Marlborough International

February 2020

Global Investment Commentary

SUMMARY

The coronavirus (COVID-19) outbreak replaced US-China trade negotiations as the primary focus for markets during February. With the expectation that the world's central banks will provide further monetary policy support, coupled with shorter-term fears about the negative effects that the spread of the virus will have on Chinese and global growth, government bond yields were driven lower throughout the month. The yield on 10-year US Treasuries reached an all-time low of 1.1%. This represented a fall of more than 2% since the most recent peak in October 2018. In the meantime, stock markets braced themselves after the final week of February proved to be the worst for global equities since the 2008 credit crisis.

Coronavirus in Context

While it is impossible to predict the extent to which a virus can spread and have greater consequences than previous outbreaks, history indicates that the global economy and markets have been relatively resilient in the face of past epidemics.

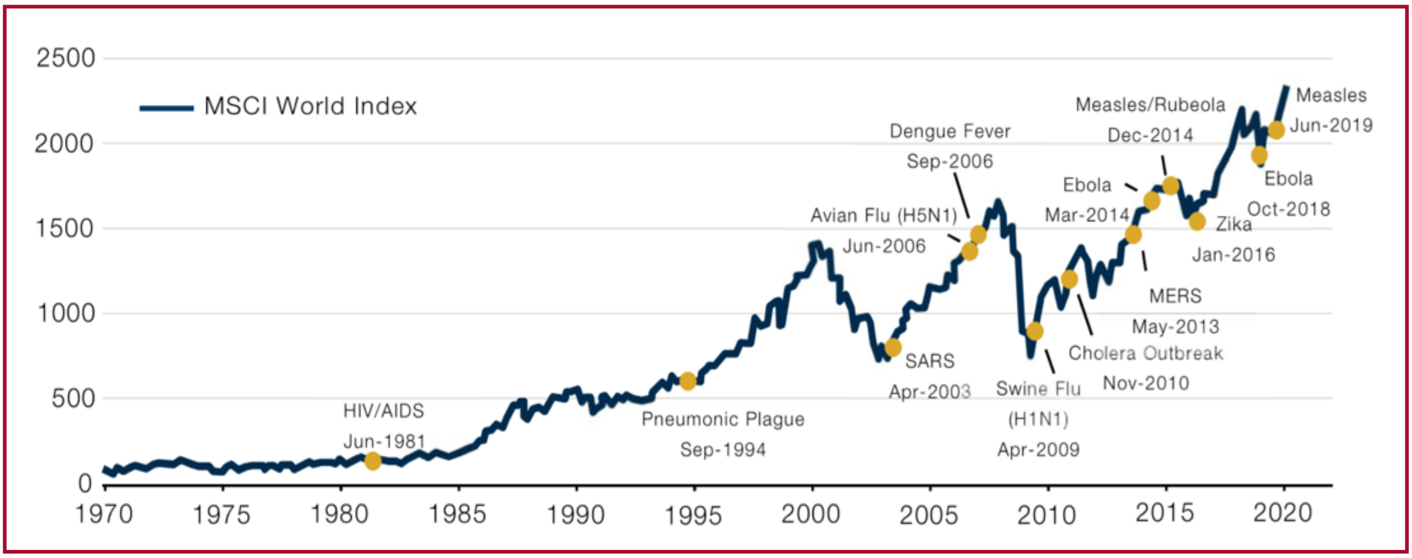
A key reason is that global health organisations are prepared for such outbreaks and are effective when mobilised. Combining these efforts with widespread public awareness and the adoption of sensible safety measures has, in the past, eventually limited the spread of viruses and their economic impact.

Individuals planning to travel to Asia may be wise to defer their trip for the time being, but home-bird investors may have little need to take action if their portfolios are diversified and aligned with their long-term financial plan.

Accepting that the economic and political backdrops have always been different, what can previous epidemics tell us about moves in financial markets? During epidemics, equities have typically experienced a short-term sell-off, which has historically been followed by a strong recovery.

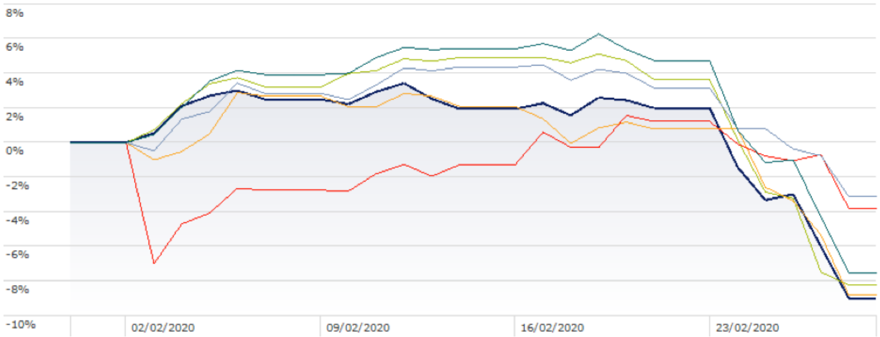
For example, following the World Health Organisation (WHO) discovering the SARS virus, the drawdowns for the MSCI World, S&P 500 and Euro Stoxx 600 were -5.30%, -3.80% and -11.10% respectively. The market moves were similar when the WHO predicted an upsurge of human deaths from Avian Flu, with drawdowns of -7.40%, -5.00% and -6.00% across the same indices. However, in the long term, the market has tended to rebound, regardless of the epidemic.

One of the heads of the WHO-China Joint Mission on COVID-19, Bruce Aylward, recently said: *"Panic and hysteria are not appropriate. This is a disease that is in the identified cases and their closest contacts.*



Source: Charles Schwab

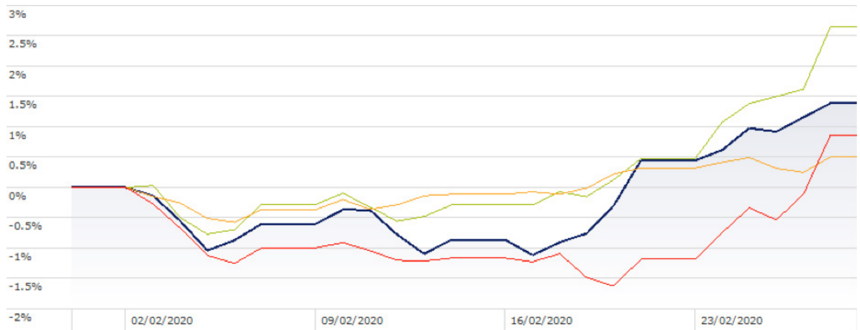
Major Equity Indices - February 2020



Investment Name	Value	Investment Name	Value
FTSE 100 TR in GBP	-8.99%	MSCI AC Asia Pacific Ex Japan PR	-3.12%
SSE 50 A Share TR CNY	-3.8%	Nikkei 225 Average TR JPY	-8.82%
S&P 500 TR in USD	-8.23%	MSCI AC Europe Ex GR EUR	-7.52%

Source: FE

Government Bond Indices - February 2020



Investment Name	Value	Investment Name	Value
BBgBarc Sterling Agg Govt	1.39%	BBgBarc US Treasury	2.65%
BBgBarc Global Treasury	0.87%	BBgBarc Euro Agg Govt	0.51%

Source: FE

It's not a hidden enemy lurking behind bushes. Get organised, get educated and get working."

Market Round Up

February commenced with an air of positivity. Better than expected US Q4 earnings results, improving business surveys for January and the expectation that the negative effects of the coronavirus would be localised and temporary allowed markets to shrug off any major concerns. That mood rapidly changed in the final week of the month with the number of cases outside China increasing, leading to a sharp sell-off that very quickly gathered momentum. In developed markets, the US S&P 500 index fell by 8.23%, Europe's MSCI (excluding UK) index closed down 7.52%, while the UK's FTSE 100 index finished 8.99% lower. Japan also suffered heavily as the Nikkei 225 index lost 8.82%. Although most COVID-19 infections are currently in Asia, Asia's MSCI (excluding Japan) index and China's SSE 50 were down by just 3.12% and 3.8% respectively. The explanation for this is the declining rate of cases in China, compared with increasing infections elsewhere.

The search for safety has triggered huge inflows into US Treasuries and UK Gilts, which has pushed their prices higher. US Treasuries gained more than 2% in the final week of the month, driving yields down to unprecedented lows. Gold, another perceived safe haven, also benefited, with the price per ounce increasing to almost $1690 at one point.

Meanwhile, oil prices have tumbled because of fears about lower demand. The oil price benchmark fell 13% during the month, adding to the steep fall in January and bringing the total year-to-date decline to 27%. The biggest trigger came from concerns about the first decline in global oil demand since 2009, due to the economic disruptions caused by the COVID-19 outbreak, together with stalling negotiations between Russia and OPEC on the implementation of further supply cuts.

UK

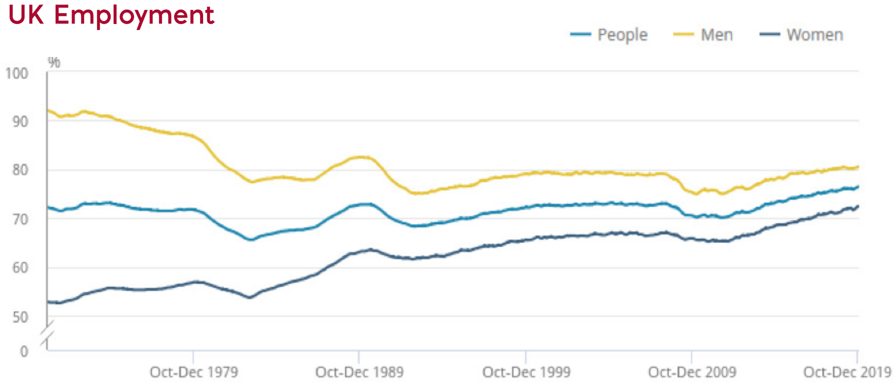
While the recent spread of COVID-19 across Europe looks increasingly likely to affect sentiment and activity, this was not yet apparent in data about UK economic confidence, which showed both consumer and business sentiment picking up. Job growth continued its recent upswing with a further 180,000 people in employment, mainly full-time, in the three months to December. The unemployment rate remained at 3.8%, the lowest level since 1975.

The UK government and the European Union also published their respective directives for the post-Brexit trade negotiations, which will start in March, but the narrative from both parties suggests the road ahead may not be a smooth one.

US

Data from the US proved a mixed bag for investors in February. Low mortgage rates continue to fuel activity in the housing market. Housing starts and permits beat expectations and home price momentum is still positive.

UK Employment



The employment rate for all people increased by 0.6 percentage points on the year to a record high of 76.5%.

UK employment rates (16-64 years), seasonally adjusted, between January to March 1971 and October to December 2019.

Source: Office for National Statistics - Labour Force Survey

The January employment report revealed a healthy labour market, with solid job gains and workers joining the labour force. Total payroll employment rose by 225,000, well above consensus expectations of 160,000. Milder than normal weather may have boosted these gains somewhat, particularly in weather-sensitive sectors such as construction.

On a less positive note, the latest job openings figures were weak. Job openings declined by 5.36% month on month and were down 14.9% year on year. While the decline is potentially a concern, it should be noted that the overall level of job openings is still higher than the high of the previous cycle, and jobless claims remain low.

Industrial production showed a second consecutive monthly decline, reflecting diminished utility output but also a sharp drop in aerospace activity due to the impact of the Boeing 737 Max grounding. The latter is expected to hit Q1 growth.

Flash purchasing managers' indices (PMIs) in February showed that the COVID-19 outbreak is beginning to have an impact on US sentiment. The fall of the composite PMI below 50 is of potential concern since it shows that the negative effect on business sentiment is broad-based.

While other recent data indicates that the US economy remains healthy, the survey data suggests the downside risks to growth if COVID-19 cannot be contained. This makes further monetary stimulus by the Federal Reserve more likely in the coming months with further interest rate cuts expected.

Bernie Sanders took the lead after a strong showing in the first three primaries to become the clear front runner in the race to become the Democratic nominee.

Eurozone

Although December data, released in February, confirmed that the eurozone economy ended 2019 on a weak note, the survey data looked more promising. The eurozone composite PMI rose 0.3 points to 51.6 in February, which is consistent with trend GDP growth. This reflects a fading of multiple drags, including the trade war, Brexit uncertainty and the emissions scandal in the automobile industry. The improvement was also reflected in German manufacturing in January.

However, the February flash PMI details in Germany and the eurozone already showed a significant impact from the coronavirus outbreak, with sharp declines in the PMI sub-component for export orders, and a sudden lengthening of delivery times. These virus-related drags are likely to intensify further in March as the COVID-19 outbreak in Italy and around the world disrupts production. The globally integrated European economy is particularly vulnerable to global supply chain disruptions, posing downside risks to growth. If the situation deteriorates further in the coming months, fiscal measures can be expected.

Asia

The virus outbreak represents a large shock to the Chinese economy. To reduce the spread of infection, the authorities in China implemented significant restrictions on travel and extended mandatory factory shutdowns. High frequency indicators such as daily coal consumption give some signs of the current level of activity. In February, coal consumption was depressed for most of the month and did not show the typical rebound that usually follows Chinese New Year. In the last week of February, coal consumption rose moderately, reflecting the efforts to restart production after the prolonged break in activity. However, it is still almost 30% below the usual level four weeks after Chinese New Year. It is expected that China's economic growth will slow sharply in the first quarter. Policymakers have responded with several supportive measures. The People's Bank of China cut the one-year loan prime rate by 10 basis points and provincial governments waived VAT, social contributions and rent to ease the financial pain, particularly for smaller businesses. But hopes of a quick and sharp recovery in Q2 could be premature given the slow recovery in production and the uncertainty around the extent to which the virus will continue to spread.

Japan's economy was expected to contract in Q4 of 2019 after a sales tax increase in October.

However, data released in February showed a larger decline than markets had expected, with GDP falling at an annualised rate of 6.3%, the worst pace since the previous hike in VAT in 2014. Exports fell for the 14th consecutive month on a year-on-year basis. With COVID-19 expected to hit Japan's inbound tourism and trade in Q1, the risks for the Japanese economy have risen.

In South Korea, the country with the most confirmed COVID-19 cases outside China, the Composite Consumer Sentiment Index fell from 104.2 in January to 96.9 in February - the largest single-month decline since June 2015. The close economic relationship between South Korea and China also weighed on the economic outlook.

Conclusion

In January's commentary, using the words of former US Secretary of Defence, Donald Rumsfeld, we referred to positioning for the 'known unknowns' and the 'unknown unknowns'. While COVID-19 was by then a 'known unknown', the speed and sharpness of its bite proved to be the latter.

Overall, we believe portfolios will benefit from maintaining a balanced approach to asset allocation given the uncertainty about how the outbreak will play out. Risk aversion could prevail in the short term if more countries see the number of cases rise in the weeks ahead. If so, core government bonds may therefore remain valuable as a portfolio diversifier, along with other alternatives such as gold. Within equities, defensive sectors have the potential to outperform if the outlook deteriorates, but key to successful navigation through these times is holding one's nerve. While current market performance may well be of concern, history tells us that a calm approach, patience and a longer-term view are likely to result in a better outcome than pressing the panic button.

Economic Projections (29/02/2020)

Economic Growth

Country/Region	Real GDP YOY Growth (%)		
	2019 (actual)	2020	2021
UK	1.40	1.00	1.50
USA	2.30	1.80	2.00
Eurozone	1.20	1.00	1.30
Germany	0.60	0.60	1.20
France	1.30	1.00	1.30
Japan	0.80	0.30	0.80
China	6.10	5.50	5.80
India	6.10	5.00	5.80
Asia (ex Japan)	5.30	4.90	5.30
Emerging Markets	4.30	4.30	4.70

Source: Bloomberg

Interest Rates

Country/Region	Central Bank Interest Rates (%)		
	2019 (actual)	2020	2021
UK	0.75	0.65	0.80
USA	1.75	1.70	1.75
Eurozone	0.00	0.00	0.00
Japan	-0.10	-0.10	0.00
China	4.35	4.25	4.15
India	5.15	4.90	5.05

Source: Bloomberg

Foreign Currency Exchange Rates

Currency Pair	Exchange Rate		
	2019 (actual)	2020	2021
GBP/USD	1.33	1.34	1.39
EUR/GBP	0.85	0.85	0.84
EUR/USD	1.12	1.14	1.17
USD/JPY	108.61	107.00	105.50
EUR/JPY	121.77	121.00	123.50
USD/CNY	6.96	6.99	6.90
USD/INR	71.38	71.90	71.50

Source: Bloomberg

Risk Warnings

The following is a summary only of some key items in the Prospectus.
Capital is at risk. Investors in Protected Cell Company (PCC) must have the financial expertise and willingness to accept the risks inherent in this investment.
Past performance is not a reliable indicator of current or future performance and should not be the sole factor considered when selecting funds.
The Master funds will be exposed to stock markets. Stock market prices can move irrationally and be affected unpredictably by diverse factors, including political and economic events.
It should be appreciated that the value of Shares is not guaranteed and may go down as well as up and that investors may not receive, on redemption of their Shares, the amount that they originally invested.
Investment in the Company should only be undertaken as part of a diversified investment portfolio.
Investment in the Shares should be viewed as a medium to long term investment.
Shares may not be redeemed otherwise than on any Dealing Day.
There will not be any secondary market in the shares of the Company.

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