

## The vaccine moment: What the latest breakthrough means for markets

Equity markets have jumped on the news that a Pfizer/BioNTech Covid-19 vaccine had reached 90% efficacy rates in late-stage clinical trials. We take a look at the impact the news has had across asset classes today. One small area of concern could emerge if US Treasury yields rise too quickly and damage views that we are entering an investment 'sweet spot'



Pfizer announced a potential Covid-19 vaccine with 90% efficiency in trials

### Welcome news, but challenges remain

As the second wave of Covid-19 continues to disrupt economies across the world, the latest vaccine news comes as a welcome boost for hopes that 2021 may be a much better year than 2020 for the global economy.

Developers Pfizer and BioNTech have unveiled interim analysis from their phase III trial that suggests their vaccine is '90% effective in preventing Covid-19', while the trial has highlighted no major safety issues so far. The firms expect to apply for emergency authorisation in the US later this month. Results are expected from other vaccines over the coming weeks.

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## *None of this changes the near-term fact that the global economy faces a challenging winter*

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None of this unfortunately changes the near-term fact that the global economy faces a challenging winter. Renewed lockdowns across the eurozone are likely to shave roughly 2% off GDP in the fourth quarter, according to our latest forecasts, while the risk of further restrictions in the US will put a considerable brake on activity.

There are also still some important questions surrounding the vaccines that will be key to the economic outlook. How effective will the vaccine prove when rolled out to the wider population? What share of the population will be vaccinated? And how long will it take to roll-out - particularly given complexities in transporting/storing some of the vaccines at the necessary sub-zero temperatures, but also because it will likely require two shots.

Alongside developments on testing, all of these questions will help determine when the global economy can return to something closer to 'normal'. In our latest forecasts, we've assumed it may not be until mid-late 2021 before growth consistently returns to many economies.

Importantly, the logistical complexities surrounding the vaccine, combined with the differences between countries in where they sit on the delivery lists, could also contribute to some regional divergences (DM vs EM?) between countries that are able to roll-out a vaccine quickly and those that can't.

You can read more about our three-scenarios for Covid-19 in our [latest monthly economic update](#).

### **□ Equities: Global rally**

It is a sea of green in global equity markets today. Europe benchmark indices are up 5-8%, led by sectors such as Energy, Financials, Industrials and Consumer Discretionary - basically, the market is closing its shorts and buying the underperformers and obvious beneficiaries from an economic recovery i.e. cyclicals and consumer discretionary. A similar sector profile is seen in today's move in the US S&P500, even if the overall US market is 'just' up 3% today. Recall that Year To date, US equities have hugely out-performed Europe (S&P 500 +12%, Euro Stoxx 50 -9%), questioning whether now is the time to rotate back into Europe?

Asian equities had enjoyed 1-2% gains overnight before the Pfizer news. But Japanese Nikkei futures, which trade in the US, have rallied 730 points or 3% since the news broke near midday in Europe.

### **□ Developed Market Rates: Injecting a dose of reality**

This was the "vaccine" moment the rates market had waited for. We had asserted that it was worth a 15-20bp reaction in the US 10yr. We've had something close to this so far. The big difference here from previous moves is that we won't need to take this back. We have moved from a digital state of no vaccine to one where there is one. This latter state is one where the medium-term prognosis is considerably better, or at least a reasonably positive inference for the future can be mapped out, with clear implications for market rates.

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*The immediate target to aim for is 1% on the US 10yr*

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The immediate target to aim for is 1% on the US 10yr. Provided no other ancillary influences come into play, it is quite conceivable that a 1-handle is hit. However, once we get there it is less clear that there will be staying power. Mapping that level out will likely be enough for now, as contemporaneous macro angst will begin to dominate again as we progress over the coming weeks into winter. The real ambition to hit that 1% level and stay there remains a 2021 one, when the vaccine gets applied and the macro prognosis is more secure.

The curve remains directional and led by longer-dated yields. So it is steeping for now, but to revert to some flattening into year-end. Note also that the structure of the curve still does not look bearish for bonds; specifically, the 5yr area remains rich and the fed funds futures strip remains very flat. This confirms the view that any uplifts in market rates will be curtailed by contemporaneous macro realities and the associated need for central banks to keep the pressure on the various easing switches.

For now, it is a steeper curve, a wider Treasury-Bund spread, all centred on hitting that 1 handle for the US 10yr. And while we will likely fade from that level, it will set a mark as to where we can transition towards in a more structural basis in 2021.

Note also that these sharp adjustments in higher in rates can spell trouble for other rates-sensitive asset classes. If some of the post-US election rallies in risk assets was premised on the reduced upside risk to yields, today's jump should have doused these hopes. Clearly positive vaccine news raises the 'rates pain threshold' across markets, but we find it is another reason not to extrapolate today's increase in rates much further. Eventually, the rise in rates will prove self-defeating, but in the near-term, the most important driver will be stop losses on carry trades entered after the US election. This should lead to higher sovereign yields.

### **□ Credit: Spreads rally, curves flatter in both EUR and USD**

There was already a very positive sentiment in the credit markets on the back of the Biden victory. Now with the vaccine news, there is further tightening. USD spreads were outperforming Euro over the past few days, but euro spreads are performing substantially well now. Defensive names are looking roughly 3-8bp tighter today and higher beta up to 10-15bp. The long end of the curve is the major outperformer as curves are flattening significantly. Euro curves (particularly in BBB rated debt) were already looking relatively flat. Furthermore, the short end of the curve is deep in negative yield territory. We are reserved on how tight spreads can go overall, seeing as in many names spreads are trading at levels of pre-covid-19.

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*Euro spreads are performing substantially well*

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At the opening in USD, there was a 5bp tightening across the curve in all sectors, it is likely USD spreads will follow the same trend as Euro.

In terms of sectors, the Covid-19 sensitive sectors have obviously been the outperformers. Leisure, autos and manufacturing have seen considerable tightening. Even though most airlines are high yield there has been a significant outperformance. Furthermore non-eligible names (for central bank support) have seen a substantial tightening. These higher beta and unsupported sectors may well see more demand through the remainder of the year.

## □ FX: A clean day for risk-sensitive currencies

Given the huge moves seen in equities today, FX markets have behaved slightly differently to the broad-based gains made against the dollar last week.

Familiar friends like NOK and AUD lead G10 FX gains (+1.7% and 0.9%) against the dollar. These are high beta trades on the global recovery story and have also been leading the charge on the Biden rally. However, today we've seen the JPY and CHF fall 1.75% and 0.85% against the dollar. In effect, these currencies are reverting to their typical safe-haven status and are today being sold off. USD/JPY as well typically has the highest correlation to US yields (where 10-year Treasuries are already up 15bp on the day).

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### *A safe-haven sell-off*

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In terms of relative moves, there may be some case for a catch-up in European currencies. After all, Asian currencies such as the CNY and the KRW had already been performing well this quarter on their seemingly Covid-free status. Europe had been priced for a lock-down double-dip and the FX market could now have greater confidence in the 2Q21 recovery.

We had felt that EUR/USD would trade a 1.16-1.20 range this quarter, but today's news could prompt an early rally above 1.20 if it becomes clear that today's news really is a break-through. A more sustainable push towards the 1.25 area probably does not come until into 2Q21, however, once the market has confidence that the virus has been contained in Europe and the ECB sounds a little more confident that they have all the needed stimulus measures in place.

As discussed below, FX markets will also watch US yields carefully such that the rise in US yields is not sharp enough to derail the rally in risk assets.

## □ EMEA FX & Rates: Clear boost to high yielders

In line with the global trend, EMEA FX received a boost from the prospects of a vaccine. As the vaccine has reduced the downside risk to the 2021 growth outlook, and following the market-friendly outcome of the US Presidential election, this a clear positive for carry, with RUB and ZAR (as well as TRY, though for the lira it is more dependent on future domestic developments) set to do better than their lower-yielding CEE peers.

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### *The boost to risk appetite*

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This is also the case from a fixed income perspective, with the likes of Russian and South African local debt set to outperform CEE bonds as the latter are more correlated to core yields. This story has very much played out in price action today. Within the CEE fixed income space, all this suggests that long-end Romanian government debt should outperform Poland, Hungary and Czech.

The boost to risk appetite suggests that the market should further pour cold water on expectations of NBH rate hikes (given the limited need to stabilise the HUF), while at the same time further raising the hurdle for NBP and CNB cuts (which up to very recently were expected by the market). Although PLN outperformed its CEE peers today (given its bigger potential for a short squeeze), we continue to prefer CZK and HUF to PLN.

## □ EM Hard Currency Debt: Spread tightening

Today's vaccine news has provided further uplift for emerging markets credit, already in the sweet spot after last week's US election outcome. In hard-currency sovereign credit, we are seeing today a double-digit spread tightening across the board, with outperformance in lower-rated frontier markets vs better rated emerging market issuers.

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There is further upside in EM credit, not least because EM sovereign spreads remain wide in comparison to pre-crisis levels (c. 90bp wider vs early March for the JPM EMBI Global Diversified as of Friday). However, this will likely only materialise gradually and there are some reasons for caution. First, it will take time for a possible vaccine to be rolled out and for emerging markets, the time lag is all but certainly higher in comparison to developed countries. Moreover, a vaccine and improving economic prospects would create upside risks for underlying core rates, and with EM credit being a rates sensitive asset class, this would offset some of the gains coming from the spread tightening. Lastly, we have seen large increases in government debt in 2020 due to the need to spend more and lower revenues amid growth contractions which makes us believe that debt sustainability will remain a key concern for emerging markets in the years to come.

All in all, we see room for more spread tightening in EM credit should the prospects for a vaccine improve further. Higher yielding EM bonds offer the best opportunity given the larger credit component (i.e. lower rates sensitivity) but debt sustainability concerns mean that credit selection is key.

## □ Commodities: Oil gets a boost on demand prospects

Suggestions of a successful Covid-19 vaccine saw prices rally across the commodity complex. ICE Brent futures jumped by almost 10% extending above US\$43/bbl during London trading sessions as the potential vaccine breakthrough provided significant relief to oil demand and it could potentially be a gamechanger to the market ahead.

In the meantime, prices of major refined products such as gasoline and diesel also got a boost amidst a restoration to the margins. The news came as OPEC+ openly discuss the possibility of

tweaking their planned supply changes ahead of their meetings at the end of this month. Currently, the cartel is planning to bring back about 2MMbbls/d of the total 7.7MMbbls/d cuts and will review this plan during the meeting, but a vaccine could potentially lower the possibilities of any tweaks. However, it remains to be seen how quickly the vaccine will become available to the public. Should real demand start to pick up in aftermath of the vaccine roll-out, demand growth could overtake supply recovery and lead to meaningful inventory drawdowns. This will lead to a more bullish oil outlook in the medium to longer term.

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### *A further catalyst to the rally in industrial metals*

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Industrial metals also rallied but with a double boost from both the vaccine news that brightens demand outlook and the US pivoting towards energy transition aftermath Biden's victory. The 3M copper in the London Metals Exchange (LME) rallied to its 29-month high extending above US\$7,000/tonne along with one of the key battery metals nickel which gained by more than 3% and is now standing above US\$18,850/tonne. With demand holding firm from the largest consumer, China, and potentially a quicker recovery coming through, a vaccine becoming available would add a further catalyst to the rally in industrial metals.

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