August Market Reflection

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Covid continues to dominate the news headlines, but has had less of an effect on financial markets. Although case numbers continue to rise in Continental Europe as lockdowns ease and holiday travel increases, hospitalisations and mortality rates are far below the levels experienced at the peak of the outbreak. This is a function of both the lower average age of those tested and found to be infected and the advances made in the treatment of symptoms. Both of these factors should ensure that future lockdowns are much less draconian than earlier in the year, suggesting lower risk to the economic recovery. Even so, headwinds are predicted to increase in the autumn as employment support schemes are gradually wound down and companies embark on more permanent staff reductions. Against this background governments will be reluctant to turn off the fiscal taps completely. Happily, bond investors have shown their willingness to keep funding the deficits, ably supported by central banks and their asset purchase programmes. Although there is concern that these new liabilities will have to repaid at some point in the future, that point is sufficiently far beyond the market's current investment horizon to be immediately worrisome. Low bond yields help to keep the interest bill down, too. Equity market leadership remains in the hands of stocks with strong growth characteristics, especially the winners from the current phase of Covid-related disruption, notably within the Technology sector. This continues to be beneficial to the US equity market, which made several new all-time highs during August. European equities and the euro have also witnessed something of a resurgence as hopes grow of a more sustainable economic recovery, with the European Union's €750bn stimulus package well received.

- The IMF's latest forecast sees the global economy shrinking by 4.9% in 2020, followed by a recovery of 5.4% in 2021.
- Investor surveys point to expectations of a vaccine being widely available within six to eighteen months.
- The second quarter reporting season has, on average, beaten analysts' reduced expectations and provided some of the positive impetus for equity markets.
- The race for the White House has started in earnest, with both parties holding their (virtual) conventions. Democrat challenger Joe Biden continues to hold a healthy lead in the polls, but the outcome will be decided in a relatively small number of swing states, meaning that the result remains far from a foregone conclusion.
- The US Dollar has continued to weaken from its March peak, now that its interest rate premium versus other currencies has been eroded. Safe haven demand has also diminished. A weaker dollar tends to signal better performance from non-US equities, notably Emerging Markets.

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- The biggest question facing investors in the medium term concerns the potential re-emergence of inflationary pressures owing to policy stimulus measures and possible supply chain disruption. This would change the investment landscape dramatically following four decades of persistent disinflationary trends.

- Investors have begun to seek out inflation insurance policies, as seen in the negative real yields available on index-linked government bonds and the strong gold price.

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