

We're staring at a Great Depression

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What is anything worth any more? What value should investors ascribe to companies, property or bonds? The ease with which seemingly solid businesses have come close to collapse in a matter of days is a vicious reminder that projections of future earnings are merely well-informed guesses.

Investors suddenly find their income dwindling as dividends are slashed or cancelled altogether. Book values become meaningless as shares trade at huge discounts to their apparent net worth. The world is a less stable place than we imagined, so uncertain earning streams are worthless.

No founder, banker, analyst or economist predicted this. In the future, the equity risk premium needs to be much higher than it used to be.

No one knows the ongoing costs of guarding against follow-on pandemics. Insurance during this episode has been useless. The shutdown is helping to erode the work ethic of a generation and is undermining the very fabric of business relations.

Even property, always seen as rock solid, looks shaky. Many tenants are refusing to pay their rents, backed up by government advice. Lenders are worried that landlord covenants will be breached. The retail and leisure markets are in crisis. The office market may not be far behind, as users decide that remote working makes all that expensive commercial space redundant. Housing values are sure to decline.

Cash is arguably the one certainty in a world falling apart, but even that is depreciating and yields essentially nothing. Theoretically, liquidity is everything now: present buying power should secure any acquirer true bargains. Certainly, purchase prices are materially lower than they were in January. However, the earnings prospects for most companies are dramatically less visible than they were. There are no safe havens.

Most days I receive details of companies that are about to enter administration. Usually the deadline to put forward a bid is a matter of days. Typically, a bidder takes on only the assets and any employment liabilities under the Tupe rules, which govern transferring staff in the business to a new owner.

All other liabilities are left behind, so the new entity is free of trade creditors, money owing to HM Revenue & Customs, contractual obligations, litigation and so forth. Sometimes purchases of failing firms can be bargains, but often they went bust for a good reason, and the wreckage left behind has a cost.

Unfortunately, central banks have cut interest rates as low as they can go. Also, they have printed money to replace diminished private sector demand and activity. But even all this state-sponsored liquidity has failed to prop up asset prices.

Fear is the dominant emotion in every boardroom — fear of customers not honouring their debts, fear of foreclosure by the bank, fear that the lockdown will last so long that the cash will run out (as well as an exaggerated fear of falling ill from the coronavirus and dying — we have idled the nation and all become hypochondriacs).

Moreover, the world is already awash with debt at every level — sovereign, corporate and household. Especially in the past decade, quoted and private companies have adopted the leveraged buyout model and geared up on cheap borrowing. There will be legions of zombie companies emerging from this slump, unable to grow and struggling to meet their interest bills. Many companies will become addicted to the various government handouts, and will have massive arrears of rent, taxes, trade creditors and overheads to pay.

The evaporation of confidence will impact millions of decisions, large and small. Investors will not back ventures. Entrepreneurs will not start companies. Employers will not hire staff. Banks will not make loans. Managers will not buy new equipment. Consumers will not make discretionary purchases. The animal spirits will have fled.

Travel and tourism is reckoned to be the world's largest industry. The sector is not simply in a downturn — it is sliding towards complete annihilation. It supports tens of millions of jobs globally, and related industries such as aviation also face a bleak future. If the West allows lockdown to stretch into the summer, the entire trade is essentially insolvent.

Currently, a large chunk of the nation is unable to work or earn a living. The economic, psychological, social and personal toll on national well-being of the shutdown is unsustainable. The collapse in output, the rise in unemployment, the vertiginous increase in debt and the destruction of confidence will surely precipitate a 1930s-style depression unless we are released from house arrest soon, and the government increases testing for the virus significantly.

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