WEEKLY MARKET RECAP

1 March 2021

Will oil prices remain demand-driven ?

- The vaccine campaign has been a game-changer for oil price.
- Oil price trends are driven by demand, while supply remains depressed.
- On 4 March, OPEC and its allies are expected to reconfirm the production cuts.

CMB
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Fig. 1

After the Covid vaccination campaigns announcement, the oil price rose again due to increased demand...

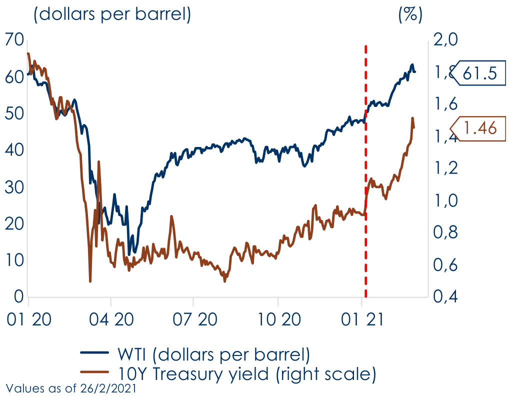
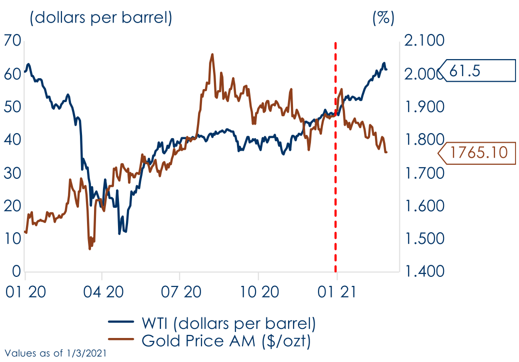


Fig. 2

... and reshaped expectations of economic growth



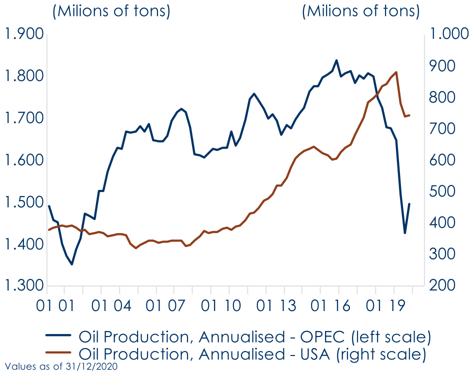
As freezing temperatures in Texas paralyzed mining operations and boosted fossil fuel prices, oil prices rose above $60 per barrel to a new high since January 2020. This recent acceleration is part of a medium-term uptrend, triggered in Q4 2020 by a faster-than-expected economic recovery (and thus rising demand) as vaccines will be rolled out against a still subdued oil supply.

The vaccination rollout was a real *game-changer* for the oil price, which stopped being driven by the infections number and concerns about new restrictive measures. Consequently, the oil price is anticipating the economic recovery acceleration. The progress made in the vaccination campaign, albeit at different speeds between countries, is reducing the likelihood of widespread lock-downs worldwide. In addition, oil demand has been supported not only by Chinese growth, but also by international trade - whose growth rate returned to pre-pandemic levels in November - and the manufacturing sector resilience (with manufacturing PMIs of the major countries above 50). Indeed, the manufacturing has been able to adapt to the pandemic and circumvent recent containment measures.

Supply, on the other hand, has not adapted so quickly. In 2020, oil supply followed dramatic fluctuations in demand. Following the oil price collapse in 2020 March, due to the breakdown in OPEC negotiations and a major rift between Russia and Saudi Arabia, OPEC+ decided in April to cut production by almost 10 mb/d between April and June, and then gradually increased it by 2 mb/d during the summer. In December, OPEC+ agreed to a further production increase of 500,000 b/d, about one million b/d less than in the original agreement, as the global economic outlook worsened again after the second wave in infections. In January, Saudi Arabia unilaterally agreed to cut its production by 1 mb/d in February and March, whereas Russia and Kazakhstan modestly increased their production to meet seasonal needs. The next OPEC meeting will be held on 4 March. However, a reconfirmation of the previously decided cutting strategy is highly likely.

US *shale-oil* production also remained depressed and fell sharply during 2020. The 2021 outlook appears to be undermined by severe investment cuts, penalized by the need to consolidate surviving companies' balance sheets. In addition, the US administration change will play an important roll. Newly elected President Biden has enacted a series of measures that do not play in favor of fossil fuels and will make the recovery of the shale-oil mining industry difficult.
Consequently, we expect this supply-demand imbalance to persist in the coming months and that oil prices could rise further in the rest of

Fig. 3
Supply has not adapted as quickly as demand and remains at an all-time low



Values as of 31/12/2020

2021 as restrictions are lifted and economic activity accelerates.

The **depressed oil supply during the pandemic poses a downside risk to oil prices,** which could return to the market relatively quickly once the economic recovery of some OPEC+ members and robust US producers becomes well established. **The biggest short-term downside risk to oil prices comes from a potential new nuclear deal with Iran** (the deal could inject 2 mb/d into the market in a short period of time).

WEEKLY MARKET RECAP

NAME	LEVEL		Δ WEEK
MSCI World AC	2 726,91	▼	-2,8%
S&P 500	3 811,15	▼	-2,4%
NASDAQ Composite	13 192,35	▼	-4,9%
SX5E	3 636,44	▼	-2,1%
DAX	13 786,29	▼	-1,5%
CAC 40	5 703,22	▼	-1,2%
FTSEMIB	22 848,58	▼	-1,2%
IBEX 35	8 225,00	▲	0,9%
FTSE 100	6 483,43	▼	-1,9%
MSCI Emerging	1 339,26	▼	-6,3%
CSI 300	5 625,92	▼	-7,6%

Strategic View

Figures on vaccine effectiveness triggered a new risk-on phase. The forward-looking components of the key leading indicators accelerated, the stock markets reacted with a reduction in risk premiums, a marked increase in prices and sector rotation.

EQUITY MARKETS

All thanks to the "reflation trade"? Large investor rotation between bonds and equities.

Equity markets were negative this week with the European SXXE index at -1,98%, driven by positive re-openings expectations in Travel & Leisure sector +2,39% (Lufthansa +10,85%, Airbus +4,11%) and driven by value sectors such as Insurance +2,27%, Energy +2,01% (Tenaris 19,02%, Technip +12,72%, Total +3,86%, ENI +3,08%) and Banks +0.81% (BNP +1,97%); conversely there was selling in Technology -4,84% (Adyen -13,34%). Given the generalized steepening of yield curves and the associated threat to equity markets, with valuations at record highs, positioning on sectors whose performance is negatively correlated to rising interest rates can become strategic: the EuroStoxx Banks index gained 1,43% over the week; the energy and commodities sectors also benefited from reflation; the EuroStoxx Oil&Gas index outperformed as well, rising almost 2,01% on the back of rising oil prices. Brent and WTI close to $66 and $63 per barrel, at the highest levels since January 2020, thanks to a series of events that accelerated the rally triggered by the discovery of Covid-19 vaccines, Saudi Arabia's unilateral production cut and the American freeze. Appointment postponed to OPEC+ meeting in March! Overall, investors seem to be in "holding mood" as they wait to see when the generalized rise in bond yields, which have reached new highs since February 2020, will stop .Last week, in his speech to Congress, Jerome Powell reaffirmed the Fed's full support for the US economy, still fragile and far from achieving full employment, removing any doubts about a possible rise in interest rates. The VIX index rose in recent days, although still below 30, while the futures curve has not inverted, indicating that traders do not expect a sell-off in the short term. Similar story overseas, the S&P500 down 2,49% and the Nasdaq100 down 4,49%.

NAME	LEVEL		Δ WEEK
Gold	1 734	▼	-2,8%
Silver	26,67	▼	-2,3%
WTI	61,50	▲	3,8%
Brent	64,42	▲	3,7%

NAME	LEVEL		Δ WEEK
VIX (S&P 500)	27,95%	▲	26,8%
V2X (SX5E)	26,86%	▲	31,1%

COMMODITIES AND VOLATILITY

The Commodity prices are surging following the increase in oil prices. Indeed, the Bloomberg Commodity Spot Index, that tracks the movements of 23 different commodities, reaches the highest level since March 2013. Gains have been sustained by the copper price (leading indicator of global demand), that has surged above 9000 $/tn for the first time since the last 9 years, and oil whereas coffee and sugar increased slightly lower.

EIA weekly data on oil inventories confirm the difficulties of Texan facilities to refine the crude oil due to the weather conditions. Indeed, inventories have increased by 1,3 billion of barrels instead of a contraction of 6,7 million of barrels expected by the market; likewise, gasoline inventories increased by 12 000 barrels despite a decrease of 3,5 million of barrels was expected.

GOVERNMENT BOND MARKETS

NAME	LEVEL		Δ WEEK
US 10-year Yield	1,40%	▲	6,9 bp
GER 10-year Yield	-0,26%	▲	4,5 bp
FRA 10-year Yield	-0,01%	▲	4,7 bp
ITA 10-year Yield	0,76%	▲	13,8 bp

Strategic View

US Government. Treasury yields showed a modest upward trend, driven by the reset of the economic growth expectations and increased fiscal stimulus. Economic normalization should put some pressure on long rates, which will however only see modest increases as they are manipulated by the Fed. We express a neutral view.
EU Government. European government bonds showed a decoupling from US bonds and a downward trend in the wake of expectations of further monetary easing by the ECB in October, justified by negative inflation and a weak economic outlook.

Despite dovish comments from central banks, the global bond market sell-off accelerated sharply, as investors reassessed the global inflation outlook and the related monetary policy. Likewise, the market anticipated the timing of the first rate-hikes across G10, in many cases directly challenging the forward guidance of central banks. In the US, the 10-year tested the 1,60% threshold, while the curve spreads (2-10 years and 5-30 years) are at their widest since 2016. The sell-off in US government bonds spilled over to the other side of the Atlantic: the beta of 10-year Bunds against USTs rose to 0,73 from 0,69 of the previous two weeks and 0,42 in January. Several ECB members spoke with small impact on the markets last week, stating that the Bank is "closely monitoring" long-term rates. President Lagarde was the first on Monday in her speech to the European Parliament, but with little following from other members until Thursday, when both Isabel Schnable and Philip Lane reiterated that point. Lane gave a detailed speech, going beyond reference to "real" or "nominal" rates, in order to focus on the relevance of OIS rates and (GDP-weighted) sovereign yields. The next central bank meetings are approaching. The ECB Governing Council will meet on 11th March (and publish its new projections) and the FOMC on 17th March. The Fed will be forced to acknowledge that the recovery is robust, which should support a flattening trend in the 5s30s, while, the ECB will have to justify why it believes the economy can tolerate tighter financing conditions, given the risks to its inflation forecasts through 2023.

CORPORATE BOND MARKETS

NAME	LEVEL YTW		Δ WEEK
USD Invest. Grade	2,05%	▼	-0,5%
EUR Invest. Grade	0,39%	▼	-0,4%
USD High Yield	4,25%	▼	-0,6%
EUR High Yield	3,32%	▼	-0,4%
Emerging Local ccy	3,44%	▼	-1,3%
Emerging Hard ccy	3,41%	▼	-1,0%

NAME	LEVEL		Δ WEEK
Itraxx Main	51,27	▲	3,8 bp
Itraxx Xover	265,426	▲	19,2 bp
Itraxx Sub Fin.	117,72	▲	8,6 bp
CDX North Am. IG	55,873	▲	4,3 bp
CDX North Am. HY	310,50	▲	15,1 bp

Strategic View

IG Corporate. Monetary policy support through direct purchases and forward guidance on "low rates for a long time" justify compressed spread levels. During the year, the improving economic cycle will further bolster fundamentals. We maintain a neutral view.
HY Corporate. Positive outlook but renewed volatility phases could provide buying opportunities. Low default rates with a peak in Q1, but still lower than previous cycles. Market support due to positive technical factors and the search for yield. We maintain a neutral view.

Last week was rather difficult for credit markets: real rates movement continued their upward trend despite the partial monetary authorities' reassurances on the expansionary policies continuation both in terms of unchanging monetary policy rates and direct purchase programs. The spreads widening weighed on the total return, which were already substantially negative due to the term structure steepening and the rates increase, especially in the medium-long segment. Short-term issues, on the other hand, remained rather anchored thanks to the forward guidance
Both IG and HY credit markets indexes closed negative (respectively -0,40% and -0,45% in Europe and -0,5% and -0,6% in the US).
HY CDS indices posted +19bp in Europe and +15bp. in the United States. The IG indices increase was more moderate with CDX IG and Itraxx Eur Main increasing by 4bp.
On the primary market, the negative tone contributed to the cooling of the activity, even if the rise in rates inevitably led to an acceleration in funding programs for many issuers.

EXCHANGE RATES

NAME	LEVEL		Δ WEEK
Dollar Index	90,88	▲	0,6%
EUR/USD	1,2075	▼	-0,4%
GBP/USD	1,3933	▼	-0,6%
EUR/GBP	0,8670	▲	0,2%
EUR/CHF	1,0971	▲	1,0%
USD/JPY	106,57	▲	1,1%

During the week, real rates in the US kept rising rapidly: on Thursday, the US 10y soared close to 20 bps, a single-day record. Such a sharp increase obviously took a toll on investor sentiment: Emerging Market currencies sold off sharply and those offering the lowest real rates were the most affected (the BRL lost almost 2% during the trading session).
The move closed a week full of verbal intervention by monetary policymakers both in the US and in the Eurozone, who unsuccessfully tried to calm the market.
Almost all major currencies suffered against the USD, especially during the rapid increase on the US real rates on Thursday. Notable exceptions were the Euro and the Yen, which closed the week almost flat against the greenback.
Rising real interest rates do not seem sustainable at the current pace: policymakers will continue to intervene verbally in the market in order to slow down (if not to stop) the movement that could hurt the economic recovery. Stopping the rate movement may open the door to a slightly more significant depreciation of USD.

THE WEEK AHEAD: UPCOMING DATA

Europe: This week, we expect to learn that Eurozone retail sales fell in January, while the unemployment rate is likely to remain stable. February's flash inflation figures should show some reversal of the one-off measures that pushed up the core rate earlier in the year.

United States: The US figures will likely confirm the ongoing recovery, though the winter storms risk could add noise into the data. Today's personal income report should again illustrate the exceptionally direct bearing of the US fiscal support and validate the ongoing repricing of the US rates. The manufacturing and services PMIs as well as the labour market report will be released. On Wednesday, the Beige Book will be published.

Asia: In Japan, indications on the state of the labour market will be released, with the publication of the official unemployment rate and the ratio of applications to available jobs. In addition, both Japan and China will announce the level of the PMI index for the manufacturing sector.

Source: CMB Monaco, Mediobanca SGR