Setting the stage for a strong recovery

- **Daily global new infections are clearly decelerating**
- **While government and central banks signal continuous support to the economy**
- **Markets took note last week with a sell-off in defensive and rate sensitive assets**

The key news of last week suggest that the stage should be set for a strong recovery in the quarters ahead.

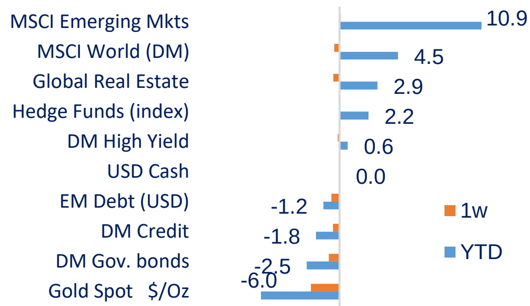
First, on the virus front: at 400,000, the daily global new infections now stand at around half of the second wave's peak of early January. Targeted restrictions are working, and vaccinations are progressing. The economy is thus proving resilient. Industrial and construction activity keep on improving, US retail sales are back to growth, and the Chinese slowdown is less severe than expected. Crucially, the US Secretary of Treasury confirmed that the administration wants to "go big" on fiscal stimulus, and that Congress will likely approve most of the proposed package. Finally, central banks are extremely clear in their intentions to maintain extraordinary support, and to tolerate a higher level of inflation.

Financial markets took note last week: not with stocks reaching record highs, which already price in quite some good news, but by putting pressure on the most defensive, rate-sensitive assets. Gold lost 2.2%, now down 6% in 2021, and all segments of fixed income were negative, also following an inverted risk hierarchy. Oil was steady, up more than 20% so far this year.

Our current positioning reflects a reasonably constructive outlook. Our three profiles are positive for the year and beating our strategic allocation, helped by our overweight in EM stocks and underweight in bonds. Our scenario is unfolding but valuations and consensual optimism are concerns: we expect volatility and keep an eye on our year-end fair values to guide our decisions.

In the week ahead we will listen to Fed officials' speeches and look at US consumer confidence, and the earnings season will continue. Stay safe.

ASSET CLASSES USD % TOTAL RETURN, YTD 2020, LAST WEEK



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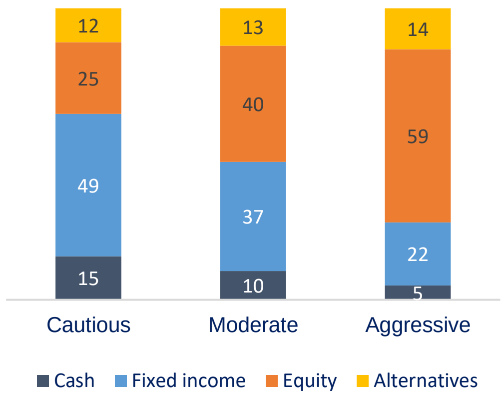
Cross-asset Update

Last week's events put to the test many commonly-held views. One has got to do with the notion that greener is better, as far as energy generation is concerned. Some Texas resident - the State in America with the highest energy production from oil, gas and wind each year - might be unconvinced, following a power outage due to adverse weather conditions which saw almost 3m Texans sheltered at home without electricity. Texas has been a leader in renewable energy deployment, in particular in terms of wind and solar capacity which generates almost a quarter of its electricity. Unfortunately, windmills and solar panels do not work best under lots of snow and their being intermittent sources of energy did not serve the Texan residents' turn during this spell of historically freezing weather. It is likely that in the US, set to increase intermittent energy generation under Joe Biden, similar challenges will become more common. The recent events prove that even the most well-intentioned policies come with strings attached. They could also prompt calls for infrastructure investments for the revamping of ailing networks, that so far have taken a backseat and been at the mercy of Congress partisanship.

Another widespread view holds that the Fed will steer the US economy out of muted inflationary conditions with a zero-yield policy, while at the same time supporting Congress stimulus with Quantitative Easing for maximum reflation. A smooth transition for markets is also part of the story. This is a benign interpretation that assumes that all that could go right will go as expected and which investors are beginning to question. Specifically, money markets are starting to discount lift-off for policy rates in 2023, about one year earlier as compared to the official Fed guidance, and that tightening in 2024 will occur at a much faster pace than in the Fed's intentions. The growing skepticism is about a higher inflation risk versus the sanguine view of Fed officials. In turn, this is fueled by the stronger recovery alongside the expectation for more stimulus further down the line. Money market projections of increasing price pressures has repercussions across asset classes. It will be more disruptive for credit than for equities, given the duration risk embedded in bonds. Losses on higher-quality bonds are already comparable to the ones suffered in 2013 on occasion of the so-called taper tantrum, and more could be in store. The derivatives markets suggest that 10-year yields could still move by 30bp in the next three months from the current levels, with 1.6% a possible target now in sight. Gold as a non-yielding asset is the primary casualty of the upward pressure on rates and a bottom for the yellow metal could be conjectured to be in place by the time investors gain more visibility on the existing pipeline of stimulus packages.

Hedging multi-asset portfolios against rising yields can be achieved by increasing their overall cyclical bias. Commodities and energy equities top the list of inflation-sensitive assets, the latter also coming with an appealing dividend yield in the mid-single digits.

TACTICAL ASSET ALLOCATION: SIMPLIFIED POSITIONING

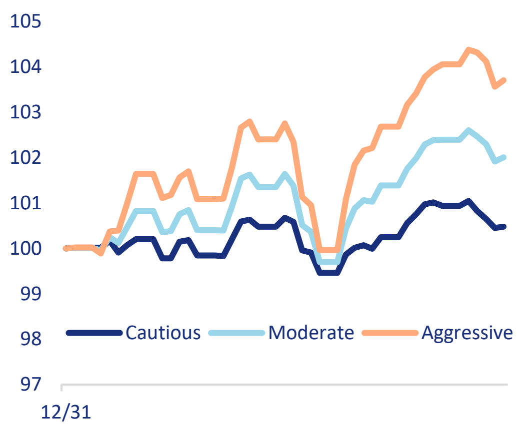


TAA – RELATIVE POSITIONING – MODERATE PROFILE

	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 – 2021 INDICATIVE PERFORMANCE



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

Fixed Income Update

The rise in 10-year Treasury yields is hogging the limelight and occupies a proportionate share of worry in investors' minds. YTD, the 10-year US Treasury yields have risen by close to 40 bps ending last week at 1.34%. Thus far, Fed officials seem comfortable with this rise, as indicated by the recently released FOMC meeting minutes and the various sound bites from them. However, markets will closely monitor Chairman Powell's semi-annual monetary policy report to the Senate Banking Committee on 23rd Feb to gauge if there are any kind concerns about steeper long-term borrowing costs. In early Feb 2020, the 10-year yield was hovering around 1.6% before the Fed rate cuts came into effect and yields collapsed. There is no reason why yields cannot move up to those levels if we see a full recovery.

Most of the major indices felt the full impact of higher yields and were in red last week even though spreads continued their race to the bottom. Even the lowest-rated bonds in the CCC category continue to show price strength, with 75% of that category of bonds trading above par according to a recent Goldman Sachs report as compared to 50% in early Nov 2020. We avoid CCC-rated bonds in our advisory portfolio due to their inherent risks and the fact that they are 11 times more likely to default than B-rated bonds. While Fallen Angels dominated last year's high-yield story, we believe this year could be a year of Rising Stars and companies which would get their ratings upgraded. Again, Chinese real estate issuers seem apt for cherry-picking. We continue to like B/BB-rated Sovereigns from the MENA region for their higher yields as well.

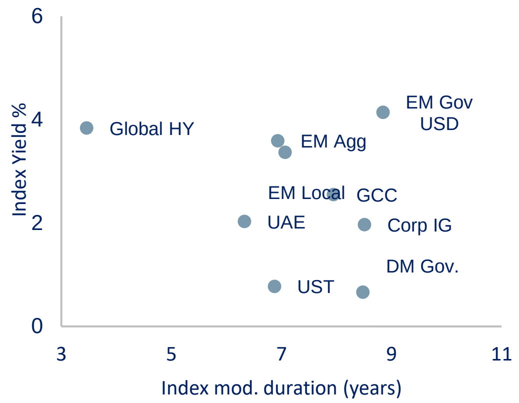
On another note, the transition from Libor to SOFR got a boost in the arm with a record amount of issuance this year so far. Even though the issuers' list remains concentrated, slowly, we can see signs of change. Last week Energy firm Enbridge Inc. became the first non-financial issuer to sell SOFR-linked debt with an order book six times oversubscribed for a $500 million deal.

Primary market activity in the Emerging Markets was relatively muted last week due to the shortened work weeks from Asia and the US. The only notable primary issuance previous week from the MENA region was the National Bank of Kuwait's refinancing deal. NBK issued $700 Mn of Perpetual Non-call 6 year AT1 bonds along with tendering their existing 5.75% AT1 bonds at 100.35. Order books were 2.5x the final tranche, and spreads tightened by 37.5 bps between IPT and final pricing. We continue our preference for the perpetual securities of the strong banks from the region. This week we anticipate the primary market to become more active after the hiatus, with more investment-grade Govt Related Entities from the UAE expected to tap the market.

FIXED INCOME KEY CONVICTIONS

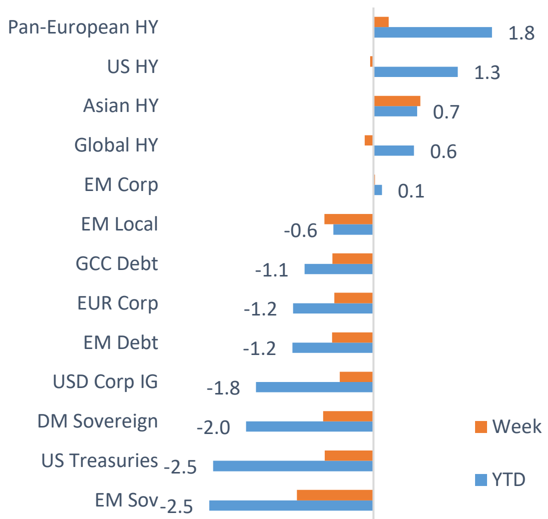
DEVELOPED MARKETS
UW DM Government
OW Credit (Cau. & Mod.)
OW High Yield
EMERGING MARKETS
OW Asia
OW IG Sovereigns
OW Latin America

FIXED INCOME VALUATIONS



Source: Bloomberg, indices modified duration and YTW

FIXED INCOME SUB ASSET CLASS RETURNS (YTD, LAST WEEK)



Source: Bloomberg

Equity Update

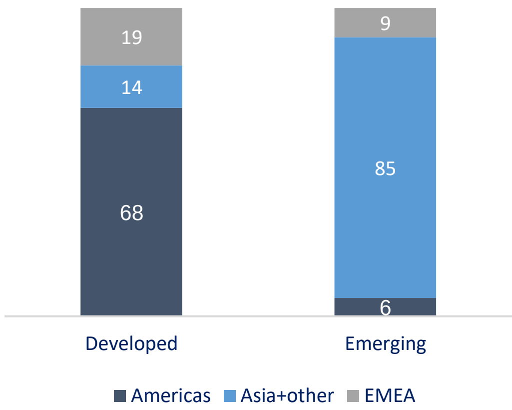
Last week saw a continuation of emerging markets outperformance, though it was flat and slightly negative for global equities. Progress on the COVID-19 vaccine front continues to buoy hopes of recovering economic growth. However, concerns of rising inflation and the uptick in Treasury yields weighed on stock performance. In line with rising yields and oil prices the Financial and Energy sector were leaders while Utilities and Healthcare were laggards. It's a continuation of year to date outperformance for banks and oil companies. The VIX continues to hover around the low 20's, indicating yields aren't yet a major worry though the trajectory of inflation/rates will continue be in focus for equity markets. Higher yields are not bad for stock performance, they imply better growth offsetting a higher discount rate. Of course, highly leveraged businesses and industries would be negatively impacted.. Higher rates should be offset by steeply recovering corporate profits and consensus forecasts are for a 30% rise in earnings for companies in the MSCI World index for 2021. Equity markets perform on many metrics but earnings remain the driving factor. Upside to our year-end Index fair values has narrowed, already overshot for China but we see near term catalysts supporting performance: U.S. fiscal stimulus, a significant drop in COVID-19 cases/hospitalisations and global economic growth rebounding.

The UAE markets gave up some of their year to date gains on disappointing results from Dubai real estate developers. Abu Dhabi real estate has fared better as government contracts offset the pandemic impact. Telecom leads performance in 2021 as dividend yields remain attractive. Banks are next and we remain bullish on further performance from both these sectors.

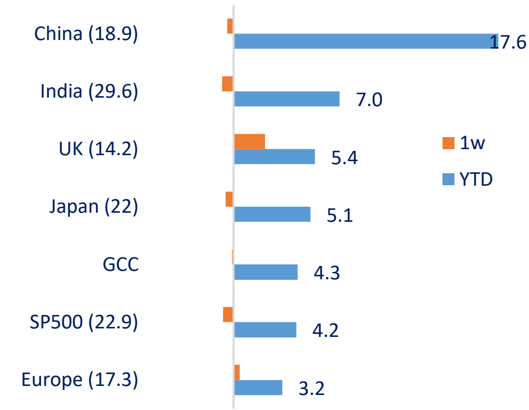
U.S. markets were down c. 0.7% last week but the stimulus packet should provide further spending power adding to the estimated $1.5 trillion in excess saving already accumulated. Some of this would find its way into equities. Strong reads on manufacturing output and Treasury Secretary Yellen's continued assertion to "go big" on fiscal relief is supportive. We view consolidations as normal, given the strong gains in recent months and solid technical backdrop (87% of S&P 500 stocks above their 200 DMA). This provides support to buying pullbacks. Earnings remain strong: 83% of S&P 500 constituents have reported and 4Q full quarter earnings growth is at c.2% y/y. Forward estimates continue to trend higher, led by Energy, Financials, Communication Services, and Technology which have also been some of the best performing sectors year-to-date. These trends support a balance between areas operating best through the pandemic and areas with the most leverage to the recovery.

The impact of social media on investments is now well established and expect some volatility around cryptos (not an asset class we provide views on) as Elon Musk tweeted ", BTC & ETH do seem high lol." Musk gave impetus to Bitcoin with Tesla. Saying it invested $1.5 bn and was prepared to begin accepting the cryptocurrency as a form of payment for its cars. According to analysts Tesla is on a trajectory to make more from its Bitcoin investments than profits from selling its EV cars in all of 2020.

EQUITY RECOMMENDED REGIONAL POSITIONING

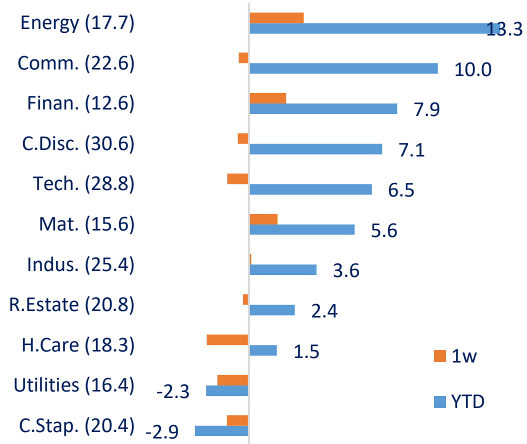


MAJOR INDICES PERFORMANCE (TR, US$) AND 2021PE



Source: Bloomberg consensus. MSCI Indices unless specified.

GLOBAL SECTOR PERFORMANCE (TR, US$) AND 2021PE



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

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