Ostrum ASSET MANAGEMENT

OSTRUM PERSPECTIVES APRIL 2021

Conclusions from the monthly strategy investment committee

THE CIO LETTER

Transatlantic divergence

Once again, the evolution of the pandemic dictates that of markets and the economy. The different paces of vaccination from one area to another explain the growing gap between the American recovery and that of continental Europe. The short-term problem is that of a lag in the cycles between countries with the United States emerging from the pandemic as several European countries take new restriction measures. The problem is also medium-term: the longer the crisis, the greater the consequences and the more difficult the recovery. This divergence is of course exacerbated by the very ambitious fiscal policy in the United States with the Biden recovery, while efforts are more measured in Europe. The lag will only partially be recouped.

This lag is reflected in the financial markets, particularly with the divergence of the US and European yield curves. The debate on the exit of the current Fed policy has started: even if Powell tries to convince that status quo will be maintained until 2023, the market is starting to play more and more with the idea of an increase in Fed funds in 2023, or even in 2022.

This context is typical of an exit from the crisis: rising rates, shrinking spreads and risky assets, particularly equities, which are well oriented. Beyond this general picture, the differences in the speed of recovery by country and by sector make the market environment very complicated. These are the equity indices that are progressing with little volatility while the sector rotation is one of the strongest recorded. The situation is therefore an opportunity for management because this differentiation allows to generate performance.

Ibrahima Kobar

CIO Ostrum

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ECONOMIC VIEWS

THREE THEMES FOR THE MARKETS

Eco

1 VACCINATION

The acceleration of vaccination in some countries is excellent news. It allows us to anticipate a long-term recovery this time.

Differences in the pace of vaccination explains the divergence in growth performance.

2 CENTRAL BANKS

We have passed a point of inflection, the overall trend is a global monetary tightening, albeit slow.

The ECB and the Fed remain extremely accommodating even though the Fed is increasingly tested by the market.

3 OVERHEATING

The magnitude of the Biden recovery raises concerns about overheating already present in some sectors (real estate). In this case, monetary policies could be reversed earlier than planned.

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

		2021 expectations									
		Growth (yearly average)					Inflation (CPI)				
	2020	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	5.6	0.4	↑	5.7	0.1	2.8	0.1	↑		
USA	-3.5	5.7	1.8	↑	6.0	0.4	2.4	0.4	↑	2.4	0.0
Euro Area	-6.8	4.2	-0.4	↓	4.4	0.2	1.5	0.6	↑	1.4	-0.1
UK	-10.1	4.7	-0.6	↓	3.5	-1.2	1.6	0.1	↑	2.0	0.4
Japan	-5.1	2.8	0.1	↑	3.0	0.2	0.1	-0.1	↓	0.0	-0.1
China	2.3	8.5	0.3	↑	8.5	0.0	1.6	0.0	↓	1.8	0.2

Source : Bloomberg & Ostrum

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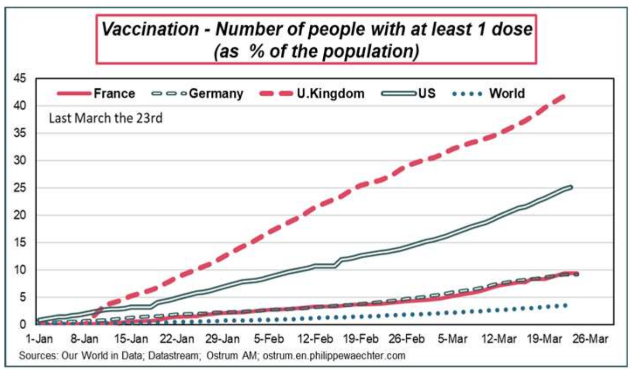
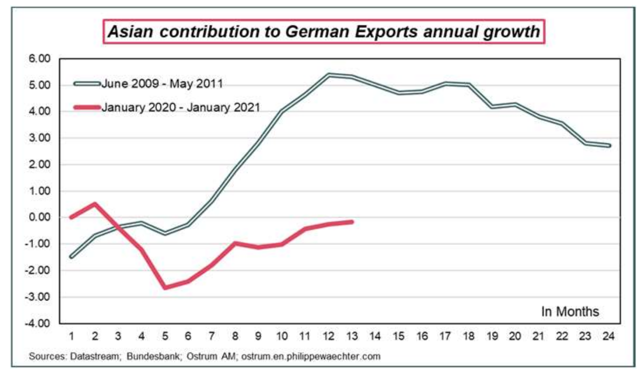
KEY MACROECONOMIC SIGNPOSTS

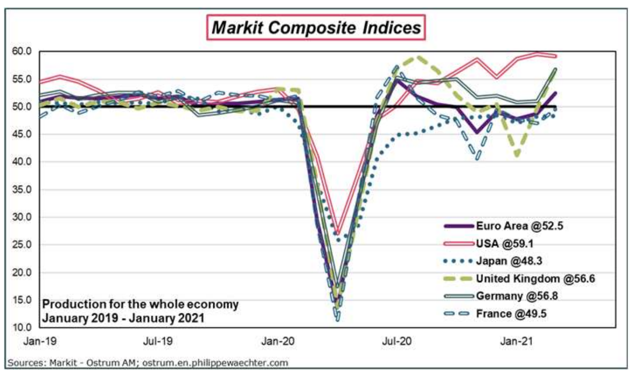
- The dynamic of vaccination still determines the recovery phase of the activity. This should reduce uncertainty in behaviors that are still too cautious, limit risks to health systems and reduce the likelihood of the virus spreading. The Anglo-Saxon countries have high vaccination rates, this is not the case of Europe which remains at the mercy of a recovery of infected patients as is the case in France.
  The other current fragility is the low overall vaccination rate. This will inevitably limit international cooperation to the risk of accentuating self-centered growth in the major regions.
- However, world trade rebounded sharply in January 2021. It is almost 6% above the figure observed a year earlier. It is now well beyond the trend observed in 2018-2019 during the trade dispute between China and the United States.
- Let us not rejoice too quickly because it is China and Asia that contribute mainly to the improvement of trade. The United States and Europe have very small contributions. Asia's dynamics are self-sustaining with limited contributions from the rest of the world. This is a big difference from what was observed in 2010 after the financial crisis.
- To be convinced, we can compare the contribution of Asia in the growth of German exports at the end of this financial crisis and now. We note that the ripple effect is much less, forcing Europe to define its own source of growth. The US recovery, due to its scale, could however have a significant impact on the pace of the euro area's GDP.

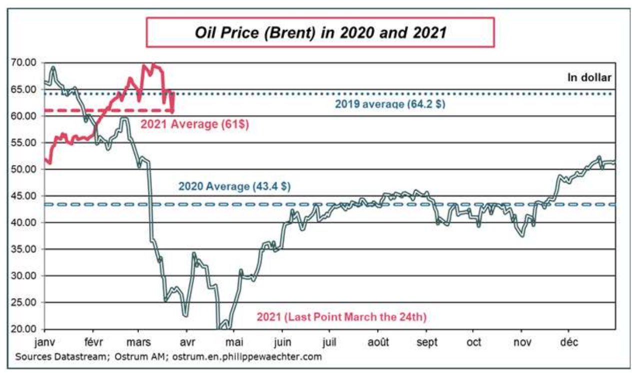


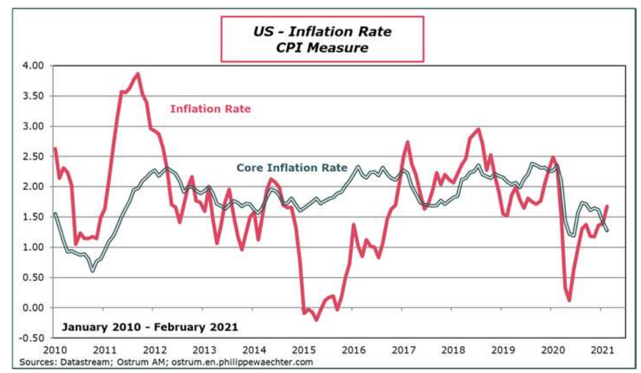


KEY MACROECONOMIC SIGNPOSTS

- The short-term dynamics measured by business surveys are bullish. This expansion began to be noticeable in February and is confirmed in March. Nevertheless, one can be a little surprised by the strength of the manufacturing sector which in Germany, and according to the Markit survey, is at its highest. The American economic improvement and Asian dynamism may have swept the German and European economies over the past two months (world trade figures refer to January).
- In Europe, despite health measures, there is a stronger service sector. The unrestricted sectors have an activity which would tend to offset that of the constrained sectors. This may be due to the strength of the manufacturing sector.
- Oil prices continue to reflect expectations of stronger growth over time. The year-to-date average price is $61 per barrel, compared to just over $40 per barrel in 2020. This will necessarily result in an increase in the inflation rate with a positive contribution from energy (it was negative in 2020). The underlying part is expected to change little in the coming months due to persistent labor market imbalances. This will not encourage central banks to change their strategy. They do not react to crude oil price movements as transmission to wages and underlying inflation is reduced.
- This acceleration in inflation expectations is partly reflected in the development of long-term interest rates. These, especially in the US, are also driven by the improved growth prospects associated with the Biden plan. As the ECB remains very active, the rate gap between the US and the Eurozone will increase and encourage the rise of the US currency. Europe will benefit from the recovery through more imports but also through a competitive effect.







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26/03/2021

BUDGETARY POLICY

Still need for very active fiscal policies

THE MASSIVE AMERICAN REFLATION

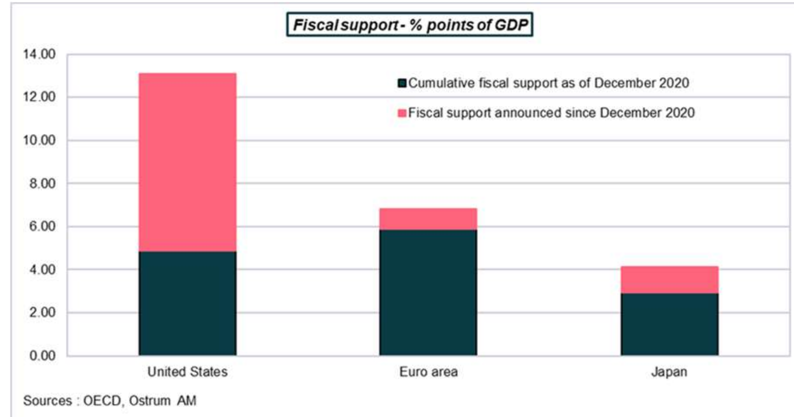
The $1,900 billion Biden plan is focused on U.S. households to create the conditions for faster demand and a return to full employment. Attention is now focused on the next program, which is expected to reach $3,000 billion and include investments in infrastructure, for energy transition and education. It should be partly financed by tax increases, particularly on the wealthiest businesses and households. The discussions promise to be intense between the Republicans and the Democrats.

MORE TIMID IN EUROPE

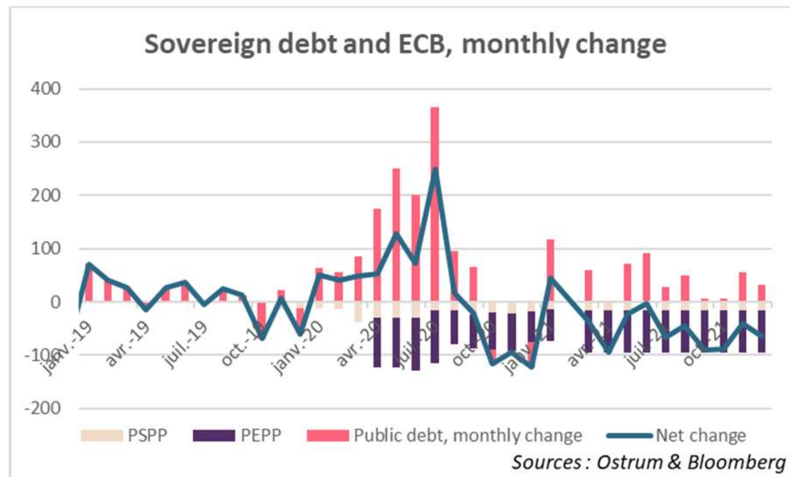
Faced with the worsening health situation, governments are extending support measures to address the crisis. The Italian government has announced new measures, between 20 and 30 billion euros, after a budget extension of just 32 billion. The first payments within the framework of Next Generation EU will not take place before the summer and will be conditioned to the validation of the recovery and resilience plans presented by the Member States.

FUNDED WITH VERY LOW YIELDS

It is essential that governments continue to benefit from low interest rates to finance their emissions and reduce debt servicing. This is facilitated by massive bond purchases by central bank.



Sources : OECD, Ostrum AM



Sources : Ostrum & Bloomberg

MONETARY POLICY

Very accommodative central banks in developed countries

BCE : PEPP ACCELERATION

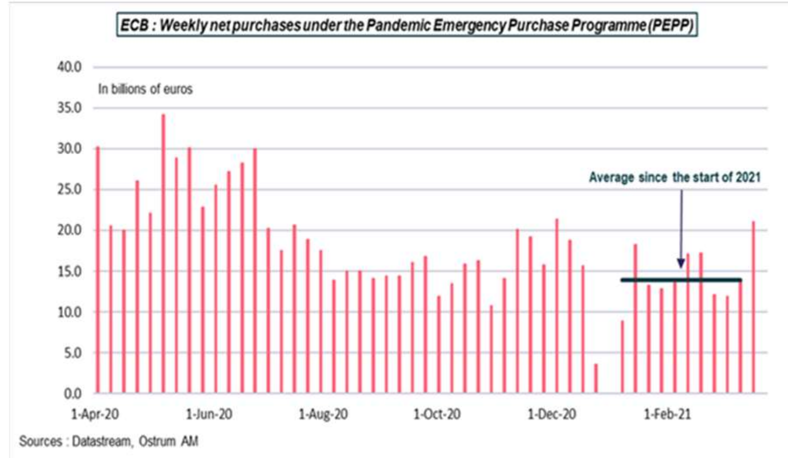
In response to the contagion of rising US rates on euro area rates, the ECB announced a significant acceleration in the pace of its asset purchases over the coming quarter as part of its Pandemic Emergency Programme (PEPP). Its weekly net purchases under this program increased sharply the week following its meeting: 21.1 billion euros against 13.9 billion on average since the beginning of the year. The TLTRO 3 transaction in March also met strong demand from banks wishing to benefit from very attractive refinancing conditions: €330.5 billion.

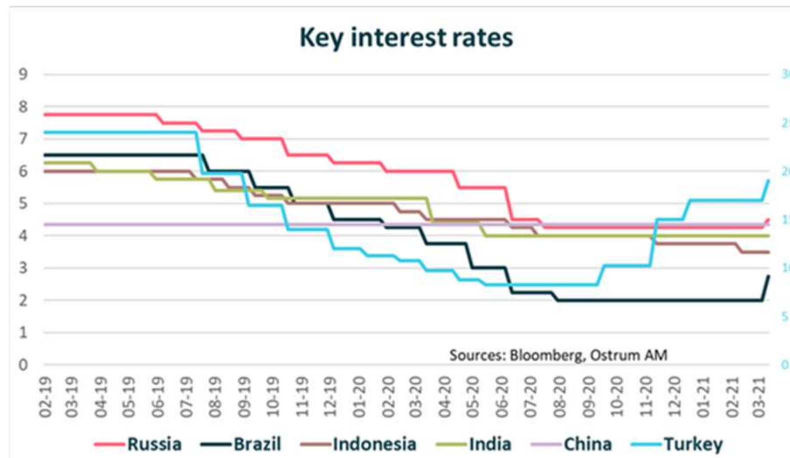
THE FED REMAINS PRUDENT

At the end of its meeting, the Fed stressed the need to maintain very accommodative monetary policy over the long term, with the US economy remaining far from full employment and inflation remaining below the 2% target in the medium term. According to the median of participants' expectations, rates are expected to remain close to zero until at least 2023. The Fed will also continue to purchase assets to the tune of $120 billion per month.

HIKE IN SOME EMERGING COUNTRIES

The rise in US bond rates is forcing some emerging countries to raise their key interest rates (such as Brazil, Russia and Turkey) in order to support their currency weakened by capital outflows.





STRATEGIC VIEWS

On the fence

Strat

Synthetic market views: too early ?

The market is on the fence: after a strong trend since the beginning of the year (rates and stock markets up) market valuations already price in a lot of good news and current valuations are consistent with a rapid overall recovery over the second half of the year. For the uptrend to resume, the economy would have to accelerate more than expected or profit expectations would have to be revised upwards. All this leaves us a little perplexed.

We maintain a slight risk bias on our portfolios but do not significantly reduce the canopy and reduce exposure on certain parts that are too risky. Moreover, our end-of-year targets are relatively close to our targets at the end of April, so the potential of the markets is limited.

Allocation recommendations: discriminant

Peripherals are expected to tighten as PEPP increases. For credit, we favor IG as well as ABS and fear widening pressure in HY which seems expensive to us. The equity market should stabilize, so we must come back to some promising themes in the long term. On the other hand, emerging companies offer interesting prospects with the EMBIGD tightening while offering an attractive port, even with a hedged currency risk.

STRATEGIC VIEWS – ASSET CLASSES – 1/2

G4 rates

01

The rise in rates in the US is expected to continue. The improvement of the cycle, the volume of issues and the Fed's laissez faire should push the Treasury towards 1.8%.

02

The acceleration of the ECB's QE has made it possible to decouple Bunds from Treasuries. This trend is expected to continue and Bund yields may hover about -0.3%.

03

The trend is rather upward in the other countries, although the upward adjustment should be more limited than in previous months.

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 be a supportive element.

03

Much of the increase in non-G4 rates has occurred. Upside potential remains on the CAD and NOK and downside potential on the AUD and NZD markets.

Inflation

01

Market expectations have adjusted sharply. The inflation curve has flattened with the increase in raw materials.

02

We are at a point where market expectations seem consistent with the projected economic scenario. The potential for curve movement is now low.

03

The rate increase, particularly in the Treasury, would therefore be mainly via real rates.

Source: Ostrum. The analyses and opinions mentioned represent the point of view of the author(s) referenced. They are issued on the date indicated, are subject to change and cannot be interpreted as having any contractual value. 26/03/2021

STRATEGIC VIEWS – ASSET CLASSES – 2/2

Credit

01

The low level of spreads on the IG leads us to be cautious on the outlook even though the ECB's QE has dampened volatility.

02

Technical factors are also an important support, with very low net issuance, especially after taking QE into account.

03

We remain cautious on high yield, where valuations appear extended after about 30 bp tightening since the beginning of the year.

Stock market

01

Valuations remain demanding. Even though the market has weathered rate increases.

02

Fundamentals remain good, earnings season has been good. It is also encouraging for the months ahead even if analyst expectations seem too optimistic.

03

Although indices are not very volatile, it is nevertheless worth noting the very violent sectoral and stylistic rotations as market reprices the economic scenario.

Emerging

01

We expect spread tightening in the EMBI from 356 to 345. This is an attractive carry for investors, whereas the risk profile seems moderate to us.

02

It should also be noted that currency hedging is much less expensive than before. We currently estimate it to be in the order of 100bp, which leaves a significant carry.

03

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

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MARKET VIEWS

Asset classes

Sovereigns		25-Mar-21	Forecast Apr-21	Forecast Dec-21
USA	Fed Funds	0.25	0.25	0.25
	10-year	1.62	1.80	2.00
UK	10-year	0.74	0.85	1.00
Japan	10-year	0.09	0.12	0.10
Euro Area	BCE, deposit	-0.50	-0.50	-0.50
Germany	2-year	-0.72		-0.60
	10-year	-0.38	-0.30	-0.30
	30-year	0.18		0.20
France	10-year	-0.13	-0.07	-0.05
	Spread	23	23	25
Italy	10-year	0.59	0.60	0.60
	Spread	118	90	90
Spain	10-year	0.27	0.27	0.25
	Spread	61	57	55
Portugal	10-year	0.16	0.21	0.20
	Spread	56	51	50

Credit / Spreads	25-Mar-21	Forecast Apr-21	Forecast Dec-21
Euro Inflation Swap 10-ans	1.46	1.40	
Libor OAS Spreads			
IG	59	58	60
HY	287	310	300
EMBI Spread	356	345	350
FX			
EUR/USD	1.18		1.25
Stock market			
S&P 500	3866		3900
Euro Stoxx	421		440
FTSE 100	6645		6800
Commodities / Volatility			
Brent Oil Prices	60.94	65.00	60.00
Gold	1734	1800	1600
VIX	22.77		20/35

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