

Can the bull market continue?

Presentation to Momentum Think Tank 2020

Steven Bell, Chief Economist

Key Issues



The virus: is it winning?



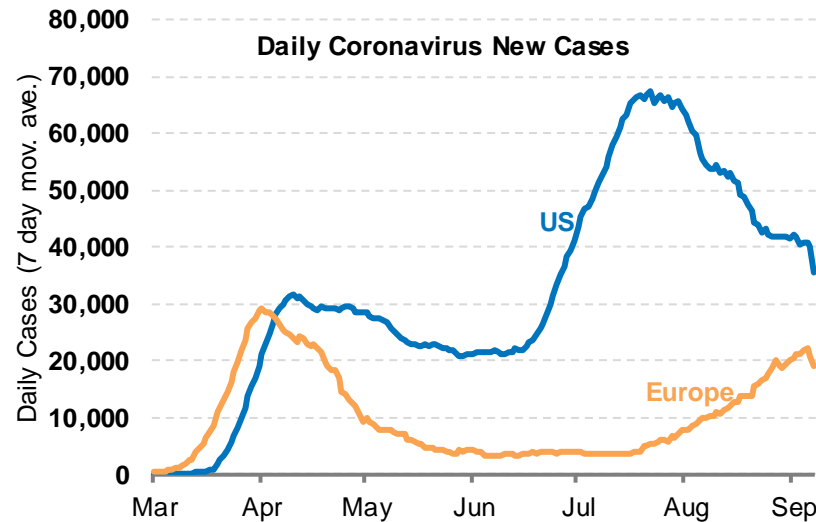
US politics: likely outcomes, likely impact



Can the bull market continue?

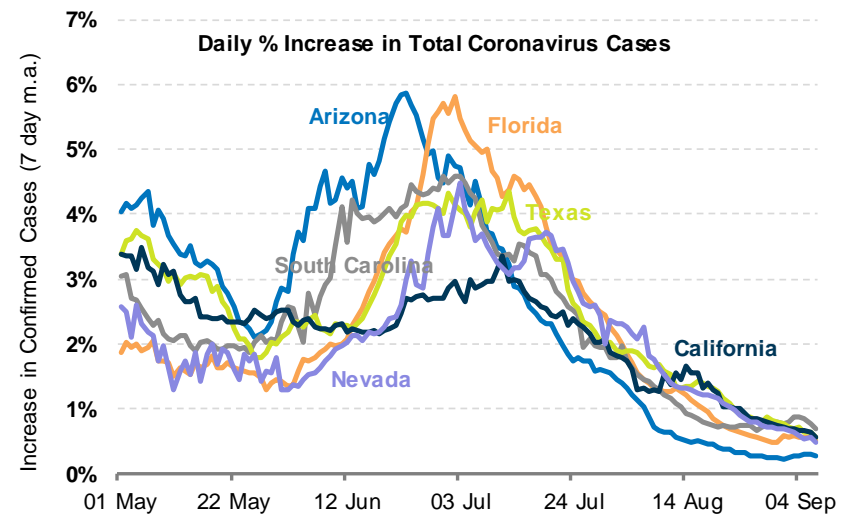
Tracking Covid-19

US second wave turns, possibly in Europe too



Source: BMO Global Asset Management and Bloomberg, as at 7 September 2020

...new cases tumble in key US states

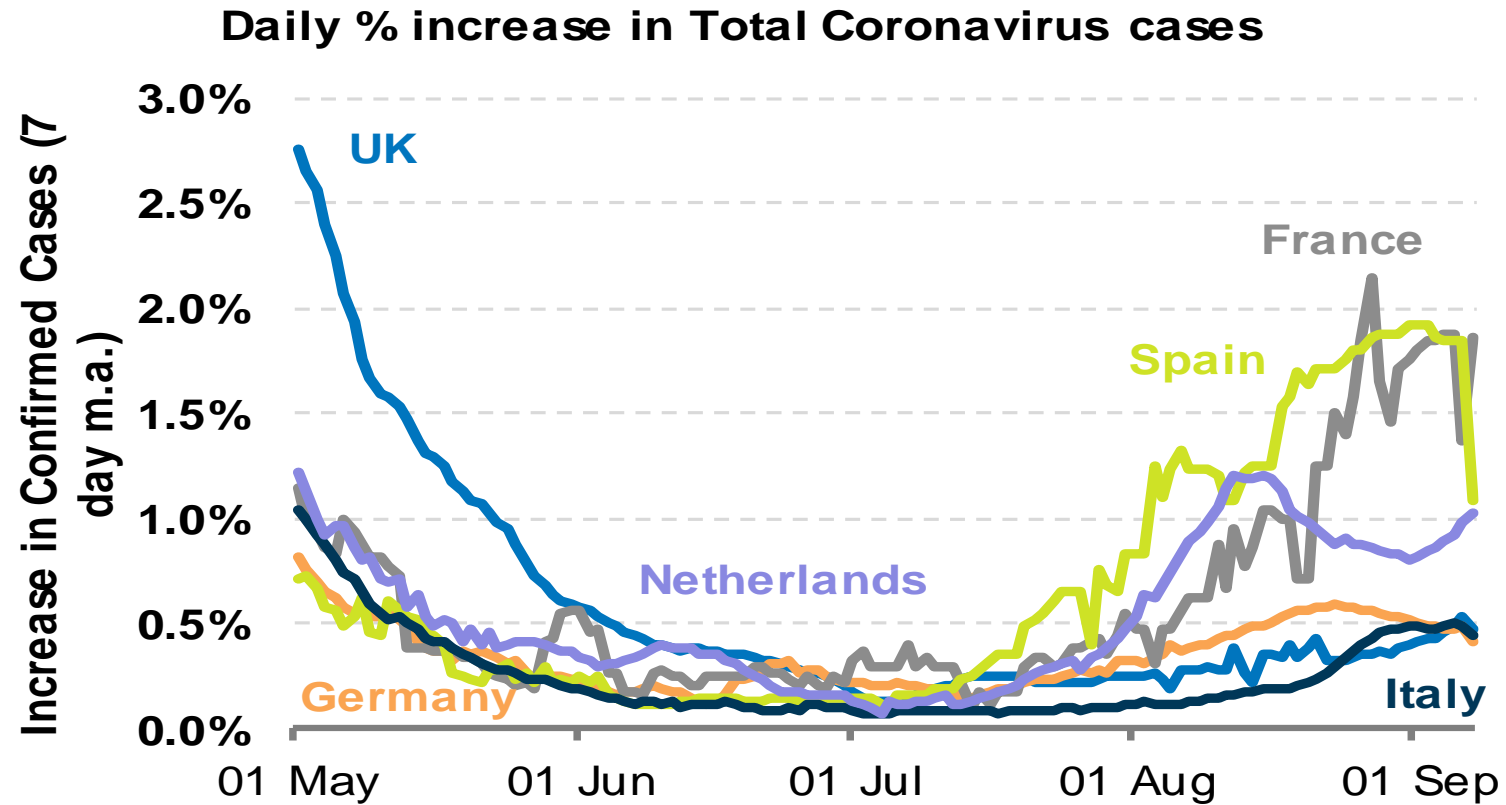


Source: BMO Global Asset Management and Bloomberg, as at 7 September 2020

- Europe had been outperforming the US but the gap has narrowed markedly
- Global daily cases of COVID-19 continue to rise. Daily deaths have fallen from their peak.
- Medical progress in therapeutics and testing has been remarkable. Oxford vaccine trials are critical as it is months ahead of rivals and could be available in large quantities by the autumn. Uncertainty remains until results are published and analysed. The recent halt to the trial is worrying but probably not critical.

Past performance is not indicative of future performance.

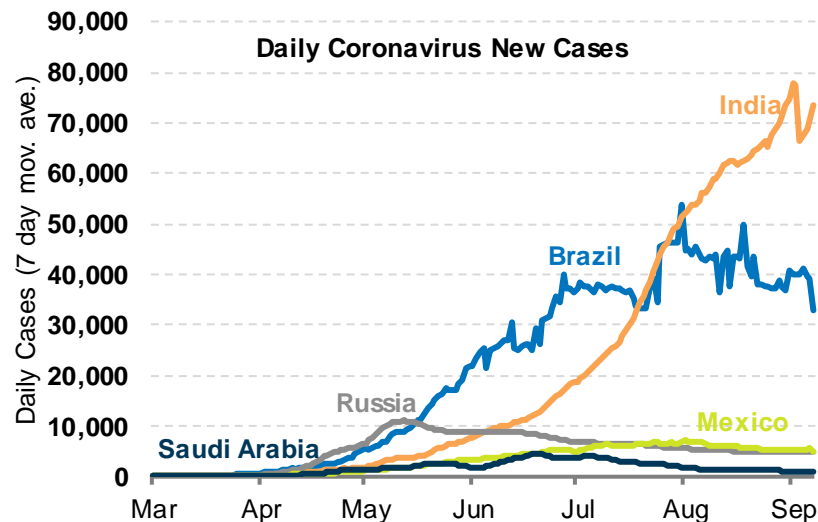
Second Waves in Europe



Source: BMO Global Asset Management and Bloomberg as at 7 September 2020

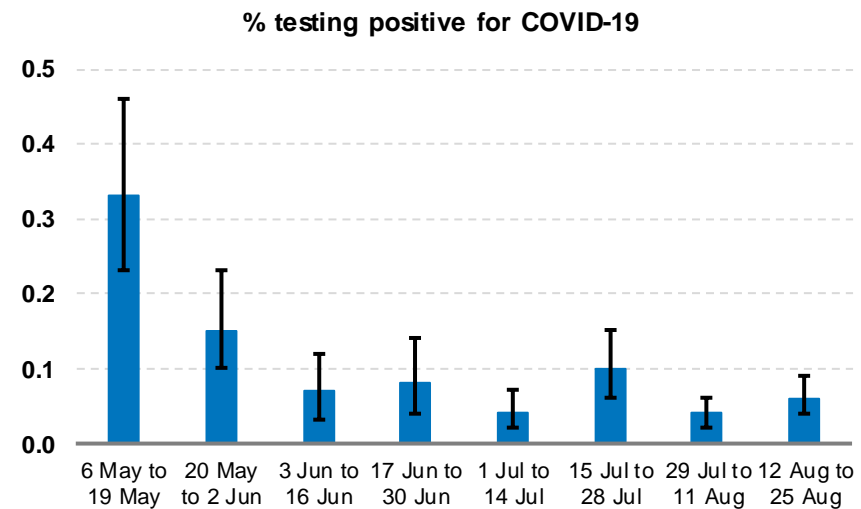
Tracking Covid-19

Some EM countries are suffering badly ...



Source: BMO Global Asset Management and Bloomberg, as at 7 September 2020

...but infections among the UK general public are flat



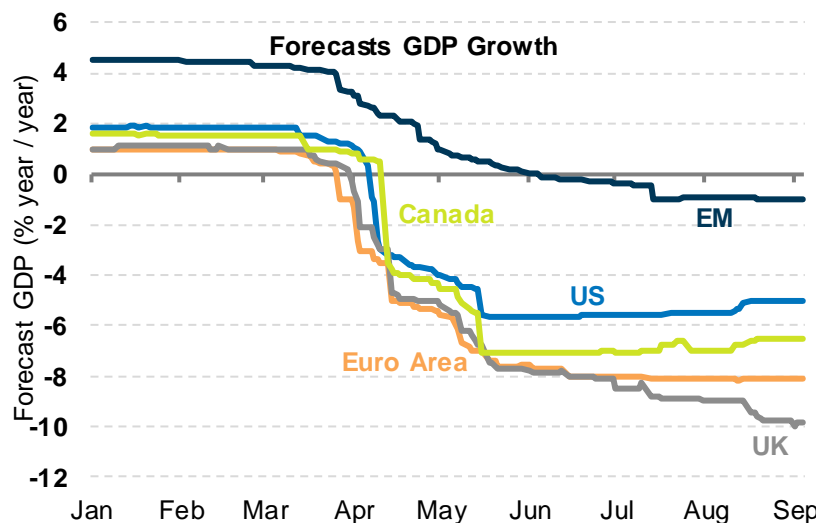
Source: ONS, as at 3 September 2020

- The virus seems to be out of control in certain EM where social distancing is impractical and health care systems are inadequate
- A high quality UK study of infection within the community (excluding those in hospital etc.) shows a rate of incidence that has been flat since lockdowns were eased. Separate data show a sharp rise in new cases and a limited national lockdown has been reimposed.

Past performance is not indicative of future performance.

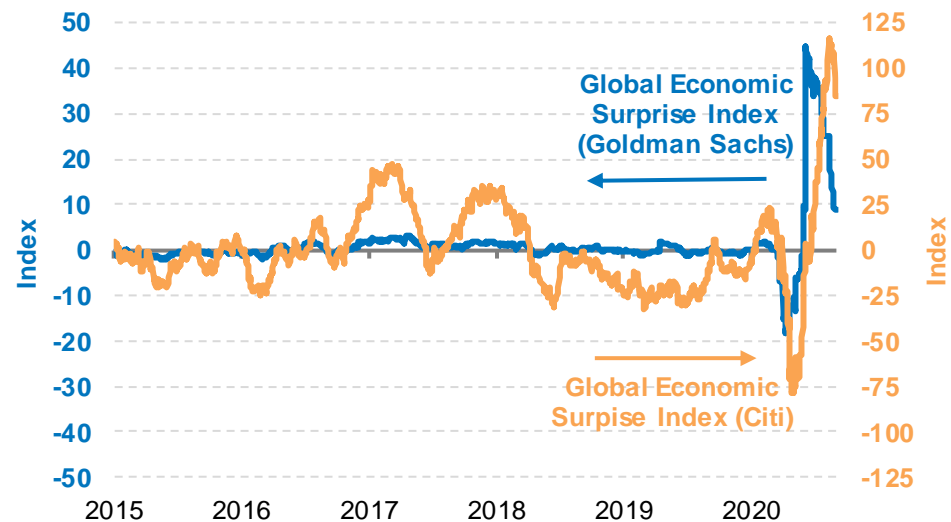
A global recession

2020 growth forecasts are edging up except in UK ..



Source: Bloomberg, as at 3 September 2020

...and data surprises remain positive



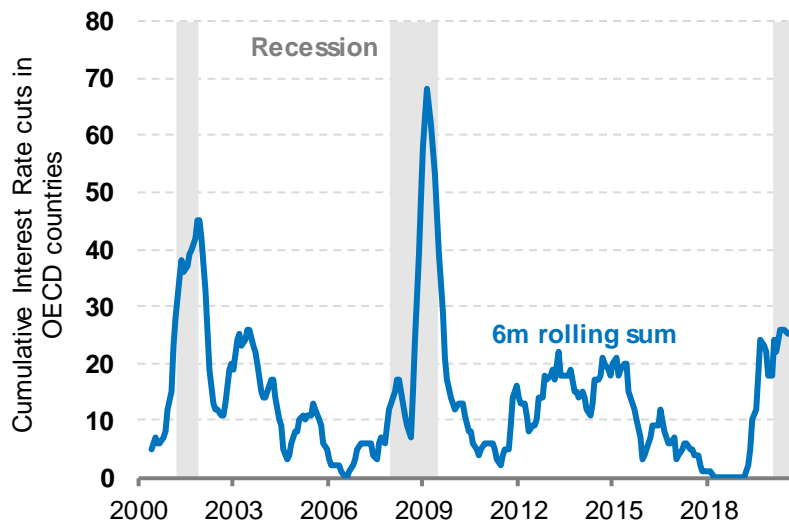
Source: Bloomberg, as at 3 September 2020

- Recent data for European economic activity have come in weaker than expected. With strong second waves in France and Spain and a more modest second wave in Germany, hopes of rapid recovery have receded.
- UK data have recently come in much stronger than expected but reimposed lockdown raises risks.
- Despite the well-documented problems with the virus in the US, recent data, notably on housing and the labour market have been strong. This is a significant surprise. .

Past performance is not indicative of future performance.

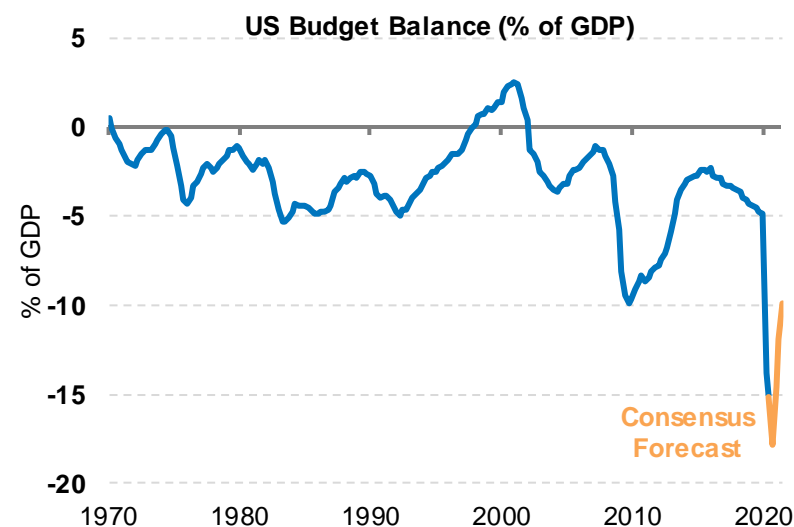
Massive monetary and fiscal support

Central banks cut rates aggressively...



Source: BMO Global Asset Management and Bloomberg as at September 2020. Note: Central Banks/ countries considered are ECB, Fed, BoE, Australia, Canada, Chile, Denmark, Hungary, Iceland, Israel, Japan, South Korea, Mexico, New Zealand, Norway, Poland, Sweden, Switzerland and Turkey.

...along with very large fiscal support



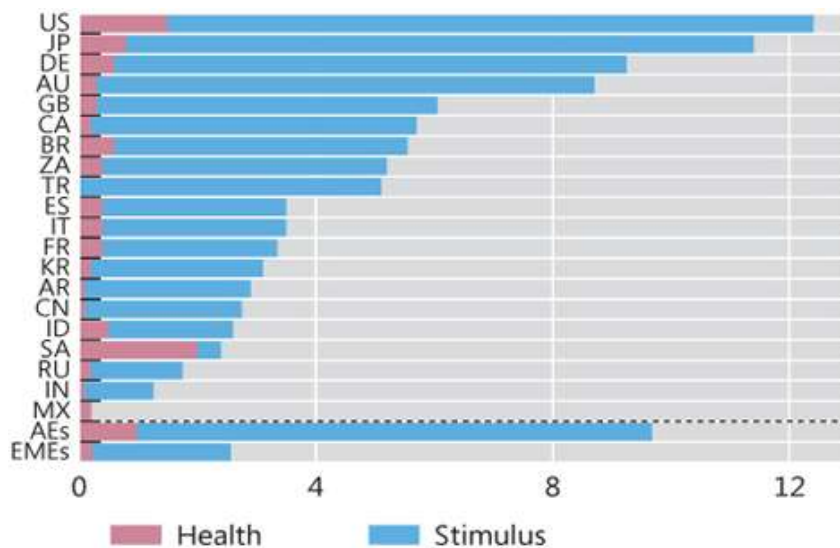
Source: BMO Global Asset Management and Bloomberg as at September 2020.

- Cutting interest rates helps a little but non-traditional measures by central banks help more. Fed buying credit, QE to infinity and measures by ECB notable.
- Huge fiscal response underway. Many of the massive US measures expire soon and a new package is needed. Progress has been limited.

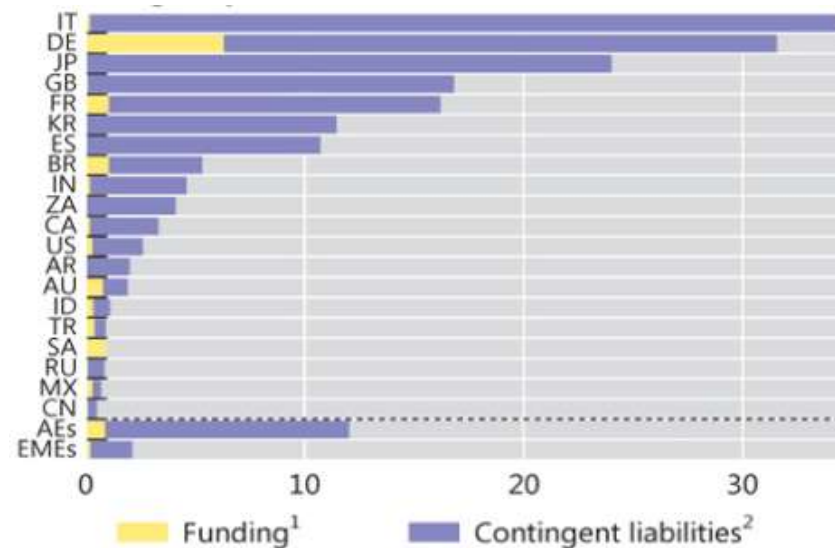
Past performance is not indicative of future performance.

Pledged Fiscal Packages

Budgetary measures



Non-budgetary measures



Source: IMF, Fiscal Monitor, April 2020 and update June 2020; IMF, World Economic Outlook; BIS calculations.

Estimates focus on government discretionary measures that supplement existing automatic stabilisers, which differ across countries in their breadth and scope. AEs = AU, CA, DE, ES, FR, GB, IT, JP and US; EMEs = AR, BR, CN, ID, IN, KR, MX, RU, SA, TR and ZA. For regions, weighted averages based on GDP and PPP exchange rates.

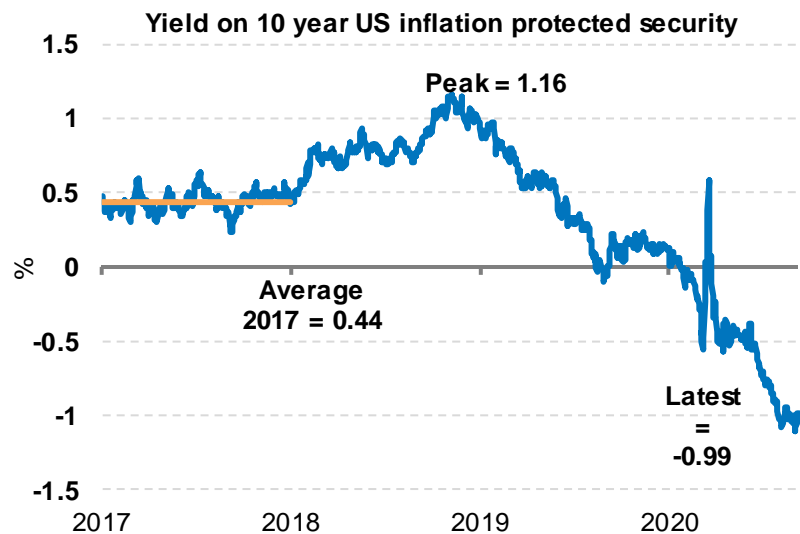
1 Equity injections, asset purchases, loans and debt assumptions, including through extra-budgetary funds. 2 Guarantees on loans and other contingent liabilities such as loans channelled through public financial agencies.

- Huge support globally is unevenly distributed and hard to gauge.
- The US has led the way of fiscal support but many lower income countries have been unwilling or unable to do much on this front. Loan guarantees have been a big feature in many countries, notably Japan and Germany (who can easily afford it) and Italy (who cannot).

Past performance is not indicative of future performance.

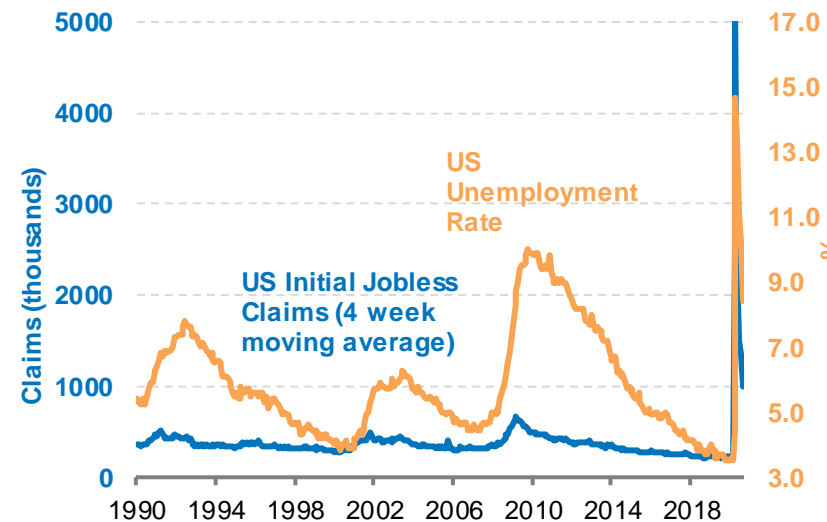
Long-term US real rates fall ever lower

Risk-free rate is very low...



Source: BMO Global Asset Management and Bloomberg, as at 7 September 2020

...but US jobs needs continued fiscal support

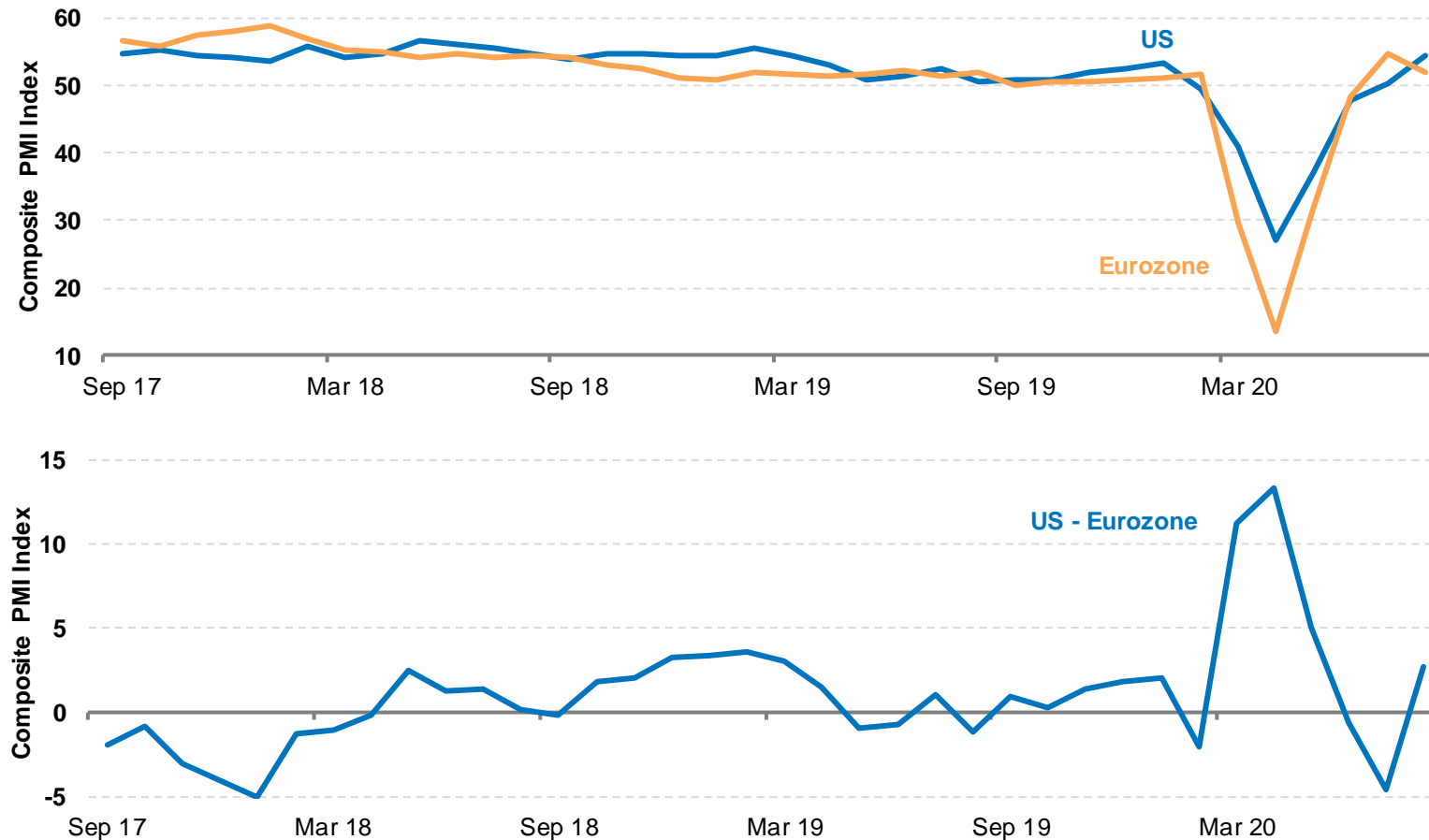


Source: BMO Global Asset Management and Bloomberg, as at 7 September 2020

- The yield on 10-year US Treasury Inflation-Protected Securities - a key component of the discount rate for assets like equities whose income is likely to rise with inflation – fell heavily since late 2018 and has recently hit a record low.
- Massive fiscal support, notably in the US has cushioned the blow of sudden, sharp, deep recession. Many forecasters are worried about further economic weakness as fiscal support is withdrawn. Many measures expired at the end of July and a new package is needed. But low interest rates limit the pressure to reduce deficits.

Past performance is not indicative of future performance.

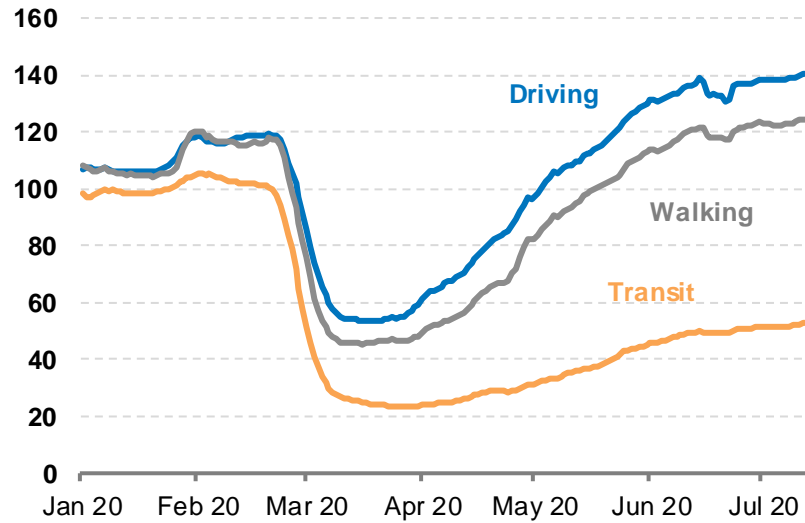
US economy now stronger than Europe again



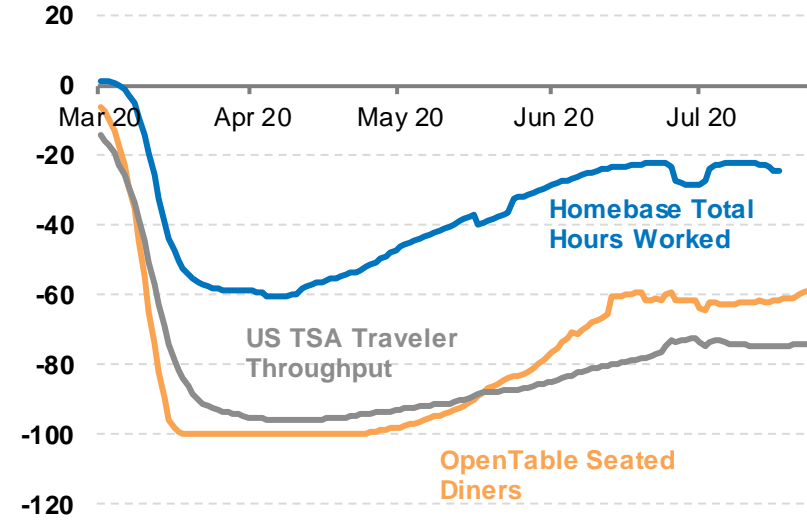
Source: BMO Global Asset Management and Bloomberg as at 7 September 2020

US Economy: High Frequency Measures

Big Data Mobility Measures



US Daily Travel, dining measures YoY Change



- The recovery in mobility data has largely flattened since mid-June.

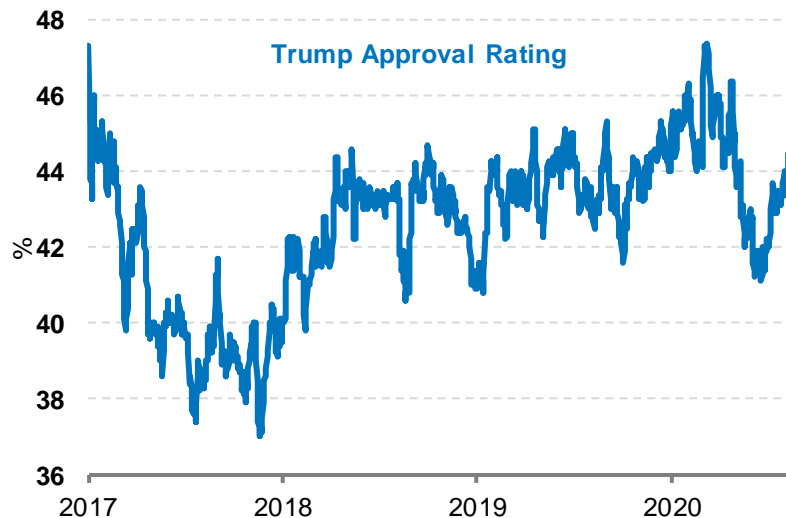
Sources: U.S. Transportation Security Agency, Opentable, Homebase, Bloomberg, Apple Mobility Trends Reports. Data through August 2, 2020.



Image source: [istock photo](#)

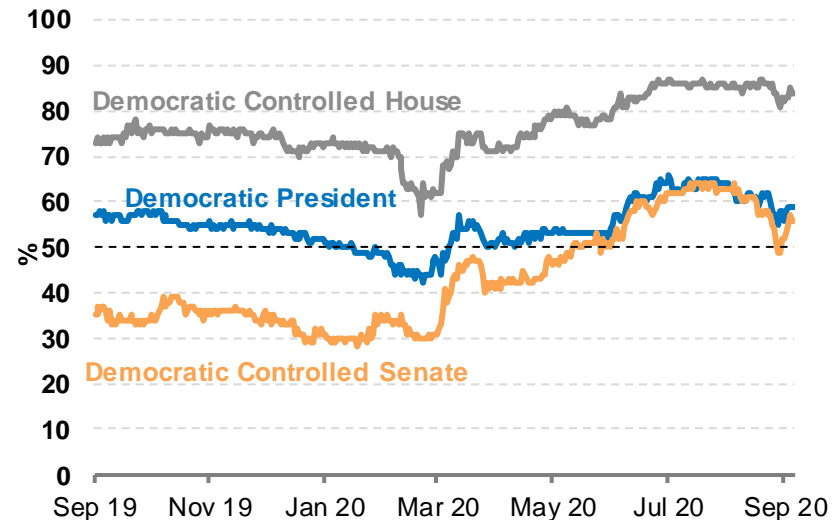
Who will win the US election?

Trump approval rating has fallen



Source: BMO Global Asset Management and Bloomberg, as at 7 September 2020

Betting markets pricing Democrat clean sweep



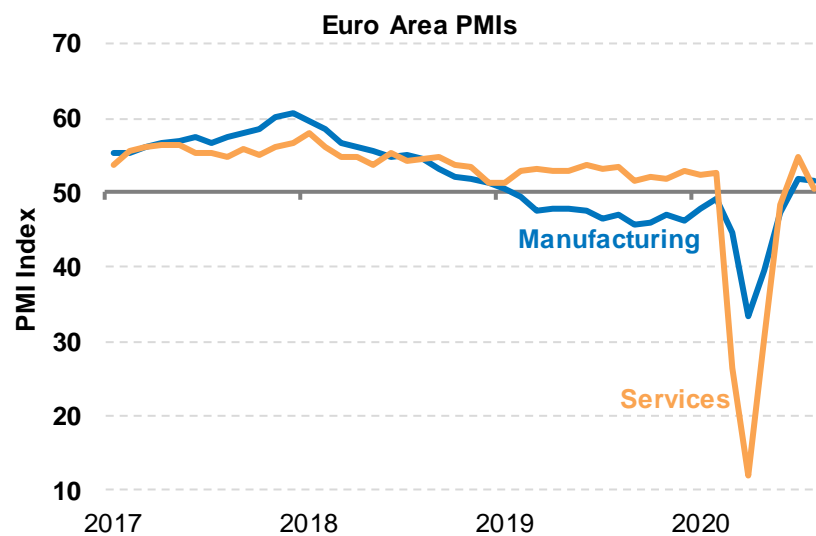
Source: BMO Global Asset Management and Bloomberg, as at 7 September 2020

- US election is a major risk for this year and Trump's approval rating has fallen significantly since the virus struck
- Betting markets and polls suggest the election will be very close but the odds on Democrats regaining the Senate and the White House have risen
- The race remains close

Past performance is not indicative of future performance.

Europe

Purchasing managers' indices bounce ...



Source: BMO Global Asset Management and Bloomberg, as at 7 September 2020

...but markets see continue low inflation



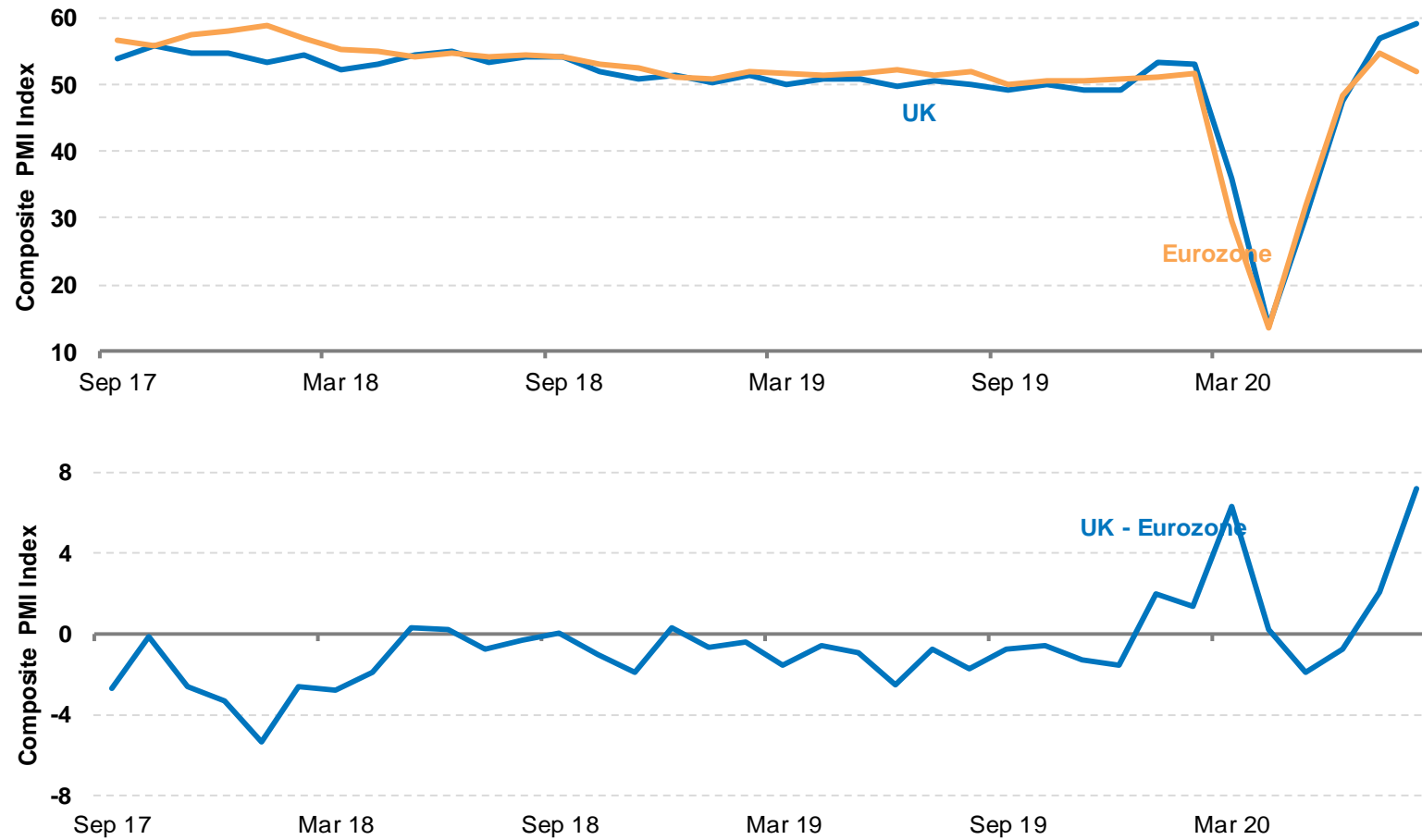
Source: BMO Global Asset Management and Bloomberg, as at 7 September 2020

Europe is well on the way to easing the lockdown and the economy has responded.

But second waves are evident in many countries and lockdown easings have been delayed or reversed

Past performance is not indicative of future performance.

UK overtakes Europe



Source: BMO Global Asset Management and Bloomberg as at 7 September 2020

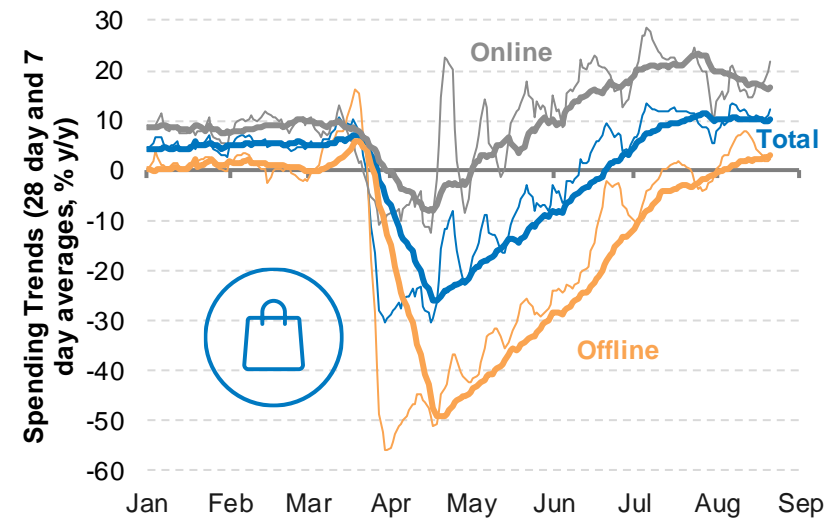
UK High Frequency Data shows strong pick up

Electricity Usage normalised for temperature and long term trend



Source: Barclays, as at 7 September 2020

Spending Trends

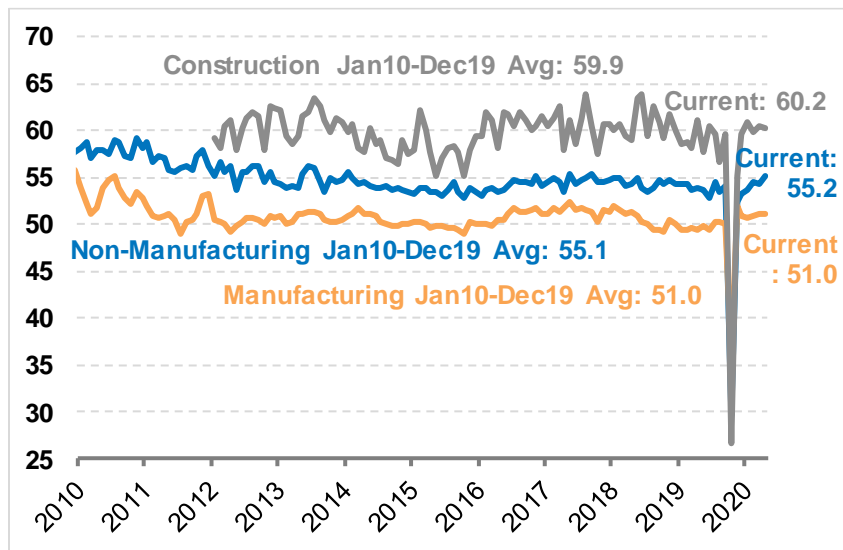


Source: Barclays, as at 7 September 2020

Past performance is not indicative of future performance.

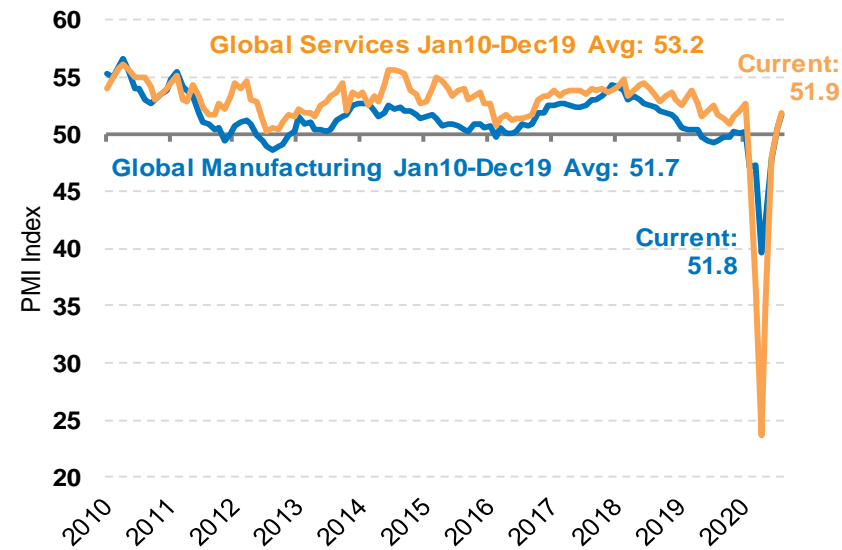
China versus the world

China's PMIs back close to pre-covid levels...



Source: BMO Global Asset Management and Bloomberg as at 7 September 2020

...and the rest of the world is catching up



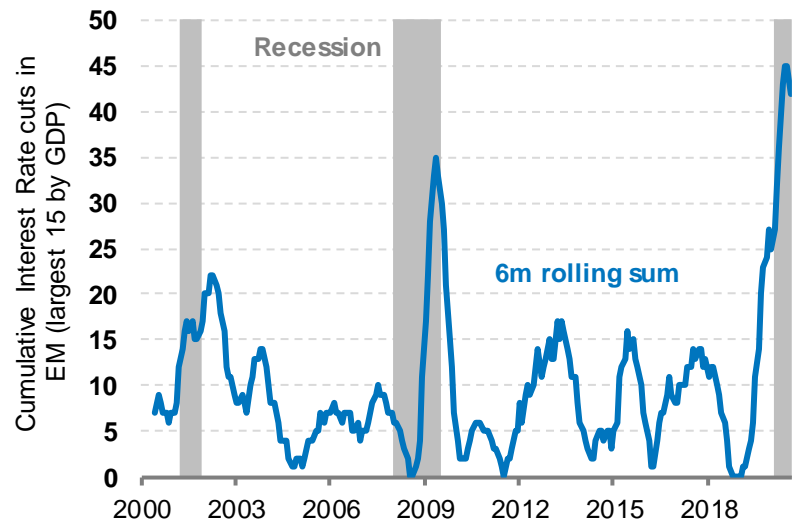
Source: BMO Global Asset Management and J. P. Morgan as at 8 September 2020.

- China's more severe lockdown has limited second waves and allowed almost complete recovery.
- The RoW was catching up fast but second waves and higher infection rates means that lockdowns in the US and parts of Europe have been reimposed or easings delayed. EM countries like India and Brazil are still suffering badly from the virus.

Past performance is not indicative of future performance.

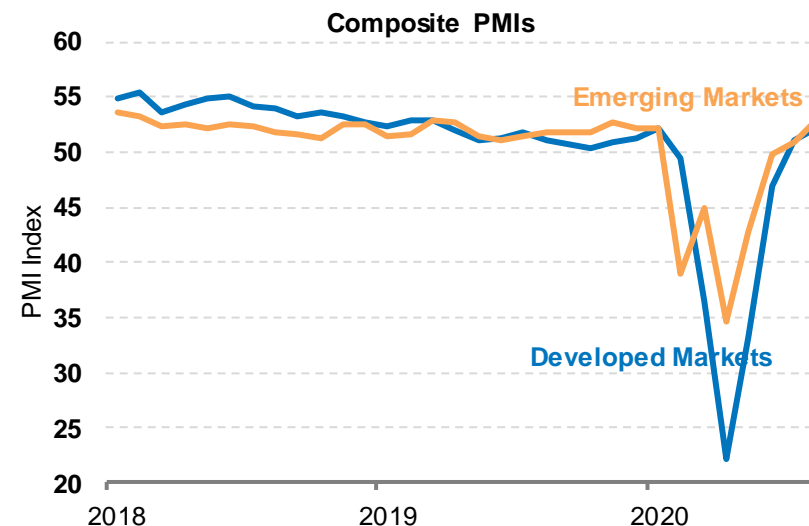
Emerging Markets

EM easing on all fronts...



Source: BMO Global Asset Management and Datastream, as at September 2020

...EM PMIs above DM



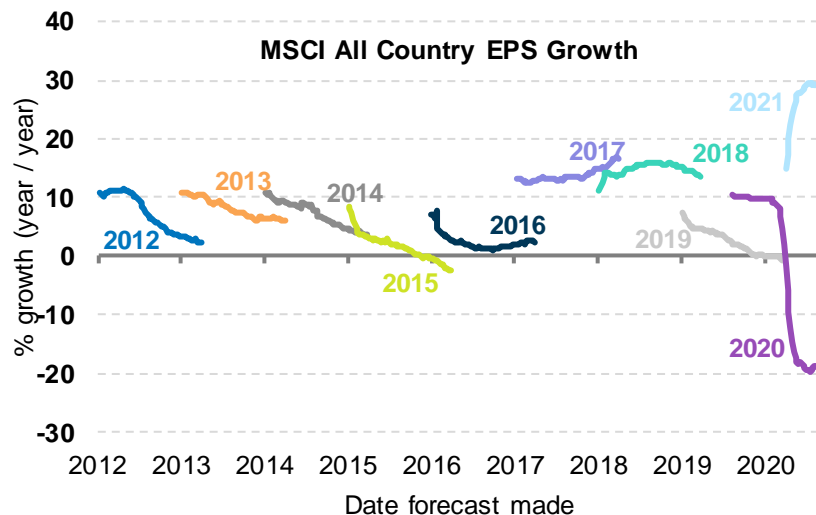
Source: BMO Global Asset Management and Bloomberg, as at September 2020

- Emerging market central banks have turned incrementally dovish year-to-date motivated by slowing growth expectations, continued disinflation and monetary policy easing in developed economies. There is plenty of headroom for sustained policy accommodation.
- The shift in monetary policy stance seems sustainable given the dovish shift in DM central banks; a broad-based slowdown in both export and domestic EM growth; continued disinflation from lower energy prices

Past performance is not indicative of future performance.

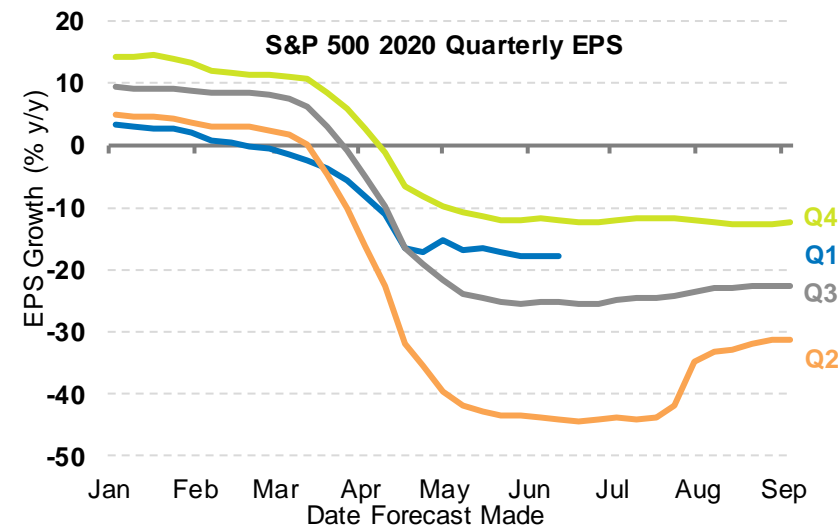
Earnings outlook improves...

2020 EPS heavily revised down...



Source: BMO Global Asset Management and Datastream, as at September 2020

...but Q2 results have beaten low expectations



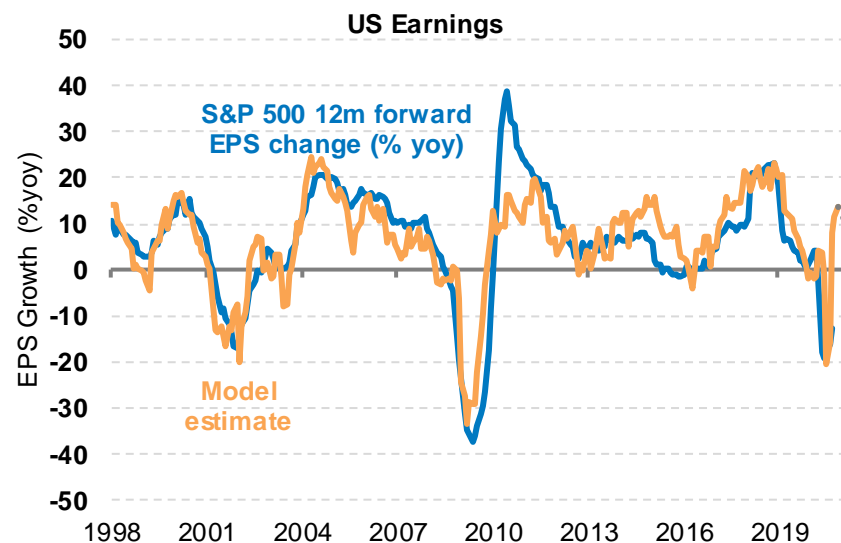
Source: BMO Global Asset Management and Bloomberg, as at September 2020

- EPS forecasts for 2020 have been slashed but projections for 2021 are above 2019. Q2 reporting season has seen a high % of companies beating analysts'. Significant beats on a cap-weighted basis are less impressive. With economic data surging, estimates for earnings in 2020H2 may start to improve but a setback to economic recovery in the US and Europe could lead to a double dip unless a vaccine come to the rescue.

Past performance is not indicative of future performance.

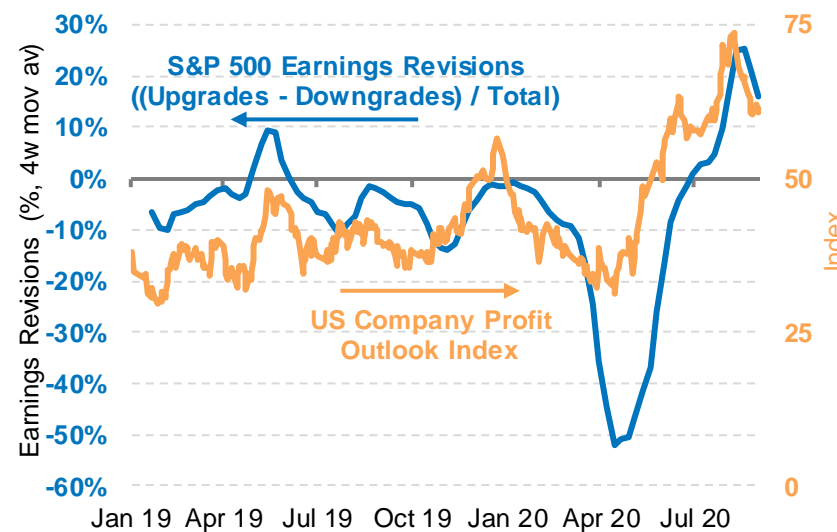
...and could improve further

Bounce in EPS forecasts ...



Source: BMO Global Asset Management, Bloomberg and Datastream, as at September 2020

...and guidance is strong



Source: BMO Global Asset Management, Bloomberg and Datastream, as at September 2020

- The recent Q2 earnings season at -35% y/y is the worst since the GFC but came in better than expected. EPS surprise (+22%) for those that have reported has been the strongest since 2009 but sales surprise has not been as strong (+2%). U.S. companies profit-outlook index, compiled by Bloomberg and based on corporate revisions to forecasts was recently at a record high and remains elevated.

Past performance is not indicative of future performance.

What news on a vaccine?



Source: BMO Global Asset Management

- Phase 1/II trials in UK show Oxford vaccine is safe and produces T-cells and antibodies
- Phase III trials started in June. Recent halt to trials may merely be temporary setback
- 100 million doses ordered by UK, 300 million by US, 300million by EU
- 30mn due in the UK by September, US may have the vaccine by 3 November
- Moderna started Phase III trials in late July. 9 vaccines in Phase III trails
- High probability that one or more of the vaccines will be successful

Conclusions:



The virus is fighting back but will probably be defeated by a vaccine. This would be a game changer



US suffering serious second wave, Europe's second wave is gathering force



Political uncertainty headed higher in the US. Major market implications



Life will never be the same again but pre-covid levels of economic activity and earnings regained by end 2021.

Risk assets would receive boost from good news on a vaccine

Acronyms, definitions and explanations

EPS = earnings per share. **P/E** = ratio of share price to earnings

US CPI and PCE deflator There are two common measures of inflation in the US today: the Consumer Price Index (CPI) and the Personal Consumption Expenditures price index (PCE). The CPI gets more press, it is used to adjust social security payments and is the reference rate for Treasury Inflation Protected Securities (TIPS) and inflation swaps. The Federal Reserve, however, states its goal for inflation in terms of the PCE.

Core consumer prices exclude volatile food and energy. In Japan the core measure excludes fresh food (notably fish); the core core measure also excludes food and energy.

Trimmed mean inflation excludes the extremes of price movements. The closely-followed US PCE version compiled by the Cleveland Federal Reserve excludes the bottom and top 8% of monthly movements. We think it is a better measure of underlying inflation than the core.

Purchasing managers' indices, PMIs The Purchasing Managers' Index (PMI) is an index of the prevailing direction of economic trends in the manufacturing and service sectors. An index of construction is also provided for a few countries. In China, we tend to use the indices compiled by the National Bureau of Statistics. The **Canadian PMI** relates purely to manufacturing which is more volatile; we use a six month moving average.

Breakeven inflation This is derived either directly from the swap market or as the difference between the yield on conventional government bonds and their inflation-protected equivalent. 5x5 measures the 5 year breakeven inflation rate 5 years ahead.

BOC. Bank of Canada, **BoE** Bank of England, **Fed, FOMC** the FOMC is the rate setting body in the US, part of the Federal Reserve

FTA a free trade agreement that imposes zero tariffs between the countries concerned

Sources: BMO GAM, Cleveland Federal Reserve, Investopedia