INVESTMENT OUTLOOK JULY 2020

WORLD ON THE MEND AS RECOVERY TAKES SHAPE

After ending the longest stock market bull run in history, the global human and economic impact of Covid-19 (C-19) was severe enough that we saw the most aggressive peace-time government policy response ever. This reassured the financial markets that governments will do whatever it takes to support growth and ensure that systemwide liquidity is not an issue. It's important to note that while economies and financial markets now point to the worst being behind us, activity levels having recovered somewhat are markedly lower than at the start of the year. In addition, some sectors are facing greater challenges to reopen than others. Unlike previous recessions, the service sector has seen a much greater decline than manufacturing, especially within tourism, live entertainment, and restaurants.

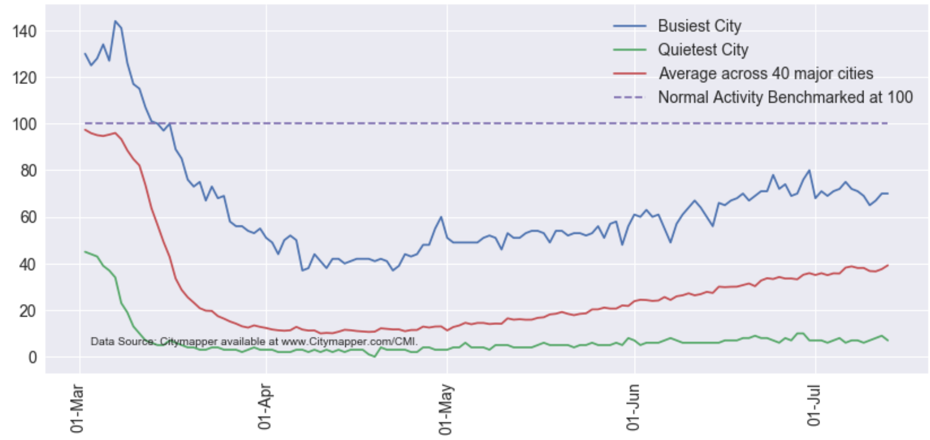
Consumer sentiment has rebounded from recent lows, which should support the outlook for spending, assuming pent-up demand follows through. Since many consumers have been under mandatory lockdowns, economy-wide savings rates have increased. Consumers will likely preserve some additional cash but may be tempted by retailers cutting their prices.

Market movements continue to be driven by expectations around the recovery's shape. How the recovery unfolds will be driven by the trade-off between infection-rates, relaxing social distancing rules, and the resulting impact on economic growth. It could be a 'V', implying a quick return to normal; a 'U', with an elongated return to normal, an 'L', with a very slow recovery; or even a 'W', where we see a recovery being hindered by a second wave of C-19 cases. Other considerations include Brexit, US elections, and US-China trade relations, but these have a marginal impact compared to C-19.

SHARES OVER BONDS FOR THE LONG TERM

Global share prices have recovered significantly since March's low, and while the near-term outlook has much uncertainty, the long-term outlook continues to favour shares over bonds. A key factor is central banks continuing to provide support via Quantitative Easing (QE), which is when they (electronically) print money to purchase assets like government bonds, which also provides support to global shares. This recovery has another significant difference – massive fiscal easing - which is financed by increased government debt issuance (bond sales). While global bond yields have fallen dramatically (meaning bond prices have risen) since the start of the year, driven by risk aversion and global central bank rate cuts, without a further decline, there is less upside potential for bonds. We retain broad global property exposure, as we expect cash flows to recover, outside the retail sector's well-known difficulties in the longer term.

City traffic show gradual return to normality



This document has been prepared by Wealthify's Investment team and the opinions expressed here are theirs.

TOP RISKS

Coronavirus lingers longer than expected, or countries see a second wave of cases

Stock markets remain highly sensitive to changes in the rate of infection.

Markets lose faith in government and central banks

Central banks have slashed rates, and many are now selectively purchasing corporate debt. What comes next remains to be seen.

Rising political turmoil

Global political unrest has not disappeared. US and China trade relations are temporarily more constructive, aiding growth, but this could easily reverse. 2020 has several national elections but the USA result preoccupies markets.

Brexit

Brexit has taken a backseat to C-19. But the process remains the UK's, and to a lesser extent's the EU's, greatest economic unknown. The UK's uncertain trade relationship with the rest of the world weighs on UK shares.

Higher unemployment

Most governments have taken positive steps to cushion businesses and employees from the impact of C-19. The withdrawal of this support coupled with any structural change in the economy, particularly in the service sector remains a risk.

INVESTMENT TYPE	OUTLOOK	RATIONALE
SHARES		
UK	+	Despite C-19 taking the headlines, negative sentiment driven by Brexit is a large, additional hurdle to investor appetite. This is surprising given UK shares have a heavy weighting to overseas earnings, at around 70% for FTSE-100 and around 50% for FTSE-250). Recent events see UK shares being historically cheap, despite the UK government and Bank of England providing significant policy support to help offset the negative economic impact. If the Brexit process is smoother than expected or postponed to allow for a longer negotiating window, then any associated positive reaction should see significant support for UK shares. However, this may be lessened if the Pound quickly rises in value too. The risk of a disorderly Brexit process should not be ruled out, hence our bias for FTSE-100 over FTSE-250 within this allocation.
US	=	Much of US share prices gains over the last decade were driven by the tech sector, which remains cash-rich in this difficult environment. However, there is the possibility that other markets, given their lower valuations, will finally play catch-up. The US has seen a strong policy response which should support the economy and shares in the longer term. However, caution remains around the short-term outlook given the lack of progress against the pandemic. The potential impact of political change in November's election should not be underestimated.
Europe ex UK	=	The European Central Bank continues to provide significant monetary support. However, there is still no consensus on how to finance the proposed European Commission's EUR750bn stimulus plan. The region is heavily exposed to the global trade cycle but does appear to be making progress against C-19. Longer-term, there is a concern of a greater-than-anticipated risk that US-China trade tensions have a European spill over, with greater risk surrounding a direct EU-US relationship deterioration. Current valuations are comparatively appealing, but not cheap.
Japan	+	Japanese share valuations remain incredibly tempting. The economy and country have fared comparatively well against C-19. Government spending support has been significant and twinned with the Bank of Japan (BoJ) providing further and faster purchases of government bonds. If the global recovery falters, and JPY strengthens, it would deliver a double punch to the Japanese stock market's crucial exporters. The continuation of Abenomics (providing fiscal and monetary support) appears certain, but any reversal would be a significant blow. That is unlikely to happen before the next election, planned for late 2021.
Emerging Markets	=	Emerging markets (EM) share performance had a difficult Q1-2020, but Q2 saw much of this lost ground regained. Swift government measures have seen a quick stemming of virus infection rates in many countries, although Brazil, India and Mexico continue to lag. The drop in US interest rates has been particularly supportive for the region. But current valuations are firmly above historical averages, and it is important to note that the region cannot recover in isolation. US interest rates' rapid decline has been supportive for EM, although a sharp reversal would be a concern.
Asia Pacific ex Japan	=	The region, so far, has held up comparatively well during 2020, with the Chinese stock market one of the best performers. However, ApacXJ as a whole is still highly dependent on global trade, in particular China and the US. Prices have risen, and valuations are no longer cheap. We look for further policy spending packages to provide support, but the region also has further monetary room to move. Post-Coronavirus, US-China trade tensions are the overriding concern, but other ApacXJ countries do benefit from this situation.
FIXED INCOME		
Government bonds		
UK	=	UK government bonds (gilts) have benefited from continued Brexit uncertainty. Despite historically low yields and significant fiscal easing, pension and insurance firms remain persistent buyers. C-19 aside, the main concern is a disorderly exit from the EU, which could trigger a growth shock and sustained inflation driven by a weakened Pound. The UK offers a diversification option due to idiosyncratic factors such as Brexit.
US	=	Investor risk aversion, combined with the coronavirus economic shock, has already provided significant support to US bonds. However, investors see potential for further easing from the Federal Reserve given a greater ability to ease further than other central banks due to the high global demand for US dollars, especially for funding and liquidity needs.
Europe ex UK	-	We believe Eurozone government bonds are overvalued given their continued distortion by Quantitative Easing. The resumption of ECB QE is likely to cap yields, but political risks and budgetary concerns may see them move higher intermittently. Concern also remains around the long-term debt sustainability of the periphery compared to the core.
Japan	-	Japanese bonds offer little income and remain severely distorted due to the BoJ's "Yield Curve Control" program. While the BoJ might alter this program, there's little expectation for significant medium-term change. Shares are an attractive way to capture Japan's economic improvement.
Emerging Markets	+	EM government bonds continue to offer a strong yield premium compared to Developed Markets. Similarly, their currencies appear undervalued, offering an additional supportive factor. Comparisons of the current Trade-Tiff with the 1998 EM crash are overdone, with external debt, Foreign Exchange reserves, and overall fiscal prudence significantly firmer.
Corporate Credit		
UK	=	The Bank of England's (BoE) expanded bond buying program will likely provide continued support, at the cost of distorting the market further. These bonds provide diversification within the corporate sphere. We are reluctant to increase our position as spreads are back to normal levels following significant policy support.
US	=	Economic concerns caused corporate yields to rise significantly before the Fed announced so-called QE infinity, causing corporate yields to drift lower. However, yields are still higher than those seen recently due to economic concerns. As with other regions, we prefer Investment Grade over High Yield, given that the additional risk premium available is unconvincing.
Europe ex UK	-	The ECB's newly expanded bond buying program has stretched this market further. These bonds are uncompelling, particularly compared to shares.
Japan	-	Similarly to Japanese government bonds, Japanese corporate bond prices have been distorted by QE. We prefer share exposure, especially whilst Abenomics continues.
Alternatives & Thematics		
Environmental	+	Companies that focus on reducing their environmental impact often have a competitive advantage as they tend to have greater resource efficiency, leading to lower costs. They may also experience lower downside risks due to more robust corporate governance, and this can support greater diversification benefits.
Global Real Estate	=	While C-19 has placed this asset class under pressure, we see this strain as being short-term. The retail sector's woes are well documented, but a sectorally and regionally diverse portfolio remains fundamentally appealing given constrained supply and low-interest rates will also provide a buffer.