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Market Update - May 2020

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After falling 34% from their peak this year, global equities (as measured by the MSCI All Country World Index) bottomed-out on 23 March. At the time of writing, they have since rallied 25%. Investors returned on signs that the Coronavirus outbreak may be peaking after a slowing in new cases in epicentres like Italy and New York. Equities were also lifted after the Fed (and other central banks) stepped-up their asset purchases (Quantitative Easing) and governments around the world unveiled record stimulus programs.

Crucially, governments and central banks are working together to ensure funding flows to the private sector during the lockdown. This 'state capitalism' of injecting money into the economy has ensured there is ample liquidity flowing through the financial system.

Despite the improving funding environment, the underlying picture for global growth looks gloomy. For instance, IMF's latest economic projections for the 2020 calendar year, see a 3% decline in global GDP, which would represent its worst performance since the Great Depression more than 90 years ago.

If equities are to sustain their recent rally over the longer term, there needs to be a fundamental improvement in growth. For that to happen governments need to ease back on lockdowns. This is starting to happen. In Germany, small shops and car dealerships (an important industry for the country) resumed business from 20 April, while schools are being gradually reopened. On 10th May Boris Johnson announced measures aimed at easing the lockdown and President Trump, with an eye to the upcoming election in November, is upping the pressure on state governors to loosen the lockdown.

A V-shaped economic recovery will only be possible if restrictions are lifted and soon. However, there is the ever-present risk that a second coronavirus wave stalls this re-opening. As the repercussions of the global lockdown response to COVID-19 are becoming clearer, corporate boards are cutting dividends in response to commercial and regulatory pressure. Some industries, such as airlines, face an unprecedented period with almost no business until more normal life resumes. The impact on company earnings (and therefore dividends) is dependent on how long lockdowns continue and how long the recovery takes.

UK payouts look particularly precarious, with dividend cover low relative to other major markets and idiosyncratic sector risks; regulators have told UK banks to cancel their 2020 dividends to retain capital, for example. Cuts to dividends serve as a reminder of the benefits of diversification in a multi-asset portfolio. Income investors need to look beyond UK financials, and towards overseas markets. While government bonds look expensive on an historic basis, the security of their coupon (and principal) repayment is reliable.

China was the first country to be impacted by the virus, and it was also the first to begin to recover from it; a strong bounce back should help other economies.

This current crisis and the fiscal stimulus that it has prompted may well prove to be the catalyst for a rotation in market leadership that will create a more favourable environment for active managers, as stock returns diverge and market indices become less top-heavy and concentrated. This should bode well for active managers following a proven, long-term approach, and we expect market conditions to remain challenging, and active management which is at the centre of our investment philosophy, in our view, is key to managing clients investments.

Please note the following:

All investments involve different degrees of risk. Please remember that past performance is not a guide to future performance. The value of units and shares and the income from them can go down as well as up and investors might not get back the amount originally invested. Exchange rates may cause the value of overseas investments to rise or fall.

Where we have expressed views and opinions, these may change over time. None of the information mentioned in this document represents a specific portfolio or holding nor constitutes a recommendation to buy or sell.

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