INVESTMENT COMMENTARY

CARTLIDGE MORLAND

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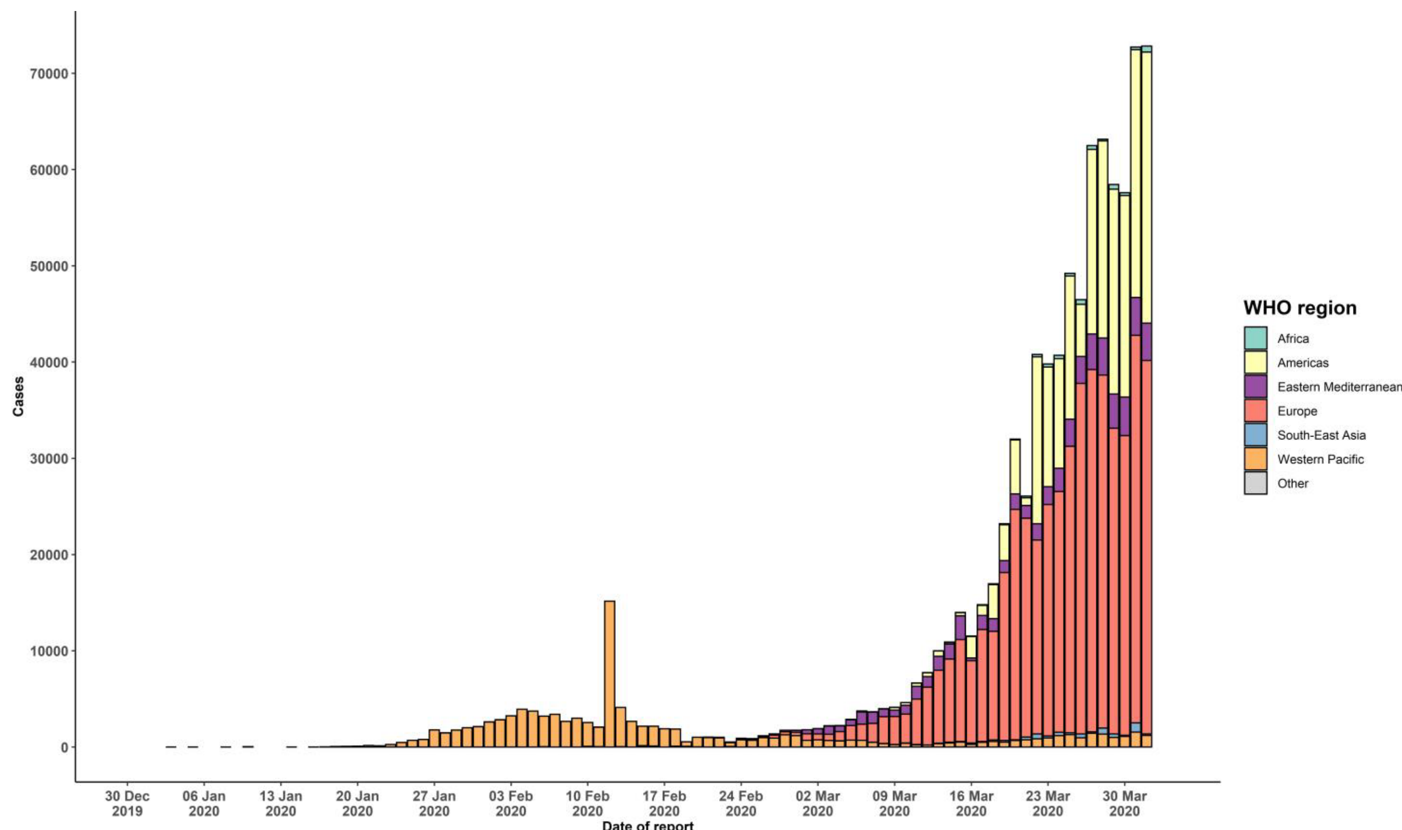
The COVID-19 crisis continues to cause significant investment market volatility as the major developed economies continue in partial or almost full lock down as the number of COVID-19 cases reaches one million globally. A quarter of those cases are in the US, the new epicentre of the virus. China is now unwinding most of its lockdown restrictions in Wuhan, the centre of the outbreak and economic activity is slowly increasing. In Italy, the first badly affected democratic, developed western economy, it now appears that the growth in the infection rate is falling – now below 5% - although the lockdown has not stopped the infection rate totally. The US is a few weeks behind Italy, with infection increasing at a faster rate, although most of the country is now in lockdown. The WHO chart below illustrates the rate of infections on a global basis. Investor sentiment should improve once the end of the lockdowns is in sight.

Epidemic curve of confirmed COVID-19, by date of report and WHO region through 2 April 2020

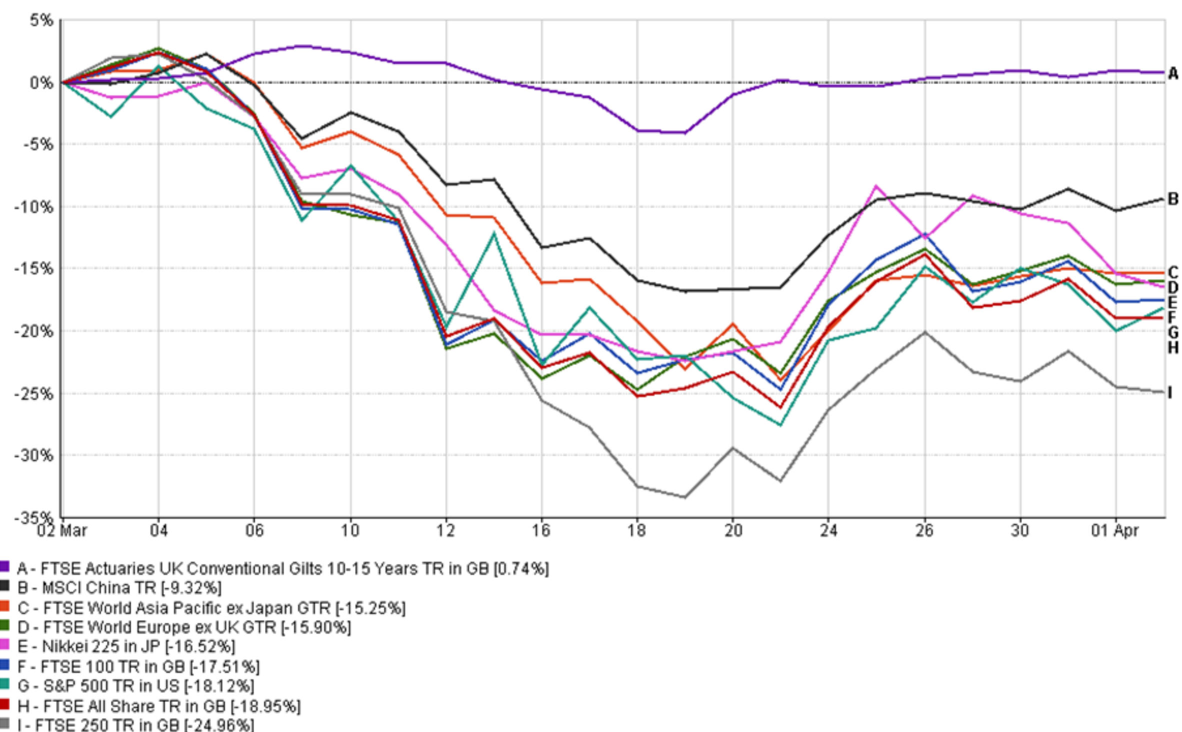


As a result of the lockdowns of the major economies, we are seeing a plethora of statistics showing the dramatic falls in economic activity across the world, with unemployment also rising by record levels as people are laid off from their jobs. The second quarter is likely to see severe economic contraction which may also impact third quarter economic levels too, if lockdowns need to be continued. Countries have adopted various policies to support companies and employees during these difficult times, so that when lockdowns are lifted, hopefully people can return to work quickly. These measures have a stronger impact in Europe. In the US, the only option that companies have is to lay off staff which is reflected in the soaring unemployment figures. US employers will have to decide whether to re-hire workers when the situation improves, so there may be a prolonged slump in income levels. The government initiatives coupled with the monetary stimulus from central banks should support the global economy through these difficult months.

The central bank monetary programmes have kept investment markets functioning – there are buyers and sellers of assets. The central banks are currently absorbing all the government bond new issuance, which is supporting the bond market. Investors have confidence in the measures that central banks have adopted. In the corporate bond market, there has been a slew of new issues although the coupons to be paid on the bonds are significantly higher than the levels that they would have been before the COVID-19 crisis. A number of companies have suspended their 2020 dividend payments so that they can retain cash. This is negative for equity investors but positive for bond holders.

Equity markets recovered to a limited extent towards the end of March as governments and central banks announced their fiscal and monetary stimulus packages, so supporting investor confidence. The last week has seen relatively subdued movements. There had been an uptick in sentiment as there were hopes that Saudi Arabia and Russia might reach an agreement on oil supply. The price of oil increased 20% in day to around $31 per barrel. Equity markets are likely to remain volatile as statistics showing severe global economic contraction in the second quarter continue to be issued and news of the spread of the virus continues in the US and infection rates may increase in other countries which have been relatively unaffected to date. Markets have priced in global recession but it is the likely length and depth of that recession which is key to investor confidence. Only when the virus has been contained and lockdowns lifted can economic activity increase, as seen in China. Equity markets will then need to look at earnings prospects for the rest of the year.

Investment Market Returns in Local Currencies Over One Month



We continue to advise clients to maintain their diversified portfolios which reflect their risk profile and to look to the longer term through these difficult and uncertain times. Where there is cash available for investment and where profits have been made in lower risk assets, it is prudent to use some of this cash and to trim these gains in favour of equities, buying on the current extreme weakness as the longer term capital growth prospects look attractive. Where appropriate, we are selling down Japanese equity positions in favour of equity markets which are likely to be supported by the recently announced stimulus packages.

FOR THOSE LIVING ON INVESTMENT INCOME

Abrupt and significant falls in asset prices are most worrying for those living off investment income, generated by investment returns from their pension or other investment portfolios. For those expecting to retire or otherwise live off investment income in the shorter term, these are worrying times too.

In accordance with our system of six monthly reviews, most CM portfolios carry a cash weighting – which in most cases will be sufficient to maintain monthly income payments for some months yet. Added to this are the naturally arising income receipts which are typically around 2.50% pa x portfolio value. Although dividends are under pressure, this income, which tops up portfolio cash positions, is likely to ensure assets need not be sold to provide cash to meet ongoing income withdrawals.

Some portfolios, closer to regular review, may naturally be close to exhausting their cash holdings. In order to provide continued liquidity, we can sell gains from gilt and international bond funds (or simply the currency gains from them) to boost cash positions. With a new tax year imminent, planning income sources is even more important than usual. Cutting any income tax payable might facilitate a lower withdrawal rate from your portfolio, without the need to reduce net monthly income. A lower withdrawal rate, whilst financial markets are lower, will mean your portfolio is eroded less by income withdrawals. Your Cartlidge Morland Partner or Director/Consultant will consider these issues as a matter of course. Those with large cash holdings outside their portfolios might consider drawing less in order to reduce withdrawal rates, even though it is unlikely to be necessary.

Many CM clients are ‘fully invested’ which means that other than adequate cash ‘contingency funds’ their non-property assets are entirely held in market investments and to a greater/lesser degree endure the fluctuations. For those in this position, an abrupt downturn is the most worrying simply because even a 15% drop in portfolio values will turn a planned 5.00% pa withdrawal rate into 5.88% pa rate.

For those living with higher withdrawal rates still, then 6.50% pa becomes 7.64% pa which is bound to cause concern. However, an increased withdrawal rate will make little difference to portfolio stability provided it is (a) for a matter of months and (b) the funds can be drawn from cash/lower risk assets over the period, without that in itself tilting the portfolio significantly towards greater risk than is mandated.

In discussing and reviewing portfolios, conditions similar to those now prevailing are always at the forefront of our minds. Such situations will inevitably arise at intervals over the lifetime of long term investment portfolios. We endeavour to ensure investors may still rely on their portfolios for the level of income withdrawal designated without such withdrawals during a ‘down’ period risking lifetime sustainability, assuming the latter to be our client’s objective.

It is fair to say that plunges in global financial markets are rarely followed by long periods of flat asset prices. It is far more usual that asset prices rebound except if significantly over-valued at the point of fall. Whilst any diversified portfolio may include elements that are over-valued, the converse will also be true and much will be at ‘fair’ value. An extended period of flat prices after steep falls would be far more problematic to certain investors – but even then, those problems would be surmountable and such conditions are definitely not those we anticipate once COVID-19 infection rates are brought under control.

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