Weekly Digest

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Unresolved Issues

It's five years since the 25th January last fell on a Monday, and so, in an effort to create some light relief in these gloomy times, let me take this relatively rare occasion to wish Scottish readers a happy Burns' Night - although I fear that the usual celebrations will be somewhat curtailed. And to readers west of Offa's Dyke, I can also wish a happy Dydd Santes Dwynwen, which is the Welsh equivalent of Saint Valentine's Day. Appropriately (for a Welshman), it is also my wedding anniversary. Perhaps less appropriately, it was also the day on which Henry VIII married Anne Boleyn. I'm happy to report we are doing much better!

Back in the real world, we continue to weigh up the continuing effects of the forces that have been driving markets for much of the past twelve months. Last autumn, we labelled the potential for a resolution of various uncertainties the "BVB" trade, with those letters standing for "Biden, Vaccine, and Brexit". In many ways that trade played out nicely, thanks to the Democrat victory in the US presidential election, the positive trial news from three vaccines in November, and the avoidance of a "No Deal" Brexit announced on Christmas Eve. But we are far from putting these factors permanently to bed. Let's take them in their original order.

The good news is that Joe Biden has now assumed the presidency. This is not meant to reveal any political bias on either my own part or Investec's. It's what the market wanted, and there is evidence for that in the response of risk assets. To be fair, we also believe that the world will benefit from a less capricious and confrontational approach to policymaking.

The World Health Organisation and the Paris Agreement can only benefit from constructive American participation.

Markets are particularly enamoured of the potential for a larger new stimulus package, and it is here that one senses the first struggle ahead of us. The new President's team has proposed a $1.9 trillion bill, but that has not met with full support in Congress. The final outcome will probably be substantially lower (around $1.2 trillion?), as more fiscally conservative Republicans push back. Remember, that for all the hype about Democratic "control" of the Senate, they are far short of the sixty seat "supermajority" that guarantees the passage of new legislation. There is plenty of horse-trading ahead, and that will characterise at least the next two years of government until the mid-term elections.

I should note at this point that, having completed my originally assigned Christmas reading list, I am now on to one of the presents that I (and probably many others) received, which is Barack Obama's The Promised Land. At least there is plenty of time to digest a 700+ page tome! I have just finished the section when he assumes power and has to push

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through the American Recovery and Investment Act to counter the effects of the financial crisis. It makes for sobering reading, and highlights the polarised state of the US legislature, as well as, perhaps more importantly, the factors that constrain bipartisan cooperation (much of which, it has to be said, are wrapped up in the self-interest of politicians who want to retain their seats in Congress). He traces the roots of such polarisation back to the signing of the Civil Rights Act in 1964, and so this is hardly on overnight phenomenon.

No doubt it has been accelerated and exacerbated by the media (both social and more traditional), a point that was nicely examined by Tim Harford in this week's Undercover Economist article in the Financial Times, at least in terms of how it plays out in the broader population. Anyway, back to Obama. If you can't handle the whole book, at least read pages 241-267!

It does, though, mean that more stimulus is on the way, which is positive. And with Janet Yellen likely to be installed as the Treasury Secretary and working hand-in-glove with Jerome Powell, her successor as the chair of the Federal Reserve Bank, there should be minimal obstacles to funding. But the composition of any policies will continue to be influenced by political intransigence. Call it a "hardy perennial", if you will.

Although I wouldn't take such statistics too seriously, we can always console ourselves with the fact that no Democratic President in a sample going back to 1900 has presided over a stock market decline on a total returns basis. Whether that's down to luck or skill is up for debate. Democratic Presidents managed to avoid a number of the big shocks including the Wall Street Crash (1929), the oil shock of 1973, the financial crash (2008) and the Covid pandemic.

Which takes us to "V" for "Vaccine". Covid itself also appears to have the potential to become a hardy perennial. The situation is developing almost as fast as I can type, and we are still far from sure what the implications are of the new variants. Governments appear to be erring towards a "safety first" approach when it comes to imposing even more restrictions on both domestic activity and travel, and therefore it is to be expected that any recovery in overall economic activity will be delayed, with a greater probability of headline-making "double-dip" recessions in the first quarter.

The companies at greatest risk are those that are burning through cash just to stay alive, but, as has been the case since this period began, those businesses with the right model for the times can continue to thrive. Therefore, it remains difficult to envisage a rerun of last March's financial market panic. Indeed, we continue to believe that investors will still "look through" the latest setbacks and focus on the prospects for what happens when vaccines have been more widely distributed. By the same token, shouty headlines about short-term difficulties in obtaining vaccine supplies should be put in the context of the longer-term rollout. Indeed, the fact that one key factory has had to curtail immediate production to increase capacity in just a few weeks is surely not a bad thing in the grander scheme of things.

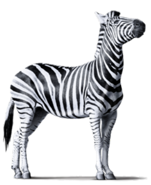
However, neither are we complacent about the short term. Yet another old market lag, this time Seth Klarman of Baupost, has joined the chorus of those claiming that we are in a stock market bubble that will end in tears. As I have written previously, we do not believe that the market is in a bubble, but that there are pockets of vulnerability. The main area to be concerned about is in the United States, where retail investor activity has risen to levels reminiscent of the late 1990s Tech Boom.

There are plenty of sound reasons why this has happened. Not least is the advent of "no-commission" trading, which became widespread in 2020, combined with the proliferation of easily accessible online accounts. This has "gamified" the stock market, making it an extremely attractive distraction for younger participants, especially in stocks with a bias towards newer technologies. There is evidence for this in the fact that the greatest exposure has been to shares with higher volatility rather than those of more staid companies. There is plenty of evidence, too, that stimulus cheques sent out by the government have been a source of funds for these activities.

None of this guarantees a major setback, but, as we saw at the end of August last year, a small reversal can accelerate quite quickly once more speculative

and leverage positions are unwound. Finally, just to put things into some kind of perspective, Charles Schwab, the leading US retail brokerage, took in $61.7bn of new money in December alone. That is roughly equivalent to the total assets under management of Investec Wealth!

Finally, a word on Brexit, where certain Leavers, notably in the farming and fishing industries, appear to be experiencing some buyer's remorse – and, of course, Remainers are in full "I told you so!" mode. The truth is that it is going to be well-nigh impossible to disaggregate Brexit from Covid effects for quite some time yet, if ever. But one cannot ignore the stories of increased "red tape" costs, as well as things like the need to collect VAT in advance on cross-border online sales. While we and markets were relieved that "No Deal" was avoided, it has always been our assertion that a deal of any sort would not be as beneficial to trade as being a full member of the single market. While investors have discounted much of that already (evident in the lower level of sterling and the shunning of UK financial assets post-referendum), it seems unlikely that we have seen the last of the fallout.



Last week's Economic Highlights

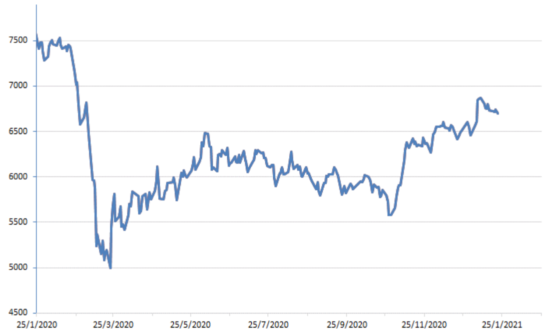
FTSE 100 Weekly Winners

Johnson Matthey PLC	9.0%
Just Eat Takeaway	8.6%
Sage Group PLC	7.4%
Ocado Group PLC	7.0%
Pearson PLC	5.5%
Hargreaves Lansdown	5.2%
Ashtead Group PLC	4.9%

FTSE 100 Weekly Losers

Entain PLC	-8.7%
International Consolidated Airlines	-6.6%
Standard Chartered PLC	-5.7%
Flutter Entertainment PLC	-4.5%
Royal Dutch Shell PLC Class B	-4.3%
Royal Dutch Shell PLC Class A	-4.2%
BT Group PLC	-4.2%

FTSE 100 Index, Past 12 Months



Source:FactSet

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