Investment Weekly

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7 February, 2021

That big US stimulus package is getting closer every day

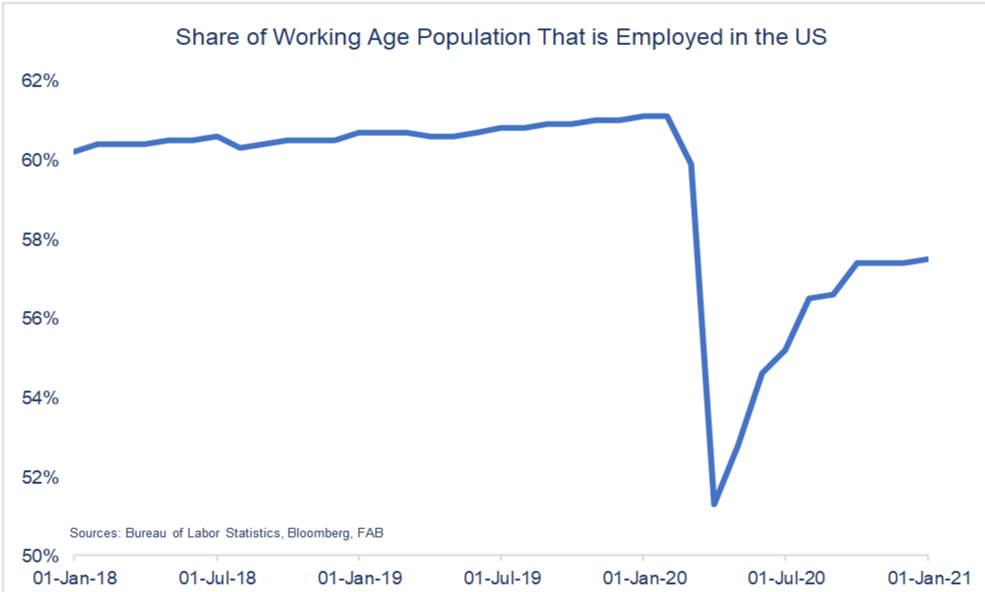
♦ **Democrats on Friday passed a pre-emptive measure that could allow them to avoid filibusters and to pass the US$1.9 trillion bill without Republican support in a few weeks.**

♦ **House Majority Leader Nancy Pelosi is referring to the bill as a 'relief package', suggesting Democrats could pass more 'stimulus' later.**

♦ **The difference between the yields on the two- and 10-year US Treasuries has reached the highest in four years as investors signalled that they see US growth accelerating.**

♦ **The dollar index had its biggest one-day drop since mid-December, too, after a negative surprise in the January employment report.**

♦ **The FAB AAC is overweight in equities, IG and EM bonds, and gold, and is underweight alternatives.**



There may have been some doubts before, but both politicians in Washington DC and traders on Wall Street seem to be saying that the big stimulus package that President Biden wants is imminent.

On Friday, House Democrats adopted a budget resolution that had cleared the Senate, paving the way to pass the US$1.9 trillion package untouched without help from lawmakers across the aisle.

The President would like some Republicans on board with his package, but the resolution allows his party to pass the bill without support from the other side of the aisle. This approach, however, runs a risk because if a single Democratic senator defects the bill fails.

Joe Biden's party closed ranks to pass the resolution, however, suggesting it could still pass. The resolution is a bit different from a new bill and is a maneuver to avoid depending on Republican approval. While it overcomes the resistance from opposition lawmakers, it also takes a bit longer to get through the two chambers than a new bill might.

Investors and traders seemed to believe this resolution signals that the full bill will get passed, or at least the market action on Friday suggested that. The S&P 500 gained 0.39%, capping five consecutive days of gains, which made last week the index's best since November.

A clearer signal, however, was seen in the bond market. The yield on the 10-year US Treasury closed at 1.16%, almost 10 basis points higher over the week. Meanwhile, the yield on the two-year fell 1 basis point last week, resulting in the biggest difference between the yields of the two maturities since 2017.

The share of the US population who is employed remains well below pre-pandemic levels

A steepening Treasury curve is commonly seen as an indication that investors expect economic growth (and/or inflation) to accelerate in the future. It appears bond investors are embracing the theory which the stock markets seems to have been preaching for several months: that there will be an economic spurt once vaccines are widespread.

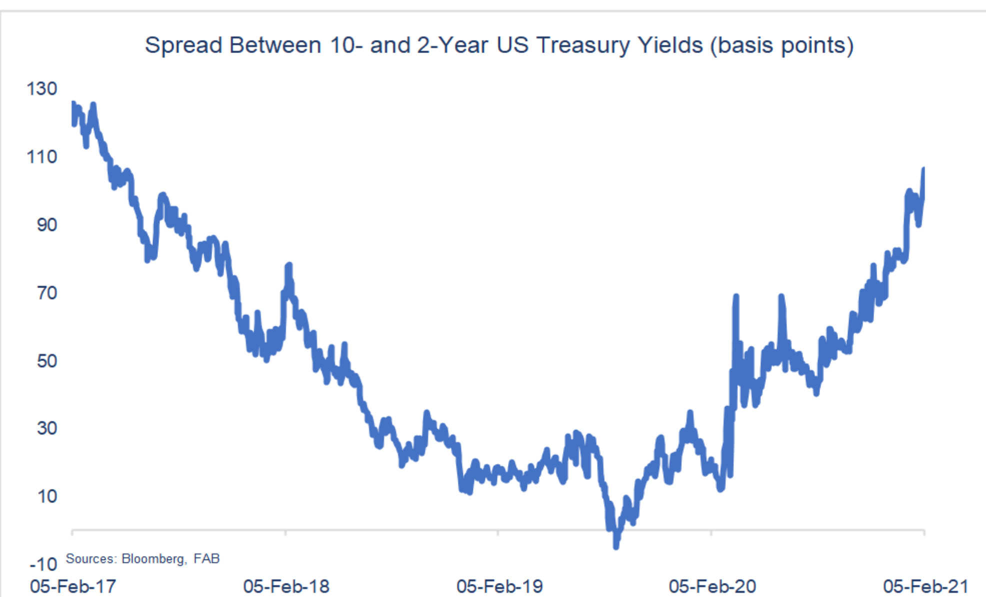
A larger difference between long and short rates is also good for banks, which stand to profit more from lending. Because of that, they tend to lend more, which helps support growth. Naturally, the difference in yields is also a result of investors seemingly expecting that more of the large upcoming stimulus will be financed with longer-term bonds.

Janet Yellen, the Treasury Secretary, has espoused that view. She recently said the low cost of debt currently available in the US means the impact of borrowing more is less costly. Hence, the country should take advantage of that to finance a much-needed infrastructure overhaul.

That seems to be the plan, though the spending under consideration right now is not part of that. Some commentators have noted that House Speaker Nancy Pelosi has referred to President Biden's US$1.9 trillion proposal as a 'relief package', instead of calling it a stimulus package.

The difference is important. By indicating that this is a relief package, she leaves the door open for an actual stimulus package, which could help rebuild the country's infrastructure and stimulate the economy in the future. For now, this is just to get the country back on its feet.

Investors seem to have picked up on the nuance, and the dollar index fell 0.53% on Friday, its biggest one-day drop since mid-December. The sudden plunge also came just as the dollar index was testing its 89-day moving average, an important resistance that could signal more strength if breached. The dollar index had rallied almost 2.8% since the start of the year, so Friday's move was meaningful.



Sources: Bloomberg, FAB

This helped spur a further rise in oil prices. Brent crude closed the week at US$59.59/ barrel, the highest level in a year. The commodity is up 14.6% year-to-date, as investors start to price-in the possibility that growth will accelerate, and that the International Energy Agency's forecast of demand going almost back to pre-pandemic levels by the year-end will materialize.

There is some foundation to that narrative as car sales in China and the US are actually up year-on-year.

With demand increasing, the decision by OPEC+ to keep output curbs is reducing inventories fast, and pushing prices higher. The rally is up-ending many oil price predictions for this year, which have been mostly looking at prices staying around the US$43/barrel average recorded for 2020.

It is a welcome surprise for oil-producing nations in the GCC region, which had also predicted that Brent crude would remain around US$45/barrel this year.

The spread between 10-year and two-year US Treasury yields hit the highest since 2017

If prices steady around current levels and FAB's forecast of an average of US$58/ barrel this year materializes, it could mean a much better fiscal outcome than most countries in the region had prepared for. And this is great news for investors.

The lower-rated countries in the region are the ones that stand to benefit the most from higher oil prices. Oman and Bahrain, for instance, could reduce their forecast deficits if they do not spend more than they had forecast.

Oman, for instance, had projected a deficit of about US$5.7 billion this year, assuming oil prices of US$45/barrel. About 63% of the country's fiscal revenues are derived from hydrocarbons, according to the IMF. Given this, and applying FAB's forecast oil price of US$58/barrel instead, that would add some US$4.1 billion in revenues to Oman's government coffers.

Bahrain offers a similar picture, with the budget calling for a deficit of US$2.7 billion on a forecast oil price of US$45/barrel. If oil were to stay around US$58/barrel, the country could get as much as US$13.8 billion more in revenues, considering that 76% of its fiscal input is derived from hydrocarbons, according to the IMF.

These two countries in particular have started to rein-in their spending and are seeking new ways to increase revenues. Both are enacting value added taxes and Oman expects to spend 14% less this year than last. Bahrain is still considering higher spending this year to deal with the fallout from the coronavirus crisis. However, the country was working its way towards balancing its budget before the crisis and is likely to stay on that path.

Perhaps most importantly, Fitch Ratings had forecast Brent crude to average US$45/barrel this year, and other agencies have similar expectations. If they are forced to revise those expectations higher, they will also have to revise upwards their assumptions about the ability of GCC countries to manage their debts, and they may have to increase some ratings.

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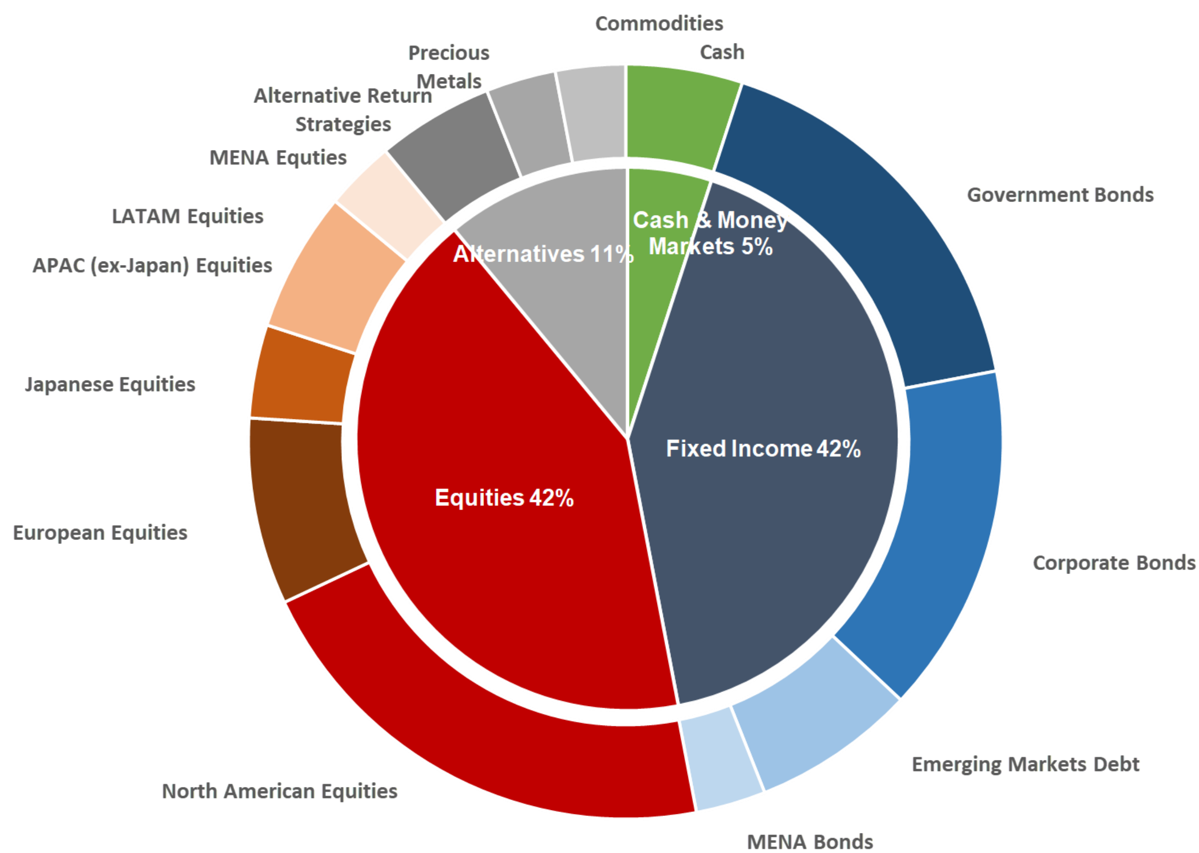
Current Tactical Asset Allocation



Asset Class	Positioning	Detail
Cash	Neutral	Moved into overweight equities position.
Fixed Income	Overweight	Keeping slightly overweight focused on EM dollar debt and corporate investment grade bonds
Equities	Overweight	Slightly overweight Japanese, US and Asia ex-Japan stock markets.
Alternatives	Underweight	However, still marginally overweight in precious metals

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