

LETTER FROM EDOUARD CARMIGNAC

16.10.2020



OCTOBER 2020

Edouard Carmignac writes on current economic, political and social issues each quarter.

Paris, October 8, 2020

Dear Investor,

Of the many changes brought by the Covid-19 outbreak, one of the least expected has been the introduction of the notion of Immaculate Conception into finance. Throwing all rules of fiscal orthodoxy to the wind, governments in developed countries have sent their budget deficits into the stratosphere – and yet obtained the required funding from their central banks with total impunity. Not a dent in either their credit ratings or exchange rates.

Will this state of bliss endure? Most decidedly not. Or, to be more precise, it will endure as long as the pandemic's effects will still be with us. As long as all countries are affected by the virus in roughly equal measure, the twin imperatives of safeguarding public health and safeguarding employment will take precedence. However, the development of a reliable, widely available vaccine – which our analysis suggests won't happen until the second quarter of next year – will inevitably raise the issue of public deficit

sustainability.

Ironically, equity and fixed-income markets could wind up fearing the end of the pandemic. Yet, are there any material grounds for such fears? Our governments will indeed, sooner or later, cease operating as disposable-income ATMs. On the other hand, the elimination of the threat to public health will reboot the economic growth engine that has been running at anything but full speed. Meanwhile, central banks will no doubt want to reassert their independence, but whatever gestures they make in the direction of tighter monetary policies are unlikely to be very threatening. With national debt levels going skyrocketing, there can be no thought of significantly lifting interest rates, as today's economies are prone to powerful underlying deflationary forces that make the risk of a lasting pickup in inflation a non-starter.

What, then, is the post-Covid investment outlook? The continuation of rock-bottom interest rates will unquestionably provide major support for share prices. Tech companies in particular stand to benefit. Their future earnings will be more attractively valued now that the pandemic has highlighted both the relevance of the services they deliver and the agility with which they can respond to even dizzying increases in demand for those services. Needless to say, the healthcare sector will retain its crucial status at a time when managing the epidemic risk remains paramount. In fixed income, the Immaculate Conception notion will soon hit its outer limits as credit ratings for countries that have fared poorly in the crisis get downgraded. Given how little room central banks have to raise interest rates, exchange rates will become the primary adjustment tool. This suggests that a ballooning fiscal deficit in the United States will put the dollar under pressure. In contrast, China's success in getting through the crisis with only limited support from fiscal and monetary stimulation is likely to boost the renminbi. Last of all, resurgent forex market volatility in a period of still abundant and cheap liquidity should further sustain the price of gold, the ultimate reserve currency.

Yours truly,



Edouard Carmignac

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