

For inquiries related to this article, please contact:

Alain.Marckus@bankfab.com

Christofer.Langner@bankfab.com

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Strong risk appetite and rising liquidity support global markets

◆ A quick and strong rebound after geopolitical fears fade show risk appetite is alive and well.

◆ Oil prices retrace after a spike, indicating investors expect there will be enough supply even after disruptions.

◆ Weaker-than-expected jobs report rekindles expectations of further monetary easing in the US.

◆ The Fed continues to expand its balance sheet, helping the dollar weaken, and stocks rally.

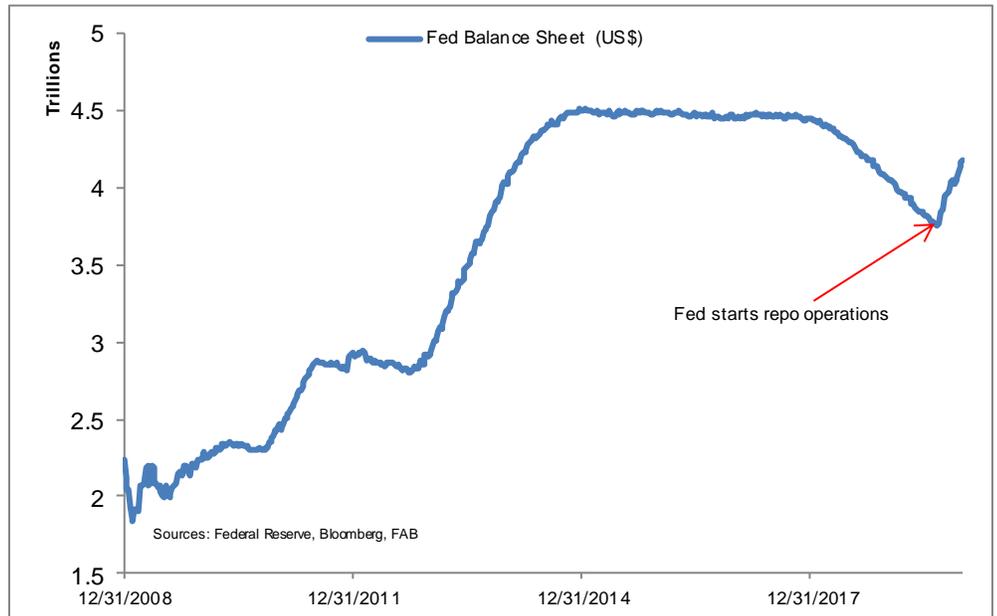
◆ Low rates and a weakening dollar should support emerging market assets, with dollar-denominated bonds offering good risk-adjusted returns.

◆ Middle Eastern bonds are particularly attractive after a period of geopolitical uncertainty in the region.

◆ Gold could benefit from a weaker dollar, and has proven to be effective as a volatility hedge.

When investors are on edge, anything is a good reason to sell risk assets. And when they are confident, they take all kinds of news in their stride. The latter is a sign of a strong equity bull market, and this was in evidence last week as markets rebounded strongly at the first sign that tensions in the Middle East were fading, and focused back on the improving trade relations between the US and China.

That's why the FAB Asset Allocation Committee remains 'risk on', despite markets rallying in 2019. The Committee remains overweight in US equities, with a



focus on above-average yielding stocks. In emerging markets the AAC has gone overweight in dollar-denominated bonds.

These two asset classes benefit from falling rates across the world and from a weakening dollar. The greenback has been shifting into a weakening trend since September as the Federal Reserve once again began to expand its balance sheet.

In the decade preceding the Global Financial Crisis, the dollar index showed a 23% correlation with the strength of the US economy. Since 2009, however, that correlation has fallen to 14%. Meanwhile, the Fed's balance sheet, which used to have little or no connection to the dollar index, has a correlation of more than 2% to the dollar index since 2016.

That helps explain why between February 2018 and September 2019 the dollar index rallied by 10.5%. In the same period, the Fed reduced its balance sheet

The dollar is weakening and risk assets are gaining as the Fed expands its balance sheet

by US\$673.4 billion, reversing some of the liquidity injection it began in 2019.

However, in the first week of September, a scare in the repo market, which banks use to fund themselves in the short-term, caused the Fed to start adding liquidity to markets again. Since then, the Fed has added US\$388 billion to its balance sheet, and this money supply boost is now circulating in the economy. That has had a clear impact on the US dollar, which has fallen 1.1% in the same period.

That trend is likely to continue as long as the Fed continues to add the US\$60 billion in liquidity every month it pledged to in the fourth quarter. To be sure, some of the governors recently suggested the Fed

could scale back those operations after having ramped-up the liquidity injection so quickly, according to the minutes of the central bank's latest policy meeting.

However, given the adverse impact a strong dollar has on the economy, and considering the growing importance of its balance sheet on the value of the greenback, Fed governors are likely to choose to continue to add liquidity with the repo operations. While the Fed is not supposed to tinker with the currency and has hardly ever done so, a weaker dollar does help its twin mandates of full employment and stable inflation.

If the dollar strengthens, it becomes cheaper to buy imported products and that translates into lower inflation in the US. Right now, the Fed has been battling to get inflation to rise, so it would favour a weaker dollar. A strong dollar also increases the price of American exports. If it is cheaper to buy from abroad and foreigners have to pay more for American products, the US trade deficit is likely to increase, which also slows down the economy.

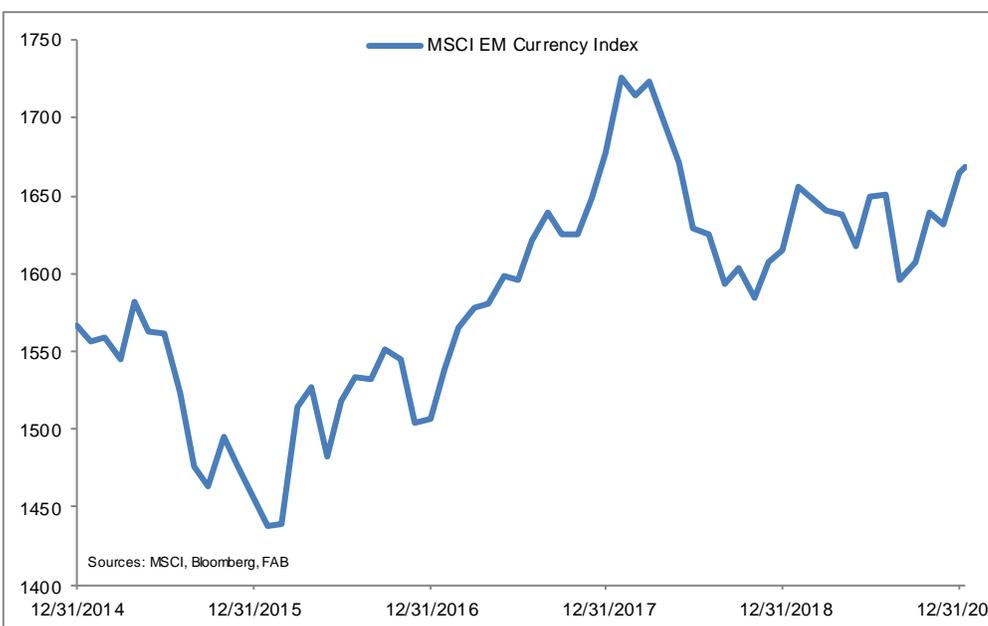
Weaker growth impacts employment, so, again, a weaker dollar makes more sense for the Fed. Hence, there are good reasons why the Fed would allow the US

dollar to depreciate and to continue to add liquidity to the economy.

As mentioned, a weaker dollar is particularly beneficial for commodities and emerging market assets. Indeed, since the Fed began to increase its balance sheet again, the average yield premium paid by the Bloomberg Barclays Emerging Markets dollar-denominated index has fallen 25 basis points, the MSCI EM Stock index has rallied 14.4%, and the MSCI EM Currency Index has gained 4.3%.

The MSCI Emerging Markets Currency index is particularly sensitive to the movements of the dollar, and it had lost 6.9% between February 2018 and September 2019, the period when the Fed was reducing its balance sheet. Similarly, stocks in developing nations had also suffered, and in the same period the MSCI Emerging Markets Stock index dropped 19.5%. Hence, more dollar liquidity and a weaker greenback can be expected to help emerging market assets to continue to do well this year.

EM assets are very sensitive to dollar liquidity and to the Fed's balance sheet decisions



Dollar-denominated commodities also benefit from the weaker dollar, with gold being perhaps one of the clearest cases from the investment standpoint. The yellow metal has been working very well as a hedge since the start of last year, which prompted the FAB AAC's decision in the fourth quarter to increase the gold allocation in the balanced portfolio to 5%, overweight compared to the benchmark.

Gold often works as an 'easy-to-invest in' proxy to other volatility hedges such as the CBOE Volatility Index (VIX), so whenever volatility falls it makes sense to add some of it to safeguard portfolios against potential market gyrations. Indeed, when the FAB AAC overweighted gold it added the caveat that investors should buy it when its prices dip.

Late November of last year provided such an opportunity. As the VIX dropped below 12, a level that indicates very low volatility expectations, the price of an ounce of gold fell to a recent low of US\$1,454. As December progressed and investors positioned themselves for the uncertainties they could face in 2020, the VIX and the price of gold increased. Then last week, as tensions in the Middle East flared up, they both spiked, with the latter moving perhaps more significantly. Gold traded at the highest level since April, 2013, and the VIX rose to 14.

Gold has started to retrace and as it becomes clearer that there is less imminent macro danger, the yellow metal is likely to correct a bit further. Again, that presents an opportunity for investors who are underinvested in the commodity to add to their positions given that the metal has established a bullish trend, which could be helped by a weaker dollar.

Other commodities would also benefit from a weaker dollar although in those other cases supply and demand could be more of a factor than it is for gold, which tends to move more as a result of global risk appetite. Apart from the dollar, global growth will be the driver for other raw materials.

News on Friday that the US created only 145,000 jobs in December have dampened some of the commodities' excitement about a weaker dollar.

Oil, for instance, has been having difficulty re-establishing a bullish trend. Brent crude lost 4.2% on Wednesday of last week, more than reversing all the gains made following the Middle Eastern flare-up of the previous week. The sharp movement may have partly been caused by hedging positions being reversed, as the net positions of traders changed significantly in only a week, according to Bloomberg.

Still, it also reflects the general feeling that there is enough oil to go around, even if output at some of the world's largest producing countries is threatened. Indeed, the news in the first week of the year could have easily caused oil to spike much further if it had happened 10 years ago.

Last week, investors were faced with a series of events that could threaten production in Iraq, Libya, Saudi Arabia, and the UAE, which together produced nearly a quarter of the world's oil output. A very basic calculation of the potential impact of a reduction of that proportion suggests Brent crude would run beyond US\$100/barrel in case production were impacted in these countries, particularly as the world economy is starting to reaccelerate. Yet, Brent continues to trade within the US\$55-US\$85/barrel range FAB forecasts for this year.

That is mainly because US production, has increased 138% over the past ten years and is now close to 13 million barrels/day, according to the US Department of Energy. However, while the US has contributed a lot more oil to the world, it has also consumed much more of it. In the same 10 years, US oil demand has increased 122% and now stands at 19.4 million barrels/day.

Traders have factored that in to some extent, as Brent crude has been trading at a higher range. A weakening dollar and a potentially higher implied risk premium,

however, could push that range slightly up in the coming months. This should be positive for Middle Eastern assets, particularly bonds, which the FAB AAC has been bullish on.

Debt securities from the oil-producing nations of the Gulf Cooperation Council have been trading at a premium to similarly-rated debt from other emerging markets, partly because of a risk premium related to the geopolitical uncertainty. That premium increased 12 basis points this month to 239 basis points, providing a potential entry opportunity. GCC bonds still offer a premium to their EM counterparts when looking at bond spreads or the total return investors can get from them.

An important issuer in the region will be in the spotlight this week after Sultan Qaboos Bin Said al Said, the ruler of Oman, passed away. In addition to being a peacemaking visionary, he had also been an important voice of tolerance in the region. Under his leadership, Oman sponsored cease-fire talks during the Iran-Iraq War in the 1980s, and hosted

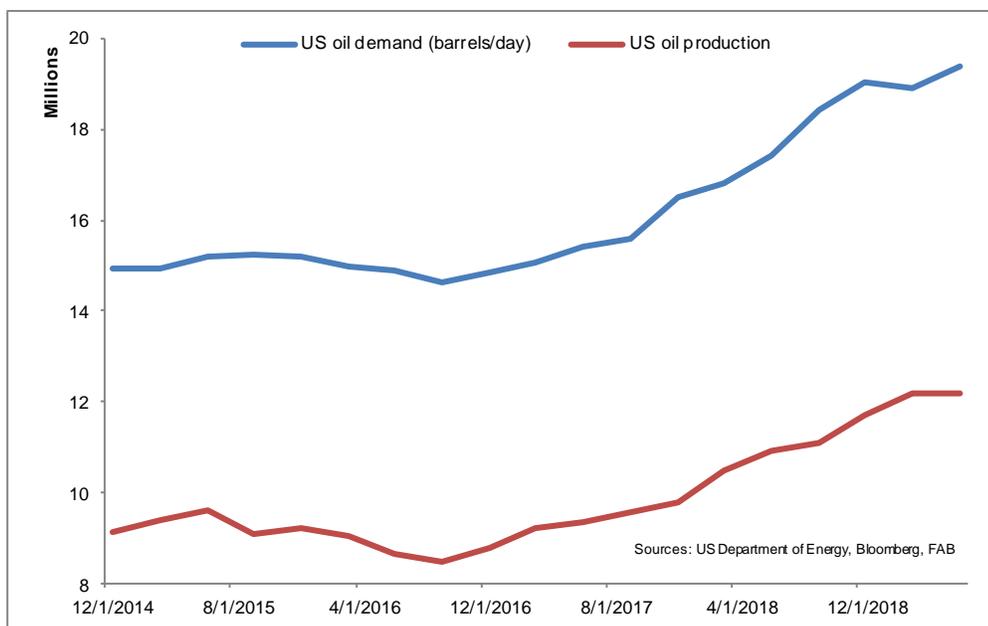
discussions that paved the way for a landmark regional nuclear deal in 2015.

Sultan Haitham bin Tariq al-Said has been named as Sultan Qaboos's successor, and has vowed to continue to build on the late Sultan's achievements. Sultan Haitham is well-versed in the national dealings of Oman, having held several key offices in the Sultanate, including Foreign Minister and Culture Minister, and is one of the architects of the Oman Vision 2040. He was a key driver in Oman's drive to reduce its dependency on oil.

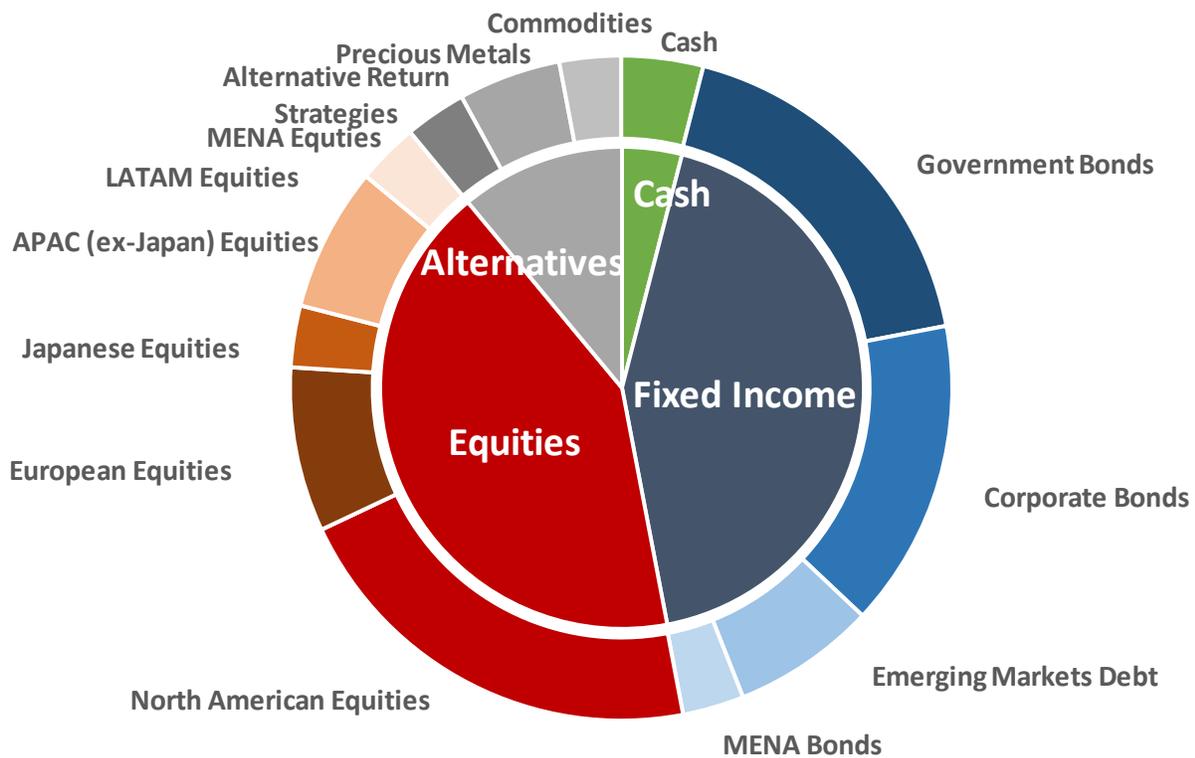
In 2018, 65% of the country's economy was driven by the non-oil sector, according to the Minister of Commerce and Industry, His Excellency Dr. Ali bin Masoud Al Sunaidi. Traffic in the Port of Salalah, for one, has risen nearly tenfold since 1998.

Oman's beautiful coast and mountains have also attracted an increasing number of tourists, with 3.2 million people visiting the country in 2017, according to the latest data available from the Ministry of Tourism, more than twice the number of a decade earlier. Those visitors also spent more time in the country, with the total number of booked nights having grown to 18.9 million in 2017, from 6.5 million in 2009. Despite its incalculable loss, Oman will continue to shine.

Oil prices continue to underestimate supply risks as investors count on US output



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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