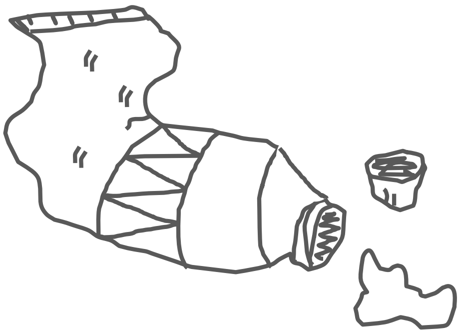
Market Focus

28 September 2021

Can we squeeze more from this rally?

The trend remains intact. Yet, and true to form, September brought with it more volatility as peak macro and earnings growth concerns combined with supply-chain problems and the persistence of Covid-19 have weighed on equity markets searching for another catalyst. More recently we have seen the Fed make a marked communication shift towards steadily dialling down their emergency monetary support, while China's largest property developer Evergrande defaulting on loan payments sent ripples through markets fearful of contagion across the property sphere and the risk such poses to growth.

However, and indeed following Jerome Powell's heavy hints at the last Fed meeting press conference that a taper announcement is likely at the November meeting and a 'dot plot' that brings the risk of a first rate hike forward into the end of next year, we have over recent days seen a lift in the 10-year Treasury yield. This is an encouraging sign the reopening/reflation trades and a rotation back in favour of the same which – supported by another strong earnings season and the prospect of a fiscal tailwind in the form of Biden's spending plans, could drive markets into the end of the year. Valuations may still be high and risks remain, but over recent weeks we have seen a large degree of complacency removed which makes for a healthier market: we think there is more to wring from this rally.



There's always more!

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Unless stated otherwise in the document, all data are as of **27.09.2021**
Please read important disclosure information at the end of the document

Global equity quantitative monitor

Since our last update in August, Europe's score in our equity regional matrix (the top-down indicator that gives us a regional view*) has climbed into very bullish territory (now at 33% up from 26%). Sentiment has improved a little, as has the economics score together with liquidity. Moreover, and while the trend score has softened a little more, our indicators suggest that valuations are now less challenging (the valuation score remains a neutral -5%). While the ECB's governing council has announced a moderate reductions in the pace of emergency asset purchases it remains very cautious in tone, while staff projections were revised up in the September meeting, GDP growth for this year up to 5.0%, from 4.6%. We continue to expect momentum to pick up in the latter part of the year, thereby attracting with it investors seeking out value plays exposed to the cycle. We also like the green themes while European luxury could also benefit from tactical opportunists buying the dip. See our recent *Market Outlook* presentation for more macro themes built around our positive view on Europe.

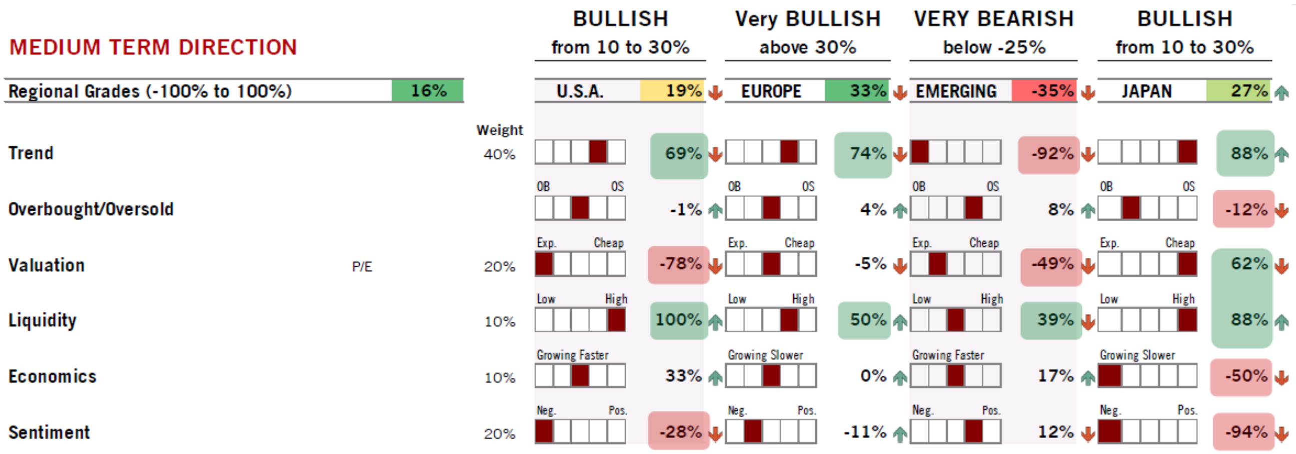
The US' regional score has climbed back into bullish territory, now at 19% (back up from 13% in August). Trend has slipped a bit (to 69% from 84%), and while the valuation score has improved slightly (to -78% from -80%) it continues to reflect markets that are 'extended' on a historical basis. The liquidity score is back up at 100% (from 83%) while the economics score has improved further (from 17% to 33%); and sentiment has also continued to get healthier (now at -28% from -38%). Having been stubbornly low throughout the summer, a more hawkish Fed and talk of taper has over recent days resulted in a rebound in the 10-year US Treasury yield which could be good news for the so-called reflation trades. We also see opportunity to seek out entry points among industrials and we would not overlook infrastructure. Either way, such trades are becoming more nuanced with quality increasingly relevant. Again see our recent *Market Outlook* for the rationale behind these themes and others.

Japan's regional score in our matrix has since our August update climbed from a neutral -7% to a bullish 27%; largely driven by the trend score shooting up to 88%. The valuation score has as one might expect softened a little on the recent rally, but remains a promising 62% (down from 78%) while the liquidity score remains at 88%. We continue to prefer the country's exporters as beneficiaries of the global recovery, as well as quality cyclicals in the region – see our recent letter on why we have been turning our attentions to *Japan*.

Emerging market equities have over the past month seen their rating drop in our matrix (to -35% from 34% last month). While the outlook for EM equities continues to be challenged by returning international trade dislocations, and divergences remain. The trend-score falling further to -92% (from -90% in August). We remain cautious in the near term in light of the recent regulatory changes and corporate liquidity events (Evergrande) in China and we would continue to take a more selective, tactical approach to EM for now.

**Our top down' Equity Regional Matrix gives us an overview of the prevailing market conditions in equity markets, drawing on macroeconomic data, trend analysis on leading indices, and sentiment. For further information on each parameter, see the endnotes.*

Figure 1: PTS Equity Regional Matrix*



MEDIUM TERM DIRECTION		Weight	BULLISH from 10 to 30%	Very BULLISH above 30%	VERY BEARISH below -25%	BULLISH from 10 to 30%
Regional Grades (-100% to 100%) 16%			U.S.A. 19% ↓	EUROPE 33% ↓	EMERGING -35% ↓	JAPAN 27% ↑
Trend		40%	69% ↓	74% ↓	-92% ↓	88% ↑
Overbought/Oversold			OB OS -1% ↑	OB OS 4% ↑	OB OS 8% ↑	OB OS -12% ↓
Valuation	P/E	20%	Exp. Cheap -78% ↓	Exp. Cheap -5% ↓	Exp. Cheap -49% ↓	Exp. Cheap 62% ↓
Liquidity		10%	Low High 100% ↑	Low High 50% ↑	Low High 39% ↓	Low High 88% ↑
Economics		10%	Growing Faster 33% ↑	Growing Slower 0% ↑	Growing Faster 17% ↑	Growing Slower -50% ↓
Sentiment		20%	Neg. Pos. -28% ↓	Neg. Pos. -11% ↑	Neg. Pos. 12% ↓	Neg. Pos. -94% ↓

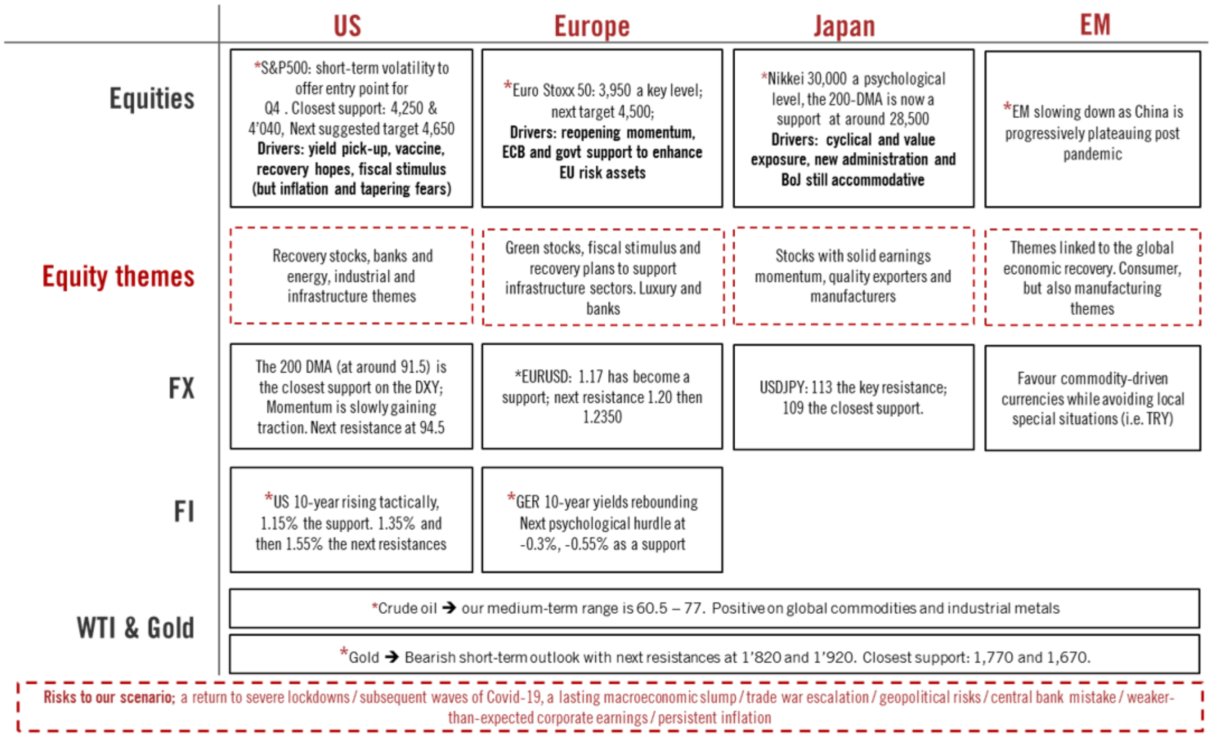
Source: FactSet; Markit, Copyright © 2020 S&P Global Market Intelligence; Pictet Trading Strategy; as of 27/9/2021.
**Criteria are explained in the endnotes*

On the macro front, as we write the 10-year US Treasury yield has been rebounding and is on the approach to the next resistance at 1.54%. Our core technical scenario remains a short-term limited rise on towards this level and then on to 1.86%. Inflation break-evens should ultimately stabilise as supply issues fade and real rates are likely to rise as the Fed now moves closer to tapering. The question is whether this recovery bounce proves more convincing (see our recent technicals on the 10-year again here (and discussion on why this should bode well for US financials). A summary of our core views is presented in the table below and for more including our preferred themes and selection lists once again we refer you to our comprehensive *Market Outlook* presentation.

US 10-year Treasury – technical chart*

*Source: Factset - Pictet Trading Strategy – as of 27/09/2021 *criteria are explained in the endnotes*
The target price presented in the chart is based upon chart analysis. This is not the product of any Pictet financial research unit

PTS short-term core views September 2021*



	US	Europe	Japan	EM
Equities	*S&P500: short-term volatility to offer entry point for Q4 . Closest support: 4,250 & 4’040, Next suggested target 4,650 **Drivers: yield pick-up, vaccine, recovery hopes, fiscal stimulus (but inflation and tapering fears)**	*Euro Stoxx 50: 3,950 a key level; next target 4,500; **Drivers: reopening momentum, ECB and govt support to enhance EU risk assets**	*Nikkei 30,000 a psychological level, the 200-DMA is now a support at around 28,500 **Drivers: cyclical and value exposure, new administration and BoJ still accommodative**	*EM slowing down as China is progressively plateauing post pandemic
Equity themes	Recovery stocks, banks and energy, industrial and infrastructure themes	Green stocks, fiscal stimulus and recovery plans to support infrastructure sectors. Luxury and banks	Stocks with solid earnings momentum, quality exporters and manufacturers	Themes linked to the global economic recovery. Consumer, but also manufacturing themes
FX	The 200 DMA (at around 91.5) is the closest support on the DXY; Momentum is slowly gaining traction. Next resistance at 94.5	*EURUSD: 1.17 has become a support; next resistance 1.20 then 1.2350	USDJPY: 113 the key resistance; 109 the closest support.	Favour commodity-driven currencies while avoiding local special situations (i.e. TRY)
FI	*US 10-year rising tactically, 1.15% the support. 1.35% and then 1.55% the next resistances	*GER 10-year yields rebounding Next psychological hurdle at -0.3%, -0.55% as a support		
WTI & Gold	*Crude oil ➔ our medium-term range is 60.5 – 77. Positive on global commodities and industrial metals *Gold ➔ Bearish short-term outlook with next resistances at 1’820 and 1’920. Closest support: 1,770 and 1,670.			

Risks to our scenario; a return to severe lockdowns / subsequent waves of Covid-19, a lasting macroeconomic slump / trade war escalation / geopolitical risks / central bank mistake / weaker-than-expected corporate earnings / persistent inflation

*Source: FactSet; Pictet Trading Strategy; as of 13/09/2021 *The target prices presented are based upon chart analysis. This is not the product of any Pictet financial research unit.*

Endnotes: References for publications of Banque Pictet & Cie SA – Trading Strategy

Model performance data is not a reliable indicator of future returns. Model performance calculation has a number of limitations and the results do not represent the results of actual trading using client assets. The data provided is gross of fees and other commissions. Fees and charges will apply and will reduce the final return. No representation is being made that the model portfolios illustrated will or are likely to achieve results similar to those shown and there are often sharp differences between model performance results and actual results achieved.

The Equity quantitative grades

Growth Grade: The Growth Grade is a proprietary formula made up of earnings revisions momentum, past earnings growth, earnings stability, and current and long-term earnings growth. A grade above 55 is considered bullish on a 3-month basis, bearish below 45 and neutral between 55 and 45.
EPS Grade: The EPS Grade is a proprietary formula consisting of current and forward EPS growth, change and surprise data. An EPS grade above 60 or below 40 is considered predictive for future out/under performance.
Sales Grade: The Sales Grade is a proprietary formula made up of current and next year's sales momentum, past sales growth, sales stability, and current and long-term sales growth. A grade above 55 is considered bullish on a 3-month basis, bearish below 45, and neutral between 55 and 45.
Value Grade: The Value Grade is a proprietary formula made up of estimated P/E, P/B, P/S and P/CF ratios. 40% of the grade is based on historical values and 60% on current market data. A grade above 55 suggests a stock is cheap, below 45 expensive, and neutral between 55 and 45.
Quality Grade: The Quality Gating is a proprietary formula that focuses on the balance sheet (i.e. change in accruals, change in free cash flows and profitability). A grade above 55 suggests a stock with a good balance sheet.
Credit Grade: The Credit Grade focusses on the passive side of the balance sheet. It is divided into three sub-components to assess both short and long-term solvency. A grade above 55 suggests a strong capital structure, while a grade below 45 suggests a weak one.
Money Flow Grade: The Money Flow Grade is a proprietary formula that gives the accumulation/distribution based on the volume flows of a stock. A grade above 55 indicates good money flow and a grade below 45 suggests weak money flow.
Smart Sentiment Grade: The Smart Sentiment grade is a contrarian indicator based on investor positioning measures such as the days to cover ratio, the put call ratio, and the short interest ratio. A weak grade suggests 'too much' optimism.
Relative Strength (RS) Grade: The RS grade measures the price momentum of a stock over its 1-year price performance.
Global Grade: The Global Grade is a weighted average of the Growth, EPS Sales, Value, Quality, Credit, Money Flow and Smart Sentiment Grades.

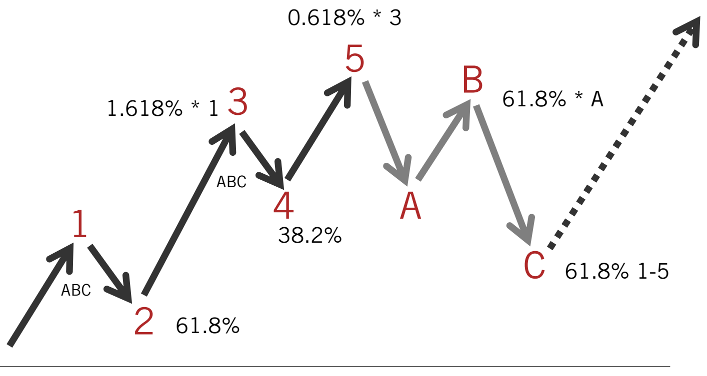
The Regional MATRIX grades

The Regional Matrix grades range from -100% to +100%. We consider a grade above 50% to be very bullish, a grade above 25% to be bullish, and a grade between 0% and 25% to be neutral. A grade between 0% and -45% we consider bearish and a grade below -45% very bearish.
Regional Grade: The Regional Grade (-100 to +100) is an indicator of a structural bull market or not. It is calculated by combining and applying weight to each of the other grades that make up the Regional Matrix (Trend, Overbought/Oversold, Valuation, Liquidity, Economics, and Sentiment). If we believe equities to be in a structural bull market, we use 15 years of data to assess Valuation.
Trend Grade: The Trend Grade (-100% to +100%) is based on a moving averages model adjusted according to the overbought/oversold conditions of the region's main indices.
Valuation Grade: The Valuation Grade (-100% to 100%) is based on the percentile rank of the regional Index stocks' P/E ratios since 1995 (current year estimated).
Economics Grade: The Economics Grade (-100% to 100%) is based on a combination of manufacturing and non-manufacturing PMIs and the **Citigroup Surprise Indices.** The Citigroup Economic Surprise Indices are an objective and quantitative measure of economic news and are defined as weighted historical standard deviations of data surprises (actual releases vs. Bloomberg survey median). A positive reading of the Economic Surprise Index suggests that economic releases have on balance beaten the consensus.
Sentiment Grade: The Sentiment Grade (-100% to 100%) is based on various contrarian and non-contrarian indicators.
Reversal date in the Trend: If the trend has reversed, we give the reversal date and indicate the direction of the reversal.

Factor trends: We look at the performance of 5 theoretical long-short selections, each built around one of our quantitative grades (i.e. growth (EPS momentum), price momentum (RS), quality, sentiment and value), and each long the top decile and short the bottom decile of stocks within the respective region in our equity universe in terms of exposure to each specific score.
Model Long Only & Absolute return regional Allocation: The Regional Allocation shows the advised net exposure in total and per region. It is calculated by multiplying the MSCI regional weight by the Regional Grade (we use the structural bull market regional grade).
Trading Strategy Exposure: The Trading Strategy Exposure shows the actual net exposure in total and per region, based on our trades.
Short-Term: 1 to 4 weeks / Medium Term: 1 to 3 months / Long Term: more than 3 months.
PTS: Pictet Trading Strategy.
Buy/Long: Stock is expected to achieve a total return that exceeds the relevant market index over the next 3 to 6 months.
Sell/Short: Stock is expected to underperform the relevant market index over the next 3 to 6 months.
Hold/Neutral: Stock is expected to be in line with total return of the relevant market index over the next 3 to 6 months.

Technical Analysis: The technical analysis used in this presentation combines traditional technical tools: graphical analysis (trend lines, support lines, continuation and reversal patterns) which determines the tendency, mathematical indicators (moving averages, RSI, MACD) used as numeric filters and Elliot wave theory which allows us to build a scenario with target levels and invalidation points.
Elliott Wave Theory: According to Elliott Wave Theory, markets move in impulse waves – with five sub-waves (numbered 1-5 or I-V) following the direction of the main trend, followed by three corrective sub-waves (A-B-C) (example to the right). These waves follow a set of specific rules and are linked to each other by target and retracement ratios based on the Fibonacci sequence, and the characteristics of each wave form an integral part of the reflection of the mass psychology it embodies.

Elliott Wave Theory



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