Stocks boosted by vaccine and stimulus hopes

UBS House View - CIO Alert

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What happened?

Global stock markets rallied strongly on Monday amid progress on a vaccine for COVID-19, and increased optimism that lockdowns can be lifted more quickly and durably. The S&P 500 finished the day up 3.15%, its best day since 8 April; the Euro Stoxx 50 closed up 5.1%; and the MSCI Emerging Markets index gained 3.9%.

The day also saw outperformance in parts of the market that have underperformed through the coronavirus crisis. Value stocks, based on the Russell 3000 value index, rallied 4.5% versus 2.3% for growth stocks, and the Russell 2000 US small-cap index rallied 6.1% versus 2.6% for the S&P 100 index of US large-caps. Meanwhile, assets that have performed well amid uncertainty, such as gold, fell back, down 0.64% on the day.

Several factors have driven the recovery in market sentiment:

- **Progress on a COVID-19 vaccine.** The day’s most notable development was an announcement from US biotech firm Moderna that its experimental COVID-19 vaccine had shown early signs of efficacy. Interim data showed that the vaccine was able to produce antibodies to "neutralize" the new coronavirus, indicating protection from future infection. The evidence also found that the vaccine, mRNA-1273, was generally safe. Phase 3 clinical trials are due to start in July, and Moderna has said that if trials continue to produce positive results, "up to 1 billion doses" could be produced per year from 2021; a more limited number of doses could be available by the end of this year. Assuming the need for two doses per person, this could eventually be sufficient to cover all of the US and half of Europe, going a long way toward permitting a full return to normal economic functioning. The development increases the chances of a faster and more sustainable return to economic normality, particularly when combined with the recent progress on the antiviral drug remdesivir.

- **Evidence that a major second wave of the virus is not inevitable.** Various economies have eased lockdown measures. Italian shops and restaurants reopened on Monday, and hopes rose in Greece.

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that the tourism industry could revive for the crucial summer season. Reassuringly, infection rates have remained low in some countries that opened up their economies several weeks ago. The reproduction rate of the virus in Germany, which began to ease its lockdown in mid-April, remains below 1, and new cases remain below 1,000 per day. While we do see some signs of the reproduction number picking up again in Germany and Austria, where restrictions were lifted a few weeks ago, technologies such as mobile apps are being rolled out globally to help with contact tracing, and the public has been made highly aware of the risks of COVID-19. This reduces the risk that major economies will have to enter another complete shutdown in the future.

- **Economic data has provided some glimmers of hope.** While much recent data for major nations has been poor, data from the German Bundesbank has raised hopes that the lockdown-driven recession may not have been as deep as feared. A real-time indicator, based on inputs including toll road traffic, electricity usage, air pollution, flights, Google searches, employment, and cash circulation, suggested that economic activity dropped by 4.6% in April, a smaller decline than consensus estimates.

- **More stimulus is on the way.** Germany and France presented a joint proposed plan for a EUR 500 billion European recovery fund, to offer grants to areas hardest hit by the crisis. Investors were also encouraged by comments from Federal Reserve Chair Jerome Powell over the weekend, in which he affirmed that more monetary stimulus would be provided if required. Powell said he was "highly confident" that the US economy would bounce back once a vaccine has been developed. He added that a Great Depression-scale downturn was unlikely, and that the US financial system was "very strong." House Democrats also passed a USD 3tr spending bill; this is unlikely to pass the Senate, though we expect at least one more large US package to provide additional support from June.

- **European short-selling rules will be lifted.** A further technical support for markets came from news that Austria, Belgium, France, Greece, Italy, and Spain would lift short-selling bans imposed in March, once they expire on 18 May.

**What are we watching?**

Monday’s developments illustrate that, even after around a month of range-bound trading, equities continue to have upside potential, provided investors can see clearer evidence of a path to sustained economic normality. To gauge progress on this, we are monitoring various indicators including hospitalization rates as economies start to reopen; news on the efficacy of drug treatments; progress on vaccine trials; and data on the prevalence of antibodies within populations, which could offer a guide to the potential severity of further waves of infection. We are also monitoring high-frequency indicators, some of which are already showing signs of increasing economic activity.
The path to our upside scenario is likely to be bumpy, with periodic setbacks. Even amid Monday’s generally positive news, cities in the Chinese provinces of Jilin and Liaoning, home to more than 70 million people, announced renewed lockdown measures to try and stem a new outbreak of the coronavirus.

What should investors do?

The recent rally, and the unpredictability of near-term market developments, continue to underline the importance of a disciplined investing strategy. Our Liquidity. Longevity. Legacy. approach to wealth management enables investors to look through short-term market noise by holding sufficient liquidity to avoid forced selling and to take advantage of longer-term opportunities in their Longevity and Legacy portfolios, including companies that stand to benefit from trends accelerated by COVID-19, such as e-commerce, and automation and robotics.

We recommend investors focus on four areas to prepare portfolios for the next stage of the COVID-19 recovery:

1. **Be selective within equities.** Equities are fully valued on some metrics, with US stocks trading at 18.5 times 2021 earnings, 15% above the 20-year average. But some parts of the market retain significant upside potential in the event of a more robust recovery. Investors seeking to position for an outcome closer to our upside scenario can consider select value and cyclical stocks, which we expect to outperform as the global economy recovers. But with much still unclear on the path to the upside scenario, opportunities that should fare better in our central scenario include more defensive and stable areas within equity markets, including quality and high-dividend paying stocks, and select consumer staples and healthcare names. More here.

2. **Go for credit.** Recent comments from the Fed suggest negative interest rates won’t be part of the “new normal.” However, rates are likely to remain low for the foreseeable future. As a result, investors will need to look for yield in areas such as riskier credit, which we currently see as attractively priced. Current spreads of 185bps for USD investment grade, 778bps for USD high yield, and 579bps for USD emerging market sovereign bonds (as per the JPM EMBIGD Index) in our view more than compensate investors for the risks. More here.

3. **Take advantage of volatility.** For investors who can implement options, put-writing strategies can provide an additional yield, while pre-committing investors to buy on dips. For more on taking advantage of higher volatility, see here.

4. **Buy into themes that are likely to be accelerated by COVID-19.** In another sign that the world after COVID-19 will be less global, US lawmakers have announced they are considering legislation to provide tax incentives to US companies to move operations out of China and boost production onshore. Higher US wage costs would likely require increased investment in automation and robotics technology, favoring companies exposed to this space. We also see opportunities in e-
commerce, health technology, and the food supply chain. For more on long-term beneficiaries of the crisis, click here.

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