Lincolnshire COUNTY COUNCIL Working for a better future

Regulatory and Other Committee

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

Report to:	**Pensions Committee**
Date:	**15 October 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

<u>Investment Commentary – October 2020</u>

Central Bankers of the World versus Global Economic Fundamentals

Six months on since the start of the coronavirus outbreak, it still dominates all of our day-to-day lives and hence stock and bond markets as well. Generally, equity prices are close to all-time highs and bond yields to all-time lows. After an early summer lull in the disease, which enabled most governments to relax what were some draconian virus control measures, there are numerous signs of increases in new cases of the virus in many countries around the globe. A so called “second wave”. Some limited, local, control measures are being introduced, which may have an effect on damping down the recovery in the world economy - which is currently under way. Anecdotal evidence suggests that the robust recovery seen in early summer has now given way to a more lacklustre upturn. Economic performance everywhere in 2020 will turn out to be well below forecasts made before the start of the pandemic.

Significant recent events

Two events seem to me to be pertinent:

- The rise in September in the incidence of coronavirus, starting in France and Spain and more recently in the UK.

- The pronouncements of Mr Jay Powell, chairman of the US Federal Reserve (the US Central Bank), known as “the Fed”, to the effect that the Fed is prepared to allow inflation to rise to above 2% before it takes action to rein it in and his promise that US short term interest rates will not rise until at least 2022.

The UK

The UK prime minister’s announcement in late September that the UK faced a “difficult winter ahead” and required an abrupt reversal of the easing of some of the coronavirus control measures sent a shock wave through the country. In particular, there was an abandonment of the government’s policy of getting office workers back to their offices. We are once again being urged to work from home. And committee members will be familiar with other measures restricting family gatherings - either in the home or out in restaurants and pubs.

Anecdotal evidence suggests that this renewed clampdown has, not surprisingly, had an adverse effect on the confidence of consumers and businesses alike. During the summer, one sensed a slow return of a belief that things would turn out to be “alright”. Businesses largely continued to hold onto their staff – obviously aided by the government’s one notable success story – the “furlough” scheme. They did so in the hope that perhaps the worst had passed and would slowly if erratically improve. That seems, in recent days, to have evaporated. The Chancellor of the Exchequer, Rishi Sunak, has just announced a raft of employee support measures to offset what is feared to be a sharp rise in unemployment this winter. This will add modestly to the already prodigious amount of financial support that the government has pledged to support the economy.

The USA and the rest of the World

Outside the UK, the optimism of mid-summer is also evaporating, to be replaced by a measure of anxiety about the coming winter. This despite unprecedented amounts of financial assistance supplied from their Central Banks in support of their respective economies. Forecasts of economic activity around the world had centred on declines in output in 2020 of between 5% and 10%. Germany seems to have coped relatively well with the coronavirus – as has most of northern Europe with declines of around 5%. The UK sadly is likely to be over 10%. Whether such figures are now valid remains to be seen. Previous beliefs about the efficacy and timing of the widespread availability of a vaccine have waned.

In the USA, the speed of the economic recovery from the trough associated with the earlier lockdown seems to have stalled. In the second quarter of 2020, roughly coinciding with the lockdown, the US economy contracted by about 30%. There has been a strong recovery in the third quarter as lockdown ended. Some forecasters expressed the view that 2021 would see a continuing strong recovery with economic output in that year exceeding that of 2019. With the current increase in US unemployment and consequent falls in consumer confidence, that seems to

many to be hopelessly optimistic. The sharp rise in company profits and earnings that such forecasts implied cannot therefore materialise.

Hence the various statements from Mr Powell, the Chairman of the Fed and others of his board, to the effect that the Fed acknowledges the challenges that the US economy, businesses and population face this winter and next year. They stand ready with unconventional actions to do what they can to blunt the worst effects of the pandemic.

Conclusion

Bringing these thoughts back to stock markets raises a conundrum. Fundamental are deteriorating in the sense that previous cautious optimism no longer seems justified. The hoped for recovery in profits will be deferred. Is that an argument to sell equities at close to all-time highs?

Or is the commitment of the Fed and all the other significant global Central Banks to keep supporting their respective economies just too strong? There is an old stock market adage in the USA – "never bet against the Fed". Globally, Central Banks have supplied virtually unlimited amounts of cash and liquid resources since the onset of the virus. They say that will continue. Not all of it reaches businesses and individuals – it goes into stock market assets. I expect that to continue.

My instinct is that Central Banks will prevail and that, for the time being, until interest rates rise, equity fundamentals are less important.

Peter Jones
28th September 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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