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Market Insight | Business Investment Outlook: May 2020

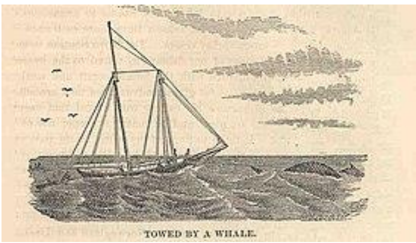
A business investor's guide to the COVID-19 Nantucket Sleighride

Looking forward from their positions in early May, financial markets are currently anticipating that the major global economies will reopen on a rolling basis. They are betting that governments and central banks will succeed with their emergency measures in containing the economic fallout from the COVID-19 coronavirus pandemic. Nevertheless, business investors bracing for recession are unclear whether recovery will be 'V', 'W' or a prolonged 'L-shape'; with each shape offering different opportunities and risks. David McClelland, Director of Carlton Strategy Advisors, comments on the outlook for business managers and their financial backers during these unprecedented times:

FT All-Share index

Unlike the financial crisis of 2008/09, which was a market liquidity event, the COVID business crisis is a cashflow and trading continuity event. This time, extended government and central bank stimuli include cheap loan schemes, furlough mechanisms and tax deferrals designed to protect household incomes and minimize the impact on businesses by preserving economic demand. However, the efficacy of these measures together with the potential magnitude and duration of downturn are triggering many business managers into a 'shrink-survive-grow' strategy; preparing for the worst, battening down the hatches and awaiting the light at the end of the tunnel.

The financial markets may be taking comfort that policy makers have transferred much of the risk from the pandemic from investors to taxpayers. However, business investment will be dependent on a pragmatic assessment of potential post-COVID scenarios, where success is predicated by how quickly business owners and their financial backers understand the 'new normal'; adapting to the market dislocation, and by evolving new rules of trade within reoriented supply chains.


TOWED BY A WHALE.

Evolutionary business theory suggests that economies often 'reboot' after a crisis better than before as the weak and uncompetitive are replaced by stronger, better led and more innovative companies. However, a number of post-COVID economic and business hurdles can be anticipated, making for a potentially rough 'Nantucket sleighride'.

Even before COVID, global trade had somewhat stalled in a climate of increased nationalism and trade protectionism amongst leading sovereign powers. Post-COVID, sovereign indebtedness may create further geo-political risk, where divisions arise between countries in which some governments are better able to support their recoveries than others, fuelling further trade tensions.

For the UK - what Brexit started, COVID-19 will almost certainly amplify. The European Commission has advised its members to reinforce protectionist measures during the crisis and already France, Germany and Spain have placed restrictions upon non-EU investors' ability to acquire more than limited stakes in businesses which are considered 'strategic' to EU nation state interests.

A second political risk is the ability to ameliorate post-COVID government debt burdens. Given a lack of political appetite for 'austerity', options appear to point towards raised taxation and/or reliance on central bank borrowing. Interest rates at record low levels mitigate in favour of the latter, but carries the risk of inflation.

In the UK, the national economy and employment have been supported in recent years by the strength of consumer services. Indeed, record low unemployment over the last decade has been one of the most notable characteristics of post financial crisis life in the UK. Going forward, until such times as there is such a thing as a COVID vaccine - or herd immunity - unemployment may be expected to increase significantly as the government withdraws temporary furlough schemes and businesses introduce redundancy measures to compensate for the ongoing absence of trade – and here, the UK's future relationship with the EU does it no favours.

Sterling's decline in the aftermath of the June 2016 Brexit vote served to raise the cost of imported goods and materials, but did little for the overall growth of exports. COVID induced disruption to cross-border 'just-in-time' supply chains may make 'reshoring' a more attractive option for indigenous businesses. However, the reverse outlook for UK companies may be just as true if foreign owners withdraw to their domestic landscapes. The potential for this is particularly acute in market over-supply situations, such as within automotive manufacturing, where the forces of industry consolidation may combine with protective sovereign policies.

Ongoing social-distancing will limit people's willingness to travel and congregate; with hugely negative consequences for city commuters, town centre retail development, airline operators and the leisure and entertainment industries amongst many others. However, some sectors will undoubtedly benefit as business and industry rebalance; the 'staycation' industry may become something of a market phoenix and most certainly online Digitech will thrive. But, the overall severity of the dislocation means that the downturn and its rebound will not be V-shaped; recovery will take some time as many businesses fail and others are forced to downsize and restructure.

Like never before, preserving cash and access to cashflow credit has become a priority, safeguarding value when the future of whole industries – never mind individual businesses – is hard to determine.

As with all major changes there are, and will continue to be, profitable investment opportunities. However, given the scale of the business and economic uncertainty, the need for detailed business planning - based on strong due diligence - will be at the forefront of decision making in these turbulent times. Hold on for the sleighride!

For information about how Carlton Strategy Advisors can help you to assess business and market opportunity and attractiveness, please contact: David McClelland via carlton-advisors.co.uk