GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

TUESDAY, AUGUST 25, 2020

- **US equity market sets another record high** (link)
- **China and US reaffirm Phase One trade deal** (link)
- **Tech sector optimism a major driver of the global rally** (link)
- **Euribor rates fix near all-time lows** (link)
- **Low volatility further boosts US markets** (link)
- **Stronger US corporate earnings expected to moderate pace of dividend cuts** (link)
- **Real rates in Mexico approach zero** (link)

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Markets rally on virus and trade optimism

Continued optimism on the virus and trade pushed global markets to a third consecutive day of gains. In the US, S&P 500 and Nasdaq futures point to yet another record close if current levels hold. Short interest on the S&P 500 fell to a 15-year low yesterday. News that the US and China recommitted to the Phase One trade deal boosted global markets. Chinese media described the talks as "constructive dialogue." Encouraging news on vaccines and a stronger than expected German IFO business confidence survey also lifted sentiment. News that Ant Group has filed for one of the largest IPOs in history is another reminder that optimism on the technology sector has been a key driver of the global equity rally. Ant Group's intention is to simultaneously list in Hong Kong and Shanghai, reportedly targeting a valuation of about $225 bn. Currency traders have been pricing out the risk of a no-deal outcome of current UK-EU trade negotiations even though UK and EU politicians have openly admitted that not much progress has been made in August.

Key Global Financial Indicators

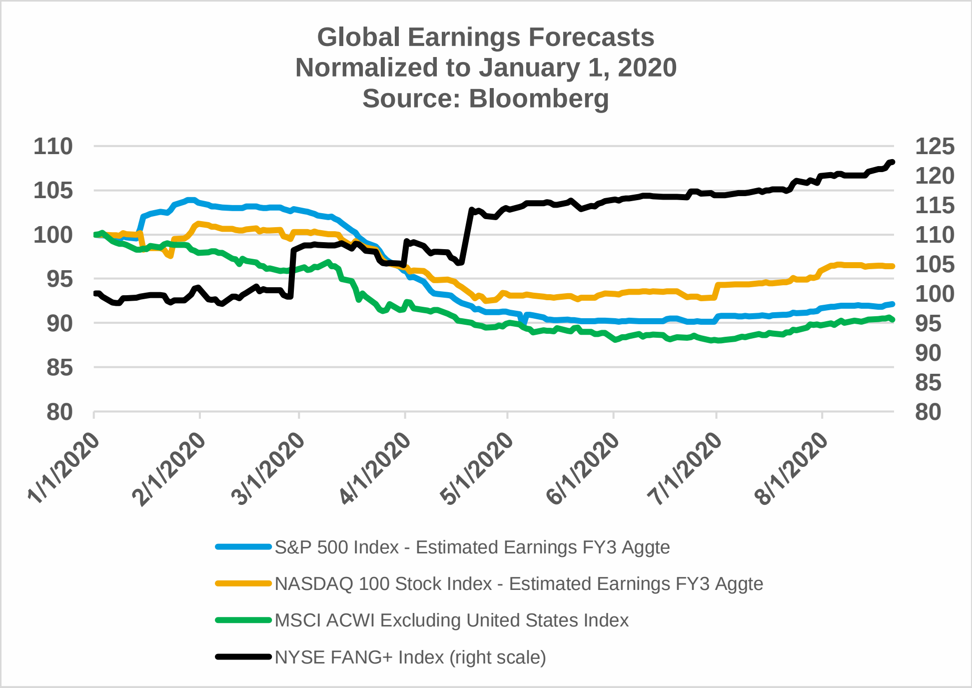
Last updated: 8/25/20 8:03 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		3431	1.0	1	7	21	6
Eurostoxx 50		3358	0.8	2	1	1	-10
Nikkei 225		23297	1.4	1	2	12	-2
MSCI EM		45	1.1	0	4	15	0
Yields and Spreads				bps			
US 10y Yield		0.68	2.8	1	9	-85	-124
Germany 10y Yield		-0.44	4.9	2	1	23	-26
EMBIG Sovereign Spread		419	1	-3	-28	51	126
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		54.9	0.0	0	-1	-9	-11
Dollar index, (+) = $ appreciation		93.2	-0.1	1	-1	-5	-3
Brent Crude Oil ($/barrel)		45.6	1.0	0	5	-23	-31
VIX Index (%, change in pp)		22.4	0.0	1	-3	2	9

Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

United States back to top

Hopes for the fast-tracking of new vaccines pushed US markets to a second consecutive record close yesterday, with futures pointing to another record this morning. Both the Nasdaq and S&P 500 set new records. The slowing pace of new infections was another positive factor for sentiment, as was news that the US Food and Drug Administration is increasing access to plasma therapy. Out of favor sectors such as cruise companies and airlines saw very big gains, followed by casinos and carmakers. However, the overall August rally has largely been powered by the technology sector (see below). Meanwhile, Treasury yields are higher across the curve today and the dollar is weaker against the euro and the yen.

Technology sector optimism has been a key driver of the global markets rally. With 58% of global market capitalization accounted for by the US stock market, the exceptionally strong performance of just a few US technology stocks has had a disproportionate impact on the world market, just as the Big Three Chinese tech stocks have led the Chinese stock market higher. These tech stocks have been driven by expectations of much stronger earnings. Looking at earnings forecasts for 2022, when normalized to January 1, 2020, forecasts for the Nasdaq 100, S&P 500 and ACWI world index (excluding the US) are below where they started the year. In contrast, forecasts for the FANG+ index are up over 22% from the start of the year. Some are worried that these expectations may be unrealistic, setting the market up for a potential shock if the earnings forecasts turn out to be too rosy.



US markets have benefited from sustained low volatility as the post-crisis rally gathers steam. The VIX is at post-crisis lows while the MOVE interest rate volatility index is only slightly above its COVID era lows. This has helped equities to continue their rally and has pushed credit spreads lower, even for high yield bonds. New issuance of corporate bonds was easily absorbed by the market, as were the large volumes of Treasury notes and bonds. Low volatility has also buoyed structured products such as mortgage backed securities, which have embedded options which make them particularly vulnerable to sudden increases in volatility. However, markets remain hostage to the health crisis and adverse developments could force a sharp reversal. The other major issue is whether the US economy is at "peak policy support" or whether further fiscal aid will be forthcoming. The consensus forecast is that another $1-1.5 tn package will be passed, but so far, the two political parties remain deadlocked over the size and composition of the new package.

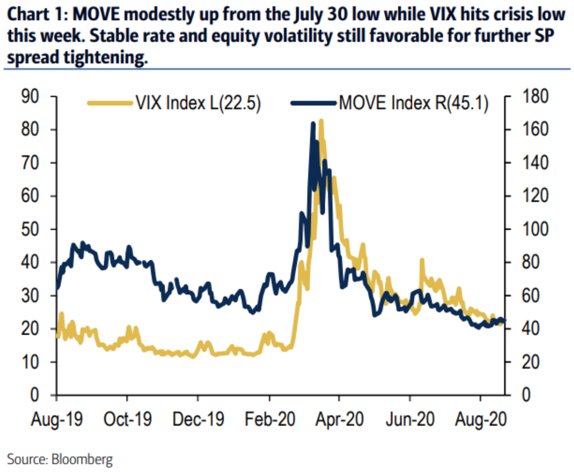


Chart 1: MOVE modestly up from the July 30 low while VIX hits crisis low this week. Stable rate and equity volatility still favorable for further SP spread tightening.

Source: Bloomberg

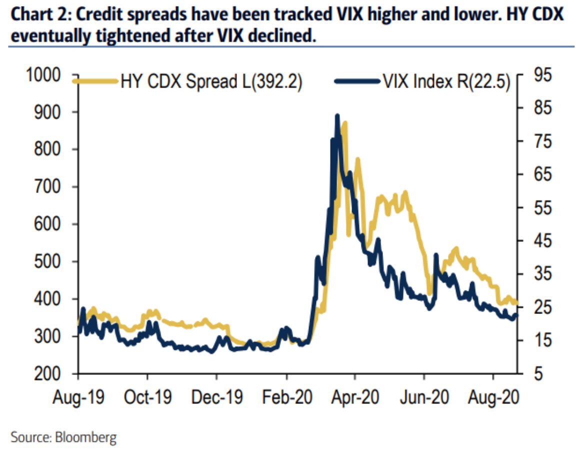


Chart 2: Credit spreads have been tracked VIX higher and lower. HY CDX eventually tightened after VIX declined.

Source: Bloomberg

Sources: Bloomberg and Bank of America

Stronger earnings from US corporations are expected to lead to lower dividend cuts than originally expected. In upgrading its earnings forecasts, Goldman expects higher dividends per share (DPS) than earlier forecasts. For the S&P 500 in aggregate, DPS will be $56 per share in 2020, which is down just 3% from the year before. Previously, they had predicted a DPS decline of 25% to $46/share. However, the market expects further dividend cuts in 2021 from current levels, as the dividend swap market is currently forecasting 50/share. Moreover, other analysts caution that the rebound in earnings forecasts may have gone too far. Based on aggregate analyst reports, forward price-earnings for the S&P 500 forecasts have had the largest six-month increase ever, based on Bloomberg data going back to 1990. This exceeds the pace of even the dotcom bubble.

Exhibit 1: Annual S&P 500 DPS growth
as of August 20, 2020

Source: FactSet, Standard and Poor's, Goldman Sachs Global Investment Research

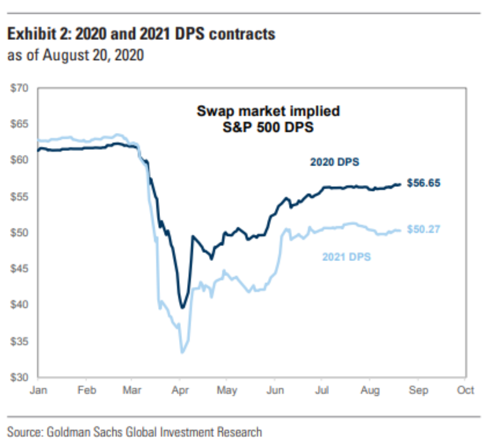


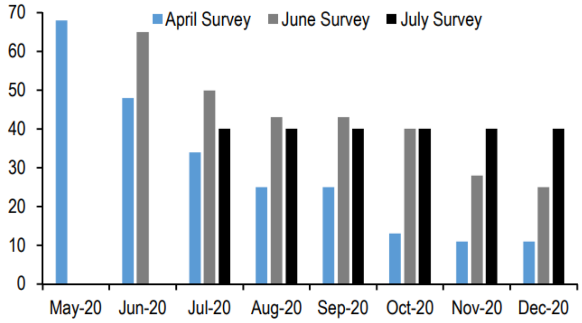
Exhibit 2: 2020 and 2021 DPS contracts
as of August 20, 2020

Source: Goldman Sachs Global Investment Research

The latest primary dealer survey by the New York Fed found that dealers expect the Fed to purchase $40 bn of mortgage-backed securities (MBS) through the end of 2020. JP Morgan reports that the 25th percentile forecast was slightly below this figure, but the great majority expect continued purchases at current or in some cases even higher levels. In addition, the latest Fed minutes reiterated the FOMC's commitment to continued asset purchases. Some investors are worried that the Fed may pull back on its monthly purchases of MBS, due to their smaller share in this QE round compared to previous rounds, but most think it highly unlikely that the Fed will taper MBS purchases at a time when the medical and economic crisis remains severe.

Exhibit 3: Market participants expect the Fed to continue MBS purchases through the end of the year

Median of dealer responses to the question "Please provide your modal expectation for the amount of purchases, net of reinvestments, of …agency mortgage-backed securities (MBS)… the Desk will conduct for each month listed below…"



Source: New York Fed, J.P. Morgan

Exhibit 4: Fed purchases of MBS have been low recently relative to Treasury purchases

Net Fed purchases (purchases – sales) of Treasuries and MBS in past and current QE periods; $bn and as % of combined total

	Net purchases ($bn)		Net purchases (%)	
QE Period	Tsy	MBS	Tsy	MBS
QE1 (Nov 2008 - Aug 2010)	309	1,203	20%	80%
QE2 (Nov 2010 - Aug 2011)	808	0	100%	0%
QE3 (Sep 2012 - Oct 2014)	770	1,351	36%	64%
QE4 To Date (Mar 2020 -)	1,763	783	69%	31%

Source: J.P. Morgan

Europe

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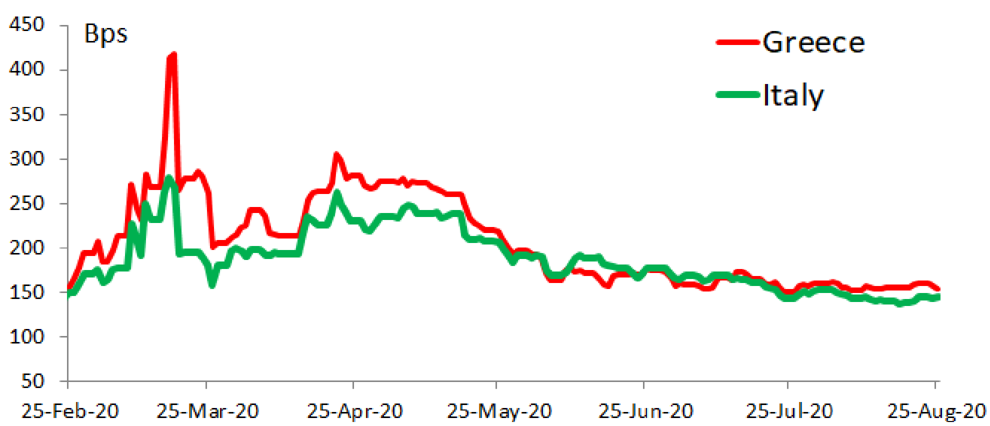
European stocks (+0.6%) **traded higher** with bank stocks (+1%) outperforming as better-than-expected German business climate data counterbalanced disappointing flash PMI data. The U.S. biotech company Moderna said that it has finished talks with the European Commission over a potential agreement to purchase 80 mn of vaccines.

The euro (+0.3% to $1.18 per euro) **gained as core yield curves steepened**. Short-dated bund yields are little changed but 10-yr bund yields rose 5 bps to -0.44%. 10-yr French yields also rose 5 bps to -0.14%.

Italian bonds underperformed this morning. 10-yr Italian spreads rose 2 bps to 145 bps as 10-yr spreads over bunds fell in Greece (-4 bps to 153 bps) and Spain (-1 bps 81 bps). Spanish hotel activity fell 64.3% yoy in July as analyst expect data will remain weak in August given the rise in Spanish covid-19 cases.

Euro area: 10-year spread over German bunds (bps)

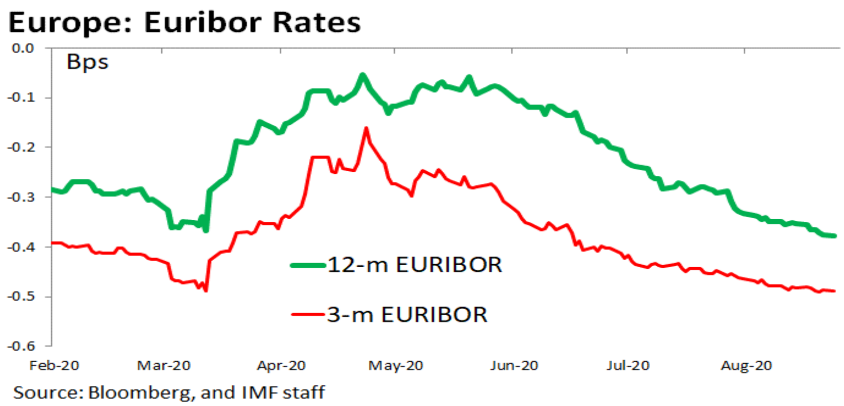


Source: Bloomberg and IMF staff

The German IFO main business climate index rose to 92.6 (92.1 expected) **in August.** The improvement boosted risk sentiment and alleviated concerns related to last week's decline in flash PMI data. The IFO current conditions component rose to 87.9 (from 84.5 in July). The expectations index (+0.5 pts to 97.5) edged higher but **analysts warn that expectations seem to stabilize at relatively moderate levels.**

The German government is expected to extend an insolvency moratorium from September 2020 to March 2021. New legislation would extend the moratorium on mandatory insolvency declarations for firms in negative equity (but not illiquid) due to the pandemic. Due to the moratorium, average monthly business insolvencies in Jan-May 2020 of 1,530 were the lowest since 1994 (1,495 then), including declines by 13% YY and 10% YY in April and May respectively.

The 3-m Euribor rate, a measure of interbank interest rates, has fixed near all-time lows of -0.49%. Some analysts believe that Euribor rates have edged lower because euro area banks took up €1.3 tn of funds in the ECB's June 2020 TLTRO III operation, making banks less likely to turn to the interbank market to satisfy liquidity needs.



United Kingdom

The British pound (+0.6% to $1.31) outperformed. Currency traders have been pricing out the risk of a no-deal outcome of current UK-EU trade negotiations even though UK and EU politicians have openly admitted that not much progress has been made in August.

Other Mature Markets

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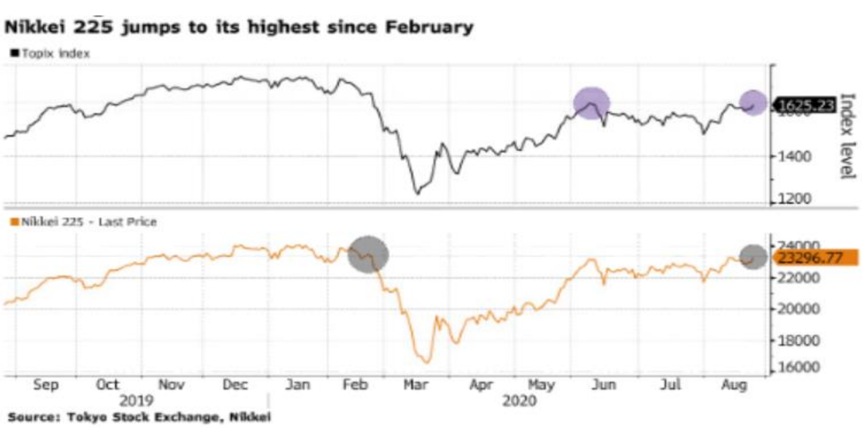
Japan

Equities rose (+1.1%), advancing to an 11-week high, driven by banks' outperformance. Prime Minister Abe visited a Tokyo hospital for a second time in about a week but clarified that it was regarding results of an examination performed last week. He is expected to hold a press conference as early as this week regarding his health and additional COVID-19 measures, according to Reuters. **10-year JGB yield rose +0.7bps while the yen weakened -0.2%.**



Emerging Markets

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EMEA equity markets are trading mixed with indices up in Czech Republic (+1.4%) and UAE (+1%), while down in South Africa (-0.6%) and Turkey (-0.3%). **EMEA currencies are most unchanged** except for the South African rand (+1.0%) and the Hungarian forint (-0.5%). **Asian equities rose +0.2% on net.** Korea (+1.6%) outperformed as consumer confidence rose to a 6-month high. Regional currencies were broadly stable. On COVID-19, Hong Kong SAR will relax social distancing rules starting from Friday, which include allowing evening dining at restaurants and reopening of movie theaters, beauty parlors and some outdoor sports venues. **Latin American equity markets were mixed on Monday.** Equities in Colombia (1.6%) and Brazil (0.8%) advanced, whereas the Argentine (-1.4%) and Chilean (-0.8%) equities lost value. Currency markets were quiet.

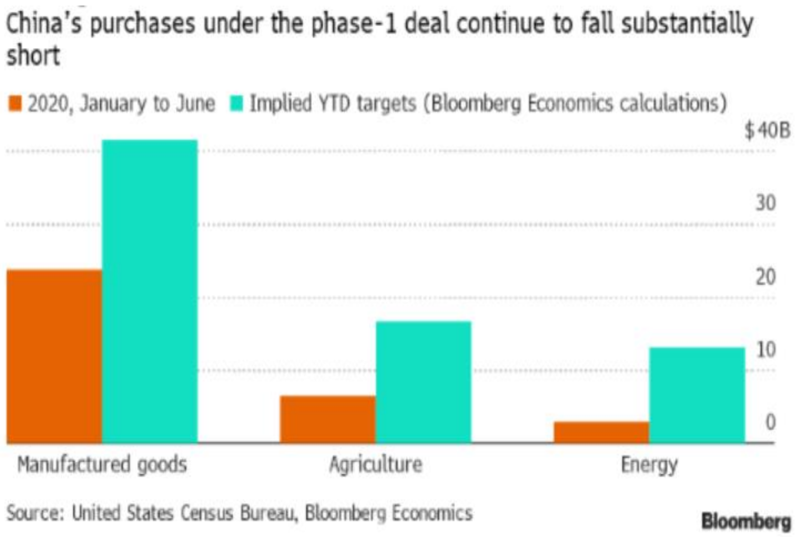
Key Emerging Market Financial Indicators

Last updated:	Level		Change				
8/25/20 8:27 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks					%		%
MSCI EM Equities		44.77	0.9	0	4	15	0
MSCI Frontier Equities		24.96	1.2	1	6	-13	-18
EMBIG Sovereign Spread (in bps)		417	-1	-5	-30	49	124
EM FX vs. USD		54.90	0.1	0	-1	-9	-11
Major EM FX vs. USD					%, (+) = EM currency appreciation		
China Renminbi		6.91	0.1	0	1	3	1
Indonesian Rupiah		14649	0.2	1	-1	-3	-5
Indian Rupee		74.32	0.0	1	1	-3	-4
Argentine Peso		73.73	-0.2	-1	-2	-25	-19
Brazil Real		5.58	0.7	-2	-8	-25	-28
Mexican Peso		21.91	0.4	1	0	-9	-14
Russian Ruble		74.81	-0.3	-2	-4	-12	-17
South African Rand		16.78	1.1	3	-2	-9	-17
Turkish Lira		7.40	-0.3	0	-7	-21	-20
EM FX volatility		11.21	0.0	0.0	1.4	2.3	4.6

Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

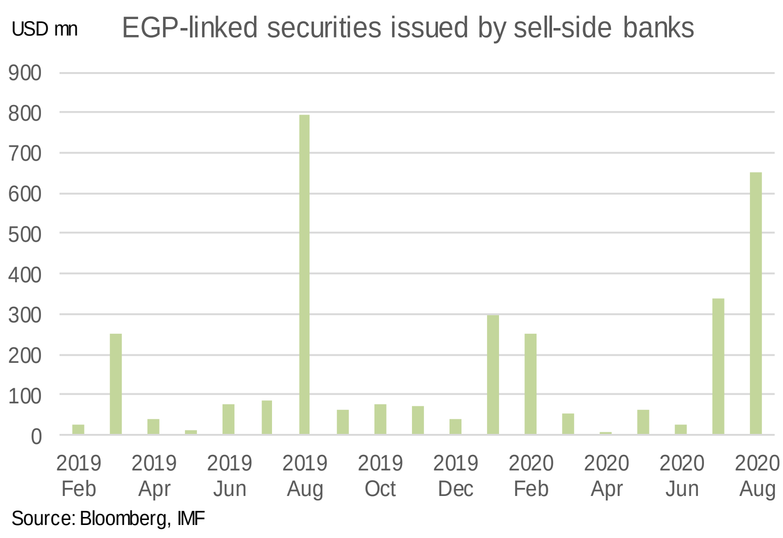
China

US and Chinese trade negotiators reaffirmed their commitment to the phase-one trade deal following a biannual review. According to the US Trade Representative, the two countries discussed the steps that China has taken, including greater protection of intellectual property rights, removing impediments to US companies in financial services and agriculture, and eliminating forced technology transfer. They also discussed purchases of US products by China and agreed on the conditions to push the deal forward, according to China's Ministry of Commerce. Chinese purchases have fallen well short of the agreed targets so far. Separately, TikTok sued the US government in federal court on Monday. It is challenging an August 6 order from the Trump administration that prohibits US residents from doing business with it. TikTok said that the company has taken extraordinary measures to protect the privacy and security of US user data. Equities (Shanghai -0.4%; Shenzhen +0.1%) were mixed and the RMB was little changed.



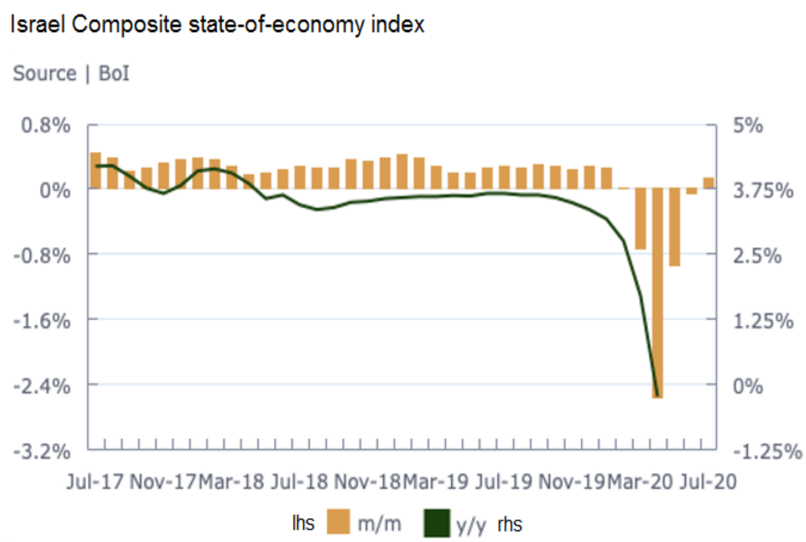
Egypt

Egypt remains among the top EM investment recommendations among sell-side firms. Market contacts observe a jump in demand for carry trades as both the volume of non-deliverable forwards and treasury bill-linked securities issuance has soared in offshore jurisdictions. The recovery in investor appetite for Egypt local markets has been supported by both stabilization of balance of payments through access to external funding through the IMF and international bond issuance, as well high level of ex-post real rates. **Inflation slowed to 4.2% yoy in July, almost a percentage point below the market consensus, while the Central Bank of Egypt continued to hold the rates unchanged at 9.25%.** Contacts also suggest that they see renewed interest in more long-dated bonds with multiple clients tapping 3-year tenors, beyond the regulated 12-month bills auctions. The Egyptian pound has appreciated 0.7% August to 15.90 pounds against the dollar. Egyptian equities have gained 8% in August and 30% from March lows but remain about 18% down year-to-date.



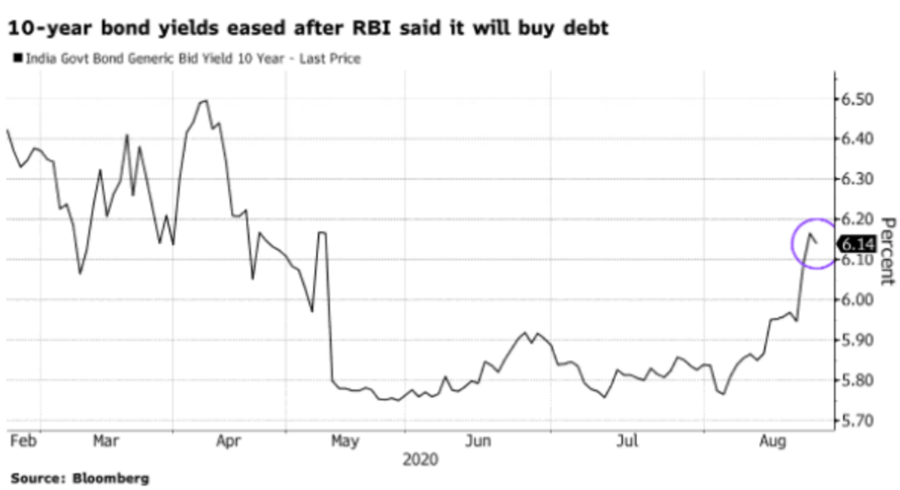
Israel

The Bank of Israel keeps its policy rate unchanged at 0.1% as expected but remains cautious due to the ongoing second covid-19 wave. The Bank of Israel has scaled down its asset purchase programs with only ILS 1.1bn of government and corporate bonds purchased in July as compared to ILS 4.2bn of government bonds purchased in June. According to the recent monetary policy statement, increase in asset purchases would be the primary tool to counter further virus-related downside risks. **The recent high frequency data suggests that the economy started to stabilize in June and July, after the larger than expected Q2 GDP contraction of 28.7% saar (against 22% consensus).** Consumer price decline in July also eased to 0.6% y-o-y as compared to 1.1% in June. Israel's equity market has been underperforming regional peers with the stock market still about 4% below the June levels and down 15% year-to-date.



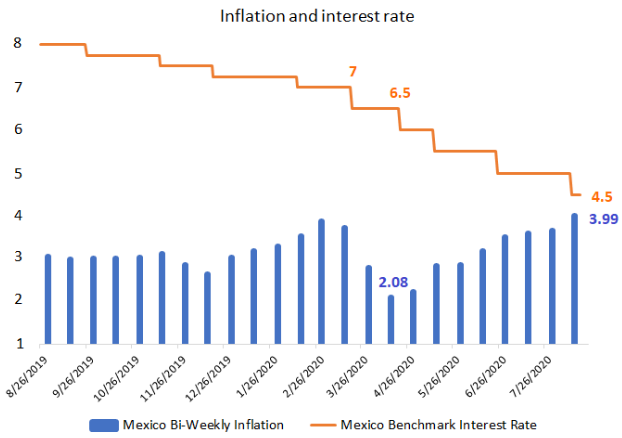
India

The 10-year bond yield fell by 3.5 bps following the central bank's special open market operations announcement. The Reserve Bank of India (RBI) said that it would be buying INR100 bn ($1.3 bn) worth of bonds (maturing in 2024, 2027, 2030 and 2032) and selling an equivalent amount of 182-day treasury bills on August 27 and September 3, respectively. The last such operation was held on July 2. **Equities and the rupee were stable.**

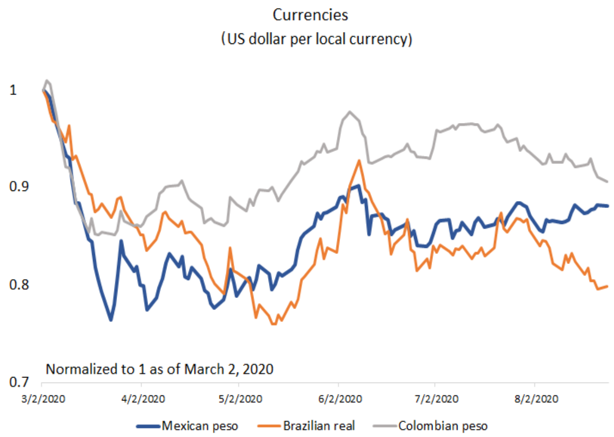


Mexico

**Inflation almost hit the upper bound of the central bank`s target, driving the real interest rate much closer to zero.** Consumer prices rose higher than expected (3.99% yoy) in the first half of August. It is now almost at the upper bound of the central bank`s target (4%). It is now only 51 bps lower than the the benchmark interest rate, which is at 4.5% after the series of cuts in the period of the COVID-19 shock. Prior to the COVID-19 policy cycle, the benchmark rate was at 7% at the beginning of March, and was cut 5 times since then by 50 bps each. In the meantime, inflation saw its lowest level in April (2.08% yoy), when the benchmark rate was at 6.5%. The August inflation number may buttress the peso by damping market expectations for further rate cuts year, according to Bloomberg. However, the Mexican peso has already been overperforming other major currencies in the region. It has appreciated by 3% against the dollar since the beginning of August, whereas the Brazilian real (-5.3%) and Colombian peso (-2.3%) have depreciated.



Data source: Bloomberg



Data source: Bloomberg

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Global Financial Indicators

Last updated: 8/25/20 8:06 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities				%			%
United States		3431	1.0	1	7	21	6
Europe		3358	0.8	2	1	1	-10
Japan		23297	1.4	1	2	12	-2
China		3374	-0.4	-2	6	16	11
Asia Ex Japan		78	1.3	0	5	22	6
Emerging Markets		45	1.1	0	4	15	0
Interest Rates				basis points			
US 10y Yield		0.68	2.8	1	9	-85	-124
Germany 10y Yield		-0.44	4.9	2	1	23	-26
Japan 10y Yield		0.04	0.8	0	2	27	5
UK 10y Yield		0.24	3.0	2	10	-24	-58
Credit Spreads				basis points			
US Investment Grade		130	0.2	0	-1	-1	33
US High Yield		521	-2.4	-8	-28	31	128
Europe IG		53	-0.5	-1	-6	1	9
Europe HY		324	-3.7	-17	-32	53	118
EMBIG Sovereign Spread		419	1.0	-3	-28	51	126
Exchange Rates				%			
USD/Majors		93.17	-0.1	1	-1	-5	-3
EUR/USD		1.18	0.3	-1	1	6	5
USD/JPY		106.3	-0.3	-1	-1	0	2
EM/USD		54.9	0.0	0	-1	-9	-11
Commodities				%			
Brent Crude Oil ($/barrel)		46	1.0	0	5	-23	-31
Industrials Metals (index)		117	0.4	0	5	4	2
Agriculture (index)		37	0.9	1	3	-1	-10
Implied Volatility				%			
VIX Index (%, change in pp)		22.4	0.0	0.8	-3.5	2.5	8.6
US 10y Swaption Volatility		54.1	0.3	-2.2	2.9	-32.6	-7.9
Global FX Volatility		9.1	0.0	-0.2	1.3	1.2	3.1
EA Sovereign Spreads				10-Year spread vs. Germany (bps)			
Greece		153	-4.6	-3	1	-110	-12
Italy		146	2.8	7	2	-53	-13
Portugal		84	-0.6	3	3	0	21
Spain		81	-0.7	4	1	0	16

Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

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Emerging Market Financial Indicators

Last updated:	Exchange Rates							Local Currency Bond Yields (GBI EM)						
8/25/2020	Level		Change (in %)					Level		Change (in basis points)				
8:07 AM	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
		vs. USD	(+) = EM appreciation						% p.a.					
China		6.91	0.1	0.1	1	3	1		3.2	-0.7	5	15	6	3
Indonesia		14649	0.2	1.3	-1	-3	-5		6.6	-1.7	-7	-27	-72	-50
India		74	0.0	0.6	1	-3	-4		6.2	7.2	17	31	-50	-66
Philippines		49	0.3	0.2	2	8	4		3.6	-0.1	-3	-11	-76	-68
Thailand		31	0.1	-0.9	0	-3	-6		1.5	0.5	3	5	-15	-15
Malaysia		4.17	0.2	0.3	2	1	-2		2.4	0.2	-1	-5	-99	-94
Argentina		74	-0.2	-0.8	-2	-25	-19		44.4	-32.1	3	-148	-742	-1822
Brazil		5.59	0.5	-2.1	-8	-26	-28		5.4	-7.3	-22	17	-130	-88
Chile		784	1.3	2.6	-1	-8	-4		2.5	0.9	1	0	-19	-77
Colombia		3857	-0.5	-1.7	-4	-11	-15		5.2	3.4	-1	2	-45	-71
Mexico		21.90	0.5	1.2	0	-9	-14		6.0	3.2	7	8	-113	-94
Peru		3.6	-0.1	-0.2	-1	-6	-8		4.2	0.0	6	19	-22	-35
Uruguay		43	0.5	-0.2	-1	-15	-13		8.3	8.3	7	-78	-282	-259
Hungary		299	-0.2	-2.2	-2	-1	-1		1.7	1.8	7	23	66	52
Poland		3.71	0.3	-1.2	1	6	2		0.8	2.0	1	0	-99	-107
Romania		4.1	0.3	-1.0	0	4	4		3.7	-8.0	2	-2	0	-34
Russia		74.8	-0.3	-2.3	-4	-12	-17		5.7	-2.0	-5	33	-129	-37
South Africa		16.8	1.2	3.3	-2	-9	-16		10.1	4.2	0	5	73	63
Turkey		7.40	-0.3	-0.3	-7	-21	-20		13.7	8.2	-50	242	-232	200
US (DXY; 5y UST)		93	-0.2	1.0	-1	-5	-3		0.30	1.6	2	2	-112	-139

	Equity Markets							Bond Spreads on USD Debt (EMBIG)						
	Level		Change (in %)					Level		Change (in basis points)				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
								basis points						
China		4762	0.1	-1	6	25	16		207	0	-3	-7	24	31
Indonesia		5339	1.2	2	5	-15	-15		214	0	-11	-32	20	58
India		38844	0.1	1	2	6	-6		217	0	9	-21	74	92
Philippines		5953	0.2	-2	-1	-25	-24		125	2	-3	-17	35	59
Malaysia		1555	-0.9	0	-2	-3	-2		148	1	-1	-11	24	36
Argentina		46737	-1.4	-4	-4	76	12		2143	-1	0	-76	335	374
Brazil		102298	0.8	3	0	5	-12		324	2	3	-21	83	109
Chile		3962	-0.8	-2	-1	-15	-15		174	1	2	-23	37	41
Colombia		1205	1.6	3	3	-20	-28		247	3	5	-17	57	84
Mexico		38030	-0.2	-3	2	-5	-13		471	3	-3	-35	116	179
Peru		18295	0.1	-1	6	-3	-11		150	1	2	-14	23	43
Hungary		35823	-0.5	-2	2	-9	-22		125	0	-5	-33	14	39
Poland		52374	-0.1	0	1	-7	-9		28	0	-2	-4	-12	10
Romania		8815	0.9	1	3	-3	-12		263	-3	10	-7	51	90
Russia		3029	0.0	-1	6	14	-1		197	1	8	-16	-21	66
South Africa		56233	-0.7	-1	1	4	-1		491	-2	-5	-26	160	171
Turkey		1108	-0.1	1	-7	14	-3		612	-7	-35	23	77	211
Ukraine		500	0.0	0	0	-5	-2		619	-3	-23	-17	77	199
EM total		45	1.0	0	4	15	0		417	-1	-5	-30	49	124

Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

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