CARTLIDGE MORLAND
INDIVIDUAL WEALTH MANAGEMENT

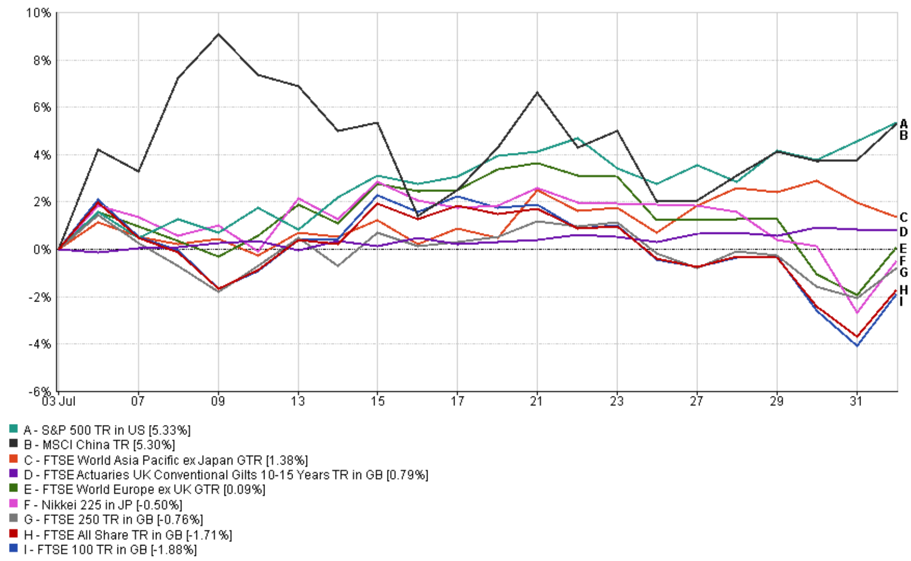
INVESTMENTCOMMENTARY

3 AUGUST 2020

OVERVIEW

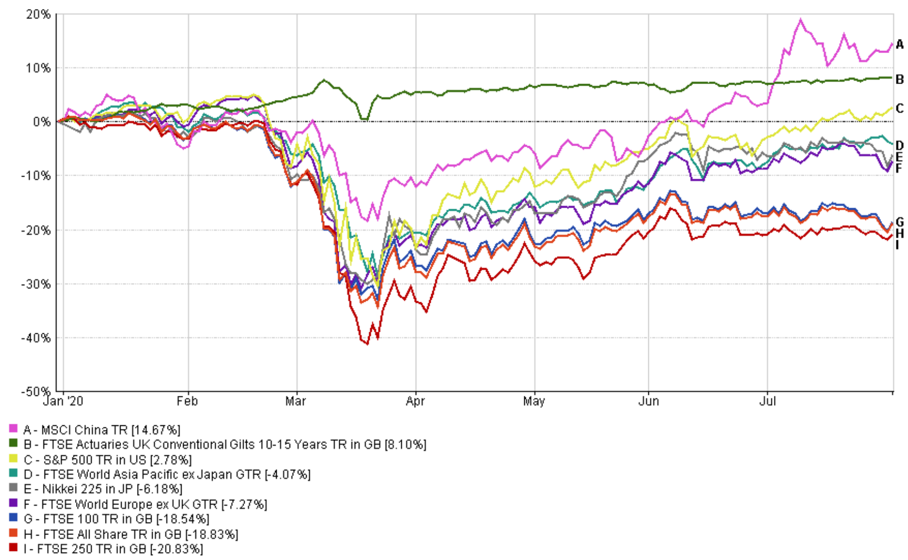
Returns from the major investment markets have been mixed over the past month with the US and Chinese equity markets making in excess of 5% whereas the performance of the UK equity market, in particular larger companies, has been lacklustre. The technology heavy US equity market remains resilient whilst sentiment towards Chinese equities has been buoyed by stronger than expected economic recovery. The US dollar has weakened over the past month whilst the pound has strengthened, so putting further pressure on the share prices of UK larger companies as the majority of their earnings are made overseas. Improving investor sentiment remains fragile as Covid-19 cases have surged in India and have risen again in parts of Spain and the US. The continued deterioration in US/China relations has also weighed on equity markets at certain points recently with each side forced to shut regional consulates by the other. Uncertainty over a UK/EU trade deal continues as negotiations carry on at a slow pace due to lack of progress on 'level playing field' businesses/state aid rules and the access demanded to British fishing waters.

INVESTMENT MARKET RETURNS IN LOCAL CURRENCIES OVER ONE MONTH



03/07/2020 - 03/08/2020 Data from FE fundinfo2020

INVESTMENT MARKET RETURNS IN LOCAL CURRENCIES YEAR TO DATE



31/12/2019 - 03/08/2020 Data from FE fundinfo2020

Investment market sentiment has been affected by the data related to economic growth as well as the level of coronavirus infections globally. New cases in the US are still high at around 50000 per day. However, some states are seeing their infection rates ease as regulations to limit infection start to have an impact. The perceived lack of control of the virus in the US and the expectation that the economic recovery may be more prolonged than anticipated has seen the US dollar weaken. Infection rates in Europe have gone up as lockdowns have been eased and travel increases. There are worries that a second wave of virus infections is imminent, which has affected investor confidence as economic recovery could be curtailed by renewed restrictions. The share prices of UK travel related companies and airlines have fallen as a consequence of travellers now returning from Spain facing a quarantine period. China and Hong Kong have also seen coronavirus cases rise recently and the Australian state of Victoria is in lockdown. The fear over a second wave has seen investors look to safer assets such as gold and government bonds.

Economic indicators for the major developed economies show that activity is now expanding as countries move out of lockdown. The UK in particular has seen positive growth in the manufacturing and service sectors. UK retail sales were up 13.9% in June from May. Food sales increased and online shopping now accounts for 30% of consumer expenditure. UK Gross Domestic Product (GDP) grew by 1.8% in May from April, a slower rebound than expected.

The US economy contracted by 9.5% in the second quarter (Q2) as the pandemic took its toll on economic activity. The US new jobless claims have risen for the first time since early in the Covid-19 crisis which has weighed on investor sentiment. The government is now considering a further emergency support package as it seems that the recovery in the labour market is fading. Following the latest meeting of the Federal Open Market Committee, Jay Powell, Chair of the Federal Reserve (Fed), commented that "it looks like data are pointing to a slowing in the pace of recovery." The US economic recovery appears to be stalling and the Fed maintained interest rates at a range of 0.0% - 0.25% and committed to keeping rates low as the economy recovers. The Fed also extended its emergency credit facilities which it launched at the start of the crisis to the end of the year as well as liquidity lines for banks. This should be supportive of the equity market. Jay Powell also stressed the need for Congress to maintain its fiscal support programme. The Senate Republicans have proposed a new $1 trillion stimulus package which includes policies relating to unemployment benefits, loans, coronavirus testing and schools funding. The package in reality has to be agreed by Congress before the summer recess.

The eurozone is now in recession with GDP falling 12.1% in Q2 following a 3.6% fall in the first quarter (Q1), with the economies of Spain and Italy most badly affected. The concern is that a second wave of coronavirus will do even more damage just as lockdowns are being eased. The European Union eventually agreed the terms of its recovery fund to support countries hardest hit by coronavirus. The package makes available grants and low interest loans for the weakest members. However, the package is still subject to further negotiations by the member states and ratification by the European Parliament. Germany is in favour, meaning the package is likely to be adopted. An important part of it is that the European Commission will enter the international bond markets as a 'sovereign' issuer for the first time. This is a significant step in the direction of the fiscal union long demanded by the weaker states – and vital in reinforcing the long-term credibility of the euro.

Chinese GDP increased by 3.2% in Q2 2020 following a fall of 6.8% in Q1. The recovery was stronger than expected and indicates a V-shaped recovery. China also avoided a technical recession of two quarters of negative economic growth.

The Q2 corporate earnings season is now in full flow. There has been mixed news - about 80% of the S&P 500 companies which have reported have beaten analysts' expectations. Four of the largest US technology companies – Alphabet, Apple, Amazon and Facebook – announced exceptionally strong results against the backdrop of the US economy contracting. The four companies are now valued at over $5 trillion. UK banks: NatWest, Barclays, HSBC and Lloyds, have had to make bad loan provisions which led to falls in their share prices as well as impacting on the broader financials sector. HSBC has announced significantly higher provisions than the market anticipated. Shell reported an £18bn net loss although the net income figure was better than expected. The UK retailer Next had stronger sales than predicted whilst the house builder, Taylor Wimpey had poor results.

The direction of equity and corporate bond markets continues to depend on whether Covid-19 can be brought under control globally and the global economy can start to recover. The encouraging news on vaccine developments is supportive of sentiment but will only be a 'game changer' once vaccines are deemed to be both safe and effective. It seems unlikely that whole countries will be put into total lockdown again and more targeted restrictions are probable which will be less damaging to economies. We continue with our diversified portfolios with an increased allocation to US equities to gain longer term exposure to growth sectors such as technology and healthcare.

The CM Investment Commentary is compiled by Angela Cooper, Managing Director of Cartlidge Morland's Investment Services team.

Angela runs the firms' investment management propositions, with over 30 years' experience in investment research working for investment companies, leading UK national IFAs and wealth managers. Angela graduated from the London School of Economics and is a Chartered Insurance Practitioner.

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Ultimately, equity and bond investors are largely investing either in corporate equity or debt. Successful profitable companies have greatest capacity to reward shareholders with (a) dividends/share buybacks and (b) a rise in the share price. The bonds (debt) of such companies are most likely to retain their value as they are less vulnerable to credit downgrades although the interest they pay will be lower than for the debt of less successful corporate issuers.

To leverage yields upwards, some corporate bond funds hold a significant proportion of their assets in BBB rated debt (low investment grade) and there is definite risk some of this will slip below investment grade, damaging capital value.

Irrespective of the extent one holds corporate debt (perceived lower risk assets) or equity (perceived medium to high risk assets) one is ultimately investing in the fortunes of companies not national economies, although there is some relationship between them. As we have observed over the last couple of months, we believe the Q3 (Autumn) reporting from companies to be most critical as it will lay bare all balance sheet/earnings damage caused by lockdown and will provide valuable clues as to the underlying pace of corporate recovery.

Debate is focussed on whether markets (and pricing) are making sufficient allowance for perceived downside risks. Are the prospects for a 'V' shaped or even 'U' shaped recovery being taken for granted based on forward forecasting - not least by the central banks - simply too optimistic? Only time will tell but economic activity IS going to expand strongly as evidenced by recent economic activity data. It will not contract to anything like Spring levels – so the situation can only get better - unless all embracing lockdown returns which is deemed highly unlikely. Prices may well reflect this already, suggesting a period of elevated risks, until the global recovery is on a firmer footing.

Inevitably, much of the media attention is on national finances as governments reel under the cost of providing support to national economies/households. To a significant degree the strain is being borne by the central banks, who are eager buyers of successive government debt issues globally. This strategy is holding global interest rates down and in turn supporting global consumers/businesses, but it risks turning global currencies into worthless paper. Investors have turned to gold because it is scarce (the central banks cannot simply create more) and it is a store of value. Normally the fact it yields nothing means that we are not gold investors but this begs the question whether US Treasuries, German Bunds or Gilts are investable with

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yields that are negative? For once we find ourselves in sympathy with the gold bullion market but with the gold price at record levels we fear for those who hold it for too long. At current prices, gold is a speculation but an intrinsic asset which (potentially) costs little to hold, whilst sovereign bonds have no intrinsic value and those of highest quality are yielding less than nothing. Until high quality sovereign bonds return to positive yield territory, gold is likely to remain comparatively attractive.

The central banks have been supporting the global economy with artificial stimuli for over 10 years now but so far without causing inflation. There have been particular reasons for the absence of inflation which we have discussed previously. There will be none whilst global economic contraction is in double figures either. It will be interesting to see to what extent central bank actions have increased the global money supply this time – and whether that causes inflation as we move from a period of double digit contraction to one of double digit growth. Inflation would present a problem – as an abrupt reverse in policy would then be needed, with an increase in global interest rates. If this happens, gold might not have been a clever purchase at its current price. Judging when to buy it is difficult enough, when to sell even more so.

As always if you have any concerns please contact your usual Cartlidge Morland Partner/ Director/Consultant.

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