August 2020

The Investment Medicine for the post Covid-19 period?

In last month's Monitor we highlighted that in the 2020 economic downturn (and in contrast to the post Great Financial Crisis period) fiscal stimulus was being applied in conjunction with monetary stimulus to alleviate the worst economic and health aspects of Covid-19.

Post the Great Financial Crisis (GFC) any US fiscal support was initially seen as an undeserved bailout for the domestic financial sector hence investors bade farewell to Bear Stearns and AIG. However, after months of prevarication the US government recognised that the likely demise of Lehman Brothers warranted a bailout for "Wall Street" so as to enable the successful resuscitation of a modern economy that is reliant on the supply of credit. Unfortunately, the strength of the "Tea Party" faction of the Republican Party provided a successful head wind to any further fiscal stimulus.

In Europe, post the GFC it wasn't until July 2012 with Mario Draghi's "whatever it takes" speech that monetary policy was perceived as an instrument to end the Euro crisis and assist in an economic recovery. Whilst from a fiscal perspective austerity was advocated by the IMF and the more conservative Northern European countries with negative political and economic consequences.

In 2020, at the outset of the pandemic the Federal Reserve (Fed) slashed short term interest rates, opened USD swap lines, re-started their quantitative easing programme and reopened the Term-Asset Backed Securities Loan Facility. The Fed also announced several notable newer programs at the end of March with the aim of providing liquidity for credit and capital markets. In Europe, the ECB has not departed from its historically low level in short term rates but it has expanded (both in terms of its size and credit quality requirements) and lengthened its quantitative easing programme. In doing so, it has appropriately used the playbook of Mario Draghi and not that of his predecessor Jean-Claude Trichet.

Supplementing this monetary stimulus, US and European fiscal authorities have acted with welcome haste in approving necessary emergency rescue packages. This is possibly because the pandemic was seen as unique in its greater impact on the wider economy (health and financial consequences) and the political difficulty in successfully assigning blame to one part of society. Whatever the reason national monetary and fiscal

Registered in Ireland No. 364773.   Registered Office: 42 Fitzwilliam Place, Dublin 2
Directors: Eugene McCague, Patrick J Lawless, Kevin Menton, Enda McKenna, Pat Cox, Greg M Lawless, Patrick A. (Tony) McArdle
Appian Asset Management Limited is regulated by the Central Bank of Ireland

organizations have instigated massive stimulus programmes. Despite some reservations expressed by a minority of investors and policymakers the magnitude of the stimulus is perceived as

a. An appropriate countermeasure to the shock experienced by the global economy and
b. A suitable assistance to the future trajectory path for growth (which will be largely dictated by the behaviour of the virus in the short term)

Notably at the end of July the real yield on US 10-year Treasuries went through -1% (See chart). This suggests that investors are seeking refuge in safe haven assets believing that economic recovery may be delayed by further outbreaks of the Covid-19 virus. It also implies that investors anticipate that the required monetary stimulus to assist in an eventual recovery will be maintained for a longer period than initially anticipated (Chairman Powell said as much at the last Federal Reserve meeting).

US Real Yield

Will this prolonged stimulus initiate the materialisation of long awaited inflation? Probably yes, although the scale of this future long term inflation is open to debate and it may be influenced by other structural factors such as debt, demographics, inequality, globalisation, technology and politics. Even so, what are the implications for asset class selection in an environment where the projected economic support creates this long anticipated inflation?

In answering such a question and in making a medium term forecast of improving economic figures and rising inflation one is required to make a couple of assumptions that should alleviate our greatest concerns. The first is that in managing the virus a successful vaccine will prove to be the “silver bullet” for a return to a normal economic

Registered in Ireland No. 364773. Registered Office: 42 Fitzwilliam Place, Dublin 2
Directors: Eugene McCague, Patrick J Lawless, Kevin Menton, Enda McKenna, Pat Cox, Greg M Lawless, Patrick A. (Tony) McArdle
Appian Asset Management Limited is regulated by the Central Bank of Ireland

environment. This is far from guaranteed as there are presently no successful vaccines for the coronavirus family however, the extensive number of proposed possibilities being developed by numerous parties offers some optimism. In a worst case scenario where the creation of a successful vaccine should prove fruitless we anticipate individuals, governments and companies will learn to adapt over time to the "new normal".

The second assumption is that monetary and fiscal officials do not tighten policy prematurely – which historically has proven to be the catalyst for previous recessions. Based on the relatively subdued levels of inflation in developed economies over the last 20 years, we believe an overapplication of stimulus may be the lesser of two evils (the greater evil being the entrenchment of deflation) and at the current moment officials from major economies seem to be in agreement.

We believe that most investors are not positioned presently for an inflationary environment and this could prove to be the greatest risk to future returns for their portfolios. Should investors wish to reduce this risk and improve their expected potential returns then they should increase their portfolio exposure to the asset classes listed below

- Cyclical equities – ability to grow revenues faster than costs
- Inflation linked bonds – built in explicit inflation protection
- Commodities – recovering demand will drive a rise in prices
- Real Estate – ability to increase rents in an inflationary environment
- Infrastructure – portfolio of assets linked to rising price levels

Asset classes best avoided and that will struggle in an inflationary environment include

- Growth equities - that have outperformed in the last decade of low inflation
- Fixed Income bonds – fixed coupon becomes less attractive in a rising rate environment
- Cash – negative real value impact on cash in the short term

It is difficult currently to envisage an inflationary environment where unemployment rates in developed economies (excluding the impact of furlough schemes - which long term are unsustainable) are in double digit territory. However, if you believe (as we do) that policymakers will eventually be successful in their ultimate goals (engineering a recovery that reduces unemployment and improves their inflation targeting) then investors should consider rotating their portfolios to the appropriate asset classes as outlined above.

Registered in Ireland No. 364773. Registered Office: 42 Fitzwilliam Place, Dublin 2
Directors: Eugene McCague, Patrick J Lawless, Kevin Menton, Enda McKenna, Pat Cox, Greg M Lawless, Patrick A. (Tony) McArdle
Appian Asset Management Limited is regulated by the Central Bank of Ireland

Appian Asset Management

Monthly Monitor

Appian AM NAV's Fund Prices 31-07-2020

NAV		MTD	QTD	YTD	SI
		%	%	%	%
AMAF	145.5305	0.64%	0.64%	-8.56%	45.53%
AGDGF	166.0427	-0.31%	-0.31%	-22.55%	66.04%
AGSCOF	145.9821	3.09%	3.09%	-22.04%	45.98%
AIF	103.6997	1.20%	1.20%	-6.37%	3.70%
AELF	103.2493	-	-	-0.45%	3.25%

Appian Asset Management Limited is regulated by the Central Bank of Ireland.

Warnings

- **If you invest in any of the funds you may lose some or all of the money you invest.**
- **Past performance is not a reliable guide to future performance.**
- **Appian Funds may be affected by changes in currency exchange rates**
- **The value of your investment may go down as well as up.**

42 Fitzwilliam Place, Dublin 2.   T: +353 1 662 3001   F: +353 1 661 9871 www.appianasset.ie

Registered in Ireland No. 364773.   Registered Office: 42 Fitzwilliam Place, Dublin 2
Directors: Eugene McCague, Patrick J Lawless, Kevin Menton, Enda McKenna, Pat Cox, Greg M Lawless, Patrick A. (Tony) McArdle
Appian Asset Management Limited is regulated by the Central Bank of Ireland