Monthly market blueprint

Investment management service

December 2020

mazars

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Foreword
The analyst doth protest too much, methinks

Dear reader,

November featured plenty of good news for markets: The US election returned multilateralism to the Oval Office, Covid-19 vaccination is set to begin before the year's end and S&P 500 companies have surpassed earnings expectations. In the background, central banks have vigorously reaffirmed their commitment to keep markets lubricated and the mounting debt cheap. It should be no surprise then that US stocks, the global equity benchmark, delivered their third best month since 1991 (up 10.8%), 1.3 years' worth of equity returns within about 20 working days. We have just entered December, traditionally also a good month for equity markets.

Our commitment to asset allocation and long-term investment allows us to see beyond contemporary and transitional risks, like the pandemic or the hyper-partisan US politics and focus on the question that is really important: are current prices reasonably supported?

If the answer is "yes, by fundamentals", all is good in the world. Companies are making money and investors are paying a fair price for the privilege of participating in future profits. If the answer is "yes, by institutions", all is still good, and probably less volatile, but it compels us to keep an eye on said institutions. This has consistently been the case for the past few years and the reason why we haven't been meaningfully underweight risk during that period. If the answer is "yes, because of everyone is buying", it's traditionally a reason to be extra cautious. But we don't have much evidence to support the contention that the current rally is a sentiment-driven bubble.

Strategically, the world is in a much better place than it was last March. Yet, there are still reasons to worry. A dearth of catalysts ahead, the closing of hedge fund and prop desk books until January, Brexit negotiation stalemate at the very last moment, pressure on high street businesses as a lot of Europe is still in lockdown and US viral loads picking up are all legitimate reasons for concern. In China, many State-Owned Enterprises are looking at a mountain of debt payments in the next quarter, even as authorities are carefully rolling back emergency-era measures. And while all of the world's political attention is on the State of Georgia's Senate runoff, which will determine the length of the leash for the Biden administration, people are perhaps less mindful of the real risk that EU-stalwart Germany might change tack after the April CDU internal election. And so, it goes.

That is the perversion of our profession as investment experts: we are literally paid to worry about the next thing. The more mindful we are of our agency responsibilities with clients, the more empathetic to their worries, the more we may fail to appreciate current context. We are conditioned to look at the next bend in the road, paying less attention to the scenery.

Investors with discretionary portfolios are naturally worried, because they take risks without any control over the outcome. Add the fact that fear of loss is about three times stronger than the happiness of gains (according to Nobel-Prize winning research), and worry becomes perpetual. The point of having experienced investment teams is to recognize that negative catalysts will always exist, and that their job is to separate tactical noise from strategic threats.

There is always the next thing and the thing after that and they may always cause some volatility, which we may be able to exploit tactically by overweighting or underweighting assets during our quarterly investment committee. However, over the longer term, as we approach the end of the Covid-19 tunnel, we see that the takeaway from this crisis is that financial Capitalism is very agile and very resilient (albeit with the helping hand of the state and central banks –which are still very much a part of the system), even more so when the threat is exogenous rather than endogenous.

To trust that asset allocation is a means for a happy retirement and the tangible attainment of financially-related goals, is to believe that financial market capitalism will continue to adapt, evolve and deliver over the longer term which is exactly the place where pensions, homes and the other long-term objectives of financial planning lie.

George Lagarias
Chief Economist, UK

Market performance - in a nutshell

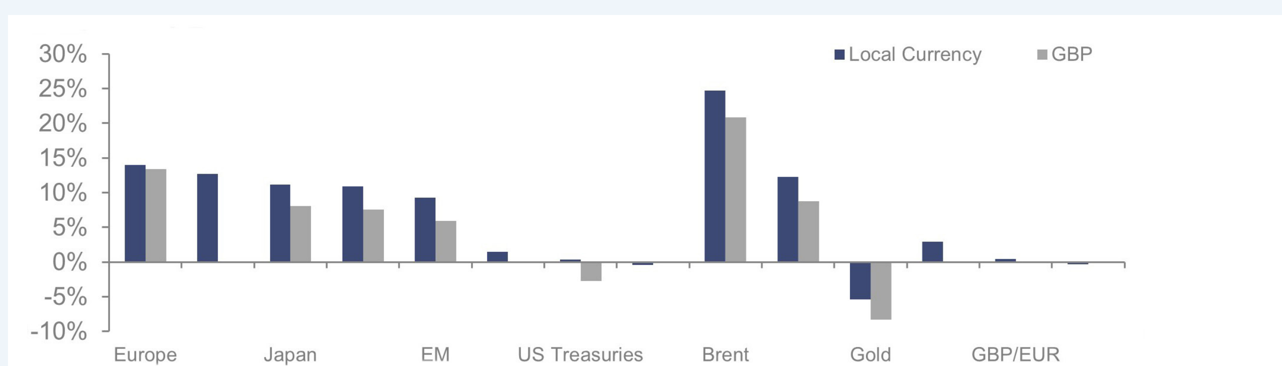
The month in review

Positive vaccine news helps equity markets to best month in over a generation

Global equity markets rallied sharply in November, as a series of better than expected vaccine media releases encouraged investors to increase their risk appetite. Global equities rose +9.3% in November. Three different vaccines all showed evidence of strong efficacy against the coronavirus and this combined with a post-US election rally encouraged investors to look beyond the bleak economic reality of 2020 to a potential return to normality in 2021. British and European equities posted their best months since 1989 and 1986 respectively, and but for a sell-off on the last day of the month both could have recorded all-time best months. UK equities were up +12.7% in November, whilst European equities rose +13.4% in Sterling terms, in doing so they provided the best returns of the major indices to British investors. Investors rotated towards the weaker performing areas in the market, Energy and Financials leading global sectors whilst more defensive sectors such as Utilities and Consumer Staples, though positive, lagged. Despite the rotation a significant performance gap remains this year between growth-style and value-style equities. US equities returned +7.5% in Sterling terms, the bias in US markets to more growth-orientated companies which has been so supportive of the indices this year turned into somewhat of a hindrance. The Presidential Election this month, whilst causing a spike in political uncertainty for a period, had a relatively muted impact on markets and ultimately the key driver of markets remained the positive vaccine news.

Emerging Market equities returned +5.9% in Sterling terms, though this rises to 9.2% in local currency terms. Despite the relative underperformance to other major markets. Emerging Markets will benefit most greatly from the AstraZeneca vaccine news, as despite the lower efficacy the logistics of storage and delivery make it the most viable vaccine in these regions. In bond markets, the UK 10-year rose 4.3 basis points to 0.31% whilst the US 10-year fell 3.5 basis points to 0.84%. The German 10-year rose 5.6 basis points to -0.57%. In credit markets, US yields fell significantly, especially so in junk debt (rated BB or below). Gold sold off sharply -8.3%, as investors moved out of the safe haven asset, falling to $1,792. Oil rallied- +22.8% to $45.2 yet this still represents a -26.2% fall year-to-date.

Basic asset classes



Source: Mazars Calculations, from 31/10/2020 to 30/11/2020

Asset allocation

Outlook and portfolios

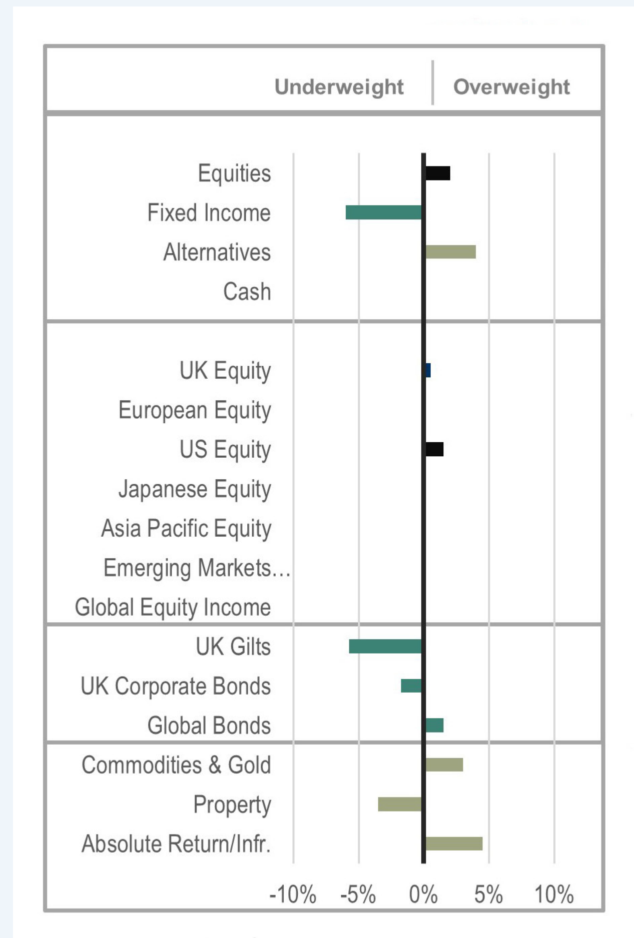
The 11-year global economic expansion cycle has come to an end, the result of a rare "Black Swan" event, a global pandemic. Economic data sharply deteriorated throughout Spring as a result of an unprecedented global lockdown. From June onwards we saw a meaningful rebound in economic activity as global economies reopened, albeit against a backdrop of deteriorating virus data. The rebound was impressive at first, but petered out throughout September, until renewed lockdowns in Europe in October and November forced consumption down again. With the virus driving economic performance, we now see that the global economy is broadly out of sync. Asia and the US are performing better, while Europe remains under pressure.

Overall, businesses aren't as pessimistic as consumers, which is why we have seen moderate restocking and orders of capital goods picking up, even as consumption sapped in areas where lockdowns are strict. Liquidity is ample but inflation remains subdued.

Central bank support and fiscal initiatives by governments have greatly contributed to the continuation of the financial cycle, even as the economic cycle broke down. At the time of writing, global equities were near peak levels, mostly driven by US stocks, while bond prices are also near all time highs.

We remain slightly overweight equities and risk, in the belief that even a central bank-guided market can still deliver returns. In terms of geographical allocation we maintain proximity with the benchmark, and rely more on our fund selection to create alpha. Our underweight in fixed income continues as a result of structurally low yields. In terms of Sterling, we keep close to the benchmark, due to Brexit uncertainty. We maintain a healthy exposure to gold, as the asset class remains uncorrelated with equity markets and would tend to gain in times of aggressive monetary accommodation. We have a small exposure in property, with an eye to zero out the asset class in our portfolios, mostly due to liquidity concerns. In terms of alternatives, we maintain exposure to infrastructure, which we believe might be a beneficiary of increased fiscal spending in the next few years.

Asset allocation based on the Mazars Balanced Portfolio as of 4 December 2020



Risks ahead

Global economic growth faltered at the swiftest pace since WWII, but overall asset prices have kept climbing as policy makers actively sought to avoid market panics. Over the short-term, Covid-19 has had a significant impact on both economic fundamentals and market sentiment, while adding to de-globalisation pressures. At the time of writing, however, the world was edging closer to a vaccine, with the first approval, in fact, coming out of the UK.

Nevertheless, despite Covid-19 being the primary driver of economic performance, markets' focus has been primarily fixed on quantitative easing, with investors convinced, for now, that central bank risk suppression will is potent enough to weather the economic storm. The reliance on policy is an assurance, but also a key risk by itself, especially in a hyperpartisan political environment.

Stock prices are near all time highs, but with earnings falling behind, short term valuations are very expensive. Global bond yields might be extremely low, and are likely to remain so for some time especially as the Fed has now effectively removed its 2% inflation target. However, many companies find themselves with weaker balance sheets. Possible inability to raise new debt or refinance old debts, especially in the face of a sudden stoppage of operational cash flows, could have devastating consequences, especially for smaller/mid-caps and companies teetering at the edge of the investment grade spectrum.

In the US, risks have somewhat been reduced, after the return of a more multilateral-oriented government, following the last election. Still, that government's efficacy will –in part- depend on control of the Senate, which will be determined in January.

In the UK, a weak economy is faced with an uncertain Brexit (at the time of writing), just a few days before the Dec 31 deadline.

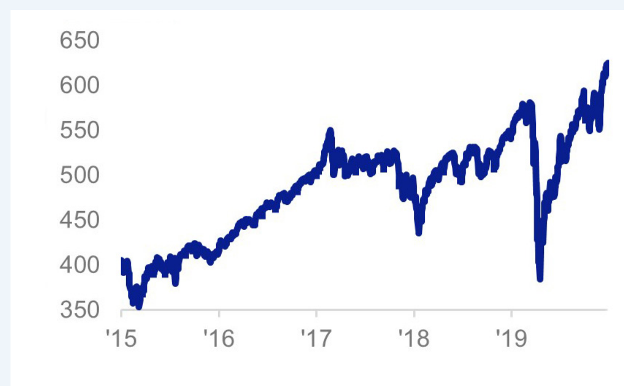
In China, growth conditions have been restored, and stimulus is slowly being withdrawn. investors will be looking closely to assess the pace of the recovery, to make sure that growth doesn't falter again.

In Europe some of the risks were mitigated, as countries have coalesced to mutualise some debt raised to fight the virus. A further risk could arise in the next few months, if the CDU primary produces a leadership that would significantly deviate from Ms. Merkel's approach to European affairs.

We feel that short-term systemic risks are being reduced but that longer term risks are building up, especially in the form of high indebtedness. The key to the recovery is the maintenance of policy support as long as it's needed, without it becoming inflationary.

Global stocks (led by the US) at all time highs

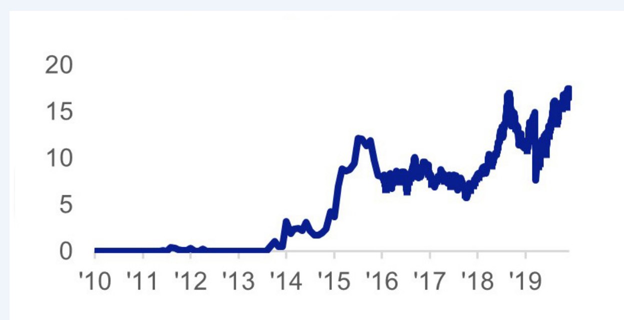
MSCI World



Global stocks are at all time highs

A record $16.5tn negative yielding bonds

(Bloomsburg Barclays global agg neg yieldingdebt market value USD)



A record negative yielding bonds are threatening returns for bond-heavy portfolios

Charts Source: Mazars Calculations

Macroeconomic backdrop
Global

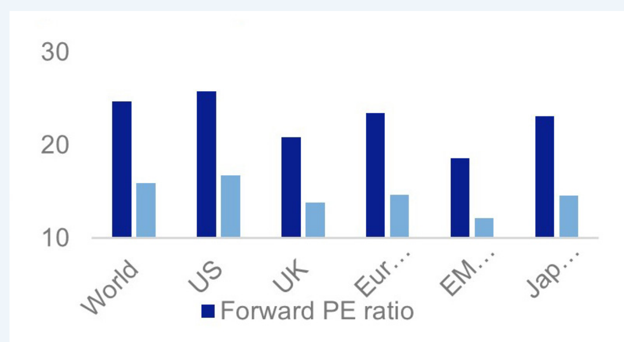
For the period, global stocks rose by +12.8% (+9.3% in GBP). The highest performing sectors were Energy and Financials while the worst performers were Utilities and Cons. Staples. Equities were trading at 24.71x times forward earnings, 55.4% above their long-term average. Gold fell -5.4% and oil prices rose +26.7%.

The post-lockdown rebound was impressive, but it started losing steam after the summer. The pandemic has thrown the global economy out of sync. Emerging markets, especially those with close relations with China, have fared better than their developed counterparts, with the US outperforming Europe. The manufacturing sector has been outperforming services, especially those heavily reliant on customer contact. Within manufacturing, trends are positive. An acceleration of capital equipment orders and inventory restocking, suggests that businesses have been planning their way back to normality. While new lockdowns imposed on Europe in October have suppressed consumption, good vaccine news should be lifting consumer and business confidence throughout the world, even if current surveys fail to capture this. Despite a pickup in input prices, inflation overall remains subdued, although this could change as higher input costs begin to feed into end product prices. Unemployment projections have been slashed, as government employment support programs seem to have worked. Central banks and fiscal planning authorities have been very supportive of both financial assets and high street businesses, although we have seen some policy failures, mostly due to constraints on policy transmission mechanisms, like banks. Overall, however, the environment is extremely liquid and is expected to remain so until at least throughout the next year, as supply chains are being repaired and travel and business relationships restored.

Outlook: Risk assets may continue to rely on the support of policy makers to coast through the end of this unprecedented crisis. On an economic level, while some policy failures have been observed, we believe that the damage may well be restored. As output gaps close, growth should continue to rebound. Thereafter, however, we wouldn't expect long term growth to be explosive, as global debt levels have now risen significantly.

Valuations remain expensive

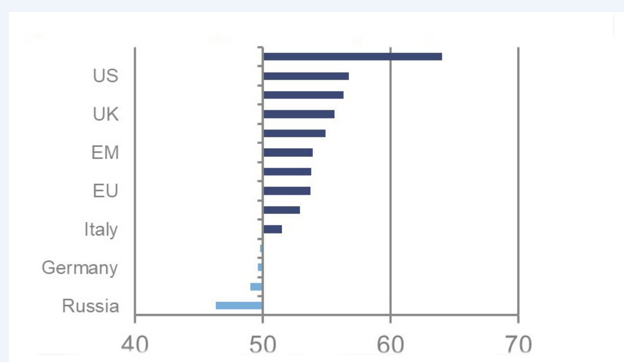
Forward price/earnings ratios



Economic activity has rebounded somewhat, but it doesn't seem to be picking up significant momentum.

Recovery is uneven

(Global manufacturing PMIs, >50= expansion)



The recovery is currently uneven, but we should expect more synchronisation as populations are being vaccinated.

Charts Source: Mazars Calculations

The FTSE 100 achieved the best month of growth in over three decades, the index of large listed companies rose +12.4%. The index had been on course for its best ever month before a sell-off on the final day of the month.

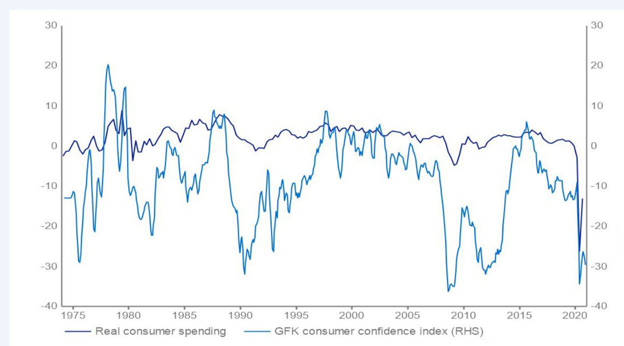
Energy and Financials were the two best performing sectors, buoyed by optimism about the economic outlook while Utilities was the worst performing sector. UK stocks are trading at 20.90x forward earnings, at a discount of 15% to the MSCI World. The 10 year Gilt yield rose 4.3 basis points to 0.305%.

Markets rallied on a string of positive media releases surrounding vaccines. Better than expected efficacy rates helped encourage investors to increase their risk appetite and the UK particularly benefited from this risk-on environment. The UK economy, as a services-orientated economy, is particularly exposed to lockdowns and listed firms in the UK are overweight to Energy and Financials. With a vaccine increasing energy demand expectations for 2021 and Banks supported by an improved lending environment these sectors performed particularly well. Despite the strong month, the FTSE 100 is down -17.60% year-to-date.

Outlook: Any upside potential in a 2021 rebound for global markets for British equities should definitely be cautiously evaluated. The UK economy suffered a deeper recession than all but one other G20 economies and also faces the largest budget deficit in peacetime. The UK is still yet to agree terms with its largest trade partner on a trade deal. Failure to achieve a Brexit trade deal in the early days and weeks of December will weigh heavily on Sterling and British equities.

UK consumer spending and confidence

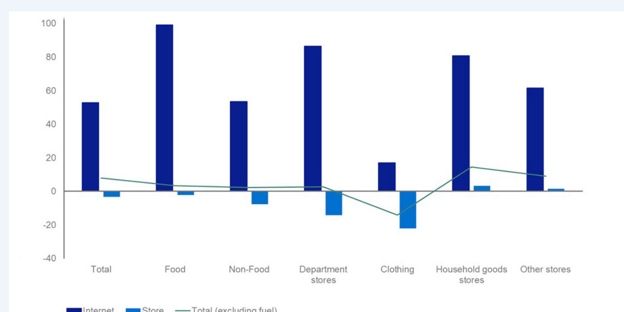
Four-quarter percentage change (LHS), index three-month moving average (RHS)



British consumer confidence fell in November as England joined Wales and Northern Ireland in total national lockdown. All but essential retailers were closed and this has translated to a marked tick downward in consumer confidence.

Growth in online sales offsets low or negative growth in stores

Value sales, seasonally adjusted, October 2020 relative to February 2020



Retail Sales data released in November showed that the growth in retail sales this year is driven by sharp rises in online sales. In all but two areas store sales have fallen. Retail sales have picked up as consumers shift their discretionary experience away from services.

Charts Source: Mazars Calculations, Refinitiv Datastream

Macroeconomic backdrop
US

For the period, US stocks rose by +10.9% (+7.5% in GBP). The highest performing sectors were Energy and Financials while the worst performers were Cons. Staples and Homebuilding Index.

Equities were trading at 25.77x times forward earnings, 53.5% above their long-term average and 4.3% above the MSCI World. 10y bonds fell 3 bps at 0.839%.

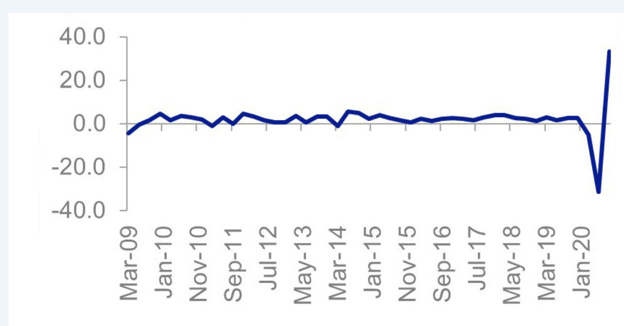
The US economy slowed down in Q2, but the rebound after Q3 has been impressive. In November, economic performance picked up at the strongest pace since 2015. Meanwhile, S&P 500 companies surprised on the upside, with a blended earnings decline of 6.3%, but 84% of them beating earnings expectations and 78% beating sales expectations. A report from Factset suggests excluding four sectors (oil, airlines, hospitality and banks) aggregate earnings would have risen 6%. Most of the macroeconomic numbers have been suggesting normalisation in terms of consumption and output. Manufacturing picked up the pace in November, on the back of strong domestic and foreign orders. The services sector followed suit, with strong demand boosting output and increasing backlogs. Employment conditions have continued to improve across the board. Inflation remains tame (Core PCE 1.4%), however persistently higher input costs could find their way in prices for end products.

As a result, the central bank continued to print a record amount of money while shedding its long standing 2% inflation goal. Despite the withdrawal of a key stimulus provision at the end of the year, the Federal Reserve has signalled that current programmes should be enough to support growth.

Outlook: The US economy has picked up steam, even as Europe is losing ground. However, economically, a lot depends on the upcoming stimulus package, which has yet to be agreed between the outgoing government, the incoming one and Congress.US risk assets continue to outperform the rest of the world, and, on a strategic basis we see few catalysts which would shift that relationship.

Biggest post-war GDP rebound

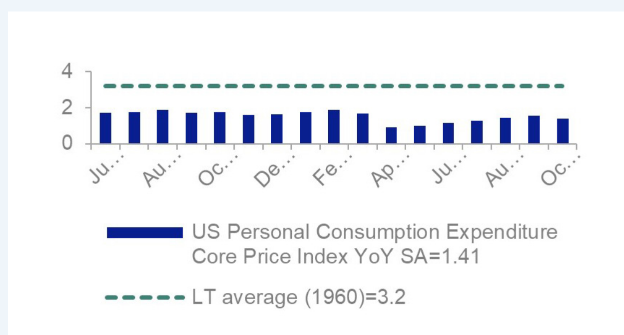
(US GDP SAAR +33% up from -33% QoQ + 7.4%, YoY -2.9%)



Consumers optimism is affected by partisan politics

No consumer inflation yet

(Core PCE 1.4 down from 1.5)



Inflation is still tame.

Charts Source: Mazars Calculations

Europe

In November, European stocks rose by +13.4%. All sectors were positive, with cyclical sectors Energy and Financials gaining as much as +30%. 10Y Bund yields rose 5.6 basis points to -0.571%.

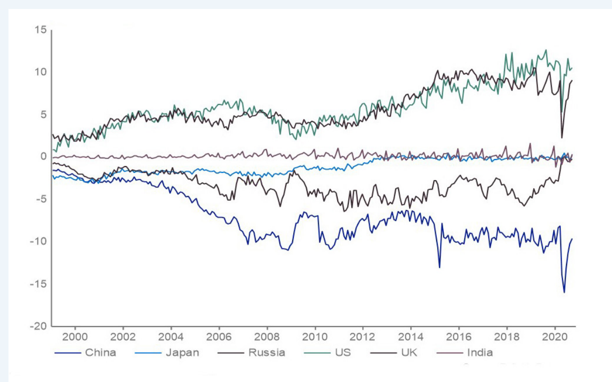
Positive vaccine news has seen a resurgence in markets, which in Europe have been led by regions and sectors most affected by the crisis. Whereas German equities have been the strongest performing year-to-date, Spanish and Italian equities gained the most in November on the vaccine news. A similar trend is observed in sectoral performance where cyclical sectors such as Oil & Gas and Autos have seen significant gains on hopes a vaccine can restore economic growth.

German GDP growth for Q3 was revised up to 8.5% from 8.2%, although output remained 3.9% below the same point last year. Eurozone consumer confidence remains mired at -17.6, with services sentiment still poor, although economic sentiment surprised to the upside. Consumer confidence in Germany ticked down as a result of the renewed shutdown. EU leaders face various geo-political issues, although Joe Biden's victory in the US Presidential election will likely reduce pressures from across the Atlantic. However Brexit negotiations are going to the wire with both sides demanding concessions.

Outlook: Europe seems to be facing a perfect storm of geo-political issues but with limited ability of monetary or fiscal policies to help growth pick up following Covid. On a forward P/E basis Europe is more expensive than all major regions aside from the US. We have moved underweight European equities as part of our move to having more of our Global equity exposure hedged.

Euro area trade balance

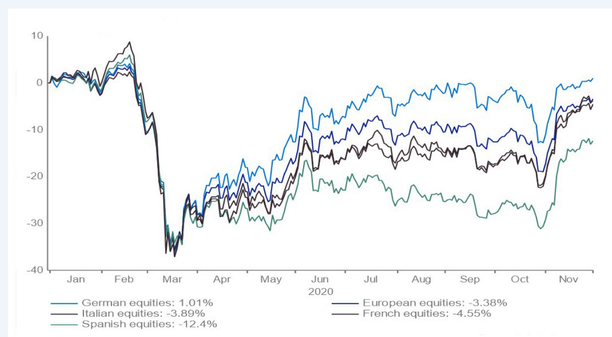
EUR billions



There have been some large swings in the Euro area's trade balances during the Covid-19 crisis, however what continues to stand out is its large trade surplus with the UK and the US.

European equities comparative total return

Per cent, year to date



German equities remain the best preforming in Europe year-to-date, however November saw countries most affected by Covid-19 significantly outperform on positive vaccine news.

Charts Source: Refinitiv Datastream

Macroeconomic backdrop
Japan and emerging markets

Japanese stocks were up +8.1% and Emerging Markets stocks +5.9% in Sterling terms. Japanese and Emerging Market equities were trading at 23.1x and 18.6x times forward P/E respectively, above long-term averages.

China's economy continued to show strong signs of recovery in November. Manufacturing activity in the region advanced to 52.1 from 51.4 previously. The latest reading signalled the strongest growth since September 2017, as the economy continued to recover after the government lifted Covid-19 lockdowns and ramped up investment. Service PMIs increased to 56.4 from 56.2 a month earlier. Exports from China jumped +11.4% year-on-year (YoY) in October, following a +9.9% gain a month earlier. Imports to China rose by +4.7% YoY in October, after a +13.2% surge a month earlier. This was the second straight month of growth in inbound shipments, as domestic demand recovers.

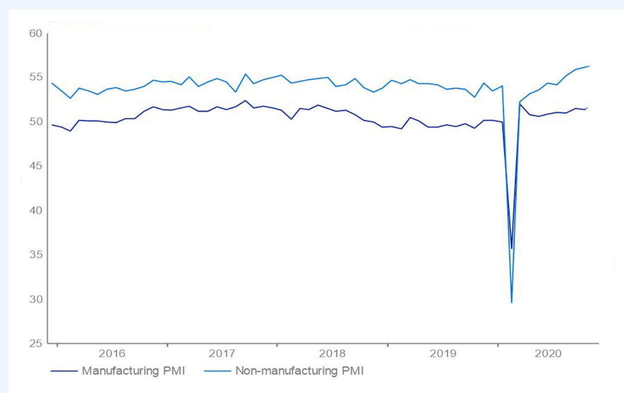
Japan's economy grew at an annualized +21.4% in Q3 2020, the highest on record, partially recovering from a record -28.8% plunge in Q2 2020. Exports from Japan declined by -0.2% YoY in October, compared with a -4.9% slump previously. Imports to Japan dropped by -13.3% YoY in October, compared with market forecasts of a -9% plunge, as the pandemic hurt domestic demand. Japan Manufacturing PMI increased to 49 in November from 48.7 previously. The latest reading signalled a contraction in the manufacturing sector for the 19th consecutive month. The service sector PMI was 47.8 in November, slightly higher than 47.7 in October as export sales and new business orders fell on the back of a third wave of Covid-19 infections in the country.

Leaders from 15 Asia-Pacific nations sealed one of the biggest trade deals in history, seeking to reduce barriers to trade in Asia, covering a third of the world's population and economic output. Economists said the deal could add almost $200bn annually to the global economy by 2030.

Outlook: As a significant drop in global demand for goods and tourism hits Asia due to Covid-19, the risks for Emerging Market economies have risen. Although these economies have experienced significant capital outflows, overall liquidity provisions have balanced the outflows.

China NBS PMIs

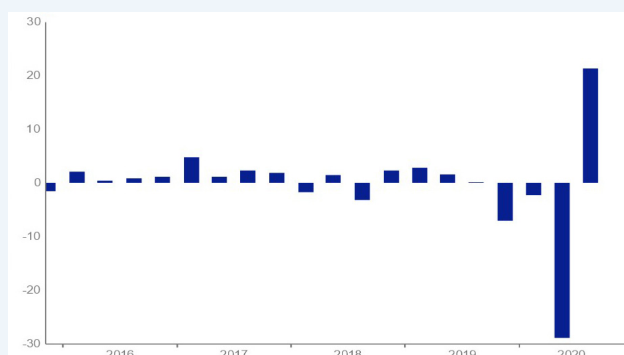
Both manufacturing and services sectors advanced in November



China's manufacturing and services sector advanced in November, signalling a sharp and accelerated rise in overall business activity in the region.

Japanese GDP

Japan's economy witnessed its first quarter of growth in a year



Japan's economy expanded +21.4% in the third quarter of 2020 as the country's rebound from Covid-19 produced its first quarterly growth in a year.

Charts Source: Mazars Calculations

Our themes

Macro theme 1

End of the beginning for Covid-19

After February 21, when it became apparent that Covid-19 was developing quickly outside of China, markets followed the "virus narrative".

Traders and longer-term investors who have, for a decade, been conditioned to respond directly and primarily to central bank stimulus, began to focus on the $15tn of new money added to the markets this year by the central banks all over the world. Unsurprisingly, the financial and media narrative began to follow the stock market rebound, and investors started focusing on a more hopeful future. Both US and global stocks have crossed pre-Covid levels and hit record highs this year. More importantly, they are all trading at very high valuations versus projected 12m earnings, which suggests that traders are now looking past the Covid-19 related earnings drop and focusing on life after.

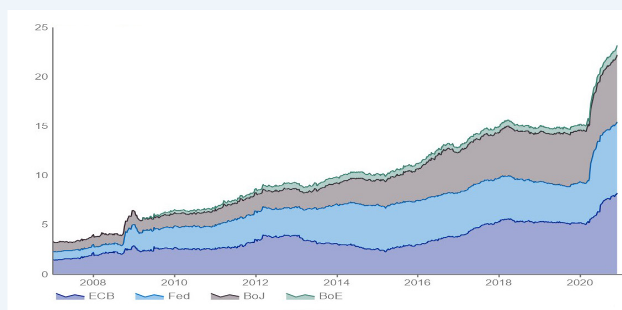
Global stocks had their best month since 1988, propelled by a series of Covid-19 vaccine breakthroughs. The rally reflects investors' growing eagerness to buy into risky assets, encouraged by progress in the development of Covid-19 vaccines at pharmaceutical groups Pfizer-BioNTech, Moderna and AstraZeneca. Investors moved out of tech stocks into sectors that they expect to benefit most from a quicker end to the health and economic crisis. The gains came despite a surge in coronavirus infections and fresh lockdowns across the globe that pose a threat to the economic recovery achieved in recent months. "We're still in the middle of the worst crisis, but there is now hope," said Laurence Boone, OECD chief economist.

Although news of a potential vaccine by the end of 2020 was positive news overall, the threat of a third wave of Covid-19 is troubling policy makers. Post the Thanksgiving holiday weekend in the US, hospitals in New York state have been ordered to expand capacity and prepare for staff shortages as public health officials get ready for a surge in new Covid-19 cases. In parts of Asia, countries like Hong Kong and India are battling the third wave of Covid-19 with officials calling for new restrictions to control rising infections. The outbreak has forced the suspension of an air travel bubbles and temporary closure of party venues. Hong Kong has also had to introduce stricter social distancing measures. As the UK emerges from its second lockdown on 2 December, Foreign Secretary Dominic Raab said England could face a third wave of coronavirus if ministers do not "get the balance right" with restrictions.

Releasing its latest forecasts for the world economy, the OECD predicts a strong rebound from this year's historic global recession in 2021, but said that the world economy would not fully regain the lost output until the end of next year. According to the report, China's economy is expected to be almost 10% larger than at the end of 2019 whereas the US is expected to regain its lost output by the end of next year, despite its current high infection rate.

Central bank balance sheets, total assets

USD, trillons



Globally, central banks and governments have committed an estimated $15 trillion of stimulus already to shield their economies from the coronavirus pandemic.

Charts Source: Mazars Calculations

Macro theme 2
Capitalism rebooted

2020 has been a trying year for free market economics.

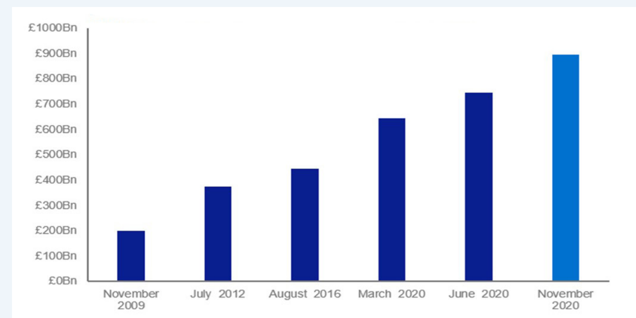
Despite notable left-wing politicians such as Elizabeth Warren and Jeremy Corbyn losing elections last year, this year has been one of the greatest shifts to the left in public policy ever seen in peacetime. An unprecedented global pandemic has encouraged nations and central banks to provide unprecedented levels of monetary and fiscal policy support. The British deficit is set to reach double the peak of the 2008 Global Financial Crisis and will be the largest ever in peacetime. The Bank of England's official bank rate has been cut to 0.10% and the Bank has expanded QE to a total of £895 billion four-and-a-half times the level in November 2009.

These measures have in part been forced by public health decisions that were made earlier this year. Governments recognised from early in the pandemic there would be a trade-off between public health and economic decisions. Most governments, Sweden a notable European exception, decided early on to enter strict lockdowns whilst using the aforementioned aggressive monetary and fiscal policy to mitigate some of the economic pain. The United States, previously a bastion of laissez-faire economics, offered 'Economic Impact Payments' to individuals wherein the IRS issued 160 million payments to individuals totaling $270 billion.

Traditional arguments against ultra-loose monetary policy, that low interest rates encourage zombie (low-productivity) firms to survive, have been side-lined. The next step for economies is deciding to what extent they wish their central banks to remain truly independent. They will also need to consider how to stimulate productivity in the face of a fragile economy scarred by lockdowns and high unemployment. Further, economies will need to decide how to tackle rising debt. Some central banks may forgive the debt of their government, some may seek to inflate their debt away (note the Fed's shift to an average inflation target). Nonetheless it is clear to see 2020 has fundamentally changed capitalism in developed economies.

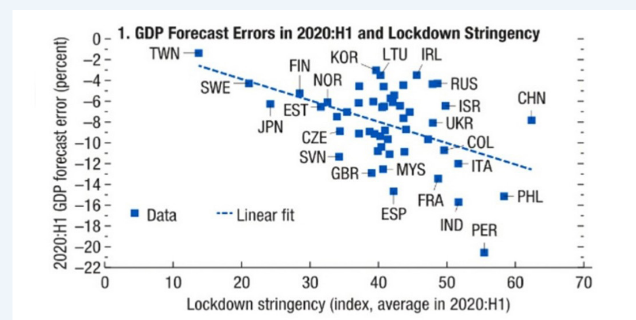
QE infinity

Bank of England purchases of bonds in £billion



The bank of England has purchased £875 billion of government bonds and a further £20 billion of corporate bonds. The bank does this to try to boost spending and investment in the economy by lowering the cost of borrowing.

GDP forecast errors in 2020-H1 and lockdown stringency



The negative correlation between lockdowns and output loss is shown above (as measured by forecast v actual GDP). In Great Britain where GDP was even more negative than a model of lockdown stringency would predict.

Charts Source: IMF, Mazars Calculations, Refinitiv Datastream

Macro theme 3

The new consumer

Lockdowns have had an outsized effect on growth hurting sectors in an uneven manner. Services have been hit more than manufacturing and consumption more than production.

Consumer discretionary items and high street retailers are taking the largest hit. Private consumption makes for about 50%-60% of total GDP in developed economies. It is the most fickle and difficult part of the GDP calculation, but by far the most important.

The services sector, which was the most hit in the crisis makes for:

- 67% of GDP in the US
- 80% of GDP in the UK
- 70% of GDP in the EU

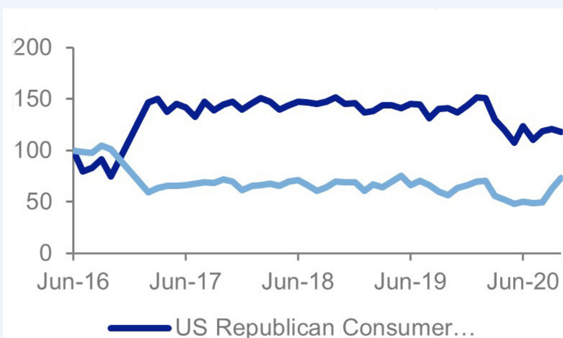
Consumption is about psychology, and that's why a lot of macroeconomic models which assume rational and repeatable consumer patterns often fail. How consumers and policy makers will respond to the virus, and how confidence in spending and investment is rebuilt is of paramount importance to predicting growth in the next few years.

In the last few years, we have witnessed the emergence of three basic types of consumers:

1. The Intermittent Consumer: This has more to do with the emergence of quarantines, where people would tend to spend more when on quarantine and less when out of it, leading to periods of very subdued consumption, followed by periods of excessive consumption. We expect this trend to be short-lived as we return to normality. However, we will be watching for signs that this crisis has left scars on consumers, or fundamentally shifted the way certain goods and services are consumed.
2. The Partisan Consumer: Consumers who tend to feel more optimistic when their Party is in power. We noticed the trend after the Brexit referendum and then again during the heated US election, where consumer sentiment changed dramatically for Republicans and Democrats along the lines of polls. Social media and stagnated incomes have been the more likely culprits for that sort of consumption pattern. We believe that hyperpartisanship, to the point where it affects economic decisions, may be with us for some time.
3. The Reluctant Consumer: With at least three major crises in the past 12 years (Global Financial Crisis, Brexit/Euro Crisis, Covid-19) and stagnated real incomes, consumers across the world have been increasingly reticent. The phenomenon of "Secular Stagnation", which we acknowledged before the Covid Crisis, is dampening consumer sentiment and favoring deposits, even at zero rates. As we expect sluggish growth rates in the foreseeable future, we feel that consumer reluctance may also be with us for some time.
4. Economists and portfolio managers alike should acknowledge that private consumption, more than 50% of the economy, may not follow historically established and predictable patterns. New types of consumers are here to stay, and we feel that only a radical shift in growth trends for the western world would change that.

The partisan consumer

(University of Michigan Sentiment Index, expectations)



Charts Source: Mazars Calculations, University of Michigan)

Equity spotlight

Markets rally on vaccine news

Pfizer announced on 9 November that its vaccine was 90% effective. This was followed by announcement of similar success by Moderna and AstraZeneca. The news has been a particular boon to those sectors which have been most affected by the crisis.

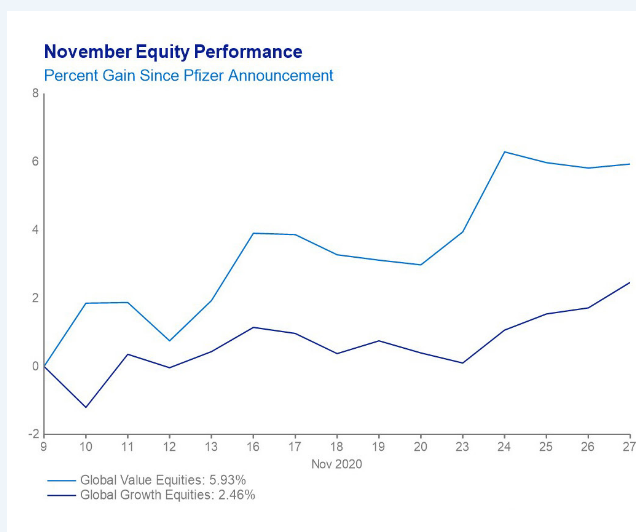
Although not always the case, in recent years stocks which are more sensitive to the economy, i.e. cyclical stocks, have also been cheapest on most metrics such as price to earnings, i.e. value stocks. With the crisis causing havoc in the economy, these sectors faced the brunt of the sell-off in March, as earnings expectations plummeted. On the other end of the spectrum have been growth stocks, in particular Tech stocks, which held up well in the initial sell-off as revenues have been less affected (or even jumped in cases such as Zoom).

The news of a vaccine wasn't a shock, as there had been suggestions for some time that trials were proceeding smoothly. However the announcement reduce the uncertainty over the timeframe for a vaccine. Further the 90% efficacy is extremely promising since regulators had previously said they would approve a vaccine that had just a 50% efficacy rate. Suddenly, sectors which faced significant bankruptcy risks the longer the crisis continued, can expect a normalisation of earnings by 2022, resulting in a rally of close to 6% in global value stocks compared to 2.5% in global growth stocks.

It should be noted that the vaccine news has not been the only news, with markets reacting positively to the prospect of a divided government following the US election results, however November has been the best month for equities since 1987.

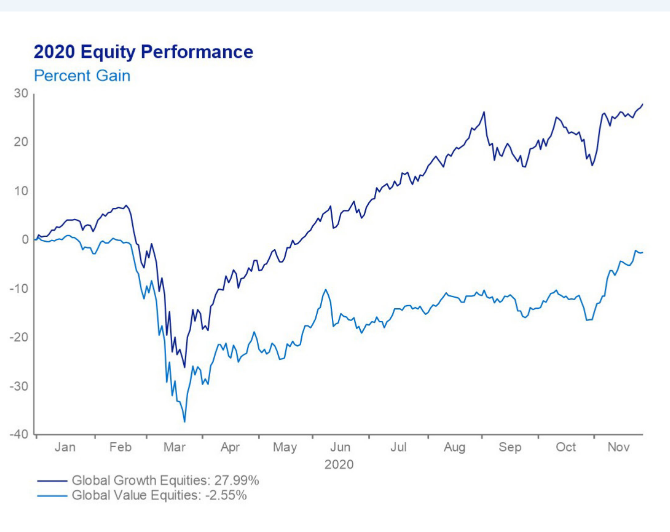
November equity performance

Percent gain since Pfizer announcement



2020 equity performance

Percent gain



Charts Source: Refinitiv Datastream

Commercial property

Open-ended commercial property funds have seen somewhat of a crisis since the Brexit vote in 2016. There is a mis-match between the low liquidity of their underlying assets, buildings, and the open-ended funds themselves which price daily.

This has led to the possibility that the FCA could force these fund to adopt a six-month redemption timeframe. Closed-ended funds (REITs) get around this issue by trading issued share on an exchange, however this adds equity-like volatility to owning these assets.

Following the Brexit vote nearly all open-ended funds were forced to suspend trading and apply significant NAV reductions as they were unable to price their holdings due to a lack of transaction data. These losses were never completely regained by several funds. Once re-opened these funds have remained largely in outflow and several have re-closed due to lack of available cash. For now we have moved out of these funds and instead use funds primarily invested in REITs, although we are now significantly underweight the asset class given the heightened volatility of these funds relative to their reward profile.

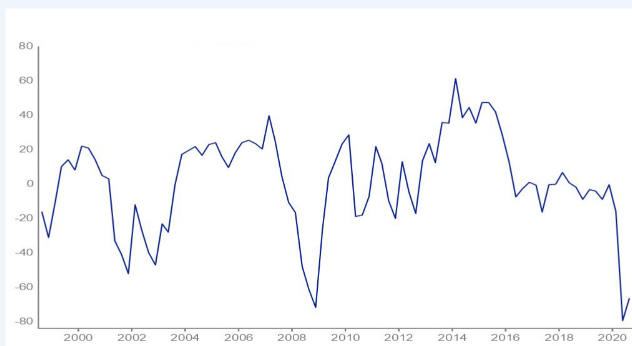
What is interesting is that although Brexit has been detrimental to sectors such as retail and offices (although the Covid-19 crisis has arguably added fuel to this fire), properties that make up what is called the industrial sector have in fact benefitted.

The term industrials tends to refer to warehouses and distribution centres. With consumers switching away from physical shopping, instead purchasing online through companies such as Amazon, well placed distribution centres were becoming more and more important before Brexit and the Covid-19 crisis. The increased difficulty of importing goods from Europe post Brexit has made prime positioned distribution centres even more important in making sure goods reach destinations without delays. Meanwhile the Covid-19 crisis has only sped up the trend to online shopping.

Offices and retail are on the wrong side of both these events: Offices with companies relocating to Europe (Brexit) and much of the population now used to working at home (Covid-19); Retail with slower expected growth (Brexit) and increased on-line shopping (Covid-19).

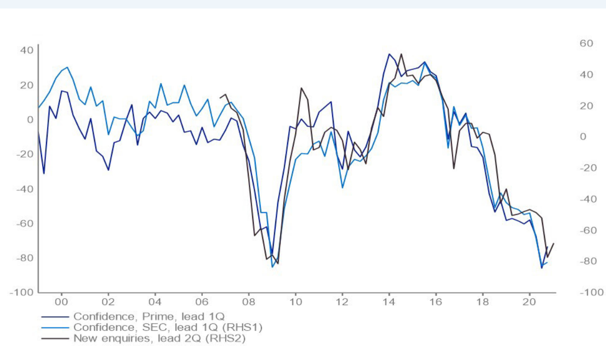
UK office demand

One-quarter percentage change



UK retail commercial property

Net balance all axes



Charts Source: Refinitiv Datastream

Equity spotlight
ESG investing

While the trend of Environmental, Social and Governance (ESG) investing, has been gaining momentum for years, this year the pace of green change has been rapidly accelerated as a by-product of the pandemic.

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ESG or ethical investing has now become a trend the investments industry can't afford to ignore. The pandemic has fuelled investor demand. Figures from Morningstar show flows into European ESG funds have reached an all-time high, attracting €52.6bn during the third quarter of 2020, helping grow overall assets across ESG funds to a record €882bn.

Opportunities for sustainable investment used to be scarce, but today it is hard to find a business that does not have an ESG policy. For example, 90% of companies in the S&P 500 index produced sustainability reports in 2019 and 81% of the FTSE 100 companies have some form of emissions reduction target.

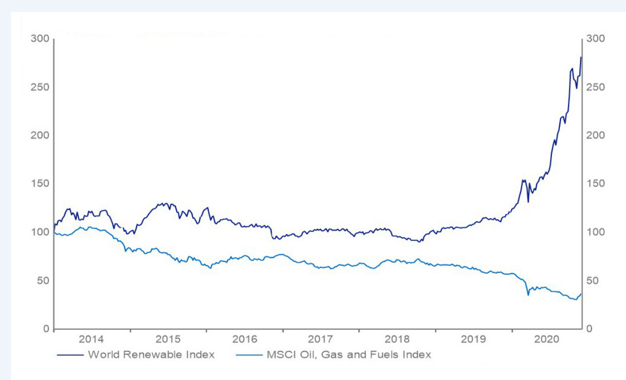
While the focus of ESG investments has largely been on environmental impact and climate change, this year we saw the 'S' in ESG come to the forefront. The social aspect of ESG was not well defined from an investment perspective but Covid-19 has definitely changed that. From early on in the pandemic, major shareholders urged company bosses to make timely payments to employees and suppliers during global lockdowns, even at the risk of losing dividend payments. Even social movements such as Black Lives Matter pushed companies to do more on racial injustice and called for greater disclosure of their staff's racial mix. Most companies will now be expected to not only disclose data on gender diversity but also racial and ethnic diversity.

As the focus on ESG investments increases, we can also see a shift in policy makers worldwide. In Europe, the EU taxonomy, which came into force this year, established an EU-wide classification system or 'framework' intended to provide investors with a common language to identify to what degree investment activities can be considered environmentally sustainable.

In the UK, chancellor Rishi Sunak announced the launch of Britain's first ever "green gilt" and also pledged that Britain will be the first G20 country to make large companies report their climate change exposures by 2025. China, the world's biggest producer of greenhouse gases, has said it will cut its carbon dioxide emissions to nearly zero by 2060. The US is also expected to re-join the Paris climate accord under Joe Biden, who has also called for a transition in America from fossil fuels to renewable energy.

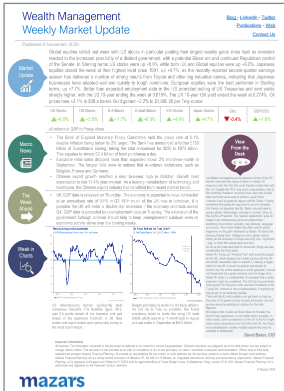
Global renewables versus oil and gas

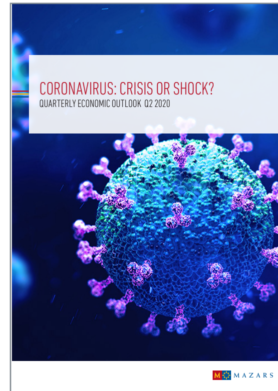
Performance relative to MSCI AW, 01/01/2014 = 100



Charts Source: Mazars Calculations, Refinitiv Datastream

More reading...





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