market matters

gemini asset management

April 2020

Review of markets over the first quarter of 2020

This quarter has not been an easy one for most investors. While it was already clear that we were in the later stages of the economic cycle, nobody could have predicted at the start of this year that large parts of the global economy would be brought to an abrupt halt by the COVID-19 pandemic.

Unfortunately, the debate has now moved on from whether or not there will be a recession this year, to how deep and how long it will be. As markets have moved to reflect this new reality, equities have fallen sharply, with the worst returns coming in March. The S&P500 in the US fell 20% over the quarter and the FTSE all share declined by 25%.

At least the defensive part of portfolios has performed as expected with government bonds rising in price, as central banks cut interest rates and restarted quantitative easing. Gold has also delivered positive returns year to date, up nearly 5%. However, concerns about the effect of the shutdowns on corporate profits have led to corporate bond prices declining, which will have detracted from the returns of fixed income portfolios. As should be expected, riskier corporate bonds (high yield bonds) have fallen by more than the more secure investment grade rated companies, with high yield energy bonds the worst hit.

Commodity prices, other than gold, fell sharply over the quarter. As countries around the world halted activity to try to bring the spread of the virus under control, demand for most commodities declined, hitting prices. Oil was caught in a perfect storm with an agreement between OPEC and Russia to constrain supply breaking down just as the outlook for demand fell. This led the oil price to fall by more than 60%.

The chart below shows the returns over the first quarter for the main equity indices around the world.

World Stock Market Returns - Quarter 1 2020

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Q1 2020
MSCI EM 79.0%	MSCI Asia ex Japan 19.9%	US S&P 500 2.1%	MSCI Asia ex Japan 22.7%	Japan TOPIX 54.4%	US S&P 500 13.7%	Japan TOPIX 12.1%	UK FTSE All-Share 16.8%	MSCI Asia ex Japan 42.1%	US S&P 500 -4.4%	US S&P 500 31.5%	Japan TOPIX -17.5%
MSCI Asia ex Japan 72.5%	MSCI EM 19.2%	UK FTSE All-Share -3.5%	Japan TOPIX 20.9%	US S&P 500 32.4%	Japan TOPIX 10.3%	MSCI Europe ex UK 9.1%	US S&P 500 12.0%	MSCI EM 37.8%	UK FTSE All-Share -9.5%	MSCI Europe ex-UK 27.5%	MSCI Asia ex-Japan -18.4%
UK FTSE All-Share 30.1%	US S&P 500 15.1%	MSCI Europe ex UK -12.1%	MSCI Europe ex UK 20.0%	MSCI Europe ex UK 24.2%	MSCI Europe ex UK 7.4%	US S&P 500 1.4%	MSCI EM 11.6%	Japan TOPIX 22.2%	MSCI Europe ex UK -10.6%	UK FTSE All-Share 19.2%	US S&P 500 -19.6%
MSCI Europe ex UK 29.0%	UK FTSE All-Share 14.5%	Japan TOPIX -17.0%	MSCI EM 18.6%	UK FTSE All-Share 20.8%	MSCI Asia ex Japan 5.1%	UK FTSE All-Share 1.0%	MSCI Asia ex Japan 5.8%	US S&P 500 21.8%	MSCI Asia ex Japan -14.1%	MSCI EM 18.9%	MSCI Europe ex-UK -20.9%
US S&P 500 26.5%	MSCI Europe ex UK 5.1%	MSCI Asia ex Japan -17.1%	US S&P 500 16.0%	MSCI Asia ex Japan 3.3%	UK FTSE All-Share 1.2%	MSCI Asia ex Japan -8.9%	MSCI Europe ex UK 3.2%	MSCI Europe ex UK 14.5%	MSCI EM -14.2%	MSCI Asia ex-Japan 18.5%	MSCI EM -23.6%
Japan TOPIX 7.6%	Japan TOPIX 1.0%	MSCI EM -18.2%	UK FTSE All-Share 12.3%	MSCI EM -2.3%	MSCI EM -1.8%	MSCI EM -14.6%	Japan TOPIX 0.3%	UK FTSE All-Share 13.1%	Japan TOPIX -16.0%	Japan TOPIX 18.1%	UK FTSE All-Share -25.1%

Source: FTSE, MSCI, Refinitiv Datastream, Standard & Poor's, TOPIX, J.P. Morgan Asset Management. All indices are total return in local currency, except for MSCI Asia ex-Japan and MSCI EM, which are in US dollars. Past performance is not a reliable indicator of current and future results. Data as of 31 March 2020.

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One doesn't need to wait for the traditional economic data to be released to appreciate the scale of the hit to the economy, which is emanating from the virus containment measures currently in place across much of the world. A few select data points demonstrate the magnitude of the shock. For example, car sales in China fell about 80% in February. Data from the restaurant booking application Opentable show that bookings are down close to 100% in nearly every country that they operate in and the number of people globally signing up for jobless benefits has seen a significant rise *(Source: JPMorgan 1st April 2020)*. Clearly, this is not just a normal recession, but a sudden shock to the economy that is unprecedented among developed economies in the post-war period.

An unprecedented shock requires an unprecedented policy response from governments and that is what we have seen.

To delve a little deeper, one of the main worries facing individuals and businesses during this crisis is whether or not they can stay solvent without having the expected and needed cash flows in order for them to avoid going bust. If a business cannot stay solvent, it will have to lay off staff and this greater level of unemployment will further compound the severity of any recession as it creates a vicious cycle: If people lose their jobs, they aren't likely to be consuming to the same extent as they were whilst they were employed, and this further limits a business's ability to generate revenues and stay solvent, which can again lead to more unemployment. The problem can be escalated further as the greater the number of people which are unemployed, the smaller the number of people you have contributing to the economy which can hinder the eventual recovery.

In order to minimse the potential of businesses and individuals going bust due to the reasons outlined above, the governments launch what are termed 'fiscal policies', which are designed to help bolster businesses and economies on the whole. Expansionary fiscal policies are intended to try and help stimulate the economy, or at least stave off the worst impacts of potential economic shocks, including large increases in the unemployment level. They usually include policies such as: tax cuts or deferrals; cheap and accessible business loans; or changes to the levels of unemployment benefit provided by government to individuals.

This time the governments have provided an extreme response in reaction to the potentially extreme outcomes that may linger on the horizon: Not only are governments running unprecedented levels of the typical fiscal responses, some governments have gone as far as guaranteeing wages up to certain thresholds. In theory, this should help stave off the spectre of mass unemployment -- as well as societal issues which may accompany it – and limit the effect the vicious cycle may have on the severity of the recession.
All major economies, however, have responded substantially and these are precisely the right kinds of policies to deal with this type of shock; it gives the economies the best chance of rebounding sharply once the health situation is under control.

	Region				
Policy Response	**UK**	**US**	**Europe**	**Japan**	**China**
Business Loans					
Wage Guarantees					
Direct Payments to Families					
Unemployment & Insurance Benefits					
Tax Breaks / Deferral					
Removal or Reduction of Debt Ceilings					
Size of Policy Response (% of GDP)	**6.3%**	**5.7%**	**Germany (4.5%) Italy (2.8%) France (1.9%)**	**0.08% - likely to announce c.11%**	**4.2%**

Confirmed Policy Announcement	
(green)	Yes
(grey)	Not yet announced
(pink)	No

Fixed Income

The response hasn't purely been down to government fiscal policy; central bankers have thrown the kitchen sink at the problem too and this is termed as 'monetary policy'.

When central banks become accommodative, they do so by making credit conditions looser for governments, businesses and, ultimately, individuals. Lower interest rates have two primary effects: The first, is that it makes credit cheaper so it is easier to meet debt repayments, making it less likely the businesses and individuals will default on their obligations; the second, is that it entices businesses and individuals to spend money as the alternative of saving makes little sense due to the rate of interest being so low.

As well as cutting interest rates -- practically to zero for major central banks --, accommodative monetary policy can entail quantitative easing, often referred to as 'printing money'. Quantitative easing (QE) is where a central bank buys government bonds, which helps keep government borrowing costs low during the time they are running the unprecedented levels of fiscal stimulus. Major central banks (CBs), like governments, have also stepped up to the challenge with some even stating that their QE response will be 'unlimited'; they will do whatever it takes, and as such have set no end date or value limit on the amount of support they are willing to provide. Further to this, CBs have even started purchasing corporate bonds directly providing liquidity to the corporate bond market and cash flow for businesses in their hour of greatest need.

The depth and duration of this recession will therefore depend on the extent to which governments fill in the gaps in their current fiscal responses, comforted by the support of the central banks, to ensure that unemployment is prevented from spiralling and bankruptcies of otherwise sound businesses are prevented.

The below chart shows the effect that COVID-19 has had on the fixed income sector with US Treasuries the only real positive over the quarter.

2013	2014	2015	2016	2017	2018	2019	Q1 2020
Euro HY 8.8%	Euro Gov. 13.1%	Euro Gov. 1.6%	US HY 17.5%	EM Debt 9.3%	Euro Gov. 1.0%	EM Debt 14.4%	US Treas. 8.2%
US HY 7.4%	EM Debt 5.5%	EM Debt 1.2%	EM Debt 10.2%	Global IG 9.1%	US Treas. 0.9%	US HY 14.4%	Euro Gov. 0.3%
Euro Gov. 2.2%	Euro HY 5.5%	US Treas. 0.8%	Euro HY 10.1%	Global IL 8.7%	US HY -2.3%	Global IG 11.5%	Global IL -2.7%
Global IG 0.3%	US Treas. 5.1%	Euro HY 0.5%	Global IG 4.3%	US HY 7.5%	Global IG -3.6%	Euro HY 10.7%	Global IG -5.4%
US Treas. -2.7%	Global IL 3.4%	Global IG -3.6%	Global IL 3.9%	Euro HY 6.1%	Euro HY -3.6%	Global IL 8.0%	EM Debt -11.8%
Global IL -3.2%	Global IG 3.1%	US HY -4.6%	Euro Gov. 3.2%	US Treas. 2.3%	Global IL -4.1%	US Treas. 6.9%	US HY -13.1%
EM Debt -6.6%	US HY 2.5%	Global IL -5.0%	US Treas. 1.0%	Euro Gov. 0.2%	EM Debt -4.6%	Euro Gov. 6.8%	Euro HY -14.6%

Source: Bloomberg Barclays, BofA/Merrill Lynch, J.P. Morgan Economic Research, Refinitiv Datastream, J.P. Morgan Asset Management. Global IL: Barclays Global Inflation-Linked; Euro Gov.: Barclays Euro Aggregate Government; US Treas: Barclays US Aggregate Government - Treasury; Global IG: Barclays Global Aggregate - Corporates; US HY: BofA/Merrill Lynch US HY Constrained; Euro HY: BofA/Merrill Lynch Euro Non-Financial HY Constrained; EM Debt: J.P. Morgan EMBIG. All indices are total return in local currency, except for EM and global indices, which are in US dollars. Past performance is not a reliable indicator of current and future results. Data as of 31 March 2020.

Asset Allocation and Fund Review

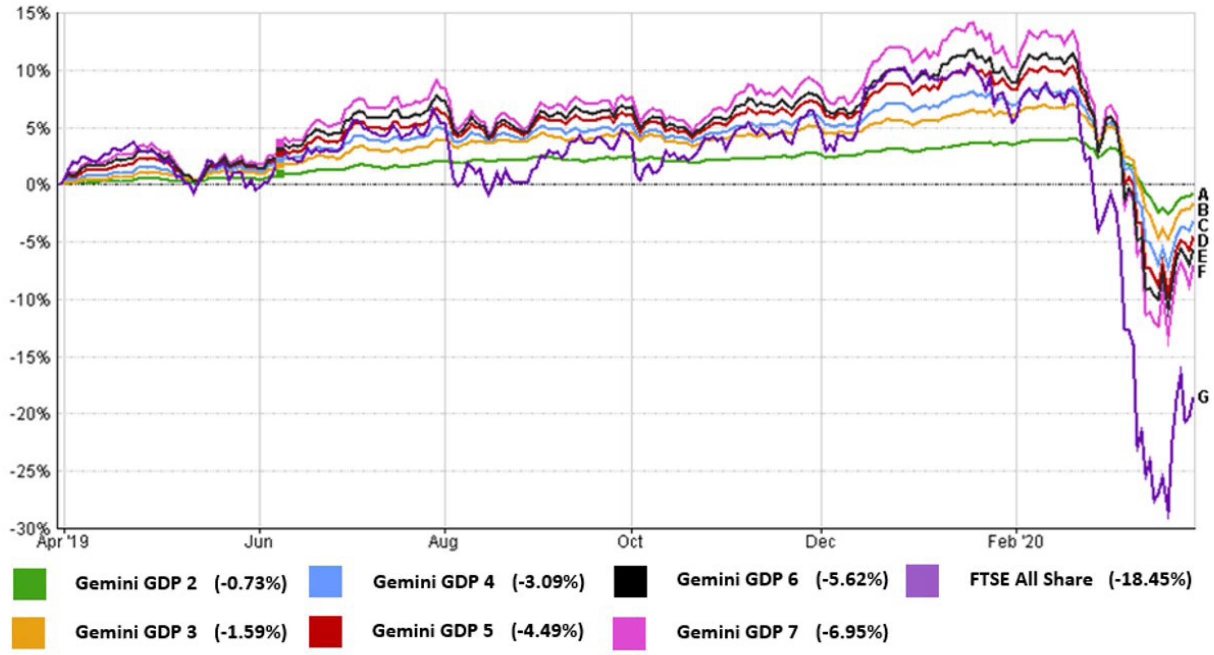
The investment committee reviewed the existing asset allocation models in conjunction with the recommendations and capital market assumptions put forward by our independent actuary, Dynamic Planner. As a result of this there were **no changes** to the asset allocation models or the funds we are invested in during the first quarter of 2020.

We maintained our overweight to cash within our models and together with the quality bias in terms of the funds and stocks we hold we have been able to protect clients from some of the inevitable downside during this very difficult period.

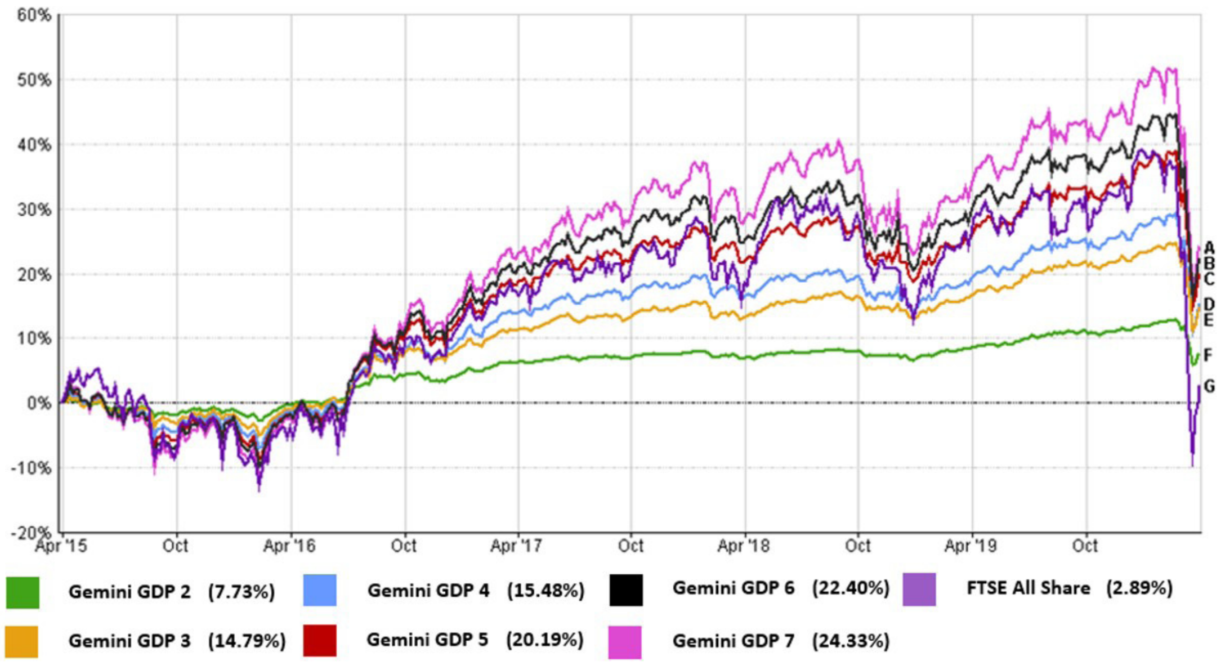
For plans that come under our Advisory service there are **no changes** to fund choice or the asset allocation models recommended for this quarter.

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 All Share 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 All Share is not like for like it does give an indication of volatility and performance differences on a risk-adjusted basis.



Source: Financial Express Analytics data 29/03/2019 to 31/03/2020. Past performance is not a reliable indicator of future results. All figures given do not include any initial, on-going or product provider fees



Source: Financial Express Analytics data 31/03/2015 to 31/03/2020. 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.