MARKET UPDATE

March 2020 MPU

It is fair to say that February was a significant month for both the economy and markets. The positive start to the month rapidly became irrelevant as the coronavirus developed into both a humanitarian and an economic threat. Markets started to price in these mounting concerns on the 20th February and we saw a sudden drop in risk assets, with the average equity fund falling circa 10% toward the end of the month. However, from an investment point of view it was not all doom and gloom, as many safe haven assets managed to produce positive returns.

Risk Assets – Oh how the Mighty have fallen (a bit)

Much like Q4 2018, we saw a reversal in many of the trends that have been in favour for several years. US equities and US technology stocks saw larger drawdowns (-12% and -13% respectively) than the global average of -10%. What may be a surprise, is that Chinese equities have held up well in the drawdown period, falling approximately half that of the global average. This was despite the very real and newly measurable economic impact of the coronavirus on the Chinese economy. The key here is that, as we saw in Q4 2018, the most expensive areas of the market fell the furthest almost irrespective of their geography or current fundamentals. This is a trend we expect to continue albeit with heightened volatility until there is any line of sight on peak virus.

Risk off Assets - Run for Cover

We have previously commented on the widely held belief that "there is no value left in bonds" however, we saw haven fixed income perform well as equity markets struggled. The US 10-year is now yielding below 1% (0.79% at time of writing) and the UK 10-year gilt fell from 0.63% on the 14th Feb to 0.27% at time of writing. Essentially these haven assets have done their job – i.e. protect capital in falling markets. This was not the case for a wide swath of other fixed income sectors. High yield bonds and global emerging market bonds correlated highly with equities, and those funds with more credit risk have suffered on a relative basis.

The misnomer of the zero-lower bound

We have said for some time that there is a global race to the bottom (and beyond) in interest rates which could take yields of all bond duration's (including the US) to 0%. We started making the call that the US 10 Year Treasury would fall to zero about eighteen months ago, when our opinions were very much an outlier. In recent weeks it has rapidly moved from outlier to, if not consensus, certainly something many more people are countenancing. The starting gun for the latest leg was fired after the Powell pivot at the end of December 2018 and continued earlier this week in the first Fed Emergency rate cut since the Lehman Brothers debacle in 2008. Again, at the time of writing, the move to zero looks almost unstoppable outside of a cure/vaccine hitting the market in the next few days.

The lights have gone out, quick call a plumber

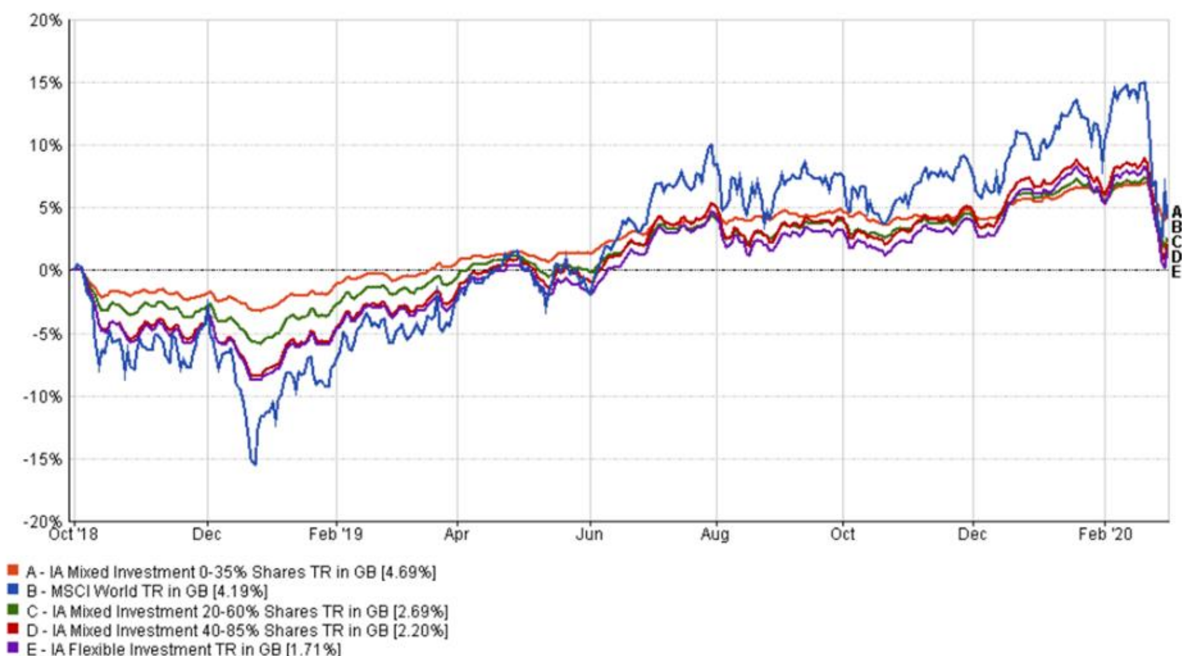
Despite what they have since said publicly, we don't believe the 50bps emergency interest rate cut had the impact which the Fed perhaps expected. American markets soared upwards for all of 15 minutes but then quickly soured and continued on their downward trajectory. "Don't bet against the Fed" had become a mantra in many investment circles over the last decade but investors weren't convinced that the Magic Monetary Bullet would cure the measurable and very real supply/demand shock of the coronavirus. We have maintained for years the theory that the biggest (if not the only) risk to markets is an event outside of central bank control. The coronavirus is, unfortunately, an example of just such an event. We don't believe the markets needed the cut and it's just yet more wasted ammunition. What markets and economies do need is imaginative fiscal policy and quickly. What we are seeing globally is a huge differentiation in such efforts and perhaps more than anything, this will give guidance to which countries will come out the strongest on the other side of this fundamentally human crisis.

Back where we started

The extent of February's pullback was significant and much of the returns generated through 2019 were lost in relatively short order. Considering that a large portion of last year's gains were a retracement of 2018's market pullback it is perhaps interesting to note that markets have been relatively flat over the whole period (see below).

Global Equity and Multi Asset performance

31.08.2018 – 03.03.2020



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IBOSS 01/08/2018.

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