THE **CAMBRIDGE** WEEKLY

16 November 2020

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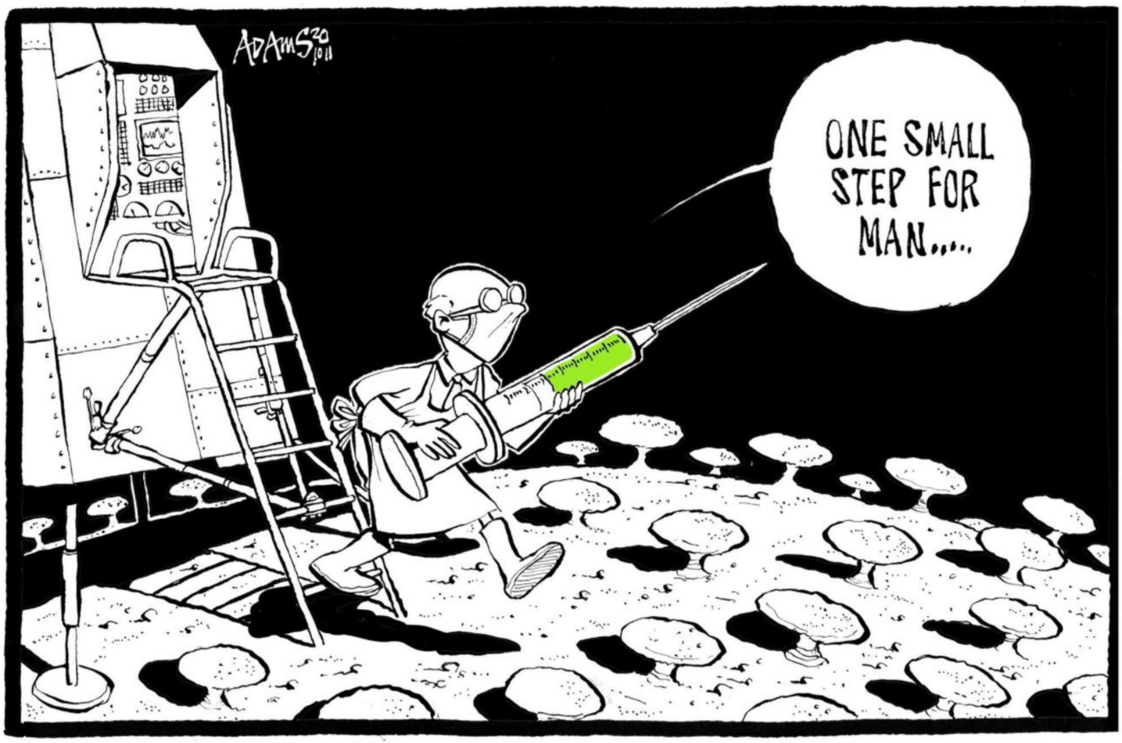


Vaccine 'Moon Landing', Christian Adams, 10 November, 2020

Change is in the air

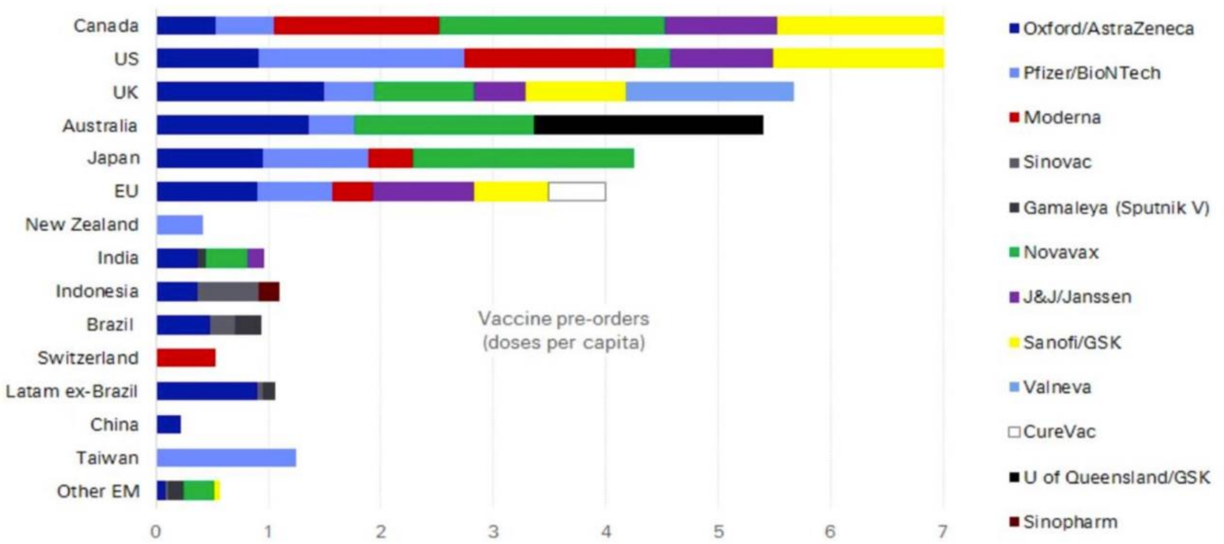
Investors have enjoyed another very good week. Optimism had already returned the previous week, with the US election eventually delivering a clear verdict. Last week then brought the news that literally everybody had been waiting and hoping for, and which we had portrayed as probable in our 'optimistic case' forward-look on these pages two weeks ago. The news last Monday that the BioNTech/Pfizer vaccine candidate had not only generated immunity against the virus, but also at an astounding efficacy of over 90% had stock markets switch from optimism to practical euphoria.

Stock markets around the western world jolted upwards by 5-8% on the day, which saw them not only erasing the declines of late October, but in most cases also returning to previous highs from the summer. Compared to the pattern of the recovery rally from late March, the market action last week was distinctly different. Those sectors and companies that had been hardest hit over 2020 by the risk that vaccines may never offer a remedy to the COVID-19 virus ('lockdown losers') rallied most. On the other hand, the 'virus victors' of the lockdown economy – especially the US tech giants – lost ground on the news. This also found its reflection in regional return differences with Europe and especially the UK for the first time in a long while leading the weekly investment return tables by a considerable margin.

This specific market reaction informs us that the reversal of regional leadership away from the US was not driven by any political frictions caused by the sitting US President's personal refusal to concede any form of defeat. This is especially so, given there were similar frictions domestically, as the UK approached and passed another one of its Brexit deadlines. With a trade deal in touching distance, but most certainly requiring some form of compromise, the departure from 10 Downing Street of two of Boris Johnson's closest and most dogmatic Brexit campaign allies is a notable development and signals that change is in the air. This augurs well for the last phase of (now yet again extended) trade negotiations, and sterling's strength over the week tells us that markets believe a deal is close.

The stock market rotation in favour of the 'lockdown losers' seems imminently rational if the arrival of vaccines – of which the western world appears to have secured plenty to go around (see table below from Deutsche Bank researchers) – offers the prospect that we will be able to return to our pre-pandemic lives after all.

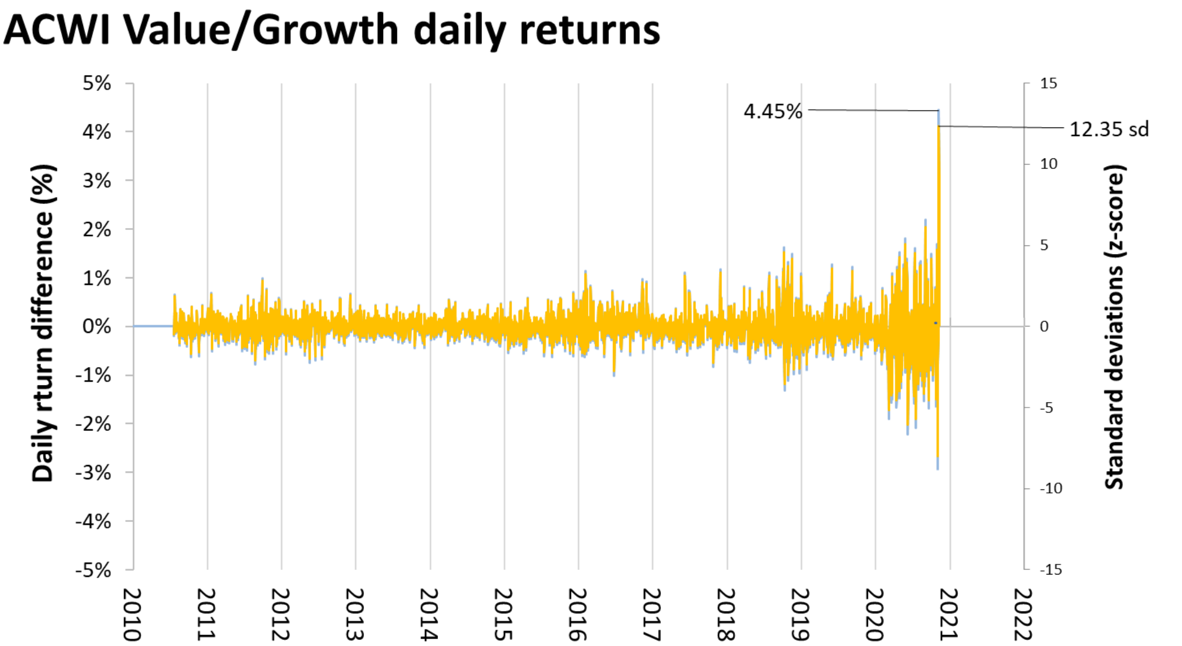
Figure 3: Advanced economies have managed to secure many diversified doses



Source : Deutsche Bank, Nature, Airfinity, various press releases. For more details, please see Vaccine portfolios: A closer look at country-level arrangements in Asia and The scramble for a vaccine: it matters who wins

Beyond these more obvious moves, our investment team was particularly interested to observe the rotational forces between growth and value shares around the world. This was best observed through the MSCI All-Country World Index that has sub-indices comprising growth stocks and value stocks. As we know, value stocks have underperformed over an extended period, indeed a phenomenal near 40% over ten years. Last Monday, value outperformed growth by some 4.5%, and then another 3.2% on Tuesday (although, of course that undoes only about 4.7% of the underperformance, when measured from the starting point ten years ago).

It may seem a tiny retracement overall, but the bounce is significant. The chart below shows the daily difference in performance between the two sub-indices, with the right axis showing it in terms of 'standard deviation'.



Source: Bloomberg, Tatton IM, MSCI

Monday's move was one of more than 12 standard deviations(!), when taking the data for ten years. Perhaps the other important takeaway from last week was that if the above was a noise chart, then the noise that was rising over 2020 has now reached cacophony level. A conclusion that arises from that is that the growth index's advancement had become very narrow, or in layman's terms, increasingly relying on a few of the mega-cap tech names. If 'change is in the air' aptly described UK's Brexit politics, it is an even more appropriate analogy for the prevailing dynamics in the stock markets – and when things get as volatile as observed, diversification is the watchword.

At the risk of overwhelming readers with market detail, we thought it may be appropriate to provide some factual evidence of just how extreme the past week has been in the UK market. Below is a list of some the biggest gainers and fallers. The overall market return really does not do justice to what just happened in the UK stock market:

Winner	**Change on week**	**Loser**	**Change on week**
Cineworld Group PLC	+50%	Games Workshop Group PLC	-13.7%
Stagecoach Group PLC	+48.7%	Gamesys Group PLC	-12%
The Restaurant Group PLC	+46.3%	Ocado Group PLC	-10.3%
Galliford Try Holdings PLC	+44.6%	Dunelm Group PLC	-10%
The Gym Group PLC	+42.6%	Spirent Communications PLC	-8.8%
Hollywood Bowl Group PLC	+42.5%	Avast PLC	-8.8%
Premier Oil PLC	+42%	Just Eat Takeaway.com NV	-7.7%
Rank Group PLC	+41.6%		
Saga PLC	+41%		
International Consolidated Air	+39.8%		
Capital & Counties Properties	+39.7%		
National Express Group PLC	+39.6%		
easyJet PLC	+39.2%		
Trainline PLC	+37.1%		
Kier Group PLC	+37%		
Rolls-Royce Holdings PLC	+34.7%		

Clearly, western societies are not out of the pandemic woods yet, and record infection and fatality numbers provide a dire warning that things still might get worse before getting better. Nevertheless, we always observe that capital markets turn or experience paradigm shifts well before the economy does. Indeed, what capital markets require is a reasonable perspective that the worst-case scenario has been averted and that light at the end of the tunnel has become a distinct possibility. A year from now, this second week of November may well be recognised as the fundamental turning point, when capital markets were no longer driven by the relief provided by emergency policy measures, but instead by the real prospect of a sustained economic recovery.

A mini boom for the housing market?

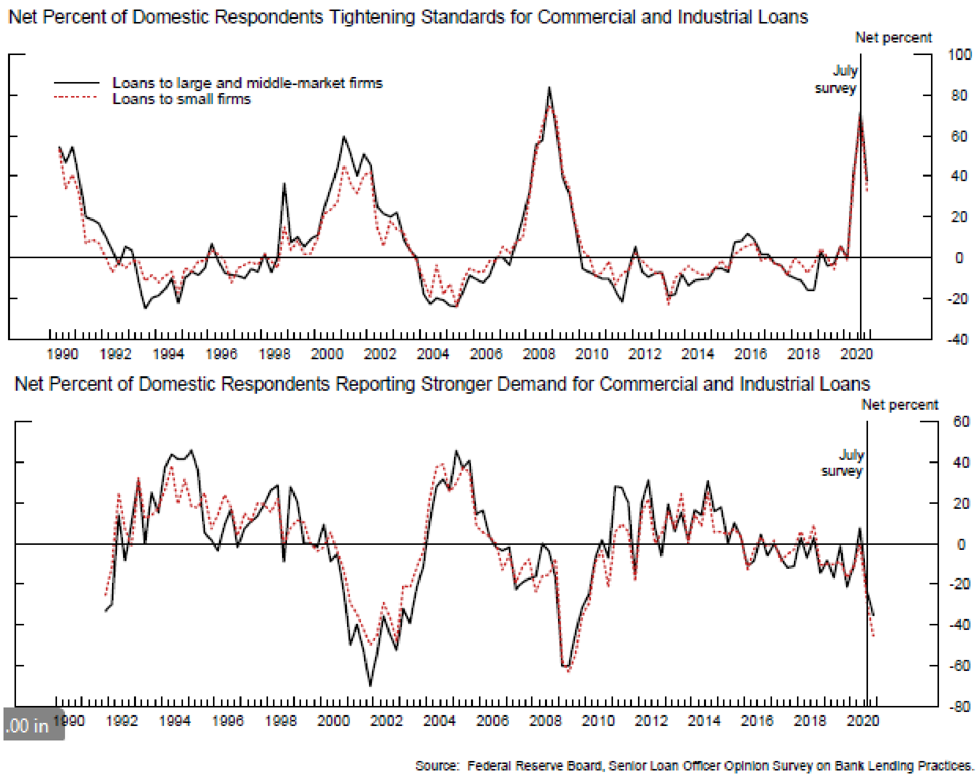
With the US Presidential election now decided (barring unlikely success in the courts), and a coronavirus vaccine by the year-end now looking a near certainty, markets are feeling positive about the prospects for 2021. But as noted before, much of the growth story for next year hinges on additional demand generated by a step up of investment activity across the global economy.

The backdrop for this is looking good. Central banks have committed to 'looser for longer' interest rates and yield levels, through continued asset purchases (our old friend quantitative easing), flooding the financial system with liquidity, while making the cost of investing cheaper than ever. This is allowing governments in the developed world to expand their fiscal support to ensure economies can bridge the gap between now and normality. This should protect the integrity of most businesses' productive capacity by avoiding 'economic scarring' from this year's activity constraints. Importantly, it should also facilitate scaling up of fiscal stimulus investment programmes to boost growth once the pandemic is behind us.

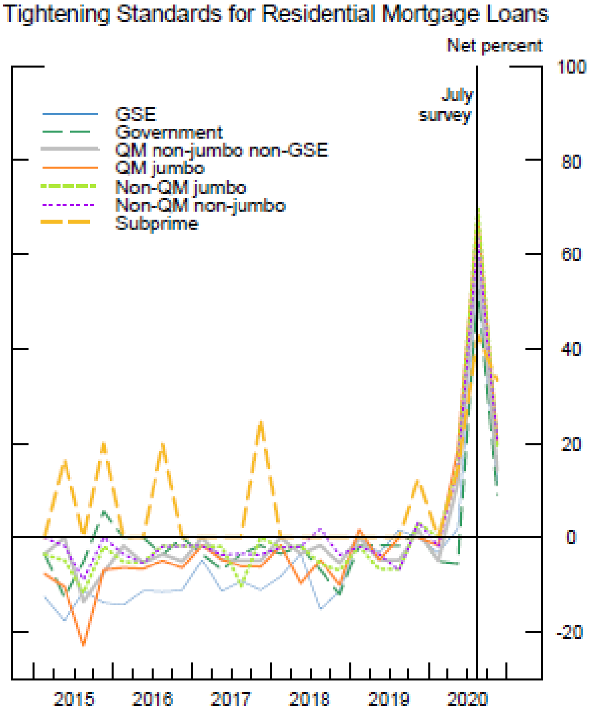
There are dangers in relying on fiscal investment, however. For starters, we have already heard politicians in the UK, Europe and the US sound the austerity alarm bells. The UK Chancellor Rishi Sunak was urging spending restraint before the latest lockdown measures hit and Republicans in the US Senate remain intent on blocking fiscal largesse. More importantly, even if much-needed public spending measures find their way past political blockades, private sector investment will still be crucial for a sustainable recovery next year and beyond. Governments and central banks can provide liquidity and pump priming investment, but it is the private sector economy that drives perpetual re-investment cycles.

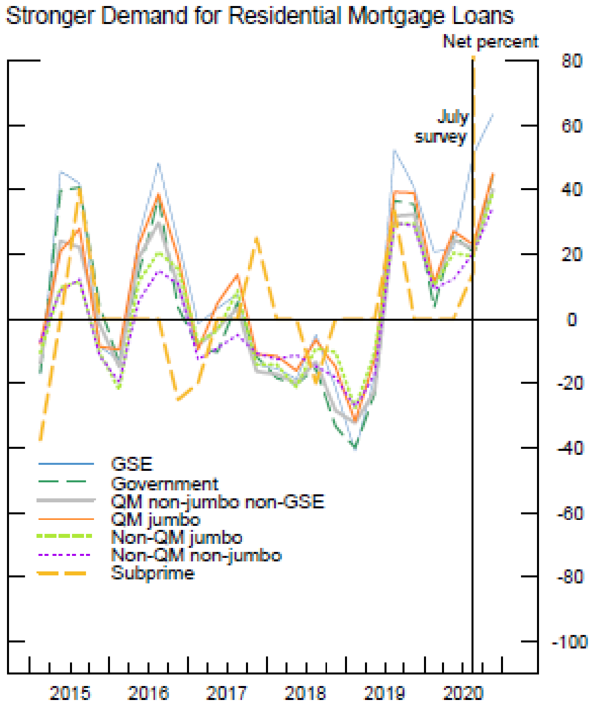
The private sector comprises (in an economist's simplified world) households and companies. On average, companies across the world reduced their leverage after the 2008-9 financial crisis, only to rebuild it as the cost of financing continued to fall. For many, the virus episode has forced them to borrow more. While the cost of that finance may be very low, the capacity to increase it further is very limited.

Bond investors still seem comfortable in lending to large companies although, up until now, equity investors have been ready to punish any business that appears to be weakening its credit ratings. Smaller companies, which are more important to the economy, have to rely on banks which in turn remain uneasy about lending to businesses that may well not be around in a few months' time – despite instructions from central authorities. The US Federal Reserve's Senior Loan Officer Survey was released last week, and showed continued relative tightness of lending constraints to corporates. Lenders might have loosened these constraints slightly in the past quarter, but the mood is still far from relaxed. Supply of bank loans is tight, demand for them is low.



By contrast, the survey shows that although banks are still stingy, they are relatively happier to lend to private individuals (20% tightening standards for mortgages, versus about 40% for company loans). While the pandemic has undoubtedly taken a toll on many (younger) people's financial positions, those with secure employment have been able to grow their savings during the crisis – and are looking like a much better bet for banks.





Source: Federal Reserve Board, Senior Loan Officer Opinion Survey on Bank Lending Practices.

In the US, there appear to be two main factors underlying this trend. First, the pegging of interest rates and bond yields to the floor has made larger mortgages more affordable for consumers. Second, widespread work-from-home policies have shifted people's focus on their living conditions and attitudes towards commuting. This in turn shifted the type of housing stock most in demand.

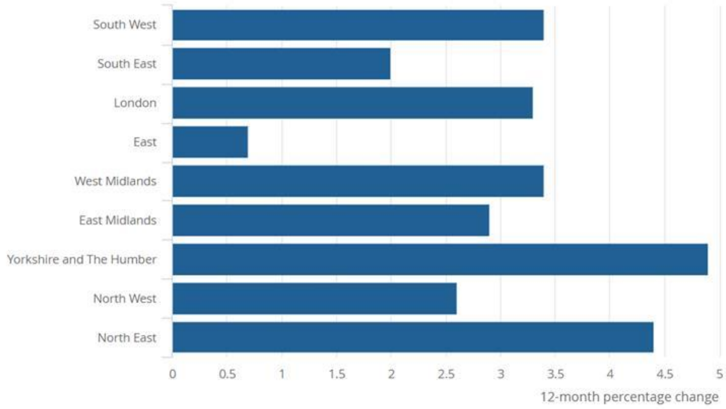
The same seems to be happening in the UK, also helped by regulatory changes, such as the suspension of Stamp Duty. Housing market data was strong immediately after the end of the Spring lockdown and has (somewhat surprisingly) remained so. Sales and prices have been trending up in recent months, despite the huge downturn in wider economic activity. According to the latest Royal Institute of Chartered Surveyors (RICS) survey, October was another strong month, with a net balance of +46% respondents reporting an increase in demand. With house sales continuing throughout the second lockdown, estate agents expect this upturn to continue.

Disparity in house prices has been a growing feature of the UK market for decades – as is evident from comparing how far your money will go in central London versus less connected regions. But with businesses no longer requiring workers to be in the office – or at least not all the time, buyers are now showing a preference for space over connectedness. This has caused a sharp increase in demand for hitherto relatively lower-valued housing stock. As shown in the chart below, the biggest price increases are coming from Yorkshire, the Humber and the North-East. We are observing the same in the US, where the urbanisation trend is now in a period of reversal. Even if virus concerns start to fade into next year, it is likely that the changed attitudes to 'WFH' will carry on into the post-pandemic years, and as such we should expect further demand in the comparatively cheap regions.

4. House prices by region

Figure 4: The strongest regional growth was in Yorkshire and The Humber

All dwellings annual house price rates of change, by English region, year to May 2020



Source: HM Land Registry and Office for National Statistics – UK House

As mentioned, increased housing demand is being substantially helped by historically low interest rates. Rates for long-term mortgages have fallen sharply, but crucially, the premium of an average 30-year mortgage rate over the yield on long-dated (30-year) government debt has come down significantly. This is a signal that low mortgage rates are not just a consequence of monetary policy – but rather that banks are eagerly competing against each other to offer buyers the lowest rate. These dynamics are doing wonders for housing affordability, which in the US is now at its highest since 2014.

However, with increased demand mostly coming in relatively 'cheap' housing stock, it is important to note that housing market optimism is in a sense rotational. Not all market segments are joining in the party. With the young and lesser educated having had to shoulder a larger part of the lockdown hardships, while the better off are escaping to the suburbs and countryside, there is downward pressure on rents. As such, buy-to-let purchases – which have been a big component of the UK market for some time – are still under pressure and could be for some time.

The outlook is therefore better for those parts of the market not so reliant on buy-to-let. Hence housebuilding is seeing a boost – as evidenced by the uptick in US lumber prices (a good indicator of housebuilding activity). The encouraging sign is that all of this is happening despite the global economy still being in the midst of its deepest short-term recession ever recorded. If growth does come through next year, we should expect further good times down the line.

As mentioned, this generates positive feedback on the economy itself. In the UK, rising house prices have an outsized effect on consumer confidence through the 'balance sheet effect'. But beyond this, new housebuilding creates jobs and boosts incomes, while increased mortgage activity – even if only for house moves – is a good sign for the demand for durable goods further down the line. This is something governments will likely want to encourage – particularly if they remain squeamish about stimulating demand through fiscal investment programmes themselves.

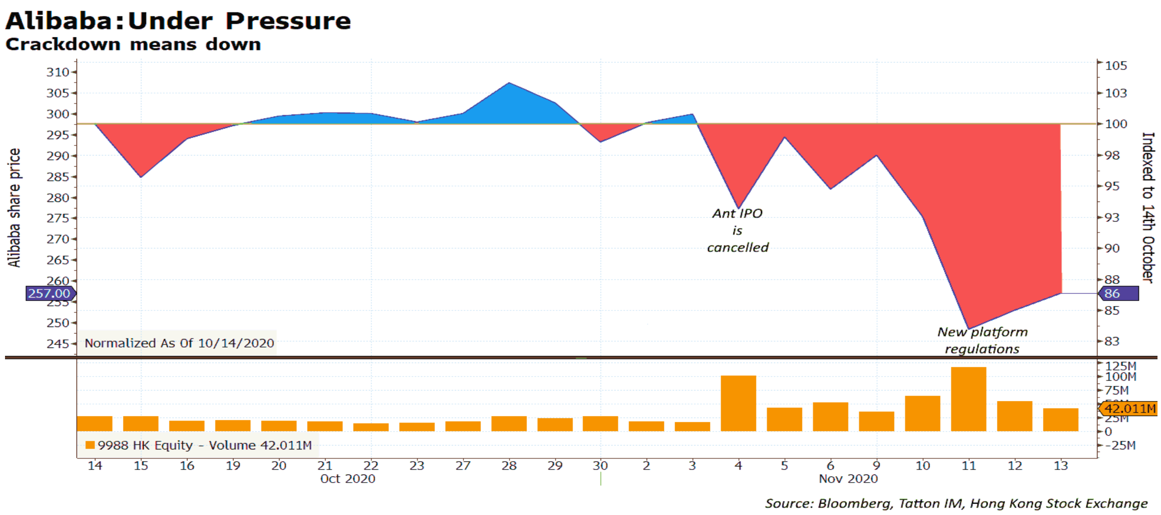
These positive trends in housing should further add to the already positive expectation for demand expansion in 2021 and beyond – from the pent-up consumer demand of 2020 and fiscal stimulus programmes that have already been signposted for 2021. This opens up the prospect of a return to higher growth rates not seen in more than a decade. Higher growth will in turn be crucial in reducing the potential drag – and anxiety – caused by increased public debt levels. Of course, higher growth would mean higher tax receipts from the same tax rates – and with GDP rising at a faster pace than the costs of servicing the debt, the debt mountain that COVID has created becomes less daunting. We suspect this is the main reason why central bankers have been willing to ditch past rhetoric in favour of encouraging politicians to borrow more to stimulate the economy. In other words, let's get out of this recession decisively now – which should lead to higher debt levels being a much smaller worry later.

China remains an exercise in risk management

Last week, Beijing forced out several pro-democracy lawmakers in Hong Kong, declaring them a threat to national security and putting another nail in the coffin of the 'one nation, two systems' principle. The move gave the Chinese authorities the power to dismiss politicians without having to go through the courts.

On Thursday, President Trump issued an executive order which will force US-regulated pension funds to divest from firms which are embedded in China's military machine. He will do more in his remaining days in office – making other sanctions or tariffs more likely. And, while the Communist Party will hardly miss Trump, there is no guarantee that President-elect Biden will be any softer on the People's Republic.

China's stock markets appear to have taken a small hit from these events. However, its major domestic stock market indices were affected much more by another story.



Remembrance Day on 11 November has a solemn tone in the UK, but in China the day carries a completely different connotation. 'Singles' day' – a reverse Valentine's Day of sorts – is when Chinese retailers slash prices and a shopping bonanza gets underway. In recent years, it has become the largest shopping day in the world, in both physical and online terms. Naturally, this is a massive boon for ecommerce companies in China. But last week, China's tech giants saw substantial falls in their share prices. Alibaba, the "Chinese Amazon" which has nearly 60% of the ecommerce market in the world's second largest economy, tumbled 10% on Wednesday.

This was another round of a fight begun in October. Two weeks ago, China and the rest of the world was preparing for the world's largest initial public offering (IPO), with fintech Ant Financial set to float at a market value of $37 billion. In recent years, Ant has become China's largest online financial platform, providing payment processing and credit to individuals and companies as a unit of Alibaba.

As we commented in last week's edition, the IPO was dramatically suspended on 3 November by the Shanghai Stock Exchange after a meeting between the China Banking and Insurance Regulatory Commission (CBIRC) and Ant/Alibaba executives, including Alibaba's founder Jack Ma.

The Wall Street Journal reports that Ma himself precipitated the destruction of his assets' worth. There has long been an air of enmity between Ma and President Xi Jinping, with Xi seeing the influential businessmen as a potential threat to party control. A few weeks before the planned IPO, the notoriously forthright Ma publicly attacked government regulators and China's large state-owned banks, accusing them of a "pawn shop mentality" that only his company was there to solve. Some have even speculated that the Ant affair was a warning shot that could lead to Ma's eventual arrest – and the entrepreneur has been suspiciously quiet since.

Later in the week the CBIRC significantly raised effective capital requirements for financial platforms – of which there is really only one. Last week, Beijing proposed new rules for the broader monopolistic platforms, not just financial ones. And while the document says "Draft for comments", all those affected know the new regime already applies.

According to officials, the primary aim is to create a level playing field for the "platform economy", to encourage competition and reduce barriers to market entry.

For the first time, authorities are attempting to define anti-competitive behaviour in the internet sector and have identified a number of practices which seem quite commonplace at present. They will examine and probably block exclusivity clauses, differential treatment of customers based on their spending behaviour and restrictive practices around access to products.

Clearly, this is a negative for Alibaba and other China tech superstars such as Tencent and Meituan. No matter what the substance of the monopolistic charges, targeted regulation specifically designed to change their business practices will hurt their revenues. International investors may worry that this might not be just about powerful tech companies; it might be a Communist Party crackdown on private sector freedoms; or it might even be an attempt to steal the success of entrepreneurship.

The draft sets out some details but is not long. One part talks of dealing with companies on a case-by-case basis, another makes it clear that large players will have no refuge in arguing these details. The regulator will be judge and jury on what counts as anti-competitive behaviour, and there will be no right to appeal.

Beijing's crackdown approach to governance – which has undoubtedly been amplified by Xi's consolidation of power over the last eight years – makes investors understandably nervous. But we would all do well to distinguish what is happening now from what has happened before.

Back in 2017, we wrote extensively about Beijing's approach to containing China's burgeoning credit bubble and rampant shadow banking sector. A comprehensive regulatory framework was lacking, and instead authorities played 'whack-a-mole' whenever a new problem arose. This creates huge uncertainty and can significantly worsen systemic risks – hurting investment prospects. Bringing the hammer down on Ant was arguably a similar case. Even so, the new anti-trust framework seems different.

China's tech sector is undeniably dominated by a handful of big players. This concentration has harmful effects, making it difficult for new market entrants, adversely affecting consumers and distorting financial markets. The government could deal with these problems as it has done in the past – delivering swift hit-and-runs whenever they so choose. But instead they have opted for a comprehensive regulatory framework, which should allow for a more stable type of governance.

Tech monopoly problems are by no means unique to China. A couple of months ago, the US Democratic Party released a mammoth report on the dangers of an unregulated tech sector, along with sweeping antitrust remedies. Much of that report is likely to end up in law under a Biden administration. European Union bureaucrats have conducted similar investigations into big tech, reaching their own policy conclusions. Interestingly, these measures were well-received in media circles, while the Chinese report (containing similar measures) has been presented as a dangerous crackdown by western media.

China's regulatory and legal systems' rules are best thought of as guidelines, and authorities have made no attempt to hide their desire to have the final say in antitrust cases. But from an investment perspective, the 'tech crackdown' is not necessarily a negative. If China's government succeeds in putting together a framework which is applied reasonably consistently – and really achieves more competition, allows smaller companies to be profitable and to become largish companies – it would be a positive for the investment community over the long run – if only for an expansion of choice and thereby risk reduction through diversification.

From our perspective, the tech story is not the real issue with China. We have maintained our view that all the ingredients for a positive Chinese investment story are there. It is the only major economy on course for positive GDP growth this year, it is well into its domestic-led transition, it offers higher yields and greater stability than most other developed nations, and is increasingly open to foreign capital. Indeed, we suspect strong investment inflows to China are all but inevitable over the next few years. But international relations and a growing global consumer distaste for anything Chinese – rather than domestic political crackdowns – could spoil the party in the short and medium term.

The delicate political situation is why we have decided to remain neutral on China up to this point, despite the obvious economic positives. In a week where vaccine positivity gripped Western stock markets, the relative advantage of China having been able to live under COVID-19 without a vaccine has lost much of its shine. This, together with the relatively downbeat Chinese news has prompted an underperformance in Chinese equities. Looking forward, China presents a curious case of immense potential tinged with significant unknown risks. We will continue therefore to monitor and assess these risks closely.

CAMBRIDGE INVESTMENTS LIMITED

16th November 2020

Global Equity Markets

Market	Fri 16:51	% 1 Week*	1 W	Technical Short	Technical Medium
FTSE 100	6316.4	+6.9	+406.4	↗	↘
FTSE 250	19279	+7.6	+1360.9	↗	↘
FTSE AS	3564.1	+7.1	+237.4	↗	↘
FTSE Small	5687.1	+7.5	+394.6	↗	⬂
CAC	5380.2	+8.5	+419.3	↗	↘
DAX	13076.7	+4.8	+596.7	↗	→
Dow	29352	+3.6	+1028.5	↗	→
S&P 500	3560.7	+1.5	+51.3	↗	⬀
Nasdaq	11773.6	-1.0	-121.6	↗	↗
Nikkei	25385.9	+4.4	+1060.6	↗	⬀
MSCI World	2509.2	+1.6	+39.2	↗	→
MSCI EM	1182.1	+0.5	+5.7	↗	⬀

Top 5 Gainers

Company	%
Int'l Consol Air	+39.6
easyJet	+38.3
Rolls-Royce	+34.7
M&S	+28.7
British Land	+27.4

Top 5 Decliners

Company	%
Fresnillo	-14.2
Ocado	-11.5
London Stock Exch	-5.1
Bunzl	-4.4
Scot Mtge Inv Trust	-4.2

Currencies

Pair	last	%1W
USD/GBP	1.317	+0.1
GBP/EUR	0.898	+0.5
USD/EUR	1.18	-0.4
JPY/USD	104.64	-1.2
CNY/USD	6.61	+0.1
Bitcoin/$	16,198	+4.1

Commodities

Cmdty	last	%1W
Oil	42.84	+8.6
Gold	1891.1	-3.1
Silver	24.65	-3.8
Copper	316.9	+0.5
Aluminium	1930.0	+1.7
Soft Cmdties	380.3	+3.2

Fixed Income

Govt bond	%Yield	1 W CH
UK 10-Yr	0.34	+0.06
UK 15-Yr	0.58	+0.06
US 10-Yr	0.89	+0.07
French 10-Yr	-0.31	+0.05
German 10-Yr	-0.55	+0.07
Japanese 10-Yr	0.03	+0.00

Global Equity Market - Valuations

Market	Div YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	3.4	19.2	14.2	13.8
FTSE 250	2.2	16.2	27.0	14.9
FTSE AS	3.2	18.5	15.7	13.9
FTSE Small	2.9	16.8	-	13.7
CAC	2.0	22.0	27.4	14.2
DAX	2.8	22.6	19.3	13.0
Dow	2.1	22.2	24.2	15.7
S&P 500	1.7	26.0	25.7	16.8
Nasdaq	0.7	35.5	31.1	19.0
Nikkei	1.6	26.2	24.8	17.2
MSCI World	1.9	24.4	23.8	15.9
MSCI EM	2.1	18.4	18.5	12.2

UK Mortgage Rates

Mortgage Rates	Oct	Sep
Base Rate Tracker	1.50	1.50
2-yr Fixed Rate	1.85	1.79
3-yr Fixed Rate	2.00	1.92
5-yr Fixed Rate	2.02	1.97
10-yr Fixed Rate	2.45	2.42
Standard Variable	3.63	3.59

* The *% 1 week* relates to the weekly index closing, rather than our Friday p.m. snapshot values
** LTM = last 12 months' (trailing) earnings;
***NTM = Next 12 months estimated (forward) earnings

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Please note: Data used within the Personal Finance Compass is sourced from Bloomberg/FactSet and is only valid for the publication date of this document.

The value of your investments can go down as well as up and you may get back less than you originally invested.

Lothar Mentel