Investment Update on Recent Market Volatility
Trevor Forbes, Chief Investment Officer – March 16, 2020

The global economy has been hit by two very significant shocks. The Coronavirus (Covid-19) and the ill-timed decision by Saudi Arabia and Russia to target the U.S. shale oil industry have caused significant supply dislocations.

Action to deal with the spread of Covid-19, has resulted in very specific impacts on demand. Significant travel restrictions, bans on events together with whole sporting seasons being severely curtailed, will lead to a demand shock. We have yet to see from the statistics the exact impact on consumer demand from any decline in confidence.

The jobs market will be important to see how short term these effects will prove to be. Companies so far have been reluctant to lay off staff due to the tightness in the availability of labor. This, of course, can change as companies understandably switch to conserving cash as revenues decline.

We have been looking for significant action by policymakers to offset these potential trends. When G7 Finance Ministers and central bank governors met via conference call on March 3, the statement issued indicated concerted action. This was immediately followed by the Federal Reserve Bank cutting interest rates by 0.5%. Eventually, it looks as though the European Union will waive budget constraints allowing individual nations to stimulate their economies. We have so far only seen small tokens and we need to see much more especially from Germany.

Last night in an unprecedented FOMC meeting brought forward by three days, the Federal Reserve Bank has reduced interest rates to near zero and is proposing to buy significant amounts of Treasury bonds and mortgage backed securities from banks in addition to what they had announced less than two weeks ago.

The stock markets globally have understandably been extremely volatile as a result of uncertainty over the likely response from policymakers. Our view has been that once we have a clear direction from central bankers and lawmakers, this uncertainty will gradually dissipate. We are starting, at last, to see some very clear direction from the Federal Reserve Bank and we now await leadership from Congress to respond with a suitable stimulus.

There will be a significant impact on corporate earnings from the measures to contain the spread of Covid-19 and the impact of the oil price war. However, the stock market had fallen from its peak on February 20 by approximately 25% by mid-morning Monday, March 16. The extent of the fall appears, to us, to discount much of the impact on corporate earnings assuming the Covid–19 epidemic can be contained. There are indications that this is already the case in China and S Korea.

Over the last twelve months, you will be aware we have reduced exposure to stocks and significantly increased investment in short dated Treasury Notes where appropriate. This has been a deliberate move to reduce exposure to potential equity market volatility. Many portfolios, as a result, now appear to be below the bottom end of the ranges set as client objectives. Although we should now be increasing equity positions, we will be looking for more confirmation that the policies being announced will have the desired impact of limiting any recession risk in the U.S. and globally. We are not at this point.

Consequently, for many of you, as a result of the action to increase investment in Treasury Notes and the recent decline in market valuation, your account (s) may have fallen below the investment guidelines you previously provided to us. As we mentioned above, we do not believe that now is an appropriate time to be buying equities. We anticipate bringing your account (s) back in line with objectives once the present volatility has subsided and returned to more normal levels. If you would like to discuss your present asset allocation, please do not hesitate to contact us.

Over the last twelve months we have also been restructuring the equity part of portfolios to reduce exposure to economic risk and maintaining and increasing investment in companies that may be relatively immune.

We remain of the view that the Covid-19 virus spread will be contained and note with encouragement that economic activity in China appears to be recovering rapidly. We believe this will prove to be similar elsewhere, but it will take time.

This too shall pass. Investors focused on the long run will be rewarded over time, especially from these equity levels. As we have seen so many times in the past, sticking to appropriate long-term financial plans is paramount in times of stress. In the meantime, we will be navigating the issues as they develop in the most appropriate way for all our clients.