State of Play

18 December 2020

Our Investment Specialist, Simon Durling, shares his thoughts in our last update of the year.

Given this is the last update before the Christmas break I thought it would be worthwhile to look back at a year which has been dominated by the COVID-19 outbreak. I want to explore the story that unfolded, including the financial support that was implemented and the subsequent market reaction to what is and will continue to be one of the biggest events in modern history.

The COVID-19 pandemic

It is hard to imagine an event in recent modern history which has such a profound effect on the way we live our lives.

The World Health Organization (WHO) announced on 9 January that COVID-19 had emerged in Wuhan, China. The government authorities there started to implement lockdowns and travel restrictions to help slow its spread but this did not stop cases emerging outside of China. Towards the end of January more information began to emerge and on 31 January the WHO declared a global health emergency for only the sixth time in its history.

The number of cases continued to grow throughout February, with particularly severe outbreaks in South Korea, Italy, and Iran. Governments reacted with a mixture of containment measures, public health warnings and fiscal measures to try and reassure citizens, and financial markets alike, in the face of mounting uncertainty. However, as cases continued to rise throughout the end of February and early March, we started to see governments implementing national lockdowns: asking people to stay at home and only to go out for essential shopping or for a medical need.

On 23 March the UK Government followed suit, announcing a national lockdown with rules including: stay at home where possible unless for 'very limited purposes', such as shopping for necessities, one form of exercise a day or

travelling to work if they could not work from home; and banning gatherings of more than two people from different households in public. Non-essential shops were told to close, and social events including weddings were stopped. In addition, the most vulnerable in society with existing medical conditions or the elderly were told to shield in their homes and not go out unless absolutely necessary.

The initial public reaction was one of fear as supermarket shelves emptied rapidly with people overbuying items like pasta, eggs, rice and famously toilet rolls! However, communities rallied to support those in need and every Thursday evening at 8pm people clapped the NHS and frontline workers who had to carry on regardless of the risks to themselves from their doorsteps.

The first national lockdown lasted until 1 June when restrictions started to be eased gradually and children began returning to classrooms, albeit in smaller class sizes initially. The easing process took four weeks until on 4 July pubs reopened and some normality returned to our lives but face coverings became mandatory in shops and indoor venues from 24 July. Infections continued to fall throughout the summer until the summer holidays began and people started to visit restaurants and pubs en masse - encouraged and incentivised by the 'Eat Out to Help Out' scheme.

As children returned to school in September and individuals returned to work throughout the summer the infection rates began to rise again despite regional restrictions introduced in the new 'tier' system announced by the Prime Minister including a 10pm curfew on pubs, bars and restaurants in England from 24 September. The planned return of some fans to sport venues on 1 October was postponed and penalties for failing to wear a mask doubled to £200 for a first offence. The devolved governments in Scotland, Northern Ireland and Wales made separate decisions from those implemented in England as they responded to their own local challenges with their own specific restrictions and rules.

Despite the tier system infection rates continued to rise along with hospital admissions and the UK Government, under pressure from all sides, implemented a second lockdown on 5 November where pubs, bars, restaurants and non-essential retail closed until 2 December and people were told to stay at home unless they had a specific reason to leave and, unlike lockdown 1.0, schools, colleges and universities remained open. The lockdown came to an end as planned and the 'tier' system came back into place as before but with local decision making now based around regional data on infection rates, hospital admissions and NHS capacity.

A collective decision on a Christmas amnesty was agreed across the devolved nations allowing three households to mix from 23 December until 27 December. Following the latest daily data, which showed there were 25,161 COVID-19 cases along with 612 deaths, a review was carried out, however, the decision was to keep the rules unchanged with the exception of Wales who have reduced the number of households from three to two. A new strain of the virus has been identified in the South East and London where infection rates have risen dramatically over the last couple of weeks and concerns have been expressed by the medical community about the potential impact the amnesty may have on infection rates and hospital admissions in the New Year.

Financial support on an epic scale

All but shutting down the global economy was always going to have a dramatic impact on economic activity - a record breaking impact in some areas: in the UK it was the sharpest economic downturn since records began. Many companies in the UK and abroad were forced to shutter their doors, some permanently whilst large scale job losses seemed inevitable and further company failures were simply a matter of time. Many companies cancelled or suspended their dividend payments to shareholders in the hope of holding back cash to ride out the storm or under pressure not to take financial support and still hand out profits at the same time.

The response from central banks and governments was almost immediate, co-ordinated and on a scale never seen before, even in the height of the financial crisis of 2008-2009. Central banks agreed to print new money to the tune of several trillion dollars, stepping into to buy back debt from the investment market and cutting interest rates to zero or near zero in an attempt to support market liquidity and confidence.

In addition, job support measures were introduced that were designed to keep employees and employers connected through furlough schemes. In the UK the government picked up 80% of employee wages, initially until the end of October but after the second lockdown this was extended until 31 March 2021. At the height of the scheme nearly 10 million workers were being paid by the UK Government at a cost to taxpayers in the billions.

To provide support for the housing market stamp duty rules were changed, reducing the rate to zero for all purchases below £500,000 until 31 March 2021, saving up to £15,000 for buyers. This had a huge impact with pent up demand pushing the average house price over the summer to new record highs. Concerns remain that once this incentive ends, with rising unemployment and a drop in demand, prices may fall in the short-term even after life returns to somewhere near normal, perhaps next summer.

One of the hardest hit industries has been hospitality. A large portion of the rise in unemployment over the last few months has been those working in this sector despite government support through a reduction in value added tax (VAT) in pubs, restaurants and cafes (excluding alcohol). In an innovative step, Chancellor of the Exchequer Rishi Sunak introduced a scheme to change behaviours and encourage people to return to restaurants, cafes and pubs after the lockdown ended. The concern was that many were fearful of returning to an enclosed space to eat a meal or enjoy a drink. So, the 'Eat Out to Help Out' scheme introduced a 50% discount up to the value of £10 per person for a short period in August. The scheme was a triumph as restaurants reported record trade, especially on days of the week that were traditionally much quieter, helping to recover some of the lost business and revenues during the lockdown. Despite the scheme costing hundreds of millions, many businesses are close to going under as the ever-changing rules and restrictions make it almost impossible for them to plan the purchase of stock or offer stable employment for employees.

Market reaction in a year like no other

Investment markets traditionally dislike uncertainty above all other factors as professional investors always assess what the future might hold rather than looking in the rear-view mirror. This disconnect between predicting the future and measuring the past was very evident in 2020.

The year began with investors focussed on the potential of conflict between the US and Iran - markets rebounded as the situation de-escalated but were thrown off again by the Wuhan outbreak.

February saw an aggressive repricing of global stock markets as investors navigated uncertainty around the economic impact of the ongoing COVID-19 outbreak. In terms of historical context, the sell-off at the end of February represented the largest weekly decline in shares since October 2008, and prompted a strong reaction from policymakers, with the US Federal Reserve implementing an emergency rate cut of 0.5% in early March. Against this backdrop, core Fixed Income assets posted strong gains as recession fears increased. Inflation expectations and growth related Commodity prices fell in line with growth expectations.

March was a difficult time for investors as the market volatility that began in February worsened when the outbreak was declared a pandemic. The consistent flow of negative headlines stoked further volatility in global stock markets as investors processed the potential fallout of shutting down entire economies. The pace of market dips was brisk and deep, with losses of 5-10% recorded on several days during the month as investors adopted a highly negative outlook for the months ahead. To add to the volatile situation, Saudi Arabia and Russia initiated an oil price war that saw the price of Brent Crude fall to an 18-year low of less than USD $23 a barrel.

During April and May the support measures from policymakers were seen as a positive and helped stock markets to rise across the board in spite of the uncertain outlook. With interest rates having been cut to low levels and central banks buying up Bonds, investors were encouraged to take more risk. This recovery in Share prices was not evenly spread though as cyclical and value stocks suffered as demand collapsed during lockdowns reducing revenues dramatically as people stopped socialising, reduced travel and stayed at home. Other sectors like technology took advantage as many consumers were forced to buy goods online and millions of people forced to work from home were supported by companies offering online communication tools like Zoom.

Throughout the summer investment markets remained sensitive to any negative news but as lockdowns ended and economies reopened markets grinded higher. Whilst not everywhere witnessed a full blown 'V' shaped recovery, the bounce back remained strong as pent up demand proved the main driver despite the uncertain outlook. During July and much of August, global stock markets delivered good performance as economies began to rebound, infection rates were falling, and there was promising news on a possible vaccine.

However, investor sentiment changed in early September as technology Shares fell, infection rates surged in the UK and Europe, and the economic rebound

began to slow as worries of a second wave increased. Over the third quarter, global Bond markets generated modest positive returns, driven by low interest rates and uncertainty created by COVID-19. October started with an optimistic view on the route to a vaccine, as well as generally positive sentiment about what a strong win for the Democrats in the US Election might have on stock markets. By the end of the month, however, stock markets were rattled by the resurgence of COVID-19 cases in the US and Europe, as well as worries about the outcome of the polls in America.

President-Elect Joe Biden's victory was positive for stock markets as it took away some of the uncertainty that defined President Donald Trump's tenure in office, whilst a Republican-controlled Senate will curtail some of the Democrats' more progressive tax and spending policies. Perhaps more significantly for investors, the announcements from pharmaceutical groups Pfizer/BioNTech and Moderna that their respective vaccines were more than 90% effective, helped to push stock markets higher over the month. This was swiftly followed by AstraZeneca also announcing successful human trials. This sentiment has broadly carried through into December as the very first vaccines from Pfizer/BioNTech were administered in the UK to Margaret Keenan, a 90-year-old woman from Coventry and (you couldn't make it up) 81 year old William Shakespeare from Warwickshire.

The outlook for investment markets at the end of this extraordinary year is much brighter than could have been imagined back in the spring. With mass immunisation beginning to gain momentum and the prospect of life returning to somewhere near normal in the months ahead, markets appear more bullish and perhaps even contemplating the start of a new economic cycle. That said, the vaccination of the global population is a logistical task the size of which has arguably never been attempted, yet alone achieved in such a short timeframe. If any complications to the roll-out of the vaccines occur this could have very negative impacts on market sentiment. In addition, the size of the stimulus package and the potential further instalments have traditionally been a trigger for higher inflation and although central banks have changed their approach slightly to allow more 'wriggle room' if inflations spikes in the short-term, any sustained inflation will potentially prompt markets to price in higher interest rates, directly impacting on Share and Bond market valuations.

Summary

The sobering statistics at the time of writing (from Johns Hopkins University) are that globally over 73 million people have tested positive with the virus and 1.6 million people have died. In the UK over 1.9 million people tested positive and over 65,000 have died. It is very difficult to compare and contrast government reactions at this stage, in part because different methods and approaches have been chosen at different times, and different countries test, measure and assess deaths attributed to the virus in very different ways. All leaders have faced the same dilemma of balancing public health and the economic consequences of slowing the spread of the virus. It is likely it will be a long time before any sensible analysis can be carried out assessing the effectiveness of the actions and decisions taken, but more importantly what lessons have been learned so

that all of us are better prepared the next time a new virus or disease strikes humanity.

The financial and economic consequences will no doubt be felt for generations to come as the enormous cost of supporting individuals and businesses through the toughest year, certainly in my lifetime, will probably take many generations to be repaid. Navigating investment markets is difficult at the best of times, let alone trying to predict the future in the midst of a pandemic. This difficulty does however provide investment opportunities as the environment changes and hopefully life starts to return to normality once the mass immunisation programme accelerates through next year and beyond. Many accept that investing over the longer-term helps negate some of this uncertainty and short-term market volatility. As always it is best to seek the advice of a professional financial adviser in case you are considering investing at any point.

Let's hope that 2021 represents a more 'normal' year for all of us. Stay safe and enjoy Christmas with your loved ones and here's to a more positive 2021.

Find out more

Listen here to our **2021 Outlook: Beyond a year of uncertainty** from our Portfolio Manager, John Mullins, as he shares his thoughts on the key themes to watch out for next year **here**.

Note: Data as at 16 December 2020.

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