Weekly Digest

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Fear and Greed

When market movements are as extreme as they were last week, it is very easy to get caught up in the emotional aspects of investing. One long-standing and widely read weekly strategy piece is entitled "GREED & fear" (sic), which perfectly encapsulates the extremes. Last week was definitely all about fear – of losing money, of the unknown and even of imminent death. This morning there was a touch of greed around as we saw equities bouncing back in response to promises of "whatever it takes" style policies to counteract the effects of COVID-19 on economies and financial markets.

There is no doubt that for most of us there has been a steep learning curve in the last few weeks. I believe that there were two especially salient factors that undermined sentiment last week. The first, which we covered in some detail last Monday, was the potentially exponential infection rate of the virus, meaning that what begins as a trickle can quickly evolve into a deluge. I tuned in to one conference call with an expert epidemiologist at the beginning of the week, and he suggested that 60% of the UK's population could be infected within twelve months, with forty-to-sixty-thousand resulting fatalities. Another call with an eminent virologist highlighted the shortcomings of the Johns Hopkins University heat map that many have been using as their primary source of data on confirmed cases, deaths and recoveries. He cautioned that the "dark" areas on the map (i.e. those with no cases) were highly unlikely to be free of the virus. Either it just hadn't started to spread properly yet, or local health authorities had insufficient resources even to diagnose cases, let alone treat them. He was particularly concerned about Africa, India and Indonesia. I note that the first case was reported in Delhi this morning, as was the first in Indonesia. Worryingly, cases in Hubei province in China also seem to be rising again after a lull.

The second destabilising factor was that the global economy was going to be caught in an unprecedented pincer movement. In the early stages of the outbreak, much of the focus was on supply chains. The concern was that production in factories across the world could grind to a halt for want of vital components, leaving everything from car dealer forecourts to iPhone shops devoid of stock. Last week the emphasis shifted to a potential demand shock. It started with the curtailment of business travel and cancellation of major trade shows, for example, but soon spread to the postponement of a number of large gatherings and sporting events. Some of this demand will be delayed until confidence returns, but some will be lost altogether.

All of this meant that we started to see some more aggressive downgrading of estimates for global economic and corporate profit growth, with widespread talk of a "global recession". This

would suggest around 2.5% growth or below for global gross domestic product and another flat year of company earnings growth at best. And don't forget this has potential implications for the US presidential election, where a weaker economy mighty play into the hands of left-leaning Democrat Bernie Sanders. I want to address this race in more detail, but COVID-19 keeps hogging the agenda! Last week's headline falls for stock markets are perhaps a little misleading in one respect, in that they are measured from what now looks to be a somewhat illusory peak that was reached after the first cases of the coronavirus were reported. This happened thanks to the expectation of potential stimulus measures, but before the full extent of disruption was evident. I know that the start of the calendar year can be viewed in itself as an arbitrary point from which to measure, but let's use it anyway. As of Friday night's close, the MSCI All Countries World Index was down 9.3% year-to-date (-9% on a total return basis). At the start of the year the Bloomberg-compiled forecast of global corporate earnings growth in 2020 was 7.3%. If that is now potentially going to be around zero, then equities have suffered only a minimal de-rating so far. And for those who cite lower bond yields as a justification for higher valuations, one could counter with the need for a higher risk premium owing to the increased uncertainty.

I sense a large contingent of investors who don't want to miss out on a potential buying opportunity, and that might make some sense if they are massively underweight equities. But for anyone who has remained close to neutral, it feels premature to be piling in. The difficulty of reading markets in the short term is exacerbated by newer structural factors, ranging from computer-driven strategies to reduced trading liquidity. Friday evening's strong rally in the United States could have stemmed as much from end-of-month portfolio rebalancing as from any increased optimism. Certainly the expectation of further cuts to interest rates is not unhelpful, particularly to companies and individuals who might find themselves cash-strapped in the weeks ahead, but it's hard to see much incremental demand being created.

Practically, in terms of our own process, we continue to consume as much information and data as we can and apply it accordingly. Our Global Investment Strategy Group and Asset Allocation Committees have increased the frequency of communication and meetings. Our equity analysts are working to identify opportunities. There will definitely be some companies with excellent long-term franchises and robust balance sheets that will be sold off too hard based on a short-term hit to current year earnings. By the same token there will be others that are short-term beneficiaries, but will not be able to sustain such growth. I have noted in the past that our investment preference is for companies with stronger balance sheets and free cash flow generation, and such exposure has definitely helped. (I'm afraid that regulatory constraints prevent me from publishing investment recommendations on specific stocks).

The main barbell to riskier assets in a balanced portfolio is a holding in government bonds, and while we have long struggled to see much value in them, given the low yields, especially relative to inflation, we have always maintained some exposure for moments such as this which we know we could never have predicted. That's the good news. The bad news is that if one considers the current yield on a 10-year UK Gilt of just 0.38%, it is increasingly difficult to see how long-term liabilities such as pension requirements and insurance contracts can be managed without assuming more portfolio risk. This probably remains the most compelling case for remaining fully weighted in equities, even if the prospective returns are not overgenerous. The market even has an acronym for it – TINA: "there is no alternative"!

Last week's Economic Highlights

FTSE 100 Weekly Winners

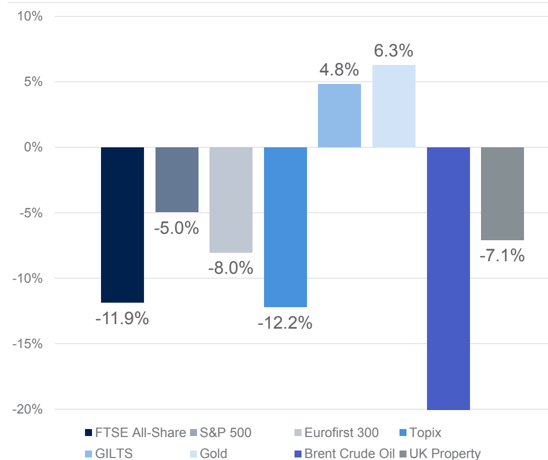
NMC Health	9.7%
JUST EAT	0.0%
Pearson	-0.7%
Rolls-Royce Holdings	-4.0%
Bunzl	-4.0%
Rentokil Initial	-4.8%
GlaxoSmithKline	-5.8%

FTSE 100 Weekly Losers

TUI	-29.5%
EasyJet	-27.0%
International Consolidated Airlines	-24.2%
WPP	-22.2%
Carnival	-19.1%
Whitbread	-18.3%
Barclays	-17.2%

FTSE 100 Index, Past 12 Months

Year to Date Market Performance



Source:FactSet

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