Market Update – COVID-19

July 06, 2020 Close unless otherwise stated

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Prepared by Aon

Our Views

- Markets have bounced back sharply as signs of an easing virus trajectory across major developed economies and unprecedented fiscal and monetary stimulus measures boosted markets. However, rising cases in the US and elsewhere is a risk for equity markets.
- As a sharp economic recovery appears to be priced into markets already, sustainable gains from here look much more difficult with valuations looking stretched. Near-term economic data looks better, but this reflects a bounce from the March/April lows.
- Bond yields remain at rock bottom levels, as global QE programmes and policy interest rates hold yield curves down. This is unlikely to change over the medium-term.

Actions for client portfolios

- **Market appreciation has ruled out scope to add to equity portfolios. For those seeking to strategically de-risk equity allocations, current conditions are shaping up to be an opportunity.** We not believe large market falls are necessarily imminent, but support for a further sustained gain in markets is low.
- **Credit risk remuneration has been falling as spreads move towards our long-term fair values. Our views are now moving towards a more neutral stance versus gilts and other government bonds on our medium-term view horizon.** We recognise that income focused investors need credit exposure to meet strategic income generation objectives, and market conditions remain constructive for those taking longer-term horizons.
- **Diversification has paid off during volatile market conditions, and we believe they retain an important role in portfolios given the degree of market uncertainty.** Any onset of market weakness or higher volatility will improve the case for using diversifiers as a funding source for adding risk to portfolios.
- **Duration positions should be taken with care.** A mild underweight looks reasonable, but we do not believe it is likely that yields will move up very much even after the virus scare has passed. Hedge ratios should be managed accordingly.

What we are watching:

- Signposts for the duration of global economic weakness. We continue to expect a relatively low octane economic recovery when lockdown restrictions are lifted. More confidence here would help the case for adding risk to portfolios.
- The scale of valuation adjustments in equities and credit, alongside technical and sentiment indicators pointing to a more sustainable market recovery.

COVID-19 Update

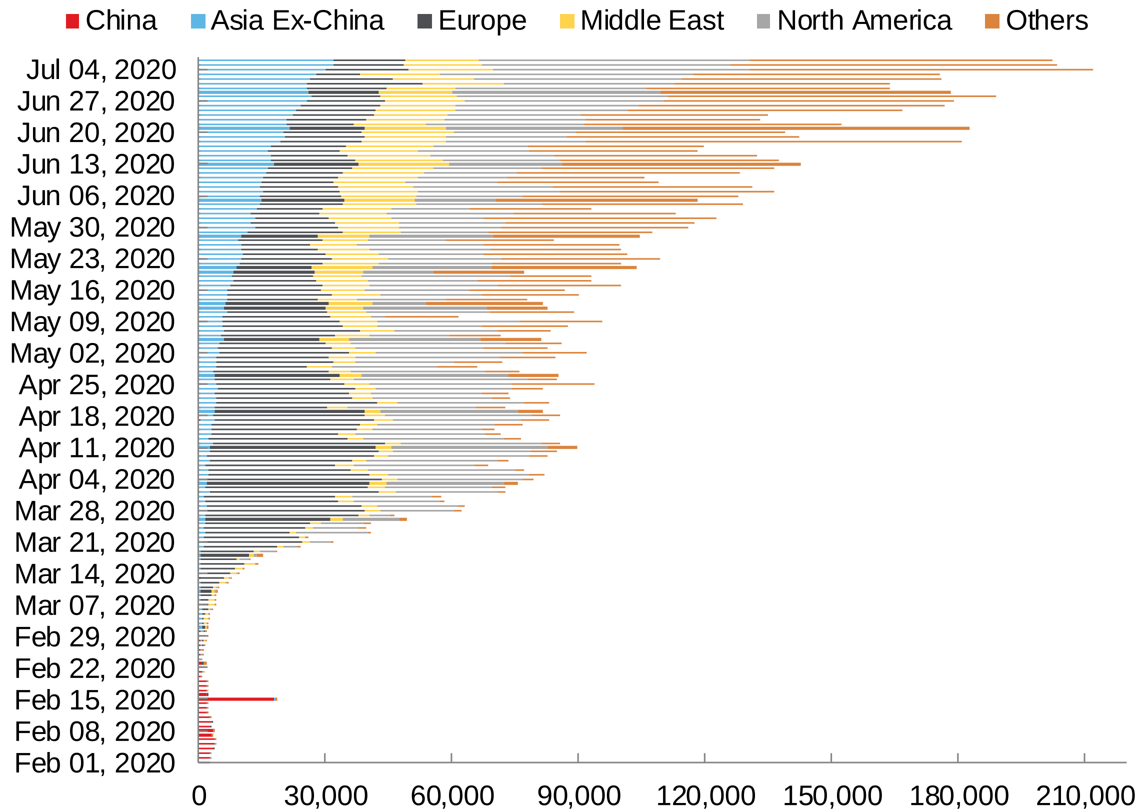
Current Situation
(06 July 2020)

Global	
Confirmed Cases	11,327,790
Deaths	532,340

Europe	
Confirmed Cases	2,791,160
Deaths	200,238

United States	
Confirmed Cases	2,833,552
Deaths	129,408

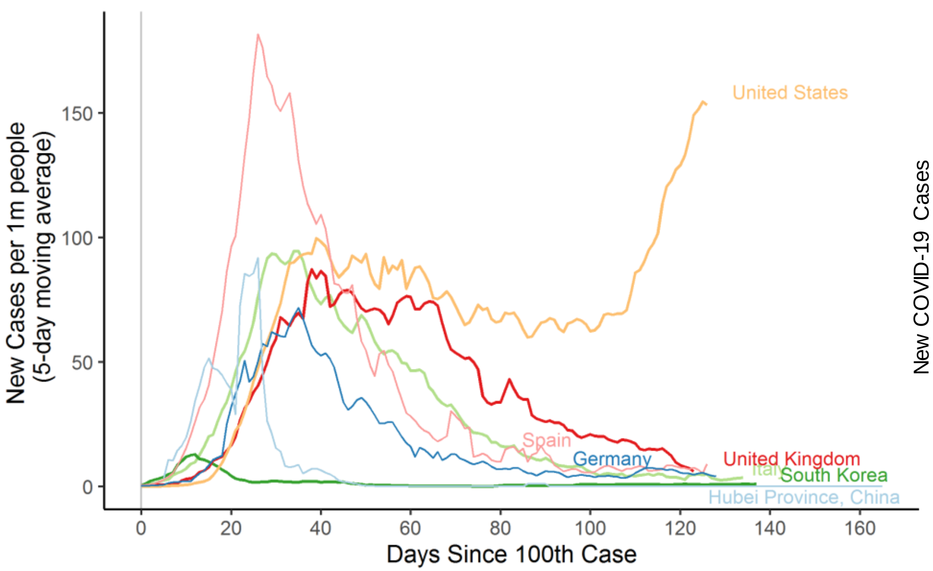
New COVID-19 Cases

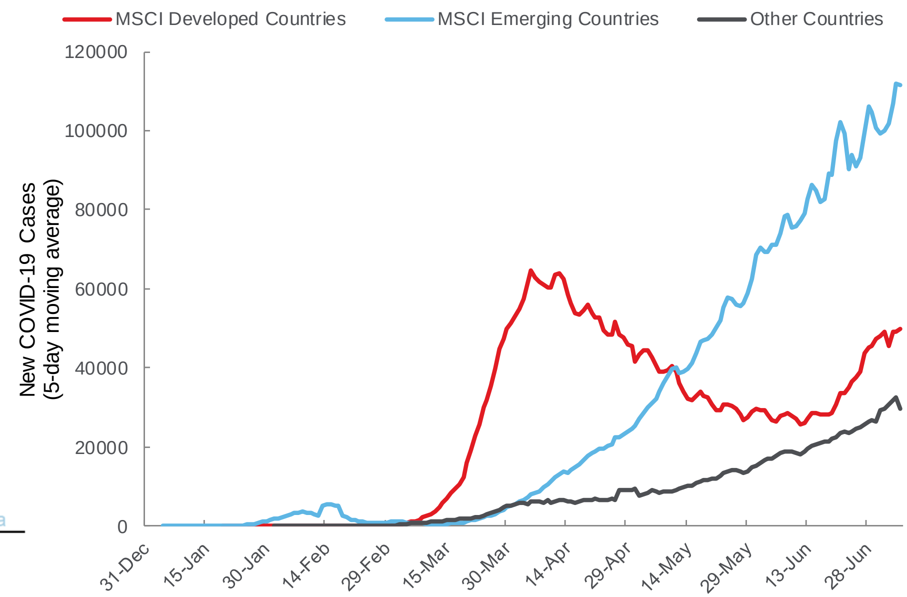


Source: FactSet, World Health Organization, National Health Authorities. Regions not shown above has been categorized under "Other".

COVID-19 Virus Trajectory

- The lockdowns appeared to have been effective in containing the first wave outbreaks across developed economies, but a new spike in cases in the US highlights the difficulty of keeping the virus under control without shutting the economy down for a prolonged period
- Signs of a “flatter” virus trajectory across major developed economies have helped markets to rebound from its mid-March lows. However, infection rates remain high amongst some emerging market economies, whilst rising cases in the US could also put the equity market recovery at risk.

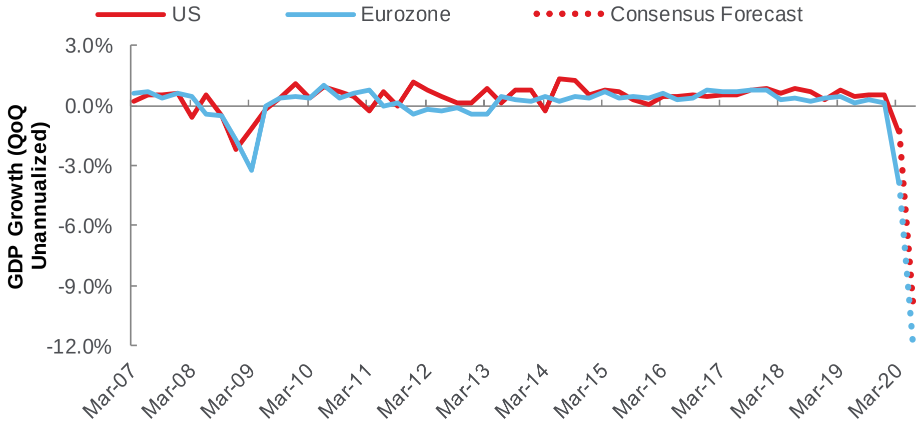




Source: Aon, MSCI, European Centre for Disease Prevention and Control, Hubei Province data sourced from John Hopkins University.
Data as at 6 July 2020.

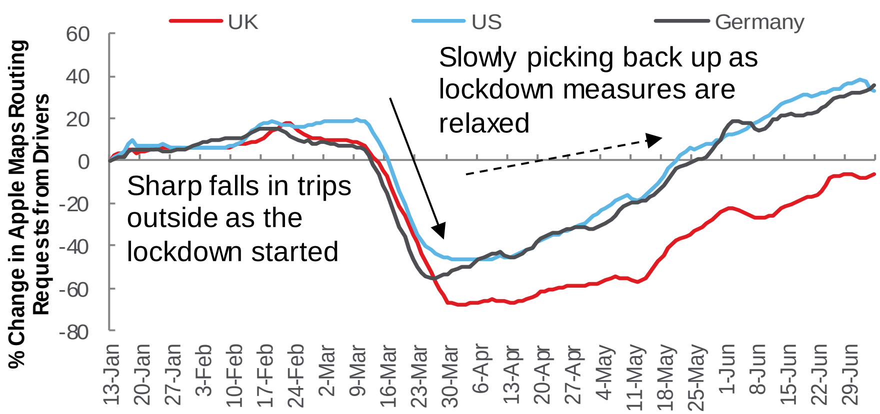
An Economic Catastrophe

Q1 GDP figures are indicating a sharp economic contraction, with worse expected in Q2



Source: Bloomberg

Apple Maps data point to some improvement in transport activity

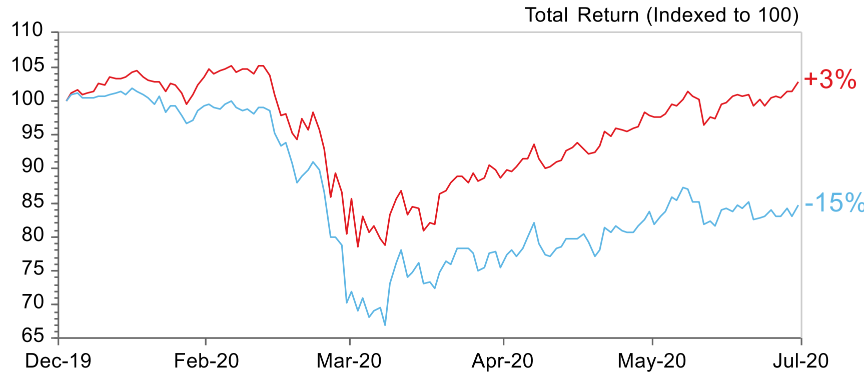


Source: Apple. 7-day moving average shown.

- The "Great Lockdown" looked to have been effective so far in containing the spread of COVID-19, but at the expense of what's likely to be the worst recession in generations
- The scale of the economic damage is starting to become apparent
  - The US unemployment rate hit a peak of 14.7% in April, the highest level since the Great Depression in the 1930s, before falling back over May and June.
  - The UK GDP fell by 20.4% in April alone, three times greater than the contraction recorded over the whole of the 2008-09 Global Financial Crisis.
- The length and severity of the recession will depend on how quickly things can get back to normal
  - Many parts of Europe and the US have relaxed their lockdown measures. However, many US states have suspended or reversed reopening plans amidst a new spike in US coronavirus cases
  - Getting back to normal would likely take a long time. Social distancing would likely persist even if official lockdown measures ended
  - A severe "second wave" outbreak is a risk, and if the virus starts escalating again another lockdown may be needed

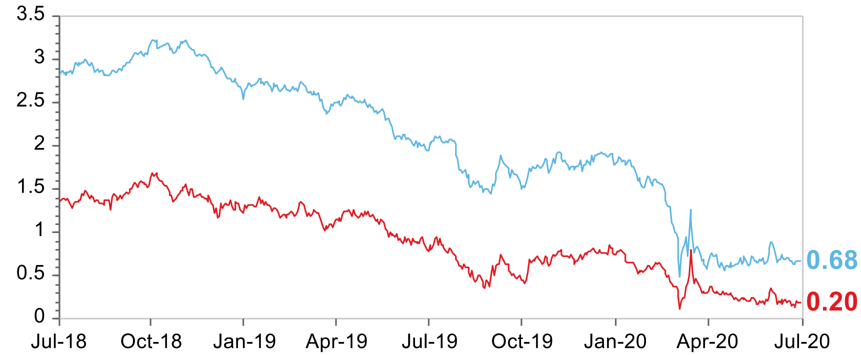
Market Reactions

Equity Market YTD (GBP terms)



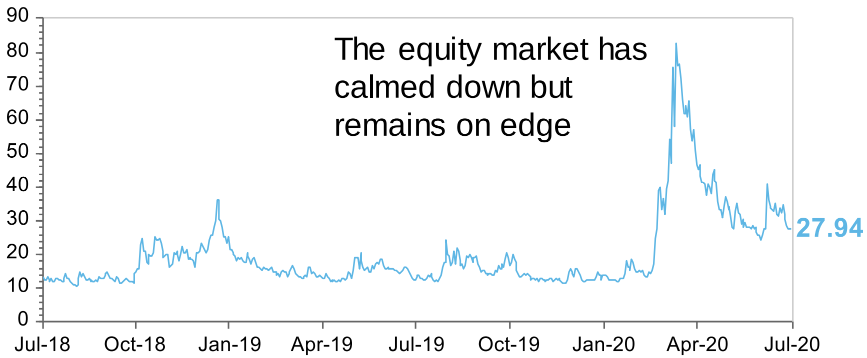
Source: FactSet

Government Bond Yields (%)



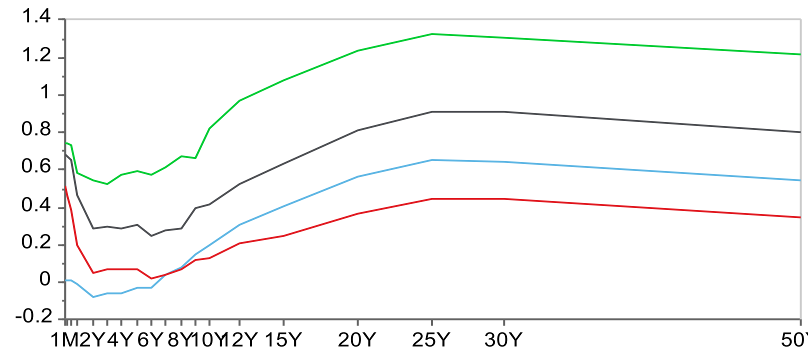
Source: FactSet

VIX



Source: FactSet

UK Gilt Yield Curve



Source: FactSet

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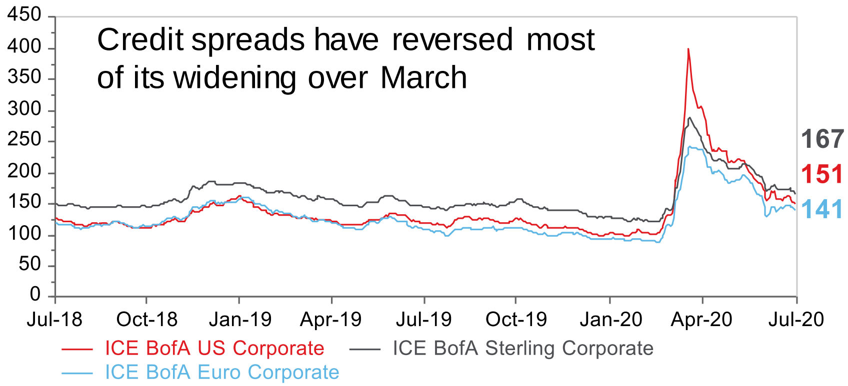
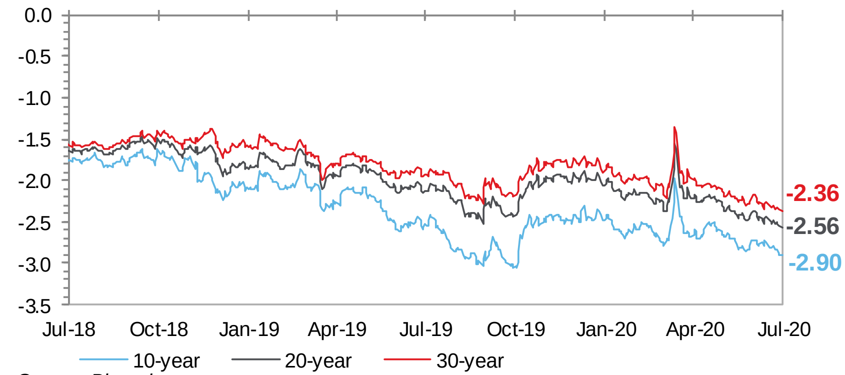
Market Reactions

Investment Grade Credit Spreads (bps)



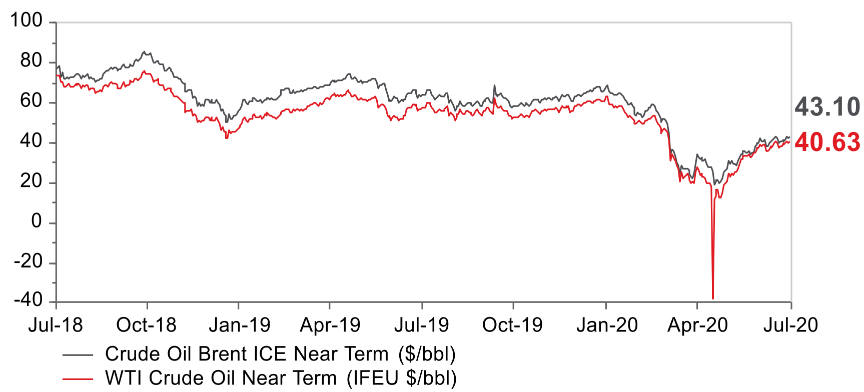
Source: Factset

Real Yields (%)



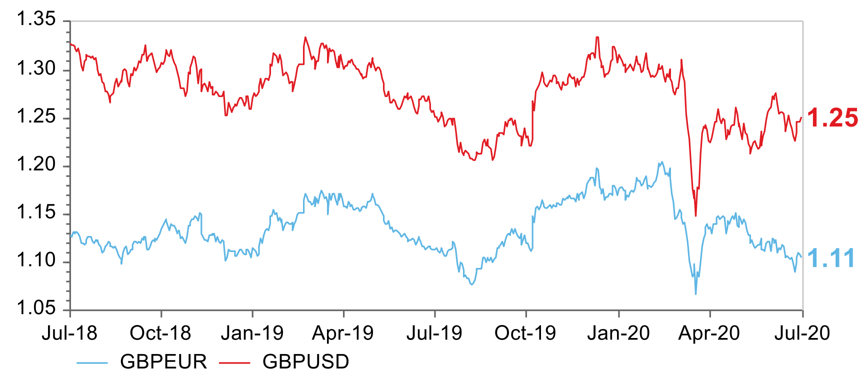
Source: Bloomberg

Crude Oil Spot Price



Source: FactSet

Sterling Exchange Rate



Source: FactSet

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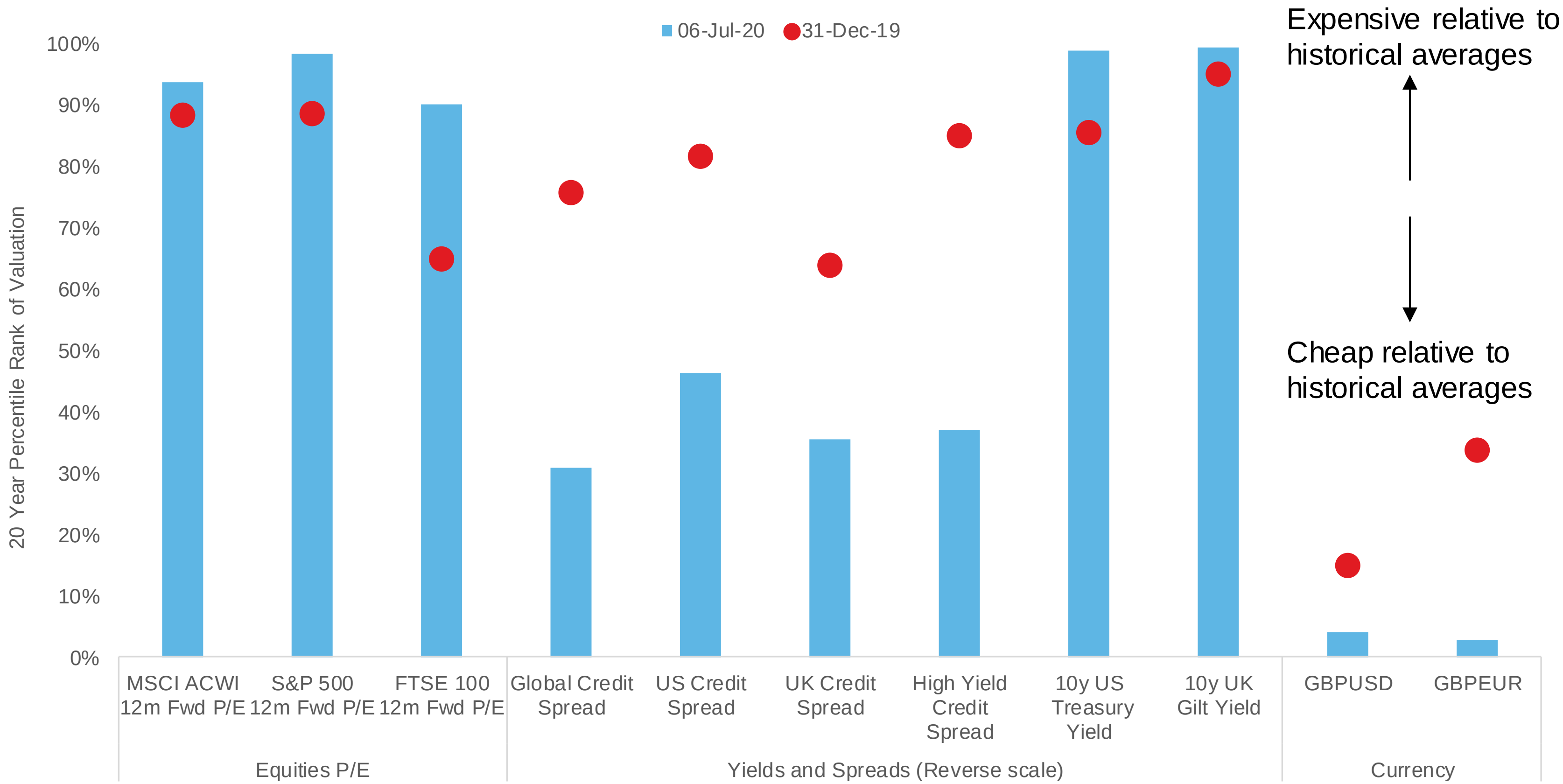
Market Valuations

Equity markets are looking expensive when valued using near-term forward earnings, but markets appear to be looking through near-term weaknesses. Note that forward looking measures of value may be using stale estimates, as the economic impact is so uncertain.

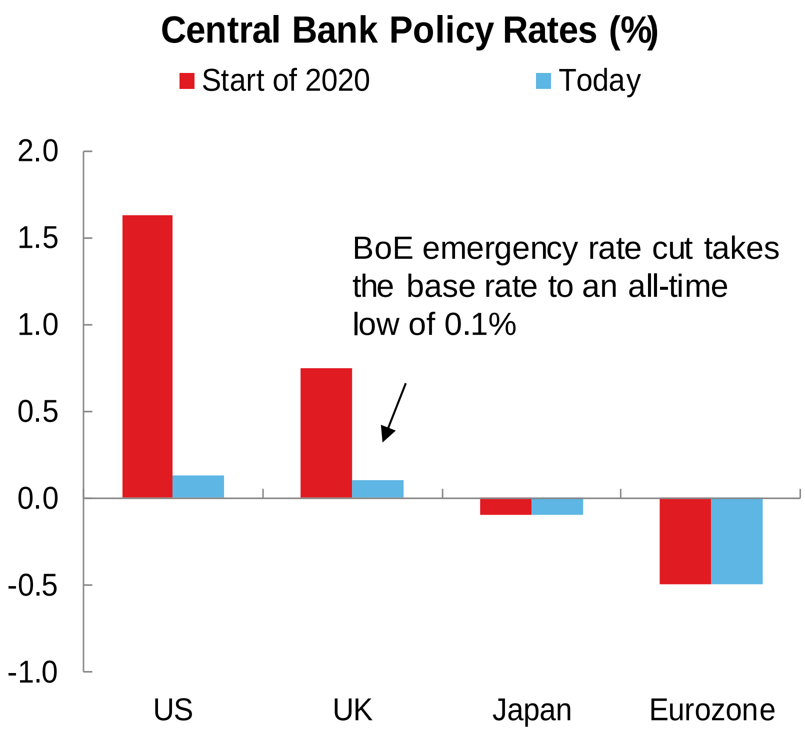


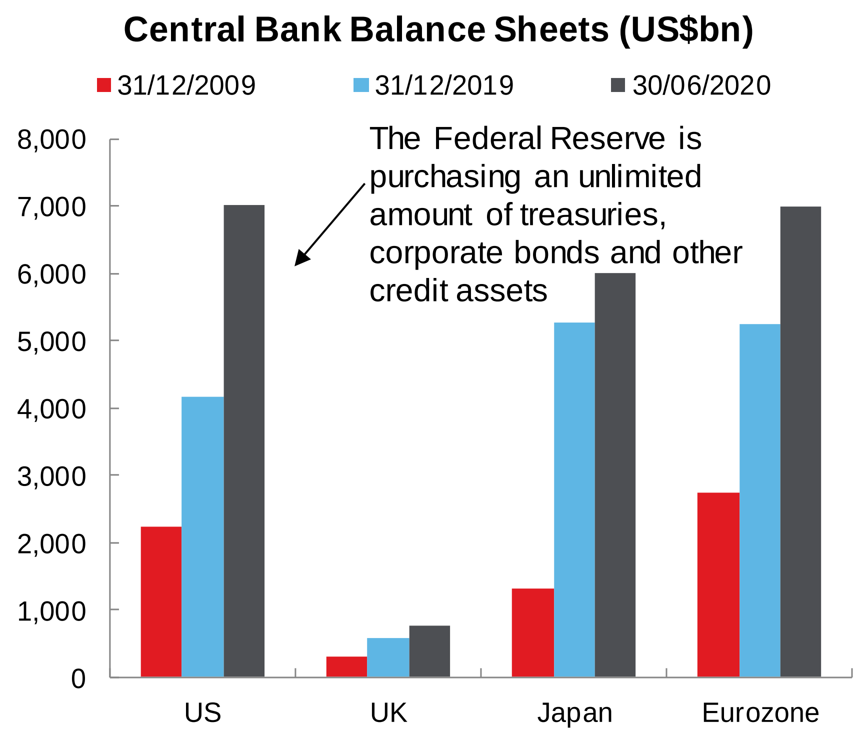
Source: Aon, Factset

Notes: Valuations used: Equity markets = Next Twelve Month PE Ratio, Credit Spread = Option Adjusted Spread, Treasury Yield =Yield To Maturity

Central Bank Actions

- Where possible central banks around the world have eased policy, but with rates being low there is a limit.
- Unprecedented new quantitative easing measures have been announced to provide further monetary stimulus.





Source: Aon, Bloomberg, FactSet
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Announced Fiscal Packages

USA	▪ Congress has passed a c.$2 trillion fiscal stimulus package. The package expands jobless benefits and provides direct transfers of up to $1,200 for Americans earning less than $75,000 per year ▪ State of Emergency declared releasing $50bn to States to deal with virus
UK	▪ £330bn in loans and £20bn in other aids have been announced to provide help to businesses. ▪ The government has agreed to cover 80% of salary for employees who are unable to work due to coronavirus related shutdowns. Similar schemes have also been introduced for self-employed individuals.
Japan	▪ Japan has approved a c.$1 trillion fiscal stimulus package. ▪ A variety of small fiscal measures have also been passed. Two small business loan bills totaling $20bn. $4bn for mask production and stopping viral spread.
Eurozone	▪ A €750bn recovery fund has been proposed by the European Commission. The proposed package will be funded by issuing mutualized EU debt. ▪ Germany have launched a €156bn supplementary budget and have launched a loan guarantee program worth up to €950bn (c.28% of its GDP). ▪ France has announced emergency fiscal spending of up to €110bn.

Appendix

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