Whitechurch Securities Ltd
WEALTH MANAGERS

Quarterly Review

31st March 2020 - 30th June 2020

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Welcome to the Whitechurch quarterly investment review. This review covers the key factors that have influenced investment markets over the past quarter and the Whitechurch Investment Team's current views and broad strategies being employed.

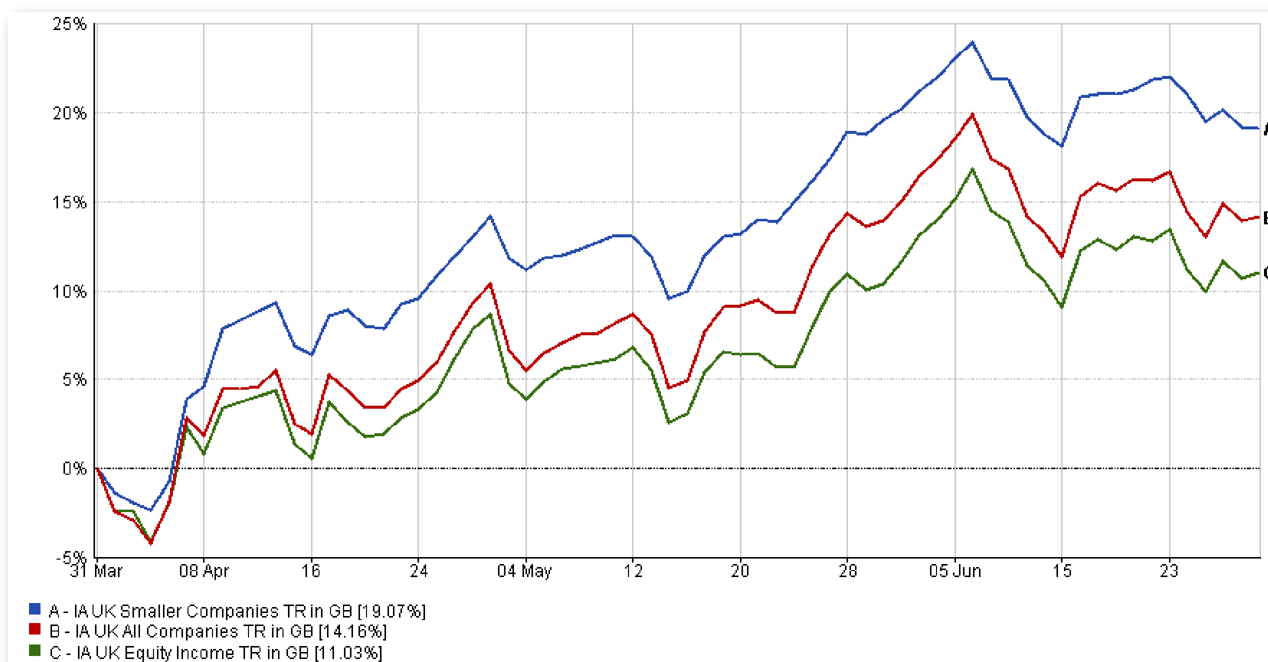
The UK market rose sharply during the quarter. Small and mid-cap stocks led the rally and significantly outperformed large-cap stocks. These gains came despite the nationwide lockdown which brought economic activity in several sectors to a virtual standstill. As a result, many companies were forced to cancel, cut or defer dividend payments. Analysts expect UK dividend payments this year will fall by between 30% and 50%, compared to 2019. The economic pressures facing businesses was confirmed by the release of GDP data for Q1 which showed the economy shrank by 2.2%, the worst quarterly figure since 1979. Economists expect Q2 to be even worse with a fall in GDP of around 20%.

UK Equities	Three Month Total Return %
IA UK Smaller Companies	19.07%
IA UK All Companies	14.16%
IA UK Equity Income	11.03%

The market rebound was driven by the extraordinary policy measures introduced by monetary and fiscal authorities around the world. From a monetary perspective, the huge boost to liquidity, from an expansion of Quantitative Easing (QE) and central bank lending, helped to stabilise stressed asset markets. From a fiscal perspective, new measures to support businesses and individuals reduced the risk of a downward economic spiral from a wave of bankruptcies and mass unemployment. In the UK, policy makers were active on both fronts, following through on the policy announcements made in March. For instance, the Bank of England bought £200bn of bonds, under its QE programme, to bring the total held to £645bn. Later in the quarter, the Bank announced it would extend the programme by purchasing a further £100bn of bonds. At the same time, the UK government announced an extension of the furlough scheme to October as part of its effort to prevent mass unemployment. Under this scheme, nearly 9m workers are being paid 80% of their salary by the government. There is also now a symbiotic link between monetary and fiscal policy – the £300bn of bonds purchased by the Bank of England approximately matches the expected level of new bond issuance required by the government to fund its fiscal deficit. In this way, the Bank of England has helped to ensure that the government's borrowing costs (bond yields) remain at record low levels.

Investor confidence was also buoyed by signs that the rate of new coronavirus infections was on a downwards trend, following its peak in late April. This trend enabled the government to begin to ease the lockdown restrictions which had hamstrung the economy. In June some businesses, including non-essential shops, were reopened. Later in the month, the government announced that the 2m social distancing rule would be relaxed to '1m plus' while bars, restaurants, cinemas and hotels would be free to re-open from 4th July. However, there was consternation in the travel industry as the government introduced a two-week quarantine period for anyone arriving in the UK from overseas. At the time of writing, the government was in the process of negotiating 'air bridges' with various countries under which such rules would be waived. Just before the quarter end, in a reminder of how fluid the situation is, the government moved to reimpose lockdown measures in Leicester following a spike in local infections. The government's failure to develop a comprehensive track and trace system, including a mobile app, means there is a risk of further local shutdowns in response to similar outbreaks.

In summary, the UK market rallied in the quarter having been hit extremely hard by the coronavirus crisis in Q1. This was driven predominantly by the expansionary policy measures undertaken by the monetary and fiscal authorities. Looking forward, the fundamental outlook depends on whether the easing of lockdown measures can be accomplished, both in the UK and globally, without leading to a significant secondary surge in coronavirus infections. In the longer term, the hope is that the development of an effective vaccine can remove the need for all precautionary measures.

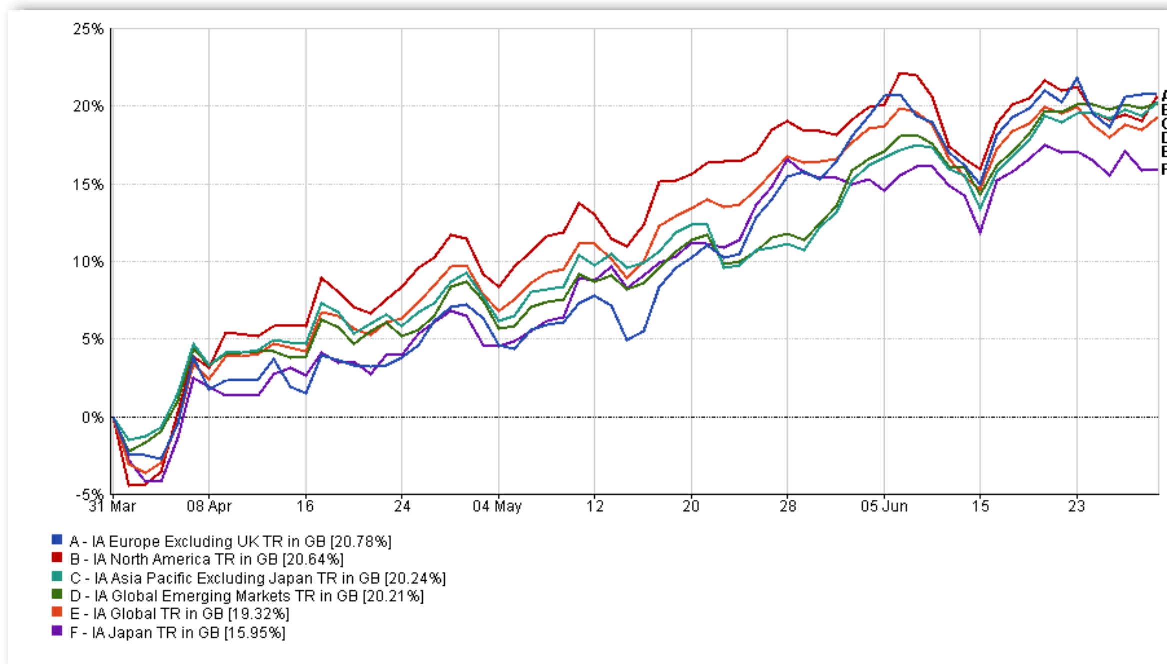


31/03/2020 - 30/06/2020 Data from FE fundinfo2020

QUARTERLY REVIEW

Q2 2020: 31st March to 30th June

Global Equities	Three Month Total Return %
IA Europe, excluding UK	20.78%
IA North America	20.64%
IA Asia Pacific, excluding Japan	20.24%
IA Global Emerging Markets	20.21%
IA Global	19.32%
IA Japan	15.95%



31/03/2020 - 30/06/2020 Data from FE undinfo2020

Global equity markets rose sharply during the quarter despite a grim recessionary backdrop. The International Monetary Fund (IMF) has forecast that global GDP will contract by 4.9% this year and that China would be the only major economy to grow, by just 1%. However, equity markets were pushed higher by the fiscal and monetary policy measures that were initiated in March. In particular, the expansion of QE by central banks stemmed the liquidity crisis in credit markets and reversed the flow of capital into safe-haven currencies such as the US dollar. By the end of the quarter, the speed of the normalisation allowed the Federal Reserve to reduce its rate of new bond purchases. However, Jerome Powell, the chair of the Fed, indicated that he was ready to re-expand QE should that be needed, as in the case of a second wave of coronavirus, stating that, "We of course would continue to react. We're not close to any limits that we might have". At the same time, Powell reiterated the Fed's scepticism towards negative interest rates by pointing towards the "negative side effects" that had been seen in countries that had implemented them. Meanwhile, Congress continued to debate a follow-up fiscal package, to the $2trn relief bill enacted on 27th March, with expectations that the programme would be agreed in July.

During the quarter, statistics were released which showed that the US economy contracted at an annualised rate of 4.8% in Q1. Unemployment rose from a record low of 3.5% to nearly 15% before easing slightly to 13.3%. The Fed's median forecast is for the economy to contract by 6.5% this year, with unemployment falling to 9.3% by the end of the year. However, the underlying assumption behind these forecasts is that the coronavirus outbreak is under control. Initially this appeared to be the case as, following a near nationwide lockdown, the 7-day average of new cases peaked on 10th April at just over 31,000. From there, new cases declined to around 20,000 in early June. However, by the end of June, new cases had once again risen above 30,000. Several states including California, Florida and Texas were forced to reimpose lockdown measures.

There are several competing theories to explain the increase in infections in the US - mass gatherings (protests/political rallies), the reopening of some states (particularly bars/restaurants) and a decline in social distancing practices. There is, as yet, no second wave in the worst impacted states, such as New York, New Jersey and Massachusetts, rather the increase appears to be coming from states that were initially relatively unaffected. This has negative implications for the economy and, potentially, also for the presidential election in November. As a result of the weak economy, widespread criticism of his handling of the epidemic and his response to the ongoing political protests, President Trump has fallen well behind the challenger, Joe Biden, in opinion polls. A victory for the latter would bring additional uncertainty in several policy areas, that are of interest to investors, including corporate taxation and pharmaceutical pricing.

European equities also saw significant gains in the quarter. There was a familiar pattern as the negative economic impact of national lockdowns was offset by expansionary macro policies. Data released, during the quarter, showed that Eurozone GDP contracted by a record 3.8% in Q1 with worse expected in Q2. In response to the weakening outlook, the ECB announced, on 4th June, that it would further expand its QE programme by purchasing another €600bn of bonds which would bring the total acquired under the coronavirus rescue plan to €1.35trn. The ECB also extended the horizon for net purchases until at least June 2021.

Source: Financial Express Analytics. Performance figures are calculated from 01/01/2020 to 31/03/2020 net of fees in sterling. Unit Trust prices are calculated on a bid-to-bid basis OEICs, Investment Trust and Share prices are calculated on a mid to mid basis, with net income reinvested. The value of investments and any income will fluctuate and investors may not get back the full amount invested. Currency exchange rates may affect the value of investments.

Investors were also buoyed by a new EU proposal for a recovery fund which many see as a step towards debt mutualisation. Under this scheme, the EU would raise funds directly in the financial market, creating EU debt instruments, and channel around €500bn to member states in the form of EU "budgetary expenditure". A further €250bn would also be made available in the form of loans. Opposition to the scheme has been led by the so-called "frugal four" of Sweden, Denmark, Austria and the Netherlands. The proposal, which is due to be discussed by member states, in July, requires unanimous agreement before it can be adopted. Most European countries are ahead of the UK in terms of re-opening their economies after lockdown. To date this seems to have gone broadly to plan. Whilst it is true that Germany saw a sharp spike in cases at a meat processing plant this appears to be an isolated incidence and the authorities quickly took steps to bring the situation under control. Investors must also be hoping that the Wirecard scandal, which broke at the end of June, is another isolated incident. The German fintech company announced that €1.9bn was missing from its accounts and that it was insolvent. This is the first time a member of the German flagship DAX-30 index has ever filed for bankruptcy.

The Japanese market rose during the quarter. The coronavirus epidemic has followed a curiously slow path in Japan despite high population density and a relatively lax lockdown. The death rate also remained modest despite an elderly demographic profile (similar to Italy). Various explanations for the positive outcome have been offered including the fact that there was already widespread use of masks (especially on public transport), the custom of bowing rather than shaking hands or hugging, low obesity rates and generally high standards of personal hygiene. Nevertheless, the release of data showed that the economy contracted by 3.4% in Q1 which is not out of line with other developed economies. However, this may be partly due to the ongoing impact of the hike in the consumption tax last year. To offset this, the Bank of Japan took a series of measures to support the economy including further QE as well as a $280bn lending scheme, for smaller business, similar to the Fed's Main Street Lending Facility which is still to be launched.

Emerging Markets continued their recovery during the quarter. This was despite a significant divergence in the pattern of the coronavirus pandemic. In China, the virus appears to be generally under control, although there was a local outbreak in Beijing which resulted in parts of the city being placed under lockdown. By contrast Latin America was extremely hard hit with more than 1.5m infections (800,000 in Brazil alone) while the World Health Organisation (WHO) warned that the pandemic was accelerating in Africa. Many of these countries are vulnerable due to highly populated cities, poor sanitation, weak healthcare systems and poor governance. Of greater significance to investors, however, was the tidal wave of monetary stimulus from central banks.

China was the first major economy to ease lockdown restrictions following a sharp fall in overall coronavirus cases. The pickup in economic activity has been mixed and the government took the rare step of not setting an annual growth target this year. The Bank of International Settlements (BIS) recently summarised the situation, "Three months after containment measures were eased, mass transit was below its pre-crisis level. Production fared better, but inventory in some sectors remains elevated. Personal consumption was the laggard, perhaps reflecting the fall in income resulting from layoffs and pay cuts." To support the economy, the People's Bank of China (PBOC) pledged to maintain ample liquidity by keeping broad M2 money supply higher than nominal GDP growth. Meanwhile the political authorities moved to strengthen their grip over Hong Kong by introducing a new security law. Several western countries have criticised this move, but it remains to be seen whether this will result in significant economic sanctions and/or further trade tensions with the US.

The Russian market was particularly strong, helped by a significant bounce in the oil price. This resulted from the new agreement, reached in April, between OPEC and Russia to curtail production and reduce the overhang of supply that had plagued the market as a result of plunging demand due to national lockdowns. Commodity prices were also aided by the extra liquidity pumped into the financial system by central banks and expectations of a gradual recovery in demand. Elsewhere, investors remained confident in Brazil's prospects, despite the surge in coronavirus cases and slumping economy, reassured by the country's sizable foreign currency reserves and low level of foreign currency debt. The Indian market also delivered a significant gain in the quarter, as investor confidence returned. However, the underlying picture in the financial system remains somewhat troubling. The pandemic and the associated economic lockdown have further exacerbated the bad debt problem within the banking system. During the quarter, Moody's cut India's credit rating to Baa3. All three of the main rating agencies now grade India just one notch above junk.

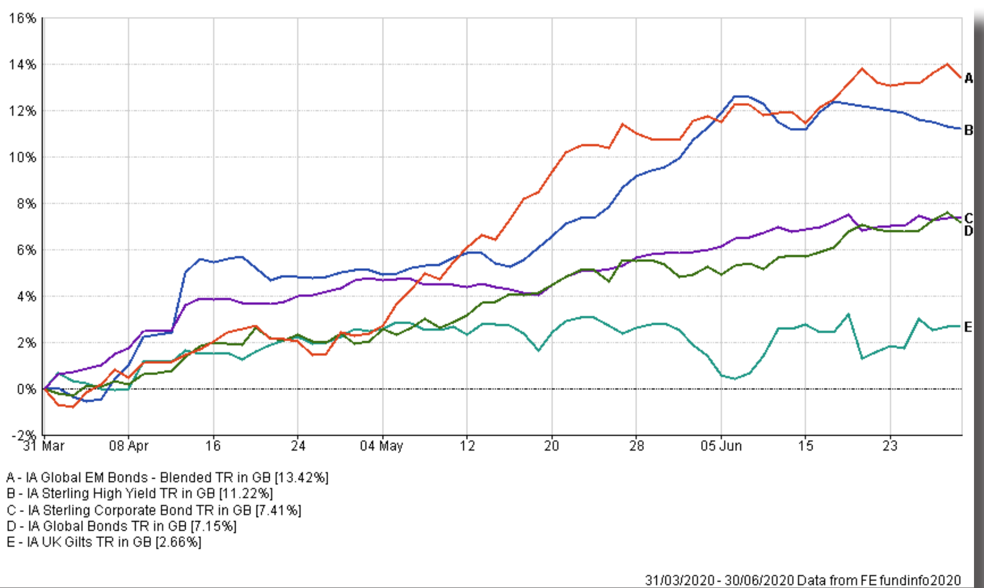
Fixed Interest	Three Month Total Return %
IA Emerging Market Bonds	13.42%
IA Sterling High Yield	11.22%
IA Sterling Corporate Bonds	7.41%
IA Global Bonds	7.15%
IA UK Gilts	2.66%

Most developed market government bond prices were relatively stable in the quarter. Initially, yields in some Emerging Market and Southern European countries edged upwards but this proved to be only a temporary phenomenon. The relative stability in government bond markets resulted from the extraordinary measures implemented by the authorities from March onwards. In particular, the huge expansion in QE by central banks in general, and the Federal Reserve in particular, stemmed the liquidity crisis in risk assets and reversed the flow of capital into safe-haven assets such as US government bonds. In addition, the new EU recovery fund, as outlined earlier, reduced further any selling pressure and led to a rally in bond prices in the European periphery.

In a reversal from the previous quarter, corporate bonds significantly outperformed government bonds. The prices of both Investment Grade (IG) and High Yield (HY) bonds surged due to central bank buying and a growing appreciation that the level of government support for the economy made defaults less likely, at least in the short term. The Federal Reserve's decision to include HY bonds in its purchase programme was particularly important for investor confidence. Corporates took advantage of the more benign market conditions to raise some much-needed capital. For example, Boeing successfully issued $25bn of bonds to help shore up its liquidity position against a background of a weakening order book.

Looking forward, whilst central bank purchasing is likely to remain important for the bond market, there is a concern that there may be

more economic pain further down the line. Any sign that defaults were increasing would be taken negatively by investors. To offset this risk, the monetary authorities may continue to do 'whatever it takes' by adding liquidity into the system. In that case, there is a clear risk that inflation, currently declining, may re-emerge with increased vigour. In that eventuality, index-linked bonds should outperform conventional bonds.



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Commercial Property

IA UK Property	-1.97%

As noted in last quarter's review, trading in most open-ended UK property funds was suspended, in March, in line with FCA rules. The suspension applied to any fund with more than 20% of the portfolio subject to Material Uncertainty (MU). Valuers attached the MU clause to all UK commercial property since they could no longer physically visit properties. More recently, valuers have begun to remove the MU clause in line with guidance from the Royal Institution of Chartered Surveyors (RICS). For instance, the clause has recently been removed from Industrial property. However, it still applies to other areas including Offices and non-grocery Retail. As a result, most open-ended funds remain closed to trading and are awaiting further updates from the RICS.

During the quarter, valuations continued to be produced with MU clauses attached. These showed that the best performing property segments included Industrial, Offices and Retail Warehouses which experienced low-single-digit percentage declines in value. The worst performing areas included non-Food Retail, Car Showrooms, Hotels and Leisure which experienced high-single or even double-digit percentage declines. Clearly this dichotomy in performance reflects whether businesses were able to remain open or subject to a complete lockdown. The pattern on rent collection was similar with, for example, many non-food retailers unable or unwilling to pay rents while their businesses could not trade.

Commodities

Precious metals continued to perform well. In dollar terms, the gold price gained 11% while the silver price rose by nearly 29%. In the first quarter, gold's strong performance had been attributed by analysts to the metal's traditional status as a safe-haven store of value. In this quarter, gold's continued attraction for investors was credited to the unprecedented injection of liquidity into the financial system by central banks and the inflationary pressures that might be unleashed. In Platinum Group Metals (PGMs), there was a reversal from the previous quarter, with the platinum price rising by 11% while the palladium price fell by 17%. The latter largely reflected the completion of stockpiling ahead of the introduction of new emissions regulations in several countries.

There was a sharp recovery in energy prices in the quarter. For example, the Brent Crude oil price rose by 58% to just under $42. This followed the agreement reached, in April, between Saudi Arabia and Russia to end their price war and cut production. Under the terms of the deal, OPEC said it would cut oil production by 9.7m barrels per day, equivalent to almost 10 per cent of global supply, in an effort to stabilise global crude markets. In the industrial metals space, the iron ore price rose by around 17% while the copper price gained 26%. The latter is often seen as a bellwether for the global economy given its wide range of usage across many industries.

Cash

With many bond yields at all-time lows, the opportunity cost of holding cash relative to bonds remained modest. In the short-term, cash deposits insulate investors from the price volatility seen in other asset markets. However, in the long-term, the real value of cash deposits is likely to continue to be eroded by inflation. We currently only hold cash for short-term tactical reasons or within lower risk strategies, where the risk profile dictates a need for a larger cash allocation.

Whitechurch Investment Team, Quarterly Review, Q2 2020 (Issued July 2020)

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