



CIO OFFICE MORNING MARKET WRAP – Sunday July 25th, 2021. ALSO AVAILABLE ON ALEXA

Last week, global markets were kind enough to align with our view for the second half of the year, which combines a reasonably constructive stance with expectations for volatility.

Volatility was clear at the beginning of the week, with growth concerns from the spread of the delta variant triggering a sell-off in risk assets, and an underperformance of cyclical sectors. Markets however recovered in the following sessions. Bottom line, stock indices ended the week +1.6% higher in developed markets, but were lower in emerging ones. Defensive assets were quite dispersed. Bond yields ended the week marginally lower, with the US 10-year Treasury closing at 1.28% on Friday. Gold lost -0.5%, just above the \$1800 mark. Oil prices followed other risk assets pattern and ended the week at \$74 for the Brent.

No doubt, the coronavirus remains a threat on the outlook, and the sharp increase in infections, the 4th wave, has a potential to generate economic turbulence. Infections rates follow the reopening dynamics, and if hospitalizations rates are currently low, the risk is that they may rise significantly in the coming weeks. However, from the data we look at, we remain reasonably confident especially for regions with a high share of their population vaccinated. Australia for example has a low vaccination rates compared to other developed countries, and has put new restrictions in place. By comparison, overall infections are sharply rising in Israel but the growth of severe cases looks significantly decoupled. What matters for the economy is the risk of strong social-distancing measures being reimposed, which happens when tensions on healthcare systems become extreme. This doesn't seem to be the case, but renewed policy efforts focus on pushing harder for people to get vaccinated. What matters for markets in the short-term may be different, which is one of the reasons why we expect volatility ahead. The summer will bring answers: our hope is that hospitalizations will not reach dangerous levels while global infections reach their peak.

A key reason for the resilience of risk markets is fundamental: another good earnings season is underway. So far only about 20% of Western listed companies have reported their Q2 results, but they exceeded consensus forecast for 85% of them in the US and 60% in Europe. The average outperformance of EPS versus expectations were respectively 18% and 8%. This illustrates that analysts struggle to anticipate the positive impact of operational leverage, but more importantly, this is the best way to deflate the objectively elevated valuation multiples. The week ahead will bring a lot more data to investors' attention.

In other news, the ECB didn't completely manage to bring clarity to their new policy framework. A 2% target inflation with an aggressive timeline, "well ahead of three year", is clearly dovish – this level has never been reached despite a decade of quantitative easing. However President Lagarde said that this doesn't necessary simply mean that interest rates will be "lower for longer". As often, policy is much clearer in China where authorities are shifting their stance from aggressive normalization to more neutrality, against the backdrop of a significant deceleration in 2021. It's good to keep in mind that China outperformed all major economies in 2020, and that its transition from being export-driven to a domestic focus is happening.

The week ahead will be dominated by an avalanche of corporate results but will also include important economic releases, especially Q2 GDP growth for both the US and Euro area. The US Federal Reserve will hold their monthly meeting, which is not expected to be eventful, with no new “dot plot” being communicated, and probably a subtle exercise of fine tuning the wording around the state of the economy and discussions on tapering. Stay safe.

MAURICE GRAVIER
Chief Investment Officer
Wealth Management
Emirates NBD

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