Investment Strategy Update

18th June 2020

CURMI & PARTNERS

Curmi & Partners Research

- US economic data suggests weak economic conditions are bottoming out as retail sales and industrial production start to pick up in May.
- Europe and UK are expected to experience a similar path, although at a slower pace, as restrictive measures started to be lifted since mid-May.
- Government sustenance in household income seen to be a key factor in supporting the rebound in spending as economies reopen. However, spike in saving rates may also indicate precautionary consumer behaviour.
- Price pressures are expected to remain weak due to low capacity utilisation and weak demand driving inflation down and keeping inflation expectation below pre-crisis levels.
- Labour market conditions continue to deteriorate as major economies see a continued decline in employment with wage growth becoming increasingly dependent on government support.
- The notable market rally since late-March is seen to be losing steam partly due to a greater realisation of the economic fallout from the crisis as well as the recent increase in infection rates raising concerns of a second virus wave.
- The ECB decision to increase its quantitative easing programme has continued to support bond markets further underpinning the re-convergence in peripheral spreads.
- Sustained monetary policy accommodation by major central banks, combined with early signs of positive cyclical developments, continues to drive the tightening in credit spreads with high yield bonds outperforming investment grade bonds.
- Challenging business conditions, pressure on cash flows and liquidity remain prime concerns for investors as defaults and rating downgrades are expected to persist.
- Clarity around the financial impact on businesses is expected to improve with the release of second quarter results, potentially providing a better environment to identify opportunities and increase credit risk on a selective basis.
- The second leg in the equity market rally since mid-May was driven by a strong rotation into cyclical and value stocks despite the downbeat macro-economic back-drop.
- Fears of a second wave has dented the value rotation leading to a sell-off in equity markets in June suggesting little appreciation of the persisting downside risk factors by the market.
- Our preference for growth stocks, in an environment of low economic growth, as well as quality companies with strong balance sheets and the ability to sustain growth in cashflows remains.

The grand policy response by fiscal and monetary authorities across countries so far seem to have bridged an important gap in supporting economic players throughout the virus shock. Because of such measures, major economic regions are in a relatively good position to experience some form of return to normality when containment measures are starting to be rolled back.

Economic data in May suggests that the worst point may be behind us. Having said that, given the extent of job losses and weak demand, while several sectors remain considerably weak, the road towards recovery is expected to be a challenging one. The possibility of a rise in infection rates as activity picks up is a fundamental threat to the economic recovery.

The strong market performance in risky assets since the sell-off in March shows a high degree of optimism on a successful reopening implying a low probability attributed by market participants to the potential risk of a second wave of infections.

As economies started to reopen since mid-May, we have seen an increase in infection rates in key economic areas leading to a sharp correction in equity markets in June.

We are now at a pivotal point in the story of the crisis which has material implications on the potential direction that financial markets are expected to take. At this stage, the key questions to answer are the following:

- Can the increase in activity be sustained while keeping infection rates within acceptable levels?
- What is the likelihood that an increase in the rate of infections brings about a second round of full-scale lockdown restrictions to the likes we have seen during the first wave or worse?
- What indicators will confirm that the economy has moved into early cycle conditions?

Other geopolitical issues are still present, contributing to increased market uncertainly, mainly: the upcoming US elections, the US/China trade relations as well as Brexit negotiations.

In view of these downside risk factors, a cautious investment approach remains warranted as we are likely to head in other phase of elevated market volatility over the Summer months. Having said that, with greater clarity around the extent of economic damage and the path towards the recovery, while downside risks potentially start to abate, the scope for identifying growth opportunities on a selective basis may become more attractive.

MACRO

United States

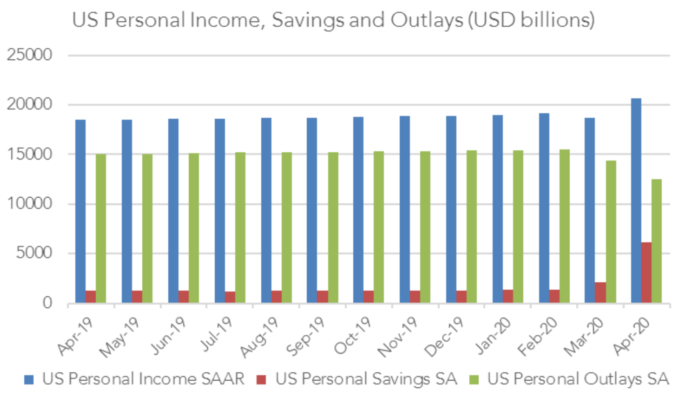
The US economy contracted by 5% in the first quarter, on an annualized basis, as confirmed by the final estimated released at the end of May. This came marginally worse than the advance estimate of -4.8%, breaking the longest streak of quarter-on-quarter expansion in the history of the US economy.

However, looking at more recent soft and hard economic data releases, we are starting to see indications of a slower rate of deterioration in economic conditions and the first signs of a rebound in activity. These indicators suggest that April was the worse month yet for the economy and with the roll-back of lockdown measures starting in May, the economic data published so for May confirms the signs of recovery in parts of the economy.

The additional $600 in weekly unemployment insurance payments by the US government under the CARES act has lead to a sharp increase in household saving. April saw a significant increase in household income, while household outlays declined due to the lockdown restrictions and precautionary savings behaviour by households. As a result, household savings have increased substantially showing a greater capacity for consumer spending to increase post-lockdown. Payments under the CARES act are scheduled to end at the end of July under the current regime. However, an extension is expected to be reached with such spending receiving high bipartisan support at this stage in Congress.

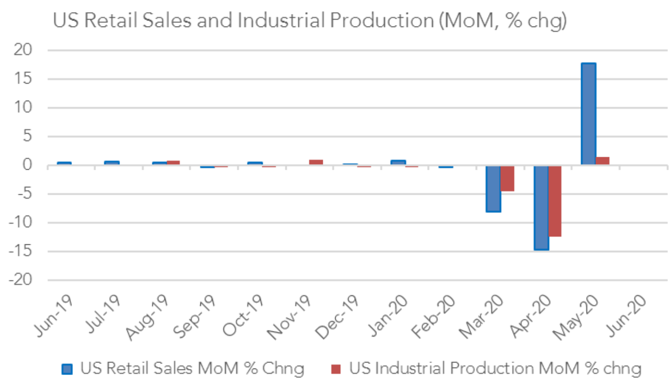
The strong rebound in retail sales and the modest increase in industrial production in the month of May show the first signs of positive cyclical developments in the US with the return in activity generally considered to be faster than expected following the reopening of the economy.

Retail sales jumped by 17.7% in May from the previous month, coming in far stronger than the 8.4% expected increase. The result is mainly attributed to strong increasing in clothing, furniture and leisure goods purchases. Motor vehicle sales increased, gasoline sales rose, bars and restaurants saw modest increases. In Nevertheless, retail sales are still below the pre-crisis levels declining by 6.1% on a year-on-year basis.



Source: Bloomberg

Industrial production also increased by 1.4% in May, on a month-on-month basis, up from the decline of 12.9% in April, with manufacturing output rising by 3.8% following the partial resumption of operations and is expected to gradually continue to climb as more production plants reopen. The positive increase in industrial



Source: Bloomberg

production comes in slightly below expectations of a 2.6% increase but still below the levels achieved in February 2020 by 16.9%.

While GDP output for the second quarter is still expected to show the worst contraction in 2020, the positive spin in activity indicators has generally supported 2020 growth expectations with several market participants revising their Q2 GDP forecasts higher despite the weaker Q1 data. In general, while growth forecasts have been revised downwards for other major economic regions, consensus estimates in June point towards a 5.7% contraction in US GDP output in 2020 which is unchanged from May consensus estimates.

US unemployment rate came in at 13.3% for the month of May, down from 14.7% in April. The surprise jobs report in May showed non-farm payrolls increasing by 2.5 million versus the expectations of 7.4 million losses. While the data came in as a striking positive surprise, the Bureau of Labor Statistics highlighted a number of issues relating to data collection and that the classification of furloughed workers may have overstated the change in payrolls. In any case, the extent of the surprise in the data shows that the state of the labour market may not as poor as feared by market participants.

The more-timely jobless claims data has stabilized suggesting that the hemorrhage in labour markets has subsided. At the same time, the paycheck protection programme may have held small firms from layoff workers.

Unemployment could have reached it peak with the reopening of the economy given the boost in retail sales and production. This would underscore the need for unemployment benefits to be gradually scaled down by Congress given the risk that generous unemployment benefits could hold back the labour market recovery.

The jobs report for June will be crucial in understanding underlying trends in labour conditions and to potentially confirm the inflection point in the labour market.

The updated projections provided by the Federal Reserve ("Fed") at the June Federal Open Market Committee ("FOMC") meeting indicate an unemployment rate of -9.5% in 2020. This is considered to be in line with consensus estimates of –9.4%. However the Fed expects unemployment to improve to just 5.0% in 2022 which is above the pre-crisis level. Fed chairman Jerome Powell in fact stated on various occasions that the crisis could lead to longer lasting damage on labour market.

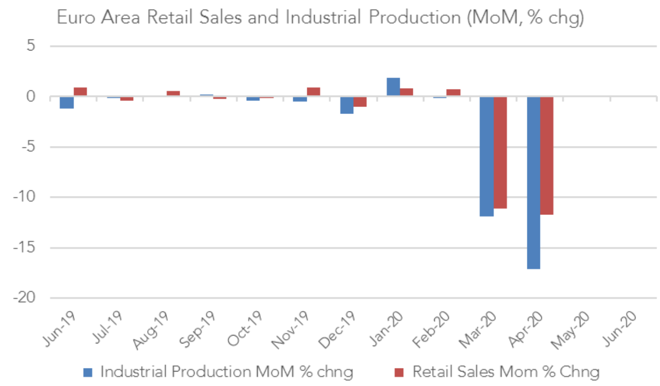
Inflation continues to be weak with CPI Inflation declining to 0.1% in May from 0.3% in April. Core PCE inflation came in at 1.04% in April and is expected to decline to 0.9% in May. The decline in inflation continues to be driven by input prices and prices charged suffering declines with the largest drops still experienced in the hardest-hit sectors.

Despite the surge in activity, the level of demand and capacity utilization remain well below pre-crisis levels. This, combined with the slow recovery expected in labour market conditions, is expected to keep pass-through effects in a weak state resulting in subdued price pressures for the medium term.

As a result, US inflation is expected to remain weak for the time being and is only expected to start to improve once activity, spending and capacity utilisation continue to recover as labour market conditions are gradually repaired. The projections provided by the Fed are in line with this view showing PCE and Core PCE inflation forecasts at 0.8% and 1.0% in 2020 then gradually climbing up to 1.6% and 1.5% in 2021 and 1.7% and 1.7% in 2022 respectively.

Euro Area

The final estimate for Q1 GDP in Europe was revised to –3.8% by Eurostat, from the preliminary release of –3.6% estimate, with France, Italy and Spain seeing the worst contractions across Euro Area member states.

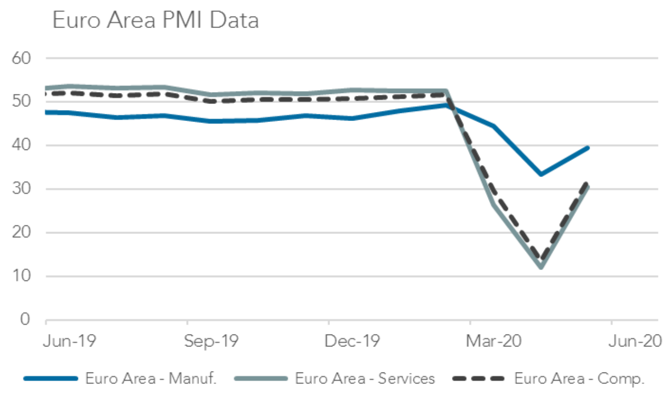


Source: Bloomberg

Industrial production and retail sales data available so far show material declines in the month of April were lockdown measures were in full force for the whole month. Similarly, France, Italy and Spain are seen to be the worst impacted across member states. Having said that, retail sales and production is expected to partly reverse in May and June, similar to what we are seeing in the US and the UK, but the recovery is expected to take a far more gradual pace.

More recent soft data started to improve, but so far only points towards a slower rate of deterioration in business conditions. Manufacturing PMI came in at 39.4 up from 33.4 in April. Despite remaining in contractionary territory, production and new orders declined at a slower pace, export sales continued to fall and job layoffs increased as companies are scaling back capacity due to weak demand.

Services PMI came in higher in May at 30.5 from the record low of 12 in April. The reading points towards contraction as the rate of normalisation in service sectors remains slow given the impact on hotels, restaurants, travel and tourism and consumer-facing firms.



Source: Bloomberg

Given the weak state of activity across the Euro Area, consensus estimates for the Euro Area GDP output growth have been revised down to -8.0% in June from -7.4% in May. The estimate is broadly in line with the updated ECB staff projections provided at the June policy meeting indicating a baseline scenario where GDP output is expected to drop by 8.7% in 2020.

Euro area inflation remained weak in May coming in at 0.1% in line with expectations and down from 0.3% in the previous month. Core inflation on the other hand was unchanged at 0.9% from the previous month. The low inflation data is attributed to the drop in energy prices and the slower increases in food, alcohol and tabacco prices as well as non-energy industrial goods compared to the previous month.

While price levels are expected to be supported over the next quarter as economic activity is expected to gain pace, inflation rates are expected to remain at relatively low levels of below 1% for the medium term. The 5y5y inflation swap rate has stabilized and is currently trading at just around 1% indicating market expectations that the pressure for lower prices is fading. In any case, given the fallout in labour markets and the waning consumer demand, price pressures are expected to remain weak. On the other hand, the inflationary pressures from the supply-side are expected to fade as supply chains and business conditions are expected to start improving with the reopening of economies.

The asymmetric implications on labour markets across member states has been noted in our previous updates resulting in a greater north-south economic divergence. Euro Area unemployment has ticked slightly higher to 7.3% in April from 7.1% in March. Despite the marginal increase in headline unemployment, underlying labour conditions have weakened considerably across European countries. Most notably, youth unemployment has seen the steepest increase from 15.1% in March to 15.8% in April with Spain at 33.2%, Italy at 20.3% and France at 21.8%.

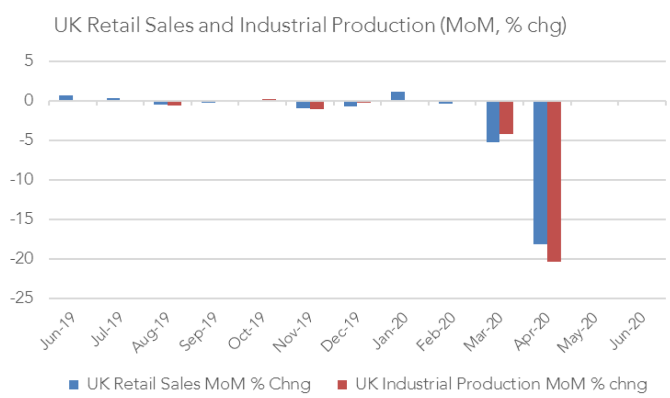
The Italian unemployment rate has actually gone down from 8% in March to 6.3% in April. However this is mainly due to individuals leaving the work force and classified as "inactive". Expectations are that Italy unemployment rate can increase with cyclical improvement due to an increase in individual who become classified as actively looking for which in essence should be viewed as a positive indicator for the worst hit nation in Europe.

Unemployment in the euro area is expected to continue to increase given that job cuts remain underway as firms adjust their productive capacity in view of the weaker outlook for demand. Job insurance schemes launched by governments are due to expire in the next months and, while bankruptcies are expected to continue to increase. Labour market conditions are expected to remain weak with declines in hours worked and wage growth only expected to gain pace at a slow rate given the slow reopening of businesses in the most-effected sectors.

United Kingdom

Following the preliminary release of GDP growth rate in the UK showing a quarter-n-quarter contraction of 2% for the first quarter, the monthly GDP estimate for the month of April shows a contraction of a staggering 20.4% on a month-on-month basis. This is the only official statistic showing the extent of the drop in output during what is considered to be the worst month for 2020 in economic terms across major economies given that lockdown restrictions were in place for the full length of the period.

Downbeat industrial production and retail sales data for the month of April likewise show a sharp declines coming in even worse than market expectations. UK retail sales dropped by 18.1% mainly driven by declines n fuel sales (-52%), clothing and footwear (-50.2%) and house-

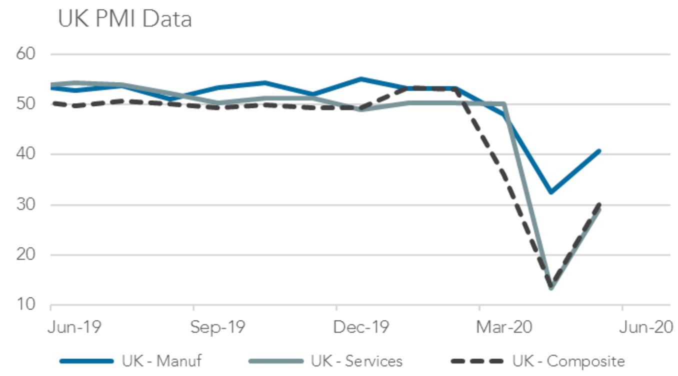


Source: Bloomberg

hold goods (-45.4%). The drop in industrial production was of –20.1% with manufacturing output declining by 24.3% mainly driven by declines in transport equipment.

On the other hand, employment insurance schemes has sustained household income while household saving up until April was at significantly high levels suggesting a high potential for consumers to increase spending when lockdown measures are eased. Similar to what we have seen panning out in the US, this may springboard increases in retail sales and production in the month of May.

Looking at the more recent survey data, UK PMIs similarly suggest that the worsening in business conditions may be bottoming out. Manufacturing PMI remains in contractionary territory but came in at 40.7 in May from the record low of 32.6 in April as output, new orders and export sales declined at a slower rate. Business confidence has improved however despite remaining at low levels compared to historical standard. Services PMI final reading was of 29.0 in May up from the record low of 13.4 in April primarily driven by sharp declines in new business, new export services. Employment continued to decline at a sharp rate while input costs and output charges fell further.



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In line with these developments is a further decline in inflation as it continued to drop in May with headline inflation coming in at 0.5% in may from 0.8% in April, in line with market expectations. The main contributors to the slower increase in price levels were the drop in fuel prices of -16.7% and decline in prices for transport of -1.7%. Housing and utilities also declined by 1.2% while clothing and footwear declined by 3.1%. Decline in inflation was also due to slow increase in cost for recreational and cultural goods, restaurants and hotels.

Conversely prices for food and non-alcoholic drinks continued to increase at a relatively faster pace of 1.8%. Consensus estimates for 2020 inflation declined marginally lower from 1.0 and 0.9% reflecting the weak growth outlook and a decrease in employment and productivity.

Despite the widely reported job cuts, UK unemployment rate in April (released in June) remained at 3.9%, well below market expectations of 4.7%. The government job retention scheme which covers over 9 million jobs is seen as providing major support to sustain the workforce.

Even though headline unemployment seems resilient, underlying indicators show signs of significant deterioration in labour market conditions. Individuals claiming for unemployment benefits continued to increase in May by 528K following the spike of 1,032K in April. These statistics do not include those workers who are receiving government subsidies of 80% of salary. Moreover, Job vacancies declined dramatically from 796K in February to 641K in March and down to 476K in April.

Average weekly earnings show a 0.1% increase on a year-on-year basis in April down from 0.3% in March with declines seen in all sectors: services, wholesale and retail, manufacturing and construction. The concern around the drop in wage growth is that this indicates greater dependence on government subsidies to support salaries with firms struggling to sustain their workforce.

Unemployment rate is expected to start reflecting the weaker trends in labour market underlying data potentially in August when companies need to start contributing to the furloughed workers wages. Various estimates of unemployment forecasts see a potential rise to the range of 8% - 10% unemployment in 2020.

RATES

Euro

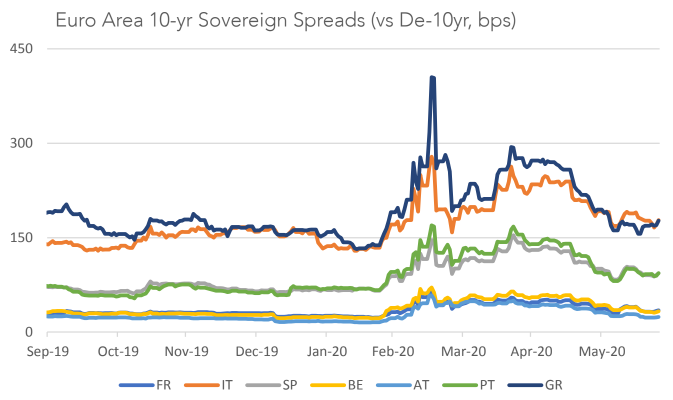
Short term rates in euro continue to trade at very low levels with overnight-indexed swap rates showing market implied forward rates to be anchored at current levels. This reflects the strong forward guidance by the ECB to maintain rates as low as possible and to continue to support financing conditions given the severe economic challenges.

Interbank funding conditions continued to improve with interbank rates recovering from the spike seen in April and short-term spreads continue to tightening as the newly announced long-term refinancing operations and the improved terms on financing referenced to loan generation take effect in the Euro Area.

At its June policy meeting the ECB kept policy rates unchanged. However, as we had notably anticipated in our previous updates, the ECB has finally announced a substantial increase in its quantitative easing programme, namely the Pandemic Emergency Purchase Programme ("PEPP"), by EUR 600 million exceeding market expectations.

The expansion of PEPP is expected to continue to support benchmark bond yields and country spreads in Europe. In fact, 10-year peripheral bond yields have already declined substantially upon the announcement.

The sizeable increase in policy response on the monetary side and the ongoing talks of a joint European recovery fund of EUR 750 billion to repair economic conditions with a focus on the worst hit nations is expected to continue to support sovereign bond yields across the Euro Area.

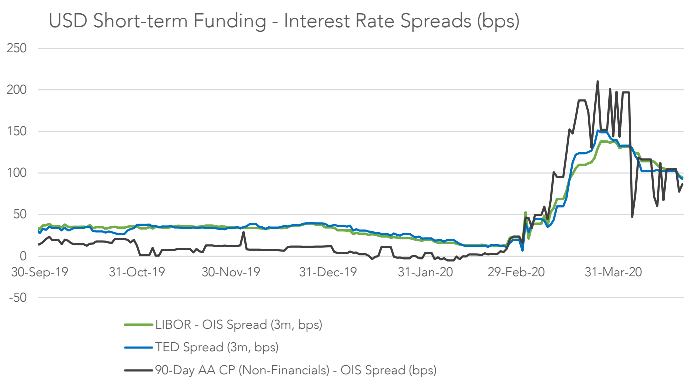


Source: Bloomberg

Moreover, with signs of potential cyclical improvements across European economies, the scope for a reconvergence across sovereign spreads is strengthened as underlying economic conditions start to improve.

US Dollar

Short term funding markets continued to relax as interest rates trade lower and towards policy rate target levels. The actions by the Federal Reserve in improving funding conditions by intervening in repo and T-bill markets is seen to have been both timely and sizeable. The effectiveness of such measures has sustained funding conditions in the US which continue to improve with



Source: Bloomberg

signs of positive cyclical improvements in the economy.

At the June monetary policy meeting the Federal Open Market Committee ("FOMC") have updated their projections showing a strong consensus amongst members that policy rates are expected to remain at current levels up until 2022. This strong forward guidance gives an important underpinning to money markets which, combined with subdued inflation expectations, is expected to maintain downward pressure on long-end treasury yields and sustain flatness in the treasury curve.

At the same time, signs of positive cyclical developments in the US, such as a rebound in labour market conditions and a strong return in consumer spending, can quickly lead to volatility in the 10-year Treasury yields as the probability of faster normalization rate increases compared to market expectations.

Sterling

While the debate around the introduction of negative rates gained further traction with the Bank of England ("BOE") Governor stating that negative rates are "under active review", it has once again decided against reducing rates further and kept the bank rate at 0.10% at its policy meeting in June.

GBP short-term rates have likewise continued to trade lower as the negative effects of the virus are seen to be reducing as the rate of contagion slowed significantly and the economy is reopening while the BOE remained active in maintaining an easing stance throughout thus reducing tension in short-term financing,

However, as broadly anticipated by the market the BOE has announced an increase in its quantitative easing programme of an additional GBP 100 million bringing the total target size of purchases to GBP 745 million.

Gilt yields have been trading lower in anticipation of such an announcement. Despite the increase in fiscal initiatives which have pushed the debt-to-GDP level for the UK to above 100% from circa 85% pre-crisis, UK government bonds are expected to remain supported given the ultra accommodative monetary stance of the BOE with yields expected to remain rangebound at the current low levels.

CREDIT

As the recent economic data releases strengthen the likelihood that we have moved past the worst point of the crisis while central banks continue to display an elevated level of commitment to sustain financing conditions and the provision of credit to the economy, the recovery in bond markets has maintained its momentum with spreads across corporate credit continuing to tighten with high yield ("HY") markets experiencing higher returns.

Within USD investment grade ("IG") corporate debt, BBB-rated securities were the best performers since our last update as spreads tightened by 64bps compared to 35bps, 21 bps and 6bps for A-, AA- and AAA-rated securities. Within high yield markets, spreads compressed by circa 145bps. The CCC space saw the strongest recovery with spreads decreasing by 264 bps compared to 143 bps and 91 bps for single B- and BB-rated debt.

The strongest recovery was seen in the Energy segment as the industry saw an improvement following the stabilisation in the oil price and slow but positive cyclical developments.

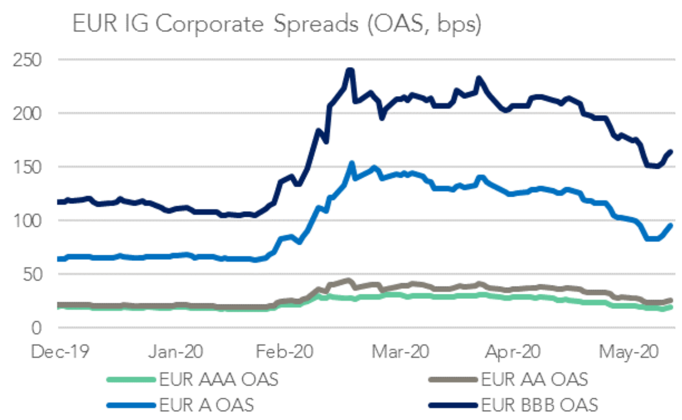
Similarly, in EUR corporate bond markets, BBB-rated bond spreads have tighten by 50 bps compared to 33bps, 11bps and 6 bps for A-, AA- and AAA-rated debt. Within the high-yield segment, CCC spreads compressed the most with spreads tightening by 368 bps while B- and BB-rated debt saw spreads compressing by 193 bps and 100 bps respectively.

Transportation and consumer cyclical industries saw the strongest recovery in spreads after stabilising at relatively wide levels following the sharp market sell-off in March.

The positive sentiment seen within capital markets during the month of April resumed in May as issuers continued to issue debt in order to improve their liquidity position in view of the weak economic conditions. Overall, the total capital raised in high yield markets increased in May compared to April while new deals in the investment grade space remained robust;

While market sentiment remains positive, corporate fundamentals are still expected to be challenging in view of the fragile business conditions. However, at this stage it could be argued that visibility on the impact on issuers' financial profiles has been improving particularly due to the access to capital markets during this unprecedented period as well as the improving financing conditions and monetary support by central banks.

Investor focus is now likely to shift to second quarter financial results to obtain clarity on the extent of the impact on financial performance of companies as well as forward looking guidance provided by management on their business outlook.



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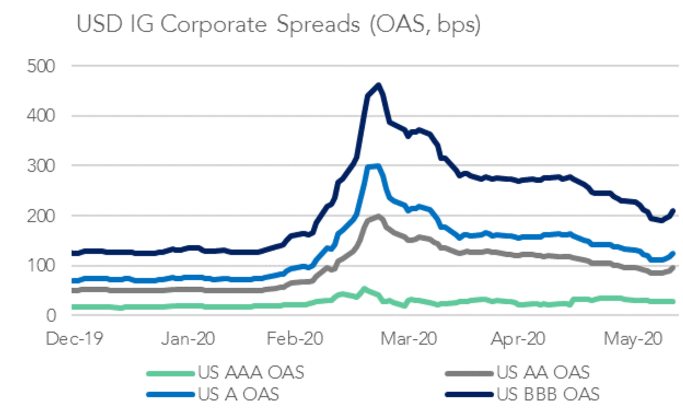

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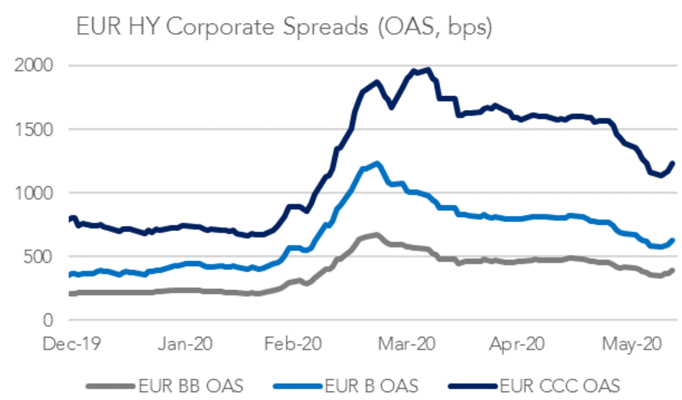

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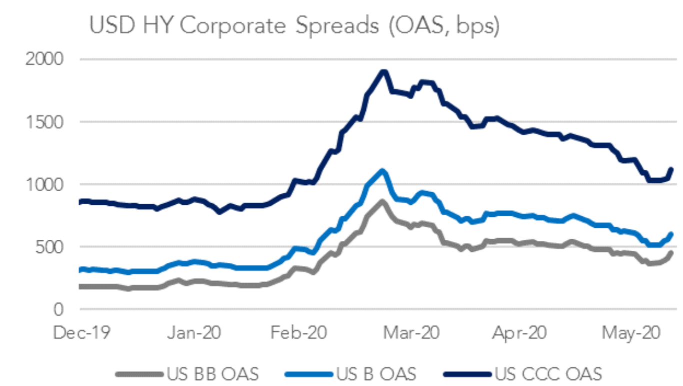

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In line with recent months, aspects such as cash balances, liquidity, and access to funding remain a prime concern for investors, on an individual issuer basis. Moreover, it should be noted that the outlook for defaults or quasi-defaults, and the overall deterioration in the ratings scenario, are expected to persist.

In view of the changes in underlying market conditions, we are moderating the relative preference for the IG credit space versus HY which we expressed in earlier updates. We view the current environment to provide us with improved conditions to proactively and selectively seek opportunities in the high yield space.

Both in IG and HY, our pronounced preferences across sectors remain unchanged. We continue to prefer avoiding cyclical sectors, particularly industries where the rate of normalisation is expected to be slow, even though in recent weeks this view would have led to losing out on potential upside during the recent rally.

We consider key risk factors that may challenge our outlook to be:

- Deterioration in virus trends leading to a second round of broad-based lockdowns;
- Economic recovery pans out at a slower pace than currently anticipated by market participants;
- Sharp steepening in benchmark curves, possibly triggered by an accelerated turnaround;
- Geopolitical risk events, such as disruptions from the US election.

EQUITY

The recovery we have witnessed in equity prices since late March has been extraordinary. The fact that the global economy was closed for an extended period was largely ignored by investors. Sentiment picked up as swiftly as central banks and governments reacted with a number of policy actions. The virus seemed like old news as equity prices continued to rally in May, with the US S&P 500 (“SPX”) briefly turning positive for the year on the 5th of June.

Investor confidence in the global economic prospects was highlighted by the rotation into value sectors. The rally up till mid-May was mainly driven by technology and other high growth stocks, as Investors tend to look for high growth stocks in a world where (economic) growth is scare. This started to change around mid-May, as sectors that had underperformed, like banks, insurance, autos and energy, started to pick up steam. Travel stocks benefited from talks of easing restrictions, with air travel expected to restart in July. Cyclical and value strategies were outperforming defensive and growth.

In our view, for a rotation into value stocks to persist, the macro-economic backdrop needs to remain supportive. We would need to see a significant improvement in macro data, a steeper yield curve and higher inflation expectations. Since the global financial crisis (“GFC”) we have witnessed a rotation into value on several occasions which has on average lasted for roughly 4 months. We have not seen a persistent rotation in value for many years as global economic dynamics have not been supportive.

More recently, the fears of a second wave of contagion has led to another sharp sell-off in June. An uptick in new confirmed cases registered across 22 states in the US has worried investors. The SPX lost 6% on 11th June, and is now circa 11% below the February highs. The impact of a second wave on the global economy would be massive, with central banks and governments having less space to announce additional supportive measures. Dr. Fauci told CNN that an increase in new confirmed cases in certain states does not automatically imply a second wave. “When you start to see increases in hospitalisation, that’s a surefire situation that you’ve got to pay close attention to,” Fauci added.

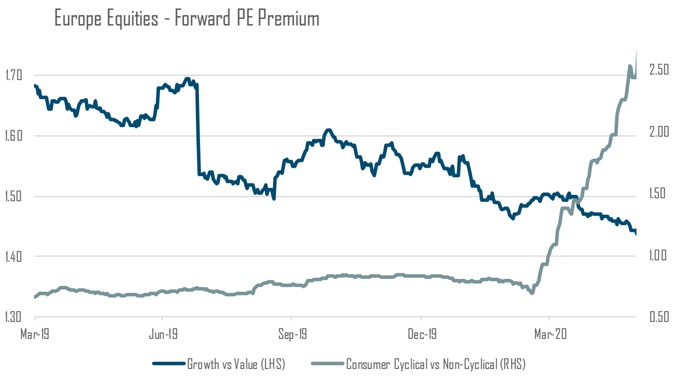
The increasing concern over a second wave brought the value rotation to a grinding halt. Value stocks are by nature more vulnerable to the economic outlook. Despite the rally in value stocks, growth stocks are trading on a higher valuation premium (39.1%) compared to the 5-year median (31.3%) and 10 year median (23.6%). Our preference for growth stocks remains unchanged as conditions remain supportive. We have added some exposure to value and cyclical names during May and early June, focusing on stocks that have the ability to grow their cash flows in the near term like renewables and luxury stocks. We remain relatively bearish on other value sectors like banks, telecoms , basic resources and construction.

Goldman Sachs say that retail activity has surged so far this year as data from the Robinhood platform shows a tripling in activity as the market declined. This surge in retail activity could have strengthened the rotation into value. The five most popular stocks on the Robinhood platform during May were (in order of preference): (1) Ford (2) General electric (3) Disney (4) American Airlines and (5) Delta Airlines. All stocks that have been hit badly by the virus-induced sell-off and which mostly fall under the value strategy. They were also the main laggards during the 11th June sell-off.

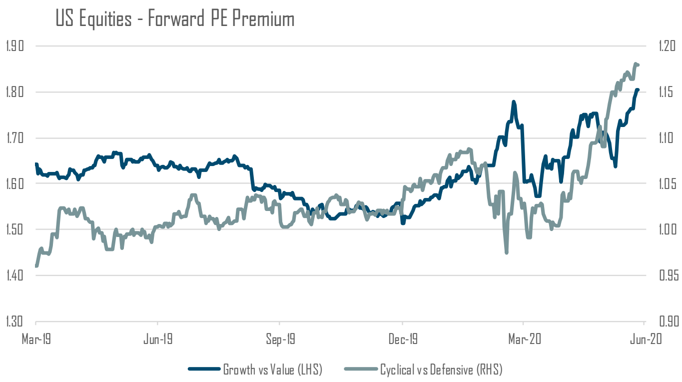
Nevertheless, equity valuations are at an all-time high against a backdrop of uncertainty. All regions we follow are trading on very high PE ratios relative to history. The low risk free rate is one argument in favour of higher equity valuations, as well as the investor's search for yield. Whilst this is a fair argument, there is no room for disappointment for such valuations to remain supported. Equity valuations (before the June sell-off) were pricing in a lot of the good news and optimism around the economic recovery, but probably not enough of the persisting downside risks. Fear of a second virus wave has started to change that to a certain extent.

In our view, at current levels, valuations leave little room for further upside. Despite the positive sentiment, a number of risks remain. We continue to recommend an underweight allocation to the asset class in view of these downside risks, namely:

- Second wave of contagion leading to another phase of lockdowns;
- Worsening US/China trade relations;
- Disruption from the US Election;
- Brexit risks.



Source: Bloomberg, Curmi & Partners



Source: Bloomberg, Curmi & Partners

ASSET CLASS VIEW AND POSITIONING

Asset Class	View	Allocation	Positioning
Sovereign Bonds	Stable	N	Benchmark bond yields continue to benefit from strong central bank support and forward guidance. This is seen to more than compensate for the determination of governments to increase public to intervene with substantially supportive fiscal measures. Given the increase in monetary support as well as the ongoing plans to launch a pan-European recovery funds, peripheral spreads remain well supported. However, given the strong performance over recent weeks, the possibility of further upside is limited in the near term. In addition to maintaining sovereign bond exposure as a hedge against risky assets in a multi-asset portfolio, improved positioning may also offer potential tactical opportunities.
Investment Grade Corporate Bonds	Positive to Neutral	O/W	Investment grade bonds remain attractive on a relative basis given the spread differentials to historic levels, but at a lower level of conviction. Strong central bank is likewise expected to continue to sustain the compression in spreads which underpins the benefits of maintaining a long duration exposure within this space, particularly in view of the low interest rates and low inflation outlook. The risk of downgrades remains prevalent and requires close monitoring in view of the challenging business conditions and general sentiment in credit markets.
High Yield Corporate Bonds	Negative to Neutral	N	The full long-term impact on the virus is still play out, and the damage dealt to weaker credit profiles is yet to become clearer possibly with the release of the second quarter financial results. High yield markets have rallied considerably from the mid-March lows. Having said that, improved market conditions may provide scope to pro-actively seek opportunities on a selective basis. The scope to remain selective in carrying high yield positions remains while the scope to opportunistically identify unjustifiably discounted bonds is starting to emerge.
Emerging Markets Corporate Bonds	Neutral	N	Confidence to add exposure in emerging market corporate bonds is starting to increase given signs of stabilisation and the reopening of the global economy. This should improve return prospects from emerging market bonds particularly given that US yields continue to trade at relatively low levels while the EM bond market has not yet recovered to the same extent as other bond markets. While our selection remains tilted towards more conservative financial profiles, the scope to continue to de-risk specific positions may be considered on an individual name basis.
Equities	Negative	U/W	Our defensive stance in equities due the widening dislocation in valuations against the deteriorating company fundamentals and a challenging economic outlook offered some protection against the recent sell-off in equity markets as fears of a second wave are increasing. We prefer to retain an overall underweight allocation in equities combined with an overarching factor tilt towards quality stocks and growth stocks. However, we have adjusted our positioning to include exposure to renewable energy as well as luxury goods in selected stocks given the strong ability of companies to grow cash flows and retain a strong balance sheet position. In terms of sector positioning, we prefer to remain underweight cyclical industries and retain our core positions in staples, healthcare and technology. At the same time, we remain on the look for potentially attractive opportunities in severely discounted cyclical equities that stand to benefit from the slow improvement in conditions brought about by the relaxation of containment measures.

N = Neutral *O/W = Overweight* *U/W = Underweight*

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