COVID-19: Weekly Round-Up

11 May - 15 May 2020

IN BRIEF

- As the US employment report for April confirms a dire month's numbers, closer to home, the UK and EU start their third round of trade talks.
- While markets have looked through the weaker economic news to date, risk appetite now faces two new headwinds: US/China tensions and risks of a second viral wave.
- 6 months out from the US Presidential election it is looking increasingly unlikely President Trump's rhetoric towards China will calm any time soon barring a perceived capitulation from China.

OUR VIEW

Monday

Last Friday's US employment report was the worst since the Great Depression but that did not stop the market's rally last week. The US equity market was up over 3% and the technology sector outperformed even that with the effect that technology has now posted positive returns year to date. The details of the US report contained little good news but largely echoed the weekly jobless claims which markets have been paying closer attention to. As such, there was always going to be less ability for this latest data point to shock markets' risk appetite. Instead, of more concern is that the last few weeks has seen the risks of 2019 returning with a coronavirus skew. US/China trade tensions was the most recent example but joining this now is the third round of EU/UK negotiations which start this week. With market's expectations set low for any real progress, the clock continues to tick towards the 1st July deadline for both sides to decide whether to extend the transition period beyond the 31st December. So far the UK government has shown little appetite for this but the impact of coronavirus on the government's focus, lack of face-to-face negotiations and the fragility of the economy all create a viable excuse should the UK want to opt for it. Sterling has rallied off its lows against the Euro sitting at 1.14 today compared to 1.06 in the depths of March however it is unlikely to appreciate being put back into the spotlight if trade talks flounder.

Tuesday

It was a relatively quiet day for markets on Monday bar incremental news around re-openings and a small number of earnings results. Asian markets in particular were softer overnight as a pick up in new case growth in South Korea weighed on sentiment. Whilst governments fully recognise that there are trade offs in lifting lockdown there will be little appetite for increased easing if new cases get out of hand. The numbers from Wuhan in China and South Korea are important given they are some of the earliest areas to ease lockdown and any resurgence in coronavirus cases will likely push out the timescales for the Western economies taking their first tentative steps. There have been many stories about new case growth picking up over the last month so we will need to see if these figures are sustained before incorporating into our economic projections. New case growth has moved away from the market's focus in recent weeks as further falls have been incorporated into the market's base case. Should we see a resurgence in South Korea or other economies that have re-opened this may test risk appetite but we would want to see this trend sustained before drawing any firm conclusions.

Wednesday

European markets were mostly calm yesterday, but this sense of serenity was shattered in the last hour of US trading where sentiment soured leading the US equities to close down 2%. Two factors conspired to cause this. First, Dr Anthony Fauci, a leading White House coronavirus task force member, warned in testimony to a US Senate health committee that reopening the US economy ran the risk of greater damage down the road if it was proven premature and led to a surge in new case growth driving a subsequent second lockdown. Second, Republican Senate bill was introduced which is designed to allow Donald Trump to issue sanctions on China if it's report on the causes of COVID-19 is deemed unsatisfactory. Neither Dr Fauci's testimony nor the Republican bill are particularly material but they serve as poignant reminders of the two big risks out there at the moment. Markets are largely ignoring the dire economic data as they look through the recession to the expected recovery ahead, but they are only able to do this if the lockdown is seen as temporary. The warning of the risk of a second wave in the US at the same time as we are possibly seeing one in South Korea has clearly struck a chord. Equally the US bill might not pass but it is a warning shot from China hawks that they still form a large bloc within the Republican party. We believe the strategic case for equities over bonds is still intact however near term volatility from concerns over a reversion to US/China tensions or a second spike in Coronavirus cases would present unwelcome headwinds for risk appetite.

Thursday

Markets took a leg lower driven by the two core risks in markets: US/China tensions and the risks of a second viral wave. First, US President Trump rather antagonistically referred to COVID-19 as the 'Plague from China' whilst China, which has been relatively more restrained during this escalation of tensions, broke cover in the China Global Times saying it was "extremely dissatisfied" with threats of US sanctions over the pandemic and threatened retaliation. Any further escalation in tensions between the White House and Beijing in a tit for tat that goes beyond the US arguably playing to the gallery of a domestic US political voter base risks impacting market sentiment. Second, new case growth in Seoul, South Korea has also picked up putting doubt over the efficacy of global lockdown easing. South Korea has previously been celebrated as a beacon of hope for the global pandemic given its intensive lockdown, so markets will continue to watch developments there closely. With these two new risks unlikely to go away in the near term, markets might struggle to keep the pace of the strong rally established in April. Given our addition to equity in March at an asset allocation level, as well as the rebalancing into equities that has taken at a portfolio level, we reduced our equity risk by 2% at our asset allocation meeting yesterday as an acknowledgement of the size of the rally as well as the ongoing risks. Given we have specific concerns around the lack of a coordinated European fiscal response to the pandemic crisis, we have focused our cuts within European equities.

Friday

Whilst the US saw a late rally to end Thursday in positive territory the same could not be said for European exchanges which suffered as US/China risks ratcheted up. Whilst the source of the late rally wasn't immediately obvious, investors are still bearing the equity/bond differential in mind which is a strategic support for equity prices. The main source of market movements came from a Donald Trump interview with Fox Business News. In it he said, in reference to Chinese president Xi, "right now, I don't want to speak to him" and that the US could "cut off the whole relationship. If we did, what would happen? You'd save $500bn." The overall interview mirrored this tone and did little to boost risk appetite. Meanwhile the US Senate passed legislation to authorise targeted sanctions against Chinese government officials involved in alleged human rights violations against Muslim ethic minority groups. With only 6 months until the Presidential election this rhetoric is unlikely to calm any time soon barring a perceived capitulation from China which looks increasingly unlikely given the global political pressure that is being levelled in relation to the pandemic outbreak. For the time being however, markets are still willing to focus on the longer-term value in equities rather than the near-term noise.

Important information

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