



CIO OFFICE MORNING MARKET WRAP – Monday August 31st, 2020. ALSO AVAILABLE ON ALEXA.

Last week was another proof of the strength of the current rally. The Fed's explicit tolerance towards temporarily higher inflation means that monetary policy will remain extremely accommodative for very long. As growth is recovering from a low level, stimulated by fiscal action, while safe assets don't yield anything, there is currently no alternative to risk-assets. From a behavioral point of view, retail investors' enthusiasm is putting huge pressure on defensively positioned institutional money: their gradual capitulation is pushing markets higher. It is obviously extremely difficult to gauge how long this adjustment will take, but valuations are objectively too elevated to support long-term returns. Another worrying fact is that the level of short-positions on US stocks is currently the lowest in 15 years, at less than 2% of the total market cap. This means that hedge-funds are already fully invested, which adds to vulnerability.

As for today, the rally is unequivocally on in the early trading hours in Asia. Stocks are adding close to 2% in Japan as the race to replace resigning Prime Minister Abe starts, which shouldn't change the current economic policy but helps the Yen paring some of its recent gains. Industrial production there for July, released this morning, was much better than

expectations at +8% month-on-month, confirming the current good shape of the global economy, but domestic retail sales kept on falling. Berkshire Hathaway also announced taking stakes in five Japanese trading companies. Chinese stocks are up 1%, with the domestic Shanghai-Shenzhen index trading close to a 5-year record and approaching the +20% year-to-date performance mark. The August PMI week has started there, and while the manufacturing gauge is close to expectations, steady at 51, the services are accelerating with the index reaching 55.2, up one point from the previous month. Hong-Kong is also up 1% gain, as both stock-exchanges are anticipating one of the hottest IPOs ever: the Chinese fintech titan Ant Group could raise more than \$30 billion. Chinese tech companies are a critical asset, and Beijing has issued a new rule limiting the export of artificial intelligence. As a result, a government approval will be needed to sell the US operations of TikTok, which can be seen as a poison pill to respond to the US sanctions to complicate the task for the enthusiastic bidders which include Microsoft and Oracle. India is unchanged and South Korea is slightly down, but the dollar trading close to its lowest in two years is a tailwind for Emerging Markets in general. While short-term interest rates will stay extremely low, the long-end of the curve is gently adding basis points, taking into account the possibility of more inflation. The US 10-year Treasury yield is currently at 0.73. With inflation expectations way above 1% on that maturity, negative real rates support gold which is firm at \$1970.

Oil prices are well oriented this morning with the main futures on Brent crude trading above \$46. Saudi Aramco discovered two new oil and gas fields in the North of the Kingdom. The discoveries look promising with current combined flows of around 3000 barrels a day of crude, 50000 of condensates and 16 million standard cubic feet of gas. Staying in our region, UAE stock markets had a gentle consolidation yesterday. Dubai is said to be considering issuing Islamic bonds in dollars, and a high level Israeli and US delegation will visit Abu Dhabi for two-days of talk. The delegation, led by Mr Trump's senior advisor and son-in-law Jared Kushner, will land in the first Israel-UAE commercial flight from El Al company, with the flight number 971 which refers to the UAE's international calling code.

There are not only good news of course, but the headwinds are well known and not fresh shocks for markets. The coronavirus infections are ticking up again in the US, and India set the sad record of daily increases globally as the number of cases worldwide surpassed 25 million. The pandemic is not over yet, but we have learnt to live with it and for the time being the bullish mechanism in risk markets look intact. For how long is a relevant, but very difficult question.

Stay safe.

MAURICE GRAVIER
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