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# Flash note
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# Andbank's view on the US economy, equity and fixed income markets

### Economic Recovery continues but is cooling

Indeed, retail sales growth picked up again in September, increasing 1.9%, showing a strength that was broad-based. Consumer spending has been also increasing in recent months while disposable incomes have been declining and it seems that the recent rapid rate of spending growth is unsustainable. The stimulus payments distributed are 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 depends more on the outcome of Senate elections than the presidential election result. Fiscal policy differences between Republicans and Democrats in the Senate are great, as demonstrated in the recent negotiations over a COVID-19 relief package. 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 Senate Republican proposal. If Biden wins the White House but Republicans hold their majority in the Senate we would expect a Biden Administration and Democratic House to agree on a large fiscal relief package but we would expect Senate Republicans to try to limit fiscal legislation to around the $500 billion, with Republicans likely block Biden’s $2trn infrastructure package as well as any attempt to roll back the 2017 tax law. Obviously, a Senate Republican majority would be more likely to support 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 likely 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 the debt by $4.95tn over the next decade, while Biden’s platform would add $5.6tn.

### Equity Market

We recognize that valuations are demanding, but in our opinion the market is not significantly overvalued. Right now the S&P would trade 7% above our fair value, but still 13% below an exit point. The premiums offered by the market (measured by the spread between the EPS yield and the yield of the risk-free asset) could seem unattractive from a historical point of view, but they are still well above past levels prior to a market shock. The S&P500 recovered +2% in October (after a -3.92% in

September), while the Nasdaq rose + 2.81%, approaching historical highs again. The corporate results period has started, but only 10% of the index has been released so far. The electoral result, in addition to the Earnings, is a key factor in assessing the fair level of the S&P500, specially because it will shed more light on the question of the tax increase that the Democratic victory may imply. We forecasts EPS next 12 months at 158, and we consider a 20x PE, resulting in a fair value for the S&P at 3,165 and an exit point at 3,800. Recommendation is marketweight.

**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, <u>yield/curve directionality should remain firmly positive and continue to steepen</u>. Therefore we keep our 1.0% objective for the 10yr.

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 of HG bonds has picked 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. We keep our Marketweight recommendation.

HY corporates 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, as MTD only 29 new high yield bonds have been priced in October, following 77 new bonds priced during September totaling $50.9bn. Default volume has been slowing during the past month, with only about $2.9bn in 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). We keep our OW to Marketweight recommendation.

**Financial market assessment**

Equities – S&P: MARKETWEIGHT (Neutral to positive Exposure)

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

US Investment Grade bonds: MARKETWEIGHT (Target Spread 70)

US High Yield bonds: MARKETWEIGHT-OVERWEIGHT (Target Spread 350-400)

Why still positive (Marketweight) in the broad US market? The chart to keep in mind

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