The Weekly Market View

July 05 2020

ADCB ASSET MANAGEMENT LIMITED

Q2 review

"First is the worst, second is the best...", so goes the old rhyme. Indeed that is exactly how it played out in financial markets this year. Q1 saw extreme volatility and loses for risk assets followed by Q2 which on several metrics turned out to be the best quarter in a while. For instance, for US equities, whilst Q1 proved to be the worst quarter since 2008, Q2 evolved to be the best quarter since 1998. Global equities, having fallen 21% in the first quarter rose c19% in the following quarter helped by unprecedented policy support. Amongst major regions, US equities outperformed the most and UK equities underperformed the most (worth noting that UK equities too delivered positive returns on an absolute basis). By global sectors, IT and consumer discretionary outperformed the most while utilities and consumer staples underperformed the most; all sectors delivered positive returns in Q2. NYSE FANG+ index, a concentrated way of playing our "new economy" theme, rose 38% in Q2 after having lost 4% during Q1. Large caps underperformed mid and small caps; however, growth outperformed value during Q2. In the fixed income space, there was little movement in the core rates markets in Q2. 10Y UST yields were little changed, but the yield curved stayed steep. In the credit sub-universe, spreads moved in line with other risk assets. USD high yield spreads tightened substantially. USD IG performed well against a backdrop of very high issuance in this space. EUR credit lagged. In FX, a period of risk-on we saw during Q2 meant USD weakness, at least against the major G10 currencies. However, GBP strength was relatively muted as Brexit concerns and BoE policy acted as a cap. EM FX movements were volatile – especially in currencies like BRL. Amongst commodities, oil prices after having gone unhinged in Q1 this year staged a strong recovery in Q2 as supply cuts and improved outlook for demand supported. Gold prices continued to rise in Q2 not only as the concerns about the pandemic remained but also on massive monetary stimulus.

Turning to market situation last week, it can broadly be described as 'risk-on'. Equity markets posted strong gains on slowing rate of increase in COVID-19 cases in the US, positive news around the vaccine development and better than expected economic data (pending home sales, consumer confidence and unemployment rate were all better than expected in the US). US equities, helped by strong performance from NASDAQ, outperformed the rest of the world. UST yields ended the week only modestly higher despite the risk-on sentiment. Oil prices rose on hopes for demand revival and on more than anticipated fall in US crude inventories last week. Gold prices were flat over the week keeping the year-to-date gains at c17%. Industrial metals posted marginal price rises. In FX, USD weakened against EUR and GBP but strengthened against JPY.

Earnings preview

As we highlighted in our last weekly, our cautious near-term outlook is in part driven by the elevated uncertainty in earnings estimates, especially as we approach the earnings season in the weeks to come. Scarce earnings guidance from the corporates makes this earnings season a lot more challenging in our view. For the context, according to Factset, the number of S&P 500 companies providing earnings guidance for Q2 has fallen to about half the usual number. Further, according Factset's analysis, fall in the number of companies issuing negative guidance is dramatic compared to the fall in the number of companies issuing positive guidance – this makes us believe that the risk of a disappointment is higher than the risk of a positive surprise. Therefore, to this extent, negative surprises could be penalised more in the current quarter than in the past. Sector wise, drop in earnings guidance was the highest in more cyclical sectors like industrials and materials – driving our cautious stance on cyclical themes and markets. However, analyst estimates have been cut substantially over the last few months. For instance based on I/B/E/S consensus estimates, earnings for S&P 500 aggregate are now projected to fall by 43%, 25% and 13% year-over-year during Q2, Q3 and Q4 this year respectively. Around mid-April corresponding estimates were for a contraction of 27%, 14% and 6% respectively. The upcoming earnings season is likely to bring to the forefront, discussions around the impact of COVID-19 economic disruption on corporate earnings. We think there is likely to be more focus on management discussion and analysis regarding the 'scars' this pandemic is likely to leave on various sectors. To the extent the timeline of earnings erosion gets extended beyond Q4 2020, markets could start to reconsider the fundamentals and long-term prospects for various sectors. Here, we are lot more confident on our structural growth stories (like the new economy) compared to more cyclical themes. Any correction (in absolute terms) in long-term growth sectors should be used by market participants to increase their exposure. After all, in a world where long-term returns from financial markets are likely to be lower, investors need to be agile. As such, within equities, we reiterate our preference for non-cyclical growth themes and quality (for our recommended equity positioning see The Equity Strategist, April 14 2020).

Global markets' performance snapshot

Index Snapshot (World Indices)

Index	Latest	Weekly %	YTD %
S&P 500	3,130	4.0	-3.1
Dow Jones	25,827	3.2	-9.5
Nasdaq	10,208	4.6	13.8
DAX	12,528	3.6	-5.4
Nikkei 225	22,306	-0.9	-5.7
FTSE 100	6,157	0.0	-18.4
Sensex	36,021	2.4	-12.7
Hang Seng	25,373	3.4	-10.0
Regional Markets (Sunday to Thursday)			
ADX	4,312	0.6	-15.1
DFM	2,061	-1.2	-25.4
Tadawul	7,312	1.1	-12.8
DSM	9,212	0.3	-11.6
MSM30	3,512	-0.4	-11.8
BHSE	1,274	-0.4	-20.9
KWSE	5,124	-0.9	-18.4
MSCI			
MSCI World	2,228	3.2	-5.6
MSCI EM	1,023	3.4	-7.3

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly %	YTD %
ICE Brent USD/bbl	42.8	4.3	-35.2
WTI USD/bbl	40.7	5.6	-34.0
Gold USD/t oz	1,772.1	0.0	16.8
Silver USD/t oz	18.0	1.2	0.9
Platinum USD/t oz	810.8	0.6	-16.1
Copper USD/MT	6,022.5	0.6	-2.2
Alluminium	1,586.0	0.6	-11.4
Currencies			
EUR USD	1.12	0.3	0.3
GBP USD	1.25	1.2	-5.8
USD JPY	107.51	0.3	1.0
CHF USD	0.95	-0.2	2.2
Rates			
USD Libor 3m	0.30	-1.3	-84.1
USD Libor 12m	0.54	-4.9	-73.0
UAE Eibor 3m	0.76	-0.6	-65.8
UAE Eibor 12m	1.39	22.0	-39.2
US 3m Bills	0.14	0.0	-91.1
US 10yr Treasury	0.67	4.4	-65.1

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Summary market outlook

Global Yields	UST yields ended the week only modestly higher despite the risk-on sentiment. Looking at Q2 broadly, there was little movement in the core rates markets through the quarter. 10Y UST yields were little changed, but the yield curved stayed steep. In the credit sub-universe, spreads moved in line with other risk assets. USD high yield spreads tightened substantially. USD IG performed well against a backdrop of very high issuance in this space. EUR credit lagged. We recommend increasing duration on US treasuries with long-term rates likely to remain pressed low on Fed's QE and low growth and inflation environment.
Stress and Risk Indicators	VIX fell consistently through the week on better than expected economic data. Despite falling in recent months, VIX still remains high compared with levels observed in recent years. As such, we believe that volatility will likely stay elevated given the range of risks on the horizon. This entire episode of the coronavirus would be a part of our 'high volatility' narrative for 2020 and our risk-barbell positioning.
Equity Markets	
Local Equity Markets	GCC markets registered mixed performances. Equities in Saudi Arabia were higher on the news of consolidation in financial sector as well as on the extension of some of the private sector stimulus measures that would have expired this month. In Qatar, news around potential consolidation in the financial sector helped too. We remain neutral on GCC equities given the potential for further dollar strength, stable to higher oil prices and potential for revival in credit growth following the interest rate cuts.
Global Equity Markets	Last week equity markets posted strong gains on slowing rate of increase in COVID-19 cases in the US, positive news around the vaccine development and better than expected economic data. US equities, helped by strong performance from NASDAQ, outperformed the rest of the world. For US equities, whilst Q1 proved to be the worst quarter since 2008, Q2 evolved to be the best quarter since 1998. Global equities, having fallen 21% in the first quarter rose c19% in the following quarter helped by unprecedented policy measures. Overall, we remain neutral on equities with an overweight on US and underweight EU and EM outside Asia. By sector we prefer IT and Communication services. Our preference is for large cap non-cyclical growth with focus of quality.
Commodities	
Precious Metals	Gold prices were flat over the week keeping the year-to-date gains at c17%. We remain overweight gold as a risk hedge against ongoing political risks.
Energy	Oil prices rose on hopes for demand revival and on more than anticipated fall in US crude inventories last week. Overall, we believe that oil prices are likely to remain sustained as the market is roughly balanced.
Industrial Metals	Industrial metals posted marginal price rises on positive economic data. Yet, we do not recommend industrial metals exposure as China reigns in demand.

Currencies								
EURUSD	EUR appreciated against the USD on a risk-on bid. We expect the euro to remain stable.							
Critical levels	R2	1.1731	R1	1.1490	S1	1.0939	S2	1.0629
GBPUSD	Broader USD weakness meant cable strength. We expect the cable to be stable with Pound sterling likely to follow the euro rather than USD.							
Critical levels	R2	1.3136	R1	1.2809	S1	1.2160	S2	1.1838
USDJPY	JPY depreciated against the USD on improved risk sentiment. BoJ yield curve targeting should put continuing downward pressure on the yen.							
Critical levels	R2	111.59	R1	109.55	S1	105.77	S2	104.03

Note: R2, R1, S2 and S1 refer to Bloomberg calculated weekly technical resistance and support levels.

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
07/06/2020	Markit US Services PMI	Jun F	47.0	46.7	Services/non-manufacturing PMI, jobless claims and PPI will be closely watched.
07/06/2020	ISM Non-Manufacturing Index	Jun	50.0	45.4	
07/09/2020	Initial Jobless Claims	4-Jul	--	1,427k	
07/09/2020	Continuing Claims	27-Jun	--	19,290k	
07/10/2020	PPI Final Demand YoY	Jun	-0.20%	-0.80%	

Japan

	Indicator	Period	Expected	Prior	Comments
07/07/2020	Household Spending YoY	May	-11.80%	-11.10%	Household spending, machine orders and PPI are important.
07/09/2020	Core Machine Orders YoY	May	-16.80%	-17.70%	
07/09/2020	Machine Tool Orders YoY	Jun P	--	-52.80%	
07/10/2020	PPI YoY	Jun	-2.00%	-2.70%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
07/06/2020	EZ Sentix Investor Confidence	Jul	-10.4	-24.8	Eurozone investor confidence, retail sales, German and French industrial data will be in focus.
07/06/2020	EZ Retail Sales YoY	May	-6.50%	-19.60%	
07/10/2020	DE CPI YoY	Jun	--	0.00%	
07/10/2020	FR Industrial Production YoY	May	-24.50%	-34.20%	
07/10/2020	FR Manufacturing Production YoY	May	-23.30%	-37.10%	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
07/06/2020	New Car Registrations YoY	Jun	--	-89.00%	Construction PMI and house prices are the key releases.
07/06/2020	Markit/CIPS UK Construction PMI	Jun	46.0	28.9	
07/09/2020	RICS House Price Balance	Jun	-25%	-32%	

China and India

	Indicator	Period	Expected	Prior	Comments
07/09/2020	CN PPI YoY	Jun	-3.20%	-3.70%	Inflation and money supply in China and industrial production in India are important.
07/09/2020	CN CPI YoY	Jun	2.50%	2.40%	
07/10/2020	CN Money Supply M2 YoY	Jun	11.10%	11.10%	
07/10/2020	CN Aggregate Financing CNY	Jun	3092.5b	3190.0b	
07/10/2020	IN Industrial Production YoY	May	-36.30%	--	

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTT News
4. Reuters
5. Gulfbase
6. Zawya

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