Lazard **Dynamic Portfolio Solutions**

Commentary

MAY
2020

Market Overview

Canada: a 290k rise in employment in May, driven primarily by Quebec lifting movement restrictions, suggests that activity is returning. Rail freight and export data suggest that a recovery will be slow however, though a rebound from the 30% decline in exports expected. Housing data show a mixed picture. Liquidity has improved to the extent that the Bank of Canada (BoC) announced it would be reducing the frequency of term repo operations. Expect the April GDP report this month to be significantly worse than the 7.2% fall in March, given restrictions came into full effect mid-March and oil firms slashed output in April.

United States: the patchwork of reopening now extends across all 50 states despite differing trends in COVID-19 case counts and varying capabilities to respond to local resurgences. Nonetheless, easing of restrictions has resulted—at least for the time being—in a bottoming in a number of high-frequency economic indicators. Most notably, the unemployment rate fell in May (although it remains very high). Legislative battles continue over renewing the fiscal stimulus measures that supported households and businesses during the lockdown, with some benefits due to expire at the end of July. With just five months to go until the presidential election, political tensions have risen, both between the US and China and around nationwide protests against police brutality and racial injustice.

Europe: the crisis has prompted a potentially effective co-ordinated monetary and fiscal response, which is good news for eurozone countries. The announcement of EUR 750 billion for a Next Generation EU fund and a step towards a common issuance of bonds should continue to be market supportive. Germany has handled the public health crisis well, and exports should recover as China reflates. France stands to be a beneficiary of COVID-19 liquidity and additional lending as much as Italy and Spain, all of which are also reopening. The UK is coming out of lockdown, though facing a negotiation impasse with Brussels as time runs out for a roadmap to a trade agreement by 31 December.

Asia: the region continues to see lockdowns reopening ahead of other regions given their earlier experience with the COVID-19 virus, and equity markets have been reflecting this. Japanese corporate profits are likely to post another 30% decline in 2Q, along with a 9% contraction in GDP. Markets in China are likely to remain under pressure due to the political risk associated with the fraying Beijing-Hong Kong relationship and a potential further breakdown in relations between the US and China over trade. The impact of COVID-19 on India is highly regionalized but the negative aggregate growth impact prompted Moody's to downgrade the country's credit rating to one notch above junk status, causing ongoing currency and market weakness.

Emerging Markets ex Asia: the policy response to the COVID-19 pandemic has not been as effective in other parts of emerging markets as it has been in Asia, increasing the likelihood of a more extended downturn in economic activity. In Brazil, changing virus case reporting from cumulative to daily numbers is illustrative of the seriousness of the pandemic, as authorities struggle to control the virus. In Mexico, the downgrade of PEMEX to junk status by rating agencies could foreshadow a longer-term decision on its sovereign bonds. Russia is reopening major cities, despite ongoing high rates of new virus cases, and is benefiting from firmer energy prices.

Commodities: Brent crude oil prices have rebounded to $40 per barrel from a late April low of $20 per barrel, reflecting a recovery in demand for gasoline in Europe and the US. However, storage levels remain very high and demand for other oil products is less transparent, potentially capping upside from here. Copper had been recovering from a low in late March and iron ore in April, as Chinese manufacturing restarted activity. In agriculture and livestock, US corn planting progress is in line with the five-year average and comfortably ahead of 2019, meat prices continued to be volatile due to the impact of COVID-19 on the supply chain. Gold appears to have hit near-term resistance around $1,700 per ounce as risk markets have recovered.

Currencies: US dollar weakness has been a feature of the recent risk-on rally, with the Canadian and Australian dollars benefiting considerably, and now in potentially over-bought territory back at February levels. The Japanese yen is trading in a fairly tight range, somewhat stronger than pre-February levels on safe-haven buying. As hard-Brexit risks reappear regarding the December negotiation deadline, the British pound will remain under pressure in an otherwise more positive European environment following recent co-ordinated stimulus action that boosted the euro. In emerging markets, commodity-related currencies have outperformed (Russia, Colombia, Chile); while the renminbi is vulnerable to any increase in US-China/China-Hong Kong tensions.

Trending market topics on Lazard's Dragonfly social media investment channel in May:

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- A proposal for negative interest rates
- Working from home is working
- An analysis of COVID charts in EM
- Turkish currency woes
- Indebted demand as a COVID response
- Stress-testing EM Debt

Views are as 8 June 2020

Important Information