Market update

Rebound week
Last week a widespread, three-day bounce in risk assets brought much needed relief to markets and investors around the globe. Although the rebound was softening a little into the weekend, the indiscriminate selling of anything and everything, that was such a feature of the previous week, had given way by Friday to a noticeably more orderly trading environment.

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The reason for this welcome pivot in sentiment and price action was a combination of 'bazooka' and 'kitchen sink' policies deployed by the world's central banks. As most of the leadership teams at these institutions had been in place during the financial crisis of 2008, there fortunately already existed a widespread understanding of the need for swift and sizeable action, as well as a playbook of the most effective tactics to put into play.

Existing policies were ramped up in terms of size and scope and new interventions were revealed for the first time. Leading the charge was the Federal Reserve, which enacted multiple programs including the direct buying of corporate bonds and unlimited buying of US government bonds, should that be required. In Europe, the ECB modified the rules on its market purchases, removing limits on the proportion of a borrower's debt they could buy as a means of targeting its responses to the areas of greatest need. The fire hose had well and truly been turned on and by the end of the week it was beginning to settle frayed nerves.

Is it over yet?
Not yet, but we do think that the initial panic phase is ending and that a period of more rational assessment of risk and reward is beginning. A huge hit to markets has been met with a huge response from nation states and all this has taken place in a few, short, extraordinary weeks. With that in mind, it is hardly a surprise that all the necessary ingredients for sustained progress are not yet in place, but at least some of them have appeared and that is an important factor in working out where we go from here.

For example, looking at the basic machinery of the financial system, it was important that actions were taken to ensure the flow of dollars to all parts of the globe. This has happened via the reactivation of dollar swap lines between the US and other central banks and by the end of the week seriously distorted foreign exchange markets had begun to stabilise. The crucial US government bond market is also calming down and as $100bn of issuance last week demonstrates, those companies with strong balance sheets are still easily able to borrow what they need. Whilst there is still a high degree of brittleness underneath the surface of all asset classes, we can take some comfort that fires are being put out rather than left to burn.

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Given that equity market volatility remains elevated and oil markets have not settled, it is still too early to sound the all clear, but as time progresses we think markets are now beginning to zone in on the crucial fundamental task of pricing the economic hit from Covid-19. Much of that impact hinges on how and when social distancing policies are relaxed, and that in turn depends heavily on when infection rates begin to level out. The initial estimates point to something between a -1% to a -4% contraction in global GDP for 2020, quite a range, but one which should narrow rapidly over the next quarter as infection rates begin to peak. We are hopeful for some good news on that front from Italy and Spain as soon as this week or next, with the UK and US following suit over the next two months.

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Similarly, over the next two weeks re-investment flows from hitherto absent pension, insurance and sovereign wealth funds should begin to make themselves felt and if the forced selling of several weeks ago really has peaked, then these seasonal money flows could have a big impact to the upside. Overall, we would say that if the first quarter of the year provided a huge shock to life and to the financial system, the second quarter will be one were we deal with the reverberations. That is both a risk and an opportunity for portfolios and we are positioning now for maximum flexibility.

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What are we doing?

Last week we began the process of rebalancing portfolios to ensure that we have everyone closely aligned to the risk profile they are happy with. In general, this involved taking profits in areas of resilience (gold, gold miners, government bonds and macro trading funds) to direct cash into areas where we see better long run opportunities (equities, convertible bonds and possibly some areas of corporate credit). It's important to note that we are not in a hurry to spend this cash, but we do want to have it available in the right place for the time for when we do want to spend it.

Similarly, it is important to highlight that the first phase of this process involved our dealing team placing over 2000 trades in a morning, without an issue, whilst working remotely from home. Similarly, our counterparties and custodian are matching and settling these trades with admirable efficiency and accuracy. We are fortunate that our industry is familiar with working online and by phone, and although we are all aware just how strange current circumstances are, it is not impacting our ability to do our core job of managing your portfolios.

Thank you for all the feedback by phone, text and email, it is important to us to know that our messages are getting through. We will send you a more detailed quarterly review at the beginning of April. Until our next update, please continue to take care of yourselves.

David Cooke
On behalf of the Saltus Investment Committee,
March 2020