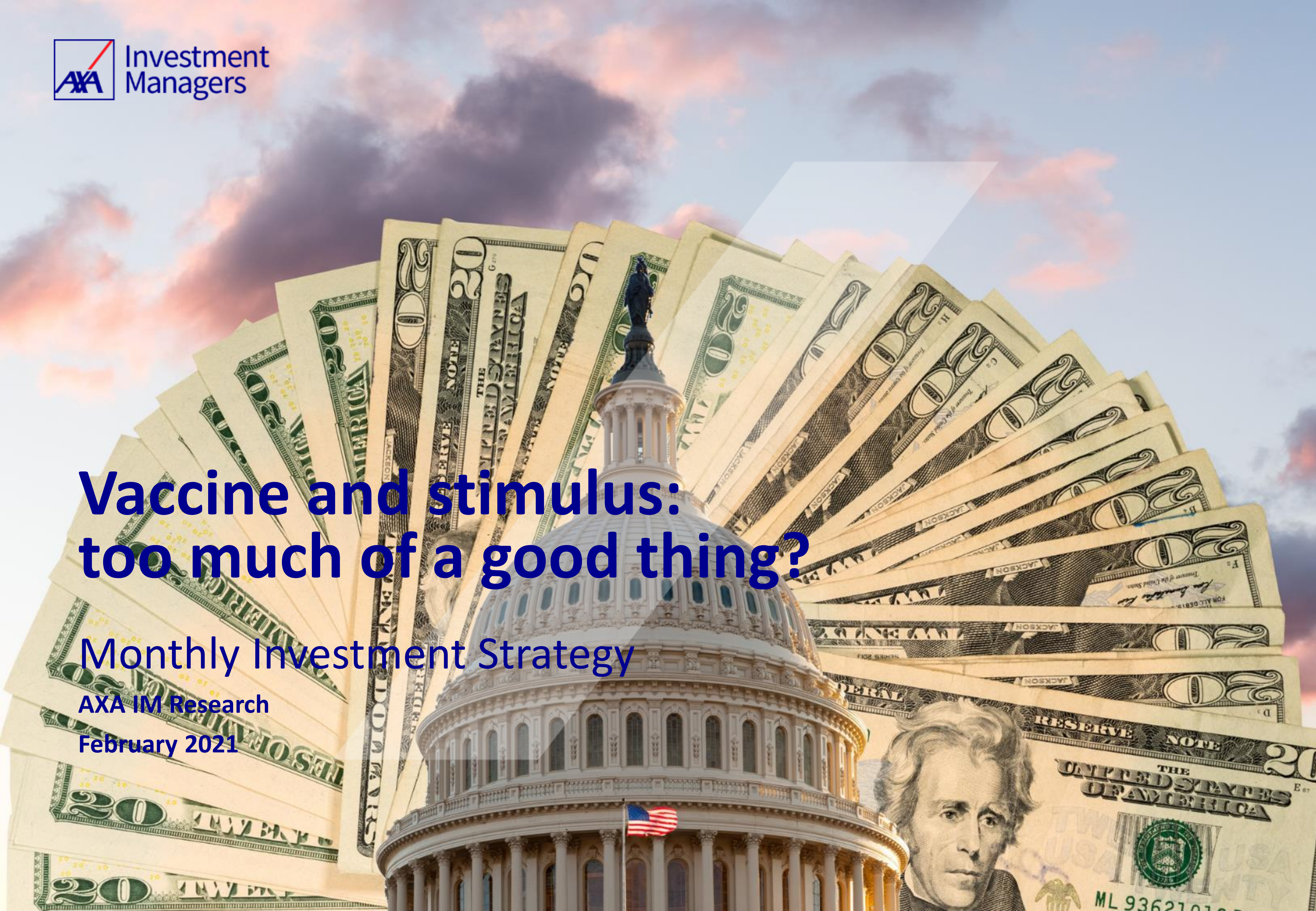
AXA Investment Managers



Vaccine and stimulus: too much of a good thing?

Monthly Investment Strategy

AXA IM Research

February 2021

Vaccine and stimulus: too much of a good thing?

Theme of the month: The cautious return of globalisation

- 15 Asia-Pacific economies signed the Regional Comprehensive Economic Partnership (RCEP), the world's largest free trade zone, covering one-third of global GDP and population. It is a looser, but broader pact than the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)
- The economic benefits of RCEP will be marginal for many signatories, where bilateral agreements already existed. Yet those without prior agreements (China, Korea and Japan), should benefit more. Otherwise, this will support supply-chain re-configuration with Vietnam amongst the likely beneficiaries.
- The EU-China Comprehensive Agreement on Investment (CAI) is designed to accelerate investment ties between the EU and China, which have lagged trade flows. Both side could gain, the EU from access to China's markets and China from tech and R&D sharing. But so far CAI is a cautious first step with several checks and balances and level playing field agreements covering only services.

Macro update: US fiscal stimulus raises economic hopes domestically, and challenges overseas

- The US looks set to pass a greater stimulus than assumed, closer to the $1.9trn proposal. This has lifted our growth forecasts further for this year to 6.2%. It also brings forward inflation concerns. Yields have risen in anticipation of both, and the Fed will have to manage any further tightening in conditions.
- In Europe, despite adaptation to lockdown, GDP looks set to fall in Q4 and Q1. A slower vaccination programme will see restrictions in place for longer amidst fears of new variants. Eyes turn to the ECB to manage rising European yields, while others hope new Italian PM Draghi can redirect fiscal policy.
- UK growth outlook improves with vaccine rollout. BoE moves away from negative rates. Both have served to underpin sterling.
- China has suffered from a renewed outbreak, disrupting New Year celebrations. Q1 GDP growth is likely to be softer now, but Q2 firmer. Travel and tourism will bear the brunt, but urban services consumption and industry may benefit. PBoC continues to show appetite for policy normalisation.
- Emerging markets posted better than expected Q4 GDP and the virus is receding more generally into Q1. Inflation rates are rising, but on balance remain within target ranges. Some central banks are becoming more hawkish, with a bias to hikes, not cuts emerging. Questions about fiscal space return.

Investment strategy: reflation trade still in train even if buffeted by the Vaccine vs Virus struggle

- FX: The net growth differential in favour of the US suggests near-term dollar strength, as FX becomes a proxy for unconventional monetary policy unwind from ultra-low interest rates. Longer term, the structural factors for dollar weakness remain in place.
- Rates: USTs started the year with a 46bp points rise in 10yr yields YtD as the economy moves from a disinflationary to inflationary setup. The overall outcome is likely to be a regime of higher uncertainty, as investors address the disconnect between inflation (rising) and central banks' agenda (tolerant).
- Credit: The profound impact of global excess liquidity on risk premia has inevitably raised concerns about the asymmetry of risk-reward amid risky assets. Out of the 6 years of negative real rate returns since 2000, 3 were negative for HY but only one of those due to a rate/policy-related risk-off (2018).
- Equity: Q4 2020 earnings seasons has sustained an upbeat note, with positive sales and earnings surprises in the US, Eurozone and Japan. Markets are concerned about the potential impact of rising bond yields on equities. US equity returns correlate positively with breakevens & negatively with real rates.

Central scenario

Summary – Key messages

Monetary policy

Monetary policy to remain key policy support. Developed economies to see asset purchases throughout 2021 with no Fed or ECB tapering until 2022.

Inflation

Energy and food to lift annual rates in 2021. Sustainable inflation in 2022 depends on spare capacity and unlikely outside US and some EMs.

Fiscal policy

Fiscal support extended in most jurisdictions. Europe rolls out support slowly, in US Biden proposes large $1.9trn boost.

Growth

Prospects for faster growth rise: virus fades, vaccines grow and large fiscal stimulus. Rebound at different pace on these factors.

Our central scenario:

A rebound from pandemic fuels 2021, recovery will take time

We forecast global growth to rise by 5.4% in 2021 and 4.1% 2022.

Economic rebound reflects vaccine and stimulus, but must overcome labour market and indebtedness headwinds. Monetary policy to support.

Emerging Markets

EM's see virus fade, but less vaccine access for now. Export economies to benefit. Less policy space for most.

Rates

Rates focus on growth and inflation prospects. CBs to assuage concerns with asset purchases, capping the rise in yields.

FX

Number of factors suggest weaker USD longer term but large fiscal boost supportive near term. Strong vaccine rollout supports currencies, incl GBP.

Credit

Tight spread levels belie yet higher corporate debt levels, implicitly locking-in central banks as an ultimate backstop.

Equities

Rotation of value and growth underway. Corporate earnings expected to rebound 2021. Equity risk premium suggests value.

Alternative scenarios

Summary – Key messages

Persistent recession *(probability 15%)*

What could be different?

- Coronavirus mutations reduce vaccine effectiveness
- Labour market dislocation and business disruption create ongoing headwinds to demand recovery
- Fiscal policy fades amidst elevated debt and political opposition
- Geo-political tensions mount in post-Covid world

What it means

- Growth/inflation expectations weaken further, a new depression threatens, corporates' earnings under more pressure
- Further monetary policy where space permits (including China). Government's continue with fiscal stimulus and divide between monetary financing blurs further.

Market implications

- Risk appetite deteriorates / equities sell off / credit widens
- Safe-haven rates rally resumes
- EM debt to come under pressure

Fast recovery *(probability 25%)*

What could be different?

- Vaccine rolls out more quickly than expected, spurring pent-up demand burst
- Labour market recovers, economies benefit from post-virus euphoria
- Virus-shock reshapes business practice, boosting productivity

What it means

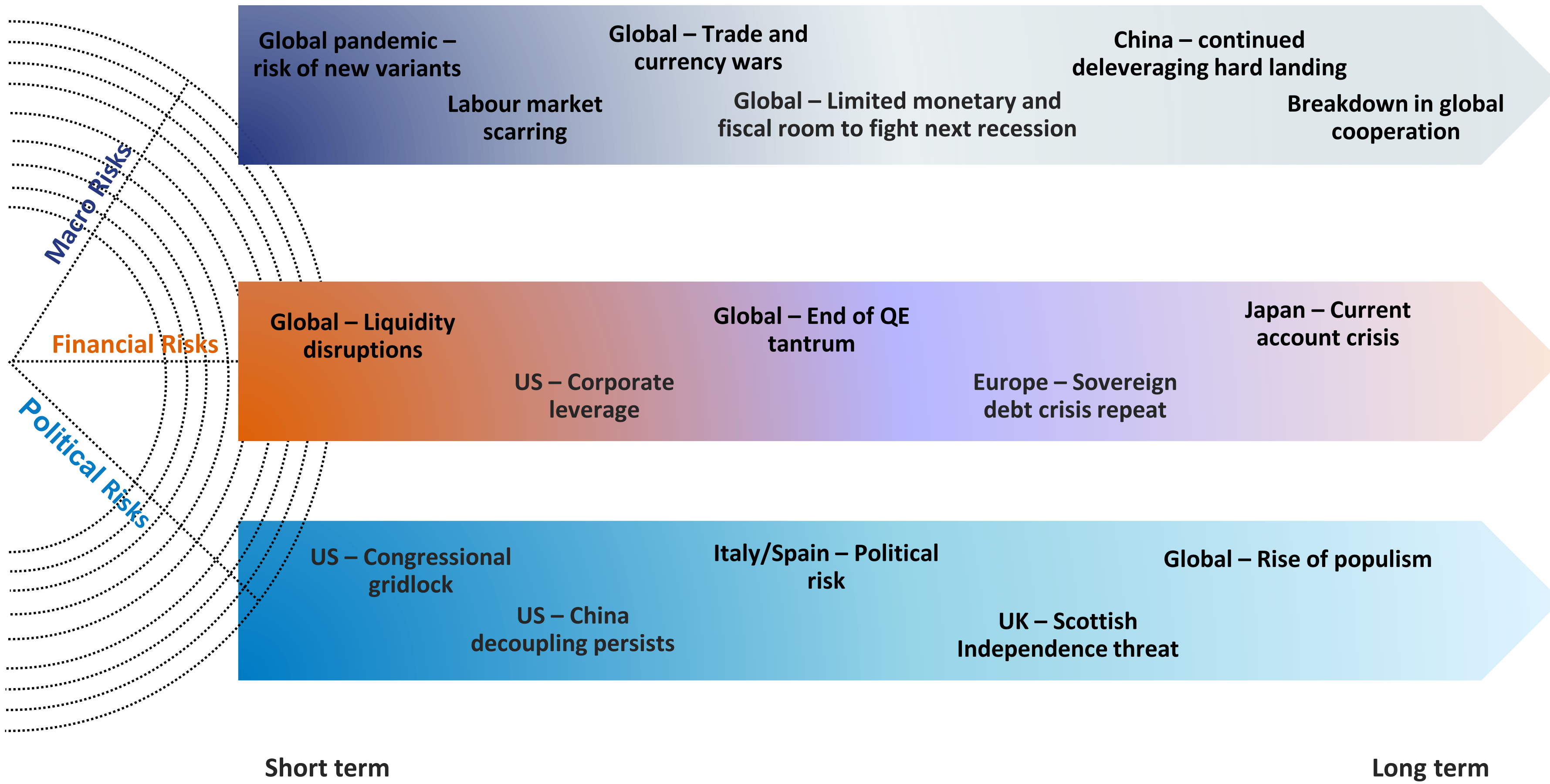
- Global/US/EMU growth surprise on the upside in a stronger and more persistent rebound after 2020
- Monetary policy fights expectations for swift tightening through forward-guidance

Market implications

- Risk-on environment with equities making further gains amidst broader rotation
- UST and EUR break-evens rise
- Spreads grind tighter

RISk Radar

Summary – Key messages



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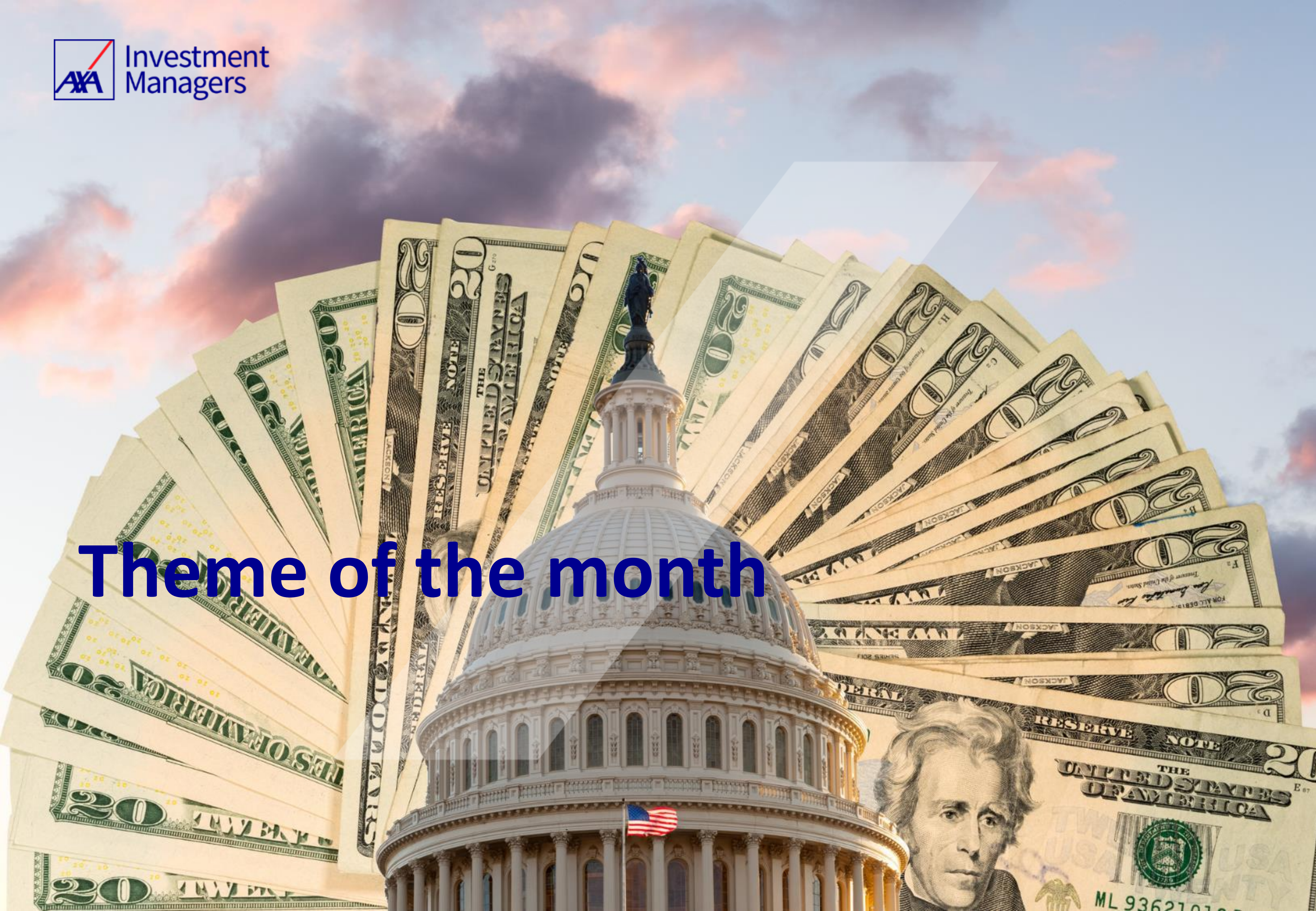


Theme of the month: the cautious return of globalisation

RCEP pulls together 15 countries in Asia Pacific to form the world's largest free trade zone

RCEP accounts for a third of global economy

- After nine years of negotiations, 15 countries in the Asia Pacific region – including the 10 ASEAN members, China, Japan, Korea, Australia and New Zealand – signed the Regional Comprehensive Economic Partnership, or RCEP, in late 2020. Accounting for one third of the global economy and population, RCEP has brought together members of different size, culture, custom and economic status, and created the world's largest free trade zone

RCEP is larger but less strict than CPTPP

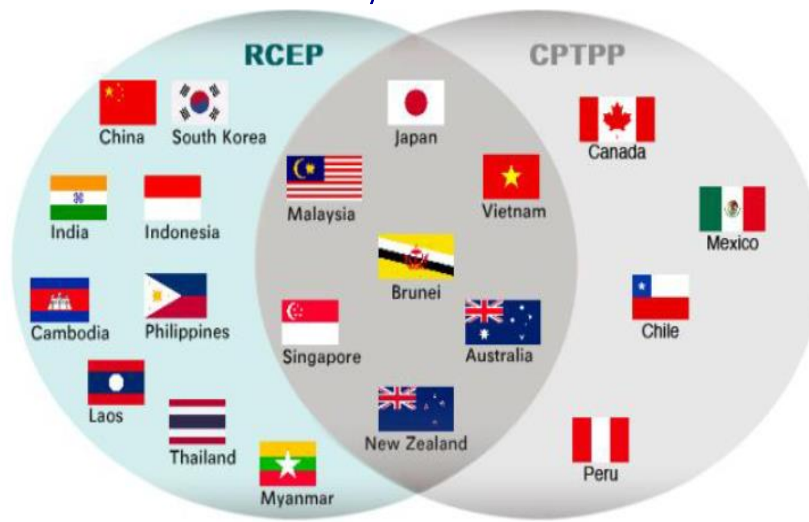
- Compared to the CPTPP, RCEP is broader in coverage, but less strict in standards. For instance, RCEP grants a longer transition period to members to undergo tariff reductions than CPTPP, which also holds higher standards on market accessibility, IP protection, treatment of state-owned enterprises, and labor and environmental rules. Nevertheless, the proliferation of these regional trade deals raises hopes that globalization is still alive and kicking, and can continue to serve as a source of economic prosperity for a large swarth of the world

RCEP vs. CPTPP

	RCEP	CPTPP
Implication	A single trade agreements within Asia	Agreements with countries in Asia Pacific and America
Date signed	November 15, 2020	March 8, 2018
Member countries	**Asia:** China, Japan, Australia, New Zealand, Korea **ASEAN:** Vietnam, Brunei, Malaysia, Singapore, Indonesia, Philippines, Thailand, Cambodia, Laos, Myanmar	**Asia:** Japan, Australia, New Zealand **ASEAN:** Vietnam, Brunei, Malaysia, Singapore **North America:** Chile, Mexico, Canada **Latin America:** Peru
Effective from	Once 6 ASEAN economies and half of non-ASEAN parties have approved	December 30, 2018
Tariff exemption	Eliminate tariffs on 90 93% of goods trade	Eliminate tariffs on 99% of goods trade
Economic size	$26 trillion (30% of world)	$11 trillion (13% of world)
Trade share	$10 trillion (27% of world)	$5.7 trillion (13% of world)
Population size	2.3 billion (30% of world)	500 million (7% of world)
FDI inflow	$422 billion (26% of world)	$310 billion (19% of world)
Benefits	Common rule of origin within APAC	Geographic diversity, greater depth
Shortfalls	Less comprehensive than other agreements	Limited provisions after US withdrawal

Source: AXA IM Research, February 2021

Two deals are not mutually exclusive



Source: AXA IM Research, February 2021

Theme of the month: the cautious return of globalisation

Modest gains from lower tariffs will be concentrated given bilateral trade agreements already exist

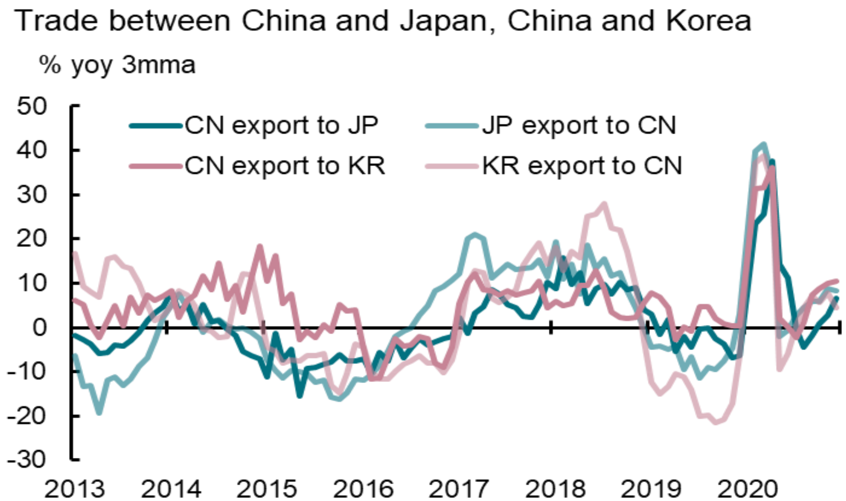
Direct gains from trade will be modest

- Notwithstanding the structural significance, RCEP – as predominantly a trade agreement – may not bring many immediate benefits from increased trade flows. This is because bilateral free-trade agreements have already proliferated between RCEP members that have either already, or are expected to, drive down tariffs in the coming years. The incremental gains from the trade pact is therefore less than meets the eye

Gains will be realized by filling "holes"

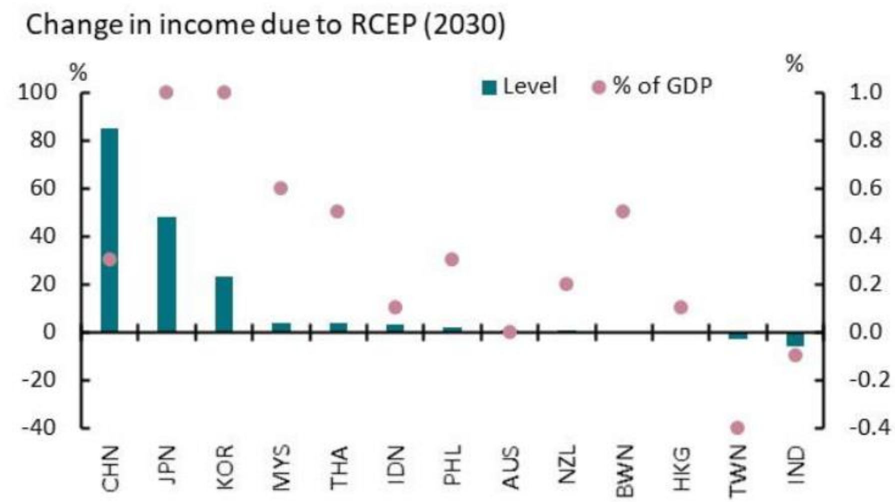
- Nevertheless, RCEP can still fill a vacuum of FTAs between China and Japan, and Japan and Korea. After the transition is completed, most of China's exports of electronic products, machineries, car parts and textile goods to Japan will be tariff-free, while 92% of Japan's exports to Korea will be levy-free. These make China, Japan and Korea the biggest beneficiaries of the trade pact, which could add $165bn to Asian economies in 2030, boosting the region's GDP by 0.3%

RCEP will benefit trade among China, Japan and Korea



Source: CEIC and AXA IM Research, February 2021

Modest trade gains will be concentrated



Source: PIIE and AXA IM Research, February 2021

Theme of the month: the cautious return of globalisation

Greater gains from RCEP lie in prospect of supply-chain reconfiguration

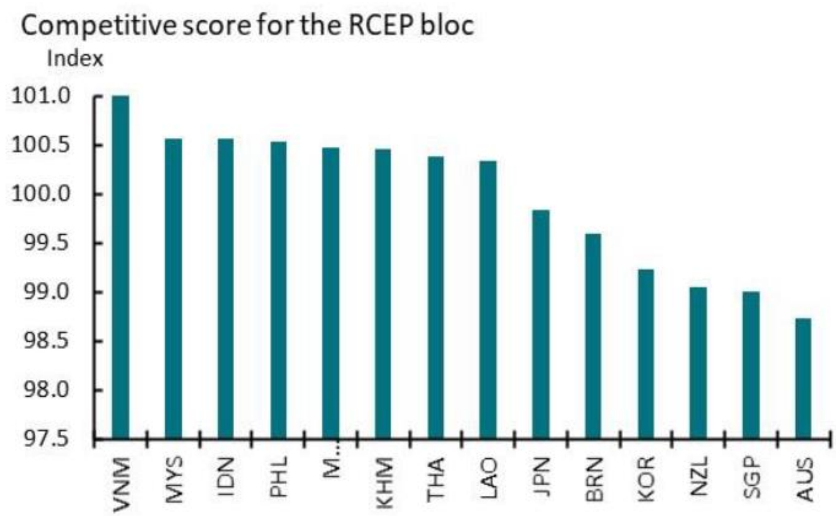
Less-developed countries can gain from supply-chain reconfiguration

- With RCEP helping to consolidate rules of origin, clearer regulation and falling transaction costs will help to accelerate regional supply-chain formation. Our competitiveness analysis and observations of changing export market shares point to one clear winner, Vietnam. The country has gained significant low-margin production capacities migrating out of China in recent years, and is the top investment destination for Asian businesses according to recent surveys

Apart from economic impacts, geopolitical significance cannot be downplayed

- ASEAN and China are among the beneficiaries. The former could gain more influence on the global stage and serve as a pivotal force in the Asia Pacific region, where the US and China compete for power. China can use RCEP to demonstrate its desire to continue reform and opening up. On the flipside, the US could see a waning of its geopolitical sway in the region along with reduced economic connections, while India could also lose for not being on the RCEP train

Vietnam tops the economic competitive index



Source: World Bank and AXA IM Research, February 2021

Vietnam gains from supply-chain migrating out of China

Sector	China's loss of global export share (in % of global exports)	Top three gainers	Increase in export share (in % of global exports)
Footwear	-5.05	Vietnam	1.53
		Indonesia	0.24
		Cambodia	0.11
Stone and Glass	-4.11	Japan	0.68
		Thailand	0.44
		Australia	0.31
Metals	-2.06	Vietnam	0.17
		Korea, Rep.	0.15
		Indonesia	0.10
Textiles and Clothing	-1.47	Vietnam	1.03
		Cambodia	0.26
		Myanmar	0.19
Mach and Elec	-1.18	Vietnam	0.47
		Korea, Rep.	0.31
		Japan	0.18

Source: WITS and AXA IM Research, February 2021

Theme of the month: the cautious return of globalisation

A ground-breaking investment deal could tighten economic links between China and EU

CAI could narrow the gap between investment and trade

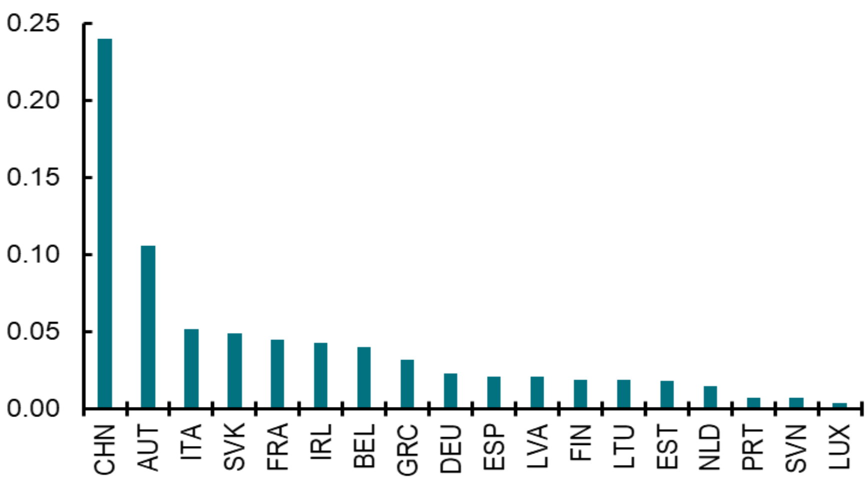
- The recently signed EU-China Comprehensive Agreement on Investment (CAI) is designed to reduce market barriers, increase accessibility and level the playing field for businesses seeking investment in each other's economies. Annual trade flows between the EU and China have increased significantly to $700bn in 2019, while bilateral investment has lagged, with cumulative positions less than $300, and the pace of flows have slowed in recent years due to economic and political reasons. CAI is designed to accelerate investment flows and strengthen the bilateral economic ties

CAI presents mutual benefits to both

- The EU will gain from lower barriers to an economy of 1.4bn people and the world's largest consumer market. Under the CAI, European businesses could also gain a level playing field versus local competition in China. China, on the other hand, could gain from greater transfers of technology, management knowhow and R&D. Beijing could also leverage the CAI to push for greater reforms consistent with the 14th Five-Year Plan

China has more to do to reduce investment barriers than EU

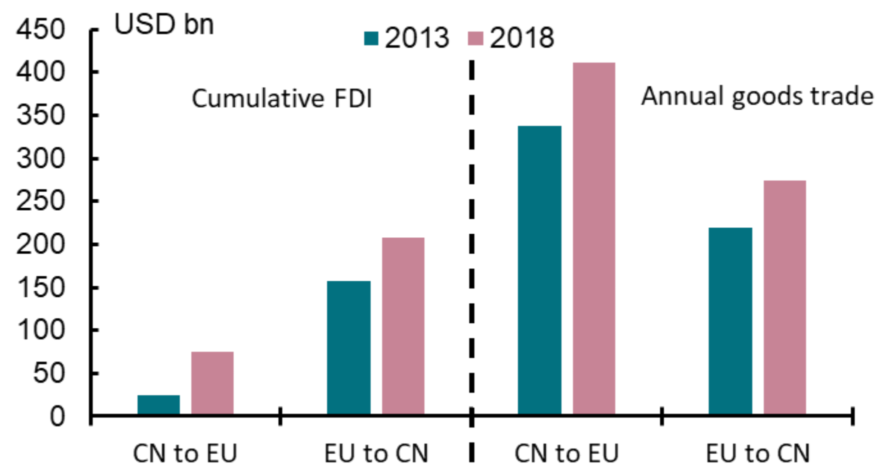
FDI restriction: China vs. EU



Source: OECD and AXA IM Research, February 2021

CAI could narrow the gap between trade and investment

Cumulative direct invesmment between EU and China



Source: CEIC and AXA IM Research, February 2021

Theme of the month: the cautious return of globalisation

A more critical assessment from the EU side

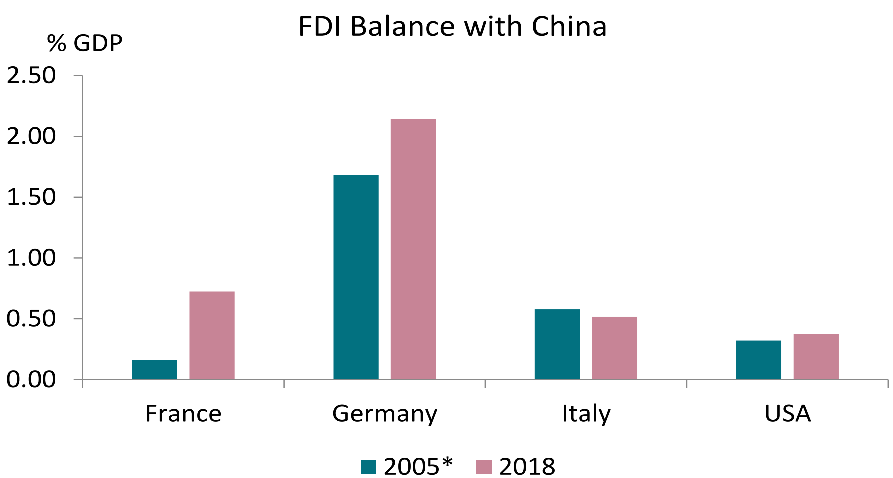
A not so comprehensive agreement…

- First details of the level playing field agreement show that only subsidies in the services sector are covered, of course this is better than nothing but given most of the EU investment in China is in the manufacturing sector it is quite limited by design. Second on market access, concessions have been made bilaterally but all of them have quite stringent criteria. For instance in the automotive sector, commitment for market access is only for new energy vehicles and only if there is no excess capacity in a particular province. For telecommunications, EU investment is capped at 50%.

… with success depending on proper implementation

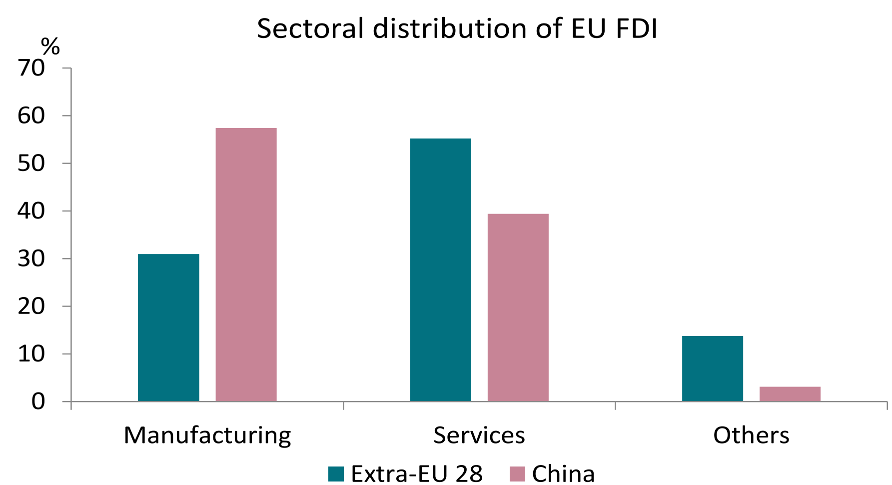
- The agreement still needs to be fully finalized and will have to be scrutinized and endorsed by the European Council and the European Parliament – which could trigger some thorny discussions, notably on the human rights implications. In any case economic benefits will depend on its proper implementation and concrete steps from China.

Germany to potentially benefit most of the CAI



Source:OECD and AXA IM Research, February 2021.

Most of EU investments in China is in the manufacturing sector



Source: Eurostat and AXA IM Research, February 2021. Note: 2017 data.

Macro outlook

Vaccines, stimulus and pent-up demand

US

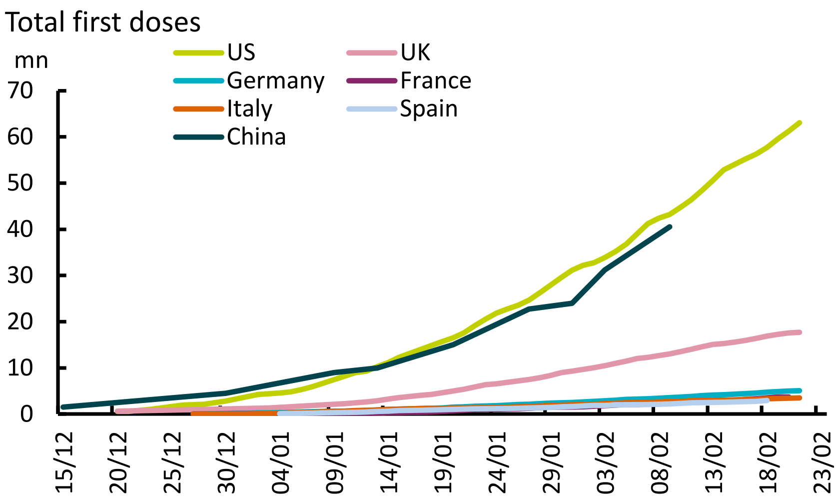
Virus coming under control, vaccines support further suppression

- Positivity rates are the lowest since October, new cases are also falling back to these levels and states with rising cases are <5% by GDP. The US appears to be getting on top of the end-year outbreak. Admittedly the early easing of restrictions in some states risks a relapse, particularly with more contagious new variants prevalent. But large-scale vaccination – at around 20% of the population – is increasingly helping. US restrictions should ease gently for now, but more significantly in Q2, which will boost growth materially.

Another stimulus package should see growth surge

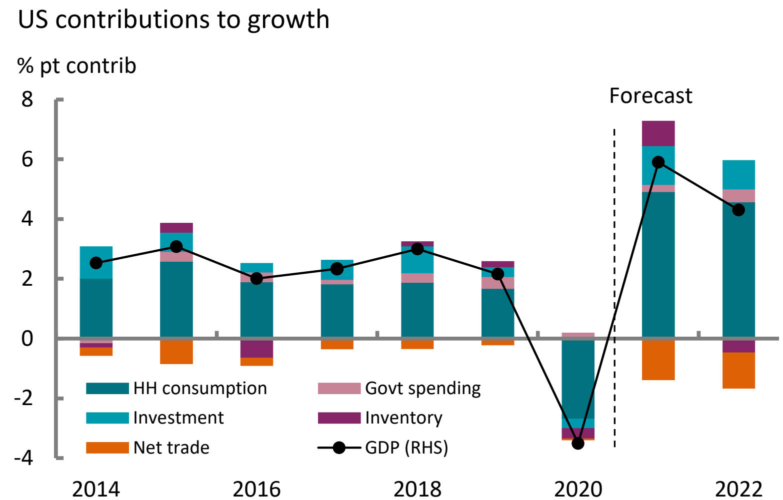
- Following $0.9trn in December, President Biden proposes a further $1.9trn (8.6% GDP) stimulus package. This now looks set to be delivered by reconciliation and so will likely be even greater than the $1trn we had assumed (although probably not the full $1.9trn). This will be a meaningful lift to growth. We forecast 6.2% GDP growth this this and 4.5% next. Consensus has also increased but to 4.8% and 3.6% respectively.

US vaccine rollout surges ahead



Source: Our World In Data, and AXA IM Research, February 2021

Turn in consumer spending to drive recovery



Source: BEA, and AXA IM Research, February 2021

Can inflation remain subdued amidst growth surge?

US

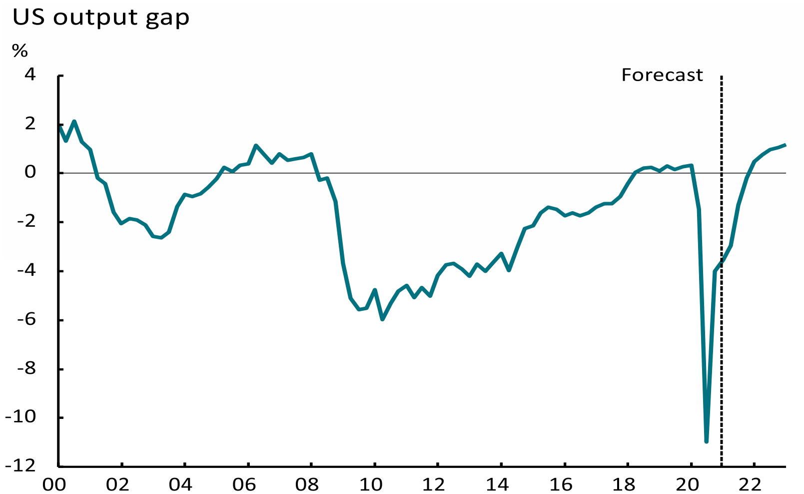
Output gap and inflation

- Our revised forecasts suggest the output gap will close faster than previously anticipated - now by end-2021. This should return inflation sustainably to target sooner. 2021 is likely to see volatile CPI inflation, rising to 2.5% by mid-year, but back below 2% by end-2021. By end-2022 we expect PCE inflation at around target. We forecast a moderate overshoot thereafter. Its scale will depend on further stimulus, but we question the consensus assumption that inflation will be as subdued as during the previous decade.

Fed's reaction function is now different – but by how much?

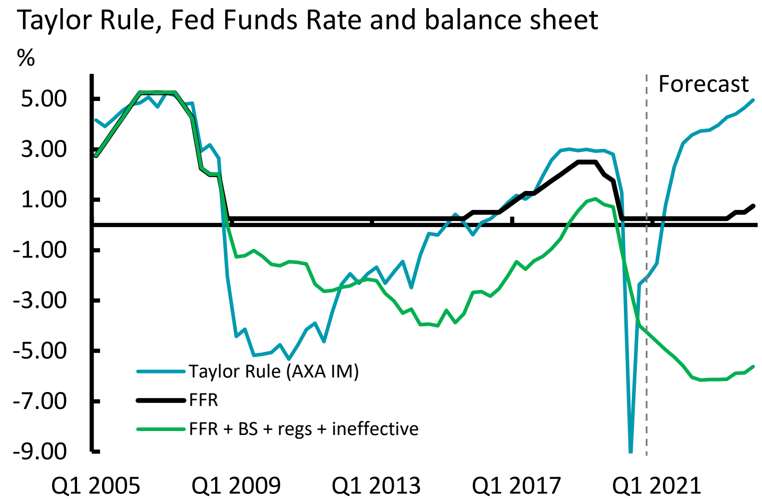
- The Fed has clearly signaled that policy will remain accommodative for some time, with the economy far from its goals. Taper discussion has been dismissed as "premature". Fed forward guidance conditions are unlikely to be met before 2023. We expect the Fed to start tapering in Jan 22 until year-end (announced in December). But even then, the Fed's monetary path looks extremely divergent with its previous reaction function. We expect the Fed to start to tighten policy – hike FFR – in mid-2023.

US to close output gap and deliver more 'excess demand'



Source: CBO, BEA, AXA IM Research, February 2021

Taylor Rule indicates divergence in expected reaction functions



Source: FRBNY, BEA, AXA IM Research, February 2021

The V-race continues

Euro area

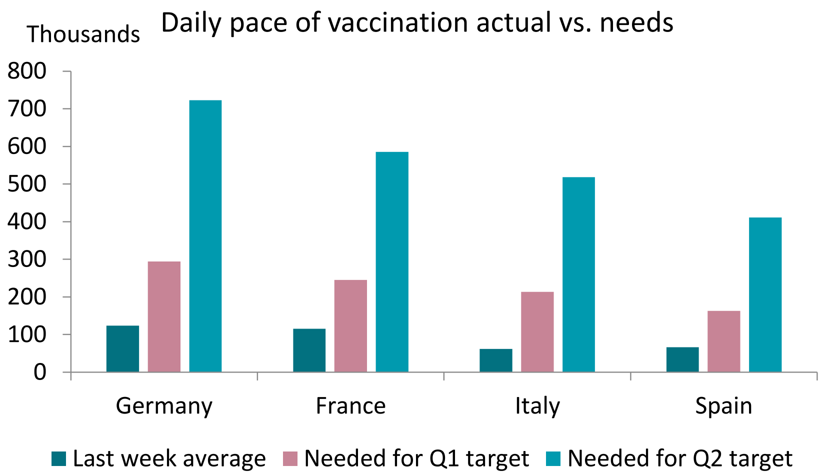
Watch out for the variants…

- Virus developments have not been too bad, with numbers of cases and positivity rates falling in the main. But governments fear it is the (relative) calm before the storm as the UK variant is expected to become prevalent in most EA countries by mid-March. As such, restrictions have been extended. Meanwhile, the supply side issues which have been a constraint in some countries in February should recede in Q2. Logistics will now be key: a substantial scale up of the vaccination pace is needed to allow a gradual reopening.

… while the economies remain stuck below baseline

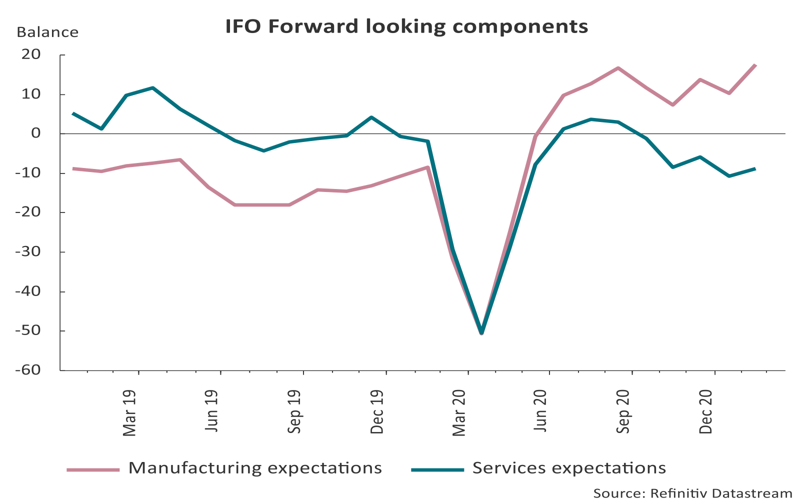
- EA Q4 GDP confirmed that the economies are coping better with the restrictions: growth dropped by just 0.6% qoq. But GDP is still 5% below its pre-covid level and the OECD weekly activity indicators show that the gap is not narrowing (economies running c. 5-10% below last year levels). Another gap which is not narrowing is the one between services and manufacturing: despite some headwinds (semi conductor shortage, bad weather, higher input prices) IFO manufacturing expectations hit their highest level since Nov 17.

A significant scale up needed



Source: OWID, AXA IM Research, as of 21 February 2021. Note: Q1 target =10% of the population, Q2 target =40% of the population vaccinated

Manufacturing divergence



Source: Datastream, AXA IM Research, February 2021

Of fiscal and monetary forward guidance

Euro area

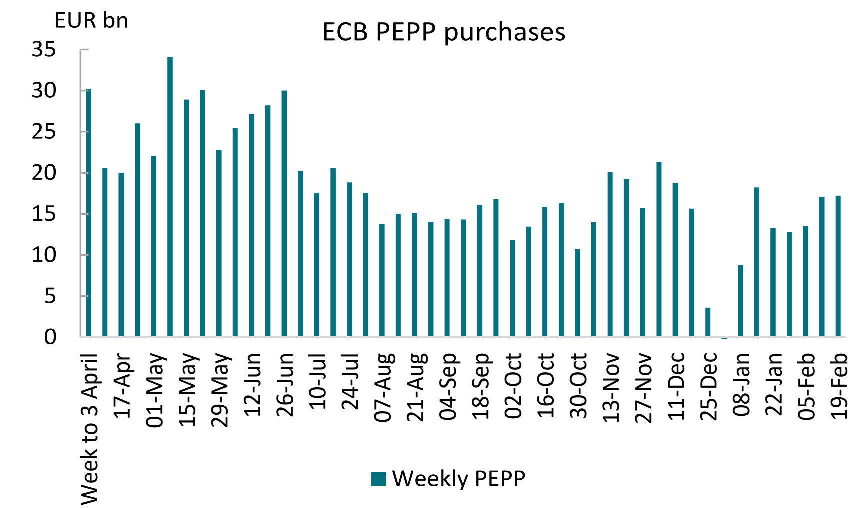
Hoping for a Draghi effect…

- The new Italian PM Mario Draghi has concentrated hopes on the fiscal front. Not only in Italy where one of his priorities will be to optimize the use of the recovery fund. But also in Europe, where he could steer the debate on the fiscal rules. So far governments have been lacking clarity beyond the likely extension of the escape clause in 2022- one factor likely limiting their fiscal support. But revamping the fiscal framework is not easy and the timing, with German elections and Italian Presidential elections, may further hamper progress.

… and more explicit ECB forward guidance

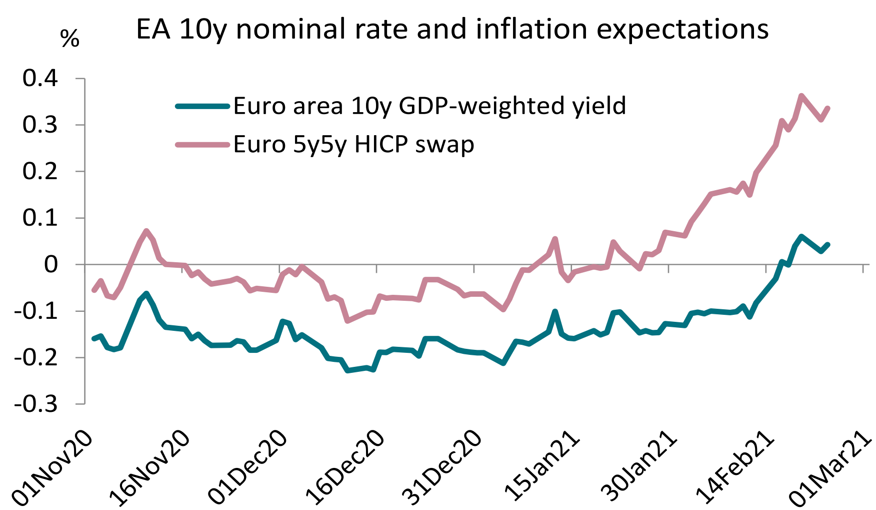
- Following US fiscal optimism, the euro area yield curves have shifted higher and steepened. We think clarification of the meaning of "preserving favourable financing conditions" is necessary. A first hint has been given via the ECB minutes: the focus is on real rates, but more explicit forward guidance, not only through higher PEPP purchases, is required to avoid tightening of financial conditions.

PEPP to provide some hints on the ECB reaction function…



Source: ECB, AXA IM Research, February 2021

… as yields are getting higher



Source: Datastream, AXA IM Research, February 2021

Turn in activity comes into view

UK

NHS delivers government vaccine target

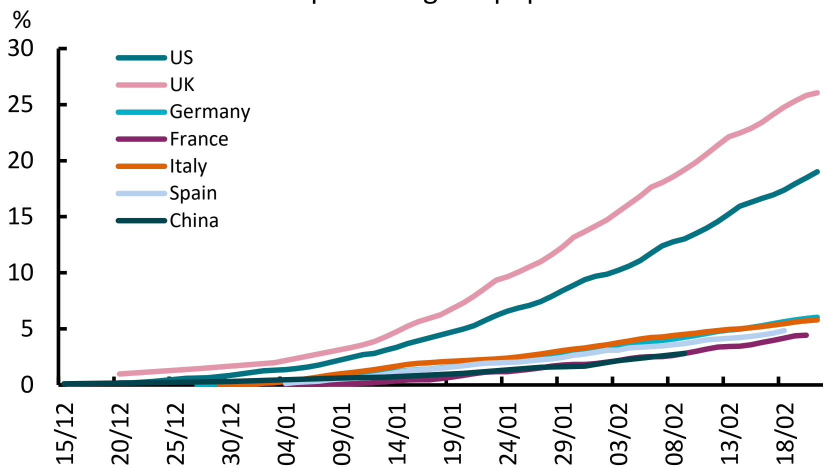
- The NHS has so far managed to deliver the ambitious vaccination target of 15m by mid-February, just under 25% of the population. Meanwhile the ongoing lockdown 3.0 is seeing new cases fall by around 25% w/w, with cases falling from a peak of 68k to the first <10k since early October. Lockdown continues until 8 March, when schools will start to return. A gradual lifting of restrictions is proposed thereafter to end on 21 June. This should deliver a meaningful pick-up in activity in Q2 and beyond.

Q1 GDP drop followed by strong, restriction-easing rebound

- The impact of Lockdown 3.0 is likely to see GDP contract by 3.5% in Q1. Much less than Q2 2020 as manufacturing and construction have remained in operation this time and services have adapted. Indeed, the 1.0% lift in Q4 GDP despite the mini Lockdown 2.0 in November is a testimony to this sectors adaptability to lockdown conditions. Thereafter, an easing of restrictions should underpin material rebound. We forecast GDP growth of 4.6% and 7.5% for this year and next (consensus 4.6% and 5.5%).

NHS delivers successful rollout of vaccines to date

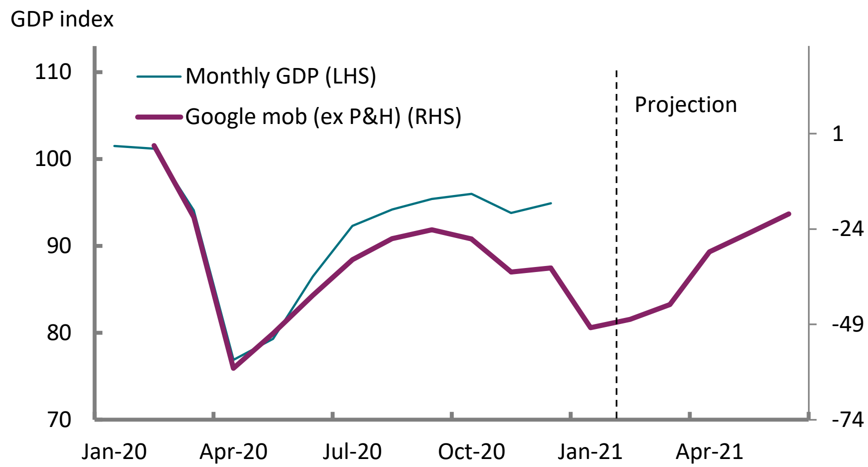
Doses administered as a percentage of population



Source: Our World In Data, AXA IM Research, February 2021

How the UK might leave lockdown (and changing relation with GDP)

UK GDP and Google Mobility (ex Parks and Home)



Source: Google, AXA IM Research, February 21

BoE may have to consider relative, not absolute policy

UK

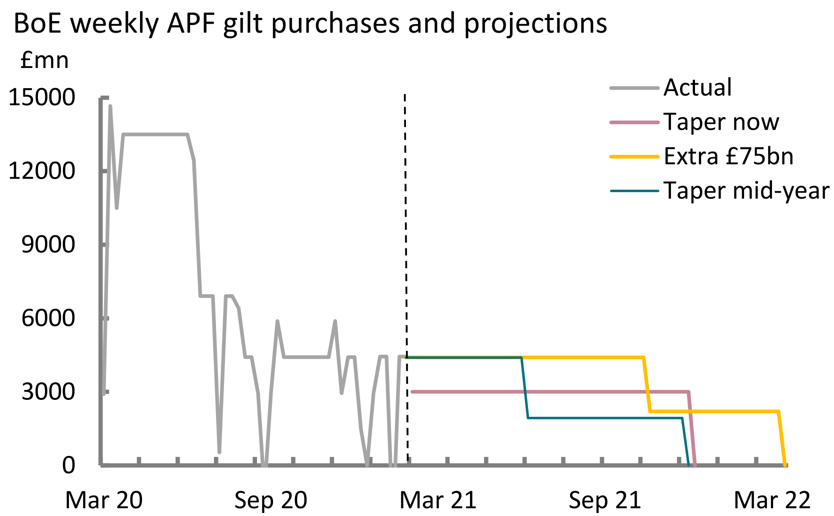
BoE outlook – no rate cut, but further QE

- The BoE lowered its GDP forecasts to 5% and 7¼% for this year and next (from 7¼% and 6¼%), now in line with our outlook. It left policy unchanged in February. The BoE instructed commercial banks to make operational preparations for future negative interest rates, but explicitly stated this conveyed no intention for future policy. In 6 months' time, when banks are ready, we expect a robust rebound and hence continue to expect no further rate reduction. However, the BoE's current QE envelope of £875bn suggests tapering purchases ahead of the ECB and Fed. We expect further expansion of QE in the May meeting and a later taper.

Pounding other currencies

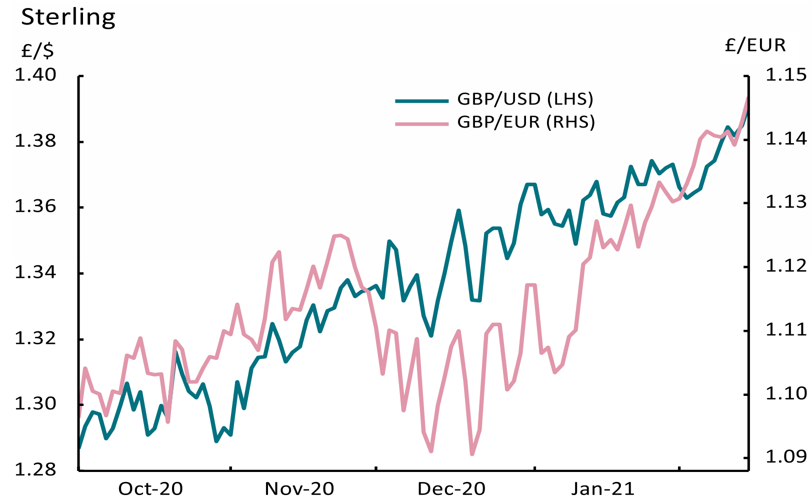
- Sterling has performed well vs EUR and USD recently. This is a combination of unwinding worst-case Brexit fears, re-pricing of expectations for negative UK rates and an efficient vaccine deployment to date. A relatively early taper by the BoE could push sterling higher still. We see scope for some further gains to the euro, but watch for short-term reversal to the US dollar.

Scenarios around BoE's current and expected QE envelope



Source: BoE, AXA IM Research, February 2021

Sterling strong performance vs USD and EUR



Source: Refinitiv, AXA IM Research, February 2021

Renewed virus causes uneven impacts

China

Growth momentum slows in early 2021

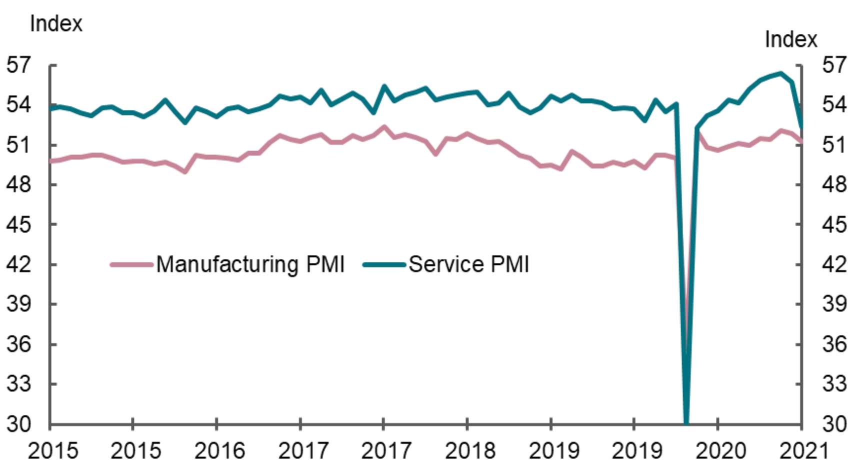
- Softer PMIs show that the Chinese economy started 2021 on a weaker footing. Renewed virus cases in northern China prompted the authorities to tighten social restrictions and reimpose travelling bans. Migrant workers were asked cancel travel plans for the lunar new year (LNY), leading to a sharp drop in cross-city/province travels - 75% below normal levels - Tourism, transportation and accommodation took the hardest hit as people refrained from long-distance holidays. This will hold back the anticipated recovery in some service-sector activities

Urban consumption boosted by "staying local"

- However, not all sectors were affected negatively by the renewed social restrictions. With millions of migrant workers staying in cities, urban consumption was boosted by a surge of holiday spending. Online retailing, car sales and restaurant revenue all grew substantially during the week-long holiday. Box office sales set a new record, despite capacity restrictions in most cinemas. Industrial activity was also unaffected by the outbreak, with strong electricity and steel production suggesting that industrial demand remains solid

PMI weakens in early 2021

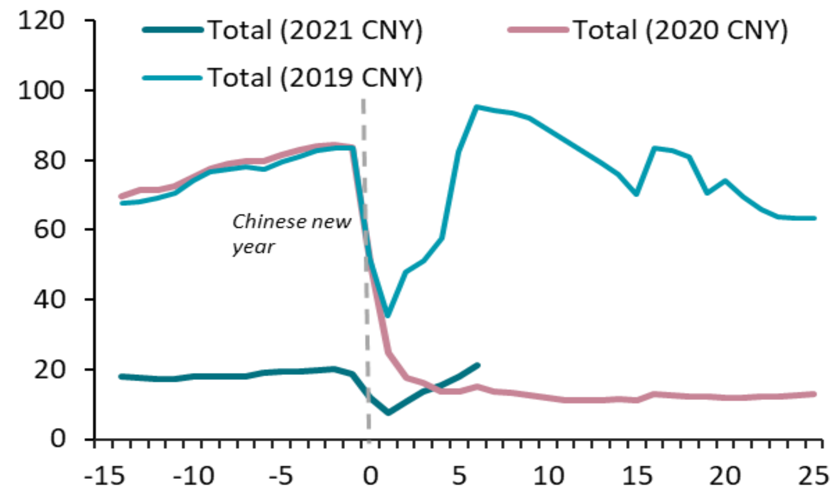
Manufacturing and services PMI



Source: CEIC, AXA IM Research, February 2021

Travel volume recovers from depressed level

Passenger volume (person times, in million)



Source: CEIC, AXA IM Research, February 2021

PBoC stays the course on policy normalization

China

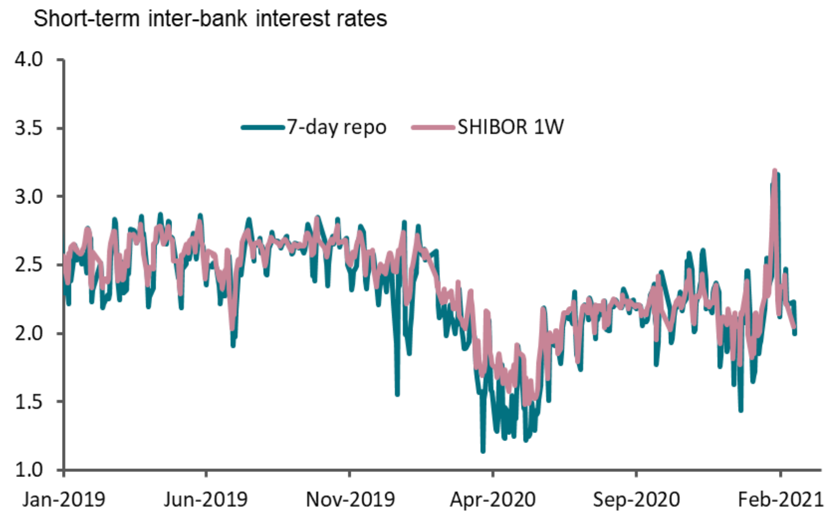
Virus outbreak won't stop PBoC from tapering

- The unexpected liquidity drainage before the LNY caught the market by surprise and suggest the PBoC was determined to withdraw excess liquidity to return monetary condition back to the normal. This desire was further manifested in the first Open Market Operation after the LNY, where the central bank net withdrew RMB260bn, mopping up the excess cash that was injected to meet holiday demand. Even though there is no urgency for immediate policy tightening given muted inflation and a firm exchange rate, the PBoC appears to be looking through the short-term impact of the outbreak and on course to normalize policy

But no sharp turn in policy operation

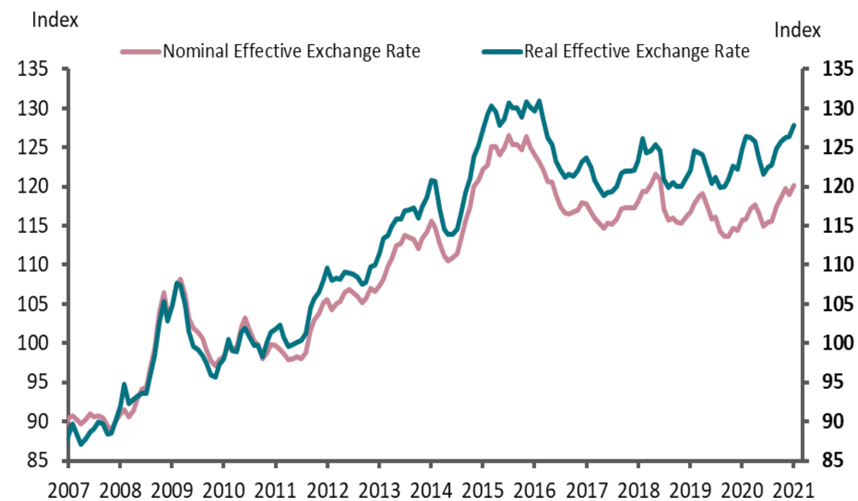
- While recent developments have aroused debate about the PBoC's intentions, we see them as consistent with our expectation of policy normalization. In a nutshell, we expect monetary policy to return to neutral in 2021 after the economy has recovered from the COVID shock. This process will be carefully managed to avoid any undue volatility for the economy. We see no RRR or interest rate hikes this year, but some macro-prudential policy tightening could be applied to targeted sectors, e.g. the property market, to rein in leverage growth and financial imbalances

PBoC operations cause some interest rate volatility



Source: CEIC, AXA IM Research, February 2021

Strong RMB tightens monetary conditions



Source: CEIC, AXA IM Research, February 2021

The government extended the state of emergency until March 7

Japan

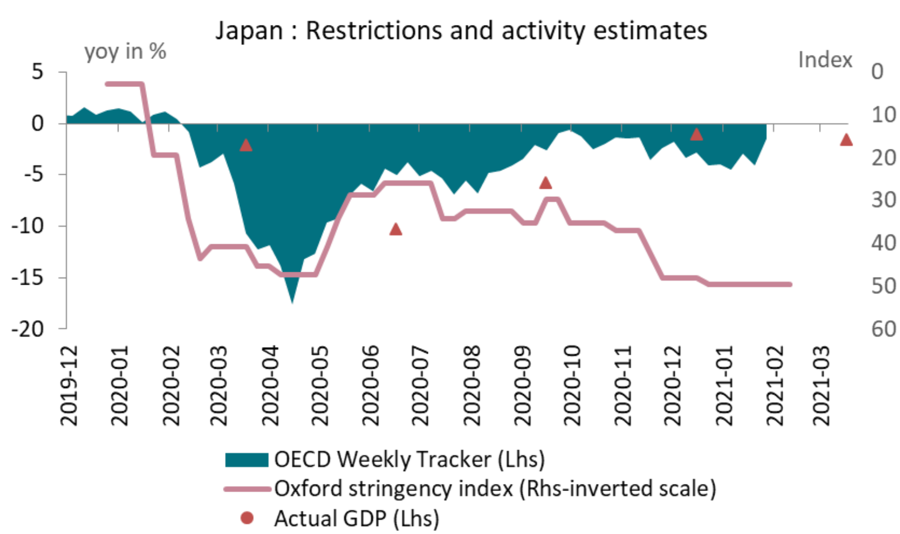
The government extended the state of emergency until March 7

- The number of new cases halved to reach November's level, but hospitals remain saturated
- A vaccination campaign has begun with healthcare workers, but logistical shortages pose a short-term constraint.

Q4 GDP figure surprised on the upside (+3% QoQ)

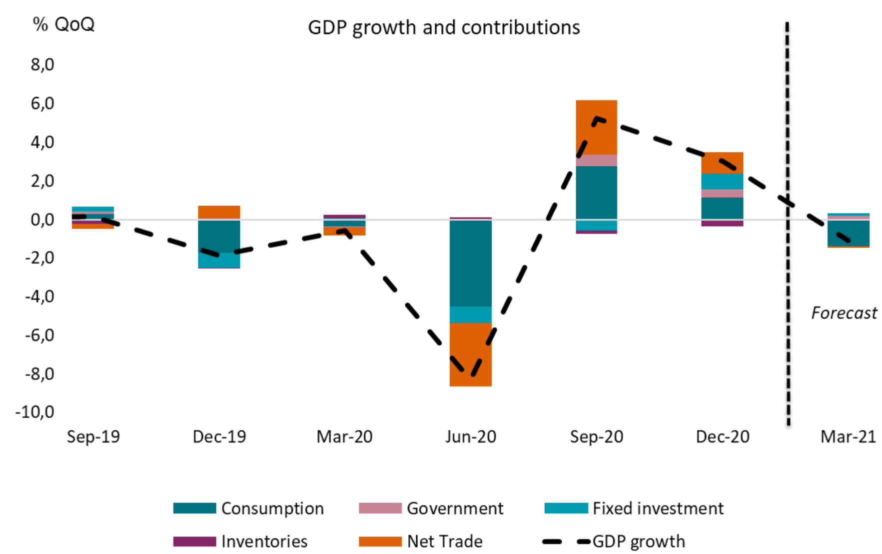
- Business investment rebounded strongly (+4.5%), exports accelerated following a solid recovery in Asia (+11%) and private consumption was robust (+2.2%).
- Due to the restrictions, we expect Q1 GDP to decline by 1.1% QoQ. Private consumption – on which we applied one-third of the shock seen during the previous state of emergency – should be the most impacted (-2.6% QoQ).
- We remain optimistic on the outlook. Activity should rebound in Q2 and accelerate in Q3.

The State of emergency no longer has the same impact on GDP



Sources: OECD, Our world in data, AXA IM Research, Feb 21

Q4 GDP figure surprised on the upside



Source: Cabinet Office, AXA IM Research, Feb 21

The BoJ is preparing its policy review conclusions

Japan

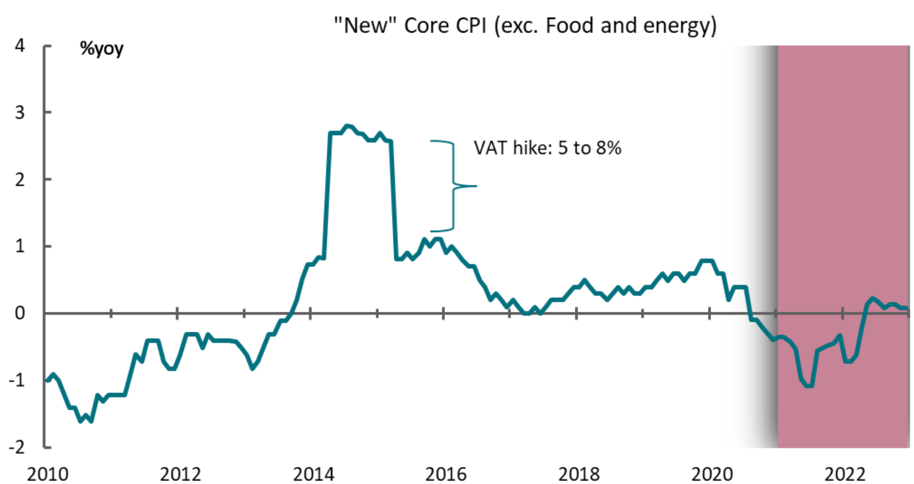
January "new" core CPI rose to +0.1% yoy from -0.4%

- The rise in CPI inflation is explained by temporary factors such as the suspension of the "Go to" program
- We expect significant volatility over the coming months, with CPI expected to reach a trough around mid-year at -1.2% yoy, worsened by impacts from mobile phone charge reductions, exchange rate appreciation and the likely reintroduction of the 'Go to' discounts.

Policy review conclusions should be released in March, but the Bank of Japan is already unveiling some details

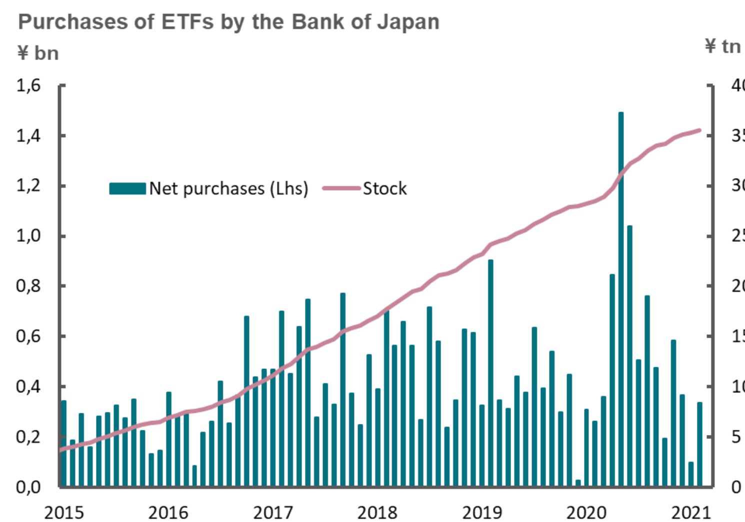
- The BoJ won't remove YCC or QQE, but may focus actions around the 10-year target range and how it intends to improve functioning in the JGB market.
- The BoJ has no plans to "permanently reduce" its ETF purchases, but we believe it can adopt a more flexible approach.
- On negative interest rate policy, we believe the BoJ may detail how it can push the refinancing rate lower by deploying further measures to alleviate the cost for the financial sector.

Due to temporary factors, inflation is going to be volatile in 2021



Source: Bank of Japan, AXA IM Research, Feb 21

ETF purchases are very volatile



Source: Bank of Japan, AXA IM Research, Feb 21

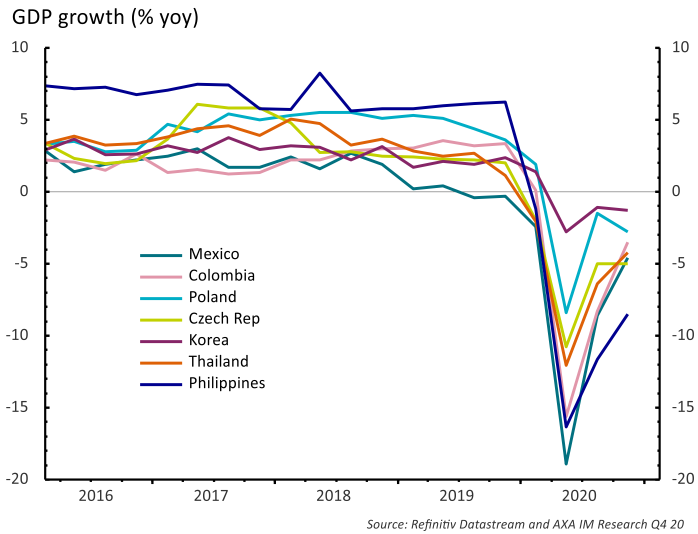
Growing resilience to restrictions as 2020 ends

Emerging Markets

Q4 2020 GDP early estimates show resilience…

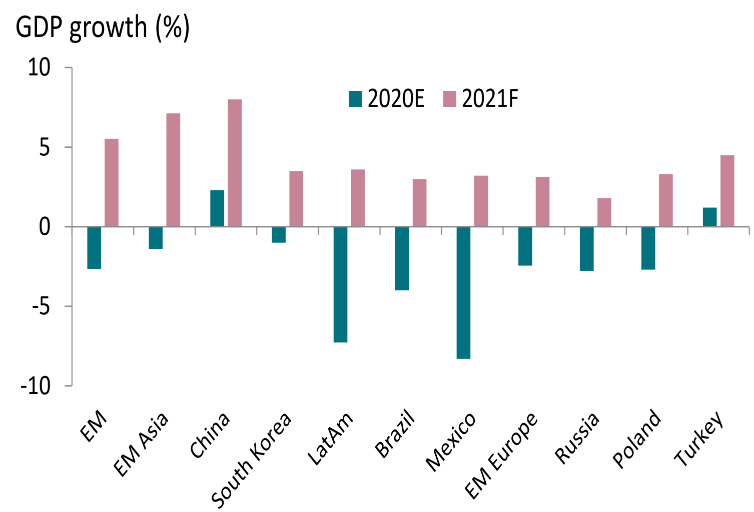
- Statistical uncertainties left aside, flash estimates of Q4 2020 GDP have been broadly better than expected.
- In Asia, GDP at end-2020 was around 2-4% lower than a year ago in Korea, Indonesia, Malaysia or Thailand. The notable exception in the region was the Philippines where GDP contracted by 8.5% yoy in Q4 2020, marking a record fall of 9.5% for the year as a whole.
- In Central Europe, the second-wave renewed lockdowns and curtailed the recovery seen in Q3 2020. Consequently, flash estimates depict weaker growth in Q4, but certainly not as much as feared. Poland outperformed with growth contracting 2.7% on average in 2020 versus -5% for Hungary or -5.7% for the Czech Republic.
- Early Q4 GDP releases in Latin America have also been rather reassuring. Still, 2020 would have marked a very deep recession with GDP growth contracting 6.8% in Colombia, 8.5% in Mexico and 11% in Peru.

Better than expected Q4 GDP growth estimates so far



Source: Datastream, AXA IM Research, February 2021

Expecting 2021 recovery



Source: AXA IM Research, February 2021

The path of normalisation in economic policy

Emerging Markets

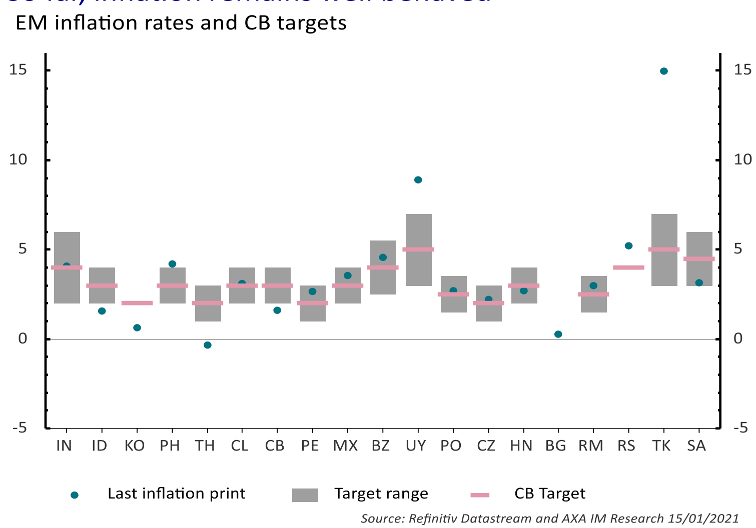
Monetary policy normalisation ahead

- CPI prints have started to surprise to the upside in Jan, but inflation remains within most central banks' targets for now. Nonetheless, some hawkish tones are emerging in some CB statements. Brazilian, Turkish and Russian central banks stayed put recently, but the prospect of future rate increases has been clearly understood. In line with expectations, Mexico and Indonesia cut rates last month, but the broad policy stance is likely to be moving towards an upcoming normalisation from historical low levels towards year-end.

The debate on public debt sustainability

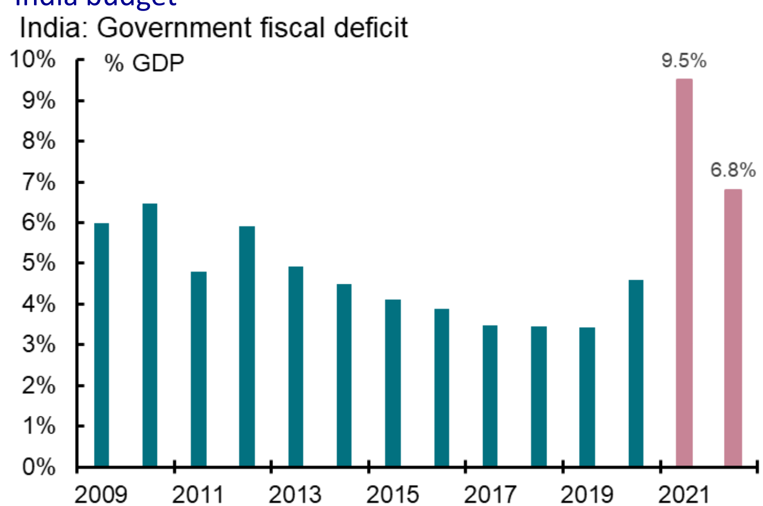
- Cutting public spending in 2021 while economic activity is still weak may prove difficult, especially for countries that implemented big stimulus packages last year such as Brazil and South Africa. As such, the prospect of new emergency aid packages in Brazil and the upcoming budget presentation in South Africa should provide important insights on the fiscal policy direction as well as markets' assessments of their debt sustainability.
- Interestingly, markets reacted positively to India's expansionary budget, despite its poor debt trajectory. RBI will pursue its yield-capping strategy. The supply-side fiscal support that is hoped to reaccelerate India's growth potential is giving Indian policymakers the time and the leeway to act.

So far, inflation remains well behaved



Source: Refinitiv Datastream, AXA IM Research, February 2021

India budget



Source: AXA IM Research, February 2021

Investment Strategy

Multi-Asset Investment views

Our key messages and convictions

Positive on equites

#1

Economic and earnings rebound remains on track amidst very loose monetary policy

#2

Despite support from unprecedented monetary and fiscal initiatives, valuations are no longer attractive due to tight spreads

Neutral on Investment Grade Credit

Negative Sovereign Bonds

#3

Monetary arsenal supportive for bonds; However, markets could anticipate Fed policy shift as fiscal stimulus takes hold

#4

Concerns over COVID-19 variants and Fed monetary policy transition generate higher volatility

Long Volatility

Source: AXA IM as at 24/02/2021

FX Strategy

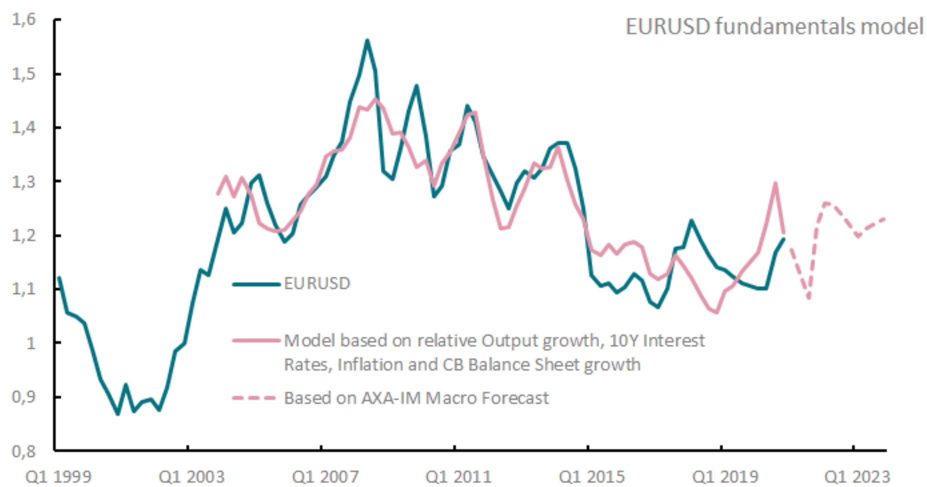
US Dollar enjoys near term tailwinds while reflation trade takes hold

- The net growth differential in favour of the US suggests near-term dollar strength, as FX becomes a proxy for unconventional monetary policy unwind from ultra-low interest rates. Longer term, the structural factors for dollar weaknesses remain in place: the loss of carry advantage; the Fed's commitment to an inflation overshoot; dollar overvaluation not fully unwound, and lack of safe-haven flows amid a global growth rebound.

- But between the euro and the yen, the euro is our preferred funding leg, as it is closer to fair value compared to the more undervalued yen. Plus, Japanese investors might also turn to currency-hedged long-term US assets, where the steep US dollar curve offers better carry. The CAD and NOK have lagged until now, while the AUD and SEK have run a bit ahead of themselves.

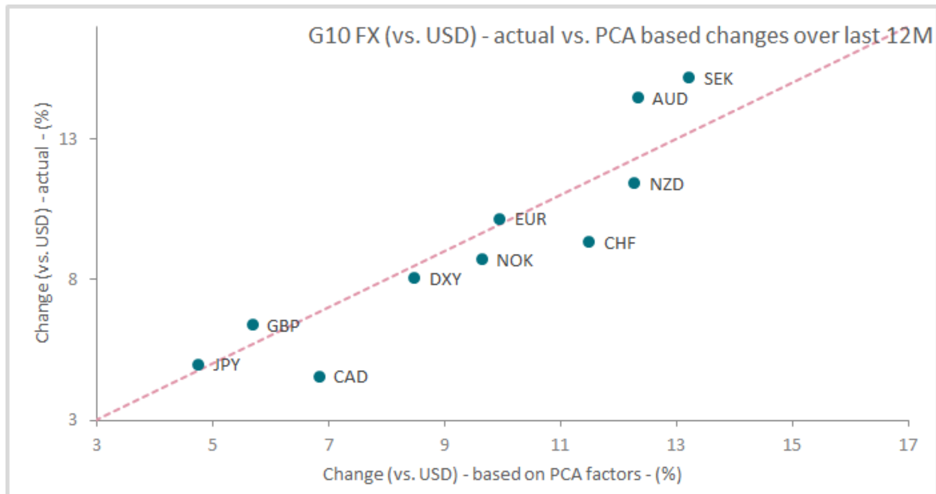
- Sterling is attractive as it remains largely undervalued, while the vaccine rollout continues to point to an earlier reopening of the UK economy than the EU. Plus, as Brexit has occurred, it allows investors to reassess their appetite for sterling exposure, and the BoE has dismissed negative rates, for now.

US Dollar enjoying near term tailwinds



Source: Refinitiv and AXA IM Research, Feb 2021

NOK and CAD lagging other High Beta currencies



Source: Bloomberg and AXA IM Research, Feb 2021

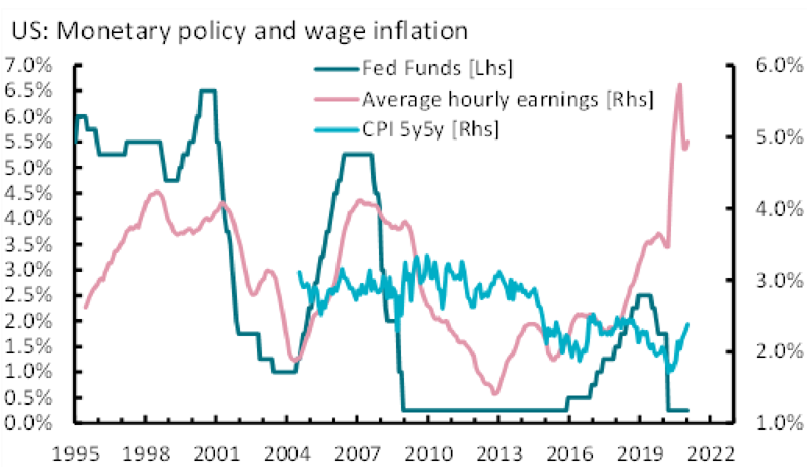
AXA Investment Managers

Rates Strategy

Inflation, monetary policy and inequality

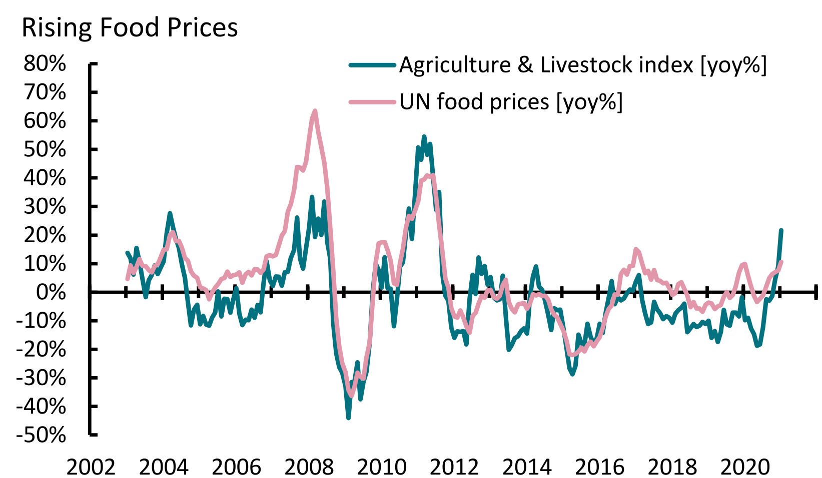
- The US Treasury market has started the year on a weak footing with a 46bp points rise in 10-year yields year-to-date as the economy moves from a disinflationary to inflationary setup. The overall outcome is likely to be a regime of heightened uncertainty, as investors address the disconnect between inflation (rising) and the central banks' agenda (tolerant).
- Two aspects of inflation are worth examining in our view. The first is related to the intrinsic 'unfairness' of inflation, particularly when the inflation source is focused on basics like food and energy. The second important variable in assessing the potential impact of inflation on fixed income valuations is the size of existing monetary accommodation.
- With almost 22% of global bonds still trading at negative yields, the interplay between higher inflation expectations and expectations about tighter monetary policy (perhaps in the form of tapering) might eventually evolve into a self-reinforcing feedback loop. Such a process would almost certainly result in a double whammy for bond holders.

A tolerant Federal Reserve as inflation rises



Source: Bloomberg and AXA IM Research, Feb 2021

Inflation-driven inequality via food prices



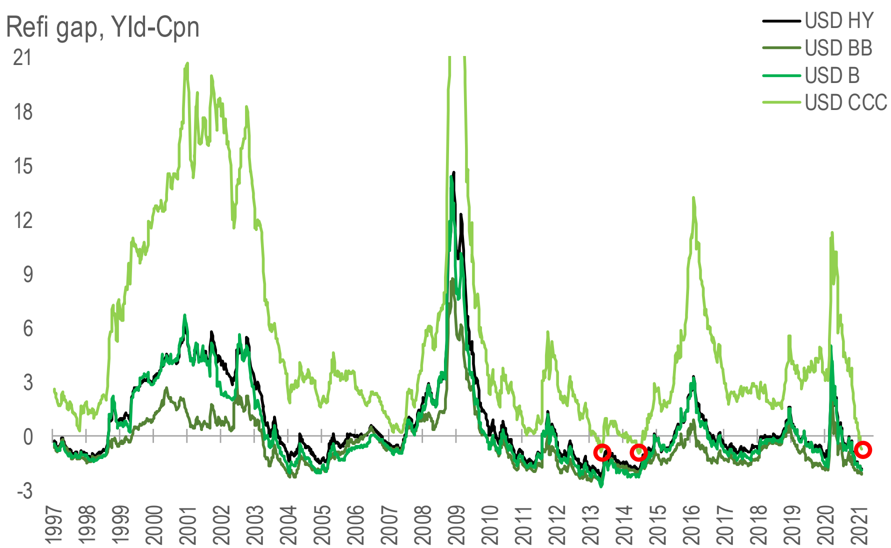
Source: Bloomberg and AXA IM Research, Feb 2021

Credit Strategy

The asymmetry in credit risk premia and the risk from rising real rates

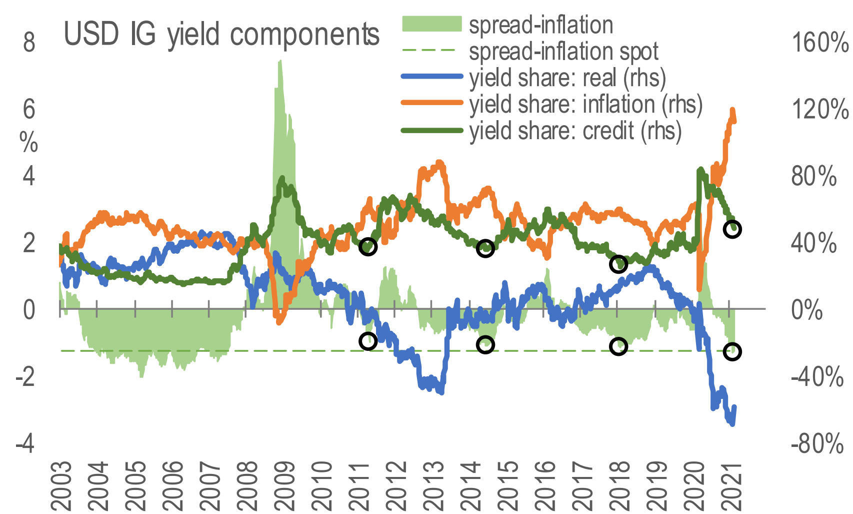
- The profound impact of global excess liquidity on risk premia has inevitably raised concerns about the asymmetry of risk-reward amid risky assets. As a result, the refinancing gap has become negative (yield below coupon) for CCCs too. While this may not foretell a significant spread correction near term, it does highlight that 2021 returns depend on carry income rather than price gains.
- Another case of asymmetry in risk premia is the differential between the credit and inflation components within credit yields. What differs this time, however, is that the low in the spread-inflation differential has been driven by the unprecedented rise in the inflation component rather than a low in the spread component.
- The mirror image of the unprecedented rise in the inflation component within credit yield is the unprecedented collapse in the real rate component. This begs the question of what happens to credit returns when real rates start to rise. Out of the 6 years of negative real rate returns since 2000, 3 were negative for HY but only one of those due to a rate/policy-related risk-off catalyst (2018).

Refinancing gap in USD CCCs at levels seen twice before in 25 years



Source: ICE, Bloomberg and AXA IM Research, Feb 2021

Credit component, normal historically, while real rate & inflation at extremes



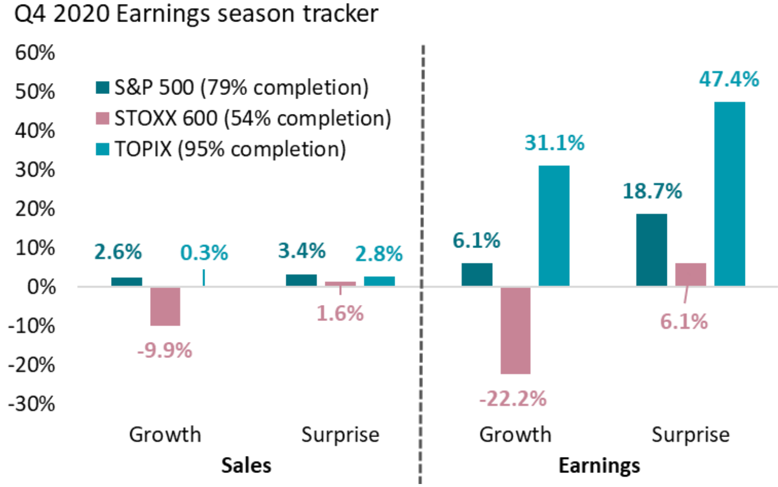
Source: ICE, Bloomberg and AXA IM Research, Feb 2021

Equity strategy

A good month despite a few cloudy days

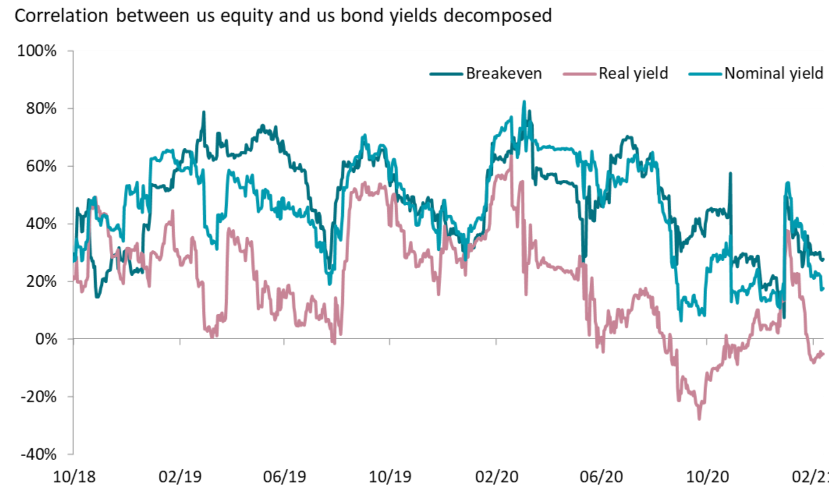
- Moving forward through the season, Q4 2020 earnings sustained an upbeat note, with positive sales and earnings surprises in the US, Eurozone and Japan. Looking ahead, earnings' visibility keeps improving and analyst revisions remain in positive territory. Global earnings consensus expectations improved in line with global growth prospects.
- Recent weeks have raised concerns about the potential impact of rising bond yields on equities. We have studied the reaction of the US equity market, since 1998, to US treasuries components (real yield & breakeven). Two notable results are: breakevens are associated with larger US equity returns, which exhibit a positive correlation with breakevens, while correlation are negative with real rates.
- We stay positive on equities with exposure to emerging markets, green economy, cyclicals and value in both Europe and US. Despite some concerns with the current pandemic situation, we still expect strong economic recovery thanks to the global Covid-19 vaccine rollout and fiscal and monetary support.

Encouraging Q4 2020 season



Source: Bloomberg and AXA IM Research, Feb 2021

Real yield need to be watched



Source: Bloomberg and AXA IM Research, Feb 2021, 3 months rolling regression

Asset allocation stance

Positioning across and within asset classes

Asset Allocation

Key asset classes	Negative	Neutral	Positive
Equities			■
Bonds	■ ▼		
Commodities			■
Cash	■		

Equities

Developed	Negative	Neutral	Positive
Euro area		■	
UK			■ ▲
Switzerland		■	
US		■	
Japan		■	
Emerging & Equity Sectors			
Emerging Markets			■
Green Basket			■
Europe Cyclical/Value			■
US small caps		■	
US Cyclical/Value			■
Global semiconductors			■

Fixed Income

Govies	Negative	Neutral	Positive
Euro core	■ ▼		
Euro periph		■	
UK		■	
US	■ ▼		
Inflation Break-even			
US		■	
Euro		■	
Credit			
Euro IG		■	
US IG		■	
Euro HY		■	
US HY		■	
EM Debt			
EM Bonds HC		■	

Legend Negative | Neutral | Positive **Change** ▲ Upgrade | ▼ Downgrade

Source: AXA IM as at 24/02/2021

Forecasts & Calendar

Macro forecast summary

Forecasts

Real GDP growth (%)	2020	2021*		2022*	
		AXA IM	*Consensus*	AXA IM	*Consensus*
World	**-3.7**	**5.4**		**4.1**	
Advanced economies	**-5.5**	**5.2**		**3.6**	
US	**-3.4**	**6.2**	3.7	**4.5**	
Euro area	**-6.8**	**3.6**	5.3	**3.2**	
Germany	**-5.3**	**2.4**	4.4	**3.1**	
France	**-8.3**	**5.5**	6.7	**3.0**	
Italy	**-8.9**	**4.4**	5.3	**3.2**	
Spain	**-11.0**	**4.5**	6.7	**4.3**	
Japan	**-4.9**	**3.5**	2.5	**2.3**	
UK	**-10.0**	**4.6**	5.7	**7.5**	
Switzerland	**-4.8**	**2.5**	3.7	**3.0**	
Emerging economies	**-2.7**	**5.5**		**4.5**	
Asia	**-1.4**	**7.1**		**5.1**	
China	**2.3**	**8.0**	7.9	**5.5**	
South Korea	**-1.0**	**3.5**	3.2	**3.0**	
Rest of EM Asia	**-6.0**	**6.4**		**4.7**	
LatAm	**-7.3**	**3.6**		**2.8**	
Brazil	**-4.0**	**3.0**	3.2	**2.3**	
Mexico	**-8.3**	**3.2**	3.7	**2.5**	
EM Europe	**-2.5**	**3.1**		**3.6**	
Russia	**-2.8**	**1.8**	3.1	**2.5**	
Poland	**-2.7**	**3.3**	4.2	**4.6**	
Turkey	**1.2**	**4.5**	4.6	**4.6**	
Other EMs	**-3.7**	**3.3**		**4.1**	

Source: Datastream, IMF and AXA IM Macro Research – As of 24 February 2021

* Forecast

Expectations on inflation and central banks

Forecasts

Inflation Forecasts

CPI Inflation (%)	2020	2021*		2022*	
		AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	**0.8**	**1.3**		**1.4**	
US	**1.2**	**2.0**	2.0	**2.2**	
Euro area	**0.3**	**0.8**	0.9	**1.1**	
Japan	**0.0**	**-0.4**	0.0	**0.6**	
UK	**0.9**	**1.8**	1.5	**1.5**	
Switzerland	**-0.7**	**0.0**	0.2	**0.2**	

Source: Datastream, IMF and AXA IM Macro Research – As of 24 February 2021

* Forecast

Central banks' policy: meeting dates and expected changes

Central bank policy
Meeting dates and expected changes (Rates in bp / QE in bn)

		Current	Q1 -21	Q2-21	Q3-21	Q4-21
United States - Fed	Dates	0-0.25	26-27 Jan 16-17 Mar	27-28 Apr 15-16 Jun	27-28 Jul 21-22 Sep	2-3 Nov 14-15 Dec
	Rates		unch (0-0.25)	unch (0-0.25)	unch (0-0.25)	unch (0-0.25)
Euro area - ECB	Dates	-0.50	21 Jan 11 Mar	22 Apr 10 Jun	22 Jul 9 Sep	28 Oct 16 Dec
	Rates		unch (-0.50)	unch (-0.50)	unch (-0.50)	unch (-0.50)
Japan - BoJ	Dates	-0.10	20-21 Jan 18-19 Mar	26-27 Apr 17-18 Jun	15-16 Jul 21-22 Sep	27-28 Nov 16-17 Dec
	Rates		unch (-0.10)	unch (-0.10)	unch (-0.10)	unch (-0.10)
UK - BoE	Dates	0.10	4 Feb 18 Mar	6 May 24 June	5 Aug 23 Sep	4 Nov 16 Dec
	Rates		unch (0.10)	unch (0.10)	unch (0.10)	unch (0.10)

Source: AXA IM Macro Research - As of 24 February 2021

Calendar of 2021 events

2021	Date	Event	Comments
March	Mar	UK	Budget
	11 Mar	ECB Meeting	Unchanged (-0.50)
	16-17 Mar	FOMC Meeting	Unchanged (0-0.25)
	18 Mar	BoE Meeting	Unchanged (0.10)
	18-19 Mar	BoJ meeting	Unchanged (-0.10)
	21 Mar	The Netherlands	General Election
	Late March	China	NPC
April	26-27 Apr	BoJ Meeting	Unchanged (-0.1)
	27-28 Apr	FOMC Meeting	Unchanged (0-0.25)
May	6 May	BoE Meeting	Unchanged (0.1)
	6 May	Scotland	Scottish Parliament Elections
June	10 Jun	ECB Meeting	Unchanged (-0.5)
	15-16 Jun	FOMC Meeting	Unchanged (0-0.25)
	17-18 Jun	BoJ Meeting	Unchanged (-0.1)
	24 Jun	BoE Meeting	Unchanged (0.1)
July	23 Jul	ECB Meeting	Unchanged (-0.5)
	27-28 Jul	FOMC Meeting	Unchanged (0-0.25)
September	9 Sep	ECB Meeting	Unchanged (-0.5)
	21 Sep	Germany	Federal Elections
	21-22 Sep	BoJ Meeting	Unchanged (-0.1)
	21-22 Sep	FOMC Meeting	Unchanged 90-0.25)
	23 Sep	BoE Meeting	Unchanged (0.1)
	30 Sep	Japan	End of term as LDP leader for PM Suga
October	21 Oct	Japan	House of Representatives term ends
	28 Oct	ECB Meeting	Unchanged (-0.5)
November	2-3 Nov	FOMC Meeting	Unchanged (0-0.25)
	4 Nov	BoE Meeting	Unchanged (0.1)
	1-12 Nov	UK/UN	Climate Conference
	27-28 Nov	BoJ Meeting	Unchanged (-0.1)
November 2022	8 Nov	US	Mid Term Elections

Latest publications

Entering the world's second largest bond market

09 February 2021

January Global Macro Monthly & Investment Strategy – The Vs to shape recovery – Vaccine Vs Virus

27 January 2021

How can President Biden tackle Climate Change?

21 January 2021

RCEP: Integrating Asia beyond trade

12 January 2021

December Global Macro Monthly & Investment Strategy – Covid 19: It's behind you… oh no it isn't

17 December 2020

India: Growth returns, but challenges remain

03 December 2020

The emerging market COVID-19 debt surge – no crisis on the horizon, yet

18 November 2020

US Election update: clarity, but not certainty

09 November 2020

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