

# Positioning for post-pandemic world

## ✓ As the world slowly re-opens, which asset classes will thrive and which will suffer?

As lockdowns are lifted and economies start to revive almost everywhere, we believe there are grounds for cautious investor optimism – at least for those of us who have a long investment horizon.

Our business cycle indicators show that economies across the world have picked themselves off the floor. Daily activity trackers from the likes of Google and Apple show most developed countries are edging towards normality, halving the declines suffered during their March and April lows, while China is already back to January levels.

Our liquidity indicators give very positive readings for riskier asset classes thanks both to the biggest money printing measures ever and the fact that bank balance sheets are robust enough to transmit this through to credit creation – unlike during the 2008-09 crisis. Total public and private liquidity creation is equivalent to 23 per cent of global GDP, compared to 17 per cent at the previous peak in 2016.

There may be more pain to come in the short term, for example in terms of unemployment, but unprecedented injections of stimulus from governments and central banks have paved the way for a global recovery.

Interest rates are going to remain low or even negative for the foreseeable future and, with a long economic expansion ahead of us, the outlook favours risky assets, both in terms of equity and credit. With sovereign bonds offering negative real returns, we see grounds for the equity risk premium (ERP) to decline over the long-term as investors become willing to pay more for the prospect of a positive real return. Currently in the US, the implied ERP is significantly above its long run average of around 5 per cent

and is even higher elsewhere, globally ERPs could decline by 2 or 3 per cent over the coming years.

In our own portfolio, we are selectively increasing exposure to parts of the market that are best placed to benefit from the start of a new economic cycle – particularly if they can also tap into long-term secular growth trends.

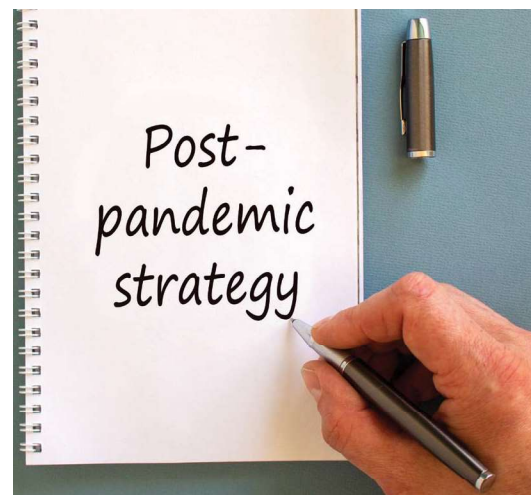
One example is the European auto sector, where we see a big opportunity from the rising popularity of electric cars. Another bit growth area is tech, with millions of people around the world switching to online working, studying, socialising and shopping during the lockdowns.

However, while we are inclined to be more cyclical, we are not prepared to go into deep value. The companies that require the greatest support from governments will have to bear the cost at some point, and that means their shareholders and bond holders will be at risk of being subordinated.

We also continue to be cautious about the least creditworthy companies (which means avoiding high yield debt), as well as those with a dying business model or product. High street retail was already in trouble before the lockdowns – with around one in 10 UK shops standing empty – and we would now expect that decline to accelerate.

Banks, meanwhile, are likely to suffer as stubbornly low bond yields prove to be a big headwind at a time of rising loan loss provisions.

Regionally, Europe seems to have hit a turning point on fiscal policy, which is clearly supportive for its markets. A new €750 billion rescue programme (a mix of grants and loans), to be funded through a commonly issued bond, is a big first step towards fiscal integration of the



single currency region. This represents a great step forward for the single currency region, especially in light of the lack of solidarity among member countries at the start of the crisis. In markets, the news sets the scene for Italian, Spanish and Greek bonds spreads over Germany to narrow, and provides the backdrop for European equities to potentially outperform the US.

Developments in the UK, however, are more mixed. Brexit negotiations are reaching a critical stage, which could lead to renewed market turbulence, particularly as heavyweight energy companies remain in the doldrums. On the flip side, UK stocks are relatively cheap and much of the market has exposure to global growth.

More generally, the complex web of risks and opportunities underscores the benefits of active asset management – seeking out select areas of the market rather than tracking a broad index.



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