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Pandemic will usher in long-lasting change in many areas

The pandemic is shaping up to be one of those momentous events that change the way we go about a lot of things in our daily lives. Consider how, in the aftermath of the 9/11 attacks, stringent security checks forever changed the experience of taking a flight. Because the pandemic's far-reaching effects straddle areas – including health, financial, and social – that are critical to our well-being, it may usher in long-lasting change in many of them.

Some of these changes are already obvious, such as working from home, online shopping and telemedicine, where the pandemic has jump-started or accelerated existing trends. What about other secular shifts that are more subtle but equally long-lasting?

In a Bloomberg article[1] on March 3, when the cataclysmic effects of the coronavirus were still unfolding, macro strategist Jim Bianco noted that the S&P 500's 11.5% plunge in the previous week marked a secular shift. Bianco pointed out that the four other instances over the past 80 years when the index had plunged more than 11% in a single week marked secular and long-lasting shifts. These historic episodes included the fall of France in the early days of World War II in 1940, the October 1987 market crash, the technology peak in April 2000, and the credit crisis in October 2008. The 2008-09 financial crisis accelerated the rise of populist movements that produced Brexit and President Trump, according to Bianco.

While my initial reaction to this article was that Bianco was exaggerating the possible effects of the pandemic, after more than two months of social-distancing and other virus-induced measures, I no longer feel that way. Even as economies reopen gradually, it may be months before students can attend schools and colleges, tourists can vacation in popular locales, and people can enjoy live sporting and entertainment events. While these are obvious effects of social distancing measures necessary to control the pandemic, below the surface, large-scale shifts are in the works.

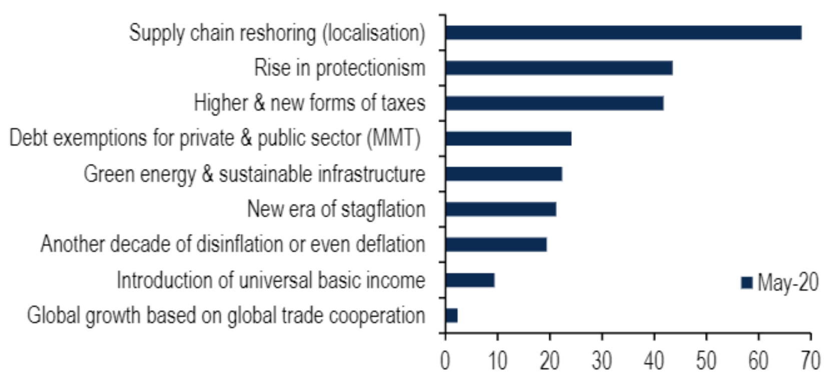
Some of the secular shifts that will reshape the financial and economic landscape in the years ahead were highlighted by participants in a recent Bank of America Global Fund Managers Survey. The biggest shift identified was the trend away from globalization and towards localization (Figure 1). Globalization made the manufacturing process very efficient but left the U.S. and other nations vulnerable to supply chain disruptions when the pandemic erupted. Concerns about access to medicines and health equipment – exemplified by the worldwide scramble for masks and ventilators at the pandemic's peak – will accelerate the move to bring supply chains for key products closer to home.

A rise in protectionism was identified as another major shift. Hopes that the U.S. – China trade war would continue to be pushed to the back burner by the pandemic have been belied in recent days by deteriorating relations between the world's two largest economies. On Wednesday, the U.S. Senate unanimously passed a bill that could bar some Chinese companies from listing on U.S. exchanges. Another likely shift identified by survey participant was the possibility of higher taxes. Although higher taxes may not be on the government agenda presently because of the precarious state of most economies, they may be inevitable down the road, given the burgeoning deficits caused by trillions of dollars in stimulus efforts.

From a portfolio perspective, these secular shifts present opportunities as well as challenges. One subject that hardly gets any attention at present is inflation. In fact, the precipitous drop in bond yields seems to imply that deflation is seen as the bigger threat to the global economy. But as the economy normalizes over the next year or two, de-globalization and increased protectionism (which means higher tariffs on imported goods) could well lead to significantly higher costs for consumers and hence a return to inflation. Of all the far-reaching effects of the pandemic, that would perhaps be the most unexpected.

Figure 1: Likely structural shifts in the post-pandemic era

Exhibit 9: Which of the following are the likely structural shifts post pandemic crisis?



Source: BofA Global Fund Manager Survey, Bloomberg

[1]https://www.bloomberg.com/opinion/articles/2020-03-03/coronavirus-emergency-federal-reserve-rate-cut-only-goes-so-far

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