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Marlborough International

Q1 2020

Global Investment Commentary

SUMMARY

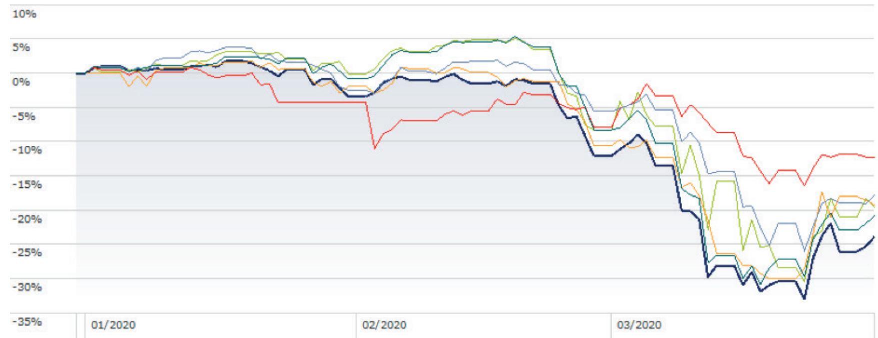
The first quarter of 2020 has proved to be very difficult for both investors and society in general. Although there were clear indications that the economic cycle was already in its later stages, since the first mention of coronavirus, or COVID-19, in late December, only the proverbial crystal ball would have predicted the impact that it has had on financial markets and day-to-day life.

Market round-up

We have moved from a relatively balanced debate as to whether there would be a recession or not this year, to assessing how deep the recession will be and for how long it will last. This change is reflected in the performance of equity indices, with the FTSE 100 and US S&P 500 falling by 23.84% and 19.6% respectively since the start of the year (in local currency terms).

In Europe, the MSCI Europe (ex UK) index declined by 20.84%, while Japan's Nikkei 225 fell by 19.23% and the MSCI Asia Pacific (ex Japan) index dropped 17.86%. Ironically, China, where COVID-19 first emerged (as US President Donald Trump was eager to remind us all), saw the least damage of all the major markets, down by 12.2%.

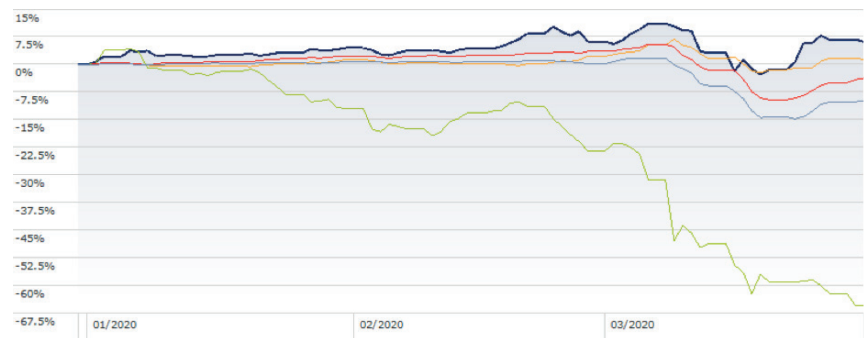
Major Equity Indices - Q1 2020



Investment Name	Value	Investment Name	Value
FTSE 100 TR in GBP	-23.84%	MSCI AC Asia Pacific Ex Japan PR	-17.86%
SSE 50 A Share TR CNY	-12.2%	Nikkei 225 Average TR JPY	-19.23%
S&P 500 TR in USD	-19.6%	MSCI AC Europe Ex GR EUR	-20.84%

Source: FE

Government Bonds & Gold - Q1 2020



Investment Name	Value	Investment Name	Value
LBMA Gold Price PM USD	6.22%	BBgBarc HY Bond	-9.81%
BBgBarc Global Agg Corp US	-3.62%	BBgBarc Global Treasury	1.38%
Oil Price Brent Crude PR	-65.55%		

Source: FE

Government bonds and gold - safe harbours in the storm

The more defensive portions of portfolios have performed as intended, with government bonds rising in price, aided by interest rate cuts from central banks around the world and the recommencement of quantitative easing (QE - printing new money!). Gold has also delivered positive returns year to date, up by 6.22%. However, concerns about the effect of the lockdown on corporate profitability and hence companies' ability to fund interest payments have led to a decline in the price of corporate bonds and this will have detracted from the returns generated by some fixed income portfolios. Predictably, higher-risk, higher-yielding corporate bonds have fallen by more than investment-grade, with high yield energy bonds being the worst hit.

Other than gold, the vast bulk of commodity prices fell sharply over the quarter. As countries around the world halted activity to try to bring the spread of the virus under control, demand for most commodities declined, hitting prices. Oil was caught in a perfect storm, with an agreement between OPEC and Russia to constrain supply breaking down just as the outlook for demand fell. This led the oil price to fall by more than 65%.

An unprecedented shock requires an unprecedented policy response

There is little need to wait for the traditional economic data to be released to appreciate the scale of the damage to the global economy caused by the virus containment measures currently in place across much of the world. A few select data points already available adequately demonstrate the magnitude of the shock. For example, car sales in China fell by approximately 80% in February and in the UK new car registrations plunged by more than 40% in March. Data from a well-known app shows that restaurant bookings are down by close to 100% in nearly every country it covers. During the week ending 28th March, 6.6 million Americans submitted claims for unemployment benefits. That is nearly double the number for the previous week, which had itself set a new record.

An unprecedented shock requires a policy response of a greater magnitude than we have seen in the past, and that is what we have had. Most encouraging has been the policy response from the likes of the UK and German governments, which have committed to pay a significant proportion of workers' wages during the lockdown. This is to enable companies to avoid laying off staff, despite the dramatic hit to sales.

Government-backed loans should also help many companies to avoid otherwise inevitable bankruptcies induced by the choking off of cash flow. However, loans may not be enough for the hardest hit companies, some of which are likely to require grants or bailouts to survive a near total drop in sales, some of which could be lost forever.

In the US, a substantial fiscal stimulus package has been agreed, valued at approximately 10% of last year's GDP. This will include some grants to small businesses and government backing for credit to be provided by the Federal Reserve Bank (the Fed) to investment-grade companies. This should ensure large companies do not fail in the near term because of a lack of cash flow. However, again, some large companies may require grants or bailouts rather than just credit to survive this shock over the longer term.

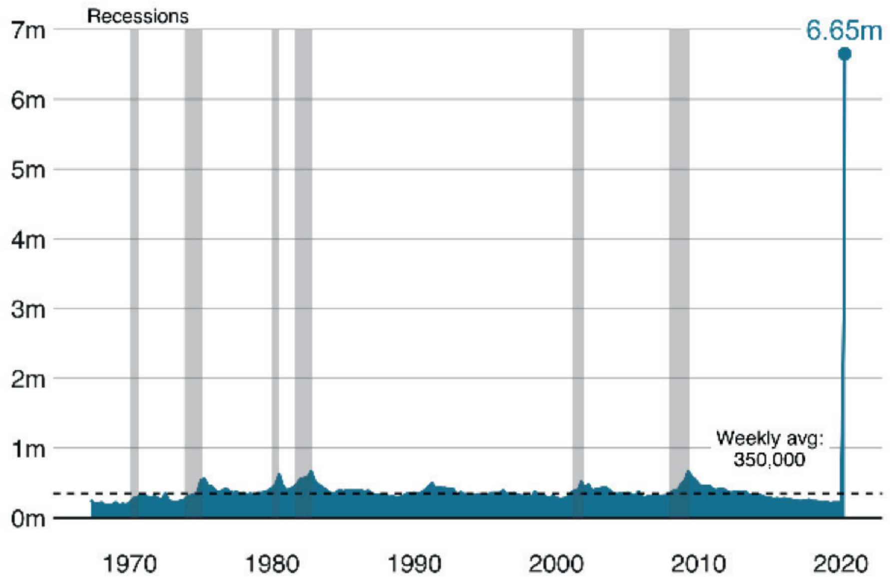
In addition, while the US fiscal package significantly increases jobless benefits for the next few months, the policy appears less effective than the UK or German policies of encouraging companies to hold on to staff. Overall, fiscal policy has already delivered a significant stimulus globally, but further measures are still likely to be needed to deal with the scale of the impact of locking down large swathes of the world's population.

Central banks have wheeled out their biggest artillery and have a seemingly endless supply of ammunition to throw at the problem, cutting rates and restarting and expanding asset purchase programmes. The Fed's commitment to purchase as many government bonds as necessary is a substantial step, which should enable it to keep government borrowing costs low, despite the massive fiscal stimulus that will be required to deal with the economic consequences of the virus.

While the European Central Bank and the Bank of England have not stated quite as explicitly that their firepower is unlimited, there appears to be no doubt about their commitment to keep government borrowing costs low and provide liquidity for investment-grade corporates. In short, central banks are doing all that can reasonably be expected of them to fight this crisis.

The depth and duration of this recession will depend on the extent to which governments, working with the support of central banks, fill in the gaps in their current fiscal responses to

US Unemployment



Source: US Bureau of Labour Statistics

avoid unemployment spiralling higher and prevent otherwise sound businesses going bankrupt. Clearly, the length of time that it takes the world to emerge from lockdown will also be a major factor, because the sooner this happens the lower the cost of the fiscal stimulus required and the smaller the growth in government indebtedness.

Conclusion

In February's conclusion we highlighted the value core government bonds, along with alternatives such as gold, could have as portfolio diversifiers and that has proven to be the case.

We also said the key to successfully navigating these times would be holding one's nerve and that too remains unchanged.

While we have not lost sight of the need for caution, given that what will happen next in the markets remains far from clear, we continue to believe that a sensible allocation to risk assets, such as equities and bonds, makes sense. There have been many pieces written of late referencing how markets have historically reacted in the aftermath of comparable scenarios (SARS, Ebola etc). The economic and political backdrops are different in each case, but in previous epidemics, equities have typically been characterised by a short-term sell off, which has historically been followed by a strong recovery. The obvious aim is to be invested when that recovery comes.

With central bank and government support, highly rated large investment-grade companies seem most likely to survive this shock whereas some lesser-rated companies may not make it through the crisis. This suggests that a selective approach, with an increased focus on quality, continues to be prudent within both bonds and equities, until there is greater clarity about exactly what lies ahead.

Economic Projections (31/03/2020)

Economic Growth

Country/Region	Real GDP YOY Growth (%)		
	2020	2021	2022
UK	-1.9	1.9	1.4
USA	0.9	2.1	2.0
Eurozone	-3.1	2.2	1.3
Germany	-1.2	1.6	1.4
France	-3.1	2.4	1.4
Japan	-1.0	1.1	0.8
China	3.3	6.4	5.5
India	4.9	5.2	6.3
Asia (ex Japan)	3.5	5.6	5.2
Emerging Markets	2.9	4.9	4.7

Source: Bloomberg

Interest Rates

Country/Region	Central Bank Interest Rates (%)		
	2019	2020	2021
UK	0.75	0.20	0.35
USA	1.75	0.45	0.80
Eurozone	0.00	0.00	0.00
Japan	-0.1	-0.1	0.0
China	4.35	4.25	4.10
India	5.15	3.85	3.85

Source: Bloomberg

Foreign Currency Exchange Rates

Currency Pair	Exchange Rate		
	2020	2021	2022
GBP/USD	1.29	1.33	1.33
EUR/GBP	0.87	0.86	0.84
EUR/USD	1.13	1.15	1.15
USD/JPY	107.00	108.00	111.00
EUR/JPY	120.00	124.00	128.00
USD/CNY	7.00	6.90	6.68INDI
USD/INR	72.45	72.20	72.50

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.

Regulatory Information

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Marlborough International Management Limited, Town Mills South,
La Rue du Pre, St Peter Port, Guernsey, GY1 3HZ, Channel Islands
Investor Support: +44 (0)1204 589 336
Email: enquiries@marlboroughgroup.com
Website: www.marlboroughinternational.gg
Administrator: (Postal applications) Louvre Fund Services Limited, First Floor,
St Peter's House, Le Bordage, St Peter Port, Guernsey, GY1 1BR

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