# Investment Strategy Update

25th August 2020

CURMI & PARTNERS

Curmi & Partners Research

- Q2 GDP data published in August shows the sharp contractions in output across advanced economies which were primarily driven by a sharp decline in consumption.
- Economic data and survey-based indices from May onwards point towards a strong rebound in activity with expectations shaping up for a strong quarter-on-quarter expansion in output in Q3.
- The surge in cases in the US seems to be brought under control with relatively low-cost measures which has abated concerns on the sustainability of the recovery and worries on the reimposition of large-scale lockdown measures.
- The reopening of economies in Europe also brought about a rise in cases, but the increased level of testing has allowed authorities to adjust restrictions as needed in order to curb the contagion.
- Whilst economic data has been generally positive, the reimposition of containment measures remains the main drag for the rebound in economic activity. At this stage, the risk of a double-dip recession remains unlikely.
- Inflation data for July has shown an uptick in price levels as deflationary forces declined with the reopening of economies.
- The string of improving data and positive headlines on the development of a vaccine has sustained investor sentiment and brought about episodes of reflationary market movements.
- Benchmark bond yields retreated from the lows whilst inflation breakeven rates started inching higher.
- The possibility of a faster rate of recovery has also triggered a rotation in equity markets where value stocks outperformed, whilst the previously favoured growth stocks underperformed.
- We view this reflationary move to be a temporary market correction given the extent of movements which we have seen across markets, specifically the decline in sovereign bond yields and the narrow equity rally driven by growth stocks.
- Moreover, our medium term outlook is characterized by a persistent output gap, weak demand and low employment which is expected to keep inflation rates and growth rates at subdued levels.
- Whilst acknowledging the notable movements in investment grade credit spreads and benchmark bond yields, we still prefer to maintain a long duration position.
- The benign environment for credit and signs of early stage conditions in the economic growth cycle has lead us to increase our allocation to high yield bonds to over weight.
- At the same time, given current equity valuation levels and our macro economic expectations of a low growth and low inflation outlook, we prefer to maintain an underweight allocation to equities with a tilt towards defensive and growth stocks.

The recent surge in virus cases, seen first in the US towards the end of July and then in Europe and the UK in mid-August, seems have had little impact on investor sentiment. Concerns about the surge in cases have been calmed when the rate of new cases started tipping back down in the US with the introduction of relatively low cost, or low impact, measures.

The more recent rise in cases in Europe is viewed as more of a controlled outbreak for a number of reasons. In view of the expected rise in cases as lockdown measures were scaled down, governments and health authorities have sought to substantially increase testing capabilities in order to have more effective and timely readings on the path of the virus. This is allowing authorities to reintroduce targeted restrictions quicker in order to curb the contagion and avoid a full-scale lockdown.

The average age of newly infected individuals has declined indicating that the spread is mostly occurring amongst younger individuals. This in turn has reduced the likelihood of hospitalizations and increased pressure on health care systems.

Economic data started to show signs of improvement,

albeit rebounding from a very low base, indicating that we are past the worst point in terms of economic performance. The Q2 GDP data released in August show dramatic rates of contraction across major economies, as broadly anticipated. The decline in consumer spending was by far the main contributor to this contraction with declines in investment, government spending and trade also contributing negatively to GDP growth, but to a lesser extent.

Having said that, the more recent data on retail sales and now the recovery in industrial production have resulted in a stronger bounce-back than previously expected. The pull-back in survey-based indices also corroborate the relatively quicker rebound in economic activity with data for the severely impacted service sector also pointing towards expansion. All in all, expectations are now pointing towards a strong quarter-on-quarter recovery in Q3.

With positive headlines on the development of a vaccine, markets have also started to price-in a faster return to normality. In fact, in a few instances throughout August we have seen reflationary trends dominating market movements. Particularly with the upward surprise in July inflation data, released in mid-August, we have seen benchmark bond yields climb higher while inflation breakeven rates increased. Equity markets rallied driven by an outperformance in value stocks over growth stocks.

The downbeat Fed minutes published towards the end of August brought about the realisation that the road to recovery will not be a straight line. The reflationary moves were quickly reversed with benchmark bond yields moving back down towards the lows.

Because of one-off factors, we expect headline inflation to stabilise and possibly partially reverse the uptick seen in July. More importantly, over the medium-term we expect the persistent output gap, the weak demand and low employment to be the overriding force that will keep inflation at subdued levels across advanced economies.

On this basis, we prefer to maintain a long duration exposure in investment-grade sovereign and corporate bond markets. The initial signs of an early-stage growth phase in the economic cycle and the loose monetary regime provides a benign environment for credit which underpins our move to shift to overweight in high yield corporate bonds.

Conversely, the megatrends that seem to be developing, or fast-tracked, with the onset of the pandemic, and the prevailing sources of uncertainty that continue to cloud business prospects, push us to remain underweight equities whilst maintaining a tilt towards defensive and growth stocks in our selection.

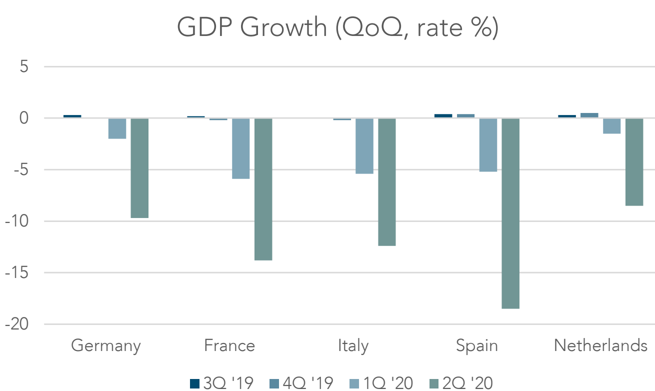
## MACRO

### Europe

The rate of new virus cases has increased across Europe over the last few weeks, most notably in Spain. This has led health authorities to reintroduce restrictions including the closure of night-clubs and bars as well as setting early closure times for restaurants.

However, a number of factors indicate that this is more of a controlled surge in European countries which also seem to be calming concerns on the sharp increase in cases. The average age of new cases has been declining, indicating that contagion is happening mostly amongst the younger generation. Therefore the likelihood of hospitalisation and pressure on health systems is expected to remain low. Secondly, the number of tests have increased substantially, even though positive test rates have increased modestly, allowing authorities to reintroduce gradual containment measures in a more fine-tuned fashion in order to curb the rate of contagion.

Nevertheless, the rise in virus cases and reintroduction of containment measures is still expected to slow down activity but the probability of a double dip recession remains low. Because of this, even though the economic data published for May, June and July have shown a marked rebound in sales and production, we expect the rebound in economic activity to start to fade.




*Source: Bloomberg*

The sharp rate of contraction in GDP for Q2, published in August, was broadly in line with expectations with the Euro Area GDP declining by 12.1% on a quarter-on-quarter basis. Whilst we had noted in previous updates

the economic performance across member states is expected to show a degree of divergence, the divergence was in fact wider than expected - Spain contracted by 18.5%, Portugal by 13.9%, France contracted by 13.8%, Italy by 12.4% and Germany contracted by 10.1%.

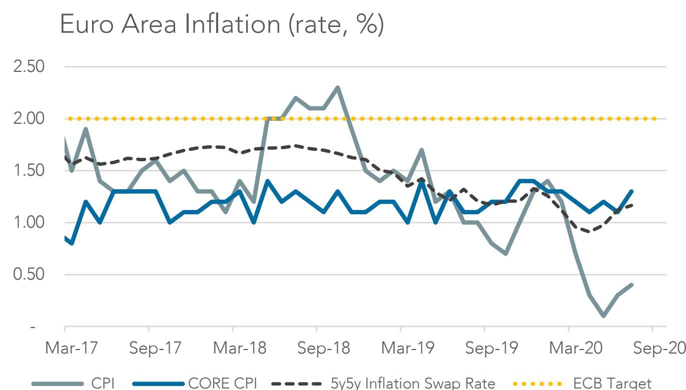
The deep contraction rates across economies was explained mainly by substantial declines in consumer spending and, to a lesser extent, declines in business investment and external trade. Having said that, more recent data shows that activity was on the rise towards the end of the quarter. Data as at June shows that retail sales have reached February levels with some countries even exceeding February levels (Germany and France). The rate of recovery is expected to slow down as activity levels continue to approach "normal" levels. Similarly, August PMI data points towards more modest growth rates now in manufacturing and services sectors with the Euro area composite index declining to 51.6 from 54.9 in July. The deterioration mainly reflects weakness in services. Survey-based indices continue to favour Germany given that the recovery in manufacturing has been relatively solid, as well as France, while Italy and Spain are expected to lag the rebound given the drag from the tourism sectors.

The reintroduction of containment measures will be a direct drag on the pace of recovery in economic activity. However, the risks of nation-wide lockdowns remains unlikely at this stage.

As governments will start to withdraw their support, namely the subsidisations of job retention schemes, whilst the rate of the recovery starts to flatten, we expect the fall-out in unemployment to become more evident.

Even though the headline rate shows that Euro Area unemployment has only increased to 7.8% from 7.2% in February, Q2 unemployment data shows that job losses totaled 4.5m which is almost equivalent to the jobs lost in the 2008 financial crisis. Having said that, when taken in the context of the extent of the decline in economic activity, the drop in employment (so far) has been better than what would normally be implied in a recessionary environment. This is primarily seen to be the result of the general strengthening in employment conditions over the last decade as well as the government job retention schemes. Yet, headline unemployment may possibly reach its peak next year even whilst the economy continues to recover on the basis of (a) fiscal cliff effects and (b) weak business prospects and high uncertainty weighing on business investment.

Looking at price levels, Euro area headline inflation ticked up in July to 0.4% from 0.3% in June (year-on-year). Contributions to the increase were mainly industrial goods (non-energy), whilst energy declined at a slower pace. Services, food, alcohol and tobacco on the other hand increased at a slower rate as price increases on food seem to be normalizing after the shortages during lockdown which drove prices higher. Core inflation increased from 0.8% to 1.2%, primarily driven by the increase in non-energy industrial goods prices.




*Source: Bloomberg*

Looking ahead, inflation is expected to retrace due to the one-off effect of delayed summer sales which pushed inflation rate for clothing and footwear in July. Social distancing and disruption in supply chains may have increased costs but the resulting inflationary effects have been mixed given the weak demand – hair salons prices increased, airfares and accommodation prices plummeted.

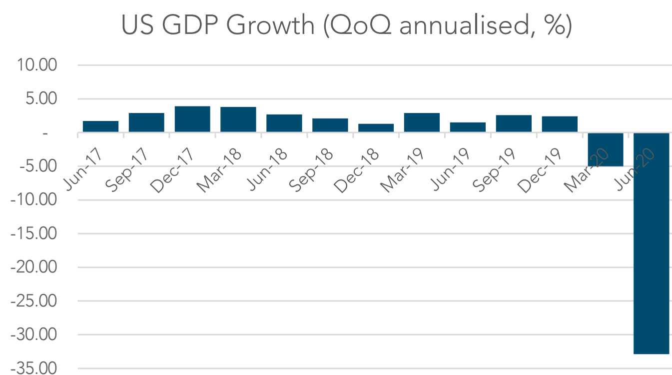
The outlook remains weak for inflation given that excess capacity in the economy is expected to weigh on prices. Weak labour markets are expected to keep demand low whilst inflationary pass-through effects are only expected to gain traction when labour market conditions are recovered.

### United States

Whilst the number of active virus cases has remained elevated in the US, the rate of new infections have been coming down with relatively low-cost containment measures. This has increased the prospects that the rebound in activity can be sustained, pointing towards a relatively more optimistic outcome for growth in Q3.

Increase in retail sales and industrial production was similarly sustained even while infection rates were rising. Survey-based activity indicators continue to point to a continued rebound although, now, non-manufacturing seems to be leading manufacturing sectors. The lingering issues with supply chains and contraction in mining may be explaining the drag in manufacturing and industrial production.

Similar to the results for the Euro area, the sharp drop in




*Source: Bloomberg*

consumption was the main contributor to the contraction in GDP of 32.9% (annualised) in the second quarter. Even though retail sales rebounded strongly in the second quarter, the increase in sales has slowed down in July but level of sales has reached above pre-pandemic levels with bars, restaurants and clothing retailers still lagging.

Business investment also fell sharply in the second quarter, however, more frequent data indicates that the rebound is underway. Durable goods have rebounded in May and June while ISM new orders and capital goods orders indicate significant increases. Drop in mining may also start to reverse given the recovery in oil prices as the number of active oil rigs is expected to increase.

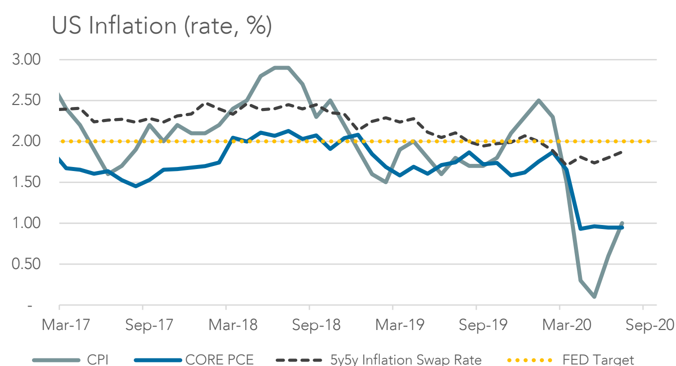
On the other hand, external trade seems to have bottomed out, but remains at significantly low levels, with exports remaining far lower than imports. This seems to be explained by the rebound in consumer and business demand. Overall we have seen positive developments on economic activity throughout, partially reversing the pessimism coming from the surge in cases in the US.

Growth expectations for 2020 have improved shifting forward the expected pace of growth indicating a shorter time to reach pre-crisis output levels.

Labour market developments seem to be consistent with this outlook. Looking at employment data shows that so far only 40% of the job losses have been recovered. The increase in employment continued despite the surge in cases. The unemployment rate declined to 10.2% in July from a high of 14.7% in April.

The swing in unemployment numbers is mainly explained by temporary workers whilst losses in permanent jobs have been relatively low. As noted in previous updates, impact on US unemployment was more notable and more imminent while unemployment in Europe and UK is still expected to grind higher. US unemployment is expected to continue to decline, albeit at a slower pace given that the rate of normalization in the hardest hit sectors is still expected to lag. Jobless claims count have started to grind lower.

As noted in previous updates, headline inflation has continued to rebound as the deeper slump in prices of goods and services that had been most impacted have started to rebound – air fares, hotel rooms, new vehicles and car insurance cost, clothing and apparel, as well as the sustained increases in food prices.

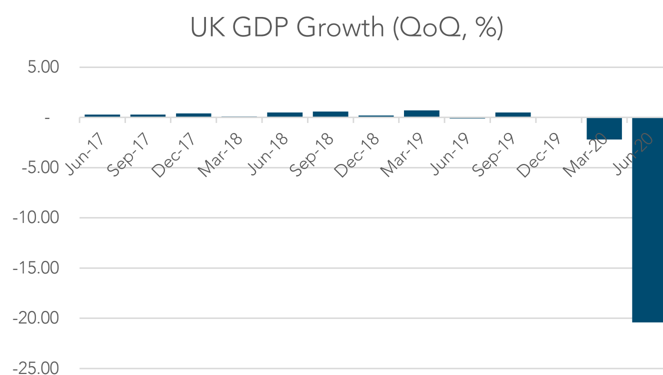



*Source: Bloomberg*

We still maintain that even though inflation may climb higher, the persisting output gap, aging demographics, high debt levels, elevated level of unemployment and low capacity utilization and the downward pressure on wages will continue to weigh on prices keeping core inflation at relatively low levels (closer to 1%) for longer.

### United Kingdom

The Q2 GDP data for the UK confirms our expectations that the UK was (and still is) expected to lag the recovery compared to other advanced economies. The UK economy contracted by 20.8% during the second quarter. Even though the monthly GDP figures for June show a month-on-month expansion of 8.7%.




*Source: Bloomberg*

Like other regions, the decline in consumer spending was the main contributor to the GDP contraction. This is expected to have a more long-lasting effect in UK, apart from the impact of lower employment, given the generally higher expenditure in sectors that are mostly affected by social distancing (20% of household expenditure spent on hospitality and entertainment sectors).

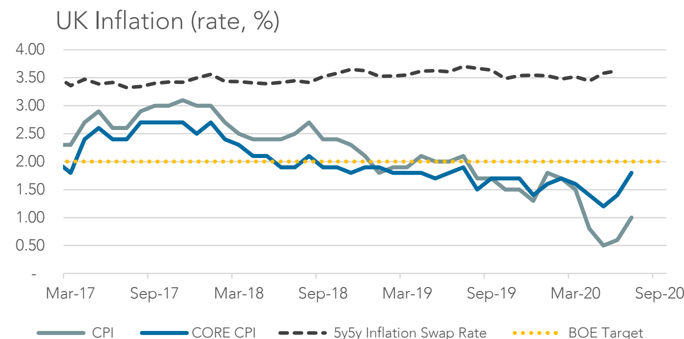
Business investment is expected to remain low for multiple factors, primarily the weak top-line growth, in-

creased indebtedness and ongoing uncertainty caused by Brexit. On the other hand, external trade may support GDP given the weakness of the pound. Imports declined more than exports on a year-on-year basis. This is possibly partly reflective of the fact that UK's main trading counterparts are recovering at a stronger rate which may result in a trade surplus this year. Consensus estimates for GDP were revised lower to -9.7% for 2020 in August.

The full extent of the impact on the labour market is yet to materialize even though the extension in the furlough scheme and the rebound in GDP may lead to a less severe impact on UK employment. Having said that, headline unemployment is still expected to climb to around 7% in 2021 from 3.9% in February.

Estimates indicate that the government is subsidizing wages of around 35% of the workforce with the scheme being extended from end-June to end-October. Number of hours worked declined, earnings declined, but unemployment remained steady at 3.9%. The count of jobless claimants has continued to increase giving a better and timelier reflection of the deteriorating labour market conditions.

Given the weak economic prospects and the high cost to extend furlough schemes further, the OBR has an even more severe outlook for unemployment, forecasting that headline unemployment will reach 11.9% in 4Q 2020. Given the longer-lasting impact on sectors including tourism and leisure, the recovery in the labour market will take longer to reach the 4% pre-pandemic level. In turn, the high level of unemployment and weak earnings, are expected to continue to weigh on demand and contribute to additional disinflationary pressures.



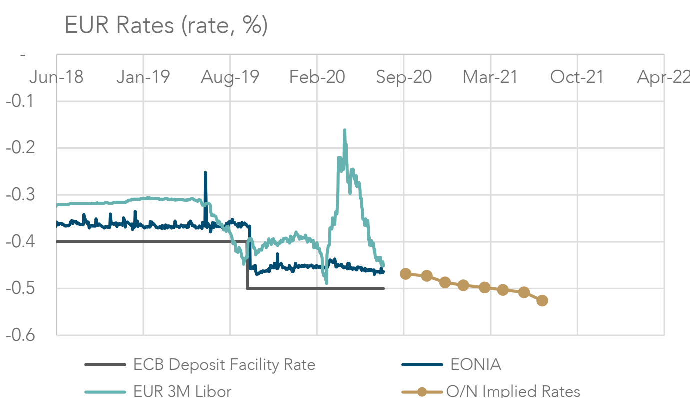

*Source: Bloomberg*

Inflation ticked marginally higher in July to 1.0% on a year-on-year basis from 0.6% in June for the same reasons noted in the Euro Area, primarily that energy prices declined at a slower rate whilst the delay in retail clothing summer sales have had a one-off upward effect on inflation rates. Inflation expected to remain weak and likely to settle at a lower rate closer to the 1% over the medium term given the expected deterioration in labour markets and the persistent low demand. Moreover, deductions in VAT and additional discounts by retailers to attract customers are also expected to weigh on inflation in the near term.

## RATES

### Euro

It was a quiet period in terms of monetary policy decisions and announcements following the ECB's decision to leave rates unchanged during the July meeting. Short-term rates have continued to grind lower as financing conditions remain easy, whilst the implied overnight forward rates continue to point towards a prolonged period of very low short-term rates.




*Source: Bloomberg*

The ECB also continued with the Pandemic Emergency Purchase Programme ("PEPP") and the Asset Purchase Programme ("APP"). The expanded PEPP is set to operate until at least the end of June 2021 and the ECB will continue with the APP for as long as necessary and end shortly before it starts raising the key ECB interest rates.

Purchases under the asset programs did actually slow down in recent weeks with President Lagarde noting that the slow down in PEPP purchases occurred due to the recent stability and recovery within markets and also reflects the lower fragmentation risks as both sovereign and corporate spreads tightened.

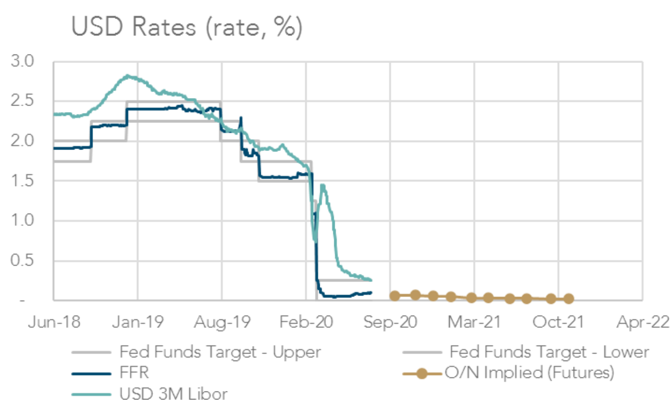
Euro benchmark yields have moved in line with recent movements in US markets, whereby yields moved lower into early August whilst climbing as safe-haven assets experienced one of the worst weeks in recent months across markets. Such movements also reflected the extensive supply in thin market conditions and improvements in investor confidence levels.

Positive momentum in sovereign peripheral bond spreads has generally slowed down in recent days following the previously sustained rally. However, we expect benchmark yields to remain stable and continue trading at low levels.

As noted in previous updates, sizeable shifts in UST curve also expected to impact Euro benchmarks yield curve.

### US Dollar

Forward implied overnight rates in USD continued to trade lower, probably excessively low and in some instances even negative. This is reflective of the generally strong expectations that the Fed will maintain interest rates low for long.




*Source: Bloomberg*

The Fed is due to release the outcome of their monetary policy framework review, probably during the Jackson Hole meeting in August or during the FOMC policy meeting in September. The minutes for the recent meetings provided insight on the discussion around average inflation targeting, communication on forward guidance and asset purchases as well as the introduction of yield curve control.

The recent rise in US treasury yields on the back of the inflation data revealed the sensitivity of markets to inflation expectations following a substantial rally which drove treasury yields to all-time lows. Given that breakeven rates have traded higher, the move was explained by higher term premium as opposed to increasing interest rate expectations. This is particularly true when considering that OIS swap rates confirm the strong underlying expectations that policy rates will remain low.

Having said that, US benchmark yields continue to be driven by the unprecedented measures rolled out by the Fed at the start of the pandemic. The stabilisation of the curve and anchoring of low yields, compared to the extreme volatility in March, has now been conditioning markets for several months.

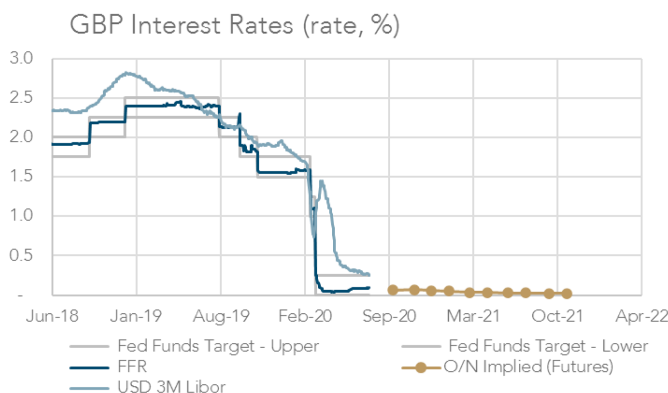
However, as has been mentioned in previous updates the market has shown the vulnerability to episodes of cheapening or increases in volatility, especially notable during the sell off in mid-August following the release of inflation figures. On the other hand, resurging concern related to the economic recovery, US political turmoil and equity market pull backs, have provided support to treasuries pulling the benchmark curve down.

### Sterling

Similar to EUR and USD money markets, implied rates still point toward a significantly low forward path of short-term rates in GBP. Money market spreads across have continued to stabilise as economic conditions bottomed out while financing conditions improved given the substantial intervention provided by the BOE.

Having said that, the scope for BOE to revise short-term financing measures and to increase its QE programme further is not excluded given the planned increases in government spending which may negatively impact borrowing rates.

UK government has seemingly increased tolerance to retain the higher national debt levels and avoid introducing austerity conditions to bring debt levels down post-Covid. Moreover, given the lag in the economic recovery and the weak inflation outlook, we expect the BOE to maintain a loose monetary policy stance for a long period of time.




*Source: Bloomberg*

In line with recent weeks and months, UK benchmark yields have been influenced by the debate on whether there is need for further cuts and negative rates to be introduced by the BOE. Additionally, there is a sense that the BOE remains a touch more optimistic on the economy compared to expectations of investors which explains the growing expectations that the BOE will likely increase monetary stimulus.

During its last monetary policy meeting in early August, the Monetary Policy Committee ("MPC"), voted unanimously to maintain the Bank rate at 0.1%. The MPC also voted to continue its existing programmes of UK Government Bond and sterling non-financial investment-

grade corporate bond purchases, which are financed through the issuance of central bank reserves, by maintaining the target for the total stock of these purchases at £745 billion.

Gilts purchases carried out by the BoE increased by £21 billion during the past month whilst corporate bond purchases increased by £1 billion during the same period.

## CREDIT

Credit markets have continued with the recovery that began in recent months as government restrictions have been eased, government aid boosted consumer demand while central banks have played their part in propping up and stabilizing credit markets through their respective QE programmes.

Within the investment-grade space, spreads have tightened marginally with EUR IG spreads tightening by 4 bps while the US IG and GBP IG spreads tightened by 1bps and 3 bps respectively. The non-investment grade market experienced wilder swings in spread movements during the past month. EUR HY and GBP HY spreads tightened by 31bps and 96bps during the past month while US HY spreads widened by 7bps.

In August, European and UK capital markets have been muted with the trend for corporate debt issuance continuing on their downward trajectory from the previous month. However, the US investment-grade and non-investment grade markets have experienced an increase in issuance during August.

Credit markets, particularly Euro markets, remained well supported during recent weeks, even within the backdrop of what is now more clearly a deterioration in the Covid-19 situation. However, an element of divergence was noted as US markets did experience some softening during August.

The notable slowdown in primary markets, mainly with respect to Euro, reflects seasonal factors but possibly also the tendency of companies to move into a more cautious phase after prioritising the bolstering of liquidity by taking advantage of policy actions during previous months).

The High Yield market ("HY") continued in its relative catch up compared to Investment Grade market ("IG"); however the most challenged sectors and individual credits are still underperforming, as reflected in the relatively high levels of dispersion.

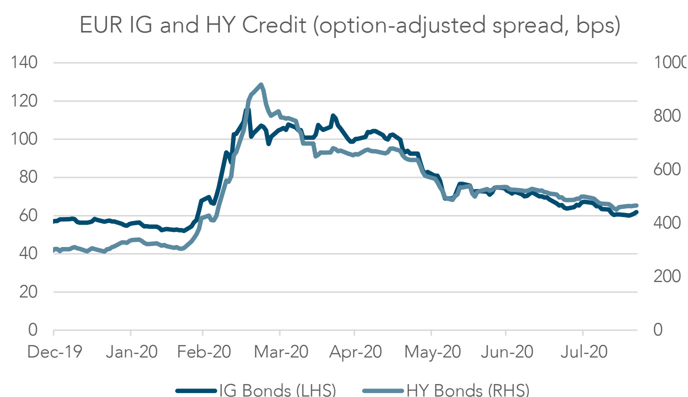
In line with economic prospects, corporate fundamentals remain challenging but following the release of Q2 results there is at least increased visibility on the financial strength and liquidity position of issuers.

Additionally, there is growing comfort that the drop in-earnings has bottomed out, unless the surge in virus cases turns out to be more problematic.

In addition to the underlying fundamentals at the onset of the crisis and the direct impact on revenues, the extent of such impact is often determined by factors including the cost structures of companies, their commitment to capital expenditures as well as vulnerability to working capital movements.

Currently it could be argued that the default rate scenario, whilst remaining negative, could turn out to be better than expected, but there are divergent views on this trajectory. However, whilst this environment confirms the relevance of maintaining a selective stance, it is also noted that, historically, periods of high default rates did not preclude above average returns in credit markets, especially if it coincides with the beginning of an improvement in economic scenario.

As noted in previous updates, the sustained pace of bond issuance, which provided access to liquidity, and

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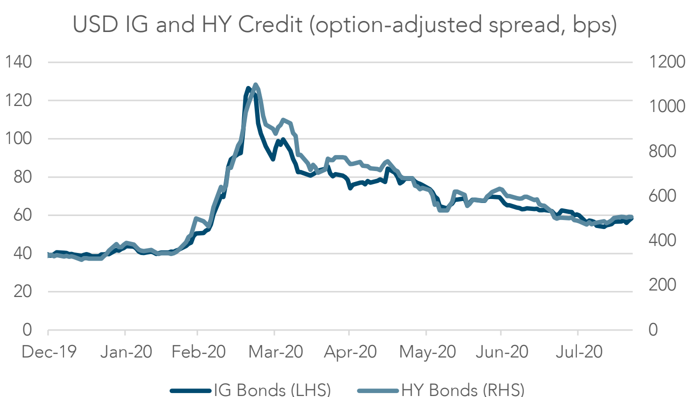



*Source: Bloomberg*

the absorption of issuance by investors and central banks, both contributed to the positive trends in credit over recent months. In fact, at this stage, indications are that the markets could benefit from tighter demand-supply dynamics in coming weeks and months given that supply dropped off in recent weeks whilst inflows have continued to rise, with markets dominated by search for yield.

This favourable technical backdrop could be expected to be more evident in the Euro and the Sterling markets as opposed to US dollar corporate bond market.

## EQUITY

Earlier this year the longest bull market in history (128 months) came to an abrupt end as COVID-19 fears dominated investor sentiment. Looking back, the last bull market has been generally unloved by investors, despite its long duration and strength. Throughout the past ten years, doubt has lingered on a number of issues including lacklustre global economic growth, soft inflation, the sovereign debt crisis in Europe, rising political risk (Brexit, US/China), weak corporate earnings growth (especially in Europe).

When looking at traditional valuation metrics since 2005, the current PE, forward PE and Price to Book are all in the 100th percentile, with the EV/ EBITDA at the 91th percentile, the Shiller PE at the 89th, and dividend yield at the 87% percentile (inverse calculation: that is how low it is compared to history). Based solely on these metrics it is difficult to argue that valuations are not at elevated levels compared to history.

Goldman Sachs estimate that since 9 March 2009, earnings growth has contributed to 36% of returns, dividends to 25% of returns while the falling interest rates led to valuation expansion accounting for 39% of return in the US. In Europe, valuation expansion has accounted for 50% of returns during the same period.

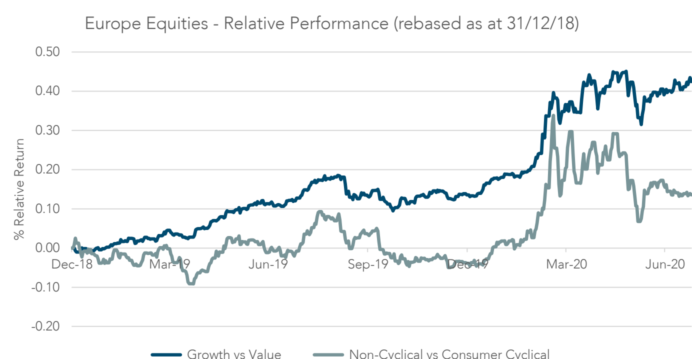
Although many reasons are often cited to explain the current high valuations, the most prevalent are: (1) the current low yield environment and (2) TINA (There Is No Alternative). Both of these reasons are valid, and could explain some of the moves we have seen since the GFC, however we believe that there are certain objections that need to be discussed.

The collapse in bond yields globally has been quite extraordinary, with yields in the US the lowest since 1880's. Today, roughly 25% of Government debt globally has a negative yield. However, the fall in yield is firstly a reflection of the loose monetary policy employed by central banks and, secondly, the low yield is a reflection of the low inflation expectations and slow growth expectations.

A lower risk free rate does not necessarily mean higher equity valuations. Both theory and history support the argument that lower interest rates should lead to higher equity valuations. However, information on growth and inflation expectations as well as the less observable equity risk premium should provide a better understanding of how equity valuations are impacted as the discount rate changes.

The lower growth and inflation expectations help explain the outperformance of growth stocks as opposed to value. Investors have been buying growth stocks to help protect against the risk of deflation, while value stocks have lagged. An inflation surprise, to the likes seen in mid-August, would possibly lead to a reversal of such moves and has in fact been explaining the temporary periods of equity market rotation.

The success of technological companies since the GFC has been unprecedented. Circa 59% of the global population now have access to the internet in the 30 years

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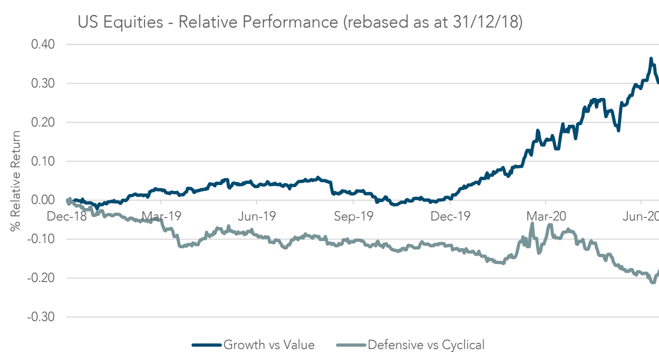


Source: Bloomberg

since it was created. The technological revolution we have seen since has been extraordinary and shares similarities with historical examples of other revolutions. However, at these levels, we think investors should be less wary of rising bond yields and more concerned on the pace at which bond yields may rise. Rising bond yields would generally be an indication of higher growth and inflation expectations, with both being positive factors for equities. However a fast revision in rates would be a negative for equity investors, since the impact of a rising discount rate would more then offset the increasing expectations on growth and inflation.

Given our expectations that inflation will remain subdued due to weak demand and low employment, we maintain our preference to be defensively positioned in equities by retaining an underweight allocation to equities and a tilt towards growth and defensive stocks in our selection.

# ASSET CLASS VIEW AND POSITIONING

| Asset Class | View | Allocation | Positioning |
|---|---|---|---|
| *Sovereign Bonds* | Stable | N | Benchmark bond yields continue to trade at low levels from strong central bank support and forward guidance. This is seen to more than compensate for the determination of governments to increase public debt to intervene with substantially supportive fiscal measures.<br>Given the increase in monetary support as well as the agreement reached on the European recovery fund, peripheral spreads remain well supported. However, given the strong performance over recent weeks, the possibility of further upside is fading in the near term.<br>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 | N | Investment grade bonds remain attractive, however, on a relative basis, we are less comfortable with maintaining a high exposure given that the spread differentials have tightened considerably and have almost reached pre-pandemic levels. Strong central bank support is expected to continue to sustain the current levels in spreads which underpins the benefits of maintaining a long duration exposure within this space, in order to earn a higher carry, particularly in view of the low interest rates and low inflation outlook.<br>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* | Neutral to Positive | O/W | Investors are increasingly able to assess the impact of COVID-19 more specifically with the release of half yearly 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.<br>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 pullback in equity markets in June as fears of a second wave started increasing.<br>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.<br>In terms of sector positioning, we prefer to remain underweight cyclical industries and retain our core positions in staples, healthcare and technology.<br>At the same time, we remain on the lookout 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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