The Weekly Market View

July 19 2020

بنك أبوظبي التجاري ADCB

ASSET MANAGEMENT LIMITED

On balance…

On the COVID-19 situation, on the one hand, resurgence of the virus in the US and renewed shutdowns in certain states created negative sentiment while news flow around a potential vaccine was the positive. On the economic data front, positive surprises on trade, GDP, industrial production and fixed asset investment in China, and CPI, retail sales and industrial production in the US were balanced by negative surprises in German Zew survey, China retail sales, Michigan consumer sentiment data and weekly jobless claims in the US. Optimism relating to a proposed EUR750bn EU recovery fund was met with some comments from leaders casting doubt on attaining a deal this week. At the time of writing this report, the two-day EU meet was still in progress. Broadly, geopolitical risks increased at the margin last week. For the first time US has officially rejected Beijing's claims in the South China sea while the Trump administration ended the special status to Hong Kong and the UK banned Huawei from its 5G network.

Against this backdrop equity markets managed to move higher. US equities gained c1% over the week making the S&P 500 index rather flat for the year. However, within the US, a rotation out of the structural growth stories (Nasdaq) into more cyclical depressed segments was observed. As we highlighted in our last week's note, long-term equity investors are still better off focussing on some of the structural growth stories. Staying with DM, Japanese equities gained for the first time in three weeks and in Europe markets posted strong gains led by cyclical themes last week. With Chinese equities correcting c5% during the week (after having rallied c27% in the prior two months), EM underperformed DM. Moving to commodities, oil prices remained rather flat. OPEC+ agreed to add back 2.0mbd of supply from August while EIA data showed that crude oil, gasoline and distillate stocks declined more than anticipated. Precious metals gained further, especially gold prices extended their strong year-to-date gains. In the FX space, EUR appreciated against the USD as markets awaited ECB meeting and European Council special meeting. Elsewhere, relative negative data surprises in the UK and in Japan drove weakness in GBP and JPY against the USD. In the fixed income space, there was little change in the yields on USTs, German bunds and UK gilts over the week. However, in case of 10Y UST yields, developments relating to virus and vaccines, data surprises and inflation expectations created some movement at the margin.

Still cautious on banks

Last week saw all major US banks report their earnings for the second quarter of the year and for most part, earnings exceeded market expectations. However, we remain underweight financials (driven by our underweight on banks) in our global equity strategy. To start with, a deeper look at banks' Q2 earnings reports reveals a strong rise in trading volumes offsetting weakness in consumer books and loans. Investment banking fees was also rather high, thanks to the record debt issuance during the quarter. However, we wonder if this support can remain in the medium-term. Further, revenue growth linked to economic activity, is one of the key drivers of banks performance over medium to long-term. Here, it is worth noting that economic growth projections point only to a gradual rebound. For instance, according to IMF's latest World Economic Outlook update, "Global growth is projected at –4.9 percent in 2020. In 2021 global growth is projected at 5.4 percent. Overall, this would leave 2021 GDP some 6½ percentage points lower than in the pre-COVID-19 projections of January 2020." This points out that recovery in the levels of economic activity is long-drawn. This plays into our narrative that during this 'rebound' phase, markets are likely to focus on the 'direction' but as we move to a 'recovery' phase, 'magnitude' should begin to matter a lot more. Further, it is worth noting that this is an unusual recession where incomes grew and house prices rose despite high unemployment. This mismatch could be corrected at some point in the medium-term and that means headwinds for banks. As such, the flat yield curve already dents the sector's profitability. We are also watching loan loss provisions and developments on this front especially in smaller banks and banks in emerging markets. Of course, valuations are cheap and investor interest in the sector is weak too – this provides a support on the downside. Long-term outlook for the sector remains clouded by disruption – especially disintermediation facilitated by technology. Further, US-China tensions spell trouble for banks with significant footprint in both countries. Consolidation and cost-cutting are key trends to watch, especially in Europe.

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Global markets' performance snapshot

Index Snapshot (World Indices)

Index	Latest	Weekly %	YTD %
S&P 500	3,225	1.2	-0.2
Dow Jones	26,672	2.3	-6.5
Nasdaq	10,503	-1.1	17.1
DAX	12,920	2.3	-2.5
Nikkei 225	22,696	1.8	-4.1
FTSE 100	6,290	3.2	-16.6
Sensex	37,020	1.2	-10.3
Hang Seng	25,089	-2.5	-11.0
Regional Markets (Sunday to Thursday)			
ADX	4,274	-0.5	-15.8
DFM	2,053	-1.4	-25.8
Tadawul	7,427	0.1	-11.5
DSM	9,311	-0.1	-10.7
MSM30	3,450	-1.3	-13.3
BHSE	1,302	1.3	-19.1
KWSE	5,046	-1.7	-19.7
MSCI			
MSCI World	2,289	1.5	-2.7
MSCI EM	1,046	-1.3	-5.3

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly %	YTD %
ICE Brent USD/bbl	43.1	-0.2	-34.6
WTI USD/bbl	40.6	0.1	-33.5
Gold USD/t oz	1,810.4	0.7	19.3
Silver USD/t oz	19.3	3.2	8.3
Platinum USD/t oz	840.2	1.5	-13.1
Copper USD/MT	6,454.5	2.1	4.8
Alluminium	1,641.8	-1.1	-8.2
Currencies			
EUR USD	1.14	1.1	1.9
GBP USD	1.26	-0.4	-5.2
USD JPY	107.02	0.1	1.5
CHF USD	0.94	-0.3	3.0
Rates			
USD Libor 3m	0.27	1.4	-85.8
USD Libor 12m	0.48	-1.0	-76.2
UAE Eibor 3m	0.58	-10.5	-74.0
UAE Eibor 12m	1.23	3.4	-46.2
US 3m Bills	0.10	-16.6	-93.3
US 10yr Treasury	0.63	-2.8	-67.3

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Summary market outlook

Global Yields	There was little change in the yields on USTs, German bunds and UK gilts over the week. However, in case of 10Y UST yields, developments relating to virus and vaccines, data surprises and inflation expectations created some movement at the margin. 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 ended lower, however remained volatile through the week. We highlight that 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	Regional equity markets registered mixed performance last week as investors digested earnings releases, virus updates, stimulus efforts from local governments and growth prospects. IMF's downbeat assessment of the economic outlook and significant downgrade of 2020 growth projections weighed on the market. We remain neutral on GCC equities given stable to higher oil prices and potential for revival in credit growth following the interest rate cuts.
Global Equity Markets	US equities gained c1% over the week making the S&P 500 index rather flat for the year. However, within the US, a rotation out of the structural growth stories (Nasdaq) into more cyclical depressed segments was observed. Japanese equities gained for the first time in three weeks and in Europe markets posted strong gains led by cyclical themes. With Chinese equities correcting c5% during the week (after having rallied c27% in the prior two months), EM underperformed DM. 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	Precious metals gained further, especially gold prices extended their strong year-to-date gains. We remain overweight gold as a risk hedge against ongoing political risks.
Energy	Oil prices remained rather flat. OPEC+ agreed to add back 2.0mbd of supply from August while EIA data showed that crude oil, gasoline and distillate stocks declined more than anticipated. Overall, we believe that oil prices are likely to remain sustained as the market is roughly balanced.
Industrial Metals	Industrial metal prices were mixed but tracked volatility in Chinese equity markets. We do not recommend industrial metals exposure as China reigns in demand.
Currencies	
EURUSD	EUR appreciated against the USD as markets awaited ECB meeting and European Council special meeting. We expect the euro to remain stable.
Critical levels	R2 1.1633 / R1 1.1531 / S1 1.1247 / S2 1.1065
GBPUSD	Relatively weaker data surprises and risks associated with Brexit resulted in weaker GBP. We expect the cable to be stable with Pound sterling likely to follow the euro rather than USD.
Critical levels	R2 1.3105 / R1 1.2837 / S1 1.2276 / S2 1.1983
USDJPY	USD appreciated against JPY as data surprises in the US outperformed those in Japan. BoJ yield curve targeting should put continuing downward pressure on the yen.
Critical levels	R2 111.23 / R1 109.12 / S1 105.49 / S2 103.97

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

Forthcoming important economic data/events

United States

	Indicator	Period	Expected	Prior	Comments
07/21/2020	Chicago Fed Nat Activity Index	Jun	4.00	2.61	Regional Fed indicators, housing data, along with claims information and PMIs are key data to watch. On the PMI front, market expectations are for an expansion in both manufacturing and services activity in the US.
07/22/2020	Existing Home Sales	Jun	4.80m	3.91m	
07/23/2020	Initial Jobless Claims	18-Jul	1,293k	1,300k	
07/23/2020	Continuing Claims	11-Jul	16,900k	17,338k	
07/23/2020	Kansas City Fed Manf. Activity	Jul	5	1	
07/24/2020	Markit US Manufacturing PMI	Jul P	52.0	49.8	
07/24/2020	Markit US Services PMI	Jul P	51.0	47.9	
07/24/2020	New Home Sales	Jun	700k	676k	

Japan

	Indicator	Period	Expected	Prior	Comments
07/20/2020	Exports YoY	Jun	-24.70%	-28.30%	Japanese trade data is expected to point to a marginal improvement from the previous month, although still contracting.
07/20/2020	Imports YoY	Jun	-17.60%	-26.20%	
07/21/2020	Natl CPI YoY	Jun	0.10%	0.10%	
07/22/2020	Jibun Bank Japan PMI Mfg	Jul P	--	40.1	
07/22/2020	Jibun Bank Japan PMI Services	Jul P	--	45.0	

Eurozone

	Indicator	Period	Expected	Prior	Comments
07/20/2020	ECB Current Account SA	May	--	14.4b	Eurozone composite PMI is expected to move into a growth territory (reading above 50) for the first time since February.
07/23/2020	Eurozone Consumer Confidence	Jul A	-12.0	-14.7	
07/24/2020	Markit Eurozone Mfg. PMI	Jul P	50.0	47.4	
07/24/2020	Markit Eurozone Services PMI	Jul P	51.0	48.3	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
07/24/2020	GfK Consumer Confidence	Jul P	-24	-27	On the consumer side, both soft and hard data are expected to show improvement in the sector, albeit marginal. PMIs are expected to point to an expansion in the business sector.
07/24/2020	Retail Sales Ex Auto Fuel YoY	Jun	-3.70%	-9.80%	
07/24/2020	Markit UK PMI Manufacturing SA	Jul P	52.0	50.1	
07/24/2020	Markit/CIPS UK Services PMI	Jul P	51.3	47.1	
07/24/2020	Markit/CIPS UK Composite PMI	Jul P	51.1	47.7	

China and India

	Indicator	Perio	Expected	Prior	Comments
07/20/2020	China 1-Year Loan Prime Rate	20-Jul	3.85%	3.85%	Mainland China policy rate is key but markets are expecting no change.
07/20/2020	China 5-Year Loan Prime Rate	20-Jul	4.65%	4.65%	

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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