Regulatory and Other Committee

Open Report on behalf of Andrew Crookham, Executive Director – Resources

Report to:	**Pensions Committee**
Date:	**16 July 2020**
Subject:	**Independent Advisor's Report**

Summary:

This report provides a market commentary by the Committee's Independent Advisor on the current state of global investment markets.

Recommendation(s):

That the Committee note the report.

Background

Investment Commentary – July 2020

Covid-19 epidemic: what has changed? Everything or nothing?

In one sense, this is a ridiculous question! The epidemic has turned the entire global way of living completely "upside down". It cannot be the same as before the crisis hit in February 2020 – at least not for a number of years and until medical advances, such as a vaccine, can give confidence in the virus being brought under control. And yet, as members will be well aware, the stock markets of the world, notably that of the USA, are at levels close to where they were before the epidemic became widespread.

Chronology of markets through the developing crisis

In late December, the world became aware of a strange new virus circulating in China. Previous serious virus outbreaks, such as SARS and Ebola, had little impact on the developed western world, so this one hardly registered as a global threat – and certainly not as an investment risk. All this changed when the Chinese authorities stunned the world with a lock down of the city of Wuhan, with its population of some 10 million people. That was on 23rd January. By the 5th February, a cruise liner, the Diamond Princes, was in quarantine at a Japanese port. By then, few could have been confident that this was a purely Asian problem. By 15th February, the first European cases had been confirmed. A week later, the full force of the pandemic was obvious in northern Italy.

It was not until then that the stock markets woke up to the seriousness of the situation – that this really was a global – not localised – pandemic.

Stock market reaction

As you will all recall, equity markets then fell very sharply. The main US stock market index, the S&P 500, fell 34% over the ensuing month or so. In the latter stages of the decline, the desperation for cash to fund margin calls in options and futures positions exacerbated the circumstances and led to panic selling. Once this phase had passed, some modest bounce back was to be expected. But the pace and extent of the subsequent rise took everyone by surprise. At the time of writing, most markets (UK equities are the exception) are within about 10% of levels seen in mid-February, before the pandemic became widespread. So, a very solid recovery in share prices has occurred. Long dated government bond prices (e.g. UK gilts, US Treasury bonds), not surprisingly because they are "safe haven investments", rose sharply when the pandemic struck – i.e. yields fell and they remain at historically low levels.

Global recession

And yet the world is in the grip of an unprecedented recession, caused by the near universal lockdown of personal freedoms and the consequent effect on working lives and hence economic output. These much needed draconian measures are now being lifted so that there are signs of an early recovery in output. Global output is still forecast to fall about 5% on the year 2020 – and probably double that figure in the UK.

Members will be well acquainted with the extraordinary efforts of Central Banks around the world to provide huge amounts of liquidity and financial support to their respective governments. The key objective of the authorities has been (and will remain) to provide private individuals with financial support to offset their loss of income from employment and self-employment. The other key aim has been to minimize the number of businesses facing bankruptcy from the lockdown and thus the resulting job losses. The issue facing investors is to judge how successful these efforts will be. At the time of writing, the coronavirus seems to be receding (except in isolated pockets) and the lockdown is largely being eased in most if not all countries around the world. Economies have stopped contracting in size and are beginning to expand again – albeit from a low base. In the early stages we may well see a "V shaped" recovery in many economies. But much economic capacity has probably been permanently lost, so that a full recovery is likely to take several years, at least, and revert to a long slog rather than a rapid bounce back. Unemployment must inevitably rise, once government support measures are withdrawn – with all the personal misery that such job losses entail.

What of markets?

Central Banks were obliged in 2009/10, at the time of the financial crisis, to step in with huge financial support. Little of that had been withdrawn when the pandemic struck. Their support during the current crisis has been many times larger – as it needed to be. So Central Bank support has not changed and cannot change, in my view, whilst the health of the global economy is so fragile. It may need to be intensified if the recession becomes entrenched.

The consequence for markets, both equities and fixed interest securities, is that ample liquidity will be an enduring feature of the financial landscape. Markets will stay at elevated levels and financial returns to investors will be inadequate to meet their respective liabilities. Investment purists, basing their views on economic prospects, will argue that markets are far too high and liable to a sharp correction. My view is that markets will be driven for the foreseeable future by excessive cash and not so called fundamentals. Are they vulnerable to a fall? Of course, but I doubt that any fall will be severe (say over 10%). Central banks and governments will stand ready to intervene, especially if the coronavirus were to return to the northern hemisphere next winter. To that extent, little has changed.

Conclusion

Peter Jones
29th June 2020

Consultation

a) Have Risks and Impact Analysis been carried out?

Yes

b) Risks and Impact Analysis

The Pension Fund has a risk register which can be obtained by contacting the author of this report.

Background Papers

No background papers within Section 100D of the Local Government Act 1972 were used in the preparation of this report.

This report was written by Peter Jones, who can be contacted on 01522 553641 or claire.machej@lincolnshire.gov.uk.

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