Spring 2020

market outlook.

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Marshall Zoing
EXCELLENCE IN WEALTH MANAGEMENT

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The UK Economy

We expect the coronavirus to be a transient issue, as activity in China (where the virus originated) is slowly returning to normal, although it is difficult to predict exactly when the worst will pass, we are optimistic the economic fallout will be worst in the first half of 2020. Many companies and individuals simply do not have the resources to sustain a prolonged (or even brief) downturn and so it is inevitable that there will be some casualties. However, the UK Government and Bank of England (BoE) are doing what they can to support people and companies.

The BoE has cut interest rates twice in the past since the beginning of the COVID-19 outbreak (from 0.75% to 0.1%), this should help reduce the burden of existing debt and encourage people and businesses to borrow if needed to bridge their finances during this period of uncertainty. The UK government has also introduced a range of measures intended to support employers and employees and therefore support the economy during these uncertain times.

Many companies in the FTSE 100 have cut their dividends in an attempt to preserve cash and protect the going concern of their business. Whilst most economic data is yet to be published, over the coming weeks and months we expect to see some unprecedented statistics as the impact of closing down the economy feeds through to hard data. Forward looking surveys such as the PMI have already confirmed sharp declines, especially in the services sector.

Fortunately, companies and equity markets are forward looking, and so whilst share prices have fallen quickly, we expect many will rebound once the outlook improves. Although not all companies will recover at the same pace as some activities will resume quicker than others. For example, the travel and leisure sector is likely to take longer than most other sectors to recover.

Unique to the UK is the outstanding issue of Brexit. At the end of 2019 and start to 2020 the new Conservative Party majority provided a boost to many domestic companies and sectors which had been lagging with the uncertainty surrounding the UK’s future relationship with the EU. Unfortunately, as a result of the coronavirus outbreak, negotiations between the UK and EU have been challenging and it is highly likely the UK will need to seek a Brexit extension beyond 2020.

The Japanese Economy

Japan's Prime Minister Shinzo Abe has confirmed that he will not stand in the next election in September 2021 which will leave a level of uncertainty and could impact sentiment in terms of who will take over given all Japanese policy has been centred around 'Abenomics'.

Wage growth continues to be absent with low unemployment levels so economy is still battling to steady inflation. With the impact of coronavirus decreasing job openings (which is wage deflationary), and national CPI already only at 0.4%, this could ultimately increase deflationary pressures.

Coronavirus will have a significant impact on Japanese economic data as their main trading partner is China. The effects will continue to be felt by imports/exports and tourism in the main and so this will need to be reviewed in the coming months as the virus is contained. This is key, as policy accelerates following Japan easing their Quantitative Easing (QE) (printing money) limits.

The Emerging Markets & Asia Economy

Over the past quarter, trade with the US has been positive as Phase 1 was agreed with China late last year, creating an element of surety just prior to the coronavirus impact. This serves as a positive, knowing that Chinese firms have potentially priced in a lot more downside than necessary.

Coronavirus has however been a dominant factor impacting markets so far in 2020 with China restricting travel in and out of the country and many other countries following similar measures. However, despite uncertainty of when the pandemic will be fully contained, China is arguably far more progressed in the containment process, to the extent that recent PMI data not only beat expectation, but was in expansionary territory (53, with below 50 being contractionary and above expansionary). GDP contraction is to be expected globally for this period due to the shutdown, and we saw this in the China release. These negative growth data sets can largely be ignored as outliers over the longer term.

Countries such as South Korea again have a stronger containment of the coronavirus, seeing corporate valuations further compressed unnecessarily, making it a strong investment opportunity (more so than it previously was).

With OPEC still somewhat fractured and the relationship between Saudi Arabia and Russia still weak, the compression in oil prices has been dramatic. It seems likely that with Russia targeting the US West Texas Intermediate (WTI) supply with its high production/low cost, and given it can swallow some of the impact of its low oil price via its currency, we could see the Saudis struggle… which could impact them significantly given their tied currency. With that in mind and a recent negative US (WTI) oil price, Russia could be the one to keep an eye on if it decided to continue to press the US oil producers for political gain. That being said, the current price level of oil is unsustainable over the longer term, but bearing in mind the low demand at present, and given global reserves are all but full, the negative oil price on WTI right ahead of the May futures contract expiry suggests producers will be selling below production cost over the foreseeable. The largest Oil ETF is gearing up to sell all of its short term oil contracts, suggesting uncertainty and a likelihood of low oil prices for longer… great for corporates in many sectors over the long term. Countries such as India stand to benefit also as massive net importers of oil, and the low price frees up capital for the Indian government, as they no longer need to subsidise oil prices.

It continues to be an incredibly attractive area as even with data from the core areas such as China and India likely to continue to compress significantly over the short term with the global pandemic uncertainty, long term growth opportunities given the recent extreme valuation compression and indeed following a year of 'unnecessarily pricing in trade downside', are immense.

The US Economy

Relations have strengthened between US and China with the start of the Phase 1 trade deal. Whilst only the first step, this was important in light of the current pandemic crisis as it removed that extra level of uncertainty. In addition, due to the pandemic, any potential stresses on China and the US to carry out the agreed level of respective purchases from each other have been abated, with both sides agreeing to relax their position. A recent drop in agriculture prices such as corn (due to the closure of US ethanol producers) has allowed China to maintain some of its phase one trade purchases, but at a much cheaper price.

The Federal Reserve (Fed) has proven to be accommodative, particularly with coronavirus impacting the economy, as employment data has weakened from its record-high levels. It is however anticipated that a large portion of the unemployment data will improve once the shutdown is over, as furloughed staff are able to claim jobless allowances in the US, thus distorting numbers. We have seen the Fed cut rates to 0.25% (upper bound) whilst also reintroducing another QE style stimulus package upwards of $700 billion.

The November US elections will be a key news story in 2020 and will heavily depend on Trump's reaction to the current pandemic. With Joe Biden the leading Democratic candidate, and with Trump's approval ratings under pressure, whilst Trump still leads, it adds an element of uncertainty to the election. A second term will be heavily dependent on Trump's handling of this pandemic, and ultimately the impact on employment data sets.

Following the Senate's approval of a $2 trillion stimulus/aid package to battle the economic impacts of coronavirus, the effectiveness and timing of the distribution will be key for Trump, both from an economic perspective and an 'election success' perspective. It is likely we will see further pressure on Trump and the Fed to provide a more targeted approach to economic stimulus, in order to directly aid the vulnerable individuals and corporates. The most recent Fed meeting saw Chair Jerome Powell suggest rates will remain at or around 0% until unemployment picks back up to 4-5%... which will likely be a few years. This suggests the Fed will remain ultra-accommodative for some time to come, which will likely be good for sentiment and thus markets once the pandemic is contained.

Growth names in the US have looked toppy over the past few years, despite being robust and continuing to grow. The external impact of the pandemic has now compressed the market valuations, making them attractive both from a valuation perspective and a growth perspective, despite the likelihood of a weak set of results for many over the past quarter.

The European Economy

Christine Lagarde has set out a framework for strategic review over the next year (the first in 16 years) and has stated that there is the potential to focus on fiscal stimulus for the area going forward. Whilst this has all likely been delayed due to the coronavirus pandemic, it is still very much on the European Central Bank's front burner. So, whilst recent eurozone talks have been inconclusive on how to further implement containment measures for the pandemic, existing funding measures will likely see previously planned fiscal stimulus pushed back.

Negotiations with Britain over Brexit and trade will now most likely be pushed back due to the impact of coronavirus, seeing the majority of key funding being focussed on its containment, and a recent meeting being non-progressive.

European markets performed strongly in 2019 despite negative sentiment and valuations continue to be attractive on a relative basis over the long term. The short term impact of the coronavirus, particularly in Spain and Italy will introduce some severe short term volatility, but valuations remain attractive in key sectors for companies with strong balance sheets despite recent contractions in eurozone GDP (short term contraction due to the pandemic). Thus, the current extreme valuation compression will see some of these companies emerge stronger.

Fixed Interest

Over the quarter, fixed income markets, like equities, have been very volatile. Corporate bonds prices fell heavily, before recovering a large portion of what they lost. Government debt was already expensive, those areas with relatively better value (mainly the US) have seen yields fall, so what value there may have been has diminished further. Although credit vs government debt is attractive, all-in yields remain relatively low, particularly compared to the valuations in equities.

Government debt remains expensive. This is perhaps not surprising: there is explicit and substantial support from central banks, however that doesn't create a long term attractive investment opportunity (a large portion of government debt still trades with a negative yield). Central banks are also buying investment grade corporate bonds, including in the US, which is unprecedented (the US Federal Reserve are even going to buy high yield bonds!). Despite the support from central banks for corporate bonds, current valuations for corporates vs government debt are still attractive.

There have been times over the quarter when it has been difficult to trade bonds over the recent market stress, however government and central bank policy has calmed market participants and allowed many companies to come to the market with new issues of bonds. From speaking to the managers of the funds we own, I know they have found numerous opportunities in recent weeks, particularly in the new issue market. Global issuance in March and April were two of the highest issuance months ever for corporate bonds. Liquidity has not been helped by large parts of the industry working remotely, but as investors adjust, and the shock coronavirus has had begins to dissipate, liquidity should improve.

Looking forward, providing we do not see a large spike in coronavirus cases, it is likely corporate bonds will continue to perform well in the short term. Dividends have been cut, and government debt offers practically zero income in most instances. Therefore, corporate bonds are an obvious place for those seeking an income to invest. However, as mentioned already, all-in yields remain low, so medium term returns are likely to be low too.

If you would like to discuss this or any other aspect of your portfolio, please do not hesitate to contact us on **01423 501 401**, Monday to Friday 9am-5pm or you can email us at **info@mzltd.co.uk**

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