

# Developed Markets Fixed Income Quarterly Q4 2020 Outlook

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As we enter the festive season, we suspect we are on both the naughty and nice list. We didn't ask for more virus and certainly did not ask for a prolonged decision on the US election. Frankly, we would rather be gifted lumps of coal. Control of the Senate remains unsettled with Georgia going into a runoff election on 5 January, though with the Republicans leading in both races, we think it is quite unlikely that the Democrats can flip the Senate this time around. However, the Pfizer/BioNTech vaccine news is certainly positive, Moderna even more so, given no ultra-cold storage issues, and logistical operations tend to win wars after all. I suspect we will become quickly saturated with positive vaccine news given the 11 in Phase 3 trials, 57 in Phase 1 or 2 and 155 in pre-clinical stages. That said, near-term vaccine positivity will likely run into long-term COVID-19 negativity over the coming months.

In the aftermath of the election, with Joe Biden now just waiting on his 306 electoral votes to be finalized by the Electoral College on 14 December and ratified by Congress on the 6 January, leaves us to conclude a concession is not relevant at this point. The general concern leading up was the coin flip "sides" outcome, which incidentally has odds of one in 6,000, though we have avoided the worst-case outcomes for the market—a "hung election" and a "blue wave"—for now. While it still feels like the coin landed "sides," the odds remain near zero on the likelihood of overturning soon-to-be-certified election results, though it is 2020 after all. The blue wave reflation trade has been deflated with Republicans likely to retain the Senate and the Democrats the House. We think this will delay immediate concerns over Biden's tax reform and progressive, Modern Monetary Theory elements to the Federal Reserve (Fed) and Treasury. For Biden's cabinet, we balance the potential of a more status quo Janet Yellen as Treasury Secretary with the likelihood of a progressive Bernie Sanders as Labor Secretary; Biden probably owes a few favours all things considered. We think president-elect Biden will have to remain balanced in his choices given the Republican-controlled Senate, but Biden and Senate Majority Leader Mitch McConnell have a history of striking deals.

With positive vaccine news increasing by the day and the unemployment situation continuing to improve, McConnell, it seems, has capitalized on this opportunity as cover to offer a reduced stimulus package. Whether this is posturing ahead of the Georgia Senate runoff elections, we think it relevant to point out that the US Treasury is flush with USD 1.6 trillion of cash, far more than their 10-year daily average balance of USD 270 billion. Less stimulus means less US dollar debasement and less Treasury issuance, and the vaccine a faster recovery, but the second virus wave also represents a short-term shock. We think the positives will outweigh the near-term negative of the COVID-19 spike in a boost to risk assets, but cannot rule out a Biden push for national lockdowns as his first act as president if model projections come to fruition. Though as Donald Trump has found with the Democrats, if the 26 Republican governors disagree, there is very little he can do to mandate a nationwide lockdown.

With the RBA, BOE and ECB all forecast to net monetize bond issuance, the Fed would need to double its current pace of purchases to remain on par with the rest of the central banks. With COVID-19 on the rise, the Fed will have ample cover to justify added stimulus at its mid-December meeting after Fed Chair Jerome Powell noted "a full economic recovery is unlikely until people are confident that it's safe to re-engage in a broad range of activities." We

think the Fed will remain at the ready to extend maturities of purchases and forward guidance which will further support long-term rates. With inflation on the backburner and lower-than-expected fiscal stimulus, we do think the period of dollar debasement is closer to the end than the beginning now that developed market governments are starting to ramp up stimulus programs of their own.

For the EU, COVID-19 continues to surge into year-end. With Hungary and Poland having indicated plans to veto the EU EUR 1.1 trillion budget and the EUR 750 billion stimulus if the EU makes access to funds conditional, the US certainly does not have a monopoly on divisive politics, of which the EU has plenty to go around on its own. Expectations are that the ECB will increase the scale of the Pandemic Emergency Purchase Programme by a further EUR 500 billion this December, as inflation remains elusive and the emergence of the second wave of COVID-19 in Europe threatens the very nascent recovery observed to date. With low rates abounding across the EU, we think the opportunity will continue to favour currency-hedged positions for foreign investors. For the UK and its negotiation with the EU for a Free Trade deal, we think cooler heads will eventually prevail, but note the binary outcome to sterling if talks go awry. We would like to talk about Brexit into 2021 as much as we would like to continue to discuss COVID-19, though it is still 2020 after all.

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