For Investment professionals only

2020 Perspective

Fidelity Live: CIO Briefing

7 April 2020

COVID-19 economic impact and the view ahead

SUMMARY

- **Changing dynamics of public and private capital** – it will be interesting to see how this dynamic evolves. How will the state process the managing of capital when it will no longer be a case of broadly giving it to the private sector but an active and long-term engagement with potential conditions attached e.g. climate change. This could be a global phenomenon but within a country specific lens, with a review of key services and supply chains to ensure they sustain and protect at country-level.
- **Look to the history books** - pre and post war scenarios of state asset management could well be worth a revisit.
- **Opportunities** – we see opportunities in trends already emerging pre crisis e.g. e-commerce, home delivery, areas of financial inclusion especially in Asia, and also technology platforms. We also see opportunities in the consumer sector especially in China. And large caps could broadly outperform small and mid-caps due to liquidity challenges, which hasn't affected markets for some time with the sense that central banks would save the day.

1 What are your views on the current situation and what are investment teams focusing on?

Andrew McCaffery, Global Chief Investment Officer, Asset Management

With the rally in recent days we have seen some of the financial signals moving into more confident positions. So volatility has shown signs of easing, a general decline in credit spreads, funding costs improving and stabilising and this all allows a certain amount of pick up in risk taking. There's also a degree of optimism around the curves of the covid-19 pandemic in many countries e.g. Austria halting some of their lock-down measures. So there is hope that some of the worst economic consequences might ease off in the coming weeks and markets are beginning to discount that slightly more favourable picture and hence the rally we have seen.

The next phase will be very challenging as markets look to properly assess the economic damage so far, how long the lock-down measures will persist and the impact. But also the effects of having moved through various shocks already - supply chain shock, oil price supply shock, the demand shocks by covid-19 and the liquidity problems. And one element to consider is how solvency will be addressed by government interventions and companies. So the situation is encouraging for now but there are still more hurdles to overcome as we wait to see the economic data and consequential company earnings feeding through.

The Fidelity investment teams are focusing on selecting the right companies, those that have moved quickly, shored up balance sheets and maintained strong underlying management. We are also looking to sovereign behaviour and how this will pan out for individual countries, as per the way Asia is seeing signs of early recovery and activity picking up.

We are also looking at credit markets and those companies with the ability to issue debt and well-positioned to manage the next phase, and we see some yield spreads look very attractive, especially in investment grade and high yield in Asia and parts of US and Europe.

2 How are you seeing the situation evolve in Asia?

Paras Anand, CIO Asia Pacific

It is still a mixed picture across Asia. China is starting to emerge from its lock-down with businesses reopening and people returning to offices. However for other parts of Asia e.g. Singapore and Hong Kong cases have rise again in the last few days as people return home and so some measures are being reinforced.

The one notable aspect is the lesser extent of the impact as a health emergency which could be attributed to the region's prior experience with epidemics such as SARS that has changed public and policy response. Overall we think it is a reasonable expectation that economically Asia will lead the world out of this pandemic**.**

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3 Are you seeing signs that companies are changing behaviour in response to the fiscal policies?

Paras Anand, CIO Asia Pacific

We have seen big differences in country response. In the US and Europe there has been bold central bank intervention and significant fiscal stimulus to support recovery in the short term and elements to drive the long-term recovery.

There has been some of that in Asia but the extent of fiscal and monetary support has been much more modest across the region, certainly in China. And this is partly because over the last two years fiscal and monetary policy has already been straddling economic strategy.

So we could be looking at a scenario which is very different to that of the wake of the Global Financial Crisis (GFC) - which saw a huge amount of fiscal stimulus in China, driving growth of the global economy - and perhaps this time roles are reversed with the US and Europe leading the charge.

For companies in Asia the connection between state and private has always been close with company strategy aligned to the overarching policy and priorities of government - e.g. Tencent and its response with gaming products and gambling issues arising in China. Whereas in the US the private sector is very separate from state. So perhaps that relationship changes in the future where we will see a more contractual quid pro quo between government and the private sector.

And all of this will combine to see a greater acceleration of ESG and sustainability in the corporate sector with companies starting to think of their responsibility to a broader set of stakeholders rather than just minority shareholders.

4 Do you think this will change the way we look at investing?

Andrew McCaffery, Global Chief Investment Officer, Asset Management

We could see significant ramifications as countries manage the framework of coming out of this pandemic differently. Globalisation has been through periods of challenge for several years and the ability for it to be resurrected with the high levels of coordination required could be impacted by countries having to reconsider their borders. Border concerns could generally be intensified until there is a more confidence around the virus and future processes.

It will be interesting to see the levels of intervention play out and the degree the West incorporates elements of state ownership with conditionality attached for example with climate change and whether certain companies gain higher profile and countries expect more from corporates. This could be a global phenomenon but within a country specific lens within sectors, and supply chains reviewed to maintain lower levels of friction from the levels coming into covid-19.

Paras Anand, CIO Asia Pacific

An interesting notion is the stress testing which was conducted in the financial sector in the years following the GFC in order to ascertain if the banking system could sustain similar shocks. And we expect something similar on a country by country basis to see whether certain key services can withstand stress in the system and whether supply chains can sustain and protect at country-level.

5 Are you seeing potential winners from these themes?

Paras Anand, CIO Asia Pacific

Companies will be tested to see which have the right balance sheets and the ability to withstand the demand and working capital shocks. One feature could be a process of transfer of assets from weak to strong hands which is a normal feature of a bear market and a change in leadership broadly with large caps outperforming small and mid-caps due to liquidity challenges, which hasn't really affected markets for some time with the sense that central banks would save the day.

We are also seeing real opportunities in trends that were emerging pre the crisis that are now becoming more prominent e.g. ecommerce, home delivery, areas of financial inclusion especially in Asia, and also the technology platforms. In contrast technology in the US could see some of the larger technology platforms e.g. Facebook and google seeing more scrutiny around data privacy, algorithms etc.

And lastly we are also seeing opportunities in the consumer sector especially in China.

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6 Are there other themes emerging in terms of new behaviours and the impact of fiscal and monetary supplies and conditionality?

Andrew McCaffery, Global Chief Investment Officer, Asset Management

The scrutiny of some of the platforms could intensify as people ask what good is actually being generated.

State intervention is considerable and speaks to the solvency aspect and where they decide capital will go to sustain companies. As a result, some sectors will go through a streamlining process and it will be interesting how far that drills into small and medium enterprises and into the private sector to keep economies running and ensure supply chains are supported.

This will change the dynamics of public and private capital and the process between them, and the challenge will be how changes are made to adapt to more agile working, the consequences for real estate and working more from home. And how will the state process the managing of capital when it will no longer be a case of broadly giving it to the private sector but an active and long-term engagement.

So the connotations of pre and post war scenarios of state asset management could well be worth a revisit.