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# Keeping you informed matters

## Economic review

April 2020

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# Outlook

## The end of 2019 saw stability returning to financial markets as the uncertain geopolitical backdrop became more favourable. The start of 2020 has been dominated by the coronavirus pandemic and a significant, broad-based market correction.

Investors were hopeful at the end 2019 that the slowing world economy could enter a new phase of growth. Signs of progress with the US-China trade war and definitive steps being completed with the UK's exit from Europe helped. However, as news emerged from China surrounding COVID-19 and the virus evolved into a global pandemic, many markets quickly fell by up to 30% from their recent highs. In response, governments have taken unprecedented measures to mitigate the spread of the disease. Many countries introduced lockdowns with travel bans, the closure of non-essential businesses, school closures and social distancing enforced by law.

Despite this, the infection spread and spiralling death rates outside of China caused widespread panic. To avert the worst of this, central banks have provided massive and coordinated fiscal and monetary support to their economies. But the first real measures of the impact of coronavirus are only now being released giving a grim reading for the immediate future.

The US Department of Labor (DOL) announced a record 6.6 million applications for unemployment benefits in the first week of April, on the heels of the previous week's record breaking 3.3 million initial jobless claims. Before this, the highest ever increase in this measure had been 695,000 in 1982, at the end of a two year bear market.

Across Asia and Europe we have also seen service and manufacturing data indicating we are heading for a slump worse than during the global financial crisis in 2008. It is becoming apparent that the resulting disruption to normal economic activity from the lockdown has led to a collapse in private sector demand and the already fragile, slowing economic growth rate has reversed. A local and global recession now appears a certainty.

In the midst of this health and financial crisis, we have also had to contend with an oil price war between Saudi Arabia and Russia. Oil and commodity prices had already been under pressure from slowing global growth, but when the two oil powerhouses outside of the US failed to agree on production cuts as demand fell, the price fell further and faster.

However, there are also signs emerging from China that the virus can be controlled and life will eventually return to normal. Whilst the political and social structure of China isn't an accurate reflection of the rest of the world, China has reported its first day without any new local infections and restrictions are being lifted. The lockdown appears to have worked.

With governments and central banks globally providing trillions of dollars to support individuals and businesses, it is hoped worst of the social and financial impact can be averted. We therefore believe that markets will recover, but accept that the outlook for investors is still very risky. The potential for a resurgence in the virus remains if these preventative measures are too slow, ignored or restrictions are lifted too soon.

Reassuringly, many companies have also shown they can act responsibly in this crisis. Many are working closely with their regulators and suspending or cancelling dividend payments and share buybacks, or halting bonuses for executives. Whilst this is bad for income investors, it does reassure us that they will remain financially strong and resilient to this set back and better placed to recover when we return to normal.

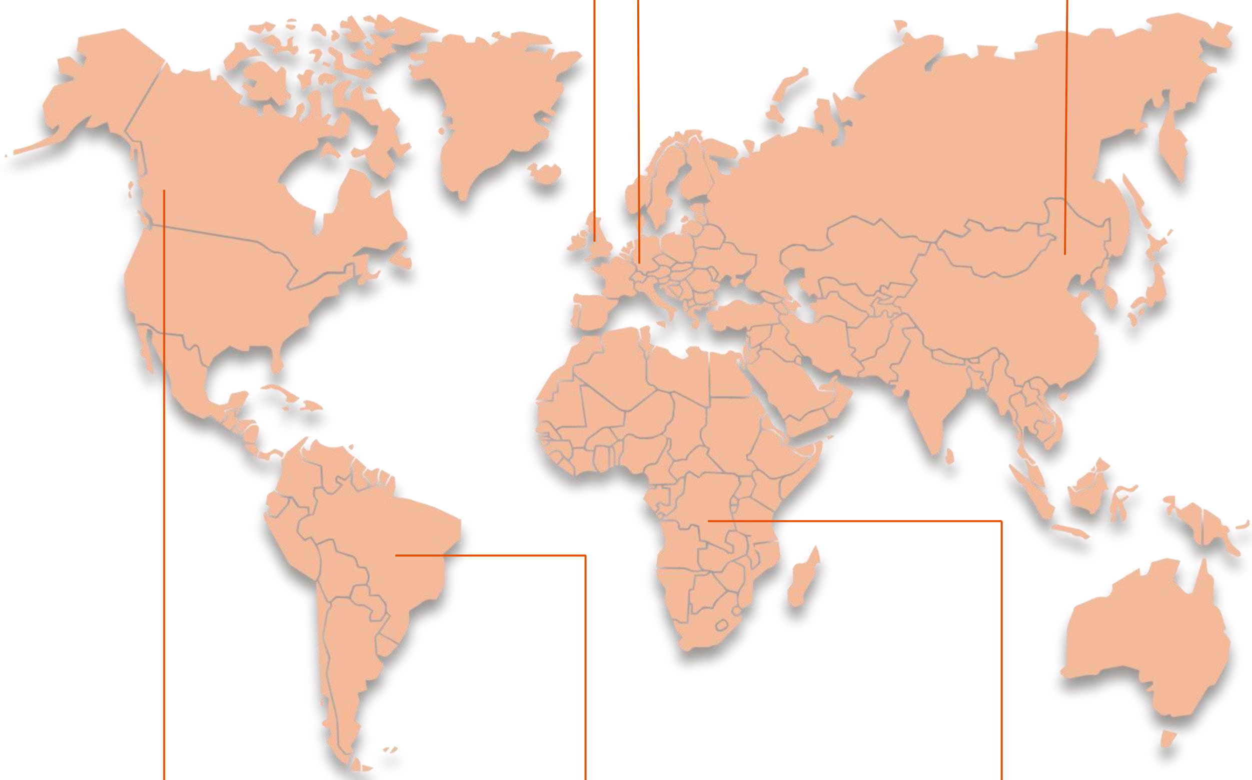
Market commentators were referring to a V-shaped recovery for markets at the start of the outbreak. However, just as governments hope to lower the peak of infections by their actions, we believe the trough in markets will mirror the success of this approach. Ultimately, the extent of the fall and the duration of this economic contraction will depend on when we see the peak in infections and the speed at which the economic lockdown can be lifted. The more protracted the lockdown, the longer economies will take to re-open. Some businesses will not re-open and unemployment will take some time to return to levels reported at the end of 2019.

# Key facts about the world

### United Kingdom
- Economic recovery stalls, national debt to surge
- Trade negotiations with EU likely to be extended beyond year end
- Hunt for yield to resume as dividend cuts begin

### Europe
- ECB underpins sovereign debt market
- Germany and Holland reluctant to fund "coronabond" for weaker Southern European countries

### Asia
- China enters post-COVID19 recovery as lockdown begins to lift
- Japan expected to slip into deep recession with third straight quarterly contraction



### North America
- New epicentre for coronavirus outside China
- Surge in unemployment claims as lay-offs rise in face of business closures

### South America
- Brazil's fiscal deficit to double as it battles coronavirus
- Hopes for moderate recovery in Latin American growth sink

### Africa
- Chinese investment in the region likely to increase taking advantage of distressed asset prices
- Middle East news to be dominated by oil over second quarter

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# Q1 Performance Review

### Key facts

- COVID-19 induced recession almost a certainty as economic growth reverses
- Policy support has led to a modest short term recovery, but this is fragile
- Government bonds regain title as safe haven asset of choice
- Income investors under pressure as threat to dividends and cuts bite
- Emerging markets suffer as dollar currency of choice for security

Developed and emerging markets have suffered their worst quarter for returns since the global financial crisis in 2008. We have seen indiscriminate panic selling as investors rushed to reduce risk and performance across asset types was initially highly correlated. Bonds, equity and even gold, a traditional safe have store of value, were all hit hard as markets tumbled. Unlike previous market crashes, this is not a financially led disruption, but a health and social crisis with few precedents to offer investors direction.

As the situation has evolved, the defensive bond element of our strategies has reasserted itself. Government bonds in particular have performed well in the immediate fallout. The L&G Index Linked Gilt fund was up 5.69% over the quarter and the Lyxor FTSE UK Gilts holding up 3.22% since being introduced to all but high risk portfolios in February. We now anticipate the investment grade bond elements to perform well as markets stabilise, then high yield bonds as confidence returns.

We are also encouraged to see that the equity managers we employ have shown a consistent approach in their funds. Short term, panic reactions can add unnecessary risk, when a calm approach is what is needed. As such, our performance has largely been as we would have expected. Income investments such as the JO Hambro UK Equity Income fund, down 35.69% for the quarter, have suffered as the prospect of deep cuts to dividends have affected this section of the market more. Much of the yield achieved in the UK's energy heavy FTSE 100 index is from mega-cap oil companies BP and Royal Dutch Shell, both of which have suffered as a result of the price war between Saudi Arabia and Russia.

More positively, we have seen good returns relative to their markets in holdings such as Scottish Mortgage (+0.33%), Loomis Sayles US Equity (-5.01%) and Fidelity Asia (-14.31%). Emerging markets have suffered as the dollar has strengthened, but the benefits of a diversified strategy and holding high quality assets will begin to take effect as markets rationalise the new environment. Over the longer term, all of our strategies remain ahead of targets and we will continue to monitor markets for new opportunities.

| SECTOR | Q1 2020 | 2019 | 2018 | 2017 | 2016 | 2015 | 5 years (annualised) |
|---|---|---|---|---|---|---|---|
| IA OE UK Index Linked Gilts | 5.5% | 5.9% | -0.5% | 2.2% | 25.1% | -1.3% | 5.9% |
| IA OE £ Corporate Bond | -4.4% | 9.5% | -2.2% | 5.2% | 9.7% | 0.2% | 4.4% |
| IA OE Property | -1.6% | -0.8% | 2.9% | 7.6% | -2.0% | 7.6% | 3.0% |
| IA OE UK Equity Income | -28.2% | 20.1% | -10.5% | 11.5% | 9.1% | 6.6% | 6.9% |
| IA OE UK Smaller Companies | -30.3% | 25.4% | -11.8% | 27.1% | 8.5% | 14.9% | 11.9% |
| IA OE North America | -14.3% | 24.6% | -1.2% | 10.5% | 30.1% | 4.5% | 13.1% |
| IA OE Europe Excluding UK | -18.9% | 20.4% | -12.2% | 17.5% | 17.1% | 9.4% | 9.7% |
| IA OE Japan | -13.5% | 17.1% | -11.3% | 17.8% | 23.5% | 16.2% | 11.9% |
| IA OE Asia Pacific Excluding Japan | -16.4% | 15.8% | -9.8% | 25.3% | 26.0% | -2.8% | 9.9% |
| IA OE Global Emerging Markets | -21.5% | 15.7% | -11.5% | 24.5% | 31.6% | -9.2% | 8.8% |

Source: Morningstar, bid-bid pricing. Net income reinvested. Past performance is not a reliable indicator of future results.

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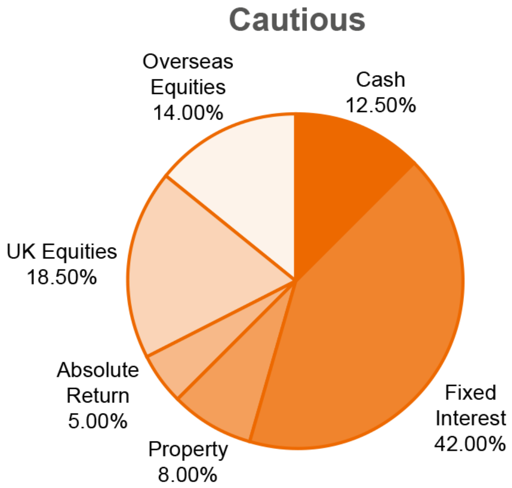
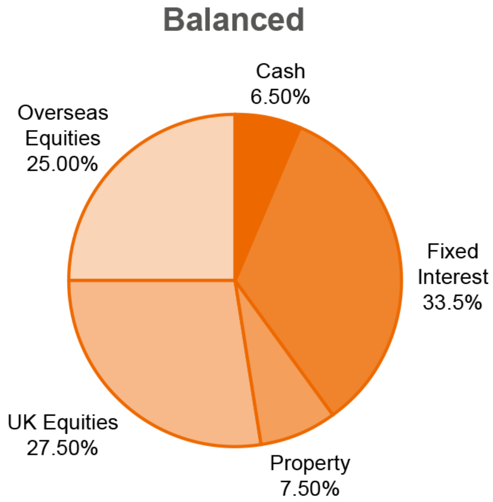
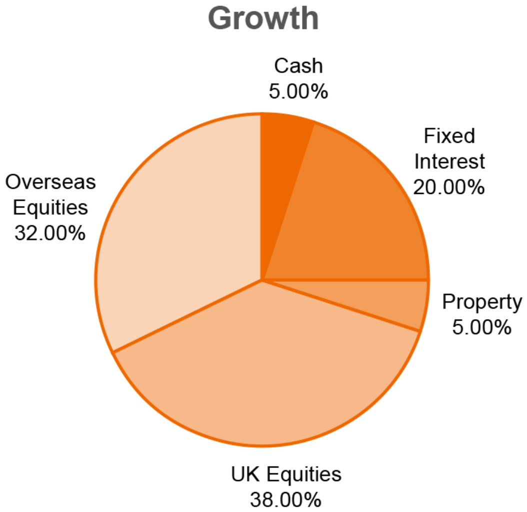
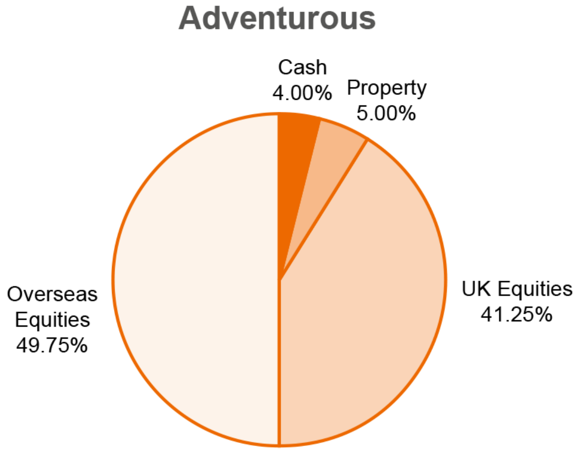
# The positioning of our strategies



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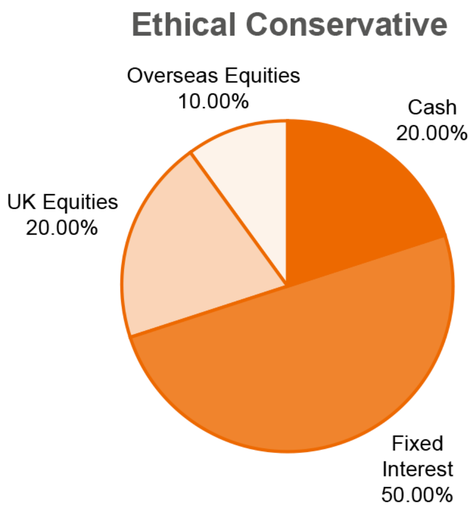


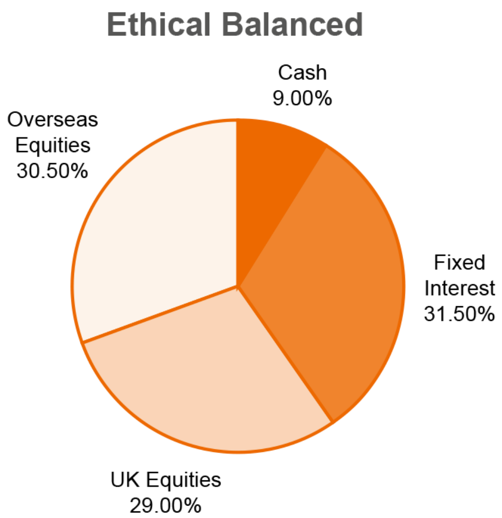


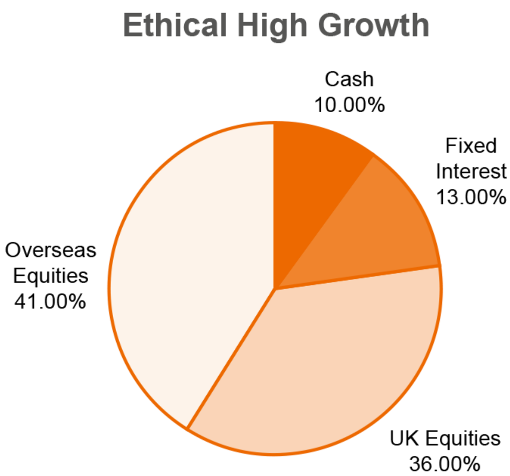

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**MM Wealth Ltd Wellbrook Court, Girton, Cambridge CB3 0NA** 01223 233331 info@mmwealth.co.uk