Issue three hundred and forty-five

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Long Covid Effects

Last week brought a slew of announcements from businesses, underlining the pressure the economy is under as a result of the coronavirus crisis. The second postponement of the new James Bond film was the last straw for Cineworld, which will completely shut its cinemas for months, sending a ripple of anguish through leisure parks, where restaurant visits are reliant on filmgoers. Easyjet has announced it will lose money for the first time in its 25-year history in 2020 and while the headlines focused on the size of the loss (the airline expects to notch up a loss of over £800m) management expects to be operating at 25% capacity in 2021, reaffirming that this will be the biggest challenge to the travel industry that we have seen. Pub operator Greene King has announced job losses and clothing retailer Edinburgh Woollen Mill has called in the administrators. For all these businesses the covid crisis has fundamentally challenged revenue generation and it's not surprising that companies in these sectors are among the first casualties. The concern is that what were otherwise healthy businesses will struggle to survive this crisis even with government support - after all, we are far from the end of this crisis. The risk here is not solely within equity markets but penetrates all asset classes in some way. For example, in alternatives half of the businesses owned by private equity are estimated to have been affected by covid, with 10% seriously impacted. Going forward the industry expects higher deal prices and low interest rates will be a headwind to generating strong returns.

From April to August equity markets have been running hard, with the blessing of central banks that have poured in trillions through stimulus and central banks that have cut interest rates. The much-talked move to online in retail has continued, but we have also seen an acceleration in that with other sectors e.g. health care branching out into online. However, this comes at a cost and even in businesses that have been less impacted by covid, we expect profit margins to come under pressure as the crisis accelerates changes to supply chains to make them more local and to source from multiple locations and businesses. Firms may forego some efficiency in return for being more robust in a crisis environment.

The fall in demand we have seen in 2020 has been far greater than anything we saw in the Global Financial Crisis. Global GDP fell by 0.1% in 2009, in 2020 it is expected it will fall by 5%. In the UK, lockdown made it hard to spend money and since reopening companies have benefited from consumers, who having been unable to spend much in lockdown, were flush with cash when business reopened. The rebound in economic activity since July has been a relief for businesses but as government support is lowered or comes to an end, it will become more apparent that some jobs are more secure than others. This sense of insecurity tends to suppress consumer spending even in those who have the cash, contributing to lower inflation and interest rates for years to come.

What tactics governments might try next is unclear. Even pre-covid, the absence of inflation since the financial crisis suggests central banks have not been fighting imaginary foes, and that extremely low interest rates have been justified. Governments will need to decide whether to increase spending and try to escape from the low inflation environment or whether to be more mindful of debt levels and accept that the benefits of low inflation and interest rates will be more helpful in tackling climate change and paying for an aging population. Low interest rates present a challenge for investors as bond yields that are already close to zero will limit the ability of bond prices to rise even if a recession challenges equity markets. Much like the business world we think investors will need to look more broadly for diversification and the ability to hedge risk.

Market Snapshot (02.10.20 – 09.10.20)

Market Snapshot (02.10.20 – 09.10.20)			10 Year Bond Yields			Currency			Commodities		
FTSE 100	6016.65	↑1.94%	UK	0.28	↑3.70%	£/$	1.3050	↑0.93%	Brent Crude	$42.82	↑10.08%
S&P 500	3477.13	↑3.84%	US	0.78	↑8.33%	£/€	1.1033	↓0.06%	Gold	$1927.40	↑1.50%
NIKKEI 225	23619.69	↑2.56%	Germany	-0.52	↑0.76%	€/$	1.1830	↑0.98%			
DAX 30	13051.23	↑2.85%	Japan	0.03	↑0.00%	£/¥	137.7900	↑1.12%			
CAC 40	4946.81	↑2.53%									

Figures quoted are in local currency
Source: FE Analytics & Financial Times

Week Ahead

Monday – Euro Area: ECB President Lagarde Speaks
Tuesday – Germany: German ZEW Economic Sentiment (Oct)
Wednesday – US: PPI (MoM) (Sep)
Thursday – UK: Autumn Budget
Friday – US: Retail Sales (MoM) (Sep)

We look forward to receiving your comments. You can now follow us on Twitter.