



Rathbones
Look forward

Review of the Week

4 May 2020

Victory is coming

This Friday we remember the victory of an older generation. They won peace and reshaped the world, becoming a timeless example for humanity, argues our chief investment officer Julian Chillingworth.

How many of you forgot to log on to work this morning?

Moving the Early May Bank Holiday to Friday the 8th in honour of VE Day no doubt caught out more than a few people. These days the weekends seem to blend into the weeks and vice versa, and that's before you start playing switcheroo with holidays.

It's a nice idea though: it always seems odd that the UK's holidays seem to celebrate banks and nothing else. Other countries' long weekends seem to have more meaning. Bastille Day in France celebrates the overthrow of a rapacious monarchy. Labor Day Weekend in the States celebrates the working man. Waitangi Day in New Zealand honours the birth of a nation. In England, we simply note the banks are closed for the day. This year, however, we have something to reflect on over the long weekend.

As GDP numbers suggest we're headed for the worst recession since World War II, it's proper to think about that time. To try to imagine what it must have been like to live through such cataclysm and eventual redemption. And what it would have meant for your life and your outlook. How it would have forged or profoundly altered your sense of identity. It's a good time to ponder what effects the war had on that generation and how it shaped the post-war society they built. It's a good time to remember that terrible war, to remember that all things pass, that there is hope. And to remember just how lucky we are: except for a few old heroes, none of us have had to experience total war. Most of us haven't known impoverishment anywhere near that of the decades that followed it, either.

This pandemic has turned our world upside-down, but it hasn't torn it asunder. We live in an age where isolating ourselves doesn't prevent us from seeing our friends and loved ones, where a good portion of commerce and entertainment can continue digitally. In the 21st century,

we live our lives in two planes. And while that comes with its problems and vices, it also means that our worlds haven't shrunk as much as you would expect because the digital realm can compensate for the real: TV, music, lectures, language lessons, tools to chat with people worldwide. Can you imagine how isolated we would feel without access to any of these marvels? How much more disastrous this would have been on our psyches and the global economy if the internet and all that piggy-backs off it were not there?

You don't have to be that old to remember life without mobiles and computers. It's easy to be nostalgic for those days that seemed less frantic, when people were less distracted and more present. But the pandemic reminds us of the awesome power these technologies have given to us all. To check up on each other instantly, in perfect clarity; to keep businesses, small and large, running despite a nationwide lockdown; to stay supplied, even if we're immobile.

All this isn't to say that times aren't tough right now. The virus has brought grief and hardship to many. It has hit our way of life and therefore our sense of identity. This Friday, when we commemorate the gritty and sturdy valour of a past generation, we should remember also those who are fighting for us today. The people working long, dangerous hours caring for our elderly and our sick. For all of us, trying in our own small ways, to look out for each other and get through this awful period of our lives. **And we should reflect on the future, and the society that we will build once we've beaten this virus.**

Hostage to fortune

Stock markets had a wobble on Friday, as investors began to worry that valuations were looking stretched after a strong upward march.

Even if you assume the most optimistic forecasts for company profits in 2021 - if you assume that businesses can quickly shrug off the effects of lockdown economics and get back to 2019 levels of income - stocks were still looking pretty well valued. For the past couple of weeks, we've felt that the level of optimism implied by stock

markets was straying toward naïve. Markets may well hit considerably lower levels in the coming months. Most company analysts are pretending this year doesn't exist, which is a reasonable idea. No-one knows how long the pandemic will dampen household spending and business production. Most companies have access to government support, either through cheap loans from central banks, or wage subsidies and bail-outs from exchequers. This should help all but the most indebted and inopportune industries survive. But how quick will the snapback to production and spending be? We feel like expecting such a deep and prolonged disruption to be washed away in less than a year is perhaps too optimistic.

Economic data continues to be terrible, as we warned a while back. This isn't a particular shock to us. Most of the world has been shut down for a month or more. Terrible news like US GDP falling 4.8% in the first quarter - and that it may eventually be revised to an 8.3% drop - shouldn't shock, even though it only accounts for two weeks of the American lockdown. This is an unprecedented shutdown of societies the world over.

We believe there are other factors that will be as important for determining the path of markets as they are difficult to analyse. First and foremost, governments can proclaim the end of a lockdown, but that doesn't necessarily mean that people and businesses will swarm out of their homes like bees in summertime. Some will, but others may be more cautious. How much of an effect this will have on the general economy - and how long the reluctance to fully return to 'normal life' will last is anyone's guess. We think it will have some effect, however, and the effect will only worsen if lockdowns are relaxed too early resulting in secondary waves of infection.

Several US states have decided to forge ahead with reopening their economies. Let's hope it's not the unsettling experiment it appears. Meanwhile, American Secretary of State Mike Pompeo's accusation that China has covered up the true origin of the virus could mean

an escalation in the US-China trade war overshadowed by the COVID-19 pandemic. Mr Pompeo says a CIA report gives "enormous evidence" that the virus was inadvertently leaked from a Wuhan biological laboratory. While the CIA itself says its findings about the origin remain inconclusive. China will be incensed by this ratcheting up of rhetoric. Not exactly what you want in an economic crisis.

Meanwhile, back in the UK, the Bank of England's policy committee meets on Thursday to discuss monetary policy action. Investors expect the announcement of another round of quantitative easing (QE) to support bond markets, possibly as much as £200 billion. QE is when a central bank creates money and then uses it to buy bonds from investors in the open market over many months. This has two effects: first, it increases the amount of cash in the economy as investors exchange their bonds for money, helping companies in the financial system pay and receive debts. **Second, buying bonds in such large amounts and for a lengthy period increases** the demand for bonds and makes them more expensive. Because bonds pay their holders fixed amounts, when their price goes up the yield (income payments divided by the price) goes down.

Why would central banks do this? Investors think in terms of bond yields, yet companies and governments think in terms of borrowing costs - bond yields are the market-based measure of borrowing costs. By lowering bond yields, the central bank makes it easier for governments and companies to borrow money.

With the cost of the pandemic skyrocketing, the government will have to issue many more bonds (borrow money) in order to pay for its support packages. The BoE and the Chancellor may be worried that investors won't be able to buy enough of the new government bonds, which would make their price drop. That would mean a rise in yields and, therefore, higher borrowing costs for the government.

Julian Chillingworth
Chief Investment Officer, Rathbones



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