INVESTMENT REVIEW – June 2020

The month of May saw equity markets mostly make a further recovery from the sharp set-backs that the coronavirus Covid-19 had brought on. Investors found encouragement in indications that the virus was running its course and that the lock-downs would continue to ease. As important was the substantial support from central banks and governments which has provided the liquidity and safety that could tide the world over the short-term pressures on corporate earnings and global trade.

The human cost of the virus has mounted around the world, with the data from the Johns Hopkins centre showing total confirmed cases up from 3.25m to 6.17m over the month while the number of reported deaths stood at 372,099 compared to 233,405 as of the end of April, although it is perhaps only by comparing excess deaths against expected mortality rates that the full impact will be clear. While there are still areas of concern, either in specific countries such as Brazil or on the efficiency of testing, the improving trends have allowed governments around the world to start to lift the restrictions they had imposed to contain the pandemic. The pace at which the easing takes place will vary as will the speed at which economic life returns to normal, or near normal, or a new normal, which seems most likely. Confidence in global scientific endeavour on testing, treatment and vaccines runs up against worries over the possibility of a second wave of infection and over the elusive nature of such viruses.

Another factor has been the impact on wider health issues of the virus, both in the limited availability or take-up of standard medical treatment and in the debilitating effect of worsening economic life for many. This has shown most sharply in job numbers: in the US more than 40m people have filed for first-time benefits and one in four workers have filed for unemployment insurance; in the UK the claims for benefits rose to 2.1m while a survey indicated that one in five employers planned to make redundancies over the next three months There has been no doubt about the sharp decline in output and consumption: in Japan GDP declined 3.4% in the first quarter when only the month of March fully reflected the lock-down, and that followed a drop of 7.3% in the last quarter of 2019; in China, where the economy contracted by 6.8% in the first quarter, the authorities have now decided to abandon a target for growth, which might bring a more sustainable approach (and their data was often treated with disdain); and in the UK retail sales were down 18% - although the shift in the proportion online at 31% as against 19% a year earlier represents a longer-term trend as well as more immediate issues.

As economies have declined it has fallen to central banks and governments to maintain and to increase their efforts to support businesses and to provide liquidity. In India, for example, there is a support package equivalent in size to the country's annual tax receipts before the crisis and to some 10% of the size of the economy. The European Central Bank is meanwhile ready to add to its €750bn stimulus programme of bond purchases. Germany's constitutional court cast doubt on the legality of the ECB's bond-buying (and perhaps on the whole future of the eurozone) and it was concerns over EU cohesion that prompted the chancellor Angela Merkel to join President Emmanuel Macron of France in a new proposal for a €500bn recovery fund that would disburse grants not loans to provide support to member states. This has met resistance from the 'frugal four' of Austria, Denmark, the Netherlands and Sweden but seems likely to proceed if on a revised basis, as would a further $3tn economic relief bill in the US which stalled in the Senate. Debt levels continue to mount, and can yet bring inflationary pressure even if a deflationary depression appears the greater threat.

Tension remains high in the US, where the crisis has compounded inequality, and in Hong Kong over new scurity laws. It was the strained relationship between the two dominant economic powers that caused some volatility in markets in the month, and this is unlikely to dissipate ahead of the US presidential elections in November. The World Trade Organisation has forecast that the volumes of merchandise trade could decline by between 13% and 32% in 2020 and could take some time to recover, as growth had already become relatively stagnant. Trade wars and a dislocation to global supply chains might squeeze the margins of companies, many of which have seen a sizeable fall in earnings and which have cut dividends to conserve cash; a Schroders study suggested that there has been a 20% drop in dividends just six times in the last 150 years compared to sixteen for total returns, but that such bear markets last longer, with a median duration 3.5 years against 1.3 years for prices.

In the UK the FTSE 100 rose by 3% over May to end at a level of 6077. The mid-sized companies in the FTSE 250 index rose 3.6% in the month and the FTSE SmallCap index gained 3.9%, while the FTSE AIM All-Share bounced further with a rise of 8%. The FTSE All-Share return including income was 3.4% in the period.

In the US the S&P 500 rose by 4.5% in May, helped by the strength in technology shares which saw the NASDAQ index gain 6.8%, so as to be now up nearly 6% for the year to date. There has been an understandable boost to many technology businesses from the crisis which has accelerated trends in business practice although the re-rating of the sector has left valuations looking ambitious. The Dow Jones Industrial index, more concentrated, gained 4.3% and smaller companies, as represented by the Russell 2000 index, were 6.4% higher.

In Europe the EURO STOXX 50 rose by 4.2% in the month, with the German market doing best of the major indices, while the Euromoney index of smaller companies gained 9.8%. In Japan the Nikkei 225 index rose 8.3%.

The MSCI Emerging Markets index in US$ only improved by a modest 0.6% in the month; the main Indian index fell and the Shanghai index was more subdued, while the Hang Seng index in Hong Kong was down 6.8% given the problems there. The MSCI Frontier Markets index was 5.4% higher, with the Vietnamese index gaining a further 12.4%.

In the bond markets the UK 10-year gilt yield dropped again from 0.23% to 0.18% and the total return for the FTSE Gilts All Stocks index was a tiny 0.04% in the month. In the US the 10-year yield was little changed as it moved from 0.64% to 0.65%, while in Europe yields fell in Italy but the 10-year bund in Germany was less negative at -0.49% as against -0.59%. The month saw positive returns from UK index-linked gilts as well as high-yield and emerging market debt given the shift in perceptions of risk.

Sterling weakened by 2% against the US$ over the month to close at a rate of $1.23:£ and it was 3.3% lower against the euro at €1.11:£, in part as the trade deal with the EU has yet to make progress. The price of gold ended the period up a further 2.6% at $1730 per troy ounce, showing its defensive attraction even as markets rallied given the concerns over inflation. The price of Brent oil rallied sharply and closed up 55% over the month at $37 per barrel, if still nearly half its level at the start of the year. The main metals were mostly higher and silver shone, while agricultural commodities were mixed and have been weak this year. The Vix index gauge of expected volatility in the US market fell by nearly a fifth in the month.

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