Investment Strategy Update

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Risk assets near a technical hurdle amid optimism and stimulus

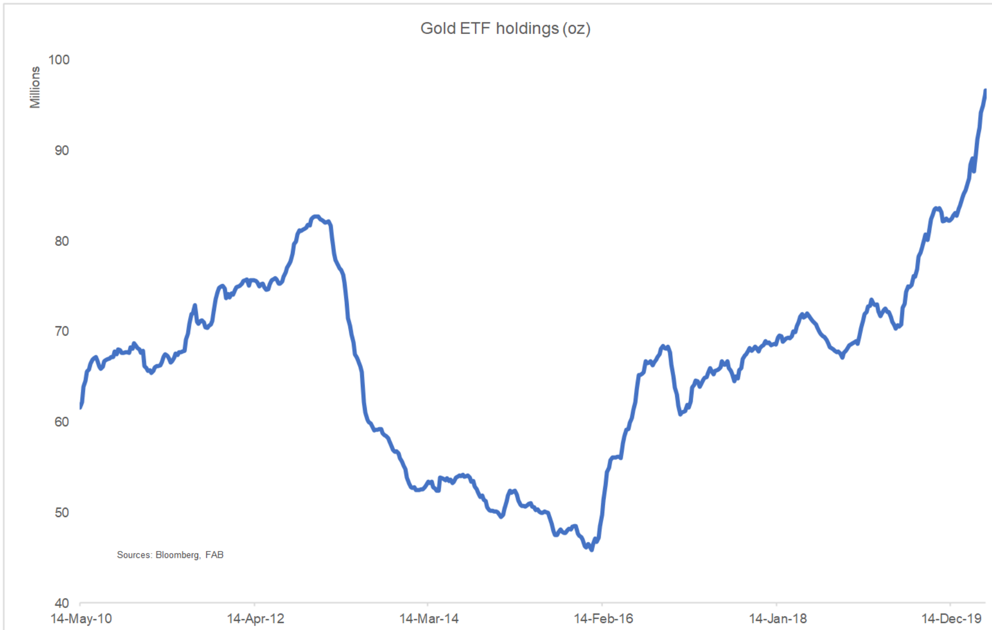
♦ Stock rally wavers as indices near technical resistances.

♦ Stimulus and optimism about economic reopening, however, have investors focused on the rebound.

♦ Investments in gold ETFs reach a record, with these funds holding 3,000 tons of bullion.

♦ Economic news continues to paint a grim picture of the world away from financial assets.

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



Economic data and risk assets continue to diverge and as stimulus continues to increase and liquidity normalizes that should not come as a surprise. The fact that the European Union, Japan and the US together have committed to more than US$10 trillion in stimulus seems to trump signs of a historic recession. European and US PMI surveys this week showed a deep economic slump and the European Commission warned today that some of the nations in the group could shrink by nearly double-digits.

The bad news has not stopped stocks from continuing to gain as investors become more optimistic about lockdowns being lifted. And there was plenty of good news on that front, with President Donald Trump saying last night that he wants to see the US economy restarting even if it means some pain in a few corners. Meanwhile, news outlets in Germany reported a leaked document that indicated Bundesliga games could resume in a couple of weeks, even as cases rose in the country yesterday.

In many ways this is the market equivalent of cabin fever. Investors are so happy that people will be allowed to go back to their lives that they are willing to ignore the economic data. That could be mostly attributed to liquidity. Risk assets have rallied almost in tandem with the improvement in Libor and other measures of funding costs. In simple terms, it has become so cheap to borrow and invest in risky assets that everyone is back doing it.

If the bad news on the economic front is not enough to challenge the optimism in markets, technical resistances may be. The S&P 500 is closing in on the 3,000 level that it was not able to surmount last week and that alone could trigger some profit-taking from high-frequency traders. Indeed, there were some signs of fatigue in the trading activity, with European indices in negative territory as the close neared. US stock futures were still in positive territory, up by about 0.4%, but prices were fluctuating.

Gold ETF holdings, a measure of retail demand for the metal, reached a record this week

Gold prices, meanwhile, were also dropping marginally, even though there were increased signs of demand for the metal. ETF holdings of physical gold, a good gauge of retail investor demand, hit an all-time high last week, according to Bloomberg. In that sense, gold was getting close to a support too.

Gold has been a good proxy for volatility and should continue to be. That means that it is natural that it would be dropping when risk assets are rallying, but it could rise if there is another sell-off. More importantly, the potential outcomes for the metal are skewed. When risk appetite increases, gold drops a little bit, but when risk aversion returns, it rallies strongly.

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