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ENTEXT
Economic Strategy & Analysis

Liquidity Dysfunction Sparks 'Kitchen Sink' Policy Response…

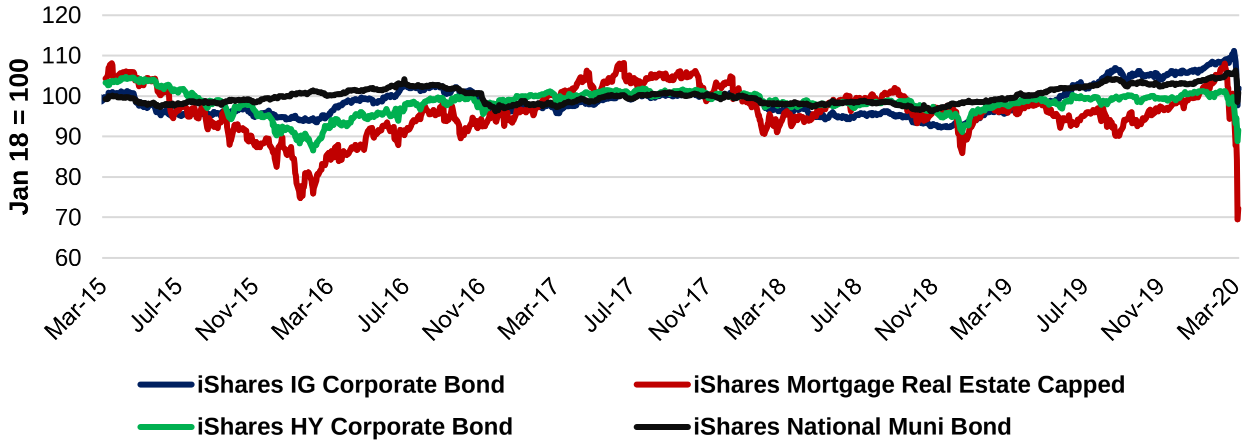
'"Dealers don't have the risk appetite and budget they normally have. But ***I've never seen that before, the inability to trade a U.S. Treasury. And I'm pretty sure I'm not the only one who experienced this."*** *The $23 billion* ***iShares 20+ Year Treasury Bond fund's price ended Wednesday 5% below the value of its assets.*** *In the almost 18-year history of the product, the average difference between its price and the value of its assets has been 0.03%. Untangling all of the causes of the various stresses in markets may prove to be difficult, if not impossible. Still, an overwhelming demand for U.S. dollars from corporations and investors is blamed for drying up liquidity.* ***Many companies are being forced to tap emergency credit lines from banks to ensure they have enough cash on hand to continue operating as their*** *revenue streams threaten to dry up. That is being exacerbated as investor demand for new corporate debt offerings disappears. Funds that invest in U.S. investment-grade corporate bonds suffered their worst outflow on record….'* From Bloomberg analysis of last week's US fixed income liquidity crash

*'The Natixis/H2O debacle…is likely to be followed by similar events as credit fund returns are scrutinised. As BOE governor Mark Carney stated this week: '****These funds are built on a lie, which is that you can have daily liquidity…for assets that fundamentally aren't liquid…'****. After historic bond inflows YTD and the growth in unhedged credit buying (notably from Japanese insurers), 'return enhancement' strategies could morph into a systemic risk if bond market distortions continue to grow.'* - Weekly Insight, June 27th 2019

"Drawing from ***my own country's experience, speedy and accurate testing and adequate personal protective equipment for medical professionals are most effective in preventing the spread of the virus****. We hope that our donation can help Americans fight against the pandemic…"* Jack Ma, announcing a donation of 500k test kits and 1m masks to the US

- As the old market saw goes, **in a liquidity crisis you sell not what you want, but what you can** and the dislocation across credit markets has been broad, exposing the inherent risks of these 'return enhancement' strategies. As risk assets price in a sharp but short global recession lasting through Q2, for **both equity and credit investors it's the distribution of the cashflow impact and leverage that matters**. US corporate credit markets have grown by $5trn since 2008 to $7trn outstanding today, driven by a surge in BBB and single-A paper outstanding – **a lot of BBB could become junk should the economy go into recession lasting 9-12mths.**
- As the implications of a US recession sink in (say -5 to 8% in Q2), **investors also began to offload high yield US municipal debt**; many hundreds of cities already stretched by huge underfunded pension liabilities will struggle with the financial implications of the virus. The distorting impact of ETF rebalancing activity has long been evident in the often frenzied last hour of US equity trading, and as high-frequency traders have withdrawn from the market **S&P futures liquidity 'top-of-book' depth collapsed further last week** to about 5% of its $80-100m long-term average while executable 30-yr Treasury ticket size has been as low as $5m in the past few days from $30-50m.

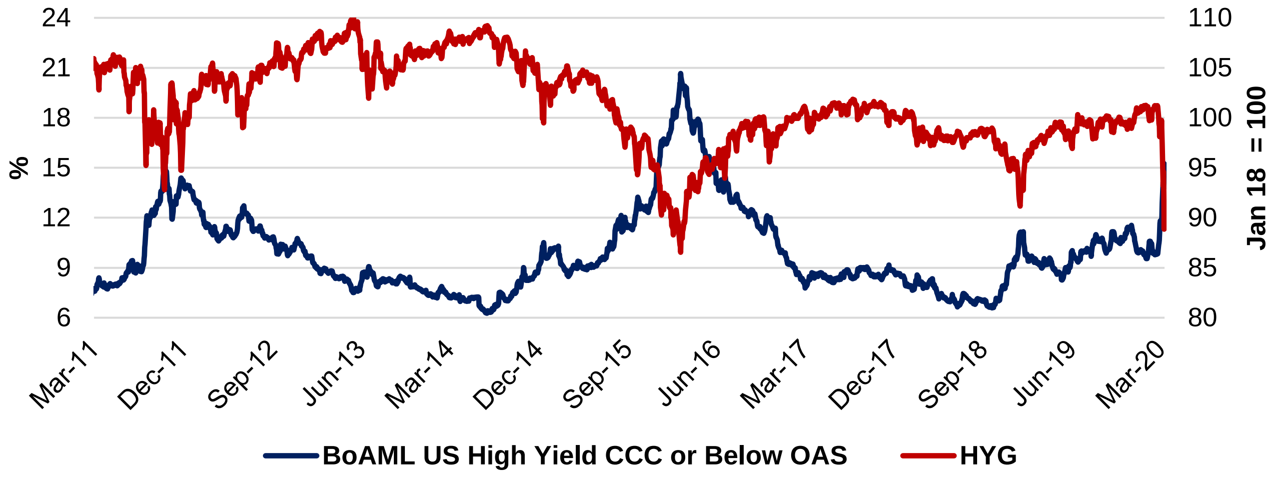
US Credit ETFs Plunged to Record NAV Discounts



Source: Entext

- Bid-ask spreads on the 30 yr last week went as wide as 8 ticks and if **the Treasury market experiences sustained large scale illiquidity it will clearly be difficult for other markets to price effectively**. Indeed, it **could lead to cascading position liquidations elsewhere** - in that context, selling by oil producers seeking to plug revenue deficits is another destabilising feedback loop from the oil market share war. The Fed uses credit spreads and issuance as a key input into its policy making as we saw in late 2018, when QT was abandoned, and last week's market dysfunction forced its hand. While we'll see new MBS buying, no central bank has yet taken the leap to buying junk paper so boosting risk appetite/reducing portfolio liquidation pressures is the strategy. But make no mistake – **nothing is now off the policy/regulatory table**, and I took profits on the HYG short on that basis, rather than the fundamental outlook…

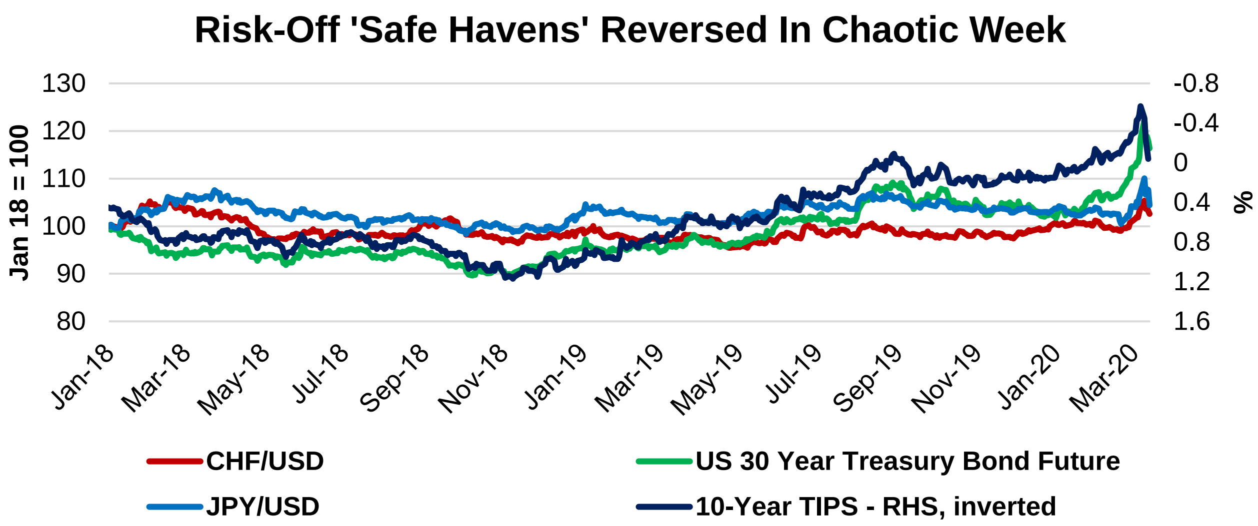
The Jaws of Credit Market Liquidity Death



Source: Entext

- We're **still well below the 2003 or 2016 spread highs** (let alone the 2000 bps seen in HY and 600 in IG in the 2008 meltdown) and without this intervention succeeding, BBB bonds could easily reach a spread of 400bps with BB bonds hitting 750 bps over and single B bonds at 1100bps in Q2. It wasn't just bonds seeing wild liquidity led gyrations last week - the **USD rally versus G10 currencies last week seems to reflect volatility in money markets, which lifted USD carry – for instance, 1-mth USD carry vs. JPY rose to about 3% by the end of the week**, despite front-end rate differentials at just 30bps. The implied cross-currency basis i.e. the gap between those numbers exploded as the supply of Dollars in the FX swap and forward market dried up. Foreign central banks will likely tap the expanded USD swap lines now offered by the Fed, easing pressure on the FX swap market this week...if that isn't apparent, it would be worrying.

- Before the Fed launched a coordinated rate cut, $700bn in new QE and expanded USD swap lines over the weekend to offset what now looks like the biggest US nominal demand shock in peacetime history, hard on the heels of its $1.5trn repo market intervention, Christine Lagarde's press conference comment that '*We are not here to close spreads, there are other tools and other actors to deal with these issues…*' revealed a harsh truth. The Eurozone has squandered the past decade debating risk reduction, debt restructuring, and sovereign/bank 'doom loops' while it should have worked on building a common fiscal space and bond market. She backtracked shortly afterward as BTPs surged in reaction claiming to be '*fully committed to avoid any fragmentation in a difficult moment for the euro area'*. **The issue now is less the fragmentation of Eurozone bond markets than of its physical borders**, which are slamming shut as national self-preservation takes precedence…



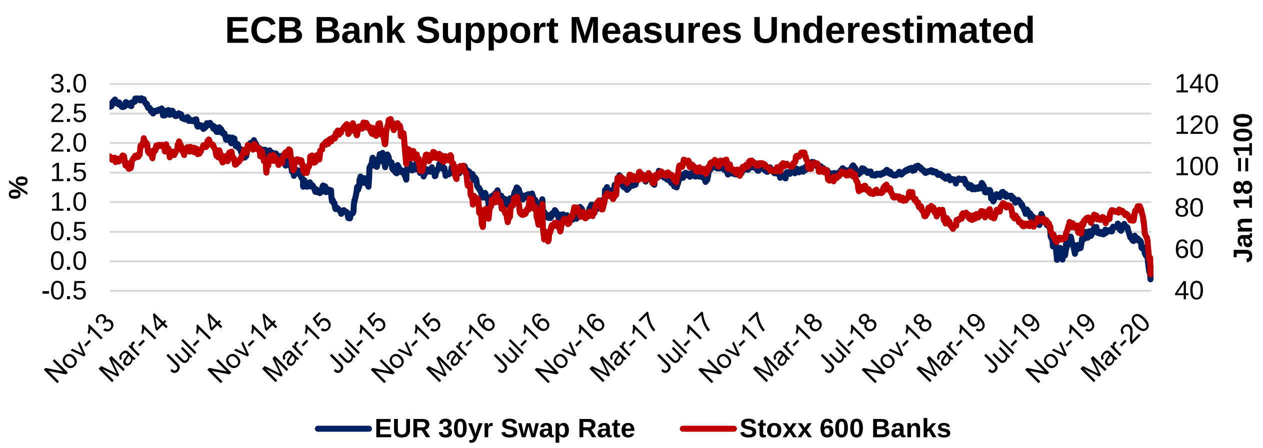
Source: Entext

- The ECB's €120bn in additional asset purchases through year-end underwhelmed, but ultimately the nature of this growth shock demands a targeted fiscal/regulatory response to avoid mass bankruptcies in the most affected sectors. The German finance minister's announcement of an **initial €550bn but potentially 'unlimited' credit program via state owned KfW for struggling firms reflects a significant paradigm shift** in Berlin's willingness to leverage the sovereign balance sheet. With the scale of layoffs looming in the usually resilient service sector in both the US and Europe (and low levels of emergency household savings in the former), fiscal policy will likely go full Keynesian by the time this is over.

- **Trump's belated recognition of the scale of the threat on Friday marks the beginning of serious US containment efforts**. Near term, Jack Ma's contribution may matter more than the bizarrely sycophantic White House press conference. The suspiciously high number of sports, media and political celebrities testing positive is ominous, and reflects the fact that they have the resources to obtain scarce testing kits, because the US decided to design its own via the CDC (rather than accept the WHO versions used in Asia) and made a shocking mess of it. NBA team the Utah Jazz got hold of 58 kits to check employees mid last week after a player fell ill, which represented almost half a percent of all the tests conducted in the US at that point. Flying blind doesn't quite capture it…

- The **administration claims that almost 2m testing kits will be rolled out over the next week**, but it's clear that given the delays containment will now be extremely difficult - the virus has been circulating in the US as well as Italy since around mid-January. Nonetheless, the CDC advising against gatherings of more than 50 indicates that the **US as well as Europe is now following the successful Asian template on how to manage this**, albeit boosted by cultural factors such as widespread mask wearing (and I can't get a taxi here without wearing one, their dubious effectiveness beyond 'virtue signalling' further reduced by my very un-Asian nose) – S. Korea is tracking China a few weeks ago in reaching a positive inflection point.

- **To minimize the economic and human costs of this crisis, we need to achieve infection curve flattening and yield curve steepening - the latter at least is now underway**, with panic duration chasing apparently having peaked mid last week and the 30-yr yield doubling from its lows while its weekly trading range was the largest since 1987. The 10-yr yield soared from a Monday low at 32bps to a Friday high retesting 1%, leaving many VaR based position management models in meltdown (as were precious metals from gold to palladium).



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- Of course, **some of this reflected a liquidity collapse as much as systemic margin calls** - last week proved that in times of extreme stress, there are no one-way bets and the only true hedge is cash. Investors now broadly accept that we are entering a sharp technical recession in the US, Europe and Japan through the next couple of quarters. Given the pandemic uncertainties, it's not clear how long the downturn will last but **a hyperactive response to head off a potential deflationary bust will make the eventual real economy recovery high-powered** – whether a slowly normalising China sees the 'revenge consumption' Beijing is now encouraging will be a tell, and activity at those reopened Apple and luxury goods outlets bears close watching over the next month.

- Although this is in many ways a far more profound event than 2008 and the shutters are literally coming down on much of the global economy, **policymakers will 'kitchen sink' the response to the dysfunction evident in markets last week –** fiscal deficits and central bank balance sheets will simultaneously soar into year-end. Indeed, **despite the current fear and loathing, it's conceivable that we end up within 12-18mths with excess liquidity driving at least some risk assets to new cyclical highs**. **If a decisive fiscal response follows the monetary one, an inflationary end to the cycle is now a plausible scenario**. Although a viral mutation/second wave is clearly a downside risk, overall, it's wise to bet on science and human ingenuity/adaptability.

- Meanwhile, Eurozone banks reacted badly to the ECB disappointing consensus expectations for a rate cut and were down an astonishing 50% from February highs last Thursday, even though it lowered capital and liquidity requirements and in another extraordinary measure, the European Banking Authority announced that it was postponing their stress tests until 2021. The single supervisory mechanism (SSM) will allow banks to operate temporarily below the level of capital defined by the Pillar 2 guidance - **post the ECB announcement their loan growth benchmark is now zero and the**

amount available is now €2.3tn at -0.75% which can be deposited at -0.5% in a straightforward subsidy. The roughly €20trn in risk weighted assets across the European banking sector will see about €800bn in capital relief as a buffer to absorb NPLs etc. - the SSM is allowing banks to support their struggling SME customers. Recent earnings downgrades of 8-10% look fully discounted and this backdrop looks bullish once any sustained market calm resumes…I've initiated a tactical long accordingly.

Quant Volatility Targeting Unwind and ETF Panic Outflows Exacerbated Slump

'…Buffet's admission (or belated statement of the obvious) that Heinz had overpaid for Kraft alongside 3G. Anheuser-Busch InBev was also built by 3G activism and ***in both cases the wider issue of aggressive leverage becoming dangerously high when projected cashflows disappoint has ramifications beyond the sector*** *…If a nominal GDP tracking 5% growth business requires a 4% cash flow yield (a FCF multiple of 25x) even a small change, say to 4% (in perpetuity) requires the cash flow yield to jump from 4% to 5% i.e. a change from 25x cash flow to 20x i.e. a 20% decline in fair value price. US consumer staple type businesses have been far riskier in this context than tech…'* Weekly Insight, 4th March 2019

- There were signs last week of a **breakdown in stock-bond inverse correlations, putting stress on all multi-asset portfolios and Risk Parity funds in particular**. These are the systematic strategies I've highlighted previously which were running high leverage coming into March and as volatility rose became become forced sellers, a self-feeding source of wider instability. The Risk Parity (RPARTR) index saw a 3-day loss exceedi**ng 9% last week Tues through Thurs, its worst on record** (data back to 1998, when the strategy went mainstream just as LTCM imploded).

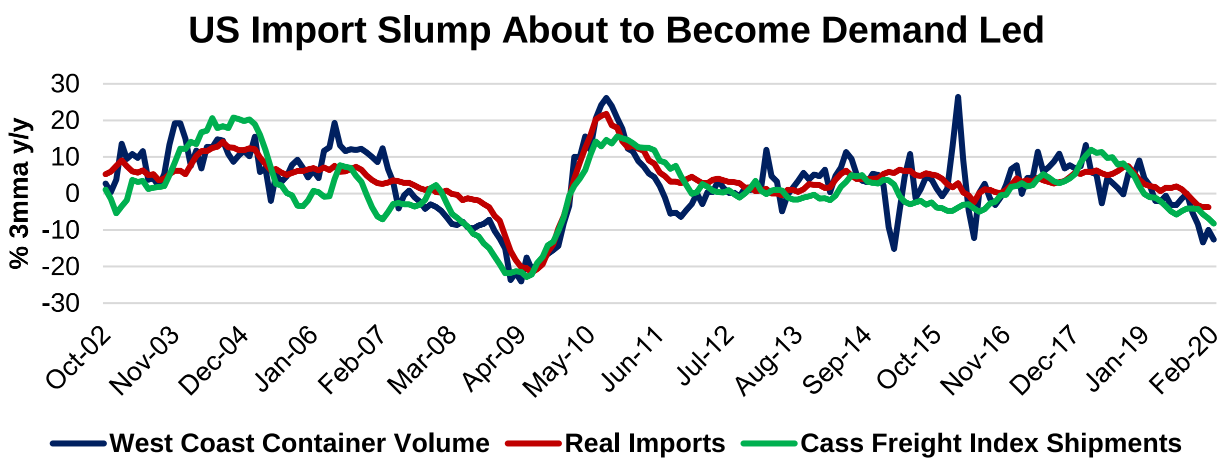
- **Low realized volatility feeding into quant based theoretical models has always fuelled the intellectual hubris of finance PhDs (think LTCM etc.) and ultimately proved toxic**. The recent low volatility regime in markets, boosted the relative risk-adjusted return of equities and drove a shift in asset allocation by risk parity and CTA managers. Just as the VIX was being weighed down by realized volatility, the market pricing of correlation was being suppressed by the substantially low level of realized correlation - the "implied correlation" for index options was at unusually low levels a month ago when the consensus brushed off pandemic risks with soundbites like 'it's just flu' and few imagined European and US Wuhan equivalents.

- The combination of low expected index volatility with low correlation had driven option prices to pre-crisis lows and fuelled the retail buying frenzy I covered back in the 20th February note. That now looks like a parallel financial universe - **S&P 500 realised volatility over the last two weeks ranks in the 99th percentile over the last 30 years**, with the former measure at the highest level since 2008. **I made the point last week that bond volatility was likely to converge with equity, and it did with a vengeance** – IG implied volatility in the US saw something approaching a 10SD move as liquidity disappeared, while the 30-yr Treasury had a stunning roller coaster ride mid-week.

- The fundamental issue is excess leverage and mispriced credit risk - almost $350bn of US debt sitting on the lowest rung of the IG ladder now yields over 5% - Occidental Petroleum after its disastrous Anadarko shale acquisition last year won't be the last to slash its dividend to protect its credit rating. Largely fixed capacity/costs (e.g. hotels) will be hard hit by a sustained drop in demand. **About $840bn of bonds rated BBB or below in the US are set to come due this year** and almost $300bn now trade below 90c on the dollar, locked out of refinancing or selling new debt.

- A large number of US IG bonds already have leverage ratios equivalent to HY and Kraft Heinz as covered a year ago in that note on 'perpetual growth' assumption risks a year ago was further humiliated when it saw its rating slashed from BBB- to BB+ by both S&P and Fitch on the same day last month, making $22bn of its bonds ineligible for the most broadly-followed IG indices. **A key question in the aftermath of the pandemic is the proportion of IG bonds potentially heading to junk as a result of the shock** exacerbating underlying business model weakness – if it amounts to $500bn plus, it could swamp the HY market, adding 50%+ to the sub IG space, unless the Fed somehow pre-empts the deluge.

- Aside from illiquidity and mispricing, **one reason the Fed is now in activist overdrive is that the prospect that a borrower with maturing debt finds it impossible to roll it over is becoming significant**, even for companies that are solvent. Across the developed markets, one in eight established companies makes too little profit to pay the interest on their loans, up from one in 14 in 2007, according to the BIS. A **recession only half as severe as the 2008/9 slump would result in $19trn of corporate debt or about 40% of the total being owed by such overleveraged companies, according to IMF analysis**. However, aside from the policy response, the PE industry has about $2trn of cash while Berkshire Hathaway alone sits on $128bn so there will be opportunistic financing and M&A, but this will be a nerve wracking few months for credit investors.



Source: Cass Information System, Census Bureau, Entext.

- **Meanwhile, consensus expectations for global EPS this year continue to tumble, and now are reaching negative 7-10% on a top-down basis,** although bottom up analysts still expect 6-8% EPS growth in 2020 – an **avalanche of downgrades is on its way into Q2 and the earnings revisions index will reach crisis lows of -50%**. The slump in transpacific trade which was supply shock led in February is about to become demand led – Apple closing all its ex China stores is a sign of things to come and we can assume many US cities will soon end up as ghost towns like Madrid and Milan.
- For China, which has just reiterated its annual growth target, the **grim Q2/3 export outlook implies much more aggressive domestic demand stimulus is on its way.** A global travel crisis lasting into next year will clearly impact sector specific capex as well, and with Boeing planes and energy key US exports, the US trade balance implications of recent developments are negative, although soft commodity exports to a recovering China which has seen huge farm output wastage may be one bright spot…

‘Herd Immunity’ Versus Containment Strategies to Split the World…

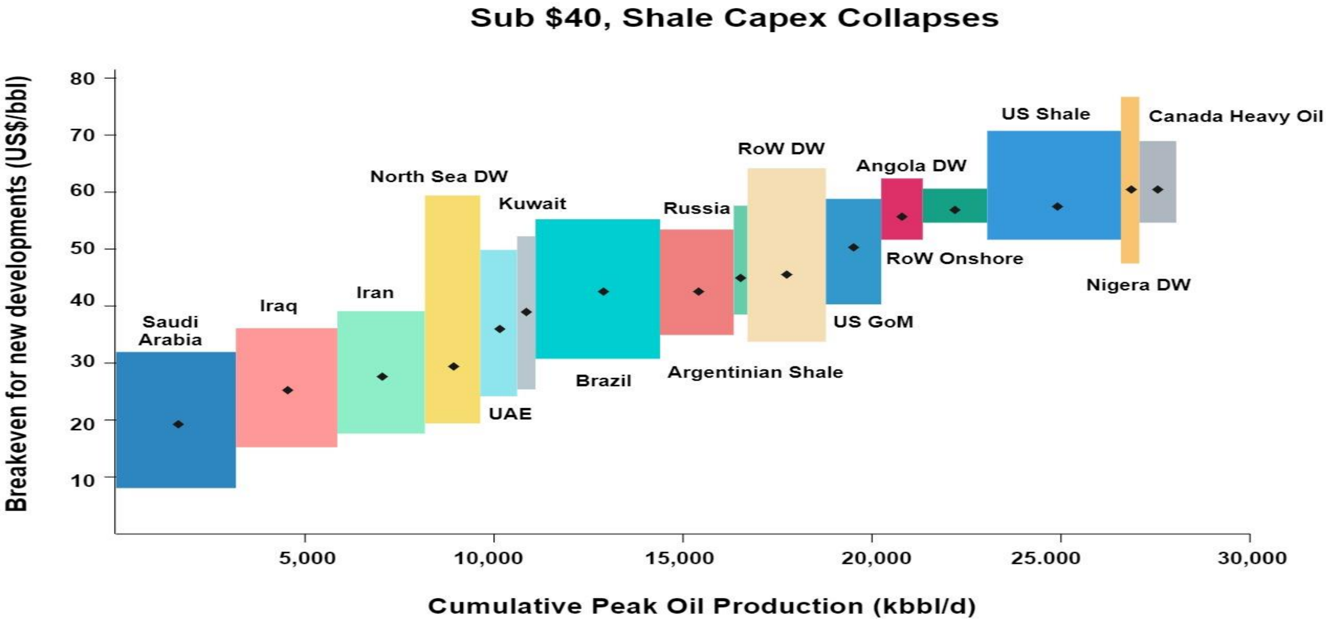
- As highlighted over the past month, the global aviation/hospitality/luxury sectors are ground zero for the sudden stop in activity. **When I wrote a month ago that global tourism was likely to fall 20% or over $1.5trn this year plus it seemed extreme**, **but now an underestimate** with spill over into the wider services and banking sectors. I got to HK at the weekend and the sight of hundreds of $100-200m apiece jets parked toe to tail on every spare apron and taxiway makes the impact very tangible, a scene now to be repeated at every major airport globally and even as countries start to bail out their airlines, the wider ecosystem of ground services, airport operators and concessions etc. faces extreme financial stress.

- Among the escalating series of international travel restrictions, India has banned all foreign tourists including from its non-resident 'persons of Indian origin' diaspora (about half of the 10m visitors a year) and implies that the huge local wedding market will collapse. With **a population density of 420 per square km (over 3x China's) and only 0.7 hospital beds per 1000 population (versus over 4 in China), India is acutely vulnerable** to a sustained local epidemic that makes it off limits to foreigners through next year, even as a vaccine is deployed. The oil windfall doesn't look enough to save the country from destabilising BoP deterioration and FX investors seem to agree, pushing the INR to a record low as foreign funds fled the equity market – **I've taken tactical profit on the short MSCI India short**, given how oversold global markets have become and the flood of soothing policy initiatives.
- The controversial UK strategy in this pandemic of delaying social distancing on behavioural grounds (i.e. there is just so long a lockdown can be sustained, and the outbreak could last for a year) amounts to letting it wash through the population (inevitably culling many over-75 Brexit and Boris voters in the process) **hinges on what level of infection constitutes 'herd immunity', with many experts believing it is as high as 90%,** which would leave the NHS devastated by millions of ICU level cases.
- Nonetheless, this is the default scenario across Africa/EM Asia (notably the Philippines and Indonesia) and LatAm so If over half the global population ends up carrying this, will Asia's exhaustive containment measures prove to be pointless short of banning international travel entirely and indefinitely? Mass and efficient testing will be key to restoring any form of normality – **it may be that by year-end, as cheap 20-minute test kits hopefully become ubiquitous, airports will test passengers for Covid before embarkation for 'biosecurity' pre-clearance.** Otherwise, most of the global long-haul fleet will be mothballed until a vaccine is widely available in mid-late 2021 and documented vaccination becomes the entry criterion. On that outlook, the slide in balance of payments tourism/remittance dependent EM FX across ASEAN etc. has a long way to go as these economies will be the last to recover…
- Meanwhile, as EU neighbours shut their borders in panic, China was sending a plane to Italy with medical experts and critical supplies, including plasma from recovered patients (a novel treatment that seemed to work in Wuhan) and ventilators which are in desperately short supply globally. As noted last week, **China is coming out of this mess with its reputation for technocratic competence and soft power enhanced** as US policy makers flail around incoherently. Even its reputation for statistical integrity has been boosted by the truly awful PMI and now industrial value-added data, far below consensus but totally plausible. The handling of this crisis is likely to have some very **significant longer-term geopolitical implications as the default global 'risk manager' as much as tech supplier of choice for many countries shifts**…

Russia Girds for Oil Price War of Attrition, as Data Flows Replace Human

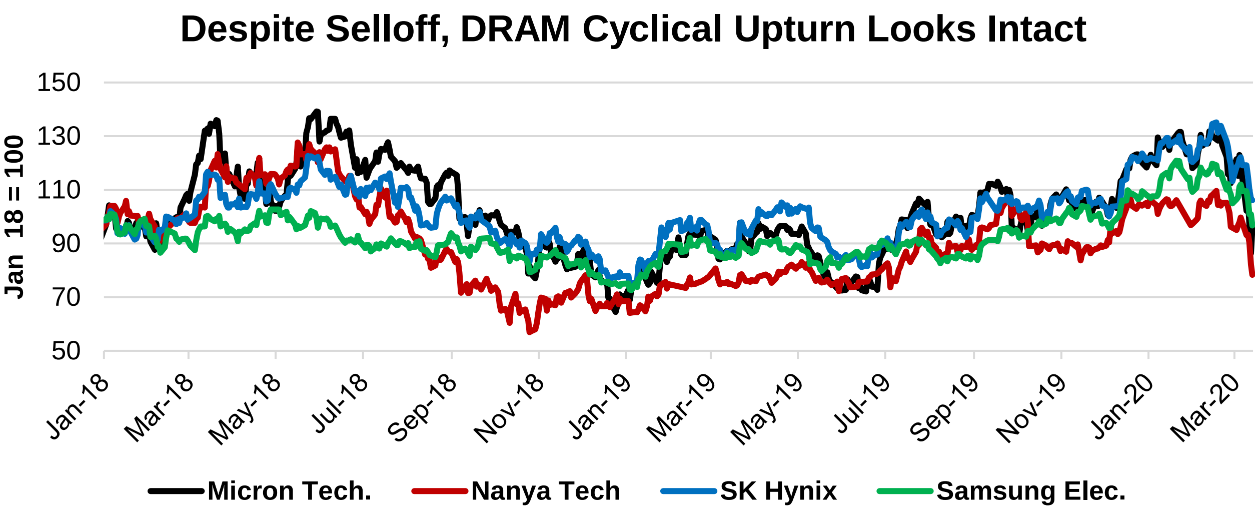
*"We believe **oil demand could soon be contracting by close to 10 million barrels a day, with perhaps more to come. We haven't seen a demand event like this in history**. People are not moving. They are not driving. They aren't flying and that's not counting the economic impact of the crisis which will also drive down demand…'*
Saad Rahim, chief economist at global oil trading house Trafigura interviewed last week

- That **10m bpd impact is about twice the biggest previous estimates, but Trafigura as a top three independent crude trader is in a good position to see current global flows** – aside from boosting refining margins and VLCC rates as oil goes into floating storage, it would be a disaster for the industry. Meanwhile, displaying the sense of humour for which he's renowned, Vladimir Putin changed his mind about retiring and backed a plan to allow him to run for two more presidential terms (i.e. to 2036) because of the current turbulent period in the world, according to his spokesman.
- With a half trillion USD in reserves (9% of GDP), a depreciating currency and a fiscal breakeven at half Saudi levels above $80/bl, **Russia is likely to win a war of market share attrition.** The Russian Ministry of Finance estimates that if oil prices drop to $25-$30 prices for a year, oil and gas revenue will decline by up to 2.4% and up to 6% if that price were sustained for three years. The risk scenario also anticipates a fall in the value of the ruble to 80-90 to the USD so total revenue from oil and gas sales would actually increase – the **FX peg is a deflationary trap for Saudi if this lasts into next year.**



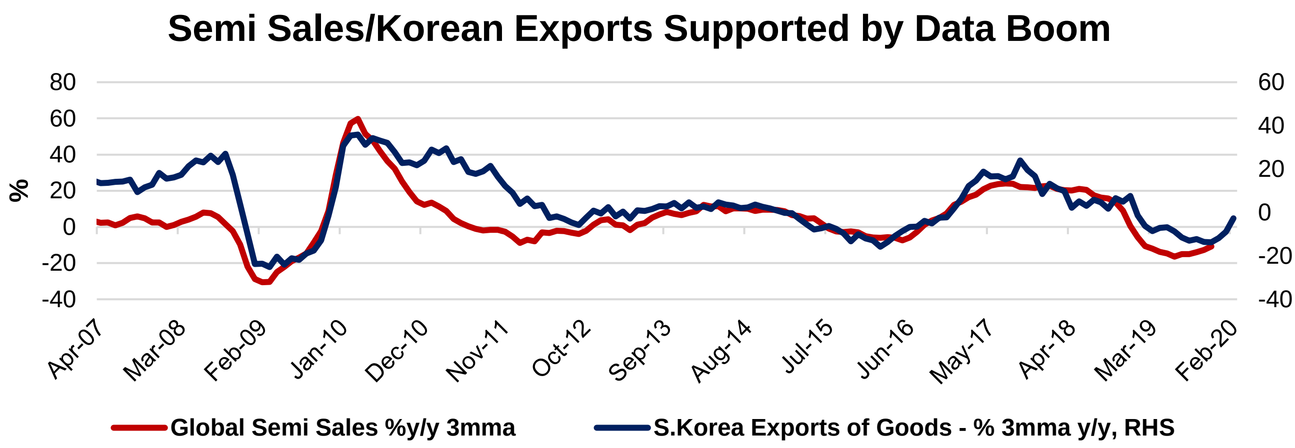
Source: Entext, IEA, Wood McKenzie

- The risk scenario also anticipates a decrease in Russia's international reserves due to the sale of FX that may result from oil prices dipping even lower. Even then, the economy is expected to grow by 1-2% in 2021, and by 3.5-4.5% in 2022. The national wealth fund will reach $140bn in March. In addition, Russia's **accumulated foreign reserves currently stand at $570bn** (about 7% held as gold) which is enough to cover costs for at least three years during an oil price slump. The only way back to the negotiating table if Saudi's 'maximum pain' strategy fails may be an overthrow of MbS and a new succession plan – this year, ex Russia, anything is possible in the energy markets and the most dependent economies.



Source: Entext

- The 'data is the new oil' soundbite is apposite right now – the pandemic isn't a disaster for all cyclicals and after the extreme correlations of recent weeks' dispersion should rise as markets become calmer into Q2. In particular, against a backdrop of low industry inventories**, demand for aviation fuel is being replaced by demand for DRAM as imploding human movement is replaced by exploding data volumes** from live streaming/video conferencing etc., At the moment, the three types of electronic products with the highest impact on DRAM and NAND Flash markets are notebook computers, servers, and smartphones and the latter has seen the biggest cutbacks. In terms of DRAM, a tight market he considerable preexisting gap between supply and demand is expected to persist even if demand drops.



Source: Korea Customs Service, Entext

- While previous H2 DRAM upside will be more limited a new downturn in prices looks very unlikely; NAND Flash looks more vulnerable if the demand shock is sustained into Q3. **Cloud server capex globally will have a further tailwind into Q2,** as will the personal device replacement cycle; home working is even harder with an underpowered laptop. Average contract price for 8GB PC DRAM modules are still recovering while Q2 server DRAM ASPs will jump ~20% q/q, NAND 5-10% while SSD ASPs look set to rise 10-15% on the latest TrendForce estimates.
- There will certainly be a volume hit from the weakness in autos (with global volumes down 5-7% this year), but **the 5G rollout/smartphone upgrade cycle in China and new gaming console launches from Sony and Microsoft remain on track**. It's also bullish that Huawei has avoided a UK ban despite a contentious parliamentary vote, and the US has extended export licences for the company's suppliers through mid-May…**Korean tech names (batteries as much as semis) look exceptional long-term value right now –** secular growth trends will reassert once pandemic fears subside .

Current Tactical Macro Trades and Thematic Stock Baskets

Open Positions	Instrument	Initiation	Status	Performance (%)
Long European Banks	Stoxx 600 Banks Index (SX7E)	12/03/2020	Open	4.7
Closed Positions	**Instrument**	**Initiation**	**Closed Date**	**Performance (%)**
Short Indian Equities	iShares India ETF	03/03/2020	12/03/2020	21.4
Short US Junk	iShares iBoxx $ High Yield Corporate Bond ETF	04/03/2020	12/03/2020	10.9
Long Japan Equities	Topix Index	08/11/2019	22/01/2020	2.4
Short US 10-year Note	US 10 Year T-Note Future	29/03/2019	22/01/2020	4.1
Long EM Local Currency Bond	VanEck Vectors J.P. Morgan EM Local Currency Bond ETF (EMLC)	03/09/2019	22/01/2020	3.9
Long MSCI EM	EEM ETF	26/09/2019	08/11/2019	6.8
Long China Internet Sector	KraneShares CSI China Internet (KWEB)	23/08/2019	17/09/2018	9.6
Short Utilities	SPDR Utilities Sector (XLU)	18/07/2019	05/08/2019	3.2
Long Copper	HG1 Sep'19 Future	29/03/2019	01/08/2019	5.8
Short MXNUSD	Bloomberg MXNUSD Spot	29/03/2019	05/31/2019	2.3
Long China Internet Stocks	KraneShares CSI China Internet (KWEB)	29/03/2019	07/05/2019	11.2
Long European Banks	Stoxx 600 Banks Index (SX7E)	06/26/2019	07/12/2019	6.2
Long AUDNZD	Long AUDNZD Forward June	29/03/2019	07/12/2019	0.2

Basket Theme	Constituents	Initiation	Status	Performance (%)
5G Infrastructure	Accelink, Cisco, Juniper Networks, Nokia, Qualcomm, Zhongji Innolight	02/01/2019	Open	16.9
Autonomous Vehicles	Denso Corp., Koito, Nexteer, Renesas, GM, Sony, Baidu	02/01/2019	Open	25.5
New Energy Vehicle	LG Chem, BYD, Samsung SDI, Toyota, Hyundai, Hanon	02/01/2019	Open	18.2
Services/Ecommerce Automation	Cognex, Delta Elec., Innovance, Keyence, Omron, Rockwell, THK	02/01/2019	Open	3.9
Esports/Social Gaming	Netease, Capcom, Electronic Arts, Nintendo, Tencent, Ubisoft, Square Enix, Douyu	02/01/2019	Open	27.4
Artificial Intelligence Software/Semis	Alibaba, Baidu, Google, Hikvision, Iflytek, IBM	02/01/2019	Open	41.1
Closed Positions	**Constituents**	**Initiation**	**Closed Date**	**Performance (%)**
Embedded Intelligence (Sensors/MEMS)	Broadcom, Murata, NXPI, Nidec, Sony, Synaptics	02/01/2019	21/02/2020	47.8
Global Oil E&P (Reserve Underinvestment)	iShares SPOG ETF	02/01/2019	21/02/2020	7.0
China Education	Wisdom Education, Tianli Education, New Oriental, New Higher Education Group, YuHua, Maple Leaf Educational Systems	22/01/2019	05/07/2019	34.3
Cybersecurity	Akamai Tech., Check Point Software, Cyberark, Fortinet, Palo Alto Networks, Proofpoint, Trend Micro	02/01/2019	06/01/2020	45.0

Source: Entext – equal weighted baskets.

Summary Asset Views

	Investment View Vs. Benchmark MSCI Weight/SAA Benchmark (6-12mths +)	Rationale
Equities		
US	Bearish/Neutral	PER premium to Japan/Europe has been driven by high momentum/quality factor weighting - retail inflows into tech and falling bond yields drove narrow breadth ATH in February, but belated volatility spike on recession risks - S&P 500 EPS looks 5 to 8% negative in 2020 if H2 recovery
Europe	Bullish/Neutral	Recent view to avoid luxury/travel vindicated - auto sector, industrials upside if China activity normalises into H2 long DAX vs CAC for first time since 2017? Banks retesting lows, but ECB support underpriced
UK	Bullish	Global funds very underweight despite record MSCI AC discount - trade deal uncertainty drag on GBP supports FTSE 100 over 350, but unorthodox pandemic response creating uncertianty
Japan	Bullish	Despite recession looming ROE/buyback uptrend intact, high correlation to China industrial recovery - o/w deep cyclicals, real estate, global niche dominant tech exposure themes in robotics, EV, sensors etc
Asia Pacific	Bullish	Earnings momentum still negative but turning, favour N. Asia over India/Asean - o/w China education, internet names, infrastructure u/w property - tech hardware supply chain still supported by 5G product cycle
GEM Equities	Neutral/Bullish	India liquidity/funding risks a drag, HK selloff on political fears LT buying opportunity - o/w cyclicals vs consumer, Taiwan outperformance stretched vs wider AXJ and Korea, cyclical semi/component exposure attractive
Fixed Income		
Government	Bearish	US bonds supported by huge YTD retail inflows, bank convexity hedging and pandemic deflation fears - synchronised global fiscal easing in response implies risks skewed to downside into H2 for 10-yr sub 1%
Investment Grade	Neutral/Bearish	IG spreads should be widening this late in cycle, supported by (unhedged?) Japanese inflows - avoid high leverage 'blue chip' names with rising business model terminal valuation risks (e.g. Kraft-Heinz)
High Yield	Bearish	Early Q1 spread tightening looked at odds with US credit quality metrics/recession risks - energy sector key to CCC spreads, shale distress intensifying into Q2 - spike to 2016 highs?
EM debt	Bullish	EMB has been preferred to EM-GBI on FX risks, but current account trends and DM yield compression supportive - Brazil/India/ASEAN FX weakness into Q2 on growth shock but real yields stil broadly positive
Commodities		
Energy	Neutral/Bullish	China 'sudden stop' demand shock now going global,aviation demand (-8%) collapsing in Q2 but US shale output decline likely into 2021 after OPEC+ price war cuts off funding
Industrial Metals	Neutral	Virus selloff looks overdone unless factory disruption lasts into 2021, China FAI accelerating into H2, LT fundamentals support zinc, copper
Precious Metals	Neutral	Following US real yields closely - gold looks crowded long, palladium premium to platinum on diesel decline extreme on physical shortage
FX		
USD	Neutral	DXY expensive on REER basis in late 90s, supported by 'safe haven' inflows, but relative yield support eroding and services growth vulnerable
GBP	Neutral/Bearish	Cheap on REER basis but looks rangebound through Q1 as focus shifts to EU trade negotiations and end 2020 brinkmanship
JPY	Neutral/Bullish	Fair value on real yield, PPP basis about 110 versus USD, pandemic risk aversion inflows supporting near term despite recession outlook
Europe	Neutral	As with JPY, risk off frenzy has driven carry sharp trade unwind , 2yr yield convergence supports and short positioning extended - can ECB offset?
GEM	Neutral/Bullish	Virus panic reversing inflows - China likely to ease faster in Q2 to offset quarantine impact, tourism/remittance reliant BOP countries like Thailand, Ppns vulnerable on sustained travel disruption into H2

Absolute return investors may wish to treat Bullish recommendations as longs and Bearish recommendations as shorts. Meanwhile those with a benchmark may wish to treat our recommendations as tilts against their own strategic benchmark, and according to any single asset class limits they may have.

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