



Investing in a time of Covid-19: Impact on pension funds

✓ **Charles Stanley Asset Management considered the impact of Covid-19 on investment markets, central bank policies and continuing trends such as the digital and green revolutions, in its recent webinar with *Pensions Age***

The recent Charles Stanley Asset Management/Pensions Age webinar explored investing in a time of Covid. An understandable topic, as trustees seek expert guidance wherever they can in these unusual times.

Yet the webinar soon highlighted how the Covid-19 pandemic has mainly accelerated trends that were already occurring.

Take globalisation.

“Everybody thought that globalisation on the whole was a good thing,” Charles Stanley Asset Management chief global strategist, John Redwood, said. “From the stock market point of view, it allowed economies of scale. It allowed the new transition to

new and better technologies. It allowed trade to be a driver of world economic growth.”

But then Covid-19 appeared. Travel halted suddenly due to the lockdown and the gradual easing of restrictions hasn’t yet resulted in a return to the norm.

As a result, governments are now seeking greater national resilience, Redwood stated, as the pandemic interrupted international supply chains.

Yet this trend was starting to emerge before Covid-19, for example with the trade disputes between the US and China, Redwood pointed out.

The digital revolution was also already in full swing before Covid-19, but during the crisis it went into overdrive.

“I think it is a pretty safe assumption that travelling all over the world is going to be reduced and international business is going to operate more by means of conferences and technologies than it did before the pandemic”, Redwood said.

While the digital revolution enjoyed a lockdown push, it was already led by public and business demand. Meanwhile, another trend that had its roots prior to the pandemic has been receiving a more top-down boost.

The green revolution is set through international targets and treaties, governments telling people how they must change, Redwood said, “telling you that you need a different type of car or to eat a different type of food or how to heat your home more effectively”.

According to Redwood, the figures for this year so far shows that ESG investing is doing slightly better than the standard models.

He gave the example of share prices, highlighting the difference between backing the green and digital revolutions, or sticking to traditional, well-known companies.

Over the past five years Amazon’s share price increased by 524 per cent, Tesla’s by 26 per cent, and Apple’s by 184 per cent, Redwood stated. In contrast, Marks & Spencer’s share price declined by 81 per cent, Ford’s by 62 per cent and Exxon Oil was down by 47 per cent.

These trends are clear to see with the benefit of hindsight, but it can be a bit more tricky for pension fund investors to see future, long-term developments, particularly while responding to current market changes.

For instance, in response to the pandemic, Charles Stanley Asset Management chief investment officer, Jon Cunliffe, noted that the activity of central banks may well generate “quite a significant tailwind”.

“In terms of the business cycle and profit cycle, there is clearly a negative backdrop,” he stated. “However, if we focus in the activities of central banks

and their impact in terms of other asset markets, we can see a something that has emerged that has developed quite a significant tailwind, and that's very low levels of bond yields across the developed world.

"If we look at the 10-year notes in the US, we have had a 40-year secular rally in bonds. Yields have fallen from their high of around 16 per cent, down to their current levels of 65 basis points in the 10-year. This signifies a tailwind for equity investing, because the lower the bond yield, the lower the discount rate applied to future equity earnings, which becomes a positive for equity valuations.

"On the other hand it could be a precursor to an ice age in terms of very low levels of interest rates, growth and inflation. Of course, as an investor, corrosive inflation, or outright deflation, becomes a concern, because that becomes entrenched in the mindsight of both corporate and consumers and can mean that we get into a Japan-style environment, where we get caught in a 'liquidity trap'."

Focusing on current central bank action, Cunliffe highlighted that in Switzerland, the entire government bond curve is in negative territory, while in Japan the only part of the yield curve that will provide positive return is in ultra-long bonds. Germany is also negative throughout and the UK is heading in that direction. The US is a relative high-yielder, but has been rallying quite sharply recently, reflecting the stance of the Fed with its asset purchases and recent rate cuts.

Honing in on the US, Cunliffe gave the example of how the Fed's balance sheet increased by \$3 trillion over a recent two-month period, purchasing \$70 billion US treasuries per day at its peak. In contrast, during the financial crisis, it was purchasing \$120 billion per month, "so this is an unprecedented increase".

This creates a portfolio channel

where those Treasuries that were held by investors get replaced by corporate bonds, so then people also move up into high yield and equities as well and property, he explained.

"An additional thing the Fed has been able to do this year is also for the first time buy corporate bonds and also backstop the high-yield bond market as well," Cunliffe added.

"That has created an easier environment in the credit market, which has also taken away some of the concerns the market would have had around insolvency. It has not completely cancelled this risk, but has created some breathing space for corporates to refinance themselves and for credit investors to feel more comfortable to hold corporate debt.

"But, in a sense, it's also postponing what could well be a more challenging environment for the corporate sector in the second half of the year. So we are not out of the woods yet as far as the corporate bond market is concerned."

The blurring of the line between fiscal and monetary policy is an additional risk, he added, as the only way the approach that central banks have adopted can work effectively is if the additional borrowing that central banks are financing can be financed at very low levels of interest.

So, what does this all mean for pension fund investors?

"Sadly, for pension funds it is hard to see us getting out of this very low interest rate environment for the foreseeable future," Cunliffe said. "For pension funds, a very long-term low bond rates also imply a very low discount rate, which means that from a liability side of a pension fund there are costs involved."

"Investment markets have been very difficult this year in particular and it is very difficult to be confident what the outlook is going to be from now on," Charles Stanley Asset Management head of fiduciary management, Bob Campion, added.

"For any pension scheme investor, the idea that they can have an investment portfolio with static assets that remains unchanged is very difficult in these very changing circumstances.

"So you need to be nimble and monitoring conditions all the time. It is very difficult for trustees to do this on their own, even with advisers, so we firmly believe that a fiduciary management approach is a great help for pension schemes as it means you have a professional team monitoring scheme needs and market conditions for you and can adapt to changes."

Charles Stanley Asset Management's fiduciary management clients certainly receive a very efficient investment strategy with a dynamic process, "which is very much led by our team's analysis", along with a very hands-on and comprehensive service, Campion stated.

"The fiduciary management service has three key principles," he explained. "We pride ourselves on providing bespoke portfolios for all our pension schemes. We are independent in our analysis and use of investment products and we are highly transparent in everything we do."

It is these core values provided by Charles Stanley Asset Management that make its fiduciary management service of great assistance for schemes investing in a time of Covid, and beyond.

➤ To find out more about Charles Stanley's Fiduciary Management Service, contact 020 3733 1522

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