Market Update

OCTOBER 2020

PARK HALL
Financial Services Limited

SQUARE MILE
INVESTMENT SERVICES

This is likely to have been the deepest recession of our lifetimes. However, as we begin to emerge from shutdowns the economic impact has not been quite as bad as many people had originally feared. As a result, profits forecasts which were too pessimistic are being revised higher, particularly in the US. Although many uncertainties remain and stock markets have been trading choppily as a result, the US market has been leading global stock market indices higher. This helped generate a modest improvement in the majority of our portfolios' values in the third quarter. In contrast, the FTSE 100 has continued to lag, falling by 4% over the last three months.

As widely expected, activity in the economy has bounced back as lockdowns have been eased over the summer months. Many fear, however, that the pandemic will become harder to contain over the winter months and governments must undertake a delicate balancing act in determining what activities should and should not take place. Thankfully, we are gaining experience both in controlling the spread of the virus and treating the disease. This makes the prospect of further national lockdowns less likely. As a result, we expect the economy to continue to recover but the pace of the rebound seems certain to slow.

COVID INFECTIONS ARE INCREASING

The pandemic has accelerated the uptake of technology and this has been a windfall for the companies that supply it. Many of these firms are listed on the American stock exchanges, which has been one of the principal reasons why US markets have performed so well this year. Some of these businesses are giant. For instance, Apple is roughly equal in value as all the companies in the FTSE 100 Index. At one stage during the last quarter Tesla became the world's 9th most valuable listed company. This is surprising as the company only started selling cars 12 years ago and has only recently begun to make small profits. The strong share price momentum in these types of companies has attracted speculators, who have pushed share prices even higher. This has left valuations at very demanding levels, with stock prices discounting strong growth in profits for many years to come. These valuations will become even more stretched if corporate tax rates rise, as they may well do if Biden displaces Trump. We do have investments in North American companies but we have limited exposure to these types of racy stocks.

One of the areas we do like in North America is insurance companies. Policy holders have been disappointed to find that certain policies did not protect them from Covid-related losses and have decided to argue their case in court. The resulting legal uncertainty has cast a shadow over the sector. In recent months, though, rulings in early cases have been in the insurance companies' favour. At the same time, insurance premiums have been climbing across the industry. These are encouraging trends. In contrast to some other sectors in the US stock markets, insurance stocks look cheap and we have added to positions.

The UK has been particularly badly affected by the pandemic and economic activity fell by an unprecedented 20% over the second quarter. This was the worst amongst the world's major economies. At the same time, the finalisation of Brexit casts huge uncertainty about the nation's relationship with its most important trading partners. These concerns have caused sterling to trade weakly in the foreign exchange markets and domestically focused businesses, such as banks, to cheapen. As a result, the composition of the FTSE 100 index has changed over the last few quarters and it now represents a much more diversified spread of businesses, many of which are international in nature. Direct exposure to the UK economy is relatively limited. A poor Brexit outcome should therefore not be too damaging for many of the businesses in the index. Dividends have been savagely cut as a result of the Covid crisis. However, our analysis suggests that these could be restored over the course of the next few years, which would leave the market on a very attractive yield. Towards the end of the quarter, the index revisited levels last seen in March and we have taken this opportunity to add some exposure for the reasons outlined above.

There is still huge uncertainty in the outlook. The battle against the virus is ongoing but, even beyond that, economic and financial circumstances are unprecedented. Interest rates look set to remain at close to 0% for years to come, allowing Governments to borrow freely and deficits to soar. The US election promises to be a very messy one. Biden is well ahead in the polls and if he wins he is likely to lift taxes to fund his spending promises. But not all is doom and gloom. There could be positive surprises on the horizon such as the discovery of a vaccine or announcements of ambitious new infrastructure spending. We believe that the portfolio is well positioned and stocked with attractive opportunities which, despite the challenging backdrop, should yield attractive returns in the quarters ahead.

THE UNCERTAINTIES REMAIN

VAST BUT POSITIVE SURPRISES

ARE ALSO POSSIBLE

Important Information

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