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EQUITY MARKETS REPORT



JULY 2020 // WRITTEN BY JAMIE CONSTABLE

EQUITY MARKETS OVERVIEW

Stop! In Q1 2020 the world effectively did as the coronavirus pandemic led to many governments putting their respective economies into hibernation. Was everything we wrote at the end of 2019 destined for the rubbish heap of history? Strangely not! We talked then of the need for fiscal stimulus and that you would hear those words a lot more in 2020, and that the scope for monetary policy to stimulate economies was becoming more limited.

China was no longer the engine for global growth. PMI's were falling. Equity markets were buoyant though, as they looked forward to stimulus and growth picking up through Q1 2020. It is very interesting to see that the themes identified then are just as and, in some cases, even more relevant today. Return we must though to the virus known as "corona".

To understand its impact, it is helpful to visualise the pandemic as a wave rising up in Wuhan in China and then radiating out, strongly to the West as it moved through Europe and then across the Atlantic into the Americas.

A recap from
2019

Turbulence left in its wake meant there was some time shifting in the amplitude of the pandemic's spread, but spread and then grow it did through the world of (then) interlocked economies and supply chains.

This pandemic has been a test of the competence of individual countries' social, political and economic systems and not least their healthcare. It is hard to imagine that these structures and systems will remain the same looking forward. This has the potential to present a myriad of investment opportunities.

Governments reactions and the shutdowns of economies as the “wave” hit their respective countries has meant that the need for fiscal support has been at a level not seen in modern economic history. We are witnessing the biggest “experiment” in open heart surgery on economies within the global system that the world has ever seen, with “economic hearts” stopped and moved onto government life support. This has taken many forms, but under some broad themes:

- **Policies to help prevent immediate widespread job losses** with government support for continuing employment under lockdown under, for example, furlough schemes.
- **Huge support packages from governments for corporates.** It has to be called support until economies start opening up again, when it is more realistic to then call it stimulus.



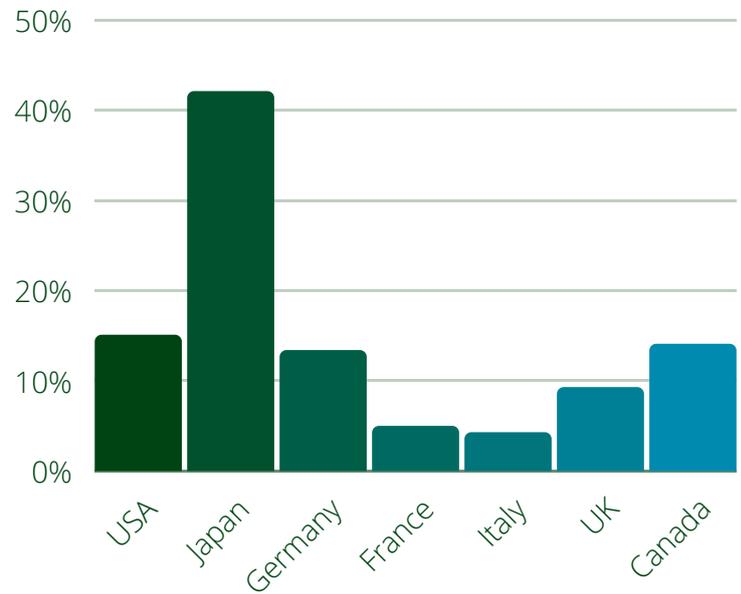
COVID-19
IMPACT

- **Further additions to Monetary measures** introduced post the Financial Crisis with interest rates cut to, effectively, zero globally and large scale increases in what had become hibernating QE schemes.

It's worth summarising the huge government fiscal support / stimulus measures initiated to date across the leading economies. These look likely to continue to expand with, for example, \$trillions more being already called for in the US, furloughing schemes being extended and, in the UK, the government talking about significant infrastructure spending.

N.B. there are quite a wide range of differing numbers being quoted for the numbers to the right, depending on how you classify tax deferrals, the GDP base year and so on; but the amounts are illustrative of the huge sums being committed, and continuing to be committed, and are likely to grow.

Stimulus Package
(equivalent of GDP)



| Country | Fiscal Support |
|----------------|-----------------------------|
| USA | \$2.9 trillion (USD) |
| Japan | ¥234 trillion (YEN) |
| Germany | €456 billion (EUR) |
| France | €106 billion (EUR) |
| Italy | €75 billion (EUR) |
| UK | £189 billion (GBP) |
| Canada | \$324 billion (CAD) |

The Financial
IMPACT



Government balance sheets have thus exploded, but sovereign debt yields have remained low. How has this happened? The UK is a prime example of "how", with the Bank of England expanding its QE programme so it has effectively bought all of the increased UK governments gilt issuance to fund the fiscal support programmes. The Bank of England now, or will shortly, own £745 billion of UK gilts, which is approximately 35-40% of GDP or, to put it another way, nearly 40% of all the gilts in issue!

Fiscal support has been complemented then with monetary policy, generally in the form of increased QE in, for example, the US, UK, Europe and Japan, and the reduction of interest rates to effectively zero. There has been talk of negative interest rates, but policy makers appear to be leaning to the view that the downside of this policy outweighs any benefits; as is also believed by your author. In the UK though, we now see the gilt yield curve at negative yields all the way out to the 7 year maturities!

Governments' have thus spent now to keep their economies on life support whilst they tackle the virus, so as to hopefully emerge with some vigour as their economies reopen.

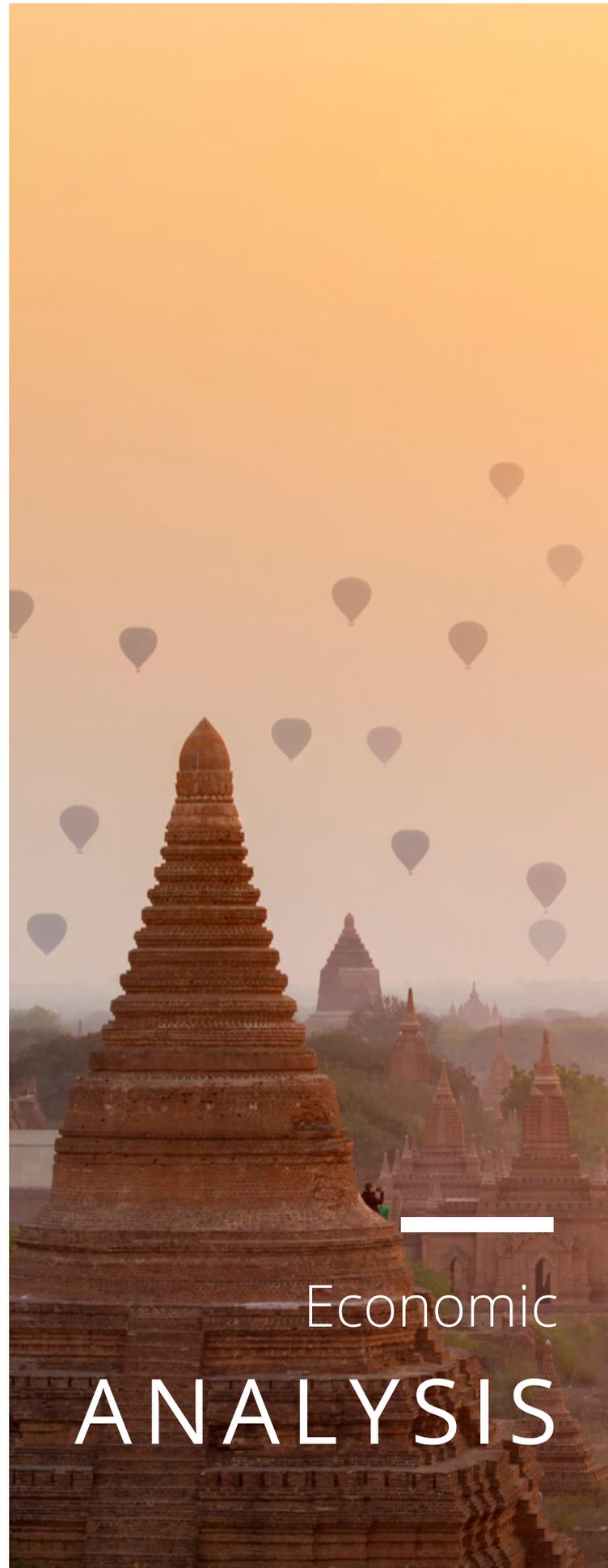
Where are they now then, as the "wave" hopefully passes?

ASIA, ANZ AND THE MIDDLE EAST

China was first in and first out. Their economy depends greatly on exports for its vibrancy; although the government have been looking to tilt more towards a western developed economy model of consumption, particularly as wages have risen.

The dilemma of being first in and first out is that the supply shock the economy first saw has then morphed into a demand shock, as the wave moved West and shut the rest of the world down. The Vietnamese, Australian and New Zealand economies are all back operating, but their borders remain effectively closed to people, but not goods.

The Asian economies are, to a significant extent, dependent on global trade, which is only at the start of its pick-up. The Middle East had to contend with oil prices going “negative” and they continue to see inflated new cases, as is the case, too, across the Indian subcontinent.



Economic
ANALYSIS

EUROPEAN EQUITY MARKETS

Eastern Europe emerged relatively unscathed and economies are advanced in their openings. Italy was the epicentre of the pandemic in Europe, and the start of the fall in the numbers of new cases there was – the trigger for the dramatic bounce in global equity indices that we have seen.

Once cases were falling in Italy it was extrapolated that the same would happen, with a lag, in other western economies, as it has. The EU “did everything it takes” again, but under Lagarde who now leads the European Central Bank (“ECB”). The ECB are very clear, though, that monetary policy alone cannot pull the EU economy out from its hibernation.

Arguments are raging over a Eur€750 billion “bounce back fund” and whether the monies should be grants or loans, how much should each country be entitled to, whether the EU can borrow itself to fund the scheme, and so on.

Meanwhile, Germany has committed huge sums to its own policies after a very well organised surgical intervention on the economy.

Economic

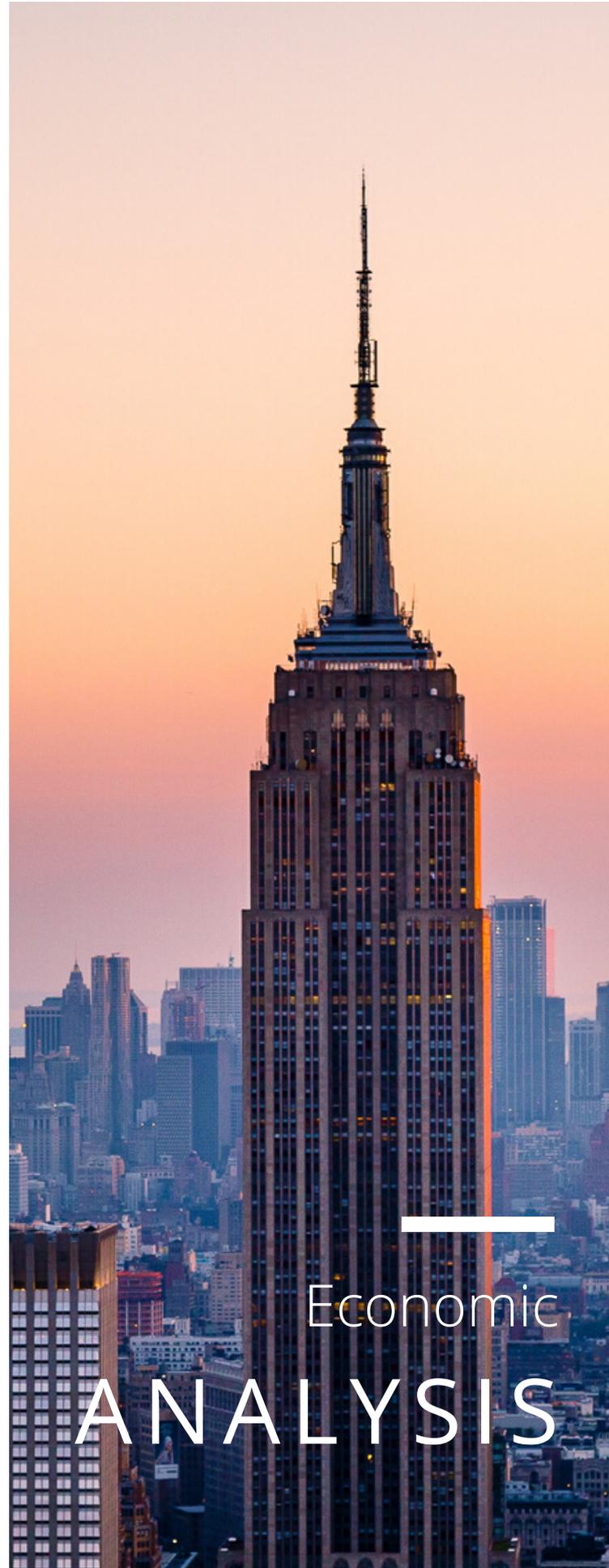
ANALYSIS

THE AMERICAS

The last to enter and now the epicentre of the pandemic. South America is not that critical to the global economy, but the situation there remains acute. The US appears to be at critical juncture in its reopening programme. States where there has been a reacceleration in cases – a continuation of the first wave not a second wave – are adamant that they will not shut down again although, step by step, they appear to be retightening.

There has been an age shift downwards for the new cases, but that is a danger looking forward for the elderly and health compromised. Trump crucially needs to see a strong economic bounce back if he is to close the lead that Biden has built in the Presidential election race. Will Trump's mood get desperate or will it be resigned?

The opinion polls currently have Biden with a double-digit lead over Trump, and are even suggesting that the Democrats could win the House and the Senate. If those events were to occur, then that could be defining moment for US economic and foreign policy and investment strategy for at least the next 4 years.



Economic
ANALYSIS

THE UNITED KINGDOM

Last, but not least, the UK. This is not the time and place to focus on the timing and the policies through and, as we exit, from lockdown; although the government seems on a mission to make the UK a difficult country to do business with! What is fact, is that the UK economy is 80% services and was probably running at around 2/3rds of normal through the lockdown. As the leisure industry started up again from 4th July, with retail now operating, too, the economy is entering a critical phase. There have been over 9 million on furlough and another 2.4 million plus self-employed claiming through that scheme. Combined, that is c.40% of all private sector employees.

The UK economy needs to get as many of these people as possible back into jobs as soon as is safely possible. A continuing recovery for the UK is dependent on the success of that. Sunak's "mini" budget announced further measures, mainly to support consumption and the corporates in those sectors, as activity picks-up. There is the, not small, matter of the Brexit trade deals to negotiate, too.



Economic
ANALYSIS

Q2 should be the trough for the global economy. Monthly economic indicators will be as extreme as economies reopen, as they were as they shut down. It is the year-on-year data that will be much more illustrative of the scale of the lost output across economies. It feels like commentators have pretty much used the whole alphabet to describe what the bounce back in activity may look like, a “V”, a “U”, a “W”, a “L” and even images like the Nike “swoosh”!

Experience from reopening in the Far East is that consumers are pretty cautious on spending as they emerge from lockdown. It appears, at least at this very early stage, that the consumer, after spending up to 3 months in lockdown, is more inclined to spend on home and lifestyle rather than on leisure activities. It does vary by geography though, and they have been able to spend on retail online through lockdown, of course.

Looking forward, a major influence on investment themes is that the virus has accelerated a number of the prevailing global themes, in some cases by multiple years. Choose your acronym/theme...“WFH”, “Zooming”, “online shopping”, the “demise of physical retail and high streets”, “re-shoring”, “digitisation of the economy”, “robotics” – the list goes on.

The expansion in government and central bank balance sheets appears to be manageable at current very low yields – at least in the short term. The initial impact of the simultaneous hit to supply and demand has been deflation, but will the increasing costs of doing business in the post-corona world lead to a longer term pick-up in prices? Will we see a boost for wages for the “essential employees” who kept economies moving? It is wage growth that is the true driver of sustained inflation. In that scenario, can sovereign debt yields stay at these historically low levels?

At the half point of 2020, we have to say that much economic uncertainty remains.

The global issues that existed as 2019 ended have not gone away. Trade wars continue to rumble, with the US Presidential election fast approaching, too.



A change in party in the White House would likely have major repercussions for the world of investment, if that is matched with a majority able to make effective policy. In the UK, there is the small matter of a Brexit trade deal with Europe and the rest of the world, which needs to be in place by the end of the year.

After precipitous falls in equity indices globally as the pandemic hit, the rapid bounce in equity prices has confounded pretty much all. That is the power of liquidity and the unprecedented (I nearly got to the end of the piece without using that currently well-worn word) amount that has been released into global financial markets in 2020. The scale of the economic recovery across countries will determine whether equity markets are correct.

At least in the short term, any recovery is going to look and feel like a “V” given that we are moving from a “Stop.” The test for governments and policy makers is to now ensure that the billions, if not trillions, they have committed to date does not “go to waste” as they move to turn support into stimulus to ensure that a bounce back becomes a recovery and then growth. The “greening” of the global economy feels like a good place to start, with both a high economic and social payback. Infrastructure will be a key word for the rest of 2020 and beyond.

We finished the 2019 report with “Let’s wait and see what 2020 has in store! It’s looking to be an interesting year for global equity markets.”



We are only half way through and 2019 already seems like a lifetime away! There are still many unknowns such as will the “wave” lap the globe again, as has been seen in other pandemics? Has the world learnt to “live with” the virus, so any re-emergence is likely to have diminishing effects? Will there be a vaccine?

The UK and the western world is now focused on reopening. Getting people back to work as quickly and as safely as possible *must* be the best way in ensuring that the economy they return to is as large as it can be. Unemployment is ultimately the crucial measure that will decide the success, or otherwise, of the rebooting of the global economy. The coming months will tell us, as support schemes are unwound, how successful governments have been.



Jamie Constable
Equity Partner & Equity Sales

jamie.constable@n1singer.com | +44 (0)20 7496 3035

N+1 SINGER

n1singer.com | +44 (0)20 7496 3000 | @nplus1singer