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**Summary Market Outlook 3 July 2020**

The world is now enduring the deepest peace time recession in the past 150 years. The distribution of the downturn has not been equal. Countries in the emerging world have suffered more due to inadequate healthcare systems, high density of population in cities with overcrowding commonplace, and a lack of means to put in place a strong enough fiscal response to protect the income of the majority of the population. The prospects for emerging markets until the rate of growth in the pandemic slows significantly in these countries, which include Brazil, Mexico, India and Indonesia remain poor compared to the developed world. Within the emerging world North Asia remains best placed.

Although at the outset some politicians described Covid-19 as a disease which struck equally amongst the rich and poor, looking at mortality rates this has been far from the case. In the developed world the poorer parts of the population, especially ethnic minorities, have suffered the most and this has reignited the debate about inequality, Black Lives Matter being one example. Inequality has been a simmering feature of post Financial Crisis society as was seen with the votes for Brexit, Trump and general rise of populist parties. Previous pandemics have been linked to rises in political extremism as highlighted by the New York Federal Reserve paper which argued that the Spanish Flu was one of the factors behind the rise of the Nazi Party in Germany who were elected in the 1930s.

On a more positive front, there has been continued progress on the vaccine front with a number now entering, or due to enter, final stages of human testing, which includes potential treatments developed by Moderna in the States and the Jenner Institute Oxford vaccine together with some other trials within China. Until a vaccine is found the impact on the service sector in particular is likely to be long lasting with behavioural changes by consumers. There has also been further progress on the treatment front with dexamethasone working successfully on serious cases reducing mortality rates, whilst the Gilead remdesivir treatment is now being developed in an inhaler form where it can be taken by patients outside of hospital. At present this treatment can only be administered intravenously and has been shown to work on milder, rather than severe cases, so the ability to administer this to patients outside of hospitals would be extremely useful.

Economic data now suggest a rapid initial bounce back from economies which were locked down. How long lasting the recovery will be and whether this start of a V continues or morphs into an initial sharp recovery which flat lines remains to be seen. At present, consumers have been sheltered from the worst economic impacts of Covid-19 in the West through either wage subsidy or in the case of the States increased levels of unemployment benefits. In the States these are due to end in the latter part of July, whilst European governments have indicated these support schemes will be gradually phased out between August and October. With sectors reliant on high levels of human interaction likely to remain subdued, this will prove a challenge to consumption.

Markets are, once again, entering an era of financial repression where Central Banks deliberately hold interest rates below the level of both inflation and nominal economic growth which in itself will aid deficit reduction over the medium term. Post the Financial Crisis periods of financial repression have provided positive returns for equity investors although these returns have been front loaded with markets front running economic recovery benefitting from the lower discount rate applied to corporate earnings. This remains an environment likely to favour high quality growth stocks with visibility of earnings or revenues. Investors will focus on the likely return to trend growth in the next

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couple of years, together with the prospects of vaccines or better treatments at a time while there is still huge stimulus in the system, both monetary and fiscal, and (albeit from a low base) improving corporate earnings. The longer term threats to markets of higher inflation, withdrawal of stimulus, and less globalisation do not pose an immediate threat. The debt overhang and savings glut all point to subdued rates of growth and inflation and consequently low interest rates.

Markets are not factoring in any major problems or setbacks to the global economy. Clearly the so called second wave would cause concerns, but this should not be confused with localised flair ups which have occurred in some European countries. In the States the disease had not really been suppressed in areas where cases are rising rapidly. Many US states eased restrictions/lockdowns at a very early stage certainly compared to countries in both Asia and Europe. President Trump now seems to be an advocate of herd immunity and be prepared to tolerate higher case numbers rather than re-impose restrictions which would damage the economy and even more importantly his chances of re-election.

Both geo-politics and the US election have the potential to upset markets. In the most recent developments Trump has seemingly pulled back from conflict with china stating the trade deal remains intact but has now looked to increase trade tensions with Europe. With trump continuing to lose ground in opinion polls increasingly erratic actions by a beleaguered president who fears an end to his term in office could result in prosecution looks likely.

In the short term, valuations remain on the expensive side, but current levels of bond yields suggest for many investors the alternatives to equities are not attractive either. Cash rates in many economies remain negative. The US Federal Reserve, who have now moved to buy cash corporate bonds, including high yield, have sent a “do whatever it takes” message to the markets and the ECB are now countenancing buying non-investment grade debt. Whilst the Fed have made pessimistic comments on the longer term impact of the Coronavirus, this means accommodative policy is here to stay, and in fact Jay Powell in his address to Congress in mid June emphasised the necessity of continuing fiscal support. The likelihood is that any Coronavirus second wave, or localised pickup would be dealt with differently now, and there is not the same level of economic risk as governments are likely to want to avoid a full lockdown. In this environment medium term investors should remain committed to equity markets but expect heightened levels of volatility in both directions to continue. The strong differentiation between winners and losers in this new world look set to continue. The US market looks likely to stay in a wide trading range as suggested in the last market update of 2600-3100 and investors should look to add to equities on bad rather than good news. Markets have once again proved this year it is better to buy when the price is right and the news is bad than when the news is good but the price is high.

**Graham O’Neill**