Monthly Newsletter Savings and Investments

Stock prices are close to historical heights despite ongoing spread of the virus

August 2020

Market overview

July provided further evidence that economic activity has improved since economies opened after lockdowns. However, over July we saw signs of pause in the recovery, particularly in the US. The pace of increase in new infections also rose in most regions from the start of July, but appeared to slow towards the end of the month in the US, while rising, from much lower levels, in Europe and Japan. Hopes for a vaccine were boosted by positive early-stage trial results. Major central banks did not announced additional monetary stimulus, having already flooded the market with liquidity and taken rates close to their lower bounds. However, governments have been under pressure to provide further fiscal support. In US Congress debated the extent to which additional fiscal support is needed, focusing on labor market. Meanwhile the EU's leaders agreed on a 750 billion EUR Covid-19 recovery package. The union will borrow vast sums collectively for the first time in history. Summing up July, equities rose for the 4th consecutive month despite historically bad Q2 GDP-data, new virus outbreaks and partial closedowns and continued US-China tensions. On the other hand, company reports have continued to surprise positively (90% of US companies reported better than expected data). We thus have a cautiously optimistic view of risk assets such as equities.

Stock market indexes' performance (until 31 July 2020)

Region	Index	Currency	Performance							
			2020 July	2020 YTD	12 Months	2015	2016	2017	2018	2019
USA	S&P 500	USD	5,5%	1,2%	9,8%	-0,7%	9,5%	19,4%	-6,2%	28,9%
Europe	MSCI EURO	EUR	-1,7%	-15,4%	-9,5%	6,1%	1,7%	8,7%	-14,2%	22,0%
Eastern Europe	MSCI EM Eastern Europe	USD	1,4%	-24,2%	-17,4%	-8,1%	33,0%	12,9%	-8,3%	26,9%
Asia	MSCI EM Asia	USD	9,2%	4,4%	14,5%	-11,8%	3,8%	40,1%	-17,3%	16,6%
Latin America	MSCI EM Latin America	USD	10,7%	-29,2%	-27,3%	-32,9%	27,9%	20,8%	-9,3%	13,7%

Major events and expectations

United states – the country most-affected by the Covid-19 with almost 5 million infections out of almost 20 million globally. After virus spread slowdown in June, new infections in the US began to rise again from mid-June, firstly in centred in the northeastern states but soon rapidly across the rest of the country. This lead that many states begun to retake protective measures or pause their reopenings. As a result, we now again see slowing spread of the virus in the US. In addition, despite higher number of infections, the number of new daily deaths is lower now than at the prior peak. This could be due to improved treatment and more social distancing among older age groups. However, hospitalization levels have risen and this adds additional pressure on health systems.

Looking at economic data, we see historical economic decline, but also recovery signs in some data. US GDP in Q2 fell by an annualized rate of almost 33% compared with the Q1, which is the largest decline in GDP since the World War II. Nevertheless, such big decline was expect and it did not harm investors' moods. They have been more focused on the recovery in some of the economic data. For example, US retail sales have rebounded by 27% since their low in April. This is important, as consumption is main engine of US economy. Consumer incomes have so far been protected by support measures from the US government, which provided stimulus cash cheques (1200 USD one-offs and 600 USD weekly cheques), which boosted consumption. However, not all the data is picking up at such a rate. The labor market, which was hit hardest, will need more time for recovery. Congress is negotiating another stimulus bill, which could see a second round of stimulus cheques as well as some extension to unemployment benefits.

Corporate earnings are better than expected. From already published data about US Q2 earnings, almost 90% of companies reported better than expected data. Of course, much lower expectations have to be considered (expectations of roughly a 45% year-on-year decline). The S&P 500 rallied 5.6% over July.

Europe appeared to manage the virus outbreak better than many other regions in the Q2, though there are some concerns about rising cases more recently. Given new infections had remained low for some time we started to see signs of rising economic activity, particularly in Germany. However, a recent outbreak in Spain and some other southern Europe countries, coming just before the peak of the summer tourist season, raised some doubt over the potential for a faster economic recovery. The risk of an increase in new virus cases as economies reopen is leading to a potentially slower and geographically differentiated recovery.

Looking at European economic data, Eurozone's GDP in Q2 fell by 12.1% compared with Q1 and this was the largest quarterly decline in the Eurozone's history. European consumer confidence rebounded quite significantly after April declines, but lately we started to see stalling signs. However, looking at leading service and manufacturing indicators such as composite PMI, it improved significantly, to 54.8 from 13.6 in April. In order for the recovery to remain its strength sentiment must continue to improve and the surge in infections numbers must be curb without and general lock downs. If the latter where to happen the pathway forward must be viewed more cautiously. Effective vaccine would clearly be a strong catalyst for a more sustained economic rebound.

Very important and historical agreement was achieved in EU in terms of fiscal stimulus package in response to Covid-19. The EU agreed on a EUR 750 billion recovery fund. For the first time in history the union will borrow vast sums collectively, the recovery fund will be backed by common bond issuance by the European Commission. This is a significant step toward potential fiscal integration across the EU and has increased demand for European government bonds.

Emerging markets. The number of new daily virus infections continued to increase in some of emerging market countries with the largest numbers in Brazil, India and Mexico. Recent outbreaks in Hong Kong have also seen the reintroduction of restrictions, which will limit the number of people in group gatherings to just two, while mask-wearing is mandatory.

While in China, the country of Covid-19 origin, the situation seems to be under control with no evidence of bigger virus outbreaks. Therefore, China's GDP for the Q2 grew by 3.2% year on year. People mobility in China and also in South Korea has recovered well without a significant rise in cases. Both countries appear to show, at least so far, that a recovery is possible without a vaccine if the virus can be brought under control with other measures. Chinese equities were up close to 9% over July.

To summarize, uncertainty about the effects of new and continued coronavirus outbreaks may cause some stock market instability, but continued stimulus – such as central bank bond purchases and government fiscal packages – will help to sustain risk appetite. The weaker economies become, the higher the probability that central banks and governments will provide even more support, but if downturns are milder, corporate earnings will recover faster and share prices can then climb without such support.

Of course, a full economic recovery can only take place if rising activity does not also lead to rising infections. But as mentioned, governments and central banks should continue supporting consumers and businesses until a vaccine is available or until the virus is brought under control by other means. The extent to which they do so will be key to the outlook from here. It appears progress is being made towards a potential vaccine, but it is too early to sound the all clear just yet.

We expect continued low interest rates and bond yields – along with a slow return to more normal growth trends – to help sustain the stock market. We thus have a cautiously optimistic view of risk assets such as equities and high yield corporate bonds, and we are maintaining our hypothesis that stock market downturns can be regarded as buying opportunities.