**Investment Weekly**

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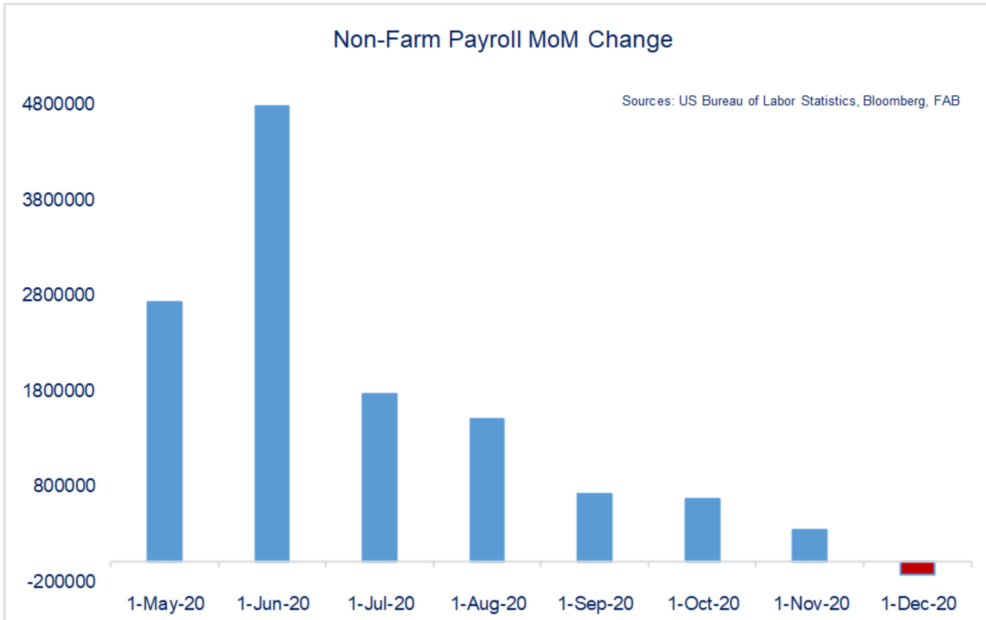
# Global investors chase the laggards, hoping for a recovery

- **The US shed jobs for the first time since May, as the latest wave of Covid-19 cases took its toll on the economy .**
- **Global manufacturing PMIs were mostly upbeat last week, but services gauges remained downbeat.**
- **Investors are still looking ahead to the full rollout of vaccines and the potential for a recovery later this year.**
- **Value-oriented sectors outperformed so far this year as investors seemed to chase last year's laggards.**
- **The FAB AAC has a neutral position in equities, and is slightly overweight in IG and EM bonds, and gold.**




It was a turbulent week in Washington DC. Capitol Hill, home to the US Congress, was invaded by pro-Trump supporters, the Georgia Senate races were called in favour of Democrats, handing the party control of Congress, and by Friday there was talk of lawmakers attempting a fast impeachment of President Donald Trump, before he steps down on 20 January.

Despite the fast and furious stream of headlines out of the US capital, global markets seemed to have turned back towards a 'risk-on' mode. US Treasuries, particularly long-term bonds, and gold sold off as investors dumped some of the safest assets.

At the other end of the spectrum were small-cap stocks in the US. The Russell 2000 rallied 5.91%, its best first full week of trading of the year since 1987, with the index rallying 7.13% between 4 January and 9 January. The movement within the index was also telling.

Energy, the worst-performing sector in the US market, was the best performer within the Russell 2000 last week, rallying 23.68% in the period. The next best performer last week were shares of companies in the basic materials sector, which gained 8.22%.

The value tilt under which the US stock market seemed to trade last week was also apparent elsewhere. The FTSE Index rallied 6.39%, outperforming the pan-European STOXX 600, which gained 3.04%. In Asia, Korea's KOSPI index gained 7.05%, while the Japanese Nikkei 225 was up 2.53%. Finally, the MSCI World index, comprised only of developed nation markets, gained 2.35%, while the MSCI EM index rallied 4.78%.

These moves seemed to send a clear message that investors still expect the world economy to pick up steam this year. Indeed, the events in Washington DC may be part of the reason for this belief.

## The US economy lost jobs for the first time since May, raising concerns about future growth

Now that the Democrats seem to have full control of the US government, they have free rein to roll out more stimulus. Even though Congress has just passed an additional rescue bill, it did not have much support for states hit by the pandemic, so this may be the first thing pushed forward, followed by an infrastructure bill.

This could support a stronger economic recovery in the US, and ultimately warrant higher earnings expectations, both of which should eventually support stock markets, especially cyclical sectors. The biggest risk for stocks, if anything, is that inflation accelerates and the Federal Reserve is forced to increase interest rates earlier than expected, which could undermine valuations.

Bond markets were factoring in some of that last week, with the 10- and 30-year US Treasuries yielding 1.11% and 1.87% respectively by the close of the market on Friday, their highest since March. Bond investors were also considering the prospect of much more Treasury issuance, to pay for additional fiscal stimulus.

The move in Treasury yields could continue, because of hedging activity by mortgage investors. The US$6 trillion mortgage market in the US is dominated by institutions who keep a tight control on their expected cashflow. When rates move upwards and they expect fewer people to refinance, they short the 10-year Treasury.

Because the 10-year Treasury yield is the benchmark for most mortgages in the US, higher yields on that bond result in even fewer people refinancing mortgages, and consequently more shorting, creating a possible short-term spiral. At some point, the higher yields attract other buyers who stop the self-fulfilling cycle.

Also, the Federal Reserve could be expected to step in and buy more long-dated bonds if the up-move in yields is very sharp and starts to have an impact on broader markets or on mortgage costs. Hence, last week's move in Treasury yields could continue, and could be an opportunity to add duration to portfolios.

The biggest victim in all this may be the US dollar, which could fall further amid additions to fiscal spending in the US. That could be good for global stocks. The US large-cap indices stand to benefit as the foreign earnings of multinationals translate into higher amounts in dollar terms.

Cyclical, and particularly energy, outperformance, as well as a weaker dollar and low rates, are a positive mix for MENA assets. Indeed, the Dubai Financial Markets General Index rallied 5.36% last week, and was up a further 1.85% this morning, while the Abu Dhabi Securities Market General Index gained 2.35% last week and was ahead 0.24% today.

The performance was partly driven by an 8.09% rally in the price of Brent crude. The commodity closed the week at US$55.99/ barrel, its highest since March, after Saudi Arabia unilaterally cut 1 million barrels/day of production for two months to help reduce stockpiles.

There was also good news on the geopolitical front in our region last week.

Saudi Arabia and Qatar announced they would resume flights between the two countries, as pictures of the first cars crossing the common border filled news websites. The UAE also said it had reopened travel routes to Qatar over the weekend, boosting excitement over potential two-way investments restarting.

While the news may have helped boost markets, there is plenty of reason to be bullish about the UAE this year. The country's PMI for December, a leading indicator resulting from a survey of purchasing managers, came in at 51.2, the highest level since August, 2019. More importantly, the fact that it came in above 50 means the economy is expanding.

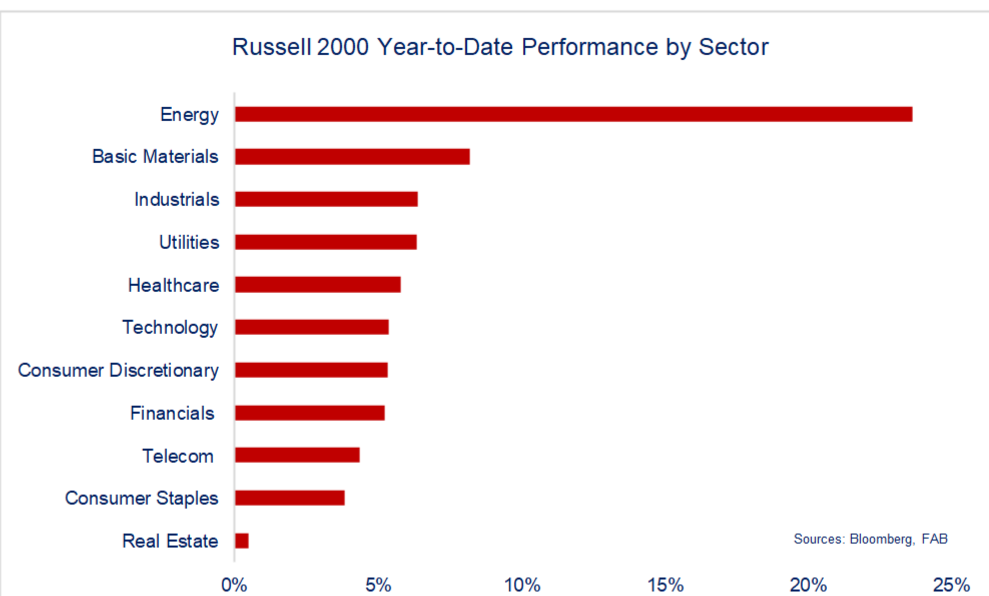
Recent official data for tourist arrivals is still not available, but many of the best hotels in the country have been fully-booked recently. More importantly, a record 2,485 property transactions took place in Dubai in December, pushing the value of such deals to 22 billion dirhams in the fourth quarter, one of the best three-months periods on record. Last week alone saw 4.4 billion dirhams in property transactions, according to Al Khaleej.

Meanwhile, the residential real estate price index for Abu Dhabi compiled by the Bank for International Settlements has been rising since June. The same index for Dubai has not yet started to rise, instead being flat over that period, although we would not be surprised to see an upturn.

UAE stock markets have already discounted some of that information. The Abu Dhabi index has risen 50.27% since 23 March, when global stock markets bottomed, while the Dubai index is up 56%. However, that is still shy of the 78.52% by which the overall MSCI EM index has risen over the same period. This difference should narrow, as the UAE benefits from higher oil prices, a weak dollar, and progressive reforms.

In a world where investors are looking at the laggards to find value, UAE assets may look particularly attractive.

## Small caps and the worst-performing sectors of 2020 were doing well so far this year



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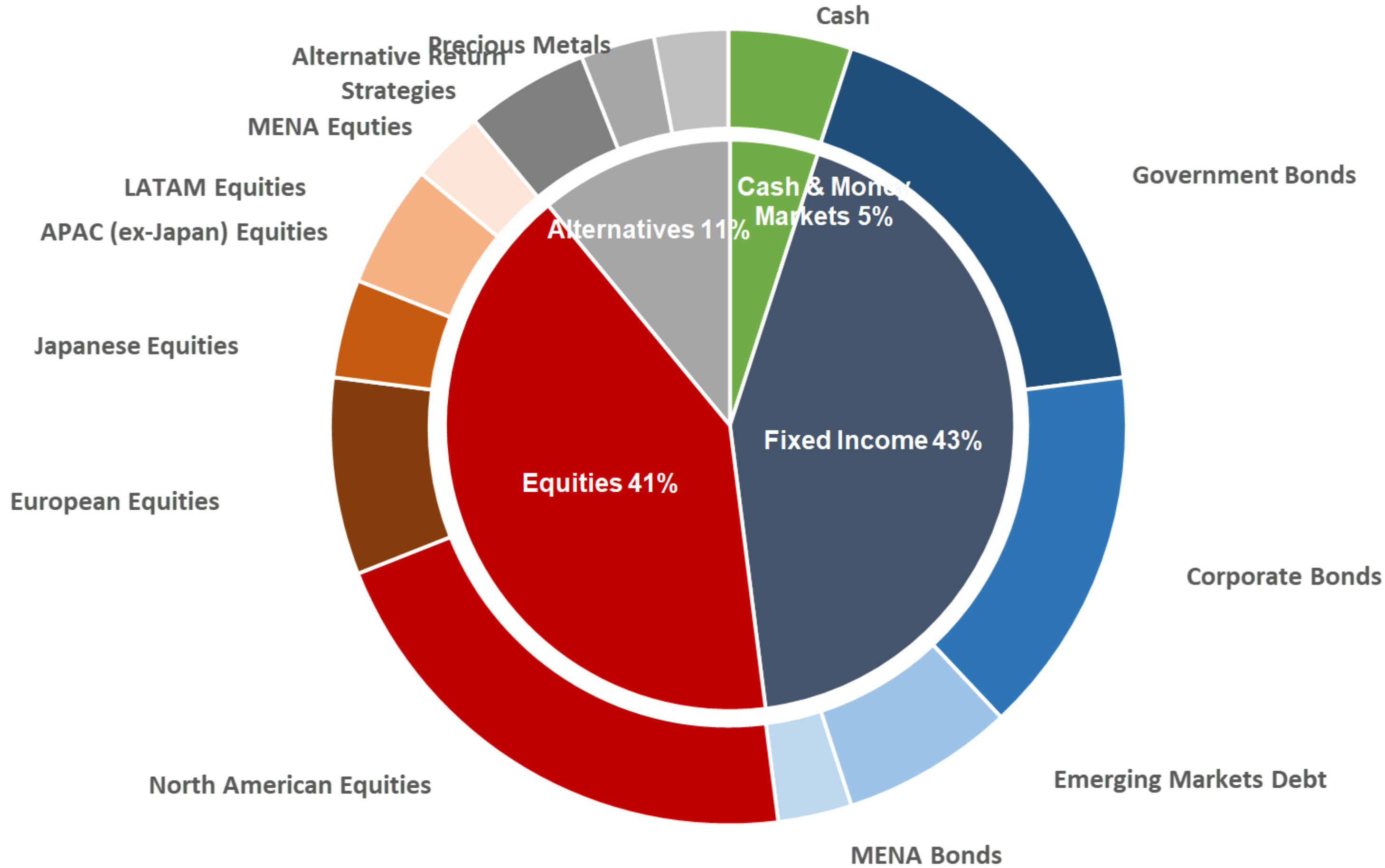
# Current Tactical Asset Allocation




| **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 | Neutral | And mildly overweight Japanese equities. |
| Alternatives | Underweight | However, overweight on precious metals specifically |

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