ZURICH

Weekly Macro & Markets View

Highlights and View

- **Retail investors collectively take on the hedge funds, forcing outsized gains in certain US stocks**

  While small investors have shown their power to take out the shorts and profit in the market, the gamification of investing leaves individuals at risk once the frenzy ebbs and fundamentals come into focus.

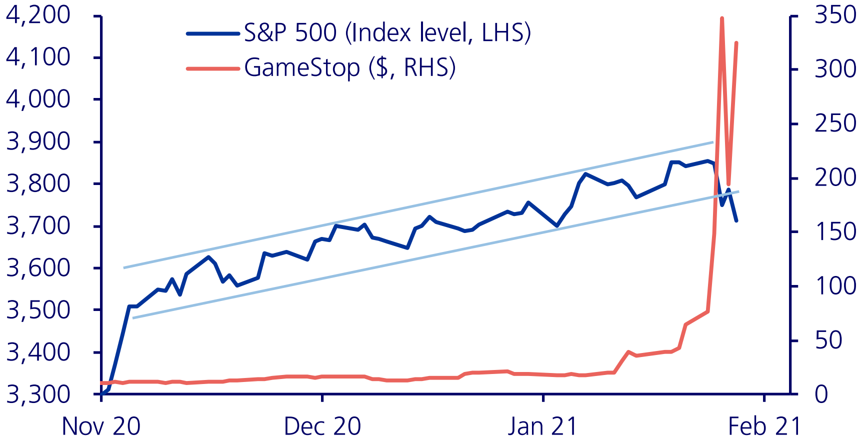
- **Fed Chair Powell underscores that any discussion on potential tapering is premature**

  The Fed's ongoing commitment to very loose monetary policy is reassuring and is expected to provide support for financial markets in the coming months.

- **Q4 GDP data for France, Germany and Spain were not as bad as had been feared**

  The data indicate that economies are becoming more resilient to lockdowns. However, the recent extension of lockdown measures still suggests that Q1 Eurozone growth will be negative.

The power of the masses



Source: Bloomberg

In a remarkable week, retail investors challenged institutional short positions in some US stocks to force a 'short-squeeze' that resulted in some massive gains. The struggling gaming company GameStop was one of several stocks at the centre of activity, surging 400%. A combination of high savings rates and free trading platforms, along with a desire to participate in the liquidity fuelled bull market, has encouraged small investors globally to get invested over the past year. The large technology stocks in the US and Asia have been prime beneficiaries. Recently, however, social media has also been used to not only identify opportunities, but harness herd impact. Call options have surged, with investors maximising their impact to force prices higher of companies that have been shorted by hedge funds. Regulators will no doubt investigate the thorny issue of collusion, though actions are likely to be limited.

More generally, equites sold off meaningfully last week with the S&P 500 breaking below its remarkably smooth uptrend. While stocks had become overbought and in need of a healthy pull-back, last week also saw Fed Chair Powell underscore the commitment to further policy support. Consequently, we suspect that in the weeks ahead abundant liquidity will keep the buy-on-dip mentality alive and the bull market intact.

Credit: An oasis of calm as retail doesn't drive credit markets

While stock markets experienced a tumultuous week, credit markets were remarkably resilient, albeit softer at the margin. Most telling, Friday saw credit spreads flat in the US and tighter in Europe despite the S&P 500 and the EUROSTOXX indices declining by nearly 2%. Even the high yield market was far more resilient than is typical amid sharp equity drawdowns. Primary markets also remained robust, particularly in the US where high yield had a record January and supply was over two times its normal pace. Inflows were also solid, particularly in US investment grade, although high yield continued the recent trend of losing flows to leverage loan markets. We believe that a key reason behind the resilience of credit markets was the inability of retail investors to drive single name price action in credit markets due to numerous constraints and restrictions. In our view, the performance gap that has opened up between equities and credit seems unsustainable in the long term and should narrow once broader spill overs from retail activity in stock markets ease somewhat.

US: Consumers are increasingly looking through the current crisis

With COVID-19 still weighing on economic activity and stock markets suffering their worst week since October it is reassuring to see that most of last week's economic data are indicative of a stabilisation, particularly in the consumer sector. The Conference Board's consumer confidence survey ticked up in January. While households see a deterioration in the current situation, expectations of future conditions have improved markedly. In combination with the increase in personal income observed in December, which was buoyed by government support measures, this provides a basis for a solid rebound in consumer spending once the economy fully re-opens. Capital goods orders also point to an acceleration in business activity, increasing by 0.6% in December, following the 1% rise in November. According to the first estimate, GDP growth slowed down to 4% in the final quarter of 2020 (annualised QoQ rate). Overall, annual GDP fell by 3.5% last year compared to 2019. Although this is still the worst drop in the post-war period, it is far better than initial consensus expectations.

Eurozone: Q4 GDP better than expected, inflation spikes in January

National Q4 GDP reports released so far were better than expected with GDP declining -1.3% QoQ in France (compared to consensus expectation of -4.0% QoQ), and GDP actually increasing +0.1% QoQ and +0.4% QoQ in Germany and Spain respectively. The data suggest some resilience to the November/December lockdown measures. Businesses and households have been able to adapt, and a lot of government support measures are also now in place. Nevertheless, the extension of lockdown measures well into Q1 suggests a double-dip recession is still likely, though from Q2 this year onwards we expect a strong rebound in the economy, provided recent difficulties in vaccine distribution can be overcome. Meanwhile, inflation data for Germany showed a much bigger than expected spike in January to 1.6% from -0.7% in December on the EU harmonised measure, due to base effects from the expiration of a temporary VAT cut introduced in H2 2020 as well as other factors. A large jump in Eurozone inflation should also be expected when the data are released this week.

Italy: PM Conte resigns, negotiations for a new government continue

In Italy, political events continued to dominate the headlines. Prime Minister Giuseppe Conte resigned last week despite surviving the confidence votes in parliament only a short while ago. As his government would have been facing fresh tests in the weeks ahead and Matteo Renzi's Italia Viva party was likely to vote against him rather than simply abstaining, as they had done previously, Prime Minister Conte chose to resign ahead of this potential outcome.

While the situation remains fluid, the latest developments still suggest that the most likely outcome is the formation of a new coalition government rather than fresh elections being called, as negotiations between the various political parties continue. Indeed, Italian 10yr government bond yields fell 11bps last week and spreads between Italian and German 10yr bonds also tightened as investors started to price in this outcome.

Taiwan: A gold medal in the category 'Growth 2020'

Taiwan's economy expanded 3% last year, showing the strongest growth in the region, even outperforming Vietnam (+2.9%) and Mainland China (+2.3%). Taiwan's real GDP growth rate of nearly 5% YoY in Q4 came in stronger than expected, driven by surging exports and a recovery in investments, while private consumption continued to contract. The Manufacturing PMI for January also climbed to an 11-year high of 60.2. Taiwan's superb economic performance last year was supported by strong exports and early containment measures against the COVID-19 pandemic, which prevented a lockdown. Global demand for electronic products, computers, LCD panels, and integrated circuits as well as auto parts, machinery equipment, metal products and chemicals remained strong into year-end. Export orders surged 38.3% and industrial production 9.9% YoY in December. The German minister for economic affairs recently asked Taiwan to increase its chip supply to help fill severe bottlenecks in the German auto industry, as car production could not meet strong demand due to a shortage of IC chips.

What to Watch

- In the Eurozone, Q4 GDP data for the region as a whole are likely to confirm some resilience despite lockdown measures, while inflation is expected to have spiked higher in January.
- In the US, the ISM surveys will show whether business activity slowed down at the beginning of the year while labour market data will give insights into the current employment situation.
- In APAC, we expect the central banks of Australia, India and Thailand to remain on hold. In addition, we will watch RBA Governor Lowe's parliamentary testimony. India's government will present the Union Budget for FY22. Japan will release the household survey for December. Indonesia will report GDP for Q4. Taiwan, South Korea, Thailand and the Philippines will release CPI statistics for January. Several important economic data reports will be released in Australia, while Hong Kong's December retail sales will be published as well.

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