AXA Investment Managers

Biden his time

Monthly Investment Strategy

AXA IM Research

September 2020

Summary of views

Theme of the month: US elections

- US elections held on 3 November could provide a major turning point for US policy, with much hanging on Presidential and Congressional votes.
- Our outlook, based on current polling, is for Joe Biden to win the Presidency. He has maintained a lead at national level far in excess of that likely needed to deliver an Electoral College majority. Biden also appears to be polling well in key states. However, the President's deficit has shrunk in recent weeks.
- The Congressional race will determine how much of either candidates' agendas might be enacted. Democrats look on track to retain a majority in the House, but the Senate race looks too close to call. Further Republican gains in the polls over the remaining weeks could see them retain a majority here.
- With mail-in votes likely to delay the election outcome and amongst a number of electoral issues already being questioned, there is a real prospect for legal challenges, particularly if the initial count is close, which could lead to a protracted period of uncertainty, and risks of a constitutional crisis.

Macro update: Q3 rebound, but winter is coming ..

- The US should post a record growth rebound in Q3 after a record collapse in Q2. Yet, the level of activity is still likely to be at least 5% below pre-Covid levels and unemployment – having fallen sharply – remains at 8.4%. With benefits being curtailed, recovery looks set to be slower beyond Q4.
- COVID-19 cases are rising again in Europe, particularly in Spain and France. Governments are reintroducing restrictions, but less stringently than in Q2. Downside activity risks are rising, not least with growth momentum slowing into the summer. Government and ECB policy support remains critical.
- The UK also sees rising virus cases. Q3 looks likely to be better-than-expected, but medium-term risks are rising again, including from Brexit.
- China's latest data suggested a broadening recovery, driven both by internal and external growth revival. This is likely to embolden the central bank to further reduce policy stimulus. We continue to expect supportive fiscal policy, which on balance, sees us consider upside risks to our current forecasts.
- Emerging markets have long born the burden of rising coronavirus, but this is also now re-emerging in areas where it had receded. Governments in the main continue to ease restrictions. Q3 will post a material rebound, but the outlook for Q4 is more cautious, particularly where fiscal support has faded.

Investment strategy: Within a realm of ballooning debt levels and ambitious earnings expectations

- FX: The risk on/risk off focus that dominated the first half of the year is finally receding and, post-Covid, value strategies arise. Yen well positioned amid dollar weakness as focus turns to fundamentals while Sterling pained by Brexit negotiations uncertainty.
- Rates: Euro Sovereigns have returned 3.3% YtD with a rather uniform performance between member states (e.g. Italy 4.3%, France 3.5% and Germany 2.3%). However, we should also be aware of risk factors that might raise the level of alert at any time, liquidity, complacency, fundamentals.
- Credit: Returns have overcome the Covid shock and downgrades and defaults are slowing, The risk is a second round of lockdowns and a relapse in economic activity that brings about a second wave of corporate stress, accelerating downgrades/defaults to the detriment of credit portfolio returns.
- Equity: Earnings revisions have been trending upwards after troughing in May and are now in positive territory in the United States. Policy support remains key with both a monetary and fiscal put in place but ditto for the need to remain selective, given the high degree of uncertainty.

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Central scenario

Summary – Key messages

Monetary policy

Central banks globally pushed beyond 2008 envelope. Only marginal additional easing from here. Fed backstopping most markets, ECB steps beyond limits

Inflation

It is hard to consider a more deflationary shock. Policy should bolster demand ahead. FX could temper localised disinflation in US and some EM.

Fiscal policy

Questions of whether to extend fiscal support, as momentum of economic recovery likely to fade into the winter

Growth

We forecast -4.2% global growth in 2020. Q3 will include strong rebounds, but growth will slow thereafter

Our central scenario:
Coronavirus sparks severe recession in most economies

We forecast global growth to fall in 2020 to -4.2%.

Economic rebound depends on policy, labour market reaction and indebtedness. As well as the virus itself.

Emerging Markets

Virus is playing out more across EM's now, with re-emergence in some areas, Latam cases have receded

Rates

Asset purchases by central banks should offset pressures from massive fiscal policy expansion, keeping yields in a range

FX

USD has found support around low levels. Euro's rise has paused under ECB scrutiny. Brexit weighs on GBP.

Credit

The sharp reduction in spreads after massive central bank intervention is now at odds with fundamentals – a risk

Equities

Earnings expectations may be optimistic. Containment of pandemic a necessary condition for rebound to be sustained

Alternative scenarios

Summary – Key messages

Persistent recession *(probability 35%)*

What could be different?

- Virus-shock fractures key labour markets leading to significant global job losses dampening demand even as virus fades.
- Coronavirus outbreak proves more persistent.
- Scale of shock results in isolationist policies: trade wars and other geo-political tensions, echoing 1930s

What it means

- Growth/inflation expectations weaken further, a new depression threatens, corporates' earnings under more pressure
- Further monetary policy where space permits (including China). Government's continue with fiscal stimulus and divide between monetary financing blurs further.

Market implications

- Risk appetite deteriorates / equities sell off / credit widens
- Safe-haven rates rally resumes
- EM debt to come under pressure

Fast recovery *(probability 10%)*

What could be different?

- Virus contained quickly and policy stimulus results in a "V-shaped" rebound
- Labour market recovers, economies benefit from post-virus euphoria
- Virus-shock reshapes business practice, boosting productivity

What it means

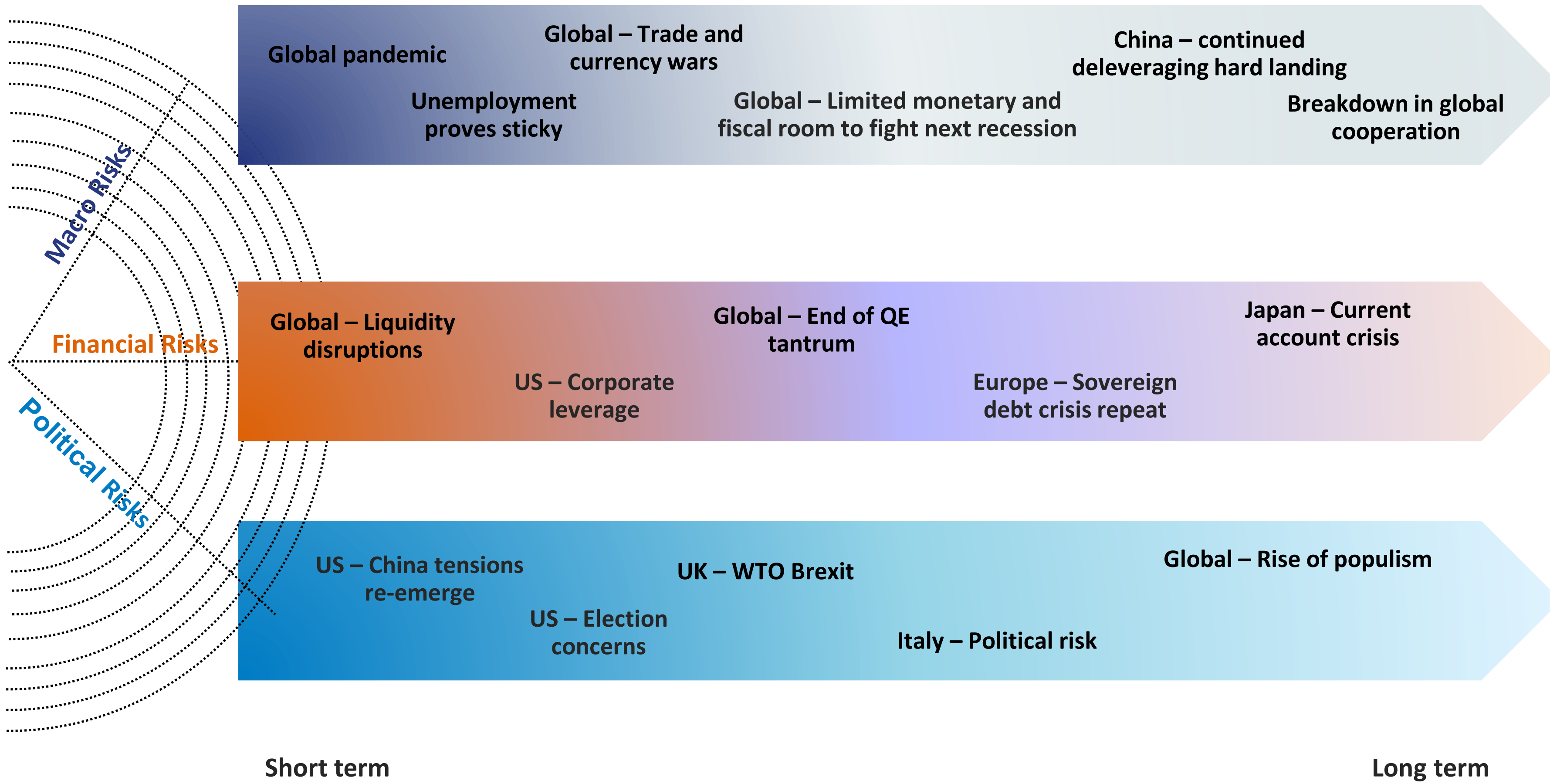
- Global/US/EMU growth surprise on the upside in a stronger and more persistent rebound after the drop in Q2 GDP
- Monetary policy fights expectations for swift tightening through forward-guidance

Market implications

- Risk-on environment with equities recovering losses swiftly
- UST and EUR break-evens rise
- Spreads rally from wides

RISk Radar

Summary – Key messages



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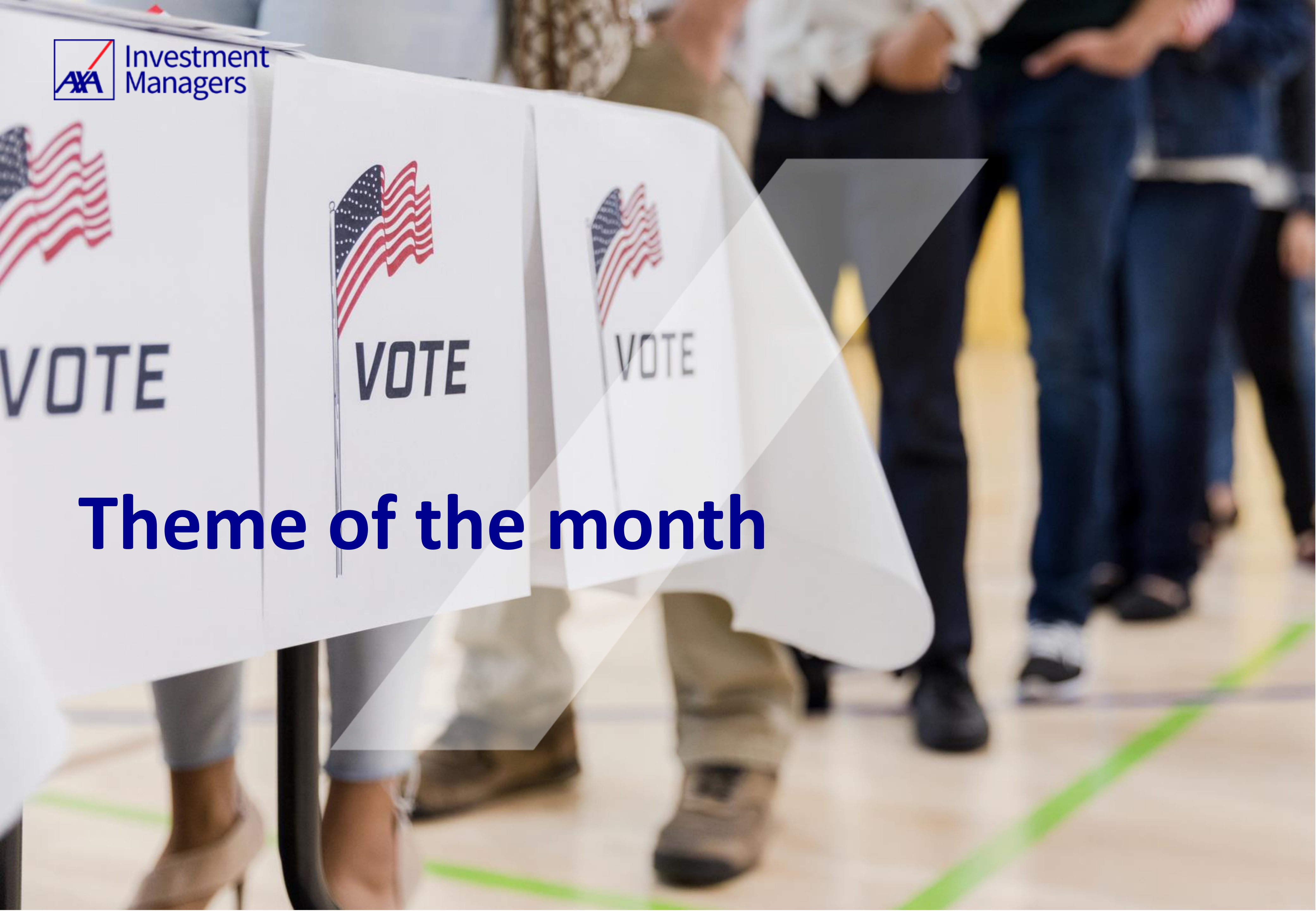


Theme of the month

Theme of the month: US Elections

Biden in poll position

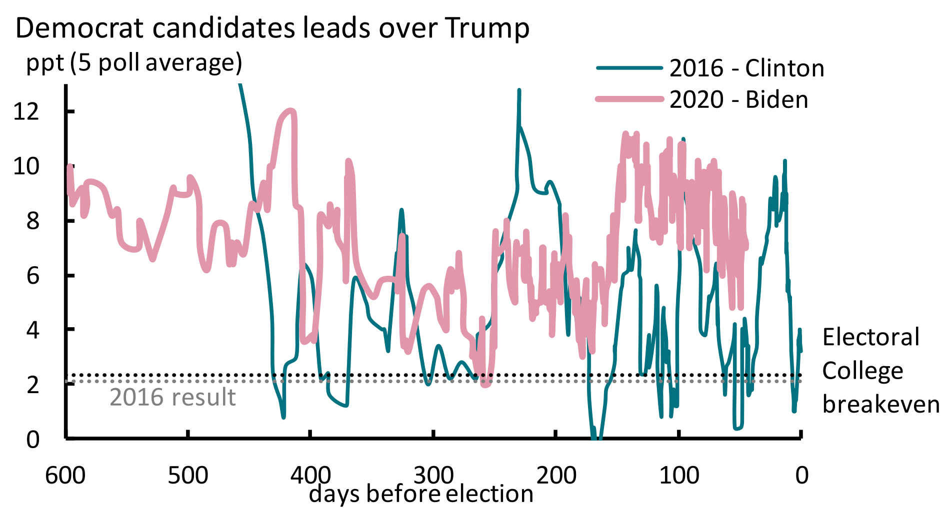
Biden's polling more consistent

- Democrat Presidential candidate Joe Biden has maintained a healthy lead in national polls. His lead rose sharply in the wake of the coronavirus impact in the Spring and although it has retraced a little since the summer, it remains above the breakeven level we estimate necessary to deliver a majority at the electoral college. A key feature of Biden's lead has been its consistency, particularly compared to Clinton's in 2016. We believe that this reflects President Trump being less of an unknown quality this time around.

The race becomes more than the Trump show

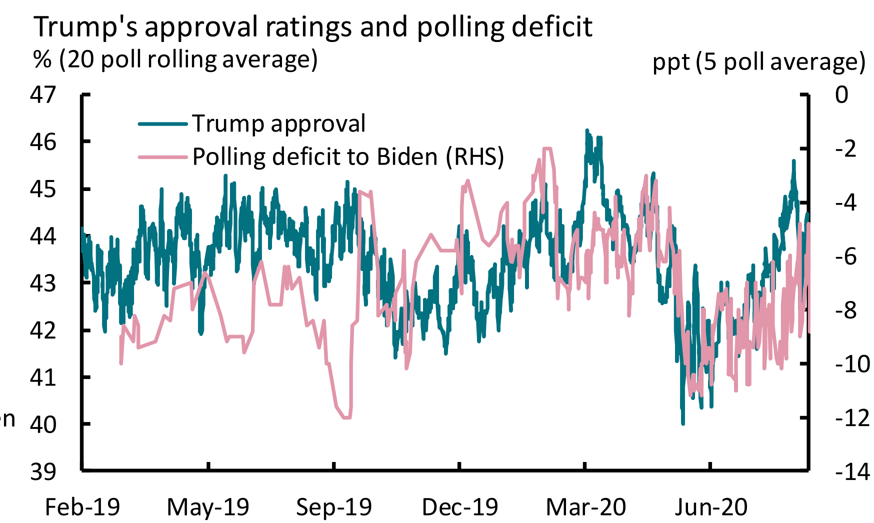
- For most of this year, Biden's lead over the President has largely (inversely) reflected broader public opinion on the President. However, more recently the President's approval rating has risen, but Biden's lead has not retreated by as much. As activity continues to improve towards year-end we suspect that the polling lead could shrink further.

Biden's lead over President Trump has softened, but remains



Source: 538, National Progress enter and AXA IM research, Sep 2020

Correlation between poll lead and President's approval weakens



Source: 538 and AXA IM Research, Sep 2020

Theme of the month: US Elections

State-by-state is where it counts

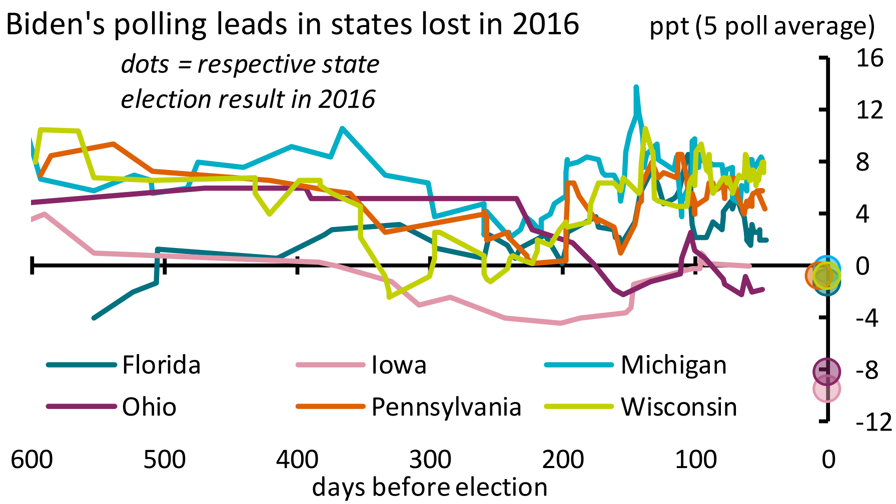
Fighting the last war?

- US elections are not won or lost on a national scale, but in key marginal States. Polling in the 2016 battleground states continues to favour Biden, although again leads have narrowed a little in recent weeks. In 2016, polls in some of these states recorded large error margins. Assuming these error margins are not repeated, polling suggests Biden should reverse most of President Trump's gains from 2016. However, other States are now becoming more competitive.

Probabilities suggest a Biden Presidency

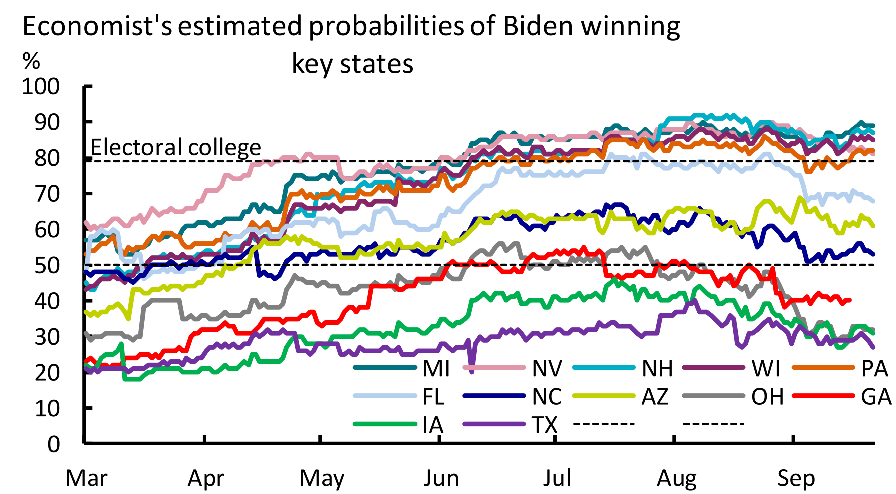
- A more comprehensive review of State polling presents a range of States that could be competitive this time around. Current polling suggests that Pennsylvania could be the marginal state to deliver an Electoral College majority. The Economist predicts a Biden Presidency as around 70% likely. The pollster 538 suggests a more cautious probability around the 60% mark. We continue to expect Joe Biden to win the Presidential vote in November.

Biden leads in 2016 battleground states



Source: 538 and AXA IM Research, Sep 2020

The Economist probability estimates by State



Source: The Economist, and AXA IM Research, Sep 2020

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Theme of the month: US Elections

Congressional race to determine scope for either President's agenda

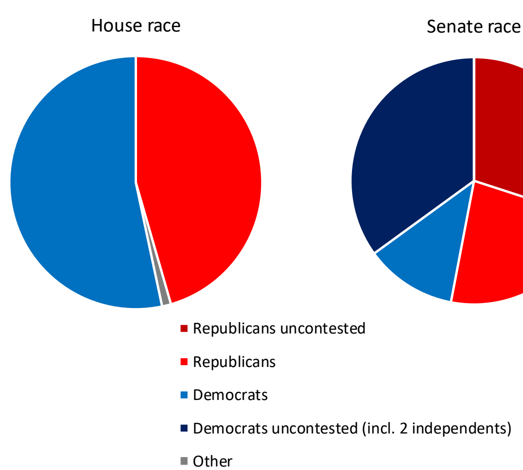
Race for the House: likely Democrat majority

- The Democrat lead in national polling is more likely to be reflected in the House of Representative elections, where all of the seats are contested. The House returned a Democrat majority in 2018 after the Mid-Term Elections, with 232 seats versus 198 Republican (1 Libertarian and 4 vacant seats account for the rest). A narrowing of Biden's national lead could reduce potential gains, but the question is likely whether the Democrat majority will be bigger or smaller than before.

Senate race is too close to call

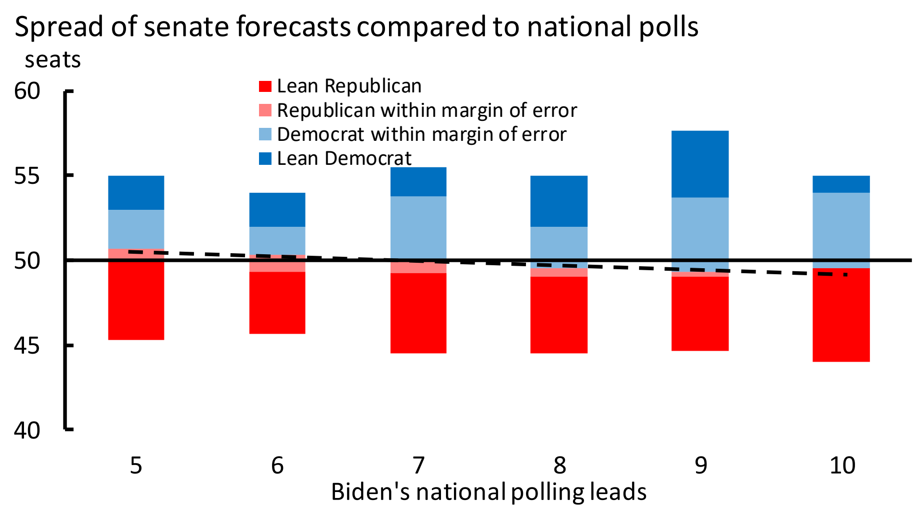
- The current Senate split is 53 Republican and 45 Democrat (2 independents caucus with Democrats). With Democrats considered likely to lose Alabama, current polling suggests that the 35-seat race will be tight, suggesting that 50-(48+2) is conceivable. This would give Democrats control by virtue of the influence of the Vice President, but by the flimsiest of margins. A further Republican rally from here – particularly if President Trump were re-elected – would likely see Republicans retain the Senate majority.

Will elections change the current mixed Congress?



Source: : 538, 270towin, Daily Kos, real Clear Politics, Sabato and AXA IM Research , Sep 2020

Senate polling tentatively correlated with national polls



Source: 538, 270towin, Daily Kos, real Clear Politics, Sabato and AXA IM Research, Sep 2020

The elections

Policy implications – Biden proposals

Spending measures	Tax raising measures
Infrastrucure - $1.3 trn over 10 years - $400 bn on clean energy research/innovation - $100 bn to modernise schools - $50 bn roads, bridges and highways - $20 bn rural broadband - $10 bn transit projects for high-poverty areas Climate Change - $1.7 trn over 10 years - Leveraging funding from additional partners, targeting $5 trn - Net-zero emissions no later than 2050 - Rejoin the Paris Accord Healthcare - To insure 97% of Americans, est. cost $750 bn over decade - Lower Medicare eligibility age to 60 from 65 - Reduce limit on cost of coverage to 8.5% - Eliminate 400% tax credit eligibility Housing - $640 bn Labour market - Raise minimum wage to $15/hour from $7.25 - Temporary visa reform - Increase employment-based green cards - Boost short-time work programs	- Top rate income federal tax rise to 39.6% from 37% - Increase social security tax on earnings >$400k - Impose standard income tax rate on capital gains and dividends on those earning over $1m - Increase corporate tax rate to 28% from 21% - Double tax on profits of foreign subsidiaries by raising GLTI rate to 21% - Introduce an Alternative Minimum Tax based on 15% of book income - *Tax Policy Center estimates measures will:* - *Raise c. $4 tn over next decade* - *93% of increases expected to fall on top 20%* - *74% on top 1%* - *46% on top 0.1%* - *Top 20% face a 5.7% reduction in after-tax income* - *Top 1% - a 17% reduction* - *Top 0.1% - a 23.4% reduction*

Theme of the month: US Elections

A contested election?

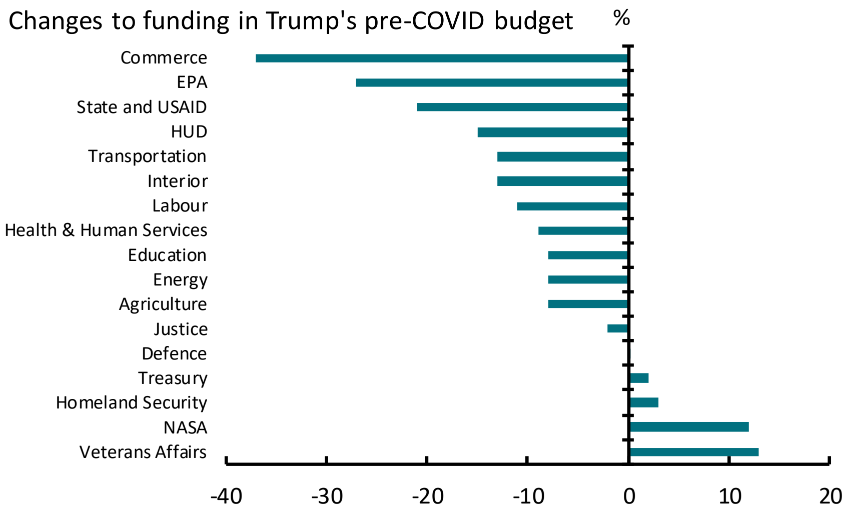
Policy agendas

- Joe Biden was a moderate in the Democrat Primaries. However, his agenda is the most progressive suggested since the 1960s. His plans to raise $4trn in taxes over a decade to boost infrastructure and Green investment would likely deliver a long-term boost to US potential GDP growth. However, markets may recoil from the increased taxation. President Trump's second-term agenda is not clearly defined. Fiscal stimulus, another tax cut package, infrastructure and trade policy are likely to be on the agenda .

Delay is inevitable, but confusion may mount while we wait

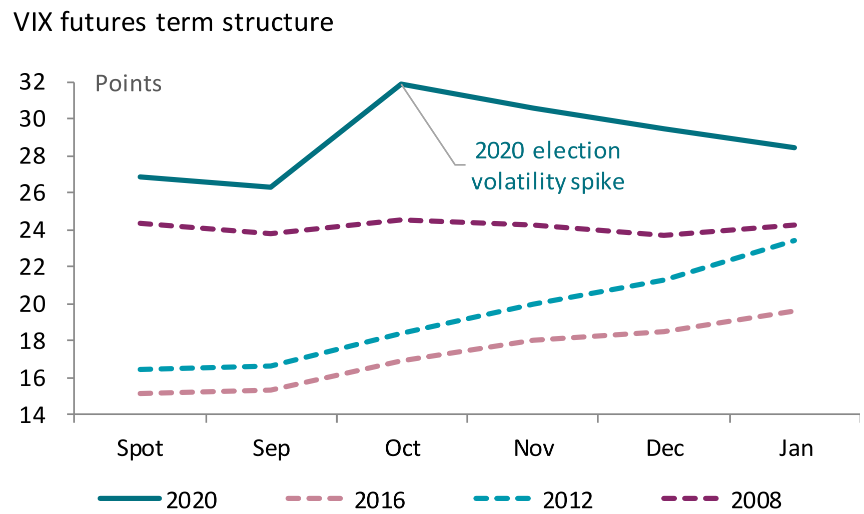
- The chances of a swift election result are low. Mail-in voting, which accounted for 25% of the 2018 Mid-Term elections, looks set to account for a far higher proportion given ongoing virus precautions. This will delay the result (in 2018 the Arizona count, with 78% votes by mail, took one week). However, with President Trump alleging that mail-in voting increases the scope for electoral fraud – there is no evidence of this – the scope for judicial challenge is high, particularly if the on-the-night count is close.

President Trump's 2020 Budget indicates second-term agenda



Source: Sep 2020

Markets braced for a contested election



Source: CBOE, Bloomberg, AXA IM Research, Sep 2020

Macro outlook

US to post record Q3 after getting virus under control

US

Recovering from the virus

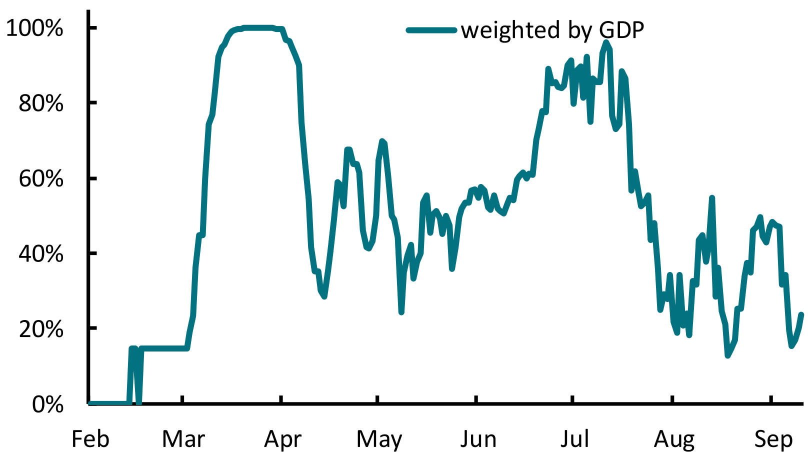
- From late July increased social restrictions particularly in US Southern states helped to rein in the re-emergence of the virus. This was achieved with a minimal attenuation in activity. In total, Q3 looks set to post the strongest quarterly growth on record (we forecast 20% annualized) – albeit materially less than was lost during the deepest contraction on record in Q2 (-31.7%).

Pace to soften into Q4

- The pace of recovery looks set to soften into Q4. High frequency data have recorded some softening at the end of Q3. Moreover, we are concerned about a deceleration in household income in the short-term reflecting the cessation of the boost to unemployment benefits and in the medium-term from the decelerating improvement in the labour market. We still expect a $1.5trn stimulus package to support Q4 activity – but in its absence, the deceleration of growth could happen much more quickly.

US regains control of virus spread

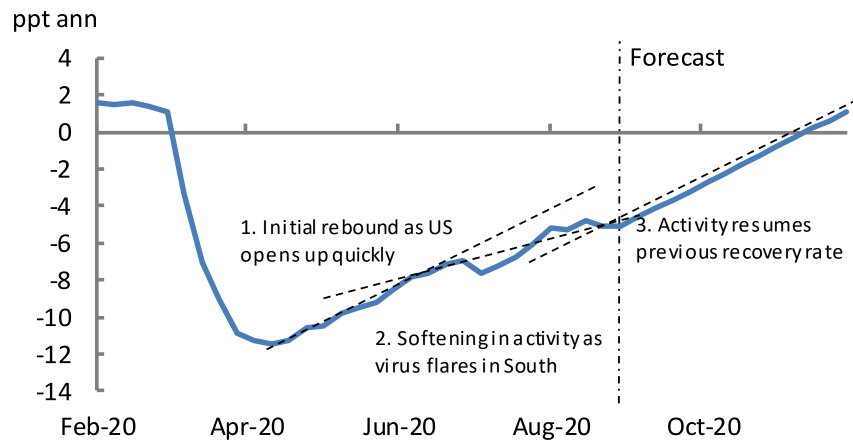
US states with increasing COVID-19 cases



Source: USA Facts, BEA, AXA IM Research, Sep 2020

High-frequency data see modest softening in latest weeks

Fed Weekly Economic Index forecasts



Source: FRBNY, AXA IM Research, Sep 2020

Rebound to slow over coming quarters

US

Growth rates disguise subdued activity

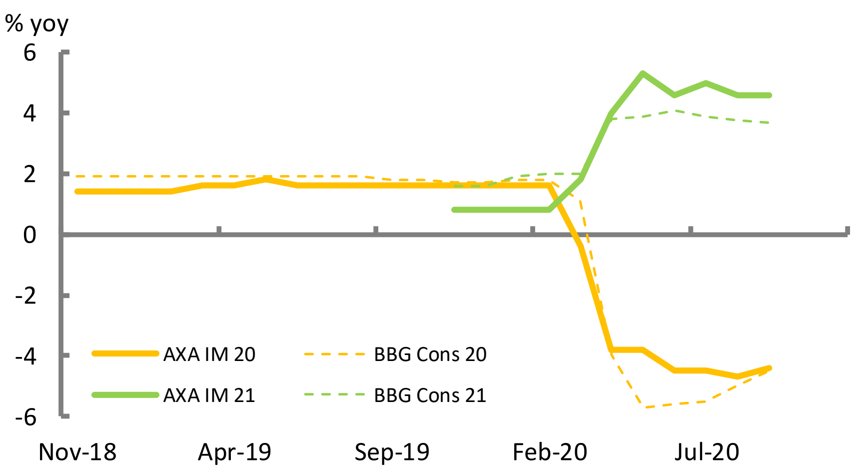
- A strong recovery in Q3 looks set to disguise a still depressed level of activity, with even consensus levels of growth in Q3 still seeing GDP 5% lower than at the start of the year. However, signs of a faster than expected bounce in Q3 have been consistent with an improvement in the consensus estimates for 2020. Our own forecasts remains at -4.7% for 2020 and +4.6% for 2021, but with increasing data suggesting some shift in growth from Q3 into Q4, we may fine tune annual figures over the coming months.

FAIT accompli

- The Federal Reserve followed the path we thought it had laid out before the summer. At the virtual Jackson Hole conference, Fed Chair Powell announced changes to the Fed’s Long Term Goals, including a shift to average inflation targeting and rate adjustments that would only react to shortfalls in employment from maximum levels. In its latest meeting the Fed announced explicit forward guidance, based additionally on labour market criteria, that suggested the Fed would not raise interest rates before 2024.

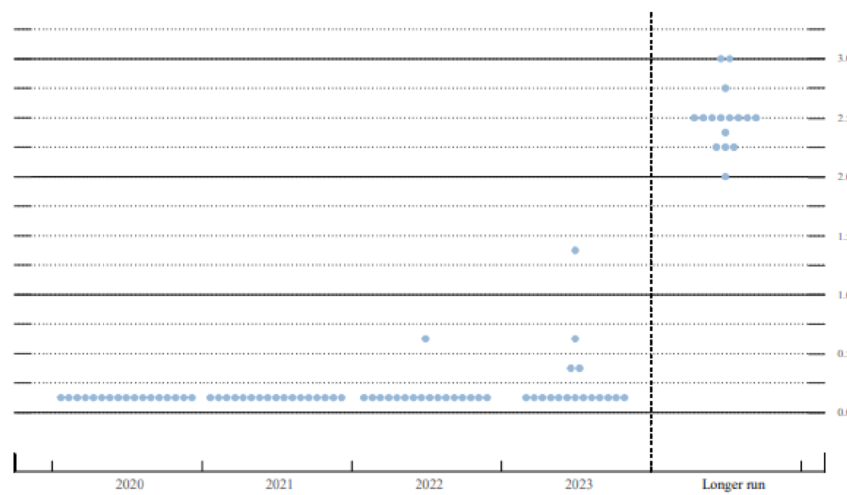
Outlook for US economy brightens

Evolution of GDP forecasts



Source: Bloomberg, AXA IM Research, Sep 2020

Average inflation target to keep Fed Funds Rate at floor



Source: Federal Reserve Bank (FRB), Sep 2020

Turning sour…

Euro area

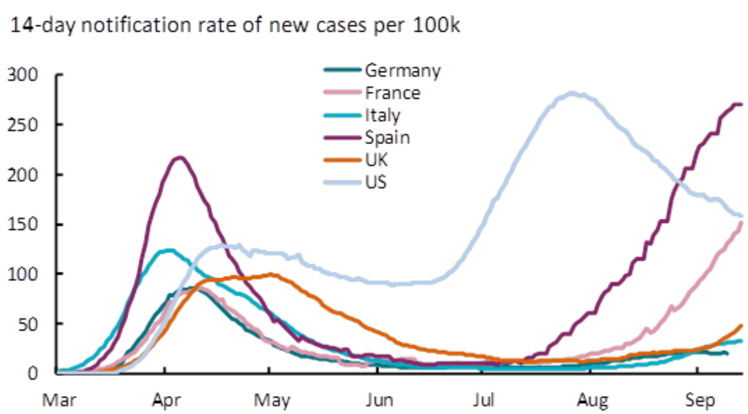
Concerning pandemic developments…

- The speed of the virus propagation is increasing sharply: Spain and France are the main hotspots. Granular data show a shift in the age distribution (number of cases for older people up significantly) and together with higher ICU occupancy and fatality rates (albeit still well below March/April levels), call for caution.
- Governments are taking actions (region of Madrid restricting mobility, use of mask becoming mandatory at some local levels in France, stricter travel provisions in Germany, Italy, Belgium). But these partial lockdowns are still less stringents than the past ones.

…While signs of the recovery plateauing are accumulating

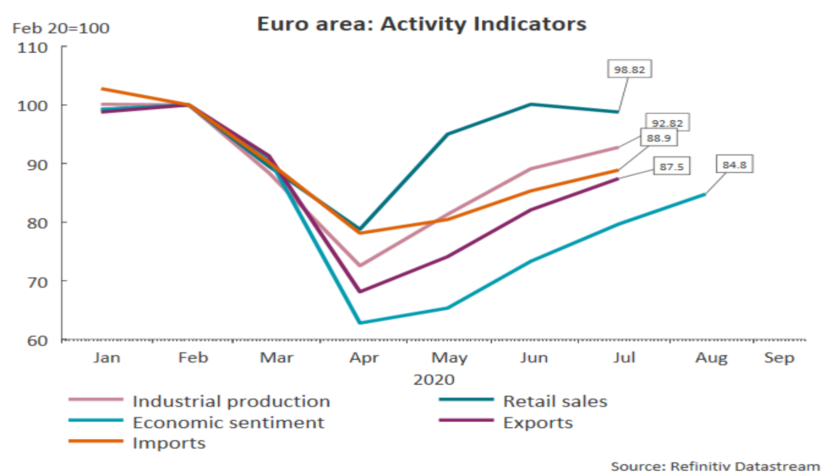
- After a record collapse in Q2 GDP (-11.8% qoq), euro area GDP is on track to bounce back by 8.9% qoq in Q3.
- But the recovery is losing steam. Euro area retail sales paused in July, annual growth in car registrations turned negative and IP still stands c.7% below its pre-COVID level. Demand weakness seems to be the main supply-side constraint, while consumer confidence failed to improve amid virus risks and uncertain employment prospects. We see Q4 GDP slowing to 2.5% qoq, with 2020 euro area average at -7.7% yoy.

Europe is closing the gap with the US



Source: World Health Organisation (WHO) and AXA IM Research, September 2020.

The recovery is losing steam: it is looking like a swoosh



Source: Datastream and AXA IM Research, September 2020.

… Means there is no room for complacency

Euro area

Recovery and Resilience plans in the making…

- Countries are starting to work on their 2021 budget and Recovery and Resilience plans. As per EC guidelines, the latter should include a minimum level of 20% of expenditure related to digital and respects the 37% climate mainstreaming target.
- France has allocated EUR30bn of its EUR100bn to the green transition and expects 40% of the plan to be financed by the Recovery and Resilience Facility. The process might be more challenging in Spain due to political fragmentation, while the RRF conditionality (funds disbursed when targets met) could be a powerful incentive-mechanism to boost Italy's potential growth.

…While ECB monetary policy support remains critical

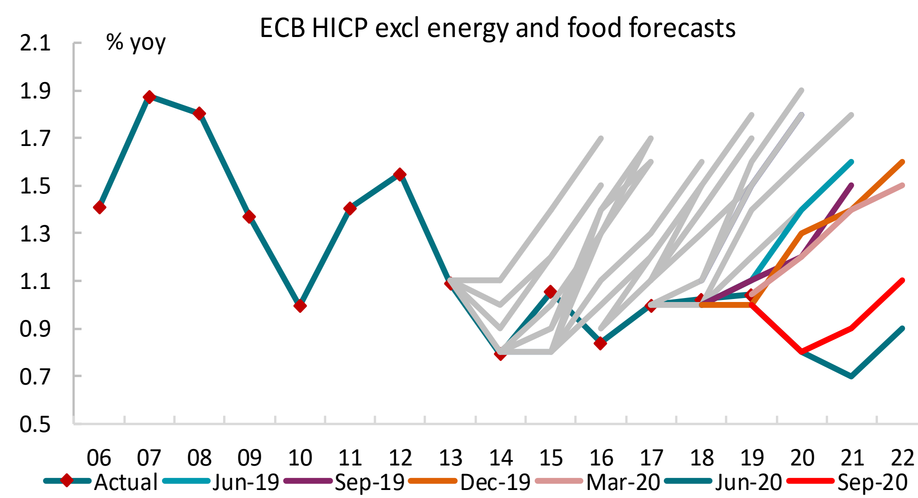
- September ECB core inflation forecasts have been upgraded, on the back of better policy mix (fiscal finally contributing). But don't be fooled by the upgrade, ECB board members keep repeating there is no room for complacency: the ECB finger is on the buzzer.
- This reinforces our view that the ECB will do more, with a time and quantum extension of the PEPP in December. A key reason is that faced with higher public debt issuance next year, the ECB will have to provide more accommodation in the form of more QE: this is the price to pay for fiscal policy helping to bring inflation back to the central bank's target.

EC Recovery and Resilience Facility grants allocation

	EUR BN		% of 2019 GDP	
	70% allocation	30% allocation - illustrative*	70% allocation	30% allocation - illustrative*
	(2021-2022 commitment)	(2023 commitment)	(2021-2022 commitment)	(2023 commitment)
Italy	44.7	20.7	2.5	1.2
Spain	43.5	15.7	3.5	1.3
France	22.7	14.7	0.9	0.6
Poland	18.9	4.1	3.6	0.8
Germany	15.2	7.5	0.4	0.2
Greece	12.6	3.6	6.7	1.9
Romania	9.5	4.3	4.3	1.9
Portugal	9.1	4.1	4.3	1.9

Source: EU Commission, AXA IM Research, September 2020. *Illustrative based on 2020 EC summer forecasts.

A better policy mix propping up ECB core inflation forecasts



Source: ECB, AXA IM Research, July 2020.

As good as it gets

UK

Fast data point to Q3 rebound

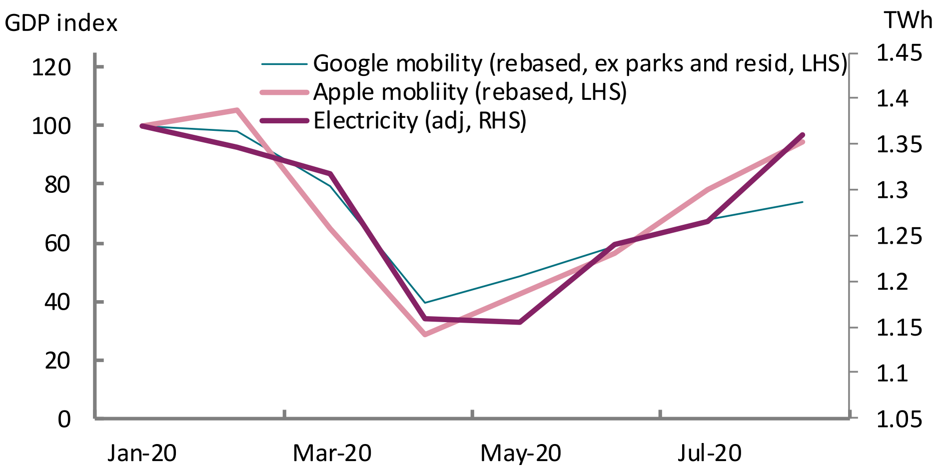
- July recorded a 6.6% rise in monthly GDP after a strong 8.7% increase in June. August looks set to post another bumper month with an Eat-Out-to-Help-Out scheme lifting restaurant spending and many Britons holidaying onshore. The BoE estimates that consumer spending had recovered pre-Covid levels, albeit with a shift in composition. A sharp pick-up in housing activity also promises further support over the coming months.

Outlook worsens beyond

- Yet the outlook is worsening. The virus is picking up sharply again in the UK and will affect economic activity, even if government restrictions fall short of those seen in Q2. Moreover, for now, the furlough scheme is being phased out and will expire by the end of October, reducing incomes for workers in virus-affected sectors. Finally, Brexit uncertainty continues to threaten business investment. We forecast UK GDP growth of -10.0% in 2020, before rebounding by 7.5% in 2021. However, if current trends persist a better 2020 may be offset by a softer 2021.

Activity proxies suggest further strong pick-up in August

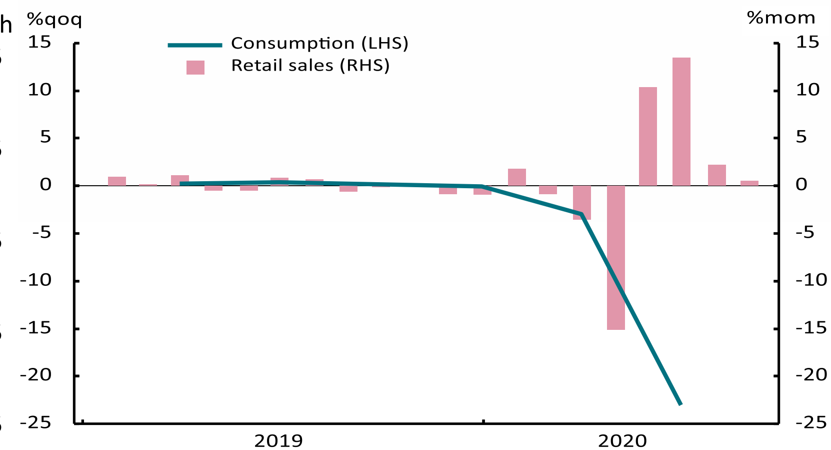
'Fast' data proxies for economic activity



Source: Apple, Google, National Grid, ONS, AXA IM Research, Sep 20

Rebound in retail activity to drive consumption recovery in Q3

Consumption and retail sales



Source: ONS, AXA IM Research, Sep 20

Investment Managers

Policy expectations weigh on markets

UK

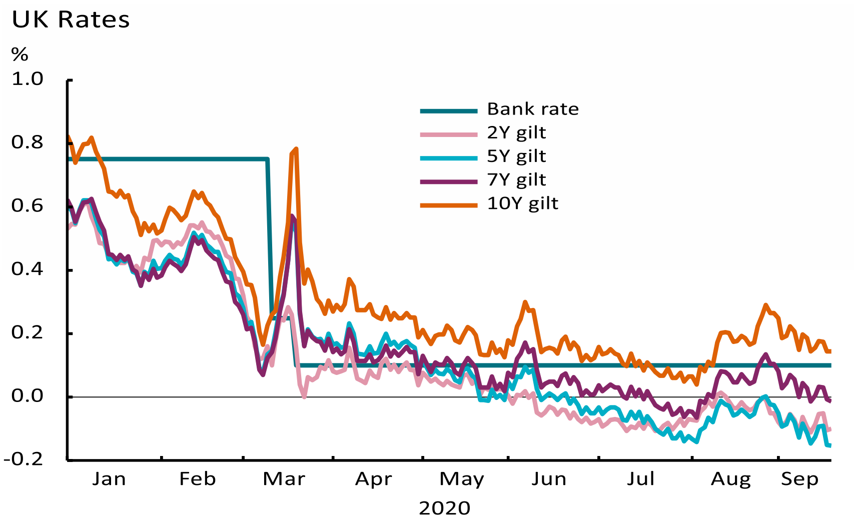
More BoE stimulus ahead, QE – expected, but not negative rates

- The BoE left its policy unchanged in September, noting better-than-expected momentum for Q3, but risks ahead. Current QE is expected to expire "around the turn of the year". We expect this to be extended in Q4, most likely with a further £75bn in November (this could come later in December). The Bank is also reviewing how to implement negative rates. On balance, we do not think expect additional stimulus next year. But if it does, a technical change to the TFS could underpin negative market rates.

Brexit - the final countdown, again.

- Negotiations towards a UK-EU trade deal continue. Fisheries and state subsidies remain the outstanding issues – items that oughtn't be insurmountable. PM Johnson has announced he would walk away from further discussions if agreement is not reached by the 15 October EU Summit. The UK have also introduced an Internal Markets Bill that threatens to re-write parts of the Withdrawal Agreement. We consider this part of the negotiations and still expect a deal by year-end, but the outlook is uncertain.

UK markets consider negative rates from the BoE



Source: Bank of England, Refinitiv, AXA IM Research, Sep 2020

Sterling slips on renewed Brexit tensions

Source: Refinitiv, AXA IM Research, Sep 2020

Recovery gains more balance and steam

China

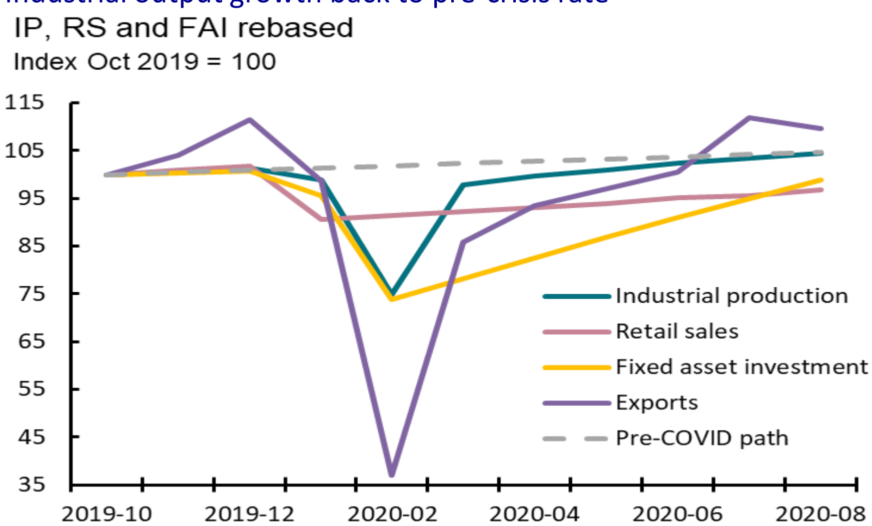
Growth accelerates as recovery becomes more broad-based

- August activity beat market expectations across the board, suggesting that China's economic recovery has gained strength, depth and breath. Industrial production growth accelerated to 5.6%, returning to the pre-crisis level faster than market expectations. While export growth delivered another positive surprise, the bright spots were in domestic demand with private consumption and investment all picking up strongly, creating a more balanced growth dynamic

Consumer spending and private investment finally catch up

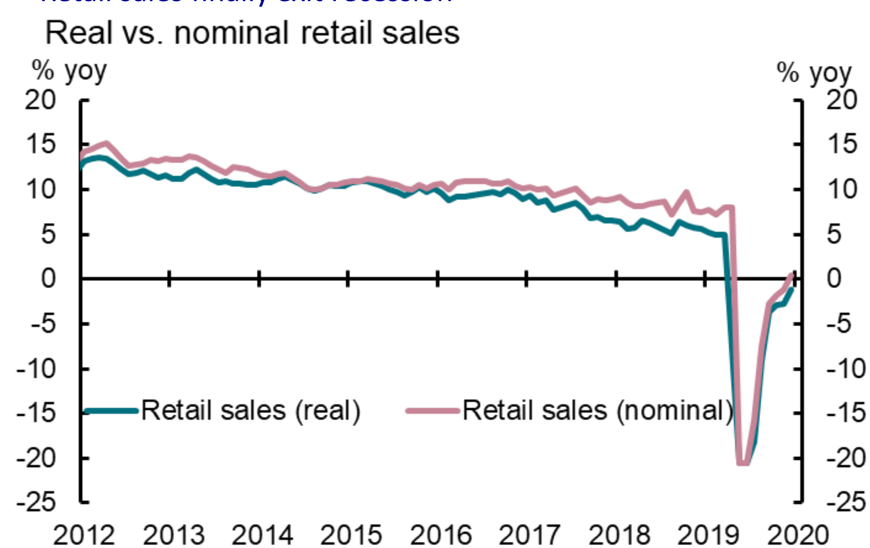
- Retail sales grew on a year-on-year basis for the first time in 2020. Besides solid stable goods sales, discretionary spending on clothing, cosmetics, mobile phones and autos also increased strongly in August, thanks in part to easing fears about the pandemic and improved labour market conditions. Manufacturing investment growth also turned positive for the first time supported by recovering demand, improved profitability and easier credit conditions

Industrial output growth back to pre-crisis rate



Source: CEIC, AXA IM Research, Sep 20

Retail sales finally exit recession



Source: CEIC, AXA IM Research, Sep 20

Continued recovery supports policy fine-tuning

China

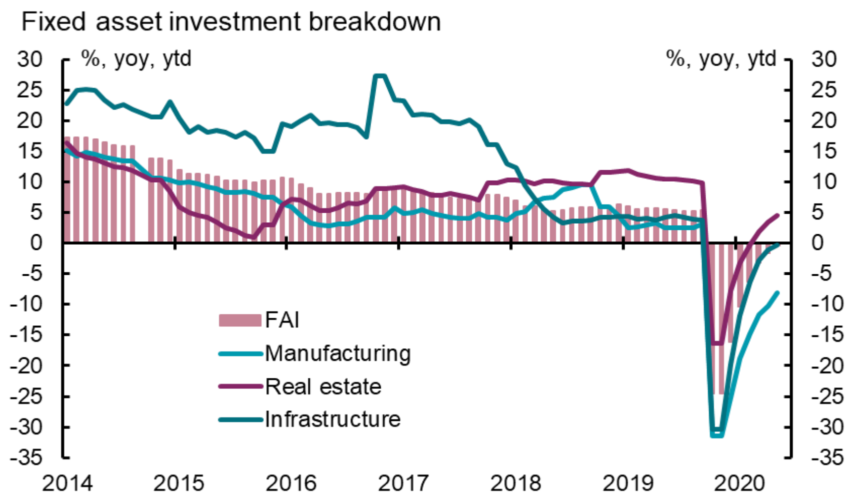
Strong data reduces the odds of further monetary easing

- Beijing will likely take the positive economic data as a validation for further fine-tuning monetary policy back to neutral. The chance for additional aggregate easing, such as RRR and interest rate cuts, has subsided, with the official attention increasingly shifted to any emergence of financial imbalances. The recent tightening of housing market policy suggests that Beijing is trying to strike a fine balance between economic growth and macro stability

Balance of risks shift to the upside

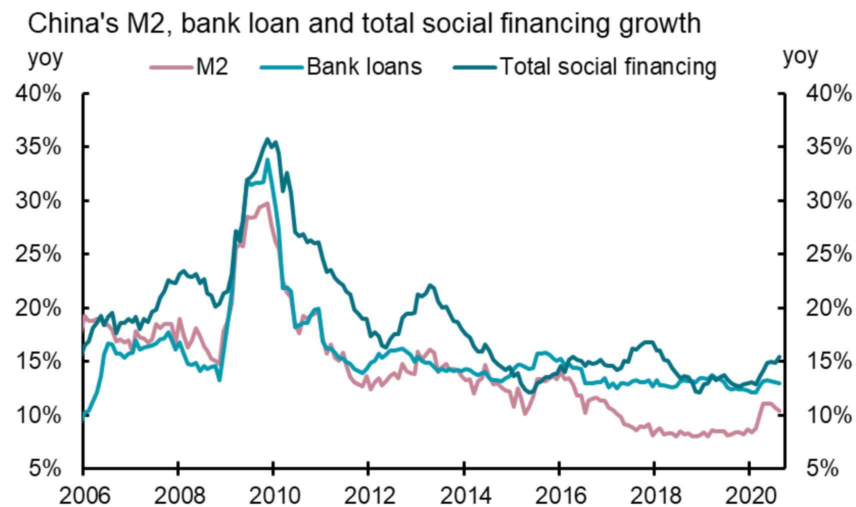
- We expect fiscal easing to proceed as planned, with the large bond issuances in August providing a solid backing for future infrastructure investment. More policy nurturing is also needed to cement the recovery in the private sector. We continue to see GDP growth accelerating to 5-6% in Q3 and Q4, and full year growth at 2.3%, but with the balance of risks now tilted to the upside

Infrastructure investment supported by fiscal easing



Source: CEIC, AXA IM Research, Sep 20

The need for aggressive monetary easing declines



Source: CEIC, AXA IM Research, Sep 20

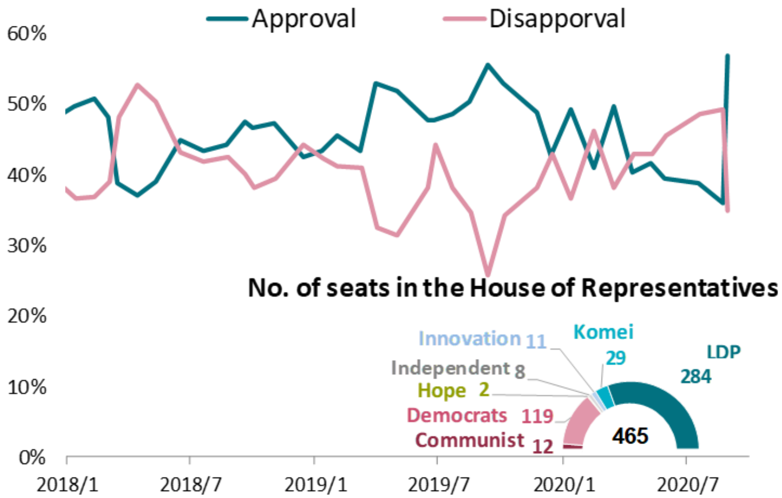
PM Suga nominated to pursue Abe's policies

Japan

What we do know about him

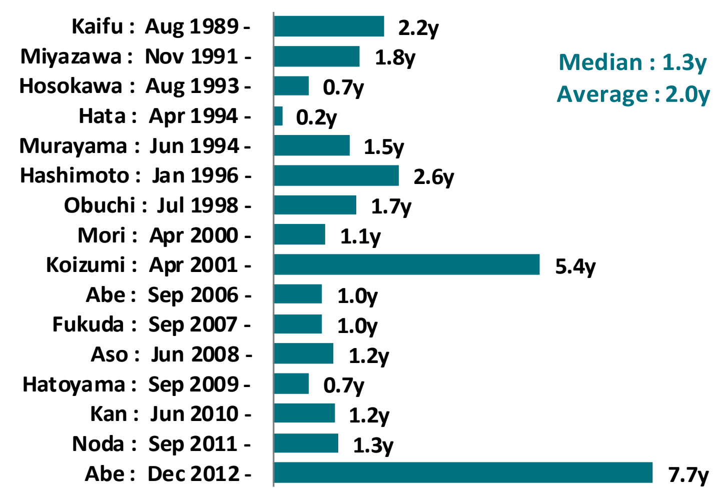
- Shinzo Abe – Japan's longest serving PM for decades - resigned suddenly on health grounds over the summer. His replacement PM Suga's economic has pledged continuity in the economic agenda for now and may turn to the polls to secure his own mandate soon.
- On the economic side:
  - Structural reform will be a priority, focusing on digitalization and on administrative and regulatory reform;
  - He also favors regional bank consolidation and regional revitalization;
  - On fiscal policy, he was opposed to any consumption tax cut, but has ruled out any further VAT changes over the longer-term.
- On the monetary policy side:
  - The relationship between the Ministry of Finance and the Bank of Japan will persist as PM Suga supports the set of measures implemented during the crisis.

Approval / Disapproval rate for Abe's Cabinet



Source: Kyodo, AXA IM Tokyo FI, Sep 20

Term of office of successive PMs from 90s



Source: Cabinet Office, AXA IM Tokyo FI, Sep 20

The recovery is facing some headwinds

Japan

A mechanical rebound is occurring but it should not hide the weakness of the recovery

The recovery remains the weakest among developed economies, both on supply and demand fronts.

- Industrial production is progressing but remains at -15%yoy in July
- Retail sales fell to -2.9% yoy in July, while August’s household spending points to a decline of -7.6% yoy. Consumer confidence has stabilised since June, but at very low levels, led by uncertainties on employment.

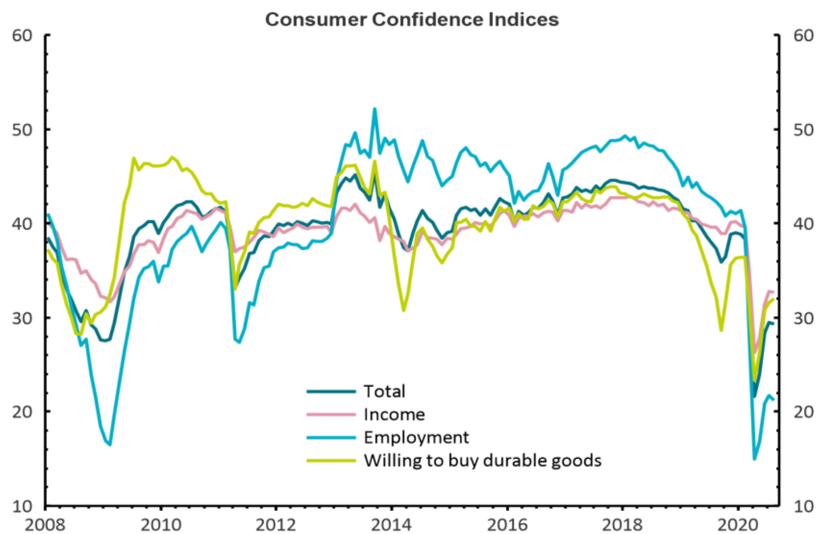
The Bank of Japan kept its monetary policy unchanged

For the time being, BoJ measures seem to be effective:

- 10Y JGB yields remain in the prescribed range [+/- 0.2%];
- bank lending remains dynamic (+6.8% YoY)

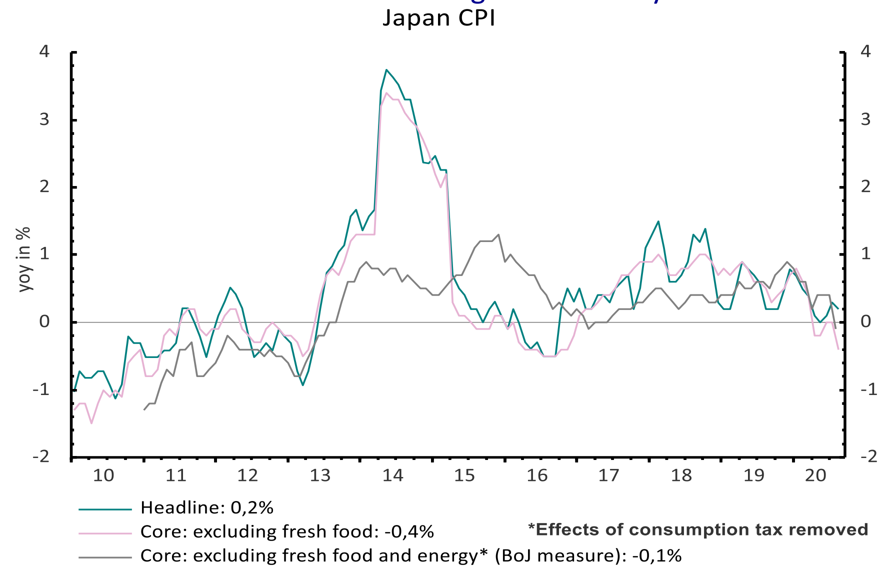
On the other side, we are sceptical of the BoJ’s inflation commitment as it does not seem sufficiently concerned about the rising risks of falling back into deflation.

Consumer confidence remains stuck at low level



Source: Refinitiv Datastream and AXA IM Research août 20

Core CPI turns back in negative territory



Source: Refinitiv Datastream and AXA IM Research août 20

COVID-19 active in EM

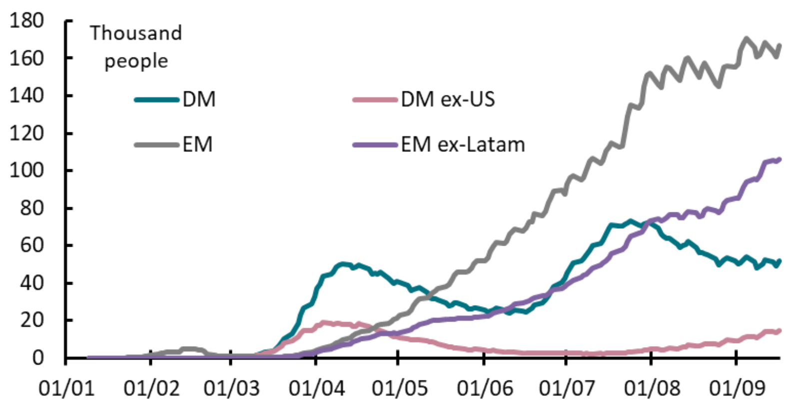
Emerging Markets

The COVID-19 outbreak is unfolding in EM

- Since the beginning of June, statistics have been showing a steady deterioration for emerging countries compared to developed (DM). The DM/EM ratio of total infection cases has halved to 0.6x from 1.3x and adjusted for the number of inhabitants, the ratio decreased even more abruptly to 3.5x from 8.1x.
- Geographically, Latin America was the hotspot of the pandemic at the start of the summer; while the number of infections remains elevated, it has been rising less aggressively in the past weeks. Meanwhile, the epidemic appears to have re-accelerated in other EM regions, Asia in particular – with India a particular concern.
- Yet, mobility restrictions continue to be relaxed at a similar pace to developed markets and by the same arithmetic, financial markets and currencies have broadly stabilized for now.

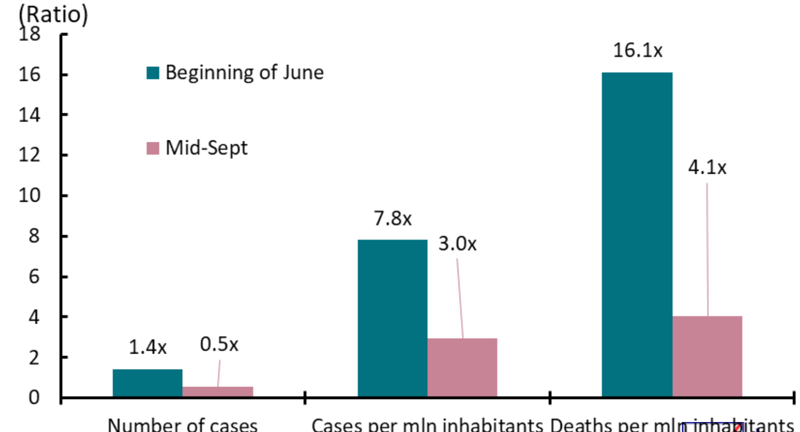
COVID-19 pandemic still active across EM…

CoVid-19 New cases



… and spreading at a faster pace than in DM space

Ratio of DM cases to EM cases



Source: Datastream, AXA IM Research calculations, Sept 16, 2020

A “swoosh” recovery in EM as well

Emerging Markets

The pandemic shock has dwarfed preceding recessions across the EM complex

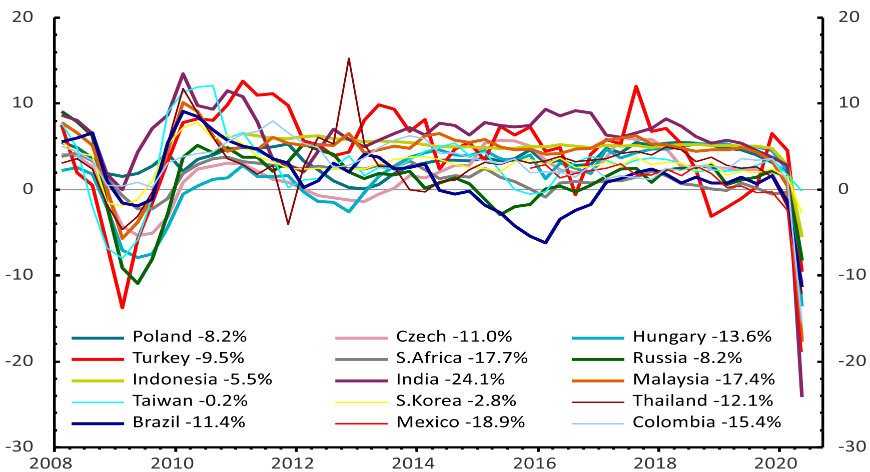
- The global lockdown caused a significant contraction of activity, in various scale. Among major EM economies, Taiwan and South Korea fared best with more controlled exposure and hence less stringent lockdown measures imposed since the start of the year, with growth nevertheless contracting versus a year ago. Tourist dependent countries such as Thailand were additionally hit by a very poor summer season. Export-oriented economies suffered demand falls from Western countries, as visible in Central Europe. The size and the timing of the government spending packages also made a difference. The sudden stop in economic activity resulting from nationwide lockdowns led to both a supply-side and a demand-side shocks. These were particularly strong in India and have resulted in broad-based contraction in Indian GDP.

Q3 technical rebound granted, but the Q4 recovery needs more fiscal support

- Central banks across the world have reduced policy rates, the scope for further rate cuts appears to be almost exhausted. The use of more unorthodox monetary policy tools, such as QE, may increase but EM institutions may think twice before embarking that way. Fiscal policy is expected to do the heavy lifting but easing space varies among countries.

A reckless second quarter

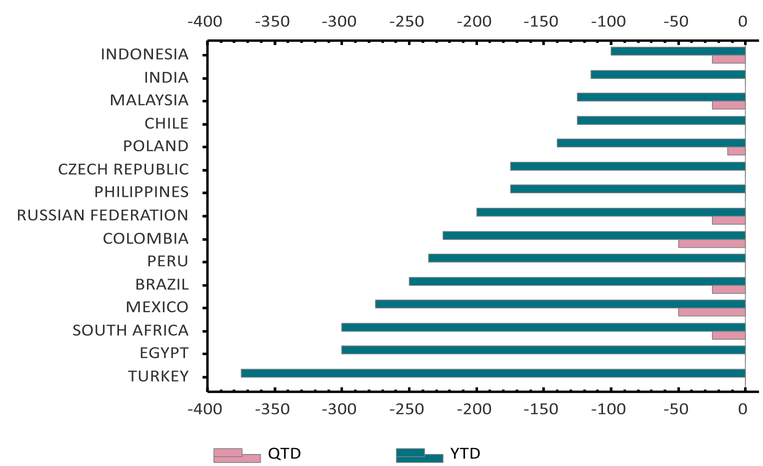
GDP data (y/y % growth)



Source: Refinitiv Datastream and AXA IM Research Q2 20

Traditional monetary policy running out of steam

Change in policy rates (bps)



Source: Refinitiv Datastream and AXA IM Research 31/08/2020

AXA Investment Managers

Investment Strategy

Multi-Asset Investment views

Our key messages and convictions

Positive on equites

#1
The growth rebound, positive economic surprises, ultra loose monetary policy and positioning remain supportive for risky assets

#2
Unprecedented support from both fiscal and monetary authorities supportive of valuations

Positive on Investment Grade Credit

Positive US Sovereign Bonds

#3
Monetary arsenal adds material support to bonds; Federal Reserve indicated it will retain full flexibility well into 2023

#4
Concerns over a second wave of COVID-19 virus and political risks generate higher volatility

Long Volatility

Source: AXA IM as at 20/09/2020

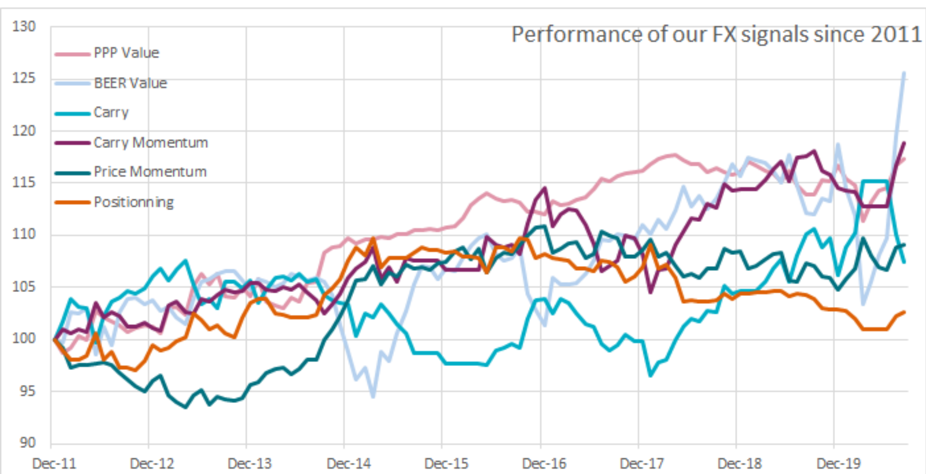
Investment Managers

FX Strategy

Yen well positioned amid dollar weakness - Sterling pained by Brexit

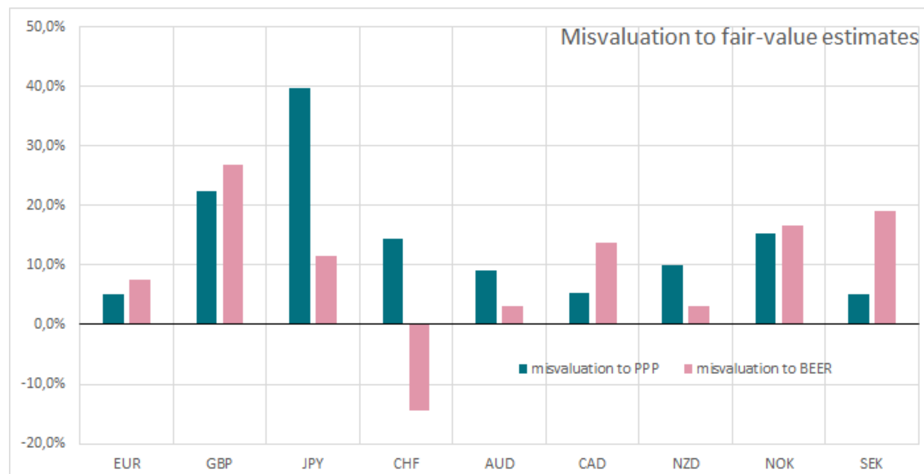
- The risk on/risk off focus that dominated the first half of the year is finally receding and post-Covid value strategies arise. By bringing global interest rates to zero over the long term, central banks have undermined the carry strategies that dominated in 2018-19. Markets are left to ponder fair value and structural strengths and weaknesses.
- On this front, the USD has more room to fall from a broadly overvalued starting point. Slowly but surely, JPY is looking more attractive. Although it underperformed vs risk-on currencies recently, it has already initiated an appreciation trend against USD.
- We have been expecting UK-EU negotiations to weigh on GBP in Q3. Implied volatility has already repriced, but we think there is room for it to rise a little further. While we think that the UK government will ultimately achieve a deal, this will probably come at the last minute once again, near October's EU summit, triggering a sharp relief rally.

Value strategies are making a come back



Source: Bloomberg and AXA IM Research, Sep 2020

Currencies undervalued vs USD across the board, JPY cheapest



Source: Bloomberg and AXA IM Research, Sep 2020

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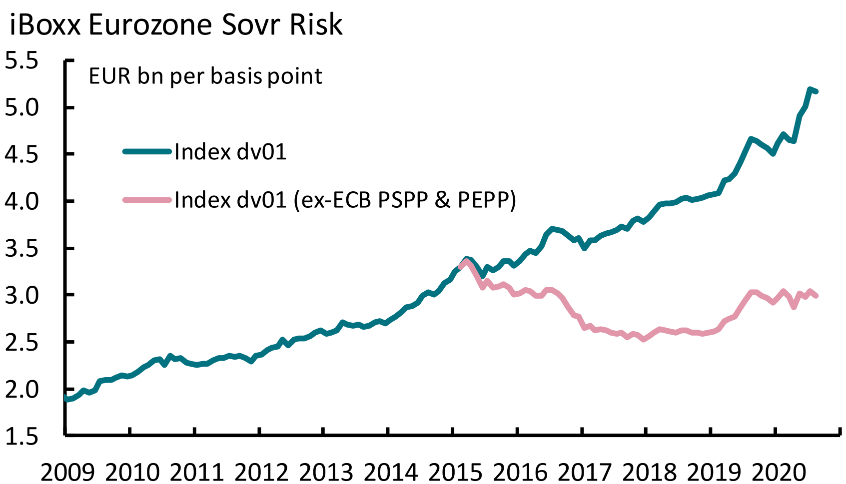
Rates Strategy

Risk factors to consider amid calm Euro govie bond markets: liquidity, complacency, fundamentals

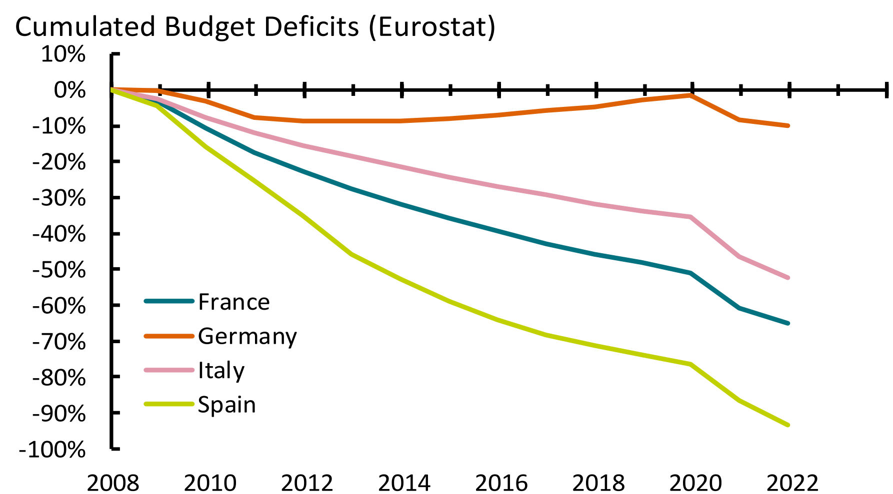
- Year-to-date, Euro Sovereigns have returned 3.3% with a rather uniform performance between member states (e.g. Italy 4.3%, France 3.5% and Germany 2.3%). However, we should also be aware of risk factors that might raise the level of alert at any time.
- Secondary market liquidity is measured across several dimensions like turnover, depth, bid-ask spreads, latency etc. Looking at volumes, we note how Bund contracts have reached new lows for Sep-20 expiry. Non-conventional monetary policy is having a significant impact on EGB liquidity as the ECB absorbs both supply and risk from the market.
- Volatility is back to pre-Covid levels, likely reflecting an improved investor sentiment on the back of the pathbreaking Resilience and Recovery Plan agreement. Risk of complacency amid slim liquidity can lead to outsized volatility spikes.
- Debt-to-GDP ratios close to or above 100% are no longer unusual but require a closer co-ordination between monetary and fiscal policy as a necessary condition to ensure the sustainability of this economic model.

Material duration extraction in the EGB markets by the ECB



Source: ECB, Markit and AXA IM Research, 18 September 2020

Debt-financed growth will weigh on sovereign balance sheets



Source: Bloomberg and AXA IM Research, Jun 20

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Credit Strategy

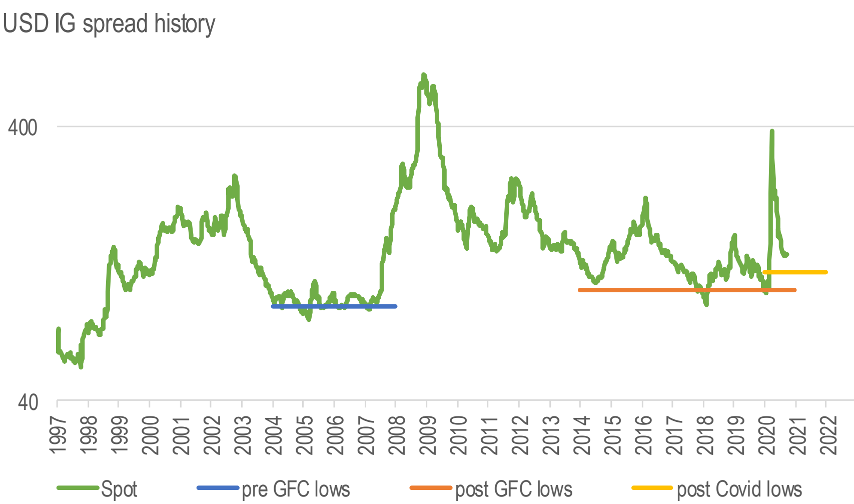
Credit returns have overcome the Covid shock and downgrades and defaults are slowing, but …

- The Covid shock has been unprecedented in most aspects of macroeconomic and market impacts. So too in credit, where the widening in spreads has been the sharpest on record and the spread recovery has been equally remarkable. The post-Covid regime is likely to be typified by a higher steady-state lower-bound for spreads, like post GFC.

- The remarkable rebound in credit is aptly reflected in its returns, where the recovery is starting to resemble previous, less severe, bearish episodes. Spread carry should bring High Yield back into positive territory over the next 6 months.

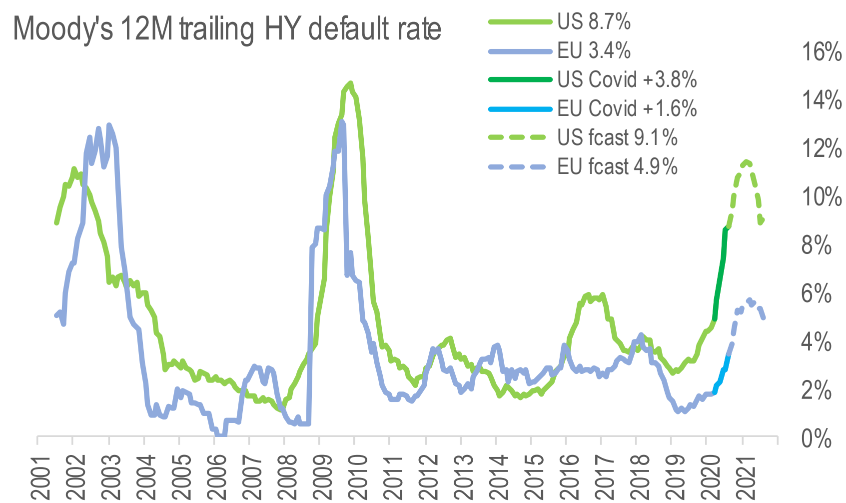
- The negative rating migration wave is slowing and has been well absorbed by credit markets, largely due to the explicit support by central banks globally through their asset purchase programs. Similarly, the pace of 12-month trailing defaults, while still rising, is starting to slow, especially in the US which has seen c.4% of additional defaults during Covid (+1.6% in Europe).
  The obvious risk is a second round of lockdowns and the associated relapse in economic activity that brings about a second wave of corporate stress, accelerating downgrades and defaults to the detriment of credit portfolio returns.

Sharpest spread widening and spread recovery on record



Source: ICE and AXA IM Research, Sep 2020

Defaults still rising but momentum is slowing – to peak in Q1 2020



Source: Moody's and AXA IM Research, Aug 2020

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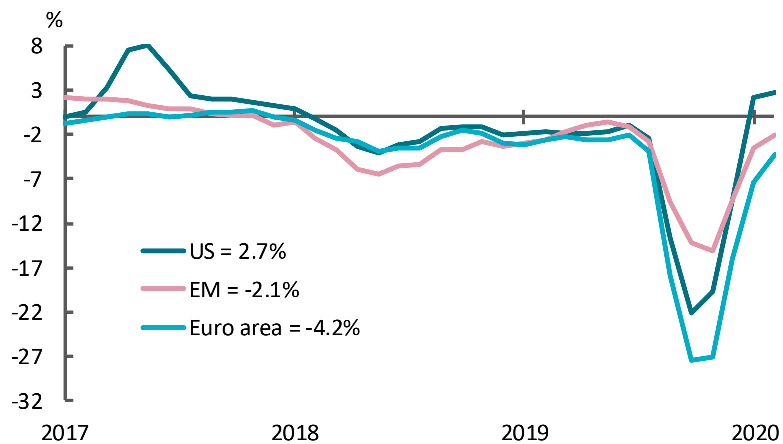
Equity strategy

Earnings momentum on the rise

- Earnings revisions have been trending upwards after troughing in May and are now in positive territory in the United States. The Q2 reporting season was encouraging with strong positive surprises. Dividend pay-outs have not been cut to the extent initially envisaged suggesting that corporate fundamentals have been more resilient than expected at the onset of the crisis. In this sense, markets do appear vulnerable to a growth disappointment given a rather optimistic economic rebound seems to be increasingly priced in.
- Consensus estimates signal that global earnings are expected to decline by 19.3% in 2020 and then rebound by 29.7% in 2021, implying that EPS is expected to regain its 2019 high-water mark by end-next year. With the repricing in interest rates, relative to bonds, the earnings yield gap is still arguably wide at 5% compared to the long-term average of 2.9% and in line with the post-2009 average which has been around 5.7%. Volatility is likely to remain elevated given the uncertainty surrounding the virus, lack of earnings visibility and the political landscape.
- Policy support remains a key tailwind with both a monetary and a fiscal 'put' well in place. We remain overweight equities in our multi asset allocation framework. In the face of our constructive stance on the asset class, we acknowledge that selectivity remains key given the high degree of uncertainty. Overall, we continue to believe that recovering activity, aggressive policy measures, subdued positioning and an ultra-low hurdle rate in other assets should support equity markets in the medium term.

A "V shape" recovery in earnings revisions

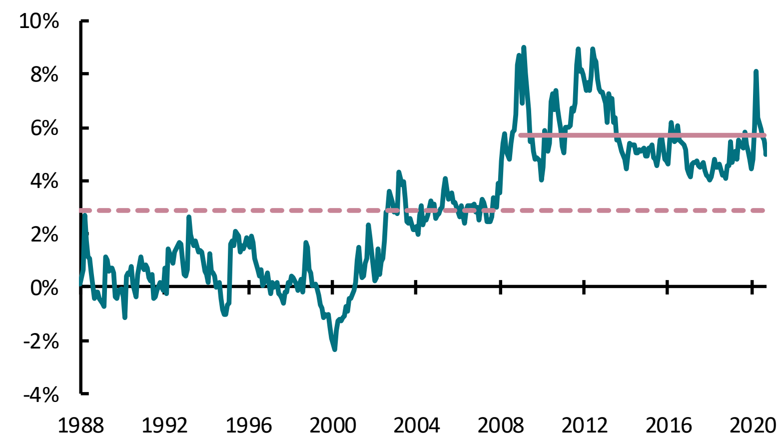
3M earnings revisions: US, Euro area & EM



Source: Datastream, IBES and AXA IM Research, Sep 20

Looking across the valley

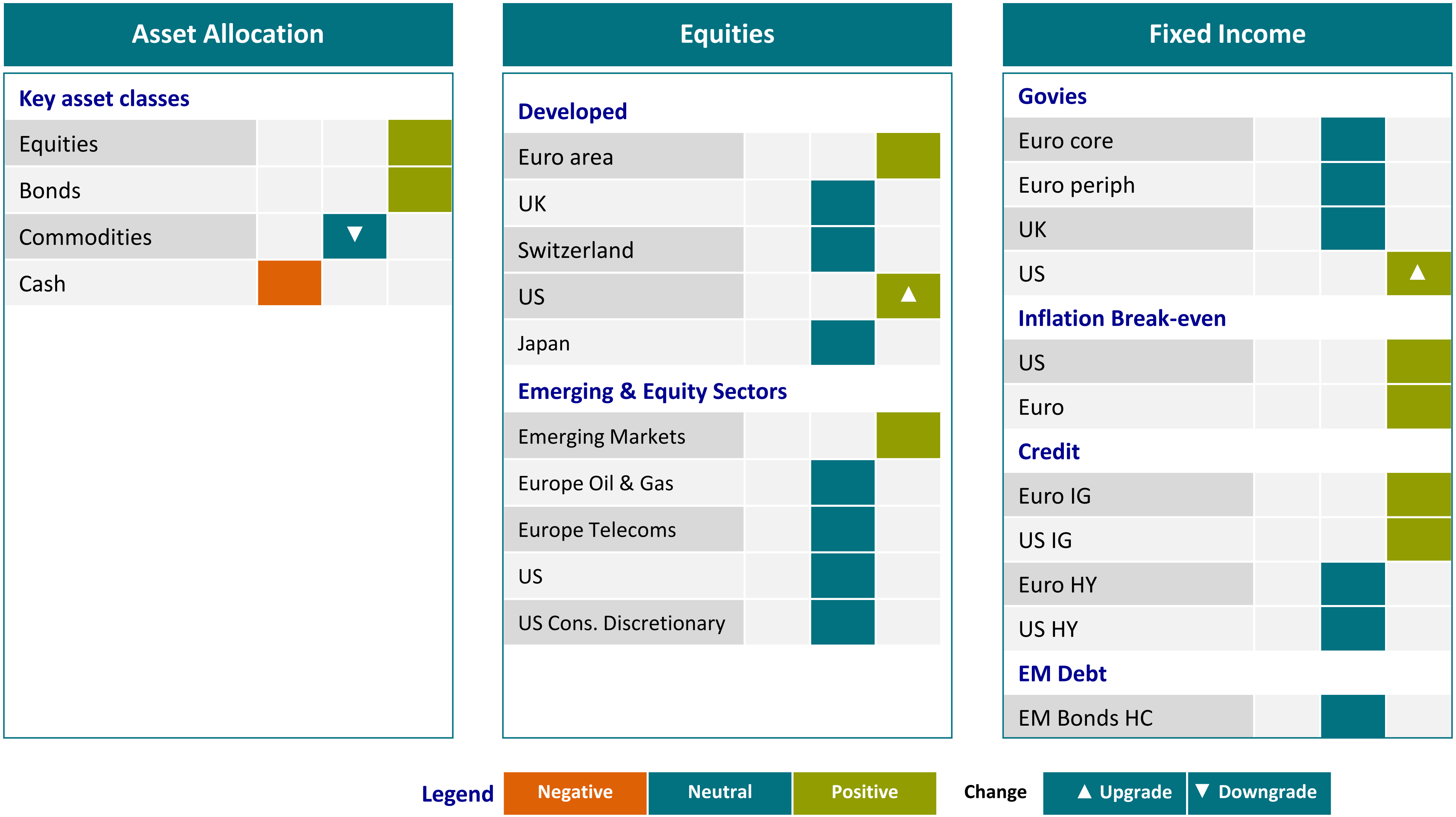
AC World earnings and bond yield gap (FY1/FY2 EPS)



Source: Datastream, IBES and AXA IM Research, Sep 20

Asset allocation stance

Positioning across and within asset classes



Source: AXA IM as at 20/09/2020

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Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2019*	2020*		2021*	
		AXA IM	*Consensus*	AXA IM	*Consensus*
World	2.9	-4.2		5.4	
Advanced economies	1.7	-6.4		4.8	
US	2.3	-4.7	-5.2	4.6	4.0
Euro area	1.3	-7.7	-7.9	5.2	5.7
Germany	0.6	-5.3	-6.1	4.3	4.7
France	1.3	-9.6	-9.6	7.4	7.2
Italy	0.3	-9.7	-10.2	4.9	5.7
Spain	2.0	-11.7	-11.7	6.9	6.9
Japan	0.7	-5.8	-5.3	3.1	2.5
UK	1.4	-10.0	-9.9	7.5	6.4
Switzerland	0.9	-6.5	-5.6	4.5	4.4
Emerging economies	3.6	-3.0		5.8	
Asia	5.2	0.5		7.2	
China	6.1	2.3	2.1	8.0	7.8
South Korea	2.0	-2.8	-1.1	4.5	3.3
Rest of EM Asia	4.4	-1.3		6.5	
LatAm	0.1	-6.5		6.5	
Brazil	1.1	-7.4	-6.2	8.3	3.2
Mexico	-0.1	-6.8	-9.6	7.0	3.6
EM Europe	2.1	-6.6		5.7	
Russia	1.3	-6.1	-5.1	3.7	3.4
Poland	4.1	-5.0	-4.1	5.4	4.5
Turkey	0.9	-5.6	-4.4	6.5	5.2
Other EMs	1.5	-4.2		3.3	

Source: Datastream, IMF and AXA IM Macro Research – As of 23 September 2020

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Expectations on inflation and central banks

Forecasts

Inflation Forecasts

CPI Inflation (%)	2019*	2020* AXA IM	2020* Consensus	2021* AXA IM	2021* Consensus
Advanced economies	**1.5**	**0.6**		**1.2**	
US	**1.8**	**0.8**	0.9	**1.6**	1.7
Euro area	**1.2**	**0.4**	0.4	**0.7**	1.1
Japan	**0.5**	**0.1**	-0.1	**0.0**	0.2
UK	**1.8**	**0.7**	0.7	**1.5**	1.4
Switzerland	**0.4**	**-0.3**	-0.7	**0.3**	0.2
Other DMs	**1.8**	**1.4**		**1.9**	

Source: Datastream, IMF and AXA IM Macro Research – As of 23 September 2020

Central banks' policy: meeting dates and expected changes

Central bank policy
Meeting dates and expected changes (Rates in bp / QE in bn)

		Current	Q4 - 20	Q1 -21	Q2-21	Q3-21
United States - Fed	Dates	0-0.25	4-5 Nov 15-16 Dec	26-27 Jan 16-17 Mar	27-28 Apr 15-16 Jun	27-28 Jul 21-22 Sep
	Rates		unch (0-0.25)	unch (0-0.25)	unch (0-0.25)	unch (0-0.25)
Euro area - ECB	Dates	-0.50	29 Oct 10 Dec	21 Jan 11 Mar	22 Apr 10 Jun	22 Jul 9 Sep
	Rates		unch (-0.50)	unch (-0.50)	unch (-0.50)	unch (-0.50)
Japan - BoJ	Dates	-0.10	28-29 Oct 17-18 Dec	20-21 Jan 18-19 Mar	26-27 Apr 17-18 Jun	15-16 Jul 21-22 Sep
	Rates		unch (-0.10)	unch (-0.10)	unch (-0.10)	unch (-0.10)
UK - BoE	Dates	0.10	5 Nov 17 Dec	4 Feb 18 Mar	6 May 24 June	5 Aug 23 Sep
	Rates		unch (0.10)	unch (0.10)	unch (0.10)	unch (0.10)

Source: AXA IM Macro Research - As of 23 September 2020

Calendar of 2020 events

2020	Date	Event	Comments
September	29 Sep	US	First US Presidential debate
October	15 Oct	US	Second US Presidential debate
	15-16 Oct	UK/EU	Crucial EU Summit
	19 Oct	China	Q3 GDP
	22 Oct	US	Third US Presidential debate
	28-29 Oct	BoJ Meeting	Unchanged (-0.10)
	29 Oct	ECB Meeting	Unchanged (-0.50)
	29 Oct	US	Q3 GDP advance estimate
	30 Oct	Euro Area	Q3 GDP flash estimate for EU19, France, Italy and Spain
November	3 Nov	US	Presidential and Congressional Elections
	4-5 Nov	FOMC Meeting	Unchanged (0-0.25)
	5 Nov	BoE Meeting	Unchanged (0.10), including Monetary Policy Report
	11 Nov	UK	Q3 GDP first estimate
	13 Nov	Germany	Q3 GDP flash estimate
	15 Nov	Japan	Q3 GDP prel. estimate
	21-22 Nov	G20	2020 Summit, Riyadh
December	10 Dec	ECB Meeting	Unchanged (-0.50)
	15-16 Dec	FOMC Meeting	Unchanged (0-0.25), including SEP
	17 Dec	BoE Meeting	Unchanged (0.10)
	17-18 Dec	BoJ Meeting	Unchanged (-0.10)
	31 Dec	UK/EU	End of transition period
January	20 Jan	US	Presidential Inauguration
	20-21 Jan	BoJ Meeting	Unchanged (-0.10)
	21 Jan	ECB Meeting	Unchanged (-0.5)
	26-27 Jan	FOMC Meeting	Unchanged (0-0.25)
February	4 Feb	BoE Meeting	Unchanged (0.10)
March	11 Mar	ECB Meeting	Unchanged (-0.50)
	16-17 Mar	FOMC Meeting	Unchanged (0-0.25)
	18 Mar	BoE Meeting	Unchanged (0.10)
	18-19 Mar	BoJ meeting	Unchanged (-0.10)

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[Preserving "Made in China" in deglobalisation](#)

02 September 2020

US presidential election preview: You're fired?

28 July 2020

July Investment Strategy – And after the summer?

22 July 2020

Natural language processing – a new tool to decode the Fed

16 July 2020

COVID-19 update: A disinflationary shock – Part 2

13 July 2020

COVID-19 update: A disinflationary shock – Part 1

10 July 2020

COVID-19 series: Judging international stimulus policy reactions to the COVID-19 shock (US, Ch, Jp, Ez)

25 June 2020

June Investment Strategy: The virus has not gone away

24 June 2020

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