Perspectives
Financial Markets

SwissLife Asset Managers

November/December 2020

Interest rates & bonds
The non-event

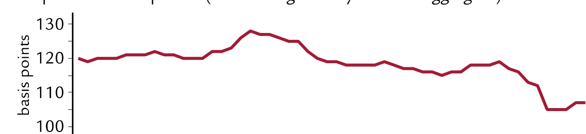
USA
- US economic data remained strong in October, but the resurgence of COVID-19 cases will likely weigh on growth and dampen the labour market recovery during the winter months.
- President-elect Joe Biden will likely not enjoy full support in Congress. While we expect both parties to ultimately compromise about a second round of fiscal stimulus, the Democrats' far-reaching expenditure and tax plans seem out of reach. Hence, markets can likely count on continuously strong monetary policy support.

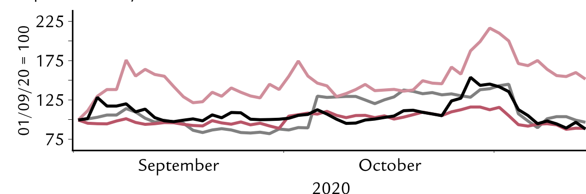
Eurozone
- Infection numbers have skyrocketed in Europe, leading to containment measures in almost every country. Service sector sentiment already took a hit, but the improving outlook for industrial activity implies that the drag on GDP will be much less severe than during the lockdowns in spring.
- The ECB has already reiterated its dovish stance verbally, effectively preannouncing further measures for the December meeting.

UK
- The Brexit saga is ongoing, but we still think that both sides will come to a last-minute agreement.
- However, the underperformance of the UK economy and the resurgence of the pandemic led the Bank of England to increase bond purchases, and the option to reduce policy rates is still on the table.

Switzerland
- Switzerland is trying to get through the second wave of the pandemic with only targeted and regional containment measures. If successful, Switzerland will again see better GDP growth numbers than its neighbours.
- The SNB has not changed its monetary policy over the past month and sight deposits have remained relatively stable.

Credit spreads and volatilities drop after US elections





The US presidential election was one of the most hedged events in financial market history. Implied volatilities soared across asset classes in the days up to the election (see chart). But in the end, all the worst-case scenarios that were mulled, from riots to significant irregularities on election day, proved to be wrong. Instead, markets ignored the ongoing noise from President Trump and swiftly started to position for a Biden presidency and a split Congress, a prospect that many market participants seem to welcome. Not even the renewed resurgence of the pandemic could spoil the mood, as the favourable news from the vaccine front improved medium-term economic prospects. In short, implied volatilities collapsed in the first half of November, and risky assets rallied. Since the end of September, EUR and USD credit spreads tightened by 21 and 25 basis points, respectively. Risk premia are now not far off their February tights even though the corporate bond universe has become much riskier, both in terms of fundamentals and duration. However, technicals remain strong, especially given the expectation of lighter new issuance into year end. The path for government bond yields is less clear, which became apparent over the past few weeks where they had a rollercoaster ride up and down. We therefore opt for a neutral stance in terms of duration.

Equities

A shot for the markets?

USA

- Equity markets reacted positively to the outcome of the US elections. Joe Biden will likely bring more predictability to trade policy, while the absence of a “blue wave”, i.e. a significant majority for the Democrats in both chambers of Congress, implies less risk for sweeping changes to regulation and the tax code, which could have harmed company earnings.
- On the negative side, we expect the COVID-19 situation in the US to deteriorate rapidly, clouding near-term economic prospects as more restrictions will likely be implemented in various states. This is counterbalanced somewhat be improved medium-term prospects due to positive news from the vaccine front.
- Overall, we expect a volatile, but moderately positive equity market development until year-end.

Eurozone

- European governments appear to be more sensitive to COVID-19 developments and have again, as in the first wave, imposed stricter containment measures than the US. This explains why the positive news regarding the BioNTech/Pfizer vaccine boosted Eurozone stocks much more than their US peers on the day of announcement.
- If the news flow on the vaccine front remains positive, this could unwind the huge underperformance that EMU stocks have accumulated throughout the year.

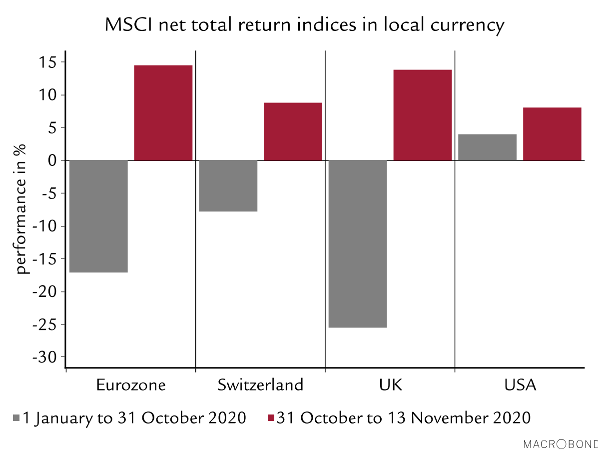
UK

- Our call to stay cautious on UK equities has been proven correct. The UK economy went into a severe second wave of the pandemic on a much weaker footing than other economies.
- We expect continued underperformance of UK equities. Not even a narrow UK-EU trade deal would be game-changing, as such an outcome already seems to be priced.

Switzerland

- As a defensive market, the Swiss equity market underperformed its more cyclical peers during the rally in the first half of November.
- Going forward, we expect the Swiss market to move in line with global equities.

Has the country rotation started yet?



In the view of many market participants, the US elections brought the “best of both worlds”, i.e. a more predictable US presidency under Joe Biden (i.e. less Twitter-induced volatility, especially regarding trade relations), while a split Congress limits his power on other issues. The 5 January runoff elections in Georgia remains a risk as a Democratic victory for these two Senate seats could still bring a fifty-fifty constellation in the Senate, where the Vice President’s decisive vote could bring Democratic projects over the finishing line. Nevertheless, such an ultra-slim majority would still require significant compromises and block many ambitious fiscal projects, which is why equity markets appear – at least currently – to be relaxed about that risk. In any case, markets swiftly changed their focus back to the COVID-19 pandemic. On that front, there is currently a tug-of-war between negative news from a massive surge in new infections both in Europe and the US and the positive news that the BioNTech/Pfizer vaccine showed high effectiveness in stage III trials, improving the medium-term outlook beyond a bleak economic situation over the winter months. The optimism has prevailed so far, and while a lot of good news is already priced, we expect the positive momentum for equity markets to moderately extend over the next few weeks. Especially, we would not be surprised to see the sector and region rotation (see chart) continuing, as the spotlight moves on companies that have so far been the losers of this pandemic.

Currencies

Risks are being priced out

USA

- The US elections led to broad-based USD weakness, as political uncertainties were priced out and as a Biden presidency is generally considered to be negative for the greenback.
- We expect the USD to depreciate against EUR and CHF until year-end amid favourable risk sentiment in financial markets, even though the extent of the depreciation will likely be limited.

Eurozone

- Cyclical currencies such as the EUR benefitted from better risk sentiment in financial markets in the first half of November.
- We expect the EUR to remain supported over the next few weeks, but the extent of EUR appreciation will likely remain modest due to a very dovish European Central Bank and weak economic dynamics across Europe.

UK

- Sterling recovered from its September lows as financial markets became again more confident that a narrow trade deal between the UK and the EU will be ultimately struck, which is also our base case scenario.
- Nevertheless, we expect GBP to weaken somewhat against EUR as the massive economic underperformance continues in the wake of renewed harsh lockdowns in the UK. On GBP/USD, we keep a neutral view.

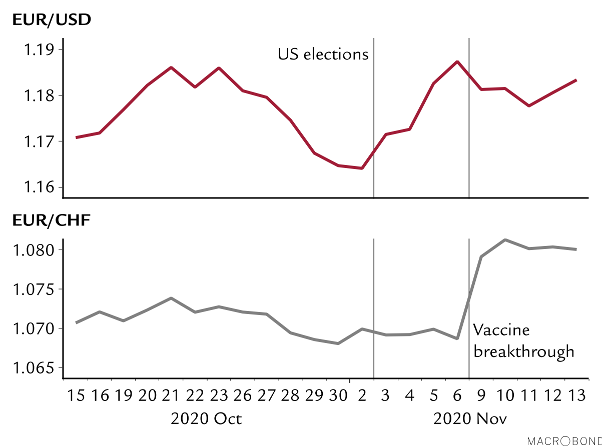
Switzerland

- The CHF strengthened against EUR in the month of October, but the return to "risk-on" sentiment in financial markets, especially after the favourable news on the vaccine front, brought EUR/CHF swiftly back above 1.08.
- We stick to our neutral view on EUR/CHF and expect CHF to appreciate versus USD, in line with our generally cautious view on the USD.

Japan

- The JPY temporarily weakened after the "vaccine news", but has been on general appreciation trend against USD since April – a trend that we expect to continue.

US elections weakened the USD, vaccine news the CHF



Two topics have dominated financial markets including FX over the past one-and-a-half months: the US elections and the news that the BioNTech/Pfizer vaccine showed very high effectiveness in stage III trials. As we had expected, the election of Joe Biden as president proved to be negative for the USD, which depreciated around 2% against EUR in the week after the election. Notably, investors attach less risk of an escalation of US-China tensions under a Biden presidency, which removed a risk premium from the greenback. Interestingly, the US elections had no effect on the EUR/CHF exchange rate, which had lost 1% in the month of October. EUR/CHF reacted however, strongly to the vaccine breakthrough and shot back to the 1.08 level that prevailed in August and September. The JPY also sold off on the news. The availability of a vaccine obviously reduces the tail risk that we will still be dealing with occasional pandemic-related recessions in 2022 and beyond, thus reducing the appeal of these safe haven currencies. Going forward, we think there is still some room for cyclical currencies such as EUR or CAD to appreciate against the USD as we expect financial market sentiment to remain risk friendly. The exception is GBP, which has already recovered by 3% from its September lows (on a trade-weighted basis) as most market participants expect an EU-UK trade deal to be ultimately struck. At these levels, we opt for a neutral view on GBP/USD and expect renewed weakness against EUR, as economic data is set to deteriorate sharply from already weak levels amid the resurgence of the pandemic.

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