March Market Reflection

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The new coronavirus and its effects have been the key influence on markets in the first quarter of 2020. What was initially seen as a local Chinese problem with negative implications for global supply chains has become the most significant pandemic for over a century. Governments around the world have been forced to introduce draconian "social distancing" measures to prevent healthcare systems being overwhelmed, and this has in turn created a demand shock of epic proportions. The effect on equity markets has been destructive, with falls, at their deepest, of around a third seen in major indices from recently achieved peaks. The most extreme selling pressure in the third week of March was exacerbated by forced selling from investors who manage their funds according to the levels of market volatility. Confidence was restored to some degree by the policy response of central banks and governments, promising a combination of liquidity and fiscal support. However, huge uncertainty remains about the depth of the downturn and the speed of recovery. Much depends on how long restrictions remain in place. The good news is that they do seem to have a positive effect in controlling the spread of the virus within two to three weeks. Crucially we believe that every measure possible will be taken to limit economic damage within the private sector, encouraging the search for long-term value in across asset classes. Although this period will be extremely painful on many levels, the ability of good companies to generate decent returns on capital will not be permanently impaired. More negatively in the short term, it is already apparent that portfolio income will be severely constrained by the decisions of many companies to suspend dividend payments in an effort to conserve cash resources and to ensure their survival to participate in the recovery.

- Economists are in a "race to the bottom" to downgrade growth estimates for 2020. It is the speed of the decline, as much as the magnitude, which is proving so difficult to compute. Global GDP is set to fall around 2% this year.

- Initial hopes for a "V" shaped recession are fading, with the consensus now shifting more towards "U". The worst of the downturn should be felt in the second quarter of the year.

- Company earnings are under severe pressure, with an aggregate decline in the range of 30-50% being pencilled in for the full year, and possibly no profits at all in the second quarter. A strong bounce is expected in 2021, especially as pent-up demand recovers across many industries.

- The lack of profits and the need to preserve cash has already led to many companies suspending dividend payments. Although dividend income will remain the least volatile element of investors' returns, overall distributions could be cut by a third or more.

- Government bond yields hit new historic lows as a consequence of the demand for safe havens and the actions of central banks, which cut interest rates again and reintroduced asset purchase programmes.

- Low government bond yields facilitate the assumption of higher debt by governments providing support to the private sector, but increase the difficulty of finding safe income.

- Alternative assets, including Gold and selected hedge funds have proved their defensive worth during a period of extreme stress, emphasising the benefits of a balanced portfolio.

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