Investment Weekly

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Investors build high hopes of more fiscal stimulus in the US

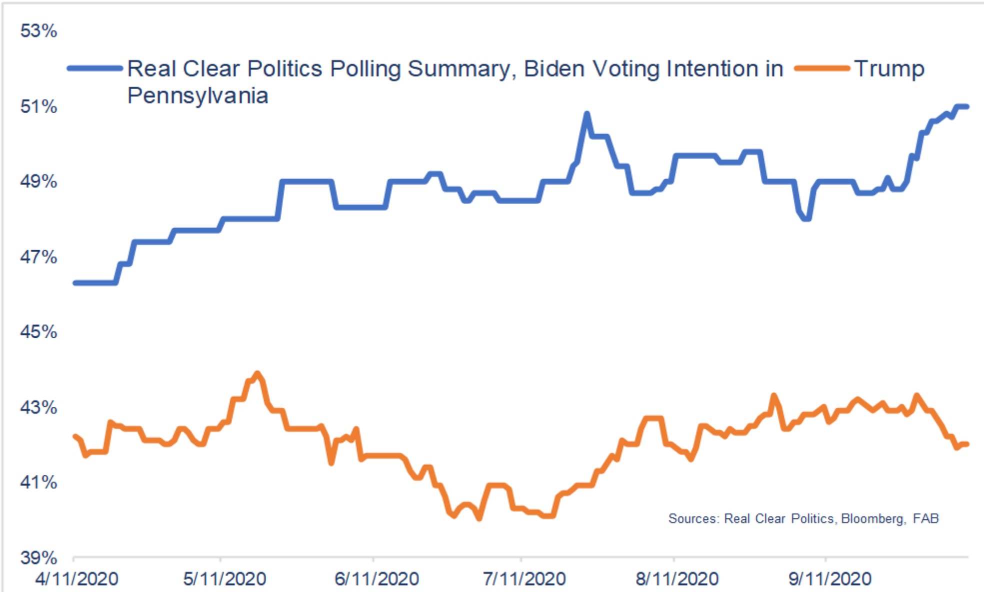
♦ The White House and the US House of Representatives continue to disagree on the format and size of another stimulus package.

♦ Prospects for more US government spending are improving, as Senator Biden leads in key polls.

♦ Higher taxes and the possibility of anti-trust action against US large tech firms calls for some caution.

♦ Here in the GCC area, PMIs suggest the region has started to grow again as economies reopen.

♦ The FAB AAC remains slightly underweight in equities, and overweight in IG bonds and gold



Global investors seem excited about the prospect of more government spending in the world's biggest economy. Markets have taken off as Senator Joe Biden's lead in the polls in key states such as Pennsylvania widened recently.

The NASDAQ Composite index was up 4.56% last week while the S&P 500 gained 3.84%. At the same time, the US Treasuries curve steepened, with the yield difference between the 30-year and two-year bonds increasing six basis points.

The latter move signals that investors are starting to price a higher likelihood of inflation returning, something that could be partly explained by expectations of forthcoming government spending.

For now, however, there is little immediate hope for more stimulus, given that extra fiscal support talks seem to be going nowhere in Washington. In fact, President Donald Trump called off negotiations on a new package with the Democratic House of Representatives early last week.

He later backtracked on that, suggesting he would endorse targeted measures aimed at avoiding tens of thousands of layoffs in the most affected industries. Nancy Pelosi, the Democratic Speaker of the House of Representatives suggested the overture was too little, too late. As it stands, the probability of a stimulus package being approved before the 3 November election seems very small.

Hence, it is unlikely that the excitement in US markets is driven by forecasts of imminent spending. Instead, investors seem to be pricing higher odds of seeing the US$3.8 trillion stimulus Democrats are promising if they win the Senate and the White House in November.

Indeed, recent fundraising increasingly suggests there is a significant probability of a Democratic sweep. While the third quarter numbers of the Federal Election Commission are only likely to be known by the end of the week, Bloomberg reported last week that in September the Biden campaign raised more than the record US$364.5 million record of August.

Vice-President Joe Biden' lead in polls has widened in swing states such as Pennsylvania

This has also emboldened investors, many of whom may have been concerned that a contested election could lead to a protracted battle in courts. The widening Democratic lead in key battleground states may have started to create a sense that a clear win could be ahead, something that would at least eliminate the uncertainty related to the transfer of power. And investors hate uncertainty.

To be sure, the election is not over yet. Four years ago, Democratic candidate

Hillary Clinton led President Trump by a comfortable margin in Pennsylvania surveys. The state was a key win for Republicans that year. A drilldown into the latest polls (some of which show Senator Biden 13 percentage points ahead in Pennsylvania), still suggests Pennsylvania remains a close call.

The biggest problem may be what happens to the Senate. If President Trump manages to stay in the White House but the Democrats win the Senate, he will face steadfast resistance to any plans of his. Meanwhile, the President himself could veto a number of Congress initiatives, including more fiscal spending. In simple terms, this scenario would translate into four years of very little being achieved in Washington.

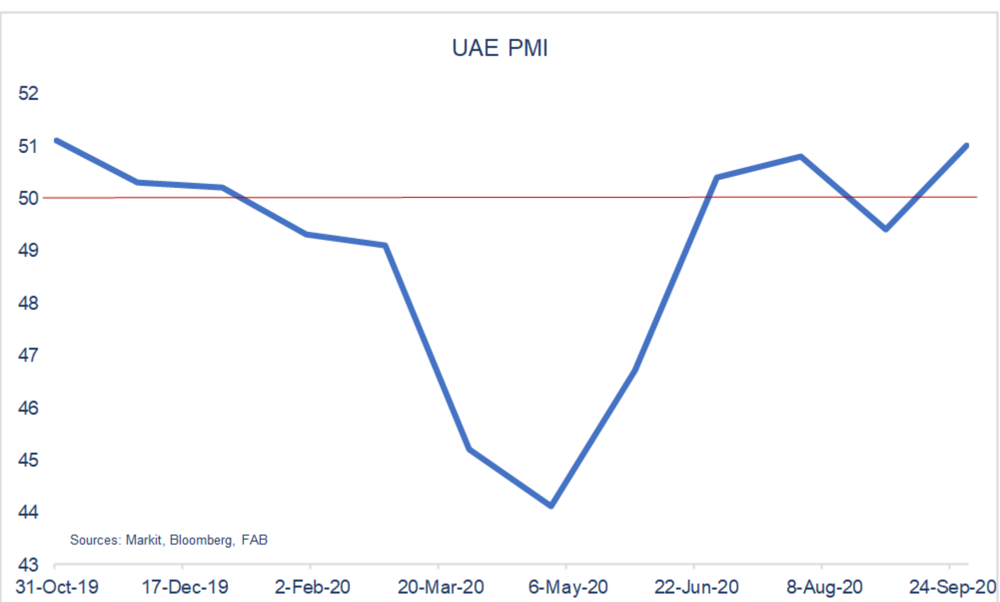
Meanwhile, the scenario that investors seem to be pricing as more likely, a Democratic sweep, may not be all roses either. The Democrats have been spearheading calls for anti-trust action against some of the biggest technology companies, which happen to be the ones that have led the stock market gains in the past few years. They also want higher taxes, which would impact these companies and could increase the burden for high-earners of owning their stock.

These factors suggest technology shares could suffer towards the end of the year if there is a Democratic sweep. The potential for more fiscal spending also points at potential gains for small-cap companies, cyclical sectors and emerging markets.

Developing nations are particularly ripe for a boost from a Democratic win. If President Trump is given another term, he is likely to turn up the heat on China, which would bring back concerns about trade and nationalism. A Democratic win does not preclude those stances, but the track record of the party suggests a more friendly and globalist approach to the rising power in the East.

Emerging markets have been particularly bruised by the pandemic-related crisis too, so they could enjoy a period of heady gains. There could be, however, quite some differentiation among the various markets. Those that have enacted less strict or shorter lockdowns, such as Brazil, are seeing their economies recover faster. Even in the Middle East that pattern is starting to emerge.

Leading indicators in the UAE and Saudi Arabia suggest their economies are growing again



The UAE, one of the most successful countries in the world in its management of the virus, has mostly been emerging from its lockdowns for several weeks now. That has started to be felt in the economy, with the number of real estate transactions and tourist visits rising rapidly. The result is also showing in leading indicators. Last week, the Markit Purchasing Managers Index survey for the country came in at 51.0, its highest level in a year and a level that signals that the economy is growing on a month-on-month basis.

Dubai individually has shown an even stronger recovery, with its latest PMI at 51.5 (anything over 50 indicates economic expansion). More than a tenth of Dubai's economy depends on tourism and the emirate has become the fourth most visited destination in the world. The fact that it was able to open its borders earlier, which could translate into a higher market share of the world's travelers, and a shift in the regional landscape, should support faster growth in the emirate next year.

The rest of the Gulf Cooperation Council is also giving signs that things could start getting better pretty quickly. Over the weekend, the Kuwait parliament passed a bill to support more lending in the country, while a recent tax change in Saudi Arabia could boost home sales there.

Capital flows are now being attracted to the MENA region, with perhaps the poster child of that being Egypt. Even after the central bank cut interest rates further last month, foreign currency reserves in the country climbed to a record, according to the central bank, a sign that global investors are still flocking to Cairo.

Finally, banks in the region could find a stronger incentive to lend in coming months as the yield on long term loans has increased more than the cost of borrowing in the short-term. While many of the financial institutions in the Middle East are still dealing with the non-performing loans resulting from the crisis, many have raised capital and could start helping to fuel growth again.

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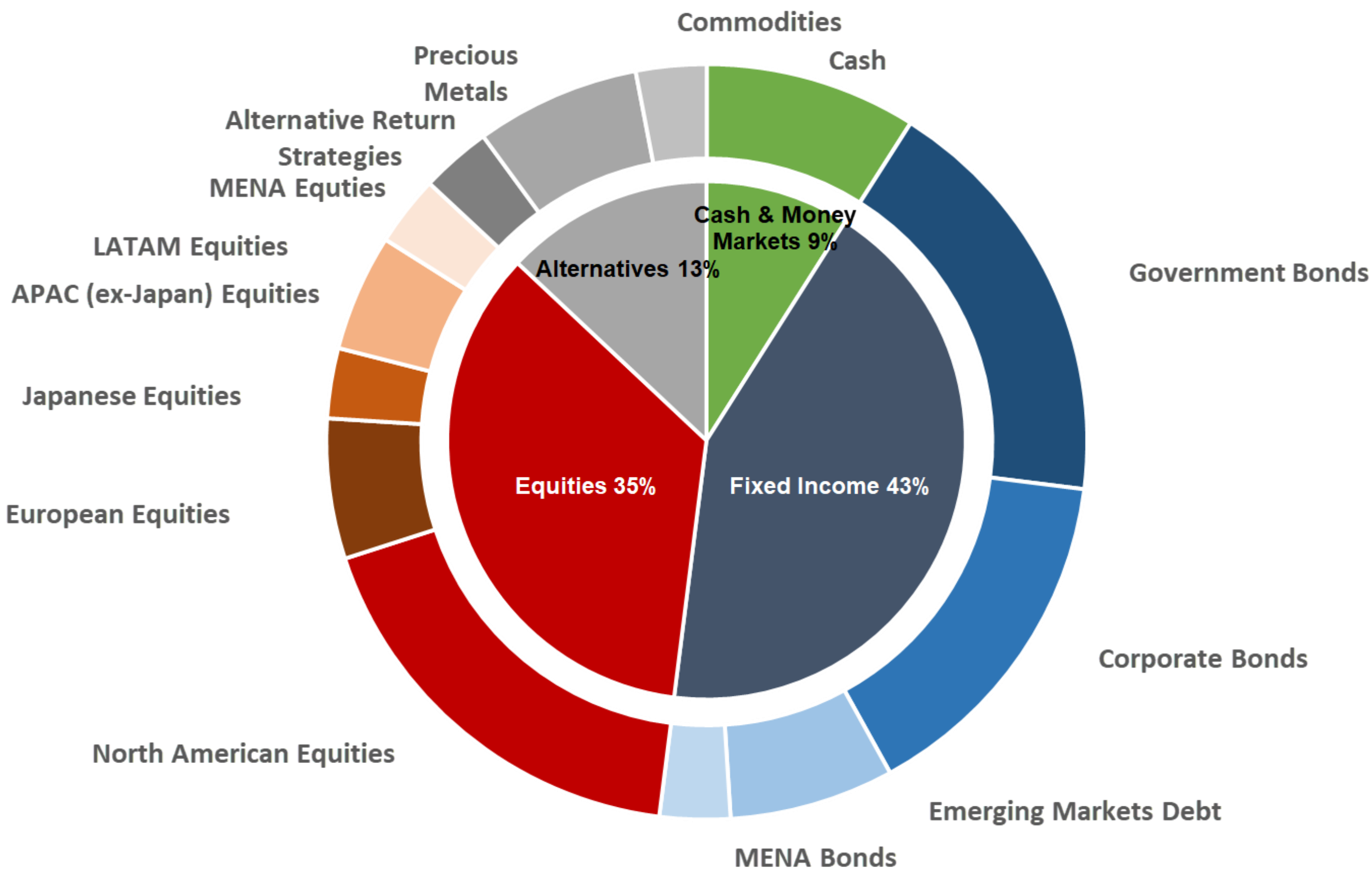
Current Tactical Asset Allocation



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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