Weekly Digest

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Healthy Appetites

A most unusual thing happened last week. My monthly credit card bill arrived, and instead of threatening to remove money from my bank account as it normally does, it kindly promised to pay something back. Not only had I not spent anything, but British Airways had refunded the cost of flights to Istanbul, which is where my wife and I had been looking forward to spending the Easter weekend. I'm hoping that easyJet will be as compliant when it comes to the cancellation of my annual golfing trip to Spain in June.

Along with many others who have remained employed but have severely curtailed their expenditure (for want of anything to spend it on other than groceries), my household savings rate has rocketed upwards in recent weeks. While it is abundantly clear that not everyone is as fortunate, there is growing talk of pent up demand and savings leading to a surge in consumption as lockdown restrictions continue to ease. One investment letter I received last week referred to "caged tigers" being released with healthy appetites. I must admit I fail to share the writer's optimism. Certainly there will be a decent recovery from the extraordinarily low current levels of activity, but anything that resembles normality still appears to be some way off for several reasons.

First, and possibly most difficult to pin down, is the psychological aspect. Just because you are allowed out doesn't mean you are going to throw caution to the wind. When it comes to Covid, there are only two states in which you can exist – either you have been infected or you haven't. However, to increase the uncertainty, unless you have had it badly and/or been tested you currently can't know for certain whether you have had it or not. Erwin Schrödinger (of eponymous cat fame) could have had a field day with this one! Thus it appears probable that people's risk-taking appetite, when it comes to social interactions, will remain low for some time. There is also growing concern about increased and prolonged unemployment. The Chancellor has recognised that risk by extending the furlough period (with some potential restrictions), but more employers are acknowledging the need to "right size" businesses for the current times. People fearing redundancy will be more circumspect. Even many companies and individuals that do survive will find themselves carrying higher loads of debt than before, another constraining factor. Also, there is growing talk of higher taxes to help pay down increased levels of government debt. When people think they are going to be taxed more in the future, they tend to save more in the present.

Second, there will be a limited amount of supply. It looks almost certain that large events such as concerts and major sports will be unable to entertain capacity crowds until either a vaccine is widely available or herd immunity is established. Restaurants, bars and hotels are going to have to operate at well below capacity to comply with physical distancing rules.

I have seen photos of a restaurant deploying dummies to make it look like the place is busier – that's just creepy. A bar in California has its customers seated in plastic "tents", which I don't find appealing. The owner of a bar in Sydney that has room for a thousand revellers rightly points out that the atmosphere will be somewhat lacking if only ten people are allowed in at a time. I have yet to visit my golf club, but the rules are pretty strict there too. Arrive and leave no more than ten minutes either side of your reserved tee time; no hospitality; and only essential items available from the pro shop. And with only nine holes of play allowed, I won't have to replace as many lost balls as usual! At least the Greeks have decided not to contain beachgoers inside plexiglass boxes, once they realised that they might as well just pop them in the microwave.

And that's if you can get there. There appears to be no joined up plan concerning cross-border travel, with all countries acting independently. There are different criteria for eligibility to travel and different rules on quarantine. Some countries, notably Australia/New Zealand and some of the Baltic countries are establishing travel "bubbles" between themselves. As for testing policies on arrival, again no consensus. Flights themselves could well have restricted capacity, and this could force prices up, pricing many out of the market. Interestingly, I note that Air France, as a condition of receiving state funds, will be asked to halve emissions from its domestic flights by 2024. Barring some currently unforeseen technological breakthrough, the only way this can be achieved physically is by cutting the number of flights in half, which again will increase costs. They could possibly buy carbon offsets, but passengers will no doubt have to pay for those… and the carbon is still created. It will be interesting to see if the green agenda is pushed in more places as a condition for financial assistance.

Last week I highlighted examples of reduced productivity in manufacturing caused by reduced numbers of workers. A Renault plant in France said much the same, citing that even though half of its workforce has returned, production is running at less than half. On top of that the company cited increased costs for protective measures. Meanwhile Volkswagen has had to shut four of its plants because there was insufficient demand for the cars they were making.

If that's the "glass half empty" view of the world, then we can take a little more comfort from the fact that overall activity is, at least, climbing out of the abyss. Goldman Sachs has created a proprietary indicator of global activity based on its own Effective Lockdown Index. This suggested in early April that the world was, in aggregate, operating at more than 16% below its peak earlier this year. That figure now stands slightly better than -14%, and so an improvement, even if woeful by normal standards. Later this week we will see initial readings for this month's purchasing manager surveys. These will almost definitely see a recovery from last month's readings, if only because a bounce from virtually no activity is still a bounce. Financial markets often latch on to such "rates of change" or "second derivatives" as a reason to change course themselves. In this case, less bad figures could spur increased risk appetite. However, the actual levels of activity suggest a more cautious approach. And there is also the fact that markets have already had a good recovery off the lows. It will be interesting to see the reaction as a gauge of investor sentiment.

From an asset allocation perspective, this leaves us sitting on our hands for now. The market offered us an opportunity to act during the dislocation of March, which we accepted, and now it's more about subtle tweaks on the tiller in terms of stock selection rather than a major changing of the sails. To add to all the uncertainty over Covid, there are several pieces of "unfinished business" in the world which also lead us to err on the side of caution. Domestically there is Brexit, where negotiations appear to be heading towards a brick wall. Internationally, the relationship between the United States and China continues to deteriorate. Related to this, and betraying a more pervasive trend, the Global Business Alliance, a body representing international companies in America, cited 77% of its members as viewing the US as becoming more protectionist, with 69% seeing other advanced economies also putting up trade barriers of some description. All else being equal, that suggests less efficiency and more cost.
To end on a lighter note, conference calls continue to be blighted by background noises from people, for example, demanding their cooked breakfast, or the sound of washing up. One of my colleagues labelled those who fail to mute their phones as "unmutineers". Genius! I should submit that to the Oxford English Dictionary.

Last week's Economic Highlights

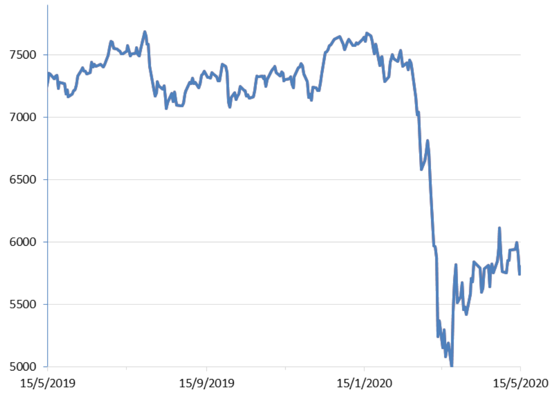
FTSE 100 Weekly Winners

Kingfisher	9.7%
Hargreaves Lansdown	8.5%
Fresnillo	8.3%
Vodafone	7.1%
Reckitt Benckiser	5.8%
Rio Tinto	5.3%
Ocado Group	4.9%

FTSE 100 Weekly Losers

Land Securities	-18.7%
Compass Group	-15.3%
Micro Focus	-14.6%
British Land	-14.1%
Rolls-Royce	-13.0%
IAG	-11.0%
Barratt Development	-9.9%

FTSE 100 Index, Past 12 Months



Source:FactSet

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