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Stocks shrug off European legal dispute around ECB stimulus

◆ German Supreme Court rules that the European Central Bank's quantitative easing program is not supported by the European Union's treaties.

◆ ECB has three months to justify its policies but can continue to buy bonds according to its plans in the meantime.

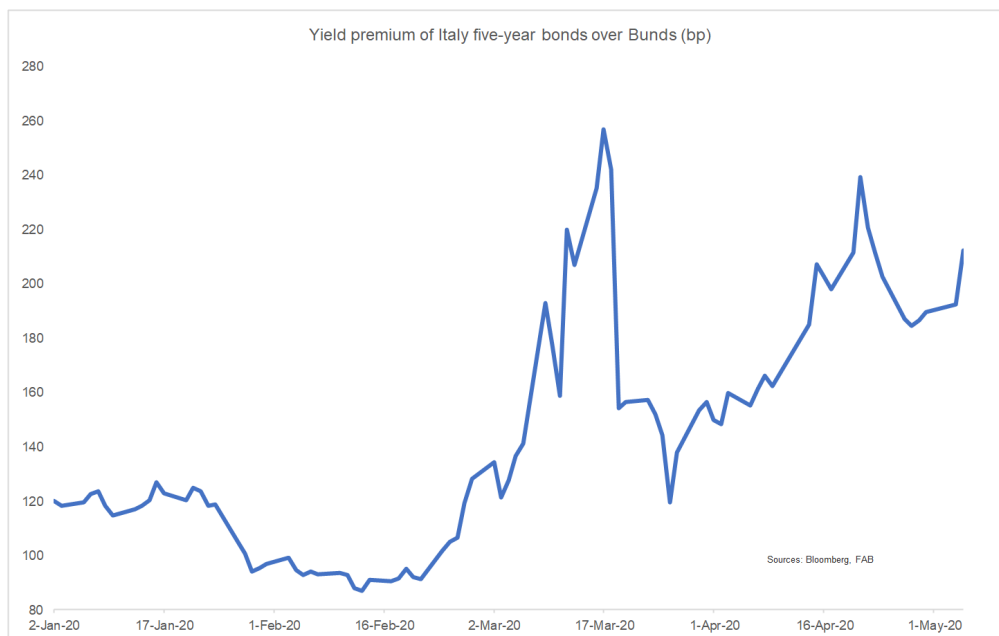
◆ Italian bond spreads over Bunds jump 20 basis points after the decision.

◆ Stocks rally as more lockdowns are lifted across the globe.

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

Central banks do not have unlimited power. The European Central Bank has just been given a reminder as the German Supreme Court decided that its latest asset purchase program did not conform to the rules of the European Union. The decision would render some of the quantitative easing measures the policymaker is using to fight the recession that stems from the Covid-19 lockdowns. It also came alongside some censure of the German government, which, according to the ruling, acted unconstitutionally by not challenging the ECB's programs.

While the ECB and the EU are likely to find a solution for the decision within the timeframe required by the court, the move had an immediate impact on the yield premiums of bonds from more indebted countries in the bloc. It also pushed the euro lower against the dollar, in a sign that investors foresaw some political haggling on the back of the German ruling. The decision has also raised questions about how much more the ECB can do to help the bloc navigate the recession.



Regardless of that, stocks were rallying at the time of writing, buoyed by the prospects of more parts of the world lifting their lockdowns and going back to work. US stock futures were pointing at a strong open as European shares were up almost across the board. US indices were continuing gains from yesterday, when they rallied after California Governor Gavin Newsom announced that many retail outlets would be able to reopen their doors this week. New York Governor Andrew Cuomo also said that he could do the same in coming weeks.

Stocks were also clinging to good news on the scientific front as the World Health Organization said it saw positive signs in a potential treatment of Covid-19 which received emergency approval from the Food and Drug Administration in the US this weekend. Meanwhile, Pfizer began vaccine trials, following other pharma companies which had started to test their own responses to the coronavirus.

The spread on Italian bonds has spiked after a German court ruled QE to be irregular

The optimism was also spreading to oil prices, with Brent crude rallying 8.9% at the time of writing. This was also helped by news that stockpiles in the US were growing more slowly, something that reassured investors that some demand is returning in the second biggest market for energy in the world.

Hence, asset prices continue to diverge from economic indicators. In the UK, for one, new car registrations fell 97.3% in April. More bad news is likely later today as the US is likely to report one of its worst services PMI readings in history. Whether stimulus alone is enough to keep the rally going is now the key question. After all, central bank powers are not limitless.

Investment Strategy Update

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