Maintaining Prosperity During Turmoil

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Although the coronavirus outbreak has caused major disruptions and geopolitical risk is on the rise, markets are looking forward to recovery. In what appears to be a rapidly changing world, many things remain the same and indeed, may be changing for the better.

By John Vail, Chief Global Strategist

While these are extremely trying times, they pale in comparison to the wars and revolutions that our elders experienced. The virus has caused an immense crisis, but at least the world is experiencing virtually no war. Many societies are clearly undergoing major societal change that has caused severe rancour and sometimes physical strife, but nothing greatly damaging to economies. Meanwhile, China's increasing prominence is clearly causing many frictions that could lead to major convulsions, but so far, level heads have prevailed.

These facts may seem like small consolations, but reasonably peaceful times allow for continuous technological improvements and competition to improve the global human condition. Although it might not seem politically correct, corporate profits among listed companies often perform very well under such conditions, especially when oligopolies dominate, fiscal spending expands and monetary liquidity is high for an extended period due to central bank fears. Thus, the virus damage was a tremendous pothole, but the markets are looking forward to recovery, especially for the profits of the greatest corporate and national beneficiaries.

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What could change this positive but outwardly unpleasant balance, especially for large companies? Will the accumulation of societal stress force a major US political upheaval this November? Will China-US tensions finally lead to convulsions?

As a firm, we have been usually willing to overlook political risks on the premise that national leaders wish what is best for their economies and societies rather than provoke major upheaval. Indeed, risk markets have quickly overlooked geopolitical risks, and quite rightly so. The profit motive is a very powerful force and investors are often sceptical of media headlines. But certainly, US-China relations are moving firmly in the wrong direction and a major Democratic victory will greatly change the landscape. Indeed, there are few moderate Democrats anymore and instead of moving to the centre after the primaries, left-wing influences are remaining strong and impossible to ignore.

In very rare cases, it is best to act aggressively, especially if one's life or society are threatened with little hope for the future, but otherwise, it is obvious that keeping calm and making studied decisions are what is best for one's condition and that of one's family. This goes for investments, as well, and clearly, it is not as if all is bleak in the investment world, as risk markets are on an upward trend.

For all the discourse of how wild the markets are, the direction of sectoral moves make sense. The question, rather, is the extent of such, particularly regarding the valuations of the sectors benefitting the most from the new conditions (if they really do last as long as many think after a vaccine becomes of an accepted reality). Indeed, the much-touted "new normal" may not really be that normal. On the positive side, monetary policy and government fiscal largesse to certain sectors, especially pharmaceuticals and hospital care, are boosting profits far beyond expectations and equity valuations might not be as extreme as they seem given that they represent all future years of profit growth.

Interestingly, for all the factors that are changing rapidly, so many others remain the same or in a long-term trend. For instance, in this piece last year, the global bifurcation of supply chains and the Japanification themes were discussed and these remain relevant today. We still believe that the former issue adds to economic growth globally, perhaps with somewhat decreased efficiency but also providing increased robustness. ASEAN will continue to be a beneficiary of bifurcation and Chinese companies will continue to benefit from the country continuing to establish its own massive internet system. As for Japanification, we continue to highlight how the West will not likely follow Japan's trends for very long, especially due to cultural differences and potential major political change, perhaps imminently so, that leads to highly reflationary and income distribution policies. The US stock market certainly is not Japanified, nor are many commodity prices, and unless US property prices fall sharply, US inflation should not drop to zero for an extended period.

Also on the positive side, it is important to note that in recent years, markets have been much more attuned to ESG considerations; thus, funds are increasingly being channelled into investments that benefit the world. Assets in ESG-related funds have continued to hit record levels and this shift in preferences is likely to shape the investing landscape for decades to come. With the support of technological advancements and increased regulatory focus, ESG will promote many new forms of beneficial economic growth, about which Nikko AM is keenly aware, as we heavily emphasize ESG factors in virtually all of our investments.

Thus, for all the differences in the world, many things remain the same or even with bright aspects ahead, so we are persevering to adapt calmly and invest wisely for our clients.

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