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Market Outlook

May 2020

MAIN MILESTONES THIS MONTH

01 The trend in the coronavirus contagion curve and the improvement in the Chinese economy acting as a leading indicator are positive signs.

02 It increases the probability that we will be in the central scenario in which recovery and economic growth return in Q3.

03 The strength and speed of the announced economic measures (monetary and fiscal) could protect markets from the worst-case scenario.

04 It is a cyclical recession, with a sharp drop in supply and demand, but shorter and different in nature from the 2008/09 crisis.

05 Headline inflation could fall in the coming months due to the drop in oil prices, to gradually rise again in 2021.

Summary by asset

- Fixed income: US investment grade corporate bonds offer an attractive return against US Treasury bonds
- Equity: In this context of high volatility, a conservative positioning seems appropriate in the short term, because volatility remains high and a second-wave of outbreaks of the pandemic could occur. However, taking a long-term view, the stock markets present attractive expected returns.
- Commodities: The price of oil is strongly in contango (i.e. the futures price is much higher than the spot price).
- Currency: The strength of the USD is due to the uncertainty of the financial markets even though its fundamentals indicate that it is overvalued.

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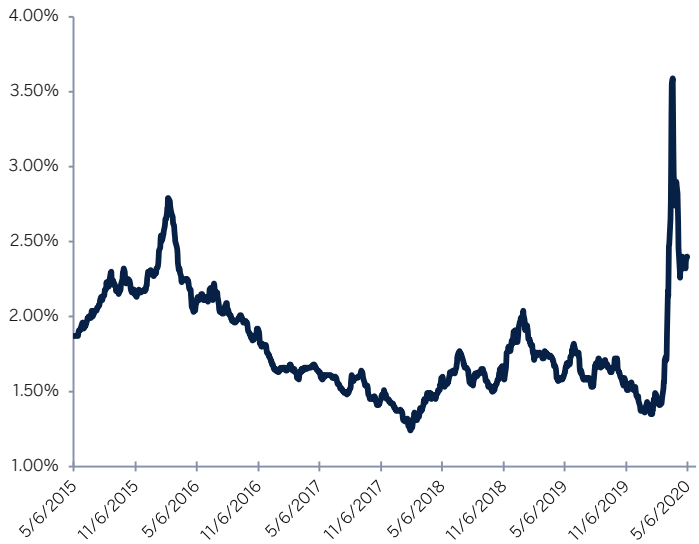
FIXED INCOME

- We see little value in government bonds of developed countries, as they offer returns (IRR) which are negative or close to 0%.
- The credit spreads offered by investment grade corporate bonds, may continue to narrow as a result of the liquidity injected by the main central banks.
- The default rates on US high-yield bonds will be notable in the coming months, but we see some attraction in maintaining a moderate exposure with an investment horizon of 3-5 years ahead.

We recommend maintaining high exposure to US investment grade corporate bonds, with plenty of (issuer) diversification.

Credit spreads (OAS) US investment grade corporate bonds

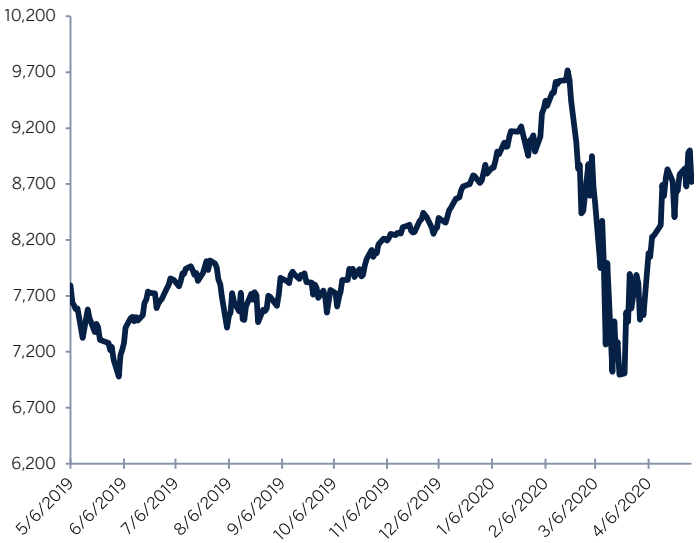
Source: Bloomberg



EQUITY

S&P 500 Index

Source: Bloomberg



- After the severe correction in equities in March, there have been strong increases over the last four weeks: over 10% in some indices.
- The following factors explain this positive behaviour: 1) in our central scenario, economic growth returns in Q3, 2) contagion containment, 3) China as a leading indicator of the re-opening of the other economies, and 4) the forecast that overall EPS in 2021 will be clearly superior to that of 2020.

With the recent rises, stock markets have become expensive again. In addition, there is still negative earnings guidance to be incorporated into the consensus figures. For that reason, it is better to look at the P/E ratio for 2021 profits.

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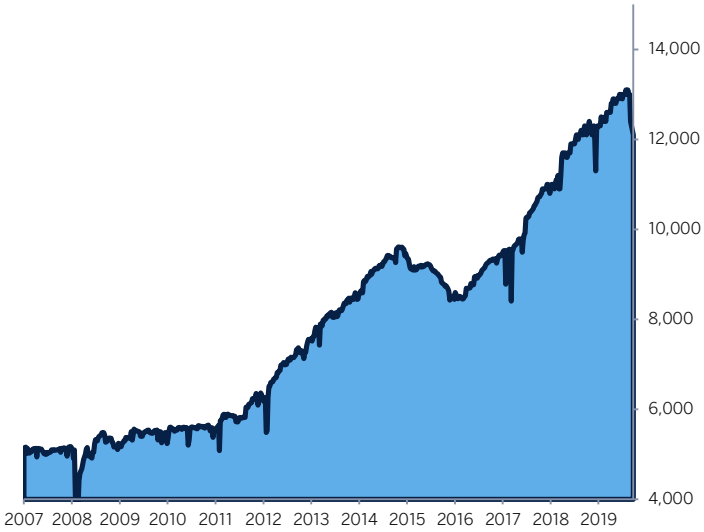
COMMODITIES

- On May 1, a new agreement was introduced to restrict supply in practically all oil-producing countries, including the United States.
- However, the fall in demand is so strong due to the coronavirus pandemic (down from 100 Mbd to 65/70 Mbd) that it will take time to rebalance the market. In addition, storage capacity is at its limit and is driving down short-term prices to extremely low levels, below the cost of production.

Commodities: The price of oil is strongly in contango (i.e. the futures price is much higher than the spot price).

US oil production

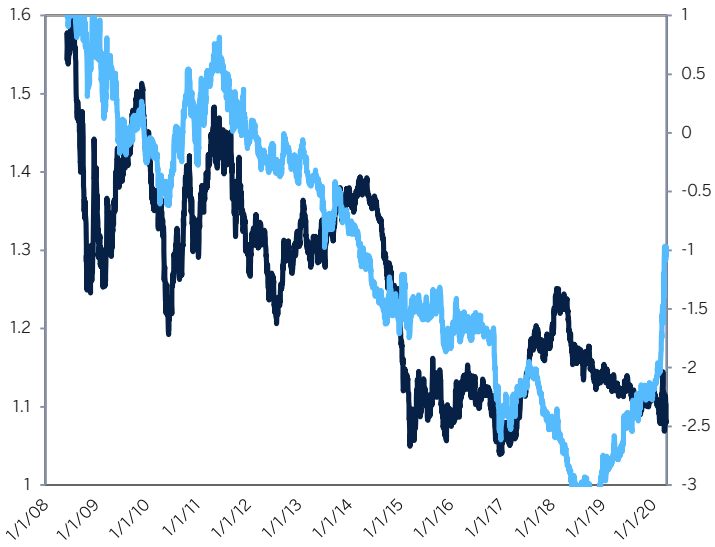
Source: Bloomberg



CURRENCIES

EUR/USD vs Interest rate spread

Source: Bloomberg



- The recent strength of the USD mainly results from "safe haven" factors within the current scenario of uncertainty.
- This situation will continue for the moment, but if the level of uncertainty falls, the dollar could weaken somewhat, which would be good for the stock markets in general and for emerging countries' assets.

Currency: The strength of the USD is due to the uncertainty of the financial markets even though its fundamentals indicate that it is overvalued.

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