DECEMBER MONTHLY COMMENTARY

21ST DECEMBER 2020

Equity markets notched their best performance on record in November as investors cheered three, separate, COVID-19 vaccines which posted pleasing results in late-stage trials. Market participants were quick to price in a sharper economic recovery, with monetary and fiscal policy remaining ultra-easy and the vaccine providing hope for a quicker return to normality in 2021. There was also further clarity for the market as Joe Biden's election to the White House, combined with a split Congress, provided another positive catalyst for risk assets. The risk-on trade was fuelled by Joe Biden's fiscal agenda and softer stance on trade, combined with the inability for Democrats to pass tax rises through Congress. Safe havens such as gold and US treasuries sold off whilst emerging markets tracked the positive sentiment seen across developed markets.

Although medium term expectations markedly improved, in the short-term the health crisis has worsened, COVID-19 restrictions in the West have tightened and economic momentum has slowed. Concerns remain over how economies were managing to deal with the pandemic as cases across the US and Europe continued to climb, resulting in further, stricter, lockdowns. Cases within the US hit 17 million by mid-December with deaths now well over 300,000. Similarly, within Europe, France implemented a new nationwide curfew as they struggled to quell a rise in cases. Germany also instituted a new nationwide lockdown. That said, investor concerns have been shrugged off throughout December as the positive vaccine news provided a light at the end of the tunnel whilst the prospect of further fiscal policy firmed, and central banks maintained their 'lower-for-longer' rhetoric.

Elsewhere, December brought the final central bank meetings of one of the most tumultuous years in memory. The Federal Reserve (Fed) maintained its asset purchases of $120bn per month and kept its ultra-low interest rates, with guidance still pointing towards no rate hike until at least the end of 2023. Additional guidance added to December's statement committed the Fed to asset purchases until "substantial" progress was made towards its goals of price stability and full employment. Forecasts for GDP growth were upgraded, with the US economy forecast to fall by only 2.4% in 2020, outperforming the initially grave predictions made earlier in the year. Fed Chair, Jerome Powell maintained that with interest rates as low as they could be, before entering negative territory, fiscal policy remains the most effective way to keep household's liquid and consumer spending supported. Powell's comments came as US Congressional leaders vowed they would soon complete negotiations on a fresh $900bn stimulus deal to bolster the US economy. In Europe, the European Central Bank (ECB) increased the size of its pandemic emergency purchase programme (PEPP) from €1.35tn to €1.85tn and pushed back the end of its main crisis-fighting tool from June 2021 until at least March 2022.

Despite such dovish tones from the ECB, the euro continued its upwards trajectory vs the dollar, trading above $1.22 for the first time since 2018, as investors were happy to see improving Purchasing Manager's Index (PMI) across the eurozone. The composite PMI for the eurozone was just shy of growth at 49.8 in December, however this was well above November's 45.3 as a

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contraction in the lockdown-hit services sector was offset by resilience in manufacturing. Optimism for this upward trend in purchasing manager's order books will likely wane as lockdowns kick in over the festive season. In recent days the Brexit mood music has improved and it now appears a path to an EU-UK trade deal is in view, with fishing rights the only remaining unresolved issue.

Although the short-term outlook for economic conditions has deteriorated in line with the re-escalation of the health crisis, the medium-term set-up for risk asset performance in 2021 has improved. The high efficiency and earlier delivery of a vaccine will support stronger global growth, reduce downside risks and bring forward the timeline to completing the global recovery in aggregate demand and corporate earnings. Declining uncertainty on these fronts, together with supportive liquidity conditions has led us to increase equity allocations across portfolios in November – however, as always, we remain mindful of the challenge's asset markets may face next year and the demanding level of valuations.

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