TPO Investment Market Update

The Bank of England (BoE) deliver their views on the effects of the Pandemic.

14 August 2020

The mainstream news channels are doing an excellent job at ignoring any positive news. Since lockdown started in March the markets have known that we would now be in recession, yet if your only source of information was the evening news you would be forgiven for believing that the recession is a bolt from the blue and yet another blow to the economy. In truth, it is the same news from March being repeated again and again.

What is seldom mentioned is the fact that for most leading economies the reduction in GDP is not as bad as originally predicted. Good news, however, doesn't get ratings. In the real world, Governments are supporting economies at an unprecedented level and this, along with generally promising news regarding vaccines and treatments, has resulted in a V shaped recovery (so far) with most markets. We mustn't be complacent, however. We are still a long way off the highs of last year and unemployment figures are genuinely depressing. Setbacks may, legitimately, be just around the corner so caution is the by word.

Economic and Political Data

The US

We are over halfway into the Q2 earnings season and reporting companies so far have beaten forecasts by about 25%. That said this is a not a broad-based improvement because what we are seeing is resilience in earnings mainly from consumer staples and tech companies. The former is a beneficiary of pent up consumer demand and staples are to a large degree agnostic to market events, the latter being a newly appointed 'safe haven' for investors in recent months.

We also saw the recommencement of unemployment benefits following the expiration of the $600 a week jobless benefits that were offered to help individuals stabilise their income. The amount is $200 lower however; and with this being expediated via an executive order over the weekend, there is the potential for legal challenges.

Second-quarter GDP showed the US economy contracting at an annualised rate of 32.9%. This is slightly less than expected but this is still the largest retrenchment in recent times.

Europe

Recent economic data has shown signs of improvement with manufacturing and servicing output increasing with the fastest rate in two years being recorded. However; one must be conscious of the low point in which we are benchmarking these notable improvements against.

The launch of the European Green Deal looks set to solidify Europe as the sustainable capital of the world – 46% of global sustainable capital is now denominated in Euros and this is set to increase as the deal will look to integrate capital markets with the climate economy and help drive private capital to sustainably focused ventures.

The ECB reaffirmed its guidance that EU banks should continue to not pay dividends or buy back shares. The problem this has brought to the fore is that banks are actually tightening their credit lending requirements, there is an aversion to take on risk because the state has essentially capped the returns of the banks (no dividends, extreme moderation on bonuses etc.) so there's no desire to take on risk in a time where it is arguably needed most.

The UK

The UK and Japan look set to finalise a post Brexit trade deal by the end of the month. Initial reports are that major parts of the deal have been agreed specifically in relation to digital and financial services which is key to both respective economics. This is also beneficial news as Japan is one of the largest Foreign Direct Investors for the UK.

We urge you to stay safe and remember that your TPO advisers are here to guide you through this storm. If you have any questions or concerns, please do get in touch.

The value of investments can fall as well as rise. You may not get back what you invest.

The BOE have forecast that the UK economy would contract 9.5% this year, less than the 14% forecast in May.

The Governor Andrew Bailey announced that he supported the Government's decision to end the furlough scheme in October. The stated reason was to help the UK workforce move forward; however, it would be surprising if there was not a financial consideration underpinning his agreement.

The UK economy has officially entered a recession (this being the technical definition of two consecutive negative GDP readings) as we saw a decline of over 20% for Q2 which followed the 2.2% in Q1.

China

China's GDP expanded by 3.2% year on year, reversing a 6.8% contraction in the previous quarter. This impressive turnaround has been credited with the countries agility in dealing with the epidemic by implementing higher fiscal spending, tax reliefs and cuts in banks' reserve requirements to bring the economy back to life.

That said we have seen diplomatic relations with the US continue to worsen. If you cast your mind back to March of this year, you will have seen headlines of President Trump and President Xi Jinping having a great deal of respect for one another and wanting to work together in the global community. Fast forward five months and the US Government has banned US companies from working with Chinese technology companies. This includes using WeChat which is owned by Tencent and Byte Dance which owns TikTok.

Meanwhile China; has issued sanctions against notable US senators Ted Cruz and Marco Rubio who have been openly critical of China's new security law on Hong Kong.

This has not been isolated solely to the US and the new law has attracted criticism on much of the world stage, particularly as we saw the enforcement of this new law with the arrest of well known Beijing critic Jimmy Lai, the Hong Kong media entrepreneur.

The BoEs commentary on the state of the UK economy

The BoE recently this month released their Monetary Policy Report (MPR) alongside its Financial Stability Report which provided an insight into the BoE's view of the current and future health of the UK economy. such we are likely to see a rise in defaults. This has started already with default forecasts at between 10 and 13%, levels not seen since the depths of the 1990 recession.

As a brief summary economy activity is expected to have a sharp rebound, whilst unemployment is expected to increase as we are seeing spare capacity in the economy. Finally, inflation is expected to be subdued and well under the BoE's 2% inflation target.

As mentioned previously the UK has entered a recession this week with one of the largest GDP drawdowns when compared to peers.

One of the reasons cited is that the UK has been late in implementing lockdown measures and in turn late in reopening their economy. In other words, the UK is acting on a lag. We saw European activity levels increase from April and the US saw activity levels increase from Mid-April.

Fast forward to the present and activity levels in the UK are significantly below Europe and the US and on par with EMEs (which is a composite of emerging market economies excluding China).

This lag though does mean we can expect further increases in activity from the UK and this is supported by looking at the High Frequency Indicators of Economic Activity.

We can see activity increasing across the board with the much-publicised increase in air travel continuing, motor vehicle traffic increasing and search engine results for the purchase of motor vehicles increasing. Meanwhile; we also saw retail footfall increase exponentially with restaurant dining also increase although not by the same magnitude. This expected to increase further following the Government's 'eat out to help out' scheme.

In terms of actual spending at the peak of lockdown average consumer spending was around 30%–40% below pre-crisis levels – as you would expect we can see expenditure on staple items remained relatively unaffected however social spending was the most impaired with a fall of over 80%.

Positively though we have seen 'Delayable Transaction', which includes the purchase of furniture and clothing as examples, rebounding after a fall which has been attributed to a pent-up demand being exercised on the easing of lockdown.

Only time will tell whether this is transitory or a permanent move to recovery but in any event for the time being the UK economy is coming back to life.

TPO Portfolios

Portfolio performance of the TPO Preferred portfolios has been gratifying in recovery although we remain cautious and particularly in the ESG sector, where valuations are higher now than they were before the Covid19 crash. An expansion of our Passive Portfolio offerings will, we believe, provide a lower cost option which may be suited to a more cost conscious environment. Whatever the pandemic has left to throw at us, the fundamentals of investment remain unchanged.

Portfolios should be correctly diversified, and the risk should be appropriate to give clients the best possible chance of receiving the returns they need to meet their financial goals.

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