January Market Reflection

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Equity markets entered the New Year on the front foot, much as they had left 2020. A further boost was provided by the Democrats' victory in two Senate run-off races in Georgia, delivering the slimmest of majorities in the Upper House. This brought the promise of increased fiscal stimulus, although with limited capacity to implement more "progressive" policies. Investors chose largely to ignore the storming of the US Capitol. The distribution of Covid-19 vaccines increased optimism about the economic re-opening trade. This was bolstered by continuing indications from the world's central banks that low rates and asset purchases will persist for a considerable time. Another trend that made itself more evident as the month progressed was the participation of retail investors, most notably in the United States. This group is generating a substantially higher volume of trade, often of a speculative nature and with limited regard to underlying valuations. In the UK, investors had their first real opportunity to express relief at the avoidance of a "No Deal" Brexit. However, as January wore on, more negative factors emerged. The main concerns revolved around Covid variants, which forced the implementation of more stringent restrictions on activity. There was a mixed performance in terms of vaccine availability and distribution in different countries, although the UK has been a notable outperformer in this respect. Nerves were also frayed by the assertions of several well-respected veteran investors that risk assets are in "bubble" territory. While Investec does not share this opinion, it was acknowledged that, in the short term, equity market sentiment indices had reached euphoric territory, increasing the risk of a pullback, which duly emerged towards the end of the month. However, there have been no real signs of contagion into other asset classes.

- The global economy, having shrunk by 4% in 2020, is widely forecast to grow around 5% in 2021. The first quarter is vulnerable to downgrades as a result of virus variants and subsequent lockdowns, countered by more pent-up demand to be released later in the year.

- Global corporate earnings, after falling an expected 20% in 2020, are forecast to rise by around 25% in 2021, surpassing the peak at the end of 2019.

- Economic and earnings growth should continue on a synchronised basis at least into 2022, providing longer-term support for equities and other risk assets.

- Government bonds continued to sell off early in the month, before recovering ground towards the end, continuing to fulfil their role as "insurance" assets in balanced portfolios.

- Greater uncertainty might emerge in the second quarter of 2021, when inflation

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indices, lapping very weak comparatives from 2020, are expected to rise sharply. Much will depend on central bank responses, although they are generally expected to “look through’ such a spike.

- A key question then will be whether or not the elevated inflation levels will persist, as this will have important implications for balanced portfolio construction.

- It remains impossible to pin down a date on which life will return to relative normality, and the uncertainty on this front suggests that markets will continue to be subject to both positive and negative short-term news flow. A period of greater volatility is to be expected, although we retain a positive long-term stance on equities.

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