COLUMBIA THREADNEEDLE INVESTMENTS

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Market updates

Investment team updates | 26 May 2020

Fixed income

Bond Markets

- Credit markets have been quiet over the past couple of weeks, with the USD outperforming the Euro and GBP, and emerging markets outperforming month-to-date.
- Rates markets are little changed, with peripheral Euro rates outperforming.

Fundamentals

- The ongoing terrible economic data seems to be at last bottoming out. There has been an improvement in developed markets as the Covid-19 lockdowns are loosened, but there are ongoing issues in EM.
- The UK is not ruling out negative interest rates.
- In Europe, the Macron/Merkel plan offers hope of greater unity.

Technicals

- Market inflows continue. There are high levels of supply in IG and government markets, with the US issuing its first 20-year bond in decades.
- High yield is quieter.
- The UK issued a negative-yielding gilt.

Valuations

- Spreads are still a little wide of long-term averages, e.g. Global IG is at one standard deviation and Euro HY around 0.2 standard deviations.
- Government bond yields very low.

European equities

- Equity markets are showing no clear short-term direction but are operating with healthy liquidity.
- There have been a few occasions where optimism over a vaccine has prompted a brief flurry led by value stocks and airlines, and other cyclicals hit by the virus have bounced. But it is not clear that any major trend change is occurring or is likely.

- The focus now is on exits from lockdown – occurring at different paces round the world – and on fiscal and monetary stimulus and other help measures. Monetary stimulus tends to boost the value of longer-term compounding growth stocks with sustainable and visible earnings (where we have always had a strong focus). These are often in sectors where the crisis has created opportunities as well as threats: online payments processing is booming, and there are beneficiaries in healthcare stocks with capabilities in vaccine development and production or diagnostics.

US equities

Markets

- US equities finished lower last week, with the S&P 500 declining by just over 2% as stocks eased off following strong gains in recent weeks. Energy led the decline, while REITs were also hit, along with airlines and banks. At the other end, healthcare stocks were higher given strength in biotech and big pharma names.
- We continued to see the outperformance of names leveraged to the work-from-home theme versus those whose business models that are locked down and waiting to reopen.
- The opinion on reopening continues to split along partisan lines, but some states have moved toward a phased reopening.
- US-China trade tensions came to the surface again last week as the White House criticised China for its handling of coronavirus. On Friday, the US announced new export restrictions on semiconductors, designed to cut off Huawei from its suppliers. While concerning, it does not yet suggest that either side would seek to jeopardise the Phase One trade deal, as abandoning it could damage any global economic recovery. Trade war headlines are likely to remain in the news as both Democrats and Republicans take up a stance on China before the election.

Economy

- Economic data continued to paint a bleak picture; there was a record 16.4% decline in April retail sales from the previous month, while initial jobless claims have reached 36.5 million over the past eight weeks, although the rate of increase continued to decline last week.
- We are starting to see signs of transport volumes inching away from the trough. Port data and railroad volumes have shown signs of improvement.

Earnings

- The Q1 earnings season has been better than feared, although the full impact of the coronavirus shutdown will not be evident until the Q2 reports. Confidence in forward-earnings guidance remains low and many companies continued to follow the trend of withdrawing 2020 guidance.
- We have noticed more convertibles coming to the market, in a rerun of 2009. They are usually seen as a cheaper way of raising capital, especially when companies are cautious about adding more debt to their balance sheets.

Virus

- Moderna released positive trial results for a potential Covid-19 vaccine, which could significantly bring forward the timeline, but it is unclear yet as to whether this will lead to disease prevention. The easing of lockdowns and any associated uptick in the infection rate remains the main point of interest.

Japanese equities

- Prime minister Shinzo Abe lifted the state of emergency across most of the country last week as the number of Covid-19 cases continued to fall. In districts where this was done, including the cities of Osaka and Kyoto, the number of infections was on a declining trend – fewer than 0.5 new cases per 100,000 people.
- The government announced a secondary wave of stimulus measures – strengthening the existing ¥117 trillion package – to raise support for furloughed workers and subsidise rent reductions.
- With Japan ahead of the global pandemic curve in terms of economic resumption, we will continue to closely monitor any signs of a secondary wave of infections.

Global equities

- Following April's sharp positive move, the second largest monthly return for the MSCI ACWI in the past 30 years, global equity markets are up again in aggregate over the month to date. However, this hides the day-to-day volatility over the period.
- While growth remains the dominant style, and technology remains strong over the month to date, there appears to have been little clear direction, with cyclical sectors coming in and out of favour off the back of any news. Despite the market's positive response to more countries emerging from lockdown and news of potential vaccines, we remain cautious and see the potential for further volatility.
- On the whole, global portfolios have held up relatively well over the month, adding to relative gains for the year to date.
- The virus might have brought economic activity to a halt for now, but it has accelerated trends that have been in place for a decade. Therefore, our overall shape remains broadly unchanged, but we continue to take advantage of market volatility, taking profits where appropriate and adding to high conviction names where we see opportunity.
- The crisis has reaffirmed our conviction in our philosophy and that high-quality companies are the likely winners over the coming years.

Multi-asset

- Ultra-low discount rates, central banks that are seeking to control credit spreads, and fading dislocations within asset markets support our continued positive stance towards risk in multi-asset portfolios.
- Yet, with markets up around 20% from where they were, and extremely pronounced weakness in economic data, our preference for quality remains.
- Our equity exposure combines a barbell of quality growth in the US, and some cyclicality from emerging Asia.
- In fixed income our preference remains for high-grade credit with caution on core government bonds at these levels, particularly given sharply deteriorating fiscal accounts as policy makers seek to manage the crisis.

Note: all data as at 22 May 2020, unless otherwise specified. Source: Bloomberg.

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