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Pandemic poised to accelerate underlying trends

We now have a two-speed economy, and much talk about a disconnect between stock market and economy. But this won't change our research and stock picking focus

Francis Ellison, Client Portfolio Manager

When meeting clients, I am often asked to give a prognosis for European economies – logically, as these same clients are often asset allocators charged with making decisions on the relative merits of asset classes, so macroeconomic analysis plays a huge part. Such discussions are part and parcel of the partnership we offer clients – the relationship is not just about selling product.

But for me, questions like this are a challenge. Firstly, there is a wealth of intelligent and useful external work done in macroeconomics, much more so than in microeconomics and the analysis of business models – but more on this later. So my advice and insight competes with myriad other sources. And secondly, because in a "normal" environment my judgements may not stray much from the consensus – we may be a tad more optimistic or pessimistic, but the difference will not be very great, nor will it be so for many others in the same boat. Forecasts cluster.

Not so currently. There is so much uncertainty in the current economic environment, and so much is changing, that market and macro forecasts have become much more disparate – and some are probably less informed, or have not kept pace with developments.

But does this really affect a stock-picking house to any great extent? Yes, our stock picking is through the prism of macroeconomics. But the path of the *overall* economy is not so relevant here when you factor in that the economy is operating at two speeds.

The economy as a whole is taking a huge hit this year, and the recovery will not have equal sides. Or as Bank of England monetary policy committee member Silvana Tenreyro put it, we will see an "interrupted" or "incomplete" V-shape.[1] If I look at my high street in west London, however, it looks more like all interruption and no V. Restaurants are closing, permanently. The few that remain have half the number of usual tables, and most of them are empty. Previously furloughed staff are now redundant. Estate agents are idle. Buses and trains are empty. Social distancing in shops has driven the consumer online, so the few remaining staff, mask-clad and nervous, have little to do. Back in the City where our office is, it must be worse – we have not been there for six months, nor has anyone in all the firms around us.

The parts of the economy that are moving at a different speed – much faster – are areas such as technology and healthcare, and this is inevitability reflected in stock market performance. Given that they are major parts of the index, there is much talk about the disconnect between stock market and economy. For if truth be told, the problems in my high street while dramatic in social terms, have little impact on much of the stock market. A local closing restauranteur and his erstwhile staff are not stock market participants in almost any sense. Their problems are an example of the growing trend of the poor getting poorer, the disadvantaged losing out again. We may anguish about them, it may – should – make us uncomfortable about societal and political inadequacies. But it does not follow that we should rail against the successes of the stronger and more robust companies that have been the focus of our portfolios – not just this year, but for decades – as their successes can be championed and have not caused or exacerbated the problems of others.

There are, of course, other businesses which have been transformed but which are neither particularly victimised or championed by the effects of the virus. Service businesses, like ours, and those of many of our wholesale investment clients have moved their work online. For us this has been an unexpected challenge, but not wholly unwelcome.

True, many of us are now working at home and technology has been key; and we miss the face-to-face contact with colleagues and clients and company management, and have had to work and train to make sure the virtual equivalents are equally effective. Other sectors have seen parallel developments: for lawyers, accountants and consulting firms technology has become critical, and the ownership of a prestigious city-centre headquarters, and the ability to fly the world to do business, have become – temporarily at least – less important.

My conclusion, perhaps unexpectedly, is that we face more of the same.
Not because Covid-19 and its effects will not dramatically change economies and employment for many years to come.
But because the underlying trends in the stock market have been in place for years and have simply accelerated this year.
Brilliant human endeavours in science and technology, effectively commercialised in a number of sectors, particularly in healthcare and technology, have created strong, investible companies with real long-term sustainability and growth – often with benevolent impacts on the environment too. Our research and stock picking has been truly successful in identifying these, enabling us to ask the right questions and deliver returns for clients. And that is not set to change.

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[1] Reuters, BoE's Tenreyro sees 'incomplete V' shape for UK recovery, 15 July 2020.

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