MARKET COMMENTARY - NOVEMBER 2020

QUILTER CHEVIOT

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Past performance is no guarantee of future returns.

The resurgence of COVID-19 in Europe and the US continued to occupy the minds of investors during October. The increased pace of COVID-19 infections has triggered fresh lockdowns in Europe and this will set economic activity into reverse in Q4. Equity markets having been in 'wait-and-see' mode for much of the month and were led lower on rising uncertainty over the virus and the outcome of the US elections.

Positive gains in US and European equities in the first few weeks were subsequently erased as volatility spiked in response to new lockdown measures. US equities were down -2.7% over the month and Europe ex UK stocks down -6%. Emerging market equities led, up +2.4%. In fixed income the US 10-year yield rose by 18 basis points, the UK 10-year gilt rose by 10 basis points while the Bund fell by the same amount. Global investment grade corporate bonds were broadly flat.

Heading into the election, investors took Biden's lead in opinion polls as an opportunity to position for economic reflation, raising bond yields and weakening the US dollar. The outcome of a divided Congress with less potential for significant policy shifts has in the short-term reversed those expectations and returned attention to election sensitive sectors, such as technology and healthcare. At least the Biden win has removed one of the uncertainties hanging over markets into year-end suggesting attention will return to the outlook for the global economy. Recent data confirms that the recovery is being sustained but the initial 'V-shaped' rebound has transitioned to a more modest pace of improvement. Persistence of infection rates in the US means that consumers and businesses have been unwilling or unable to return to their previous norm and so the trend growth rate will likely remain below that of pre-pandemic levels. Consumer confidence has moderated and while business confidence has regained the COVID-19 loss, industrial production is still contracting, albeit at a slower rate.

The second wave of Covid-19 will likely accelerate the regional and sector divergences in economic recovery. The resurgence of government-imposed lockdowns has led economists to revise down global growth for 2020 and 2021 however the scale of the decline in GDP for the quarter is unlikely to repeat that witnessed earlier in the year. In many cases much of the workforce has migrated to new remote working and patterns of consumption; durable goods and home demand will remain while services demand will likely continue to languish. Global GDP is expected to recover to pre-pandemic levels by the end of 2021 primarily led by China and the US but the rate of recovery in Europe and the UK is expected to lag, with GDP roughly -3% and -7% respectively, below 2019 levels by the end of next year.

The continued rise in COVID-19 cases in the US, now eclipsing 100,000 per day, has so far not impeded the continued reopening of the US economy. The US ISM rose sharply expanding to 59.3 in October, much better than expectations and the new orders index, a strong lead indicator of demand, continued to rise. The unemployment rate has fallen to 8%, the economy has now regained roughly 50% of the 22 million jobs lost in the first few months of the pandemic. While the jobs report shows a continued recovery in employment, the pace of progress has slowed considerably and the rise in permanent job losses, previously considered temporarily unemployed, will provide a drag on consumption.

The new round of government-imposed lockdowns in Europe is likely to further impair mobility and stifle economic activity, this is against a backdrop of continued divergence in prospects for the manufacturing sector, which has continued to recover and service sectors, where activity has slowed. The major European economies have agreed to extend job retention schemes which has so far shielded the labour market from levels of unemployment akin to that of previous recessions. The UK has followed suit and the BOE has announced additional stimulus to support medium-term growth and inflation expectations. The near-term outlook for the UK economy remains highly uncertain and dependent on the evolution of the pandemic as well as the nature of the UK's exit from the single market at the end of the year. GDP projections for Q4 have been revised down but it is likely we see a more delayed labour market correction next year.

The recovery in China has been characterised by strong export growth plus credit stimulus focussed on infrastructure. Previous stimulus efforts of a similar kind generated positive spill overs and Chinese import data suggests this is again having a positive effect. Effective policy combined with success in controlling the virus

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has allowed economic recovery to gather pace. Third quarter, GDP growth rose 4.9% year-on-year. China is likely to be one of the only major economies to experience positive economic growth in 2020 which has boosted local and Asian emerging market sock prices of late.

The Q3 corporate results season continued the trend seen last quarter for US and European companies to exceed expectations albeit year-on-year growth is negative. Growth style companies have long been winners over value and the potential catalysts for a rotation are a key topic of debate but the gulf in sector profitability highlights the significance of the 'winners' and 'losers' from COVID-19. A consistent trend is emerging where sectors such as energy, financials and consumer discretionary continue to struggle compared to consumer staples, technology and health care which in some cases are continuing to generate year-on-year absolute gains in earnings. The profitability of these sectors is less contingent on the success of vaccine trials, economic reflation or a 'return to normal' but this greater uncertainty comes at a price.

While the short-term outlook for markets may have deteriorated with the second wave lockdown in Europe, we believe the medium-term prospects have improved. Virus uncertainty will likely remain a feature of markets for some time to come but there are encouraging signs that a vaccine could return life to some semblance of normal in 2021. A smooth transition to a new Biden administration would also help calm investors nerves. We continue to see international markets as offering the best opportunities despite low valuations of UK companies.

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