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10 August, 2020

## Markets look at the direction of the data instead of the number

◆ Global economic data remains gloomy by historic standards.

◆ However, most of the data has shown significant and steady improvement since the lows of April.

◆ Much of the gain has been fuelled by stimulus measures.

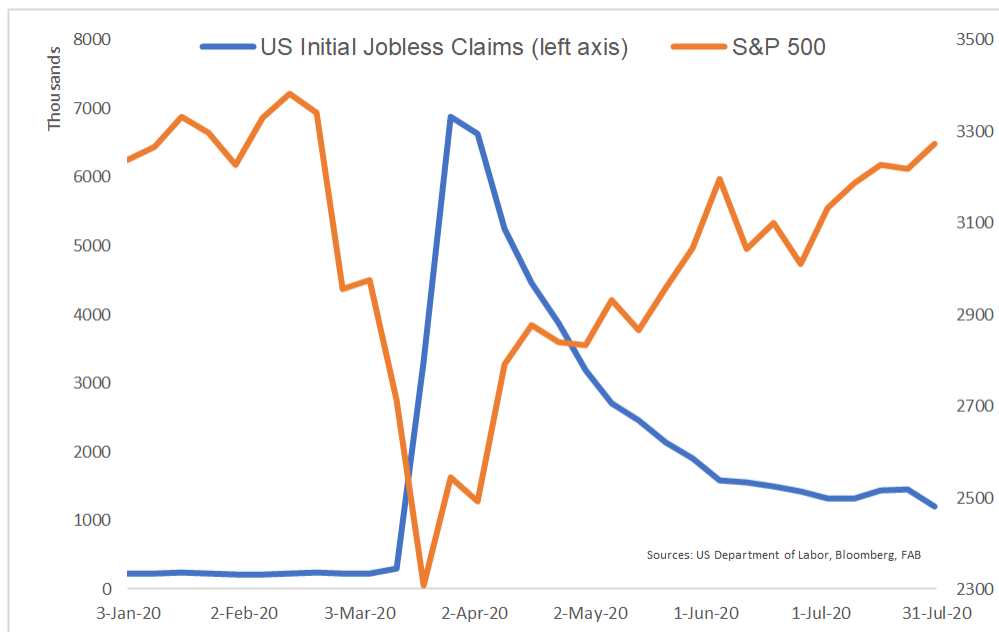
◆ Despite high unemployment levels, investors are only likely to react negatively if the direction of the economy worsens.

◆ Even then, the general expectation of more stimulus to plug the gap could backstop risk asset prices.

◆ The FAB AAC remains underweight equities while favouring gold and investment-grade debt.

It has been mind-boggling for most economists to see such a deep and broad recession as the one spreading across the world being met with one of the fastest, strongest gains for stock markets in recent history. The S&P 500 gained 20% in the second quarter while the US registered the highest unemployment and the worst drop in GDP since World War II. The key, however, is less the economic data itself and more its trend.

The direction of travel has indeed improved consistently over the past five months. After a record 6.6 million Americans filed for unemployment benefits in the week ended 3 April, the number has been declining and mostly coming in better than economists expected. Risk asset prices have gained in tandem. Indeed, historically, stocks care whether things are getting better, not whether they are good.



This is why the news about fiscal stimulus in America has become so important for US stocks. It is clear that much of the economic recovery was related to the stimulus measures taken in March, such as the paycheck protection program and extra welfare payments.

In other words, if the money stops pouring out of Washington DC, the economic data could start getting worse, and that could trigger a sell-off. Any such market drop, however, is likely to be short-lived, as the Federal Reserve and politicians are likely to react to any major volatility.

Similarly, the impact of the US election on the market has become less about who actually becomes president in the next term and more about the uncertainty related to the outcome. Hence, markets could react more poorly to swinging polls than to a clearer prospect of a Democratic leader in the White House for the next four years.

### US markets have gained as the data has improved steadily even if the numbers are scary

Even when it comes to the relationship between the US and China the dynamic seems to be similar. While the recent escalation of tensions between the two countries is reason for concern, it is not unexpected, and therefore has failed to swoon markets so far.

Understanding that pattern will be important for portfolio asset allocation in coming months. While there are reasons to expect higher volatility, particularly in August when there is less liquidity, the extent of negative moves is likely to be determined more by the trend than the headline. And with so much money sloshing around, unless things start getting markedly worse, investors are likely to continue to add risk.

# Investment Strategy Update

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