Climbing a Wall of Unemployment Worry

It has been a momentous couple of months for the world and the world's economies. The short-term panic in financial markets peaked in late March and then the initial recovery kicked in. That recovery has run at a pace and length that has many questioning whether financial markets have got ahead of themselves in looking forward to economic recovery.

The global economy has never been purposefully restricted in the unfortunate experiment we have all been subjected to since March and the financial markets reacted with panic to the unforeseen risk that Covid-19 has added to the economic outlook. The US equity market saw its fastest 30% retreat in history into late March only to be followed by the best April performance in over 40 years. Most major equity markets lost between 30 and 40% before regaining roughly half those losses as the panic subsided and optimism about recovery took hold. Talking about recovery when the greatest unemployment catastrophe in decades is occurring seems hard to justify so what are markets thinking?

The world economy has never conducted such a large-scale economic shutdown and the resulting unemployment tsunami has already seen 36m Americans lose their jobs in only 8 weeks with Depression era levels of job losses. Officially US unemployment in April was up to 14.7% but the wider "underemployment" rate is near 23%. However, up to 80-90% of US job losses are seen as temporary, at least for now. Short-term things will likely get worse in the US and definitely will in countries like Australia and New Zealand that have postponed layoffs with wage subsidy schemes that will help preserve some jobs but just delay the inevitable for many others. All this terrible employment news needs to be balanced against the unprecedented Government spending and Central Bank liquidity support designed to counter the worst effects of the crisis. Financial markets are anticipating that 2021 will be significantly better than 2020. That will likely be correct if most of the jobs lost are only temporary and that as the virus recedes employers re-hire most of those laid off. That is not to say there will not be some permanent damage done to some people, businesses, and specific industries like tourism. It will likely take two or three years to repair most of the damage the virus has done in a few months but as long as that looks the most likely path forward financial markets will look to anticipate the recovery in the economy and company earnings. Against that backdrop regaining half the losses from the panic lows of late March seems fair enough for now but much can still go wrong. There are no guarantees, but the markets generally are factoring in the most likely outcome at this point.

Below the surface of the market indexes though another factor is at play. Many market indexes like the S&P500 or NZX50 are dominated by a few large companies that are weathering the coronavirus crisis better than most. Technology focussed stocks like **Microsoft, Amazon, Apple** and others have business models that are less impacted by the global economic disruption. **Microsoft** for instance started 2020 around US$159 and is now up to US$186 despite the overall market being down 8% year to date and 13% off its February highs. Similarly, **Apple** is up 6% for the year and **Amazon** 26%. The performance of these mega stocks masks the fact the wider stock market has been weaker than the headline index suggests. The same is true in New Zealand with **A2 Milk** and **F&P Healthcare**'s strength masking the weakness in the broader market.

Overall, the market recovery to date seems rational but it is important to remember it is based on optimism that 2021 will be significantly better than 2020 and the extent of the recovery is a little misleading as large and mega-cap stocks that have proved relatively immune to the virus are leading the market performance. There are still many sectors like Financial, Energy, Tourism & Travel, and Retail that have been hit extremely hard. Within those sectors the companies with sound balance sheets will recover while for others the virus and its economic effects could prove worse yet. Evidence of actual economic recovery will be needed to sustain further broad market gains from here.

The companies mentioned above are named to further the discussion. This should not be construed to be personalised advice nor a recommendation to invest in these companies. Please contact Kinnell & Co. regarding how best to take advantage of the trends discussed above.

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