

For inquiries related to this article, please contact:

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



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The arrival of more 'normal' markets should be welcomed

Last night the S&P 500 edged up 0.2% to a new all-time closing high, at 3,389.78, prompting questions as to whether this can continue. Amongst the popular sayings in markets, one that has stood the test of time goes along the following lines: "There are two kinds of investors: one who can't time the markets... and the other being one who knows they can't time the markets".

Sure enough, our own FAB Asset Allocation Committee (AAC) operates its investment policy on the basis of a series of occasional tilts, in which the members decide how different buckets of risk (conservative, balanced, and growth) might best be apportioned. Given the many uncertainties in recent months the AAC has been marginally underweight in global equities, by an average of just a few percentage points on its grids. But the AAC has also been overweight in gold, in cognizance of its useful hedging qualities. After such a substantial run-up in gold, the members recently thought it correct to take some of that money off the table, although remain overweight.

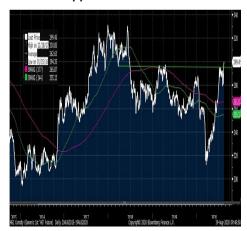
We are mindful that a closing high in the S&P 500 - or any market - should be kept in perspective. These have not been 'normal' markets, given the possible once-in-a-lifetime kind of backdrop. We are conscious that Wall Street's view has been different to Main Street's - for instance what happens if the US stimulus checks to consumers simply stop, and are not tapered in a gradual manner? Or if the US (and other economies) really do recover well - how would markets react if the Fed and its counterparts took away the monetary punchbowl, deeming that extra liquidity wasn't needed? Although there are plenty of unanswered questions, in essence what we actually expect to see is a return to so-called 'normal' markets those which are driven by a stream of pushes and pulls, ups and downs. By and large, that would be a good development.

In relation to the pandemic, we have advocated looking at the FT's rolling collation of global deaths. Although it in effect tells the story of infection rates 2-3 weeks earlier (and is also far from perfect), it should be a 'harder' number than estimates of the number of infections. A glance at the relevant FT page today counter to the mood of journalistic headlines we continue to read - suggests that the 7- day moving average of deaths (last at 5,670) could actually have peaked. Of course we know a resurgence of the coronavirus is likely during the Northern Hemisphere winter, but if it takes place from a lower interim base that would be easier to cope with.

The prospective P/E on the S&P 500 of 26.2x for 2020 is in practice largely irrelevant, given that investors are concentrating on the outlook for 2021 and beyond. We have seen how the Citi Economic Surprises Indices – and the tally of impressive 'beats' in second quarter earnings have shown that analysts were far too pessimistic. Although uncertainties remain (US/China trade, the US elections, Brexit, and so on) analysts may actually turn out to be too low in their forecasts of 2021 earnings. The latter have only moved up to \$164.42 (from a 'disaster' low of close to \$161). Accordingly the current S&P 500 P/E ratio of 20.6x for 2021 may be too high (i.e. earnings could beat), and if the US 10-year Treasury yield doesn't rise much above 1% then equity P/Es in the mid-20s could still be justified.

We continually read about US equities indices in particular being disproportionately driven by the largest six or so names, and how investors are so concerned about this. Although the large technology stocks will correct from time-to-time, we accept the 'New Economy' has arrived, and are looking hard for the next group of stocks that will challenge them - or which will spawn new tech or tech-related sectors.

Chart: Copper Prices



The US dollar index (DXY) is trading at a two-year low (currently at 92.29), and a bearish crossover on our very long-term technical averages is due. If correct, this might limit the extent of any bounce to about the 96 level prior to a resumption of downside. The implications of a confirmation of a 'big picture' turn in the US dollar should usher in opportunities in emerging markets and commodities.

For some weeks we have been thinking that after all the liquidity-driven upside seen in many equities markets, surely the time for non-precious metal commodities to begin to shine would arrive. Copper is the commodity bellwether - apart from crude oil - that many investors follow closest, given its wide usage in construction and electronics. Today's chart clearly shows the likelihood of a bullish break above the \$3/lb level for the red metal. Last night's US July housing starts usefully exceeding expectations was a catalyst, while a necessary increase in infrastructure spending - and China - could be others. Investors are advised to be properly diversified, to think long-term, to stick to quality - and not to attempt to time the markets.





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