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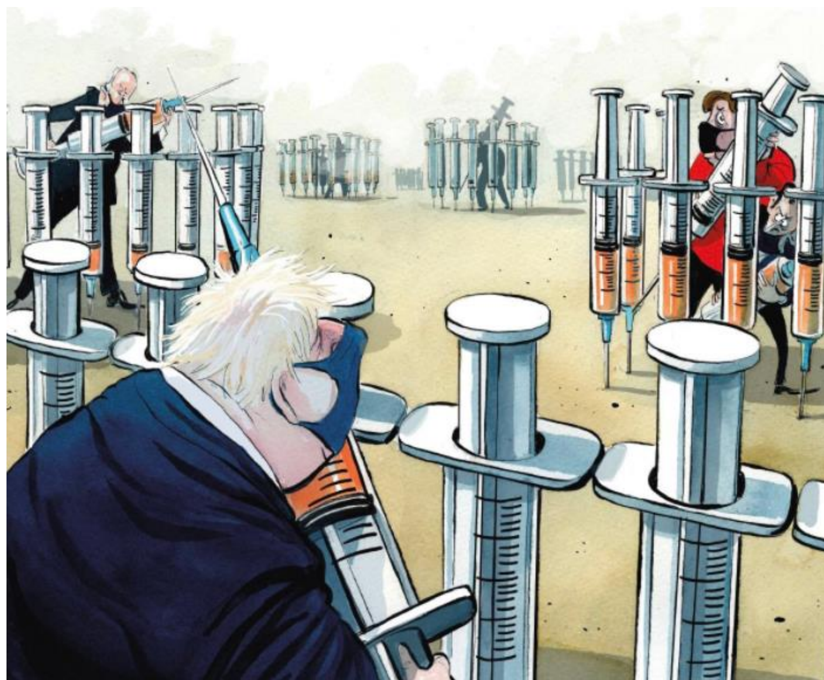


Vaccine protectionism, Morten Morland, 27 Jan 2021

A fraying of nerves

In the middle stages of the pandemic, when things had the potential for going very, very badly, there was a sense of global solidarity and unity among people and politicians. Maybe China received opprobrium – it was certainly demonised by many in the US – and the iconoclast in the White House enjoyed being different. Here in Europe, although Brexit rumbled in the background, the alien enemy created allegiance and a concerted defence effort.

But allies have returned to bickering now the enemy seems to be in retreat. Perhaps this was inevitable, perhaps it is a sign of a return to normality. The UK Government is probably enjoying being the clear leader among European vaccination campaigns, given it was its first big effort organised outside the European Union (EU). The possibility that the UK has a surfeit of vaccines may also give Johnson some bargaining chips for some of the trading issues that were not adequately addressed in last year's rushed through trade deal. Although if that is the plan, then time is of the essence, given there are reliable sources that project that come March there will be a widespread surplus of vaccine vials as production is ramping up rapidly.

Meanwhile, the fault-lines of the EU are yet again exposed. As Jonathan Eyal says in the *Singapore Strait Times*, "the 27 European states decided last year that they will give powers to the EU to procure coronavirus vaccines collectively, the move hailed as a grand gesture". But the process fell to a small, under-resourced team led by someone with no direct experience. The UK put the processes into the hands of experienced pharmaceutical professionals and generously prefunded the retooling of production facilities for unproven vaccines – all at tax-payers' risk.

So, the European Commission's ability as an executive body is back under scrutiny. However, let us not forget that the Euro appreciated sharply when the €750 billion mutual European Recovery Fund was being

negotiated (see chart below). The bonds to be raised – and the monies to be disbursed – will be in the hands of the Commission, and the event underpinned much positivity.

Meanwhile, the Italian government is falling apart, which generated some brief selling pressure in Italian government bond markets. As a whole, since the start of the year, the Euro has weakened a bit and European stocks have underperformed somewhat.

Still, holders of European equities and currency should probably not get disheartened. Indeed, one can make a case that exposing the fragility of the Commission is nothing new, and that this event means governments have a much stronger hand in enforcing change ahead of the European Recovery Fund's foundation.

For the larger European companies, the most important driver of performance will be overall global growth, although the European Recovery Fund will support domestic growth, which will be important for unloved domestic banks. Last week, stock markets giving back most of their early January gains may have had some causality with European squabbling and the Biden administration in the US facing a possible delay to its stimulus measures. However, in our opinion this is more of an overdue market consolidation than a sign for a meaningful setback to the recovery narrative.

Lastly, in the US, a stock market upset around names like GameStop is under way in the form of a 'short-squeeze' covered very widely around the world. To provide a bit more insight beyond such headlines, we have this week dedicated an explanatory article to what has been described as a retail investor revolt, but at the end of the day has more to do with groups of people sensing an opportunity to make money – while potentially being unaware of the risks they are taking. The resulting excessive levels of stock-specific volatility have potentially been more instrumental in putting a dampener on markets last week than what has been discussed above.

There was much noise coming from those involved about taking on and punishing the 'hedge fund villains' (while also making huge profits) that use shorting techniques to accelerate and profit from the demise of failing companies. We observe that this alleged 'storm on capital markets' only comes three weeks after the storm of the US Capitol by a similarly angry mob. It, therefore, has left many people wondering whether it is another expression of the deep dividedness of US society – this time between young and emancipating

retail DIY investors and the generation of Baby Boomers who hold the bulk of the nation's financial wealth through their appointed (hedge) fund managers.

Whatever the deeper reasons, this episode increases the threshold for those willing to bet on the demise of a market-listed company due to poor corporate performance. We suspect that financial regulators will swiftly address any issues of wilful market manipulation for personal gain, as this has for a very long time been a financial crime for institutional investors. If left unchecked, there is a risk that over the longer term the function of the 'invisible hand' of markets that drives capital towards its most effective use – of this usually scarce resource – is disrupted. Over the shorter term, it could reduce daily liquidity in smaller stocks and prevent all investors from being able to sell securities at what is deemed a fair price at a time of their choosing. This is because short selling is known to enhance the willingness of market participants to trade shares which may otherwise be deemed 'one-way streets', and thus unfairly deprived of access to cost-effective traded capital and forced to seek finance from banks and private equity financiers.

Internet traders take on hedge funds at their own game

As widely reported in the media, the past week in equity markets has been a wild ride through the depths of the internet. GameStop, a consumer electronics store that looked destined to be another retail casualty, saw its stock price propelled to unthinkable heights over the last five days, after retail traders turned the company into an online sensation. At the end of last year, GameStop traded at around $10 a share. Last week, it stood at $42. On Thursday, the share price hit $469 at its peak, but then fell sharply to close at $193.

This meteoric rise was instigated on social media site Reddit by members of the /r/WallStreetBets forum. Their plan is simple: find stocks that are the target of intense short-selling, then coordinate on buying that stock to force up the price and cause a 'short squeeze', catapulting share prices upward. GameStop is the most stark case, but the WallStreetBetters have targeted many previously unloved US stocks – leading to some astonishing market moves.

Last Wednesday, Wall Street trading volumes hit all-time highs, surging past the record set all the way back in 2008 as more than 23 billion shares changed hands. According to clearing house OCC, the most actively traded options were in Nokia, GameStop, Palantir and BlackBerry. All four were the topic of intense discussion and buying recommendations on Reddit. WallStreetBets, where amateur investors gather and share tips, saw its membership rise from 2.8 million to 4.3 million between Wednesday and Thursday, with around 316,000 users openly announcing their intention to buy stock options.

The trend has wreaked havoc on short sellers, most notably hedge funds. Melvin Capital, which took out a large position against GameStop, was pushed to near-insolvency after losing billions in its short positioning. The 'short squeeze' phenomenon occurs when short sellers essentially betting that some share price will go down are forced to close their positions and buy the underlying stock.

Short sellers borrow stocks from stock holders who are willing to lend them out, and then sell those borrowed shares in the market. Of course, the short-seller, who only borrowed the shares, will have to give them back to the lender at a later date. If the prices falls in that time, the short-seller buys the stock at a lower price in the market and gives it back to where it was borrowed from - and makes a profit. Short positions are a derivative of the underlying asset, but in reality they work like a simple directional call on

where that asset's price will go. This is why short positions can amount to more than 100% of the outstanding shares of a company; shares can be lent, borrowed and promised several times over, as long as there are willing buyers and sellers.

However, the risks for short-sellers are asymmetric. Prices can only fall to zero, so the upside of short sellers' bets against a stock are limited to the stock's value. But there is no limit to how high prices can go – meaning a short sellers' potential losses are unlimited. When this happens, hedge funds are forced to close their short positions and buy the stock to stop haemorrhaging capital. Buyers quickly outnumber sellers and a short squeeze ensues.

None of that is new. So why have large numbers of retail investors decided now is the time to coordinate their actions via internet chat rooms to punish hedge funds (and make a healthy profit in the process)? The media is describing the WallStreetBets phenomenon as not just a get-rich-quick scheme but a virtual protest movement. A "War on Wall Street" and "Stock Market Insurrection" have made headlines, while comparisons have been drawn to the Occupy movement and Black Lives Matter. Some have even gone as far as to lump in the Reddit investors with Trump supporting rioters, with one outlet suggesting that, after attacking the US capitol, the disgruntled public are now attacking capitalism.

These grand narratives should be tempered. While short-selling hedge funds may have been forced to endure heavy losses from the coordinated buying of stocks that fundamental investment analysis would identify as doomed, record high trading volumes and soaring share prices are hardly bad things for corporates and financial companies. We have seen many market fads over the past few years, from Bitcoin (which, suspiciously, has calmed its price movements since short-targeting came into force) to Tesla, and even the bankrupt car rental company Hertz. For many in the flash buying mob, this is just another timely and profitable bandwagon bet.

Certainly, though, there are some non-financial motivations for the mass buying. Getting one over on the politically unpopular hedge fund class of ultra-high earners is always a nice bonus for the anti-establishment investor. What this highlights to us is the growing voice – and importance – of individual retail investors. With personal investment technology now widespread, people are no longer bound by heavy entrance fees or institutional barriers to the market. Moreover, if on top they succeed in coordinating their trades by means of internet forums, they have the power to move share prices almost at will. With the pandemic leaving many with rising cash savings and barred from many everyday activities, activist day trading can seem mightily appealing.

It also exposes real problems for hedge funds in particular. Fund managers may hope that forums like WallStreetBets are banned or regulated for their role in potential 'market manipulation', but short sellers at large hardly have much of a leg to stand on here, politically speaking. Hedge funds and short sellers, after all, are the stereotypical 'bad guys' when market manipulation gets talked about, given their past success in banding together themselves to accelerate and ultimately profit from the demise of a seemingly doomed company for their own benefit and that of their investors.

The widespread, and now coordinated, presence of retail investors in the market whose actions are sometimes not driven by fundamental company investment research brings big risk for hedge funds. Not only can flash mob purchases lead to damaging market swings, but individual retail investors are also much less likely to engage in the stock lending practices that hedge funds rely on to operate. If equities are in the

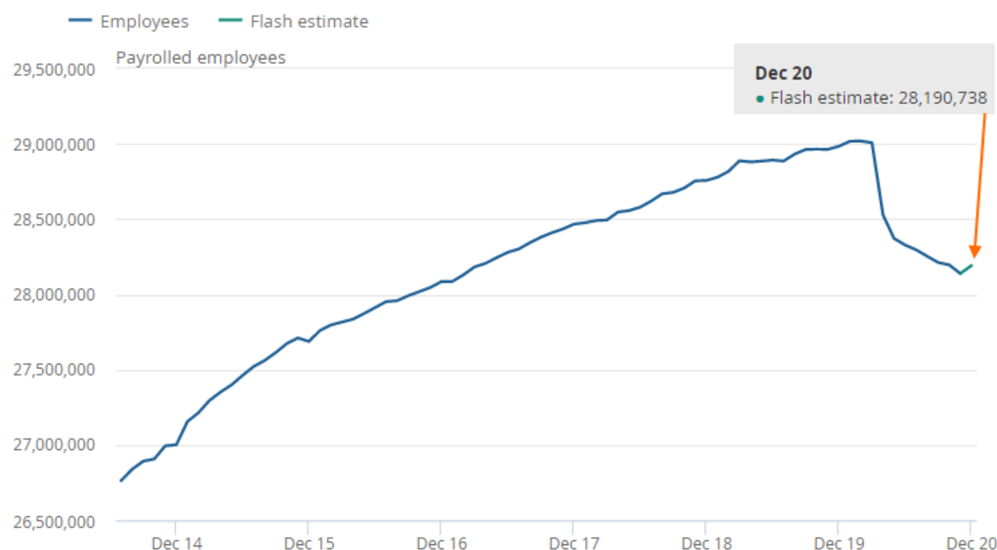
hands of those unwilling to lend them out, liquidity dries up for short-sellers and they must scramble to cover positions, further amplifying the short squeeze dynamics that drive the prices to stratospheric heights.

In the short run, we suspect these dynamics will lead to some risk aversion from short sellers, potentially buying more cover for their positions. In the long run, the biggest risk and potential damage is likely to be for those internet buyers who jump on the bandwagon late. As with any gamble, sooner or later your luck runs out.

Unemployment figures aren't reporting unemployment

The labour market will be at the heart of a post-pandemic economic recovery. We are in the middle of Britain's sharpest recession in hundreds of years, but this is not any normal downturn. The virus and repeated lockdowns have reduced demand and, once restrictions are substantially eased, activity will certainly rebound. But the induced recession can easily turn into a 'classic' recession, with its hallmark of low consumer demand, defaults and deflation and especially high unemployment. The UK Government is spending billions on furlough payments and other subsidies to prevent unemployment from spiralling.

Keeping an eye on the labour market is therefore a vital part of assessing Britain's economic outlook. On that front, headlines last week were both a little gloomy and somewhat encouraging. According to the



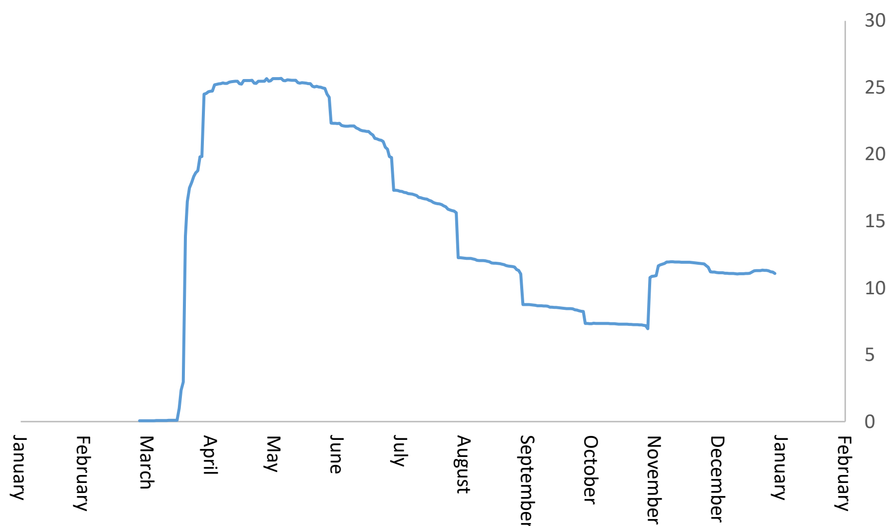
Source: ONS, Tatton IM

Office for National Statistics, the UK's unemployment rate rose to a four-year high in November, while the number of redundancies was similarly high. But the actual figure was more comforting: 5% (1.72 million) of Britain's workforce looking for a job were unable to work in the three months to November (as per the international definition of unemployment), 0.6% higher than in the previous quarter and 1.2% high than the year before.

For the worst recession in living memory, that is not a bad statistic – and better than expected. More granular weekly data, not used in the survey on which the unemployment data is based, suggest that the biggest chunk of job losses came in September and October, while the number out of work remained mostly flat in November. Redundancies seem to have peaked, with rates holding steady into the end of the year. The PAYE source even suggests payrolls have started to tick up, as shown below.

With the vaccination programme well underway, and the second half of the year looking brighter than the first, this is a decent enough starting point.

As always, there are complications to the picture. The Government is still handing out billions of pounds in furlough payments to around 3.82 million furloughed employees (some 11% of the workforce – see chart below) and, with an indefinitely long economic shutdown again underway, this will almost certainly need to be extended at the Chancellor's Spring Budget. Such fiscal cushioning makes labour market fundamentals hard to assess. The jobless increases in September and October, for example, came as businesses were told emergency support would end – with unemployment only falling when the Government reversed its decision in November.



Source: HMRC, ONS, Tatton IM

Another aspect arises around 'migrant' workers. According to research from the Economic Statistics Centre of Excellence, 1.3 million foreign-born workers (close to 2% of the workforce) left the UK between July 2019 and September 2020. Brexit impacts and a COVID-ravaged economy forced the exodus, which hit London's 'domestic' demand particularly hard. Almost 700,000 of leavers came from the capital, meaning London lost nearly 8% of its population in just over a year, hitting the businesses supplying their day-to-day needs.

In normal times, this free flow of labour could be a positive for businesses, suggesting a workforce pool able to respond dynamically to decreased demand. But with post-Brexit immigration rules and no clear end to the pandemic in sight, this could become a permanent demographic shift, leading to a shortage of labour. That would be difficult for businesses, but the remaining workforce should benefit relatively. And, once an economic recovery is underway, you would expect Britain to be able to attract labour from elsewhere if

needed. But politics complicates the situation. With its new points-based immigration system, the Government may not be quick enough to spot supply gaps, or be able to replicate the benefits of market forces regulating a natural free flow of people.

There are also concerns about the disparities in the labour market. For those with stable employment and a stock of pre-existing savings, the pandemic has been mighty kind to their balance sheets – helped by Government support schemes and enormous monetary easing from the world's central banks. Those without such a cushion have struggled, with only a fraction of their wages being paid and no job prospects to be found.

Age disparity is another big factor. For at least 30 years, the demographic that benefitted most from growth in employment has been the over-50s, with an increased share of the workforce and disproportionate share of wage growth. So, in absolute terms, it is no wonder that jobless claims from this older cohort has increased.

Relatively speaking, however, the under 50s – and particularly under 25s – have been hit hardest, with unemployment increasing the most in those categories since the pandemic. There are many reasons for this, with younger workers much more likely to be employed in virus-hit sectors like hospitality, as well as having less stable or senior positions. But the result is a more uneven labour market and greater inter-generational inequality.

Inequality between age groups was a theme long before the pandemic, but like many issues, it has been accelerated by the virus. The perceived direct health threat from the virus is clearly lower for younger people, and yet in aggregate they have shared a heavier economic burden and will be last in line to receive vaccinations (and perhaps even the last to regain old freedoms). This is likely to increase the political divide between generations that has become so acute in recent years, with the potential of leading to a boiling over of tensions, towards social unrest as we saw in the Netherlands last week.

Addressing these problems is no easy task, but an extension of furlough and other emergency support schemes is sure to be the first port of call. The silver lining to the grim 2021 we have had so far is that the virus has forced Government budget hawks back into retreat. But unfortunately, emergency support will have to be withdrawn sooner or later. At that point, we will see the full extent of the damage to Britain's labour market. Until then, policy will be key to avoiding the worst of it.

Global Equity Markets

Market	Fri 15:33	% 1 Week*	1 W	Technical Short	Technical Medium
FTSE 100	6449	-3.7	-246	⬂	⬈
FTSE 250	20274	-1.6	-323	⬀	⬈
FTSE AS	3662	-3.3	-124	→	⬈
FTSE Small	6218	-2.6	-169	⬈	⬈
CAC	5447	-2.0	-113	→	⬈
DAX	13560	-2.3	-314	⬀	⬈
Dow	30442	-1.8	-555	→	⬈
S&P 500	3765	-2.0	-76	⬀	⬈
Nasdaq	13297	-1.8	-246	⬈	⬈
Nikkei	27663	-3.4	-968	⬀	⬈
MSCI World	2711	-1.6	-45	⬀	⬈
CSI 300	5352	-3.9	-218	⬈	⬈
MSCI EM	1351	-3.0	-42	⬈	⬈

Global Equity Market - Valuations

Market	Div YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	3.3	19.2	14.7	13.9
FTSE 250	1.9	18.6	21.1	15.1
FTSE AS	3.0	19.0	15.5	14.0
FTSE Small x Inv_Tsts	1.8	17.8	-	15.0
CAC	2.0	22.1	17.3	14.4
DAX	2.7	23.3	15.4	13.1
Dow	2.0	22.1	20.2	15.9
S&P 500	1.6	27.3	22.4	17.0
Nasdaq	0.7	35.1	33.5	21.8
Nikkei	1.5	28.3	24.3	17.3
MSCI World	1.8	25.9	21.2	16.1
CSI 300	1.6	19.9	15.9	12.4
MSCI EM	1.8	21.4	16.2	12.3

Top 5 Gainers / Top 5 Decliners

Company	%	Company	%
Micro Focus Int'l	+13.4	Prudential	-15.1
Pearson	+11.4	Imperial Brands	-10.1
Hargreaves Lansdown	+4.3	Whitbread	-10.0
Centrica	+4.1	Rolls-Royce	-8.9
British Land	+2.8	Glencore	-8.5

Currencies / Commodities

Pair	last	%1W	Cmdty	last	%1W
USD/GBP	1.373	+0.4	Oil	56.10	+1.2
GBP/EUR	0.885	+0.5	Gold	1860.5	+0.3
USD/EUR	1.21	-0.2	Silver	27.32	+7.2
JPY/USD	104.70	-0.9	Copper	358.8	-1.0
CNY/USD	6.43	+0.8	Aluminium	1984.5	-0.7
Bitcoin/$	37,180	+11.6	Soft Cmdties	407.1	-1.7

Fixed Income

Govt bond	%Yield	1 W CH
UK 10-Yr	0.32	+0.01
UK 15-Yr	0.54	+0.01
US 10-Yr	1.08	-0.00
French 10-Yr	-0.28	+0.00
German 10-Yr	-0.51	+0.00
Japanese 10-Yr	0.05	+0.01

UK Mortgage Rates

Mortgage Rates	Jan	Dec
Base Rate Tracker	1.50	1.50
2-yr Fixed Rate	1.79	1.81
3-yr Fixed Rate	2.05	2.05
5-yr Fixed Rate	1.98	2.00
10-yr Fixed Rate	2.55	2.55
Standard Variable	3.62	3.62

* The *% 1 week* relates to the weekly index closing, rather than our Friday p.m. snapshot values
** LTM = last 12 months' (trailing) earnings;
***NTM = Next 12 months estimated (forward) earnings

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