CARMIGNAC'S NOTE

07.10.2020

How 2020 is changing the game

Author(s)
Didier Saint-Georges

Published
October 7, 2020

Length
2 minute(s) read

Imagining the future is never an easy task when the shock wave from a blast is still propagating. The 2020 public health crisis quite clearly fits that description. Daily news feeds and successive emergency relief programmes have a way of cluttering our mental space – not to mention the latest developments in the US presidential election campaign.

And yet, due to its unique severity, the shock we've experienced in 2020 may well have momentous long-range consequences for investors.

Due to its unique severity, the 2020 shock is likely to have momentous long-range consequences

Those consequences are likely to determine potential GDP growth rates, along with the future of inflation – issues that no one concerned with the financial market outlook can afford to dodge.

The future of growth

For the time being, virtually all the Covid-related loss of income has been covered by the corresponding governments. This unprecedented public-sector support has helped produce heartening signs of recovery. However, this newfound interventionism has brought about a mind-bending increase in fiscal deficits that could be financed only by a no-less-extraordinary degree of central-bank intervention.

We would be guilty of wishful thinking, or at any rate undue optimism, if we expected that trend to continue without a hitch. The issue of fiscal deficit sustainability can't be sidestepped indefinitely. This suggests the need to build an "upper-bound scenario" for government spending into our long-term outlook.

The probable discovery of a vaccine will no doubt soon help us make our way back to some kind of "normality". But it would be wrong to underestimate the time lag until a vaccine can make the pandemic's impact a thing of the past.

This leads us to establish a medium-term decline in GDP growth as our baseline scenario. The sectors best suited to this low-key economic environment will be well-equipped to increase their competitive edge – and with it their relative outperformance in the market.

Potential GDP growth rates have been weakened, making it impossible for central banks to tighten monetary policy

The future of inflation

The prospect of a very arduous economic recovery has unsurprisingly given wings to “new monetary theory”. But the proposed expansion of the money supply primarily to finance fiscal deficits ultimately raises the question as to the intrinsic value of currencies. It thus underpins our belief that we should maintain limited currency risk in our portfolios and a significant allocation to gold.

The other question raised by this scenario has to do with inflation. In the short run, there is certainly a strong case for rising prices, and both governments and central banks ardently advocate such a pickup in inflation, as it would lower the real cost of national debt.

On the other hand, the long-term deflationary forces at work will be with us for quite a while. Moreover, cutting-edge technology has generated economies of scale that are slashing the cost of the services delivered by that technology. The latter can now respond – with almost unlimited capacity – to even staggering hikes in demand for virtual communication, access to information and data storage.

Besides, even if current hopes for an uptick in inflation were borne out, central-bank determination to keep real interest rates as low as possible provides bond markets with a fairly clear outlook and gold prices with additional support.

So though the prospect of a near-term improvement does argue in favour of some exposure to the “re-starting the economy” investment theme in our portfolios, the 2020 shock has strengthened our convictions on medium-term trends. Our funds accordingly give precedence to high-quality growth stocks, gold miners, corporate bonds meticulously selected for issuers’ ability to get through these troubled times with no major difficulty, and low currency risk.

Source: Carmignac, Bloomberg, 06/10/2020