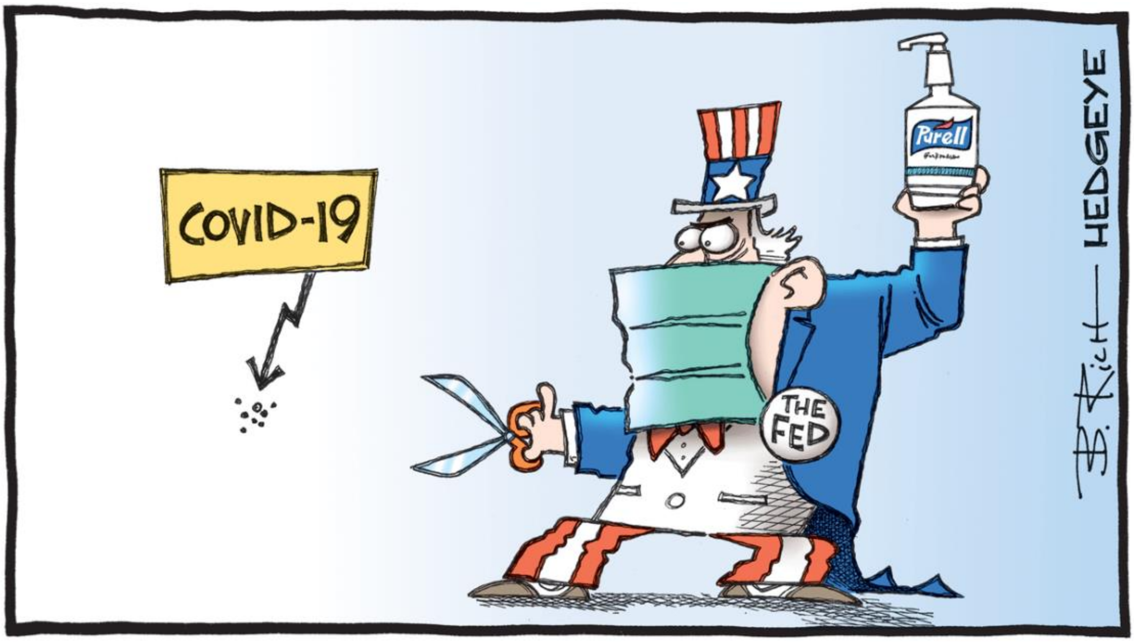
THE **CAMBRIDGE** WEEKLY

9 March 2020

Lothar Mentel

Lead Investment Adviser to Cambridge

9th March 2020



US central bank Fed virus containment action, 3 March 2020

Coronavirus market update – ramping up countermeasures can be scary

Since our last update a week ago, market dynamics have developed very much along the lines we outlined as our expectation. The US Federal Reserve has taken the lead and lowered US interest rates by 0.5% to provide additional monetary stimulus to counter the economic pressures the virus containment actions inflict on economic activity levels worldwide. Western governments have not only taken decisive steps to prevent an uncontrolled spreading of the virus, but are also standing at the ready to mobilise fiscal spending programs to get the global economy back on track, once the worst has passed.

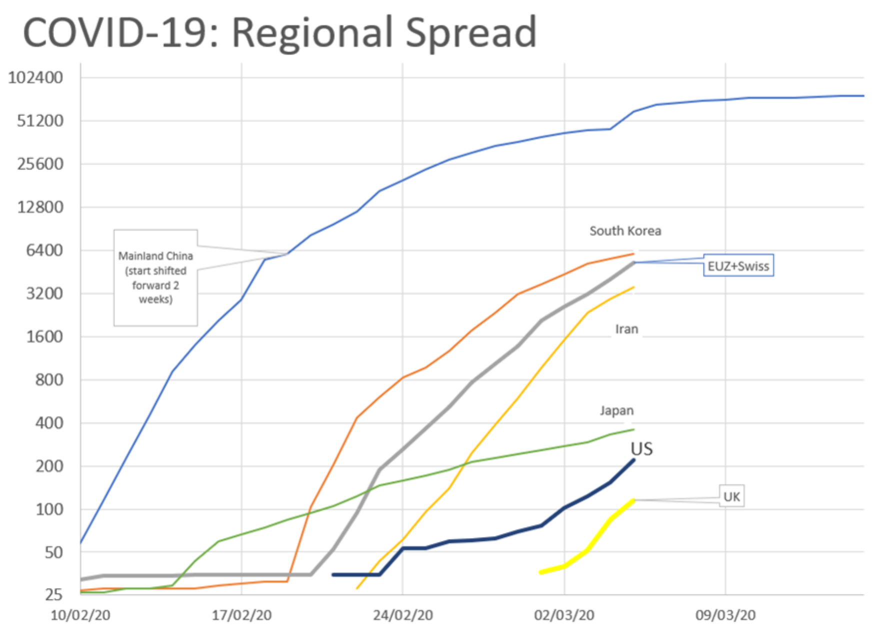
Stock markets in the meantime have done precisely what we suggested and have ricocheted wildly between recovering stunningly, falling precipitously and recovering again, thereby providing the financial media outlets with plenty of headline-grabbing record numbers.

Normally an impressive new non-farm payroll jobs report in the US would be greeted jubilantly, but Friday's announcement that an impressive 273,000 jobs were added in February simply served as a reminder that so much has changed since then. All these backward-looking numbers prove is that employment was in good shape before the pandemic took hold.

As we wrote last week, when a disturbance like the COVID-19 stops being faraway or abstractly economic, rational considerations and impact assessments go out of the window as the disturbance turns into an exogenous shock, resulting in the overwhelming emotions of greed and fear taking control. At the time of writing, markets are experiencing another wave of downdraft, despite the economic data flow surprising on the upside – at least regarding the position the global economy found itself in before the virus fear took grip of everybody's' imagination.

In those tumultuous moments we – as a matter of principle – take a big step back from the noise and look at the bigger picture. From that vantage point, we observe the following:

Capital markets are correct in taking the virus impact as a global challenge, rather than a regionally isolated affair centred on China, as was previously assumed. As our chart recording the growth of infection cases below shows, it is symptomatic for this virus epidemic/pandemic, that once the number of confirmed infections goes above a certain threshold, the increase becomes exponential. In other words, the spread of the virus cannot be contained through quarantining, but only slowed through social distancing, as the slower rate of increase amongst the Japanese society appears to prove (bowing, instead of hand shaking).



Source: humdata.org, Tatton IM

While this may feel disheartening or even alarming to our predominantly UK audience, it does explain the rigorous action plans and preparations that governments across the western world have put in place. They are not overreacting but rather doing all they can to ease the inevitable pressures their healthcare systems will come under, by trying to spread the impact over time.

This is where the first positive point comes in. As can be seen from the chart above, new infection numbers in both China and South Korea have flattened markedly after a certain time period had passed (note that the China graph above was shifted forward two weeks to keep the chart visually compact). The same appears to be true for fatalities. There are a number of possible explanations for this, ranging from populations learning how to reduce further infection through social distancing, - to a limited pool of infirm who get struck by this illness (which is not dissimilar to seasonal flu), the difference being that COVID-19 is affecting people not over the whole winter, but all at the same time. There is even the possibility that China's health professionals may be beginning to have success with the application of various existing antiviral drugs they have been applying on a compassion-driven 'trial and error' basis for more than five weeks now.

From this perspective, the extent and length of disruption to economic activity – and travel – that capital markets have begun to price into risk assets may already be an example of overshooting to the downside.

The other positive to consider is the concerted stimulus action that is possible – and becoming evident – in the face of a common global threat. Politicians, in predictable fashion, never 'let a good crisis go to waste' and even the most fiscally conservative governments – like Germany or the Netherlands – announced over the week that they are standing at the ready to mobilise many tens of €-billions of fiscal stimulus support to get their disrupted economies back on track. Let us also not forget that China has already started its stimulus programs and the Trump administration will quickly follow suit if required. Neither the US or Chinese governments can afford their nations to suffer any more than a very short-term economic downturn as they both face crucial political events over the coming 9-14 months.

So, paradoxically, the worse the interruptions in the short term, the larger the stimulus package and thereby 'economic fuel' further down the line, later in the year and next. From the perspective of long-term investors, this means that beyond the horrible cost of human lives, this virus epidemic may have just extended the already extraordinary life-span of the underlying long term economic cycle, beyond the usual 18 months which economists otherwise never dare to look beyond.

Undoubtedly, the coming weeks will be unnerving and volatility in valuations of personal investments will add to this. We would therefore strongly suggest focusing on one's personal wellbeing, and not the very short-term ups and downs of long-term investment strategies. As we showed in last week's updates, viral epidemics and their economic impact have historically always passed and led to a stronger economic environment thereafter. This even applies in the case of the Spanish Flu of 1918, which was the worst of all global epidemics (and far more aggressive than COVID-19), and hit Western societies when they were at their weakest following World War I.

As the old adage goes: 'history may not repeat itself exactly but it always rhymes'. Attempting to gain from the heightened volatility is the reserve of the bravest and most risk- tolerant market punters. In contrast, those who in the past have stuck to their long-term investment goals and strategies have ultimately been rewarded with consistent and still very rewarding returns, even if the journey at times feels uncomfortable. The most recent example came just over 10 years ago, when there was ample opportunity to yield during the darkest moments of the crisis, but those who stayed patient were rewarded over a relatively short time period.

Fed follows its script – no 'shock and awe' intended

The US Federal Reserve opted for decisive and swift action this week, when its Federal Open Market Committee announced on Tuesday that it would immediately be cutting the fed funds rate by 50 basis points to a range of 1% - 1.25%. In the words of Chair Jerome Powell: "we saw a risk to the outlook for the economy and chose to act."

The response from markets was decidedly volatile. Initially the S&P rallied 8% from last Friday's intra-day low, before backing off a further 4%, to end the day lower. The problem, of course is that loosening monetary policy isn't a potential cure for a global pandemic. Lower interest rates in themselves don't instil confidence, and we are living in a time when confidence (or lack of) is driving investor sentiment.

Also, by responding to mounting pressure to act, particularly after hectoring tweets from Donald Trump which demanded that the Fed "should ease and cut rate big", Powell has helped create the notion that the unanimous decision to reduce the Fed Funds Rate was a result of the Fed bowing to political pressure. Some have questioned the timing, the wisdom and the motivations, of the Fed's shock rate cut, suggesting even that it calls into question the Fed's independence.

We are not inclined to go that far, although we do think that this is yet another example of the Fed using the only tools at its disposal during times of crisis. The problem with attempting to "shock and awe" global markets is that when you apply the same tactic too many times, you end up achieving the opposite effect. Now market participants are asking if the Fed has painted itself into a corner, and whether when it meets next the FOMC will be compelled to push interest rates even closer to zero. That said, the Fed does have a history of swiftly reversing cuts, as it did following its response to the Long Term Capital (fund) crisis in 1998.

Whether the Bank of England's Monetary Policy Committee (MPC) chooses to follow suit is more a question of when rather than if. The next MPC is scheduled for 26 March. Will they wait that long or take emergency actions of their own? If it does go for emergency measures, the most likely date would be next Wednesday, 11 March, namely Budget Day.

The Bank of England's incoming chief Andrew Bailey managed to whip up mutterings of political interference himself this week, after he signalled that he's already discussed with the Treasury "how to ensure the most effective coordination" between the Bank and the new Chancellor of the Exchequer, Rishi Sunak, and that "We can't let our notions of independence get in the way of us".

When Sunak delivers his first Budget Speech, we expect it will include a series of measures aimed at helping businesses and households. With the Bank, like the Fed, almost out of ammunition, the baton must be passed on to governments to act decisively, and to look beyond the immediate medical emergency.

Not only do governments need to rapidly make short-term finance available for companies facing financial distress, almost as rapidly, they need to offer reassurance that demand will resume soon, so that layoffs don't start to snowball. And they also need to give hope to fragile small and medium-sized businesses to ensure that longer-term growth plans are not shelved indefinitely.

On that front, news of the terminal grounding of Flybe this week, after the government rejected its request for a £100 million loan, is disturbing. Naturally, the COVID-19 pandemic made Flybe's case for a bailout even weaker – if airlines are about to enter a prolonged period of near-empty domestic and international flights, who can say whether £100 million would be anywhere near enough?

Retailers are also feeling anxious. Intu Properties, which owns the Trafford shopping centre in Manchester and the Lakeside centre in Essex announced this week that it had failed to obtain an emergency £1.3 billion cash injection from its investors, blaming "extreme market conditions". The company could now breach a number of debt covenants in July.

Both Flybe and Intu are suffering from self-inflicted wounds as well as disastrous timing. The greater concern is that the government may soon have many more cases on its hands where it will have to undertake a risk-based analysis to decide whether it is more prudent to let many of these companies go under, taking hundreds of jobs with them. From that perspective, it is encouraging to see that central banks are prepared to take pre-emptive steps to lower the financial stresses that will be arising from the rising risk premiums companies will have to afford to secure ongoing financial liquidity.

US presidential primaries: ‘Joe-mentum’ arrives

Meanwhile, November’s US Presidential Election match-up started to take shape, as former Vice President Joe Biden emerged as the big winner from the Super Tuesday primaries. So far, forecasts have Biden capturing 10 states, including Texas, whereas his closest rival Bernie Sanders took three states and also appears likely to capture California, the state offering the highest number of delegates.

Biden’s return to front-runner status was all but assured in the beginning of the week, when two of the more centrist Democratic challengers in the race, Mayor Pete Buttigieg and Senator Amy Klobuchar, dropped out of the race and pledged their endorsement to Biden.

A poor Super Tuesday showing forced Michael Bloomberg to concede defeat on Wednesday (he also pledged to donate his well-funded campaign to help Biden beat Trump in November), and the announcement that Senator Elizabeth Warren (another one-time front runner who faded badly) would also be dropping out of the race duly arrived on Thursday. At the time of writing Warren had given no indication as to whether she would be endorsing Joe or Bernie, or staying silent on the matter.

Warren’s absence is considered a boost for Bernie, who will be hoping that her progressive fanbase will switch over to his side. But whether this will be enough to win the race remains doubtful. Part of Bernie Sanders’ appeal (since the 2015 election cycle) has been his ability to galvanise disaffected young voters, who see him as the ‘change’ candidate needed to change the US system. But as yet, his popularity has not resulted in him convincing large enough numbers of young people (historically the segment of the voting population with the lowest voter turnout), to vote for him.

It will be interesting to see how Joe Biden handles his return to the spotlight, now that he has the full backing of the Democratic elite. Biden has a history of making gaffes and missteps, and a long legacy of being a Washington insider. President Trump has plenty of ammunition to aim in his direction, and of course his impeachment trial centred on his determination to find ‘dirt’ on Biden and his son, Hunter.

Judging by the way his erstwhile opponents so quickly combined to endorse him, it appears the Democratic party is convinced that the best way to defeat Trump is to avoid the far-left candidate and go with the return to normalcy that Biden is selling to the electorate. Markets appear to have reacted positively to Biden taking the lead, although analysts have also suggested it increases the chances of a Trump victory in November.

It will be even more interesting to see how COVID-19 affects the election, particularly should things worsen and the US is forced to ban large gatherings and insist people avoid physical contact. Conventions and rallies could be cancelled and we may see politicians avoiding the time-honoured tradition of shaking hands and kissing babies.

Erdogan's brinkmanship raises tensions across Europe

Somewhat lost in the COVID-19 noise and distraction, President Erdogan significantly increased pressure on Europe over the past week, by allowing Syrian refugees to attempt to cross into Greece without restraint. It may be that its timing (in seeking aid from Europe) is not great, given the rapidly rising economic pressure from COVID-19. However, European leaders and the wider NATO alliance will be concerned that Turkey is being driven further towards Russia.

And yet, the burgeoning relationship between Russia and Turkey hit a decidedly difficult patch after Erdogan's opportunistic military campaign on the Syrian border. Erdogan has been increasingly isolated on all sides, after committing his troops to an unwinnable ground offensive against Bashar al-Assad's regime and threatening to draw Turkey into military conflict with Russia. This week, Erdogan appeared to be pushing Turkey deeper into the Syrian quagmire, and moving it closer to the brink of disaster and humiliation.

Erdogan had hoped to carve out a new zone of control in Syria's Idlib province in the North, with the aim of resettling millions of refugees. Putin has been insistent that Assad must have full control over all Syrian territory. The situation escalated when some 33-55 Turkish soldiers were killed by Russian-backed Syrian forces last week, while on a convoy to Idlib. Political tensions have been ratcheting up since, and on Wednesday a fistfight erupted in the Turkish parliament during a speech by a member of the opposition party who accused Erdogan of disrespecting Turkish soldiers who had died in Syria.

The real issue of course, is the region's ongoing battle of wills between liberalism and authoritarianism. And right now, the region's biggest authoritarian, Vladimir Putin, seems to hold all the cards. Thursday's emergency meeting in Moscow between Putin and Erdogan (described as "tense") resulted in a ceasefire. The deal also includes the set-up of a security corridor along the crucial Idlib east-west highway, which is another step towards achieving Russia's key goal of allowing the Syrian government to secure its highways.

Turkey has also brought forward the timeline for activation of its Russian-made S400 missiles, being made operational in April. While said to be defensive, this is a worry for Greece. Nobody looks to be in a strong enough economic position to bear the consequences of more conflict. And the seemingly uncontrolled spread of COVID-19 in Iran puts the region at an even greater risk of stress. Together with the cease fire this some hope that the parties may decide to focus more on what combines, then divides them. Nevertheless, given the Middle East historical ability to generate far reaching disruptions, we will be watching the events closely.

CAMBRIDGE
INVESTMENTS LIMITED

9th March 2020

Global Equity Markets

Market	FRI 15:01	% 1 Week*	1 W	Technical Short	Technical Medium
FTSE 100	6443.5	-2.1	-137.1	↘	⇘
FTSE 250	18640	-3.6	-691.0	↘	→
FTSE AS	3589.0	-2.3	-84.6	↘	⇘
FTSE Small	5321.3	-1.2	-63.4	↘	→
CAC	5126.4	-3.5	-183.5	↘	→
DAX	11466.0	-3.6	-424.3	↘	→
Dow	25437	0.1	27.1	↘	→
S&P 500	2930.6	-0.8	-23.7	↘	⇗
Nasdaq	8430.2	-0.4	-31.6	↘	↗
Nikkei	20749.8	-1.9	-393.2	↘	→
MSCI World	2192.4	2.4	51.2	↘	⇗
MSCI EM	1039.3	3.4	33.8	↘	⇗

Top 5 Gainers / Top 5 Decliners

Company	%	Company	%
Fresnillo	11.7	Carnival	-16.3
Wm Morrison	7.4	Evraz	-15.8
J Sainsbury	6.6	Int'l Consol Air	-15.0
AstraZeneca	6.2	Informa	-14.9
Tesco	5.3	TUI	-14.7

Currencies / Commodities

Pair	last	%1W	Cmdty	last	%1W
USD/GBP	1.305	1.7	Oil	46.84	-7.3
GBP/EUR	0.870	-1.1	Gold	1683.9	6.2
USD/EUR	1.13	2.9	Silver	17.36	4.1
JPY/USD	105.21	2.5	Copper	256.1	0.6
CNY/USD	6.93	0.9	Aluminium	1720.0	1.8

Fixed Income

Govt bond	%Yield	1 W CH
UK 10-Yr	0.23	-0.22
UK 15-Yr	0.42	-0.25
US 10-Yr	0.70	-0.45
French 10-Yr	-0.36	-0.08
German 10-Yr	-0.74	-0.13
Japanese 10-Yr	-0.12	+0.03

Global Equity Market - Valuations

Market	Div YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	5.5	18.5	11.9	13.3
FTSE 250	4.3	21.6	13.0	14.3
FTSE AS	5.3	19.3	12.0	13.4
FTSE Small	3.9	-	-	13.9
CAC	3.6	18.0	13.0	13.5
DAX	3.5	19.8	12.6	12.5
Dow	2.6	18.0	16.2	15.1
S&P 500	2.1	19.2	17.0	16.1
Nasdaq	1.0	25.8	21.6	18.1
Nikkei	2.2	18.4	16.5	16.9
MSCI World	2.5	19.2	16.3	15.3
MSCI EM	2.8	14.6	12.7	11.8

UK Mortgage Rates

Mortgage Rates	Feb	Jan
Base Rate Tracker	2.50	2.48
2-yr Fixed Rate	1.48	1.49
3-yr Fixed Rate	1.65	1.66
5-yr Fixed Rate	1.71	1.72
10-yr Fixed Rate	2.61	2.61
Standard Variable	4.26	4.24

* The *% 1 week* relates to the weekly index closing, rather than our Friday p.m. snapshot values
** LTM = last 12 months' (trailing) earnings;
***NTM = Next 12 months estimated (forward) earnings

For any questions, as always, please ask!

If anybody wants to be added or removed from the distribution list, please email enquiries@cambridgeinvestments.co.uk

CAMBRIDGE
INVESTMENTS LIMITED

9th March 2020

Please note: Data used within the Personal Finance Compass is sourced from Bloomberg/FactSet and is only valid for the publication date of this document.

The value of your investments can go down as well as up and you may get back less than you originally invested.

Lothar Mentel

www.cambridgeinvestments.co.uk | enquiries@cambridgeinvestments.co.uk
Tel : 01223 365 656 | CB1 Business Centre, 20 Station Road, Cambridge, CB1 2JD