GLOBAL MARKETS ANALYSIS
Monetary and Capital Markets

Global Markets Monitor

MONDAY, DECEMBER 21, 2020

- **Europe on high alert amidst new virus mutation in UK** (link)
- **Japan adopts record budget** (link)
- **China passes new regulations for foreign investment in local companies** (link)
- **Fed allows US banks to restart share buybacks** (link)
- **Polish central bank said to intervene to weaken currency** (link)
- **Survey finds global investors are very bullish for 2021** (link)

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Markets slump as virus spread intensifies

Global markets were a sea of red as bad news on the virus hit across multiple parts of the globe. Several Asian countries that tackled the crisis successfully in the past are now reporting new outbreaks. A new virus mutation in the UK disrupted holiday travel in Europe, sending regional stocks sharply lower. South Africa has also reported a similar variation of the virus. US equity futures are deep in negative territory and oil prices are plunging. Safe haven assets such as bunds, Treasuries and the dollar are in high demand as investors run for cover. The virus news overshadowed the $900 bn US stimulus deal agreed upon last night and due to be voted on later today. The continued impasse on Brexit talks rounds out the bleak picture this morning.

The GMM will be on holiday break starting tomorrow and will be back on January 5th. We wish our readers best wishes for the holidays and the new year.

Key Global Financial Indicators

Last updated: 12/21/20 7:31 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities				%			%
S&P 500		3698	-0.4	1	4	15	15
Eurostoxx 50		3450	-2.7	-2	-1	-9	-8
Nikkei 225		26714	-0.2	0	5	12	13
MSCI EM		51	-0.1	1	4	14	14
Yields and Spreads				bps			
US 10y Yield		0.94	-4.5	1	8	-102	-102
Germany 10y Yield		-0.57	-3.5	1	-2	-35	-42
EMBIG Sovereign Spread		351	-2	-13	-27	62	62
FX / Commodities / Volatility				%			
EM FX vs. USD, (+) = appreciation		57.0	-1.5	0	1	-7	-7
Dollar index, (+) = $ appreciation		90.6	0.7	0	-2	-7	-6
Brent Crude Oil ($/barrel)		50.4	-3.5	0	12	-24	-24
VIX Index (%, change in pp)		22.9	6.9	4	5	16	15

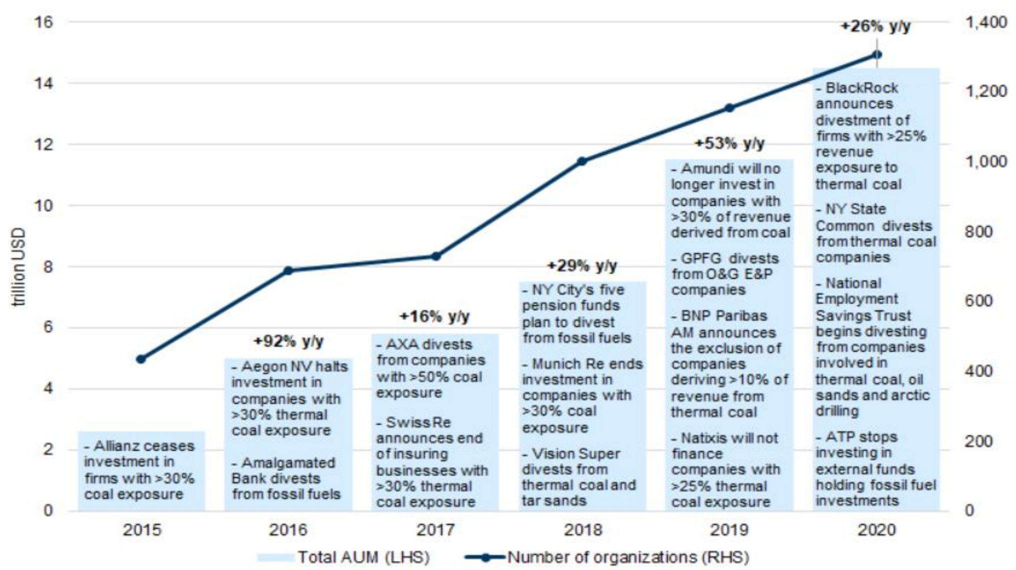
Colors denote tightening/easing financial conditions for observations greater than ±1.5 standard deviations. Data source: Bloomberg.

Trends in global ESG Investment

Fossil fuel divestment pledges continued to grow in 2020, but at a slower pace. Driven by pressure from investors, governments and other stakeholders, companies and asset managers are increasing their commitments to divest from sectors such as oil, coal and oil sands. Energy companies themselves have pledged to reduce emissions, with all the US and European oil majors having introduced reduction targets for emissions. According to analysis by Goldman, two-thirds of assets under management (AUM) in their sample have promised to divest from coal, and 75% of AUM have promised to divest from coal and oil sands. Large banks and insurance companies, fund management companies and sovereign wealth funds have taken the lead in divestment pledges. The pace of new pledges slowed in 2020, probably due to pandemic effects, but these are expected to accelerate in 2021.

Divestment commitments march forward but decelerated in 2020

Total AUM committed to fossil fuel divestment (LHS) and number of organizations making such commitments (RHS)



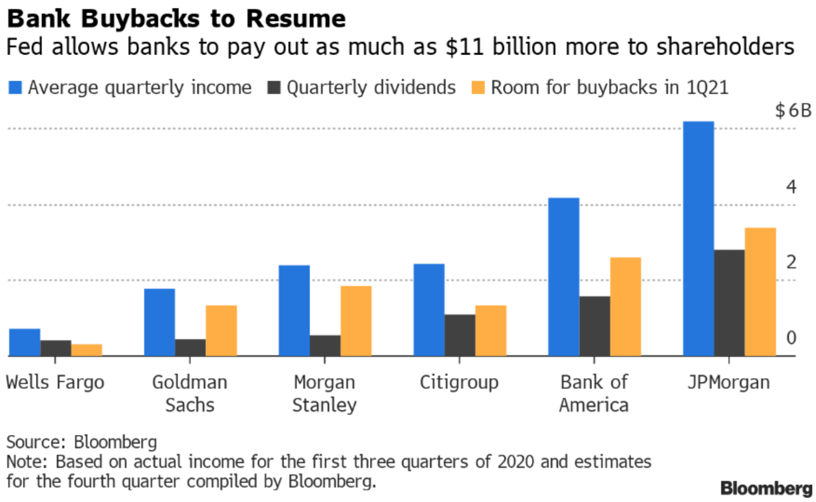
bar graph labels show AUM y/y growth rates

Source: Goldman Sachs Global Investment Research, 350.org

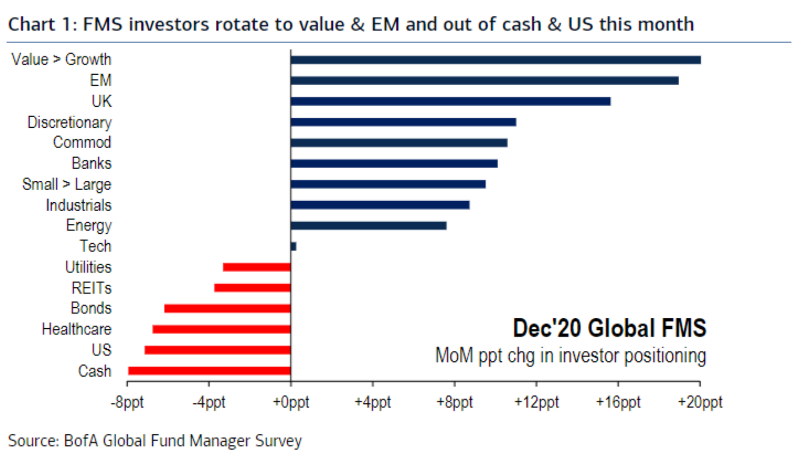
United States back to top

US equities fell back from all-time highs on Friday but managed to finish the week up 1.2%. The US Commerce Department announced it would blacklist more than 60 Chinese companies, including Semiconductor Manufacturing International (SMIC), in order to protect US national security. Treasury 10-year yields rose to 0.94%, 5bps higher for the week. Dallas Fed president Kaplan said it would be time to taper bond buying only when the economy is showing clear signs of recovery. Copper reached $8,000/ton for the first time in seven years. According to analysts, the China recovery scenario, a weaker dollar, and a green-inspired reflation wave have all worked to boost copper, as electric vehicles need four times more wiring than those with combustion engines. China's relative success in containing the pandemic and vaccine hopes have also fueedl gains across industrial commodities such as iron ore and crude oil in recent weeks.

The US Fed gave banks permission to restart share buybacks based on the latest stress test results. Vice Chair for Supervision Quarles said that banks performed well during the pandemic and have the capacity to continue to lend to individuals and businesses even if there is a “sharply adverse future turn in the economy.” JP Morgan announced it would begin buybacks in Q1 of next year and that its board had approved a buyback program of $30 bn. Goldman also said it would commence buybacks. The stocks of the four largest US banks were up 2% in post session trading in response to the news. Dividends for Q1 next year remain limited to the level paid out in Q2 of 2020, and payments to shareholders cannot be greater than the banks' average quarterly income for 2020.



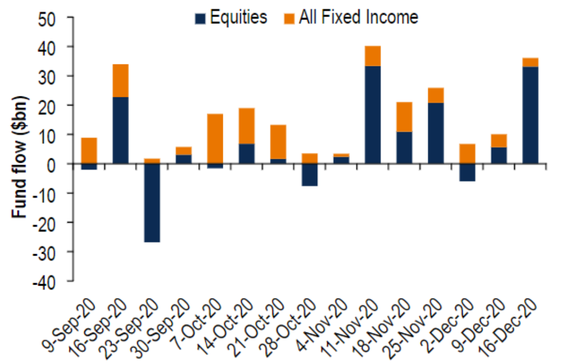
The latest Bank of America finds that investors are more bullish than at any previous point in the year. This is a view shared by most banks, who expect healthy returns for risk assets in 2021. Investor cash holdings have fallen to just 4%, the lowest in 2020, as they race to put money to work before the end of the year. 70% of those polled expect the vaccines to have a positive impact on the economy in Q1 or Q2. Popular trades include overweighting emerging markets versus developed markets, value stocks over momentum and technology stocks, and favoring Europe and the UK over the US market. Some analysts are worried that markets are "priced to perfection" and that investors are overly optimistic, raising the risk of a major market selloff if there are any unexpected setbacks relating to the economy or the pandemic.



With stock markets at or near record highs, equity mutual funds and exchange traded funds (ETFs) have experienced heavy inflows. The past week saw inflows of $33.1 bn, the third highest weekly inflow ever, up $5.57 bn from the previous week. These inflows came at the expense of other asset classes, with investment grade (IG) bond mutual funds and ETFs seeing their inflows shrink by substantial numbers.

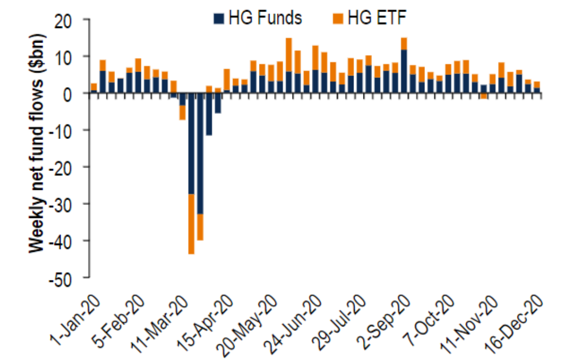
Emerging market funds and ETFs also saw smaller inflows as investors rotated into the US equity space, which is expected by most analysts to do very well next year. The reopening of the economy following the spread of vaccinations is forecasted to result in a major boost to GDP and corporate earnings in the year ahead.

Figure 1: Flows for the broad US asset classes: stocks and bonds



Note: data are for US-domiciled funds only.
Source: EPFR Global.

Figure 2: High grade fund and ETF flows, $bn



Note: data are for US-domiciled funds only.
Source: EPFR Global.

Europe

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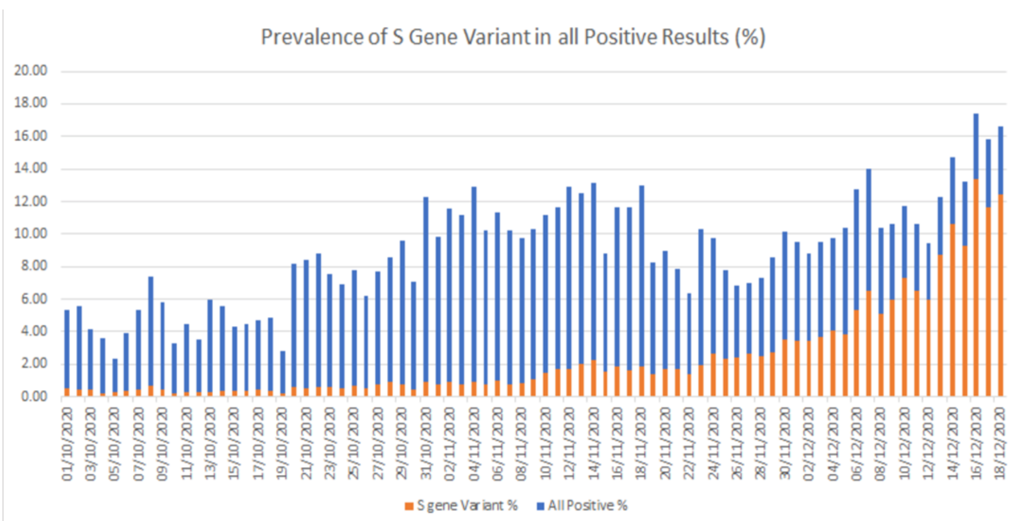
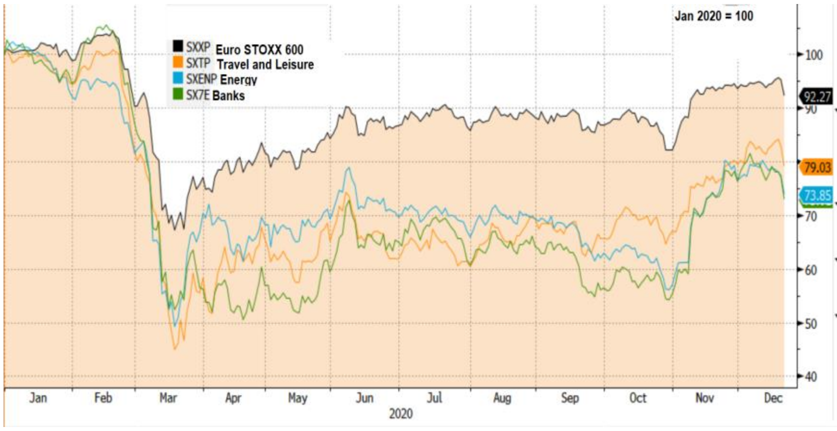
Europe moves to high alert as a potentially more contagious virus mutation emerges in the UK. The UK government announced a new level of restrictions (Tier 4) in London and other parts of the UK, banning all travel as well a closing of non-essential businesses as a new strain of COVID-19 becomes dominant among new infection cases. At this stage information about the new virus strain remains limited, with government officials reporting that it could be up to 70% more contagious. Importantly, there is no evidence that the mutation reacts differently to the vaccine. **European countries including Germany, France, Italy and the Netherlands have suspended air and ground travel with the UK until further notice**. The spread of the new strain outside the UK remains limited at this stage.

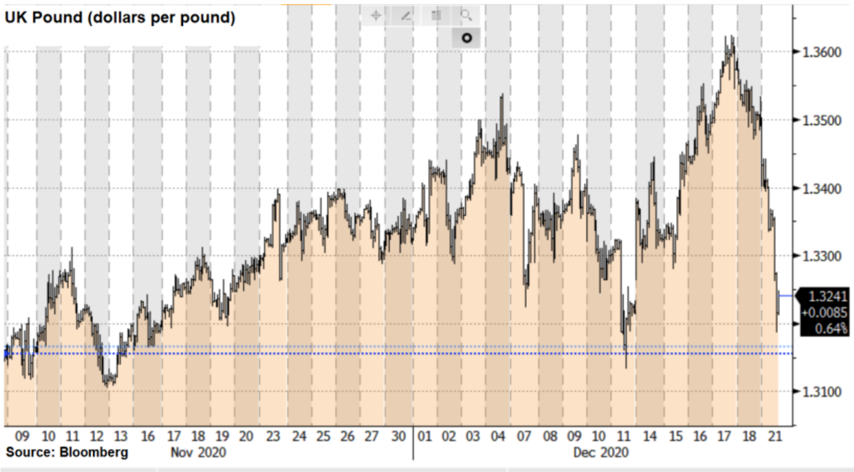


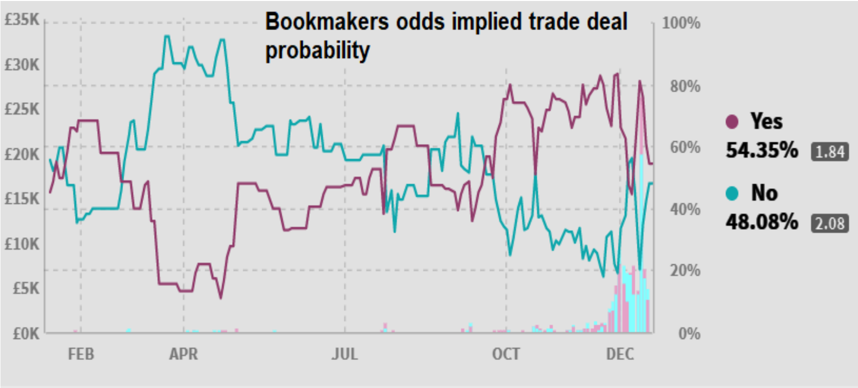
European equities were deep in the red with Euro STOXX 600 down 3% and country level blue-chip indices underperforming in Spain (-4%) and Germany (-3.5%). UK's more domestically focused FTSE 250 was also down 3.6%. Energy (-6%), travel and leisure (-5%) and banks shares (-4%) were underperforming the broader index.



European bond markets were trading in a risk-off mode. German 10-year bund yields declined by 4 bps while UK's 10-year gilt yields dropped by 8 bps. Southern European spreads were widening with Italy (+5 bps) and Greece (+5 bps) underperforming. Corporate credit benchmarks were also wider with investment grade spreads increasing by 5 bps and speculative grade jumping by 27 bps.

The euro (-0.8%) depreciated on broader dollar safe-haven demand while the sterling (-2%) was hit by the double effect of the virus spread and no-deal Brexit fears. The negotiations over the weekend seem to have generated limited progress with access to fisheries remaining the main area of disagreement. Media reports suggest that the European Parliament would no longer have time to ratify the deal under the normal legislative procedure with Europe exploring alternative stop-gap solutions if a trade deal is reached. In the UK, while the Prime Minister Johnson has previously excluded extension of the transition period, some, including the Mayor of London Sadiq Khan, are calling for an extension of trade talks given the escalation of COVID-19 and potential implication on supply-chains after December the 31st. The bookmaker's odds implied trade deal probability has dropped to 55% from 80% on Friday.





Other Mature Markets

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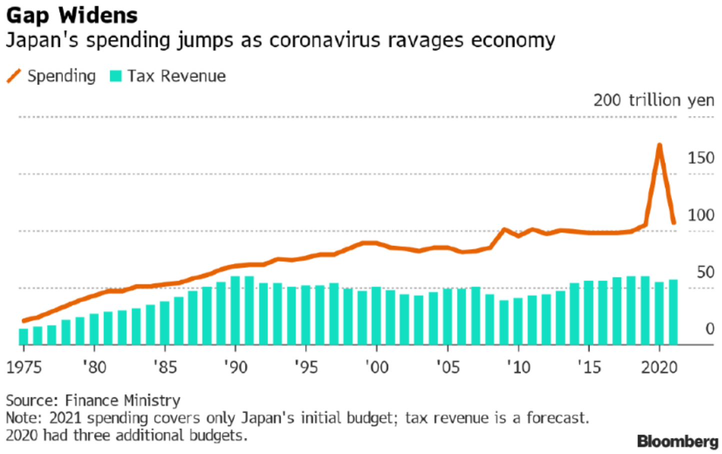
Japan

The cabinet approved a record budget for the next fiscal year. The budget envisages 106.6 tn yen ($1.03 tn) in overall spending starting in April 2021, a 3.8% increase from last year's initial budget. Actual spending could rise much higher given the likelihood of extra budgets—three extra budgets added 73 tn ($0.71 tn) yen to total spending last year. The budget would require the government to issue a record 221 tn yen ($2.14 tn) of debt. The supply of 40-year bonds, the country's longest-maturity debt bond) will increase by 600 bn yen ($5.8 bn) to accommodate institutional investors' demand. The Bank of Japan has refrained from increasing purchases of bonds maturing over 25 years at its regular operations, letting the market determine the level of super-long yields. **Equities declined (NIKKEI: -0.2%); the yen depreciated (-0.5%); long-term government bond yields increased (30-year: +0.5 bp).**



Source: Bloomberg.

Australia

Australian dollar depreciated on renewed COVID-19 concern. Sydney urged its residents to curb activities to avoid fanning an outbreak, with a new health order limiting gatherings in homes and entertainment venues for at least three days. Other states also imposed travel restrictions on people from the Sydney metropolitan area. **The Australian dollar depreciated (-1.8%)**, underperforming currencies in the Asia Pacific region. **Equities fell (-0.1%)**, with shares in travel and leisure-related companies facing large declines.

Emerging Markets

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EMEA currencies and stock markets sold off sharply on the global virus news. Poland and the Czech Republic were especially hard hit. **Most Asian stock markets declined,** led by Thai (-5.4%) and Indian (-3.0%) equities while currencies depreciated on weaker market sentiment in the region due to the COVID-19 situation (Indonesia, Korea, Singapore, Thailand) and falling oil prices (Malaysia). **Thai markets significantly underperformed** on the news of a COVID-19 outbreak in a province near Bangkok over the weekend. **In Indonesia,** Jakarta, the country's capital, extended the social distancing restrictions until January 3, 2021. **Latin American markets were lower last week, and look set to join the global selloff today.**

Last updated:	Level		Change				
12/21/20 7:35 AM	Last 12m	index	1 Day	7 Days	30 Days	12 M	YTD
Major EM Benchmarks			%				%
MSCI EM Equities		50.99	-2.5	1	4	14	14
MSCI Frontier Equities		28.24	-0.7	2	2	-7	-7
EMBIG Sovereign Spread (in bps)		351	-2	-13	-27	62	62
EM FX vs. USD		57.05	-1.4	0	1	-7	-7
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.55	-0.2	0	0	7	6
Indonesian Rupiah		14130	-0.1	0	0	-1	-2
Indian Rupee		73.79	-0.3	0	0	-4	-3
Argentine Peso		82.84	-0.1	-1	-3	-28	-28
Brazil Real		5.22	-2.7	-2	4	-22	-23
Mexican Peso		20.47	-2.6	-1	-2	-7	-8
Russian Ruble		75.26	-2.4	-2	1	-16	-18
South African Rand		14.87	-2.2	1	4	-4	-6
Turkish Lira		7.69	-0.8	2	3	-23	-23
EM FX volatility		10.44	1.1	0.2	0.2	4.0	3.8

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

Emerging Market Fund Flows

EM local bonds saw another week of inflows (+$954 mn, from +$0.5 bn), with only Hungary (-$12 mn) seeing small outflows among measured countries. Non-residents also had net inflows in the EM equities, albeit a fraction of last week's tally (+$ 0.5 bn, from +$5.5 bn), with inflows to India (+$2.2 bn) remaining in excess of +$2 bn for a sixth week while Korea (-$1.9 bn) saw its greatest outflows since March. Within the bond fund flows, inflows moderated while remaining above +$2 bn for the sixth week. Hard currency bond fund inflows (+$1.5 bn) were nearly unchanged while local currency bond fund inflows (+$975 mn) fell to a six-week low. Non-ETF inflows (+$2 bn) continued to remain comfortably ahead of ETF inflows (+$0.5 bn).

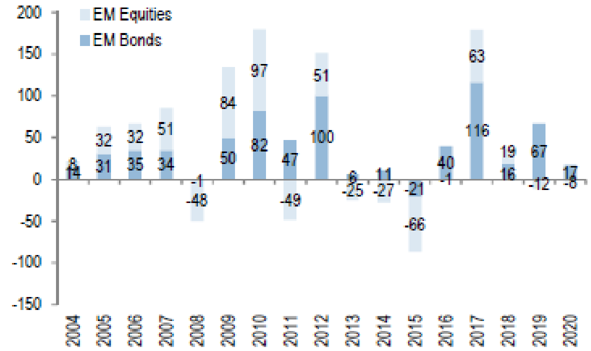
Exhibit 1: Weekly Cross-Asset Flows

USD billion

	Asset	8w flows (8w ago → current)	This wk	YTD
Fund Flows	EM Bonds and Equities		6.4	8.8
	EM Bonds		2.5	17.0
	Hard Ccy		1.5	20.1
	Local Ccy		1.0	-3.1
	EM Equities		4.0	-8.1
	US HG		3.7	195.3
	US HY		-1.2	46.0
	Global Equities		33.1	-275.5
	EM Bond and Equity ETFs		2.8	8.0
	EM Bond ETFs		0.5	8.7
	EM Equity ETFs		2.3	-0.7
	Non-resident EM flows*		1.5	-92.9
	EM Local Bonds		1.0	-37.3
	EM Equities		0.6	-55.6

Exhibit 2: Annual EM bond and equity fund flows

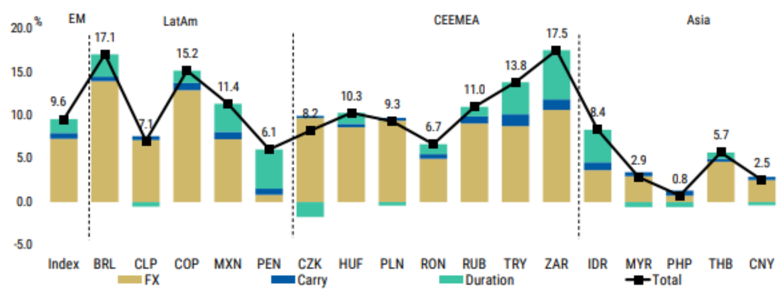
USD billion



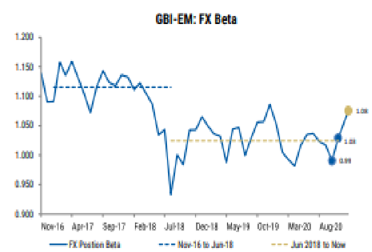
*Using high frequency non-resident EM portfolio flow data where available. Source – All charts and data in this report: J.P. Morgan, EPFR Global, Bloomberg Finance L.P.

Morgan Stanley analysis showed that most investors outperformed the benchmark (in local currency bonds) by an average of 74 bps – 40 bps in November and 34 bps in December so far. The outperformance is mainly driven by Colombia, Indonesia, Mexico, Russia and South Africa. This is important as the rally since the start of November has been particularly strong: GBI-EM is up 9.6% in just a month and a half. Investors added positions in November, but mostly in EM currencies rather than local currency bonds as currency beta increased from 0.99 to 1.03, the biggest rise since June 2019. Considering the rally in December so far, analysts believe that the FX beta could have increased to 1.075, moving towards the over-positioned territory but still below the peak seen in December 2019.

Exhibit 2: GBI-EM return between November and mid-December



Source: Bloomberg, Morgan Stanley Research



Source: Bloomberg, company websites, Morgan Stanley Research estimates;

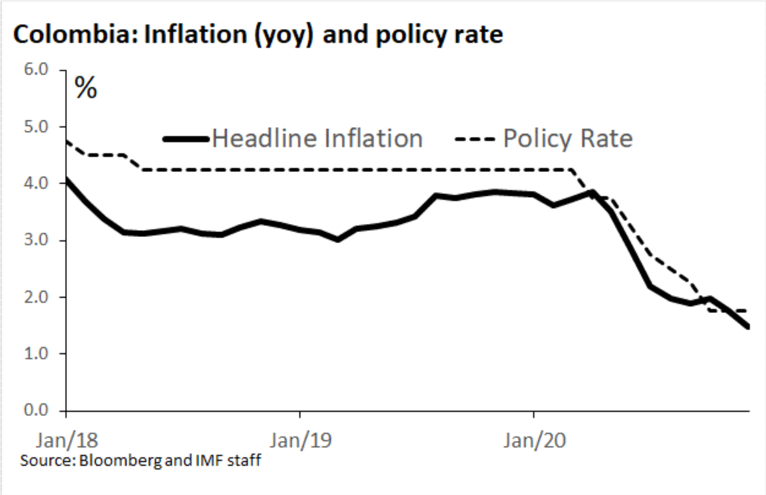
*Blue dot is based on actual data while yellow dot is based on estimates.

China

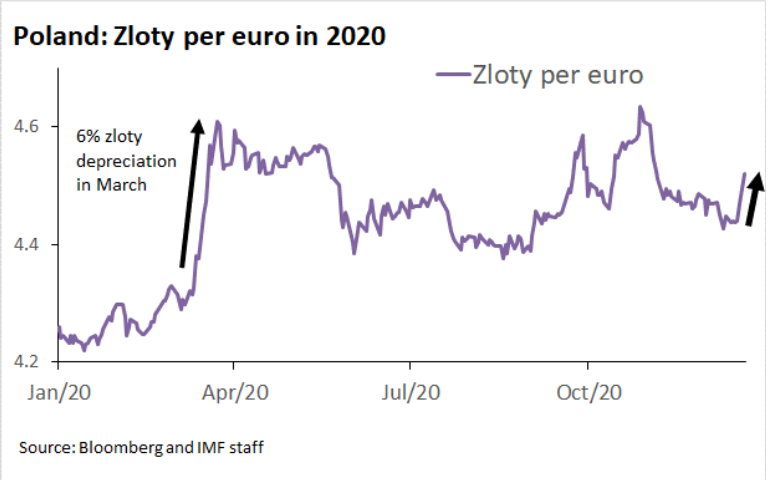
China introduced new national security rules for foreign investment. The Ministry of Commerce and the National Development and Reform Commission jointly announced the new rules to conduct security reviews on foreign investment that may affect national security. The measures, which will come into effect from January 18, 2021, cover foreign investment in military-related areas, key agricultural and energy resources, and vital infrastructure (including internet technology). **On Friday, the U.S. Commerce Department added more than 60 Chinese firms to a blacklist, citing national security concerns.** The blacklist now included SMIC, China's largest chipmaker. SMIC's share price dropped 3.6% today. **The loan prime rates (LPRs) remained unchanged.** The 1-year and 5-year LPRs were kept at 3.85% and 4.65%, respectively, as the People's Bank of China maintained its medium-term lending facility (MLF) rate earlier. **Equities gained CSI 300: +0.9%); RMB depreciated (-0.2%).**

Colombia

10-yr local yields fell 6 bps to 5.41% on Friday as **the central bank kept it policy rate unchanged at 1.75%.** The central bank was widely expected to keep rates unchanged following an easing cycle of 250 bps earlier in 2020 but 2 out of 7 MPC members wanted to cut rates another 25 bps. At the press conference, **Governor Echavarria said that the large downside inflation surprise in November was a key factor for some MPC members to vote in favor of rate cuts**. Headline inflation fell to 1.49% yoy in November. The currency was little changed.



Poland
The zloty fell 1% against the euro even though November retail sales fell less than expected in November (5% mom compared to 8.9% mom expected). **According to multiple reports, the central bank sold zloty in the local FX market on Friday to weaken the currency**, with the zloty closing 0.6% lower against the euro. Monetary Policy Committee member Zyzynski commented that Friday's intervention should be interpreted as a move to "encourage" the zloty to return to a level of 4.5 per euro. Central bank policy statements have reiterated multiple times in recent months that the currency had not adjusted to the global pandemic shock and remains too strong, harming the economy. **The Polish government also plans to suspend flights from the U.K. from Tuesday onwards**.



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Global Financial Indicators

Last updated: 12/21/20 7:34 AM	Level: Last 12m	Level: Latest	Change: 1 Day	Change: 7 Days	Change: 30 Days	Change: 12 M	YTD
Equities					%		%
United States		3709	-0.4	1	4	15	15
Europe		3447	-2.8	-2	-1	-9	-8
Japan		26714	-0.2	0	5	12	13
China		3421	0.8	2	1	14	12
Asia Ex Japan		88	-0.2	0	2	20	20
Emerging Markets		51	-0.1	1	4	14	14
Interest Rates					basis points		
US 10y Yield		0.90	-4.3	1	8	-101	-101
Germany 10y Yield		-0.61	-3.4	2	-2	-35	-42
Japan 10y Yield		0.01	0.1	0	0	0	2
UK 10y Yield		0.18	-7.2	-5	-13	-61	-65
Credit Spreads					basis points		
US Investment Grade		100	-0.2	-6	-11	-3	3
US High Yield		395	-1.4	-10	-53	-5	2
Europe IG		53	4.3	2	1	8	9
Europe HY		268	23.7	7	-8	59	61
EMBIG Sovereign Spread		351	-1.8	-13	-27	62	62
Exchange Rates					%		
USD/Majors		90.67	0.7	0	-2	-7	-6
EUR/USD		1.22	-0.7	0	3	10	9
USD/JPY		103.7	-0.4	0	1	6	5
EM/USD		57.1	-1.4	0	1	-7	-7
Commodities					%		
Brent Crude Oil ($/barrel)		50	-3.8	0	12	-24	-24
Industrials Metals (index)		136	-1.5	0	5	17	19
Agriculture (index)		45	-1.0	2	1	9	8
Implied Volatility					%		
VIX Index (%, change in pp)		28.6	7.0	3.9	4.9	16.1	14.8
US 10y Swaption Volatility		57.9	1.1	-4.4	2.7	-2.4	-4.1
Global FX Volatility		8.2	0.0	0.2	0.6	2.7	2.2
EA Sovereign Spreads					10-Year spread vs. Germany (bps)		
Greece		127	5.3	5	-1	-44	-38
Italy		116	2.5	0	-6	-50	-44
Portugal		63	2.1	5	2	-4	0
Spain		64	2.5	2	-1	-5	-1

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: 12/21/2020 7:36 AM	Exchange Rates							Local Currency Bond Yields (GBI EM)						
	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
		vs. USD	(+) = EM appreciation						% p.a.					
China		6.55	-0.2	-0.1	0	7	6		3.4	-0.6	0	-4	14	23
Indonesia		14130	-0.1	-0.2	0	-1	-2		6.0	-0.1	-10	-27	-133	-112
India		74	-0.3	-0.3	0	-4	-3		6.0	1.3	0	-3	-103	-90
Philippines		48	0.0	-0.1	0	6	5		3.7	0.4	0	2	-61	-65
Thailand		30	-0.9	0.0	1	0	-1		1.4	-0.5	-10	-9	-31	-25
Malaysia		4.05	-0.3	0.1	1	2	1		2.5	-2.0	-8	1	-87	-81
Argentina		83	-0.1	-0.7	-3	-28	-28		56.7	0.0	132	386	-1530	-591
Brazil		5.22	-2.7	-2.0	4	-22	-23		5.8	-5.2	-3	-71	-53	-48
Chile		735	-1.2	-0.2	5	3	2		2.8	-0.7	-13	-3	-48	-54
Colombia		3418	-0.1	0.6	7	-3	-4		5.1	-6.8	-8	-7	-82	-84
Mexico		20.47	-2.6	-1.1	-2	-7	-8		5.6	-8.2	-19	-45	-131	-136
Peru		3.6	-0.2	-0.1	-1	-7	-8		3.5	-1.0	-18	-51	-93	-98
Uruguay		42	0.4	0.5	1	-11	-11		7.2	-15.1	-18	-19	-368	-365
Hungary		296	-1.5	-1.6	3	1	0		1.5	-0.4	-9	-8	43	33
Poland		3.70	-1.6	-1.3	2	4	2		0.7	2.1	-3	8	-117	-122
Romania		4.0	-0.6	0.3	3	8	7		2.7	-6.0	-14	-20	-141	-130
Russia		75.3	-2.4	-1.9	1	-16	-18		5.6	2.0	2	7	-58	-51
South Africa		14.9	-2.2	1.1	4	-4	-6		9.5	-4.1	-18	-29	-3	2
Turkey		7.69	-0.8	2.2	3	-23	-23		13.1	-7.5	-33	91	97	140
US (DXY; 5y UST)		91	0.7	0.0	-2	-7	-6		0.35	-2.7	0	-2	-138	-134

	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		5047	0.9	2	2	26	23		205	-1	-2	-7	29	29
Indonesia		6166	1.0	3	11	-2	-2		188	3	-5	-10	29	32
India		45554	-3.0	-2	4	9	10		154	0	2	-17	31	29
Philippines		7225	-0.7	-1	1	-7	-8		108	2	-8	-9	39	42
Malaysia		1648	-0.3	-1	3	2	4		111	-1	-6	-15	2	-1
Argentina		52347	-1.4	-3	2	35	26		1380	16	3	1	-529	-389
Brazil		118024	-0.3	3	11	3	2		256	6	-5	-13	44	41
Chile		4211	0.3	4	4	-11	-10		145	3	-7	-10	6	12
Colombia		1426	-1.2	3	15	-13	-14		209	4	-5	-8	44	46
Mexico		43874	-1.0	1	5	-1	1		391	8	-12	-42	94	99
Peru		20730	-0.4	1	10	2	1		139	4	-14	-3	31	32
Hungary		40500	-2.7	-3	6	-11	-12		96	2	-4	-12	10	10
Poland		53970	-3.0	-2	3	-6	-7		2	0	-4	-8	-14	-16
Romania		9516	-1.5	-1	5	-4	-5		203	-2	-10	-2	30	29
Russia		3190	-2.5	-2	5	6	5		163	4	-9	-23	29	32
South Africa		58612	-2.0	-1	4	2	3		387	11	2	-39	62	67
Turkey		1380	-2.1	-1	4	24	21		465	11	-31	-34	59	64
Ukraine		508	0.0	0	1	0	0		497	11	12	-72	69	77
EM total		51	-2.5	1	4	14	14		421	0	17	-10	97	128

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