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Beyond the abyss of Covid- 19



[French Version](#)

This year, if we've learnt one thing, it's that assumptions we have about the future can be destroyed overnight. This was true at any time in the past, and it will remain true in the future. Simply, change is the only constant. The Covid-19 crisis will transform the world of tomorrow.

Our global system will adjust in ways that will have significant implications that extend far beyond the lockdown. The post-pandemic future will presumably be one where health is the new wealth and where politics, societies and financial markets are shaken up and re-shaped.

Realistically, from an economic or financial market lens, we do not know how this crisis will end: especially when epidemiologists still understand so little about the virus. However, what we can deduce from historical observations, is that it often pays to keep an optimistic mind set when investing.

What we are currently living is destructive, painful and stressful. Nevertheless, history also shows us that some of the most useful innovations were born of panic-driven necessity. During the Great Plague of 1666, Isaac Newton had to work from home, too. He used this time wisely, completing some of his best work (1). World War II started on horseback and concluded, tragically, with nuclear power. Globally, we are racing to find a vaccine against our common enemy. Medically, we are more prepared to fight a virus than ever before. But psychologically, "what was a tragic, but expected part of life 100 years ago is now a tragic and inconceivable part of life in 2020" (2). Our modern world, accustomed to the feeling of being in control, has a very different tolerance for pandemics than at any time prior to the last few decades.

In fact, very little of what happens in the world is within our control. But when you can't control what's happening, you can control the way you respond to what's happening, and that's where you power lies. Ultimately, wealth planning is about preparing for the worst, but planning for the best.

In this piece, we will try to present some expectations about what the future may hold. However, readers should understand that this is not a set of forecasts, rather it is an acknowledgement of what is *likely* to occur, an aid to help navigate potential scenarios, without giving a guesstimated timescale. This is basically our vision of the future, that avoids overconfidence and false precision as much as possible.

GROWTH



The coronavirus will be remembered for catalysing one of the worst synchronised global economic slumps in modern history. Never before have we seen the kind of GDP contractions now being projected, and never before have investors had to deal with such extreme levels of uncertainty. We are clearly in uncharted territory and it will take years for the associated legacies to be known and felt. Perhaps it is easier to back-out of a government-induced recession, but that it yet to be seen, especially when a new dilemma seems to be emerging: The longer the confinement, the slower the economic recovery. The faster the deconfinement, the riskier the recovery. In the words of Luis Garicano, an economist and member of the European parliament, for the next few months, absent of a vaccine, we likely face a “zombie recovery where, in economic terms, we are not really alive and not really dead... an in-between world.” In other words, rather than the much fabled V-shaped recovery, we see more likelihood of a “check-mark” shaped rebound – a precipitous drop in growth followed by a slow and gradual climb back towards prior levels as governments tentatively lift restrictions.

DEBT

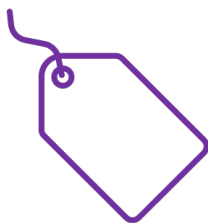


Authorities around the world have been prompt to act and implement stimulus measures, building a bridge to prevent economies from collapse until lockdowns are lifted. Those responses were a necessity and the costs judged as simply irrelevant for the time being. This means that:

- **Budget deficits** are going to reach unprecedented heights. The only consolation is that this will be a global phenomenon and investors will likely maintain perspectives of relativity. Tomorrow, the new norm for public debt to GDP ratios could easily be 150% or above. The unwinding of public deficits in coming years, if any, through fiscal consolidation (higher taxes combined with lower public expenses) is a realistic perspective, but not the only one. This is not to say that investors should not be scared by the mounting debt piles. But, if the current crisis is a transitory shock, then public spending should be considered as a one-off, an immediate solution to fill the demand crater caused by lockdowns. Unorthodox fiscal policy will not necessarily become a permanent fixture of our economies. While low interest rates offer us a perfect opportunity to add debt at this time, some claim that this could have negative side effects for future generations. At the end, we will never 'get out of debt'. Government debt doesn't have to be paid off, it doesn't get written off, it is rolled over. As long as the economy continues to grow in the future, you can expect the debt to grow simultaneously.
- **Central Bank balance sheets will balloon.** This is nothing new: What is new is the magnitude and the scope of eligible instruments and the rapid descent down the quality curve.

Ultimately, the simultaneous surge in budget deficits and central bank balance sheets means that the inglorious Modern Monetary Theory (MMT, sometimes dubbed the "Magic Money Tree") is a not-too-distant reality. Taking the current yield offered on some high quality bonds into consideration, we should not be overly surprised when ideas about perpetual zero-coupons arise, in some sort of civil savers support in the war against the pandemic.

INFLATION



From an economic point of view, the most significant questions are concerned with inflation. Are we heading towards a deflationary spiral or an outbreak of rising inflation?

In the short term, the collapse in global demand favours the disinflationary theory. The massive decline in output caused by the pandemic will not snap back in some months. Supply capacity could be ramped up relatively quickly but a return to previous levels of demand will be more slow and gradual. Furthermore, the massive oil price contraction and more broadly, the sharp fall in commodity prices, will create a wave of deflationary pressure. We believe this should be temporary: We will slowly transition away from deflationary pressures into a more inflationary environment. Ultimately, the current crisis is very different from a traditional economic or financial crisis. As of today the financial system is up and running. Money supply and credit are expanding. The consequent on-shoring of activities (discussed more in the "Politics" section) could also contribute to inflationary pressures.

RATES



If implementing lockdown strategies was a challenge for public authorities, withdrawing their support for the economy will be even more hazardous. Rising volatility should be expected as policymakers prepare to exit their current policy settings.

The common observation on rates is that we are in some sort of administrated market. This is not a free market where pricing is defined by the equilibrium of supply and demand. Marginal buyers or sellers are simply irrelevant in front of the capacities of central banks. We are de-facto in the regime of yield-curve control (maybe not yet officially, but at least inadvertently for now). At the Fed's current pace of bond buying,

it could have bought the entire stock of US debt in approximately one year. In terms of rates, the race to the third permanent zero is ongoing (already Japan and the Eurozone seem to have arrive there, the US could be on its way). In a nutshell: interest rates at zero could become the new normal.

It is simply too early to be bearish on US Treasuries. A retracement is possible, but the old adage “never fight the Fed” at time of massive economic slack and deflation fears, should cap any rise in yields. Higher inflation will become a growing threat but not before a full recovery of economic activity to pre-crisis trend levels.

The potential crowding-out effect (rising public sector spending driving down private sector spending) is a nightmare for most economists from the perspective of efficient allocation of capital. But we believe this is a temporary posture. Bailouts should mean shareholder dilution, but not a reversal to Marxist economics.

EQUITIES



Without sturdy economic growth, companies will find it much more difficult to generate earnings. This crisis, therefore, reinforces the need to be more selective when it comes to individual securities. It's fair to claim that such an assertion from an investment management team is nothing more than some sort of ideological and preconceived notion. But considering that the aftershocks of the pandemic are only just beginning, a clear understanding of liquidity and solvency parameters is pertinent in order to avoid investment traps and plays on firms that make (permanent) losses from activities. An ability to assess balance sheet strength, while demanding, will be more rewarding than simply buying a “quality label”.

The current crisis will likely leave scars that foster a greater propensity to save money and an avoidance of debt, risk and excessive leverage going forward. Higher savings ratios will limit economic growth but on the upside, this could also mean that the balance sheets of households and companies become more robust over time. Companies that put emphasis on chasing sales growth without profits, will draw more skepticism from an investor perspective. As of yesterday, when a company reported poor earnings, it was often said they missed analyst estimates. But earnings don't miss estimates; estimates miss earnings. Maybe tomorrow we will say that estimates miss earnings.

There is one dimension where Covid 19 should not lead to major changes: stock leadership. Growth stocks and technology behemoths should continue to dominate. The idea that top performing companies are able to capture a very large share of the rewards, making it very difficult for rivals to properly compete, remains relevant in the current context. The positive feedback loop in which a company's success is driven by cheap capital and its access to cheap capital is a result of its success is here to stay.

Other winners of tomorrow could easily be pharmaceutical, biotech and life-science companies with massive flows of capital directed towards virus related research. Government budgeting exercises over the coming years will have to strongly improve the preparedness for another pandemic.

Digital consumption, privacy, security and big data are the battlefields of competitive advantages. Social distancing will continue for the foreseeable future and all of the aforementioned will become even more relevant in a disparate, digitalised society. It is a sign of the times when 'Fortnite'(an online video game) appears more times in Google searches than 'football'.

It is also expected that appetite for sustainable investment will receive another boost.

Environmentally-friendly business models will remain at the forefront of investor (and increasingly regulatory) considerations, especially given that there is mounting evidence to suggest that such pandemics are a result of our broken relationship with nature. [Zoonose theories](#) consider that deforestation (because of logging, mining, road building through remote places, rapid urbanisation and population growth) is bringing people into closer contact with wild animals which harbour pathogens. An economic recovery plan that promotes an ecological transition looks necessary. The social dimension of ESG will also recalibrate upwards.

POLITICS



In terms of the new normal, Yuval Noah Harari, the author of *Sapiens*, believes that liberalism may no longer come as a complete package (free markets, free trade and personal freedoms). Rather, we are shifting towards a “liberal buffet” whereby leaders pick and choose the combination they wish for. For example, the policies of US President Donald Trump strongly support free markets inside the US, while undermining global free trade. The pandemic, which offered an opportunity to strengthen global ties, uniting us against the “invisible enemy”, seems to be causing deeper divisions and accelerating this shift. Recently, the US administration has been pointing a finger at China with regard to the origins of the virus and President Trump has said tariffs would be “the ultimate punishment”. This is a new blame game in which the stakes seem even higher than they were in the previous episodes of the US/ China trade war.

The Covid-19 crisis represented another major blow for the Eurozone. The initial lack of solidarity came as blessed bread for populists and nationalists and will cast shadows on the integrity and sustainability of the European Union. Harari notes that even though many of today's populist and authoritarian regimes describe themselves as “anti-liberal”, none of them rejects liberalism in its totality, further

supporting his “buffet” theory.

It is reasonable to expect that the result of this new form of liberalism will be more regionally localised supply chains (if not full repatriation of production), especially when it comes to goods that are perceived as “essential” or “strategic”. The retreat of globalization is not new but it will probably accelerate. Prior to the crisis, the economy relied heavily on lean, “just-in-time” production because stockpiling is expensive. However, the pandemic has highlighted the need for “just in case” supply chains in which cash and resources are set aside for a rainy day. Politicians will also have to grapple with the gap between the haves and the have-nots that the pandemic has magnified. We were not all equal in front of the pandemic. The lower middle-income class has suffered the worst blow, with many not having the option to work-from-home. The fragility of gig workers^[3] which have become an inherent feature of modern society, is a massive threat to social cohesion. It is difficult to build any scenario on how and where these issues will lead us, but growing inequality could set the table for radicalisation, populism and social disobedience with far-reaching consequences.

LIFESTYLES



Life after lockdown will not be the same. Companies that had dilly-dallied with regard to home-office solutions were, all of a sudden, forced to roll-out such technologies which will probably stick. In an interview with the Financial Times, the chief executive of Tata, Natarajan Chandrasekaran, forecast a major shift to more flexible working arrangements from here on out. He believes that working-from-home models could boost productivity by 25% due to the fact that we will spend less time commuting, less money on office premises, and have more flexibility to figure out when we work most effectively. On a longer-term timescale, the implications of this could be vast – reduced need for cars (and travel more broadly), reduced CO2 and NO2 emissions and perhaps even a reduced need to live in big cities, potentially influencing real estate market dynamics.

In terms of public life, in order to prevent a second wave of infections and reverse all prior efforts to “flatten the curve”, social distancing will be an integral part of daily life for the foreseeable future; forget hand bags, face masks are likely to become the most coveted accessories for Fall/Winter 2020. In order to ensure a two-metre space between customers, businesses will have to alter the way they operate. Where “having a reservation” used to be a requirement for exclusive restaurants, it may be that we can now only buy the most basic things, such as do-it-yourself equipment, by appointment only. Spanish shops, which are gradually reopening, have implemented such booking systems to limit potential contagion. That’s goods, when it comes to services, we could be entering an “empty chair economy”. To uphold social distancing, restaurants will probably only operate at a fraction of their prior capacity, while public transport and airplanes may be forced to keep a proportion of seats empty. Again, this could potentially create some inflation through higher ticket costs, while impacting corporate margins. But let see what will be the propensity of people resume normal habits in front of this invisible enemy.

It is still unseen whether consumption (the backbone of the economy) will revert to pre-crisis norms. This is largely dependent on whether people still have purchasing power – looking at the 30 million jobless claims in the US, it seems like wishful thinking in the immediate future, though we have to balance pessimistic perspectives against the global downpour of fiscal stimulus packages, unlike anything seen before during peace time. There is also a psychological variable at play: Shopaholics, may be at home curating lists of all the things they are going to buy after lockdowns are lifted. Or, more people may have used the quarantine for introspection, realising that they were living just fine without access to all the things they usually consume. Maybe minimalism may trump consumerism. From a sustainability perspective, this would help to respect our planet’s boundaries.

PRIVACY



In a world where data is the new commodity, concerns about the privacy of individuals were already growing. The pandemic has intensified such fears, with many governments, in a bid to reopen their economies while minimising the risk of a rise in new cases, toying with technologies that monitor and track individuals. In Lichtenstein, for example, bracelets which immediately detect symptoms in the wearer are being trialled. When a device can read your blood pressure, your reactions, your temperature – that’s surveillance on a whole new level. In certain Asian countries, as well as in Italy, smartphone applications allowed authorities to quickly identify suspected carriers of the disease and track their movements. Fine if these are temporary measures, however, there is the danger that after coronavirus fades away, data-hungry governments could argue that they need to keep such surveillance systems in place in case of a second wave, a new foreign disease, ...

Overall, the key takeaway is that the crisis has reshuffled the cards, and at the end of all this, the world will be a different place than it was before the pandemic struck. But change is not something to be feared: with change comes great opportunity. Perhaps this is the perfect occasion to tone up flabby economies and build true economic muscle for the future. Yes, the “zombie land” economy that we may face in the next months will present a tough operating environment for firms and those that have been idling along in a permanent twilight for years, or that don’t add true value, will be shaken out. But when it comes to the survival of the fittest, the real value creators, the innovators have a chance to shine. Supply chains may become shorter, but it is unlikely that globalisation, a concept that dates back to the Silk Road will disappear. As stated at the introduction, while you can’t control what’s happening, you can control the way you respond to what’s happening. As such, in the holiday from reality, we have a chance to envisage how we want the future to look and adapt our lifestyles accordingly. What is sure, is that volatility will be a given as the world tries to find its feet and adapt to our new normal. During this time, we favour high quality companies with resilient business models, who may use their balance sheet opportunistically in the recovery. We believe that protean portfolios which are padded out with shock absorbers such as US Treasuries should endure.

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<https://www.washingtonpost.com/history/2020/03/12/during-pandemic-isaac-newton-had-work-home-too-he-used-time-wisely/>

2 - <https://www.collaborativefund.com/blog/whats-different-this-time/>

3 - Gig workers are independent contractors, online platform workers, contract firm workers, on-call workers and temporary workers. Gig workers enter into formal agreements with on-demand companies to provide services to the company's clients.

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