**Investment Strategy Update**

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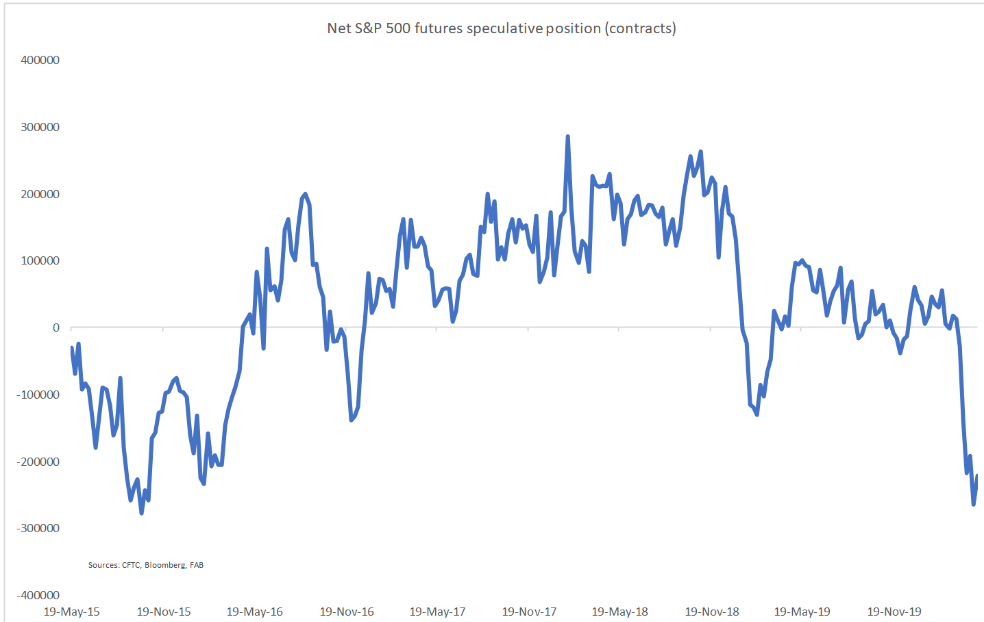
# Risk assets face litmus test as uncertainty builds up

- **US stocks are approaching key technical levels that could determine whether they face a correction or continue to rally.**
- **The number of contracts shorting the S&P 500 is near the highest in five years, a sign that most hedge funds expect a correction soon.**
- **President Donald Trump is seeking to bar US government-related pension funds from investing in China.**
- **Wuhan, home to the first cases of the new coronavirus, sees new infections, prompting China to attempt to test all residents.**
- **FAB AAC remains underweight in equities and overweight in gold.**




Risk assets are facing a sort of moment of truth as the S&P 500, one of the best gauges for the broader market, approaches key technical levels. Analysts are suggesting that a consistent break beyond the 2,940 level is important to confirm that the index was not simply undergoing a bear market bounce.

That marker is a mere 0.3% away from yesterday's closing figure of 2,930.32 and could be breached as early as tonight if the gains seen in European markets spill over into the US session. The Stoxx 600 was up 0.3% and the FTSE 100 was rallying nearly 0.9% at the time of writing. If the S&P 500 can hold for a few days above the 2,940 level, it could see its rally supported. The reverse would be a bearish signal and could start a new round of selling, particularly since the index turned south the last time it closed above 2,939, on 29 April.

Speculative positions are indicating which outcome investors expect. As of 6 May, there was a net short position of 222,414 contracts on S&P 500 futures, according to the Commodities and Futures Trading Commission. Short positions on the index were deeper only once since October 2015: a week earlier, when there were 265,608 net short contracts.

This, however, does not necessarily translate into weaker stocks ahead. On the contrary, if the S&P 500 is able to break the key barrier this week, many of the investors who have bought these short positions on the index will have to cover them. To do so, they need to buy the index and that could cause stocks to rally more. The large short position also means that if there is a sell-off, there would soon be a bounce as those investors who were short take profits and close their positions.

Setting aside the technical aspects of US stock markets right now, investors have little incentive to bet on a strong rally from here. With about half of the companies in the S&P 500 having reported their first quarter results, earnings have dropped 15.1% on average. Energy and consumer discretionary companies were the biggest losers, with their profits dropping 40.3% and 28.1% respectively, according to Bloomberg. Also, a significant number of companies cut guidance and nearly one in three of those that have reported numbers canceled or reduced dividends.

**The number of positions shorting the S&P 500 is near the highest in five years**

Hence, while there could be technical support from here, the prospect of a protracted recession along with falling earnings suggests caution at the very least. This may be the perfect time to take a step back instead of joining the fray.

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