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"Coronavirus" COVID-19 – update for Investors. 27th April 2020.

From the lows recorded a month or so ago, equity markets and most notably the US market, have made a strong recovery despite there being no immediate sign of a vaccine to combat Covid-19. Also, lower risk assets such as UK Gilts and US Treasuries have also performed well during this time. Of course, the overwhelming catalyst for greater stability and upwards movement in price has been the actions of central banks around the world, led by the Federal Reserve. A banking crisis has been so far avoided and market reassurances given by extraordinary levels of monetary support, asset purchases and the provision of liquidity. As at Friday's close the S&P500 had rebounded around 25% from its lows a month earlier. The Vix [volatility index] has also dampened down from its all-time high.

When viewing economic fundamentals, news flow would certainly suggest some caution for now. Jobless figures, particularly in the United States have soared, with claims rising to over 26 million in just 5 weeks. Economic indicators point squarely to a sharp manufacturing slowdown as depicted by Purchasing Managers Indices and the Congressional Budget Office forecasts the US Economy to shrink by 5.6% this year whilst delivering a record deficit of around $3.9 trillion. Real US GDP is forecast to fall a whopping 40% during Q2 and naturally consumer confidence levels have softened considerably. The collapse in the oil price is symptomatic of over supply during a period of global population lock down, although the extent of the oil price collapse has been quite unsurpassed. Oil inventories now stand almost full, with oil demand at its lowest in decades.

Given the extent of the Covid-19 inspired economic reaction it is not surprising to see corporate earnings disappointments and dividend suspensions. As economic and corporate data has weakened, the absolute valuation of equities has strengthened, with the S&P 500 PE soaring to a two-decade high following the rally (around 24x on our 2020 forecast).

The chart shows the S&P500 index.

Looking out from here we have identified 3 scenarios – a best case, a worst case and a central case scenario. We are adopting a position within Alpha Beta portfolios which reflects the central case scenario. This points to an outcome whereby a recovery to previous earnings high points takes time and is punctuated by a blend of positive and negative news which will drive markets for a period. We envisage gradual lockdown easing rather than a sudden return to normality. There will become a "new normal" as we enter a period of steady transition and unemployment reduces steadily but not instantly. Whilst equities are likely to exhibit some volatility in the coming months, we do envisage high quality bond markets offering some protection, supported by ongoing asset purchases and quantitative easing. We envisage the oil price similarly taking time to affect a steady recovery along with corporate earnings, likely to reach the previous zenith perhaps in 2022. So, a steady recovery albeit a "corrugated one" which offers a good entry point for those seeking a medium to long term growth opportunity.

At portfolio level, we have been pleased with the defensive qualities of our asset mix in difficult markets and we added equity exposure to capture some of the recovery to date. From here we will rebalance portfolios in favour of asset classes best equipped to benefit from our central case scenario by increasing the blend of quality long duration fixed income plus cash for lower risk strategies. This will leave portfolios well balanced and able to capture upside opportunities whilst retaining some defensive measures to guard against adverse market movements.

We remain alert to this fast-moving market with prudence and "Risk First" at the forefront of our minds. As ever, we would be pleased to hear from you should you have any questions or feedback.

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Important Information: