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State of Play

2 December 2021

Our Investment Specialist, Simon Durling, shares his thoughts in our latest update. When the COVID-19 virus emerged in early 2020 the race against time to develop vaccines began. As the virus has mutated different strains have accelerated the spread with the latest variant, 'Omicron', spooking investment markets. State of Play looks at the threat posed and the subsequent market reaction to the news.

Omicron variant identified

Whilst a full-blown lockdown is not expected at this point following the discovery of a new COVID-19 variant called 'Omicron', the change in stance by the UK Government to re-impose mask wearing in shops and on public transport provided a timely reminder that this virus is not yet defeated. The success of the vaccines preventing serious illness and death have so far been above 90% in efficacy, helping to protect the NHS. However, after scientists in South Africa identified this new strain, concerns have been raised by the World Health Organisation and some drugs companies, including one of the COVID-19 vaccine producers, Moderna, that this new variant represents a real threat. Although it is clear that the experts aren't yet certain of the threat that the new variant poses given that Professor Andrew Pollard, the Director of the Oxford Vaccine Group said that 'existing vaccines should work against the new strain, but that would only become apparent after more research in the coming weeks.'

In response, the UK, in addition to the re-introduction of mask wearing, has also changed travel rules requiring arrivals to take a PCR test on day two and to isolate until a negative test result is received. In addition, several countries in Southern Africa have been placed on the 'red' travel list. So far mask wearing has been restricted to shops, public transport, banks, and hairdressers. Gyms, pubs, and restaurants along with other hospitality venues are not having mask rules reintroduced as the UK Government is concerned about the possible economic consequences for a sector already the hardest hit by lockdowns and restrictions imposed in the last 18 months.

What is the potential threat?

Initial analysis in South Africa on the Omicron variant displayed 50 mutations - by comparison the Delta variant, which spread quickly across the world in the spring, had 13. So, why is the new variant potentially such a threat? Firstly, vaccines which were developed on the original Wuhan virus may not offer the same degree of protection. Secondly, whilst the Delta variant had two mutations which were linked with the part of the protein that attaches to human cells making it more infectious and able to spread, the new Omicron has 10. If this does indeed make this virus more transmissible policy makers around the world will be concerned that approaching winter and Christmas, a time when socialising with friends and families is at its highest, that the next wave of infections could place enormous pressure on health services.

So far, the findings in South Africa are those infected with the new variant have shown only mild symptoms and no evidence yet has emerged that this could be worse than the Delta strain. However, given it was only found two weeks ago, the limited data thus far means any meaningful conclusions are impossible at this stage. Some have accused the government here and elsewhere of overreacting and panic as they do not know the extent of the threat the new strain poses. However, those in power will be mindful of past events and decisions, which in hindsight if they had been made earlier, may have reduced the levels of infections and loss of life.

Once tests and analysis have been carried out over the next 2-3 weeks scientists may have a better understanding of how the variant reacts and spreads, and whether it is indeed mild symptoms only. More importantly for the UK, where vaccination rates are high, the effectiveness of the vaccines to the new strain will be vital in understanding whether it is three steps forward followed by two steps back. The vaccine makers have committed to trying to adapt existing jabs to help protect against new strains, whilst these may not take as long as the original vaccines, it will still require significant work to arrive at a finished product and yet again, will be a race against time.

Market reaction

After recovering strongly from the pandemic sell-off last spring, investment markets demonstrated how fragile sentiment is as the FTSE 100, the Index of leading shares in the UK, suffered its worst day in 18 months falling by 266 points/3.6% in just one day. Sectors worst affected in the first lockdowns like travel, tourism and hospitality were again hit hard with double-digit falls and with oil prices plummeting, oil and energy companies were also affected. At the start of this week investors paused for breath as the leading indices rose before falling again on Tuesday. Market volatility looks set to remain until more information is known about the real threat of the new variant and the effectiveness of vaccines.

Warnings over the risks posed by the COVID-19 Omicron variant by the Chairman of the Federal Reserve, Jerome Powell, also cautioned that inflation could persist 'well into next year'. He also acknowledged that inflation pressure couldn't be ignored indicating that the financial support currently in place would be finished sooner than planned saying; 'The rise in cases and emergence of the Omicron variant pose downside risks to employment and economic activity and increased uncertainty for inflation. Greater concerns about the virus could reduce people's willingness to work in person, which would slow progress in the labour market and intensify supply chain disruptions.' Investors also saw this as a sign that interest rates in the US could rise sooner than first thought in response to the highest inflation in 30 years.

Whilst new COVID-19 restrictions announced by the Prime Minister to tackle the new variant are unlikely to derail the economy like last year, they could trigger another 'pingdemic' where workers must isolate at home after testing positive for Omicron leading to staff shortages. The financial impact, whilst not significant, will slow the economy and soften the momentum. The Institute of Economic Affairs thinks that while making face masks compulsory again in shops and public transport stops short of being 'a game-changer', the tightening of self-isolation rules will disrupt schools and businesses in the weeks leading up to Christmas.

The other immediate problem is a loss of consumer confidence. Whilst hospitality has avoided the need for customers to wear face coverings so far, many owners of restaurants and venues have received multiple cancellations in the wake of the news of the new strain hitting a sector that barely survived the impact of closing for months on end. The same worry exists for travel companies and airlines. Again, whilst travel is allowed to the majority of the world, additional travel requirements and rules dent the attraction of staying in hotels or flying abroad for some fun and sunshine. No doubt many will jump through these extra administrative hoops, but even if a small minority choose to sit tight this could have financial consequences. Staff shortages, higher fuel costs, and supply issues become irrelevant if you have no customers to serve.

Find out more!

Listen **here** to our latest Market Views from Stefano Amato, Head of Multi-Asset Solutions UK, as he shares his thoughts on the main themes dominating markets.

Note: Data as at 30 November 2021.

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