Prime Partners

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MARKET INSIGHT

APRIL 2020

CITYWIRE TOP 50 INDEPENDENT ASSET MANAGER

Market Analysis

April 2020

Disruption reigns supreme on the markets

What remains to be written about March 2020, which will no doubt go down in the annals of economics and finance?

The plunge of asset prices says it all: frightened by the spread of Covid-19 and the ensuing economic uncertainty, investors have given way to panic. The ability of price mechanisms to function collapsed as liquidity vanished abruptly from the markets. These developments are easy to explain in hindsight but hard to predict.

The fact that all markets have suffered major disruption (albeit to varying degrees) is evidence of a snowball effect that is in many ways unprecedented.

> "A return to growth in the second half of the year is not unrealistic."
>
> **FRANÇOIS SAVARY,** CHIEF INVESTMENT OFFICER, PRIME PARTNERS

There is no longer clarity on the economic and financial cycle; this has led to reduced liquidity and ultimately aroused fears about solvency. In this context, the price mechanism has fostered what could be termed a "financial crash".

It is not only shares that have suffered over the recent weeks: corporate bonds, the government debt of less stable countries and commodities have all experienced downturns as investors cashed out.

Truth be told, the oil war that Saudi Arabia and Russia embarked on early in the month was "the icing on the cake" that inflamed an already difficult situation. The swift closure of the credit market, which greatly contributed to the freefall of financial asset prices, was a significant event of the past month.

In these circumstances, top financiers and governments were obliged to rise to the challenge. Exceptional times call for unprecedented measures!

After a few missteps to begin with, especially by the ECB, it has to be acknowledged that the arsenal of measures available has expanded greatly in recent weeks. These are historic in their scope, even surpassing those put in place during the 2008 crisis.

In the case of the United States alone, the combined monetary and budgetary initiatives are expected to amount to over USD 6 trillion, or 30% of GDP! It is true that the extent of the economic shock caused by the pandemic will be vast.

By no means does the resolute response from central banks and governments seek to prevent a recession, which is inevitable; the aim is to minimise mass bankruptcies and a permanent rise in unemployment, both of which are synonymous with a long-term downturn in economic activity.

In other words, the purpose of deploying resources is primarily to promote an economic recovery as early as the second half of 2020, once the spread of Covid-19 has been brought under control.

This "bet" by politicians and money market operators that the shock will be savage but temporary appears to have raised considerable doubt amongst investors.

The huge spike in the VIX – the "fear index" – proves that they were dubious (to say the least) about this assumption. They can hardly be blamed, given the lack of short-term clarity and bearing in mind the efforts that everyone will have to accept if the spread of Covid-19 is to be halted in the next few weeks.

We are still inclined to believe that a resumption of growth in the second half of the year is not unrealistic, if more reassuring figures on the pandemic emerge by the end of April. As things stand at present, there is nothing regarding the current situation in China to contradict this theory.

So, despite the insufficiently cautious stance expressed in our last monthly bulletin, we are constructing our investment policy based on this premise.

Events over the last two months have naturally had a negative effect on the performance of our asset allocations.

Of course we regret this, but we think that the pandemic-related damage is to a great extent already reflected in asset prices.

The level of volatility as expressed by the VIX index indicates that fear is the dominant force. The measures introduced by the central banks are beginning to have an impact on the credit markets, although they have certainly not returned to normal and attempts to stabilise yield spreads are still feeble. Moreover, while it is encouraging to see a few investment grade issuers return to the market, time will tell whether this phenomenon will last.

As for equities, whose P/E ratios have contracted by close to 30% in just a few weeks, we feel that the repercussions for business activity have mostly been factored into prices already; in other words, a 20% downturn in earnings for 2020 is envisaged, against the background of a sharp rise in the equity risk premium (far higher than its normal historic level).

Trying to engage in market timing is a dangerous game, which we have always found hard to follow. As such, we prefer to hold to a medium-term course when deciding on our investment policy.

This attitude is all the more justified given the extensive support measures we referred to above. These should reduce the market disruption over the coming months.

In this regard, it is worth mentioning the improved behaviour of stock markets at the end of this period, which seems to suggest that they are attempting to establish a floor after their plummet into the depths. Without doubt, we have to attribute this to the effect of the enhanced monetary and budgetary stimulus measures.

Bottoming-out phases on the markets are hardly ever swift after such extensive jolts as those we are experiencing. However, we must remember that such circumstances give rise to the best bargains, provided that we keep a 12 to 18-month horizon in view.

In short, it is still our intention to once again take positions in risk assets when the conditions are right.

How do we define these conditions? With economic figures hard to predict, we will be watching both the Covid-19 statistics and the credit market. Specifically, we want to see the theories borne out that the pandemic in Europe and the US can be brought under control by the end of April. Investors will then be able to envisage a recovery in the international economy during the second half of the year.

For the corporate debt market, we want the yield decrease that started on 20 March to continue. In fact, for the "back to normal" rationale, events should proceed in three stages: injection of liquidity; re-opening of the credit market; and thirdly, a long-term recovery of the stock markets. The first phase has already been accomplished and the second is taking shape at the moment. As for the third, it is still uncertain, despite the rebound in market prices at the end of the period.

To conclude, while we must admit that we ought to have been more resolute and strengthened the defensive slant of our asset allocations as early as the beginning of February, we cannot rewrite history.

Despite the particularly difficult conditions on all markets for the past two months, we have tried to remain reasonably calm amid mounting panic. Just as panic is often conducive to the wildest forecasts, investors tend to be drawn to a short-term perspective.

Amid the unprecedented crisis that is Covid-19, we applaud the action of governments and monetary authorities, who have shown that they are able to take the long view; indeed, they have fully understood that it is essential to safeguard the likelihood of as strong a recovery as possible once the pandemic is under control.

All the same, we must be realistic. It is important not to let improved market performance at the end of March lull us into thinking that a return to calm is a matter of course. It will take time for stability to be re-established and volatility is set to persist.

Nevertheless, we feel that it is no longer the time for risk-reduction in portfolios.

Identifying medium-term opportunities remains our priority. And we will be looking for them in equities in particular.

As regards our decision to restrict our exposure to credit, and to high yield debt in particular, we continue to hold fast to this course of action.

However, some opportunities in high-quality investment grade debt may be considered.

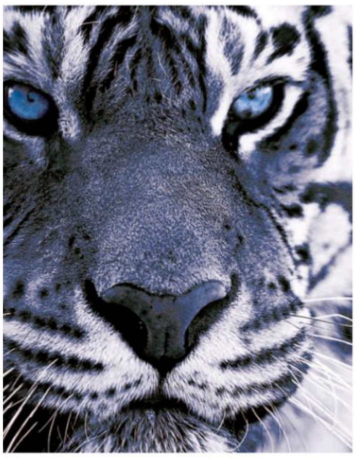
We remain positive as regards gold, despite its erratic performance over recent weeks.

We are still keen on holding alternative liquid investments even though some products have performed disappointingly of late.

In these hard times, we are examining all the various components of our portfolios with a critical eye, assessing their attractiveness over a 12 to 18-month horizon. We have immediately disposed of or reduced our exposure to products we view as having insufficient potential for recovery in the medium term.

Last but not least, we would like to wish you and those dear to you all the best in this extraordinary situation. Our kindest regards,

Geneva, 27 March 2020



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