DART CAPITAL

Views from the Monument

2 June 2020

Investment Managers

Richard Whitehead
richard.whitehead@dartcapital.com

Chris Bellchambers
chris.bellchambers@dartcapital.com

Andrew Savage
andrew.savage@dartcapital.com

Research Team

Alexander George
alexander.george@dartcapital.com

Michael High
michael.high@dartcapital.com

Dart Capital
61 Queen Street, London EC4R 1EB
Tel: 020 7283 1117
Fax: 020 7283 0891

Market Update

Richard Whitehead
Chief Executive

Thankfully we are nearly free of the lock-down and what a relief for everyone. Life can, we hope, begin to revert to the new normality, whatever that means. We at Dart Capital have for a couple of weeks maintained a skeleton staff of four at HQ, all of whom are able to go to and from the office either walking or cycling, without using public transport.

Below you will find our thoughts on where the market is and some detail on a number of positive changes we have made in recent weeks.

We wrote to you when we initially entered lock-down in March to state that remaining fully invested through this chaos of Stage 1 was our intended path. We mapped out three stages of action starting with the fog and chaos of a locked-down population and a large swathe of the economy closed. Fortunately swift and unimaginable government intervention has softened the immediate impact of this initial period.

Thankfully remaining fully invested so far has proved the correct course of action, albeit with some significant portfolio changes in March to steer through the uncertainty. We are now almost in Stage 2 where more of the economy will begin to function again, yet there is more blurring than we expected as government policy deliberately passes the emphasis to companies as to when they return to work and at what pace. Different sectors will take longer to get restarted. We all know schools have to return to allow the human means of production the chance to get the economy moving again. The speed with which the economic activity gains momentum and the full opening of our economy will ultimately dictate investor’s confidence in the underlying share prices of companies. It will only be at the end of Stage 2 that we will witness the real cost of Covid-19 on the UK economy. Stage 3 is still quite some time away where the new economic norm is recognised and the costs of this understood.

As I write to you it is no surprise that the UK stock market is still in negative territory this year -18% and the French and Germans in local terms -21% and -13%. The Russell 2000 index (which some believe measures the "real" US economy) is also still -16% in local terms.

Each company and sector has its own social distancing challenges. At Dart Capital we have the advantage of a large and very modern office in order to spread people out and protect them. Whilst I understand that some companies may in future opt for more home working, returning to the office has made an enormous and positive difference for us. You can now hold a normal conversation without losing the first and last word of every sentence and group meetings are not at the peril of the worst broadband connection on the call. Lock-down and mobile working, whilst possible, is not our way to run a collegiate and collaborative investment management business. I do accept that every company is different and such working may work well for some. We have tried it, worked with it, learnt from it, but the vote from us is still to hold face to face meetings, where practical and of course when safe to do so.

This has been an incredibly difficult time for everyone. The mental cost for some of being interned in cramped spaces may never be known. We have been particularly conscious of turning many small apartments for some of our younger colleagues into mini offices for remote working with multiple screens, printers in cramped spaces and unpredictable working hours. I have never witnessed anything like this before and let's hope this is the beginning of the end to Covid-19.

On a positive note, the city has gradually begun to return, albeit very slowly. Last Friday was the first indication of the return to normal as I cycled past London Bridge station there was a steady stream of commuters, of all ages, with laptop-carrying rucksacks hurrying to their offices. I know of quite a few other senior teams who have returned to their offices early to map out what the future holds.

I apologise for triviality at a time of immense suffering but one thing is certain, any company offering "Covid-19 Health and Safety Equipment" are onto an absolute winner. We have two industrial size anti-bacterial dispensers in the office, necessitated under government guidance, each looking like the product of the worst metal-work project of my earlier education, but costing £600! At a time of such pain and hardship there have been other unlikely winners during this crisis as the surge in enquiries to the tourist office of Barnard Castle will testify.

Perhaps the single question we are being asked at the moment is not about the stock market but around future UK taxation and how the Chancellor will seek to raise more from us all to help pay for the staggering government debt of this crisis. We are assessing a range of possibilities and will be happy to share these thoughts at our forthcoming meetings with you.

Alexander George, CFA
Associate Director of Research

Markets have stabilised over recent weeks, with volatility abating somewhat as news of the re-opening of the US and European economies has helped bolster sentiment. Although stock markets have recovered some of their losses from the lows in mid-March, we expect them to remain choppy as traders react to economic data, which will be very weak by historic standards for at least the next few months, as well as data on the progression of the virus. When positioning portfolios we weigh the aforementioned short-term risks against the fact that equities continue to offer far better value than bonds on a longer-term view, whilst corporate profits should recover over the second half of this year as the global economy bounces back aided by very supportive Central Bank and government policy. Against this backdrop we believe that the ability to move tactically is vital, and having added significantly to American stocks during the market turbulence of March, we used the sharp rebound in the US stock market to trim back exposure two weeks ago.

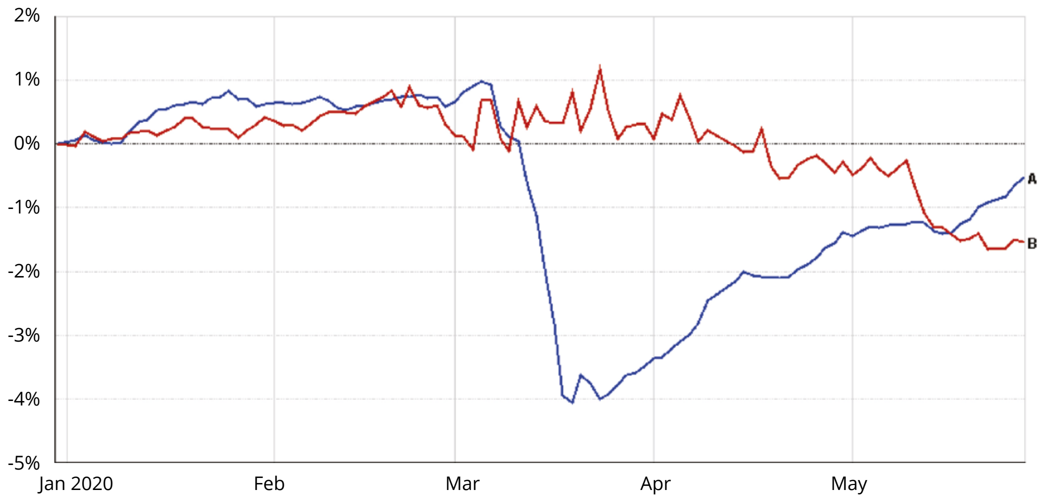
At the peak of the market turbulence in March, the corporate bond market was in the middle of its own liquidity induced sell-off with traders who were liquidating positions forced to accept lower prices amidst a dearth of buyers. We took advantage of these moves by adding further exposure to short-dated corporate bonds, funded through reducing exposure to our last remaining absolute return strategy which was up on the year at that point, as shown overleaf. Since that time market conditions have improved significantly, with the expansion of Central Bank bond buying programmes helping to ease liquidity concerns and we have seen a significant tightening in credit spreads. The moves in the corporate bond market are well demonstrated by the HSBC bond which we highlighted in one of our market updates in March. The bond, which matures in 2023, saw its yield rise to 3.5% during the sell-off, having traded at a yield of below 2% a month earlier, a move which had pushed its price from £117 to a low of £109. Amidst the stabilisation in the corporate bond market the bond's price has moved back up to £112, with the yield now down to c.2.3%.

Corporate bond prices have recovered from their lows in mid-March

HSBC Bank Plc 6.5% 7 Jul 2023 Price Chart

Source: Refinitiv Datastream

Adding corporate bond exposure in mid-March has helped boost returns as markets have stabilised



31/12/2019 - 28/05/2020
Data from FE fundinfo 2020

As we outlined in our quarterly Investment Brief, whilst we increased the quality of our underlying stock exposures during the market upheaval, we were keen to maintain the overall level of exposure to equities during the market sell-off so as to ensure that portfolios would participate should there be a sudden upturn in market sentiment. It is notable that within the equity market the rebound has been led by the technology sector with many of the largest companies in this sector, including Apple, Microsoft and Amazon, having gained 30% or more from their lows in March. In contrast, up until recent weeks, companies which are perceived as being more exposed to the "real economy" have lagged, with banking and energy stocks particularly weak. Although our equity allocation is tilted towards the technology, healthcare and consumer goods sectors where cash flows are more predictable, we do retain some exposure to cyclical sectors which would likely perform better should market sentiment continue to improve.