London&Capital

FROM GROWTH, TO UNPRECEDENTED GLOBAL CONTRACTION, TO RECOVERY

Global Macro & Market Outlook
Second Quarter 2020

PARTNERSHIP INVESTMENT CHOICE PRUDENCE

London & Capital's approach to investing is the same as our approach to our clients.

We listen and observe. We ensure we have a complete understanding and then invest accordingly to provide financial stability and investment returns. No hunches, just learning from homework and history.

Call us on **+44 (0)207 396 3200** or visit **londonandcapital.com**

CONTENTS

INTRODUCTION

Pau Morilla-Giner
Chief Investment Officer

The nature of the economic shock experienced in recent weeks is unparalleled, with governments driving economies into recession in order to deal with a public health emergency. The impact on markets has been equally severe and despite some more recent relief for asset prices, a great deal of uncertainty remains, and the situation is fluid.

Financial markets have faced three key challenges that have required separate targeted policy responses.

Pau Morilla-Giner
Chief Investment Officer

GLOBAL MACRO & MARKET OUTLOOK Q2 2020

PUBLIC HEALTH CRISIS

Governments have largely adopted policies of aggressive suppression in order to slow the spread of COVID-19. These measures are showing some tentative success, but it is uncertain how long lockdowns will last and therefore how deep/protracted the economic shock will be. In order to stabilise, financial markets need to be more confident in the effectiveness and duration of government measures.

Key points of focus:

- A great deal of focus will remain on COVID-19 trends in major hotspots along with clinical data from antiviral studies as the focus/narrative of financial markets moves from “stimulus” to “science”.
- Some “flattening the curve” progress is under way, but until there is clearer evidence of a definitive abatement, investors will remain on edge.
- Abatement does not need to be very broad. If a seminal place like NYC saw deceleration in transmissions it would be great for sentiment even if wider case numbers keep rising.
- Clinical data on antiviral drugs from GILD and REGN are due out toward the end of April – these could wind up being the single most important catalysts in the entire month.
- Social distancing is working, but April will still be a brutal month as the COVID-19 fallout peaks, both on the health (transmissions, hospitalisations, deaths) and economic fronts. May should see a modest improvement but not material, however, stocks have probably anticipated much of this during their March slide.

A great deal of uncertainty remains, and the situation is fluid

GLOBAL MACRO & MARKET OUTLOOK Q2 2020

GLOBAL RECESSION

There will be a severe recession in the first half of this year, but without a full understanding of the virus' trajectory it is difficult to be sure that it will not extend further. In order to support the economy through what will be a very challenging period, governments and central banks have launched an unprecedented package of fiscal spending and monetary policy support. If successful these measures will help to offset the economic shock and prevent cascading risks that would deepen a recession (i.e. surging unemployment, debt defaults etc).

This bailout will in time haunt the free markets

”

Corporate impact: sayonara profits, hello cash flow

- Profit forecasts are mostly irrelevant for next 2 months.
- Upcoming Q1 earnings season (which kicks off mid-month with banks) will be a total mess with the whole world in the dark about the ultimate impact of COVID-19.
- Companies will be reluctant to provide guidance and analysts will struggle to accurately model projections.
- Equity investors will therefore shift from a focus on Earnings to Free Cash flow and balance sheets, given emphasis on liquidity. This could be beneficial to the high-quality names in our STAR strategies.

Stimulus consequences post the immediate short-term

- In the US a fourth stimulus bill is likely, but it will likely focus on unemployment assistance and plugging state/local government budget.
- The credit problem has been moved onto the Fed's balance sheet. The stimulus bill will eventually lead to regulation and higher taxes, and a further move away from capitalism.
- This bailout will in time haunt the free markets: How can you lever up to do buybacks (and make executives richer) then ask for a bailout and most importantly have no firepower to buy back your stock when it is cheap because you were so irresponsible?
- The 2008 bank bailout inflated asset values and increased inequality by benefiting the super-rich. Current bailouts come with printed money, which effectively deflates the real wages of the middle class in relation to asset values such as prime real estate.

GLOBAL MACRO & MARKET OUTLOOK Q2 2020

FINANCIAL MARKET STRESSES

The COVID-19 shock triggered a wave of investor selling in many asset classes, not just equities, and this in turn has exposed several financial market vulnerabilities. A surging US Dollar and poor liquidity in bond markets compounded fundamental concerns and increased market volatility. Central Banks have responded and eased these pressures by increasing the availability of US Dollars globally and launching asset purchase programmes to buy government and corporate bonds.

Are we past the worst?

- **There are typically three phases of a market sell-off:**

First phase: De-risking, simply selling to reduce the chance of losing more money as outlook deteriorates.

Second Phase: Indiscriminate selling, when investors are scared or must raise cash. In this phase even safe-haven assets fall sharply.

Third phase: Markets become more predictable in direction overall and the assets that make up those markets behave in a more predictable manner as well. For example, the share prices of companies that should not suffer from the economic slow-down outperform those that will, and companies that are more financially secure benefit accordingly. This does not mean that equity markets will go up, or that volatility in the form of big market moves up and down are behind us, but it could suggest that the price swings between and within asset classes are more predictable and based on fundamentals.

- The short-term outlook for the world economy is as bad as I can recall in my career; economic activity is somewhere between stalling and stopping depending on which industry you look at.
- Commentators have wildly differing views of the shape of the downturn and recovery phase, it depends on your view of the spread of COVID-19, testing profiles and potential vaccines.
- I do not know how any of that will play out, but I tend towards the more pessimistic end of the range; why? Because I can see no clear end point and the world economy will struggle in this environment.
- There are mitigating factors; the actions taken by governments to provide support and finance to individuals and businesses are massive in scale, they just need to have ensured delivery to the point of need. These moves, along with the actions of central banks and regulators suggest that the worst financial market stress will be averted, particularly in the corporate bond markets. I am also reassured by bond holder friendly actions in the banking sector. Following guidance from their domestic regulators, banks across the UK and Eurozone have been cancelling dividends and share buybacks to improve their financial strength and their resilience to a downturn.

Personally, I do not think the impact of the economic slowdown is reflected in asset prices and we could see equity market test lows again, but there will be a recovery.

If markets have moved through the irrational phase, then making investment decisions based on fundamentals will start to make investment outcomes more predictable.

ASSET CLASS VIEWS

- **Credit remains under strain.** The $2T stimulus bill and Central Banks' actions will certainly provide enormous support to credit markets…BUT several industries remain under extreme stress and will remain a drag on IG and HY (including non-airline travel like cruise ships, hotels, etc., energy, and retail).
- **Market valuations** are above the bottom levels of the 2008 Global Financial Crisis. While comparisons are always difficult to make, there is room for asset prices to fall further.
- **Main biases in equities** and bonds still valid:
  - **Underweight equities:** Still relevant.
  - **Bias towards stocks** that have the balance sheet strength and Profit and Loss resilience to see through this crisis: Still relevant.
  - **On the fixed income side,** there is a preference toward asset-backed versus cashflow-backed debt securities, and with special focus on sectors that entered this crisis in a position of strength (for example, large banks and insurers): Still relevant.
- **All crises expose and penalise the weakest links most severely.** Winners are ALWAYS those companies that survive through time. Focus on quality, low-leveraged companies that are best positioned to be self-sustaining through times of turbulence. Companies will take the lead in implementing preventative measures once the worst of the crisis has passed:
- **Retailers** that stayed open during the pandemic (like Walmart) have already adopted changes to ensure the safety of their staff and customers and these will probably become commonplace. Walmart is now checking the temperature of all employees and making masks/gloves available to staff while it (and others) are constructing plexiglass screens to protect cashiers (temperature checks and face masks will likely become ubiquitous throughout society).
- **"Contactless"** will be a huge theme, at least with regards to payments but also perhaps the entire shopping experience as well (such as Amazon's Go stores, a technology it is now willing to sell to anyone who wants it).
- **Airlines** also are at the forefront of preventative techniques, including increased air filtration on planes and the use of "fogging" (which could be adopted by retailers, restaurants, cruise ships, concert venues, movie theatres, etc., as they attempt to entice people back once the crisis has passed).
- **Safety** will likely become a major competitive differentiator: companies that emphasise safety and their anti-COVID-19 steps could achieve a significant advantage over peers. Is the USD on its way to losing a LOT of value in next 3 years?
- **This is a question** with immense investment implications.
- **The argument for a higher USD** is "USD shortage." One source recently estimated the global shortage at $13 trillion. Indeed, the market traded in mid-March as if it wanted a higher dollar.
- **The counter argument** is that the Fed and Trump want a weaker dollar.

The house view is that we suspect that the Fed will keep printing until it gets its way.

GLOBAL MACRO & MARKET OUTLOOK Q2 2020

- **The house view** is that we suspect that the Fed will keep printing until it gets its way. Gold did not behave as expected in March - What happened?
- **Financialisation** of gold through derivatives and ETFs have caused a large mispricing and an unsustainable disconnect in supply and demand for gold.
- **Investors** will increasingly favour physical gold, gold royalty companies and quality gold miners. Owning gold ETFs defeats the purpose for owning gold unless they are 100% collateralised.

Most gold ETFs do not allow for delivery of physical gold.

However...

- **If there ever was** a case of throwing the baby out with the bath water, Gold would be it. Financial markets are never fully efficient, so this is an opportunity to use to our advantage.
- **Interest rates** have been dropped to zero at the fed funds rate level, and the US federal deficit will be larger than 10% of GDP (larger than after the 2008 crisis) due to the $2 trillion bailout.
- **With record deficit spending** and interest rates at zero, we may be faced with an environment where the Fed keeps rates below inflation for some time until the economy normalises after the outbreak is controlled. This would be the perfect environment for gold bullion.

The house view is that we suspect that the Fed will keep printing until it gets its way.

GLOBAL MACRO & MARKET OUTLOOK Q2 2020

DEVELOPED MARKETS OUTLOOK

A few short weeks has changed the way we live, with 'lockdowns', 'social distancing' and 'flattening the curve' now part of our vernacular. The markets moved from cautious optimism at the start of the year to despair by mid-March. Given the enormous uncertainties surrounding our day-to-day lives, not knowing when normality will return makes this macro update the most difficult that we have written even taking into account the GFC (Global Financial Crisis).

We have decided to adopt the route of a Q&A format, responding to key questions which clients have posed to us. This is not an exhaustive list but some of the critical trends that have arisen from the Great Lockdown Recession.

Today we are confronted with a crisis like no other. COVID-19 has disrupted our social and economic order at lightning speed and on a scale that we have not seen in living memory ”

How deep will the economic contraction be?

The Managing Director of the IMF sums it up rather well in her summary of the new World Economic Outlook, "Today we are confronted with a crisis like no other. COVID-19 has disrupted our social and economic order at lightning speed and on a scale that we have not seen in living memory". In the IMF's latest update, global growth is now expected to contract by 3% (representing a 6.3% cut from the forecast made in January) making it deeper than the GFC and similar in depth to the Great Depression in the 1920s. GDP is expected to fall by 6.1% in the major economies, with all countries set to suffer a severe recession in the second quarter. Emerging economies are also forecast to contract by 1%, held up somewhat by China and India who are both still expected to register mildly positive economic growth. However, there will be considerable economic dislocation across emerging economies, with the poorest countries suffering severe economic hardship. Overall the IMF estimates a loss in potential output of almost $9 trillion, unprecedented in size, which means misery for many countries and people.

	Actual	Forecast		Change from January 2020	
	2019	2020	2021	2020	2021
World	2.9	-3.0	5.8	-6.3	2.4
USA	2.3	-5.9	4.7	-7.0	3.0
EU	1.2	-7.5	4.7	-8.8	3.3
JAPAN	0.7	-5.2	3.0	-5.9	2.5
UK	1.4	-6.5	4.0	-7.9	2.5
CANADA	1.6	-6.2	4.2	-8.0	2.4
CHINA	6.1	1.2	9.2	-4.8	3.4
INDIA	4.2	1.9	7.4	-3.9	0.9
AE	1.7	-6.1	4.5	-7.7	2.9
EM	3.7	-1.0	6.6	-5.4	2.0

Source: IMF World Economic Outlook April 2020

GLOBAL MACRO & MARKET OUTLOOK Q2 2020

INTRODUCTION
DEVELOPED MARKETS OUTLOOK
FIXED INCOME
EQUITIES
ALTERNATIVES
FX

How long will the downturn last?

The duration of the recession is dependant initially on the length of the lockdown but also on the effectiveness of the massive policy support that has been put in place across all economies. The projected consensus quarterly growth profiles are eye-opening, with Q2 activity expected to decline by anywhere 10-40% before bouncing back in the second half of the year by a similar magnitude. However, the full recovery may not take place until late 2021 or even early 2022.

There are tentative signs that the virus may be easing in some of the hardest hit European nations and some large Asian economies seem to be stabilising. It is early days but there is hope. China is gradually reopening factories and consumers re-emerging. Within the EU, countries are gradually attempting to re-open towards the end of Q1 2020 and there are signs elsewhere pointing towards planning how to bring lockdowns to an end. Science will guide the way forward, but authorities will eventually have to weigh-up the potential long-term hit to the economy versus the loss of life. A near-impossible choice but one that may have to be made.

If the lockdown is brought to a gradual end towards the end of Q2 2020 or the beginning of Q3 2020, we should begin to see a decent bounce back in activity through to 2021. China will be a key signpost for us all. Clearly, if the lockdown continues into Q3 or reappears later in the year then growth could be even lower. In this case, consensus estimates suggest that the 3% IMF projection may need to be lowered by at least 1%. Of course, the margin of uncertainty means that a quicker and fuller return to normality could act as a positive catalyst.

What will be main reasons for the economic recession?

Social distancing to limit the spread of the virus has and will have a profound impact on consumers, businesses and global trade. As a result, both domestic and external demand will take a substantial hit.

In terms of domestic demand, both personal consumption and business investment are likely to contract significantly. Consumer spending on discretionary items (i.e. cars, travel, luxury goods, new mobile phones etc) will fall significantly in Q2 2020. Spending on necessities may hold up but will not be enough to offset the impact of the closure of retail shops and outlets. The sharp rise in unemployment, albeit with wages being supported in many cases by governments, may add to consumer cautiousness through the remainder of the year.

Business investment and output will inevitably come to a halt in most cases (apart from essential goods including medical supplies). The disruption to supply chains particularly from Asia has had a profound impact and even though China is gradually reopening, there is now disruption for the end manufacturers across the Western economies. This will be offset by the pump-priming by governments but nowhere enough to prevent a sharp contraction in Q2 2020.

The duration of the recession is dependant initially on the length of the lockdown but also on the effectiveness of the massive policy support

What positive action has been taken by policymakers?

The good news is that fiscal and monetary policymakers across the globe have responded aggressively to offset the impact of the lockdown and are set to add to the stimuli. Independent economic experts have calculated that the combined global fiscal and monetary support is now approaching almost 30% of Global GDP with more action likely after lockdown ends. This is not surprising as governments have to offset the forced lockdowns they initiated.

Monetary Policy: There is a multi- faceted assault by Central banks.

(i) Interest rate cuts of almost 1.00% globally, with advanced economy rates down by just over 1.00%. The Federal Reserve responded with two emergency cuts taking rates close to zero, to the so-called lower bound, which may well be breached in coming months. Other key Central Banks followed suit cutting rates close to zero and wherever already in negative territory introducing lower tier levels.

(ii) New and enhanced asset purchase programmes. The Fed has stated that there may be no cap to the buying of Treasuries and Mortgage Backed Securities. They have added corporate bond purchases including ETFs to their rollout. Variants of the Fed package have been unveiled by all major Central Banks. Estimates suggest that the balance sheet of the major Central Banks may well double to 60% as a percentage of GDP.

(iii) Credit and liquidity facilities to ensure the smooth function of markets. Banks have been provided with enormous facilities to ensure credit flows to hard pressed consumers and businesses remain unimpaired. It is important to note that this flow of liquidity is not to shore up bank balance sheets, as in 2008/2009.

GLOBAL MACRO & MARKET OUTLOOK Q2 2020

Fiscal Policy: This is also multi-faceted.

(i) Direct fiscal easing led by a near $2 trillion loosening in the US and the likelihood of a further $1 trillion package. This amounts to a discretionary loosening amounting to almost 8% of GDP. The global fiscal easing is almost 10% of GDP with more yet to come. There is direct and targeted support for consumers (income support), business (tax breaks and grants, loans and rebates) and employers (tax breaks, grants, loans and income support measures).

(ii) Loan guarantees that will support businesses but also consumers. The US programme amounts to almost a fifth of the GDP at $4 trillion whereas the German equivalent is even bigger at 25% of GDP. Italy's support is approaching 50% of GDP.

(iii) Liquidity for banks to ensure that they can use the strength of their balance sheets to support businesses and consumers. The scale of the lending programmes is enormous and inevitably it has stumbled largely due to the unprecedented demand. Regulators have also eased on requirements to allow greater forbearance allowing consumers and businesses to delay payments and not suffering credit impairment.

(iv) International organisations such as the IMF and World Bank are using their resources to help the economies that need it most. The IMF has made around $1 trillion available to emerging economies and is also likely to alleviate debt repayments and even debt write-offs where necessary.

(v) The next stage of support (post-lockdown) is likely to include tax cuts and large infrastructure plans including spending on technology, productivity enhancing production means and re-directing global supply chains.

Governments and Central banks have responded quickly and aggressively. They have certainly provided the support for a quick recovery but we await positive news on the spread of the virus coming to an end and normality returning.

What is left to discuss in coming months and quarters?

On-going analysis will allow more pertinent discussion around the following issues in the coming months:

- Will inflation emerge from the current deflationary shock?
- Will globalisation now face the biggest challenge even greater than President Trump's rewriting of trade agreements?
  Will multinationals decide to re-orientate supply closer to home?
- Will the move to cleaner technology accelerate considering the immense drop in global pollution levels?
- Will governments accelerate the shift to faster internet/broadband technology to enhance productivity?

FIXED INCOME

GOVERNMENT BONDS

- **Government yield curves have steepened somewhat, potentially more to come.**
- **Despite many G4 central banks upscaling Quantitative Easing (QE) efforts, better value is offered by credits.**

Yields on many Developed Market (DM) government bond markets hit all time lows as an initial reaction to COVID-19 in early March. The swiftness and the sheer scale of policy responses by the US, UK and Europe in particular, created a perfect storm for their respective yield curves: cuts in the official interest rates will clearly help the floating rate part of the borrowing economy, but the combination of QE resumption and fiscal injections are arguably the stronger forces that affect the curves' shape.

The efficacy of central banks, buying a new batch of sovereign bonds, may have been questioned by some as not having the immediate impact into real economy; especially as market focus has recently turned towards corporates' ability to access new capital, and not so much on the actual underlying cost of borrowing. This is where the significant boost in public spending comes into play, and in many cases, governments have pledged up to 10% of their GDP to individuals and companies to allow them to navigate through these uncertain times.

The US Fed has all but announced it will engage in a form of Modern Monetary Theory (MMT), which acknowledges the US Treasury's current inability to collect tax revenue to anywhere near those of normal times. Therefore creating a significant spike in unfunded debt issuance. In the interim, the Fed will engage in a Bank of Japan (BoJ) style strategy by buying up to 80% of new Treasury issuance and hold it on its balance sheet. The Bank of England (BoE) has hinted the same strategy. These may be looked upon as transitory measures but are essential to maintain a low level of government bond yield volatility.

In combination, this will hold back nominal yields from rising too far at this stage. This year's story is that of fiscal rectitude, it is still to be seen whether next year's narrative is that of reflation. On the case of the latter, many had felt that the record amount of public money being borrowed will undoubtedly stoke up inflation. 2020 will be a year of "lost" GDP across the globe, which brings with it a huge amount of spare capacity. This is the reason why we cannot worry about inflation at this stage. By way of a guide, the break-even inflation rate in the US remains at the low level 1.3%, driven mainly by a collapse in the "real yield" as implied by the Treasury Inflation Protected Securities (TIPS) market to -0.55%.

Such low real and nominal yields will be maintained well into the second half of 2020, with many central banks using a BoJ style model to not let nominal yields rise too much from current levels. This backdrop should ultimately re-focus investors' attention on looking to capture yields offered by high grade non-sovereign debt, which is covered below.

CORPORATE INVESTMENT GRADE

- **The market dislocation seen in late March has recovered somewhat, but more recovery is likely.**
- **Yield spreads had hit levels synonymous with a spike in defaults: this presents opportunities.**

LCAM strategies are invested in corporate bonds but we have deliberately taken a very selective approach over the past five years largely due to our rigorous sectoral approach and our collective view on the long-term weakness of economic growth post-GFC.

This has meant focussing on companies that have high cash balances, access to credit, lower refinancing risks, lengthening maturity of outstanding debt and are part of critical economic sectors.

How is the current climate different to previous crises?

The most important feature here is that unlike the GFC and the European banking crises, the effect of COVID-19 is clearly not a result of negligent financial management, but is delivering cashflow challenges that are very much out of control from governments to households to companies. This of course is the reason why authorities globally are striving to protect businesses from folding, by throwing multiple lifelines designed to keep them solvent.

In summary, we expect the effect of higher borrowing by corporates to be transitory in nature, and while debt metrics will look abnormally high for the next 2 to 3 quarters, we are taking a medium term view that the vast majority of the credits in which we invest will see through the tough economic conditions we are in currently, and will aim to rebalance their balance sheets once order books revert to normal conditions early next year.

Risks: The biggest risk to our strategy is that there are multiple recurrences of COVID-19 debilitating economic activity, or that the policy responses are deemed ineffective to cushion the pain caused by a rise in defaults across both corporations and households.

LCAM strategies are invested in corporate bonds but we have deliberately taken a very selective approach over the past five years

GLOBAL MACRO & MARKET OUTLOOK Q2 2020

FINANCIALS

- **Banks have the role of key conduits to ensure public programmes get to support the economy.**
- **Central banks and regulators have given banks some balance sheet slack to see us through.**

The outbreak of COVID-19 has led to the closure of whole swathes of the global economy. As a result, the Developed World is now set to experience a very sharp contraction in real GDP. This will impact bank balance sheets adversely. The impact is likely to manifest itself on both core equity Tier-1 capital (CET1) and risk weighted assets (RWAs) simultaneously, as summarised below:

CET1 Decrease will be affected by the cumulative decrease of the main sources of income (Net Interest Income and Net Trading Income), leading to:

- Lower contributions to capital compared to pre-COVID-19.
- Banks' earnings impacted by lower sovereign rates leading to contracting Net Interest Margins.
- Potential credit risk losses arising from the impairment of financial assets not measured at fair value through profit and loss (unsecured exposures).
- A rise in oil non-performing loans (NPLs) resulting in increased asset provisioning, and in some cases a release of retained earnings.

RWA Increases:

- Driven by deterioration in asset quality, predominantly from increase in credit risk from corporate and retail exposures.
- Should NPLs rise, banks will revise their calculation of their risk weightings in an upward direction.

Bank CET1 ratios are thus set to decline as they are impacted by capital depletion, on the numerator side, and by the increase of the total volume of RWA.

The above analysis addresses the effect of the crisis on both banking profitability and their balance sheets.

However, policy responses announced by most regulators provide comfort to us as investors in bank debt. These policies aim to navigate both banks and corporates through these extraordinary times without endangering their solvency. These include the following measures which are individually important, and collectively, powerful.

- Regulatory countercyclical buffers have been eliminated or reduced, and banks encouraged to use this extra capacity to lend.
- Having been leant upon and/or instructed, banks have now scaled back or eliminated distributions such as staff bonuses, share buy-backs and dividend payments (equity not on Preferred debt) to preserve capital. This is a significant saving.
- The Fed changed the way RWAs are measured, materially easing regulatory requirements. The European Central Bank is expected to follow.
- The Fed adopted an interim rule that allows banks to exclude US Treasuries and deposits at the Fed from the regulatory Supplementary Ratio calculation. This eases the capital requirements giving them increased flexibility to lend.

Without a functioning financial system, all the measures announced by the authorities cannot be effectively actioned. The temporary yet powerful set of regulatory responses are designed to encourage the free flow of money to those needing to access it, as well as to shield the banks from the challenging transitory effects of the crisis. Bank equity prices may lag any broader market recovery due to concerns over profitability but yield spreads on both senior and subordinated bank debt have reached levels that offer value.

Risks: As outlined above, without a fluid financial system many parts of the global economy will come to a halt. The risks to banks in this environment are a significant rise in loan defaults, which will put tremendous strain on some of the weaker institutions' balance sheets. We place a very low probability of this happening.

EQUITIES

Over the last five weeks, equity markets have experienced an unprecedented and unique environment. There has never been, in recent times, a situation like COVID-19 which has resulted in, not only a slowdown in the global economy, but a lockdown.

Equity markets have struggled with how to process this situation as although there is hope that this does not last long, it will mean minimal revenues for many companies as a large part of the World's economy goes into hibernation.

This will cause financial stress for many businesses, economies and consumers as costs dwarf revenues.

However, there has been a rapid response from Governments and Central Banks to try to ensure that financial stress is avoided and that it does not start a downward economic spiral. Essentially, there is commitment to a "whatever-it-takes" approach of financial stimulus.

Global equity markets have experienced the most rapid crash in modern history as illustrated in the table on the next page:

Peak	Through	Drawdown	Months from peak to trough	Months from trough to full recovery	EPS Decline
05/01/1973	04/10/1974	-48%	20	69	-21%
28/11/1980	13/08/1982	-26%	20	2	-21%
21/08/1987	04/12/1987	-33%	3	19	-35%
01/09/2000	04/10/2002	-47%	25	58	-38%
12/01/2007	06/03/2009	-56%	25	48	-58%
19/02/2020	Latest Low	-34%	1		
Average		-42%	19	39	-34%
Median		-47%	20	48	-35%

Source: London & Capital and Bloomberg Data

The COVID-19 crash, in terms of velocity and depth, is only comparable to the October 1987 crash. True earnings damage for companies remains to be seen but current expectations are for unprecedented quarterly declines for the second quarter of 2020 followed by a rapid recovery for the rest of the year.

EQUITIES
OUR POSITIONING

Despite this indiscriminate environment, it is reassuring that London & Capital Equities have held up better than Global Stock Markets (e.g. Peak to Trough MSCI World Index declined by 30.8% v. London & Capital Global STAR UCITS fund down 23.4% for the period 19th February to the 18th March). This is despite normally resilient consumer businesses being decimated by lockdowns.

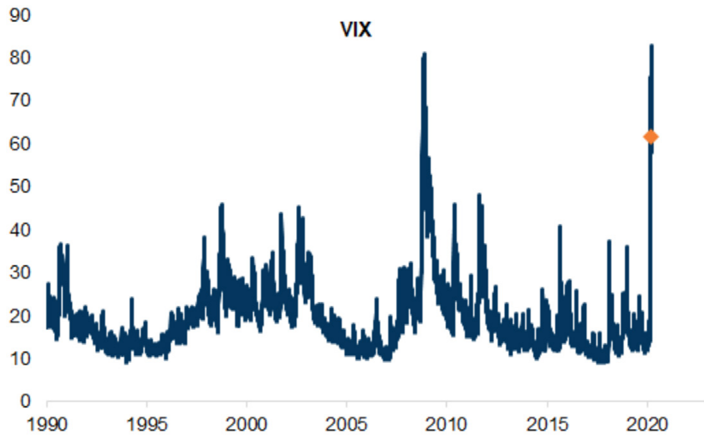
Once the markets can see a route map to normalisation then share prices will recover rapidly. However, this market needs to find a base before longer term investors return and currently there are risks of a false dawn.

The level of current market volatility is unhelpful and the first signs of stabilisation will occur when volatility normalises. Investors generally dislike volatility as it creates too much uncertainty, so this needs to reduce before investors re-invest.

In fact, the VIX S&P 500 Volatility Index (see right) hit an all-time high in March and currently remains at extremely elevated levels.

Despite this indiscriminate environment, it is reassuring that London & Capital Equities have held up better than Global Stock Markets

VIX S&P 500 Volatility Index



Source: Goldman Sachs Research

A reduction in the daily amplitude of the VIX Index would help to indicate a return to normality.

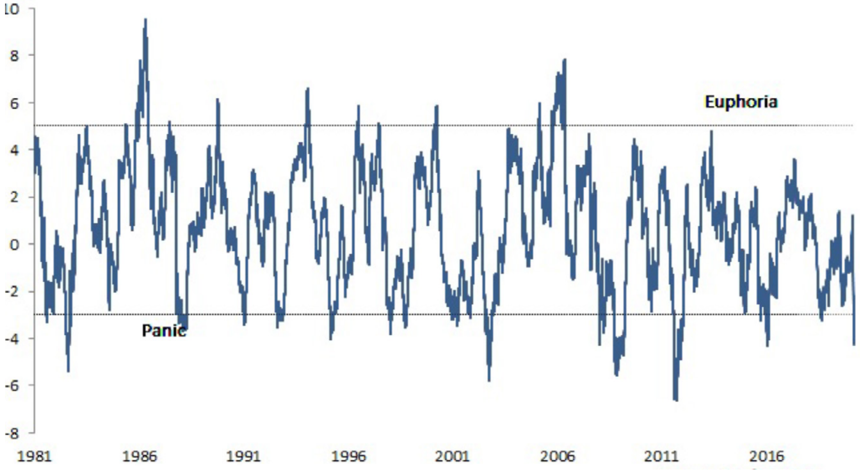
If the recent low is tested but the market doesn't go significantly below the low then that is a positive indication and it would be even more positive if the market was sustained above the upside resistance level.

Conversely, if the recent low doesn't hold then in all likelihood another down leg will occur for markets.

Two factors are currently constructive for longer term investors.

Firstly, investor sentiment which is a contrarian indicator. The risk appetite measure shown below has entered panic territory, from which historically, good equity returns have been achieved i.e. fear and greed mentality.

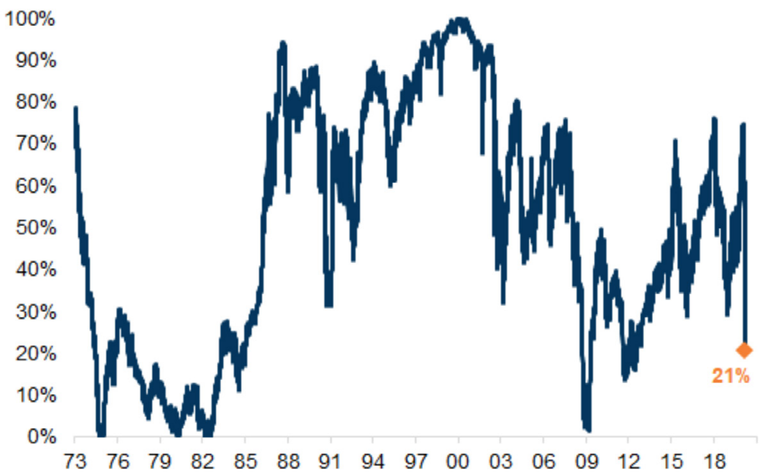
Global risk appetite



Source: Credit Suisse

Secondly, valuations are now very supportive.

Blended Equity Valuation Metrics Percentile Ranked (100 = The Highest Valuation)



Source: Goldman Sachs Research

GLOBAL MACRO & MARKET OUTLOOK Q2 2020

These depressed levels of valuation have historically been a good indicator of strong longer term returns for equity investors.

In fact, the most bullish prognosis is that with the huge amounts of stimulus combined with a potentially short term impact and low valuations (government bond markets are yielding close to zero), then equity markets may reach new high as quickly as they fell. However, there are elevated levels of uncertainty which means negative outcomes could still occur.

In conclusion, for braver, longer term investors these market levels are likely to represent an opportune entry point for good longer term returns but markets may well get worse before they get better.

Given this outlook, the focus for investors should be in high quality franchise businesses that can get through this challenging period and maybe even come out stronger. A strong balance sheet is essential and these type of businesses will be representative of the London & Capital equity holdings.

For braver, longer term investors these market levels are likely to represent an opportune entry point ”

ALTERNATIVES

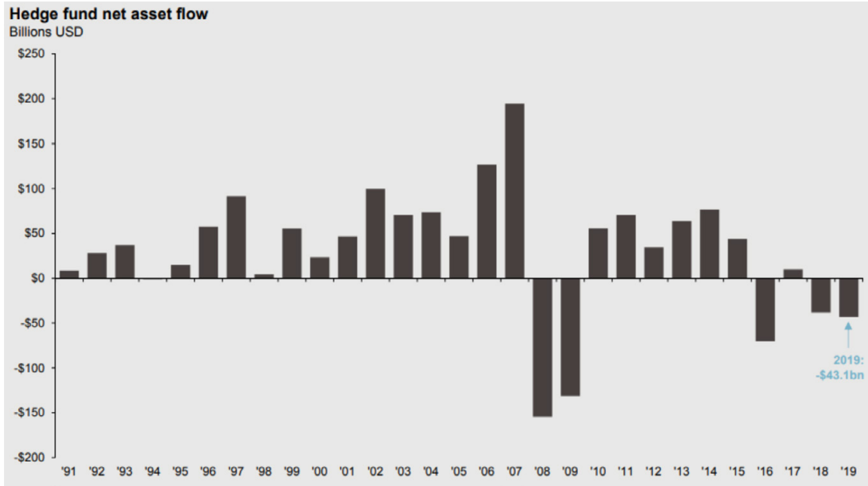
The hedge fund industry has certainly not been immune from the sudden and severe shock we saw to financial markets in the first quarter of 2020. In fact, many large institutional funds were caught wrong footed and were forced to liquidate portfolios at the worst moments in mid-March, exacerbating some of the strange moves we witnessed in safe haven assets. Of course, there are always hedge funds which 'do what they say on the tin' with more defensively positioned managers faring well and long volatility or tail hedge strategies posting returns better, in some cases, than in the midst of the 2008 financial crisis.

We have always favoured a measured approach, utilising strategies that use little to moderate leverage and don´t exhibit a high level of beta over time. Those funds which have been conservatively run and are sitting on high levels of cash, have been presented with a buying opportunity not seen for over 10 years. One area is merger arbitrage where market stress has created a rich opportunity set despite the lower overall levels of corporate deal flow in the offing.

Industry flows have been negative for some time, as the huge wave of institutional investment over the last 10 years has plateaued, and it remains to be seen if this trend will now accelerate. For those funds which have not delivered when expected, we think that will be the case. However, a number of large funds that have been closed to new investment for some time have opened up in order to opportunistically raise more capital.

GLOBAL MACRO & MARKET OUTLOOK Q2 2020

Hedge fund net asset flow

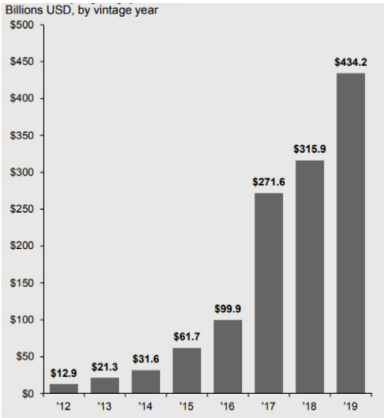


Source: HFRI, JP Morgan

In terms of private markets, the current COVID-19 crisis will take time to feed through into valuations but there´s no doubt that high valuation multiples that were prevalent until a couple of months ago will need to be revised down in line with public markets, should the stress persist. Immediate funding from investors will likely take a pause but the severity and duration is yet to be seen. However, it is important to remember that private equity ´dry powder´ remains at record levels with a number of blockbuster funds raised in the last 12 months. Therefore, recent fund vintages will be able to take advantage of any stress in private markets by picking up cheap assets.

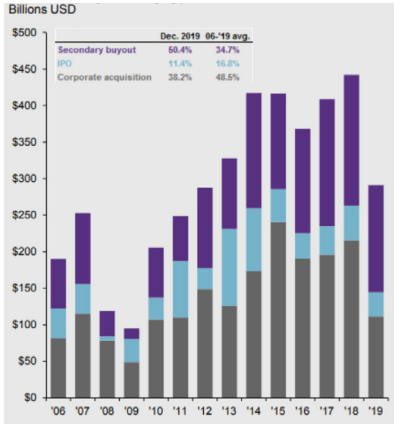
In terms of private markets, the current COVID-19 crisis will take time to feed through into valuations

Private equity dry powder



Source: Pitchbook, S&P LCD, JP Morgan

Private equity exits by type



Source: Pitchbook, Jay Ritter, University of Florida, J.P. Morgan Asset Management

Another factor to bear in mind if capital markets freeze up, is that exit opportunities will be fewer and farther between. We had already seen a significant drop off in exits in 2019 and as this situation is unlikely to improve any time soon, some funds and investors may be sat on private positions much longer than they had anticipated.

ALTERNATIVES
OUR POSITIONING

Despite the market volatility, our approach to alternatives remains consistent other than to add some new ideas where we have seen some opportunities emerge. We are complementing client portfolios with a highly select number of upper quartile liquid hedge fund strategies with a strong, long-term track record of alpha generation. The idea is to provide diversifying sources of return, capturing attractive alphas away from traditional long only strategies.

London & Capital hedge funds are positioned to be broadly uncorrelated to markets, although the existing set of managers tend to have a variable net exposure with the ability to adapt to the prevailing market environment. With outperformance versus traditional assets already exhibited in Q1, we feel confident we can deliver meaningful value for clients into any further market volatility.

– Equity L/S: We have concentrated our exposure around a leading equity long short manager with a growth bias and variable net market exposure. The current defensiveness being applied to portfolio construction means that the strategy is navigating the current environment very well and we believe will remain a strong constituent going forward as a true stock picking environment emerges from the crisis.

– Global Macro: Macro strategies have the potential to benefit from global macroeconomic policies and the effect these have on rates, fixed income and FX. We are expressing this through a developed markets strategy with a relative value approach and an EM-focused strategy utilising a combination of debt, rates and FX.

- Event Driven: Arbitrage strategies across both hard and soft catalyst event driven plays are enjoying a rich opportunity set and some complex situations which provides for added alpha. Recent volatility has created a great entry point and the manager we utilise looks set to benefit as we move forward and things normalise.
- Volatility Trading: We have reintroduced volatility trading into the hedge fund mix as a higher volatility regime offers a very strong opportunity set for such strategies. We utilise a manager that expresses trades in liquid instruments with a market neutral stance and has typically done very well in periods following extreme volatility events such as the one recently witnessed.

In Private Equity we have introduced a select number of idiosyncratic funds and direct investments involved in disruptive areas such as tech, biotech and longevity which should be less tied-in to the current economic backdrop. However, we will be scouring the private equity market for ideas that may emerge from the current crisis, including secondary opportunities and turnaround funds. We are also focusing on delivering strong tax-efficient ideas for clients through a selection of EIS investments.

In Private Equity we have introduced a select number of idiosyncratic funds and direct investments … which should be less tied-in to the current economic backdrop

FX

As the COVID-19 crisis intensified in late February and early March, the trade weighted US Dollar (USD) initially came under pressure as speculative investors cut long Dollar positions versus low yielding currencies such as the Euro, Japanese Yen and Swiss Franc.

However, as the full scale of the economic shock became clear and risk aversion escalated, demand for USD increased sharply due in part to its safe haven credentials, but also from compelled buyers scrabbling to raise USD cash. According to the Bank of International Settlements approximately 80% of global trade is conducted in USD. As a result, a very significant majority of international borrowing is undertaken in USD. With large parts of the global economy going into lockdown and trade revenues collapsing, it has forced international USD borrowers to raise liquidity to fill the shortfall and service debt payments.

In order to curb upward pressure on the Dollar the US Federal Reserve has deployed the same policy response as it did during the Global Financial Crisis when deleveraging exposed the same vulnerabilities.

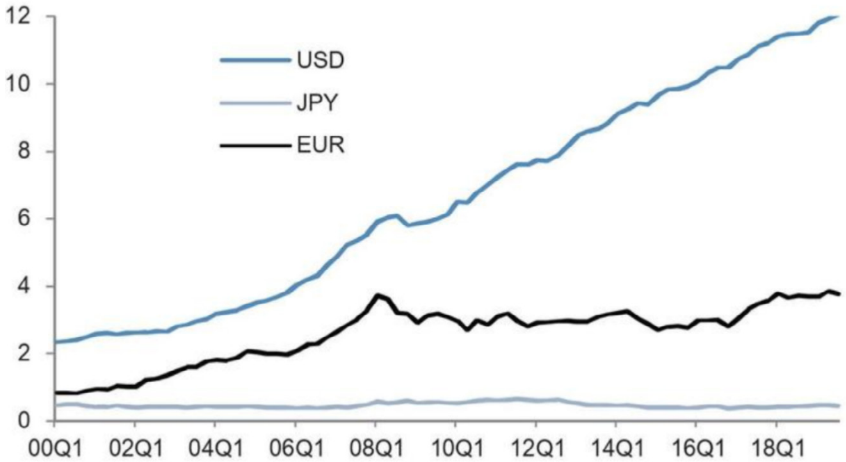
The US Federal Reserve has restarted USD liquidity swap lines with other global central banks who in turn provide USD to local banks. These measures have shown some early success at dampening the squeeze, but as the chart below shows global Dollar borrowing is very significant and therefore demand for will not fade quickly whilst the global economy is shut down and investor risk aversion remains elevated.

Looking through the current dynamics underpinning Dollar strength, valuations remain rich versus both Sterling and the Euro, especially following the reset in interest rate and growth differentials over recent weeks. Add to this the far larger quantitative easing programme underway in the US and it appears the conditions for medium-term Dollar weakness are being set.

GLOBAL MACRO & MARKET OUTLOOK Q2 2020

As was the case following the financial crisis, there was an ongoing need for abundant liquidity and a weaker Dollar to aid the global recovery – this would again be welcomed across the world and particularly in the White House.

Foreign currency credit to non-bank borrowers. $tn equivalents. Sum of cross border bank lending and FX-debt issuance.



Source: BIS / JPM

As the global economy shuts down international borrowers will feel the squeeze.

In order to curb upward pressure on the Dollar the US Federal Reserve have deployed the same policy response as it did during the Global Financial Crisis when deleveraging exposed the same vulnerabilities

About London & Capital

London & Capital is an independently owned wealth management company, providing private and institutional investors from across the globe with expert offshore and onshore investment strategies.

We are headquartered in London with a presence in Barbados and are regulated by the FCA (UK), the SEC (US).

London and Capital Asset Management Limited

Two Fitzroy Place	**T**	+44 (0)20 7396 3200
8 Mortimer Street	**F**	+44 (0)20 7396 3201
London W1T 3JJ	**E**	invest@londonandcapital.com
United Kingdom	**W**	londonandcapital.com

London and Capital Caribbean Limited

1st Floor, One Welches	**T**	(246) 537-4182/3
Welches, St Thomas	**F**	+44 (0)20 7396 3201
Barbados	**E**	invest@londonandcapital.com
BB22025	**W**	londonandcapital.com

Call us on **+44 (0)207 396 3200**
or visit **londonandcapital.com**

London&Capital