



OAK INVESTMENT MANAGEMENT GROUP



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Covid 19: What we have learnt

The human world is emerging from wilfully ceasing all physical interaction for three months. Flus and pandemics are nothing new, but our reaction to Covid-19 most certainly is. The cause of the quick spread (global travel), our novel reaction (instant information) jars with our systematic approach (segregation) and individual treatment (intensive care) the former which is literally thousands of years old and the latter perhaps one hundred years old.

At the same time, the search for an antidote bypasses the ethical question of, is that the right thing to do as a society? Counter-intuitively breaking the chain of viruses that go to, from and around us might have profound implications. On the other hand, the mention of 'herd immunity' created a political storm in the UK because that was presented as if individuals were being sacrificed for the greater good: Even though on the evidence so far, this is the only way that the disease will be normalised. All this comes to a largely materialistic world, devoid of God or overarching principles from whom death is usually hidden away. On a personal level, few have been exposed to the conscious heroism of their own societies one hundred years ago, for whom the deaths to date would constitute one battle.

Leaving aside questions of the actual virility of the disease, the 'noise' associated with co-morbidity of victims and pre-emptive statistical assumptions about the spread of the disease itself, what have we learnt about the human world in which we live? And divining material advantage from a human tragedy, how can this be read to investors advantage going forward?

In the West we live in a rich, democratic and thus sentimental world. Any money that can be thrown at a perceived danger will be. This is predictable, right and proper but fraught with danger. In the panic of the moment, governors risk recalibrating the economy of the governed for many years to come. This is fundamentally different to command economies or state guided economies of the East for whom operation is already intimately connected with predilections of their governments. Therefore, although this was a large economic shock and was relatively consistent across the planet it is likely that it will make the West relatively less rich, less democratic and eventually less sentimental.

Just like the World Financial Crisis of 2007/8, the simultaneous consensus of the West to insulate as many private economic entities as possible from most of the immediate economic shock of Covid-19 in 2020 has profound consequences. In both instances there has been an explicit large transfer of private to public debt as well as an implicit nationalisation of risk. This means that for the first twenty years of the twenty first century the state in the West has defined the normalised rate of growth for their economies and, whilst still abstaining from as much interference in the manner in which economies have been run, is converging with the East. Globally, therefore, the signalling power of money is being muted bringing: misallocations of resources; future sub-optimal returns; clustered systemic risk and the debasement of the savings for the current and earnings of future generations.

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From a practical point of view insulation in the short-term from an economic shock is just that – it is insulation not payment. The bill will need to be paid and government *per se* does not have any resources other than the power to tax. Unlike the East in the West the bill will need to be paid consensually, with parliamentary scrutiny and control; support of opinion makers; economic stakeholders; and ultimately the plurality of the people. Payment will be evenly spread at not fall on the shoulders of a compliant state-controlled behemoth

There are three options facing the Western governments deal with this situation. First would be to raise taxes and cut spending; second would be to stimulate economic activity by lowering taxes and increasing spending (ballooning their balance sheets even more in the short term); and third, would be to debase their monetary base – and since we live in a highly interdependent economic world this would be a competitive debasement.

Notwithstanding their incompatibilities, judging on prior actions democratic governments of the West are likely to do all three simultaneously. This was the inconsistent manner in which President Franklin D. Roosevelt went about rebuilding the USA in the 1930s. It is telling that the terminology has been deployed by Boris Johnson's Conservative and populist government recently.

What is the investor to do in view of what is coming? Side-step zombie companies with high volume and low margins (they will have their reckoning soon); seek businesses with productivity and resilience (products that consumers are likely to need and are not sensitive to pricing pressures); aim for solid cashflow and competitive positioning (barriers to entry will increase and benefit well-entrenched players); optimise debt (equity rich companies will make a tempting target for government taxation); prepare for a much more localised world (onshoring or nearshoring already started will be increasingly important as globalised trade becomes more segmented); drive efficiencies through lower head count and technology (governments will target income as a wide tax net, not only increasing unemployment but also increasing the required income of the employees who are left).

Private companies of the West will be tested as never before by the bill they will be expected to pay for the Pandemic both directly through their operations and indirectly through their taxes which ultimately all come from for-profit economic activity. Though many will fail, those that survive will succeed and thrive. Capitalism is the notion that there is not an endless supply of capital, as opposed to what is 'promised' by command economies around the world. Even the richest societies in the world cannot efface this notion, or if they do they face a long or a short road to poverty, and with poverty to serfdom. In this way, although painful the restriction of capital is inevitable, is coming and is salutary.