

What a difficult quarter it has been. As we wrote our update for the 4th quarter 2019 at the end of last year, we had never heard of Covid-19. Well, we certainly have now. The speed at which the virus has spread around the world has been astounding and its effect is being felt fully by people and portfolios. I am afraid that such is the rate of change of infections and deaths in the UK that by the time you read this, any commentary that I give will be very much out of date. I have therefore concentrated instead on the matters that have led to sharp portfolio falls in the first quarter and what are thoughts are moving forwards.

So fast has the news deteriorated, we now have the quickest 20% drop in the US market ever recorded. Known as a "Bear" market that represents a 20% fall from a previous peak, this figure was reached on the 12th March 2020 after just 16 days from the previous peak, quite extraordinary when you think it took the same markets 188 days to fall 20% during the great financial crisis. Our diversified portfolios have weathered the market fall better than this, but it has still been a difficult time.

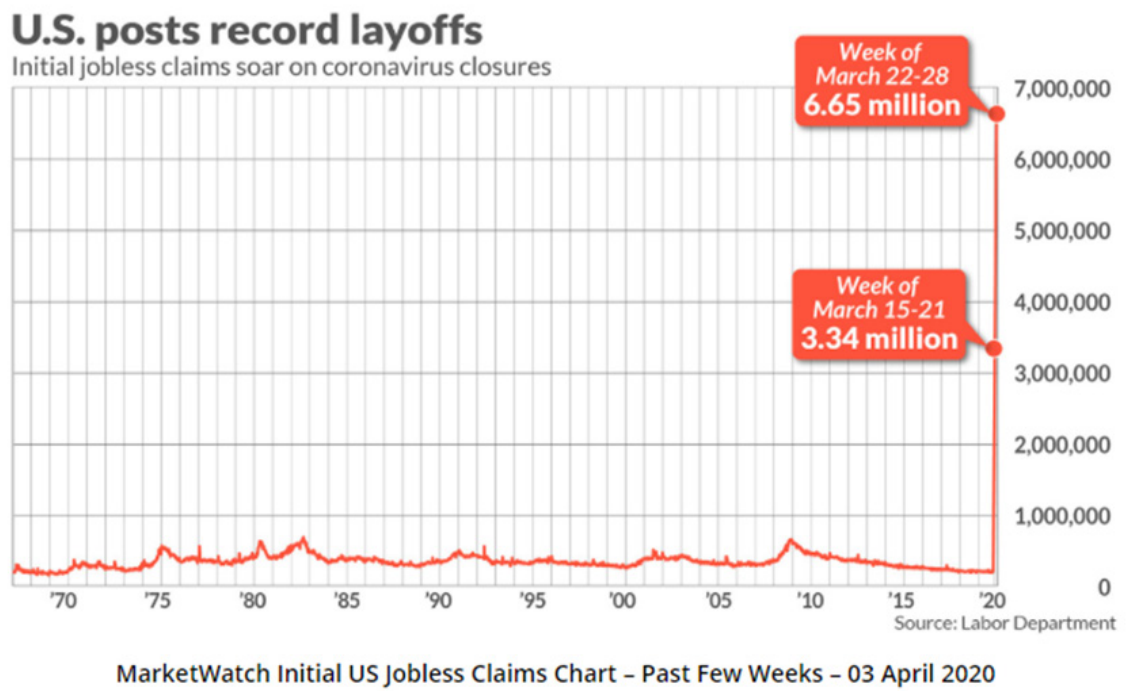
**The quickest "Bear" market in history - the fall of the S&P 500**

<b>Date of bear market</b>	<b>No. of Trading Days to fall 20%</b>
12th March 2020	16
28th October 1929	30
19th October 1987	38
28th May 1962	115
29th August 1966	139
9th July 2008	188
27th November 1973	221
12th March 2001	242
29th January 1970	288
21st October 1957	305
22nd February 1982	310

Although the market falls have been swift, the response from governments and central banks around the world has been just as hasty. Decisions have had to be made based on imperfect and changing information and this improvisation in the UK has led to a dramatic change from misguided "herd immunity" through to full lockdown. Policymakers seem to have absorbed many of the lessons from the great financial crisis and have acted immediately, with significant scale and with an open acceptance that they do not know how much this stimulus will cost, but they will willingly spend it. The US Federal Reserve has said it will buy US treasury bonds in unlimited quantities and in a radical move, the Fed will for the first time buy corporate debt.

In one important respect what we are seeing today is different from anything that has preceded it in modern times. In past crises governments have sought to boost economic activity, whether to fight wars or counter the effects of a natural disaster or a downturn. This time governments are suppressing economic activity, through restrictions on movement, in order to slow the progress of the coronavirus. The vast interventions by central banks and governments are designed not to stimulate activity, but to preserve jobs and businesses for the upturn when it comes.

It is very interesting that the US has taken a different view, where they have added \$600 per month to unemployment payments rather than preserve jobs. This is actually a small pay rise for a large proportion of the recently unemployed (an increase of over 9.9 million in the last two weeks).



The problem is that some of this unemployment may become permanent and it will be interesting to see how the US copes should demand return sooner than expected.

Not only have we had a Covid-19 global pandemic to deal with in the first quarter, but we have also had a trade war break out with regards to oil. The chart below shows the effect this has had on the global crude oil price.



Russia and Saudi Arabia failed to agree on production cuts on the 6th March and are now trying to produce as much oil as they can, to see which national economy can tolerate the strain on its revenues. Such cuts probably would not have raised the already weak oil price, but they would have had the effect of only a modest drop in earnings.

You may note that previous falls in the oil price such as we have seen in March are actually precursors to a significant recovery in global markets as this is effectively a huge cost cut to global trade, however the onset of Covid-19 has pushed any immediate recovery back somewhat.

It is difficult, but at times like this it is important to try and place painful short-term events into a more meaningful context. Bear markets may well be a mercifully rare but nevertheless reoccurring feature but, thankfully, bull markets have historically proven to be more protracted and persistent. Think long term and persevere and you should be rewarded. These times have usually proven later to be times to think about buying, rather than selling up at depressed prices. We continue to monitor our portfolios extremely closely, looking at the levels of leverage (debt) in all the positions that we hold, and our focus is on quality growth companies that can best ride out this storm. Markets and the oil price are at a very attractive valuation point for the longer-term investor, governments and central banks are bringing in unprecedented changes to support the economy. We will, on your behalf, take advantage of opportunities in the market as and when they arise.

The recovery potential of markets is illustrated perfectly in the global financial crisis. On 15th September 2008 Lehman Brothers filed for bankruptcy and the final leg of the down market began. If you had remained invested in the FTSE 100 through this period, just over a year later, you would have been 9.61% above the level on that fateful day. If you had sold your portfolio when the market was looking at its worst in March 2009, you would have lost over 30%. Whilst past performance cannot be used as a guide to future returns, we have been here before and as with previous bear markets, the portfolios will come back from this difficult time.



## **A review of the 1st quarter for CIM Strategic Income**

As it became clear that Covid-19 was moving out of Asia and into Europe and the wider world, we initially reduced less liquid equities by selling part of our holdings in Foresight UK Infrastructure Income and VT RM Alternative Income to buy the Vanguard FTSE All World High Dividend Yield fund. The fund looks for global companies with a higher than average forecast dividend yield. Companies such as Nestle, with strong global demand and high barriers to entry sit well within this new holding.

As the sell-off gathered momentum into March we started to be concerned about the global oil price falls and the effect on high yield bonds. The BAML U.S. High Yield Index looks at U.S. companies who issue high yield debt. The index contains over 900 companies and close to 2,000 bonds, providing a comprehensive view of the U.S. high yield market. An important question to ask is – how much of the index is exposed to the energy sector? The answer is 11.7%. For comparison, the energy sector has an approximate 2.8% weight within the S&P 500. With such large differences in exposure, we recognise the importance of oil prices on the bond market and we therefore cut our holding in Royal London Short Duration Global High Yield Bond fund. We allocated this capital into a more defensive Vanguard Short Term Global Bond Index, hedged back to sterling. We like the attractive opportunities in high yield credit and hope to return to this space soon.

Domestic stocks such as airlines and consumer discretionary stocks like restaurants and cinemas were starting to come under pressure from the threat of governments trying to contain the spread of Covid-19. We therefore further reduced some of our broad equity index exposure, instead choosing to focus on specific strategies that had an equity focus with a more defensive approach. We decided to invest instead in a global defensive income strategy, Trojan Global Income, that looks to invest in global leading companies like Unilever, Roche and Novartis that we expect to defend capital better than peers in the months that follow. We like the strong cashflows generated by these companies that will be invaluable as earnings come under pressure from the global shutdown in trade.

As we reduced exposure to European and US index funds, we invested in a more defensive holding in JPM Global Macro Opportunities and topped up Invesco Physical Gold ETF. I am sure I do not need to write on the defensive qualities of gold at times of market stress, and the JPM fund is a good companion in seeing portfolios through difficult times. We have also bought our first US Dollar Treasury fund as we expect the US Dollar to provide additional diversification and defensive qualities to the portfolio.

The previous changes have helped to insulate the portfolios from the worst of the market in March, but we have also used market weakness to add to defensive equity holdings as the market offered us attractive purchasing points. One such fund is the iShares Consumer Staples fund. The fund is a low-cost portfolio of leading US companies focussed on everyday necessities like cleaning products (Proctor and Gamble / Colgate-Palmolive) and leading brands that consumers are still expected to seek out such as Coca Cola and PepsiCo. We have tried to focus on products that consumers in lockdown will still require / demand.

Towards the end of March, as markets stabilised a little, we also started to increase our exposure to income maximiser strategies. As companies strive to save precious cashflow at this time of low demand, they have started not only cutting costs, but also postponing or cancelling dividends, which will emerge as one of the largest casualties of this crisis. According to a Morgan Stanley survey of European quoted companies: “94% of Retail dividends appear to be subject to suspension, while 70% of Luxury dividends and 68% of Autos dividends are exposed to either cuts or suspensions”. Meanwhile, regulators are putting pressure on the Banks to suspend dividends. In France and Germany, quoted companies will need to suspend dividends to qualify for state aid. The Schroder US Income Maximiser gives us exposure to large US companies in the S&P 500 and has the added advantage of selling call options to boost the dividend it pays out to clients using the premium it receives for these options. This is a mainstream and very liquid derivate option and allows the fund to increase its dividend from the average US equity dividend of under 2.4%, to almost 5% per annum. The Schroder Asian Income Maximiser fund adopts a similar strategy focussed on Asian stocks, with an even higher yield at over 7%. Strategies like this will be invaluable as we move through the rest of 2020.

In summary, the changes do all sound quite defensive, but we are mindful that we need to balance the conservative nature of the clients in this portfolio, with the portfolios ability to still rebound when markets start to improve. The falls in the first quarter have been disappointing for us, but we have implemented sensible strategies throughout the quarter that will see us through this period and will also add value over the longer term to our clients.