INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

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Market updates

Investment team updates | 1 May 2020

US equities

Politics/economy

- On 30 April, the "stay at home" order in Texas expired and has not been renewed by the Governor. Texas is the second largest state economy in the US and would be in the top eight global economies if it were a sovereign nation. Therefore how things play out there will be informative for what we can expect for the rest of the country.

Sectors

- US equities finished marginally down last week, following big gains in the previous two weeks. More defensive sectors such as REITs and utilities performed the worst. Financials came under pressure with big banks reporting weakness in credit and citing recession concerns. Industrials struggled, with airlines, parcel/logistics, truckers and building materials some of the biggest decliners. Healthcare held up slightly better as strength in big pharma and biotech helped to offset some softness in hospitals, managed care and distributors.
- While there was a lot of carnage in the physical commodity with May oil contracts trading negative last week, the energy sector was the best performer in the S&P last week and the only sector to post a gain. This was due in large part to the fact that the sector has been the worst performer this year with a lot of small/mid cap exploration & production stocks already down 80-90% for the year. Also, a lot of the oil market dislocation has been at the front end of the curve – energy equities tend to trade relative to longer dated prices.

Earnings

- We are just over a quarter of the way through earnings season (28.8% of the S&P 500's market cap has reported) and while we are looking at an overall earnings decline of around 15%, there is some variability within that figure as cyclicals are expected to decline closer to 40% and technology flat. Although earnings are missing estimates by -3.7%, ex-financials earnings are surpassing expectations by 5.7%. As the majority of business in Q1 was conducted before the lockdown, a better guide to the full impact of lockdown will be the Q2 earnings. Due to the difficulty of forecasting the impact from the lockdown, a big theme of this earnings season has been the widespread withdrawal of full-year guidance.
- As of last Friday, 88 S&P 500 constituents have announced a reduction in their planned Capex for the year. This is a trend that bears watching as a continued pull back in Capex will have a material impact on the duration and shape of the downturn.
- Reduction in capex by large firms materially impacts the revenue and profit growth of small/mid-size firms as they tend to bear the brunt of the reduction in spending.
- Small/mid-size companies begin announcing earnings this week. We are very interested in hearing from this cohort given outsized representation from the consumer discretionary, industrial, energy and banking sectors; areas at the centre of the present storm.

- The Q2 load factor for Southwest Airlines will be around 7.5%; this is typically around 80%.
- 70% of Lockheed-Martin employees are working from home, exceptions are production line assembly and workers on classified projects. All Lockheed Martin offices remain open but subject to increased social distancing requirements.

Virus

- There was news from Gilead that its remdesivir antiviral treatment did not improve patients' condition or reduce the pathogen's presence in the bloodstream in a first clinical trial. However, some trends in the data actually suggest a potential benefit.
- There are still three upcoming trial read-outs for therapeutics designed to reduce the severity of the virus symptoms and so relieve pressure on hospital intensive care units. Although the outcome of these will be binary, a positive trial result could be a game changer.

European equities

- As new case diagnoses and fatalities are starting to show falling figures, Europe is starting to plan for re-opening, but the approaches differ widely, both in terms of restrictions and proposed relaxations. Even jogging is criminalised in Paris, while Sweden's voluntary approach has been controversial.
- Heavy-handed state intervention is evident in specific sectors, notably airlines and banks, where dividends have been passed. But painful redundancies are likely in the leisure and travel sector, so furloughing has not been enough, and the re-openings are unlikely to save much of the summer holiday season.
- All this has helped our focus on high-quality and resilient business models. We have trimmed some stocks, for example in luxury and drinks, where the rally seems to have gone too far. Conversely we have reinforced weightings in certain healthcare stocks and in payment processing companies, where the "new normal" environment may enhance opportunities and growth too.

UK equities

- On the UK desk, we have noted the wider sense from parts of the market that central banks seem to have done enough. But we remain wary of the possibility that we haven't yet reached the bottom of the current bear market and, just like 2002, there could be more 20+% false rallies – each of which feel like "the one". It is all too easy to be whiplashed by the market's pendulum-like mood-swings.
- Amid the noise, our aim is to remain an impassive observer and stay primed to leap into action – investments made at the height of uncertainty in the global financial crisis (GFC) of 2008/09 provided some of our best returns of the last cycle, and this period will be no different in affording us some great opportunities.
- Our contrarian instincts and embedded investment approach together inform our conviction that this is not a time to just go out and buy more of the defensive stocks that everyone likes – the best time to invest is when it feels most uncomfortable.
- We want to lean-in to the crisis and build positions in the possible engines of our fund's capital growth for years to come, and our sense is that there will be some outstanding opportunities to become owners (never renters) of good businesses which have been floored by the tsunami of recent events. There are firms out there affecting changes in a matter of weeks that would have otherwise taken years.
- We have been closer to our management teams than ever before as they navigate this tumultuous period. Ultimately, we want to be owners of businesses that will have a good crisis and come back stronger and start the recovery on the front foot.

- On dividends, we saw the market dividend falling 33% peak-to-trough during the GFC and with notable payer Royal Dutch Shell cutting in late April we think a slightly deeper reduction could be shaping up this time around.
- Looking past this period of disruption, we fully expect this core pillar of equity ownership to be restored, albeit most likely in a slightly revised state to reflect a more prudent mood. Make no mistake, dividends will be back!

Global equities

- After February and March's steep declines, April looks set to be one of the best months for the MSCI ACWI over the past 30 years. With one day of trading remaining, it is currently only bettered by April 2009 and the MSCI ACWI is now 15% off mid-February highs.
- Energy has been the standout sector over the past week (to 29 April), and, alongside strong performance from banks, has contributed to a resurgence of value towards month end. Although, the value rebound has been sharp in recent days, there is limited evidence for a sustained rally and this is more likely a case of reversion to the mean.
- While the market continues to take central bank support and the gradual emergence from lockdown positively, we remain cautious and see the potential for further volatility. We retain our conviction in high-quality companies with strong balance sheets, many of which are exposed to themes that have likely been accelerated as a result of the Covid-19 pandemic.

Fixed income

- Economic data is weak globally. Unsurprisingly, manufacturing and consumer confidence is shattered, with joblessness rising and worse to come in Q2, 2020.
- Credit Spreads across both investment grade and high yield are much tighter through the month, retracing around half of the sell-off.
- "Fallen Angels" to hit high yield indices at month end. These companies include Ford, Marks and Spencer and Pemex and will make the market larger by around 10%.
- Covid-19 cases growth is slowing, while countries are announcing plans and timetables for reopening economies.

Figure 1: Credit market returns – April 2020

Market	April 2020 TR	YTD 2020
Euro IG	3.6%	-2.7%
US IG	5.3%	1.0%
UK IG	4.7%	1.3%
Euro HY	5.9%	-9.5%
US HY	3.8%	-9.8%

Source: ICE BoAML, 30/4/2020.

Multi-asset

- Equity markets have rebounded convincingly since March's lows, retracing about half the sell-off and shrugging off the more dire economic implications of the Covid virus.
- Our expectations are for a bleak second half of 2020 and, as chances of a sharp rebound in economic activity appear very slim, instead anticipate a more protracted road to recovery.
- Although equities are highly sensitive to where earnings – and economic growth – land, huge uncertainty around those earnings and a meaningful policy response to bridge the gap may mean investors "look through" the short-term impact.
- We retain our preference for equities, but are increasingly expressing that view through high quality, non-cyclical areas such as the US.
- In credit too, our preference remains for investment grade. Although high yield spreads have widened dramatically, the prospect of a severe economic recession may lead to challenged/ highly levered business models and more widespread defaults.

Note: all data as at 29 April 2020, unless otherwise specified. Source: Bloomberg.

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