CARTLIDGE MORLAND
INDIVIDUAL WEALTH MANAGEMENT

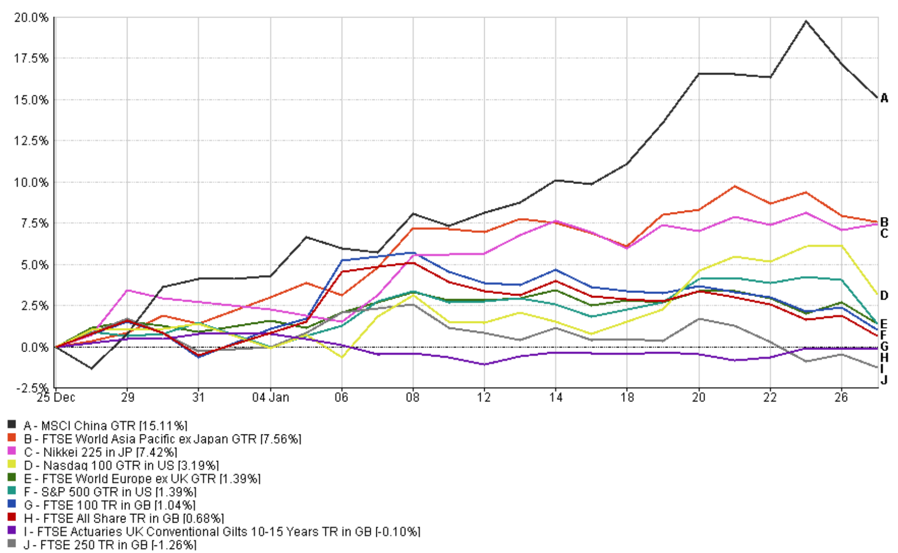
INVESTMENT COMMENTARY

28 JANUARY 2021

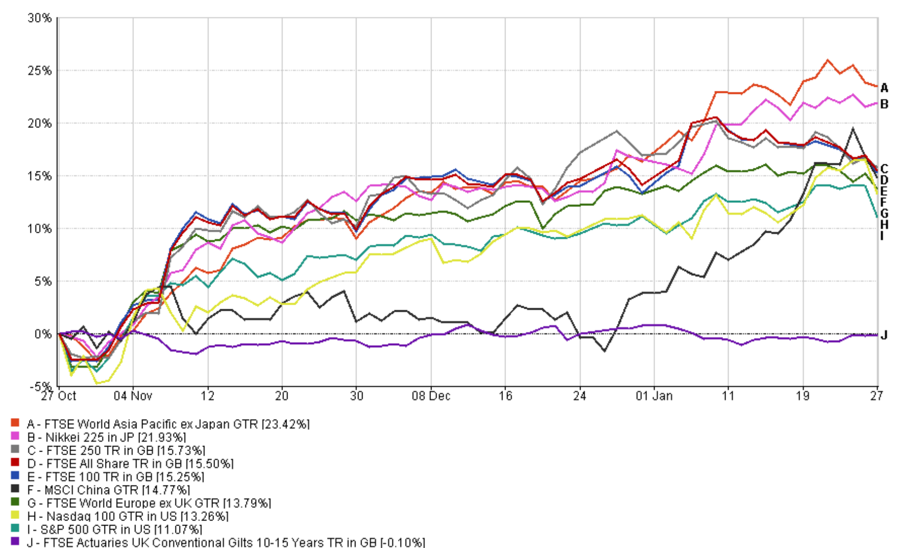
OVERVIEW

Since the December 2020 edition of our commentary, a UK/EU trade deal has been agreed and President Biden has taken over at the White House, with the Democrats also gaining control of the Senate – just! Whilst the removal of these uncertainties has been beneficial for investor confidence, the emergence of new strains of Covid-19 and high levels of infection have seen countries tightening restrictions/ locking down once again. The approval of more vaccines across the world and assurances that they will offer some protection against these new virus mutations is positive news for markets, but the speed of roll out of vaccinations across the globe is essential for society and economies. The major equity markets have risen over January 2021 on the hope that economies will gradually reopen during 2021.

ONE MONTH INVESTMENT MARKET RETURNS IN LOCAL CURRENCIES



THREE MONTH INVESTMENT MARKET RETURNS IN LOCAL CURRENCIES



In the short term, the re-introduction of further virus-related restrictions will lead to reduced economic activity in those countries/regions worse effected by the pandemic – including the UK, Europe, North America, South America, India and South Africa. Although the levels of economic contraction are not likely to be as severe as those experienced over the first and second quarters of 2020, it is highly possible some economies will enter recession again. Those economies which are driven by the strength of the service sector are likely to be most affected. The speed of the roll out of effective Covid-19 vaccinations will dictate how quickly countries can return to some sort of normality and will impact on investor confidence. Evidence from Israel, which is the leader in vaccinating its population, points to new cases falling steeply. Due to experience in handling previous epidemics, the Asia Pacific region has coped well during the Covid-19 pandemic with local restrictions introduced promptly to arrest the spread of the virus. Their economies have been less affected as a result, which is reflected in the performance of Asian stock markets.

The major central banks have remained supportive of economies with interest rates maintained at historically low levels and asset purchase programmes continuing. Governments have taken on huge amounts of debt to support individuals and businesses throughout the pandemic as well as to fund massive health and vaccination costs. The US Congress agreed a stimulus package before former President Trump left office and the new Democrat administration has plans for measures worth a further $1.9 tn. This figure is likely to be pared back to get the package through Congress. Such stimulus has provided support for the US equity market with it hitting an all-time high. These fiscal and monetary measures are likely to see inflation pick up. Unlike 2008 when the monetary stimuli largely recapitalised a broken global financial system, this time they are flowing directly into economies. The central banks are likely to accept higher inflation, as any rise in interest rates in short term would dampen a post-pandemic recovery. In fact some inflation could be beneficial in inflating away some of the massive pandemic debt piles. Over the longer term, countries will have to adapt fiscal policy - raising taxes to reduce these debt levels. Adding to pressure on government finances is rising unemployment, as employees are laid off, rather than furloughed. The UK unemployment rate has crept up to 4.9% for the three months to 31 October 2020 and in the US it has reached 6.7% in November and December.

We have commented in previous publications on approval of effective Covid -19 vaccines and their roll out supporting companies in the cyclical sectors of equity markets such as travel, leisure, commodities. These sectors have been badly affected by the pandemic-related restrictions and therefore should recover quickly when the restrictions can finally be lifted. Consequently, the share prices of companies in these sectors have recovered strongly over the last three months. However, news relating to the efficacy and supply of vaccines together with the organisation of vaccination programmes is likely to impact on investor sentiment, which could swing between support for cyclical companies or quality growth companies, (those with reliable and growing longer term earnings which are less affected by the pandemic). Poor economic data may also weigh on investor confidence.

The CM Investment Commentary is compiled by Angela Cooper, Managing Director of Cartlidge Morland's Investment Services team.

Angela runs the firms' investment management propositions, with over 30 years' experience in investment research working for investment companies, leading UK national IFAs and wealth managers. Angela graduated from the London School of Economics and is a Chartered Insurance Practitioner.

OUR VIEW

Our bulletins have commented continually on the evolving 'Brexit' situation over recent years. The theme has dominated sentiment towards UK assets – and fears for the Sterling exchange rate have acted as a strong deterrent to international investors. Sterling assets became increasingly toxic as the domestic political situation lurched from one EU related crisis to the next under Theresa May's premiership. The 2019 general election broke the domestic political deadlock but the basis of the UK's future trading relationship with the EU remained uncertain. This continued to weigh heavily on sentiment towards UK assets and it began to affect sentiment in continental markets too, especially in Germany (the largest exporter to the UK after the US).

Inevitably, there remains considerable border/customs disruption as exporters/importers and indeed officialdom familiarise themselves with a new regime. This should be temporary - the agreement reached appears fair to both sides and is viewed favourably overall. Services exports (more important to the UK than the EU) were never intended to be addressed in the agreement relating to goods and resolution in that area remains subject to negotiation, with an outcome anticipated towards the end of March. Borders are far more porous where services are concerned so they have to be dealt with differently.

UK asset prices have responded favourably to the agreement with the EU and to the introduction of global vaccination programmes against Covid-19. As conditions normalise, and the economy enters a sustained recovery phase, there is scope for prices to increase further. Much the same may be said of European bourses.

Developed Western markets take their lead from the US. The comparative predictability of a Biden administration, with a slim majority in both houses of Congress, is perhaps welcome to global investors following the impulsive, abrupt and (sometimes) aggressive nature of Presidential policy making under Mr Trump. President Biden has pledged to take as firm a line with China as did Mr Trump which may be unpopular in some business quarters, but probably better for the US in geo-political terms and for the free economies. Some US large tech company valuations remain a real concern. We have observed previously that lockdowns have opened a host of fresh applications for some of these critical

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OUR VIEW....continued

technologies with mobile phones, laptops, PCs in high demand, which perhaps justifies apparently high valuations on forward growth prospects. Tesla's share price has rocketed on the strength of its projected future production levels and battery technology.

We continue to maintain diversified portfolios but have rebalanced, where appropriate, by taking profits from growth-oriented equity funds, especially US equity funds, which have benefited from their technology and consumer discretionary exposure. This has permitted topping up holdings in funds which have greater exposure to cyclical sectors whether in the US or elsewhere – subject to current portfolio geographic target weightings. As countries bring the spread of the virus under control through vaccination programmes and as economies re-open, we expect to see more upside in these types of funds. Although short term economic data will be weak, investors should look through these to a recovering global economy. Our fixed interest exposure will be maintained according to risk tolerance. UK government bond (gilt) exposure is retained as portfolio insurance in the event of equity market falls. However, we prefer corporate bond funds and global bond funds to give exposure to credit and currencies. Index linked bond funds should provide some protection for part of the bond element in portfolios if inflation does start to pick up. We expect to see the UK equity market find more favour over time as the uncertainty over the trading relationships with the EU and the rest of the world become clearer. The UK equity market has significant exposure to cyclical sectors such as financials, travel and energy which should benefit further from economic recovery. **Inflation remains a threat to portfolios in the longer term, so it is important portfolios remain diversified investing in assets which offer some protection against the impact of inflation.**

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