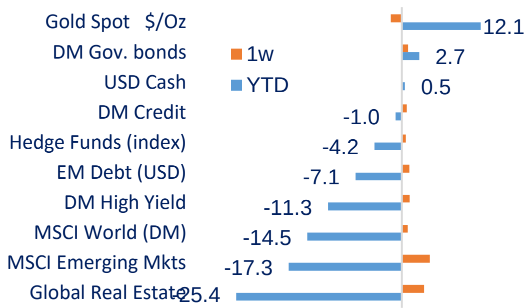
A strong start to the second quarter

- **Q1 GDP numbers are out and show a historic, synchronized, double-digit collapse**
- **Risk markets have clearly decided to trust policymakers and to look through the crisis**
- **Our valuation-based discipline calls for caution but we remain neutral for now**

With many major economic numbers being released, last week provided more details on the COVID19 disruption. Let's say it bluntly, it's not nice. The global GDP contracted at an annualized rate of c-12% in the first quarter alone. On this measure, China was close to -35%, the Euro area -14% and the US -5%, reflecting the progression of the outbreak. The magnitude is phenomenal, and the synchronization adds to the complexity of the recovery. The rebound has arguably started in China or South-Korea in March, and their PMI numbers for April are pointing to an expansion. But the momentum is fading: they cannot recover without the West. The peak of the pandemic is close in Europe and not too far in the US, but April remains frozen as restrictions are only starting to be, very gradually, lifted.

With policy responses as historic as the economic downturn, equity markets have been quick to look through the crisis. Multiples have been boosted by liquidity injections, despite one of the sharpest drops in profits ever in Q1 and the evaporation of any forward looking guidances. Paying high multiples without visibility on earnings looks disconnected, especially compared to the devastated commodity markets. We believe in the recovery, but neither its timing nor its shape are certain. Our level of conviction is not high enough to turn radically defensive –again- now but we are closely watching the developments on the healthcare front first, and gauging the realism of the different asset classes in front of it. Stay safe.

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



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Cross-asset considerations

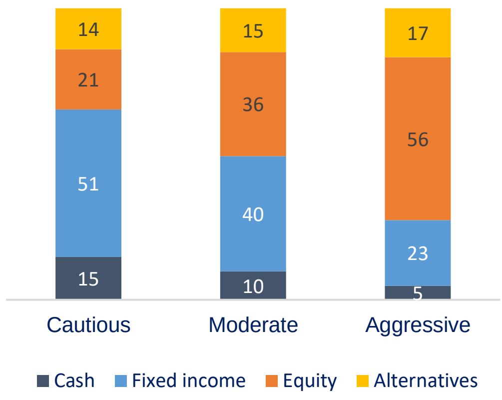
There has been an increased focus on gold as a haven of last resort since the Great Covid-19 Crisis has seen the authorities across the major countries step up stimulus efforts at unprecedented levels. Year-to-date the yellow metal is up in the low double digits, not a bad performance considering the degree of disruption in the economy and the dismal returns of risk assets in general. One might be tempted to extrapolate and project very ambitious targets for 2020 and beyond. While we hold the view that the case for gold is intact for the medium term with new all-time highs to be expected, on shorter time frames we would tend to see a holding pattern develop in the $1,600-1,800/oz range, so enthusiasm should be held in check.

We advocate that investors buy weakness instead of chasing returns as some headwinds could temporarily slow down gold's ascent. In particular, with US Treasury yields at the lower bound and real rates now driven by inflation, one must hold a positive view on inflation to see real rates drop further from the current depressed levels and gold move higher. Yet, the developed economies are entering their most deflationary patch, with Q2 activity sinking beyond expectations as the repercussions of lockdowns remain hard to gauge. And if one rather looks through the intense economic damage beyond the current quarter and projects an economic recovery and hence resuming price pressures, then one would rather buy equities than cling to safe havens. In short, upside from low real rates and the announcement effect of liquidity injections seems to be almost in the prices for the immediate future. We do not deny that $1,800/oz can be within reach on further uncertainty and that a fully-fledged recovery is not round the corner, but breaking that level decisively, which is our target price for the year, would require fresh drivers and no competing assets in sight.

If we abstract from these shorter time horizons we would tend to find plenty of reasons to accumulate gold, which in real terms has not even reached its previous all-time highs recorded in January 1980, about 30% above the current inflation-adjusted prices. The sheer size of stimulus interventions, beyond the announcement effect off which gold has so far traded, dwarfs all of the Great-Financial-Crisis measures and will with time debase the value of currencies, by increasing their supply by all means beyond what is justified by the levels of economic activity. The growing consensus for so-called 'helicopter money', the monetization of budget deficits by central banks to allow governments to spend freely without incurring new debt, is only making matter worse by increasing the deluge of money which will be inundating the system. Barely sustainable debt levels accumulated during the crisis, which would be dampening economic growth rates, combined with plentiful liquidity would be the fuel to the fire of gold's long term bull market.

The dearth of income-generating assets alongside the new degree of uncertainty brought about by the virus, expected also to bolster persistently higher savings rates, are all pointing in the same direction of higher gold prices. Patient investors buying weakness will be rewarded.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

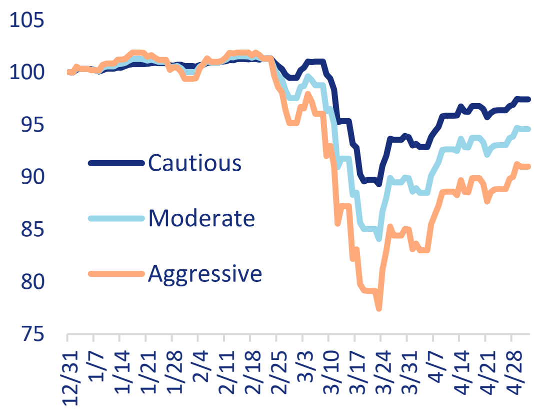


TAA – RELATIVE POSITIONING – MODERATE PROFILE

	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

Last FOMC meeting could be termed as a "dead rubber" in sporting parlance. All the decisions were already taken in previous emergency meetings, and an array of tools had already been decided. Moreover, Powell clearly mentioned the rates are going to remain "lower for longer," which puts a cap on the already cratered inflation expectations. That means the "Term Premium" in credit curves will continue to languish. This interpretation makes a strong case for taking positions in long-duration quality credits that have price dislocations due to a multitude of reasons while sticking to a shorter duration in credits where the curve is flatter.

The Fed has reduced its bond purchases to $8bn/ day this week. US Treasuries bear flattened last week with a large supply meeting Fed's reduced bond purchases putting pressure on the front end of the curve. The size of total Treasury issuance is expected to reach $4tn this year, out of which FED might have to absorb $2.5tn. Even though the majority of this issuance is going to be front end, the sheer size leaves enough space for the introduction of the previously announced 20-year treasury bonds.

The success of FED's monetary policy can be judged by the pace with which Libor-OIS spreads have come down post 23rd March. As on Friday, Libor-OIS spreads were at 50 bps with 3-Month Libor setting at 0.54% on 1st May, which was the lowest level since Dec 2015. Money market funds have seen close to $82bn net flows since end-March, indicating investor confidence building up pushed by increased liquidity in the system. US investment-grade corp issuance notched another record month, touching USD 285bn in April while HY issuance reached $ 37bn as compared to only $4.5bn in March even though 71 companies filed for bankruptcies which is already almost half of 2019 total cases.

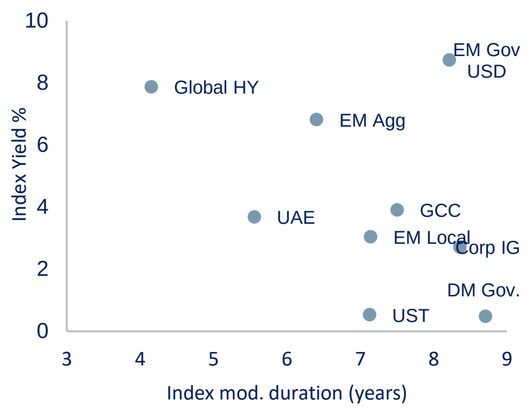
This week the ECB kept its asset purchase programs unchanged but introduced more generous terms for its TLTROs and a new long-term funding facility, the PELTRO (pandemic emergency long-term refinancing operation). The PELTROs will be held until the year end and will mature between June and September 2021. With Italy maintaining its investment-grade rating, PELTRO provides incentives for buying Italian bills. However, still deteriorating macro conditions continue to put pressure on long-end sovereign spreads in the EU since ECB support is limited to the front-end of the curve.

All the major debt indices returned positive last week with Global HY and Emerging Market Debt indices leading the returns chart. GCC Bloomberg-Barclays index tightened significantly with a lot of interest in the front-end of quality credits. Most of the A-rated short duration credits have rallied to yield below 3%. This price action has made the KSA curve steeper compared to Abu Dhabi. However, KSA EUR bonds have been under pressure due to the possibility of KSA issuing new bonds soon in the currency. We repeat our "Stay Up in Quality" clarion call while maintaining aversion to short call date GCC Bank perpetuals.

FIXED INCOME KEY CONVICTIONS

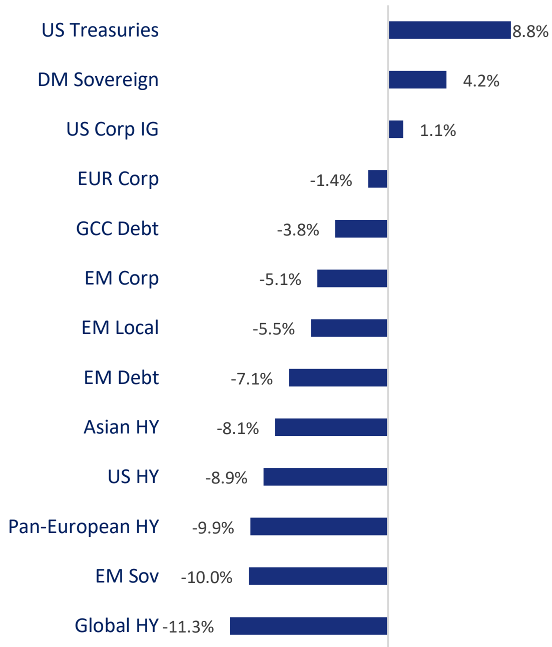
DEVELOPED MARKETS
OW US within Government
OW Corporate Credit
UW High Yield
EMERGING MARKETS
OW GCC
OW Local Currency
UW Latin America

FIXED INCOME VALUATIONS



Source: Bloomberg, indices modified duration and YTW

CHART: YTD FIXED INCOME SUB ASSET CLASS RETURNS



Source: Bloomberg

Equity Update

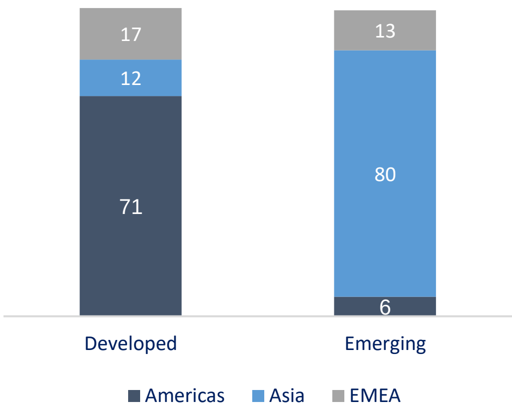
Global equities pulled back on Friday, after rallying through April and most of last week, with many companies stressing an uncertain outlook in their 2020 guidance and on a resurfacing of US tensions with China. Markets have welcomed the start of global preparedness for a vaccine by 2021 and the positive testing from the US on the efficacy of Gilead's Remdesivir (which now has US FDA approval) as a treatment for virus patients. The week however, ended with investors concerned about a trade-war like scenario with tensions exacerbated between the US and China. Though oil prices remain volatile, the GCC markets are up in April, led by the Dubai Index + 15%, supported by a recovery in logistics and real estate.

April saw a sharp recovery of most global indices from March lows, though economic recovery looks to be lagging, with a flat trajectory at best. With indices now trading above our fair values and valuation multiples above long term averages (a result of lower earnings), we reiterate our focus on alpha by investing in companies with sustainable growth strategies, dividend players with strong cash flows and serviceable leverage. Sector preference continues for tech companies in the connectivity and data subsectors, healthcare in the big pharma, digital and gene editing sectors and consumer durables with majority revenue from food and household cleaning products. Consumer companies that have held up well this year include Pepsi, which highlighted increased sales from breakfast foods and Unilever which benefited from consumers stocking essentials.

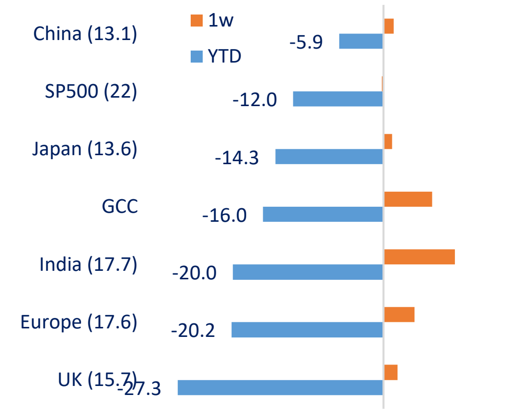
The S&P 500 posted its best monthly return +12.8% in over 32 years, despite ending the week on a down note. Friday saw a slew of disappointing tech earnings and economic data in the US. Along with an expected GDP contraction, Jobless Claims in the past six weeks add up to a loss of over 30 mn jobs i.e 18% of the US workforce. Personal Consumption and PMI numbers also disappointed. The Fed's stimulus has been a strong support to the markets and continues as the Fed increased aid to energy companies. Even the larger E&Ps cannot withstand the continued low prices. Whilst BP, Total and Chevron haven't cut dividends but cut cap ex and buybacks, Shell cut dividends for the first time since the 1940's. Shell is 8% of the FTSE dividend and adds to other European companies that have cut dividends.

FAANG (+10% YTD) earnings dominated US market movements last week, with just five of these tech heavyweights comprising 20% of the S&P 500 Index. Amazon has had a spectacular year to date rally +24%, but disappointed on earnings and a plan to spend Q2 profits on its coronavirus response to protect employees. Apple announced flat y/y revenue growth and provided no guidance, for the first time in over a decade. Microsoft and Alphabet Q1 sales and profits surprised positively, the former buoyed by demand for internet-based software and cloud services needed to accommodate a shift to remote working during the coronavirus crisis. The lack of growth elsewhere will keep the FAANGs in favour for some time to come.

EQUITY RECOMMENDED REGIONAL POSITIONING

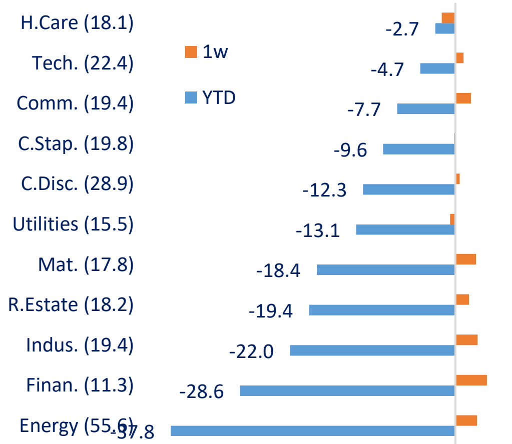


MAJOR INDICES PERFORMANCE (TR, US$) AND 2020PE



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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