Smith & Williamson

Investment outlook

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

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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 COVID-19 vaccine announcement is a booster for equities over bonds

Equities were boosted in early November by vaccine announcements from Pfizer-BioNtech and Moderna. Given that test results show these vaccines prevent 90-95% of infections, it could potentially be a game changer to break down transmission chains and allow herd immunity to be achieved. However, there are huge logistical challenges to vaccinate the global population.

For the economy, the vaccine announcement should increase the probability that consensus 2021 expectations of +5.2% global real GDP growth are met[1]. At the very least, the most vulnerable parts of the population can be vaccinated reducing the need for governments to implement economically damaging national lockdowns. The vaccine should also allow pandemic-hit industries, such as hospitality, travel and leisure, to slowly recover.

Major central banks are expected to remain dovish on monetary policy and governments supportive from a fiscal point of view. A strengthening and broadening macro backdrop with increased visibility is likely to be positive for global equities. The MSCI All Country World equity index has already returned 64% (including dividends) from its low this year on the 23 March[2] in anticipation of a strong rebound in 2021 and is already above pre-COVID levels, but we feel there is further to go. The improving economic situation is less conducive for long-term government bonds. Since the recovery in equities this year, total returns for both 10-year UK Gilts and US Treasuries have been broadly flat. Looking forward, we expect equities to continue to outperform bonds.

Opportunities in the divided states of America

Barring Republican lawsuits that substantially change the vote count in key swing states, Joe Biden is heading to the White House on the biggest turnout ratio since 1900. However, the new Democrat president will enter office on 20 January with a highly divided nation across gender, racial, demographic and educational lines. These divides have been made worse by the pandemic. There is also increasing wealth creation divergence between urban and rural communities. Data from Brookings, a US-based non-profit public policy organization, found that Joe Biden's 76m votes came from predominantly densely populated urban areas that account for 70% of GDP, up from 64% under Hilary Clinton in 2016[3], with the GDP share difference coming from largely Trump supporters in suburban and rural areas.

While the gap in the popular vote was bigger than four years ago, the presidential race was tighter in the electoral college system; Biden won by 50,000 votes in Wisconsin, Georgia and Arizona, compared to Trump winning by 77,000 votes in Pennsylvania, Wisconsin and Michigan in 2016[4]. These small margins of victory, along with the income inequality in the urban-rural areas, probably go some way to explain why the last two elections have been so acrimonious and point to long-term risks in the stability of the country.

Democrats will be disappointed that the "Blue Wave" of winning the White House and control of both houses of Congress predicted by some polls did not materialise. In the House of Representatives, Democrats maintained control, but lost seats. The Democrats failed to win control of the Senate, where Republicans can now block key parts of Biden's pre-election agenda (i.e. raising taxes to pay for increased fiscal spending). That said, the Democrats do have a second opportunity to gain control of the Senate, if they win the two run-off elections in Georgia on 5 January.

In terms of investment themes, our initial thoughts from a Biden presidency are that:

i) A split Congress will be seen as a positive for stocks, since it reduces the risk of corporate tax increases and concerns over potentially business unfriendly ideology from the left of the Democratic party (i.e. restricting share buyback policies);

ii) Renewable energy should benefit from the president-elect's symbolic promise to re-join the 2015 Paris climate accord and use of executive authority to impose greater regulatory pressure on non-renewable energy and emissions.

iii) Emerging Asia should gain from an expected multilateral approach by the US over trade policy, compared to Trump's policy to impose ad hoc tariffs on China.

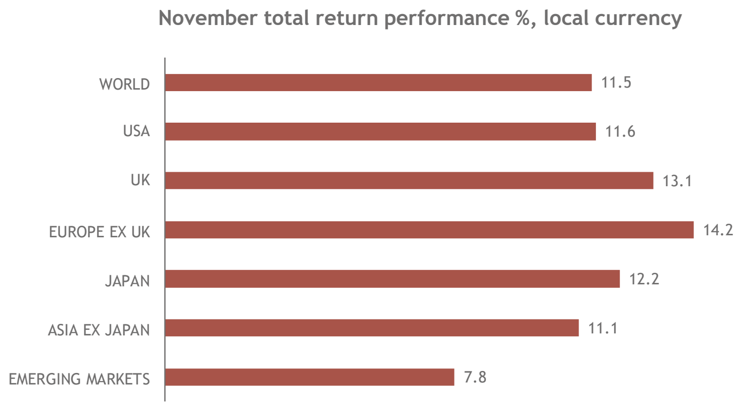
iv) The tech sector may struggle to maintain its recent market leadership. On historically high valuations, there is an added risk that the new administration looks to rein in the sector through tighter regulation and anti-trust interventions. This may leave the sector vulnerable to profit-taking.

While positive long-term investment themes will provide a tailwind to some areas of the US stock market, we remain cognizant of the risks of political deadlock. On a risk-to-reward basis, we see more opportunities in non-US equities and particularly in the UK, where valuations are less demanding. The risk of the UK leaving the EU without a trade deal has probably fallen after the US election. Joe Biden has said that his administration will not agree to a trade deal with the UK if the Good Friday Agreement is undermined. PM Johnson will not want to risk failing to achieve a trade deal with either the US or the EU, particularly given the economic pressure already faced by the country from the ongoing Coronavirus pandemic.

1 Bloomberg, data as at 17 November 2020
2 Refinitiv, data as at 25 November 2020
3 Brookings, Biden-voting counties equal 70% of America's economy. What does this mean for the nation's political-economic divide? Mark Muro, Eli Byerly Duke, Yang You, and Robert Maxim, 10 November 2020
4 There's a strategy behind Trump's sulking, Gerard Baker, The Times, 12 November 2020

Equities

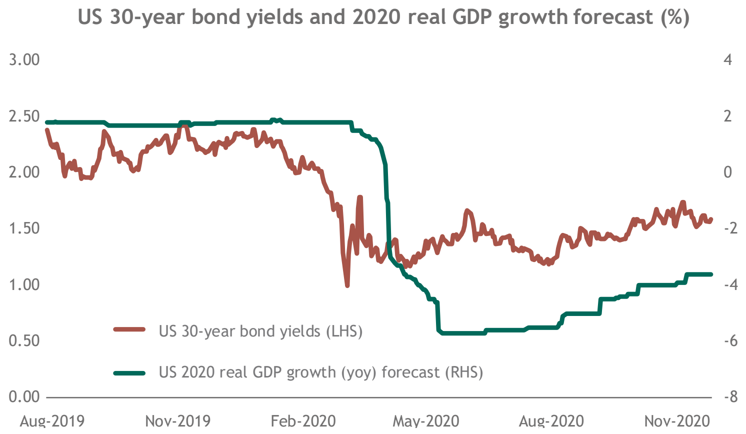
Encouraged by the vaccine news, equity indices experienced a historic month of performance in November. An acceleration of the rotation into unloved laggards has seen non-US equity regions outperform. Most notably in November, Europe ex UK is up 14.2% and the UK is up 13.1%. Even against a backdrop of quasi-lockdowns and no deal Brexit fears, MSCI Europe ex UK experienced its strongest rally since the Global Financial Crisis and MSCI UK its strongest in 30 years. Equity markets continue to rally looking through the pandemic and forward to a continued economic recovery.



Source: Refinitiv Datastream/Smith & Williamson Investment Mangement LLP, data as at 30 November 2020

Fixed interest

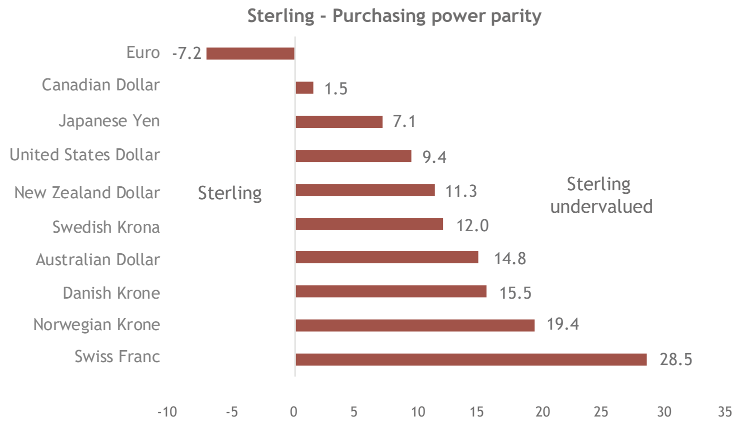
Long bond yields tend to move in tandem with expectations of economic activity. As investors become more optimistic on the growth outlook, they reallocate from safe holdings (i.e. bonds) and invest in riskier assets (i.e. equities). This drives bond yields higher as depicted in the right-hand chart. The US 30-year government bond yield has risen from 0.51% at the end of July to 0.83% at the end of November. At the same time, expectations of US 2020 real GDP growth improved from -5.7% to -3.6%.



Source: Bloomberg/Smith & Williamson Investment Management LLP, data as at 30 November 2020

FX and commodities

At these late stages in the Brexit trade-deal negotiations, the risk of a 'no-deal' outcome remains a distinct possibility. While it would be difficult to see this result as positive for the UK economy in the short term, cheap valuations on UK assets might help to limit further potential downside. Equity valuations are inexpensive compared to the rest of the world on most measures, and sterling also looks relatively cheap. Purchasing power parity is a relative measure of currency strength based on the value of goods one can buy in different countries with foreign currency. According to figures from the OECD, sterling looks good value relative to 9 of the G10 currencies. At around $1.33 currently, even after recent weakness in the US dollar, the UK currency remains well below the levels it was trading at prior to the 2016 referendum.



Source: OECD/Bloomberg/Smith & Williamson Investment Management LLP, data as at 30 November 2020

Market highlights

Market returns (Total return (%), sterling)	1 month	3 months	1 year	5 year
Equities				
MSCI All-Country World	8.8	6.5	12.0	93.8
MSCI UK	13.1	5.7	-13.5	17.1
MSCI UK Broad	13.2	6.3	-12.2	19.2
S&P 500	7.5	4.2	13.8	117.0
MSCI Europe ex UK	13.4	7.5	7.1	63.1
MSCI Japan	9.0	12.3	9.2	67.4
MSCI Pacific ex Japan	11.1	7.5	0.6	69.1
MSCI Emerging Markets	5.8	10.1	15.1	91.1
Bonds				
iBoxx GBP Gilts	-0.4	0.5	5.5	28.7
iBoxx USD Treasuries	-2.7	-0.2	4.5	36.4
iBoxx GBP Corporate	2.1	2.7	6.9	34.9
Commodities and trade-weighted FX				
Oil Brent Crude ($/barrel)	27.1	5.7	-23.8	8.1
Gold ($/ounce)	-5.7	-9.8	21.4	66.8
GBP/USD	3.3	-0.3	3.2	-11.3
GBP/EUR	0.5	-0.3	-4.9	-21.7
EUR/USD	2.7	0.0	8.5	13.3
USD/JPY	-0.3	-1.7	-4.8	-15.4

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	30-Nov	Yields (%)	30-Nov
UK GDP (YoY%)	-9.6	-10.00	GBP/USD	1.34	MSCI UK	3.88
UK CPI Inflation (YoY%)	0.7	0.90	GBP/EUR	1.12	MSCI UK broad	2.86
Bank of England Base	0.10	0.10	EUR/USD	1.20	10 Year Gilt	0.34

All values and charts as at 30 November 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.

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