Ostrum
ASSET MANAGEMENT

OSTRUM PERSPECTIVES
MAY 2021

Conclusions from the monthly strategy investment committee

THE CIO LETTER

Good news are already priced

Ibrahima Kobar

CIO Ostrum

Recent economic data have been robust and very consistently above consensus expectations. Similarly, the current reporting season looks rather encouraging. Paradoxically, this observation leads us to be more cautious. On the one hand, the reservoir of good news seems to be running out. On the other hand, the widely known and anticipated progress of vaccination should not provide an additional surprise in the near future. More importantly for the investor, all this good fundamental news already seem to be priced in by financial assets. It is therefore difficult, in a central scenario of reopening and normalizing of the economy, to find a lot of upside potential for many asset classes.

In addition, monetary policy, which was extraordinarily accommodating last year, is starting a slow shift. Several central banks in emerging countries have already raised their key interest rates, the Bank of Canada has reduced its QE. But above all the Fed is beginning to suggest that a tapering could be announced in the second half of the year, while the squabbles within the ECB show that the unity on the current policy is cracking. The central banks may therefore, little by little, be less supportive of the market.

In this context, with an economy still recovering we must remain optimistic, especially in the medium term. But it's not impossible that much of the improvement in this year's valuations is already behind us. It's certainly our view.

Eco

ECONOMIC VIEWS

THREE THEMES FOR THE MARKETS

1 VACCINATION

The acceleration of vaccination is spreading and is great news. It allows us to anticipate a lasting recovery this time around.

The delay in some emerging countries remains a problem that may weigh on the recovery.

2 CENTRAL BANKS

The overall trend is for slow monetary tightening.

The Fed is expected to announce a tapering after this summer and put it in place next year.

Differences in views at the ECB may lead to a reduction in QE.

3 BUDGETARY POLICY

A fundamental part of the recovery momentum is the plan for families announced by Biden.

The ECB report shows the systemic risk of a sharp rise in bankruptcies if government support policies were withdrawn.

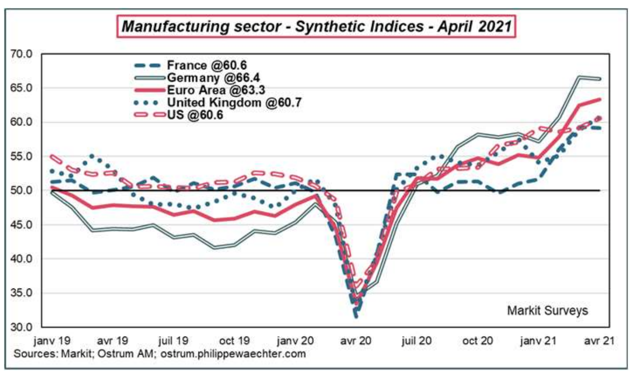
		2021 expectations									
		Growth (yearly average)					Inflation (CPI)				
	2020	Bloomberg Consensus			Ostrum		Bloomberg Consensus			Ostrum	
		Forecast	3 month change		Forecast	Gap to consensus	Forecast	3 month change		Forecast	Gap to consensus
World	-3.8	5.8	0.6	↑	5.7	-0.1	2.9	0.2	↑		
USA	-3.5	6.3	2.2	↑	6.0	-0.3	2.6	0.5	↑	2.4	-0.2
Euro Area	-6.8	4.1	-0.3	↓	4.4	0.4	1.6	0.7	↑	1.4	-0.2
UK	-10.1	5.5	0.8	↑	3.5	-2.0	1.5	0.0	↓	2.0	0.5
Japan	-5.1	2.9	0.3	↑	3.0	0.1	0.1	0.1	↑	0.0	-0.1
China	2.3	8.5	0.1	↑	8.5	0.0	1.6	0.0	↓	1.8	0.2

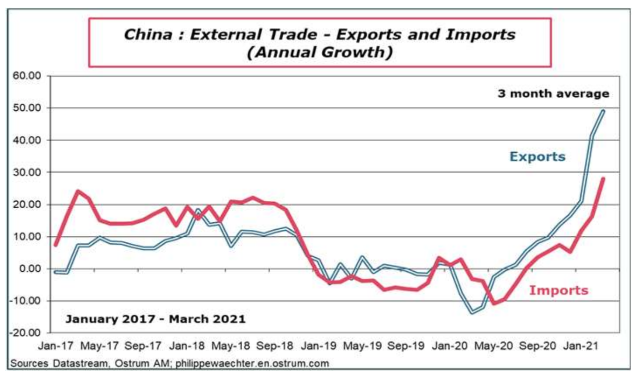
Source : Bloomberg & Ostrum

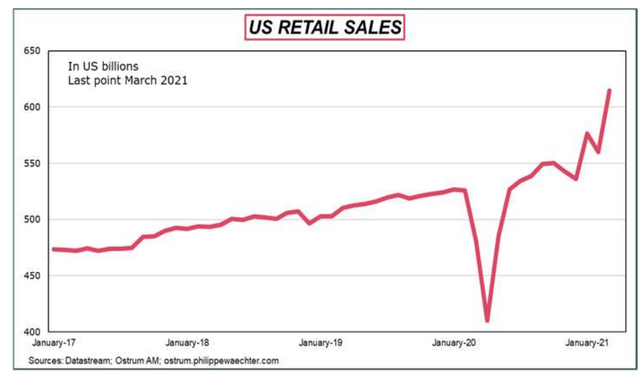
Ostrum ASSET MANAGEMENT

KEY MACROECONOMIC SIGNPOSTS

- The recovery in economic activity is evident. In the manufacturing sector, surveys suggest a rapid acceleration in activity from March. This dynamic has positive effects on the service sector, particularly for those which are linked to the economic cycle but not affected by health constraints. In France, the services index in the monthly INSEE survey fell by 11 points during the November containment, this decline is only 3 points in April 2021.
- The reason for this recovery can be found in Asia and China. There, activity has grown rapidly for several months but without having a strong impact on the expansion of the rest of the world since Chinese imports, in particular, were showing little change. This is no longer the case, the rapid growth in China is now associated with a sharp rise in imports. This translates into an acceleration of orders to manufacturers. In the latter, stocks had been reduced in recent months. As a result, production is in the recovery phase. In the Eurozone, activity in the first quarter had a mixed pace, it will be much more robust in the spring months.
- Europe will also benefit from the US stimulus. With the distribution of checks for $ 1,400 since mid-March, household consumption has risen sharply. At the same time, households have a very optimistic view of the labor market and their income. They will therefore spend these checks and allow the activity to take place over time. This change in tempo also results from the acceleration of vaccinations. This allows many reopening of stores, restaurants… creating as many jobs. In the USA, we can see the importance of the speed of vaccination in reducing uncertainty. Europe is still penalized in this regard.

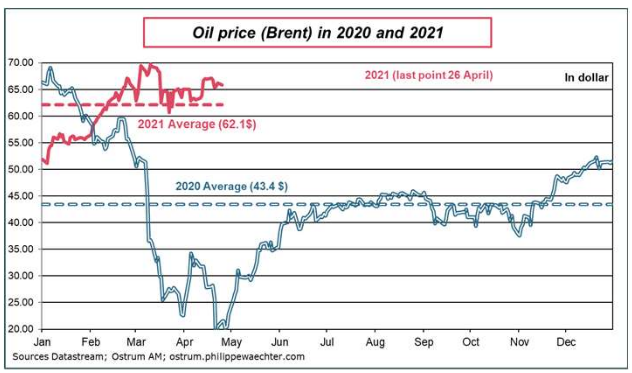


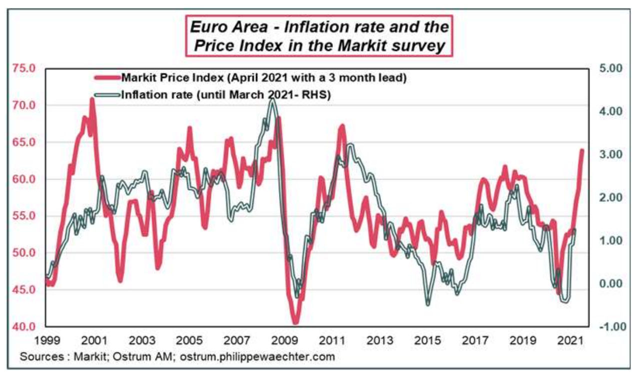


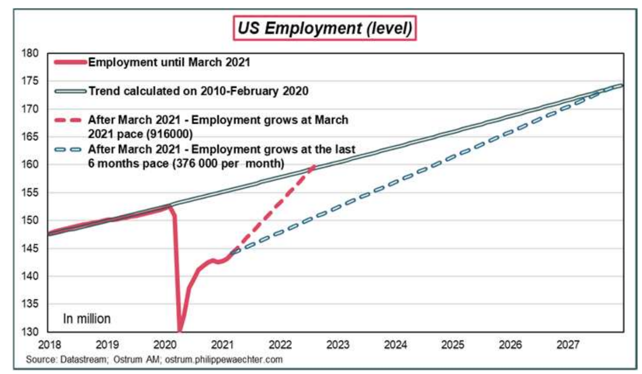


KEY MACROECONOMIC SIGNPOSTS

- This phase of greater robustness in domestic demand will be beneficial for imports, which will also benefit global growth and Europe in particular. This will be additional support for the Old Continent, whose recovery plan is more of a structural plan than a plan aimed at rapidly bending the economic cycle. It takes external impulses to find a solid trend.
- The other important point is the change in US taxation on companies as desired by Joe Biden. The objective is a fair contribution from each actor in the economy to the financing of collective needs. This would go through a mechanism making it possible to greatly reduce the tax optimization situation. Europe quickly followed the lead of the USA on this point because it is a reform desired for a long time within the OECD.
- Inflation will continue to accelerate over the next few months, reflecting the rise in the price of oil. Central banks will not intervene in this upward movement in prices. First, because it would be counterproductive since the rise in the price of oil is not transmitted to wages. Then, a tightening of monetary policy would weigh on activity in the near future while the impact on purchasing power is current. There would therefore be a double counter-cyclical effect. Finally, because the Fed is much less finicky on the inflation target. This is now 2% in the long term.
- The role of economic policy is long term. The return to the pre-crisis employment trend will take several years even in the United States, even if the stimulus plans are effective.







BUDGETARY POLICY

Still need for very active fiscal policies

COLOSSAL FISCAL STIMULUS IN THE UNITED STATES

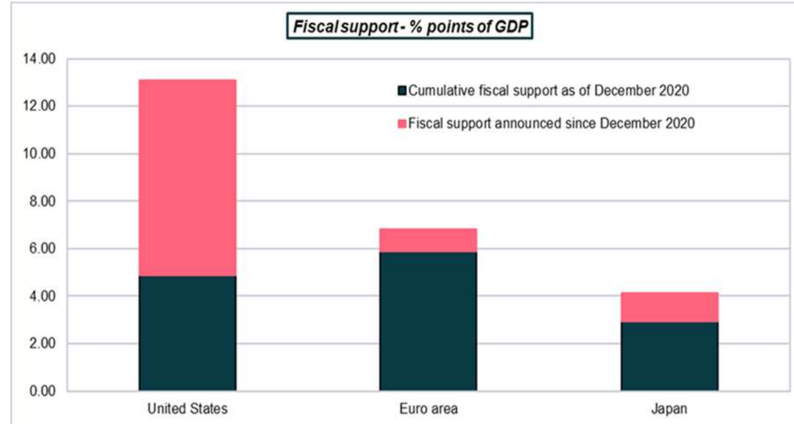
Barely after the $ 1.9 billion stimulus package was ratified, Joe Biden announced two massive new programs designed to boost growth and jobs and reduce inequality. The $ 2.3 trillion infrastructure plan will be financed, among other things, by a corporate tax hike. The $ 1.8 trillion family plan will be funded by raising taxes on wealthier households. Discussions promise to be intense between Republicans and Democrats.

MUCH SMALLER MEASURES IN EUROPE

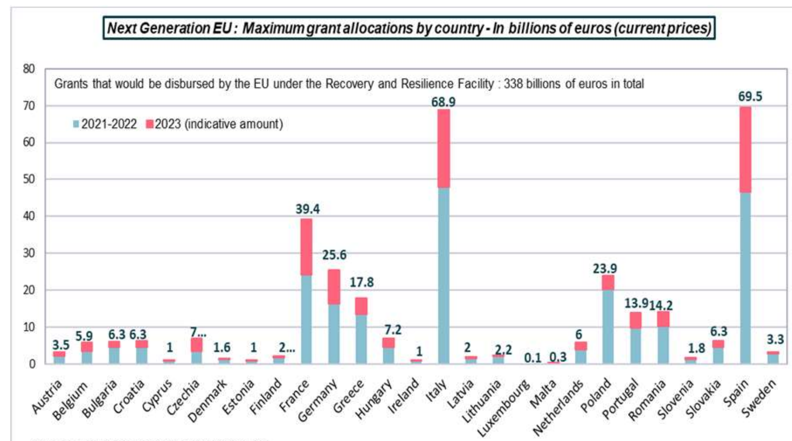
Faced with the still deteriorating health situation, governments are extending measures to support the economy, like Italy. They also present their final recovery and resilience plan to the European Commission in order to benefit from the first payments under Next Generation EU. It is essential that the latter do not fall behind. To this end, all governments must accept the raising of the own resources ceiling.

POLICY FACILITATED BY KEEPING INTEREST RATES LOW

It is essential that governments continue to benefit from low interest rates in order to finance their issues and reduce debt service. This is facilitated by continued massive bond purchases by central banks.



Sources : OECD, Ostrum AM



Sources : European Commission, Ostrum AM

MONETARY POLICY

Very accommodative central banks in developed countries

BCE: CONTINUED TO ACCELERATE ITS PURCHASES

At the meeting of April 22, the ECB reaffirmed the need to maintain a very accommodating monetary policy and thus to continue at a significantly higher pace its purchases of financial assets, during the current quarter, as part of the pandemic emergency purchase programme (PEPP). Christine Lagarde said a reduction in asset purchases ("tapering") was premature at this stage and that this issue was not addressed at the meeting. She stressed that such a decision was not tied to a specific date but would depend on a joint assessment of financing conditions and inflation prospects.

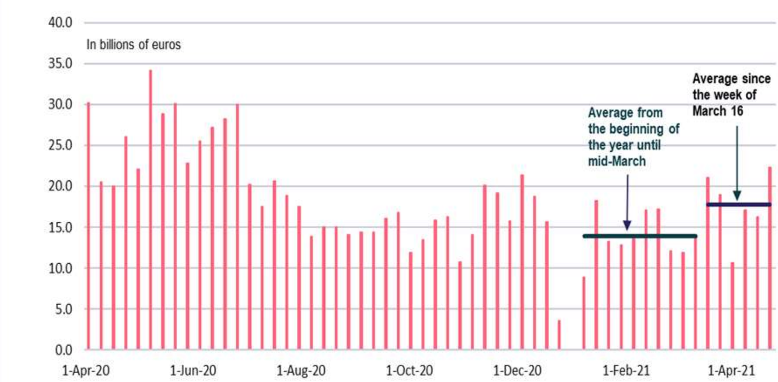
THE FED REMAINS PATIENT

At the meeting on April 27 and 28, the Fed said that while the recovery was taking place at a faster pace than expected, due in particular to the vaccination campaign and significant budget support, it remains uneven and far from complete. The Fed will thus continue its asset purchases, at a rate of $ 120 billion per month, for some time yet until more significant progress is made in achieving its objectives of full employment and inflation.

ADJUSTED MONETARY POLICY IN SOME COUNTRIES

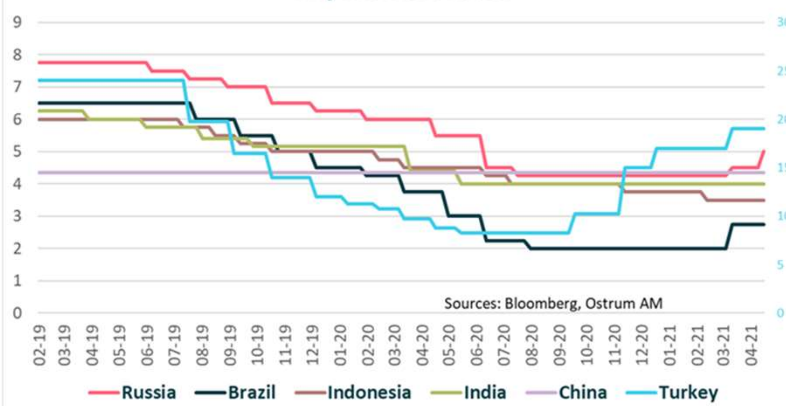
The Bank of Canada has decided to reduce the pace of its asset purchases due to improved growth and prospects. Russia's central bank raises key rates again amid inflationary pressures.

ECB : Weekly net purchases under the Pandemic Emergency Purchase Programme (PEPP)



Sources : Datastream, Ostrum AM

Key interest rates



Sources: Bloomberg, Ostrum AM

STRATEGIC VIEWS

Waiting for Jay

Strat

Synthetic market views: consolidation ?

US long rates stabilized, allowing equity markets to continue to rise, especially growth stocks. After peaking at 1.74% at the end of March, the US 10-year interest rate consolidated and fell below 1.60% with no clear explanation. The decline in US real interest rates weakened the greenback, but commodity prices rocketed to new heights. At the end of the month, equity investors took their profits despite a good Q1 earnings season. Spread markets continued to rally.

We are slightly reducing the risk profile on our portfolios because of the still tight valuations on spread assets and equities.

Allocation recommendations: discriminant

The deterioration in deficits, particularly in Italy, leads us to be cautious on the peripherals. For credit, we remain cautious on HY but continue to favor IG. In the equity market, despite tight valuations, investor appeal is still present, especially for growth stocks. On emerging markets, the valuation of the spread reached our target of last month, but continues to offer an attractive carry.

STRATEGIC VIEWS – ASSET CLASSES – 1/2

G4 rates

01

The lull in US rates should prove short-lived. A resumption of higher yields is likely given the growth and inflation backdrop and the outlook for tapering.

02

The ECB's QE acceleration has been confirmed. However, the better-than-expected PMIs in April and the rise in vaccination are putting pressure on the Bund.

03

The trend is upward in the United Kingdom where deconfinement has begun. The BoE will not extend QE. Stability will prevail in Japan.

Other sovereigns

01

Net emissions (post QE) will be negative overall, but deficits are deteriorating in Italy. This leads to more caution on peripheral debts.

02

The admittedly late implementation of the European stimulus program will generate issues competing with semi-core securities.

03

Much of the hike in non-G4 rates appears to be done. We are even expecting rates to ease in Norway, Australia and New Zealand.

Inflation

01

Break-even points include a cyclical rise in inflation linked to industrial and now agricultural commodities..

02

The level of points appears consistent with the recovery momentum and consumption potential given the available savings.

03

In the short term, inflation surprises are likely to remain on the rise in the United States. The gradual withdrawal of monetary support will then be accompanied by a rise in real rates.

Source: Ostrum. The analyses and opinions mentioned represent the point of view of the author(s) referenced. They re issued on the date indicated, are subject to change and cannot be interpreted as having any contractual value. 04/30/2021

STRATEGIC VIEWS – ASSET CLASSES – 2/2

Credit

01

Spreads on the European IG have been moving within a narrow range since the start of the year. The CSPP maintains an environment of low volatility.

02

Technical factors are an important support on the IG. Net emissions remain limited, especially after taking QE into account. The final flows have picked up lately.

03

We are a little more cautious on HY, where valuations appear tight after a 50bp tightening over the year as the volume of issues is very large.

Stock market

01

Valuations have risen, the decline in volumes and volatility in April leaves the risk of complacency of stakeholders as the annual objectives are reached.

02

The fundamentals are good, the first earnings publications for Q1 confirm the recovery in profitability.

03

The lull in interest rates encouraged the return to the growth theme. Quality is also sought after.

Emerging

01

We expect the EMBIGD spread to tighten slightly from 345 to 340bp. We consider the spread to have reached its valuation of 345bp, which was our target last month.

02

The spread is still above almost 100bp from the lowest of the last 3 years.

03

However, it is important to be discriminating in terms of investments. We are particularly positive on Asia where the economic rebound is more marked.

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04/30/2021

MARKET VIEWS

Asset classes

Sovereigns		30-Apr-21	Forecast May-21	Forecast Dec-21
USA	Fed Funds	0.25	0.25	0.25
	10-year	1.63	1.75	2.00
UK	10-year	0.84	0.80	1.00
Japan	10-year	0.10	0.06	0.10
Euro Area	BCE, deposit	-0.50	-0.50	-0.50
Germany	2-year	-0.68		-0.50
	10-year	-0.20	-0.15	0.00
	30-year	0.36		0.50
France	10-year	0.16	0.18	0.40
	Spread	36	33	40
Italy	10-year	0.90	0.95	1.20
	Spread	111	110	120
Spain	10-year	0.48	0.50	0.65
	Spread	68	65	65
Portugal	10-year	0.48	0.50	0.55
	Spread	68	65	55

Credit / Spreads	30-Apr-21	Forecast May-21	Forecast Dec-21
Euro Inflation Swap 10-ans	1.43	1.40	
Libor OAS Spreads			
IG	55	55	
HY	240	255	
EMBI Spread	339	345	
FX			
EUR/USD	1.20	1.20	1.25
Stock market			
S&P 500	4181		3900
Euro Stoxx	3975	4030	4050
FTSE 100	6970		6800
Commodities / Volatility			
Brent Oil Prices	66.53	65.00	60.00
Gold	1769	1800	1600
VIX	18.61		20/35

Additional notes

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