TierOne

Market Outlook 15 June 2020

Summary

Markets are clearly now prepared to look through the problems in 2020 in the belief that even if a full recovery takes two years, corporate earnings in 2022 will be back at previous levels. In markets outside of the States, valuations remain relatively attractive with, for example, estimates of the non-US Shiller PE having fallen to around 11x from 17x both in Asia and Emerging Markets. Japan price to book valuations for equities remain attractive. However, the potential for permanent damage to either consumer or business sentiment resulting from the pandemic is a prominent risk. The rise in the savings ratio may be an indicator of this. But it is too early to see whether either consumer spending or corporate capex has been permanently damaged. So many businesses were shut down by government directives around the globe that spending plans by chief executives cannot be assessed.

Markets which are pricing in at the higher end of the trading range are expecting full speed recovery and so currently valuations are stretched. However, any vaccine/treatment news will move markets and positive news here will outweigh disappointing economic data.

Western economies have been through the worst stage of the Phase 1 of this pandemic, although clearly there remains the risk of a second wave when the northern hemisphere comes into winter. The containment of the virus in Australia and other warmer countries suggests the summer months in the northern hemisphere are not likely to be a period of extreme risk. The emerging world continues to suffer problems. It appears that India is giving up on its lockdown due to economic necessity and together with Brazil, Indonesia and Mexico, appears to be moving to a strategy of herd immunity driven by economic necessity. There may well be a combination of different types of recovery depending on the region and economic sector.

Although markets are today focused on an improving outlook for economic activity and corporate profits, geo-politics will once again be a concern. As we saw in 2018, protectionism is an economic extension of nationalism and if such policies are stepped up, they can pose a threat to economic activity and corporate earnings in normal times. It is unlikely President Xi will sit back and allow America to make the running on this with no form of response.

In the short term, markets have clearly had a good run and with increased concerns about geo-politics and the possibility of a resurgence of the disease in the US after a speedy opening up of its economy, a trading range of the S&P 500 in the 2600-3100 level looks likely to be maintained for some months.

The catalysts which might break this range would be:

- Clarity on the economic rebound
- News on vaccines or medical treatments
- Escalation/De-escalation in US China trade tensions
- Developments in the US Election
- Developments in the Black Lives Matter movement

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