INVESTOR INSIGHT

Spring 2021

A look at the markets by **RSMR**

Welcome

Welcome to the latest edition of our 'Investor Insight' which provides high-level commentary on the global markets and how these might be affecting your investments.

We hope you find this useful.

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The global economy: What's going on?

Recovery hopes fuel inflation fears

A zigzag start to the year saw the market recovery at the end of 2020 plunge into global lockdowns, rising Covid-19 deaths and economic pessimism.

But by the end of March, global economic growth expectations improved significantly, driven by the UK, US, Asia and China, led by efficient vaccine programmes, government support and easier business borrowing.

> "So far there is no firm evidence of more inflationary pressures than during a standard economic cycle"

This about-turn led markets to challenge the acceptance that low economic growth means low inflation with bond markets pushing yields higher testing the resolve of central banks and governments.

While inflation has been on the back burner for the last three years, it is now central to economic debate about which inflationary force may dominate the global recovery: structural factors, such as disruption and debt, which ease inflation, or economic expansion, which stokes it.

So far there is no firm evidence of more inflationary pressures than during a standard economic cycle, with longer-term sluggishness due to the pandemic, but it will take most of 2021 to discover if this is right. Meanwhile, market volatility is likely.

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The asset classes – a quick round-up

EQUITY MARKETS

As expected, markets fluctuated after a progressive start following heartening vaccine programme news.

They remained positive but volatile due to bond market uncertainty with fluctuating returns as investors tested the declining yields of recent years.

There was a shift from growth-based stocks, which drove markets during the last two years, to value-based ones, more likely to benefit from an improving global economy which is a threat to equities if it brings inflation.

The US tax and spending package has been a catalyst, supporting out-of-favour sectors, such as energy and luxury goods, supressed during the pandemic.

One concern for investors is rapid growth which, if it leads to higher interest rates, may create greater business uncertainty.

The US government approach, and hopes for higher economic growth, have created inflation concerns, limiting momentum created by the vaccine programme success.

The Office For Budget Responsibility (OBR) says that the UK economy is scarred and will remain around 3% below its expected Gross Domestic Product (GDP) level by 2024.

Overall, equity markets rose with the strongest returns in the US and UK, and the weakest in Japan and emerging markets.

FIXED INTEREST

Bond markets have been volatile as investors tried to assess if there will be a medium-to-long-term rise or fall in yields.

Bonds had their worst annual start since 2015 but this changed with Democrat control of the US Senate and anticipation of the more forceful stimulus package.

This has raised the threat of inflation, harmful for bonds and equities, as the earnings discount rate by which businesses are valued, rises.

A market concern is that, with significant tax and spending stimulus and money supply adjustments, greater demand for goods and services could trigger inflation.

In the UK, government bonds suffered the worst quarter for 20 years as Britain's economic prospects brighten.

Although US treasuries have been central to this, UK debt has also been sold, falling more than 6.5% in total return terms. (source: Financial Express March 2021)

Debt issued in Germany, France and Italy fared slightly better as their economies struggle more in emerging from the pandemic due to less effective vaccine programmes.

Discussion has shifted from fears of negative UK interest rates to when policymakers will raise them if rapid growth stimulates inflation.

PROPERTY

Some commercial property changes due to the pandemic will be temporary while others may be permanent.

In terms of rents, data centre, care homes and supermarkets had a 100% collection rate, industrial properties were at 98%, offices at 95% and retail warehousing at 87%. Leisure fared worst, with only around 54% of rents collected in Q4 2020. (source: Janus Henderson March 2021)

Fundamental changes in property use are best illustrated by office staff home working, which could lead to lower occupancy and new roles for these buildings.

While investor retail property demand is unlikely to revive soon, most are likely to focus on well-located units with a secure, long-term income, and high-quality tenants.

Offices remain subdued, with limited leasing due to slower decisions from potential occupiers, a usual response to economic weakness and further evidence of how the pandemic is influencing home working.

The high street remains weak but there may be a consumer boom if lockdown ends in June. Casualties will continue. Even big names, like John Lewis, have announced store closures and job losses.

Many direct property investors' approach is as much about how easily investments can be turned into cash, market access, and time scales as about the scope it offers.

While direct property can offer little movement it should not be ignored but these practicalities must be taken account in any investment decision.

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Global round-up

- Forecasts suggest the US economy will recoup lost output by the third quarter of this year.
- Eurozone Composite Purchasing Managers' Index (PMI) rose to 52.5 in March from 48.8 in February. (source: JPM Guide to markets March 2021)
- The UK produced 9.9% fewer goods and services in 2020 than 2019, worse than in 1921 after WWI and Spanish Flu. (source: FT March 2021)
- Covid-19 has tilted economies away from services towards manufacturing. North Asia remains where the West sources goods.
- Russia benefited from higher oil prices, but inflation forced the central bank to raise interest rates which will delay economic recovery.
- Asian economies' more efficient pandemic response helped Japan recover its export-led economy, particularly with China.
- North Asia, India and Vietnam are most likely to enjoy sustained economic recovery.
- The EU recovery budget, due to take effect this autumn, is regarded as a strong government support statement.
- Japan's GDP rose 11.7% in the fourth quarter 2020. (source: BOJ March 2021)

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So, what’s next?

We all want economic growth, but this can be a hazardous time for financial assets.

President Biden wants to emphasise wage growth for recovery despite higher inflation risks.

The key question for markets is the nature of the upturn. If it is accompanied by limited inflationary pressures with spare capacity, especially in the jobs market, it will be relatively positive.

But this is the first time tax and spending and money supply measures have been applied substantially to the global economy since the banking crisis. Most investment portfolios have been assembled expecting indefinite low interest rates and inflation and, if anything rocks this, there could be a nasty market correction.

Assuming a successful vaccine programme, there could be a sharp increase in global economic activity in the second half of 2021. This could increase inflation, although there is currently no reason to believe this will be above central bank targets if they continue current policies.

The best hope for markets is that recent decades’ dominant forces return. A global savings glut is likely to keep interest rates very low and as a result, near zero bond yields should support buoyant equities.

During the medium term, successful growth investors should benefit from a continuation of the ‘winner-takes-most’ environment but in 2021 ‘living dangerously’ will be the price for likely long-term investment success.

About RSMR

Independent specialist research.

RSMR was formed in 2004 to meet a growing demand from financial advisers for specialist and impartial investment research.

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We are best known within the financial industry for our ‘R’ fund ratings – this rating is given to investment funds that meet our stringent research criteria. We don’t limit ourselves to just looking at performance – we also look carefully at the people, processes and capabilities that are required to make effective investment decisions.

We work in partnership with your financial adviser, providing the benefit of our broad industry insight and rigorous research. This quarterly market summary is designed as a ‘snapshot’ of the more thorough and lengthy commentary that we provide to your adviser on a quarterly basis.

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