Investment Weekly

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March 8, 2020

The Fed is putting its powder to work

♦ The Fed reducing rates by 50 basis points last week initially unnerved markets…

♦ …before they rallied on the back of a recovery in Joe Biden's democratic contention ranking

♦ February's very good US non-farm payrolls (+273K new jobs) showed services strength, but are largely pre-virus

♦Markets will continue to require central bank support until global Covid -19 infections appear to peak

♦…together with promises - and the reality - of fiscal stimulus from G7 governments

♦ Chinese equities will have been officially supported, nonetheless their firmness is helpful

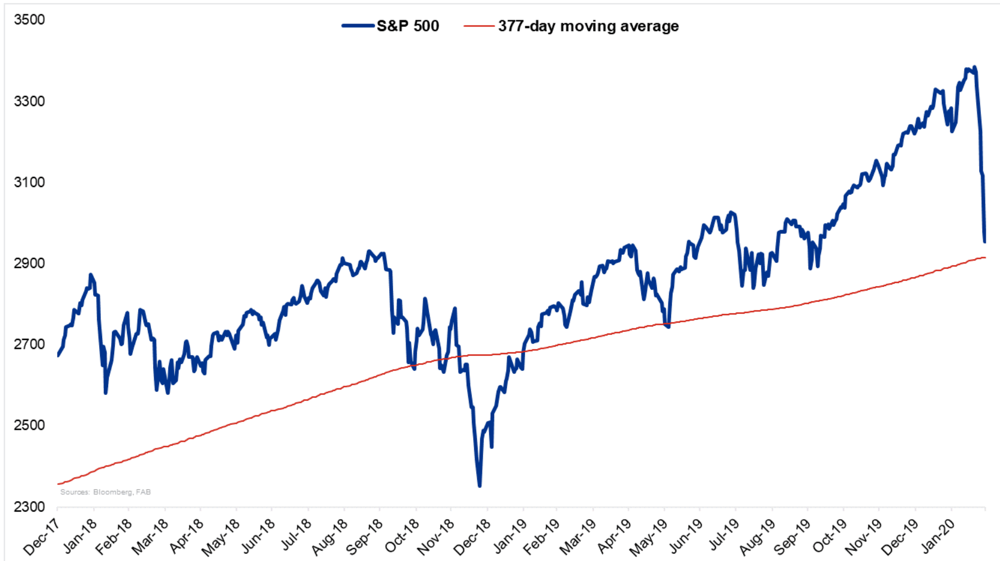
♦ The US dollar fell 2.2% on its index last week further to a significant fall in US rates expectations

♦ The OECD now expects global economic growth of 2.4% this year, vs. 2.9% in 2019

♦ …and sees a recovery to 3.3% in 2021

♦ As echoed by the Asian Development Bank, global growth could suffer by 0.4% this year due to Covid-19

♦ Crude prices could fall even further in the short-term (from $45.27/barrel on Brent) if Saudi Arabia increases production



♦ …following the failure of 'OPEC+' to reach agreement on a further output cut; Russia refused to share in a combined reduction

♦ Lebanon is set to default on a bond payment of $1.2 billion due this Monday, amid its continued economic crisis

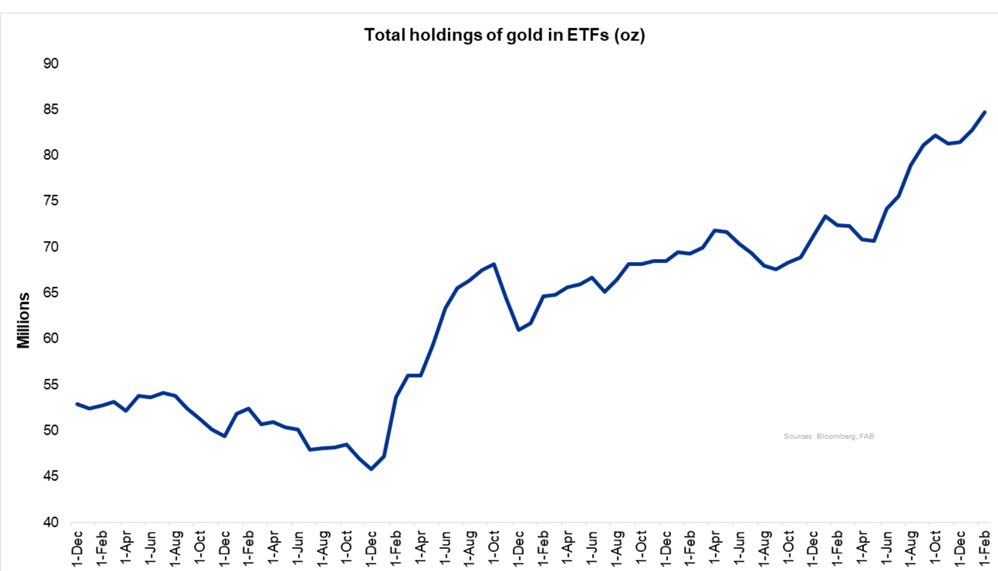
♦ In Saudi Arabia, the leadership has taken further steps to consolidate its power

♦ The FAB Asset Allocation Committee is Overweight in Bonds, Neutral in Equities, Overweight in Gold, and Underweight in Cash

The markets remained very volatile last week, reflecting concerns that Covid-19 cases will continue to accelerate further outside China. However the MSCI All Country Equities index was actually 0.4% higher over the week, partly on the back of the S&P500 index closing 0.6% ahead. Chinese equities as represented by the CSI 300 Index were up 5.0%, also helped by a firmer renminbi (which strengthened from 6.9920 to 6.9920 to the US dollar). The bull market in global bonds continued, with the Bloomberg Barclays Global-Aggregate Index (unhedged) last week rising by 2.5% (to 534.5859), a new all-time closing high, at which the yield-to-worst has fallen to 0.90%. Over the same period, the US Treasury 10-year yield fell by almost 39 basis points, from 1.1486 to 0.7623% - having traded as low as 0.6604% intraday. The demand for so-called 'haven' assets continued strongly, with for instance the yen strengthening from 107.89 to 105.39 vs. the US dollar. Views expressed via futures markets that a large reduction in US official rates came to fruition, with the Fed duly obliging with a 50 basis point reduction in the Fed funds rate. The fact that this reduction was the first 50 basis point reduction since the financial crisis - and that it was a genuine surprise coming ahead of the next scheduled meeting - appeared to unnerve investors. Of course not assuming they are infallible, traders however now expect the Fed funds rate to be trading at just 0.34% in 12 months' time, vs. an effective mid-rate of 1.09%, hence the comments from some observers that rates are heading towards zero. However, that would entail the Fed using up most of the limited rate cushion at their disposal. The virus situation would have to deteriorate markedly for the Fed to even begin considering this. The FAB Asset Allocation Committee (AAC) has the situation under active review; although it expected the US 10-year Treasury yield to trade lower from 1.9175% at the year-end, the lower boundary was only expected to be 1.30%.

An about-turn in OPEC policy- minus the '+'

In commodities, the failure of OPEC+ (i.e. including Russia) to reach a deal for another significant crude production cut - Russia refused - was largely responsible for a 10.4% fall in Brent crude prices (from $50.52 to $45.27/ barrel). This comes on the heels of analysts concluding that for the first time in a decade oil demand could actually fall this year. As readers would expect, the FAB AAC is reviewing its previous downside limit assumption for the current year of $55/barrel in light of the new conditions. Saudi Arabia apparently decided this weekend to reverse course, and increase production, posting historically very large contract price reductions. **Turning to gold, the yellow metal closed at $1,673.83/oz, for a rise of 5.5% over the week.** For some months the AAC has had a favourable and improving view of gold, which we believe is in a continuing bull market, although the exposure is couched almost totally in terms of its efficacy as a hedge against numerous and unforecastable risks in economies and markets. ETF demand for gold has been growing for some time, and just last week went to yet another all-time high. An especially bullish divergence has been the uptrend in dollar gold prices despite a firming dollar against most other currencies in much of last year. A bullish milestone was the price successfully moving above the $1,400-1,450/oz level, which has historically brought out scrap recovery and jewelry dishoarding. Lower interest rates have also helped. Lastly, although demand from central banks diversifying their reserves is price-sensitive and has recently slackened, bar demand from Ultra High Net-Worth Individuals has continued to grow. Such investors don't want paper gold (perhaps because they don't trust the necessary counterparties), and tend to want 'allocated' gold i.e. their own bars, rather than a share in a bar (which are usually 400 ounces). The previous closing high of gold was $1,772.25, reached on 28th September, 2012.



The S&P500 index so far resembles late-2018

The proprietary traders at the desks of the investment banks, and hedge funds, love to see volatility in markets, providing opportunities for them to make profitable trades. Seasoned pros know it is probably best, on average, to invest in bull markets, and to trade in more bearish and choppy periods. So it is interesting to note that for the last few weeks, since market volatility (a.k.a. downside) became more apparent, the Fridays have seen strong rallies in the S&P500 off its intraday lows. Traders have wanted to close their - mainly net-short - trading books before the weekend. At the same time, some long-term investors have been taking advantage of the lower prices to buy; they are not attempting to predict the market bottom, and they know it is quite foolish to try to do so. These days, periods of re-pricing in markets seem to occur faster - and when market commentators officially label a 'bear market' as such, it is in reality usually history or close to being so. So far the bellwether S&P500 index, for instance, is down 12.2% from its closing high of 3,386.15 posted on 19th February this year. We cannot be sure how long this period of higher volatility will last, although we believe (by reference to the attached chart) the current market backdrop looks similar to the sharp 19% fall in stock prices seen in the last quarter of 2018. In late 2018 investors were mainly concerned about the escalation of a US/China trade war, and today it's Covid-19. Although like many other commentators we are busy trying to ascertain the extent of the economic disruption - from micro to macro - we remain mindful that equities recovered sharply from their low point at year-end – and that our long-term moving average continued upwards with the index breaking back above it. Today's buyers of stocks already expect earnings downgrades and profit warnings, and are prepared to look across what is likely to be a 'V-shaped' profitability picture, to the recovery on the other side.

The benefits of diversification are considerable

The AAC met on more than one occasion last week to review market developments, and decide on whether to make changes to its asset allocation grids. The members (1) Reduced the Asia ex-Japan equity allocation back to neutral, from overweight; the previous small overweight was via an overweight in Indian equities; and (2) Further increased the allocation to gold (as a general market hedge). As a result the grids were neutral across all the regional equities buckets. The global fixed income segments carry moderate overweights in (a) Corporate Investment Grade, and (b) EM dollar-denominated debt (via a small overweight in Asian High-Yield bonds). The Committee cannot be certain when the current period of market - and especially equity - volatility will come to an end, although the members are constantly reviewing prospective risk in the markets, and particularly whether the equity market outlook turns into anything worse than a healthy correction.

Lastly, kindly find some final observations on current market conditions:

♦ We know that the current economic disruption from the Covid-19 virus could be substantial and in various forms – but that it will be a passing event

♦ The energy, financials and materials sectors have understandably been amongst the very worst performers, but in due course will spawn buying opportunities

♦ One market participant was quoted saying, "Those rules you have in your mind . . . have been broken." We believe that is too pessimistic a view

♦ However, markets have begun to price-in a fairly dire economic scenario

♦ The VIX index has recently traded as high as 49 - its highest since early 2009 - before easing to 40 last week

♦ …and it should gradually now subside as investors get to grips with downgrades – prior to normalcy returning

♦ Probably the all-important risk is now whether US consumers reign-in their spending

♦ Analysts will be slow to mark earnings estimates down; $172.35 in SPX earnings for 2020 still looks optimistic

♦ The likelihood is that, for equities, a continued fall in the US 10-year yield will reinforce the equity 'valuation bottom' taking shape

♦ When bad things like this (virus) happen - and not helped by low interest rates - unexpected fissures of weakness will be exposed

♦ In equities, re-emphasize a lack of debt, good cash levels, and adequate previous operating margins

♦ Cyclical companies will be suffering disproportionately - so we will be able to buy these even more cheaply than we expected

♦ The importance of healthcare, biotech and pharmaceuticals will be underlined in subsequent market phases

♦ A six-month hit to earnings will drag earnings on the S&P downwards, almost certainly for a fall for 2020 vs. 2019 – don't expect earnings to stabilize before Q4

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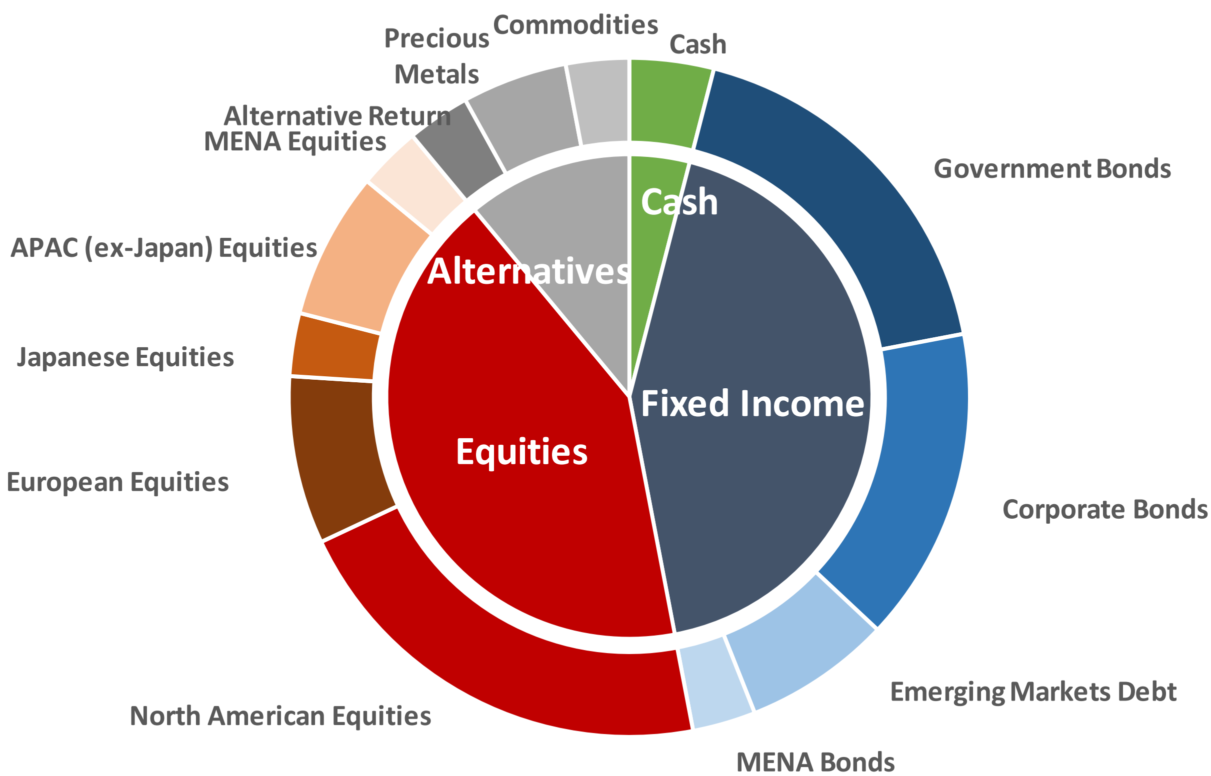
Current Tactical Asset Allocation



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

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