



CIO OFFICE MORNING MARKET WRAP – Sunday August 30th, 2020. ALSO AVAILABLE ON ALEXA.

Against many predictions, the rally remained strong last week, with robust positive returns from almost all major asset classes. Stocks gained 2.8% on average across developed and emerging markets, led by the US in the former, up for a fifth consecutive week and printing new all-time highs, and by China in the latter, adding 4%. The MSCI China's performance in 2020 is +21% in US Dollar so far, second only to the US Nasdaq, up more than 30%. Bonds were also well oriented in both their rate and spread component, as the key event of last week was obviously the speech from the Fed chairman at Jackson Hole symposium on Thursday.

Jerome Powell announced an expected but now official shift in the way inflation is considered by the Fed: inflation is no longer the absolute evil threatening economic growth and financial stability. As a result, the institution will tolerate higher levels in the years ahead before acting to counter it, as it is now moving to an average inflation target over multiple years. Interest rates could stay at zero for years even if the once red line level of 2 percent inflation is crossed. The timing looks appropriate, as global core CPI is quickly rising and approaching 2%, due to an impressive pent-up demand for goods since global economies reopened. US Personal

Spending topped consensus on Friday, rising 1.9% from the prior month, and the core deflator, one of the Fed's preferred inflation gauge, rose to 1.3%. Other speakers at Jackson Hole were aligned with the Fed, committing to quantitative easing across public and private assets, discussing the merits of negative interest rates and calling for fiscal stimulus.

This explains the holistic rally of the end of last week, which included Gold and Oil. Of course, equity valuations have risen from expensive to very expensive, a theme we write about for months. Of course, there are key unanswered questions: there is still no compromise in Washington on a fiscal stimulus bill, the virus is still not under control especially in America, with schools set to reopen imminently, and the tensions between the US and China are only getting worse every day. This is why we expected and still expect turbulences, but on the other hand, it would be irresponsible to ignore that the Modern Monetary Theory becoming real is a powerful driver for equity multiples. While monetary inundation kills risk-free yields, fiscal stimulus and massive leverage boost growth, so there is little, if any, alternative to risk-assets to generate return. The current valuations are not crazy if we assume a perfect economic recovery and persistently ultra-low interest rates. Market action is explained by the still defensive positioning of institutional money, for whom every positive day on markets is an additional pressure to put their unproductive cash at work. And retail investors are here to push markets, especially technology. Timing the end of this process is extraordinarily difficult, especially as the US Presidential Election being only 2 months away doesn't help finding compromises on both domestic and international topics.

There was another key news last week: Japan Prime Minister Abe unexpectedly said he will resign due to health issues, and a new Prime Minister should be elected to succeed him in September. Mr. Abe was so prominent in the economic transformation of Japan in the last decade or so that his policy was dubbed Abenomics, a combination of fiscal expansion and monetary accommodation, in tandem with the Governor of the Central Bank Mr. Kuroda. Given the political landscape and the majority of Mr. Abe's party at the Diet, there shouldn't be a major change in strategy. The week ahead will be rich in macro-economic data for August, starting with the monthly leading indicators, ISM and PMIs, and ending with the monthly job report in the US. According to the consensus, the unemployment rate in the US could return to single digits. This could provide further ammunitions for President Trump as Mr. Biden's lead in the polls has started to erode.

Stay safe.

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