



- Relative valuations in the US continue to support small cap stocks ([link](#))
- Foreign official demand for US Treasuries increased in November ([link](#))
- Italy's sovereign spreads widen on recent news ([link](#))
- Japan's PMI composite weakens in January ([link](#))
- Chile raises \$4.25 bn the in euro and US dollar markets ([link](#))

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Risk rally takes a pause as COVID concerns mount

Concerns about the economic and social impact of the pandemic are weighing on investor sentiment and tapering earlier hopes for a rapid end to the pandemic. Risk assets rallied significantly following the first news about the development of effective vaccines against the Covid-19 virus back in early November, with global equities rising by close to 22% since then. However, investors seem to be coming to terms today with a much grimmer reality on the ground, as soaring infection rates lead to longer and more widespread restrictions globally. Yesterday's warnings by the new US administration that the death toll from the pandemic could rise by as much as 100 thousand over the next month further dampened investor sentiment. European equities are down by about 1% so far this morning, with most EM markets trading in the red and US equity futures pointing to a negative start. Conversely, Treasuries and Bunds are seeing somewhat heavier demand, with 10-year yields about 2 bps lower. And while the greenback has been slightly bid, oil prices are down by close to 3% today on concerns over weaker demand going into the summer.

Key Global Financial Indicators

Last updated: 1/22/21 8:04 AM	Level		Change from Market Close				
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	YTD
Equities			%				%
S&P 500		3853	0.0	1	4	16	3
Eurostoxx 50		3584	-0.9	0	2	-5	1
Nikkei 225		28631	-0.4	0	8	19	4
MSCI EM		56	0.2	3	13	24	9
Yields and Spreads			bps				
US 10y Yield		1.09	-1.9	0	17	-68	17
Germany 10y Yield		-0.52	-1.9	3	8	-26	5
EMBIG Sovereign Spread		354	-3	2	-1	59	3
FX / Commodities / Volatility			%				
EM FX vs. USD, (+) = appreciation		57.4	-0.6	-1	0	-6	-1
Dollar index, (+) = \$ appreciation		90.2	0.1	-1	0	-7	0
Brent Crude Oil (\$/barrel)		54.7	-2.5	-1	9	-13	6
VIX Index (% change in pp)		23.4	2.1	0	-1	10	1

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

United States

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During yesterday's trading, the value to growth rotation continued amid strong economic data. The NASDAQ index rose 0.6% while the Russell 2000 dropped 0.9%, with the S&P 500 marginally higher. The Treasury yield curve steepened with the 10-year yield up 2.7 bps to 1.1% and the 30-year yield up 4 bps to 1.87%. The move was driven by TIPS breakevens that widened 3 to 5 bps across the curve, after a strong 10-year TIPS auction. The upsized auction cleared 1.4 bps through pre-auction level, the largest stop through since January 2018. The dollar weakness accelerated yesterday for the 4th straight session, with the DXY index down 0.4% to 90.

Relative valuation continues to support a potential outperformance by small cap stocks. Russell 2000 index just closed its best quarter in history by rising 30% in Q4, compared to 15% in NASDAQ and 11% in S&P 500. However, the relative forward P/E between small and large cap firms remains at a two-decade low. Analysts believe there is more re-rating potential for small cap stocks if economic recovery takes hold which would accelerate the cyclical/value rotation.

Chart 1: Small caps' PE vs large has barely edged up despite 30ppt of outperformance since August

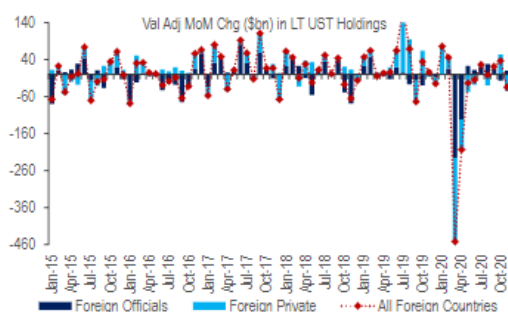
Relative fwd P/E of the Russell 2000 vs. Russell 1000 (12/1978-12/2020)



Source: BofA US Equity & Quant Strategy, Russell Investment Group, I/B/E/S, Compustat

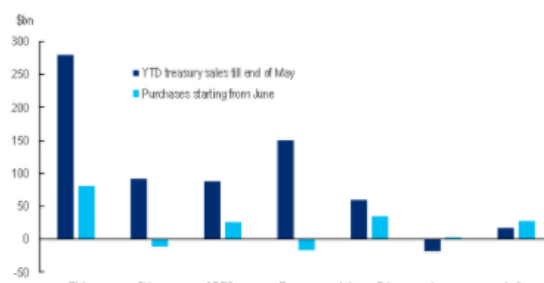
Foreign official demand for US Treasuries returns while private investors reduce holdings. November TIC data show that on the aggregate, foreign demand for long-term Treasuries declined. However, despite the \$45 bn reduction in holdings by foreign private investors, official investors increased their holdings \$10 bn. Supported by higher oil prices in November, OPEC nations bolstered their reserves by buying Treasuries they had sold earlier in the year. Saudi Arabia was the biggest buyer (\$7bn) followed by UAE (\$6.5 bn). EM as a whole purchased \$23 bn in November compared to \$7 bn in October. Most DM countries unloaded Treasuries in November, led by a \$17 bn sale by the UK, which according to analysts is in part due to hedge funds initiating shorts on Treasuries.

Figure 4. In November, foreign officials purchased \$10bn in USTs while private investors reduced UST holdings by \$45bn



Source: Citi Research, Haver, Note: We calculate valuation adjusted change by adjusting the previous month's holdings by the change in 5y UST yield.

Figure 5. The EM complex has purchased back only small portion of the USTs they sold earlier in the year



Source: Citi Research, US Treasury, Note: Purchases/sales of long term Treasuries are valuation adjusted.

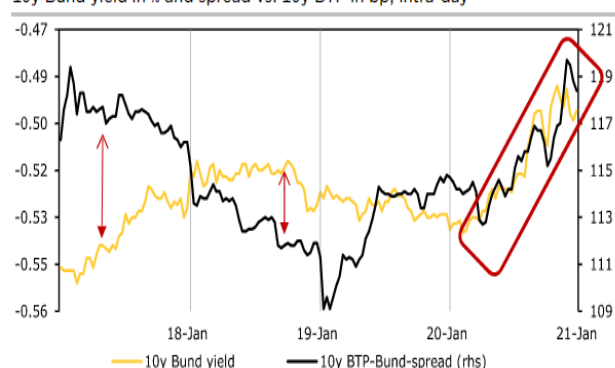
Europe

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European equities slipped about 1% as economic data continue to be lackluster. DAX (-0.9%), CAC 40 (-1.2%), EuroStoxx 600 (-1.0%), Italy's Titans 30 (-2.0%), and Spanish Ibex (-1.5%). Bank stocks (-2.7%) are strongly underperforming following Lagarde's press conference yesterday and today's poor data prints.

In **sovereign debt markets**, Italian spreads widened slightly (+5 bps) after the ECB hinted yesterday that the PEPP envelope may not be used in full. Market contacts are interpreting the comments as signaling less action by the ECB towards compressing sovereign spreads further. German 10-year yields at -0.51% (-1 bps); French OATs are at -0.27% (+1 bps); Italian at 0.72% (+4 bps); and Spanish at 0.12% (unch). Despite the widening of Italian spreads, liquidity conditions in the BTP market remain ample, as measured by Bloomberg's indices.

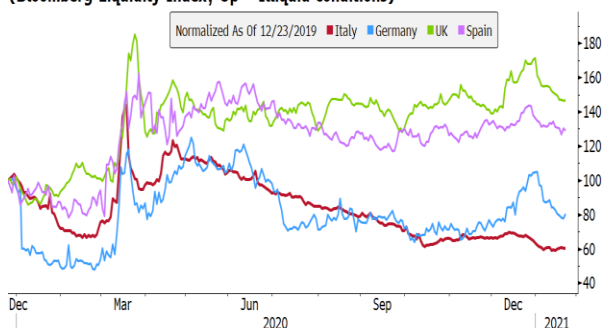
10y Bund yield in % and spread vs. 10y BTP in bp, intra-day



Source: Bloomberg, Commerzbank Research

Sovereign Liquidity Indices

(Bloomberg Liquidity Index; Up = Illiquid conditions)



Source: Bloomberg
GLOST Index (Italy Govt Securities Liquidity Index) FI: Sov Liquidity Daily 23

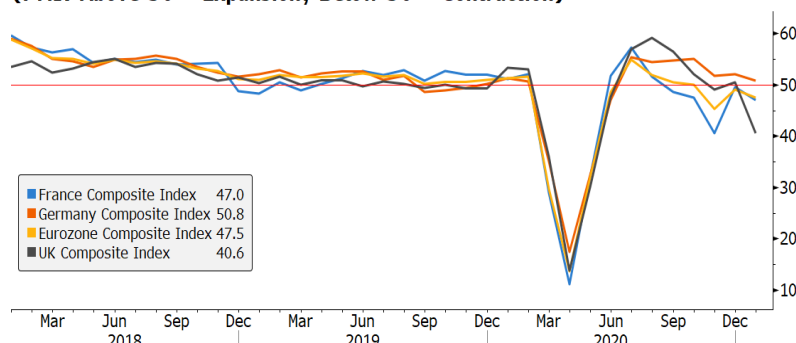
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Macro data released today for December and January continue to paint a bleak landscape across European economies. In the **UK**, December retail sales (including autos) grew 2.4% y/y, compared to 4.0% expected. In **France**, the Composite PMI for January dropped to 47.5 from 49.5, diving deeper into contractionary territory. Similarly, the **German** Composite PMI fell to 50.8 from 52.0, though still signaling an expansion in activity.

European Production Indices

(PMI: Above 50 = Expansion; Below 50 = Contraction)



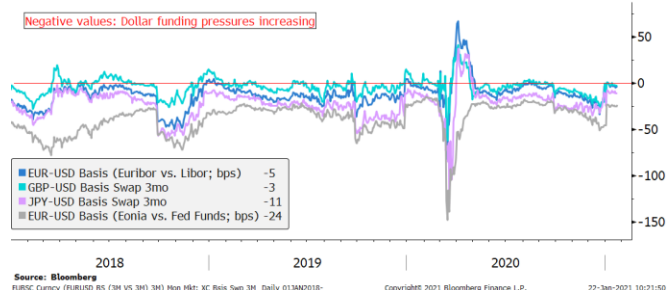
Source: Bloomberg
HPIFRCA Index (Markit France Composite PMI SA) Macro: EZ PMI Monthly 31JAN2016

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In **money markets**, cross-currency basis spreads have tightened notably, reflecting ample dollar funding conditions across the euro-, pound-, and yen-dollar pairs.

Cross-Currency Basis Swaps (3 mo)



Other Mature Markets

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Japan

PMI composite weakened in January. Composite PMI declined from 48.5 in December to 46.7 in January, with both manufacturing and services components falling. The figures suggest that the resurgence of COVID-19 both at home and abroad is hitting a broad range of sectors. The services sector is particularly hit as the state of emergency is re-imposed. **Consumer prices excluding fresh food fell 1% y/y in December.** The decline in core CPI was driven by lower prices of durable goods and energy, falling wages, and deflationary pressures from a negative output gap. The Japanese yen depreciated against the US dollar (-0.2%), while equities declined (NIKKEI: -0.4%).

Back Down

Activity fell again as a partial state of emergency resumed



Emerging Markets

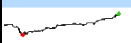



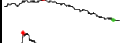

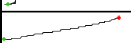
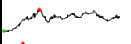
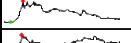
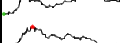

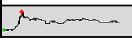
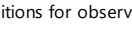

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In Asia, stock markets broadly fell, led by Hong Kong (-1.7%), Indonesia (-1.6%) and India (-1.1%). Conversely, Chinese share prices rose (CSI 300: -0.1%). Currencies generally weakened, led by the Korean won (-0.4%). **In Hong Kong SAR**, the government intends to impose a lockdown for the first time; one that will affect parts of the Kowloon district. **In Indonesia**, Bank Indonesia said that it intervened in the domestic NDF market to support the currency, while the rupiah depreciated by about 3% against the greenback today. **In India**, tens of thousands of farmers are protesting contentious new agricultural laws. The government offered to suspend the laws for 18 months, while protestors demand a full repeal.

In EMEA, Equities traded 0.5-1% lower. Russian equities (-1.5%) underperformed as oil prices remain under pressure. Currencies also traded with a cautious tone, with the Russian ruble (-1.3%) erasing year-to-date gains against the greenback.

In Latin America, equity markets saw losses on Thursday. Argentina underperformed as the equity index fell 3.5%, followed by Chile (-1.3%) and Brazil (-1.1%). Local currencies were mostly weaker. Among currencies, the Brazilian real was the worst performer, depreciating by about 1% against the dollar. 10-year government bond yields rose 18 bps in Brazil and were mixed in other countries.

Key Emerging Market Financial Indicators

Last updated: 1/22/21 8:07 AM	Level		Change				YTD
	Last 12m	index	1 Day	7 Days	30 Days	12 M	
Major EM Benchmarks			%				%
MSCI EM Equities		56.32	-1.8	3	13	24	9
MSCI Frontier Equities		29.61	-0.1	0	6	-5	4
EMBIG Sovereign Spread (in bps)		354	-3	2	-1	59	3
EM FX vs. USD		57.40	-0.6	-1	0	-6	-1
Major EM FX vs. USD			%, (+) = EM currency appreciation				
China Renminbi		6.48	-0.3	0	1	7	1
Indonesian Rupiah		14035	-0.2	0	1	-3	0
Indian Rupee		72.98	0.0	0	1	-2	0
Argentina Peso		86.52	-0.1	-1	-4	-31	-3
Brazil Real		5.41	-1.0	-2	-5	-23	-4
Mexican Peso		19.93	-1.0	-1	1	-6	0
Russian Ruble		74.98	-1.5	-2	1	-18	-1
South African Rand		15.11	-1.1	1	-3	-5	-3
Turkish Lira		7.42	-0.6	1	3	-20	0
EM FX volatility		10.20	0.0	-0.2	-0.4	4.2	-0.5

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

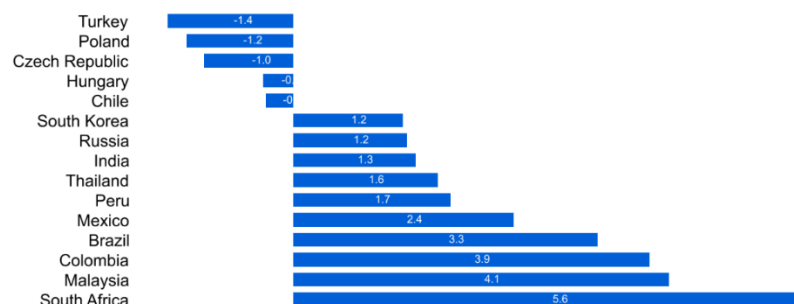
Malaysia

The government extended restrictions on movement in six states and federal territories until February 4 amid surging COVID-19 cases. Based on its forecasts, the government is concerned that COVID-19 cases could jump significantly. While its neighbors—Indonesia and Singapore—started their vaccination programs, Malaysia is only scheduled to get its first delivery of vaccines in February. Finance Minister Tengku Zafrul Abdul Aziz said that economic growth is likely to be at the lower end of the forecast range of +6.5%-7.5% due to renewed movement restrictions. **CPI declined 1.4% y/y in December, larger than expected.** Adjusted for inflation, 10-year Malaysian government bond yields currently look relatively high compared to emerging market peers (see chart below). The Malaysian ringgit weakened by about 0.4% against the US dollar today, while equities gained (+0.1%).

Real Yields

Developing markets 10-year bond yields adjusted for inflation

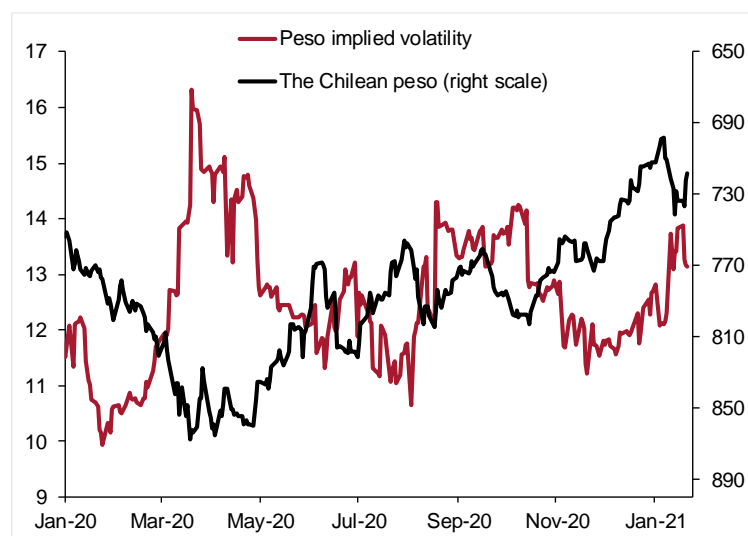
■ Real 10-year bond yield



Source: Bloomberg

Chile

Chile raised about \$4.25 bn in euro and US dollar markets on Tuesday, including \$1.5 bn of sustainability bonds, the largest deal posted by a Latin American sovereign in foreign debt markets. The government also issued \$1.65 bn in euro-denominated ESG bonds. According to Chile's finance ministry, both the euro and US dollar offerings were oversubscribed by investors. The Chilean peso saw gains for two consecutive days after the deal, appreciating 1.9% against the dollar on Wednesday and up 0.6% yesterday. The peso implied volatility continued to decline, indicating increasing confidence from investors in the nation's economic prospects.

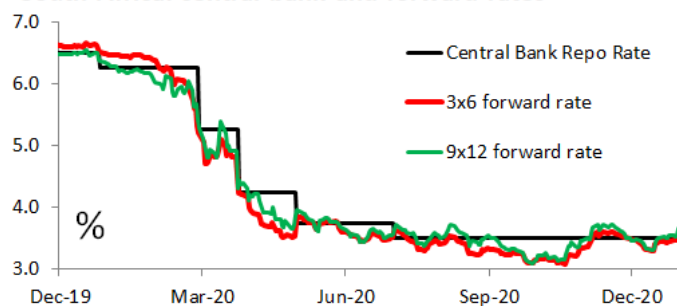


Source: Bloomberg

South Africa

The rand (-1%) and equities (-0.5%) sold off after retail sales grew a better-than-expected 1.8% m/m (vs. 1.0% consensus). Yesterday, yields on bonds maturing in 2035 or later fell 8 bps after the central bank (SARB) left its repo rate on hold (at 3.50%) but lifted its headline inflation forecasts by 0.1 ppt to 4.0% and 4.5% for 2021 and 2022 respectively. **The SARB's Quarterly Projection model now forecasts two 25 bps rate hikes in each of Q2 21 and Q3 21.** Contacts generally expect the SARB to leave policy rates "low for longer" but traders are positioning for a hike later in 2021. However, analysts at Goldman Sachs believe that inflation will print meaningfully below the SARB's outlook (at 3.6% y/y in 2021 and 4.0% y/y in 2022) and are expecting another 75 bps of rate cuts.

South Africa: central bank and forward rates



Note: A 3x6 forward contract fixes a forward rate for the period starting at the end of month 3 and ending at month 6.

Source: Bloomberg and IMF staff

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Global Financial Indicators













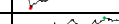
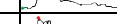
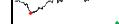



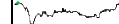



















Last updated: 1/22/21 8:05 AM	Level		Change				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
Equities			%				%
United States		3847	0.0	1	4	16	2
Europe		3585	-0.9	0	3	-5	1
Japan		28631	-0.4	0	8	19	4
China		3607	-0.4	1	7	18	4
Asia Ex Japan		99	0.4	4	15	33	10
Emerging Markets		56	0.2	3	13	24	9
Interest Rates			basis points				
US 10y Yield		1.09	-1.9	0	17	-68	17
Germany 10y Yield		-0.52	-1.9	3	8	-26	5
Japan 10y Yield		0.05	0.6	1	4	5	3
UK 10y Yield		0.31	-2.4	2	12	-33	11
Credit Spreads			basis points				
US Investment Grade		95	0.7	0	-6	-4	0
US High Yield		368	2.7	-6	-33	-29	-12
Europe IG		50	1.1	-1	-2	6	2
Europe HY		257	7.2	-1	-6	44	15
EMBIG Sovereign Spread		354	-3.0	2	-1	59	3
Exchange Rates			%				
USD/Majors		90.24	0.1	-1	0	-7	0
EUR/USD		1.22	0.0	1	0	10	0
USD/JPY		103.8	-0.3	0	0	6	-1
EM/USD		57.4	-0.6	-1	0	-6	-1
Commodities			%				
Brent Crude Oil (\$/barrel)		55	-2.5	-1	9	-13	6
Industrials Metals (index)		134	-1.7	-2	1	17	1
Agriculture (index)		49	-1.4	-4	9	21	3
Implied Volatility			%				
VIX Index (% change in pp)		23.3	2.0	0.1	-0.9	10.4	0.6
US 10y Swaption Volatility		55.9	0.7	-2.4	0.2	-0.1	-4.3
Global FX Volatility		7.6	0.0	-0.2	-0.7	2.4	-0.5
EA Sovereign Spreads			10-Year spread vs. Germany (bps)				
Greece		121	5.3	0	-4	-41	2
Italy		124	5.5	8	9	-37	12
Portugal		58	0.7	4	-5	-13	-2
Spain		63	0.9	3	-1	-4	2

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: 1/22/2021 8:08 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		6.48	-0.3	0.0	1	7	1		3.3	-1.7	4	-11	20	-1
Indonesia		14035	-0.2	-0.1	1	-3	0		6.3	-6.8	3	27	-59	25
India		73	0.0	0.1	1	-2	0		6.0	0.6	3	6	-84	10
Philippines		48	-0.1	0.0	0	6	0		3.7	3.1	0	2	-62	1
Thailand		30	-0.2	0.1	1	1	0		1.4	-0.2	-3	6	-19	7
Malaysia		4.04	-0.4	-0.2	0	1	-1		2.6	-0.5	3	4	-71	2
Argentina		87	-0.1	-0.9	-4	-31	-3		51.8	-21.7	0	-271	38	-430
Brazil		5.41	-1.0	-2.1	-5	-23	-4		6.5	14.8	18	73	38	92
Chile		723	-0.7	1.4	0	7	-2		2.8	0.1	-2	3	-48	5
Colombia		3480	-0.2	-0.5	-2	-4	-1		5.1	0.6	-1	-2	-67	-1
Mexico		19.91	-0.9	-0.6	1	-6	0		5.6	2.6	-10	7	-133	3
Peru		3.6	-0.2	-0.4	0	-8	0		3.8	1.6	8	22	-61	16
Uruguay		42	-0.2	0.5	0	-11	0		7.2	-2.6	-4	-13	-346	-3
Hungary		294	-0.2	1.5	1	3	1		1.6	-3.3	-2	9	27	8
Poland		3.73	-0.2	0.6	-1	2	0		0.6	3.9	1	-6	-143	-4
Romania		4.0	0.0	0.7	0	8	-1		2.3	-11.0	-31	-43	-158	-42
Russia		75.0	-1.5	-1.8	1	-17	-1		5.9	1.2	9	19	-9	16
South Africa		15.1	-1.1	0.8	-3	-5	-3		9.6	-2.5	-9	-7	15	-3
Turkey		7.42	-0.7	0.7	3	-20	0		13.4	-9.0	0	27	304	33
US (DXY; 5y UST)		90	0.1	-0.6	0	-7	0		0.44	-0.6	-1	8	-114	8

	Equity Markets							Bond Spreads on USD Debt (EMBIG)						
	Level		Change (in %)				YTD	Level		Change (in basis points)				YTD
	Last 12m	Latest	1 Day	7 Days	30 Days	12 M		Last 12m	Latest	1 Day	7 Days	30 Days	12 M	
								basis points						
China		5570	0.1	2	12	35	7		202	-1	-6	-4	28	-6
Indonesia		6307	-1.7	-1	5	1	5		177	2	-6	-11	12	-10
India		48879	-1.5	0	6	19	2		159	3	2	7	30	8
Philippines		7046	-1.3	-3	-2	-6	-1		93	3	-7	-13	19	-12
Malaysia		1597	0.1	-2	-2	1	-2		107	-4	-9	-5	3	-3
Argentina		48473	-3.5	-5	-4	15	-5		1431	2	-20	70	-553	63
Brazil		118329	-1.1	-2	1	0	-1		272	2	3	16	56	22
Chile		4553	-1.3	0	9	-2	9		140	0	-2	-6	-4	-4
Colombia		1446	-0.9	0	3	-12	1		219	0	-3	12	47	14
Mexico		44810	-0.7	-3	5	-2	2		376	2	-6	-11	81	16
Peru		21404	-0.6	-1	4	4	3		132	0	-4	-5	18	0
Hungary		43675	-1.3	-1	6	-2	4		77	0	-3	-20	-19	-19
Poland		57000	-0.4	-2	3	-2	0		-13	-1	-2	-16	-37	-12
Romania		10281	-0.3	1	7	1	5		200	-2	2	-4	18	-3
Russia		3371	-1.5	-2	4	6	2		172	11	10	8	30	6
South Africa		63900	-0.4	1	9	10	8		389	5	-3	0	51	9
Turkey		1533	-1.2	1	9	25	4		461	5	-7	-5	94	16
Ukraine		499	0.0	0	-2	-1	0		496	9	-4	-2	139	5
EM total		56	-1.8	3	13	24	9		421	0	17	-10	97	128

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

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