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Reasons to be cheerful (Part 1)

During this period of uncertainty, we are committed to keeping you up-to-date with our thoughts on markets and the funds, portfolios and trusts in which you are invested. Neil Birrell, Chief Investment Officer, provides his latest investment update and explains why there are still reasons to be cheerful.

You will have to forgive the rather cheesy title to this update, but as the song that heralded the advent of Tony Blair's New Labour government said - "things can only get better".

If any of you have read or listened to any of my recent updates they have not been laced with optimism and have all been time stamped. This one was written on Thursday 26th March 2020, the third day of lockdown in the UK. The spread of COVID-19 around the world continues apace, but there are some tentative signs of improvement in some countries, which is obviously good news.

Tuesday was a fascinating day in the markets. The Purchasing Managers Index data coming out of Europe, the UK and US showed the economies to be heading downhill fast and clearly indicated recession looming and yet, through all that, stock markets posted rises of around 10% all around the world and bond prices fell. Not exactly the reaction you would expect, but we live in unprecedented times. That was followed up yesterday with another positive day, although much more modest in scale. Today it is a bit more mixed. European markets are lower, but the US is higher even in the face of very poor jobless claims data, showing that the economy is slowing quickly. However, the market is still up!

I should say up front that I am not suggesting that we have hit the nadir of this market crisis. Personally, I don't think we have, but that is just my view. I have been wrong before and, simply, I don't know. However, the last two days have refocussed my attention on the discounting mechanism in markets. It is easy to get caught up in the noise that surrounds us in periods of market stress. Let's be in no doubt; the dual supply side and demand side shock to the economy is very bad and the stress in financial system is dangerous, but governments and central banks are acting decisively to try and mitigate the damage.

What really drove the writing of this note was a virtual meeting (we are all working from home) I had with the team that works with me on the management of the Premier Diversified fund range which invest across asset classes; fixed income, equities, property shares and alternative investments. They are younger than I am and have not had the experience of going through as many periods of market turmoil as I have. The funds behaved well in the sell-off, but had a tougher time in the last 10 days as correlations picked up on the back of indiscriminate selling across all asset classes. It has been tough.

What struck me during our discussion was their enthusiasm for the opportunities they were seeing in all this turmoil.

Before getting onto specifics, it is worth looking back on some previous periods of severe market stress. The sell-off in the early 1970's was due to the oil price jumping from $3 to $12 and the resulting inflation-driven boom and bust (nothing like now). Black Friday in 1987 came more from speculative activity reversing (nothing like now). The dotcom bubble needs little explanation (nothing like now). More recently, markets lived through the global financial crisis of 2008, the feared break-up of the Euro in 2011, the taper tantrum in 2015 and the end of cycle fretting at the end of 2018... (you get the picture).

They all happened for very different reasons and the recoveries all came about for different reasons - no read over to today is possible. But markets did recover and those who stayed invested made their money back and more. Before the oil crisis in the early 1970's the FTSE All-Share Index peaked at 226 in April 1972, it then fell 70% before bottoming in December 1974, in less than three years it recovered all the losses. The busting of the dotcom bubble saw the index fall 51% from peak to trough and recover in two years and three months. The global financial crisis caused a fall of 48%, recouped in just over four years. This time is different, it always is, but recovery will come. To predict when or how it will happen requires luck not skill and just at the moment, the news flow is so bad it is difficult to guess the when or how, but it will happen.

To get back to the team's discussion, as we went round the group there was clear disbelief at the valuations of some of our holdings, and we asked ourselves: how could others be selling them down here? Could they not see the opportunity? Jon Hudson, who manages the UK equity portfolio, had got on his bike (literally) to visit his local B&M store to see empty shelves. His understanding of the company's supply chain gives him great comfort that they will be selling goods to customers tomorrow and his analysis of the company's financial position tells him it will be around to do so. Jon and Benji Dawes, who he works with, are asking for cash to be allocated to the UK, as they have a number of holdings they want to add to.

In the US we have been adding to Stryker. The company develops, manufactures and markets speciality surgical and medical products. The share price had fallen 43%, it's not clear to us why a good company like that should suffer such a share price fall, it has rallied 21% in the last two days.

In our alternative investment portfolio we hold Hadrians Wall Secured Investments, an investment trust in wind-up with a very high percentage of its capitalisation in cash, which means the rest is standing on a very significant discount. Hipgnosis Songs invests in the musical intellectual property rights and owns the rights to a wide range of well-known artists. It gets paid royalties in a number a ways, including when a song is played on the radio, downloaded or streamed. It is a big beneficiary of the move to streaming services such as Spotify and Apple Music. You might think it is a beneficiary of self-isolation and work from home that is being created by COVID-19. The share price was 110p in mid-January, it fell to 87.5p last week, a fall of 20%, before rising back to 105p this morning. I cannot explain either of those moves to you, other than investors must be selling to raise cash. Nothing has changed in the company or its outlook; maybe if times become hard, less music will be streamed, but this is a long-term secular growth trend.

In our property shares positions, the largest exposure is to German (mostly Berlin) residential property. It has been hit hard in this sell-off but the long-term supply/demand dynamics are compelling, making the rationale for the fall in prices difficult for us to understand.

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I could recount similar examples across our entire range of funds; multi-asset multi-manager, US equities, UK equities, European equities and global equities, I cannot list them all. Our fund managers are finding opportunities to buy into investments that they believe are attractive over the long term at prices that do not reflect that opportunity. There will be volatility along the way but market dislocations give active investors the chance to buy high quality assets at cheap prices.

This update is not intended to suggest you should buy. Far from it, as that is not our job. Our job is to effectively manage our clients' money. We do this by providing high quality investment products and actively managing our products to meet their investment objectives. To that end we take long term investment views whilst looking to take advantage of short term opportunities. Our fund managers are seeing lots of opportunity. However, as Chief Investment Officer, I have to caveat that with; it could go lower first. But recovery will come and good, active fund management can capitalise on the opportunities ahead.

Neil Birrell
Chief Investment Officer
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Data sourced from Bloomberg and FE Analytics.

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