Prime Partners

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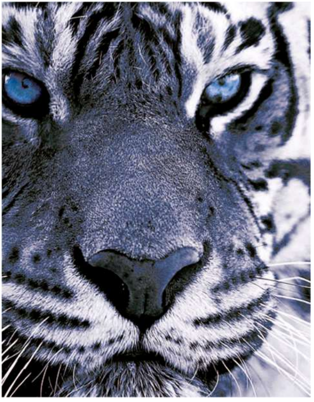
MARKET INSIGHT

MARCH 2020

CITYWIRE TOP 50 INDEPENDENT ASSET MANAGER



Market Analysis

March 2020

Fear returns to the markets with a vengeance – as panic

Covid-19 completely dominated the month of February.

At first, market participants were reassured by mounting evidence that the epidemic was being brought under control in China and this drove risk assets to new highs. Then fears intensified when it was confirmed that the virus had spread to other regions, especially Europe, leading to a sharp fall in stock markets and a retreat to the most secure assets, bonds in particular.

If we take a closer look at market behaviour since mid-January, a few odd signals eould be observed for example, the stock market rally was dependent on a small number of securities, especially momentum stocks; conversely, cyclical equities struggled and safe havens (USD, CHF, JPY, gold, risk-free debt) performed well enough to suggest that the flight to safety had been in the pipeline for some time. In other words, investors were not necessarily as untroubled as the rising equity indices might have suggested.

The fall in risk assets has been all the more precipitous as they had reached lofty valuations in the rally that began in the autumn of 2019.

The VIX index, which rose from under 15 to 40 in just a few days, is a prime example of the wave of investor panic.

Seeing US stocks lose more than 12% in less than ten days is far from normal. And the steep fall in the yields of the safest US bonds is quite extraordinary!

In such circumstances, it is not easy to stay calm, especially as the most irrational fears are nourished by the lack of hard facts.

If we try to put things into perspective, it is clear that there is no reason to doubt that central banks around the world will conduct liquidity injections – in fact, this is to be expected. Secondly, the economic figures published in recent weeks have actually confirmed that the global economy was starting to stabilise at the beginning of 2020. Finally, the latest data from China on the trajectory of Covid-19 indicate that it is possible to control the spread of the disease, once certain measures are implemented.

On the other hand, it is undeniably true that the spread of the epidemic to other continents is an unwelcome development, as this raises doubts as to whether it will be possible to bring the situation under control around the world before the end of the first quarter of 2020, although this cannot be ruled out categorically.

"We recommend that you do not succumb to the prevailing sense of panic."

FRANÇOIS SAVARY, CHIEF INVESTMENT OFFICER, PRIME PARTNERS

It is important to be crystal clear about what we mean here. "Control" does not imply that the Covid-19 problem will disappear within a few weeks; we have never supposed that.

"Control" means being able to show, by means of hard data, that the spread of the epidemic can be contained. In this respect, the figures from China are fairly reassuring.

Similarly, the death rate from this epidemic remains low and it seems that human beings are not all equal before this virus, at least when it comes to the risk of dying from it.

The situation created by the current market correction is unpleasant, especially since panic begets more panic amid so much uncertainty.

Downgrading 2020 forecasts for economic growth and earning is reasonable. Given the severity of the markets' reaction in late February, it could be argued that these factors are to a great extent already priced in.

The question is: will it go any further? Should we consider an imminent, sustained recession that will foster a broader downturn in risk assets over the weeks to come?

We stand by our view that Covid-19 will not lead to a lasting global recession, and that the recovery in growth will be as sharp as the fall that we must expect over the course of the next few months. It still seems reasonable to believe that we are looking at a V-shaped recovery in the economic cycle and profit growth, since the death rate from this illness is so low.

We entered 2020 with a defensive position on equities and we were keen to seize consolidation opportunities to restore our exposure to neutral in view of, firstly, the trade agreement between the US and China, and secondly, the accommodative monetary policy around the world.

While we may have been surprised by the speed with which stock markets have fallen, we do not feel the need to give up on the idea that they have the potential to recover once it is confirmed that the spread of the epidemic has been brought under control.

As such, we are not reviewing our index targets, especially since we based them on lower profit growth forecasts than the consensus.

Our defensive stance has shielded us from the recent shock. Our hedging instruments, which we renewed at the beginning of February, have served their purpose in the recent stock market correction. We will be looking to sell them over the coming weeks.

In a second phase, we might make some purchases in the markets, as simply selling our hedges will be unlikely to bring us back to a neutral position on equities.

In light of the events of the recent weeks, we have devised a plan of actions, which we will reassess constantly as Covid-19 events unfold and their consequences for the global economic outlook become clearer.

We recommend not succumb to the prevailing sense of panic.

Unfathomable are the ways of market sentiment; whatever some may say, predicting future twists and turns is very difficult. The recent correction confirms this in no uncertain terms.

Should we be preparing for a market recovery as swift as that seen in early 2019, for example?

As we will have to be "playing it by ear" on the economic front over the next few months, we are not inclined to think so. After February's shock there will need to be a phase restoring market conditions to normal before we can contemplate a rally that will return stocks to their mid-February levels.

We expect volatility to remain high over the coming weeks. In addition, we still believe that we are far enough into the economic cycle that going overweight on equities cannot be justified.

We must face the fact that economic growth will suffer from the effects of the panic that Covid-19 has unleashed. Accordingly, we are adjusting the time horizon underlying the strategic options that we have reaffirmed above; in other words, the third quarter of 2020 must be included in any stock market recovery scenario, as the first quarter of this year will be so hard hit by the (temporary) effects of Covid-19.

In conclusion, it is always a shame to be holding risk assets when they suffer from shocks as considerable as the one experienced in the second half of February 2020.

Then again, we derive some comfort from having confronted this situation with a defensive position in risk assets. Besides, over the past few months we have urged investors not to overload credit and equity exposure in portfolios. We certainly do not regret this choice. In fact, we reiterate it and say that we still favour equities over corporate debt.

Lastly, uncorrelated liquid alternative assets, which up to a point served their purpose in the upheavals of recent weeks, are still interesting instruments looking ahead to the next 6 to 12 months.

Put simply, we have made plenty of good decisions as well as mistakes!

If we look towards the future and refuse to succumb to the panic that seems to have taken hold of financial market participants, we feel encouraged to hold firm to our strategy of buying on weakness on the stock markets. Likewise, we remain in favour of convertible bonds and alternative assets, as we still have no intention of abandoning our risk management policy.

We had foreseen that the risk/return ratio on portfolios would worsen during 2020. Recent events have shown just how right we were.

Geneva, 4 March 2020

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