Key Economic Figures/Events of the Week

- The mood on markets has been a predominantly optimistic “buy now like there is no tomorrow” thanks to positive Q2 results reported in the USA. As of Friday (14/08) over 80% of S&P500 companies have beaten the expectations. However they had been heavily downgraded due to the devastating effects of Covid-19.
- Despite that, Fed’s July meeting minutes, published on Wednesday (19/08), have added some bitterness to this fizzing sweet lemonade mood reigning on markets. The regulator is not very optimistic about economic growth in 2H2020, having noted that the health crisis would hamper the economic recovery pace, with the pace dependent on the efficacy of virus containment measures. Statistics on new cases do not, unfortunately, give market analysts ground for hope that the coronavirus is even under control.

Oil&gas production has decreased drastically, but the demand shock is not overcome yet

(Total world oil and gas rig count data)

Source: Bloomberg, Baker Hughes

- This week online OPEC+ meeting has confirmed previously set targets for output cuts and has appealed for the full compliance by its members. Member countries which are still not in compliance will be expected to compensate for the overproduction by reducing their production volumes even further until the end of this year. Production volumes are among lowest historically, influenced by 3 main contributing factors: OPEC+ cuts, sanctions on Iraq and Venezuela and high bankruptcy rates among oil production companies with high overheads. Despite that, oil analysts believe that the demand is not yet balanced with the output as economy is recovering slower than expected earlier. Second wave of quarantines and travel restrictions will also continue to hinder the recovery pace. However, large oil companies could benefit from the current situation as they have both, the flexibility in managing their running costs and a normally lower breakeven point, thanks to the diversity of oil fields on books, and the decreasing number of competitors due to massive bankruptcies among small independent oil producers.

Weekly Investment Insights

- This week Teva (Ba2/BB/BB-) bonds have been hit again following the news of a new court case initiated by the US Justice Department. Teva USD-denominated bonds have fallen 3%-5% as the result. We keep Teva’s bonds as we believe that the company will reach an agreement and will pay a moderate fine, which is a usual industry-wide scenario. The most important development for us is the corporate results which have reaffirmed the belief in Teva's will and ability to decrease the debt load. In 1H2020 the company has re-paid the debt of $1.8bln and is on track to reduce its net-leverage down to 3x by 2023. However, we shall wait for the right price to sell this position as the company will print new bonds for refinancing as its maturity profile suggests. Moreover, we are getting pessimistic about the pharmaceutical sector for bonds in general, as the stable cashflow is being outweighed by litigation risks, while positive events, such as new treatment patents, often result in limited price upside for bonds.

- We have revisited our view on Turkish bonds and decided to sell the few sovereign ones we have held. We believe that is that the country will be hit by a drastic 30%-50% currency devaluation in the next 3 months due to the lack of foreign reserves with the Central Bank to maintain the currency rate. That will inevitably result in a sell-off on the sovereign Eurobonds market. At the same time, the high degree of integration of the Turkish economy into the global economy, as well as the focus on consumers both, locally and internationally, should help Turkish economy to recover quickly. Corporates have access to foreign currency through export, while senior bonds of Turkish banks should not suffer a lot as the population used to keeping savings in foreign currency and gold will not come to withdraw deposits, which should contribute to financial system stability.

Strategy

This week we have continued with the sale of positions most vulnerable to possible correction. We have sold Pemex (Ba2/BBB/BB-) bonds as we do not believe in further oil price rally and Mexico is still experiencing its own difficulties aggravated by Covid-19. We do not believe that Pemex will be allowed to default, rather we think that Pemex prices may be 10% lower until the end of the year. Following the same logic, we have sold Sasol (BBB/Ba2) bonds which have recovered from 50% to 97.5% for 2022 maturity, thanks to a generally high-risk appetite and the company's drive to lower its debt burden. However, the company may run out of time while implementing all those measures and that might result in some type of restructuring. We have also sold the few Turkey sovereign bonds we held.

We hope you will find this information useful and we will be glad to answer your questions

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