ARIA | CAPITAL

INVESTMENT INSIGHT

A weekly look inside the investment world.

"Let's do this another way."
Barack Obama

Friday, 5 June 2020

In this week's Investment Insight

The V sign
The eurozone economy will be hit by Europe's sharpest recession since World War II in the first half of this year, but the current outlook points to it withstanding the impact and bouncing back strongly in the second half of the year. Aggressive asset purchases by the ECB will help member countries to absorb the fiscal hit from the coronavirus and will provide strong support for sovereign bonds, leading to a convergence of core and peripheral eurozone debt spreads. If the so-called coronabonds finally get ratified by EU members later this month, apart from a V-shaped recovery we may finally witness an important step in the federalisation of Europe, significant from an economic perspective quite apart from any political one. At the end of a week that has seen European shares make strong advances, partly in anticipation of the aforementioned recovery, in this week's *Inside Track* we examine the possibilities.

Why the safe option isn't so safe
Inflation concerns abound for some, savers especially. Hardly surprising after the post-GFC money printing spree followed now by more of the same due to the coronavirus. A comination of choked-up supply chains, isolation-relief driven demand spikes and the sheer wall of liquidity pumped in by central banks trying to kick-start Covid-supressed economies may well lead to more inflation in asset prices. Of course that's welcome if you're a borrower, as most governments are. As long as it doesn't get out of hand, inflation has a powerful and welcome effect on the real size of your debt obligations. But, for the cautious saver, the mattress or the bank might be the least safe location for any surplus. In *Pic of the Week* we explain why.

Newswire
Some interesting nuggets from this week's newswires.

Market view
A visual snapshot of recent market performance.

The Inside Track: The V sign

Things are looking optimistic in Europe, both economically and, for those with federalist ambitions, politically.

Nobody likes the “R word”, but there’s no avoiding the reality that Europe is in recession. What’s of most significance, however, is how long it lasts and “not very long” might be the answer. There are several reasons:

1. We know from past evidence that when downturns are not associated with a banking crisis (as this one isn’t), economies tend to recover quickly. This was seen during two historical downturns that bear similarities to now: the Hong Kong SARS outbreak in 2002 to 2004 and the UK’s three day working-week recession in 1974. In both cases recoveries were swift.

2. A legacy from post-GFC belt-tightening and personal credit restriction, household debt levels in the Eurozone are low by historical standards.

3. Europe’s manufacturing sector has been trimming down and shaping up over recent years in recognition of the need to be more globally competitive.

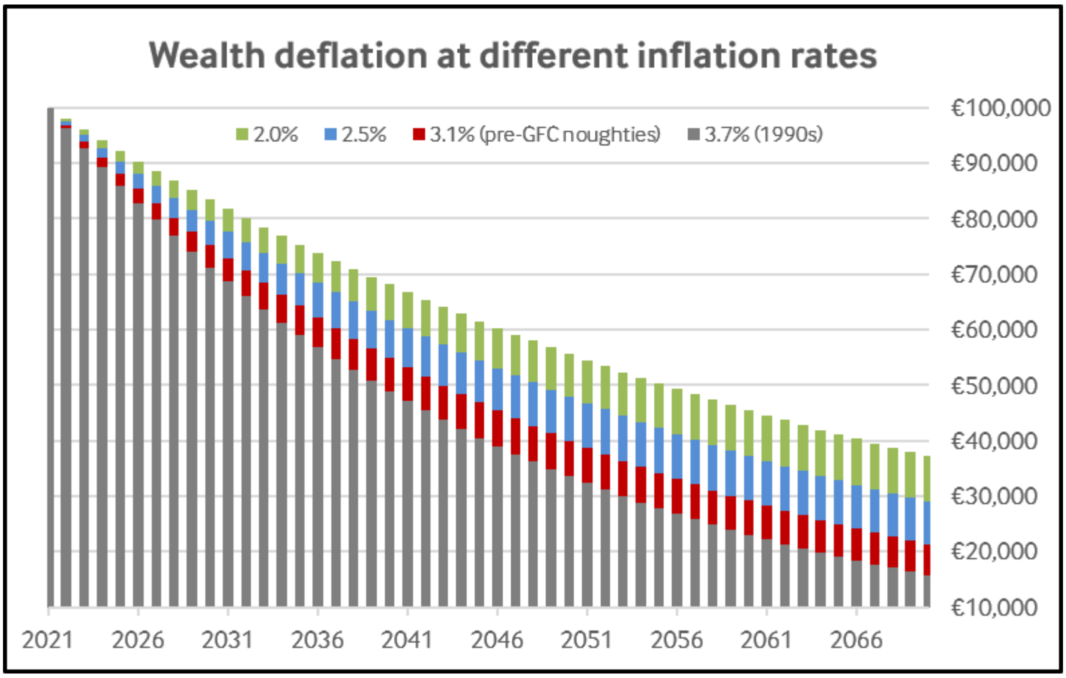
4. Many European governments and regulators have introduced support measures for businesses impacted by the coronavirus, with EU support for their supports impending. This will lead to above-target budgetary deficits, but consensus macroeconomic policy increasingly favours this “modern monetary theory” style approach.

5. Almost all European banks should have enough capital to withstand the coronavirus hit, with a couple of notable German exceptions.

This combination of aggressive monetary, fiscal, and employment policies across the Eurozone will likely offer the supports necessary for a V shaped recovery in the second half of this year.

Pic of the Week: Why the safe option isn't so safe

There are lots of reasons why, following a decade of recently expanded money printing, a decent inflationary pickup might be much welcomed by many governments and central bankers. Of course inflation, or too much of it at any rate, can become self-propogating and lead to unwelcome social as well as economic challenges. A "sensible amount" however, could do the trick nicely. So what sensible amount might we anticipate? If the past is any guide to the future (it often isn't!), then put aside notions of benign sub-1% levels "enjoyed" for much of post-GFC period and, instead, consider the pre-GFC portion of the noughties when the average annual inflation rate in Ireland over the preceding 10 years was 3.1%, or the 1990s when the average annual rate over the preceding 10 years was 3.7%. Let's ignore the 1980s when the figure exceeded 12%. In the chart, we see the impact on €100,000 over fifty years based on these two rates, with lower 2% and 2.5% rates also shown for caution/optimism. The value destruction is substantial. Even if we look only 20 years into the 50 year period, annual inflation at the 1990s rate more than halves the value of savings over that period. The conclusion for careful savers or investors, therefore, is that staying safe could prove a very unsafe tactic. The cost of being uninvested could be a high one.



Newswire

...on Monday
Shares in European banks, miners and travel companies all show strong gains as European indices advance.

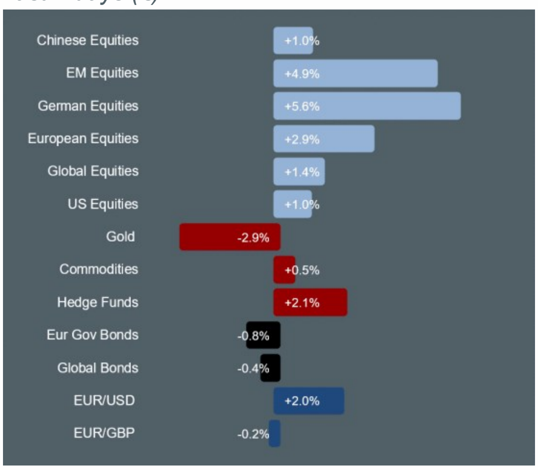
...on Tuesday
Shares on Germany's DAX continue to recover, as car manufacturers start to see signs of optimism.

...on Wednesday
The CSO publishes May employment data, showing a 5.6% unemployment rate using standard methodology (which excludes those in receipt of the Pandemic Unemployment Payment), or 26.1% using COVID-19 adjusted methodology.

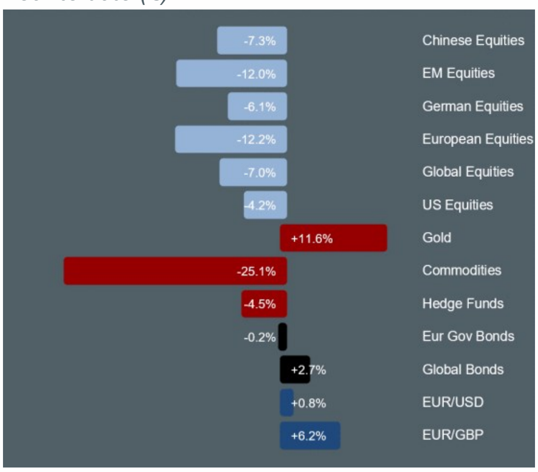
...on Thursday
Asian shares reach a two-month high on expectations of further government stimulus.

Market View

Last 7 days (€)



Year to date (€)



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