Time to be cautious, but not too pessimistic

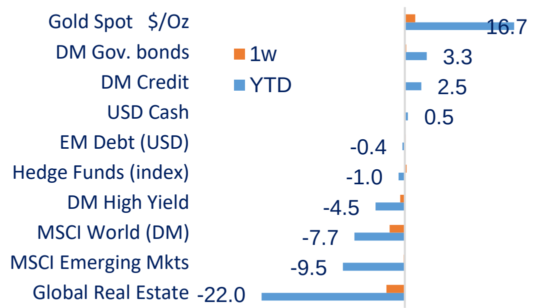
- **Markets are concerned by the resurgence of infections worldwide, especially in the US**
- **We see this as a logical phase on the road to recovery but markets remain vulnerable**
- **We keep our defensive stance taken earlier in June, waiting for opportunities**

Last week was negative for risk markets, as the number of coronavirus cases re-accelerated globally, with a clear spike in the Southern states of the US in particular. As we write for long, this is unfortunately not illogical, several weeks after restrictions started being lifted. Local outbreaks are inevitable, but manageable as the world is much better prepared. This comes however at a time when markets are vulnerable, and when most of the positive flows from the quarter-end capitulation of too defensively positioned investors are behind us.

Our scenario is unchanged and actually includes some market turbulence in the coming months. The consumer-led recovery is happening, as evidenced by another 8.2% month-on-month rise in US consumption, a double-digit surge in global auto sales, and robust increases in PMIs. The recovery is simply not going to happen in a straight line and will take time. We are not as pessimistic as the IMF which downgraded again their macro forecast for 2020 and 2021, but we agree that the recovery will not be complete until the end of next year at best. Having said that, we believe in a volatile, uneven but significant bounce in H2. We don't expect a broad second wave but a collection of local waves which will dent consumers' confidence and generate market volatility. Ultimately, the global economy will improve and the immense piles of money currently kept in cash will be put at work once volatility abates, which could happen after the US election or when a vaccine is ready.

Next week will be rich in economic data, especially manufacturing PMIs and the US monthly job report on July 2nd. The Fed chairman will deliver a speech and the minutes of the last FOMC will be released. Stay safe, and ready to seize opportunities in the coming months.

ASSET CLASSES USD % TOTAL RETURN, YTD 2020, LAST WEEK



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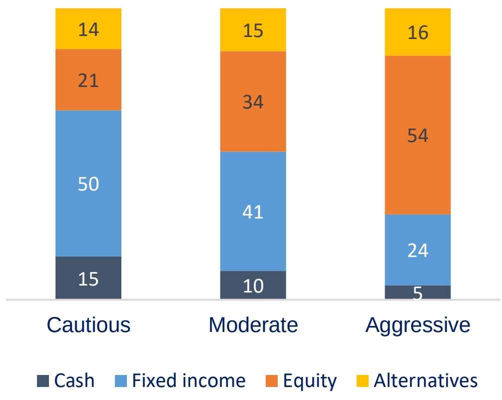
Cross-asset considerations

For the second time this month the advance of global equities has been stalled by concerns related to a new corona virus wave, spreading globally and with particular intensity in the Americas. Investors are focusing on the negative feedback loop between increased mobility, virus resurgence and the prospect for stops to the reopening of the economies, or actually for renewed lockdowns in the worst possible case in some of the US states. The timing of this second wave is unfortunate, since it will slip into the next quarter where US growth is projected to be strongest this year following the unprecedented slump in Q2. For risk assets to be substantially unscathed no matter what in terms of virus dynamics valuations should be inexpensive, allowing investors to look through shorter term developments, but with multiples very rich on any possible metric this is simply not possible. The chasing of asset returns to the point that they become priced for perfection, rather than being some form of irrational exuberance, is simply a reflection of excess liquidity finding its way in financial markets, with policy makers implicitly spurring this kind of reactions. If the worst case scenario materializes, the quarter with best sequential growth would soon be gone to roll over into Q4, dominated by the US elections, historically a reason itself for increased market volatility.

Since divining the future is not an option in financial markets, limiting downside risk remains the next best course of action. Government bonds have almost completely lost their diversification benefits, with yields at the lower bound, or in some cases actually negative and overvaluation rife across countries stemming from widespread Quantitative Easing programs. Investors who are familiar with the Forex market could position themselves long on the Japanese Yen against the US dollar, or long on the latter against the EM currencies, trades which consistently delivered positive returns in past times of crisis. Yet, timing FX positioning and on a leveraged basis, to avoid minuscule returns, may not be for everybody – and won't work if volatility doesn't spike. Breaking with the past, in keeping with the current extraordinary times, one could think of holding an offsetting position in DM high-grade credit, rather than government bonds. Since the June 8 highs in equities US IG corporate spreads have barely moved, supported by Fed purchases. A yield of almost 2.2% on an asset class backstopped by the Federal Reserve has an appeal of its own, considering the dearth of yielding assets and the current degree of uncertainty. It is at the same time unfortunate that this represents one more instance of moral hazard encouraged by policy-makers. Investors have to move up the risk spectrum for policy-related reasons, rather than being driven by market forces. One would expect that high-quality corporate bond purchases are temporary, although whatever form of non-conventional stimulus implemented in the past has proven extremely difficult to remove without unintended side-effects.

For now this new form of risk is more than offset by diversification benefits and appealing volatility-adjusted returns. We must only continue to hope that the distortions induced by excessive central bank liquidity will never be exceeding its benefits.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

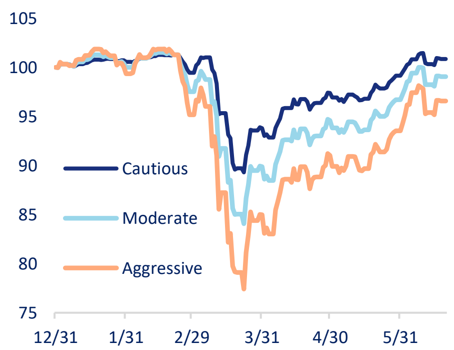


TAA – RELATIVE POSITIONING – MODERATE PROFILE

	UW	N	OW
Cash			>
DM Gov.	<<<		
EM Debt			>>
DM Credit			>>>
DM H. Yield		=	
DM Equity	<<<		
EM Equity	<		
Gold			>>>
Real Estate	<		
Hedge Funds	<<<		

UW/N/OW: Underweight/Neutral/Overweight

TAA – YTD INDICATIVE PERFORMANCE



Source: Bloomberg. CIO Office calculation based on TAA applied to market indices, net total return in USD.

Fixed Income Update

There is a tug-of-war going on between improved economic growth outlook and rising infection cases in the USA, leading to volatility in the asset prices. US Treasury yield curve bull-flattened last week with 30-Year treasury yield tightening by eight bps to close below 1.40% for the first time in June. 10-year yield oscillated between 0.6% and 0.7% before closing at 0.64% on Friday. The bad news on the virus front has translated to weak performance on the riskier asset classes with Global HY index losing 0.8% last week. EM Debt was flat, generating marginal positive returns over the same duration.

The Fed's Corporate Credit Facilities portfolio increased by an additional $1.85 billion for the week ended June 24, bringing total facility asset purchases to $8.7 billion. According to various reports, the universe of eligible bonds under the SMCFF could be $1.9 Tn and accounting for issuer caps; it could be more than $500 Bn. The size of SMCFF is $250 Bn. This means there is enough and more ammunition to support the current IG spreads, and we reiterate our preference for long-duration in the IG credit to take advantage of the gradual spread tightening. Three key factors support our theory. Firstly, the recent steepening in the yield curve has resulted in attractive valuations, secondly, expected slowdown in the IG issuance in the second half and lastly, low rate environment and hunt for yield will entice investors to extend maturities to capture the additional yield.

It is the turn of the HY issuers to set new monthly records in the primary issuance markets. With both USD and EUR denominated IG primary issuance has crossed the 1 trillion mark, June USD HY issuance crossed $50 Bn surpassing the previous high of $45.5 Bn set in September 2013. Sectors that have been hard hit by the pandemic related economic closures, including leisure, gaming, and hospitality, accounted for more than half of the bonds sold while the sectors qualifying under the CARES act, including Healthcare, aerospace, and defense contributed 12% of the overall volumes. Investors are still risk-averse since the majority of the issuance is from BB, and B rated issuers while CCC-rated deals were very few.

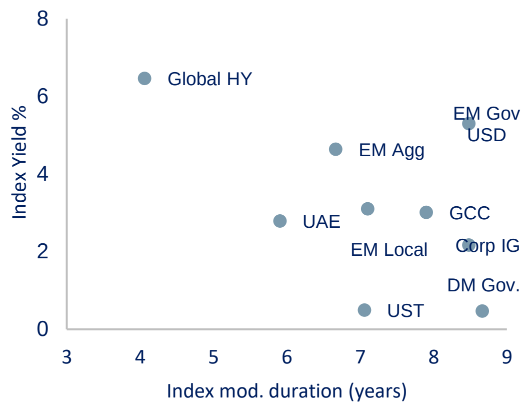
GCC spreads remained tight and the index surpassed USD Corp IG index in terms of YTD returns. DP world came to the market with USD denominated perpetual Sukuk with a tranche size of $1.5 Bn. The order book was oversubscribed by 3x, and there was 50 bps of spread tightening between the IPTs and the final print. The company resorted to a higher cost of debt to maintain its credit metrics within the rating agency's investment-grade reference range. The issuance received 50% equity weightage from Moody's and Fitch.

S&P revised a host of ratings for the issuers in the Indian financial sector on the expectations of deteriorating asset quality, a rise in credit costs, and declining profitability over the next 12 months. The company lowered its rating on four non-bank finance companies (NBFCs): Shriram Transport Finance Co. Ltd. (STFC), Bajaj Finance Ltd., Manappuram Finance Ltd., and Power Finance Corp. Ltd while affirming ratings on Muthoot Finance Ltd. and Hero FinCorp Ltd.

FIXED INCOME KEY CONVICTIONS

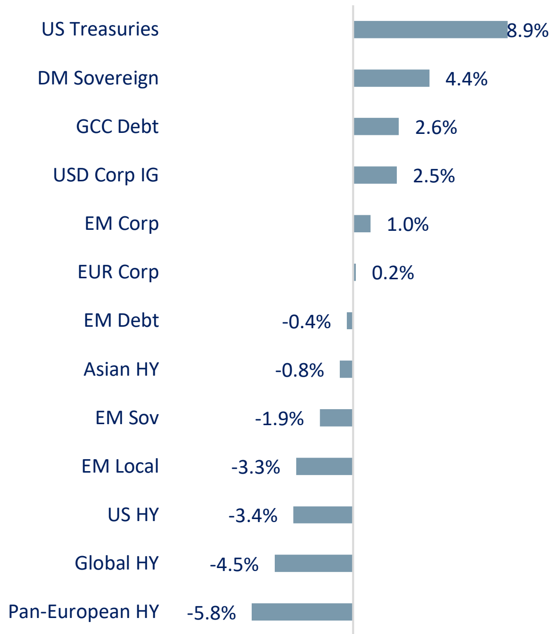
DEVELOPED MARKETS
OW US within Government
OW Corporate Credit
Slight UW High Yield
EMERGING MARKETS
OW Asia
OW IG Sovereigns
OW Latin America

FIXED INCOME VALUATIONS



Source: Bloomberg, indices modified duration and YTW

CHART: YTD FIXED INCOME SUB ASSET CLASS RETURNS



Source: Bloomberg

Emirates NBD PRIVATE BANKING

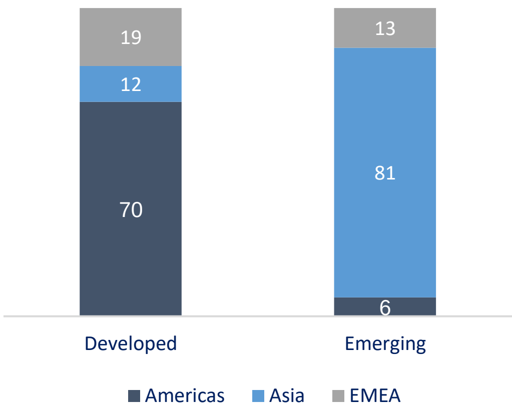
Equity Update

Equities had a volatile week, with concerns about COVID-19 outweighing positive macro data. The speed of the economic recovery has surprised positively with global economic surprises now back to their February level. The latest flash PMIs have moved close to expansion territory in Europe and the US. Whilst the rebound in equities from March lows and the record second quarter performance (so far) are in line with the improving data and the low interest rate environment, the disconnect between the strong equity market and the as yet weak economy remains. Hence, volatility will be the norm in the next few months, yet we see it within a range. For the S&P 500 we expect the Index to trade between 2700 and 3200, barring any major setbacks. With global equities down 2.1% for the week, what could be the next catalyst for an upswing? Investor positioning is still light with plenty of cash on the sidelines and outside the active Robinhood traders group, retail sentiment is weak. Amid elevated tail risks, the lack of widespread investor participation could give legs to the rally. Besides improving economic data, other catalysts include earning upgrades or positive guidance in the Q2 earning updates. Investors have disregarded this year's earnings and focused on 2021. Analysts have recently lifted their S&P 500 profit expectations for 2021, after cutting them since January. Currently at $159.78 per share, the consensus earnings estimate implies a 26% growth from 2020 expectations. Earnings estimates for 2020 have also stopped being revised down, holding steady for the past month.

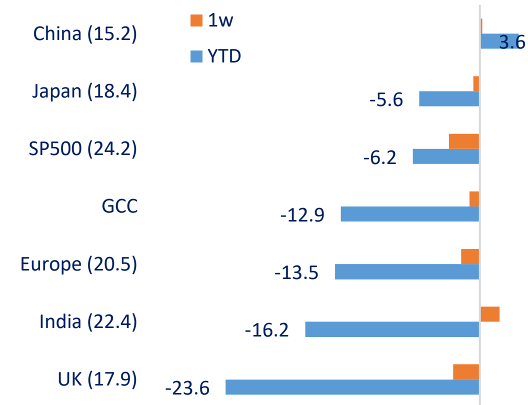
The cyclical sectors i.e. financials and energy were the worst performers last week, the latter in line with the move in oil prices. We are underweight both sectors, along with materials and industrials. US banks had a dismal week with the Fed capping bank dividends and banning share buybacks through Q3 2020. This is hardly a surprise, though any extension to beyond year-end would be. This follows the ECB's warning back in March of aggressive action, should European banks not cut dividends. The big US banks had already suspended buybacks but the formula for capping payouts using an average of earnings from the past four quarters is unexpected. Bad loan provisions were severe in Q1. The Fed warned that an extended economic slump could leave U.S. banks with $700bn in potential losses, hence the need to protect capital buffers while supporting the flow of credit.

National Commercial Bank "NCB", Saudi Arabia's largest bank by assets, has offered to acquire the Samba Financial Group. This is the biggest consolidation amongst banks so far in 2020. NCB offered to pay a premium of upto 27.5%, i.e. $15.6 bn through a share swap. The combined bank would have total assets of about $210 bn making it the third largest in the region. In the last few years, GCC banks have seen a wave of consolidation as banks have synergized strengths and costs. The PIF is the largest shareholder in NCB and Samba along with other Saudi pension funds. The Saudi Central Bank, SAMA, has recently shored up the banking sector with $27 bn in stimulus packages to aid employment and credit, to tide though lower oil prices and the economic effects of the virus. Both banks are part of our KSA recommended list.

EQUITY RECOMMENDED REGIONAL POSITIONING

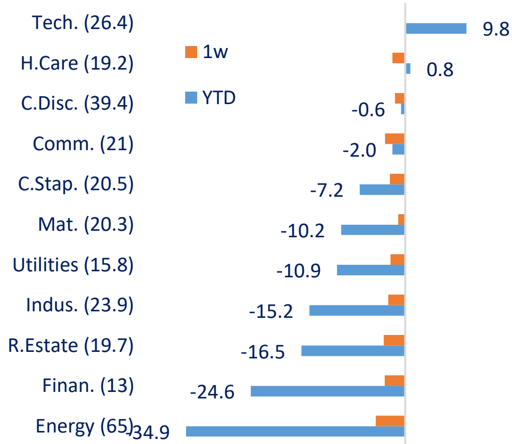


MAJOR INDICES PERFORMANCE (TR, US$) AND 2020PE



Source: Bloomberg consensus. MSCI Indices unless specified.

GLOBAL SECTOR PERFORMANCE (TR, US$) AND 2020PE



Source: Bloomberg consensus. MSCI All Country World sectors US$.

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