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Mid-year outlook: markets could rise more despite the recession

08/06/2020

Summary

The financial markets reacted to the coronavirus with an unprecedented first-quarter drop, then turned around quickly. This appetite for risk in the face of the deepest recession since the 1930s is quite unusual, but the markets are being driven by optimism about potential economic improvement down the road – so we can't exclude a further rise in equity prices.

Key takeaways

- Despite the market's confidence in a quick rebound from the recession, we think investors should be cautious and maintain a neutral allocation in the medium term – while remaining ready to take advantage of select opportunities
- We expect bond yields to remain low given the tremendous monetary-policy support from central banks, which represents a "reloading" of the financial repression policies triggered in response to the global financial crisis and subsequent European debt crisis
- We are neutral to positive on the credit sector overall, as continuing central bank intervention will likely provide substantial support for this sector
- Over the long term, we prefer equities over low-yielding bonds for investors in search of returns, even though investors seeking a "safe haven" have pushed up equity valuations in the US; valuations are more moderate in Europe and Asia
- Growth stocks – particularly the tech sector – may benefit from the fact that growth is scarce in this current recession, and from the greater demands being placed on the digital world in times of Covid-19

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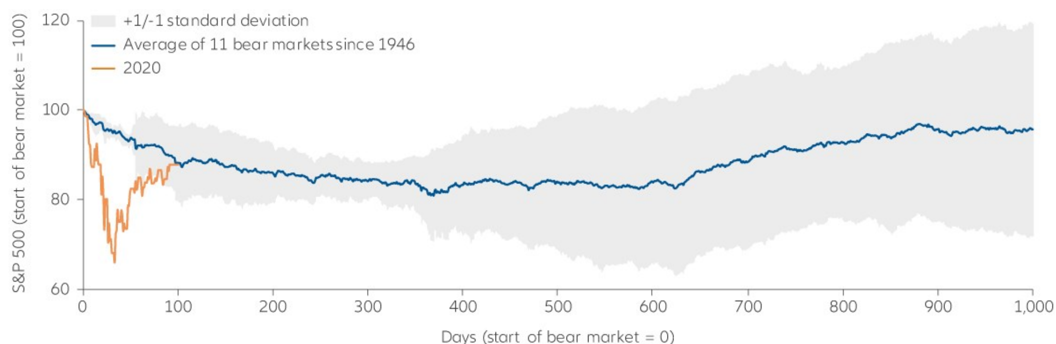
For the market rebound to have staying power, four uncertainties must be addressed

During the first quarter of this year, the coronavirus caused the financial markets to drop faster than the average of all 11 bear markets since 1946. But despite unsettling economic fundamentals related to the pandemic, this bear market suddenly turned around far more quickly than its historical counterparts (see chart). Investors seemed reassured by news of a possible peak in coronavirus infections and related deaths, by the prospect of vaccines and therapies, and by massive amounts of fiscal and monetary-policy stimulus.

The coronavirus bear market fell faster – and has so far recovered faster – than the average bear market
(Current bear market vs average of all bear markets from 1946-2009)



Source: Bloomberg as at 22 May 2020. Bear markets defined as periods in which the S&P Index 500 falls by at least 20%.

This market rebound occurred even as the economic picture deteriorated, highlighting the disconnect between market performance and the wider economic outlook. The question is: will this bounce last? While this recovery in equity prices is fragile, we think it may continue as long as investors embrace a better growth outlook on the back of massive monetary and fiscal stimulus, and they continue to see evidence that infection rates are past their peak. But the rally in equities would be on a much sounder footing if we were to see improvement in at least some of the following four areas.

1. The world must make more progress in fighting the virus

2. Economic data need to rebound – which requires a robust private sector

3. The risk of financial contagion must be contained

4. Valuations need to be more attractive in some markets

What should investors do next?

So far this year, the financial markets have shown surprising confidence that the economy would rebound from the virus-triggered recession. Based on all the evidence we have presented, investors should be cautious while remaining ready to take advantage of opportunities. Here are the key ideas investors should keep in mind for the rest of the year.

Keep up the hunt for income →

Consider growth stocks

Use sustainability

Identify the winners

Amid continued low bond yields, keep up the hunt for income

- We expect bond yields to remain low given central banks' tremendous support so far and their commitment to do more if necessary. This is "financial repression reloaded" – a continuation of the policies implemented a decade ago (including low interest rates and increased regulations) to help countries grow their way out of debt.
- Monetary and fiscal support may generate higher inflation in the medium to long run, but we don't expect inflation to be a major factor in the pricing of nominal bonds. Still, we are finding value in some inflation-linked bonds.
- We are neutral to positive on the credit sector overall. While valuations are not overly attractive and global indebtedness is at record levels, central banks are price-insensitive buyers, and they will continue to directly intervene in investment-grade bonds and, to some extent, high-yield bonds. This will likely provide substantial support for this sector.
- "Fallen angels", in particular, could be attractive in this environment. Convertible bonds are also interesting, since they have historically performed well in times of volatility and offer potential upside from their equity-like characteristics.

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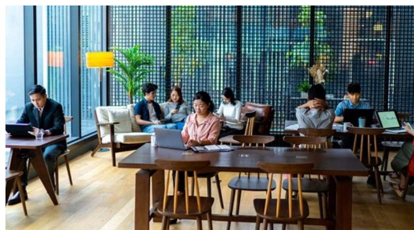

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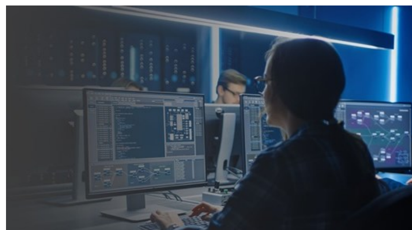

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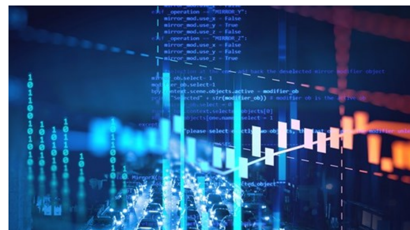

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by Anthony Wong | 17/06/2020

Summary

Despite the impact of the coronavirus pandemic, and continuing tensions with the US, China remains on course to become the world's largest economy by 2030. This could represent the coming decade's most transformative development in global financial markets – and a major opportunity for investors.

Key takeaways

- While it has been a challenging year so far, we expect China to resume its growth trajectory and become the world's largest economy by 2030
- The previously export-led Chinese economy is shifting its focus to higher-value, tech-driven sectors, with growth fuelled by the country's burgeoning middle class
- Improved accessibility, governance and transparency have increased the appeal of Chinese A-shares to foreign investors
- Many indices underplay China's growth story; a lack of exposure to China could mean

benchmark investors miss out

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