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# Market updates

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Investment team updates | 23 April 2020

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## Fixed income

- Government bonds were constructive last week, with core yields modestly lower in spite of higher risk markets – such as equities and credit – and lower volatility. The bond market direction reflects the interplay between fiscal and monetary policy, with the US government issuing short-dated debt and the Federal Reserve investing further along the yield curve.
- Actual economic data is, of course, poor with jobs being lost, consumption slashed and investment intentions on hold until the uncertainty lifts. European consumer sentiment is now at its worst since the 2009 financial crisis (expect more of this globally), and Japan's service sector PMI fell to a record low.
- There is some supportive monetary policy news, with rumours that the European Central Bank will buy HY debt, which will encompass fallen angels and ETFs. The European Council is meeting today.
- Oil recovered a little yesterday, up around 6%, while in company news there's perhaps a theme of dividend cuts – for example, Pernod halted share buybacks while Heineken cut its dividend.

## Emerging market debt (EMD)

- The market adjustment we've seen in spreads is unlike anything in history, both in terms of speed and the amount of change, and how the market has adjusted. Previously it would have been unheard of to experience the five standard deviation move that we've seen in just a few weeks.
- We have been rotating out of higher quality sovereigns into quasies to take advantage of some unwarranted decompression, and adding some high-quality IG corporate exposure where, in some instances, credit curves had become inverted – unjustifiably in our view. We will likely hold some of these exposures to maturity given the extremely low default risk, thereby reducing some of our NAV volatility.
- We have no exposure in the countries which have been most affected: Lebanon (which is in default), Ecuador (which is going into reprofiling of debt), and Argentina (likewise).

## Multi-asset

- Drawing on views from across our investment platform, much focus has been on the potential “shape” of the recovery. After what will undoubtedly be an extremely weak Q2, uncertainty bands for the longer-term economic impact of Covid-19 remain very wide. So, our work has considered asset class returns under a number of different scenarios.
- Investment grade credit is one area that continues to emerge favourably, as a targeted beneficiary of the policy response to the crisis and with elevated spreads even accounting for greater leverage.
- This aligns with our desire to participate in risk assets with a strong focus on quality. To that end, our latest asset allocation move was to upgrade US equities to favour from neutral, offering exposure to high-quality businesses that are well equipped to deliver growth even in the current environment.

## Global equities

- Global equity markets remain up for the month to date, as participants focus on the positive news – be that policymaker support or certain countries (and US states) starting to ease their lockdown restrictions. Even WTI crude oil futures briefly trading negative has not significantly dented this month’s positive move.
- There is no change in market leadership, with high-quality, growing companies still dominant. Our growth strategies remain ahead, but the environment remains a challenge for income.
- While many companies have already adjusted, or indeed removed, guidance to account for Covid-19, we are now in quarterly earnings season which should give further insight into the extent of the crisis’ impact on the corporate world.
- Volatility is down from March highs but will likely remain elevated, hence we retain our cautious stance in portfolios, preferring high-quality companies with strong balance sheets. Where we see some weakness in preferred names, and the long-term investment thesis remains strong, we may use the opportunity to add to positions.

## European equities

- The market has recovered strongly from the lows reached in mid-March – at the time of writing indices are between 15% and 20% off the lows. This recovery has tended to favour defensives and strong business models, so our funds have kept up with the rally.
- The oil price decline is generally positive for Europe, which is a net importer. But as it is partly indicative of a Covid-19-related collapse in demand it is an ominous portent, and many are unable to benefit, such as airlines, locked-down consumers and even some of the transport sector.
- Our focus in terms of new opportunities has been in healthcare, technology (including payments processing, where increased online trade will stimulate growth), and telecoms infrastructure.

## US equities

- Unsurprisingly, we have witnessed an array of negative data points with retail sales over the past week plunging 8.7% month-on-month and 6.2% year-on-year led by discretionary weakness, while staples gained on consumer stock piling.
- Although we are still in the early stages of the Q1 earnings season (around 15% of S&P 500 companies have reported by market cap), a number of firms are beating on their Q1 numbers but subsequently suspending forward guidance. The lack of visibility from the global lockdown means companies are unwilling to stand by any form of financial guidance.
- The aerospace super-cycle is finally over after 18 strong years – Airbus has cut its A320 family production to 40 per month, with additional substantial cuts to A330neo and A350 rates<sup>1</sup>. The International Air Transport Association predicts global passenger miles will be down 48% in 2020 – no other year since the second world war gets close to this figure<sup>2</sup>. Railroad volumes continue their accelerating decline, and US auto sales in April are projected to be around seven million SAAR (Seasonally Adjusted Annual Rate) – a level last seen in the early 1960s.
- Our data science and healthcare teams note that of the 70 countries that have seen more than 1,000 Covid-19 cases, two-thirds appear to be past the peak of daily new cases. Only China and South Korea are more than a month past the peak in daily new cases and are down to a small number of new daily cases. A key question is whether we will see a material second or third wave of infection as countries relax containment measures.

Note: all data as at 22 April 2020, unless otherwise specified. Source: Bloomberg.



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<sup>1</sup> Reuters, Airline crisis forces Airbus to consider A320 output cuts, 3 April 2020

<sup>2</sup> IATA, COVID-19 Puts Over Half of 2020 Passenger Revenues at Risk, 14 April 2020