
Market updates

Investment team updates | 24 July 2020

Fixed income

- After a quiet start to the week, markets were more “risk-off” on US Covid-19 news, jobs data and increased China/US tensions. Moves include:
 - Core bond yields slid a little lower all week, with the US 10-year ending 23 July at 0.57%.
 - Credit spreads have swayed up and down a little, ending the week (23 July) a little wider.
 - Equities moved higher mid-week led by banks and energy, but were down on 23 July -1.2% led by tech.
 - Gold, up more than 20% year-to-date, was higher again on 23 July at \$1,900.
 - Oil nudged higher to \$42 a barrel.
- In the US, the rise in jobless claims suggests damage from Covid revisiting economy. Markets are waiting for additional US stimulus, Tesla hit a milestone in managing to report a profit for its fourth straight quarter.
- China and US tensions are escalating, and China has shut its US consulate in Chengdu.
- In the UK retail sales were up 13.9% in June – the largest increase since 1996.

US equities

Markets

- The S&P 500 was up for the third straight week, by 1.3%, while the Russell 2000 was up by 3.6% (17 July).
- There was a notable shift back in favour of value and cyclicals with the industrials sector leading the way. Materials and healthcare also did well. Consumer discretionary and tech underperformed, giving up some of their gains, but these are still the top two performing sectors over the year to date.
- Optimism over a vaccine was the major market driver and the reason for cyclical outperformance. Whether this turns into a sustained period of value outperformance is still up for debate, especially as there are still record levels of valuation dispersion between growth and value stocks. However, growth and momentum names still continue to benefit from the liquidity boost to markets and a number of secular trends playing to their advantage.

- Several notable names which have rallied hard in recent months fell back over the last week, including Netflix (-10.2%), Amazon (-7.4%) and Adobe (-7.3%).
- Negotiations over the next coronavirus relief bill in Congress are ongoing. The main point of contention between Republicans and Democrats centres on the size of the package, with Republicans looking to cut back the support.

Vaccine

- Pfizer and BioNTech announced that two coronavirus vaccines they are jointly developing had been fast tracked by the Food and Drug Administration (FDA). Earlier this week, the US government spent \$2 billion to secure the first 100 million doses of the potential vaccine from the companies, so they can be distributed free of charge to US citizens.
- While some debate remains about how much of the antibody is required to keep people protected, the recent developments and multiple “shots on goal” from many competing companies have increased the likelihood of a viable vaccine by the year end.

Earnings and M&A

- Q2 earnings have started to come through and generally companies have been managing to beat the, admittedly low, market expectations.
- As at 23 July, 25% of the S&P 500 by market cap has reported, and 75% of companies have beaten their lowered estimates, with earnings exceeding estimates by 13.6% in aggregate. Earnings are expected to fall 43% at this stage, though when cyclical companies are excluded, that figure improves to -21.6¹.
- Large cap banks which have suffered under increased provisioning for loan losses and squeezed net interest margins were rescued by blockbuster trading revenues. We expect small cap banks to fare worse, which are much more reliant on their loan book as a share of the business and don't have the offset of an investment bank.
- Chevron announced it was buying Noble Energy this week for \$13 billion including debt, which at just a 7% premium to its share price and six-times trough EBITDA is very cheap. Chevron's decision to pull out of its deal for Anadarko Petroleum last year has given it the balance sheet strength to carry out this transaction. Although it is not such a big deal, it will give Chevron more acreage in the Permian Basin and provide revenue diversification through Noble's offshore project in Israel. Energy consolidation in the US has been on the cards for some time, but this deal at such a low price has taken away much of the bull case for equity holders in the other US exploration and production companies.

European equities

- The Q2 results season is underway in Europe. So far there have been positive surprises, but it is in the wake of sharp downgrades to expectations owing to Covid-19.
- The positive results support the general premise that the recovery will be V-shaped; however, it is likely that the recovery will not reach previous levels of activity.
- We are wary of stocks which where valuations have become stretched, or cyclicals where the recovery has overrun and the business remains vulnerable to the after-effects of the virus.
- European lockdown relaxations have been successful to date – the focus is on containing local flare-ups and potential infection from worse-hit areas elsewhere, notably the US and Latin America.

¹ Credit Suisse data, 23 July 2020

- Brexit negotiations have predictably reached an impasse, with fisheries, state aid and European Court of Justice control at the forefront. At the same time, UK politics appears messy with further pressure for Scottish independence, an unsettling report on Russian political meddling, and uncertainties regarding the post-EU future.

Multi-asset

- We have been weighing up better-than-expected activity indicators in May and June (eg US retail sales month-on-month, jobless claims, mobility etc) with concern about grim virus data still emerging from southern US States and certain emerging markets.
- The latter is leading to a marked softening in very high frequency data, when coupled with expiring stimulus packages, which in the US in particular will deliver a hit of indeterminate magnitude to personal income.
- In Europe, however, the European Recovery Fund has been in focus, with the €390bn grant component symbolic in that it creates a precedent for fiscal transfers – positive news for the euro and for periphery spreads.
- In credit markets, meanwhile, we have seen global high yield underperforming investment grade. Debate continues on credit, where we have been more favourably positioned in investment grade since late March, but where carry in high yield looks attractive in the current environment.

Note: all data as at 23 July 2020, unless otherwise specified. Source: Bloomberg.



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