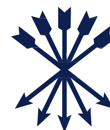
Monthly Letter



September 2020

Economic environment

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Most countries have gradually rolled back strict containment measures and a sizable global rebound began in May. In fact, investors remain convinced of a swift and complete recovery, the V-shaped scenario. However, whether this jump-start to the recovery could be maintained is questionable and a reverse-square foot recovery – rapid gains for some months, then a much slower pace and an incomplete return to normal – cannot be excluded as a baseline economic scenario.

Firstly, the continued spread of Covid-19 is an ongoing drag on behaviour and the normalization in cross-border mobility. India is now the second worst hit country, surpassing Brazil and behind the US. Over 2 million new cases have been reported in the past month and the virus is now spreading through the country's smaller towns as the pandemic threatens to overwhelm an already overworked health care system.

In Europe, while the situation was generally under control for most of the summer, August saw a resurgence in the number of new cases, jumping back to the figures recorded in May. That said, there are several reasons why mortality is much lower now than it was back in the spring despite surging new cases. Indeed, at the peak of the first wave, only seriously ill people were tested, while today testing is much more broadly based across the population. Furthermore, older individuals appear to be self-shielding, reflecting a recognition of their greater vulnerability and leading to the decline in the average age of newly infected individuals. Given the sharp age-related correlation of mortality, any given number of new infections in the second wave will thus put less pressure on healthcare systems, resulting in fewer fatalities. In addition, improved treatment including therapeutics and treatment techniques, has reduced the mortality rate for hospitalized people. Overall, Europe's second Covid-19 wave seems distinct from the first, warranting the implementation by governments of a different approach. In particular, they have focused on tracing contacts of positives cases, responding to flare-ups with localized measures and an even greater emphasis on wearing masks. Yet, while the bar is very high for renewed broad based shutdowns of economic activity, the new increase represents a powerful headwind.

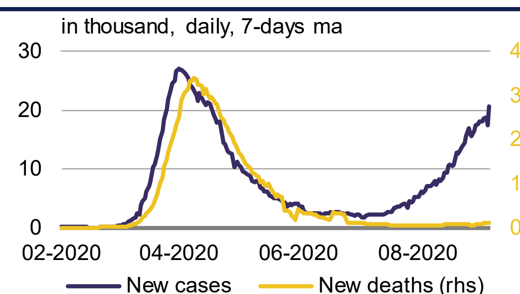
Secondly, lockdowns and large fiscal transfers pushed households saving rates to record highs and investors have built their optimism on the fact that these developments will enable a consumer spending surge. Admittedly, elevated saving rates and pent-up demand have helped powered May-July spending recoveries in most countries. However, signs of a loss of economic momentum since July have become evident. Surveys have shown an increase in business confidence, yet consumer confidence remains lacklustre and the pace of improvement in the labour market continues to moderate, namely in the US. What's more, the fear of recurrent pandemic shocks in the future may structurally raise households' precautionary savings.

Performances in local currency

	Price as of 08/31/20	1 month % change	2020 % change
Equity markets			
CAC 40	4 947	3.4%	-17.2%
Eurostoxx 50	3 273	3.1%	-12.6%
S&P 500	3 500	7.0%	8.3%
Nikkei 225	23 140	6.6%	-2.2%
Currencies			
1 € = ...USD	1.19	1.3%	6.4%
1 € = …JPY	126.41	1.3%	3.8%

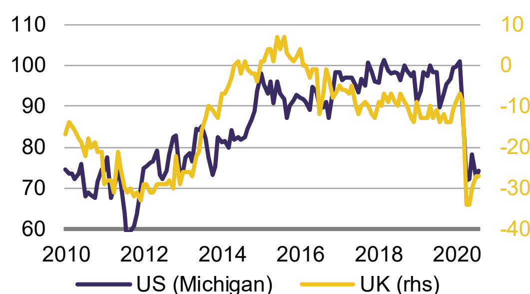
		Price as of 08/31/20	1 month bp	2020 bp
Government bonds				
3 M	Eurozone	-0.56%	1	8
3 M	United States	0.09%	1	-145
10 Y	Eurozone	-0.40%	13	-21
10 Y	United States	0.70%	18	-121

Europe – Covid-19 new cases and deaths



Source Bloomberg, Rothschild & Co Asset Management Europe

World – Household confidence



Source Macrobond, Rothschild & Co Asset Management Europe

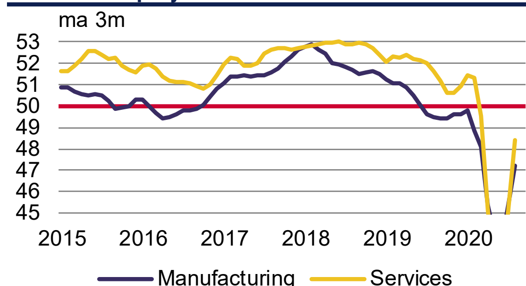
Thirdly, uncertainties regarding fiscal stimulus remain. In the US, President Trump announced an executive order last month that extends additional unemployment payments, but of $300 a week, which compares to $600 at the outset of the coronavirus outbreak. The initial program expired at the end of July and Congress has been unable to agree on an extension, many Republicans expressing concern that the weekly benefit was too generous, giving people an incentive to stay unemployed. Meanwhile, Bank of England's Chief economist has warned against extending the government's job retention scheme, pointing that such a move would prevent a necessary process of adjustment taking place. These developments underscore the likely swing in global fiscal policy towards tightening as supports designed to be temporary are withdrawn before recoveries are complete.

Uncertainties regarding monetary policies are also apparent. After 18 months, the Fed completed its monetary policy framework review and presented the conclusions at this year's Jackson Hole conference. Two notable changes to its framework will likely keep short term rates anchored near zero for a prolonged period. Firstly, the Fed will no longer tighten policy simply due to the unemployment rate falling below its estimate of the natural rate. Secondly, the most meaningful change is the embrace of *average* inflation targeting. This implies that the Fed will invite an overshoot of its 2% inflation objective after a period in which inflation has undershot that objective. For instance, it seems unlikely that the Fed would have hiked rates in late 2015 and late 2016 as inflation had been undershooting its target for several years.

Yet, ultra-accommodative monetary policies for a prolonged period do come at the cost of risks related to market distortions, collateral damage and unintended consequences. Correspondingly, worries are growing that the reality could resemble to a K-shaped recovery where growth continues but is uneven, split between the upper path of the K – financial markets – and the lower path – the real economy. Indeed, while the stock market soared to new heights, unemployment, although somewhat improving, remains a problem, particularly in lower income groups. Furthermore, considering that, in the US, more than 50% of the stocks and mutual funds are owned by the top 1% of earners, some fears that the benefits of the Fed policy and fiscal policy flow mostly to the top, thus widening inequalities.

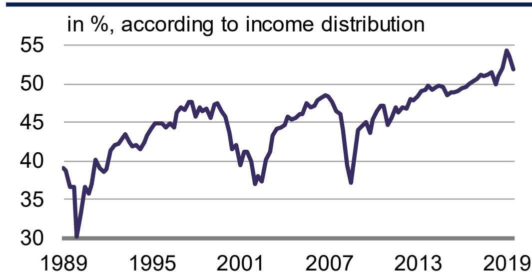
In short, the illusion of an easy catching-up of economic activity, resulting from the restarting of production and substantial pent-up household demand, could give way to a more complex reality as temporary or deferred job losses could become permanent, especially since business bankruptcies are still to come, despite the aid and guarantees provided by the public sector.

World – Employment PMI index



Source OECD, Rothschild & Co Asset Management Europe

US – Share of equity market held by top 1%



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