Coronavirus update

| 30 March 2020 |

This letter is the third update on our thoughts and our investment strategy. We hope it will reassure you that in this time of high anxiety we are continuing to act on your behalf with logic, care and diligence.

None of us will now be untouched by the real impacts of the coronavirus. Even for those of us who can maintain our equilibrium in the face of personal threat, concerns for our families and friends, physical restrictions and lack of apparent progress in restraining the virus's spread will present unprecedented challenges. In this context, please forgive any comments in the text below that may seem insensitive. Relating to financial affairs, the nature of the letter is necessarily, as far as possible, analytical and dispassionate.

This letter is structured to answer the following questions: What has happened recently? How has this changed our view on the outlook for growth? What is our view on investment markets and our current investment strategy?

First the facts. At the beginning of March, investors lost all complacency about COVID19. Since then, the spread of the virus has not abated and the UK has joined Italy and Spain (and been joined by Germany and the two most economically important states in America, California and New York) in instituting lock-downs of movement and interaction. Anxiety in the real world has been equally evident in financial markets, and volatility (the daily percentage rise or fall) has hit record levels in global share markets with fixed income, commodities and currency markets also seeing turbulence only exceeded in the 2007 financial crisis.

Governments and monetary authorities have acted aggressively to offset the economic impact of their chosen antiviral measures, policy announcements providing periodic solace for asset markets that have recently seen almost as many sharp rises as sharp falls. Global share prices in sterling terms have therefore fallen by a relatively modest 3% over the past two weeks. At the time of writing, their decline this year is just under 20%, slightly less than their gains in 2019.

So how has our view on the outlook for global growth changed? In our last letter we said that a material global recession and decline in corporate profits over the current quarter was inevitable. The news has not improved. With approximately one-third of the world economy suddenly functioning at around three-quarters of its capacity (on a best guess basis) we must be braced for a recession on a scale more dramatic than anything we have previously seen, however short it may be.

As noted previously, from an investment perspective however, more important than how sharp the fall will be, remain the questions of how soon it will be over and how quickly we will then recover. Our optimism on these two points has not materially changed.

Looking first at our view on how soon the recession will be over, the key is a judgement upon how quickly the virus will be brought under control so that restrictions on activity can be eased. Whilst we are in the midst of an acceleration in viral incidence it may seem wishful thinking to expect better news, but we have great confidence in the ability of the medical community globally to deliver material progress. Their efforts are two-pronged, developing tests and developing a vaccine. To be clear, we do not expect a cure or a widely available vaccine this year; however we do think that, as the World Health Organisation and the UK Government emphasise, more and better testing can be a game-changer. If we can tell when someone has had the virus and recovered from it (widely believed to be many), we can quickly release large numbers of people who may therefore be immune, to return to work.

Looking at a cure, multiple vaccine programmes are likely to produce candidates by the end of the summer. Unfortunately, the nature of vaccine production (it is slow to scale) makes it unlikely that any of the candidates will be widely available before next year, but critical workers (in the medical community) would be given priority and could begin to receive immunity in early autumn. The main point is that COVID19 should not be a recurring nightmare.

With these developments in the pipeline, news that the lock-downs are restraining the progress of the virus in Europe and America, as has been the case in China and Korea, would be doubly encouraging that a turn is near.

So how sharp will the recovery be and to what level? Both depend on how much damage has been done to the fabric of our economies (employment, investment and consumer confidence) by forcibly putting the social-consumption portion of them into hibernation. There will undoubtedly be a one-off release of considerable pent-up demand as social restrictions are eased, but the purpose of the massive monetary and fiscal stimulus programmes announced throughout the world is to ensure that as little labour is shed during this period as is possible, so that the economic engine can quickly “rev up” back to close to its original speed and that the pent-up demand is funded.

Last week was an important week in assessing progress. First, the financial plumbing was tested and found resilient. The Federal Reserve appeared to win its battle with money markets, decisively regaining control of the US Treasury bond market and restoring some discipline to corporate credit markets. Simultaneously, the European Central Bank deployed its €750bn in new firepower and eased the tensions in peripheral European sovereign bond prices. Secondly, fiscal programmes of unimagined scale and scope in peacetime have been passed in the UK and the US, with continental Europe the only disappointing laggard. The encouraging aspect of the UK and US plans, aside from their size, is the innovative and widespread nature of their design. The UK has, to all intents and purposes, temporarily reversed the polarity of HMRC. Its function is no longer tax collection, but income distribution!

In sum, we continue to believe that we should endeavour to look beyond this current crisis. Crucial to this view is our judgement that the financial system itself is resilient and that the monetary and fiscal policy measures taken by central banks and Governments worldwide will substantially protect the fabric of the world economy whilst it is voluntarily shut down (on a rolling basis) to control the viral load on our healthcare systems. Earnings and, unusually, dividends will certainly suffer a blow as corporations (shareholders) share the pain felt by their employees and their suppliers, but when the smoke clears we believe that the intrinsic value (long term earnings power) of the global economy will have been only modestly impaired by this traumatic, but temporary, experience.

We accept however, that advice to look beyond this crisis is easy to give, but hard to follow. The human impact of the virus will continue to grow and even if it passes us by as individuals, it will be harrowing to watch. Our job is to do the right thing on your behalf, not the easy thing. We hope that the thoughts that are outlined above give you some reassurance that we continue to deserve your trust and that you will call us and discuss any concerns or questions you may have regarding the measures we are taking in your individual portfolios to navigate this unfortunate period.

John Haynes
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