INVESTMENT COMMENTARY

CARTLIDGE MORLAND

27 March 2020

With nearly a third of the world in lockdown as countries fight the spread of COVID-19, the global economy is at a virtual standstill.

As we write this update, global equity markets have fallen after rising over the past few days following announcements of unprecedented levels of support from the major central banks and massive fiscal packages announced by governments. The US Government is finally set to approve a $2 trillion coronavirus relief package today. The quickening of the spread of the virus in the US has led to further investor nervousness.

The central banks have acted quickly to ensure that the financial system continues to function during these challenging times. Interest rates around the world have been slashed and central banks have restarted or increased monetary stimulus packages to ensure that there is sufficient liquidity in the financial system. The US central bank, the Federal Reserve, is committed to doing “whatever it takes” to ensure that functioning markets continue. The Fed has an open ended programme of buying US government bonds and mortgage backed securities with other types of assets set to be included. It is buying corporate bonds to support that part of the market with other targeted loan programmes on the way. The Bank of England, the European Central Bank and the Bank of Japan have all adopted programmes to support lending to businesses and individuals. The level of global monetary stimulus is awesome.

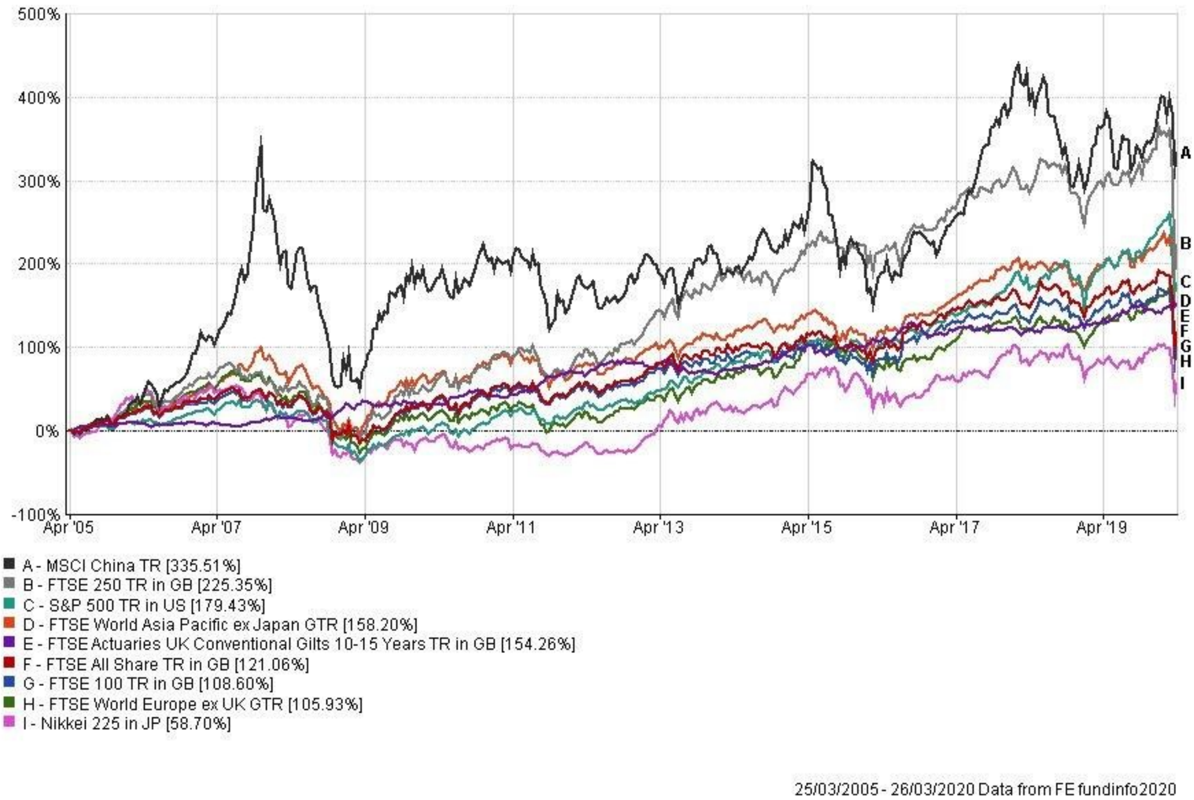
Governments around the world have announced packages to support individuals and companies affected by coronavirus. Wage bills are being met in whole or in part, grants and loans are available to affected businesses and funding for health services to cope with demands on hospitals and testing.

These initiatives are much needed to support individual and companies during these uncertain times and will cushion the impact of a severe, short-term (hopefully) global recession. However, investment markets are likely to remain extremely volatile as it is the containment of the virus and fall in the number of new cases around the world which will give investors confidence. New cases in China have fallen dramatically and the lockdowns imposed in the country are winding down. Life is returning to some sort of normality as will the economy with perhaps a sharp pick up in second quarter economic growth. Its equity market has started to recover. It cannot be predicted when the turning point will come for other countries and sentiment becomes less negative. Once the virus is under control, hopefully testing and eventually a vaccine will settle markets. We advise clients to remain invested to gain exposure to any uptick in equity markets.

The steep falls in asset prices do present opportunities. Fund managers are actively reviewing their holdings and their watchlists of possible new holdings. Where their investment theses for these holdings remains strong, they will buy on weakness where cash is available and perhaps sell shares of companies with less compelling fundamentals. They are looking at the prospects for companies in the next three to five years from here.

As advised in our previous bulletins, we manage portfolios in line with client objectives and risk tolerance and look to the longer term. The chart below showing equity market returns over the past fifteen years, including the great financial crisis in 2008/9, illustrates the need to invest for the longer term looking through shorter-term volatility.

Local Currency Investment Market Returns over 15 Years



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ON OUR ADVICE TO 'SIT TIGHT'

When markets have plunged and remain volatile there is natural tendency to 'action', whether to close positions that appear too risky or to take advantage of opportunities which appear under-priced. Having advisers who merely say 'sit tight' might suggest client portfolios have been cut loose during a storm.

It is the function of the underlying fund managers who are being paid to run their funds, according to public mandates, who must judge pricing/risk within their portfolios and act accordingly. That is what investors are paying them to do. Obviously, those currently deployed in your portfolio are trusted by Cartlidge Morland to deliver, otherwise their funds would not be present in your portfolios. Conversely, the best managers will not succumb to 'enforced activism'. They will trim, expand and eliminate positions as they consider fit but will not engage simply in activism in order to 'crowd-please' or to 'puff' subsequent reporting.

'Asset allocation' (ie allocation to sectors/areas of risk) is widely considered to be the most important determinant of portfolio risks and returns. This area is Cartlidge Morland's direct responsibility and all portfolios are being re-examined in terms of the risks held and to determine scope for adjustment.

Clients should bear in mind that our ongoing programme of six monthly detailed review/adjustment ensures that funds held remain those favoured by our research process. Asset allocation is reassessed six monthly with the future in mind. Equity markets have fallen fairly uniformly, although the fall in the level of Sterling has reduced the falls in overseas markets in Sterling adjusted terms.

Until COVID-19 is in retreat, the degree of longer term damage to the global economy, to individual economies and to the companies that operate within them is impossible to assess on any rational basis. There will be certain asset allocation changes we may wish to make but at this stage they will be relatively minor, because little is clear. We will wish to ensure that no client is approaching risk levels that will not allow a viable position if markets remain depressed for the long term. We are definitely not expecting the latter on the basis of what we know presently.

CARTLIDGE MORLAND AND LOCKDOWN

- All our London staff are now working from their homes and our answering service is answering our switchboard and directing calls appropriately. In the absence of client meetings, office presence is not critical for consultancy and investment management staff, given all of our modern client records and research material are held electronically and can be accessed remotely, subject to security protocols.
- In our Scunthorpe Administration Centre, a skeleton staff remains to conduct dealing and certain essential tasks which might not be accomplished so reliably from home. Most of the staff there are now working remotely, as the first cases of COVID-19 are now apparent in North Lincolnshire.
- Nobody feels able to meet us presently and alongside our clients, we have to be mindful of the Prime Minister's appeal to avoid gatherings of more than two people and neither to travel nor mingle unless absolutely essential. We are available by telephone, email and by most forms telephone conferencing.
- We are disrupted to the extent we cannot interact with our clients quite as usual, but in reality can continue to deliver key services to clients normally.
- Inevitably – there is some disruption to our operations with certain tasks taking longer than usual. Partners and Directors have been distracted by organisational issues and above all, the need to constantly reassess financial markets and the political/ economic situation, to a more intense degree than usual. The latter are essential tasks at this time.

BEYOND COVID-19

Clients will retain their long-term financial security whether reliant on their portfolios for income or otherwise. Shorter term adjustments in current arrangements may be necessary if the current situation persists much longer than six months.

The longer-term effects and associated costs of government/central bank intervention cannot be reconciled at this point. Of necessity, governments have intervened in the market economy globally and to an extent unprecedented in peacetime. Their withdrawal from such intervention will be far more difficult to achieve.

There are likely to be distinct changes to national social, political and economic life. Whilst one can guess at the shape of some these changes, so much still depends upon the duration of 'lock-down'. Many of these changes will only become apparent much later.

Cartlidge Morland clients, all of whom hold diversified portfolios, will probably suffer some disappointments either with regard to the performance of individual investment funds, or the failure of holdings within them. Even in combination, such individual disappointments should have little effect on overall portfolio values in the medium term. It is inevitable that many others in advanced economies, such as the UK, will feel considerable shorter term financial hardship and that 'lockdown' is likely to result in business failures, increased unemployment and an overall reduction in demand. The global gravity of this worsens as each day of lock-down passes but it would have to persist for longer than currently anticipated, for stimuli to lose their considerable upside effects. By definition, the global economy is now in recession as its normal functioning has ceased temporarily.