NATIXIS INVESTMENT MANAGERS

Perspectives

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IN SHORT

- Global growth expectations continue to benefit from reopening prospects
- Inflation expectations are already pricing in high prints over the coming months, but this should prove transitory
- The drivers of the market rally remain in place, suggesting it has further to run

The global picture supports a constructive outlook

News surrounding the pandemic has steadily improved this month, with cases dropping sharply across the US and Europe, and retreating in India. As such, confidence in reopening timetables is increasing, with global growth expectations growing in tandem. More and more US states are lifting Covid-related restrictions and Europe is set to gradually phase out measures over the summer. With growth already booming in the US, questions have arisen about 'peak growth', but we believe growth indicators could remain at very high levels for some time. We also believe this cycle does not resemble others, suggesting previous hypotheses cannot de facto be applied to present conditions.

The big debate remains over inflation, with the latest US CPI print coming in above 4%. Still, most of this jump was due to supply chain bottlenecks and pent-up demand, factors the Federal Reserve has stated it expects to prove "transitory". Moreover, inflation expectations were already high, suggesting these moves are already mostly priced in. Indeed, despite the high print, Treasury yields barely moved and have even retreated since the US CPI figure was released. As such, we believe that markets may not react significantly to inflation fears as we go forward. Also, we expect the Fed to maintain its course, especially given its focus on the labour market and an "inclusive recovery", suggesting we may be past the biggest jump in yields. However, yields could still overshoot, so we remain cautious on sovereigns and favour shorter durations.

We continue to prefer credit, even if already tight spreads and longer duration indices suggest less potential upside from here – though the carry remains attractive compared to sovereigns. High yield should do better as it is less rate-sensitive, but we remain selective. EM hard currency corporate debt also has more room for spread tightening, and therefore potential to absorb higher Treasury yields.

The fundamental drivers of the risk asset rally remain intact, suggesting there is more to run despite the recent pause. Indeed, fiscal and monetary support will remain abundant, while the earnings rebound is set to continue throughout the year. We believe the cyclical rotation should continue as reopening accelerates and we continue to favour more cyclical sectors such as financials and energy. We also believe that European assets should continue to outperform, especially as the growth outlook for the second half of the year should be buoyant. Despite recent challenges, we believe that clarity on whether the summer Olympics are happening or not and improvements in vaccination rates should help Japanese markets, as much of the bad news is now priced in. As such, we favour more value-oriented sectors and continue to look for opportunities to add to equity allocations.

Asset class details

Equities

We maintain our constructive view on equity markets, which should continue to be supported by improving growth prospects thanks to vaccinations and reopening, ongoing fiscal and monetary support, and strong rebounds in earnings growth.

As such, we expect the cyclical rotation to continue over the coming months, as the reopening trade is not yet reflected across all sectors, despite recent strong performances. We therefore continue to favour cyclical sectors such as financials, energy, and materials.

European stocks should also benefit from the more value-tilted construction of their indices, as growth should be very strong in the second half of the year as the EU Recovery Fund disbursements begin. We expect Japan to perform better as uncertainty surrounding the Olympics clears and vaccinations accelerate after recent clusters.

While valuations are high, they are not extreme, especially given high expectations for earnings growth over the coming quarters. Still, we are monitoring sentiment and positioning as we do not want to fall into complacency. But given high levels of cash in the market and ongoing worries, we do not believe investors are there yet.

Fixed Income

Despite high inflation prints and a sharp rise in inflation expectations, Treasury yields have remained steady, and even retreated further to ~20 basis points below their February highs.

Given how much is now already priced into inflation expectations, we believe we have now likely seen the majority of any reactions in yields. Moreover, the Fed is likely to remain on its stated course, only removing support gradually, with tapering likely to begin in 2022 and rate hikes the following year.

Still, some further upside is possible and we therefore remain more prudent on sovereign debt. In particular, given ongoing discussions on the PEPP QE program in the European Central Bank and strong growth prospects for Europe in the coming quarters, European yields could remain on upward trajectories.

The longer duration of IG indices and the very tight spreads suggest less room to absorb higher rates than in HY, though we remain selective given lingering default risks. We continue to see opportunities in hard currency emerging market corporate debt, where the carry is attractive and there is further room for spread compression.

Currencies

With risk-on sentiment, yields stable and improving data from outside the US, the dollar could remain under pressure, though stronger growth and earnings, and higher carry should eventually limit the downside. As such, we expect broad range-trading against major currencies, though some EM and commodity-linked currencies should benefit.

Commodities

With reopening prospects improving, oil prices should move higher again as OPEC+ maintains supply cuts. However, the balance is fragile and the overall abundant supply is likely to limit appreciation potential at some point.

We expect demand for gold to improve with the reopening of EM economies leading to better physical demand, along with low real yields, and high medium-term inflation expectations.

Alternatives

Alternatives continue to provide diversification and re-correlation opportunities. We believe that real assets can also help provide income in a world where interest rates will remain lower for longer.

Asset Classes	Negative	Neutral	Positive
Equities			●
Fixed Income		●	
Equities			
US		●	
Europe			●
Japan			●
Asia ex Japan			●
Emerging Markets		●	
Asia		●	
Latam		●	
Europe		●	
Fixed Income			
Sovereign US	●		
Sovereign EUR	●		
IG US		●	
IG EUR		●	
HY US		●	
HY EUR		●	
EM Hard Ccy		●	
EM Local Ccy		●	
Commodities			
Oil		●	
Gold		●	
Base Metals		●	

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