Strategy & Outlook MARKET UPDATE

May 2020

April
Following the worst quarter for global equities since 2008, equities rebounded for their best month in more than 10 years, rising by 11.1% in euro terms. Over the course of the month, the extreme measures to contain the spread of the virus in Europe saw hospital admissions declining in Italy and more importantly the numbers requiring ICU admissions falling. New hospital admissions in New York also began to move lower. Expectations for the beginning of a gradual return to normal grew. China has already begun this process, with restrictions being eased. Elsewhere, the extreme stress in global funding markets continued to abate. Credit spreads have tightened dramatically, helped by the US Federal Reserve's decision to venture into the high yield credit market, another landmark decision to add to the many interventions that global central banks have made. Implied volatility has fallen. Further evidence of the rapid bounce back in Chinese activity came as leading corporates in sectors from luxury goods to staples confirmed the pick-up we had seen in the on-the-ground economic data (traffic, steel consumption, auto sales etc). This bodes well for the West's eventual reopening. Two European travel and leisure companies highlighted how strong forward bookings are as people rebook rather than cancel, setting the stage for a demand squeeze in H2 as pent-up demand of H1 meets natural demand of H2. Technology stocks continued to lead the market higher as they reported. They confirmed seeing short-term benefits from this crisis (streaming subscriptions accelerating, online credit card spend in the US +50 percent, gaming devices sold out, use of data increasing) and also cementing their long-term position as the integral infrastructure of the next decade.
Just how much progress the leading healthcare companies in the US and around the world are making to providing a definitive solution to this healthcare crisis became more evident over the month. Gilead's early trial of its Remdesivir drug showed a profound positive effect in treating those in ICU and a second, wider trial showed even better results. Johnson & Johnson announced they will be able to produce 1bln+ doses of their vaccine by early 2021 and Abbot will roll out 20mln tests a month next month for anti- bodies. Four studies have also shown there is strong potential that the countries most affected by Covid-19 are those without a universal BCG vaccination programme.
On the negative side the oil price move was one for the history books as the front-month contract, that is oil priced in West Texas due for delivery now, traded not only negative but as low as -$40 for a few hours. With short term oil storage in the US close to capacity financial speculators were left to face the reality that oil futures contracts involve delivery of a commodity with nowhere to put it. The situation was exacerbated by a proliferation of retail investors being exposed through ETFs and funds which track front month energy prices as well as a high-profile scandal in an Asian commodity trading house. Prices have recovered somewhat for now. The solid performance of the equity market in the light of this turmoil (and subsequent potential credit issues) is to be noted, especially in light of the continuous calls for "pull backs" after the recent record-breaking rally.

Positioning
We remain at the upper end of our asset allocation range. The changes we have made over the last 2 months were triggered by the signals coming from our three-pillar investment process. There was a 6-month build up that culminated in a 1-month global asset market crash. We entered the crisis at the lower end of the range in growth assets which meant we were able to exploit the opportunities presented by the market crash - investing in equities (moving from underweight to overweight), changing the equity mix in the portfolios (from defensive to cyclical whilst also adding further to high quality equities and structural growth stories) and investing in corporate credit and periphery bonds. These are a combination of strategic and tactical changes. Strategically, equities are attractive, but risk management around certain levels will lead to tactical changes to asset allocation, as always. This highlights the proactive nature of our process, pointing out areas in the market where excessive positioning/risks have built up and avoiding them.

Outlook
Despite the rapid short-term bounce back in some assets our constructive view and positioning remains unchanged since last month. China continues to show the way for a steady but slow economic normalisation post Covid-19. Various activity indicators we monitor improve over the last month. Some corporate commentary recently has been probably more sanguine than economic surveys would have predicted with CEOS from global semi-conductor and materials companies in particular surprising with both the current level of activity and their outlook for the near term. The main economies in Europe have put plans in place for the slow re-opening of their economies in early May. Further stimulus measures were announced for example with Germany considering a "cash for clunkers" style programme whilst in the US the first round of the government stimulus payments arrived in bank accounts. This was met with a surge in online spending, which rose by over 80% year on year. Against all this April has seen the largest net selling of equities in 6 years according to one large US institution to leave their Hedge Fund clients with the lowest exposure to equities in a decade.
In summary, growth has collapsed, but the key question is not how bad it will be but for how long it will extend. Stimulus has been huge. Monetary authorities in 2008 didn't even have the tools they have now have, so it took a long time to first create them, then deploy them – this time, the tools have been deployed very rapidly. In addition, fiscal stimulus is being promoted globally, in the order of 5-10% of GDP, rather than the lurch towards fiscal austerity that characterised the last crisis, which in turn reduced the ability of fiscal policy to mitigate the economic damage. All the ingredients for a significant recovery are there. Whilst in the near-term equities will be heavily driven by moves in credit, news-flow around Covid-19 cases and economic data, for medium term investors equity valuations are now on your side for the first time in years.

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75 St Stephen's Green, Dublin 2. Tel: +353 1 670 2500.
email : info@merrion-investments.ie **web :** www.merrion-investments.ie / www.cantorfitzgerald.ie