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SUNARES-Report April 2020

It is difficult to be clever in a market that fell so rapidly and has subsequently sprung back to life, in equally dramatic fashion. Earnings, GDP, unemployment numbers are all difficult to read much into at this point, as the world has been stopped in its tracks. We are now into US earnings season, where weaker companies are getting all the bad news out now, at a moment where problems can be blamed on the virus shutdown. However, there are pockets of strength in the market too. The US is performing well, whilst the UK and Europe look anaemic by comparison. This is partly down to strength in technology, as well as in healthcare and biotech. It is also because the Fed have been so quick and generous in their provision of funding to *"save"* everything. Gold and the precious metal mining stocks are performing admirably, after having been sold down along with everything else in the March panic. The gold shares represented by the HUI index recovered from the sell-off low of 142.51 and reached a closing price of 249 on 21st April – close to a 75% rally. Gold broke out of its trading range in June 2019 and has been enjoying upside since then. However, it too was caught in the market's cash raising drop in March and traded intra-day at a low of US$1,451.55. It has recovered since then to trade up to US$1,747.36 at its recent high. This is sensible considering ongoing uncertainties about the world economy, as well as a proper response to the trillions of dollars and other currencies promised by central banks and being brought into existence.

The year has of course been dominated by the rapid spread of the coronavirus across the world. The virus has hit different parts of the world at different times, but inter-connected financial markets experienced dramatic sell-offs together (except China which has been remarkably robust). Rolling shutdowns of normal life and daily economic activity have swept across the world and created the largest peacetime collapse in output. At the same time there has been an intensification of the Russian-Saudi Arabian oil price war, which contributed to the spike in volatility, as measured by the VIX index, which reached levels last seen in the financial crisis. There has been an intense and compressed period of panic-selling, as investors sold anything they were able to, in order to raise cash. No asset class has been spared. As we have already mentioned, traditional safe haven assets like gold and government bonds were also subjected to large price swings, similar to price moves that took place in 2008. A dash for cash in every corner of the market for those who had to pay for losses elsewhere or were panicked into selling.

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CENTRAL BANKS

The drain on, and lack of market liquidity has seen the world's central banks step forward with monetary intervention that is extraordinary, in terms of speed and scale of intervention. On 15th March, the US Federal Reserve cut rates to zero and unleashed quantitative easing and yet markets remained unsettled and dropped further. The message seemed to be that monetary intervention is all very well, but the initial market drop demonstrated that it needs to be combined with fiscal intervention and policy, thus targeting the real economy. This is a brief summary of financial support that has been announced so far:

- US$7tn: announced/promised global central bank liquidity to address the 2020 crash and recession.
- US$5tn: announced/promised fiscal stimulus to address the 2020 crash and recession (to be underwritten by central banks).
- US$13tn: Federal Reserve, European Central Bank, Bank of Japan, Bank of England, Swiss National Bank have already bought US$13tn of financial assets since Lehman's collapse and are now set to buy a further US$7tn this year alone.
- 853: central banks cut interest rates 853 times since Lehman...and there have already been 65 rate cuts in 2020.

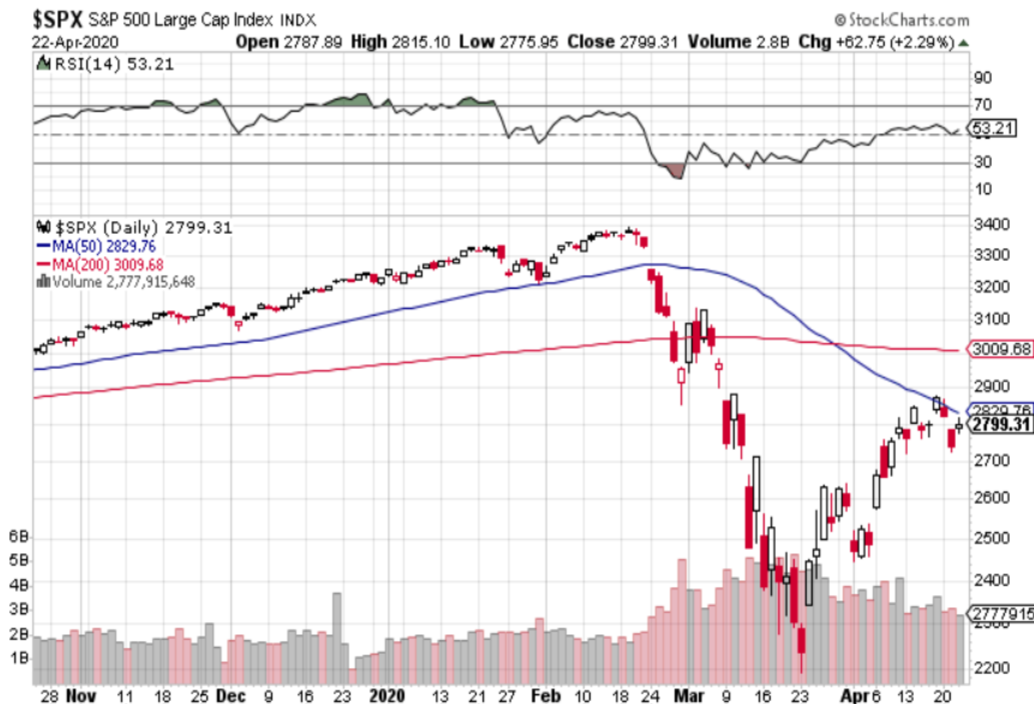
Governments and central banks are committed to doing *"whatever it takes"* to underpin the economy and the markets. We have arrived at the stage of game-changing *"helicopter money"*, with money being created and distributed in a manner that few thought would ever happen. One example of this is where companies have placed staff on furlough, giving them a leave of absence from work that is backstopped by money from the government. However, the main action is the intervention in markets themselves. The consequences of intervening in this manner should not be underestimated. A look at the rapid expansion of the US Federal Reserve balance sheet below, shows the scale of what has been done so far. It dwarfs prior interventions in both scale and the speed of its introduction – where will it end?

Federal Reserve Banks Total Assets. Source: Bloomberg

OUTLOOK

Analysts and economists are grappling to understand the impact of the shutdown on earnings and GDP growth. This is an almost impossible task as many important measures are based on surveys. In turbulent times it becomes difficult to read too much into surveys, as the quality of the inputs is certainly not as reliable as normal. Market volatility remains elevated, but less extreme than at the peak of the selling, partly because it is now possible to look toward the re-opening of economies. China is getting back to work and the apparent effectiveness of social distancing policies in Europe is leading several countries to tentatively stage a return to activity i.e. opening more shops, schools and businesses. There is some light shining at the end of the tunnel, but it is early days.

Records have been set in terms of the speed and scale of the markets falls, but it is worth noting that the subsequent market rally has also been record breaking. Many investors are dismissive of the recovery and point out that the biggest rallies occur in bear markets. However, this has been the most impressive recovery in history. At no point during the rallies in the 1930s or 2008 did stocks manage to claw back as much of the losses as quickly as they have in 2020. The S&P 500 bottomed on 23rd March and since then it has retraced more than 38.2% of its decline (closer to 50% as of 8th April), both closely watched Fibonacci levels. Looking at all historical instances of the S&P 500 clawing back more than 30% of its decline after 11 days, not a single one was *"just a bear market rally."* Currently the S&P500 has bounced to the 50-day moving average and what follows will determine what sort of market we are in. We expect volatility to remain in place, which presents opportunity.



S&P500 index six months until 22 April 2020. Source: stockcharts.com

EUROPEAN DEBT BURDEN AND THE CONDITION OF BANKS

As there are so many problems to contend with, some important issues have received relatively less coverage than they normally would. The dramatic shift in European bond yields presents a picture of a fractured continent, rather than one of unity and togetherness. Italian government 10-year BTPs currently yield +2.23% and have traded as high as 2.42% and as low as 0.90% in just the last 6 months. German 10-year government Bunds currently yield -0.44% and have traded as high as -0.16% and as low as -0.86% over the same six-month time span. European convergence is being questioned because of the response that different countries had to the virus. When times get tough, there has been a tendency to look after number 1 at the expense of others.

Europe looks to Germany and its economically more robust Northern counterparts for support that is needed in other countries i.e. Italy as the largest example. However, Germany itself is not in the shape that is was before either and there is a reluctance to take on the burden of providing funding. There is current discussion that the European Central Bank (ECB) will be the institution that provides the workaround to the problem. Unlike the US, every European member state issues its own debt. To suggest a departure from this practice in Europe is toxic to politicians who wish to be re-elected. Jointly issued debt to cope with the economic fallout of the virus, such as Eurobonds or coronabonds is a non-starter. The transfer mechanism is likely to be an ECB fudge.

It is worth remembering that the scale of debt and leverage in the financial system is still the very heart of the issue. If the banks were in good shape, with strong balance sheets then they would not have share prices trading at the low levels we see today:

Italy's Unicredit from 2007 to 22 April 2020. Source: Bloomberg

Germany's Deutsche Bank from 2007 to 22 April 2020. Source: Bloomberg

Both UniCredit and Deutsche Bank are Global Systemically Important Banks (G-SIBs) and fall into the too-big-to-fail category. We have used these merely as examples of the sector, in order to indicate the extreme stress in the sector itself. What further steps and intervention will be necessary to ensure the survival of the financial system that provides funding for governments, which in turn provides pensions, schools etc? There is more support that will be promised and that should concern us all, as investors and as citizens.

CONCLUSION AND PERFORMANCE UPDATE

In simple terms, further printing/ creation of money will be required to maintain the current economic system. In our opinion the ownership of gold and gold-producing companies is a sensible step to provide a counterbalance to what is in process. Bank of America recently upgraded its gold price forecast to US$3,000 per ounce. A few years ago, this headline would have been laughed at, but investors are starting to take note and are adding to portfolios. The sector performance versus the S&P500 is in the early stages of a recovery so there appears to be a long distance that the sector could travel.

On the performance side, the fund ranking company Citywire, have released the end of March 2020 performance numbers for the natural resource sector and, within it, the SUNARES fund. Calculated in GBP the fund ranked in first place over 5 and 3 years and second place over 1 year in the maximum drawdown category (one method investors use to measure risk).

The fund also delivered a strong performance in GBP in its peer group and was top ranked in 3 and 5 years and ranked in second place over one year as follows:

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5 Year ranking	% return	3-year ranking	% return	1-year ranking	% return
1 / 21	+18.89%	1 / 21	-12.08%	2 / 21	-16.14%

This link to Citywire contains further information on both ranking and performance:

https://citywire.co.uk/fund/sunares-sustainable-natural-resources/c207134?assetClassID=13&timePeriod=60§ion=Global

The fund has a good level of exposure to the gold sector and we continue to look for quality across different markets amidst the volatility. There are now a host of companies that trade at dislocated prices (below book values for example) and we remain optimistic about future developments and navigating the way ahead.

We send you our sincere good wishes during these difficult times. Keep safe and well.
We look forward to being in touch again soon.

Yours sincerely,

The SUNARES team