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## Melt-up continues despite tensions between the US and China

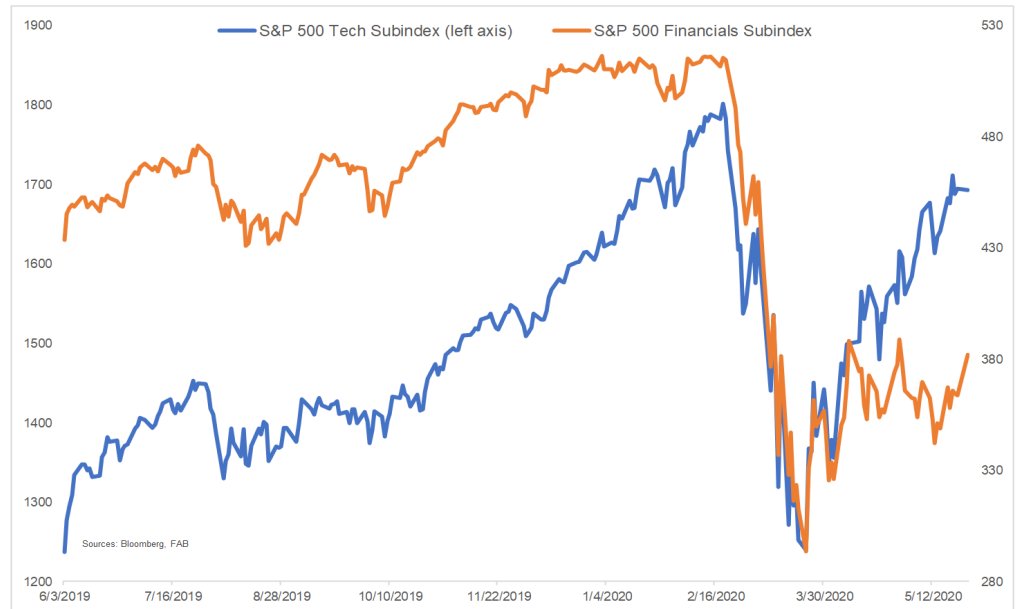
◆ S&P 500 briefly traded above 3,000 yesterday and futures were pointing at a stronger open today.

◆ The index is testing a resistance that could push traders to invest more even amid extreme valuations.

◆ Downside potential is larger than the probable upside, making this a dangerous point of entry.

◆ However, some investors are looking at the possibility that the beaten-down sectors will catch up with the leaders.

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



Wall Street is moving ever further from Main Street. Yesterday, the S&P 500 index rallied as much as 2.2% during the day, though it pared some of the gains towards the end of the session to close 1.2% higher. This left the index trading at nearly 24 times its expected earnings for the next 12 months, the highest such valuation it has sported since the 2000 dotcom bubble — which was also the only time it was valued so high.

That raises the question of how much further it can go. Technical analysts say the S&P 500 is breaching a key resistance and could test the 3,200 level. If it goes beyond that it could rise to 3,700. The amount of cash sitting on fund balance sheets after the March sell-off is also near a record, suggesting that there could be plenty of money chasing returns, which could continue to fuel the rally.

However, it is fair to argue that just stimulus and central banks are not enough to push risk assets up forever.

With unemployment at a record high in the US and in several other countries, there could soon be a dearth of consumers to buy the products of companies that comprise the S&P 500 and most stock indices across the globe. In fact, global GDP is likely to see its first coordinated major recession since the 1930s.

Then there is a raft of unknowns as well. The disagreements between the US and China deepened over the weekend as Beijing signaled that it could change Hong Kong's Basic Law to include more restrictions on protests. The US responded with a threat to cancel Hong Kong's preferred status and to impose sanctions on senior Chinese officials. In Hong Kong, people took to the streets, restarting the protests that the Covid-19 pandemic had stifled.

These events may be a prologue of much more to come. The US is set to review its preliminary trade agreement with China in October, just ahead of the US elections.

### Some of the cyclical stocks, such as financials, are yet to fully participate in the rally

And the street manifestations are becoming a more common fact in emerging markets, with Chile and other countries seeing riots and mass demonstrations against the deepening inequality that the virus has laid bare.

At this stage, investors seem to be confident that the more than US\$17 trillion in stimulus being poured out by central banks and governments will be enough to restore normalcy. They seem to have taken comfort in the images of people bathing in the sun in US and European beaches last week. However, even if technical analysts are right about the upside, the potential downside is much larger. That suggests that for long-term investors patience pays better right now.

# Investment Strategy Update

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