Investment outlook

A monthly round-up of global markets and trends
November 2020

In this issue

Investment outlook
The global economy shows resilience to COVID-19 headwinds

Market highlights
Equities, fixed income, and FX and commodities

Market returns
Asset class by asset class

Please read the important information section

COVID-19

Please visit our COVID-19 hub for insights and webinars on the personal finance and business implications of the outbreak:
www.smithandwilliamson.com/covid-19-hub

Investment outlook

The global economy shows resilience to COVID-19 headwinds

Notwithstanding recent market volatility from rising new COVID-19 cases in parts of Europe, global equities have recovered their losses from the pandemic sell-off in March and including dividends reinvested are broadly flat year-to-date[1]. Stock prices have undoubtedly been helped by unprecedented fiscal and monetary stimulus to boost market liquidity and stimulate the global economy. Along with the lifting of lockdowns, this has led to a rebound in private consumption globally.

In the USA, September underlying retail sales rose 9.1% from a year ago, the fastest growth rate on record from data that starts in 1993[2]. Elsewhere, UK retail sales were 7% higher than they were in February[3]. One area where policy has particularly boosted growth is in the residential sector. US existing home sales are running at their highest rate since the boom of the mid-2000s and in the UK, lower stamp duty has triggered a rush of housing activity, with mortgage approvals (a lead indicator of sales) running at their fastest pace since 2007[4].

There are some areas, however, such as hospitality and travel, where expenditure has been slow to recover. The International Air Transport Association does not expect global air passenger traffic to return to pre-COVID-19 levels until 2024[5]. Nevertheless, equities appear to be ignoring the growth impact on the economy from the recent spike in new COVID-19 cases and are looking through to 2021 in a more positive frame of mind.

Consumers save the day for equity markets

Back in our July Investment Outlook we argued that this business cycle could be extended beyond an initial rebound as the economy reopened. Our optimism was partially driven by consumers having the financial wherewithal to sustain spending. A way to measure this consumer spending power is to look at the drivers of the household savings rate (a measure of unspent monthly income as a share of take-home pay). In the UK, the household savings rate rose to a record 28% in the second quarter, against a 60-year average of 9%, helped by government fiscal handouts[6]. While it could be argued that the worry caused by the pandemic lifted voluntary precautionary savings, it can also be argued that in fact much of the rise in savings was involuntary. In other words, consumers may have been unable to spend; for example, when non-essential stores were shut and holiday makers were unable to travel (or deterred due to quarantine rules). Looking forward, we believe there is room for these savings to now be used to sustain consumption after the lockdown has been lifted in December. However, we see three risks:

First, households in the US (and other major economies) could use up their savings too quickly, a point recently made by Fed Chair Powell. That said, US household balance sheets are in a relatively healthy state. In the second quarter, US household liquid assets (including deposits, mutual fund and equity holdings) were 3.1 times bigger than total liabilities (mainly mortgages), roughly double the ratio post the 2008 Global Financial Crisis[7]. Households could potentially use these assets to finance consumer expenditure through this bumpy period.

Second, a sharp acceleration in unemployment could discourage households from spending their savings. The UK's coronavirus Job Retention Scheme (national furlough scheme), which paid 80% of furloughed employee wages at its maximum, expired at the end of October, but it is now being extended into December during the lockdown. A research house, Capital Economics (CE), estimates that pandemic-related fiscal support will fall to around 5% of GDP in March 2021 from a peak of 20% last May[8]. With less financial support coming from the government, the risk is that redundancies rise, and consumption growth slows.

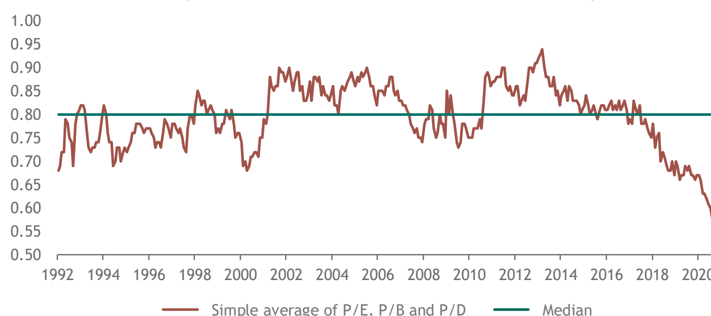
Third, the recent rise in new COVID-19 cases across Europe, and the resulting local lockdowns in Spain, France and the UK could undermine consumer confidence, the growth outlook and the ability to spend. Nevertheless, the Eurozone service Purchasing Managers Index (a surveyed proxy of consumption) has dipped only slightly to 46 in October, below the boom/bust threshold of 50, but remains substantially higher than a record low of 12 in April[9].

In short, unlike the Global Financial Crisis in 2008 when policy stimulus was largely directed to shore up the balance sheets of the banks (i.e. Wall Street), more money has been directed towards consumers (i.e. Main Street), as evidenced in raised savings rates. Moreover, the latest data shows that US real median incomes are growing by around 1% a year, compared to deep contractions in the previous 3 recessions of -4.4% (2008), -2.1% (2000-01) and -4.5% (1990)[10]. This data suggests the government handouts have worked to ensure the stimulus has been more equitable, thus increasing the likelihood that consumer pent-up demand will be supported by both savings and incomes. Certainly, the fundamental backdrop for company earnings has improved. Current consensus one year forward global Earnings Per Share annual growth rose to a decade-high of 20%, up from a low of -2% in May[11]. Given this favourable environment, we remain constructive on equities despite the obvious risks. This includes the uncertainty over the as yet unknown outcome from the US presidential election and a potential disputed result in the courts.

[1-4, 6, 7, 10, 11] Refinitiv Datastream, data as at 26 October 2020
[5] International Air Transport Association, data as at 28 July 2020
[8] Capital Economics, data as at 20 October 2020
[9] Bloomberg, data as at 23 October 2020

Equities

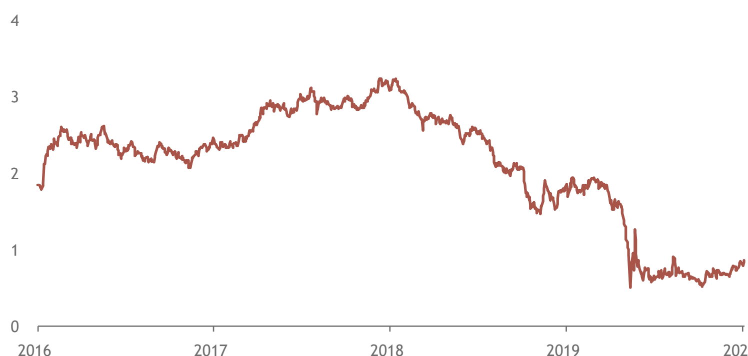
Since the UK's vote to leave the European Union in 2016, a discount has opened in valuation terms between London-listed equities and their overseas peers. The coronavirus crisis has pushed interest rates lower around the world, making those companies which exhibit earnings growth (like the 'big-tech' firms in the US) more attractive. The UK market is relatively underexposed to these sectors, with larger weightings to financials, materials and energy. This has led these 'value' orientated sectors to underperform, further exacerbating the valuation gap between the UK and rest of the world. Looking at a simple average of dividend yield, price-to-book and price-to-earnings ratios (three of the most common valuation metrics) reveals the UK trading at valuation of only around 0.55x the broader world. Valuation is often said to be a poor market timing tool, but extreme readings can lead to sharp turning points.



Source: Refinitiv Datastream/Smith & Williamson Investment Management LLP, data as at 2 November 2020

Fixed income

Despite political uncertainty and risks of a second covid-19 outbreak, US government bond prices have fallen over the course of the month. Benchmark 10-year bond yields, which move inversely to prices, rose from 0.5% in August to 0.8% end of October (see chart). This could potentially be attributed to higher inflation expectations or concern over governments' fiscal expansions undertaken to fight the covid-19 recession. US government bonds' performance may lead investors to question their value as a portfolio hedge during equity market volatility while yields remain so low.



Source: Refinitiv Datastream/Smith & Williamson Investment Management LLP, data as at 2 November 2020

FX and commodities

In the last month, the copper price reached a two and a half year high. Also referred to as "Dr.Copper", the price of copper is seen to be an indicator of health of the global economy and in particular trade. Given the base metal is a fundamental input across many industries and products, when copper demand is high it demonstrates that demand for goods (from China, for example) is strong which drives the price higher. This rising demand signals that we are in a global economic recovery.

Source: Refinitiv Datastream/Smith & Williamson Investment Management LLP, data as at 2 November 2020

Market highlights

Market returns (Total return (%), sterling)	1 month	3 months	1 year	5 year
Equities				
MSCI All-Country World	-2.4	1.8	5.5	81.2
MSCI UK	-5.1	-5.2	-22.2	3.8
MSCI UK Broad	-4.4	-4.0	-20.8	5.8
S&P 500	-2.7	1.9	9.8	107.8
MSCI Europe ex UK	-5.8	-3.1	-4.2	45.2
MSCI Japan	-1.6	8.7	0.8	56.1
MSCI Pacific ex Japan	-0.6	0.4	-9.2	54.5
MSCI Emerging Markets	2.1	4.3	8.7	78.0
Bonds				
iBoxx GBP Gilts	-0.6	-2.3	5.1	30.6
iBoxx USD Treasuries	-1.3	-0.8	7.1	43.4
iBoxx GBP Corporate	0.2	-0.2	4.7	34.6
Commodities and trade-weighted FX				
Oil Brent Crude ($/barrel)	-8.4	-13.0	-37.7	-22.5
Gold ($/ounce)	-1.0	-4.8	24.5	64.8
GBP/USD	0.0	-1.5	-0.1	-16.3
GBP/EUR	0.7	0.0	-4.3	-20.6
EUR/USD	-0.7	-1.5	4.4	5.4
USD/JPY	-0.9	-1.1	-3.3	-13.4

Glossary of terms

Bonds – The relationship between price and yield. Yield is the return you get on a bond. When the price of a bond changes prior to maturity due to supply and demand pressures, so does its yield. When the price of a bond goes up due to demand, the yield goes down to compensate. This is so the bond's fixed rate of return (coupon) remains relatively constant – and vice versa. A bond's price and its yield are inversely related. A key factor which influences a bond is the prevailing interest rate. When interest rates rise, the prices of bonds fall, thereby raising yields. This is because the older bonds are sold in order to buy new higher yielding bonds.

Equities – A stock or any other security representing an ownership interest.

Fed – Federal Reserve Bank.

FX – Foreign Exchange.

GDP – Gross Domestic Product.

GFC – The global financial crisis (GFC) refers to the period of extreme stress in global financial markets and banking systems between mid 2007 and early 2009.

IMF – International Monetary Fund

Monetary policy – Actions of a central bank or other agencies that determine the size and rate of growth of the money supply which will affect interest rates.

V Shaped Recovery – Real GDP growth trajectory.

Key macro data	Latest	2020 Consensus forecast	Spot rates	31-Oct	Yields (%)	31-Oct
UK GDP (YoY%)	-21.5	-10.00	GBP/USD	1.29	MSCI UK	4.73
UK CPI Inflation (YoY%)	0.5	0.90	GBP/EUR	1.11	MSCI UK broad	3.55
Bank of England Base	0.10	0.10	EUR/USD	1.16	10 Year Gilt	0.30

All values and charts as at 31 October 2020. Total returns in sterling.
Returns are shown on a total return (TR) basis i.e. including dividends reinvested (unless otherwise stated).
Net return (NR) is total return including dividends reinvested after the deduction of withholding tax.
Source: Thomson Reuters Datastream and Bloomberg

Important information

Please remember the value of investments and the income from them can fall as well as rise and investors may not receive back the original amount invested. Past performance is not a guide to future performance.

This document contains information believed to be reliable but no guarantee, warranty or representation, express or implied, is given as to their accuracy or completeness. This is neither an offer nor a solicitation to buy or sell any investment referred to in this document. Smith & Williamson documents may contain future statements which are based on our current opinions, expectations and projections. Smith & Williamson does not undertake any obligation to update or revise any future statements. Actual results could differ materially from those anticipated. Appropriate advice should be taken before entering into transactions. No responsibility can be accepted for any loss arising from action taken or refrained from based on this publication. The officers, partners and employees of Smith & Williamson, and affiliated companies and/or their officers, directors and employees may own or have positions in any investment mentioned herein or any investment related thereto and may trade in any such investment.

Sources

MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indexes or any securities or financial products. This report is not approved, endorsed, reviewed or produced by MSCI. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

Neither Markit, its Affiliates or any third party data provider makes any warranty, express or implied, as to the accuracy, completeness, fitness for purpose or timeliness of the data contained herewith nor as to the results to be obtained by recipients of the data. Neither Markit, its Affiliates nor any data provider shall in any way be liable to any recipient of the data for any inaccuracies, errors or omissions in the Markit data, regardless of cause, or for any damages (whether direct or indirect) resulting therefrom. Without limiting the foregoing, Markit, its Affiliates, or any third party data provider shall have no liability whatsoever in respect of any loss or damage suffered by you as a result of or in connection with any opinions, recommendations, forecasts, judgments, or any other conclusions, or any course of action determined, by you or any third party, whether or not based on the content, information or materials contained herein. Copyright © 2020, Markit Indices Limited.

The Bank of England base rate, Retail Price Index (RPI), Consumer Price Index (CPI) and Sterling Overnight Index Average (SONIA) are public sector information licensed under the Open Government Licence, http://www.nationalarchives.gov.uk/doc/open-government-licence.

For further information

Contact	Direct line	Email address
Daniel Casali	020 7131 8985	daniel.casali@smithandwilliamson.com
David Goebel	020 7131 8908	david.goebel@smithandwilliamson.com
Sam Pham	020 7131 8352	sam.pham@smithandwilliamson.com
Sarah Giarrusso	020 7131 4218	sarah.giarrusso@smithandwilliamson.com

Our offices: London, Belfast, Birmingham, Bristol, Dublin (City and Sandyford), Glasgow, Guildford, Jersey, Salisbury and Southampton.

Smith & Williamson Investment Management LLP authorised and regulated by the Financial Conduct Authority.
Smith & Williamson International Limited Regulated by the Jersey Financial Services Commission.
Smith & Williamson Investment Management (Europe) Limited Regulated by the Central Bank of Ireland.
© Tilney Smith & Williamson Limited 2020. 150620lw