TierOne

Market Update 20.04.20

Summary
Markets have gone into the second quarter, placated by the huge fiscal and monetary packages and with some evidence that peak intensity of cases (in the developed world) is now occurring. Focused has moved to potential exit strategies. If economies can return to some level of normalisation by the end of the year, albeit with a caveat that travel and leisure sectors are likely to be impacted negatively for longer, markets will be able to make progress. The environment remains volatile and we will continue to see news of unprecedented events

Year to date the Chinese and US stock markets have been the best performers, and this seems justified by the economic policy response in both cases. China is now emerging from an authoritarian lockdown which appears to have successfully stemmed the spread of the disease. The policies employed by the US administration, while looking to contain deaths (50,000 today), remain focused on avoiding long lasting economic carnage. Markets will now be highly sensitive to how the prospects for recovery pan out in practice, and until this becomes clear, they may settle into a trading range. Any positive news, either on vaccines or potential cures, even if only widely available many months ahead, will be viewed as positive news and today markets rapidly discount future events at an unprecedented rate. This was seen with the most rapid decline into bear market territory in history which has left the S&P 500 23% off its intraday lows, one of the most rapid rebounds into bull market territory.

To date the market has played out the recession copybook in classic fashion with cyclicals and highly geared companies, which we hold least in our portfolios, the hardest hit. In fact, it is these companies that have rebounded the most. After the initial rebound in these hardest hit stocks, market attention is likely to refocus on who will be the long-term winners in the post Coronavirus world. In a typical recession earnings declines of up to 50% can occur, but in general, stock markets take 12-15 months to move from peak to bottom, rather than the four weeks which has just happened. Studies of previous downturns show markets typically recover in 2-3x the period it took them to fall. In other words, a 12 month bear market takes 2-3 years to regain all the lost ground under this formula, but with the level of uncertainty persisting, it would be unrealistic to expect a full recovery in only three months. However, even if the economic recovery is sluggish, being more U-shaped than V-shaped, one lesson from the GFC is that stock market recoveries can be very different. Despite the fact it took a decade for the global economy to return to more normalised levels of economic growth, in contrast the stock market rebound was V-shaped and today with the influence of quantitative trading and risk parity fund (refer to these noted on our cover email), markets are likely to anticipate and take on board positive or negative future news flow at a much faster rate than has occurred in the past. Positive news on vaccines, drug treatments, or successful containment of the disease once lockdown measures are relaxed, could well result in a V shape stock market recovery even if the economic rebound is more muted….more

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