MONTHLY HOUSE VIEWS

August 2020

One step at a time

Macro

We note continued divergence between "soft" economic data (i.e., confidence surveys) and "hard" reports on actual activity – the former reflect the move from lockdown to resumption of some activity while the latter show that industrial production and retail sales remain well below end-2019 levels. We continue to register new highs in COVID-19 cases across the globe – especially in the US sunbelt and Latin America – suggesting that lockdown restrictions will only be eased slowly, thereby ensuring that recovery from the recession will be gradual. As a result, government attention across Europe and the United States is now shifting from support measures to recovery stimulus plans.

Central Banks

We see little chance of a shift in monetary policy settings, which are set to remain very accommodative for the foreseeable future. In the US, the Federal Reserve (Fed) is discussing ways to anchor rate expectations close to zero for the next few years while continuing to buy up much of the Treasury issuance to finance support for households and businesses. The European Central Bank (ECB) will hold rates negative and is using the flexibility of its Pandemic Emergency Purchase Programme (PEPP) to boost holdings in periphery sovereigns. It has also improved terms on its long-term refinancing operations to provide a lifeline to embattled banks.

Markets

Central bank purchases will keep government bond yields low while also supporting high-quality corporate bond spreads (the yield differential over sovereigns). We remain more wary of lower-quality issuers in the High Yield (HY) segment given the default risk, although the abundance of liquidity does provide some support to highly leveraged firms. Equity markets offer more long-term potential, although the sharp rally since late March means further upside may be constrained in the short term. We expect the euro to continue its recent recovery against the dollar, given attractive valuations and lower risk of new lockdowns.

Bottom line

We maintain a broadly diversified, balanced approach to asset allocation. Much of the recent rally in equities has been driven by a small number of internet and tech giants, especially in the US, and we would balance exposure to these leaders with other sectors and markets. Within our Neutral exposure to equity markets, we maintain a preference for the euro zone, and highlight the attractions of Asian technology groups – in terms of growth and valuation – within emerging markets. Investment Grade (IG) corporate bonds remain a preferred Overweight within fixed income while low-yielding sovereigns offer little diversification benefit or upside potential. Our preferred offsets for equity risks remain gold and hedge funds.

OUR ASSET ALLOCATION

The table below presents the latest conclusions of our Global Investment Committee

			Summary house views					
			Strong UW	UW	N	OW	Strong OW	Change since last GIC
EQUITY		**GLOBAL EQUITY**			■			
EQUITY		**United States**			■			
EQUITY		**Eurozone**				■		
EQUITY		**United Kingdom**			■			
EQUITY		**Japan**			■			
EQUITY		**Emerging**			■			
FIXED INCOME	SOVEREIGN	**GLOBAL RATES**		■				
FIXED INCOME	SOVEREIGN	**U.S. Treasuries**		■				
FIXED INCOME	SOVEREIGN	U.S. Breakeven			■			
FIXED INCOME	SOVEREIGN	**Bunds**		■				
FIXED INCOME	SOVEREIGN	EMU Breakeven			■			
FIXED INCOME	SOVEREIGN	**Gilts**		■				
FIXED INCOME	SOVEREIGN	Gilts Breakeven			■			
FIXED INCOME	SOVEREIGN	**JGBs**		■				
FIXED INCOME	SOVEREIGN	**EM Govies ($)**		■				
FIXED INCOME	CORPORATE	**U.S. IG**				■		
FIXED INCOME	CORPORATE	**U.S. HY**			■			
FIXED INCOME	CORPORATE	**EMU IG**				■		
FIXED INCOME	CORPORATE	**EMU HY**			■			
FIXED INCOME	CORPORATE	**UK IG**				■		
FIXED INCOME	CORPORATE	**UK HY**			■			
FIXED INCOME		**Duration USD***		■				
FIXED INCOME		**Duration EUR***		■				
FIXED INCOME		**Duration GBP***		■				
FOREX		**EURUSD**				■		
FOREX		**USDJPY**			■			
FOREX		**GBPUSD**			■			
FOREX		**EURCHF**			■			
FOREX		**EM FX (vs. USD)**			■			
CMDTY		**Brent**		■				
CMDTY		**Gold**				■		
ALTERNATIVE		**ALT. STRATEGIES**				■		
ALTERNATIVE		**L/S Equity**		■				
ALTERNATIVE		**Event-Driven**				■		
ALTERNATIVE		**FI Arbitrage**				■		
ALTERNATIVE		**Global Macro / CTAs**			■			
		Cash			■			

	Positioning	*Duration
O/W	Overweight	Long – 7-10 years
N	Neutral	Intermediate – 5-7 years
U/W	Underweight	Short – 3-5 years

EQUITIES	
United States	The sharp rally since late March means further upside may be constrained in the short term.
Europe	There remains the possibility that the European Council will approve the proposed €750bn recovery fund at its mid-July summit.
Eurozone	The region seems to have been successful so far in preventing a second wave of coronavirus infections, which should help avoid new restrictions on activity. We are Overweight.
UK	The country has been harder hit by the pandemic than many continental economies but valuations are extremely cheap. We remain Neutral.
Switzerland	Swiss high-quality blue chips should remain sought after, suggesting continued resilience for now.
Japan	The government's support package for the economy is the largest on offer among advanced economies as a percentage of GDP and lockdown measures have been less restrictive than elsewhere. We are Neutral.
Emerging (EM)	We continue to Overweight Asia within a Neutral view on EM equities and highlight the growth and valuation attractions of Asian tech stocks.

FIXED INCOME	
Sovereigns	With inflation well below target and the central bank continuing to buy large amounts of government bonds, long rates are unlikely to rise significantly.
Duration*	We prefer shorter-dated bonds across markets.
Inflation-linked	Inflation should recover in the longer term. We maintain our Neutral view.
Investment Grade	We continue to Overweight IG bonds, given the support from central bank purchases and investors' search for alternatives to government bonds with a yield pick-up.
High Yield	We keep a neutral stance on HY, where the weakest issuers are especially vulnerable to economic woes.
Emerging debt (in € and $)	Several EM countries face a worsening health crisis and resulting economic risks. We remain Underweight.

CURRENCIES	
EUR/USD	The euro has been benefitting from the swift recovery in equity markets and the unprecedented monetary and fiscal stimulus in Europe. We remain Overweight.
GBP/USD	There is little doubt that "no deal" would be damaging to the UK and the pound, at least in the short-term. However, valuations remain attractive.
EUR/GBP	With little progress to date in tense Brexit negotiations with the EU, we anticipate increased headwinds for sterling.
USD/JPY	The yen has spent much of this year trading in a tight band between 106 and 110 versus the dollar and we do not expect it to break out of this trading range.
EUR/CHF	The Swiss National Bank appears to have been intervening actively over recent months to stem upside in the CHF. With fiscal and monetary easing keeping liquidity ample, we expect risk appetite to revive, helping push the franc lower.
Emerging	Despite emerging currencies' attractive valuations, it is too early to paint a positive picture.

ALTERNATIVES	
Hedge funds	We highlight the attractions of Long-Short Credit, emerging market Global Macro specialists and Merger Arbitrage as sources of yield.
Gold	Gold demand shows little sign of flagging despite higher prices and we remain Overweight.
Oil	With little sign of a sustained pick-up in demand, oil prices may trade lower.

Source: SGPB, 17/07/2020
* Duration: short = 3-5 years, medium = 5-7 years, long = 7-10 years
HY = High Yield bonds (higher return but greater risks), IG = Investment Grade bonds (higher quality but lower return)

ECONOMIC OUTLOOK

One step at a time

The global economy is recovering from a very low base as lockdown measures are eased and businesses reopen. Vast support from governments and central banks has sparked a powerful rally in risk assets but the real economy may lag the recovery in equity markets, given the persistent spread of COVID-19. Our investment process keeps us balanced at Neutral.

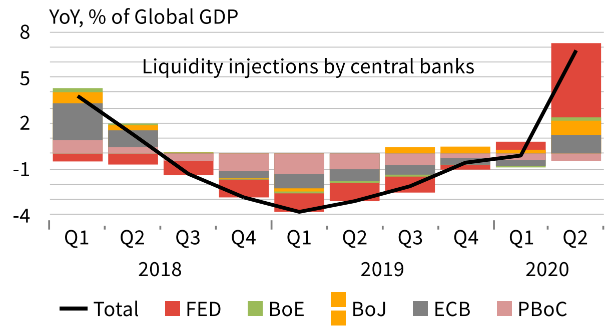
Despite widespread lockdowns, a sudden stop in economic activity, surging unemployment and a terrible toll in illness and death, the second quarter witnessed a powerful rally in risk assets, with the MSCI World equity index rising 18.8% in dollar terms. With the benefit of hindsight, we can summarise the underpinnings of the rally as follows:

First, we now know the lockdowns – where enacted and complied with – worked well and mostly lasted only a few months. There was also much better news on treatment for the coronavirus, helping reduce the mortality rate. All of this has allowed for controlled exit from lockdown, and tepid resumption of economic activity.

Second, governments and central banks unleashed hitherto unthinkable levels of fiscal spending and monetary stimulus to help stabilise economies and provide liquidity to financial markets, backstopping wages and cashflows across entire economies. This has provided a powerful fillip to risk assets such as equities. However, the policies are not without long-term consequences: government debt levels are at post-World War II highs and central banks have become dominant players in financial markets. Nonetheless, huge government intervention was called for to prevent a near-term collapse, and they duly delivered.

Interestingly, equities have not been the only assets to rally – safe havens have been equally well bid, with gold trading above $1,800 and government bond yields near all-time lows. Indeed, volatility remains high and the pandemic is still spreading across much of the globe – including in the US, the world's anchor economy. The critical question is where do markets go from here?

Massive support from central banks



Source: SGPB, Macrobond,, 17/07/2020

It is exactly at times such as these – when uncertainty and imperfect information rule the roost – we must rely on our investment process. At present, this is how the world looks through the lens of its four main pillars:

Economic Regime: Despite significant economic data surprises on the upside, the global economy is on track to suffer its deepest recession since the 1930s, with global output set to contract by 4.9% in 2020 according to the International Monetary Fund (IMF). Much of the recent improvement in data reflects the shift from lockdown to gradual reopening.and we await further confirmation of economic stabilisation over the coming months.

Valuations: Valuations for equities remain challenging. US equities, which dominate global markets, are currently trading at their highest multiples (on forward price-to-earnings, price-to-sales, price-to-cash-flow and price-to-book-value) since the aftermath of the tech bubble in 2001-2002. However, while equities are expensive, so are other asset classes such as sovereign bonds, leaving few alternatives.

Momentum: As noted above, momentum was strong throughout the second quarter. At present, the ten-month moving average metric we favour is about to tip higher. Should this be sustained, we would view it positively for risk-taking.

Sentiment: Sentiment for risk assets has swung wildly from optimism to pessimism and back again since February. However, we are far from the euphoria or the despair which often mark peaks and troughs in markets, leaving us in neutral territory.

Bottom line. Taking all the above into account, we have opted to remain Neutral in risk allocation for now. Equity markets remain volatile and thus more unpredictable than usual; they are also historically expensive on most measures. Nonetheless, we note the economic regime and the momentum signals are shifting towards increasing risk.

Past performance should not be seen as an indication of future performance. Investments may be subject to market fluctuations, and the price and value of investments and the income derived from them can go down as well as up. Your capital may be at risk and you may not get back the amount you invest.

FIXED INCOME

Expectations vs liquidity

Low long-term rates on sovereign bonds imply investors expect dire economic straits, while tighter corporate bond yield differentials ("spreads") suggest a much more benign outlook. How can that be? Thanks to central bank largesse, abundant liquidity is swirling through all asset classes. However, indiscriminate buying should be avoided.

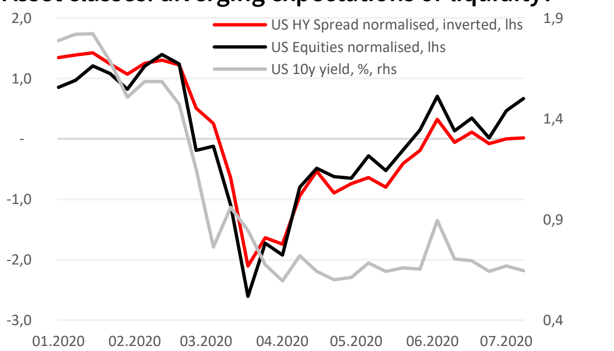
In an economic slowdown, it is reasonable to expect central banks to lower rates and drive sovereign yields down, while riskier assets like corporate and emerging bonds struggle under the weight of higher risk aversion and deteriorating financial conditions. However, this playbook doesn't work in today's peculiar environment, where a deep economic recession, triggered by an external shock, has been met with unprecedented policies. Central banks worldwide have flooded financial markets with huge amounts of fresh money, blurring the lines between optimism and pessimism.

Sovereigns

US. The Federal Reserve (Fed) will continue to provide exceptional support for the economy via low rates and asset purchases. In addition, they now plan to enhance monetary policy further, with ongoing discussions about forward guidance and yield curve targets. No decisions have been taken so far, but the framework review is likely to be completed soon. Bond yields are therefore likely to stay low across all maturities. The recent strong 30-year bond auction confirms strong appetite even for ultra-long-dated securities, a sign of low-for-long rate expectations and the need to put liquidity to work.

Eurozone. The European Central Bank (ECB) is also stepping up efforts to keep rates low and convince markets that's where they will stay. The recent downward revisions to growth and inflation projections by the Eurosystem staff, coupled with the central bank's reassurances about the proportionality of its asset purchases, suggest the ECB will maintain an ultra-accommodative stance.

Asset classes: diverging expectations or liquidity?



Source: SGPB, Bloomberg, 17/07/2020

As a consequence, German yields remain negative across all maturities. Peripheral spreads are also down from March's highs: although risks linger, liquidity and the search for yield remain strong supports.

UK. The recent £30bn package provides significant stimulus to the economy, but the resulting extra funding needs are unlikely to drive rates up given continued central bank purchases.

Credit

US. Since the beginning of June, spreads have traded close to 150 bps for Investment Grade (IG) and 600 bps for High Yield (HY) bonds. The health emergency in the US has intensified recently, but support from fiscal and monetary policy remains the main driver for credit markets. We continue to like IG bonds, given the support from Fed purchases and investors' search for alternatives to Treasuries with a yield pick-up. We remain neutral on HY with a clear preference for higher quality issuers.

Eurozone. ECB purchases target a specific sub-group of "eligible" IG corporate bonds which, like in 2016, have unsurprisingly outperformed. But as time passes, substitution effects mean that investors end up increasing exposure to non-eligible bonds as well, helping tighten spreads. We maintain our Overweight on IG bonds, which will also be supported by a better balance in net supply due to lower issuance. We keep a neutral stance on HY, where the weakest issuers are especially vulnerable to economic woes.

UK. The Bank of England (BoE) has added $6.8bn to its Corporate Bond Purchase Scheme since the beginning of April, with IG spreads narrowing slightly over the last month.

Emerging Market (EM) debt

Surveys indicate that investors are keen on hard-currency emerging debt and recent fund inflows have been positive. However, many EM countries face a worsening health crisis and resulting economic risks. Here again, liquidity may offset fundamentals for now but we remain cautious.

EQUITIES

Keeping our balance

Markets have rallied hard since late March leaving little further upside potential, especially given the recent acceleration in COVID-19 infections. However, the gradual exit from lockdowns and ample support from fiscal and monetary policies are powerful supports. All in all, we remain Neutral.

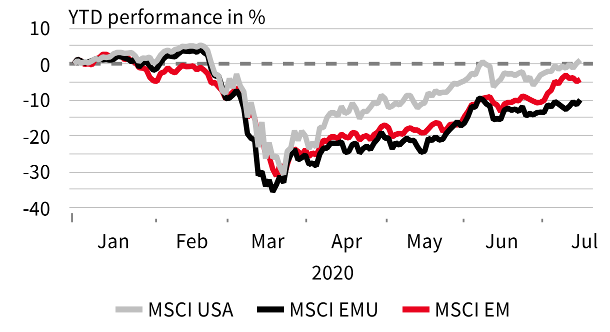
US. The second-quarter earnings season is getting under way with analysts projecting a -45% year-on-year (YoY) fall in profits, the sharpest decline since 2008-2009. While such low expectations offer some potential for upside surprises, the hurdle will be higher in Q3 and Q4 when the consensus is expecting quarterly bounces of 36% and 15% respectively.

US equities have rallied over 44% from their late-March low despite the collapse in earnings expectations, leaving valuations looking extended – the forward price-to-earnings ratio (PER) is the highest since the tech bubble in 2000-2002. However, this marks divergent trends across sectors. The largest tech and internet giants are up 50% year-to-date (YTD) and currently trade at 51x earnings. On the other hand, strip the 10 largest growth stocks from the S&P 500 index and the remaining 490 members are down around 10% YTD. In this context, we suggest a balanced spread across sectors within a Neutral allocation.

Eurozone. Analysts have revised down Q2 earnings forecasts and now expect a -59% fall YoY, leaving room for upside surprises given that many countries had begun to ease lockdowns by early May. Moreover, the region seems to have been successful so far in preventing a second wave of coronavirus infections, which should help avoid new restrictions on activity, unlike large sunbelt states in the US such as California and Texas.

Although the euro zone has lagged global markets so far this year, the region has begun to outperform since easing began in early May. Valuations look less stretched than in the US and the planned EU recovery fund should help allay market worries about euro zone break-up and encourage investors back to the region. We maintain our sector preferences – notably, Healthcare, Communications Services and Utilities – and continue to Overweight the euro zone versus other regions.

2020 Performance driven by CoViD-19



Source: SGPB, Macrobond, 17/07/2020

UK. The UK has been slower than its neighbours to ease lockdown restrictions which in turn will slow the economic recovery. Moreover, there has not yet been a breakthrough in negotiations with the EU about the bilateral regime after the Brexit transition period expires at year-end, meaning reduced visibility for businesses. However, the market is attractively valued versus cyclically-adjusted earnings and we remain Neutral.

Switzerland. Swiss equities continue to outperform other regional markets thanks to the high weighting in quality stocks in defensive growth sectors like Consumer Staples and Healthcare. Moreover, margins have come under less pressure than across other European markets while returns on equity remain resilient. Finally, the pace of earnings revisions over the past three months has been rather resilient at -7.6% versus -14.3% for the MSCI World global equity index.

Japan. Tokyo has proved resilient so far this year, helped no doubt by consensus expectations of +2.1% earnings growth this fiscal year. The government's support package for the economy is the largest on offer among advanced economies as a percentage of GDP and lockdown measures have been less restrictive than elsewhere. Moreover, the market is trading close to decade lows on cyclically-adjusted PER. We maintain a Neutral exposure to Japanese equities.

Emerging Markets. Q2 GDP data confirms that China is growing again, at 3.2% YoY versus -6.8% in the first quarter. Perhaps in anticipation, Chinese domestic equities have outperformed other global stock markets so far this year. Other regions, notably Latin America, continue to struggle with high COVID-19 infection rates and are likely to lag Asia. We continue to Overweight Asia within a Neutral view on EM equities and highlight the growth and valuation attractions of Asian tech stocks.

CURRENCIES

Swimming in liquidity

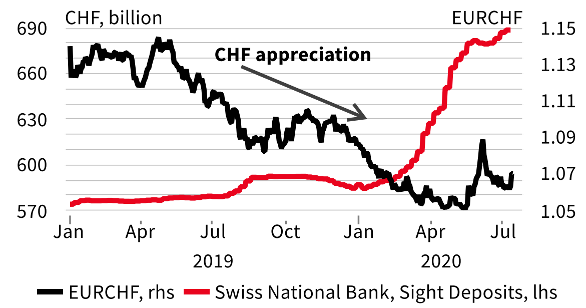
With interest rates and bond yields close to zero across much of the globe, carry trades have fallen out of favour. Currencies now tend to trade on swings in sentiment – recession fears bolster safe havens like USD, JPY and CHF while risk appetite, driven by liquidity, boosts EUR. As the global economy begins to recover, we expect some US dollar weakness.

Dollar Index. The dollar can no longer derive much support from interest rate differentials against other advanced economies, with monetary policy settings due to remain extremely accommodative for years to come. Bouts of risk aversion should provide a temporary boost to the greenback, despite the fact that many risks (trade war with China, pandemic spread in the sunbelt) are specific to the US. Nonetheless, abundant liquidity should support risk appetite in the medium term, pushing the Dollar index lower again.

EUR/USD. The euro has been benefitting from the swift recovery in equity markets and the unprecedented monetary and fiscal stimulus in Europe. COVID-19 appears to be contained on the continent, despite the emergence of several local outbreaks, while the US has still not managed to bring its first wave under control. If approved, the €750bn recovery fund should go some way to addressing fears of a euro area break-up. The euro still looks cheap and should continue to gain ground.

GBP/USD. Recently, traders have become much more aware of Brexit risks, especially at a time when the economy is on the back foot. EU and UK negotiators have their work cut out in order to formalise the future relationship before the December 31 end to the transition period. There is little doubt that "no deal" would be damaging to the UK and the pound, at least in the short-term. Overall, we anticipate increased headwinds for sterling, despite its attractive valuation.

The SNB has intervened to stop CHF appreciation



Source: SGPB, Macrobond, 17/07/2020

USD/JPY. Although we have seen some spikes in volatility, the yen has spent much of this year trading in a tight band between 106 and 110 versus the dollar. Risk sentiment has been by and large positive since late March yet the yen has not experienced any significant weakness. On the other hand, when investors have run for safety, they have tended to prefer gold as a safe-haven option. All in all, we don't expect USD/JPY to break out of its trading range.

EUR/CHF. The Swiss National Bank (SNB) appears to have been intervening actively over recent months to prevent EUR/CHF dipping below 1.05 on safe-haven flows into Swiss francs. With fiscal and monetary easing keeping liquidity ample, we expect risk appetite to revive, helping push the franc lower. Moreover, investor concerns about euro zone break-up may soon be allayed by the prospect of a recovery fund financed by joint EU borrowing.

EM currencies. It is still too early to paint a positive picture for emerging market currencies. South American counters, and currencies reliant on commodities such as the South African Rand, remain vulnerable. The Brazilian Real is already down 25% against the US dollar since the start of the year but the pandemic there is still not under control. EM currencies are trading close to all-time lows versus the dollar on average but lack catalysts for a lasting reversal.

USD/CNY. The renminbi has continued to drift higher against the dollar in recent weeks, touching 7 CNY for $1. Tensions with the US – on trade, on COVID-19, on the national security law for Hong Kong and so on – continue to run high and the People's Bank of China appears to have judged that further devaluation might be counter-productive at present. We now expect the renminbi to trade sideways against the dollar.

ALTERNATIVES

Diversification benefits

With little sign of a sustained pick-up in demand, oil prices may trade lower. Gold demand shows little sign of flagging despite higher prices and we remain Overweight. Within a generally constructive stance on Hedge funds, we highlight the attractions of Long-Short Credit, emerging market Global Macro specialists and Merger Arbitrage as sources of yield.

Commodities

Oil

Since March, the slump in oil prices has pushed many shale producers to retrench, with the rig count tumbling from 683 in March to 185 at present, just above its 2009 recession low. Worries about the long-term impact of the transition to renewables on the value of oil and gas reserves have caused some energy majors to write down asset values. In recent weeks, BP and Shell have slashed almost $40bn from their reserves.

The International Energy Agency (IEA) warned recently that risks to its market outlook were "almost certainly to the downside" given the resurgence in COVID-19 cases across the globe. The IEA forecasts an average decline in oil demand of 8.1 million barrels per day (mb/d) this year – the largest in history – with supply set to fall 7.2 mb/d, leaving the market facing continued oversupply and downward pressure on prices.

With OPEC and Russia confirming an easing in output cuts, we expect oil prices to trade slightly lower in coming months.

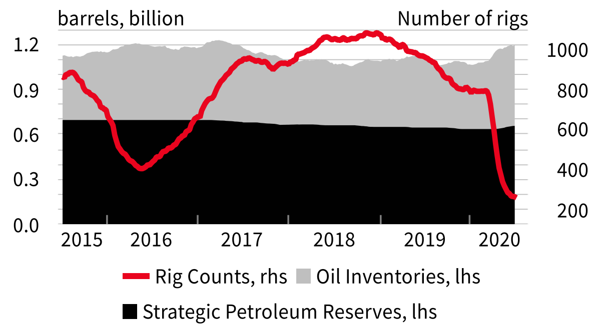
Gold

Gold supply was severely constrained during the pandemic lockdown. Output from mines fell 3% year-on-year (YoY) in Q1 while recycling – which accounts for over one quarter of total supply – fell 4% YoY to its lowest level since 2017. So far, there has been little sign of a pick-up in gold supply.

Despite higher prices (up 19.3% year-to-date), gold demand has been strong. New purchases of ETFs generated 104 tonnes (t) of purchases in June, taking the first-half total to 734t, well above the highest-ever annual total of 646t in 2009. In addition, central banks continue to add gold to their currency reserves with another 40t of net purchases in May. Moreover, the opportunity cost of holding gold remains low with central banks having fixed rates close to zero or below while ramping up their purchases of sovereigns, keeping yield curves rather flat.

We continue to Overweight gold for its diversification benefits and upside potential.

The number of US rigs in operation has collapsed



Source: SGPB, Macrobond, 17/07/2020

Hedge funds

Long/Short (L/S) Equity

After spiking higher in March and April, the dispersion between individual stocks' returns has begun to fall back, perhaps reducing opportunities for L/S managers. Our preferred segment is funds with a variable bias, which were able to move short in March and then increase exposure again to capture the rally.

Event Driven

M&A volumes have picked up again in the US, with June back at December 2019 levels. Spreads – the difference in stock prices between predator and prey – remain high at around 6%, meaning attractive return potential in Merger Arbitrage. Special Situations funds have more directional bias – an advantage during bull markets – but increased corporate activity offers new trade opportunities.

Fixed Income Arbitrage

We like strategies which combine attractive sources of yield with strict risk controls and L/S Credit fits the bill. Worsening balance sheet quality among speculative grade issuers provides attractive short opportunities. Credit spreads remain wider than at year-end but sustained central bank purchase programmes should see further tightening ahead.

Global Macro / CTAs

Our Neutral stance on trend-followers (known as CTAs) remains unchanged. Periods of range-bound trading – which often occur when liquidity is abundant but fundamentals are weak – can prove problematic for managers. We continue to highlight the merits of emerging market Global Macro funds – yields are attractive and the pandemic has created new trade opportunities.

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