COVID-19 – FIVE YEARS ON

On 11 March 2020, the World Health Organisation declared Covid-19 a global pandemic. Five years on, Carmignac's experts look at the legacy for economies, financial markets and sustainable investing.

ECONOMIC IMPACT

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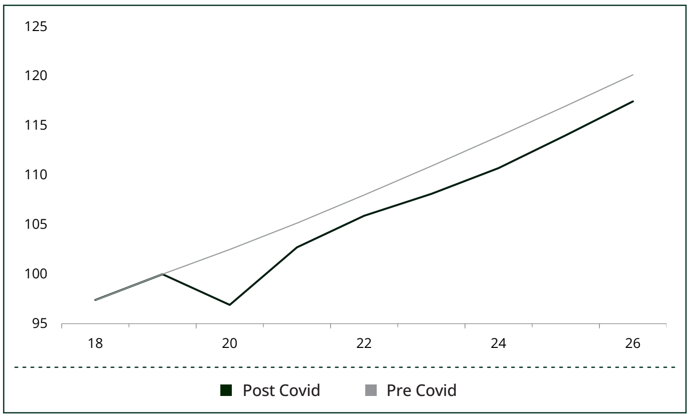
PERMANENT LOSS OF GLOBAL GDP

Five years ago, a black swan appeared. The Covid-19 pandemic ushered in the sharpest global recession (real global GDP contracted 2.7%)[1] since World War II, as consumers sheltered in place to protect themselves from the virus or obey government-imposed lockdowns. Beyond the horrific death toll, the pandemic took a lasting toll on the global economy.

The World Bank forecasts for this year show the global economy has returned to a trend growth pace similar to the pre-pandemic norm, but real global GDP is still 2.8%[2] below the level expected in its projections made just before the pandemic struck. In this L-shaped recovery, some pandemic losses have never been recouped.

The main reason for this permanent loss of output is that the pandemic led to irreversible losses of human capital, not only in terms of tragic early deaths, but also in lasting ability impairment (e.g. long Covid), as well as lost human skills due to educational and training opportunities that never took place because of lockdowns.

CHART: World: real GDP trajectory and projections



Source: World Bank, January 2025

GAP BETWEEN DEVELOPING AND DEVELOPED MARKETS

In developing countries, the fact that the recession could not be buffered by fiscal and monetary responses, led to additional longer-term effects on output due to widespread bankruptcies and banking woes. Using International Monetary Fund ("IMF") projections before and after the pandemic, we can assess that the scarring effect of the pandemic for the emerging and developing countries was almost 6% of GDP[3].

In contrast, in developed economies, the policy response was extremely strong and prevented the collapse of the financial system. There was an extraordinary coordination of both arms of the policy mix, with generous income substitution schemes enacted by fiscal authorities (whether through unemployment benefits or 'furlough' schemes) funded by monetisation by central banks. As a result, the scarring effect of the harsh lockdowns were efficiently mitigated.

(1) World Bank, January 2025.
(2) World Bank, January 2025.
(3) IMF, Carmignac, February 2025.

And conversely, the lockdowns had positive effects on the supply side of the economy. By forcing small businesses to switch to online marketing and distribution, it gave a boost to digitalisation of the economy. Likewise, workers had no choice but to adopt nomadic working techniques. The share of employees working remotely in Europe increased from 6% in 2019 to 14% percent by 2022, although this was 22% in capital cities[4]. The work-from-home dynamic is a source of persistent debate on productivity, with commuting savings and flexibility being pitted against the loss of in-person collaboration and home distractions. However, a study[5] by the US Bureau of Labor Statistics concluded that industry-level total factor productivity rose by 1.2 percentage points over 2019-2022 thanks to development of remote work.

This trend was most visible in the US, where it is paving the way for faster adoption of artificial intelligence ("AI") technology versus other developed economies. As a result, productivity in the US returned to its pre-Covid trend line in 2024.

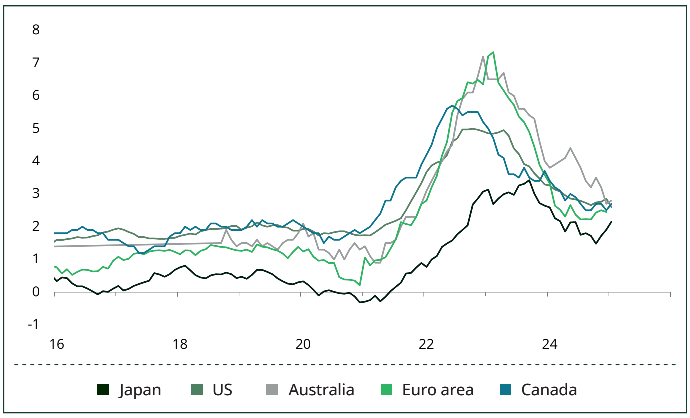
THE RETURN OF INFLATION

While the excess liquidity injected into economies by central banks may have propped up Western economies (to an extent), the immediate response was a parabolic rise in equity and property prices. This wave then inevitably morphed into goods and services inflation.

The inflation outburst that accompanied the reopening of economies shook central banks' beliefs that all supply-side shocks could be treated as transitory.

After a decade of undershooting inflation, the Federal Reserve ("Fed") had grown notably complacent about inflation risks and its shift towards a fuzzy 'flexible average inflation targeting' in 2019 proved a costly intellectual legacy in 2021. Today, the Fed finds itself in a difficult place, as the new administration blames it for not tackling the post-reopening inflation. Moreover, the fact that it has missed its inflation target for four years now gives it less flexibility in its ability to deal with the tariff shock.

CHART: Trimmed-mean inflation % YOY



Source: National central banks, January 2025.

UNRAVELLING OF PAX AMERICANA

The pandemic revealed the fragility of hyper-globalised supply chains, disruptions to which could cause dangerous shortages and lasting inflation pressures spreading through the economy. The debate about the necessary shock-proofing of supply chains rapidly turned into a geopolitical blame game. China was viewed as guilty of misrepresenting the lethality of the virus in the early weeks of the Wuhan outbreak. It reacted with commercial retaliation when Australia officially complained about this misbehaviour. And during the dash-for-cash on financial markets, emerging countries noted which among them were deemed worthy of receiving emergency dollar liquidity from the Fed, and which were not (notably India was excluded from the Fed's emergency lending facility).

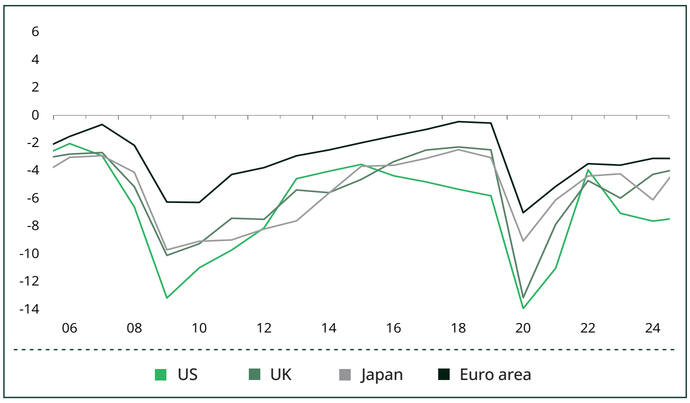
In a way, the pandemic accelerated the unravelling of the Pax Americana towards what we have been calling the global discord of a multipolar world.

FISCAL DOMINANCE AND DISCONTENT

In domestic politics, the pandemic further eroded the credibility of technocratic and bureaucratic 'elites' that were, rightly or wrongly, perceived as incompetent, dishonest, or power-hungry in their management of the pandemic. The frantic use of government-funded income transfers widened the 'Overton window' of the acceptable response to any kind of economic shock. The fact that these fiscal injections were permanently monetised marked another step towards the 'coordination' of fiscal and monetary policies. This coordination - in a context of public debt ratios jumping by an average 20 percentage points[6] - took us closer to a dangerous regime of 'fiscal dominance', whereby a central bank is actually restricted into allowing higher inflation, in order to manage the soaring government debt.

The pandemic-induced inflation also widened wealth disparities, fuelling social frustration, particularly among low-earners and the young. The paradox is that this resentment was exploited by populists in recent elections advocating for even more fiscal largesse (through tax cuts in the US, or social transfers in Europe) implying more risk of fiscal dominance, and, ultimately, more inflation.

CHART: Fiscal balance (% GDP)



Source: BIS, January 2025.

(4) OCED: The new geography of remote jobs? Evidence from Europe (December 2024).
(5) The rise in remote work since the pandemic and its impact on productivity: Beyond the Numbers: U.S. Bureau of Labor Statistics.
(6) BIS, Carmignac, January 2025.

FINANCIAL MARKET IMPACT

Kevin THOZET
Member of the Investment Committee

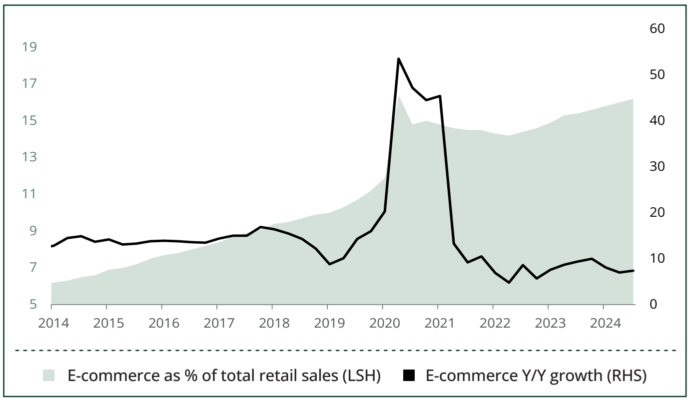
THE CONSUMER PENDULUM

The consumer pendulum swung from great lockdown-induced restrictions to ‘revenge spending’. Companies most exposed to consumers saw their revenues ballooning and deflating back to trend. Hopes that revenue growth would remain in high-single to low-double digits gradually ebbed. Now, we could see revenue growth rates return to pre-covid levels, or even lower, for several sectors including luxury, skincare and beauty, and hospitality.

Several factors are behind this phenomenon, not the least, weaker economic growth than the years preceding 2020, but two Covid ‘hangovers’ are still being felt today. Firstly, the ‘bullwhip effect’ – whereby distributors overordered in response to a demand spike - left many retailers with excess inventories. Secondly, it appears some form of projection bias took hold, with some retailers expecting preferences to remain the same as during the Covid years.

E-commerce is a prime example. In the US, online shopping as percentage of retail sales jumped from 10% to 15% in a matter of weeks during 2020, but year-on-year growth has since slowed. It took another four years for e-commerce to come back to the 15% mark.

CHART: Evolution of e-commerce annual growth rate and penetration as a % of retail sales, in %



Source: Carmignac, Census Bureau, as of December 2024.

One area where consumer habits have been more profoundly transformed is the shift from goods to services following the end of lockdowns, with experiences such as travel and entertainment proving more popular than physical goods. This shift, natural as a rising global economy leads to a preference for services, was amplified by inflation.

The contrast between auto manufacturers and cruise lines is a perfect illustration.

Early in the pandemic, auto manufacturers profited from high demand and bottlenecks in the production of high-margin models. Since 2023, however, there has been a notable drop in demand for cars in Europe, driven by the material increase in prices and competition from cheaper Chinese models. With the average price for a new car at €48,000 today, and consumer sensitivity to price changes high, the European auto sector is struggling. The average earnings per share for auto manufacturers has dropped from 120 in 2022 to 65 today[7].

In contrast, cruise lines have proved popular beyond their traditional clientele in recent years. Average earnings per share have shot up from 9 in 2022 to 35 today. But part of the great run of cruise line operators could be explained by the decision to stop adding passenger capacity during Covid, meaning they may have temporarily over-earned. So, while structural improvement is evident, there may also be some cyclicality at play. The consumer pendulum could soon swing back.

TURBOCHARGED DIGITALISATION

Lockdown, and the subsequent shift in working patterns, has undoubtedly accelerated digitalisation across numerous sectors. This quantum leap in digital adoption is most evident in the tech sector. Microsoft, Apple, and Alphabet all surpassed the $2 trillion market capitalisation within a year of Covid, with share prices increasing by 56%, 78% and 56% respectively[8]. Today, these companies continue to dominate markets with a combined market cap of US $8.9 trillion.

The digitisation trend shows no sign of abating. Global IT spend accelerated from $4 trillion in 2019 to more than $5 trillion expected for this year[9].

In 2020, AI was not part of the public consciousness quite like today, but the explosion in data use during the pandemic certainly accelerated things, impacting sectors well beyond tech. In healthcare, telehealth and chatbots became necessary (and are commonplace today) and machine learning helped to forecast virus spread and improve vaccine development

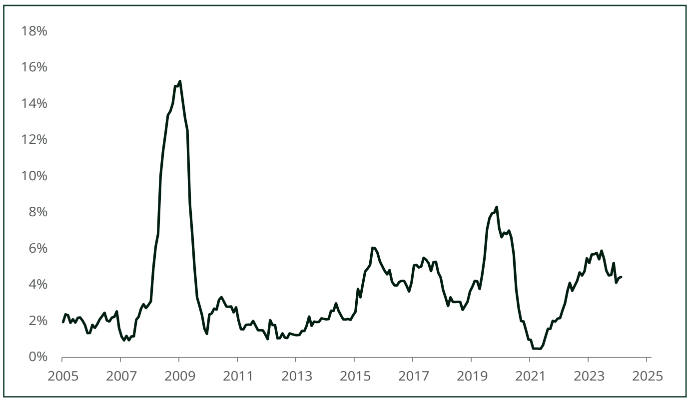
(7) Stoxx Europe 600 Automobile & Parts.
(8) March 11 2020 – March 10 2021.
(9) Forrester: Global Tech Spend To Grow 5.3% In 2024, Reaching $4.7 Trillion - Forrester, Gartner Forecasts Worldwide IT Spending to Grow 9.3% in 2025.

processes. And in education, online learning soared in popularity - Duolingo has seen the number of users triple[10], for example. And more broadly, as supply chains were disturbed, huge progress was made in logistics optimisation, inventory management and demand forecasting. 40% of companies accelerated their AI strategies during the pandemic[11]. But there is a flip side to such a jump. To fully roll out AI within an organisation, it's vital to modernise and homogenise systems. This can have a significant impact on operations and for companies doing the most heavy lifting this has been, and is likely to continue to be, a source of earnings volatility. L'Oréal, for instance, is taking advantage of the lower-demand environment at play to transfer its systems towards SAP.

DEFAULTS RETURN

After an understandable spike when the pandemic commenced, default rates were maintained at artificially low levels as governments provided much needed lifelines to struggling companies. The situation today is very different. Delinquencies have picked up from 0.5% at their five-year lows in 2021 to more than 4%[12], triggered by the transformation in supply chains and the material increase of the cost of capital with inflation and interest rate uncertainty.

CHART: Evolution of global speculative-grade default rates for issuers with bonds and loans



Source: Carmignac, Moody's, December 2024.

Real estate is the unfortunate poster child of this post-pandemic shift. Commercial real estate and offices suffered as remote working became more entrenched and some malls also struggled as e-commerce became increasingly common. Couple this with the natural 'boom and bust' evolution in demand and the shifting economic environment and times were indeed tough.

Testing labs are another cautionary tale. Following a surge in testing numbers at the height of the pandemic, many labs took advantage of ultra-low bond yields to significantly increase borrowing. For some, the 'return leg' of rising yields and falling demand for tests proved a toxic combination. This story is far from over. The €4,500 billion raised in corporate bonds during the 2020-2021 era[13] will be maturing soon and based on current calculations, the coupon to be paid to roll such a debt will be 1.4 times higher.

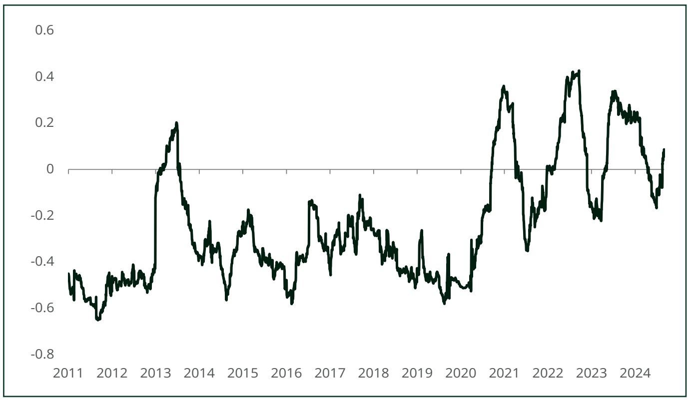
But defaults are not necessarily negative for the asset class, or for society as whole. 'Economic Darwinism' is necessary for sustainable and productive long-term growth, as well as for adequate capital allocation and efficient price discovery mechanisms. Credit markets today offer attractive yields ranging from 3-6% (in EUR terms) but caution around refinancing and certain issuers' supply chains remain.

THE BUSINESS CYCLE IS BACK

As inflation bit and central banks had to unwind stimulus and adopt restrictive policies, the business cycle returned with a jolt. Fundamentals once again started to dictate the movement in asset prices. The equity-bond correlation has become more volatile since 2021, meaning the pursuit of portfolio diversification requires more active assessment.

The return of the business cycle, the end of financial repression and the desynchronisation of economic blocs means that active investors have regained their compass to anticipate downturns and upturns in the economy and financial markets.

CHART: Evolution of the correlation between equity prices and bond prices over 6-month rolling periods



Source: Carmignac, Bloomberg, February 2025.

(10) Duolingo.
(11) World Economic Forum and Appel State of AI report.
(12) Carmignac, Moody's, December 2024.
(13) BofA Global Research, PitchBook/LCD, February 2025.

SUSTAINABLE INVESTMENT IMPACT

Lloyd MCALLISTER
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NET NEGATIVE ENVIRONMENTAL IMPACT

Images of the Venice canal and Delhi air turning crystal clear during the pandemic prompted a widespread belief that lockdowns were environmentally beneficial. However, the truth is the total environmental impact of Covid-19 was negative. Early statistics, like global oil demand reducing from 100mboe to 85mboe in March 2020, and China and India's coal consumption falling by 36% and 26% in March 2020 compared with prior year, make it sound like an environmental positive. However, the reality is that these declines constituted a drop in the ocean of cumulative greenhouse gas emissions and as a result, had no detectable impact on atmospheric CO_2 levels[14].

While it is true that there were improvements in air particulate pollution, noise and water pollution levels, these temporary gains were heavily overcome by significant permanent increase in soil degradation from single use plastic waste disposal, with approximately 3.4 billion single-use facemasks/face shields disposed every day because of the pandemic[15].

CHART: Evolution of global speculative-grade default rates for issuers with bonds and loans

Source: Le Quéré et al. Nature Climate Change (2020) ; Global Carbon Project, 2020.

While the death toll from Covid-19 was relatively limited compared to the Bubonic Plague of the 1300's and Spanish flu in 1918 thanks to modern governance systems, science and technology, there were still lessons to be learned. Notable failures in preparation, international coordination and infection control were identified as key lessons in post-pandemic inquiries[16]. Positively, today, 90% of surveyed epidemiologists and virologists believe that the world is better prepared to fight the next pandemic[17]. When considering the next major pandemic, 96.1% of those polled thought it was very likely to be spread via the air and that the next major global health challenge will likely occur in the next 5 to 25 years. On a look forward basis, epidemiologists and virologists note that temperature increases and extreme weather events are impacting how humans, animals and insects interact and we are finding viruses in new places. This increasing risk is tricky to reconcile with Donald Trump's decision to leave the WHO and the incoming health secretary's general distrust of vaccines.

THE RISE OF SYSTEM STEWARDSHIP

The huge drop in global GDP had a major negative impact on the market capitalisation of companies and value of portfolios. As a result, the concept of 'system' stewardship rose as it became clear that individual companies can be worth significantly more or less at a portfolio or system level than their individual enterprise value suggests.

Take, for example, shareholders of biotech companies working on Covid-19 vaccines. They had an economic interest in those vaccines that dwarfed their economic interest in the shares of the companies themselves as their product could allow the re-opening of the economy. This, therefore, removed the earnings constraint that deflated the value of their broader portfolio. Similar examples today are cited in relation to anti-microbial resistance and climate change, whereby the value of companies perpetuating negative externalities that boost their own share price, but increases the chance of negative systemic risks, are increasingly being assessed from a portfolio return and system-risk perspective by institutional investors, rather than an individual-company profit perspective.

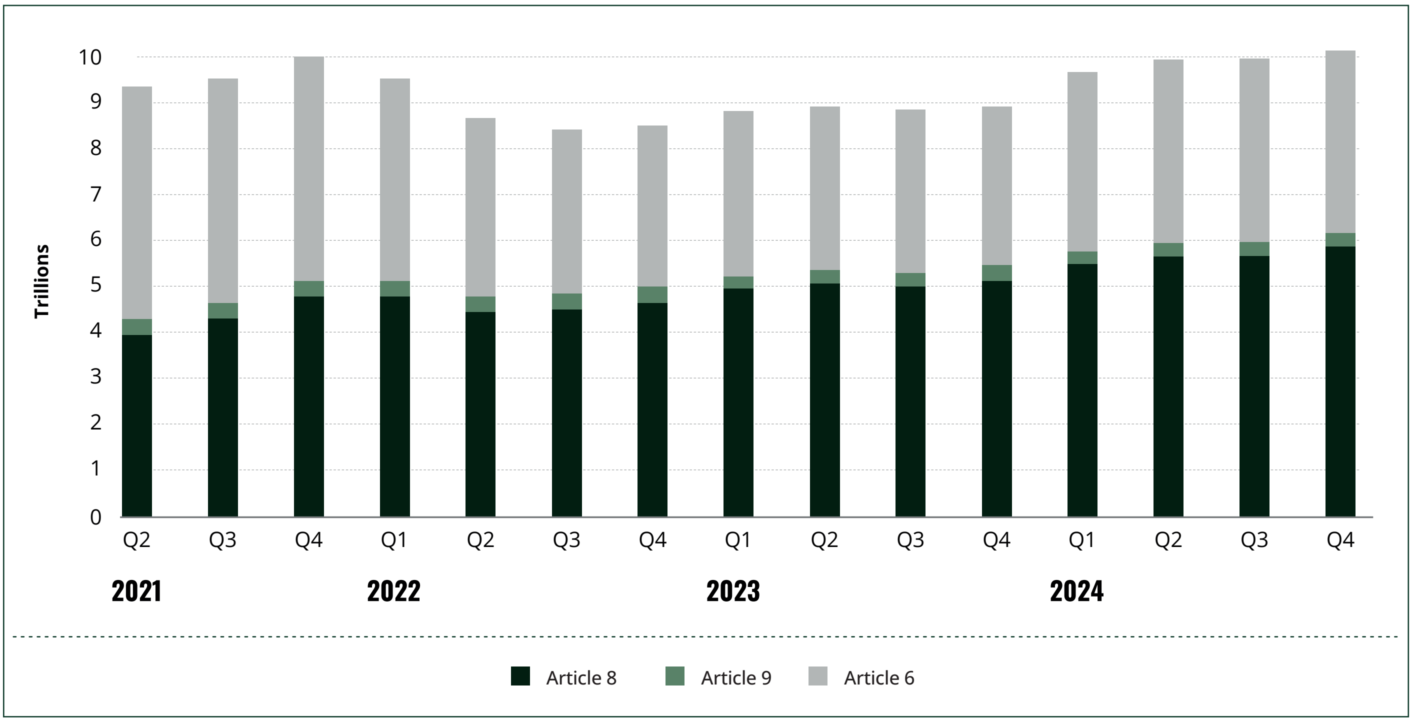
ESG INVESTING MATURED

It was no coincidence that the pandemic coincided with a boom in sustainable investment, as investors felt the vulnerability of our financial markets to systemic events.

The introduction of the Sustainable Finance Disclosure Regulation (SFDR) in Europe in March 2021, one year after the pandemic began, meant that investors were better primed to consider the role of ESG factors in financial outcomes

(14) Impact of COVID-19 on CO2 emissions. (15) Avishek Talukdar, Sayan Bhattacharya, Saptarshi Pal, Pracheta Pal, Soumyajit Chowdhury, Positive and negative impacts of COVID-19 on the environment: A critical review with sustainability approaches, Hygiene and Environmental Health Advances, Volume 12, December 2024. (16) The Lancet Commission on lessons for the future from the COVID-19 pandemic; Sachs, Jeffrey D et al. The Lancet, Volume 400, Issue 10359, 1224 - 1280. (17) Abbot Pandemix Defence Coalition: Sustaining Readiness – expert insights on pandemic preparedness (September 2024).

and the necessity to invest in resilience as well as growth. Flows into Article 6, 8 and 9 funds have ebbed and flowed since the introduction of the legislation. However, what was immediately clear, and a significant departure from history, was the importance of the Article 8 category, whereby ESG issues are taken into account in their own right alongside financial factors. The Article 8 category captured 40% of European assets at the introduction of the legislation. This has since grown to 58%. It is the most startling revealed preference of end-investors from the pandemic.



Source; Morningstar Direct. Assets as of December 2024. Based on SFDR data collected from ther prospectuses on 97.8% of funds availaible for sale in the EU, excluding money market funds of funds, and feeder funds.

DISCLAIMER

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