COVID-19: How What we Know can Help Us

By Jeff Elliott, PhD., CFA

In my previous blog, I outlined several of the key facts and unknowns related to the current global pandemic, including potential treatments and the results of possible health policies aimed at allowing a return to “normal.” At Signature, the examination and discussion of these issues has formed a key part of our investment outlook, helping us to identify risks and opportunities as the markets react to this unprecedented set of circumstances.

As I explained, we don’t know how well the various re-openings will work and what pace is the right pace to balance economic recovery without tipping countries or regions back into lockdown. In our view, this will have do be done slowly or else there will be accidents and outbreaks, and this is probably where we are a little more cautious than the market seems to be right now.

It is difficult to imagine a scenario that doesn’t result in decreased economic activity for a significant period, particularly if additional lockdowns are necessary. There are also knock-on effects from the lockdowns in terms of the ability of governments to fund stimulus programs and the longer-term economic impacts of those programs. The current set of fiscal and income support policies drafted in haste in March are premised on COVID-19 being a temporary shock and will expire unless politicians act to extend.

The potential for global spillovers as the virus lingers should also not be ignored, from things like: 1) damage to emerging market economies and potential for defaults, as they go through their own health emergencies and take economic hits from decreased tourism and depressed commodity prices; or 2) the risk to Eurozone stability as sovereign balance sheets are stressed, raising debt sustainability issues; or 3) further deterioration of China/U.S. relations as both countries try to shift blame for the pandemic – which risks accelerating deglobalization slowing growth structurally.

If we assume that the virus is here for a while, a sharp drop in consumer confidence needs to be priced in by the market. We question whether people are going to rush back to shop in malls or to take flights until there is greater certainty and comfort around a path to a vaccine. A complicating factor is the potential undermining of confidence in government assurances if clear policy mistakes are made (e.g. if aggressive re-openings in the U.S. results in a true second wave).

There are also likely some fundamental changes to the economy as a result of our experience with this pandemic (things like the willingness to work from home) and we are gearing our portfolios toward some of those themes now. In recent weeks we have shifted to a more defensive asset mix by reducing overall equity exposure and raising cash as the rally of the S&P 500 Index above 2900 feels too far too fast to us, given the uncertainty surrounding the forward path of both the virus and the economy.

But we have also been tilting our portfolios to benefit from some of the longer-term structural trends we expect to emerge or to accelerate in the post-crisis world. This has included increasing exposure to both health care and technology. Within health care we have added to our pharma exposure as pharmaceutical companies emerge as part of the solution to the current crisis and as multi-year anti-pharma political headwinds subside. In the broad technology and digitization space we continue to see winners from both accelerated adoption of work from home technologies, such as video conferencing and video gaming, as well as the accelerated brick and mortar disruption from e-commerce on a global basis.

What do we need to know?

There are several signposts or catalysts that would give us comfort that we have a visible path to sustained recovery. We need to find an acceptable balance between human health and economic "liberation," so anything that changes that balance would make us more positive:

- Evidence that aggressive re-opening of economies doesn't cause significant new outbreaks would be a positive sign, but this is essentially trying to disprove a negative and to a certain extent the market seems to be assuming this already.

- Any data that demonstrates that COVID-19 isn't as fatal as it seems, or that the at risk population can be accurately defined and protected, allowing the "less at risk" population to really re-engage in the economy would also be positive – however implementation of policies around will be difficult.

- Any drug or medical treatment (including the successful development of a vaccine) that clearly reduces the health costs of COVID-19 would also shift that balance and we believe could be the single biggest catalyst for improvement in sentiment.

The path forward

We have a great deal of confidence on two aspects of the path forward. Firstly, we are not done with the virus and we will have to deal with it and the impacts on the economy until a vaccine is developed. We believe this will drive sentiment and sentiment may be volatile as things progress. Secondly, we will get through this. Human ingenuity and the knowledge and technology we have at our disposal will find a solution. We may just have to wait for a while for it.

Sources: Bloomberg Finance L.P. and Signature Global Asset Management.

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Published May 15, 2020.

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