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Equity Strategy

22 April 2020

In our last strategy report we discussed the possibility of equities falling to new lows. We felt that despite the sharp drawdown there was more bad news that needed to be priced in. This was not the case, with investors reacting positively to unprecedented policy support announced by central banks and governments. The old Wall Street adage that investors should never fight the FED couldn't have been more appropriate. Currently, we are of the view that risks remain elevated with a high risk of disappointment that could lead to weakness in the equity market. This is especially true in the macro space as economic data published since the COVID-19 outbreak has been very poor. Following the rally, investors are pricing in a strong economic recovery in the second half of 2020. Whilst this may be correct, we think that a lot will depend on how fast the 26 million jobs lost in the US can be recovered and how long it will take for economies to come back to some form of normality. The situation remains very uncertain, but investors seem rather convinced.

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A V-shaped recovery is being priced in by investors

Equities have recovered strongly in April. At the start of the year everyone expected the bull market to continue unabated, until COVID-19 spread outside of China. A sharp sell-off ensued over March (SPX fell circa 34%) as investors feared a prolonged recession, followed by a strong rally (SPX +25%) as central banks and governments introduced policy measures to support the global economy while COVID-19 cases started to grow at a slower pace.

We have gone from the longest bull market in history to the shortest bear market. The current bear market (bear market is defined as a decline of 20% or more) started on 19/02 and lasted till 23/03 or 33 days. Looking at data from 1928, this bear market was the shortest in history (excluding corrections, defined as declines of between 10% to 19%).

Goldman Sachs ("GS") have looked at bear markets since 1835. Bear markets were categorised by GS into three types: (1) Structural (long term build up of structural imbalances and financial bubbles) (2) Cyclical (economic cycle driven) (3) Event driven (exogenous shock). The average length of a bear market was calculated by GS at 27 months, with the average for structural the longest (42 months) and steepest in terms of price action (average decline of -57%), followed by cyclical (27 months with an average decline of 31%) and event driven (8 months with an average decline of 28%)

COVID-19 driven equity market weakness led to an event driven bear market. This was the first event driven bear market since 1987 which was caused by computerized program trading strategies when the Dow Jones tumbled 22.6% in one day. The bear market lasted for just over 3 months in 1987 compared to just over one month in FY20 bear market.

The magnitude of losses was larger than the average in FY20. The SPX lost circa 34% during the FY20 bear market compared to the average of 28% for event driven bear markets. This was in line with the losses recorded during the 1987 event driven bear market. Another similarity between the two is that both bear markets came after a prolonged bull market. The 1987 bear market came after a bull market that had lasted for 60months vs 131 months in 2020.

The economic impact from COVID-19 will be severe despite the relatively short bear market. The economic data published in recent weeks has been appalling, and we think weakness will persist in the coming weeks. The US Labor Department has reported that circa 26 million jobs have been lost over the past weeks. To put this into perspective, the jobs lost so far have nearly cancelled out the job gains recorded since the global financial crisis in 2008.

Equity market currently pricing in a sharp economic recovery in 2H20. During past recessions, investors waited for confirmation that measures announced by central banks and governments were working. Looking back at the most recent recession, the SPX bottomed in March 2009 despite policy action being announced in October 2008. This time around, the unprecedented policy support and slowing down in the growth rate of viral infections were sufficient for equity investors. The closer we get to 2H20 the more attention will shift to economic data, and whether it is improving at a sufficient pace to support the current recovery expectations.

We think current expectations could be optimistic. The global economy has come to a halt since mid February and the return to normality is not imminent. The V-shaped recovery currently being expected would imply that most of the 26 million jobs lost in the US would be recovered. Although this could very well happen, we are less optimistic. Lockdowns are still in place in many countries around the world, although there are plans in place to slowly re-open economies. This will probably be a slow process which will continue to weigh on global economic growth for longer.

A second peak would be detrimental for equity markets. There are currently no signs indicating a clear possibility of a second peak and it is not being priced in by investors. If we see the probability of a second peak rising (i.e. probability of a V shaped recovery falling) we could potentially see equities weakening.

Earnings outlook remains clouded and visibility unlikely to improve imminently. We do not expect a lot of insight from management during the 1Q20 earnings releases. We expect earnings to be weaker than current consensus, leading to earnings downgrades.

Country/Region Overview - US

US stocks have recovered sharply from the steep losses suffered during March. The SPX reached an all time high on 19/02, but then plunged 33.8% (total return in US$ or -33.6% in Euros) in four weeks on fears of an economic depression. Then, the SPX rallied 24.8% (or 22.7% in Euros) during the past three weeks as investor optimism around control on viral spread and the rapid response from central banks and governments.

Data is showing that viral spread globally is slowing down, an important catalyst for equities. In the US, total confirmed cases exceeded 580k till 14/04, with daily growth rates starting to fall on 10/04 while the 3-day rolling average started to show declines on 09/04. While this is a positive, it is also worth noting that a return to normality could take more time. Morgan Stanley's biotech analyst warns that the "path to re-opening the economy is going to be long. It will require turning on and off various forms of social distancing and will only come to an end when vaccines are available, in the spring of 2021 at the earliest".

The actions taken by the FED and the US government have been supportive for risky assets. The FED announced a number of policy measures to help limit the negative impact on the economy from the action taken by the government to limit viral spread. In addition, a number of fiscal measures have been announced, more recently the CARES act, a $2 trillion measure which targets four key areas: (1) Households (2) small businesses (3) Business and markets (like airlines, that have been hit hard) (4) State and Local Governments.

Equity markets have reacted positively to the above measures/news with the SPX now just 16.0% off its all time high. A month ago, the main concerns for investors were (1) Possible funding or liquidity shortages (2) Insufficient response from governments and central banks (3) failure to control the virus spread. The FED and US Government announced measures have reduced the risk of (1) and (2) while the recent data shows that the risk of (3) is also much lower. We still see downside risk for the economy from here as data published has so far been shockingly bad.

We think investors will probably look through weakness in 1Q20. Most companies have withdrawn their guidance in light of uncertainty brought about by COVID-19. We expect weaker results than currently being expected by the street but investors to be less reactive to these misses. We do not expect management to provide any update to guidance bearing in mind the current lack of visibility. GS think that commentary provided by management will offer some key signals for investors including (1) path to normality and employment trends (2) likely impact of policy support and (3) financial liquidity and capex plans.

As things stand, 2Q20 will be more important for equity valuations. The equity market is currently pricing in a recovery in the second half of the year. Therefore, we expect management to have more visibility on 2H20 performance during 2Q20 earnings calls. If uncertainty is still elevated at that point, the probability of a recovery in 2H20 will fall, which could lead to a fall in equity prices.

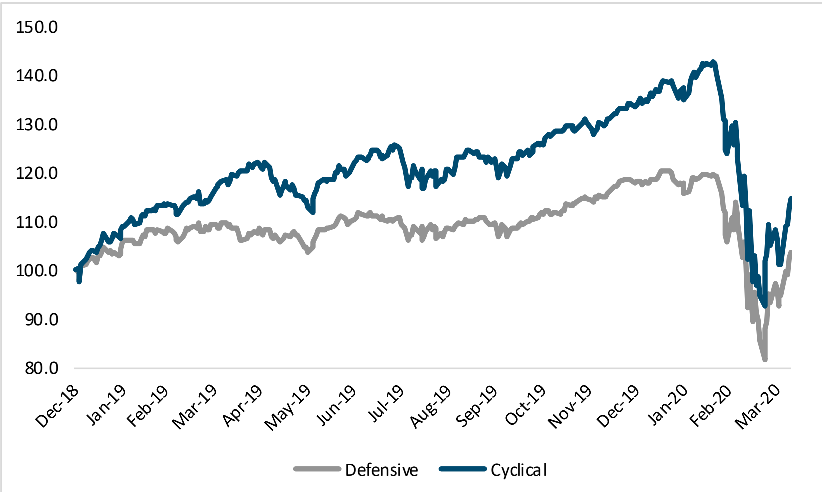
We could also see new lows if macro data weakness persists for longer than expected. Although most data is backward looking, we think that employment levels need to show signs of improvement in June/July to support the equity market. In previous bear markets investors have tended to wait for evidence that announced measures are working. This has not been the case this time around (apart from liquidity measures), making future data prints essential for this rally to persist.

The 12-month forward PE based on GS EPS forecast for FY21 is 16.4x. It was 13.2x a few weeks ago during the lows recorded during March. Consensus is looking for EPS of $177, a 12-month forward PE of 15.8x.

The yield gap has narrowed to 613bp (09/04) from 744bp (20/03), which is still above the median (2006 to 2020) of 374bp. The support provided by the FED and government has been the main driver of this movement in earnings yield over the past weeks. Assuming the earnings yield remains at current levels, and that GS's EPS FY21e remains unchanged at $170, we estimate the near term (3month) fair value of the SPX at $2,564 (8% downside). We leave the full year target unchanged at $3,000.

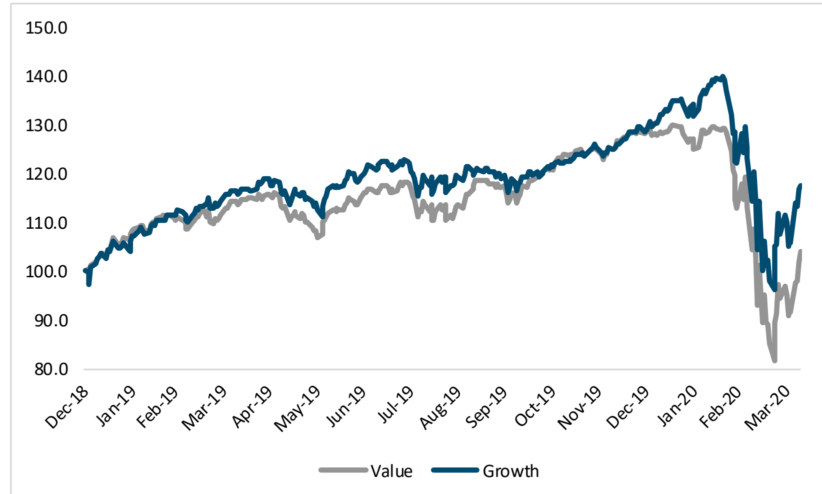
Performance overview by style - US

Defensive and cyclical (rebased to 100 on 31/12/2018)



Source: Bloomberg

Value and growth (rebased to 100 on 31/12/2018)



Source: Bloomberg

Performance overview by sector - US

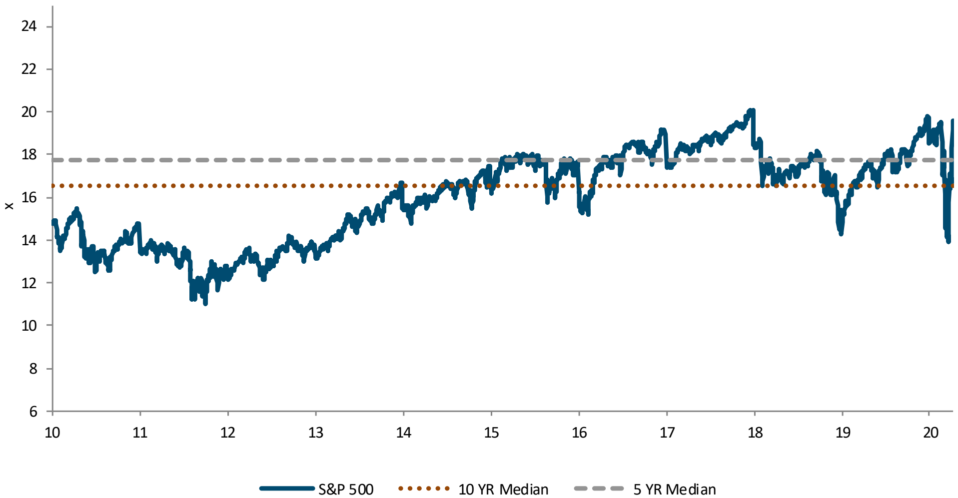
	Strategy	FY19	1 mth	3 mths	LTM	YTD	01/01 to 18/02	19/02 to 23/03	24/03 to 09/04
Food & Staples	Defensive	26.9%	-0.7%	-3.8%	15.4%	-4.7%	1.3%	-11.2%	5.9%
Household & Personal	Defensive	34.1%	-2.0%	-6.2%	9.8%	-6.2%	2.9%	-21.8%	10.8%
Telecoms	Defensive	26.9%	-2.7%	-10.4%	2.9%	-11.3%	-1.2%	-23.0%	13.3%
Pharm & Life sciences	Defensive	17.9%	4.6%	-3.8%	7.5%	-3.3%	0.5%	-21.6%	15.7%
Media & Entertainment	Cyclical	34.2%	0.9%	-16.3%	-2.1%	-12.7%	8.0%	-29.9%	7.7%
Tech hardware & equipment	Cyclical	62.6%	1.2%	-14.7%	14.6%	-11.2%	5.8%	-30.9%	9.0%
Software & services	Defensive	44.2%	5.4%	-6.2%	15.6%	-3.2%	14.4%	-31.2%	10.6%
Retailing	Cyclical	26.7%	3.6%	-6.2%	0.9%	-4.5%	9.4%	-24.6%	9.0%
Banks	Cyclical	40.6%	6.6%	-31.2%	-15.2%	-31.9%	-4.3%	-47.3%	17.9%
Semi-conductors & eqip	Cyclical	51.5%	5.1%	-10.6%	10.2%	-9.4%	7.8%	-31.4%	8.1%
Food Beverafe & Tobacco	Defensive	24.9%	-0.1%	-8.1%	2.2%	-8.2%	3.1%	-30.2%	19.1%
Transportation	Cyclical	21.2%	2.1%	-22.2%	-19.1%	-21.7%	1.4%	-37.0%	8.8%
Diversified financials	Cyclical	24.5%	2.7%	-17.3%	-3.5%	-15.6%	3.4%	-38.4%	16.8%
Materials	Cyclical	24.6%	6.5%	-13.4%	-8.0%	-15.7%	-1.7%	-36.1%	19.9%
Commercial & Prof services	Defensive	39.0%	-6.6%	-16.0%	1.3%	-13.3%	10.8%	-36.8%	10.2%
Utilities	Defensive	26.4%	-3.1%	-4.3%	9.0%	-5.0%	9.7%	-35.6%	22.5%
Health care & equip	Defensive	24.7%	2.2%	-11.2%	4.7%	-10.2%	2.9%	-35.1%	21.3%
Capital goods	Cyclical	30.9%	-4.2%	-24.9%	-14.7%	-22.9%	3.0%	-43.7%	17.7%
Consumer durables & apparel	Cyclical	34.4%	-5.8%	-24.6%	-14.6%	-25.2%	-0.3%	-45.8%	18.6%
Insurance	Cyclical	29.4%	-1.3%	-20.8%	-9.2%	-20.3%	5.1%	-42.9%	18.8%
Real estate	Defensive	29.0%	0.1%	-6.4%	1.4%	-7.5%	8.1%	-37.7%	28.3%
Energy	Cyclical	11.8%	2.1%	-42.5%	-45.5%	-42.4%	-10.1%	-55.9%	23.3%
Consumer services	Defensive	29.0%	-5.2%	-28.5%	-18.1%	-26.8%	1.9%	-44.9%	11.6%
Autos & components	Cyclical	25.1%	-6.2%	-35.1%	-35.2%	-36.9%	-9.1%	-48.8%	14.3%
S&P 500 Index		***31.5%***	***1.8%***	***-14.4%***	***-1.1%***	***-13.2%***	***4.6%***	***-33.8%***	***14.1%***

Source: Bloomberg

Returns above are price return

Valuation - US

Forward PE



Source: Bloomberg

Valuation table

Historical Data	S&P500	Value	Growth
Current Forward PE ratio (FPE)	19.6x	16.1x	23.7x
Forward PE ratio (Jan 20)	18.9x	15.5x	24.5x
10 Year data			
Highest	20.1x	18.3x	24.7x
Highest (date)	18/12/2017	13/12/2016	19/02/2020
Lowest	11.0x	9.8x	12.3x
Lowest (date)	03/10/2011	03/10/2011	03/10/2011
Median	16.5x	14.4x	18.6x
95th percentile	19.0x	17.0x	22.2x
5th percentile	12.6x	11.4x	13.8x
Historical rank (since 2006)			
Percentile	99.2%	82.9%	99.2%
Current FPE, % above/ (below) median	18.8%	11.9%	27.1%
Current FPE, % above/ (below) Jan 20	3.8%	3.8%	-3.4%

Source: Bloomberg

Country/Region Overview – EU/UK

The price action in Europe has been even more severe than the US. The SXXP tumbled 35.3% (total return in EUR) from the highs of February to 18/03. Since then, the SXXP has recovered just 19.1%. We think this is due to a number of factors, mainly the SXXP's value tilt as well as the lack of unity by member states to reach an agreement on fiscal measures to tackle the virus threat. **The UK's equity market reaction was very similar to Europe.** The UKX fell 32.3% (or -39.5% in Euros) in just over a month (to 23/03), then recovering 17.2% (or 24.1% in Euros) over the past three weeks.

There are signs that viral spread is slowing down. Italy and Spain have been particularly hit hard by the virus. Italy has reported more than 20k deaths while in Spain over 17k have lost their lives over the past two months. **There are similar positive signs in the UK.** The death toll in the UK is currently just over 11k. The good news is that new confirmed cases are slowing down, as the control measures announced by governments helped to control the spread.

The European economy is being slowly restarted as new cases growth slows. In Italy, some shops have been allowed to re-open but with strict rules over social distancing. Lombardy and other badly affected regions are expected to remain under lockdown for longer. Spain allowed some businesses to resume operations while Austria and Denmark have started to lift restrictions gradually. A return to normality will probably be a long process, but a resurgence needs to be avoided at all costs. **Three surveys indicate the impact of COVID-19 on the UK's economy during the March lockdown.** The RICS survey and the Report on Jobs point to declines in house prices and employment similar to global financial crisis ("GFC"). A special BCC business tracker suggests that around half of SME respondents have less than three months of cashflow in reserve; around half of surveyed small firms intend to furlough more than three-quarters of their staff in the coming weeks.

Southern Europe to be hit harder than the North, including the UK. Economists expect the macro impact on Spain and Italy to be significant, raising doubts on the sustainability of their current debt levels.

The SXXP 12-month forward PE based on GS EPS forecast for FY21 is 15.9x. It was 13.3x a few weeks ago during the lows recorded during March. GS are not expecting EPS to recover to FY19 levels (Eur25.3) at least until FY23. We think that earnings (FY20 and FY21) could be revised downwards in the coming months as we get additional information on the economic impact.

Both SXXP and UKX are today above the 3 month price target set by GS. The 3 month price target for the SXXP was set at Eur300 (10.1% downside from current price) and £5,300 (9.2% downside from current price) for the UKX. The 12-month price target for the SXXP has been set at Eur370 (10.8% upside) and £6,300 (7.8% upside) for the UKX.

The yield gap has narrowed to 640bp (09/04) from 960bp (16/03). The current level is still above the median levels observed since 2006 (570bp). Since our last report, GS have revised SXXP's EPS FY21 forecast down to Eur20.9. Assuming the earnings yield remains at current levels and GS's FY21 EPS estimate remains unchanged (Eur20.9), the near term PT is Eur340 (in line with current prices).

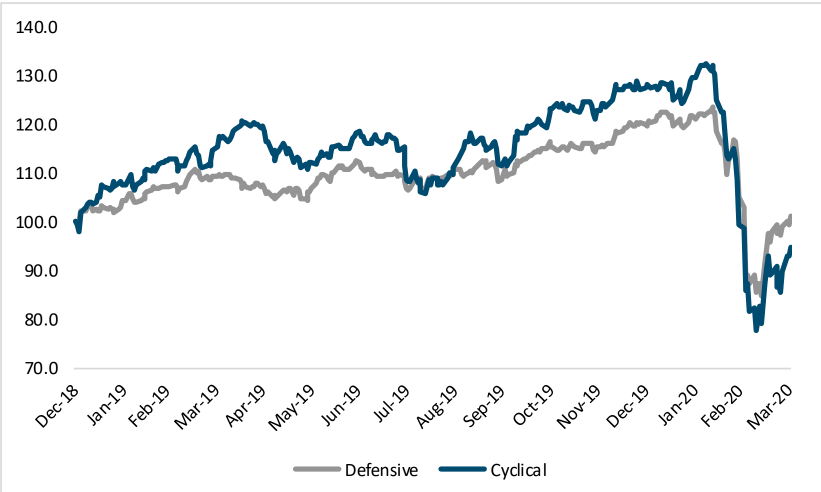
Political risk could lead to a widening in the earnings yield in the coming months. The EU's handling of the COVID-19 situation, or the help provided to Italy and Spain, could revive talks of a breakup. While we think this is unlikely, it could lead to an expansion of the earnings yield and a lower price target.

Brexit has been out of focus for investors during the COVID crisis. The UK has indicated that it needs no extension to the current deadline (December), despite COVID-19. This increases the possibility of equity market volatility as the December date gets closer. Even before COVID, it was unlikely that a deal could be agreed before the deadline, and therefore we think it is even more unlikely today. We still think that a deal staggered over a number of stages, similar to the US/China deal, could be targeted by the EU and the UK.

We think that the above factors could lead to a higher earnings yield by year end. We revise our year end price target to take into consideration the lower expected FY21 EPS and the above risks. We are now expecting the SXXP to close FY20 at Eur304 (circa 12% below current levels).

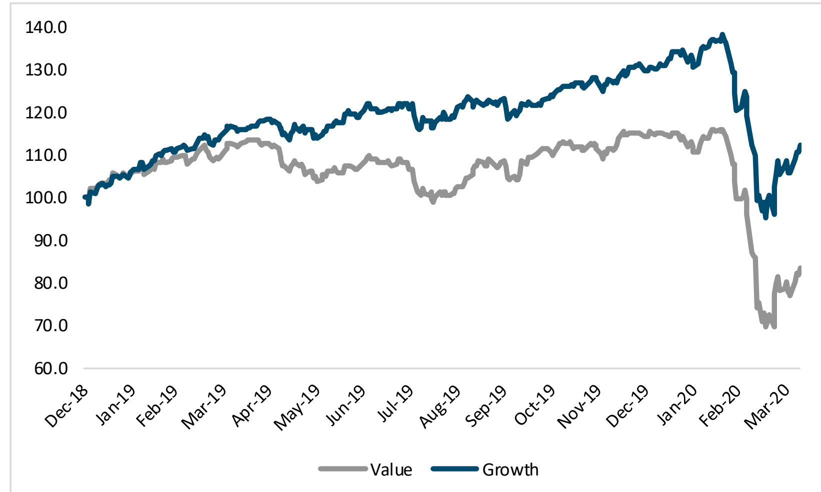
Performance overview by style - EU

Defensive and cyclical (rebased to 100 on 31/12/2018)



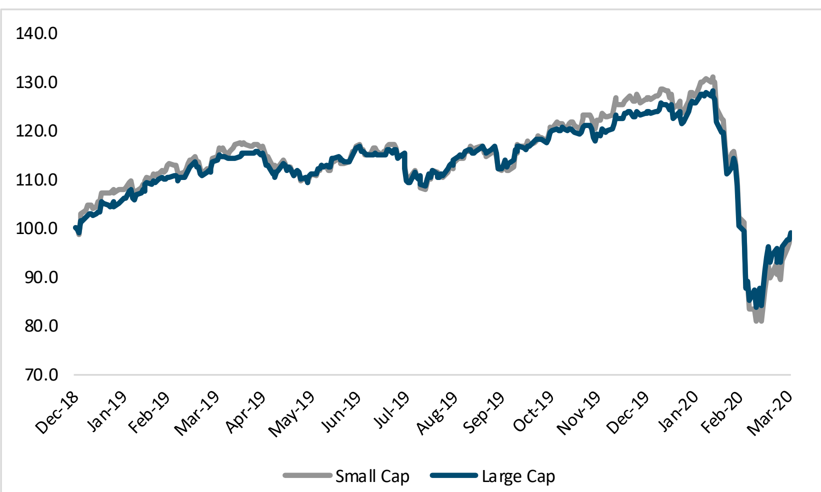
Source: Bloomberg

Value and growth (rebased to 100 on 31/12/2018)



Source: Bloomberg

Small Cap vs Large Cap (rebased to 100 on 31/12/2018)



Source: Bloomberg

Price performance by style index

	1 mth	3 mths	LTM	YTD
Small vs Large				
Small Cap	-2.8%	-21.6%	-11.6%	-21.2%
Large Cap	-1.2%	-19.7%	-10.3%	-18.8%
Cyclicals vs Defensives				
Cyclicals	-3.9%	-15.9%	-7.8%	-15.6%
Defensives	-4.6%	-26.0%	-18.6%	-25.4%
Growth vs Value				
Growth	0.2%	-14.1%	-0.9%	-13.1%
Value	-3.9%	-27.1%	-22.0%	-26.4%
US vs Europe				
S&P 500 (EUR)	6.7%	-13.1%	1.9%	-10.8%
STOXX 600	-1.9%	-20.3%	-11.0%	-19.6%

Source: Bloomberg

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Performance overview by sector - EU

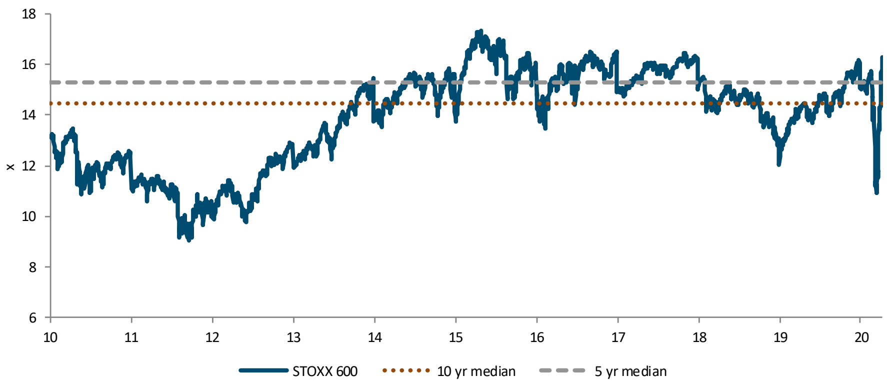
	Strategy	FY19	1 mth	3 mths	LTM	YTD	01/01 to 14/02	14/02 to 20/03	24/03 to 09/04
Chemicals	Cyclical	32.5%	4.7%	-14.0%	-3.8%	-15.0%	2.6%	-29.5%	9.4%
Basic Resources	Cyclical	24.2%	7.3%	-23.4%	-27.5%	-24.4%	-3.9%	-40.4%	12.8%
Construction & Materials	Cyclical	40.9%	-5.0%	-21.9%	-8.3%	-22.1%	2.6%	-39.2%	13.3%
Industrial Goods & Services	Cyclical	35.9%	-6.6%	-26.2%	-13.7%	-25.4%	2.6%	-41.1%	11.4%
Automobiles & Parts	Cyclical	21.1%	-3.3%	-33.2%	-29.6%	-32.2%	-6.7%	-42.4%	8.4%
Food & Beverage	Defensive	29.0%	0.1%	-15.4%	-8.0%	-15.2%	2.2%	-27.3%	9.6%
Personal & Household Goods	Defensive	31.0%	-0.1%	-14.6%	-3.1%	-12.9%	3.6%	-29.0%	10.0%
Health Care	Defensive	32.1%	3.3%	-7.0%	10.2%	-5.6%	7.0%	-24.5%	10.5%
Retail	Cyclical	37.6%	0.5%	-14.9%	-3.3%	-15.1%	1.7%	-29.7%	9.6%
Media	Cyclical	20.2%	-3.1%	-23.2%	-15.2%	-23.1%	1.0%	-39.3%	16.1%
Travel & Leisure	Cyclical	23.2%	-9.9%	-35.0%	-25.5%	-35.3%	0.9%	-53.7%	22.9%
Telecommunications	Defensive	5.1%	-3.0%	-17.9%	-14.7%	-16.7%	5.3%	-27.5%	2.8%
Utilities	Defensive	30.9%	-10.7%	-11.0%	3.9%	-11.3%	16.7%	-33.0%	5.8%
Banks	Cyclical	14.3%	-11.8%	-38.2%	-35.8%	-37.5%	2.1%	-43.4%	-1.9%
Insurance	Cyclical	30.8%	-6.0%	-27.6%	-17.7%	-27.0%	5.4%	-45.7%	10.6%
Real Estate	Defensive	27.7%	-11.7%	-20.2%	-9.3%	-20.6%	6.4%	-37.8%	9.0%
Financial Services	Cyclical	43.6%	-4.5%	-19.5%	0.5%	-18.9%	7.9%	-42.0%	13.8%
Technology	Cyclical	37.1%	5.1%	-14.4%	1.9%	-11.5%	7.0%	-33.0%	10.8%
STOXX 600 Index		***27.7%***	***-1.9%***	***-20.3%***	***-11.0%***	***-19.6%***	***3.7%***	***-35.1%***	***9.4%***

Source: Bloomberg

Returns above are price return

Valuation – EU/UK

Forward PE - EU



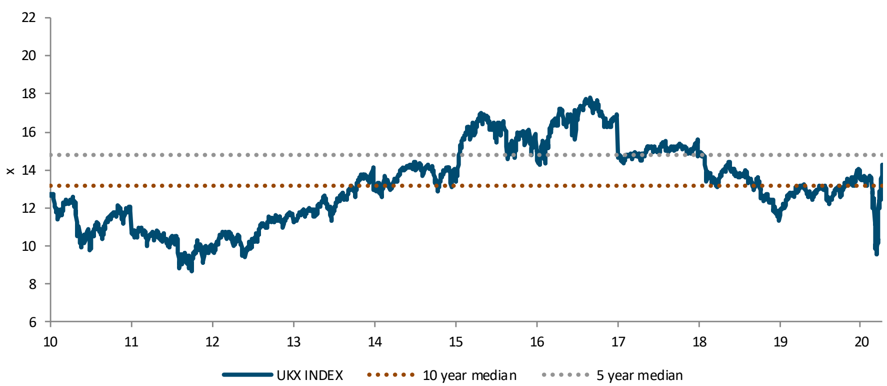
Source: Bloomberg

Valuation table

Historical Data	SXXP	SX5E	DAX	CAC
Current Forward PE ratio (FPE)	16.3x	15.5x	15.4x	17.0x
Forward PE ratio (Jan 20)	15.3x	14.7x	14.6x	15.0x
10 Year data				
Highest	17.3x	16.6x	15.9x	17.2x
Highest (date)	27/04/2015	13/04/2015	10/04/2015	27/04/2015
Lowest	9.0x	7.4x	7.8x	8.0x
Lowest (date)	22/09/2011	12/09/2011	12/09/2011	22/09/2011
Median	14.5x	13.5x	12.9x	14.2x
95th percentile	16.3x	15.5x	14.7x	16.1x
5th percentile	10.4x	9.1x	9.7x	9.5x
Historical rank (since 2006)				
Percentile	94.2%	96.1%	95.9%	99.7%
Current FPE, % above/ (below) median	12.5%	14.2%	19.7%	19.7%
Current FPE, % above/ (below) Jan 20	6.1%	5.5%	6.0%	13.4%

Source: Bloomberg

Forward PE - UK



Source: Bloomberg

Valuation table

Historical Data	FTSE100	FTSE250	FTSE350
Current Forward PE ratio (FPE)	14.3x	13.8x	14.2x
Forward PE ratio (Jan 20)	13.6x	15.1x	13.8x
10 Year data			
Highest	17.8x	17.8x	17.6x
Highest (date)	02/09/2016	07/12/2015	02/09/2016
Lowest	8.7x	10.2x	8.8x
Lowest (date)	04/10/2011	08/08/2011	04/10/2011
Median	13.2x	14.6x	13.4x
95th percentile	16.7x	16.6x	16.7x
5th percentile	9.9x	11.3x	10.1x
Historical rank (since 2006)			
Percentile	76.2%	52.9%	72.8%
Current FPE, % above/ (below) median	8.5%	-5.3%	6.0%
Current FPE, % above/ (below) Jan 20	4.6%	-8.5%	2.7%

Source: Bloomberg

Country/Region Overview – Emerging markets

Emerging markets ("EM") have lost circa 20% on a YTD basis. EM equities had a strong run during 4Q19 and in the first weeks of 2020, but then sold off sharply in line with global equities. Within EM, Latin America was the hardest hit region, with the MSCI Emerging markets Latin America down 41.6% YTD (in USD terms). On the other hand, the MSCI China, the best performing region within EM, was down 7.9% by 09/04 (in USD terms).

The price action in the oil market is a clear negative for oil exporting countries. COVID-19 and its impact on demand for oil exacerbated the disagreement between Saudi Arabia and Russia, that eventually led to a price war in 1Q20. The price of crude oil has dropped below $20 a barrel, and while this is good news for oil importers in EM (India, Indonesia, the Philippines, South Korea, Turkey and Central and Eastern Europe) , it is clearly bad news for oil exporters in the Middle East, Latin America and Malaysia (Colombia, South Africa, Brazil, Mexico, Russia, Chile etc)

The direct impact from virus diverged in EM countries. By the end of 1Q20, several countries in Asia were showing signs of recovery. South Korea handled the virus effectively leading to a much lower spread rate compared to other countries. China announced complete lockdown at the end of January, lifting these measures in April.

China is expected to return to growth in 2Q20. The Chinese economy contracted 6.9% in 1Q20, the largest decline since 1967. Whilst this is obviously negative, data published late in March showed that the economy was starting to show signs of recovery. China's manufacturing (manufacturing PMI reading at 52) and consumer spending have improved, but other indicators like retail sales, the property sector and discretionary spend remain weak. Even as the Chinese economy returns to normality and factories restart production, there is the risk that demand for Chinese goods may remain weak as countries remain focused on fighting COVID-19.

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India took a strong stance to fight COVID-19 with all citizens urged to stay at home. However, the country's high debt levels left little room for any meaningful fiscal stimulus. On the positive side India is a net oil importer and should benefit from the low oil price, possibly providing some room for interest rate cuts. Non-performing loans ("NPL") could prove to be a problem in the near term.

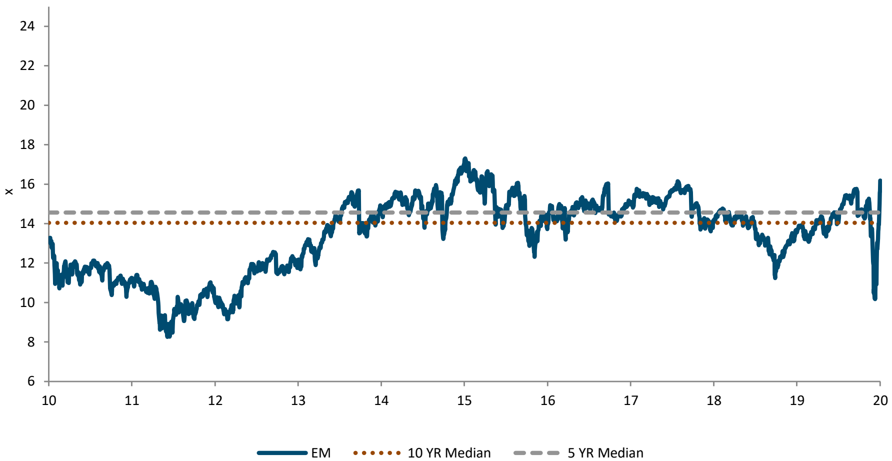
Latin America has been hit hard due to its dependence on global growth and commodities. Brazil has been one of the hardest hit, with the interest rate cut to an all time low of 3.75% in March despite extreme weakness in the currency. The BRL is down circa 26.7% YTD (against the US Dollar) and a swap line has been established with the FED in order to avoid stress in US$ funding markets. The central bank has also engaged in an asset purchase program, covering payroll costs of SME's for two months and suspension of debts owed to the federal government.

Tensions over trade talks could be back on the agenda. COVID-19 has highlighted a supply chain issue, as most of the World relies on China for many items. This could lead to US/China trade talks to be complicated in the near term. We could see other countries revisiting their reliance on China over the coming months. This is clearly a risk for the Chinese economy.

The outlook for EM is less clear in the near term with COVID-19 impact made worse by the weakness in the oil price. We prefer stocks with a strong balance sheet that generate significant cash flows, similar to our strategy in developed economies. We have Alibaba as a single name pick that is EM focused (include in EM ETF). The high exposure to financials (21.3% in both EEM and Amundi).

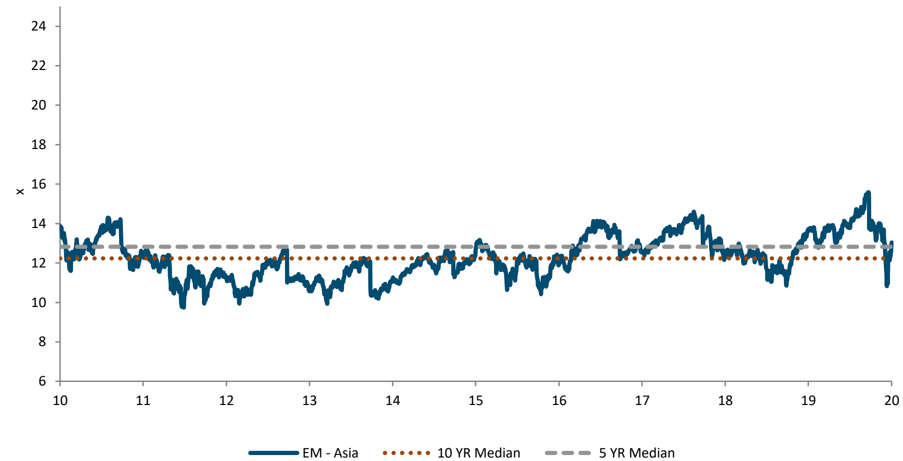
Valuation – Emerging markets

MSCI Emerging Market Index



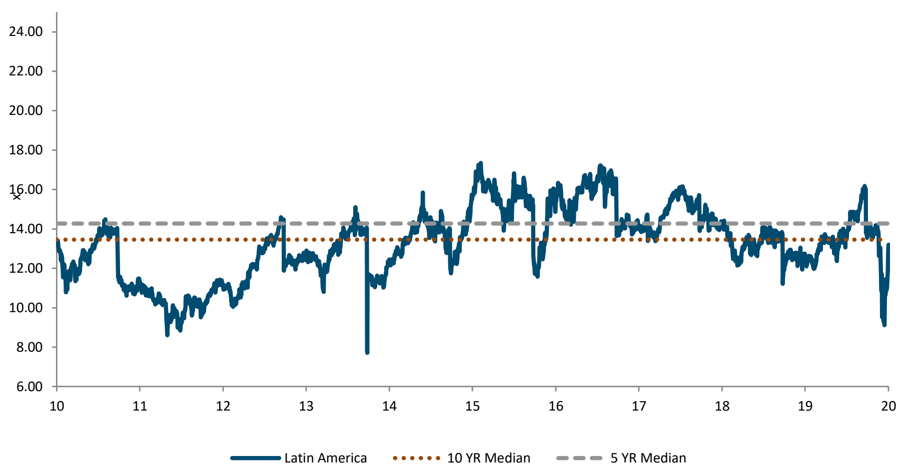
Source: Bloomberg

MSCI Emerging Market Index - Asia



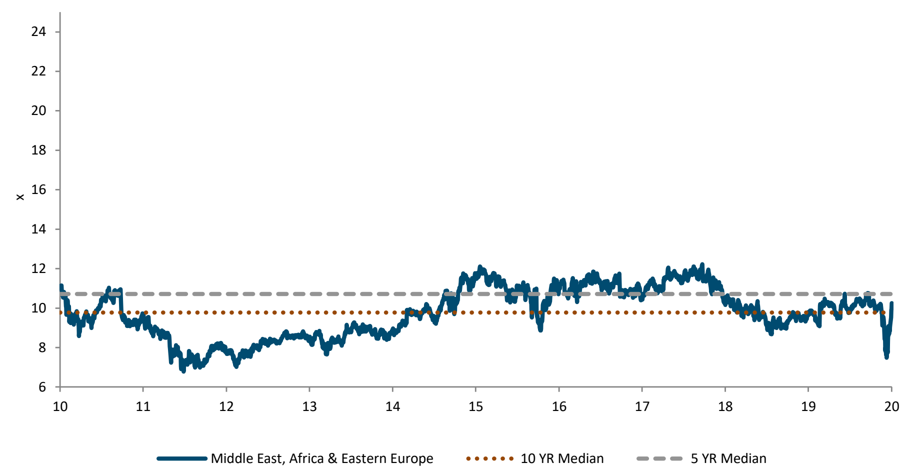
Source: Bloomberg

MSCI Emerging Market Index – Latin America



Source: Bloomberg

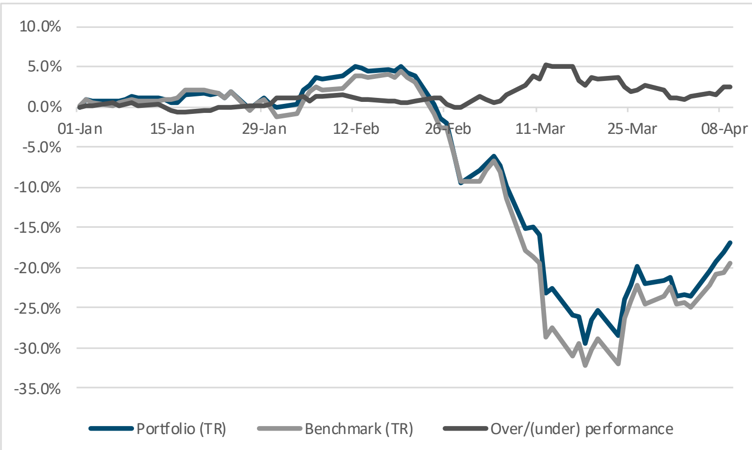
MSCI Emerging Market Index – Middle East, Africa and Eastern Europe



Source: Bloomberg

Portfolio - Performance

Performance – Portfolio vs Benchmark



Source: Bloomberg

Performance by sector – Portfolio vs Benchmark (average weights are being used)

	Weight			Total Return			Contribution to return		
	Port	Bench	+/-	Port	Bench	+/-	Port	Bench	+/-
Food & Beverage	13.0%	7.6%	5.5%	-7.1%	-12.2%	5.1%	-0.6%	-0.8%	0.3%
Technology	11.2%	6.1%	5.1%	-7.2%	-10.9%	3.7%	-0.5%	-0.6%	0.0%
Industrial Goods & Services	9.8%	11.5%	-1.7%	-48.3%	-25.4%	-22.9%	-6.4%	-3.1%	-3.3%
Not Classified	0.0%	0.6%	-0.6%	-5.6%	-0.1%	-5.5%	0.0%	0.0%	0.0%
Insurance	8.8%	5.8%	3.0%	-24.1%	-27.0%	2.9%	-2.3%	-1.7%	-0.7%
Real Estate	7.7%	2.3%	5.4%	-33.0%	-20.7%	-12.3%	-3.6%	-0.5%	-3.1%
Personal & Household Goods	7.1%	8.5%	-1.4%	-14.9%	-13.0%	-2.0%	-1.3%	-1.0%	-0.3%
Travel & Leisure	7.0%	1.3%	5.7%	-5.0%	-35.4%	30.4%	-0.5%	-0.5%	0.0%
Health Care	20.4%	15.3%	5.0%	-12.3%	-5.4%	-6.9%	-0.6%	-0.7%	0.1%
Banks	4.1%	9.0%	-4.9%	-48.4%	-37.5%	-10.8%	-2.5%	-3.7%	1.2%
Retail	8.8%	3.0%	5.8%	-1.3%	-15.1%	13.8%	-0.2%	-0.4%	0.2%
Financial Services	0.6%	2.6%	-2.0%	-11.0%	-18.9%	7.9%	-0.1%	-0.5%	0.5%
Utilities	0.4%	4.6%	-4.2%	-2.5%	-11.4%	8.8%	0.0%	-0.6%	0.6%
Oil & Gas	5.2%	5.3%	0.0%	-39.2%	-31.0%	-8.2%	-1.4%	-1.7%	0.2%
Media	0.3%	1.8%	-1.5%	-13.4%	-23.3%	9.8%	0.0%	-0.5%	0.4%
Telecommunications	0.2%	2.9%	-2.7%	-9.0%	-17.1%	8.1%	0.0%	-0.5%	0.5%
Chemicals	0.2%	4.4%	-4.2%	-16.4%	-14.4%	-2.0%	0.0%	-0.6%	0.6%
Construction & Materials	0.1%	3.0%	-2.9%	-17.1%	-22.0%	4.9%	0.0%	-0.7%	0.7%
Automobiles & Parts	0.1%	2.1%	-2.1%	-34.7%	-32.0%	-2.6%	0.0%	-0.7%	0.7%
Basic Resources	2.7%	2.5%	0.1%	-10.2%	-24.4%	14.2%	-0.5%	-0.6%	0.2%

Source: Bloomberg

The portfolio generated a total return of -16.8% till 09/04/2020 compared to -19.4% for the benchmark. Since 20/03, the portfolio has generated total return of 8.6% vs 9.5% for the benchmark. This underperformance over the past month was primarily due to our underweight position in the asset class during a rally.

Portfolio bottomed on 18/03 with a total return of -29.5% vs -32.2% for the benchmark. Since then the portfolio has generated a total return of 12.6% vs 12.9% for the benchmark.

Airbus and AroundTown the main laggards. As we noted last month, Airbus and AroundTown remain the two primary underperformers as at 09/04. We think the performance of these two stocks is not justified. We have therefore recommended to increase our position in both names (to their original weight) as we expect them to perform well as the number of COVID-19 cases stabilse and economies return to some sort of normality.

Kuerig Dr Pepper, McDonalds and SAP the best performers during April. US stocks have performed well in April, in line with the policy response adopted by the FED. SAP pre-reported numbers 1Q20 numbers and were taken well by the market. The stock's investment case was built around its shift from a licence business model to a subscription business model. We had argued that this should make the Company more resilient during a downturn. In fact, despite a c.30% fall in licence revenue, cloud and other revenue continued to grow.

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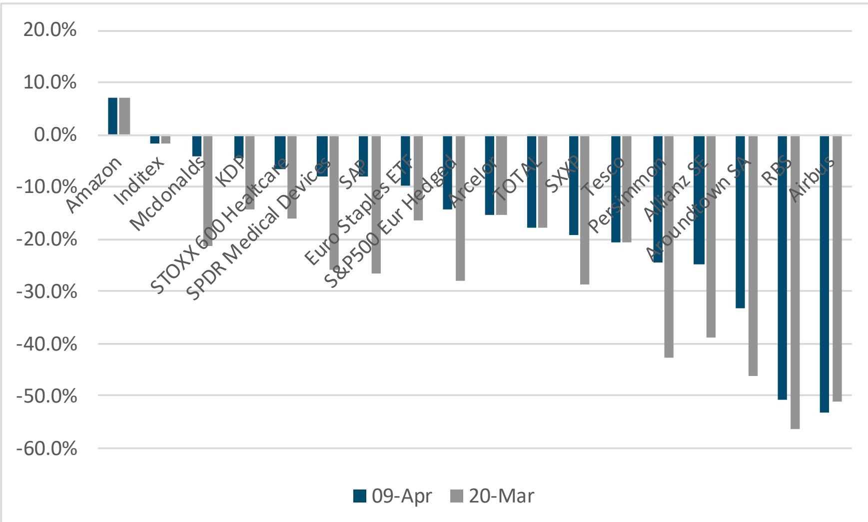
Portfolio - Performance

Total return on a YTD basis



Source: Bloomberg

Note: *The chart includes TR of positions that have been closed. Performance in such cases has been calculated from the start of the year to the date position was closed as follows:*

28/01/2020 – ITX

26/02/2020 – Total, Arcelor & Amazon

13/03/2020 - Tesco

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Portfolio – Sector exposure

Sector weighting as at 09/04 and our sector view

	Weight			Current	CP	GS EU
	Port	Bench	+/-	Position	View	View
Food & Beverage	17.4%	8.3%	9.2%	OW	OW	OW
Technology	14.8%	6.8%	8.0%	OW	OW	OW
Industrial Goods & Services	7.5%	10.7%	-3.3%	N	N	N
Not Classified	0.0%	0.7%	-0.7%			
Insurance	9.9%	5.2%	4.6%	OW	N	N
Real Estate	7.4%	2.2%	5.2%	OW	OW	N
Personal & Household Goods	8.4%	9.0%	-0.7%	N	N	OW
Travel & Leisure	8.9%	1.2%	7.8%	OW	OW	UW
Health Care	17.6%	17.6%	0.0%	N	N	OW
Banks	3.3%	7.0%	-3.7%	UW	UW	N
Retail	2.3%	3.3%	-1.0%	N	N	N
Financial Services	0.7%	2.5%	-1.8%	N	N	N
Utilities	0.5%	4.5%	-4.1%	UW	UW	N
Oil & Gas	0.3%	4.5%	-4.2%	UW	UW	N
Media	0.4%	1.7%	-1.3%	N	N	N
Telecommunications	0.3%	2.9%	-2.7%	UW	UW	OW
Chemicals	0.2%	4.6%	-4.5%	UW	NV	N
Construction & Materials	0.1%	2.9%	-2.8%	UW	UW	OW
Automobiles & Parts	0.1%	1.9%	-1.8%	UW	UW	UW
Basic Resources	0.1%	2.5%	-2.4%	UW	UW	N

Source: Bloomberg

Our current sector positioning is largely in line with our FY20 equity market outlook. The largest divergence is in the insurance sector (however we had trimmed some Allianz gains in February which is not reflected in the Bloomberg portfolio – The Allianz weighting in the BB portfolio stood at 9.4% at the end of the period).

Our OW in Travel & leisure is mainly due to McDonalds. Airbus is being included in Industrial goods and services. We are comfortable with both exposures at these levels.

GS have an OW on construction & materials and telecommunications. We think telecoms have structural problems including low growth prospects, intense competition and significant capex needs which hits FCF (low rates help). As for construction, we expect this sector to do well in times of expansion or if Governments announce large infrastructure projects. We think that the recent COVID-19 related stimulus makes infrastructure investments less likely as countries budgets (and imposed targets) are under pressure.

As the equity markets normalise we will look to increase exposure to Technology and other growth sectors. This will be covered later on, but the low growth low inflation environment could be set to persist for longer. Sectors like technology and luxury goods have performed relatively well in this environment.

Review of COVID-19 indicators

Percentile rank for COVID-19 indicators

	20/03	Percentile rank	09/04	Percentile rank
Yield Spread	53.0	20.1%	49.2	19.4%
Volatility (1 month chg)	359.2	99.9%	-11.9	26.5%
Financial conditions (1 month chg)	308.3	100.0%	34.1	90.4%
USD strength	1292.5	100.0%	1247.5	97.3%

Source: Bloomberg

Indicators we follow are now more favourable for the equity market. Last month we highlighted a number of indicators we were following to asses investor sentiment. We looked specifically at the yield curve, volatility, financial conditions and the strength of the US Dollar.

There has been significant improvement since 20/03 in the indicators we follow. In March, three of the four indicators were at or close to 100%. A lower percentile rank would be positive for the equity market. Since then, all of our indicators except for US Dollar strength are positive.

In this respect, we have increased our exposure to the asset class. We have increased Airbus and AroundTown to our original weighting as we believe current valuations levels are attractive. In addition we have added Amazon, Alibaba and Microsoft to our equity selection.

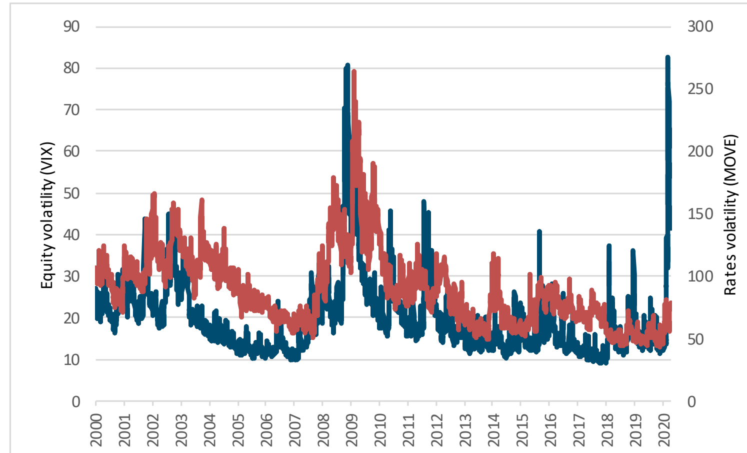
Growth stocks should perform well in the current environment. Unless we get a second peak, or if the economies fail to recover after the action taken by governments and central banks, we think that technology stocks should perform well. We have selected stocks that have a strong balance sheet and a robust business model, while generating sufficient free cash flows.

Review of COVID-19 indicators

US Yield Curve

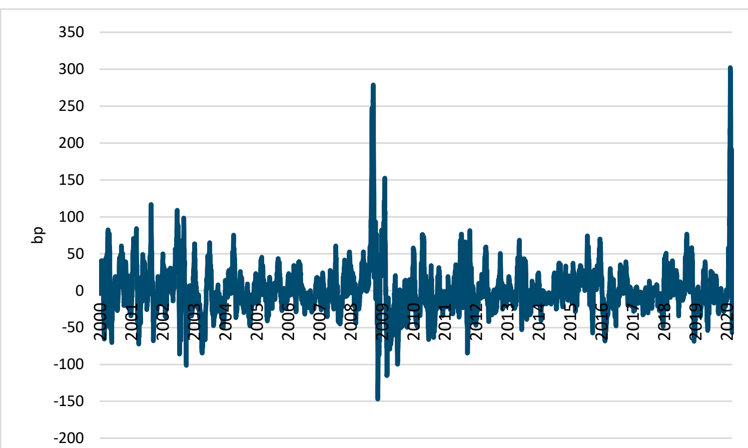
Source: Bloomberg

Volatility



Source: Bloomberg

US Financial conditions



Source: Bloomberg

US$ Basket

Source: Bloomberg

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