Smith & Williamson

Investment outlook

A monthly round-up of global markets and trends
January 2021

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Investment outlook

A review of a tumultuous 2020

The investment landscape in 2020 has been dominated by the COVID-19 virus, lockdowns and unprecedented policy easing by central banks and governments around the globe. The US election and UK-EU negotiations provided further risks to markets. The pandemic led to a global economic shock that established new multi-generational records. For instance, UK GDP fell by over 11% in 2020, the biggest decline since the Great Frost of 1709[1].

In financial markets, the MSCI All Country World equity index fell 32% in total return terms (including dividends from peak-to-trough during the year), while government bonds outperformed as investors became more risk averse[2]. The low point came on the 23 March when the Fed said that it was prepared to buy US corporate bonds as part of a new round of quantitative easing (e.g. asset purchases). Global equities then went on to rally 63% from the trough, supported by – at various points – fiscal and monetary stimulus, economic recovery and hopes of a successful vaccine rollout, to close out the year up 15%[3].

The main winners of 2020 were 'growth' equities and direct COVID beneficiaries such as Big Tech, following widespread adoption of e-commerce and working from home. Long-term government bonds benefited from central bank asset purchases. In turn, gold gained from concerns about the debasement of the fiat currency system from money printing: the US created 25% more dollars in 2020 than existed previously[4]. Despite the virus originating in Wuhan, China was one of the quickest economies to re-open and MSCI China equities rose 28% in 2020[5]. China's economy benefitted from lockdowns in the West, since services were restricted, but buying goods was not. China even managed to boost its share of global merchandise exports, driven by stimulus in the West creating demand. The biggest losing sectors were energy (-32%), real estate (-9%), banks (-11%), with the COVID-exposed UK and Eurozone the laggards in geographical terms[6].

Loving unloved stocks in 2021

We maintain an optimistic outlook for equities for four reasons. First, the rollout of vaccines and a gradual opening up of economies from lockdowns should encourage households to run down savings rates to sustain consumption - see our November *Investment Outlook*.

Second, we expect a synchronised broad-based global economic recovery that supports company earnings. The IMF forecasts that a record 79% of nearly 200 economies will experience growth higher than 3%[7]. Not only would this recover much of the lost output last year, but it adds support to consensus global Earnings Per Share growth of 28% expected in 2021[8].

Third, central bank liquidity is still projected to remain highly accommodative. The ECB topped up its pandemic emergency purchase program by €500bn in December to €1,850bn and extended the horizon of net bond purchases to the end of March 2022[9]. In a major policy change in September, the Fed made clear that it intended to "run hot" with regards to maintaining easy monetary policy in order to achieve above 2% inflation[10]. Morgan Stanley forecasts that the combined balance sheet of G4 central bank assets will rise by $3.4trn by the end of 2021[11].

Fourth, we expect a weaker dollar to provide a tailwind for global stocks by reducing concerns over the ability of borrowers to pay down large dollar-denominated debts and providing upside to the reflation story. Our dollar pessimism stems from the sharp relative increase in debts accumulated by the US from COVID. For comparison, the US has borrowed $12,800 in debt per capita in 2020 versus $7,000 for the UK, $5,300 for France and Germany and $1,200 for China[12].

Furthermore, there is an upside for the euro against the dollar after the creation of the €750bn European Recovery fund last July. For the very first time the EU can issue bonds raised at the federal level to help fund financially weaker countries, such as Spain and Italy, to strengthen cohesion within the union for the single currency.

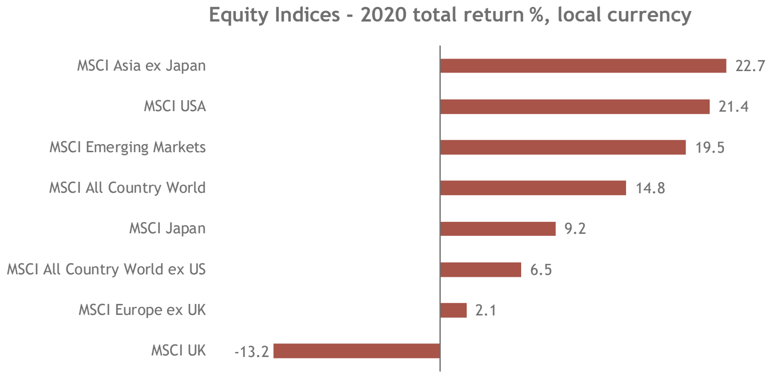
Given the constructive macro backdrop for equities, we see some of the unloved parts of the market could benefit. Cheap "value" equities (e.g. financials, energy, industrials, UK, emerging markets and the Eurozone) are priced at a record valuation discount to expensive "growth" (tech, US). The UK should benefit from less uncertainty now that a trade deal has been agreed from the EU. We see a broadening economic recovery encouraging a rotation into these unloved stocks. Encouragingly, following the vaccine announcement in early November, global MSCI value stocks have outperformed growth stocks by 6% to year-end[13]. Considering that value total returns have underperformed growth by 48% since the start of 2007, we see room for further outperformance[14].

In terms of the risks, we continue to monitor; i) a sudden removal of accommodative policy, perhaps if inflation returns at a pace that exceeds central bankers' expectations; ii) fears of another COVID-19 surge, or a disappointment in the effectiveness in vaccines/a mutation to a more virulent virus; iii) social unrest in the politically-polarised United States (see our December *Investment Outlook*); and iv) extended valuations in some sectors (e.g. technology) bringing about a broader market rout.

[1] UK Government, Spending review 2020, 15 December 2020
[2,3,4,5,6,8,13,14] Refinitiv/Smith & Williamson, 30 December 2020
[7] World Economic Outlook, IMF, October 2020
[9] European Central Bank, Monetary Policy Decisions, 10 December 2020
[10] Federal Reserve, FOMC Statement, 16 September 2020
[11] Morgan Stanley, 2021 Global Macro Strategy Outlook, Back to Life, Back to Liquidity, 21 November 2020
[12] Barron's, The Renminbi Will Gain Wider Use Globally, Gavekal's CEO Says, 5 December 2020

Equities

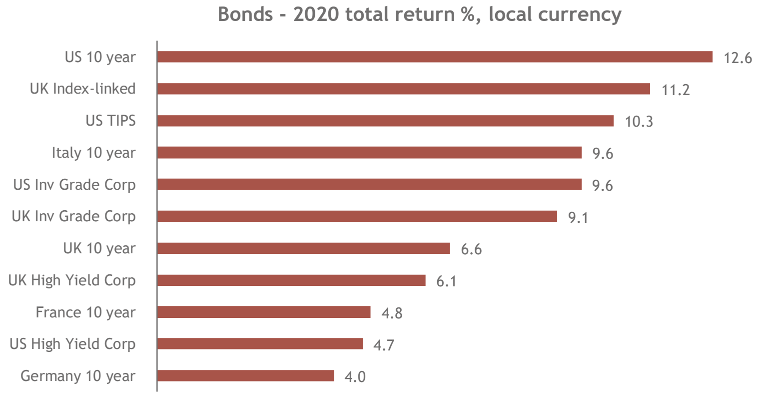
2020 has been a turbulent year for equities driven by the global pandemic. This year saw historic records broken with the S&P 500 experiencing its fastest bear market (20% decline in value) in history and then subsequently the shortest bear market in history. The Russell 2000 (US small cap equity index) in November had its best monthly performance in history and the UK its best monthly performance in 30 years. The outlook for 2021 remains positive for global equities. Even after such a volatile year most major indices (ex UK) are seeing the year out with positive total returns. However, with the risk of 'no-deal' Brexit avoided and the coronavirus vaccine roll out, UK equities could catch up with their peers in 2021.



Source: Refinitiv Datastream/Smith & Williamson Investment Management LLP, data as at 31 December 2020

Fixed interest

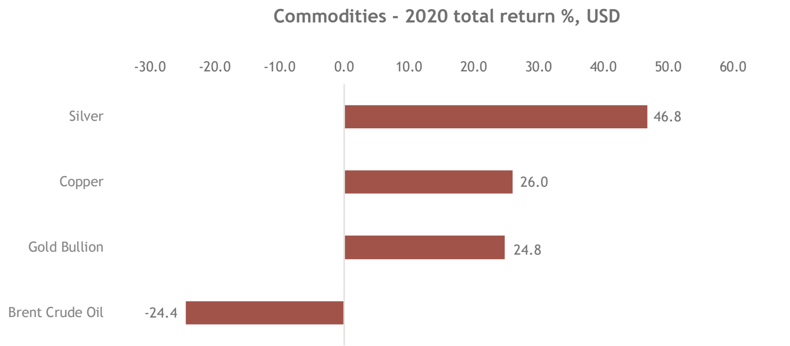
Central bank's asset purchases program benefitted all developed market bonds in 2020. US 10-year nominal government bonds rallied 12.3%, whilst the UK equivalent rose 6.7%. Unlike previous programs in the aftermath of the global financial crisis, major central banks extended purchases to corporate bonds to help fight the economic fall out of the pandemic. US and UK investment grade rose 9.3% and 8.7%, respectively, whilst US high yield ended the year up 4.6%. The rebound in economic activities and support from both governments and central banks raise concerns over an inflation overshoot, propelling inflation-protected government bonds.



Source: Refinitiv Datastream/Smith & Williamson Investment Management LLP, data as at 31 December 2020

FX and commodities

The collapse in demand for oil amid a global pandemic saw Brent crude oil prices falling 24.4% in 2020. Meanwhile, precious metals benefited from worries that central banks and governments' economic support would lead to higher inflation – gold ended the year 24.8% higher, whilst silver rose 46.8%.



Source: Refinitiv Datastream/Smith & Williamson Investment Management LLP, data as at 31 December 2020

Market highlights

Market returns (Total return (%), sterling)	1 month	3 months	1 year	5 year
Equities				
MSCI All-Country World	2.2	8.6	13.2	97.4
MSCI UK	3.0	10.6	-13.2	22.9
MSCI UK Broad	3.7	12.2	-11.7	25.4
S&P 500	1.4	6.1	14.7	118.9
MSCI Europe ex UK	2.1	9.1	8.2	66.3
MSCI Japan	1.7	9.0	11.4	66.2
MSCI Pacific ex Japan	2.8	13.6	3.4	66.6
MSCI Emerging Markets	4.9	13.3	15.0	100.6
Bonds				
iBoxx GBP Gilts	1.5	0.5	8.8	32.2
iBoxx USD Treasuries	-2.5	-6.3	5.2	30.6
iBoxx GBP Corporate	1.7	4.0	8.6	38.5
Commodities and trade-weighted FX				
Oil Brent Crude ($/barrel)	8.8	26.6	-21.8	45.4
Gold ($/ounce)	7.0	-0.1	24.8	78.6
GBP/USD	2.4	5.7	3.2	-7.3
GBP/EUR	0.1	1.3	-5.3	-17.7
EUR/USD	2.3	4.3	9.0	12.6
USD/JPY	-1.0	-2.2	-5.0	-14.2

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	2021 Consensus forecast	Spot rates	31-Dec	Yields (%)	31-Dec
UK GDP (YoY%)	-8.60	5.35	GBP/USD	1.36	MSCI UK	3.70
UK CPI Inflation (YoY%)	0.30	1.50	GBP/EUR	1.12	MSCI UK broad	2.32
Bank of England Base	0.10	0.10	EUR/USD	1.22	10 Year Gilt	0.24

All values and charts as at 31 December 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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