Investment Weekly

For inquiries related to this article, please contact:

Alain.Marckus@bankfab.com
Christofer.Langner@bankfab.com

بنك أبوظبي الأول
FAB
First Abu Dhabi Bank

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Fed and fiscal support welcome as virus cases rise

- ♦ **President Donald Trump signs record US$2 trillion stimulus bill.**
- ♦ **Federal Reserve actions facilitate monetary mechanisms and help normalize the supply of dollars.**
- ♦ **High-yield spreads tighten and global stocks have first positive week since 6 March.**
- ♦ **Investment-grade companies issue a record amount of bonds as credit markets reopen, though high-yield market remains shut for now.**
- ♦ **Covid-19 cases in the US surpass those in China, while total deaths accelerate, led by Italy and Spain; Singapore and China see a rise in imported cases.**
- ♦ **FAB AAC remains underweight equities and overweight gold amid continued uncertainty in markets**

Capitol Hill has finally joined the Federal Reserve in the war against the economic fallout from the Covid-19 pandemic. On Friday, President Donald Trump signed into law a US$2 trillion relief package agreed by Congress to fight a recession in the US, and as the number of known infections in the US surpassed China.

As restaurants and hotels close, the number of people unemployed in the US could reach its highest in history. US unemployment was at 3.5% in February. Considering that 152 million Americans are fit for work, according to the Conference Board, and more than 3.5 million had filed for welfare benefits in March by the 20th, the unemployment rate could double this month.

Last week alone, the US Department of Labor revealed that a record 3.3 million Americans filed for welfare benefits in the week ended 20 March. That number is likely to be exceeded this Thursday as the numbers of the week ended 27 March will reflect the more stringent measures in states such as New York and California. Before last week, the highest print for weekly US initial jobless claims was 695,000, in October, 1968.

Such large additions to the unemployment rate are consistent with a severe US economic contraction. In the Global Financial Crisis, US unemployment peaked at 9.9%, in December, 2009. By the end of the second quarter of 2009, US GDP had contracted by 3.9% year-on-year. The Conference Board released a study that forecast US GDP would contract 1.6% this year if the Covid-19 pandemic is controlled by May, but that it could shrink by as much as 6% if the virus is still rampant as August approaches.

A record number of Americans filed for welfare benefits in the week ended on 20 March

The actual unemployment rate for March will be known this week, and the monthly jobs report could have an impact on the market. Economists surveyed by Bloomberg still expected the rate to see only a slight uptick to 3.8%. An increase much larger than this could cause a further down-leg in stock markets.

Apart from US jobs, investors seem to be focusing on the number of virus cases as they try gauge when some semblance of normality might return. As of now, the outlook remains dismal. The US recorded 19,252 new cases on Saturday, bringing the total number of people diagnosed with the coronavirus in the country to 101,277. Meanwhile, Italy and Spain have lost about 15,000 people to the virus.

While the news on the health and the economic fronts are not improving, at least markets have recovered a bit. The MSCI World stock index rallied 10.7% last week, helped by US equities as the Dow Jones Industrial Average gained 12.8% over the week. The two indices are still down 25% and 26.8% respectively since their recent high on 12 February.

Some of that recovery may have been due to quarter-end buying and fund rebalancing. Goldman Sachs estimate that pension funds may have to buy some US$167 billion in equities to reposition their portfolios in the coming days. Some buying may also have been prompted by funds adding some risk before they close their first quarter numbers, so-called 'window dressing'. There is also a chance that the underlying 'liquidation' selling may now slow down.

One of the drivers of the sell-off had been an excess demand for dollars as the world was forced into rapid deleveraging. Given that a majority of the world's foreign currency loans are in dollars, reducing leverage increases the demand for dollars. That also seems to be abating as a number of Fed initiatives take effect.

For instance, basis swaps, used to hedge interest rate and currency movements and which provide a measure of flows in and out of a certain currency, had ballooned in the past two weeks. Many of them retreated last week. The Japanese yen one-year basis swap, for instance, dropped to -73.5 on Wednesday, its lowest in at least two years.

However, last Tuesday, Japanese banks had taken over US$90 billion of dollar funding through the swap line at rates of around 0.35%, compared to 2% costs in the currency markets, according to Bloomberg. They continued to borrow through the swap lines at a record pace throughout the week, and that began to ease the basis swap for the yen. Similar dynamics were seen in other currencies, which helped the dollar index retreat 4.3% last week, to 98.365.

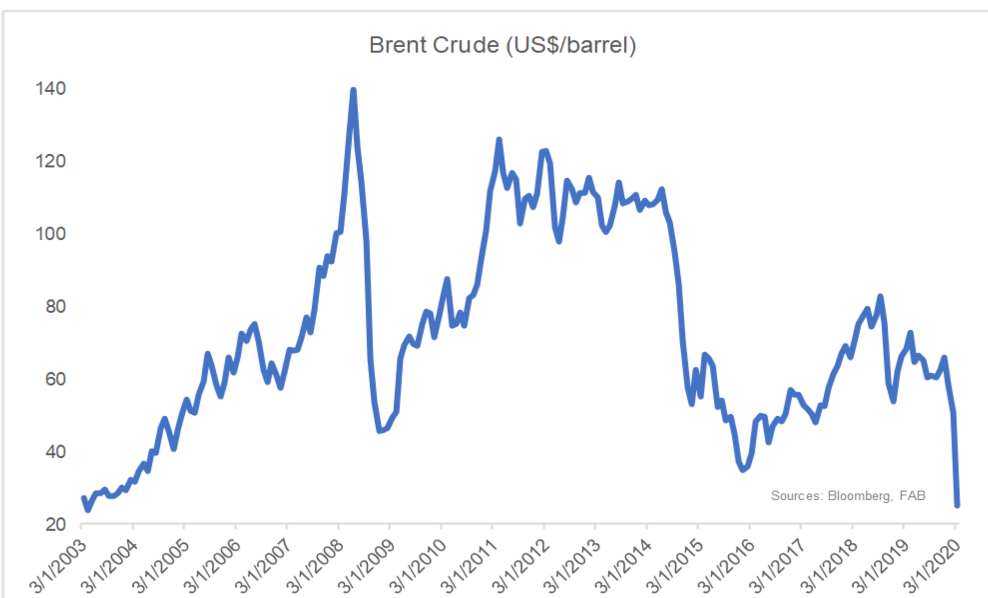
Bond markets also saw some signs of normalization, with corporate issuance in investment-grade resuming. Nearly US$65 billion of higher-rated bonds were issued in the US and European markets on Thursday, making it one of the busiest days for the asset class in several months. The week as a whole was a record for investment-grade bond issuance, with about US$100 billion of new bonds issued. Despite the additional supply, spreads for investment-grade companies dropped, with the Markit CDX IG index falling 40 basis points to 112 basis points. The movement came even amid news that retail investors had pulled a record US$38 billion out of US investment-grade funds in the week ended March 25.

High-yield spreads tightened too, with the average yield premium of the Bloomberg Barclays US Corporate High-Yield index falling 92 basis points, to 9.21%. There were, however, no new issues in the space, according to Bloomberg, and so far junk-rated companies have only sold US$3.8 billion in March, with most of that in the first week of the month.

Crude oil prices have dropped to levels not seen since 2003 as supply outpaces demand

While the outlook seemed to improve in credit markets, it remained bleak for the oil industry. The grounding of many airlines has reduced the need for jet fuel by more than 70%, equivalent to some 5 million barrels/day of crude oil demand. American drivers, who use about 9 million barrels/day, are also keeping their cars in the garage. Altogether, some analysts estimate that currently daily oil demand has dropped by more than 20 million barrels/day.

This comes as Russia, Saudi Arabia and other OPEC members have increased production as part of a price and market share war. The result has been extreme. Brent crude prices are down 52% since the start of March, with Brent quoted on Friday at US$24.9/barrel, the lowest close in more than 15 years. Meanwhile, Bloomberg reported that pipeline operators in the US have told shale oil producers to stop shipping crude, as they were running out of storage space. Some traders reported buying light Texas oil for as low as US$13/barrel last week, while Oklahoma Sour is changing hands at US$5.75, Nebraska Intermediate at US$8, while Wyoming Sweet was quoted at US$3/barrel. If the crude oil markets are any indication of the health of the world economy - and even allowing for the price war, then the worst is not yet behind us.



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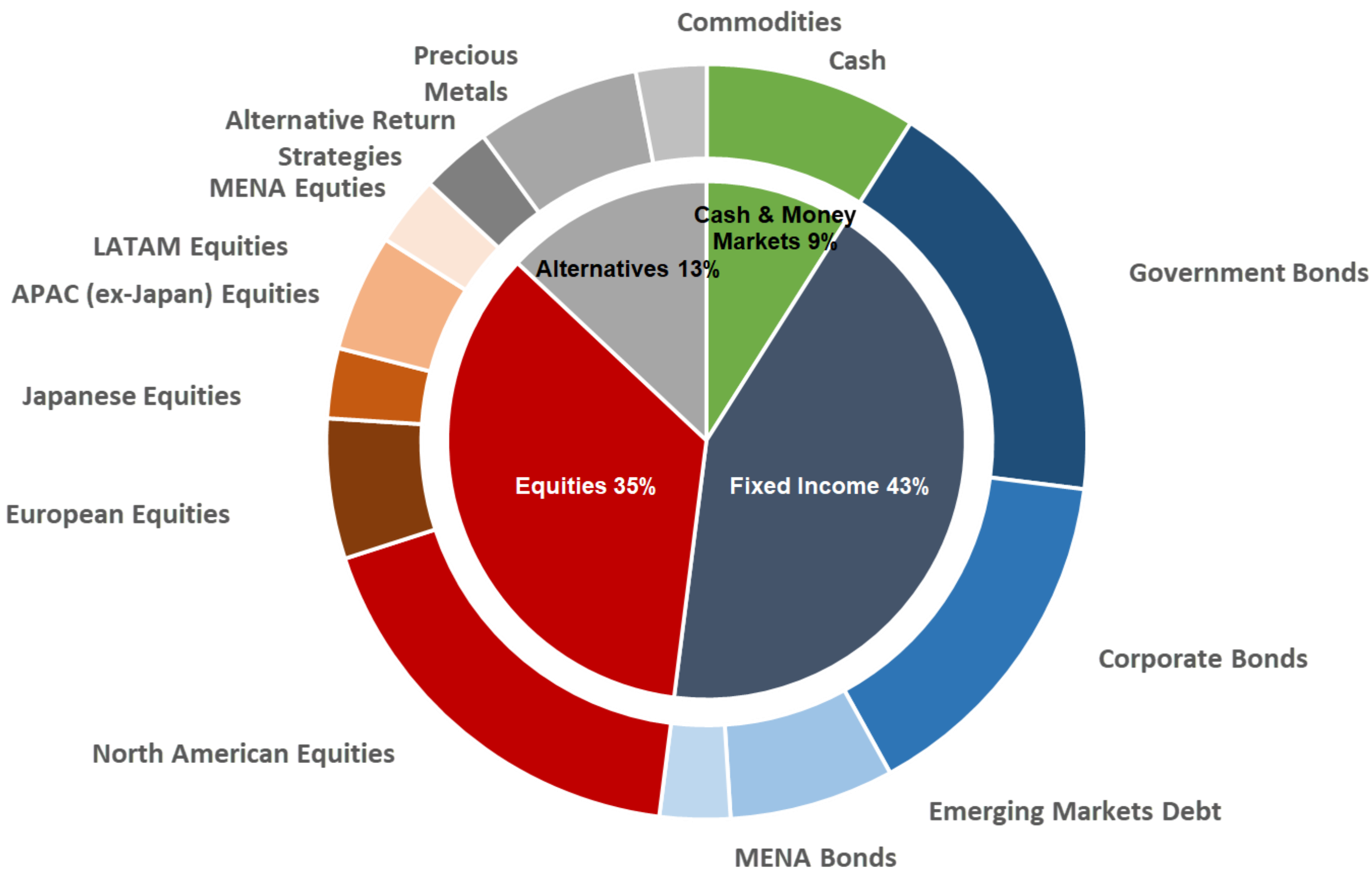
Current Tactical Asset Allocation



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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