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Coronavirus/market volatility: Threadneedle Dynamic Real Return update

Multi-asset | March 2020

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Markets have been trying to digest the impact of Covid-19 on economic activity and government policy. This is hard. The financial impact will be a function not only of the spread and lethality of the virus, but on the response of people and governments to the threat the virus poses to public health.

Markets are essentially trying to assess the outcome of two (still evolving) policies with opposing economic impacts – public health measures on the one hand, and monetary and fiscal stimulus on the other. The fiscal response has been variable in both size and focus; the monetary response, meanwhile, has been huge.

Despite meaningful stimulus measures being delivered (with more anticipated), the speed of the market moves has been astonishing, further fuelled by the collapse in the price of oil. Equities have fallen up to 35% from their January highs[1]; credit spreads are back to levels not seen since 2012 (and are quickly pushing through this); and core government bond yields fell to new lows. The feedback loop between volatility-sensitive strategies and higher experienced volatility has been particularly intense. This has led to ETFs, for example, trading multiple percentage points below NAV.

Resulting portfolio activity in our multi-asset funds has been based on an overarching understanding that the impact of Covid-19 on economic activity is severe, but temporary – but the depth and duration are unknown. Valuations are cheap, but not so cheap as to drive a

[1] Bloomberg, 18 March 2020.

meaningful increase in our risk appetite at this juncture. Rather, we have maintained or raised cash and are gradually nibbling into our favoured asset classes and taking profit in areas such as long duration that have done well.

Portfolio

In the Threadneedle Dynamic Real Return Fund, this has meant adding to Asian and US equities. Asia is furthest along in fighting the virus and is supported by plenty of policy stimulus. US equities provide our clients with more exposure to quality global businesses with strong balance sheets. Meanwhile, we took some profits in US TIPS (Treasury Inflation-Protected Securities), which rallied as markets sought safe havens and discounted central banks moving to their lower policy bounds.