NEW IRELAND
Securing your future

COVID-19 Market Update

May 2020

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"No winter lasts forever, no spring skips its turn." – Hal Borland

When learning how to perform a hill start in your car, you get familiar with the concept of the biting point – releasing the clutch and pressing the accelerator in sequence, just to the point when the engine releases and you move onwards and upwards. If you are a learner, you might cut out a few times and there may be a few coughs and splutters in the process. As you get everything in sync, you start to take off more smoothly and then build up a head of steam. We believe that this is a good metaphor for where we are in investment markets.

COVID-19 hits the markets as oil plummets...

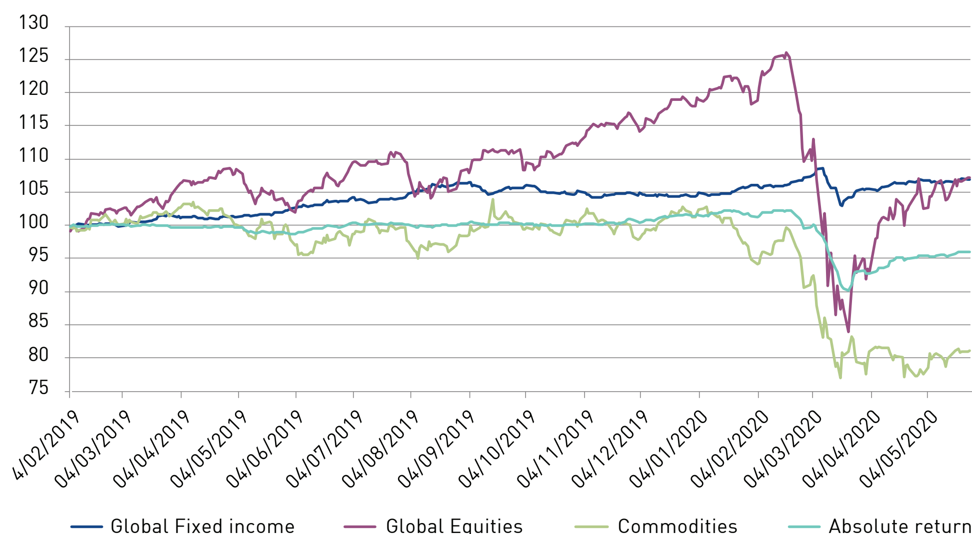
Investors have experienced a rollercoaster ride since the middle of February. The sharpest sell off in US equity market history, with risk assets plummeting in value, was followed by a flight to quality, particularly benefiting safe haven assets such as long dated government bonds. At the same time, the world's major oil producers failed to agree appropriate production levels and supply increased at a time when demand was plummeting. In response, oil prices spiralled lower.

Central Banks intervene at unprecedented levels...

We then witnessed the announcement of the largest level of State and Central Bank intervention in history. Developed country governments announced multi-trillion dollar packages of cheap loans to businesses, accompanied by tax cuts and major state investment programs. Markets took confidence that those in charge would do whatever it takes to arrest the declines and to get the global economy back on an even keel.

The rebound was almost as sharp as the sell-off. April turned out to be the best month in equity markets for over 80 years. The chart below shows that it was by no means an even recovery, with frequent setbacks and heightened volatility remained. Back to the hill start analogy, the engine spluttered on occasion and slipped back a few times.

Year to Date Asset Class Performance



Source Bloomberg 19/05/2020

Warning: Past performance is not a reliable guide to future performance.

Commodities are goods that can be traded, bought or sold. The chart above shows this asset class dropping sharply in line with shares, primarily driven by the sharp drop in oil prices. On the other hand, gold, often considered a safe haven, reached highs not seen since 2012.

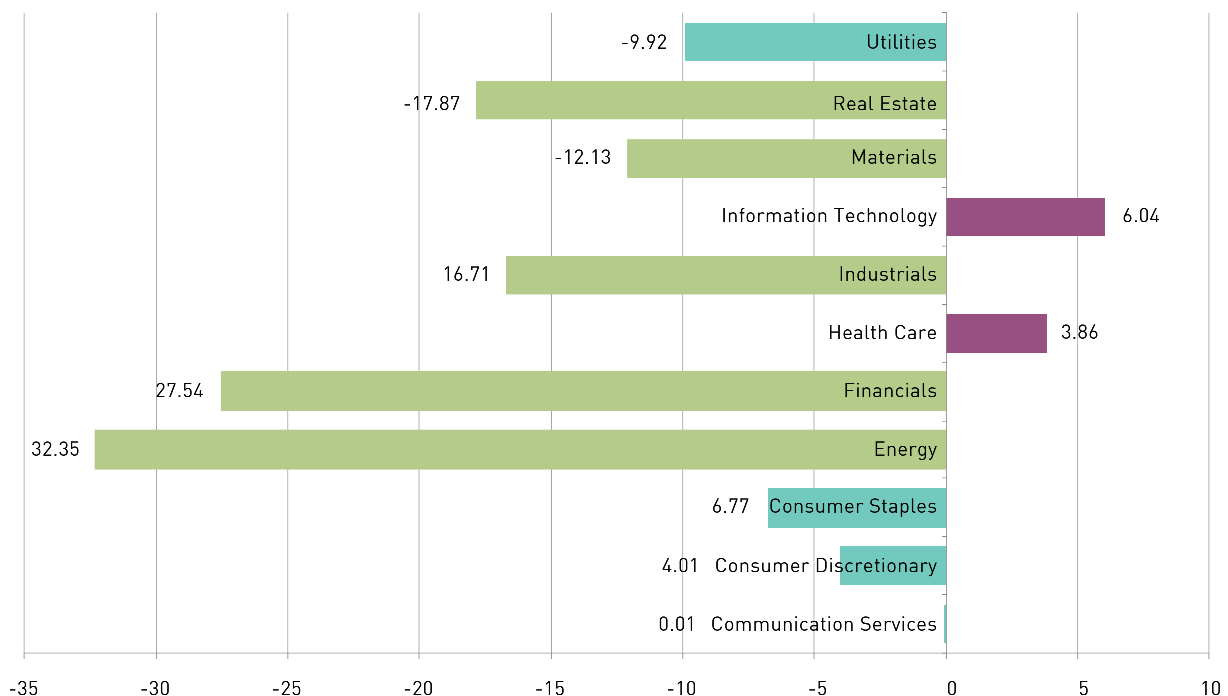
A resilient bond market...

The bond market remained very resilient throughout the crisis, again emphasising its importance in a well-diversified portfolio. Central Bank bond buying programs provided a guaranteed buyer with deep pockets, which has snapped up billions of dollars of government and corporate bonds. In response, corporates have tapped the markets by issuing record levels of new bonds at ultra-low rates.

It is not a one-speed World...

It has by no means been an even recovery. On a geographical basis, the US has rebounded sharply while European markets remain down over 20% this year. It is interesting to see who are the real winners and losers in the stock market. The chart below shows the energy sector as the hardest hit, reflecting the sharp drop in oil prices and falling demand. Financial shares across the globe struggled, as a weak economy is likely to put pressure on bank balance sheets and ultra-low interest rates will make it harder for banks to grow margins.

Unsurprisingly, the big winners were the tech sector and health care stocks. With bricks and mortar retail outlets shuttered, online retail boomed through the crisis, with some notable winners like Amazon posting 26% year on year sales growth for the first quarter of the year. Many of you have become familiar with online meeting software firm Zoom Technologies. Its recent share price surge now values it higher than the world's seven biggest airlines. In the first 3 weeks of this quarter, the NASDAQ Index is up over 20%. Typically, in a recessionary environment, we see defensive stocks like utilities and consumer staples come to the fore. In this case, technology shares have taken a clear lead.



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Investors looking beyond today's earnings...

We have seen earnings reported by most quoted companies in the US for the first quarter. Given that the COVID-19 crisis struck half way through the quarter, the results do not reflect the full brunt of the shutdown. We are likely to see the full impact in the quarter 2 earnings season, when analysts predict earnings to be 41% lower than the previous year.

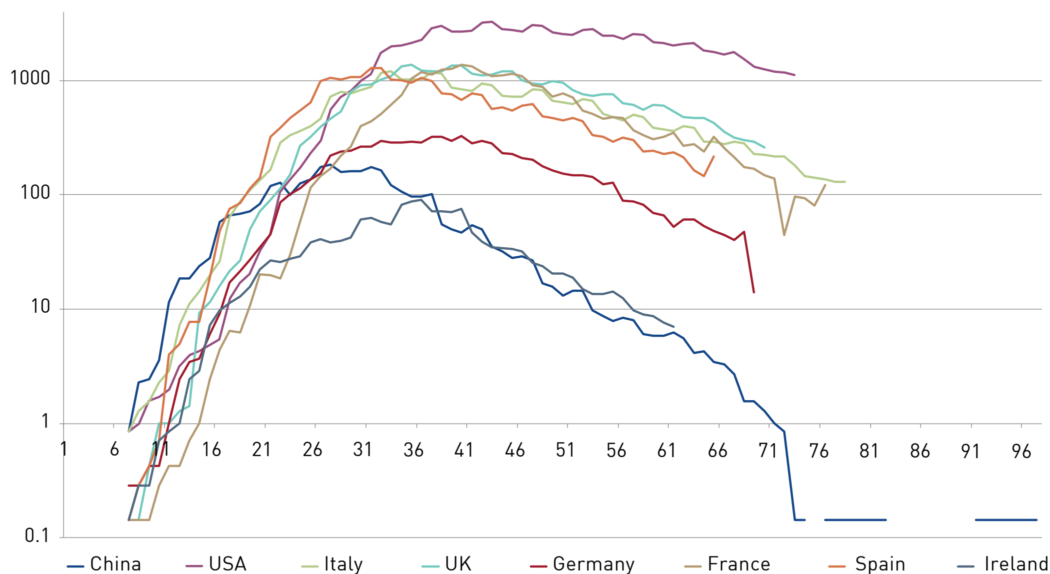
The economic data has been dreadful and really captures the extent of the crisis. The US announced job losses of over 20 million in one month. Consumer confidence has taken a real dent and by any measure, businesses are nervous and are retrenching.

However, stock markets focus less on what happened yesterday and are anticipating what they expect to see in the future. They expect massive Central Bank and government policy measures to take effect, leading to improved business and consumer confidence, a return in demand and stronger consumer confidence. This is predicted to play out in the second half of this year, into 2021 with estimates of US earnings to grow by over 25% next year.

So with all of this negativity, what have been the main pillars of the market recovery?

First and foremost, the February/March sell-off was based on a healthcare crisis. For markets to calm, we needed to see evidence that the authorities were getting to grips with the disease. Strict lockdown measures halted the spread of COVID 19 as demonstrated by the chart below:

7 day rolling average of fatalities



Source: Capital Economics Bloomberg 12/5/2020

The next recovery trigger was seeing the world reopening, but at the right pace. In recent weeks, we have seen announcements of construction restarting, retail outlets getting ready to open their doors and industry slowly cranking up. The key here is the balance between getting the economy back up and running, and not doing so too quickly that we would see a second wave of illness emerging.

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While we are absorbing dire economic data about joblessness, economic slowdown and consumer confidence, markets are looking ahead to what will come next. They are looking to recovery in the second half of the year with an improved corporate earnings picture in 2021.

There is a well-known phrase in investment circles "don't fight the Fed." It refers to the folly of taking a stance counter to the direction of the US Federal Reserve, their Central Bank. Monetary authorities across the globe, including the Fed, have taken concerted action to stimulate economies through interest rate cuts and massive bond buying programs. While these steps may take some time to take effect, stock markets are taking confidence that they will ultimately lead to recovery.

EU countries are finalising another wave of economic supports for business. A North-South debate is taking place about the form of those supports, whether they should consist of loans or grants. A big question to follow will be what the French and German governments will want in return?

So, if you thought our metaphoric car was going to smoothly take-off up the hill, along came some challenges that seemed from a distant past. President Trump claimed that the COVID-19 virus came from a lab in Wuhan Province and that China should be punished for this. He also moved to prevent the Chinese tech firm Huawei from manufacturing and purchasing American-made semiconductor chips, which would damage the company's major expansion plans. The US-China trade deal, made earlier this year, included an agreement that China would purchase $200 billion in US goods and services this year and next year. It looks almost impossible for these stretching targets to be met, particularly following the lockdown in recent months. It is likely that trade tensions will increase during the summer, particularly given that the US presidential election is less than six months away.

While we have all been absorbed with events surrounding the COVID-19 Crisis, Brexit talks continued between UK and EU representatives. All reports suggest that the talks have gone badly so far and that it is unlikely that the UK will seek an extension to current arrangements beyond the end of the year. In the event of a no-deal exit, we could see both blocs fall back on the World Trade Organisation's most favoured nation status with tariffs, for example, on foodstuffs such as beef and cheese at 40% or more. Such additional disruption to trade in an already challenged economic environment could damage any fragile recovery.

We are living in extraordinary times with a heightened level of uncertainty. Interpreting wildly fluctuating economic data and company earnings is by no means straightforward in this environment. We can expect some negative surprises that will cause us to slip back, but we believe that the scale of financial support from governments and Central Banks should prevent the global economy from slipping back so far that it gives up all of its recent gains. Growth is likely to be muted but with interest rates likely to remain low for a very long time, investors are looking to a recovery albeit with some speedbumps along the way.

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