INVESTMENT STRATEGY
WEEKLY VIEW

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'RISK-ON' REMAINS THE WAY TO GO

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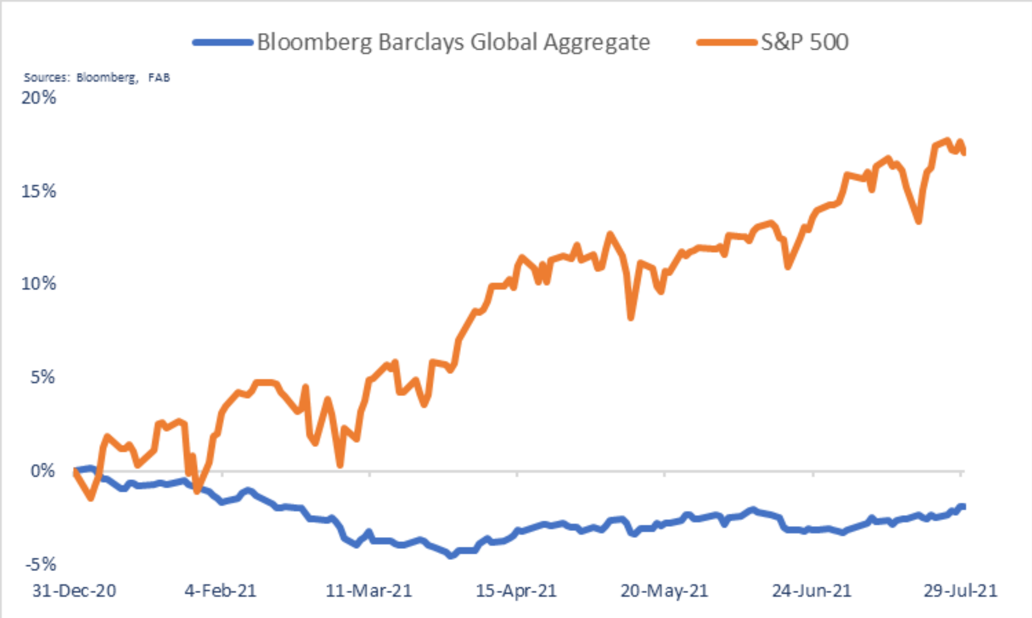
- US stock indices ended the week with small losses after a volatile week.
- Chinese assets have been underperforming as global investors grapple with Beijing's interventions.
- The Federal Reserve has started assessing when to taper its asset purchases.
- The FAB AAC is overweight in equities, IG and EM bonds. It is underweight cash and neutral in gold.



This year began with many analysts suggesting stock valuations were so high that they did not see much upside to indices such as the NASDAQ Composite or the S&P 500. The devil is in the detail, and what many analysts failed to see was that the valuations were based on bearish forecasts. If the expected profits are low, the price-to-forward earnings will be higher. As analysts accepted the US recovery is strong, they revised their profit forecasts upwards, giving the stock market room to rally.

In fact, bearish investors who may have parked their cash in safer securities such as government bonds could be feeling sore at this stage. While the Bloomberg Barclays Global Aggregate Index, one of the broadest bond measures, is down 1.92% so far this year, the S&P 500 has gained 17.05%. At Friday's closing level of 4,395.26, the S&P 500 is also just shy of the year-end FAB Global Investment Outlook target of 4,400, although that level was exceeded earlier last week.

Amid this backdrop, the FAB Asset Allocation Committee (FAB AAC) met on Thursday to review its 'risk-on' position. While some members expressed concern about the direction of certain asset classes into the end of the year, the FAB AAC unanimously decided to keep its overall allocation unchanged. That entails a small overweight in EM and corporate investment-grade bonds as well as a similar position in developed market stocks, and in Asia ex-Japan shares.

The FAB AAC has held this position since January. Not all risk assets have performed well, however, with China contributing to some minor losses in EM bonds and Asia ex-Japan equities. Some FAB AAC members highlighted the possibility this could continue to be the case for a bit, but agreed to stay put.

The S&P 500 has had a stellar year-to-date; meanwhile bonds performed negatively

Last week was particularly painful for Chinese stocks, especially those traded in Hong Kong. The Hang Seng Index fell 4.98% in a very volatile week, its worst weekly loss since the last week of February. The index is now down 4.7% for the year to date. The onshore CSI 300 Index fell 5.46% last week, too.

The drop was prompted by an announcement the week before that China had requested companies that provide tutoring and online classes, including some stock market darlings, to focus less on profits and more on their social function.

This came a week after Beijing removed Didi Global's ride-hailing application from app stores in China, just days after the company had listed its shares in New York. According to reports, the move was prompted by the company's decision to go ahead with a US IPO even after being told not to do so by Chinese regulators.

The last round of intervention in the technology industry by Beijing comes after giants such as Tencent and Alibaba were fined earlier this year for supposed breaches of privacy rights and excessive market power.

The first salvo in that direction actually came last year, when Chinese regulators halted the IPO of Ant Financial, which was set to be one of the biggest in history, just days before the event, saying, in broad terms, that the digital finance company had to conform to Chinese banking regulations more closely if it wanted to be listed.

Beijing has also been cracking down on real estate companies, as home affordability increasingly becomes a social issue in China, and this has adversely impacted its bond markets. About 23% of the Bloomberg Barclays Asia US Dollar High-Yield index is comprised of real estate borrowers, with China representing 43% of that segment.

Real estate in China has therefore been among the key culprits of the 6.1% drop in the Asia index since the start of June, even as developed global benchmarks such as the 10-year US Treasury rallied by 3.4% over the same period. The clampdown came after the average selling price for a home in Shanghai jumped to 6,081.3 yuan/square foot (US$941.1/square foot) at the end of February, the third-highest price since the China Real Estate Information Corporation began to track these prices.

Curiously, many of the supposed problems which have prompted government intervention in China are being faced in the US, and in the EU as well. The difference, perhaps, is the way the problems are dealt with. While China's central government has the power to simply impose fines and shut down IPOs, US and European regulators have to resort to courts and parliaments to enforce change.

Both the US and the EU have mounted multiple legal challenges to what some say are the near-monopolistic practices of Facebook, Amazon or Google. So far, very few have moved forward, and slowly. One of the complaints Chinese regulators have made against Didi Global is the lack of formal employment ties between drivers and the company, a similar problem to the one that led to a court decision against Uber in California earlier this year.

Just as China is forcing real estate developers to sell property at a discount to reduce their leverage, Federal Reserve Chairman Jerome Powell had a closed-door meeting with Secretary of Treasury Janet Yellen last week to discuss quickly-rising home prices. This comes as the median sales price for a US existing home reached US$363,300, the highest ever, after rising 19.7% so far this year.

Unlike in China, US regulators are very unlikely to try to force developers to cut prices. However, they must surely be considering the extent to which the continued buying of US$40 billion per month of new mortgage-backed securities is helping to fuel rising home prices, and whether the Fed should consider reducing the pace of those purchases.

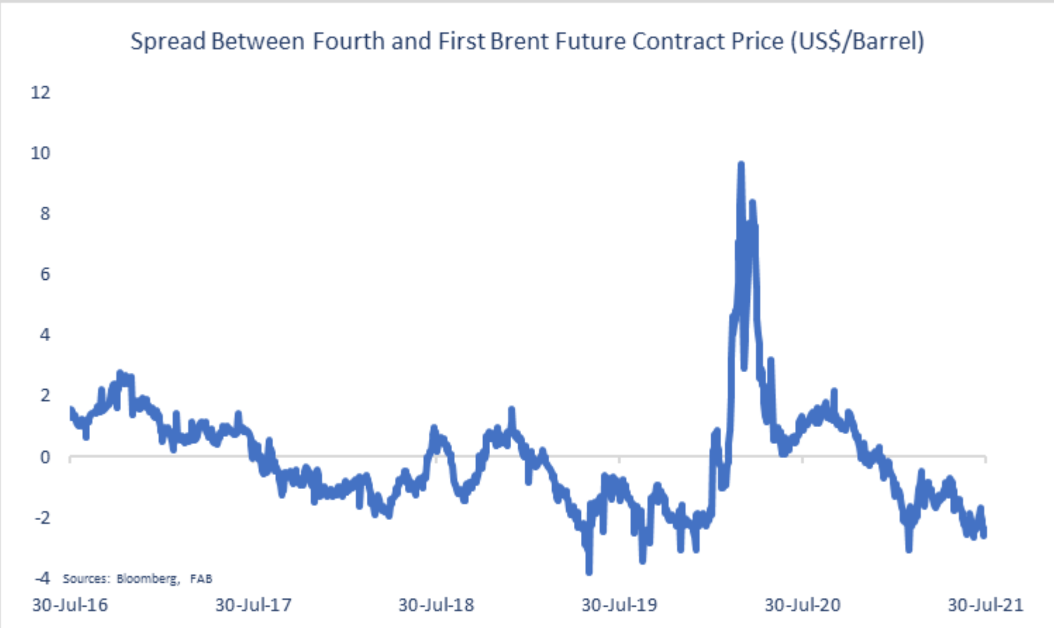
Anyhow, it looks like reducing the pace of any asset purchases remains off the Fed's table for now, at least that was the message that Chairman Powell delivered after the Federal Open Market Committee meeting last Wednesday. The central bank was also vindicated by the data released the day after.

US GDP, which was earlier projected to have expanded at an 8.5% pace in the second quarter, posted an annualized rate of 6.5%, while core PCE, the Fed's preferred measure of inflation, also surprised to the downside, coming in at 3.5% year-on-year, compared to the 3.7% median forecast.

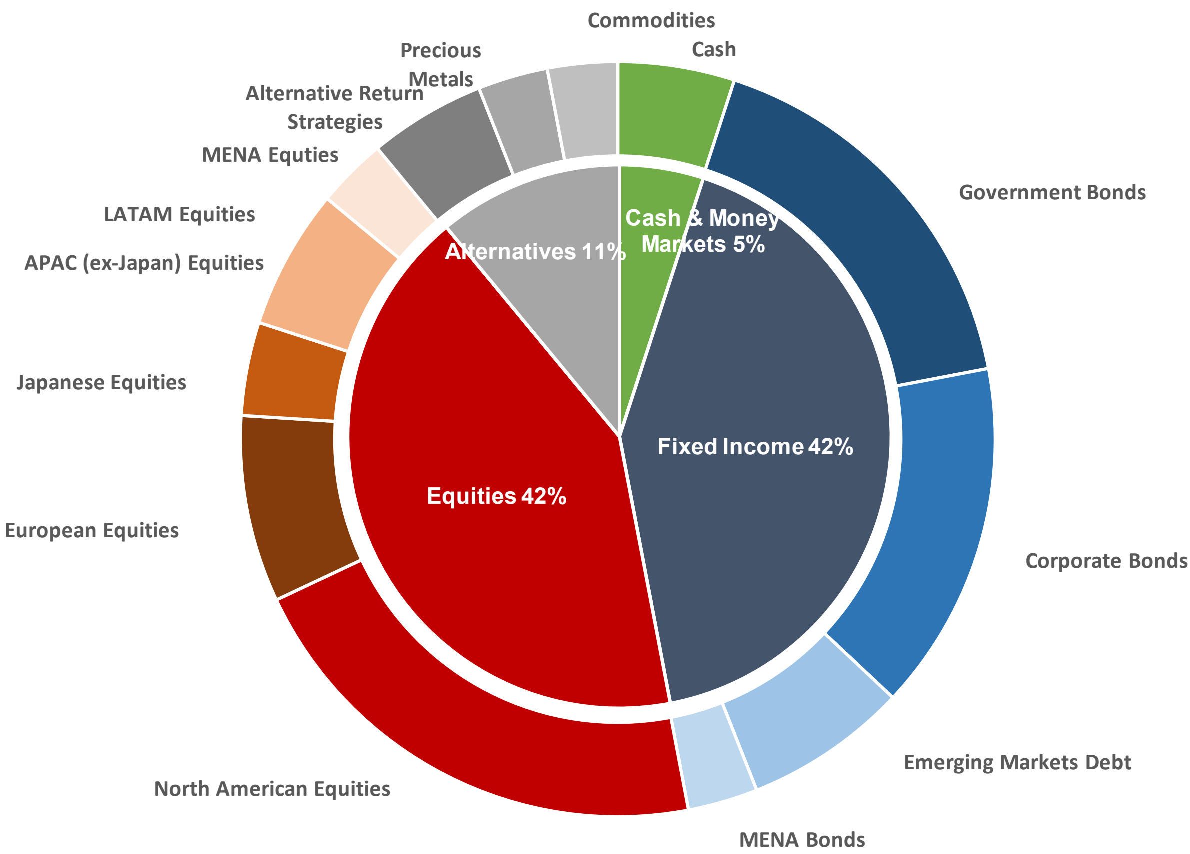
The next significant data point investors will look at is this week's nonfarm payrolls. The median estimate among economists surveyed by Bloomberg is for 900,000 jobs to have been created in July, and for the unemployment rate to have fallen to 5.7%, from the current 5.9%. These would be important signals to markets that the US economic recovery remains on track, and also key regarding the conversation about when the Fed will start to taper its asset purchases. The central bank has focused a lot on its full-employment mandate lately, ignoring what it calls 'transitory' inflation.

Even if the jobs figure misses estimates, however, there are indications that the recovery remains strong. For instance, crude oil contracts, often seen as a real-time thermometer of the state of the economy, are in backwardation, meaning buyers are paying higher prices for energy now than in the future, a sign of stronger current demand than supply. This, and the continued recovery that should ensue as the rest of the world emerges from Covid-related restrictions, suggests investors should continue to hold, and/or to buy risk assets into any intermediate corrections.

Oil futures are in deep backwardation, a sign of strong current demand for energy



Asset Class	Positioning	Detail
Cash	Underweight	Putting cash to work in risk assets.
Fixed Income	Overweight	Keeping a slight overweight focused on EM dollar debt and on corporate investment grade bonds
Equities	Overweight	Slightly overweight in Asia ex-Japan and US markets.
Alternatives	Underweight	However, reducing the underweight in hedge funds



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