# Monthly Letter

August 2020

## Economic environment

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Amid a sudden stop in activity in March and April, the global economy fell into historic synchronized recession in Q2 2020. However, investor anguish was only fleeting. Indeed, monetary and fiscal policies have been deployed in an unprecedented concerted manner, and the response has generally been swifter and bigger compared to the Great Financial Crisis (GFC). In addition, as most countries have gradually rolled back strict containment measures, a sizable global rebound began in May as many businesses reopened, factories restarted production, and more people left their homes to engage in various activities. According to the Markit survey, business confidence rose in the eurozone and the UK to the highest level in over two and five years, respectively.

Yet, while these data hint at a sharp rebound in Europe – and in other regions – at the start of Q3 2020, there are base effects at play and more importantly, weakness in the sub-components such as backlogs and employment warn of downside risks compared to investors' optimistic outlook. Indeed, the recent rebound in activity can be explained in part by the temporary satisfaction of latent pent-up demand accumulated during the containment period. Also, the immediate impediment to a complete recovery relates to the interaction of the pandemic and the easing of restrictions. While the decisions to relax restrictions in April and May opened the door for a robust bounce in economic activity, it has often come too early, namely in the US and some large EM economies. The emergence of an ongoing ebb and flow of restrictions across the globe will therefore constrain recoveries, particularly in the service sector.

The limits of emergency policy support delivered during 1H20 also represent an impediment to a complete recovery. In the eurozone, the unemployment rate has increased only marginally, up to 7.8% from 7.4% earlier this year, while remaining stable at 3.9% in the UK. However, these this data likely provide a false read in the health of the jobs market. Indeed, governments' furlough programs have been widely used, with data showing millions of employees have benefited from the program. For instance, the impact is clearly seen in the UK pay data with growth falling to 0.7% y/y from a peak of 4% as the program pays 80% of workers' wages, up to £2,500/month. What's more, facing a challenging environment due to lockdowns and social distancing, most people who have lost their jobs have stopped searching for work. Therefore, they are not classified as unemployed since only people without a job but have been actively seeking work are considered as unemployed. Overall, the unemployment rate is expected to rise in the coming months as employment-subsidy schemes expire, bankruptcies pick up and people return to the labour market.

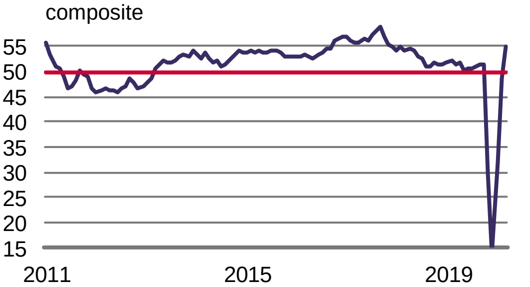
In the US, the rise in the unemployment rate since the start of the Covid-19 crisis has been much greater than that in Europe. The unemployment rate declined in May and June but, at 11.1%, remains far above its level before the outbreak and greater than the peak during the GFC. In fact, businesses have responded to the shock

### Performances in local currency

| | Price as of 31/07/20 | 1 month % change | 2020 % change |
|---|---|---|---|
| **Equity markets** | | | |
| CAC 40 | 4 784 | -3,1% | -20,0% |
| Eurostoxx 50 | 3 174 | -1,8% | -15,2% |
| S&P 500 | 3 271 | 5,5% | 1,2% |
| Nikkei 225 | 21 710 | -2,6% | -8,2% |
| **Currencies** | | | |
| 1 € = ...USD | 1,18 | 4,8% | 5,0% |
| 1 € = ...JPY | 124,75 | 2,9% | -0,4% |

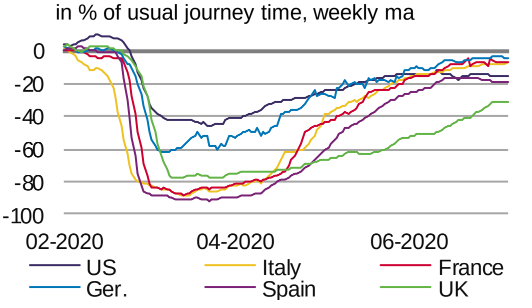
| | | Price as of 31/07/20 | 1 month bp | 2020 bp |
|---|---|---|---|---|
| **Government bonds** | | | | |
| 3 M | Eurozone | -0,57% | 5 | 6 |
| 3 M | United States | 0,08% | -1 | -15 |
| 10 Y | Eurozone | -0,52% | 4 | 2 |
| 10 Y | United States | 0,53% | -7 | -19 |

### Eurozone – Business confidence index



Source Macrobond, Rothschild & Co Asset Management Europe

### World – Mobility index

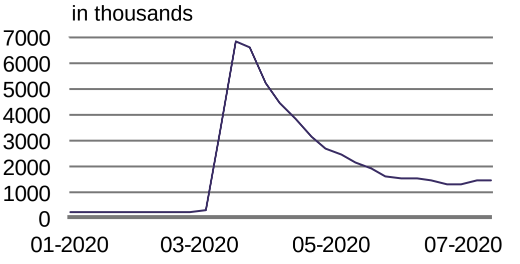


Source Macrobond, Rothschild & Co Asset Management Europe by increasing the number of lay-offs much more rapidly, in part reflecting the traditional hire-and-fire structure of the American labour market. What's more, a large part of the tax expenditures under the CARES Act has been focused on income support for the unemployed by granting a generous increase in the benefits paid to such an extent that some of them have paradoxically found themselves in a more financially advantageous situation when leaving the labour market. Yet, fiscal negotiations in Congress are bogged down in partisan bickering and with no agreement in sight, it looks like there will be at least some lapse in extended unemployment insurance. In addition, the weekly improvement in the initial jobless claims from a peak in March of 7 million has stalled to almost 1.5 million, still meaningfully higher than the weekly pace of 200,000 prior to the shock. Combined with trackers of consumer spending – from panels of millions credit and debit cardholders – showing little growth since late June, this suggests the US economy has lost momentum.

Incidentally, although business confidence indexes have generally been improving, consumers' confidence has remained depressed in most countries as the length of the pandemic and required lockdowns have been much more pronounced than what was expected by most investors. In fact, many businesses might turn worried that underlying demand could be insufficient to sustain the recent improvement in economic activity. After all, the World Health Organization has warned that the pandemic continues to accelerate, with the number of cases worldwide doubling since mid-June. Part of the increase is due to improved testing capacity, but most is the result of poor management of the pandemic in some countries.

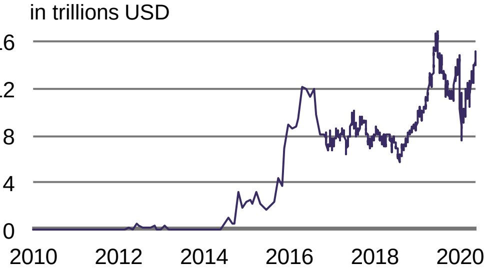
Overall, a growing number of countries have been forced to reintroduce restrictions and reinforce social distancing and quarantine measures. Admittedly, the worst of the economic collapse has been passed, but the easy part of the rebound has probably already been accomplished and a great deal of uncertainty surrounds the projections of economic growth due to the evolution of the pandemic and the persistence of the shock. Furthermore, fiscal policy might end up being forced to change tack in order to prevent fiscal positions from becoming unsustainable. Meanwhile, if credit quality continues to deteriorate, banks will need to replenish their buffers, thus tightening the availability of credit. Central banks may also face the unpalatable choice of increasing their already outsize ownership of financial assets in the economy. As yields on government bonds fell further, debt trading at negative rates has climbed once again. This reinforces the "The Is No Alternative" (TINA) argument, pushing investors into risky assets and raising questions – and risks – regarding the integrity of financial markets. As the IMF recently stated, "The extent of the recent rebound in financial market sentiment appears disconnected from shifts in underlying economic prospect."

**US – Initial jobless claims**




Source Macrobond, Rothschild & Co Asset Management Europe

**World – Negative yield bonds**




Source Bloomberg, Rothschild & Co Asset Management Europe