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# Interview with Chris Watling from Longview Economics

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As readers would know, AFM place considerable store on the data we receive from **Longview Economics** in London. Last week we had a chance to catch up with Chris Watling, Longview's Founder and CEO, who we have previously described as the "entertaining economist". Not only do we have a high regard for his economic opinion, but Chris has the ability to communicate exceptionally well. Unfortunately, the quality of our Zoom connection wasn't as good, so we have transcribed the discussion instead.

**Chris Gosselin, AFM:**

***Chris, welcome from Australia, where to date we seemed to have fared much better than the UK, Europe and the US from an infection perspective. However, from an economic perspective, what are going to be the longer-term effects of the pandemic, and are markets getting ahead of themselves in the meantime?***

**Chris Watling:**

Thanks Chris, and welcome to you from London. When I was down in Australia in February this year I didn't imagine we would see this virus create such shockwaves around the world, or that it would be such a long time before I would be able to travel back to see you in person.

I recently listened to a very good interview with the History Director from the Institute for Economic Affairs who was discussing pandemics in the past, and in terms of the global economy, how this one plays out, and how different it may or may not be. The really interesting thing he said, amongst others, was that the pandemics in the past always came back in a second or third wave. And he listed plenty of examples, so I think we've all these challenges ahead which we don't yet know the answers to.

***Q: So you're saying the big question is we don't know how long it's going to take to come out of this, or how bad the second or third wave might be?***

**Chris Watling:**

I think that's absolutely the question. The extent of the relief rally we've had so far is quite extraordinary. The S&P500 has rallied 36% from its lows to highs, and the DAX a bit more than this, over 40%. I suppose it reflects back on a "sugar rush" and investors assuming that it is all priced into the market. Looking forwards to Q3 and Q4 and into 2021 is the real question. What we've seen in terms of Q2 is almost like natural disaster economic shock - a very quick down leg, with a rapid bounce due to the fiscal support.

Now we need to think of the longer-term recessionary effects. We're probably going to get a normal recession now from Q4 onwards. That's why I think it's extraordinary what the market's pricing in if you look at valuations.

***Q: How confident are you that the markets have got it right? I get the impression you're saying that perhaps the markets have become over enthusiastic based on a V-shaped recovery?***

**Chris Watling:**

The market's movements reflect the immediate future, so I think that's what we've been seeing. Leading into the lows back in March markets priced in the lockdown. With the rally since then they've priced in the fiscal and monetary stimulus, and the huge amount of cash that people will have saved as a result of being in lockdown. Now we have to start thinking beyond that, beyond Q3.

How does the world economy look? I think early indications from China are actually not that good. And I think there is potentially a dreadful economic realty. Company cash flows for instance: A lot of them are getting by with debt, but they're not making *more* money. They're making a heck of a lot *less* money. There'll be repercussions from that.

So I think one thing we're really worried about is the supply side response of the US, because at about a quarter of world GDP the US is still the most important economy in the world. So, it's a driving force of the global economy, although of course China does as well. The US economy looks good on the surface, but when you drill into the detail, it's much less impressive.

For instance if one looks at the US Paycheck Protection Program, which is their furloughed workers scheme for small businesses, while the first tranche totalled $340 million, it only got through to 1.6 million businesses.

However, there's around 30 million small businesses in the US, and they create over half of the employment and two out of three jobs. So to date there would be about 80 to 85% of small businesses in the US that haven't had any support to speak of, and that's a real concern. And you'll see that in jobs claim numbers and data we're going to see in payrolls later this week. And further on in Q3 there are some real concerns bacause credit conditions are starting to tighten quite sharply.

***Q: One of the things you've spoken about previously is that your concern about the number of "Zombie" companies in the United States*** **- in other words, not able to cover their interest payments, never mind do any capex.**

**Chris Watling:**

When we looked at it a year ago there were about 13% of listed US companies which we categorised as Zombie companies.  Any slowdown in spending will put those companies under extreme risk because firstly, they're not making money, secondly they don't have cash sitting in the bank, and finally they are less likely to have access to debt to keep them going at a time when credit conditions are tightening. Also many of them lot of won't be able to claim government relief, reflecting another level of vulnerability in the US economy.

There are also the unicorn companies. While they may be exciting businesses, they don't yet make any money. QE and close to zero interest rates have allowed all sorts of companies continue to survive, but along with start-ups won't find it so easy to raise capital.

All of these issues point to the challenges facing the supply side of the global economy.

**Q: Chris what's your view on consumer confidence and the demand side? In Australia, Westpac have deferred their dividend, as has ANZ bank. So although there might be high levels of government support or stimulus both here and globally won't consumer confidence have taken a hit, even if they remain employed?**

**Chris Watling:**

That's right. From a from an economic point of view the big question we have is what happens to the household savings rate? Even though for some it's gone up in the short term as a result of enforced saving from the lockdown, many employees have lost jobs, so they've had to dig into savings if they had them. The US household savings rate in March, which is the latest data we have, is up from 7 to 13%. That's going to come down in Q3, but the question is, does it normalize from there?

Consumers going to be much more cautious going forward, and all these things feed into the consumer confidence numbers, and it's unlikely it will normalise quickly because of such high unemployment levels.

***Q: Chris, how do you think other aspects will change? For instance, the way we do business going forward: Office space, office rentals, transport, telecommuting. To what extent are all those things going to change the way the world works?***

**Chris Watling:**

It's a good point because there's a lot of concern in those sectors, and how it's going to flow through the system as well. Commercial property is an obvious example as it seems inevitable that working from home will pick up to some extent. So, again I suspect the profile of consumer spending after the initial bounce will fade and the economic challenges will come, likely as we reach Q3 especially if there's a second wave of infections.

***Chris, as always great to talk to you, and there are lot of people who enjoy listening or reading your views and common sense. I know you're busy, so we really appreciate it. Thanks so much for your time, and until the next time, stay safe.***

**Chris Watling:**

My pleasure, always good to talk.


Chris Watling

*CEO & Founder, Longview Economics*


Chris Watling founded Longview Economics in 2003 with a desire to produce research that was independent, courageous and relevant to every investor type. Chris has been obsessed with markets and generating intelligent investment advice since beginning his career at Cazenove in 1994. Prior to that, he trained at KPMG in London. Longview has built relationships with over 150 clients across the globe and are constantly seeking to deliver cutting edge market analysis and trading ideas.

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