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Market updates

Investment team updates | 22 January 2021

US equities

Markets

- On Wednesday 20 January Joe Biden was inaugurated as the 46th President of the United States in a ceremony which passed off without event compared to the scenes at the US Capitol two weeks prior. Now that the Democrats have control of the presidency and the House of Representatives, and effective control of the Senate, we will be looking to see whether Biden is able to enact his campaign agenda. Most pressing are coronavirus relief measures and rapid deployment of the vaccine. Biden has already signalled a further $1.9 trillion relief package, but in order to get bipartisan support in Congress the final figure may be somewhat lower.
- As soon as he arrived in office Biden signed off a flurry of executive orders, immediately undoing some of Donald Trump's most contentious policy items. A number revolve around the coronavirus: for instance, mandating the use of masks on all federal property and interstate travel. He also committing to re-joining the Paris Climate Accord and the World Health Organisation, revoked the ban on immigration from Muslim-majority countries, and took away permits for an oil pipeline and drilling in the Arctic. While these early signs indicate the direction of travel for the Biden presidency, they will need the support of Congress to become more than just symbolic acts.
- So far this year, markets have made good upward progress with the S&P 500 up by 2.7% over the year-to-date (to 21 January) touching all-time highs again this week. This performance has however been bettered by small cap return, with the Russell 2000 up 8.5% in 2021 so far, continuing the outperformance for small caps which began at the back end of 2020. To widen the lens slightly, over three months to 21 January the Russell 2000 has returned 31.7% to the S&P 500's 12%. At a sector level we are seeing more of a pro-cyclical rotation with energy so far the leading sector, bouncing back from a torrid 2020 and helped by a higher oil price and more financial discipline among producers.
- Q4 earnings season has begun and the signs so far have been relatively positive. Companies representing 12.5% of the S&P 500 by market cap have reported, with earnings ahead of estimates by 22.3% in aggregate and 90% of companies beating projections. Based on this start, current estimates for the whole of the earnings season are for an EPS contraction of -6.7%, but with cyclicals excluded this figure improves to +4.6%. Bearing in mind that this is the last quarter with a tough pre-pandemic comparator, a modest earnings contraction would be somewhat expected.

- Big banks have reported generally good headline figures, but stock prices did not react positively, largely because the numbers were flattered by the release of reserves set aside for bad loans in 2020, and the compression of net interest margins which means the outlook is still uncertain. Netflix also issued a strong set of numbers, with an increasing subscriber count and indicated that buybacks may be on the horizon. Shares are up 7% this year.

European equities

- Joe Biden's presidential win, as expected, brings a return to more Europe-friendly policies, including the US reverting to the Paris climate accord.
- It also promises reflationary policies to support the US – and the world – during continued Covid-19 prevalence.
- Europe has started the year well, with the UK outperforming slightly (as is sterling) in light of the Brexit agreement reached in December.
- German politics looks set to stay on track as Armin Laschet moves to replace Angela Merkel. But Italian politics, however, is ever more precarious and the ruling coalition is under pressure.
- We continue to focus on quality but are mindful that high valuations may not be sustainable, and some more defensive counters may benefit from an end to the virus, and from reflationary economic policies.

Fixed income

News

- In the US 10-year inflation expectations have reached a two-year high of 2.2%. Meanwhile, initial unemployment claims came in at a lower 900,000 in the week ending 15 January. But that wasn't the biggest news in the US this week, as Joe Biden was inaugurated as the 47th president – and immediately set about reversing a series of Trump-era policies on the World Health Organisation, the Paris Climate agreement and the wall on the Mexican border.
- Elsewhere in the US Netflix stock was up 12% this week on the addition of 8.5 million customers in Q4 (led by the release of The Queens Gambit), and the platform now has more than 200 million subscribers in all. The University of Michigan Consumer Sentiment Index fell to 79.2 from 80.7 in December.
- In the eurozone, the CPI inflation rate in December was -0.3% year-on-year. In the UK, the CPI inflation rate was 0.6% year-on-year, which was slightly higher than expected.
- Meanwhile, car registrations fell 24% in the eurozone in 2020, though they were improving into the year-end – luxury brands such as BMW did better than mass market ones, eg Renault.
- Turning to the coronavirus, Wednesday 20 January saw Spain chalk up a record number of cases (in excess of 18,000), and the UK record fatalities. However, vaccine roll out in the latter is at 7.6% of population as of Thursday 21 January. Germany is to stay in lockdown until mid-February at least. The UK government is less reluctant to put a date on lifting its own restrictions.

Markets

- US core government bond yields moved around a little over the week but ended Thursday 21 January at 1.10%, +2 for the week. Euro bonds finished Thursday +4 at -0.50%
- In credit spreads, based on BofA Merrill Lynch Bond Indices, both Global IG and HY are both 4% tighter year-to-date. This week, Global IG ended Thursday 21 January at 99bps having circled the 100 point all week; while Global HY ended it at 394bps. European HY tightened over the week.
- In FX the dollar/euro was little changed throughout the week, with the euro ending Thursday 21 at 1.216.
- Oil started the week at $52.4 per barrel and tracked a little lower over subsequent days to $52.5.

Multi-asset

- After a period of deep and protracted underperformance of UK equities, last week we neutralised our underweight to the market. Valuation discounts on UK stocks are meaningful and, with the risk of a no-deal Brexit removed and mounting M&A interest, a neutral stance seems prudent. However, the structural headwinds associated with the skinny Brexit deal prevent us from feeling more positive here.
- We continue to concentrate asset allocation portfolios in areas with good expected earnings, like Emerging Asia, Japan and the US; indeed, over the medium term there is a good relationship between profitability and returns.
- The UK and Korea, for instance, are trading at almost the same multiple – around 15.1x this year's earnings – but where the UK's aggregate earnings are expected to be just 1% over end-2019 levels by 2022, they are expected to double in Korea over the same period.
- Anchored bond yields remain central to sustaining equity valuations.

Note: all data as at 21 January 2021, unless otherwise specified. Source: Bloomberg.