Swallow Financial Planning

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INVESTMENT NEWS

Covid Crisis Week 7

During the current crisis we are trying to keep our clients up to date with what is happening within the investment world.

Where Are We Now?

All the markets have fallen, some more than others. From the 19th February to the 4th April markets moved as follows:

Date	04/04/2020	
All World Equities	(22.70%)	(.46%)
Developed Market Equities	(33.52%)	-
Emerging Markets	(21.32%)	1.31%
Global Value	(36.48%)	(.32%)
Global Min Volatility	(21.49%)	0.39%
UK FTSE 100	(26.17%)	5.78%
UK FTSE 250	(35.72%)	5.38%
UK FTSE All Share	(28.18%)	5.79%
UK Higher Yield	(39.54%)	(.19%)
UK Smaller cos	(37.37%)	1.98%
UK Value	(35.70%)	4.41%
UK REITS	(32.17%)	4.98%
International REITS	(33.52%)	-
Managed Bonds	(6.07%)	4.82%
Short Dated Bonds	(.47%)	0.19%
Cash	-	-
Gold	6.45%	4.25%
Silver	(16.92%)	9.20%

Bricks and Mortar funds have been suspended so data isn't available. The above funds are all actual passive tracker results within the areas described after charges.

The figures show the return from the 19th February to the 4th April (7 weeks). The final column shows the growth since our last bulletin on the 20th March (2 weeks).

We expect the markets to be very volatile with further significant falls and rises on a daily basis.

INVESTMENT NEWS

Covid-19

This is a global pandemic started in China. The number of cases and deaths is rising rapidly. The epicentre has moved to Italy, Spain and USA.

The social exclusion measures in the UK mirror what is happening elsewhere. The rate of escalation seems to mirror Italy at the same stage in their timeline. If new cases subside at the end April, quarantine rules should be relaxed late May.

The UK government is planning for a 12 week lock down and hoping for 8 weeks. Unfortunately if you ease the self isolation rules too soon, you will simply create a new spike which will necessitate a new lock down.

With nearly one in three people in the world essentially under lockdown, the coronavirus outbreak has brought the global economy to a virtual standstill.

It is the mitigation actions which are having a much worse effect on the global economy than is the virus itself.

The war against the virus will be won.   Humans will develop a “herd immunity” and the scientists will create a vaccine for the future.

Central Banks Reaction

With less and less in their arsenal Central Banks are undertaking more and more extreme measures to try and mitigate the short term pain (Jupiter described it as QE Infinity and beyond!).

The Bank of England have cut rates to 0.1% (and don’t preclude negative interest rates). The Bank of Australia has cut rates to 0.25%, while the European Central Bank has announced a new bond-buying programme worth a total of €750bn. The Bank of England propose purchasing commercial paper from UK firms.

The US Federal Reserve has suggested it will buy an unlimited amount of US Treasuries (i.e. unlimited quantitative easing) but has also committed $300bn to purchasing corporate bonds and mortgage-backed securities.

What worries me is the long term effect of these actions.   The books we have been told to throw away warn us that these actions will lead to inflation or even hyper inflation. The other suggestion is that we will end up with a re-run of the 1970’s.

The 1970’s was an era of rising prices and poor economic growth.

Central banks' balance sheets and public debts will soar in tandem. With quantitative easing, the bulk of government bonds will soon be held by central banks. None of these measures will prevent the recession – we are already in it, but they should ease the pain and support the recovery.

The Effect On Global GDP

As the mitigation effects are driving the global downturn it is thought that the GDP falls (and hence the economic effect on markets) will be very sharp ***but*** the hope is that they will be short lived. Vanguard produced interesting research suggesting that European GDP would return to near pre crisis levels about 6 months after the lock down ends.

If the lockdown ends in June, it is expected GDP will be back at almost pre crisis levels in December; If it's December, then June 2021.

The service sector has seen catastrophic falls in output. The current figures of a 40% drop are probably not enough. Manufacturing on the other hand has not been as badly effected.

3 million US people filed for unemployment benefits in a single week. That is 5 x the peak of the Global Financial Crisis (GFC) in 2008.

The USA is expected to have a GDP fall in the current quarter over 3 x the level seen in the GFC.

China is getting back to normal very quickly but we don't know about recurrence of the virus.

The most optimistic hope for the current situation is that we will see a V shaped recovery. Say -50% drop in GDP Q2, +20% Q3 and +25% Q4. This scenario would have a dramatic positive effect on current equity prices.

Corporate Returns

Corporate profits are sure to decline sharply, as will dividends and the financial markets are already valuing this in. Equity valuations in the US, Europe and Japan are consistent with a double-digit percentage cut in dividends this year. Share buybacks, the biggest source of demand for US equities, will stop.

Under some political pressure, the European and UK commercial banks have now confirmed they will not be paying dividends during the virus crisis, nor will they buy back their own shares. This action is designed to help them absorb more losses on loans they have already advanced, and to have more capacity to lend to the many businesses and individuals who are now short of money.

Currencies

Like in all times of uncertainty one would expect the US dollar will be king, driven in part by the shortage of dollars in offshore markets.

The Effect On The Value Of Your Savings

The average S&P 500 bear market is a drop of about 40 per cent, with a peak-to-trough phase of 18 to 24 months. The unique aspect of this sell-off is its speed, this is the fastest bear market on record. Historically recoveries to new highs take twice as long as the initial declines.

If the above is true for this crisis we could envisage an equity market recovery over the next six months. Due to the fall in values new cash can expect greater long term returns.

Many strategists point out that sharp rallies in bear markets are common and argue that we haven’t yet seen the lows.

Bond markets are pricing in close to zero interest rates and weak inflation for the foreseeable future.

The two most likely scenarios are as follows:

We Have A V Shaped Recovery In GDP

In which case the current prices are either cheap, or at worst fair value, so now is a buying opportunity.

We Have A Prolonged Recession

The most likely cause of this is a second wave of infections within countries that successfully controlled the first wave. In this scenario the economic impact is likely to be more drawn out, threatening a deeper contraction and a more serious equity market impact.

In which case the current prices are still expensive and will be liable to further falls.

Should You Keep Taking Income From Your Funds?

If you don't need income from your funds stop taking it. For many clients we have set aside a cash pool to pay income during a crisis such as this and in many cases the cash is sufficient for 1 to 2 years income needs. We expect the current drop in values to have largely recovered during the next 1 to 2 years.

What About Capital Lump Sums?

Now is a ***really bad time*** to take lump sums out of invested assets. Defer this if at all possible.

Is Now A Time To Buy?

Now is probably the best time to buy equities that we have seen for 10+ years. We do not of course know whether tomorrow or next week might be an even better time!

Whilst we believe now is a great time to invest, we would recommend staging your cash onto the market over say the next 3 to 9 months, depending upon how cautious you are.

Structured products may well be worth considering, we propose to explain more about structured products in the next week or two.

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How Can We Plan For The Future?

As stated above you need to defer access to savings if at all possible for 3 to 5 years.

If inflation returns, having asset backed savings will be the best hedge against losing the real value of your savings.

It is essential that we review client portfolios to restore portfolio weightings, spread risk and help our clients to best benefit from the upswing whenever that may occur.

Summary

We have always promoted the returns from asset based investments (equities, bonds and property) ***as a whole*** in other words the total return be it income or capital growth. Most of the growth in the last 20 years has been around market events rather than any actual growth in the value of companies, property or fixed interest investments.

If you accept this hypothesis then the purpose of equities & property is their dividend yield. The price you pay for equities is therefore the risk you are prepared to take for the greater yield you receive over secure investments. Our view is that Bonds are no longer secure investments (save for high quality government bonds which have no yield anyway) so the level of income assets should provide, is compared with cash. Thus if you could get 1% returns on cash holdings with NS&I, you would expect between 3% and 5% dividend returns on the FTSE 100 or commercial property. The next 6 months will tell us whether this differential will be restored in months or years.

The information and statistics provided in this bulletin have been taken from several sources and are available upon request. The figures are approximations and conjecture and should not be relied upon. You should not act on any comments made herein without a personal consultation and discussion with your financial adviser. Figures given today will change tomorrow. ADLS 6/04/2020.

Investments are subject to market risk, including the possible loss of the money you invest. Bond funds are subject to the risk that an issuer will fail to make payments on time, and that bond prices will decline because of rising interest rates or negative perceptions of an issuer's ability to make payments. Diversification does not ensure a profit or protect against a loss in a declining market. Performance data shown represent past performance, which is not a guarantee of future results. Note that hypothetical illustrations are not exact representations of any particular investment, as you cannot invest directly in an index or fund-group average. E.&.O.E.