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INVESTMENT

Investment Commentary

March 2020

Introduction

■ Investors entered 2020 in high spirits, buoyed by steady economic growth, accommodative monetary policy and the Phase One trade deal between the US and China which had seemed to remove the risk of an all-out trade war. However, having appeared resilient in the face of emerging concerns about the Covid-19 outbreak in January 2020, equity markets have fallen sharply over the past few weeks as the virus has spread rapidly across the globe. The global spread of the outbreak has led the World Health Organisation (WHO) to declare Covid-19 a pandemic.

Economic impact & policy response

■ From a financial market standpoint, the concern is that the outbreak will constrain economic activity and dampen corporate earnings. Indeed, forecasts for global economic growth in 2020 have been revised materially lower in recent weeks.

■ For instance, in early March 2020, the International Monetary Fund (IMF) warned that global growth this year will fall below 2019 levels due to the coronavirus crisis. The IMF had previously forecast a rise in global growth from 2.9% in 2019 to 3.3% this year. The downward revision reflects the combination of demand and supply side shocks emanating from the virus outbreak. Perhaps more concerning for investors was the fact that the IMF was unable to specify by how much it now expects growth to undershoot 2.9% due to the uncertainty surrounding how the pandemic would develop and the timeliness and effectiveness of any policy response.

■ Similarly, around the same time as the IMF, in its Interim Economic Outlook, the OECD lowered its global GDP growth forecast by half a percentage point. The OECD's revisions are shown in Figure 1 below.

Figure 1: OECD Interim Economic Outlook Forecasts

OECD Interim Economic Outlook Forecasts, 2 March 2020
Real GDP growth
Year-on-year % change

	2019	2020		2021	
		Interim EO projections	Difference from November EO	Interim EO projections	Difference from November EO
World[1]	2.9	2.4	-0.5	3.3	0.3
G20[1,2]	3.1	2.7	-0.5	3.5	0.2
Australia	1.7	1.8	-0.5	2.6	0.3
Canada	1.6	1.3	-0.3	1.9	0.2
Euro area	1.2	0.8	-0.3	1.2	0.0
Germany	0.6	0.3	-0.1	0.9	0.0
France	1.3	0.9	-0.3	1.4	0.2
Italy	0.2	0.0	-0.4	0.5	0.0
Japan	0.7	0.2	-0.4	0.7	0.0
Korea	2.0	2.0	-0.3	2.3	0.0
Mexico	-0.1	0.7	-0.5	1.4	-0.2
Turkey	0.9	2.7	-0.3	3.3	0.1
United Kingdom	1.4	0.8	-0.2	0.8	-0.4
United States	2.3	1.9	-0.1	2.1	0.1
Argentina	-2.7	-2.0	-0.3	0.7	0.0
Brazil	1.1	1.7	0.0	1.8	0.0
China	6.1	4.9	-0.8	6.4	0.9
India[3]	4.9	5.1	-1.1	5.6	-0.8
Indonesia	5.0	4.8	-0.2	5.1	0.0
Russia	1.0	1.2	-0.4	1.3	-0.1
Saudi Arabia	0.0	1.4	0.0	1.9	0.5
South Africa	0.3	0.6	-0.6	1.0	-0.3

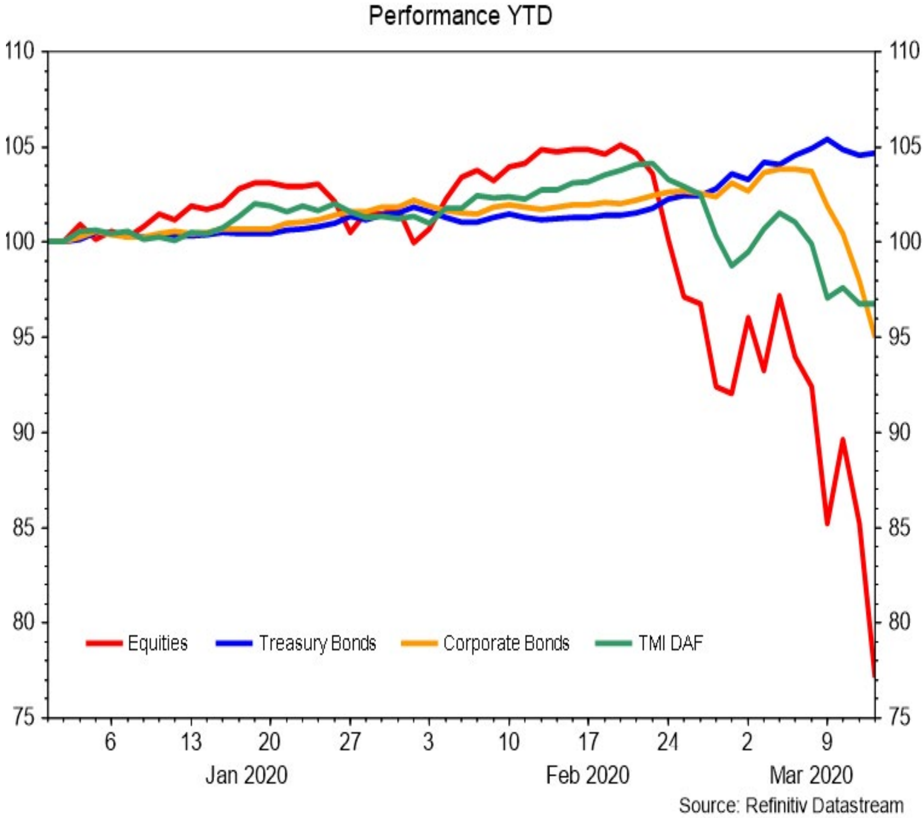
Note: Projection based on information available up to February 28. Difference from November 2019 Economic Outlook in percentage points, based on rounded figures.

1. Aggregate using moving nominal GDP weights at purchasing power parities.
2. The European Union is a full member of the G20, but the G20 aggregate only includes countries that are also members in their own right.
3. Fiscal years, starting in April.

Financial market impact

■ Figure 2 illustrates the performance of a range of financial assets that can be viewed as proxies for the components of a balanced portfolio (as at 13th March 2020). As the chart illustrates, for a broadly balanced portfolio, the bulk of the loss in value has been driven by equities. Alternatives and corporate bonds have provided some diversification. However, as is typical in periods of crisis, cross asset class correlations have spiked and that has resulted in some loss of diversification benefit.

Figure 2: Year-to-Date Performance – Equities (S&P 500 ETF), Government Bonds (3-7yr US Treasury ETF), Corporate Bonds (Intermediate-Term Corporate Bond ETF) & Alternatives (TMI Diversified Assets Fund).



Policy response

■ The global policy response has been swift and partly coordinated. Key global developments in this regard include:

US

■ On 15th March, the US central bank (Fed) announced its second emergency interest rate cut in 2 weeks, reducing rates by 100 basis points. It also announced that it will increase bond purchases by at least $700 billion, split between Treasuries ($500bn) and Mortgage-backed securities ($200bn).

■ On 3rd March, the Fed surprised the markets with an emergency rate cut of 50 basis points. On 12th March, it followed this with an announcement of $1.5 trillion in capital injections in repo markets to mitigate what it described as “highly unusual disruptions” stemming from the coronavirus outbreak.

Euro Area:

■ On 12th March, the ECB announced an expansion of its quantitative easing programme with €120bn of extra bond purchases. It also launched a new programme of cheap loans to banks (alongside a plan to make the rates on its existing bank lending scheme more favourable).

UK:

■ On 11th March, The Bank of England announced an emergency rate cut of 50 basis points, taking interest rates from 0.75% to 0.25%

Japan:

■ On 16th March, the Bank of Japan committed to further purchases of commercial paper and corporate bonds until the end of September. The BOJ also introduced a low-cost lending facility for companies affected by the outbreak while raising its annual ETF purchase target.

China:

■ In early February, China announced a broad range of fiscal and monetary policy stimulus measures, including tax concessions for companies in sectors that are directly affected by covid-19 (e.g. tourism), tax exemptions and subsidies for manufacturers of medical supplies and medicines, supply of ample liquidity to the financial system and announcement of a special re-lending fund to be distributed by banks to select companies (such as those highlighted above) at low rates. Further measures are expected in the weeks ahead.

■ The expectation is that these policies will underpin investor and business confidence and help avoid further tightening of financial conditions. If successful, these stimulus measures will provide the foundation for a recovery, first by the financial markets and ultimately the real economy.

Looking Ahead

■ As we have noted in recent client updates, at this point there is no way of knowing exactly how long the elevated level of financial market volatility will persist as it all depends on news about the spread of Covid-19. Importantly, TMI's investment process is designed to ensure that client portfolios are resilient to events such as this – we have worked with each client to determine the appropriate strategic asset allocation in line with the profile of their expected future liabilities, risk tolerance, capital and regulatory constraints and, where required, corporate credit rating requirements.

■ At this point the best response is to focus on long term investment objectives and implement asset allocation strategies that align with those objectives. For institutional investors, this means maintaining allocations to the main asset classes in line with the positions set out in rigorously designed investment mandates. We are keeping a close eye on incoming data and reassessing the implications for client portfolios on a daily basis. We expect that the ongoing sell-off will ultimately provide attractive opportunities to tactically increase allocation to risk assets and boost risk-adjusted returns.

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