Weekly Digest

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John Wyn-Evans
Head of Investment Strategy

Constant Learning

However tempting it might be for more seasoned market operators to utter the words "I've seen it all before", I really don't think there is anyone on the planet qualified to hold such an opinion today. The last week felt at times like Black Monday (1987), 9/11 and the bankruptcy of Lehman Brothers combined, with elements of all three of those events conspiring to create extraordinary volatility and loss of wealth. In these pages over the past few weeks I have tried to emphasise the need for calm and the adherence to a sound long-term investment strategy, but I readily acknowledge how such advice can sound disingenuous in the light of the markets' gyrations. Even so, it remains paramount to maintain a clear plan for what will undoubtedly still be very trying days ahead, especially when we take into account that we are all likely to be touched personally in some way by the coronavirus itself.

First, some thoughts on last week. Yet again, it was the growing realisation of the impact of the virus on normal daily activities and the effect that would have on economic growth and company profitability that lay at the heart of risk asset declines. I commented last week that investors would not start to feel comfortable until they had some idea of where the bottom of the "V" in economic activity might lie. The only certainty that emerged was that the "V" would be deeper than previously supposed as more countries imposed increasingly draconian containment measures. It's possible that we might have got away with less steep falls but for two significant faux pas. We have consistently maintained faith in "the authorities" to provide the correct responses to the unfolding crisis – even if not always as early as markets would like – but both President Trump and the European Central Bank were complicit in the latest mayhem. The former imposed a surprise travel ban between the US and most of Europe at a time when the world was crying out for co-ordinated responses, not unilateral self-preservation and finger-pointing; the latter, in the guise of its President, Christine Lagarde, effectively appeared to be ready to throw Italy to the wolves during its post-meeting press conference. Such mistakes served to create what can best be described as a major liquidation event, with investors rushing to raise cash from safe as well as more risky investments. Much of this selling was not by choice, but rather forced by the need to reduce leverage or to meet margin calls. The great majority of our investors will not find themselves in such a position, and will therefore be able to benefit from the eventual recovery – however implausible that might currently feel.

Also adding to the sense of doom last week was a malfunctioning US dollar funding market. As happened last October, a shortage of dollars loomed, threatening already curtailed economic activity even more. As we wrote last October, the fundamental problem now is very different to the liquidity squeeze that unfolded during the financial crisis. Then the key factor was a lack of solvency in the banking sector; now it's more a rapid rise in the demand for dollars running up against regulatory supply constraints. Again, we continue to believe that central banks, with the Federal Reserve to the fore, will stop at nothing to continue to provide funds to the system, a belief backed up by last night's aggressive 1% interest rate cuts and accompanying policy tweaks.

In terms of how things play out from here, things have not fundamentally changed since last week, other than that the trough in activity, and therefore profitability, is going to be even deeper than envisaged then. The onus now shifts firmly to governments to create a "bridge" from here to the upslope of the eventually recovery. This will allow, by whatever means necessary, companies and individuals who have been relatively prudent but still face financial stress, to get to the other side in one piece. We have to give some credit to our government for laying some of the foundations for such a bridge in last week's Budget, and others around the world are making similar commitments, but I doubt we have yet seen anything like the full extent of the measures required.

From an investment perspective, very little has changed. Portfolios are designed to withstand varying degrees of stress, and we would expect that all clients are exposed to the level of risk that they can tolerate. Our industry has chosen to define risk as "volatility", or the amount a given type of portfolio or financial instrument can be expected to move around. It's a convenient measure, and one that can be observed and captured numerically, for example in the widely quoted VIX Index, which measures the volatility of the S&P 500 equity index in the US. But no less an authority than Warren Buffett continues to believe that volatility is a poor measure of risk, and prefers to think in terms of the "permanent loss of capital". From a purely practical perspective I have a lot of sympathy with his approach. After all, an investment that goes to zero and then doubles will still be worth zero. Our key objective at this stage is ensure that your portfolios get to the other side of this difficult period intact and with the potential to accumulate decent gains in the recovery.

And volatility will have a vastly different effect depending on where you are in the investment cycle. Clients in the decumulation phase can potentially be hit by "sequence risk", in that taking too large an income (in the form of a capital withdrawal) from a temporarily depressed portfolio could put future income at risk. On the other hand, those still accumulating assets should be excited by the fact that, current malaise notwithstanding, the potential for future returns is going to be greater from today's lower starting point.

Last week's Economic Highlights

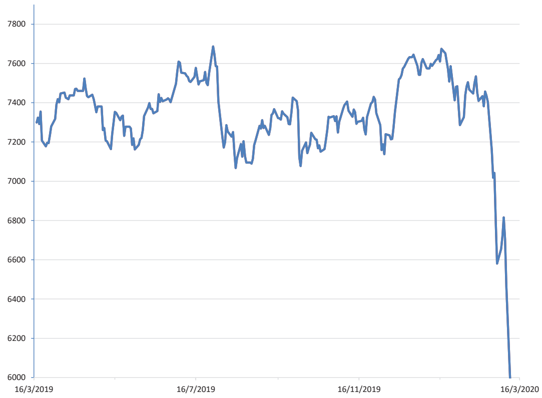
FTSE 100 Weekly Winners

Ocado Group	5.4%
Just Eat	0%
Pearson	-4.9%
Scottish Mortgage Investment Trust	-5.6%
HSBC Holdings	-5.7%
Rio Tinto	-6.6%
Wm Morrison	-7.7%

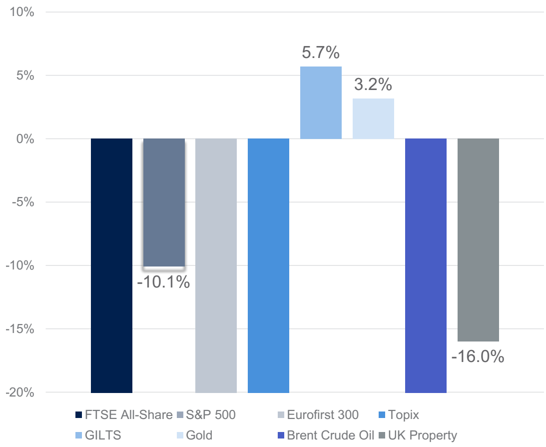
FTSE 100 Weekly Losers

Carnival	-41.4%
GVC Holdings	-38.5%
Micro Focus International	-38.1%
Centrica	-37.9%
Marks and Spencer Group	-36.8%
TUI	-32.5%
Royal Dutch Shell	-32.1%

FTSE 100 Index, Past 12 Months



Year to Date Market Performance



Source:FactSet

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