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26th August 2020

Market Update

The 11th Hour

Last week saw a further round of Brexit negotiations and unsurprisingly little progress was made. Frustration was visible from both Michel Barnier and David Frost as they each claimed the other side to be unreasonable. Level playing field requirements, such as the UK's potential use of state aid, continue to be the major stumbling block. With the likely October deadline fast approaching, both sides are issuing warnings that time is running out. Nonetheless, both sides still see the possibility for an agreement to be struck. While the chance of no-deal is real, it seems likely that the hard talk is simply negotiating tactics, holding out for a last minute breakthrough.

A Weaker Wave

Since the start of July, daily confirmed cases of Covid-19 have been increasing in the UK and similar trends have been seen across many countries as society re-opens post-lockdown. The second wave appears to be upon us.

However, concerning as these headline figures are, there is good news to be found in the detail. Coronavirus linked deaths in the UK have continued to fall, maintaining the downward trend that has been in place from mid-April. This can broadly be attributed to three main factors: increased testing, meaning that cases which may have previously been missed are now being identified; a higher proportion of cases being identified in younger people, who are less likely to experience severe forms of the disease; and improved treatment techniques, meaning that survival rates are improving.

Balance Point

This trend suggests that the current balance between public health concerns and the economy is at a reasonable level. The increasing focus on localised virus responses can also be viewed positively from an economic perspective. Should a low death rate be maintained then it is increasingly unlikely that we will have to return to national lockdown, a situation that would be dire for businesses up and down the country.

Pain Still to Come

That is not to say that the current situation is all rosy, however. While business is returning across the economy, many sectors continue to face major challenges. Retail is one such area. While online operations have seen surges in demand since the virus took hold, physical retailers have struggled even since shopping restrictions were relaxed. A recently released CBI survey shows that two thirds of retailers are now cutting jobs, the highest level since data began in 1983. A reminder, as if any were needed, that the economic impact of this virus will have long lasting consequences.

Range-Bound

Against this backdrop, equity markets broadly remain trendless. Since June, the FTSE 100 has been range-bound in the low 6,000s. Strong gains were initially experienced following the losses of March as the government and Bank of England launched huge stimulus packages. Since then, however, there has been little additional risk appetite, with investors awaiting proof that the economic recovery is in place.

Crisis Valuations Justified?

Bond markets remain elevated compared to historic levels, however recent weeks have seen some weakness. This can in part be attributed to building expectations that the US Federal Reserve will no longer provide the shock and awe stimulus tactics that sustain such high prices, but may also be explained by an evaluation of supply and demand. The huge increases in government spending we have seen in recent months look set to be funded in large parts by higher government borrowing. While demand is unlikely to collapse, this increase in supply will eventually be a challenge for bond prices. The recent movements could well be the first stages of a reassessment of value for government bond markets.

Recession - Confirmed

After a 2.2% fall in Q1, a 20.4% fall in Q2 means the UK has now officially entered recession. With such a dramatic drop in output, this is now the deepest recession since quarterly growth records began in 1955.

The economic pain has been worse than that experienced by the US and amongst the worst in Europe. The extent of the damage can be attributed to the length of our lockdown and on the dependence of our economy on the badly hit service sector. On the plus side however, and the reason behind strong market movements today was a sharp bounce back of 8.7% in June, above average expectations of 8.0%. Nonetheless, this still leaves a long way to go before full recovery.

While Q2 was the worst quarter on record, Q3 may well be the best quarter, with much of the missing spending from Q2 leading to pent up demand for when the ability to spend has returned. This is likely to mean that the recovery over the coming months will initially be sharp, but it must also be assumed it is likely to decelerate, as the job market looks set to worsen as the year goes on. ONS figures show that 730,000 jobs have been lost since the start of lockdown and with the ending of furlough scheduled for October, it seems likely that many more job losses will occur as companies are increasingly expected to stand on their own two feet.

Vaccine

The development of an effective and safe vaccine for Covid-19 is the global dream currently, as immunity could allow close social interaction once more, permitting society and the economy to return to pre-crisis conditions.

High profile scientists are often reminding us that success in this search is not guaranteed and that even if a vaccine is developed, by itself it would unlikely be a panacea. However, that appears not to dent the growing confidence that one of the many treatments currently in development may prove successful.

Goldman Sachs has issued a forecast believing that US authorities will approve a vaccine by the end of 2020. Elsewhere, Russia now claims to have developed a successful vaccine, which it intends to rollout to its population. International scepticism of this has been high, with the belief that the drug has not yet been sufficiently tested. Yet, the confidence of Russia does seem to be impacting markets, with strong gains on the day of this announcement. This is a reminder that should an internationally recognised drug be approved, then markets are likely to experience a significant rally.

Cheese, and Other Trades

EU-UK trade negotiations have been out of the headlines recently, but with the next round of talks due next week, expect Brexit discussions to increase in volume once again.

In their absence though, we seemingly have had good progress in talks between the UK and Japan, being led on the UK side by Liz Truss, international trade secretary. Largely working from the blueprint of the EU-Japan free trade agreement, a quickly arranged deal is seen as achievable, although a last minute argument over Stilton may be proving an unexpected hurdle.

At a national economic level a Japanese free trade deal may not be the most significant development, with the potential agreement expected to add only around 0.07% to Britain's GDP (compare this with the expected 5% loss from our departure from the EU single market and customs union). However, it will be seen as important as an early win for our post-Brexit freedoms. What's more, a deal with Japan is also seen as a stepping stone to the greater prize of joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), a Japanese driven trade agreement which includes Japan, Australia, New Zealand, Canada, Mexico and Singapore, amongst others. If membership is achieved, this will be a seen as a real prize of Brexit.

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