

OSTRUM VIEWS MARCH 2021

Conclusions from the monthly strategy investment
committee

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 **NATIXIS**
INVESTMENT MANAGERS

THE CIO LETTRE

How high?



Ibrahima Kobar
CIO Ostrum

A classic dilemma in an economic recovery phase: economic policy must not be tightened too quickly at the risk of endangering a convalescent recovery, it must not be tightened too late at the risk of creating activity overheating or financial bubbles. We are at the heart of this dilemma, particularly with the debate on the U.S. stimulus package, an additional \$1.9 trillion, which some people think is exaggerated. How far should we go in terms of economic stimulus? The authorities have chosen their side, they prefer the risk of doing too much to the risk of doing too little.

Markets have moved in the direction we expected, rising rates, good performance of risky assets. However, they did so more quickly than expected, so that signs of overheating appeared. The rise in interest rates has led to a correction in certain "high-duration" equities, such as tech, which are benefiting from the economic recovery. It is the market equivalent of the economic policy dilemma: rates that rise because the horizon clears and it is positive for all assets, rates that rise too fast out of fear of overheating or inflation, and markets stumble. How high can the rates go without destabilizing?

For the time being, the central banks, the Fed and ECB, guarantee very favorable monetary conditions. Risky assets should remain well-oriented even if valuations are already anticipating a lot of good news. But hesitations between too much and too little could end up awakening volatility.

Eco

ECONOMIC VIEWS

THREE THEMES FOR THE MARKETS

1 OVERHEATING

The Biden plan, while the US economy appears resilient, raises concerns about the potential risk of overheating.

The very generous fiscal stimulus could then prove oversized.

2 CENTRAL BANKS

Central banks are increasingly "tested" by markets. Rate hikes are gradually priced-in.

This could lead to even more movement on long rates.

3 INFLATION

Between fiscal stimulus and very lax monetary policy, fears of inflation are rising.

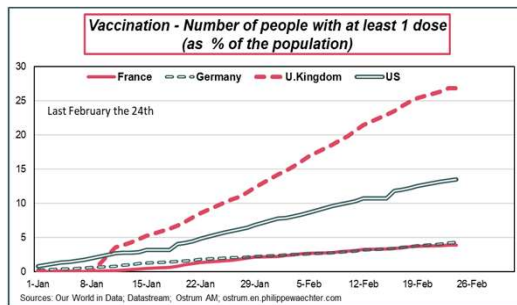
There is a short-term risk associated with the surge of commodities. And a medium-term risk if anticipation stabilizes at a high level.

	2021 expectations										
	2020	Growth (yearly average)				Inflation (CPI)					
		Bloomberg Consensus			Ostrum		Bloomberg Consensus			Ostrum	
		Forecast	3 month change		Forecast	Gap to consensus	Forecast	3 month change		Forecast	Gap to consensus
World	-3.8	5.4	0.3	⬆️	5.5	0.1	2.8	0.1	⬆️		
USA	-3.5	4.9	1.1	⬆️	5.5	0.6	2.2	0.3	⬆️	2.0	-0.2
Euro Area	-7.0	4.2	-0.4	⬆️	5.0	0.8	1.1	0.2	⬆️	1.0	-0.1
UK	-10.2	4.6	-0.8	⬆️	2.0	-2.6	1.5	0.1	⬆️	2.0	0.5
Japan	-5.2	2.7	0.2	⬆️	3.0	0.3	-0.1	-0.2	⬆️	-0.2	-0.1
China	2.3	8.4	0.2	⬆️	8.5	0.1	1.6	-0.3	⬆️	1.8	0.2

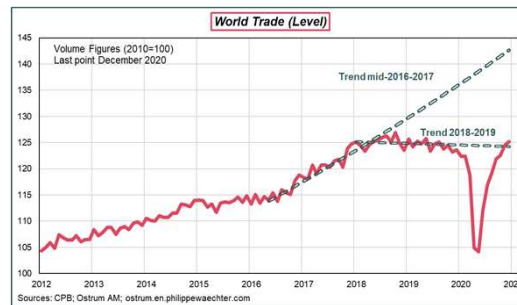
Source : Bloomberg & Ostrum

KEY MACROECONOMIC SIGNPOST

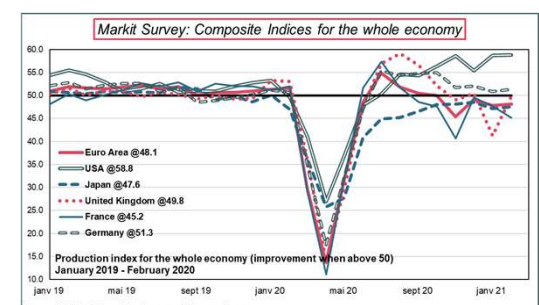
- The health crisis continues to dominate macroeconomic dynamics. Uncertainty leads to excess savings behaviors.
- However, the situation is beginning to change due to the rate of vaccination in several countries. This is the case in the United Kingdom, where the government plans to relax sanitary constraints and containment. In the US, the combination of vaccines and health measures imposed by Biden is changing the profile of the epidemic. Europe is lagging vaccination and is still causing caution in behavior.
- The pace of economic activity is robust in the manufacturing sector (cf. world trade). The services sector is strong in the USA but weak in the Eurozone. This translates into rather strong prospects across the Atlantic and less dynamic in Europe.
- However, macroeconomic dynamics are still insufficient to be self-sufficient on both sides of the Atlantic. Economic policies will have to remain active in the coming months to compensate for the prudent behavior of economic actors. The measures implemented in France, for example, will have to be extended even if their effectiveness decreases.
- China, moreover, has a more selfish behaviour since its growth does not cause a strong impulse on the world economy. It exports a lot, but it doesn't matter. Western countries buy Chinese products, but they sell very little of them. Given the size of China, it's a drag on the recovery of the rest of the world.



UK headstart is remarkable



World trade recovery

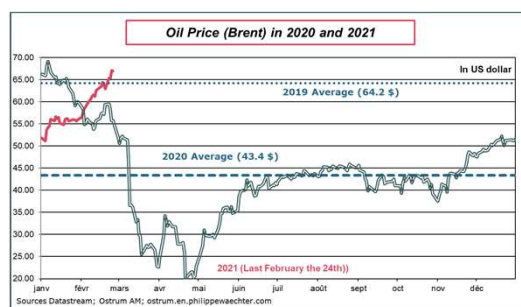


US leads, Europe lags

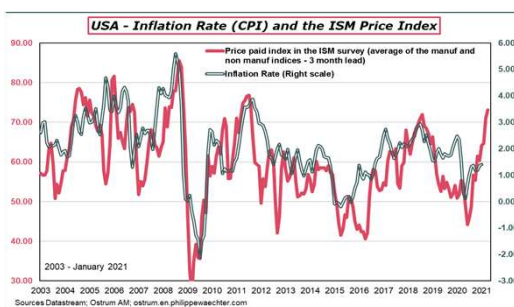
KEY MACROECONOMIC SIGNPOST

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- Inflation will accelerate in the coming months due to higher oil prices. The underlying indicators of inflation, the labour market in particular, do not suggest a rapid acceleration. The Biden Plan can alter this balance.
- Active economic policy will require central banks to remain very accommodative and interventionist in order to maintain low interest rates to ensure debt sustainability.
- The important point will be on the American recovery. Joe Biden's idea is to leave no one on the side of the road. The middle class has been affected by globalization but also by the pandemic. This broad policy could have an impact on the global economy as a whole. Domestic demand will accelerate across the Atlantic and increase imports.
- Europeans can take advantage of it as they did after the Reagan revival in the early 1980s. The situation is not directly comparable because the instruments are not the same and also because Reagan's policy brought the world into financial globalization. That had been a source of acceleration of trade. That is not the pattern that currently works.
- Europe must do everything to take advantage of this impetus in order to emerge from this crisis quickly.



Oil price rises, a Biden effect



What will boost US and Euro inflation rate ?



Worried households are eager to save

BUDGETARY POLICY

Too much of a good thing

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THE AMERICAN DEBATE

The Biden package would add 1,900 billion dollars in stimulus. This would bring the deficit to nearly 4 trillion and would therefore constitute an extraordinary stimulus. It should also be noted that the deficit does not disappear afterwards; there is almost \$1trillion a year on average over the next five years. In total, this means a cumulative deficit of \$9 trillion over six years. Crazy figures, to give an order of magnitude recall that the GDP of the United States in 2020 was 21,000 billion.

The risk is, therefore, also to push the economy into overheating.

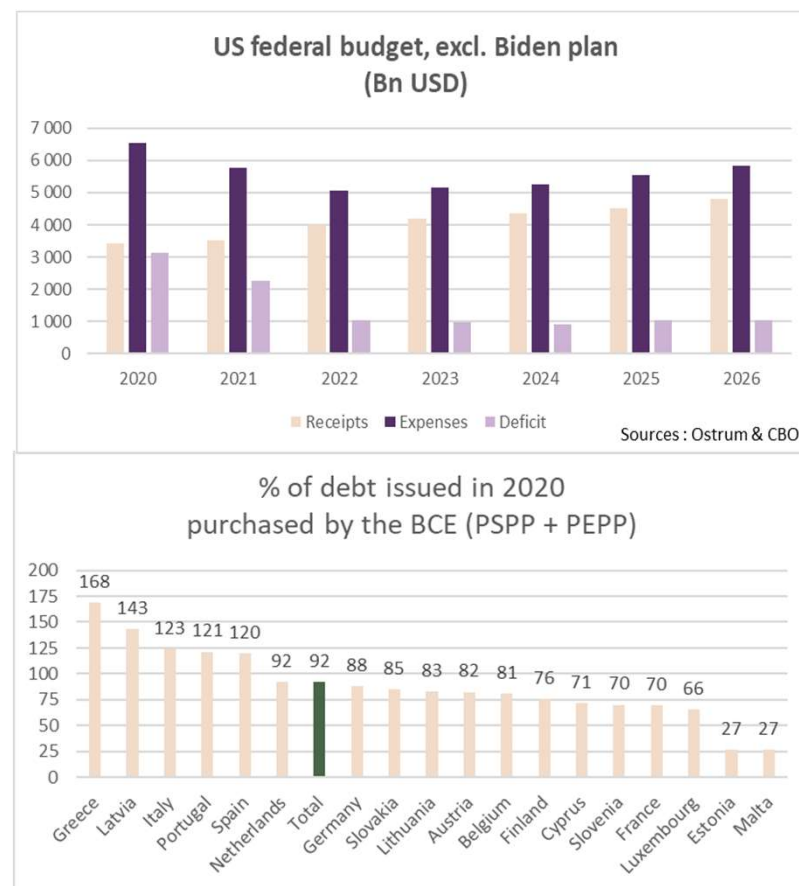
EUROPE MORE « REASONABLE »

In the Eurozone, the governments adopt new support measures (32 billion euros in Italy in particular) and present recovery and resilience plans to the European Commission in order to benefit from the 1st installments of the European recovery plan (2nd semester).

It is becoming increasingly clear that the deficit will not go away next year. The debate is focused on the indefinite postponement of fiscal consolidation.

FUNDED WITH VERY LOW YIELDS

The maintenance of very low interest rates, accentuated by the massive purchases of bonds by central banks, allows countries to benefit from a clear reduction in debt service and thus reduce fears about sustainability.



MONETARY POLICY

Central banks to remain very accommodative

BCE : QE AND TLTRO REINFORCED

The current pace of purchases is consistent with the increase of the PEPP from €500 billion to €1,850 billion and its extension to the end of March 2022. The ECB also reiterated unambiguously its desire to maintain very favorable financial conditions for a long time. This year's QE is larger than the expected net issuance of sovereign paper.

The TLTROs offered to banks on very favorable terms were extended by one year, until at least June 2022, to encourage them to lend.

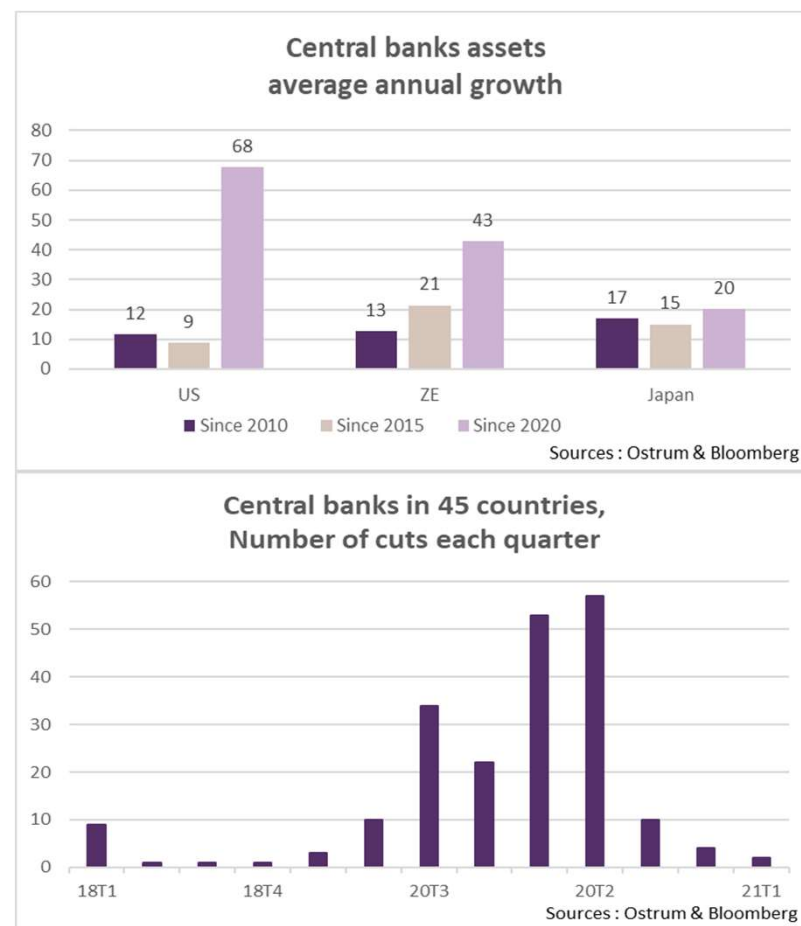
FED : REINFORCED GUIDANCE

The Fed has committed to maintaining a very accommodative monetary policy over the long term despite encouraging signs of recovery and a colossal fiscal stimulus.

The size of the upcoming deficit and therefore the very high funding requirements suggest that QE will need to be increased, it is very plausible that it will be extended beyond 2021.

INFLEXION POINT

In the rest of the world, central banks maintain a very lax policy. However, we are beginning to see debates about an exit from this policy, even though this is very premature at the moment.



STRATEGIC VIEWS

Exuberance

8

Synthetic market views: a market that gives the benefit of the doubt

The announcement of vaccines and the US election in early November cleared the horizon. Biden's U.S. stimulus package and the extremely accommodative policy from central banks have provided a boost to the markets. The expected scenario is quite positive, despite growth figures, which remain tepid. If the momentum is undeniable, it seems to us that the level of the markets calls for a pause and on a number of asset classes our expectations for the end of March are close to current prices.

We maintain a risk bias on our portfolios (momentum required) but a performance in March similar to that seen since the beginning of the year, would place the markets on unreasonable valuations. We are expecting a trend that continues but that calms down.

Allocation recommendations: choosing your risks

With markets that seem very optimistic, we remain cautious about allocations. Peripherals should tighten, especially on long maturities. For credit, we favor IG as well as ABS and fear a deviation of the HY. The equity market should stabilize, so we must come back to some promising themes in the long term. On emerging markets, the stabilization of the EMBIGD at 350 bp offers an attractive yield, even with a hedged currency risk.

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26/02/2021*

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STRATEGIC VIEWS – ASSET CLASSES – 1/2

9

G4 rates

01

After the very rapid and simultaneous rise in rates in all OECD countries, central banks began to give voice. The increase is expected to subside.

02

Action by central banks should also affect prices. In Europe in particular, after two months of positive net issuance, the rest of the year will be negative when QE is accounted for.

03

So we expect much lower growth over March. And a steepening of the curve with intermediate maturities at risk

Other sovereigns

01

Net issuance (post QE) will be negative in Europe for the rest of the year, so peripherals should be well supported. Spreads should tighten.

02

The implementation of the European recovery programme during the year should also provide a support element.

03

Much of the rise on CAD, AUD, NZD, SEK, NOK and CHF rates seems to be behind us after the strong movement recorded. We are globally neutral.

Inflation

01

The rapid rise in raw materials will push inflation, albeit temporarily, to higher levels. The shock can be quite large.

02

The inflation curve has therefore flattened considerably (it is reversed in Europe and the United States) and this movement could continue.

03

Oil can continue to grow in the short term. The sharp rise in other commodities, particularly metals, will also support the asset class.

STRATEGIC VIEWS – ASSET CLASSES – 2/2

10

Credit

01

Fundamentals are improving on credit with the economic recovery. Default rates are currently lower than expected.

Attention, however, to the resumption of M&A which is often harmful to bonds credit.

02

Technical factors are also an important support, with in particular a volume of net emissions that should remain very limited, especially after taking QE into account.

03

Prudence on high yield, where valuations appear tense after two months of tightening in 2021.

Stock market

01

Immediate prospects are not encouraging. Valuations are very tense. The market has already stalled after a very good performance.

02

The fundamentals remain good, the season of results has been supportive. It is also encouraging for the future even if the expectations of analysts seem too high.

03

With valuations that we expect to remain stable, the market will mainly follow the evolution of profits. We expect a performance of 0% at 3 months, and 5% by year-end.

Emerging

01

We expect the EMBI to stabilize at 350 bps. This is an interesting port for the investor, whereas the risk profile seems moderate to us.

02

It should also be noted that currency hedging is much less expensive than it was. We currently estimate it to be close to 90bp, which leaves a significant carry.

03

Nevertheless, it is necessary to be discriminating in terms of investments. We are particularly positive in Asia where the economic rebound is stronger.

MARKET VIEWS

Asset classes

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		24-Feb-21	Forecast	
			Mar-21	Dec-21
Sovereigns				
USA	Fed Funds	0.25	0.25	0.25
	10-year	1.53	1.50	1.30
UK	10-year	0.78	0.80	0.10
Japan	10-year	0.15	0.13	0.00
Euro Area	BCE, deposit	-0.50	-0.50	-0.50
Germany	2-year	-0.65		-0.60
	10-year	-0.23	-0.27	-0.30
	30-year	0.24		0.20
France	10-year	0.03	0.03	-0.05
	Spread	23	30	25
Italy	10-year	0.80	0.63	0.60
	Spread	118	90	90
Spain	10-year	0.48	0.38	0.25
	Spread	61	65	55
Portugal	10-year	0.37	0.28	0.20
	Spread	56	55	50

		24-Feb-21	Forecast	
			Mar-21	Dec-21
Credit / Spreads				
Euro Inflation Swap 10-ans		1.32	1.25	1.21
Libor OAS Spreads				
IG		59	57	60
HY		287	302	300
EMBI Spread		350		350

FX				
EUR/USD		1.22		1.25

Stock market				
S&P 500		3830		3850
Euro Stoxx		411		430
FTSE 100		6652		6300

Commodities / Volatility				
Brent Oil Prices		65.89	65.00	50.00
Gold		1770	1850	1900
VIX		29.92		20/35

Additional notes

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Siège social : 43, avenue Pierre Mendès-France – 75013 Paris – www.ostrum.com

