State of play

6 May 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:

> *"In this week's blog I explore why fear is the dominant emotion influencing decisions, driving behaviours and why it is likely to shape our future long after lockdowns are lifted."*

President Franklin D. Roosevelt famously said in the opening line of his first inauguration speech in 1933: "So, first of all, let me assert my firm belief that the only thing we have to fear is…fear itself". Since the outbreak of COVID-19 in China last December, fear has been the dominant emotion influencing everything from political decisions to human behaviour in response to the pandemic. As such, does fear therefore provide an insight into our world long after lockdowns have been lifted?

COVID-19: An update

Politicians worldwide are grappling with the ramifications of deciding which sections of society and the economy are safe to start the journey back to the closest form of normal that can be observed from at least 2 metres away. Governments are weighing the frustrations of people and businesses against the fear of the virus spreading more fiercely than before, once certain freedoms have been restored. Countries that are lifting restrictions are doing so incrementally as experts and health authorities weigh the success of each measure before the next phase is introduced.

As we approach the first ever Friday May Bank Holiday to celebrate VE Day 75, commemorating the declaration of peace in Europe in World War II, the UK Government announced that Prime Minister Boris Johnson would outline the UK exit strategy this coming Sunday. There has been speculation in the press and debate on social media about what the plan might mean for schools, transport and what sectors of the economy will be reopened to help kick start the recovery from the self-induced financial coma.

The fear for the UK Government is that, having been criticised for starting the lockdown too late, failing to procure and distribute enough PPE (Personal Protective Equipment) for the front line and being slow to test sufficient numbers of people, especially NHS key workers, ending the restrictions too soon could trigger a second more deadly wave of the virus. Work is underway to test a tracing app on the Isle of Wight in preparation to help suppress the spread of the virus after restrictions are lifted, although this has faced some resistance and concerns about data protection. South Korea remains a strong example for the UK of what can be achieved using quarantine, contact tracing and mass testing. It has achieved a huge reduction in new cases without mandatory lockdowns and plans to reopen its schools to certain age groups who are approaching exams on 13 May.

Chile became the first country globally to commence issuing immunity passports which would be valid for three months. The idea is individuals who have had the virus and recovered can return to work safely. Scientists appear confident that the initial research suggests that the immunity will last at least three months, but potentially even longer.

The response in the US is dominated by devolved power, as each states' authorities make individual decisions about how and when to lift lockdowns. Although leadership is directed from the White House, the ongoing friction between the federal government and the states respective governors makes for a chaotic approach, with wild variations depending on how far advanced the spread of the virus is and its citizens public mood to confinement. This tension has prompted a change in political approach from President Donald Trump. Fearful that new polls suggest a surge in support for the probable Democratic nominee, Joe Biden, President Donald Trump has turned his firepower externally at China. Wounded by the economic impacts and the perceived inconsistent approach to the crisis, the President knows his re-election chances rest on the path of the virus and the success of the enormous financial interventions.

Economic impacts and response measures

The fall in President Donald Trump's re-election odds may have far reaching economic consequences globally. The President has turned from being complimentary about the Chinese regime back in early February to speculating about the likelihood of the virus having been created in a Chinese laboratory. This rhetoric includes threats to impose trade tariffs yet again as well as trade barriers. President Trump knows that being "at war" with China plays to his "America First" policy which had a large part to play in his election first time round. Any new trade war creates the prospect of more financial damage on top of the huge impact of the temporary global shutdown.

So far, since this crisis began, fear of the financial and economic consequences have provided a catalyst for unprecedented response measures by governments and central banks. The size of government borrowing is set to grow on a scale not seen before in modern history. The spending on the crisis is expected to be about 5% of global gross domestic product. Some countries more, some countries less, but all with the one aim of averting a global depression which might take many years to recover from. Any additional intervention in the coming weeks is likely to focus on bringing the economy back to life, including long overdue infrastructure projects, incentives for companies to move their production onshore, large scale healthcare expansion and big spending on disaster preparedness.

The Sunday press in the UK shared some polling numbers from the latest YouGov surveys of 1,654 adults in the UK carried out on 30 April and 1 May. They provide an interesting insight into the state of mind of the public and how fear is affecting their behaviour and opinions. Nearly twice as many people asked were opposed to schools reopening in the next few weeks (47% versus 28%). Also, 77% said that they did not expect to be able to have a foreign holiday until at least next year at the earliest, with 20% of those asked saying never.

As I mentioned in my weekly blog a couple of weeks ago, China attempted to restart the economy by providing time limited vouchers for its people to spend in shops. Instead of creating a boost to consumer spending, individuals bought necessities with the vouchers, putting off using their own cash and savings. This behaviour could be an important factor in determining the shape of the recovery and how fast lockdowns are lifted.

Governments can decide on rules and incentivise certain behaviour, but without the right public reaction, it might not succeed. So, as an example, if Prime Minister Boris Johnson decided to reopen schools next Monday (highly unlikely given what has been said so far) it doesn't mean that parents would be willing to send their children back to school. If parents fear for their children's and their families' safety, they may choose to keep their children at home until they feel it is safe, regardless of what the government decides.

History shows us that when the public is fearful the urge to save in uncertain times is very strong. When they are unsure about their job security, or worse, have been furloughed or even laid off, the urge to save is even stronger as they feel poorer. This can create the worst kind of economic paradox. Individually saving for a rainy day or when times are uncertain is often sound financial advice, but for the country, if everyone followed this approach, it could lead to economic disaster, especially when over two thirds of the UK economy is reliant on consumer spending.

If you apply this fear factor across different sectors, like travel and tourism, the survey results are very worrying indeed. It also explains why the parent company of British Airways, IAG (International Airlines Group), announced large scale job cuts and warnings that their business is unlikely to recover to 2019 levels for several years. Virgin Atlantic announced this week over 3,000 job cuts and the end of its operations from London Gatwick. When news breaks that household brands are in trouble the fear factor with the public is simply magnified.

If any economy is to restart, the mobility of its workers being able to get to work is essential. The rail unions and rail companies have confirmed that in order to keep to the strict social distancing, they are only able to provide 15% of the normal daily capacity, compared to before the crisis began. Signs that the lockdown measures were being less observed than a few weeks ago have been demonstrated by our roads becoming busier and a far cry from the emptiness at the start of lockdown. However, those workers who have been able to work from home are unlikely to return to the daily commute anytime soon. Many companies may re-evaluate their business model and look to reduce costs by keeping many of their employees working from home.

The Government have confirmed that over 6 million workers are having 80% of their wages paid by the furlough scheme until the end of June. In addition, nearly 2 million have applied for welfare since the crisis began. Unemployment rates in the US have sky rocketed and may reach the 1930's depression levels within weeks. All of the forecasts vary, but all agree, the economic shock is going to be severe on almost every measure.

Market conditions

If we revisit the fear factor, history tells us that markets fear uncertainty the most, often triggered by geo-political flash points like wars or unexpected surprises. When it is hard to be sure about what might unfold politically or economically investors' appetite for greed diminishes and fear takes over. As yet, despite some record breaking economic numbers and with probably more to follow, markets appear to remain convinced that the lifting of lockdowns and the massive financial interventions will provide a "floor" to the value of assets, with technology stocks tipped to gain the most in the "new normal" as consumers do more business online and also the take up of the various online communication tools has expanded rapidly. Despite a small sell off in stocks at the end of last week, markets were driven higher on 5 May, optimistic that the end of lockdowns across the globe indicated the start of what they hope will be a sharp recovery in demand helping to achieve the "V" shaped recovery most investors crave.

The prospect of the world lifting restrictions has also helped the price of oil recover sharply from recent record breaking lows. This will not prevent many oil producers having to "turn off the taps" until the oil over supply subsides. Storage facilities remain nearly full and production cuts are insufficient to meet the cut in demand. Once this imbalance is addressed, the price of oil is likely to recover later this year, but the outlook remains uncertain.

Other asset classes remain unclear as to their potential future value. Assessments of company balance sheets in many sectors will not be fully known for a few weeks as the rating agencies are likely to downgrade a sizeable proportion of corporate debt in the process, as many sectors look to central bank and government safety nets to survive.

Find out more

Read our latest **A Month in the Markets** by Portfolio Manager, John Mullins, for his full review of March and his outlook for markets as we continue to navigate the volatile climate during COVID-19 here.

Note: Data as at 5 May 2020.