Investment Strategy Update

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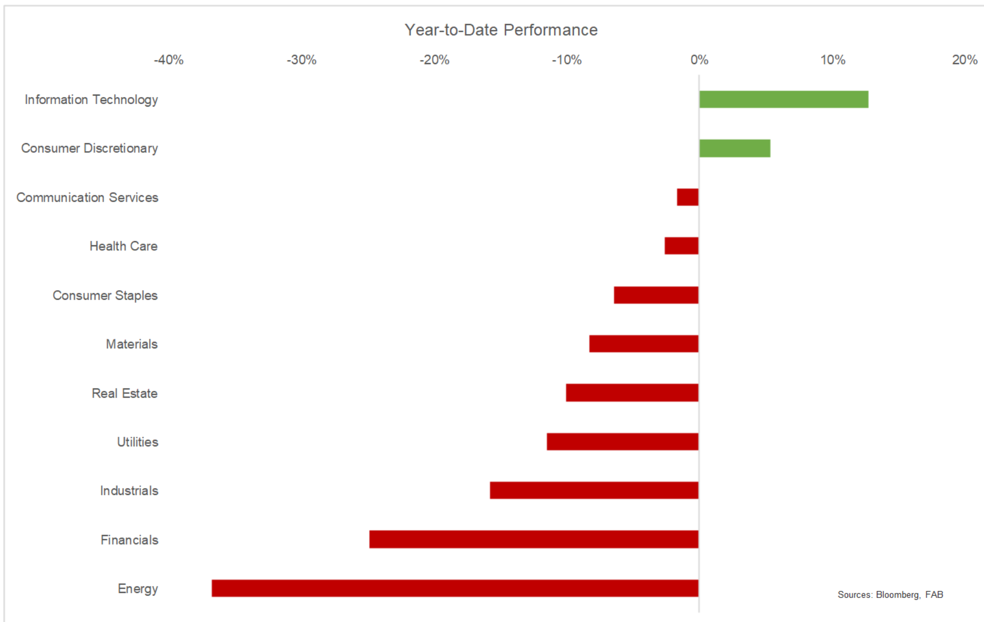
Investors hold their breath after the best quarter since 1998

- **The S&P 500 index is up 18.1% since 31 March, yet it remains 5.5% down year-to-date.**
- **The gains, however, followed the worst quarter since 2008.**
- **Excluding technology, equities are still deeply in negative territory.**
- **Investors have been chasing the laggards in the past few weeks, though, focusing on the economic recovery.**
- **The coming quarter, however, could be fraught with political risk.**
- **FAB AAC remains overweight high-quality investment grade bonds.**



It has been a rollercoaster ride. The S&P 500 ended the first three months of the year 20% down, its worst quarterly performance since 2008. It then gained 18.1% between 31 March and June 29, putting it on track for its best quarterly performance since 1998.

The rally, however, has been flagging in June, and the S&P 500 has been stuck between 3,000 and 3,200 for the whole month. The main driver for the gains of April and May, technology stocks, continued to outperform, up more than 5% in June, but that was far from the 13.7% gain logged in April or the 6.8% rally of May. As for the broader index, it is up a mere 0.29% month-to-date.

Gold, meanwhile, is up 12.1% this quarter, its best performance since 2016. High-yield bonds are up 10.1% for the period and liquid corporate investment-grade corporate bonds have gained 9.5%, using the Bloomberg indices as a gauge.

As the new quarter starts, therefore, there is a lot to celebrate but many investors may take a step back and reassess their positions. Record monetary easing is likely to continue to make growth and higher yielding assets attractive. However, some rebalancing could take place in the next three months, especially since there are a lot of political flashpoints ahead.

By some measures, stocks are extremely expensive. On 29 June, the MSCI World index was trading at 22.14 times the earnings forecast for the next 12 months, near the highest such valuation in 20 years. That is also more than two standard deviations away from the 15.8 long-term average. Assuming the index will revert to the mean, either earnings forecasts will rise substantially or stock prices will drop.

Gold is also at its highest price since 2011 and near its all-time highs, although on an inflation-adjusted basis it is still some 17% away from that year's record.

Only shares of technology and consumer discretionary companies are positive YTD

Which then brings back the issue of monetary easing. Investors are likely to continue to follow the Federal Reserve and other central banks when they are investing this quarter. The Bank of Japan, the European Central Bank and the Federal Reserve are all buying corporate and government bonds, so there will be support there.

The bond buying puts more cash into circulation, which favours gold and supports equity valuations, especially of high-growth companies or those that pay higher dividends. The issue, however, is profits. In two weeks, companies start to report their second quarter earnings. Depending on how bad they are, investors may have to reassess the value of stocks.

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