



CIO OFFICE MORNING MARKET WRAP – 20th October, 2021. ALSO AVAILABLE ON ALEXA.

Asian stocks are in the green this morning following the US rally, with Japan, South Korea and Australia advancing. S&P 500 futures are climbing with the key benchmark close to record highs. Markets continued to recover yesterday buoyed by solid earnings with inflation concerns taking a backseat. US equities gained less than 1% and Europe and Asia were also in the green. Most sectors of the S&P 500 advanced, with energy and healthcare leading. The yield on the 10-year note climbed above 1.6%, crude oil extended its rally, gold rebounded, and the US dollar weakened.

There is nothing better than a batch of strong corporate earnings to rekindle investor animal spirits. Of about the 10% of companies of the S&P 500 having reported, more or less four out of five beat profit forecasts. Netflix reported his best quarter this year helped by Squid Game after a first half relatively light on new content, adding 4.4 million subscribers, well above consensus numbers. Johnson & Johnson raised its guidance on strong performance across its main divisions, and insurance company Travelers beat estimates for revenue and core income. Halliburton, the leading oil-service company, recorded the second consecutive quarter of improved revenues and earnings. In a sign of headwinds due to rising inflation, consumer goods bellwether Procter & Gamble warned about rising input costs, but maintained its guidance for the year.

The Australian dollar-Japanese yen cross is on a tear, with the dollar breaking resistance levels and close to making new highs for the year against the yen. Granted, most investors have the same degree of interest in this currency cross as a teenager can have in the daily chore of taking out the trash. But asset allocators know that it is a bellwether for global risk taking, as broad trends in stocks-to-bonds,

cyclical-to-defensive-stocks and the oil price tend to have the same direction as AUDJPY. The Australian dollar seems to have much more to go, to fill in its undervaluation versus terms of trade, while considering its still massive short positioning against the yen. So, if the currency signal is anything to go by, it seems that global equities and cyclical stocks will continue to climb their steep wall of worry into year-end, in spite of endless debates about inflation and the outlook for tighter policy.

Inflation angst has had investors pull forward the expected timing for rate lift-off by the Fed to the second half of 2022. JPMorgan joined BlackRock strategists in saying that markets have priced in too much tightening and sees little room for shorter-maturity yields to rise further in the shorter term. Fed funds futures are now pricing in a 25 bp increase by September 2022 and 45 bps by December. On the other hand, elevated price pressures alongside the Fed's tapering should see further upside on longer-dated yields, still making for a sombre outlook for high-quality bonds. Sovereigns, corporates and EM credit have on average seen low-single digit losses year-to-date.

Asia high-yielding bonds have suffered even larger losses in the wake of the Evergrande debt crisis, leaving investors wondering when a turning point for the asset class may be in sight. Major tops and bottoms of the Bloomberg Barclays Asia High Yield Index and of the MSCI China Index, the equity benchmark, tend more often than not to be aligned time-wise given the relevance of the equity factor in HY credit and the influence that the Chinese economy has on the Asian region. Our assumption is that the Chinese authorities will be pushing on the pedal of more monetary and fiscal stimulus by year end in order to stabilise the economy hit by many headwind. The recent bottoming-out attempt of the MSCI China Index should be a sign that investors are starting to discount a turn in the policy outlook, and if that is successful both Chinese equities and Asia high-yielding bonds should rebound from the current lows. Seasonality is also positive into February 2022, the start of the Chinese Lunar Year.

Stay safe.

MAURICE GRAVIER
Chief Investment Officer
Wealth Management
Emirates NBD

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