



Investment outlook

A monthly round-up of global markets and trends
April 2020

In this issue

Investment outlook

Rising market risks from the coronavirus outbreak

Market highlights

Equities, fixed income, and FX and commodities

Market returns

Asset class by asset class

Please read the important information section

Investment outlook

Rising market risks from the coronavirus outbreak

Global equities have fallen at a rapid pace since peaking in mid-February. It took just 19 days (on 12 March 2020) for the US S&P 500 index to enter an equity bear market (defined as a drawdown of more than 20%). This is the fastest on record from data going back over 100 years. We are in the midst of an unprecedented event for society and markets. This makes it difficult to give any short-term predictions with any certainty. These are difficult times, but we are encouraged by the scale of response by policymakers.

There is much comparison between the current Global Coronavirus Crisis (GCC) and the last bear market during the Global Financial Crisis (GFC) in 2008, but there are many differences between these sell-offs. During the GFC, investors were worried about banking sector counterparty risk leading to systemic risk in the financial system. In contrast, the GCC has started out as a health scare shock. However, it has now turned into a liquidity crisis and could potentially morph into a financial crisis, like the GFC, if government lockdowns are extended for a long period of time. While the coronavirus outbreak is the catalyst for the sell-off, years of ultra-low interest rates have encouraged long-term investors to take on more risk than they would have normally done in order to seek returns. Clearing prices have also been impaired somewhat by tighter regulations introduced since the GFC. This includes the so-called US Volcker rule that has lowered the number of market makers providing liquidity to the market. In addition, considerable amounts of capital now follow algorithmic and passive investment strategies, which have led to many investors heading for the exit at the same time. This has added to market volatility and extreme price swings.

Looking forward, there is the supply-side shock coming from China and the locking down of whole advanced economies (e.g. Italy, Spain, France and the UK). This will inevitably lead to lower demand growth too. In its March Fund Manager Survey, Bank of America noted that fund managers reduced their global growth expectations by the biggest monthly amount from available data going back to 1994. Lower growth and company earnings' expectations adds stress to financial markets.

Policy makers have strongly reacted to recent market volatility and new measures of unprecedented size are being released daily. The Fed cut interest rates to zero and restarted its quantitative easing programme to initially buy \$700bn worth of Treasury and mortgage-backed securities, but soon scrapped the target and left it unlimited. Meanwhile the ECB launched a new

E750bn Pandemic Emergency Purchase Program (PEPP) to alleviate "serious risks" relating to the coronavirus outbreak. The Fed also reinstated a facility that provides more funding for the US commercial paper (CP) market. This is an important source of short-term finance for companies to draw on if banks become unwilling to lend to them. The Fed's CP facility should also alleviate the need for companies to run down cash assets, which unless prevented could help spread contagion through US (and global) financial markets. The ECB and BOE have also announced similar CP facilities.

The bottom line is that global central banks are finally injecting liquidity direct to the corporate sector, reducing credit risk and providing a backdrop for financial markets to stabilise.

Aside from central banks willingness to provide liquidity to financial markets, government around the world have stepped-up fiscal stimulus. UK Chancellor, Rishi Sunak, recently rolled out a £350bn rescue package to keep Britain's businesses and workers afloat through the coronavirus crisis. Meanwhile, the Trump administration has introduced a \$2trn-plus fiscal package to backstop the US economy. European governments (including fiscally conservative Germany) have also introduced policy to support their respective economies.

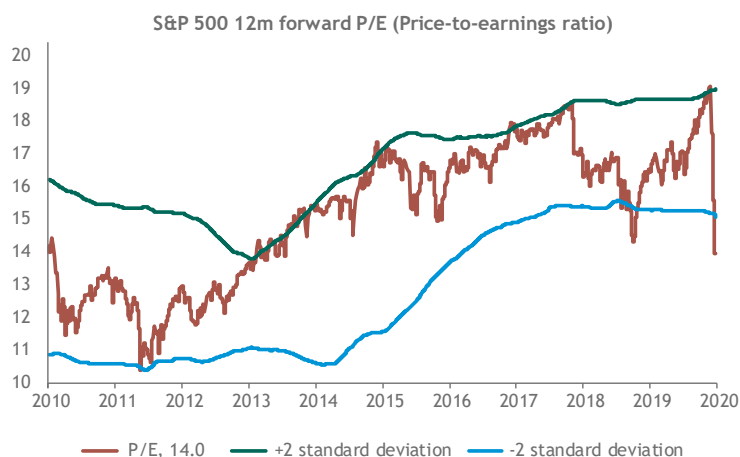
Markets continue to look for more coordinated fiscal and monetary responses by the world's major economies to stabilise the global economy and keep markets liquid, while also containing the coronavirus outbreak.

Encouragingly, population quarantines have led to a plateauing in the number of coronavirus cases in China and the recovery rate of those infected has risen to 85%. Restrictions on China's population are being eased. High frequency stats such as coal consumption, daily passenger volumes show that Mainland economic growth is gradually beginning to recover. There is a risk of the virus reappearing, but we all should be encouraged to see how effective 6 weeks of containment has appeared to be.

Should coronavirus cases top-out in the coming months, this should create an environment for the market to find a trough. Once that happens, less demanding equity valuations, incremental policy easing and a loosening in travel restrictions will provide an opportunity for economies to recover and for equity markets to rally from their currently oversold positions.

Equities

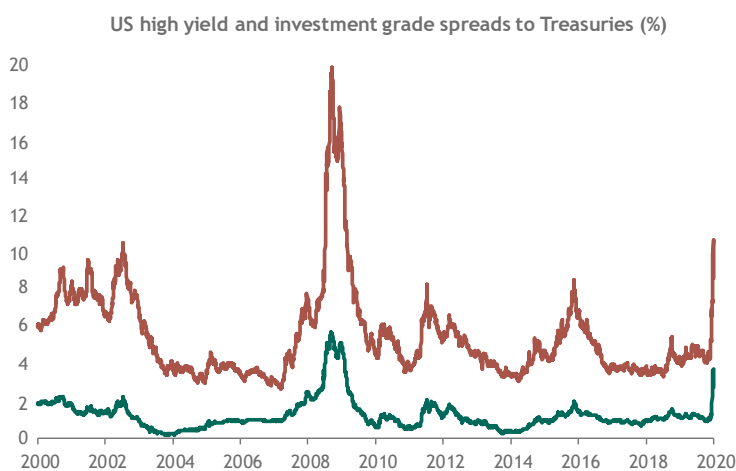
Market valuations have come down considerably. Equities included in the US S&P 500 index now trade on 13.9x forecast earnings over the next 12 months, a level last seen in 2013. Stocks also look extremely cheap relative to bond markets. Even with the heightened uncertainty, equity valuations are at a level that offers a more favourable risk-reward payoff than over a month ago. This could add support to the market. However, one risk to these lower equity valuations is that we do not yet know the impact on corporate earnings from the downturn; it is too early to start seeing this in analysts' estimates.



Source: Refinitiv Datastream/Smith & Williamson Investment LLP, data as at 1 April 2020

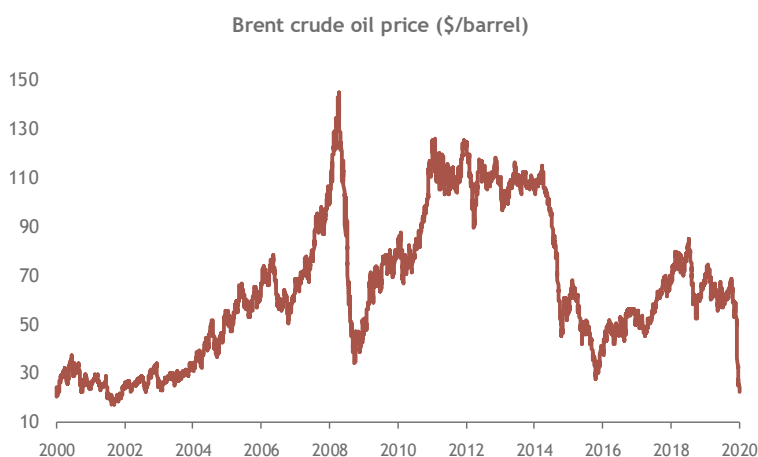
Fixed income

One condition necessary to stabilise equities is for financial stress in the corporate bond markets, as evidenced by widening US credit spreads (the cost of borrowing in capital markets over Treasuries), to ease. In March, the Fed has introduced two new facilities to inject funds into the primary and secondary market for investment grade bonds. However, these monetary tools do not apply to the riskier high-yield corporate debt market. Arguably, both investment grade and high yield corporate credit spreads probably need to narrow for equity markets to recover from here.



FX and commodities

The Brent crude oil price has fallen to its lowest level for 17 years on expectations of a sharp decline in global energy demand. On the supply side of the equation, following a refusal by Russia to reduce oil output in line with weaker global growth, Saudi Arabia said they would expand their output to its maximum amount in a full-scale oil price war. This failure in the Saudi/OPEC-Russian arrangement to keep oil production balanced with demand increases the potential for a glut of crude oil to flood the market and could cause further falls in energy prices. Nevertheless, Russia is now seeking talks with Saudi Arabia to resolve their differences.



Market highlights

Glossary of terms

Bonds – The relationship between price and yield. Yield is the return you get on a bond. When the price of a bond changes prior to maturity due to supply and demand pressures, so does its yield. When the price of a bond goes up due to demand, the yield goes down to compensate. This is so the bond's fixed rate of return (coupon) remains relatively constant – and vice versa. A bond's price and its yield are inversely related. A key factor which influences a bond is the prevailing interest rate. When interest rates rise, the prices of bonds fall, thereby raising yields. This is because the older bonds are sold in order to buy new higher yielding bonds.

Equities – A stock or any other security representing an ownership interest.

GDP – Gross Domestic Product.

Monetary policy – Actions of a central bank or other agencies that determine the size and rate of growth of the money supply which will affect interest rates.

Market returns (Total return (%), sterling)	1 month	3 months	1 year	5 year
Equities				
MSCI All-Country World	-10.8	-15.9	-6.2	41.6
FTSE 100	-13.4	-23.8	-18.4	2.9
FTSE 250	-21.7	-30.7	-18.6	1.4
S&P 500	-9.7	-14.1	-2.2	65.8
MSCI Europe ex UK	-11.2	-17.3	-7.5	21.2
MSCI Japan	-4.2	-10.9	-1.5	33.3
MSCI Pacific ex Japan	-17.8	-22.6	-19.7	11.6
MSCI Emerging Markets	-12.8	-18.3	-13.2	19.8
Bonds				
iBoxx GBP Gilts	1.6	7.0	10.7	27.6
iBoxx USD Treasuries	6.7	16.9	19.9	44.8
iBoxx GBP Corporate	-7.5	-5.6	0.0	17.0
Commodities and trade-weighted FX				
Oil Brent Crude (\$/barrel)	-55.3	-65.9	-67.0	-58.6
Gold (\$/ounce)	1.6	6.0	24.4	35.7
GBP/USD	-2.9	-6.4	-4.8	-16.5
GBP/EUR	-2.8	-4.2	-2.6	-18.2
EUR/USD	-0.1	-2.2	-2.3	2.2
USD/JPY	0.1	-0.7	-2.5	-10.0

Key macro data	2020		Spot rates	31-Mar	Yields (%)	31-Mar
	Latest	Consensus forecast				
UK GDP (YoY%)	1.1	-0.60	GBP/USD	1.24	FTSE 100	5.78
UK CPI Inflation (YoY%)	1.7	1.30	GBP/EUR	1.13	FTSE 250	4.26
Bank of England Base	0.10	0.20	EUR/USD	1.10	10 Year Gilt	0.31

All values and charts as at 31 March 2020. Total returns in sterling.

Returns are shown on a total return (TR) basis i.e. including dividends reinvested (unless otherwise stated).

Net return (NR) is total return including dividends reinvested after the deduction of withholding tax.

Source: Thomson Reuters Datastream and Bloomberg

Important information

Please remember the value of investments and the income from them can fall as well as rise and investors may not receive back the original amount invested. Past performance is not a guide to future performance.

Sources

MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indexes or any securities or financial products. This report is not approved, endorsed, reviewed or produced by MSCI. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

FTSE International Limited (FTSE) London Stock Exchange Group plc and its group undertakings (collectively, the "LSE Group"). © LSE Group 2020. FTSE Russell is a trading name of certain of the LSE Group companies. "FTSE®" is a trade mark of the relevant LSE Group companies and is used by any other LSE Group company under license. All rights in the FTSE Russell indexes or data vest in the relevant LSE Group company which owns the index or the data. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company's express written consent. The LSE Group does not promote, sponsor or endorse the content of this communication.

Neither Markit, its Affiliates or any third party data provider makes any warranty, express or implied, as to the accuracy, completeness, fitness for purpose or timeliness of the data contained herewith nor as to the results to be obtained by recipients of the data. Neither Markit, its Affiliates nor any data provider shall in any way be liable to any recipient of the data for any inaccuracies, errors or omissions in the Markit data, regardless of cause, or for any damages (whether direct or indirect) resulting therefrom. Without limiting the foregoing, Markit, its Affiliates, or any third party data provider shall have no liability whatsoever in respect of any loss or damage suffered by you as a result of or in connection with any opinions, recommendations, forecasts, judgments, or any other conclusions, or any course of action determined, by you or any third party, whether or not based on the content, information or materials contained herein. Copyright © 2020, Markit Indices Limited.

Copyright © 2020, S&P Dow Jones Indices LLC. Reproduction of S&P US Index Alert in any form is prohibited except with the prior written permission of S&P. S&P does not guarantee the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions, regardless of the cause or for the results obtained from the use of such information. S&P DISCLAIMS ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P be liable for any direct, indirect, special or consequential damages, costs, expenses, legal fees, or losses (including lost income or lost profit and opportunity costs) in connection with subscriber's or others' use of S&P US Index Alert. (2019)

For further information

Contact	Direct line	Email address	Contact	Direct line	Email address
Daniel Casali	020 7131 8985	daniel.casali@smithandwilliamson.com	Sam Pham	020 7131 8352	sam.pham@smithandwilliamson.com
David Goebel	020 7131 8908	david.goebel@smithandwilliamson.com	Sarah Giarrusso	020 7131 4218	sarah.giarrusso@smithandwilliamson.com

Our offices: London, Belfast, Birmingham, Bristol, Cheltenham, Dublin (City and Sandyford), Glasgow, Guildford, Jersey, Salisbury and Southampton.

Smith & Williamson Investment Management LLP authorised and regulated by the Financial Conduct Authority.

Smith & Williamson International Limited Regulated by the Jersey Financial Services Commission.

Smith & Williamson Investment Management (Europe) Limited Regulated by the Central Bank of Ireland.

We have taken great care to ensure the accuracy of this newsletter. However, the newsletter is written in general terms and you are strongly recommended to seek specific advice before taking any action based on the information it contains. No responsibility can be taken for any loss arising from action taken or refrained from on the basis of this publication. © Smith & Williamson Holdings Limited 2020. eb49420