NATIXIS INVESTMENT MANAGERS

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Pulse

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IN SHORT

- While reopening prospects continue to improve, we might have seen peak in growth in the US and China already
- Bond yield suggests that inflation fears have receded after peaking in May
- We remain constructive on risk assets given fundamental support and expect the cyclical rotation to continue

Macroeconomic overview

- Data continues to come in strong as economies reopen and pent-up demand hits the streets. The US labour market added 850'000 jobs in June, the most since last August and above expectations for 700'000. The Euro Area Composite PMI rose to 59.2 in June, its highest level since 2006. However, some signals also suggest that growth might have peaked in the US and China, though it is set to continue at a robust pace. Indeed, the last PMI surveys dropped slightly in the world's largest economies. By comparison, after lagging the US and the UK, European economic indicators keep improving and are expected to peak during the third quarter.
- Inflation expectations have been receding as investors are leaning more towards the Federal Reserve's "transitory" narrative, after most of the move appears to arise from supply chain bottlenecks, which should gradually improve in the second part of the year. Moreover, the last jobs report in the US also pointed in this direction: the only segment with large wage gains is Leisure & Hospitality — the lowest paid sector. In addition, indicators used to assess Mr. Powell's inclusive recovery are showing signs of stagnation, for instance, labour participation rates for Americans with no college degree and the unemployment for African Americans, which actually deteriorated in June.
- Despite spiking new cases, UK hospitalisations have not increased significantly, suggesting that vaccines work well against the Delta variant. Prime Minister Boris Johnson reiterated that England was on track to lift almost all Covid restrictions by July 19th. Meanwhile, in some US states and European regions, spreads are occurring, but they remain in clusters and contained for now. Emerging markets continue to lag on the vaccination front, but cases remain very low in China and seem to have peaked in India.
- President Biden agreed on a bipartisan deal with some Republican Senators, worth less than USD600 billion, but the road to approval remains complicated. Indeed, Democrats have said they want a big reconciliation bill that includes their priorities and not just traditional infrastructure before agreeing to the bipartisan package. With the debt ceiling coming soon, we could see intense negotiations over the coming months.
- With German elections due on September 16, the Greens have recently faded against the Christian Democratic Union (CDU), which is now leading the polls. CDU head Armin Laschet has suggested that the European Union will have to return to the currently-suspended Maastricht Treaty stability policies, which suggests tough negotiations ahead as most EU countries do not currently comply with the Maastricht Treaty and may want to extend the suspension past the current 2023 expiration.

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- OPEC+ failed to reach an agreement on production increases over the coming months at its July meeting. The initial reaction was a spike in prices to six-years highs before retreating to around USD 73.4 per WTI barrel and USD 74.5 per Brent barrel. A stronger US dollar and abundant supply should cap prices over the medium-term though. The US dollar is consolidating in a broad range but could be towards the top of that range. Still, we believe the downside should be limited by higher US carry, better US growth, ongoing fiscal spending.

Market outlook

- Equity markets continue to grind to new highs supported by large-cap growth stocks and the prospect of ongoing fiscal expansion in the US. In the meantime, although the cyclical rotation has paused for now, we believe that there is still room for it as there is more reopening to happen. As such, we still see potential for energy and financials, Europe, and Japan.
- The US 10-year yield keeps retreating and currently stands below 1.3%, well below the 1.77% March high, which has helped growth to outperform cyclicals in recent weeks. In addition, after peaking in May, breakevens continue to fall suggesting that inflation concerns are easing for now. Moreover, core Eurozone sovereign yields have also fallen on comments by Christine Lagarde highlighting the risk of virus variants and their potential effects on the recovery. However, even though the big move is likely behind us, we still prefer to underweight sovereigns as overshoots are possible.
- Credit continues to prove resilient, which is a positive sign for equities as widening spreads tend to foresee stress in the equity market. Against this background, we prefer corporate debt against sovereign in part because the carry is more attractive. Within credit, we favour high yield on a selective basis although we remain constructive on investment grade.
- Overall, our medium-term outlook remains supported by strong growth and fundamentals: vaccination, fiscal stimulus, monetary support, and very strong earnings. However, the second half could prove bumpier as we these tailwinds could start to fade.

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