Weekly Digest

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Hallelujah!

As chance would have it, I was about half way through writing this week's missive when news broke about Pfizer's Covid vaccine, and therefore the text will be split into two distinct parts – pre- and post-vaccine! This is huge news, mainly because the efficacy rate of 90% is well beyond the hopes of most. Indeed, the Food & Drug Administration (the US regulator) had set a hurdle rate of just 50% for potential approval. We had identified this measure as a key determinant of how markets might react to news from the clinical trials, and it's about as good as it could ever have been expected to be. And the vaccine seems to be very safe as well, which is an added bonus.

Not for the first time, I will borrow copiously from a colleague who is far better qualified to comment on these matters than me, namely Dr Jimmy Muchechetere, who has skillfully guided us through the pandemic.

The technology behind the vaccine, mRNA (Messenger RNA) is relatively new, and it is extremely exciting that it has been validated by these trials. Manufacturing should not be a big hurdle. Unlike traditional vaccines which require a host animal to grow the virus that is then used to carry the vaccine into cells, mRNA vaccines are manufactured entirely in the lab. The biggest challenge will be getting the vaccine closer to where it is to be used. This is because the cold chain requirements are taxing - the vaccine has to be kept at a constant temperature of -80 degrees celsius.

Thankfully, cost should not be a big problem in the developed world at around $30 per dose. Vaccine equity may mean having to subsidise developing countries to ensure global population immunity, which is crucial to restarting global travel. Vaccine uptake is often key to get to population level immunity, but, at such a high efficacy rate, vaccine coverage does not need to be as high as it might otherwise have been. The UK has already secured 30 million doses, but it will quickly become apparent even to the less gifted mathematicians that this does not cover the whole population, and so the roll out will first take in front line workers and vulnerable citizens. However, we still await news from other vaccine trials – although it will be interesting to see whether anyone is willing to receive a vaccine which has lower efficacy. Having said that, if results are consistent with data released so far, hopes for elevated efficacy are high in other vaccines too.

This news bodes well for Moderna's vaccine, on which results are due in the next fortnight. The technology is the same as the Pfizer/BionTech vaccine - indeed, it was Moderna that pioneered it. There is less read-through for the traditional

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vaccines being developed by AstraZeneca, Johnson & Johnson, Sanofi and others. We continue to expect results from those companies in the next few weeks.

Outstanding questions remain. How long does immunity last? Does it work just as well in the older population? Does it reduce severity in those 10% not protected? Will there be a need for a booster? We expect Pfizer to conduct a phase IV follow-up study. And as soon as we get answers to some of these questions, we shall be commenting on them. From a market perspective, the reaction has been nothing short of extraordinary, and the headline index moves, impressive as they are, woefully understate the underlying rotation in favour of companies that have, hitherto, been clobbered by Covid. Everything I write now comes with the caveat that markets are currently moving very fast and that share prices can be highly volatile in such an environment. If we look at the FTSE 100, it is up 4.7%, but the best performers are up 20% or more. These, unsurprisingly, are exposed to global travel – Rolls Royce (jet engines), IAG (owner of British Airways and Iberia), Informa (exhibitions) and Compass (catering). Bottom of the heap are companies such as Ocado and Just Eat, both of whom have benefitted enormously from lockdowns. It's a similar situation in the United States. "Stay at Home" stocks such as Zoom (video conferencing) and Peloton (fancy home exercise bikes) are in retreat, while travel-related shares have taken off again.

Another feature of a day like today is that it's not just operational leverage into a post-Covid recovery that is being sought out. It is also financial leverage. The worst performing shares this year have been those of affected companies with large debts (or other contingent liabilities). The longer that social and travel restrictions continued, the greater their risk of running out of cash and the subsequent need to refinance with either expensive new debt or a dilutive equity issue. Some have got to the point where a tiny sliver of equity sits atop an enormous pile of debt – the combination of the two is the "Enterprise Value" of the company. In such cases just a small shift in the enterprise value (driven mainly by changes in opinion on the operational outlook) can turbo-charge the equity. This is a phenomenon that works in both directions. Today, it's all to the upside.

If it's a "risk on" market, then, again unsurprisingly, safe havens are also falling out of favour. Government bond yields are up on a combination of factors. First, there is less reason to hold bonds as an insurance policy; second, inflation expectations, as priced in bond markets, have popped up; and third, the need for endless monetary stimulus from central banks is now, potentially, less pressing (although so is the need for more fiscal stimulus, which will curb issuance). Even so, we think there is a limit to how far government bonds might sell off owing to the already large amount of debt which has to be serviced.

Gold is another casualty today, partially because "disaster insurance" is now less needed, but also because bond yields have backed up further than inflation rates have risen, thus increasing real yields, to which gold is highly sensitive. But there remain plenty of other challenges in the world that can make gold a valuable risk diversifier in balanced portfolios.

In the world before noon today, all the focus was on the US election outcome. Although events didn't play out exactly as the pollsters had expected, in the end they provided an object lesson in sticking to a game plan. While there had been widespread predictions of a Democratic "Blue Wave", we awoke on Wednesday to the news that, if the counting of ballots were to be stopped immediately, Donald Trump would remain President. Cue pandemonium and another beating for the opinion pollsters. And yet, in the heat of battle, many seemed to forget that such an early outcome was well within the range of expectations owing to the huge number of absentee ballots that had been cast and which would only be counted later in the process in many states. Thus, as the days ticked by, crucial states such as Wisconsin, Michigan, Pennsylvania, Georgia and Nevada turned from red to blue.

Of course, even as I write this, the result is still not official, and the President refuses to concede. Even so, it is as clear as it can be that he has no substantial evidence to support his claims of voting irregularities, and even a number of leading Republicans have urged him to accept the result as it stands. Thus, and quite logically, markets are taking Joe Biden's inauguration as read, and starting to price in the effects of his policies.

But there are also policies that are being "priced out", as it were, owing to the fact that control of the Senate looks much less assured. Here there are still four seats in play. Two, North Carolina and Alaska, are all but certain to remain in Republican hands, which would take the overall tally to 50-48 in favour of the Republicans. That leaves us in the extraordinary situation of having to wait for run-offs in both of the Georgia seats which will take place on January 5th. The Democrats would have to win both of them - a tall order in a traditionally red state, and one which Biden shaded only narrowly – to reach 50-50, with Vice President Kamala Harris having the casting vote. Even then, with some Democratic senators not fully supportive of their own party's more progressive policies, and with the filibuster remaining a formidable obstacle to the passage of bills, the Democrats could not be assured of fulfilling all of their objectives. Thanks to that piece of maths, companies that were under threat from increased regulation, notably in the Technology and Healthcare sectors were enjoying a decent rally.

Heading in the other direction were sectors where the reflation trade looked less powerful owing to the fact that a divided Congress would block larger stimulus packages. Energy and Financials, so often the whipping boys of the market recently, were under pressure again, but are now beneficiaries of the vaccine news. One could have tried to trade these movements, but it would have been well-nigh impossible to move faster than the market.

We took a conscious decision not to trade the US election for that very reason - rather to focus on longer term goals. Having said that, it would be surprising if all the new news has been priced in efficiently, and so we can still position ourselves for a less fractious world, and one in which, for the next four years, at least, there will be a new leader in the field of sustainability. The ESG (Environmental, Social, Governance) train has barely left the station.

Joe Biden and the vaccine make up the first two legs of what we have dubbed the "BVB" trade. The third leg is Brexit, which is a much more domestic issue. Under this scenario, a Joe Biden win (more so had it been a Blue Wave), positive vaccine news and a Brexit deal (which is the market's preferred outcome) combine to create a reflationary impulse. This would favour what are broadly called "Value" stocks, but which I would prefer to call "short duration" stocks - meaning that their earnings are much more prone to the vagaries of economic cycles. We have already seen how the market feels about the first two legs, and now we await the third. As I have written before, the Brexit outcome has enormous implications for the level of the pound and the relative performance of mid and small-cap shares relative to large cap.

But as we have also seen, you have to be "in it to win it", as it were, because markets just get marked up (or down) immediately on the news. That involves taking a view and assuming some element of risk that you are wrong.

As for today's moves (and those of last week), there might be some merit in waiting for the dust to settle and reassessing valuations. However, my experience also tells me that, once the mark-up has occurred, the majority of investors tend to suffer from "sticker shock", in which they can't bring themselves to buy into a new trend at a price so much higher than yesterday's. Funnily enough, once everything resets to zero overnight, they are often much more comfortable participating.

Last week's Economic Highlights

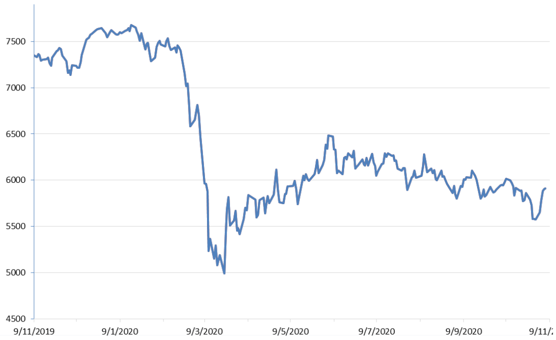
FTSE 100 Weekly Winners

RSA Insurance Group PLC	53.2%
Taylor Wimpey PLC	16.5%
Polymetal International PLC	14.9%
Ocado Group PLC	13.4%
Fresnillo PLC	12.7%
Persimmon PLC	12.2%
Barratt Developments PLC	12.2%

FTSE 100 Weekly Losers

AVEVA Group PLC	-5.5%
Rolls-Royce Holdings PLC	-2.5%
Lloyds Banking Group PLC	-2.4%
Associated British Foods PLC	-1.6%
BT Group PLC	-0.4%
Imperial Brands PLC	-0.4%
J Sainsbury PLC	-0.3%

FTSE 100 Index, Past 12 Months



Source:FactSet

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