R.C. BROWN
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MARKET COMMENTARY NEWSLETTER

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BUDGET & CORONAVIRUS SPECIAL

The World According to Glenn.............

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When I was a child growing up in South Wales, Corona was a brand of soft drinks that was delivered door to door. Flavours ranged from the mainstream lemonade to a few rather more exotic concoctions; I remember that limeade very much resembled a urine sample being left at the front of the house, and my grandmother (who had an almost certainly unintentional Socratic bent) renamed dandelion and burdock as dandelion and hemlock. I recall that I had a particular liking for this flavour of pop when I was but a callow youth. But *tempus fugit* and corona has taken on a far more concerning aura and never more has it been true that "heavy is the head that wears the crown".

Misquoting Shakespeare is an oft used literary trope, but in the case of Covid 19 it must be true that world leaders are struggling under the weight of responsibility for managing the fallout from a virus that has spread rapidly and as yet has no cure. The virus itself seems to kill relatively few of those who are infected and the majority of people (apparently something like 80% of the population) won't catch it.

This is not to attempt to downplay the impact of the virus on those affected, nor am I denying the tragic consequences it will have on victims and their families. But I do want to spend some time trying to understand why the impact on world stock markets has been so large when seasonal flu kills far more people every year and in the UK more people are killed in road accidents than are likely to die from the virus. However, the need to stop (as far as possible) the transmission of the virus is beginning to have far reaching consequences on the global economy. People have been told not to travel and to stay at home. Emergency measures have been taken in many parts of the world to enforce quarantine restrictions on those suspected of being infected, in China whole cities have been put into lock down where no one can go in or out and Italy has self-isolated 60m people. This enforced inactivity hits both the supply and demand side of the economy, which is an unusual occurrence and has got many eminent economists excited by this convergence of bad news. If you think about it for a while the numbers are potentially very scary; if 80 % of the population won't be infected then 20% will. On top of this 20% there will be those who have self-isolated while pending confirmation as to whether they are infectious or not. So, if large numbers of people are not at work making stuff and can't use their enforced leisure time in spending, then I acknowledge that for as long as the virus is a threat and for some weeks afterwards while supply pipelines refill that the impact on economic activity will be huge.

My guess of a 20% infection rate is just that; a guess. Angela Merkel thinks that up to 70% of Germans could be infected, but I've no idea how she came up with that number. I suppose the true impact will be somewhere between the two and that implies a pretty scary scenario to a population that was brought up to believe that modern medicine will protect us from nightmare scenarios. But if this really is a nightmare scenario then it is likely that stock markets will over react to the bad news and create good buying opportunities for long term investors.

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Most of the hit to economic activity will be permanently lost (after all if I choose not to go the pub on a Friday night nor have dinner out with my wife on Saturday, because I am afraid of strangers without a certificate saying they are virus free coming within two metres of me, I am not going to be able to go out twice or three times on future Fridays and Saturdays when the perceived danger has passed). Equally I will not be able to take the ski trip that was cancelled and nearly had me quarantined half way up an Alp. But that shiny bright new car I've promised myself, because I'm worth it, will be an even more important purchase as it will reward me for being sensible with my discretionary spending when things are uncertain.

In the meantime, fiscal stimulus packages will act to support both employers and employees so that we can all get back to work as soon as the all clear is sounded. Our freshly minted Chancellor has announced £30bn of fiscal stimulus alongside a synchronised 0.5% cut to base rate ("so much for the independence of the Bank of England" says the cynic in me) to make sure that the engine of economic growth is kept ticking over and is ready to accelerate as soon as the lights go green.

There has been much debate as to whether the shape of the recovery will be V, U or L shaped. I won't pretend to know the answer to this but would say that a V shape is possible but unlikely given the downtime and, if we have an L shaped recovery, we're all doomed, so we are most likely to see a U shaped pick up. The length of flat-bottomed part of the U remains unknown but is where the most potential is to make changes to portfolios ready for the recovery. We are not quite at this point but we are readying ourselves.

There are several questions to bear in mind. In a time of a near zero (or even negative) risk free return on a risk free asset (normally the return to redemption on short term domestically held government bonds) should we re-assess investment risk from the perspective of a long term investor who is saving for retirement? There are many excellent academic studies of investment risk and expected return but these are meaningless to most clients.

How much risk is a client willing to take in order to build enough capital in order to meet their investment objective? How much risk is appropriate?

For many people there will be a very long-term process in which capital is built and consumed over many decades, with the ultimate objective (probably never expressed in these terms) of living comfortably over their whole life and dying just before they run out of money.

Nobody likes to face up to the inevitability of their own demise, but surely it must be a central plank of financial planning. Ultimately clients have to be comfortable with making a trade-off between risk and return and adjusting the amount saved in the capital accumulation phase to ensure a comfortable living in retirement. In an environment of low inflation and low investment returns it may be that we should all be asking ourselves; "Do I want to work longer or save more every month?" Making people work longer is attractive to governments who have ratchetted up the age we can take our state pension because it has several benefits for the state; firstly, the longer you make people work the less time you will have to pay them an income in retirement. And secondly, the less time you have to fund the pension liabilities of retired people the lower your funding risk.

When planning for the long term it's good to be optimistic about longevity and pessimistic over the cost of living. The implications of running out of capital with a few years of life still to clock up makes me come over all Micawberish ("Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery" Dickens: David Copperfield).

Clients who do not expect to need to draw on their portfolios for several years are likely to be able to stomach the vicissitudes associated with a steep fall in stock markets and look forward to a recovery well within their long-term investment horizon. Perhaps we should consider introducing the R C Brown Distinguished Service Medal For Not Panicking In The Downturn.

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