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B Capital Commentary and Outlook Update 2Q2020

What started rather well for 2020 was derailed by the now well-covered COVID-19 pandemic. Whilst I have written to you a number of times over the last two months to keep you updated with the ongoing healthcare crisis and the effects on the global economy, it's worth just recapping again how the bear market has affected asset prices year-to-date as well as making some forecasts for the future.

During the quarter the MSCI World index of developed market companies fell rapidly over 22 days to a low of -32% on 23rd March 2020, which is a stunning and steep reversal of the gains made during 2019, catching out almost everyone participating in financial markets. Both regional and the emerging markets groupings fell by the same amount and at the same time countries with debt and currency imbalances were strongly affected by the usual investor race to the dollar. High yield and emerging market fixed income, which are not part of the model portfolios, suffered heavily as Saudi Arabia and Russia added to the pain by entering a production war sending the price of oil down -67% from the start of the year to below $20 a barrel.

China used its authoritarian abilities to the maximum and enacted a swift and very strict lockdown in the Wuhan region. Europe, on the other hand, spent two months thinking about what to do and was slow to react. The effect on the first European countries to see significant infections has been dire and remains a tragic story over a month later. The new focus is on the countries with a delayed start to the significant infection rates, such as France and the UK and latterly the United States of America.

A somewhat blasé approach to lockdown will cost economies dear as it has become increasingly clear that the earlier and stricter the lockdown, the quicker the infection and death rates will fall.

Nonetheless, there are some bright spots ahead as at the time of writing the Wuhan region has been released from lockdown and in the first week of April China witnessed its first day without a death from the coronavirus pandemic. Germany has displayed Teutonic effectiveness by introducing an early policy of mass detection in order to separate carriers from the uninfected and as a result has seen a much lower mortality rate than other European countries. The combination of mass testing, separation and lockdown seems to be the way forward. In the first few days of April, the peak infections in Italy and Spain appear to have passed and numbers are in general reducing, indicating that the disease is coming under control.

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For all economies in the first half of this year, the damage to global GDP has been done. How much more damage and for how long remains an unknown but for B Capital and many institutional market participants the base case is that the first half of 2020 will see a significant and sharp recession. The likelihood is that as the global economy restarts in different regions that there will be a strong pick up in demand and hiring which by the third quarter of the year will probably be the fastest rate of growth and hiring ever on record. However, it's important to remember that this will be from a sudden and very low base set in the first half of the year.

The model portfolio asset allocations were upgraded to reduce risk in 2019 ahead of a possible slow down. It would be mendacious to suggest that the coronavirus pandemic was forecast or even thought about before the beginning of this year. But the improvement in the quality of the companies held in the portfolio during 2019 has provided some strength during this sudden bear market. Companies with stronger balance sheets and capital reserves are in a better position to weather the storm versus those in emerging markets where a combination of lower capital buffers and a damaged local currency will necessarily impact profits.

We would expect there to be bankruptcies across certain sectors that cannot operate at all in this environment, such as airlines, cruise liners, hotel groups and amongst the weaker capitalised banking sector in Europe.

We had added gold and silver during the second half of 2019 and although these dipped significantly in the middle of March (likely due to leveraged hedge fund margin calls), they have now recovered back to much higher levels and are starting to provide the kind of balance expected during a period of crisis. Indeed with the dramatic interest rate cuts by central banks around the world and ongoing sense of worry for investors, we expect gold to reach $1800 per ounce this year. That is not to say that we have given up on equities which in our view remain the long-term driver of inflation-adjusted growth rates in portfolios.

The blue-chip nature of the companies owned in the model portfolios have already stood the test and the current rebound underway is somewhat reassuring as negative returns since the stock market nadir on 23 March 2020 have retraced half or more of those negative moves. The short-dated investment-grade government and corporate fixed-income allocations have risen in value as investors have rushed to bonds and cash and (where allocated) our absolute return fund withstood the bear market with a small drawdown of -6%, which has also recovered somewhat after the end of the quarter.

In our active models and of note for advisory clients we have suggested a renewed focus on the corporate survivors and winners from the extended lockdown period caused by the coronavirus health crisis. A 'big tech' strategy has been in place for clients for a number of years and we think that this merits attention today. The background macro picture and detailed research has been sent to you already and I hope that you will consider the benefits to the portfolios of adding an allocation to "e commerce rebound" companies we have selected for the future.

Happy Easter and Stay Safe.

Lorne Baring
Managing Director

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