INVESTMENT UPDATE: THE CASE FOR CAUTIOUS OPTIMISM

10th September 2020

As anyone forced to frantically alter their travel plans over the summer will attest, covid-19 continues to exert a powerful influence on our lives. Worryingly, new infections are rising once again in many corners of the world, including Europe and the UK. Indeed, infection rates in Spain have recently surpassed those witnessed as the virus spread around the globe in March and April. Whether or not this constitutes a “second wave” of infections, there are reasons to believe the economic impact should not be as severe as it was six months ago.

Firstly, most governments have thus far avoided re-imposing nationwide lockdowns, opting instead for localised measures that allow activity in unaffected areas to carry on. Secondly, after months of adjusting to the requirements of this brave new world, human experience and adaptability has unearthed numerous ways to work around the obstacles presented by the pandemic threat.

As a result, when we look at measures of economic activity – from job openings to manufacturing output to the number of trips people are making to cinemas, bars and restaurants – we find that the rise in new infections has not so far derailed the recovery from April’s lows.

Nonetheless, we think it wise to expect the pace of this recovery to ease somewhat. Some industries remain effectively closed and social distancing measures limit the productivity of others. Though the US economy created 1.4m jobs last month, 8.4% of the labour force remains unemployed.

Closer to home, Rishi Sunak’s furlough scheme has succeeded in limiting job losses so far, but the scheme’s expiry at the end of October may present an uncomfortable point of reckoning. Though the global economy is undoubtedly in better shape than it was, we believe there is much for policymakers still to do.

With this in mind, we turn to two political events that, beyond the coronavirus, are likely to dominate headlines over the remainder of the year: Brexit and the US presidential election. Both events are complex and deserving of more attention than the scope of this update permits (we will seek to update you on both issues in subsequent notes).

For now, we merely observe that – as important as they undoubtedly are – the timing of these events is in some ways an unwelcome distraction from the already considerable task policymakers face to keep the nascent economic recovery on a sound footing. While we believe additional fiscal support (that is additional government spending) is required on both sides of the Atlantic, the political backdrop creates a great deal of uncertainty over when, if, or in what shape any additional stimulus might arise.

Thankfully, the outlook for monetary policy (that is the setting of interest rates and other market mechanisms typically overseen by independent central banks) is much clearer. At the recent annual symposium of central bankers in Jackson Hole, Wyoming, the Federal Reserve (the US central bank) announced a change to how it will pursue its objective of price stability. While somewhat arcane, this change effectively opens the door for monetary policy to remain exceptionally supportive for a long time yet to come.

But what does all this mean for investors? We would suggest it calls for a degree of cautious optimism. Economic conditions are improving. After a decade of post-financial crisis austerity, governments around the world have changed tack, spending freely and doing much to accelerate this recovery. Meanwhile, central bankers have left little doubt about the lengths to which they are willing to go to promote economic growth. This is a supportive backdrop for long-term investors.

Nonetheless, investors should steel themselves for the possibility of short-term disruption. To an extent, our cautious optimism is based on an expectation that government policy – particularly in the UK and the US – will remain actively supportive of economic growth. We are wary of the risk that political considerations may distract from this economic imperative. Uncertainty around government policy may well amplify short-term financial market fluctuations. In addition, though stock market valuations for the most part appear reasonable, signs of exhuberance in some areas – most notably in the shares of some US technology companies – may need to be corrected (see 'An Extraordinary Year').

Though we believe stocks are well placed to deliver reasonable returns to long-term investors, we are tactically underweight equities across the Omnis Managed Portfolio Service. This underweight is concentrated in the US on account of our concerns over valuations. Elsewhere, we are overweight stocks in the UK, Asia and emerging markets, where we believe valuations are better than reasonable.

The fraught political calender is likely to play a sizeable role in shaping investor experiences over the remainder of the year. However, over time, the uncertainty surrounding key events such as Brexit and the US election will fade. As it does so, we believe an improving economic outlook, a supportive policy backdrop and reasonable valuations justify a cautiously optimistic outlook for long-term investors. While, for now, we are leaning marginally towards the 'cautious' side of this balance, we expect a volatile market to offer us opportunities to exercise a little more of our optimism. We stand ready to act as and when these opportunities arise.

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