Strategy-setting in the time of COVID-19

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Whether setting an investment strategy or a strategy for a business, risk and uncertainty are always critical considerations. As the immediate crisis response phase turns towards a hoped-for return to normality, we ask ourselves how the future will look. What will turn out to be temporary, where will we see persistent changes, and what will we ultimately realise is a permanent shift? In this piece, we outline three areas we are assessing, with a view to ensuring that we take sound investment decisions, on behalf of our clients and our business, for a re-imagined world.

1. What will the market opportunities be?

It is too early to tell how asset allocations are likely to evolve, both in client portfolios and across markets at a macro level. Some asset classes have seen a persistent widening in spreads, consistent with mispricing of underlying risks (such as CLOs). Cash-flow assumptions have proved vulnerable, in some cases given regulatory pressure such as for banking stocks, and the likelihood of windfall taxes has increased. Monetary policy measures will distort asset prices, with asset owners likely to see a permanent boost to valuations. With risk-free rates lower for much longer, the dynamics of search for yield will endure, including its impetus towards illiquid alternatives. Asset classes such as distressed debt will see a rise in supply.

Correlations across asset classes typically rise during periods of market volatility. But the source of the shock matters. Dependencies across global supply chains, for example, have been a strong driver in this crisis, whereas penalisation of low-transparency assets was a predominant feature in the 2007-08 crisis. Interestingly, trade finance seems to have fulfilled it promise as a low beta asset class, to date. In designing asset allocations and product sets, scenario analysis is critical for forming a robust view of likely risk/return over time.

All this points to a thoughtful and proactive assessment with clients, and as a business, about potential investment and product opportunities. Managers need to be flexible and responsive to evolving demand.

2. A globalised world stands together and apart

As an international asset manager with deep roots in the Middle East, we are used to straddling very different geographical regions, and acting as a bridge between them.

The similarities and differences during this crisis have been striking, and how these play out in the recovery will help shape our strategies. Similar are the monetary and fiscal policy responses, differing in design, but united in intent. For example, the scale of the fiscal stimulus packages in Saudi Arabia and Bahrain are estimated at 4% and 29% respectively[1], while the UK and US are currently heading towards 3% and 5% respectively. We are watching bond markets closely, especially given the different starting points in terms of fiscal headroom and debt levels.

Levels of state involvement are a key difference across regions. We will be paying particular attention to the likely reshaping of the corporate sector across the western world, and issues of corporate independence and sound governance. Any interventions are likely to prove persistent in many cases, as evidenced by the 2007-08 crisis.

The geopolitical complexities of oil supply have added an additional layer of uncertainty into fiscal and business planning across the Middle East. Making a probabilistic assessment of oil price moves is always challenging, but critical for gauging likely economic prospects across the Middle East.

The crisis has reinforced the inter-connected nature of the world, our dependence on each other and our ability to work together. Global partnerships have sprung up to help tackle the crisis, the spirit and approaches of which we hope will be a permanent feature in the recovery.

[1] Source: Arabia Monitor

3. Conscious of the impact on people and planet

The underlying challenges of sustainable development are still with us. Global temperatures are still rising. Many challenges have been exacerbated, with widespread risks to livelihoods, human rights and further pressure on countries already facing food crises before the pandemic such as Ethiopia, Kenya and Somalia. And the crisis has highlighted critical dependencies, such as the link between air quality and the underlying respiratory conditions that have proved so fatal in this crisis. The need – and opportunity – for private sector investment remains strong, but estimates suggest that over $95 billion has been withdrawn from emerging and developing economies since the crisis began.[2]

The crisis has also shown that money wasn't the barrier to addressing the sustainability challenge at a governmental level. The humanitarian case for COVID-19 suppression was won swiftly; the devastating humanitarian impact of climate change rarely gets much attention.[3] Climate-related disasters already affect more than 108 million people every year.[4]

Nor were some of the perceived barriers to change as impassable. The virtual revolution has arrived and – despite some challenges – it seems unlikely we will ever need to travel as much for in-person meetings. Carbon emissions in 2020 will surely be much lower than predicted.

Many responsible investment products were incepted in the past decade, and so this will be their first large-scale test in bear markets. It is too early to tell how performance will fare[5], and if integration of Environmental, Social and Governance factors does indeed prove a high value-added risk reduction tool. Nonetheless, we believe that companies that have taken a responsible approach will see the benefits, for example with treating colleagues fairly, and stakeholder-centric approaches, being judged important parts of crisis response.

The critical question for those setting a strategy in the time of COVID-19 is simple: does your strategy embrace uncertainty? The issues we have highlighted are only some of many, and the answers will be unclear for days, months and years. What we can do, however, is carefully identify and consider, then strike a balance between making bold commitments and retaining flexibility to adapt.

[2]Source: https://www.un.org/en/un-coronavirus-communications-team/calibrating-covid-19-crisis-response-sdgs
[3]See, for example, analysis of the most under-reported humanitarian crises of 2018: https://careclimatechange.org/wp-content/uploads/2019/02/Suffering-In-Silence-2018.pdf
[4]Source: IFRC, Cost of Doing Nothing, 2019: https://media.ifrc.org/ifrc/wp-content/uploads/sites/5/2019/09/2019-IFRC-CODN-EN.pdf
[5]Some early analysis has been conducted that supports ESG out-performance, such as: https://www.gbm.hsbc.com/insights/global-research/esg-stocks-did-best-in-corona-slump