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Just don't look down!

Summary: Financial markets have had a surprisingly good run since April despite considerable risks. This includes the struggle to reactivate economies hard hit by the COVID-19 pandemic; the threat of a new round of trade wars; looming elections in a number of countries including the U.S., Singapore, Poland, and Trinidad and Tobago; and rising geopolitical tensions in Asia and

North Africa. Q2 2020 earnings, to begin on July 13th, are expected to be ugly and provide little guidance for the rest of the year. But investors do not appear worried. Although we are steering through highly uncertain seas, there is momentum based on a belief there will be a time after COVID-19. The markets are pricing to where they expect the economy to be in 2021 and 2022, which is up. That view encompasses a post-COVID-19 world, a return to moderate global growth, and a U.S. that has moved past the November 2020 elections without a crisis.

Like two women walking on the edge of a rooftop, investors have taken the attitude they should not look down; that could be bad for their health. An example of this was evident last week when bad news about U.S. coronavirus numbers was trumped by good news on the jobs numbers, a trend that followed on July 6 with positive Non-Manufacturing ISM numbers for June. Like our two women above, investors are walking a narrow path to success based on their ability to look forward and up. Looking down at the risk could jeopardize matters. It was the French writer Marcel Proust who wrote, "The real voyage of discovery consists not in seeking new lands but seeing with new eyes." Our bet is that before we reach 2021, investors will be looking at the world around with them with new eyes, especially if some of the risk factors prove to be deeper and more enduring than they are presently accounted for. And there is a good chance for that though we hope we are wrong. Bottom line – July is likely to be a good month, but the closer we get to Labor Day, the greater the chance there will be for risk factors to upset the apple cart.

It's the Economy, Stupid (MacDonald): U.S. politics are increasingly focused on the November elections, which could see a change in the White House and possibly a loss of control by the Republicans in the Senate. Opinion polls currently weigh heavily in Democratic contender Joe Biden's favor, with *RealClear Politics* national average as of July 5th being at 49.6% for Biden and 40.9% for Trump. There remains, however, four months between today and when Americans cast their ballots. In politics that is a lifetime.

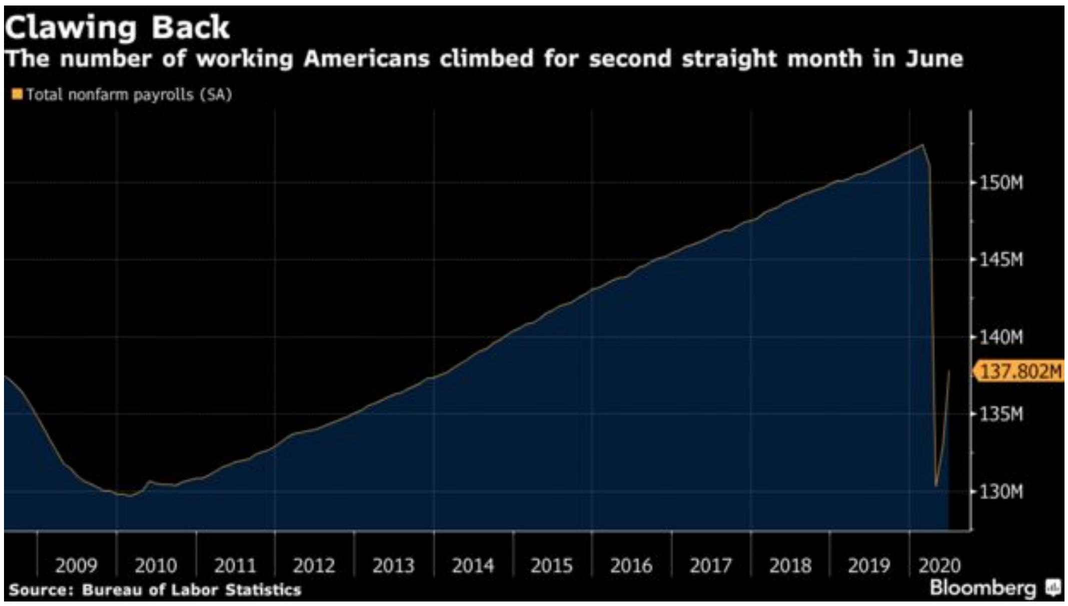
One of the key factors that will determine the vote is likely to be the economy and, for many, this comes down to jobs. Without gainful employment it is difficult to put food on the table and keep a roof above one's head. It also leads to feelings of insecurity. This has an impact on politics. Indeed, it was James Carville, one of Bill Clinton's campaign advisers, who coined the phrase, "It's the economy, stupid." It was true for 1992 and it is true in 2020. Although the economy is not the only factor, it probably looms the largest for most Americans and factors into socio-economic inequities which played a part in the recent racial unrest.

Battleground States in the Race for the White House

State	Joe Biden (Democrat)	Donald Trump (Republican)
Florida	48.0%	43.0%
Pennsylvania	48.7%	41.7%
Wisconsin	48.5%	42.0%
North Carolina	47.2%	44.2%
Arizona	47.5%	44.0%

Source: Real Clear Politics. https://www.realclearpolitics.com/.

The June jobs report was unexpectedly good news. U.S. payrolls grew by 4.8 million, dropping unemployment to 11.1 percent, from 13.3 percent in May and 14.7 percent in April (the peak). The leading sector in employment gains was leisure and hospitality, with large gains in retail trade, education and health services, manufacturing, and professional, business and other services. The sector that was most problematic was the energy sector, in particular oil, which continued to lose jobs. Government employment remained about the same, while employment in utilities declined by 3,000, bringing the 6-month net loss to 10,000.



One of the positives for the economy was that construction employment rose by 158,000 in June. Although heavy and civil engineering construction still struggled, employment gains in the sector came from strength in residential building permits and new home sales. Together with manufacturing, the upswing in these sectors point to a broader recovery in the economy. The main question, however, remains the trajectory of COVID-19 and if it can be brought further under control through the summer and fall. A preventive vaccine would do much to help.

For anyone looking for further economic momentum, the July 5th reporting of the June Non-Manufacturing ISM report was another boost and markets took it as such. Despite COVID-19, riots and demonstrations, the Non-Manufacturing ISM Index demonstrated a strong bounce back into positive numbers (hitting 57.1) after two prior months of being in negative territory. Anything under 50 is considered recessionary. One of the respondents from the ISM survey gave a cautionary positive outlook, "Businesses are starting to reopen and the economy seems to be on the road to recovery, but let's not get too complacent, [as] COVID-19 is still a pandemic, [and] a vaccine has not been developed. Economics is the reason for the push for businesses to reopen. Utmost care and awareness still needs to be cautiously and religiously observed."

As goes the economy, so goes the political scene. COVID-19 brought an end to the longest streak of economic growth since the late 19th century. The shutting down of both supply and demand was brutal and it forced attention on the structural inadequacies in the American system in terms of health care and socio-economic inequities. The U.S. government responded to the situation by pumping massive stimulus into the economy, while the Federal Reserve reduced interest rates close to zero and bought bonds to maintain a high degree of liquidity. With employment numbers rebounding at a faster-then-expected rate and other positive data, there is a hope for a V-shaped recovery. There is also hope in the White House that the recovery's pace is sustainable. Indeed, President Trump stated that the June jobs figures proved the economy is "roaring back".

The major risk facing the employment picture is that parts of the economy are forced to shut down again because of COVID-19. Another round of shutdowns would slow the recovery or even stall it as employers become more cautious and delay rehiring workers. Another consideration is that many businesses that were already struggling either fire many workers or go bankrupt. This potentially becomes more problematic with the coming expiration of the federal government's extra $600 in weekly unemployment benefits.

How does this filter back into the market? Investor perceptions have changed their time horizon from year-end 2020 to late 2021 or 2022, when they expect to see a stronger rate of return. They know that 2020 is going to be bad and that the recovery, and a new normal, will not become more evident until next year. Because of this prices for securities will be marked to where they are expected to be in 2021 or 2022. Considering that the planet should be past COVID-19 by then and economic growth will have recovered, stocks and bonds will be more expensive. This argument is compelling many investors to buy now, pushed by a fear of missing out.

There is a political calculation in the positive investor perception, which looks increasingly (reflecting opinion polls) to a Biden victory. At first glance a Biden victory would not be good for the market; he has promised to raise the corporate tax rate from 21 percent to 28 percent, roll-back Trump tax breaks for high earners and could make Senator Elizabeth Warren Secretary of the Treasury. If the incoming Biden administration leans strongly in the direction of the progressive wing of the party, this would be bad news for insurance, healthcare, banks, pharmaceuticals and big tech as policies would be to add regulations, break up companies considered too large, or radically overhaul the sector (as with healthcare and possibly banking).

But the calculation is that Biden will not go the progressive route, at least not until the economy is back on firmer ground. As Greg Valliere, chief U.S. political strategist at AGF Investments, noted (July 6, 2020 *Barron's*): "If Biden is elected, his first priority will be to get the economy recovering to where it was in 2019, and a severe increase in taxes and regulations would work against that. And if markets thought he would shift to the extreme left, they would be reacting more negatively."

We believe that while Biden has an edge on Trump currently (largely through the President's self-induced errors), the four month stretch to the actual vote in November leaves open a reversal in fortunes. President Trump has considerable ground to catch up, especially in swing states. He needs a break on the COVID-19 front, sustainable and faster-than-expected growth, a few gaffes from Biden, and a strong showing at the debates. Other items would include postponing the start of any new trade wars (that hurt U.S. farmers and fishermen), tone down racially divisive comments, take a break from Twitter, and listen to some of the smart people around him on COVID-19. All of this could be beyond him, but if he wants to be re-elected he has be more pragmatic. Trump is also hurt by his inability to campaign in front of large audiences, which have been trimmed due to people being concerned about catching the virus –even if the President is not.

For Biden, the political landscape has been better-than-expected. Trump has made many self-inflicted mistakes, which have driven up his numbers in opinion polls without having to be actively on the campaign trail. The trick is to eventually come out of the "basement" and start campaigning without making many gaffes and hold his own in the debates. Economic bad news benefits him, while playing the good news as being the result of bipartisan cooperation is his path to the White House. His challenge is less with the economy over which he has less control, but with motivating the Democratic base and persuading independents he can manage the economy without breaking it.

Most Americans look to the 2020 elections with the words of the President Ronald Reagan's 1980 campaign question, "Are you better off now than you were four years ago?" For Biden and Trump, with the American economy being a big bet, the question is, "Are you feeling lucky?" In four months we will find out the answers.

Egypt – Under Pressure (Windorf): Over the past few months Egypt has faced several heightened challenges stemming from the worsening Coronavirus pandemic, associated socio-economic pressures, and geopolitical events involving Libya and Ethiopia. Although we do not see a debt default looming as considerable international assistance has been forthcoming via the International Monetary Fund ($5.6 billion), we are concerned that through the rest of 2020 and into 2021 Egypt is likely to see an increase in political risk and economic stress. Its sovereign ratings will remain under pressure.

Following the initial outbreaks of the Coronavirus in mid-March, Egypt closed its borders, imposed a nation-wide lockdown with curfews, and halted most international flights. According to the World Health Organization (WHO), as of July 5, 2020, Egypt had 74,035 confirmed cases of COVID-19 and 3,280 deaths. Thus far, Egypt appears have handled the outbreak of COVID-19 in a better fashion than other developing countries, such as Iran, India and Brazil. Nonetheless, the pandemic is straining the country's fragile healthcare system.

The measures taken to contain COVID-19 had an immediate impact on the economy, hitting the tourist sector particularly hard. That sector directly accounts for around 5 percent of GDP and indirectly for 15 percent (including related investments and employment). The government has been sensitive in regard to its efforts to combat the pandemic given the importance of tourism as well as Suez Canal zone receipts and workers remittances, which have all been greatly affected during the past several months. And, as an effort to maintain positive public perceptions about those measures, the police have been arresting healthcare workers who are critical of the government's general response to the pandemic, including insufficient supplies of hospital gear.

Egypt Key Economic Indicators

	2018	2019	2020F
Real GDP %	5.3	5.6	2.0
Inflation %	21.6	13.9	9.5
Unemployment Rate %	11.6	10.8	10.3
Budget Deficit/GDP	-9.7	-8.1	-8.2
Current Acct./GDP	-2.4	-3.6	-4.5
External Reserves (months of goods and services imports)	6.6	6.6	6.2

Source: International Monetary Fund

The damage done to the economy led Egypt to turn to the IMF for help. The Egyptian-IMF relationship has been strong with the Arab country having secured considerable assistance in 2016 which helped it successfully implement a reform program. That same reform program raised Egypt's status as a sovereign issuer with investors, which allowed it to raise $5 billion in June – its largest issuance in international bond markets. The changed economic landscape due to COVID-19, however, downgraded Egypt's economic outlook: the country's real GDP will grow just 2 percent in 2020, down from the 5.6 percent level achieved in 2019. Consequently, in late June the IMF announced a new 12-month $5.2 billion Stand-By Arrangement under its Rapid Financing Credit Facility to help the country overcome the COVID-related downturn. The combination of international bond financing, the new IMF package, and other anticipated multilateral arrangements should cover the country's funding gap of roughly $10 billion by the end of 2020. While that gap could increase as future effects from the pandemic may worsen, we believe at present Egypt's improved standing in international markets will support any future funding challenge needs.

While the economy has been stabilized for now, Egypt is facing an upswing in geopolitical tensions from two directions, Libya and Ethiopia. Following the brutal overthrow of Libyan President Muammar Gaddafi in 2011, Egypt has maintained a resolute stance in the face of many complicated military and political developments within its western neighbor's borders. As the struggles for control of Libya's eastern regions and its capital Tripoli have escalated during the past few years, Egypt, Russia, and the United Arab Emirates have supported the rebel contingents under General Khalifa Hifter. The UN-recognized Libyan government's militias under Prime Minister Fayez al-Serraj have been aided by Italy, Qatar, and Turkey. The last has sought to rekindle a past relationship with Libya dating back to the days of the Ottoman Empire. This has been evident by a recent maritime pact, which bolsters Ankara's claims over potential offshore natural gas fields, and a sending of troops to the North African country. While Turkey's military assistance secured Tripoli and caused Hifter's forces to retreat to the eastern regions and Sirte, the strategic city overlooking important oil fields that he seized in early January, a stalemate ensued bringing the geopolitical crisis back to the United Nations for resolution. Hifter's 15-month failed campaign to capture Tripoli resulted in a humanitarian crisis placing one million people in extreme poverty and causing 500 thousand to become internal refugees.

Egyptian President Abdel Fattah el-Sisi recently warned both sides of the conflict that his military would directly intervene to protect Egypt's western border if Turkish-backed forces attacked Sirte, amounting to crossing a "red line". This caused Italy, Germany, and the U.S. to call for a cease-fire and de-escalation of tensions. On July 1, UN Secretary General Antonio Guterres informed Hfiter there could only be a political resolution to the conflict that he launched in April 2019 against the UN-supported government in Tripoli.

While this political situation smolders on Cairo's western border and will most likely end up in the UN Security Council for debate, Egypt faces another potential crisis with Ethiopia. In early July, Egypt informed the UN that it faces an "existential threat" from Ethiopia's recently completed colossal hydro-electric project on the Blue Nile. Begun in 2011, the Grand Ethiopian Renaissance Dam project (GERD) is Africa's largest hydro-electric power plant, backed by large reservoirs.

Although GERD will provide electricity and water to more than 50 million Ethiopians, the Sisi government contends it will endanger the livelihoods of more than 150 million Egyptians and Sudanese who live downriver. Because Egypt relies on the Nile for 90 percent of its fresh water needs, its foreign minister warned the UN Security Council of the potential for conflict should the UN fail to intervene. Sudan has acted as an intermediary between Egypt and Ethiopia following the collapse of U.S.-mediated talks this February. The Security Council members have taken no immediate action, but expressed support for the African Union to revive formal dialog between the rival parties.

Egypt and Ethiopia have both previously hinted at military actions to secure their vital interests. Neither country can afford to engage in any form of confrontation, considering the COVID-19 pandemic's effects sweep across various African regions. Ethiopia is also affected by unprecedented swarms of locusts. Instead there is a need for both parties to press for realistic negotiations to agree how much water Ethiopia would release downstream including under potential drought conditions, and how future disagreements be resolved.

Egypt's Sovereign Debt Ratings with Peer Group

Country	**S&P**	**Moody's**	**Fitch**
Egypt	B (stable)	B2 (stable)	B+ (stable)
Ethiopia	B (negative)	B2 (negative)	B (negative)
El Salvador	B- (stable)	B3 (positive)	B- (negative)
Ghana	B (negative)	B3 (negative)	B (stable)
Jamaica	B+ (negative)	B2 (stable)	B+ (stable)
Nigeria	B- (stable)	B3 (negative)	B (negative)
Pakistan	B- (stable)	B3 (under review)	B- (stable)

Source: Trading Economics

The outlooks for Egypt's sovereign ratings are stable at present. However, we believe those ratings would be subject to downward pressures if the global pandemic worsens and/or should the Sisi government exert military actions in either Libya or against Ethiopian interests.

Briefs (MacDonald)

Poland – Second Round Vote for President: On July 12th Poland goes to the polls for a second round vote for president. The incumbent, conservative populist Andrzej Duda, is competing against Rafal Trzaskowski, the current mayor of Warsaw. Opinion polls are very close. If Duda wins re-election, the Law and Justice Party (PiS) will continue to rule the country largely unchecked (as it controls the legislative body), which has resulted in a conservative or as some would say, a more authoritarian national agenda. Poland is no longer regarded as fully democratic by Freedom House, a NGO, and relations with the European Union have been strained. Duda has promised to keep Poland strong, honor traditional pro-family values, and "defend children against LGBT ideology." He is also proposing to ban same-sex adoption, which he describes as the "enslavement" of children. Trzaskowski has promised to be more supportive of LGBT rights and will seek to stall the PiS program unless there are major compromises. Trzaskowski is also more pro-EU and regards himself as a political moderate. Opinion polls give Trzaskowski a tiny edge.

Trinidad and Tobago – Elections: On August 10, 2020, citizens in Trinidad and Tobago will go to the polls to cast their ballots for the next government. The outgoing People's National Movement (PNM), led by Prime Minister Keith Rowley, is seeking another term in the face of competition from the main opposition party, the United National Congress (UNC), led by former Prime Minister Kamla Persad-Bissessar. There are a number of other parties contesting the elections, such as the Congress of the People (which had a sole seat in the past parliament) and Movement for Social Justice.

2020 has been tough on Trinidad and Tobago. The economy has struggled over the last couple of years due to lower global energy prices and the COVID-19 pandemic has only made things worse despite a relatively good job by the government in dealing with the outbreak. Real GDP is expected to contract by 4.5 percent in 2020, before making a recovery next year. At the same time, Trinidad has recently experienced an outbreak of attacks against the police, which were alleged to be from criminal gangs pushing back against the government. There have also been charges of corruption leveled against the Rowley government, while relations with the United States have been more strained than usual due to disagreements over Venezuela. The elections are expected to be hard fought and the results close.

Suriname – Tough Times for Debt Management: With the country waiting for the presidential election sometime in July, bad news hit Suriname on the debt management front. Suriname was unable to make a $23 million payment on the $125 million Akobaka Dam bonds. The debt obligation was incurred in December 2019 as a means to pay Alcoa for overdue electricity bills. Fortunately the bondholders appear willing to reschedule the loan. Fitch downgraded Suriname on the news to C. The rating agency noted the government's next foreign currency commercial debt service payments are for $25.4 million interest on its 2026 USD bond due at end-October and $27.7 million principal and interest on the 2023 bond due end-December. According to Fitch, it "…views the risk of a broader restructuring of foreign currency debt as high, reflecting the government's high debt burden, acute shortage of foreign currency and distressed financing conditions."

Sadly, Suriname's new government is stepping into office in very tight financial conditions, an economy in recession, and little access to international capital markets. Moreover, measures needed to get the economy back on track are not likely to be popular, especially if they include raising prices for public services, downsizing government personnel and cutting state expenses. The new government will also have to follow through on corruption cases involving the past government. Suriname has a tough road ahead, which will probably include the restructuring of its debt.
