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QUARTERLY INVESTMENT BULLETIN

JULY 2020

General Economic Overview Quarter Two 2020

There is no doubt that this quarter has been more positive than quarter one, but it has also been more volatile, particularly towards the end of June when we saw some localised jumps in coronavirus cases, notably in the US. As expected the pandemic continues to dominate news flow and will do so for the rest of 2020, but optimism has been seen in global stock markets, as there have been substantial gains from the March lows.

There is no easy fix to the woes of the global economy caused by the lockdown and, although there are plenty of positive noises coming from a number of countries with declining infection rates, lower death rates and potential vaccines, nothing is yet giving the level of certainty needed to fully open up the global economy. Much of the developed world has seen the suppression tactics prove effective, and getting the R rate or spread multiplier below 1, which defines contraction, has allowed parts of the economy to re-open, but data at the end of June saw some localised areas jump above this again causing further concern. The emerging world has had a different experience with areas such as India and Latin America struggling to find the economic and healthcare balance needed, and opting in the main for a herd immunity approach. This has led to a major increase in cases in these countries and creates wider concerns for transmission back to those countries that have managed to suppress the spread of the disease.

There is no doubt that Covid-19 has transformed the world, and not evenly or equally. The global economy has seen only muted growth in the 10 years post the Financial Crisis (GFC), described by Lawrence Summers, the former US Treasury Secretary, as 'secular stagnation' in his address to the IMF in 2013. Since the speech by Summers there have been brief periods of strong output growth, notably in 2017, but these stronger cyclical upswings have proved temporary which is why growth stocks have outperformed value to such a large degree. In the post Financial Crisis period there has been a long running trend decline in global long-term interest rates to zero and below. The world was already experiencing disinflationary or even deflationary trends prior to the Covid-19 lockdown, when the measures put in place by governments reduced demand through restricting the ability of consumers to spend. Pandemics have also historically increased risk aversion in the private sector resulting in higher savings rates, both by households and by businesses who invest less preferring to maintain higher levels of 'rainy day' money. Until an effective vaccine is found consumer spending in sectors requiring high levels of personal service will remain under pressure and way below pre-pandemic levels. Covid-19 is only likely to increase the trend towards secular stagnation that has been manifest in the post GFC period.

The more recent positivity shown in global stock markets has been built around the potential for a more rapid recovery in the global economy. This confidence has been driven in the main by the actions of governments and central banks. Since the GFC, Central Banks have responded by cutting rates lower than even during the depths of the crisis itself and with rates at, or in many cases below, the zero lower bound traditional monetary policy has become redundant. Central Banks have responded to this through unconventional policies of negative rates and QE. They have also accepted that in a zero rate world there is a need for increased levels of fiscal spending, a message the Fed Chair reiterated in his address to Congress on the 16th June when he stated that continued fiscal support to the US economy by government was necessary. In the short term, the rise of populism demonstrated by concerns over inequality which resulted in the vote for Brexit, the election of Donald Trump, and the global spread of the Black Lives Matter movement strongly suggests austerity policies will not be adopted.

How debt is paid for over the longer term will become more of an issue down the road than it is today, but is likely to involve some form of higher taxes together with forms of debt monetisation. A continued positive is that the annual cost of servicing debt is likely to remain negative in real terms and below the nominal growth rate of many economies, and central banks seem set to keep rates at these levels, a form of financial repression. Even if real bond yields gently rise, equities are likely to continue to respond positively to better growth prospects as long as inflation remains within central bank targets. The risk here is that market sentiment can change if it believes that low debt servicing costs will not prove sustainable over the medium term if, for example, there was a sharp rise in inflation which forced central banks to raise rates around the world. In the short term this seems unlikely as the economic shock caused by the pandemic will remain disinflationary but it is something long term investors need to monitor.

There is improving economic data coming from western economies, and quite importantly China as PMI figures and manufacturing data improves from a very low base. Certain sectors such as technology and healthcare have benefited from the crisis and this is evidenced in the share prices of companies in these sectors. These areas continue to be sought by investors and the current themes look set to persist for some time to come. There are however some worrying signs for assets such as property which in sectors like retail and hotels is vulnerable and subject to significant re-valuation.

As long as governments and central banks continue to support economies and pump cash into the system then a level of stability is ensured. Sentiment is still easy to shift, and if we get further waves of the virus or negative news on vaccines then investors will once again seek safety. The world's economy remains fragile and we are likely to see volatile markets in the short term.

Equity Markets

As with many previous crises the initial reaction in risk assets is a significant sell off which generally goes beyond fair value and can create investment opportunities for those with liquidity. This was certainly the case in March and, since the lows, markets have recovered strongly despite moments where negative news flow has caused volatility. This quarter global markets have been up on average over 17%, the strongest being the US, but European markets have had a stronger June as the US flattened out. Equity markets have been reassured by the intervention delivered by central banks and governments and this has given investors confidence to build positions in risk assets once more. As we will see in the following sections there is often a disconnect between the economic data and the performance of stock markets. Many economies face significant issues in the coming months but markets have seemingly discounted this and are looking further ahead to 2021/22 when the data is expected to improve.

It helps to consider the market framework over three different time frames. In the short term, news flow will drive market direction and volatility, taking into account new cases of the coronavirus, vaccines/treatments, and economic data such as PMIs. Technical factors such as whether markets are overbought or oversold and the ratio of puts to calls are also important over shorter timeframes.

Over the medium term, looking at 2021 and 2022, this could be a positive period for markets. Previous eras of financial repression (when governments hold real interest rates below zero) have often been profitable for equity investors especially in the early stages. In other words, markets front-run negative real rates with a lower discount rate driving equity valuations higher. Next year the global economy is likely to return to trend growth, especially with the prospect of vaccines/better treatments being widely available. There will still be huge stimulus in the financial system next year, both monetary and fiscal, and this will be occurring at a time of improving corporate earnings. With a backdrop such as this it is not a time to be too bearish on the medium term prospects for equity markets.

Longer term, from the mid-2020s, threats could emerge to valuation levels in the form of higher inflation, the withdrawal of stimulus, both monetary and fiscal, and less globalisation, but these are not an immediate concern to markets.

UK

The UK continues to face the double whammy of the Covid-19 outbreak and the negotiations on Brexit. This is reflected in the currency markets where the pound is weak against other countries and will only strengthen if there is an improvement in Covid-19 data and the Brexit negotiations

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move forward. The UK share market cyclically adjusted PE ratio sits at a decade low against the Eurozone and the US, and lower UK valuation multiples reflect a structural decline in UK corporates with domestic costs having risen against a backdrop of weak global demand. The government have continued to support the economy with monetary and fiscal stimulus which has been aided by the actions of the Federal Reserve in the US and to a lesser extent the ECB, allowing the UK stock market to recover from its March lows. PMI data has improved in the last month but, as we have seen, the economy had produced its worst quarterly fall since 1979 of 2.2% for quarter one of 2020 (ONS data). This is likely to be eclipsed by the figures for the second quarter given that April saw a decline of 20.4% (ONS data) in GDP alone. Clearly records are going to be broken as the economy came to an abrupt halt in March – most recessions are more gradual with a slow improvement following on, but this is a very different scenario with a number of areas of the economy struggling to operate effectively following the full lockdown such as the travel and retail industries. The government faces a difficult task coming out of lockdown as the economy needs to get moving again but this has to be balanced with the health of the population and the ability of the NHS to cope.

US

The US economic recovery is the barometer for market sentiment around the globe, and there has been some optimism that things have started to turn around in May and June. Spending in May bounced back, growing by a record high of 8.2% (US commerce dept.) which followed a 12.6% drop in April which was the worst since the government began tracking data. Vehicle parts and recreational goods were the main contributors in the goods category and healthcare and food in services. Businesses are beginning to emerge from the lockdowns, which has offered some relief and is backed by a President who wishes to drive the economy forward as he heads towards November elections. Unemployment data was unexpectedly positive in April adding 2.5 million jobs, however more than 19 million remain unemployed. Some states, such as New York have made great progress in supressing Covid-19, but other areas of the US are now seeing a rising trend in infections, mainly those that imposed fewer lockdown measures in the first few months such as Texas, Florida and North Carolina. This is a worrying sign and state Governors are beginning to impose restrictions to curb further spread. The economy looks fragile and will weaken if there is a second wave of infections but optimism is still prevalent in markets, particularly in those sectors continuing to thrive such as healthcare and technology.

There have been encouraging economic data points with US factory and services activity contracting at a slower rate in June demonstrating progress as businesses slowly emerge from coronavirus shut downs. The IHS Markit survey data rose from 37.0 in May to 46.8 in a preliminary reading for June, indicating a contraction but at a much slower rate. This market composite output index has therefore

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shown an improvement in both manufacturing and service sectors, and US new home sales rose by the most in 11 months indicating housing activity has begun to recover.

Europe

Preliminary figures showed the economy suffered its worst contraction on record in the first quarter. The downturn came on the back of frozen business and household activity for most of March due to measures adopted by governments to contain the spread of the pandemic. According to data from national statistical institutes, Covid-19 wreaked havoc on both domestic and external demand in France, Italy and Spain, while contractions in smaller Eurozone economies were sizeable but less severe. Prospects for the second quarter data are even bleaker, due to protracted lockdown measures, with a bigger blow to activity expected, as suggested by collapsing consumer and business confidence and a diving PMI reading in April. This paints a very poor picture for the economy which, like many others, has had to cope with an abrupt halt of economic activity in Q1 this year. The economy is seen contracting 7.0% in 2020, which is down 2.9 percentage points from last month's forecast (source Focus Economics). In 2021, GDP is predicted to increase by 5.1%.

The most recent news, whilst accepting data on growth and the economy is dire, has been more positive in a relative sense as lockdown measures are reduced. The economic recovery in Europe is looking more hopeful as the data on the coronavirus epidemic is showing a decline in cases in recent weeks. This has been backed by the ECB with Christine Lagarde indicating that the Eurozone was probably past the low point of the crisis. This was somewhat tempered by the fact that they noted that some industries will have suffered irredeemable damage, such as airlines and hotels. The focus of investors has shifted to the support being given by European Union, as several measures were unveiled in April including the provision of loans to help pay for furloughed workers, as well as loans offered from the European Stability Mechanism (ESM) fund. The European Commission (EC) has proposed its version of the plan, calling it 'Next Generation EU'. The EC plans to use the EU budget as a guarantee to be able to offer €250 billion of loans and €500 billion of 'grants' - which in reality will be smaller due to the additional funding to the EU budget that will be required in the future. The plan will now be discussed at the next EU summit in July, with the hope that it could be passed along with the EU's Multiannual Financial Framework, however the vote requires unanimous backing. Other economic indicators have been improving and badly hit countries such as Spain and Italy have seen an improvement in confidence indicators and manufacturing data as well as retail sales starting to build up again (source Focus Economics). The European rebound has not been as strong as in the US but Europe's exposure to financials and cyclically sensitive sectors such as industrials, materials and energy give it the potential to outperform in the second phase of the recovery, when economic activity picks up and yield curves steepen.

Asia and Emerging Markets

Asia has been at the forefront of the fight against the pandemic which has circled the globe. China in particular has been the focal point for many as it can be seen as the model for how the virus has developed and spread and how it has been combated. The economy is slowly recovering from the coronavirus-induced economic shock in the first quarter, when GDP shrunk for the first time in decades. It was however evident by the end of the first quarter that the coronavirus was being contained and the economy was able to largely reopen in Q2, even though there was a localised resurgence in Beijing in the second half of June. Manufacturing in China bounced back strongly helped by pent-up demand in global supply chains, and manufacturing capacity returned to around 90% of previous levels. Anecdotal evidence on traffic and road usage suggested many parts of the economy were back to more normal levels of activity. Service sector activity has been more muted, for example even fully open hotels are operating at around 50% of capacity and taking into account hotels which remain shut, occupancy levels are only at around 40% of available rooms. Other parts of the service sector such as restaurants and cinemas have also lagged the rebound in the economy. The latest Chinese data just released showed a second straight month of expansion in the manufacturing sector in June. The question now will be whether there is enough follow through from the global economy to keep China's manufacturing sector working at more or less full capacity. To date, China has demonstrated it is easier to reboot the manufacturing side of an economy than the service one.

There are some other potential issues that need to be monitored. Diplomatic rifts with the United States threaten to lead to an escalation in trade tensions although this seems to have softened in late June. Unusually China's top leadership decided to remove its traditional annual economic growth target at the opening of the National People's Congress (NPC) on 22 May. Instead, Premier Li Keqiang stressed the importance of stabilizing jobs and alleviating poverty. Against this backdrop, the government unveiled a larger fiscal deficit target for this year and off-budget measures to shore up economic growth and support employment. The most recent manufacturing data was more upbeat with PMI data rising as activity in China's factories showed expansion.

India is another significant economy in the region that can be seen to be struggling to impose measures that balance healthcare and economic stability. Economic data paints a grim picture: the private-sector PMI slumped in April to the lowest reading since current records began in December 2005, while industrial production plunged year-on-year in March at the fastest pace since at least April 2006. Prime Minister Modi has not come out of this situation well in the eyes of the population which may lead to unrest further into the year. Indonesia has similar issues as manufacturing

conditions deteriorated at a record rate, consumer confidence tumbled to a ten-year low and exports shrank sharply on weaker demand. In response to the gloomy macroeconomic picture, the government ramped up its fiscal stimulus in mid-May.

A number of emerging market economies have suffered significantly from the coronavirus pandemic, with one problem being that large parts of the workforce are employed in what is called the informal economy, where they need to earn money every day to live. Even where lockdowns have been imposed, in countries such as Peru this is having a devastating impact on human lives despite the government recognising the severity of the pandemic. In Brazil and Mexico the governments have not responded in a timely manner to the dangers of the virus with a lack of understanding of how contagious and deadly this illness can be. In Brazil Bolsonaro has continued to ignore medical advice, which has resulted in a huge death rate and throughout the second quarter case numbers have continued to accelerate. Mexico has also seen growing case numbers with the new President Amlo unwilling to lock down the economy.

In Brazil, industrial output fell in March at the sharpest rate in nearly two years, while retail sales dropped at the fastest pace in over four years in the same month, reflecting the impact of social distancing measures. Turning to Q2, the manufacturing PMI fell to a record low in April as factory closures and weaker demand battered production and new orders. Meanwhile, on 6 May, the lower house of Congress passed the 'war budget', unlocking an estimated BRL 600-800 billion for recovery measures, while also giving the Central Bank permission to undertake quantitative easing to shore up the economy. Retail sales dropped 16.8% month-on-month in seasonally-adjusted terms in April and to combat this at its 16–17 June meeting, the Central Bank of Brazil's Monetary Policy Committee (COPOM) unanimously decided to chop the benchmark SELIC interest rate from 3.00% to a new historical low of 2.25%. In Mexico Preliminary data revealed that the economy shrank for the fourth successive quarter and at the steepest rate since the 2009 global financial crisis in Q1, as the Covid-19 pandemic started to take its toll. A still-reeling industrial sector and a sharp pullback in services activity led the downturn. Output in the automotive sector, which forms the backbone of the country's manufacturing industry, collapsed by 99% in April as plants shut down operations. The economy is set to suffer a deep recession this year. Most economies in these regions have similar stories and will struggle to regain pre-Covid growth rates until some way into the future.

By mid-June Latin America, which is home to just 8% of the global population was suffering half the world's new coronavirus deaths. Populist leaders in Brazil and Mexico have played down the seriousness of the virus and whilst these markets have bounced after the severe Q1 selloff, a sustained rally in emerging markets will need to see a deceleration of new case numbers.

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Within Asia and emerging markets as a whole e-commerce companies such as Tencent, Alibab, and JD.com, and in Latin America Mercado Libre have outperformed so there has been a similar trend of new economy stocks outperforming in the developing world as well as in the developed markets. Stocks exposed to travel and leisure such as hotels and airlines have been weak, although in some countries where domestic travel is a much larger part of the overall tourism spend such as China, stocks in these sectors have been less affected.

Overall, within the emerging market region, Asian economies are better placed as they generally have stronger fiscal positions and they continue to have societies where there is likely to be acceptance of a more coordinated and sensible approach to combatting the virus. Society in Asia is relatively orderly, based in many cases on Confucian principles, where it is frowned upon to engage in actions which cause harm to others. This has helped societies within Asia to resist a rapid spread of the virus. For long term investors current valuation levels look attractive and historically have been associated with excellent medium term returns and therefore as and when the coronavirus new cases fall, the region should be in a position to see a more sustained rally.

Japan

Despite the government's best efforts the economy will, like many, shrink in 2020. The effect of the pandemic has been reducing but it still weighs heavily on the prospective economic growth of the country in the immediate future. The economy looks likely to contract in the second quarter given the broader global conditions for trade and consumer spending. To help businesses and consumers cope, the government rolled out stimulus worth roughly 20% of GDP in April, which subsumed previously announced stimulus and included subsidies for businesses to help them retain employees. On 27 May, the cabinet approved additional stimulus which doubled the amount previously provided, bringing the total to 40% of GDP. This should provide interim support for the economy and help to bridge the gap as lockdown restrictions ease. The impact of the shutdown along with the hit on exports means the worst quarter's data is yet to come for Q2. It is expected the economy will contract by 9.5% q/q (source Schroders) - faring better than most of its developed market counterparts - reflecting a lower scale of shutdown and strong government support. Recovery will be gradual as consumers and firms remain cautious against a backdrop of deflation and weak global trade. Nonetheless, strong balance sheets in the corporate sector and relatively low unemployment due to strict employment laws should mean relatively little permanent damage is done. April data showed that official unemployment only edged up by 0.1% to 2.6%. Including furloughed workers, 'unemployment' reached 11.4% - significantly lower than equivalent estimates in the US and the UK.

As noted in last quarters review the Tokyo Olympics has been postponed until 2021 which had been expected to boost the economy significantly towards the end of the year.

Fixed Interest

As we identified last quarter, our expectations entering into 2020 were, like many investors, of relative stability in fixed interest markets after cuts in 2019. This was of course turned on its head by mid-March as governments and central banks rushed to deliver packages of support to a global economy that was in a rapid shutdown. Over the second quarter of the year we have seen some of the results of these actions and some relatively positive returns from fixed interest investments as spreads have tightened and greater confidence returned over improving economic conditions.

Perhaps one of the surprising effects of the support given by governments to the economy has been the ability of investors to absorb the increased level of issuance by governments around the globe. In the UK the 30 year government bond yield dropped below the equivalent borrowing cost in Japan for the first time in June despite a huge expansion in issuance. UK yields across a range of maturities have sunk in 2020 with shorter term borrowing costs turning negative despite the full year gilt sales looking to top £400 bn. This has led to views that the gilt market has become 'Japanified'. The market would expect to see yields rise but the additional support to the bond markets from the Bank of England (£300bn since March) is helping prop up the market. Returns from government debt look meagre but many investors still prefer safety to combat the weakness in the UK economy. Most new issuance is also short dated and this is helping support the long end of the gilt market where institutional investors look to hedge their long term liabilities. The surge in borrowing that will result from all the fiscal support is not going to be fully financed by pension funds and insurance companies but by central banks through quantitative easing and other programmes. With the lower bound on official interest rates creating an effective floor and massive bond purchases creating a ceiling, bond yields might find it hard to move much at all in the foreseeable future. For return seeking investors, this relegates the asset class somewhat and even in multi-asset portfolios, the hedging properties of bonds may well be curtailed for some time.

The credit market has seen movement in spreads in the quarter helping to deliver positive returns. The strongest returns coming from areas where spreads widened furthest. Spreads are still elevated but not at crisis levels as governments have indicated support and central banks have acted – examples being the support the ECB has recently given to the non-investment grade area of the market. Rates will be kept deliberately low in this environment with capital returns fluctuating within an anchored range giving less opportunity for bond investors to make permanent capital gains. There are still concerns about the amount of BBB issuance in the market and the consequences of

companies falling into the Junk category. The high yield market seems to have coped at the moment and with defaults limited thanks to low rates and government support, and investors are returning to the asset class. The risk is that this situation changes as we move out of lockdown and support is reduced. Traditional leveraged high yield companies will face financing issues as they tend to burn through cash pretty quickly when revenues decline. Access to credit markets should be there but it won't be as easy for leveraged companies as it is for the better quality large cap names.

One of the other effects of the halt to economic activity has been the cutting of dividends by companies keen to preserve cash buffers and to survive the pandemic period. The yield on the Stoxx Europe 600 index which measures pay-outs on the region's biggest listed companies has dropped to 3.13% from 3.45% at the turn of the year (source FT). This has led to investors looking elsewhere for income including the high yield market. An area that has benefitted more than most is Europe's high yield market. A recent Bank of America survey noted that investors were now more comfortable looking at riskier alternatives. The European industrials sector for example offers yields of 4% higher than the expected dividends on industrial equities. With the central bank purchasing programme and very low rates the chance of defaults is much lower which encourages this type of activity. This activity has been mirrored in the US as the Fed surprised markets in April by pledging to support lower grade debt by buying ETF funds.

In an era of low rates – financial repression – the debt markets remain difficult to negotiate for investors as government and central bank intervention make it difficult to judge true value. For a number of years investors have been calling the end of the bond bubble but it has remained defiant delivering surprising levels of return – it is not clear whether this can continue although the potential returns are much lower if we believe we have zero as our lower rate boundary. Corporate debt still seems to offer the greatest opportunity, with care needed in high yield areas, but these assets have greater risk associated with them than in previous periods and are more closely correlated to equities..

Property

The sector still has a number of question marks over valuations in the commercial property sector with the market not yet fully activated and the ability of valuers to provide accurate valuations still restricted. The problems for landlords are acute in certain sectors, particularly with rental income hit significantly, notably in retail areas.

During March we saw the suspension of all of the physical property funds as the material uncertainty clause came into operation, which was declared across the whole UK property market due to a lack

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of evidence of transactions, rapidly altering covenants, an inability to inspect property as well as government mandated closures. This affected both daily traded and institutional funds, bank lending and REIT NAV valuations. Funds and properties are still being valued but this clause means a high degree of caution should be attached to the valuation. A lack of evidence causes valuations to be more qualitative and sentiment driven rather than quantitative. The FCA rules apply to a fund where more than 20% of its assets are subject to the material uncertainty clause which has then resulted in the suspension of funds so that all customers can be treated fairly. This is intended to be a short term tool and we have seen that the clause has already been removed from certain sectors such as industrials, supermarkets and long dated good quality income assets. The likelihood is that offices will be next, with the most affected areas last such as retail and leisure sectors. Looking at returns, BMO have calculated that the worst affected sectors have fallen in value by around 15%, the best by around 3%. Each physical property fund will be affected differently but a fall of between 4-8% in capital terms would be expected to the end of May.

Rents have clearly been affected and a similar pattern has emerged with retail and leisure sectors the worst affected and industrials, warehousing and offices still being relatively robust. The shutdown is gradually being lifted but there are still restrictions which limit the ability of properties to move back to full pre lockdown usage.

The UK government has developed packages to alleviate some of these issues, suspending business rates and providing loan capital though banks but debt has to be paid back slowing recovery in profitability.

There are some positives in certain sectors where transactions have picked up such as the industrials and warehousing sectors. The lockdown period has accelerated change in the office sector and the future emphasis may be more about quality of space than quantity with an increase in working from home and flexible working arrangements. The lockdown period has also accelerated change in retail with many businesses extolling the virtues of click and collect, leading some managers to believe that a lot of property will still be required, albeit in a different format.
The global REIT / property securities market is sensitive to interest rate movements with the global REIT space dominated by US assets, therefore the path and outlook for US interest rates and US economic growth will be important influences on future returns. Rates have now stabilised and at very low levels taking some pressure off property owners with higher levels of borrowing.

There is no easy answer to the current situation for real assets such as property and many investors will have to remain locked out of these assets in the short term although the number of sectors

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under the material uncertainty clause has reduced giving some hope that funds may open again in the coming months.

Summary

The world is now enduring the deepest peace time recession in the past 150 years. The distribution of the downturn has not been equal. Countries in the emerging world have suffered more due to inadequate healthcare systems, high density of population in cities with overcrowding commonplace, and a lack of means to put in place a strong enough fiscal response to protect the income of the majority of the population. Until the rate of growth in the pandemic slows significantly in these countries, which include Brazil, Mexico, India and Indonesia, the prospects for emerging markets remain poor compared to the developed world. Within the emerging world North Asia remains best placed.

Whilst at the outset some politicians described Covid-19 as a disease which struck equally amongst the rich and poor, looking at mortality rates this has been far from the case. In the developed world the poorer parts of the population, especially ethnic minorities, have suffered the most and this has reignited the debate about inequality. Inequality has been a simmering feature of the post Financial Crisis society as was seen with the votes for Brexit, Trump and general rise of populist parties. Previous pandemics have been linked to rises in political extremism as highlighted by the New York Federal Reserve paper which argued that the Spanish Flu was one of the factors behind the rise of the Nazi Party in Germany who were elected in the 1930s.

On a more positive note, there has been continued progress on the vaccine front with a number now entering, or due to enter, final stages of human testing. This includes potential treatments developed by Moderna in the States and the Jenner Institute Oxford vaccine together with some other trials within China. Until a vaccine is found, the impact on the service sector in particular is likely to be long lasting with behavioural changes by consumers.

Economic data now suggests a rapid initial bounce back from economies which were locked down. How long lasting the recovery will be and whether this start of a V continues or morphs into an initial sharp recovery which flat lines remains to be seen. At present, consumers have been sheltered from the worst economic impacts of Covid-19 in the West through either wage subsidy or in the US increased levels of unemployment benefits. In the US these are due to end in the latter part of July, whilst European governments have indicated these support schemes will be gradually phased out between August and October. With sectors reliant on high levels of human interaction likely to remain subdued, this will prove a challenge to consumption.

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Markets are once again entering an era of financial repression where central banks deliberately hold interest rates below the level of both inflation and nominal economic growth which in itself will aid deficit reduction over the medium term. Post the Financial Crisis periods of financial repression have provided positive returns for equity investors although these returns have been front loaded with markets front running economic recovery benefitting from the lower discount rate applied to corporate earnings. This remains an environment likely to favour high quality growth stocks with visibility of earnings or revenues. Markets are not factoring in any major problems or setbacks to the economy. Clearly any second wave of infections would cause concerns, but this should not be confused with small localised flair ups which have occurred in some European countries, whilst in the States the disease had not really been suppressed in areas where cases are rising rapidly.

In the short term, valuations remain on the expensive side, but current levels of bond yields suggest for many investors the alternatives to equities are not attractive either. Cash rates in many economies are negative. The US Federal Reserve, who have now moved to buy cash corporate bonds, including high yield, have sent a 'do whatever it takes' message to the markets and the ECB are now countenancing buying non-investment grade debt bonds. Whilst the Fed have made pessimistic comments on the longer term impact of the coronavirus, this means accommodative policy is here to stay.

In this environment medium term investors should remain committed to equity markets but expect heightened levels of volatility in both directions to continue. The strong differentiation between winners and losers in this new world looks set to continue. The US market looks likely to stay in a wide trading range as suggested in the last market update of 2600-3100 and investors should look to add to equities on bad rather than good news. Markets have once again proved this year it is better to buy when the price is right and the news is bad than when the news is good but the price is high.

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