JOHN RAISIN FINANCIAL SERVICES LIMITED

Independent Advisors Report

Market Background January to March 2020

The resolution of some of the trade tensions between the United States and China in late 2019 and the further loosening of monetary policy by the US Federal Reserve and European Central Bank in the second half of 2019 had led to a general view that global stocks would likely continue their long upward trend through 2020. Indeed, on 19 February 2020 the US S&P 500 Index reached a new record closing high of 3,386 almost 5% above the 31 December 2019 closing figure of 3,231. On 24 February 2020, however, equities across the globe began to rapidly fall following the decision of Italy to quarantine 10 towns in response to Coronavirus. By 31 March 2020 despite unprecedented monetary and fiscal stimulus by central banks and governments world equity markets were down by over 20% for the Quarter and the potential impact of Coronavirus on both financial markets and the world economy looked extremely serious.

It is easy to overlook but in January and until late February 2020 it continued to seem as if 2020 would be a positive year for stocks and for at least some large economies. Major developed market equity indices – for example the S&P 500, MSCI EMU, FTSE All Share, Nikkei 225 traded until mid-February above or around their high closing levels as at the end of 2019. At his press conference on 29 January 2020 the Chairman of the US Federal Reserve Jay Powell stated *"I would say, now there are grounds for what I would call "cautious optimism" about the outlook now for the global economy. Many analysts are predicting a pickup in growth this year, although still to relatively modest growth rates."* The Bank of Japan Summary of Opinions from the Monetary Policy meeting of 20/21 January 2020 included the statement *"The probability that the global economy will follow its recovery trend through the middle of this year seems to be increasing."* The January 2020 meetings of the interest rate setting committees of the US Federal Reserve, the Bank of Japan and the Bank of England all maintained interest rates/monetary policy unchanged.

Although in January 2020 China had imposed a quarantine in Wuhan and a number of other cities Coronavirus then appeared a Chinese centred issue. World markets, the world economy and world governments only, and then dramatically, reacted to Coronavirus from 24 February 2020 the following the decision, over the weekend of 22/23 February of Italy to quarantine 10 towns in response to Coronavirus. Concerns regarding Coronavirus started to hugely affect US equity markets and other major markets including Europe, the UK and Japan on Monday 24 February. By the end of Friday 28 February, the S&P 500 had fallen approximately 13% from its 19 February all time high.

The governments of a number of leading world economies - the UK, Canada, France and Italy announced major fiscal initiatives to support their economies and citizens and also, by extension, financial markets on or before 20 March 2020. Measures included income subsidies for laid off workers, tax deferrals and state loans or guarantees for companies The German Parliament and US Congress also agreed unprecedented fiscal support packages in the last week of March. While these measures were crucial to mitigating the adverse impact of Coronavirus on economies and financial markets going forward it was the unprecedented and truly extraordinary interventions of the US Federal Reserve which, surely, prevented a financial market meltdown in March 2020.

On 28 February Federal Reserve Chair Jay Powell stated that *"… the coronavirus poses evolving risks to economic activity. The Federal Reserve is closely monitoring developments and their implications for the economic outlook. We will use our tools and act as appropriate to support the economy."* The actions subsequently taken by, and led by the US Federal Reserve during March 2020 were unprecedented even in comparison to those following the 2008 financial crisis. These actions, the actions of other central banks and huge fiscal stimulus by governments including the UK, France and (finally) the US succeeded by the end of March in averting a complete collapse in financial markets which during that tumultuous month seemed a genuine possibility.

At an emergency meeting on 3 March 2020, the US Federal Reserve, reduced the target range for federal funds rate (its main interest rate) by ½%, to the range 1 to 1 ¼%. The Federal Reserve was however clear that action by central banks could not nearly, in itself, counter the potential economic impact of Coronavirus. Chair Jay Powell stated at the press conference following the rate cut on 3 March that while the US Federal Reserve had eased monetary policy to *"provide a meaningful boost to the economy"* also stated that *"The virus outbreak is something that will require a multi-faceted response. And that response will come in the first instance from healthcare professionals and health policy experts. It will also come from fiscal authorities, should they determine that a response is appropriate. It will come from many other public and private sector actors, businesses, schools, state and local governments."*

Coronavirus equity related market chaos continued and was compounded by adverse reaction to an oil price plunge on 9 March arising from Russian and Saudi Arabian action which resulted in a trading break in New York, the first time this measure had been used. As the Coronavirus crisis unfolded, as expected, the demand for and price of US Treasury and other haven bonds increased. Then, also, in the week commencing 9 March the demand for such bonds fell despite further equity market falls meaning that both equity and haven bonds were collapsing together and therefore, in effect, breaching a fundamental expectation of financial market behaviour. An unwelcome effect was a rush by investors to hold cash particularly in US dollars resulting in a significant strengthening of the dollar v other currencies.

Then in a highly unusual (and unscheduled) Sunday meeting on 15 March the US Federal Reserve intervened on an unprecedented scale. Interest rates were reduced by a full 1% to the range 0% to ¼% and an asset purchase programme announced of *"at least"* $500bn of Treasury bonds and *"at least"* $200bn of mortgaged backed securities to *"support the smooth functioning of markets…."* To further support the flow of credit to businesses and households the US Federal Reserve also announced measures to ease requirements upon and to support banks and other savings institutions. To directly support not only the US markets and economy but other major developed markets and economies the Federal Reserve also announced, in a press release, on 15 March 2020 *"co-ordinated action"* with the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank and the Swiss National Bank to lower the cost of borrowing dollars internationally *"to ease strains in global funding markets, thereby helping to mitigate the effects of such strains on the supply of credit to households and businesses, both domestically and abroad."*

The European Central Bank (ECB) acted decisively at an emergency meeting on 18 March announcing a 750 billion Euro Pandemic Emergency Purchase Programme (PEPP) covering government and corporate debt (in the words of the official press release) to *"…counter the serious risks to the… outlook for the euro area posed by the outbreak and escalating diffusion of the coronavirus, COVID-19."* The Bank of England also acted decisively reducing Bank Rate by from 0.75% to 0.25% on 10 March and then on 19 March to an all time low of 0.10% together with the introduction of a £200 billion purchase programme of government and corporate bonds. On 10 March, it also introduced measures to facilitate further lending to businesses by UK banks.

Turmoil however continued in markets when they reopened on Monday March 16. The S&P 500 fell by 12% only to rise by 6% on 17 March and then to fall by 5% on 18 March. In the context of the clearly rapid spread of Coronavirus in Europe, closures and severe disruption to businesses not only in Europe but the US, including for example the closure of the properties of the high end hotel and casino operator Wynn resorts and a warning by United Airlines, in a letter to employees of 15 March that "…*We expect both the number of customers and revenue to decline sharply in the days and weeks ahead…"*, coupled with an admission by President Trump that the Coronavirus crisis could last till *"August, could be July, could be longer…"* US markets fell 12%. 18 March was a day of panic in world markets with the FTSE All World equity index falling almost 7%, government bond prices falling, oil prices again plummeting, sterling falling to its lowest level against the dollar since the 1980s. The S&P index closed on Friday 20 March at 2,305 which was 15% lower than at the close on Friday 13 March.

Then on the morning of 23 March, the US Federal Reserve intervened in an unprecedented manner. First it extended its purchases of Treasury Bonds and mortgage backed securities from $700billion to (in the words of the official press release) *"the amounts needed to support smooth market functioning and effective transmission of monetary policy…"* This meant that to help facilitate the supply of credit to households and businesses the US Federal Reserve was prepared to buy unlimited amounts of government securities. Secondly, in an extraordinary break with previous precedent the Federal Reserve announced initiatives to purchase both new issue and secondary market corporate debt. This meant that in effect the Federal Reserve was prepared to directly support employers and act as a backstop in the corporate bond market.

In the days following this extraordinary intervention by the Federal Reserve of 23 March 2020, financial markets began to recover with the S&P 500 closing at 2,585 on 31 March a full 12% higher than on 20 March. Admittedly, after much argument Congress finally passed a huge $2.2 trillion fiscal stimulus on 27 March to assist US business and families. However, there can be no doubt that during March 2020 the US Federal Reserve acted decisively and in an unprecedented manner to avoid a financial market meltdown while the US Congress argued over what measures to take.

In summary, over the Quarter global equity prices fell heavily with the MSCI World Index down 21% (in $ terms). All sectors of equity markets saw significant declines with, for example, travel, financials and energy particularly badly hit while areas likely to be more in demand in a lockdown such as information technology saw smaller declines. As the Quarter progressed it also became clear that many companies would either suspend or reduce Dividend payments going forward. European and UK equities were especially badly affected with the MSCI EMU Index down 25% (in Euro terms) and the FTSE All Share down 25% (in £ terms). The S&P 500 lost 20% as did the Nikkei 225.

Despite volatility the leading government bond prices rose (and yields fell) over the Quarter, as investors favoured their perceived safety as equity markets fell and a severe global recession became increasingly likely/inevitable. The US 10 Year Treasury Bond increased in value as its yield fell to 0.7% at the end of March compared to 1.92% at the end of December. The 10 Year UK Gilt and 10 Year German Bund also clearly increased in value as their yields fell from 0.82 to 0.35 and -0.19 to -0.46 respectively. Corporate credit, and in particular high yield weakened.

Even though the effects of Coronavirus were only really felt by the world economy and financial markets from late February onwards GDP data for the first Quarter 2020 demonstrates the immediate and devastating economic effects. The "Second" estimate from the US Bureau of Economic Analysis, issued on 28 May 2020, indicated that US *"gross domestic product (GDP) decreased at an annual rate of 5.0 percent in the first quarter of 2020…In the fourth quarter* [of 2019]*, real GDP increased 2.1 percent….The decline in first quarter GDP reflected the response to the spread of COVID-19…This led to rapid changes in demand, as businesses…switched to remote work or cancelled operations, and consumers cancelled, restricted, or redirected their spending…"* In the previous three Quarters an annualised rate of approximately plus 2% was achieved. Eurozone GDP was down 3.6% in the first Quarter of 2020, compared to the previous Quarter, according to (revised) estimates issued by Eurostat on 9 June 2020. *Eurostat stated "These were the sharpest declines observed since time series started in 1995…"* In each of the previous three Quarters Eurozone GDP increased by plus 0.1%-0.3%. The UK Office for National Statistics (release 13 May 2020) included in relation to Coronavirus the statement *"There has been a widespread disruption to economic activity, as services output fell by a record 1.9% in Quarter 1; there were also significant contractions in production and construction."*

In conclusion the calendar year 2020 began positively for both financial markets and the global economy. The realisation, however of the health/economic implications of Coronavirus during late February and March 2020 resulted in both a huge worldwide equity market sell off and a closedown of large parts of the world economy. Only because of both huge fiscal and monetary policy intervention, and in particular the intervention of the US Federal Reserve, was a meltdown in financial markets avoided. Going forward this downturn will be far more difficult to resolve than that of 2008. This is because this crisis, which arises from a deadly disease, is affecting all economic sectors while the previous one was a financially originated and focussed crisis.