Rathbones
Look forward

Review of the Week

26 May 2020

A matter of perception

While we're all theorising about whether looking at a castle is the best form of optometry, really important issues are going unaddressed. Chief investment officer Julian Chillingworth stays focused on what matters.

Whether you support No. 10 adviser Dominic Cumming's cross-country dash during lockdown or think him foolish, anyone can agree the result is terrible.

The furore drags attention from truly urgent matters like tracing and containing COVID-19, supplying proper protective gear for the NHS and other essential workers, and getting as much of the country safely back to work as soon as possible. Instead we're theorising about how many rest stops per 100 miles a toddler requires and whether looking at a castle is the best form of optometry. And jokes aside, with public morale slipping in the lockdown, this news is extremely unhelpful. Whether Mr Cummings was justified or not is as irrelevant as the route he took: what matters is the perception. This is just one more politico/MP/scientific adviser who believed the rules didn't apply to them. How many households will now, after months of strain, decide that if "the elites" can do whatever they want then they should be able to as well? Hopefully, not many ...

Widespread disregard of the lockdown and distancing measures could flow through to a resurgence of the virus, requiring a renewed lockdown. At that point, many businesses would be at the end of their tether. The prospect of another two or three shuttered months could mean widespread layoffs, another beating for the public finances and a body blow for the NHS and other care workers that have already endured a gruelling spring.

What gives us hope that most people will stick to the rules is our peculiar temperament, which takes pleasure in indignation. Often times, the flagrant disregard of proper etiquette by a rude passenger only hardens everyone else's resolve that the rules matter. The tut-tut/shared-eye-roll railway carriage conspiracy that is so truly and wonderfully British.

It has been a long lockdown though, so the announcement of the next phase of relaxing the lockdown in England is very welcome. They differ in timing and extent from the devolved nations, which set out their own paths several weeks ago, but the gist is the same. We're trying to reopen as many businesses as we can as long as it keeps employees and customers safe. In England, outdoor markets and car showrooms can open on 1 June. Other non-essential retailers will be able to open from 15 June. Before any business opens, it must complete a risk assessment in conjunction with employees and unions. That means setting out the risk and how to counter it, just like with any other risk, such as a fire in an office building or the myriad dangers listed on the risk board at a construction site. On the face of it, this seems to be a good compromise. As long as employees have recourse to complain about bullying or blow the whistle on corner-cutting, this seems like the best way to get the nation back to work.

As for cafes, pubs, restaurants, hairdressers and beauty salons, they will have to remain closed. Exactly how much of these industries will emerge from the lockdown is a dreadful unknown. These businesses tend to be small operations with little national voice. They also employ a substantial slug of UK workers. And there are so many other businesses that remain in limbo: cinemas, gyms, theatres, libraries, accommodation providers, museums and galleries, to grasp at just a few.

No matter which way you cut it, it's a stressful time. Yet, if we use our common sense and look out for each other, we will keep making steps towards the light at the end of the tunnel.

The great con trick

It's the strangest dichotomy: as economic news becomes a series of doom notes, stock markets have climbed steadily higher.

There's a lot going into this confusing mixture. But there are two main reasons for the rally. Some of the gains are driven by investors who are focusing six months to a year out. If you're investing today based on how you believe the situation will be down the line, you're likely to be going into the market when the economic data looks its absolute worst because you're buying into that future improvement. The second factor in share price appreciation is down to the effects of low interest rates. As the returns offered by 'safe' investments such as bank accounts and government bonds grind lower, that makes companies' future earnings all the more valuable. In the parlance, this is 'discounting' future cash flows into today's values.

This second, discounting factor has been engineered by the world's central banks, many of which have cut interest rates virtually to zero (or below) and created money to buy huge amounts of bonds in the open market (quantitative easing). By committing to purchasing so many billions of pounds' worth of assets, a central bank can help keep a lid on yields (borrowing rates) for governments and large businesses. Allied to this, the knowledge that a huge institution has a standing order to buy vast amounts of bonds gives traders and investors the confidence that they won't be caught holding bonds that no one wants to buy. All this helps keep confidence in our financial system and ensures money continues to flow to where it's needed.

Here in the UK, the Bank of England has helped hammer down 10-year gilt yields to less than 0.15%. Last week, the UK government even sold its first negative-yielding bond: a three-year issue for -0.003%. The new bank governor, Andrew Bailey, has kept open the possibility of negative interest rates, too. Although, you have to wonder whether that's a good idea during a pandemic, when businesses and households are hoarding cash to stay afloat …

It seems more likely that Mr Bailey is keeping this option open for the post-pandemic elephant in the room, which has Brexit stencilled on its side. The negotiations between the EU and UK are continuing, albeit in a haphazard manner, and the government is chillingly adamant that it will push ahead with a hard Brexit come hell or high water. Organising a withdrawal from a complex trading bloc in six months is a tough ask at the best of times. Attempting to do so over Zoom while fighting a pandemic smacks of hard-headed folly.

There are a lot of unknowns out there for Mr Bailey – and for all of us investors. How quickly will the UK will be able to return to work? How effective will workers and businesses be? How well-oiled will our supply chains be halfway through 2021? How will all the debt piled on by governments, businesses and households be unwound over the coming years, and how will that affect people's confidence to spend and live their lives? Not to mention the countervailing effect of greater savings by the luckier among us. How will all these factors affect inflation, our GDP growth and borrowing costs?

In short, these are weighty and complicated questions that are virtually impossible to answer with certainty. We believe it is better to be aware of them and ensure that portfolios are well diversified and include protection against these risks.

What matters most right now is that people can overcome worries about their health and jobs and get back to normal – safely – as soon as possible. If people trust government policies and businesses' implementation, then they should be willing to spend again. And if the middle classes and wealthier among us come out of the lockdown with the confidence to spend liberally, it could help kick-start the economy in 2021.

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