Autumn 2020

market outlook.

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The UK Economy

A key attraction of the UK equity market has historically been its premium yield versus its global peers. One of the many consequences of the COVID-19 pandemic has been a large number of UK listed companies suspending dividends. This coupled with Brexit uncertainty has contributed to the UK equity market lagging many of its global peers in 2020.

As we approach the end of the year and look to 2021, whilst there will no doubt be stumbles along the way, the UK's position outside the EU will become clearer and a large amount of uncertainty will be removed (and equity markets hate uncertainty). Whilst the UK's economic future outside the EU is anything but certain, it is worthwhile remembering that the majority of the FTSE 100 derives its revenue offshore and therefore, is not dependent on the prosperity of the UK economy.

With many people once again subject to lockdowns, it is understandably difficult to envisage a world post the coronavirus. However, we are confident COVID-19 is a transient issue, and the prospect of a viable vaccine continues to build.

Compared with other global equity markets, shares listed in the UK currently trade at a valuation discount, which presents an opportunity for when earnings eventually normalise and dividends are reinstated, once the coronavirus subsides.

Like most other governments and central banks across the globe, the UK has been very supportive of the economy during 2020. Most recently the Bank of England has expanded its quantitative easing programme and the UK government has extended its furlough programme through to the end of March next year. These recent measures build on other fiscal and monetary policies to support UK companies and consumers during these difficult times, and demonstrate a willingness to act when necessary.

The Japanese Economy

Whilst the Japanese markets have performed well since the trough of the pandemic in March, the economy has been hit with a major blow that has elevated levels of uncertainty surrounding its economy. In August of this year Japanese Prime Minister, Shinzo Abe, stepped down due to ill health. He was replaced by Yoshihide Suga, one of Abe's top aides. Whilst we can expect Suga to maintain high levels of stimulus to support the economy, and perhaps even take a more fiscal approach, Abe was the creator of the modern day Japanese monetary policy. As such, this will likely cause some waves in the economy as policy approaches are altered.

With the 2% inflation target levels in Japan still elusive, the pandemic has hindered inflation levels even further. With Japan spending decades in deflation, obtaining wage growth was key. Prior to the pandemic they were struggling to stimulate wages, even with the jobless rate at a meagre 2.2% and a job-to-applicant ratio at 1.63 jobs per person. Even with these numbers, wage growth was absent, but the pandemic has increased the jobless rate, whilst also decreasing the job-to-applicant ratio… both wage deflationary impacts. This adds uncertainty as to how the Bank of Japan and indeed the new Prime Minister will respond.

Small to medium sized companies continue to outperform their large cap peers, and will likely continue to do so over the longer term. This is driven by an immense level of under research by analysts when compared to small/mid-caps in other developed market economies. As a result, not only do valuations look attractive within this market cap bracket, but they tend to be less geared in to global growth than their large cap counterparts.

The Emerging Markets & Asia Economy

With lower levels of fiscal support packages than the western developed markets, countries such as China and India have arguably more clarity to their economic data releases. The strengthening manufacturing and industrial production data out of these economies can give investors an element of comfort that these markets are stabilising and growing.

With the past couple of years seeing much of Emerging and Asian Markets negatively pricing in trade frictions with the US, valuations looked attractive. Following the impact of the pandemic, they look even more attractive than prior. With the wall of worry surrounding US President Trump's trade negotiation tactics now a thing of the past, President elect, Joe Biden, will likely take a more tactful approach to trade with countries such as China. As such, this is a likely catalyst to these valuations being realised. Markets bounced on the Biden victory.

The Chinese 5 year plan was announced at the end of October which saw a reverted focus on manufacturing, as well as heavier investment in innovation. This is a boon for Chinese companies and markets, as when combined with Premier Xi's announcement that there will be a focus on opening up the Chinese economy to global investment and competition, the potential for stable and diversified growth is immense.

Whilst there is plenty of opportunity for growth in the Asian and Emerging Markets, one can't be complacent, as it is heavily country specific. Regions such as South America are still rife with political instability, pandemic ignorance, and high (likely increasing) investment default rates.

The US Economy

With Joe Biden and the Democrats winning the White House, global markets have breathed a sigh of relief. That being said, it could be thought the medium to long term implications of a change in leadership party are somewhat irrelevant, as both the Republicans and the Democrats would/will need to address global trade and also funding for the pandemic. We see this key factor as positive for markets, despite the short term 'noise' surrounding the election, and slight differences in how the Democrats and Republicans would approach these two issues.

The Joe Biden victory will likely remove the market shocks and volatility that we have become accustomed to over the past 4 years that have been driven primarily by Donald Trump's unfiltered access to his Twitter account, and his often conflicting and confusing statements.

US Federal Reserve Bank Chairman, Jerome Powell, has expressed the Bank's willingness to remain accommodative, whilst also making it clear that interest rates will remain low for at least the next 3 years. He also put pressure on the White House and lawmakers to agree a funding plan for the pandemic. This gives the economy a good level of support going into 2021.

Whilst valuations do look stretched for the growth/technology large cap names (Microsoft/Apple/Alphabet/Amazon etc.), these types of companies are not as one dimensional as they once were pre 2008/9. As such, they sit over multiple sectors and still offer growth opportunities for investors, even if by normal metrics they look stretched.

We are yet to see clarity in employment data, with salary support packages driven by the pandemic still distorting data.

The European Economy

Valuations look attractive but require that catalyst of fiscal stimulus. We have seen 1.35 trillion in support provided by the European Central Bank (ECB) to help fend off the financial impact of the coronavirus, and they have suggested more will be provided in December with the markets expecting a further 500 billion. This support has helped buoy markets and will aid businesses going into 2021.

The economic uncertainties introduced by the pandemic have arguably made the EU a 'tighter knit' project, bringing countries closer together in terms of support and monetary/fiscal funding. As, with countries that had large debt to GDP (Gross Domestic Product), such as Italy and Greece, being shunned prior to the pandemic, most member countries have elevated Debt to GDP levels now, so support is there for all!

Whilst there is support by the ECB, with a second wave of the virus causing further lockdowns, in order to keep the economy stable going into 2021, the above mentioned funding is likely sapping assets from Christine Lagarde's (Head of the ECB) original fiscal stimulus plan, intended to be announced just prior to the pandemic. As such, this unknown adds an element of uncertainty to European markets over the medium term.

The European markets were handed a boost with a Joe Biden/ Democrat victory in the US, as it seems likely European trade negotiations with the US will be more accommodative and less heated than when under the Trump regime.

Fixed Interest

Central bank support remains explicit, and while there has been much criticism of governments, they have also supported economies via fiscal policy. Perhaps not surprisingly, corporate bonds have continued to perform well from the March lows. Companies have taken advantage of substantial and explicit central bank support. As a result, we have seen a year of record debt issuance.

The lack of liquidity in bond markets in March was understandable - a risk off event coinciding with a shift to work from home meant not all market participants were able to be as active as they would like. However, going forward, market participants will have adjusted to new working arrangements, we are therefore, unlikely to see a return to the same levels of reduced liquidity.

Company leverage is likely to increase in the near term. However, it is important to balance worries over increasing leverage in the short term, with management teams working hard to reduce leverage through the next year. It is also important to note record issuance has left many companies with substantial liquidity to deal with periods of economic weakness in the next year.

Developed market government debt remains expensive. Relative to this, corporate bonds do offer some value, however, it is important to note returns are still likely to be subdued in the medium term, consequently, we prefer equities.

If you would like to discuss this or any other aspect of your portfolio, please do not hesitate to contact us on **0800 028 3200**, Monday to Friday 9am-5pm or you can email us at **mywealth@wealthatwork.co.uk**