Monthly Newsletter Savings and Investments

A ray of light after it suddenly became dark

April 2020

Market overview

The first quarter of 2020 is now behind us and this quarter has been tough one for most investors. While it was already clear that we were in the later stages of the economic cycle, nobody could have predicted at the start of this year that large parts of the global economy would be brought to complete suspend by the COVID-19 pandemic. The debate lately has moved on from whether or not there will be a recession this year, to how deep and long it will be. However, the COVID-19 pandemic and reactions to it among decision makers and market participants seem to be entering a new phase. Everyone realises the magnitude of short-term problems, but the focus of attention is gradually shifting to the question of when a recovery will come and how it will look. Despite very serious developments around us, with tragic consequences for many, we are cautiously optimistic about the prospects for economic recovery late in 2020 – with financial markets reacting positively before then, as the outlook becomes clearer.

Stock market indexes' performance (until 31 March 2020)

Region	Index	Currency	Performance							
			2020 March	2020 YTD	12 Months	2015	2016	2017	2018	2019
USA	S&P 500	USD	-12,5%	-20,0%	-8,8%	-0,7%	9,5%	19,4%	-6,2%	28,9%
Europe	MSCI EURO	EUR	-17,2%	-25,6%	-18,5%	6,1%	1,7%	8,7%	-14,2%	22,0%
Eastern Europe	MSCI EM Eastern Europe	USD	-23,1%	-36,7%	-25,9%	-8,1%	33,0%	12,9%	-8,3%	26,9%
Asia	MSCI EM Asia	USD	-11,9%	-18,3%	-14,1%	-11,8%	3,8%	40,1%	-17,3%	16,6%
Latin America	MSCI EM Latin America	USD	-34,6%	-46,0%	-42,6%	-32,9%	27,9%	20,8%	-9,3%	13,7%

Major events and expectations

Second phase of COVID-19 pandemic. We see some signs that the spread of COVID-19 may have peaked in some European countries, also indications that the number of coronavirus deaths in New York has stopped climbing. We started to see signs that the spread of COVID-19 may soon culminate. However, the coming weeks will doubtless be extremely stressful in much of the world, especially the United States but also in Europe – above all from a human perspective, as we empathise with all victims, but also from the perspective we have a responsibility to try to interpret: economic and market developments.

It is now becoming clear that the world's economies and markets are entering a kind of second phase. We know more about how the virus spreads, what countermeasures to take and their impact – but not everything. It is increasingly possible to see the big picture and make forecasts, causing markets to calm down somewhat. Many observers now say it may be possible to start lifting the paralysing lockdowns at some time between May and late June, depending on country and events. We share that view. In our assessment, the world economy can withstand this extreme stress without excessive, lasting losses of value. All the extremely powerful steps that have been taken by governments and central banks to offset the impact of the pandemic have the potential to soften the decline and hasten the recovery once it starts, especially if the forecasts that we can begin easing restrictions before summer prove correct.

However, it is over-optimistic to believe everything will soon revert to normal; the process is likely to be fairly protracted. We will see effects on the supply of goods and services, since lost production resources due to businesses that went bankrupt or sharply reduced their capacity will take time to replace or restore. We will also see effects on demand, since purchasing power falls as people lose their jobs, while some consumption patterns will probably be affected for a long time; for example, perhaps we will travel less and save more. Naturally no one knows the exact course of events, which will depend on the spread of the virus.

Impact on financial markets. In fixed income market, government bond yields have plunged as investors were searching and moving to safest asset classes and government bonds is one of them. But yields on corporate bonds have meanwhile moved in the opposite direction, rising sharply. In other words, corporate bond prices have fallen. This has meant tough times for everyone who invested in corporate bonds, especially those with higher risk, known as high yield bonds. It is not unusual for this to happen. The risk that companies will encounter payment problems increases in times like these; investors want compensation for this in the form of higher yields and thus lower bond prices. This effect has been amplified because market liquidity has occasionally been strained. We now foresee that today's HY bond yields will provide good compensation even for fairly negative events ahead. We thus foresee good potential returns for long-term investors. In the near term, though, prices may fluctuate strongly.

In stock markets, we foresee a similar but less clear picture. Now that share prices are 20-25% below their February peaks, the market has already priced in much of the weakness ahead. We also expect it will be necessary to make sharp downward revisions in corporate earnings forecasts for 2020 and perhaps 2021, so the downturn is partly justified. But once our picture of events more clearly suggests that the world will move towards normalisation within a reasonable period, share prices will probably also have shifted to a more positive trend. There will then probably be room to predict rising corporate earnings going forward**.**

Government stimulus and relief packages. An unprecedented shock requires an unprecedented policy response. And that is what we have seen.

In the US, a very substantial fiscal stimulus package has been agreed, worth about 10% of GDP (2000 billion USD), which will include grants from large to small businesses and for households. The rumors of another big (1500 billion USD) coronavirus relief package said to include a combination of tax cuts and grants to households. This added to positive sentiment. "Financial Times" has done a poll which shows that 73% of Americans say the pandemic has reduced their family's income and almost half say they would be without income all together if they were to become ill. This is yet another indication of how severe and widespread the negative impact on the economy is and how crucial it is to find ways to get people back to work as soon as possible.

In Europe we also saw encouraging fiscal relief packages. For example, in UK and Germany governments have committed to pay a significant proportion of workers' wages during the shutdown to enable companies not to lay off staff despite the dramatic hit to sales. This is precisely the right kind of policy to deal with this type of shock, to give those economies the best chance of rebounding sharply once the health situation is under control. Germany is so far the country in Europe, which has launched the biggest fiscal response to the crisis with 4.4% of GDP in direct fiscal stimulus, tax deferrals worth 14.6% of GDP and liquidity and loan guarantees of 32% of GDP.

Overall, fiscal policy has already delivered a significant stimulus globally but further measures are still likely to be needed to deal with the size of this shock.

Central banks have thrown monetary packages, cutting rates to their lower bound and restarting and expanding asset purchase programmes. The Federal Reserves' commitment to purchase as many government bonds as necessary is a substantial step, which should enable it to keep government borrowing costs low, despite the massive fiscal stimulus that is required to deal with the economic consequences of the virus. While the European Central Bank has not been quite as explicit that their firepower is unlimited, we do not doubt its commitment to keep government borrowing costs low and provide liquidity for investment grade corporates. In short, the central banks are doing all that can reasonably be expected of them to fight this crisis.

The economic recovery. Our main scenario continues to be U-shaped economic trend. We now have the initial steep decline behind us and are moving along the bottom of the U, hoping that the trend will start climbing again relatively soon. But unlike the letter U, we must expect the ride back up to the old level to take far longer than the downward slide. Still, in our main forecast we expect the world economy to accelerate late in 2020 and grow at a relatively healthy rate in 2021. We are starting at a lower level, with higher unemployment and various new structural imbalances to deal with, yet the trend will be positive.

Our market view. Given our main scenario, it will not be a question of whether the economy turns around, but when. And of course it matters what happens before then. As for whether things will get worse before they get better, that remains to be seen. We expect investors to gradually lift their focus of attention from the stimulus measures now being undertaken to their impact on the economy and on growth. We expect a series of dramatically negative macroeconomic statistics in the near term. On the other hand, after the stock market declines of recent weeks, a lot of negative news is already priced into market expectations.

Once developments more clearly suggest that the world will move towards normalisation within a reasonable time period, share prices will probably also have shifted to a more positive trend. But the road ahead is lined with extreme uncertainties. Another common pattern is that after a rapid initial downturn, we see one or more "false starts" before the market rebounds in a lasting way. Obviously it is hard to predict whether it will happen this time around; perhaps investors will choose to see through bad news and focus on the recovery that all the powerful government and central bank actions have led them to hope for.

At present, however, we see clear risks that the weak economic statistics likely to be published over the next few weeks, and continued reports about the spread of the virus, may lead to new share price downturns. But if the light at the end of the tunnel intensifies, such news will probably be regarded as buying opportunities. Remember that some of the most successful long-term investments have often been made when uncertainty was at its greatest: something that is likely to be true this time as well.
