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General Economic Overview – Quarter 1 2021

In the first month of a new year it is relatively common for markets to follow the momentum of the previous year, and 2021 followed this trend. All this quickly changed after the holiday period was over. The end of 2020 saw a significant recovery in markets over the year, with rising optimism on economic growth as vaccines were being rolled out, and confidence that the new year would bring back some normality. This confidence quickly retreated as we fell back into more lockdowns across the globe as case rates and death rates increased, particularly in the UK where infection rates spiralled much higher. Another lockdown increased pessimism about the economy, although this was offset by the longer-term faith in the vaccine roll-out. By the end of quarter one an unexpected transformation had taken place as global growth expectations significantly improved, certainly in the UK and the US, as well as in Asia and China. This was led by the effectiveness of the vaccine roll-outs in these countries and by the supporting fiscal packages and monetary easing. At the same time this transformation led markets to challenge the low growth low inflation mantra that we have been observing for some time. The first quarter was then defined by the volatility in bond markets as they challenged the levels of yields that had been stable for much of 2020 pushing close to the previous highs of 2018. Whilst inflation has been kept on the back burner for much of the last three years it has now moved to front and centre in the economic debate.

The debate centres around which inflation force will be dominant in the global economy – structural or cyclical. There have been periods before when there was a two-way pull on inflation between the structural disinflationary forces of disruption, debt, and demographics and the cyclical expansion forces. We last saw this in the second half of 2016, but the difference this time round in the short term is the extent to which expansionary fiscal policy is occurring at a time of loose monetary policy. There are some underlying influences at work - Morgan Stanley estimate that by the end of March US households have lost $49bn in income but have received $1.3tn in transfers. This will increase further with the passing of the Biden fiscal package. This is combined with a US administration belief that the unemployment rate is understated due to US workers leaving the labour force (when individual benefits end there is no point signing on as unemployed in the States) and Janet Yellen, the US Secretary of the Treasury, believes that there should be a broad-based recovery benefitting Main Street more than Wall Street.

The global effect of this policy is significant and, when combined with the rapid roll-out of vaccinations, it should lift global income by 1% this year and, together with the vaccine announcements, has resulted in significant upgrades to global growth forecasts for 2021 and beyond. A booming US economy has implications for the rest of the world and manufacturing partners of the US, including much of Asia, Mexico, and Canada, should benefit from the US rebound. Faster US growth is also a positive for other advanced economies who can borrow in their own currency as there is both the potential for higher exports, and also the resurgence of animal spirits amongst corporates which could boost capex.

At the back end of 2019, investors focused on the prospects for stronger growth rather than thinking about the implications of a possibly overheating American economy. Bond markets have become concerned that with significant levels of both monetary and fiscal stimulus, which have not been tried together in the post GFC period, greater demand for goods and services could lead to capacity constraints and cause higher inflation. Market commentators have raised the prospects once again of 'bond vigilantes' forcing governments to change course if longer term borrowing rates rise significantly.

As yet there is no firm evidence that we will see anything more than a cyclical pick-up in inflationary pressures with, over the medium term, long-term secular influences continuing to constrain inflationary pressures. It will take most of 2021 to be certain that this view will prevail and as a result markets this year may continue to see elevated levels of volatility as the 'bond vigilantes' do battle with the Fed and other central banks.

It is of course too early in the year for trends to be firmly established but the inflation debate will be a theme that comes through on a regular basis, as will the effectiveness of the vaccine roll-out and any threats to its efficacy as mutations circulate. Global growth looks to be in a strong position for most regions except for Europe, but this may change further into the year as vaccines are rolled out and economies open up again.

Equity Markets

The equity markets have made a positive start to the year with most indices delivering positive returns, but the journey has been relatively bumpy with sentiment once again creating frequent periods of uncertainty. This has been generally directed by bond markets which have seen yields fluctuate as investors test the current yield ranges at the long end of the yield curve.

The main threat is the improving economic growth picture which brings with it heightened inflation expectations. As might have been expected, the equity markets have responded to this by moving in a yo-yo fashion through the quarter after what was a progressive start in January on the back of the vaccine based boost we saw from November 2020 onwards. Within this there has been a rotation from the growth-based stocks, which drove markets in 2019 and 2020, to value-based stocks which are more likely to benefit from an improving global economy. The fiscal package passed by the US legislator was a catalyst for this to continue, supporting sectors that have been out of favour such as energy and consumer discretionary. One concern for investors has been the rising yield environment which, if it leads to higher interest rates, would imply a higher discount rate on company earnings. This would create greater uncertainty about the value of future cash flows, lowering current valuations. More recently, the fiscal support packages in the US plus higher growth expectations have prompted inflation concerns which has limited any vaccine-led momentum. The switch in sentiment has also prompted investors to take profits from last year's winners, such as the technology stocks, and invest in real assets which has seen price rises for raw material such as oil and rare metals. At a regional level Asia and emerging markets have had a very strong period based in part on a weakening US dollar. New upgrades on the US economy have shifted expectations and led to a strengthening of the currency which has had a negative effect on Asian equity markets relative to the US.

Quarter one saw equity markets rise overall with the strongest returns coming from the US and the UK, and the weakest from Japan and emerging markets.

UK

The UK economy recorded its worst economic performance for over 300 years in 2020 as it reeled from the initial shock of the coronavirus crisis before staging a better-than-expected recovery later in the year. Official figures showed that the UK produced 9.9 per cent fewer goods and services last year than in 2019, worse than in 1921 after the First World War and Spanish Flu outbreak. As companies and households began to recover, performance improved, and the economy grew one per cent in the final quarter of the year. This continues to look weak by international standards with output in Q4 7.8% below the pre-pandemic peak, twice the fall of that in Germany and three times that of the US.

The decline was initially quite broad but has since focused on the travel and hospitality industry which continues to struggle. The schemes put in place which saw the government inject £352bn of support packages largely worked but pushed the public debt to GDP ratio to 97.5%, the highest since the early 1960's. There are however green shoots as we move further away from the initial pandemic breakout in March 2020 as society has adapted to the tiered system and subsequent lockdowns. Consumer spending has shown a milder contraction in the later lockdowns with 35% of retail sales online, up 15% year on year. The furlough scheme has shielded many employees and been very successful, and Brexit, which has been a restriction other developed economies have not had to deal with, is now moving forward if not fully resolved.

The most significant success has been the vaccine roll-out which has pointed towards a strong economic recovery this year. The Office of Budget Responsibility (OBR) has forecast that the economy will be 12% bigger than it is today (March 2021) in 12 months' time. There is also over £160bn in bank savings, accumulated over the pandemic which, if used by consumers as the economy opens up, could significantly boost GDP. Longer term, the OBR have noted that the economy will still have suffered scars as it will remain around 3% below its expected GDP level by 2024. This can change if we have a stronger than expected recovery but structural changes such as higher unemployment and lower population growth will continue to act as a drag. The UK stock market was lagging its international counterparts in the recovery with its higher weighting in energy and financials but has started to swing round in 2021 as investors have rotated into stocks that will benefit from a broader based growth.

US

Investors are viewing the US differently after the Senate election in Georgia in January when a close contest was pushed towards the Democrats after the Capital Hill insurrection which resulted in a previously unexpected gain of two Senate seats, leaving the Democrats in control of both Houses of Congress. As a result, President Biden has been able to put in place a further significant stimulus package of US$ 1.9 trillion, worth approximately 8% of US national income. The United States, with its successful vaccine roll-out, has seen upgrades to economic growth forecasts with some private commentators forecasting growth in the 7-8-9% range. Markets are concerned that with the strength in growth and some supply-side disruption there will be a return of inflation despite its absence for the past 30 years. The US Federal Reserve has indicated it will tolerate an overshoot of its 2% target to compensate for persistently low inflation in previous periods. Market volatility is occurring as some bond investors worry that when the anticipated rise in inflation occurs, possibly in the middle of the year, the Fed will be less comfortable than it is now. In the autumn of 2020 investors grappled with the effects of economic scarring that the pandemic might leave but it now looks like the United States (and North Asia) will return to normality quicker than other regions. Covid-19 was an exogenous shock, and the strong policy response has allowed risk appetite for those consumers remaining in work and some corporates to recover quickly. Forecasts now suggest the US economy will recoup its lost output by the third quarter of this year.

Upgrades about the scale of the of the recovery in the US keep coming. The latest fiscal package compelled the OECD to raise its forecast for the US to 5.6% from 4.2% and more recently the Federal Reserve indicated its median forecast was for 6.5% - other forecasts have been even higher. Although the US stimulus package and the roll-out of vaccines is at the core of this change the US dollar has also added weight to the argument and a stronger dollar supports Wall Street.

US equities have been the best place to be for the last ten years with the dominance of technology companies and US multinationals. This has faded in recent months as investors focused on a more robust global economic recovery. The equity fall-out from these new forecasts follow the recent trend of an investor rotation towards value with the US market coming back into favour, although the Dow Jones is outpacing the Nasdaq rather than the other way round.

Europe

As European countries were among the first to have Covid-19 lockdowns so they were some of the first to have second, and now in 2021, third waves. Some of the issues have been well documented with the ability to source vaccines and the co-ordination of this within different countries heavily criticised in the press over the last few months. It is likely that these latest lockdown measures in the major European economies will slow down recovery and result in weaker than expected Q1 data.

There have been some positive surprises however as the most recent flash Eurozone Composite Purchasing Managers' Index (PMI), produced by IHS Markit, rose to 52.5 in March from 48.8 in February. This surprised markets on the upside with the index moving above the 50-threshold for the first time in four months. The manufacturing sector moved further into expansionary territory, logging the best result in the survey's history, supported by increasing new orders - especially from abroad - and a record high increase in output. Meanwhile, the services sector continued to contract but at the softest pace since July 2020. This difference in sector performance is common across the developed world. Other positives include the employment statistics which saw jobs added as companies have expanded capacity with the recovery in sight. A further negative for the economy is however inflation. In January 2021 Eurozone inflation hit its highest level in a year as a shortage of materials and soaring shipping costs disrupted supply chains. The impact has been felt hardest in the car, chemicals, metals and mining sectors.

The ECB have supported the bond market and have indicated a willingness to continue this alongside a loose monetary policy with negative rates persisting in some countries. The EU recovery budget is also seen as a strong statement of fiscal support and will come into force in the autumn of 2021. The European commission has also hinted at relaxed fiscal rules continuing.

Asia & Emerging Markets

Asia was the first region to go into the pandemic, and the first to come out in any form from the Covid-19 related problems, with China seeing a strengthening of its global economic position rather ironically due to Covid-19. Asian markets had outperformed from the summer of 2020 and expectations of positive vaccine news and a weakening of the US currency saw the broader emerging market region outperform in the fourth quarter of the year with the November vaccine announcements accelerating this trend. January of this year saw further strength in emerging markets aided by US$ weakness, but with the election of Biden and the clean sweep in Congress by the Democrats, a robust programme of fiscal expansion with a $1.9tn package to immediately support the economy was voted through. A further proposal for $3tn of infrastructure spending, and a rapid vaccine roll-out has meant expected US growth rates have edged up to the 7-9% level with a knock-on effect on US Treasury yields.

Emerging market debt has also de-rated as a result of the general move upwards in global bond yields, increasing the borrowing costs for a region of the world already heavily indebted.

While the major move in currency markets year to date has been euro and yen weakness, if this was followed by significant strength for the dollar, the liquidity conditions in the emerging world would suffer and this could impact on the economies of the more vulnerable countries in the region with current account deficits.

The attraction of emerging markets remains faster growth and for some countries this is an attainable goal with the world in recovery mode. Covid-19 has tilted the economic balance away from services towards manufacturing, and North Asia continues to be the region the West relies on for manufactured goods. China has become the factory of the world, and other Asian countries including Frontier markets such as Vietnam and Bangladesh have also seen a significant industrialisation of their economies. Whilst China, due to its size, is suffering from the law of big numbers, other countries have taken up the baton. China continues to focus on the 'Dual Circulation Strategy' where it will lower its reliance on overseas demand and continue to grow its consumer space. China has seen significant growth in wages, which of course has benefitted domestic consumption, but its competitive advantage on cost has begun to disappear, hence the leadership is pursuing different economic goals.

The Post Financial Crisis period has to some extent been a lost decade for the non-Asian parts of the emerging world and many investors may not realise that today two thirds of the MSCI Emerging Markets Index is in three countries: China (40%), South Korea (13%), and Taiwan (13%). Economic output per head in these countries is respectively $11,000, $31,000, and $27,000 which compares with $1,800 of India which is 9% of the index, and $6,400 in Brazil which is 4% of the index. The emerging market indices have now become dominated by a small number of very large companies connected to the technology and e-commerce sectors such as TSMC in Taiwan, the global leader in semiconductors, and Tencent in China both around 6% of the index.

China has recovered the best from the pandemic and even last year it grew by over 2% with growth of 8% plus expected this year. The country has now successfully navigated its way through two crises, the GFC and Covid-19, and has emerged stronger on the world stage from each of these. The whole Asian region is arguably the manufacturer for the world and is therefore benefitting from a global recovery led by manufacturing with Western consumers diverting service sector spending towards manufactured goods.

Since the vaccine announcements in November last year there have been rising prices in oil, hard, and soft commodities, with 'green economy' areas such as copper, nickel and rare earths performing particularly well. Whilst this would normally benefit the non-Asian part of the emerging world, the poor handling of Covid-19 in many Latin American countries, combined with higher debt levels, has hampered progress. Brazil, the dominant market in Latin America, has highlighted another key risk: politics and poor governance. Brazil's President Bolsonaro has replaced the head of state oil company Petrobras with an army General after refusing the company price rises. As a result, Petrobras investors have lost around 20% of their money in local currency terms despite the rise in oil prices. This highlights the importance of governance and risks in investing in State controlled or influenced entities in the emerging world which may at times be required to do 'national service'. The replacement of several ministerial posts including the Foreign and Defence Ministers by Bolsonaro highlights the political pressures on the leader after the poor handling of the Covid-19 crisis and consequently Brazil has been forced to raise interest rates this year.

In 2018 Mexicans, sickened by worsening corruption, elected Manuel Obrador with the hope this left leaning President would bring radical economic change, however Mexico has seen a far bigger excess death toll during the pandemic than any large country. Vaccinations will eventually get the virus under control and the strength of the US economy should be a medium term positive for the country, but high levels of debt remain a problem.

Russia has been a beneficiary of a higher oil price, but rising inflation has forced the central bank to raise interest rates and this will further hold back any domestic economic recovery. Under Putin there has been a focus on making the economy resilient to a crisis even if consumer demand has remained depressed for many years because of how the Kremlin manages the budget and the rouble. Russia now has little risk from overseas creditors with little foreign ownership of debt.

Countries such as South Africa and Indonesia are vulnerable to rising US Treasury yields with their reliance on overseas funding of their domestic bond markets. In contrast, India can finance its deficits internally and this remains the major market outside of North Asia with strong growth prospects and, as a leader in generic drug manufacturing, it should be able to deliver a successful vaccine roll-out over the remainder of the year.

Prospects for emerging markets are more nuanced than was the case six months ago, with many markets having already seen a strong recovery and those with current account deficits vulnerable to US$ strength if it occurs. Whilst a stronger US economic recovery is a positive for global growth prospects, it is likely to raise the financing costs of the emerging world which has recently seen overseas selling of financial assets. Overall, North Asia together with India and Vietnam seem the economies best placed to enjoy a sustained recovery and Asia, as the manufacturing centre of the world, remains favoured over Latin America and Eastern Europe.

Japan

The forecasts for growth in the Japanese economy have recovered from the state of emergency that was central to the decline in 2020. The more recent state of emergency in quarter one is not seen as significant as that of last year. Although the activity in the service sector has been cut back, mobility and spending should recover from Q2 onwards. Consumer confidence is on the increase, helping to build expectations of a strong recovery in the latter part of the year assuming the vaccine roll-out continues to progress. The more efficient response of Asian economies to the pandemic has helped Japan to recover its export-led economy, particularly in trade with China. The Tankan survey of large manufacturers has been in negative territory since Q4 2019 but has been heading to a positive reading in Q1 which is a major turning point in the sentiment around the economy and where it is in the cycle.

According to a comprehensive estimate, GDP increased 11.7% in seasonally adjusted annualised terms (SAAR) in the fourth quarter 2020, somewhat lower than the 12.7% from the preliminary estimate and slowing markedly from the 22.8% expansion in the third quarter. The result was driven by milder growth in private consumption, which increased 9.0% in the quarter. Nevertheless, Q4’s reading was still the second strongest rate of growth in at least 25 years, highlighting resilient consumer spending despite spiking Covid-19 infections and the implementation of associated restrictions during the quarter.

Japan continues to have significant structural issues, the most significant being a declining population, but with a high debt to GDP ratio and national debt at over 200% of GDP there are other headwinds to stimulating the economy. The Olympics are due in the summer with some doubts still hanging over it as, without any foreign spectators, the event loses significant economic benefit. A further delay into 2022 seems unlikely at this point.

The problems of a deflationary environment have been well documented but not all is negative for investors as the Asian region is stronger and has weathered the pandemic much better than other global economies.

Fixed Interest

The first quarter of the year has seen quite a lot of volatility in bond markets as investors try and get a handle on the short- and medium-term direction of travel. The bond market has suffered the worst start to a year since 2015 with the Bloomberg Barclays Multiverse, which tracks $70tn of debt, indicating it would be the worst quarter since 2018. This reversal started gathering steam in January 2021 when the Democrats won control of the US Senate and the prospect of a more forceful stimulus package became more likely. This has raised the threat of inflation, which is not only negative for bonds but also for equities, as the discount rate for earnings rises.

Bond markets have become concerned that with significant levels of both monetary and fiscal stimulus, which have not been tried together in the post GFC period, greater demand for goods and services could lead to capacity constraints and cause higher inflation. Market commentators have raised the prospects of bond investors forcing governments to change course if longer term borrowing rates rose significantly. Since the GFC, markets have benefitted from declining short- and long-term interest rates, together with a significant fall in real yields, resulting in a much lower discount rate being applied to the future earnings of corporates. The post Financial Crisis market recovery was not driven by hopes of higher growth which was the driver of returns in the late 90's bull market, but rather a higher price being paid by investors for earnings at a time when cash rates and 10-year bond yields were either close to zero or negative. The yields on the ten-year US Treasury have been as high as 1.7% climbing from 0.9% at the beginning of the year. This is not just a US phenomenon as the Australian 10-year yields have already surpassed pre pandemic levels and Japan's rose above 0.1% in Q1 for the first time since 2018.

This brings us back to the UK where government bonds have been suffering the worst quarter for two decades as Britain's economic prospects brighten. Although US treasuries have been at the centre of the storm, the selling has been seen in UK debt as well, which has fallen over 6.5% in total return terms. Debt issued in Germany, France and Italy has fared slightly better because their economies have struggled more coming out of the pandemic with less effective vaccine roll-outs. The narrative has moved from the possibility of negative interest rates in the UK to when policymakers will need to raise rates if rapid growth stimulates inflation. Central banks have continued to back an accommodative policy on interest rates and inflation for the time being. The Bank of England believe the rise in gilt yields is consistent with the change in economic outlook. Gilt demand as a safe haven option has fallen as risks over the pandemic and Brexit have subsided whilst at the same time issuance has increased to pay for the current levels of government stimulus. The situation in Europe is different as economic prospects are less certain. The EU has provided less fiscal support, so recovery is expected to be slower in conjunction with the slower vaccine roll-out.

Bond markets are certainly an area to watch in 2021. Real rates remain below the ten-year average, with the ten-year real yield at minus 0.7% against a ten-year average of plus 0.3%. Bond markets are probably in a waiting period until the tone of the economic recovery is more established and fair value in long term interest rates that reflect growth and inflation are clearer. Fixed interest markets therefore face a testing time with higher levels of volatility expected in 2021.

Property

As we enter the second quarter of 2021, we still have some property funds closed to transactions even though the material uncertainty clause was removed in Q3 2020. The issue for these funds is that they need to be positioned for the inevitable rush to exit that will take place on opening, as investors seek to create liquidity before either a further suspension occurs or the FCA set new regulations. To date those funds that have opened have been able to cope with the outflows and have remained open, which has enabled many investors to adjust their property holdings.

There is no doubt that many of the changes in the commercial property sector created by the coronavirus crisis are still in place – some of them will be temporary and some longer term created by structural changes in the economic environment. This has of course affected different areas of the market in different ways. Most physical property funds have seen the retail and leisure market suffer much more than the warehouse and office sector. Rental income returns highlight the difference in the way sectors have responded. Data from Janus Henderson illustrates this with the alternatives sector (excluding leisure and student accommodation), which includes assets such as a data centre and care homes, having a 100% rent collection rate, as did the supermarkets. Payments from tenants at industrial assets followed closely at approximately 98%, then offices at 95% and retail warehousing at 87%. The leisure sector however has fared the worst, with around 54% of rents collected for the fourth quarter of 2020. The deeper, more structural changes may take more time to come through and become established trends, such as use of offices and the increase in home working. This could lead to lower occupancy levels and reduced demand but also to potentially new uses. As an example, several large property managers have been integrating more residential use into buildings even before the pandemic hit.

While investor demand for the overall retail property sector will struggle to pick up in the near term, investors are likely to remain focused on core, well-located retail space with secure and long-term income streams, underpinned by high-quality tenants. The office occupational market remains subdued, with limited leasing activity reflecting delayed occupier decision-making. This partly reflects the normal reaction of companies to economic weakness, but also the pandemic's impact on working from home. The high street remains an area of weakness although there may well be a consumer boom post the full release of lockdown in June, if it takes place. There will continue to be casualties and even high street stalwarts such as John Lewis have announced store closures and job losses. Most UK physical property funds had a negative year in 2020 but returns were not as poor as the equity market – albeit the suspension of funds reduced the effect of market movements for much of the early pandemic period reducing price volatility.

The global REIT market also had a negative year in 2020 mainly due to those areas that suffered from the pandemic, such as retail properties, but like many other sectors it has seen a turnaround in 2021. REITs in 'growth' sectors offer highly visible long-term compounding return potential, driven by permanent and powerful secular tailwinds such as e-commerce, mobile data, cloud computing, 5G and changing demographics. The growth prospects of many real estate companies exposed to these trends have improved, however in the aftermath of recent underperformance of the wider REITs sector, these companies have seen their previously high valuation premium disappear. Since the announcement of the Pfizer vaccine's efficacy against Covid-19 on 9 November 2020 REITs, as well as equity markets have seen a significant rotation to 'value'. Specifically, 'value' REITs are up on average 52% (source Bloomberg to March 8th 2021), while 'growth' REITs have declined by 7%. The rotation away from 'growth' real estate sectors that have directly benefited from Covid-19 (industrial/logistics, cell towers, data centres, single-family rental housing, storage), towards 'value' sectors that have been negatively impacted by

Covid-19 (shopping centres, regional malls, hotels, office, coastal apartments) has been strong, and has happened in a very short space of time. This trend looks likely to continue into 2021.

The REIT market remains sensitive to interest rates however and the current fears for inflation later in 2021 could affect this market's future potential.

As we identified in the previous review, the position for many investors in direct property is probably now as much about liquidity, access, and timeframe requirements as it is about the diversification that direct property can provide. With FCA changes soon to be published this may become more difficult to manage for those with a shorter-term investment horizon as access to funds could be more restrictive. Fundamentally, direct property can offer low correlations to other asset classes so should not be ignored but clearly practicalities need to be factored into any investment decision.

Summary

There have been several market phases since the start of 2020. The first was when growth was disrupted by Covid-19. The second was when significant monetary easing and fiscal support allowed markets to rally. At this stage markets priced in a 'lower forever' interest rate regime, but investors are now seeing a shift to a lower but not forever mentality on interest rates. Whilst politicians want to see growth come back, it can be a dangerous period for financial assets. The post GFC period was bad for the economy but good for financial assets with some commentators labelling QE as welfare for the wealthy, illustrated by the asset price reflation which was a stated policy objective. Today in the States the Biden administration wants to set a different pathway emphasising wage growth and the administration is likely to pursue this policy despite a risk of higher inflation.

Although there has been significant discussion in the financial press about the threat of inflation, the data so far has not really supported the likelihood of any meaningful increase in inflation around the globe. The structural influences of high unemployment and limited wage demands, as well as technological advances continue to dominate, but this can change, and the bond markets keep testing global financial stability hence the yo-yo nature of markets in the first quarter. There is always an interplay and overlap between secular and cyclical forces in an economy and investors must contend with this. In the post GFC period powerful secular forces (ageing demographics, high debt levels, technology innovation and excess global savings) kept both growth and inflation at low levels. So called secular stagnation was a positive backdrop for equity markets, keeping interest rates at historically low levels and justifying the re-rating of equities. The key question for markets is how the anticipated cyclical upturn will unfold. If it is accompanied by limited inflationary pressures which remain constrained by secular forces with the spare capacity (especially in the labour market) caused by the severity of the Covid-19 recession remaining in place, there will be a relatively positive backdrop. This, however, is the first time both monetary and fiscal stimulus have been applied in large doses to the global economy, and today there is a rejection of the austerity policies which followed the Financial Crisis. Most investment portfolios have been constructed in the belief that interest rates and inflation will stay low indefinitely and the Covid-19 pandemic has further reinforced the lower for longer interest rate mentality so, if anything did rock this consensus there would likely be a nasty market correction.

Looking a little further ahead to the second half of the year, assuming success with the roll-out of vaccines, there could be a sharper than expected upturn in global economic activity. This could see an increase in inflationary expectations, and it is important that central banks continue to adopt an accommodative stance. Structural disinflationary forces remain but some cyclical inflationary forces are likely to gain ground and gather momentum over the next 12 to 18 months. There is no reason to yet believe that the three D's of Debt, Demographics and Devices (technological innovation) will result in a long-term breakout of inflation above central bank targets. The best outcome for markets is that the same long-term forces that have dominated recent decades will re-emerge after the pandemic – the 'goldilocks world'. A continuation of the global savings glut is likely to keep equilibrium interest rates very low during the 2020s and as a result, near zero bond yields should continue to support buoyant equity markets. This year, however, will see expansionary fiscal policy (especially in the United States) challenge the now more established short-term view of low inflation, and whilst this might be good for the world economy in the short term, it would not necessarily be good for asset prices. The factor most likely to puncture the long running bull market in global equities would be a rise in the long-term discount rate applied to corporate earnings. Clearly, this battle will also determine the short-term relative performance of growth versus value investment strategies. Value stocks typically outperform when growth becomes more plentiful and so would be the primary beneficiary of the reflation trade if it persisted. Over the medium term, successful growth investors should benefit from the continuation of a 'winner takes most' investment environment, but 2021 is a period when 'living dangerously' is the price to pay for the likelihood of continued long-term investment success.

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