June 2020

The Post COVID-19 Investing World
Version 1

What will be the long-term impacts of COVID-19 and the lockdown of economies around the world?

FORSYTH BARR

This is Version 1.0 of our post-COVID views. The outlook remains highly uncertain, and our views will evolve and may change.

Making predictions amid the "fog of war" is always difficult. People tend to over-extrapolate current impacts into the longer-term. Following the 9/11 terrorist attacks many were predicting people would stop flying and no longer want to work in high-rise buildings. But only six months later travel had bounced back to normal. And the Freedom Tower, built on the site of the destroyed World Trade Centre, is the same height as the original buildings.

Furthermore, we don't even have clarity over the near-term, let alone the long-term. There are a few things we do know. Global economic activity will see the largest fall in modern history. Policymakers have responded with massive stimulus. And economies are steadily reopening. But how long will the virus's social and economic disruption last? Will there be second and third waves of the virus? If, and when, will there be a medical solution? To what extent will policymaker actions limit long-term damage to economies? What shape will the eventual economic recovery take? These unknowns will have a bearing on the long-term implications.

For the immediate future the market will remain focussed on the virus's containment (or not), the lifting of lockdown measures, and the impact on economic activity and company profits. But investors should also consider longer-term implications.

Subject to the above caveats, we see a post-COVID world that is more indebted, slower growing, higher taxed, more digital, less global, and more local. We believe both corporate earnings growth, and steady and reliable income will be scarcer and prized by investors.

> "...we see a post-COVID world that is more indebted, slower growing, higher taxed, more digital, less global, and more local."

Higher debt

Probably the easiest post-COVID prediction to make is the world will have higher debt, particularly governments.

Even before the crisis many major governments were running fiscal deficits and facing rising debt. Governments have committed unprecedented sums to assist people and businesses through lockdowns, and support recoveries on the other side.

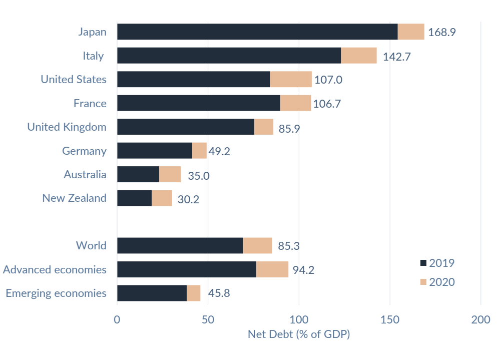
Forecasts have most developed world countries' sovereign debt rising by around 15% to 25% of GDP collectively hitting the highest level since World War II. Emerging market debt is expected to reach the highest level ever.

75 years ago repayment of debt was helped by the baby boom and strong population growth in the decades that followed. Today we face the opposite, the world's population growth is slowing (populations are in natural decline in many countries), and the ageing population means higher pension and healthcare costs for governments. Rebuilding balance sheets through normal measures (growth and/or austerity) looks highly challenging (at best).

On the positive side, supressed inflation, low interest rates, and government-central bank coordination means a sizeable debt load is more manageable than it was in the past.

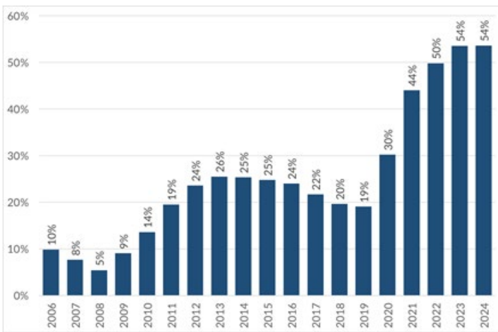
Fortunately, New Zealand entered the crisis with one of the strongest sovereign balance sheets in the world. In May's budget the government committed NZ$50 billion to a COVID-19 Response and Recovery Fund, albeit much of this commitment remains unallocated. Treasury's base case forecast is for net debt/GDP to rise from 19% in 2019 to 54% in 2023, still low by global standards.

GOVERNMENT NET DEBT/GDP



Source: IMF, NZ Treasury, Forsyth Barr analysis

NZ GOVERNMENT DEBT TO GDP



Source: NZ Treasury, Forsyth Barr analysis

Lower economic growth

Global real economic growth has been trending lower for decades due to a combination of structural (demographic) and long-term cyclical factors (high debt, declining productivity improvements). Barriers to growth have likely only been exacerbated.

1. Demographics

Whilst not a change due to COVID, the demographic headwind will steadily strengthen in the decades ahead. Due to a declining birth rate and increased life expectancy, growth in the world's population is slowing and the population is ageing. One impact (of many) is slower economic growth. Slower growth in the world's working-age population means slower growth in incomes as well as demand for goods and services, and less need for investment in new production capacity.

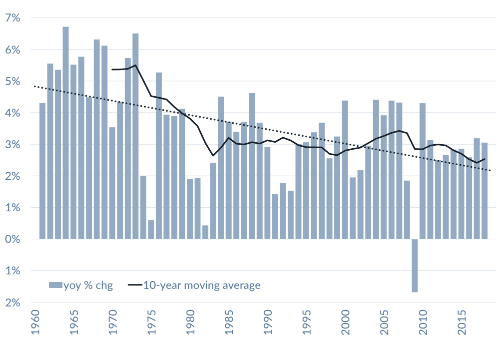
In most developed countries the working age population is forecast to actually decline. In Japan, Europe, and China it already is. In contrast, the United States, Australia, and New Zealand are in the minority of countries in which growth is expected to remain positive, albeit at a slower rate. The expected growth is solely due to immigration. Immigration policies and patterns will significantly influence economic growth in individual countries in the years ahead.

2. High debt

Global economic growth benefited from 80 years of debt accumulation. Rising debt allows consumers, businesses and governments to "pull forward" consumption and investment — have now, pay later. If appetite for more and more debt subsides, investment is limited to growing in line with (slowing) population and productivity growth.

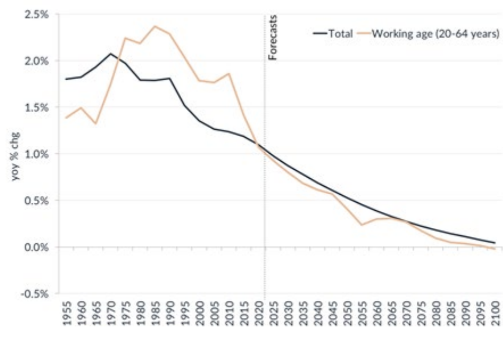
Studies consistently show a negative correlation between debt and economic growth over the long term. An IMF study estimates that each 10% increase in debt-to-GDP slows annual real per capita GDP growth by around 0.2 percentage points per annum. Evidence also suggests non-linearity, with the restraint on growth rising as debt increases, particularly above 90-100% of GDP. Lower growth reflects lower investment, and therefore less growth in capital stock and labour productivity.

WORLD REAL GDP GROWTH



Source: World Bank, Forsyth Barr analysis

WORLD POPULATION GROWTH RATES



Source: United Nations, Forsyth Barr analysis

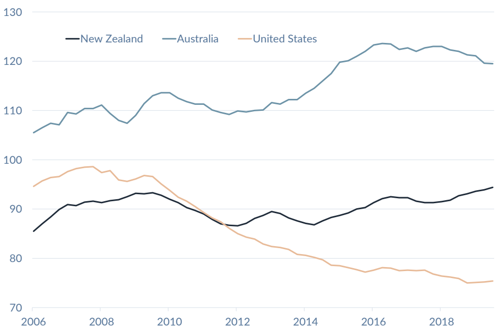
3. Increased savings

The severe economic shock could change households and companies' mindset to debt.

COVID will impact earnings and wealth. Balance sheets will need to be repaired. After two major crises in thirteen years we could see increased aversion to debt, and greater desire for stronger balance sheets and precautionary savings despite low interest rates.

Post the Global Financial Crisis (GFC) we saw a mindset shift and multi-year deleveraging of US households. Could this now happen in high household debt countries like New Zealand and Australia? Or across businesses broadly?

HOUSEHOLD DEBT AS % OF GDP



Source: Thompson Reuters, Forsyth Barr analysis

4. Excess capacity

The COVID demand shock and lift in unemployment will, in general, release capacity in economies and reduce the medium-term need for investment.

Ultra-low interest rates may support a higher number of zombie companies in the economy. A "zombie company" is one which is generating just enough cash to service its debt. Its lenders don't pull the plug on credit, so it limps along, but doesn't have enough money to invest and flourish. Zombie companies mean less capital destruction, greater industrial overcapacity, and more competition pressuring corporate margins.

Low interest rates (at least in the near term)

The COVID crisis has only further entrenched central bank commitments to ultra-low interest rates.

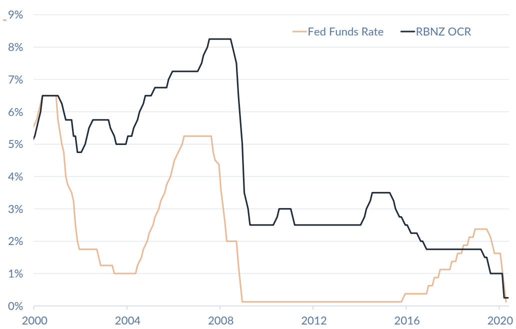
Over the past decade a combination of high debt, anaemic economic growth, and threat of deflation has meant unconventional central bank policies like negative interest rates and QE (quantitative easing, the purchasing of government bonds or other securities) have become conventional.

Furthermore, the higher the debt levels, the more the cost of servicing will rise if interest rates rise. All else equal, higher debt means central banks can change interest rates by less to have the same expected impact on the economy.

Pre-COVID the RBNZ had already expected "interest rates will need to remain at low levels for a prolonged period". The COVID demand shock and resulting lift in unemployment will only compound the challenges.

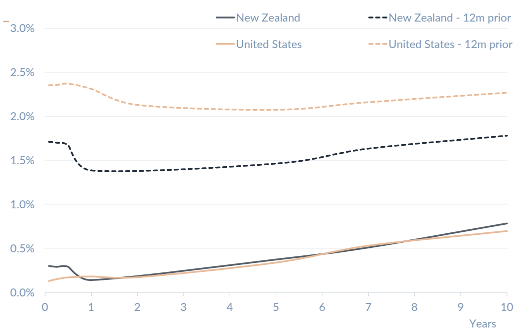
The majority of central bank cash rates are now effectively at zero, and quantitative easing is being used to put pressure on longer-term rates (either explicitly or implicitly).

CENTRAL BANK CASH RATES



Source: Thompson Reuters, Forsyth Barr research

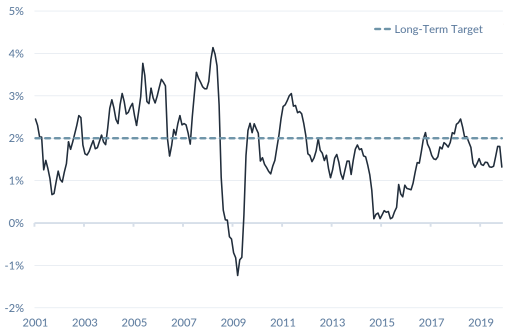
GOVERNMENT BOND YIELD CURVE



Source: Thompson Reuters, Forsyth Barr research

Even if inflation emerges medium to long-term we expect central banks will be reluctant to raise rates. The US Federal Reserve has an explicit "symmetric" 2% inflation target, i.e. an average 2% inflation target over time. Even if inflation starts to rise, we expect the Fed would justify ongoing easy policy given inflation has consistently undershot its target over the past decade. Fed officials have predicted the cash rate will remain close to zero until at least the end of 2022.

US INFLATION (PCE INDEX)



Source: Thompson Reuters, Forsyth Barr research

Some worry we may be seeing a decline in central bank independence. Central banks' quantitative easing (buying government debt) is effectively enabling much of the massive government rescue and stimulus spend. There is precedent. During World War II, the Fed agreed with the US Treasury to hold long-term rates below 2.5%. This agreement continued until 1951 to ensure the post-war demand for credit wouldn't cause a spike in interest rates and undermine the recovery. We could see a similar (albeit likely less formal) arrangement in coming years. The risk is, in time, too much government spending fuels inflation.

Greater economic vulnerabilities

Over past decades each successive crisis has been tackled with heavy fiscal stimulus, lower interest rates, and more extreme monetary policies. Each subsequent cycle has begun with higher debt. Balance sheet expansion increases financial fragility. And each subsequent crisis has required an even more extreme economic remedy.

The current crisis clearly isn't a financial one, but the previous one was. The GFC started with a mispricing of risk in the US housing market. Will today's ultra-easy financial conditions create excesses and imbalances down the road? The Federal Reserve's response to the tech bubble bursting in 2000 helped fuel the US housing bubble in the years that followed. Where are imbalances building today? Are we sowing the seeds of the next financial crisis?

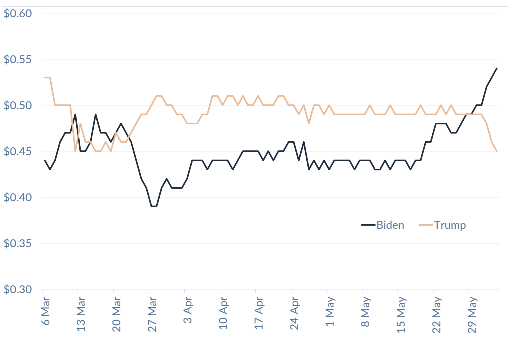
Higher taxes?

How governments respond to higher debt levels will vary. Options include austerity, increased taxes, inflation, financial repression, or just printing money.

- **Austerity:** The post-GFC turmoil in countries such as Italy and Greece highlights the political challenge of tightening budgets and imposing economic pain on the populace. This seems even less likely now given probable demands for greater investment in areas of the public sector like healthcare.
- **Taxes:** A more politically palatable alternative could be higher taxation, particularly for corporates and higher income earners.

In many countries corporates have enjoyed lower tax burdens in recent years. Politically, these may prove hard to sustain after another round of taxpayer-funded bailouts. In the US, Democrat Presidential candidate Joe Biden's tax policies include lifting the corporate tax rate to 28%, partially reversing the 1 January 2018 cut from 35% to 21%. A 7% lift would reduce the S&P500's earnings by c.9-10% (based on 2019 levels). In New Zealand, by way of example, a 5% increase in the corporate tax rate would reduce earnings by c.7%. New Zealand's imputation regime may mean a lift in corporate taxes is not value fully lost to investors (dependent on any tax rate changes to individuals and investment funds).

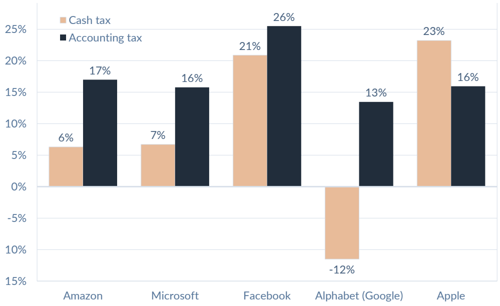
US PRESIDENTIAL ELECTION ODDS



Source: PredictIt, Forsyth Barr analysis

Large, transnational companies are likely to be a target, particularly big tech which pays low effective tax rates. This was already on governments' radar pre-crisis, and is only likely to escalate in priority.

EFFECTIVE TAX RATES (2019)



Source: Company reports, Forsyth Barr analysis

Growth in inequality around the world (likely only worsened by COVID) and demands for fairness means higher income earners are more likely to be targeted. Measures might include taxes on capital gains, income, gifts, inheritance, wealth, and/or financial transactions. The current New Zealand Government has ruled out capital gains taxes, but plans to announce policies before September's election.

- **Inflation:** Governments and central banks are likely to be biased toward higher inflation. Inflating away government debt, however, is not as simple as it first appears. Firstly, as the past decade (and longer in Japan) has highlighted, generating inflation is not necessarily straightforward. Secondly, a large part of government spending is typically linked to inflation. Higher inflation lifts government deficits.
- **Financial repression:** Forced ownership of government bonds by institutions such as banks, pension funds, and insurers, coupled with quantitative easing and yield curve management programmes, helps supress government borrowing costs. Ultimately, the lower returns are passed through to conservative savers.
- **Printing money:** A currency-issuing government (such as New Zealand, Australia, the United States, and Japan) can always digitally print money. That, in effect, makes borrowing voluntary. As shown by Japan, yield curve control also means countries can also control the cost of borrowing. In practice, countries continue to borrow to exhibit discipline, maintain confidence in the currency, and prevent unconstrained expenditure and resulting inflation. Where will government appetites or the market's tolerance for monetisation of debt peak?

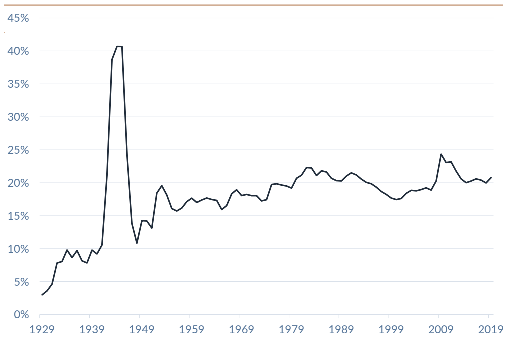
Bigger government

The phrase, originally attributed to economist Milton Friedman, “we are all Keynesians now” is again being appropriately used to describe government responses to a crisis. Governments typically play a larger role in economies during crises, a position which doesn’t fully revert once conditions normalise.

A lender of last resort: Around the world governments are providing grant and loan schemes to support businesses. For many the consequences are extreme. Whether they can access government funding or not will determine whether they survive, e.g. airline, tourism operators, hospitality.

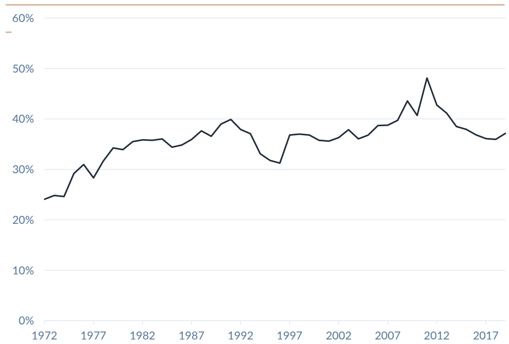
- **An investor:** Infrastructure will be a key cornerstone of stimulus packages aimed at refloating economies. These will be crucial to fill the hole in private sector investment. President Trump has called for a US$2 trillion infrastructure package. Infrastructure investment is central to China’s ¥4.75 trillion stimulus plans. This year the New Zealand Government has added NZ$15 billion to the medium-term infrastructure budget.
- **Healthcare:** There’ll likely be demand for reinforcing healthcare supply chains of critical medical products, greater capacity to deal with pandemic outbreaks, and, possibly, in the healthcare sector more broadly.
- **An owner of assets:** State bailouts could mean increased government ownership of previous private-sector assets. As an example, in New Zealand there is a distinct possibility that some or all of the government’s NZ$900 million debt support for Air New Zealand is converted to equity. The current Deputy Prime Minister has already called for changes to the company’s business model: “It won’t have a bottom line profit margin, but it will have contingencies which will show its value to the national economy”.
- **Provider of state welfare:** Increased unemployment means more people are reliant on state aid for income. Growth in inequality could see greater redistribution policies.

US FEDERAL GOVERNMENT SPEND AS % OF GDP



Source: Federal Reserve Bank of St. Louis, Forsyth Barr analysis

NZ GOVERNMENT NET EXPENDITURE AS % OF GDP



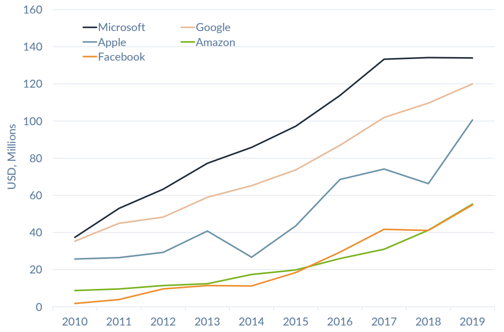
Source: NZ Treasury, Forsyth Barr analysis

Leading companies could become even more dominant

Leading companies in industries with high barriers to entry could become more dominant. The cost of capital for venture capital could be higher. Slower overall economic growth will make it harder for smaller companies to grow revenue and new entrants to gain traction. Corporates with strong balance sheets will continue to invest and see increased, and more favourably priced, acquisition opportunities.

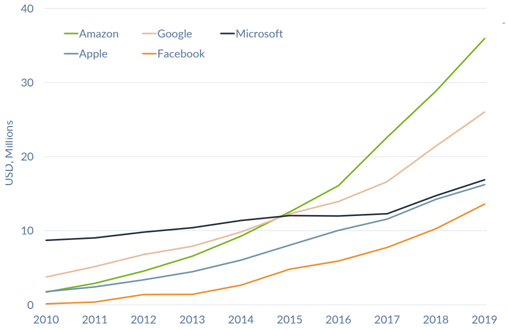
Big tech, some of the largest companies in the world and with substantial cash balances, are a case-in-point. In the past two months Alphabet's (Google) self-driving vehicle venture Waymo has raised an additional US$3 billion of external investment. In contrast, Uber is cutting US$1 billion in fixed costs, laying off a quarter of its workforce, and reducing venture investment such as its work on self-driving vehicles.

CASH AND SHORT-TERM SECURITIES

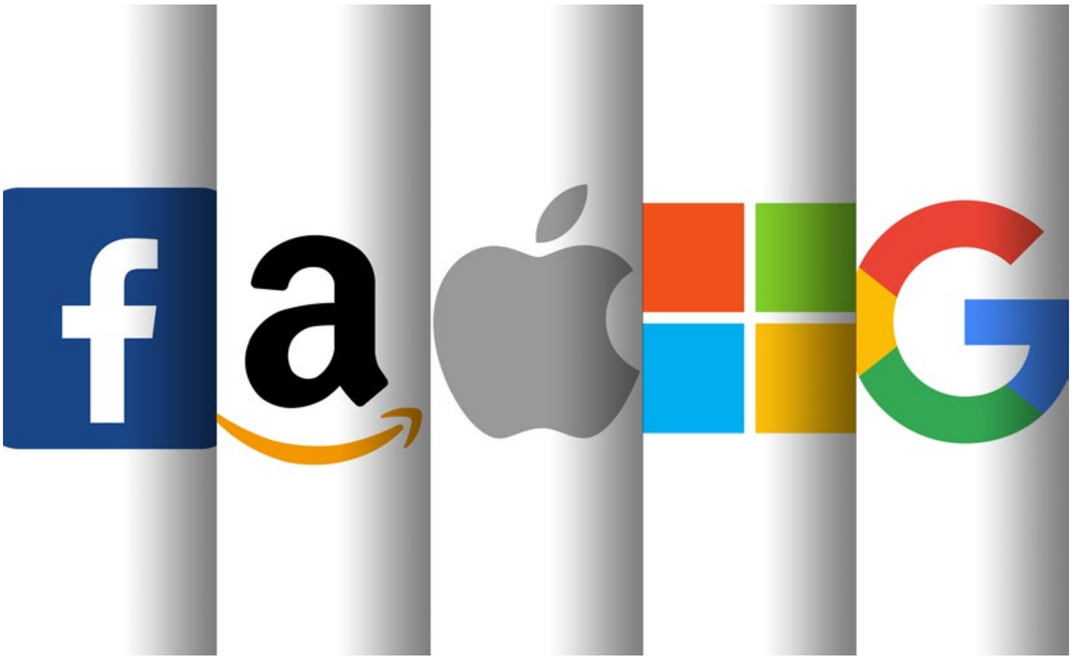


Source: Thompson Reuters, Forsyth Barr analysis

ANNUAL RESEARCH AND DEVELOPMENT



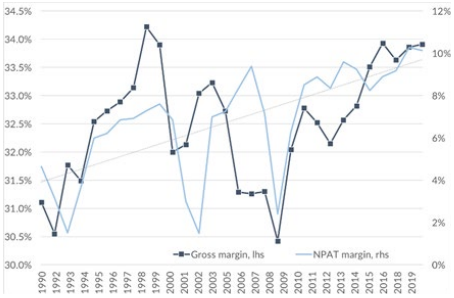
Source: Thompson Reuters, Forsyth Barr analysis



Margin pressures, particularly in competitive industries

Over recent years, US corporate profit margins have risen to record levels helped by tax cuts, low interest rates, and low cost inflation including benefits from globalisation (such as low-cost manufacturing and supply chains).

S&P500 GROSS AND NPAT MARGINS



Source: Bloomberg, Forsyth Barr analysis

In many competitive industries a combination of reduced demand and a low cost of capital (including resulting corporate zombification) may intensify competition and pressure gross margins. Additionally, a shift in corporate focus away from driving efficiencies, including from outsourcing to low-cost countries (globalisation) to supply chain resilience (de-globalisation), may lift operating costs.

Accelerating digital adoption

The shift to digital is clearly not a new trend. Technology has been the clear sector winner over the past decade, transforming how businesses operate and households consume. But the current crisis has only accelerated that trend. Microsoft CEO Satya Nadella summed it up: "We have seen two years' worth of digital transformation in two months".

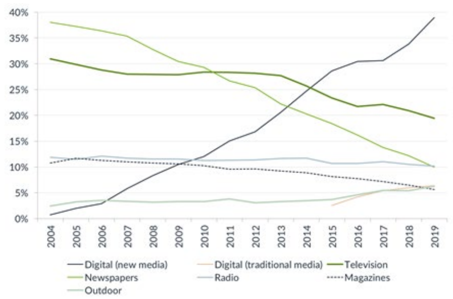
Restrictions on travel and social interaction have forced everyone — governments, companies, schools, and individuals — to embrace digital. Many changes have delivered productivity benefits and will prove enduring. Companies are now more likely to move their information technology to the cloud, and have staff working from home. Households are more likely to consume digital content and shop online.

Increased working-from-home (WFH) may reduce the need for office space, or shift housing demand from inner cities to the suburbs. WFH is not a new consideration — in a two-year internal study, Google concluded there was no significant difference in the performance of remote and co-located teams. But uptake has likely been accelerated. Tech companies Twitter and Square have announced all employees will have the option to WFH permanently. Facebook has said it will also allow some employees to work remotely full time and expects 50% of its workforce to be doing so within five to ten years.

In New Zealand, call centre customer satisfaction of customers of telco company Vocus actually improved during lockdown. Vocus is now closing its physical call centre, with the 200 or so staff shifting to permanently WFH. A win-win-win — more satisfied customers, happier staff (100% support the move), cost savings for shareholders.

One surprise through the lockdown has been the resilience of digital advertising revenue. Advertising is the principal form of revenue for tech giants Alphabet (Google) and Facebook. Digital has been steadily, but rapidly, taking market share from traditional media, chiefly TV, newspapers, and radio. This accelerated during lockdown. While many companies pulled or reduced advertising, many also shifted more to digital. It helped that people stuck at home were spending more time online. Digital also benefited from its relatively lower pricing, actionable ads (e.g. click to buy), and digital's better ability to measure the customer response (i.e. how many clicked on an ad or made a purchase).

PERCENTAGE OF NEW ZEALAND ADVERTISING SPEND



Source: Advertising Standards Authority, Forsyth Barr analysis

Looking forward, the attrition rate of media and retailers who've failed to transition to a digital world will likely rise. Will there be greater e-learning or telemedicine? And what about business travel? Will the savings in time, cost, and carbon emissions outweigh meeting in person?

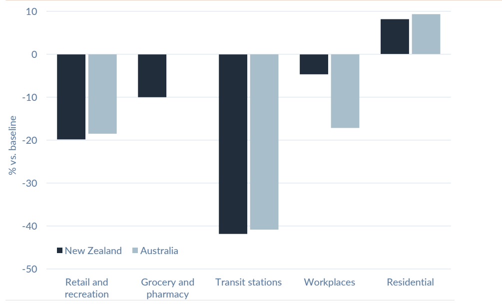
Technology companies that are able to monetise the ongoing digital revolution are likely to be members of a select group that can deliver material earnings growth in a low-growth world.

Other potential trend accelerants?

We reiterate, people have a tendency to over-extrapolate short-term impacts into the long-term. We do believe, however, COVID could be a trend accelerant in the following segments.

- **Healthcare:** Healthtech may support opening up of economies (Immunity Passports), personal monitoring (wearables/smart watches), and boost efficiency including by shifting the point-of-care to the patient (telemedicine, personal medical devices such as digital stethoscopes, portable ECG monitors, and digital otoscopes which can be used at home and the results shared electronically with doctors). Medium to long-term technologies, such as robotic surgery and artificial intelligence-aided diagnostic imaging, could make healthcare more effective, efficient, and accessible.
- **Robotics and automation:** Automated factories, that utilise less labour, have been less disrupted by social distancing. Increased online shopping will boost warehouse automation. Investment in automation and robotics may help to offset increased operating costs for businesses due to de-globalisation and a desire to shorten and reinforce supply chains (discussed further below).
- **Food:** Will COVID accelerate or slow the trend toward healthier and more sustainable foods, including meat alternatives, low/no-alcohol beverages, and local manufacturing? Consumers may demand greater food chain safety and transparency. Or will the economic impact mean many can no longer afford the typical price premium and revert to lower cost products? Increased food delivery seems likely to last. Many restaurants have ramped up delivery services. Google mobility data suggests more New Zealanders have returned to work than to the supermarkets — greater online grocery shopping is now probably the norm.
- **Digital cash and crypto currencies:** Like all things digital, COVID will likely accelerate greater adoption of fintech (financial technologies). The health risk of handling cash could promote greater use of digital cash — the World Health Organisation has encouraged cashless transactions. Massive quantitative easing and resulting concerns about the debasing of fiat currencies could boost adoption of crypto currencies.

GOOGLE MOBILITY DATA (WEEK TO 7 JUNE)



Source: Google, Forsyth Barr analysis

Boost for Brand New Zealand?

New Zealand's success in containing and (hopefully) eradicating COVID should be good for Brand New Zealand.

New Zealand edges back to normal after quashing coronavirus in 49 days

Washington Post

WORLD

New Zealand Has Just One Remaining Case of Coronavirus

It's one of only a few countries pondering the possible extinction of the pathogen within its borders

Wall Street Journal

Vanquish the Virus? Australia and New Zealand Aim to Show the Way

The Straits Times

A focus on quality assurance should benefit our primary exporters. If New Zealand is able to remain COVID-free in a virus disrupted world, the country could be an attractive destinations for industries such as education, film production, or high end tourism. Weta Digital has highlighted the impact of production delays on its business globally, and is actively encouraging its international clients to shoot and produce more films in New Zealand. Border restrictions are an issue, but not insurmountable. The crew for James Cameron's "Avatar 2" movie arrived in late May and faced a two-week quarantine before commencing production.

Hardening of US-China tensions… Cold War II?

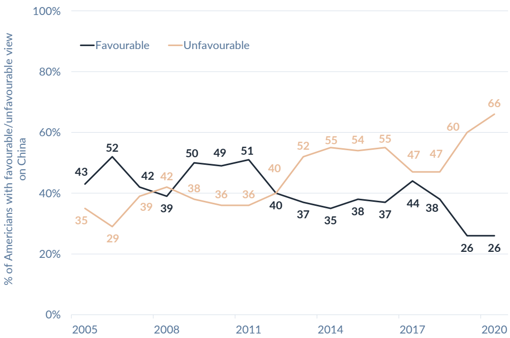
Even before COVID, tensions between the US and China had been rising. The virus has added fuel.

There has been a war of words between the two countries on the pandemic's source. China has faced criticisms that it initially suppressed information about the virus's spread, substantially increasing the resulting health and economic impact around the world. A group of US senators are pushing for legislation which would impose sanctions against China unless it provides "full accounting of the events leading up to the outbreak". The Chinese Communist Party has responded aggressively to any perceived blame, and its plans for tighter new security laws in Hong Kong highlights an increased willingness to act in the face of international criticism.

There has been a significant shift in US public views. A Pew Research Centre survey in March found 66% of Americans have an unfavourable view of China, the most negative rating since the survey started in 2005. China concerns are now bi-partisan.

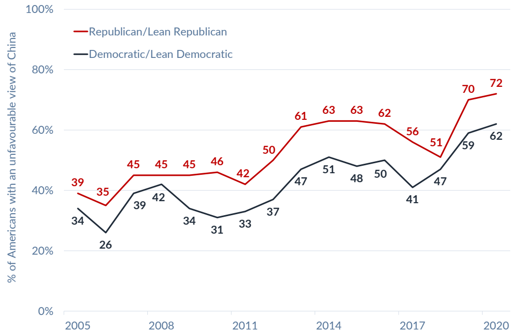
For President Trump, who currently trails in the polls, "strength" against China is likely to be a key campaign plank in November's US election. Democratic candidate Joe Biden will be pressured to match Trump's hawkish stance. There are concerns COVID may mark the beginning of a "new type of cold war".

HARDENING UNITED STATES PUBLIC OPINION OF CHINA…



Source: Pew Research, Forsyth Barr analysis

….ON BOTH SIDES OF THE POLITICAL FENCE

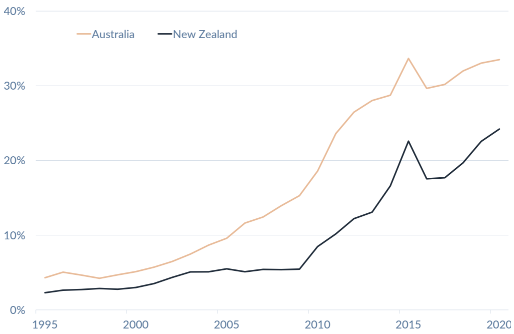


Source: Pew Research, Forsyth Barr analysis

NZ and Australia: A US-China balancing act

For countries like New Zealand and Australia it may become harder to finely balance our relationships with key allies and with China, our largest trading partner.

NZ AND AUSTRALIAN EXPORTS TO CHINA: % OF TOTAL EXPORTS



Source: Stats NZ, Australian Bureau, Forsyth Barr analysis

The response to Australian Prime Minister Scott Morrison's call for an inquiry into the source of the virus is a warning. Chinese officials called for its consumers to boycott Australian goods. China has slapped an 80% tariff on Australian barley imports, and suspended meat imports from four Australian meat processing plants which account for around 20% of the country's meat exports to China. There have been reports that China could also target Australian exports of wine, seafood, oatmeal, fruit and dairy. China is clearly prepared to leverage its economic might as a geo-political tool.

For New Zealand exporters that compete against American and Australian companies for the spending of the Chinese consumer geo-political tensions may be both a risk and an opportunity.

De-globalisation

The stalling (or even the start of a reversal) in the decades' long globalisation trend was likely happening pre-COVID. A changed political climate with a rise in populism (e.g. Trump and Brexit), anti-migration sentiment, and trade wars, gave companies pause to consider the merits of international supply chains, particularly if they crossed the borders of political rivals such as the US and China. COVID has intensified these questions.

Governments have recognised these commercial and strategic vulnerabilities. US agencies are currently looking for ways to encourage or push companies to shift sourcing and manufacturing out of China. Japan has committed ¥244 billion to support Japanese companies shifting production out of China. The new EU trade commissioner stated, "We need an evidence-based discussion on what it means to be strategically autonomous. For example, we need to look at how to build resilient supply chains". An April Thomas Industrial Survey suggested 64% of US manufacturing companies are likely to repatriate or "re-shore" some of their production.

Supply chain security will be a particular concern for companies involved in strategically important industries such as healthcare (will the US remain comfortable that 80% of its antibiotics are supplied by China?), defence, food, information technology, financial services, and energy.

Fear of protectionism and tariffs is rational. There will be winners and losers from any greater localisation. In general, it's likely to mean reduced efficiency and increased costs putting pressure on corporate profit margins. Greater investment in automation and robotics may help both facilitate and reduce the cost of local manufacturing.

Fragility in Europe

COVID-19 has broken some of the European Union's key principles. The Schengen Area's open borders have been closed. The Maastricht Treaty's rules on fiscal discipline have been set aside. There are renewed questions about financial vulnerability of Italy (particularly) and Spain. Forecasts have Italy's government debt hitting over 160% of GDP in the next year and over 200% by 2025. France and Spain are headed above 120%. Will COVID unite or divide Europe? Will the financially stronger countries within the EU be prepared to underpin the weak? EU's long-term viability is again being questioned (as happens with every hurdle it faces).

Escalating focus on businesses' social license to operate and ESG

Pre COVID the ESG dam had burst. Internationally 2019 saw a (no exaggeration) tsunami of inflows into sustainable investment funds. Will this trend continue, or will ESG be relegated to a "luxury good" many economies and companies can't afford as they battle the economic ravages of COVID?

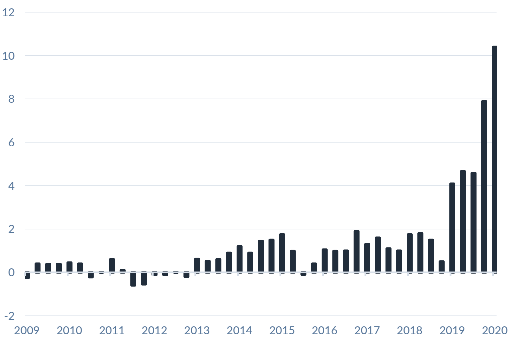
> *"I suspect an awful lot of the environmental agenda and targets will be put on the back burner for a number of years. Not because we all care less about the environment. I think the much greater political issue is going to be massive unemployment across Europe, massive government indebtedness."*

MICHAEL O'LEARY, CEO OF RYANAIR

So is Michael right? So far the data and rhetoric would suggest not.

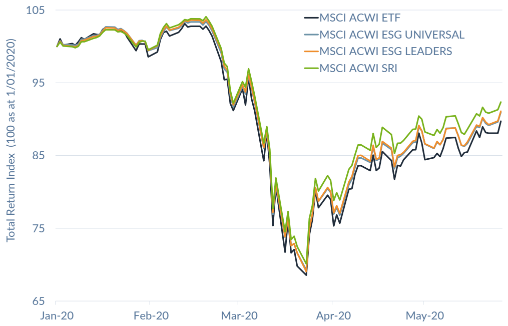
- Despite the market downturn, 1Q 2020 saw a record US$10.5 billion of inflows into sustainable investment funds.
- ESG equities indices have generally outperformed general broad-based indices through the crisis.

ESTIMATED SUSTAINABLE FUNDS U.S QUARTERLY FLOWS (USD BILLIONS)



Source: Morningstar, Forsyth Barr analysis

PERFORMANCE SINCE 1 JANUARY: ESG INDICES VS. MSCI WORLD



Source: Thompson Reuters, Forsyth Barr analysis

- Some policymakers are looking to prioritise ESG objectives in rescue and stimulus packages. Many European Union officials are calling for its "Green Deal" (targeting net-zero carbon emissions by 2050 and a 50-55% cut versus 1990 levels by 2030) to be at the heart of EU measures. It is already seeking to make emissions cuts a requirement for any airlines bailout. UK Prime Minister Boris Johnson has promised to prioritise low-carbon investment. In New Zealand the recent budget included NZ$1.1 billion allocated to create 11,000 environment jobs.
- In the US (on 13 May) 330 companies with a combined market cap of US$11.5 trillion (including Microsoft, Nike, Salesforce, Adobe, Nestle and VISA) lobbied Congress to include "resilient, long-term climate solutions" into economic recovery plans.
- Companies' treatment of staff has generated news headlines in New Zealand and around the world.

Sixth confirmed Amazon worker dies amid calls for the company to release data on coronavirus infections

Amazon, Instacart workers launch May Day strike to protest treatment during the coronavirus pandemic

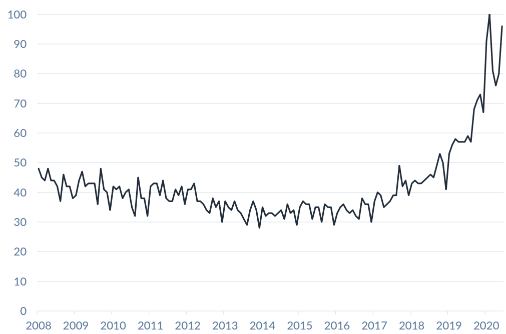
Liverpool reverse decision to furlough staff after fierce criticism

Coronavirus: Fletcher Building proposes huge staff pay cuts, union claims executives will keep earning 'megabucks'

- We've seen political pressures, particularly on those that have received government aid, to prioritise protecting staff, vulnerable customers, and society in general over returns to shareholders. The latest data we have is that around 30-40% of US and European companies have cancelled, postponed or cut their dividends.

We expect the focus on ESG factors in investing will likely only increase post COVID. Before now the focus had predominantly been on the "E", environmental, and "G", governance. But COVID has brought "S", social, to the fore. We expect to see increased pressure on companies to balance the bottom line with supporting the environment, society and broader stakeholders.

GOOGLE SEARCH INDEX FOR "ESG"



Source: Google, Forsyth Barr analysis

More TINA, with growth and income particularly prized

TINA is shorthand for, in a world of ultra-low interest rates (and low returns from bonds and term deposits), “there is no alternative” (for some investors) to equities to generate an acceptable investment return. Even lower rates will likely mean even more TINA. Furthermore, in a post-COVID world the prized investment attributes of growth and income are likely to be scarcer.

Earnings growth for companies will be harder to deliver. Economic and revenue growth will be slower. Competition, fuelled by soft demand and a low cost of capital, will pressure margins. De-globalisation and investment in supply chain resiliency may lift costs. The tax burden may increase. Balance sheet conservatism/rebuilds will reduce earnings per share (EPS) accretive share buybacks.

We expect investors will prize companies that can still deliver earnings growth against this challenging backdrop.

Income will be harder to find. Interest rates will remain ultra-low. Dividends will be lower with more cash redirected toward reducing debt and building a balance sheet buffer.

In a yield-starved world we expect investors will prize companies with strong balance sheets that can deliver steady and predictable income to shareholders.