May Market Reflection

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The confidence that investors rediscovered during April's equity market recovery continued through May despite a stream of negative company news, a rising Covid death toll and further evidence that the global economy will suffer the deepest recession in living memory. Financial markets are of the opinion that the worst of the virus-related disruption is already behind us in terms of overall economic activity, and there is some truth in this, as countries around the world relax lockdown restrictions. Sentiment has also been bolstered by the unprecedented scale of policy support offered by central banks, as well as levels of fiscal loosening that one might usually associate with wartime. The markets' rally has consequently begun to broaden out to embrace more economically sensitive companies, as opposed to the initial recovery which featured mainly "all weather" defensive companies and those that benefitted directly from the dislocation. Even so, there remain myriad uncertainties which have the potential to create future obstacles. Uppermost is the progression of the virus, with the threat of a "second wave" of infections not to be ignored. This could either be the result of increased social interaction, or driven by the (as yet unproven) seasonality of the virus. Investors continue to react positively to any positive news relating to the development of a vaccine, although history suggests that a degree of caution should be exercised in terms of the timescale. The continued deterioration of relations between the US and China is another reason to hold back from assuming excess risk in portfolios, with the lack of progress in Brexit negotiations providing further uncertainty for the UK. We retain a benchmark position in equities against the background of improving Covid sentiment.

- Economists are finding a floor in terms of their expectations for growth in 2020, with the majority in the -3% to -4% range. The trough of activity will have been passed in April, during which period the world was in maximum lockdown.

- The game now turns to assessing the speed and extent of the recovery. Although the initial bounce might be strong, especially as pent-up consumer demand is released, sustained high levels of unemployment combined with higher debt loads suggest a longer period before previous levels of activity are regained.

- One longer-term casualty of the coronavirus appears to be the total dividend payout, especially of the UK market. Companies are currently conserving cash, either by choice, out of necessity, or by decree in the case of banks. Some will take the opportunity to reset their payments at lower, but more sustainable, levels.

- Government bond yields have remained very low thanks to investor and central bank demand. In the longer term, the threat of higher inflation as a result of shorter supply chains, lower capacity in some sectors, and a hiatus in the march of globalisation, could exert more upward pressure on yields.

- In the short term, though, there is increasing talk of negative bank base rates in the UK, a possibility no longer denied by the Governor of the Bank of England. Despite a lack of income, cash plays a valuable role in balanced portfolios as a risk dampener and provides useful firepower during periods of market stress such as was witnessed in March.

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