



# Navigating uncharted territory



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There has never been a time in history quite like it...

A global pandemic, the likes of which the world has not experienced since 1918, and a response in terms of lockdowns, which are unlike anything that has come before (at least since the Great Plague?!).

The biggest falls to economic output over a single month and a single quarter that we've EVER seen.

Given this, perhaps it's not surprising that stocks saw the fastest drop into a bear market (defined as a fall of 20% or more) of all time.

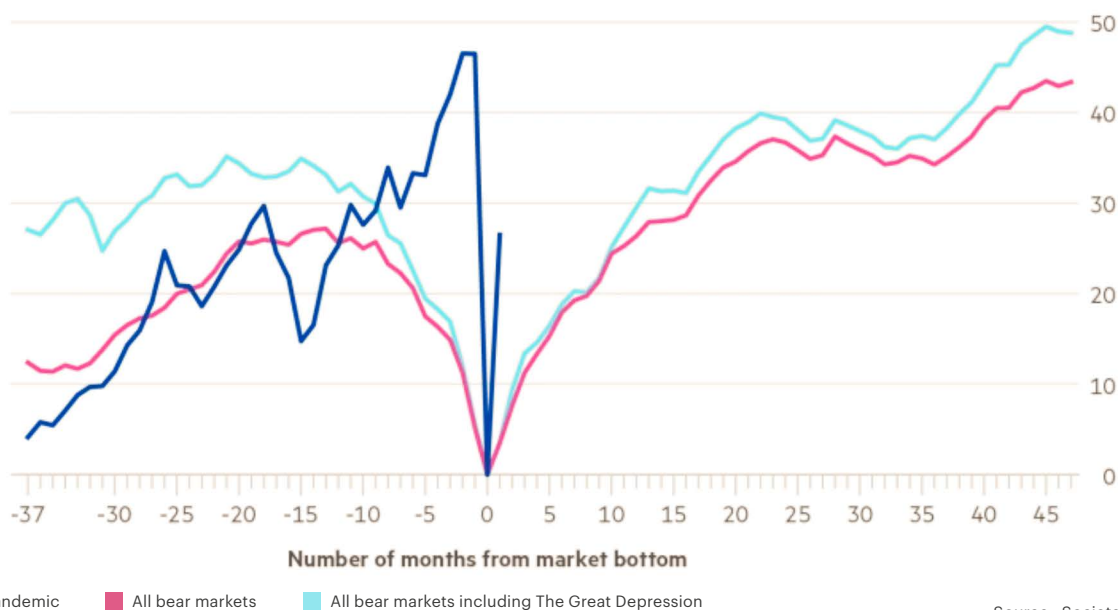
But then we have seen the recovery....

Having seen the fastest drop, we've now seen the fastest return to a bull market (where markets are at least 20% from their lows) that we've ever seen.

Chart one was published in the Financial Times on 11 May, using data from Societe Generale. It compares the recent market movements to past bear markets throughout history. The contrast is quite remarkable.



**Chart one:** How markets have rebounded through history



This is based on the S&P 500 index, which is the main US stock market. Since this chart was published, markets have recovered even further and, on 8 June, the US market briefly turned positive for 2020 so far!

Looking at the IFSL Equilibrium funds, they remain slightly down so far in 2020 but are higher than they were 12 months ago, with cautious up 1.16% and adventurous up 1.65% from 7 June 2019 to 9 June 2020.

Other markets remain well below their peaks but have also recovered a long way. For example, the FTSE 100 here in the UK closed at 6,335 on 9 May, 16% below the 7,542 level it was on 31 December 2019. However, it is also a long way from where it was on 23 March when it got as low as 4,993 and has rebounded 26.9% since then.





## Sticking to strategy

When the market started falling earlier this year, we did what we normally do in a typical correction and started buying.

Of course, this turned out not to be a typical correction. Several of the trades we put on therefore made our returns worse in the short term, as markets carried on falling after we'd bought them.

For example, our first volatility trade was added in February when the FTSE 100 was around 7,150. We took between 2% to 5% (depending on the fund) from low-risk assets and used this to buy a FTSE tracking fund, with the intention to sell if the market recovered. This is something we had done six times over the previous 12 months to good effect.

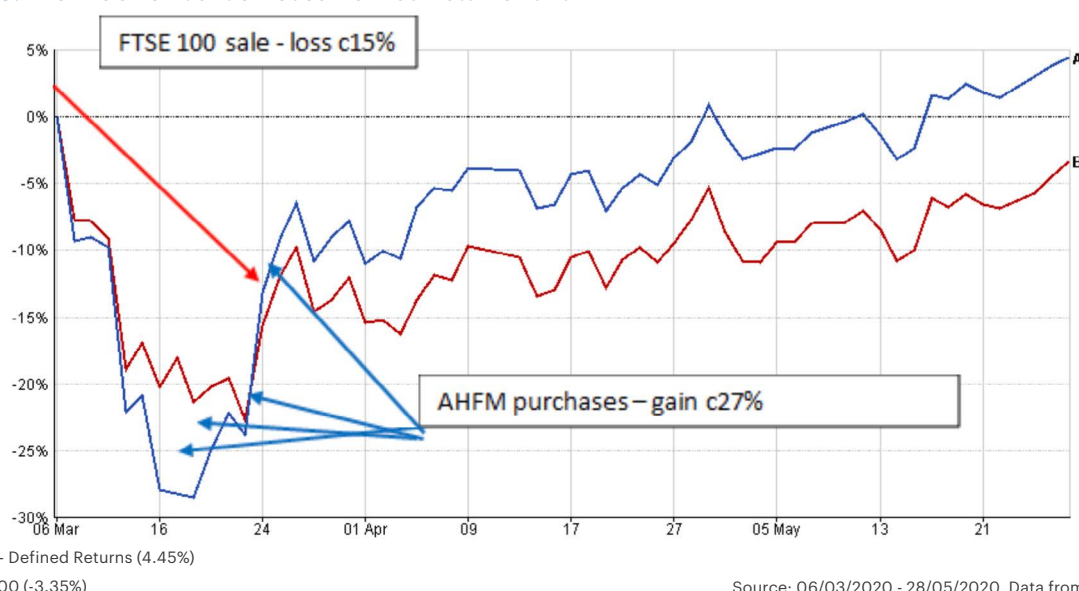
At the time 7,150 seemed like a good entry point, with us not yet knowing the extent of the spread of the virus. This trade is still significantly under water.

However, our next buying point was at 6,550 and this trade is now in profit, despite the market still being down since then! This is because, having initially bought an index tracking fund, we switched it to defined returns during the lows of late March.

Chart two shows the FTSE 100 in red against the Atlantic House Defined Returns Fund in blue. This chart is shown from 6 March, when we bought the FTSE tracker at c6,550, to 28 March.

As you can see, whilst the market was down over this period, the Atlantic House Fund ended up in positive territory. We've also marked on the chart the points at which we sold the FTSE tracker and bought the Atlantic House fund.

**Chart two:** FTSE 100 vs Atlantic House Defined Returns Fund



We sold the FTSE 100 tracker at a loss of around 15% on 24 March and bought into defined returns instead. We bought at several points (including some direct products as well as the Atlantic House Fund) and gains since then range from 14.8% to an incredible 46%! Overall, the weighted gain from these purchases are around 27% (this varies slightly from fund to fund due to different transaction dates and amounts).

If you add the 15% loss and the c27% gain, this works out as an approximate overall gain of almost 8%, despite the market being down over this period. We sold much of the additional defined returns we bought at the market low on or around 28 March, so this gain is now "in the bank".

Another trade which felt painful for a while was also to

do with defined returns. On 11 March, when the FTSE 100 was at 6,000 and the S&P 500 was at 2,808, we bought a defined returns product from Goldman Sachs.

This promised to pay a 20% pa (non-compound) return should the markets be at or above those levels on any of the first six anniversaries. At the time, we thought this was almost too good to be true, but a couple of weeks later when the FTSE fell to 4,993, the product was down over 22%.

However, since the recovery this product has gone up sharply. As of 9 June, we could have sold it for an 11% gain from purchase. We will not do so of course, as the gain will increase to 20% provided the FTSE does not drop 335 points from here (and the S&P 500 also remains above its starting point).



## Offence and defence

Whilst the above changes to portfolios were “offensive” in nature, we also made several “defensive changes”.

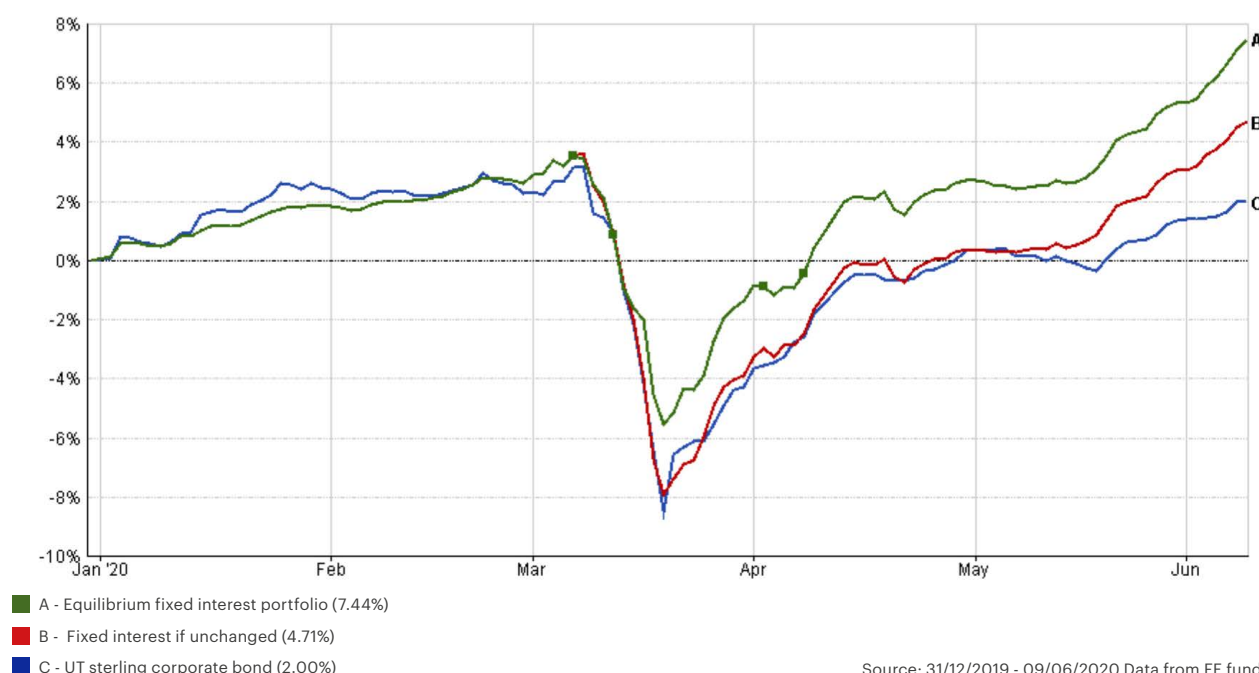
In particular, we sold many of our fixed interest funds in early March. We were worried that corporate bonds could be hit by many of the same issues which had hit stock markets, and that they could fall sharply.

This did indeed turn out to be the case. However, having fallen, many of the funds became much more attractive as

the yields that they produce increased. We therefore have bought back many of the fixed interest funds we sold.

Chart three shows our fixed interest portfolio in green from the beginning of 2020 to 9 June, compared to the average corporate bond fund in blue. The red line shows what would have happened to our portfolio had we not made the changes.

**Chart three:** Fixed interest portfolio vs average corporate bond fund



Had we not made the changes we would have seen our fixed interest funds fall just as much as the average fund, but at least they would have recovered more quickly. However, by selling and then buying back at a lower price, we reduced the losses but still benefited from the gains.

As the world has changed rapidly around us, we have reacted as quickly as we can to change the portfolio accordingly.

Whilst we’ve not always made the right move at the right time and not every move we have made has worked out as yet, the changes we have made in 2020 have had a positive effect on the portfolio overall.



## General economic view

We are the middle of the steepest recession of all time here in the UK, and the same can be said for many places around the world. Most countries are now slowly emerging from lockdown which means their economies will rebound, but it will take time to get back to previous levels.

The outlook remains largely dependent on what happens with the virus. A second wave could cause another big hit, whilst effective treatments could lead to a much quicker rebound.

We expect interest rates and levels of inflation to remain low for at least the next 12 months.

## Equity markets

Investors are generally trying to look through what is happening at present and are having to make decisions on what company profits might look like in two years' time. That makes markets vulnerable to a pullback but we still think they are likely to be higher in 12 months' time. We are less positive on the UK than we were and have increased overseas exposure.

## Fixed interest

We think certain corporate bond markets look good value at present as their yields have gone up in the recent sell off. There is little chance of interest rates going up in the short term which could hurt these bonds, but there is a higher risk of default in the current environment. Despite this, we think the potential return is worth this risk and have increased exposure.

## Commercial property

As we said last month, we expect property to be hard hit by the economic downturn. The lockdown has exacerbated existing issues in the high street with people now shopping online, and we think the office market is also challenged by the increase in remote working. However, some part of the industrial market may benefit from these shifts.

## Cash

With interest rates remaining at record lows, returns on cash will remain almost zero. We retain higher cash balances than usual as protection against further market falls and have diversified this into different currencies.

## Balanced asset allocation

For a typical balanced portfolio, we are roughly neutral on fixed interest but remain underweight property. We are underweight traditional equity but are instead holding more defined returns. The overall risk/return profile of our portfolios is slightly above long-term averages given our positive long-term equity outlook.

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