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Investment review - Q4 2020

23 December 2020

It has not been the year anyone had expected or the one anyone has wanted, but from a financial markets and investment perspective we have come through it in good shape. As this end of year update is written, most clients should actually see modest gains in portfolio values for the year as a whole, an outcome that seemed unlikely towards the end of the first quarter.

The recovery since the dark days of late March has been powerful and, frankly, quite extraordinary particularly since we are still in the teeth of the COVID-19 storm. The platform for the initial recovery phase was based on the deployment of extensive support packages, the launch of multiple vaccine projects and the possibility, if everything went according to plan, of it being a relatively short-lived economic downturn.

In the final quarter of the year, the actual approval and arrival of vaccines has provided another significant leg up for markets. There is still much work to be done, but it is now possible for financial markets, and us, to look further ahead with greater positivity to a time when we will be reading about this pandemic in the history books than on the front pages of the media.

Navigating the storm

The better-than-expected annual outcome has required a higher than usual level of investment activity not only to avoid some of the worst falls, but also to participate in the subsequent recovery. The UK stockmarket, for instance, is still showing a decline of more than 10% in the calendar year to date, which puts this year's generally positive investment returns into some sort of perspective. It also provides some reasonable satisfaction that we have weathered the storm quite well by navigating away from the areas most troubled by the raging pandemic.

We have been active in repositioning both stock and bond market exposure during the year, the former having been tilted much more towards higher growth or more resilient regions such as Asia and the US, and the latter into areas of fixed interest markets that offered greater value and where default concerns appeared overdone. There is often more one could have done with the benefit of perfect hindsight, but optimising all manoeuvres was always going to be a tall ask given we were, and to some extent still are, venturing into completely uncharted waters and with extremely poor visibility.

So, as the year has progressed hope has turned into reality, and with it renewed optimism that we can, at last, think about the time when this wicked virus will be behind us. There is hope also that a more sustained economic recovery can develop. It may take some time for the worst affected economies, including the UK, to return to pre-COVID levels of activity, but 2021 is likely to see some of the best economic growth numbers since World War II.

In fact, some forecasts suggest world GDP growth, flattered by already stronger momentum in Asia, may actually return to 2019 levels by the middle of 2021. This assumes that large swathes of the developed world population are vaccinated by then, the chances of which should steadily increase as more vaccines receive approval, and can be rolled out quickly. Eradicating the virus does, however, remain an enormous logistical task and we must pray that the efficacy of the current vaccines and the global inoculation programmes are not threatened by the emergence of new variants of the disease.

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Positioning beyond 2020

Although we undoubtedly still have some difficult weeks ahead to contain the resurgence of the virus, we can now look beyond the immediate challenges with some greater confidence. This is reflected in our current positioning. Having a full commitment to stockmarkets, as we now do for each risk strategy, is based upon and around a number of factors and themes. In no particular order of importance, these include renewed optimism over the scale of the likely economic recovery itself in 2021; the longer term growth opportunities, particularly in regions of the world less impacted, economically, by the pandemic, such as Asia and the USA; the step-change in technology adoption and innovation now driving the digital economy; the significant policy initiatives that are guiding the decarbonisation of our planet and pledging huge sums for vital infrastructure investment in both the advanced and developing world; and the substantial monetary and fiscal stimulus underpin that is likely to remain in place, allowing the relative attraction of, and reward from, risk assets versus cash to be maintained.

As noted, our asset allocation within stockmarkets looks markedly different to what it did a year ago as a result of the altered landscape, and we expect it to continue to evolve as this coming year and the rest of the decade unfolds. In the short term, the terrain for stockmarket recoveries is likely to be quite uneven across the globe as lockdown strategies vary, countries recover at different speeds and some have more localised issues to contend with. In due course the UK and continental European stockmarkets may become a more attractive investment proposition than they have done this year, particularly once we have a clearer picture of the challenges and opportunities that lie ahead in a post-Brexit era.

But in the meantime, we believe there are more clear-cut investment opportunities elsewhere in the world which we are accessing via a broad range of active managers, all of whom will be focused on participating in the economic upswing as it gathers speed. Even when the virus dust has settled, however, we still expect more durable levels of higher economic activity to emanate from Asia and the US, so our exposures to these regions are likely to remain as the bedrock of our stockmarket commitments for the foreseeable future. We will, of course, continue to keep things under constant review.

Close eye on fixed interest

As demand returns and as the stockpile of consumer savings finds its way back into the economy, so it will be important for central banks to remain disciplined, as they have said they will. They will need to look through any upward moves in inflation and not respond by altering their current highly accommodative stance. Many businesses and economies are simply not ready yet to withstand a rise in interest rates or removal of stimulus packages. That time will come in due course, and we will need to remain vigilant as this next and subsequent years unfold. For the time being, however, the backdrop and immediate outlook for fixed interest investments looks set to remain relatively benign. Real (inflation-adjusted) yields on government bonds remain quite unattractive, but corporate debt continues to offer good levels of income return and scope for further capital growth, particularly as default risks fade and balance sheets become strengthened during the economic revival.

We leave the day-to-day intricacies of fixed interest investment to specialist managers whose job it is to manoeuvre within the construct of credit markets, identifying the best balance between risk and reward. Over the past year, active management and fleet of foot have produced some solid returns from this traditionally rather dull, yet worthy (especially from a risk management perspective), asset class. This coming year is likely to be no different, requiring agility as economies recover and the time for reduced policy support draws closer. As things currently stand, there is no need for concern, but we will be watching closely for signals that point to some necessary repositioning within fixed interest markets.

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Decisive and active management

Much of 2020 has been an unparalleled test for the world's population, medical profession, scientists, businesses, governments and central banks. The coronavirus has touched everyone and everything, requiring continual adaptation. As far as our investment positioning is concerned it is highly likely that further modifications will be required as the anticipated recovery gathers more momentum, the world economy gets back on course and our understanding of the medium- and longer-term consequences of the pandemic improves.

Pivotal to accessing the opportunities ahead will be the maintenance of a blended and diversified approach that can capture both resilient long-term growth and the shorter term recovery potential and value that is now emerging. As we have hopefully demonstrated during this past year, we can achieve this balance though our own decisive, active management. Our expectation is that underlying active managers will do the same. It will not be all plain sailing, but the new year should increasingly herald an improved line of sight for investment in risk assets as the thick pandemic fog lifts and brighter conditions emerge.

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