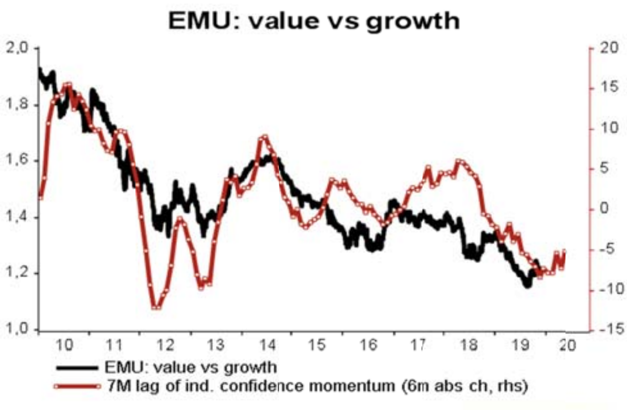
GIAM Macro & Market Research - Market Commentary

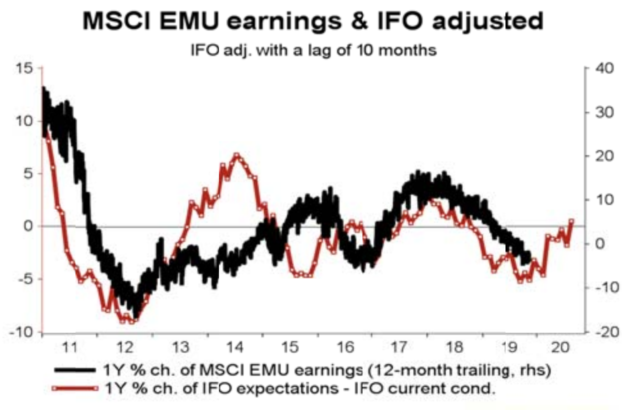
November 21, 2019

Equities: Positive signs in the macro momentum are discounted in part. We reduced the OW position. Remain constructive mid – term

- **Since early October, as risks on trade and Brexit abated and confidence indicators stabilized, bond yields have increased and equities rallied.**
- **Consistent with a full risk-on phase Banks, Auto, Value and Cyclicals all outperformed.**
- **After the rally, cyclicals' outperformance and price-earnings expansion looks a bit stretched for the short term, conditioning our recent recommendation to reduce overweight position in equities.**
- **Mid-term we remain constructive. Green shoots in the macro momentum coupled with investors' still defensive equity positioning, low rates and credit spreads plus accommodative global central banks should continue to support equities vs government bonds.**

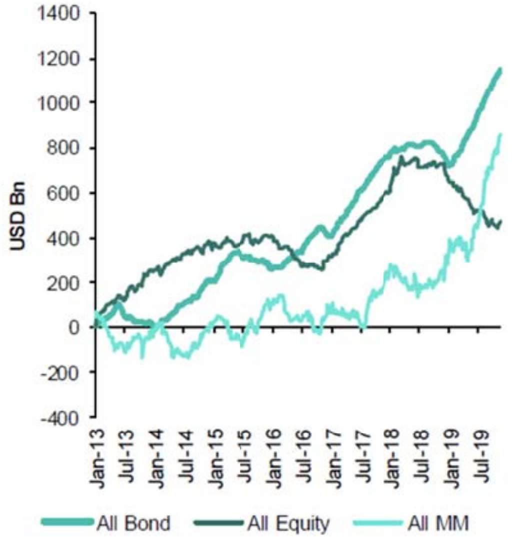
Since early October markets rallied on decreased exogenous risks (Brexit and US-China trade frictions), a supportive Q3 reporting season (company data finally beaten reduced analysts' expectations) and first signs of economic stabilization.
For the latter, **we received early signs of stabilization in confidence indicators. This, together with stabilization in bond yields**, promoted a surge in investors' confidence, triggering also a sector/style rotation vs Value, Cyclicals and bank names and inflows into global equity funds (32 bn USD in the last 3 weeks).





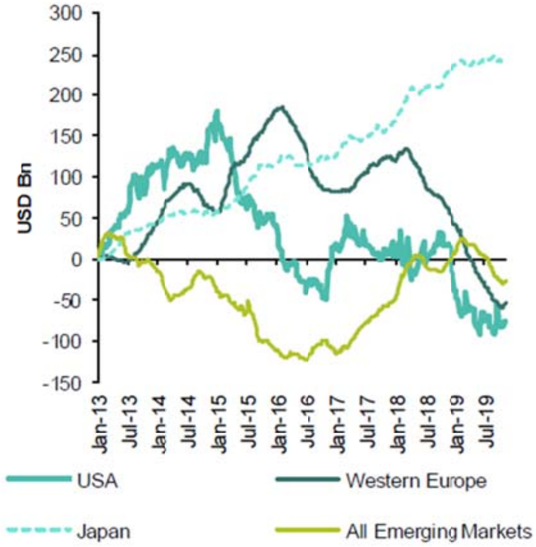
Such inflows put, for the time being, an end to the long lasting aggressive equity selling which remains quite heavy year-to-date - nearly 190 bn USD - i.e. the **equity positioning remains,** for the time being, **relatively defensive**.

EXHIBIT 1: **Cumulative weekly flows into Mutual Funds and ETFs**



Source: Bernstein analysis, EPFR global

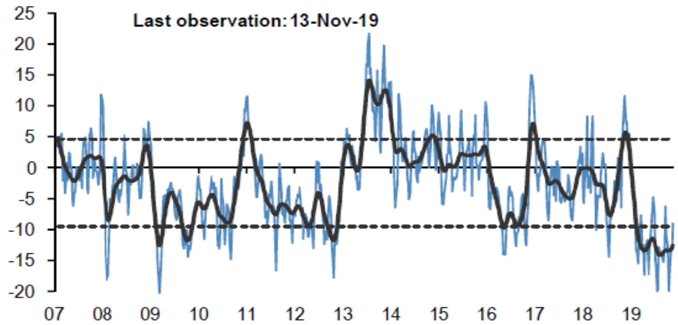
EXHIBIT 2: **Cumulative weekly flows into Dedicated Regional Funds and ETFs**



Source: Bernstein analysis, EPFR global

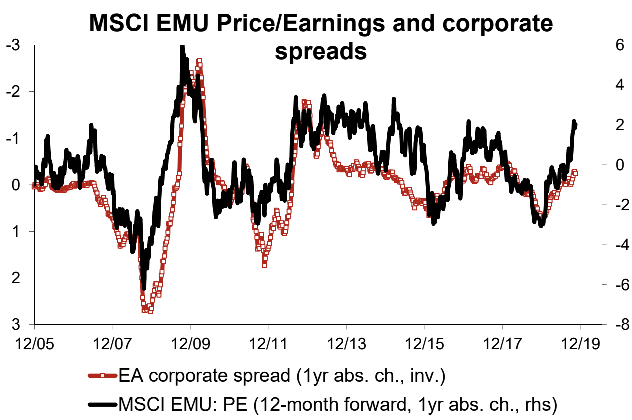
Chart A1: Fund flow indicator

Difference between flows into Equity and Bond funds: $bn per week. Flow includes US domiciled Mutual Fund and globally domiciled ETF flows. We exclude China On-shore funds from our analysis. The thin blue line shows the 4-week average of difference between Equity and Bond fund flows. Dotted lines depict ±1 StDev of the blue line. The thick black line shows a smoothed version of the same series. The smoothing is done using a Hodrick-Prescott filter with a Lambda parameter of 100.

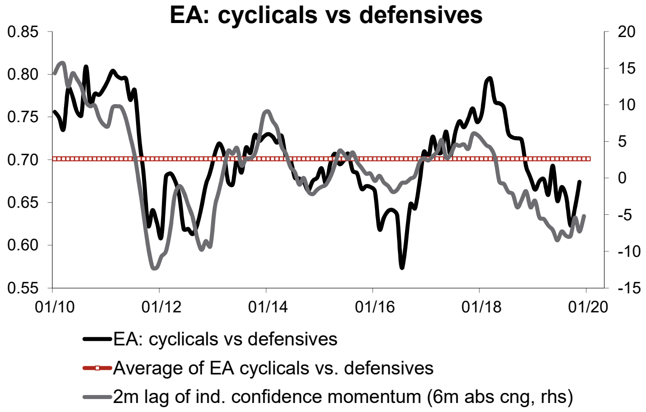


Source: Bloomberg, ICI, J.P. Morgan.

As said, after **the last upward move (and positive inflows), equity markets show some exuberance in their Price-to-Earnings ratios.**

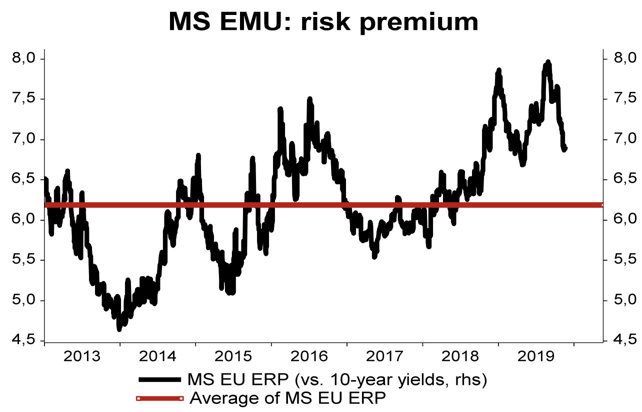


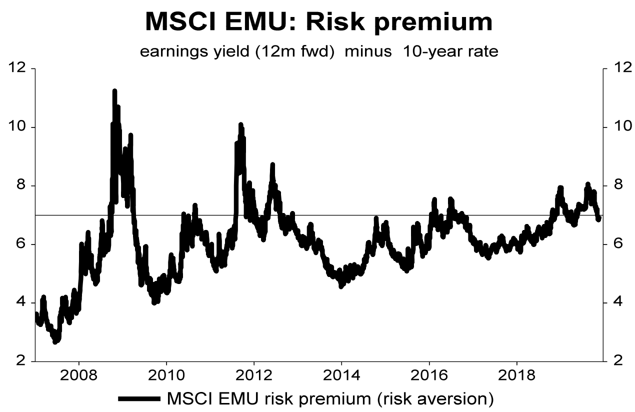
The performance of **cyclicals relative to defensives** has also well anticipated the bottoming in leading indicators for the short term.

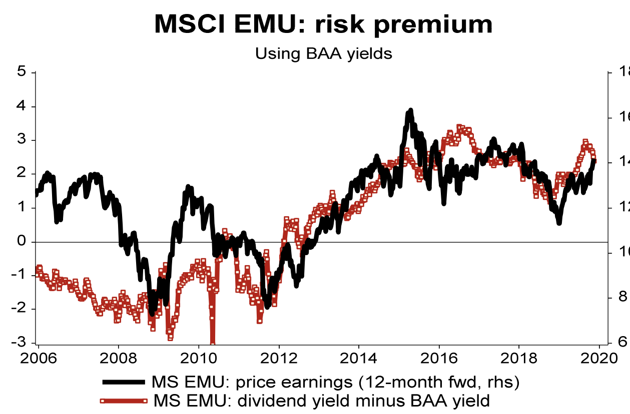


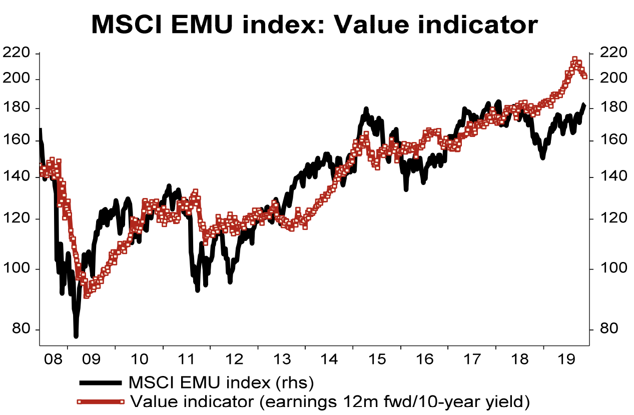
For these reasons **we recently decided to reduce the recommended OW position in equities.**

That said, reduced exogenous risks, a possible continuing stabilization in the economy, an overall still defensive positioning and dovish global central banks (low rates and low credit spread) **warrant our constructive view for the mid-term.**
Equity risk premium (a measure of relative valuation vs bonds) also remains quite high, notwithstanding the recent downward move.

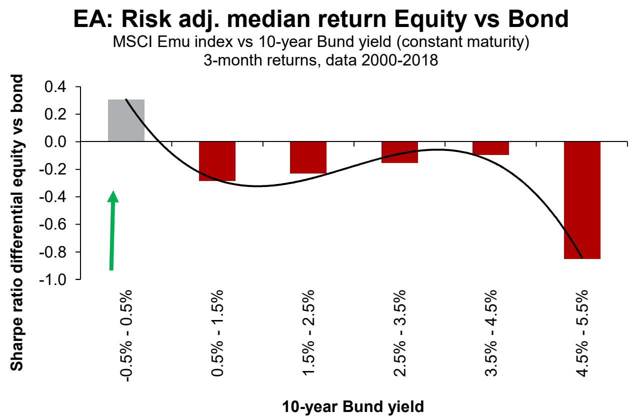


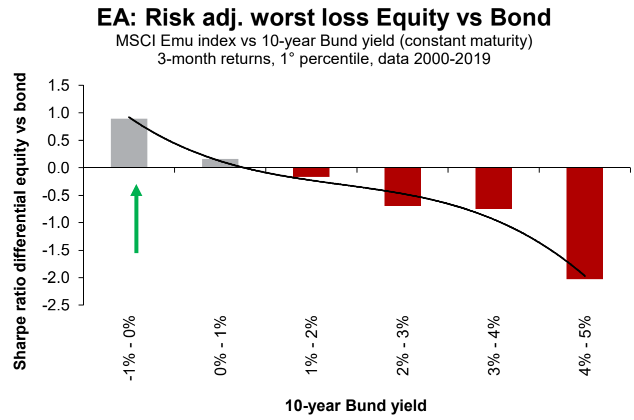






The low yield environment is rather **supportive for the relative performance** of the total return of equities over bonds, even when adjusted for respective volatility (Sharpe ratio). Historically, when the nominal yield has been in the current bracket, the quarterly return of the S&P500 over 10-year Treasury bonds has been **higher both on median and in the lowest percentile** (worst loss).





	12/31/2018	10/4/2019	11/20/2019	YTD	Period change
US 10-year rate	2.69	1.51	1.74	-95	23
JP 10-year rate	0.00	-0.21	-0.11	-11	10
GER 10-year rate	0.25	-0.59	-0.35	-60	24
ITA 10-year rate	2.77	0.83	1.30	-147	47
S&P 500	4984.2	5960.4	6292.2	26.2	5.6
Nasdaq Composite	7709.9	9353.4	10005.6	29.8	7.0
MSCI EMU	288.8	337.2	359.4	24.5	6.6
Eurostoxx 50	1196.5	1419.8	1520.3	27.1	7.1
FTSE MIB	36437.6	44446.2	48428.5	32.9	9.0
FTSE 100 (UK)	5950.4	6573.6	6704.1	12.7	2.0
SMI (Switzerland)	17246.3	20779.5	21959.3	27.3	5.7
TOPIX	2223.1	2395.6	2575.7	15.9	7.5
Nikkei225	31769.9	34648.5	37466.0	17.9	8.1
MSCI China	133.1	144.2	151.7	14.0	5.2
MS world ($)	7771.7	9074.1	9607.1	23.6	5.9
MSCI EM (in US$)	2162.7	2287.9	2418.2	11.8	5.7
MSCI EU Banks	94.1	93.5	102.8	9.3	10.0
MSCI EU Auto	267.8	289.3	327.3	22.2	13.1
MSCI IT Financials	13390.8	15854.1	18057.6	34.9	13.9

MSCI EUROPE	7546.0	8754.5	9296.1	23.2	6.2
MSCI EUROPE Growth	5883.8	7210.6	7616.3	29.4	5.6
MSCI EUROPE Value	9189.2	10051.6	10738.6	16.9	6.8
MSCI EUR CYCLICAL SECTORS	1513.2	1729.9	1880.5	24.3	8.7
MSCI EUR DEFENSIVE SECTORS	2276.1	2703.8	2774.0	21.9	2.6

Authors:

Michele Morganti michele.morganti@generali-invest.com

Vladimir Oleinikov vladimir.oleinikov@generali-invest.com

www.generali-investments.com