A welcome, but still fragile, rebound

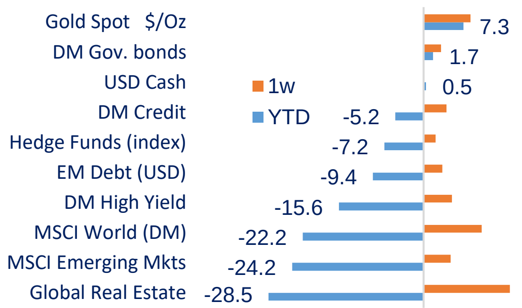
- **Last week saw a sharp rebound across all asset classes, led by developed market equities**
- **Some, though not all conditions, have been met for markets to stabilize**
- **An improvement on the pandemic itself is the only catalyst which will unlock value**

Last week was positive on financial markets, despite a risk-off session on Friday. All asset classes were in the green, led by DM stocks with double digit returns. A significant part of the forced-selling could be behind us, but we see last week as a technical, thus temporary, rebound, made of short-covering and delta hedging of derivatives positions. The rally was triggered by the formidable fiscal and monetary responses being announced everywhere. The terrible US weekly jobless claims number, above 3mn, only confirms that support will happen, and may even be increased. The times of "bad news is good news" is making a comeback.

We now have value in many financial assets, and extraordinary stimulus. What we don't have is factual evidence that the pandemic is under control, as the number of infected people tops 600,000 globally, with the epicentre now firmly set in the West. Our base case remains that it is a matter of months, but the short-term remains unpredictable. Before calling the bottom, we would like to see either more capitulation or abating volatility, synchronized with positive news on COVID19 – should it be herd immunity or treatment.

Our positioning is close to our long-term asset allocation because of the medium to long-term reconstituted expected returns. We are confident in the ability of our robust and diversified asset allocation to stomach the volatility and deliver returns. But despite last week's rally, the time is not for speculation and leverage. Keep safe.

ASSET CLASSES USD % TOTAL RETURN, YTD 2020 AND WEEK



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Cross-asset considerations

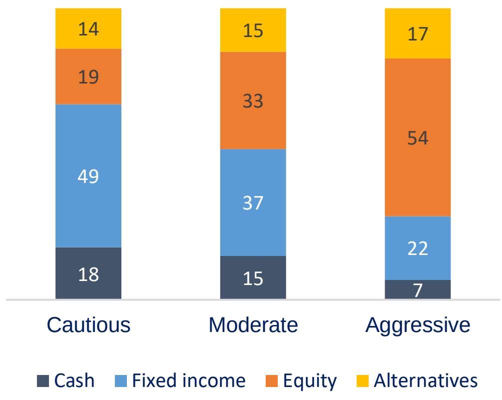
The Great COVID-19 Crisis is straining the whole global economic system and society on multiple fronts. The US is now the epicentre of the pandemic, with the highest number of infected cases worldwide and critical areas like New York State struggling against the spreading of the disease. France and Italy have strongly supported the issuing of euro area bonds for aiding weaker countries, with Germany so far resisting the idea and bringing back to mind the unresolved flaws of the common area. In China new cases are at zero, excluding infected people coming from abroad, but activity is ramping up slowly and stimulus is still necessary to underpin and put a weak economy back on track.

At a more mundane level investors may have noticed that the 60/40 portfolio, the common balanced benchmark made out of 60% equities and 40% long-dated Treasuries, on the US market has lost more than 30% peak-to-trough providing little diversification when it was most needed. This has happened for two different reasons. Firstly, each round of monetary easing has squeezed some value out of government bonds and Treasuries, with yields close to the lower bound, have now a reduced sensitivity to equity movements. Secondly, the double deflationary whammy of collapsing crude prices and crashing growth expectations has seen real yields rise while market dislocations pushed nominal yields away from their lows.

While market stabilisation following massive central bank interventions should address the second factor and the negative equity-bond correlation is expected to be re-established, the first, related to bonds being overvalued, is set to remain firmly in place. The question is then how to diversify portfolios looking beyond bonds. Keeping it simple, we hold the view that within alternative assets the answer is provided by gold. As central banks pull out all the stops to reflate the system, the US Federal Reserve open-ended QE being a case in point, excess liquidity, depressing real yields, will eventually find its way into the gold market. Also, there is currently little visibility as to how long the next growth impulse will last and whether it will survive this new liquidity wave. At that point gold would maintain its appeal supported by stimulus even under conditions of stagnating business activity.

Inflation-liked bonds, which like gold are boosted by real rates now capped by mounting easing efforts, should be alongside nominal bonds in a well diversified portfolio. Although US real yields are negative across the curve up to the 30-year maturity, chances of capital gains are higher for linkers. With the role of monetary policy exhausted and the whole system under the threat of lockdowns, fiscal stimulus via money-printing will further flood the major economies with liquidity giving an inflation comeback more than a fair chance – in the future. Even in the absence of inflation, in the post-GFC environment inflation-protected securities saw quite a bull run as yields dropped faster than price pressures did. In relative terms we see linkers as a proposition worth considering versus nominal bonds, provided reflation is achieved and a more prolonged recession is avoided.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

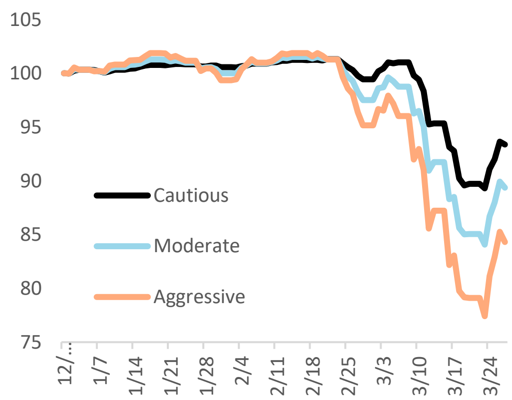


TAA – RELATIVE POSITIONING – MODERATE PROFILE

	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

Fixed Income markets reacted positively last week to the Fed's unlimited and broadened QE, and multiple tools to infuse liquidity, open up debt capital markets, and improve credit flows. Its buying of Treasuries and High-grade Municipal bonds will provide a reliable backstop to the Federal and state governments' borrowing costs, thereby making it easier for them to fund their deficits, expanded by to the fiscal stimulus packages in place to fight the Covid-19 contagion.

The Fed's Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility will help alleviate the liquidity conditions in the Debt Capital and Credit markets. High-quality issuers should benefit from this tool as it helps ensure the proper functioning of the debt market. It helps open up the stagnant primary issuance market and provides liquidity in the secondary market resulting in tighter Bid-Ask spreads.

Bond Index spreads across sub-asset classes peaked on Monday and started to tighten post the above announcements. High Yield Indices were up last week, with the US HY index gaining 7.3%. However, we still see much volatility and would advise investors to be cautious as HY issuers are still susceptible to cash crunches in the short term. Investment Grade Bonds remain the primary beneficiaries of Fed interventions, and the Bloomberg Barclays IG Credit Index OAS spreads tightened by 36 Bps and still are trading quite wide according to our estimates. There are attractive short duration high-grade global bank senior papers that can beat the current dollar deposit rates and provide higher returns, in our opinion.

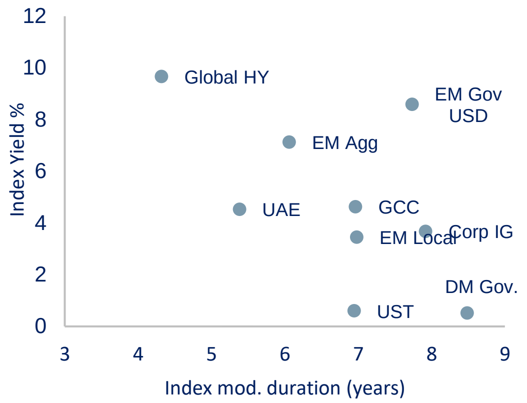
GCC was positive with IG Sovereigns rallying. The KSA and Abu Dhabi Government recovered more than 70% of their price drops from the highs of late February. Oman and Bahrain Sovereign issues also rallied to a lesser extent. Moreover, highly leveraged names in the Retail, Real Estate, and Education sector continue to suffer due to lack of investor appetite. S&P has downgraded the outlook to negative of five banks in the UAE including FAB and Mashreq due to challenging operating environment and lower profit margins while reaffirming Abu Dhabi's sovereign rating.

Broader Emerging Market bonds have continued to underperform on lingering uncertainty. Indian NBFC High-Yield issuers still trade at distressed levels owing to concerns on the countrywide lockdown effect on the cashflows. We keep our conviction on these names due to the supportive policy framework from the Reserve Bank of India, strong capitalization ratios and granularity of the business as per the current scenario. However, a long-drawn lockdown will make it difficult for the small business borrowers and NPLs will tick-up due to lack of collections, putting a lot of pressure on the credit rating of these issuers. Slovenia was the first emerging market sovereign issuer to raise EUR 1.1 Bn last Tuesday. The books were covered 1.5x giving hope that the higher quality emerging market issuers should be able to access the market if the backdrop remains supportive for some weeks.

FIXED INCOME KEY CONVICTIONS

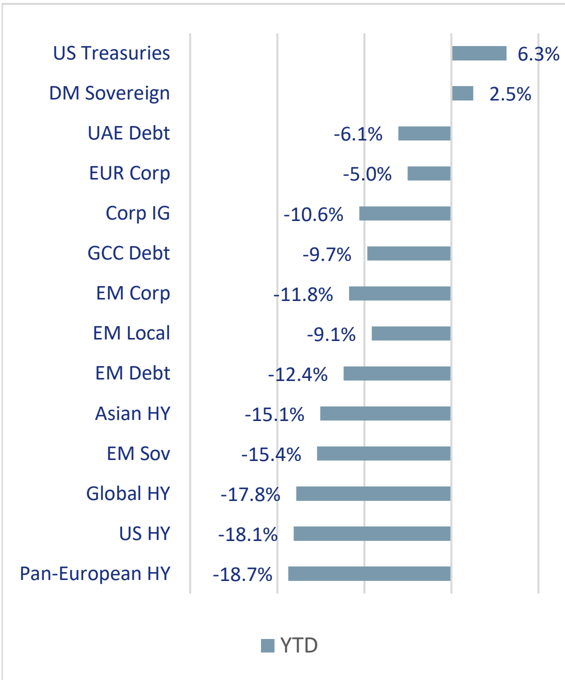
DEVELOPED MARKETS
OW US within Government
OW Corporate Credit
UW High Yield
EMERGING MARKETS
OW GCC
OW Local Currency
UW Latin America

FIXED INCOME VALUATIONS



Source: Bloomberg, indices modified duration and YTW

CHART: YTD FIXED INCOME SUB ASSET CLASS RETURNS



Source: Bloomberg

Equity Update

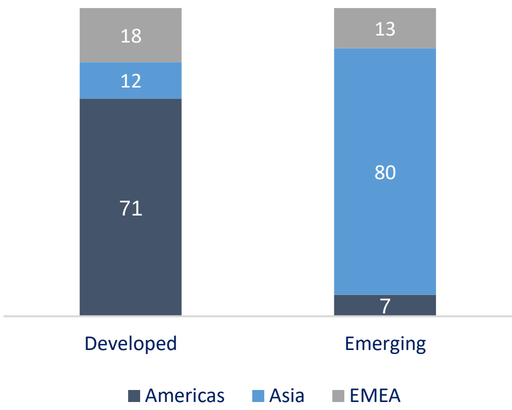
After falling 30% from all-time highs in mid-February, DM indices had their best weekly performance in years with the S&P 500 +10%, Nasdaq Composite +9% and the Nikkei +17%. Massive stimulus plans everywhere lifted sentiment. However, we aren't out of the woods yet, with GDP set to fall in 2020. US jobless claims at more than 1% of the population were a record. It is difficult to estimate when businesses will resume, hence economic growth forecasts and earnings outlooks globally are foggy. Have equity markets fully priced in the recession? We don't foresee a sustained rally or stabilization of markets until the virus outbreak is under control.

Valuations are looking optically attractive in most markets but underlying EPS estimates are too high. For the S&P 500, earnings growth for 2020 at the beginning of the year was estimated at 9% (we had forecast 4%). If earnings drop by -10% (a possibility, it's too soon to determine with certainty) that implies an EPS of 149 (2019 EPS was USD 166) and a 19X P/E multiple would take us to 2830 for the S&P 500 and a long term average of 16.5X to 2460. However, there will be pockets of outperformance. Technology, healthcare and consumer staples, our preferred sectors have been more resilient, not only in the US but globally. Layer that with selectivity, with a preference for companies with very strong balance sheets and we have our list of the winners, through this downturn. On the downside, Ford, GM and Boeing announced plant shut downs, energy and commodity companies tapped into credit lines and luxury good companies guided for a fall of 10-25% in revenue. On the upside, Nvidia stated that they've seen an increase of 50% in gaming hours and T Mobile a 26% increase in SMS (texting), a 77% increase in MMS (pictures), time on calls up by 17% and smartphone usage up 38%. Healthcare companies have accelerated production of testing kits (Roche) and clinical trials for cures and vaccines. S&P Global Market Intelligence's survey found companies expect to invest more in employee communication and collaboration technology, on mobile devices and services, on bandwidth, network capacity and information security.

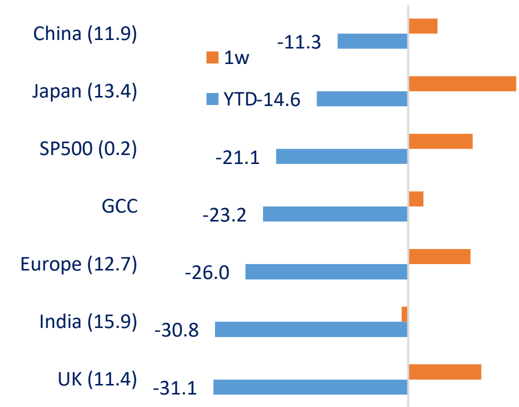
The UAE and KSA markets ended the week close to flat on low volumes, even post a mid week rally as low oil prices continue to weigh on sentiment and downgrades to earnings continue. The UAE announced a considerable economic stimulus package with the banks announcing leniency on interest payments for individuals and SMEs. Business here too is affected by the necessary lock downs.

Indian markets recovered from a 13% drop on Monday to end the week flat. India too is in a nationwide lockdown, with most businesses at a standstill. Stimulus measures are large and the liquidity infusion and rate cut by the Reserve Bank of India will ease liquidity issues for banks, with rate cuts passed on in the form of lower lending rates to individuals and companies. However, the period of lockdown is uncertain and sales in some industries such as auto and farm equipment have completely stalled.

EQUITY RECOMMENDED REGIONAL POSITIONING

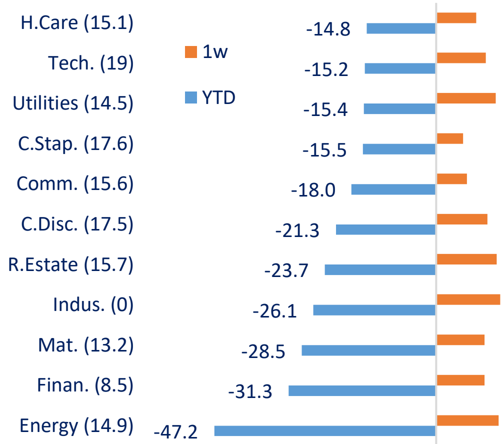


MAJOR INDICES PERFORMANCE (TR, US$) AND 2020PE



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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