

For inquiries related to this article, please contact:

Alain.Marckus@bankfab.com

Christofer.Langner@bankfab.com

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Bearishness deepens as President Trump rekindles trade war

◆ **European stocks slump as investors in Frankfurt and Paris catch up with New York after a long weekend in the Old Continent.**

◆ **US Secretary of State Mike Pompeo adds to spat between the US and China by saying that there is “enormous evidence” that Covid-19 originated in a Wuhan laboratory.**

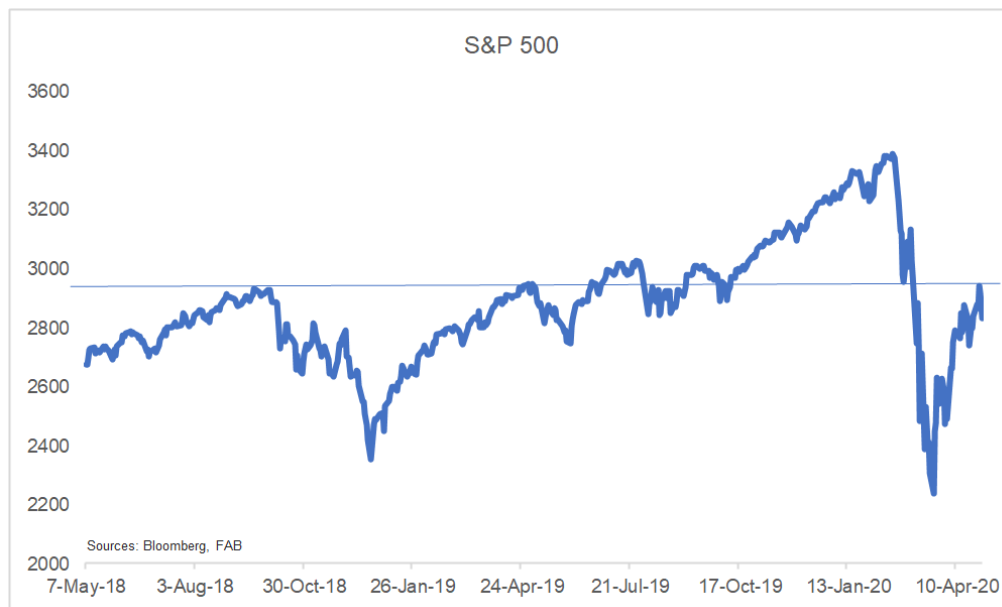
◆ **European factory surveys continue to paint a dire picture of the economy.**

◆ **Stocks retreat just as they hit a technical resistance.**

◆ **FAB AAC remains underweight in equities and overweight in gold.**

Europe is feeling the full impact of the so-called ‘Monday effect’. Most stock markets in the region were closed on Friday due to a holiday, so they missed the sell-off endured by US indices following President Donald Trump’s comments about China, which increased the animosity between the US and the nation and risked rekindling the trade war.

As traders came back from the long weekend to their desks in Amsterdam, Frankfurt, London and Paris, the key order seems to have been “sell”. The French CAC 40 index was down 4% at the time of writing, while the DAX in Germany was falling 3.4% and the broader STOXX 600 was down 3.8%. The trading action was also dragging down US stocks and the S&P 500 futures were down 1%. Perhaps more important, the VIX volatility index was nearing 40 again, a key level that indicates a significant deterioration in sentiment, while the dollar and Treasuries were rallying amid haven demand.



The negative sentiment was mostly driven by comments from President Trump and his close aides which attempted to link China to the origin of the Covid-19 virus and suggested the US may seek some sort of retaliation against the Eastern nation. In a virtual town hall yesterday, President Trump promised to provide a report linking the coronavirus outbreak to China. Today, Secretary of State Michael Pompeo added that he saw “enormous evidence” that the pandemic originated in a laboratory in Wuhan. Neither has provided evidence to back their assertion.

More evidence of the severity of the economic slowdown in Europe added to the dismal setting. The Eurozone manufacturing PMI dropped to 33.4, far below the 50 level which signals a recession and the lowest in history. The retreat comes after the STOXX 600 had rallied 21.3% between 23 March and the end of April, pushing its forward price-to-earnings ratio to 17.4 times, the highest valuation in at least 15 years.

The S&P 500 was unable to breach a key resistance level, giving fodder to the bears

In other words, despite all the stimulus announced to counter the global economic slump resulting from the lockdowns, stocks were overdue a correction. The question now will be how far the selloff will go. At least liquidity measures, such as commercial paper rates, continued to indicate reduced stress.

Still, the sudden turn negative is vindicating bears who were claiming that the recent rally in risk assets was only a temporary bounce. Indeed, many indices are starting to retreat exactly as they hit key technical resistances, which could help exacerbate the strength of the sell-off, at least temporarily. For now, the best advice to investors continues to be to tread with caution.

Investment Strategy Update

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