AN UPDATE ON GLOBAL MARKETS FOR Q1

Global markets fell sharply in Q1 and entered technical bear market territory mid-March, as markets rapidly priced in significant disruptions to business activity stemming from COVID-19 containment efforts. While this bear's cause is highly unusual— no pandemic or pandemic response has caused a bear in modern history—equities behaved as we would expect. Equities priced in the negative effects before those were clear, and we expect them to do the same in any rebound.

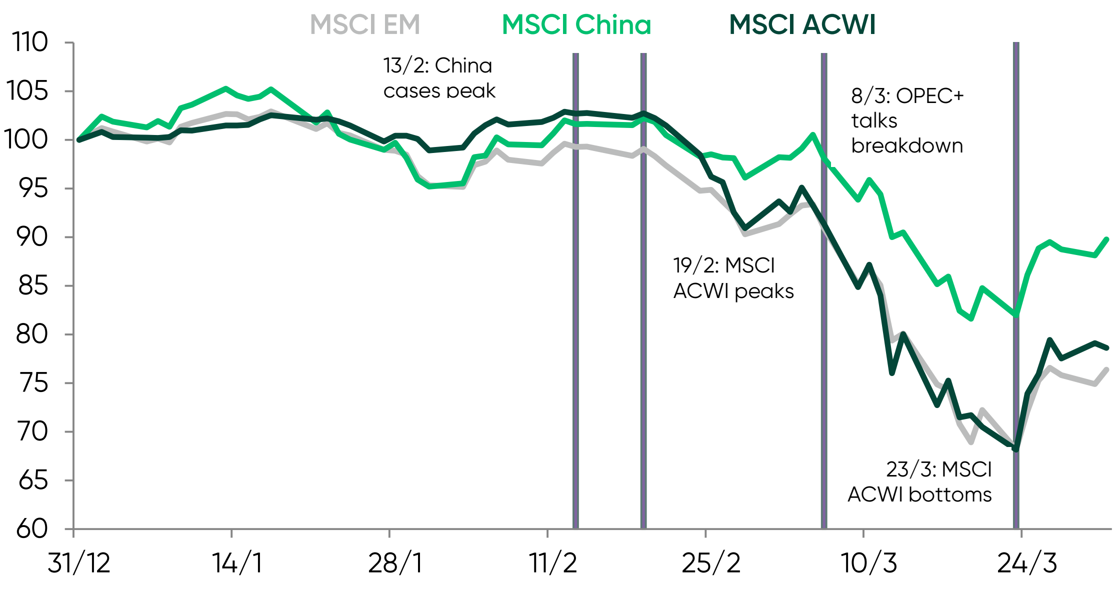
EMERGING MARKETS

Emerging Market equities were broadly impacted by fears related to the impact of the Coronavirus outbreak. China's official manufacturing and nonmanufacturing PMIs moved deeply into contractionary territory. These record-low readings show the impact of several provinces ordering factories to close for weeks after the annual Lunar New Year holiday. Industrial production, retail sales and fixed asset investment also contracted sharply in January – February compared to the same period a year ago.

China also offers an early glimpse at what recovery might look like, although the Chinese economy has been hampered by the disease hitting global demand. On 12 March, China's Vice Minister of Industry and Information Technology, Xin Guobin, noted that outside the Hubei province, the work resumption rate was 60% for small- and medium-sized firms and over 95% for larger businesses. Private sector data corroborate this. US shipping company FedEx noted in its 17 March Q1 earnings call that 65 – 70% of small manufacturers and 90 – 95% of large manufacturers have restarted production. Moreover, another Chinese official recently estimated that 100 million migrant workers have since returned to work.

But reopened factories aren't necessarily operating at full capacity. March official PMIs improved, but were still hampered by faltering developed-world export demand as the US and Europe stepped up COVID-19 countermeasures. Accordingly, Chinese equities have fallen alongside global markets since early March (Exhibit 1). After plunging in late January due to the virus's escalation, the MSCI China A-share Index outperformed both the MSCI EM and MSCI All-Country World Index of Developed and Emerging Market equities by over 20 percentage points at its high.

Exhibit 1: Emerging Markets Q1 2020 Performance (Indexed to 100)



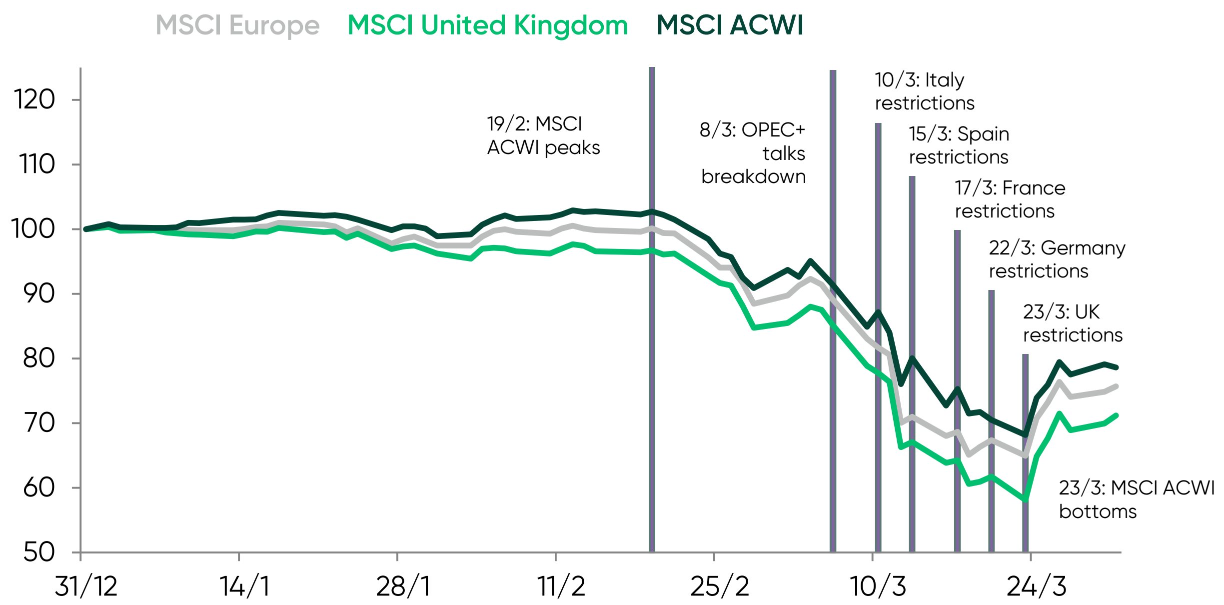
Source: FactSet, Returns as of 31/03/2020 in USD.

Q1 also brought some notable examples of heightened political risk in EM countries. First, Russian President Putin announced constitutional amendments that many warn would pave the way for him to retain control after his term ends in 2024. Additionally, the collapse of talks between OPEC and Russia, which were aimed at extending and deepening oil production cuts, weighed on oil prices. Surprise production increases, along with falling demand due to COVID-19-related restrictions on business and travel, contributed to oil prices' -49.4% decline in March. COVID-19 restrictions that prevent or delay travel, commuting and industrial production likely mean lower oil prices are less positive than usual for EM oil importers. For major EM oil exporters like Russia, the UAE, Saudi Arabia and Mexico, low prices are likely an added headwind.

EUROPE & THE UK

By the end of Q1, most of developed Europe was under some form of lockdown. Many restrictions didn't ramp up until mid-March, but the latest March data already show COVID-19's damage. Exhibit 2 chronicles the introduction of certain European restrictions and shows how UK and European equities subsequently performed relative to the MSCI All-Country World Index. Further, IHS Markit's March flash PMIs showed both the Eurozone composite and UK composite falling to record lows. These figures likely foreshadow further negative economic data in the near term, such as a Q1 GDP contraction in some developed world economies. This weakness will likely persist as long as COVID-19-related restrictions disrupt businesses.

Exhibit 2: Europe & the UK Q1 2020 Performance (Indexed to 100)



Source: FactSet, Returns as of 31/03/2020 in USD.

Most policymakers in developed Europe have already announced huge economic response packages in an attempt to support their economies. Germany unveiled a €750 billion plan-including a €400 billion "stabilisation" fund to backstop corporate debt at risk of default, while France earmarked €45 billion in aid for businesses and workers. The French government also guaranteed up to €300 billion in corporate borrowing from commercial banks. The UK government will provide £330 billion in loan guarantees to businesses and defer VAT payments worth £30 billion.

Similarly, central banks unveiled monetary measures to combat the crisis, with quantitative easing (QE) asset purchase programmes featuring prominently. The ECB will buy €750 billion in public- and private-sector securities until end of 2020 via its Pandemic Emergency Purchase Programmeme (PEPP). Along with a previously announced plan of €120 billion in asset-buying, the ECB is now up to around €1.1 trillion in QE this year. The BoE cut interest rates twice in March, lowering the Bank rate to 0.1%, and slated £200 billion worth of new QE, which will target government and corporate bonds.

Early in the quarter, a couple notable political events transpired. On January 31, the UK officially left the EU, a development more than three and a half years in the making. Some uncertainty remains, as the UK and EU must negotiate a new trade deal before the Brexit transition period ends in December. Many experts forecast flagging growth due to the quick exit timeline, which indicates to us that pessimism towards the UK economy remains rampant. However, reaching a trade deal with the EU shouldn't be as onerous as feared. Both sides have an incentive to get a deal done, and they already have harmonised regulation. After Brexit became official, businesses appeared to be moving along (before COVID-19), although trade talks could resurrect uncertainty if they end up coming down to the wire later this year.

Additionally, in Spain, Prime Minister Pedro Sánchez's centre-left Socialist Party formed a minority coalition with the leftist populist Podemos—the country's first government in nearly a year. Positively, this development removes some longstanding political uncertainty, but many investors fear the leftist coalition will make good on their campaign pledges and implement a slew of anti-business policies (e.g., raising income and capital gains taxes, taxing banks and rolling back labour market reform). Yet it looks highly unlikely this government will be able to get much done. The Socialist-Podemos coalition lacks a Parliamentary majority and entered power only because a Catalan separatist party abstained from the investiture vote. This government may not even have much staying power, given their dependency on smaller parties like the Catalan separatists.

UNITED STATES

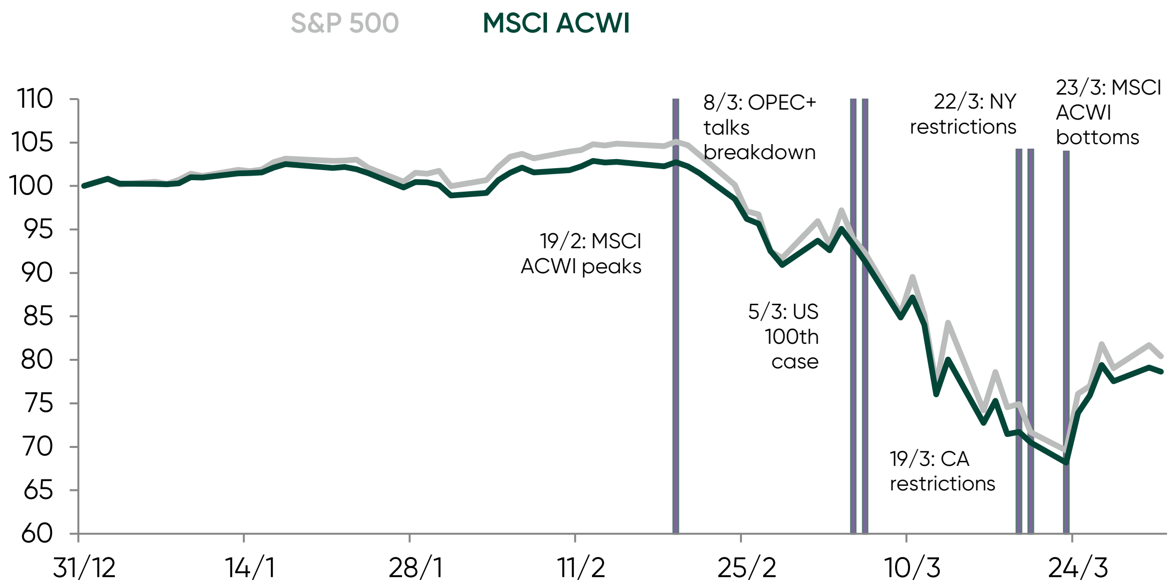
The S&P 500 declined sharply in Q1, making it the fastest-developing bear market on record. After discounting fears over rising US-Iran tensions early in the year, US equities saw renewed volatility as concerns over the economic impact of the novel coronavirus grew. The bear market began before data started to confirm an economic contraction. IHS Markit's March US flash composite PMI fell to 40.5 from February's 49.6. This headline figure likely understates the damage, as the manufacturing PMI's supplier delivery times surged. While an uptick in delivery times normally speaks to rising backlogs and robust demand, in this case it points to supply chain problems from COVID-19 containment efforts. Meanwhile, jobless claims spiked to 3.3 million in the week ending 21 March, doubling to 6.6 million the following week, illustrating the speed with which much of the country shut down.

Q1 saw the Fed make their first "emergency" announcements since 2008, including one on a Sunday, which induced panic, implying the central bank saw things others didn't. Markets responded negatively following both announcements. The Fed's backstop of corporate bond markets did spur new issuance, helping ease investors' fears. Other measures taken involved serving as lender of last resort to the private sector as well as banks. We think this is an interesting expansion of the Fed's role, which might help boost confidence and benefit impacted businesses in the short term, but, to us, it isn't stimulus that will prompt a recovery.

Our view of Congress's fiscal response is largely similar. Many called it stimulus. We don't consider it true stimulus, though, because it doesn't generate new demand where none existed before. Instead, it is a very large bailout. The Coronavirus Aid, Relief and Economic Security (CARES) Act gives cash to households and hospitals, expands unemployment benefits and offers bridge loans for large and small businesses as well as state and local governments to remain solvent while the economy stagnates. Among the more relevant provisions for markets: $58 billion in funding-in the form of loans and grants for airlines and related industries. In exchange for aid, it seems the government will take an equity stake in the recipient companies. Notably, firms taking a loan under the programme can't buy back shares while the loan is outstanding, and for an additional year thereafter. We don't see this as much of a concern for markets because buybacks aren't a major equity driver, and companies in need of aid are highly unlikely to return profits to shareholders in the near term anyway.

Fiscal and monetary responses might keep a distressed situation from worsening more than it would have otherwise, but they can't cure COVID-19 or hasten the end of lockdowns. Until then, expect further deterioration in economic data, negative earnings revisions and sentiment remaining fearful. Throughout history though, equities have recovered before sentiment and data has improved. Exhibit 3 displays how US equities performed relative to the MSCI All-Country World index in Q1 2020.

Exhibit 3: United States Q1 2020 Performance (Indexed to 100)



Source: FactSet, Returns as of 31/03/2020 in USD.

Beyond the virus's economic impact, US politics were also a main story. Headlines sensationalised impeachment proceedings throughout the early part of the year, but markets appeared indifferent. As January closed, the Senate voted not to call new witnesses, and President Trump was acquitted on 5 February. We think it is too early to know the possible election implications of impeachment for the presidency and Congress.

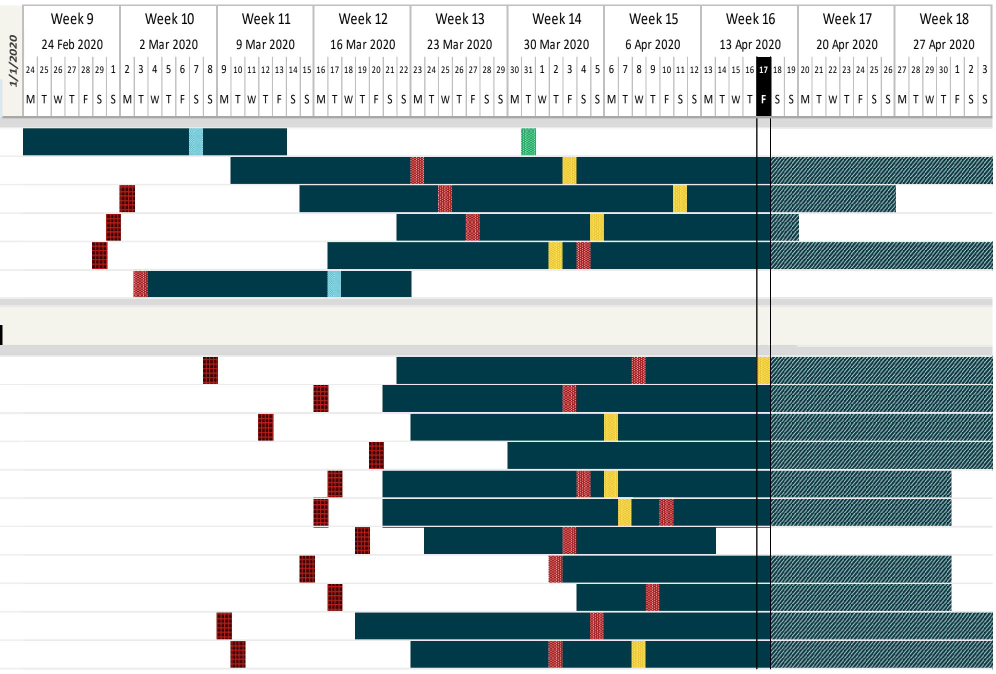
COVID-19 TRACKING

Most countries and US states have instituted similar COVID-19-related restrictions and are following a similar timeline from their initial outbreak. While many European countries have extended their initial restrictions, several countries are beginning to shift their focus to unwinding restrictions. Most states in the US are expected to have restrictions in place until at least 30 April.

Exhibit 4: Containment Measures

Display Week 9

Country/State	Restrictions: Start	Initial End	Extended End	% Through	Cases: Reach 100	Peak	Trough	Economy Recovers
China	23/1	13/3	-	100%	17/1	13/2	07/3	31/3
Italy	10/3	03/4	03/5	71%	23/2	23/3		
Spain	15/3	11/4	26/4	79%	02/3	25/3		
Germany	22/3	05/4	19/4	93%	01/3	27/3		
France	17/3	02/4	11/5	57%	29/2	04/4		
South Korea	04/3	22/3	-	100%	20/2	03/3	17/3	
United States								
New York	22/3	17/4	15/5	49%	08/3	08/4		
New Jersey	21/3	-	-	0%	16/3	03/4		
Massachusetts	23/3	06/4	04/5	60%	12/3			
Virginia	30/3	10/6	-	26%	20/3			
Pennsylvania	21/3	06/4	30/4	68%	17/3	04/4		
Illinois	21/3	07/4	30/4	68%	16/3	10/4		
Michigan	24/3	13/4	-	100%	19/3	03/4		
Florida	03/4	30/4	-	54%	15/3	02/4		
Texas	04/4	30/4	-	52%	17/3	09/4		
California	19/3	-	-	0%	09/3	05/4		
Washington	23/3	08/4	04/5	60%	10/3	02/4		



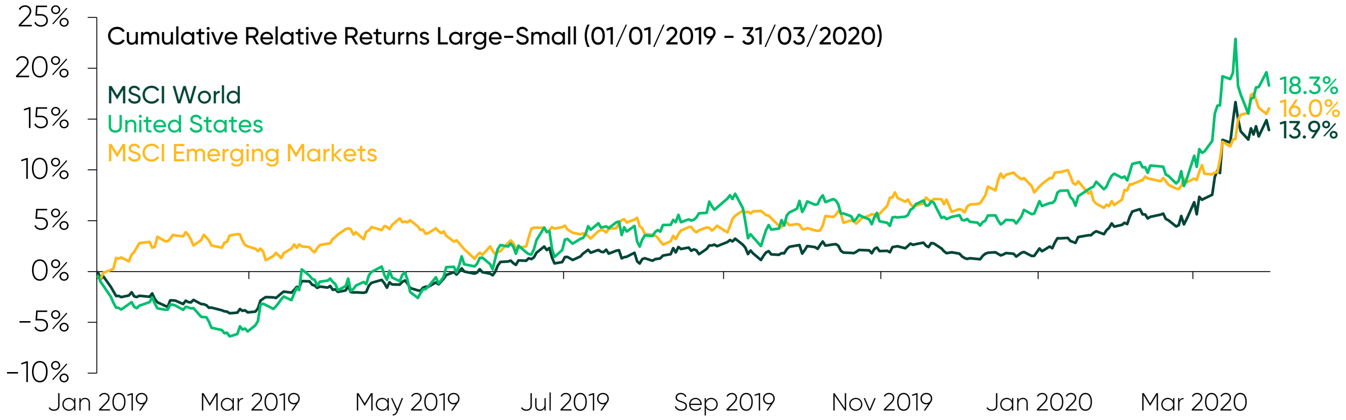
Source: National Governors Association, IMF, BEA & John Hopkins. Data as of 16/04/2020.

Market cycle turning points are impossible to predict and are clear only in hindsight. Accordingly, we can't know now when this bear market will end. Yet, markets typically price in events 3 to 30 months in advance, meaning equity markets are likely to begin a recovery well before we get an all-clear sign, in anticipation of better days to come. Business disruptions, institutional responses and widespread lockdowns, won't last forever. A vaccine will arrive, and its development will be widely discussed. Markets will price all of this, just as they priced COVID-19's fallout, and the history of bull markets shows equities recover faster than most can envision today.

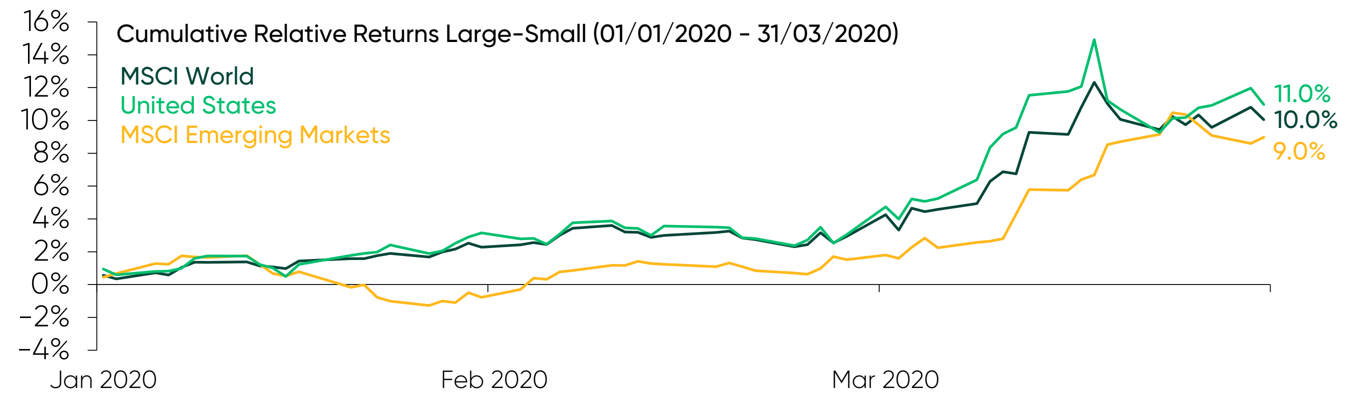
DOWNTURN CHARACTERISTICS

During the market downturn, we have notice several important trends in leadership. Spreads between large and small cap companies have continued widening, as displayed in Exhibit 5. When the line is rising, large companies are outperforming small companies.

Exhibit 5: Regional and Size Performance



Cumulative Performance	MSCI World Large Cap	MSCI World Small Cap	S&P 500	Russell 2000	MSCI EM Large Cap	MSCI EM Small Cap
01/01/2019 –31/03/2020	2.17%	-11.74%	4.93%	-13.37%	-7.43%	-23.47%



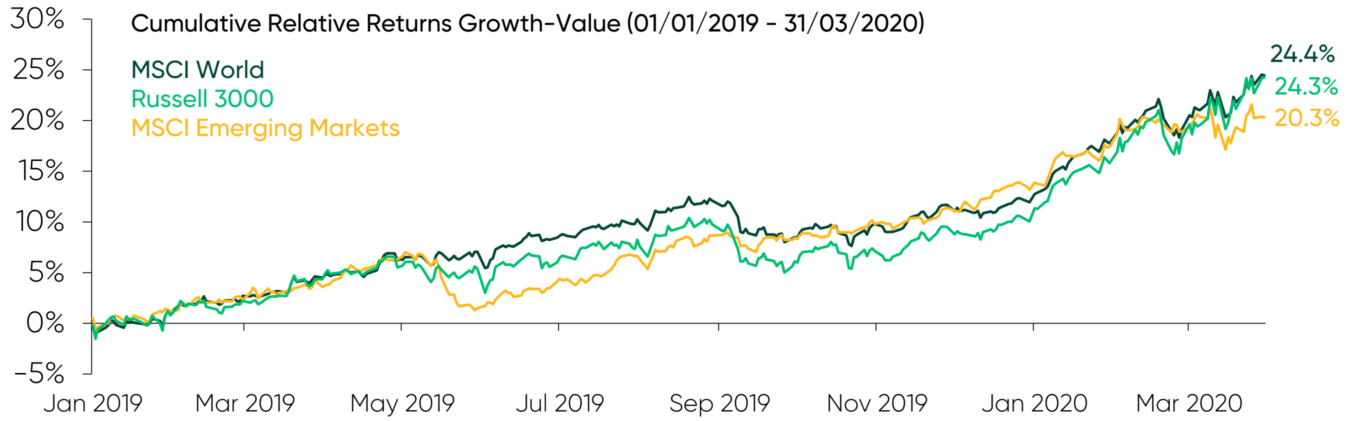
Cumulative Performance	MSCI World Large Cap	MSCI World Small Cap	S&P 500	Russell 2000	MSCI EM Large Cap	MSCI EM Small Cap
01/01/2020 – 31/03/2020	-20.01%	-30.06%	-19.72%	-30.69%	-22.39%	-31.37%

Source: Performance shows total return % change cumulative performance 01/01/2019 – 31/03/2020 and 01/01/2020 – 31/03/2020 respectively for the MSCI World Large Cap, MSCI World Small Cap, S&P 500, Russell 2000, MSCI EM Large Cap, and MSCI EM Small Cap Indices. FactSet. Data in USD.

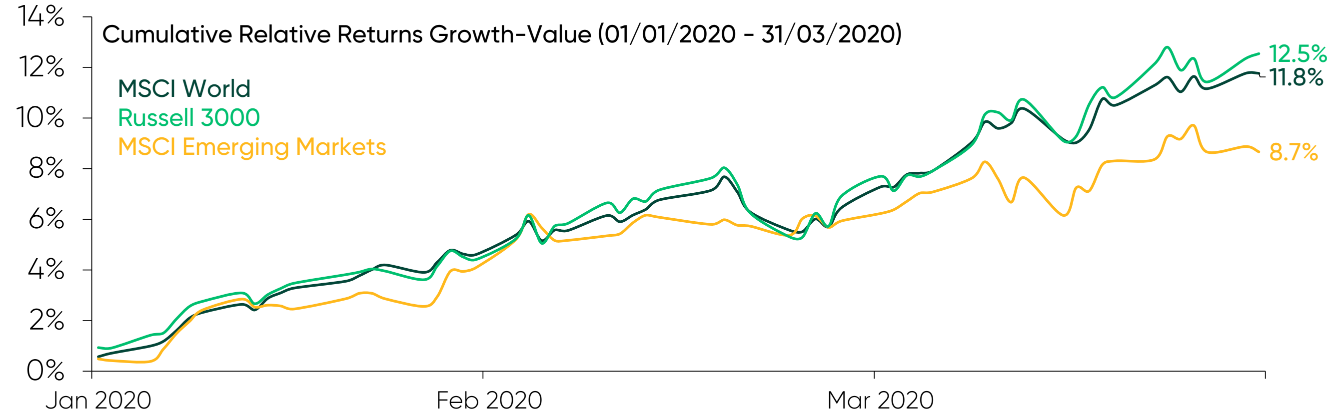
This is primarily a result of larger companies (and those that are larger within their respective cap ranges) being in a better financial position to endure an economic contraction. Additionally, growth-tilted sectors, which have led this year, tend to be comprised of larger companies.

Growth has continued its leadership as investors have punished traditional value sectors. Commodity-sensitive sectors have led the charge down tied to falling demand. Financials, the quintessential value sector, have suffered stress on their liquid capital in the near term and falling interest rates/flattening yield curves have compressed their profit margins. When the line is rising, growth companies are outperforming value companies.

Exhibit 6: Style Performance



Cumulative Performance	MSCI World Growth	MSCI World Value	MSCI EM Growth	MSCI EM Value	Russell 3000 Growth	Russell 3000 Value
01/01/2019 –31/03/2020	13.37%	-11.08%	0.91%	-19.41%	15.15%	-9.12%

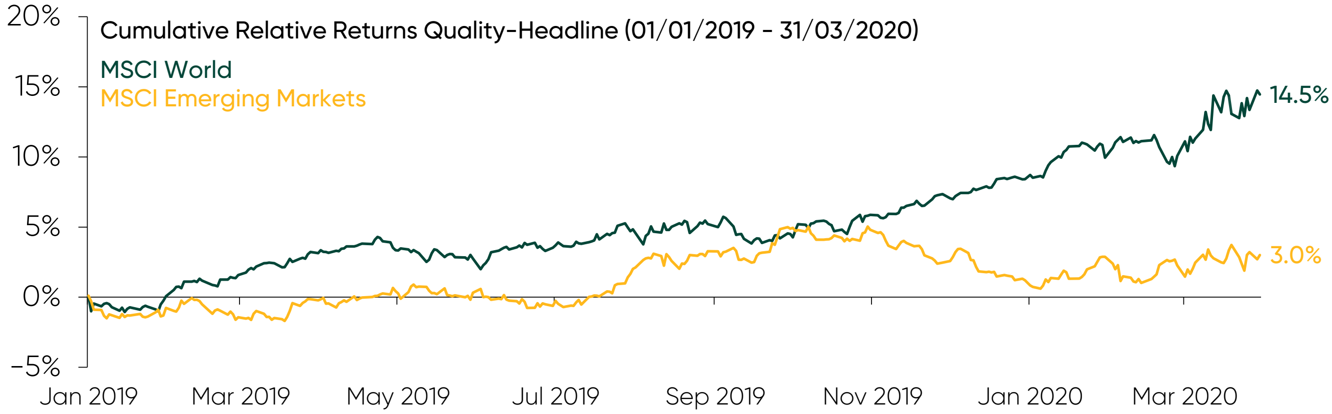


Cumulative Performance	MSCI World Growth	MSCI World Value	MSCI EM Growth	MSCI EM Value	Russell 3000 Growth	Russell 3000 Value
01/01/2020 – 31/03/2020	-15.20%	-26.96%	-19.34%	-28.00%	-14.93%	-27.47%

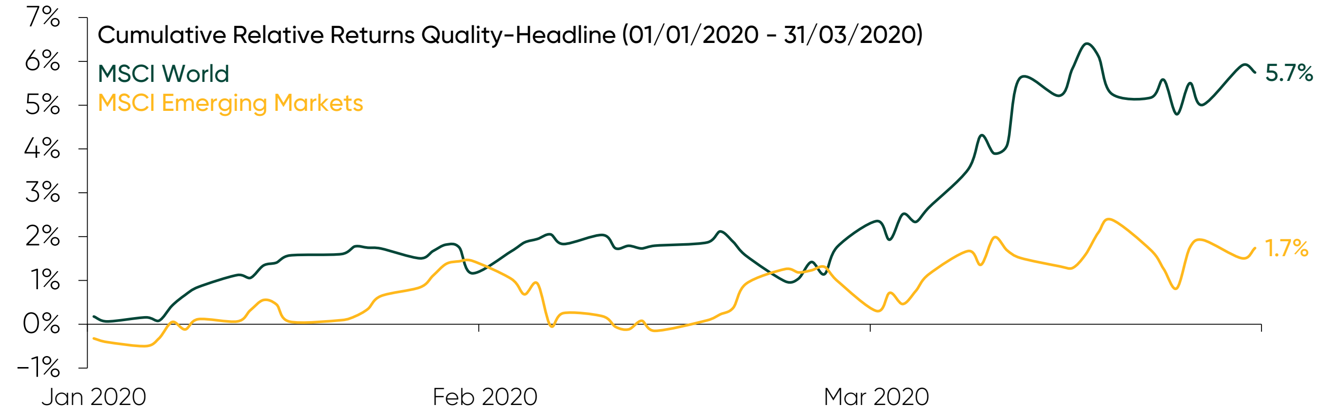
Source: Performance shows total return % change cumulative performance 01/01/2019 – 31/03/2020 and 01/01/2020 –31/03/2020 respectively for the MSCI World Growth, MSCI World Value, MSCI EM Growth, MSCI EM Value, Russell 3000 Growth, and Russell 3000 Value Indices. FactSet. Data in USD.

Firms with more sustainable earnings have outperformed through the uncertainty, though the spread is more narrow in EM.

Exhibit 7: Quality Performance



Cumulative Performance	MSCI World Quality	MSCI World Index	MSCI EM Quality	MSCI EM
01/01/2019 –31/03/2020	15.25%	0.79%	-6.52%	-9.52%



Cumulative Performance	MSCI World Quality	MSCI World Index	MSCI EM Quality	MSCI EM
01/01/2020 – 31/03/2020	-15.31%	-21.05%	-21.86%	-23.60%

Source: Performance shows total return % change cumulative performance 01/01/2019 – 31/03/2020 and 01/01/2020 – 31/03/2020 respectively for the MSCI World Quality, MSCI World, MSCI EM Quality, and MSCI EM Indices. FactSet. Data in USD.

In our view, category leadership throughout the downturn, and investment opportunities within the ensuing recovery will be predicated on how long the widespread shutdowns remain in place. If the shutdowns persist for several months or longer, we will likely face a long economic contraction, following which, we would expect to find greater opportunities in the more cyclical categories that typically do best early in economic recoveries. But if the shutdowns are lifted in the near future, we will likely see a shorter, sharper contraction with the high-quality, growth-oriented companies that led before the downturn continuing to lead in the recovery.

While market and economic declines may be sharp, the duration of the shutdowns and corresponding contractions matters more than the magnitude. Duration is what will determine whether a swift market rebound will help even out full-year results or if a longer downturn is in store. To us, the highest probability outcome is that the widespread shutdowns are lifted within the next 3 months, allowing economic activity to resume quickly. In that scenario, equities should start recovering well before COVID-19 is gone, restrictions are removed, or the economy recovers.

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