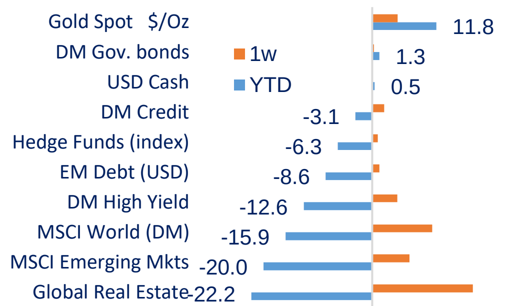
A strong start to the quarter

- **Markets rallied last week, as the size and scope of policy responses dramatically increased**
- **Some signs of deceleration on the pandemic were encouraging but uncertainty prevails**
- **We have neutralized our allocations to major asset classes, with clear segment preferences**

Financial markets had a strong rally last week. The 76-day lockdown of Wuhan was officially ended, and more importantly for markets, the size and scope of the policy response was dramatically increased. Fiscal plans are being boosted from Japan to Italy, and in the US, the Fed announced a detailed program of an astonishing USD 2.3 trillion credit to businesses and public entities. Stock markets surged as a result, with Developed Markets up 11% and Emerging Markets 7%. As a typical liquidity-driven rally, everything was up including bonds. Short-covering, i.e. forced-buyers, were probably a significant part of the flows. Brutal rallies are part of a landscape combining uncertainty with a fragile market structure. The cumulative increase in US initial jobless claims is now 17 million, and more than ever, "time is money". Our assumption is still, that most of the restrictions will be lifted by the summer, but the challenges are multiple, from testing to tracking.

With regards to asset allocation, we have just neutralized our positioning on the major asset classes, expressing convictions in segments: investment grade corporate and EM within fixed income, Emerging Asia in equities, and Gold within alternatives – a currency which cannot be printed. As we write, our profiles are respectively down "only" -4%, -8% and -12% in 2020. We see value only at a reasonably long horizon and continue warning about short-term volatility. This week, we will hope for a formal agreement at the OPEC+ and closely watch China's Q1 GDP numbers. Stay safe, and invest for the long-term.

ASSET CLASSES USD % TOTAL RETURN, YTD 2020 AND WEEK



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Cross-asset considerations

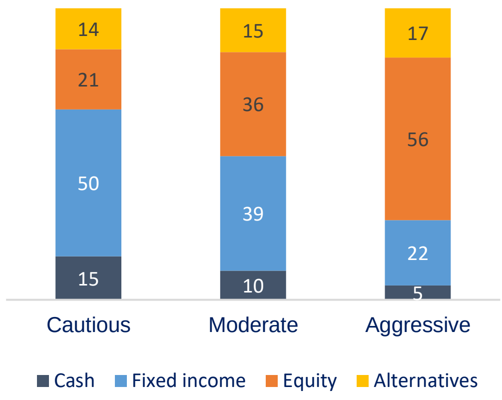
Comparisons between the current crisis and the Great Recession of 2008 or even the Great Depression abound nowadays, due to the magnitude of its near-term economic damage which, when extrapolated for long enough into the future, easily brings to mind apocalyptic scenarios. Some studies have assessed that the losses for the US economy through the first three quarters of this year can be twice as large as during a comparable period of the GFC. Given the recent record spike in jobless claims, US unemployment is projected to reach 20% in the very next months, a level last seen only during the depression recorded in the 1930s. Yet, key differences today versus past occurrences would have us think that we should see light at the end of the tunnel, already sometime in the second half of the year.

The huge deleveraging pressures seen post-2008 are today absent and, as ex Fed chair and Great Depression expert Ben Bernanke recently put it, "It is not a very good comparison. The Depression was 12 years long". Today, with a large and temporary external shock which ultimately is government-induced via complete stops to activity, we should expect an outcome between a disaster, marked by a prompt recovery, and a recession, where existing imbalances delay the return to trend growth. The start of this pandemic-related recovery will be highly dependent on the duration of the lockdowns and in this respect China is the template other nations are looking to, with its 76-day freeze to activity in Wuhan. What makes everybody hopeful is the unprecedented size of public interventions amounting to more than 2.5% of global GDP in fiscal terms, combined with massive liquidity injections and commitments in the form of credit to businesses or loan guarantees.

Markets have already discounted a fair amount of good news, with equities retracing almost 50 percent of the drop and market-implied measures of inflation expectations nudging higher, in spite of the dramatic forthcoming macroeconomic newsflow. Now the question is whether risk assets have run ahead of themselves, since backstops can only cushion the economic damage, but not eliminate it. The answer most likely is a resounding yes. Across the major global economies households will suffer income losses and companies cash flow disruptions and revenue falls which will only be contained by support measures, but impossible to eliminate. Central banks may have managed to cap asset volatility, but will be hard put to suppressing downside from the current levels.

Given the high uncertainty, we continue to advise investors not to chase returns. Bear markets are usually punctuated with short-term rallies and it seems now too early to look for signs of a turn in business activity. In the short run we find the best risk-adjusted returns in the markets backstopped by central banks, or in safer assets. This rationale underpins our TAA Committee's latest decision to increase the allocation to DM IG bonds and gold to overweight. Eventually, the persistent boost to money supply will cause investors to be overweight cash, generating meaningful rebalancing flows in favor of stocks and triggering a strong rally. But most likely it will be a long and winding road to lead us there.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

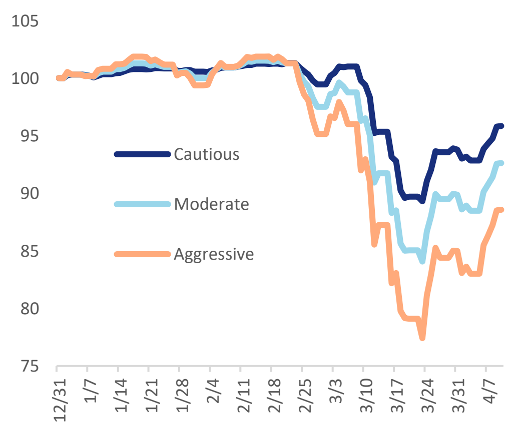


TAA – RELATIVE POSITIONING – MODERATE PROFILE

	UW	N	OW
Cash		=	
DM Gov.	<<<		
EM Debt			>>
DM Credit			>>>>
DM H. Yield	<<<		
DM Equity	<		
EM Equity			>
Gold			>
Real Estate	<		
Hedge Funds	<		

UW/N/OW: Underweight/Neutral/Overweight

TAA – YTD INDICATIVE PERFORMANCE



Source: Bloomberg. CIO Office calculation based on TAA applied to market indices, net total return in USD.

Fixed Income Update

The FED has struck again. With its new USD 2.5 Tn stimulus, the central bank has declared that it will also buy bonds of recently fallen angels, giving a leg of hope to US HY. It is not surprising that US HY was the topper in the weekly returns league table, generating +5.3% last week. Global HY OAS spreads traded below 1,000 bps for the first time in a month. The risk-on tone resulted in US Treasuries and other govt benchmark bond yields rising across Developed Markets.

We have increased our overweight to Investment grade credit in the three TAA profiles following our conviction on the asset class. We continue to maintain the overweight on Emerging Markets as the growth revisions are less severe for these economies in the TAA profiles as well. Investment Grade sovereigns remain our preferred asset class within Emerging Markets.

Demonstrating our conviction, Emerging Market IG Sovereign issuers took advantage of the issuance window to print blockbuster deals. First off the block was the Republic of Indonesia (Baa2/BBB) that issued a three-tranche 4.5 Bn issue. It also created history to issue a 50-year tranche for the first time by any Asian sovereign amid strong demand from pension funds and Asian life insurers. The robust investor demand resulted in 25 to 65 bps tightening in the final pricing as compared to the initial price thoughts. The 10-year bond yielding close to 4% is our favorite pick.

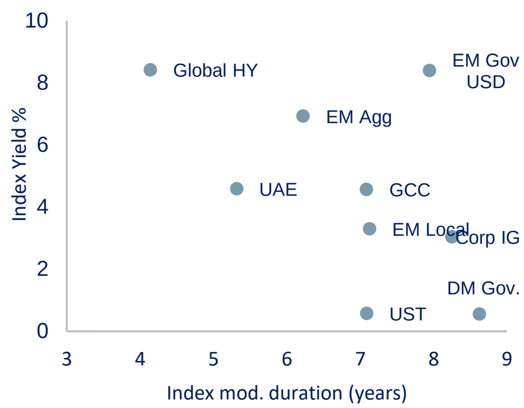
Closer home in the GCC, Qatar, and Abu Dhabi sold large three-tranche deals on consecutive days, demonstrating impressive investor appetite for quality GCC credits despite the volatile oil fundamentals. Abu Dhabi issued USD 7 Bn bonds with the final pricing for the 5-year, 10-year, and 30-year papers lower by around 45 bps across the curve. The peak order book reached USD 44 Bn. The pricing was generous as compared to the existing 2024, 2029, and 2049 papers by 30 bps that helped the bonds rally in the secondary market.

MENA HY sovereign space continued to trade weakly despite the nascent recovery last week. Among the notable names, Egypt, Bahrain, and Oman, Egypt is our top conviction. The sovereign has come out of the IMF program with lots of economic reforms that have resulted in lower inflation and a stable currency. It has been the darling of the world for its carry trade opportunity. Its forex reserves have come down sharply by USD 5 Bn to around USD 40 Bn but still enough for eight months of effort. Bahrain ranks second due to its smaller refinancing need and unutilized line of credit from the GCC neighbors. Oman will find it difficult unless it accesses the debt markets soon with fiscal deficit to GDP projections in the range of 15%-20%, according to economists. However, considering the IMF war chest to fight the COVID-19 related economic slowdown impact and improving chances of oil price stabilization, we foresee a very slim chance of any HY sovereign defaults in the region, if at all.

FIXED INCOME KEY CONVICTIONS

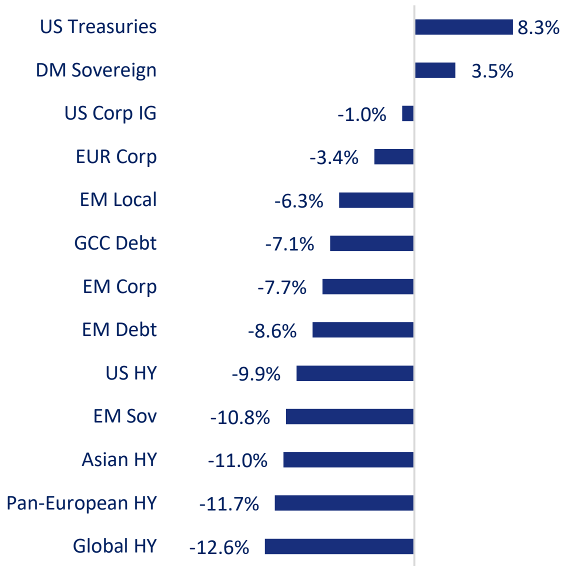
DEVELOPED MARKETS
OW US within Government
OW Corporate Credit
UW High Yield
EMERGING MARKETS
OW Asia
OW IG Sovereigns
UW Latin America

FIXED INCOME VALUATIONS



Source: Bloomberg, indices modified duration and YTW

CHART: YTD FIXED INCOME SUB ASSET CLASS RETURNS



Source: Bloomberg

Equity Update

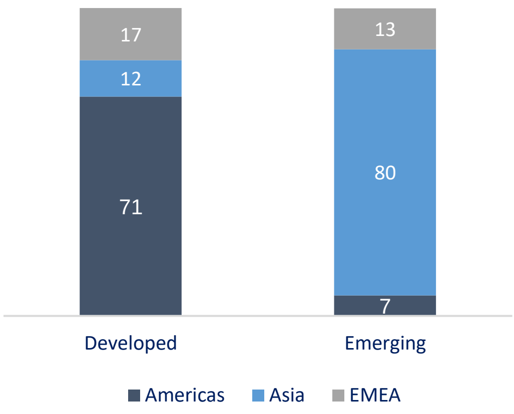
What has led to last week's astronomical rally in global equities (+10.5%), inspite of a marked slowdown in economic growth and unemployment growing at a record pace (specially in the US)? In a holiday shortened trading week, the S&P 500 (+12.10%) had the best weekly return since 1974. Increasingly optimistic data in the US with regard to COVID-19 and large stimulus from the Fed were welcomed by equity and bond holders alike. Further stimulus announcements included a USD 2.3tn loan program to mid-sized companies and purchasing of High Yield bond ETFs. With the considerable rally in Europe and the US, DM equities fared better last week than EM. India which has been the worst performer amongst large markets year to date, led EM with Dollar gains of 12.9%, though the lockdown is severely impacting the economy. In the GCC the Abu Dhabi market led, with double digit gains. Oil prices retraced recent gains, despite progress on OPEC+ production cuts. The reduced supply is still above the new demand estimates for April which are c. 20 mn/ bbl a day lower.

We have revised down our fair values for end 2020 for the major global equity indices as the lockdowns continue to impact supply/ demand and earnings for corporates across the world. Whilst China production is estimated to be back at 60-80%, logistics globally are still not at full capacity, affecting supply. Consumer demand for the services industry is at 20% (airlines, hotels, gyms, hairdressers, contract workers). Discretionary purchasing too is at low levels: 50% by some estimates. Consumer staples (food, household supplies) is the only industry seeing increased demand as people hoarded essentials, which is now returning to normal in April.

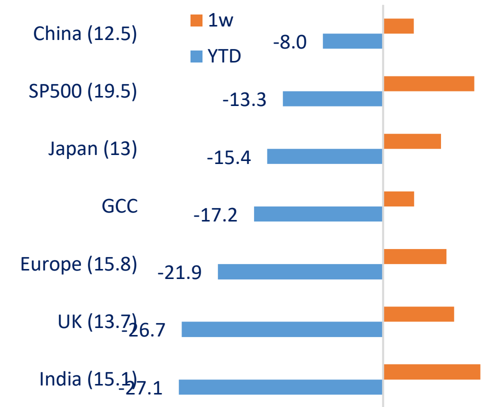
The S&P 500 is rallying on the back of multiple expansion, trading at a forward P/E of 19.5X. We estimate earnings to fall by 10% for 2020 and a 2020 year end 18.5X Price/Earning which leads to a fair value of 2775 for the S&P 500, where it is currently already trading. The economic impact of the lockdowns has affected the profitability of many businesses. The US consumer remains key to economic growth and demand will be affected by unemployment and lower wealth. Buybacks and dividends are already cut by one third for 2020. However, the US remains our preference in DM as it is home to the world's most profitable tech, healthcare and consumer companies, which will ride the downturn much better with their strong balance sheets.

Our severest revisions have been to Europe and the GCC as we see earnings drop of 15% for both in 2020. These markets have a low allocation to the tech sector (6.7% for the MSCI Europe) and high allocation to financials which face a direct impact from any slowdown in economic growth. Tech has been the favoured sector and even more so this year as cloud services, e-commerce, connectivity, high speed processors, digital payments get prominence with the work and study from home guidelines, in place for the foreseeable future. The only geography where we still see flat to positive earnings growth is EM Asia and reasonable upside as valuation multiples are still in the low to mid teens for China and India.

EQUITY RECOMMENDED REGIONAL POSITIONING

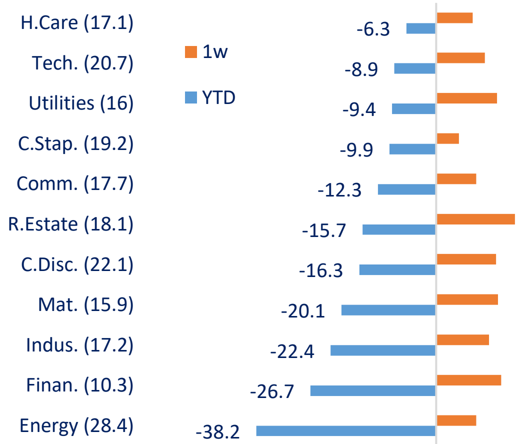


MAJOR INDICES PERFORMANCE (TR, US$) AND 2020PE



Source: Bloomberg consensus. MSCI Indices unless specified.

GLOBAL SECTOR PERFORMANCE (TR, US$) AND 2020PE



Source: Bloomberg consensus. MSCI All Country World sectors US$.

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