



Market Update – COVID-19

September 21, 2020 Close unless otherwise stated

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Our Views

- Markets have bounced back sharply as initial outbreaks across major developed economies slowed and unprecedented fiscal and monetary stimulus measures boosted markets. However, new spikes in cases in the US and Europe is a risk for equity markets.
- As a sharp economic recovery appears to be priced into markets already, sustainable gains from here look much more difficult with valuations looking stretched. Near-term economic data looks better, but this reflects a bounce from March/April lows.
- Bond yields remain at rock bottom levels, as global QE programmes and policy interest rates hold yield curves down. This is unlikely to change over the medium-term.

Actions for client portfolios

- **Market appreciation has ruled out scope to add to equity portfolios. For those seeking to strategically de-risk equity allocations, current conditions are shaping up to be an opportunity.** We do not believe large market falls are necessarily imminent, but support for a further sustained gain in markets is low.
- **Credit risk remuneration has been falling as spreads move towards our long-term fair values. Our views are now moving towards a more neutral stance versus gilts and other government bonds on our medium-term view horizon.** We recognise that income focused investors need credit exposure to meet strategic income generation objectives, and market conditions remain constructive for those taking longer-term horizons.
- **Diversification has paid off during volatile market conditions, and we believe they retain an important role in portfolios given the degree of market uncertainty.** Any onset of market weakness or higher volatility will improve the case for using diversifiers as a funding source for adding risk to portfolios.
- **Duration positions should be taken with care.** A mild underweight looks reasonable, but we do not believe it is likely that yields will move up very much even after the pandemic has passed. Hedge ratios should be managed accordingly.

What we are watching:

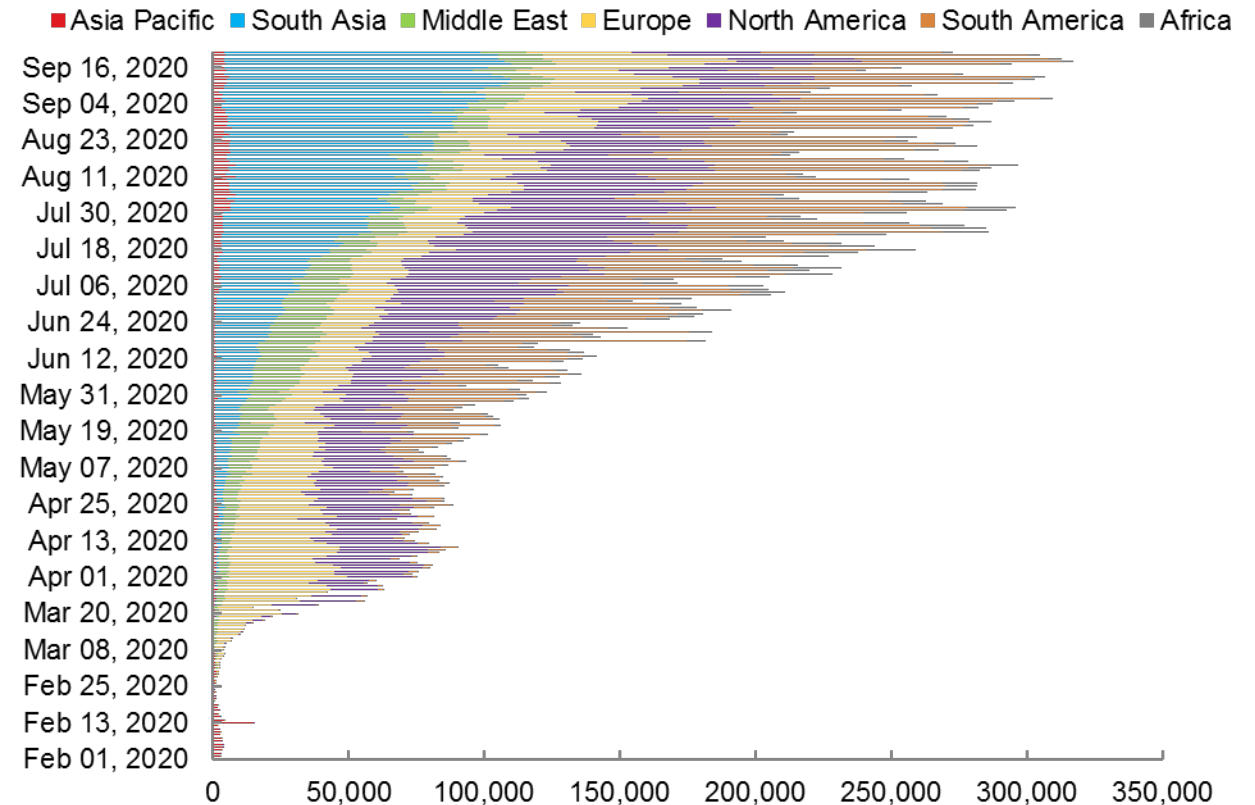
- Signposts for the duration of global economic weakness. We continue to expect a relatively low octane economic recovery when lockdown restrictions are lifted. More confidence here would help the case for adding risk to portfolios.
- The scale of valuation adjustments in equities and credit, alongside technical and sentiment indicators pointing to a more sustainable market recovery.

COVID-19 Update

Current Situation (21 September 2020)

Global	
Confirmed Cases	30,949,804
Deaths	959,116
Europe	
Confirmed Cases	5,236,252
Deaths	230,164
United States	
Confirmed Cases	6,703,698
Deaths	198,094

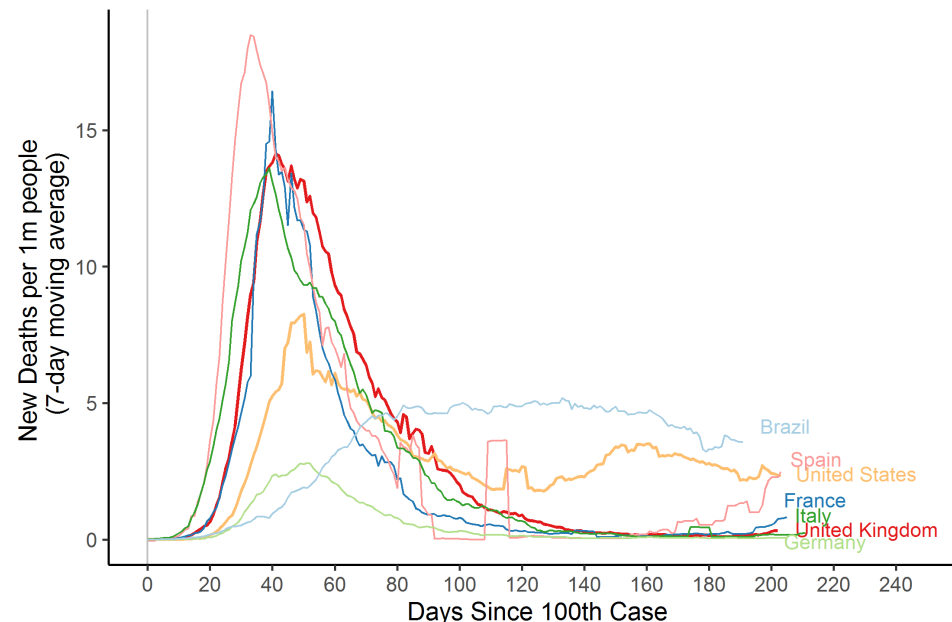
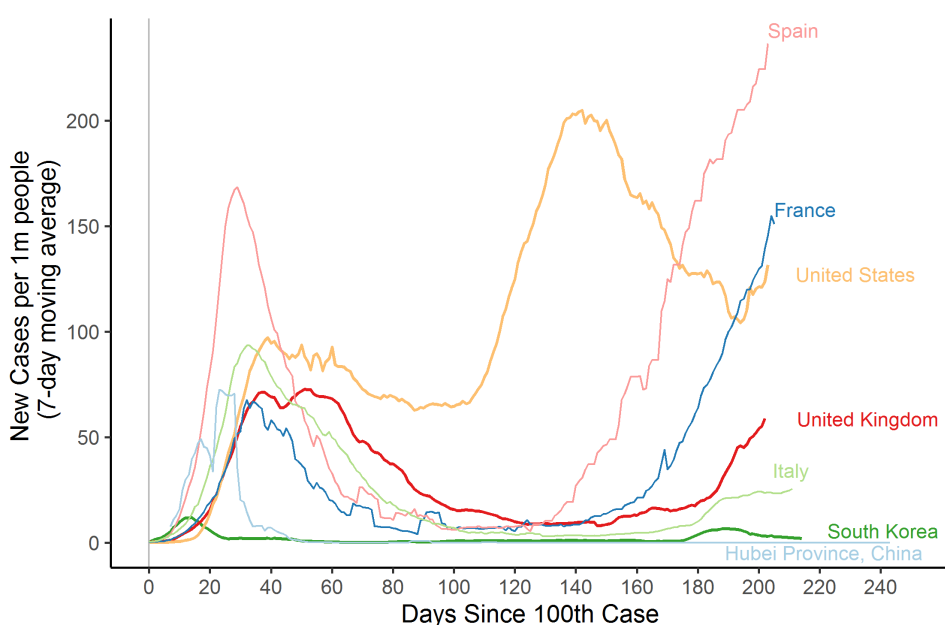
New COVID-19 Cases



Source: FactSet, World Health Organization, National Health Authorities. Regions not shown above has been categorized under "Other".

COVID-19 Virus Trajectory

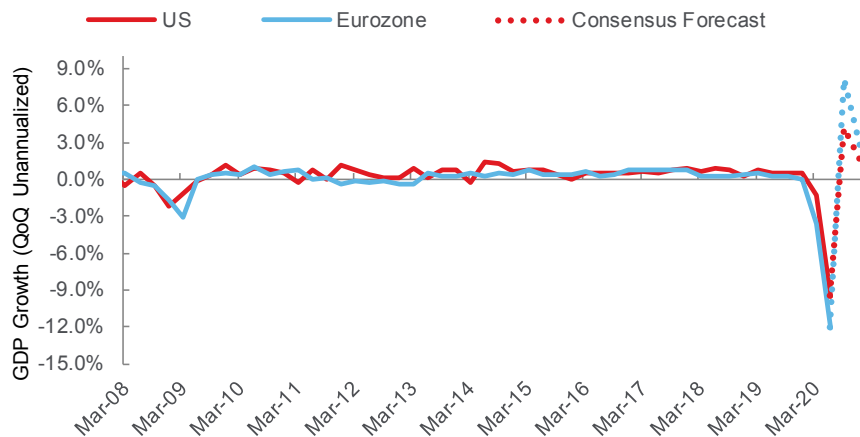
- The lockdowns appeared to have been effective in containing the first wave outbreaks across developed economies, but a new spike in cases in the US, Spain, France and elsewhere highlights the difficulty of keeping the virus under control without shutting the economy down for a prolonged period.
- Despite a new spike in cases in the US and Europe, equity markets continued its rebound as mortality rates remained significantly below that seen during the first wave. Much of the improvement in mortality has been attributed to better treatment including the use of Dexamethasone for patients with severe cases of coronavirus, as well as a younger age profile of infections. However, infection rates remain high globally and a further deterioration could put the equity markets recovery at risk.



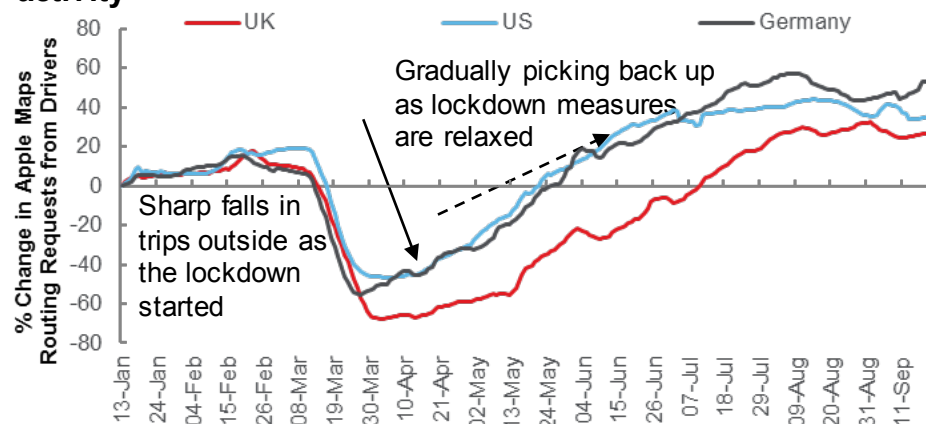
Source: Aon, MSCI, European Centre for Disease Prevention and Control, Hubei Province data sourced from John Hopkins University.
Data as at 21 September 2020.

A historically bad recession, but markets are pricing in a sharp recovery

Q2's GDP contraction was the worst on record, but economists are expecting a sharp rebound in Q3



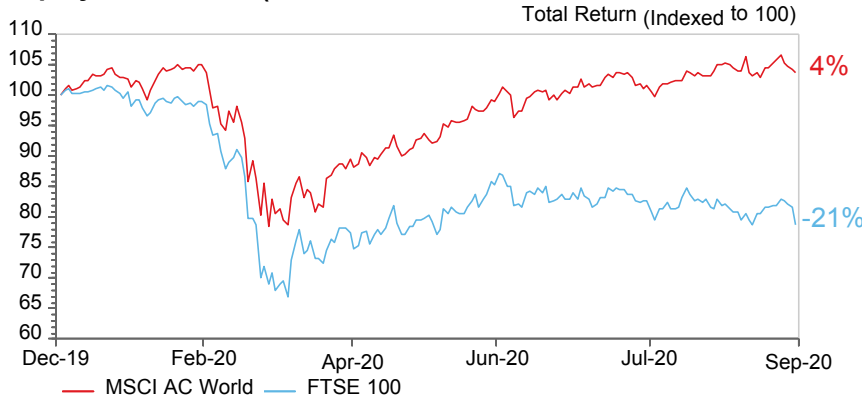
Apple Maps data point to some improvement in transport activity



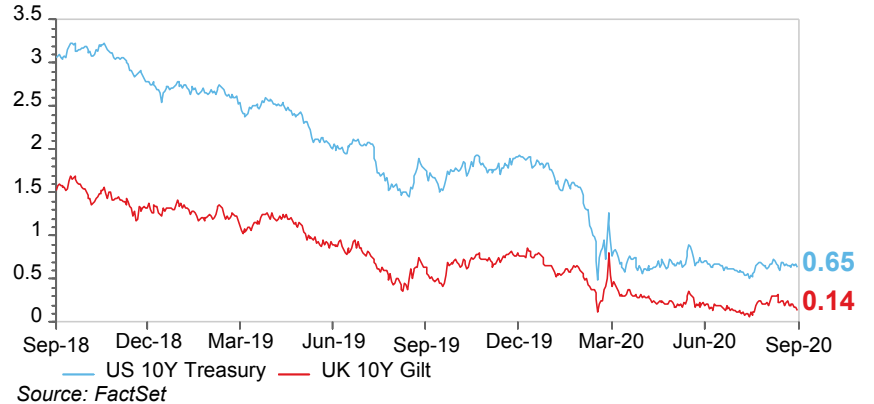
- The “Great Lockdown” looked to have been effective so far in containing the spread of COVID-19, but at the expense of what’s likely to be the worst recession in generations.
- Q2’s economic data was the worst on record.
 - The US economy contracted by 9.5% quarter-on-quarter in Q2, whilst the Eurozone economy contracted by 12.1%.
 - The UK’s GDP fell by 20.4% in Q2, three times greater than the contraction recorded over the whole of the 2008-09 Global Financial Crisis.
- The length and severity of the recession will depend on how quickly things can get back to normal.
 - Many parts of Europe and the US have relaxed their lockdown measures. However, many US states have suspended or reversed reopening plans amidst a second spike in US coronavirus cases, which appeared to have slowed the increase in cases.
 - Getting back to normal would likely take a long time. Social distancing would likely persist even if official lockdown measures ended.
 - A severe “second wave” outbreak is a risk, and if the virus starts escalating again another lockdown may be needed.

Market Reactions

Equity Market YTD (GBP terms)



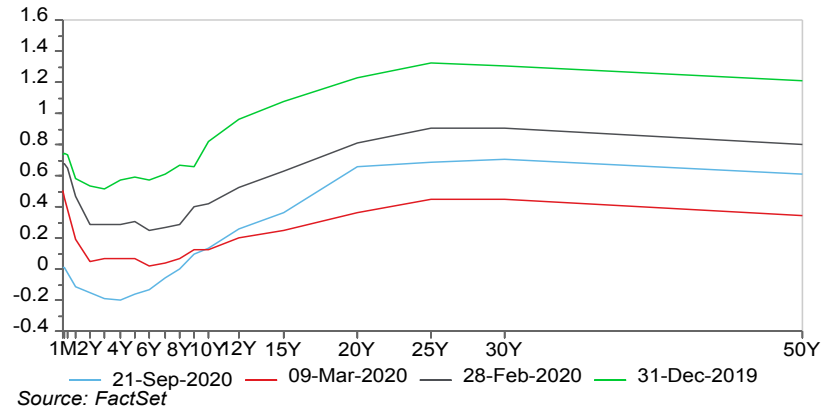
Government Bond Yields (%)



VIX



UK Gilt Yield Curve



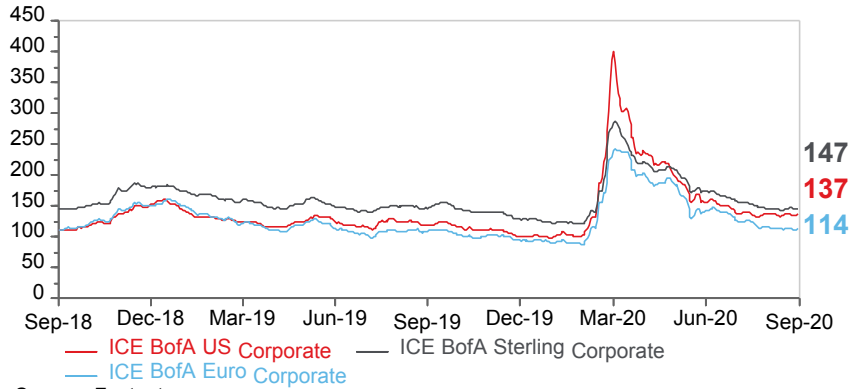
Past performance is no guarantee of future results.

22 September 2020

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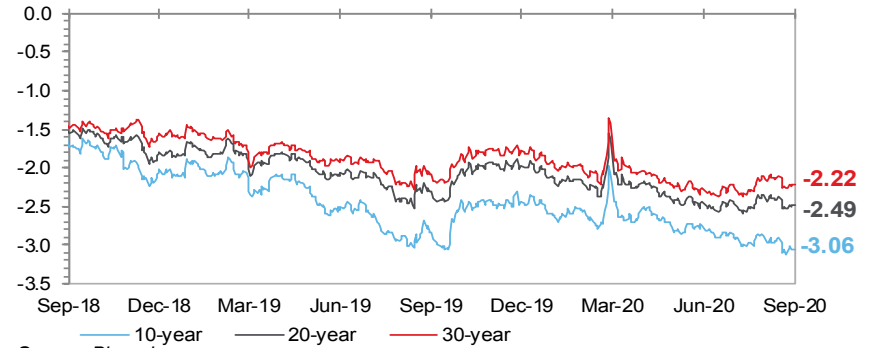
Market Reactions

Investment Grade Credit Spreads (bps)



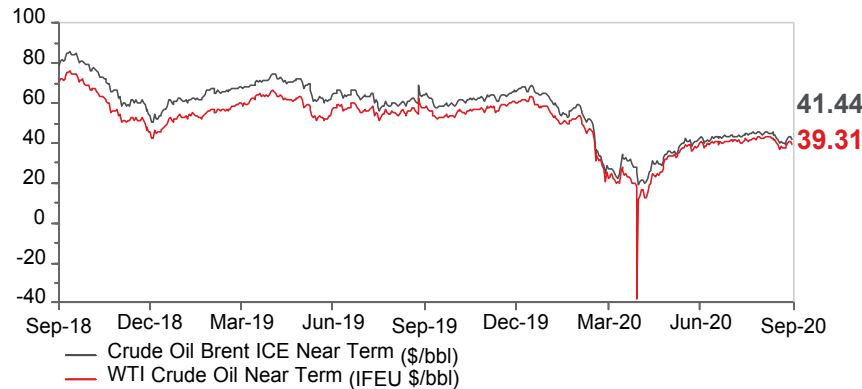
Source: FactSet

Real Yields (%)



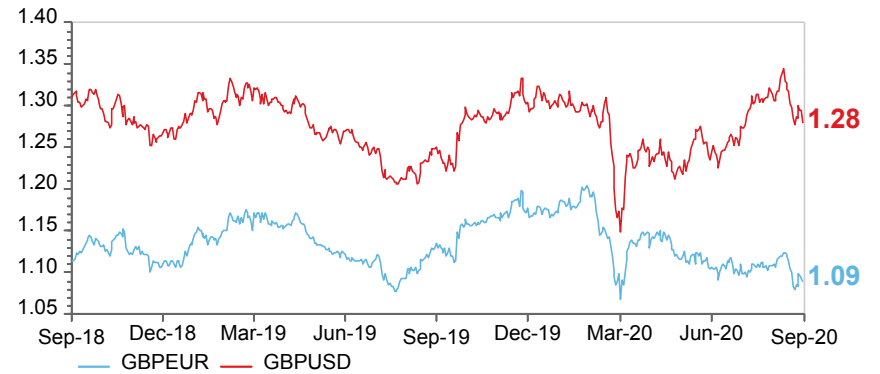
Source: Bloomberg

Crude Oil Spot Price



Source: FactSet

Sterling Exchange Rate

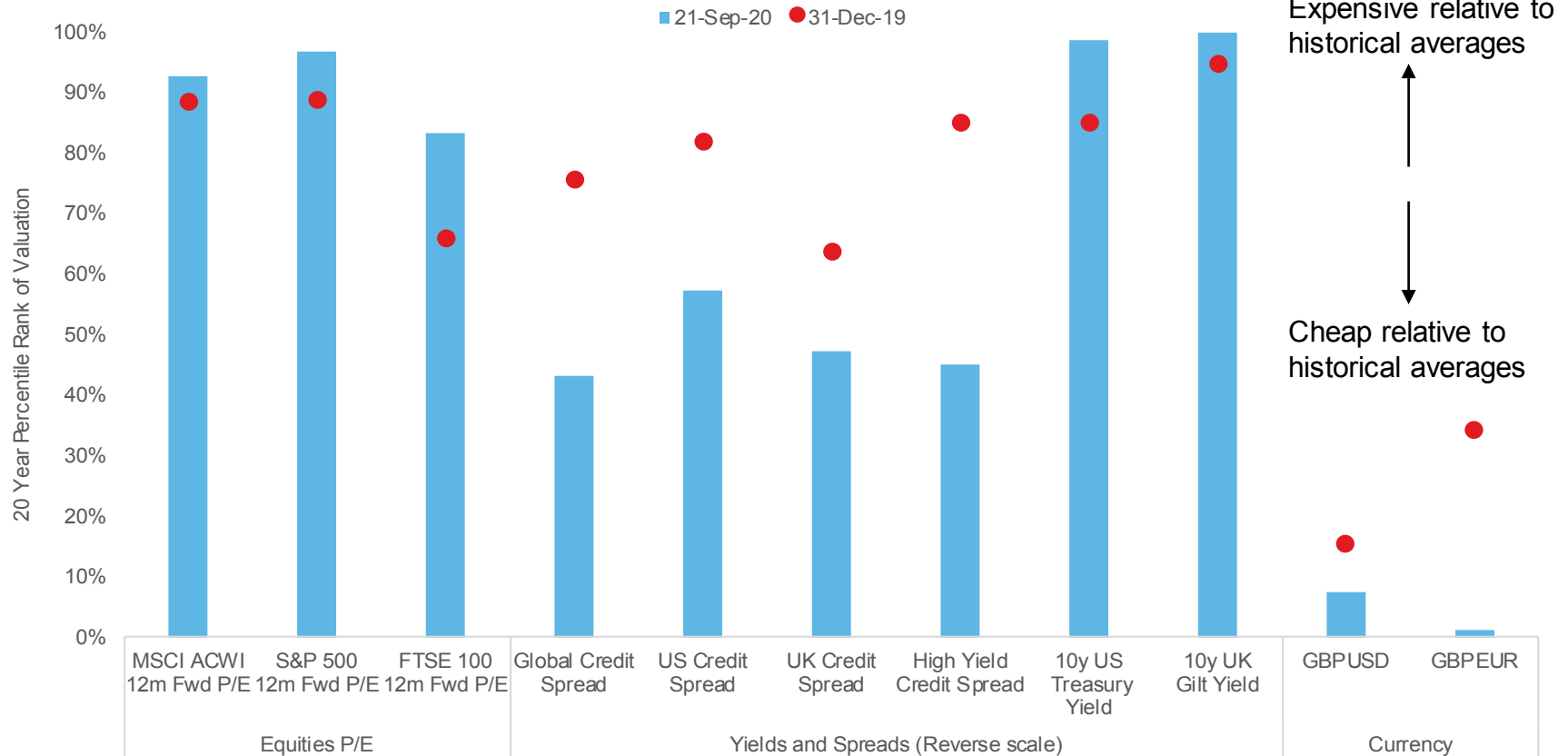


Source: FactSet

Past performance is no guarantee of future results.

Market Valuations

Equity markets are looking expensive when valued using near-term forward earnings, but markets appear to be looking through near-term weaknesses. Note that forward looking measures of value may be using stale estimates, as the economic impact is so uncertain.



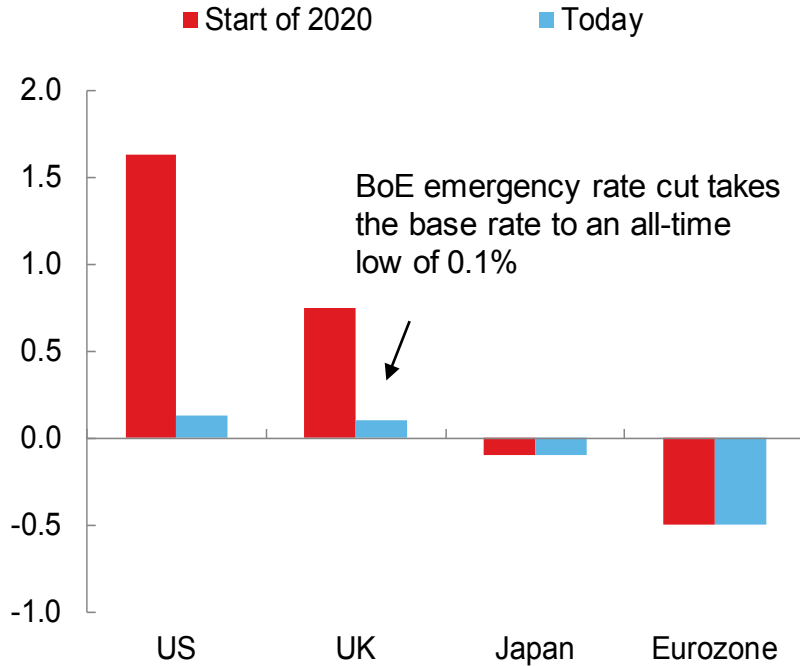
Source: Aon, Factset

Notes: Valuations used: Equity markets = Next Twelve Month PE Ratio, Credit Spread = Option Adjusted Spread, Treasury Yield = Yield To Maturity

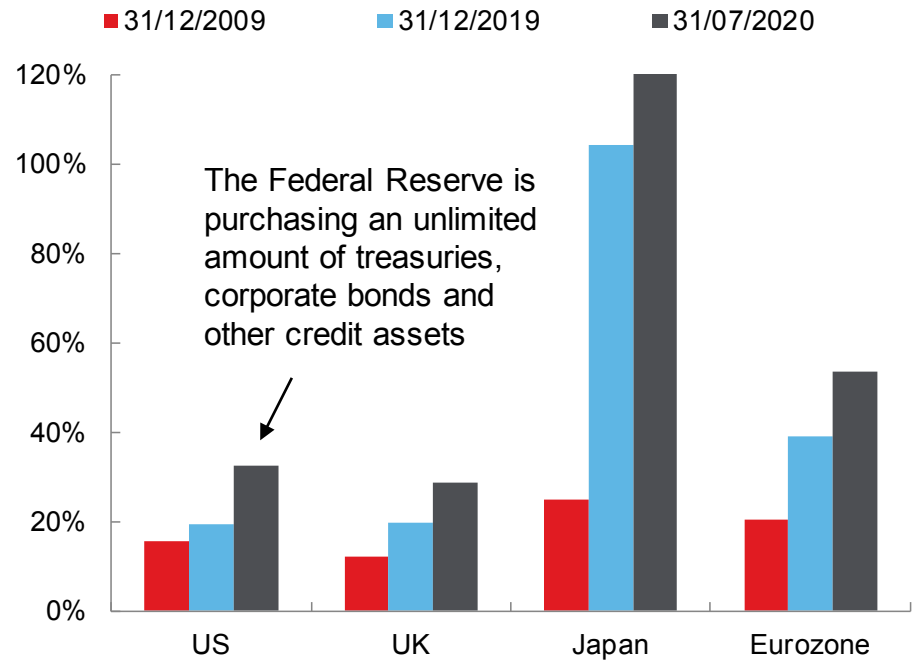
Central Bank Actions

- Where possible central banks around the world have eased policy, but with rates being low there is a limit.
- Unprecedented new quantitative easing measures have been announced to provide further monetary stimulus.

Central Bank Policy Rates (%)



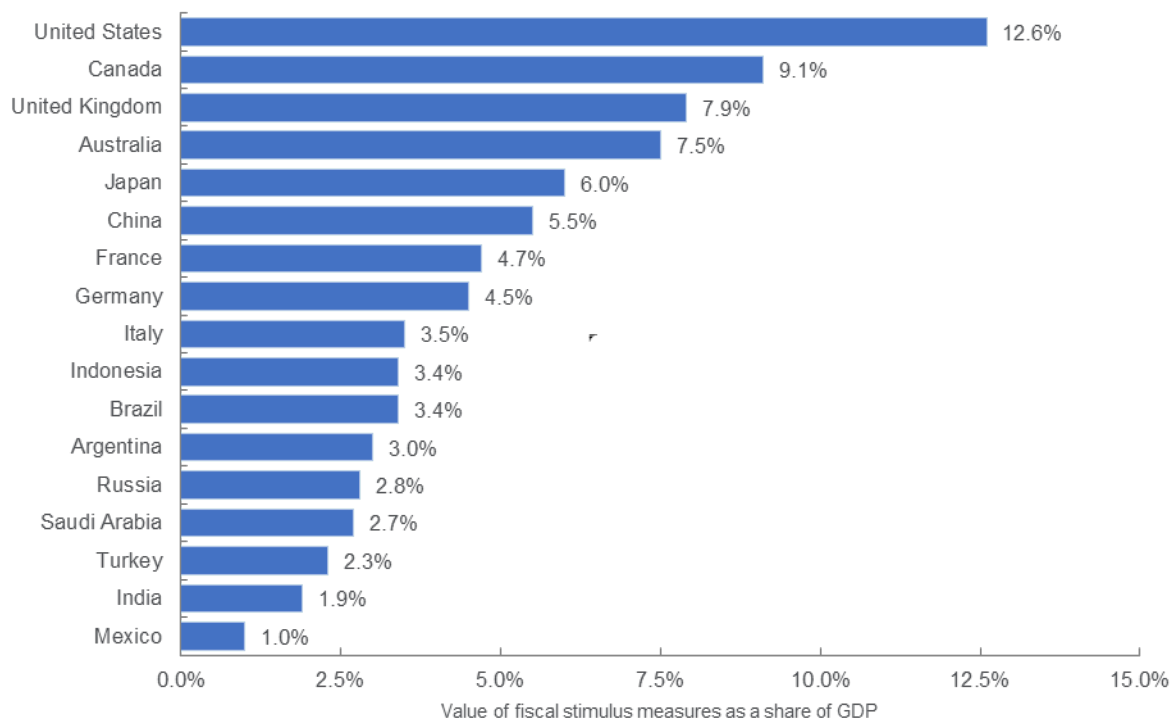
Central Bank Balance Sheets as % of GDP



Source: Aon, Bloomberg, FactSet. Balance sheets to GDP ratios as at 31/7/2020 have been calculated using GDP figures from the end of 2019. Past performance is no guarantee of future results.

Fiscal Packages Are Large Across the G20

Value of COVID-19 fiscal stimulus packages in G20 countries as of July 2020, as a share of GDP



Source: Goldman Sachs

USA:

- A \$2 trillion stimulus package approved in the US.
- A further \$400 billion has been approved and signed into law to replenish funds for small businesses

UK

- £330bn in loans and £20bn in other aids have been announced to provide help to businesses.
- The government has agreed to cover 80% of salary for employees who are unable to work due to coronavirus related shutdowns, but this has been tapered from the start of August, with the scheme ending by October.

EU

- A €750bn recovery fund has been agreed. The proposed package will be funded by issuing mutualized EU debt.

Appendix

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