GOLDLAKECAPITAL

Q3 2020 MARKET REVIEW – 29 October 2020

Although the global economy has suffered its biggest decline since the second world war, stock markets experienced their fastest recovery following a market crash due to rapid and unprecedented monetary and fiscal measures taken by central banks and governments around the world. Equity and other asset prices continue to be supported by the prospect of low interest rates for longer.

Europe and the US are facing an exponential growth in Covid-19 cases

The number of new Covid-19 cases has grown exponentially in Europe and the US since the end of September and the re-opening of schools and universities. Initially, the epidemy seemed to spread quickly through younger generations without significant increases in the death rate or the number of people needing hospitalisation but the situation has worsened in the last month. Governments have sought to avoid full lockdowns with more targeted and incremental regional lockdowns in order to avoid crippling the economy. Given the resurgence of the virus in recent weeks, it is likely that stricter lockdowns will be needed. The economies which had started to recover in the summer are showing signs of slowing down again with worsening business and consumer sentiment. We expect governments to remain under pressure to provide more financial support to households and businesses over the coming months.

Unprecedented fiscal measures to tackle the economic impact of Covid-19

The Covid-19 pandemic has led to the sharpest economic downturn since the second world war with global GDP (Gross Domestic Product) estimated to have fallen by 9.8% in the second quarter. After years of austerity in major economies, governments have had to take significant measures to help businesses and people cope with the economic fall-out of the lockdowns. The International Monetary Fund (IMF) estimates that governments globally have already deployed $12 trillion to support their economies through the crisis. This is equivalent to 8.45% of 2019 global GDP. We expect governments to continue to use fiscal spending to stimulate the economy thereby increasing government debt to historically high levels. The high level of government debt will keep pressure on central banks to keep interest rates low for longer as it is the only way to ensure that the debt is manageable. Governments and central banks also have a strong incentive to promote inflation in order to help deflate the real value of the debt over time.

The UK and the European Union are likely to agree a ‘bare-bone’ trade deal

The UK and the European Union (EU) are continuing to negotiate a trade agreement ahead of the 31 December 2020 deadline. The negotiations have been extended to mid-November when the outcome of the US presidential election should hopefully be known. If Joe Biden wins the US presidential election, the UK government will face pressure to agree a trade deal with the EU and to comply with the Northern Ireland protocol (agreement between the UK and the EU to avoid a hard border between the Republic of Ireland and Northern Ireland). If Donald Trump wins the election, it may embolden the UK government to risk a ‘no-deal’ outcome with the European Union. If the UK and the EU fail to agree a deal, we should expect significant economic disruptions in the UK and part of Europe. Given the significant risks associated with a ‘no-deal’ outcome, it is likely that the two parties will agree a ‘bare-bone’ trade agreement which will allow for a smoother transition. In any case, there will be significant changes to the trading relationship between the UK and European Union with more trade frictions (custom forms, border checks, slower logistics). The economic reality of the new relationship between the UK and the EU will become clearer over the next few months and years.

Towards a Green New Deal?

On a positive note, the Covid-19 crisis seems to be leading to a global consensus around a Green New Deal. As governments are under pressure to put in place fiscal packages to help their economy through the crisis, many countries are taking this opportunity to invest in the de-carbonisation of their energy sector, in green infrastructure and in environmentally friendly technologies.

Following strong gains by green parties in the May 2019 European Parliament elections, the European Union launched 'The European Green Deal' as part of its commitment to reach net zero carbon emissions by 2050. On 22 September 2020, President Xi Jinping announced China's aim to become 'carbon neutral' before 2060. This is a significant announcement given that China is responsible for 28% of the world's greenhouse gas emissions, more than the US and the European Union combined. China is aiming to reach its objective by continuing to invest heavily in clean technologies such as renewable energy, electric vehicles and energy storage. As part of his election campaign, Joe Biden has committed to significant investments in green infrastructure in what he calls a 'Clean Energy Revolution' designed to bring the US to net zero carbon emissions by 2050. The three major blocs, the US, China and the EU are now in an open race to invest in the clean technologies of the future. Significant investments in infrastructure, de-carbonisation and renewable energy could lead to a more sustainable global long-term recovery.

Given the low interest rate environment and the increasing likelihood of a strong fiscal response in the US and Europe, we are looking to carefully increase the allocation to equities and other assets likely to benefit from a fiscal led upswing. We are also increasing the allocation to real assets to protect the portfolio against the risk of rising inflation.