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Wealth Managers

Update on current market developments

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Britain cuts rates

This morning, the Bank of England unveiled a wide-ranging response to the situation. It also announced a 0.5 percentage point interest-rate cut. The Bank also cancelled its increase in the countercyclical buffers, a regulation which limits the amount banks can lend commercially. It proposes a £100bn Term Funding scheme for banks which are lending to small and medium-sized enterprises. These measures mean commercial banks have access to £190bn of permitted additional lending. Future lending can be financed by existing cash and reserves and by the Term Lending money available at 0.25% or thereabouts. The regulator has warned the banks not to use this cheap money to boost bonuses and dividends.

There is some two-way trade now in the markets after the big falls of recent days. Bulls point to the large new sums of money being made available to sustain businesses and asset values and to the fact that shares are a lot lower now.

Bears point to the worsening hit to the economies from the virus, which will bring down profits and dividends and lead to more financial stress in a range of companies. We fear there is still more bad news to come as we strive to see through the epidemic's impact, with many commentators and forecasters who have been too optimistic, having still to revise their forecasts and estimates down. It looks too early to sound all clear for the world economy and markets.

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COVID-19 coronavirus

The virus outbreak in China damaged the Chinese economy substantially this quarter and led to downgrades of Chinese GDP and wider world output. This was compounded by the Japanese sharp decline in activity at the end of last year based on the tax rise, and the likely continued weakness of Japan owing to proximity to China and the virus problems.

The spread of the epidemic to Italy has reminded markets that the health problem is still far from its peak. It brings with it, economic weakness. People decide to cancel travel plans, avoid events, restaurants and hotels and reduce their higher end discretionary spending. We have been warning that until we can see things getting better around the world generally, we should expect downward revisions to official and private sector forecasts or growth, profits warnings from companies, and cash flow problems for businesses facing much reduced revenue. As we feared, the equity market has sold off on this new reality. We recommended being at the bottom end of the allowed risk bands, and proposed safe-haven investments in US Treasuries, precious metals and cash.

Oil shock hits markets

This week the bearish scenario has been compounded by the news that OPEC and Russia have fallen out over production cuts. Against a background of weak oil demand and continuing strong supply from the US, the oil price had been held above $50 a barrel by substantial OPEC and Russia production cuts. Saudi is now threatening to expand production and has offered aggressive price cuts in the market to sell more crude.

Whilst the immediate dispute is with Russia, which turned down a renewal and extension of the production agreements, both Saudi and Russia might like to destabilise US shale output. Some of this is higher cost and vulnerable to price cutting and production increases from Saudi and other OPEC producers. All the time the oil price war continues we should expect a sharp downturn in oil investment, reduced demand for oil services, problems for highly leveraged, high-cost producers in servicing their debts, and dividend cuts from oil majors whose cashflows will be restricted.

At the Investment Strategy Committee last week, we drew up three new scenarios around a base case of much-reduced global growth. This case led us to downgrade Japanese shares and the FTSE 100 and to promote UK government bonds and cash alongside US Treasuries. We think it is still soon to buy back or to increase risk and will keep you informed of how we think the virus and the oil problems are developing.

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