gemini
asset management

marketmatters

July 2020

Review of markets over the second quarter of 2020

The second quarter of 2020 has seen a strong reversal in performance for risk assets - such as equities, high yield bonds (i.e. debt issued by companies with lower credit ratings) and investment grade credit (i.e. debt issued by companies with a high credit rating), but before looking at this in more detail, it is useful to set the scene once more from quarter one to fully appreciate the magnitude of the reversal.

Assets markets all over the world suffered some of the most aggressive declines that we had ever seen, and the outlook for individuals, businesses and economies looked challenging to say the least, with a whole host of variables at play which could greatly affect investment prospects all over the world moving forward. A few of these variables which were plaguing the investment outlook were: The length and strength of national lockdowns; the potential for the emergence of a vaccine; unknown strength and length of both monetary and fiscal policy; the ability of companies to withstand the immense revenue pressures due to the drop in activity and demand; or even the ability of people to bounce back and return to some form of normality during the 'Covid chaos' in order to spur on the global recovery.

As well as noting the bleak picture outlined above, it is important to remember that towards the very end of the first quarter of this year, central banks and governments around the world stepped up to the plate to deliver what was seen as the most generous stimulus packages ever implemented. So, even in the depths of an extremely challenging global economic landscape, these stimulus packages led to the beginning of an incredible rally in risk assets which continued throughout the second quarter as shown in Figure 1 below.

Figure 1: Source - Financial Times

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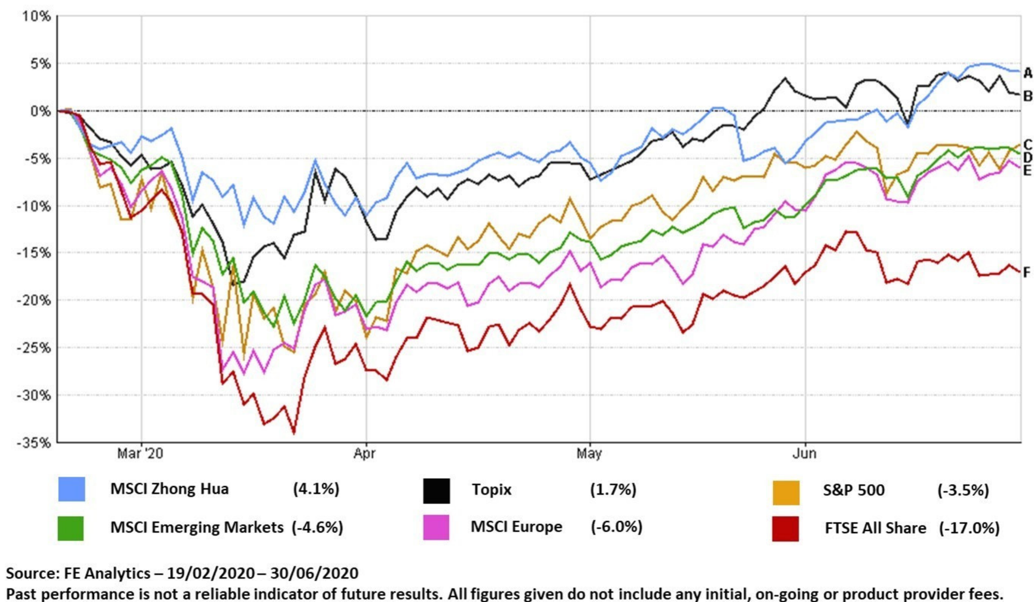
Figure 1 shows the returns from the bottom of a bear market (a market which has fallen 20% from the previous peak) and the time it has taken to 'bounce' from this bottom. As you can see, both the ferocity of the market falls and subsequent recovery has been unprecedented since at least 1870 and is a true testament to both central banks and governments worldwide. They have clearly learned some valuable lessons from the 'Credit Crisis' in 2007 and 2008, specifically that both the speed and size of the response counts. The governmental and central bank stimuli which began in quarter one and continued well into quarter two, with new policies being proposed, has certainly become a ballast to the market recovery in more or less every major asset class.

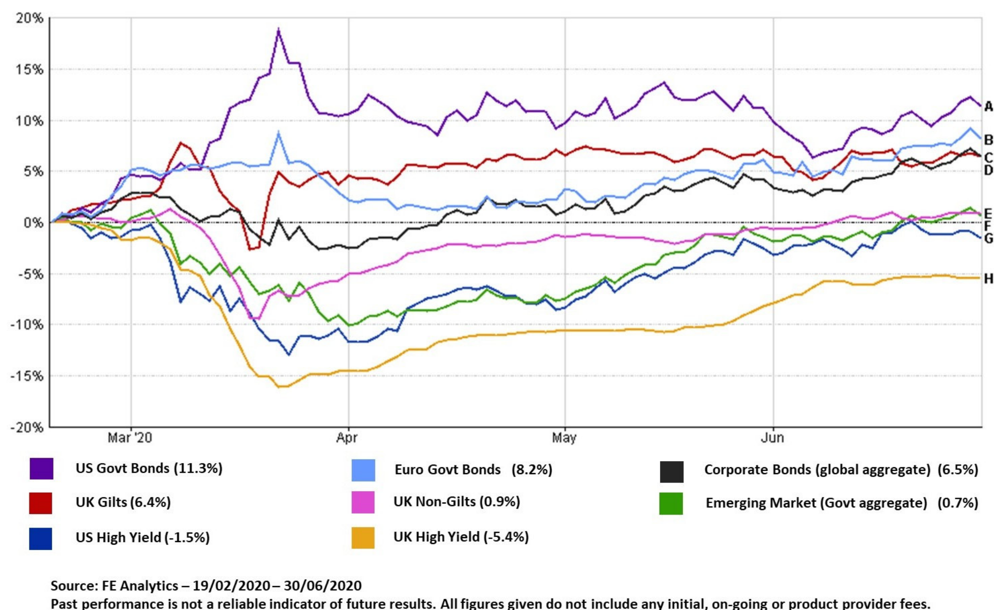
Figure 2: Main equity market performance since the 'Covid chaos' began:



In **Figure 2** we see that by the end of the second quarter most equity markets had not fully recovered, but the bounce was certainly strong enough to offset most of the declines, with the exception being the FTSE All Share. The UK market continues to be the most adversely effected by the collapse in the oil price and the ultra-low interest rate environment, this is due mainly to the heavy weights to both energy and financials held within the index.

Markets appear to have accepted the worst in terms of the ability of companies to perform well during 2020, with consensus earnings expectations for companies falling drastically in quarter two as revenues collapsed on the back of lockdown policies. The likely reason the equity markets continue to push on higher is because investors are banking on a strong bounce back in earnings throughout the second half of 2020 and beyond, essentially pricing in a quick return to activity following the releases of lockdown policies.

Figure 3: Fixed Interest performance since the 'Covid chaos' began:



As seen in **Figure 3**, there has been a great deal of difference found within the different bond markets around the world. Since the start of the second quarter corporate bonds have done very well, with government bonds lagging.

However, if we look at performance from the start of the market crash, we see the opposite picture as government bonds performed excellently in the initial downturn whilst investors piled into the 'safer' assets. This trend reversed as more generous support packages were pledged from central banks and governments which included but were not limited to direct intervention from the Federal Reserve (Fed) in the US in both the investment grade and high yield credit markets; essentially the Fed switched from not only being the 'lender of last resort' but also played the role of 'buyer of last resort' too!

A common theme in this Market Matters has been surrounding the vast amount of support injected into the markets and economies by central banks – through cutting interest rates; huge quantitative easing programs; or, direct market intervention through asset purchases to support prices - and governments – through the production of employment support schemes, such as furlough; helicopter money policies, whereby the government places a cheque directly in the back pocket of citizens; or, increases in government spending. These policies have acted as a boon to asset prices, and so it is only fair to ask the question: "What happens next and will these policies continue?". In June 2020, Jay Powell, Chairman of the Fed, stated, "We're not even thinking about thinking about raising interest rates", and Rishi Sunak, Chancellor of the Exchequer, borrowed a phrase from ex-ECB President, Mario Draghi, by stating, "We'll do whatever it takes", knowing full well the significance these words can have to market perceptions – these two quotes are but a drop in the ocean of supportive speeches and pledges made and frequently reiterated by finance ministers and central bankers the world over.

However, even given the extraordinary efforts of the policy makers, most people would agree that we are not out the woods yet with much depending on the strength of any economic bounce out of the lockdowns and the speed with which societies can return to some semblance of normalcy. Much of this social and economic recovery depends on the virus situation which has a clear effect on the ability of the businesses and economies to reopen. At the moment, the virus has not yet been brought under complete control, nor has there been a vaccine approved, and as such this leaves a great deal of uncertainty and limits the confidence regarding a strong and prolonged recovery.

Another risk which is naturally enveloped within the idea of a stimulus led recovery is whether the stimulus may be sustained long enough to effectively mitigate the destructive effects the virus has had on economic and business activity. There is a worry of 'fiscal fatigue' whereby governments may find it too costly to increase or prolong the current policies, and this has been typified by the furlough scheme in the UK. Upon implementation this was heralded as one of the most generous policies created in order to help those who faced immediate unemployment due to the lockdown of many businesses. Such a generous policy would be difficult for Chancellor Sunak to continue infinitum, and as such the spectre of increased unemployment may continue to linger so long as the virus has an impact on businesses being able to operate and earn revenues.

In summary, throughout quarter 2, the markets rallied on the back of fiscal and monetary stimulus, combined with the reopening of economies and businesses. It is likely that monetary support is here to stay, but in some countries, there is a risk that fiscal stimulus may become less generous. Meanwhile, rising infection rates could lead to further social distancing measures being imposed and further lockdowns.

Asset Allocation and Fund Review

The investment committee reviewed the existing asset allocation models in conjunction with the recommendations and capital market assumptions put forward by our independent actuary, Dynamic Planner.

As a result of this there were changes made to the asset allocation models and the funds for those plans that receive our discretionary fund management (DFM) service during the second quarter of 2020.

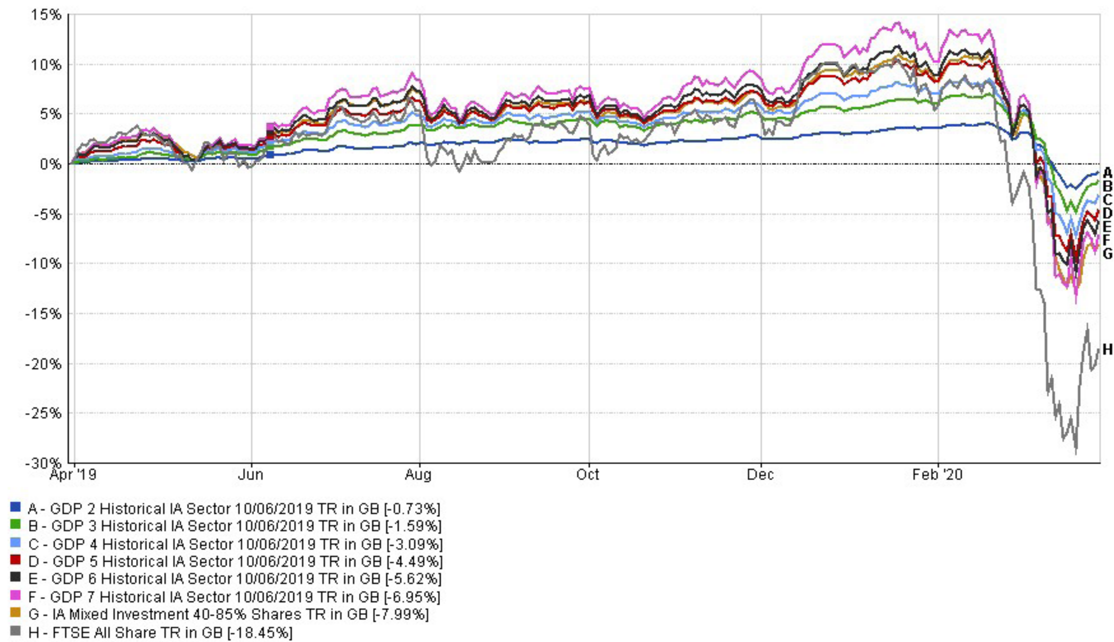
For plans held under our advisory service and managed by Gemini Wealth Management we are recommending changes to the asset allocation models and these are detailed on the accompanying insert.

For plans on the Old Mutual Wealth and Standard Life Wrap platforms that receive our advisory service we are also recommending some fund changes as detailed on the same insert.

Portfolio Performance

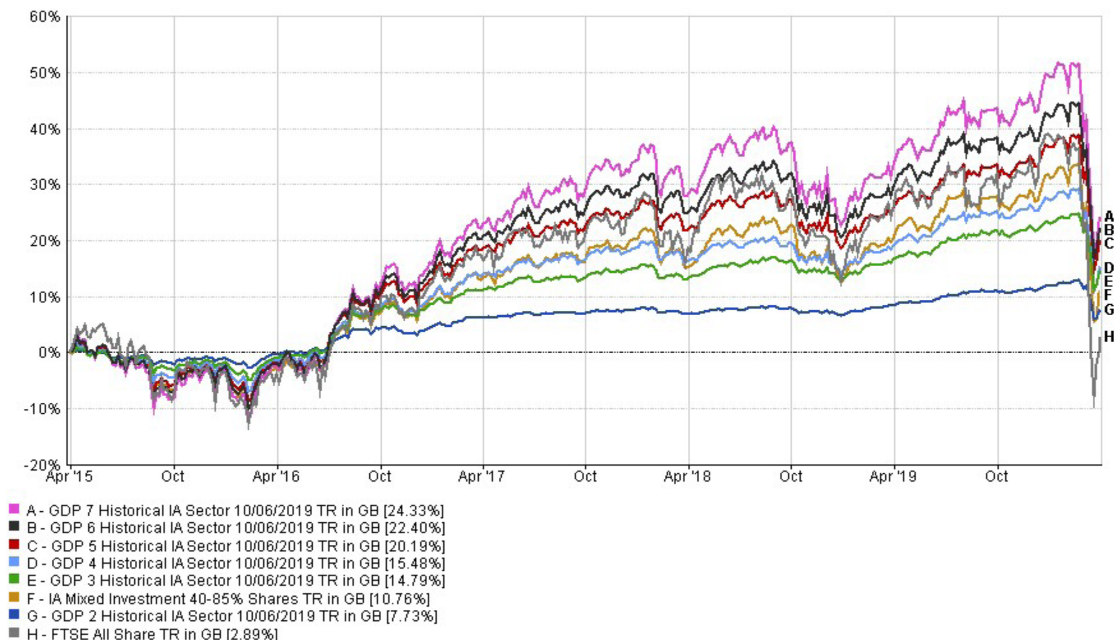
The charts below show performance of our discretionary risk rated portfolios over the course of the last 1 and 5 years. The charts are based upon our existing discretionary models looking back and so only take into account the asset allocation and fund changes made since March 2017 i.e. since the models were created. The data beyond this therefore presumes investment in the same funds and asset allocations as of March 2017. The charts compare performance against the FTSE 100 in order to demonstrate the importance of spreading risk through diversification. Whilst a direct comparison of our portfolios with an equity index such as the FTSE 100 is not like for like it does give an indication of volatility and performance differences on a risk-adjusted basis.

Figure 4: Portfolio Performance - 1 year:



Source: Financial Express Analytics data 30/06/2019 to 30/06/2020. Past performance is not a reliable indicator of future results. All figures given do not include any initial, on-going or product provider fees

Figure 5: Portfolio Performance - 5 year:



Source: Financial Express Analytics data 30/06/2015 to 30/06/2020. Past performance is not a reliable indicator of future results. All figures given do not include any initial, on-going or product provider fees

The value of an investment and the income from it could go down as well as up. The return at the end of the investment period is not guaranteed and you may get back less than you originally invested.

Discretionary Service

Asset Allocation Changes

Going into the previous quarter we had maintained an underweight to UK equity due to the political and Brexit uncertainty that existed at the start of the year. We now feel that these risks have subsided somewhat and with the sell-off experienced in the UK equity markets we felt it was an opportune time to increase our weighting to the UK which now brings us into a neutral position with our third party actuaries strategic asset allocation model (i.e. in line).

In lower risk models the increase to the UK was at the expense of the only other equity allocation in these models i.e. US. There were some slight changes to the equity allocations to Japan, Far East excluding Japan and Emerging Markets of between 0.5% and 1.0%. This again is at the expense of the allocation to US equity in these portfolios. Japan continues to look attractive from an equity valuation perspective and with the continued relative positive performance of the US we felt better opportunities existed in these regions.

We maintained an overweight to cash within the models at the expense of property. Property was reviewed very closely, and a fund identified for inclusion, however, the Investment Committee felt that with so much uncertainty surrounding this sector due to the covid outbreak, we would hold back on our allocation at this time.

The current asset allocation model for our discretionary portfolios is shown below in the Advisory section.

Fund Changes

There were some fund changes implemented during quarter two as detailed below:

Inclusions

With the increased allocation to the UK we felt a further fund was required to give further diversification to this sector. Following a very vigorous UK sector review with a number of potential funds were analysed. Following this review it was agreed that the BMO Responsible UK Equity fund be included into the portfolios. With its multi cap approach and focus on consistency of performance we felt that this fund was an excellent addition to the portfolios.

Replacements

European Equity - During the quarter we replaced the HSBC European Index fund with two new funds being the Premier Miton European Opportunities fund and Baillie Gifford European fund. Whilst the HSBC fund had nor underperformed and was consistent against its peer group we felt that with the covid situation the ability of an active fund manager to be selective around company choice would be a better option moving forward for this sector. Both funds have ranked highly for us with two different approaches and little stock overlap.

Asia Pacific excluding Japan - A fund that had been a mainstay in the portfolio for a number of years, being Stewarts Asia Pacific Leaders, was replaced during the quarter for the Fidelity Asia Pacific Opportunities fund. We had concerns regarding the size of the Stewarts fund compared to its stock holdings and noticed an increased cash holding. We felt that the strategy was being hampered due its size and thus replaced it with what we feel is a much nimbler Fidelity fund. Fidelity have a strong Asian offering with a large research team and with a lower holding overlap to peers we felt this fund would be an excellent addition to the portfolios.

We also effectively promoted one of the other funds already held within some of our portfolios being the JPM Asia Growth fund. This fund has performed well and like Fidelity, JPM have a large Asian research team and expertise in this region. The JPM and Fidelity funds will be the main Asian funds moving forward in our portfolios. This effective promotion has moved the Merian Asia Pacific fund to a limited number of portfolios.

Advisory Service

For plans that come under our Advisory service and managed by Gemini Wealth Management, there are **changes recommended to the asset allocation models for this quarter, as follows:**

The rationale for these changes can be seen under the Discretionary asset allocation section overleaf.

Advisory	Sector	Risk 1	Risk 2	Risk 3	Risk 4	Risk 5	Risk 6	Risk 7	Risk 8	Risk 9	Risk 10
	Cash(Money Market)	100.00	51.00	20.00	15.00	10.00	9.00	0.00	0.00	0.00	0.00
	Fixed Interest	0.00	37.00	53.00	41.00	29.00	17.00	12.00	9.00	0.00	0.00
	UK Equity	0.00	10.00	11.00	14.00	18.50	20.00	30.00	20.00	15.00	3.00
	Europe ex UK Equity	0.00	0.00	0.00	5.00	5.00	6.00	6.00	6.00	6.00	0.00
	North American Equity	0.00	2.00	8.00	10.00	13.50	15.00	13.00	10.00	6.00	5.00
	Japanese Equity	0.00	0.00	5.00	5.00	7.00	8.00	8.00	6.00	6.00	0.00
	Asia Pacific ex Japan Equity	0.00	0.00	0.00	5.00	6.00	10.00	13.00	23.00	25.00	28.00
	Emerging Market Equity	0.00	0.00	0.00	0.00	6.00	10.00	13.00	26.00	42.00	64.00
	Specialist	0.00	0.00	3.00	5.00	5.00	5.00	5.00	0.00	0.00	0.00
	Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Sector	Risk 1	Risk 2	Risk 3	Risk 4	Risk 5	Risk 6	Risk 7	Risk 8	Risk 9	Risk 10
Cash(Money Market)	100.00	51.00	20.00	15.00	10.00	9.00	0.00	0.00	0.00	0.00
Fixed Interest	0.00	37.00	53.00	41.00	29.00	17.00	12.00	9.00	0.00	0.00
UK Equity	0.00	10.00	11.00	14.00	18.50	20.00	30.00	20.00	15.00	3.00
Europe ex UK Equity	0.00	0.00	0.00	5.00	5.00	6.00	6.00	6.00	6.00	0.00
North American Equity	0.00	2.00	8.00	10.00	13.50	15.00	13.00	10.00	6.00	5.00
Japanese Equity	0.00	0.00	5.00	5.00	7.00	8.00	8.00	6.00	6.00	0.00
Asia Pacific ex Japan Equity	0.00	0.00	0.00	5.00	6.00	10.00	13.00	23.00	25.00	28.00
Emerging Market Equity	0.00	0.00	0.00	0.00	6.00	10.00	13.00	26.00	42.00	64.00
Specialist	0.00	0.00	3.00	5.00	5.00	5.00	5.00	0.00	0.00	0.00

Fund Changes

In line with our discretionary portfolios we are recommending the following changes to the funds held in portfolios that receive our **advisory service under the Old Mutual Wealth and Standard Life Wrap platforms only.**

Sector	Recommended Sell	Recommended Buy
UK Equity		BMO Responsible UK Equity
European Equity	HSBC European Index	Premier Miton European Opportunities Baillie Gifford European
Asia Pacific ex Japan	Stewart Asia Pacific Leaders Merian Asia Pacific	Baillie Gifford Pacific Fidelity Asia Pacific Opportunities JPM Asia Growth

For certain plans the Fidelity Asia Pacific Opportunities fund is not available and will thus be replaced by the Baillie Gifford Pacific fund, which is our next choice fund.

The value of an investment and the income from it could go down as well as up. The return at the end of the investment period is not guaranteed and you may get back less than you originally invested.