"Sell in May" wouldn't have been a great idea this time

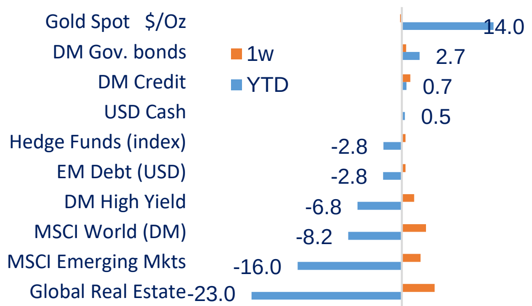
- **The rally in risk-assets intensified last week, ending a very positive month of May**
- **The scenario of a significant bounce of global activity in H2 is gaining credibility**
- **Valuations are however stretched and crucial economic data will be released this week**

Markets didn't pay much attention to geopolitical and social tensions last week, with an intensification of the equity rally. It was a good month: every asset class was positive, led by oil prices, followed by stocks, high yield and emerging market debt. The backdrop indeed is a perfect combination of a credible economic rebound in H2, meeting high liquidity and low interest rates.

On the macro front, Friday's consumer report in the US was stunning: consumer spending plunged 13.6% in April, slightly more than expected, but personal incomes were up 10%, boosted by social benefits, which resulted in a record high savings rate, close to 33%. This illustrates the magnitude of the stimulus but also the potential for consumption to rebound, especially as in the meantime, inflation collapsed. Crucial economic data will be released in the week ahead: global PMIs for May, and the US monthly job report on Friday will give precious cues on the timing of the recovery. PMIs for China are just out as we write. Services remain strong but manufacturing number is weaker than in April – global demand is needed to run China's factories at full capacity and rising tensions with the US are clouding the outlook.

The positive macro scenario is fully priced-in, but the combination of pessimistic positioning and room for further rotation towards cyclical sectors could support markets, especially as restrictions are being eased in India, Indonesia and soon in New York City. Our positioning is unchanged. Year-to-date, our three profiles are down less than -1%, -3% and -7% respectively.

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



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Cross-asset considerations

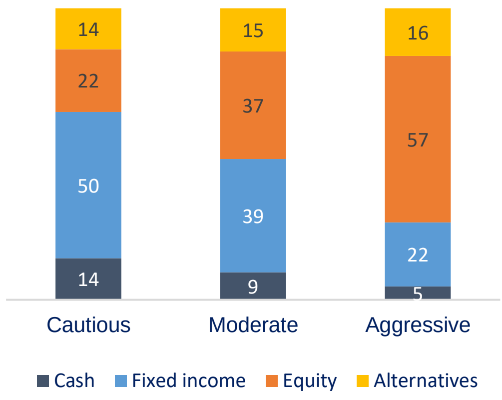
Usually the United States make financial market headlines, but this time Europe's turn has come. It has taken the COVID-19 crisis to crystallise the urgency in the euro area for extraordinary measures aimed at shifting it in the direction of a fiscal union from a monetary one, rather than a well thought-out design of the European leaders eager to confer more stability to the common project. In the same way that authentic family bonds become stronger when tested during harsh times, Angela Merkel and Emmanuel Macron have decided that the challenges posed by the pandemic require closer ties at a European level, or the union risks unravelling.

Under their leadership the European Commission announced Wednesday a proposal for a €750bn fund aimed at supporting recovery efforts. This plan marks quite a departure from past initiatives, since the bulk of the proceeds should be allocated in the form of grants to the countries most severely hit by the current crisis. Grants rather than debt make a stark difference, as the rescued countries would not be burdened with unsustainable debt loads and at the same time, with the richest contributors making larger repayments to fund the initiative, the proposal implies the sharing of debt. Hence, although this is not the same as eurobonds, it breaks with the long-held taboo of debt mutualization. While the so-called "frugal four", Austria, Sweden, Denmark and the Netherlands, will do their utmost to thwart Merkel and Macron's designs, Germany is well aware that there is no European Union without Italy or Spain, even less so a common market for German exports.

Removing the tail risk of the break-up of the Union should imply a rerating of some european assets. The euro has responded promptly, breaking out of its monthly range above 1.10 to trade at 1.11, and above. Sentiment has also changed, with derivates contracts making it now more expensive to be bullish the euro than the dollar for the next month. Further strength should only be expected once the proposal has been approved, though, and summer time should provide more clarity in this respect. The US dollar has also started to weaken significantly against the major commodity currencies, the Canadian and the Australian dollar. The former has broken through an important technical level and recorded a two-month high, the latter is close to testing a three-month high after snapping back from levels last seen during the Great Financial Crisis.

If we take a step back from the momentous times in Europe to look at the bigger picture, we would be tempted to say that the currency markets are pointing to further dollar weakness driven by an improving outlook outside of the United States. This would allow for the further easing of global liquidity conditions and the rerating of the most cyclical assets, EM and possibly European equities. For now capped bond yields and the event risk posed by the US elections later this year constitute quite a hurdle in this sense. Post elections, times could be ripe for a rotation within risk assets, though, as policy stimulus permeates the economy and investors act on US dollar overvaluation.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

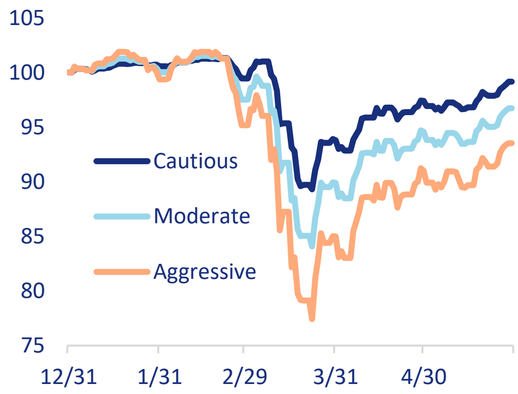


TAA – RELATIVE POSITIONING – MODERATE PROFILE

	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

We enter the month of June with trepidation. When we look back at the level of spreads in various benchmarks across the sub-asset classes within Fixed Income, there is a significant amount of normalization being priced in. "A rising tide lifts all boats" is a proverb that was in action during April and May as liquidity infused by the central banks calmed the nerves of investors and supported credit across the world, opening up primary issuance markets and tightening bid-ask spreads in the secondary market to a large extent. However, rising default rates in high-yield and the spate of downgrades keep us on our toes. Increasing Geo-political tensions add a higher degree of uncertainty to the mix. While we don't foresee a significant blowout in the spreads in the near term, we would rather err on the side of caution in the short term.

Powell commented on negative rates last Friday, mentioning that this particular policy tool may not be appropriate for the US and is in line with our views on the subject despite fed funds futures pricing negative rates around the middle of 2021. The Fed is likely to add yield curve control in addition to the ongoing QE before succumbing to the lure of negative rates. According to Powell's comments, we expect to receive ample guidance in case FED considers going for negative rates since money market funds, which are vast consumers of T-Bills, are not compatible with the negative rate regime.

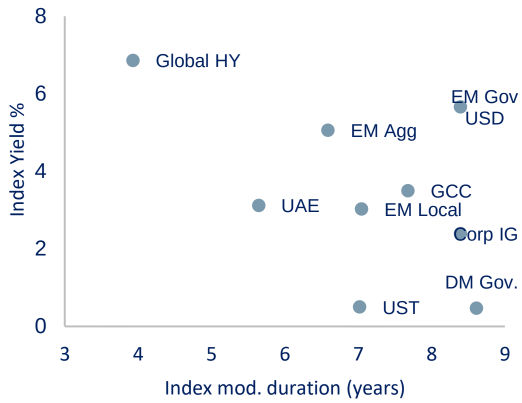
Spreads continue to grind lower, with high-yield spreads closing below 700bps for the first time since the crisis and EM spreads trading below 450 bps. High yield and EM Debt indices returned more than 5% and 4.5% last month while safe assets such as treasury and IG credit returns were muted. We believe most of the spread tightening in the Developed Market Investment Grade asset class is complete, and investors have to look towards Emerging Markets to generate desired returns. With IG sovereigns spreads still trading wider to historical, there is ample value along with relative safety since sovereign solvency is not at the forefront of the risk spectrum.

GCC debt markets had one of the best months in history, with the regional index returning more than 3% last month with more noticeable gains in the front-end of the curve. The OAS spreads are pretty tight, trading below 300 bps for the second week consecutively, in line with an improved oil-price outlook. The Kingdom of Saudi Arabia has announced several austerity measures while maintaining fiscal support for the economy to weather the Covid-19 related shutdowns. A combination of these factors has improved investor appetite for MENA region bonds. Abu Dhabi tapped its April three-tranche issue before the Eid break to take the total bonds issued to USD 10 Bn amidst phenomenal demand. Egypt followed suit by selling USD 5 Bn of debt and pricing the bonds within the Bahrain curve as per our views that Egypt is a safer credit in the HY sector of the MENA region as compared to Bahrain and Oman.

FIXED INCOME KEY CONVICTIONS

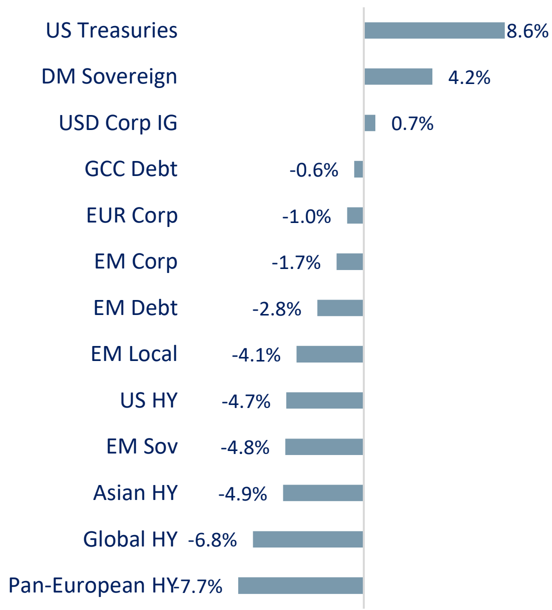
DEVELOPED MARKETS
OW US within Government
OW Corporate Credit
UW High Yield
EMERGING MARKETS
OW Asia
OW IG Sovereigns
UW Latin America

FIXED INCOME VALUATIONS



Source: Bloomberg, indices modified duration and YTW

CHART: YTD FIXED INCOME SUB ASSET CLASS RETURNS



Source: Bloomberg

Equity Update

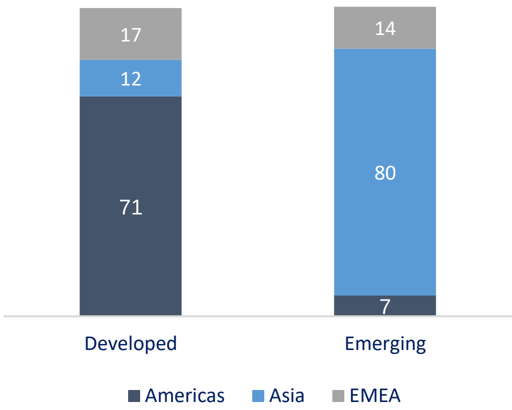
Global equities rallied in May led by a strong performance from the main developed markets: the US, Europe and Japan. The upbeat tone for DM continued into last week, however sector rotation saw out of favor sectors: Financials, Industrials, Real Estate and Utilities gain. Industries most punished by the effects of the economy shutting, airlines and cruise companies, were the top performers in anticipation of an uptick in spending on discretionary goods and services. The US bank rally was significant as it portends hope in a V shaped economic recovery and the broader market rally is important for the S&P 500 to maintain the 3000 level, which is the 200-Day Moving Average. The reopening of the economy, progress on vaccines and additional fiscal stimulus are all leading to optimism. Moderna is one of the 5 companies in the lead for vaccine development and has shown promising results from its Phase I (early) trials on limited samples of people. It is still too early to come to any conclusion and will take time for more rigorous and extended testing and then finally production. At this time it is difficult to say, which company will have the most effective vaccine. Technology and healthcare, not only lead year to date sector performance, both are in the green and we retain our preference, along with the US in DM.

WTI Crude had one of its strongest monthly return ever. The UAE and KSA markets however, performed more in line with EM than oil in the month of May, as GCC economies are only now, slowly starting to open up. Tourism is yet to resume with airlines starting flights in a phased manner. Markets were closed for the Eid break and the MSCI rebalance should boost trading volumes this week.

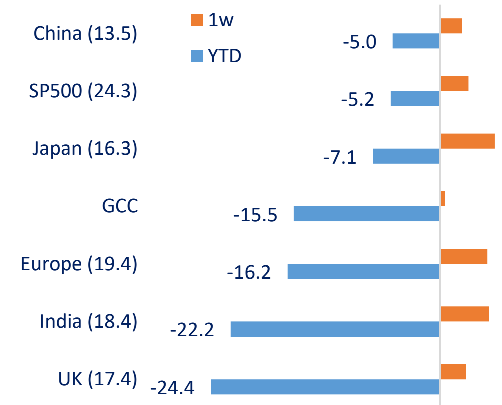
The US S&P 500 and MSCI China remain the best performing major equity indices globally c. -5% year to date. The S&P 500 is however trading at a high multiple, 24X forward Price to Earnings, justified only by a look through to 2021. China had negative returns in May and broader EM were laggards up just +0.8%, compared to +4.8% for DM. Chinese data indicate manufacturing and auto sales are recovering but consumer spending, the biggest driver of growth is still declining, amid widespread job losses. US China relations have been in focus with Pres. Trump highlighting the administration's frustration with China, including possible trade sanctions for Hong Kong. The Hang Seng Index, -18% year to date has been amongst the worst performers globally, with local protests adding to the COVID lockdown impact. Restrictions have been put on Huawei's semiconductor supply from US companies and whilst the China government has reportedly spent c. USD 2.2 bn on developing technology on the chip front, the US still leads on high end wafers. The US Senate bill on possible delisting of the 230 China companies listed in the US, has led to increased volatility for these companies stocks. Their operations are inland China focused but their ownership is one third US investors.

India should regain lost economic ground, as it opens up. Sovereign funds and DM corporations continue to scout for opportunities in Asia's growth economies. Reliance Jio's digital platform continues to see interest, with Microsoft and Abu Dhabi's Mubadala Investment Company reportedly interested in investing.

EQUITY RECOMMENDED REGIONAL POSITIONING

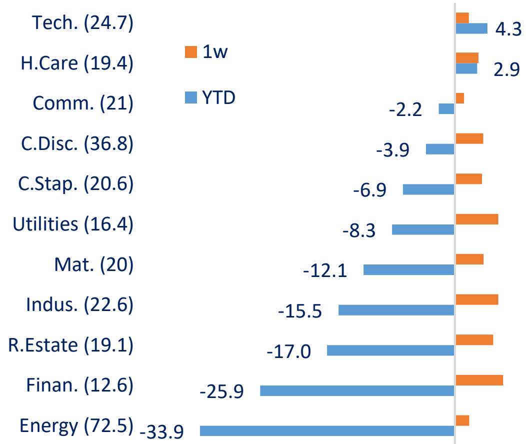


MAJOR INDICES PERFORMANCE (TR, US$) AND 2020PE



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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