

Manager's Quarterly Review Q1 2020

	Q1 2020	Return	Level
Equity	MSCI AW Index	-21.37%	442
	S&P 500 Index	-19.60%	2585
	MSCI EM Index	-23.60%	849
	MSCI CH Index	-10.29%	77
	FTSE 100 Index	-23.84%	5672
Debt	BBARC GA Index	-0.33%	510
	US G2Y Index*	2.27%	0.253%
	US G10Y Index*	8.11%	0.668%
	US G30Y Index*	15.14%	1.316%
Infrastructure	S&P GI Index	-29.18%	1,961

*Total Returns are calculated using active futures

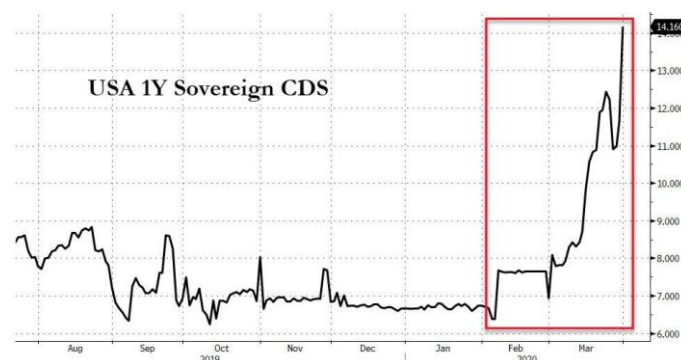
(Source: Bloomberg)

The year started on a positive note, with a number of equity markets, led by the US, registering new highs, still buoyed by the Federal Reserve pumping \$60bn a month into the repo market and expectations for around 3% growth in the World economy. Then two exogenous shocks gripped the markets. The spread of COVID-19 outside of China provided the catalyst for a huge correction in equities, in credit and in any other risk asset class, from mid-February onwards. While a collapse in the oil price, to below \$20 a barrel at one stage, was triggered by the outbreak of a price war between Saudi Arabia and Russia, added to the gloom.

Equity markets ended the Quarter deeply in the red, with credit markets suffering from an increasing liquidity crunch. Sovereign bonds, on the other hand, saw huge demand driving the yields down sharply, with the yield on 10-year US treasuries falling to a historic low, as investors scrambled to preserve capital. Central banks across the globe responded aggressively, reactivating QE and loosening monetary policies, where possible.

The extraordinary and unprecedented response from the Federal Reserve and the Bank of England, to do whatever it takes, has provided some assurance to the markets. However, given the nature of this exogenous shock, market uncertainty will not be addressed by monetary and fiscal tools alone. For now, the monetary policy tools have helped arrest the free fall.

The Quantitative Easing exercise comes at a cost. The post COVID-19 world will be a highly indebted one with central bank's balance sheets bloated with all the debt they are promising to buy. This will also impact the cost of debt as sovereign default rates increase. US Treasury, the ultimate risk-free asset, has recently seen a spike in its Credit Default Swap spreads.



(Source: Bloomberg)

The Coronavirus is clearly terrible news but more disturbing for the markets is its non-medical effects on the daily life and economy. With vast swaths of the economy in lockdown at the end of Q1 and severe disruption to supply chains, economic activity is collapsing and a significant decline in GDP lies ahead as we move into Q2 and a recession now look unavoidable.

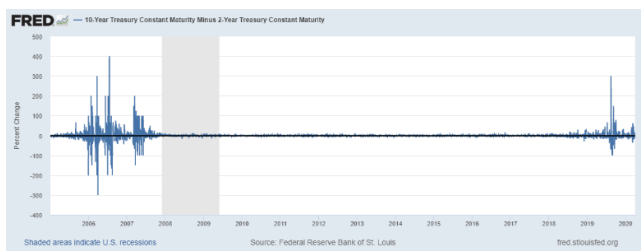
The debate is now centred on the shape of the recession and recovery and whether we will get a V, U or L-Shaped recovery. The sooner we can all see that infection rates have peaked, have tested those that have successfully fought off COVID-19 and have the antibodies and ultimately have a vaccine that can be rolled out, the sooner and steeper the recovery.

A disturbing impact of the lockdowns experienced across the globe and lack of demand for many goods and services is on highly leveraged companies and their ability to service debt. Clearly, the longer we don't have a cure for the virus, the deeper its impact will be on the economy.

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The 10-2-year US Treasuries yield graph is shared below. As we noted previously, the yield curve inverted briefly in August 2019 and historically, 12-15 months after such inversion, there is a recession. Here we are 8 months later and it looks like we are heading into a recession, albeit on our central case scenario, a short lived one.



(Source: Federal Reserve Bank)

Clearly COVID-19 has been a game changer this year for the economy and was not known back in August 2019 but it will provide some ammunition to predictive power of the yield curve.

Given the speed and magnitude of the collapse in both the economy and the markets, economists and analysts are still in the process of slashing their forecasts, implying that earnings based valuation models are still struggling to capture the full impact of the COVID-19 shock. The Cyclically Adjusted PE ratio for the US market is now under 25 and will clearly fall further from here. If our central scenarios play out, we believe it should find a new equilibrium around 20ish mark based on the current levels of the market and expected earnings revisions.

In Q4 2019 we took an active decision to dial down on risk after registering strong gains in our portfolios, despite the markets making new highs. Our cash cushion has helped us in the recent turmoil enabling us to take advantage of the sharp declines. At a technical level, many markets went from extreme overbought to extreme oversold positions inside a few weeks. As a result, we recently added modestly to our US and Emerging market equity positions following the recent dip to around the 2300 level on the S&P.

We believe that once the COVID-19 induced correction is over, many markets will rebound strongly. Given that scale of both fiscal and monetary easing and historically low interest rates, equities will be in a prime position to benefit. We don't expect the return of buy backs anytime soon, but we do expect Federal Reserve to hold Corporate Bonds on its balance sheet for some time to come.

Our portfolio returns:

Performance %	Year to Date	Quarter to Date	Month to Date
AB1	-5.67	-5.67	-4.38
AB2	-8.28	-8.28	-6.06
AB3	-10.74	-10.74	-7.43
AB4	-12.85	-12.85	-8.48
AB5	-14.66	-14.66	-9.70
AB6	-15.80	-15.80	-10.54

(Source: ABP and Morningstar, for Indexed funds solution, Data as at 31/03/2020)

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