ECONOMY & FINANCIAL MARKETS

ANDBANK
Private Bankers

Andbank Monthly Corporate Review

Andbank Monthly Corporate Review – October 2020

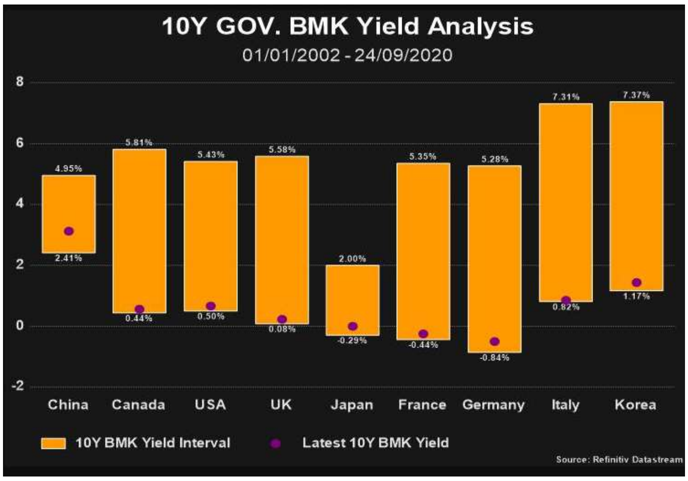
Why is a market correction possible and would it not necessarily be serious?

Alex Fusté
Chief Global Economist
+34 673 041 058
alex.fuste@andbank.com

EXECUTIVE SUMMARY

CHART OF THE MONTH

No one is positioned for a corner steepening, but conditions are on the table



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	3.352	3.124	-6,8%	MW	3.592
Europe - Stoxx Europe 600	363	341	-6,2%	MW	392
Euro Zone - Euro Stoxx	356	360	1,1%	MW/OW	414
Spain IBEX 35	6.792	6.623	-2,5%	MW	7.286
Mexico IPC GRAL	37.232	37.995	2,1%	OW	41.795
Brazil BOVESPA	94.666	100.622	6,3%	OW	110.684
Japan NIKKEI 225	23.512	20.764	-11,7%	UW	24.917
China SSE Comp.	3.228	3.038	-5,9%	UW	3.342
China Shenzhen Comp	2.152	1.938	-9,9%	UW	2.132
India SENSEX	37.986	35.051	-7,7%	MW/OW	42.061
Vietnam VN Index	913	893	-2,2%	OW	1.072
MSCI EM ASIA	594	591	-0,5%	OW	709

FIXED INCOME GOVIES CORE & CORPORATE CREDIT (DM)

Asset Class	*Indices*	*Current Price*	*Fair Value*	Expected Performance to Fair Value 2020
Fixed Income Core countries	US Treasury 10 year Govie	0,65	1,00	-2,6%
	UK 10 year Gilt	0,20	0,80	-4,8%
	German 10 year BUND	-0,54	-0,40	-1,2%
	Japanese 10 year Govie	0,01	0,00	0,1%
Fixed Income Peripheral	Spain - 10yr Gov bond	0,23	0,40	-1,3%
	Italy - 10yr Gov bond	0,86	0,90	-0,1%
	Portugal - 10yr Gov bond	0,24	0,40	-1,3%
	Ireland - 10yr Gov bond	-0,19	0,00	-1,6%
	Greece - 10yr Gov bond	1,05	1,40	-2,6%
Fixed Income Credit	Credit EUR IG-Itraxx Europe	62,03	70	-0,2%
	Credit EUR HY-Itraxx Xover	363,25	350	1,2%
	Credit USD IG - CDX IG	59,15	70	-0,1%
	Credit USD HY - CDX HY	398,22	350	2,5%

FIXED INCOME EMERGING MARKETS

Asset Class	*Indices*	*Current Price*	*Fair Value*	Expected Performance to Fair Value 2020
Fixed Income EM Europe (Loc)	Turkey - 10yr Gov bond (local)	12,93	12,50	6,7%
	Russia - 10yr Gov bond (local)	6,30	5,25	10,0%
Fixed Income Asia (Local curncy)	Indonesia - 10yr Gov bond (local)	6,85	6,00	8,5%
	India - 10yr Gov bond (local)	6,06	6,80	-4,4%
	Philippines - 10yr Gov bond (local)	3,09	3,00	1,5%
	China - 10yr Gov bond (local)	3,10	3,00	1,6%
	Malaysia - 10yr Gov bond (local)	2,77	2,00	6,8%
	Thailand - 10yr Gov bond (local)	1,30	0,25	8,7%
	Singapore - 10yr Gov bond (local)	0,85	0,40	3,8%
	Rep. Korea - 10yr G. bond (local)	1,33	0,75	4,9%
	Taiwan - 10yr Gov bond (local)	0,39	0,00	3,2%
Fixed Income Latam	Mexico - 10yr Govie (Loc)	5,70	6,20	-2,5%
	Mexico - 10yr Govie (USD)	3,32	4,00	-4,6%
	Brazil - 10yr Govie (Loc)	7,04	7,50	-1,9%
	Brazil - 10yr Govie (USD)	4,30	4,00	3,5%

COMMODITIES & FX

Asset Class	*Indices*	*Current Price*	*Fair Value*	Expected Performance to Fair Value 2020
Commodities	Oil (WTI)	40,4	40,00	-0,9%
	GOLD	1.880,1	1.600	-14,9%
Fx	EURUSD (price of 1 EUR)	1,167	1,15	-1,4%
	GBPUSD (price of 1 GBP)	1,29	1,32	2,7%
	EURGBP (price of 1 EUR)	0,91	0,87	-4,0%
	USDCHF (price of 1 USD)	0,92	0,97	5,0%
	EURCHF (price of 1 EUR)	1,08	1,12	3,5%
	USDJPY (price of 1 USD)	105,59	107,00	1,3%
	EURJPY (price of 1 EUR)	123,21	123,05	-0,1%
	USDMXN (price of 1 USD)	22,42	22,25	-0,7%
	EURMXN (price of 1 EUR)	26,15	25,59	-2,2%
	USDBRL (price of 1 USD)	5,66	5,50	-2,8%
	EURBRL (price of 1 EUR)	6,60	6,33	-4,2%
	USDARS (price of 1 USD)	76,05	95,0	24,9%
	USDINR (price of 1 USD)	73,85	74,00	0,2%
	CNY (price of 1 USD)	6,82	6,75	-1,1%

USA

November's US election is not the most important in a generation

Analyzing the US elections does not make sense from a market point of view

The market literature insists on incorporating the predicted election result into asset prices, attributing market movements to changes in the polls. As is often the case, everything said and written by these analysts is misleading, so I would not waste too much time trying to surmise the market implications of one result or another. Certainly, there is a great difference in the substance of each candidate's proposals. Almost as many differences as there were between Obama and Trump. But if we look at the composite returns of the S&P during the Obama era, and compare them with the return offered during the Trump era, we see that there is very little difference (12.4% vs. 13.9% ar) (Source Gavekal Sept,21). Bonds also offered a positive return of 6.9% during Obama, and 9.8% during Trump. The only asset in which there were differences in performance was in the return on dollar cash for European investors (+2.32% in the Obama era vs -0.68% with Trump). But this difference was minimal for Japanese investors, suggesting that the different performance in the USD/EUR during the Obama and Trump era had more to do with local factors in Europe, rather than political specificities. So, apparently, all the agonizing we observe in the calculation of the possible effects on the markets resulting from the victory of one candidate or another makes very little sense. This conclusion is also supported by the sector performance of the S&P 500. Under Obama, the three best-performing sectors were consumer discretionary, technology and health care. Under Trump, the three best-performing sectors have been technology, consumer discretionary, and health care. Under Obama, the two worst-performing sectors were financials followed by energy. Under Trump, the worst performers were… exactly the same. Meanwhile, industry ended up doing much the same under both presidents. We should not make a case on appearances, as initial conclusions about the effects of politics are often wrong. For example, the tech sector was viewed as widely hostile to candidate Trump, who was theoretically going to develop a regulatory hell against these companies. However, the tech sector has taken off like never before. Similarly, in 2016, one could expect a favorable environment for developers (Trump is a former developer), but the reality is that developers have performed mediocrely. Much the same for banks. At the start of the Trump years, hopes were for financial deregulation that could boost bank returns. Yet, financials have ended up being one of the biggest laggards. Energy stocks were seen as promising investments but have ended up being the only sector that has performed negatively throughout the term. So apparently, for the tech companies of this world, or the banks, or the energy companies, it doesn't matter who is in the Oval Office. Will monetary policy change after November? Will the decision to run large budget deficits change after November? Will US policy towards China change dramatically after November? Most likely not.

Could the Democrats push the market back into a more broad-based cycle?

The divergence between the Obama and Trump years has to do with dispersion. During the Obama era all sectors posted positive returns and sector dispersion did not appear excessive. In the Trump years, technology and consumer discretionary advanced strongly, while the rest of the market returned rather soft returns, pushing the divergence between the technology and energy sectors to an extreme never seen before. During the Obama era, the equally weighted S&P 500 index outperformed the capitalization-weighted index. With Trump the opposite happened. It could be said that both Obama and Trump were drivers of the bull market, but with Trump the advance has become increasingly narrower.

The US dollar under Biden

Investors and analysts today tend to think that a Democratic victory would weaken the USD (consensus is for a -4% depreciation), while a Trump victory would strengthen it (near +3%). I cannot disagree more. The US dollar has been broadly weaker under Trump, while it was broadly stronger under Democrats (Obama). To some extent, this makes sense. Trump is an avowed mercantilist, and mercantilists typically like having weaker currencies. The FOMC adopted outcome-based liftoff criteria, where it expects to maintain the current policy target range "until labor market conditions have reached levels consistent with the Committee's assessments of maximum employment and inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time."

Financial market assessment

Equities – S&P: MARKETWEIGHT

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

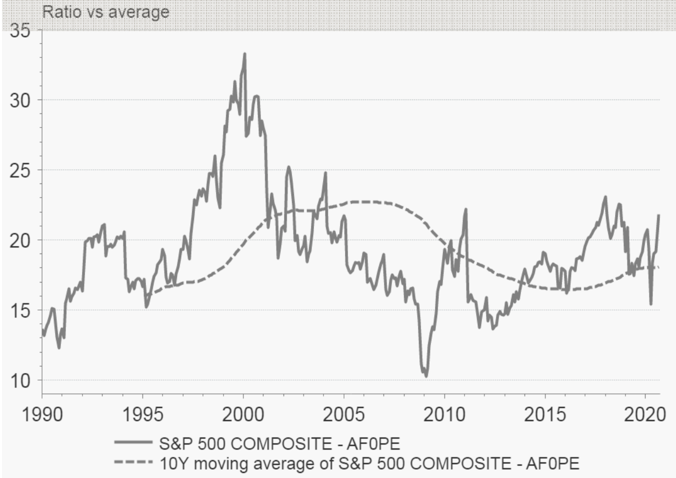
CDX IG: MARKETWEIGHT (Target Spread 70)

CDX HY: MARKETWEIGHT-OVERWEIGHT (Target Spread 350)

Forex – DXY index: MARKETWEIGHT

US price-to-earning ratio

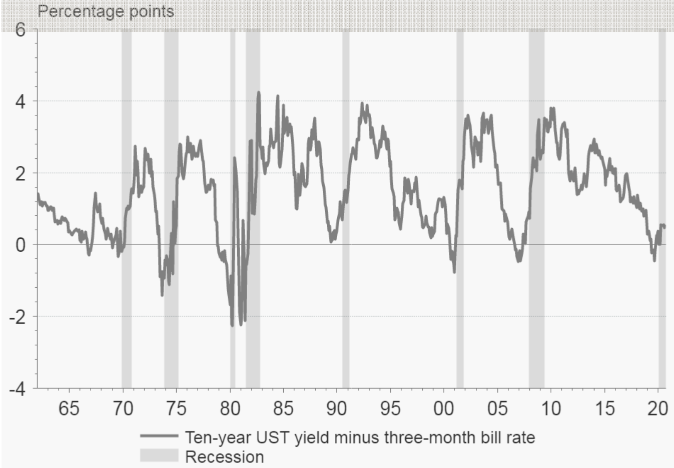
Ratio vs average



Source: Refinitiv Datastream / ANDBANK

US yield curve slope and recessions

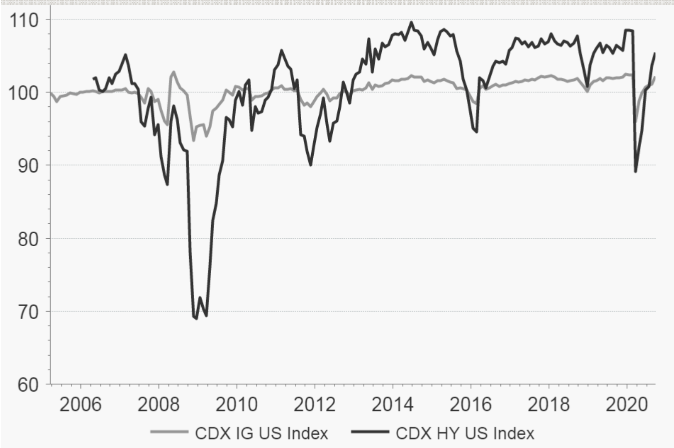
Percentage points



Source: Refinitiv Datastream / ANDBANK

CDX IG & HY

North America



Source: Refinitiv Datastream / ANDBANK

EUROPE
Hit by a second wave

Sentiment recovery close to a peak

Sentiment has continued to improve across all the manufacturing and services surveys. A "V shaped" recovery has also been witnessed in retail sales, but remains incomplete in the industrial and external figures, which still lag behind. The doubt is whether we could have already seen the best in terms of sentiment, especially as the pandemic situation is now deteriorating in Europe. Spain and France are among the worst performers, while Germany and Italy are still holding up well. On the positive side we have the uptick in the savings rate, as a precautionary movement, but allowing for some margin in terms of future spending. Most of the guarantee schemes expiring in September have been rolled over, thus avoiding the feared "cliff effect". The importance of phasing out the stimulus is obvious and it is the consensus among economists and politicians.

The central bank improves its estimates but maintains the dovish tone, so as not to generate disorder in the markets. "The currency does matter"

New ECB macro projections point to a less gloomy 2020 in terms of growth, with modest downwards revisions to the 2021-2022 GDP projections. The inflation path shows a slow but positive trend that has allowed Lagarde to say that "deflation risks have receded". A larger stimulus has not been discussed, though the consensus expects an increase in the PEPP envelope (+€300-350 bill.), for the late 2020/late 2021. Euro strength is the dominant topic and is included in the ECB's formal communication, which has refrained from "entering a currency war" but refers constantly to the currency's impact on inflation. 1.20 could be seen as a "psychological resistance" in the short term for the ECB. What could be the macro impact of a stronger euro? Under ECB assumptions (as published in December 2019), a 13% euro appreciation against the US dollar would point to both real GDP growth and HICP inflation being 0.2% lower in 2020 and 0.4%-0.5% lower in 2021. Should appreciation continue, the ECB could take action, though its intervention is uncertain and would depend on the speed of the currency movement.

Meanwhile the BoE has started a debate on negative rates, a tool that has never been rejected and that now seems a question of "when more than if", with an eye on Brexit.

Hard Brexit: has it become more likely?

The probability ascribed to a no-agreement exit is now close to 50% due to the loss of confidence in the British government after they introduced a bill ("Internal Market Law") that could violate the Withdrawal Agreement signed with the EU. The US Democrats have warned that they would not back any trade agreement with the UK if its government contravenes the Good Friday Agreement. The bill might change during the Chambers discussions, with some Conservative politicians having shown strong opposition. By the end of September legal proceedings regarding the bill will have finished. Next stop at the European summit on the 15-16th of October, where a "light agreement", limited to certain sectors, could finally be this year's maximum outcome.

Bond markets

The environment remains calm in the corporate bonds universe, but not without periods of volatility. This may likely be the general trend during the next months, with the start of the corporate earnings season (which is expected to be disastrous), and in the middle of an electoral period in the US that is projected to be aggressive.

Even so, spreads offer great resistance and solidity (compared to equities). The sectors that show the most vulnerability are financials and airlines.

By category, it is still the investment grade bonds that perform the best, supported by flows that already double the outflows seen in the worst moments of the Covid crisis. In the high-yield universe, the ground lost in flows is being recovered, but at a slower pace than the flows seen in the IG universe. September has been marked by the return of primary issuance, especially hybrids, which are in high demand. All this despite the fact that the risk premium paid for these bonds has fallen significantly. Regarding the financial sector, of note is the poor performance of banks and insurers in the UK (due to the threat of a hard Brexit).

The much expected mergers have started in Spain (Caixa and Bankia), followed by rumors of a big merger in Switzerland (Credit Suisse and UBS). We see this as credit positive for the sector. We modify (improve) the target level for HY spreads, but keep them stable for IG bonds.

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)

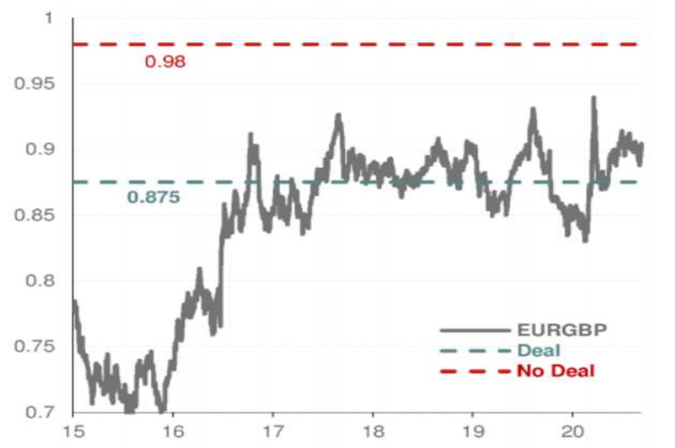
ECB: Macro Scenario

		2020E	2021E	2022E
IPC	sep-20	0,3%	1,0%	1,3%
	jun-20	0,3%	0,8%	1,3%
	dic-19	1,1%	1,4%	1,6%
	sep-19	1,0%	1,5%	
	jun-19	1,4%	1,6%	
PIB real	sep-20	-8,0%	5,0%	3,2%
	jun-20	-8,7%	5,2%	3,3%
	dic-19	1,1%	1,4%	1,4%
	sep-19	1,2%	1,4%	
	jun-19	1,4%	1,4%	

Fuente: BCE, Andbank España

Fig. 9: EUR/GBP Brexit scenarios

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



STOXX 600 - EPS

1Y % Change

Source: Refinitiv Datastream / ANDBANK

CHINA

Tech & trade war intensifies between US and China. Fiscal stimulus to continue

US-Sino war continues

ByteDance, Oracle, and the Treasury Department have tentatively agreed to terms for Oracle's bid for the US operations of TikTok. Under the plan, Oracle would acquire a minority stake in a newly formed TikTok (that would be headquartered in the US) with an independent board approved by the US government. The board of directors of the newly formed company would have to consist entirely of US citizens and would include a national security committee. Oracle would have full access to TikTok's source code and updates to make sure there are no backdoors for the company's Chinese parent to access data. Oracle and Walmart still aim for significant stakes in the new TikTok. That move, if combined with existing American investors, could put majority ownership in US hands. Walmart Chief Executive Doug McMillon is expected to get a board seat if the deal goes through. US President Trump also indicated Microsoft is still involved, but without elaborating. Meanwhile, the FT has reported that ByteDance agreed to list TikTok on a US stock market at some point after its proposed partnership deal with Oracle, as part of its effort to satisfy the Trump administration's national security concerns. IPO in the US — and not in China or Hong Kong — was one of several commitments made by ByteDance to avert a ban from the White House. These steps confirm that the White House is getting most of the prerogatives it was demanding. Meanwhile, ByteDance may receive capital in exchange for the loss of control.

A **global group of chip sector** suppliers plan to warn the Trump administration against a proposal to blacklist SMIC (~981.HK~), arguing it would be "detrimental" to US industry. The companies are represented by the semiconductor and electronics manufacturing suppliers industry group SEMI, which drafted a letter to be sent to Commerce Department Secretary Wilbur Ross. **Icloud:** China's state-owned China Electronics Corp. (CEC) has entered the cloud computing market amid fears of further restrictions on Chinese access to US technology. The company unveiled its "China electronics cloud" services, which will use hardware developed by CEC chip-making subsidiary Tianjin Phytium Information Technology and will run the domestically developed Kylin operating system. **US charges five Chinese residents** and two Malaysian businessmen in a wide-ranging hacking effort that encompassed targets from companies to pro-democracy activists. Federal prosecutors said the Chinese nationals had been charged with hacking more than 100 companies in the US and abroad. The US State Department has **revoked visas** for more than 1,000 Chinese nationals to suspend entry from China of graduate students and researchers deemed security risks. The head of the US Department of Homeland Security said that Washington was blocking visas for certain Chinese people to "prevent them from stealing and otherwise appropriating sensitive research". **WeChat:** US Justice Department announced that WeChat users will not face civil or criminal penalties even if the US bans the Chinese-owned messaging app through other actions next week. Commerce Secretary Wilbur Ross is set to release regulations by Sunday clarifying which WeChat transactions will be prohibited. **Soybean & politics:** China has more than doubled its planned soybean purchases from the US since August, as the commodity emerges as one of the few diplomatic tools left for Beijing to exert pressure on Washington. We do not link the increase to China's purchase commitments under the Phase One trade deal. Instead, the move was likely intended to highlight China's influence as US President Trump courts farm votes ahead of the November election.

Geopolitical clash – India & Taiwan

India: Foreign affairs ministers from China and **India** reached a five-point consensus to diffuse recent tensions. China will maintain communications with India through diplomatic and military channels and commit to "restoring peace and tranquility" in their disputed border area. Chinese State Councilor said that the "imperative is to immediately stop provocations such as firing and other dangerous actions that violate the commitments made by the two sides". **Taiwan** is set to open an economic dialogue with the U.S., laying the groundwork for talks on a free trade agreement while the island unwinds cross-strait economic integration with Beijing. Taiwan's Ministry of Foreign Affairs said that discussions are underway for a visit by US undersecretary of state for economic growth, energy and the environment. The senior U.S. diplomat for East Asia, David Stilwell, said this month that Washington would bolster ties with Taiwan by establishing a new bilateral economic dialogue. Meanwhile, the US plans to sell as many as seven major weapons systems, including mines, cruise missiles and drones, to Taiwan, as the Trump administration ramps up pressure on China. Pursuing seven sales at once is a rare departure from years of precedent in which US military sales to the island were carefully calibrated to minimize tensions with Beijing.

Financial market outlook

Equities – SHANGHAI Idx: UNDERWEIGHT

Equities – SHENZHEN Idx: UNDERWEIGHT

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

Forex – CNY/USD: MW (Target 6.75)

China Broad, price/earnings, Datastream index
Ratio

Source: Refinitiv Datastream / ANDBANK

China - 10Y Government Bond Real Yield
Per cent

Source: Refinitiv Datastream / ANDBANK

USDCNY exchange rate
Spot rate

Source: Refinitiv Datastream / ANDBANK

JAPAN

New prime minister. Japan stocks typically do well after a long-term premier passes torch.

Politics: Yoshihide Suga elected prime minister. Slight change in focus

Yoshihide Suga (the former chief Cabinet secretary) was elected Japan's prime minister by both houses of parliament, his immediate focus being to revive the battered economy while keeping the novel coronavirus under control. After announcing the members of his Cabinet, Suga will be formally inaugurated in a ceremony at the Imperial Palace. His tenure will last through the remainder of Abe's term as LDP leader until September 2021.

Suga also said that the consumption tax "needs to be raised beyond the current 10% in the future", citing the rapidly aging population. He maintains that Japan must first be on track for recovery before it improves its balance sheet.

Analysts expect no major change to the relationship between the BOJ and an administration led by Suga. However, Suga's emphasis on protecting employment could prod the BOJ to pay more attention to the job market (rather than financial markets) in conducting monetary policy. Japan stocks typically do well after a long-term premier passes the torch. According to the historical market patterns around a change in prime minister, no Japanese leader taking over from a long-serving premier has seen stocks fall on their watch. According to Mizuho Securities analysis, every successor to a Japanese leader who has been in office for around five years or more has lasted at least a year in office, and local stocks have risen during each of those terms. However, the sample size is small given frequent shakeups in the government. The new PM said that a snap election is not on the cards, but Japan's fractured opposition parties are rallying to offer a viable alternative to the ruling coalition in preparation for a lower house election that will be held within a year. The new Constitutional Democratic Party, to be formed officially next Tuesday, will consist of nearly all the members of the existing party of the same name, as well as most of the current Democratic Party for the People and many independents. Yukio Edano, who heads the existing Constitutional Democrats, was elected Thursday as the new party's first leader

Japanese investors continue with global carry trade strategy

Domestic investors: Net buyers of ¥300.1B in foreign long-term debt vs ¥377.7B of net purchases in previous week. Net sellers of ¥438.6B in foreign equities.

BOJ leaves rates unchanged, upgrades economic assessment

BOJ voted 8-1 to leave short and long-term rates unchanged. Economic assessment was upgraded, noting economy has started to pick up, with activity resuming gradually, though BOJ reiterated that conditions remain severe due to coronavirus effects. Assessment upgrade extended to the outlook, where BOJ sees an improving trend via pent-up demand and supported by policy stimulus.

Japan eases business restrictions despite COVID-19 risk

The Nikkei discussed the relaxation of business restrictions on restaurants and karaoke parlors in Tokyo from Wednesday 16th, which are now back to normal business after having been asked to close by 10pm. Starting Saturday, the central government's request to ease the limitation of audiences for public events (limited to 5,000 people until now) will be granted. The government is also considering including Tokyo in its domestic travel subsidy program from 1-Oct.

Corporates

Sony launches PS%: Sony's PS5 launch sets up a head-to-head battle with Microsoft's next-generation Xbox. Sony Interactive Entertainment CEO Jim Ryan told the Nikkei, "our exclusive games for the PS5 are easily the best we have ever had in any platform." Given that pricing has been a big factor in the competition with Microsoft, Sony's digital edition will cost $100 more than the Xbox Series S. Ryan acknowledged the importance of price but suggested it was more important to provide consumers with "certainty that their purchase will be valid for many years to come."

Japanese chipmakers scramble to replace Huawei sales after US ban: US sanctions against Huawei have forced Japanese chipmakers to launch a wider network to seek new sales and make up for the gap left by lost sales to Huawei. Japanese chipmakers supplied about ¥1.1T ($10.4B) in parts to Huawei last year. Even supplying chips to a third party could run afoul of US export regulations if the products in question are ultimately used by Huawei.

Financial market outlook

Equities – N225: UNDERWEIGHT

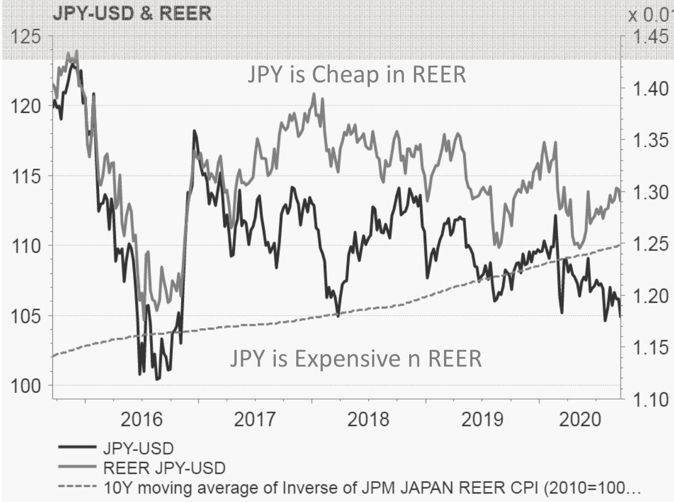
Bonds – Govies: MARKETWEIGHT (Target yield 0.00%)

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

Japan Nikkei 225 price / earnings
Ratio

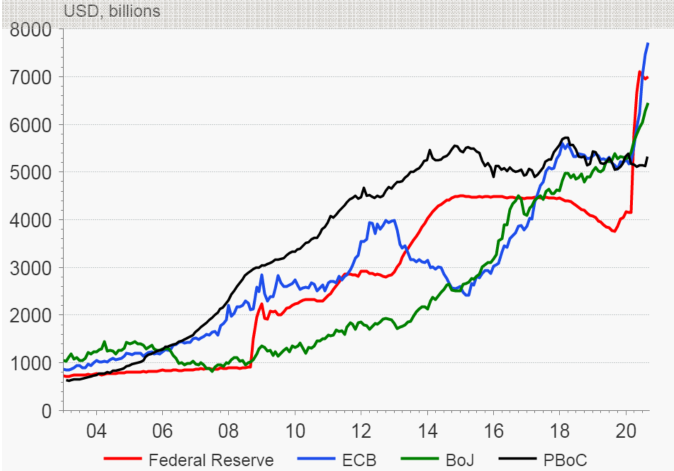
Source: Refinitiv Datastream / ANDBANK

JPY-USD & REER



Source: Refinitiv Datastream / ANDBANK

Major central bank balance sheets - total assets
USD, billions



Source: Refinitiv Datastream / ANDBANK

MACRO ECONOMY

INDIA

Bonds, equities and Fx continue receiving love from investors. We maintain confidence in equities and Fx

Economics & Covid

India also took a big economic hit from the pandemic, with GDP growth contracting by -23.9% YoY in 2Q20, a record fall after a +3.1% YoY rise in 1Q20. Growth is picking up from its 2Q nadir, though only slowly, and high frequency indicators suggest an (uneven) recovery. With the exception of high-contact activities like domestic travel, several high-frequency indicators (passenger car sales, etc.) had pointed to a strong rebound after lockdown was lifted. But these have stalled, raising questions about how long pent-up demand can continue to drive the economy. Certainly, the spike in unemployment rates has now corrected, but this is probably due to the return of migrant workers to their villages, which pushed down urban joblessness, while the government's rural job-guarantee program kicked into overdrive. Looking at 3Q and FY GDP growth, business activity dipped again in July after local lockdowns were reimposed. The surging number of Covid cases means further localized restrictions cannot be ruled out and, with many migrant workers being in no hurry to return to the cities, this will cause a prolonged contraction in the urban workforce, which in turn could cut potential growth. As we see it, with growth in the July-Sept quarter set to remain deep in negative territory, India is heading towards a full-year GDP contraction of -10%. In any case, it is questionable whether the GDP data for India is comparable with that of the other countries, knowing that the fiscal stimuli promoted by the Delhi government have been infinitely lower than the fiscal programs seen in the other countries, as Delhi seeks to avoid a deterioration in public finances. The pandemic continues to soar in India in absolute terms, though it remains below the US and Brazil on a per-capita basis, with the worst-affected states—Maharashtra, Andhra Pradesh, Tamil Nadu and Karnataka—being among the most important economically. Delhi began relaxing its lockdown in June, and the government is clear that it will not reimpose nationwide restrictions. However, the high number of Covid-19 cases has forced many states to impose local lockdowns, which is creating economic uncertainty.

Banking system.

India's banks are preparing to absorb yet another round of bad debts. The RBI forecasts that the NPL ratio will rise by 4pp to 12.5% by the end of March 2021. Around half of all outstanding bank loans were under the repayment moratorium that ended on Aug 31. What happens next is uncertain, as the Supreme Court has ruled that new defaulters will be reprieved until further notice. This will probably lead risk-averse banks to further tighten lending standards.

External sector as a silver lining

India's external position has strengthened dramatically, largely thanks to much weaker demand for imports. India recorded its first quarterly current-account surplus for 13 years in 1Q20 and is on track to post another surplus in 2Q. Together with surprisingly strong capital inflows into equities, this has enabled the RBI to boost India's forex reserves to a record level.

The central bank is helping, but its firepower is limited

The RBI cut rates by 115bp early in lockdown. But with inflation now running above its upper target of 6%, the central bank has had to pause its easing cycle.

Bond market tantrum.

The government knows that a bigger fiscal stimulus is needed, and Delhi now seems to be preparing a more aggressive fiscal response, though it has indicated it that it may delay this until after a vaccine is available, fearing that the multiplier effect will be lackluster while economic uncertainty remains so high. This fiscal conservatism is at the root of the bond market's tantrum. Greater certainty about public spending plans could flatten the yield curve and reduce borrowing costs.

Indian Equities: Are they worth the love they're receiving

Indian equities have followed the global trend, bouncing back since their March trough, but they now seem to be overpriced (see the chart 1). Yet this self-evident truth has never stopped investors from bidding up markets to new highs. What next? Prices can keep rising while money remains cheap and easy, and with global money set to remain abundant, share prices could continue to rise even as the real economy suffers from a deep and prolonged recession.

Financial market outlook

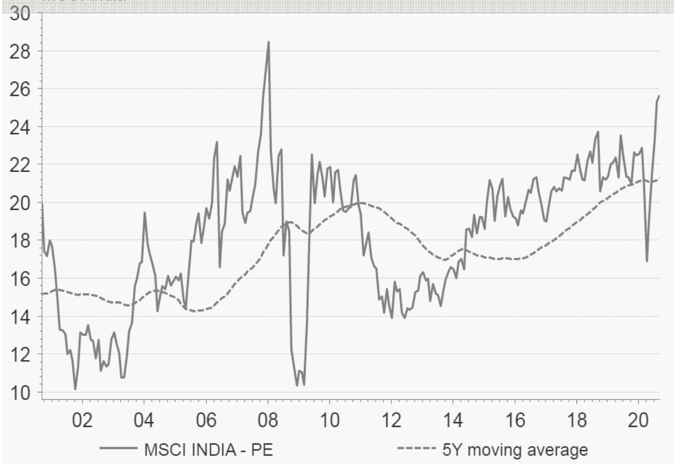
Equities – SENSEX: MARKETWEIGHT-OVERWEIGHT

Bonds – Govies: UNDERWEIGHT (Target yield 6.8%)

Bonds – Corporates: MW-UNDERWEIGHT

Forex – INR/USD: MARKETWEIGHT-OW (Target 74)

PE (ltm) - India
MSCI India

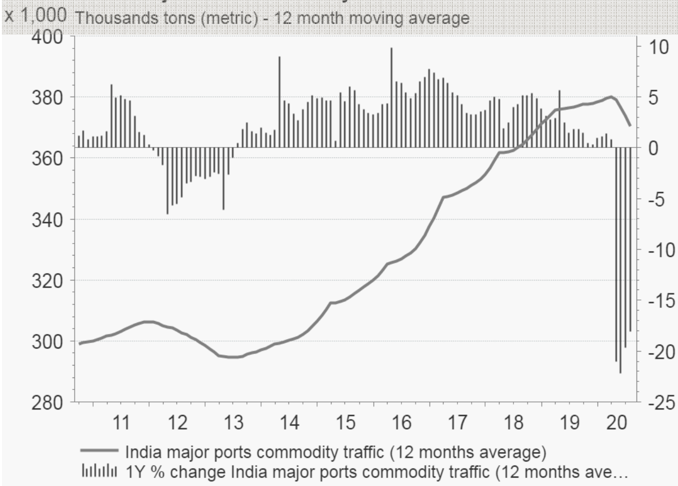


Source: Refinitiv Datastream / ANDBANK

India - 10Y government bond Real Yield
Per cent

Source: Refinitiv Datastream / ANDBANK

India - Major Ports Commodity Traffic
Thousands tons (metric) - 12 month moving average



Source: Refinitiv Datastream / ANDBANK

ISRAEL
Marketweight equities. Overweight bonds & hedge the currency

Geopolitics

An Israeli delegation arrived in Bahrain on 23 September for talks on carrying out an agreement to normalize relations. The visit follows last week's signing in Washington of US-brokered normalization accords between Israel, the United Arab Emirates and Bahrain. The Israeli-Bahraini "Declaration of Peace" pledged the parties to seek agreements on opening embassies and in areas including security, investment, tourism, direct flights, technology and energy. The Israeli delegation travelled on the first commercial flight from Israel to Bahrain, operated by Israir Airlines, flying over Saudi Arabia after the authorities there permitted overflights to and from Israel. Israeli Prime Minister Benjamin Netanyahu tweeted on 22 September that he had "an outstanding, very friendly conversation" with Crown Prince Salman Bin Hamad of Bahrain on "how to turn this peace into economic peace, technological peace and tourist peace. Meanwhile, the Crown Prince had "underscored the importance of securing regional and international stability and enhancing efforts to support peace in the region," and that "potential areas of bilateral cooperation were also reviewed". This new peace treaty with the UAE & Bahrain, and the cancellation of the annexation of parts of the West Bank, gave the market and the NIS a push in the right direction.

Monetary, Fiscal

Monetary: The most significant (favorable) factor that affected the Israeli financial markets was the drop in credit risk spreads, after the Israeli central bank announced that “it is starting to buy corporate bonds”. The Israeli central bank is now stepping up its financial aid to the struggling economy, buying about 600 million NIS of Israeli corporate bonds in the month of July.

Fiscal: The Israeli government did not pass a new budget for 2020-2021, and instead decided to delay the vote for a few months. Although the two opposite parties of the coalition don’t get along, neither wants another election process now. A mild call from the government to increase its support to closed businesses came from the central bank, which published a study claiming “the aid of the Israeli government to its economy is one of the smallest in the developed world compared to its GDP”.

Equity Market view: Neutral

The equity market remains above its 10-year average PE ratio, which means that it could be trading at a demanding level from a historical perspective, but that we find normal after the necessary re-rating process experienced by all the world's assets in a zero-rate environment.

Israel’s leading equity index, TA-35, dropped by 5% on August, as the technology sector led the declines (with a 7.5% drop) and the banking sector contributed with a fall of 5.94%. Major sectorial indices responded negatively to rising fears after the government decided to impose a second lockdown. Fears of a new wave of layoffs led to an abrupt fall in expectations for cyclical companies’ services.

Bond Market view: Positive

However, a sharp increase in the number of Covid-19 infections and a call from the government to force a new national shutdown sent the Israeli bond and equity markets, along with the local currency, to a sharp drop in prices, after the strong rebound observed in the last 4 months.

The credit spread in the CPI-linked TelBond60 index increased to 1.52%, compared with 1.46% in mid-August, 1.67% in mid-July and 1.2%-1.25% pre-Covid.

The credit spread in the non CPI-linked TelBond Shikli50 increased to 1.4%, compared to 1.31% in mid-August, 1.71% in July, and 1.3%-1.35% pre-Covid.

Financial market outlook

Equities – TLV35 Index: MARKETWEIGHT (Slightly expensive)

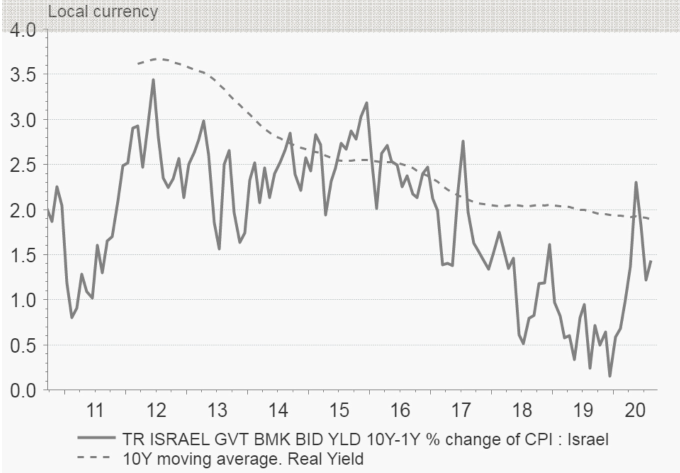
Bonds – 10Y Gov: MARKETWEIGHT-OW (Positive real yield)

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

Israel price/earnings, Datastream index
Ratio

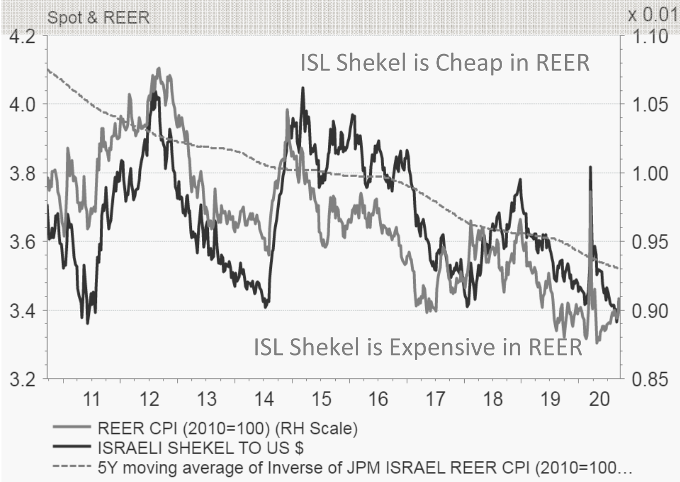
Source: Refinitiv Datastream / ANDBANK

ISRAEL GOVERNMENT BMK REAL YIELD 10Y
Local currency



Source: Refinitiv Datastream / ANDBANK

Israel Shekel
Spot & REER



Source: Refinitiv Datastream / ANDBANK

BRAZIL

In our view, the authority has concluded their easing cycle. OW Equities and USD denominated bonds

Fiscal noise down? Bonds & Fx remain resilient

The disclosure of a worse-than-thought GDP contraction in 20Q2 (-11.4% y/y or -9.7% q/q) was muted by the administration's announcement that the Coronavoucher will be cut in half and extended until year-end and that a new constitutional amendment bill to tackle future civil service expenditure rises (Administrative Reform) will unexpectedly be introduced in Congress now, both appeasing the market. Without more concrete fiscal advancements, the yield curve steepened but just by a few basis points, keeping the price of bonds broadly stable.

Meanwhile, the BCB's Copom interrupted a long easing cycle and held the Selic policy rate at its historical low of 2.00% p.a. The Committee considered it appropriate to use forward guidance as an additional monetary policy tool, provided the current fiscal regime is maintained and long-term inflation expectations remain well anchored. In our view, the authority has concluded the easing cycle and rates will remain low for a long time. We still see the Selic ending 2020 at 2.00% p.a., and the policy rate reaching 3.00% by end 2021.

The BCB also decided to bring forward the traditional month-end FX line auctions, which resulted in some volatility for the BRL (which went from 5.25 to 5.3885, depreciating by 1.3% from the previous Friday close). Despite volatility, we still see the USDBRL trading at 5.5 by yearend (with some research firms having a more constructive view, fixing the BRL-USD pair at 5.25 by year-end). Looking beyond, these same researchers see the currency at 4.90 by end-2021.

The BCB also published its monthly GDP proxy, which posted a third positive gain in July (2.1% m/m). IBC-Br now stands -6.5% below pre-pandemic levels, recovering 55.5% of the fall observed in Mar-Apr20. This report, and another set of activity data, have skewed the risks to 20Q3 GDP estimates to the upside, currently at 4.6% q/q (or -7.6% y/y).

Mobility

Broad retail sales jumped by 7.2% m/m in July (last reading) and are now only 2.0% below pre-pandemic levels. Core sales (ex-vehicle, ex-construction), which had suffered significantly less in the pandemic, are clearly on a V-shaped recovery path and grew by 5.2% m/m, standing 5.3% above Feb20 level. But the service sector disappointed in July and growth slowed to 2.6% m/m (previous: 5.2%), being more severely hit and still struggling in the reopening phase.

In August, IPCA receded to 0.24% m/m (July: 0.36%), bringing the year-on-year reading to 2.4% y/y (BCB's 2020 target lower bound: 2.5%). The education group contributed the most to the headline slowdown, while the food and beverage group picked up and should pressure the IPCA ahead. Underlying inflation readings remain at muted, below-target levels, as underlying services (a group of demand-sensitive prices) slowed to 2.3% y/y (from 2.5%). These figures show that the proxies for demand-led inflation are below the BCB's target range lower bound (2.5%), demonstrating how wide the negative output gap still is.

Covid: Daily infections on a downward trend

On 18 September, Brazil reported the third largest number of cumulative cases in the globe (4,495k from 4,282k the previous Friday) but still the second largest number of fatalities (135,793 from 130,396 a week before). All said, Brazil is moving around 30k daily cases. This figure is well below the 60k daily cases that we saw in early August, and the trend has been one of constant moderation. This fits with the good news that the number of active cases has dropped from 806k to 500k current cases.

Financial market outlook

Equities – iBovespa: OVERWEIGHT

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

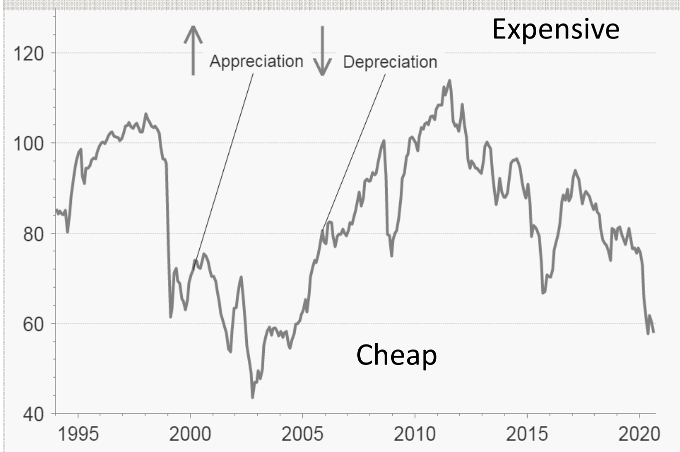
Bonds – Govies USD: OVERWEIGHT (Target yield 4%. Spread 300)

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

Brazil equities (USD), 2008 vs 2020
Bovespa, rebased, 100 = crisis start date

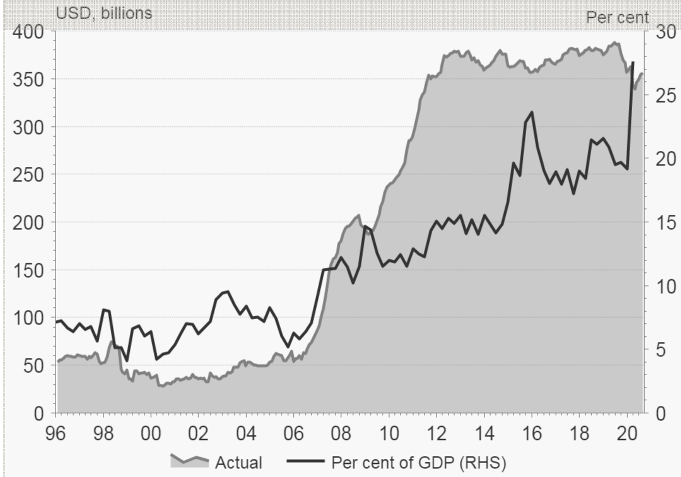
Source: Refinitiv Datastream / ANDBANK

Brazil real broad effective exchange rate
Index, January 2010 = 100



Source: Refinitiv Datastream / ANDBANK

Brazil foreign reserves
USD, billions



Source: Refinitiv Datastream / ANDBANK

MEXICO

Fiscal noise is starting to sound. Politics add pressure. Risk of rating cuts.

Fiscal: Use of non-recurring sources combines badly with increasing debt-to-GDP ratio.

Income from VAT (consumption) and other taxes continue to fall due to the impact of poorer economic dynamics, which have ended up affecting tax collections. Public spending, however, has continued to grow, resulting in a Debt-to-GDP ratio that has reached 53% and is expected to continue to rise, as estimates are for a double-digit decline in economic output for the year. The fall in income has been mitigated throughout the use of non-recurring resources such as funds earmarked for countercyclical spending. This has made it possible to maintain the primary surplus in 2020, though not in a sustainable way. The 2021 budget was presented and we consider that it has been built on assumptions that are too optimistic given the level of growth projected in 2021. The government assumes a GDP growth of 4.7% in 2021, while the central bank itself (like many other analysts) believes that growth will be in the area of 2.5%. This can lead to a deviation in budget execution resulting in a deficit that is far from the forecasted, something to which the rating agencies could respond with potential cuts in the country's rating. The poor outlook for growth in the oil platform and in crude prices is not favorable for the satisfactory execution of this budget either. According to government sources, the primary balance is expected to be zero for 2021, but the deterioration could be rapid as a consequence of the significant distance that could open between the optimistic economic scenario set by the government and a reality that may not be so favorable Recent analysis by BofA and JP Morgan predict the loss of the country's investment grade rating between 2021 and 2022.

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 50bp to leave rates at 4.5%. The decision was not unanimous this time around, as a member surprisingly voted for a cut of just 25bp, suggesting that we could be nearing the end of the easing cycle. The fact that inflation in August was fixed at an annual rate of 4.05%, above the high part of Banxico's long-term goal, contributes to this hypothesis. The median level from local surveys points to a rate in the 4.00% area (current level) at the end of 2020, while forecasts are for rates to remain unchanged in 2021.

Politics

The Odebrecht case shakes the foundations of Mexican politics, and the serious accusations made by the former director of Pemex (Emilio Lozoya) promise to generate a political earthquake. The former manager indicates to former presidents Peña Nieto, Calderón and Salinas of accepting millionaire commissions, even offering details on the quantities and locations of the deliveries. AMLO has just carried out one of his popular consultations regarding whether these former public officials should be brought to justice. As with the popular consultation on the new airport project, a minimal participation in the consultation was enough for AMLO to materialize his objectives of paralyzing the important infrastructure. Thus, the risk is that AMLO will take the results of these consultations as a source of legitimacy to carry out his plans to put his political enemies in the dock. If this materializes, the political noise could be of great magnitude, and can lead to some kind of institutional crisis accompanied by the corresponding instability. Something to which the rating agencies could respond with another rating cut. It should be mentioned, however, that since the extradition of Mr. Lozoya, the political noise has ceased. The question we ask ourselves is whether this calm precedes the storm that is coming as we approach the elections.

Mexican Bonds & Fx

Local bonds: Underweight. Our target spreads for the local bond remains in the 500–520 bp range (slightly above its 10-year average of 425 bp) meaning that yields in local bonds should trade near the 6.2% level (currently at 5.69%).

US dollar-denominated bonds: Underweight. Regarding the USD-denominated Mexican bond, we set the target spread vs the UST bond in the 300 bp area, suggesting a target yield of 4% for this bond (currently at 3.28%). Target for MXN-USD at 23.50.

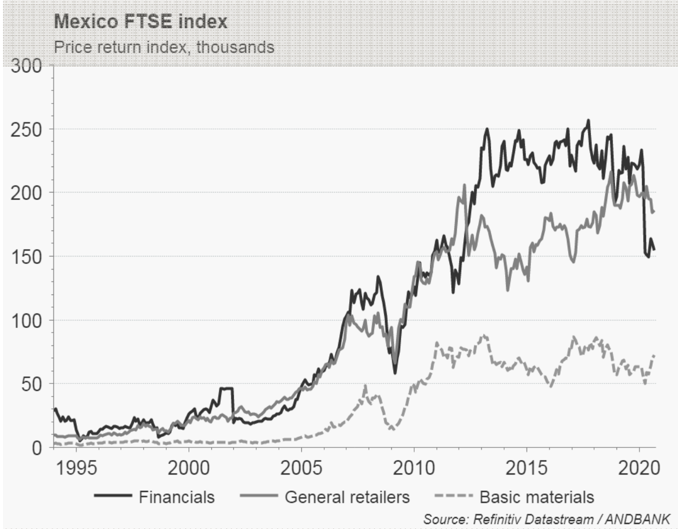
Financial market outlook

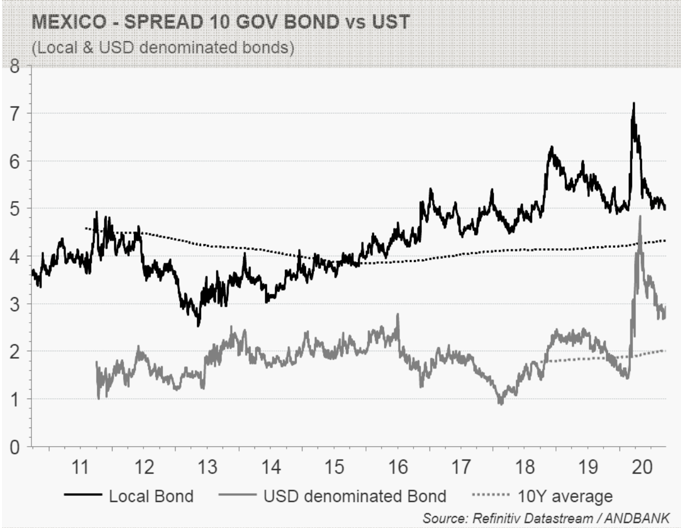
Equities – Mex IPC: OVERWEIGHT

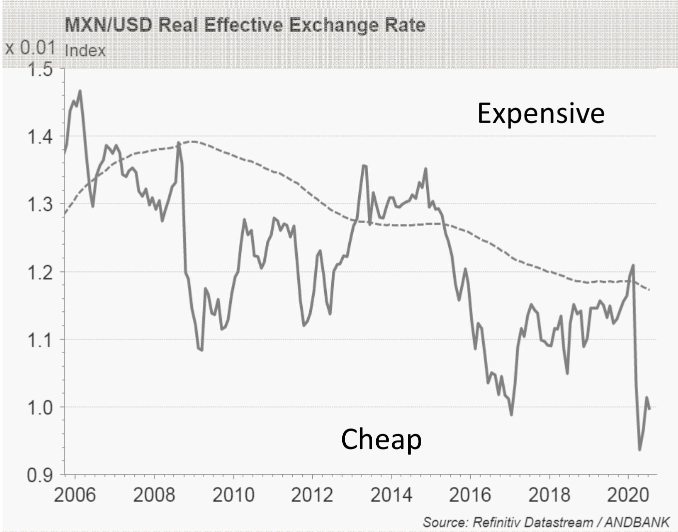
Bonds – Govies Local: UNDERWEIGHT (Target yield 6.2%. Spread 520bp)

Bonds – Govies USD: UNDERWEIGHT (Target yield 4.0%. Spread 300bp)

FX – MXN/USD: UNDERWEIGHT (Mid-term target 23.50)







ARGENTINA

Post debt deal, reality prevails over expectations.

After several months of tough negotiations Argentina successfully closed the exchange of its hard currency debt. In foreign law bonds, participation totaled 93.5% of the eligible amount, and given CACs 99.01% is going to be modified (similar percentage in local law bonds), with almost no holdouts. Contrary to what is expected by much of the market, NY sovereign bonds operate with rates above 13%, increasingly far from the 10% reference with which the NPVs of the exchange proposals were discussed.

Despite having one of the longest lockdowns in the world, the public health situation is getting worse. Economic activity indicators show that the economy is improving (EMAE +7.14% MoM in June), but the drop is expected to be much sharper than for Latam peers this year (-12% YoY vs -5.3% Brazil, -7% Colombia,-5.6% Chile)

Without access to capital markets, the monetary expansion to fund the emergency measures and the almost complete lack of demand for ARS is putting pressure on Central Bank reserves, despite the USD 200 limit on USD purchases at official FX for retail investors. The BCRA took new measures aimed at "salvaging" the situation: i) foreign currency purchases are capped at USD 200 per month and credit card purchases in FX are subject to a 35% withholding against income tax or personal assets tax, on top of the 30% PAIS tax; ii) mandated corporates with monthly hard currency debt maturities above USD 1 M between Oct-15-2020 and March-31-2021 must present a refinancing plan to the Central Bank. Coupon payments are excluded. In the refinancing plan they may only access official FX up to 40% of the principal maturities.

Argentina now is seeking to avoid repayments to the International Monetary Fund in the period 2021-2024 as it negotiates a new deal with the lender. The bulk of its repayments on its current stand-by arrangement with the IMF, totaling almost USD 40 Bn, are in 2022-2023.

Now it's time for Provinces & Corporates

At the moment, Mendoza is the nearest to making a deal, with a 67.3% acceptance for its current offer (NPV USD 80 @10%). Buenos Aires province announced the seventh extension of its offer deadline (until 09-Oct), but with no changes. Córdoba disclosed a draft proposal (Avg. NPV USD 70 @10% for their 3 bonds) but no formal offer yet. Neuquén is looking for amendments of secured (2028, NPV USD 78 @10%) and unsecured (2025, NPV USD 74 @10%) bonds, but the offer was lower than expected, leading to low acceptance levels. Other provinces are also in talks with creditors, but with no formal offers yet. Off the record, provincial officials talk of significant pressure from central government to trim debt service for the following 2-3 years, with aggressive coupon reduction, as seen in the sovereign restructuring. Corporates have been pursuing a different strategy, with a focus only on extending short-term maturities for longer-dated bonds (i.e. YPF, Telecom, CGC). They have had some success, but this may now change after the Central Bank's new guidelines.

Inflation with a slight acceleration

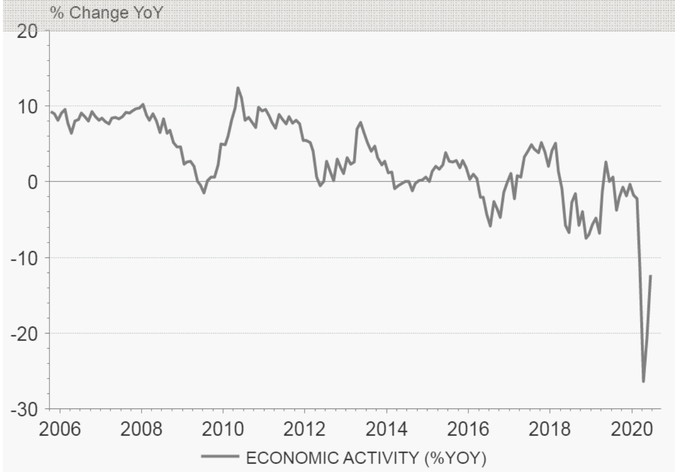
The CPI rose 2.7% MoM in August (vs. +1.9% MoM in July), with a YoY rise of 40.7%. Seasonal prices (+4.0% MoM) and Core CPI (+3% MoM) are growing above headline CPI, while the Regulated category of the index (+1% MoM) continues to artificially lower the average.

The gap between the official FX (75.37) and the Blue Chip Swap (135.82) and black market FX (137) is 80% and 82% respectively.

Financial market outlook

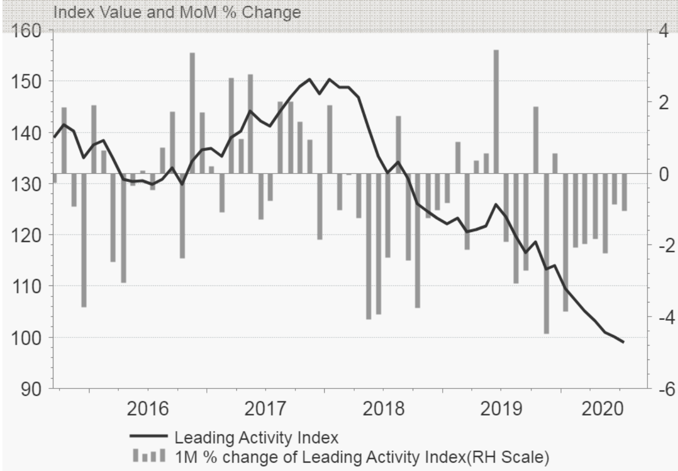
Bonds – 10YGov USD: NEUTRAL
FX – USD-ARS: NEGATIVE (2020 year-end target 95)

ARGENTINA - ECONOMIC ACTIVITY INDICATOR
% Change YoY



Source: Refinitiv Datastream / ANDBANK

ARGENTINA - LEADING INDICATOR
Index Value and MoM % Change



Source: Refinitiv Datastream / ANDBANK

Argentina foreign reserves
USD, billions

Source: Refinitiv Datastream / ANDBANK

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	PE EPS 2020	PE EPS 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	132	165	156	-20,0%	25,00%	25,46	20,36	20,00	3.352	3.124	-6,8%	MW	3.592
Europe - Stoxx Europe 600	16,9	21	20	-35,0%	25,00%	21,50	17,20	17,00	363	341	-6,2%	MW	392
Euro Zone - Euro Stoxx	17,1	22	21	-32,0%	27,00%	20,79	16,37	17,50	356	360	1,1%	MW/OW	414
Spain IBEX 35	310,0	449	414	-56,4%	45,00%	21,91	15,11	16,00	6.792	6.623	-2,5%	MW	7.286
Mexico IPC GRAL	2.320	2.785	2.666	-18,0%	20,00%	16,04	13,37	14,25	37.232	37.995	2,1%	OW	41.795
Brazil BOVESPA	5.838	7.006	6.708	-20,0%	20,00%	16,22	13,51	15,00	94.666	100.622	6,3%	OW	110.684
Japan NIKKEI 225	1.063	1.276	1.221	-20,0%	20,00%	22,12	18,43	17,00	23.512	20.764	-11,7%	UW	24.917
China SSE Comp.	226	249	243	-10,0%	10,00%	14,31	13,01	12,50	3.237	3.038	-6,1%	UW	3.342
China Shenzhen Comp	75,1	83	81	-10,0%	10,00%	28,71	26,10	24,00	2.157	1.938	-10,2%	UW	2.132
India SENSEX	1.576	1.813	1.753	-15,0%	15,00%	24,14	20,99	20,00	38.058	35.051	-7,9%	MW/OW	42.061
Vietnam VN Index	53,6	62	60	-10,0%	15,00%	17,06	14,84	15,00	914	893	-2,3%	OW	1.072
MSCI EM ASIA	35,4	41	39	-10,0%	15,00%	16,77	14,58	15,00	594	591	-0,5%	OW	709

POSITIONING, FLOW & SENTIMENT ANALYSIS

Risk Outlook: Neutral // Positioning: Neutral

Andbank's Assessment: +0.5 (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 the positioning in risk markets and assets should be neutral.

Market Positioning (MW-UW bias): Asset allocation in equity remains high in global portfolios 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. Japan and Taiwan follow the U.S. in positive flows, but with much lower volumes. China and South Korea suffered outflows, on increasing tensions with the US and North Korea, respectively.

Surveys & Sentiment Analysis (MW-OW bias): Sentiment from investors is still negative and our contrarian reading therefore suggests a 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	362,47	22,22%
	Euro Stoxx 600	.STOXX	Lateral bearish	268,57	433,90	344,91	368,75	441,75	368,78	19,79%
	Ibex	.IBEX	Lateral bearish	5.814,50	10.100,00	6.421,00	7.321,90	8.375,60	6.929,80	20,86%
	S&P	.SPX	Lateral bullish	2.191,86	3.393,52	3.155,00	3.588,11	3.393,52	3.319,47	2,23%
	Japón	.N225E	Lateral bullish	16.358,19	24.448,00	22.329,94	24.116,00	24.116,00	23.360,30	3,23%
	China	.SZSC	Lateral bearish	1.691,00	2.333,36	2.122,00	2.333,36	2.441,38	2.208,30	10,55%
	India	.BSESN	Lateral bearish	24.833,00	42.273,00	36.911,00	40.122,00	42.273,87	38.845,82	8,82%
	Brasil	.BVSP	Lateral bearish	57.600,00	119.593,00	90.147,92	105.703,62	119.593,10	98.289,71	21,67%
	México	.MXX	Lateral bearish	30.000,00	45.955,00	35.277,54	40.030,95	41.388,00	36.017,35	14,91%
OTROS	Oil West Texas	WTCLc1	Lateral	10,37	51,00	34,37	43,57	50,00	40,71	22,82%
	Gold	XAU=	Lateral bearish	1.659,00	2.072,49	1.863,66	2.072,49	2.230,00	1.949,69	14,38%
	Treasury 10Y USA	US10YT=RR	Lateral bearish	0,1289%	1,3210%	0,5040%	0,7890%	0,8658%	0,6962%	24,37%

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

DEVELOPED MARKETS

Fundamental assessment

US Treasury: Floor 1.5%. Fair value 2.28%. Ceiling 2.5%

Swap spread: The swap spread was fixed at 0bp. For this spread to normalize at +3bp, with the 10Y swap rate anchored in the 1.5% area (our LT inflation expectation), the 10Y UST yield would have to move towards 1.5%.

Slope: The slope of the US yield curve (10-year minus 2-year bond yield) was fixed at 54bp. With the short-end normalizing towards 1%, to reach the long-term average slope (of 128bp), the 10Y UST yield would have to move to 2.28%.

Real yield: A good entry point in the 10Y UST would be when the real yield hits 1%. Given our long-term CPI forecast of 1.5%, the UST yield would have to rise to 2.5% to become a "BUY".

GER Bund: Floor 0.30%. Fair value 1.08%. Ceiling 1.5%

Swap spread: The swap spread was fixed at 24bp. With the swap spread to normalize at 18bp, with the swap rate anchored in the 0.5% area, the Bund yield would have to move towards 0.32% (entry point).

Slope: The slope of the EUR curve (10-year minus 2-year bond yield) was fixed at 20bp. If the short-end normalizes at 0%, to reach the 10Y average yield curve slope (108bp), the Bund yield would have to move to 1.08%.

Real yield: A good entry point in the German Bund would be when the real yield hits 0.5%. Given our CPI mid-term forecast of 1%, the Bund yield would have to rise to 1.5% to become a "BUY".

UK Gilt: Floor 1.38%. Fair value 2.25%. Ceiling 2.5%

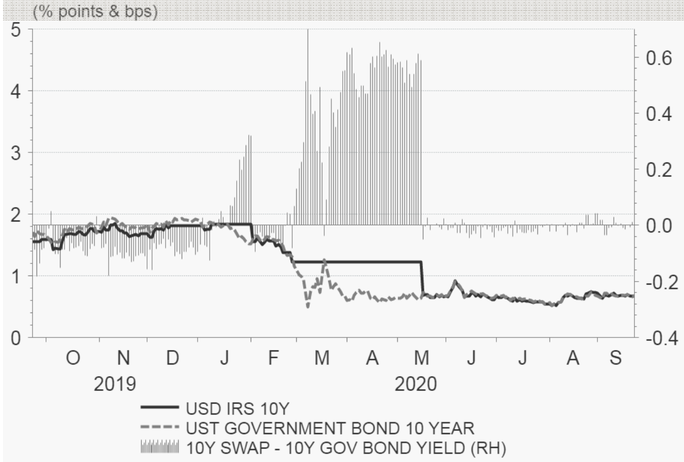
Swap spread: The swap spread was fixed at 13bp. For the swap spread to normalize at 12bp, with the swap rate anchored in the 1.5% area, the 10Y UK Gilt would have to shift to 1.38%.

Slope: With the 2Y bond normalized at 1%, to reach the average slope at 1.25%, the 10Y Gilt would have to move to 2.25%.

Real yield: Given our CPI mid-term forecast of 1.5%, the Gilt yield would have to rise to 2% to become a "BUY".

SWAP SPREAD USD

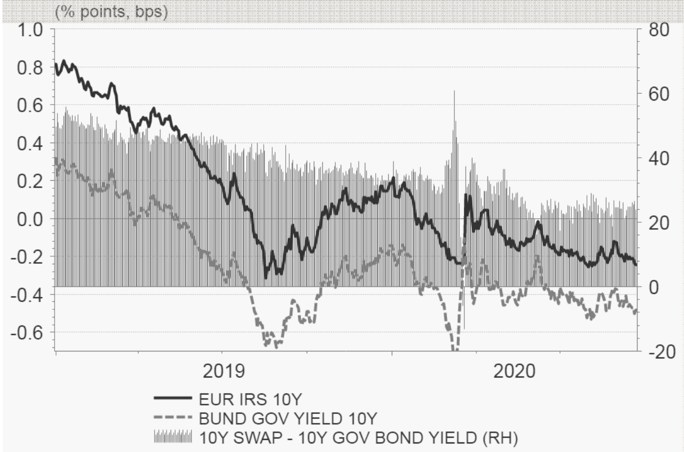
(% points & bps)



Source: Refinitiv Datastream / Fathom Consulting

SWAP SPREAD EUR

(% points, bps)



Source: Refinitiv Datastream / Fathom Consulting

EUROPEAN PERIPHERAL BONDS

Tactical targets – 10Y yields

Spanish bono: Target yield at 0.4%
Italian bond BTPI: Target yield at 0.9%
Portuguese Gov bond: Target yield at 0.4%
Ireland Gov bond: Target yield at 0%
Greek Gov bond: Target yield at 1.4%

EMERGING MARKET BONDS

Fundamental targets

To date, our rule of thumb for EM bonds has been "buy" when the following two conditions are met: 1) The US Treasury real yield is at or above 1%; and 2) EM bond real yields are 1.5% above the UST real yield.
Assuming that the first condition is met, we should only buy those EM bonds offering a real yield of 2.50% or more. The markets (and government bonds) that meet such requirements are shaded gray.

		10 Year Yield Nominal	CPI (y/y) 3 month Mov Avg	10 Year Yield Real	Projected change in Yield	Target Yield
EM ASIA	Indonesia	6,90%	1,43%	5,47%	-1,00%	5,90%
	India	6,00%	6,58%	-0,58%	1,00%	7,00%
	Philippines	2,99%	2,55%	0,44%	0,00%	2,99%
	China	3,11%	2,44%	0,67%	0,00%	3,11%
	Malaysia	2,73%	-1,52%	4,25%	-1,00%	1,73%
	Thailand	1,31%	-0,82%	2,12%	-0,75%	0,56%
	Singapore	0,87%	-0,44%	1,31%	-0,50%	0,37%
	South Korea	1,33%	0,42%	0,91%	0,00%	1,33%
	Taiwan	0,36%	-0,44%	0,80%	0,00%	0,36%
EME	Turkey	12,61%	11,77%	0,84%	0,00%	12,61%
	Russian Fed	6,20%	3,50%	2,70%	-0,75%	5,45%
LATAM	Brazil	7,30%	2,82%	4,49%	-1,00%	6,30%
	Mexico	5,81%	3,76%	2,05%	-0,75%	5,06%
	Colombia	5,08%	1,88%	3,20%	-1,00%	4,08%
	Peru	5,15%	1,75%	3,40%	-1,00%	4,15%

ENERGY – OIL

Fundamental view (WTI): Target range USD35-45bbl.

Buy < USD35; Sell >45

Short-term drivers

(Price Positive) – Asia Pacific Petroleum Conference (APPEC): Several updates out of the S&P Global Platts Asia Pacific Petroleum virtual conference held in September: 1) OPEC's Barkindo says oil-demand growth in China is the only certainty (Platts). 2) Bullish Citi analysts see $60/barrel oil returning before the end of 2021 (Bloomberg). 3) Vitol forecasts global transportation demand (ex-jet fuel) could hit pre-pandemic levels by Q4'21.

(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 Short-Term) – Much Gulf of Mexico production remains shut in; another storm on the horizon: Data released yesterday from the US Bureau of Safety and Environmental Enforcement (BSEE) showed that 70 out of the GoM's 643 manned platforms remained evacuated in the wake of Hurricane Sally, shutting in production of nearly 31% of the region's crude output. At the same time, producers are watching Tropical Depression 22 (NHC), which has formed north of the Bay of Campeche and may strengthen to a tropical storm or hurricane before it impacts the Texas Gulf Coast this weekend.

(Price Positive) – Saudi oil minister uses JMMC meeting to warn cheaters: In forceful comments at the last meeting of the OPEC+ Joint Ministerial Monitoring Committee (JMMC), Saudi Energy Minister Abdulaziz said that the group would never leave the market unattended and that he wanted to make those who bet against oil "jumpy." The joint communique after the meeting stressed that members would be "proactive and preemptive" in response to changing market dynamics and that "further necessary measures" could be taken by the group in the future. FT notes that Abdulaziz also harangued pact members who have produced above their quotas, seemingly calling out the UAE, a Saudi ally recently suspected of overproducing by hundreds of thousands of barrels.

(Price Positive) – Refining trends suggest China demand bigger than it looks: Bloomberg reports that a surge in Chinese buying of blending fuels suggests that the country's demand for oil may be larger than official figures indicate. The article notes that China's fuel consumption was already back at year-ago levels in May and that the country's imports of mixed aromatics for gasoline production have doubled in the first seven months of the year.

(Price Negative) – Trading houses are looking to charter tankers for storage. IEA sees oil-market outlook as "more fragile": September's edition of IEA's monthly Oil Market Report notes signs that while August's conditions could be characterized as a delicate rebalancing, the outlook for the global oil market now appears even more fragile. The report observes that the uncertainty created by Covid shows little signs of abating, contributing toward its downgraded view of H2 global demand growth. At the same time, the IEA points to increased OPEC+ production and signals that trading houses are looking to charter tankers for storage.

(Price Negative) – **Iraq considers its production cut contribution as its economy struggles:** Officials in Iraq have resurfaced a debate over whether to ask to be exempt from OPEC+ oil supply cuts as low prices squeeze the country's finances. There are differing views between the oil ministry and the prime minister's office over whether to fully comply with the cuts or ask for an exemption. Baghdad has complained that it has struggled to revive its oil industry as other OPEC members benefited and boosted their market share. Officials also have criticized the pact, which was signed by the previous caretaker government under which Baghdad committed to a big cut in its output.

(Price Negative) –Iraq's Kurdish region unable to meet Baghdad's request to cut output: Platts reported that Iraq's semiautonomous Kurdish region was unable to comply with Baghdad's request to cut output by 120K bpd due to financing needs; instead, it cut output by just 50K to 410K bpd. The Kurdistan Regional Government (KRG) is in talks with Baghdad over issues on salaries and transferring oil revenue to the federal government. The request also comes as Iraq produced 3.75M bpd in August, ahead of the effective quota of 3.40M bpd when compensation cuts are factored in.

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 (which saw the gold price skyrocket 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): 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): 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): 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 carry out the exercise of deciding 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 Govie) 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).

Gold to the S&P500: This ratio stands at 0.58x, just shy of the LT average of 0.62x. Given our estimated fair value price for the S&P of US$3,109 the price of gold must approach US$1,927 for this ratio to remain near its LT average.

Negative drivers for gold

Gold in real terms: Given the global deflator (now at 1.12934), 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$1,730. 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$1,096.

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 72.55 and still remains well above its 20-year average of 65.8x, 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$1,772/oz. Meanwhile, the Gold/Palladium ratio is at 0.84, well below its 20-year average of 1.827x, suggesting that gold is cheap relative to palladium.

Gold to oil: This ratio is at 47.70, still well above its 16-year average of 16.9x. Considering our fundamental long-term target for oil of US$40 pb (our central target for the long term) and that the utility of oil relative to gold will remain unchanged, the price of gold must approach US$676 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 22.5; **EUR-MXN:** Target 25.6
USD-BRL: Target 5.50; **EUR-BRL:** Target 6.33
USD-ARS: Target 95
USD-INR: Target 74
CNY: Target 6.75
RUB: NEUTRAL
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	-31,52	0,31	32,1	-34,1	-2,1	-1,45
USD vs G10	-31,12	0,69	32,7	-34,0	-1,2	-1,53
EM	0,41	0,38	3,9	-0,8	1,4	-0,72
EUR	26,44	-2,93	31,3	-8,6	10,7	1,52
JPY	2,71	0,27	4,0	-15,0	-5,8	1,34
GBP	0,19	-0,35	4,3	-6,5	-1,2	0,54
CHF	1,66	-0,35	2,3	-6,0	-1,8	1,57
BRL	-0,47	-0,18	0,7	-0,8	-0,2	-0,76
MXN	0,63	0,53	3,3	-0,5	1,2	-0,53
RUB	0,26	0,03	1,2	-0,3	0,4	-0,40
AUD	1,18	1,42	6,1	-5,2	-0,5	0,55
CAD	-1,29	1,27	6,1	-5,0	-0,2	-0,40

Positive
Neutral-Positive
Neutral-Negative
Negative

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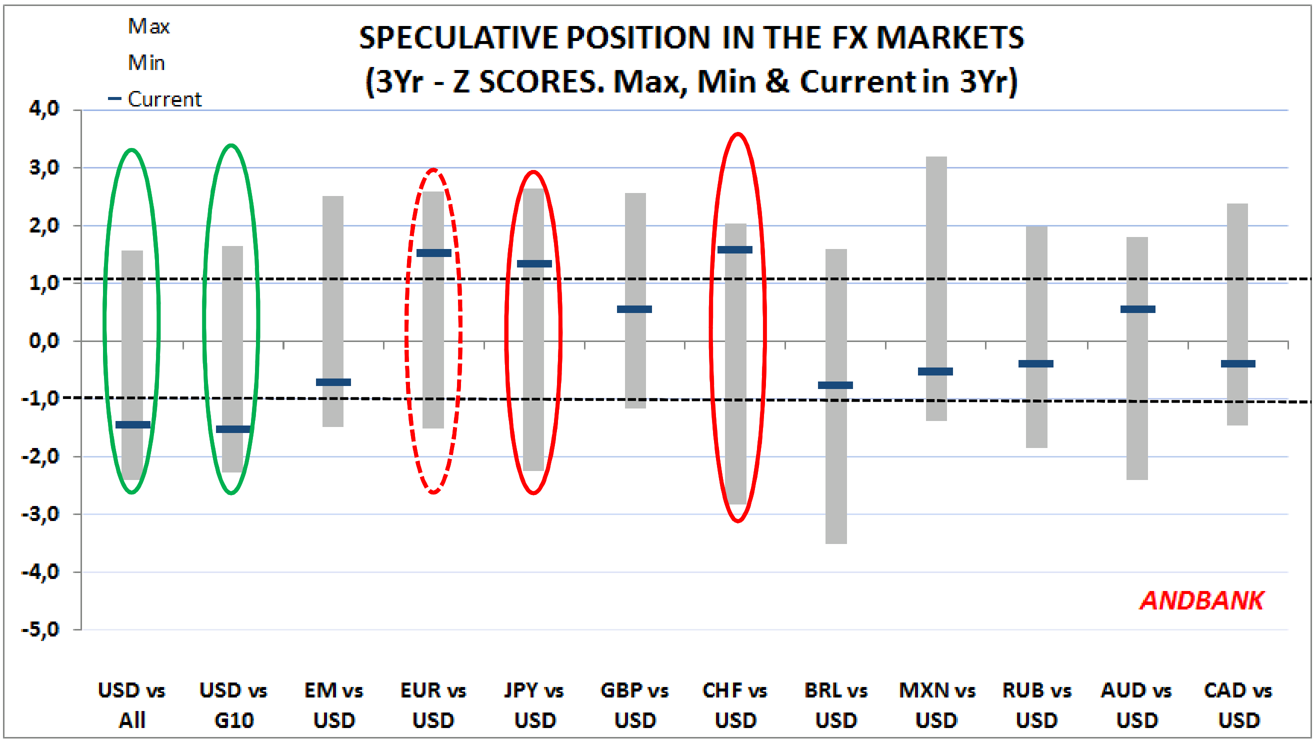

The currencies we technically favor are circled in green

SUMMARY TABLE OF EXPECTED RETURNS

Asset Class	*Indices*	*Performance Last month*	*Performance YTD*	*Current Price*	*Fair Value*	**Expected Performance to Fair Value 2020**
Equity	USA - S&P 500	-4,2%	3,7%	3.352	3.124	-6,8%
	Europe - Stoxx Europe 600	-0,9%	-12,6%	363	341	-6,2%
	Euro Zone - Euro Stoxx	-1,2%	-11,8%	356	360	1,1%
	SPAIN - IBEX 35	-2,6%	-28,9%	6.792	6.623	-2,5%
	MEXICO - MXSE IPC	1,1%	-14,5%	37.232	37.995	2,1%
	BRAZIL - BOVESPA	-4,7%	-18,1%	94.666	100.622	6,3%
	JAPAN - NIKKEI 225	-7,1%	-0,6%	21.507	20.764	-3,5%
	CHINA - SHANGHAI COMPOSITE	-4,7%	5,5%	3.237	3.038	-6,2%
	CHINA - SHENZEN COMPOSITE	-6,0%	23,4%	2.158	1.938	-10,2%
	INDIA - SENSEX	-1,5%	-7,9%	38.049	35.051	-7,9%
	VIETNAM - VN Index	3,7%	-5,0%	914	893	-2,3%
	MSCI EM ASIA (in USD)	-2,5%	5,0%	594	591	-0,5%
Fixed Income Core countries	US Treasury 10 year Govie	0,5%	11,5%	0,65	**1,00**	-2,6%
	UK 10 year Gilt	0,9%	5,6%	0,20	0,80	-4,8%
	German 10 year BUND	1,1%	2,6%	-0,54	**-0,40**	-1,2%
	Japanese 10 year Govie	0,2%	-0,3%	0,01	0,00	0,1%
Fixed Income Peripheral	Spain - 10yr Gov bond	1,4%	2,1%	0,23	0,40	-1,3%
	Italy - 10yr Gov bond	2,4%	5,1%	0,86	**0,90**	-0,1%
	Portugal - 10yr Gov bond	1,3%	1,8%	0,24	0,40	-1,3%
	Ireland - 10yr Gov bond	1,0%	2,3%	-0,19	0,00	-1,6%
	Greece - 10yr Gov bond	0,1%	3,9%	1,05	1,40	-2,6%
Fixed Income Credit	Credit EUR IG-Itraxx Europe	-0,2%	-0,5%	62,03	70	-0,2%
	Credit EUR HY-Itraxx Xover	-1,0%	-3,7%	363,25	**350**	1,2%
	Credit USD IG - CDX IG	0,2%	1,4%	59,15	70	-0,1%
	Credit USD HY - CDX HY	-0,7%	0,0%	398,22	**350**	2,5%
Fixed Income EM Europe (Loc)	Turkey - 10yr Gov bond (local)	4,5%	0,7%	12,93	**12,50**	6,7%
	Russia - 10yr Gov bond (local)	-1,4%	3,9%	6,30	**5,25**	10,0%
Fixed Income Asia (Local curncy)	Indonesia - 10yr Gov bond (local)	0,2%	6,5%	6,85	6,00	8,5%
	India - 10yr Gov bond (local)	0,6%	8,8%	6,06	6,80	-4,4%
	Philippines - 10yr Gov bond (local)	-2,5%	14,0%	3,09	3,00	1,5%
	China - 10yr Gov bond (local)	-0,4%	2,5%	3,10	3,00	1,6%
	Malaysia - 10yr Gov bond (local)	-0,8%	6,7%	2,77	2,00	6,8%
	Thailand - 10yr Gov bond (local)	0,8%	2,1%	1,30	0,25	8,7%
	Singapore - 10yr Gov bond (local)	1,2%	8,3%	0,85	0,40	3,8%
	Rep. Korea - 10yr G. bond (local)	0,9%	3,1%	1,33	0,75	4,9%
	Taiwan - 10yr Gov bond (local)	-0,4%	2,3%	0,39	0,00	3,2%
Fixed Income Latam	Mexico - 10yr Govie (Loc)	1,3%	14,2%	5,70	6,20	-2,5%
	Mexico - 10yr Govie (USD)	-1,0%	2,6%	3,32	4,00	-4,6%
	Brazil - 10yr Govie (Loc)	-0,6%	3,1%	7,04	**7,50**	-1,9%
	Brazil - 10yr Govie (USD)	-0,6%	2,1%	4,30	4,00	3,5%
Commodities	Oil (WTI)	-5,3%	-33,9%	40,4	40,00	-0,9%
	GOLD	-4,5%	23,9%	1.880,1	1.600	-14,9%
Fx	EURUSD (price of 1 EUR)	-2,3%	4,1%	1,167	**1,15**	-1,4%
	GBPUSD (price of 1 GBP)	-3,8%	-3,0%	1,29	1,32	2,7%
	EURGBP (price of 1 EUR)	1,6%	7,3%	0,91	0,87	-4,0%
	USDCHF (price of 1 USD)	2,2%	-4,6%	0,92	0,97	5,0%
	EURCHF (price of 1 EUR)	0,0%	-0,7%	1,08	1,12	3,5%
	USDJPY (price of 1 USD)	-0,3%	-2,8%	105,59	107,00	1,3%
	EURJPY (price of 1 EUR)	-2,5%	1,1%	123,21	123,05	-0,1%
	USDMXN (price of 1 USD)	2,5%	18,4%	22,42	**22,25**	-0,7%
	EURMXN (price of 1 EUR)	0,2%	23,4%	26,15	25,59	-2,2%
	USDBRL (price of 1 USD)	3,1%	40,9%	5,66	5,50	-2,8%
	EURBRL (price of 1 EUR)	0,8%	46,6%	6,60	6,33	-4,2%
	USDARS (price of 1 USD)	2,7%	27,0%	76,05	**95,0**	24,9%
	USDINR (price of 1 USD)	0,8%	3,5%	73,85	74,00	0,2%
	CNY (price of 1 USD)	-0,3%	-2,0%	6,82	**6,75**	-1,1%

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

UPWARD REVISION   DOWNWARD REVISION

PRINCIPAL CONTRIBUTORS

Together
Everyone
Achieves
More

Eduardo Anton
US: Equity, Bonds & Corporates
+1 305 702 0601

David Tomas
Spain & Europe: Equity
+34 647 44 10 07

Jonathan Zuloaga
Mexico: Rates, Equity & FX
+52 55 53772810

Yair Shani
Israel: Rates, Corporate bonds & Equities
+972 3 6138218

Marian Fernández
Europe: Rates, Macro & ECB
+34 639 30 43 61

Sofiane Benzarti
Luxembourg: Global Flows & positioning
+352 26 19 39 21

Alicia Arriero
Europe: Corporate Credit IG & HY
+34 91 153 41 17

Carlos Hernández
Global Technical Analysis
+376 873 381

Juan Manuel Lissignoli
Uruguay & Argentina: Bonds, FX, Macro & Politics,
+598 2626 2333

Rodrigo Octavio Marques de Almeida
Brazil: Bonds, Equity & FX
+55 11 3095-7045

Alex Fusté
EM Asia & Japan: Bonds, Equities & FX
Brazil: Bonds, Equity, FX.
Commodities: Energy & Precious Metals
+34 673 041 058

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