OENO FUTURE

MONTHLY MARKET REPORT

APRIL 2020

COVID-19 MARKET UPDATE

The US stock markets peaked on 19th February 2020. Since then the economic picture has changed dramatically. The decade-long bull market which had started in March 2009 came to a juddering halt shortly after February's high due to the rapidly-spiralling outbreak of COVID-19 which had begun as what seemed a new strain of flu in the previously obscure Chinese province of Hubei. To understand the breakneck speed at which the past few weeks' financial events have unfolded, one needs to look at the underlying causes and analyse COVID-19 as the main trigger.

The outbreak has been traced back to 1st December 2019, the date when the earliest known person with symptoms first emerged. Some two months later the World Health Organisation (WHO) declared the outbreak to be a Public Health Emergency of International Concern on 30th January 2020, and on March 11th it was officially recognised as a pandemic.

Wuhan is the most populous city in central China with a population of 11 million. One of China's largest industrial hubs, the city boasts three national development zones, four scientific and technologic development parks, over 350 research institutes, 1,165 hi-tech enterprises, numerous enterprise incubators and high-profile investments from 230 Fortune Global 500 firms. Major local industries include automotive, steel and iron manufacturing, opto-electronic technology, pharmaceuticals, biological engineering, new material industry and environmental protection.

Given the city's size and industrial strength, the rest of the world really should have paid more attention to what was going on there, especially following the 23rd January announcement that travel in and out of Wuhan was suspended. Being a major industrial hub this meant that components were not going to be shipped all over the world. Car manufacturers like Honda, Nissan, PSA Peugeot-Citroen, with their just-in-time model of manufacturing, faced the biggest headache and it was not too long before they were shutting factories.

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The first reported death from COVID-19 hit the news on January 9th in Wuhan followed by the first one outside mainland China on February 1st in the Philippines. The first death outside Asia was on February 14th in France. These are most likely incorrect, as all data concerning the outbreak will be, as they do not include people who die at home and in nursing homes etc., but they serve to demonstrate the slow build up. Stock markets are forward-looking in their makeup, but failed to see the creeping danger; they continued on their merry way north for almost another month with the US ones recording new all-time highs along with a couple of the major European ones. By the 13th March more than 40 countries had reported deaths on every continent except Antarctica. From this point restrictions on air travel started to be introduced around the world and then quarantine for specific areas followed by whole countries.

Table 1 U.S. Jobless Claims (Thomson Reuters)

The rapid increase of measures designed to prevent transmission and containment of the outbreak meant that sections of economic activity were restricted or closed entirely, resulting in a huge drop in consumption, orders and temporary or permanent job losses. The past four weeks have seen the jobless claims count rise by 21,782,000, with Nonfarm Payrolls (NFP'S) declining 701,000 in the week including 12th March. Next month's NFP'S will reflect those latest weekly jobless claims. To put them into perspective the Great Depression saw the unemployment rate hit 25% with over 13 million jobs lost. In comparison the Financial Crisis of 2008-09 saw just under 7 million US jobs lost. All the jobs created since the Financial Crisis have now been lost.

Fitch Ratings forecasts a 2020 global recession with global Gross Domestic Product (GDP) falling 1.9%. I find this somewhat optimistic. The Organisation for Economic Cooperation & Development's (OECD) leading indicator suggests that major economies are expected to post their largest monthly contractions on record. The OECD further noted that it's indicators "are not yet able to anticipate the end of the slowdown, especially as it is not yet clear how long, nor indeed severe, lockdown measures are likely to be."

Goldman Sachs predicts US GDP to decline 9% in Q1 and 40% in Q2 before rebounding 9% in Q3. The Centre for Economics & Business Research (CEBR) predicts that the UK Q2 GDP will drop 31%. Europe's Central Banks/Financial Institutes forecast even worse performances. France Q2 GDP is expected down 35%. Italy is losing 3% GDP per month at least.

Taking the leisure market as an example & tourism in particular one can see from the airline industry the amount of damage being inflicted on the airlines balance sheets. In March aviation executives convened in Brussels to discuss the state of the industry. They thought Europe was going to dodge a major hit from COVID-19. Bookings would return to normal within a few weeks and airlines should not use the outbreak as an excuse to seek government aid and prop up failing businesses. A month later the industry is facing annihilation; as a whole the predicted global loss of revenue is predicted at $252 bn. Consolidation will happen and new alliances will be formed.

Governments have long protected airlines for reasons of both national pride and jobs. The airlines are still liable for lease rentals and other fixed costs. So far Italy has pledged E600m to nationalise Alitalia, Norwegian Air has secured government funding of $270m, Finland has pledged E600m to prop up Finnair, which it already owns 56% of, and SAS AB will get 3bn Swedish Krona in state guarantees from Sweden and Denmark. US & UK airlines are lobbying their governments for aid, with Virgin Atlantic probably only having enough cash for another week or so. The Chancellor said he would only step in as a "last resort" so Virgin will get taken over or go bust. Easyjet has secured £600m of funding. The US has set aside $58bn to aid its airlines. This all presents a sobering insight of just one area of the global economy.

WHAT HAS THIS MEANT FOR THE STOCK MARKETS SO FAR AND WHAT DO I EXPECT FOR THE NEXT SIX MONTHS?

There are several similarities between the causes of the stock markets crash in 1929-1932 and today. Before the 1929-32 crash the stock markets had enjoyed well above par growth, roughly 20% per annum on average. During 1929-32 global GDP fell an estimated 15%, the US jobless rate reached 25% and the Smoot-Hawley Tariff Act of 1930 raised US tariffs on over 20,000 imported goods.

The decline of the Dow can be seen from the chart to the right. The fall went from above 379.61 on September 4th 1929 down to 41.81 on July 7th 1932.

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COVID-19 PANDEMIC PEAK TO TROUGH FALL 2020

Currently we have stock markets that had reached new all-times, global GDP forecast to drop who knows how much, unemployment shooting up, again to who knows where, and Trump's bitter tariff wars. The Dow declined 89% from its 1929 peak to its 1932 trough, losing 8.4% alone on 12th August 1932. The peak to trough falls so far in 2020 are illustrated to the right.

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The 1987 crash peak to trough fall was 31%, the 1999-2002 Dot-Com crash peak to trough fall was 34%, while the 2007 financial crisis peak to trough fall was 49%. The past 50 years have seen several Bear markets. The lengths of these bear markets are shown below:

LENGTH OF PREVIOUS BEAR MARKETS

It takes, on average, 2 years for markets to fully recover. However the 1929-32 crash took until November 1954 to fully recover. Event driven market falls average roughly 30%. One anomaly is Japan's stock market which peaked at 38,957.44 on 29th December 1989, losing 81.06% peak to trough in 2009. It has only got back to a high of 24,286.10 in 2018, still down 37.66% from its peak.

These two examples indicate the markets could still suffer very serious declines. The last two bear markets have been of much longer duration. The current rebound is based on optimism about the length of the lockdown, the amount of government stimulus provided, central bank rate cuts and quantitative easing.

Goldman Sachs had predicted the COVID-19 outbreak would be a short -lived risk for financial markets, projecting the S+P 500 to end the year at 3,400.00, or up 14%. If the contagion lasts for an extended period of time, however, the US economy could slip into a recession and the index could fall to 2,450, losing 18%. That low has been well and truly surpassed, year-end wise they are depending on lockdown ending soon.

The start of Q1 earning season has begun. I fully expect that we will see a very sharp reduction in earnings, not as bad as Q2 will be, due to the longer reporting period which will be in the Q2 numbers. Forward guidance of earnings will be dire, at the best, & really should make investors think about the prospects of future profits, dividends & price/earnings ratios. The US banks have started ramping up their bad loan provisions, with Citigroup reporting a 46% drop in profits. This was caused by a sharp increase in provisions against credit cards losses; which tend to move in lockstep with unemployment & contributed 16% of its net income for 2019.

I expect the markets to make another sharp correction lower, testing the yearly lows seen already & eventually surpassing them. The FTSE 100 has some technical support at 4884, then at 4752; after that there is nothing to stand in the way of a test 4,000. Below 4,000 lies 3845. If things turn really ugly, with lockdowns in place through the summer then the FTSE 100 could test 3019. S+P 500 can test the 2075/2097 area, then 1864/1884 & 1763.

The length of the lockdown and unemployement figures will be key to how long the recession will last. I expect it will take several years for company balance sheets to be repaired enough to justify the sort of levels we have seen the stock markets hit recently. Restrictions on share buybacks and dividends will be payback for the aid provided by the authorities, and the world will have to get used to a lower return on investments in stock markets for several years.

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MIKE HEFFERNAN
HEAD FINANCIAL ANALYST

Mike Heffernan started working in the City in the 1980s, advancing quickly to become a dealer and then a broker in 1988. For 10 years he pursued a very successful career in broking for the highly acclaimed Harlow's International & Spot CHF desks before turning his attention on the Asian market. Now Mike helps Oeno to stay ahead of the game in his role as Head Financial Analyst.

THE EYE OF THE STORM

As lockdowns continue all over the globe we have rare time to digest what has hit us over the past two months. The start of the new decade could not have been more disruptive. The enormous changes that have transformed our societies, the way we think about each other, and the functioning of our economy are simply incredible. Our current reality was the stuff of science fiction as recently as Christmas which now feels so long ago we might as well be living in a different galaxy. We have been battered by volatile markets, had our liberties curtailed for the greater good and, most strangely of all, many of us will be experiencing a sense of time that we didn't realise was possible.

Right now we are in the eye of the storm with yet more troubles ahead. Volatile markets have become relatively calm, a rally is mending damaged portfolios, and we are all eating, exercising and drinking more. As spring weather shows much promise, the most difficult decision of the day is working out which bottle of wine to open and how early can it be done. We can almost relax. And yet the conditions for further economic woes are right before us. We are just starting to see Q1 figures. Thet are bad, but they'll be positively stellar compared to Q2 which will be the worst that anyone in our current generation will have witnessed.

Unemployment is skyrocketing just as economic activity is collapsing. Central banks and governments have flushed incredible sums of cash into the financial system to head off a deflationary collapse. Chances are it will be unavoidable and a depression is a genuine possibility. Should we pull through, it may be simply to face astonishing inflation on the other side as all the money-printing chickens eventually come home to roost. In short, it promises to be the most exciting and challenging decade of our lives.

At Oeno we see things differently. The sun is currently shining on fine wine investment, as per the graph below, while other asset classes are being battered on all sides. There are three key reasons why – consumption, hedging and low volatility.

CONSUMPTION

Idleness is driving home wine consumption to record levels, something I have seen first-hand. One sector of the retail market that is doing very well is alcohol in all forms and wine in particular. The conditions for this are unprecedentedly perfect. The COVID-19 virus has impacted most greatly the world's largest wine consumption markets: London, New York, Paris, Los Angeles, Chicago, Sydney, Hong Kong, Singapore, San Francisco, Berlin, Madrid, and Milan – the list goes on. The elevated crisis this virus has brought is unlike any other before because it has afflicted the most affluent cultures and societies. And affluent people drink more wine than anyone else.

High income earners can no longer travel (for work or leisure), dine out, attend the theatre or concerts, network at business functions, watch sport, visit family, drive much if at all, and in some cases even leave the house. Around the world there are more than one billion of the world's most affluent people locked-in at home, stuck for things to do. There are kids to manage, some home improvements to do, perhaps an evening walk to take, and then there are the evenings – so we open a bottle of wine, cook some great food and watch Netflix. Repeat. Every day. For weeks. With no end in sight.

Spending on wine is rocketing. Right across the UK, retailers and online merchants are reporting 'busier-than-Christmas' levels of sales. Some consumption is fatalistic, 'I may not be around next year to enjoy it so why not have it now?'. Cellaring wine is just another form of stock-piling. Yet cellars built up over many years are being depleted at a rapid rate. Much is stress related – surviving work on raging markets, dealing with cooped-up kids, cabin fever, and so on. A great deal is simply boredom. There is almost nothing else to do.

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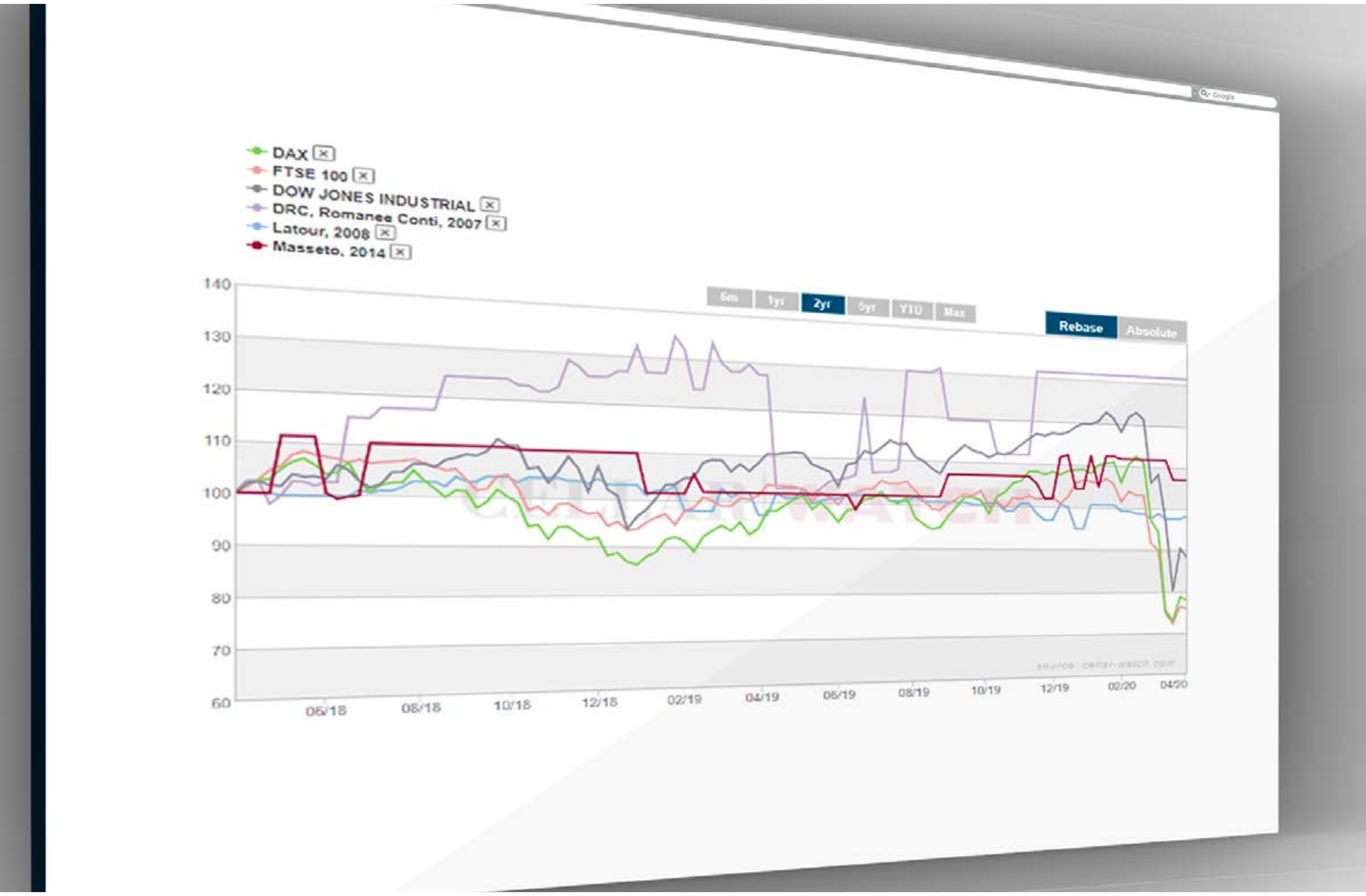
What can this all mean for the fine wine market? Undoubtedly older vintages will become scarcer, especially the so-called ‘drinking’ vintages that sit outside the classics. Don’t be surprised to see significant price rises on 2001, 2004, 2007, 2008, 2011 and 2014 Bordeaux. In Burgundy it will be the 06s, 07s, 08s, 11s, and 13s that disappear. In Italy say goodbye to the 05s, 07s, 08s, 11s, 12s and 14s (yes even the 14s!). It’s difficult to find older vintages from California under normal circumstances, but expect to see most everything from the 00s drunk up and even the 10s, 11s and 12s will be hard to find. Smart investors will snap up these ‘lesser’ years while they are still great value as they disappear from the market faster than the great vintages of 2000, 2005, 2009, 2010, 2015 and 2016.



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HEDGING TO MAKE A DECENT RETURN

Our immediate concerns are with deflationary pressures across all asset classes. COVID-19 is both a supply and demand shock to the global economy. Valuations in equity markets are still elevated despite recent drops and without factoring in forward earnings challenges. As deteriorating economic conditions manifest into unemployment and business closures we may see commercial property valuations under pressure. Consumer goods can expect to fall in price as excess inventory is dumped with firms prioritising cash over margins. There will be few sectors spared. Deflationary influences on fine wine, however, are mitigated by the fall in supply described above. Oeno has a fine wine strategy that can hedge your capital risk over both the medium and long-term based on the vintages best suited to immediate, near or long-term consumption.

Longer-term investors will also be thinking about the inflationary impacts of the vastly increased money supply. Again, the fall in supply of these highly sought after wines is a consistent tail-wind behind fine wine prices. As a result fine wine has comfortably outpaced inflation over the past three decades. It would seem that any concerns about high inflation are not currently an issue, but may begin to emerge in the next two to three years.

VOLATILITY

Fine wine and other collectibles come into their own as an asset class in times of financial duress. Gold is often seen as a comparable safety hedge, perhaps a better one historically, but the price of gold is easily manipulated through paper trading and central bank interventions. Setting aside the en-primeur system in Bordeaux (currently suspended), there is really no derivative or paper market for fine wine. When you buy or sell from Oeno the transaction is 100% backed by the physical stock, so prices cannot be manipulated. While this does reduce the liquidity of the fine wine market, it beneficially stabilises price volatility – a key attraction at the moment. We often don't make enough of this as we should.

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Oeno sources the vast majority (>95%) of its stock direct from the producing wineries and is able to do so because of its excellent relationships. That makes your investment in fine wine incredibly secure. Volatility in the economy is also providing amazing opportunities for Oeno to buy wine. With the collapse of trading in the on-trade, cash-stressed suppliers are diverting restaurant allocations to off-trade clients. In some cases they are offering wines that are rarely available in this channel. Keep an eye out for once-in-a-generation opportunities to secure uniquely rare parcels of wine with us.

WHAT TO DO

Recently we have seen some positive signs that the medical issues of COVID-19 are beginning to be addressed and there is some hope that rates of infection are stabilising. This has underpinned the recent rise in equities, but we should all be aware of a classic bear market rally. The economic challenges have not even begun. The reality will hit both Q1 and Q2 earnings and we expect equity market have further to fall. The current rally is therefore a great opportunity for investors caught out by March's declines to raise cash and lock it away for a rainy day. But in the longer term cash is a terrible investment and allocating reserves to fine wine now would be a very smart move.

JUSTIN KNOCK MW
CHIEF WINE ANALYST

Justin Knock has the rare distinction of being one of the few Masters of Wine to pass the notoriously tough exams first time round in 2010. He has held numerous high-profile roles in the wine industry such as UK Director of the California Wine Institute. With extensive experience in wine production, distribution and marketing, Justin brings a wealth of industry expertise to the company as Oeno's Chief Wine Analyst.

WHAT TO BUY RIGHT NOW

In these treacherous economic times most wine merchants have turned to online platforms to supply their clients with ready-to-drink wines.

Oenofuture Ltd has been one of the first to do so, offering an exceptional portfolio including great wines sourced directly from our producers. Fantastic examples include our Saint-Emilion agency in Bordeaux which provides the superb Clavis Orea Saint-Emilion Grand Cru 2016 and our Piemontese agency Poderi Gianni Gagliardo with early drinking wines like the great white Roero Arneis 2018, or delicious reds Dolcetto d'Alba Paulin 2018 and Barbera d'Alba Superiore Madama 2017.

Other great choices include our world-class Lebanese estate Chateau Belle-Vue whose 2011 vintage of La Renaissance is perfect now, but will continue to age gracefully for many years to come. Our clients also have the possibility to explore our range of wines ready for consumption in the shape of a few packages beginning with the 'Grand Oeno Selection' which allows our clients to sample legendary wines like Chateau Mouton Rothschild 1982 or Masseto 2011.

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’The Oeno Pairing Selection’ enables our clients to have a large selection of wines to pair with all the components of a great meal, the ‘Muscles and Finesse Selection’ pairs off the meatiest wines against the most subtle in our range, and the ‘Around the World Selection’, showcasese wines from the four corners of the world, from the very classic regions like Champagne to the lesser known but nevertheless superb wines from Silver Heights in China.

In terms of wine investment we have seen a surge in interest in the great Italian wines which we sometimes carry like the famed Soldera 2011 in Tuscany recently shown at our portfolio tasting, as well as the legendary Screaming Eagle 2016 from Oakville in Napa Valley. Investment in fine wines is strong at the moment with interest very high for some of the rarest and finest wines in the world including among which Liber Pater 2015 and previous vintages, and DRC wines either by single cru or in the form of assortment cases. Burgundy has started the year very well for us with a very successful En Primeur Campaign, focusing on our favourite estates like Mischief & Mayhem, Domaine Alain Burguet, Domaine des Beaumont, as well as a small exceptional parcel of Lucien Le Moine ‘Hospices de Beaune’ top cuvees in Magnum!

This small snippet proves that the fine wine scene remains buoyant, and we look forward to more action with some exciting Bordeaux En Primeur which should see a surge in interest over the next few months. Given that the campaign this year has been cancelled, we have been able to secure some exciting 2018s including some Chateau Margaux, Chateau Mouton Rothschild and Chateau Palmer to name a few. We are now planning our next trades which will most likely include a parcel of Chateau Latour 2011 as well as a very special collection of Library Barolos from Poderi Gianni Gagliardo.

OLIVIER GASSELIN
DIRECTOR OF TRADE

Olivier Gasselin has been in the wine trade since 2001 with his career taking him all over the globe as head sommelier and wine buyer for restaurant groups like D&D London and Hakkasan. Olivier was awarded Best Sommelier in the Middle East three times, also winning the Sommelier Wine Challenge at Imbibe Live 2016, before completing his WSET Diploma in 2018. As Head of OenoTrade Olivier uses his extensive contacts to keep everything running smoothly.

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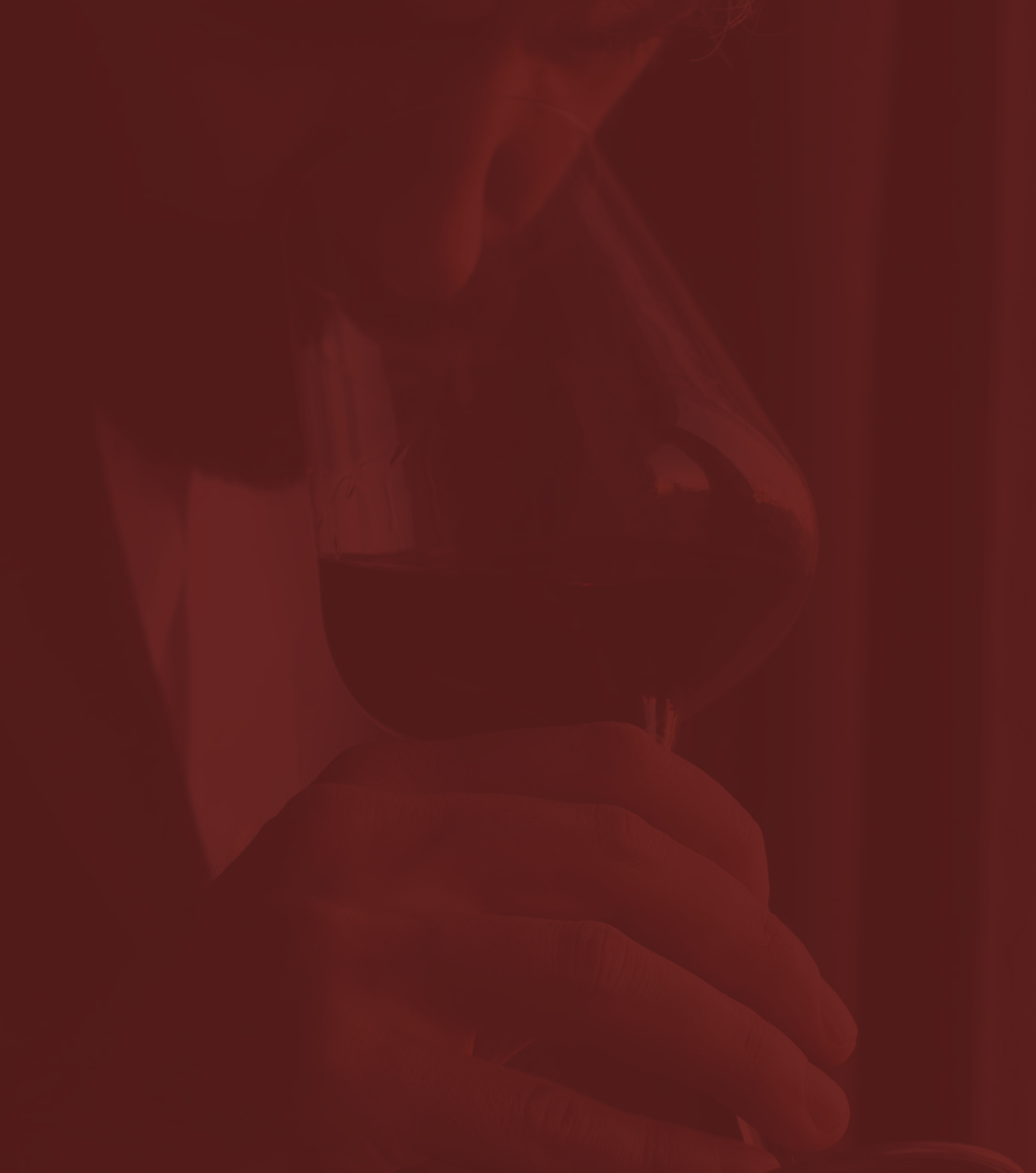

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