INFORMATION FOR INVESTMENT PROFESSIONALS

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Market updates

Investment team updates | 7 May 2020

Fixed income

- Credit spreads were little changed this week, although EM was tighter. Core government yields were a shade higher.
- Investment Grade spreads, meanwhile, were tighter by nearly 40% from the wides of late-March. This was led by USD market, and specifically short-dated USD.
- Euro High Yield was only 25% tighter over same period
- Economic data is as bad as feared and business and consumer confidence has collapsed, with a huge rise in unemployment.
- No Inflation.

US equities

Market

- With April now in the rear-view mirror, in USD terms the S&P 500 was up 12.8% for the month (-9.3% year-to-date), the Nasdaq Composite was up 15.5%, the Russell 2000 was up 13.7%, the Russell Value was up 11.2%, and the Russell Growth was up 14.8% (all monthly figures). Overall, we saw a continuation of the quality growth style outperforming the broader market, interspersed with cyclical interludes.

Earnings

- Just over two-thirds of companies in the S&P 500 by market cap have reported Q1 earnings, with positive earnings per share surprises from the technology, energy, and healthcare sectors. The main highlights from earnings season are:

  o The theme of beating estimates and withdrawing guidance for 2020 continues.

  o Several companies expect the shock to be short lived and to have passed the worse by the time economies reopen. Many pointed to the rebound we are seeing in China as the economy reopened with supply and production largely back to pre-crisis levels and demand also gradually improving. However, we have observed that the recovery in Chinese domestic flights has been somewhat anaemic, presumably due to the difficulty of implementing social distancing on flights.

  o US companies are relying more on pay cuts and furloughs than outright layoffs to maintain flexibility.

  o Many companies have emphasised their support for dividends, but nearly all have reduced share buybacks.

Economy

- The data we received this week continue to reflect the impact of the lockdown.
- Q1 GDP dropped at a 4.8% seasonally adjusted annualised rate (SAAR). It was the first contraction for GDP since 2014 and the worst quarter since Q4 2008.
- Personal consumption was the big drag, falling 7.6% for its worst decline since 1980. Consumption accounts for two-thirds of total output.
- The US six-week total jobless claims is now greater than 30 million (around 18% of the workforce).
- April's ISM manufacturing gauge fell to 41.5 from March's 49.1.
- April’s consumer confidence reading dropped to 86.9, a decline of 31.9. This capped the worst two-month drop since 1967. However, respondent expectations for improvement in the next six months rose.
- The US April autos SAAR of 8.6 million was the weakest since 1970s, yet better than feared – retail SAAR of 7.6 million held up fairly well, while the fleet segment (especially rental car channel) was weak. The mix shift towards trucks continues, which suggests the auto sales rate is holding up better than headlines would suggest.

Virus

- Although not a gamechanger, there was positive news from biotechnology firm Gilead with the emergency FDA approval of Remdesivir, which is said to lessen the effects of coronavirus in hospitalised patients. It also said it would donate its entire stockpile to the government.

Japanese equities

- The MSCI Japan index was down over the week as Covid-19 concerns continue to weigh on market sentiment. Prime minister Shinzo Abe extended the state of emergency from 6 May-31 May, with existing containment measures to be reviewed in the middle of the month.
- Industrial production fell sharply in March, while exports also fell given lockdowns in major US and European cities.
- The Bank of Japan continues to facilitate fiscal expansion and corporate financing as part of a co-ordinated response with the government.

European equities

- After the fall and the sharp recovery, the short-term direction of the market is less clear. But market volumes remain healthy, having if anything slightly improved.
- Falls in infections and fatalities from Covid-19 continue, and lockdowns have been slightly relaxed in some countries. The talk now is all about exit strategies.
- However, although this may be earlier than some expected, they will not represent a 100% reversal. Airlines may require temperature checks or health certificates and may require empty middle seats. Distancing will affect high-street retail and restaurants.
- Our broad high-quality stance remains and continues to support performance and limit our exposure to the most volatile areas. We have, for example, dodged the worst of the dividend cuts and desperate capital raisings.

Multi-asset

- This week's asset allocation discussion focussed on equites, as the group continued to debate the impact of the lockdowns on their future path.
- On one hand, markets only appear to be pricing in a fall in global GDP of around 2%, where the actual contraction could be much deeper. Yet, pent-up demand may be quickly unlocked as businesses re-open, and the impact of low bond yields on risk asset prices should not be underestimated.
- All in all it was decided to leave broad asset class views unaltered but continuing on a path of more targeted and quality exposure. To that end, we took UK equities down to neutral, but in the context of a "favour" for equities as a whole. Though UK equity valuations have rarely been cheaper, we no longer see a clear catalyst to close the valuation cap between the UK and global markets.
- Instead, we prefer to take cyclical exposure in Asian emerging markets, while the US offers exposure to quality-growth.

Note: all data as at 6 May 2020, unless otherwise specified. Source: Bloomberg.