London &Capital

THE BEGINNING OF THE END FOR TRUMP AND COVID-19

US ELECTIONS

WHAT HAS HAPPENED (IN CASE YOU HAVE BEEN LIVING UNDER A ROCK)?

Joe Biden has won the US presidential election.

The Senate will probably stay in Republican hands (all eyes are on Georgia for the results of the runoff in January).

Biden had an ambitious agenda with regards to major spending programmes (healthcare, clean/renewable energy, infrastructure, and education amongst others), but without a clean sweep there could be policy gridlock.

DOES THIS MEAN THAT PRESIDENT-ELECT BIDEN WILL HAVE HIS HANDS FULLY TIED?

Some key policies can still be achieved through executive action, like changing course on climate change:

- The US is set to re-join the Paris climate agreement
- Biden is to halt new drilling permits on federal land, BUT he pledged not to negatively impact US shale oil/gas production
- The importance of renewable energy will grow
- For other policies (like healthcare reform or corporate taxes), Biden will have to find compromise if Mitch McConnell (Senate majority leader) is to agree with him.

WHAT IS THE IMPACT ON MONETARY POLICY?

Overall, there is no change in policy stance, it is still: “lower for longer”, zero rates and more QE/wider liquidity support.

AND ON FISCAL STIMULUS?

A clean sweep would suggest a high likelihood of another large stimulus bill (ie USD 1 Trillion+).

With a Republican Senate, the size of the bill would be much smaller (perhaps around USD 500 Billion).

WHAT ARE THE IMPLICATIONS FOR EQUITIES?

It might seem counter-intuitive for markets to rejoice (after all, political gridlock seems worrying at a time when decisive fiscal impulse is needed). However, here are some positives for equities:

- Biden is likely to be unable to impose higher corporate taxes
- Gridlock mitigates the prospect of more severe regulation on Banks, Big Tech and Energy companies
- The election results reinforce the status quo of markets anchored by low interest rates
- A divided congress takes the most extreme policies out of play from for both parties

From a geographical perspective, Emerging Market (EM) Equities (especially Asia) may benefit from much more stable foreign policies and trade policies.

WHY NOT GO "FULL IN" ON EQUITIES?

Chairman Powell put it best last week: "Fiscal policy can do what we can't, which is to replace lost incomes for people who are out of work through no fault of their own."

Any further stimulus deal could fail to plug the economy's pandemic hole.

WHAT ARE THE IMPLICATIONS FOR FIXED INCOME?

On Treasuries, the short-end will still be anchored by the Federal Reserve (the Fed), and the longer-end will be under less pressure.

With respect to credit spreads, fundamentals supporting further gradual spread are narrowing to pre-COVID-19 lockdown levels.

We continue to focus on the following areas:

- Banks:
  - Improving balance sheets
  - Positive earnings trends
  - Supportive Fed and regulations
  - Source of strength
- Utilities:
  - Key stable economic sector
  - Resilient balance sheets
  - Regulated
  - Non-cyclical
- Pharma:
  - Strong balance sheets and key economic sector
  - Regulated
  - Benefitting from COVID-19
  - Demographics supportive
- Technology:
  - Key economic sector
  - Key beneficiary of new global work trends
  - High operating cash flow sectors
  - Barriers to entry

London
&Capital

COVID VACCINE

WHAT HAS HAPPENED?

Pfizer and BioNTech announced yesterday (09.11.20) that the vaccine they are working on “is more than 90% effective in preventing symptomatic cases of COVID-19”.

Belief that a vaccine could mean a progressive return to normal, pushed markets up, mainly driven by sectors that had been badly left behind since March: airlines, banks and hospitality (Cineworld shares were +50% post news, even if they are still -80% so far this year).

ALL VERY ENCOURAGING, THEN?

Yes, 90% effectiveness is nothing short of outstanding. Plus, as some scientists mentioned yesterday, it should bode well for the likelihood that other vaccines end up being successful. This is crucial: the Pfizer vaccine is NOT easy to distribute globally (it needs to be stored at ultra-low temperatures. As we speak, the World Health Organization and UNICEF must be mapping the global availability of cold-chain storage capacity).

GREAT! IS THERE A “BUT”?

Yes: we do not know its efficacy in the long term, and we also do not know if this vaccine prevents infectiousness, i.e. if it prevents someone from getting COVID-19 symptoms but they can still spread it to others.

WHAT ARE THE NEXT HURDLES FOR THIS VACCINE?

Application for emergency authorisation is the next step in America and Europe, and this cannot take place until the company has amassed two months of safety data from participants (i.e. until end of November/December).

Health authorities might authorise it for use in high-risk groups before 2021, but, if all goes smoothly, approval will not come until Q1 2021.

WHAT ARE THE IMPLICATIONS FOR THE ECONOMY AND MARKETS?

This announcement could set the stage for a broader economic recovery in 2021. Monetary and fiscal support could combine with pent-up demand from consumers.

On the back of this, we have started to see significant rotation within risk markets. Across US and Europe, sectors hit the hardest by lockdowns were the ones that did best, and sectors like Technology were the ones that did worst (Nasdaq, for instance, was down -1.5%).

In theory, if this triggers higher expectations for economic recovery, it could take the US 10 Year Treasury yield towards 1.5% (where it was pre-COVID-19).

From a geographical perspective, US risk markets could lag in any vaccine-driven rally due to heavy exposure to Technology.

Until yesterday, best case scenarios were mainly around government stimulus and the “lower for longer” mantra from central banks. Science has offered credible hope towards restoration of economic activity in 2021.

DOES THIS MERIT ANY ASSET ALLOCATION MOVES?

Yes. London & Capital reduced exposure to high grade credits and increased equity exposure across risk profiles.

Gold retains a space in the asset allocation: it was never intended to be an equity hedge, but will act as a store of wealth in a world where fiat currencies will continue to be debased (London & Capital's exposure to gold has now been segregated in between physical metal and equities in gold miners).

ADDENDUM: 10 IMPORTANT LESSONS FOR INVESTORS

Now that news of vaccine suggest we are at the beginning of the end of COVID, it is good to take stock and reflect on some key lessons for investors:

01 DO NOT FIGHT CENTRAL BANKS...

This strategy has been particularly rewarding when it comes to credit in companies with strong growth prospects and solid balance sheets.

02 ...BUT EXPECT THEM TO LOSE RELATIVE IMPORTANCE IN NEXT 5 YEARS

Since the Lehman Brothers collapse, so much attention has been on central bankers: their actions, their omissions, their words, their silences, their dot plots.

Do not expect central banks to be as important from now on: rates are close to zero, so marginal impact of monetary stimulus will be lower, and the transmission mechanism remains broken.

03 WE HAVE ENTERED 'THE AGE OF FISCAL DOMINANCE'

There is a new sheriff in town: Fiscal Authorities. Fiscal stimulus is key to providing relief to companies and restoring confidence of households.

04 CONSUMERS WILL REMAIN CAUTIOUS...AND UNLESS THEY RE-JOIN THE PARTY, THERE IS NO V SHAPE RECOVERY

Saving ratios have increased and will remain high for a long time (i.e. higher buffers of cash). Wealth managers like us tap into an opportunity to help clients increase the yield that such a cash pool provides.

05 ACCEPT THAT VOLATILITY IS GOING TO BE HIGHER THAN IN THE LAST 10 YEARS

Investors need to care less about mark-to-market considerations and more about the inherent quality and nature of the investments they hold.

When crisis strikes, breathe, step back and look at the big picture. Ask yourself these questions: are most of my assets liquid? Are they resilient? Is the thesis that made me buy these assets still valid?

06 THINK LONG TERM...

Long term performance is available to those who remain invested for that long-term horizon.

07 ...BUT DO NOT FORCE YOURSELF TO PREDICT TOO FAR INTO THE FUTURE

There is such high VUCA (Volatility, Uncertainty, Complexity and Ambiguity) that it is foolish to need to be right over long time horizons. Focus on shorter maturity bonds or sectors of structural strength.

08 WITHOUT A GROWTH CATALYST, VALUE EQUALS VALUE TRAP

The cheapest equity sectors (hospitality, energy, industrials, transportation, financials) can remain cheap until there is a catalyst for recovery in growth and inflation.

09 INFLATION IS NOT A PROBLEM IN THE SHORT TERM, BUT PAY ATTENTION

The era of deflation still with us, BUT even modest inflation expectation shifts could create deep reverberations across financial markets.

10 SUPER CHEAP BANK EQUITIES ARE COMPATIBLE WITH STRONG BANK BALANCE SHEETS

Banks face a potential rise in bad loans, but their balance sheets are far, far stronger than in 2008. Our exposure to financial bonds is still deserved.

London
&Capital

DISCLAIMER