March 2020 Portfolio Review

Looking back at last month's review and our mid-month update, it would be an understatement to say that March has proved to be an eventful month. It would also be an understatement to say that the use of the word "unprecedented" has been unprecedented and I will try to avoid it here. However as one leading financial commentator noted, the point of maximum panic has probably been reached with the point of maximum pessimism still to come. More on that later.

March saw public-health prioritised globally as country after country enacted widespread quarantines and shutdowns with a large restriction on economic activity. It is the length and depth of these restrictions that will have a major outlook on global economic performance as it is natural to ask what the economic damage is likely to be and it is this that the markets are trying to price in. But with Market moves over the last few weeks being driven more by an extreme liquidity preference than very specific expectations of future earnings or values, there has been a lot of volatility both on the upside as well as the down, which is why we recommend riding this through rather than trying to time any movements. Individual stocks and markets experienced bear market conditions due to falls in excess of 20%, but also bull market conditions with some stock markets rising in excess of 20% over three successive days of recovery.

But this is also a multi-faceted issue with both the coronavirus crisis and oil price war having a profound impact on economic growth and the cash position of companies. Either would have been a significant disruptor. Many businesses in the most affected sectors such as tourism and hospitality, aviation and retail will have to cut or suspend dividend payments entirely for a period to preserve their cash resources and the viability of their businesses. Companies that receive government assistance to stay afloat, will find it particularly difficult to justify maintaining their dividend payments to shareholders. Even those companies that are benefitting somewhat (food, logistics, pharma for example) and have ample financial capacity to keep paying dividends are likely to adopt a cautious approach, given the high level of uncertainty. Many companies are having to currently suspend forward looking earnings guidance, as clearly there are too many 'unknowns' due to Covid-19.

To extend the metaphor, the global economy itself has tested positive for Covid-19 and is on a ventilator with central banks and governments pumping in a combination of oxygen and steroids to speed recovery. The patient is expected to be sick for three months but will survive. How long a stay in hospital is required and how quickly it is back up on its feet is still an unknown. Some expect the patient to bounce back quickly while others think the convalescence period will be long. Perhaps we should focus first on getting the patient off life support and out of critical care? Then we can begin to assess how long it takes to return to full health.

And importantly these steps are being taken. In terms of preparing the ground for a pick up in economic activity, we have already seen government and central bank intervention in terms of a Monetary Policy response and a Fiscal Policy response. We are also seeing a huge interventionist policy in terms of Fiscal boost for the economy with more to come.

In the US, the Federal Reserve (Fed) stepped into the breach announcing 'whatever it takes' with a barrage of new programmes to help keep financial markets functioning. This includes an open-ended commitment to keep buying assets under its QE programme. The Fed will be moving for the first time into the corporate bond market purchasing investment grade bonds. The Fed also made some reassuring comments about the US economy and said that it 'is not going to run out of ammunition'. While this will keep markets functioning, we now need US politicians to get their act together. Here, Markets reacted nervously as a $2 trillion Senate proposal to support the US economy initially crashed to defeat after failing to secure the support of the Democrats who felt if favoured bigger companies. However, the subsequent market-sell off appeared to bring US politicians to their senses and a deal was agreed and voted through. The $2 trillion deal includes direct cheques to many American households, an expanded unemployment insurance programme, loans to businesses and additional resources for healthcare providers.

In Britain, the government has pledged a £50 billion fiscal package in addition to £330 billion in loan guarantees to support businesses and individuals during the tough times ahead; importantly, this also includes a scheme to pay 80% of wages for companies affected and support for many of the self-employed.

So the question is, how do we pay for it all? Even without a clear answer on how the bill gets paid, that the bill needs paying is beyond any doubt. If no spending measures or rule changes were announced, the government-ordered shutdown would be absolutely catastrophic for the economy and – consequently – human lives.

Taking the government's rhetoric of 'wartime economy', the spending seen now should not be thought of as government spending in any usual sense. Governments will dip into bond markets to fund their massive aid programs, and those bond values will be pegged down by the extraordinary monetary injections from central banks. In short, the answer is: we print the money.

That solves the immediate problem of where the money comes from. But of course, it raises plenty of other concerns. Mention of the 'money printing' tactic conjures the memory of the barrels of worthless cash in 1920s Germany and the destructive hyperinflation in 2000s Zimbabwe. When the need for cash is regularly met just by printing more of it, inflation soars and a currency ceases to function, either as a store of value or as a medium of exchange.

But to be clear, few seriously think that the current policy will result in hyperinflation. In the short term, it is unlikely to result in any inflation at all. Economists would describe the current state of depressed economic activity as a deflationary shock. For at least the duration of the lockdown, government measures will at best only compensate for falling demand elsewhere and thus the money injected is merely replacing the normal money flows that are no longer occurring.

When the economy slows down massively as it now has, less money is created (through loans, bond issuance, capital investment, etc.). Policymakers' hope, then, is that their support measures act just as an equaliser. Central banks provide liquidity that otherwise the private sector, and predominantly private banks and financial markets, would create. Governments and central banks are not adding in extra cash

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to the economy, they are just making sure enough money flows around to keep the economy whirring and those that had to be 'mothballed' from falling over for no fault of their own.

I mentioned earlier points of panic and pessimism and whilst volatility will continue, it is probable that the point of maximum panic has already been reached. Where exactly the point of maximum pessimism is, remains to be seen and depends on how deep or long the shutdowns are. On a brighter note, China appear to be lifting restrictions and returning to work.

However, it is somewhere between these two points where value and buying opportunities lie, some resilient companies will emerge even stronger and the opportunity to lock in high levels of income at low prices is already here. To finish with the words of another veteran institutional investor, 'The most money in equity markets is made when things go from bad to less bad'.

Portfolios – A note of caution

In the near to medium term it is important to remember that if you are getting unduly bearish, this is only normal in times of uncertainty, but you are fighting the Fed and nearly every central bank and government in the world along with the single-minded dedication of various health care professional and scientists to find a cure/vaccine and to prop up the global economies whilst this is done.

With financial planning at our core, it is vital not to throw long-term investment plans and beliefs overboard and encash your portfolios in a bout of panic or apocalyptic vision. We are relieved to observe that there were very few among our portfolio holders. However, the rapid 20% recovery swings evidence our point that any recovery is likely to happen so unexpectedly and vigorously that most will miss it, leaving those outside of the market nursing crystallised losses, while those who stayed put will find themselves rewarded for their patience.

Portfolios – March 2020

As the general sell off took hold over the month of March almost all asset classes were affected. From the start of the month to the lowest point at 23rd March the FTSE All Share had fallen 25%, the FTSE 100, 24% and the S&P500 was 15% lower. By the end of the month these had recovered to between 10% and 15% down. Equities were not affected in isolation as fixed income markets were also impacted, falling between 5% and 10%.

Mid-month Property funds moved to suspend trading on funds as the independent surveyors stated it was impossible to value assets in the current market. This measure, as we have seen on several occasions in the last decade, was taken to protect investors in the funds against the risk of needing to sell assets to satisfy redemptions. Across the property funds held in the portfolios with Threadneedle, Legal & General (L&G) and Kames there is a high level of liquidity and in the case of Threadneedle and L&G relatively little exposure to retail which would appear to be coming under greatest pressure. As a result, we are currently generally comfortable with the property exposure as it is.

Against this environment, there were some notable casualties as currency movements and Italian Sovereign debt exposure adversely impacted the H2O multi-returns fund which ended the month approximately 25% lower. As expected, the equity index trackers moved in line with indices, falling 10% and 16%.

However, there were some notable exceptional performers. Amongst the larger holdings in growth portfolios, where the US market had fallen heavily and ended the month 10% lower, the Loomis Sayles US Equity fund stemmed the fall to -1.5%. The Troy Trojan fund only dipped -1.8% and the Lindsell Train UK Equity fund halved the decline of the UK markets ending -6% for the month.

Therefore, the combination of diversification, high quality in the underlying investments and active management helped to keep growth portfolios to between 8% to 10% lower for the month which is pleasing in the circumstances. The income portfolio was 15% lower over the given due to the heavier weighting in UK equities.

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.