So, where now?

And just like that, we are six months into 2020. And what a year it has been so far! When we penned our thoughts for the year, back in January, some of the key factors that we thought would shape the course of financial markets for the years ahead were continued low energy costs, large scale fiscal spending, the direction of US-China trade wars, the main stream embracing sustainable investing more widely and Trump's re-election for a second term in office.

Who would have thought then that a deadly virus would claim so many lives and send the world into a complete lockdown with economic activity coming to a near standstill. Financial markets in March witnessed one of the sharpest drawdowns in living memory. The ferocity and speed of the sell-off meant it was worse than any stock market fall since the South Sea Bubble in 1720. Subsequently financial markets have rallied as lockdowns have eased across the globe and we all grapple with restoring some sort of normality. At the time of writing most financial markets are largely back to where they were at the beginning of this year.

S&P 500 daily drawdown profile YTD

Top 10 S&P 500 peak to trough drawdowns since 1920

	Name	From	Trough	Drawdown	Time to trough (months)	Recovery (months)
1	Great Depression	Sep–29	Jun–32	-86.1%	34	267
2	World War II	Feb–37	Apr–42	-57.6%	62	45
3	Global Financial Crisis	Oct–07	Mar–09	-56.8%	17	34
4	Tech Bubble	Mar–00	Oct–02	-49.2%	25	56
5	OPEC Crisis/Watergate Scandal	Jan–73	Oct–74	-48.2%	21	70
6	Vietnam War	Dec–68	May–70	-36.1%	19	23
7	**Coronavirus Pandemic**	**Feb–20**	**Mar–20**	**-33.8%**	**1**	**?**
8	Black Monday Crash	Aug–87	Dec–87	-33.5%	3	20
9	Post WWII Inventory Recession	May–46	Jun–49	-29.6%	37	31
10	Cuban Missile Crisis	Dec–61	Jun–62	-28.0%	6	14

Source: Bloomberg, CapitalSpectator.com. Data correct as at end 31 May 2020. All performance figures are in USD. Coronavirus Pandemic peak to trough drawdown was from 20 February to 23 March 2020. Recovery period between 23 March 2020 and 31 May 2020.

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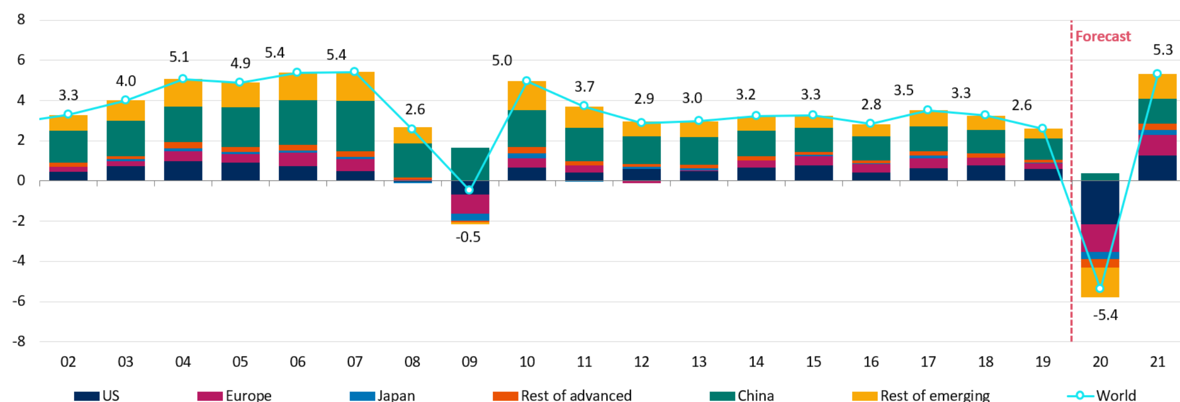
A company's share price is really a reflection of all its future earnings and this is exactly what we saw – most of the bad news was captured by markets before we entered April as investors anticipated the economic slump before it had even been realised. It is for the same reason that they have also captured the recovery, hence the share price rebound that has followed. We talked to three different asset managers, we work closely with, on issues we think will have a bearing on the course of financial markets. Below are some of the highlights from our discussions.

Q. A QUESTION WEIGHING ON EVERYONE'S MIND IS WHETHER WE WILL SEE A SECOND WAVE OF THIS VIRUS AND WILL IT RESULT IN THE INTRODUCTION OF ANOTHER PERIOD OF LOCKDOWN. WHAT DO YOU THINK THE IMPACT OF THIS WOULD BE ON FINANCIAL MARKETS?

Cazenove. The impact of a "second wave" of coronavirus cases is likely to be meaningful but not to the same degree as we saw between February and March, mainly because the drop in economic activity would be less from the current state of partial reopening rather than full or close to full production levels. On top of this, government and central bank support programs which will still be active and which have in some cases only started to be drawn down are likely to help prop up the economy and markets in such an event. The emergence of "detect and trace" technology in many countries, as well as the increased adoption of "work from home" and "consume from home" practises in many cases, should also help mitigate the negative impact.

Interest rates meanwhile are likely to stay lower for longer, although it is unlikely that they will go any lower given the negative impact on the financial system as well as the savings of the older demographic. These trends are supportive to equity and credit markets, as well as gold, whilst the return from government bonds is likely to be lower than what we have seen over the last few market cycles.



Forecasts are not guaranteed and should not be relied upon.
Source: Schroders Economics Group, 28 May 2020.

Rathbones. We believe the spectre of Covid-19 will continue to be a major dampener on investor sentiment, but the very generous support for unemployed workers in the US and furloughed workers on this side of the Atlantic should mitigate much of the economic pain for households and businesses. Most startlingly, data released in May showed that personal income for US households jumped 10% to $20.7 trillion. That is a much higher monthly figure than what was typical before the pandemic. And with nothing to spend it on, that money is flowing into savings: $6.1trn in April alone, compared with roughly $1.3trn each month before the pandemic. That is a lot of pent-up demand on Main Street.

A second leg down in equity markets remains a risk, and we believe it is premature to shift focus from the kinds of quality businesses that can emerge with growth intact from the pandemic into cheaper but more economically sensitive 'value' or 'cyclical' stocks that may continue to be vulnerable in anything but the most optimistic 'V-shaped' recovery scenario.

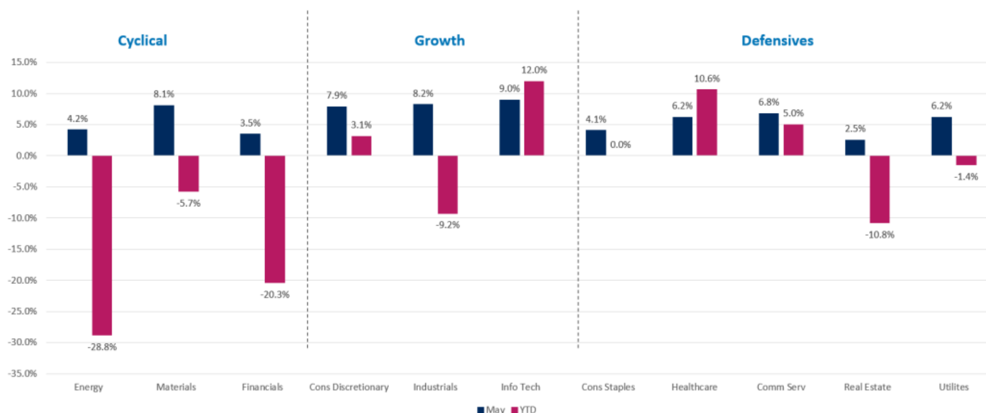
Q. AS WE EMERGE FROM THIS CRISIS WHICH SECTORS DO YOU THINK ARE WELL POSITIONED TO BENEFIT FROM CHANGES TO CONSUMER BEHAVIOUR AND WHICH DO YOU THINK ARE LIKELY TO SUFFER LASTING DAMAGE AND NEED A RADICAL OVERHAUL?

Quilter Cheviot. This crisis will probably accelerate some of the trends that have already been around for years. Concerns over climate change, consumption from home, the decline of the high street and the move towards a cashless society are some examples. Companies with products to sell for home consumption, whether it is Netflix or Disney or any company with a good online offering, would most likely stand to benefit. The 'Amazonisation' of the world will not only benefit Amazon itself but also producers of packaging for example. Payment processing businesses such as Visa would be a good example of a beneficiary of going cashless. There will probably be an even higher demand for green investments like renewable energy.

Coming out of lockdown companies in possession of strong consumer brands would probably be in a good position to benefit from the pent-up demand for consumption, whether it is sportswear companies like Adidas, JD Sports or beverage makers such as Diageo. In many ways we like the same quality companies as we did before the crisis. For obvious reasons the travel and leisure sectors will probably continue to struggle for a while. The airline industry will probably go through some significant change with no obvious winners. The cruise lines have a big mountain to climb and this is not a place to look for bargains.

Cazenove. We believe that technology and healthcare stocks will continue to lead stock markets in the coming years, with many companies in these sectors exhibiting superior earnings growth driven by secular trends which have only been accentuated by the recent pandemic. We also believe that companies generating high and robust dividend income, such as infrastructure stocks, will continue to trade at a premium in an increasingly low interest rate environment.

Finally, we see stronger growth prospects and greater pricing inefficiencies for selective companies in markets such as China A shares and US smaller companies. We have been adding to all of these themes in client portfolios in recent years. We do see some opportunities in 'bombed out' sectors, especially where financial stress is forcing consolidation in the industry and allowing the stronger to become even stronger such as energy, retail and hospitality. It can however be very difficult to identify these winners and avoid value traps.



Source : Thomson Reuters. Data to end May 2020, total return in GBP

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Q. THE HANDLING OF BOTH THE CORONAVIRUS PANDEMIC AND THE DOMESTIC CIVIL UNREST HAS MADE THE RE-ELECTION OF TRUMP LESS CERTAIN. WHAT CAN WE EXPECT IF THE DEMOCRATS WIN? WILL US-CHINA RELATIONS THAW? AND WHAT ABOUT RELATIONS WITH THE UK?

Rathbones. Our analysis of US elections suggests the economy is invariably the determining factor. If unemployment falls swiftly in the third quarter, the legacy of a strong economy in 2017-2019 could still carry Trump to victory, so Biden has a long way to run yet. If Biden were to win, the market reaction could vary depending on who he chooses as his running mate, and whether the Democrats can take the Senate. While a centrist himself, there are rumours Biden may choose to run with someone who appeals to the so-called progressive wing (read, socialist). If he sticks with a member of the establishment, such as Kamala Harris, we believe markets could have a better reaction to a Biden victory.

Biden's more redistributive policies, such as raising corporation tax, will be hard to pass if the Democrats do not control both chambers in the Capitol, and we see this as unlikely. Some strategists view Biden as the most market-positive candidate for President, given his centrist policies and the reinstitution of a rules-based system for international trade, so long as his redistributive and regulatory policies are curtailed by Congress. While he would probably maintain a hawkish stance toward China, a Biden presidency could be better for post-Brexit US-UK trade negotiations.

Quilter Cheviot. US-China relations may be fraught for some time whoever is in the White House. But Biden would work to repair the rules-based world order and that would probably mean more of talking to China and other adversaries and less China-bashing, mainly aimed at a domestic audience. Biden would also work more closely with allies on this issue and others. In that sense US-China relations are likely to become less hostile. Having said that, China's expansionist ambitions seen in Taiwan and the South China Sea, not to mention Hong Kong, and its increasingly hostile behaviour towards countries criticising it, probably means there will always be tensions. It is more a question of how the tensions will be managed.

A Brexit trade deal with the US is probably harder with the Democrats than with Trump. A Biden administration would probably focus on reviving the Trans-Pacific Partnership trade deal and the trade negotiations with the EU, both abandoned by the Trump administration. It is however unclear to us what kind of trade deal the UK could expect to get with the Trump administration, considering the President's protectionist leanings.

Q. THE PANDEMIC HAS PUT CHINA, THE RULING CCP AND ITS EXPANSIONIST POLICIES IN THE SPOTLIGHT. ADDITIONALLY, LARGE-SCALE DISRUPTION TO SUPPLY CHAINS HAS LED TO A RE-THINK OF GLOBALISATION. WILL GLOBALISATION ROLL BACK?

Quilter Cheviot. The China-2025 policy set out in 2015 by the CCP clearly lays out their objectives of moving away from being the manufacturing engine of the world to being a leader in high end, value added goods and services. A roll back of globalisation will likely accelerate this trend. China does not offer the inexpensive labour market it did 15 or 20 years ago, and we have seen the trend to manufacture lower end goods to Vietnam, Bangladesh, Sri Lanka etc. for many years.

The opportunity in China lies with the 1.4 billion consumers and we have preferred funds focused on local consumption and consumer trends in China for quite some time and moved away from more value-oriented funds. Most Chinese are not middle class and there are over 400 million millennials in China so there is plenty of scope for long term consumption growth. The political risks are real and Chinese expansionism affects the whole region and these risks must be mitigated by diversification.

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Rathbones. China is countering US isolationism with the exact opposite – more liberalisation and opening up. It relaxed a lot of restrictions on foreign investment in China this year, especially equity investment. This is a relief for investors, but not enough to counter the overall effect of the global recession and trade tensions. China has also announced a large fiscal stimulus. Changes in Chinese lending have led to changes in developed market macro indicators, like the purchasing managers indices of business activity. We estimate that China's expansion of its fiscal deficit is approximately the same as the increase in 2009, following the global financial crisis.

However, geopolitical risks have risen at the same time. China appears to be using the pandemic to stretch its influence in the South China Sea, in Hong Kong and along its mountainous border with India. These worrying escalations are riling up its regional neighbours and the US too. America is likely to become more bellicose in response as the presidential election approaches. This simmering conflict between the world's policeman and the ascendant rival is already spilling over into commerce. We expect yet more tariff battles and diplomatic thrusts aimed at hurting corporate champions on both sides of the Pacific Ocean.

Q. IT LOOKS INCREASINGLY LIKELY THE UK WILL CRASH OUT OF THE EU ON WTO TERMS OR WITH A VERY SKINNY DEAL COBBLED TOGETHER AT THE LAST MINUTE. WHAT DOES THIS MEAN FOR THE UK, THE EU AND THE FUTURE OF EUROPE AS A WHOLE?

Cazenove. The political ramifications on the European Union from Brexit are likely to outweigh the economic impact, despite the UK being a key trading partner for the bloc. The UK's exit has forced the union to reconsider its future direction with Germany, France and the rest of "peripheral" Europe having very different views, increasing the possibility of further fractures and even break-up. The impact on the UK on the other hand will probably be more economic and will ultimately depend on the nature of the trade terms agreed both with the EU as well as other major global trading partners. That said, when the dust settles it may prompt further fractions between the home nations, with the Irish border question and continued devolvement of powers to the Scottish and Welsh assemblies likely to come back to the fore once the terms of the deal are better known.

Concerns over a no deal return

Source: Bloomberg. Data to 31 May 2020.

Rathbones. Overall, markets remain calm and continue to be supported by the massive stimulus from central banks and the promise of further fiscal support from governments. Sentiment towards UK equities remains extremely negative: the market-implied equity risk premium for the UK is still near its highest on record, telling us that investors are demanding more compensation for the risks around future earnings than they did at the height of the financial crisis. This is far from the case in other developed markets. But stock market momentum matters in country allocation, and the FTSE's has been among the weakest for a long time.

We remain bearish on the structural, long-term outlook for Europe, which is expected by economists to take a greater hit to 2020 GDP from the pandemic than other major markets. This is particularly troublesome given the Eurozone's greater underlying fragilities. We would have a more favourable view of Europe if we became more convinced of the sustainability of a global cyclical upswing, but for now we see better opportunities elsewhere.

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