

Mazars Wealth Management investment newsletter

Winter 2021



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Foreword

Had you somehow been fortunate enough to have slept through 2020, you would have awoken to find that global equities had risen by nearly 16% during the year and could be forgiven for thinking that the world economy was in rude health. The reality is, as we are all too aware, altogether different with buoyant markets owing their gains mostly to the monetary and fiscal measures put in place to combat the effects of Covid-19, and partly to an optimism that that this year will be far better for businesses than last. A continuation of loose monetary policy also helped provide positive returns for bonds. Gold benefitted from its safe-haven status and a fear of rising inflation to post a 20% return for the year. Commercial property and Oil suffered steep losses as a direct result of lockdown measures.

Beyond the headline numbers there has been a huge dispersion between the returns in different sectors, with those which benefitted from enforced changes in working and social patterns, e.g. technology and online retail, massively outperforming sectors such as travel and energy. These sectoral differences were reflected in geographical returns, as the tech-heavy US market saw significant gains whilst the UK market, with its exposures to banking and energy stocks, was one of the few markets which lost money during the year.

The announcement of successful vaccine trials during November certainly played a large part in reviving stock market optimism, and though we, like most, hold an expectation that economic activity might be less encumbered by restrictions come springtime, we must acknowledge that our short term economic fate depends on the course of the virus. Beyond this, we must then consider what are the lasting socioeconomic effects of the pandemic and whether such an extraordinary episode in our history might be a catalyst for economic

restructuring and refocusing, or might we simply return to something resembling the old norms. These questions are not just interesting, they are important for the medium term prospects of sectors and asset classes, and it would not be too surprising to see similar dispersion in investment returns in the years to come, though not necessarily in the same pattern as seen last year.

Elsewhere, geopolitics continues to influence markets, not least here in the UK where a Brexit deal was announced giving much more certainty about the future trading relationship with the EU. Not all questions have been settled, notably the nature of financial services trade, a key part of the UK economy. Further, the compromise reached to ensure a 'level playing field' does not allow for a full stop at the end of the Brexit process. Nonetheless the deal does largely bring to an end a long period of uncertainty for the UK, and obviously avoids the unfavoured no-deal option.

At our January meeting the Investment Committee voted to make changes to our portfolios which move closer to our new strategic asset allocation. These changes include a greater weighting to overseas equities (with some currency hedging), a move away from sovereign debt towards a more diverse range of bond investments, and the complete removal of commercial property funds. Within our tactical positioning we hold the view that what worked well last year may not do so this year, and therefore favour the UK geographically, and have reduced exposure to 'growth' stocks.

I hope you find this newsletter interesting and relevant to you, and I would very much welcome any feedback you may have. Please do feel free to get in touch with your thoughts either by phone on: **020 7063 4259**, or by email on: david.baker@mazars.co.uk.

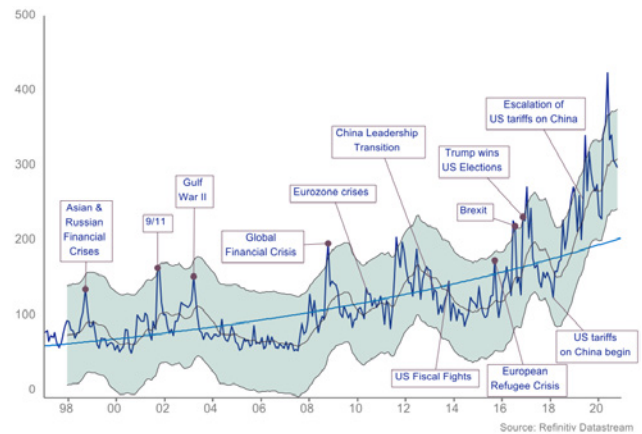
Economies and markets in brief

Geopolitics still sewing confusion

Although the US presidential election has removed some uncertainty on the direction of America's foreign policy, geopolitical stability remains a concern. President Trump is furthering the current foreign policy agenda in a lame duck period, which could complicate issues for President-Elect Joe Biden after inauguration. NATO has an internal issue, with Greece and Turkey in dispute over drilling rights in the Mediterranean. And while a deal has been achieved on Brexit, questions remain over trade in services amongst other issues. As the chart shows, although uncertainty has dropped a little since the middle of the year, it remains elevated by historical standards.

Global economic policy uncertainty has risen

World Economic Policy Uncertainty Index



Vaccine news a boon for struggling sectors

Markets have rallied significantly since the news in early November that the Pfizer, Moderna and AstraZeneca vaccines have a c.90% efficacy. It has also seen a reversal of the trend that saw value and cyclical stocks suffer far more than their growth counterparts, in particular Tech stocks. With hopes that economies can return to normal, these unloved sectors have rebounded far more strongly. However gains have not been nearly enough to overcome the gap year-to-date.

Equities have experienced a rotation in favour of value stocks

Value vs growth equities Q4 2020

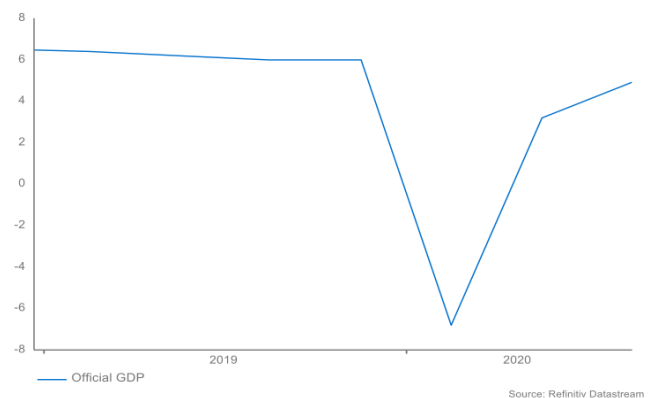


China leading the recovery

Having been the first country to lift lockdowns in early April, re-open factories and businesses, and lift travel restrictions gradually, China was the only G20 economy to grow its GDP in 2020. China experienced a sharp contraction of -6.8% in the first quarter of the year as its economy ground to a halt during large-scale shutdowns and quarantines to prevent the virus spread. This was China's first contraction since 1992 when officials began keeping quarterly GDP data. However, the country saw a dramatic reversal as its economy grew by +4.9% between July and September, making it the first major economy to recover from the Covid-19 pandemic. The quick recovery was a product of its stringent lockdowns, large scale testing, population tracking and fiscal stimulus via credit expansion. Both domestic and overseas consumption picked up, especially for personal protective equipment (PPE), and electronics, such as laptops, as many of its Western trading partners endured pandemic-induced lockdowns.

China's economy has staged a V-shaped recovery

Official China GDP, percent



'Long-Covid' – trends set to outlive the pandemic

Much has been made of the 'unprecedented' times we are living in, so much so that the Oxford English Dictionary has been unable to pick word of the year, and instead elected to choose several. One thing is certain however; Covid-19 has accelerated some trends we have been observing for years. We consider the impact of four of these major trends below.

Retail

Lockdowns have forced consumers to change consumption habits and nowhere is this clearer than the rapid shift towards online retail. Global retail ecommerce is predicted to have reached \$3.9 trillion by the end of last year, according to research by GroupM. Areas with low rates of ecommerce penetration such as Canada and Australia have seen the fastest growth this year. An increased digital presence is vital for retailers, with UK footfall in December down 29% year-on-year. The graph below shows how vital online sales have been; in all areas except clothing, online sales growth ensured retail sales were higher than pre-pandemic levels. Some caution in interpreting this data is necessary, for example the massive growth in food can be explained by an inability to go to a pub or restaurant encouraging consumers to order more food deliveries. However, we do expect the pandemic to mark a secular shift in consumer spending habits towards online retail due to increased confidence in using online channels.

Inequality

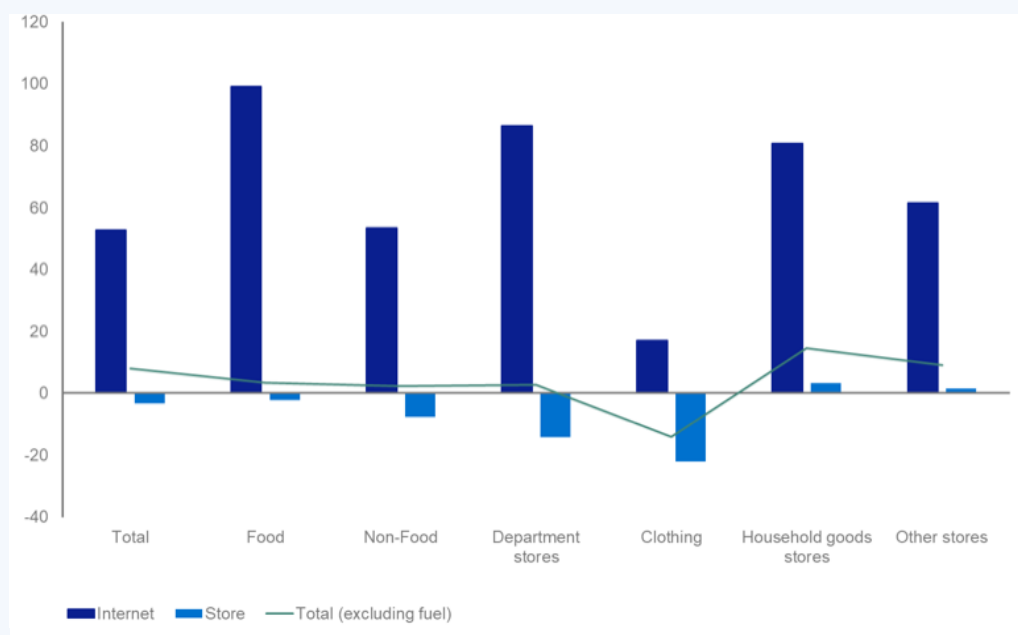
The pandemic has affected most greatly those who already had financial difficulties. A study by UCL found that of those who were financially comfortable pre-Covid, more are doing better than are doing worse. There is a growing divide between those who can work from home, such as in professional services, and the highly impacted industries such as tourism and hospitality. In addition, those employed in these industries are on average younger and resultingly have less in the way of savings. Lockdowns have hurt the real economy, whilst QE supports financial assets. This two-pronged mechanism has led to rising pressure for wealth taxes, both as a method of financing the unprecedented level of government debt, but also addressing rising inequality. Regardless of the fiscal environment we expect this trend to continue long into 2021 as hospitality will need time to see employment levels recover.

Peak globalisation

Globalisation went on a tear starting from the mid-1980s until it hit a plateau during the financial crisis in 2008. Since then, global trade as a percentage of GDP has flat-lined in the face of trade wars, and now a pandemic. As leaders all over the world rushed to shut borders and impose lockdowns to contain Covid-19, trade was obviously impacted.

Overall sales grow despite store closures

Sales October 2020 relative to February 2020



'Long-Covid' – trends set to outlive the pandemic

In past decades, trade has tended to grow more rapidly than world output, but this is no longer the case. Instead, trade growth has been abnormally weak in recent years. World trade volume actually fell in 2019, even though the world economy grew fairly steadily. Even before the pandemic hit, several factors such as President Trump's 'America First' policy and President Xi Jinping's 'Made in China 2025' initiative were already hurting globalisation. The pandemic has further added fuel to the trend away from globalisation by reinforcing concerns around the world that supply chains have gone too far. Export bans have been imposed over concerns about inadequate domestic production of medical equipment, PPE, pharmaceuticals and food.

The world economy is at a critical inflection point in history in which fears about dependence on others are growing. An inward turn is not exactly the end of globalisation, only a partial reversal. But undoing the resulting damage is likely to prove difficult.

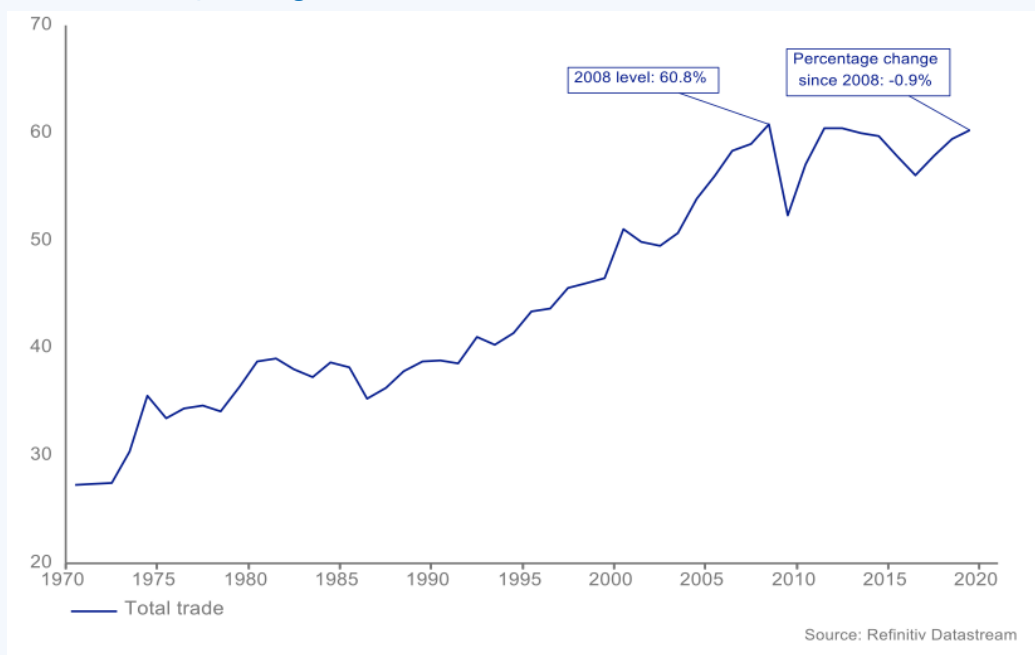
The end of the office

Demand for office space has significantly diminished due to Covid-19, as large proportions of office goers continue to work from home and physical distancing rules mean people will be unable to cram into lifts and busy office spaces. Experts predict a major shift in the commercial property market even when the pandemic is behind us.

According to the Royal Institution of Chartered Surveyors' quarterly survey, a key sentiment barometer for the commercial property market, 79% of respondents said demand for office space had deteriorated and predicted a sharp fall in office rents and capital values nationwide. The vast majority, 93% of respondents, also expect businesses to scale back their space requirements over the next two years. The pandemic forced companies to adapt new policies and use technology to facilitate remote working. Most employees are now accustomed to a flexible workplace and dispersed teams, a trend that will have an impact on office life as we know it, potentially reshaping the entire "office economy".

Global trade has not grown since 2008

Global trade as a percentage of GDP



Jargon Buster...

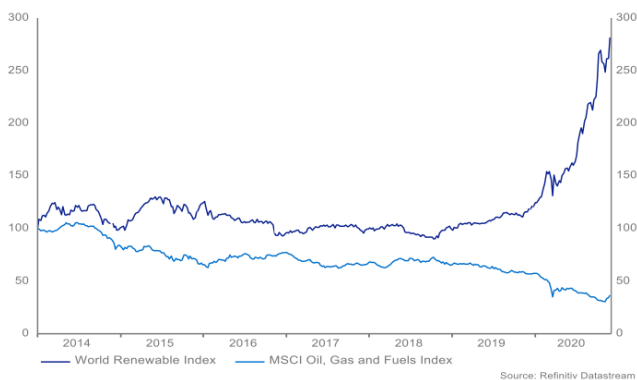
SRI stands for socially responsible investing, which is an investment strategy which seeks to consider both financial return and social / environmental good to bring about positive social change. There is no precise definition of a socially responsible investment, and funds with similar goals often have titles such as sustainable, green or ethical.

ESG investing – in focus

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.

Renewable stocks have significantly outperformed traditional energy stocks

Global renewables vs oil&gas since 2014



We have run Sustainable models at Mazars since 2016, and have done further work to develop

a consistent sustainability scoring system, which we believe is a necessary step to accurately assess the funds we use in our portfolios. The methodology scores each of our funds on seven different metrics on a scale of 1-4. The seven metrics we judge a fund on are as below:

- 1 ESG integration in strategy
- 2 Impact of the fund
- 3 Stewardship and engagement
- 4 UN PRI signatory
- 5 Screening
- 6 Contribution to UN SDGs
- 7 Overall analyst score

The information relating to the above metrics is obtained directly from our fund managers during meetings and from their published sustainability reports. There are four ESG ratings categories ranging from 1 (the lowest rating) to 4 (the highest). We score each fund on the seven metrics above and reach a weighted average total score for the fund out of 4.

The table below explains what each score means:

Total sustainability score	
4	The fund integrates ESG in its strategy and considers the positive, social and environmental impact of its investments as a critical part of its investment process. The Fund invests in companies providing solutions to sustainability challenges, is a UN PRI signatory and contributes to the UN SDGs via all its investments.
3	The fund integrates ESG in its strategy and negatively screens out controversial companies operating in industries like oil & gas, armaments, mining etc. and/or positively screens companies that set positive examples of environmentally friendly products and socially responsible business practices.
2	The fund does not explicitly follow an ethical strategy or call itself a sustainable fund; but in its portfolio construction, focuses on ESG considerations and invests in quality businesses.
1	The fund is not a sustainable fund and can invest in any business it sees as a viable investment. Passive funds also fall in this rating.

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