CARTLIDGE MORLAND

Financial Markets - Your Concerns

Over the past month global equity markets have plummeted as coronavirus has quickly spread around the world. These are worrying times for investors so we have answered questions below that clients have asked us.

We would like to assure you that our experienced investment and consultancy teams monitor equity markets on an ongoing basis and meet frequently to discuss strategy.

Q: Should I sell all the equity holdings in my portfolio and invest in cash and go back into equities at a later point?

A: This is a normal reaction in times of equity market stress. If you sell equity funds after markets have fallen over 25%, you are crystallising those losses by investing in cash. Equity markets have corrected rapidly over the last month and equally when they do start to recover, you need exposure to them. History tells us that it is difficult to decide when to invest after such a sell off. After the shock of the financial crisis in 2008, who would have been able to know that the key time to be back in the market was March 2009?

If you are a longer-term investor and the risk profile of your portfolio is appropriate, you should stay invested. At some point, investor confidence will start to improve and equity markets will begin to recover. You need to be invested in equity funds at that point.

Q: Should I invest cash now?

A: The answer follows on from question one. If equity markets have fallen over 25%, you are buying assets much cheaper than a month ago. Equity markets may fall further but in the longer term a 25% discount is worth having. It may be prudent to invest cash on a phased basis as it is not known in which direction equity markets will travel in the shorter term. You will not be committing all your investment on one date. If you have not used your ISA allowance, this could be invested in cash initially and then allocated to funds over an agreed time period.

Q: Should I just invest in index (passive) funds?

A: Index funds track or partially replicate a specific index eg FTSE All Share index (UK), S&P 500 index (US). Therefore, through the fund, you invest in the companies which comprise those indices which then means that your fund may have a high exposure to the oil or technology sector, for example. If those sectors are the hardest hit when markets fall, then your fund will fall in value to the same extent as we have seen of late with the share prices of oil and airline companies falling rapidly. We recommend that most portfolios invest in a range of actively managed equity funds where risk parameters allow. Our investment team, through both quantitative and qualitative analysis, seeks to invest in funds which are run by experienced managers who are successful in identifying anomalies in markets or in share prices. Such managers research the companies in which they invest in great depth and over the longer term such companies should outperform. In the current climate, there are lots of opportunities for good stock-picking managers where share prices have fallen substantially but which the managers know from their research that prices have been discounted too much. We often use index funds in the large cap end of the US equity market, as this part of the market is so efficient with a high level of research undertaken and it is difficult for active managers to out-perform. Tracking funds provide broadest exposure to a general rebound in equity prices.

Q: I want to maintain my income level in my portfolio but how should I do this when equity markets are so volatile?

A: Rather than selling equity funds at currently discounted levels, cash for income could be raised from more defensive assets. These assets have probably retained their value or perhaps even made profits during the recent equity market sell-off as investors seek safer investments. This strategy allows time for equity markets to recover. It might also be possible to confine withdrawals from where they are most tax efficient by substituting taxable pension income for ISA or investment portfolio withdrawals, for example. The effect of not needing to reserve cash to pay income tax to HMRC will reduce the amount/burden of withdrawals from portfolios collectively.

Q: How is my portfolio protected against equity market falls?

A: Portfolios are constructed to reflect your objective and risk profile. Each risk profile has set parameters so that an appropriate level of risk rated assets is maintained. The performance of lower risk assets such as cash, gilts, corporate bond, protected and direct commercial property funds are not highly correlated with returns from equity funds, so provide downside protection when equity markets fall. Corporate bond and property funds also provide a useful income stream which comprises an important element of total returns. The higher the attitude to risk, the higher the level of equity exposure.

Q: The World's Major Economies Are in a Period of Lockdown – What Will the Effect be on the Global Economic Situation?

A: Our worst fears are now realised, with the global economy experiencing a sharp contraction in both manufacturing and service activity. The effects on employers, their employees and the long-term consequences are unpredictable, because nobody can accurately predict how long this period of lockdown will last.

- Governments around the World have announced huge rescue packages to support their national economies with further aid to businesses and citizens due to be announced. Such aid is intended to avert the collapse of businesses starved of normal cashflows and will undoubtedly be welcomed by markets.

- It is fortunate that the US/UK banking systems are in good shape to absorb this shock, whilst European banks have strong support from a credible ECB and a relatively strong collective currency. In summary, the global financial system is in relatively good shape, in comparison with 2008.

- Government finances in US, UK, Japan, China and most European countries remained weak as a consequence of the 2008 global financial crisis and the need to nurse the global economy since then. The latter said, most major countries' governments remain highly creditworthy and are able to borrow very cheaply. Added to this, the major central banks remain able to conduct credible quantitative easing programmes including buying-in corporate debt issues to support business.

- Markets are likely to remain volatile and shocked, as a global economic lockdown of this type is unknown in peacetime and indeed a complete unknown for the modern, integrated, global economy. The collective action taken by governments, central banks and indeed businesses themselves may well act as the shock absorber necessary to conserve businesses so that 'normal service' and profitability may resume once the worst is over.

- It is likely to take a while for consumer demand to recover as many grapple with damage caused to personal finances by loss of earnings. At least so far, it seems likely that businesses and individuals are more likely to be extended long lines of soft credit (which will eventually have to be repaid) rather than hard cash. The latter may act as a suppressant to revival in consumer demand and business demand/investment in the earlier stages of recovery when it comes.

- As we have said, there are actions investors can take on an individual basis to mitigate the long-term effects of this fall in financial markets. Any clients requiring advice on any aspect should contact their Cartlidge Morland partner/consultant. Maintaining diversified portfolios and waiting for the situation in global markets to settle is essential at this stage.

- The 'V' shaped dip in markets we were hoping for only last week, now seems less likely. Central bank/government actions might normally be expected to engineer it but with the duration of global economic lockdown now so unpredictable, it seems more realistic to anticipate more of 'U' shaped curve, with an elongated base. We spoke of a potential 'L' shaped curve in our bulletin of last week – a steep fall, followed by a very long and flat period for equity prices. This still seems unlikely unless either (a) the disruption caused by COVID-19 prevails for longer than any credible prediction presently or (b) the global economy suffers additional unexpected trauma.

Cartlidge Morland and 'Lockdown'

We are required by the FCA to have written 'disaster recovery' plans and part of that planning has been put into effect.

- Our client records and all correspondence have been stored electronically since 2007. All are available via 'remote access' to authorised staff wherever they may be, subject to the availability of modern communication links.

- Our London office remains open – with a permanent skeleton staff. Consultancy staff and investment management staff are being encouraged to work from home. Our London reception staff will either connect clients to the home/mobile telephones for those who are being called or will otherwise email messages to arrange call-backs.

- There are currently no cases of COVID-19 in the Scunthorpe area, nor any being treated at Scunthorpe General Hospital. Our Administration Centre remains open as normal and dealing is occurring as usual. We have contingency plans for remote working by dealing, finance and administration staff if the COVID-19 situation changes in that locality.

- We remain available for meetings with our clients as usual but strictly subject to the proviso that CM personnel exhibiting COVID-19 symptoms will self-isolate and will not be available. Equally, we presume any of our clients or contacts exhibiting symptoms will not invite meetings.

- Our Investment Committee and Wealth Management Group continue to meet as usual, subject to the absence of COVID-19 symptoms amongst members.

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18 March 2020

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