WATTERSON
FINANCIAL PLANNING

Market Update

January | 2021

SQUARE MILE
INVESTMENT SERVICES

The arrival of a vaccine has set a time line for the pandemic causing markets to celebrate. Share prices around the world have surged and the blue chip FTSE 100 index enjoyed one of its best months on record in November. The UK market made further gains through December as the Brexit trade deal was finally agreed. Over the quarter, the FTSE All Share index gained by 12.5% though it remains some 10% lower than where it started the year even once dividends are included. Elsewhere, gilt prices were little changed though bonds issued by corporations strengthened in price. The jump in markets over the quarter has resulted in a healthy improvement in your portfolios' valuation and brings returns into positive territory for the year.

THE ARRIVAL OF A VACCINE CAUSES MARKETS TO LEAP

This winter was always going to be a very difficult one for us all, as the pandemic reaches its peak. In contrast, the forward looking nature of markets means they are now beginning to reflect the prospects for the economic recovery, which is likely to be rapid. Lockdowns have restricted our spending on activities in areas such as restaurants and holidays. The upside is that the money has been saved instead and demand is likely to rebound quickly once restrictions are eased. Unlike in more normal recessions, companies don't have large amounts of unsold stock in their warehouses, so production will return to full speed once the economy reopens. Governmental and central bank support have been massive and this has helped to keep many businesses afloat and wages paid. Sadly, some firms have folded, and many of the resulting job losses have fallen on the poorly paid. However, the economic impact has been modest as a consequence. Incidentally, many of the headline grabbing business closures would have probably happened anyway over the coming years as High Street shoppers shift to on-line. Covid has merely accelerated this trend.

Central banks have pumped money into the economy as never before. Interest rates are already at rock bottom and governments have stepped in to keep the economy turning over. The Bank of England has injected huge sums into the financial system. Unlike in 2008, where the finance was trapped in the stressed commercial banking system, the money has flowed through into businesses and to individuals. Government spending has gone through the roof as measures such as the furlough scheme have been introduced. Money supply has shot up as a result. Those clients old enough to remember the 1970s may fear a resurgence in inflation and some economists are predicting an up-tick in prices. Conversely, other economists argue that the increase in debt compounds the deflationary forces playing on the economy. Some costs are likely to rise over the next year or two, but we do not expect a dangerous self-feeding cycle of inflation to develop. Nevertheless, it is something that we are closely monitoring and we will take prompt action if we fear that inflation is to become a problem.

Much has happened over this quarter. President Trump failed to win a second term, and while President-elect Biden looks an uninspiring choice, he will bring an element of welcome stability. Biden will not be as business friendly as Trump, though he is likely to be more predictable, which will make investment decisions easier. The UK has also agreed a Brexit trade settlement. The deal is far from generous and will bring additional short term costs to the economy. However, it is preferable to no deal at all. We hope that the nation will take advantage of the opportunity to shed unwanted EU rules but as yet it is too early to say where the precise economic benefits will arise.

We continue to be active in the portfolios and trading activity over 2020 was greater than normal. We expect to make further changes over the coming quarters as we continue to reposition the portfolios in response to rapidly changing market and economic conditions. Over the last few months we have been gradually building up our equity exposure. The recent purchase of the FTSE 100 index tracker proved to be well timed and benefited from November's bounce in markets. For once, the UK was the strongest amongst the major global markets.

The outlook is looking rosier. However, global markets are already reflecting the improvement, and areas such as US technology related stocks appear dear. Many of these stocks have performed very strongly over the last few years and have received a further boost thanks to the pandemic. As a result, the importance of these companies within the index has grown significantly. We are sure that some great businesses can be found in this sector but expectations in the market are very high. Not least, we have concerns about the growing threat of greater regulatory oversight and anti-monopoly action. History has not been kind to investors who overpay for profits promised in the distant future. Our preference is for more mundane, less glamorous companies which tend to be more reliable, though we are beginning to look more closely at recovery plays at this stage in the cycle.

Long term returns are likely to be more modest than markets have produced over the last few decades. Interest rates and government bond yields look set to remain at negligible levels for years to come. Investors must be prepared to risk their capital if they intend to maintain its value versus inflation, never mind hope to grow it in real terms. Equity returns are likely to average medium to high single digits. We continue to uncover opportunities for attractive, albeit modest returns from secure investments however, the main driver of any return must come from equities. We have been adding to this latter component of the portfolio. We are in the stage of the investment cycle when gains from stockmarkets are typically at their most sustainable. However, our enthusiasm is tempered by high valuations within the US market, and not least of its leading technology related businesses, as well as the precise implications of Brexit where short term costs will need to work through the economy in the UK.

OUR RECENT PURCHASE OF UK EQUITIES ARE SHOWING STRONG GAINS

Important Information