J. SAFRA SARASIN
— ASSET MANAGEMENT —

Cross-Asset Weekly

06 November 2020

After the US-elections and in a new Covid-wave

It feels that this has been the longest US election campaign ever. And it might just fit that it takes longer than usual to declare who the winner is. It seems likely so far that there is no 'Blue Wave' in which Democrats are able to win the presidency and the senate. As a result, we expect the fiscal stimulus under either president to be smaller than what has been anticipated in the case of a clear Democratic sweep. A smaller fiscal stimulus and slower economic growth are likely to weigh on inflation expectations – providing the base for very expansionary Fed-policies for years to come. Still, over the next 6 to 12 months, we expect developed market government bond yields to be moderately higher with steeper yield curves as the global economy continues to recover and a Covid-19 vaccine becomes available – as we show in our monthly forecast update.

Meanwhile, GDP growth in Europe and in the US over the winter is likely to be weaker than previously expected, as the very strong rise of Covid-infections has taken us by surprise. However, we also note that fiscal transfers will soften the blow from new lockdowns, which are more targeted to specific sectors and regions. Overall, we estimate that the return of 'semi' national lockdowns could lead to a 1-2½% hit to 4Q20 GDP.

In equity markets we stick to our tech overweight, but continue to expect cyclical sectors to outperform over the medium term, into 2021, as the manufacturing recovery remains broadly intact. EM remains our highest conviction overweight on a regional level, given that (a) we expect the US Dollar to weaken further and that (b) Covid risks are well contained, in particular in EM Asia.

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Global Macro: Forecast Update

Navigating the different waves

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More restrictive measures to control the pandemic and the high probability that the forthcoming US fiscal package will take more time to come about will weigh on the near-term growth outlook in Europe and the US. A smaller fiscal package also means that the Fed will probably have to do more to help reflate the economy. Still, over the longer run, we remain confident that the global recovery will continue to unfold.

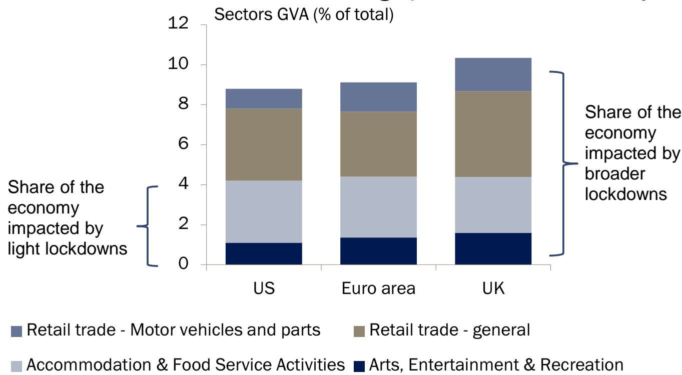
GDP growth in Europe and the US over the winter months is likely to be weaker than previously expected

GDP growth in Europe and the US over the next 3 to 6 months is likely to be weaker than we previously expected. The extremely rapid increase in new Covid-19 cases in Europe, and the restoration of various forms of national lockdowns – shutting down the hospitality and entertainment sectors, and in some cases non-essential stores – have taken us by surprise. Covid cases in the US lag behind those in Europe, but they will probably rise over the coming weeks, forcing authorities to introduce more stringent restrictions once again.

The return of 'semi' national lockdowns could lead to a 1-2% hit to 4Q20 GDP

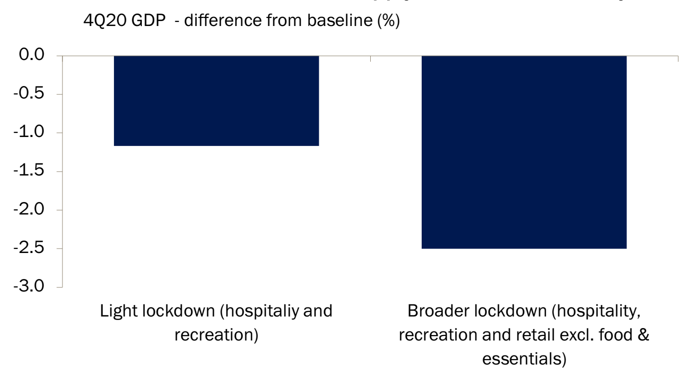
A supply-side approach suggests that a full one-month shutdown of these sectors, followed by a full and immediate re-opening, would provide a 1-2½% hit to GDP in the fourth quarter of the year (Exhibits 1-2). Clearly, there is a high probability that at least some of the restrictive measures will need to remain in place for longer than a month, and perhaps throughout the winter, to keep the health situation under control.

Exhibit 1: New lockdowns are affecting up to 9% of the economy



Source: Macrobond, J. Safra Sarasin, 04.11.2020

Exhibit 2: A 1% to 2½% hit to the supply side of the economy



Source: Macrobond, J. Safra Sarasin, 04.11.2020

The US fiscal package will probably be both, more reactive to economic conditions and somewhat smaller than previously expected

What's more, the US election results suggest that Mr Biden will take the presidency but that the Republicans will keep their lead in the Senate. The implication is that the next fiscal package is likely to be smaller than under the status quo ($1-1.5tn vs $1.5-2tn), our assumption so far, and might take more time to come about. Republicans will probably want to see evidence that the pace of the recovery is slowing before taking action. Yet we shouldn't exclude the possibility of a deal being passed before year end. Mitch McConnell, the Senate majority leader, said earlier this week that the stimulus should be the Senate's top priority. He also indicated that aid for both, state and local governments, a big Democratic priority, could be part of the plan, a reversal from his stance prior to the election.

The medium-term growth outlook remains encouraging as fiscal transfers will soften the blow from the new lockdowns

Over the medium term, we think the outlook for the global economy remains encouraging, for three reasons. First, fiscal transfers to both workers and businesses affected by new lockdowns imply that some spending will be postponed but not cancelled i.e. that pent-up demand will build up. Households are likely to reallocate some of their spending budgets

towards the goods sector, as we have seen over the last few months. In short, GDP growth is likely to get shifted around but the level of GDP in advanced economies should not be materially different by the end of 2021 from what we previously expected.

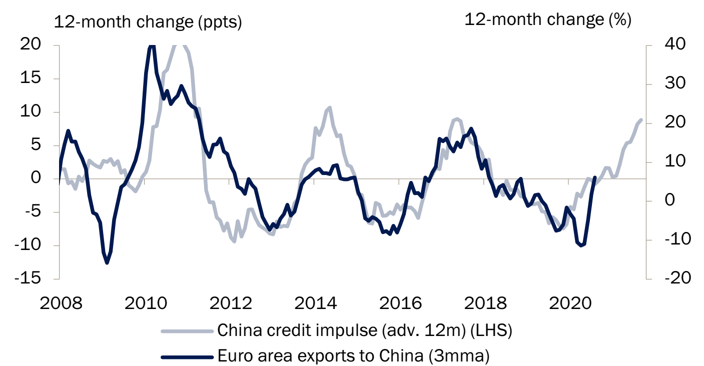
The global manufacturing sector should continue to expand

Second, the global manufacturing sector should continue to expand over our forecast horizon. Lockdowns in spring have caused low levels of goods inventories, spurring production. The strong rebound in new orders suggests that there is still positive momentum (Exhibit 3). In addition, the Chinese economy should continue to grow rapidly over the next 12 months, and boost advanced economies' external demand (Exhibit 4).

Exhibit 3: More upside momentum in global manufacturing activity

Source: Macrobond, J. Safra Sarasin, 04.11.2020

Exhibit 4: A boost to Euro area external demand



Source: Bloomberg, Refinitiv, J. Safra Sarasin, 04.11.2020

Corona vaccines will probably start to be distributed from next year, easing the crisis

Finally, better treatment against Covid-19 and the probable introduction of vaccines next year should help control the disease. There is still a lot of uncertainty around the exact time line, about future vaccines' effectiveness and about the ability of drug companies to produce enough doses. But the health situation will probably look better than it does today, allowing some form of normality to return to the global economy.

The Fed will probably have to do more help reflate the economy

So what are the implications for inflation and central banks? The resurgence of the pandemic has already led the ECB and the Bank of England to announce or deliver more stimulus. In addition, the pricing out by bond markets of a big fiscal package that would have gone through under a 'blue wave' has already weighed on long-term inflation expectations. The probability that the Fed will have to do more to reflate the economy, via additional bond purchases or by shifting the duration of its portfolio, has therefore clearly risen.

Key changes to the forecasts:

4Q20 and 1Q21 GDP growth in Europe and the US to be weaker than previously expected

A smaller and more reactive US fiscal package imply that the US recovery in 2021 will be somewhat shallower than previously anticipated. Still, it should remain solid

China to grow faster in 2021 than previously expected. This should boost Europe's and Japan's external demand

Exhibit 5: GDP and CPI forecasts

Macro Forecasts in % yoy

		2019	2020	2021
US	GDP	2.2	-3.9	4.1
	CPI	1.8	1.2	1.8
Euro area	GDP	1.3	-6.7	5.2
	CPI	1.2	0.2	0.3
Switzerland	GDP	1.1	-3.7	4.4
	CPI	0.4	-0.7	0.0
UK	GDP	1.4	-11.0	5.6
	CPI	1.8	0.9	1.1
Japan	GDP	0.8	-5.4	3.3
	CPI	0.5	0.2	0.3
China	GDP	6.1	2.2	8.2
	CPI	2.9	2.7	2.0

Source: Macrobond, J. Safra Sarasin, 06.11.2020

Fixed Income: Forecast Update

US election outcome to weigh on yields in the short term

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A split congress in the US would lead to a contentious and more modest fiscal package, a lower US growth profile over the next quarters and hence a more muted trajectory for Treasury yields. The Fed will likely consider a more proactive policy approach with respect to asset purchases in December. Still, over the next 6 to 12 months, we expect developed market government bond yields to be moderately higher with steeper yield curves as the global economy recovers and a Covid-19 vaccine becomes available. We expect credit to do well thanks to continued monetary support from central banks.

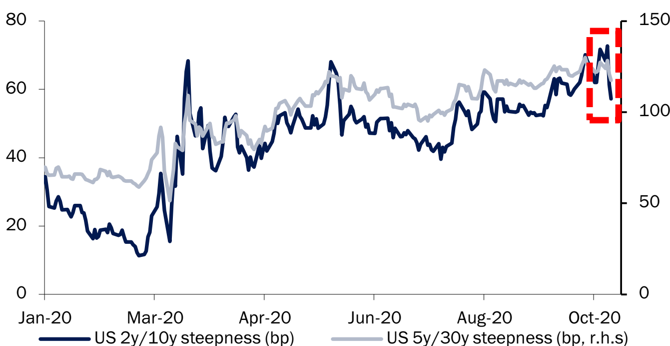
Likely no "blue sweep" but a period of uncertainty

Although Biden looks set to win the presidency, the expected 'Democratic blue sweep" will probably not materialise, even if the Democrats still have a chance of flipping the Senate majority in Georgia on January 5th 2021. President Trump's campaign has started to mount legal challenges with respect to mail-in ballots in several states. Consequently, it could take time until the result is official, which will give way to a period of uncertainty.

US curve steepening trades are unwound

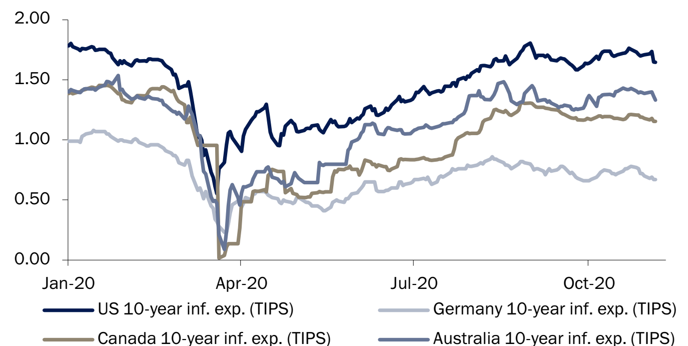
The US Treasury market has staged a fierce reversal of the popular steepening trade and long-term yields have fallen by almost 20bp from the highs a few days ago (Exhibit 1). As we already pointed out, any change in the reflation narrative would lead to a sharp temporary reversal of the current steepening trade, (see our Cross Asset Weekly *"The road to a steeper US curve is not a straight line"*, 30th October 2020). When it became clear that the Democrats were probably not going to take the Senate, market-based inflation expectations, the main driver of the recent curve steepening, started to reverse (Exhibit 2).

Exhibit 1: A fierce reversal as curve steepeners are unwound



Source: Bloomberg, J. Safra Sarasin, 05.11.2020

Exhibit 2: Inflation expectations have started to drop again



Source: Bloomberg, J. Safra Sarasin, 05.11.2020

A split congress would have implications for the rates market

Republicans have a good chance of holding on to their Senate majority. A split congress always implies the danger of gridlock, even more so when considering how deeply divided the US is along party lines. It seems clear that Republican senators who have up to now resisted a more generous fiscal package are unlikely to change their view after the election. A potential Biden presidency will therefore need to deal with Republicans that are less willing to strike a large deal. The approval of a fiscal package will therefore be more contentious and could take longer to come through. This comes at a time where the Corona pandemic is worsening and where a large and timely fiscal stimulus is needed to bridge the gap until a vaccine becomes widely available. Consequently, we would look for lower growth expectations over the next few quarters in the US and a lower trajectory for

yields and curve steepness as more policy support from the Fed will likely be priced into the yield curve.

More support from the Fed if needed

With a fiscal package now likely more modest (and possibly delayed) and the headwinds from the Corona crisis not abating, the Fed will probably consider a more proactive approach, i.e. a potential change to its asset purchase program in December. Any adjustment will be contingent on the growth dynamic in the US, and in particular on the impact of Covid-19 related restrictions on the important services sector. A tightening of credit conditions or a fall in brake-even rates would lead to an accelerated pace of corporate and MBS purchases and to a pivot of Treasury purchases to longer term bonds and TIPS.

Treasury yields to revert to the old trading range for now

After the premature optimism for a large fiscal package, Treasury yields will now likely revert back to the old trading range of 60 to 80bp in coming weeks, until there is more clarity on the election outcome and the handling of the current surge in Covid-19 cases. US 10-year break-even rates should drift back to the 1.6% area, while real yields should remain low. Our current year-end target for 10-year Treasury yields of 90b is therefore likely at the upper end of the potential set of outcomes.

Medium term, the road to moderately higher US yields and a steeper curve is intact

Over the next 6 to 12 months, the recovery in the global economy and a potential availability of a Covid-19 vaccine should clear the way to moderately higher US Treasury yields and a steeper curve as the current low inflation expectations will likely pick up.

Euro area rates to stay depressed for now and rise moderately over the next 6 to 12 months

The ECB has already indicated further easing measures in December, with all instruments being considered. The most likely outcome will be an increase and extension of the *Pandemic Emergency Purchase Program* (PEPP), more favourable lending rates under the *Targeted Long Term Refinancing Operations* (TLTRO) as well as adjustments to the 'tiering-mechanism' for bank reserves. European yields will therefore stay at depressed levels for now before rising moderately over 6 to 12 months as the global economy gains traction and inflation expectations increase. Euro area peripheral spreads will likely continue to tighten further on the back of unconditional support by ECB asset purchases.

A split government would not necessarily be negative for credit risk assets

We already noted that an outcome with split chambers of congress is not necessarily bad for credit (see our Cross Asset Weekly *"Yields to increase slightly more in a Democrat Clean Sweep"*, 16th October 2020) as it would imply expectations for looser financial conditions for longer than in a "blue sweep" where growth and inflation expectations would likely rise more strongly. Credit risk assets typically do well in an environment which is characterised by moderate growth and continued strong monetary support. While in the short term, uncertainties could lead to volatility, credit should continue to do well over the medium term, even under the outcome that is currently the most likely.

Forecast update: 10y Bond yields

	04-Nov-20	Dec-20	Jun-21	Dec-21
USA	0.77	0.90	1.20	1.25
Germany	-0.65	-0.45	-0.15	-0.10
Switzerland	-0.52	-0.50	-0.30	-0.25
UK	0.25	0.35	0.35	0.40
Japan	0.04	-0.15	0.00	0.00

Source: Bloomberg, J. Safra Sarasin, 06.11.2020

Forecast update: FX

	04-Nov-20	Dec-20	Jun-21	Dec-21
EUR-CHF	1.07	1.07	1.05	1.05
EUR-USD	1.17	1.20	1.23	1.24
EUR-GBP	0.90	0.89	0.91	0.92
GBP-USD	1.30	1.35	1.35	1.35
USD-JPY	105	102	101	100
USD-CHF	0.91	0.89	0.85	0.85
USD-CNY	6.71	6.70	6.65	6.60
XAU-USD	1'899	1'960	1'900	1'850

Source: Bloomberg, J. Safra Sarasin, 06.11.2020

Global Equities: Forecast Update

What has changed? Election update and equity allocation

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A potential Biden/split-Congress US election outcome has material implications for markets as less fiscal stimulus than anticipated may be forthcoming while the prospect for corporate tax hikes has diminished as well. The immediate impact is a rotation back into the more defensive/growth part of the market, as the risk for rates has shifted to the downside. We stick to our tech overweight, but continue to expect cyclical sectors to outperform over the medium term, into 2021, given that the manufacturing recovery remains broadly intact. EM remains our highest conviction overweight on a regional level, as (a) we expect the US Dollar to weaken further and that (b) Covid risks are well contained, in particular in EM Asia.

A Biden presidency with a Republican Senate appears likely but is not confirmed yet

The final result of the US election has yet not been released. Pathways to both, a Republican presidency and to a "blue sweep" with a Democratic-controlled Senate remain, but the combination of a Biden presidency and a Republican-controlled Senate appears the most likely outcome as of now.

A divided Biden government has major implications for markets

Such a result has three major implications for markets: a) the potential for fiscal stimulus has diminished, flattening the path of the US recovery in the coming quarters, b) less fiscal stimulus may bring the Fed back into play, reversing the risk of an uptick in rates we mentioned before and c) Biden's domestic political agenda is set to be scaled down from a "blue sweep" scenario with less green spending and corporate tax hikes hanging in the balance (admittedly, the pressure to hike taxes in order to balance the budget is reduced as well). Lastly, his foreign policy agenda, namely a more conciliatory approach towards key trading partners, should be largely unaffected compared to a "blue sweep" scenario.

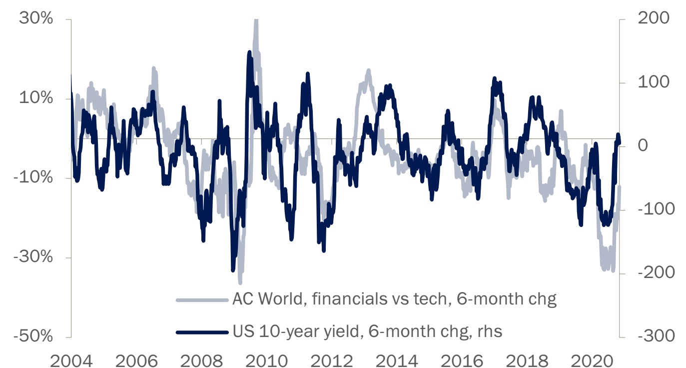
The impact on equities is most notable at the sector level

What does such an outcome hold for equities? The impact is most notable on the sector level. The combination of a shallower growth trajectory and lower rates provides support to the more defensive/growth end of the market, temporarily reversing the recent rotation into cyclical sectors and value. Tech is a key beneficiary, supporting our overweight position in the sector. The main victim of a lower rates/slower growth scenario are financials, which are primarily driven by rates. Tech and financials themselves, are the key drivers of value vs. growth, which should underperform as long as rates keep falling (Exhibits 1, 2).

Exhibit 1: Value vs. growth is mainly a trade on financials vs. tech…

Source: Refinitiv, J. Safra Sarasin, 05.11.2020

Exhibit 2:…with financials vs. tech being driven by US Treasury yields



Source: Refinitiv, J. Safra Sarasin, 05.11.2020

Cross-Asset Weekly

06 November 2020

Regulatory changes to reach zero emission target may still be forthcoming despite less fiscal spending on clean energy

Regarding green investments and taxes, we identified potential key beneficiaries among sectors in a previous note. On the tax side, it does not appear as if the market had priced much in the run up to the election. There has been no noticeable move in valuations for the most exposed sectors, as support for Biden has strengthened. In terms of green investment, Biden's clean energy fiscal plans may be scaled back somewhat but the structural shift towards renewables would no longer face the same headwinds as it did under Trump, This would likely be further supported by new federal regulation and executive action pushing towards the zero emission goal.

Risks remain with both a "blue sweep" scenario and a Trump presidency possible

At this point, it should be noted that we may still see a tilt towards a "blue sweep" as the race for both Georgia Senate seats will go into a run-off in January. Although Republican candidates have won, they have not managed to secure a 50% majority, which is necessary to avoid a run-off vote. If the Democratic Party were to flip both seats, they would hold a voting majority in the Senate under a Democratic president, with his VP holding the majority vote (50 Republican seats and 50 Democratic seats + 1 VP vote). If this were to become likely, we would expect the trades described above to reverse, as an undiluted Biden agenda would be priced.

Furthermore, we would highlight, that a hotly contested election scenario cannot be excluded in the coming weeks, given the tightness of the race (and likely the final result). The current administration appears all but prepared to challenge the outcome in court.

We stick to our EM overweight and to our constructive outlook on cyclicals

On the outlook for non-US equites, we retain our highest conviction overweight in EM equities, which should continue to benefit from a weakening US Dollar and may receive further support from a somewhat more trade-friendly stance under Biden. We keep euro area equities on neutral, due to challenges to the domestic cycle, as Covid restrictions are tightened across the continent. Selected cyclical sectors (e.g. industrials), however, should outperform, given their exposure to the global manufacturing cycle, which remains broadly intact. Lockdowns also appear more targeted than in spring, with the aim to protect the production capacity. It should also be noted that we regard the current reversal as temporary and believe that the pro-cyclical recovery continues over the coming 6 to 12 months, justifying our general underweight positioning in defensive sectors, such as staples, utilities and health care. Lastly, we have upgraded UK equities to neutral, as valuations have reached extremely stretched levels across sectors and risks from a rise in sterling appear limited. Please find our latest allocation and targets below.

Forecast update: Equity allocation

Regional allocation	
Emerging Markets	↑
China	↑
USA	↑
United Kingdom	→
Japan	→
Eurozone	→
Switzerland	↓

↑ indicates overweight
→ indicates neutral weight
↓ indicates underweight

Sector allocation	
Information Technology	↑
Industrials	↑
Energy	→
Materials	→
Consumer Discretionary	→
Banks	→
Insurance	→
Communication Services	→
Real Estate	→
Utilities	↓
Consumer Staples	↓
Health Care	↓

Source: J. Safra Sarasin, 06.11.2020

Forecast update: Equity index targets

Index	Current	Dec-20	Dec-21
MSCI World	2467	2550	2700
S&P 500	3510	3600	3800
Nasdaq 100	11891	12500	14000
FTSE 100	5906	6200	6500
DJ Euro Stoxx 50	3216	3400	3600
SMI	10306	10500	11200
MSCI Japan	1000	1050	1125
MSCI EM	1166	1250	1350

Source: Refinitiv, J. Safra Sarasin, 06.11.2020

Economic Calendar

Week of 09/11 – 13/11/2020

Country	Time	Item	Date	Unit	Consensus Forecast	Prev.
Monday, 09.11.2020						
JN	06:00	Leading Index CI	Sep P	Index	92.80	88.40
Tuesday, 10.11.2020						
UK	08:00	ILO Unemployment Rate	Sep	%	--	7.10%
	08:00	Employment Change 3M/3M	Sep	1'000	--	-153k
FR	08:45	Industrial Production MoM	Sep	mom	--	1.30%
IT	10:00	Industrial Production MoM	Sep	mom	--	7.70%
GE	10:00	ZEW Survey Expectations	Sep	Index	45.00	56.10
US	16:00	Jolts Job Openings	Sep	1'000	6500.00	6493.00
Wednesday, 11.11.2020						
US	13:00	MBA Mortgage Applications	Nov 06	%	--	3.80%
Thursday, 12.11.2020						
GE	08:00	CPI EU Harmonised MoM	Oct F	mom	0.00%	0.00%
	08:00	CPI EU Harmonised YoY	Oct F	yoy	-0.50%	-0.50%
UK	08:00	GDP QoQ	3Q P	qoq	15.80%	-19.80%
	08:00	GDP YoY	3Q P	yoy	--	-21.50%
EU	10:00	Economic Bulletin				
	11:00	Industrial Production SA MoM	Sep	mom	0.90%	0.70%
US	14:30	CPI YoY	Oct	yoy	1.30%	1.40%
	16:00	Core CPI YoY	Oct	yoy	1.70%	1.70%
Friday, 13.11.2020						
FR	08:45	CPI EU Harmonised MoM	Oct F	mom	--	-0.10%
	08:45	CPI EU Harmonised YoY	Oct F	yoy	--	0.00%
EU	11:00	GDP SA QoQ	3Q P	qoq	12.70%	12.70%
	11:00	GDP SA YoY	3Q P	yoy	-4.30%	-4.30%
US	16:00	U. of Mich. Expectations	Nov P	Index	--	79.20
	16:00	U. of Mich. Sentiment	Nov P	Index	82.00	81.80

Source: Bloomberg, J. Safra Sarasin as of 06.11.2020

Market Performance

Global Markets in Local Currencies

Government Bonds	Current value	Δ 1W	Δ YTD	TR YTD in %
Swiss Eidgenosse 10 year (%)	-0.53	0	-6	0.4
German Bund 10 year (%)	-0.64	-1	-46	3.3
UK Gilt 10 year (%)	0.23	-4	-64	4.9
US Treasury 10 year (%)	0.77	-10	-111	10.7
French OAT - Bund, spread (bp)	27	-1	-3	
Italian BTP - Bund, spread (bp)	129	-10	-31	

Stock Markets	Level	P/E ratio	1W TR in %	TR YTD in %
SMI - Switzerland	10’286	19.8	7.9	0.3
DAX - Germany	12’531	18.6	8.4	-5.1
MSCI Italy	630	21.5	10.5	-19.0
IBEX - Spain	6’889	28.6	8.0	-25.7
DJ Euro Stoxx 50 - Eurozone	3’206	20.8	8.7	-11.9
MSCI UK	1’651	19.6	5.7	-21.1
S&P 500 - USA	3’510	25.3	6.1	10.3
Nasdaq 100 - USA	12’078	31.6	6.4	39.3
MSCI Emerging Markets	1’166	18.5	4.1	6.9

Forex - Crossrates	Level	3M implied volatility	1W in %	YTD in %
USD-CHF	0.90	6.1	-1.6	-7.0
EUR-CHF	1.07	4.4	0.1	-1.6
GBP-CHF	1.19	8.7	-0.2	-6.7
EUR-USD	1.18	6.6	1.7	5.8
GBP-USD	1.31	9.3	1.5	0.2
USD-JPY	103.4	6.7	-1.2	-5.0
EUR-GBP	0.90	8.1	0.2	5.6
EUR-SEK	10.31	6.0	-0.6	-1.6
EUR-NOK	10.88	10.3	-2.1	10.2

Commodities	Level	3M realised volatility	1W in %	YTD in %
Bloomberg Commodity Index	73	12.4	2.2	-10.1
Brent crude oil - USD / barrel	40	42.6	7.4	-41.0
Gold bullion - USD / Troy ounce	1’949	15.6	3.7	28.6

Source: J. Safra Sarasin, Bloomberg as of 06.11.2020

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