Psigma
Investment Management

Brief View from Psigma

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Given the market gyrations of the last few weeks, I thought a brief update would be sensible.

To be clear, the market volatility we have experienced is to be expected given the gravity of the situation concerning COVID-19 and the fact that certain asset markets had become unsustainably expensive. Our views from the early days of the emergence of this virus were that investors were underestimating the likely impact on economic conditions, brought about by fear of the virus spreading from China.

Those fears have now been realised with worrying outbreaks now occurring across Northern Italy, Iran, South Korea and Japan. This has morphed from a Chinese and regional Asian issue into a global problem and efforts to contain the virus within China have failed. Governments and global authorities acted too slowly and failed to grasp the severity of the situation. One can take the view that they continue to do so. It is obvious that both global supply chains will continue to be impacted and that the immediate global economic outlook is, therefore, darker than we assumed at the start of 2020.

Reports from China suggest that certain areas of the economy are getting back to normal; one hopes for the global economy that this is that case, as the longer this went on in China the higher the chance there was of a financial/ economic "accident", as parts of China's financial system have become increasingly precariously unbalanced. However, three concerns weigh on my mind that might mean this resumption of activity in China is premature. Firstly, all emerging research into this virus suggests that the virus has a long incubation period and sufferers are asymptomatic; in simple terms it is hard to tell whether China has been rash in trying to restart its economy. The second point is that China has imposed draconian measures on large parts of its economy; it will be almost impossible for the rest of the world to follow suit with China should they suffer their own outbreaks. Finally, I would take all information out of China and the politically influenced World Health Organisation with a healthy pinch of salt.

The impact upon the global economy will be hard felt in the first quarter and, as we stand now, it will likely drag into the second quarter as well. Predicting how economic conditions pan out beyond that point is currently pointless. There is certainly the case to be made that there will be a strong bounce-back, should the worst effects of the panic surrounding the virus subside. However, economies are driven by confidence; if fears remain, we should expect global economic conditions to undershoot previous forecasts. This will obviously have an impact upon corporate profits.

The obvious question to ask is why many markets outside of Asia and commodity markets simply brushed off any fears of this virus and its swingeing effect upon economic conditions. The chief reason is that nobody now expects any central bank anywhere to even dare think about tightening monetary policy in the coming quarters. Indeed, most market commentators have now joined us in our long-held contrarian view that the Federal Reserve (the "Fed") would cut rates this year; the market now fully expects a cut in US interest rates by June. Personally, I also expect a continuation of the Fed's "not quantitative easing" programme; the Fed might think they have a choice and can stop financing the Trump Administration's deficit, but my view is that they don't. These expectations have led investors to aggressively buy long-duration government bonds, with the US 30-Year Treasury yield hitting new record lows most days at a miserly 1.8%. Amazingly, the whole US yield curve is now below the rate of core US CPI inflation. Gold investments have boomed higher on this news.

The other main reason for markets to continue to defy economic reality is that investors feel that they have no choice because of the Fed's actions but to take higher levels of risk. This combined with the complacency of an 11-year bull market has led certain favoured parts of the equity market to enjoy parabolic moves, fuelled by a tsunami of retail buying. At the same time, the perceived safer areas (and some more questionable parts) of global fixed interest markets have seen their yields plummet to new, previously unimaginable depths (Greece 10-year bond yield at 1%). This panic buying slammed into reverse on Friday and yesterday, with the NASDAQ down close to 4% in one session on Monday. In all honesty, this could just be a pause in the bubble being brewed through a mixture of desperation for a return, investor complacency and the Fed's loose monetary policy. Last week we decided to reduce our positions in investments most linked to these parts of the markets and took profits.

On the opposite side of the expensive assets, there are several good value investments that have become cheaper this year, albeit with the expectation of profitability reduced. The UK, Japan and emerging markets have all lost money this year, setting up a potentially attractive point to increase exposure in the coming months, as long as the situation over COVID-19 doesn't become considerably worse. As a guide, the FTSE 100 Index closed down 3.3% yesterday, taking total losses for the year beyond 5%.

We are taking a steady approach with our portfolios. We maintain a positive long-term view on all the investments within our portfolios, although we are starting to take profits across those investments that have become excessively expensive. We will continue this process. It could well be that we start to rotate into some of the "beaten down" areas of global markets, but before we do so we would like further clarity on the outlook for both COVID-19 and the global economy. At this time, it would be pure guesswork, even if markets are likely to rally in the very short term after the pernicious falls of recent sessions.

Looking further out, it is inescapably obvious where the long-term value remains amongst global investments and we are operating our portfolios with necessary balance and diversification but tilted towards the investments where we feel more confident in being able to continue to achieve our clients' long term aims. Once the current concerns over COVID-19 subside and if central bankers stop manipulating global asset markets then we expect a healthy period of positive returns from such investments to resume.

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