REVIEW AND ECONOMIC OUTLOOK

You certainly have asked yourself: did equity investors lost their minds? We have been wondering for weeks about the strength of the equity markets. Many analysts and big players express similar concerns and making a profound point: when buyers in the market shifts from big and institutional investors to small and retail investors, the market will likely be soon in trouble. But Warren Buffett already dumped its aviation and bank stocks weeks ago and is sitting on tons of cash. And legendary investor Stanley Druckenmiller claims that the risk-reward for equity is maybe as bad as he has ever seen. In March and April alone, hundreds of thousands of retail investors have opened a US trading account, according to Charles Schwab with retail volumes going through the roof. What does this tell us? Small investors appear persuaded that the markets are headed for a V-shaped recovery. But history suggests a more complicated story!

TACTICAL ASSET ALLOCATION

Liquidity	Overweight
Bonds	Neutral
Equities	Underweight
Alternative Investments	Neutral

MACROECONOMICS

Looking at the fundamentals, it is very clear: the gap emerging between the financial market and the real economy is unsustainable despite the bazookas from central banks around the globe.

On the virus front we certainly have seen some progress. Infection cases have been decreasing and potential vaccines are in phase one of testing. We got further evidence of the economic slump that gripped us in Q1 (German and UK GDP shrank by 2.2% and 2.0%, respectively), and additional indications of the even deeper Q2 economic hole. US GPD in Q1 shrank by 5% with staggering raising unemployment numbers while FED's Powell warned about "significant" downside risk to growth alongside default probabilities rising and unbelievable sizes in future government debts. Either you have a monetarising of government debts (e.g. ECB holds 47% of Italy's debt) which leads probably to higher inflation or you need to increase taxes. Both scenarios are not much welcomed. Regionalisations of the supply chain (deglobalisation) will also lead to higher prices. The FED expects year-end unemployment at 9% (double the pre-crisis level), which cannot be without any effects on consumption. The ECB confirmed the probability that the crisis is between modest and severe expectations. However, central banks affirmed they will do more than whatever it takes. We are not that certain if these supports will be indefinite as claimed since everything has its price. For the time being, people around the globe are feeling good about reopening and the cheap money. But it is still a long way for corporates and households as the potential nightmare has just started.

FIXED INCOME

In May, US rates traded within a narrow range of 14 bps. Price action was not coupled to riskier assets anymore, as the fly-to-quality has stopped. Supply was more of a topic, but record auctions were easily absorbed by investors. In the UK, for the first time, negative-yielding government bonds (3y) have been sold. Sentiment in peripherals improved further after various announcements of recovery plans and support measures by the EU but political discussions for approval and more details just have started. Nevertheless, Italy was able to place EUR 22 bn in bonds.

This underscores how the stimulus and support from politics and central banks work. But debt levels are rising. G20 debt-to-GDP ratio is expected to rise just under 100% by the end of the year, up from 81.6%. The same counts for credit, where corporates are piling up to draw credit lines and selling a record amount of new bonds in the primary market. A rising oil price and different rescue packages for key industries, fuelled the rally. HY indices from US and Europe tightened between 100 and 120 bps. About half of the Corona-widening has recovered now.

On the other side, default rates are rising. Especially in the US where the energy, retail and transportation sectors are most affected. According to Moody's Investors Service, the U.S.' trailing 12-month high-yield default rate jumped from April 2019's 2.8% to April 2020's 5.4% and may average 12.7% during 2020's final quarter. We expect more to come.

In general, we still like credit as many corporates offer better entry levels and fresh supply balances out the rising demand. We expect this to continue in June with many issuers trying to fill their war chests ahead of the summer break. But the balancing act between risk and return in credit will continue. Selectivity is the key.

EQUITIES

Since the equity markets are irrational for the time being, let us have a closer look into scientific evidences. The economist Robert Shiller, who shared the 2013 Nobel Prize in Economic Science, suggests that investors are responding to a widely shared narrative that says stock prices tend to rebound sharply after a big fall, and that you have to get in early to make the largest profits. One or the other hears the term V-shaped related to. Shiller already described in 2000 just before the Dot-Com bubble burst the power of contagious popular stories that spread through word of mouth, the news and social media. In standard economic theory, investors are supposed to carefully weigh things like the level of prices, interest rates, expected corporate earnings etc. before they invest. But Shiller outlined that a narrative is often more emotionally compelling and resonant than an argument about valuation or something else.

EQUITY INDICATORS

Valuation	Negative
Momentum	Attractive
Seasonality	Neutral
Macro	Negative

After stocks dipped at the end of 2018, and again in the spring of last year, the market did rebound, and quickly reached new highs. This strengthened the V-shaped narrative, Shiller said. So does the widespread belief that the FED, through its massive asset purchases, has put a floor under the stock market. The consensus seems to be that investors do not worry, as the FED has their back. However, there is one big issue with that: analysis show that this is not true! Stocks do not always rebound in a V-shape. During the last lengthy bear market, which accompanied the Great Recession, stock prices started falling in September 2007, and did not bottom out until February 2009, 17 months later! During the Great Depression, in the 1930s, the bear market lasted even longer. It began with the Wall Street crash of October 1929 and lasted until the middle of 1932. By then, the market was down about 80 percent from its pre-crash peak. Stocks did not hit new highs until the 1950s.

In the current context, that seems like a scary narrative. Shiller is pointing to the Great Depression again. In early 1930, the stock market rallied for a while, much like it is doing now, only to roll over and go into another remorseless decline. But people tend to forget. The recent past is more resonant. Some do study historical episodes, of course. Today, stocks have clearly topped the recent uptrend and we will find out if this is 1930 all over again. Until we see what happens to the economy in the coming months, we won't know for sure if the optimism and derring-do that small investors are exhibiting is justified or crazy. A rapid recovery could generate a big rebound in corporate profits, which would be supportive of the stock market. An extended economic slump could decimate earnings for years, which would surely crush stocks. Because the upside is rather limited with uncertainties looming for weeks or months to come, we remain underweight in Equities.

ALTERNATIVES

As for the oil market, output cuts by OPEC and its allies are boosting prices of physical oil as supply tightens. The easing of global lockdown, demand is recovering in major oil consumers such as China and India. Despite pockets of demand emerging, analysts remain cautious on the outlook due to the potential for a resurgence in coronavirus cases and the return of supplies as prices rise. Fuel stockpiles could swell should refiners increase operating prices too quickly and run ahead of themselves. Probably consumption patterns will likely be different than in pre-Corona days as society adopts a new normal – at least until a vaccine is available.

Gold as a hedge in turmoil market environment did not turn out to be the right trade in March. The unusual pricing behaviour continued from the lows in March until today where we are experiencing a positive correlation to equity markets with an astonishing performance of more than 16 percent. For weeks to come, trading ranges should remain within USD 1650- 1750 per oz. unless US-China tensions escalates, or concerns arise about second wave crisis with flows into safe haven assets – in gold to be confirmed tough.

The EUR/USD traded unspectacularly the last month until the last few days of the month with USD weakening as flows moved to risk-on mood. The hope is the reopening of the global economies leads to increases in those industries hit hardest during the crisis and an overall return to normal economic levels. This week the European Commission reportedly proposed a bigger-than-expected recovery fund proposal to aid member states in dealing with the economic fallout from the virus outbreak. The EUR 750 bn package in loans is certainly a good start but nothing compared what the FED did so far. The currency pair has certainly a positive momentum, but the risk-off mode be applied.

Should you require further information or advise, please do not hesitate to contact your Clarus Capital relationship manager.

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MARKET OVERVIEW AS OF FRIDAY, 29 MAY 2020, 3:05 PM

FIXED INCOME

	Rate	Δ 1m	Δ 3m	Δ ytd
USD Overnight	0.06	0.01	-1.51	-1.48
USD 1y Swap	0.30	-0.10	-0.70	-1.47
USD 3y Swap	0.27	-0.05	-0.61	-1.40
USD 5y Swap	0.37	-0.03	-0.56	-1.35
USD 10y Swap	0.66	0.05	-0.41	-1.22
EUR Overnight	-0.46	0.00	0.00	-0.01
EUR 1y Swap	-0.24	0.01	0.21	0.08
EUR 3y Swap	-0.31	0.00	0.15	-0.07
EUR 5y Swap	-0.28	-0.01	0.12	-0.17
EUR 10y Swap	-0.13	-0.03	0.08	-0.34
CDX Xover 5y	5.61%	-0.66%	1.97%	2.82%
iTraxx Xover 5y	4.30%	-0.47%	1.26%	2.23%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
USD Deposit 1m	0.2%	0.5%	0.9%	0.9%
USD Aggregate 1-3y	0.2%	1.1%	2.7%	2.5%
USD Aggregate 3-5y	0.5%	1.9%	4.5%	4.3%
USD Aggregate 5-7y	1.0%	2.4%	5.6%	5.5%
USD Aggregate 7-10y	0.9%	0.9%	5.8%	6.0%
EUR Overnight	0.0%	-0.1%	-0.2%	-0.2%
EUR Aggregate 1-3y	0.2%	-0.7%	-0.6%	-0.6%
EUR Aggregate 3-5y	0.5%	-1.4%	-0.9%	-0.8%
EUR Aggregate 5-7y	0.7%	-1.9%	-0.9%	-0.6%
EUR Aggregate 7-10y	0.9%	-2.5%	-1.0%	-0.2%
US Corp. HY	4.8%	-3.4%	-2.8%	-4.7%
EUR HY	2.8%	-5.5%	-6.4%	-7.3%

EQUITY

	Price	P/E	D. Yield	FCF yield
MSCI World	6'344	22.1	2.3%	5.4%
S&P 500	3'030	24.2	2.0%	4.8%
NASDAQ	9'417	28.6	0.9%	3.7%
Euro Stoxx 50	3'082	18.4	3.3%	7.1%
SMI	9'928	18.8	3.5%	8.3%
FTSE 100	6'152	18.2	4.1%	8.5%
DAX	11'676	19.3	3.1%	4.8%
MSCI Asia Pacific	151	15.7	2.7%	5.6%
FTSE China A50	13'266	10.2	3.2%	7.6%
MSCI Emerging Market	925	14.5	2.9%	6.8%
PH Semiconductor	1'805	21.7	1.8%	4.7%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
MSCI World	3.9%	0.9%	-5.4%	-8.2%
S&P 500	3.1%	2.6%	-3.5%	-6.2%
NASDAQ	4.8%	11.3%	12.1%	7.8%
Euro Stoxx 50	2.9%	-7.4%	-16.8%	-17.7%
SMI	0.6%	1.0%	-5.4%	-6.5%
FTSE 100	0.6%	-6.5%	-16.3%	-18.4%
DAX	5.1%	-1.8%	-11.8%	-11.9%
MSCI Asia Pacific	3.0%	-3.1%	-7.9%	-11.6%
FTSE China A50	-0.9%	-0.4%	-2.4%	-7.8%
MSCI Emerging Market	0.6%	-8.0%	-11.0%	-17.0%
PH Semiconductor	0.4%	5.8%	5.1%	-2.4%

COMMODITY

	Price	FCST 19	FCST 20	Δ Future
Gold	1'731	1387	1'669	-1.3%
Silver	18.28	16.2	17	-11.2%
Platinum	878	864	820	-13.0%
Palladium	1'942	1502	2'000	-23.4%
Crude Oil	32.88	57.0	34	-2.5%
Brent Oil	34.51	64.0	39	1.7%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
Gold	1.0%	10.5%	18.1%	13.7%
Silver	19.4%	10.6%	5.8%	1.1%
Platinum	9.9%	1.0%	-3.6%	-10.7%
Palladium	1.5%	-21.6%	8.1%	2.4%
Crude Oil	72.0%	-27.3%	-38.8%	-44.1%
Brent Oil	42.4%	-30.4%	-40.7%	-45.6%

FOREIGN EXCHANGE

	Price	FCST 19	FCST 20	Δ Spot
EUR/USD	1.1119	1.1100	1.1200	0.7%
GBP/USD	1.2349	1.2900	1.2700	2.8%
USD/CHF	0.9637	0.9900	0.9600	-0.4%
USD/JPY	107.25	108.00	108	0.7%
EUR/CHF	1.0716	1.1000	1.0800	0.8%
USD/RUB	70.58	64.10	72.00	2.0%
EUR/RUB	78.48	71.10	80.81	2.9%

	Δ 1m	Δ 3m	Δ 6m	Δ ytd
EUR/USD	2.5%	-0.5%	0.9%	-1.0%
GBP/USD	-0.7%	-3.6%	-4.5%	-6.9%
USD/CHF	1.3%	-0.8%	3.8%	0.3%
USD/JPY	-0.5%	0.5%	2.1%	1.2%
EUR/CHF	-1.2%	-0.2%	2.8%	1.3%
USD/RUB	3.5%	-5.9%	-8.9%	-12.2%
EUR/RUB	1.2%	-5.2%	-9.6%	-11.2%

Source: Clarus Capital Group, Bloomberg

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IMPRESSUM

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