Cave's Quarterly

Cave&Sons

Stockbroking & Investments Since 1906

Edition 18, Q2 2020 Round Up

Recession to Recovery

Australian bushfires, Iranian missile attacks, nationwide lockdowns, Hong Kong protests, mass demonstrations against racial injustice, a worldwide health pandemic and a stockmarket crash – the first half of 2020 was eventful, to say the least! With a global economy on life support and March's ferocious sell-off still fresh in investors' minds, many did not predict such a resolute bounce back in stocks and investor confidence throughout the second quarter; the sharpest 30% drawdown in the history of global equities in Q1 was followed by the strongest 50-day advance, which saw US markets testing recording high levels in June.

As the virus spread outside of China and South East Asia, much of the initial attention was on Western economies and the European hotspots of Italy, Spain, and the UK. With the number of cumulative global cases surpassing 11 million however, the focus is now firmly on the US and countries in the developing world. New cases are soaring in some of the world's most populous nations in India, Brazil and Mexico and several US states have had to reverse plans to reopen their local economies after an uptick in infections and deaths. Despite this bleak outlook, investors' risk appetite remains strong and shares have continued to rally off their March lows with the market seizing on any opportunity to rise.

Fearful of taking the punchbowl away from the party too soon, Central Banks and governments remained in "whatever it takes" mode and continued to deliver record levels of fiscal and monetary stimulus to prop up the global economy. Lower interest rates and sustained, subdued inflation levels have created a supportive environment for risk-assets and investors were quick to shift from recession worries to recovery optimism as countries emerged from their lockdowns.

Global Equities

The UK has suffered high infection and death rates during the COVID-19 crisis which has delayed the easing of lockdowns. As a result, our domestic FTSE100 index has been a serial underperformer among the major developed markets, gaining 9% since the end of March. This performance differential has been accentuated further by our overweight exposure to financials, energy, and stocks in the worst affected leisure and hospitality sectors. With everything going on, it is easy to forget that a year-end deadline has also been set for the UK/EU trade deal, and with Brexit negotiations reportedly having reached a stalemate, economic uncertainty is likely to persist for some time.

In the US, the S&P 500 index registered its biggest quarterly gain since 1998, bouncing back with a 20% rise and regaining practically all the ground lost in the March sell-off. The rally has further bolstered the 'Big Tech' names that dominate the US stockmarket, with the likes of Facebook, Amazon, Apple, Netflix and Google benefitting from policies that have kept billions of people indoors, reliant on video conferencing, streaming services and home delivery. While coronavirus cases continue to surge across the pond, economic activity is picking up and recent data for unemployment and consumer confidence topped analyst expectations. Any further deterioration in US/China trade talks look set to prompt risk-off episodes but, for the meantime, investors seem bent on riding the wave of unprecedented Federal Reserve stimulus.

European economies were the first outside of East Asia to impose stringent lockdown regimes and, so far, have managed to avoid a second wave of infections as restrictions have been lifted into summer. Activity data shows consumers returning to non-essential retail and a ramped-up policy response from the ECB (European Central Bank) has seen an increase to its quantitative easing (QE) program, rules on fiscal deficits relaxed and work subsidy schemes implemented to keep unemployment across the region low. Much of the attention in recent weeks has been over the proposal by Germany and France to launch a €750 billion recovery fund, which would see €500 billion worth of grants distributed to the worst affected member states, such as Italy and Spain, and €250 billion made available in loans. Whilst still to be agreed by all 27 members, this perceived move towards a more united and stable EU assisted the sharp +16% rise in equities, as represented by the Euro Stoxx 50 index.

As the first region to be affected by the COVID-19 crisis, Asia Pacific nations are months ahead in the pandemic recovery cycle and were reasonably successful in containing the initial outbreak through border shutdowns and advanced testing and contact tracing. Equities held up relatively well through the market downturn and have since trended higher, helped by more encouraging manufacturing, construction, and services data. The Hang Seng (China) and Nikkei 225 (Japan) indices rose +9% and +18% correspondingly since the end of March.

Alternatives

The price of oil remained extremely volatile as the industry grappled with a huge lockdown induced demand shock and in-fighting among some of the major producers regarding production cuts. Indeed, at one point in late April, the price of US West Texas Intermediate (WTI) oil turned negative for the first time in history, falling as low as low as minus $37.63 a barrel as weak demand and difficulties in managing storage capacity saw traders briefly paid to take physical delivery of the commodity. An agreement between OPEC (Organisation of Petroleum Exporting Countries) members to slash production by record amounts was subsequently reached and producers have extended this pact through July. Having started the year trading above $60 a barrel, oil prices closed out the quarter around $40, almost 100% higher than levels seen at the end of Q1.

Precious metals continued to perform well, providing investors with a source of uncorrelated returns through periods of heightened market volatility and risk-off swings. Aided by its inflation-hedging properties and historically low correlation to traditional asset classes, gold is also benefiting from the structural tailwinds of monetary easing, which has lowered the opportunity cost of holding the metal. Gold futures climbed nearly 13% in the second quarter, exceeding $1,800 an ounce for the first time since 2011.

Commercial Property

The UK commercial property sector played host to some of the worst performing names through the quarter, with a complete shutdown of non-essential retail souring investor sentiment and depressing rent collection by landlords. Not all sectors have been impacted in the same manner however, and trends that existed pre-crisis have been exacerbated; retail, leisure and hospitality remain severely challenged, whilst industrials and offices have proved comparatively resilient. Investor concerns over the implications of social distancing and the rise in E-commerce for shopping centres were vindicated in June as Intu Properties (which owns the Trafford Centre) collapsed into administration.

Fixed Interest

The combination of falling interest rates and global Central Banks pumping billions into quantitative easing programmes has pushed government and corporate borrowing costs to record low levels. Despite the strong rally in riskier assets, more defensive options such as bonds have offered upside and downward pressure on yields (bond prices rising) saw global investment grade and high yield credit outperform their sovereign counterparts. The yield on the UK 10-Year Gilt and the US 10-Year Treasury Note stood at 0.17% and 0.66% respectively at the end of June.

Whilst credit spreads remain above pre-COVID levels, a recent tightening suggests that expectations for corporate defaults have eased. Historically a tool reserved only for the major developed markets, most emerging market (EM) Central Banks have engaged in their own version of quantitative easing since March. EM debt was the top performer within the fixed income asset class across Q2, returning +11%.

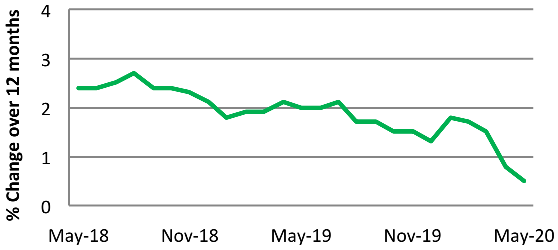
Outlook

Looking to the second half of the year, global financial markets will have to contend with a new source of uncertainty in the form of a US presidential election in November. Donald Trump's perceived poor handling of the COVID-19 crisis and the Black Lives Matter movement have combined with a slumping US economy to send his approval ratings into freefall. As a result, polls and betting markets have now moved in favour of a victory for Trump's Democratic rival, Joe Biden.

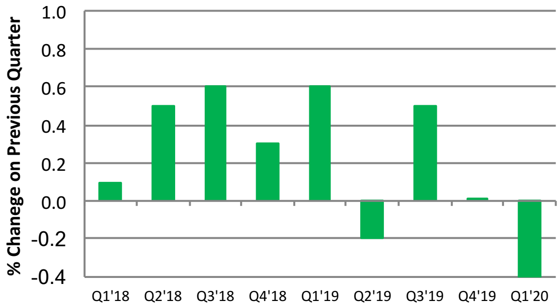
L, U, V, W, or ✓ - market analysts continue to obsess over the likely shape of any economic recovery. Mindful of heightened geopolitical tensions, the dangers of a second wave of infection and political risks moving forward, we continue to advocate an investment strategy which focuses on long-term fundamentals and diversifies by asset class, regions, and sectors to try and mitigate periodic bouts of volatility. Cognisant of the futile process of attempting a wholesale exit and re-entry through periods of stress, we remain fully invested to harnesses the power of time in the markets.

A year in numbers

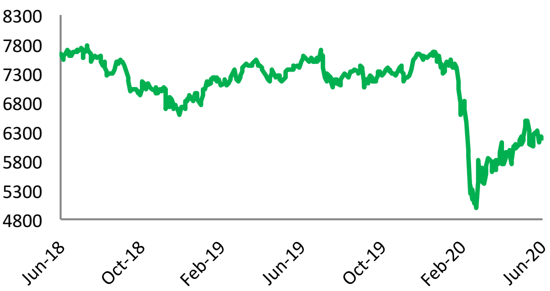
UK Consumer Prices Index (CPI)



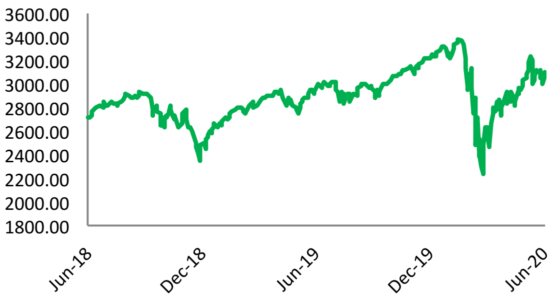
UK Gross Domestic Product



FTSE 100 Index



S&P 500 Index



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