TierOne

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Summary

There are a number of alternative pathways from where we are now. At one extreme, successful relaxation of restrictions without further disease flare ups could see the world successfully navigate its way out of the crisis with an upturn in economic activity starting during the third quarter, boosted by encouraging news on treatments and vaccines. At the other extreme, if a second wave of infections occurred requiring a re-imposition of restrictions, another lockdown, combined with a lack of positive news on vaccines or anti-viral treatments, would see markets severely disappointed. In between these extremes there are many varying scenarios.

Equity markets have now risen sharply from their March lows, greatly aided by the liquidity support provided by central banks which are now even prepared either to purchase, or accept as collateral, non-investment grade bonds. This is in marked contrast to the Global Financial Crisis. From a technical perspective, Markets will now be driven by short term news flow. Without definitive news positive or negative, a trading range of the States between 2600-3000 would seem a plausible outcome for the time being.

Progress in European markets has been more muted than in the States, hampered by the lack of cohesion in the fiscal policy response. While a rescue fund has been agreed, whether this is made available through grants (favoured by the southern European countries especially hard hit by COVID-19) or loans (favoured by northern Europe) could prove difficult to resolve. Northern Europe, including Germany, has shown no appetite for Corona Bonds, or in other words bonds guaranteed by the EU. In recent weeks, some tensions have appeared in the inter-bank lending market in Europe with suggestions some banks are unwilling to lend to those in southern Europe.

China on the other hand, has embarked on fiscal stimulus, and there are already signs of increased spending on fixed asset investment and infrastructure. This stimulus now will be different from that in 2018 when it was more focused on the consumer and should begin to impact on the Chinese economy in a positive way after a one or two quarter lag, something which happened both in 2009 and 2016.

Many market commentators have looked to previous bear markets for insight, and in those associated with normal recessions, it is quite typical for a significant bear market rally to occur before another decline retesting the earlier low. This, for example, was the pattern seen in the GFC. However, perhaps on this occasion, the best analysis is to highlight the difference with previous recessions. This recession will be exceptionally deep and driven by government policy, but in all likelihood will be exceptionally short. Typical recessionary periods last for over a year and consequently the accompanying bear market is also a long drawn out affair. With the re-opening of economies now in focus, there is a likelihood of a statistically large rebound in output in the July-September quarter, although absolute levels of output will remain significantly below the previous peak. Arguably, this can already be seen in market moves with the quickest decline into bear market territory ever, with a US bear market lasting only a month with a fall of 35% and a new bull market underway with the US rallying over 40% from its intra-day lows and around 30% from its closing low……more

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