ZINNECKER BIMONTHLY – APRIL / MAY 2020

REVIEW

The development of the COVID-19 disease has completely thrown all our thoughts and forecasts for the global economy and its capital markets from one month to the next! In the last six weeks, the stock markets have answered the question of the importance and severity of this new disease, whose seriousness was initially misjudged by the world public and has been played down by some politicians until recently. What is certain, however, is that this disease is a pandemic of global proportions, for which there are no medicines yet available. Moreover, in many countries the health care systems are already completely overstretched in diagnosis and therapy, given the existing rate of spread. Today's situation is reminiscent of the Spanish flu triggered in the USA 102 years ago.

Shares, bonds, gold and the currencies have reacted accordingly on a global scale. While investors have tried to protect themselves with government bonds, precious metals and with dollar and yen purchases, the stock indices have lost at least 25% of their value since the highs of this year and are in bear markets. The extent of this fall in prices and the behavior of investors is in technical terms comparable to the crash of October 1987. Investors around the world are now faced with the question of how the disease will continue to spread, whether the measures taken by policymakers will be effective, and the extent and length of the economic recessions. There is no textbook in modern economic history for assessing the development and changes in global economic cycles and their capital markets according to Covid-19.

OUTLOOK

During the development of the Industrial Revolution 4.0 of the last decades, many socio-political mistakes continue to have an unresolved effect until today, and new ones have been added in the last four years, which threaten to destroy the achievements of globalization for all states. As if that were not enough, since the beginning of the year the COVID-19 disease has been spreading worldwide with a high rate of infection, which is already marked as a pandemic. Without having been prepared for it, many governments, with the exception of the USA until recently, have taken ad hoc decisions to curb the rate of spread in order to save healthcare systems from collapsing, following the experience in China and Italy. The naive handling of COVID-19 by the Trump government is now becoming visible in its effects. In only 4 weeks, the entire global economy has come to a virtual standstill, and with today's knowledge of the course of the disease, nobody knows when the Western service and production industries will resume work.
It is already clear that the lockdown cannot be a fundamental solution to the problem and will therefore be temporary. A prolonged lockdown would result in major and politically unjustifiable damage to the economies and their workforce, not to mention the additional financial burdens that would be beyond the control of those states, which are already highly indebted in some cases, such as Italy. It is therefore to be

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expected that economic activities in Europe will gradually be ramped up again at the end of April or the beginning of May, provided that the daily growth rates of new infections fall drastically by Easter in line with the pattern of China. The last daily percentage changes of less than 10% give encouraging reasons for this.

The appearance of the corona virus and the resulting global pandemic undoubtedly represent a turning point in all areas of life in the civilized world. It is already beginning to address the question of whether, where and to what extent private and public life in the economy and society will change. Since there is no experience from past periods, many assumptions are still vague and speculative. One thing, however, already seems certain that many public and private work processes will be simplified and made more efficient through the expanded use of the Internet and digital storage media. This applies, for example, to all social networks, schools and education, health care and fiscal and financial systems. In the private sector, interactive communication via G5 will be incorporated across all states into all areas of corporate and operational management, e.g. through the expansion and networking of home offices and online conferences.

The Western corporate culture developed over the past 30 years to diversify products and production sites globally in order to create new markets and additional shareholder value has shown its limits in the economic crisis now unleashed by Corona. A rethink towards greater national independence in strategically important products for the basic supply will be a consequence of this. This also applies to all globally operating companies for their strategically important production and service sectors. Governments in her own interest will supervise foreign takeovers in future. A certain degree of deglobalization should be the consequence. The trade restrictions triggered by the USA are also getting a new and different significance. Trump's ludicrous ideas of "America First" could therefore be history as early as November.

What will happen to the EU? Already today, after the first effects of the pandemic, all members should have realized by now how important cooperation and solidarity are for the continued existence of the EU and how susceptible to disruption and fragile the community still is today. If archaic and nationalistic ideas and the stubborn insistence on national sovereignty will further prevail, the EU and the Euro will be history in a few years' time.

Will the majority of people have changed in their values, their political views and in their living and consumption habits after the end of the lockdown and after the experience of the fast approaching severe recession? Experience from previous crises of the last century suggests that this will be a gradual and lengthy process with an uncertain outcome. However, the consumption habits of the respective age groups will adapt more quickly to future disposable incomes and changed consumption needs. This is particularly true for the older well off generations representing a population share of around 30%. This question will occupy the capital markets and stock exchanges, especially in the USA, as the consumption share of approx. 70% has become a predominant driver to the growth of national GDPs.

In its latest study, the US bank J.P. Morgan estimates that the US economy will contract by 10% in the past quarter and by around 25% in the second quarter. The European economies should also at least fall into these parameters, if not worse, not to mention the less industrialized countries. It is already clear that globally, several

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industries will be hit hard, many companies will be pushed to the brink of extinction and some will not survive. Unemployment will rise dramatically everywhere in the coming months and the governments of all countries will very soon be faced with fatal and unreasonable decisions on the reopening of the labor markets, weighing up the possible social and economic damage. The background to this is the anxious and unanswerable question of what the existing social and financial systems of the respective countries can ultimately withstand.

CAPITAL MARKET OUTLOOK

The imminent start of the reporting season, starting in the USA, will shed some light on the degree of the descent of corporate profits. Many companies are already demanding financial aid promised by governments. Dividend payments will be cancelled or cut and managements will be forced to rethink and realign their current business models to ensure their future viability. Covid-19 is an economic game changer for the entire corporate world like never before in peacetime. The stock markets have already tried to price it in over the past few weeks. The investment banks have already lowered their earnings estimates for the S&P 500 by 25% to 30% for 2020. They are based on the assumption that global economic activity will resume as early as the second quarter and not later. I expect that, the decline in profits of European companies will be of a similar magnitude, with the cyclical companies of the "old economy" possibly being hit even harder.

The systemic economic changes triggered by the pandemic will affect consumer-related services and goods-producing industries differently in their medium- and long-term future prospects. Labor-intensive air transport, tourism, traditional retail trade and the restaurant and hotel industry have already been hit particularly hard. These also include mass and cultural events. Normalization of consumption can only return once the older citizens with their strong purchasing power have been vaccinated or are immune against the virus. On the other hand, the leading online and communication service providers will benefit from the system change and altered consumer behavior. These include the leading technology companies and network equipment suppliers that will provide the necessary technical network for the work from home, which in part will revolutionize many work places. Finally yet importantly, there are the companies in the food industry and healthcare sector with pharmaceuticals and biotechnology, which satisfy the basic needs of a modern society.

Companies in the metallurgy, oil and automobile industries, together with their suppliers, which have long been suffering from structural change and oversupply, are also facing difficult times. With dwindling financial reserves and high investment and restructuring costs and a below-average automotive recovery, several companies should become insolvent or should be rescued through mergers. Momentary supply change disruptions have meanwhile lead to production curtailment and shutdowns with many capital goods producers.

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The differing business conditions have already found their reflection in the degree of the individual and selective stock price recoveries during the recent sharp rebound towards the end of the quarter. The further development of the relative strength of different sectors could also be an important indicator of whether and when a resilient stock market valuation has been achieved. The future equity structure of the **Millennium Global Opportunities** Fund will be a mirror of the thoughts and ideas mentioned herein.

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