

Economic Update

Volatility continues but since our last correspondence there has been a subtle, yet important, shift in the underlying tone of financial markets. Confidence levels are beginning to repair themselves albeit very gradually. Due to the necessary mobility restrictions that have been implemented around the world, there will be a deep global recession experienced in the first half of this year but a recovery in activity looks highly likely towards the latter stages of 2020.

This is largely due to the speed and coordinated policy responses of the major central banks and governments. The benefit of having lived through the GFC, a mere decade ago, means that the threats of having the banking system fail, and the implications of that for businesses and the broader economy, are thankfully well understood. Having this playbook close to hand has resulted in interest rates being slashed, liquidity being pumped into the system and trillions of dollars in fiscal stimulus announced. In anecdotal support of this view I have spoken with several of the banks operating in New Zealand over the past week and their message is clear - the current challenges are nothing like the horrors of the GFC, our financial systems are functioning. The equity market reaction to COVID-19 is almost unique in its speed and violence but many of the building blocks which support our economy are intact. I don't believe that the growth recovery for the Western world will necessarily be rapid, due to the scar tissue that will remain, but conditions will improve this year.

My confidence in the medium-term prospects for the equity market have also strengthened. That is not to say that directionally we will travel back to the levels enjoyed before this crisis interrupted, but I believe the trend will be positive. The bears (those who expect markets to fall from here) will have days where they feel vindicated. The headlines around the world will at times be horrifying, in terms of the human loss and desperation surrounding the efforts being taken, but this process has a finite life. The businesses that survive the challenges ahead will emerge stronger than they were previously. This is a reality that we have seen through many cycles. Costs will be stripped out and the way that those businesses operate will be reviewed, in detail. Operating efficiencies will be achieved and the profits that companies enjoy when the environment returns to normal will be higher. Not all will get there, but those that do will be better for it.

If I were to look at the world today as simply an investor (difficult in the current environment as I am also a father), I would say that this is one of the most exciting times of my career. Not because I believe that markets are about to shoot higher but because the opportunities that we have today, to make money for our clients, are very evident. The companies that I described earlier, those which will survive this crisis, will emerge in better operating shape and the prices that we can buy them at have dramatically changed. Many of these will still have to engage in a process of improving the health of their balance sheets through raising capital, but again this will be another opportunity to own these businesses at attractive prices. The other opportunity is to recognise that despite almost all stock prices having collapsed, the underlying operating experiences of each business during this time has been very different.

(Article courtesy of Slade Robertson, Managing Director, Devon Funds Management Ltd)