State of play

30 April 2020

In the midst of this unprecedented global event, our Investment Specialist Simon Durling, provides you with the latest COVID-19 developments, alongside our market and investment insights.

COVID-19: An update

One of the factors driving the decision to enter into lockdown to contain the spread of COVID-19 is a desire to control the “R0” rate. This measures how infectious or contagious a disease is and describes the average number of people an infected individual can expect to pass the virus onto. The World Health Organization estimated at the start of March that the global COVID-19 R0 stood somewhere between 2 and 2.5. By comparison seasonal flu is estimated to be roughly 1.3 while measles has a reproductive value of between 12 and 18. To bring an outbreak under control the R0 value needs to drop below one.

Before the UK introduced restrictions and social distancing, the R0 rate was estimated to be around 3. This has now dropped to 0.75 following nearly 6 weeks of containment measures. One of the many challenges facing any government is that until a successful vaccine is developed, how do you lift certain restrictions and maintain an R0 rate at a maximum of 1. As an example, by reopening schools the R0 rate will jump significantly, as will opening restaurants or cinemas. Remember - the R0 rate is a measure of how infectious the disease is not how deadly it is.

This is the challenge facing Prime Minister Boris Johnson as he returned to work following two weeks of rest and recovery -

balancing the need to continue to contain the virus spread against the economic consequences of shutting down vast chunks of the economy. The likely path will involve lifting restrictions in phases over a prolonged period of time. By suppressing the spread of the virus the NHS can maintain sufficient critical care capacity to cope with the numbers of people infected. As an example, one expectation is that some none essential retailers like DIY stores or garden centres may be allowed to reopen, provided they can demonstrate the 2 metre distance discipline that supermarkets have managed.

One theory being discussed and considered is social distancing in “bubbles”. Instead of each household remaining away from others, certain family and friends could be allowed to congregate and meet but in restricted numbers. This may allow grandparents to mix with sons, daughters and their grandchildren, but no others. Clearly, judging what restrictions to lift and when carries a certain amount of risk in all scenarios, but avoiding a second more deadly wave of the virus appears to be the main factor. However, although these decisions will be driven by medical and scientific guidance, ultimately the final decision will always be a political one.

Each country across the world has its own set of demographics (shape, age and split of population) and local considerations that need to be respected when assessing the best way to lift the lockdown. One thing is for sure - each country is keeping a close eye on what is and isn’t working in countries already starting to lift restrictions. Only time will tell what happens to infection rates and social behaviour after lockdowns gradually ease.

Economic impacts and response measures

When I think through my more than thirty years in this profession and reflect on other financial or market traumas I have lived and worked through, I struggle to find an easy comparator to the current crisis.

Firstly let’s look at the economic responses by governments and central banks and reasons for optimism. The financial and monetary interventions are unprecedented, in fact, it’s not unreasonable to describe them as extraordinary. They equate to more than any other market crash in history, even adjusting for inflation. Also, the rhetoric from both governments and central banks is universally “whatever it takes” in tone and content. In addition, medical and scientific developments, for those working in that line of work, talk of the speed of progress as breath-taking. The fact that several trials for a vaccine to inoculate the world against COVID-19 were underway in a matter of weeks when most of the previous successful vaccine achievements have taken several years, allows governments and markets alike to be hopeful. If a vaccine is successfully developed before the earliest expectations of the end of this year and the massive financial interventions buy enough time for less businesses to fail, then a "V" shaped recovery becomes a possibility. This is where the economies of the world snap back to life with huge pent-up demand and life returns to somewhere near normal very quickly, and the long-term financial impact is limited. Markets appear to have taken this outcome as their central expectation given the recent market rally and recovery in asset prices.

The reasons why the future reality may look very different and that markets may be considered complacent are numerous. Firstly, when you try to compare this crisis with previous events, to my mind at least, the differences appear to outweigh the similarities. Flooding the market with almost unlimited liquidity, the global policy response can easily be compared with 2008 in terms of size and scale. However, the current lockdown reaches parts of the economy that during the financial crisis were broadly unaffected. The UK and many other western economies are dominated by the service sector, from hospitality to tourism and entertainment. Whilst utilising a grant or a loan from the government or being able to furlough your staff wages for three months helps keep the business afloat, many businesses may take many months to recover, if at all. How many big brand names or staple parts of our society will no longer be in existence after the crisis has finally passed? Also there are signs that human behaviour is already starting to change during lockdown and may affect the way we all evaluate how we spend our money in the future. As I mentioned in last week's blog, being in lockdown and not being able to spend as much of our disposable income as normal, whether this be on big ticket items like a car or a holiday, or on life's niceties, may drive a different shape of recovery than what we have seen in modern history. Lots of different media commentators agree that life after this crisis may look very different to the one before the outbreak began.

Regardless of how events will unfold, we can be sure that we are living through very uncertain times and whether you are a fund manager or a small investor, nobody can be sure of what will happen next, and I believe it always pays to keep an open mind.

Market conditions

Stock markets have continued their strong rally buoyed by countries starting to lift their lockdowns and faith in the scale of the economic interventions. Also, in light of limited new economic data this week, markets have seen a brisk trade in stocks driving the rally further away from 23 March lows. Values now sit 10-30% higher from this recent low point depending on which region you assess.

The oil market soap opera has seen unprecedented volatility as the world's storage capacity continues to fill up with many oil tankers still at sea and nowhere to store the oil they carry. The price of oil, often an indicator to the health of the world's economy, is painting a very different picture when compared to how stocks are being valued. This is not unusual as prices of companies are calculated in a very different way to commodities, but there still remains what appears to be a difference in outlook between the two. The record cuts in oil production by the oil producing countries around the world is insufficient to match the fall in demand for the black stuff, considering the drop in air travel, car travel and how many industries are still shutdown. The outlook in the short-term remains uncertain.

Find out more

Listen to our latest **Market Views: Check point** podcast with Portfolio Manager John Mullins, as he discusses how the team is positioning itself as we continue to navigate the volatile climate during COVID-19 **here**.

Note: Data as at 28 April 2020.