SRS
Strategic Retirement Solutions

Market View

The global equity markets have, for now, moved on from the pandemic. They are focussing instead on the recovery, when will it begin, how fast will it be? In the meantime markets are being supported by Central Banks printing money through Quantitative Easing (QE) and from governments through Fiscal Stimulus. As long as QE programmes keep being announced and developed then bond markets are underwritten and thus, through complex pricing methods, so are the equity ones. The Fiscal programmes are aimed at keeping defaults low and it is hoped will help stimulate an early recovery, once the global consumer is allowed to spend again. The big unknown is just how much spending power the consumer has? Some will have ended the lockdown with more cash than normal in their bank accounts, others will now be unemployed and unsure of their economic future. In the USA, the Chair of the Federal Reserve Bank stated that "40% of households earning less than $40,000 will have seen one person lose their job". Just how quickly those individuals get back to work will dictate how fast consumer spending recovers. It may also dictate who will be the next US President? It does seem though that post Covid-19 we might be looking at a very different global economy over the next decade.

What are the long term implications from the Pandemic?

We have to start with a caveat. Most long term predictions rarely come true, few predicted that advert funded internet search engines (Google) or internet based platforms where participants hand over valuable marketing data for free (Facebook) would become some of the largest and most cash generative companies in the world. Many fund management houses have published detailed research as to how they think the world will change post Covid-19. The following are some of the most common points.

1. The end of Globalisation. Consumer spending in the Old World has been stimulated by cheap components and finished goods from the New World. Even before the pandemic the election of Donald Trump and perhaps even Brexit had highlighted a backlash against globalisation from many voters, as lower paid jobs were exported or outsourced to the Far East. The global lock-down has highlighted just how fragile these convoluted supply chains had become and thus how risky they are. The widespread belief is now that they will be repatriated, however, the reality is that even before the virus, despite all of Trump's efforts and rhetoric, few manufacturing jobs have returned to the USA during his Presidency. It is simply a matter of cost and capability. Low cost means low wages, that can only be achieved outside America or the UK. Our view is that globalisation will not go away, but it will change. Western multinationals faced with government pressure to move away from China, might not return home, they will look to move to another, more politically acceptable, low cost country. The Western consumer is addicted to low cost goods, the only alternatives are hugely expensive and complex robot factories (the Japanese solution). For now, it will be easier to move a factory from China to Vietnam, Indonesia, India etc. and that will be the option most companies will probably take.
2. Working from home. The big winner from the pandemic has been the Cloud. For many companies buying into existing Microsoft and Amazon Cloud computing packages has saved their businesses. It has also highlighted to them just how much money could be saved if some tasks and roles were not housed in expensive offices. We suspect that this will not be a wholesale change for every role. Job satisfaction for many comes not through the task but via the social contact with colleagues. For others working from home does suit their lifestyle and family commitments more. Thus, we feel that whilst this will be an obvious post Covid-19 change, it will initially be piecemeal. However, the key to a more wholesale change will be the schools, some classes are perfectly suited to being taught over the internet, others not. If the government moves towards part time schooling for health reasons then home working will have to become the long term norm and not just a short term fix. Housing, may be a major beneficiary, the trend for downsizing may be reversed, bigger homes with an office and a gym may be more desirable in the future.
3. The rise of eCommerce. The other big winner has been internet shopping, either for home delivery or click and collect. The system has creaked at times but companies have gradually found ways of making it work. High Street retailing has been in decline for years. Post Covid-19, travelling on public transport to crowded city centre flagship stores will be psychologically very difficult, especially if the predicted second virus wave comes around the key Christmas shopping season. Shops need to change, the successful retailer in the future will have to evolve, with the internet first and the high street site second. In the

UK the supermarket sector has just been handed a huge sales bonus, how they invest this cash will be critical as to how eCommerce continues to develop in the UK. Heavy investment in home delivery and or click and collect will be needed. The High Street, already moving from retail to hospitality may be heavily impacted.

4. Hospitality. In the UK economy this broad sector is a huge employer, especially amongst lower income households. Pubs, restaurants, coffee shops, cafes, hotels, gyms, cinemas etc. have all been closed and will be the last to reopen with what is likely to be much reduced capacity. This is where the biggest economic impact will be seen, maybe this sector will need the vaccine or for Covid-19 to burn out before it can fully recover. Can the pub change, hopefully not, but gyms have moved online as Peloton has successfully proved; movies have been released direct to the likes of Netflix and the new Disney channel. In the short run many businesses in this sector will not survive. However, they will be reborn in the future once the pandemic has truly passed.
5. Healthcare. This is an expensive service, funded in the UK by tax revenue, globally by insurance, that has been historically difficult to change. The pandemic has highlighted the need to invest and also to adapt. Wearable technology, medical consultations by video and greater use of diagnostic testing are likely to become more common in the future. Track and tracing apps are perhaps the just start of what will be a signification long term evolution from bricks and mortar based surgeries to a home based, technology supported, healthcare system.
6. Climate Change. Even before Covid-19, governments had been considering Green Stimulus packages in order to boost "sluggish" economies, especially in Europe. With the temporary global halt to polluting there is an extra impetus behind the climate change agenda. Much will depend on the Chinese and their plans, but we should be looking for car scrappage schemes for new electric vehicles, restrictions on vehicle use in cities, development of battery storage working with wind and solar power and possibly a reduction in aircraft use. Driving forces here will be a loss of profitable business travel, widespread government funding of national carriers and possible slot/capacity restrictions at airports.
7. Corporate World. Even before Covid-19 the move away from old technology to new was starting to accelerate, the big tech companies are emerging from the pandemic even stronger. Their enormous cash balances have accelerated during the lockdown, where this cash goes will have significant implications for the future. Buying businesses in healthcare and transportation seem obvious, but with the move away from cash, payment processing seems likely as well. Banks will evolve to become pure lenders, they no longer need our cash, it is cheaper to borrow from the Central Banks. 48% of the S&P 500 by value is represented by Technology, Computer Services, and Healthcare, just like steel companies in a war they are all doing very nicely from this crisis.

Markets

Given that the global economy is undergoing its harshest economic crisis since 2008 and unemployment is the worst since 1929 the performance of the equity markets looks to be irrational? But if we look a bit deeper all may be not what it first appears. The FTSE 100, is down year to date by 17% whereas the Nasdaq 100, dominated by tech is actually up by 7%. Clearly, a UK market heavy with oil stocks will struggle compared to the likes of Amazon and Microsoft but there are other factors at play as well. QE forces interest rates down along the whole of the yield curve, so 10 year interest rates are far lower than they would be without QE. Company shares are valued on a multiple of their profits. The multiple that is applied (the P/E Ratio) is also a function of bond yields. So if interest rates are low then theoretically companies should earn much higher future profits and thus today's share prices can tolerate a much higher valuation. For some market participants (typically old school value investors) this is a problem, for others (typically Hedge funds and quant funds) this is just fine. No doubt over the coming months we will see one side or the other taking leadership in this complex market.

We are also starting to see a geopolitical "blame game". China stung by criticism is being more assertive, especially with Hong Kong and Taiwan. Trump meanwhile is trying to use this to his advantage in what looks like it is going to be a particularly fractious Presidential Election? The global economy does not need another trade war at this critical time. Markets are addicted to stimulus and here the news flow is presently very good, Europe seems to be getting its act together, though there is a long way to go yet. The riots in the US should give impetus to more fiscal stimulus in the US as unemployment hits 20%. This economic news flow should support the markets as economies slowly emerge from lock-down. Furthermore, it seems that if a second wave does happen then it will not be met with total lock-down perhaps only the most vulnerable will have to shutter? However, as the pandemic passes we are only now beginning to see what economic damage it has done. Some companies have lost two to three months of income or about 20%, there will a temptation to increase prices in order to catch up. Might the biggest consequence of

SRS
Strategic Retirement Solutions

Market View

Covid-19 be the ultimate return of inflation?

May 2020