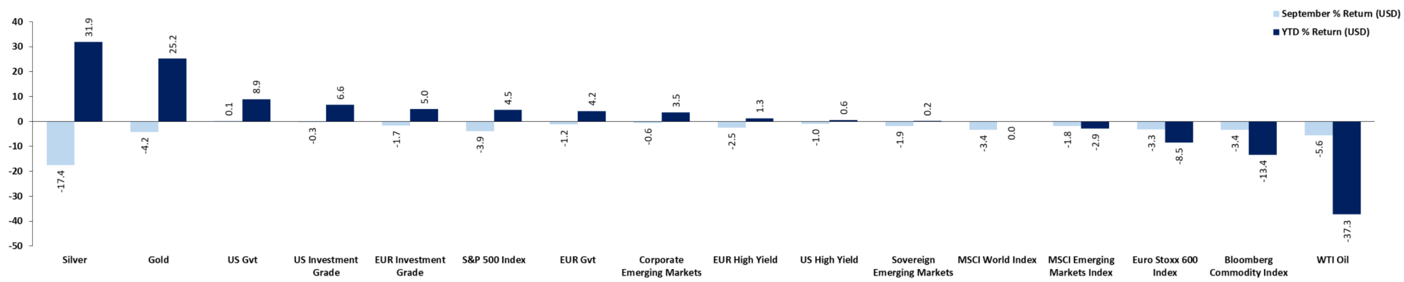
October 2, 2020

Monthly Market Wrap, September 2020

Over the summer, governments gradually lifted lockdown measures in a hope to revive the economies and the warmer weather would dampen the spread of the virus. Fast forward a couple months later and the number of total cases has now topped 33 million while deaths exceed 1 million. Countries and markets are now bracing for new waves of spreads. Meanwhile, the US fiscal stimulus conversation continues to make the headlines and drive markets in the near-term.

Chart 1. Asset Class Return YTD (USD Base)

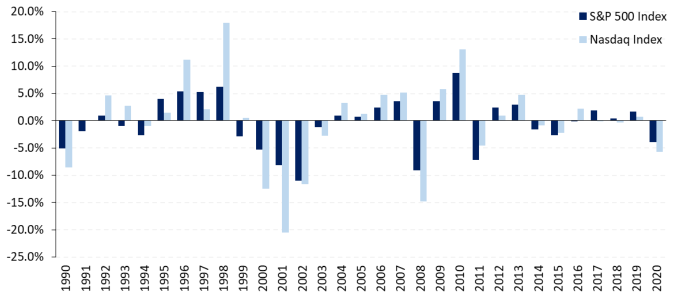


Equities

The month of September witnessed some large moves in both crowded and expensive pockets of equity markets. The S&P 500 Index was down -3.9% this month, though it ended up +8.5% this quarter, an impressive performance in light of current economic outlook and virus headwinds. In comparison, the Nasdaq Index dropped -5.7%, its worst month since September 2008 **(Chart 2)**. In August, we pointed out the high level of complacency and crowding, notably in FAATMAN stocks, which fuelled a fair portion of the rally since March lows. Yet, our cautiousness was proven right in this instance with the index down -13.4% since its peak earlier in the month. However, despite the sell-off in risk assets and mega caps, volatility remained relatively flat supported by stable investor sentiment.

On the other side of the Atlantic, European equities performed in line with global equities, respectively down by -3.3% and -3.4%. From a valuation stand point, the more traditionally oriented (e.g. European equities) indices continue to trade at lower multiples than the more tech oriented indices (e.g. US equities) with the former currently trading in line with historical averages on a P/B basis and North American equities currently trading over +2SD expensive at the moment. While they benefited from the shift online caused by the pandemic, growth stocks came under pressure this month as positive vaccine news temporarily led value stocks to outperform their growth counterparts.

Chart 2. Historical September Return S&P 500 vs. Nasdaq Index



Source. Bloomberg, MAM Research

Chart 3. S&P 500 Index (Weekly)

Source. Bloomberg, MAM Research

Chart 4. EuroStoxx 600 Index (Weekly)

Source. Bloomberg, MAM Research

Fixed Income

The big news over the past quarter was the Federal Reserve's shift to average inflation targeting, allowing inflation to run above target for a while to compensate for periods of below-target inflation. As a result, investors are currently expecting rates to remain lower for even longer. However, the absence of an agreement in congress on the next stimulus package meant yields were mostly unchanged across the spectrum for the month of September. Inflation breakeven rates **(Chart 6)** dropped a few basis points meanwhile the US 10-Year treasury yields were essentially flat **(Chart 5)**.

Across Europe, yields dropped slightly with German 10-Year yields down -12 bps and Italian 10-Year yields down -23 bps on a risk off move brought forward by rising virus cases in the region, Brexit uncertainty, and new containment measures.

We continue to believe yields have seen their lows for this economic cycle and the yield curve is likely to steepen. The absence of yield contraction on the farther end of the curve despite swings in economic uncertainty were supportive of that idea. The next moves in credit are likely to be more challenging and less rewarding that it has been in the first three quarters. Investment grade spreads continue to fail to offer compelling value in most developed countries.

Currencies

A series of swift moves occurred in the forex market this past month. In early September, there was a strong move lower on the GBP (c.-3% vs. USD) **(Chart 9)** driven, in part, by a lack of progress and resolution in the still ongoing Brexit negotiations. Following the placing of the Internal Market Bill before parliament in the UK, discussions with the EU have been rather complicated since the bill was aimed to modify the terms of trade between the UK and Northern Ireland.

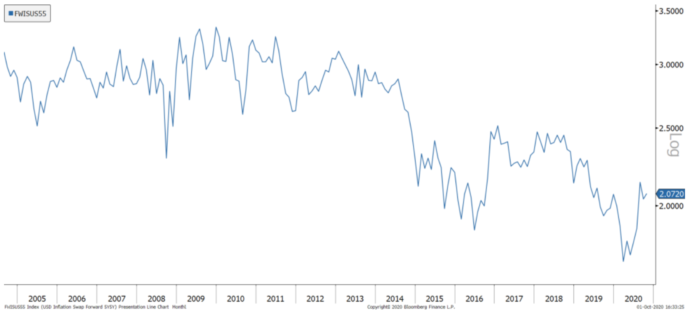
Once again the dollar proved itself to be a counter cyclical currency after the currency appreciated **(Chart 7)** for the first time in six month against its G10 peers on rising pandemic spread fears, notably across Europe. Considering the recent loss of relative carry attractiveness and paused new round of fiscal stimulus, the currency seems more likely to be in a brief consolidation phase rather than a new bull market.

In fact, real money flows ahead of month-end showed somewhat of a strength in the Euro with the union's currency able to withhold the pressure to drop lower as it was supported by short covering and option interest ahead of nearly EUR2.8 billion of 1.1600 strikes. We do note that further short covering should currently be anticipated on a move above 1.1720.

Chart 5. US 10-Yr Treasury Bonds (Weekly)

Source. Bloomberg, MAM Research

Chart 6. US 5Yr5Yr Forward Breakeven Rate (Monthly)



Source. Bloomberg, MAM Research

Chart 7. US Dollar Index (Weekly)

Source. Bloomberg, MAM Research

Chart 8. USD/Euro Spot Exchange Rate (Weekly)

Source. Bloomberg, MAM Research

Chart 9. USD/GBP Spot Exchange Rate (Weekly)

Source. Bloomberg, MAM Research

Commodities

The strong rally in commodity prices observed over the most recent months was brought to a halt in September with rising number of Covid cases across Europe forcing governments to implement stricter containment measures while the fiscal stimulus conversation in the US continues to drive markets in the near-term. Silver **(Chart 11)** was the worst performing asset over the period, down by as much as -17.4% meanwhile gold **(Chart 10)** prices pulled back by more than -4%. Rising yields on the backdrop of new Covid cases, dampened inflation expectations, and a stronger dollar were all supportive of a pullback. However, it should be short lived with all roads still structurally leading to a weaker greenback in the longer-term. Copper **(Chart 12)** prices have been a fairly good indicator of economic recovery in the past and continues to be one to this date. However, investors' net long positioning in the commodity has become very elevated. Chinese imports of commodities should also begin to slow down in the near term, hence reinforcing negative pressure on prices, despite investor sentiment on commodities being still generally quite positive. Copper closed down -0.28% after the September pullback and data showed China had evidently been stockpiling on commodities with imports much stronger than the underlying final demand.

Emerging Markets

Emerging market equities did not post outstanding returns last month with the MSCI EM Index down -1.8% **(Chart 13),** but still fared better than their developed market counterparts despite the stronger dollar. The continued rise in new Covid cases in EM countries as well as the lack of traction among EM currencies partially explains the negative returns in EM equities. We will note that once again the major portion of the underperformance was coming from the LATAM region which closed the month down -3.8% overall driven by Brazilian equities which pulled back -7.2% last month. Almost a third of the decline was driven by the local currency after political uncertainty and ongoing economic struggles resulting from the pandemic continue to weigh in. The Brazilian peso was down as much as -2.1% in September. In contrast, Mexico performed relatively well, up +1.4%, thus despite the peso depreciating a little over -1% against the dollar. As expressed in our previous research, for EM equities to attract more bid from global investors, EM currencies will firstly need to start participating when the dollar weakness resumes. Unlike what they did during its first weakness over the summer **(Chart 14)**.

Chart 10. Gold Spot Prices (Monthly)

Source. Bloomberg, MAM Research

Chart 11. Silver Spot Prices (Weekly)

Source. Bloomberg, MAM Research

Chart 12. Copper Front Month Rolling Futures (Weekly)

Source. Bloomberg, MAM Research

Chart 13. MSCI EM Index (Weekly)

Source. Bloomberg, MAM Research

Chart 14. MSCI EM FX Index (Weekly)

Source. Bloomberg, MAM Research