INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

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# Market updates

Investment team updates | 16 April 2020

## Fixed income

- There has been a remarkable rally in spread markets since the low point of a couple of weeks ago.
- Notably, in the second quarter to date both US and global investment grade spreads are around 20% tighter – led by the short end of the market. Euro and UK markets have lagged but are still tighter.
- Meanwhile high yield (HY) yields are also a lot lower – over 350 basis points in the case of US dollar yields – and this has driven a near 15% rally in the market in a few weeks. Euro spreads are also much tighter at around 250basis points.
- Spread market valuations are now still attractive, but less so than was the case.

## Emerging market debt (EMD)

- Market conditions in EMD have started to somewhat improve in April after an appalling March (which marked the worst and sharpest sell off in the history of the asset class, coupled with extremely high redemption requests). Spreads narrowed by 100 basis points from the widest levels seen last month and redemption pressure has eased massively. ETFs are now trading at 1-2% premiums to NAV versus 7-8% discounts at the height of the sell-off in March.
- The relative attractiveness of EMD versus other asset classes in fixed income has improved now that major central banks have announced more QE/monetary stimulus. This will take time to feed through and increased defaults/restructuring amongst more challenged sovereigns will offset this. At the same time, recent actions from the IMF and other multilateral lenders suggests there is something of a backstop developing here too.

## Multi-asset

- The brutal economic impact from Covid-19-induced shutdowns has grown more apparent in the last week or so; for example, European PMIs are in the 20s-30 and US jobless claims in the millions.
- But this is occurring at the same time as Covid-19 itself might be plateauing at its epicentre, and as we have had even more stimulus measures from major central banks and governments.
- Markets seem to have embraced the latter, rallying strongly and with lower volatility.
- Our asset allocation group retains its preference for taking portfolio risk in higher quality parts of the market and in particular has been turning incrementally more positive on investment grade credit – helped by central bank purchases' skew towards corporates.

## Global equities

- Last week was the first since mid-January that the MSCI ACWI posted a positive return on each day of the week (in local currency). It is now up 5.6% month-to-date and has recovered by over 20% since lows on 23 March. While the headline return is positive, it masks weakness in certain markets, notably within Europe.
- Having led markets during March's volatility, growth and quality continue to outperform. While the energy sector has recorded the strongest return since 23 March, it has lagged the wider market in the first half of April as consumer discretionary proved the standout sector.
- Against this backdrop, global funds have delivered positive absolute returns and performed broadly in line with benchmarks. The resilience of stocks that we own during March's drawdown means that they have, in some cases, lagged those that had sold off more aggressively. As mentioned last week, we anticipate further market volatility from here and global portfolios should be relatively well positioned.
- Taking a medium- to long-term view, it's likely that the Covid-19 pandemic will see an acceleration of trends and opportunities that we've seen across markets in recent years (e.g. cash to card, e-commerce, environment). Our portfolios are already well positioned to benefit from them, and we intend to use the crisis as an opportunity to add to quality businesses exposed to these trends, where the volatility affords us a better point of entry.

## US equities

- Last week was one of best weeks for the S&P 500 index in over 40 years – up by over 12%.
- The market rallied on both unprecedented Fed and fiscal action as well as signs we have reaching a peak in new cases in Europe and the US.
- Unsurprisingly, value and cyclical stocks topped the market as momentum growth names trailed.
- Having recovered about half of the market decline, the key question is: have we reached a bottom in the market or is this a bear market rally?
- Looking ahead, this week marks the beginning of the Q1 earnings season. S&P 500 earnings are expected to decline by around -15% with non-cyclical stocks earnings expected to be flat while cyclical sectors are expected to see an earnings decline of around -40%.
- From a political viewpoint, Bernie Sanders has now endorsed Joe Biden to be the Democrat presidential nominee. We expect to see a lot of political uncertainty in H2 2020 as the Democrats could take over the Senate which increases the likelihood of a reversal of some of the tax cuts.
- Finally, this crisis is likely to have profound consequences societally: a re-appreciation of the role of government and multilaterals.

## European equities

- Painful contractions in leading economies are now forecast (the OECD estimates -25% for the median economy) and this will prompt steep rises in unemployment and reduced capital expenditure.
- Within Europe, many companies have cancelled future guidance and the prognosis for 2020 earnings is grim, though there is likely to be a significant rebound in 2021.
- Against this backdrop, strong stimulation through monetary policy will support long-term assets and favour strong, sustainable growth franchises at the expense of poor-quality cyclicals – this should continue to support our relative performance.

## UK equities

- Long-term gains in the FTSE Mid 250 space have been driven by sustainable earnings growth over the long term.
- The recent crisis has seen a return to valuations which imply future returns will barely cover costs of capital, and rolled back 16 years of earnings progress.
- The breadth of the market has narrowed significantly as it has fallen. The dispersion of returns was extremely low in Q1 and historically this indicates it will subsequently be quite high.
- This all makes it an interesting time for active managers in the Mid 250 space, but importantly our process has not and will not change.
- Outperformance has been driven by more defensive names in defence and food delivery. These have become quite large so we have selectively taken profits and recycled into more cyclical/optically challenged names.

Note: all data as at 15 April 2020, unless otherwise specified. Source: Bloomberg.

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