Investment Weekly

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The strong get stronger as central bank liquidity increases

- **The NASDAQ Composite turns positive for the year as large tech stocks erase their Covid-19 losses.**
- **Five companies alone have accounted for nearly a quarter of the S&P 500 gain since the 23 March low.**
- **The US saw unemployment rise to a record 14.7% in April, with the majority of losses among low-paid jobs.**
- **Average hourly earnings increased, as the highest-paid workers retained their positions.**
- **Markets are now contending with the potential impact of the crisis on elections in the US and Europe.**
- **The FAB AAC remains underweight equities and overweight gold amid continued market uncertainty.**

Maybe it is the law of nature, but the Covid-19 pandemic is exacerbating the disparities in the financial and economic world. The lockdown enacted by many governments around the world is impacting poor people the hardest, while in stock markets the biggest companies are gaining the most.

Perhaps the best embodiment of this came in the nonfarm payrolls report on Friday. US unemployment rose to 14.7%, the highest since the data began to be published. At least 20.5 million jobs were lost in April, according to the Bureau of Labor Statistics. However, the pain was spread unevenly. Blacks and Hispanics, the poorest ethnic groups, saw unemployment rates increase more than others, to 16.7% and 18.9% respectively, compared to 14.2% for whites.

Daycare and school jobs declined by 793,000, as schools closed, while retailers laid off 2.1 million people. The largest decline happened in leisure and hospitality, a sector which laid off 7.7 million people, or 47% of its workforce. Waiters, receptionists, and cleaners are among those comprising the bulk of the jobs in this sector and are some of the lowest-paid workers in the US.

This reality became apparent in a 4.7% spike in average hourly wages. This was the statistical result of removing some of the lowest-paying jobs from the tally, while those in tech, finance or law, to mention a few, who can work from home, remained employed. Then there is the so-called ‘underemployment rate’, which now represents 22.8% of all those considered to be in the workforce. This means nearly a quarter of Americans willing to work either do not have a job, or have part-time work, or are doing something that does not match their skills.

The US lost 20.5 million jobs in April, eliminating eight years of job creation in a month

By the way, the number of Americans considered ‘in the workforce’, dropped dramatically. A broader number, the employment-to-population ratio, offers a better perspective of the true pain: 48.7% of all Americans, or 126.6 million people in the US, are out of a job.

The US numbers can be extrapolated to the rest of the world, where data is either less reliable or not as frequent. Indeed, even China, which often faces questions about its economic data, is experiencing the highest unemployment since it began to publish such numbers. At the end of February, 6.2% of people in the country's urban areas were jobless. In short, the world’s largest economies are facing their highest unemployment yet.

To battle the epic recession that stems from this high unemployment, central banks have been using the only tool available to them: monetary easing. While governments are doubling down with fiscal easing, the impact of adding liquidity to the system is much faster, even if less effective at getting people back to work.

Perhaps the only solace that the poorest people have is cheaper gasoline prices. But even that is reversing, with Brent crude prices having gained nearly 45% over the past two weeks. It remains low at US$31/barrel, which is not good news for Middle Eastern countries.

Monetary easing may help even Brent, but its quickest impact is, in reality, in other asset prices. With money more plentiful and cheaper, those who have access to it can deploy it into investments capable of generating higher returns than what they have to pay for their loans.

That is more or less what has been seen in the stock market. US equity indices have recouped a significant portion of their March losses. After rallying 6% last week, the tech-heavy NASDAQ Composite Index is now positive by 1.7% for the year. To be sure, however, it is still 7.1% down from its 19 February high. The S&P 500 remains 9.3% down for the year and 13.5% below its 19 February high. Still, it has rallied nearly 31% since the 23 March low.

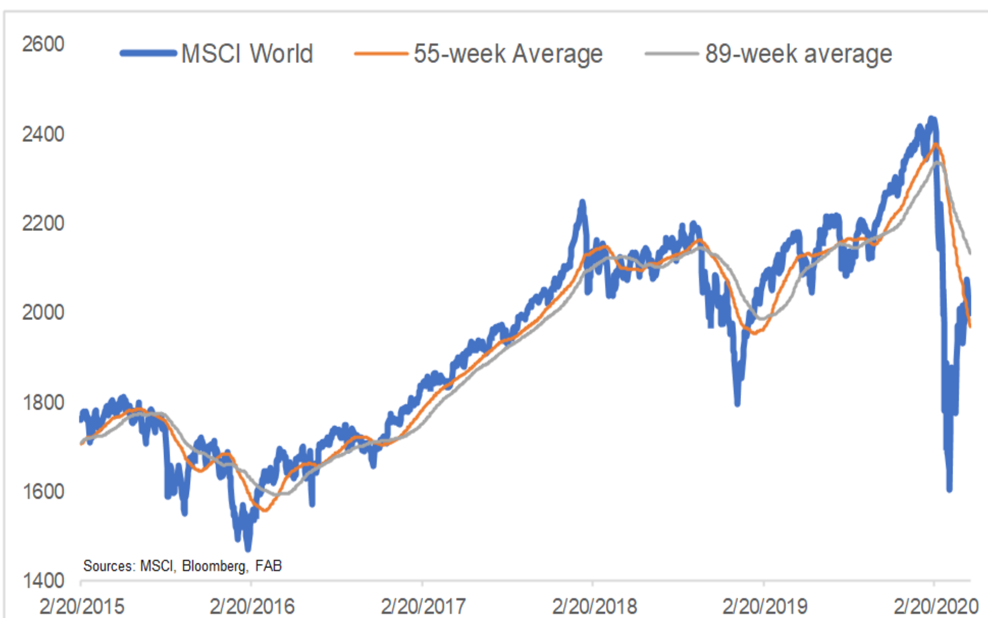
This rally, however, was largely driven by a few large, cash-rich companies . Nearly a quarter of all the gains in the S&P 500 since the 23 March low were driven by five stocks: Microsoft, Apple, Amazon, Facebook and Alphabet (the parent company of Google). These stocks now represent a fifth of the market cap of the S&P 500. The strong are getting stronger. Even within different sectors the pattern has been the same, with the largest, most liquid companies outperforming the smaller ones.

That raises the risk that any bad news related to these stock market mammoths could drag down the entire index. It also increases the potential volatility of the index. However, perhaps more important, it gives these companies a lot of firepower when it comes to mergers.

Most large acquisitions in the US involve some sort of stock payment. Companies that have more valuable shares (and more of them) are in a better position to acquire others that may be earlier in their development. Nearly all of the names mentioned above have been serial-acquirers, and they are likely to step up that process. This is not necessarily a bad thing, but it may prompt more scrutiny, particularly at a time when political turmoil is likely to increase.

Before the Covid-19 crisis, they had already been the focus of increased questioning in Congress, with some policymakers calling for antitrust reviews of their businesses. While that has taken a backseat to general concerns about the global economy and how to restart it, as things normalize and politics get heated again, questioning and scrutiny of these behemoths will return.

World stocks are testing resistances as unprecedented liquidity is added to the system



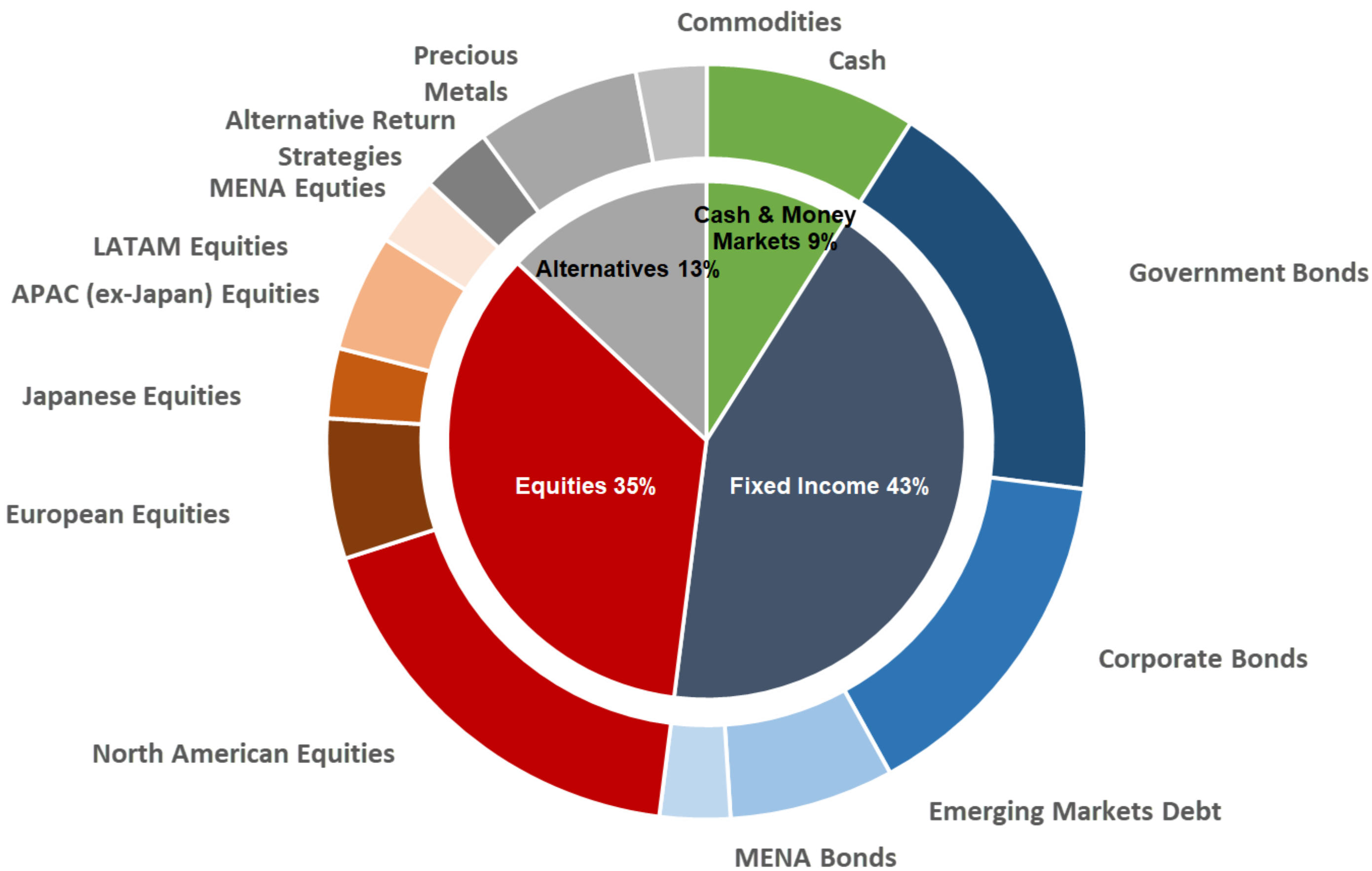
Sources: MSCI, Bloomberg, FAB

And politics are, indeed, set for an interesting time ahead. Poor people across the world have lost their jobs and in emerging markets they have also seen the price of everything they buy go up as their local currencies depreciated. Meanwhile, stock and bond markets, especially in the developed world, are rallying, making the value of holdings of rich people larger.

That is a recipe for dissatisfaction, which is likely to be reflected in polls over the coming months and years. Perhaps the first and most important of them will be the November general election in the US. The latest surveys have seen Joe Biden, the Democratic presumptive nominee, leading Trump in opinion polls in key states. A Democratic victory amid record unemployment of the poorest Americans is almost certain to lead to a review of taxes in the US, particularly taxes on income for high-earners, and for capital gains. Stock markets could suffer if they are forced to price in the likelihood of such taxes.

In Europe and several developing nations a similar dynamic could see nationalists winning upcoming elections and perhaps questioning much of the thought framework that created many of the globalist institutions that now exist. The world is likely to be very different in the next five years.

Current Tactical Asset Allocation



Asset Class	Positioning	Detail
Cash	Overweight	After taking profits on some equity positions.
Fixed Income	Overweight	Keeping slightly overweight focused on EM dollar debt and corporate investment grade bonds
Equities	Underweight	After taking profits on part of the US and European equity exposures
Alternatives	Underweight	However, overweight on precious metals specifically

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