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Investment Strategy

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Highlights Editorial Changes this month Summary of our main recommendations

. The epicentre of the pandemic has shifted to the emerging markets. It appears to be under control in Asia and Europe. But concerns about the US (Southern and Western states) remain.

. Good economic news, including a rebound in leading indicators, confirms our U-shaped recovery scenario with an acceleration in growth in 2021.

. The financial markets seem too optimistic presently. Risks exist that we consider underestimated: Brexit, China/US tensions, US elections.

. In the equity markets, we maintain our "buy on dips" strategy. In the event of a consolidation we would strengthen pro- cyclical positions.

Stock markets have rallied since their lows in late March, recouping three quarters of the declines registered since mid-February in the wake of the Covid-19 pandemic. Since early June, the stock markets have been hesitant, and the positive factors have been counter-balanced by uncertainties. In recent days, the positive factors have regained the upper hand.

The pandemic is stabilising in Asia and Europe, but not in the Americas!

Hard lockdown measures were successively implemented in Asia and then in Europe. The timing depended on the evolution of the pandemic. Since April in China, May in Europe and partially in the United States, these confinement measures have been lifted without leading to a general increase in the number of new infections. New outbreak hotspots are being managed locally by dedicated teams, sometimes with new local lockdown measures, but overall, health authorities seem to have the pandemic under control. Hence the fairly rapid easing of lockdowns.

Today, the worst affected regions are the emerging markets (Latin America and India in particular) and the Southern and Western states of the US where there is a spike in the number of new infections, requiring new partial lockdown measures. The health authorities are concerned about these spikes, but they have developed the means and techniques to manage outbreak hotspots and stop the Coronavirus from spreading beyond the local level. Until a vaccine or effective treatment is developed, this pandemic will remain a serious health problem, penalising economic activity and posing a risk to the financial markets.

Our U-shaped economic scenario remains intact.

Economic figures for the second quarter are disastrous and worse than expected. We have marginally revised down our forecasts for 2020 in mature economies, especially the eurozone and the United States. But more importantly, all leading indicators for May started rising, as soon as global lockdowns ended. The scenario of a rebound in economic growth from the second half of the year, and amplifying in 2021, remains unchanged. The role of reflationary economic policies is essential for anticipating this. We are monitoring this rebound in post-lockdown growth with higher frequency indicators than only monthly economic data. And as for the Chinese economy since the spring, we are monitoring daily data for Covid-19, road congestion figures in major cities, and Google's activity indicator: these frequent data confirm the rebound in activity.

There are numerous risks:

1. Brexit will take place at the end of this year, and the UK authorities have reiterated that they do not plan to ask for an extension. Negotiations need to move forward considerably over the next few weeks to maximise the chances of this deadline being met. So far, progress in these negotiations has been very slow, so concessions on both sides will be necessary. Our base-case scenario is that Brexit will take place in an orderly manner, with an agreement, but the risks are great.

2. Tensions between the United States and China may resurface very quickly. The Phase 1 agreement decided at the end of 2019, remains valid, but it may be challenged on account of the worsening relations between the two superpowers and the present recession. Tensions persist over several issues (technology, intellectual property, opening up the Chinese market, Hong Kong etc.). The long-term strategic competition between the two countries has no short-term solution.

3. The US presidential election is now a pressing topic. Both candidates have a tough stance towards China. Mr Trump is behind in the polls, but could take initiatives to get back on track. We know little of Mr Biden's agenda on issues that are worrying the markets, such as a wealth tax (put forward by the left-wingers of the Democratic Party), climate and the health care reform. A significant signal will be sent with the nomination of the Vice-President of the Democrat candidate. Let us not forget though that the election concerns both Congress and the Senate, and according to some polls, the Democrats could also win a majority there.

4. Negotiations on the European Stimulus Fund continue. This is an important milestone in European history because the Commission's budget would increase significantly and organise large transfers of solidarity between European countries. The next step is the European summit on 18 July, which should bring good news.

5. The risk of a second wave of the Covid-19 pandemic will remain as long as there is no vaccine or effective treatment. Some scientists fear the return of the pandemic on a large scale in the autumn in the northern hemisphere.

Awaiting the consolidation which will provide another opportunity to strengthen positions

Positive factors have dominated the markets in recent days. Observers often say that if further problems arise, monetary authorities and governments would intervene again, and ultimately, the economic recovery and the rebound in profits would support the stock markets. This market expectation incorporates a 'perfect' scenario. However we fear that the reality will be complicated by risks of corporate defaults, the challenge of completely eradicating the virus without a vaccine or treatment, the American elections and international tensions. Equity markets are expensive, and will be sensitive to bad news. But it is clear that liquidity is abundant and with interest rates close to zero, and negative in Europe and Japan, equities are the asset to favour in the long term. In our scenario, a U-shaped growth trend will accelerate in 2021. The markets are moving too fast today, in our view.

We will take advantage of the next phase of volatility to reinforce positions, particularly in pro-cyclical sectors/countries, which benefit most from the anticipated economic recovery. Our preferred markets remain the United States, the eurozone and the emerging countries, particularly Asia excluding Japan. We turn neutral on the United Kingdom.

Changes this month:

1. We turn neutral on the UK market (from positive). UK equities have suffered from the impact of the pandemic, which has been particularly bad there. They are very cheap compared with other stock markets. But the UK's economic growth prospects are worse than others, not least because of Brexit but more specifically on account of the risk of a hard Brexit (i.e. without an agreement). The composition of the UK market, with many defensive stocks, does not favour this, at a time when we are highlighting cyclical stocks.

2. We raise our target on gold, with a new forecast range of $1700-1900 per ounce (instead of $1600-1800). We remain positive on gold as the fundamentals in place that favour it are unchanged: real interest rates are negative, monetary policies are (and will) remain extremely accommodative and Quantitative Easing is massive. Gold is a way of diversifying risk, so it is helping to limit portfolio volatility.

Summary of our main recommendations

Equities

Global
- **Higher volatility should resurface, as high expectations require confirmations.** High valuations expose equity markets to bad news in coming months.
- **An opportunistic approach to strengthen pro-cyclical equity exposure**. Downside risks are limited by an improvement in the basis of comparisons (for activity, earnings growth…) as we enter Q3. New highs are expected over the medium term.

Markets
- **US outperformance to continue.** The relative uptrend remains fully intact.
- **Invest in Euro Area stocks:** the likely adoption of a Recovery Fund in coming weeks liberates potential for a reduction in the risk premium.
- **Turning neutral on the UK market,** due to Brexit uncertainties and absence of narrative.
- **Buy Emerging Markets:** They are in a broad bottoming process versus developed market indices. Asia (75% of the index) is our focus: we like China, Taiwan, South Korea, India and Singapore.

Sectors
- **Positive on Materials and Insurance.**
- We are positive on Healthcare except on Pharmaceuticals.
- **In Europe: positive on Technology and Energy.**

Bonds

Govies
- We are **negative on German govies**, whatever the maturity, and on long-term US govies.
- We are **positive on the front-end of the US yield curve for USD-based investors** as short-term yields have limited upside.
- We **are positive on periphery debt** (Portugal, Italy, Spain, Greece) **on a buy on weakness strategy**.

Investment Grades
- We **prefer corporate bonds** over government bonds.
- We **like EUR and US IG bonds with a duration at benchmark** (5 and 8 years, respectively).
- We are **positive on eurozone convertible bonds**.

High Yield
- **We are neutral on both US and eurozone HY.**

Emerging
- **We are positive on EM local currency bonds,** for both USD and EUR based investors, and **neutral on EM hard currency bonds (sovereigns and corporates)**.

Forex

AUD/USD & NSD/USD
- We think that the AUD and the NZD will hover around current levels short-term. Then, we see an upside potential respectively to 0.71 and 0.66 over the next 12 months.

USD/NGD & USD/ MYR
- We see the SGD and the MYR remaining steady short-term before appreciating over the next 12 months.

USD/INR
- We revised down our 3 and 12-month targets to 75

Commos

Oil
- OPEC+ output restrictions and declining US shale oil production together with the demand recovery should help reducing the crude stockpiles. We expect Brent prices to recover around $45-55 in H2 2020 and to rise further in 2021

Gold
- Real interest rates should remain extremely low for an extended period. Gold is seen as a refuge from 'unfettered currency printing". We revise upwards our expected trading range to $1700/1900/oz for the coming 12 months.

Base Metals
- Demand is slowly recovering with the reopening of the economies lead by China, the leading buyer, thanks to infrastructure spending and other stimuli. Copper and Nickel are the more

Alternatives

Real Estate
- Positive for a 'value-added' commercial investment strategy, executed by first-class asset managers. Neutral on REITs with 'long-only' strategies, irrespective of geography.

Alt. UCITS
- **We upgrade Relative value to positive and downgrade Event-Driven to neutral.** Positive on relative-value, Macro and Long-Short equity.

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