EURIZON
ASSET MANAGEMENT

Macro Markets

EURIZON'S INVESTMENT VIEWS
ON MAIN ASSET CLASSES

August 1, 2019

Eurizon Capital SGR S.p.A.
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Capitale sociale euro 99.000.000,00 i.v. - Codice Fiscale e Iscrizione Registro Imprese di Milano n. 04550250015 - Società partecipante al Gruppo IVA "Intesa Sanpaolo", Partita IVA 11991500015 (IT11991500015) - Iscritta all'Albo delle SGR, al n. 3 nella Sezione Gestori di OICVM e al n. 2 nella Sezione Gestori di FIA - Società soggetta all'attività di direzione e coordinamento di Intesa Sanpaolo S.p.A. ed appartenente al Gruppo Bancario Intesa Sanpaolo, iscritto all'Albo dei Gruppi Bancari. Socio Unico: Intesa Sanpaolo S.p.A. - Aderente al Fondo Nazionale di Garanzia

SCENARIO

In short

The main asset classes have continued to performe positively in the past month, although the stabilisation of the pace of growth suggests that the financial markets are waiting to assess the evolution of Central Bank behaviours, the trend of macroeconomic data, and the outcome of US-China trade negotiations. Italian government stood out in the month as the top performing asset, with a sharp narrowing of spreads.

A closer look

Over the past month, on the financial markets **government bond rates have stabilised in the US and in Germany at levels close to the lows hit in June** (2% area for the 10-year Treasury and -0.4% area for the Bund), while **stock indices have increased at a slower pace than in the previous months** (which did not prevent the S&P 500 from hitting new all-time highs above the 3000 mark). **Corporate bond rates and spreads dropped in both the Investment Grade and High Yield segments** (more so in Europe than in the USA), with emerging country bonds also performing well (bonds in local currency more than bonds in hard currency). However, **Italian government bonds emerged as the top performing asset class in the month**, after Italy avoided the opening of an excessive deficit procedure. BTP spreads tightened sharply, building on the narrowing trend observed since the end of May. **The dollar strengthened slightly against the euro, and emerging currencies recovered against the dollar and the single currency**.

After expressing markedly pronounced directional movements over previous months, the financial markets have slowed their pace of growth in waiting to assess developments in terms of monetary management, the trend of macro data, and USA-China trade negotiations.

For what concerns the **Central Banks**, Powell and his colleagues lived up to expectations, pre-emptively cutting policy rates at the meeting held on 31 July to counter the risk of a slowdown of the economy. Fed Funds futures are currently pricing in two further interest rate cuts by the end of the spring of 2020, totalling 50 bps, plus one the following year. It is too early to tell whether the Fed will effectively cut short-term rates so aggressively. The striking of a trade deal between the US and China, or an improvement of economic data, would reduce the need for a hefty rate cut. However, it is reassuring that in the present context of low inflation the US Central Bank will have a free hand in countering any potential slowdown of the economy.

Similar considerations apply to the ECB, as market expectations have built up for a deposit rate cut and a probable reopening of Quantitative Easing. For what concerns interest rates, EONIA futures are pricing in a 15bps cut (from -0.40% to -0.55%). Consensus still needs to gel on the technicalities and size of the purchases should QE be reopened. The timing and details of these actions are uncertain, although the first tangible decisions will be taken at the September meeting.

The new accommodative turn taken by monetary policies is the main reason for which to remain bullish on the evolution of the economic cycle in the medium term, despite persistently weak macro data. Over the past month, indications of a stabilisation of the industrial cycle have come both from the United States and in China but are not enough to conclude that the slowdown phase which began at the beginning of 2018 is effectively over.

One element of uncertainty that has hitherto balanced the positive impact of lower interest rates and of additional fiscal stimulus in China are the **trade tensions between the USA and China**. The new truce agreed on to the side of the G20 meeting in Osaka at the end of June is yet further evidence of the fact that both sides are set on preventing an all-out trade war. However, the issue remains unresolved and remains a source of uncertainty. **The baseline scenario contemplates the reaching of an agreement, albeit partial, in order to contain effects on economic growth economic. However, there is no telling yet how and when this will happen.**

Lastly, for what concerns **Europe and Italy**, the appointment of the new heads of the key European institutions following the European elections turned out to be a smoother and swifter process than expected. In particular, the financial markets appreciated the naming of Christine Lagarde as Mario Draghi's successor at the helm of the ECB. The appointment is expected to guarantee continuity in terms of a pragmatic and flexible approach to monetary policy management in the Eurozone. This appointment, combined with the indication that the ECB is already preparing new monetary easing measures and with the averting of an excessive deficit procedure against Italy, explain the pronounced tightening of BTP spreads. Despite the improvement, however, Italian spreads area still wide compared to those of issuers with sovereign ratings similar to Italy's (for instance Spain and Portugal). Therefore, there is still a margin for a further narrowing of the differential, especially on the longer maturities, before work will start in earnest in the autumn on drafting the Budget Law 2020.

Scenario focus points

Market movements in the past few months (interest rates down sharply, strong recovery of stock lists) are pricing in scenario evolutions which still need to be confirmed and that therefore represent sources of uncertainty that should be monitored. Market focus will be in particular on the Fed and ECB's effective monetary policy accommodation and, especially, on the stabilisation of macroeconomic indicators.

EURIZON ASSET MANAGEMENT

Investment views

Eurizon Capital SGR's investment views on the main asset classes are outlined below.

ASSET CLASS	VIEW	
EQUITY	- = + NEUTRAL (previous month: NEUTRAL)	**Neutral view on equity.** Neutral view confirmed on equity in light of valuations which are starting to seem a little stretched and still not supported by an improvement in cycle indicators. By geographical region, the following order of relative preference is confirmed: (1) USA, (2) Europe, Japan, emerging countries, (3) Pacific excl. Japan.
GOVERNMENT BONDS	- = + NEUTRAL USA; NEGATIVE GER AND "QUASI CORE" (previous month: NEUTRAL GER, "QUASI CORE" and USA)	**Neutral view on US, negative on Germany and "quasi-core" Euro.** Neutral view confirmed on US duration in light of an already very pronounced decline in interest rates. Negative view taken on the duration of German and "quasi-core" Euro area bonds which at current rate levels seem to price in most of the probable reopening of QE.
	- = + NEUTRAL ON PERIPHERALS (previous month: NEUTRAL)	**Neutral view on peripheral Euro area government bonds.** Neutral view confirmed on peripheral Euro area bonds, with a relative preference for Italy combined with curve flattening strategies.

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ASSET CLASS	VIEW	
SPREAD BONDS	- = + POSITIVE (previous month: POSITIVE)	**Positive view on spread bonds.** Positive view confirmed on the spread markets, as the low level of core rates and the accommodative turn taken by the Central Banks encourage investor search for return. Equal preference for Investment Grade, High Yield and emerging market bonds.
CURRENCIES	- = + POSITIVE YEN AND EMERGING CURRENCIES (previous month: POSITIVE YEN and EMERGING CURRENCIES)	**Positive view on yen and emerging currencies.** Positive view confirmed on the yen and on the emerging currencies.

Further information on financial market trends available in video format at **www.eurizoncapital.it**:

Eurizon View, the monthly update on Eurizon Capital's views on the economic scenario, and expectations for the main asset classes.

Analysis of the month, the monthly publication that offers an overview of the main economic themes that have guided market trends in the past calendar month.