WATTERSON
FINANCIAL PLANNING

Market Update

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SQUARE MILE
INVESTMENT SERVICES

Financial markets performed strongly over the quarter as they recovered their poise following the frenetic selling that occurred in March. Economic activity is rebounding and markets have responded favourably to the determination displayed by governments and central banks to support businesses and consumers through this period. Prices of bonds issued by solid companies have recovered, returning to levels seen at the beginning of the year. Yields on developed market government bonds remain at record low levels thanks to the on-going support of central banks. Stock markets around the world have rallied and in the US have been led higher by the internet related technology giants, leaving them either above or not far off where they were at the year's open. However, outside of the US, many stock markets are still trading significantly below where they started the year. For instance, the UK's FTSE 100 is down 17% this year, despite the 9% recovery over the second quarter.

It is not easy to comprehend the enormity of what has and is occurring around the world. We are all seeing first-hand the effects of the virus and subsequent shutdowns on our lives; this is happening across nations and continents. Central banks have issued colossal quantities of new money to provide finance for businesses and governments. Governments in turn have deployed these loans as aid through furlough schemes and direct grants to both businesses and consumers. The scale of these packages goes way beyond what happened in 2008 and the cost is comparable to the expense of a major war. Trying to gauge whether this will be sufficient to offset the severity of the crisis is very difficult, though governments in the UK, Europe and US are drafting further budgets to help prop up their economies.

FINANCIAL MARKETS BOUNCE

The avalanche of monetary and fiscal responses by authorities around the world is reinforcing pent-up demand, ensuring a surge in activity as economies reopen. Yet, the virus has not been tamed and large sections of the economy face huge challenges, such as travel & leisure, which face a lengthy delay before activity returns to anything like normal. In short, the recovery will happen, but the lasting damage will linger. It will take many quarters before the lost GDP can be fully regained. Worryingly, these worst affected industries are big employers. As such, many people have been made unemployed and the UK unemployment rate could touch 10% this year as the furlough scheme is withdrawn.

Those who remember the 1970s may have concerns about this slew of freshly printed money and its impact on inflation. It will have escaped few that trips to the supermarket have become noticeably more expensive. However, it should be recognised that the monetary injections have been put in place to offset the lost activity caused by the shutdown. Spending will jump once lockdowns are relaxed but consumers are going to be much more cautious over the coming months of uncertainty, particularly those whose jobs are threatened. While prices for some goods will go up, incomes are unlikely to. In effect, we will all end up a little poorer as a consequence but an inflationary spiral is very unlikely to develop in the near term.

Turning to the portfolio, there has been an unusual level of activity over the quarter, as we start the process of restructuring it to reflect the new environment. There have been a number of changes to the fixed income component, repositioning towards funds where we feel prospects are more attractive. We have also upped the portfolio's exposure to the US dollar. This is principally to improve the diversification away from the UK. The Bank of England is investigating whether it would be advantageous to push interest rates into negative territory. Meanwhile the threat of a hard Brexit overhangs. Either one of these events could place further pressure on the price of sterling. Within the equity section of the portfolio we have made some alterations to the UK component, reducing exposure to emerging markets over fears of the impact of falling global trade and we have added a position in a global sustainability fund. We believe that government spending will become a key driver of the economic recovery once the initial bounce is over and that many governments are planning budgets based around infrastructure and the environment. Towards the end of the quarter, we took advantage of the rebound in stock prices to reduce overall equity exposure a little.

In the near term, the current market rally may be running out of steam and we should not be surprised if stock prices slip back a little. Clearly a resurgence in the pandemic is a threat, which is difficult to quantify, but there are other factors that could act as a catalyst. Companies will shortly be announcing their second quarter results, which should provide markets with a better idea of the difficulties that many of them are facing. Politics could also present unwelcome distractions. President Trump is now well behind in the polls and he may be tempted to play to his nationalist support base with further trade spats.

Overall, investors should be able to take some solace from the continued support of governments, which will offset the worst of the impact of the pandemic. Though we suspect that financial markets may face some further turbulence over the coming months, even if we believe this is unlikely to be as sudden or severe as the impact experienced in March.

ECONOMIC ACTIVITY IS RECOVERING BUT THE OUTLOOK REMAINS UNCERTAIN

Important Information