Psigma
Investment Management



# View from Psigma

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We have resisted the temptation to further update you over the last ten days, as the developments with the Covid-19 virus, the global economy and financial markets had closely followed the challenging path that we outlined in our last note.

The news around the medical emergency has continued to deteriorate, as expected, with the peak in infections in the UK and the US not forecast to occur until late May, whilst the global economic situation has looked grim. This has translated into some of the highest levels of market volatility we have ever experienced. However, we sense that the news of the week so far (enough to fill a whole decade, in truth) gives us a higher level of certainty over the outlook for the UK and global economy.

Today, we will update you on our latest views and the important "signposts" that we are following.

## Certainty Replaces Confusion

The very simple truth is that we still can't accurately predict how great the economic damage inflicted upon the UK and Europe by the "shutdowns" will be in the coming months. However, we feel more positive that at least there now appears to be a firm plan set in place by our government, tracking those previously put in place across Europe, Asia and, of course, China.

The constant changes to recommendations and the uncertainty were creating confusion. Now we appear to have certainty, and perhaps we are in a position where we can use the Chinese experience as a guide to how western economies will fare in the coming months. If so, we should expect a month of near total shutdown, as announced by the Prime Minister on Monday night, potentially followed by a slight thawing of the economic freeze in month two, before a further economic improvement in month three.

Following the Chinese experience, by the time we get towards the end of May, hopefully life should be getting back to "normal" (as of yesterday, we estimate that China's economy is back up to about 85% of pre-Covid-19 levels). Obviously, risks to such forecasts abound and making any predictions seem relatively pointless at this precise time, but with China lifting restrictions on Hubei province yesterday and, according to our sources in Asia, implying that Wuhan's own "lockdown" will end around 8th April. Such an announcement would bring investors a modicum of relief, especially were it to coincide with definitive news from Italy that the rate of infections and tragic deaths from Covid-19 had peaked and were starting to trend down.

We would be naïve to assume that this pattern from China is certain to be repeated in the UK or the US, particularly in the latter where the Federal approach is chaotic at best, and there is certainly the chance of "second round effects", but we feel we can finally start to think about the likely length of the economic disruption.

## What Does Normal Look Like?

Another factor we will have to consider is what the world looks like after the Covid-19 pandemic is controlled. Two of the major concerns that we already held heading into 2020, leading us to be sceptical of the optimistic projections most had for corporate profits growth, were the threat of "deglobalisation" and the disruption of global supply chains.

It is of vital importance, even when one is so distracted by ceaseless immediate headlines, to focus on the bigger picture. The world we see ahead is one where tensions between China and the US remain elevated, especially after the recriminations fly between the two countries over this situation. In addition, after such a lengthy period of economic disruption, one must question how quickly we can recover when complex supply chains will need recalibrating and various parts and components are scattered across the world, following rolling economic shutdowns in different regions. We also cannot answer convincingly what "end demand" will look like following the Covid-19 outbreak and cannot accurately forecast whether there will be "pent up demand" or indeed whether lost economic ground can be recovered.

## Governments Aim to Soften the Blow

In order to try to fill the economic hole created by the Covid-19 shock, governments have been forced to turn to enormous fiscal packages. As you will have read in past notes, we have been critical of most global governments' continued profligacy during the last decade and we despair at the state of nearly all countries' finances, but we have to concede that in this situation governments need to spend previously unthought of sums of money. Insufficient action here could lead to an economic depression and the human impact could be severe. Having made the decision to shut down large parts of their respective countries, governments must act decisively to curtail the economic impact upon consumers and businesses.

Sadly, the way these things work is that some of the money created will end up in the pockets of the undeserving, but we have no choice but to accept that this is the case and recognise that massive fiscal support is required. The good news since we last wrote is that the authorities seem to have grasped the severity of the economic blow and are finally starting to come up with a suitable response. More will be required in the immediate future, but we are starting to move in the right direction.

## Central Banking Cavalry Ride to the Rescue

One might well ask when reading about the gargantuan fiscal response, how are cash-strapped governments going to pay for all their emergency packages? Financial markets are not presently in a strong enough position to support a deluge of new government bond issuance, which collectively will be running into trillions of dollars. It is here that the central banks step in.

Governments will spend money they don't have; the Treasuries will create new bonds; and the central banks will buy them. This of course opens many philosophical concerns and is not a sustainable long-term approach, but it is the only real option here. This is the reason why the central banks across the developed world have launched fresh quantitative easing packages. These actions are not as "free", as many assume, and, notably, the gold price has risen aggressively in the last few days. In our view, this demonstrates the suspicions of some investors, following an announcement from the US Federal Reserve that they will buy pretty much any quantity of nearly any asset for as long as they need to into the future.

This revelation was another important message to help bring some confidence back into the financial system and should mean that fixed interest investments can stabilise and recover. How this financial alchemy of central banks develops in the future and what it means for asset markets is a question for another day.

## Conclusion

Lenin once said that "There are decades where nothing happens, and there are weeks when decades happen"; the last few weeks have been such an instance. However, as we have hopefully demonstrated today, we now have a clearer view of what the response to this developing situation will be, as well as an enhanced understanding of the fiscal and monetary support that will be provided by governments and central banks.

We cannot be certain of either the economic trajectory or the likely behaviour of financial markets in the immediate future; however, we have confidence that the steps taken should lead to better outcomes than we imagined only a few weeks ago.

This gives us renewed confidence in our investment strategies, even if we expect volatility to be high and the economic situation to remain challenging.

We have ensured that we understand the risks of each of our selected investments and have used the recent volatility and forced selling of others to our advantage.

There are many investments that we can now find where we have the potential to make very positive returns in the future, even if the promise of such returns from those assets might have to wait until further certainty is available.

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For further insights from our CIO Tom Becket check out the Psigma Voice, our communication platform providng you with a variety of investment and market commentary.

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