May market update

Another rebound month

May was another month of recovery and healing in global markets, as improving trends in Covid-19 infection rates and the lifting of social mobility restrictions boosted investor optimism. Over the course of the last two months a combination of state intervention and a peaking in infection rates has allowed a wide variety of risk assets to move off their lows, clawing back up to 60% of previous falls, an impressive rate of recovery matched only by the previously impressive rates of decline.

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Although this pace of change is dizzying, it is also broadly rational and explainable. The co-ordinated interventions from central banks and governments have unleashed a huge wave of liquidity into the financial system and real economy on a scale which has never been seen before. In a world where, for example, the US money supply now expanding at an annual rate of 61%, it is unsurprising that previously illiquid, malfunctioning bond markets have begun to work again, and investor sentiment has begun to recover.

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Importantly, these interventions are ongoing, adaptive and still huge in size, with the EU request for a €750bn rescue fund perhaps the most eye catching of recent initiatives. Of course, it is worth reminding ourselves that the purpose of all these measures is to provide a bridge for households and corporations to help crossover from our 'old' normal existence to whatever shape the 'new' normal takes. In that sense, it was perhaps the steady decline in infection rates over May coupled with an easing in mobility restrictions that did the most to boost investor sentiment. Markets are always looking for turning points or, in this case, the point which things 'stop getting worse' and that has now clearly passed in western nations.

Is this for real?

Whilst riskier assets were recovering sharply in May, the safer assets (that had been in such high demand two months earlier) broadly held steady, with little evidence of selling pressure. The fact that markets could cheer a recovery so enthusiastically whilst refusing to let go of assets that might help in a downturn, was a neat underlining of just how hesitant investors are about embracing the end of the coronavirus crisis. The full damage assessment has not yet been made and the prospect of bankruptcies or corporate restructurings later in the year coinciding with a potential second wave of outbreaks is not an appealing one. The forecast by Moody's credit rating agency that US corporate default rates will more than double by year-end is a sobering reminder of the scale of what might be coming.

Additionally, some old risks have re-emerged after being pushed out of sight and mind for several months. Sino-US trade tensions returned with a darker edge, just ahead of the forthcoming presidential election. Closer to home we have the thorny issue of Brexit to deal with, whilst simultaneously trying to build consumer confidence and nurse decimated industries back to health.

> "We can put together resilient, sensible portfolios that have a reasonable shot"

That is a tough background to invest against, but if we draw out a little and look for those longer term opportunities where the valuations of assets have much of this scenario priced in, then we can put together resilient, sensible portfolios that have a reasonable shot at continuing to recover losses and can go on to generate positive returns into the future.

As an investment committee we are looking at opportunities in areas as diverse as commodities, small cap equities and private debt funds which we can blend with cash, safer bonds and gold to match your specific risk profile. It is true that the recovery in April and May has left less of a cushion for bad news in the near future, but from the perspective of the multi-year time horizons your portfolios are managed to, there are enough solid ideas around for us to take advantage of, whilst not getting too carried away with the recent burst of optimism.

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Portfolio performance
Portfolios delivered between +2.5% to +4.5% during May, depending on the specific risk mandate, with the higher risk portfolios returning the most. There were some big moves in global equity managers across the board, with those with more of a growth tilt in the lead. Regionally, Asia lagged the US and UK reflecting the earlier re-opening of their economies and therefore slightly higher starting point. As mentioned above there was very little selling of more defensive assets with strategic bond managers also producing solid, positive returns.

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

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