GLOBAL OUTLOOK

ECONOMY & FINANCIAL MARKETS

ANDBANK
Private Bankers

Andbank Monthly Corporate Review – May 2021

So far this year, the S&P Index has set 25 new all-time highs

Corporate Review

May 2021

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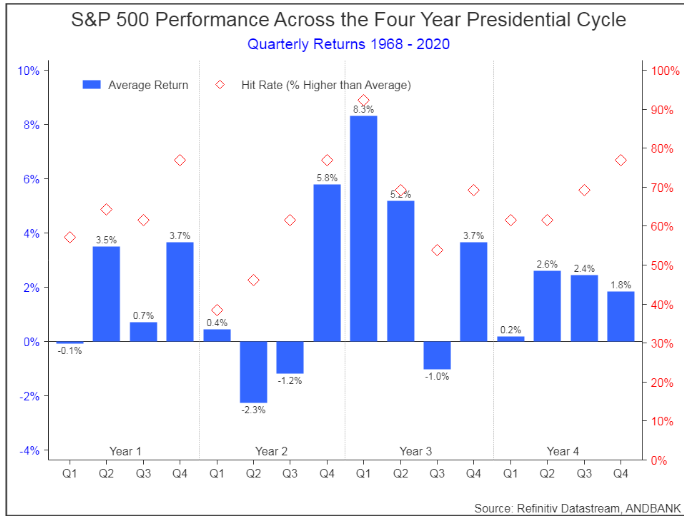
EXECUTIVE SUMMARY

CHART OF THE MONTH



EQUITIES

Index	INDEX CURRENT PRICE	Current Fair Value (EPS 12 month fw)	2021 E[Perf] to Fair Value	Recomm	2021 Exit Point	Max. Risk Premium	E[Perf] to Exit point
USA S&P 500	4.188	4.023	-3,9%	MW	4.627	1,15	10,5%
Europe - Stoxx Europe 600	439	444	1,1%	OW	511	1,15	16,3%
Euro Zone - Euro Stoxx	443	432	-2,5%	MW	496	1,15	12,1%
Spain IBEX 35	8.685	8.154	-6,1%	MW-UW	9.377	1,15	8,0%
Mexico IPC GRAL	48.924	52.305	6,9%	OW	60.151	1,15	22,9%
Brazil BOVESPA	120.595	114.303	-5,2%	MW-UW	131.449	1,15	9,0%
Japan NIKKEI 225	28.992	30.029	3,6%	MW	33.032	1,10	13,9%
China SSE Comp.	3.443	3.417	-0,7%	MW-UW	3.930	1,15	14,1%
China Shenzhen Comp	2.282	2.405	5,4%	MW/OW	2.766	1,15	21,2%
India SENSEX	48.944	60.962	24,6%	OW	70.106	1,15	43,2%
Vietnam VN Index	1.220	1.399	14,7%	OW	1.609	1,15	31,9%
MSCI EM ASIA	750	728	-3,0%	MW	837	1,15	11,6%

ANDBANK ESTIMATES

FIXED INCOME GOVIES CORE & CORPORATE CREDIT (DM)

Asset Class	*Indices*	*Current Price*	*Fair Value*	Expected Performance to Fair Value*
Fixed Income Core countries	US Treasury 10 year Govie	1,58	1,80	-0,7%
	UK 10 year Gilt	0,77	0,80	0,2%
	German 10 year BUND	-0,25	-0,25	-0,2%
	Japanese 10 year Govie	0,08	0,25	-1,3%
Fixed Income Peripheral	Spain - 10yr Gov bond	0,40	0,35	0,7%
	Italy - 10yr Gov bond	0,81	0,50	3,1%
	Portugal - 10yr Gov bond	0,40	0,35	0,6%
	Ireland - 10yr Gov bond	0,10	0,15	-0,4%
	Greece - 10yr Gov bond	0,89	1,35	-3,1%
Fixed Income Credit	Credit EUR IG-Itraxx Europe	50,66	55	-0,2%
	Credit EUR HY-Itraxx Xover	249,63	250	1,3%
	Credit USD IG - CDX IG	51,29	60	0,1%
	Credit USD HY - CDX HY	271,86	275	1,8%

FIXED INCOME EMERGING MARKETS

Asset Class	*Indices*	*Current Price*	*Fair Value*	Expected Performance to Fair Value*
Fixed Income EM Europe (Loc)	Turkey - 10yr Gov bond (local)	17,83	16,00	26,8%
	Russia - 10yr Gov bond (local)	7,05	6,60	8,4%
Fixed Income Asia (Local curncy)	Indonesia - 10yr Gov bond (local)	6,42	5,50	11,7%
	India - 10yr Gov bond (local)	6,05	5,50	8,5%
	Philippines - 10yr Gov bond (local)	3,98	5,00	-5,5%
	China - 10yr Gov bond (local)	3,19	2,20	10,1%
	Malaysia - 10yr Gov bond (local)	3,11	2,30	8,6%
	Thailand - 10yr Gov bond (local)	1,63	0,81	7,7%
	Singapore - 10yr Gov bond (local)	1,59	1,50	1,8%
	Rep. Korea - 10yr G. bond (local)	1,97	1,90	1,9%
	Taiwan - 10yr Gov bond (local)	0,37	1,35	-7,6%
Fixed Income Latam	Mexico - 10yr Govie (Loc)	6,65	7,30	-0,7%
	Mexico - 10yr Govie (USD)	3,28	3,55	0,0%
	Brazil - 10yr Govie (Loc)	9,14	8,80	8,9%
	Brazil - 10yr Govie (USD)	4,21	4,55	0,2%

COMMODITIES & FX

Asset Class	*Indices*	*Current Price*	*Fair Value*	Expected Performance to Fair Value*
Commodities	Oil (WTI)	62,4	60,00	-3,8%
	GOLD	1.779,1	1.900	6,8%
Fx	EURUSD (price of 1 EUR)	1,207	1,19	-1,4%
	GBPUSD (price of 1 GBP)	1,39	1,41	1,5%
	EURGBP (price of 1 EUR)	0,87	0,84	-2,8%
	USDCHF (price of 1 USD)	0,91	0,89	-3,0%
	EURCHF (price of 1 EUR)	1,10	1,06	-4,3%
	USDJPY (price of 1 USD)	108,33	106,40	-1,8%
	EURJPY (price of 1 EUR)	130,78	126,62	-3,2%
	USDMXN (price of 1 USD)	19,91	21,00	5,5%
	EURMXN (price of 1 EUR)	24,03	24,99	4,0%
	USDBRL (price of 1 USD)	5,44	5,30	-2,5%
	EURBRL (price of 1 EUR)	6,56	6,31	-3,9%
	USDARS (price of 1 USD)	93,27	140	50,1%
	USDINR (price of 1 USD)	74,64	74,00	-0,9%
	CNY (price of 1 USD)	6,48	6,50	0,3%

MACRO ECONOMY

USA

Any further rise in yields is likely to be more moderate in nature

Could inflation become a problem and cause yields to skyrocket?

At the moment, the US breakeven expectations curve reflects a modest overshoot of inflation over the next two to five years, followed by lower levels of inflation. This appears to be exactly what the Fed hopes to deliver. As long as that curve remains inverted, the market is signaling that inflationary pressure will be transitory, and there is little need for central banks to sharply change tack. The speed of recovery, the cautious approach to tapering, and the rejection of preemptive tightening under the new framework, all create some risk for inflation, especially if prices rise faster than we expect. We would worry more if the economy did overheat, as the cost of slowing things down could be higher than the Fed allowing an inflationary spiral.

The unprecedented increase in growth and inflation expectations over the last six months are unlikely to be repeated going forward, and any further rise in yields is likely to be more moderate in nature, driven by a different set of catalysts. The wider market appears to be falling in line with the Fed's assessment and, aided by the higher yields on Treasuries, we seem to be finding some stability at current levels.

Core inflation surprised on the upside increasing 0.3% MoM, as Covid-sensitive sectors increased 1% MoM while the remainder of the core increased about 0.2% MoM. Hotel prices and vehicle insurance prices jumped, while travel and recreation prices remain below pre-pandemic levels. We expect strong demand to continue to drive up prices through 2Q21 and Q3. Meanwhile, the headline CPI increased 0.6% — the largest monthly increase since August 2012— due to a 9% MoM spike in March gasoline prices, which have since flattened.

Looking ahead to the future movement of the UST 10Y yield

In an environment of 6-7% growth in the USA for 2021, and notable growth of 3-4% expected for 2022, it is most likely that we will continue to see a normalization (rises) in long term yields, but we are clear that this will be a very gradual movement (controlled by the Fed to avoid destabilizing the markets and the economy). In short, a telegraphed movement that the market can absorb reasonably well. We are thinking of a UST10 yield of 1.8% for this year, which will slowly rise above 2% throughout 2022.

March provided a slew of positive economic data, indicative of a broadening recovery driven by stimulus checks and increased vaccinations.

Retail sales rose 9.8% MoM, the highest rise in ten months. Americans are still buying online with sales at non-store retailers up 29% versus March 2020. However, in-person retailers also showed heady gains: food and drink services rose 13.4%, auto sales grew 15.5%. **Manufacturing**: The Empire Survey of NY manufacturers climbed to 26.3, achieving its fastest expansion since 2017. The Philadelphia general activity index also surged to 50.2 on increased orders and shipments, the highest reading since April 1973. **Labor:** Non-farm payrolls rose 916K after February's +156K in upward revisions. However, employment is still 8.4 million below its pre-pandemic peak. Leisure and hospitality continues to make solid gains, adding 280K jobs in March and 384K jobs in February. Chair Powell has highlighted low labor force participation as a reason to maintain extraordinary policy accommodation. In March, the participation rate rose just 0.1 to 61.5%, the same reading as December. Initial jobless claims fell to 576K, a Covid-era low. Claims need to fall substantially further, down to around 300K per week, before the jobs market approaches full employment.

Fiscal package. Will economic conditions run too hot?

The fiscal support this year will come at a time when the economy is also benefiting from other powerful tailwinds. Combined, these forces will boost the level of GDP growth above 6% in 2021. The proposed American Jobs Plan by the Biden Administration envisions significant spending on US infrastructure and tax increases to pay for it. The proposal is billed as a $2.3 trillion spending program over eight years. The proposed tax increases would pay for it over 15 years. The tax increases include a proposal to raise the corporate tax rate to 28% from 21%, as well as other changes to the tax code, with a particular focus on reducing the ability of companies to offset US taxes due to taxes paid in other jurisdictions. The proposal is still in its early stages with many important details unclear. There has already been pushback by Democratic senators which may limit the corporate tax rate to 25% rather than 28%. The proposal's chances in Congress are uncertain given the narrow Democratic majority in the Senate, and the low likelihood that it would receive any Republican Party support.

Financial market assessment

Equities – S&P: MARKETWEIGHT (But bias to our 4 rotation strategies)

Bonds – Govies: UNDERWEIGHT (10Y UST. Target 1.80%)

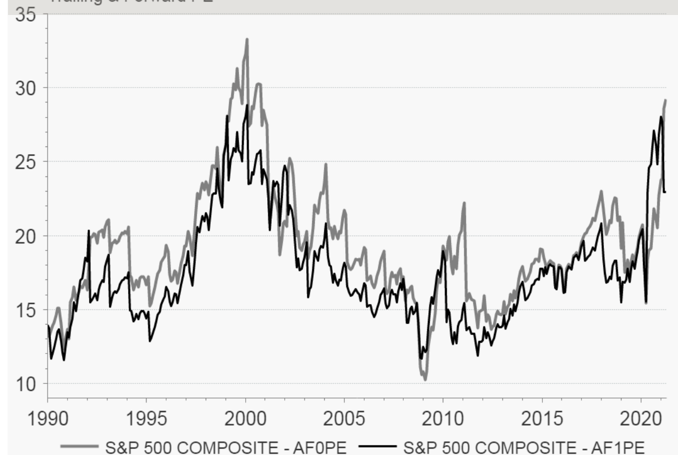
CDX IG: MARKETWEIGHT (Target Spread 60)

CDX HY: OVERWEIGHT (Target Spread 275)

Forex – DXY index: MARKETWEIGHT-OVERWEIGHT

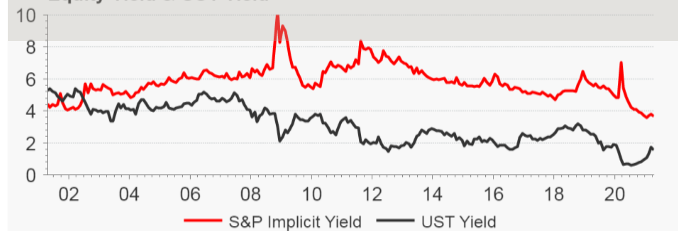
US price-to-earning ratio

Trailing & Forward PE



Source: Refinitiv Datastream / ANDBANK

Equity Yield & UST Yield



Source: Refinitiv Datastream / ANDBANK

Federal Reserve balance sheet

Four-week change, USD, billions

Source: Refinitiv Datastream / ANDBANK

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MACRO ECONOMY

EUROPE

The consensus expects EPS growth of 35%. We expect 41% growth.

The pace of daily doses has accelerated since March

The EU's vaccine production capacity is increasing massively, as illustrated by the ramp up of BioNTech/Pfizer deliveries to Europe in the second quarter (250 million doses, quadruple the agreed 1Q quantity). According to the Internal Market Commissioner, by mid-July, member states will have enough doses to vaccinate 70% of adults. The EU's commitment to reach the threshold of 70% of the adult population by the end of the summer therefore remains in place. The economic outlook has barely changed during the last month with minor downward GDP revisions (4% growth expected in 2021) and upward revisions of the CPI (to 1.5%). Manufacturing sentiment remains upbeat with improvements on the service side. The ECB estimates a 0.3% increase in GDP due to positive spillovers from the Biden stimulus plan. However, the recovery remains uneven within the EU (Italy lagging).

ECB on a "monitoring stance" in April and May. Exit strategy talks.

The "significant increase in the asset purchase program during the coming quarter", announced in March, helped to stabilize nominal yields. Moreover, the spread between the treasury and the bund (due to short covering?) has become lower after peaking at around 200bp. The ECB has primarily succeeded in preserving favorable financial conditions but was less successful "drawing the line" with the US economy. Markets are no longer expecting the ECB to increase its PEPP programme (only 6% of the consensus expects this), and the consensus is that the announced figure will be fully utilized. Surveys regarding an exit strategy, point to a reduction in the purchases from July onwards and the pre-announcement of the PEPP conclusion by year end, to be implemented by the following quarter in 2022, conditional on the pandemic subsiding and the economy recovering as expected. Exit (tapering) talks may still be premature, and the doves could keep the backstop in place for longer.

Bond market: Govies & Corporates

Govies: We are sticking to our targets: -0.25% for the bund, 75-80 bp for the Italian spread. The tightening of spreads has stopped due to the hurdles of the NGEU in the German Constitutional Court, and Poland's delayed ratification), but we expect it to resume once the path for the rescue fund has been cleared. **Corporates**: Credit spreads have remained well supported in 1Q21 despite the record new issues, especially in the financial sector. The key driver behind the positive performance (which will probably continue to be the case) was the specific support from the ECB APP (and its recent acceleration), counteracting the effect of the rise in inflation expectations and the negative move in yields. Inflows in credit markets experienced a net recovery (after the spike in volatility seen mid-February), though the investment grade category had a poorer performance (given the lack of attractiveness of many of its issues). The ESG bond category has garnered most of the interest. Looking ahead, we believe the pace of issuance will decline and that ECB support will continue (especially on ESG), which keeps us relatively optimistic about the European corporate bond category. The financial sector will remain stable (in terms of credit quality). We also favor cyclical names, which can benefit from exposure to the USA or China, especially in the high yield category, which due to its shorter duration and higher carry should benefit in the current market context. We are Neutral in investment grade (Itraxx IG) and more positive in the high yield (Itraxx Xover) category. See target levels below.

Equity market

We are starting the earnings season for 1Q21 results. Given the strong rally in European equities during the first three months, many investors are starting to worry that there is too much priced-in and that we could be disappointed from here. Topline (sales) growth expectations are also much higher this quarter. The consensus is expecting EPS growth of 35% YoY, despite the initial setback in vaccination and the relatively weaker fiscal support. The 2021 EPS forecast has been revised higher, driven by commodities and financials, but the recovery in cyclical business also helped. Year to date, the upgrades are concentrated in energy, materials and financials. Cyclical sectors were disproportionately hit by COVID and are expected to bounce back strongly as lockdowns ease and vaccinations continue to roll out. In fact, these names have been recovering well over the past months, but still stand 16% below their previous highs. In this "reflationary" scenario we think cyclicals will manage to reach expectations and financial results will continue to represent a tailwind for the market.

Financial market assessment

Equities – Stoxx Europe: OVERWEIGHT

Equities – Euro Stoxx: MARKETWEIGHT

Equities – Spain's Ibex: MARKETWEIGHT-UNDERWEIGHT

Bonds – Core governments: UNDERWEIGHT (Bund target −0.25%)

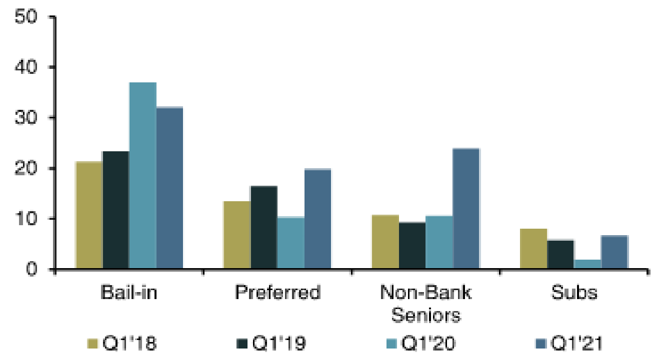
Peripheral – OW IT (0.5%). MW: SP (0.35%), PO (0.35%), IE (0.15%), GR (1.35%).

Credit – Itraxx Europe (IG): MARKETWEIGHT (Target Spread 55)

Credit – Itraxx Europe (HY): MARKETWEIGHT-OW (Target Spread 250)

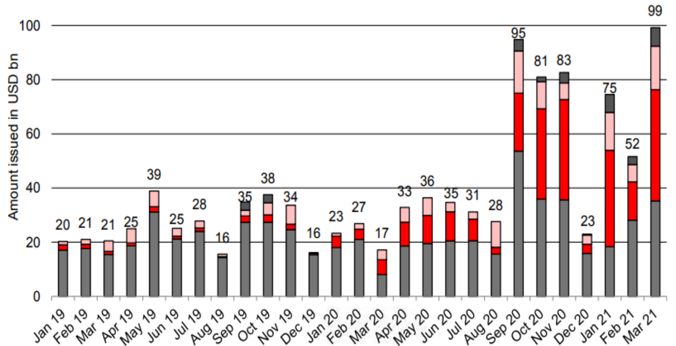
FX – EUR/USD Target 1.19 (Buy USD at 1.23, Sell USD at 1.16)

Record Q1 in Financials issuance...
iBoxx € Financials eligible issuance, in €bn



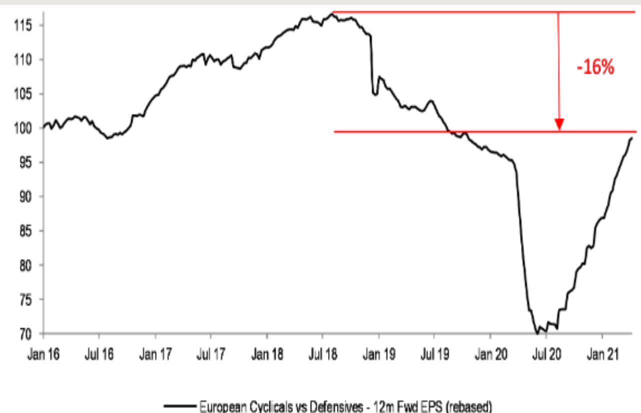
Source: Markit, Bloomberg, Commerzbank Research

Green bonds Social bonds Sustainability bonds Sustainability-linked bonds
120



Source: Climate Bonds Initiative, Bloomberg, UniCredit Research

Figure 26: European Cyclicals 12m Fwd. EPS relative to Defensives



Source: IBES

CHINA

How much should we worry about a war over Taiwan?

Risk is low now, but rapidly rising

Taiwan is the most important geopolitical issue in Asia today, following China's recent assertion of full political control over Hong Kong, and the hardening of the US-China strategic rivalry (especially in the semiconductors industry). The question often centers around TSMC (Taiwan Semiconductor Manufacturing Corp), which has taken over global leadership in semiconductors. As China pushes for technological self-sufficiency, wouldn't it make sense for it to try to seize Taiwan's crown jewels? The risk of a war over Taiwan is currently low but the risk is perceived to increase in the long term. A military assault for this purpose makes little sense as Taiwan's chip-manufacturing facilities would be unlikely to survive a military conflict. Moreover, the tech sanctions against China by the US and its allies that would certainly follow such a conflict would make it impossible for TSMC to rebuild and could well cripple China's domestic chip industry. A conflict would involve tough sanctions against China, and this would be disastrous for the Asian giant, at a time when it seems to have been left behind in the race for a definitive solution to the pandemic, with a set of vaccines that seem to lack the right effectiveness of North American vaccines.

Why do Chinese and US interests collide, making Taiwan a dangerous flashpoint?

Taiwan is the one place where a truly core interest of China (territorial integrity) collides with core interests of the USA (protection of its Pacific perimeter and a fellow democracy). The risk lies in this clash of core Chinese and American interests, and the reason this risk is rising is that China's military capabilities are growing rapidly. China's technical ability to launch a successful takeover of Taiwan will soon not be in doubt, and the key variable is the quality of the US deterrent. To be effective, that deterrent must have economic and political dimensions, as well as military. And this is where doubts loom. Since recognizing Beijing and the CCP in 1979 as the "Authorities in China", the US has been intentionally cautious about how much it would support Taiwan in the event of war, a policy known as "strategic ambiguity". Of course, one purpose of this policy was to deter China from invading Taiwan, but in our view, another and at least equally important purpose, was to deter Taiwan from reckless actions that would provoke a military response by China. Despite recent calls for the US to make its security guarantee to Taiwan explicit, "strategic ambiguity" will almost certainly remain the US position.

Will the quality and deterrence of the US' capabilities be enough to prevent unilateral action by China over Taiwan?

Today, the US deterrent remains the only constraint on China. Despite (valid) complaints from US strategists that "the military component of this deterrent is weak", the economic component is strong, given the US' grip over core technologies and Washington's willingness to use this grip to cripple China's tech capabilities (see Huawei's Slow Strangulation). At present this is probably enough to dissuade China from taking unilateral coercive action on Taiwan. In a few years, it might not be, especially if China perceives that the US is unable to mobilize its allies and/or is too worried about the commercial damage to its own companies from an economic embargo. Therefore, the risk now is quite low. Even though China may be capable of a successful takeover, the cost of subsequent US-led economic and tech sanctions would be too high for it to stomach. Those concerned about Taiwan risk should keep their eyes focused on how quickly China can cut its technological dependence on the US, and how well the Biden administration can bolster the economic, political and military deterrents to Chinese military action. Beijing will continuously assess whether the benefits of an attack outweigh the costs.

Meanwhile, this month, the US and Japan noted shared concerns over China's use of economic coercion; they reiterated objections to China's maritime activities in the South China Sea and expressed concerns regarding "human rights situations in Hong Kong and Xinjiang". The statement drew a rebuke from Beijing that said it "deplored and rejected" the statement, which "severely violates basic norms governing international relations".

Risk of contagion from distressed debt on AM firms controlled by Beijing

The Chinese financial regulator has asked banks to continue lending to Huarong Asset Management. Several state-owned banks have also been notified to be prepared to support Huarong. The latest measures are aimed at containing contagion from the distressed asset manager, which has seen its shares suspended since the end of March, and ensuring Huarong's onshore cash situation is stable. The banking and insurance regulator said the company was operating normally and has adequate liquidity.

Beijing says it has no desire to replace dollar with digital yuan

The PBOC's deputy said China has no intentions of toppling the dollar as the world's main reserve currency. Li Bo said the yuan's internalization is a natural process and the digital yuan is to be used for domestic purposes only. International "interoperability is a very complex issue," said Li, "and we are not in a hurry to reach any particular solution yet," before admitting there could be cross-border use in the long term.

Financial market outlook

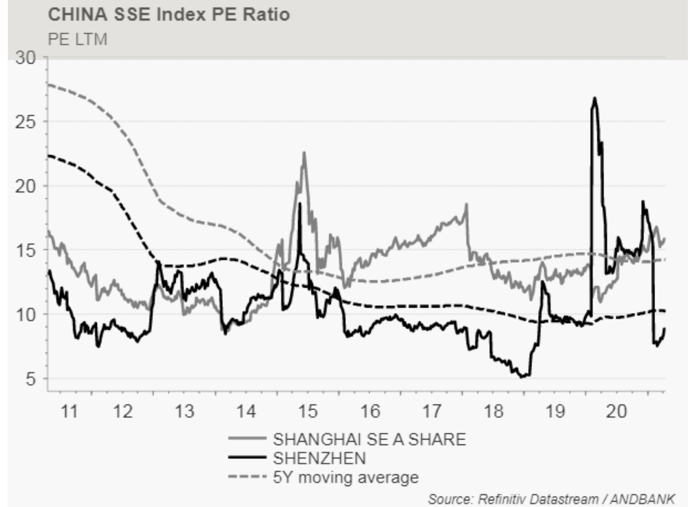
Equities – SHANGHAI Idx: MARKETWEIGHT-UNDERWEIGHT

Equities – SHENZHEN Idx: MARKETWEIGHT-OVERWEIGHT

Bonds – Govies: OVERWEIGHT (10Y Yield target 2.20%)

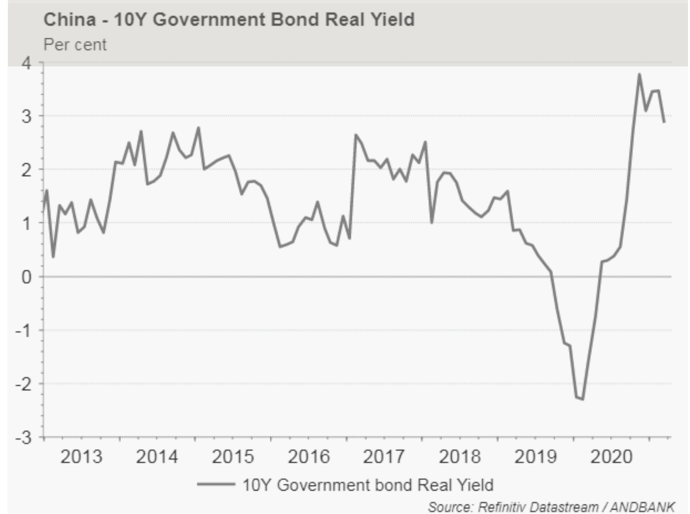
NEW! Forex – CNY/USD: MW (Target 6.50)

CHINA SSE Index PE Ratio
PE LTM



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

The confrontation with China is accentuated. Kuroda says he will continue QQE "as long as necessary"

Macro – Hiring by companies slows down, although manufacturers' sentiment brightens in April and figures from the external sector were positive

A Kyodo News survey found some 22% of major companies in Japan are planning to cut new hires for the business year starting next April from the current year, indicating many firms remain cautious about the outlook amid the coronavirus pandemic. Many of those planning to curb new hires were in sectors hit hard by the pandemic such as transport and tourism, which saw demand evaporate. Firms in sectors ranging from materials to energy are scaling back hiring for FY22. Thirty-seven firms (34%) said they will maintain the same levels as FY21, while only 17% are seeking to increase new hires. On the positive side, the Tankan manufacturers' sentiment index rose to 13 in April from 6 in March. Most sectors saw improvement, led by a sharp moderation in pessimism among textiles, outweighing softer readings in other sectors. Autos/transport equipment recorded a notable gain. The non-manufacturers' index edged up to -3 from -5 as wholesalers, retailers and IT registered sharp increases. On the external front, the March trade balance was ¥663.7bn vs consensus ¥493.2bn and revised ¥215.9bn in prior month. Exports expanded by +16.1% YoY vs consensus +11.4% and 4.5% in prior month, while import growth softened at +5.7% YoY vs consensus +4.7% and +11.8% in prior month. BoJ's Kuroda stressed that conditions remain severe due to coronavirus effects and that "the BoJ will continue QQE with yield curve control, aiming to achieve 2% inflation, for as long as necessary".

Geopolitics. PM Suga vows to stand firm on China. Formal statement on Taiwan

According to Kyodo, Prime Minister Yoshihide Suga said in an online think-tank event that Japan will stand firm to defend sovereignty, democracy and human rights throughout the region as China increases its military and economic assertiveness. Suga noted that China continues attempts at unilateral changes to the *status quo* in the East and South China seas. But he also said Tokyo will seek a "stable and constructive relationship" with China. Nikkei discussed the US-Japan joint statement, highlighting Biden and Suga's emphasis on "the importance of peace and stability across the Taiwan Strait" and encouraged "the peaceful resolution of cross-Strait issues". It also stated that they share serious concerns regarding the human rights situation in Hong Kong and the Xinjiang Region. The last time that Taiwan was mentioned in a US-Japan leaders' statement was in 1969. The Defense Minister indicated that Japan is giving strong consideration to positioning new F-35B stealth fighter jets on the southern island of Kyushu which would beef up deterrence against China's increasingly frequent maritime forays in the East China Sea.

Pandemic – More regions to adopt stricter virus measures

The central government will add three prefectures neighboring Tokyo to the list of areas in need of stricter measures to curb a rebound in coronavirus infections. Osaka's governor indicated that he intends to ask the central government to declare a fresh state of emergency in Osaka Prefecture amid a resurgence of novel coronavirus cases. Tokyo's governor also said on Sunday 19 that she might ask the central government to issue a fresh coronavirus state of emergency for the capital to deal with a recent spike in cases. The nationwide tally of new cases surpassed 4,000 for a fifth consecutive day on Sunday 18 with the quasi-emergency measures set to officially commence in four additional prefectures. Vaccine minister Taro Kono said on Sunday 19 that Pfizer will increase supply of its coronavirus vaccine, allowing the country to procure enough doses by the end of September to inoculate all eligible residents. Prime Minister Yoshihide Suga and Pfizer CEO Albert Bourla agreed to boost supply during telephone talks.

Corporate

CVC Capital Partners will postpone submitting a formal proposal to acquire Toshiba until further notice after the appointment of a new CEO. Toshiba confirmed that it had not received any binding proposals from CVC as of Friday. Toshiba (~6502.JP~) is considering rejecting a buyout offer from CVC Capital Partners as the conglomerate seeks to remain listed. Toshiba senior officials have conveyed their position to creditor banks and asked them not to provide funding to CVC for a planned acquisition.

Japan's nuclear regulator decided to effectively ban Tokyo Electric Power Company (TEPCO Holdings) from restarting its largest nuclear plant due to serious safety flaws. The company has seen restarting the seven-reactor Kashiwazaki-Kariwa complex as a main pillar of its business restructuring plan. It is the first time the regulator has issued a corrective order for a commercial nuclear reactor.

Kagome has stopped importing tomatoes from China's Xinjiang region. Kagome, which also makes pasta sauce and tomato juice, is the first major Japanese corporation to stop doing business with the region.

SoftBank Group (9984.JP) is investing $500M in mortgage lender Better, which values parent Better Holdco at about $6bn. SoftBank is buying shares from the company's existing investors. Better is expected to go public later this year.

Financial market outlook

Equities – N225: MARKETWEIGHT

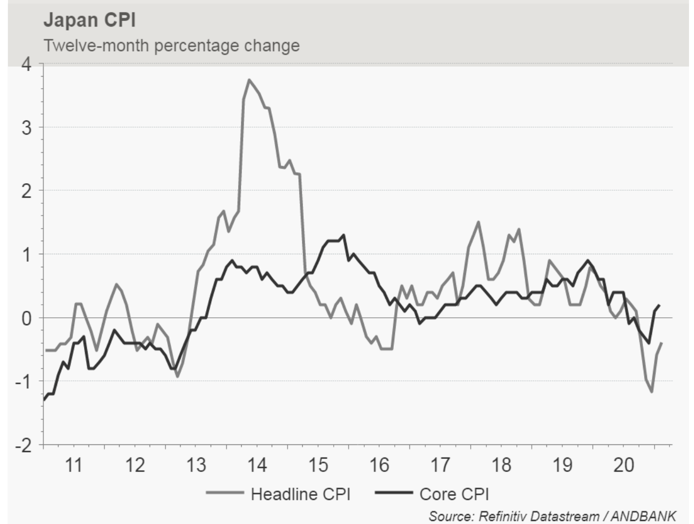
Bonds – Govies: UNDERWEIGHT (Target yield 0.25%)

Forex – USD-JPY: MARKETWEIGHT-OW (Mid-term target 106.4)

Japan Nikkei 225 price / earnings
Ratio

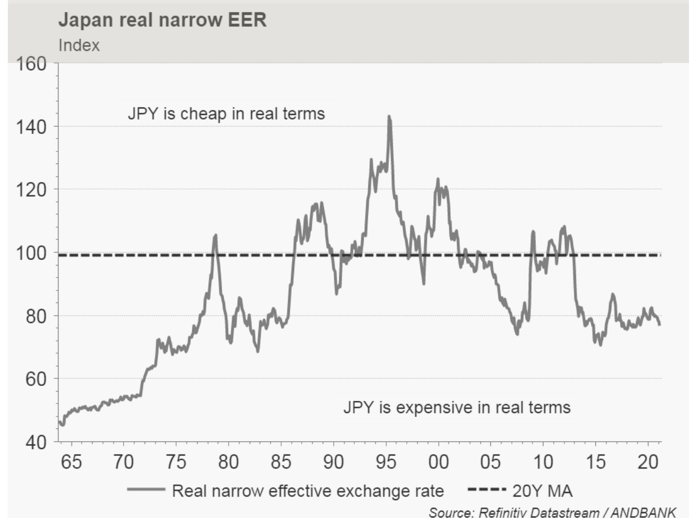
Source: Refinitiv Datastream / ANDBANK

Japan CPI
Twelve-month percentage change



Source: Refinitiv Datastream / ANDBANK

Japan real narrow EER
Index



Source: Refinitiv Datastream / ANDBANK

INDIA

Indian equities may look vulnerable in the short-term

The worsening pandemic raises doubts about growth projections

India has emerged as the worst affected country in the pandemic. Yet Narendra Modi's government is reluctant to reimpose a national lockdown. These may not derail the country's economic recovery, but they do mean that the IMF's growth forecast of 12.5% this fiscal year is too optimistic. While a full national lockdown is unlikely, state governments are threatening fresh restrictions. The industrial powerhouse Maharashtra, home to the Mumbai business hub, has limited the range of permissible activities. The impact of such localized restrictions on corporate profitability is hard to quantify. This time around, there is less scope to trim expenses as firms have been slow to rehire and the price of key inputs like fuel has risen. Hence, even if sales do not crater, the outlook for Indian corporate profits is far from bright.

But what are the structural problems that prevent India from taking off?

The million-dollar question is whether India has managed to escape from the structural slowdown that began before the arrival of the pandemic. Growth began to flatten in 2018 and fell to just 4% in 2019-20, well below its 7-8% potential. A key reason is India's waste of human capital, which has worsened during the pandemic. Due to lockdown, the labor participation rate stands at just 40%, among the lowest in the world. India's inability to create jobs for its populace could make it harder to recover high structural growth once the economic cycle normalizes. India has recovered many of the jobs it lost during last year's national lockdown, but not in full. The estimated number of people employed in March was 398M, a fall of 8M from the 406M recorded in February 2020. Nevertheless, many rural migrants working in urban jobs returned to their villages, taking farm jobs with lower wages. Reverse migration is restarting, as big cities like Mumbai and Delhi tighten controls. One of the pre-existing trends in India that needs to be reversed is India's failure to create manufacturing jobs. For example, the clothing sector currently employs only 30M Indians, 8M fewer than a year ago. But these job losses are not just a consequence of lockdown. In 2016, more than 50M Indians worked in manufacturing. A comparison with China where over 110M people work in manufacturing, down from a peak of about 140M in 2014 highlights India's failure. Given that the adult population (aged 15 years and above) grows at well over 15M per year, India needs to create new jobs. An influx of youthful workers should be an economic boon in a well-functioning economy, yet —paradoxically— India's growing population has not boosted the labor force. At the beginning of 2020, the labor force numbered some 440M people; by March, it had fallen to 425M. Young Indians are struggling to find employment, even as others drop out of it. India's labor participation rate fell to a scarcely believable 40% in 2020-21, down from 46% in 2016-17. This compares with a global average of 65%. Even more disturbing is the labor participation rate for Indian women at 21% in 2019 (one of the lowest in the world), on a par with socially-repressive countries in the Middle East and could have fallen to just 9% in 2020-21. This failure of policy may be the biggest factor preventing its economy from realizing its enormous potential. It is akin to driving a steam locomotive, while only burning two-thirds of its coal capacity.

Could a high US dollar and higher UST yields pose a risk to Indian equities?

The US dollar index hit a five-month high and treasury yields maintained their relentless march higher, marking what has been a sort of tightening of financial conditions that, together with a worsening Covid-19 situation, could make investors reassess the surprising notion of India as an EM haven. India's equity market, which has more than doubled (in US dollar terms) over the past year, has perhaps been the biggest winner from liquidity injections undertaken by developed-market central banks. By the end of 2020 "non-resident" inflows to Indian equities had exceeded a whopping US$23bn. This trend continued in January and February, with US$7.5bn flowing into Indian stocks, compared to US$3bn for EMs (ex-China) as a whole. What's behind the flood of money into an economy hit hard by the pandemic? There are high hopes of a quick rebound, aided by lots of fiscal largess. Yet as a global hub for vaccine production, India clearly retains an advantage over other EMs in inoculating its adults. However, the Covid situation in India has in fact worsened, with cases rising sharply again —not far off the peak seen in September. Add in the possibility of headline-grabbing "double mutant" variants driving the latest surge in infections, and Indian equities look vulnerable to foreign investors.

On the positive side

The Reserve Bank of India has grown its foreign exchange reserves by about US$100bn to US$580bn over last year. This buffer emerged as the RBI acted to dampen rupee appreciation and should mitigate against any disorderly exit of foreign capital. In fact, an orderly exit of hot money may be welcomed by policymakers, fretting about the RBI's forex actions keeping government bond yields unduly high. In addition to having some policy headroom, India continues to run a current account surplus. Currency weakness is therefore unlikely to turn into a rout. The bigger worry for investors is that until valuations become more attractive, an overbought Indian equity market will likely lack new buyers.

Financial market outlook

Equities – SENSEX: OVERWEIGHT

Bonds – Govies: OVERWEIGHT (Target yield 5.5%)

Bonds – Corporates: OW

Forex – INR/USD: MARKETWEIGHT (Target 74)

ISRAEL

Economy back to normal. Political situation far from normal (but with no impact on assets)

GDP & INFLATION

Israel's GDP for 4Q 2020 rose 6.5% QoQ. FY2020 growth was finally fixed at -2.6%. On a quarterly basis, personal consumption was the main positive driver of the economy (+17.7%), although investments also contributed positively, rising by 65.6%. Public consumption (spending) grew by an important 25.5%, mostly due to government attempts to revive the economy. Looking at the full year, personal consumption dropped by 9.5% YoY due to the three lockdowns that were imposed during the year, with a noteworthy 4.8% decline in investments.

Israel's CPI rose by 0.6% QoQ in March. Most of the rise came from clothing, which was up by 5.8%, entertainment 2.2% and transportation 0.9%. Not surprisingly, all of these segments suffered during the pandemic and are recovering after most restrictions were lifted in recent weeks.

Bond market. We expect a lower yield curve in the coming months

Consumer price index (CPI) for March was once again higher than expected (0.6% vs. est. 0.5%) for the third straight month and led to a rise in CPI-linked bonds (both governmental and corporate bonds). Although inflation rose in recent months, it is still considered a temporary phenomenon and the consensus is that by the end of the year, inflation will return to its pre-pandemic level. The strong currency (Shekel) and the high rate of unemployment support that assumption.

We think that the primary reasons for the rise in the inflation environment will not hold in the long term, meaning a high probability of a lower yield curve in the coming months. The 10-year non-CPI linked yield slightly dropped this month, following a similar trend in overseas markets.

Corporate bonds are trading at record low spreads. The current credit spread in the CPI-linked TelBond60 index decreased to 1.02% compared with 1.12% in late-March, 1.67% in mid-July and 1.25% during pre-Covid19 crises. The current credit spread in the non-CPI linked TelBond Shikli50 decreased to 1.02% compared to 1.19% late-March, 1.71% in mid-July, and compared to pre-Covid19 spread levels of 1.3%-1.35%.

We believe that the risk-return prospects for the corporate bond market are not favorable and recommend reducing this position.

Equity Market

Israeli stocks enjoyed a positive run throughout last month, mainly due to a return to a fully open economy. Like previous months, financial stocks led the market while bank stocks rose by 5.3% and the insurance sector gained nearly 8%. The sector's performance was supported by very favorable financial results for 2020. In general, the statements revealed a very strong balance sheet position for the sector due to good risk management during the Covid19 crisis. In addition, a surge in personal spending is brightening the near future for the sector.

Homebuilders were the top performer of the month, rising by 14.5%. The sector is enjoying very supportive tailwinds, where high demand cannot be satisfied due to low inventory.

The technology sector lagged the market, like its peers in overseas markets. The sector dropped by 0.5%, although volatility was higher than usual.

The elections held at the end March ended with (more or less) the same result as the previous three elections held in the last two years. Negotiations to establish a government are taking place now, but even if a new government is formed, it is unlikely that it will survive the entire term.

Surprisingly, the market is ignoring the political chaos and the main drivers remain the return to normality and the highly supportive monetary policy. Compared to other developed country markets, we still maintain the view that the Israeli market is priced and well positioned for further gains by the end of the year.

Financial market outlook

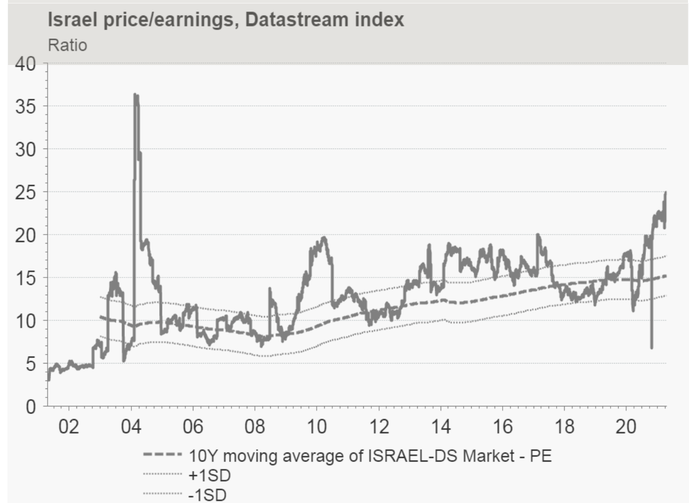
Equities – TLV35 Index: MARKETWEIGHT-OVERWEIGHT

Bonds – Government–10Y Gov: MARKETWEIGHT-OW (Still positive real yield, though historically below long-term average)

Bonds – Corporates: MARKETWEIGHT-OW

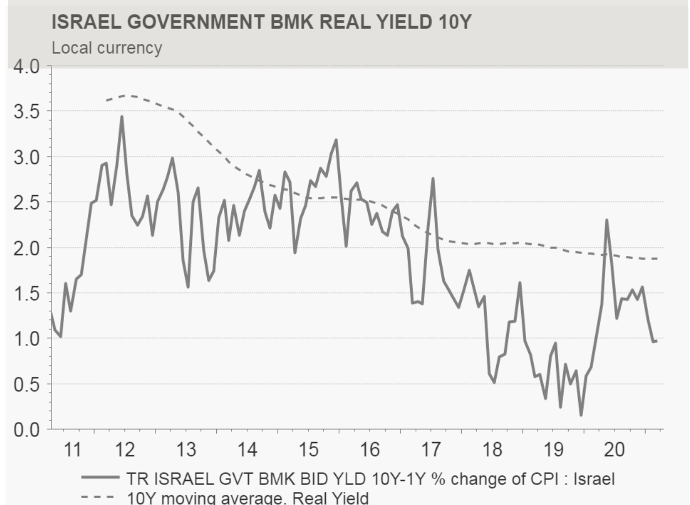
FX – ISL vs USD: Slightly expensive in REER

Israel price/earnings, Datastream index
Ratio



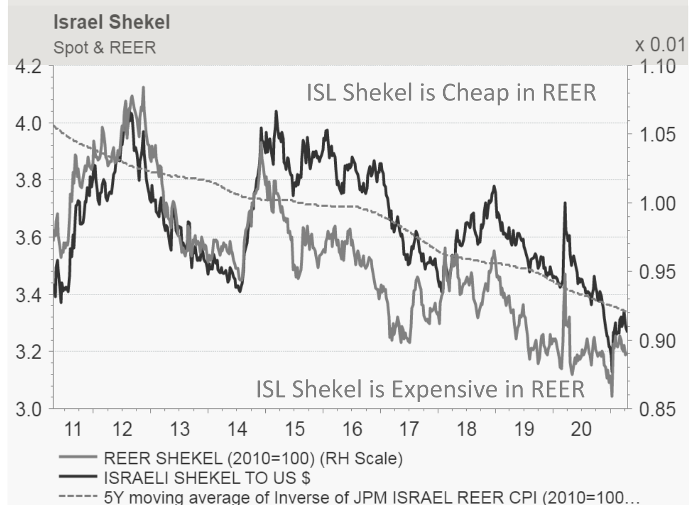
Source: Refinitiv Datastream / ANDBANK

ISRAEL GOVERNMENT BMK REAL YIELD 10Y
Local currency



Source: Refinitiv Datastream / ANDBANK

Israel Shekel
Spot & REER



Source: Refinitiv Datastream / ANDBANK

BRAZIL

The two main topics of discussion are still fiscal sustainability and the speed of vaccination

Fiscal risk: More budget cuts still needed

Brazil has a long history of fiscal imbalance. However, it's important to say that over the past 20 years, there has been a lot of improvement, notably around the composition of government debt. Today, Brazil holds less than 5% of its total debt internationally, while its international reserves exceed US$350 bn (20-25% of GDP, depending on FX). There has also been great improvement in the maturity schedule of domestic debt, with approximately 18% of the debt maturing in less than 12 months, compared with percentages higher than 30% as recently as 2006. It's important to put that in context when discussing Brazil's fiscal situation because the discussion is not about where we are today, but the future trajectory of the debt. In that sense, there is a lot of concern that the situation might derail if the central government doesn't take it seriously. For example, Brazil has only recently approved a formal spending ceiling, and since then, year after year the probability of breaching the ceiling appears as front-page news.

This year was no different. The 2021 budget discussion was very heated and ended up with a hefty BRL 225 bn being left out of the debt ceiling calculation, because it will be targeted at pandemic-specific programs. No one denies the need for fiscal measures in the middle of a pandemic, however by starting at an already elevated level (although not as high as 20 years ago), the pandemic expenditure is driving Brazil's public debt close to 100% of GDP; much higher than its developing economy counterparts. In February, the consolidated public sector posted a primary budget deficit of BRL 11.8 bn, a result of central government net revenues dropping by -1.9% YoY and total outlays receding by only -0.4% YoY in real terms. While the administration and Congress still debate the pointy issues of the 2021 budget, the administration has to present Congress with the parameters for the 2022 budget by 15 April 2021.

Market Sentiment

There is still considerable frustration on the part of international investors with the pace of structural reforms. In our opinion, there is zero chance that any of the necessary structural reforms can be undertaken in 2021, and we very much fear they will not be carried out in 2022 either (as it is an election year). Precious time has therefore been lost by the Brazilian government and Senate, which will lead to the persistent risk of a fiscal and debt crisis. **The external front is still supportive for Brazil**. In February the current account gap narrowed to 0.5% of GDP in 12 months, while FDI and net portfolio investments posted a positive surprise, accumulating a total of 2.8% and -0.4% of GDP, respectively

Central bank: Inflation & Selic rate projections

As analysts fine-tune their expectations regarding next steps for monetary policy, inflation reports become particularly relevant. The week brought us surprising inflation data. Regulated price readjustments are sustaining CPI at unusually high levels, leading the CPI in March to post 0.93% MoM growth. The year-on-year reading picked up to 6.1%, well above the BCB's upper-limit for 2021 (5.25%). External account data indicates that inflation pressures are not stemming from there, as Brazil's current transactions deficit has been comfortably covered. With this latest inflation reading and the BCB Deputy Governor's recent remarks, we believe the Copom will deliver a 75-bp hike at the May meeting and eventually bring the Selic rate to 5.50% by end-2021 and 6.50% by end-2022.

Economic recovery & FX forecast

Estimates point to a marginal gain of 2.1% MoM (-4.1% YoY) for the broad retail sales index in February, which includes vehicles and construction material sales, and 0.6% MoM (or -3.9% YoY) for core retail sales. Projections for service revenues are for a strong monthly reading of 2.0% MoM (-3.4% YoY) but is poised to be wiped out with the re-implementation of restrictive measures across the country in response to the worsening health situation. Industrial production contracted by -0.7% MoM (+0.3% YoY) in February, interrupting a sequence of nine months on the rise, and production in March should drop further, according to more timely data available. Labor data posted possibly the last improvement in the quarter, with the creation of 402K formal jobs (net) in February. In the previous month, the unemployment rate had edged up to 14.2% (from 13.9% in the quarter ended in December), still capped by the historically low participation rate. Lastly, March's trade balance of US$1.5bn was trimmed again by imports of oil-drilling rigs. Despite the deterioration in the pandemic outlook and persistently high fiscal noise, our outlook for USD/BRL remains unchanged at 5.30 by the end of 2021. Analysts' expectations are for USD/BRL at 5.20 by the end of 2022.

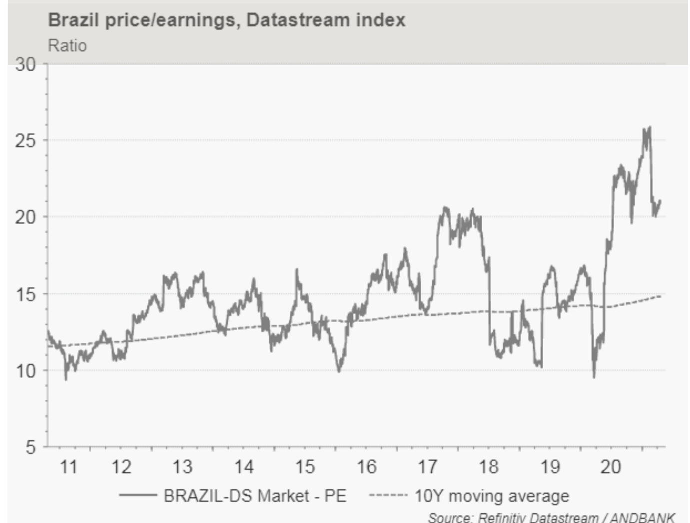
Financial market outlook

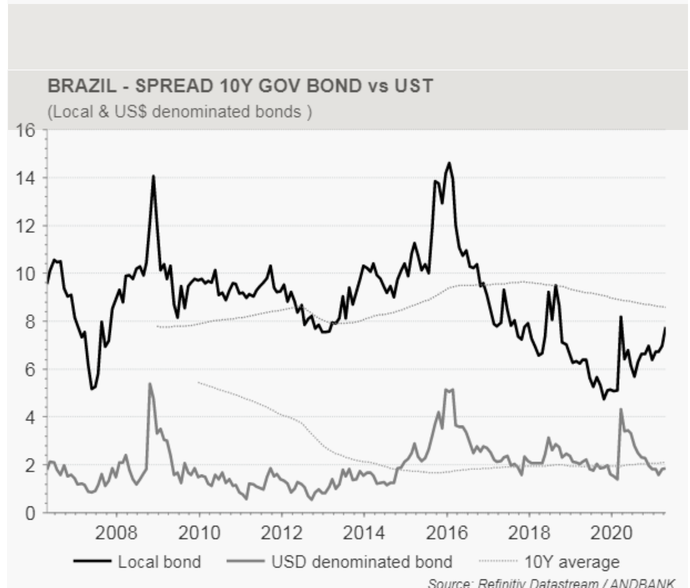
Equities – iBovespa: MARKETWEIGHT-UNDERWEIGHT

Bonds – Govies Local: MW-OVERWEIGH (Target yield 8.80%. Spread 700)

Bonds – Govies USD: MARKETWEIGHT-UW (Target yield 4.55%. Spread 275)

FX – BRL/USD: MARKETWEIGHT-OW (Mid-term target 5.30)





MEXICO

Despite Obrador's efforts to discourage investment, Mexican equities enjoy a favorable external environment

Pandemic & Politics to further hit the already scarce appetite of direct investment from abroad

In April, the epidemiological traffic light was updated so that 5 states were classified as orange, 19 as yellow and 8 as green. There are no longer any red light locations.

It should be noted that the vaccination campaign is progressing slowly, currently 2.6% of the population has been vaccinated and around 396,000 daily doses are being given.

After the definitive suspension of the electricity law, a hydrocarbon law has advanced that is driving for the same outcome. This law seeks to regulate the import of gasoline and its distribution, a possibility that started with the 2014 energy reform. In practice, legal issues are expected in the form of breaches of current contracts under private initiatives and international treaties such as the T-MEC. All these steps taken by the Obrador administration point to over-regulating the markets, distancing the country from the liberalizing trend pursued by previous reforms. Furthermore, the move towards repealing the reforms reached under the previous government unleashes a sense of legal uncertainty, which may further hit the already scarce appetite of direct investment from abroad. Bad omens then for the economic reactivation from business investment.

In the political arena, polls still show a favorable drag effect for the president's party due to its high level of approval. However, many analysts now hope that his party could lose its qualified majority (2/3) in Congress and with it the possibility of making amendments to the constitution. This approach has characterized President Obrador's way of governing, which he may lose after the mid-term elections, resulting in a weaker position with less capacity to legislate by decree.

Fiscal path

In the public finance arena, the February 2021 data showed that the fall in tax revenues continued. The drop in income has been offset by lower spending. Although we expect this movement in expenditure to continue in Q1, we believe it will reverse in the Q2 as a consequence of the June electoral process. This will probably lead to a more pronounced deterioration of the public accounts as the government does not have the counter-cyclical funds to finance spending.

Inflation for the first fifteen days of March rebounded and stood at 4.67% in annual terms. Underlying CPI also rose (to 4.12%) led by an increase in prices of non-food products, reflecting the supply shock caused by the pandemic in different sectors, which has consolidated the impact of the underlying part of the indicator. The increase in core inflation was also compounded by a rebound in the non-core index that has seen adjustments in energy prices.

Central bank and monetary policy

Banxico unanimously decided to hold the rate at 4% at its last meeting. The decision was due to the increase in inflation in the first three months of the year, as it reached a level above the upper range of the central bank's long-term goal (3 +/- 1%) during the first half of March. The main surveys and forecasts related to inflation with respect to the target and the difference between the observed and potential GDP, point to a prolonged pause for movements in the reference rate. The probability that Banxico's next decision is to raise rates has been rising in recent days. The hypothetical move could come as soon as late-2021.

Equity market

For the Mexican stock market and other local assets, the favorable environment that has benefited emerging markets is still in place due to the greater global stimulus, advances in vaccination campaigns and even the weakness of the dollar. All these aspects are still reflected in local growth estimates of around 5% in 2021. The economic recovery in the US is expected to stimulate the local manufacturing sector and exports will therefore continue to have a positive impact on Mexican GDP.

In the short term, better performance is expected following quarterly reports from Mexican corporations. The main risks that are perceived point towards the second part of the year when there will be domestic political factors and more information on the performance of the economy and its impact on public finances, in addition to the possible fiscal deterioration of Pemex. Short-term legal initiatives that threaten private investment once again generate uncertainty. The 12-month consensus target for the IPC Mexican Index is 52,200 points.

Financial market outlook

Equities – Mex IPC: OVERWEIGHT

Bonds – Govies Local: UNDERWEIGHT (Target yield 7.30%. Spread 550bp)

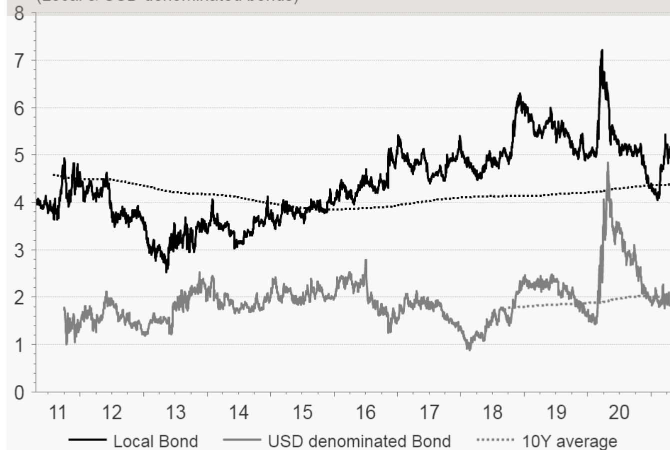
Bonds – Govies USD: UNDERWEIGHT (Target yield 3.55%. Spread 175bp)

FX – MXN/USD: UNDERWEIGHT (Mid-term target 21)

Mexico equities price/earnings ratio
Datastream index

Source: Refinitiv Datastream / ANDBANK

MEXICO - SPREAD 10 GOV BOND vs UST
(Local & USD denominated bonds)



Source: Refinitiv Datastream / ANDBANK

MXN/USD Real Effective Exchange Rate
Index

Source: Refinitiv Datastream / ANDBANK

ARGENTINA

Economic restrictions again. The government's pandemic management did not prevent them.

The Government introduced new health restrictions as COVID-19 cases began to increase rapidly last month. New measures include the suspension of school classes and movement restrictions until the end of April, between 8pm and 6am in the city of Buenos Aires and the 40 municipalities that make up Greater Buenos Aires (AMBA). Economic activity at the end of January was just -1.3% below pre-pandemic levels (February 2020) but the new measures are likely to halt the recovery process.

The Economy Minister, Martin Guzman, visited Washington to hold meetings with financial institutions, US Treasury officials and the IMF's Managing Director, Kristalina Georgieva. Guzman also travelled to Europe (Germany, Italy, France and Spain) meeting with his peers to obtain their support in the negotiations with the IMF and to amend the terms of the loan with the Paris Club.

Still no indications regarding the timeline and content of the new program. Argentina continues to push for a longer maturity and lower rates than the conventional Extended Fund Facility, but the IMF has politely ruled out these kinds of modifications which require a change in the fund's statues. Alejandro Werner, IMF head for the Western Hemisphere, has been the most outspoken official regarding the appraisal of the current economic situation saying that there is significant uncertainty about Argentina's economic policy path to make its debt sustainable with significant differences of opinion within the ruling coalition about which direction it should take.

Our base case continues to be that an agreement will be reached after the October Congress elections, possibly in 2022. One positive piece of news for Argentina is that the IMF capital expansion for members is going to be larger than initially expected (US$650bn vs 500bn) translating into US$4.35bn of fresh funds for Argentina.

Province of Buenos Aires: rising tensions

The province of Chaco reached an agreement with creditors leaving only the Province of Buenos Aires (PBA) and La Rioja in arrears. After 10 months without news, the PBA published details of a new offer shown to hedge fund GoldenTree Asset Management which was emphatically rejected. The fund made a counter-offer that was dismissed by PBA. The next day, funds from the Buenos Aires Ad Hoc Bondholder Group, including GoldenTree, submitted two legal claims against the province in the US District Court of New York seeking US$366M in unpaid interest and principal.

For Governor Kicillof, cutting a deal with provincial bondholders isn't a priority, especially during a pandemic and before congress elections, with PBA being a critical political battleground (with 40% of Argentina's population).

Prices heating up

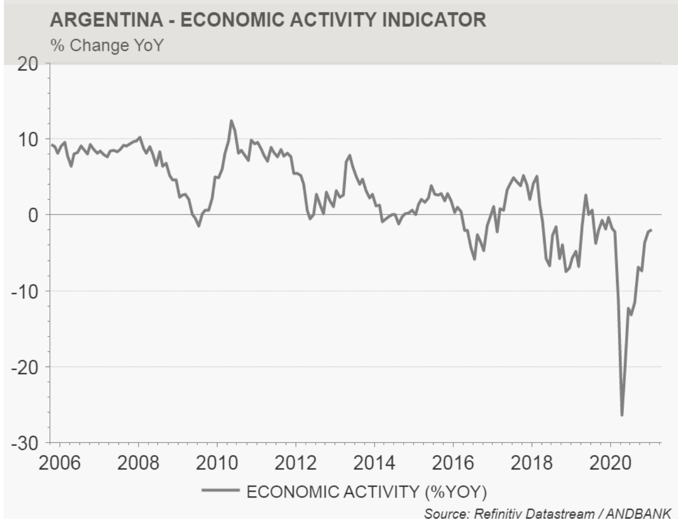
The March CPI reading was 4.8% MoM (+42.6% YoY), well above market expectations (+3.9% MoM) and the highest monthly record since September 2019, following the post primary elections sell-off. Core prices accelerated to +4.5% MoM, while regulated prices came in at 4.5% MoM. Seasonal prices explain most of the figure with a 7.2% MoM spike in March.

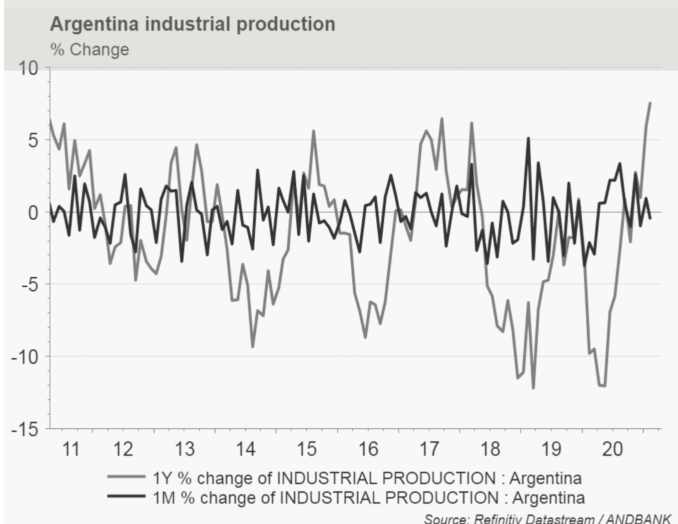
The COVID-19 second wave will probably cause a temporary deceleration in the coming months, but significant upside risks remain in place with higher fiscal needs amid new health restrictions and less appetite for Treasury bonds (demand at the last debt auction was around half of the ARS 75bn the government tried to raise).

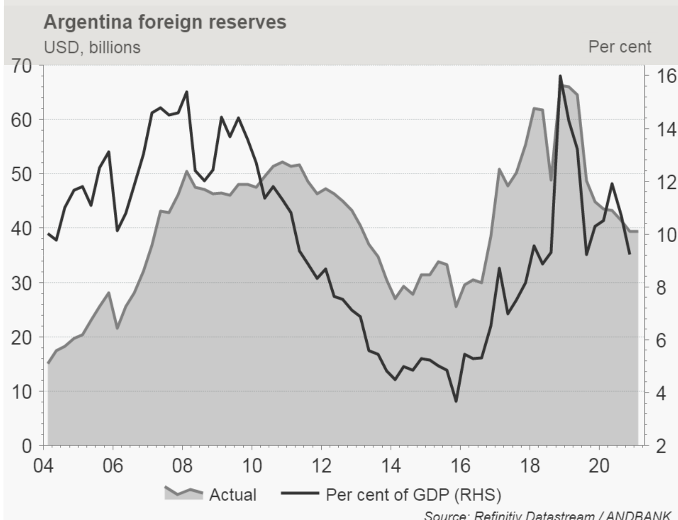
Financial market outlook

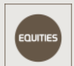
Bonds – 10YGov USD: NEUTRAL

FX – USD-ARS: NEGATIVE (2021 year-end target 140)









EQUITIES

GLOBAL EQUITY INDICES
Fundamental assessment

Index	Projected EPS 2021	EPS Growth 2021	PE EPS 2020	PE EPS 2021	PE EPS nxt 12m	INDEX CURRENT PRICE	Current Fair Value (EPS 12 month fw)	2021 E[Perf] to Fair Value	Recomm	2021 Exit Point	Max. Risk Premium	E[Perf] to Exit point
USA S&P 500	180,00	29,5%	30,13	23,26	22,00	4.188	4.023	-3,9%	MW	4.627	1,15	10,5%
Europe - Stoxx Europe 600	24,30	41,0%	25,50	18,09	18,00	440	444	1,1%	OW	511	1,15	16,3%
Euro Zone - Euro Stoxx	23,60	46,0%	27,41	18,77	18,00	443	432	-2,5%	MW	496	1,15	12,1%
Spain IBEX 35	428	88,5%	38,27	20,30	18,75	8.688	8.154	-6,1%	MW-UW	9.377	1,15	7,9%
Mexico IPC GRAL	3.300	102,5%	30,02	14,83	15,60	48.924	52.305	6,9%	OW	60.151	1,15	22,9%
Brazil BOVESPA	6.250	206,7%	59,17	19,30	18,00	120.595	114.303	-5,2%	MW-UW	131.449	1,15	9,0%
Japan NIKKEI 225	1.285	25,4%	28,28	22,56	23,00	28.992	30.029	3,6%	MW	33.032	1,10	13,9%
China SSE Comp.	258,70	16,8%	15,55	13,31	13,00	3.443	3.417	-0,7%	MW-UW	3.930	1,15	14,1%
China Shenzhen Comp	107,60	23,9%	26,27	21,21	22,00	2.282	2.405	5,4%	MW/OW	2.766	1,15	21,2%
India SENSEX	2.500	55,0%	30,34	19,58	24,00	48.944	60.962	24,6%	OW	70.106	1,15	43,2%
Vietnam VN Index	76,50	27,8%	20,37	15,94	18,00	1.220	1.399	14,7%	OW	1.609	1,15	31,9%
MSCI EM ASIA	44,10	24,1%	21,11	17,02	16,00	750	728	-3,0%	MW	837	1,15	11,6%

ANDBANK ESTIMATES

POSITIONING, FLOW & SENTIMENT ANALYSIS
Risk Outlook: Neutral // Positioning: Slightly cautious

Andbank's Assessment: -3 (in a −7/+7 range)

Aggregate (UW bias): Flows have been driving markets and are positive, although not as much as previously. Our contrarian reading is to be selective as some consolidation could be expected.

Market Positioning (MW-UW bias): Positioning remained stable month-on-month; asset allocation in equity has a negative tilt with consistent exposure to the asset class in portfolios. The Put-Call ratio indicates a low hedging level of portfolios. Finally, skew at the current level reflects current fear of a violent downside movement.

Flow Analysis (OW bias): Net inflows into US equities indicate a positive momentum, but at a lower pace than previous months. China benefited from positive flows as its last GDP growth figures showed, although slightly slower than estimated, but still a recovery.

Surveys & Sentiment Analysis (UW bias): Sentiment from investors is extreme. We keep a contrarian stance.

TECHNICAL ANALYSIS
Trending Scenario. Supports & Resistances

	Name	Refinitiv Ticker	View 1 month	Principal Support 12M	Principal Resistance 12M	Support 1 month	Resistance 1 month	Target (TA) 12M	@	Return to Target (TA)
INDICES	Euro Stoxx Index	.STOXXE	Bullish	329,29	443,29	418,90	443,29	443,00	440,21	0,63%
	Euro Stoxx 600	.STOXX	Bullish	338,57		419,05		445,00	438,55	1,47%
	Ibex	.IBEX	Bullish	7.663,50	9.676,00	8.112,00	8.850,60	9.231,00	8.571,60	7,69%
	S&P	.SPX	Bullish	3.209,00		3.853,00		4.193,00	4.170,42	0,54%
	Japón	.N225E	Lateral bearish	24.448,00	38.957,00	27.629,00	30.714,52	32.817,46	29.683,37	10,56%
	China	.SZSC	Lateral bearish	1.744,00	3.156,96	2.119,00	2.511,97	2.441,00	2.220,22	9,94%
	India	.BSESN	Lateral bearish	35.987,00		48.403,97	52.516,76		48.803,68	
	Brasil	.BVSP	Lateral	90.147,00		107.319,15	125.323,53		120.700,67	
	México	.MXX	Lateral bullish	35.652,42	50.603,00	46.372,90	50.041,60	52.714,31	48.514,10	8,66%
OTROS	Oil West Texas	WTCLc1	Lateral	34,49	66,60	57,26	66,60		63,22	
	Gold	XAU=	Lateral bearish	1.659,00	2.072,49	1.659,00	1.874,86	1.897,13	1.763,21	7,60%
	Treasury 10Y USA	US10YT=R	Lateral bullish	0,5040%	1,9730%	1,4290%	1,9730%		1,5733%	
	Bund 10Y German	DE10YT=R	Lateral bullish	-0,9090%	-0,1420%	-0,3900%	0,1420%		-0,2945%	

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

Fundamental view (WTI): Target range USD55-65bbl

Buy < USD55; Sell >USD65

Short-term drivers

***(Price Negative)* – A "new understanding" is taking shape in the talks with Iran to reinstate the 2015 nuclear deal**: Iranian Foreign Ministry said that Iran welcomes the prospect of talks with Saudi Arabia in an effort to promote regional peace and stability. The two countries, which cut diplomatic ties in 2016, held talks in Baghdad on April 9, with another round scheduled late in April. The talks come amid indirect approach between the US and Iran on a return to the 2015 nuclear deal (US National Security Adviser Jake Sullivan described the talks as "constructive"). Meanwhile, Iran's Deputy Foreign Minister Abbas Araghchi said this weekend that a "new understanding" was taking shape in the talks and that Iran would start work on a full draft text for negotiators to discuss. Iranian officials said in April that "an interim deal on the 2015 nuclear accord could be a way to gain time for a lasting settlement". Negotiators have begun drafting proposals for the US and Iran to return to compliance with the nuclear deal.

***(Price Positive)* – Saudi Arabia exports fall due to its voluntary cut in production:** Platts reported that Saudi Arabia drew on its stockpiles in February while exports fell, reflecting the impact of its voluntary 1M bpd production cut. Exports fell 957K MoM to 5.63M bpd in February, breaking a seven-month run of increased shipments. Total output was down to 8.15M bpd from 9.10M in January, while inventories fell 137.21M barrels in February to 134,572M barrels, the lowest since JODI began compiling figures in Jan-02.

***(Price Positive)* – Chinese imports from Saudi Arabia rise on stronger demand and less port congestion:** China's crude imports from Saudi Arabia were up 8.8% MoM in March to 1.85M bpd (though below the 1.94M bpd from April), allowing Saudi Arabia to retain its position as China's biggest supplier for a seventh-straight month. Some of the gains were driven by a clearing of congestion in Shandong ports, which had previously slowed oil arrivals. Arrivals from Saudi Arabia are expected to drop further in April given the voluntary 1M bpd supply cut and the recent increase in prices of Arab light crude for the Asian market.

***(Price Positive)* – China's oil-product exports could rise more than 30% in 2021:** Platts reports that analysts expect China's oil-product exports to rise by 31.7% YoY in 2021 as the recovery in the jet-fuel market and an improving global economic backdrop supports demand. The country's product exports dropped 17.4% in 2020 on pandemic impacts on jet-fuel demand.

***(Price Positive)* – Vehicle miles traveled tops 2019 levels in the US for first time since before the pandemic.** Vehicle miles traveled on US interstates ended the week of April 11 slightly higher than 2019 levels. A large portion of the boost was from trucking, which rose 7% vs the same period two years ago. Weekly passenger miles were just 1% below their 2019 level, but much higher than the -40% YoY for some points during the pandemic.

***(Price Positive)* – Shutdown of Dakota Access could bring 400K bpd off the market:** The operators of the Dakota Access oil pipeline argued in a federal court that the system's shutdown would be even more harmful than previously anticipated. The pipeline began operating in 2017 and was the biggest system carrying oil from the Bakken shale basin of North Dakota and Montana (and transports 570K bpd) but has been engaged in legal battles with Native American tribes and activists since before the line started construction. The DC Court canceled a permit allowing the pipeline to operate below the Lake Oahe waterway in North and South Dakota. The US Army Corp of Engineers will conduct an environmental review to decide on the line.

***(Price Positive)* – Interior Secretary Haaland rescinded a previous interior department order to expand available acreage for oil and gas leasing in the National Petroleum Reserve in northern Alaska**. Around 18M acres were made available for leasing in December, up from the ~13M acres in a previous Obama administration plan. This means less potential output.

***(Price Positive)* – New US sanctions to Russia do not target the energy sector but could signal moves to come:** Platts reports that while the US sanctions issued against Russia on April 15 do not specifically target the energy sector, but analysts note the structure of the sanctions leaves room for stricter moves to come. It notes that future targets could be the Nord Stream 2 pipeline (which has been the target of US criticism) or even energy projects in Russia or its overseas joint ventures.

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 45% surge over the past two years, this rally has garnered limited headlines, unlike the tech sector. The total market of the precious metal 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 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 could experience surging real rates would be 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. Our constructive view is that the emerging world will recreate a gold-prone cycle, such as the one experienced in 2001-2011. Gold bull markets can 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 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).

Gold is cheap relative to palladium, though fairly valued relative to silver. The Gold/Silver ratio is at 66.7 and is right at its 20-year average of 66.25x, suggesting that gold is just slightly 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$1,740/oz. Meanwhile, the Gold/Palladium ratio is at 0.65, well below its 20-year average of 1.84x, suggesting that gold is cheap relative to palladium, or palladium is even more expensive than gold.

Negative drivers for gold

Gold in real terms: Given the global deflator (now at 1.14535), 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$1,564. Therefore, in real terms, gold continues to trade well above its 20-year average of US$1,004. For the gold price to stay near its historical average in real terms, the nominal price (or equilibrium price) must remain near US$1,149.

Gold to oil: This ratio is at 29.22, still well above its 20-year average of 17.74x. Considering our fundamental fair value for WTI oil at US$60 and assuming that the function utility of both commodities will remain unchanged, the price of gold must approach US$1,064 for this ratio to remain near its LT average.

EXCHANGE RATES

Flow analysis & Fundamental targets

EUR-USD: Target 1.19 (Buy USD at 1.23, Sell USD at 1.16)
USD-JPY: Target 106.4; **EUR-JPY**: Target 126.6
GBP-USD: Target 1.41; **EUR-GBP**: Target 0.84
USD-CHF: Target 0.89; **EUR-CHF:** Target 1.06
USD-MXN: Target 21; **EUR-MXN:** Target 25
USD-BRL: Target 5.30; **EUR-BRL:** Target 6.31
USD-ARS: Target 140
USD-INR: Target 74
CNY: Target 6.50
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	-8,09	2,24	32,1	-35,3	-3,1	**-0,24**
USD vs G10	-8,43	2,68	32,7	-35,6	-2,3	**-0,30**
EM	-0,33	0,44	3,9	-1,0	1,3	**-1,10**
EUR	12,16	-1,67	25,1	-8,6	11,2	**0,10**
JPY	-6,92	-0,76	6,1	-15,0	-6,0	**-0,14**
GBP	2,19	0,32	4,3	-6,5	-0,9	**1,08**
CHF	-0,22	-0,61	2,2	-6,0	-1,7	**0,64**
BRL	-0,47	-0,01	0,7	-0,8	-0,2	**-0,73**
MXN	-0,09	0,41	3,3	-0,7	1,1	**-1,11**
RUB	0,22	0,04	1,2	-0,3	0,3	**-0,28**
AUD	-0,14	-0,59	6,1	-5,2	-0,3	**0,04**
CAD	1,05	0,65	6,1	-5,0	0,3	**0,28**

Positive
Neutral-Positive
Neutral-Negative
Negative

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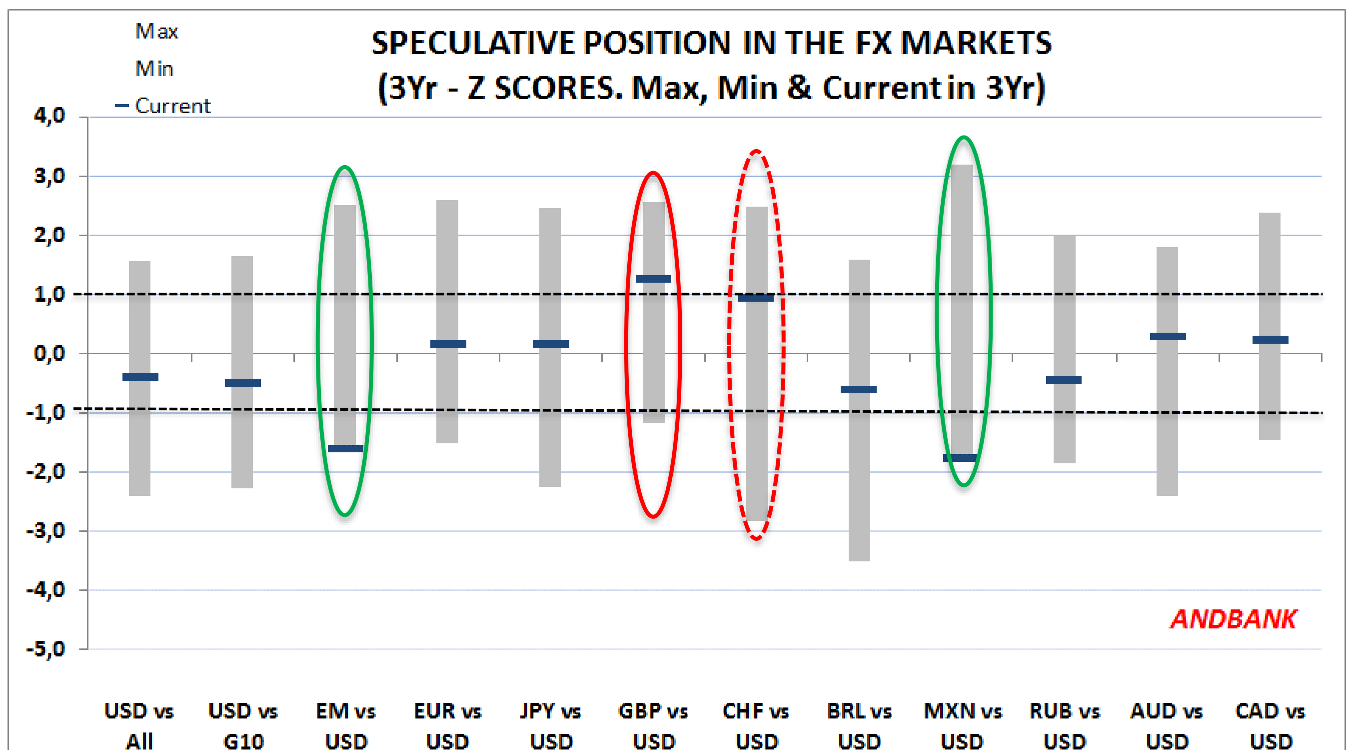

The currencies we technically favor are circled in green

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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*
Equity	USA - S&P 500	5,5%	11,5%	4.188	4.023	-3,9%
	Europe - Stoxx Europe 600	2,8%	10,3%	439	444	1,1%
	Euro Zone - Euro Stoxx	3,2%	11,6%	443	432	-2,5%
	SPAIN - IBEX 35	2,2%	7,8%	8.682	8.154	-6,1%
	MEXICO - MXSE IPC	2,5%	11,0%	48.924	52.305	6,9%
	BRAZIL - BOVESPA	4,5%	1,3%	120.595	114.303	-5,2%
	JAPAN - NIKKEI 225	-1,3%	5,6%	28.992	30.029	3,6%
	CHINA - SHANGHAI COMPOSITE	0,2%	-0,9%	3.443	3.417	-0,7%
	CHINA - SHENZEN COMPOSITE	2,8%	-2,0%	2.282	2.405	5,4%
	INDIA - SENSEX	-0,1%	1,3%	48.944	60.962	24,6%
	VIETNAM - VN Index	3,7%	10,5%	1.220	1.399	14,7%
	MSCI EM ASIA (in USD)	3,4%	5,2%	750	728	-3,0%
Fixed Income Core countries	US Treasury 10 year Govie	1,2%	-5,0%	1,58	1,80	-0,7%
	UK 10 year Gilt	0,2%	-4,5%	0,77	0,80	0,2%
	German 10 year BUND	-0,6%	-2,8%	-0,25	-0,25	-0,2%
	Japanese 10 year Govie	-0,1%	-0,5%	0,08	0,25	-1,3%
Fixed Income Peripheral	Spain - 10yr Gov bond	-0,7%	-2,9%	0,40	0,35	0,7%
	Italy - 10yr Gov bond	-1,4%	-2,2%	0,81	0,50	3,1%
	Portugal - 10yr Gov bond	-1,7%	-3,3%	0,40	0,35	0,6%
	Ireland - 10yr Gov bond	-0,6%	-3,5%	0,10	0,15	-0,4%
	Greece - 10yr Gov bond	-0,3%	-1,9%	0,89	1,35	-3,1%
Fixed Income Credit	Credit EUR IG-Itraxx Europe	0,2%	-0,1%	50,66	55	-0,2%
	Credit EUR HY-Itraxx Xover	0,6%	0,4%	249,63	250	1,3%
	Credit USD IG - CDX IG	0,2%	-0,1%	51,29	60	0,1%
	Credit USD HY - CDX HY	0,9%	1,4%	271,86	275	1,8%
Fixed Income EM Europe (Loc)	Turkey - 10yr Gov bond (local)	3,8%	-38,5%	17,83	16,00	26,8%
	Russia - 10yr Gov bond (local)	0,0%	-7,4%	7,05	6,60	8,4%
Fixed Income Asia	Indonesia - 10yr Gov bond (local)	2,4%	-2,6%	6,42	5,50	11,7%
	India - 10yr Gov bond (local)	1,0%	0,6%	6,05	5,50	8,5%
(Local curncy)	Philippines - 10yr Gov bond (local)	3,8%	-7,1%	3,98	5,00	-5,5%
	China - 10yr Gov bond (local)	0,3%	0,7%	3,19	2,20	10,1%
	Malaysia - 10yr Gov bond (local)	1,9%	-2,8%	3,11	2,30	8,6%
	Thailand - 10yr Gov bond (local)	0,3%	-4,0%	1,63	0,81	7,7%
	Singapore - 10yr Gov bond (local)	0,9%	-5,8%	1,59	1,50	1,8%
	Rep. Korea - 10yr G. bond (local)	-0,7%	-2,3%	1,97	1,90	1,9%
	Taiwan - 10yr Gov bond (local)	0,1%	-0,7%	0,37	1,35	-7,6%
Fixed Income Latam	Mexico - 10yr Govie (Loc)	1,8%	-9,5%	6,65	7,30	-0,7%
	Mexico - 10yr Govie (USD)	1,0%	-4,6%	3,28	3,55	0,0%
	Brazil - 10yr Govie (Loc)	2,5%	-15,5%	9,14	8,80	8,9%
	Brazil - 10yr Govie (USD)	2,2%	-5,1%	4,21	4,55	0,2%
Commodities	Oil (WTI)	1,3%	28,5%	62,4	60,00	-3,8%
	GOLD	3,9%	-6,2%	1.779,1	1.900	6,8%
Fx	EURUSD (price of 1 EUR)	2,6%	-1,2%	1,207	1,19	-1,4%
	GBPUSD (price of 1 GBP)	1,1%	1,7%	1,39	1,41	1,5%
	EURGBP (price of 1 EUR)	1,6%	-2,9%	0,87	0,84	-2,8%
	USDCHF (price of 1 USD)	-2,7%	3,3%	0,91	0,89	-3,0%
	EURCHF (price of 1 EUR)	-0,1%	2,1%	1,10	1,06	-4,3%
	USDJPY (price of 1 USD)	-1,3%	4,9%	108,33	106,40	-1,8%
	EURJPY (price of 1 EUR)	1,2%	3,7%	130,78	126,62	-3,2%
	USDMXN (price of 1 USD)	-3,4%	0,2%	19,91	21,00	5,5%
	EURMXN (price of 1 EUR)	-0,8%	-0,8%	24,03	24,99	4,0%
	USDBRL (price of 1 USD)	-5,9%	4,7%	5,44	5,30	-2,5%
	EURBRL (price of 1 EUR)	-3,5%	3,5%	6,56	6,31	-3,9%
	USDARS (price of 1 USD)	1,5%	10,9%	93,27	140	50,1%
	USDINR (price of 1 USD)	2,6%	2,2%	74,64	74,00	-0,9%
	CNY (price of 1 USD)	-1,3%	-0,6%	6,48	6,50	0,3%

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

UPWARD REVISION DOWNWARD REVISION

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