INVESTOR INSIGHT

Spring 2020

A look at the markets by **RSMR**

Welcome

Welcome to the latest edition of our 'Investor Insight' which provides high-level commentary on the global markets and how these might be affecting your investments.

We hope you find this useful.

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The global economy: What's going on?

You do not need to be a market analyst to know what has caused the global economic upheaval.

The coronavirus pandemic, which started in Wuhan, China, in December 2019, has, at the time of writing, hit 185 countries and 1.4m people, causing 85,500 deaths and created turmoil in global markets after their recent recovery.

The rapid economic reverse has hit investor confidence with many main markets down almost 40% from their peak.

Lockdowns in 100 countries to combat the contagion has stifled all but essential business such as food and logistics.

Governments have responded with significant economic stimuli to keep markets working and businesses supported while cash flow slows or ceases. The UK injected a £330bn business support package in late March. Germany, France and Italy acted similarly and the US agreed a £2tr rescue package.

Amid this bleak outlook, most international gross domestic product (GDP) forecasts for the first half of 2020 indicate recession with great uncertainty to follow.

We are in a period of uncertainty with no defined end nor any understanding of how long it will take to get back to normal afterwards.

"The rapid economic reverse has hit investor confidence with many main markets down almost 40% from their peak."

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The asset classes – a quick update

EQUITIES

The global pandemic has led to dramatic, indiscriminate falls in global equity markets with some sectors hit harder than others, including leisure, travel, retail and energy.

Oil and associated companies have also suffered as oil-producing countries' production agreements collapsed, causing a global price crash.

Falls have been worsened by uncertainty created by a near universal, even temporary, global economic shutdown and concerns about how this will affect revenues, as most companies will be hit severely.

Economists have not finalised the ramifications for global GDP but various micro-indicators, such as urban traffic congestion, confirm that activity has plummeted.

Latest forecasts reveal a surge in downward revisions to earnings per share (EPS). March was the second worst month for the S&P 500 index, the only worse one being during the 2008 banking crash.

FIXED INTEREST

The most obvious outcome of government rescue packages has been lower interest rates and an increase in the differential between government bond yields and corporate bond yields known as the spread.

During the summer, the workings of the government bond market will be dictated by how the global policy response to the pandemic is financed.

Bond returns are lower than official rates in some cases and generally these will set the lowest acceptable return for longer-term government bonds.

There has been remarkable intervention by governments, including direct purchase of corporate debt and the bankrolling of credit facilities aimed at preventing a financing disaster.

This should limit the potential for the worst-case scenario for credit investors: massive defaults on debt that destroy investor wealth.

The borrowing surge resulting from the vast fiscal support will be financed by central banks through quantitative easing and other programmes rather than pension funds and insurance companies.

With lower interest rates creating an effective floor, and massive bond purchases creating a ceiling, bond returns may not move much for the foreseeable future.

For return-seeking investors, this relegates the asset class and, even in multi-asset portfolios, the hedging properties of bonds may be curtailed for some time.

PROPERTY

Property has had a difficult time with buildings facing valuation difficulties and real estate investment trusts (REITs) and property shares subjected to indiscriminate selling as coronavirus concerns shook investors' nerves.

This is a worrying period for property investors as transactions decline and asset values are hard to judge. All physical property funds suspended retail fund market dealing because valuers are unable to access assets.

Distribution, logistics and warehousing remain popular due to consumer demand for last-mile delivery, same-day delivery and click-and-collect, which may increase during the pandemic, but this has pushed up prices and suppressed returns.

Meanwhile, the office sector is fragmenting. As city centre office values rise, that of many out-of-town office parks falls. Retail units and town centres, already suffering due to online shopping, face a steeper recovery as the economy is effectively shut down for an unspecified time.

This is aggravated by rental pressures, and with many companies closed down, cash flow is under severe stress. The UK government has suspended business rates and provided loan capital though banks but debt must be repaid and the lockdown's duration is unknown.

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Global round-up

- UK domestic companies have been hardest hit with larger, globally-based businesses having longer-term resilience.
- The World Bank has warned that, in the best case, coronavirus will knock 4% off GDP growth in emerging Asian economies.
- The dramatic oil prices crash driven by the break-up of OPEC+ production controls is generally positive for Asia.
- Asia looks better placed to come through the crisis faster and stronger than elsewhere.
- In Japan Yen-denominated merchandise exports fell 1.0% in February in year-on-year terms, after dropping 2.6% in January.
- Brazil emerged from recession in 2019 but looks certain to see economic contraction in 2020.
- The US tech market has not suffered nearly as much as the consumer or energy sectors.
- The European economy could contract 4.1% in 2020, down 5.1% from last month's forecast.
- End-of-March data showed China's manufacturing index rebounded unexpectedly.

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So, what's next?

This economic crisis differs to when markets last fell as steeply from the start of the year.

Unlike the Great Financial Crash (GFC) this is not just about balance sheets but a simultaneous lack of supply and demand which has hit the global economy very hard, in most cases turning low growth levels into contraction. Most economies are expected to shrink for the first two quarters.

This is unique. Governments have steepened the recession to smooth the rise in infections to save lives. This creates an economic halt with huge risks and, to avoid these, governments must provide gargantuan fiscal support to secure the survival of businesses and individuals until the pandemic recedes.

Investors must consider the possibility of lower markets, against the chances of a sizeable rally when better pandemic news arrives.

When there is evidence of proven measures to control coronavirus' spread, there will be a case for committing cash to equities, but a long-term rally will need evidence that lockdowns can be relaxed without a massive infection spike, or a widely available vaccine.

Until such certainty emerges, investors must remain cautious. There are significant risks for markets if the economic downturn turns into global depression

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About RSMR

Independent specialist research.

RSMR was formed in 2004 to meet a growing demand from financial advisers for specialist and impartial investment research.

The RSMR team is made up of individuals with expertise from across all areas of the financial industry – from asset management, strategy and fund research through to business development, strategic planning and market research.

We are best known within the financial industry for our 'R' fund ratings – this rating is given to investment funds that meet our stringent research criteria. We don't limit ourselves to just looking at performance – we also look carefully at the people, processes and capabilities that are required to make effective investment decisions.

We work in partnership with your financial adviser, providing the benefit of our broad industry insight and rigorous research. This quarterly market summary is designed as a 'snapshot' of the more thorough and lengthy commentary that we provide to your adviser on a quarterly basis.

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