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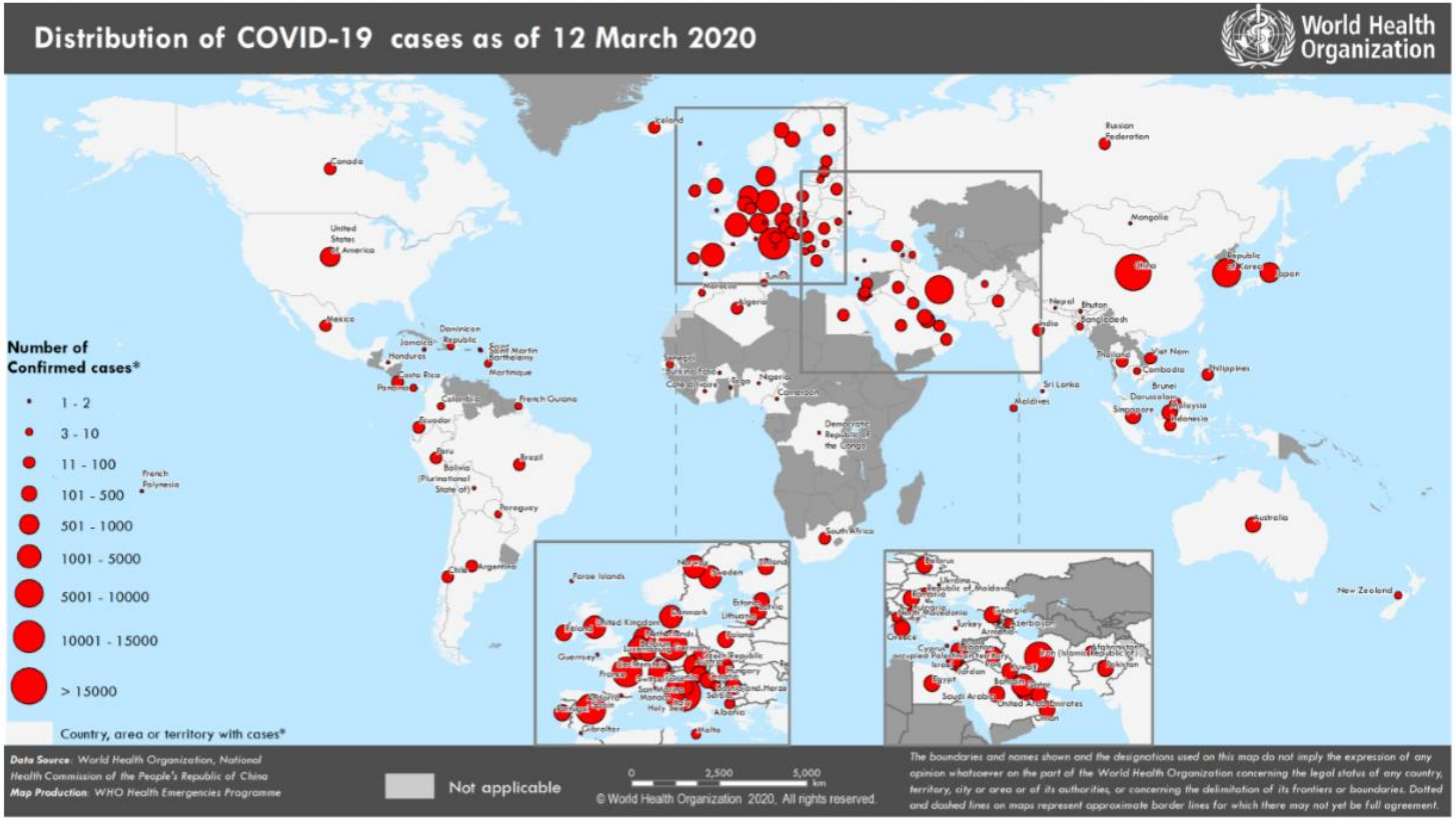
Sarasin Global Strategy and Outlook

March 2020

Coronavirus – the biggest challenge to global growth since the 2008 Financial Crisis

nCoV19 outbreak

Figure 1. Countries, territories or areas with reported confirmed cases of COVID-19, 12 March 2020



"We are deeply concerned both by the alarming levels of spread and severity, and by the alarming levels of inaction. WHO therefore have made the assessment that COVID-19 can be characterized as a pandemic "

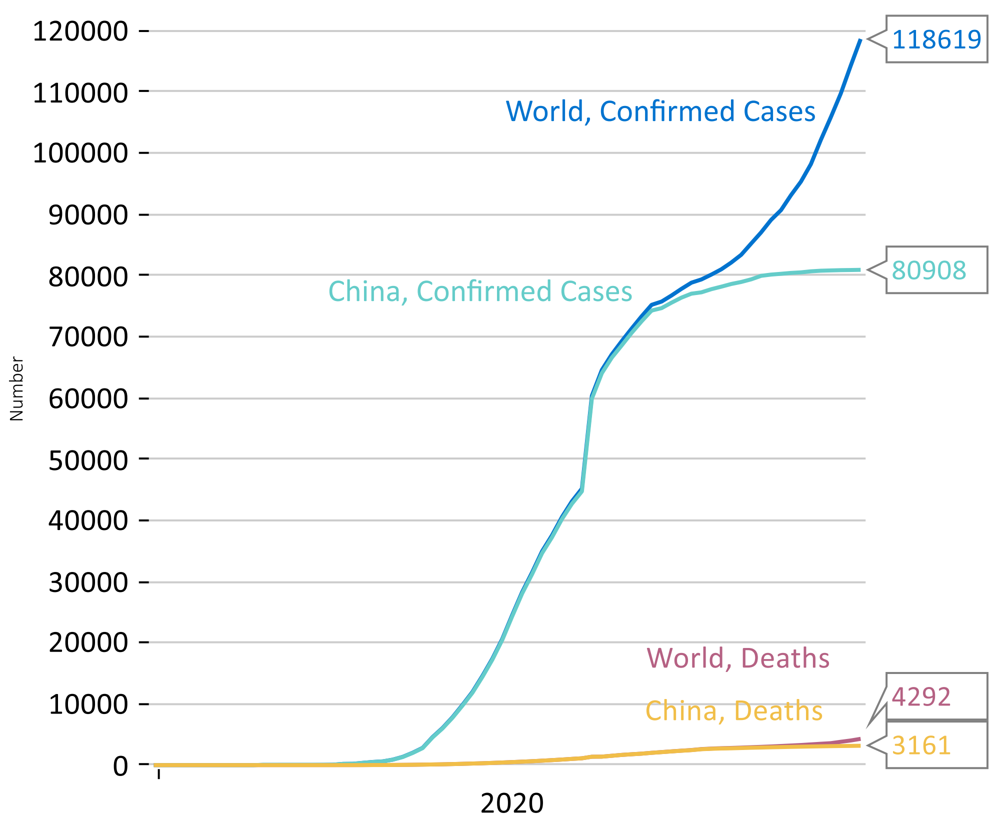
WHO Director General 11 March 2020

Source: WHO March 2020 (Updated weekly)

It spread beyond China in mid-February – tracking depends on national healthcare, testing and reporting standards

Global cases and fatalities

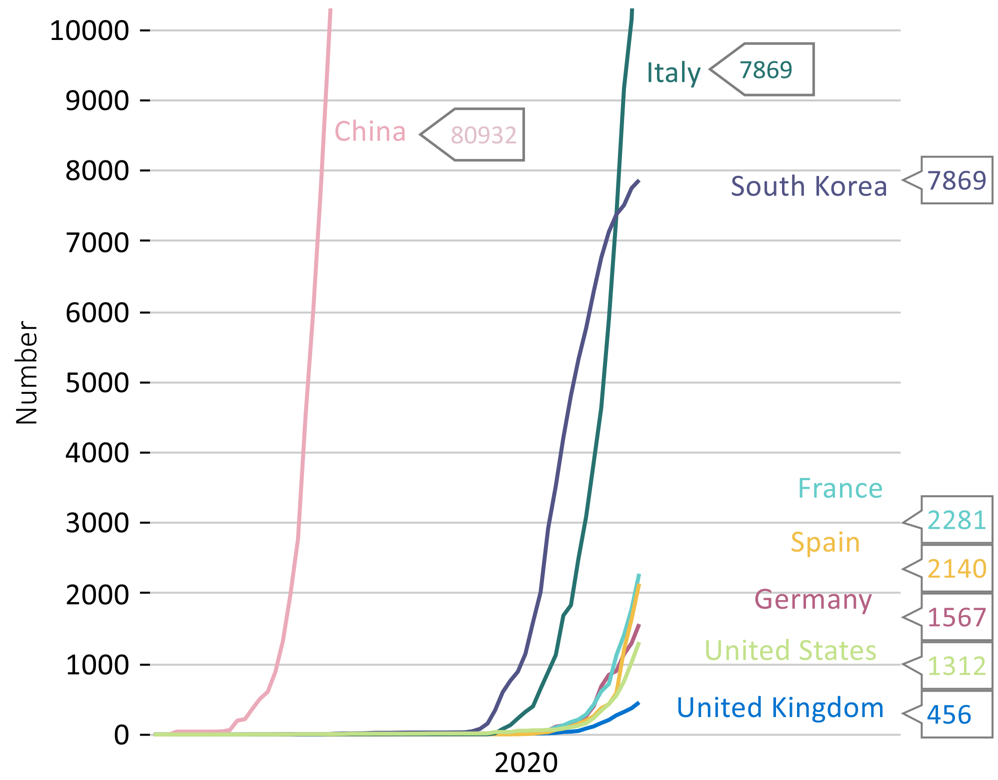
Novel Coronavirus (COVID-19)



Of all cases of Covid-19, 0.9% are expected to die [BBC & scientist sources]. The World Health Organization has reported *"globally, about 3.4% of reported Covid-19 cases have died"*. However, this is of those reported. Many cases are mild and go unreported

Gradual spread - UK is two weeks behind Italy

Novel Coronavirus (COVID-19), Confirmed Cases



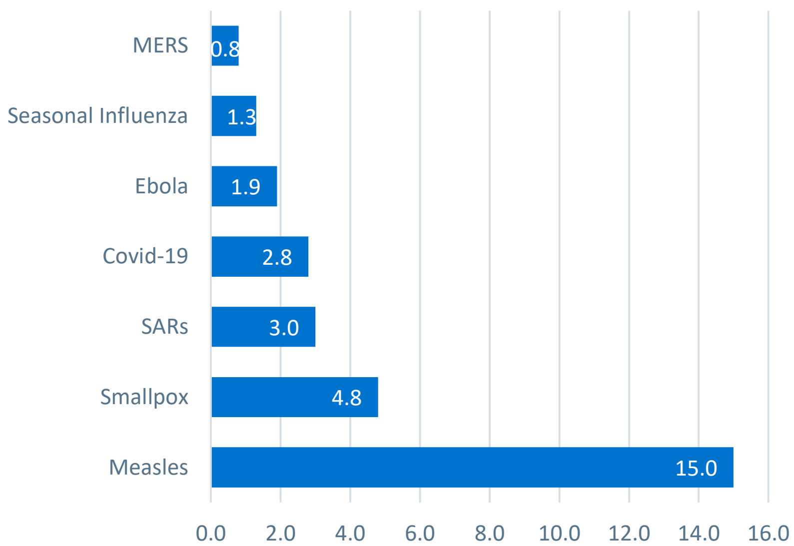
Source: Macrobond

Scale capped at 10000

China's draconian actions cut the reproduction rate below one

The UK government plan: contain, delay, mitigate, research

How Contagious is Each Disease?
Approximate Reproduction Number R0



Source: World Health Organisation, Centers for Disease Control, King Saud University, Nature, Bloomberg

- An R0 of 1 means each infected person passes it on to one more
- Below one, the disease will peter out
- Above one, the disease will spread rapidly

'Infectiousness' is measured by the **reproduction number (R0)**

R0 = b x k x d

= The probability of infection after contact with an infectious person (b)

x The contact rate (k)

x The infectious duration (d)

- Probability of infection can be reduced by not shaking hands and hygiene measures (hand washing)
- Containment & distancing reduce the contact rate
- Duration can be reduced with quarantine (complicated if symptoms are not evident)

Contain

Each patient isolated at first. Suspected cases self-isolate. Then selected communities

Difficult given delay in showing symptoms

Delay

Population distancing - school closures, home working, no large gatherings

Delay into summer period to relieve pressure on NHS

Mitigate

NHS is planning for up to a 2% mortality rate among those infected

Bring back retired NHS staff

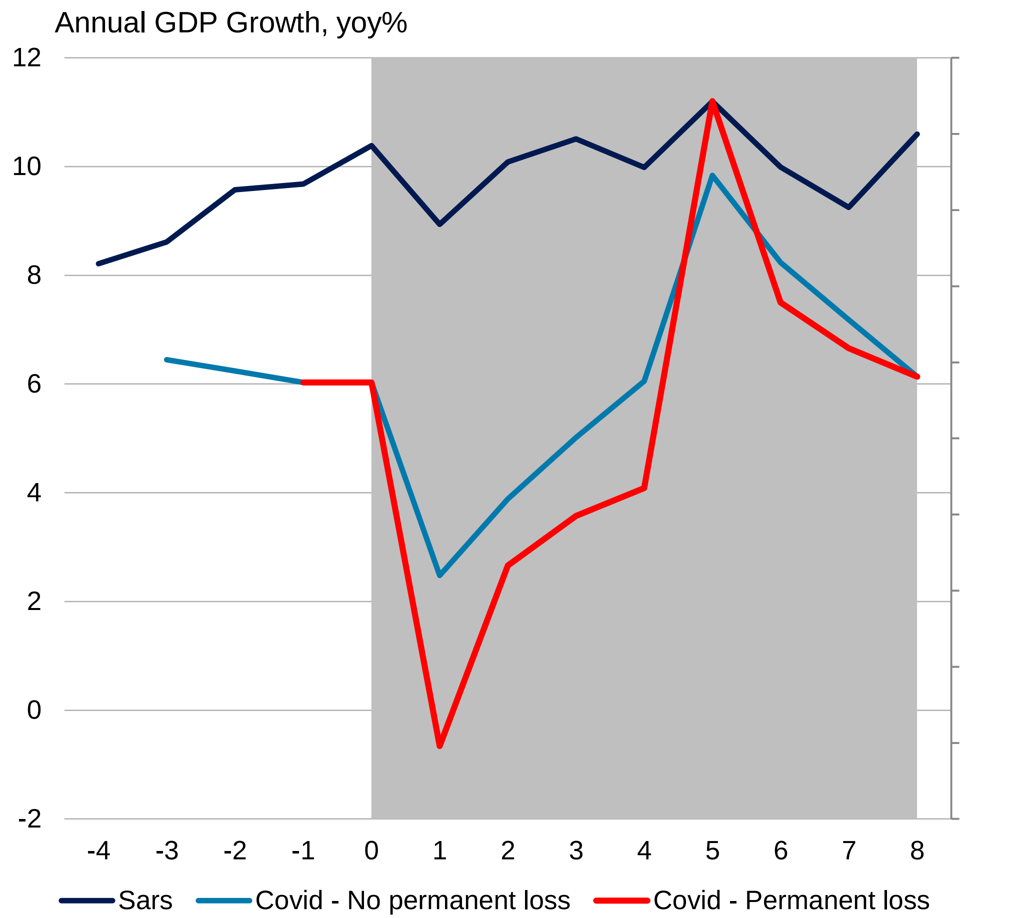
Research Antiviral drugs; A vaccine will take at least 12-24 months

China Impact: Quantifying this difficult at this stage, with both temporary AND permanent loss in activity

The Chinese PMI indicates economy will shrink in Q1 2020

Source: Macrobond

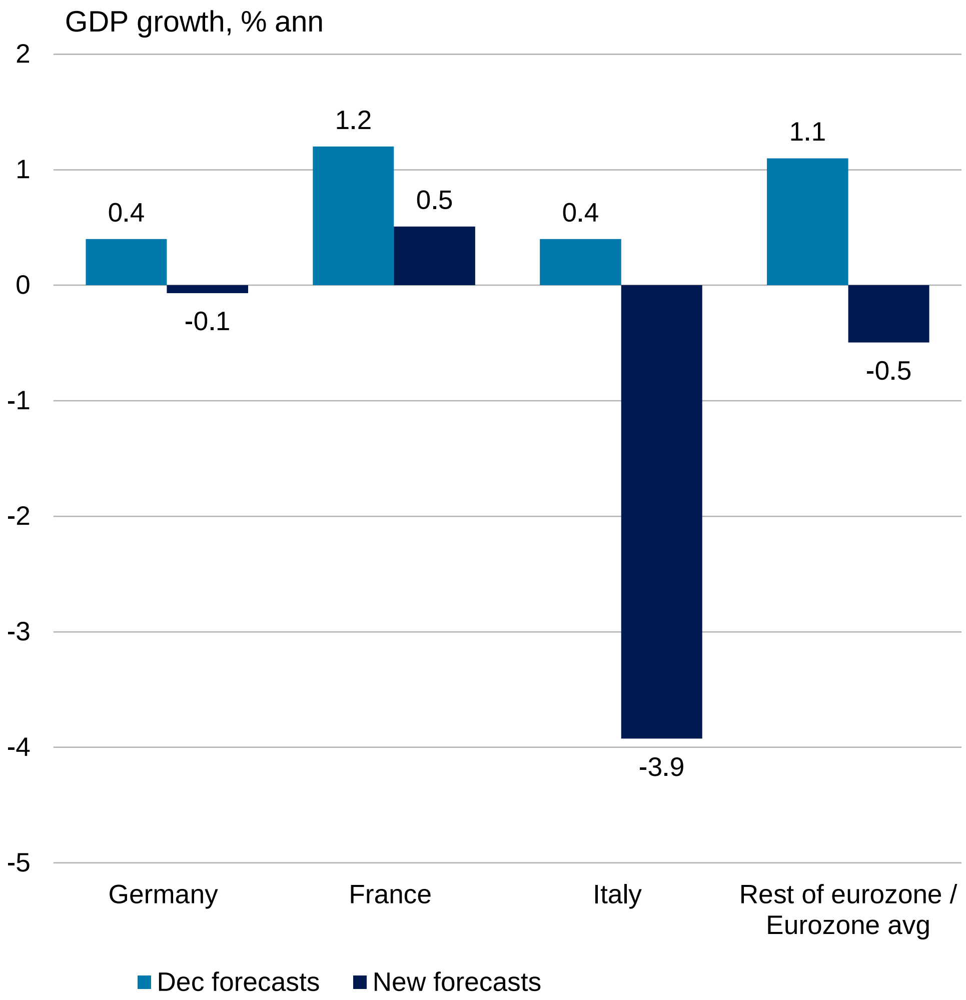
GDP trajectory: COV-19 vs SARS



Note: T0 in Sars is Q1 2003, and in Covid Q4 2019, and the number of quarters before and after shock. The no permanent loss scenario assumes GDP level returns to its previous trend with significant catch-up in Q2, Q3 and Q4 resulting in 2020 growth of 4½% lower than our previous forecast of 5.8%. In the permanent loss scenario, we assume 2.5% loss in 2020 GDP with a sharp fall in Q1 and a similar rebound in subsequent quarters. This results in 2020 growth of merely 2 ½%.
Source: Sarasin and Partners

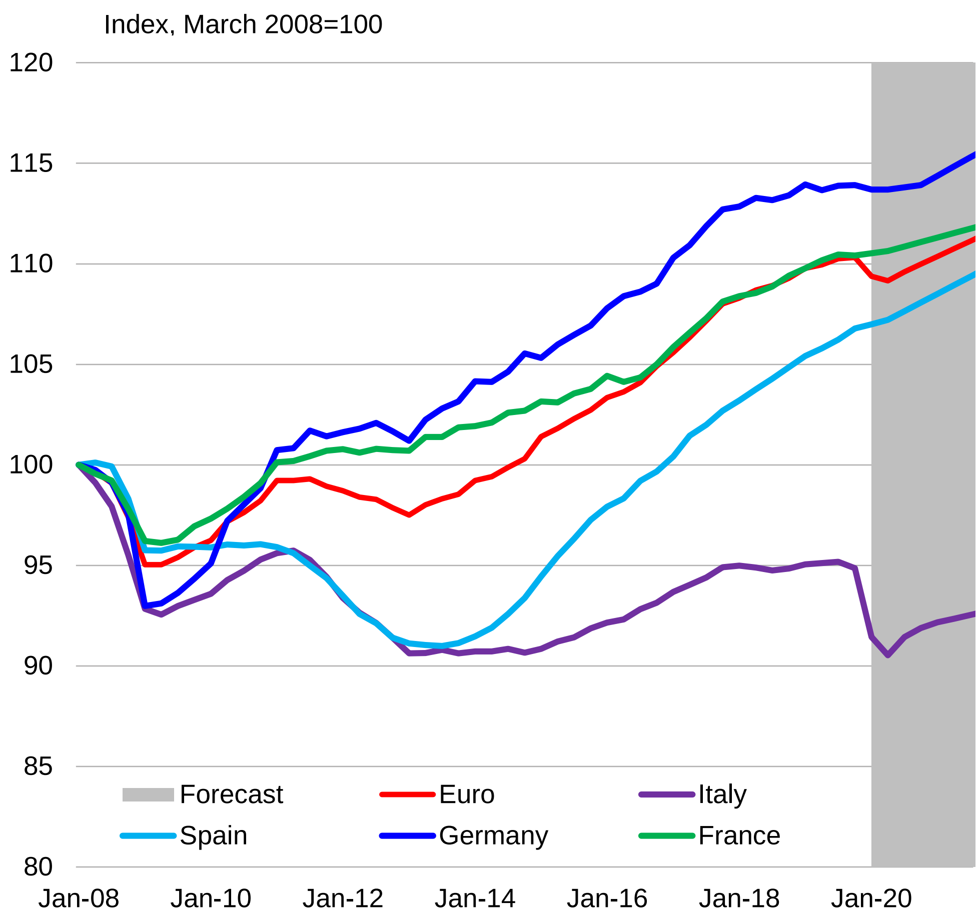
Eurozone Impact: GDP Estimates – Italy shock (15% of EZ economy) will pull euro area into recession in Q2 2020

Adjusting the baseline for 2020 GDP growth



Source: Sarasin and Partners

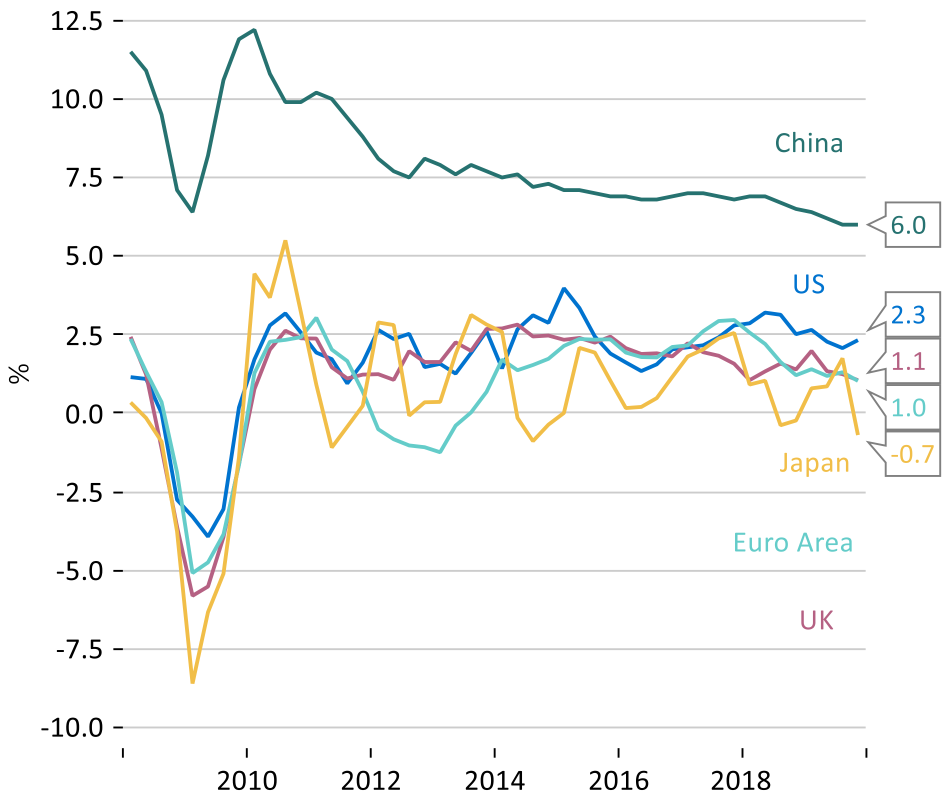
L-shaped recovery?



Source: Macrobond

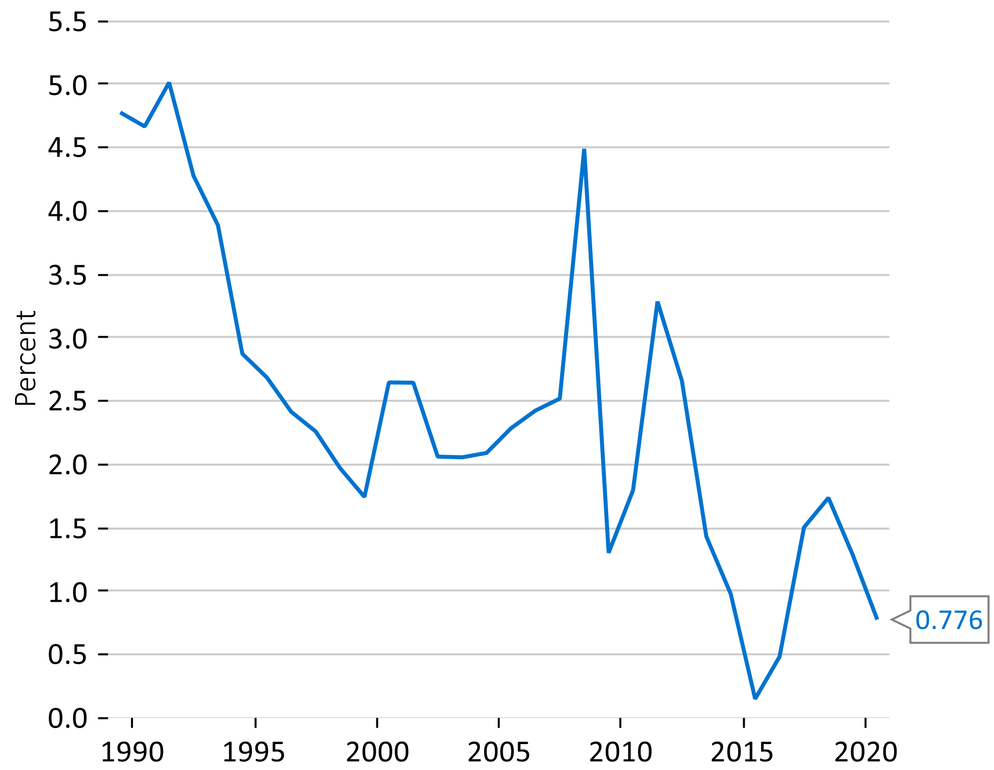
Market & economic outlook: Global growth already slowing & global inflation below-target before Coronavirus outbreak

GDP, annual growth (yoy %)



Source: Macrobond

The global demand shock could supress inflation further



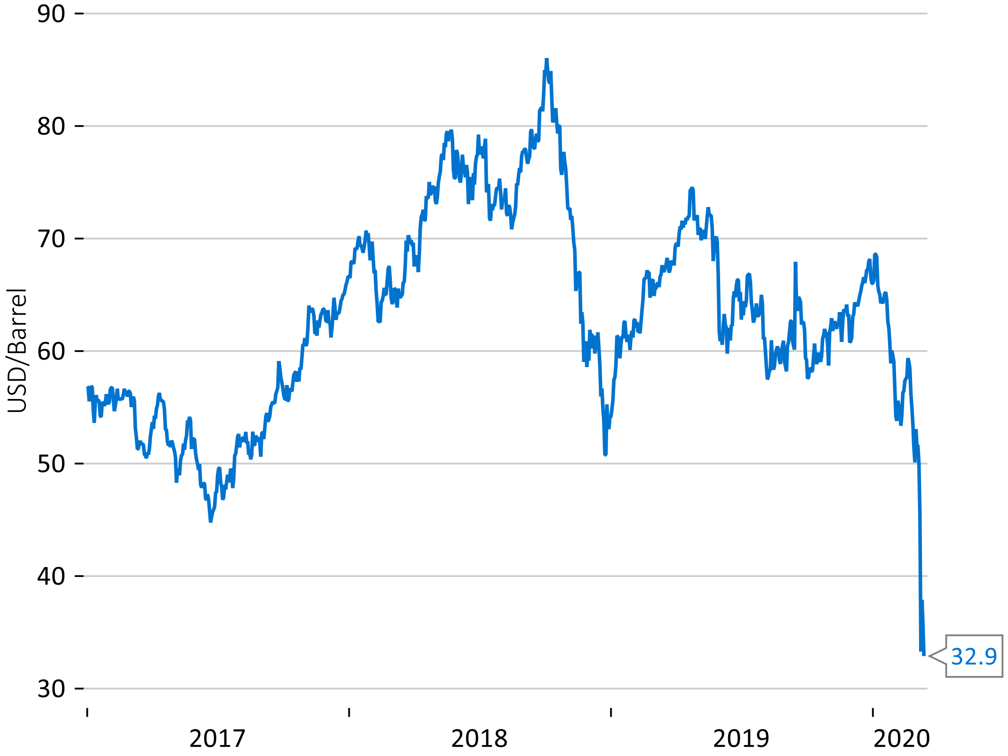
Source: Macrobond

"We know that this shock is somewhat unusual as it affects significant elements of both supply and demand"
Kristalina Georgieva IMF March 4th 2020

Oil price collapse now adds *credit risk* across the oil industry and state owned energy companies…

Oil prices

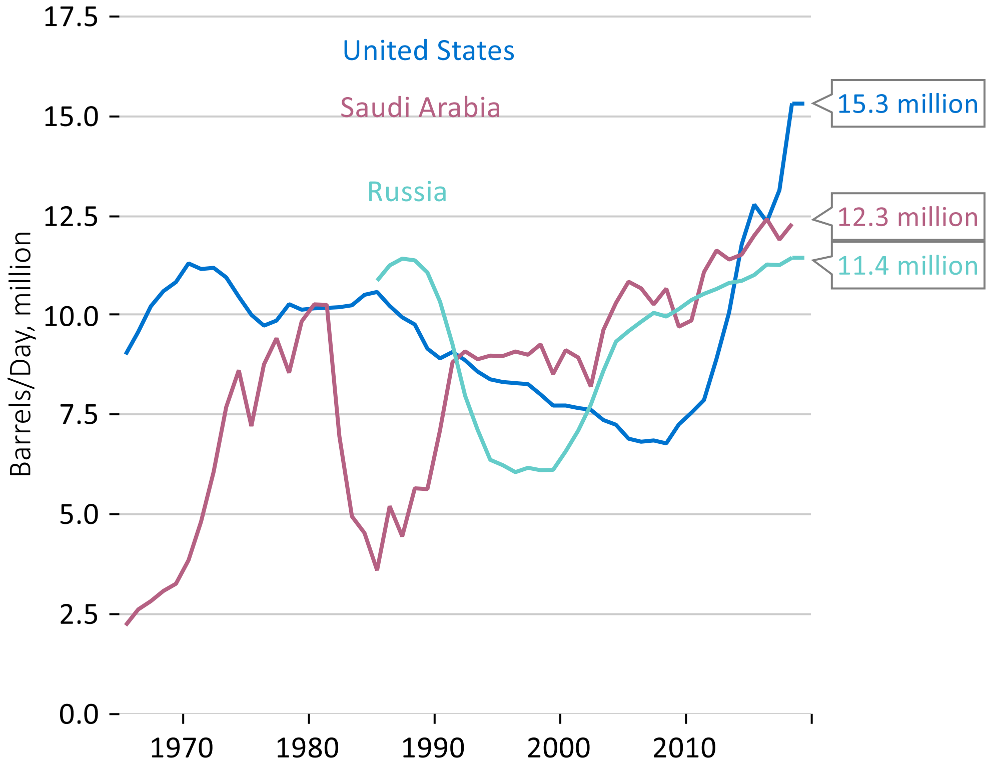
Crude Oil, Brent, Spot, FOB North Sea, ICE, Close, USD



Source: Macrobond

Price war among the 3 major producers

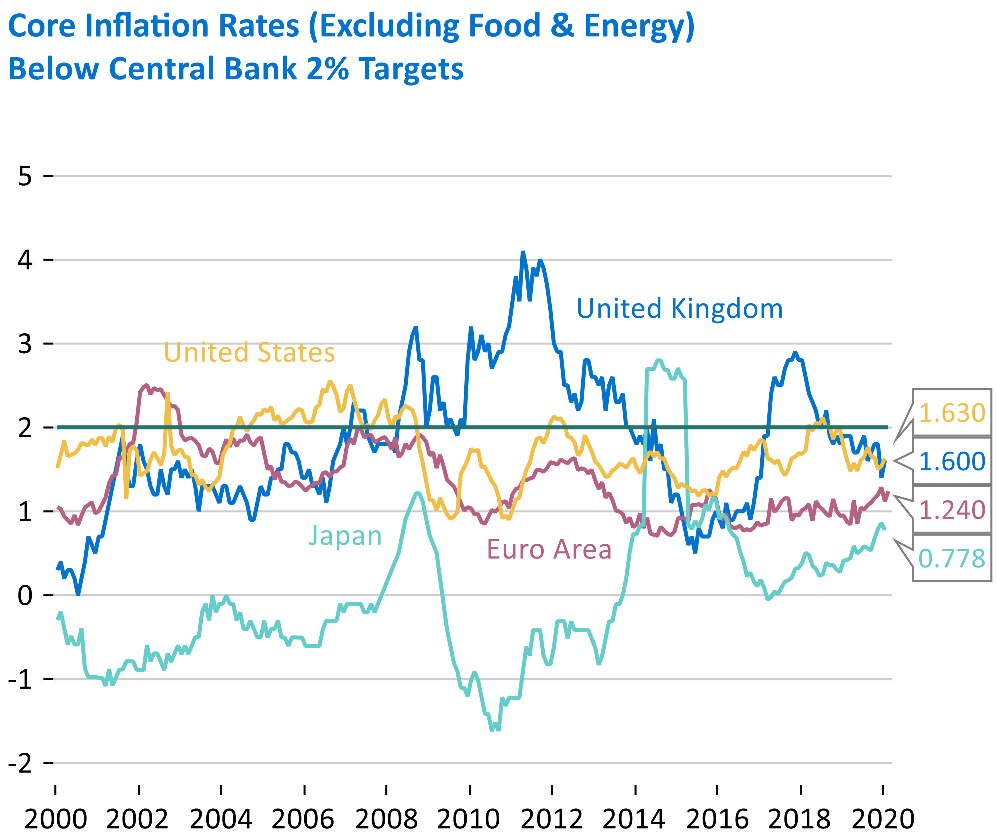
BP Statistical Review of World Energy, Oil, Production, Barrels



Source: Macrobond

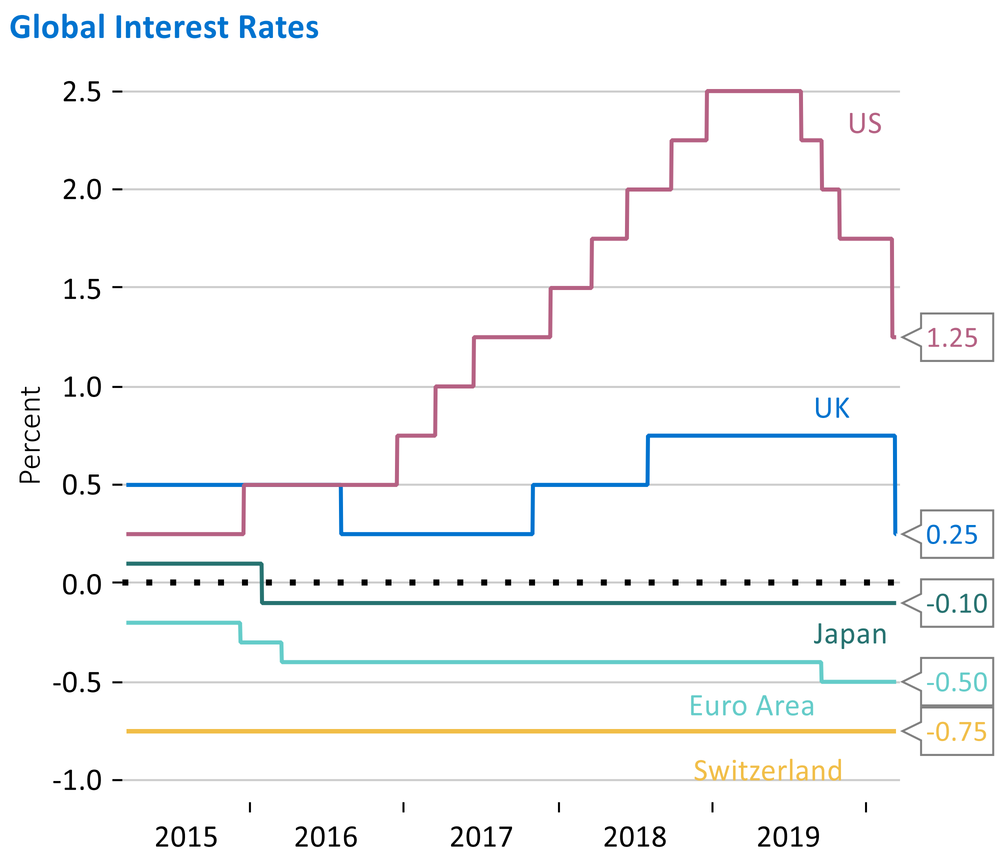
With core inflation well below 2%, *central banks can still ease (note UK & US)* but their toolkit is largely exhausted…

Core inflation stubbornly below 2%



Source: Macrobond

Little room for lower rates

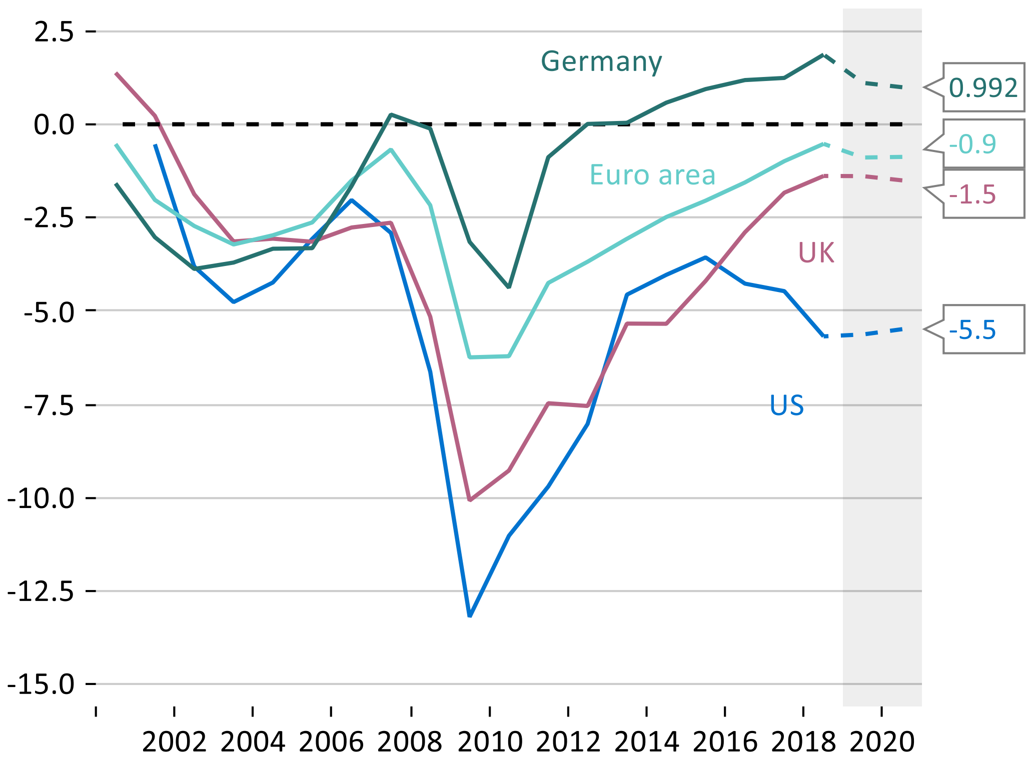


Source: Macrobond

While there is growing pressure across all markets for government spending and monetary policy coordination…

Fiscal policy - Following Trump's lead to deficit…

Government budget, % share of GDP



Source: Macrobond

"The Governor and I have been in constant communication about the evolving situation…and our responses have been carefully designed to be complementary and to have maximum impact, consistent with our independent responsibilities"
Sunak, 12 March 2020

"Projected deficits rise from 4.6 percent of gross domestic product (GDP) in 2020 to 5.4 percent in 2030"
Congressional Budget Office 2020

"Fiscal measures intended to support the economy are certainly very welcome, particularly under present circumstances
Christine Lagarde
Feb 26 2020

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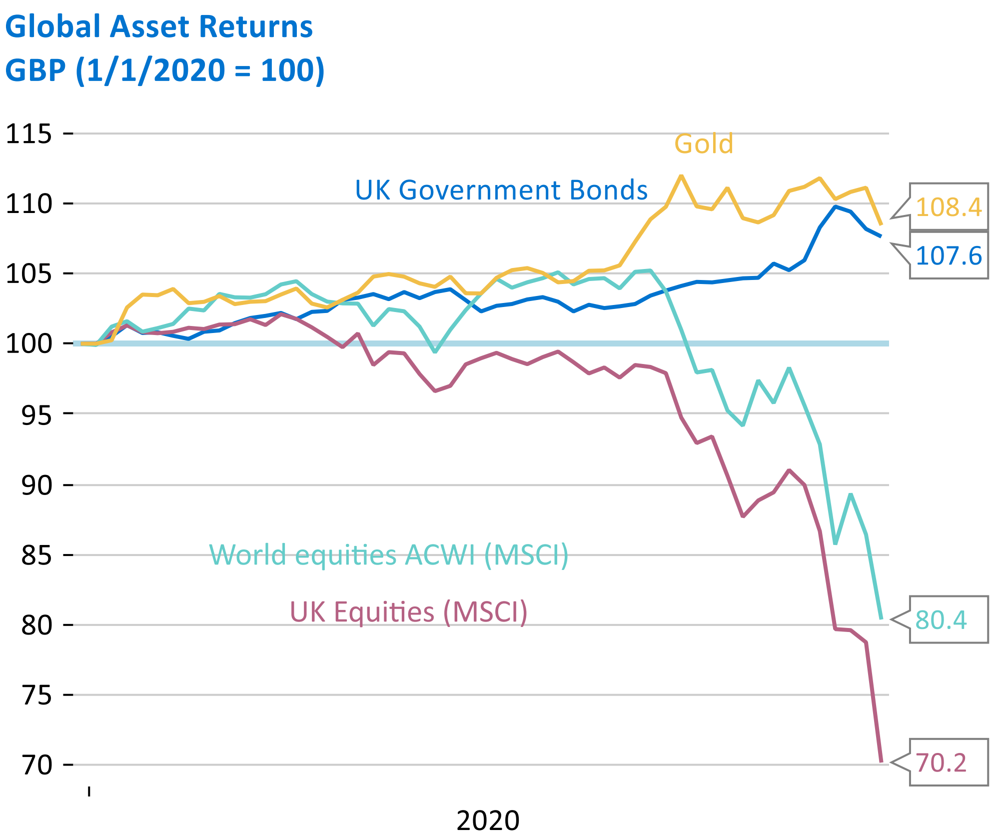
01 Asset markets & growth opportunities

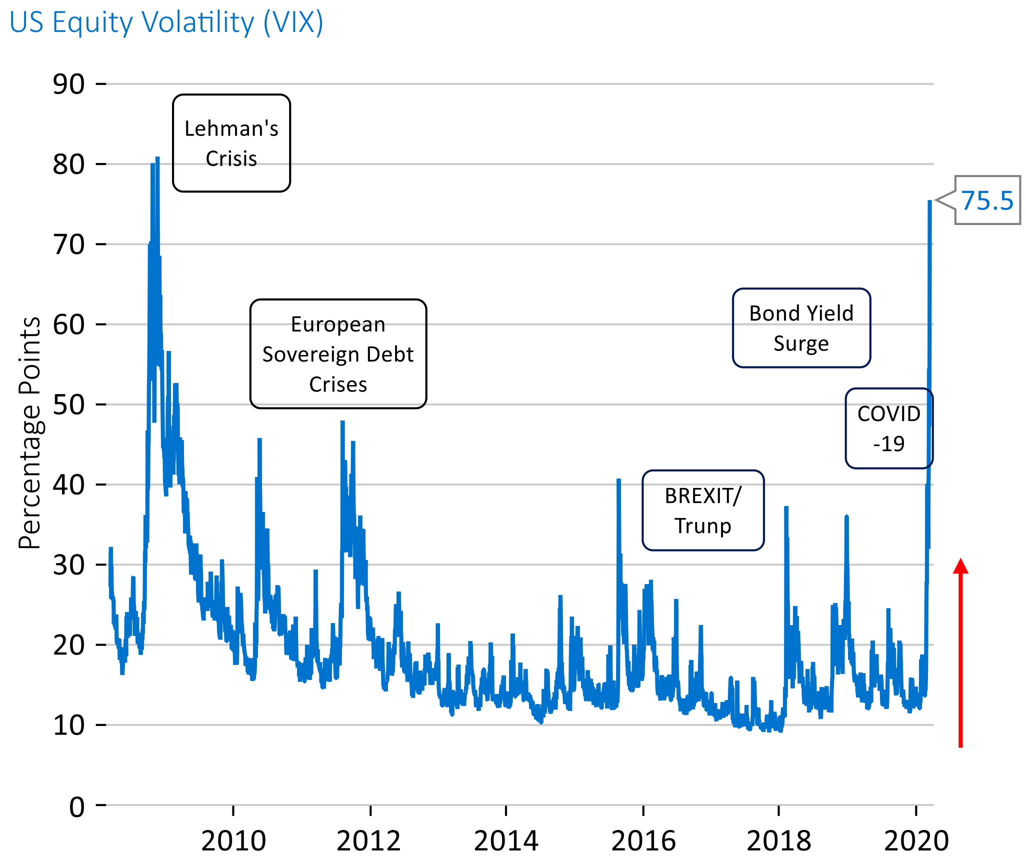
Equity declines in 2020 among the fastest in recent history – volatility close to Euro crisis levels…

Global asset markets correct at unprecedented rates



Source: Macrobond

Equity volatility still close to all time lows in 2019

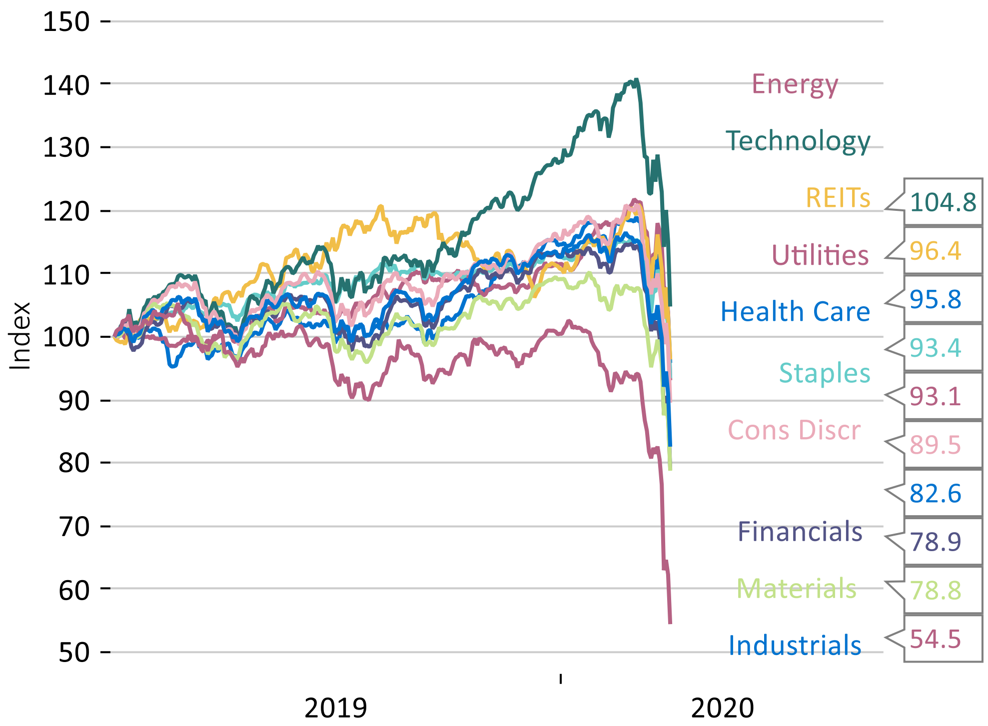


Source: Macrobond

Sector divergence is widening while local dividend less bond yields are at, or close to, all-time highs…

US equity regional outperformance

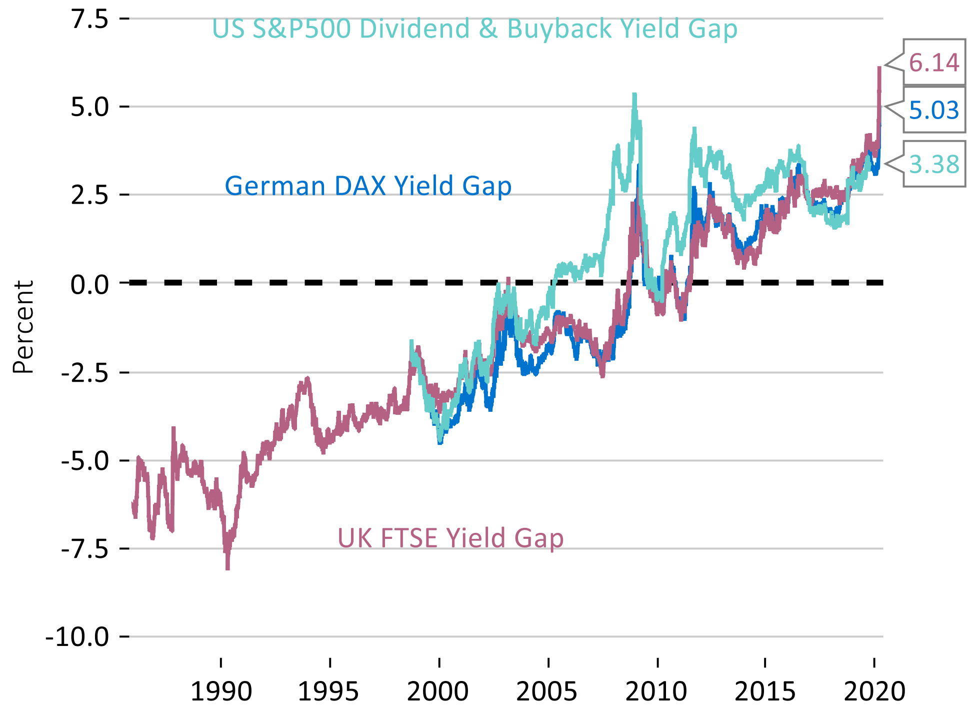
MSCI ACWI, Sectors
Total Return GBP Last 12 Months



Source: Macrobond

Dividend bond yield gap close to all time highs

Equity Dividend
and 10 Year Bond Yields

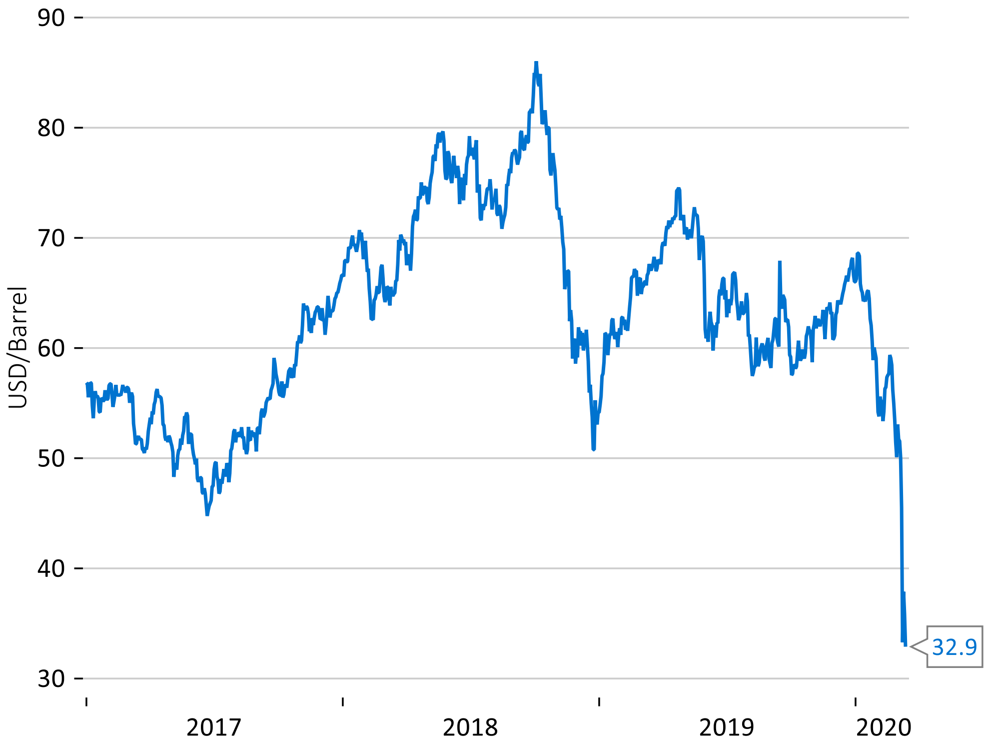


Source: Macrobond

Crude oil prices back below $50 per barrel suggest major oil companies dividends now at risk…

Many oil companies value their reserves at $70-$80 pbl

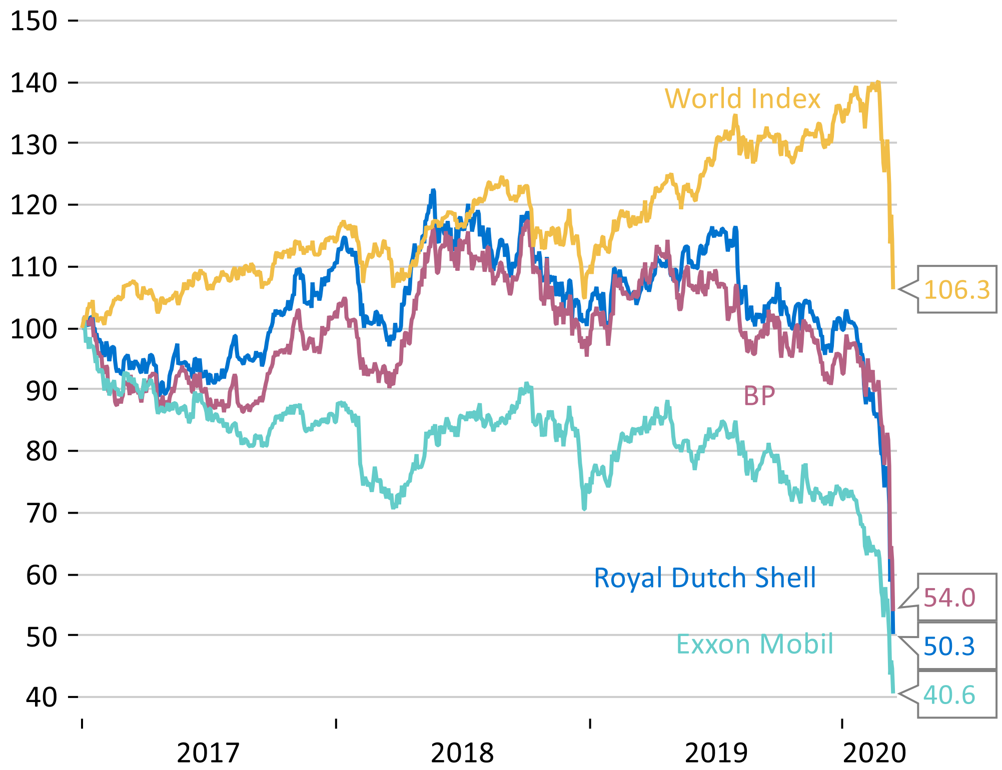
Crude Oil, Brent, Spot, FOB North Sea, ICE, Close, USD



Source: Macrobond

Dividend yields of 7%-9% suggest cuts are imminent

Major Oil Companies' Share Prices (Rebased, GBP)



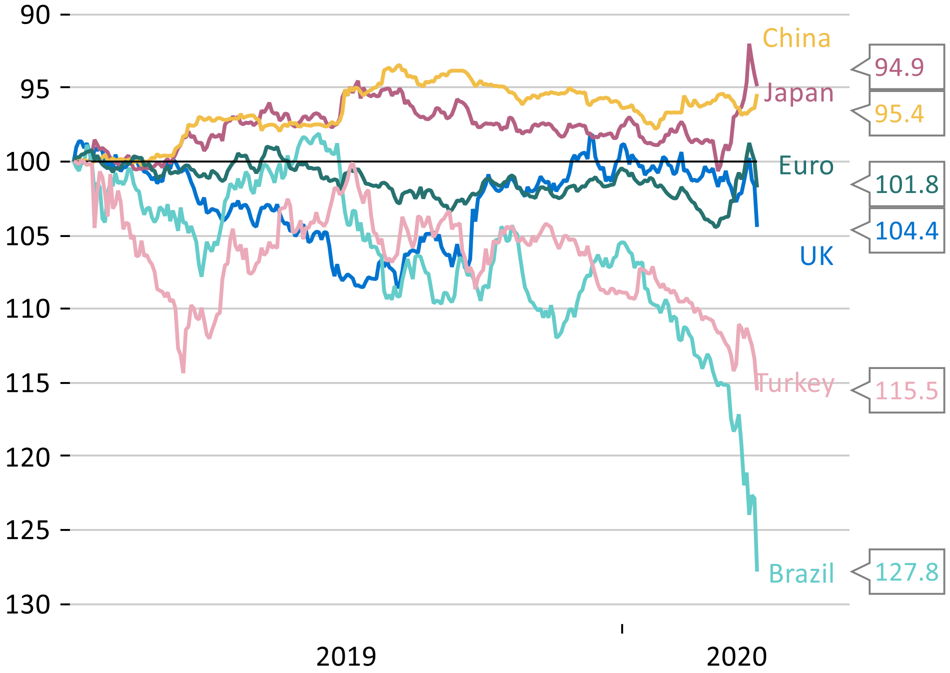
Source: Macrobond

Remarkable stability among major currencies – note though recent weakness in US Dollar

Only struggling EM currencies have fallen

Currencies per US Dollar

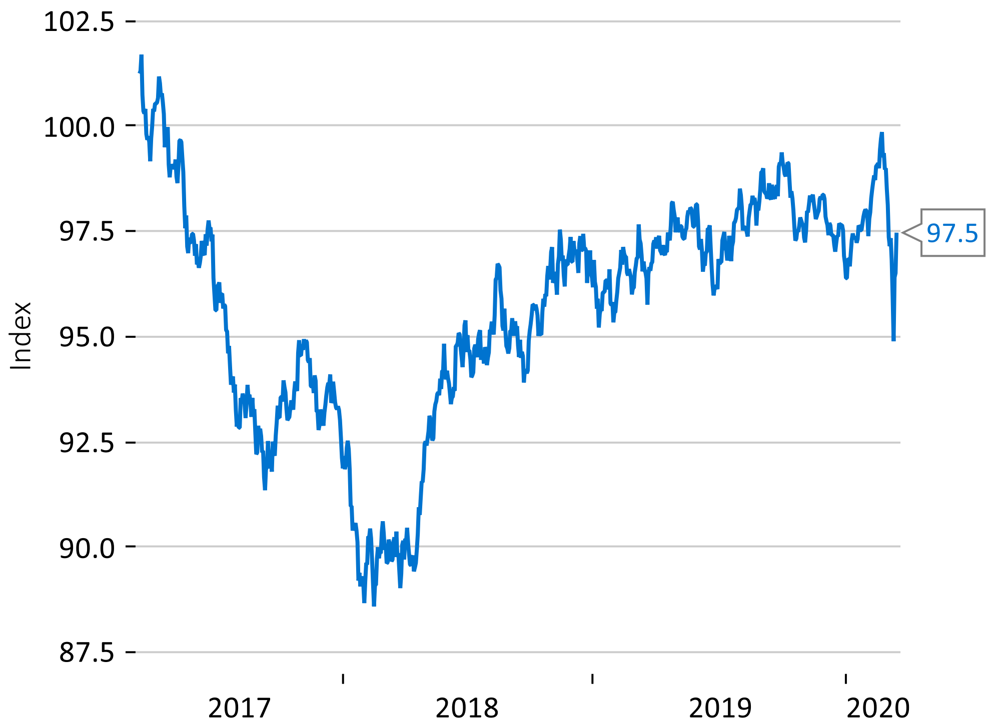
Last 12 Months (Rebased)



Source: Macrobond

US Dollar weakens as interest rate differentials narrow

US Dollar Index (DXY)

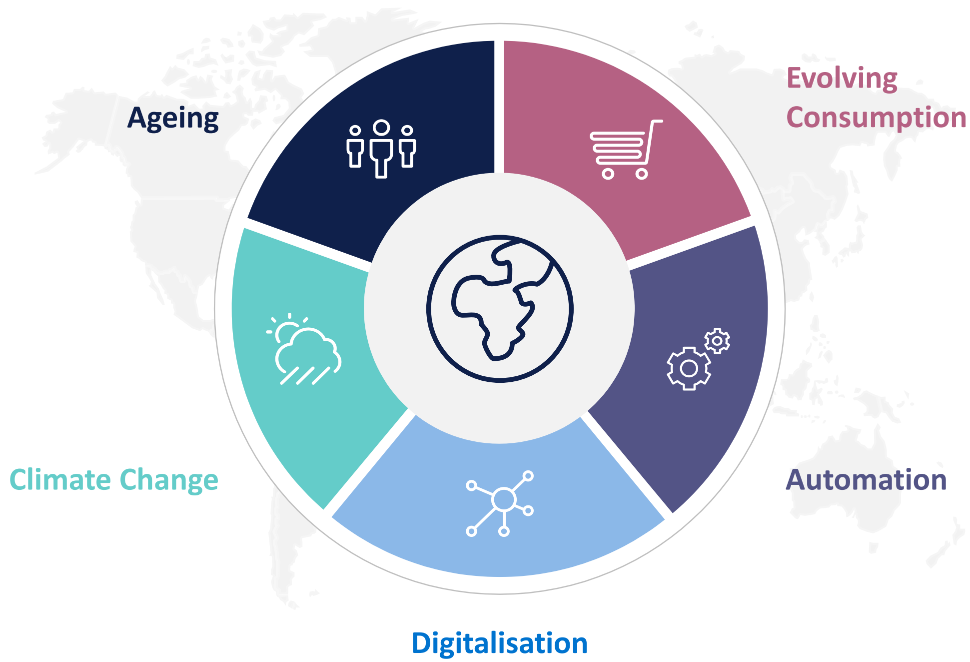


Source: Macrobond

Thematic & Stewardship - long-term opportunities intact

Securing tomorrow – very low exposure to energy & materials & emphasis on quality and visibility has helped thematic returns

Thematic = Cash flows

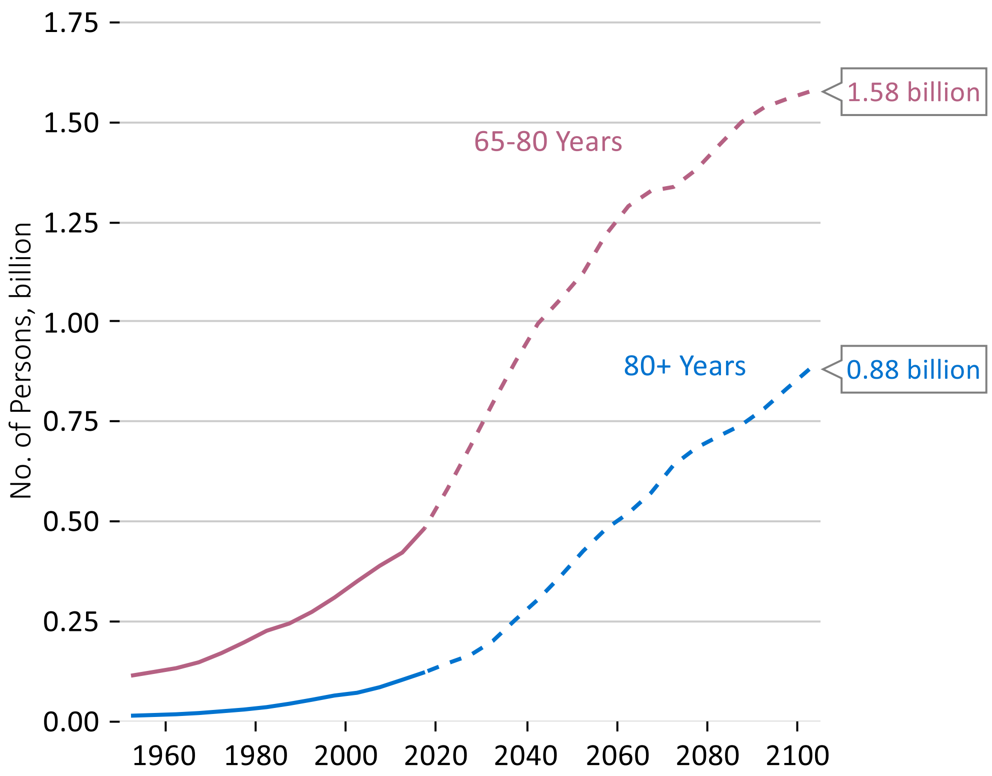


Stewardship = Capital protection

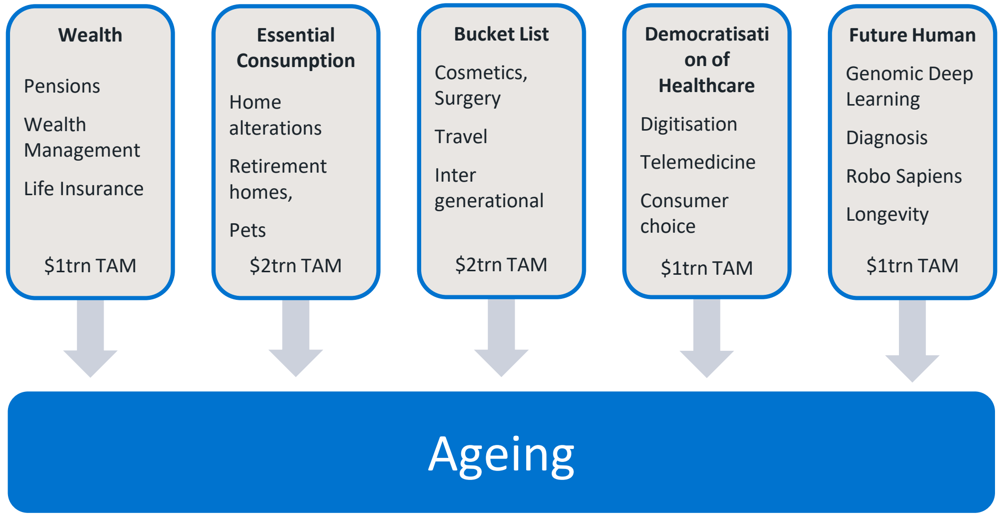
Ageing :The fatality rate from Covid-19 is highest among the elderly – but the number of 65-80 year-olds still set to double in 20 years

Over-80s are most vulnerable but are not key grey market

United Nations, World Population by Age



Source: Macrobond

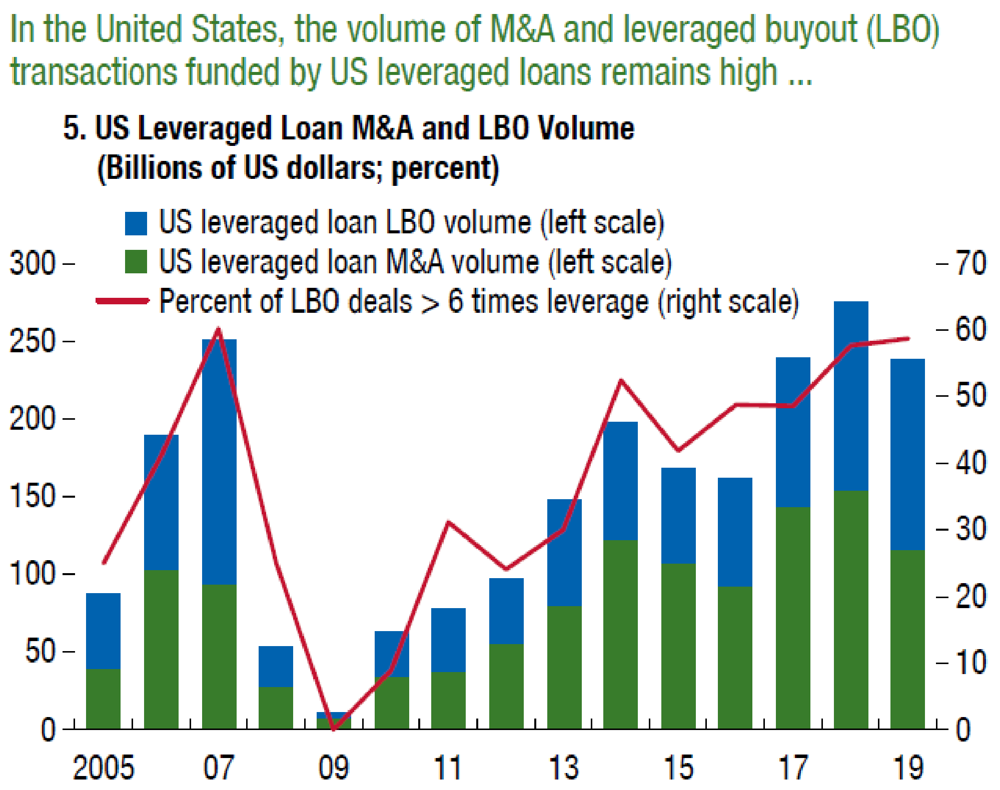


- Coronavirus may increase the spending on prevention of disease
- 3% of healthcare spend goes to prevention of chronic disease among OECD countries - the other 97% goes towards "sick care" treatment
- 1% of Americans account for ~25% of healthcare spending

02 Risks

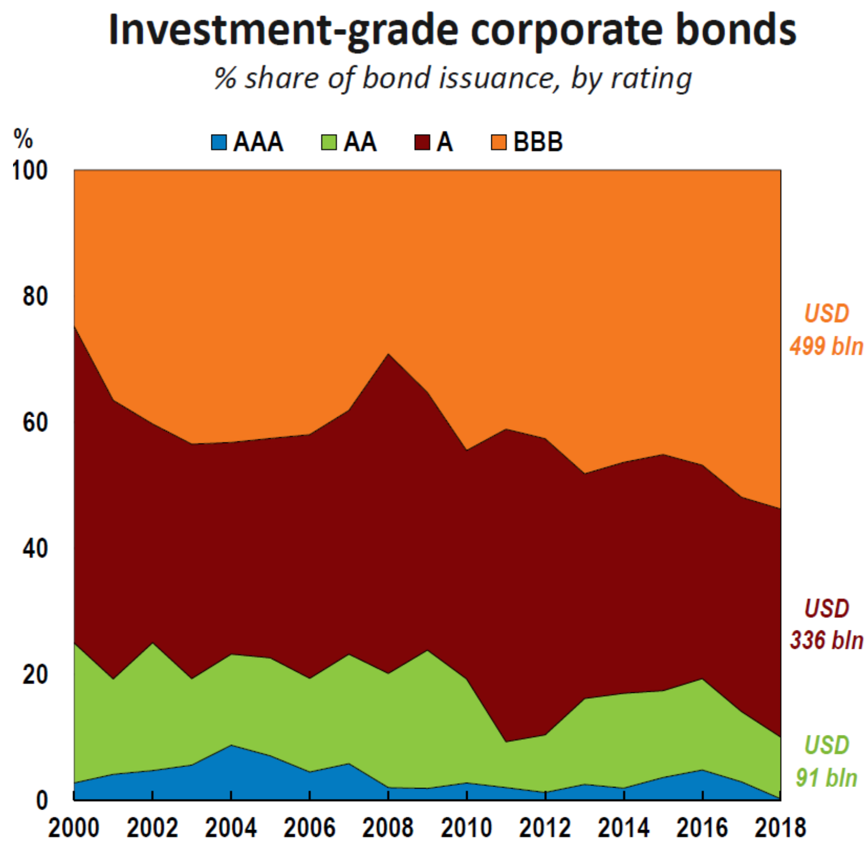
Risk 1: Corporate and EM credit markets could be vulnerable to energy & COVID-19 led credit squeeze

Significant increase leveraged loan volumes in the US



Source IMF Stability Report Oct 2019

Marked increase in 'risky' debt

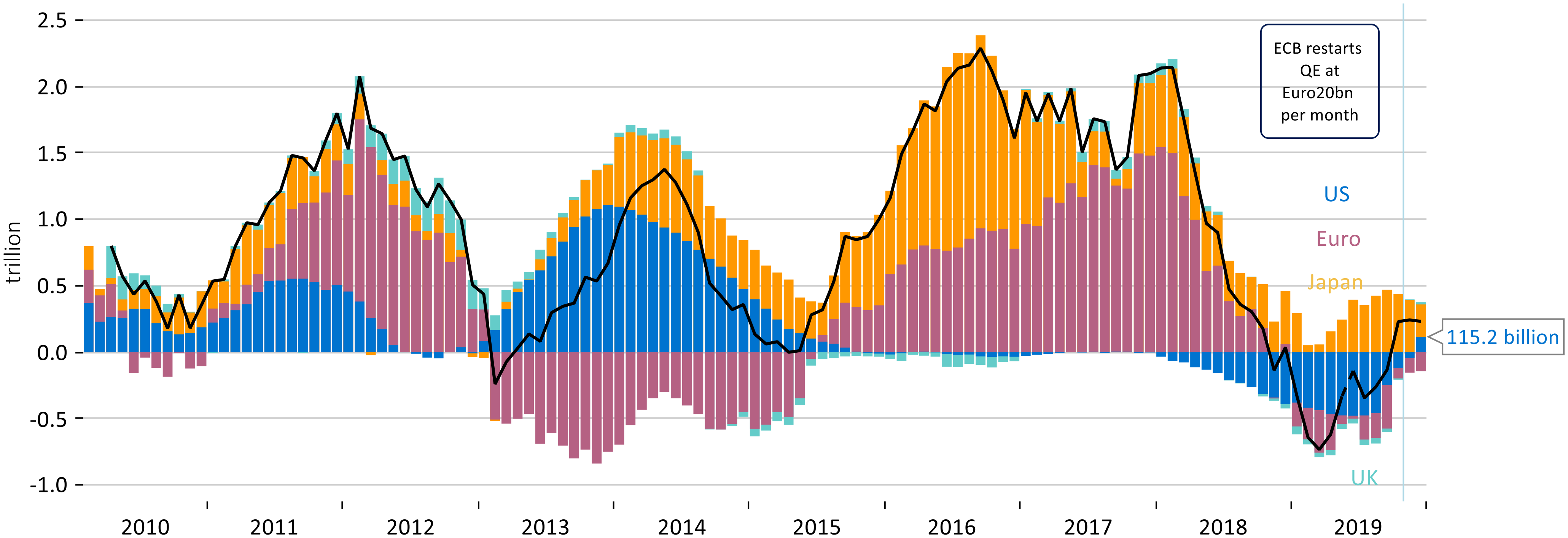


Source: OECD

Risk 2: How much room is there for further bond purchases by Central Banks and at what long-term cost?

Central bank asset purchases turn positive supporting global asset prices

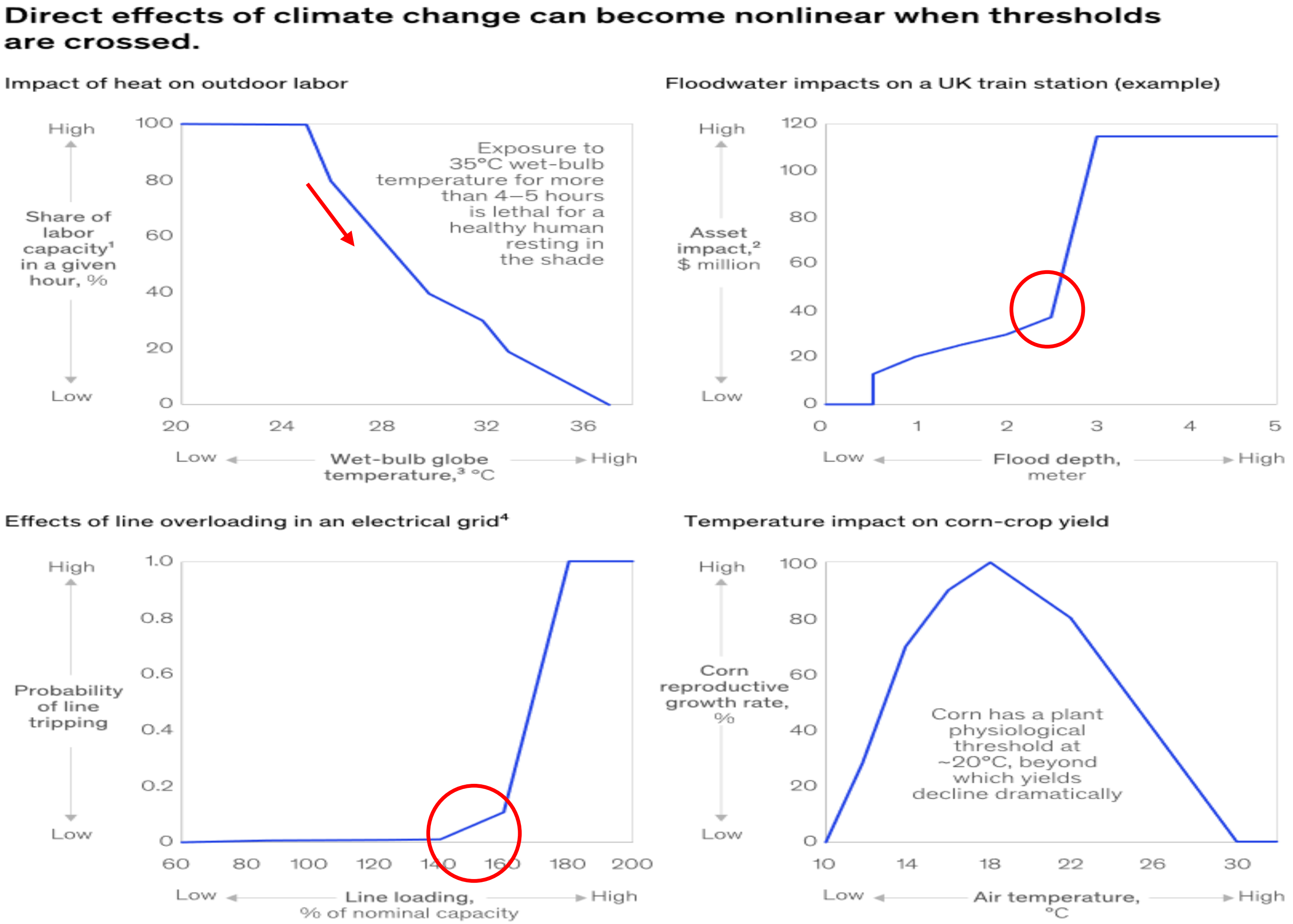
Central Bank Asset Purchases
USD trillion, 12 month rolling sum



Source: Macrobond

Risk 3. Climate - How climate hazards can become economic risks…

Many of the impacts are non-linear and could have unexpectedly large economic consequences



Climate Risks & Economic Impact

- **Workability** : Will India get too hot to work?
- **Food systems** :Will the world's breadbaskets become less?
- **Physical assets**: Will mortgages and markets stay afloat in Florida?
- **Infrastructure services**: Will infrastructure bend or break under climate stress?

Source: McKinsey Climate Risk & Response 2020

03 UK and Brexit update

UK – A generous budget (+ 1.3% GDP) focusing on virus mitigation, 'levelling-up', education and investment…

Co-ordinated fiscal & monetary policy decision

Table 1: Budget 2020 policy decisions (£ million) (1)

	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Total spending policy decisions	-355	-19,255	-40,185	-45,640	-48,780	-49,440
Total tax policy decisions	+960	+1,355	+3,755	+7,110	+7,625	+7,520
Total policy decisions	+605	-17,900	-36,430	-38,530	-41,150	-41,920

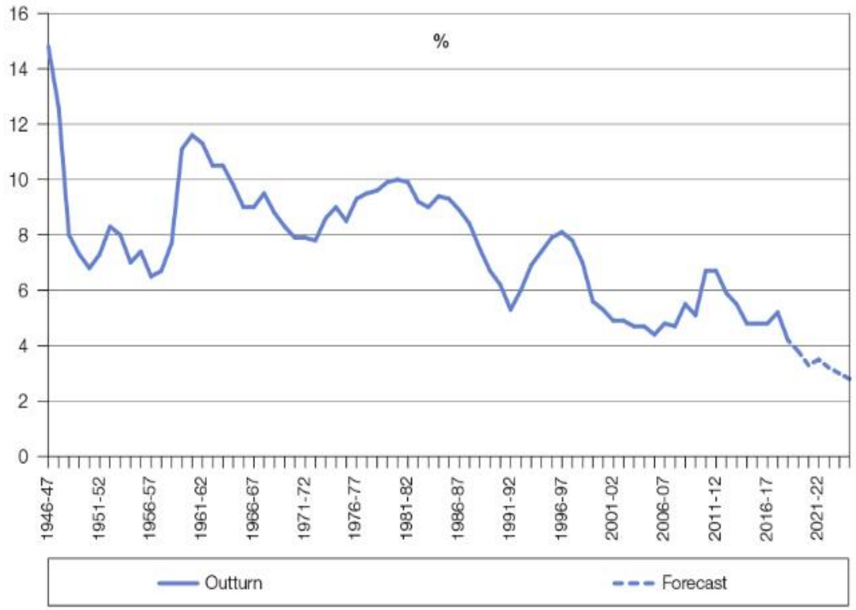
1 Costings reflect the OBR's latest economic and fiscal determinants.

"The reduction in bank rate will help to support business and consumer confidence at a difficult time, to bolster the cash flows of businesses and households, and to reduce the cost, and to improve the availability, of finance."
Bank of England, 11 March 2020

Source: HM Treasury Budget 2020/BOE

Funding made possible by low interest rates

Chart 1.6: Debt interest to revenue ratio from 1946-47 to 2024-25



The debt interest to revenue ratio is defined as public sector net interest paid (gross interest paid less interest received) as a proportion of non-interest receipts.

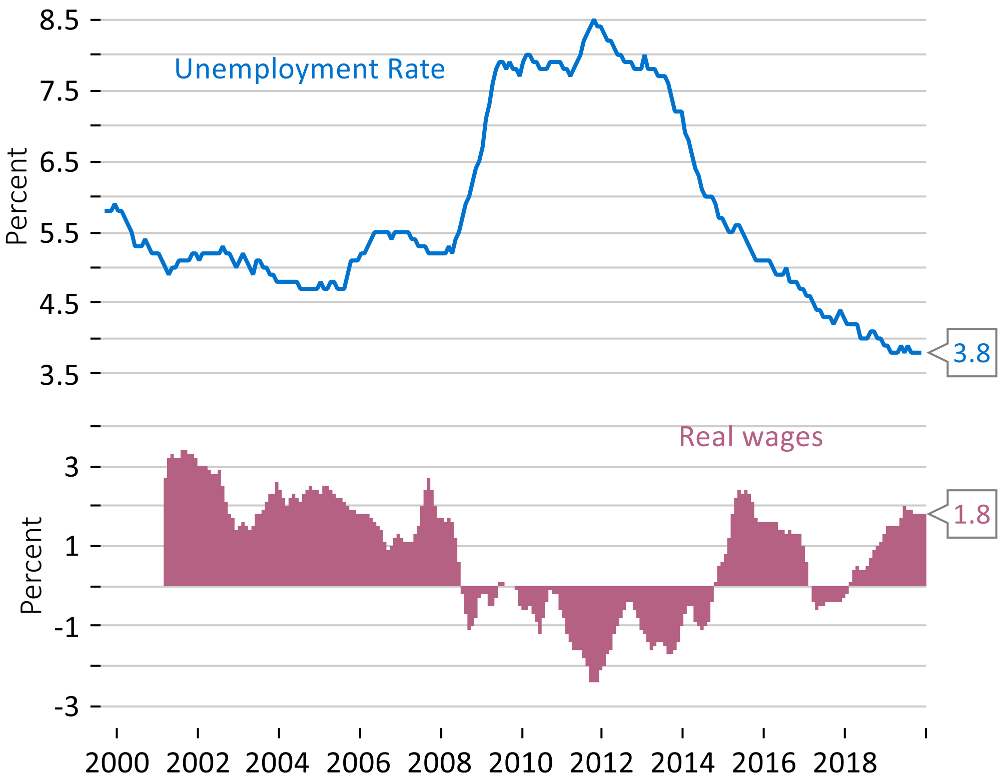
Source: Office for National Statistics, Office for Budget Responsibility and HM Treasury calculations.

Source: HM Treasury Budget 2020

Expect the UK economy to face challenges in the short term but the labour market remains strong underpinning consumption

Tight labour market supports real wages

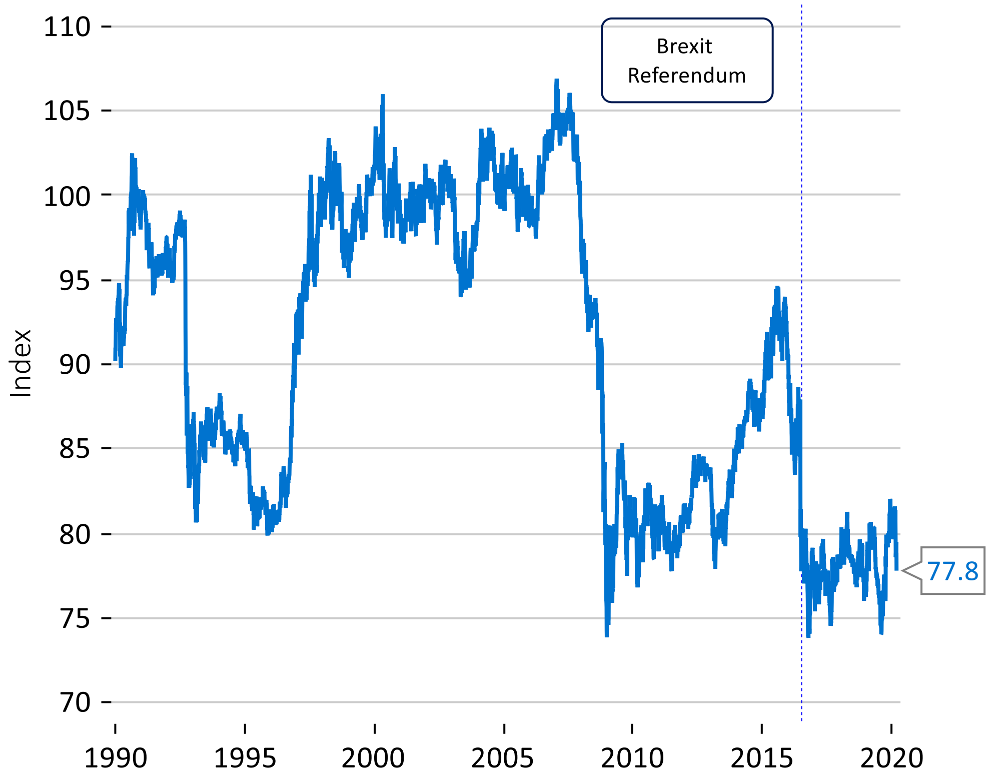
UK Unemployment & Real Wages



Source: Macrobond

Gradual Sterling rebound

UK Effective Exchange Rate Index (BOE)



Source: Macrobond

EU27 and UK trade talks

Fisheries, Finance & Freedom to Diverge…

EU Mandate for Michel Barnier

"The EU wishes to establish an ambitious, wide-ranging and balanced **economic partnership** with the UK. The mandate stresses that the future partnership should be underpinned by robust commitments to ensure a **level playing field** for open and fair competition, given the EU and the UK's geographic proximity and economic interdependence.

On **fisheries**, the mandate outlines that the future partnership should uphold the existing reciprocal access to waters as well as stable quota shares. The agreement on fisheries should be established by 1 July 2020".

Source: EU Commission 25 Feb 2020

UK opening position

"It is a vision of a relationship based on friendly cooperation between **sovereign equals**, with both parties respecting one another's legal autonomy and right to manage their own resources as they see fit. Whatever happens, the Government will not negotiate any arrangement in which the UK does not have control of its own laws and political life. That means that we will **not agree to any obligations for our laws to be aligned with the EU's**, or for the EU's institutions, including the **Court of Justice**, to have any jurisdiction in the UK…if it is not possible to negotiate a satisfactory outcome, then the trading relationship with the EU will rest on the 2019 Withdrawal Agreement and will look similar to Australia's".

Source: The Future relationship with the EU Feb 27 – UK Government

Neutralising the risk budget

Risks to the downside increasing, and Global Q1 GDP growth likely negative

Global strategy update

Bonds	Modest underweight – Gilts at neutral and corporates at underweight • Neutral gilts: US and UK Central banks to cut interest rates towards zero to offset recession risk and falling inflation. • Underweight Corporates: spreads likely to widen on account of falling growth and oil prices • High Yield: Extreme caution to reflect liquidity and default risks
Equities	Neutral – Global growth baseline has shifted materially lower – earnings risks rising materially • Central bankers remain dovish and US presidential cycle supportive • Global dividend strategies attractive *where supported by sustainable thematic trends* • Portfolio protection strategies attractive if volatility ebbs
Alternatives	Neutral – but note liquidity/rate risks in leveraged/opaque assets • Clear preference for liquid uncorrelated assets and gold
Cash	Modest overweight • To reflect heightened uncertainty and volatility.
Risks	Current: Virus impact increases risk of global recession, excessive corporate leverage, UK/EU 2020 trade negotiations, oil collapse threatens high yield credit Longer-term: China's growth experiences long-term damage from virus, global trade linkages under estimated, central bank toolkit largely exhausted

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