A CORRECTION OR A CHANGE IN TREND?

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IN A WORD:

Last week was quite negative for European equities, with the Stoxx Europe 600 losing 3.6%. The flagship US equity index, the S&P 500, shed only 0.6% thanks to a powerful rally on Friday but it still posted a fourth consecutive week of decline. The dollar continued to strengthen.

Uncertainty escalates

Equities began to fall in early September with profit-taking on technology stocks, which had risen spectacularly in previous months.

Last Monday, this drop broadened as many uncertainties increased: i) the sharp resurgence of contaminations in Europe is fuelling fears of new draconian lockdown measures that would hurt the economy; ii) in the United States, the dissension between Democrats and Republicans is making it less likely that new fiscal support measures deemed necessary by the Fed will be adopted before the elections, iii) the outcome of the elections themselves; iv) Brexit, v) revelations of major international banks involved in massive dirty money laundering.

The markets hate uncertainty, sometimes even more than bad news! This uncertainty could persist for 1 to 2 months (Brexit mid-October, US elections on 3 Nov or a little longer if a recount of votes is needed). As for the resurgence of the Coronavirus, we will know in a few weeks' time whether, as in the United States last summer, we can get by without strict lockdown measures.

Paradoxically, the resurgence of Covid-19 cases has given a fresh impetus to technology stocks, which were the main winners during lockdown, i.e. stocks benefiting from homebased work, leisure and shopping. On the other hand, stocks, which are more sensitive to the economic cycle, suffered badly.

A correction, not a change in trend

The outlook for 2021 remains good. Around the world, 173 teams are working on Covid-19 vaccines. The first are expected to be available in the first half of 2021. If this is the case, it should help the worst-affected sectors (air transport, Horeca, shows, etc.).

The economy is expected to continue to benefit from the impressive monetary and fiscal stimuli that are far greater than the measures put in place in 2008-2010.

The pick-up in activity in China - the world's second-largest economy - appears to be consolidating, which is important for Asia but also for the rest of the world. The good resilience of industrial metal prices can be explained by Chinese demand.

For these reasons, we believe that we are dealing with a correction and not a change in trend, and this correction should offer good entry points to complement equity positions.

How far can the decline go?

Given the positive outlook for next year, in our opinion, the correction in the S&P 500 index should not fall below its 200-day moving average, i.e. around 3100 (-13% from the top, 6% vs. Friday's close).

From experience, we know that the best entry points often coincide with a time of maximum uncertainty. At the moment, however, uncertainty is growing (Covid-19, US elections, Brexit etc.) and will perhaps reach a peak shortly before the US elections.

However, we cannot rule out any good news such as an agreement between Democrats and Republicans on further fiscal stimulus. This hope lifted American stock markets on Friday.

The week ahead

On Wednesday we will have an indication of the strength of the economic recovery in China with the publication of Manufacturing and Services PMIs (purchasing managers' indices).

These figures will show whether the recent signs of an acceleration in China's recovery are confirmed.

On Friday, all eyes will be glued to the US jobs report. Only half of the jobs lost during the Coronavirus crisis have been reinstated. Investors have become very sensitive to signs of a weakening recovery. The consensus among economists is that unemployment will continue to fall, albeit at a slower pace than in the previous two months.

On Friday, too, we await the inflation figures for the euro area. In August, the euro area fell into deflation territory with a 0.2% decline in prices, thus fuelling doubts about the ECB's ability to meet its 2% inflation target. This price decrease was partly due to temporary effects (temporary cut in VAT in Germany and the postponed Sales period). The euro, which is losing some of its strength, should also help things along.

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