THOMAS MILLER INVESTMENT

Investment Commentary

July 2020

Recent economic developments

■ Economic reports over the past month have highlighted the severity of the decline in the pace of economic activity in the months since the outbreak of Covid-19. In the US, following a contraction of 5% (annualised) in the first quarter of 2020, Gross Domestic Product (GDP) fell at an annualised rate of 32.9% in the second quarter. That marked the worst quarterly decline in US GDP on record. This is illustrated in the figure below.

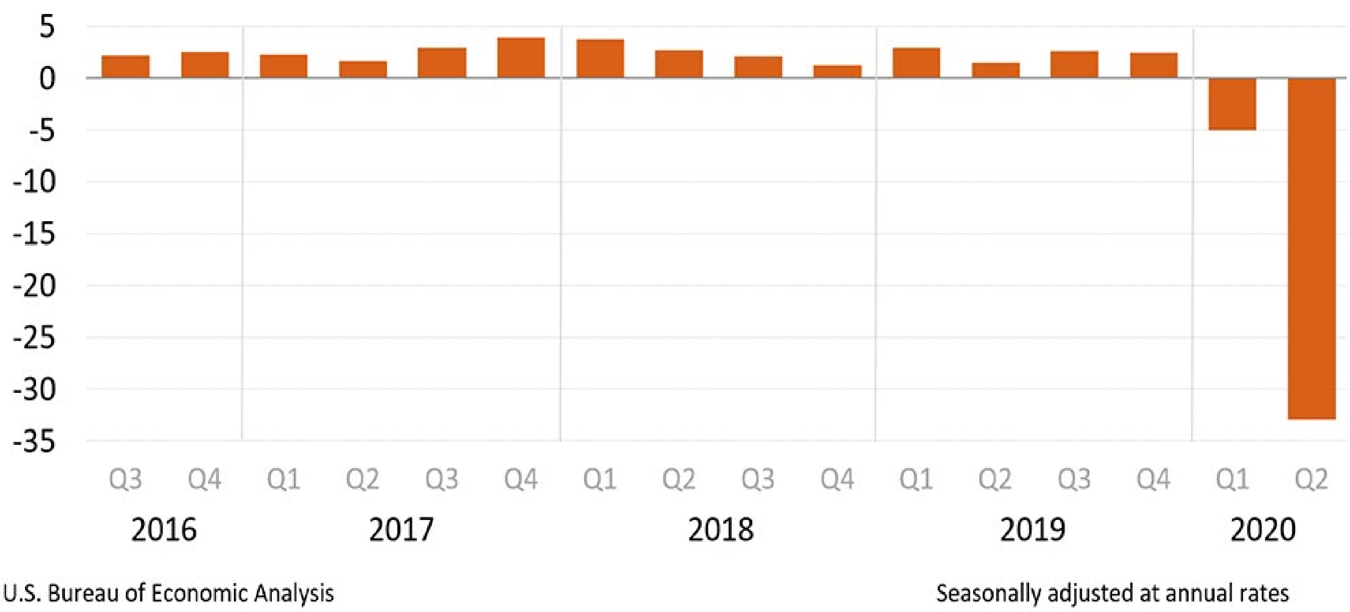
■ Furthermore, US labour market conditions deteriorated in July as the number of Americans filing for unemployment benefits rose by more than expected in the second half of the month. Indeed, with 1.43 million new filings for unemployment benefits, the last week of July marked the 19th consecutive week in which the number of claimants exceeded one million. Again, an unprecedented statistic.

■ In a sign of the global nature of the recession, Germany, France and the UK have also reported record rates of economic contraction during the second quarter of 2020. Importantly though, the pace of economic activity has picked up across the board in recent weeks as various governments have taken steps to lift lockdowns. In some cases, this has driven sharp rebounds in economic growth rates and fuelled hopes of a rapid recovery from the recession.

■ While the initial recession itself is likely to prove relatively short-lived, the shape of the ensuing recovery remains highly uncertain. How things turn out will be driven by a combination of factors including the path of the outbreak (e.g. a resurgence in infection rates could undermine efforts to re-open economies and therefore harm growth) and the extent to which both monetary and fiscal support measures are sustained.

■ For instance in the US, while the Federal Reserve (Fed) looks set to maintain accommodative monetary policy, it now seems likely that fiscal policy support measures such as enhanced unemployment benefits and furlough schemes will either be scaled down or phased out entirely in the weeks ahead. This risks undercutting the recovery by taking out a key driver of consumption demand.

Figure 1: Real US GDP - percentage change from previous quarter



■ Outside the US, news that European Union (EU) governments have reached an agreement over new fiscal stimulus boosted financial markets. The agreement paves the way for the European Commission to raise funds on capital markets on behalf of all EU states. The total package of 750 billion euros will be distributed among the countries and sectors most impacted by the coronavirus pandemic in the form of grants and loans.

■ In the financial markets, the rally in risk assets that began in late March accelerated again in July as investors were encouraged by the combination of positive news on the development of potential coronavirus vaccines, commitment by the Fed to maintain monetary policy support for as long as necessary and further steps to re-open economies across the globe.

■ In general, the trends that have been in place across financial markets for the past few months persisted in July. Equities and other risk assets rallied, government bond yields fell slightly, corporate bond spreads tightened a little further and the US dollar fell against a broad range of currencies.

■ As we have noted in recent months, the ongoing rally in risk assets has been fuelled by the provision of significant liquidity and stimulus by major central banks, particularly the Fed. Importantly, in the absence of renewed lockdowns or fiscal policy errors that stifle the nascent recovery, the ample supply of liquidity should continue to support financial markets in the months ahead.

■ Overall, our assessment of the balance of risks means that we continue to position client portfolios close to benchmark levels across the major asset classes as we seek to balance the desire to participate in broad market gains with the ongoing need for downside protection.

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