INVESTMENT REVIEW – March 2020

Markets saw sharp falls in February as investors reacted to the spread of the coronavirus Covid-19 and its impact on economic growth or on individual companies. The reaction was in part based on an assessment of the developing position and in part on a fear of the unknown, given the difficulty of quantifying its extent. There is a good chance that markets will recover if the virus proves to be containable and if various stimulus measures can offset some of the impact, although there is likely to be continued volatility and there are continued risks. Equity markets struggled in the month although most fixed interest holdings rallied as bond yields again contracted.

The concern mounted as the virus took hold outside of China: in Italy, where the health system of an advanced nation was slow to identify it, where the measure will constrain already limited growth and where it served to spread around the world; in Iran, where the authorities were not open in their handling of the outbreak but proved open to infection themselves; and in South Korea, where there was also pressure on growth. The World Health Organisation declared the risk to be very high but did not declare a pandemic, because that is likely to prompt the panic that the name suggests and as it might be seen as an admission that the virus was out of control, even as it does take hold in other countries. The draconian quarantine that China imposed has appeared to be successful in limiting the spread outside of Hubei province (some 65,000 cases there in a population of 59m with a fatality rate of 2.9% compared to 13,000 with a fatality rate of 0.4% amongst the other 1.3bn in the populace) but their approach came at a cost to the economy and to individual freedom that complex democracies might not be able to replicate, while there is a risk that their easing of the measures proves premature. We have fast become expert epidemiologists, or at least tapped into their thinking, but there is significant uncertainty.

That is also true of the economic impact, both in its scale and duration, which makes specific changes tempting but perhaps illusory too. Companies such as Diageo, Microsoft and Rio Tinto have warned of lower revenue and profits, mostly in relation to business in China which has seen a sharp drop in output (except for face masks): the official purchasing index for manufacturing showed a level of 35.7 in February (when anything below 50 indicates a contraction). The Chinese economy had already been slowing, while accounting for over a sixth of global GDP and a quarter of its annual growth; at least the drop in pollution will be a positive. Whereas after the SARS outbreak there was a sharp recovery, this time the rebound is likely to be more protracted; individual countries will probably tip into recession, and the whole world might slip into one after what has been a drawn-out if subdued economic cycle. There had already been some pressures such as in Japan, where the increase in consumption tax last year did after all have an impact and which, combined with the disruptive effect of a typhoon, led to an annualised fall of 6% in the economy in the final quarter of 2019. Central banks will provide support and the US Federal Reserve is expected to cut interest rates again, although a monetary stimulus may have limited effect on what has been a supply and demand shock, given the disruption to complex business chains and to consumer confidence. Governments will need to combine adroitness in containing the disease with ambition in counteracting its impact.

The third element of uncertainty is how markets react, either as efficient discounting mechanisms that mark down the shares of airline companies, for example, or as entities that are prone to irrational fear as well as rational analysis. Markets proverbially climb walls of worry, especially with a leg-up from quantitative easing (the fourth stage of which is well underway in the US, even if not described as such), but they also dread uncertainty, so there is likely to be continued volatility which can bring opportunity in itself.

It is not as if there were not enough going on in the UK and the rest of the world. Boris Johnson has kept a low profile as flood waters rose and as civil servants sparred with ministers, one of whom resigned leaving a new Chancellor of the Exchequer in Rishi Sunak to present a Budget that may be limited by global issues and another one of whom, as Home Secretary, introduced a new law on immigration. The US elections are heating up, European politics has proved problematic still in France and Germany, the religious divisions in India have been costly and the crisis in Syria took another turn for the worse, even as the prospect of peace in Afghanistan improved.

VINTAGE ASSET MANAGEMENT

In the UK the FTSE 100 fell by 9.7% over February to end at a level of 6581, having already faltered in January, taking the index back to a level last seen in mid-2016. The mid-sized companies in the FTSE 250 index fell by 8.6% and the FTSE SmallCap index by 8.7% while the FTSE AIM All-Share lost 9.9%. The FTSE All-Share return including income was -8.9% in the period.

In the US the S&P 500 fell by 8.4% in the month, the concentrated Dow Jones Industrial index by 10.1% and the NASDAQ index by 6.4%, as technology shares had initially performed better and as it even managed a tiny gain on the last day of the torrid last week of February. Smaller companies, as represented by the Russell 2000 index, fell 8.5%.

In Europe the EURO STOXX 50 fell by 8.6% in the month, with the Italian market more resilient than other major exchanges as was the Euromoney index of smaller companies, which slipped 3.2%. In Japan the Nikkei 225 lost 8.9%.

The MSCI Emerging Markets index in US$ fell by 5.4% in the month helped by markets in China which had already seen sharp previous declines. The Hang Seng index in Hong Kong was off 6.6%. The MSCI Frontier Markets index was down 5.9%.

In the bond markets the UK 10-year gilt yield dropped from 0.52% to 0.44% and the total return for the FTSE Gilts All Stocks index was 1.3% in the month. In the US the 10-year yields also fell, from 1.51% to 1.15%, to reach a record low level, while in Germany they turned more negative again at a level of -0.61%. The month saw positive returns from government and corporate bonds although the riskier high-yield and emerging market debt indices declined, given concerns on credit defaults.

Sterling weakened against the US$ by 2.9% in the month to close at a rate of $1.28:£ and it was down 2.3% against the euro at €1.16:£. The price of gold initially rose but then faded in the general sell-off to close the month off 0.2% at $1586 per troy ounce. The price of Brent oil was down a further 11% over the month at $50 per barrel, having already fallen 15% in January, given concerns over a slow-down in growth and lower demand from transport. The main metals and agricultural commodities were mixed. The Vix index gauge of expected volatility in the US market more than doubled in the month.

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