



Part 3: COVID-19 Science and Economics

September 8, 2020

In the third installment of our COVID-19 series, our moderator, Hugo Scott-Gall, co-director of research on the Global Equity team, checks back in with our in-house COVID experts, Research Analyst Camilla Oxhamre Cruse, Ph.D., and Global Strategist Olga Bitel, on why cases are rising in some areas and declining in others, where we are on a vaccine and testing, and potential risks to our base-case scenario for the global economic recovery.

Camilla's and Olga's comments are edited excerpts from our podcast, which you can listen to in full below.

https://media.blubrry.com/the_active_share/b/content.blubrry.com/the_active_share/The_Active_Share_12_COVID_19_S

We hoped summer would bring steadily falling cases, but we've seen cases rise in key parts of the world. Why is that happening?

Camilla: Case increases have varied. In the United States, we've seen case increases in states that opened early—many southern states. In other states, like New York, we've seen a decline. But in the past week, we appear to have reached some sort of peak, with both cases and death rates stabilizing. I think that's because we've learned more about the virus and how it spreads most efficiently—loud indoor environments with poor ventilation where people are in close proximity. With that knowledge, we can adjust our behavior.

Summer's nearly over. We're going to be indoors more. How will we avoid an increase in infections, and therefore a heavier economic hit?

Camilla: We shouldn't forget that we've been going through this now for months. People spent a good part of

spring and early summer basically locked into their homes. So there's a measure of COVID fatigue. And with that comes more high-risk behavior.

Olga: When the second wave comes, our respiratory and healthcare systems will be inundated by COVID-19 along with the ordinary flu, which spikes around October and November. The ability of healthcare providers to care for this case load will influence how much of a renewed lockdown we need.

But the medical community has gotten much better. We know a lot more about the virus than we did in February and March. And we're better able to deal with cases before they show up in hospitals. So our base case remains that there will be no significant lockdowns. The risk is higher in the United States and lower in Europe and in China.

Nevertheless, the risk of lockdowns raises the specter of additional headwinds to the economic recovery. But we need to remember that while industrial production (supply) is lagging, retail sales volume (demand) has already exceeded pre-crisis levels. So, there's significant room for catchup to address current levels of demand, even before we see further acceleration in demand.

What if we don't see lockdowns, but people just don't want to go out?

Olga: The fear factor is omnipresent and will likely increase as cases skyrocket. This will further limit socializing indoors. Small businesses, such as restaurants, that have mitigated this by having outdoor space will have to close in large parts of the United States, Europe, and even China. But most large-scale events have been closed to the general public, even in the summer, so they shouldn't be affected.

Will some of our behavioral changes become permanent?

Camilla: I think there will be sustainable behavioral changes that affect how we interact with others. But behavioral changes don't have to be evil. We didn't fully utilize technologies we had before, because they weren't part of our culture; now they are.

While in-person interaction is still important in the business world, working from home is working fine for many people. The same goes for trends in healthcare, such as telemedicine; we're getting more comfortable interacting with our doctors online. Post-pandemic, the pendulum might, to some extent, swing back. But it doesn't necessarily have to swing back to exactly where we were pre-COVID.

Olga: Humans are social animals, so I don't think a pandemic, however long it lasts, will disrupt hundreds of thousands if not millions of years of evolution. We've seen this in previous pandemics, in 1918 and more recently in the 1950s, when there was another flu-like pandemic. People reverted back to normal social interactions with a vengeance. I expect something similar to happen this time, when we're finally rid of this for good.

Can we talk more about how the pandemic has inspired the adoption of new technologies?

Olga: A lot of the technology-enabled social interaction and consumerism we're seeing in this pandemic was not available in previous pandemics.

Payments is a good example. Large groups, especially in southern Europe, were forced overnight to drop in-person shopping with cash and shop online with digital payments of different forms. Now that their convenience,

cheapness, and safety have been proven, I think digital payments are likely to stay.

As Camilla noted, the same thing is true of working remotely, especially for high-end services firms—accountants, asset managers, architects, etc. It doesn't mean that we'll never go back to the office. But the pandemic has forced us to rethink the quality of our daily interactions, such that we may end up going to the office three days a week rather than five. Some studies have shown this leading to a sustained increase in productivity.

We're all very focused on a vaccine; should we be more focused on testing?

Camilla: We need both. We will get a vaccine; the question is how long it will take to develop a reasonably good one for the different patient population cohorts, because we're not all equal in terms of our immunological response. Then there will be a rollout phase. We're probably looking at mass distribution of a vaccine in the fall of 2021.

What are we going to do until then? We have to get on with life, with our economy. But at the moment we're fighting an invisible virus. We don't know where it is, we don't know where it's spreading. The only way we can get control over the pandemic is to put eyes on it, and that means testing—of the symptomatic and asymptomatic.

But testing has been surprisingly poor, particularly in the United States. We have the technology, but we have struggled with the logistics. To give you an idea how much, testing has doubled over the last couple of months, but over the same period the viral spread has quadrupled.

And the testing logistics have to work across the entire country. It doesn't help if one area in the country gets control over the virus when the neighboring area does not, because the virus doesn't really know borders.

Why has testing been so slow to scale up in the United States?

Olga: This is not a problem of molecular biology; it is a problem of industrial organization. While we're great believers in free-market economies and the capitalist systems of industrial organization, rapidly scaling testing requires a centrally coordinated, organized, and even mandated response.

You're asking a company to build a large-scale manufacturing testing facility that will be closed within a year or 18 months. It's really hard to get private-sector investment to scale up very quickly for that, because most private-sector investment is geared toward longer-term payouts with more durable asset bases and business models.

How would you rate your confidence in a reasonably effective vaccine coming to market in the next six to nine months?

Camilla: We don't need the perfect vaccine. We can develop that in the second or third generation. What we need is a reasonably good vaccine, and by "reasonably good," the U.S. Food and Drug Administration means about 50% better than a placebo in reducing infection and the likelihood of developing severe disease. And I'm quite confident that we will have a reasonably good vaccine by early next year.

Data from the leading vaccine candidate will start coming out in October or November. Then we will have real-world data from sizable trials of 30,000 patients, different population cohorts, so we can compare how the vaccine works in the younger versus older population.

What do you make of claims that there are some ongoing negative health consequences for people who have contracted COVID-19?

Camilla: We tend to focus a lot on the cases and the death rate, and underestimate the morbidity of the virus, which is the impact on the body. This virus is not just a respiratory virus; it has a systemic impact—neurological and cardiovascular effects. It induces a potent immunological response, and that has a detrimental effect on the entire body. Patients survive but become critically ill, so it's a long way back to a normal, pre-infection life.

Here's a tricky but important question for Olga. As we speak, the S&P 500 Index is back at its all-time high. Why?

Olga: From my vantage point, there are a couple of reasons.

First, equity market multiples are a function of prevailing interest rates, and interest rates are a fraction of what they were in February 2020. The 10-year U.S. Treasury was a touch above 2% then, and now it's 0.6%. If you use the prevailing interest rate as your denominator and nothing else changes, you can expect equity-market multiples to be more than double their levels in February 2020.

Second, we are in the early stages of economic recovery, and valuations in the equity space tend to adjust first. Stock prices are bid up on the expectations of better earnings.

And given the extreme levels of recession, the dynamic is starker this time.

If the economic recovery slows because we all want to stay indoors, would that present a risk to equity markets?

Olga: I see two risks, the first being that the recovery is minimized by the prevailing pandemic headwinds, such that everybody suffers—akin to the scenario that we experienced in March, with at least the threat of lockdowns if not outright lockdowns.

Another risk, which I think is just as powerful but a bit more subtle, is that underneath the index gains, we're going to see a more pronounced rotation in market leadership.

Companies with the best earnings-growth visibility (quasi-technology/digital consumer stocks and select portions of the healthcare universe) have been disproportionately rewarded, and rightly so. In recessions, that happens.

But as we move into the economic recovery, what is already apparent in the macro data will start to filter through bottom-up earnings revisions and expectations for repricing more of the cyclical components of the market, such as higher-quality industrials, technical equipment, industrial commodities, higher-end chemicals, things like that.

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