Market Update

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thomascarroll GROUP PLC

SQUARE MILE INVESTMENT SERVICES

Both markets and events are continuing to move extraordinarily rapidly. On Tuesday, the US Congress essentially agreed to back a $2 trillion package to bail out the US economy which was well received by financial markets and saw the S&P 500 climb by 9%. Nonetheless, moves likes this do not normally mark the bottom of bear markets: they are more symptomatic of the continuation of uncertainty in stock markets.

In our opinion, there are three essential elements that need to be in place before we are likely to see markets bottom out and from where they can make a decent recovery.

First, it is essential that companies gain access to the funds they need to survive over what is likely to be a challenging period for the economy. If large swathes of the corporate fabric are allowed to disappear, a deflationary slump is almost certain to develop. We believe that central banks and governments are doing the right thing in offering financial support to businesses, enabling them to furlough employees, albeit at reduced wages, rather than force them onto the dole. As a result, we will have a workforce still largely in place which should support a more rapid economic recovery once the worst of the pandemic is over.

Central banks are being very active in supporting the banking system to ensure funds start flowing. Although last week we saw some dislocation in the international banking system leading to disruption in the corporate bond market, those pressures are now easing. Central bank action is now having an effect and companies will start to see the financing they need to weather the worst of the storm.

Secondly, governments are working to offset the impact of the economic shock caused by the collapse in demand for goods and services by ensuring people continue to have money in their pocket. While some sections of the economy will be slow to resume normal business once the worst of the crisis is over, restaurants and cinemas, for example, others will enjoy the benefit of pent up demand. This should lead to a very rapid recovery in economies once the pandemic has eased, something that many economists are predicting. Indeed, history suggests that the rebound following external events such as the spread of Covid-19 can be very vigorous and quite different from the drawn-out recovery following the credit crunch of 2008 due to the structural issues within the banking sector that caused it.

Finally, the principal event that financial markets need to see in order to rally in a confident manner is reassurance that Covid-19 has been fully contained and that we are not going to experience a second wave of infections. History shows that viruses such as this can emerge rapidly and then to die away with equal speed, and frequently the most contagious viruses are the quickest to disappear. However, there is the danger that as quarantine measures are put in place, the virus will move from one zone to another and re-infect countries such as China and Korea. At this stage it is too early to say how Covid-19 will behave.

Markets will of course react very favourably to the development of a vaccine, but this is at least 12 months away at best estimates. Improved therapeutic action to combat the worst medical aspects of the virus will be very positive. Although the mortality rate is relatively low, a large number of people, up to 5%, are likely to be hospitalised. Any new treatments that can be found to treat the worst symptoms will ease the strain on hospitals considerably. This will be very positive and will release the pressure on governments to keep large numbers of the population under lockdown.

Once we can determine the likely timeframe for the duration of this outbreak, markets will be able to act accordingly and with a degree of confidence. We are continuing to see very volatile trading in both equity and bond markets which is to be expected and may persist for some time. However, once there is some certainty that the worst of the impact of the virus has passed, markets will be poised to rebound and potentially rebound quite significantly.