INVESTMENT OUTLOOK APR 2021

VACCINE AMBITIONS AND ACTIONS ARE CRITICAL

Financial markets remain enthused about the rate of vaccination programs across much of the world. This has been accompanied by an improving economic outlook for 2021 and 2022. While US GDP (Gross Domestic Product) is forecast to rise above pre-covid levels in Q2-2021, this is not anticipated to occur in the UK or Eurozone until 2022, although there is still significant uncertainty around these forecasts. Understandably, there remains caution, given the continued evolution of Covid-19 strains. However, the decline in Covid-19 cases and vaccination roll out success is seeing greater geographical diversity. This has seen a tightening of lockdown conditions in France and Germany, while restrictions are easing in the US and United Kingdom.

As before, restrictions are impacting the Service sector more than Manufacturing, although this would appear to be less so than before as businesses and people adapt. Looking ahead, a post-Covid-19 world appears likely to benefit from significant policy support as well as pent-up consumer and business spending. Crucially, policy support is likely to be further reinforced in 2021, and beyond, by both the United States and the European Union, via President Biden's USD1.9bn stimulus and the Recovery Fund EUR750bn respectively. President Biden has drawn up plans for a further stimulus, focused on clean energy, infrastructure, and clean energy, possibly as large as USD3trn.

Consumer sentiment continues to recover, but understandably still stands below pre-crisis levels. This reflects not only the economic uncertainty ahead but also the potential end of the various furlough and unemployment support programs as economics look towards normalisation. Broadly speaking, consumers have seen a significant increase in, largely forced, savings throughout the pandemic as many activities have been curtailed. This is likely to support the medium-term outlook for spending activity. Ordinarily, more optimism would normally be required to spark pent-up demand following a recession. But this is no ordinary recession, and the reopening of economies should be a suitable catalyst. We expect economically the worst is behind us with activity levels remaining volatile in the months ahead.

Market movements continue to be sensitive to expectations around the recovery's shape, which is reliant on social distancing rules and driven by infection rates. Other considerations include how the new US administration approaches its international relationship, especially with relation to US-China trade policy. Similarly, investors will pay close attention to any plans for the withdrawal of stimulus, but we expect that these will not materialise meaningfully until Covid-19 cases are significantly lower. We look for the global economy to show strong growth in 2021 and 2022.

SHARES OVER BONDS FOR THE LONG TERM

Investors remain focused on looking through potential near-term difficulties to the time where vaccines are comprehensively rolled out and the reversal of Covid-19 is well underway. This has supported strong price growth in shares. As with the Global Financial Crisis, both bond and share prices have been supported by central bank Quantitative Easing (QE) programs (where central banks purchase financial assets to increase the money supply to support the economy). However, this recovery has one significant difference – massive fiscal easing, financed by increased government debt issuance (bond sales). Global bond yields had fallen dramatically (meaning bond prices rose) since the start of the pandemic due to risk aversion and global central bank rate cuts. But with the economic outlook improving, bond yields have recovered somewhat. This is one reason for our short-duration bias, which sees less impact from rising rates. We also remain cautious on the outlook for bonds due to the potential for higher inflation in the medium term, both from pent-up demand but also from the aftereffects of significant monetary and fiscal stimulus. However, bonds will likely provide protection in the event that the situation worsens. We retain broad global property exposure, as post-Covid we expect the sector, outside the retail sector's well-known difficulties, to recover.

TOP RISKS

New covid-19 variants are vaccine resistant.
Stock markets remain highly sensitive to the rate of infection. A successful and efficient vaccine roll out is key to further gains.

Markets lose faith in policy support.
Central banks have slashed interest rates, and many are providing further easing. Government led fiscal support remains key.

Reopened economies with record stimulus may see inflation shock
Pent up demand and historic stimulus may see a 1970s style inflation shock.

Rising political turmoil
Global political unrest has not disappeared. US and China trade relations remain a risk.

Brexit
Brexit is now behind us. The UK's evolving trade relationship with the rest of the world still weighs on investor sentiment.

Higher unemployment
Most governments have taken positive steps to cushion businesses and employees from the impact of C-19. The eventual withdrawal of this support coupled with any structural change in the economy, particularly in the service sector remains a risk.

INVESTMENT TYPE	OUTLOOK	RATIONALE
SHARES		
UK	+	International investor sentiment towards the UK has improved, spurred on by a successful vaccine roll out. Despite Covid-19 taking the headlines, UK shares still face lingering negativity driven by Brexit. This is surprising given UK shares have a heavy weighting to overseas earnings, at around 70% for FTSE-100 and around 50% for FTSE-250. UK shares remain comparatively and historically cheap, despite the UK government and Bank of England providing significant policy support to help offset the negative economic impact of the pandemic. Policy support should continue to be a positive, although the risk of a hasty withdrawal remains.
US	+	US policy makers have delivered a comparatively stronger fiscal and monetary response than expected, which will support strong economic growth ahead. This is particularly likely to benefit firms with the greatest exposure to the US markets, such as small and middle-sized firms. This contrasts with the prior decade where much of US share prices gains were driven by the tech sector, which remains cash-rich. There are some near-term inflation risks, but the Fed appears comfortable these will not become entrenched. The possibility remains that other markets, given their lower valuations, will finally play catch-up.
Europe ex UK	=	The European Central Bank (ECB) continues to provide significant monetary support. However, fiscal responses across the region differ significantly. Crucially, the region is heavily exposed to the global trade cycle which should accelerate in 2021. Lockdown has been particularly economically challenging for Europe, with generally longer and more severe lockdowns in place compared with other regions. This has somewhat offset by more generous government schemes which have supported consumer spending. Longer-term, a key risk remains in that US-China trade tensions widen to include Europe.
Japan	+	Japan's economy and country have fared comparatively well against Covid-19. Government spending support has been significant and twinned with the Bank of Japan (BoJ) providing more and faster purchases of government bonds. If the global recovery falters, and JPY (Japanese Yen) strengthens, it would deliver a double punch to the Japanese stock market's crucial exporters. Despite his departure as Prime Minister, the continuation of Abenomics (providing fiscal and monetary support) appears certain, any reversal would be a significant blow. That is unlikely to happen before the next election, planned for late 2021.
Emerging Markets	+	Emerging markets (EM) share performance has seen a broad-based recovery. Swift government action saw a quick stemming of virus infection rates in many countries, while lower US interest rates have been economic supportive for the region. While current valuations are firmly above historical averages, the region remains well positioned to benefit from the cyclical upswing we anticipate. But it is important to note that the region cannot recover in isolation. Global interest rates' decline has been supportive for EM shares, a further sharp rise would be a concern.
Asia Pacific ex Japan	+	As a whole, the region has been supported by persistently solid growth in China. So, while Asia Pacific ex Japan (ApacXJ) is still highly dependent on global trade the region has seen a less difficult pandemic, at least economically, than most. We look for further policy spending packages to provide support, and the region is one of the few that has monetary policy room to ease further if needed. Post-Coronavirus, US-China trade tensions are the overriding concern, but other ApacXJ countries do benefit from this situation.
FIXED INCOME		
Government bonds		
UK	=	UK government bonds (gilts) had benefited from both continued Brexit uncertainty, as well as significant monetary policy easing. We do not expect the Bank of England policy rate to rise in the medium term, which should keep short-term rates fairly stable, despite longer term rates having drifted higher due to inflation concerns. This reinforces our short-duration bias. Should more policy support be required we see policy makers standing ready to act.
US	=	Investor risk aversion, combined with the coronavirus economic shock, provided significant support to US bonds. However, while investors see little concern about a pre-emptive tightening from the Federal Reserve there is concern around longer term inflation. A persistent inflation shock would be a concern but a one-off boost from normalisation is something we would expect to be looked through by the Federal Reserve.
Europe ex UK	-	We believe Eurozone government bonds are overvalued given their continued distortion by Quantitative Easing. The resumption of ECB QE is likely to cap yields, but political risks and budgetary concerns may see them move higher intermittently. Concern also remains around the long-term debt sustainability of the periphery compared to the core.
Japan	-	Japanese bonds offer little income and remain severely distorted due to the BoJ's "Yield Curve Control" program. While the BoJ might alter this program, there's little expectation for significant medium-term change. Shares are the more attractive way to capture Japan's economic improvement.
Emerging Markets	+	EM government bonds continue to offer a strong yield premium compared to Developed Markets, although this comes at the expense of higher volatility. Similarly, their currencies appear undervalued, offering an additional supportive factor. Comparisons of the current situation with the 1998 EM crash are overdone, with external debt, Foreign Exchange reserves, and overall fiscal prudence significantly firmer.
Corporate Credit		
UK	=	The Bank of England's (BoE) expanded bond buying program will likely provide continued support, at the cost of distorting the market further. We are reluctant to increase our position as spreads are historically tight reflecting renewed optimism about the outlook and a high demand for yield pick-up.
US	=	Continued economic optimism coupled with central bank purchases have driven spreads to historically narrow levels. But yields available are still firmly above government bonds. As with other regions, we prefer Investment Grade over High Yield, given that the additional risk/reward premium that is on offer is unconvincing.
Europe ex UK	-	The ECB's newly expanded bond buying program has stretched this market further. These bonds are uncompelling, particularly compared to shares.
Japan	-	Like Japanese government bonds, Japanese corporate bond prices have been distorted by QE. We prefer share exposure, especially while Abenomics continues.
Alternatives & Thematics		
Environmental	+	Companies focused on reducing their environmental impact often have a competitive advantage due to greater resource efficiency, leading to lower costs. They may also experience lower downside risks due to more robust corporate governance, and this can support greater diversification benefits.
Global Real Estate	=	While Covid-19 has placed this asset class under pressure, we see this strain as being resolved post-Covid. The retail sector's woes are well documented, but a sectorally and regionally diverse portfolio remains fundamentally appealing given constrained supply and low-interest rates which also provide a buffer.