In the wake of news-flow surrounding the Covid-19 pandemic, the past month has been an extremely challenging time in financial markets. All major international stock markets have suffered significant declines and losses of some 30% and more have been seen to date.

The equities that we hold across the Credo product range have unfortunately not been spared. The purpose of this note is to explain the way that we've approached the crisis to date, as well as to share our thoughts about current positions and prospects for our holdings going forward.

It is probably fair to say that few could have ever conceived where we are today and the truth is that nobody knows how or when the situation will eventually end:

- In the best case, we think it is conceivable that antiviral drugs and antibody therapy could prove effective in treating serious cases, which would reduce mortality and relieve the capacity pressure on hospitals, whilst a vaccine is developed in record time (perhaps in the next few months). Old age pensioners and vulnerable people might be isolated during this time, but the working population and schools may return to some form of normality after a relatively short interruption, albeit with some social distancing measures and travel restrictions in place to contain spread going forward. The younger population could over time develop "herd immunity" from mild and asymptomatic cases further reducing the spread. The government could step in and socialize much of the costs to protect jobs and support businesses over a short period until things return to normal.

- In the worst case, we think it is conceivable that it could take up to 18 months to develop a vaccine, during which time we may all be quarantined at home. What started as a healthcare pandemic could then morph into a full-blown financial crisis similar to 2008/9, with widespread bankruptcies and unemployment. Whereas in both the global financial crisis and the 2011 European sovereign bond "PIGS" crises the central banks and treasury could step in and restore confidence by providing essentially free funding to financial institutions as well as recapitalisations where necessary and buying up bad assets, it is not clear to us how effective monetary and fiscal policies can prove against a health pandemic.

Whilst it may appear intuitive today for those with a short term horizon to ride the massive sector rotation over the next few months by buying "defensives" (e.g. utilities & grocers) and selling "cyclicals" (e.g. consumer discretionary & industrials), we are conscious that this too shall pass – probably at some point in the next 6-18 months (although no-one can be sure of the exact timing). We believe that the market is likely to bottom well in advance of the last case of Covid-19 when it becomes clear that the worst is over and the end is in sight. The rally that follows would almost certainly be accompanied by a sharp reversal in the direction of sector rotation which we are witnessing today (indeed this was also the case in 2009) – at which point no investor would want to be stuck with a portfolio of utilities, for example.

Counterintuitively, with any investment horizon of longer than, say, 12 months, we believe that the real opportunity today may be to invest in "beaten up" shares (as opposed to overbought defensives). One does however need to be scrupulous in going through company balance sheets to make sure that they will survive and prosper once the fog clears. As was evident between 2008 and 2012, we are conscious too that many cyclical sectors could start to recover sooner rather than later, whilst others are more capacity sensitive and would therefore take longer to recover (e.g. airlines and aerospace).

Although we are all hoping for the best case scenario (disruption not exceeding 6 months), as investors we must simultaneously prepare for the worst (up to, say, 18 months?).

A few summary points regarding our current positioning and view:

- In terms of asset allocation, we went into this comparatively well positioned in both the Credo Best Ideas Portfolio (BIP) as well as the Credo Dividend Growth Portfolio (DGP), with 10 and 15% in cash respectively.

- In terms of sector positioning however, and with the benefit of hindsight, we were unfortunately not particularly well positioned. Having said that, and in our defence, this has been the fastest market sell-off ever and it has been extremely challenging to make timeous adjustments. To illustrate: a similar market decline of 30% took all of 12 months in the 2008/9 global financial crisis (eventually culminating in the fall of e.g. Lehman Brothers and Bear Stearns); on this occasion, the drawdown took less than a month.

- As coronavirus started spreading in the Far East at the beginning of the year, we were quick to sell out of Las Vegas Sands, given its presence in Macau, exposure to the Chinese market, and leveraged balance sheet.

- Apart from that, we have not sold out of the core BIP and DGP holdings as we believe that the basket of equities we hold continues to offer value, albeit that future prospects for many of the companies have clearly been impaired by the economic fallout of Covid-19. We will keep interrogating our positions on a continuous basis.

- Going forward, we are focusing more than ever on balance sheets, cash generation and the prospective need for refinancing over the next couple of years. Today, the corporate debt markets are effectively shut for refinancing and raising equity will prove heavily dilutive for those in need of capital. Based on this, any heavily leveraged business or one which is reliant on raising capital or refinancing is currently toxic.

- The one position which is considered potentially problematic is Meggit: after being one of the best performers in the portfolio last year, it is a business that now faces tough times, given its exposure to the airline industry. The company has slightly over $1bn of net debt, all of which matures next year, and it could prove problematic to refinance at acceptable rates. The fall in share price has however been so severe that we do not consider it wise to sell at these levels: a small improvement in news-flow could potentially lead to a nice bounce; we will continue to monitor the situation.

- We are presently identifying stocks that could be bought for long term portfolios, potentially including the likes of Facebook, Visa, and IG Group. We also recently bought auto insurer Progressive Corporation which we believe is a good stock for these times.

At a more macro level, we believe that corporate bailouts (in the form of actual handouts, as opposed to mere loans) are more likely in the US than the UK, for example, simply because it is an election year which means that a president seeking re-election will spare no expense to keep the economy going. A cynic might add that the Republicans need substantial corporate donations, and that Donald Trump's own businesses are exposed to the crisis (so he can effectively bail "himself" out as well, if and when other similar industries such as airlines and hotels are offered assistance). In addition, American individuals own more individual stocks in their 401(k) portfolios than any population anywhere else in the world (where defined benefit pension plans are more prevalent and bonds typically play more of a role).

In the UK, Boris Johnson has just won a landslide in the recent general election, so the strategy seems to be one of providing bridging loans (not handouts). The focus also appears to be more on SME's and protecting jobs. Bailing out big corporations like Virgin, would not go down well in the current environment, hence we suspect shareholders in the UK are more likely to take a hit in these times in the form of corporate restructurings, debt to equity conversions, etc.

In closing: markets are discounting mechanisms, and security prices are likely to go through a bottoming process well before Covid-19 clears up fully. When that happens, we are determined to participate in the bull market which is certain to follow. It is with this in mind that we will continue to manage every client portfolio to the very best of our abilities.