



## DOUBTS EMERGE OVER THE REBOUND

- ▶ Central bank support looks like a given
- ▶ The US elections are expected to create volatility
- ▶ Certain segments and themes could still manage to perform well

Nobody was prepared for an unprecedented crisis like Covid-19 but there is no denying that the authorities rose to the challenge. After hesitating for a few days, they unveiled measures which stopped a catastrophe turning into a disaster. Over only a few weeks, we managed to avoid in our view:

- A major depression; thanks to fiscal packages to help existing activities and struggling employees as well as stimulus plans.
- A sanitary crisis morphing into a financial meltdown; thanks to unprecedented monetary interventions from central banks and broader reach. In only 3 months, the Fed's balance sheet ballooned by almost as much as during the six and a half year period following the 2008 crisis when four quantitative easing episodes occurred, the biggest monetary manipulation ever.
- A huge oil crisis which would have triggered a wave of country and company bankruptcies. This was avoided thanks to a price rebound and a last-minute OPEC+ agreement.
- A fresh European crisis; thanks to new ECB initiatives and a Franco-German proposal, subsequently improved by the European Commission, to create a coordinated European recovery fund. Italy took the brunt of the crisis and was political and economically fragile. Quick action had to be taken and Europe reacted. This is not yet a done deal but clearly the risks of a European crisis have abated.

Major risks have not disappeared but they have retreated and reopening strategies are for the moment proceeding satisfactorily. High frequency data (traffic, hotel and restaurant reservations) suggest people are moving much more again. Add in May's surprising job creations in the US and the impression is that the economy is rebounding faster than expected. The financial market rebound has been spectacular. The big question now is whether it can last.

### A WAVE OF M&A DEALS IS TAKING SHAPE

First of all, central bank action has been so efficient that market valuations have generally risen but left them disconnected from the economic situation. Bar a new shock and the sort of central bank backtracking that triggered the market sell-off in 2018, the situation could last. We believe central banks will continue to support markets in the coming months.

However, our economic recovery scenario makes it hard to extrapolate the positive contribution of the economic cycle to recent asset reratings. Unlike previous recessions caused by corporate restructuring, companies will emerge from this crisis with even more debt and lower margins. In these circumstances, it is tricky to establish the foundations for another dynamic cycle. As for M&A developments, the crisis has reshuffled the cards. Some companies will have been considerably weakened, others less so. The most robust will now have an opportunity to gain market share cheaply.

Investors are not yet focusing on next November's US elections and yet they will probably create some volatility. If the Democrats were to win the presidency and gain control of Congress, Donald Trump's 2017 tax cuts are likely to be cancelled, shaving around 10% off S&P500 earnings per share<sup>1</sup>.

Elsewhere, talks between the UK and the European Union on Brexit details are running late. But the deadline is the end of 2020 so we can expect investors to pay more attention to the risks involved.

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<sup>1</sup> Source : Goldman Sachs.

## RELATIVE CONFIDENCE

Without prejudging the future course of the epidemic, the second part of 2020 looks neither upbeat nor worrying. Abundant liquidity should offset a fundamentally grey scenario. Against this backdrop, **it makes sense for portfolios to maintain balanced risk profiles in our view**. Central bank liquidity has been a powerful market driver for the last two years but its effects have not been properly grasped, even by central banks themselves. And yet this liquidity has propped up today's asset prices.

**To tap into the global reopening theme, we have recently focused on European equities but we will be moving into more defensive markets as we only have limited confidence in the recovery.** We have been reinforcing sectors like healthcare and taking positions in themes like M&A, digitalisation and security that could do well in the post-Covid 19 environment. **The crisis has only reinforced SRI at both the ethical and financial levels. ESG-compliant investments have outperformed and especially during the lockdown.** We fully intend to extend our ESG approach to our investment universe.

**In fixed income, we prefer emerging country and subordinated financial debt.** Previous quantitative easing episodes all ended up encouraging investors to look beyond the developed zone for higher yields. Emerging bonds are currently more attractive and oil price stabilisation has improved the picture in our view. They could also be lifted by hopes for a firmer recovery in China in 2021. As for subordinated financial debt, it is clear that European and ECB action seeks to ensure that banks continue to fund the economy within a stable framework. European banks are well capitalised. We believe they are now better protected against an inevitable rise in defaults and therefore offer some appeal.

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