Coronavirus - Market update

May 27th, 2020

We are now two months past the commencement of lockdown, and you can sense a growing impatience in the country for an end to this phase of the pandemic and the overbearing sense of government control. It is clear that we are at an extremely challenging period for our leaders, tasked with navigating a path to the other side, and conflicted by the interests of preserving heath on the one hand and the harsh realities of the economic data on the other.

The decisions made over the coming weeks will likely shape all our lives for the next multi year period.

The critical Covid numbers are now 5.5 million cases around the world with 350,000 deaths and 50% of those now in the Americas, where numbers continue to rise. Deaths continue to reduce in the European area though China still has spikes appearing that are quickly dealt with through regional lockdowns - I suspect something we will have to get used to here in the coming weeks.

Clearly, commerce - both here and around the world - needs to start working again soon. Sensible economics will drive prosperity and of course tax revenue and, as we all recognise, money makes the world go around.

Not surprising then to witness more of what has got us through the Global Financial Crisis ten years ago and since, and has helped maintain liquidity around the world - fiscal stimulus. Up until 10 months ago $4.5 trillion of fiscal policy had been pumped into the global markets - in the last ten months that has expanded by a further $4 trillion - quite extraordinary numbers and of course highly supportive for markets, which sense that central banks and governments will do whatever it takes to avoid a severe economic downturn or indeed depression.

This week, we have also seen announcements by Ursula von der Leyen, (pictured) president of the European Commission, of real progress on the 'Next Generation European Union' - €750 billion recovery plan. This really matters as Germany, in particular, has been showing signs of growing unease about the welfare of the weaker European states. €750 billion represents 5.4% of EU GDP and will be composed of €500 billion in grants and €250 billion in loans. Together with the EU budget - €1.1 trillion - and €540 billion in other initiatives, this provides a total package of €2.4 trillion.

The package will be funded by new debt issued in financial markets between 2028-2058 + budget increases. The funding will be dispersed from January 2021, according to the size of the economy, population and severity of GDP damage and youth unemployment. Given my concerns aired in my last piece on the state of Europe, this strategy provides some cohesion and is perhaps an early sign of greater European fiscal unity. Repayment of the Bonds will be paid for with new taxes including carbon, plastics, and new digital taxes. Von der Leyen pronounced

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that the 'European Green Deal is our Growth strategy' - a clue I suspect to the source of some of our own tax increases coming.

Does this market rally make sense and is it sustainable?

This of course is the multimillion-dollar question. A number of our clients are sitting on cash waiting to deploy it into the markets and these periods always demonstrate the difficulty of market timing. There is very clearly a disconnect currently between market direction and economic reality. The market is fixated on the other side of the pandemic and better times ahead as the economy reopens, and spending returns but, in my view, deep questions remain as to the timeframe that this process can realistically be delivered over. Some of the economic risks and realities seem to be being completely overlooked.

How long, for example, will it take for unemployment in the US to return to where it was? Unemployment in the US has grown from 5 million to circa 40 million in 10 weeks. That represents circa 20% of the workforce and it strikes me that with large areas of commerce likely to remain subdued for some time, (hospitality and travel for instance), there could well be social unrest as large swathes of the US unemployed populous lose sight of the American dream and remain stuck in a darker reality. The events around the George Floyd killing at the hands of the police this week are hardly likely to help those with feelings of abandonment in a racially divided country.

Here in the UK the end of Rishi Sunak's furlough period will almost certainly lead to a further swathe of redundancies and corporate failures and whether these are factored into the current market rally is open to debate. Consumer spending is what is required to help us out of this period but given comments above and a deep sense of fear for many, it is savings rates that are increasing as individuals pay closer attention to their own balance sheets through the lockdown period.

This is evidenced by the 80% contraction in mortgage approvals in April and this was the lowest level of approvals since the BOE started recording them in 1993. At the same time, household deposits increased by £16.2 billion in April, well in advance of the average £5 billion per month that had occurred over the previous six months.

Wall Street or Main Street?

So, investing at this point has to be actioned cognisant of the fact that there will almost certainly be further short-term market volatility, as this ongoing trade-off between Wall Street and Main Street attempts to identify a dominant force. The stock market remains a force that looks through the current situation and factors in business expectations it sees six to nine months ahead.

There is clearly optimism out there and never underestimate the worlds leading economy - the USA. However, the reality of economics and corporate earnings will ultimately dictate stock market pricing and, in my view, some short-term caution is warranted right now, though long term investors may want to look through this.

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