



**GENERALI**  
INVESTMENTS

# Market Perspectives

## (Vir)alteration of investor optimism

February 2020



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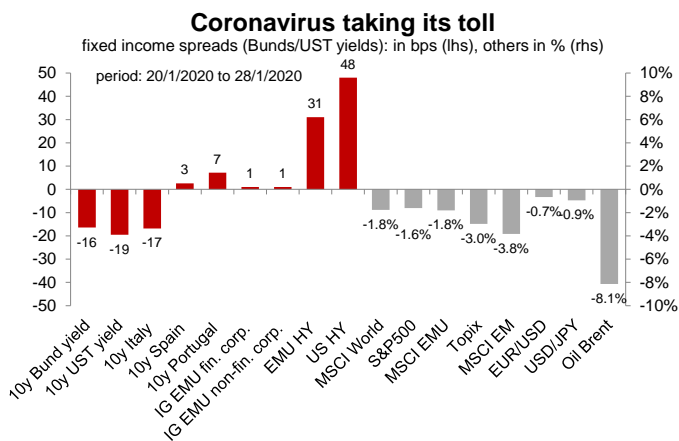
# Global View – (Vir)alteration of investor optimism

Vincent Chaigneau / Thomas Hempell

- **Just as the trade truce provided broad-based relief, the Coronavirus is unsettling global markets.**
- **The fast-spreading disease is challenging the tender global macro green shoots, but we still see resilience in US and EA domestic demand.**
- **Experience from past episodes suggests that markets tend to overshoot, but rebound sharply once the number of new infections starts to slow.**
- **Even before the Coronavirus, we had embraced a slightly more cautious stance on early signs of investor complacency. We maintain a (smaller) pro-risk tilt in the portfolios, but reduce overweights in Equities and HY Credit. We keep our overweight in IG corporates and underweight in core bonds.**

Financial markets staged a strong start to the new year, propelled by the 'phase one' US/China trade agreement. And yet, a new spectre has caught the markets. The confirmation of human-to-human transmission of the Coronavirus on Jan. 20 and a first US case a day later caused risk sell-off in the second half of January.

Indeed, the global economy still looks vulnerable, with green shoots in manufacturing still young. The Coronavirus is spreading faster than the deadly 2003 SARS epidemics and China's weight in the world economy has almost doubled to 19% since then. Yet, as we argue in a [Focal Point](#), the mortality rates is much lower than with SARS and China has taken swifter action. Medical advances will likely facilitate a vaccine much faster than for SARS in 2003 (when it took about 20 months).



Risks of major economic disruptions in case of an uncontrolled global spreading exist. Yet, experience from past epidemics suggests that a V-shape market rebound is likely when the number of new cases starts to slow. Some investors will try to front run the turn in sentiment.

What is more, global data point to a continued gradual recovery. The global PMI is set to increase for a fourth

straight month in January, led by a rebound in new orders. Global data and the supply chain will suffer from the disruptions in China over the coming weeks. But consumption in the advanced economies is set to hold up well, with the recent decline in oil prices (Brent oil -12% ytd) and bond yields adding to purchasing power while employment and earnings growth remains decent.

A new source of political uncertainty may yet come to the fore. US Primaries will kick off in Iowa on Feb. 3. The race is neck-and-neck, and a Warren or Sanders victory may trigger markets fears of higher taxes and stricter regulation, with Pharma, Fracking, Tech and Financials particularly vulnerable. On a positive note, stability concerns about the Italian government have ebbed after the ruling PD was able to prevail in its stronghold of Emilia Romagna in regional elections.

## Scaling back our tactical pro-risk tilt

Just ahead of the market correction on Coronavirus fears, the sharp rally in risky assets (Q4) and investor surveys had highlighted a significant shift in positioning and sentiment. With the global rebound set to remain shallow (and US growth set to cool further), corporate earnings are unlikely to provide any large boost near term. Yet with central banks retaining an accommodative stance and the Fed continuing its balance sheet expansion, we would deem it premature to throw in the towels to the benefit of safe haven core government bonds.

Bonds	29/01/20*	3M	6M	12M
10-Year Treasuries	1.61	1.65	1.70	1.75
10-Year Bunds	-0.38	-0.30	-0.25	-0.15
<b>Corporate Bonds</b>				
BofaML Non-Financial	92	90	85	85
BofaML Financial	95	95	90	90
<b>Forex</b>				
EUR/USD	1.10	1.11	1.13	1.15
USD/JPY	109	108	107	106
<b>Equities</b>				
S&P500	3264	3280	3275	3265
MSCI EMU	131.7	132.0	131.0	133.0

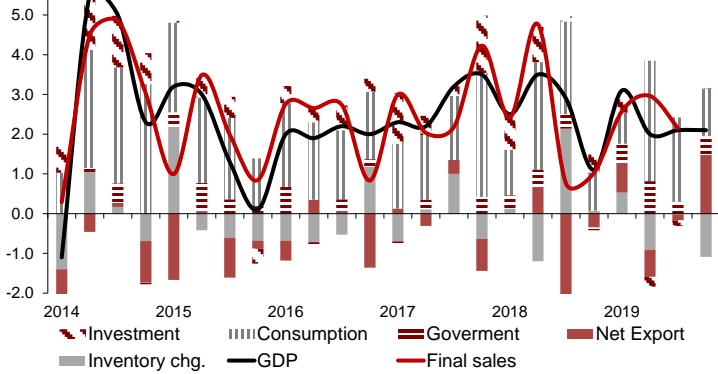
\* avg. of last three trading days

We favour a cautious stance in the very near term. We maintain, but scale back the pro-risk tilt in our tactical positions. We keep our defensive stance on core Govies and our favourable stance on euro area IG Credit, though. A small further uptick in inflation and a lower flight-to-quality premium point to higher core rates, while high quality corporate bonds remain underpinned by the persistent ECB purchases. The USD has recovered on Coronavirus angst, but we still see it past its peak.

# USA

**Paolo Zanghieri**

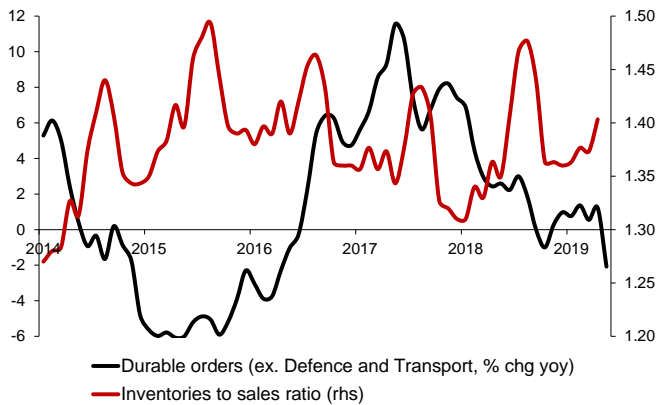
**Contributions to GDP growth**  
% qoq annualized, seasonally adjusted



- GDP growth remained stable in Q4. We expect annual growth to slide from 2.3% to 1.6% in 2020.
- Confidence indicators show signs of a tentative rebound in manufacturing, but data on activity continue to disappoint. Political uncertainty will resurface, as the campaign for the 2020 election proceeds.
- The Fed plans to stay on hold in 2020 but slower growth will likely trigger a rate cut in Q2.

GDP grew in Q4 by 2.1% (qoq ann.), in line with expectations, implying a 2019 annual growth rate of 2.3%. In 2020 growth should decelerate to 1.6%. The weakness will be mostly concentrated in Q1. The halt to the production of the Boeing 737 MAX is likely to shave annualized growth by 0.5-0.8 pp (which should reverse when production resumes in H2 as announced). Moreover, activity will feel the full impact of the tariff rise that occurred in the second half of 2019. In the remainder of 2020, demand will likely accelerate while capex will remain subdued. Whereas the signing of the Phase 1 deal with China has reduced the risk of an escalation in trade tensions, a durable solution will not be easy to find. Moreover, political uncertainty will increase as the presidential election day (Nov. 3) approaches, especially if a more extreme Democratic candidate emerges after the first round of primaries at the beginning of March.

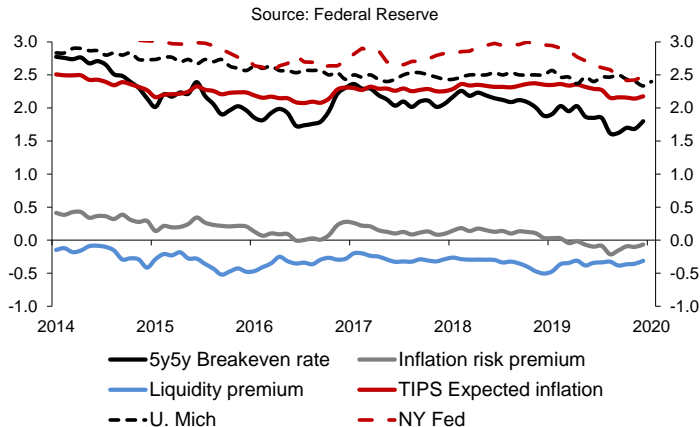
**Orders and inventories**  
3-mth moving average



**Capex remains weak**

The latest data on manufacturing confidence were mixed. The ISM weakened further to a ten year low of 47.2, but other sentiment measures like the Markit PMI and the index developed by the NY Fed pointed to some improvement. Hard data, meanwhile, remain on the weak side: fixed investment was flat in Q4 and durable good orders posted a year-on-year contraction in December after a few months of feeble growth. This, and the pick up in inventories signal that business confidence in the recovery is not that strong. On the contrary, consumption and more broadly the services sector continued to show healthy growth, with the ISM increasing for the fourth month in a row, to 55.

**TIPS breakeven rate and expected long term inflation**  
Source: Federal Reserve



**The Fed is confident, but will have to cut rates in Q2**

As expected, the FOMC did not act on rates and used its January meeting to clarify some points on its T-Bill purchase program. It reiterated that the program is meant just to restore a level of reserve big enough for the smooth functioning of monetary transmission. This level should be reached at sometime in Q2. On top of that the Fed is still confident in its outlook of moderate growth (with, if anything a bigger concern about slow consumption growth), and intends not to touch rates. Instead, we think that subdued investment and overall weakening growth in the first month of the year, together with low expected and realized inflation, will trigger another rate cut in Q2.



# Euro Area

**Martin Wolburg**

- A mixed macro news flow over the past month suggests that the recovery from the H2/2019 weakness is bumpy.
- We do not expect the Coronavirus epidemic to fundamentally alter the outlook and stick to our 2020 growth forecast of 1.0%.
- We expect the ECB to stay on hold for the time being.

The turn in the global manufacturing cycle has started to become more and more visible in sentiment indicators. The euro area manufacturing PMI recovered from its low in mid-2019. While the January reading of 47.8 still suggests output contraction in manufacturing there are signals for ongoing improvement: First, forward-looking sentiment components like export orders also trend up. Second, the 2019 EUR weakness (broad effective exchange rate -1.7% yoy) will lend ongoing support to export activity. Third, with the US-Chinese Phase 1 trade deal signed and the UK leaving the EU orderly by Jan. 31 two major sources of global uncertainty are off the table for the time being.

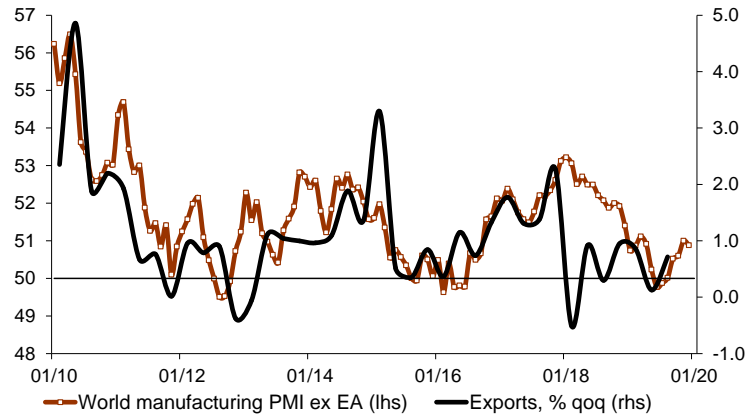
## Recovery on a bumpy road

In spite of these green shoots the recovery will remain bumpy. Domestic activity had weakened throughout 2019. Employment growth lost momentum (+0.1% qoq in Q3/2019) and loan expansion of non-financial corporations eased (to 3.2% yoy in 12/2019, a two-year low). On top, ongoing strikes in France dampened services sector confidence. More recently, the Coronavirus epidemic emerged as a new potential headwind. If it would cause a drop of Chinese output by 2% (as in the SARS case), model simulations show that euro area activity would suffer by 0.08 pp on a one-year horizon. Confidence effects would come on top. Back to the SARS period, confidence fell from the start to the peak of the epidemic. This would translate into a fall of the composite PMI by around 1 point (from 50.9 now) and drag another 0.1 pp from growth. However, we rather consider this as the upper limit given that in 2003 the Iraq war, rising oil prices and the fallout from the burst of the dotcom bubble were major drivers denting confidence. Last, crash-Brexit effects are on the table again if a EU-UK agreement cannot be finalized by year-end and the transition agreement is not extended.

## Growth outlook unchanged, ECB on hold

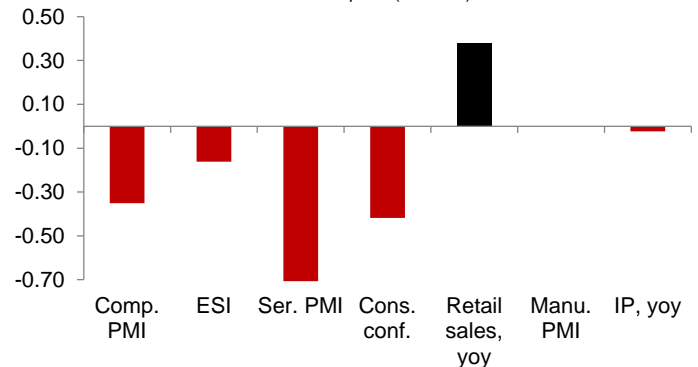
All in all, we left our 2020 growth outlook of 1.0% unchanged. At its January press conference ECB President Lagarde did not indicate any immediate action. With growth expected to improve and the underlying inflation metrics showing some tentative signs of improvement we continue to expect an unchanged policy stance throughout the year. The ECB's focus will be on the policy review. The results shall be presented in December.

## Euro Area Export Prospects



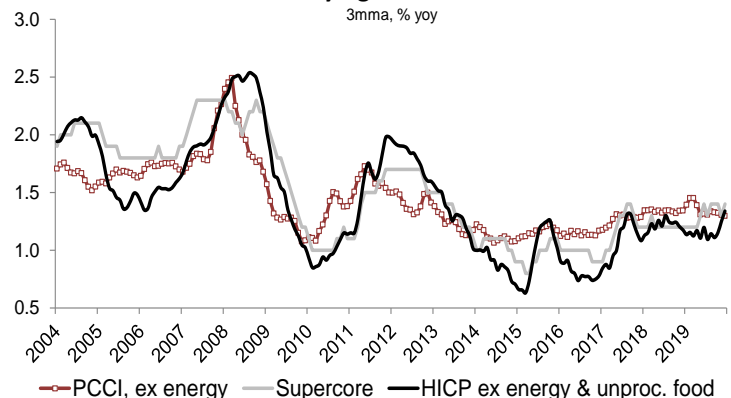
## EA activity during SARS

change in z-score of variables from the start of SARS (12/2002) until the peak (03/2003)



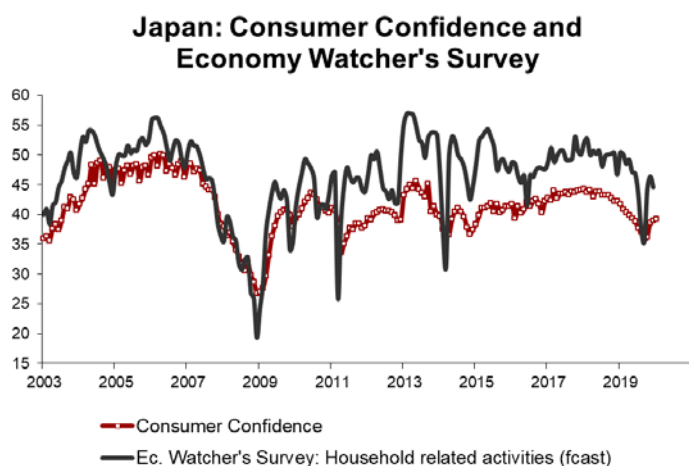
## ECB Underlying inflation measures

3mma, % yoy



# Japan

**Christoph Siepmann**



- **Japan has been only limitedly affected so far by the Coronavirus. However, sentiment and export effects could play a role.**
- **Q4 GDP growth likely dropped markedly after the October sales tax hike, but is expected to turn positive again in Q1.**
- **The BoJ will likely stay at the sidelines in 2020.**

Japan has recorded so far a limited number of people infected by the Coronavirus. While any prognosis is difficult, the current risk – similar to other countries – likely lies more with sentiment than with infection rates themselves. Unfortunately, sentiment indicators are typically not recent enough to cover the impact in full. Among this data, Japan's January manufacturing PMI continued to improve, but remained in slightly contractionary territory. The upturn was mainly driven by new export orders which came in above the 50-index line for the first time since November 2018. The output PMI sub-index also increased. The slight uptrend was matched by realized industrial production (IP) which also turned positive for the first time since the sales tax hike and the typhoon Hagibis. Nevertheless, summed over Q4 IP dropped by 4.0% qoq, clearly reflecting these headwinds. Real exports also improved in December, after two months of declines, mainly driven by high-tech related goods. In sum, we expect GDP growth in Q4 to drop by about 4% qoq annualized.

### **Growth to turn positive again in Q1**

Looking ahead, Japan should be able to participate in an upturn of world manufacturing demand. However, with a share of 19.1% of real exports, China is the second most important export destination after the US. Given the hope that China's drastic measures will succeed, frictions should remain moderate. Private consumption should also recover from the sales tax hike shock. Thus, we see Q1 GDP growth to turn positive again. As the international upturn is likely to remain shallow, the positive impact on Japan will also be limited. Domestically, the support from the fiscal program should come increasingly into play. Despite the rising talk about an end of the Abe administration, we do not expect any major policy change near-term. Thus, barring an acceleration of the Coronavirus in Japan, we stick to our growth forecast of 0.6% in 2020.

Japan's headline CPI rose to 0.8% yoy, up from 0.5% in the previous month. Core inflation (excluding fresh food) rose by 0.7% yoy. The increase was mainly due to a less negative contribution from energy. Excluding the impact of the sales tax hike and of free education, core inflation rose by 0.4% yoy. Thus, price pressures remain muted. Nevertheless, we expect the BoJ to stick to its current policy throughout 2020, given the improving outlook, the new mix between fiscal and monetary policy and in order to minimize side effects of its policy.

# China

Christoph Siepmann

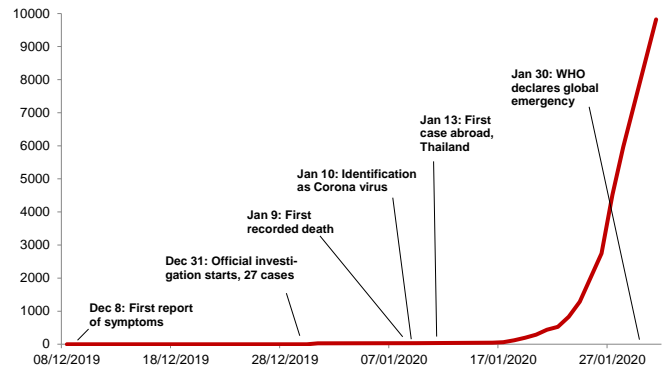
- Over the short term, China's outlook is dominated by the Coronavirus (nCoV) outbreak.
- February will be decisive to assess whether the government measures to quarantine the province of Hubei will be effective.
- We tentatively cut China's growth outlook by 0.2 pp to 5.7% in 2020 but stress that these numbers are highly uncertain.

Since the last report, China saw two important developments: the Phase 1 trade agreement with the US and the outbreak of the new Coronavirus. Of course, the latter dominates all other news, for the time being. After doctors first reported about symptoms in early December, new infections have followed an exponential path. It seems not unlikely that numbers will surpass several 100K in early February. Compared with the SARS epidemic 2002/03, the infection seems to spread faster but looks less deadly. The government responded with largely isolating the city of Wuhan (11 million inhabitants) and the surrounding province of Hubei by Jan. 23 in order to cut off human infection lines. Among other measures it also lengthened the Chinese New Year holiday, during which Chinese usually use to travel and visit their families. The WHO estimated the incubation period of up to 14 days. So it will last until early February to assess whether China's measures will be effective to bring down new infection rates. If this were the case and the outbreak largely confined to the region of Hubei, the economic impact would be also limited. Comparing with SARS which concentrated on Beijing and Guangdong (responsible for 15% of GDP by that time), the province of Hubei accounts for about only 4% of GDP. A proportional response would reduce China's GDP by 0.5 pp in the short term, reduced to 0.25 pp over the year due to a rebound in H2. However, if the virus were to spread more forcefully to other regions, the impact is clearly higher. One approach draws on the fact that private consumption contributed 3.6 pp to China's 2019 GDP growth. A drop of household demand by 10 pp would then result into a loss in GDP growth of 1.2 pp. We stress that all these numbers come with a high degree of uncertainty.

## Green shoots likely derailed

Before the nCoV outbreak, China showed some signs of stabilization. Q4 GDP real growth came in unchanged from Q3 at 6.0% yoy, while both manufacturing PMIs remained in expansionary territory. Some of these effects can be attributed to the relief, the Phase 1 trade deal with the US brought about. Although US concession regarding tariffs were rather limited, it signaled both sides to be on a de-escalating path. Real activity data also showed some end-of-quarter relief. Despite the nCoV outbreak, the January NBS PMIs dropped only slightly. Data will be scarce over the next month due to the Chinese New Year break. SARS peaked after about four months. Thus the current crisis is likely to create sizeable worries for the weeks ahead.

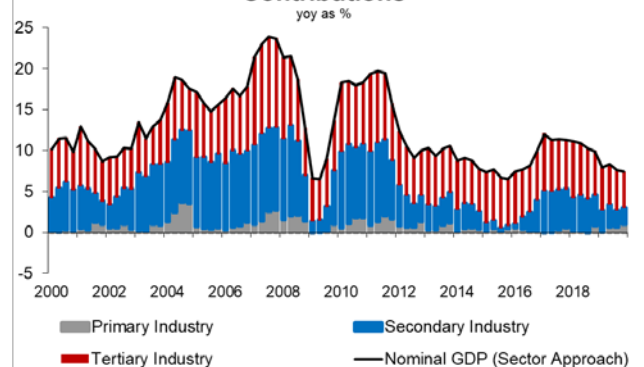
Development of Infections with nCoV in China



China: Manufacturing PMIs and Industrial Production

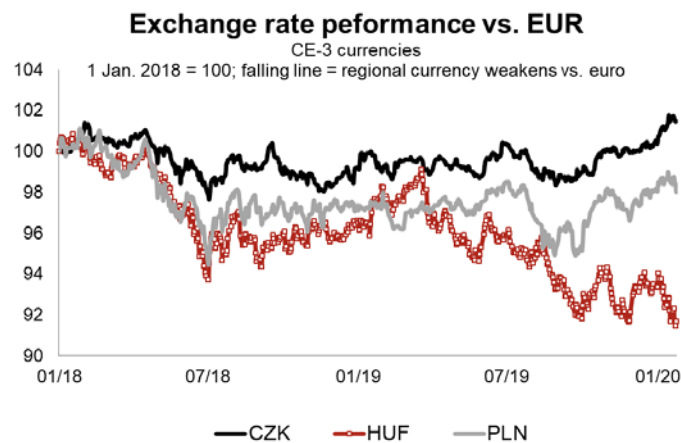
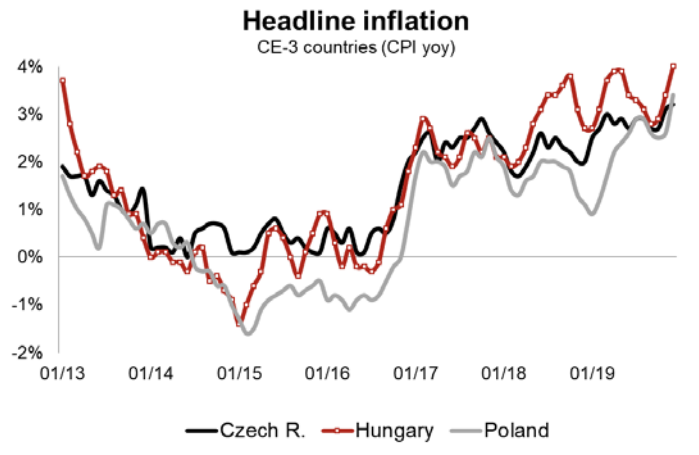


China: Nominal GDP Growth and Sector Contributions



# Central and Eastern Europe

Radomír Jáč



Main Forecasts	2018	2019e	2020f	2021f
<b>Czech Republic</b>				
GDP	2.8	2.5	1.9	2.4
Consumer prices	2.1	2.8	2.8	2.1
Central bank's key rate	1.75	2.00	2.00	2.50
<b>Hungary</b>				
GDP	5.1	4.9	3.5	3.0
Consumer prices	2.8	3.4	3.6	3.4
Central bank's key rate	0.90	0.90	0.90	1.00
<b>Poland</b>				
GDP	5.2	4.2	3.6	3.4
Consumer prices	1.6	2.3	3.3	2.9
Central bank's key rate	1.50	1.50	1.50	1.75

GDP and consumer prices: annual % change; CB interest rate: in %, year-end

- **Headline inflation accelerated in all three CE-3 countries at the end of 2019. Also core CPI stands above targeted inflation levels of the regional central banks. However, monetary policy stays unchanged due to lasting global risks.**
- **Particularly, monetary policy stance remains loose in Hungary, despite growing CPI. This sent the forint to its new lows against the euro. The MNB tightened financial conditions via liquidity tender but its monetary policy interest rates are still stable at low levels.**

Inflation in the CE-3 region accelerated in late 2019 and stands well above central banks' targets in all three countries. Headline CPI for December reached 3.2% yoy in the Czech Republic (with the target set at 2%), 4% yoy in Hungary (target: 3%) and 3.4% yoy in Poland (target: 2.5%). The increase was partially driven by commodity prices but core inflation pressures are visible too, as all three economies operate above their potential.

Inflation is expected to increase further in Hungary and Poland in Q1 and to remain at levels seen in late 2019 in case of the Czech economy. However, the CE-3 central banks are still reluctant to tighten their monetary policy, as they see anti-inflationary risks in external developments. That said – while the Czech CNB holds its key rate at 2.00% and seriously debates the possibility of a rate hike, and Poland with the key rate at 1.50% is also well above levels seen in the West, monetary policy in Hungary remains relaxed. The MNB keeps its base rate at 0.90% and O/N deposit rate at -0.05%. This has recently led the Hungarian forint to weaken against the euro and to underperform against the Czech crown and Polish zloty. While the CZK and PLN benefit from the better global risk sentiment, the HUF is hit by the MNB stance.

## Weak forint gives wake-up call to Hungarian MNB

The EURHUF exceeded 337, its historical high, and the MNB tightened financial conditions via FX tenders, as it cut liquidity supply in a second half of January. This led to a marginal increase in money market interest rates and government bond yields. However, the EURHUF hovers in the range of 337-338, as the MNB apparently does not want to rush any meaningful monetary policy tightening.

The Czech CNB will release quarterly macro forecast in early February. It may still recommend a rate hike for H1 but we expect the CNB to keep interest rates on hold. Besides the emerged external risks, the recent CZK firming is also a factor acting in anti-inflationary direction.

The Polish MPC keeps its wait-and-see policy stance. The NBP key interest rate is likely to stay on hold at 1.50% during the whole 2020 and almost certainly with no change in Q1, as an increase in inflation in early 2020 is expected by the central bank.



# Bonds/Fixed Income Strategy

Florian Späte

- Concerns about the impact of the Coronavirus keep a tight grip on international government bond markets. Safe haven flows led to a sharp decrease in sovereign yields.
- While the near-term outlook is shaky, yields are forecast to rise again once there are signs that the epidemic will remain contained. Particularly, euro area yields have leeway to recover.
- Italian government bonds reacted very positively to a regional election result. As the likelihood of snap election is reduced, there is more scope for BTPs to perform well going forward.

While geopolitical worries in the Middle East turned out temporary at the beginning of the year, concerns about contagion from the outbreak of the Coronavirus in China triggered lasting safe haven flows. The macroeconomic data flow was overall in line with expectations. If anything, they surprised slightly on the upside but failed to impact international bond markets sustainably.

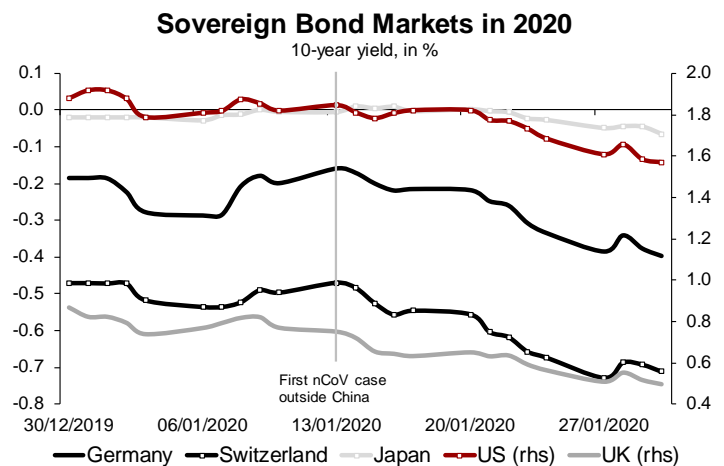
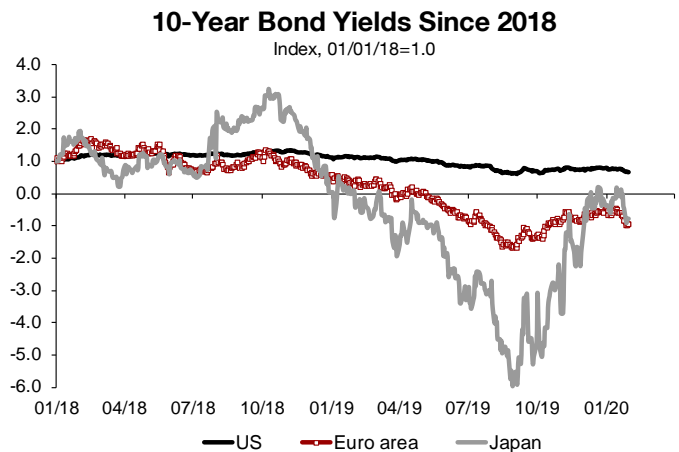
At large, 10-year US Treasury yields have fallen by 34 bps to 1.57% (15 bps driven by lower inflation swaps) since the start of the year and 10-year Bund yields have dropped from -0.19% to -0.39% (decrease in break-evens by 7 bps). Over the same period, financial markets have adjusted expected future Fed cuts as well. Compared to the start of the year, some additional 19 bps of rate cuts are priced. Accordingly, 2-year US yields have come down by 16 bps (2-year Bund yields only declined by 5 bps).

## Impact on bond markets unlikely to last

The near-term outlook for international bond markets appears highly uncertain. The future moves will very much depend on the news flow with respect to the spreading of the epidemic. In case there are signs that the epidemic might not be contained a further decrease in yields is likely. Even the troughs marked in late summer 2019 will likely come into reach again. Given safe haven flows tend to occur in nominal bonds, particularly inflation linked bonds appear vulnerable in this scenario.

However, as soon as there are signals that the authorities will be able to contain the epidemic and the economic fallout will be limited, financial markets will swiftly change gear. Accordingly, in the medium term there is leeway for yields to resume their modest upward trend prevailing in Q4 on back of a moderately recovering global economy.

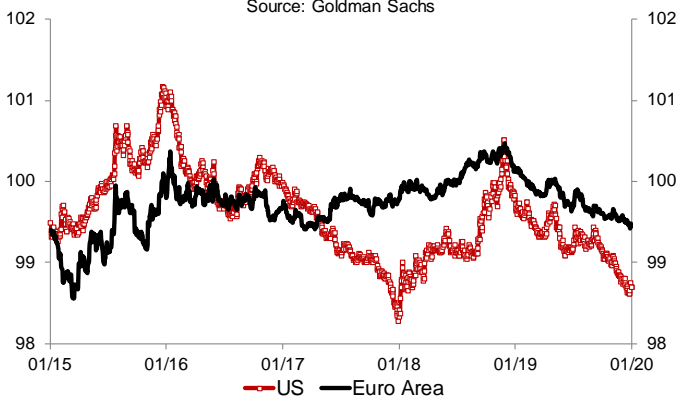
While we recommended going long US Treasuries in November, we think the recent decrease in US yields made the risk/reward of this investment idea less attractive. In November, markets expected the Fed to remain on hold in 2020 and even speculated about key rate hikes in 2021. Meanwhile, financial markets price almost two additional rate cuts until 2021. We think markets are running ahead of themselves as we only forecast one additional key rate cut in H1 2020.



# Bonds/Fixed Income Strategy

**Financial Conditions**

Source: Goldman Sachs

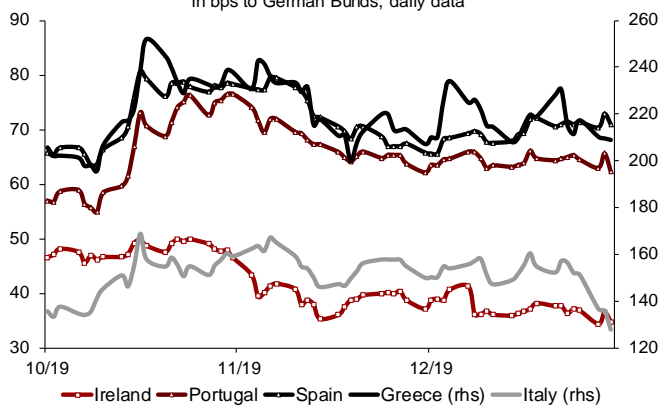


Accordingly, we see leeway for US yields to increase over the medium term again. This applies even more as the US economy is seen to gather pace over the course of 2020 (not least due to still very ease financial conditions). All in, 10-year US yields are forecast to rise to 1.75% on a 12-month horizon.

This applies even more to euro area core yields. The euro area economy is already bottoming and quarterly growth rates are expected to inch upwards. Moreover, inflation rates are seen to creep upwards over the course of the year. This environment conflicts with euro area core yields well in negative territory. Meanwhile, only 30-year Bunds are trading in positive territory. Over the course of the year, this apparent contradiction is expected to be (at least) partly resolved by higher euro area core yields. On a 1-year horizon, we see 10-year Bund yields to rise to -0.15% again.

**10-year Sov. Spread Euro Area Peripherals**

in bps to German Bunds, daily data



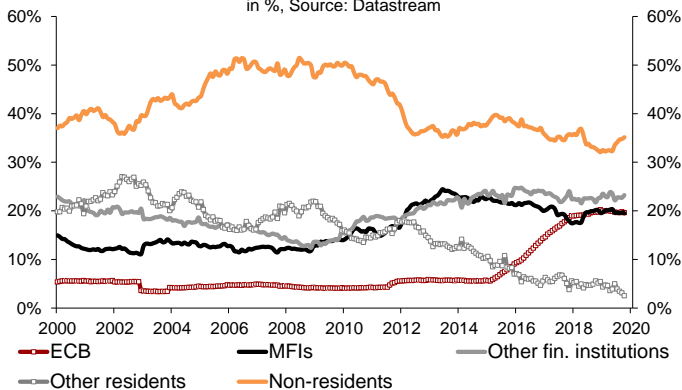
**Less political uncertainty to support BTPs further**

The performance of euro area non-core government bonds year-to-date has been mixed so far. While Iberian sovereigns slightly underperformed core bonds, Italian and Greek bonds have yielded already a considerable total return in January (2.9% and 2.4%). In addition to the decrease in underlying yields, also spreads tightened significantly.

Above all, the victory of the Partito Democratico (PD) in Emilia Romagna triggered a noticeable spread tightening. The election result is an important relief for the ruling coalition in Rome as calls for a snap election will abate. The eurosceptical Lega has lost momentum and a more moderate and patient strategy will likely be adopted. However, the crisis of the Five Star Movement (M5S) deepened. This will not facilitate resolving the numerous issues within the coalition. Overall, the likelihood that the coalition of PD and M5S will prevail for the time being increased, but the fragile majority in parliament will reduce the appeal of taking bold structural reforms.

**Italian Government Bonds: Ownership**

in %, Source: Datastream



In this environment, Italian sovereign bonds can continue to perform well. Supported by a moderate economic recovery and the still rather high risk premium (although the rating of Italy is similar to the one of Portugal, the spread to German Bunds is around twice the Portuguese one), there is some leeway for tighter spreads.

Overall, the environment for non-core euro area bonds remains favorable. This applies especially to higher-yielding bonds which will eventually trigger a further convergence of euro area government spreads. What is more, the share of non-domestic investors in BTPs is rather low (despite a slight increase recently). Hence, there is scope for a further rise in the months to come. This is all the more true as the low yield environment will keep demand for higher yield bonds on an elevated level.

# Corporate Bonds

Elisa Belgacem

- After a strong issuance the first week of the year the primary market is mostly on pause as the reporting season has started.
- The CSPP is currently running in a nearly EUR 5 bn per month in line with our expectations strongly supporting the eligible universe.
- The beginning of the year saw the continuation of December 19 with continued tightening of IG while HY was massively compressing.
- The recent Coronavirus risk off related mood has caused most of the tightening in HY to reverse while IG has been very resilient.
- Overall, we expect the technicals to be stronger until year-end resulting in tighter spreads in IG while HY should trade in current range in H1 after some widening in H2 as default rates are expected to pick-up

Since November last year credit market have put great attention to first data releases of the new ECB QE CSPP 2. As anticipated we have seen in the first weeks of purchases the share of credit going significantly up compared to previous programs going from below 15% on average to currently slightly below 30% of the overall program size of EUR20bn. We are currently running near EUR5bn per month pace, in line with our expectations.

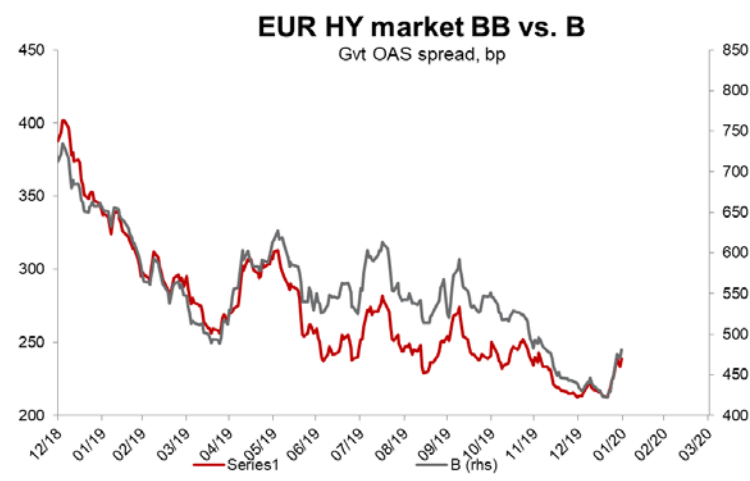
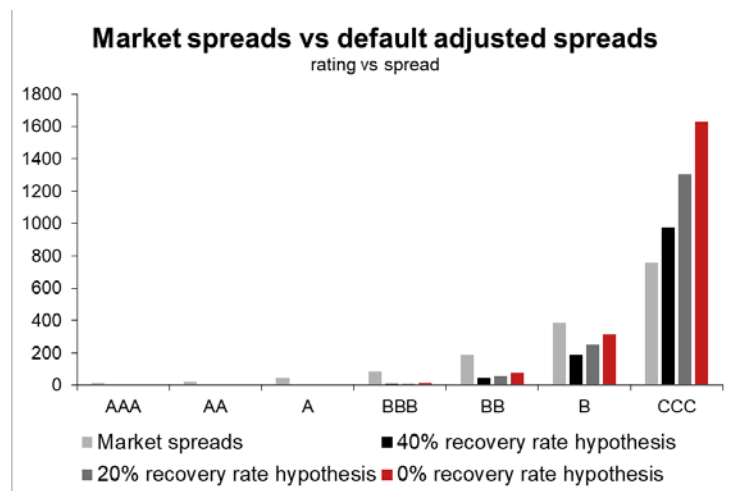
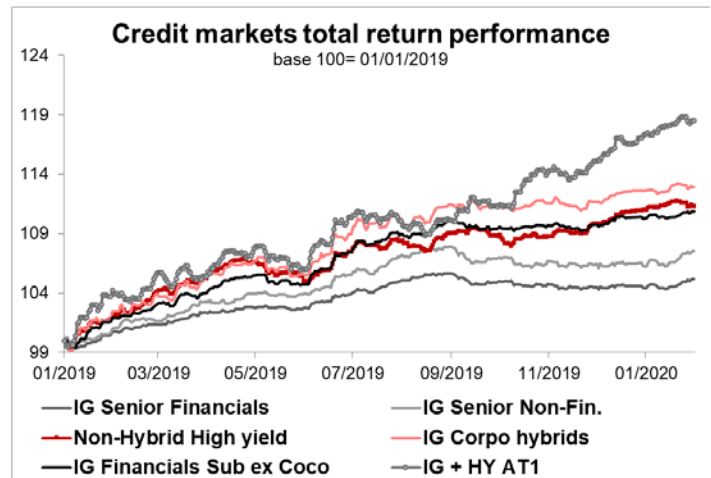
We think that there is still room for further valuation divergence between eligible and non-eligible assets. Later on, we think there is leeway to move our recommendation towards ineligible assets to catch less distorted prices.

The recent risk aversion phase led by the rapid spread of the Coronavirus has barely impacted IG while HY has erased most of Dec 19 tightening.

On this background we keep our positive stance on credit toward the end of the year. Overall, we forecast EA IG corporate bond spreads to tighten by up to 15 bps over the next three months. We also keep our preference for long-dated credit vs. short-dated.

**At current yield levels we also reiterate our preference for non-financials versus financials going forward.**

Nonetheless we expect default rates to increase moderately – staying to idiosyncratic levels – although we continue to prefer taking risks within IG and subordinated notes of IG rated instruments versus high yield embedding higher risk of defaults. In terms of sectors, we expect the most de-rated sectors of the IG space to benefit the most from the ECB action including Autos and real estate. In contrast, we would rather recommend a defensive positioning in HY preferring defensive and domestic players.

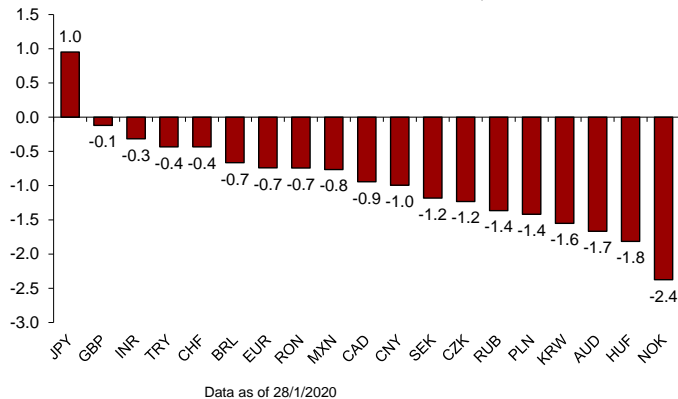


# Currencies

Thomas Hempell

## FX performance

vs. US dollar 20/1/2020 to 28/1/2020, in %



- The fallout from the Coronavirus has provided new support to the USD, with global data green shoots questioned.
- Further USD weakness seems to be delayed, but not reversed. The near-term EUR/USD outlook is almost balanced. We still see upside by year-end, but trim our forecast to 1.15.
- The SNB is proving hesitant to counter CHF strength. Short-term, Coronavirus uncertainties keep weighing on EUR/CHF. We still expect a recovery over the course of the year, but slightly pare back the forecast.

The USD and the JPY have been the winners from mounting market concerns over the spreading Coronavirus. In fact, the USD has recovered almost all its December losses against major peers. The virus and the wide-ranging measures taken by China and other Asian countries will leave a strong mark on those economies, but we see good chances of a rebound thereafter. Short term, the USD as a counter-cyclical currency may still benefit from uncertainties about the recent global green shoots. But we do not see it as a game changer towards renewed persistent US dollar strength.

### Slightly trimmed EUR/USD outlook

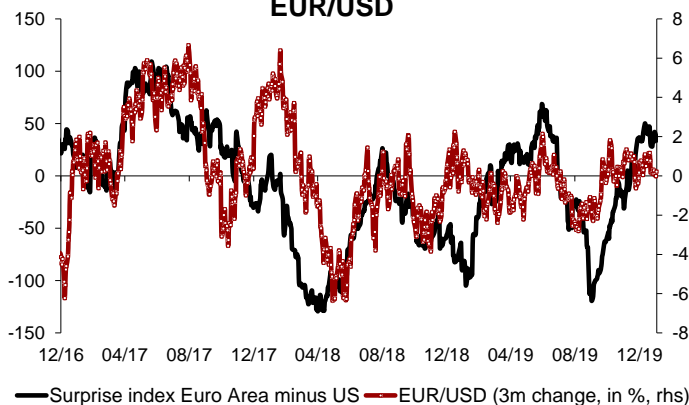
The euro area will be more affected than the US by the potential disruptions in manufacturing and trade. Yet the fallout on the EUR/USD should prove relatively muted. Global carry trades are increasingly funded in EUR. Higher global risk aversion thus tends to underpin the single currency, largely offsetting the downside pressures from the economic side. With the global recovery challenged, though, we trim our forecast path for the EUR/USD, with 3- and 12m forecasts lowered to 1.11 and 1.15 (from 1.12 /1.17).

### Inactive SNB encourages CHF bulls

The CHF has soared since last autumn, with the EUR/CHF falling to around 1.07, the lowest reading in almost two years. The monetary easing by the ECB in autumn, but also SNB inaction despite falling inflation rates seem to have encouraged CHF bulls. Speculative investors have fully pared their sizeable net short CHF positions over the past months. The re-listing of Switzerland as a 'currency manipulators' by US Treasury just strengthened this trend. In fact, in deviation from past behaviour, the SNB has unwound its FX intervention despite the CHF rebound (see lower chart).

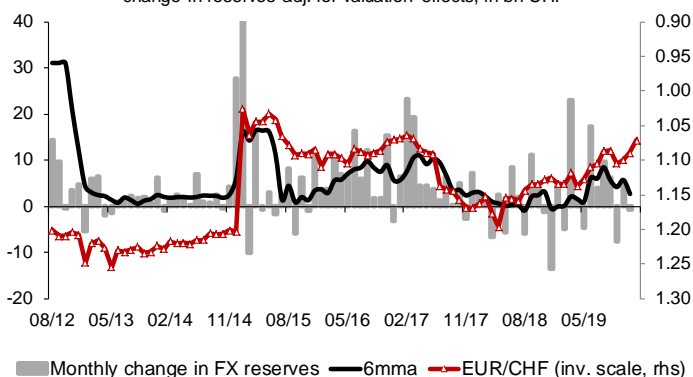
We do not expect the SNB to tolerate much further CHF strength going forward, though, so the risk of resumed FX intervention and even further rate cuts remains in place. Similarly, an unwinding of the Corona fears and a rebound in Bund yields would support a EUR/CHF recovery. We thus still see mid-term upside for EUR/CHF, but moderately pare back our expected path to 1.08 and 1.10 on a 3-/12-month horizon.

## Relative economic data surprises and EUR/USD



## Swiss FX intervention and EUR/CHF

change in reserves adj. for valuation effects, in bn CHF





# Equities

Michele Morganti / Vladimir Oleinikov

- **Coronavirus, lower oil prices and bond yields induced a risk-off attitude, especially for EMs.**
- **We have a constructive view on the epidemic progress but higher PEs are a cap short term, inducing us to reduce our OW stance in equities.**
- **Compared to 2002-3 (SARS), equities are relatively more appealing. Furthermore, Q4 earnings season looks decent with macro momentum bottoming.**
- **Low relative equity volatility vs bonds' one, low credit yields and dovish global monetary policies will continue supporting sentiment. We maintain a constructive stance for the next 3 and 12 months.**

In January, equities were affected by the risk-off attitude and have shown mixed performance. The FTSE MIB did the best (+3.2%). The SMI and S&P500 have outperformed the MSCI EMU index (2.3% and 1.4% vs 0.7%) while the FTSE100 and Topix showed negative performance (-0.7% and -1.2%). The MSCI EM index suffered the most (-1.5%). Growth performed in line with Defensives (+2.7%) and outperformed Value and Cyclical (-0.9% and -0.2%).

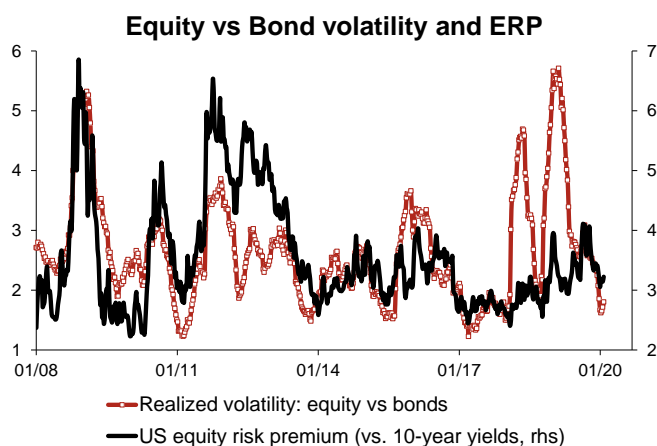
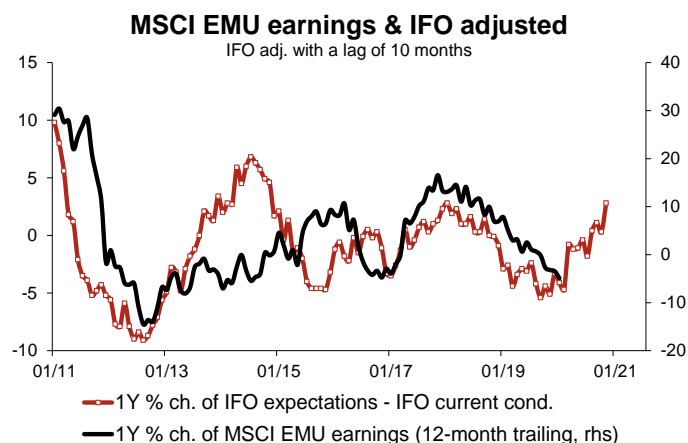
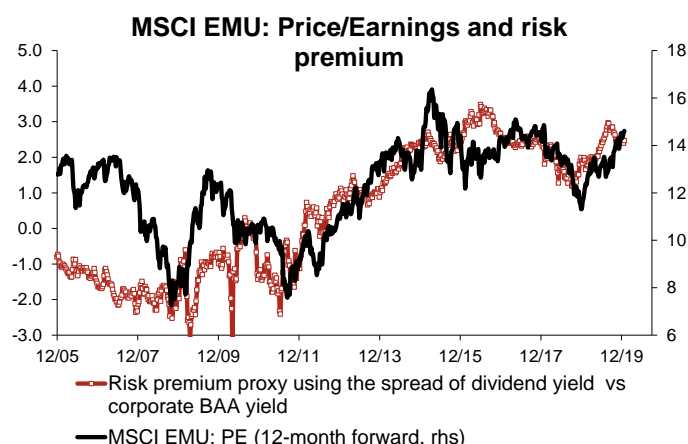
## Investors adopting a cautious stance

Notwithstanding resilient global macro surprises (ex UK and Japan) and rebounding firms' confidence, investors maintained a cautious approach inside equities. Indeed, yields and inflation expectations declined and yield curves flattened, not helping both cyclical and value names. Some frictions between Trump and the EU on tariffs but plunging oil prices and, even more, the spreading of Coronavirus are the reasons behind investors' prudence.

As to the latter, we do not expect an escalation of the epidemic in our base case. We note some key differences to the SARS case in 2002-2003 which should support the market better this time. First, the equity risk premium is much bigger today: dividend yield minus BAA yield is 5 pp higher. Second, the banking sector is at a discount to the MSCI EMU index by 40% in terms of PEs while it was appreciably higher valued at that time (discount of 16%). Third, the trade-weighted euro was on its way up (around +10% yoy) which represented a headwind for earnings, while today it is around -4% yoy. Lastly, current volatility (VIX, 16) is for structural reasons nearly half the one occurred by the end of 2002 (30), as the Fed Funds rates were much higher (at 6% vs 1.75% today) and global monetary support was much lower than nowadays. In sum, in our base scenario (no pandemic escalation) market losses would represent an occasion to buy.

## Higher PEs to represent a cap in the short term

The higher PEs represent a potential cap for performance in the very short term. That said, low relative equity volatility vs bonds' one, low credit yields and dovish global monetary policies will continue supporting sentiment.



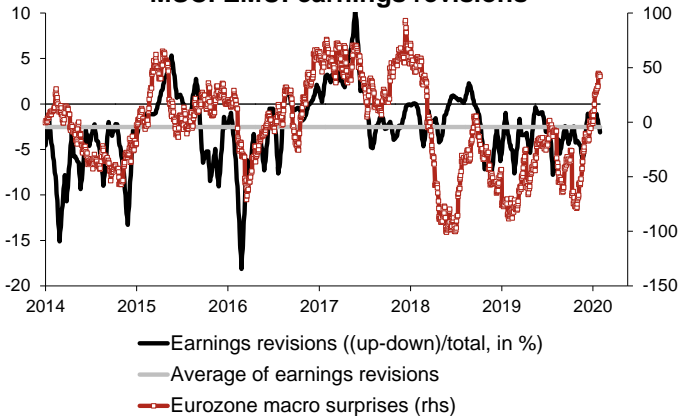
# Equities

Analysis of the median stock: Q4 2019 reporting season

Median stock	Earnings Growth		Sales Growth		availability
	Q3 2019	Q4 2019	Q3 2019	Q4 2019	
	S&P	7.07 %	6.40 %	3.52 %	
Stoxx	0.00 %	9.21 %	6.10 %	4.59 %	15.7%
Euro Stoxx	(11.20)%	9.21 %	6.75 %	4.60 %	10.1%
Topix	0.91 %	(1.98)%	2.25 %	0.19 %	22.7%

Median stock	Earnings Surpr		Sales Surpr		availability
	Q3 2019	Q4 2019	Q3 2019	Q4 2019	
	S&P	3.93 %	2.66 %	0.54 %	
Stoxx	2.31 %	3.85 %	0.58 %	0.42 %	15.7%
Euro Stoxx	(0.27)%	0.87 %	0.26 %	0.77 %	10.1%
Topix	1.50 %	1.60 %	(0.33)%	(1.75)%	22.7%

MSCI EMU: earnings revisions



The macro momentum is already benefitting from such monetary support, which is seen in the recent readings for the IFO index and the macro surprise index. This in turn should stabilize earnings revisions. Profits are starting to find support also due to a less vigorous labor costs momentum, stabilizing capacity utilization and global new exports.

The reporting season is going decently well. In the US the median stock (37% of S&P 500 firms reported) shows a 6.4% yearly earnings growth and 3.4% sales growth. Surprises are 2.7% for earnings and 0.5% for sales.

Should the Coronavirus not represent a major issue (our base case), the economic cycle stabilization should trigger at some point also a rotation into Value sectors and equities in general at the expense of bonds' inflows. The Italian risk has also recently abated thanks to the regional elections' results which reduced the probability of new national elections while banks continue to offload their non-performing loans.

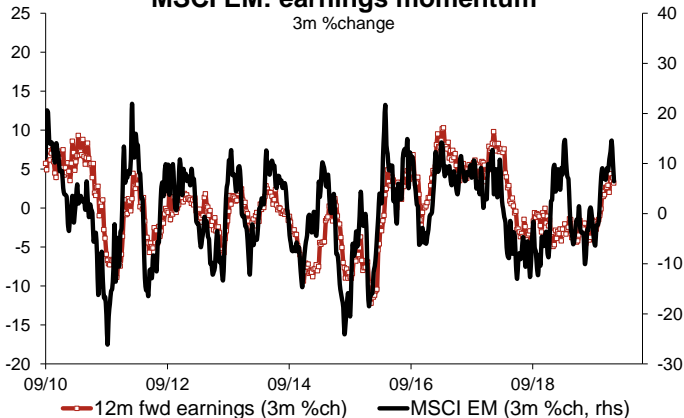
### OW EU, Value vs Growth, N Cyclical vs Defensives

Inside equities, we have a slight preference of EMU and EMs vs US (euro hedged), and we use as a hedge an OW on SMI and UK and stay neutral on Japan. We are also neutral on cyclicals vs. defensives. OW: Utilities, discretionary and energy. UW: Real Estate, Materials and IT. Limited OW on Momentum, software, Low Leverage. Neutral on Quality. Banks (OW): a more helpful regulation news flow comes on top of the recent stabilization in the economic momentum. The greater clarity in regulation could also support a higher M&A activity (something which the ECB encourages).

### EM: to suffer from Coronavirus short term

The "phase one" trade deal between the US and China reached on December 13th, 2019 had boosted investor sentiment but the outbreak of Coronavirus in China sent jitters through the markets and investors are mulling the economic dangers from the virus spreading. As a result, EM equities underperformed the MSCI World (-1.5% vs 0.6%). EM multiples vs history are now trading at a slight discount of 3% vs norm. The conventional PE vs the MSCI World for EM stocks is somewhat below historical average. Earnings estimates for 2020 and 2021 have been positively revised especially for Asian countries, in which we currently see risks in the short term. The Fed's expected easing in Q2 would support lower EMBI spreads and local policy rates in EMs, which would reduce the EMs' cost of capital. Unless the spreading of Coronavirus comes out of control (not our base case), green shoots emerging in Asia's business cycle would further strengthen earnings stabilization, thus supporting EM equities. Within the EM universe, we favor Brazil and CEE markets (ex. Turkey).

MSCI EM: earnings momentum



# Asset Allocation

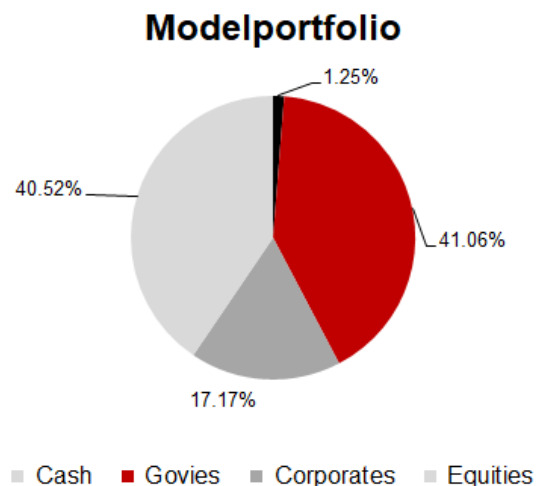
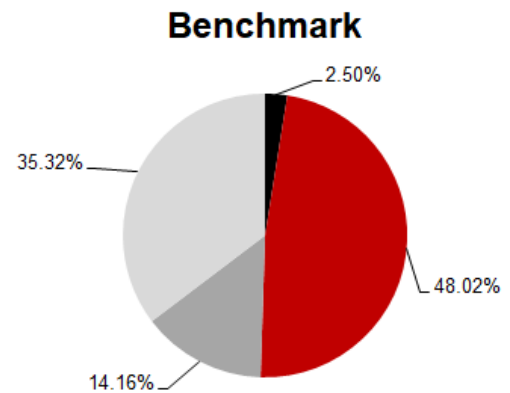
Thorsten Runde

- So far, in 2020, the development on financial markets can be divided into two different sub-periods, one before and one after the outbreak of the Coronavirus.
- All in, nearly all asset classes in our investment universe revealed positive total return figures since the beginning of the year (until January 29<sup>th</sup>).
- The 10Y+ government bond segment accounts for the largest gains across all regions. With performance figures of around +5% peripherals and US Treasuries did particularly well.
- Apart from EMs, equity markets remained in positive territory so far, clearly led by North America, revealing a good +1.5% gain.
- Looking ahead, we basically maintain our general pro-risk stance, though at a reduced overall level of aggressiveness. The UW in core govies should be kept in favor of EA IG credit. This more cautious approach is all the more advisable as with the Coronavirus another risk factor appeared on the agenda, at least in the short-term.

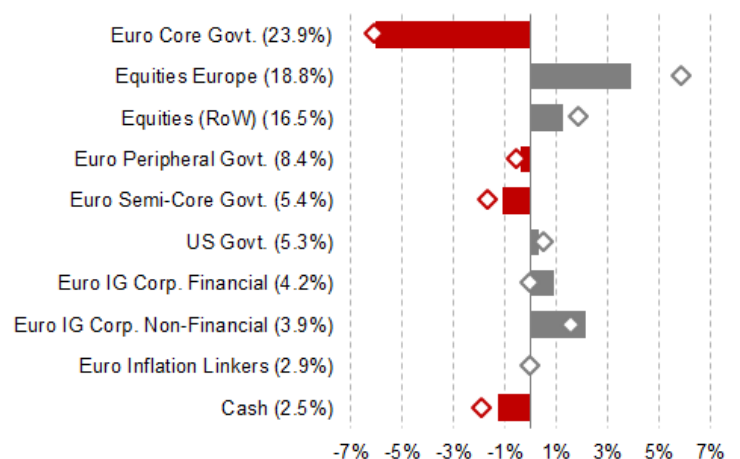
The development on financial markets can be divided into two different sub-periods, one before and one after the outbreak of the Coronavirus. In the Pre-Corona period markets had a strong start into the new year with performance figures clearly in favor of risk assets, particularly in favor of equities. Thus, the overweight in equities at the expense of government bonds had paid off quite well. That said, in the Post-Corona outbreak period from mid-January onwards a broader risk sell-off was triggered, shifting the relative attractiveness between equities and government bonds clearly towards the latter. Scaling back active positions already on January 20<sup>th</sup> the drawback in TAA performance could be limited. Although the performance contribution of equities is negative so far in 2020, the overall outperformance is still around +11 bps. The TAA portfolio particularly benefited from the overweight positions in medium- to long-dated BTPs which rallied in the Post-Corona period.

### Pro-risk tilt to be maintained at reduced levels

Bottoming global growth, easing trade concerns and continued massive monetary policy support will proceed to underpin risk assets. That said, with the US Primaries a new source of political uncertainty is likely to emerge. Together with the recent rally (until mid-January) and the more aggressive positioning by global investors a more prudent tactical allocation stance deems advisable. This holds in particular in the near-term until the success of the measures to contain the spreading of the Coronavirus hopefully materialize. We recommend reducing the overall level of aggressiveness. That said, the UW in core govies should be kept in favor of EA IG credit



### Active Positions in TOP 10 Benchmark Constituents\*



\*Benchmark weights in parentheses, diamonds indicating previous recommendations

# Forecast Tables

## Growth

	2018	2019f	2020f	2021f
US	2.9	2.3	1.6	1.8
<i>Euro area</i>	1.9	1.2	1.0	1.1
Germany	1.5	0.6	0.8	1.3
France	1.7	1.3	1.2	1.3
Italy	0.7	0.1	0.5	0.6
<i>Non-EMU</i>	1.6	1.3	1.2	1.5
UK	1.4	1.3	1.2	1.4
Switzerland	2.8	0.8	1.2	1.6
Japan	0.8	1.1	0.6	0.9
<i>Asia ex Japan</i>	6.2	5.2	5.2	5.3
China	6.6	6.1	5.7	5.7
Central/Eastern Europe	3.0	1.8	2.7	2.9
Latin America	0.1	- 0.1	1.6	2.0
<b>World</b>	<b>3.6</b>	<b>2.8</b>	<b>2.9</b>	<b>3.1</b>

## Inflation

	2018	2019f	2020f	2021f
US	2.4	1.8	2.1	2.2
<i>Euro area</i>	1.8	1.2	1.3	1.4
Germany	1.8	1.4	1.4	1.5
France	1.9	1.2	1.2	1.3
Italy	1.1	0.8	1.1	1.1
<i>Non-EMU</i>	2.3	1.7	1.9	1.8
UK	2.5	1.8	2.0	1.8
Switzerland	0.9	0.4	0.3	0.9
Japan	1.0	0.5	0.7	0.7
<i>Asia ex Japan</i>	2.6	2.8	3.2	2.6
China	2.1	2.9	2.8	2.1
Central/Eastern Europe	6.0	6.7	5.0	5.0
Latin America	4.0	4.0	3.7	3.6
<b>World</b>	<b>2.8</b>	<b>2.6</b>	<b>2.7</b>	<b>2.5</b>

Regional and world aggregates revised to 2015 IMF PPP weights; Latin America Inflation excluding Argentina and Venezuela

## Financial Markets

3-month LIBOR	29/01/20*	3M	6M	12M	Corporate Bond Spreads	29/01/20*	3M	6M	12M
USD	1.77	1.75	1.50	1.50	BofAML Non-Financial	92	90	85	85
EUR	-0.42	-0.45	-0.45	-0.45	BofAML Financial	95	95	90	90
JPY	-0.04	-0.10	-0.10	-0.10	<b>Forex</b>	<b>29/01/20*</b>	<b>3M</b>	<b>6M</b>	<b>12M</b>
GBP	0.69	0.80	0.80	0.80	EUR/USD	1.10	1.11	1.13	1.15
CHF	-0.68	-0.75	-0.75	-0.75	USD/JPY	109	108	107	106
<b>10-Year Bonds</b>	<b>29/01/20*</b>	<b>3M</b>	<b>6M</b>	<b>12M</b>	EUR/JPY	120	120	121	122
Treasuries	1.61	1.65	1.70	1.75	GBP/USD	1.30	1.31	1.35	1.35
Bunds	-0.38	-0.30	-0.25	-0.15	EUR/GBP	0.85	0.85	0.84	0.85
BTPs	0.92	1.00	1.00	1.05	EUR/CHF	1.07	1.08	1.09	1.10
OATs	-0.11	-0.05	0.00	0.10	<b>Equities</b>	<b>29/01/20*</b>	<b>3M</b>	<b>6M</b>	<b>12M</b>
JGBs	-0.04	-0.05	-0.05	0.00	S&P500	3264	3280	3275	3265
Gilts	0.53	0.60	0.65	0.80	MSCI EMU	131.7	132.0	131.0	133.0
SWI	-0.76	-0.70	-0.65	-0.55	TOPIX	1698	1690	1705	1725
<b>Spreads</b>	<b>29/01/20*</b>	<b>3M</b>	<b>6M</b>	<b>12M</b>	FTSE	7459	7430	7430	7425
GIIPS	100	95	95	90	SMI	10773	10570	10615	10810
BofAML Covered Bonds	40	40	40	38					

\*average of last three trading days

### 3-Months Horizon

Government Bonds	10-Year Bunds	-0.39	-0.30	-0.21
	10-Year Treasuries	1.47	1.65	1.83
	10-Year JGBs	-0.06	-0.05	-0.04
	10-Year Gilts	0.50	0.60	0.70
	10-Year Bonds CH	-0.90	-0.70	-0.50
Equities	MSCI EMU	125.0	132.0	139.0
	S&P500	3126	3280	3434
	TOPIX	1589	1690	1791
	FTSE 100	7070	7430	7790
	SMIC	10091	10570	11049
Currencies	EUR/USD	1.08	1.11	1.14
	USD/JPY	104.25	108	111.75
	EUR/GBP	0.82	0.85	0.88
	EUR/CHF	1.06	1.08	1.10

### 12-Months Horizon

Government Bonds	10-Year Bunds	-0.31	-0.15	0.01
	10-Year Treasuries	1.37	1.75	2.13
	10-Year JGBs	-0.02	0.00	0.02
	10-Year Gilts	0.59	0.80	1.01
	10-Year Bonds CH	-0.91	-0.55	-0.19
Equities	MSCI EMU	117.9	133.0	148.1
	S&P500	2977	3265	3553
	TOPIX	1506	1725	1944
	FTSE 100	6715	7425	8135
	SMIC	9848	10810	11772
Currencies	EUR/USD	1.08	1.15	1.22
	USD/JPY	97.72	106	114.28
	EUR/GBP	0.79	0.85	0.91
	EUR/CHF	1.04	1.10	1.16

\*The forecast range for the assets is predetermined by their historical volatility. The volatility calculation is based on a 5 year history of percentage changes, exponentially weighted. The length of the bars within each asset group is proportional to the relative deviations from their mean forecasts.



# Imprint

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