Monthly Market Review September 2020

A look at what has happened in investment markets over the month of August.

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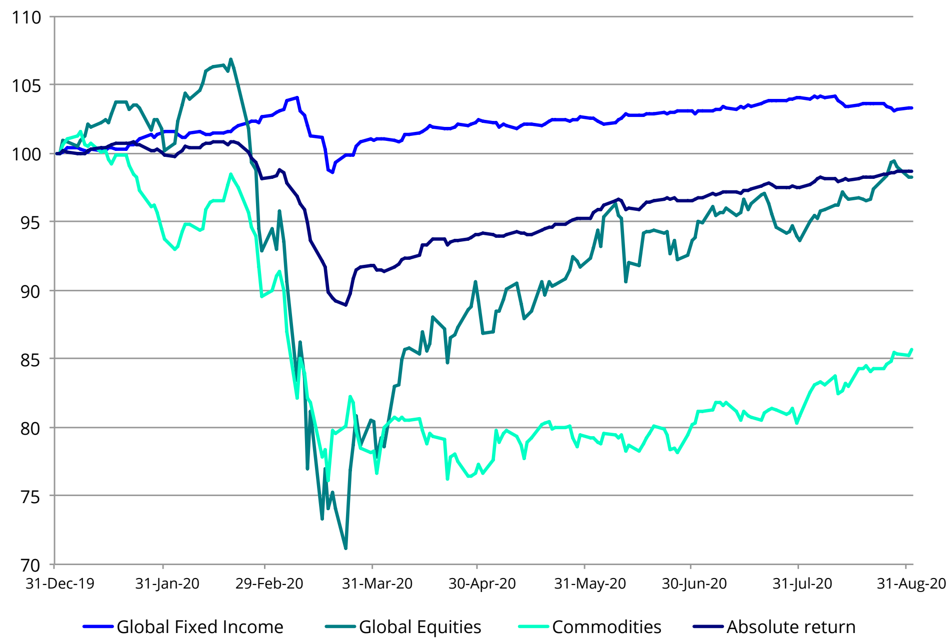
Bulls and bears square up for a fight

As this most unusual of summers draws to a close, there can scarcely have been a time in recent market history, when the bulls and bears had so much to argue about. Following the swiftest and largest policy response to a global crisis ever, stock markets have rallied hard and August saw the major global indices effectively reset to January 1st levels. Considering the scale of the worldwide COVID-19 crisis, this is a truly remarkable outcome and it has left a lot of investors unclear on what happens next.

Table 1: Asset class performances year to date to end August



Source Bloomberg 01/09/2020

WARNING: Past performance is not a reliable guide to future performance.

In the bear corner…

Pessimists make three main arguments:

1. **Trees don't grow to the sky**
   Since the low in markets in late March, the global equity market has delivered 38% in growth in euro terms, making it an exceptional period of returns. The pace has begun to slow in the late summer as can be seen in the chart above and there's little doubt the big recovery is done. Arguably, stocks have gotten expensive, particularly in the US, which has led the recovery with a 42% gain. In the lead has been the technology sector, with the big global names way out in front. Returns from the likes of Amazon, Facebook, Netflix and Tesla have been nothing short of extraordinary and in some instances the valuations they are now sporting bear resemblance to the late 90's technology bubble.

2. **The economy has a lot of recovering to do**
   The global economy has had a very substantial impact from the COVID-19 pandemic and much of this is yet to play out. In July the US posted its worst ever drop in economic growth with a 32.9% decline and yet markets have continued to rally. There is a lot of optimism that the recovery will be swift and that will result in exceptional earnings in 2021, but with little room for error.
3. **COVID hasn't gone away**
   By the end of August we reached over 25 million cases of COVID-19 and over 850,000 fatalities. The US has been garnering most of the bad news headlines during the summer but attention has since switched back to Europe with resurgences in Spain, Germany and France now to the fore. Some of this is due to increased testing, but it also seems to be more broadly spread in the population rather than being so concentrated in vulnerable age groups.

In the bull corner...

Optimists bring three main arguments...

1. **You can't fight the Fed (US Federal Reserve)**
   What the US Federal Reserve says and does is driving markets and August saw an important shift in policy. Federal Reserve Governor Jerome Powell sketched out a new approach to US monetary policy that will allow inflation and employment run higher. It plans to target inflation that averages 2% over time, and so far markets have responded very positively. This is because it suggests the Fed will allow the economy run a bit faster for periods of time before applying interest rate brakes.
   A big driver behind the recovery in risk assets like shares has been lower rates. With the likelihood now being that rates could stay near zero for many years, asset prices are continuing to rise to reflect that, despite the very difficult economic conditions in the immediate term.
2. **There's lots still to recover**
   The headlines about the global stock market recovery disguise a lot. The US market has done very well and by the end of August was +3.2% for the year to date. Indeed August saw the S&P 500 make all-time highs despite a 32.9% drop in economic growth for Q2. By contrast markets in Europe and the UK were nursing losses of -10.5% and -23% respectively. Similarly while technology stocks have grown by 23% year to date, financials and energy stocks are down -23% and -38% respectively. The stock market has been paying very handsomely for those sectors that have fared best in the crisis, but has also punished those worst impacted.
3. **A vaccine or cure will happen**
   Markets are paying a lot of attention to the progress being made on the vaccine front. Quite aside from Russia's approval of the Sputnik V vaccine, (approved on 11 August without Phase 3 trials), there is unprecedented collaboration happening between governments and pharmaceutical companies to deliver a vaccine in record time. A smooth path to success is probably 12-18 months away at best.

Summary outlook

In the coming months it's likely that three stories will influence the direction of markets: **Central Bank & fiscal policy, the second waves of COVID-19 and the outcome of the US election.** Most prominent amongst these is the direction that Central Bank and fiscal policy takes. With the latest news from the Federal Reserve, it seems on balance likely that risk assets such as equities can continue to make gains. That said, the recovery that has been made so far has been concentrated in sectors such as technology and in the US and it seems quite possible that we'll see other sectors and regions play catch up. Second waves of COVID-19, localised lockdowns and indeed the US election may however create periods of uncertainty and volatility in the months ahead. The immediate difficulties faced because of the economic impact of COVID-19 should be balanced against the colossal supports being provided by authorities and on balance should provide a confident backdrop to long term investors.

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WARNING: If you invest in these funds you may lose some or all of your investment.
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