The Trades

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A Covid Summer: Sun, sea and volatility

by Cranley Macfarlane

I am not sure that I went clubbing on a Sunday night even when I was a student. As the parent of a ten month-old I was unlikely to be queuing outside a nightclub last Sunday to celebrate "Freedom Day" at midnight. As it was the "Freedom Day" party was gate-crashed by the Delta variant. The UK is now the testing ground for whether the vaccination of a large proportion of the population is sufficient to combat a new wave of Covid infections. We won't know the outcome for this strategy for several weeks. But we do know the Delta variant has put paid to the hopes that life would return to its pre-pandemic form this summer.

Six months ago, the start of vaccinations and optimism around the end of the pandemic meant that investors' main concern was too much demand causing inflation and the risks associated with that. In the first few months of the year bonds sold off, cyclical equities rallied, and I was merrily thinking about the possibility of finally getting abroad in the summer for a holiday.

However, in June the Delta variant started to cause concern. Then in July China provided a worrying example of what a post-Covid recovery looked like when the People's Bank of China cut reserve requirements for banks to boost their flagging economic growth. These concerns caused the US Treasury market to reverse much of its move from the start of the year. In equities, investors sought refuge in the growth on offer from mega-cap tech and sold cyclical stocks, such as banks and travel companies (the latter no doubt impacted by the likes of me once again cancelling and re-booking their holiday flights). Things came to a head this Monday, ironically "Freedom Day", with a broad equity market sell-off and investors seeking refuge in US Treasuries and the US Dollar.

This is not to say that the prospect of economic growth has disappeared. Jamie Dimon, CEO of JP Morgan, last week said the second half of the year could see the strongest ever economic growth in the US. Unlike after the Great Financial Crisis in 2009, banks, companies and households are flush with cash. Monetary policy remains extremely supportive, even with inflation running above target. The conditions are ripe, therefore, for the type of recovery that Dimon suggests could happen. Stock markets quickly came to this conclusion also and rebounded on Tuesday.

What this see-saw in markets reflects is a lack of confidence, which is where the outcome to the UK experiment comes in. According to the UK Government's Scientific Pandemic Influenza Group on Modelling, hospitalisations per day by the end of August could be somewhere between 100 and 10,000. Where we end up depends on whether the public proceeds with caution or with reckless abandon. And this leaves the economic recovery in somewhat of a Catch-22. Proceed cautiously and the likelihood is that this Covid wave will not be as severe as feared, but the economic recovery will be shallower; if caution is thrown to the wind, we might see a boost to the economy in the short-term, but we run the risk of renewed restrictions.

It is little wonder that markets are skittish. And it is why *Endeavour* is positioned with a mixture of investments offering reliable growth, high quality cyclical exposure, and solid defensiveness to navigate such choppy waters.