



June 29th, 2020

Pause for Breath

- **Markets pause as COVID cases rise**
- **We see risks to the upside balancing the near-term downside risks**
- **Economic data has generally been better than market expectations**
- **We do not expect governments to re-impose such draconian lockdowns**
- **Policy makers to remain very supportive of their respective economies**
- **Consumer spending is better particularly in China - supportive of Chinese equities**
- **Gold destined for \$2000**
- **We expect merger and acquisition volume to pick up**

Many risk markets have been in pause mode in the past few weeks, trading largely side-wards since the start of June. However, Friday's lurch down in the US equity market implies a risk of a potential sell-off should the S&P500 (3009) breach the 3000 level. For choice, we think the market will hold. However, even if we see some short-term downside, we believe that ongoing policymaker support and the prospect of news flow from drugs companies on their stage 3 trials will keep investors worrying about the upside risk as much as the downside risk.

Economic data has generally been better than market expectations. The Citi economic surprise index for the G10 countries has moved to an all-time high, indicating that most parts of the world see a surprising rebound in their economies.

Investor concerns remain focused on the pace of COVID-19 new cases. Headlines every day show that pace of new cases in India, Indonesia and Brazil in particular shows no abating. In the United States, many of those states that aggressively reopened are seeing a significant spike in new cases.

However, we would expect that developed country governments will not be minded to re-imposing the scale of the lockdowns that we saw through March and April. Governments may feel that they are morally on the right side of the argument to accommodate a higher infection rate as long as the death rates remain low. For example, CDC data shows that in the United States, for those below the age of 55, the death rate is currently around 0.0022%, or equivalent to one death per 45,000 people in this age group.

We would concede that in many economies where there has been of relaxation of the down, households remain cautious about venturing out. On many measures levels of activity remain well below the levels of early this year. In the United States, hotel occupancy is down at 44%. The impact on discretionary spending is still severe - Royal Caribbean shares which peaked at \$75 in early June were down 10% on Friday to \$46. The stock traded at \$130 at the start of the year. However, Harvard calculates that according to US credit card data, consumer spending has recovered a good measure now down only 8.9% year-on-year.

There is better news on the consumer in China. The annual 618 shopping festival completed on June 18th, and according to data from Syntun, Chinese online gross merchandise volume reached RMB 457 billion, a 44% increase

year on year. Many analysts have characterised the good data as a reflection of the release of pent up demand following the end of the lockdown; however, the data remains impressive. Average daily sales of passenger vehicles are just 4% below the long-term average.

We expect China's consistent better economic news with the likely prompting a further policy action from the government and central bank to keep the equity market moving forward. Understandably some investors are concerned a potential renewal of a trade war with the United States. However, President Trump has tended to show more noise than action on trade disputes in recent months. Tactically the equity market looks to be a better place than others with lower valuation and good domestic investor support.

Active rather than passive management is the order of the day in the Chinese equity market, unless the passive vehicle references true growth companies. Active managers have outperformed the broad benchmarks by a good measure in recent years. A survey by bfinance found that over the past five years, the average A-shares manager delivered a return of 5.3% per annum versus -6.2% from the MSCI A-shares index. The report also noted that it is important that investors should avoid State-Owned Enterprises which make up 56% of the index; they typically generate 10% return on equity or less.

Our confidence that broad risk markets will hold up is largely predicated on our conviction that policymakers should remain very engaged in providing ongoing support. It is only when that support is moderated/switched off that we would be more concerned. We doubt that governments will be able to step away until unemployment is falling back and clearly on its way back to pre-crisis levels. This week's US employment data should show a further fall in the unemployment rate to 12.4% in June. However, such an improvement is unlikely to moderate the Fed's intervention. There is still a long way to go before anyone can talk about full employment again.

Despite our confidence in policymakers being supportive of the global economy, it doesn't diminish our view that the gold price can climb still further. Gold continues ended the week at \$1771 had briefly attempted to breach the \$1780 level. Year-to-date the yellow metal is up close to 17%. Other than the March dip, the metal has continued its rise throughout the year. Recent investor concerns about COVID-19 cases give a handy narrative to those who want to characterise the recent rally as just short-term. However, in our view the persistent strength of gold through this year shows that it's probably reflecting more the long-term concerns that investors have about the building levels of debt and the central bank's actions undermining fiat currencies. Investors should keep in mind the 2011 all-time high of \$1917.90. Given the likely struggles for the global economy for the balance of the year, we would envisage a break above that level which could unleash a follow-through buying to push the price into uncharted territory and targeting easily \$2000.

We expect mergers and acquisitions to be an increasing feature of the capital markets in the coming quarters. In the mayhem of COVID-19, it's quite understandable that merger and acquisition (M&A) activity has dropped significantly. Globally M&A activity down 35.5% year on year the value of \$1.8 trillion. The drop in activity is across all geographical areas except for Asia-Pacific, which is flat year-on-year. However, there are some signs on the pickup. Sectors such as the energy sector and financials are still ripe for further consolidation. Over the weekend, in Saudi Arabia, NCB proposed a merger with Samba with a total value of \$45bn. Interestingly across the world financial sector, M&A is flat year-on-year, we expect more action. The more that companies recognise the global economy is not going to recover particularly quickly, the more pressure there will be under to consolidate with rivals to build market share in a smaller market and cut costs.

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