Alan Boswell Financial Planners

Market Update - June 2020

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Unsurprisingly, following the COVID-19 induced lockdown, the latest UK macroeconomic data has slumped. April underlying retail sales volumes (excluding fuel) registered a record decline of 18% from a year ago, while consumer confidence has fallen to levels last seen in 2012. The Independent Office of Budget Responsibility forecasts a near 13% real GDP decline for 2020. If correct it will be biggest decline since the Great Frost of 1709, which was the coldest winter in Europe for more than 500 years.

The slump in UK (and EU) output caused by COVID-19 has overshadowed the upcoming 30 June deadline: the last straightforward opportunity to extend the post-Brexit transition period for the UK leaving the EU beyond the end of 2020 by one or two years. Given that valuable negotiation time has been lost to COVID-19 and the wide gap in the two negotiating positions, politicians do have a valid reason to extend the transition period. However, the UK government's view is that without a cliff edge the necessary compromises won't be made, so more time would not make any difference.

If an agreement is not reached by the end of June, an extension can still be agreed by end-December before the current transition period runs out. However, once the June deadline passes, the legal and political obstacles to agreeing one further down the road are significantly higher. With so much to do and the personalities involved, there is plenty of risk that the UK and the EU fail to reach an agreement in the time available.

As a result of these negotiations, sterling could be vulnerable over the coming months amid big trade and budget deficits, zero interest rates and around 30% of government debt held overseas. The lack of clarity on the UK's future relationship with the EU could be a potential catalyst. Assuming the world recovers, more of this money will pour out of the US through a widening fiscal and current account deficit. This would then increase the supply of USD in the global financial system and could well lead to a new downward leg in the greenback and a rally in GBP.

Brewing inflation risk beyond the near term a sudden rise in inflation is a key risk for any unprepared portfolio. Currency devaluation, more local supply lines, tariffs and trade-war could all increase costs. Potentially, higher inflation could mean central banks are forced to tighten monetary policy in order to abide by their mandates. In the near term (1 to 2 year) the outlook across the post-COVID-19 globe is disinflationary which is reflected in very low government bond yields. One way to observe this is through US real GDP growth and its lead on underlying inflation. With the consensus forecasting large GDP declines, US core (excluding food/energy) consumer price inflation is expected to drop from its current position of around 2% to near zero in 2021.

However, equity investors should not despair. From data going back to 1965, a 0-2% inflation range for each country has seen annual US S&P 500 and German DAX returns of 10.3% and 11.9% respectively. For the moment, global equities are in a sweet spot of current low inflation enabling policymakers to step-up monetary and fiscal stimulus to lift markets higher. The MSCI All Country World Index has already retraced more than half of its losses since the market peaked in mid-February.

Nevertheless, the risk of higher consumer price inflation over the medium-term (3-5 years), primarily due to policy responses to COVID-19, has increased and is a potential risk for portfolios. Essentially, more money is being directed to Main Street (consumers) over Wall Street (banks), the opposite of what happened during the Global Financial Crisis (GFC) in 2008 when funding was used to repair balance sheets of the financials.

Looking forward, when consumer confidence recovers and unemployment rates decline following the lifting of lockdowns, pent-up demand could lead to higher inflation in the years ahead. To hedge against this risk, many investment managers are favoring inflation protected government bonds (particularly US Treasury Inflation-Protected Securities) and gold.

We expect market conditions to remain challenging. In our view, active management and a multi-asset strategy, which is central to our investment philosophy, is the key to managing clients' investments.

Please note the following:

All investments involve different degrees of risk. Please remember that past performance is not a guide to future performance. The value of units and shares and the income from them can go down as well as up and investors might not get back the amount originally invested. Exchange rates may cause the value of overseas investments to rise or fall.

Where we have expressed views and opinions, these may change over time. None of the information mentioned in this document represents a specific portfolio or holding nor constitutes a recommendation to buy or sell.

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