State of play

14 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 look at Prime Minister Boris Johnson's strategy on lifting lockdown, alongside some of the economic data that is starting to emerge and what this shows us."

COVID-19: An update

In his speech to the nation last Sunday evening, the Prime Minister outlined the governments intended steps to take the country back to work and, where possible, back to somewhere near normal life. As he explained the conditional measures that would have to be met at each stage, it highlighted the challenge faced by those in power, both here and elsewhere, in striking the fine balance between saving lives and breathing life back into the economy.

Unlimited exercise and an encouragement to return to work where possible were set against the social distancing that will remain until a vaccine or successful treatment are found. The rail network remains restricted to just 10-15% capacity to adhere to the 2 metre rule which makes it impossible for all those who commute by train to get to work, unless they are keen to become cyclists or battle the likely spike in traffic. In addition, guidance was issued in a 50 page document outlining the rules and advice required for employers to be able to reopen and protect their employees whilst continuing to supress the virus - with the government urging companies and individuals to apply common sense.

Additional timescales were shared about the earliest dates that each phase would commence and what each phase might entail. Every suggestion was subject to review, with warnings about returning to lockdown if any spikes in infection occurred and how regional differences may be applied if pockets of infection emerged. Schools were included in this phased plan, however this was met with angry reactions from teaching unions who were surprised that younger year groups would be first to go back, given the practicalities of managing young children and maintaining the necessary social distancing required to keep them and their families safe.

Lastly, the plan included the quarantine of individuals flying into the UK for a minimum of 14 days, as well as temperature checks and other potential measures on arrival. Again, strong reactions appeared on social media regarding the hundreds and thousands who have been landing from overseas since this crisis began back in February – without even a temperate check as they passed through passport control. Although a special arrangement has been agreed with France, this new measure represents a sharp change in direction. This prompted a u-turn by International Airlines Group, parent company of British Airways, who had planned to increase flights from July, but have now confirmed, following the introduction of quarantine, that this would now be impossible.

The Prime Minister's plans were in stark contrast to the messages from Scotland, Wales and Northern Ireland, making the plan specific to England and therefore creating confusion. Nicola Sturgeon, Scotland's First Minister, rejected Westminster's approach robustly, arguing that it was too early to change the plan or the slogan, sticking with the "Stay at Home" message for now.

A very gradual lifting of restrictions is understandable given the stories from China, South Korea and Germany, where the easing of lockdowns has prompted a spike in new cases. In Germany, Chancellor Angela Merkel urged individuals to follow the rules, as the weekend saw Germany's infection rate rise from 0.83 to 1.3 in just four days. As you know from my blog two weeks ago, once the infection rate rises above 1, the virus is growing and spreading. The higher the infection rate, the faster the spread. There is also up to a 14 day delay in infection rates being affected, so this spike is before the easing of restrictions commenced.

In contrast to the UK plan, Germany announced last week that it would reopen most aspects of its economy and allow all students back in the coming weeks. Class sizes have been cut in half with hallways set up with one-way systems and break times will be staggered. Students are told to dress warmly to allow for windows and doors to be kept open for air circulation, whilst both teachers and students have been told to wear face masks. Germany decided to allow older children back to school first because they felt they are better able to comply with rules on masks and social distancing. The UK and other countries are watching with interest, keen to learn from others.

Economic impacts and response measures

Chancellor of the Exchequer, Rishi Sunak, announced an extension to the furlough scheme until the end of October, maintain the 80% level of wages for employees placed on the scheme. In a sign of wanting to encourage companies to put their staff to work, the government stated that if companies restarted their businesses on a gradual basis, the government would cover the gap between part-time hours worked and normal full time output. There are now 7.5 million workers being paid by the national purse, with 1 million businesses being supported.

This announcement was shortly followed by the release of figures showing the largest month-on-month fall in the UK gross domestic product figures since records began with a contraction of 5.8% in March. The economy shrank by 2% over the first quarter, the worst since the final quarter of 2008 - during the middle of the financial crisis. Given these figures only include the first week of the lockdown, it is a stark reminder that worse is yet to come. The Bank of England has predicted the biggest economic slump in 300 years.

A leaked internal document published in the Daily Telegraph gave stark warnings from the Treasury about economic news becoming very grim indeed. They (the Treasury) have revised the likely borrowing by the UK with a "base case" scenario of a budget deficit (difference between the UK income and spending) of £337 billion compared with the original £55 billion published in the March budget. The guidance included a "toe-curling" possible "L-shaped economic decline" seeing the deficit rise to £516 billion in the current financial year (April 2020 – April 2021) possibly reaching a cumulative £1.19 trillion over the next five years. This is caused by a much sharper contraction of 21% after lockdowns were imposed (this is not a typo: 21%). In response to these potential outcomes the document outlines a proposed package of significant tax rises of approximately 5 pence on income tax coupled with pay freezes and an end to the triple lock on state pensions.

According to insurance giant Legal & General in a recent survey it conducted alongside Economics Consultancy CEBR, the virus outbreak and subsequent lockdown has changed the way the public spend their time and money compared to before the outbreak. Whilst adults in lockdown are spending approximately £250 million a week extra on food, alcohol, entertainment and indoor hobbies, it fell well short of the overall spending reduction in the wider economy.

The research comprised of a study of more than 2,000 adults aged between 35 and 54. It showed a significant shift in spending habits with 24% decrease on takeaways, 9% less on tobacco and 14% less on fitness, reflecting the closure of gyms and health clubs. As you would expect there was a small increase of 6% on alcohol and 5% on streaming services. The survey also asked adults how their daily habits had changed, revealing that they now spend an additional two

hours and 22 minutes watching TV and playing video games and another two hours socialising on digital platforms such as Zoom.

In addition, people said they spent an average of 20 more minutes each week exercising and an hour on hobbies, such as baking bread. Whilst this increased spending at home is understandable after being asked to "Stay at Home", this is dwarfed by £17.9 billion less spent per month in other parts of the economy, shining a light on how severe the financial impact could prove to be over the weeks and months ahead.

Market conditions

Stock markets stalled following the bank holiday weekend. After a strong relief rally since the end of March lows, markets are concerned by fresh COVID-19 outbreaks in China and South Korea and the escalating tension between the US and China. The angry exchanges have the potential to undo the first phase of the trade agreement which was reached at the end of 2019. Added to these concerns are the worsening economic news, driven by unemployment figures in the US and the size of the furlough scheme in the UK.

The one underlying positive for investors is the "whatever it takes" attitude of governments and central banks around the world. Markets are looking to the next round of announcements, eyeing a longer-term intervention from the European Central Bank and the potential for further interventions from the Federal Reserve in the US.

Further corporate earnings numbers have been received by markets with caution as some of the numbers reflect a period before the crisis and the lockdowns, and are yet to show the true impact on company revenues until much later in the summer.

One aspect in particular which has hit investors hard is companies suspending or cutting their dividends. Most corporations are preparing for their revenues and profits to take a sizable hit over the next few months because of the lockdowns, and are choosing to hold back the cash from dividends to support their businesses through this crisis. A large amount of money is invested in these high yielding stocks including small investors, equity income funds and multi asset income funds which are used to generate income for clients.

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 13 May 2020.

Important Information