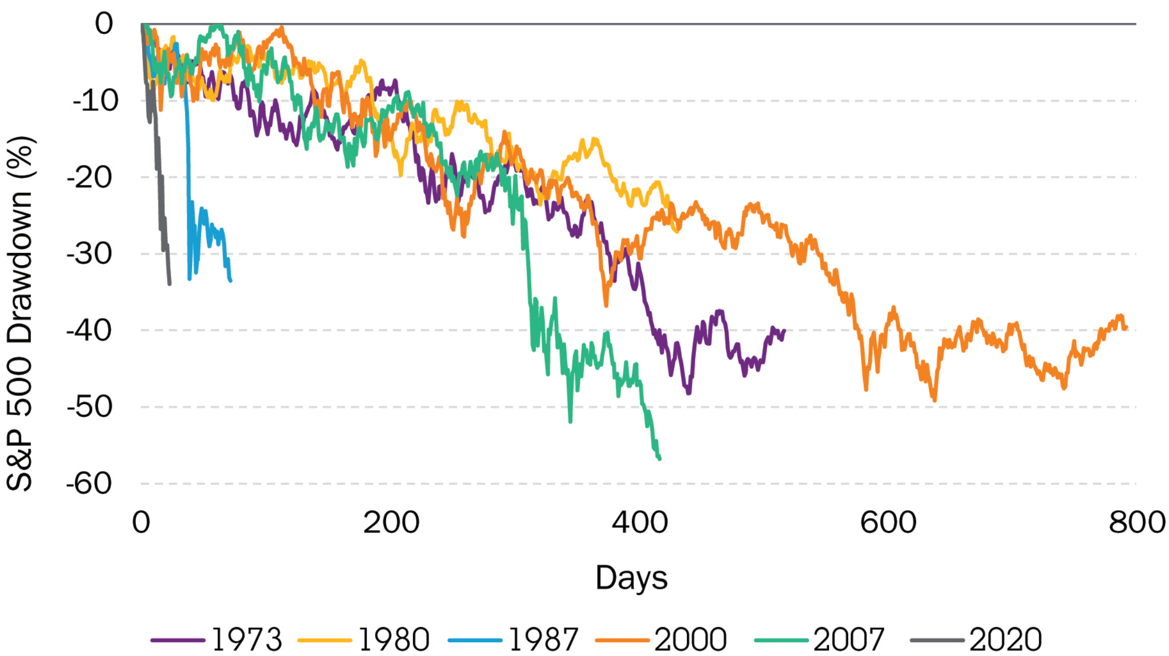
Welcome to the DC Investment Update for Q1 2020

What a difference a quarter makes. As the dust settles on Q1 2020, it gives us an opportunity to assess the damage to public markets as a result of COVID-19. MSCI World in Euro terms was down 19.2% for the year in stark contrast to the returns investors experienced over the course of 2019. We have seen an impressive bounce back in performance since the lows on the 18th of March when the VIX, as an indicator of implied volatility on the S&P 500, hit levels higher than the depths of the equity market sell off during the Global Financial Crisis (GFC) in 2008).

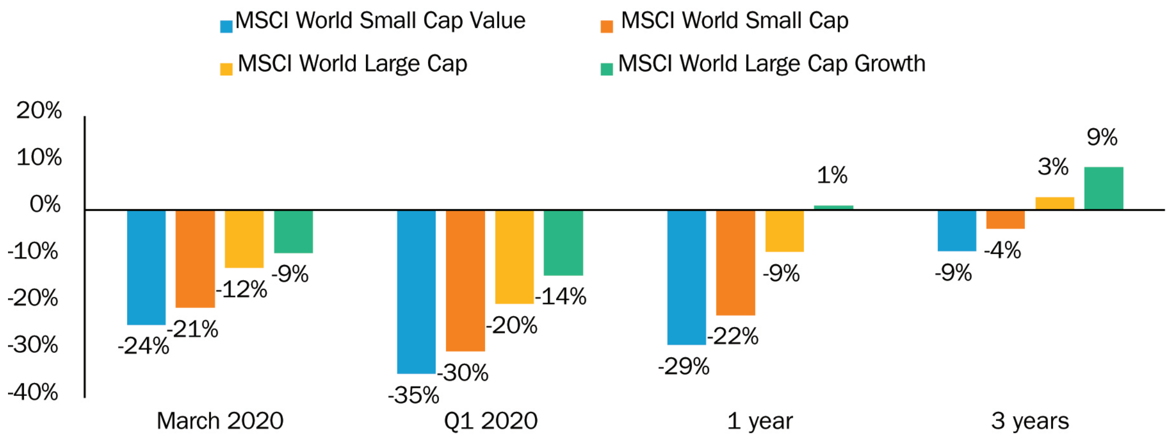
US equity markets: 2020 vs previous bear markets



Past performance is not a reliable indicator of future returns.

Source: S&P, Epoch, 31 March 2020

This rally has been particularly strong in the US led by growth and large cap companies, a byword for Tech in recent years. As an example, Tesla was trading higher than it was at the end of January when there was a far more sanguine outlook for economic growth both in the US and globally.



Past performance is not a reliable indicator of future returns.

Source: MSCI 31 March 2020, in USD.

€ The bounce in equity prices has correlated with the flattening of the COVID curve, a term which has become ingrained in the media coverage of this crisis. The flattening of the curve and a drop in new cases and deaths in Europe give us hope that the end is near, and we can return to some kind of normality sooner rather than later.

The key financial factors that have dominated investor focus have been the support global economies are being offered by Governments and Central Banks in terms of fiscal support (government spending) and monetary support (lower interest rates and a broader inclusion of what can be included in the Quantitative Easing (QE) programmes that have been a key policy tool for Central Banks since the GFC over 10 years ago).

Governments have acted very quickly to support their citizens and businesses that have been impacted by the decisions made by politicians to effectively shut down their economies in a bid to fight the virus. Here in Ireland there have been a wide range of policies from enhanced unemployment income support, mortgage support and supports for businesses to ensure that individuals and businesses are well setup to ensure this does not become another credit crisis. Unique to Ireland, SMEs employ over 70% of those in work, far higher than our European counterparts so it’s vital for Ireland that these businesses are supported, and the government has handled this well so far. In US the we have witnessed a $2 trillion rescue package signed into law to provide

financial relief to people there. While there has been a wide range of measures, the most eye-catching has been the $1,200 stimulus cheques that Americans will receive directly from the Government. Interesting the Treasury has delayed these cheques after it ordered Donal Trump’s name to be printed on them.

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respective QE programmes to include a wide range of securities that they can purchase. In the US the Fed moved to purchase sub investment grade credit, also known as high yield debt, for the first time. This was particularly welcome for US Oil and Energy businesses that had been hit by both COVID and a collapse in the oil price. Over the last decade there has been a rule of thumb – do not fight the Fed. For the time being that would appear true as investors think about COVID induced shutdown exit strategies. Should we see economies remain closed for longer than expected, this would be bad news for risk assets including equities.

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The outlook from here is highly uncertain at the moment and the asset research team have outlined 3 possible scenarios as a way to help understand possible outcomes:

	GLOBAL RECOVERY	EXTENDED GLOBAL RECESSION	CREDIT SQUEEZED AND DEFAULTS
Epidemiology	▪ Public health policy measures are highly effective - virus spread controlled by mid-Q2	▪ Problem transmissions occur up to Q3. Public health policy is less effective; control of the virus and social distancing easing takes 4 months; with new cluster cases in localised areas	▪ Problem transmissions occur up to Q3. Public health policy is less effective ▪ New cluster cases continue in localised waves through the northern hemisphere winter
China	▪ Recover in factory output is largely complete by early-to-mid Q2; Consumers confidence recovers in Q3	▪ Recovery in factory output is delayed until Q3; consumer confidence recovers only in Q4	▪ Recovery in factory output is delayed until Q3; consumer confidence recovers only in Q4 ▪ Slower recovery in export sectors
US and Europe	▪ US and Europe have an acute contraction until mid-to-late Q2 ▪ Highly effective government credit support for households/businesses ▪ SMEs are most affected; service sectors (aviation, travel, tourism) will be significantly affected ▪ Energy sector affected by lower oil price to Q3	▪ Global recession over Q1 to Q3; US and Europe contract significantly throughout Q2 and Q3 ▪ Acute, sustained and broad-based decline in corporate earnings in 2020 ▪ Large-scale government credit support for households/business ▪ Consumer confidence does not recover until Q4	▪ US and Europe contract through Q1 2021 ▪ A shock to employment, incomes, and global trade drives deleveraging given high debt levels ▪ Company funding and credit conditions are acutely affected leading to defaults ▪ Policy is insufficient or ineffective; economic recover is weak from Q2 2021

We believe economic policy is more likely than not to avert the self-reinforcing negative spiral of defaults, unemployment, lost income and declining consumption of scenario 3. However, scenario 3 is still a plausible if relatively low likelihood outcome from here – perhaps 10% likelihood.

The difference between scenarios 1 and 2 comes down to the effectiveness of public health policy, the length of suppression measures and economic shut down, and the effectiveness of economic policy (support for small and mid-sized enterprises especially). We have a roughly equal likelihood for these two scenarios.

Having said this, for the purposes of decision making, we think it is more useful to track the pathway of the disease and policy effectiveness (both public health and economic) by country as it is likely important differences will emerge (i.e. different countries will experience different scenarios concurrently).

Reference for the employment numbers: https://merrionstreet.ie/en/News-Room/News/Government_Launches_Major_OECD_SME_and_Entrepreneurship_Policy_Review_as_Part_of_Future_Jobs_Ireland.html

LifeSight

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