INFORMATION FOR INVESTMENT PROFESSIONALS

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Market updates

Investment team updates | 5 June 2020

Fixed income

- The “risk rally” continues: credit spreads are around 10% tighter this month, while Global IG spreads, which have been in a range of 100bps-340bps this year are now 170bps over. Equities continue to rally – led by higher energy prices (circa $38 barrel) and banks.
- China’s service PMI is at 55.0 – higher than expected and the best since late 2010.
- Sterling is higher on hopes of Brexit breakthrough. UK mortgage applications, meanwhile, are at their lowest since early 1990s.
- Context (yields and returns):
    - USA HY: yield 6.4% (was 11.4% in late March), market returned around 20% from lows on 23 March.
    - Euro HY: yield 5.1% (was 8.6% in late March), market returned around 16% from lows on 23 March.
    - Global IG: returned around 11% over the same period.

US equities

Markets

- The S&P 500 was up 3% last week for the second week in a row and continuing the trend of value outperforming growth and momentum. From the market lows on 20 March the index has now rebounded by more than 30%.
- All sectors were higher, with financials leading the way as they benefited from the rotation to value and cyclicals. Industrials also scored well as airlines had another good week. Communication services lagged the index as FAANG stocks fell behind after a strong run. Energy stocks were also lower with exploration and production companies particularly weak.
- Optimism stemmed from the reopening theme and the stocks most exposed to this performed best. Equities were more generally supported by positive positioning from hedge funds and CTAs, the potential for more stimulus and the “FOMO” trade – participants getting involved for “fear of missing out” on the upside.
- Tensions between the US and China rumble on, especially as China continues to clamp down on Hong Kong’s autonomy. However, as in the previous week the market was largely unmoved by these concerns.

- Protests broke out across the US after the death of George Floyd, who was killed at the hands of a police officer while under arrest. A number of protests turned into riots leading President Trump to threaten military intervention if the disturbances didn't abate. Despite the protests, the market's upward movement continued.

Economy

- Confidence surveys are showing signs of bottoming out. We are starting to see "green shoots" of recovery in rail volumes and intermodal volumes as they move off the lows. This will help the likes of UNP and Norfolk Southern which are implementing precision scheduled railroading (PSR) and so are well placed to benefit from the recovery.
- In the coming weeks the market rally is likely to be tested as some of the stimulus programmes enacted by Congress are set to expire. As economic support and employment packages are wound down, workers and businesses could become exposed. Congress continues to weigh options for another round of stimulus, but as yet no agreement has been reached.
- Labour Department figures for initial jobless claims rose by 2.1 million last week, which is still far above pre-crisis levels but continues the consistent downward trend in the rate of growth.

Virus

- Vaccine company Novavax announced it was moving to human testing for its Covid-19 vaccine.
- The timeline for the rollout of a successful vaccine, however, remains highly fluid. Some economists have suggested the economy won't fully recover until a vaccine is deployed.

European equities

- The trend towards relaxing lockdowns continues, and borders are opening in some places – though the UK is for now persisting with a two-week quarantine strategy which may continue to endanger trade and the summer holiday season.
- For the UK, too, Brexit remains a concern as negotiations have brought no break-through. While the fishing industry, at the forefront of the impasse, has few stock market implications, Nissan's comments querying the viability of industrial businesses with an export dependency in the wake of no deal are a concern.
- Chinese trade tensions have been surpassed by the George Floyd-related demonstrations at the forefront of US politics, creating more uncertainty around the outcome of the November elections.
- In Europe a value rally has benefited some of the worst hit industries such as airlines, travel, retail and banks. But in the wake of Covid-19 it is difficult to generate enthusiasm for their relative prospects, even if the bounce back is "V-shaped" as only the most optimistic can expect.
- Capital raisings continue to feature, and we have participated as many of the companies concerned have repaired balance sheets, improving their survivability at the very least, but also giving flexibility for future M&A.

UK equities

- May was a quieter month for fund raises after April's flurry in the small-cap space, but as a firm we took part in the Hyve and Ted Baker rights issues.
- Broadly, we feel the market has rallied too hard considering the negative global economic outlook, with indicators set to look reasonably poor in the upcoming months.
- We have been trimming some of the outperformers and looking at more defensive options.
- May was a reasonable month of outperformance in the UK Equities midcap space, and we retain a balance between high quality growth compounders, growth names trading at a reasonable discount and pure value.
- We have not changed our positioning and remain on the lookout for new ideas and are mindful of the looming prospect of higher unemployment and the subsequent ramifications.

Japanese equities

- Another strong week for Japanese equities given the improvement in global market sentiment, with electronics makers and telecommunication firms providing the biggest boosts to the Topix index.
- News flow over the week included the Mitsubishi Motors/Renault/Nissan alliance announcement to combat the virus impact on the auto industry. Toyota, meanwhile, reported a ¥2.5 trillion operating profit last year and has guided for ¥1.5 trillion this year, despite Covid-19 concerns. Nissan, however, lost ¥40 billion last year with further losses expected going forward. We are witnessing the gap widen between the "survivors" and the laggards.
- Interestingly, Japan has grown to be the second-largest market for activist investors in the world behind the US. Investors have identified the vast cash hoards on the balance sheets of many Japanese companies – with 56% of the Topix companies net-cash compared to 16% of the S&P.
- We have taken profits from outperformers while adding to laggards, are sticking to our preference for higher quality names but added in sectors that have underperformed – autos and financials.

Global equities

- Global markets continued their strong positive run in May, with the MSCI ACWI finishing 4.4% up for the month. This has continued into June and, as at Wednesday 3rd, the index is now only 5.5% down on the year, having been as low as 32% at one point.
- While technology remained strong, as it has been all year, we saw a value rally towards month-end with cyclical sectors such as materials, industrial and consumer discretionary all finishing strongly.
- The market continues to react positively towards countries emerging from lockdown and news of potential vaccines, but we question whether the rally over the past couple of months has seen a dislocation from fundamentals. With the tug of war between positive news (vaccines, central bank support etc) and negative (recession, reescalation of cases etc), we remain cautious and see the potential for further volatility.
- The overall shape of portfolios remains broadly unchanged, but we continue to take advantage of market volatility, taking profits where appropriate and adding to high conviction names where we see opportunity.

Multi-asset

- Markets have continued their steady march higher, with global equities and global investment grade having retraced around two-thirds of their fall/spread widening respectively.
- Market focus appears to be on the gradual reopening of economies, which in most cases has occurred without major setbacks in numbers of new virus cases.
- With fresh tensions between the US and China, and in a US election year, the asset allocation group reviewed its preference for Asian equities. The latest measures represent an escalation of last year's tensions, and all the conditions of the Phase 1 trade deal are now unlikely to be met.
- However, China's response has been relatively measured, seeking to prevent escalation, just as domestic data is recovering, supported by more targeted policy stimulus.
- No changes were made to asset allocation, where Asia and the US remain the regions we favour most. Together they offer a blend of defensive and cyclical properties, while both consistent with our overarching preference for quality.

Note: all data as at 5 June 2020, unless otherwise specified. Source: Bloomberg.

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