MARKET COMMENTARY - DECEMBER 2020

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Past performance is no guarantee of future returns.

Global equities recorded their best month for 45 years in November, as optimism surged on positive vaccine news and relief that the US election did not produce any major negative surprises. Gains were widespread geographically as well as across asset classes from corporate credit to commodities and crypto currencies. The possibility of a return to "normal" is, of course, welcome in terms of both economic recovery and corporate earnings although markets have, to a large extent, already discounted this. Meanwhile, with Covid-19 infections and hospital admissions continuing to rise in the US and parts of Europe expected to remain in some form of lockdown for several months, there are likely to be setbacks along the way.

The vaccine news prompted a strong rally in most major markets alongside rotation to sectors particularly hard hit by the pandemic. Global equities returned over 9% with Europe and the UK up around 13% and being, for once, among the best performers. The US and Asia were not far behind at 11% although Japan (9%) and emerging markets (5%) lagged. Bond markets were little changed. Strong manufacturing data from China increased the likelihood of a cyclical upturn resulting in commodity price rises - copper hit a seven year high of $7,000 and Brent crude ended November up 25% at $48. Gold eased back to $1,770.

Economic fundamentals have taken something of backseat to vaccines, but the recovery continues albeit at a different pace across regions, and some loss of momentum in the advanced economies. China's latest purchasing manager indices surprised on the upside for manufacturing and services as did exports. With no sign of a second Covid-19 wave, GDP is expected to expand to over 8% in 2021 before settling at around 5.5% thereafter. The Chinese authorities will continue to scale back pandemic support measures and this will slow infrastructure investment and property development. The vaccine rollout will boost confidence and pent-up demand could see retail sales rise over 15% next year. US and China tensions over Hong Kong are likely to persist but after two years of recession, China's travel corridor should help the recovery. Most of the rest of Asia will also experience a significant rebound, although for trade-dependent economies, such as Singapore, the resurgence of infections in advanced economies and vaccine implementation will influence the pace of recovery.

After a solid Q3, US economic data has softened slightly as infections and hospital admissions accelerate, and further fiscal measures are delayed by political wrangling. Although Black Friday retail sales were strong, other gauges of consumer activity remain flat with restaurant bookings slipping back to July levels. This reflects a loss of momentum in the labour market which was confirmed by weaker payroll data in early December. GDP is expected to grow 5% in 2021 after falling to 3.4% this year. Businesses impacted by the pandemic - notably hotels and airlines - are seeing price rises as are sectors like automobiles where production has been restricted. However, financial markets are assuming that the Federal Reserve will look through a short-term inflation overshoot and is unlikely to raise interest rates before 2022.

Japan sits somewhere in the middle of the pandemic "bust and boom" with real GDP at the end of Q3 still 4% below the pre-Covid-19 level, despite exports regaining all the ground lost during the crisis. Vaccine herd immunity is likely to lag other countries and a low-key Olympics in Tokyo will have more modest benefits than originally anticipated. As a result, after a 5% decline this year, GDP is only expected to expand 2% in 2021. A second wave of infections means the Eurozone is ending 2020 in double-dip recession. GDP should expand 4% in 2021 having fallen 7% in 2020. Germany has fared relatively well after experiencing limited lockdowns during the first Covid-19 wave, while a manufacturing upturn - reflecting its exposure to China - is also boosting the economy. By comparison, Spain and Italy had extensive lockdowns and tourism has been hard hit by travel restrictions. This income will not be recovered and - combined with deteriorating fiscal conditions and political fragmentation - means recovery will be a slow process. The European Central Bank intervened again in November with additional and lengthier support measures.

The UK under-performed throughout the pandemic and the latest monthly data showed that the rise in infection rates from the August low had already started to impact the economy before November's second lockdown. After rising 1.1% in September, GDP growth slowed to 0.4% in October. It remains 8% down on pre-pandemic levels and below the 7% decline during the 2008/09 global financial crisis. November could see a 10% contraction - albeit far lower than in the spring - before rebounding

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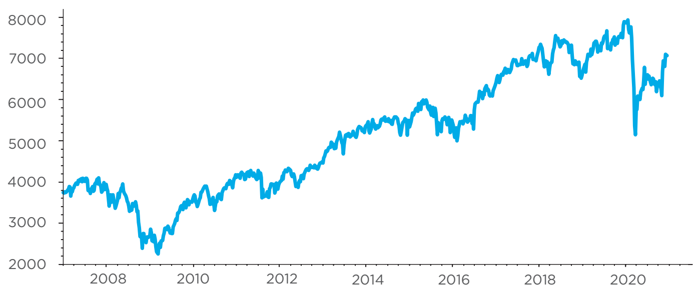

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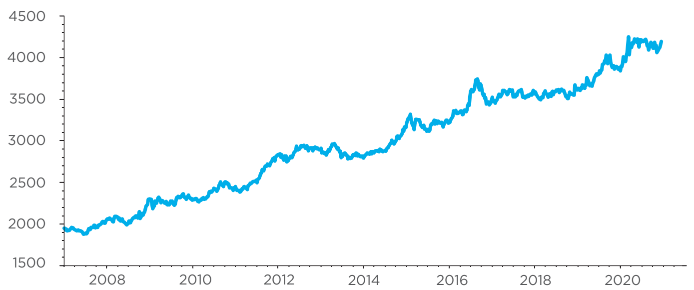

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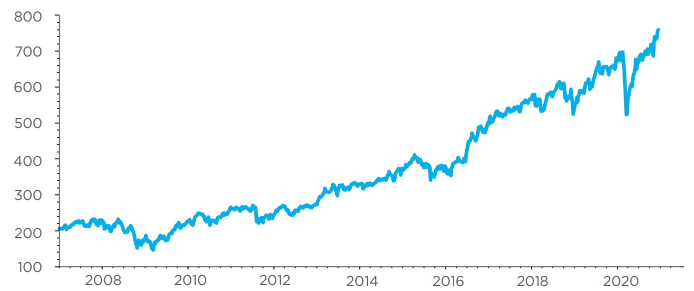

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this month as restrictions are eased. Furlough has been extended and the Bank of England may yet feel compelled to move to negative interest rates. As with the UK's weaker Eurozone counterparts, GDP growth of 4.5% in 2021 suggests output is unlikely to recover for several years. A "no deal" Brexit is still in the balance and, if no agreement can be reached, the resulting trade disruption would mean recovery lags other advanced economies.

The 2021 global economic outlook appears favourable, with vaccines in sight and turbo-charged monetary and fiscal policies. Manufacturing will benefit from inventory re-stocking as trade returns to normal levels and improving consumer confidence could release pent-up demand across a wide range of goods and services. With no sign of higher corporate taxes to help rebalance fiscal budgets let alone pay down government debt, those companies that survived the pandemic are likely to benefit. Investors have taken this on board which is why valuations are already discounting a significant upturn. However, behavioural indicators suggest a degree of caution is needed as much depends on delivering mass vaccination programmes on an unprecedented scale and how widely these are accepted. If a "return to normal" stretches beyond H2, there could be scope for disappointment even though markets can travel further before central banks start re-positioning monetary policy.

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