INFORMATION FOR INVESTMENT PROFESSIONALS

COLUMBIA THREADNEEDLE INVESTMENTS

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Market updates

Investment team updates | 12 June 2020

Fixed income

- Market were not very happy yesterday, 11 June, with US equities down 6% – the worst fall since March – and marking three consecutive days of falls. Energy was especially weak. Credit spreads are also wider: Global IG is wider by 15bps; European High Yield yields are higher by 0.3% at 5%; US High Yield yields have risen from 6% to 6.8% this week; Emerging Market dollar sovereign spreads are wider by 30bps in just a few days; and core government bond yields are lower – the US 10-year was 1% last Friday and is now 0.7% - although they are still above March lows.
- Why so? The fear and potential emergence of a second wave of Covid-19 in three US states is the root cause: cases are rising quickly in Texas, California and Florida. The US initial jobless claims, meanwhile, did fall to 1.5 million, but continuing claims are still high at 21 million.
- In the UK the economy contracted by 20% in April (compounding a -6% fall in March). Barclaycard says credit card transactions in the UK are down 27% year-on-year in May, from -35% in April. Energy prices - fell with Brent Crude down 8%.
- It's not been all bad news though: the US employment report exceeded expectations by 10 million jobs; the European Central Bank has gone beyond expectations with its Pandemic Emergency Purchase Programme; Germany has delivered a large fiscal boost; there is lower supply and large inflows in IG and HY; and Covid-19 looks to be being brought more under control in increasing numbers of developed markets.
- The US Federal Reserve is appearing dovish and we expect no rate rise into 2022, with QE to be maintained with upside flex. It estimates US GDP will be -6.5% in 2020, +5% in 2021, and +3.5% in 2022. Inflation in 2020 is expected to be 1.7%, which equates to a U-shaped recovery.
- CPI in May was 0.1% year-on-year, while Core CPI was 1.2% – so no inflation at present.
- The trials of the retail sector continue: Inditex (owner of Zara/Massimo Dutti) is to close 1,200 stores out of 7,400.

US equities

Markets

- The S&P 500 ended last week up 4.9%, meaning US equities were higher again for the third week in a row. The market was once again led by value and cyclical stocks, as they continued to outperform growth and momentum names.

- Energy was the best performing sector as WTI crude gained more than 11% for the week, while financials were also strong, led by the banks. Within consumer discretionary we saw some better performance from department stores, restaurants and retailers as the US economy continued to emerge from lockdown. At the other end, the healthcare sector was the worst performer with some weakness in pharma and biotech, while the rotation away from stocks connected to the "stay at home" theme continued in consumer staples.
- Positioning data shows that investors are still underweight equities in their allocation, running at about 40% for non-bank investors, which is below historic averages, suggesting there is still some scepticism about the market exuberance.
- Civil unrest continued in response to the death of George Floyd and although the market wasn't knocked off its upward course, the public gatherings could yet have implications for another wave of coronavirus infections and subsequent damage to businesses.

Economy

- The strong non-farm payrolls jobs number on Friday was a big surprise to the upside, as it showed that 2.5 million jobs were actually added to the economy in May compared to expectations for a 7.5 million decline. The unemployment rate accordingly fell back to 13.3% from a high of 14.7% the previous month. The rebound in leisure and hospitality amid an earlier than expected restart to the economy was a notable boost.
- Expectations for recovery were once again coming through in the data releases last week. Improvements in air travel, truck traffic, restaurant reservations and clothing purchases are showing improvement. US auto sales also rebounded more than expected in May and global PMIs seem to have troughed. growth.

Companies

- Company commentary focussed on the rebound in demand with airlines citing particular strength. American Airlines plans to fly 55% of its normal domestic schedule in July, up 20% from May. Other companies which provided updates last week also majored on the recovery theme: Lyft saw a big month-on-month increase in rides in May, while Marriott is steadily recovering its hotel occupancy rates. Microchip, in the semiconductor space, raised guidance on account of easing supply concerns.

Portfolio activity

- In the American Fund we have added exposure to quality value names in line with our investment process, topping up existing holdings and initiating on JP Morgan.

European equities

- The market has recovered sharply, although unlike the US the main European index has not reverted to positive territory year-to-date. Optimism over the loosening of lockdowns and a quick return to something approaching normality have led this.
- Fears of a second wave, and of continuing growth in the virus in the US and Russia, however, have been put aside.
- Disturbances in the US and the ramifications of the Chinese clampdown in Hong Kong may cause markets to pause for breath.
- Value stocks have led the last part of the rally in Europe, for example banks, travel and hospitality, which is not helpful for our funds. This sharp rotation may, however, be ending, and market direction now varies day by day.

Multi-asset

- The savage falls across equities and corporate bonds have been swiftly reversed, with some equity markets a whisker away from all-time highs. However, the latter half of this week delivered a sharp reminder of ongoing pitfalls as we saw sharp negative returns on fears of a "second wave" in some US states.
- How to reconcile a "sudden stop" in global economic activity with buoyant financial asset markets has been a key area of focus for us. Although the near-term shock to economic activity and corporate balance sheets will be huge, what matters for forward-looking markets is how the world emerges in 2021 and 2022 – our base case leaves us comfortable owning quality risk, even as markets recover.
- An important element of this has been the response from policy makers, which has eclipsed anything we've seen before in both speed and size. The creation of a €750 billion European recovery fund could, in our view, be a game changer, addressing Europe's Achilles heel and taking a necessary step toward debt mutualisation.
- Additionally, last week's increase in the ECB's PEPP program by €600 billion, accompanied by a 12-month extension, was an important development.
- The policy news for the euro area in recent weeks has been remarkably constructive, leaving us feeling incrementally more positive on the euro.
- No other changes made to asset allocation.

Note: all data as at 12 June 2020, unless otherwise specified. Source: Bloomberg.

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