Where To From Here?

Image: Getty Images

With encouraging signs of an economic recovery, most markets saw positive returns in the second quarter of 2020. This is probably not too surprising coming off the lows of the first quarter but encouraging still.

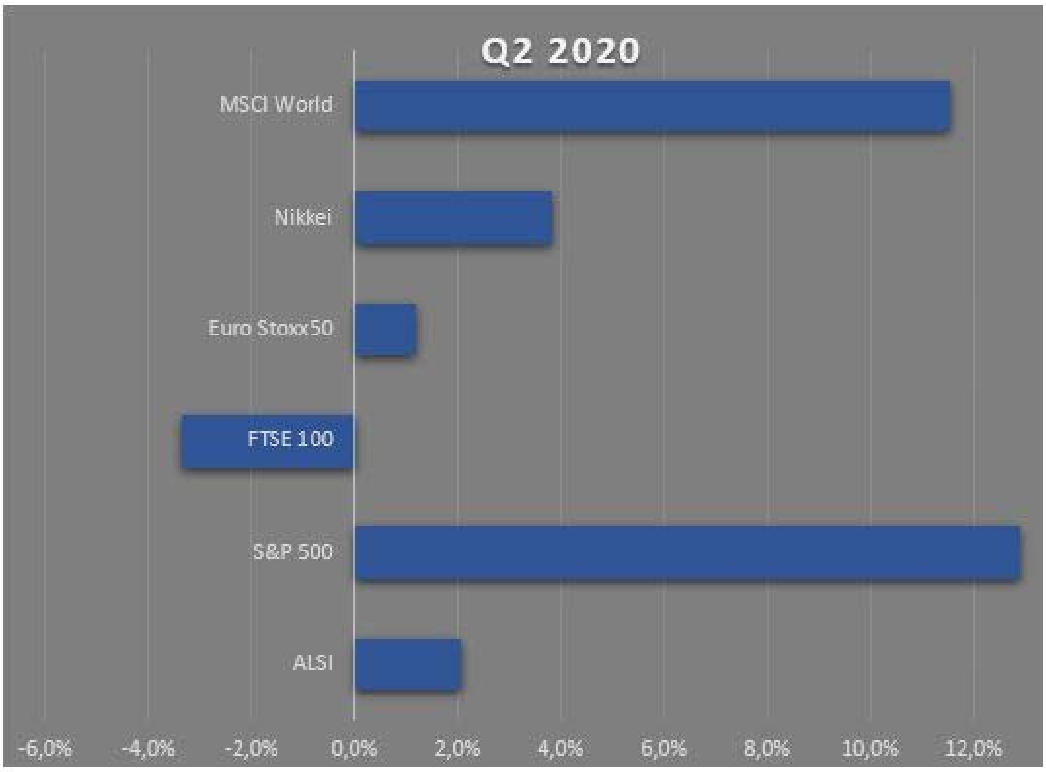
The US economy saw a drop in annualised GDP of 32.9% quarter on quarter, but more recent indicators suggest that activity is recovering. In fact, ISM activity indices are now above pre-virus levels. The labour market also seems to be on the up, with jobless claims slowly easing.

Across the ocean, we expect the recovery in activity in the Eurozone to be more gradual, following a 12.1% plunge q/q in the second quarter. In fact, the August Composite PMI numbers while expanding at 51.6, indicate a slower rate of expansion relative to the July level of 54.9.

While short-time working schemes prevented unemployment from rising too sharply relative to that of other developed economies, the absolute rate of unemployment is still creeping up in the zone causing concern for the medium-term outlook.

The UK saw a sharper contraction in output, but again some signs of recovery are starting to come through. Activity has rebounded as the economy opened up following the national lockdown with the services PMI rising sharply to a six-year high of 60.1. However, keep in mind that this comes off a particularly low base.

Against this still gloomy backdrop, stock markets have performed surprisingly well:



Source: Investing.com; sashares.co.za

Locally, both our economy and our stock market are lagging global peers with a muted recovery in the All-Share Index and dismal GDP numbers keeping most South African investors nervous.

We can't help but wonder whether the global exuberance is perhaps a bit premature.

While many observers expect a further rate cut in SA following the dismal drop in GDP in the second quarter, other central banks around the world haven't got much left to work with, with international interest rates at all-time lows.

In the US, it is largely expected that the Federal Reserve will step up the pace of its asset purchases eventually, but it looks unlikely that this will happen any time soon. Many Fed officials are making work of playing down the market's expectation of a major loosening in policy, even though they have recently stated the new policy goal of lifting inflation to an average of 2% (previously, 2% was their upper limit) and maximising employment.

US stock markets are dominated by tech stocks that have markedly outperformed their peers over the last few years. We have spoken about this before but would like to remind readers that this cannot last forever. Tech valuations are increasingly stretched, and these giants have become so big, that further growth may be difficult to achieve. Due to these shares making up such a large component of the market, a correction in tech share prices will drag down overall markets and is a risk that we feel is not getting enough attention. See more below.

The US election could also be a catalyst for a dramatic change in market dynamics. While Donald Trump is widely seen as good for business and therefore markets, his ongoing feud with China creates immense volatility. The tech-heavy Nasdaq plunged 10% in three days this week, following Trump's suggestion that the US economy needs to "decouple" from China. As expected, this drop pulled through to losses in the S&P 500 and Dow Jones. The effect of a Joe Biden win is probably more difficult to predict – while corporate taxes will most likely rise, there may be some extra government spending that will improve growth.

It is clear that there are so many variables muddying the outlook for the US markets and it is no different in the rest of the world.

Inflation turned to deflation in the Eurozone in August, mostly driven by the sharp fall in energy prices. This will be a major concern for the European Central bank. Unemployment is also expected to increase quite quickly once the various furlough schemes expire in both the Eurozone and UK, with many businesses either permanently reducing the number of staff or failing completely. The ECB does not have much room to move when it comes to interest rates, but it is widely expected that it will eventually implement more easing. The Bank of England is in a similar position, recognising the need for further stimulus but probably not moving on interest rates any time soon.

So, what do we do as investors? Do we make changes to our portfolios? Move all our money to "safe" assets like cash? We have seen time and time again that making drastic changes to your portfolio during exceptional market conditions or in reaction to news flow (like this article!) is probably one of the worst moves an investor can make. The exception is if you haven't seen a financial advisor in the last few years and you are not working according to a set plan.

The best advice we can give you if you already have a good advisor and set financial goals is to stick to it through the volatility. If not, we strongly recommend that you see an advisor as soon as possible. The news is full of articles that will intimidate and confuse investors. It is an advisor's job to help you stick to your personal investment goals through the good times and the bad!