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Investment Commentary

January 2021

Recent economic developments

■ Taken together, recent economic reports and several indicators of current economic activity show that after peaking in the third quarter of 2020, the pace of economic growth has slowed across the developed markets in recent weeks. In most instances, the decline in growth momentum in November and December has resulted from renewed restrictions on economic activity due to a resurgence in Covid-19 infection rates. The forecast growth figures for Q4 2020 would confirm significant contractions in gross domestic product (GDP) across the major economies during 2020.

■ As would be expected, the impact of the resurgence in Covid-19 infection rates has been most readily observable in the labour market. In the US, this has resulted in a slowdown in the pace of improvement in non-farm payrolls as well as a series of larger-than-expected increases in the number of Americans filing for unemployment benefits. The recent announcement of the long-awaited extension of government aid in the form of support for businesses and extended unemployment programmes should help to mitigate the impact on consumer spending and retail sales. It is also noteworthy that the US Federal Reserve recently reiterated its commitment to monetary policy stimulus in its ongoing attempt to hold short-term borrowing rates near zero.

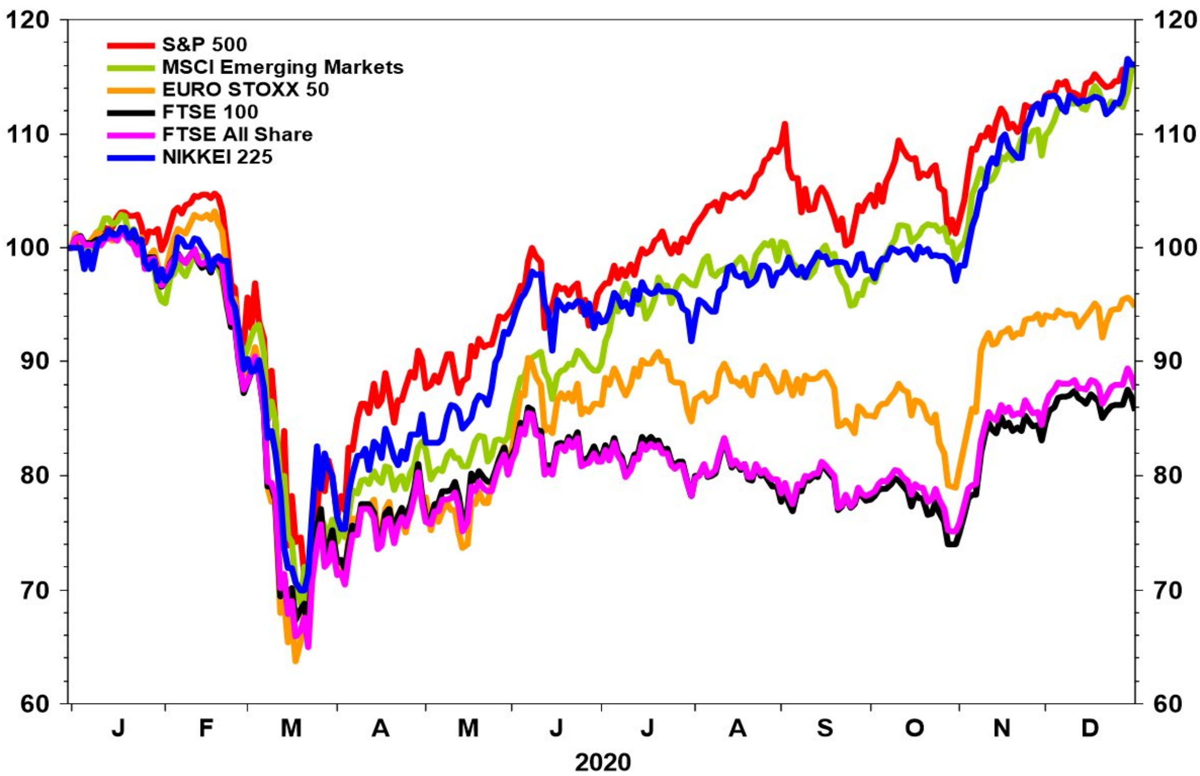
■ Likewise, in the UK there has been a notable loss of economic momentum since Q3 partly as a result of increasingly tougher Covid-19 restrictions on economic activity. The latest available figures showed that the UK economy contracted by 2.6% in November, leaving GDP around 8.5% below its pre-pandemic peak. However, as in the US, recent decisions by the UK government to extend labour market support programmes should help to mitigate the downside risk to the economy in the short term.

■ Forecasts for both the UK and EU economies were dragged lower by uncertainty over the future UK-EU trading relationship. That element of economic uncertainty was lifted when both parties reached a trade deal in December 2020. Avoiding a no-deal scenario has raised growth projections and both economies are now expected to experience brisk economic growth in the year ahead following the severe contractions recorded in 2020. Recent confirmation of ongoing expansionary monetary policy by both sets of central banks will also help to underpin economic growth in the year ahead.

■ Looking across the major developed economies, the main risk to growth remains the uncertainties surrounding the path of the Covid-19 crisis. Specifically, the strength of economic activity in the year ahead will be influenced by the speed and effectiveness of the vaccination programmes being implemented by various governments.

■ Despite occasional bouts of risk aversion, financial markets have remained buoyant in recent months, with equities (and other risk assets) trending higher and bonds remaining resilient even as the economic outlook has improved. Chart 1 illustrates the performance of selected equity indices over the course of 2020.

Chart 1: Performance of selected equity indices in 2020



Source: Refinitiv Datastream

■ As the chart shows, by the end of the year, some equity markets had made a full recovery from the sharp Covid-19 induced sell-off. Indeed, US equities finished the year close to new all-time highs. Unfortunately for UK-focused investors, UK equities failed to make a full recovery and therefore under-performed their international counterparts.

■ In the fixed income markets, government bond yields rose slightly (and capital values declined) in December. Corporate bonds were also broadly flat for the month although high-yield bonds recorded strong gains on the back of rallies in the energy and industrial sectors. Currency markets saw a continuation of the downward trend in the US Dollar that has been in place since late March 2020.

■ Looking ahead to 2021, we expect both monetary and fiscal policies to remain expansionary across the major developed economies. Given that combination, successful implementation of the Covid-19 vaccination programmes should help to fuel strong economic growth and a rebound in corporate profits. That should boost returns to risk assets such as equities and alternatives. However, that combination is likely to create a challenging environment for fixed income investments.

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