Peak Uncertainty

As of writing the final result of the US election is still not available. Up to the election, uncertainty was high and markets don't like that. For equity markets, October was very much a repetition of September: a strong correction which left major equity indices at or below the lows reached in September. A tight race for the US presidency as well as the Senate together with a strong second wave of COVID-19 invections in many countries weighed on risky assets in October.

While equities ended the month lower, traditional «risk-free» assets such as US Treasuries also fell. Credit spreads, a measure of default risk of private issuers, have also tightened over the period. The fixed-income market thus speaks a different language than the equity market for the time being.

Macro-economic data has mostly surprised on the positive side since the strong correction following the first COVID-19 wave. The latest numbers in the US – the last ISM Manufacturing reading at 59.3 vs. 55.4 expected – have just underlined this tendency.

Therefore, while uncertainty is high, markets have shown an astonishing resiliance in spite of the October correction. The S&P 500 is still at the level of before the beginning of the pandemic. Both the tight US presidential race and the resurgence of the virus could not stop an overall risk-on environment.

Uncertainty is high, but in both ways: there are downside risks as well as upside «risks». With interest rates lower and liquidity in the global economy higher than at the beginning of the year, a clear outcome in the US election or progress with a vaccine could spark a strong rally.

Investors are positioned neither extremely defensive nor overly optimistically and equity volatility, while not yet very low is back at the upper-bound of its pre-pandemic range.

Finally, for the first time in at least half a century, fiscal policies are on the rise, thereby providing support for the real economy.

«Peak Uncertainty» has therefore weighed on equity indices in October: The S&P 500 index has lost 3% in October and the Nasdaq is down 2.24%. Once again, Europe's performance is far worse with the Euro Stoxx 50 index falling 7.37%. Outliers are US small caps – the Russell 2000 added 2.29% in October – and Emerging Market equities which are up 3.5% on average. Since the beginning of the year, neither the uncertainty created by the pandemic nor the uncertainty surrounding the US presidential election could, however, halt the S&P 500 and the Nasdaq from printing a positive performance: the indices are up 0.96% and 21.67%, respectively. Meanwhile, the old continent's equity market suffers from old problems and the Euro Stoxx 50 index, which is heavily exposed to financials and «value» stocks is down 21% YTD.

This leaves us with a mind-boggling difference of 42.7% between these two indices which are a reflection of the antagonistic forces in place this year.

FX markets moved «in tandem» with the stock-market narrative: safe-haven currencies appreciated in October. The dollar appreciated against the euro and the yen and the Swiss franc, the European and Asian «regional safe haven currencies», appreciated slightly versus the greenback. The Swiss franc also appreciated against the euro while Emerging Market currencies saw a small correction.

Fixed income markets, which are often said to be a more precise precursor of events to come than equity markets, have drawn a different picture in October: the US 10-year Treasury yield has risen by 17bps and the Japanese 10-year government bond added 3bps. The German 10-year Bund yield, which fell by 11 bps, does not fit the picture. However, credit spreads have also continued to tightens on both sides of the Atlantic. US investment grade spreads are 11bps tighter. High-yields spreads are lower, too: 12bps in US and 2bps in Europe. Which asset class is right this time? With decreasing uncertainty – in one way or another – the picture will becom clearer, soon.

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD
S&P 500	3 262	-1.46	-5.87	-3.01	-3.01	0.96
Nasdaq	10 917	-2.40	-5.47	-2.24	-2.24	21.67
Russell 2000	1 542	-1.24	-5.99	2.29	2.29	-7.56
Euro Stoxx 50	2 958	-0.06	-7.52	-7.37	-7.37	-21.01
Stoxx 600 EUR	342	0.18	-5.56	-5.19	-5.19	-17.67
FTSE 100	5 577	-0.08	-4.83	-4.92	-4.92	-26.05
SMI	9 587	0.32	-4.36	-5.89	-5.89	-9.70
NIKKEI 225	22 977	-1.52	-2.29	-0.90	-0.90	-2.87
MSCI EM Index	1 120	-0.06	-1.44	3.52	3.52	0.49

Currency % Change	Price	1 day	5 days	MTD	QTD	YTD
DXY	93.978	0.02	1.30	0.10	0.10	-2.50
EUR-USD	1.1651	-0.20	-1.76	-0.60	-0.60	3.91
USD-JPY	104.56	-0.05	-0.14	-0.88	-0.88	-3.87
USD-CHF	0.9162	0.11	1.29	-0.51	-0.51	-5.50
EUR-CHF	1.0674	-0.11	-0.50	-1.13	-1.13	-1.70
GBP-USD	1.2957	0.21	-0.63	0.29	0.29	-2.26
EUR-GBP	0.8992	-0.42	-1.15	-0.89	0.89	5.92
JP EM FX Index	54.25	-0.09	-1.58	-0.48	-0.48	-11.65

10 yr Yield Bps Change	Price	1 day	5 days	MTD	QTD	YTD
US	0.86	4	2	17	17	-106
Germany	-0.63	1	-5	-11	-11	-44
UK	0.26	4	-2	3	3	-56
SWITZERLAND	-0.53	2	-3	-4	-4	-6
Japan	0.04	1	0	3	3	5
US IG Spread	134	0	2	-11	-11	33
US High Yield spread	496	-2	47	-12	-12	169
EUR High Yield spread	485	9	35	-2	-2	168

Commodity % Change	Price	1 day	5 days	MTD	QTD	YTD
BBG Commo Index	71.6	-0.04	-2.69	1.03	1.03	-11.50
Gold Spot $/OZ	1881.7	0.75	-1.07	-0.22	-0.22	24.02
Crude Oil WTI	35.4	-2.18	-10.81	-12.03	-12.03	-42.06

Volatility	Price	1 day	5 days	MTD	QTD	YTD
VIX	38.5	0.95	10.99	12.17	46.15	24.76

Equity % Change	Price	1 day	5 days	MTD	QTD	YTD
S&P 500	3 261.9	-1.46	-5.87	-3.01	-3.01	0.96
UTILITIES	318.3	-0.52	-3.30	5.43	5.43	-3.08
ENERGY	213.1	-1.53	-7.34	-6.33	-6.33	-53.32
TELECOM	197.3	-0.62	-3.58	0.92	0.92	8.62
CONS STAPLES	639.1	-0.52	-4.84	-3.04	-3.04	-1.22
REAL ESTATE	210.4	-1.23	-4.69	-3.90	-3.90	-12.45
CONS DISCRET	1 171.6	-3.04	-6.27	-2.99	-2.99	18.79
MATERIALS	394.8	-0.66	-4.78	-1.30	-1.30	2.32
HEALTH CARE	1 180.2	-0.42	-6.03	-4.13	-4.13	-0.67
INFO TECH	1 943.1	-2.72	-6.74	-5.43	-5.43	20.60
FINANCIALS	392.4	-0.65	-6.45	-1.96	-1.96	-23.26
INDUSTRIALS	636.6	-0.78	-7.17	-2.17	-2.17	-7.42

Source Bloomberg | 30.10.2020

Macro Update : Covid's second wave : a headwind for the fourth quarter but…

The Covid-19 pandemic is spreading again in the developed world, prompting a number of European countries to introduce new restrictions and lockdowns.

There is no doubt this second lockdown will remove some steam from the European area recovery with some negative economic consequences. The Euro Zone PMI' surveys show that the services activity, which accounts for nearly two-thirds of the GDP, has contracted to 46.9 in October from 48 the prior month.

Nonetheless, we have some reasons to believe that the global economy including the European one should not contract in the fourth quarter.

Respectively to the first quarter, restriction measures are clearly softer: European factories remain open and this makes a huge difference this time. Indeed, China's economic activity has almost fully recovered to pre-pandemic levels with the Manufacturing PMI to the highest level since January 2011 and Chinese imports from European Union above its pre-pandemic levels. In the absence of any second wave over there, the recovery in Asia and China should continue to support the Manufacturing activity worldwide and the European one in particular despite the new measures.

Therefore, we expect the new soft lockdown in Europe to be much less impacting economically relative to the first one. On top of that, additional policy support will be provided with the extension of the different emergency schemes.

In the US, the economic rebound continues to surprise. U.S. GDP rose above expectations at 33.1% in the third quarter with robust Consumer spending (up 40.7% but still below the peak registered in the Q4 2019). Investment spending was very strong with residential investment rising 59.3% and spending on equipment up 70.1% (all of these figures are annualized). Overall, the third quarter was a solid start to the recovery.

Continuous rebound in Manufacturing PMIs.

	March-20	April-20	May-20	June-20	July-20	August-20	September-20	October-20
Global	47.3	39.6	42.4	47.9	50.6	51.8	52.4	53
USA	49.1	41.5	43.1	52.6	54.2	56	55.4	59.3
Europe	44.5	33.4	39.4	47.4	51.8	51.7	53.7	54.8
Switzerland	43.7	40.7	42.1	41.9	49.2	51.8	53.1	52.3
UK	47.8	32.6	40.7	50.1	53.3	55.2	54.1	53.7
China	52	50.8	50.6	50.9	51.1	51	51.5	51.4
Emerging	49.1	42.7	45.4	49.6	51.4	52.5	52.8	53.4

Services PMIs make a pause in some regions.

	March-20	April-20	May-20	June-20	July-20	August-20	September-20	October-20
Global	36.8	23.7	35.2	48.1	50.7	52	51.6	51.6
USA	52.5	41.8	45.4	57.1	58.1	56.9	57.8	56.6
Europe	26.4	12	30.5	48.3	54.7	50.5	48	46.9
Switzerland	28.1	21.4	36.2	49.1	51.6	51.7	55.1	50.4
UK	34.5	13.4	29	47.1	56.5	58.8	56.1	51.4
China	52.3	53.2	53.6	54.4	54.2	55.2	55.9	56.2
Emerging	42.1	31.6	41.4	49.3	49.4	51.5	53.1	53.1

China nearly back to normal, supporting EU activity.

Source Bloomberg

Macro Update : US Election update: Towards the best scenario for financial markets?

As we are writing, the final outcome for the US elections is unknown. But we can say that there is a high probability that:

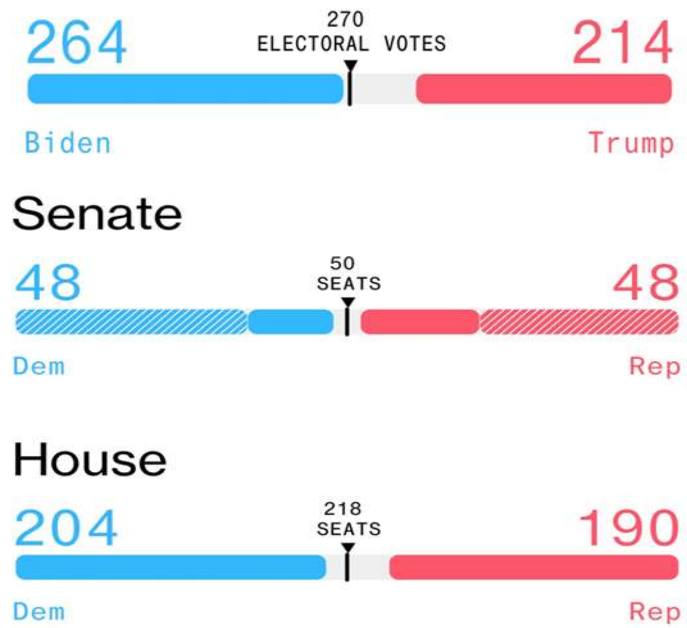
- Biden wins the Withe House
- Republican will conserve the Senate
- Democrats will conserve the House of Representatives.

As announced weeks before, President Trump contests the results and request a recount in Wisconsin with lawsuits in Pin Pennsylvania, Michigan and Georgia while Biden requests a full recount.

There is little doubt that Biden will take the oath of office on January 20th, but he might not officially become the "president-elect" before days, maybe weeks. In this context, financial markets could remain significantly volatile.

However, the outcome, if correct, is somewhat positive for financial markets. Indeed. A democrat President and House would lead to maybe a slightly less generous stimulus package than with a blue wave but still a significant one. In addition, a republican Senate would not block it but instead customize it with less tax increase.

Who's winning the race for President as of November 5th.



Source Bloomberg

Equity strategy

The inability of America's elected representatives to agree on a new stimulus plan before the presidential elections combined with a sharp surge in Covid-19 cases in Europe, did overcome the resilience of financial markets. The indices performance in October moved in tandem with the virus spread: The regions hardest hit by the virus were also those that corrected the most. European indices plunged more than 7% on average, dragged by the German DAX index, which was penalized by the disappointing earnings of SAP, the software company, which has also suffered from profit taking after its good performance in recent months. Meanwhile, Asia, and in particular China, ended the month with a gain. The local A-Shares did well with the CSI300 up 2.35% for the month. Meanwhile, in the United States, despite good numbers, technology giants such as Netflix, Amazon and Apple failed to meet investors' high expectations, and corrected during the month.

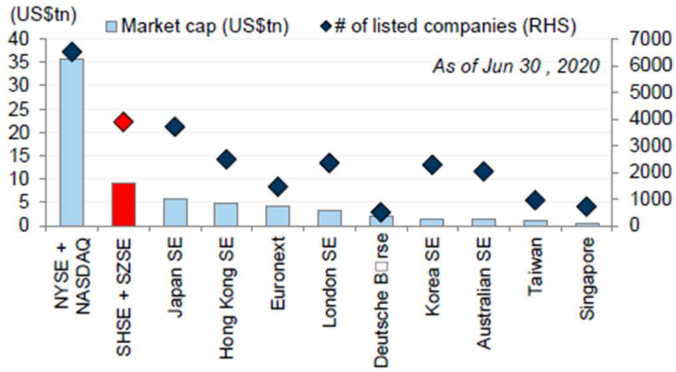
With the Continued uncertainty on US Elections combined with a COVID-19 second wave, we believe that it is a good time to get exposure to China. 2020 has been an unprecedented, challenging, and eventful year, but China will likely deliver 2.0% GDP growth.

The economic resiliency and respectable equity market returns amid the Covid-19 disruptions and continued external pressures reinforce what we view as an underappreciated investment case for A shares as one of the largest, most liquid, growthy, dynamic, underowned, and strategically important asset classes in a diversified global portfolio, in addition to the index inclusion and financial market reform tailwinds that should drive allocation and portfolio flows over time.

Given the ongoing structural shifts in corporate fundamentals, market microstructure, regulatory framework, accessibility, global capital allocation, and index composition in the 2nd largest equity market in the world, we believe it is time to better comprehend and engage this "have-to-have" market.

WHY INVEST IN A-SHARES?

A LARGE EQUITY MARKET
China A is the second market by market cap globally

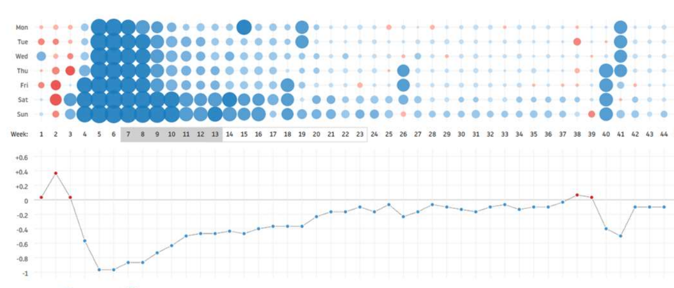


Source: Goldman Sachs

CSI300 LOW CORRELATION with major Equity Indices
0.23% S&P500 correlation over 5 years

Source: Cité-Gestion, Bloomberg

SHANGHAI TRAFFIC almost back to normal
Daily and weekly congestion level & Difference from 2019



Source: TomTom

Fixed Income Strategy

Who is right? The equity or the bond market? In October, stocks corrected while Treasuries fell and credit spreads tightened. Risk-off together with risk-on across asset classes seems to show that there are antagonistic forces at play in the market.

There are several possible explanations for this phenomenon: on one hand, a large part of the bond market is now «manipulated» by central banks buying up not only government bonds but also credit from private issuers. This puts a floor on investment grade credit. On the other hand, while central banks have a tight grip on the short end of the Treasury curve, their resiliance in controlling the longer parts of the curve is yet to be seen.

The appetite for credit remains high. October saw again a record amount of new issues which were absorbed easily and without having an negative impact on credit spreads.

The longer end of the German Bund curve is not far away from the lows seen in March. More recently, long Bund yields have even fallen again, reflecting a renewed fall in inflation expectations in the eurozone. Meanwhile, the 30-year US Treasury yield has risen well above the lows seen in March and is now in a clear upward trend at least since August. This is probably due to the Fed's new approach to measuring inflation: away from a single recent number to an average – in other words inflation will be allowed to overshoot in the future.

As the balance sheets of central banks continue to balloon, central banks are running out of tools to fight the next downturn. Fiscal policy is gradually stepping in and this may be a game-changer.

So is the recent stock and bond market divergence really a contradiction? Not necessarily. It might well be that the stock market is more sensitive to short-term news coming from the US election and second COVID-19 wave. Bond-investors concentrate more on fundamentals and the medium to long-term. There the extent and impact of fiscal policies will be seen and this might begin to affect inflation expectations.

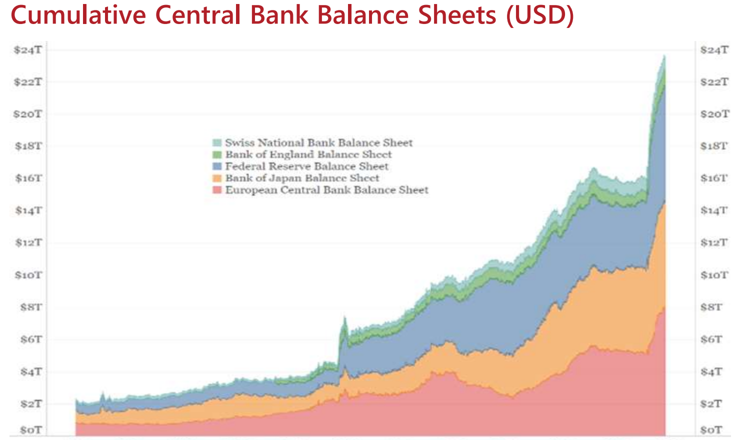
USD and EUR IG and HY spreads, normalized as of 19.12.2019

Source: Bloomberg/Cité Gestion

US 30-year Treasury yield vs. Germand 30-year Bund yield

Source: Bloomberg/Cité Gestion

Cumulative Central Bank Balance Sheets (USD)



Source: Bianco Research

FX & Commodity strategy

Despite some volatility, the US dollar Index remained steady in October. After having depreciated during the month, the US dollar recovered broadly on the back of:

- Heavy short-positioning that have been reduced ahead of the US elections as investors wanted to take some risk off the table before the outcome.
- An interest rate differential in favor of the US dollar, thanks to the reflation trade that has pushed US Treasury yield higher.
- The perspective of new lockdowns, notably in Europe that triggered some selling flows from the euro into the US dollar.

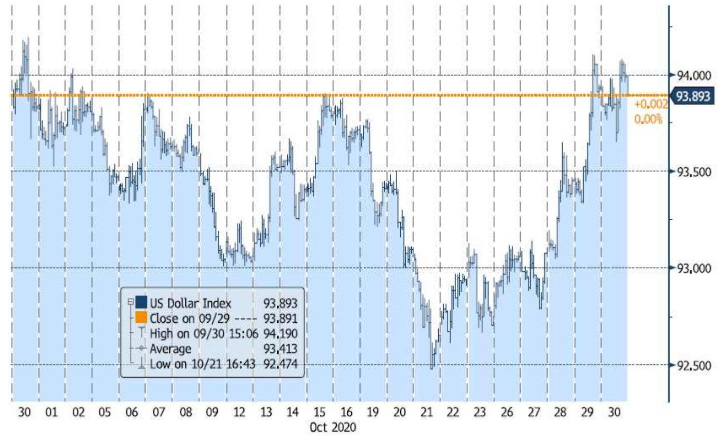
Since the US election risk is nearly behind, the focus will shift to the massive stimulus package. In this context, we believe the US dollar will resume its downward trend. Therefore we expect the dollar to broadly weaken toward the end of the year. Gold, the euro, the yuan and the emerging currencies should be the main beneficiaries of the move.

Elsewhere, we believe there will be some interesting development for Sterling. Despite some interminable political discussions between the EU and the UK, some progress towards an agreement have been made.

With GBP globally undervalued, a positioning much cleaner and the perspective of a massive stimulus package in the US that would affect the US dollar, GBPUSD currency pair seems to be the best trade should a «Brexit deal» be found.

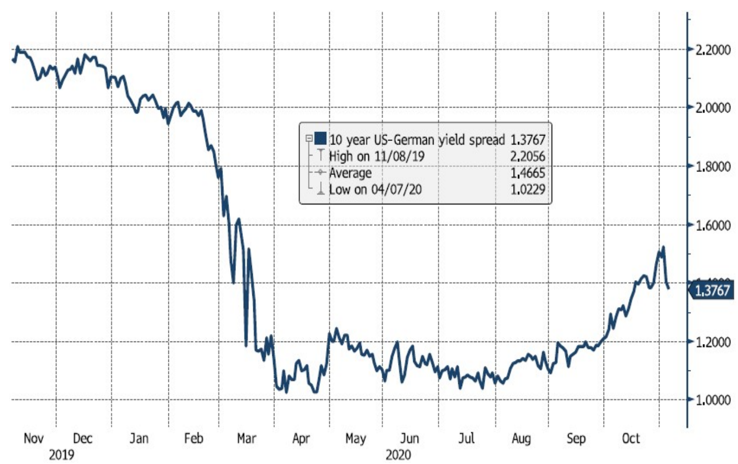
Therefore, we turn positive on the currency pair with a target at 1.37.

The US Dollar steady in October



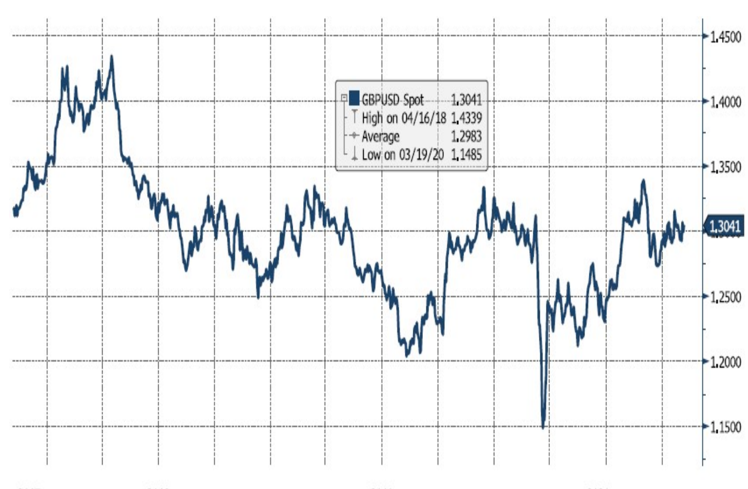
Source Bllomberg

Interest rate differential helped the dollar recently.



Source Bloomberg

GBPUSD could rise towards 1.37 on an agreement.



Source Bloomberg

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