Marlborough International

Q2 2020

Global Investment Commentary

SUMMARY

It has been a very strong quarter for equities and corporate bonds as central banks and governments provided enormous amounts of stimulus and economies started to reopen. Despite the strong rebound in risk assets, traditional portfolio hedges such as government bonds and gold also held up well.

Market round-up

As economies have started to reopen, data has shown signs of a sharp rebound. For example, US retail sales rose 17% month on month in May, while UK retail sales rebounded by 12%. Although sales are still down 6% and 13% year on year respectively, a clear positive can be found in the the speed and magnitude of the bounce back.

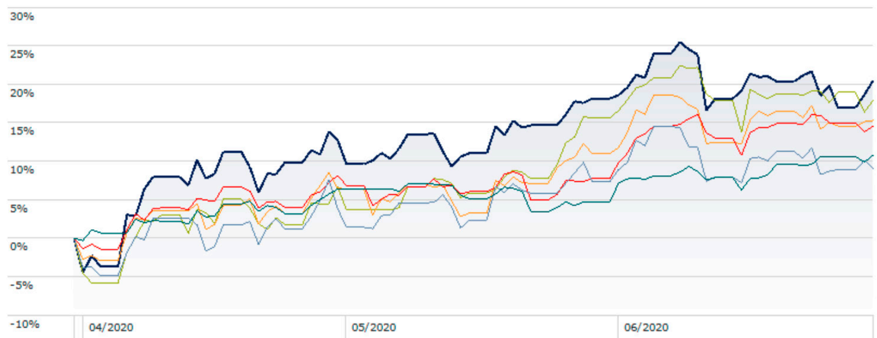
This is reflected in the performance of major equity markets during Q2:

UK (FTSE 100)	+9.15%
US (S&P 500)	+20.54%
Europe (MSCI Europe Ex UK)	+15.35%
Asia (MSCI Asia Pac Ex Japan)	+14.59%
Japan (Nikkei 225)	+17.97%
China (SSE 50)	+10.83%

Central Bank Firepower

Another positive is that central banks globally have made clear that they stand willing to use their full firepower to keep government and corporate borrowing costs low. The Bank of England, for example, recently increased its quantitative easing programme by a further GBP 100 billion, helping to keep UK 10-year Gilt yields low at around 0.2%.

Performance - Major Indices



Investment Name	Value	Investment Name	Value
S&P 500 TR USD	20.54%	FTSE 100 TR GBP	9.15%
MSCI AC Asia Pac Ex JPN PR	14.59%	MSCI Europe Ex UK GR EUR	15.35%
Nikkei 225 Average TR JPY	17.97%	SSE 50 A Share TR CNY	10.83%

Source: FE, 1 April to 30 June 2020

The worst-case scenario of the COVID-19 pandemic developing into a liquidity crunch appears to have been avoided and central banks seem willing to continue to provide liquidity support where necessary. This has helped high yield and investment grade bonds rally during the quarter.

Risks Remain

Significant risks remain, however, and prominent among these are:

- Central banks have been clear that they can only lend, not spend, and so will not necessarily be able to save companies that face solvency concerns, rather than just liquidity issues.
- Some companies will therefore still face administration and we have unfortunately already seen some examples this quarter.
- The virus has not been fully contained, or a vaccine approved.

In Europe, Australasia and some parts of Asia, including China, new infections have fallen to low levels and economies are reopening. In the UK, new infections have also continued to fall, albeit not to levels as low as in many other parts of Europe. However, in the US, the number of new infections is rising again, while several emerging markets, including India and much of Latin America, have been unable to get the virus under control.

Another risk comes in the form of potential fiscal fatigue from governments, which could potentially roll back their stimulus measures too soon, before the virus has been fully contained and the economy and labour markets allowed to recover. The UK's announcement that companies will have to contribute to the cost of furloughing workers from August, with the scheme set to expire at the end of October, is one example of this risk. An as yet unknown number of currently furloughed workers could find themselves unemployed in the coming months.

In the US, incomes have so far been supported by stimulus cheques and unusually generous unemployment benefits, which are due to expire at the end of July. If these benefits are not extended, many unemployed Americans could experience a significant reduction in their incomes in the second half of the year.

Political risks also remain, with the US election fast approaching, tensions between China and the rest of the world escalating and the final details of any Brexit trade deal still unresolved.

Brexit

While in the past the Brexit section dominated the content of this commentary, more recent events can probably be summed up in the same three words uttered by EU chief negotiator Michel Barnier after the first round of talks: no significant progress.

With both sides continuing to negotiate the best deal possible, amid all the soundbites, one important date came and went. The final day of June was the last date on which the UK could request an extension to the transition period. As expected, no such extension was requested, meaning that the UK is now committed by international law to leaving the EU on 31st December this year.

Sector Performance Tells a More Complex Story

Although markets generally look to be pricing in a quicker than expected recovery, it is worth noting that a closer examination of sector performance reveals a more complex story. For example, online retailers are up very strongly year to date, while department stores are down sharply, along with other sectors that have been most affected by the coronavirus, such as hotels, airlines, energy companies and banks. While most of the worst-performing sectors year to date have also lagged during the rally since late March, energy companies have actually been one of the best-performing sectors, as oil prices partially recovered. Additionally, some of the best-performing sectors year to date, such as food retailers and supermarkets, have lagged the most during the rally. So, it is imperative from a stock selection perspective to look beneath the index level for both opportunities and risks. It is also important to be aware that many companies are not starting the second half of 2020 where they were at the beginning of the year, even though some indices may give that impression.

Conclusion

Overall, the market has rallied on the back of fiscal and monetary stimulus, combined with the reopening of economies. Monetary support is seemingly here to stay, but in some countries there is a risk that fiscal stimulus may become less generous. Meanwhile, rising infection rates could lead to the return of lockdown measures. Our approach remains largely unchanged, with a relatively neutral allocation, relying on the expertise of respective managers to focus on quality companies that can continue to trade successfully even if some of the risks do become reality in the second half of the year.

Economic Projections (30/06/2020)

Economic Growth

Country/Region	Real GDP YOY Growth (%)		
	2020	2021	2022
UK	-8.80	6.00	2.50
USA	-5.60	4.00	2.90
Eurozone	-8.10	5.50	2.20
Germany	-6.20	5.00	2.10
France	-9.80	6.30	2.80
Japan	-4.90	2.50	1.20
China	1.80	8.00	5.40
India	4.20	-4.70	7.20
Asia	-0.10	4.90	4.50
Emerging Markets	-0.50	5.00	4.80

Source: Bloomberg

Interest Rates

Country/Region	Central Bank Interest Rates (%)		
	2020	2021	2022
UK	0.10	0.15	0.55
USA	0.25	0.35	0.60
Eurozone	0.00	0.00	0.00
Japan	-0.10	-0.10	0.00
China	4.25	4.20	*
India	3.60	3.70	*

Source: Bloomberg

(Bloomberg forecast currently unavailable for 2022)

Foreign Currency Exchange Rates

Currency Pair	Exchange Rate		
	2020	2021	2022
GBP/USD	1.27	1.32	1.36
EUR/GBP	0.90	0.88	0.86
EUR/USD	1.14	1.17	1.20
USD/JPY	107.00	107.00	105.00
EUR/JPY	122.00	125.00	127.00
USD/CNY	7.07	6.93	6.85
USD/INR	75.00	73.45	74.00

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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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

Marlborough International