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WEALTH MANAGEMENT

Coronavirus - Market update

June 19th, 2020

This week has seen a further pull back in markets as a dose of reality check kicks in. Given the large run up in markets since the March 23rd low, as I suggested in my last piece on May 27th, it is unsurprising to see a pause for breath in the market rally.

Central Bank expansionary balance sheets and the fiscal stimulus likely to underpin the market advance

What of course is continuing a pace is the massive central bank balance sheet expansion - now approaching $20 trillion and the fiscal programmes that continue to underpin market confidence. Without this, the markets would be behaving very differently, and the impact of the stimulus is of course surprising many professionals in the market, who have not been expecting such a robust recovery.

When one considers the level of fiscal stimulus though it is not entirely surprising - these are utterly staggering numbers. In the States the impact of cash handouts has in fact lifted disposable income for the unemployed above what it was when individuals were employed. This has led to a significant increase in retail sales over the last month (May retails sales were up over 17.5%) and though sales remain down 6% from the highs, this is feeding through to strong numbers and even auto sales are on the increase.

In the UK, the Bank of England has announced another £100 billion of extra bond purchases (QE) this week and this is welcome as inflation has slipped alarmingly low and it is very key in the UK that we do not fall into a disinflationary trap. With March GDP down 5.8% and April's down an astonishing 20%, (for context the worst numbers since the great depression), a deflationary trap would be very easy to fall into.

9.5 million employed individuals remain on furlough and a further 2 million plus self-employed. This is putting an enormous strain on public finances. In April the government borrowed £54 billion - the highest ever amount borrowed in a calendar month and for the first time since 1963, UK debt rose above 100% of GDP. Gross central government debt - the money owed to the holders of gilts, national savings and creditors of Network Rail - exceeded £2 trillion for the first time ever in May. It rose £200billion over the past year to hit £2.009 trillion according to the ONS. In the G7 countries, net debt is either above 100% of GDP or expected to exceed it in France, Italy, the US and Japan as well as the UK. Only in Germany and Canada is debt expected to remain below this threshold.

These are huge numbers, though most certainly the likely right strategy short term to stabilise growth. How Rishi Sunak proposes dealing with paying back the UK debt will likely come into sharp focus in the autumn.

Some better news in the Eurozone

It appears this week that there is much better news coming out of Europe. I wrote last time about the EU's €750 billion recovery plan and early signs are that there is recognition within the EU that this is a plan that must carry unified support. Finding an early understanding of the principles of agreement appears to have been recognised and we will see whether this generates further momentum in the weeks ahead. There also appears to be better news on Brexit.

Is this likely to feed through to better European equity prices?

Investors have been falling out of love with European equities for a while, not entirely surprising given the challenging economic conditions and numerous political hurdles. European equity performance has lagged far behind the US and developed markets, with the MSCI Europe ex-UK index returning 39.3% over the past five years, against 93.3% from the S&P 500 and 67.9% from MSCI World.

Last year UK investors withdrew £3.8 billion from European equities and with Covid-19 having its epicentre in Europe, that process has carried over, particularly with Europe having imposed some of the strictest lockdown measures. The additional challenges around Brexit, tensions with EU institutions, a heavily indebted Italy and widespread resistance to President Macron and his plans for labour reform, might suggest a combination of reasons to avoid investment in the region.

The fact remains though that Europe is home to numerous exciting businesses now on very undemanding valuations. Astute fund managers will identify these opportunities and I suspect now maybe a good time for patient investors with a three to five-year view to invest, though clearly this might be regarded as a rather contrarian strategy given the backdrop described.

In terms of the medical stats, we are now at new cases of circa 140,000 per day globally with over 301,000 cases in the UK and sadly over 42,000 deaths. In my view, we are likely to see an increase in regional lockdowns where spikes emerge in the coming weeks and the US, in particular, looks likely to suffer problems down the track with its rather more cavalier attitude to the Covid situation and massively growing numbers of positive tests.

That aside, it is welcome news that an outline strategy of lifting us out of this mess is emerging from Government and I am certainly sure that we are all looking forward to more social interaction with friends and family in the weeks ahead.

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