INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

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Market updates

Investment team updates | 29 May 2020

Fixed income

- Strong rally continues in risk markets:
    - Global IG spreads are at 187, from 341 in late March, led by autos, mining and energy. This is a total return of around 6% since 23 March. There has been a deluge of new issuance – around €1 trillion year-to-date in the US market, which is twice last year's volume.
    - European HY is yielding 5.6%, from 8.6% in late March. This is a total return of around 15% since 23 March.
    - The EM USD Sovereign Index has also returned around 15% since 23 March.
    - The S&P500 has a total return of around 36% since 23 March.
- There appears to be optimism around a vaccine for Covid-19, and many major economies are now reopening.
- The EU has proposed a recovery fund of €750 million (€500 million in grants and €250 million in loans)
- The ECB expects eurozone GDP to contract between 8% and 12% this year.
- China and US tensions are rising.
- US initial jobless claims are at about 2.1 million, and there has been a fall in continuing claims by around 4 million.
- Durable goods orders fell (only) 7.4% in April.

US equities

Markets

- US equities rallied last week in a risk-on move led by a rebound in value and cyclical stocks; the S&P 500 was up 3.2% and the Russell 2000 was up 7.8%. Stocks leveraged to the stay/work at home theme underperformed those which would benefit from a reopening, in a reversal of the trends from the previous week.
- Value stocks meaningfully outperformed growth and momentum last week. The gap in valuations between growth and value remains the widest it has been since the early 2000s. The recent market rally has been characterised by the outperformance of quality and growth with brief value rotations. Whether this turns into a sustained period of value style leadership remains to be seen.

- At a sector level, industrials performed best as airlines and rail stocks rebounded. REITs also did well, particularly those connected to hotels, casinos and retail. Healthcare was the only sector which ended the week lower as big pharma was the main drag.
- Positive sentiment came from the reopening theme and optimism in the search for a Covid-19 vaccine.
- Accommodative central bank policy continues to provide liquidity. The monetary stimulus from the Federal Reserve far exceeds the sum total of its operations during the global financial crisis. Its balance sheet now exceeds $7 trillion. Chairman Powell reiterated this accommodative stance in press conferences last week and indicated that the Fed was prepared to do more.
- US-China tensions remain elevated, especially with China announcing it would impose new national security laws in Hong Kong.

Earnings

- An improvement in consumer demand in April and May was a feature of earnings updates last week, as some consumer-facing companies reported that demand trends following reopening were more positive than expected. Those retailers with online platforms have also been able to partially offset the decline at physical stores. Direct government loans to businesses have also been cited as helpful.
- Airlines had a good week subject to a modest uptick in demand.
- Q1 earnings are down 15% year-on-year and Q2 is on course for a -40% drop.

Virus

- Moderna's possible Covid-19 vaccine continued to drive positive sentiment, especially when it was announced that deployment could come as early as the end of this year.

European equities

- Covid-19 news has included the progressive relaxation of lockdowns in most countries, the easing of pressure on healthcare systems and improving statistics on fatalities and infections. Progress has been made in the search for vaccines and antibody tests, although not without some problems – vaccine tests may be hindered if the disease dies out so much that there are few infected victims to test for example. Travel restrictions will be relaxed later, but there is some optimism in this area too.
- Europe has seen reasonably positive markets in the near term, a continuation of the recovery seen since late March. There has, however, been a short-term trend reversal favouring "value" stocks of poor quality for the first time this year, which has hampered us as we have a natural bias towards quality.
- We are generally defensive; economic data is not yet encouraging and there is little visibility over the medium-term impact of the virus and associated lockdowns.

Japanese equities

- It's been a strong week with the Topix Index closing at its highest level since February, as the government approved a secondary stimulus package to combat the economic blow dealt by Covid-19 and further relaxed containment measures. The package, which follows an initial stimulus package in April, is worth $1.1 trillion (¥117 trillion) and includes a raft of loan guarantees and private sector contributions. Combined, the new measures will double the total committed stimulus plans to $2.2 trillion or about 40% of Japan's GDP.

- The government officially lifted its state of emergency for the entire nation – with autos and electronics leading gains across sectors.
- The TSE Mothers Index, a Japanese index for high growth companies, has continued to demonstrate strong performance since March's sell off returning around +7% year-to-date.
- Interestingly, we witnessed positive foreign inflows into the asset class this week for the first time in more than three months, suggesting investors are identifying opportunities in Japan's equity market and sensing the worst of the environment is now behind us.

Multi-asset

- There were no changes made this week to broad asset allocation, which favours equities and credit, holds a dislike for core government bonds and stands neutral on commodities, UK commercial property and cash.
- This is set within a positive view on prospective returns to risk overall, with investors appearing to be being modestly overcompensated for the economic risks ahead – substantial though they are.
- While we are not expecting a sharp bounce-back in economic growth, we do expect market liquidity to continue to improve, and for the risk premia associated with that market disorder to fade.
- Our latest asset allocation strategy group meeting focussed on the outlook for UK commercial property, which has come under pressure from Covid-related shutdowns. Yet, while the lockdown may accelerate existing problems in the retail sector, for example, the asset class entered this crisis in reasonably good condition, such that should allow it to recover as cities reopen. Neutrality was maintained.

Note: all data as at 28 May 2020, unless otherwise specified. Source: Bloomberg.