WEEKLY MARKET RECAP

THOUGHT OF THE WEEK: Brussels' position is clear, Pacta sunt servanda!

After last week events, Brexit is again making headlines. The eighth round of bilateral negotiations between Michel Barnier and David Frost ended last Thursday in London with nothing to show for it, however, the economic fallout of COVID-19 has partially changed the interests of the two sides. The scenario for the UK economy is particularly fragile: despite the rebound in UK economic growth in July and August, consumers and businesses, who fear the end of government support in the autumn, remains very cautious.

Fig. 1

Retail sales speak for positive growth in Q3

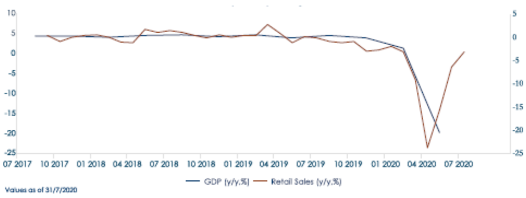
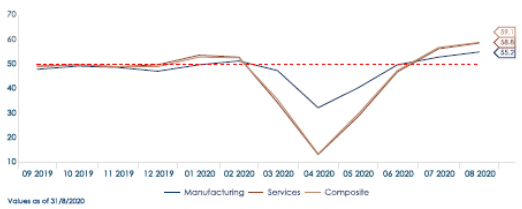


Fig. 2

Composite PMI improved up to August



What happened last week?

On September 7, the British Prime Minister, Boris Johnson, returned to threaten UK's withdrawal from the EU without agreement, reiterating that the next European Council will have to sanction the closure of negotiations, in order to get the agreement approved by the legislative bodies of the two parties, the European Parliament and the British Parliament. The British Prime Minister said he wants to reach an agreement similar to the one that the EU has with Canada in order not to derogate from the promise made to his electorate to recover, after the end of the transition scheduled for December 31, 2020, "full control of its laws, rules or waters for fishing" and the right to return to being "an independent country", free to trade with any foreign country to prosper "powerfully" in the future. To complicate the situation, **on Wednesday, September 9, a national bill was presented to the British Parliament - called Internal Market Bill**, which seeks to create scope for the UK government to unilaterally reinterpret parts of the Withdrawal Agreement reached between the EU and the UK. The UK bill aims to give the ministers in London the power to ignore some key clauses of the agreement and, in particular, the part of the agreement already reached on the border between Ireland and Northern Ireland (Northern Ireland would no longer be allowed to remain in the single market, thus re-proposing the problem of the physical border to the south with Ireland and the rights of EU citizens residing in the UK, generating uncertainty about the recognition of their residence). **The 58-page text of the law openly admits that some clauses violate the international agreements signed by London**, stressing that the measures taken "will take effect despite any relevant international or national law with which they may be incompatible or irreconcilable". The parties to the termination agreement contrary to UK law "will cease to be valid and recognized by national law". Articles 42, 43 and 45 of the text rewrite the Protocol, effectively removing decision-making and interpretative powers in Brussels to give them to London. A benign interpretation of the government's strategy is that the Bill constitutes an attempt to safeguard the UK's internal market in the event that no FTA is reached by the end of 2020. A fatalistic interpretation is that the provisions within the Bill signal that Downing Street no longer believes an FTA is within reach. the European Commission has stated that the EU grants the UK until the end of September to amend the Internal Market Bill (which is a clear breach of the withdrawal agreement). At the same

Fig. 3

UK stimulus measures

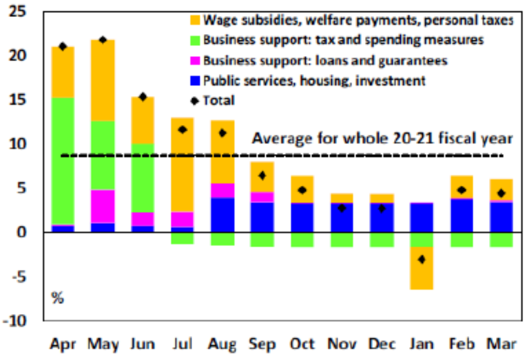


Fig. 4

Level of Total Hours Worked and Number of People in Employment

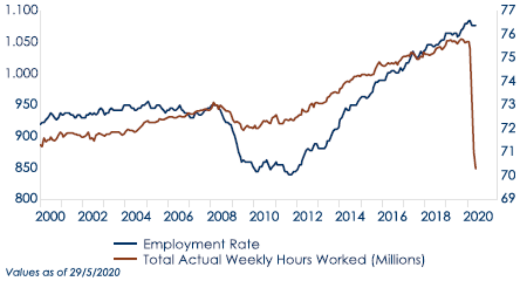
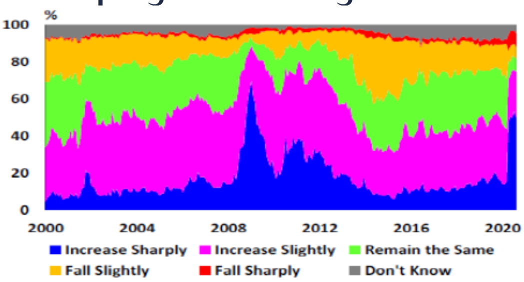


Fig. 5

Percentage of people Expecting Unemployment to ... year ahead



Source: BOE

time, the EU is studying the possibility of legal action against the UK to prevent Prime Minister Johnson's plans to violate the Withdrawal Agreement. This agreement already signed by both parties contains, in fact, a number of mechanisms and legal remedies to address violations of legal obligations contained in the text, which the EU will not hesitate to use.

What are the positions of the two parties?

Although both parties have an interest in reaching an agreement, Brussels has made it clear that compliance with the Withdrawal Agreement is the essential prerequisite for the resumption of negotiations on the future partnership, while it is clear from the words of the members of the British government that their primary concern is now to ensure the freedom to subsidize their companies, contrary to European legislation. Brussels fears that a derogation from state aid rules will result in unfair competition for European companies. The issue of state aid has been one of the main points of contention in bilateral negotiations. Last week London stated on state aid that in the future it intends to follow WTO rules "which for over 25 years have facilitated international trade and are respected by the vast majority of WTO countries".

What is the most likely outcome?

The Internal Market Bill presented to Parliament on Wednesday has raised Brexit-related risk. The most probable outcome remains a base case remains a “thin” free trade agreement, ratified by December and designed to extend the negotiations time. The agreement will leave many aspects unresolved in some areas (data and security, for example) and will foresee a period of implementation (to take into account the evolution of customs procedures, for example) that will extend until 2021. However, the move to unilaterally reinterpret parts of the Withdrawal Agreement, and consequent risks to UK trade and relations, has raised the risk premium on UK investments generally.

Is this move by Premier Johnson just a negotiating strategy or is it also due to the worsening UK economic situation?

The reason for this new tension between London and Brussels seems to be hidden In the need to derogate from EC state aid rules and support British industries affected by the pandemic. The expected rebound in growth for T3 reflects a relatively benign confluence of factors: fiscal support has remained very high, the easing of lockdown has allowed more spending including pent up demand, while the lagged effects of lockdown have kept infection rates low and reassured consumers. However, even that very limited sweet spot may now be fading: government support will decrease. Current government plans imply that net fiscal support measures will fall to an average of £15 billion per quarter (2-3% of GDP) in Q4 2020 and Q1 2021. Some new stimulus measures are planned, such as the job retention bonus. However, the great support of the Job Retention Scheme and the Self-Employed Income Support Scheme will come to

Fig. 6

Consumer saving plans hit record high

Fig. 7

UK – How long will firms' cash reserves last?

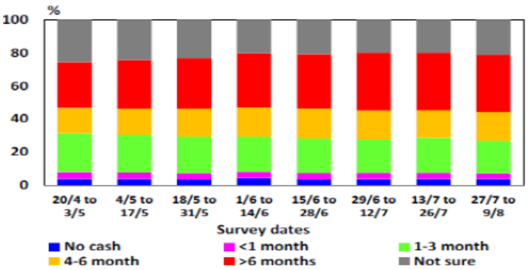
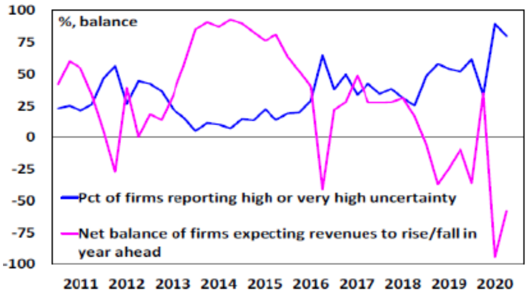


Fig. 8

UK – Deloiitte CFO survey readings on uncertainty and revenues



an end and the payment of deferred taxes in Q2 and Q3 will still be due. As a result, consumer and business uncertainty remains high and weighs on consumption and investment expectations. An indication of what might happen in the labour market once subsidies are removed is the range between the employment rate and hours worked.

Therefore, consumer confidence remains low, as they fear a significant increase in unemployment in the coming quarters on the back of the reduction of the redundancy scheme and the resumption of labor force participation. At the same time, companies' caution about investments and hiring remains high.

In particular, the BoE Decision Maker Panel's survey of companies also suggests considerable caution on the part of companies and reports that companies that seem to expect a persistent impact of COVID-19 on sales (a new 5% loss of sales by mid-2021), fear a shortage of funds and plan substantial and persistent cuts in investment. Companies expect investments to be even lower than pre-COVID-19 levels even beyond mid-2021. Perhaps most noteworthy are the very substantial cuts that companies plan for Q3 and Q4.

Therefore, in the need to support British companies in the coming quarters could reside the negotiating strategy of Prime Minister Boris Johnson.

EQUITY MARKETS

NAME	LEVEL		Δ WEEK
MSCI World AC	2 368,14	▼	-1,6%
S&P 500	3 340,97	▼	-2,5%
SX5E	3 315,81	▲	0,1%
DAX	13 202,84	▲	0,8%
CAC 40	5 034,14	▼	-0,4%
FTSEMIB	19 820,75	▲	0,4%
IBEX 35	6 943,20	▼	-1,9%
FTSE 100	6 032,09	▲	1,6%
MSCI Emerging	1 091,79	▼	-0,2%
CSI 300	4 627,28	▼	-0,9%

Strategic View

The speed and intensity of the market drop has brought certain markets to potentially attractive levels, creating the technical assumptions for a rally. The extensive liquidity provided by central banks, the tax stimulus measures and potential inflows could support another equity rally.

The week on the stock markets was still volatile, penalized once again by the sales on the Tech names and by the weakness of the oil (the differential between the two sectors has reached levels no longer ignored with the Tech sector up to today dominating the market and that of Oil&Gas in extreme suffering, thanks to (or due to) the "sustainable" trend). With 14%, Technology is now the largest sector of the SX5E. Healthcares + Staples + Industrials today represent 45% of MSCI Europe, against just 10% of Banks + Energy. The NYSE Index FANG+, which contains Tesla, Nvidia, Alibaba, Twitter and Baidu (as well as Facebook, Apple, Amazon, Netflix, and Alphabet's Google) has gained 63% since the beginning of the year, towards a +3,3% for the S&P500 index and +22% for the Nasdaq Composite. Considering the -12% since the beginning of September, bullish analysts on the Tech sector start to intercept research papers and comments of the more bearish colleagues ready to reconsider the "Return of Value vs. Growth". For this purpose, among the Value sectors in Europe this week has been the case of Auto which has gained 18% since the beginning of June and 4,5% in the last one week with the Stoxx 600 Automobiles & Parts Index (towards a Stoxx 600 Index remained essentially flat). To this are added the tensions between Trump administration and China and the growth of contagions (or the fear of the same among investors, especially after the amplified news of the "obstacle race" for the search of the vaccine, as in the case of AstraZeneca and in spite of the CEO stated that a vaccine could still be available before the end of the year although delays in trials), which are weighing on trust.

COMMODITIES AND VOLATILITY

NAME	LEVEL		Δ WEEK
Gold	1 941	▲	0,3%
Silver	26,73	▼	-0,7%
WTI	37,33	▼	-6,1%
Brent	39,83	▼	-6,6%

NAME	LEVEL		Δ WEEK
VIX (S&P 500)	26,87%	▼	-12,6%
V2X (SX5E)	23,72%	▼	-25,2%

The oil price remained below $40 per barrel in the wake of concerns on the demand side (fears of new closures of economic activity). In particular, the news flow during the week confirmed that Saudi Arabia has reduced the sale prices of Arab Light crude oil for Asia by more than $1,40 per barrel, bringing it to $0,50 below the regional benchmark. Aramco also reduced the price for US buyers. This decision marks the second consecutive month of price cuts for barrels to Asia, and for the first time in six months for U.S. refiners, after Saudi crude oil exports to the U.S. dropped to the lowest level in decades in August. Inventories remain high.

GOVERNMENT BOND MARKETS

Last week government bond markets in advanced economies have been stable. In the Eurozone there was a slight over performance of the peripheral countries against the core. The ECB monetary policy meeting merely confirmed the existing monetary policy measures and a colorless press conference confirmed the dovish tone. The main news came from the ECB statement with the explicit mention of the exchange rate for the first time in two years and the blog post meeting

NAME	LEVEL		Δ WEEK
US 10-year Yield	0,67%	▼	-5,2 bp
GER 10-year Yield	-0,48%	▼	-0,8 bp
FRA 10-year Yield	-0,19%	▼	-1,6 bp
ITA 10-year Yield	0,98%	▼	-3,4 bp

Strategic View

US Treasuries. The Fed's massive expansive monetary policy has brought government bond yield far below 1% on the main maturities. Our view remains neutral in light of the current volatility.
Euro government bonds. Despite the monetary easing, we do not see value in this asset class given the significant negative yields, particularly on triple-A issues.

of the chief economist P. Lane, which now seems to have become a tool to give more color (if not correct, as in previous months) the press conference communication. Both the rates (-0,50% for the deposit rate, 0% for the interest rate on the main refinancing operations and +0,25% for the marginal refinancing operations) and the forward guidance remained unchanged. No changes have been communicated even with regard to the securities purchase programs already in place (PEPP will be 1 350 billion euro until the end of June 2021 and should be used in full and APP of 20 billion euro, more than 120 billion euro added until the end of the year). As expected, revisions to growth and inflation estimates have also been published. The updated growth estimates showed an improvement for 2020 (-8% vs. -8,7% of the central scenario of the June projections) and a slight downward revision for 2021 (5% vs. 5,2%); the estimates for 2022 are unchanged at 3,3%. The risks remain unbalanced downwards. On the inflation side, the ECB has kept the expected dynamics for the next three years substantially unchanged (0,3% in 2020, 1% vs. 0,8% in 2021 and 1,3% in 2022), showing that the disinflationary impact of the appreciation of the single currency is considered absolutely temporary by the central institution. Friday morning, however, ECB Chief Economist, Philip Lane, underlined in the post-meeting blog that he is concerned about the strength of the currency. He said in an ECB blog that "the scale of the upward revision in core inflation has been significantly muted by the appreciation of the euro". That shows that some voices at the ECB may wish to take action to counter euro strength at some points. There was also little change in the US government term structure, which had a modest flattening. This week the FOMC meeting will be the main event. Markets hope for a clarification of the new monetary policy framework - in particular, guidance on the amount and duration of inflation overshoot the Fed would be comfortable with. More immediately relevant, however, will be the extent to which the Fed pivots to "accommodation".

CORPORATE BOND MARKETS

The credit markets have had a mixed week, with more or less flat spreads for the week along with most other financial markets, while volatility has returned. The weakness of the last week on the credit markets was mainly due to the risk off seen in the tech stocks markets, which has spilled over to the high beta parts of the credit. The technical environment remains strong, however, with the primary market indicating that investors continue to have ample liquidity which they are ready to invest. In summary, therefore, we remain cautiously optimistic about the markets and still expect a shrinking trend, albeit more slowly and less linearly than in the past. CDS indices were almost unchanged with the Xover at 326 after betraying at a low of 295 in the week, in which, among other things, the six-monthly roll on the new series has been recorded. Main closed at 55 (+3).

NAME	LEVEL YTW		Δ WEEK
USD Invest. Grade	1,95%	▲	0,3%
EUR Invest. Grade	0,53%	▼	0,0%
USD High Yield	5,56%	▼	-0,2%
EUR High Yield	4,49%	▼	-0,3%
Emerging Local ccy	3,23%	▲	0,1%
Emerging Hard ccy	3,70%	▼	-0,1%

NAME	LEVEL		Δ WEEK
Itraxx Main	55,41	▲	2,6 bp
Itraxx Xover	326,103	▲	0,3 bp
Itraxx Sub Fin.	135,62	▲	11,3 bp
CDX North Am. IG	69,82	▲	3,1 bp
CDX North Am. HY	357,91	▼	-8,5 bp

Strategic View

Corporate IG: monetary easing could further support the asset class to opt for, especially in Europe, over the most speculative segment (high yield) and government bonds, as corporate IG presents a more interesting risk/return ratio at this stage in which it is difficult to predict how the scenario risks will evolve
HY Corporate: although a further deterioration in the baseline scenario could impact the weaker issuers by bringing default rates back to higher levels, the scale of monetary and fiscal policies are likely to stabilise.

NAME	LEVEL		Δ WEEK
Dollar Index	93,33	▲	0,7%
EUR/USD	1,1846	▲	0,1%
GBP/USD	1,2796	▼	-3,6%
EUR/GBP	0,9258	▲	3,9%
EUR/CHF	1,0767	▼	-0,4%
USD/JPY	106,16	▼	-0,1%

Strategic View

US interest rates have collapsed and the Fed has supplied markets with an unprecedented supply of USD cash to alleviate funding issues, easing its policy stance more proactively than other central banks globally. Within G10 currencies, we remain mildy bearish on the US dollar (USD).

EXCHANGE RATES

The European Central Bank meeting held on Thursday, September 10 was the highlight of the week for the currency market (and the EUR in particular). President Lagarde reiterated the statements of some board members, stressing that the currency is not an ECB's target, but that it is closely monitored for its impact on Eurozone inflation. The EURUSD exchange rate remained stable close to 1,18 until the ECB meeting and then appreciated slightly until it exceeded briefly 1,19 and then fell back. The statements made by Lagarde during the press conference lead to think that a further expansive intervention by the Central Bank seems unnecessary at the moment, thus "crystallizing" the gap in terms of monetary support between the ECB and the FED in favor of the latter and, consequently, shifting to the USD "the burden of proof" for a possible appreciation.

EURGBP has achieved the largest movement during the week, after the UK government expressed its intention to introduce a law in blatant violation of the agreements reached so far with the EU during the negotiations that are defining how the UK will exit from the EU. The pound depreciated more than 4% against the eur, returning to 0,93 area. We expect that the pressure on the pound will remain extremely high throughout the period, and subject to great volatility.

Emerging currencies maintained a generally positive pitch during the week, but did not see (as was the case in previous weeks) the outperformance of South American currencies compared to other geographical areas. The reduction of international media interest in the Belarusian affair brought back interest in the Ruble, which, unlike other emerging currencies, did not benefit from the weakening of the USD. The solid fundamentals, the decidedly uncrowded positioning and the reduced probability of sanctions make the Ruble one of the most interesting currencies in the emerging universe.

THE WEEK AHEAD: UPCOMING DATA

Europe: This week we expect to learn that euro-zone industrial production rose in July, and that hourly labour costs rose in Q2 due to the slump in hours worked. We will also be looking at the detailed inflation data for August. In the UK there will be the decision on the official rates of the Bank of England, followed by the usual press conference with indications on the policy of the institution.

United States: The FOMC meeting will be the main event, while the agenda of macroeconomic data remains rich: on the supply side, indications will arrive from the change in industrial production, together with the Leading indicator and the Empire index of the manufacturing sector. Looking at consumption, however, we will know the trend of retail sales for the month of August, as well as the level of consumer confidence measured by the index of the University of Michigan.

Asia: poor week of indications. In Japan, inflation data for August will be published, while in China it will be the turn of the publication of foreign investments.

Source: CMB Monaco, Mediobanca SGR

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