Amplia Monthly Investment Letter

Stabilising markets

If March was the worst month for US large-cap equities since October 2008, then April was the opposite: S&P 500 gained 12.7% in April, thereby posting its best month since 1987. The rally has been uneven, with select companies that profit from the lock-downs, such as Amazon, Netflix and Delivery Hero reaping most of the gains whilst some other sectors, such as energy, have seen a more modest recovery. At any rate, the daily price swings are not measured anymore in double-digit per cents, and the stock price volatility has halved from its March peaks. The obvious question is now, is this a bear-market rally with further downside or start of a sustaining recovery.

Factors speaking for asset price recovery and against it

The largest single contributing factor to the recent gains has probably been the reversal in the spreading of the COVID-19 virus, and the subsequent gradual loosening of the lock-downs. This has reduced the uncertainty faced by investors, and as we know, the markets do not like uncertainty. Another significant factor has been the unprecedented support from the governments and central banks, which we discussed at length in the previous issue of this letter. Thirdly, equity markets have the capability of looking beyond several quarters of negative growth, and clearly investors are presuming that normal activity resumes in a year's time or shortly thereafter.

On the hand, the economic data has been as gloomy as feared (if not gloomier) and despite the approval of Gilead's Remdesivir as a reactive treatment to the virus, no breakthroughs on the vaccination side have been made so far.

Our markets positioning

In terms of equity markets, we think that the upside in the very short term is limited, given the strength of the past weeks' rally. Hence, we have taken a more cautious stance on equities at the beginning of May, after raising the stock allocation at the end of March and mid-April. We feel this reduction is prudent, given the considerable drop in consumers' disposable income amid rising unemployment and decline in capital expenditure by companies.

Looking at the brighter side of things, central banks across the globe and governments especially in developed countries are continuously announcing new stimulus measures and expanding the amount of liquidity circulating in the economy. Hence, we also deem it improbable that the markets would breach the lows seen in the second half of March.

Moreover, the development of the COVID-19 drug will continue to progress, and we think that the markets are not paying due attention to this. The development is driven by many very talented researchers in close coordination with each other. One should compare its development to the progress of clinical trials of a normal drug and the associated share price movements by the company developing it. There will be ups and downs, as news break about the status of the approval path and acceptance by medical authorities, but the point is that the value is created over time, not in a single event. Equity markets will climb as a function of time in anticipation of the drug, all else being equal.

Thus, to summarise our views on equities for the moment: we remain cautious in the short-term. Should we see a sell-off in the upcoming weeks, we would be inclined to add to the positions again. In the meantime, selectivity is key: we would favour large companies with valuable brands, unlevered balance sheets and business models that are not capital-intensive until we start having better visibility again.

On the bond markets, the recent months' developments have been interesting, to say the least. Five-year European investment-grade credit spreads spiked from circa 40 to 140 basis points from February to mid-March, only to drop to low 80'ies in the following two weeks. These sharp moves reflected the market expectations of considerably rising default rates in the investment-grade -rated bonds and the subsequent receding of credit concerns. The credit spreads started to normalise after the ECB and the Fed began monthly buying bonds of investment-grade companies and – the Fed since recently – of the so-called "fallen angels", i.e. companies whose bonds were investment-grade before the crisis but got downgraded to high yield in the aftermath.

In the short-term, we see considerable value in mainstream EUR- and USD-denominated bonds, both investment grade and high yield. This is because we see signs of more and more investors returning to the bond market, and because the massive bond buying programs of the central banks should push bond prices higher. By applying a selective approach across sectors and countries and avoiding companies which have little control over their revenue base (most single-commodity producers such as oil & gas or copper producers), one can find great names and lock in attractive yields in the current environment where interest rates are very low.

With the central banks expanding their balance sheets without an end in sight, buying gold as a hedge against inflation may be reasonable. However, the gold price plummeted 12,45% within only 10 days in March. This once again emphasises the fact that correlations increase in times of market turmoil, and as such, cash may be a better short-term portfolio protection vehicle than gold.

As to currencies, the risk-off sentiment still weighs on GBP, EUR, SEK, NOK and CNY. Contrary to this, the currencies traditionally regarded as safe havens (JPY, CHF and USD) are trading at high levels. When and whether this trend reverses depends on the general investor mood. Those who think that the markets will recover soon may do well by establishing long positions in the risk-on currencies. For instance, with the USD having lost recently its interest rate carry edge, taking long positions in EUR/USD forwards is suddenly not expensive anymore.

In Zurich on 5th May 2020,

with kind regards

Juho Kivioja