

Are We Nearly There Yet?

One of the few benefits for parents of small children from the onset of COVID-19, and the ensuing lock down, is that the words above have been temporarily absent from the back seats of car journeys. Today it is investors (and fund managers) who are heard to utter the question, as last week saw the first three-day period of back to back positive returns in equity markets in two months.

We are not going to pretend that we know the answer to that question, but our advice, which we have been putting into practice, is to selectively start to put money back into the market as and when opportunities in quality companies arise. While we are unlikely to perfectly time the bottom of the market, by putting some capital to work now you are positioned to partake in any recovery, whether it be V, U or L-shaped. In the past week we have witnessed the resilience of some of the companies that we own, such as Nike, whose CEO commented that *"it's in time like these that strong brands get even stronger"* and Abbott Laboratories*, that leapfrogged the pack in COVID-19 testing by developing a way of detecting infection within 5 minutes, clearing the way for the large scale testing that has proven to be successful in South Korea and Singapore.

One source of potential downside risk comes in the form of cuts to dividend and buyback policies. Corporates are coming under increased pressure not to pay equity holders returns in the form of dividends or to use the generous governmental incentives to repurchase their own stock. The risk of seeing regulation to force through such changes varies from sector to sector, however those companies with a degree of governmental ownership are most at risk; the French government does not hold any equity in our sole French holding, L'Oréal. We have witnessed some of our holdings, such as Assa Abloy and Rational take pre-emptive action to reduce or second-half weight their proposed dividend payment; we are yet, however, to see any of our holding pass on their payment.

The banking sector in Europe has already experienced the ECB ruling that there should be no dividend distribution until October 2020 at the earliest, which is significant as unlike UK banks the European banking sector normally pays annual rather than quarterly dividends and mostly in May/June. We do not own any Eurozone banks, but do own Swiss and US Banks that we expect will face a degree of pressure to do likewise, however we believe the risk of such rulings are low for the time being.

Those companies that have received governmental aid will face enormous criticism should they then continue to buy back shares. This is likely to be of more significance to US corporates where buybacks are a substantial part of total returns. The buyback yield in the US has averaged around 2.5% over the past 10 years, compared to 0.5% in Japan and less than 0.5% in Europe. We have relatively little exposure to companies that have benefitted from state aid given the focus paid to resilient cash flows and sound balance sheets in our investment process.

We also seek risks of us revisiting the market lows as the corporate and economic data is released over the coming weeks (albeit that the UK and Europe have told companies to delay their AGMs and trading updates by a few weeks given the uncertainty). We expect that the market is braced for these numbers to be catastrophically bad, but expectations of how poor they will be range widely.

*Abbott Laboratories is also owned in the VT Tyndall North American Fund, run by Felix Wintle

While the rate of new infections in the US continues to increase, we remain cautiously positioned, especially given the difficulty in enforcing any meaningful lockdown around New York, New Jersey and Connecticut. We do find encouragement from Italy, where the growth rate in new infections has started to decrease, and thus for those countries that have enforced lockdowns, that there is hope at the end of the tunnel, even if these conditions will have to be enforced longer than initially planned so as not to see the rate increase once again. As for a vaccine, Gilead is at the forefront of running clinical trials for a potential cure. However, within the Fund, Johnson & Johnson, GlaxoSmithKline and Roche all have products that are part of the 22 late stage trials with completion dates expected this year. Even if initial prognoses are positive, we are unlikely to see industrial scale roll out of a vaccine before 2021.

“Are we nearly there yet?” Surely the answer is always “Almost, not much longer to go now”

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