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ACTIVE INSIGHT: WEEKLY GLOBAL FIXED INCOME VIEWPOINT

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Sunny times ahead?

April has finished, and what a contrast it was to March. Risk is back on. US High Yield issued more than $37bn of bonds – the highest month in over 3 years. The S&P500 index posted the best monthly return since 1987, yet 10-year US Treasuries widened from 58bps to 60bps.* That is all you really need to know. Treasuries continue to track the overwhelmingly poor economic data. In contrast, equities are focused on the US Federal Reserve support. Which will prevail? I suspect that we will see a bit of a pullback as the reality of the challenges in the second quarter sets in, but certainly not to the same extent we saw in March. The recent Institute of Supply Management survey came more or less in line with expectations; however, the devil is in the detail. New orders fell to 27.1 from 42.4. with the spread to inventories falling to -22.6. According to Bloomberg, this is the lowest in the history of the survey and illustrates that inventories will need to be utilised before new production is required.**

As we move through the second quarter, we'll begin to see the tension between poor data on one side, and alleviation of the lockdown on the other. What we cannot price in at the moment is the length of the time to recovery. What we do know is that the incentive is there to get everyone back to work. According to Gallup, 50% of Americans say that their financial position is getting worse. I'm also beginning to think about how this is all going to be paid for. Clearly taxes are going to have to go up. If this is mishandled, and we see a fiscal tightening before the recovery has taken hold, then we could be looking at subdued consumer disposable income, and therefore lower spending for quite some time.

On to the medical news, there is some progress on Gilead's Remdesivir. To be clear, this is not a vaccine. In the current trial, it alleviated recovery times from 15 days for those with a placebo to 8 days for those taking Remdesivir. It shows progress that there are drugs that can have an inhibitory effect on the virus. At the same time, President Trump has announced Operation Warp Speed, gathering together the best and the brightest in the US to accelerate the development of a vaccine by year end. This seems to be highly unlikely to succeed in such a short time frame - but we can only hope. In parallel there are antibody tests being developed and, in our view, that will be the short-term game changer as we come out of lockdown.

The Fed and Returns

It is interesting to see what a significant effect the US Federal Reserve's intervention has had on fixed income returns;

- BBB rated credits returned 6.4% in April, the best month in the history of Barclays index data, which goes back to 1988.
- April was the best month for High Yield since Jan 2019, with gains of 4.5%.
- Energy High Yield saw record monthly returns of 21%. This really defies belief given most shale producers breakeven at $40.

*Bloomberg (April)

**Source: IMS survey, April 2020

- BB bonds had the best month since 2009, returning 4.78% after March's worst loss since 2008. In contrast, CCC bonds barely broke even with a return of 54bps for April. This is probably the best illustration of the reality of the fundamental situation over technicals.
- More generally, the S&P500 index returned 12.8% for the month, the best month since 1987. Technology stocks led the way, with the NASDAQ posting a 15.5% total return. Despite the problems in Southern Europe, even Italy (3.8%) and Spain (2.5%) had positive monthly returns.
- Commodities are a tale of two opposites - gold surged 6.9% in April, and WTI oil collapsed by 8%.

Sources: Bloomberg and Mirabaud Asset Management, as at 30 April 2020

A word on earnings

The trend is one of general weakness, which will worsen in the second quarter. Most guidance has been withdrawn. The question is whether markets can look through Q2 into the recovery in Q3.

However, there are some practical challenges that will impact earnings. To illustrate the point, Amazon posted first quarter sales of $75.5bn, up 26% YoY. However, earnings fell short of estimates as shipping costs increased by 49%. There will also be approximately $4bn of Covid-19 related expenses. Furthermore, for the oil majors, the decline has been dramatic. Exxon posted a loss of $610m, the first one in 32 years. It is shutting capacity and cutting costs. Chevron had 17 rigs running in the Permian at the beginning of the year, and now has 5. It is shutting 400,000 barrels of daily output.

How are we positioning global portfolios?

The last week in April has been busy for our global strategies. We have continued to buy European investment grade bonds. Furthermore, we have also begun to buy short maturity bonds in market leading companies that we think have the liquidity to get through the crisis - Boeing and Delta Airlines are two examples of this. The US is providing plenty of support for airlines and both companies have accessed the bond market to boost liquidity, (Boeing initially launched a $10bn deal that was upsized to $25bn as a result of strong demand) and the first maturity bonds are well covered. In addition, both are cutting capital expenditure and are making significant efficiency gains to preserve liquidity.

We also bought some Euro government bonds this week as well, on anticipation of the European Central Bank adding more support. We have also begun to re-set the CDX hedge across the funds, and this now stands at 5%.

Our key takeaways

Liquidity trumps all and over the next few months, we will wait for the cold reality of economic damage to set in before adding significant risk.

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