The Weekly Market View

February 03 2020

ADCB ASSET MANAGEMENT LIMITED

Markets gone viral

Concerns around the spread of novel coronavirus (2019-nCoV) have sent markets tumbling last week. With more than 17,300 reported cases of infection across 25 countries and 362 deaths at the time of writing this report according to CNN live updates, investors have started to worry about the potential impact of the virus on an already weak global economic growth. Over the past week, the World Health Organization (WHO) declared the virus a global health emergency and the US state department issued a level four warning on travel to China. This development along with some disappointing data (like the disappointing Chicago PMI, drop in core durable goods orders in the US and a contraction in Q4 GDP of France and Italy), has resulted in a significant risk-off move in the markets. As a result, equity markets saw declines, with DM outperforming EM. Within the developed world, equity markets in Germany, UK and Hong Kong posted significant losses and US equity markets outperformed despite declining in absolute terms. Within commodities, gold posted gains thanks to its safe haven status. Prices of crude oil and industrial metals fell. Central bank actions have determined FX moves. With US having the most scope to cut interest rates, USD indeed weakened against the majors (EUR, GBP and JPY). GBP strengthened against the greenback thanks to the Bank of England's decision to keep rates unchanged. Fixed income space saw some strong moves too. In the US, the 10Y-3M yield curve inverted and the real yields on US 10Y bonds once again turned negative. In Europe, bond yields edged lower on disappointing economic data with the 10Y Italian BTP yields declining the most. In the UK, gilt yields ended higher for the week as the Bank of England refrained from reducing policy rates.

Just infected, not inflected

The 2019-nCoV outbreak could be seen, by some equity investors, as an opportunity to take profit as markets wait for earnings to rebound, especially after an impressive rally over recent months which has seen sentiment improve markedly. We disagree. In our note Coronavirus concerns are overdone, we stick to our asset allocation, we looked at the performance of equity markets following the outbreak of epidemics in 13 previous instances. On an average equity markets rose 0.4%, 3.1% and 8.5% in the 1 month, 3 month and 6 month periods subsequent to the outbreak of epidemics. Maximum drawdowns were 7.4%, 13.7% and 4.3% over similar time frames. The drawdowns of 7.4% over 1 month and 13.7% over 3 months following the outbreak of Ebola in October 2018 coincided with the market sell off on broader macro fears of tighter policy by Fed and disappointing corporate earnings. To that extent, we think coronavirus can at best be 'a factor' and not 'the factor' influencing equity markets in the near-term.

Further, this entire episode would be a part of our 'high volatility' narrative for 2020 and our risk-barbell positioning. At this stage the 2019-nCoV story also dovetails with our equity asset allocation which prefers US high quality growth stocks over European and emerging market stocks. China ratcheting up stimulus (liquidity injections of USD174bn were announced at the time of writing this report) because of the coronavirus fears would confirm our yield curve steepening hypothesis too. For details on our asset allocation views, see Quarterly Investment View, January 2020. Key risk to our constructive view is a protracted spread of the 2019-nCoV resulting in pronounced weakness in global consumption – which has been the key driver of global growth in recent years.

Global markets' performance snapshot

Index Snapshot (World Indices)

Index	Latest	Weekly %	YTD %
S&P 500	3,226	-2.1	-0.2
Dow Jones	28,256	-2.5	-1.0
Nasdaq	9,151	-1.8	2.0
DAX	12,982	-4.4	-2.0
Nikkei 225	23,205	-2.6	-1.9
FTSE 100	7,286	-4.0	-3.4
Sensex	40,723	-2.1	-3.7
Hang Seng	26,313	-5.9	-6.7
Regional Markets (Sunday to Thursday)			
ADX	5,156	-1.4	1.6
DFM	2,790	-1.1	0.9
Tadawul	8,247	-1.0	-1.7
DSM	10,442	-1.3	0.2
MSM30	4,079	-0.1	2.5
BHSE	1,658	0.5	2.9
KWSE	6,325	-0.1	0.7
MSCI			
MSCI World	2,372	-2.2	-0.7
MSCI EM	1,073	-5.1	-4.7

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly %	YTD %
ICE Brent USD/bbl	58.2	-4.2	-14.2
WTI USD/bbl	51.6	-4.9	-15.6
Gold USD/t oz	1,589.2	1.1	4.4
Silver USD/t oz	18.0	-0.3	0.6
Platinum USD/t oz	961.0	-4.5	-1.4
Copper USD/MT	5,570.0	-6.7	-9.5
Alluminium	1,703.5	-3.5	-4.8
Currencies			
EUR USD	1.11	0.6	-1.2
GBP USD	1.32	1.0	-0.4
USD JPY	108.35	-0.9	-0.2
CHF USD	0.96	-0.8	0.3
Rates			
USD Libor 3m	1.75	-2.5	-8.2
USD Libor 12m	1.81	-3.9	-9.5
UAE Eibor 3m	2.07	3.1	-6.2
UAE Eibor 12m	2.36	2.4	2.9
US 3m Bills	1.54	0.8	-0.3
US 10yr Treasury	1.51	-10.5	-21.4

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Summary market outlook

Global Yields	In the US, the 10Y-3M yield curve inverted and the real yields on US 10Y bonds once again turned negative. In Europe, bond yields edged lower on disappointing economic data with the 10Y Italian BTP yields declining the most. In the UK, gilt yields ended higher for the week as the Bank of England refrained from reducing policy rates. However, we believe the long-term US rates will remain in line with the Fed's target Fed fund rate and further curve steepening risks are rising.
Stress and Risk Indicators	VIX spiked sharply on increased worries of the coronavirus. We believe that volatility will likely stay elevated given the range of risks on the horizon. This entire episode of the coronavirus would be a part of our 'high volatility' narrative for 2020 and our risk-barbell positioning.
Equity Markets	
Local Equity Markets	GCC markets were not immune to the impact of the coronavirus. With oil prices falling sharply, GCC equity markets experienced weakness. Equity markets in Abu Dhabi and Kuwait posted gains while all other markets posted losses. We remain neutral on GCC equities given the potential for further dollar strength and range-bound oil prices, but we maintain our overweight call on Saudi equities. We also prefer banks in the regional context.
Global Equity Markets	Equity markets saw declines, with DM outperforming EM. Within the developed world, equity markets in Germany, UK and Hong Kong posted significant losses and US equity markets outperformed despite declining in absolute terms. Overall, we remain neutral on equities with an overweight on US and underweight EU and EM.
Commodities	
Precious Metals	Gold posted gains thanks to its safe haven status in a risk-off environment. We remain overweight on gold as a risk hedge against ongoing political and (potential) inflationary risks.
Energy	Oil prices fell sharply as concerns of the coronavirus negatively impacting global growth, and therefore the demand for oil, intensified. Overall, we believe that oil prices are likely to remain sustained as the market is roughly balanced.
Industrial Metals	Industrial metal prices fell further as the virus concerns in China impacted the demand outlook. We do not recommend industrial metals exposure as China reigns in demand.
Currencies	
EURUSD	EUR strengthened against the USD owing to a range of factors including a relief rally following the UK leaving the EU and a disappointing US Chicago PMI which fell to its lowest since December 2015. We expect the euro to remain stable.
Critical levels	R2 1.1147 · R1 1.1120 · S1 1.1041 · S2 1.0990
GBPUSD	GBP strengthened against the greenback as the Bank of England kept its interest rates unchanged. We expect the cable to be stable with Pound sterling likely to follow the euro rather than USD.
Critical levels	R2 1.3295 · R1 1.3250 · S1 1.3121 · S2 1.3036
USDJPY	JPY appreciated against USD on a general weakness in the latter. BoJ yield curve targeting should put continuing downward pressure on the yen.
Critical levels	R2 109.42 · R1 108.89 · S1 108.07 · S2 107.78

Note: R2, R1, S2 and S1 refer to Bloomberg calculated weekly technical resistance and support levels.

Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
02/03/2020	Markit Manufacturing PMI	Jan F	51.7	51.7	Market attention will be on the labour market data.
02/04/2020	Factory Orders	Dec	1.20%	-0.70%	
02/04/2020	Durable Goods Orders	Dec F	2.40%	2.40%	
02/05/2020	MBA Mortgage Applications	31- Jan		7.20%	
02/06/2020	Initial Jobless Claims	1- Feb	215K	216K	
02/07/2020	Change in Nonfarm Payrolls	Jan	160K	145K	
02/07/2020	Unemployment Rate	Jan	3.50%	3.50%	
02/07/2020	Wholesale Inventories MoM	Dec F	-0.10%	-0.10%	

Japan

	Indicator	Period	Expected	Prior	Comments
02/03/2020	Jibun Bank PMI Mfg	Jan F		49.3	Japan PMI manufacturing will be important.

Eurozone

	Indicator	Period	Expected	Prior	Comments
02/03/2020	Markit Manufacturing PMI	Jan F	47.8	47.8	Focus will be on PMI and trade data.
02/06/2020	ECB Publishes Economic Bulletin				
02/07/2020	Trade Balance	Dec	15.0b	18.6b	

United Kingdom

	Indicator	Period	Expected	Prior	Comments
02/03/2020	Markit PMI Manufacturing SA	Jan F	49.8	49.8	Manufacturing PMI will be important.

China and India

	Indicator	Period	Expected	Prior	Comments
02/03/2020	Caixin PMI Mfg (CH)	Jan	51	51.5	All eyes will be on China January releases for PMIs and trade. In India, focus will be on the RBI meeting.
02/03/2020	Markit PMI Mfg (IN)	Jan		52.7	
02/06/2020	RBI MPC Meeting (IN)	6- Feb	No Change		
02/07/2020	Exports YoY (CH)	Jan	-4.50%	7.60%	
02/07/2020	Imports YoY (CH)	Jan	2.00%	16.30%	
02/07/2020	Trade Balance (CH)	Jan	$36.75b	$46.79b	
02/07/2020	Foreign Reserves (CH)	Jan	$3095.00b	$3107.92b	

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTT News
4. Reuters
5. Gulfbase
6. Zawya

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