CAMBRIDGE
INVESTMENTS LIMITED

# THE **CAMBRIDGE** WEEKLY

## 8 February 2021


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*Source: Matt, 4 February*

## Calming of nerves

After January's misbehaviour – everything from riotous insurrection at the US Capitol to rebellious share speculation – February began with a more predictable return to normality. The share price of now internationally famous US video game store GameStop has fallen by around 87% ($469 last week to $60 at time of writing). Likewise, frictions within the European Union (EU), caused by frustration in not being able to receive the promised volume of COVID vaccines, also calmed. This composure seems driven by acceptance that while the EU's rushed procurement process had been suboptimal, it would likely be only a very short-term issue, given how vaccine production is ramping up everywhere and more vaccines are moving closer to being granted their licences.

Beyond the mere calming of last month's disturbances, there was also genuine uplifting news. An all-around positive review and efficacy assessment in *The Lancet* medical journal of the highly politicised Russian Sputnik V COVID-19 vaccine was one of them. Not only did it boost the credence of the Oxford/Astra Zeneca vaccine, as they are both based on the same underlying principles, it can also be produced and distributed globally at nearly the same cost and ease as annual flu jabs.

Another positive development was the resolution of Italy's latest government crisis, with the appointment of former European Central Bank President Mario Draghi to form a new national unity government. The very highly respected Draghi is widely expected to pull off another 'whatever-it-takes' course of action for Italy, much in the same way as he did back in 2012 at the height of the euro crisis, which he was credited with resolving (temporarily at least).

In the meantime, the Biden administration is swiftly rebuilding the diplomatic relationships that had fared so badly under his predecessor. More importantly, Biden's team has hit the ground running and is executing their strategy to pull the US out of the pandemic at impressive speed, having now administered more than twice as many COVID vaccinations (34 million) than the EU (14.5 million).

Back at home, the UK is finally and squarely on the front foot in fighting the pandemic, with a larger proportion of the population vaccinated than in any other large-population country (with the US second and China for once lagging very far behind). This encouraging improvement in the timeline to recovery afforded Bank of England governor Andrew Bailey a surprisingly optimistic outlook for the UK's 2021 economic development - although it gave sterling an upward boost that exporters could probably have done without. Cash savers were perhaps less enthusiastic about Bailey's comments, given his signal for banks to make preparations to administer negative interest rates to depositors' cash holdings.

Despite the very negative experience of Eurozone banks with their negative interest rate regime of the past five years, UK banks rallied. This was because Bailey stressed that preparedness was strictly only to be seen as an act of prudent planning, whereas he was actually painting the picture of a happy ending that would more likely raise expectations of interest rate movements in the other direction. For the time being, we agree with the market sentiment – as expressed in the rising share price of banks – that there is a low probability for rates to go negative. At the same time, the Bank's call for prudency can only be welcomed. After all, last year taught us plenty about the importance of advance disaster planning.

## January review: Consolidation

| Asset Class | Index | January | 12 months | 2019 | 3-yr annualised | 5-yr annualised |
|---|---|---|---|---|---|---|
| Equities | FTSE 100 (UK) | -0.8 | -9.2 | 17.3 | -1.4 | 5.1 |
| | FTSE4Good 50 (UK Ethical Index) | -1.1 | -11.8 | 13.9 | -3.7 | 1.7 |
| | MSCI Europe ex-UK | -2.2 | 6.8 | 20.0 | 3.6 | 6.8 |
| | S&P 500 (USA) | -1.5 | 12.6 | 26.4 | 13.0 | 16.9 |
| | NASDAQ (US Technology) | 1.0 | 38.3 | 31.4 | 22.0 | 24.5 |
| | Nikkei 225 (Japan) | -1.5 | 10.3 | 15.0 | 2.7 | 7.2 |
| | MSCI All Countries World | -0.9 | 12.3 | 21.7 | 7.9 | 13.6 |
| | MSCI Emerging Markets | 2.6 | 22.8 | 13.8 | 4.4 | 15.0 |
| Bonds | FTSE Gilts All Stocks | -1.7 | 2.8 | 6.9 | 5.3 | 4.4 |
| | £-Sterling Corporate Bond Index | -1.1 | 4.5 | 11.0 | 5.5 | 6.4 |
| | Barclays Global Aggregate Bond Index | -1.3 | 2.6 | 2.7 | 5.3 | 5.1 |
| Commodities | Goldman Sachs Commodity Index | 4.5 | -13.8 | 13.1 | -7.8 | 0.2 |
| | Brent Crude Oil Price | 5.8 | -6.7 | 17.9 | -7.2 | 8.9 |
| | LBMA Spot Gold Price | -2.5 | 12.5 | 14.2 | 11.3 | 10.7 |
| Inflation | UK Consumer Price Index (annual rate)* | 0.1 | 0.9 | 1.3 | - | - |
| Cash rates | Libor 3 month GBP | 0.0 | 0.4 | 0.9 | 0.6 | 0.6 |
| Property | UK Commercial Property (IA Sector)* | -0.2 | -3.9 | -0.8 | -N/A | -N/A |

**Data sourced from Morningstar Direct as at 31/01/21. * to end of previous month (31/12/20). All returns in GI**

Perhaps there is little surprise that after a very strong end to 2020, January 2021 would start on a slightly softer note. However, this was not the case for most of the month and the negative stock market numbers only came about during a short sharp sell-off during the last week of January – with much of this drop already being recovered during this first week of February.

The jury is still out on whether the general downdraft was driven by the upheaval caused by rebellious retail investors in the US or the gradual rise in fixed interest yields over the course of the month which was also responsible for the negative returns in bonds (given the negative relationship between yields and bond prices, but also equity valuations' yield dependency).

At the top level, global equities declined just 0.9% in sterling terms, but this slight fall masks some performance differences at the regional level. European, US equity and Japanese markets were a little weaker during the month, down around 1.7% on average. The performance of developed markets stood in contrast to the gains seen in emerging markets and specifically the technology sector in the US, rising by 2.6% and 1% respectively.

There are understandable reasons for this divergence. Western markets are still largely under lock-down measures, which has once again increased the attractiveness of those NASDAQ-listed companies that benefit, not suffer, when people have to cope with staying at home. On the other hand, the rapid vaccine rollouts in the UK and US provide a clear path towards economic

normalisation and possibly support for more cyclical (economically leveraged) sectors, as their respective economies march towards reopening.

Emerging market equities benefited from three factors: a weaker US dollar (only against emerging market currencies – see separate article), rebounding agricultural and industrial commodity prices, and also improving demand for exports, particularly in high-tech areas like semiconductors. Global supply chains for semiconductors – used in TVs, games consoles and electric cars – are largely concentrated in the South East Asian markets of Taiwan, South Korea and China. Meanwhile, commodity producing countries like those in Latin America saw the benchmark commodity index rise 4.5% on the back of a near 6% jump in oil prices.

January is also the start of the corporate earnings announcement season for the last quarter of 2020. So far, company earnings are proving to be far more resilient than earlier forecasts. While there are always pockets of strength at a sector level, as earnings are general snapshots of what did well at that certain point in time, companies more broadly appear to be in far better financial shape than anticipated.

Overall then, January could have been worse and a combination of rebounding consumer demand and improvements in the underlying economy may well provide a solid foundation for the next leg higher in global equity markets through 2021, and beyond.

## Vaccine dividend expectations

As the British government and media are keen to point out, the UK is one of the world leaders in vaccine numbers. After trumpeting the speedy approval of the BioNTech/Pfizer, Oxford/Astra Zeneca and Moderna vaccines, the government has administered jabs to more than 10 million Britons. At the time of writing, 16 shots have been handed out per 100 people, a figure beaten only by smaller population countries like Israel, the United Arab Emirates and the Seychelles.

Such good news that is sorely needed. Not only has the UK suffered one of the worst death tolls of any nation in the world, for much of last year we also laboured under stricter and longer lasting restrictions than elsewhere. As a consequence, Britain suffered by some measures one of the biggest economic contraction of any developed world nation in 2020. Now in the mire of a third national lockdown, businesses and livelihoods are under existential threat.

Boris Johnson and his Cabinet have made clear that vaccinations are the route out of the crisis – and we would agree. But it has now been two months since the Prime Minister declared that the “scientific cavalry” had arrived. By most accounts, the mass vaccination program is hitting its targets, while recent lockdown measures have brought new case numbers down sharply. And yet, for many the situation has never looked bleaker. Until last week, deaths and hospital admissions were higher than at any point during the first wave and there is no clear end to restrictions in sight – putting immense pressure on businesses and individuals.

The question for investors, as well as for the general public, is when the rapid vaccination programme will translate into some kind of normality – and the much-needed economic recovery that comes with it. The government has promised a timetable for lifting restrictions by 22 February,

but schools – almost certainly the first sector to reopen – are not set to return until 8 March at the earliest. Clearly, whatever happens with the vaccination schedule, Boris Johnson does not see an end to restrictions anytime soon. According to insider reports, the government is determined to make this lockdown the last, but throughout the pandemic it has repeatedly been swayed by political winds. And the political opposition to prolonged lockdown is building. Anti-lockdown backbenchers in the Tory Party are growing in prominence, with Mark Harper, chair of the lockdown-sceptic Covid Recovery Group, last week urging the government to open schools before 8 March.

More notable are reports that Chancellor Rishi Sunak is increasingly concerned about the shifting criteria that need to be met for restrictions to be lifted. According to a *Telegraph* source at the Treasury: "Rishi is concerned that the scientists have been moving the goalposts in recent weeks. It's no longer just about hospitalisations and protecting the NHS but cases and case numbers." The fact these complaints are coming from inside the Treasury is significant, and underlines how politicised virus containment has become.

What complicates matters is that the pandemic has brought age disparities into sharp focus. The young are much less likely to be badly affected by the virus and much more likely to be badly affected by recession. If the touted 'vaccine passport' bestows freedoms only on the old and vulnerable, continued restrictions could prove an extremely charged political subject.

As we have written before, capital markets certainly see light at the end of the tunnel. Prices drifted down at the end of January, but as last week's recovery perhaps evidenced, investors are generally confident that virus impacts will peter out as we head into the second half of the year. While there is potential for many businesses to struggle in the short-term, the longer-term investment world is much more concerned with what happens after the pandemic.

We can see this playing out in currency markets, where sterling has strengthened against its global peers in recent weeks. The pound's value against the euro shows this starkly. While things look dour from the ground, currency traders clearly recognise Britain's vaccination success, and what it means for the timing of the economic recovery, versus the comparatively sluggish rollout on the continent.

Interestingly, however, this 'vaccine dividend' has not buoyed UK equity markets, with the FTSE 100 lagging behind other major stock markets over the last week. As we have noted in the past, this is due to the global focus of the UK's biggest companies, with most earning the bulk of their revenues abroad rather than domestically. Domestic virus developments therefore have only a small impact on the index compared to global news.

Markets are so convinced of the recovery in the latter half of the year that investors are beginning to worry instead about the post-pandemic future. We cannot know what long-term changes COVID will bring, but we can already see from those places where virus prevalence is low that consumers are keen to make up for lost time, particularly on leisure and services. Consumers will want to do and buy more than they ordinarily would to make up for all that they were unable to for a year or more. Depending on whether this increased demand is moderated by those who remain fearful to mingle, it is quite possible that the ensuing temporary shortage of at least certain services against

urgency of demand, backed by surplus savings will lead to an upward price push which in the short term may feel very much like a return of inflation. However, economists are likely to point out at this point that such phases of 'de-mob' happiness tend to fizzle out and create neither sustained economic momentum, nor structural inflation pressures.

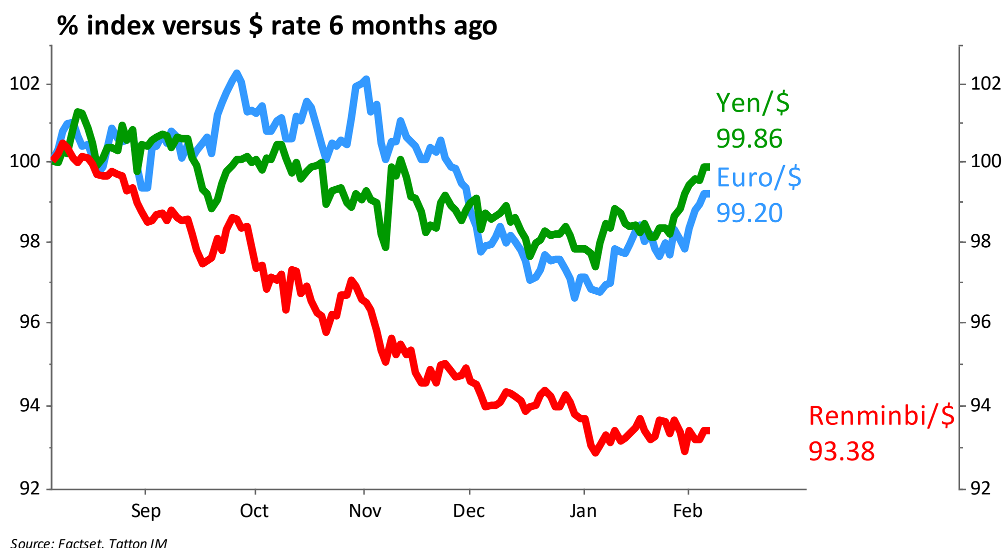
The biggest worry is what happens when the extraordinary support from governments and central banks runs out. This is why western governments last year announced very substantial fiscal investment initiatives that will allow them to phase out support programmes.

The best-case scenario is that these initiatives gather pace just as the 'catching up' effect peters out, that resurgent demand will not hit prolonged supply bottlenecks, that those sectors reliant on social proximity will not have suffered irreparable damage, and that consumer and business demand functions have not changed for good.

Common sense tells us that a best case scenario of such complexity is very unlikely to fall in place as outlined. Even if the hopes for a 'roaring twenties' still feel a little far-fetched, or at least uncertain, there is likely to be decent levels of growth over the coming 18 months with plenty of catch-up potential still in the ugly ducklings of 2020.

## The uncertain strength of the US dollar

The dollar has been on a good run lately. Over the last month, its value against the other main currencies has steadily risen. The move has been particularly pronounced against the euro, which fetched $1.23 in currency trading at the beginning of the year, but has since fallen to $1.20. Moves have been less pronounced against the Chinese renminbi (RMB) and – particularly – sterling. Buoyed by a rapidly progressing vaccination programme and a fading of Brexit uncertainties, sterling itself been strong in recent trading. That it has stayed mostly flat against the dollar so far this year is therefore a sign of the greenback's strength.




It marks a change from what we saw last year. For most of 2020, the dollar steadily but surely sank in value against other major currencies by around 10%, as the US Federal Reserve (Fed) unleashed historic monetary support and markets turned positive on the prospects for post-pandemic recovery. As the world's reserve and 'safe haven' currency, this risk-on sentiment is positive for global currencies and global growth – leading to dollar weakness when investors expect a cyclical rotation.

Coming into 2021, those cyclical expectations were bigger than ever. Markets are practically certain that a strong global economic rebound will be underway in the second half of this year. As such, we expected relative dollar weakness – or, at least, not strength – to continue over the medium term. So, how does the recent rally figure into the outlook?

We should be careful here to distinguish short-term price movements from longer term economic trends – all of which are reflected in relative currency values. Markets are certainly still positioned for a global economic recovery later this year, but for the shorter term this confidence has faltered somewhat in recent weeks. The increased risk aversion has sent traders into dollar assets, pushing up the currency. The short-term trend was compounded by technical factors last week after many short-sellers were squeezed out of their positions – particularly against the Japanese yen.

Short-term changes in market direction are no surprise, but the question is whether they will lead to a sustained trend in currencies. For now, the dollar is supported by the fact that, not only have short-term global growth expectations been pushed backwards, but US growth expectations have remained relatively more positive. Recent data from Asia – previously leading the way in COVID recovery – points to a much less upbeat outlook than the beginning of the year, while Europe continues to struggle with repeated lockdowns and vaccine procurement.

What's more, one of the big factors behind dollar weakness last year was continued strength of the Chinese RMB. But the Communist Party often takes a proactive approach toward its currency, and we know that there is only so much RMB appreciation it is willing to tolerate – particularly as

it continues to deleverage the domestic economy. If the RMB falls against the dollar too rapidly or too much (some point to Chinese authorities willing to tolerate 7% appreciation per year), it might be forced to intervene (mostly not directly but via large commercial banks) – limiting the dollar's downside.

These factors suggest the dollar has little to drag it down over the next few weeks – global developments permitting. Beyond those consolidation considerations, two factors are for now likely to limit dollar upside.

First, global risk appetite remaining constructive. As countries become increasingly successful in rolling out the vaccine, and fiscal support prevails, investors are likely to direct their attention towards regions and sectors that struggled throughout 2020. A lot of those are outside of the US, and hence not dollar-denominated. Of course, there may well be delays and backslides before we get there, and much will also depend on the nature of stimulus deployed in the US and elsewhere. But by and large, this appears to be the direction of travel and speak in favour of a weaker dollar.

Second, inflation-adjusted remuneration for US dollar yields remains firmly in the negative – despite the recent steepening in the US yield curve (i.e. yields on longer maturity bonds rising more than shorter maturity bonds). Moreover, there is some evidence that the dollar is more sensitive to the short-end of the curve (around the two-year part). For this to change, the market would need to price-in interest rate hikes by the Fed, which will take some time from here. So again, for now, negative real yields are not very dollar-supportive.

Of course, currency rates are always a comparative business. While the dollar has more negative real returns than the euro, could it be that Eurozone inflation expectations rise and take the shine of the euro? This may well be a development down the line, and tie into our view that a dollar meltdown appears less likely in the coming months.

Even if dollar weakness may have run its course against developed world currencies, a clearer picture emerges in emerging markets. Last year, the dollar only fell against Covid winners, whereas the laggards saw their currencies weakening. With the global economy recovering and also reaching wider parts of emerging markets, these currencies are likely to see some appreciation.

Besides cyclical and asset allocation-driven considerations, there is some evidence that currencies move in long-run cycles. The US dollar peaked (in nominal terms) in 2001, troughed with the global financial crisis in 2008, and since then had been on an upward trend. One factor may have been that US assets and its currency have been supported by a relative lack of confidence in the world's second most prominent currency: the euro. Since the financial crisis, an ongoing structural crisis in the Eurozone has led to a preference for dollar assets.

Meanwhile, observers like Crossborder Research point to the effects of Basel 3 regulation which requires banks to load their balance sheets with safe assets. On a global scale these safe assets happen to be US Treasuries. But this rebuilding process has been broadly completed.

The impact of both of those factors is now greatly diminishing. There is no great structural crisis in the Eurozone, and Basel 3 is beyond the peak of implementation. This takes away a big structural push toward the dollar, and could lead to a weaker long-term trajectory.

Still, for the short-term the US currency looks well supported. We should remember that longer-term trends are never a straight line, and we could well be in for more strength in the short-run. It is important to note, however, that ultimately sustained dollar strength right now would be a negative for the global economy – tightening financial conditions and choking off recovery before it has begun. Thankfully, cyclical and structural indicators suggest this will not be the case.

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8th February 2021

### Global Equity Markets

| Market | Fri 16:25 | % 1 Week* | 1 W | Technical Short | Technical Medium |
|---|---|---|---|---|---|
| FTSE 100 | 6496 | +1.4 | +88 | → | ↗ |
| FTSE 250 | 21082 | +4.2 | +853 | ↗ | ↗ |
| FTSE AS | 3713 | +2.0 | +71 | → | ↗ |
| FTSE Small | 6472 | +3.9 | +241 | ↗ | ↗ |
| CAC | 5650 | +4.6 | +251 | ⬀ | ↗ |
| DAX | 14045 | +4.6 | +612 | ⬀ | ↗ |
| Dow | 31166 | +3.9 | +1183 | ⬀ | ↗ |
| S&P 500 | 3882 | +4.5 | +168 | ↗ | ↗ |
| Nasdaq | 13812 | +5.7 | +741 | ↗ | ↗ |
| Nikkei | 28779 | +4.0 | +1116 | ↗ | ↗ |
| MSCI World | 2758 | +3.6 | +96 | ⬀ | ↗ |
| CSI 300 | 5483 | +2.5 | +131 | ↗ | ↗ |
| MSCI EM | 1388 | +4.4 | +58 | ↗ | ↗ |

### Top 5 Gainers / Top 5 Decliners

| Company | % | Company | % |
|---|---|---|---|
| Whitbread | +18.4 | Pearson | -11.0 |
| Carnival | +18.3 | BP | -7.1 |
| Natwest | +15.6 | GlaxoSmithKline | -6.5 |
| easyJet | +14.0 | Unilever | -6.0 |
| InterCont'l Hotels | +12.8 | TUI | -4.6 |

### Currencies

| Pair | last | %1W |
|---|---|---|
| USD/GBP | 1.373 | +0.2 |
| GBP/EUR | 0.876 | +1.0 |
| USD/EUR | 1.20 | -0.9 |
| JPY/USD | 105.45 | -0.7 |
| CNY/USD | 6.47 | -0.6 |
| Bitcoin/$ | 38,072 | +9.9 |

### Commodities

| Cmdty | last | %1W |
|---|---|---|
| Oil | 59.63 | +6.7 |
| Gold | 1809.0 | -2.3 |
| Silver | 26.87 | +0.4 |
| Copper | 359.4 | +1.1 |
| Aluminium | 1993.5 | +0.5 |
| Soft Cmdties | 420.5 | +3.3 |

### Global Equity Market - Valuations

| Market | Div YLD % | LTM PE | NTM PE | 10Y AVG |
|---|---|---|---|---|
| FTSE 100 | 3.2 | 19.7 | 14.7 | 14.0 |
| FTSE 250 | 1.8 | 19.3 | 22.0 | 15.2 |
| FTSE AS | 2.9 | 19.5 | 15.5 | 14.1 |
| FTSE Small x Inv_Tsts | 1.6 | 18.3 | - | 15.1 |
| CAC | 1.9 | 22.9 | 18.0 | 14.5 |
| DAX | 2.5 | 24.0 | 15.9 | 13.2 |
| Dow | 1.9 | 22.7 | 20.7 | 16.0 |
| S&P 500 | 1.5 | 27.9 | 22.8 | 17.0 |
| Nasdaq | 0.7 | 35.7 | 34.1 | 21.9 |
| Nikkei | 1.4 | 28.7 | 24.4 | 17.3 |
| MSCI World | 1.7 | 25.9 | 21.4 | 16.1 |
| CSI 300 | 1.6 | 20.1 | 15.2 | 12.4 |
| MSCI EM | 1.8 | 21.3 | 16.5 | 12.3 |

### Fixed Income

| Govt bond | %Yield | 1 W CH |
|---|---|---|
| UK 10-Yr | 0.49 | +0.16 |
| UK 15-Yr | 0.72 | +0.17 |
| US 10-Yr | 1.15 | +0.09 |
| French 10-Yr | -0.23 | +0.06 |
| German 10-Yr | -0.45 | +0.07 |
| Japanese 10-Yr | 0.06 | +0.01 |

### UK Mortgage Rates

| Mortgage Rates | Jan | Dec |
|---|---|---|
| Base Rate Tracker | 1.50 | 1.50 |
| 2-yr Fixed Rate | 1.79 | 1.81 |
| 3-yr Fixed Rate | 2.05 | 2.05 |
| 5-yr Fixed Rate | 1.98 | 2.00 |
| 10-yr Fixed Rate | 2.55 | 2.55 |
| Standard Variable | 3.62 | 3.62 |

* 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

If anybody wants to be added or removed from the distribution list, please email
enquiries@cambridgeinvestments.co.uk

**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