UOB Investment Insights
Quick Note

10 June 2020

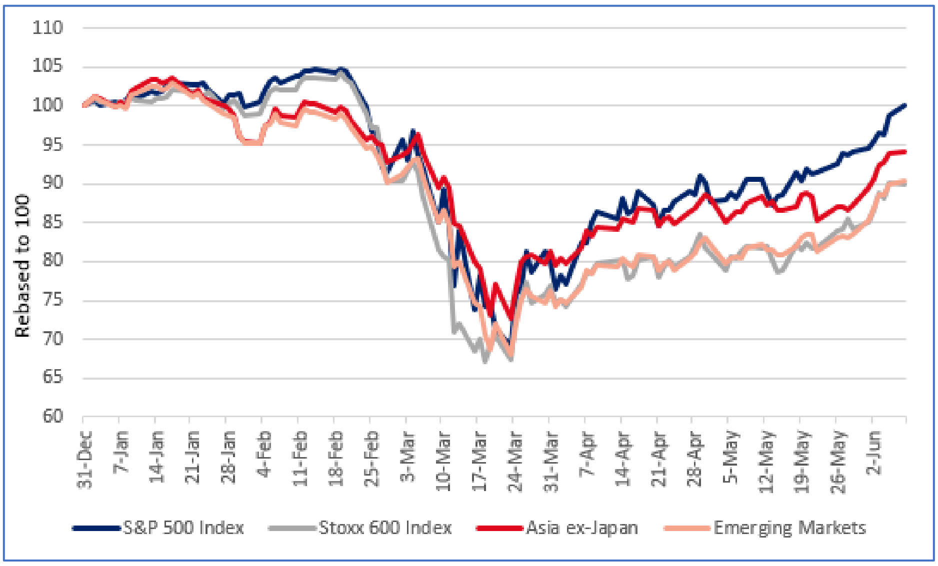
Wave of Euphoria in Equity Markets as Economies Reopen?

- With global equities showing strong gains over the past two weeks, it is easy to feel left out if you are not invested in the market. However, this is not the time to throw caution to the wind.
- Despite markets moving higher, economic fundamentals remain poor at best. The pace of the recovery is likely to be gradual and drawn out, with a recovery in corporate earnings expected to occur later part of the year and in 2021.
- With equity valuations higher compared to two months ago, we advocate investors to focus on Core strategies to enter the markets. With respect to equity exposure, be selective and go for equities with quality characteristics as they have stronger fundamentals that can withstand the uncertainties.

Equities rise on recovery hopes and vaccines

- Equities are getting all the attention these days as they climbed relentlessly higher. In particular, the US S&P 500 Index and the NASDAQ Index have rallied more than 40% from their March-lows, with the latter hitting a record high on 5 June 2020.
- The equity rally is not just a US phenomenon. European and emerging markets are also participating (Figure 1). The excitement of economies reopening and hopes of a viable COVID-19 vaccine have powered recent rallies.
- Another possible support for equity markets is the concept of TINA ("There is no alternative"). Investors are turning to stock markets simply because other asset classes offer lower returns. Most 10-year government bonds are offering yields of less than 1%.

Figure 1: Global Equities Powering Ahead



Source: Bloomberg, as of 9 June 2020.

- On a sector basis, we note that cyclical sectors such as Industrials, Financials and Consumer Discretionary are also rallying in recent days. This is in contrast to market movements a month ago, when rallies were mostly driven by gains seen in technology and healthcare stocks.

- With such strong moves, it drives optimism, but we advocate against throwing caution to the wind at this juncture. Being selective is still key when participating in the markets.

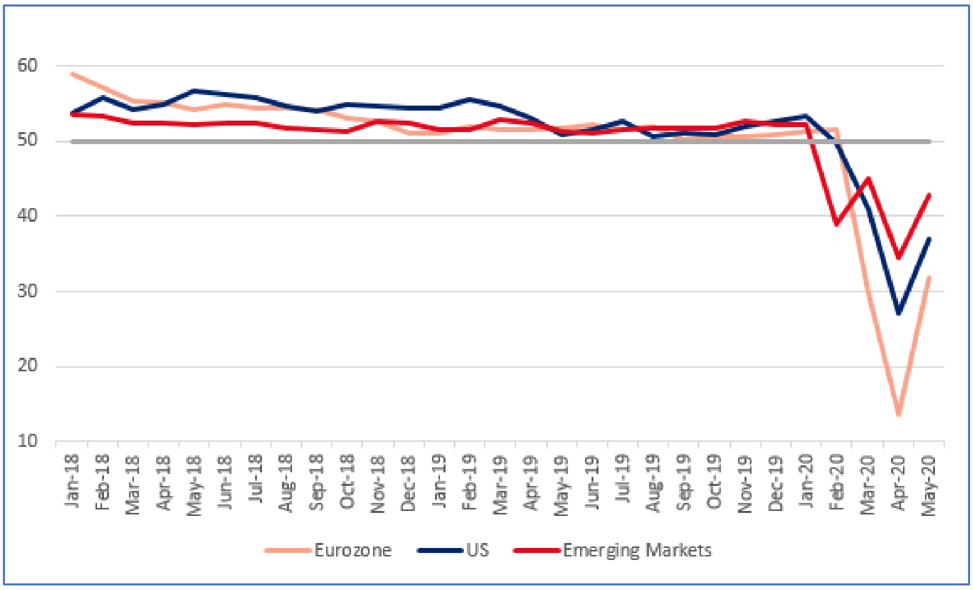
Economic fundamentals still poor; pace of recovery likely to be gradual

- Equities tend to be forward-looking, as markets look ahead toward an eventual recovery as economic activities resume. At times however, this can also lead equity markets to run a little ahead of themselves.

- The trend of recent economic data, while improving, continues to indicate a weak economic backdrop. It is vital to note that due to the phased resumption of economic activities worldwide and the possibility of another wave of COVID-19 infections, businesses are likely to remain cautious in their investment and hiring plans until there is more clarity.

- The trend of Purchasing Manager Indexes (PMI) readings remain in contractionary territory (Figure 2). Additionally, readings of new orders and new export orders remain depressed, suggesting that demand is still weak. This development is reflected in the trend of corporate earnings downgrades.

Figure 2: PMIs Globally Remain in Contractionary Territory



Source: Bloomberg, as of 9 June 2020.

- Consumers are more inclined to save, rather than spend, if they are not confident of holding on to their jobs in an uncertain economic climate. This means that recovery in consumer spending is likely to take some time.

- In the US, labour markets remain weak. Recent headline US employment data have turned for the better, but the Bureau of Labor Statistics (BLS) had acknowledged a 'misclassification error'[1] that led to May's unemployment rate being lower (13.3%) than what it actually is (about 16.3%). To put things in perspective, US unemployment rate peaked at 10% during the Great Recession. The US still needs to bring the pandemic under control in order to

[1] Source: U.S. Bureau of Labor Statistics, 5 June 2020.

fully reopen the economy and re-hire the laid-off workers over time. Even so, there are expectations that not all jobs will be immediately restored, leaving some workers unemployed over a longer term.

- Piecing the points above together, the pace of economic recovery is likely to be gradual. Our base case of a U-shaped economic recovery remains, with the recovery occurring in the later part of the year (3Q – 4Q 20), with the condition that the COVID-19 pandemic is brought under control some time in 2H 20.

- Lofty equity valuations make for shaky grounds amid an uncertain economic backdrop. Investors should take note that the economic conditions at the beginning of the year (reasonably good growth and low unemployment) and now (a severe recession with very high unemployment rates) differ dramatically. Equity markets should indeed make a recovery as economic conditions improve but they appear to run too far ahead of themselves.

- There are other risks besides COVID-19 on the horizon, such as a possible escalation of US-China tensions or any unexpected market volatility stemming from social unrest in developed markets turning for the worse, either of which can give markets a reason to sell down from the currently-expensive valuations.

What should investors do?

- **Enter the markets with understanding of potential short-term risks.** Market momentum has been strong, but valuations especially for the US markets are expensive due to lower earnings expected, while geopolitical risks are rising. Ride through this uncertainty by maintaining a medium to long term investing horizon.

- **Ensure adequate diversification in your portfolio.** The possibility of renewed market volatility on a second wave of infections or escalating geopolitical tensions between the US and China warrants us to advocate diversification between asset classes and geographies.

- **Focus on Core Solutions.** As equity market valuations are higher than before, you can instead focus on **Core Solutions** such as investment grade bonds or multi-asset solutions that are likely to weather market volatility better. For equity exposure, go for market segments that have stronger fundamentals that are able to withstand growth uncertainties such as **Equities with Quality characteristics**.

- **Enter the market in tranches.** By staggering your entry points, you participate in growth should markets continue rising. On the other hand, you are less impacted if market sell-offs occur in the months ahead, as the investment is only a fraction of the intended amount at the point of investing.

- Please speak to your UOB adviser to determine the right solutions for you in light of the latest developments.

**All data are sourced from Bloomberg unless otherwise stated.*

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RIGHT BY YOU