For inquiries related to this article, please contact:
Alain.Marckus@bankfab.com
Christofer.Langner@bankfab.com

بنك أبوظبي الأول
FAB
First Abu Dhabi Bank

January 26, 2020

Virus-related fears may provide EM buying opportunity

- **Markets began to react to fears of a new coronavirus becoming a repeat of the SARS crisis of 2003-2004.**
- **The new virus continues to spread, although appears less deadly than SARS was.**
- **Unlike the situation in 2002, China is being far more proactive about containing the disease which could limit its economic impact.**
- **Asian assets have been hit hardest by the market impact but they could bounce back the strongest once the fear passes.**
- **Risk assets saw profit-taking as investors coped with the news flow and watched President Donald Trump's impeachment trial unfold.**
- **Gold prices advanced as volatility returned, confirming the yellow metal's uptrend.**

If there was ever an opportunity to show how much China's importance to global markets has increased, this chance came during the past week. As news of an epidemic of a new deadly flu-like virus in the country became more stark, investors sold risk assets from New York to Taipei and bought haven assets. That was very different from what happened in 2002, when the outbreak of a seemingly deadlier virus in the country caused pain in some Asian markets, but left US assets fairly unscathed.

To put it in numbers, the MSCI Asia Pacific ex-Japan index fell 5.5% between November, 2002, and June, 2003, during the height of the Severe Acute Respiratory Syndrome (SARS) epidemic. The S&P 500 actually rallied 8.2% over the same eight months.

China was much less important back then, however. At the end of 2002, when China was identified as the infamous source of SARS, a virus that would kill nearly 800 people in less than a year, the country's GDP was US$1.4 trillion, one tenth of the US$14.3 trillion it represents now. It was only the world's sixth largest economy. What is more, the entire Chinese economy was a mere 12% of the US, the world's largest economy. It is now equivalent to 67%.

This is why this time the world is not immune to China's current epidemic, and investors do need to worry. And if history is any guide, the new disease could indeed dent economic growth in both China, its neighboring countries and the rest of the world.

The MSCI APAC ex-Japan rose 55.4% in the year after the SARS epidemic was controlled

In 2002, the SARS epidemic pushed several Asian countries into recession. Singapore, for instance, was growing at a 6.6% rate in June, 2002, yet one year later it recorded negative growth of 0.3%. Hong Kong in similar fashion was expanding at a 4.1% rate in December, 2002, but went on to shrink by 0.6% in the twelve months to June, 2003.

Extrapolating that into the Chinese economy, which already grew last year at its slowest rate in recent history, suggests world growth could slow down more than previously expected. Asian economies, which are now quite closely integrated with China, could be particularly vulnerable. This helps explain why the MSCI Asia Pacific ex-Japan index fell

2.4% last week, its worst week since August, 2019.

Oil prices, which in the past year have been much more sensitive to demand factors, also reflected those expectations of slower growth. Brent crude prices fell 5.3% last week, also their worst performance since August. The drop came despite news of oil supply disruptions in Iraq, where protesters reduced the country's output, and Libya, where eastern military commander Khalifa Haftar all but halted exports.

Libya produces nearly 1.5 million barrels of crude a day, while Iraq's output is nearly 4.6 million barrels a day. A disruption in these two countries could have a significant impact on oil prices, but the market was so focused on the potential growth slowdown that oil prices still tumbled last week.

In a similar vein, the S&P 500 dropped 1% and the NASDAQ fell 0.8% as investors who were skittish about recently higher valuations decided to take some profits.

Analysts have started to revise their earnings expectations for the current year upwards, particularly for technology companies. That has made some of the valuations more compelling, as investors are usually willing to pay more for higher expected profits.

Furthermore, the general negative feeling about Asia may provide a good entry point into the asset class, which had rallied significantly in the past four months as the 'phase one' trade agreement between the US and China was concluded.

If history is any guide, the sell-off in Asian assets started by the Chinese coronavirus could be followed by a strong recovery. Once investors became confident that SARS was coming under control, around April, 2003, that kicked-off an epic rally in the MSCI Asia ex-Japan index. Between the end of the first quarter of 2003 and the same date a year later the index gained 55.4% in dollar terms.

Such an outsized return this time may be unlikely, but it could still be very worthwhile, particularly amid the continued quantitative easing by the world's most important central banks. In fact, that monetary stimulus may even be increased as a result of the economic impact of the current epidemic.

China could add monetary stimulus after cutting reserve requirements seven times

Investors should have a preview of how the virus may impact the global economy this week, as the Federal Reserve's policy-setting committee meets on Tuesday and Wednesday. The central bank is not expected to cut or increase rates but investors will be watching its language carefully to assess whether the Fed governors have become more bearish on the economy following the spread of the new virus.

Investors will also pay close attention to the Fed's plans related to its repo market program. Since the central bank began buying short-term bonds to correct a liquidity issue in the interbank market in September, it has added US$386 billion in new money to the economy. That has helped fuel a 1.3% fall in the dollar index, as well as a rally in EM stocks and bonds, along with other risky assets.

The Fed had signaled that it would discontinue a US$60 billion a month short-term bond buyback program in April, but the global slowdown expectations stemming from the viral outbreak could force the bank to extend that. Any indications that the Fed will indeed keep adding liquidity to the economy could support a further rally in risky asset prices.

The People's Bank of China is also likely to add more stimulus to the economy as it gets a clearer picture of the economic impact of the coronavirus epidemic. The central bank already cut the reserve requirements for lenders in the country this month, its seventh consecutive cut in two years, but could announce further easing in coming weeks.

Monetary stimulus may be accompanied by fiscal stimulus this time, too, as China rebuilds confidence after it has been forced to lockdown at least a dozen cities in the country in its attempt to contain the spread of the virus. Such a policy cocktail added to the rebound effect could make Asian assets perform well this year.

Dollar bonds, especially from China, are among global bonds that could fare well. That asset class is dominated by developers, which tend to do well when interest rates are dropping. While these securities could see a period of correction amid the news related to the coronavirus, they could rebound significantly once the fear subsides. That also fits well with the current tactical overweight position of the FAB Asset Allocation Committee (AAC) in EM dollar-denominated bonds.

A Chinese rebound could also be good news for UK and European assets, which have become increasingly correlated to their Asian counterparts. The two asset classes, however, are also contending with their own idiosyncratic issues, the terms of Brexit being the most important of them.

This week will be key in that sense as the UK will officially leave the European Union. While negotiations for the effective decoupling of the economies will continue for the rest of the year, there are signs that the UK economy could rebound quickly.

UK business optimism figures last week showed a significant positive shift. Economists had predicted that the quarterly optimism balance index of the Confederation of British Industry would come in at negative 20, reflecting dismal confidence in the future amid the uncertainty of exactly how Brexit will happen. Instead, the number came in at positive 23, indicating that business owners may start considering new investment again, after halting it for nearly two years as they awaited clarity on the future of the country's divorce from the EU.

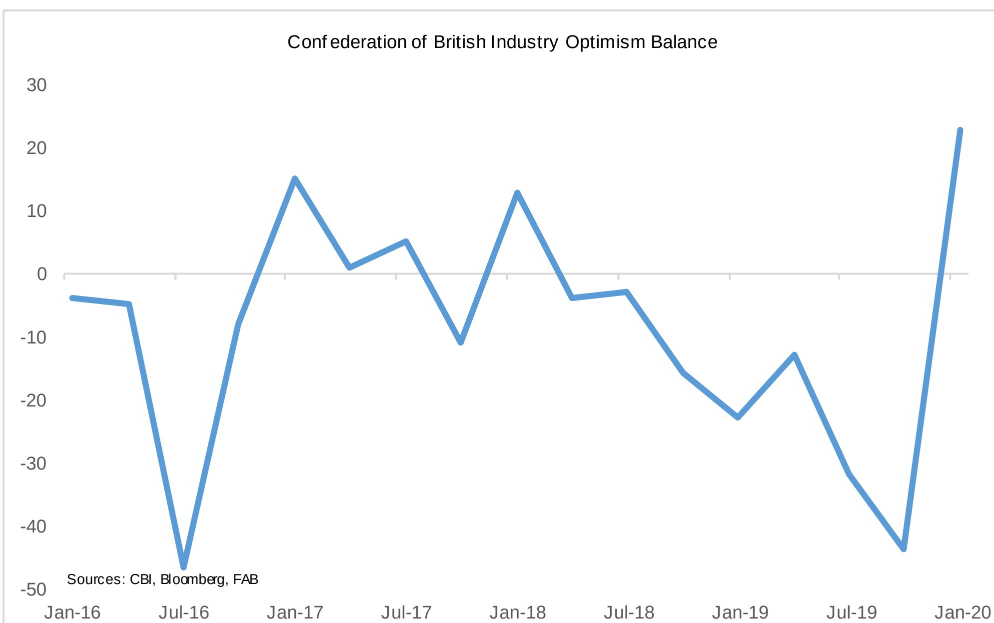
Similarly, the UK Composite PMI beat forecasts by a significant margin, coming in last week at 52.4, compared to a median forecast of 50.7. The PMI is important because it indicates future expectations of investment and is considered a leading indicator, or a number that shows where the economy is going. A number above 50 indicates expansion, and below that suggests a contraction.

Despite the positive news, there is still a significant chance that the Bank of England (BoE) will cut rates when it meets later this week. Analysts generally do not expect Governor Mark Carney to make any move just two months before handing over to Andrew Bailey. However, two members of the policy-setting committee have clearly expressed their intent to cut interest rates, and markets are implying a 60% probability of such a move.

The latest positive data and the upcoming change at the top of the BoE suggests it will stay on hold. However, the recent strength of the British pound could prompt policymakers to reduce rates to avoid the future impact of a stronger currency.

The pound is likely to be negatively affected if there is a rate cut. However the currency has shifted to an uptrend since it became clear that Prime Minister Boris Johnson's Conservative Party was on track to win a majority in Parliament (as it did) in December, 2019.

British industry optimism is at the highest in more than three years, signaling a recovery



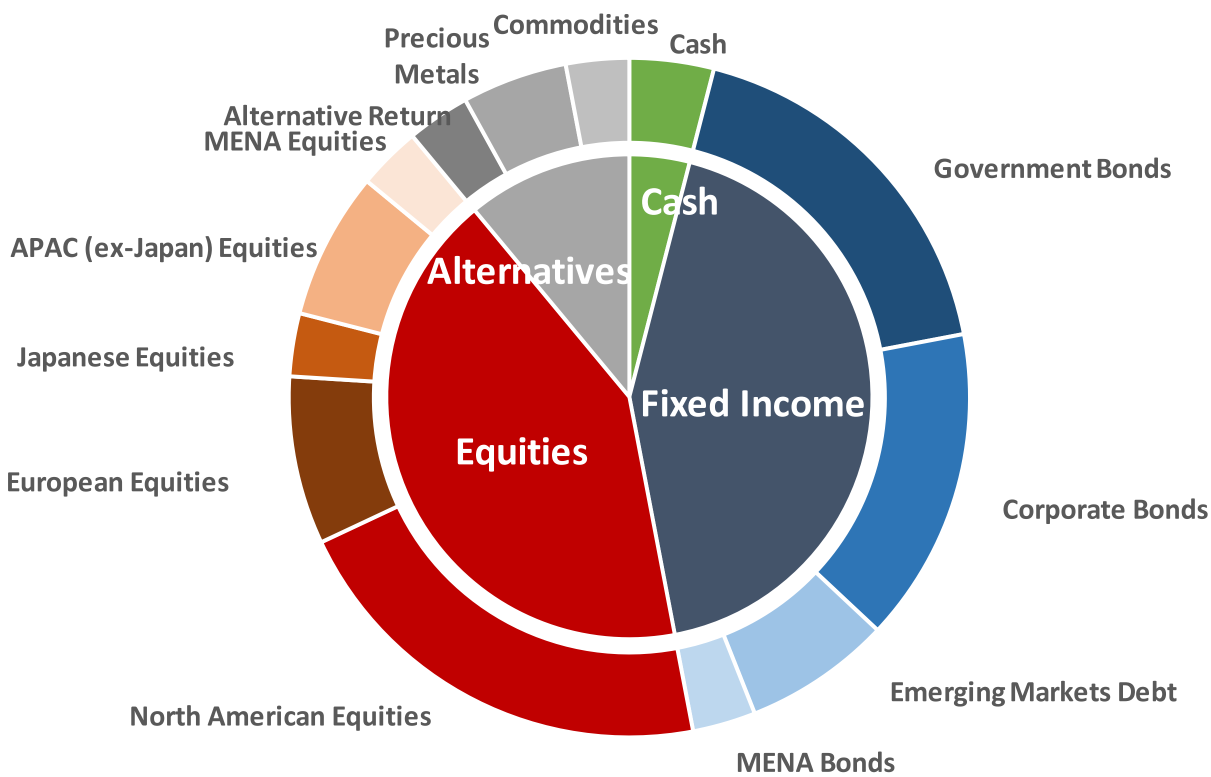
Having said that, the currency has also wobbled a bit lately, weighed down both by heightened rhetoric out of Downing Street, and by prospects of a rate cut. These two factors are likely to continue to impact the pound, and a cut could see the pound move down towards the US$1.29/GBP level. Similarly, indications that a trade deal with Europe is not going to be completed by the end of the year could weigh on the British currency later on.

The euro is not likely to be immune to the debate, either. The currency has already depreciated 1.7% against the dollar so far this year, as investors begin to price in the impacts of Brexit on the mainland. It could come under more pressure in coming weeks, particularly after comments by ECB Chairwoman Christine Lagarde on Friday suggesting that the central bank could still move on rates. Those comments came as a response to the central bank's announcement earlier in the week that it was reviewing its inflation goals and tools, something that analysts understood meant it would stand pat for the rest of the year.

In any case, both central banks reaffirming that they will continue to maintain high levels of liquidity should continue to buoy risk asset prices.

Investment Weekly

Current Tactical Asset Allocation



Asset Class	Positioning	Detail
Cash	Neutral	After allocating more cash to investment grade corporate debt
Fixed Income	Overweight	Moving to slightly overweight after adding overweight to EM dollar debt and corporate investment grade bonds
Equities	Overweight	Rotating US exposure to defensive stocks
Alternatives	Underweight	However, overweight on precious metals specifically

Investment Weekly

Disclaimer: *This report has been prepared and issued by Products & Services - Elite & Private Banking ("P&S-EPB") of First Abu Dhabi Bank PJSC ("FAB") outlining particular services provided by P&S-EPB. This report is for general informational purposes and does not constitute or form part of any offer or invitation to sell, or any solicitation of any offer to purchase or subscribe for, any shares in FAB or otherwise or a recommendation for a particular person to enter into any transaction or to adopt any strategy nor shall it or any part of it form the basis of or be relied on in connection with any contract therefore. Anyone proposing to rely on or use the information contained in this publication should independently verify and check the accuracy, completeness, reliability and suitability of the information and should obtain independent and specific advice from appropriate professionals or experts.*

This report is provided on a confidential basis for informational purposes only and is proprietary to P&S-EPB. This report may not be disclosed to any third party or used for any other purpose without the prior written consent of P&S-EPB. The manner of circulation and distribution may be restricted by law or regulation in certain countries, hence any unathorised use or disclosure of this document is prohibited.

The information in this report reflects prevailing conditions and our views as of this date, which are accordingly subject to change. In preparing this report, we have relied upon and assumed, without independent verification, the accuracy and completeness of all the information available from public sources or which was otherwise reviewed by us. FAB PJSC makes no representation or warranty, expressed or implied, as to the accuracy, timeliness or completeness of the information in this report. FAB PJSC shall have no liability to the Customer or to third parties for the quality, accuracy, timeliness, continued availability or completeness of any data or calculations contained and/or referred to in this report nor for any special, direct, indirect, incidental or consequential loss or damage which may be sustained because of the use of the information contained and/or referred to in this report or otherwise arising in connection with the information contained and/or referred to in this report, provided that this exclusion of liability shall not exclude or limit any liability under any law or regulation applicable to FAB PJSC that may not be excluded or restricted.

Past performance is not a guarantee of future performance and should not be seen as an indication of future performance due to a variety of economic, market or other factors. The information contained in this report does not purport to contain all matters relevant to any particular investment or financial instrument and all statements as to future matters are not guaranteed to be accurate. Any projections of potential risk or return are illustrative and should not be construed as limitations of the maximum possible loss or gain. Data included in this report may not take into account all potentially significant factors, such as market risk, liquidity risk and credit risk. Undue reliance should not be placed on forward looking statements in making an invewstment decision.

In addition, our analysis are not and do not purport to be appraisals of the assets, stock or business of the recipient and has been prepared without taking into account the objectives, financial situation or needs of particular person. Even when this presentation contains a kind of appraisal, it should be considered preliminary, suitable only for the purpose described herein and not be disclosed or otherwise used without the prior written consent of P&S-EPB. FAB clients may already hold positions in the assets subject to this report and may accordingly benefit from the buying or selling of such assets as referred to in this report. This document does not purport to set out any advice, recommendation or representation on the suitability of any investment, transaction or product (as referred to in this document or otherwise), for potential purchasers. In receiving this report, the client is fully aware that there are risks associated with investment activities. Potential purchasers should determine for themselves the relevance of the information contained in this document and the decision to purchase any investment contained herein should be based on such investigation and analysis as they themselves deem necessary. Before entering into any transaction potential purchasers should obtain the investment offering materials, which include a description of the riks, fees and expenses and ensure that they fully understand the potential risks and rewards of that transaction (including, without limitation, all financial, legal, regulatory, tax and accounting consequences of entering into the transaction and an understanding as to how the transaction will perform under changing conditions) and that they independently determine that the transaction is appropriate for them given their objectives, experience, financial and operational resources and other relevant circumstances. Potential purchasers should consider consulting with such advisers and experts as they deem necessary to assist them in making these determinations.

FAB is acting solely in the capacity of a potential arm's-length contractual counterparty and not as a financial adviser or fiduciary in any transaction unless we have otherwise expressly agreed so to act in writing. FAB does not provide any accounting, tax, regulatory or legal advice. FAB is licensed by the Central Bank of the UAE.

London: *FAB London Branch is Authorized by the Prudential Regulation Authority. Subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from FAB London branch on request. Registered in England & Wales: Company No: FC009142: VAT No: GB245 3301 91.*

Paris: *FAB Paris Branch is licensed by the French Prudential Control Authority as a credit institution. FAB Paris is registered in France under the company number: RCS Paris B 314 939 547.*

Switzerland: *This publication is for informational purposes only and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis and/or may not be eligible for sale to all investors. This report is for distribution only under such circumstances as may be permitted by applicable law. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness. All information and opinions as well as any prices indicated are currently as of the date of this report, and are subject to change without notice. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. At any time the First Abu Dhabi Bank PJSC and/or FAB Private Bank (Suisse) SA may have a long or short position, or deal as principal or agent, in relevant securities or provide advisory or other services to the issuer of relevant securities or to a company connected with an issuer. Some investments may not be readily realizable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. Futures and options trading is considered risky. Past performance of an investment is no guarantee for its current or future performance. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in foreign exchange rates may have an adverse effect on the price, value or income of an investment. First Abu Dhabi Bank PJSC and/or FAB Private Bank (Suisse) SA expressly prohibit the distribution and transfer of this document to third parties for any reason. First Abu Dhabi Bank PJSC and/or FAB Private Bank (Suisse) SA will not be liable for any claims or lawsuits from any third parties arising from the use or distribution of this document.*

Singapore: *First Abu Dhabi Bank P.J.S.C., Singapore Branch is regulated by the Monetary Authority of Singapore and holds a Wholesale Bank license.*

For more details relating the investment products, please refer to the Prospectus and/or offering document on https://www.bankfab.ae/en/invest

Please contact your relationship manager for information relating to subscription, redemption, dividends, client eligibility and/or any other information relating to the investment products.