Investment Managers

...Saltus

Cornerstone Asset Management

Investment review for the quarter ending 30th June 2020

"There are decades where nothing happens; and there are weeks where decades happen" Vladimir Ilyich Lenin

Looking back, it is hard to believe that we are only just halfway through the year, given the extent of the revolution in all our lives. If the first quarter of the new decade was characterized by collapses and reversals, the second quarter has been much more about recovery from low points, both socially and economically. In many places there has even been a return to some form of 'normal', although it must be said that both investors and individuals are still trying to work out exactly what that means.

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The early intervention by central banks had an almost immediate effect in stabilizing sentiment and preventing the inner machinery of the financial system from freezing up. Companies were able to access capital in record breaking amounts and as time progressed and the effectiveness of lockdown became apparent, investors began to look ahead to a peak in infection rates and a steady easing of restrictions. After the panic selling of late March had exhausted itself, events "stopped getting worse" and new money flooding into the system began to work its healing magic.

Investors surfed this wave of liquidity nearly all the way to the end of June, before a sharp reminder of the fragility of sentiment arrived after the Federal Reserve declined to provide any additional stimulus on top of what had previously been announced. Given that they had already expanded their balance sheet by approximately $3 trillion in a few short months, they could perhaps have been forgiven for taking some time off. However, investors thought otherwise, pushing the US stock market down -6% in a day and signalling that the market recovery had probably gone far enough for now. This intra month retreat was enough to stall momentum but not enough to reverse it, leaving us entering a noisy, bumpy period of consolidation which will probably stretch over the entire summer.

As we write, backward looking economic releases look awful, but they are also, in the round, marginally less awful than expected. Similarly, although the risk of a second infection wave is already a reality in several countries – the US has a higher infection rate now than it had in March for example – this wave is being met with better treatments and less uncertainty about what to do to control it. Future healthcare and economic impacts should hopefully then be much less dramatic than before and, of course, behind all of this is the insurance policy provided by the amount of liquidity currently coursing through the planet's financial system.

This system is now servicing a total debt burden of around $200trn with an economy of about $73trn, according to the IMF and JP Morgan, with individual nations managing burdens only ever seen before in wartime. The implications of what this means for your portfolios and the world we live in will need some careful thought, a process made even more complex by the unusual amount of uncertainty over just how much permanent damage has actually been caused by lockdowns.

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Nobody really knows the answer to that question yet, nor are we likely to know exactly until well into the future. In the interim we will have to work with what information is available and the most important data will undoubtedly come with the imminent summer reporting season. Management guidance on the path of corporate profits will be the crucial ingredient in determining if the market recoveries to date have been too much, too little or just right.

To make things even more interesting, this assessment will have to be undertaken in tandem with not only considering the chances of a second wave of infections, but also against a backdrop of rising political risk. The forthcoming US Presidential elections and accelerated Brexit negotiations are likely to be noisy, messy affairs before they eventually reach their conclusions, to cite two of the more obvious examples.

Although the ability of any particular politician to upset asset markets with an unfriendly policy tweet is still very real, overall it seems to us that governments are signalling clearly that in terms of real policy initiatives, they are broadly happy to live with higher debt burdens, rather than embark on some form of austerity to payback emergency borrowing. That, overall, is supportive for risk appetite, as is the knowledge that central banks are hovering in the background ready to intervene again if needed.

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Our initial read is that the sum of all these factors is an environment of continued low inflation, low interest rates and low, but positive growth. In other circumstances, this would imply a dull investment outlook, with few surprises or opportunities. However, given that the financial system is running with a 273% ‘mortgage’ prices will remain highly sensitive to real or imagined changes in growth, inflation and the path of interest rates. Volatility is not going away, and we will have to remain very nimble in adapting portfolios to shifting sentiment and circumstances.

Looking back over this active period, your investment committee has been busy not only trying to ‘catch the bounce’ in a sensible manner, but also trying to steadily build in even broader diversification than normal into portfolios. As well as investing across different geographies and asset classes, we also try to include different investment styles and liquidity profiles, with the aim of reducing our dependence on any ‘one thing’ going right to generate performance. This ongoing push to increase the spread of investments is in part driven by the knowledge that traditional safer investments such as government bonds not only offer zero return, but may also end up offering zero protection in any future period of stress, such is the extreme level of overvaluation. However as one source of diversification withers away, others usually present themselves and we can still see decent risk/reward opportunities in several asset classes, spanning everything from convertible bonds to smaller company equities. In addition, our ‘bench’ of global unconstrained managers offers us an additional tool to address opportunities, cherry picking the best individual ideas, without picking up undue reliance on any other relevant factor.

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Overall, we remain broadly in the ‘glass half full’ camp when we look to the future, judging that exceptional support from the authorities and contained second wave outbreaks will be enough to offset the economic and political risks. It is a delicate balance though, and the longer-term changes to how we live our lives and how markets respond to that will undoubtedly be deeper than we currently envisage. Looking back, we suspect that future generations might just see this revolutionary period as one where the speed and flexibility of our adaptation to new circumstances is what shines through. They are certainly key features which we will try even harder to embed deeper into the investment process.

With thanks for your continued support,

The Saltus Investment Team, July 2020

	UK Equities	US Equities	Europe (ex UK)	Japan	Asian	Other Equities	Property	Alternatives	Bonds	Cash
MAP 2	4.0%	3.4%	0.0%	2.1%	1.4%	10.8%	4.3%	28.9%	32.9%	12.4%
MAP 3	6.6%	7.1%	0.0%	4.2%	2.1%	16.3%	3.3%	24.9%	24.1%	11.4%
MAP 4	9.8%	12.0%	0.0%	7.1%	3.1%	22.3%	2.0%	16.0%	18.9%	8.9%

	Quarter	Benchmark Quarter	Year to Date	Benchmark Year to Date	Benchmark
MAP 2	7.86%	0.50%	-1.79%	1.10%	CPI plus 2%
MAP 3	9.35%	0.75%	-3.06%	1.60%	CPI plus 3%
MAP 4	10.86%	1.00%	-4.37%	2.11%	CPI plus 4%