BARINGS INVESTMENT INSTITUTE

22 January 2021

THE WEEK AHEAD

Cautious Optimism or Cold Realism?

WATCH LIST

Date		Period	Consensus		Previous
U.S.					
Mon 1/25	FHFA House Price Index	Nov	0.6% M/M	▼	1.5% M/M
Tue 1/26	Conference Board Consumer Confidence	Jan	89.0	▲	88.6
Wed 1/27	FOMC Meeting	Jan	0%-0.25%	-	0%-0.25%
Thu 1/28	GDP, annualized (Advance Estimate)	4Q20	4.6% Q/Q	▼	33.4% Q/Q
Thu 1/28	New Home Sales	Dec	850K	▲	841K
Fri 1/29	Personal Income	Dec	0.1% M/M	▲	-1.1% M/M
Fri 1/29	Personal Spending	Dec	-0.5% M/M	▼	-0.4% M/M
Fri 1/29	PCE Deflator	Dec	0.3% M/M	▲	0.0% M/M
Fri 1/29	Pending Home Sales	Dec	-1.0% M/M	▲	-2.6% M/M
Fri 1/29	Employment Cost Index	4Q20	0.5% Q/Q	-	0.5% Q/Q
Europe					
Tue 1/26	U.K. Unemployment Rate	Nov	5.2%	▲	4.9%
Thu 1/28	Germany Consumer Price Index (Preliminary Estimate)	Jan	0.6% M/M	▲	0.5% M/M
Fri 1/29	France GDP (First Estimate)	4Q20	-4.0% Q/Q	▼	18.7% Q/Q
Fri 1/29	Germany GDP (First Estimate)	4Q20	0.0% Q/Q	▼	8.5% Q/Q
Fri 1/29	Spain GDP (First Estimate)	4Q20	-1.5% Q/Q	▼	16.4% Q/Q
Asia Pacific					
Tue 1/26	South Korea GDP (Preliminary Estimate)	4Q20	1.3% Q/Q	▼	2.1% Q/Q
Wed 1/27	China Industrial Profits	Dec			15.5% Y/Y
Thu 1/28	Japan Retail Sales	Dec	-0.7% M/M	▲	-2.0% M/M
Fri 1/29	Japan Unemployment Rate	Dec	3.0%	▲	2.9%
Fri 1/29	Japan Industrial Production (Preliminary Estimate)	Dec	-1.5% M/M	▼	-0.5% M/M

Arrows indicate consensus forecast compared to the previous period. Local dates of release.

U.S.

- **The new administration's first full week will provide clarity** on Cabinet approvals and how well the divided Congress intends to work together—giving a sense of what can feasibly be expected to pass this term.
- **4Q GDP is set to expand**, but at a slower pace than the surge in 3Q. Q4 GDP should remain below 2019-levels as many sectors remain in pain during the early stages of vaccine deployment.

Europe

- **4Q GDP for France, Germany and Spain will show second wave and restriction damage.** Declines should range between below -1% for Germany to below -3% for France and Spain.
- **Germany CPI preliminary January print is set to decline further** from the historical low of -0.3%. Technical drivers (base effects, oil prices) will likely invert and push inflation back into positive territory.

Asia Pacific

- **Japan retail sales and industrial production** for December will give a better picture of how rising cases and restrictions are weighing on both the supply and demand recovery.

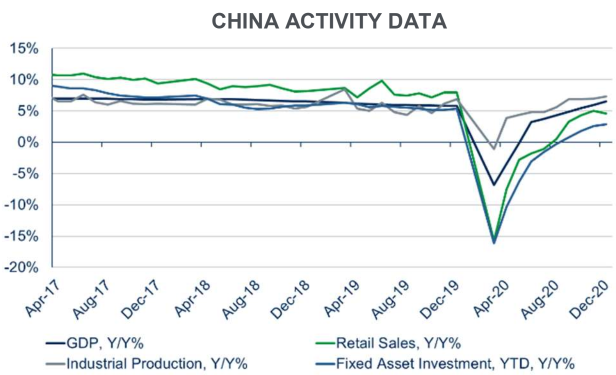
Institute's Central Scenario

China's Q4 GDP data supports our baseline scenario that it leads the global recovery. However, as domestic demand continues to lag within China, we watch to see if the PBOC will react. U.S. housing data supports our baseline that strong demand and low interest rates will keep housing as a strong source in the 2021 recovery. Meanwhile in Europe, the ever-changing Italian political climate proves that ECB policies are supportive and sufficient for the time being. Please see our Monthly Macro Dashboard.

IN REVIEW

China Supply and Demand Diverge

China ended 2020 stronger than expected, though the gap between the supply and demand recovery widened. China's 4Q20 GDP beat expectations, rising 6.5% Y/Y—an acceleration from 4.9% Y/Y growth in Q3. This leaves China's GDP up 2.3% for the year, as the economy continues to lead the global recovery, consistent with our baseline scenario.



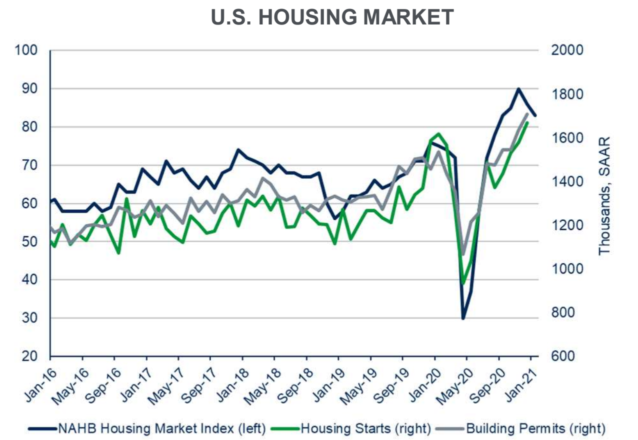
Source: Bloomberg. As of January 21, 2021.

Activity data suggests continued improvement in the supply-side of the economy amid an acceleration in industrial production, while improvement in domestic demand undershot expectations as retail sales growth slowed. Within December's retail sales data, consumer staples improved, but non-essential goods and auto sales growth decelerated. Rising COVID cases in China have led to greater restrictions and warrant monitoring, though this shouldn't upend the recovery there. Growth is expected to continue into 1Q21, particularly given a low base-effect, but a balanced recovery in China has yet to be achieved.

U.S. Housing Strong, but Less Affordable

The U.S. housing market recovery remains strong, but limited supply and rising input prices will limit growth in 2021. Housing starts and permits beat expectations in December, both rising to the fastest pace since 2006 due to robust demand, record-low mortgage rates, Millennial entry, a better labor market for higher-income earners, and moves to single-family and suburbs amid the remote school and work-from-home environment. 2020 saw the most single-family construction since 2005, despite pandemic-induced lockdowns and rising permits—a leading indicator—suggest demand remains robust in 2021.

Demand remains strong, but supply is extremely tight due to underproduction over the last decade. Moreover, rising input prices, such as for lumber, are pushing home prices higher.



Source: Bloomberg. As of January 21, 2021.

Declining affordability and rising construction costs likely weighed on the NAHB housing market index, which fell from record-highs in January, and could limit growth this year.

Italian Politics Shouldn't Upend the EU Recovery

Last week's Italian government crisis ended with little trouble. Prime Minister Giuseppe Conte obtained a confidence vote from parliament, ending the risk of early elections and helping calm bond markets, which were stable given the transience of Italian governments and the ECB QE firewall. However, less certain is the government's ability to use the EU Recovery Fund to relaunch the economy. With a limited majority in parliament, Conte's destiny depends on every MP's goodwill, which is rarely free in politics. This crisis has likely diminished strong action to use EU funds to tackle Italy's deep-seated structural problems (and vested interests). As the laggard in major EU economies, Italy holds the key for the success of the EU-funded relaunch of the EU economy, though the EU Commission vetting process could ensure effective spending. To be continued.

Earnings Update

While only 10% have reported, Q4 earnings are exceeding expectations as the estimated S&P 500 earnings stands up by around 5%. Mostly financial firms have reported so far and the sector's boost appears to be due to revenue being increased by equities trading, coinciding with the rise of retail trading, as well as credit loss reserves being cut in 5 of the biggest banks by $6 billion. Further cross-sector previews highlighted upside risk from outsized estimate cuts in Q2 and Q3, a better macro backdrop and elevated operating leverage. However, worsening virus trends and delayed stimulus in Q4 may lead to less companies beating expectations relative to history.

KEY FINANCIAL INDICATORS

Rates	Yield	1 W Change	1M Change	3M Change	6M Change	12M Change	YTD Change
Fed Funds	0.25%	0 bps	0 bps	0 bps	0 bps	-150 bps	0 bps
U.S. SOFR	0.06%	-2 bps	-3 bps	-2 bps	-6 bps	-148 bps	-1 bps
3 Month USD Libor	0.22%	-2 bps	-1 bps	1 bps	-4 bps	-160 bps	-2 bps
3 Month Euribor	-0.54%	0 bps	-1 bps	-4 bps	-10 bps	-15 bps	0 bps
3 Month U.S. T-Bill	0.08%	-2 bps	-1 bps	-2 bps	-4 bps	-148 bps	0 bps
2-Year U.S. Treasury	0.12%	-2 bps	1 bps	-3 bps	-3 bps	-145 bps	0 bps
10-Year U.S. Treasury	1.09%	0 bps	14 bps	30 bps	48 bps	-74 bps	18 bps
10-Year German Bund	-0.53%	-2 bps	4 bps	7 bps	-6 bps	-32 bps	4 bps
10-Year U.K. Gilt	0.30%	-2 bps	6 bps	11 bps	16 bps	-37 bps	10 bps
10-Year JGB	0.03%	1 bps	3 bps	1 bps	2 bps	4 bps	1 bps
Fixed Income	**Yield**	**OAS**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
Barclays Capital U.S. Government-Treasury	0.66%	N/A	0.0%	-0.6%	-1.0%	6.5%	-1.0%
Barclays Capital U.S. TIPS	0.79%	N/A	0.5%	0.6%	1.9%	10.5%	0.1%
Barclays Capital U.S. Aggregate	1.17%	35	0.1%	-0.3%	0.3%	6.3%	-0.6%
Barclays Capital Global Aggregate	0.87%	34	-0.1%	-0.3%	2.0%	8.6%	-0.7%
Barclays Capital U.S. ABS	0.43%	29	0.1%	0.1%	0.4%	4.2%	0.1%
Barclays Capital U.S. MBS	1.20%	20	0.1%	0.1%	0.4%	3.6%	0.0%
Barclays Capital U.S. Corporate Investment Grade	1.83%	93	0.2%	-0.2%	1.9%	8.1%	-0.9%
BAML Euro Corporate Investment Grade	0.22%	90	0.0%	0.1%	1.2%	2.3%	2.7%
Barclays Capital U.S. Corporate High Yield	4.11%	345	0.5%	1.2%	5.5%	7.0%	0.6%
BAML European Currency High Yield Non-Financial	2.86%	346	0.2%	0.7%	4.9%	3.0%	3.5%
CS U.S. Leveraged Loans	4.75%	450	0.3%	1.7%	4.4%	3.4%	4.2%
CS Western European Leveraged Loans Non-USD	4.41%	434	0.3%	1.0%	3.6%	3.2%	3.7%
JPM CEMBI Broad Diversified	4.15%	324	0.2%	0.0%	3.5%	5.6%	6.9%
JPM EMBI Global Diversified	4.77%	358	0.1%	-1.1%	3.5%	2.9%	3.8%
JPM GBI-EM Global Diversified	4.31%	N/A	0.4%	-0.7%	7.0%	2.5%	2.2%
Equities	**Price**	**Div Yield**	**1W Return**	**1M Return**	**3M Return**	**12M Return**	**YTD Return**
S&P 500	3,851.85	1.47%	1.1%	4.0%	12.3%	17.8%	2.6%
Euro STOXX 600 (Local)	410.84	2.05%	0.4%	3.8%	12.4%	-3.1%	3.0%
U.K. FTSE 100 (Local)	6,740.39	3.51%	-0.1%	3.2%	14.5%	-11.9%	4.3%
Japan Nikkei 225 (Local)	28,523.26	2.22%	0.2%	6.6%	21.0%	18.4%	3.9%
China Shanghai Composite (Local)	3,583.09	1.98%	-0.4%	5.5%	7.7%	15.7%	3.2%
MSCI AC World (Local)	668.44	1.76%	1.1%	4.6%	14.7%	16.1%	19.0%
MSCI Emerging Markets (Local)	1,400.97	1.67%	2.7%	10.8%	21.1%	27.9%	30.0%
Commodities/Currencies	**Price**	**1W Change**	**1M Change**	**3M Change**	**6M Change**	**12M Change**	**YTD Change**
S&P GS Commodity Index	433.66	0.1%	6.3%	18.9%	28.6%	1.6%	5.9%
WTI Crude ($/bbl)	53.24	0.6%	8.6%	28.7%	30.4%	-9.1%	10.1%
Copper ($/lb)	3.65	0.8%	0.5%	16.0%	25.8%	28.0%	3.8%
Gold ($/oz)	1,856.60	-0.1%	-1.2%	-2.2%	2.3%	19.2%	-1.6%
U.S. Dollar Index	90.48	0.1%	0.5%	-2.8%	-5.6%	-7.3%	0.6%
Euro (USD/EUR)	1.21	-0.5%	-1.1%	2.3%	5.8%	9.2%	-1.1%
British Pound (USD/GBP)	1.36	0.0%	1.1%	5.2%	7.8%	4.9%	-0.3%
Japanese Yen (Yen/USD)	103.57	-0.4%	0.2%	-1.9%	-3.4%	-6.0%	0.3%
Chinese Yuan (CNY/USD)	6.47	0.0%	-1.1%	-3.2%	-7.5%	-5.7%	-1.1%

Source: FactSet and Bloomberg. As of January 20, 2021.

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*As of September 30, 2020
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