February 2020 Portfolio Review

Last month's review noted the uncertainty that the developing Coronavirus (Covid-19) outbreak was creating in markets and asked the question, how do markets price in the risk, when there is limited visibility on how bad the outbreak could become and what will be the adverse impact on the Chinese economy? One month later and for Chinese, read Global economy and markets have begun to answer the question on how risk is priced in!

Markets are worried that the virus could cause a significant slowdown of the global economy especially in China which, given its involvement in global supply chains, is having severe knock-on consequences elsewhere, even if not yet directly impacted by the virus.

There is high level of confidence that from a public health perspective, the issue will be capably and successfully addressed over the coming quarter and that the negative impacts on global growth stemming both from inevitable (and possibly extensive) 'quarantining' will be temporary and quickly recovered. Whilst not sanguine, Covid-19 appears to be materially less mortal than initially feared - probably under 1% in Developed World healthcare settings compared to around 0.2% for seasonal 'flu. For reference, SARs (Severe Acute Respiratory Syndrome in 2003) and MERs (Middle Eastern Respiratory Syndrome in 2012) had 10% and 30% mortality rates respectively. An additional sense of proportion can be gained from putting the current outbreak, having seen around 80,000 infections and 2800 deaths at the time of writing, in the context of around one billion people each year catching influenza globally, with between 290,000 and 650,000 fatalities depending on the severity of the strain.

But it is early days and markets need to have uncertainty removed. As we write this morning, global investors appear to be taking comfort from supportive comments from some central bankers. Chair of the US Federal Reserve (Fed) Jerome Powell has said the Fed would 'act as appropriate' to mitigate the impact of coronavirus on the US economy. The Governor of the Bank of Japan, Haruhiko Kuroda, has echoed those remarks today as has the Bank of England. Financial markets, driven partly by emotion, are likely to continue to be susceptible to bouts of volatility until the spread of the virus is contained and its effects upon economic growth prospects can be properly assessed. The negative impact on stock markets, arises from the containment measures which are clearly having an adverse impact on travel, leisure activities and global supply chains. UK and US companies with activities linked to air travel and China are starting to flag the negative short-term trading impact from coronavirus and containment travel restrictions. Containment measures are expected to affect demand and supply in the two largest European manufacturing economies, Italy and Germany, with both likely to suffer a technical recession in the first and second quarter of 2020. All of this naturally impacts future earnings and it is this downgrade in expectations that is causing some of the drop. Coronavirus is not Armageddon but it is creating uncertainty and markets hate uncertainty.

But, there is a strong argument not to be overly concerned by the volatility we are currently experiencing. These market corrections are often short-term during volatile periods such as these and we have seen on many occasions that certain stocks/markets tend to become oversold which can create excellent buying

opportunities. Legendary investor Benjamin Graham's famous comment that **'In the short run, the market is a voting machine but in the long run it is a weighing machine',** seems highly appropriate in the current stock market climate. From an investment perspective, experience suggests that stock markets look past one-off events and there are good reasons to believe that this will be the case again. Specifically, the foundations of the world economy are still generally strong, with consumers, corporations and the financial system all in robust positions to absorb the shock. Furthermore, Governments and financial authorities are also fully engaged in offsetting any impact that containment measures might have. With this in mind, the likelihood of a sharp rebound once the worst is past is also high.

Away from Coronavirus, the years of Brexit uncertainty, with multiple elections and round-the-clock media coverage, are now behind us after the UK officially left the EU at the end of last month. Except, of course, it isn't behind us and the public posturing game has already started. The government announced that it wants a Canada-style arrangement with the EU. Alternatively, it will consider walking away from talks in June; Britain will not accept EU supervision as part of any future trade deal and that the so-called 'level playing field' rules the bloc wants to impose are 'undemocratic'. Is it sovereignty or bust? Johnson has always placed a high value on establishing a credible threat in Brexit negotiations, but as the negotiators know themselves, every form of overseas trade deal requires a compromise of one's own specific standards in order to generate products and services that can be distributed in regions under differing jurisdictions. Nevertheless, markets are becoming more convinced that a harder Brexit could be the endgame. There is more to run on this one.

In the US, despite election day still some nine months away, the Republican and Democratic campaigns are in full swing. Barring a calamity, Donald Trump will not face any Republican challenge, since his party almost unanimously voting to acquit him in the senate. But what of the Democrats? The most likely challenger is Senator Bernie Sanders and the 78-year-old self-described socialist plans to shake up America's economy, financial system and political establishment. Has this also been a catalyst for US market sell off? Probably not at this point but either way, it is not so clear that a Republican-controlled Congress and four more years of Trump would be unequivocally good for markets. There was the 'Trump market' rally back in late 2016 when the President was first elected – on the expectations of tax cuts and regulatory rollbacks. But since then, trade wars against China (and the rest of the world) have created a significant degree of uncertainty. That destabilisation has been a big factor in reducing business investment, a crucial economic demand component which would have otherwise propelled economic growth.

In summary, there will be some short term volatility but against this we are not inclined to try to change/sell down our holdings in what are fundamentally sound long-term investments facing short-term disruption With interest rates set to remain at current low levels for the foreseeable future we can see no better place to invest for the long term than in good quality companies, with emphasis on the long term.

Portfolios

Equity indices fell as speculation over the implications of the global spread of the virus took hold. The FTSE100, ended the month almost -11.5% down. From the 20th February, the peak to trough decline of the S&P500 was -11.7% and the EuroStoxx approximately -10%.

As the equity markets fell, 'safe-haven' assets held steady as the rotation from 'risk-on' to 'risk-off' was

made. The money obviously must go somewhere and from the 20th February, when markets began to sell off, indices such as the UK Gilts All Stocks rose +1.5%.

As might be expected, the higher risk Beckford James portfolios, (those with higher equity content) fell in line with markets but even at the highest risk end, the fall was cushioned by diversification and was held to less than -8%.

At the other end of the risk scale, the reaction of the more cautious portfolios is key. In this case, the most cautious (risk 3/10) portfolio stemmed the decline to less than -2.2% for the month, with the peak to trough drawdown being no more than -3.5%.

Maintaining low volatility in the more cautious portfolios was helped by the higher weighting in the Vanguard UK Inflation-Linked Gilt Index fund currently at 12.83% of the risk 3/10 portfolio.

Until the virus is contained, we would expect short term speculation to maintain a higher level of volatility. Hopefully investors will take some reassurance that the diversification and ongoing rigorous assessment of funds within portfolios is helping in challenging times.

All returns rounded and quoted gross of ongoing fees.

As always, please contact your adviser at Beckford James with any questions, or call the Head Office on 01225 437 600.