

# Investment Strategy



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Highlights Editorial Changes this month Summary of our main recommendations



## The coronavirus epidemic

Isolation measures, implemented to curb the coronavirus epidemic, are having a major direct impact on economic activity in affected countries. Our base-case assumption is that the contraction in activity will be transitory (Q1 in China, Q2 in other impacted countries), and the recovery will be confirmed in the second half of the year, and will continue in 2021.

## Strong stimulus from economic policies on the rise

Strong stimulus from economic policies in the wake of this exogenous shock are multiplying. Central banks, (including the Federal Reserve with its surprise rate cut on 3 March) are using all the tools at their disposal. Other measures (including fiscal policy) will follow.

## A spike in volatility and tensions on the financial markets

Fears over the economic climate have had a negative impact on the financial markets, with bond yields dropping sharply, and rising tensions on equities, which fell by more than 10% over 10 trading sessions.

## We stick to our "buy on dips" strategy

We maintain our positive view on risky assets and our "buy on dips" strategy on equity markets. No change to our preferences: we like the eurozone, the United States, the United Kingdom and the Emerging Markets.

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## Coronavirus: latest update

In China, where the virus originated, the number of new cases of infection is tailing off. It appears that the epidemic is reaching a peak in this country. On the other hand, the epidemic is spreading to numerous countries where the number of new cases is constantly on the rise. At the time of writing, there were more than 93,000 reported cases and more than 3,200 deaths in 81 countries (South Korea, Italy and Iran are severely affected). Isolation measures are being taken everywhere in a bid to stem contagion.

### Economic recovery delayed but not derailing

Isolation measures are having a significant direct impact on the economy of affected countries. In China, for example, the manufacturing sector and certain regions were paralysed in February with activity coming to a near standstill. The impact will hurt first quarter figures. However, the recovery started to take shape in early March. In other countries, the same pattern is beginning, with a likely slowdown in activity in the second quarter and then a subsequent recovery.

We have revised down our economic growth forecasts for the first half of the year, especially for China (Q1) and in other countries (especially Q2). The key assumption is that the contraction in activity will be transitory, and the recovery will be confirmed in the second half, and continue in 2021.

## A “complicated” situation in the financial markets

### Fears over the economic climate took their toll on bond markets in the initial stages.

The fall in interest rates was rapid, especially in the United States, where 30-year rates reached all-time lows in mid-February. On 3 March, for the first time in history, the yield on 10-year US bonds fell below 1%! The whole US yield curve plummeted to record lows (in yield terms); expectations of a cut in Fed fund rates were so strong that the Fed decided to cut it by 50 basis points on 3 March prior to its scheduled meeting of 18 March. In Europe, bond markets reacted less dramatically: admittedly, rates fell but did not set new records (e.g. in Germany). Dollar-denominated assets therefore served as a safe-haven, hence the strength of the greenback in February. The dollar has bucked its trend lower in recent days on the back of expectations (and then the announcement) of a Fed rate cut.

During 10 trading sessions as of 19 February, equities followed suit, posting a sharp downward movement. Volatility indices (VIX and V2X) surpassed 40, reflecting extremely high tensions on the markets, with losses of more than -10% on most stock markets.

# We stick to our "buy on dips" strategy on stock markets

## We maintain our positive view on risky assets and our "buy on dips" strategy on equity markets.

- Coronavirus is an unforeseeable exogenous risk. It will have far-reaching consequences but the impact will be temporary. In China, where the virus originated, the recovery is already taking shape, and it will be the first country in which the V- or U-shaped recovery scenario will be confirmed.
- Reactions of economic policies to this exogenous shock are increasing. Central banks are using all the tools at their disposal to limit the impact of isolation measures. For example, the Fed surprised the markets with a rate cut on 3 March. In the coming weeks, there will be multiple initiatives (nearly worldwide), including rate cuts, liquidity injections and loans to companies with serious cash problems. Fiscal policies may be more expansionary going forward.
- Interest rates are very low, setting new records on almost all parts of the yield curve. Real rates are negative, which is a new phenomenon on US long-term bonds (30-year). TINA ("There is no alternative") remains a strong argument over the long term. To hedge against inflation, investors will need to take on more risk and invest outside fixed-income markets.
- Equity market valuation is favourable. No doubt, earnings forecasts for the next few months will be revised down. That said, valuation ratios remain very cheap in Europe, and have tumbled below historical averages in the US (stocks relative to interest rates). The equity dividend yield on the S&P500 is 2%. By comparison, the 30-year US rate is 1.57%.

In the short term, the lows on the equity markets have probably not yet been reached, although the bulk of price declines seem to be behind us. Against this economic backdrop (described above) we expect an extended period of volatility and remain bullish during downturns. The best way of judging when the window of opportunity to buy is about to close is to watch transactions that are showing increasing insensitivity to bad newsflow. Historically, purchases made when volatility is at 40%, or even at the levels reached by stock market indices when volatility was previously at 40%, are winning bets, as long as investors are patient.

Highlights

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Summary of our main recommendations



### Changes this month

The main changes this month relate to monetary policies that will be more accommodative than expected. Given the economic impact of isolation measures to curb the spread of the Coronavirus epidemic, monetary and fiscal policies will be relaxed again in the coming weeks and perhaps G7 countries will take concerted actions. Since the Fed's surprise rate cut, we have been reviewing our scenario. A paper providing more details will be published shortly.

We remain positive on gold and raise our target to \$1535/1735 per ounce. Gold remains a safe-haven investment, which is very volatile, like all risky assets at the moment.



## Equities

## Global



- **Take advantage of volatility to buy on dips.** The coronavirus outbreak delays but does not derail the outlook for improving growth and earnings trends.
- **Downside risks are limited.** Too many investors are looking for opportunities to raise their equity exposure, among others in front of a lack of alternatives in the fixed income space (TINA).

## Markets



- **No end in sight for US outperformance:** the trend is your friend. Most liquid market with a deep breadth of opportunities, particularly in areas with secular growth potential.
- **Positive on the Euro Area as a play on a gradual improvement in the global growth outlook.** Attractive dividend yield of 3.2%.
- **Good relative potential for the UK:** improving corporate sentiment, attractive dividend yield.
- **Positive on Emerging Markets**, based on a sharp recovery in the second half.

## Sectors



- **Globally: positive on Energy and Financials (ex EU banks).**
- **In Europe: positive on Technology and Construction Materials.**

## 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.**
- We remain **neutral on periphery debt** (Portugal, Italy, Spain).

## 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 focus on quality credit in the US and do not make that discrimination in the eurozone.**
- We are **positive on eurozone convertible bonds.**

## High Yield



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

## Emerging



- **We are positive on EM local currency bonds**, for both USD and EUR based investors, and **EM hard currency corporate bonds. Neutral on EM hard currency.**

## Forex

## EURUSD

## CNY

## RUB



- **We revised our 3-month EURUSD target to 1.10 (from 1.12)** as the environment should remain supportive for the greenback short term. The 12-month target remains unchanged (1.14).
- **We see the USDCNY sliding towards 6.80 (from 7.00) over the next 12 months** supported by the expected economic rebound in China. We keep the 3-month target unchanged at 7.0.
- **Positive drivers should help the USDRUB to fall to 62.0 from 64.0 (stronger RUB) over the next 12-months.**

## Commos

## Oil



- Excessive pessimism linked to the corona virus (around \$50/b for the WTI) offers a buying opportunity. Expected lower US shale supply growth, OPEC+ restraint and better economic momentum later this year should help a price recovery in the 2nd half of 2020. We expect Brent prices to go back in the \$60-70 range.

## Gold



- We keep our positive stance on Gold and upgraded our trading range to 1450-1650 for the coming 6 to 12 months.

## Base Metals



- Strong price fall due to the Coronavirus. A rebound could be limited until we see a more decisive pickup of the world economy and more notably China

## Alternatives

## Real Estate



- Positive for a 'value-added' commercial investment strategy, executed by first-class asset managers. Positive for a "value-added" commercial investment strategy, executed by first-class asset managers. We are Positive on value-added strategies across emerging markets.


## Alt. UCITS



- Positive on Event-Driven (upgraded last month), Macro, Long-Short equity. Cautious on relative-value strategies.







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