Investment Weekly

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15 November, 2020

Investors disregard the bad news and looking into 2021

- **The S&P 500 is up 9.64% so far this month, while the Russell 2000 has rallied 13.34%, and the NASDAQ 100 has gained 8.0% over the same period.**

- **Meanwhile, US Treasuries are down and yields on the safest bonds are up in a typical 'risk-on' move.**

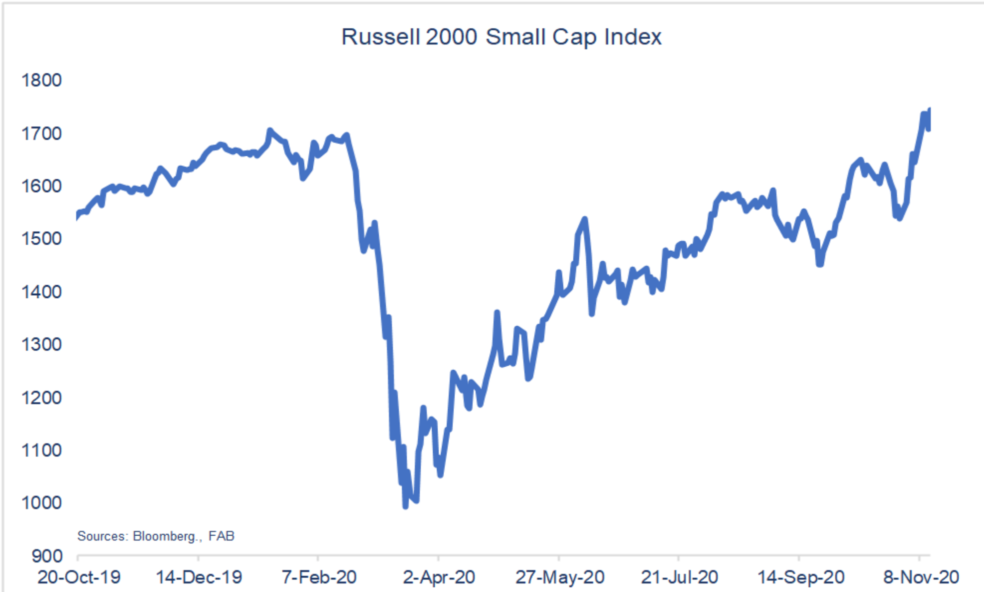
- **Repositioning after the US election outcome, followed by good vaccine news may explain much recent activity.**

- **Investors seem to be looking far into 2021, past the increasingly grim present of solid increases in Covid-19 deaths and widening lockdowns.**

- **The FAB AAC is slightly underweight in global equities, overweight in IG and EM bonds, and gold.**

For much of this year, market commentators have been dumbfounded by the markets, and how they have been dissonant with economic data. The month of November so far has been no exception. While some forward-looking economic data has started to indicate a renewed economic slowdown in much of the developed world, stock markets have been posting new records, and the safest assets are being shunned.

The Russell 2000, the US stock index comprised of small- and mid-cap companies, for instance, closed last week at 1744.04, its highest level on record, having gained 13.36% so far this month. Given the high sensitivity that smaller companies have to economic cycles, a rally in the Russell 2000 is usually seen as a strong sign of risk appetite by investors. This rally suggests they are still hungry for small- and mid-caps.



Large-cap indices have also performed well, but unlike the Russell 2000. The S&P 500 closed at a new high on Friday, too, but it has 'only' gained 9.64% in November. The Dow Jones Industrial Average, which has a larger component of old economy stocks, outperformed its broader cousin, and is up 11.24%. The NASDAQ 100, which had paced equity gains earlier this year, underperformed, but is still up 8.01% so far this month.

The story is not too different for the riskier bonds. The Bloomberg Barclays US High-Yield Index has risen 2.6% in November so far, while the EM dollar bond index in the same family is up 2.4%.

Meanwhile, in the past week alone the 30-year US Treasury bond has dropped 1.19%, and the yield has risen 4.7 basis points. Gold, another haven asset, saw its price fall 3.18% to $1,889.20/oz last week. Both moves suggested some investors may be converting portions of their cash (or near-cash) holdings into riskier assets.

The Russell 2000 index of mostly US-based small-cap stocks hit a record on Friday

Such moves would normally suggest a strong economic recovery is shaping-up. While that may be the case further down the road, right now the opposite is true. Much of the high-frequency data collected by Bloomberg suggests activity is slowing in Europe and the US.

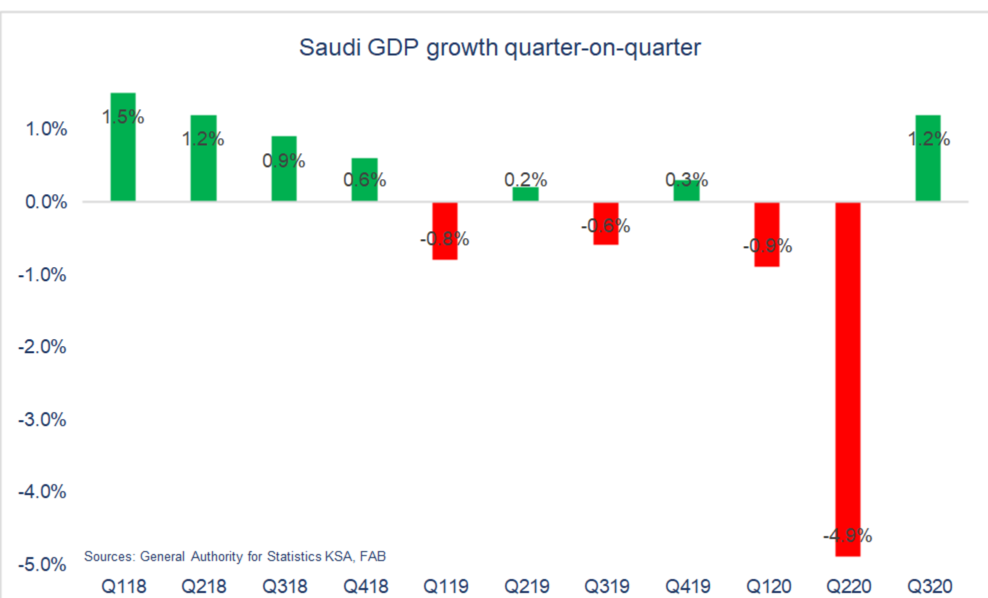
This is coming as a result of rising numbers of Covid-19 cases, hospitalizations, and deaths linked to the virus. Facing the prospect of overwhelmed health systems, governments are starting to toughen social distancing measures, with curfews and stay-at-home orders now the norm across much of the Northern Hemisphere. Despite being wary of the total lockdowns of April, many governments are closing their economies.

California has reported a spike in the number of Covid-19 cases and joined Oregon and Washington in asking travelers arriving in the state to quarantine. Other states in the US, including New York, are starting to impose restrictions on movement again as Covid-19 cases increase with the advance of winter. On Friday, the US reported a new daily record of 190,000 virus cases.

Many European countries are quickly moving to full lockdowns as the numbers get grimmer there, too. With daily deaths from the virus averaging nearly 500, France has moved to full stay-at-home orders. Belgium, where hospitals are officially overwhelmed, has done the same. Germany has imposed curfews although has stopped just short of France's tough reaction.

In France, however, where President Emmanuel Macron caved and implemented a national lockdown on 30 October, factories and construction sites remain active in an attempt to limit the impact to a contraction of 15% of GDP, rather than up to 30%, according to forecasts from the Finance Ministry.

Last week the ZEW survey of expected business conditions for the Eurozone countries came in at 32.8, indicative of a deep contraction ahead.



Backward-looking figures were already bad. Industrial output was down 6.8% in September, versus last year, compared to consensus expectations of a 5.8% contraction. Even the blowout GDP growth for the region of 12.6% in the third quarter was marginally below the 12.7% forecast.

Surprisingly, oil prices have been rallying and Brent crude is up 14.2% so far this month. This may be partly explained by speculators closing short positions, but may also be a reflection of investors discounting better economic times arriving sometime next year, and the possibility that technological and healthcare advances achieved during the pandemic may prove to have been worthwhile.

The recovery off the recent lows in crude oil prices is of course particularly good news for the Middle East. The biggest economies in the region are slowly moving away from being dependent on hydrocarbons, but oil remains a lynchpin of activity. A recovery in crude prices is part of the reason why Saudi activity rebounded in the third quarter, for one.

Saudi Arabia's GDP grew at the fastest pace in Q3 since 2018 as the country began to reopen

For the first time last week, Saudi Arabia's General Authority for Statistics released a 'flash' estimate of third quarter GDP less than two months after the period ended. This is in contrast with delays of six months or more in the past. The Authority said it will now regularly release flash data shortly after the end of the quarter.

The report showed that the KSA economy grew 1.2% compared to the second quarter, when it had shrunk by 4.9% compared to the first three months of the year. While the rebound comes off a low base, it was the fastest growth for the country since early 2018. Although the Authority did not link the rebound to oil, the average price of a barrel of Brent crude in the third quarter was US$43.31, 30.3% higher than in the second quarter.

Other industries played a part, too, and Crown Prince Mohammed bin Salman spent a good part of a speech to the Shura Council this weekend highlighting the country's progress in moving away from hydrocarbon dependency. However, oil remains of paramount importance.

Crude oil tends to provide good indications of the current economic situation, given its high sensitivity to activity. The initial jump in November, for instance, happened after a larger than expected drawdown in US inventories indicated that demand was recovering, which may have prompted large short positions to be unwound.

The further rally seen last week, however, did appear to more reflect future expectations, amid news of two potential vaccines being approved in the US before year-end, as well as final clearance by the Food and Drug Administration for the emergency use of a highly effective treatment for Covid-19.

These developments suggest that sometime next year the world may indeed return closer to normal, causing stocks to rally even further. Nonetheless, investors need to remember that between now and then there are likely to be some speed-bumps along the way.

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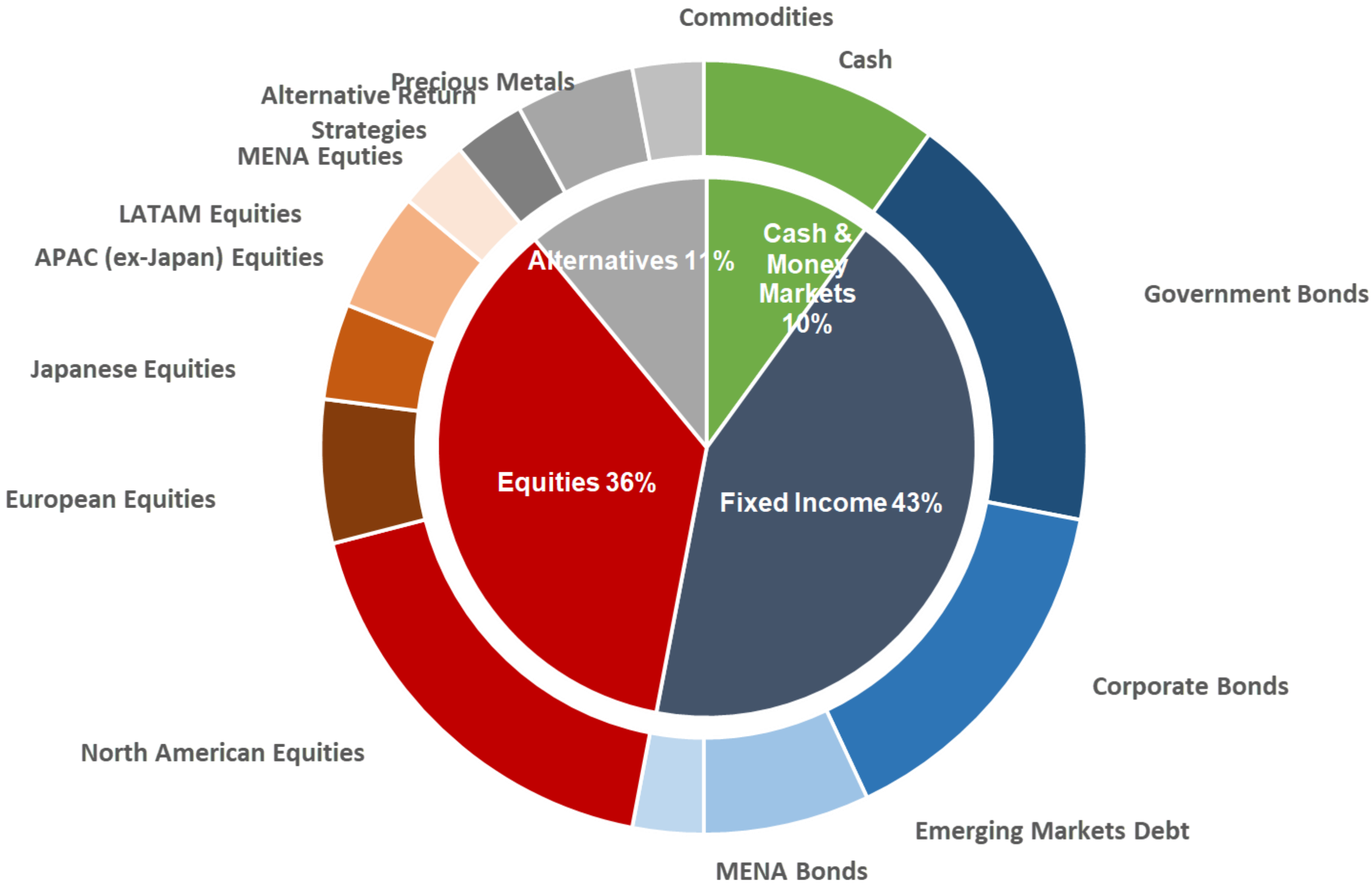
Current Tactical Asset Allocation



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	However, mildly overweight Japanese equities.
Alternatives	Underweight	However, overweight on precious metals specifically

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