levels before tougher environment-inspired regulations come in. With growing environmental problems, which will likely continue to put a lot of pressure on the market for fossil fuels over the coming decades, OPEC's most serious risk is of sitting on a big chunk of "stranded reserves" that it can no longer extract and sell. Producers therefore have a powerful incentive to monetize as much of their reserves as soon as they can.

(Price Negative) **–** Are OPEC producers able to structurally fix prices? While it is true the agreement between the Saudis and Russia to strangle the global energy market has worked well in achieving a considerable increase in the price of oil, this has been at the cost of a loss of market share, meaning that OPEC producers are no longer able to easily fix prices without bearing costs. Back in the 1970s and the early 2000s, the exporters cartel agreed to cut output and the approach worked well, as the principal competition was among conventional oil producers (in particular between OPEC and non-OPEC producers). Today's biggest threat to any conventional oil producer comes from non-conventional producers and alternative energy sources. Energy cuts from conventional oil should therefore easily be offset (in theory) by a rapid increase in shale oil production.

PRECIOUS METALS - GOLD

Fundamental price for gold at US$1,800 – US$2,000/oz.

Positive drivers for gold

Gold is not a crowded trade: In spite of a 55% surge over the past two years, this rally has garnered limited headlines, unlike the tech sector. Accordingly, the total market of the precious metal and mining sector is small enough to keep running without hitting the big numbers problems. The daily volume traded on the LBMA and other gold marketplaces is around US$173bn (just 0.08% of the total in the financial markets).

The three identified threats that could end the gold rally seem to be distant: The 1976-80 rally ended when US short rates were jacked up to break inflation, causing a rise in the USD. The 1985-88 rally ended when Germany pulled out of the Accord Plaza deal and US rates started to push up rates (prompting a rise in the US Dollar). In the 2001-11 period (when the gold price skyrocketed from $300 to $1,800/oz), President George W. Bush's "guns & butter" policies spurred a rise in EMs, which became new gold buyers. This ended in 2011, when the USD started to strengthen. Looking at this history, when gold bull markets get going, they usually feed on their own momentum for quite a while, and only end when facing higher nominal rates, a stronger USD or a rise in real rates. Therefore, the only three threats to the unfolding gold bull market seem to be: 1) Higher nominal rates. 2) Stronger USD. 3) A rise in real rates. But how real and dangerous is each of these risks in bringing an abrupt end to the gold rally?

Risk #1. Higher nominal rates (LOW RISK): It is almost impossible to find an OECD central banker even thinking of raising interest rates in his or her lifetime.

Risk #2. Stronger USD (LOW RISK): The US current account balance has been gradually improving, leading to a shortage of dollars and a rise in its price. We do not foresee a jump in this current account balance that will boost the USD again. Rather, the balance (deficit) could remain stable at around 2% of GDP and keep the USD well supported but stable, far from a strong rebound that could end gold's bull market.

Risk #3. A rise in real rates (LOW RISK): So if nominal rates are not going to rise, the only way OECD countries can experience surging real rates is through an already low inflation rate collapsing even more. But how? Such a deflationary outcome could be triggered by a permanent collapse in the price of energy, a collapse in real estate, or even a collapse in the Renminbi. There are few signs of such shocks unfolding permanently. With this in mind, it seems that a surge in real rates is not an immediate threat.

Momentum - Gold bull markets usually feed on their own momentum for quite a while. Gold bull markets may build up over multi-year periods. In the 2001-2011 period, it was the new wealth being created in EMs, with a strong affinity for gold, that pushed gold prices higher. In contrast, in the 2011-2020 decade, most of the world's wealth has been created in campuses on the US-West coast, by people with scant interest in this "relic", and with EM growth having been much more moderate. Despite this, the gold price has ripped higher and is showing strong momentum. Imagine now if EMs thrive again, led by Asia, what a tailwind that would be for gold.

Gold as the new anti-fragile asset: Gold, like the US Treasury bond, is an anti-fragile asset. Investors should always decide which anti-fragile asset should be kept in their portfolio to protect themselves against instability in financial markets, demand or supply shocks or a collapse in real rates (due to inflation shocks). The answer will have a lot to do with the perception of which of the two traditional anti-fragile assets (Gold & US Treasuries or other Tier 1 Govies) is likely to perform better in the future. This, in turn, will depend on the relative supply of each asset. The one with the lower relative supply will be the one that will perform better and will better display its quality as an anti-fragile asset in the face of a shock. In this respect, we are very clear that the supply of US Treasury bonds will be almost unlimited, whereas the supply of gold will remain very limited over the next decade.

Negative yields still make gold attractive: The disadvantage of gold compared to fixed income instruments (gold does not offer a coupon) is now neutralized, with negative yields in a large number of global bonds (>US$13tn of face value is yielding negative rates).

Negative drivers for gold

Gold in real terms: Given the global deflator (now at 1.1299), the price of gold in real terms (calculated as the current nominal price divided by the US Implicit Price Deflator-Domestic as a proxy for the global deflator) is US$1,680. Therefore, in real terms, gold continues to trade well above its 20-year average of US$971. For the gold price to stay near its historical average in real terms, the nominal price (or equilibrium price) must remain near US$1,097.

Gold remains expensive relative to silver, though it is cheap relative to palladium (preference for store of value over productive assets). The Gold/Silver ratio is at 77.29 and still remains well above its 20-year average of 65.9x, suggesting that gold is expensive relative to silver. For this ratio to reach its long-term average, assuming that silver is better priced than gold (which is highly probable), then the gold price should go to US$1,620/oz. Meanwhile, the Gold/Palladium ratio is at 0.81, well below its 20-year average of 1.827x, suggesting that gold is cheap relative to palladium.

Gold to oil: This ratio is at 46.9, still well above its 16-year average of 17.1x. Considering our fundamental fair value for WTI oil at US$45 and assuming that the function utility of both commodities will remain unchanged, the price of gold must approach US$770 for this ratio to remain near its LT average.

EXCHANGE RATES

Flow analysis & Fundamental targets

EUR-USD: Target 1.15

USD-JPY: Target 107; **EUR-JPY**: Target 123

GBP-USD: Target 1.32; **EUR-GBP**: Target 0.87

USD-CHF: Target 0.97; **EUR-CHF:** Target 1.12

USD-MXN: Target 22; **EUR-MXN:** Target 25.3

USD-BRL: Target 5.50; **EUR-BRL:** Target 6.33

USD-ARS: Target 95

USD-INR: Target 74

CNY: Target 6.75

RUB: NEUTRAL-OVERWEIGHT

AUD: NEUTRAL

CAD: NEUTRAL

Currency	Mkt Value of Net positions in the currency (Bn $)	Change vs last month (Bn $)	3-yr Max (Bn $)	3-yr Min (Bn $)	3-yr Avg (Bn $)	Current Z-score 3-yr
USD vs All	-27,32	6,67	32,1	-34,1	-3,1	**-1,15**
USD vs G10	-27,48	6,44	32,7	-34,0	-2,2	**-1,24**
EM	-0,16	-0,22	3,9	-0,8	1,4	**-1,13**
EUR	24,52	-3,40	31,3	-8,6	11,5	**1,20**
JPY	1,68	-1,84	4,0	-15,0	-5,8	**1,18**
GBP	-0,16	-0,40	4,3	-6,5	-1,3	**0,43**
CHF	1,99	-0,18	2,3	-6,0	-1,7	**1,64**
BRL	-0,49	-0,06	0,7	-0,8	-0,2	**-0,81**
MXN	0,47	-0,14	3,3	-0,5	1,2	**-0,69**
RUB	-0,14	-0,02	1,2	-0,3	0,4	**-1,48**
AUD	0,48	-0,70	6,1	-5,2	-0,4	**0,28**
CAD	-1,45	-0,03	6,1	-5,0	-0,2	**-0,46**

Positive
Neutral-Positive
Neutral-Negative
Negative

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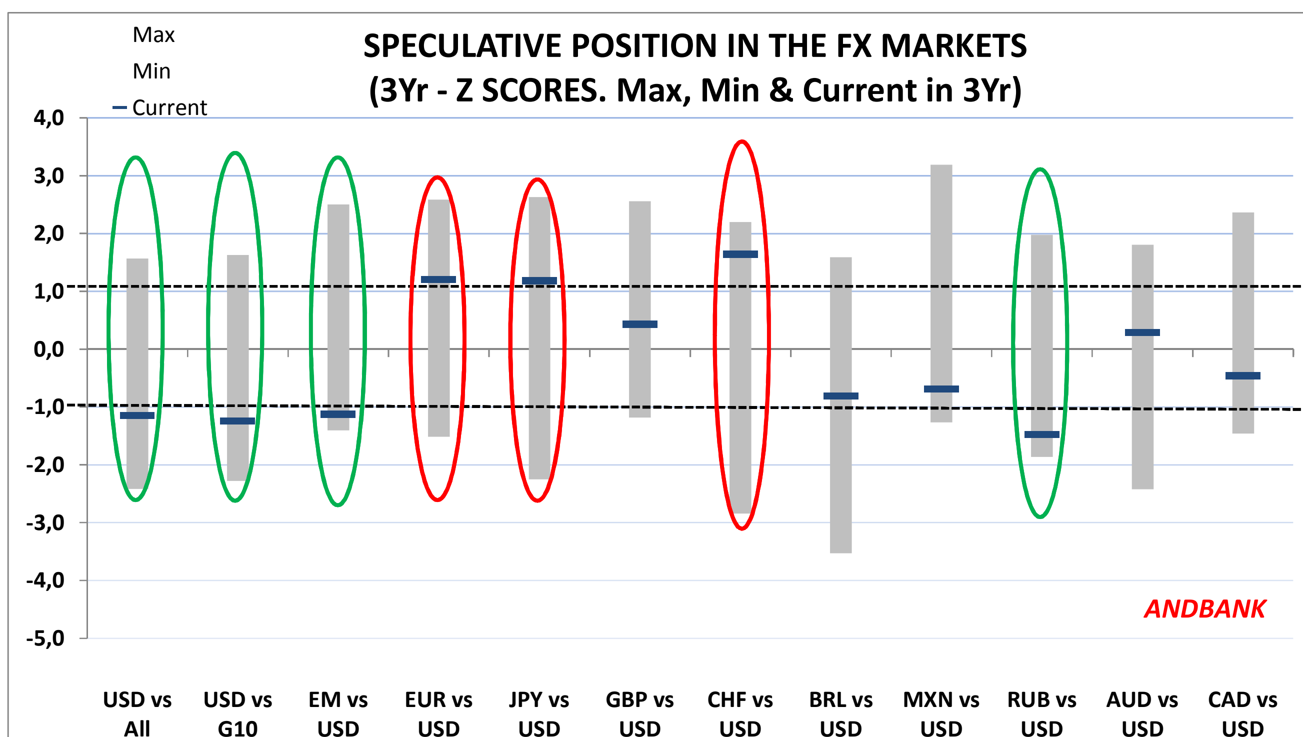

The currencies we technically favor are circled in green

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SUMMARY TABLE OF EXPECTED RETURNS

Asset Class	*Indices*	*Performance Last month*	*Performance YTD*	*Current Price*	*Fair Value*	**Expected Performance to Fair Value (Next 12 months)**
Equity	USA - S&P 500	-2,3%	1,2%	3.270	3.364	2,9%
	Europe - Stoxx Europe 600	-5,6%	-17,7%	342	348	1,5%
	Euro Zone - Euro Stoxx	-6,0%	-17,5%	333	357	7,2%
	SPAIN - IBEX 35	-4,5%	-32,4%	6.452	6.831	5,9%
	MEXICO - MXSE IPC	0,9%	-15,1%	36.988	37.670	1,8%
	BRAZIL - BOVESPA	-0,1%	-18,8%	93.952	102.254	8,8%
	JAPAN - NIKKEI 225	-6,6%	-1,5%	21.507	21.101	-1,9%
	CHINA - SHANGHAI COMPOSITE	0,2%	5,7%	3.225	3.064	-5,0%
	CHINA - SHENZEN COMPOSITE	3,4%	29,0%	2.223	1.955	-12,1%
	INDIA - SENSEX	2,3%	-4,0%	39.581	37.266	-5,9%
	VIETNAM - VN Index	2,6%	-3,7%	933	905	-3,1%
	MSCI EM ASIA (in USD)	3,2%	9,7%	621	598	-3,6%
Fixed Income Core countries	US Treasury 10 year Govie	-1,2%	10,1%	0,86	1,00	-0,3%
	UK 10 year Gilt	-0,1%	5,2%	0,26	0,80	-4,1%
	German 10 year BUND	0,7%	3,4%	-0,64	-0,40	-2,5%
	Japanese 10 year Govie	-0,2%	-0,5%	0,04	0,00	0,3%
Fixed Income Peripheral	Spain - 10yr Gov bond	0,7%	3,0%	0,13	0,40	-2,0%
	Italy - 10yr Gov bond	0,5%	6,3%	0,73	0,90	-0,6%
	Portugal - 10yr Gov bond	1,0%	3,0%	0,09	0,40	-2,4%
	Ireland - 10yr Gov bond	0,6%	3,0%	-0,28	0,00	-2,5%
	Greece - 10yr Gov bond	0,8%	5,4%	0,88	1,40	-3,3%
Fixed Income Credit	Credit EUR IG-Itraxx Europe	-0,1%	-0,6%	65,31	70	0,0%
	Credit EUR HY-Itraxx Xover	-0,9%	-4,1%	382,21	350	4,3%
	Credit USD IG - CDX IG	-0,1%	1,4%	65,15	78	0,5%
	Credit USD HY - CDX HY	-0,1%	-0,2%	418,35	440	3,7%
Fixed Income EM Europe (Loc)	Turkey - 10yr Gov bond (local)	-10,1%	-7,2%	14,06	13,25	20,5%
	Russia - 10yr Gov bond (local)	0,4%	5,5%	6,18	5,25	13,6%
Fixed Income Asia (Local curncy)	Indonesia - 10yr Gov bond (local)	3,0%	9,3%	6,57	5,60	14,3%
	India - 10yr Gov bond (local)	1,3%	10,8%	5,89	6,80	-1,4%
	Philippines - 10yr Gov bond (local)	-0,7%	14,8%	3,05	3,00	3,4%
	China - 10yr Gov bond (local)	-0,2%	2,3%	3,17	3,00	4,5%
	Malaysia - 10yr Gov bond (local)	1,0%	8,2%	2,62	1,60	10,7%
	Thailand - 10yr Gov bond (local)	-0,1%	2,1%	1,32	0,60	7,0%
	Singapore - 10yr Gov bond (local)	0,5%	8,9%	0,78	0,40	3,9%
	Rep. Korea - 10yr G. bond (local)	-1,3%	1,8%	1,50	1,40	2,3%
	Taiwan - 10yr Gov bond (local)	0,6%	3,2%	0,29	0,25	0,6%
Fixed Income Latam	Mexico - 10yr Govie (Loc)	-0,9%	12,4%	6,01	6,00	6,1%
	Mexico - 10yr Govie (USD)	1,0%	4,0%	3,18	3,50	0,6%
	Brazil - 10yr Govie (Loc)	-0,4%	-0,6%	7,58	7,50	8,2%
	Brazil - 10yr Govie (USD)	2,7%	4,7%	4,02	4,00	4,2%
Commodities	Oil (WTI)	-7,9%	-44,1%	34,1	45,00	31,9%
	GOLD	-0,8%	24,1%	1.883,3	1.600	-15,0%
Fx	EURUSD (price of 1 EUR)	-0,7%	3,8%	1,163	1,15	-1,2%
	GBPUSD (price of 1 GBP)	-0,2%	-2,7%	1,29	1,32	2,3%
	EURGBP (price of 1 EUR)	-0,5%	6,6%	0,90	0,87	-3,3%
	USDCHF (price of 1 USD)	-0,4%	-5,2%	0,92	0,97	5,7%
	EURCHF (price of 1 EUR)	-1,0%	-1,6%	1,07	1,12	4,5%
	USDJPY (price of 1 USD)	-0,5%	-3,5%	104,79	107,00	2,1%
	EURJPY (price of 1 EUR)	-1,2%	0,1%	121,92	123,05	0,9%
	USDMXN (price of 1 USD)	-1,4%	12,5%	21,30	**22,00**	3,3%
	EURMXN (price of 1 EUR)	-2,0%	16,9%	24,77	25,30	2,1%
	USDBRL (price of 1 USD)	1,0%	42,9%	5,74	5,50	-4,3%
	EURBRL (price of 1 EUR)	0,3%	48,3%	6,68	6,33	-5,3%
	USDARS (price of 1 USD)	2,0%	30,8%	78,32	**95,0**	21,3%
	USDINR (price of 1 USD)	1,6%	4,3%	74,43	74,00	-0,6%
	CNY (price of 1 USD)	-1,4%	-3,9%	6,69	**6,75**	0,8%

** For Fixed Income instruments, the expected performance refers to a 12 month period*

UPWARD REVISION   DOWNWARD REVISION

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Achieves
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