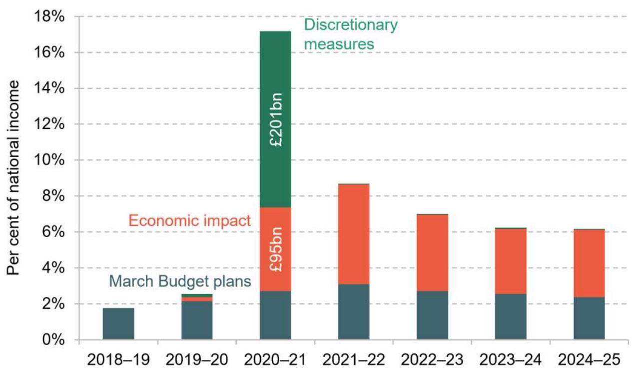
Overview of 2020

March last year was bleak, but most markets finished the year on a high, apart from the UK. Governments concerted financial support spirited a recovery seemingly detached from the health crisis and our economic reality.

We always advocate fully investing funds that can be afforded time in the market, rather than market timing. However, we cannot dismiss prevailing opportunities and immediate threats to growth and income. In this our first issue, we will explore those concerns with the guidance of our investment partners. Algernon Percy is a Portfolio Manager and Managing Director of Waverton and Lothar Mentel is the Chief Investment Officer at Tatton IM.

What about 2021? - After an eventful final quarter of last year, the beginning of 2021 has been no calmer.

How big is Monetary policy? – Algernon at Waverton eagerly points out in the US, following the Biden victory, the pandemic relief package could reach $4trn in aggregate and as a percentage of GDP could more than double that of the financial crisis of 2008. The figures in the UK are just as eye watering. The IFS forecast the deficit to climb to £350 billion (17% of GDP) in 2020–21, more than six times the level forecast just seven months ago at the March Budget. Around two-thirds of this increase comes from the large packages of tax cuts and spending increases that the government has introduced in response to the pandemic. But underlying economic weakness will add close to £100 billion to the deficit this year.



Lothar at Tatton explains that governments have thrown caution to the wind about borrowing and spending, as they have never been able to as cheaply. Janet Yellen, President Biden's newly appointed Treasury Secretary made this point in front of the US Congress. The new administration intends to utilise these funds in 2021 to finance new greener infrastructure programs and provide industry subsidies targeting CO2 emission reductions.

Will this bring Inflation? – Algernon thinks the monetary environment is fundamentally inflationary. The pandemic relief programs have allowed government spending to take the place of the private sector in protecting vulnerable businesses from failing. Once confidence returns the household savings accrued though lockdown and business bounce back loans can take up slack. The success and capacity to keep inflation in check, depends on the effectiveness of vaccine roll out, the quashing of a mutating virus, and whether central banks are disciplined enough to put the brakes on at the right time. They think this is unlikely in the US with the Democrats impatience to get on with business. The same in the UK, as Johnson's team naturally throw caution to wind. Further, austerity was now seen by many politicians as unpopular and a mistake following the 2008-09 crash.

With this is mind, Algernon sees the markets building in inflation expectation. Whilst short-term bond yields remain ultra-low reflecting the current monetary policy, long term yields are creeping up. Inflation is also being reflected more in commodity prices

The long-term perspective – Lothar wants us to get our mindset beyond the pandemic and the vaccination roll out. He says this recession has ended the longest economic cycle in history, and this is a good thing, because it was long in the tooth. If we are at the beginning of a new cycle, a new set of opportunities will be presented, but clearly a few issues to be ironed out. Chiefly, but not alone, is the debt mountains. With lots of additional money in the economy Tatton also worry about inflation. However, they consider inflation a factor of demand outstripping supply, and there is no evidence of that in the near term. It starts to become structural if it finds its way into wages, and again employment has crumpled. Should we worry about the debt? – Lothar says - sort of, but there is a way out. On those rare occasions when we have hit those debt to GDP numbers, notably after the two World Wars, debt was written on extremely long terms. Janet Yellen recently suggested this, and that debt is written with 50-to-100-year maturities. If it is pushed far enough down the line, GDP growth and inflation will have whittled it down and it becomes largely irrelevant. We note that Peru managed to issue a 100-year bond at 3.2%.

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And Brexit – Lothar observed that a Brexit deal fed into the markets even before it had even happened. Given all the other concerns, the negotiating factions seemed to have no choice but to do a deal at the last minute. Lothar suggests the deal has a few short comings. There are teething problems with the movement of goods, but it is hard to determine whether this is Brexit related or COVID-19. A deal was done on goods, but 80% of the UK economy is services. There are positives and Lothar points to the vaccination program. The UK are ahead of the curve for vaccinations and should come out ahead of everyone else.

The FTSE 100 has been unloved because of Brexit and the global recession. When the global economy returns from lockdowns the UK should be on the front foot and the UK stocks upgraded accordingly.

How are markets looking? Lothar at Tatton sees the same story as Q4 2020 playing out now we are the depth of a second (or possibly third) wave. Markets are propped up by government spending and optimism for a better post pandemic future.

Fundamentally, he believes markets are getting ahead of themselves and too optimistic about the future. Yes, he says, we will have an economic bounce back later in the year, but you must ask if the easing of lockdowns go as well as markets have suggested, will the central banks pledges be as supportive. This undermines equity markets and if central banks started to let yields run higher expect pressure on equity earnings.

Overall, Lothar's outlook is positive and sees little reason to go underweight risk because the prospect for low-risk assets is dire.

What about Telsa and the overvalued US market, are they in a bubble? - Tesla shares doubled in less than two months. The fever over electric vehicle investments has surpassed that of the 'dot com' bubble in 1999.

Another fund manager, Baillie Gifford, a big beneficiary of Tesla sees this differently. Elon Musk's goal of 20million car output in 2030 would put the business ahead of Toyota and VW's pre-pandemic output. They see Telsa as one of many opportunities in tech and healthcare and expect these to be revolutionary over the next 5 to 10 years.

For a more sobering thought we can turn to veteran investor Jeremy Grantham who believes the US market has all the characteristics of a bubble that is ready to burst.

UK Equities - Investor confidence in the UK dropped during the pandemic and UK shares lagged other regions. However, investors are monitoring many stocks where price fails to reflect true prospect. Several UK companies have indicated plans to resume dividend payments deferred last spring.

Wages and salaries in the UK are now higher than they were in Q4 of 2019, showing that the government schemes supporting income have worked, although this does come at a cost.

The FTSE All share General Retailers sector has returned +0.5% in sterling terms year to date showing a gap in the perception of how retailers were trading against their actual performance.

UK valuations remain compelling and will be bolstered by a successful roll-out of a vaccine program - there's cause for optimism in UK equities.

A falling dollar – One consistent factor of recent times has been a strong dollar. One of the consequences of fiscal expansion could be a weaker dollar. This also supports commodity rises, accelerating economic growth and higher inflation.

Our summation - At XL we monitor the state of market conditions which enhances our authority to challenge our investment partners and better understand their insights. The latest data monitor taken from the Organisation for Economic Co-operation (OECD) most recent forecasts suggests there could be a significant shift to the highpoint of economic output within the next 12 to 18 months. This supports Waverton's thesis on inflation and commodities but does signpost an eventual slump in market conditions. Cash will again become a favorable destination. In the meantime, there will be opportunities and as Tatton IM have highlighted risk assets (equities and commodities) should have the most favorable environment in 2021. We are recommending our clients fully invest, but at their annual reviews re-evaluate profits and measure income requirements thoughtfully.