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Market Review – A Man-Made Recession

From early February the impact of the COVID-19 outbreak in China was beginning to be felt on global businesses. The hospitality, retail, tourism and travel industries in particular were beginning to voice concerns about the impact of the coronavirus. Typically at that point of the year, the Chinese New Year would be in full swing with tens of millions of tourists travelling throughout China and the globe, to celebrate with friends and relatives.

In touristic cities such as Istanbul, a marked decline in hotel rooms was seen. Chinese travellers typically stay longer and spend more than those from other countries. For example in the US, they stayed for an average of 18 days and spent US$7,000 per visit in 2019, according to a 13D Global Strategy and Research report.

With Chinese spending already having slowed during 2019 due to the US / China trade war, mounting concerns were justified as China now accounts for circa sixteen per cent of global GDP and around a third of global growth annually, meaning any slowdown in spending there would have far reaching implications for global growth generally.

Notwithstanding the importance of the Chinese consumer, the MPL investment team were also concerned by the fact that China as a whole (and particularly Hubei province where the coronavirus pandemic originated) is a hugely important manufacturing centre and closely integrated into global supply chains.

The lockdown on travel and industry there would very quickly lead to sufficient supply chain disruption so as to impact wider sectors such as Technology, which is closely linked to Chinese suppliers. If the tech sector struggled, then that in turn would affect demand for the energy and material inputs used to create technology products. This in turn (and getting to the crux of the matter), would create a catalyst for a market correction, originating from an unknown and unforeseen event/source that from that point could easily derail the ten-year-old bull market.

By late February and with this scenario beginning to unfold, we received earnings releases from a wide range of companies including industrial, IT and health-care businesses for whom Coronavirus was clearly fast becoming the dominant theme. Amongst others, Alcoa Corp, a large-scale manufacturer of aluminium products, said it was seeing supply chain bottlenecks in China for bauxite, caustic soda and coal gas, all essential inputs to the manufacturing process, and which shortages would inevitably impact production.

Apple Inc. meanwhile stated it was not expecting to meet previously given second-quarter financial guidance because production of its products had slowed or been halted in China due to the outbreak of the COVID-19 virus and subsequent lockdowns. And a Visa Executive commented that… “It's too early to tell how the outbreak will impact the company. If planes are not flying in and out of China, if hotels are not being filled, which they're not at the moment, and if the supply chains are being impacted, which I suspect they are, there's going to be some impact. It's just going to depend on how long this goes on."

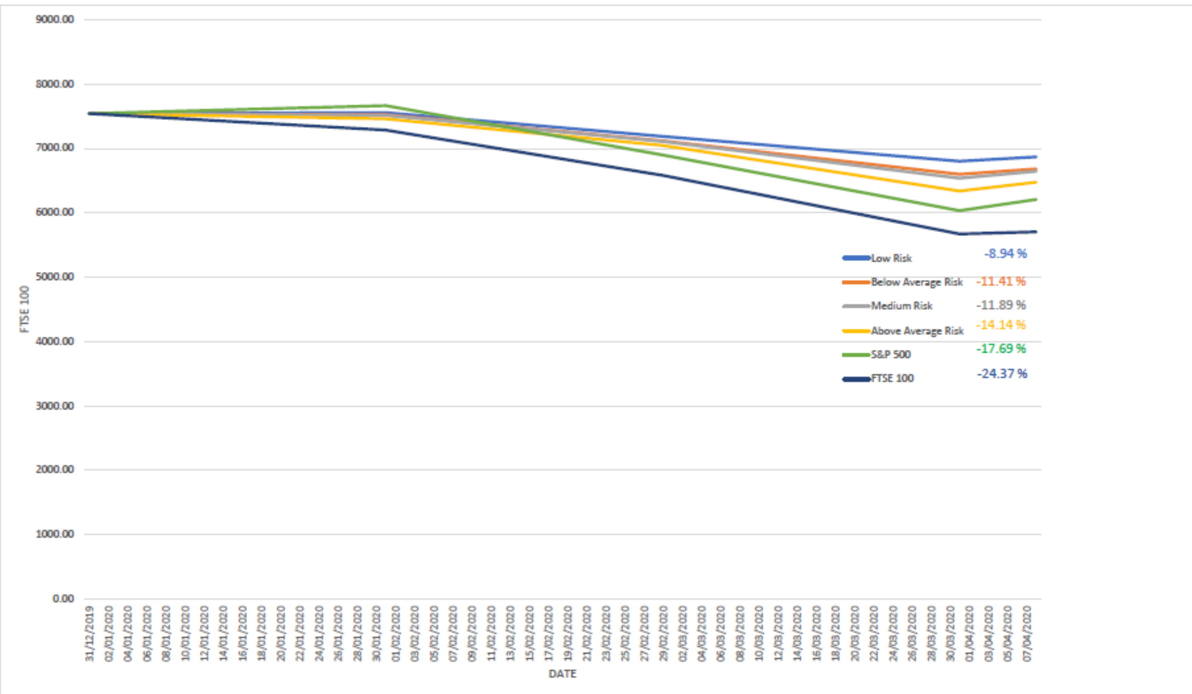
Global economic problems were then further compounded by an inability of Russia and Saudi Arabia as members of OPEC+, to agree to cuts in oil production. With global demand for oil already being significantly impacted and reduced by the unfolding global lockdown, the Russo-Saudi spat provided further downwards momentum to falling oil prices, resulting in further drawdowns in global equity indices as listed companies exposed to the oil and energy sectors now found themselves being marked down.

Prompted by the level of uncertainty raised within these earnings releases and the resultant implications for global growth, the MPL investment team adopted a neutral stance on global equity markets and began to reduce exposure by raising cash.

Whilst our concerns were justified here, we could not have anticipated the full extent or indeed the relative violence with which global financial markets have responded: (a) to the pandemic itself, and: (b) to the efforts of global governments and central banks, which have in effect created a man-made recession by mandating the shutting down of the global economy in a desperate effort to arrest the spread of the virus. In the absence of any vaccine with which to combat the virus' spread, governments in reality had little alternative.

FTSE 100 and S&P 500 versus MPL Low to Above Average risk Portfolio performance,

<u>January 2020 to present</u>



Portfolio Allocation

With the prospect of COVID-19 forcibly bringing about a man-made global recession (albeit we hope only a brief one!), from experience we know that companies which have relatively non- or super-cyclical business models coupled with strong cashflow characteristics, generally survive recessions.

Whilst taking a neutral stance on global equity markets as a whole from late February, the MPL investment team paid attention to areas of the equity market which may face liquidity problems as this pandemic develops.

Exposure to Mid-capitalisation companies in both the UK and the US was sharply reduced with the complete sale of the iShares FTSE-250 Index and the iShares Russell 2000 Index Funds. Exposure to emerging markets equities was similarly reduced via a reduction in the Carmignac Emergents fund.

Despite the very extensive and unprecedented actions taken by both Governments and global central banks to provide liquidity to the global economy, going forward from here the onset of any real economic recovery will only come with positive news surrounding a reduction in new cases and indeed deaths associated with COVID-19. And for the world to move ultimately to fighting the virus rather than from operating from a completely defenceless stance, effective vaccines are required and to this purpose over 400 biotech and pharmaceutical companies are racing to create new vaccines or repurpose existing drugs to this end.

However, at times when market 'panic' and volatility walk hand in hand, the correlation between financial asset classes becomes closely linked, and investment opportunities will be created. From a position of cash, we will be adding to those companies that led the bull market which preceded this global pandemic, such as technology giants Apple and Microsoft, and retail giant Amazon to name but a few, via the AXA Framlington Global Technology and JP Morgan US Equity Income funds.

With reference to the manner in which the phrase 'The New Normal' is now being used, the global population is being challenged as never before in the way that they communicate with one another, work, and indeed co-exist. Whilst this pandemic will eventually reach the point of exhaustion, this New Normal will continue to evolve and will result in many businesses (including logistics, retail and technology companies) moving into a new position of being even more necessary than they already are in terms of enabling and feeding the growth of the global economy.

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